U.S. Department of Transportation

AGENCY FINANCIAL REPORT
FISCAL YEAR 2011

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FOREWARD

FOREWARD

The United States Department of Transportation's (DOT or Department) Agency Financial Report (AFR) for fiscal year (FY) 2011 provides an overview of the Department's financial performance and results to Congress, the President and the American people.

THE REPORT DETAILS INFORMATION about our stewardship over the financial resources entrusted to us. Additionally, the report provides information about our performance as an organization, our achievements, initiatives and our challenges.

The AFR is the first in a series of reports required under the Office of Management and Budget's Program for Alternative Approaches to Performance and Accountability Reporting. This is the second year that the Department has participated in this voluntary program in an effort to strengthen its annual reporting documents and to present more streamlined and timely information to clarify the relationship between performance, budgetary resources and financial reporting. The Department intends to provide a more meaningful, transparent and easily understood analysis of accountability over its resources. The report provides readers with an overview of the Department's highest priorities, as well as our strengths and challenges.

The Department's FY 2011 annual reporting includes the following two components:

AGENCY FINANCIAL REPORT (AFR)

The following AFR report, is organized into two major sections: The Management's Discussion and Analysis section provides executive level information on the Department's history, mission, organization, key activities, analysis of financial statements, systems, controls and legal compliance, accomplishments for the fiscal year and management and performance challenges facing the Department.

The Financial Details section provides a Message From the Chief Financial Officer, consolidated and combined financial statements, the Department's notes to the financial statements and the Report of the Independent Auditors.

The Other Accompanying Information section provides Improper Payments Information Act reporting details and other statutory reporting requirements.

ANNUAL PERFORMANCE REPORT (APR) [available February 2012]

The APR will be produced in conjunction with the FY 2013 President's Budget Request and will provide the detailed performance information and descriptions of results by each key performance measure.

The FY 2011 summary of performance information will be found on page 13 of the AFR.

The APR report satisfies the reporting requirements of the following major legislation:

- Reports Consolidation Act of 2000
- Government Performance and Results Act of 1993
- Chief Financial Officers Act of 1990
- Government Management Reform Act of 1994
- Federal Managers' Financial Integrity Act of 1982
- Federal Financial Management Improvement Act of 1996
- Improper Payments Information Act of 2002

The reports will be available on the Department's Web site at: **www.dot.gov/about.html#perfbudgplan**

MESSAGE FROM THE SECRETARY

MESSAGE FROM THE SECRETARY

I am pleased to present the U.S. Department of Transportation's (DOT) Annual Financial Report. Consistent with the requirements of the statute, this material provides reliable and complete information on DOT's financial operations and performance for the fiscal year that ended September 30, 2011.

RAY LaHOOD

THIS REPORT IS PRESENTED together with our annual Performance Report that will be released in February 2012, accompanying the Budget of the President. I am very pleased that DOT again received an unqualified audit opinion on its financial statements, as we have for the past several years. We made significant progress during 2011 and, as we look ahead, 2012 will be another year when DOT will lead the Nation in promoting safety and critical transportation investments that are vitally needed to help our economy and create jobs throughout the country.

JOBS FOR OUR ECONOMY

The Department is at the forefront of addressing our Nation's infrastructure needs, and this means investment, construction, and jobs. Our challenges are significant. As recently as 2005, the World Economic Forum ranked America's infrastructure the best in the world. Today, we are not even in the top ten. Close to 69,000 of America's bridges are substandard—more than one in four. The average commuter spends about 240 percent more time stuck in traffic than 30 years ago, and annually this drains $100 billion in wasted fuel and lost productivity from our economy. Although the challenges that we confront are considerable, DOT has an opportunity to continue our important initiatives from 2011 and in so doing, support the Administration's critical efforts to get the economy moving again.

The President has put forward the following initiatives:

- In the short-run, we can create quality, middle-class manufacturing and construction jobs doing things our economy needs, from coast to coast. At a time when interest rates are low and a million construction workers are looking for work, we can hire tens of thousands of them right away.
- In rebuilding our roads, bridges, transit systems, and airports, we can spur the creation and growth of small businesses, America's economic engine. When we construct new roadways, rail lines, or transit systems, businesses emerge all along the routes, and—in turn—hire American workers.
- Over the long-term, we can restore America's economic competitiveness by making sure that the American people can get themselves and their products where they need to go. By 2050, the United States will be home to 100 million additional people, which is the equivalent of another California, Texas, New York, and Florida combined. If we settle for the status quo, our families and neighbors will fight paralyzing congestion. If we stand still, our next generation of entrepreneurs will find America's arteries of commerce impassably clogged.

The bottom line is that investment in transportation is a job-creation plan for people throughout the country. This also is about restoring America's standing as a Nation that builds the best roads, bridges, transit systems, and airports in the world.

The programs embodied in the President's recently proposed *American Jobs Act* are the remedy the economy needs right now. The President's plan includes a $50 billion immediate investment in construction jobs rebuilding America's roadways, railways, transit systems, and airports. The *American Jobs Act* will spur the hiring of American workers to upgrade 150,000 miles of road, to lay or maintain 4,000 miles of track, to restore 150 miles of runways, and to put in place a next-generation air-traffic control system that will reduce travel time and delays. Although we expect enactment of the President's agenda for jobs and growth, even now the Department is moving ahead with important initiatives to promote transportation investments and jobs. These include a new agenda of high-priority infrastructure projects, continuing progress on our High Speed Rail initiative, and further investment in our Next Generation Air Transportation System (NextGen).

HIGH-PRIORITY INFRASTRUCTURE PROJECTS

In keeping with a recommendation from his Jobs Council, the President directed certain Federal agencies to identify high-priority infrastructure projects that can put people back to work as soon as possible. These are projects that are already funded and, with some focused attention, could be expedited to get construction underway more quickly while still protecting safety, public health, and the environment. The Department selected six key projects to start this important initiative, including replacing the Tappan Zee Bridge in New York and Whittier Bridge in Massachusetts; extending transit systems in Los Angeles and Baltimore; and installing NextGen technology at two Houston airports. These important projects will assist many in these areas who are in need of work.

"In rebuilding our roads, bridges, transit systems, and airports, we can spur the creation and growth of small businesses, America's economic engine."

HIGH SPEED RAIL

In the short-term, DOT's vision for high-speed rail will create important manufacturing and construction jobs. To date, 30 rail companies from around the world have pledged that, if selected for high-speed rail contracts, they will hire American workers and expand their bases of operations in the United States. Once track is laid and stations constructed, high-speed rail will spur economic development. It will generate quality jobs at small businesses all along its corridors. Our highways and airports simply cannot handle the substantial growth forecast over the next several decades, and a new, modern, high-speed rail network must be an important part of the solution.

NEXTGEN

The aviation sector is essential to the country's economic health and growth. Civil aviation makes up over five percent of gross domestic product, and it generates more than 10 million jobs, with earnings of nearly $400 billion. It is because of aviation's importance that DOT will continue to devote major energies toward the implementation ofNextGen. NextGen is a comprehensive transformation of our National Airspace System that is being designed and built to take us to the next level of safety, while also making air travel more convenient and dependable. It will increase controllers' and pilots' awareness of potential danger as well as their ability to avoid it. Appropriately equipped aircraft will be able to receive information about traffic, weather, and flight-restricted areas; and advances in ground tracking and conflict warnings will make runway incursions less likely. Further, our latest estimates show that in the next 7 years, NextGen improvements will help us cut carbon dioxide emissions by 14 million tons. We will save about 1.4 billion gallons of jet fuel, and reduce delays about 35 percent. That will bring $23 billion in cumulative benefits to our economy. NexGen is vital to protect and expand the aviation system's contributions to our economy. Its design and implementation mean the protection and creation of important jobs in our aviation industry. These, in turn, will help us all be safer in the air and aid us in getting were we need to go faster and more efficiently.

TRANSPORTATION SAFETY

While investment and job creation is our high priority in 2011 and beyond, we continue to increase our efforts to promote safer driving. This includes our priority initiatives to reduce distracted driving, implement our new five-star ranking system for safer cars, and continue construction of better, safer roads.

DISTRACTED DRIVING

Our campaign against distracted driving has become an important component in our safety initiatives. Distracted driving is unsafe, irresponsible, and, in a split second, it can be devastating. Distracted driving-related crashes caused nearly 5,500 deaths and 450,000 injuries during 2009.

Several months ago, the Administration partnered with local governments to test a simple idea. We asked if it was possible to adapt a proven strategy, which has already reduced drunk-driving and increased seatbelt use, and use it to encourage people to keep their hands on the wheel and off the phone.

After a year of research in two cities—Syracuse, New York, and Hartford, Connecticut—we know that this approach is a success. In Syracuse, the data shows that, because of high-visibility enforcement, both handheld cell phone use and texting behind the wheel have declined by one-third. In Hartford, handheld use dropped by 57 percent and texting behind the wheel dropped by nearly three-quarters. The Department intends to build on this success. We are going to test our three part formula of tough laws, strong enforcement, and ongoing public awareness at the Statewide level in several locations, and we are going to continue to remind people to take personal responsibility and turn off the cell phone every time they get into the driver's seat.

FIVE-STAR RANKINGS

During 2011, we continued to implement with great results one of our new safety initiatives at the National Highway Traffic Safety Administration (NHTSA)-a tougher five-star ranking system for new cars. Since the NHTSA rankings were created in 1979, automobiles have gotten progressively safer. Over time, though, we started to see that consumers were having a harder time determining which vehicles deliver exceptional safety performance. The Department brought NHTSA's rating system into the 21st century by mandating more rigorous crash tests. This includes an additional side impact test and using data from female test dummies—for the first time ever—so we can learn the effects of crashes on women as well as men. Under this new ranking system, we recognize vehicles with advanced safety technologies such as electronic stability control, lane departure warnings, and forward collision warning systems. Ultimately, this new five-star system will combine all of a car's safety ratings into an overall vehicle score and aid consumers in making informed decisions.

SAFER ROADWAYS

In addition to safer drivers and safer cars, DOT continued its efforts to make roads safer in 2011. This meant safer intersections, better signs and lighting, and more effective crash barriers. For example, we allotted more than $1 billion in the last two years to road projects to improve traffic management and install hundreds of miles of rumble strips and cable medians. Also, we required that highway projects built with Recovery Act funds include wider shoulders, more effective guard-rails, and—if they are local roads—bike and pedestrian paths. All of these measures are important improvements that promote safety.

INVESTMENT FOR AMERICA

Our transportation system is a central part of our shared heritage. The canals that first made interstate commerce possible, the transcontinental railroad that connected our coasts, the interstate highway system that enabled a half-century of umivaled opportunity and prosperity—American workers dreamed these modern wonders. American workers wielded the shovels, forged the iron, laid the tracks, and poured the concrete that brought these projects to life. American workers passed these valuable assets on to us, their children and grandchildren. The U.S. Department of Transportation continued this proud tradition in 2011 through our support of important investments in highway, air, rail, and maritime projects. In the coming year, we hope to further these initiatives, continue our important safety programs, and move forward with the Administration's vital agenda for jobs and investment in America.

RAY LaHOOD

NOVEMBER 2, 2011

MANAGEMENT DISCUSSION AND ANALYSIS

MISSION

UNITED STATES DEPARTMENT OF TRANSPORTATION MISSION AND VALUES

MISSION

The Department's mission is to serve the United States by ensuring a fast, safe, efficient, accessible and convenient transportation system that meets our vital national interests and enhances the quality of life of the American people, today and into the future.

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

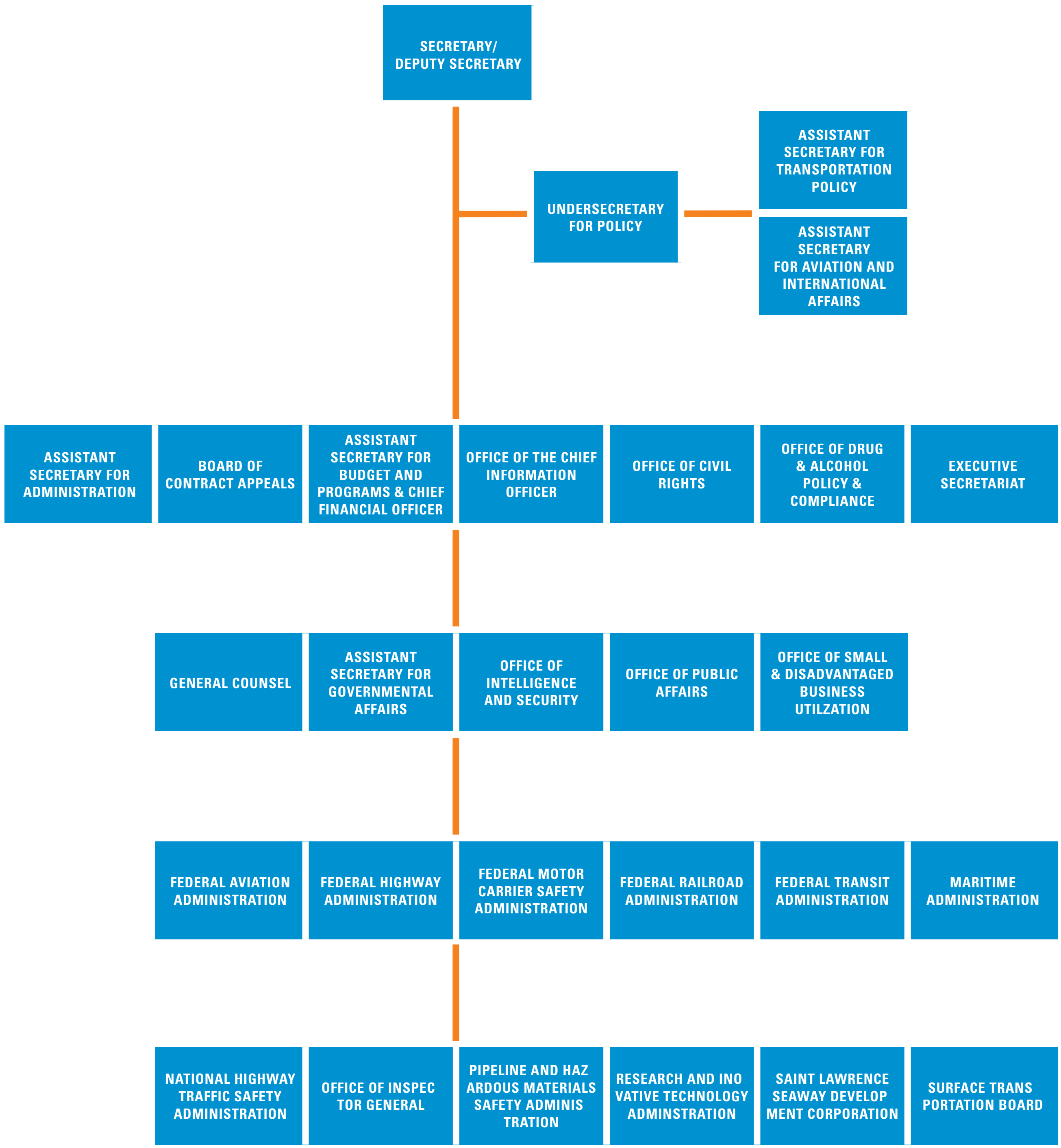
Established in 1967, DOT sets Federal transportation policy and works with State, local, and private sector partners to promote a safe, secure, efficient, and interconnected National transportation system of roads, railways, pipelines, airways, and seaways. DOT's overall objective of creating a safer, 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 and consumer protection 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.

ORGANIZATIONAL CHART



OVERVIEW OF LEGISLATIVE AUTHORITIES

The DOT strategic plan summarizes the legislative authorities of each Operating Administration (OA). To provide a context for the reader, highlights of the responsibilities of each OA 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 and issuance of regulations to prevent alcohol and illegal drug use in transportation systems.

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.

FEDERAL RAILROAD ADMINISTRATION

The Federal Railroad Administration's (FRA) mission is to ensure that our Nation has safe, secure, and efficient rail transportation.

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 natural or unnatural disasters.

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

PHMSA's mission is to protect people and the environment from the risks inherent in transportation of hazardous materials—by pipeline and other modes of transportation.

RESEARCH AND INNOVATIVE TECHNOLOGY ADMINISTRATION

The Research and Innovative Technology Administration (RITA) works to advance DOT priorities for innovation and research in transportation technologies and concepts.

SAINT LAWRENCE SEAWAY DEVELOPMENT CORPORATION

The U.S. Saint Lawrence Seaway Development Corporation (SLSDC), a wholly owned government corporation, 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

This is the last year that the Department will report against "New Ideas for a Nation on the Move", our Strategic Plan for Fiscal Years 2006–2011. The Department will continue to track many of the measures found in the following pages, but as the agency builds upon progress in improving transportation and develops new strategic priorities, some measures will be dropped and new ones developed.

Preliminary results indicate that Department met nearly 80% of its performance targets for the year. Like every government agency, however, there are areas that we can improve upon. A brief discussion of our results by strategic objective follows.

SAFETY

DOT tracks the safety of Americans on the highways, in the air, on transit systems, and on railroads. In FY 2011, preliminary results show that we met 9 out of 10 safety goals. Fatalities in general aviation (GA) did not decline as quickly as anticipated. Most of the fatalities occurred in the area of experimental aircraft, which are predominately amateur-built. These aircraft accounted for approximately 26 percent of GA fatal accidents while only contributing 5 percent of GA flying hours. FAA continues to pursue multiple avenues for addressing this issue.

REDUCED CONGESTION

One of DOT's strategic objectives is to reduce the congestion across the modes of transportation. We do this in a variety of ways, from providing funds that keep our highways in a state of good repair, managing air traffic efficiently, and encouraging the use of mass transit in order to reduce traffic on roadways. For the second year in a row, the Department saw a contraction in the number of people across the country using mass transit. Ridership continues to be affected by a general decline in the economy, relatively high unemployment, and a decline in state and local tax revenues used to support transit.

GLOBAL CONNECTIVITY

DOT contributes to the economy and American businesses' connection with markets across the world by moving products, goods, and vehicles with as little delay as possible. In FY 2011, the St. Lawrence Seaway, which is a vital waterway between the upper Midwest and global markets, was open 99% of the shipping season. On the roadways we continue to improve the flow of traffic in freight corridors, but results were mixed in limiting delays at border crossings. Three of the five monitored crossings saw a decrease in delays, while those in Buffalo, NY, and Blaine, WA, saw increases. An increase in North American trade and the resulting growth in commercial vehicle traffic likely contributed to the mixed results and additional unexpected delay.

ENVIRONMENTAL STEWARDSHIP

The transportation system has a significant impact on the environment and DOT mitigates that impact whenever possible. For the fourth year in a row, there were no violations of air pollution standards in major metropolitan areas. Streamlining the process for completing environmental impact statements, however, continues to be a challenge.

SECURITY, PREPAREDNESS AND RESPONSE

While the Department of Homeland Security has primary responsibility for the security of the transportation system, DOT must ensure it is prepared to continue operating during a crisis. To this end, DOT tracks the readiness of key staff and member agencies. DOT, through the Maritime Administration, has a role in supporting the Department of Defense during military mobilization. For the fourth year in a row we have exceeded the readiness requirements for shipping capacity and commercial ports.

ORGANIZATIONAL EXCELLENCE

Mindful of the need to wisely use taxpayer money, DOT tracks the cost and scheduling associated with major system purchases and major infrastructure projects. Although we did not make our cost and schedule targets for major infrastructure projects as a whole, we are seeing improvements within individual projects. DOT agencies will continue to review the finance plans, project management plans, and cost estimates that are required for each major project.

PERFORMANCE SUMMARY TABLES

SAFETY PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2005	2006	2007	2008	2009	2010	2011 TARGET	2011 ACTUAL	MET/NOT MET
Passenger vehicle occupant highway fatality rate per 100 million passenger vehicle miles traveled (VMT)	1.15	1.11	1.08	.97	.89	0.87#	0.85	0.89-0.83#	Potentially Met
Large truck and bus fatality rate per 100 million total VMT	0.185	0.177	0.169	0.155	0.121 (R)	0.108 - 0.119#	0.121	0.118–0.129#	Potentially Met
Motorcyclist fatality rate per 100,000 motorcycle registrations	73.48	72.42	72.48	68.52	~56.27	65#	63	56–58#	Potentially Met
Non-occupant fatality rate per 100 million VMT	0.20	0.19	0.18	0.18	0.17	0.16#	0.16	0.17–0.16#	Potentially Met
Number of commercial air carrier fatalities per 100 million persons onboard	N/A	N/A	N/A	0.4	6.7(R)	0.3*	7.9	0.0*	Met
Fatal Accidents per 100,000 Flight Hours in General Aviation	N/A	N/A	N/A	N/A	1.16(R)	1.16#	1.08	1.16*	Not Met
Rail-related accidents and incidents per million train miles	18.14	17.05	17.62	16.76	16.90	15.90*	16.40	14.86*	Met
Transit fatalities per 100 million passenger-miles traveled.	0.428	0.389	0.437	0.332	0.273	0.188	0.453	0.167	Met
Number of natural gas and hazardous liquid pipeline incidents with death or major injury	41	35	47	40	49	39(R)	45	39#	Met
Number of hazardous materials transportation incidents with death or major injury	48	32	36	24	29	19(R)	34	27#	Met

*(r) Revised; * preliminary estimate; # projection from trends*

REDUCED CONGESTION SUMMARY

PERFORMANCE MEASURE	2005	2006	2007	2008	2009	2010	2011 TARGET	2011 ACTUAL	MET/NOT MET
Percentage of travel on the National Highway System (NHS) meeting pavement performance standards for "good" rated ride	52	54	57	56	57	58	58%	58%	Met
Percentage of deck area on National Highway System (NHS) bridges rated as deficient, adjusted for average daily traffic	29.9	29.2	29.7	29.5	29.2	28.7	28.0	28.5	Not Met
Percentage of total annual urban area travel occurring in congested conditions	28.6	28.4	27.8	26.3	26.6#	26.8#	27.1	26.3	Met
Average percent change in transit boardings per transit market (150 largest transit agencies)	1.9	2.1	2.5	4.3	2.2	-4.2	2.0	0.6	Not Met
Percent of transit bus fleets compliant with the Americans with Disabilities Act (ADA)	96	97	98	98	98	98	98	98	Met
Percent of key transit rail stations compliant with the ADA	91	92	93	95	95	95.2	94.5	95.2	Met
Percent of all flights arriving within 15 minutes of schedule at the 35 Operational Evolution Partnership airports due to National Airspace System related delays	88.44	88.36	86.96	87.29	88.98	90.56	88.0	90.26*	Met

*(r) Revised; * preliminary estimate; # projection from trends*

GLOBAL CONNECTIVITY PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2005	2006	2007	2008	2009	2010	2011 TARGET	2011 ACTUAL	MET/NOT MET
Percent of days in the shipping season that the U.S. portion of the St. Lawrence Seaway system is available	99.7	99.0	99.4	98.8	99.4	99.8	99	99	Met
Number of freight corridors with an annual decrease in the average buffer index rating.	N/A	3	5	21	19	14	13	14	Met
Number of National Highway System border crossings with a decrease in unexpected delay.	N/A	N/A	4	3	3	5	5	3	Not Met
Percent share of the total dollar value of DOT direct contracts that are awarded to women-owned businesses	6.29	8.04	10.4	6.57	10.94	8.0*	6	11.24	Met
Percent share of the total dollar value of DOT direct contracts that are awarded to small disadvantaged businesses	15.60	16.13	19.29	16.15	13.36	14.57*	15	19.54	Met

*(r) Revised; * preliminary estimate; # projection from trends*

ENVIRONMENTAL STEWARDSHIP PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2005	2006	2007	2008	2009	2010	2011 TARGET	2011 ACTUAL	MET/NOT MET
Number of areas in conformity lapse	5.8	1.3	0.0	0.0	0.0	0	3	0	Met
Number of hazardous liquid pipeline spills with environmental consequences	127	106	97	128	111	88	104	99#	Met
Number of Exemplary Human Environmental Initiatives undertaken	N/A	N/A	N/A	11	16	10	10	9	Not Met
Median time in months to complete environmental impact statements for DOT funded infrastructure projects	56	57	67	64	79	63.9	48	70	Not Met

*(r) Revised; * preliminary estimate; # projection from trends*

SECURITY PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2005	2006	2007	2008	2009	2010	2011 TARGET	2011 ACTUAL	MET/NOT MET
Percentage of DoD-required shipping capacity complete with crews available within mobilization timelines	95	93	97	97	96	96	94	97	Met
Percentage of DoD-designated commercial ports available for military use within DoD established readiness timelines	87	100	100	100	100	100	93	100	Met
Percent of DOT personnel with emergency management responsibilities who are prepared to respond to disasters and emergencies	N/A	N/A	N/A	N/A	100	100	100	100	Met
Percent of DOT agencies meeting annual response requirements	N/A	N/A	N/A	N/A	96	96	100	94	Not Met

*(r) Revised; * preliminary estimate; # projection from trends*

ORGANIZATIONAL EXCELLENCE PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2005	2006	2007	2008	2009	2010	2011 TARGET	2011 ACTUAL	MET/NOT MET
Percent of major federally funded transportation infrastructure projects with less than 2 percent annual growth in the project completion milestone as reported in the finance plan.	89	89	89	79	78	84	90	66	Not Met
Percent of finance plan cost estimated for major federally funded transportation infrastructure projects with less than 2 percent annual growth in project completion cost.	81	84	83	82	84	84	90	82	Not Met
For major DOT aviation systems, percentage of cost goals established in the acquisitions project baselines that are met.	97.00	100	100	96.08	100	97*	90	100	Met
For major DOT aviation systems, percentage of scheduled milestones established in acquisition project baselines that are met.	92.00	97.44	97.00	93.88	93.75	90.74*	90	94	Met

*(r) Revised; * preliminary estimate; # projection from trends*

FINANCIAL HIGHLIGHTS

DOT has chosen to produce an Agency Financial Report (AFR) and Agency Performance Report (APR). DOT will include its FY 2011 APR with its Congressional Budget Justification and will post it on DOT's website at www.DOT.gov by February 15, 2012.

The financial statements and financial data presented in this Report have been prepared from the accounting books and records of the U.S. Department of Transportation in conformity with generally accepted accounting principles (GAAP). GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB). Department management is responsible for the integrity and fair presentation of the financial information presented in these statements.

The Hiring Incentives to Restore Employment (HIRE) Act of 2010 and the American Recovery and Reinvestment Act of 2009 (ARRA or the Recovery Act) continue to significantly impact the Department's financial statements when comparing FY 2011 amounts to FY 2010 amounts for certain financial statement line items. HIRE provided $19.5 billion in additional funding in FY 2010, initially increasing Investments. Of the $48 billion in appropriations provided by ARRA in FY 2009, $39.6 billion was obligated in FY 2010 and an additional $7.9 billion was obligated in FY 2011. Through September 30, 2011, $31.5 billion of ARRA funds have been disbursed.

On September 16, 2011 the President signed H.R. 2887, the Surface and Air Transportation Extension Act of 2011 granting a temporary extension to make expenditures from the Highway Trust Fund through March 31, 2012 and granted a temporary extension of authority to the Airport and Airway Trust Fund to January 31, 2012. DOT has been developing several reauthorization proposals subject to OMB and Congressional approval.

OVERVIEW OF FINANCIAL POSITION

ASSETS The Consolidated Balance Sheet reports a decrease in total assets to $85.7 billion at the end of FY 2011, compared with $103.7 billion at the end of FY 2010. The Fund Balance with Treasury line item decreased by $12.8 billion as ARRA funding provided in FY 2009 continued to be disbursed in FY 2011. Investments also decreased by $6.4 billion as funding provided by HIRE was spent on highway, transit and other surface transportation construction projects.

The Department's assets reflected in the Consolidated Balance Sheet are summarized in the following table.

ASSETS BY TYPE

DOLLARS IN THOUSANDS	2011	%	2010	%
Fund Balance with Treasury	$39,761,625	46.4	$52,504,709	50.6
Investments	26,682,058	31.1	33,050,889	31.9
General Property, Plant & Equipment	13,740,507	16.0	13,907,474	13.4
Direct Loans & Guarantees, Net	4,187,635	4.9	2,892,100	2.8
Inventory & Related Property, Net	845,833	1.0	823,603	.8
Accounts Receivable	266,388	.3	244,316	.2
Cash & Other Assets	247,528	.3	329,250	.3
Total Assets	**$85,731,574**	**100.0**	**$103,752,340**	**100.0**

LIABILITIES The Department's Consolidated Balance Sheet reported total liabilities of $18.4 billion at the end of FY 2011, as summarized in the table below. This represents a modest increase from the previous year's total liabilities of $17.3 billion. The largest increase was in the Debt line item from additional loans made through the Transportation Infrastructure Finance and Innovation Act (TIFIA) program.

LIABILITIES BY TYPE

DOLLARS IN THOUSANDS	2011	%	2010	%
Grant Accrual	$6,560,755	35.7	$6,965,999	40.4
Debt	4,342,866	23.6	3,077,439	17.8
Other Liablities	4,051,687	22.1	4,159,702	24.1
Accounts Payable	2,187,163	11.9	1,717,081	10.0
Environmental & Disposal Liabilities	1,068,076	5.8	1,103,562	6.3
Loan Guarantees	158,425	.9	237,739	1.4
Total Liabilities	**$18,368,972**	**100.0**	**$17,261,522**	**100.0**

NET POSITION The Department's Consolidated Balance Sheet and Consolidated Statement of Changes in Net Position report a Net Position of $67.4 billion at the end of FY 2011, a 22 percent decrease from the $86.5 billion from the previous fiscal year. The decline is mainly attributable to a return to pre-ARRA and pre-HIRE funding levels. Net Position is the sum of 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 2011 was $78.1 billion. Surface and air costs represent 98.4 percent of the Department's net cost of operations. Surface transportation program costs represent the largest investment for the Department at 77.2 percent of the Department's net cost of operations. Air transportation is the next largest investment for the Department at 21.2 percent of total net cost of operations.

NET COSTS

DOLLARS IN THOUSANDS	2011	%	2010	%
Surface Transportation	$60,319,117	77.2	$60,769,477	77.1
Air Transportation	16,544,662	21.2	16,775,815	21.3
Maritime Transportation	484,393	.6	568,602	.7
Costs Not Assigned To Programs	421,434	.5	394,503	.5
Cross-Cutting Programs	347,273	.4	336,503	.4
Less Earned Revenues Not Attributed To Programs	3,876	-	471	-
Net Costs of Operations	**$78,113,003**	**100.0**	**$78,844,429**	**100.0**

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 2011 fiscal year, the Department had total budgetary resources of $140.8 billion, which represents a 19.3 percent decline from FY 2010 levels of $174.5 billion. Budget Authority of $131.8 billion consisted of $74.2 billion in appropriations received and $57.6 billion in borrowing and contract authority. The Department's FY 2011 obligations incurred totaled $90.3 billion compared with FY 2010 obligations incurred of $113.8 billion.

Net Outlays reflect the actual cash disbursed against previously established obligations. For FY 2011, the Department had net outlays of $78.6 billion, compared to FY 2010 levels of $97.9 billion, a decrease of 19.8 percent. As expected, disbursements have decreased as the Recovery Act program and HIRE funding winds down (i.e. as lower levels of obligations from FY 2011 and FY 2010 are liquidated).

RESOURCES

DOLLARS IN THOUSANDS	2011	2010	CHANGE
Total Budgetary Resources	$140,800,746	$174,546,066	% (19.3)
Obligations Incurred	$90,313,536	$113,847,631	(20.6)
Net Outlays	$78,551,159	$97,943,743	(19.8)

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 airport planning and development programs.

Financial information for Heritage assets and Stewardship Land is presented under the Financial Report section of this report in the Notes to 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 U.S. 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 U.S. Department of Transportation in accordance with GAAP for Federal entities and in 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.

FY 2011 FMFIA ASSURANCE LETTER TO THE PRESIDENT

The following is text of the Secretary's letter to the President; dated November 2, 2011:

I am pleased to report on the effectiveness of the internal controls and financial management systems for the U.S. Department of Transportation (DOT) during Fiscal Year (FY) 2011. This report is based on our successful implementation under the Federal Managers' Financial Integrity Act of 1982 (FMFIA); Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Control; and OMB Office of Federal Procurement Policy's Acquisition Assessment.

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

With the exception noted for compliance with the Federal Information Security Management Act (FISMA), DOT is able to provide reasonable assurance that the internal controls and financial management systems in effect during the period of October 1, 2010, through September 30, 2011, met the objectives of both Sections 2 and 4 of FMFIA. During FY 2011, DOT conducted its assessment of internal controls and compliance with applicable laws and regulations in accordance with OMB Circular A-123.

FISMA COMPLIANCE

In late 2010, the Inspector General (IG) issued a report on DOT's compliance with FISMA. The purpose of this review was to determine the effectiveness of DOT's security program and practices in the areas of policies and procedures, enterprise-level information security controls, management of information security weaknesses, and system-level security controls. As a result of this review, IG made 27 specific recommendations. Senior management and the Department's Chief lnformation Officer (CIO) have been collaborating and monitoring corrective actions. Although some progress has been made since 2010, these same conditions substantially existed during 2011, with many corrective actions in progress. We expect that the IG's report on FISMA for 2011 will reach a similar conclusion. As a consequence, the Department's compliance with FISMA during 2011 again constituted a material weakness in internal control under Section 2 of FMFIA.

Corrective actions by the CIO have continued into 2011. A summary of these actions is enclosed [see pp. 23–24]. The CIO's plan includes the implementation of a management approach, resulting in successes with (1) improving the issuance of Personal Identity Verification smartcards to Agency personnel; (2) achieving compliance with U.S. Department of Homeland Security security requirements; and (3) implementing Trusted Internet Connection capabilities. The Agency also is implementing automated continuous monitoring technology to provide near real-time awareness of vulnerabilities and risk.

FMFIA INTERNAL CONTROL PROGRAM

For FY 2011, DOT enhanced its standardized and consistent FMFIA Internal Control Program approach for managing control and compliance activities. The DOT identified and documented meaningful Components and Assessable Units (AU). Inherent risk assessments were conducted to classify and prioritize each AU. Management Control Reviews, leveraging the five standards of internal controls, as prescribed by the Committee of Sponsoring Organizations of the Treadway Commission and the U.S. Government Accountability Office, were conducted to identify, assess, document, and communicate key management and programmatic internal controls and related risks or weaknesses.

Note: Please see the end of this section for the attached FISMA Act Compliance:Corrective Action Summary

OMB CIRCULAR A-123, APPENDIX A INTERNAL CONTROL PROGRAM

During FY 2011, DOT conducted an assessment of the effectiveness of internal controls over financial reporting, including safeguarding of assets and compliance with applicable laws and regulations in accordance with the requirements of OMB Circular A-123, Appendix A. During FY 2011, DOT assessed and tested controls over key identified business processes, including Credit Card Management, Cash Management, Procure to Pay, Travel Management, and Grants Management.

The major OMB Circular A-123, Appendix A activities in FY 2011 included evaluating entity level, process level, and in-depth testing at the transaction level of internal controls over financial reporting for the five identified business processes. All deficiencies were communicated to senior management and mitigated using existing remediation procedures.

OMB A-123 ACQUISITION ASSESSMENT

In accordance with guidance from the Office of Federal Procurement Policy and OMB Circular A-123, the DOT Office of the Senior Procurement Executive (OSPE) developed a 3-year assessment reporting cycle of the DOT's acquisition offices and programs, and in FY 2011, OSPE is conducting an entity level top-down assessment for the Federal Aviation Administration, the Federal Motor Carrier Safety Administration, the Maritime Administration, and the Volpe Center. As of September 30th, the OSPE has not identified any material weaknesses during their review.

As a result of our FMFIA reviews in FY 2011, I conclude that the Department has made substantial progress in enhancing its internal controls and financial management program. Additional enhancements are planned and underway in FY 2012.

RAY LaHOOD

SYSTEM, CONTROLS, AND LEGAL COMPLIANCE

FEDERAL MANAGER'S FINANCIAL INTEGRITY ACT (FMFIA)

The FMFIA requires agencies to conduct an annual evaluation of its internal controls and financial management systems and report the results to the President and Congress. The agency then prepares an annual Statement of Assurance based on its assessment of the effectiveness of its controls and financial system conformance with Federal requirements.

The Secretary of Transportation provided the President and Congress a Statement of Assurance for the fiscal year ended September 30, 2011, stating that DOT is able to provide reasonable assurance that its controls and systems met the objectives of FMFIA, except for compliance with the Federal Information Security Management Act (FISMA).

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.

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.

Objectives of Control Mechanisms:

- Financial and other resources are safeguarded from unauthorized use or disposition.
- Transactions are executed in accordance with authorizations.
- Records and reports are reliable.
- Applicable laws, regulations, and policies are observed.
- Resources are efficiently and effectively managed.
- Financial systems conform to government-wide standards.

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. 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 Department's Office of Financial Management. Any identified FMFIA material weaknesses and material nonconformances are also reported, as well as milestones established to resolve the challenges and/or accomplishments achieved. Specific guidance for completing the self-assessment and end of fiscal year assurance statement and reporting on 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:

- Significant weakness of the safeguards (controls) against waste, loss, unauthorized use or misappropriation of funds, property, or other assets.
- Violates statutory authority, or results in a conflict of interest.
- Deprives the public of significant services, or seriously affects safety or the environment.
- Impairs significantly the fulfillment of the agency's mission.
- 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:

- Prevent the primary accounting system from centrally controlling financial transactions and resource balances.
- Prevent compliance of the primary accounting system, subsidiary system, or program system under the Office of Management and Budget Circular A-127.

FY 2011 FMFIA MATERIAL WEAKNESSES

STATUS OF INTERNAL CONTROLS (FMFIA SECTION 2)

The DOT is reporting one material weakness in FY 2011, based on non-compliance with FISMA standards and OMB requirements for information security programs and enterprise-level controls. This material weakness was also reported in FY 2010. Senior management and the Department's Chief Information Officer (CIO) have been collaborating and monitoring corrective actions. Although some progress was made in FY 2011, the same conditions substantially existed during FY 2011, with many corrective actions in progress.

STATUS OF FINANCIAL MANAGEMENT SYSTEMS (FMFIA, SECTION 4)

The DOT is reporting no material nonconformances for FY 2011.

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.

DOT performed in-depth testing of the controls over five focus area business processes for each Operating Administration (OA) including Credit Card Management, Cash Management, Procure to Pay, Travel Management, and Grants Management. Additional testing of high-risk key controls from the remaining seven non-focus area business processes was performed for OAs whose transactions are material to the Department-wide financial statements.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)

The Secretary has determined that our financial management systems were in substantial compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA) for FY 2011. In making this determination, management considered all the information available, including independent auditor reports on the Department's internal controls and compliance with selected provisions of laws and regulations. Also considered were the results of management's assessment of its internal controls and financial management systems reviews, including the Inspector General's most recent Federal Information Security Management Act (FISMA) report on the effectiveness of the Department's security program.

The FFMIA requires that agencies' financial management systems routinely provide reliable and timely financial information for managing day-to-day operations as well as to produce reliable financial statements, maintain effective internal control, and comply with legal and regulatory requirements. 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) at the transaction level. In addition, CFO Act 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.

Management conducted its assessment of the effectiveness of internal controls over financial systems and compliance with applicable laws and regulations in accordance with the Federal Managers' Financial Integrity Act of 1982 (FMFIA) guidance, and the requirements of OMB Circular A-123, Management's Responsibility for Internal Control and Circular A-127, Financial Management Systems.

With the exception of the Department's compliance with FISMA during FY 2011 that again constituted a material weakness in internal control under Section 2, Internal Control over Operations, under FMFIA, the Department is able to provide reasonable assurance that the internal controls and financial management systems in effect during FY 2011, met the objectives of both sections 2 and section 4, Financial Management System Requirements, of FMFIA.

DOT continues to make progress on the Financial System Modernization (FSM) initiative to improve its current financial management systems and business processes. This multiple-year, Department-wide program is led by the Office of the Assistant Secretary for Budget and Programs/ CFO, includes participation and support from each Operating Administration (OA) and includes Department-wide executive sponsorship.

FEDERAL INFORMATION SECURITY MANAGEMENT ACT (FISMA)

The Federal Information Security Management Act (FISMA) requires federal agencies to identify and provide security protection commensurate with the risk and magnitude of potential harm resulting from the loss, misuse of, unauthorized access to, disclosure of, disruption to, or modification of information collected to maintained by or on behalf of the an agency. FISMA also requires that each agency report annually on the adequacy and effectiveness of information security policies, procedures, and practices, and on FISMA compliance. OMB further requires that Agency Heads submit a signed letter that provides a comprehensive overview of these areas. This report and signed letter were delivered to OMB November 15, 2011. In addition, FISMA requires agencies have an independent evaluation performed of agency information security programs and practices. At the Department, this annual evaluation is performed by the Office of the Inspector General (IG). This year's (FY 2011) annual FISMA report will be finalized no later than November 15, as required by the Office of Management and Budget.

The DOT has 12 Operating Administrations and the OST that for Fiscal Year 2011 operated a total of 510 information systems, an increase of 50 systems over the FY 2010 inventory, of which 345 belong to the Federal Aviation Administration (FAA). The FAA's air traffic control system has been designated by the President as 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 $78 billion in federal funds each year.

DOT cyber security program continues to have a material weakness as a result of significant deficiencies its enterprise and systems controls. Specifically, DOT still needs to make progress in other critical areas, such as: improving contingency planning and testing; updating and correcting its inventory of reportable systems; ensuring that standard configurations are properly applied to DOT desktop and laptop computers; and implementation of a continuous monitoring strategy and program across the Department. Also required is continued progress on remaining open recommendations.

As part of its commitment to resolve this material weakness, DOT made improvements during 2011 through the issuance of new cyber security policy for the majority of its components. It expects to issue policy for OST in the near future. DOT also created and deployed the prototype of a new performance management tool named "IT Vital Signs". DOT increased the issuance of Personal Identity Verification (PIV) cards to 84% of the DOT employee population, and successfully closed 25 open audit recommendations. The full FY 2011 FISMA report is anticipated to be available in early December 2011 and can be found at **www.oig.dot.gov**

SSAE-16 REVIEW ON DOT'S FINANCIAL MANAGEMENT SYSTEM

The Statements on Standards for Attestation Engagements (SSAE) 16 report summarized the results of an independent review by Clifton Gunderson, LLP of general, application, and operational controls over the DOT Enterprise Services Center (ESC). The ESC performs services including accounting; financial management; systems and implementation; media solutions; telecommunications; and data center services for DOT and other Federal organizations.

This is the first year that a SSAE-16 audit has been conducted on DOT's Delphi financial system. A Statement on Auditing Standards (SAS) 70 audit was completed for the previous six years. Effective for reports dated after June 15, 2011, SAS-70 was replaced with the new standard SSAE-16.

Delphi is hosted, operated and maintained by Federal Aviation Administration employees at the Mike Monroney Aeronautical Center in Oklahoma City, OK, under the overall direction of the DOT 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 and Futures Trading Commission, the Institute of Museum and Library Services, the National Credit Union Association, the Consumer Product Safety Commission 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) SSAE-16.

This year's SSAE-16 audit of Delphi was conducted by Clifton Gunderson, LLP. Clifton Gunderson concluded that management presented its description of ESC controls fairly in all material respects, and that the controls, as described, were suitably designed for all stated control objectives.

Clifton Gunderson made additional recommendations to DOT management for improving controls in configuration management and security. We agree that implementing these recommendations will further enhance controls over ESC operations. In accordance with DOT Order 8000.1C, the corrective actions taken in response to Clifton Gunderson's recommendations are subject to audit follow-up. Clifton Gunderson performed additional testing and provided a follow-up management letter to OIG on September 30, 2011, reporting no significant changes to the control environment between July 1, 2011, and September 30, 2011.

FEDERAL INFORMATION SECURITY MANAGEMENT ACT COMPLIANCE: CORRECTIVE ACTION SUMMARY

Improving the Department's Cyber Security—Establishing a Robust Information Security Program.

I. WHY IS THIS ISSUE SIGNIFICANT?

The DOT operates and oversees significant elements of the critical infrastructure of the United States. Much of the DOT framework relies upon, and is integrated with, computer networks, computer mediated communications, online databases, and a wide variety of other computer and computer network capabilities. Cybersecurity attacks against any piece of the infrastructure have the potential for serious consequences to critical operations, either in a direct failure of a system or in the compromise of information.

II. ACTIONS TAKEN IN 2011:

- Finalized Version 1 of the Cybersecurity Strategic Plan (December 2010)
- Deployed "IT Vital Signs" dashboard for performance management and monitoring across the department (April 2011)
- Compliance review of all operating administration cybersecurity programs—June 2011
- Issuance of revised comprehensive Departmental Cybersecurity Policy (July 2011)
- Plan for pilot to require use of DOT Personal Identity Verification (PIV) card as primary authenticator for network login (September 2011)
- Increased PIV card issuance and provisioning for a total of 10,582 non –FAA issued and a total of 4,525 non-FAA provisioned.
- 90% + approved based security configurations for DOT assets (October 2011)
- Hiring of Cybersecurity specialist for forensic analysis, and compliance assessment (October 2011)
- Formed a team to execute a Password Reduction project that will reduce the burden of excessive usernames and passwords on employees.

III. ACTIONS REMAINING AND EXPECTED COMPLETION DATE:

- Development of standardized Departmental cybersecurity procedures (phase 1) (February 2012)
- Implement secure Domain Name System (DNS) for third-level domains and below (March 2012)
- Improve response to U.S. Computer Emergency Readiness Team security alerts (SARS) to 100% (March 2012)
- Consolidation of external network connections to DHS-approved Trusted Internet Connections (April 2012)
- Complete hiring of cybersecurity vacancies (September 2012)
- Piloting and selection of technology to support continuous monitoring (December 2012)
- Complete the issuance of PIV cards to all personnel (December 2012)

IV. RESULTS OR EXPECTED RESULTS:

It is expected that the (re-)establishment of strong Departmental cybersecurity policy will serve as the foundation for office and agency programs to manage risk across the Federal network. Key among the controls to be implemented will be increased use of the PIV card to access DOT networks and systems, increased use of Federally approved secure standard configurations for systems and technology assets, and enhancement of the DOT CIO's cybersecurity workforce to provide improved expertise and coverage in development and operation of the Department's program.

Improving the Department's Cyber Security—Increasing Protection of Personally Identifiable Information (PI)

I. WHY IS THIS ISSUE SIGNIFICANT?

The Department's "safety" mission relies significantly on the trust relationship between the Department and the American people. If the public cannot trust the Department to collect, use, store, share, and dispose of PII in ways that do not unnecessarily erode individual privacy, then it is less likely to trust other activities conducted by the Department. Additionally, failure to assess appropriately privacy risk and protect PII creates unnecessary exposure and increases the potential for information to be lost, stolen, or used in an authorized manner causing physical, financial and/or reputational harm to individuals as well as result in embarrassment, increased oversight, and loss of funding for the Department.

II. ACTIONS TAKEN IN 2011:

- Hiring of Departmental Chief Privacy Officer (CPO) to establish program direction and operational oversight (February 2011)
- Establish CPO oversight of incident response management for those incidentals with a nexus to privacy (June 2011)

III. ACTIONS REMAINING AND EXPECTED COMPLETION DATE:

- Develop and submit for approval updated privacy policy and compliance requirements (December 2011)
- Initiate review of existing privacy documentation in accordance with Privacy Act and E-Government Act (January 2012)
- Revamp compliance management program with focus on critical privacy risk analysis (January 2012)
- Develop and deploy dedicated role-based privacy training for general staff, privacy officers, project managers, and executives (June 2012)
- Rationalize and appropriately reduce use of sensitive PII, including but not limited to social security numbers (SSN), throughout Department (January 2013)
- Establish privacy program built on the best practices endorsed by the CIO Council (June 2012)

IV. RESULTS OR EXPECTED RESULTS:

The Department currently faces significant risk of unauthorized collection, use, exposure of PII. Implementing a robust privacy program allows for privacy controls to be injected into the business and system development lifecycles at the initial stages and increase staff awareness of their responsibility to protect PII and report unauthorized activity.

INSPECTOR GENERAL'S FY 2011 TOP MANAGEMENT CHALLENGES

DEPARTMENT OF TRANSPORTATION OFFICE OF INSPECTOR GENERAL APPROACH

The Office of Inspector General (OIG) issues an annual report on the Department of Transportation's top management challenges to provide a forward-looking assessment for the coming fiscal year. The Reports Consolidation Act of 2000 requires the OIG to identify and summarize the most significant management challenges facing the Department in FY 2011.

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 and draws from several dynamic factors to identify key challenges. These include new 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.

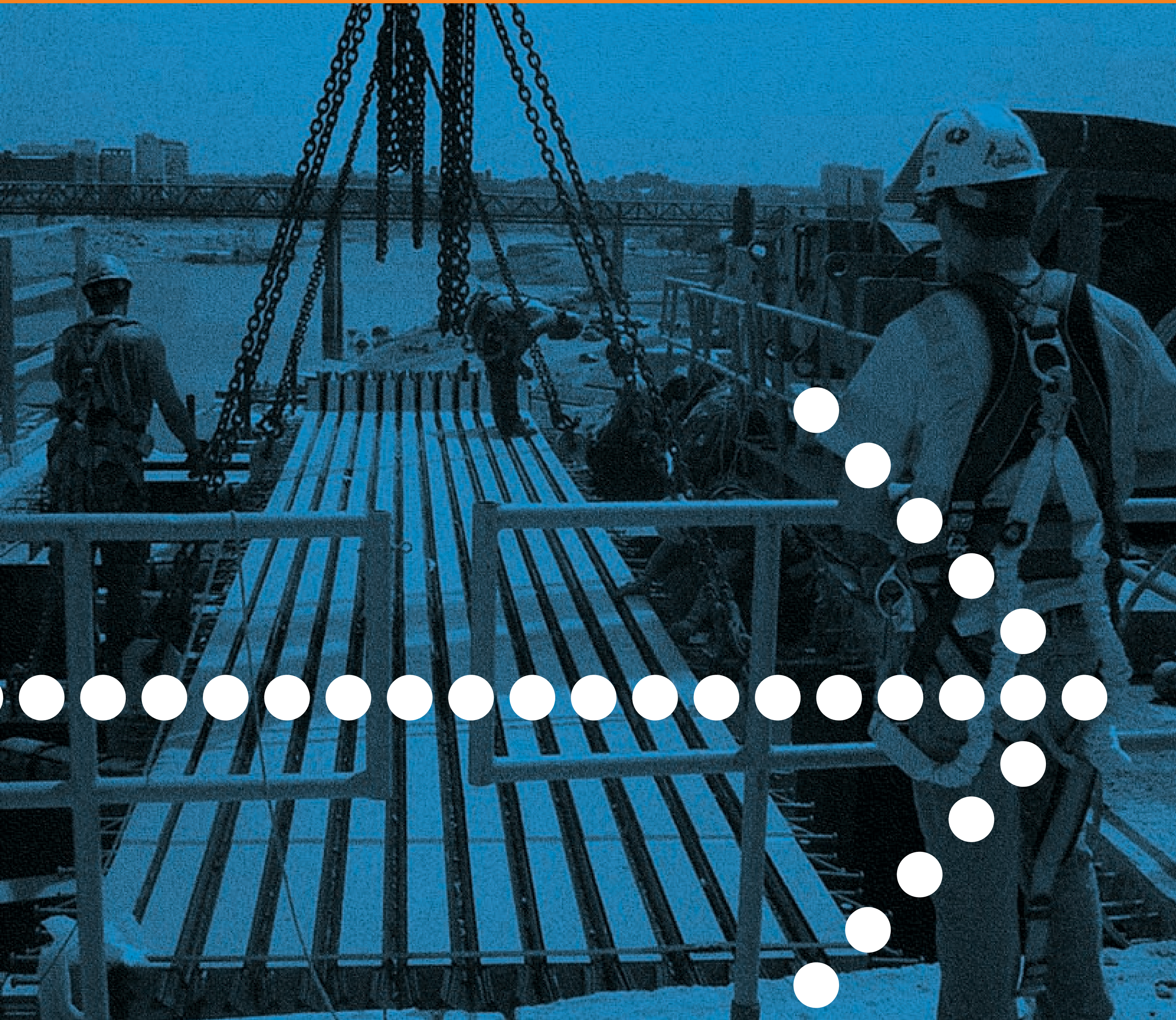
For FY 2011, the OIG identified the following nine significant challenges.

- Ensuring Transparency and Accountability in the Department's Recovery Act Programs
- Maintaining Momentum in the Department's Oversight of Highway, Motor Vehicle, Hazardous Materials, and Transit Safety
- Maintaining Momentum in Addressing Human Factors and Improving Safety Oversight of the Aviation Industry
- Improving the Department's Oversight of Highway, Transit, and Pipeline Infrastructure
- Identifying Sufficient Funding Sources To Support Future Federal Investment in Surface Transportation Infrastructure
- Transforming the Federal Railroad Administration To Address Significantly Expanded Oversight Responsibilities
- Advancing the Next Generation Air Transportation System While Ensuring the Safe and Efficient Operation of the National Airspace System
- Implementing Processes To Improve the Department's Acquisitions and Contract Management
- Improving the Department's Cyber Security

They will be further discussed in the DOT Annual Performance Report to be issued in February 2012 which will be located on DOT's website. **www.dot.gov/about.html#perfbudgplan**

The significant challenges identified by the OIG for FY 2012 will be discussed in the Other Accompanying information of this report.

FINANCIAL REPORT



MESSAGE FROM THE ASSISTANT SECRETARY FOR BUDGET AND PROGRAMS, AND CHIEF FINANCIAL OFFICER

CHRISTOPHER P. BERTRAM

I am pleased to issue the Department of Transportation's (DOT) Fiscal Year 2011 Agency Financial Report (AFR). In addition to this information, DOT is preparing two other documents—our Annual Performance Report and Citizens Report, a short summary of our activities, which will be published in February 2012. For the accompanying AFR, we highlight our progress during 2011 on several fronts. We had a positive year, with notable achievements in many areas, including reducing improper payments, a successful financial audit, continuing efforts to modernize our financial systems, and a focus on risk management and improvement in internal controls.

IMPROPER PAYMENTS

DOT continues to work with its Operating Administrations to maintain low rates of improper payments. During 2011, we tested our largest grant programs, which include the Airport Improvement Program, the Federal-Aid Highway Construction and Planning Program, the Federal Transit Administration's (FTA) Capital Investment Grants, and FTA's Formula and Bus Grants. Together, these four programs represent over 90 percent of DOT's grants. Our analysis found that estimated improper payment rates for these programs did not exceed 1.8 percent, a significant achievement. Moreover, the payments cited as improper during testing were non-systemic improper payments, resulting from administrative or documentation errors, which were mistakes having a low impact.

ANNUAL FINANCIAL AUDIT

During 2011 we continued our emphasis on improved financial management, which contributed substantially to another unqualified audit opinion—DOT's tenth in the last eleven years. The Department had no material weaknesses. The audit provides a useful independent review of our financial processes and system of controls, and provides important information to further our program of continually strengthening our safeguards and stewardship of taxpayer dollars.

FINANCIAL SYSTEMS MODERNIZATION

DOT continued to forge ahead with financial management improvement and modernization efforts in 2011. Our recent focus formed the foundation for this program, with an emphasis on long-term strategic planning. In the coming years, this initiative will center on system applications and improved financial reporting. During this period we also plan to address some related business process improvements, including such key activities as grant payments, vendor payments, and tools for better financial analysis.

RISK MANAGEMENT AND INTERNAL CONTROL IMPROVEMENT

DOT continues to focus on identifying risks that could impede meeting its objectives and in improving our system of internal controls to manage the risks identified. Risk management includes monitoring our performance through indicators such as changes in the amount and rate of improper payments, and by assessing the rate and degree of progress we make in addressing internal control challenges. Some of these areas are brought to management's attention through important oversight activities, such as audits by the Department's Office of Inspector General and our annual external financial statement audit conducted by independent public accountants. In addition, our risk management strategies, as well as our priorities for change actions, are informed by inputs from ongoing business processes that increase our institutional knowledge about our business and the vulnerabilities that require attention, including:

- Information obtained from our work to reengineer and streamline our financial management business processes to improve standardization and consistency across the Department;
- Continuous monitoring of the feasibility of various paths for our Financial Systems Modernization initiative;
- Implementation laboratories for our grants payment initiative that is scheduled for roll-out during fiscal year 2012; and, among others, our
- Multi-year assessments of our system of controls utilizing OMB's Circular A-123, *Management's Responsibility for Internal Control*.

Looking ahead, we will build on our financial management accomplishments, and our financial systems and programs will continue to support the Department's critical transportation investments that promote jobs and economic growth, along with important safety initiatives.

Sincerely,

CHRISTOPHER P. BERTRAM

U.S. Department of Transportation

Office of the Secretary of Transportation

Office of Inspector General

Memorandum

Subject:	ACTION: Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2011 and 2010, Department of Transportation Report Number: QC-2012-009	Date:	November 15, 2011
From:	Calvin L. Scovel III Inspector General	Reply to Attn. of:	JA-20
To:	The Secretary		

I respectfully submit our report on the quality control review (QCR) of the Department of Transportation's (DOT) audited consolidated financial statements for fiscal years 2011 and 2010.

The audit of DOT's consolidated financial statements as of and for the years ended September 30, 2011, and September 30, 2010, was completed by Clifton Gunderson, LLP under contract to the Office of Inspector General (attached). The contract required the audit be performed in accordance with generally accepted Government auditing standards and Office of Management and Budget Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended.

Clifton Gunderson, LLP concluded that the consolidated financial statements present fairly, in all material respects, DOT's assets, liabilities, and net position as of September 30, 2011, and September 30, 2010, and net costs, changes in net position, and budgetary resources for the years then ended, in conformity with U.S. generally accepted accounting principles.

DOT substantially corrected two of the five significant deficiencies in internal control reported in Clifton Gunderson, LLP's fiscal year 2010 audit report, but the remaining three significant deficiencies in internal control are again included in this year's report.

Clifton Gunderson, LLP's Fiscal Year 2011 Audit Report

Clifton Gunderson, LLP reported three significant deficiencies in internal control and seven actual or potential instances of reportable noncompliance with laws and regulations.

Significant Deficiencies

1. **Financial and Fund Status Monitoring and Reporting** - DOT management needs to continue addressing the overreliance of manual journal entries for financial reporting. Also, DOT needs to employ cost accounting methodologies or cost finding techniques to compensate for financial system limitations in order to fully implement managerial cost accounting requirements. Finally, DOT needs to strengthen fund status monitoring and reporting to reduce the risk that anti-deficiency violations may occur.

2. **Undelivered Orders** - DOT needs to strengthen controls for monitoring inactive obligations and reduce unneeded obligations by an estimated $1.4 billion. These funds could possibly be made available for other DOT requirements.

3. **Implementation of GrantSolutions Grants Management System** - The Federal Railroad Administration and the Federal Motor Carrier Safety Administration need to improve the effectiveness and functionality of their grants management processes and systems in order to strengthen controls and safeguard obligations.

Noncompliance with Laws and Regulations

Anti-Deficiency Act - DOT's management needs to report four actual violations of the Anti-Deficiency Act to the President and Congress—one for the Maritime Administration, and three for the Federal Motor Carrier Safety Administration. Furthermore, DOT's management needs to complete its assessment of two potential violations of the Anti-Deficiency Act at the Federal Highway Administration. These OAs should also enhance their internal control systems for monitoring of fund balances.

Federal Managers' Financial Integrity Act - DOT's management needs to enhance its annual FISMA reporting process to provide sufficient and timely information on its assessment of the adequacy of its information security program and any significant deficiencies identified that need to be reported in the annual assurance statement.

We performed a QCR of Clifton Gunderson, LLP's report and related documentation. Our QCR, as differentiated from an audit performed in accordance with generally accepted Government auditing standards, was not intended for us to express, and we do not express, an opinion on DOT's financial statements or conclusions about the effectiveness of internal controls or compliance with laws and regulations. Clifton Gunderson, LLP is responsible for its report dated November 11, 2011, and the conclusions expressed in that report. However, our QCR disclosed no instances in which Clifton Gunderson, LLP did not comply, in all material respects, with generally accepted Government auditing standards.

Clifton Gunderson, LLP made 35 recommendations to strengthen DOT's financial, accounting, and system controls. We agree with all, and therefore, are making no additional recommendations. DOT officials concurred with Clifton Gunderson, LLP's findings on the significant deficiencies and actual or potential instances of noncompliance. The Department also committed to its submitting to OIG, no later than December 31, 2011, a detailed action plan to address the findings contained in the audit report. In accordance with DOT Order 8000.1C, the corrective actions taken in response to the findings are subject to follow up. Accordingly, please provide us with periodic progress reports on the actions taken to reduce the approximately $1.4 billion in unneeded obligations discussed in Clifton Gunderson, LLP's "Undelivered Orders" significant deficiency.

We appreciate the cooperation and assistance of DOT representatives and Clifton Gunderson, LLP. If we can answer any questions, please call me at x61959, or Lou Dixon, Principal Assistant Inspector General for Auditing and Evaluation, at x61427.

Attachment

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Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

Secretary and Inspector General,
U.S. Department of Transportation

In our audit of the U.S. Department of Transportation (DOT) for fiscal year (FY) 2011, we found:

- The consolidated balance sheets of DOT as of September 30, 2011 and 2010, the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources for the years then ended (hereinafter referred to as "consolidated financial statements") are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- No material weaknesses in internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations, although internal control could be improved;
- Progress has been made in FY 2011 on the five control deficiency conditions noted in the FY 2010 auditor's report. As a result, two control deficiencies are no longer reported as significant deficiencies in this report; however, certain matters relating to the remaining three conditions continue to exist and are reported herein as significant deficiencies;
- Six instances of reportable actual or potential noncompliance with the Anti-Deficiency Act within the U.S. Merchant Marine Academy, Federal Motor Carrier Safety Administration, and Federal Highway Administration; and
- An instance of noncompliance with the Federal Managers' Financial Integrity Act of 1982 (FMFIA). Improvements are needed in DOT's process and procedures for developing its FMFIA statement of assurance as they pertain to the effectiveness of its information security program and its compliance with the Federal Information Security Management Act (FISMA).

The following sections discuss in more detail: (1) these conclusions, (2) our conclusions on Management's Discussion and Analysis (MD&A) and other supplementary information, (3) our audit objectives, scope and methodology, and (4) agency comments and our evaluation.

OPINION ON FINANCIAL STATEMENTS

In our opinion, the accompanying consolidated financial statements including the accompanying notes present fairly, in all material respects, in conformity with accounting principles generally accepted in the United States, DOT's assets, liabilities, and net position as of September 30, 2011 and 2010, and net costs, changes in net position, and budgetary resources for the years then ended.

As discussed in Note 1U, *Summary of Significant Accounting Policies*, and Note 20, *Excise Taxes and Other Non-Exchange Revenue*, the accompanying financial statements reflect actual excise tax revenues collected through June 30, 2011, and excise tax revenues estimated by the Department of the Treasury's Office of Tax Analysis for the quarter ended September 30, 2011.

In addition, there has been a change in taxpayers' Heavy Vehicle Use Tax reporting requirements resulting in a shift of revenue to FY 2012.

As discussed in Note 1U, *Summary of Significant Accounting Policies*, the Surface and Air Transportation Extension Act of 2011 temporarily extended authority to make expenditures from the Highway Trust Fund through March 31, 2012, and granted a temporary extension of authority to the Airport and Airway Trust Fund to January 31, 2012. DOT has been developing several reauthorization proposals subject to OMB and Congressional approval.

As discussed in Note 1I, *Summary of Significant Accounting Policies,* and Note 8, *General Property, Plant and Equipment,* the accompanying financial statements reflect $2 billion of construction in progress and air traffic legacy assets currently in use with a net book value of $745 million relating to the implementation of FAA's plan to upgrade to a new air traffic control system referred to as ERAM. The implementation of ERAM will begin in FY 2012, and will result in certain legacy assets being retired while others will continue to be utilized in ERAM.

CONSIDERATION OF INTERNAL CONTROL

In planning and performing our audit, we considered DOT's internal control over financial reporting as a basis for designing our auditing procedures and to comply with the Office of Management and Budget (OMB) audit guidance for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting and compliance or on management's assertion on internal control included in the MD&A. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting or on management's assertion on internal control included in the MD&A.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies summarized below, and described in Exhibit I, to be significant deficiencies in internal control over financial reporting.

Exhibit I

1) Financial and Fund Status Monitoring and Reporting;
2) Undelivered Orders; and
3) Implementation of GrantSolutions Grants Management System

We do not believe that the significant deficiencies described in Exhibit I are material weaknesses.

We also noted certain other nonreportable matters involving internal control and its operation that we will communicate in a separate management letter to DOT management.

SYSTEMS' COMPLIANCE WITH FFMIA REQUIREMENTS

Under the Federal Financial Management Improvement Act of 1996 (FFMIA), we are required to report whether the financial management systems used by DOT substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The objective of our audit was not to provide an opinion on DOT's compliance with FFMIA. Accordingly, we do not express such an opinion. However, our work disclosed no instances in which DOT's financial management systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, or the SGL at the transaction level.

COMPLIANCE WITH LAWS AND REGULATIONS

Except for actual and potential violations of the Anti-Deficiency Act and improvements needed in the process and procedures for developing DOT's FMFIA statement of assurance on whether the department-wide financial management systems conform to government-wide requirements described in Exhibit II, our tests of DOT's compliance with selected provisions of laws and regulations for FY 2011, disclosed no other instances of noncompliance that would be reportable under United States generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

STATUS OF PRIOR YEAR'S CONTROL DEFICIENCIES AND NONCOMPLIANCE ISSUES

As required by United States generally accepted government auditing standards and OMB Bulletin No. 07-04, as amended, we have reviewed the status of DOT's corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditor's Report dated November 12, 2010. Exhibit III provides a discussion on the status of prior year findings and recommendations.

DOT has made progress in FY 2011 on the five internal control deficiency conditions noted in the FY 2010 auditor's report; two of which are no longer considered Significant Deficiencies for purposes of this report. However, certain matters relating to these remaining three conditions continue to exist and further improvements are needed. These conditions are reported in Exhibit I as follows:

1) Financial and Fund Status Monitoring and Reporting;
2) Undelivered Orders; and
3) Implementation of GrantSolutions Grants Management System

With respect to laws and regulations compliance issues reported in FY 2010, the actual or potential Anti-Deficiency Act violations associated with the U.S. Merchant Marine Academy, Federal Motor Carrier Safety Administration, and Federal Highway Administration were not resolved in FY 2011 and are described in more detail in Exhibit II.

CONSISTENCY OF OTHER INFORMATION

DOT MD&A and other required supplementary information (including stewardship information) is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Other information, exclusive of the MD&A and the Financial Report sections of the FY 2011 Agency Financial Report, is presented for additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

OBJECTIVES, SCOPE AND METHODOLOGY

DOT management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the United States, (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met, (3) ensuring that DOT's financial management systems substantially comply with FFMIA requirements, and (4) complying with other applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States. We are also responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing whether DOT's financial management systems substantially comply with the three FFMIA requirements, (3) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing, and (4) performing limited procedures with respect to certain other information appearing in the Agency Financial Report.

In order to fulfill these responsibilities, we (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements, (2) assessed the accounting principles used and significant estimates made by management, (3) evaluated the overall presentation of the financial statements, (4) obtained an understanding of DOT and its operations, including its internal control related to financial reporting (including safeguarding of assets), and compliance with laws and regulations (including execution of transactions in accordance with budget authority), (5) tested relevant internal controls over financial reporting, and compliance, and evaluated the design and operating effectiveness of internal control, (6) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA, (7) tested whether DOT's financial management systems substantially complied with the three FFMIA requirements, and (8) tested compliance with selected provisions of certain laws and regulations.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to DOT. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB audit guidance that we deemed applicable to DOT's financial statements for the fiscal year ended September 30, 2011. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to the financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB guidance. We believe that our audits provide a reasonable basis for our opinion.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on a draft of this report (Exhibit IV), DOT concurred with the facts and conclusions in our report. We did not audit DOT's response and, accordingly, we express no opinion on it.

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This report is intended solely for the information and use of DOT management, DOT's Office of Inspector General, OMB, the Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
November 11, 2011

EXHIBIT I

DEPARTMENT OF TRANSPORTATION
INDEPENDENT AUDITOR'S REPORT
SIGNIFICANT DEFICIENCIES
September 30, 2011

1. Financial and Fund Status Monitoring and Reporting

Conditions:
DOT management in its effort to achieve standardization of its Operating Administrations' (OAs') use of journal entries (JEs), issued a JE policy in May 2010. DOT, as a whole, has made progress in this area from the prior year; however, additional work is needed to improve in this area. In addition, in our audit report issued in FY 2010, we reported four potential Anti-Deficiency Act (ADA) violations within DOT and found several weaknesses within the department's fund control policies and processes. During our review this year, we found that DOT management had six instances of actual or potential ADA violations for which it either had not yet submitted the ADA report or completed its assessment of the potential ADA violations. As a result, our prior year findings related to fund control policies and processes remain. In addition, we reported on DOT's lack of implementing managerial cost accounting in our prior year's Management Letter. This condition has not been addressed by management and is included as part of this financial reporting finding. Our summary of these three issues and their status in FY 2011 is as follows.

a) Overreliance of Journal Entries for Financial Reporting
Although DOT has made continued improvements in this area this year, management's focused attention is still needed to ensure reliability of the financial reporting process used by DOT both during the year and at year end.

DOT and its OAs recorded an absolute value of about $73 billion JEs related to transactions not recorded through DOT's general ledger system, Delphi, modules such as the Budget Execution Module (BEM) or by using Delphi's standard transaction codes. In addition, reclassification and adjustment JEs in the approximate amount of $58 billion were recorded as a result of entries not being properly recorded in the general ledger system initially. We further noted some of the OAs allowed their third party service provider, Enterprise Service Center (ESC), to approve journal vouchers through a blanket approval authorization without the OAs' financial management review or oversight. DOT also recorded approximately $701 million in absolute value of activity to the "00000" object class code, which the department describes as not applicable. Furthermore, an absolute value of approximately $1.5 billion of the undelivered order (UDO) balance contained UDO transactions recorded in the general ledger without a specific purchase order number.

The use of journal entries - a manually intensive process - has a high risk of error, is time consuming, and utilizes resources that could be spent on other financial reporting matters.

b) **Implementation of Managerial Cost Accounting**

As reported in our FY 2010 Management Letter, certain OAs, such as FHWA and FRA, have not implemented cost accounting methodology or cost finding techniques to compensate for the limitations of the current financial system, in accordance with the Statement of Federal Accounting Standards (SFFAS) 4, Managerial Cost Accounting Concepts & Standards for the Federal Government, and SFFAS 30, Inter-Entity Cost Implementation Amending SFFAS 4. Management provided a limited analysis of its costs, but that does not alleviate the fact that several major OAs that are material to the business operations of DOT have not implemented any cost accounting/allocation methodology.

c) **Fund Status Monitoring and Reporting**

In FY 2010, we identified several weaknesses in the department's fund control policies and procedures and made several recommendations for improvement. We found that some of our prior year findings for certain OAs and all of our recommendations remain open in FY 2011. DOT's OAs did not follow a formalized systematic fund control reporting and monitoring process throughout the year for their status of funds. In FY 2010, we reported that not all OAs used the Budget Execution Module (a module within the Delphi accounting system to record budgetary activity) as the system of record for budgetary data to establish fund limitations and to monitor the status of funds. During our review this year, we noted that certain OAs continued to use other systems or processes to capture the budget financial data. In addition, each OA used various tools and resources to monitor their status of funds throughout the year and at year-end. These tools and resources consist of various Delphi web based reports or Excel spreadsheets that may or may not provide the necessary budgetary data to monitor the OAs' fund status and are manually intensive to produce. Certain Delphi web based reports did not include financial data at the allotment level, which is the level DOT applies funds control. In addition, the OA personnel responsible for monitoring the status of funds varied among OA division offices and level of employees. Such inconsistency in fund control monitoring processes increases the risk of introducing errors into the system that may not be prevented or timely detected.

In addition, in our FY 2010 report, we noted four potential ADA violations within the Maritime Administration (MARAD), Federal Highway Administration (FHWA), and Federal Motor Carrier Safety Administration (FMCSA). During FY 2011, DOT management disclosed three instances related to FMCSA's ADA violations instead of the one instance first identified in FY 2010. To date, DOT management has not completed its internal review processes. As a result, it either has not submitted a final report for known ADA violations or has not completed its assessment of potential ADA violations at September 30, 2011, as discussed in Exhibit II.

Recommendations: We commend DOT management for the progressive efforts and improvements it has made in its internal control and monitoring processes over the past year. However, as evidenced by the conditions noted above, continued diligence in this area is needed to further advance the progress made to date. Accordingly, we recommend that DOT management:

1) **<u>Overreliance of Journal Entries for Financial Reporting</u>**

a) Continue to periodically monitor and analyze OAs' use of journal entries to ensure consistent implementation of the department-wide JE policy in conjunction with OAs' financial management.

b) Work with DOT OAs to review and/or refine their financial reporting processes so that the journal entries are recorded through the appropriate subsidiary systems. Adjusting journal entries should only be used for limited transactions, such as parent/child/corpus, quarterly accruals, and unusual one-time entries.

c) Direct the OAs to take ownership of the journal entries affecting their financial statements. In addition, the cause for the underlying data to be incorrectly recorded in the first place should be researched and rectified. The OAs' accounting and financial reporting policies should also be revised to ensure that all journal vouchers are reviewed by the OAs' financial management office.

d) If the department's Oracle R12 upgrade takes place, continue to define and re-engineer business processes that aid in the design and configuration of the upgrade. R12 should be configured as a fully integrated financial management system allowing for the use of event driven rules (based on Treasury Transaction codes) in the subsidiary modules. In addition, as part of the Oracle R12 upgrade, management should ensure that consistent and standardized data elements and data fields can be utilized to process and record transactions to achieve the greatest efficiency and consistency in its financial reporting for future years.

e) Perform a periodic review to verify whether the use of the "00000" object class is consistent with pre-established policy. If the use is inconsistent with policy, the OAs should promptly reclassify amounts to the proper object class.

f) Continue to research the underlying cause of the nul UDO activity. The activity recorded in the general ledger should be identified and corrected with a specific document number reported in the Delphi subsidiary system to properly account for the open obligations.

2) **<u>Implementation of Managerial Cost Accounting</u>**

a) Establish department-wide policies to achieve maximum efficiency and consistency for the OAs' implementation of managerial cost accounting.

b) Work with the OAs to develop cost finding techniques supported by cost accounting policies and procedures to compensate for the lack of a cost accounting financial system.

c) If the department's Oracle R12 upgrade takes place, implement managerial cost accounting by standardizing the use of data elements and accounting fields to enable the aggregation and reporting of cost data.

3) **Fund Status Monitoring and Reporting**

a) Develop and implement a process to monitor the status of funds which includes formalizing policies and procedures at the department level. Accordingly, the information should be disseminated to each OA to ensure that a systematic process is used to monitor the status of funds. The policies at a minimum should include the following:

- OA division/office including the level of the staff responsible for monitoring the status of funds,
- The frequency of the status of funds review, and
- The financial system and documentation (i.e., reports) that should be used to track and/or monitor the status of funds.

b) If the department's Oracle R12 update takes place, ensure that consistent and standardized data elements and fields can be used to process and record transactions to achieve the greatest efficiency and consistency in its financial reporting within the department for future years. In addition, the department should work with its Oracle vendors to ensure that standardized budget fund status reporting can be generated and is user friendly to further facilitate OAs' funds control management and monitoring throughout the year and at period ends.

c) Consider incorporating into its core financial system the elements of the February 2005 Core Financial System Requirements Exposure Draft—issued by OMB's Office of Federal Financial Management—and its proposed requirements, such as the funds management requirements. According to OMB Memorandum M-10-26, issued in June 2010, this exposure draft remains in effect and federal agencies have an on-going responsibility to comply with them. The department should make certain, upon implementation of the Oracle R12 update if that occurs, that each funds management requirement included has been met to ensure that funds management from a financial system capability perspective has been adequately addressed.

2. Undelivered Orders

Conditions:
DOT obligates its budgetary resources when it enters into a binding legal agreement such as a grant or a contract with a third party. At the end of the grant or contract period, any previously obligated but not disbursed amounts (also known as undelivered orders, UDOs) associated with completed or cancelled projects should be de-obligated enabling the unused funds to potentially become available for other agency program needs. When the unneeded obligations continue to remain on DOT's books, they are considered to be inactive invalid obligations. DOT initially reported approximately $110.9 billion in UDOs at September 30, 2011. Of that amount, about $1 billion was related to contracts and $9.4 billion was related to grants with no activity for over 12 months. In our FY 2010 report, we identified internal control weaknesses related to the OAs' monitoring and liquidating of invalid obligations in a timely manner. Although certain improvement has been made during FY 2011, DOT's OAs need to continuously improve upon their management and monitoring of inactive obligations to ensure that the status of budgetary resources is reported accurately and represent valid DOT obligations. During FY 2011, we identified the following deficiencies in DOT's internal control relating to UDOs:

a) During our statistically based sample testing of the UDO balances at September 30, 2011, we noted numerous instances in which the UDO balance should have been de-obligated because the project was completed or the amount recorded could not be substantiated by management. The projected value of the error to the entire UDO population was estimated to be an overstatement of approximately $1.4 billion. DOT recorded an adjustment in that amount to its Statements of Budgetary Resources at September 30, 2011.

b) During our site visits with FHWA and Federal Transit Administration (FTA) field offices in FY 2011, we found that certain of these field offices did not properly monitor inactive projects and liquidate unused obligations in a timely manner. Some projects had remained inactive or had been completed with unused obligations carried forward into the current fiscal year. Those projects' period of inactivity ranged from one year to more than four years.

Recommendations: The projected error in the UDO balance at September 30, 2011, and the reasons for the extent of these errors still need management's attention to avoid an escalation of the problem in FY 2012 and beyond. We continue to recommend that DOT take the following actions to reduce the errors in the UDO balance and mitigate the risk of significant errors in the future:

1) Standardize the inactive UDO review process throughout DOT by providing data downloads of inactive UDOs on a quarterly basis to OA management and require the OAs to report the status of these inactive UDOs to DOT management. Internal review of the inactive UDOs should focus on the inactive projects and contracts and could, for example, be incorporated into DOT's A-123 Appendix A implementation efforts. One technique could include a review of support documentation obtained by using a stratified sampling method. Timely follow up of areas with a higher degree of invalid obligations should be performed to ensure better compliance.

2) Communicate to the OAs the need to be more diligent in following up with their contracting officers, project managers or grantees to identify and de-obligate unneeded obligations in a timely manner.

3) Ensure that OAs perform the periodic inactive project reviews to ascertain that inactive obligations are liquidated in a timely manner throughout the year. Particular attention should be paid to stagnant or closed projects with open obligations. Timely reconciliation with the OAs' grantees or contractors should be performed.

4) Update policies and procedures to include specific procedures for timely monitoring and liquidating inactive obligations. The qualifier "timely" should be clarified in the guidance to ensure consistent implementation of the requirements.

5) Work with FHWA management to revise its inactive grant procedures and inactive project reports to also identify projects in which no expenditures have been reported since the grants were awarded after 1 year of inactivity. Justification as to why a project is still valid should be reviewed for its reasonableness and documented.

6) Work with FHWA and FTA management to report the status of inactive earmarked grants in their budget justifications that are prepared annually and sent to the Office of

the Secretary of Transportation (OST). OST should consider incorporating this information in its budget formulation reports.

7) Work with FHWA and FTA management to ensure that due diligence is properly performed to identify if grantees are ready to proceed on a project prior to award. FHWA and FTA management should also follow up on those grants that have no disbursements after 1 year to identify grants that have stalled and are not proceeding.

3. Implementation of GrantSolutions Grants Management System

Conditions:
Federal Railroad Administration (FRA) and FMCSA collectively received over $2.2 billion in funding during FY 2011. In addition, both OAs incurred approximately $9.8 billion in obligations and reported over $2.2 billion of unobligated funds as of September 30, 2011. The majority of these obligations are appropriated for specific grant programs. In order to strengthen and streamline their controls surrounding the grants management process, FRA and FMCSA have implemented the GrantSolutions grants management system. Both OAs' implementation of an automated grant management system is a significant improvement over the manual processes previously used. However, we identified several areas for improvements to enhance the effectiveness of the grant management process including the functionality of the FRA grants management systems in FY 2010 and noted that the majority of the finding conditions remain unchanged in FY 2011.

a) Lack of Grant Award Obligations Interface with Delphi
The GrantSolutions system does not interface with the Delphi general ledger system. The lack of an interface requires DOT personnel to manually input obligation data into each of the grant management systems separately. The non-integration of GrantSolutions with Delphi creates redundancy and inefficiency that increases the risks that grant awards are not recorded in the general ledger system accurately or in a timely manner.

b) Active Prior Years' Awarded Grants not Recorded in GrantSolutions
FRA does not use GrantSolutions to process and obligate grants that are awarded to Amtrak in Delphi, which amounts to billions of dollars annually. In addition, FRA and FMCSA have not migrated all currently active grants awarded in prior years into GrantSolutions. As a result, management has to consult both hard copy files and GrantSolutions to monitor and determine the status of some active projects. This is an inefficient process. When all grants are not recorded in a single grant management system, management cannot readily determine the completeness and accuracy of the grant activities including grant obligations and expenditures.

c) Grant Disbursement Data not Recorded in GrantSolutions
FRA does not record grant disbursements within GrantSolutions. Instead, its grantees submit Requests for Advance or Reimbursement (SF-270) directly to the ESC in Oklahoma City, for subsequent recording into Delphi. The ESC personnel process the SF- 270 in MarkView and forward the request to the appropriate grant manager and/or Contracting Officer's Technical Representative (COTR) for review and approval. Once approved, the grant manager or COTR subsequently updates FRA's administrative records to track the fund status of the grant obligation by updating a manual tracking spreadsheet and filing hard copies of the requests for reimbursement in the official grant file. As a result, FRA uses two separate systems to track obligations and expenditures,

which makes the grant post award monitoring manually intensive, inefficient, and prone to human errors. FRA informed us that they are planning to migrate to DOT's new grant payment system, iSupplier, for processing disbursements. This new system will directly interface with Delphi and subsequently to GrantSolutions.

d) **Federal Financial and Grant Progress Reports not Accomplished through GrantSolutions**

FRA and FMCSA do not require their grantees to submit their Federal Financial Reports (SF-425) and Progress Reports through the GrantSolutions system. Currently, all financial and progress reports are submitted to both OAs either through the mail or as email attachments. This process requires extra time for staff to download the reports from email accounts, scan the hard copies, and then upload them into GrantSolutions. As a result, the current grant post award monitoring process is manually intensive, inefficient, and prone to delays and human error. FRA indicated that they have tested the report functionality in GrantSolutions and have requested a change in GrantSolutions to begin using this system functionality. The change is schedule for deployment in October 2011.

e) **Non-use of Electronic Signatures in GrantSolutions**

In addition to requiring grantees to electronically accept grant awards through GrantSolutions, FRA requires grantees to print the grant document, sign it, and then return the hard copy to FRA. Once FRA receives the signed grant document, it is signed by the FRA Administrator and sent to ESC for recording the obligation. This administrative process can result in significant delay between the time the grant is approved for funding by the FRA Administrator and when the obligation is actually recorded in Delphi. FRA's manually intensive grants management process heightens the susceptibility of risk of errors being recorded without being detected. Also, there is an increased risk of not recording obligations in a timely manner. FRA and FMCSA will begin to require electronic signatures in FY 2012.

f) **Lack of Statements on Standards for Attestation Engagements (SSAE) 16 Review for GrantSolutions**

The Department of Health and Human Services (HHS) operates GrantSolutions. HHS did not have an SSAE 16 review performed for GrantSolutions on controls at the service organization in FY 2011, as required by OMB Memorandum M-09-33, Technical Amendments to OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Instead, it obtained and provided DOT with a certification and accreditation for GrantsSolutions. Although HHS has demonstrated that an Authority to Operate was issued for GrantSolutions in June 2011, as the result of the certification and authorization, the scope, intent and assurances provided by this effort does not substitute for an SSAE 16 examination. The review of the SSAE 16 will assist FRA and FMCSA in implementing the necessary user controls and in assessing and evaluating certain control risks related to using GrantSolutions as their grants management system.

g) **Finalization and Implementation of the Grants Manual**

We noted that FRA did not have a grant reference manual for its grantees, grant management, and program personnel to use as a day-to-day operational tool to properly process and actively manage and monitor their grant awards in FY 2010. FRA management indicated that a draft financial guide was still not finalized in FY 2011. Management plans to get this document into final clearance by January 2012.

Recommendations:

We continue to recommend that DOT management ensure FRA and/or FMCSA:

1) Implement GrantSolutions capabilities and functionalities that include integration with the DOT Delphi accounting system or other planned disbursement system such as iSupplier. In addition, management should update the system functionality to include grantee financial and progress reporting submissions directly into GrantSolutions.

2) Record all active grants in GrantSolutions. This includes grants awarded to Amtrak and any open prior year grants.

3) Identify, assess, and evaluate specific programmatic/operational and financial risk within their grants management processes, including the implementation of a grantee risk assessment process to be performed annually to determine whether additional oversight efforts are necessary to mitigate grantee risks that could result in questioned costs. Management should subsequently implement control activities to address such risks. These control activities should include the development of a grant manual that incorporates the operational, programmatic, and financial management requirements, as well as management review of the applicable SSAE 16 report and consideration of the SSAE 16 report results.

EXHIBIT II

DEPARTMENT OF TRANSPORTATION
INDEPENDENT AUDITOR'S REPORT
NONCOMPLIANCE WITH LAWS AND REGULATIONS
September 30, 2011

1. Anti-Deficiency Act

Conditions:

a) Maritime Administration (MARAD)

In FY 2009, DOT reported Anti-Deficiency Act (ADA) violations related to the Maritime Administration's (MARAD's) United States Merchant Marine Academy (Academy). In addition to the actual violations DOT reported to the President, the President of the Senate, the Speaker of the House of Representatives, OMB Director and the Comptroller General, the Government Accountability Office (GAO) identified additional potential ADA issues in its audit report, "Internal Control Weaknesses Resulted in Improper Sources and Uses of Funds; Some Corrective Actions Are Under Way", issued in August 2009. The potential ADA violations that GAO identified involved midshipmen fee transactions that occurred during calendar years 2006 and 2007.

During FY 2010, MARAD estimated that about $9 million in midshipmen fees, paid in prior years, were used by the Academy to pay for items and services that should have been paid with appropriated funds and may have to be refunded. MARAD indicated that it had $3.1 million available and requested an additional $6 million in its FY 2011 budget request to cover potential refunds. MARAD received $6 million in its FY 2011 appropriations to reimburse midshipmen for overcharged fees for academic years 2003-2004 and 2008-2009. During FY 2011, DOT determined that, MARAD's actions constituted violations of the act, totaling $5 million. DOT indicated that a draft ADA report to the President and Congress was vetted with department officials and OMB, and a final report should be submitted shortly.

b) Federal Motor Carrier Safety Administration (FMCSA)

In May 2011, GAO reported on the improper obligation of Commercial Vehicle Information Systems and Networks (CVISN) grant funds by FMCSA. GAO reported that FMCSA found that it had committed 47 statutory violations between fiscal years 2006 through 2010, totaling about $23 million, and that the department concluded in March 2011 that FMCSA had violated the ADA. The department said it was preparing an ADA report to the President and Congress identifying the CVISN violations, but had not established a date for transmitting it.

FMCSA indicated that there were two primary causes of its improper obligation of grant funds: (1) the agency's failure to keep track of the grants awarded, and (2) the dissemination of an erroneous policy to states. FMCSA reported that other issues regarding its grant management practices exacerbated the primary causes—the issuance of incorrect guidance to states, insufficient program oversight, lack of training for program staff, and a lack of written policies and procedures for staff to follow.

FMCSA's ADA violations totaled about $26 million. These transactions occurred from FY 2005 to FY 2010. DOT indicated that a draft ADA report to the President and Congress has been prepared. A final ADA report will be issued when the department completes additional follow-up review work including interviews with those responsible for the violations.

c) **Federal Highway Administration (FHWA)**
During FY 2010, FHWA reported that FY 2010 obligations in the American Reinvestment and Recovery Act (ARRA) appropriation account for the Refuge Roads program may be in excess of the amount apportioned under Category B of the Apportionment and Reapportionment Schedule (SF-132) approved by OMB on April 28, 2010. A potential ADA violation of approximately $1 million involving obligations over the apportioned amount is under review. In addition, FHWA reported that one project obligated for the Transportation Investment Generating Economic Recovery (TIGER) discretionary grant program during FY 2010 was made before the allotment advice was provided by DOT's OST. As of the date of our report, DOT management had not completed its assessment of these FHWA potential ADA violations.

Recommendations: MARAD, FMCSA and FHWA management have taken several corrective actions to address internal controls related to the potential anti-deficiency matters in FY 2011. However, we recommend that DOT management direct the relevant OAs and OST to take the following actions:

MARAD

1) Continue to implement and monitor the implementation of the recommendations made by GAO in the aforementioned GAO report.

2) Promptly report any potential ADA violation to DOT/OST management.

3) Complete its process to reimburse midshipmen for overcharged fees.

FMCSA

In addition to the corrective actions that GAO reported that FMCSA was taking to improve its management of grant awards, we recommend that FMCSA:

1) Revise its grant management manual so that the agency has a consistent, standardized, documented and well-reconciled process for grants awards—the recommendations include enhancing documentation of FMCSA's state billing process reviews and requiring division offices to reconcile GrantSolutions to Delphi on a monthly basis and to resolve any differences within 60 days in order to maintain an accurate fund status for grants.

2) Ensure sufficient and prompt legal counsel involvement when program funds are first appropriated, and ensure legal counsel's review of FMCSA's policies regarding grant programs before disseminating information to the states.

3) Complete development and implementation of the new training structure for CVISN staff referenced in the GAO report so that the staff has adequate training to manage the program.

FHWA

1) Promptly complete its analysis to determine if ADA violations occurred and immediately report any violation to DOT/OST management.

2) Evaluate the cause for the over-obligation and establish a comprehensive internal control system for monitoring funds on a real-time basis when an obligation is made. In addition, a reporting tool to monitor the overall fund status should be used so FHWA's budget, program and financial management personnel can monitor the actual spending at the Treasury fund symbol, allotment, fund, BPAC and grant level on a monthly basis.

OST

1) Promptly determine if ADA violations have occurred within FHWA and immediately report any violations to the President and the Congress, as required by law.

2) Transmit its reports on MARAD's and FMCSA's ADA violations to the President and Congress as soon as possible.

3) Incorporate the internal review of OAs' fund control monitoring and grant reconciliation processes into DOT's A-123, Appendix A implementation efforts.

2. Federal Managers' Financial Integrity Act

Conditions:

Improvements are needed in DOT's process and procedures for reporting material weaknesses in its FMFIA statement of assurance as they pertain to the effectiveness of DOT's information security program and its compliance with FISMA requirements. FISMA requires the agency to prepare an annual report that addresses the adequacy of information security policies, procedures and practices. FISMA also requires that a significant deficiency in a policy, procedure or practice identified by DOT's annual review be disclosed as a material weakness in its annual assurance statement. We were not provided sufficient evidence to determine that this process had occurred. We did, however, determine that DOT had consulted with the OIG as to its FISMA audit results to assist in developing the Department's conclusions on the information security program. While this is an important part of this process, OMB Circular A-123 states that "Management has primary responsibility for assessing and monitoring its internal controls, and should use other sources as a supplement to—not a replacement for—its own judgment." DOT's process to assess and monitor controls and annually report on its information security should have sufficient documentation for the auditor to determine that the process was completed properly. However, the evidence provided to support that DOT had made its own assessment on its information security program was insufficient.

We also observed that while the department followed its policy in implementing its internal control program in FY 2011, the policy remained in draft at FY 2011 year-end.

Recommendations:

We recommend that DOT management:

1) Direct the Chief Information Officer to enhance its annual FISMA reporting process to provide sufficient and timely information on its assessment of the adequacy of its information security program and any significant deficiencies identified. This process

should provide sufficient documentation for the auditor to determine that the assessment was made, how the conclusions were reached, and how the results were captured in the annual assurance statement.

2) Finalize the department's draft internal control program policy.

EXHIBIT III

DEPARTMENT OF TRANSPORTATION
INDEPENDENT AUDITOR'S REPORT
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2011

Prior Year Condition	**Status As Reported at September 30, 2010**	**Status as of September 30, 2011**
Control Deficiencies		
1. Financial Accounting, Reporting & Analysis	***Significant Deficiency:*** The DOT has weaknesses in the following: • Over reliance and use of journal entries • Fund status reporting throughout the year and at year-end	Repeated as a Significant Deficiency number 1 and included in Exhibit I.
2. Undelivered Orders (UDO)	***Significant Deficiency:*** • Various testing errors resulting in actual and projected errors of approximately $1.5 million in UDO at September 30, 2010. • Untimely liquidation of inactive projects by FHWA and FTA Divisional or Regional offices, identified during our FY 2010 site visits.	Repeated as a Significant Deficiency number 2 and included in Exhibit I.
3. Grant Accruals	***Significant Deficiency:*** FHWA did not perform the look back analysis to either evaluate the accuracy and reliability of the accrual estimate as of September 30, 2010 or update their estimates for FY 2010.	Issues related to FHWA's lack of look back analysis has been resolved in FY 2011. The remaining issues are downgraded to a Management Letter deficiency.
4. Implementation of GrantSolutions Grants Management System	***Significant Deficiency:*** FRA has the following control weaknesses in its implementation of GrantSolutions Grant Management System: • Lack of grant award obligations interface with Delphi • Lack of commitment accounting implementation • Active Amtrak and prior year awarded grants not recorded in GrantSolutions • Complete reconciliation of cumulative balances between GrantSolutions and Delphi not performed • Grant disbursement data not recorded in GrantSolutions • Non-use of electronic signatures in	Limited improvements have been made, and the majority of the reported issues are repeated as a Significant Deficiency number 3 for FRA in Exhibit I

Prior Year Condition	Status As Reported at September 30, 2010	Status as of September 30, 2011
	GrantSolutions • Lack of Statement on Auditing Standards (SAS) No. 70 examination for GrantSolutions • Finalization and implementation of the grants manual	
5. Information Technology Controls over Financial Systems and Applications	***Significant Deficiency***: DOT had significant weaknesses reported in ESC's SAS 70 report related to Delphi's configuration management controls, life cycle risk monitoring and risk mitigation process.	These issues have been resolved in FY 2011.
Compliance and Other Matters		
1. Noncompliance with the Anti-Deficiency Act (ADA)	MARAD, FMCSA and FHWA management reported four potential ADA matters in FY 2010.	Repeated as actual or potential non-compliance violations and included in Exhibit II.

DEPARTMENT OF TRANSPORTATION
MANAGEMENT'S RESPONSE TO FY 2011
INDEPENDENT AUDITOR'S REPORT
November 11, 2011

U.S. Department of Transportation

Office of the Secretary of Transportation

Assistant Secretary
for Budget and Programs
and Chief Financial Officer

1200 New Jersey Avenue, SE
Washington, DC 20590

November 11, 2011

MEMORANDUM TO: Calvin L. Scovell, III
Inspector General

Denise Wu
Partner, Clifton Gunderson, LLP

Sal Ercolano
Partner, Clifton Gunderson, LLP

FROM: Christopher P. Bertram

SUBJECT: Management's Response to the Audit Report on the Consolidated Financial Statements for Fiscal Years (FY) 2011 and 2010

The Department of Transportation (DOT) is pleased to respond to the unqualified audit report on our Consolidated Financial Statements for FY 2011 and 2010. For the fourth consecutive year, no material weaknesses in any agency or at the consolidated department level were identified in the auditor's report on internal controls. This is confirmation of DOT's continued commitment to protecting and managing the resources, assets, and programs entrusted to us. We take great pride in our ability to sustain strong and vigilant financial management, as demonstrated in our achievement of an unqualified audit opinion.

We concur with the three significant deficiencies contained in your report on internal controls over financial reporting, and with the seven instances of non-compliance found in certain provisions of selected laws and regulations that you reviewed. The Department plans to submit a detailed action plan to the Inspector General no later than December 31, 2011, to address the findings contained in your report.

We appreciate the professionalism and cooperation exhibited by your office during the audit. Our combined efforts and teamwork made the difference in successfully meeting the objectives of the financial audit process. Please refer any questions to David J. Rivait, Deputy Chief Financial Officer.

PRINCIPAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

As of September 30:

DOLLARS IN THOUSANDS	2011	2010
ASSETS		
Intragovernmental:		
Fund balance with Treasury *NOTE 2*	$39,761,625	$52,504,709
Investments, net *NOTE 3*	26,682,058	33,050,889
Accounts receivable *NOTE 4*	97,516	163,114
Other *NOTE 5*	123,152	123,418
Total intragovernmental	**66,664,351**	**85,842,130**
Cash	34,289	41,882
Accounts receivable, net *NOTE 4*	168,872	81,201
Direct loan and loan guarantees, net *NOTE 6*	4,187,635	2,892,100
Inventory and related property, net *NOTE 7*	845,833	823,603
General property, plant and equipment, net *NOTE 8*	13,740,507	13,907,474
Other *NOTE 5*	90,087	163,950
Total assets	**$85,731,574**	**$103,752,340**
Stewardship property, plant and equipment *NOTE 9*		
LIABILITIES *NOTE 10*		
Intragovernmental:		
Accounts payable	$21,451	$38,023
Debt *NOTE 11*	4,342,866	3,077,439
Other *NOTE 15*	2,561,301	2,717,013
Total intragovernmental	**6,925,618**	**5,832,475**
Accounts payable	1,186,794	700,042
Loan guarantee liability *NOTE 6*	158,425	237,739
Federal employee benefits payable *NOTE 12*	978,918	979,016
Environmental and disposal liabilities *NOTE 13*	1,068,076	1,103,562
Grant accrual *NOTE 14*	6,560,755	6,965,999
Other *NOTE 15*	1,490,386	1,442,689
Total liabilities	**18,368,972**	**17,261,522**
Commitments and contingencies *NOTE 17*		
NET POSITION *NOTE 18*		
Unexpended appropriations—earmarked funds	1,127,600	1,211,520
Unexpended appropriations—other funds	25,654,071	37,001,417
Cumulative results of operations—earmarked funds	30,832,675	37,822,289
Cumulative results of operations—other funds	9,748,256	10,455,592
Total net position	**67,362,602**	**86,490,818**
Total liabilities and net position	**$85,731,574**	**$103,752,340**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF NET COST

For the Periods Ended September 30:

DOLLARS IN THOUSANDS	2011	2010
Program Costs *NOTE 19*		
SURFACE TRANSPORTATION		
Gross costs	$61,126,121	$61,555,071
Less: earned revenue	807,004	785,594
Net program costs	**60,319,117**	**60,769,477**
AIR TRANSPORTATION		
Gross costs	17,214,141	17,266,745
Less: earned revenue	669,479	490,930
Net program costs	**16,544,662**	**16,775,815**
MARITIME TRANSPORTATION		
Gross costs	863,357	1,094,863
Less: earned revenue	378,964	526,261
Net program costs	**484,393**	**568,602**
CROSS-CUTTING PROGRAMS		
Gross costs	738,477	717,840
Less: earned revenue	391,204	381,337
Net program costs	**347,273**	**336,503**
Costs not assigned to programs	421,434	394,503
Less earned revenues not attributed to programs	3,876	471
Net cost of operations	**$78,113,003**	**$78,844,429**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION

For the Periods Ended September 30:

DOLLARS IN THOUSANDS	2011 EARMARKED FUNDS	2011 ALL OTHER FUNDS	2011 TOTAL	2010 EARMARKED FUNDS	2010 ALL OTHER FUNDS	2010 TOTAL
CUMULATIVE RESULTS OF OPERATIONS:						
Beginning balance	$37,822,289	$10,455,592	$48,277,881	$22,481,668	$10,455,213	$32,936,881
BUDGETARY FINANCING SOURCES:						
Appropriations used	5,037,496	15,964,657	21,002,153	5,376,150	42,319,961	47,696,111
Non-exchange revenue *NOTE 20*	48,691,798	109,444	48,801,242	45,854,087	63,241	45,917,328
Donations/forfeitures of cash/cash equivalents	1,212	-	1,212	491	452	943
Transfers-in/(out) without reimbursement *NOTE 18*	58,921	5,196	64,117	19,477,151	(19,490,004)	(12,853)
OTHER FINANCING SOURCES (NON-EXCHANGE)						
Transfers-in/(out) without reimbursement	(782,441)	788,803	6,362	(1,603,241)	1,603,235	(6)
Imputed financing	698,858	119,923	818,781	584,475	120,252	704,727
Other	(31,059)	(246,755)	(277,814)	(671)	(120,150)	(120,821)
Total financing sources	**53,674,785**	**16,741,268**	**70,416,053**	**69,688,442**	**24,496,987**	**94,185,429**
Net cost of operations	60,664,399	17,448,604	78,113,003	54,347,821	24,496,608	78,844,429
Net change	(6,989,614)	(707,336)	(7,696,950)	15,340,621	379	15,341,000
Cumulative Results of Operations	**30,832,675**	**9,748,256**	**40,580,931**	**37,822,289**	**10,455,592**	**48,277,881**
UNEXPENDED APPROPRIATIONS						
Beginning balance	1,211,520	37,001,417	38,212,937	1,212,951	50,425,385	51,638,336
BUDGETARY FINANCING SOURCES						
Appropriations received *NOTE 1U*	5,021,360	5,299,664	10,321,024	5,437,001	28,891,819	34,328,820
Appropriations transferred-in/(out)	9,240	20,265	29,505	3,608	74,108	77,716
Other adjustments	(77,024)	(702,618)	(779,642)	(65,890)	(69,934)	(135,824)
Appropriations used	(5,037,496)	(15,964,657)	(21,002,153)	(5,376,150)	(42,319,961)	(47,696,111)
Total budgetary financing sources	**(83,920)**	**(11,347,346)**	**(11,431,266)**	**(1,431)**	**(13,423,968)**	**(13,425,399)**
Total unexpended appropriations	**1,127,600**	**25,654,071**	**26,781,671**	**1,211,520**	**37,001,417**	**38,212,937**
Net position	**$31,960,275**	**$35,402,327**	**$67,362,602**	**$39,033,809**	**$47,457,009**	**$86,490,818**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

COMBINED STATEMENTS OF BUDGETARY RESOURCES

For the Periods Ended September 30:

DOLLARS IN THOUSANDS	2011		2010	
BUDGETARY RESOURCES *NOTE 21*	**BUDGETARY**	**NON- BUDGETARY CREDIT REFORM FINANCING ACCOUNTS**	**BUDGETARY**	**NON- BUDGETARY CREDIT REFORM FINANCING ACCOUNTS**
Unobligated balance, brought forward, October 1	$60,471,640	$226,795	$57,993,684	$264,137
Recoveries of prior year unpaid obligations	1,005,484	198	3,487,556	47,428
Budget authority:				
Appropriations received (Note 1U)	74,216,804	0	97,406,343	-
Borrowing authority	175,000	1,181,282	127,363	2,476,284
Contract authority	56,204,824	0	64,909,999	-
Spending authority from offsetting collections				
Earned				
Collected	2,813,302	382,466	3,057,377	400,675
Change in receivables from Federal sources	(43,751)	0	(86,639)	-
Change in unfilled customer orders				
Advance received	(342,995)	0	(536,194)	-
Without advance from Federal sources	131,509	(86,710)	(312,631)	108,377
Expenditure transfers from trust funds	4,576,891	0	4,028,917	-
Subtotal	**137,731,584**	**1,477,038**	**168,594,535**	**2,985,336**
Nonexpenditure transfers, net	(6,781)	-	51,617	-
Temporarily not available pursuant to Public Law	(11,002)	0	(5,007)	0
Permanently not available	(59,918,971)	(175,239)	(58,581,302)	(291,918)
Total budgetary resources	**$139,271,954**	**$1,528,792**	**$171,541,083**	**$3,004,983**
STATUS OF BUDGETARY RESOURCES				
Obligations incurred:				
Direct	$86,927,097	$1,285,814	$108,981,763	$2,778,188
Reimbursable	2,100,626	0	2,087,680	-
Subtotal	89,027,723	1,285,814	111,069,443	2,778,188
Unobligated balance:				
Apportioned	33,552,539	39,047	42,144,037	11,356
Exempt from apportionment	317,713	0	319,222	-
Subtotal	33,870,252	39,047	42,463,259	11,356
Unobligated balance not available	16,373,979	203,931	18,008,381	215,439
Total status of budgetary resources	**$139,271,954**	**$1,528,792**	**$171,541,083**	**$3,004,983**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

COMBINED STATEMENTS OF BUDGETARY RESOURCES *CONT'D*

For the Periods Ended September 30:

DOLLARS IN THOUSANDS	2011		2010	
CHANGE IN OBLIGATED BALANCES	BUDGETARY	NON- BUDGETARY CREDIT REFORM FINANCING ACCOUNTS	BUDGETARY	NON- BUDGETARY CREDIT REFORM FINANCING ACCOUNTS
Obligated balance, net:				
Unpaid obligations, brought forward, October 1	$110,640,417	$4,194,500	$107,086,559	$2,519,805
Uncollected customer payments from Federal sources, brought forward, October 1	(1,102,192)	(325,263)	(1,512,864)	(216,886)
Total unpaid obligated balance, net	**109,538,225**	**3,869,237**	**105,573,695**	**2,302,919**
Obligations incurred	89,027,723	1,285,814	111,069,443	2,778,188
Gross outlays	(84,595,015)	(1,664,909)	(104,054,373)	(1,056,065)
Obligated balance transferred, net				
Unpaid obligations	22,214	-	26,344	-
Recoveries of prior year unpaid obligations, actual	(1,005,484)	(198)	(3,487,556)	(47,428)
Change in uncollected customer payments from Federal sources	(90,665)	86,710	410,672	(108,377)
Obligated balance, net, end of period:				
Unpaid obligations	114,089,855	3,815,207	110,640,417	4,194,500
Uncollected customer payments from Federal sources	(1,192,857)	(238,553)	(1,102,192)	(325,263)
Total unpaid obligated balance, net, end of period	**$112,896,998**	**$3,576,654**	**$109,538,225**	**$3,869,237**
NET OUTLAYS				
Net Outlays				
Gross outlays	$84,595,015	$1,664,909	$104,054,373	$1,056,065
Offsetting collections	(7,043,681)	(382,466)	(6,546,842)	(400,675)
Distributed offsetting receipts	(282,618)	-	(219,178)	-
Net outlays	**$77,268,716**	**$1,282,443**	**$97,288,353**	**$655,390**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

NOTES TO PRINCIPAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

A. REPORTING ENTITY:

The Department of Transportation (DOT or Department) serves as the focal point in the Federal Government's coordinated national transportation policy. It is responsible for helping cities and States meet their local transportation needs through financial and technical assistance, ensuring the safety of all forms of transportation; protecting the interests of consumers; promoting international transportation agreements; and conducting planning and research for the future.

The Department is comprised of the Office of the Secretary and the DOT Operating Administrations, each having its own management and organizational structure, and collectively provides the necessary services and oversight to ensure the best transportation system possible. The Department's consolidated financial statements present the financial data for various trust funds, revolving funds, appropriations and special funds, of the following organizations:

- Office of The Secretary (OST) [includes OST Working Capital Fund]
- Federal Aviation Administration (FAA)
- Federal Highway Administration (FHWA)
- Federal Motor Carrier Safety Administration (FMCSA)
- Federal Railroad Administration (FRA)
- Federal Transit Administration (FTA)
- Maritime Administration (MARAD)
- National Highway Traffic Safety Administration (NHTSA)
- Office of Inspector General (OIG)
- Pipeline and Hazardous Materials Safety Administration (PHMSA)
- Research and Innovative Technology Administration (RITA) [includes Volpe National Transportation System Center]
- Surface Transportation Board (STB)

The Saint Lawrence Seaway Development Corporation (SLSDC) is also a DOT entity. However, since it is subject to separate reporting under the Government Corporation Control Act and the dollar value of its activities is not material to that of the Department, SLSDC's financial data is not included in the DOT consolidated financial statements. However, condensed information about SLSDC's financial position is presented in Note 24.

B. BASIS OF PRESENTATION:

The consolidated financial statements have been prepared to report the Department's financial position and its results of operations as required by the Chief Financial Officers Act of 1990 (CFO Act) and Title IV of the Government Management Reform Act of 1994 (GMRA). The statements have been prepared from the DOT books and records in accordance with Office of Management and Budget (OMB) form and content requirements for entity financial statements and DOT's accounting policies and procedures. Unless otherwise noted, all dollar amounts are presented in thousands.

The Consolidated Balance Sheets present agency assets and liabilities, and the resulting net position (which is the difference between the two amounts). Agency assets substantially include entity assets (those which are available for use by the agency). Non-entity assets (those which are managed by the agency but not available for use in its operations) are immaterial. Agency liabilities include both those covered by budgetary resources (funded) and those not covered by budgetary resources (unfunded).

The Consolidated Statements of Net Cost present the gross costs of programs less earned revenue to arrive at the net cost of operations for both the programs and the agency as a whole.

The Consolidated Statements of Changes in Net Position report beginning balances, budgetary and other financing sources, and net cost of operations, to arrive at ending balances.

The Combined Statements of Budgetary Resources provide information about how budgetary resources were made available as well as their status at the end of the period. Recognition and measurement of budgetary information reported on this statement is based on budget terminology, definitions, and guidance in OMB Circular No. A-11, "Preparation, Submission, and Execution of the Budget," dated August 2011.

Since DOT custodial activity is incidental to Departmental operations and is not considered material to the consolidated financial statements taken as a whole, a Statement of Custodial Activity has not been prepared. However, sources and dispositions of collections have been disclosed in Note 22 to the consolidated financial statements.

The Department is required to be in substantial compliance with all applicable accounting principles and standards established, issued, and implemented by the Federal Accounting Standards Advisory Board (FASAB), which is recognized by the American

Institute of Certified Public Accountants (AICPA) as the entity to establish Generally Accepted Accounting Principles (GAAP) for the Federal Government. The Federal Financial Management Improvement Act (FFMIA) of 1996 requires the Department to comply substantially with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the U.S. Government Standard General Ledger requirements at the transaction level.

C. BUDGETS AND BUDGETARY ACCOUNTING:

DOT follows standard Federal budgetary accounting policies and practices in accordance with OMB Circular No. A-11, "Preparation, Submission, and Execution of the Budget," dated August 2011. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. Each year, Congress provides appropriations to each Operating Administration within DOT to incur obligations in support of agency programs. For FY 2011 and FY 2010, the Department was accountable for trust fund appropriations, general fund appropriations, revolving fund activity and borrowing authority. DOT recognizes budgetary resources as assets when cash (funds held by Treasury) is made available through warrants and trust fund transfers.

Programs are financed from authorizations enacted in authorizing legislation and codified in Title 23 of the United States Code (U.S.C.). The DOT receives its budget authority in the form of contract authority and direct appropriations. Contract authority permits programs to incur obligations in advance of an appropriation, offsetting collections, or receipts. Subsequently, Congress provides an appropriation for the liquidation of the contract authority to allow payments to be made for the obligations incurred. Funds apportioned by statute under Titles 23 and 49 of the U.S.C., Subtitle III by the Secretary of Transportation for activities in advance of the liquidation of appropriations are available for a specific time period.

D. BASIS OF ACCOUNTING:

Transactions are generally recorded on an accrual or modified cash accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. Excise taxes and other non exchange revenue is recognized on a modified cash basis consistent with applicable federal accounting standards. All material intra-departmental activity and balances have been eliminated for presentation on a consolidated basis. However, the Statement of Budgetary Resources is presented on a combined basis, in accordance with OMB Circular A-136.

Intragovernmental activity and balances result from exchange transactions made between DOT and other Federal government entities, while those classified as "with the public" result from exchange transactions between DOT and non-federal entities. For example, if DOT purchases goods or services from the public and sells them to another Federal entity, the costs would be classified as "with the public," but the related revenues would be classified as "intragovernmental." This could occur, for example, when DOT provides goods or services to another Federal government entity on a reimbursable basis. The purpose of this classification is to enable the Federal government to prepare consolidated financial statements, and not to mix public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

DOT accounts for earmarked funds separately from other funds.

E. FUNDS WITH THE U.S. TREASURY AND CASH:

DOT does not generally maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The funds with the U.S. Treasury are appropriated, revolving, and trust funds that are available to pay current liabilities and finance authorized purchases. Lockboxes have been established with financial institutions to collect certain payments, and these funds are transferred directly to Treasury on a daily (business day) basis. DOT does not maintain any balances of foreign currencies.

F. INVESTMENTS IN U.S. GOVERNMENT SECURITIES:

Investments in U.S. Government Securities are reported at cost and adjusted for amortized cost net of premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment using the interest or straight-line method. The Department's intent is to hold investments to maturity. Investments, redemptions, and reinvestments are controlled and processed by the Department of the Treasury. The market value is calculated by multiplying the total number of shares by the market price on the last day of the fiscal year.

G. RECEIVABLES:

Accounts receivable consist of amounts owed to the Department by other Federal agencies and the public. Federal accounts receivable are generally the result of the provision of goods and services to other Federal agencies and, with the exception of occasional billing disputes, are considered to be fully collectible. Public accounts receivable are generally the result of the provision of goods and services or the levy of fines and penalties from the Department's regulatory activities. Amounts due from the public are presented net of an allowance for loss on uncollectible accounts, which is based on historical collection experience and/or an analysis of the individual receivables.

Loans are accounted for as receivables after funds have been disbursed. For loans obligated prior to October 1, 1991, loan principal, interest, and penalties receivable are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on past experience, present market conditions, and an analysis of outstanding balances. Loans obligated after September 30, 1991, are reduced by an allowance equal to the present value of the subsidy costs (resulting from the interest rate differential between the loans and Treasury borrowing, the estimated delinquencies and defaults net of recoveries, the offset from fees, and other estimated cash flows) associated with these loans.

H. INVENTORY AND RELATED OPERATING MATERIALS AND SUPPLIES:

Inventory primarily consists of supplies that are for sale or used in the production of goods for sale. Operating materials and supplies primarily consist of unissued supplies that will be consumed in future operations. Valuation methods for supplies on hand at year-end include historical cost, last acquisition price, standard price/specific identification, standard repair cost, weighted average, and moving weighted average. Expenditures or expenses are recorded when the materials and supplies are consumed or sold. Adjustments for the proper valuation of reparable, excess, obsolete, and unserviceable items are made to appropriate allowance accounts.

I. PROPERTY AND EQUIPMENT:

DOT agencies have varying methods of determining the value of general purpose property and equipment and how it is depreciated. DOT currently has a capitalization threshold of $200,000 for structures and facilities and for internal use software, and $25,000 for other property, plant and equipment. Capitalization at lesser amounts is permitted. Construction in progress is valued at direct (actual) costs plus applied overhead and other indirect costs as accumulated by the regional project material system. The system accumulates costs by project number assigned to the equipment or facility being constructed. The straight line method is generally used to depreciate capitalized assets.

DOT's heritage assets, consisting of Union Station in Washington, DC, the Nuclear Ship Savannah and collections of maritime artifacts, are considered priceless and are not capitalized in the Consolidated Balance Sheets (See Note 9).

J. ADVANCES AND PREPAYMENTS:

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenses or capitalized, as appropriate, when the related goods and services are received.

K. LIABILITIES:

Liabilities represent amounts expected to be paid as the result of a transaction or event that has already occurred. Liabilities covered by budgetary resources are liabilities incurred which are covered by realized budgetary resources as of the balance sheet date. Available budgetary resources include new budget authority, spending authority from offsetting collections, recoveries of unexpired budget authority through downward adjustments of prior year obligations, unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and permanent indefinite appropriations or borrowing authority. Unfunded liabilities are not considered to be covered by such budgetary resources. An example of an unfunded liability is actuarial liabilities for future Federal Employees' Compensation Act payments. The Government, acting in its sovereign capacity, can abrogate liabilities arising from other than contracts.

L. CONTINGENCIES:

The criteria for recognizing contingencies for claims are (1) a past event or exchange transaction has occurred as of the date of the statements; (2) a future outflow or other sacrifice of resources is probable; and (3) the future outflow or sacrifice of resources is measurable (reasonably estimatable). DOT recognizes material contingent liabilities in the form of claims, legal actions, administrative proceedings and environmental suits that have been brought to the attention of legal counsel, some of which will be paid by the Treasury Judgment Fund. It is the opinion of management and legal counsel that the ultimate resolution of these proceedings, actions and claims, will not materially affect the financial position or results of operations.

M. ANNUAL, SICK, AND OTHER LEAVE:

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. The balance in the accrued annual leave account is adjusted annually to reflect the latest pay rates and unused hours of leave. Liabilities associated with other types of vested leave, including compensatory, credit hours, restored leave, and sick leave in certain circumstances, are accrued based on latest pay rates and unused hours of leave. Sick leave is generally non-vested, except for sick leave balances at retirement under the terms of certain union agreements, including the National Air Traffic Controllers Association (NATCA) agreement, Article 25, Section 13. Funding will be obtained from future financing sources to the extent that current or prior year appropriations are not available to fund annual and other types of vested leave earned and not taken. Nonvested leave is expensed when used.

N. RETIREMENT PLAN:

For DOT employees who participate in the Civil Service Retirement System (CSRS), DOT contributes a matching contribution equal to 7 percent of pay. On January 1, 1987, FERS went into effect pursuant to Public Law (P.L.) 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, could elect to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to which DOT automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. For most employees hired since December 31, 1983, DOT also contributes the employer's matching share for Social Security.

Employing agencies are required to recognize pensions and other post retirement benefits during the employees' active years of service. Reporting the assets and liabilities associated with such benefit plans is the responsibility of the administering agency, the Office of Personnel Management (OPM). Therefore, DOT does not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to employees.

O. FEDERAL EMPLOYEES HEALTH BENEFIT (FEHB) PROGRAM:

Most Department employees are enrolled in the FEHB Program, which provides current and post-retirement health benefits. OPM administers these program and is responsible for the reporting of liabilities. OPM contributes the 'employer' share for retirees via an appropriation and the retirees contribute their portion of the benefit directly to OPM. OPM calculates the U.S. Government's service cost for covered employees each fiscal year. The Department has recognized the employer cost of these post-retirement benefits for covered employees as an imputed cost and an imputed financing source.

P. FEDERAL EMPLOYEES GROUP LIFE INSURANCE (FEGLI) PROGRAM:

Most Department employees are entitled to participate in the FEGLI Program. Participating employees can obtain basic term life insurance where the employee pays two-thirds of the cost and the Department pays one-third of the cost. OPM administers this program and is responsible for the reporting of liabilities. OPM calculates the U.S. Government's service cost for the post-retirement portion of the basic life coverage each fiscal year. Because OPM fully allocates the Department's contributions for basic life coverage to the pre-retirement portion of coverage, the Department has recognized the entire service cost of the post-retirement portion of basic life coverage as an imputed cost and an imputed financing source.

Q. FEDERAL EMPLOYEE COMPENSATION BENEFITS (FECA):

A liability is recorded for actual and estimated future payments to be made for workers' compensation pursuant to the Federal Employees' Compensation Act (FECA). The actual costs incurred are reflected as a liability because DOT will reimburse the Department of Labor (DOL) two years after the actual payment of expenses. Future revenues will be used to reimburse DOL. The liability consists of (1) the net present value of estimated future payments calculated by the DOL, and (2) the unreimbursed cost paid by DOL for compensation to recipients under FECA.

R. ENVIRONMENTAL AND DISPOSAL LIABILITIES:

DOT recognizes two types of environmental liabilities: unfunded environmental remediation and unfunded asset disposal liability. The liability for environmental remediation is an estimate of costs necessary to bring a known contaminated site into compliance with applicable environmental standards. The asset disposal liability includes both the cost to remove and dismantle an asset when that asset is no longer in service and the estimated cost that will be incurred to remove, contain, and/or dispose of hazardous materials. DOT estimates the environmental remediation and asset disposal costs at the time a DOT-owned asset is placed in service.

Estimating the Department's environmental remediation liability requires making assumptions about future activities and is inherently uncertain. Costs for estimates of environmental and disposal liabilities are not adjusted for inflation and are subject to revision as a result of changes in technology and environmental laws and regulations.

S. USE OF ESTIMATES:

Management has made certain estimates and assumptions when reporting assets, liabilities, revenue, and expenses. Actual results could differ from these estimates. Significant estimates underlying the accompanying financial statements include the allocation of trust fund receipts by Treasury's Office of Tax Analysis (OTA), accruals of accounts and grants payable (including American Recovery and Reinvestment Act funds), accrued workers' compensation, and accrued legal, contingent, environmental and disposal liabilities.

T. ALLOCATION TRANSFERS:

DOT is a party to allocation transfers with other federal agencies as a transferring (parent) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account and subsequent obligations and outlays incurred by the receiving entity (child) are charged to this allocation account as the delegated activity is executed on the parent entity's behalf. Generally, all financial activity related to these allocation transfers (e.g. budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived.

DOT allocates funds, as the parent, to the following non-DOT Federal agencies in accordance with applicable public laws and statutes: Bureau of Indian Affairs, Bureau of Reclamation, U.S. Forest Service, National Park Service, Bureau of Land Management, Fish and Wildlife Service, Department of the Army, Appalachian Regional Commission, Tennessee Valley Authority, U.S. Army Corps of Engineers, Internal Revenue Service, Department of Housing and Urban Development, Denali Commission, Department of Navy, and Department of Energy.

U. REVENUES AND OTHER FINANCING SOURCES:

EARMARKED EXCISE TAX REVENUES (NONEXCHANGE):

DOT receives funding needed to support its programs through non-exchange earmarked excise tax revenues related to the Highway Trust Fund (HTF) and the Airport and Airway Trust Fund (AATF).

Excise taxes collected are initially deposited to the general fund of the U.S. Treasury. The IRS does not receive sufficient information at the time the taxes are collected to determine how these payments should be distributed to specific earmarked funds. Therefore, the U.S. Treasury makes initial semi-monthly distributions to earmarked funds based on estimates prepared by Treasury's Office of Tax Analysis (OTA). These estimates are based on historical excise tax data applied to current excise tax receipts. When actual tax receipt amounts are certified by the IRS, generally four months after each quarter-end, adjustments are made to the estimated receipt/revenue amounts previously provided by OTA, at which time the difference is transferred by Treasury to the HTF and AATF accounts.

The DOT September 30, 2011 financial statements reflect excise taxes certified by the IRS through June 30, 2011 and excise taxes estimated by OTA for the period July 1, 2011 to September 30, 2011 as specified by SFFAS Number 7, Accounting for Revenue and Other Financing Sources. Actual tax collections data for the quarter ended September 30, 2011 will not be available from the IRS until January 2012. Except with respect to Heavy Vehicle Use Taxes discussed further in Note 20, management does not believe that the actual tax collections for the quarter ended September 30, 2011 will be materially different than the OTA estimate, which would be recorded in the DOT's accounting system.

APPROPRIATIONS (FINANCING SOURCE):

DOT receives annual, multi-year and no-year appropriations. Appropriations are recognized as revenues when related program and administrative expenses are incurred. Additional amounts are obtained from offsetting collections and user fees (e.g., landing and registry fees) and through reimbursable agreements for services performed for domestic and foreign governmental entities. Additional revenue is received from gifts of donors, sales of goods and services to other agencies and the public, the collection of fees and fines, interest/dividends on invested funds, loans and cash disbursements to banks. Interest income is recognized as revenue on the accrual basis rather than when received.

On March 18, 2010, the President signed H.R. 2847, the Hiring Incentives to Restore Employment (HIRE) Act. The Act extends authority to make expenditures from the HTF through December 31, 2010 and; provides additional revenues to the HTF by restoring interest foregone since the HTF stopped earning interest on its balances after FY 1998, transferring $14.7 billion to the Highway Account and $4.8 billion to the Mass Transit Account from the General Fund. Going forward, the HTF will resume earning interest on its invested balances. Also refunds and credits of fuel taxes paid on fuel used for exempt purposes will be paid by the General Fund instead of the Highway Trust Fund. (These amounts are reflected in notes 3 and 18).

On July 22, 2011, FAA's authorization to collect excise taxes expired as Congress did not approve an extension to the existing authorization or pass a longer term reauthorization bill. This resulted in a loss of revenues for the AATF in the approximate amount of $419 million. A new short term extension was passed by Congress and signed by the President on August 5, 2011, reauthorizing FAA to again collect excise tax revenue through September 15, 2011.

On September 16, 2011 the President signed H.R. 2887, the Surface and Air Transportation Extension Act of 2011 granting a temporary extension to make expenditures from the HTF through March 31, 2012 and granted a temporary extension of authority to the Airport and Airway Trust to January 31, 2012. DOT has been developing several reauthorization proposals subject to OMB and Congressional approval.

Effective October 1, 2011, DOT is operating under a continuing resolution (CR), Public Law 112-36, for its appropriation and many of its programmatic and financing authorities. The CR will be in effect through November 18, 2011.

AMERICAN RECOVERY AND REINVESTMENT ACT:

On February 17, 2009, the President signed into law the American Recovery and Reinvestment Act (ARRA), which designated over $48 billion to the DOT operating administrations. The funding was provided to Federal Highway Administration, the Federal Aviation Administration, the Federal Transit Administration, the Federal Rail Administration, the Office of the Secretary and the Maritime Administration. These funds were designated to invest in transportation infrastructure, including transit capital assistance, high speed rail, pavement improvements and bridge repair, as well as to preserve and create jobs, and promote economic recovery that will provide long term economic benefits. In the final stages of the program as of September 30, 2011, the Department had obligated $47.5 billion and disbursed $31.5 billion.

V. FIDUCIARY ACTIVITIES:

Fiduciary assets and liabilities are not assets and liabilities of the Department and as such are not recognized on the balance sheet. In accordance with the provisions of the Federal Accounting Standards Advisory Board's, Statement of Federal Financial Accounting Standards (SFFAS) No. 31, Accounting for Fiduciary Activities, this activity is reported separately in a note disclosure. The Maritime Administration Title XI Escrow Fund contains fiduciary activity (See Note 25 for specific required disclosures).

W. RELATED PARTIES:

The Secretary of Transportation has possession of two long term notes with the National Railroad Passenger Service Corporation (more commonly referred to as Amtrak). The first note is for $4 billion and matures in 2975 and; the second note is for $1.1 billion and matures in 2082 with renewable 99 year terms. Interest is not accruing on these notes as long as the current financial structure of Amtrak remains unchanged. If the financial structure of Amtrak changes, both principal and accrued interest are due and payable. The Department does not record the notes in its financial statements due to the present value of the notes was immaterial at September 30, 2011 discounted according to rates published in OMB M-11-12 Appendix C and the maturity dates of 2975 and 2082.

In addition, the Secretary of Transportation has possession of all the preferred stock shares (109,396,994) of Amtrak. Congress through the Department continues to fund Amtrak since 1981; originally through the purchase of preferred stock, notes receivable and then through grants after 1997. The Amtrak Reform and Accountability Act of 1997 changed the structure of the preferred stock by rescinding the voting rights and eliminating the preferred stock's liquidation over the common stock. The Act also eliminated further issuance of preferred stock to the Department. The Department does not record the Amtrak stock in its financial statements because it is not publicly traded and no fair market value can be placed on it.

Amtrak is not a department, agency or instrumentality of the United States Government or the Department. The nine members of Amtrak's Board of Directors are appointed by the President of the United States and are subject to confirmation by the United States Senate. Once appointed, Board Members, as a whole, act independently without the consent of the United States government or any of its officers to set Amtrak policy, determine its budget and decide operational issues. The Secretary of Transportation is statutorily appointed to the nine member Board. Traditionally, the Secretary of Transportation has designated the Administrator of the Federal Rail Administration to represent the Secretary at Board meetings (See Note 17).

NOTE 2. FUND BALANCE WITH TREASURY

	2011	2010
FUND BALANCES:		
Trust Funds	$7,142,146	$7,337,993
Revolving Funds	747,954	709,663
General Funds	31,455,847	44,077,582
Other Fund Types	415,678	379,471
Total	**$39,761,625**	**$52,504,709**
STATUS OF FUND BALANCE WITH TREASURY:		
Unobligated balance:		
Available	$16,979,464	$25,560,214
Unavailable	2,313,572	2,474,563
Obligated balance not yet disbursed	20,360,093	24,378,245
Non-Budgetary Fund Balance with Treasury	108,496	91,687
Total	**$39,761,625**	**$52,504,709**

Fund Balances with Treasury are the aggregate amounts of the Department's accounts with Treasury for which the Department is authorized to make payments. Other Fund Types include uncleared suspense accounts, which temporarily hold collections pending clearance to the applicable account, and deposit funds, which are established to record amounts held temporarily until ownership is determined.

The U.S. Treasury processes cash receipts and disbursements. DOT receives appropriations as budget authority, which permits it to incur obligations and make outlays (payments). In addition, DOT also receives contract authority to permit the incurrence of obligations in advance of an appropriation. The contract authority is subsequently replaced with the appropriation or the spending authority from offsetting collections to first cover and then liquidate the obligations. As a result, DOT does not have typical Fund Balance with Treasury amounts as funds remain invested in securities until needed to make payments.

NOTE 3. INVESTMENTS

As of September 30, 2011

	COST	AMORTIZED (PREMIUM) COST	INVESTMENTS (NET)	MARKET VALUE DISCLOSURE
INTRAGOVERNMENTAL SECURITIES:				
Marketable	$44,121	$116	$44,237	$44,359
Non-Marketable Par Value	24,942,797	-	24,942,797	24,942,797
Non-Marketable Market-Based	1,630,564	11,685	1,642,249	1,669,632
Subtotal	**26,617,482**	**11,801**	**26,629,283**	**26,656,788**
Accrued Interest	52,775	-	52,775	
Total Intragovernmental Securities	**$26,670,257**	**$11,801**	**$26,682,058**	**$26,656,788**

As of September 30, 2010

	COST	AMORTIZED (PREMIUM) COST	INVESTMENTS (NET)	MARKET VALUE DISCLOSURE
INTRAGOVERNMENTAL SECURITIES:				
Marketable	$44,258	$351	$44,609	$44,825
Non-Marketable Par Value	31,499,950	-	31,499,950	31,499,950
Non-Marketable Market-Based	1,451,884	11,176	1,463,060	1,506,521
Subtotal	**32,996,092**	**11,527**	**33,007,619**	**33,051,296**
Accrued Interest	43,270	-	43,270	
Total Intragovernmental Securities	**$33,039,362**	**$11,527**	**$33,050,889**	**$33,051,296**

Investments include non-marketable par value and market-based Treasury securities and marketable securities issued by the Treasury and other Federal entities. Non-marketable par value Treasury securities are issued by the Bureau of Public Debt to Federal accounts and are purchased and redeemed at par exclusively through Treasury's Federal Investment Branch. Non-marketable market-based Treasury securities are also issued by the Bureau of Public Debt to Federal accounts. They are not traded on any securities exchange, but mirror the prices of particular Treasury securities trading in the Government securities market. Marketable Federal securities can be bought and sold on the open market. The premiums and discounts are amortized over the life of the non-marketable market-based and marketable securities using the interest method.

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for Government purposes. Non-Marketable par value Treasury securities are issued to DOT as evidence of these receipts. These securities provide DOT with authority to draw upon the U.S. Treasury to make future expenditures. When DOT requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Treasury securities are an asset of DOT and a liability of the U.S. Treasury. Because the DOT and the U.S. Treasury are both a part of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or liability in the U.S. Government-wide financial statements.

NOTE 4. ACCOUNTS RECEIVABLE

As of September 30, 2011

	GROSS AMOUNT DUE	ALLOWANCE FOR UNCOLLECTIBLE AMOUNTS	NET AMOUNT DUE
INTRAGOVERNMENTAL			
Accounts Receivable	$97,511	$-	$97,511
Accrued Interest	5	-	5
Total Intragovernmental	**$97,516**	**$-**	**$97,516**
PUBLIC			
Accounts Receivable	193,439	(24,745)	168,694
Accrued Interest	444	(266)	178
Total Public	**193,883**	**(25,011)**	**168,872**
Total Receivables	**$291,399**	**$(25,011)**	**$266,388**

As of September 30, 2010

	GROSS AMOUNT DUE	ALLOWANCE FOR UNCOLLECTIBLE AMOUNTS	NET AMOUNT DUE
INTRAGOVERNMENTAL			
Accounts Receivable	$163,109	$-	$163,109
Accrued Interest	5	-	5
Total Intragovernmental	**$163,114**	**$-**	**$163,114**
PUBLIC			
Accounts Receivable	102,713	(21,696)	81,017
Accrued Interest	405	(221)	184
Total Public	**103,118**	**(21,917)**	**81,201**
Total Receivables	**$266,232**	**$(21,917)**	**$244,315**

NOTE 5.OTHER ASSETS

Intragovernmental Other Assets are comprised of advance payments to other Federal Government entities for agency expenses not yet incurred and for goods and services not yet received and undistributed assets and payments for which DOT is awaiting documentation. Public Other Assets are comprised of advances to States, employees and contractors.

NOTE 5. OTHER ASSETS:

	2011	2010
INTRAGOVERNMENTAL		
Advances and Prepayments	$123,152	$123,418
Total Intragovernmental	**$123,152**	**$123,418**
PUBLIC		
Advances to States for Right of Way	$43,956	$59,188
Other Advances and Prepayments	46,031	104,473
Other	100	289
Total Public	**$90,087**	**$163,950**

NOTE 6. DIRECT LOANS AND LOAN GUARANTEES, NON-FEDERAL BORROWERS:

The Federal Credit Reform Act of 1990 divides direct loans and loan guarantees into two groups:

- Pre-1992—Direct loan obligations or loan guarantee commitments made prior to FY 1992 and the resulting direct loans or loan guarantees; and
- Post-1991—Direct loan obligations or loan guarantee commitments made after FY 1991 and the resulting direct loans or loan guarantees.

The Act, as amended, governs direct loan obligations and loan guarantee commitments made after FY 1991, and the resulting direct loans and loan guarantees. Consistent with the Act, Statement of Federal Financial Accounting Standards 2, Accounting for Direct Loans and Loan Guarantees, requires Federal agencies to recognize the present value of the subsidy costs (which arises from interest rate differentials, interest supplements, defaults [net of recoveries], fee offsets, and other cash flows) as a cost in the year the direct or guaranteed loan is disbursed. Direct loans are reported net of an allowance for subsidy at present value, and loan guarantee liabilities are reported at present value. Foreclosed property is valued at the net realizable value. The value of assets for direct loans and defaulted guaranteed loans is not the same as the proceeds that would be expected from the sale of the loans. DOT has calculated the allowance for pre-1992 loans using the allowance for loss method.

Interest on the loans is accrued based on the terms of the loan agreement. DOT does not accrue interest on non-performing loans that have filed for bankruptcy protection. DOT management considers administrative costs to be insignificant.

DOT administers the following direct loan and/or loan guarantee programs:

- The Railroad Rehabilitation Improvement Program is used to acquire, improve, or rehabilitate intermodal or rail equipment or facilities, including track, components of tract, bridges, yards, buildings, and shops; refinance outstanding debt incurred; and develop or establish new intermodal or railroad facilities.
- The Transportation Infrastructure Finance and Innovation Act (TIFIA) Loan Program provides Federal credit assistance for major transportation investments of critical national importance such as highway, transit, passenger rail, certain freight facilities, and certain port projects regional and national benefits. The TIFIA credit program is designed to fill market gaps and leverages substantial private co-investment by providing supplemental and subordinate capital.
- The Federal Ship Financing Fund (Title XI) offers loan guarantees to qualified ship owners and shipyards. Approved applicants are provided the benefit of long term financing at stable interest rates.
- The OST Minority Business Resource Center Guaranteed Loan Program helps small businesses gain access to the financing needed to participate in transportation-related contracts.

An analysis of loans receivable, allowance for subsidy costs, liability for loan guarantees, foreclosed property, modifications and reestimates associated with direct loans and loan guarantees is provided in the following sections:

DIRECT LOANS

OBLIGATED PRIOR TO FY 1992 (ALLOWANCE FOR LOSS METHOD)	2011 LOANS RECEIVABLE, GROSS	INTEREST RECEIVABLE	ALLOWANCE FOR LOAN LOSSES	VALUE OF ASSETS RELATED TO DIRECT LOANS, NET
DIRECT LOAN PROGRAMS				
(1) Railroad Rehabilitation Improvement Program	**$265**	**$-**	**$-**	**$265**

OBLIGATED AFTER FY 1991	2011 LOANS RECEIVABLE, GROSS	INTEREST RECEIVABLE	ALLOWANCE FOR SUBSIDY COST (PRESENT VALUE)	VALUE OF ASSETS RELATED TO DIRECT LOANS, NET
DIRECT LOAN PROGRAMS				
(1) Railroad Rehabilitation Improvement Program	$506,159	$696	$(12,271)	$494,584
(2) TIFIA Loans	3,931,737	-	(310,086)	3,621,651
Total	**$4,437,896**	**$696**	**$(322,357)**	**$4,116,235**

OBLIGATED PRIOR TO FY 1992 (ALLOWANCE FOR LOSS METHOD)	2010 LOANS RECEIVABLE, GROSS	INTEREST RECEIVABLE	ALLOWANCE FOR LOAN LOSSES	VALUE OF ASSETS RELATED TO DIRECT LOANS, NET
DIRECT LOAN PROGRAMS				
(1) Railroad Rehabilitation Improvement Program	$3,729	$-	$-	$3,729

OBLIGATED AFTER FY 1991	2010 LOANS RECEIVABLE, GROSS	INTEREST RECEIVABLE	ALLOWANCE FOR SUBSIDY COST (PRESENT VALUE)	VALUE OF ASSETS RELATED TO DIRECT LOANS, NET
DIRECT LOAN PROGRAMS				
(1) Railroad Rehabilitation Improvement Program	$411,746	$1,105	$(2,518)	$410,333
(2) TIFIA Loans	2,527,782	-	(219,554)	2,308,228
Total	**$2,939,528**	**$1,105**	**$(222,072)**	**$2,718,561**

TOTAL AMOUNT OF DIRECT LOANS DISBURSED (POST-1991)

	2011	2010
DIRECT LOANS PROGRAMS		
(1) Railroad Rehabilitation Improvement Program	$108,031	$42,575
(2) TIFIA Loans	1,309,906	564,988
Total	**$1,417,937**	**$607,563**

SUBSIDY EXPENSE FOR DIRECT LOANS BY PROGRAM AND COMPONENT

SUBSIDY EXPENSE FOR NEW DIRECT LOANS DISBURSED

	2011 INTEREST DIFFERENTIAL	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER SUBSIDY COSTS	TOTAL
DIRECT LOAN PROGRAMS					
(1) Railroad Rehabilitation Improvement Program	$-	$8,625	$(8,625)	$-	$-
(2) TIFIA Loans	-	98,913	-	-	98,913
Total	**$-**	**$107,538**	**$(8,625)**	**$-**	**$98,913**

	2010 INTEREST DIFFERENTIAL	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER SUBSIDY COSTS	TOTAL
DIRECT LOAN PROGRAMS					
(1) Railroad Rehabilitation Improvement Program	$-	$1,388	$(1,388)	$-	$-
(2) TIFIA Loans	-	85,140	(30,980)	-	54,160
Total	**$-**	**$86,528**	**$(32,368)**	**$-**	**$54,160**

MODIFICATIONS AND RE-ESTIMATES

	2011 TOTAL MODIFICATIONS	INTEREST RATE RE-ESTIMATES	TECHNICAL RE-ESTIMATES	TOTAL RE-ESTIMATES
DIRECT LOAN PROGRAMS				
(1) Railroad Rehabilitation Improvement Program	$-	$-	$1,128	$1,128
(2) TIFIA Loans	-	-	1,004	1,004
Total	**$-**	**$-**	**$2,132**	**$2,132**

	2010 TOTAL MODIFICATIONS	INTEREST RATE RE-ESTIMATES	TECHNICAL RE-ESTIMATES	TOTAL RE-ESTIMATES
DIRECT LOAN PROGRAMS				
(1) Railroad Rehabilitation Improvement Program	$-	$-	$(728)	$(728)
(2) TIFIA Loans	-	-	36,346	36,346
Total	**$-**	**$-**	**$35,618**	**$35,618**

TOTAL DIRECT LOAN SUBSIDY EXPENSE

	2011	2010
DIRECT LOANS PROGRAMS		
(1) Railroad Rehabilitation Improvement Program	$1,128	$(728)
(2) TIFIA Loans	99,917	90,506
Total	**$101,045**	**$89,778**

BUDGET SUBSIDY RATES FOR DIRECT LOANS FOR THE CURRENT YEAR COHORT

	2011 INTEREST DIFFERENTIAL	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER	TOTAL
DIRECT LOAN PROGRAMS					
(1) Railroad Rehabilitation Improvement Program	0.00%	1.75%	-1.75%	0.00%	0.00%
(2) TIFIA Loans	0.14%	10.97%	0.00%	0.00%	11.11%
Total	**0.14%**	**12.72%**	**-1.75%**	**0.00%**	**11.11%**

The subsidy rates disclosed pertain only to the current year's cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes modifications and re-estimates.

SCHEDULE FOR RECONCILING SUBSIDY COST ALLOWANCE BALANCES (POST-1991 DIRECT LOANS)

BEGINNING BALANCE, CHANGES, AND ENDING BALANCE

	2011	2010
Beginning balance of subsidy cost allowance	$222,072	$93,499
Add: subsidy expense for doirect loans disbursed during the reporting years by component		
Default costs (net of recoveries)	107,538	86,528
Fees and other transactions	(8,625)	(32,368)
Total of the above subsidy expense components	**98,913**	**54,160**
Adjustments		
Subsidy allowance amortization	(9,385)	6,427
Other	8,625	32,368
Ending balance of the subsidy cost allowance before reestimates	320,225	186,454
Add or subtract subsidy reestimates by components		
Technical/default reestimate	2,132	35,618
Total of the above reestimate components	**2,132**	**35,618**
Ending balance of the subsidy cost allowance	**$322,357**	**$222,072**

The economic assumptions of the TIFIA upward and downward re-estimates were the result of a reassessment of risk levels as well as estimated changes in future cash flows on loans. The re-estimates executed in FY 2011 also reflected the restructuring of a loan for the South Bay Expressway project due to borrower bankruptcy.

The South Bay Expressway project emerged from bankruptcy in April 2011. As a result of restructuring during the bankruptcy proceedings, the outstanding principal balance of the TIFIA loan was reduced from $172 million (pre-bankruptcy) to $92.5 million. The Department was granted an equity share of the company's assets, in an amount of $6.9 million. Private bank lenders to the project were also provided an equity share of the company's assets. Although the principal balance of the TIFIA debt was reduced, the TIFIA loan will accrete interest at a higher rate, and as a result, it is expected that up to 90 percent of the original loan balance will be recovered.

The bank and TIFIA lenders have engaged in third party discussions regarding a sale of the company's assets. Under the terms of the sale, the Department would retain the TIFIA debt, but would receive a cash payment for its pro rata share of other assets. The terms of the sale also offer a substantially better credit profile for the TIFIA loan. Increased cash inflows from the anticipated sale are reflected in the FY 2011 year end re-estimate.

The Railroad Rehabilitation Improvement Program's upward re-estimate was a result of an update for change in the discount rate between time of loan obligation and disbursement and an update for actual cash flows and changes in technical assumptions.

DEFAULT GUARANTEED LOANS FROM POST-1991 GUARANTEES

LOAN GUARANTEE PROGRAMS	2011 DEFAULTED GUARANTEED LOANS RECEIVABLE, GROSS	INTEREST RECEIVABLE	FORECLOSED PROPERTY	ALLOWANCE FOR SUBSIDY	VALUE OF ASSETS RELATED TO DEFAULT GURANTEED LOANS RECIVABLE, NET
(3) Federal Ship Financing Fund (Title XI)	**$212,071**	**$8,797**	**$60,100**	**($209,833)**	**$71,135**

LOAN GUARANTEE PROGRAMS	2010 DEFAULTED GUARANTEED LOANS RECEIVABLE, GROSS	INTEREST RECEIVABLE	FORECLOSED PROPERTY	ALLOWANCE FOR SUBSIDY	VALUE OF ASSETS RELATED TO DEFAULT GURANTEED LOANS RECIVABLE, NET
(3) Federal Ship Financing Fund (Title XI)	**$258,383**	**$10,757**	**$28,110**	**($127,440)**	**$169,810**

GUARANTEED LOANS OUTSTANDING

	OUTSTANDING PRINCIPAL OF GUARANTEED LOANS, FACE VALUE	AMOUNT OF OUTSTANDING PRINCIPAL GUARANTEED
Loan Guarantee Programs		
(3) Federal Ship Financing Fund (Title XI)	$1,788,909	$1,788,909
(4) OST Minority Business Resource Center	4,055	3,041
Total	**$1,792,964**	**$1,791,950**

	2011 OUTSTANDING PRINCIPAL OF GUARANTEED LOANS, FACE VALUE	AMOUNT OF OUTSTANDING PRINCIPAL GUARANTEED
NEW GUARANTEE LOANS DISBURSED		
Loan Guarantee Programs		
(4) OST Minority Business Resource Center	3,130	2,348
Total	**$3,130**	**$2,348**

	2010 OUTSTANDING PRINCIPAL OF GUARANTEED LOANS, FACE VALUE	AMOUNT OF OUTSTANDING PRINCIPAL GUARANTEED
Loan Guarantee Programs		
(3) Fed Ship Financing Fund (Title XI)	$22,544	$22,544
(4) OST Minority Business Resource Center	2,214	1,661
Total	**$24,758**	**$24,205**

	2011 LIABILITIES FOR POST-1991 GUAR ANTEES, PRESENT VALUE
LIABILITY FOR LOAN GURANTEES (PRESENT VALUE METHOD POST-1991 GUARANTEES	
Loan Guarantee Programs	
(3) Federal Ship Financing Fund (Title XI)	$158,334
(4) OST Minority Business Resource Center	91
Total	**$158,425**

SUBSIDY EXPENSES FOR LOAN GURANTEES BY PROGRAM AND COMPONENT

SUBSIDY EXPENSE FOR NEW LOAN GURANTEES DISBURSED

LOAN GUARANTEE PROGRAMS	2011 INTEREST SUPPLEMENTS	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER	TOTAL
(4) OST Minority Business Resource Center	$-	$86	$-	$-	$86
Total	**$-**	**$86**	**$-**	**$-**	**$86**

LOAN GUARANTEE PROGRAMS	2010 INTEREST SUPPLEMENTS	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER	TOTAL
(3) Federal Ship Finance Fund (Tital XI)	$-	$1,400	$(1,037)	-	$363
(4) OST Minority Business Resource Center	$-	41	-	-	$41
Total	**$-**	**$1,441**	**($1,037)**	**$-**	**$404**

MODIFICATIONS AND RE-ESTIMATES

LOAN GUARANTEE PROGRAMS	2011 TOTAL MODIFICATIONS	INTEREST RATE RE-ESTIMATES	TECHNICAL RE-ESTIMATES	TOTAL RE-ESTIMATES
(3) Federal Ship Financing Fund (Title XI)	$-	$-	$2,318	$2,318
(4) OST Minority Business Resource Center	-	-	(87)	($87)
Total	**$-**	**$-**	**$2,231**	**$2,231**

LOAN GUARANTEE PROGRAMS	2010 TOTAL MODIFICATIONS	INTEREST RATE RE-ESTIMATES	TECHNICAL RE-ESTIMATES	TOTAL RE-ESTIMATES
(3) Federal Ship Financing Fund (Title XI)	$-	$-	$31,909	$31,909
(4) OST Minority Business Resource Center	-	-	(71)	($71)
Total	**$-**	**$-**	**$31,838**	**$31,838**

TOTAL LOAN GURANTEE SUBSIDY EXPENSE

LOAN GUARANTEE PROGRAMS	2011	2010
(3) Federal Ship Financing Fund (Title XI)	$2,318	$32,272
(4) OST Minority Business Resource Center	(1)	(30)
Total	**$2,317**	**$32,242**

BUDGET SUBSIDY RATES FOR LOAN GUARANTEES FOR THE CURRENT YEAR COHORT

LOAN GUARANTEE PROGRAMS	2011 INTEREST SUPPLEMENTS	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER	TOTAL
(3) Federal Ship Finance Fund (Title XI)	0.00%	8.15%	-4.89%	0.00%	3.26%
(4) OST Minority Business Resource Center	0.00%	1.79%	0.00%	0.00%	1.79%
Total	**0.00%**	**9.94%**	**-4.89%**	**0.00%**	**5.05%**

The subsidy rates disclosed pertain only to the current year's cohorts. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loan guarantees reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes modifications and re-estimates.

SCHEDULE FOR RECONCILING LOAN GUARANTEE LIABILITY BALANCES (POST-1991 LOAN GUARANTEES)

BEGINNING BALANCE, CHANGES, AND ENDING BALANCE	2011	2010
Beginning Balance of the loan guarantee liability	$ 237,739	$ 310,710
Add: subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	86	1,441
Fees and other collections	-	(1,037)
Total of the above subsidy expense components	**86**	**404**
Adjustments:		
Fees Received	1,035	7,147
Foreclosed Property and Loans Acquired	(212,214)	113,080
Claim Payments to Lenders	-	(222,967)
Interest accumulation on the liability balance	125,494	(10,894)
Other	4,054	8,421
Ending balance of the loan guarantee liability before reestimates	**156,194**	**205,901**
Add or subtract subsidy reestimates by component:		
Technical/default reestimate	2,231	31,838
Total of the above reestimate components	**2,231**	**31,838**
Ending balance of the loan guarantee liability	**$ 158,425**	**$ 237,739**

MARAD made three new Federal Ship Financing Fund (Title XI) loan guarantee commitments in FY 2011 aggregating $797.8 million. These loans have not been disbursed. MARAD has acquired title to two vessels for $50 million through foreclosure proceedings and receipt of $4.1 million is pending court distribution from the sale of two vessels previously acquired through foreclosure proceedings.

The lingering downturn in the economy has led to volatility in financial markets which could affect loan repayments under direct and loan guarantee programs. Under the Federal Credit Reform Act, upward reestimates are automatically covered by permanent indefinite budget authority, which ensures DOT will have sufficient resources to cover any losses incurred in its existing portfolio without further action by Congress. DOT continues to evaluate the risks to affected markets in light of evolving economic conditions, but the impact of such risks on DOT's loan and loan guarantee portfolio reserves, if any, cannot be fully known at this time. The sufficiency of DOT's portfolio reserves at September 30, 2011 will largely depend on future economic and market conditions and could differ from current estimates.

NOTE 7. INVENTORY AND RELATED PROPERTY

As of September 30, 2011

	COST	ALLOWANCE FOR LOSS	NET
INVENTORY			
Inventory Held for Current Sale	$101,934	$-	$101,934
Excess, Obsolete and Unserviceable Inventory	13,766	(13,766)	-
Inventory Held for Repair	550,604	(119,266)	431,338
Other	40,712	(10,590)	30,122
Total Inventory	**$707,016**	**($143,622)**	**$563,394**
OPERATING MATERIALS AND SUPPLIES			
Items Held for Use	$238,612	($1,840)	$236,772
Items Held in Reserve for Future Use	30,212	-	30,212
Excess, Obsolete and Unserviceable Items	325	(325)	-
Items Held for Repair	28,492	(13,037)	15,455
Total Operating Materials & Supplies	**$297,641**	**($15,202)**	**$282,439**
Total Inventory and Related Property			**$845,833**

As of September 30, 2010

	COST	ALLOWANCE FOR LOSS	NET
INVENTORY			
Inventory Held for Current Sale	$101,772	$-	$101,772
Excess, Obsolete and Unserviceable Inventory	12,678	(12,678)	-
Inventory Held for Repair	518,277	(112,840)	405,437
Other	47,166	(10,798)	36,368
Total Inventory	**$679,893**	**($136,316)**	**$543,577**
OPERATING MATERIALS AND SUPPLIES			
Items Held for Use	$232,835	($1,907)	$230,928
Items Held in Reserve for Future Use	30,429	-	30,429
Excess, Obsolete and Unserviceable Items	629	(629)	-
Items Held for Repair	34,954	(16,285)	18,669
Total Operating Materials & Supplies	**$298,847**	**($18,821)**	**$280,026**
Total Inventory and Related Property			**$823,603**

Inventory consists of supplies and materials used to support FAA National Airspace System (NAS) located at the Mike Monroney Center Aeronautical Center in Oklahoma City. Primarily, operating supplies and material consist of unissued materials and supplies that will used in repair and maintenance of various activities within FAA and to support the training vessels and day to day operations at the U.S. Merchant Marine Academy.

NOTE 8. GENERAL PROPERTY, PLANT AND EQUIPMENT

As of September 30, 2011

MAJOR CLASSES	SERVICE LIFE	ACQUISITION VALUE	ACCUMULATED DEPRECIATION	BOOK VALUE
Land and Improvements	30	$102,630	$(1,997)	$100,633
Buildings and Structures	15-40	5,844,963	(3,167,777)	2,677,186
Furniture and Fixtures	15-20	71,881	(68,900)	2,981
Equipment	15-20	16,848,561	(9,979,207)	6,869,354
ADP Software	15-20	649,129	(412,916)	236,213
Assets Under Capital Lease	6-10	184,777	(90,139)	94,638
Leasehold Improvements	40	135,623	(71,136)	64,487
Aircraft	40	407,579	(314,378)	93,201
Ships and Vessels	11-20	1,949,078	(1,716,857)	232,221
Small Boats	20	23,980	(17,082)	6,898
Construction in Progress	-	3,361,052	-	3,361,052
Other Misc. Property		8,664	(7,021)	1,643
Total		**$29,587,917**	**$(15,847,410)**	**$13,740,507**

As of September 30, 2010

MAJOR CLASSES	SERVICE LIFE	ACQUISITION VALUE	ACCUMULATED DEPRECIATION	BOOK VALUE
Land and Improvements	30	$190,310	$(20,376)	$169,934
Buildings and Structures	15-40	5,386,086	(2,981,314)	2,404,772
Furniture and Fixtures	15-20	77,208	(72,487)	4,721
Equipment	15-20	17,844,345	(10,340,037)	7,504,308
ADP Software	15-20	577,430	(294,756)	282,674
Assets Under Capital Lease	6-10	204,580	(104,678)	99,902
Leasehold Improvements	40	125,230	(61,793)	63,437
Aircraft	40	401,353	(324,251)	77,102
Ships and Vessels	11-20	1,950,592	(1,662,816)	287,776
Small Boats	20	26,768	(18,761)	8,007
Construction in Progress		2,950,694	-	2,950,694
Total		**$29,794,814**	**$(15,887,340)**	**$13,907,474**

CONTINUED...

The FAA is currently developing and testing the En Route Automation Modernization (ERAM) system to upgrade the management of air traffic in the en route airspace and to enable the implementation of certain NextGen capabilities. As of September 30, 2011, construction in progress includes $1.98 billion related to the ERAM system.

The schedule for commissioning ERAM is tentatively expected to begin in 2012; however, the schedule has not been finalized and will depend upon the results of continued system development and testing. FAA expects to deploy the ERAM system at 20 air route traffic control centers over the next several years. When fully deployed and commissioned, the ERAM system will replace four legacy air traffic systems currently being depreciated over service lives ranging from 5-20 years.

As of September 30, 2011, the acquisition cost of the four air traffic legacy systems currently in use was $2.1 billion with a net book value of $745 million. Depreciation on these air traffic legacy systems was $121 million and $136 million in FY 2011 and 2010, respectively. When the ERAM deployment schedule is finalized, and the disposal date of the legacy systems is known, FAA will adjust the accounting records of the legacy air traffic systems in accordance with applicable accounting standards to reflect the reduced net book values and the remaining useful lives.

FAA conducted an in depth review and validation of its personal property assets in FY 2011. The review included a statistical sampling and validation of many personal property assets across the United States and Canada to confirm the asset's existence. As a result of the review, FAA adjusted its property records in FY 2011 for assets previously retired but not recorded in the appropriate year's financial statements. The adjustments made to FAA's accounting records were not material to DOT's FY 2011 or prior year financial statements.

NOTE 9. STEWARDSHIP PROPERTY, PLANT AND EQUIPMENT:

PERSONAL PROPERTY HERITAGE ASSETS

Implied within the Maritime Administration's mission is the promotion of the nation's rich maritime heritage. One aspect of this entails the collection, maintenance and distribution of maritime artifacts removed from agency-owned ships prior to their disposal. As ships are assigned to a non-retention status, artifact items are collected, inventoried, photographed and relocated to secure shore-side storage facilities. This resulting inventory is made available on a long-term loan basis to qualified organizations for public display purposes.

MARAD artifacts and other collections are generally on loan to single purpose memorialization and remembrance groups, such as AMVets and preservation societies. MARAD maintains a web-based inventory system that manages the artifact loan process. The program also supports required National Historical Preservation Act processing prior to vessel disposal. Funding for the maintenance of heritage items is typically the responsibility of the organization requesting the loan. The artifacts and other collections are composed of ships' operating equipment obtained from obsolete ships. The ships are inoperative and in need of preservation and restoration. As all items are durable and restorable, disposal is not a consideration. The artifacts and other collections are removed from inventory when destroyed while on loan. A total of 11,675 units of artifacts and other collections were collected as of September 30, 2011 and 11,791 units were collected as of September 30, 2010. There were 16 additions of artifacts and other collections on loan through September 30, 2011 and 132 artifacts and other collections withdrawn from the items in storage through September 30, 2011.

REAL PROPERTY HERITAGE ASSETS

Washington's Union Station support's DOT's mobility mission, facilitating the movement of intercity and commuter rail passengers through the Washington DC metropolitan area. The Federal Railroad Administration (FRA) has an oversight role in the management of Washington's Union Station. FRA received title through legislation, and sublets the property to Union Station Venture Limited which manages the property.

Washington's Union Station is an elegant and unique turn-of-the-century rail station in which a wide variety of elaborate, artistic workmanship characteristic of the period is found. Union Station is listed on the National Register of Historic Places. The station consists of the renovated original building and a parking garage, which was added by the National Park Service.

The Nuclear Ship Savannah is the world's first nuclear-powered merchant ship. It was constructed as a joint project of the Maritime Administration and the Atomic Energy Commission (AEC) as a signature element of President Eisenhower's "Atoms for Peace" program. In 1965, the AEC issued a commercial operating license and ended its participation in the joint program. The ship remains licensed and regulated by the U.S. Nuclear Regulatory Commission (successor to the AEC). The Nuclear Ship Savannah is listed on the National Register of Historic Places. The ship is a boldly-styled passenger/cargo vessel powered by a nuclear reactor.

Actions taken by the Maritime Administration since FY 2006 have stabilized the ship and rehabilitated portions of its interior for work-day occupancy by staff and crew. The ship is currently located in Baltimore, MD, where it is being prepared for continued "SAFSTOR" (The NRC method of preparing nuclear facilities for storage and decontamination) retention under the provisions of its NRC license.

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

	2011	2010
INTRAGOVERNMENTAL		
Other Liabilities	$545,975	$368,316
Total Intragovernmental	**545,975**	**368,316**
Federal Employee Benefits Payable	978,918	979,016
Environmental and Disposal Liabilities (Note 13)	1,068,076	1,103,562
Other Liabilities	811,775	842,958
Total Liabilities Not Covered by Budgetary Resources	3,404,744	3,293,852
Total Liabilities Covered by Budgetary Resources	14,964,228	13,967,670
Total Liabilities	**$18,368,972**	**$17,261,522**

Liabilities Not Covered by Budgetary Resources are those liabilities that Congressional action is needed before budgetary resources can be provided. Intragovernmental liabilities are those liabilities that are with other governmental entities.

NOTE 11. DEBT

	2010 BEGINNING BALANCE	2010 NET BORROWING	2010 ENDING BALANCE	2011 NET BORROWING	2011 ENDING BALANCE
INTRAGOVERNMENTAL DEBT					
Debt to the Treasury	$2,476,373	$599,357	$3,075,730	$1,265,710	$4,341,440
Debt to the Federal Financing Bank	1,975	(266)	1,709	(283)	1,426
Total Intragovernmental Debt	**$2,478,348**	**$599,091**	**$3,077,439**	**$1,265,427**	**$4,342,866**

NOTE 12. FEDERAL EMPLOYEE BENEFITS PAYABLE

	2011	2010
Expected Future Liability for FECA	$978,918	$979,016

The Department of Labor administers the FECA program and calculates the estimated actuarial liability for each federal agency. The estimated FECA liability of DOT includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases, as well as an estimate for those cases incurred but not reported. The estimated liability is not covered by budgetary resources and thus will require future appropriated funding.

In addition, Other Liabilities (Note 15) includes $223,842 and $226,974 at September 30, 2011 and 2010, respectively, for intragovernmental FECA liabilities representing amounts billed to DOT by the DOL for FECA payments made on DOT's behalf.

NOTE 13. ENVIRONMENTAL AND DISPOSAL LIABILITIES

	SEPT. 30, 2011	SEPT. 30, 2010
PUBLIC:		
Environmental Remediation	$597,629	$623,799
Asset Disposal	470,447	479,763
Total Public	**$1,068,076**	**$1,103,562**

Environmental remediation generally occurs under the Resource Conservation and Recovery Act of 1976 (RCRA), the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA or Superfund), or the Toxic Substances Control Act (TSCA). Environmental remediation includes the fuel storage tank program, fuels, solvents, industrial, and chemicals, and other environmental cleanup activities associated with normal operations or the result of an accident. Cost estimates for environmental cleanup and asset disposal liabilities are not adjusted for inflation and are subject to revision as a result of changes in technology and environmental laws and regulations.

As of September 30, 2011 and 2010, DOT's environmental remediation liability primarily includes the removal of contaminants on the Nuclear Ship Savannah, containment of exfoliating ship paint for the non-retention ships in the National Defense Reserve Fleet (Fleet), and remediation at various sites managed by the FAA and MARAD.

In addition, there is a foreseeable environmental liability related to a site with MARAD and numerous other external parties, where the loss is probable and the estimate cannot be determined."

The National Maritime Heritage Act requires that MARAD dispose of certain merchant vessels owned by the U.S. government, including non-retention ships in the Fleet. Residual fuel, asbestos, and solid polychlorinated biphenyls (PCB) sometimes exist onboard MARAD's non-retention ships. Non-retention ships are those MARAD vessels that no longer have a useful application and are pending disposition. The asset disposal liability at September 30, 2011 includes the estimated cost of disposing 145 ships. In addition, FAA records an asset disposal liability upon the decommissioning of an asset to cover preparatory costs required to meet regulatory standards allowing for the safe disposition of the asset.

NOTE 14. GRANT ACCRUAL

The grant accrual consists of an estimate of grantee expenses incurred but not yet paid by DOT. Grantees primarily include state and local governments and transit authorities.

Grant accruals by Operating Administration at September 30, 2011 and 2010 are summarized as follows:

	2011	2010
Federal Highway Administration	$4,456,561	$5,024,636
Federal Transit Administration	1,331,012	1,300,083
Federal Aviation Administration	653,432	557,486
Other	119,750	83,794
Total Grant Accrual	**$6,560,755**	**$6,965,999**

NOTE 15. OTHER LIABILITIES

As of September 30, 2011

	NON-CURRENT	CURRENT	TOTAL
INTRAGOVERNMENTAL:			
Advances and Prepayments	$1,165,850	$740,608	$1,906,458
Accrued Pay and Benefits	-	101,372	101,372
FECA Billings (Note 12)	124,687	99,155	223,842
Uncleared Disbursements and Collections	-	119	119
Other Accrued Liabilities	43,754	285,756	329,510
Total Intragovernmental	**$1,334,291**	**$1,227,010**	**$2,561,301**
PUBLIC:			
Other Accrued Unbilled Payments	$-	$53,487	$53,487
Advances and Prepayments	-	144,630	144,630
Accrued Pay and Benefits	115,706	884,199	999,905
Deferred Credits	-	2,221	2,221
Legal Claims	-	66,537	66,537
Capital Leases	84,933	21,379	106,312
Other Custodial Liability	-	40,144	40,144
Other Accrued Liabilities	13,769	63,381	77,150
Total Public	**$214,408**	**$1,275,978**	**$1,490,386**

The Federal Transit Administration (FTA) received $2.75 billion from Federal Emergency Management Agency (FEMA) in FY 2003 to rebuild parts of the transit system that was destroyed during the World Trade Center attacks on September 11, 2001. The $1.2 billion of Non Current Intragovernmental Governmental Advances and Prepayments is the remaining portion and expected to be paid out as the project progresses. The current portion of the advances and prepayments for this same project is approximately $370 million.

As of September 30, 2010

	NON-CURRENT	CURRENT	TOTAL
INTRAGOVERNMENTAL:			
Advances and Prepayments	$1,422,192	$749,761	$2,171,953
Accrued Pay and Benefits	-	100,395	100,395
FECA Billings (Note 12)	126,010	100,964	226,974
Uncleared Disbursements and Collections	-	142	142
Other Accrued Liabilities	245	217,304	217,549
Total Intragovernmental	**$1,548,447**	**$1,168,566**	**$2,717,013**
PUBLIC:			
Other Accrued Unbilled Payments	$-	$56,623	$56,623
Advances and Prepayments	-	112,456	112,456
Accrued Pay and Benefits	107,317	835,090	942,407
Deferred Credits	-	37,670	37,670
Legal Claims	-	87,252	87,252
Capital Leases	85,452	21,506	106,958
Other Custodial Liability	-	38,400	38,400
Other Accrued Liabilities	57,633	3,290	60,923
Total Public	**$250,402**	**$1,192,287**	**$1,442,689**

NOTE 16. LEASES

ENTITY AS LESSEE:

CAPITAL LEASES:	2011	2010
SUMMARY OF ASSETS UNDER CAPITAL LEASE BY CATEGORY		
Land, Buildings & Machinery	$184,777	$204,580
Accumulated Amortization	(90,139)	(104,678)
Net Assets Under Capital Lease	**$94,638**	**$99,902**

CAPITAL LEASES: FUTURE PAYMENTS DUE

FISCAL YEAR	
2012	$9,721
2013	7,122
2014	6,833
2015	6,824
2016	6,824
2017+	94,463
Total Future Lease Payments	**$131,787**
Less: Imputed Interest	25,475
Net Capital Lease Liability	**$106,312**

The capital lease payments disclosed above relate to FAA and are authorized to be funded annually as codified in the United States Code - Title 49 - Section 40110(c)(1) which addresses general procurement authority. The remaining principal payments are recorded as unfunded lease liabilities. The imputed interest is funded and expensed annually.

OPERATING LEASES: FUTURE PAYMENTS DUE

FISCAL YEAR	LAND, BUILDINGS, MACHINERY & OTHER
2012	$275,967
2013	235,365
2014	167,192
2015	146,849
2016	130,997
2017+	647,385
Total Future Lease Payments	**$1,603,755**

Operating lease expense incurred during the years ended September 30, 2011 and 2010 was $294.9 million and $282.8 million, respectively, including General Services Administration (GSA) leases that have a short termination privilege; however, DOT intends to remain in the leases. Estimates of the lease termination dates are subjective, and any projection of future lease payments would be arbitrary.

NOTE 17. COMMITMENTS AND CONTINGENCIES:

Information pertaining to legal claims is not availableat this time

LEGAL CLAIMS:

As of September 30, 2011 and 2010, DOT's contingent liabilities, in excess of amounts accrued, for asserted and pending legal claims reasonably possible of loss were estimated at $86.6 million and $92.1 million, respectively. DOT does not have material amounts of known unasserted claims.

In October 2010, the Governor of New Jersey cancelled a major project with FTA, the Access to Regions' Core (ARC) Tunnel. The amount owed was $271 million. In September 2011, a $95 million settlement was reached between DOT, FTA management and the State of New Jersey. Terms of the settlement require the State of New Jersey to repay FTA $95 million over a five year period beginning in FY 2012.

GRANT PROGRAMS:

FHWA pre-authorizes states to establish construction budgets without having received appropriations from Congress for such projects. FHWA does not guarantee the ultimate funding to the states for these "Advance Construction" projects and, accordingly, does not obligate any funds for these projects. When funding becomes available to FHWA, the states can then apply for reimbursement of costs that they have incurred on such projects, at which time FHWA can accept or reject such requests. For the fiscal year ended September 30, 2011 and 2010 FHWA has pre-authorized $41.4 billion and $40.2 billion, respectively, under these arrangements. These commitments have not been recognized in the DOT consolidated financial statements at September 30, 2011 and 2010.

FTA executes Full Funding Grant Agreements (FFGAs) under its Capital Investment program (New Starts) authorizing transit authorities to establish project budgets and incur costs with their own funds in advance of Congress appropriating New Starts funds to the project. As of September 30, 2011 and September 30, 2010, FTA had approximately $1.6 billion and $1.87 billion respectively, in funding commitments under FFGAs, which Congress had not yet appropriated. Congress must first provide the budget authority (appropriations) to allow FTA to incur obligations for these programs. Until Congress appropriates funds, FTA is not liable to grantees for any costs incurred. There is no liability related to these commitments reflected in the DOT consolidated financial statements at September 30, 2011 and 2010.

FAA's Airport Improvement Program provides grants for the planning and development of public-use airports that are included in the National Plan of Integrated Airport Systems. Eligible projects generally include improvements related to enhancing airport safety, capacity, security and environmental concerns. FAA's share of eligible costs for large and medium primary hub airports is 75 percent with the exception of noise program implementation, which is 80 percent of the eligible costs. For remaining airports (small primary, reliever, and general aviation airports), FAA's share is 95 percent of the eligible costs.

FAA has authority under 49 U.S.C. 47110(e) to issue letters of intent to enter into Airport Improvement Program grant agreements. FAA records an obligation when a grant is awarded. Through September 30, 2011, FAA issued letters of intent covering FY 1988 through FY 2026 totaling $7.5 billion. As of September 30, 2011, FAA had obligated $5.5 billion of this total amount leaving $2 billion unobligated. Through September 30, 2010, FAA issued letters of intent covering FY 1988 through FY 2026 totaling $6.5 billion. As of September 30, 2010, FAA had obligated $5.2 billion of this total amount, leaving $1.3 billion unobligated.

AVIATION INSURANCE PROGRAM:

FAA is authorized to issue hull and liability insurance under the Aviation Insurance Program for air carrier operations for which commercial insurance is not available on reasonable terms and when continuation of U.S. flag commercial air service is necessary in the interest of air commerce, national security, and U.S. foreign policy. FAA may issue (1) non-premium insurance, and (2) premium insurance for which a risk-based premium is charged to the air carrier, to the extent practical.

During FY 2011, FAA provided premium war-risk insurance to 55 airlines. For these airlines, combined hull and liability per occurrence coverage limits range from $100 million to $4 billion. FAA also provided non-premium war-risk insurance to 36 carriers with 1,590 aircraft for Department of Defense charter operations for Central Command.

As of September 30, 2011, there are no pending aviation insurance claims. There is approximately $1.7 billion available in the Aviation Insurance Revolving Fund to pay claims to carriers covered by premium insurance. If premium insurance claims should exceed that amount, additional funding could be appropriated from the General Fund. The Department of Defense and State Department have agreed to pay claims to the carriers covered by non-premium insurance.

MARINE WAR RISK INSURANCE PROGRAM:

MARAD is authorized to issue hull and liability insurance under the Marine War Risk Insurance Program for vessel operations for which commercial insurance is not available on reasonable terms and conditions, when the vessel is considered to be in the interest of national defense or national economy of the United States. MARAD may issue (1) premium based insurance for which a risk based premium is charged and (2) non-premium insurance for vessels under charter operations for the Military Sealift Command.

During FY 2011, MARAD wrote non-premium war risk insurance with a total coverage of $448.5 million for six companies on six vessels and the coverage ranges from $52 million to $84.5 million to cover hull liability and vessel's crew. During FY 2010, MARAD wrote non-premium war risk insurance with a total coverage of $396.5 million for five companies on five vessels and the coverage ranges from $66 million to $84.5 million to cover hull liability and vessel's crew. The Department of Defense has fully indemnified MARAD for any losses arising out of the non-premium insurance. There have been no losses and no claims are outstanding for this non-premium insurance. There is approximately $45 million in the Marine War Risk Insurance fund to reimburse operators that may be covered by premium insurance in future periods. MARAD has not issued premium War Risk Insurance in approximately 20 years. MARAD would have to request Presidential authority to write any premium insurance and no such request is pending at this time.

The Department of Defense has agreed to indemnify MARAD for any claims arising under non-premium insursance. As of September 30, 2011, there are no outstanding claims for either premium or non-premium insurance.

ENVIRONMENTAL LIABILITIES:

As of September 30, 2011, FAA has estimated contingent liabilities, categorized as reasonably possible of $158.6 million related to environmental remediation. Contingency costs are defined for environmental liabilities as those costs that may result from incomplete design, unforeseen and unpredictable conditions or uncertainties within a defined project scope.

NATIONAL RAILROAD PASSENGER SERVICE CORPORATION (AMTRAK)

The United States and the Department are not at risk if Amtrak fails and they do not guarantee the indebtedness of Amtrak, whose debt is secured primarily by assets of the corporation. Amtrak has been operating with an accumulated deficit and is dependent upon appropriations from Congress to continue operations. Amtrak has been receiving federal funds from Congress through the Department since 1981. For FY 2011 and FY 2010, the Department issued grants to Amtrak for $2 billion and $2.2 billion, respectively. These grants were for both operating and capital improvements. Refer to Note 1W (Significant Accounting Policies) for additional information.

The Passenger Rail Investment and Improvement Act of 2008 (PRIIA) stipulated that the United States Department of Treasury ("Treasury") in consultation with the DOT and Amtrak, may make agreements to restructure (including repay) Amtrak's indebtedness, including leases, outstanding as of the date of enactment of PRIIA. Under this provision, Treasury and DOT entered into a Memorandum of Understanding (MOU) consulted and acknowledged by Amtrak,to restructure and enable Amtrak to exercise certain early buyout options on selected Amtrak leases.

The effective date of the MOU is October 15, 2010 and shall remain in force until July 1, 2013. During the three year period of the MOU, prior to any amounts being paid, the equipment must be operable and appraised at a fair market value. Treasury will then advance to FRA for the benefit of Amtrak the lesser of the amounts shown on the schedule attached to the MOU (not to exceed $420 million) or the amounts due and payable with respect to termination of selected leases. In FY 2011, $51 million was paid to FRA for the benefit of Amtrak. The estimates for FY 2012 and FY 2013 are $124.8 million and $244 million, respectively.

NOTE 18. EARMARKED FUNDS

DOT administers certain earmarked funds, which are specifically identified revenues, often supplemented by other financing sources, that remain available over time. No new legislation was enacted as of September 30, 2011 that significantly changed the purpose of the earmarked funds or redirected a material portion of the accumulated balance. Descriptions of the significant earmarked funds are as follows:

HIGHWAY TRUST FUND

The Highway Trust Fund (HTF) is comprised of the Highway Corpus Trust Fund and certain accounts of the Federal Highway Administration, Federal Motor Carrier Safety Administration, Federal Transit Administration, Federal Railroad Administration and the National Highway Traffic Safety Administration. The HTF was created in 1956 by the Highway Revenue Act of 1956 with the main objective of funding the construction of the Dwight D. Eisenhower System of Interstate and Defense Highways. Over the years, the use of the fund has been expanded to include mass transit and other surface transportation programs such as highway safety and motor carrier safety programs. Overall, there are 76 separate treasury symbols in the HTF.

HTF's programs and activities are primarily financed from excise taxes collected on specific motor fuels, truck taxes, and fines and penalties. The Highway Revenue Act of 1982 established two accounts within the HTF, the Highway Account and the Mass Transit Account. During FY 2010, $14.7 and $4.8 billion was transferred from the General Fund to the Highway and Mass Transit Accounts restoring foregone interest earned since 1998.

AIRPORT AND AIRWAY TRUST FUND

The Airport and Airway Trust Fund (AATF) was authorized by the Airport and Airway Revenue Act of 1970 to provide funding for the Federal commitment to the nation's aviation system and typically includes annual funding for four distinct areas within FAA: Operations; Grant in Aid for Airports; Facilities and Equipment; and Research, Engineering and Development.

Funding currently comes from several aviation related excise tax collections from passenger tickets, passenger flight segments, international arrivals/departures, cargo waybills and aviation fuels.

MASS TRANSIT ACCOUNT

In FY 2005 and prior, FTA's formula and bus grant programs were funded 80 percent by certain earmarked excise tax revenues and 20 percent from the Treasury general receipts account. These funds are considered earmarked but not reported as part of the HTF.

Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) legislation (PL 109-59) changed the way FTA programs are funded. Beginning in FY 2006, the FTA formula and bus grant programs are funded 100 percent by the HTF.

The following is a list of other earmarked funds for which the DOT has program management responsibility:

- Aviation Insurance Revolving Fund
- Pipeline Safety
- Emergency Preparedness Grant
- Aviation User Fees
- Essential Air Service and Rural Airport Improvement Fund
- University Transportation Centers
- Contributions for Highway Research Program
- Cooperative Work, Forest Highways
- Safety of Cross-Border Trucking Between the United States and Mexico
- Payment to Air Carriers
- Right of Way Revolving Fund Program Account
- Alaska Pipeline Task Force, Oil Spill Liability Trust Fund
- Right-of-Way Revolving Fund Trust Fund
- Technical Assistance, United States Dollars Advanced from Foreign Governments
- Gifts and Bequests, Maritime Administration
- Special Studies, Services and Projects
- Gifts and Bequests, DOT Office of the Secretary
- Equipment, Supplies, etc., for Cooperating Countries

NOTE 18. EARMARKED FUNDS:

Balance Sheet as of September 30, 2011

	HIGHWAY TRUST FUND	AIRPORT & AIRWAY TRUST FUND	MASS TRANSIT	OTHER EARMARKED FUNDS	FY 2011 TOTAL EARMARKED
ASSETS					
Fund Balance with Treasury	$5,335,210	$921,692	$717,292	$2,729,655	$9,703,849
Investments, Net	16,301,908	8,685,715	-	1,694,435	26,682,058
Accounts Receivable, Net	31,287	-	1,593	4,616,109	4,648,989
Property, Plant & Equipment	154,188	-	-	3,244,084	3,398,272
Other	313,046	-	883	309,701	623,630
Total Assets	**$22,135,639**	**$9,607,407**	**$719,768**	**$12,593,984**	**$45,056,798**
LIABILITIES AND NET POSITION					
Accounts Payable	$207,813	$4,515,206	$1,444	$520,215	$5,244,678
FECA Liabilities	25,761	-	-	1,122,378	1,148,139
Grants Accrual	4,747,416	-	27,893	663,812	5,439,121
Other Liabilities	190,099	-	-	1,074,486	1,264,585
Unexpended Appropriations	-	-	45,100	1,082,500	1,127,600
Cumulative Results of Operations	16,964,550	5,092,201	645,331	8,130,593	30,832,675
Total Liabilities and Net Position	**$22,135,639**	**$9,607,407**	**$719,768**	**$12,593,984**	**$45,056,798**
STATEMENT OF NET COST					For the Period Ended September 30, 2011
Program Costs	$45,216,344	$11,117,011	$194,847	$4,631,099	$61,159,301
Less Earned Revenue	121,766	-	-	574,584	696,350
Net Program Costs	45,094,578	11,117,011	194,847	4,056,515	60,462,951
Costs Not Attributable to Programs	-	-	-	201,448	201,448
Net Cost of Operations	**$45,094,578**	**$11,117,011**	**$194,847**	**$4,257,963**	**$60,664,399**
STATEMENT OF CHANGES IN NET POSITION					For the Period Ended September 30, 2011
Beginning Net Position	$25,088,216	$4,473,264	$885,278	$8,587,051	$39,033,809
Budgetary Financing Sources	36,949,333	11,735,948	-	5,020,226	53,705,507
Other Financing Sources	21,579	-	-	(136,221)	(114,642)
Net Cost of Operations	45,094,578	11,117,011	194,847	4,257,963	60,664,399
Change in Net Position	(8,123,666)	618,937	(194,847)	626,042	(7,073,534)
Net Position End of Period	**$16,964,550**	**$5,092,201**	**$690,431**	**$9,213,093**	**$31,960,275**

NOTE 18. EARMARKED FUNDS

Balance Sheet as September 30, 2010

	HIGHWAY TRUST FUND	AIRPORT & AIRWAY TRUST FUND	MASS TRANSIT	OTHER EARMARKED FUNDS	FY 2010 TOTAL EARMARKED
ASSETS					
Fund Balance with Treasury	$4,776,346	$881,730	$937,341	$3,401,502	$9,996,919
Investments, Net	24,454,591	7,078,432	-	1,517,866	33,050,889
Accounts Receivable, Net	7,938	-	809	3,606,105	3,614,852
Property, Plant & Equipment	141,781	-	-	2,799,969	2,941,750
Other	318,973	-	784	407,921	727,678
Total Assets	**$29,699,629**	**$7,960,162**	**$938,934**	**$11,733,363**	**$50,332,088**
LIABILITIES AND NET POSITION					
Accounts Payable	$53,446	$3,486,898	$508	$437,381	3,978,233
FECA Liabilities	21,634	-	-	1,120,795	1,142,429
Grants Accrual	4,264,344	-	50,324	576,428	4,891,096
Other Liabilities	271,989	-	2,824	1,011,708	1,286,521
Unexpended Appropriation	-	-	48,480	1,163,040	1,211,520
Cumulative Results of Operations	25,088,216	4,473,264	836,798	7,424,011	37,822,289
Total Liabilities and Net Position	**$29,699,629**	**$7,960,162**	**$938,934**	**$11,733,363**	**$50,332,088**
STATEMENT OF NET COST					For the Period Ended September 30, 2010
Program Costs	$39,429,077	$10,220,422	$391,035	$4,890,588	$54,931,122
Less Earned Revenue	266,331	-	-	483,528	749,859
Net Program Costs	39,162,746	10,220,422	391,035	4,407,060	54,181,263
Costs Not Attributable to Programs	-	-		166,558	166,558
Net Cost of Operations	**$39,162,746**	**$10,220,422**	**$391,035**	**$4,573,618**	**$54,347,821**
STATEMENT OF CHANGES IN NET POSITION					For the Period Ended September 30, 2010
Beginning Net Position	$9,733,737	$3,899,318	$1,276,046	$8,785,518	$23,694,619
Budgetary Financing Sources	54,473,665	10,794,368	267	5,438,148	70,706,448
Other Financing Sources	43,560	-	-	(1,062,997)	(1,019,437)
Net Cost of Operations	**39,162,746**	**10,220,422**	**391,035**	**4,573,618**	**54,347,821**
Change in Net Position	**15,354,479**	**573,946**	**(390,768)**	**(198,467)**	**15,339,190**
Net Position End of Period	**$25,088,216**	**$4,473,264**	**$885,278**	**$8,587,051**	**$39,033,809**

NOTE 19. INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUES:

For the Period Ended September 30, 2011

	INTRA-GOVERNMENTAL	WITH THE PUBLIC	TOTAL
SURFACE TRANSPORTATION			
Federal-Aid Highway Program			
Gross Costs	$205,979	$36,529,322	$36,735,301
Less Earned Revenue	33,814	49,587	83,401
Net Program Costs	**172,165**	**36,479,735**	**36,651,900**
Mass Transit Program			
Gross Costs	54,811	11,998,065	12,052,876
Less Earned Revenue	331,763	44,372	376,135
Net Program Costs	**(276,952)**	**11,953,693**	**11,676,741**
Other Surface Transportation Programs			
Gross Costs	348,097	11,989,847	12,337,944
Less Earned Revenue	170,455	177,013	347,468
Net Program Costs	**177,642**	**11,812,834**	**11,990,476**
Total Surface Transportation Program Costs	**72,855**	**60,246,262**	**60,319,117**
AIR TRANSPORTATION			
Gross Costs	2,736,750	14,477,391	17,214,141
Less Earned Revenue	253,538	415,941	669,479
Net Program Costs	**2,483,212**	**14,061,450**	**16,544,662**
MARITIME TRANSPORTATION			
Gross Costs	91,010	772,347	863,357
Less Earned Revenue	353,465	25,499	378,964
Net Program Costs	**(262,455)**	**746,848**	**484,393**
CROSS-CUTTING PROGRAMS			
Gross Costs	45,001	693,476	738,477
Less Earned Revenue	383,278	7,926	391,204
Net Program Costs	**(338,277)**	**685,550**	**347,273**
Costs not assigned to programs	77,477	343,957	421,434
Less: Earned Revenues not attributed to programs	-	3,876	3,876
Net Cost of Operations	**$2,032,812**	**$76,080,191**	**$78,113,003**

NOTE 19. INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUES

For the Period Ended September 30, 2010

	INTRA-GOVERNMENTAL	WITH THE PUBLIC	TOTAL
SURFACE TRANSPORTATION			
Federal-Aid Highway Program:			
Gross Costs	$107,913	$30,575,531	$30,683,444
Less Earned Revenue	32,019	49,913	81,932
Net Program Costs	**75,894**	**30,525,618**	**30,601,512**
Mass Transit Program			
Gross Costs	31,795	12,565,530	12,597,325
Less Earned Revenue	416,483	1,549	418,032
Net Program Costs	**(384,688)**	**12,563,981**	**12,179,293**
Other Surface Transportation Programs:			
Gross Costs	312,499	17,961,803	18,274,302
Less Earned Revenue	85,003	200,627	285,630
Net Program Costs	**227,496**	**17,761,176**	**17,988,672**
Total Surface Transportation Program Costs	**(81,298)**	**60,850,775**	**60,769,477**
AIR TRANSPORTATION			
Gross Costs	2,572,942	14,693,803	17,266,745
Less Earned Revenue	182,693	308,237	490,930
Net Program Costs	**2,390,249**	**14,385,566**	**16,775,815**
MARITIME TRANSPORTATION			
Gross Costs	278,417	816,446	1,094,863
Less Earned Revenue	464,143	62,118	526,261
Net Program Costs	**(185,726)**	**754,328**	**568,602**
CROSS-CUTTING PROGRAMS			
Gross Costs	44,715	673,125	717,840
Less Earned Revenue	376,785	4,552	381,337
Net Program Costs	**(332,070)**	**668,573**	**336,503**
Cost not assigned to a program	72,511	321,992	394,503
Less: Earned Revenues not attributed to programs	471	-	471
Net Cost of Operations	**$1,863,195**	**$76,981,234**	**$78,844,429**

Surface Transportation Program costs includes those operating costs incurred by the Operating Administrations authorized by SAFETEA-LU (FHWA, NHTSA, FMCSA, FRA and FTA), to promote safety and mobility of the nation's highways and railroads and among the nation's drivers and auto manufacturers.

Air Transportation Program costs include those operating costs incurred 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.

Maritime Transportation Program Costs include those operating costs incurred to promote the development and maintenance of a U.S. merchant marine that is sufficient to carry the Nation's domestic waterborne commerce, a substantial portion of which is trade with other nations, and to serve as a naval and military auxiliary in time of war and national emergency.

Cross-cutting Program costs include those operating costs incurred to provide goods and services on a reimbursable basis for those Operating Administrations whose mission is primarily cross modal.

NOTE 20. EXCISE TAXES AND OTHER NON-EXCHANGE REVENUE:

The Internal Revenue Service (IRS) collects various excise taxes that are deposited in the HTF and AATF. Monthly, the United States Treasury, Office of Tax Analysis (OTA) estimates the amount collected/revenue recognized, and adjusts the estimates to reflect actual collections quarterly. The IRS submits certificates of actual tax collections to DOT three months after the quarter-end and, accordingly the DOT financial statements are adjusted to reflect such actual amounts at that time. Total taxes recognized for the year ended September 30, 2010 and 2009 includes OTA estimates as follows:

NOTE 20

	SEPT. 30, 2010	SEPT. 30, 2009
Actual	13,067,434	12,437,337
Estimate	11,578,829	12,408,576
Under (Over) accrual	**1,488,605**	**28,761**

These differences were reflected as an adjustment in the DOT subsequent year's financial statements. During FY 2011, DOT continued to experience differences between its estimated and actual excise tax collections as follows:

NOTE 20

QUARTER ENDED	12/31/10	3/31/11	6/30/11
Actual	12,105,789	11,525,131	12,652,687
Estimate	12,519,077	11,533,701	12,454,366
Under (Over) accrual	**(413,288)**	**(8,570)**	**198,321**

Total taxes recognized in DOT FY 2011 financial statement include the OTA estimate of $11 billion the for quarter ended September 30, 2011.

The amount of Heavy Vehicle Use Tax (HVUT) revenue recorded in FY 2012 will likely be substantially higher than the amount recorded in FY 2011. Typically, the majority of HVUT receipts are received by the Internal Revenue Service (IRS) with the filing of annual tax returns in August, and the funds collected are transmitted to the Highway Trust Fund (HTF) for the account of the DOT Federal Highway Administration (FHWA) by the end of the fiscal year in September. However, on July 20, 2011, the IRS issued regulations that changed the due date for HVUT returns for the tax period July 1, 2011 through June 30, 2012, from August 31, 2011 to November 30, 2011. This temporary change in filing due dates had the effect of reducing non-exchange revenues in FY 2011 by an estimated $705 million. Since the receipt of this amount will be delayed until November 2011, the funds collected will be deposited in the HTF for the account of the DOT FHWA in the first quarter of FY 2012. Accordingly, such HVUT receipts to be certified by the IRS, the agency that collects the tax, will not be reflected in DOT's non exchange revenue until FY 2012.

For the years ended September 30, 2011 and 2010, respectively, excise taxes and associated nonexchange revenue, which are reported on the Statement of Changes in Net Position, were as follows:

NON-EXCHANGE REVENUE

	2011	2010
HIGHWAY TRUST FUND		
Excise Taxes and Other Non-Exchange Revenue		
Gasoline	$24,986,425	$24,836,919
Diesel and Special Motor Fuels	9,801,522	9,135,819
Trucks	3,226,317	2,767,199
Investment Income	15,812	17,325
Fines and Penalties	18,170	24,918
Total Taxes	**38,048,246**	**36,782,180**
Less: Transfers	**(1,125,811)**	**(1,203,149)**
Gross Taxes	**36,922,435**	**35,579,031**
Less: Refunds of Taxes	-	(569,069)
Total Excise Taxes	**36,922,435**	**35,009,962**
Other Non-Exchange Revenue	173	161
Net Highway Trust Fund Excise Taxes & Other Non-Exchange Revenue	**36,922,608**	**35,010,123**
FEDERAL AVIATION ADMINISTRATION		
Excise Taxes and Other Non-Exchange Revenue		
Passenger Ticket	8,084,593	7,261,070
International Departure	2,508,289	2,324,017
Fuel (Air)	530,572	651,475
Waybill	426,703	395,119
Investment Income	223,011	181,415
Tax Refunds and Credits	(8,432)	(18,728)
Other	21,917	35,379
Net Federal Aviation Administration Excise Taxes & Other Non-Exchange Revenue	**11,786,653**	**10,829,747**
Other Miscellaneous Net Non-Exchange Revenue	91,981	77,458
Total Non-Exchange Revenue	**$48,801,242**	**$45,917,328**

NOTE 21. COMBINED STATEMENT OF BUDGETARY RESOURCES:

The amount of direct and reimbursable obligations incurred against amounts apportioned under Category A, B and Exempt from apportionment, as defined in OMB Circular No. A-11, Part 4, Instructions on Budget Execution, are as follows:

NOTE 21

	2011			2010		
	DIRECT	REIMBURSABLE	TOTAL	DIRECT	REIMBURSABLE	TOTAL
Category A	$6,111,514	$496,567	$6,608,081	$7,192,018	$836,297	$8,028,315
Category B	82,022,600	1,341,001	83,363,601	104,494,200	1,000,490	105,494,690
Exempt from apportionment	78,797	263,058	341,855	73,733	250,893	324,626
Total	**$88,212,911**	**$2,100,626**	**$90,313,537**	**$111,759,951**	**$2,087,680**	**$113,847,631**

NOTE 21

	2011	2010
Available Contract Authority at year-end	$26,852,717	$26,432,116
Available Borrowing Authority at year-end	$1,356,282	$2,603,647
Undelivered Orders at year-end	$109,518,183	$106,634,884

The amounts reported for undelivered orders only include balances obligated for goods and services not delivered and does not include prepayments.

TERMS OF BORROWING AUTHORITY USED:

Under the provisions of the Federal Credit Reform Act of 1990, DOT direct loan and loan guarantee programs are authorized to borrow funds from Treasury to support its credit programs. All loan draw downs are dated October 1 of the applicable fiscal year. Interest is payable at the end of each fiscal year based on activity for that fiscal year. Principal can be repaid at any time funds become available. Repayment is effectuated by a combination of loan recoveries and upward re-estimates.

EXISTENCE, PURPOSE, AND AVAILABILITY OF PERMANENT INDEFINITE APPROPRIATIONS:

DOT has permanent indefinite appropriations for the Facilities and Equipment, Grants in Aid and Research, Development and Engineering appropriations to fully fund special projects that were on-going and spanned several years.

UNOBLIGATED BUDGETARY RESOURCES:

Unobligated balances of budgetary resources for unexpired accounts are available in subsequent years until expiration, upon receipt of an apportionment from OMB. Unobligated balances of expired accounts are not available.

STATEMENT OF BUDGETARY RESOURCES VS BUDGET OF THE UNITED STATES GOVERNMENT:

The reconciliation for the year ended September 30, 2010 is presented below. The reconciliation for the fiscal year ended September 30, 2011 is not presented, because the submission of the Budget of the United States (Budget) for FY 2013, which presents the execution of the FY 2011 budget, occurs after publication of these financial statements. The Department of Transportation Budget Appendix can be found on the OMB website (http://www.gpoaccess.gov/usbudget) and will be available in early February 2012.

NOTE 21

DOLLARS IN MILLIONS	BUDGETARY RESOURCES	OBLIGATIONS INCURRED	DISTRIBUTED OFFSETTING RECEIPTS	NET OUTLAYS
Combined Statement of Budgetary Resources	$174,546	$113,848	$(219)	$97,944
Funds not Reported in the Budget				
Expired Funds	(308)	-	-	-
Financial Statement Adjustment	(786)	714		
Distributed Offsetting Receipts	-	-	219	217
Other	(5)	(5)	-	5
Budget of the United States Government	**$173,447**	**$114,557**	**$-**	**$98,166**

Other differences represent financial statement adjustments, timing differences and other immaterial differences between amounts reported in the Department's Statement of Budgetary Resources and the Budget of the United States.

The Financial Statement Adjustment of $786 million is primarily caused by the reversal of a $767 million adjustment recorded at the end of FY 2009, for which DOT consulted with OMB on its reporting of the FY 2010 Report on Budget Execution and Budgetary Resources (SF 133).

NOTE 22. INCIDENTAL CUSTODIAL COLLECTIONS

NOTE 22. INCIDENTAL CUSTODIAL COLLECTIONS

REVENUE ACTIVITY:	2011	2010
Sources of Cash Collections		
Miscellaneous Receipts	$1	$19,068
Fines, Penalties and Forfeitures	-	-
Total Cash Collections	**1**	**19,068**
Total Custodial Revenue	**1**	**19,068**
Disposition of Collections		
Transferred to Treasury's General Fund	1	19,068
Net Custodial Activity	**$-**	**$-**

NOTE 23. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

	2011	2010
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated		
Other	$90,313,537	$113,847,631
Less: Spending Authority from Offsetting Collections and Recoveries	8,436,394	10,194,866
Obligations Net of Offsetting Collections and Recoveries	81,877,143	103,652,765
Less: Distributed Offsetting Receipts	(282,618)	(219,178)
Net Obligations	81,594,525	103,433,587
Other Resources		
Transfers In/Out Without Reimbursement	(8,872)	(6)
Imputed Financing From Costs Absorbed by Others	818,781	704,727
Other	(277,814)	(120,821)
Net Other Resources Used to Finance Activities	532,095	583,900
Total Resources Used to Finance Activities	**82,126,620**	**104,017,487**
RESCOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not yet Provided	2,694,348	4,921,176
Resources That Fund Expenses Recognized in Prior Periods	188,689	231,453
Credit Program Collections That Increase Liabilities for Loan Guarantees or Allowances for Subsidy	(395,673)	(404,267)
Other/Change in Unfilled Customer Orders	23,189	645,292
Anticipated Resources not yet realized	135,321	(18,602)
Resources That Finance the Acquisition of Assets	2,984,042	2,142,542
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	(28,227)	19,403,513
Total Resources Used to Finance Items Not Part of the Net Cost Of Operations	**5,601,689**	**26,921,107**
Total Resources Used to Finance the Net Cost of Operations	**$76,524,931**	**$77,096,380**

NOTE 23. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET: (CONT.)

	2011	2010
COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD:		
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	$36,563	$6,461
Increase in Environment and Disposal Liability	3,332	0
Upward/Downward Reestimates of Credit Subsidy Expense	(83,330)	(43,394)
Increase in exchange revenue receivable from the public	(96,607)	4,228
Change in Other Liabilities	166,462	174,084
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	**26,420**	**141,379**
COMPONENTS NOT REQUIRING OR GENERATING RESOURCES:		
Depreciation and Amortization	1,122,529	1,173,561
Revaluation of Assets or Liabilities	62,585	291,694
Other Expenses and Adjustments not Otherwise Classified Above	376,538	141,415
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	**1,561,652**	**1,606,670**
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**1,588,072**	**1,748,049**
Net Cost of Operations	**$78,113,003**	**$78,844,429**

NOTE 24. REPORTING ON AFFILIATED ORGANIZATION ACTIVITIES

SAINT LAWRENCE SEAWAY DEVELOPMENT CORPORATION

The U.S. Saint Lawrence Seaway Development Corporation (SLSDC), a wholly owned Government corporation and operating administration of the Department, is responsible for the operation and maintenance of the U.S. portion of the St. Lawrence Seaway. This responsibility includes maintaining and operating two U.S. locks, controlling vessel traffic and promoting trade development activities on the seaway.

NOTE 24: CONDENSED INFORMATION:

	2011	2010
Cash and Short-Term Time Deposits	$33,164	$34,283
Long-Term Time Deposits	1,836	2,839
Accounts Receivable	459	86
Inventories	274	266
Other Current Assets	26	1
Property, Plant and Equipment	84,784	75,687
Deferred Charges	4,242	3,546
Other Assets	514	600
Total Assets	**$125,299**	**$117,308**
Current Liabilities	$6,904	$3,825
Actuarial Liabilities	4,242	3,546
Total Liabilities	**11,146**	**7,371**
Invested Capital	99,921	90,818
Cumulative Results of Operations	14,232	19,119
Total Net Position	**114,153**	**109,937**
Total Liabilities and Net Position	**$125,299**	**$117,308**
Operating Revenues	$22,319	$29,375
Operating Expenses	29,987	25,226
Operating Income (loss)	(7,668)	4,149
Other Financing Sources	2,781	2,734
Operating revenues and othe financing sources over (under operating expenses)	(4,887)	6,883
Beginning cumulative results of operations (deficit)	19,119	12,236
Ending cumulative results of operations (deficit)	**$14,232**	**$19,119**

MARAD NON-APPROPRIATED FUND INSTRUMENTALITY (NAFI)

The Non-Appropriated Fund Instrumentality (NAFI) operate using their own funds generated from the proceeds received from various non-governmental sources, rather than appropriated funds. At DOT, NAFI's operate as a separate fiscal entity under MARAD to provide or assist the U.S. Merchant Marine Academy in providing programs and services for students, personnel and authorized civilians from sources other than Congressional appropriations. Although considered Governmental, NAFI cash balances and operating expenses are separate and distinct from those recorded in the books of the Federal Government. For the fiscal years September 30, 2011 and September 30, 2010, NAFI operating revenues and proceeds from midshipmen fees totaled $7.6 million and $10 million, respectively.

NOTE 25. FIDUCIARY ACTIVITIES:

The Title XI Escrow Fund was authorized pursuant to the Merchant Marine Act of 1936, as amended. The fund was originally established to hold guaranteed loan proceeds pending construction of MARAD approved and financed vessels.

The Act was recently amended to allow the deposit of additional cash security items such as reserve funds or debt reserve funds. Individual shipowners provide funds to serve as security on MARAD guaranteed loans. Funds deposited and invested by MARAD remain the property of individual shipowners. In the event of default, MARAD will use the escrow funds to offset the shipowners' debt to the Government.

Fund investments are limited to U.S. Government securities purchased by MARAD through the Treasury.

NOTE 25: SCHEDULE OF FIDUCIARY ACTIVITY

For the quarter ended September 30:	2011	2010
Fiduciary Net Assets, beginning of year	$28,194	$141,756
Contributions	-	-
Disbursements to and on behalf of beneficiaries	(9,349)	(113,562)
Increases/(Decreases) in fiduciary net assets	(9,349)	(113,562)
Fiduciary net assets, end of year	**$18,845**	**$28,194**

FIDUCIARY NET ASSETS	As of September 30, 2011	and 2010
Fiduciary Assets		
Fiduciary Fund Balance with Treasury	$286	$295
Investments in Treasury Securities	18,559	27,899
Total Fiduciary Net Assets	**18,845**	**28,194**

REQUIRED SUPPLEMENTARY INFORMATION

DEFERRED MAINTENANCE:

DOT ENTITY	MAJOR CLASS OF ASSET	METHOD OF MEASUREMENT	*ASSET CONDITION	**2011 COST TO RETURN TO ACCEPTABLE CONDITION	**2010 COST TO RETURN TO ACCEPTABLE CONDITION
FAA Deferred Maintenance not available at this time					
FAA	Buildings	Condition Assessment Survey	4 & 5	$61,607	$74,155
	Other Structures and Facilities	Condition Assessment Survey	4 & 5	229,240	194,000
MARAD Force (Various Locations)	Vessels, Ready Reserve Survey	Condition Assessment Survey	2	9,753	9,191
	Real Property, Buildings (Anchorage)	Condition Assessment Survey	3	150	7,672
	Real Property, Structure, U.S. Merchant Marine, Academy, NY	Condition Assessment Survey	2&3	20,062	-
	Real Property, Structure, U.S. Merchant Marine, Academy, NY	Condition Assessment Survey	4&5	60,750	-
	Other (Fleet Craft)	Condition Assessment Survey	3	3,254	-
Total				**$384,816**	**$285,018**

***Asset Condition Rating Scale:**

1 Excellent
2 Good
3 Fair
4 Poor
5 Very Poor

****Acceptable Condition is:**

FAA Buildings	3	Fair
FAA Other Structures and Facilities	3	Fair
MARAD Vessels, Ready Reserve Force	1	Excellent, Ships are seaworthy and ready for mission assignments within prescribed time limits
MARAD Real Property, Buildings	3	Fair, Buildings are safe and habital
MARAD Real Property, Structures	3 4 5	Fair, Adequate water depth, shore power, and mooring capabilities. Poor, Structure needs major repairs. The majority of the components are marginally functional or jeopardized. Very Poor, Age and/or concdition is such that the item should be replaced or undergo major renovation. Struce is not safe and is inhabitable

Deferred Maintenance is maintenance that was not performed when it should have been or was scheduled to be performed and delayed until a future period. Maintenance is keeping fixed assets in acceptable condition, and includes preventative maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve assets in a condition to provide acceptable service and to achieve expected useful lives.

COMBINING STATEMENTS OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

For the Period Ended September 30, 2011

DOLLARS IN THOUSANDS	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
BUDGETARY RESOURCES						
Unobligated balance, brought forward, Oct. 1	$32,525,358	$3,321,905	$10,500,855	$477,984	$13,872,333	$60,698,435
Recoveries of prior year unpaid obligations	-	486,422	85,560	31,774	401,926	1,005,682
Budget authority						
Appropriations received	41,878,677	16,030,132	11,357,911	593,822	4,356,262	74,216,804
Borrowing authority	-	-	-	195,000	1,161,282	1,356,282
Contract authority	43,042,152	3,515,000	8,360,565	-	1,287,107	56,204,824
Spending authority from offsetting collections						
Earned						
Collected	103,190	978,829	342,151	481,143	1,290,455	3,195,768
Change in receivables from Federal sources	32,717	(41,794)	(5,034)	(12,098)	(17,542)	(43,751)
Change in unfilled customer orders						
Advance received	3,174	(45,926)	(331,114)	21,077	9,794	(342,995)
Without advance from Federal sources	63,465	(13,097)	(2,679)	94,391	(97,281)	44,799
Expenditure transfers from trust funds	-	4,549,882	-	-	27,009	4,576,891
Subtotal	**85,123,375**	**24,973,026**	**19,721,800**	**1,373,335**	**8,017,086**	**139,208,622**
Nonexpenditure transfers, net	(1,199,128)	(40,760)	1,186,392	5,750	40,965	(6,781)
Temporarily not available pursuant to Public Law	-	(5,812)	-	-	(5,190)	(11,002)
Permanently not available	(44,671,150)	(3,632,929)	(9,686,359)	(214,998)	(1,888,774)	(60,094,210)
Total budgetary resources	**$71,778,455**	**$25,101,852**	**$21,808,248**	**$1,673,845**	**$20,438,346**	**$140,800,746**
STATUS OF BUDGETARY RESOURCES						
Obligations incurred:						
Direct	$40,960,010	20,865,661	$11,021,174	637,387	$14,728,679	$88,212,911
Reimbursable	90,355	679,980	9,179	395,618	925,494	2,100,626
Subtotal	**41,050,365**	**21,545,641**	**11,030,353**	**1,033,005**	**15,654,173**	**90,313,537**
Unobligated balance:						
Apportioned	16,655,280	1,670,513	10,752,663	372,656	4,140,474	33,591,586
Exempt from apportionment	-	-	-	15,435	302,278	317,713
Subtotal	**16,655,280**	**1,670,513**	**10,752,663**	**388,091**	**4,442,752**	**33,909,299**
Unobligated balance not available	14,072,810	1,885,698	25,232	252,749	341,421	16,577,910
Total status of budgetary resources	**$71,778,455**	**$25,101,852**	**$21,808,248**	**$1,673,845**	**$20,438,346**	**$140,800,746**

COMBINING STATEMENTS OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

For the Period Ended September 30, 2011

DOLLARS IN THOUSANDS	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
CHANGE IN OBLIGATED BALANCES						
Obligated balance, net:						
Unpaid obligations, brought forward, Oct 1	$63,206,294	$9,285,955	$19,715,003	$369,261	$22,258,404	$114,834,917
Uncollected customer payments from Federal sources, brought forward, Oct. 1	(334,747)	(342,944)	(66,614)	(73,274)	(609,876)	(1,427,455)
Total unpaid obligated balance, net	**62,871,547**	**8,943,011**	**19,648,389**	**295,987**	**21,648,528**	**113,407,462**
Obligations incurred	41,050,365	21,545,641	11,030,353	1,033,005	15,654,173	90,313,537
Gross outlays	(36,242,104)	(21,102,064)	(11,943,323)	(986,679)	(15,985,754)	(86,259,924)
Obligated balance, transferred, net						
Unpaid obligations	-	-	-	-	22,214	22,214
Recoveries of prior year unpaid obligations, actual	-	(486,422)	(85,560)	(31,774)	(401,926)	(1,005,682)
Change in uncollected customer payments from Federal sources	(96,181)	54,891	7,714	(82,293)	111,914	(3,955)
Obligated balance, net, end of period:						
Unpaid obligations	68,014,555	9,243,110	18,716,473	383,813	21,547,111	117,905,062
Uncollected customer payments from Federal sources	(430,928)	(288,053)	(58,900)	(155,567)	(497,962)	(1,431,410)
Total unpaid obligated balance, net, end of period	**$67,583,627**	**$8,955,057**	**$18,657,573**	**$228,246**	**$21,049,149**	**$116,473,652**
NET OUTLAYS						
Gross Outlays	$36,242,104	$21,102,064	$11,943,323	$986,679	$15,985,754	$86,259,924
Offsetting collections	(106,364)	(5,482,785)	(11,037)	(501,611)	(1,324,350)	(7,426,147)
Distributed offsetting receipts	-	(10,742)	43,322	(41,841)	(273,357)	(282,618)
Net outlays	**$36,135,740**	**$15,608,537**	**$11,975,608**	**$443,227**	**$14,388,047**	**$78,551,159**

COMBINING STATEMENTS OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

For the Period Ended September 30, 2010

DOLLARS IN THOUSANDS	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
BUDGETARY RESOURCES:						
Unobligated balance, brought forward, Oct. 1	$25,819,161	$3,598,143	$8,953,472	$543,188	$19,343,857	$58,257,821
Recoveries of prior year unpaid obligations	-	425,738	542,305	20,483	2,546,458	3,534,984
Budget authority						
Appropriations received	41,943,123	15,526,737	11,789,581	610,268	27,536,634	97,406,343
Borrowing authority	-	-	-	319,363	2,284,284	2,603,647
Contract authority	51,750,152	3,515,000	8,360,565	-	1,284,282	64,909,999
Spending authority from offsetting collections						
Earned						
Collected	247,666	916,686	436,306	524,404	1,332,990	3,458,052
Change in receivables from Federal sources	(11,188)	(92,865)	(7,760)	18,741	6,433	(86,639)
Change in unfilled customer orders						
Advance received	1,785	(817)	(410,065)	(25,287)	(101,810)	(536,194)
Without advance from Federal sources	(165,864)	(27,370)	(10,375)	(98,578)	97,933	(204,254)
Expenditure transfers from trust funds	-	4,000,000	-	487	28,430	4,028,917
Subtotal	**93,765,674**	**23,837,371**	**20,158,252**	**1,349,398**	**32,469,176**	**171,579,871**
Nonexpenditure transfers, net	(1,406,637)	(48,627)	1,561,151	50,000	(104,270)	51,617
Temporarily not available pursuant to Public Law	-	-	-	-	(5,007)	(5,007)
Permanently not available	(44,046,000)	(3,521,002)	(9,401,608)	(221,502)	(1,683,108)	(58,873,220)
Total budgetary resources	**$74,132,198**	**$24,291,623**	**$21,813,572**	**$1,741,567**	**$52,567,106**	**$174,546,066**
STATUS OF BUDGETARY RESOURCES:						
Obligations incurred:						
Direct	$41,536,569	20,218,239	$11,308,034	895,647	$37,801,462	$111,759,951
Reimbursable	70,271	751,479	4,683	367,936	893,311	2,087,680
Subtotal	**41,606,840**	**20,969,718**	**11,312,717**	**1,263,583**	**38,694,773**	**113,847,631**
Unobligated balance:						
Apportioned	16,881,341	1,704,024	10,015,855	231,710	13,322,463	42,155,393
Exempt from apportionment	-	-	-	15,526	303,696	319,222
Subtotal	**16,881,341**	**1,704,024**	**10,015,855**	**247,236**	**13,626,159**	**42,474,615**
Unobligated balance not available	15,644,017	1,617,881	485,000	230,748	246,174	18,223,820
Total status of budgetary resources	**$74,132,198**	**$24,291,623**	**$21,813,572**	**$1,741,567**	**$52,567,106**	**$174,546,066**

COMBINING STATEMENTS OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

For the Period Ended September 30, 2010

DOLLARS IN THOUSANDS	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
CHANGE IN OBLIGATED BALANCES:						
Obligated balance, net:						
Unpaid obligations, brought forward, Oct 1	$52,631,073	$9,680,164	$22,058,387	$402,202	$24,834,538	$109,606,364
Uncollected customer payments from Federal sources, brought forward, Oct. 1	(516,259)	(463,179)	(84,750)	(153,110)	(512,452)	(1,729,750)
Total unpaid obligated balance, net	**52,114,814**	**9,216,985**	**21,973,637**	**249,092**	**24,322,086**	**107,876,614**
Obligations incurred	41,606,840	20,969,718	11,312,717	1,263,586	38,694,773	113,847,631
Gross outlays	(31,031,619)	(20,938,189)	(13,113,796)	(1,276,041)	(38,750,793)	(105,110,438)
Obligated balance, transferred, net						
Unpaid obligations	-	-	-	-	26,344	26,344
Recoveries of prior year unpaid obligations, actual	-	(425,738)	(542,305)	(20,483)	(2,546,458)	(3,534,984)
Change in uncollected customer payments from Federal sources	181,512	120,235	18,136	79,836	(97,424)	302,295
Obligated balance, net, end of period:						
Unpaid obligations	64,706,294	9,285,955	19,715,003	369,261	22,258,404	116,334,917
Uncollected customer payments from Federal sources	(334,747)	(342,944)	(66,614)	(73,274)	(609,876)	(1,427,455)
Total unpaid obligated balance, net, end of period	**$64,371,547**	**$8,943,011**	**$19,648,389**	**$295,987**	**$21,648,528**	**$114,907,462**
NET OUTLAYS						
Gross Outlays	$31,031,619	$20,938,189	$13,113,796	$1,276,041	$38,750,793	$105,110,438
Offsetting collections	(253,414)	(4,915,870)	(26,241)	(499,604)	(1,252,388)	(6,947,517)
Distributed offsetting receipts	-	(12,776)	93	(85,402)	(121,093)	(219,178)
Net outlays	**$30,778,205**	**$16,009,543**	**$13,087,648**	**$691,035**	**$37,377,312**	**$97,943,743**

NON-FEDERAL PHYSICAL PROPERTY; TRANSPORTATION INVESTMENTS

DOLLARS IN THOUSANDS	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
					September 30:
SURFACE TRANSPORTATION:					
Federal Highway Administration					
Federal Aid Highways (HTF)	$32,800,748	$34,470,595	$37,860,105	$29,649,943	$34,556,573
Other Highway Trust Fund Programs	366,672	481,762	216,263	155,061	148,271
General Fund Programs	51,119	31,740	3,228,009	11,616,036	7,906,180
Appalachian Development System	329,161	185,316	321,480	90,091	243,853
Federal Motor Carrier	196,967	144,455	837	-	-
Total Federal Highway Administration	**33,744,667**	**35,313,868**	**41,626,694**	**41,511,131**	**42,854,877**
Federal Transit Administration					
Discretionary Grants	$11,719	$27,174	$16,424	$17,171	$25,068
Formula Grants	2,086,876	1,329,811	743,604	428,696	220,047
Capital Investment Grants	2,662,845	2,473,141	2,175,758	1,930,185	1,924,741
Washington Metro Area Transit Authority	28,430	46	33	-	110,321
Interstate Transfer Grants	1,774	360	316	-	-
Formula and Bus Grants	4,193,989	5,968,651	7,264,278	7,345,804	7,182,145
Total Federal Transit Administration	**8,985,633**	**9,799,183**	**10,200,413**	**9,721,856**	**9,462,322**
Total Surface Transportation Nonfederal Physical Property Investments	**$42,730,300**	**$45,113,051**	**$51,827,107**	**$51,232,987**	**$52,317,199**
AIR TRANSPORTATION:					
Federal Aviation Administration					
Airport Improvement Program	$3,923,719	$3,753,840	$4,034,970	$4,015,463	$3,388,712
Total Air Transportation Nonfederal Physical Property Investments	$3,923,719	$3,753,840	$4,034,970	$4,015,463	$3,388,712
Total Nonfederal Physical Property Investments	**$46,654,019**	**$48,866,891**	**$55,862,077**	**$55,248,450**	**$55,705,911**

The Federal Highway Administration reimburses States for construction costs on projects related to the Federal Highway System of roads. The main programs in which the States participate are the National Highway System, Interstate Systems, Surface Transportation, and Congestion Mitigation/Air Quality Improvement programs. The States' contribution is ten percent for the Interstate System and twenty percent for most other programs.

The Federal Transit Administration provides grants to State and local transit authorities and agencies.

Formula grants provide capital assistance to urban and nonurban areas and may be used for a wide variety of mass transit purposes, including planning, construction of facilities, and purchases of buses and railcars. Funding also includes providing transportation to meet the special needs of elderly individuals and individuals with disabilities.

Capital investment grants, which replaced discretionary grants in FY 1999, provide capital assistance to finance acquisition, construction, reconstruction, and improvement of facilities and equipment. Capital investment grants fund the categories of new starts, fixed guideway modernization, and bus and bus-related facilities.

The Washington Metropolitan Area Transit Authority provides funding to support the construction of the Washington Metrorail System.

Interstate Transfer Grants provided Federal financing from FY 1976 through FY 1995 to allow States and localities to fund transit capital projects substituted for previously withdrawn segments of the Interstate Highway System.

The Federal Aviation Administration (FAA) makes project grants for airport planning and development under the Airport Improvement Program (AIP) to maintain a safe and efficient nationwide system of public-use airports that meet both present and future needs of civil aeronautics. FAA works to improve the infrastructure of the nation's airports, in cooperation with airport authorities, local and State governments, and metropolitan planning authorities.

HUMAN CAPITAL INVESTMENT EXPENSES

September 30:

DOLLARS IN THOUSANDS	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
SURFACE TRANSPORTATION					
Federal Highway Administration					
National Highway Institute Training	$4,083	$1,205	$375	$109	$133
Federal Motor Carrier Safety Administration					
California Highway Patrol	127	722			
Safety Grants	748	426	1,230	845	636
Idaho Video	-	302	399	9	-
Kentucky IT Conference	-	-	-	-	-
Massachusetts Training Academy	172	-	-	-	-
Minnesota Crash Investigation	-	-	-	-	-
New York Crash Reconstruction	36	180	-	-	-
Tennessee Crash Investigation	165	167	-	-	-
Federal Transit Administration					
National Transit Institute Training[1]	3,879	4,577	3,440	3,886	3,246
National Highway Safety Administration					
Section 403 Highway Safety Programs	247,254	171,836	143,639	138,221	123,340
Highway Traffic Safety Grants	416,241	485,721	566,790	565,787	576,063
Pipeline and Hazardous Materials Safety Administration					
Hazardous Materials (Hazmat) Training	7,798	13,263	13,263	13,153	16,974
Total Surface Transportation Human Capital Investments	**680,503**	**678,399**	**729,136**	**722,010**	**720,392**
MARITIME TRANSPORTATION					
Maritime Administration					
State Maritime Academies Training[1]	8,978	9,406	11,041	10,810	11,459
Additional Maritime Training	555	800	1,751	2,365	2,146
Total Maritime Transportation Human Capital Investments	**9,533**	**10,206**	**12,792**	**13,175**	**13,605**
Total Human Capital Investments	**$690,036**	**$688,605**	**$741,928**	**$735,185**	**$733,997**

1 Does not include funding for the Student Incentive Payment (SIP) program which produces graduates who are obligated to serve in a reserve component of the United States armed forces. Does not include funding for maintenance and repair (M&R).

The National Highway Institute develops and conducts various training courses for all aspects of Federal Highway Administration. Students are typically from the State and local police, State highway departments, public safety and motor vehicle employees, and U.S. citizens and foreign nationals engaged in highway work of interest to the Federal Government. Types of courses given and developed are modern developments, technique, management, planning, environmental factors, engineering, safety, construction, and maintenance.

The California Highway Patrol educates the trucking industry for the Federal Motor Carrier Safety Administration about Federal and State commercial motor vehicle/carrier inspection procedures, and to increase CMV driver awareness. The Idaho Video Program develops video training material utilized by the FMCSA National Training Center for the purpose of training State and Local law enforcement personnel. The Massachusetts Training Academy provides training to State law enforcement personnel located in the northeast region of Massachusetts. The Minnesota Crash Investigation program provides training and develops processes and protocols for commercial motor vehicle crash investigations.

The National Transit Institute of the Federal Transit Administration develops and offers training courses to improve transit planning and operations. Technology courses cover such topics as alternative fuels, turnkey project delivery systems, communications-based train controls, and integration of advanced technologies.

The National Highway Safety Administration's programs authorized under the Highway Trust Fund provide resources to State and Local governments, private partners, and the public, to effect changes in driving behavior on the nation's highways to increase safety belt usage and reduce impaired driving. NHTSA provides technical assistance to all states on the full range of components of the impaired driving system as well as conducting demonstrations, training and public information/education on safety belt usage.

The Pipeline and Hazardous Materials Safety Administration administers Hazardous Material Training (Hazmat). The purpose of Hazmat Training is to train State and local emergency personnel on the handling of hazardous materials in the event of a hazardous material spill or storage problem.

RESEARCH AND DEVELOPMENT INVESTMENTS

September 30:

DOLLARS IN THOUSANDS	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
SURFACE TRANSPORTATION					
Federal Highway Administration					
Intelligent Transportation Systems	$152,799	$128,931	$111,219	$129,993	$98,694
Other Applied Research and Development	74,942	63,906	28,259	159,389	244,156
Federal Railroad Administration					
Railroad Research and Development Program	$3,308	$2,259	$3,349	$5,647	$6,027
Federal Transit Administration, Applied Research and Development					
Transit Planning and Research	$3,144	$6,076	$6,914	$7,228	$13,751
Pipeline and Hazardous Materials Safety Administration, Applied Research and Development					
Development Research and Development Pipeline Safety					
Applied Research and Development Pipeline Safety	$5,494	$12,762	$9,198	$7,362	$2,365
Applied Research and Development Hazardous Materials	1,072	1,084	1,593	1,622	2,855
Research and Innovative Technology Administration, Applied Research and Development					
Research and Technology	$1,036	$1,036	$1,936	$6,137	$6,134
Total Surface Transportation Research and Development Investments	**$241,795**	**$216,054**	**$162,468**	**$317,378**	**$373,982**
AIR TRANSPORTATION					
Federal Aviation Administration					
Research and Development Plant	$4,217	$3,498	$3,381	$5,590	$5,848
Applied Research	102,782	88,114	95,764	103,042	129,954
Development	844	814	1,102	2,008	2,238
Administration	32,050	33,519	35,055	36,723	35,875
Total Air Transportation Research and Development Investments	**$139,893**	**$125,945**	**$135,302**	**$147,363**	**$173,915**
Total Research and Development Investments	**$381,688**	**$341,999**	**$297,770**	**$464,741**	**$547,897**

The Federal Highway Administration's research and development programs are earmarks in the appropriations bills for the fiscal year. Typically, these programs are related to safety, pavements, structures, and environment. Intelligent Transportation Systems were created to promote automated highways and vehicles to enhance the national highway system. The output is in accordance with the specifications within the appropriations act.

The Federal Transit Administration supports research and development in the following program areas:

Research and development in Transit Planning and Research supports two major areas: the National Research Program and the Transit Cooperative Research Program. The National Research Program funds the research and development of innovative transit technologies such as safety-enhancing commuter rail control systems, hybrid electric buses, and fuel cell and battery-powered propulsion systems. The Transit Cooperative Research Program focuses on issues significant to the transit industry with emphasis on local problem-solving research.

Transit University Transportation Centers, combined with funds from the Highway Trust Fund, provide continued support for research, education, and technology transfer.

Capital investment grants, which replaced discretionary grants in FY 1999, provide capital assistance to finance acquisition, construction, reconstruction, and improvement of facilities and equipment. Capital investment grants fund the categories of new starts, fixed guideway modernization, and bus and bus-related activities.

The Office of the Secretary's Office of Emergency Transportation is involved in research and development of mapping software for the Crisis Management Center, transportation policy, and outreach efforts.

The Pipeline and Hazardous Materials Safety Administration funds research and development activities for the following organizations and activities.

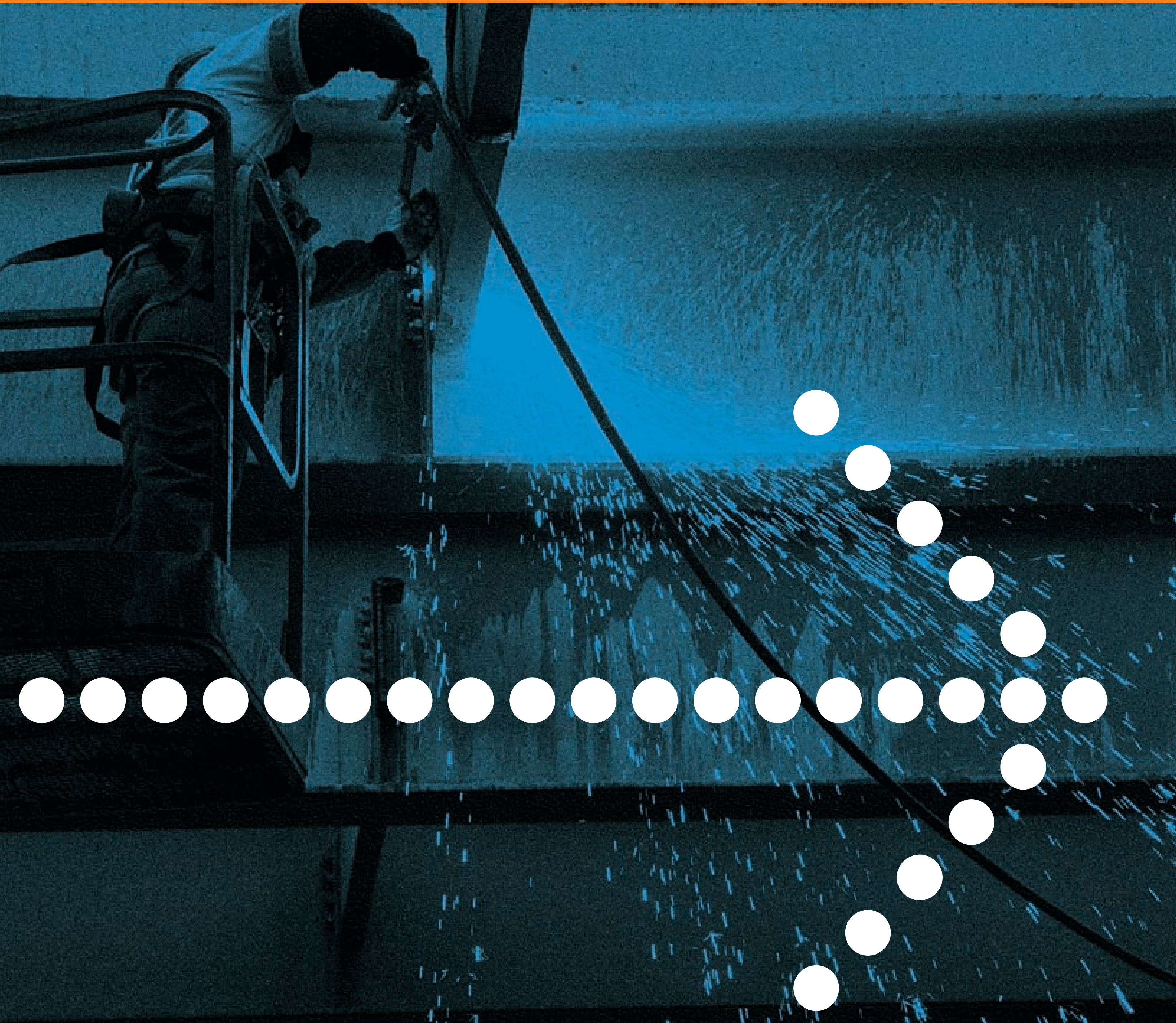
The Office of Pipeline Safety is involved in research and development in information systems, risk assessment, mapping, and non-destructive evaluation.

The Office of Hazardous Materials is involved in research, development, and analysis in regulation compliance, safety, and information systems.

The Research and Innovative Technology Administration's key mandate is to coordinate research across DOT to maximize and leverage the taxpayers' $1.2 billion annual investment in research, development and technology (RD&T) activities.

The Federal Aviation Administration (FAA) conducts research and provides the essential air traffic control infrastructure to meet increasing demands for higher levels of system safety, security, capacity, and efficiency. Research priorities include aircraft structures and materials; fire and cabin safety; crash injury-protection; explosive detection systems; improved ground and in-flight de-icing operations; better tools to predict and warn of weather hazards, turbulence and wake vortices; aviation medicine, and human factors.

OTHER ACCOMPANYING INFORMATION



SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT

SUMMARY OF FINANCIAL STATEMENT AUDIT

Audit Opinion	UNQUALIFIED
Restatement	NO

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
None	0					0
Total	**0**	**0**	**0**	**0**	**0**	**0**

TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES

EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING (FMFIA, SECTION 2)

Statement of Assurance	UNQUALIFIED

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
Total Material Weaknesses						

EFFECTIVENESS OF INTERNAL CONTROL OVER OPERATIONS (FMFIA, SECTION 2)

Statement of Assurance	UNQUALIFIED

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
FISMA Noncompliance	1					1
Total Material Weaknesses	**1**					**1**

CONFORMANCE WITH FINANCIAL MANAGEMENT SYSTEM REQUIREMENTS (FMFIA, SECTION 4)

Statement of Assurance	UNQUALIFIED

NON-CONFORMANCES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
Total Non-Conformances	**0**					**0**

CONFORMANCE WITH FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)

	AGENCY	AUDITOR
Overall Substantial Compliance	YES	YES
1. System Requirements	YES	YES
2. Accounting Standards	YES	YES
3. USSGL at Transaction Level	YES	YES

MEMORANDUM

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

Subject: INFORMATION: DOT's Fiscal Year 2012 Top Management Challenges

Department of Transportation
Report Number PT-2012-006

November 15, 2011

From: Calvin L. Scovel III, Inspector General

s/R
C. L. Scovel III

Reply to Attn. of: J-1

To: The Secretary, Deputy Secretary

As required by law, we have identified the Department of Transportation's (DOT) top management challenges for fiscal year 2012. The Nation's economy and the quality of life for all Americans rely heavily on a safe transportation system. The Department spends over $78 billion annually on a wide range of programs and initiatives to meet this objective, and we continue to support its efforts through our audits and investigations.

Improving safety remains the Department's top priority, and it undertook several initiatives in fiscal year 2011 that reflect this commitment across various modes of transportation. These include issuing new regulations to keep unsafe drivers off highways, undertaking new bridge safety efforts, and pursuing rulemakings to address pilot professionalism and training. However, recent safety incidents demand renewed focus across several key areas for fiscal year 2012 and beyond. These include doing more to ensure controllers maintain safe separation between aircraft, addressing pilot fatigue issues, identifying and addressing vehicle safety defects, and improving pipeline safety oversight at the state and Federal levels.

The Department must address these challenges in an austere budget environment while also executing new infrastructure efforts across the Nation and handling longstanding management issues. For example, many highway and transit projects funded by the American Recovery and Reinvestment Act are still under construction and require vigilant oversight to maximize those investments. Budget constraints and problems with existing projects are also forcing the Department to rethink investments and priorities for the Next Generation Air Transportation System—which is critical to meet future air travel demands. The Department must also better balance and prioritize resources to achieve its vision for intercity passenger rail.

Moreover, expanding and supporting our Nation's transportation infrastructure translates to billions of dollars on contracts for goods and services. Careful stewardship of every taxpayer dollar is critical given current fiscal pressures and the growing demand for improvements. The Department continues to face management challenges to strategically plan and oversee acquisitions and must adequately prepare its workforce to ensure each project achieves mission results. Finally, supporting all of the Department's programs and efforts are hundreds of information systems that will require resources to ensure security programs mitigate emerging cyber threats and vulnerabilities.

We continue to build a body of work to assist the Department with its critical mission; improve the management and execution of programs; and protect the Department's resources from fraud, waste, abuse, and violations of law.

We considered several criteria in identifying the following nine challenges, including their impact on safety, documented vulnerabilities, large dollar implications, and the ability of the Department to effect change in these areas:

- Enhancing the Department's Oversight of Highway, Bridge, and Transit Safety
- Ensuring Effective Oversight on Key Initiatives That Can Improve Aviation Safety
- Ensuring Effective Oversight of Hazardous Liquid and Natural Gas Pipeline Safety
- Ensuring Effective Oversight of ARRA Projects and Applying Related Lessons Learned To Improve DOT's Infrastructure Programs
- Managing the Next Generation Air Transportation System Advancement While Controlling Costs
- Managing DOT Acquisitions in a More Strategic Manner To Maximize Limited Resources and Achieve Better Mission Results
- Improving the Department's Cyber Security
- Defining Clear Goals To Guide the Federal Railroad Administration in Its Transformation
- Utilizing Department Credit Programs To Leverage Limited Federal Transportation Infrastructure Resources

We are committed to keeping decision makers informed of emerging and long-standing issues identified through our audits and investigations. We appreciate the Department's responsiveness to our findings and recommendations and the commitment to taking prompt corrective action.

This report and the Department's response will be included in the Department's Annual Financial Report, as required by law. The Department's response is included in its entirety in the appendix to this report. If you have any questions regarding the issues presented in this report, please contact me at (202) 366-1959. You may also contact Lou E. Dixon, Principal Assistant Inspector General for Auditing and Evaluation, at (202) 366-1427.

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cc: Martin Gertel, M-1

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CHAPTER 1

ENHANCING THE DEPARTMENT'S OVERSIGHT OF HIGHWAY, BRIDGE, AND TRANSIT SAFETY

Surface transportation safety statistics have improved in recent years—especially those related to motor vehicles. From 2005 to 2009, fatalities and injuries related to motor vehicle crashes declined by 22 percent and 18 percent, respectively. Large truck and bus fatalities dropped by 29 percent between 2007 and 2009. To maintain these positive trends, the Department must work with its state and local partners to tackle persistent challenges, build on key initiatives, and address longstanding concerns with motor carrier, vehicle, bridge, and transit safety.

KEY CHALLENGES

- Strengthening the Federal Motor Carrier Safety Administration's (FMCSA) oversight of the motor carrier industry to remove unsafe operators
- Improving National Highway Traffic Safety Administration (NHTSA) processes for identifying and addressing vehicle safety defects
- Following through on new Federal Highway Administration (FHWA) initiatives to enhance bridge inspections and maintenance
- Enhancing the Federal Transit Administration's (FTA) oversight of rail transit safety

STRENGTHENING FMCSA'S OVERSIGHT OF THE MOTOR CARRIER INDUSTRY TO REMOVE UNSAFE OPERATORS

Despite the recent decrease in large truck and bus fatalities, FMCSA must take additional actions to remove unsafe commercial drivers and motor carriers from our Nation's highways. A key focus for FMCSA is to follow through on its commitments to strengthen the Commercial Driver's License (CDL) program. Program weaknesses continue to allow individuals and third-party testers to exploit the program, resulting in hundreds of fraudulently issued CDLs. Since 2006, our office has opened 28 CDL fraud investigations in 16 states, often with the coordination and support from other law enforcement agencies and FMCSA.

In 2011, FMCSA issued new regulations to tighten controls over CDL testing. However, our work has shown that it will be difficult for FMCSA to ensure that states swiftly and effectively implement new regulations. Therefore, it must provide sustained management attention to achieve success. For example, FMCSA has made limited progress implementing its 2005 standards for timely communication of serious traffic convictions among states. Such action would help remove CDLs, when appropriate, from drivers who commit these violations.

FMCSA has also taken action to address congressional and National Transportation Safety Board (NTSB) concerns about passenger carrier safety, an issue which received increased attention this year after several fatal bus crashes. For example, FMCSA hosted a nationwide summit on motor coach safety in September 2011 that identified stakeholder concerns over delays in issuing new regulations, such as one from NHTSA requiring seatbelts on motor coaches. Our ongoing work on FMCSA's response to NTSB recommendations on new entrants[1] shows that FMCSA implemented a more stringent safety assurance process that new entrants must complete. FMCSA also initiated a new vetting process to identify reincarnated carriers[2] applying to transport passengers and household goods. However, before FMCSA expands the vetting process to all new motor carrier applicants, it will need to develop a risk-based approach to better target its limited resources.

IMPROVING NHTSA'S PROCESSES FOR IDENTIFYING AND ADDRESSING VEHICLE SAFETY DEFECTS

A tragic crash in 2009 involving a Toyota vehicle that accelerated out of control and killed four occupants brought significant public, media, and congressional attention to NHTSA's oversight of vehicle safety. Our review of NHTSA's Office of Defects Investigation (ODI)[3] found that ODI followed established processes in conducting investigations of both Toyota and non-Toyota vehicles. However, ODI needs to improve its processes for identifying and addressing potential safety defects. We also found that ODI needs to assess whether it has sufficient staff and expertise to operate effectively. Further, while ODI's processes are well-respected internationally, its limited information sharing and coordination with foreign countries may reduce opportunities to identify safety defects or recalls in an increasingly global automobile industry. By taking steps to improve its processes and international relationships, ODI can more effectively meet its mission of saving lives and preventing injuries from motor vehicle crashes.

FOLLOWING THROUGH ON NEW FHWA INITIATIVES TO ENHANCE BRIDGE INSPECTIONS AND MAINTENANCE

According to FHWA, about one-fourth of the Nation's more than 600,000 bridges have major deterioration, cracks in their structural components, or other deficiencies. Given the enormity of the problem, and the limited funding available to address such deficiencies, our reports and testimonies over the past 2 decades have emphasized the need to improve the quality of inspection data and implement data-driven, risk-based oversight to prioritize bridge safety risks. This year, FHWA announced an initiative to help states identify and target higher priority bridge problems. This initiative uses risk-based metrics and detailed criteria and clarifies the minimum requirements that states must meet to comply with National Bridge Inspection Standards. However, FHWA still needs to adopt recently updated standards for data that will help better diagnose bridge problems and continue to support the states most in need of improved systems to manage their bridges.

ENHANCING FTA'S OVERSIGHT OF RAIL TRANSIT SAFETY
In 2009, transit rail crashes, including the Washington Metropolitan Area Transit Authority crash, killed 9 people and injured 159 others. These crashes raised concerns about the effectiveness of safety oversight of the Nation's transit systems and increased congressional and media attention on transit safety.

Our ongoing work is seeking to highlight actions FTA can take now to enhance rail transit safety oversight. Key areas we are examining include whether the National Transit Database captures sufficient information to allow FTA to fully identify safety trends and risks across the country. We made recommendations to FTA for improving available safety data and developing and implementing safety goals and performance measures. FTA is considering our recommendations and ongoing actions to implement them.

RELATED PRODUCTS The following related reports, testimonies, and correspondence can be found on the OIG Web site at **www.oig.dot.gov**.

- Process Improvements Are Needed for Identifying and Addressing Vehicle Safety Defects, October 6, 2011
- Statement for the Record: FMCSA Is Strengthening Motor Carrier Safety Oversight but Further Action and Attention Are Needed, July 21, 2011
- Letter to Chairmen Rockefeller and Pryor Regarding Whether Former NHTSA Employees Exerted Undue Influence on Safety Defect Investigations, April 4, 2011
- Letter to Chairmen Murray and Olver and Ranking Members Bond and Latham Regarding FHWA's Actions in Response to OIG's January 2009 Bridge Report, October 18, 2010
- FHWA Has Taken Actions but Could Do More To Strengthen Oversight of Bridge Safety and States' Use of Federal Bridge Funding, July 21, 2010
- FHWA Oversight of the Highway Bridge Program and National Bridge Inspection Program, January 14, 2010
- Audit of the Data Integrity of the Commercial Driver's License Information System, July 30, 2009
- National Bridge Inspection Program: Assessment of FHWA's Implementation of Data-Driven, Risk-Based Oversight, January 12, 2009

CHAPTER 1 FOOTNOTES

1 New entrants are newly registered motor carriers, including passenger carriers.

2 Reincarnated carriers are those that FMCSA has put out of service but who have tried to evade the law by applying for new operating authority under new names.

3 ODI is responsible for carrying out NHTSA's oversight of vehicle safety.

CHAPTER 2

ENSURING EFFECTIVE OVERSIGHT ON KEY INITIATIVES THAT CAN IMPROVE AVIATION SAFETY

The United States continues to operate the world's safest air transportation system. However, our audit and investigation work and recent incidents underscore the need for the Federal Aviation Administration (FAA) to take additional actions to improve safety. With tightening budgets, it is also important for FAA to strategically position itself to use its oversight resources wisely.

KEY CHALLENGES

- Identifying and addressing the causes of recent increases in operational errors
- Maintaining momentum in addressing pilot training and fatigue
- Advancing risk-based oversight of repair stations and aircraft manufacturers
- Enhancing air carrier collaboration and making domestic code share arrangements more transparent to consumers
- Implementing Airline Safety and FAA Extension Act of 2010 requirements

IDENTIFYING AND ADDRESSING THE CAUSES OF RECENT INCREASES IN OPERATIONAL ERRORS A top priority for FAA is to accurately count and identify trends that contribute to operational errors—events where controllers fail to maintain safe separation between aircraft. FAA statistics indicate that between fiscal years 2009 and 2010, operational errors increased by 53 percent, from 1,234 to 1,887. However, it is unclear whether this reported increase is due to more operational errors being committed or to improved reporting.

According to FAA, the Air Traffic Safety Action Program[4] has encouraged controllers to report operational errors. However, our ongoing work shows that a number of other factors may also be contributing to increases in reported operational errors. These include the lack of a baseline of the true number of errors and a new automated system for detecting losses of aircraft separation near airports.[5] FAA is in the early stages of implementing the System Risk Event Rate tool, which is designed to track and evaluate system-wide risk when aircraft fly closer together than separation standards permit. Implementing systems and processes that capture accurate and complete data is critical for FAA to determine the true magnitude of operational errors, assess their potential safety impacts, identify their root causes, and develop actions to effectively address and mitigate them.

MAINTAINING MOMENTUM IN ADDRESSING PILOT TRAINING AND FATIGUE The February 2009 fatal crash of Colgan Air flight 3407 underscores the importance of addressing longstanding concerns about pilot training and fatigue. In January 2009, FAA issued a Notice of Proposed Rulemaking (NPRM) revising crew training requirements to incorporate more realistic training scenarios, use flight simulators, and work with new special hazard practices for pilots and crew members. Extensive industry comments on the proposed rule prompted FAA to issue a Supplemental Notice of Proposed Rulemaking (SNPRM) in May 2011 to address the comments. The revised proposal requires ground and flight training to teach pilots how to recognize and recover from stalls, as well as remedial training for pilots who perform poorly in training. Congress gave FAA until October 1, 2011, to issue a final rule; however, FAA has yet to complete this action.

FAA also published a NPRM in September 2010 that, if adopted, would significantly change existing flight, duty, and rest regulations for commercial carriers by basing them on scientific factors—such as time of day flown and sleep considerations—rather than on type of flight operations. However, it will be difficult for FAA to address this issue or finalize new rest rules given the significant opposition the proposed rule faces from the aviation industry. In addition, the NPRM does not impose requirements on carriers to track pilot domicile or commuting factors that can contribute to fatigue even though many pilots reside hundreds or thousands of miles from their assigned duty locations. As part of its investigation into the 2009 Colgan Air accident, NTSB concluded that both pilots were impaired because of fatigue and that both had commuted hundreds of miles before the flight. Following the crash, and at the request of Congress, the National Academy of Sciences completed a study noting that there were not enough available data to determine the role commuting plays in contributing to fatigue or whether commuting should be regulated. While FAA's proposed rules could significantly enhance pilot training and fatigue programs, our work shows that FAA still faces challenges tracking pilots with poor performance and training deficiencies, overseeing air carrier programs aimed at improving pilot skills, and improving its awareness of the extent of pilot commuting and fatigue within the air carrier industry.

ADVANCING RISK-BASED OVERSIGHT OF REPAIR STATIONS AND AIRCRAFT MANUFACTURERS

According to FAA, there are over 4,800 FAA-certified repair stations worldwide that perform maintenance for U.S. air carriers. Since 2003, we have repeatedly highlighted weaknesses in FAA's oversight of aircraft repair stations, such as the need for FAA to target its surveillance to those facilities with the greatest risks. FAA implemented a new risk-based system for repair stations in 2007, which we are currently reviewing. In addition, our criminal investigations have identified significant improprieties by repair station personnel. For example, our investigation of an FAA-approved repair station led to the sentencing of the president, owner, and chief inspector for having made false representations to a customer concerning the calibration of a tool used in repairing and certifying the airworthiness of turbine parts. We also investigated a former FAA-licensed mechanic, who was found guilty by a Federal jury for fraudulently altering the historical service record for helicopter blades he sold to obscure that the blades had been rejected and should have been scrapped. In another investigation, two FAA-certificated employees at a repair station were sentenced for making false statements in connection with repairs made to helicopter drive train components and for improperly performing required inspections of helicopters. Given air carriers' increasing reliance on repair stations, it is imperative that FAA provide more rigorous oversight of this industry.

FAA's oversight of aircraft manufacturers also remains a concern—due primarily to weaknesses in its Organization Designation Authorization (ODA) program and Risk-Based Resource Targeting (RBRT) system. FAA created ODA in 2005 to standardize its oversight of organizational designees—organizations that supplement FAA's safety inspector and engineer workforce.[6] However, FAA has not adequately trained engineers on their new enforcement responsibilities under ODA, and some FAA certification offices have not effectively tracked or addressed poorly performing ODA personnel. In addition, ODA significantly reduced FAA's role in approving individuals who perform work on FAA's behalf. FAA's implementation of RBRT—a system for identifying higher risk aircraft certification projects—has not been effective for measuring risk and directing FAA engineers' oversight efforts to high-risk projects because it relies on subjective input from engineers, does not contain detailed data, and has experienced repeated technical difficulties. In response to these findings, which we reported in June 2011,[7] FAA is working to establish and improve ODA and RBRT policy, training, and tools to ensure that ODA organizations comply with safety requirements and that the Agency targets its limited engineering resources to the highest risk projects.

It is also critical that FAA place its approximately 4,300 aviation safety inspectors where they are most needed. A 2006 National Research Council study conducted at the direction of Congress concluded that FAA's methodology for allocating inspector resources was ineffective and recommended that FAA develop a new approach.[8] In response, FAA completed a new staffing model in October 2009. While FAA used the model to assist in preparing its fiscal year 2012 budget request, it must further refine this tool so that it more effectively allocates inspector resources.

ENHANCING AIR CARRIER COLLABORATION AND MAKING DOMESTIC CODE SHARE ARRANGEMENTS TRANSPARENT TO CONSUMERS To meet passenger demands, major and regional air carriers use domestic code share agreements—a marketing arrangement in which one air carrier sells and issues tickets for another carrier's flight. While such agreements can reduce carrier costs and enhance customer service, FAA faces several challenges in ensuring code share partners work together to improve safety programs. Likewise the Office of the Secretary (OST) could improve transparency of code sharing for consumers. FAA's 2009 Call to Action plan for airline safety encourages mainline and regional carriers to address a wide range of safety and operating concerns, including code sharing issues. While some progress has been made, FAA has not issued guidance to operators involved in these arrangements to encourage safety collaboration. Oversight of code share a greements is also important to ensure that they do not have unintended consequences that could impact the margin of safety, such as the inclusion of financial incentives and penalties for performance that may be counter to safety efforts.

IMPLEMENTING AIRLINE SAFETY AND FAA EXTENSION ACT OF 2010 REQUIREMENTS In August 2010, Congress enacted the Airline Safety and FAA Extension Act, which contains measures intended to improve safety and address longstanding pilot concerns, such as fatigue, training, and professionalism. In addition to mandating completion dates for pilot training and fatigue rules, the law requires mentoring programs and a more focused FAA approach to increase air carriers' adoption of voluntary safety programs. FAA is also required to establish and maintain a database of pilot performance records from FAA, prior employers, and the National Driver Register that air carriers must access and review during the pilot hiring process. Continued management attention will be needed to ensure these safety improvements are implemented in a timely and effective manner.

RELATED PRODUCTS The following related reports and testimonies can be found on the OIG Web site at **www.oig.dot.gov**.

- Progress and Challenges With FAA's Call to Action for Airline Safety, February 4, 2010
- Letter to Senator Claire McCaskill Regarding FAA's Progress in Implementing Past OIG Recommendations To Improve Oversight of Outsourced Maintenance, January 11, 2010
- Air Carriers' Outsourcing of Aircraft Maintenance, September 30, 2008
- Review of Air Carriers' Use of Aircraft Repair Stations, July 8, 2003
- FAA Needs To Strengthen Its Risk Assessment and Oversight Approach for Organization Designation Authorization and Risk-Based Resource Targeting Programs, June 29, 2011
- FAA and Industry Are Taking Actions To Address Pilot Fatigue but More Information on Pilot Commuting Is Needed, September 12, 2011

CHAPTER 2 FOOTNOTES

4 A voluntary, non-punitive safety reporting program approved by the Administrator in September 2009.

5 In January 2008, FAA began implementing the Traffic Analysis and Review Program, which automatically identifies when operational errors or other losses of separation between aircraft occur at terminal facilities.

6 Organizational designees are aircraft manufacturers and other companies that FAA has approved to perform certain functions on its behalf, such as determining compliance with aircraft certification regulations. The organization is responsible for overseeing the employees who perform the delegated functions.

7 OIG Report Number AV-2011-136, "FAA Needs To Strengthen Its Risk Assessment and Oversight Approach for Organization Designation Authorization and Risk-Based Resource Targeting Programs," June 29, 2011.

8 National Research Council Report: "Staffing Standards for Aviation Safety Inspectors," September 20, 2006.

CHAPTER 3

ENSURING EFFECTIVE OVERSIGHT OF HAZARDOUS LIQUID AND NATURAL GAS PIPELINE SAFETY

The Nation's aging oil and gas pipeline infrastructure is vulnerable to ruptures caused by corrosion and other pipe defects. In 2010, a 54-year old gas pipeline in San Bruno, California, exploded, killing 8 people and destroying 38 homes. In the same year, a leaking pipeline spilled nearly a million gallons of crude oil into a tributary of the Kalamazoo River in southwest Michigan. In July 2011, a pipeline under the Yellowstone River in Montana ruptured and leaked hundreds of barrels of oil. Given the significant safety, environmental, and economic consequences of such accidents, it is critical that the Pipeline and Hazardous Material Safety Administration (PHMSA) effectively oversee pipeline operators and ensure that states carry out their pipeline safety responsibilities.

KEY CHALLENGES

- Strengthening pipeline operators' integrity management programs
- Ensuring state pipeline safety partners effectively execute their pipeline safety responsibilities
- Addressing human factors in pipeline control rooms
- Facilitating the successful implementation of the Secretary's Call to Action

STRENGTHENING PIPELINE OPERATORS' INTEGRITY MANAGEMENT PROGRAMS Federal regulations require that pipeline operators develop Integrity Management (IM) programs, which include conducting inspections, identifying and repairing defects, and continually evaluating risks to pipeline integrity. Over the last decade, effective IM programs have become a key component of PHMSA's national strategy to improve pipeline safety and reduce pipeline accidents—especially in densely populated or environmentally sensitive areas. According to PHMSA, this program has resulted in the discovery and repair of almost 40,000 anomalies that later could have resulted in accidents. PHMSA or its state partners regulate and inspect these IM programs. Despite PHMSA's efforts to oversee and strengthen operator IM programs, there has not been an appreciable reduction in significant IM-detectable hazardous liquid pipeline accidents[9] in high-consequence areas.

The National Transportation Safety Board's (NTSB) recent investigation of the San Bruno accident raises a number of concerns regarding Federal and state oversight of gas pipeline operators' IM programs. Specifically, NTSB recommended that PHMSA expand the use of meaningful IM metrics; revamp its inspection protocols to validate operator IM data; ensure pipeline operators' leak, failure, and incident data are incorporated into their risk models; and establish performance goals for operators.

While PHMSA has several efforts underway to enhance its IM inspection program, such as focusing on the quality and number of field visits, the Agency faces challenges in accomplishing these improvements while meeting its other inspection activities. These include inspecting pipeline construction, control room management, gas IM, and other programs.

ENSURING STATE PIPELINE SAFETY PARTNERS EFFECTIVELY EXECUTE THEIR PIPELINE SAFETY RESPONSIBILITIES Under PHMSA's statutory authority, states are allowed to assume all or part of the regulatory and enforcement responsibility for intrastate hazardous liquid and natural gas pipelines. Most states have supported the concept of common stewardship in pipeline safety.[10] According to PHMSA, this cooperative relationship between the Federal Government and states forms the cornerstone of the Nation's pipeline safety program. State pipeline safety regulators currently oversee about 90 percent of the 2.5 million miles of our Nation's pipeline infrastructure. PHMSA distributes Federal grant funds to encourage states to take on more responsibility for overseeing pipeline safety and to improve states' program performance. These grants increased from $19.5 million in 2008 to $30.2 million in 2010.

Despite these investments, the San Bruno explosion and other recent accidents call into question the effectiveness of states' oversight of pipeline operators as well as PHMSA's monitoring of state oversight programs. In its August 2011 investigation report on the San Bruno accident, NTSB[11] cited the California Public Utilities Commission for failure to detect inadequacies in the Pacific Gas and Electric Company's IM program. The report also cited weaknesses in how PHMSA monitored state oversight programs—a longstanding NTSB concern. One such weakness is the lack of meaningful metrics that allow PHMSA to assess the effectiveness of state oversight programs. These weaknesses undermine PHMSA's efforts to ensure that states fully execute their responsibilities. Effective PHMSA oversight is particularly critical given the expansion of Federal pipeline safety initiatives in recent years, with corresponding increases in state oversight responsibilities in high-risk areas. The latest initiative—implementing the Distribution Integrity Management Program—went into effect February 12, 2010. Under this initiative, which originated from our 2004 recommendation, states will be responsible for overseeing more than 1,400 operators of local gas distribution systems—where the highest rates of pipeline-related fatalities and injuries occur—as they establish IM programs. Operators were given until August 2, 2011, to develop and implement their programs.

ADDRESSING HUMAN FACTORS IN PIPELINE CONTROL ROOMS A 2005 NTSB study found that some aspects of an operator's pipeline control system influenced the severity of 10 of 13 hazardous liquid pipeline accidents. In many cases, the problems were aggravated when controllers monitoring the systems failed to quickly recognize and respond to leaks. For example, controllers in Michigan misdiagnosed Supervisory Control and Data Acquisition (SCADA)[12] alarms and chose to ignore them, continuing the flow of product into the Kalamazoo River. Pacific Gas and Electric's SCADA systems were not sufficient to quickly identify the location of the failure. In each of these incidents, the consequences of the accidents were exacerbated because controllers failed to implement procedures to quickly shut down the flow of product in the pipelines.

In December 2009, PHMSA issued a rule requiring operators that use SCADA systems to develop and implement control room management procedures by February 2013. However, the Agency moved the implementation timeframe up by 16 months, to October 2011, for most of the required procedures due to growing concerns about operator control room management. As with operator IM programs, the challenge for PHMSA will be ensuring operators develop and implement effective control room management procedures, while also meeting its current oversight priorities.

FACILITATING THE SUCCESSFUL IMPLEMENTATION OF THE SECRETARY'S CALL TO ACTION In response to several recent serious pipeline accidents in 2010 and 2011, Secretary LaHood issued a "Call to Action" for improving pipeline safety. In doing so, the Secretary and the PHMSA Administrator challenged the pipeline industry and key regulatory agencies—including the Federal Energy Regulatory Commission, the National Association of Regulatory and Utility Commissioners, and state public utility commissions—to increase efforts to identify and repair or replace high-risk pipelines. Of particular concern are pipelines constructed with cast iron, bare steel, and other material that may have a higher risk of leaking or exploding. Moreover, in support of the Secretary's initiative, PHMSA convened a pipeline safety forum, issued additional pipeline safety guidance, and requested that Congress increase the maximum civil penalties for pipeline violations.

However, achieving the Secretary's Call to Action will not be easy. First, PHMSA lacks the authority to require operators to accelerate the repair or replacement of high-risk pipelines. Second, PHMSA relies heavily on its state pipeline safety partners to oversee much of this work. Third, PHMSA must rely on key Federal and state regulatory agencies that play important roles in achieving the Secretary's program. Given this limited authority and the sizable resources needed to achieve the Call to Action, the Secretary and PHMSA will be significantly challenged to ensure corrective steps are taken and that high-risk pipelines no longer pose a threat.

RELATED PRODUCTS The following related reports and testimonies can be found on the OIG Web site at **www.oig.dot.gov**.

- Pipeline Safety: Progress and Remaining Challenges, March 16, 2006
- Integrity Threats to Hazardous Liquid Pipelines, September 18, 2006
- Notification of Reviews of PHMSA's Oversight of Pipeline Safety, October 27, 2010

CHAPTER 3 FOOTNOTES

9 PHMSA defines "IM-detectable" as significant incidents that are caused by internal corrosion, pipe seam welds, and other factors that are potentially detectable by integrity assessments under the hazardous liquid IM rule.

10 All states, except Alaska and Hawaii, have assumed oversight and enforcement responsibilities over intrastate natural gas pipelines, with nine states acting as PHMSA's agents overseeing safety of interstate natural gas pipelines. Fifteen states have assumed safety oversight and enforcement of the intrastate hazardous liquid pipelines, with 6 states acting as PHMSA's agents overseeing safety of interstate hazardous liquid pipelines.

11 NTSB Pipeline Accident Report NTSB/PAR-11/01; "Pacific Gas and Electric Company Natural Gas Transmission Pipeline Rupture and Fire, San Bruno, California, September 9, 2010;" August 30, 2011.

12 SCADA systems collect real-time data from pipeline sensors and display it to controllers, who in turn can react to abnormal or emergency situations by remotely operating pipeline pumps and valves.

CHAPTER 4

ENSURING EFFECTIVE OVERSIGHT OF ARRA PROJECTS AND APPLYING RELATED LESSONS LEARNED TO IMPROVE DOT'S INFRASTRUCTURE PROGRAMS

The American Recovery and Reinvestment Act (ARRA) infused more than $48 billion for transportation infrastructure projects, including high-dollar and complex projects. Many projects are still under construction and require vigilant oversight. At the same time, the Department may have significantly less Federal funding available to address growing demands, including addressing the Nation's aging surface infrastructure. The American Society of Civil Engineers graded both the Nation's road and transit infrastructures as "D-" and "D," respectively.[13] Using lessons learned from the oversight of ARRA infrastructure investments, the Department can stretch Federal dollars by keeping projects within budget; on schedule; and free from fraud, waste, and abuse.

KEY CHALLENGES

- Maximizing the return on highway and transit investments by improving use of oversight mechanisms
- Strengthening financial oversight of grantees through Single Audits and detecting improper payments
- Providing vigilant oversight of the Transportation Investment Generating Economic Recovery (TIGER) Program to ensure effective execution of grants
- Preventing and detecting transportation fraud through proactive measures

MAXIMIZING THE RETURN ON HIGHWAY AND TRANSIT INVESTMENTS BY IMPROVING USE OF OVERSIGHT MECHANISMS The Federal Highway Administration (FHWA) and the Federal Transit Administration (FTA) have taken significant actions to improve oversight of highway and transit projects but remain challenged to ensure ARRA funds are appropriately spent and maximize the return on limited Federal dollars. FHWA is responsible for overseeing more than half of DOT's ARRA funds, which have been obligated to over 13,000 highway projects. As of August 2011, FHWA reported that almost 70 percent of these projects were completed with 78 percent of ARRA funds expended. FTA received a smaller amount of ARRA funds but has directed these funds to a number of major projects.

To oversee these expenditures FHWA has taken several actions, such as using National Review Teams (NRT), enhancing programs for monitoring states' oversight of local public agency (LPA) projects, and updating the policy requiring Value Engineering (VE) studies. However, FHWA faces significant challenges in carrying out these actions. First, FHWA must monitor states' efforts to address management weaknesses identified during NRT reviews to ensure effective oversight of both ARRA and non-ARRA projects and more rigorously analyze NRT results to better understand emerging risks. Second, FHWA has yet to enhance states' LPA programs or adequately address the associated risks, which impact both ARRA and non-ARRA projects. These risks include a lack of state resources to adequately oversee LPAs and insufficient LPA resources for administering contracts and assessing quality, noncompliance with Federal labor requirements, and improper processing of contract changes. FHWA must follow through on promised actions, such as establishing uniform procedures and criteria for Division Offices to use when assessing states' ability to ensure LPAs meet Federal requirements. Finally, FHWA has not completed its update of the VE regulations, as required by Congress more than 5 years ago.[14] FHWA plans to publish its final rule on VE requirements by the end of 2011. Opportunities to improve project performance, cost, and quality may be lost for ARRA and non-ARRA projects if FHWA fails to ensure states conduct VE studies.

FTA has a large portfolio of major projects in New York City—some of which received ARRA funds—that require sustained management attention to prevent further cost increases or schedule delays. For example, after experiencing significant cost increases and years of schedule delays on FTA's $1.4 billion Fulton Street project, increased project oversight, risk assessments, and robust recovery plans have prevented additional cost increases and delays. However, years of complex work remain, and FTA will need to sustain a high level of oversight to mitigate risks.

STRENGTHENING FINANCIAL OVERSIGHT OF GRANTEES THROUGH SINGLE AUDITS AND DETECTING IMPROPER PAYMENTS We continue to identify vulnerabilities in DOT Operating Administrations' financial oversight of ARRA grantees and their compliance with the Office of Management and Budget's (OMB) ARRA accountability requirements. For example, FAA's approach to Airport Improvement Program (AIP) grant oversight is inadequate to effectively prevent or detect improper payments. While FAA took several actions to increase oversight of AIP grantees—including adding technical expertise and conducting site visits—a national consulting firm FAA hired to test its controls over ARRA grants determined that 14 of 24 ARRA-recipient airports did not meet FAA requirements to have adequate documentation to justify their ARRA payment requests.

Full compliance with OMB's Single Audit[15] requirements would help the Department and its Operating Administrations prevent or detect improper payments.[16] Since May 2010, we have issued 135 Single Audit action memorandums on deficiencies in grantees' procedures or in their operations in overseeing ARRA funds, such as improper reporting and inadequate monitoring of subrecipients. Our ongoing audit of DOT's implementation of Single Audit recommendations found that for some grantees, Operating Administrations frequently issued late or incomplete management decisions on Single Audit findings, failed to include evaluations of grantees' corrective action plans, and did not confirm that grantees implemented corrective actions. Our evaluation of DOT Operating Administrations' tracking systems for identifying grantees with unresolved findings and problematic Single Audit histories determined that the tracking systems at FHWA, FAA, and the National Highway Traffic Safety Administration were ineffective. The Federal Railroad Administration (FRA) did not have a tracking system.

PROVIDING VIGILANT OVERSIGHT OF THE TIGER PROGRAM TO ENSURE EFFECTIVE EXECUTION OF GRANTS

In February 2010, the Office of the Secretary (OST) awarded $1.5 billion in ARRA funding for TIGER discretionary grants to 51 recipients across the Nation. These multimodal surface transportation projects are expected to support economic recovery. As of September 2, 2011, 14 percent of these funds had been expended. Congress provided additional $528 million in fiscal year 2010 and $527 million in fiscal year 2011 non-ARRA funds for the TIGER Discretionary Grant Program. The additional and continued funding of discretionary grants underscores the need for strong oversight controls.

OST relies heavily on four Operating Administrations—FHWA, FTA, FRA, and the Maritime Administration (MARAD)—to carry out the program and ensure recipients meet ARRA requirements. OST and these Operating Administrations must coordinate to oversee TIGER program performance and ensure efficient use of the ARRA funds. While FHWA and FTA have longstanding procedures in place to administer grant programs, FRA and MARAD are still developing their capabilities. In addition, OST and DOT Operating Administrations must have sound mechanisms to track and monitor individual projects. Such mechanisms include consistent and accurate reports from grantees, current program risk assessments, and performance measures to assess whether projects are meeting program goals. OST needs to ensure effective oversight of ARRA-funded TIGER projects because the policies and procedures established in the initial TIGER program will serve as the model for managing non-ARRA TIGER projects.

PREVENTING AND DETECTING TRANSPORTATION FRAUD THROUGH PROACTIVE MEASURES ARRA funding and significant construction activity emphasize the need for DOT and our office to continue to aggressively pursue counter-fraud efforts so that limited Federal dollars are not wasted. Our office has worked with DOT to deter fraud schemes through ongoing outreach, targeted assessments of projects with fraud risk indicators, and investigations of criminal and civil complaints. As of August 2011 we have 59 open ARRA investigations (see table 4-1)—46 of which the Department of Justice is reviewing for potential prosecution. These investigations illustrate the need for DOT to take action to deter fraudulent activity on all DOT-funded projects.

TABLE 4-1. OPEN INVESTIGATIONS INTO ALLEGATIONS OF ARRA FRAUD, BY OPERATING ADMINISTRATION, AS OF AUGUST 31, 2011

ALLEGATION	FHWA	FAA	FTA	DOT	MARAD
False Statements, Claims, Certifications	18	2	2	1	1
Anti-Trust Violations, Bid Rigging, Collusion	4	1	1	0	0
Disadvantaged Business Enterprise Fraud	11	4	2	0	0
Conflict of Interest	0	0	0	0	0
Embezzlement	0	0	1	0	0
Prevailing Wage Violations	7	0	1	0	0
Other	0	0	0	0	0
Kickbacks	0	0	0	0	0
Corruption[a]	1	1	0	0	0
ARRA Whistleblower	0	0	1	0	0
Total	**41**	**8**	**8**	**1**	**1**

Source: OIG
[a] This type of investigation involves allegedly dishonest or fraudulent conduct by individuals who are responsible for overseeing ARRA-funded projects.

DOT Operating Administrations' role in outreach is critical to ensuring recipients of Federal grants and contracts have meaningful ethics programs and sound internal controls. To date, our office has provided 291 fraud awareness and prevention presentations to over 20,000 DOT officials, state department of transportation officials, local transit authority staff, and aviation authorities. Another valuable tool in identifying and stopping fraud is the use of independent risk assessments. For example, we are examining whether some projects were intentionally underbid, allowing contractors to make up the lost revenues in fraudulent change orders and false claims. DOT's Operating Administrations could conduct similar analyses as part of their oversight activities.

RELATED PRODUCTS The following related reports, testimonies, and correspondence can be found on the OIG Web site at **www.oig.dot.gov**.

- New York City Fulton Street Transit Center: FTA's Sustained Focus on Key Risk Areas Will Be Needed Until the Project Is Completed, August 15, 2011
- Federal Highway Administration's Oversight of Federal-Aid and Recovery Act Projects Administered by Local Public Agencies Needs Strengthening, July 15, 2011
- Ensuring ARRA Funds Are Spent Appropriately To Maximize Program Goals, May 4, 2011
- FAA Fulfilled Most ARRA Requirements in Awarding Airport Grants, February 17, 2011
- Actions Needed To Strengthen the Federal Highway Administration's National Review Teams, January 6, 2011
- Improper Payments Identified in FAA's Airport Improvement Program, December 1, 2010

CHAPTER 4 FOOTNOTES

13 American Society of Civil Engineers, "2009 Report Card for America's Infrastructure," March 25, 2009.

14 The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59 (2005).

15 The Single Audit Act requires state or local grantees to maintain a system of internal control over Federal programs to demonstrate compliance with pertinent laws and regulations. Independent single audits are conducted annually, in accordance with OMB Circular A-133, to determine whether grantees are complying with these requirements.

16 An improper payment is any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes payment to an ineligible recipient, payment for an ineligible service, duplicate payments, payment for services not received, and payments that do not account for credit for applicable discounts. OMB instructs agencies to report payments for which insufficient or no documentation was found as improper payments.

CHAPTER 5

MANAGING THE NEXT GENERATION AIR TRANSPORTATION SYSTEM ADVANCEMENT WHILE CONTROLLING COSTS

The National Airspace System (NAS) handles almost 50,000 flights per day and more than 700 million passengers each year. To reduce congestion and meet airspace demands, the Federal Aviation Administration (FAA) is developing the Next Generation Air Transportation System (NextGen)—a multibillion-dollar program that is expected to move today's system, from ground-based to satellite-based air traffic management. NextGen is the most complex effort FAA has embarked on and will require investments from both the Government and the airline industry.

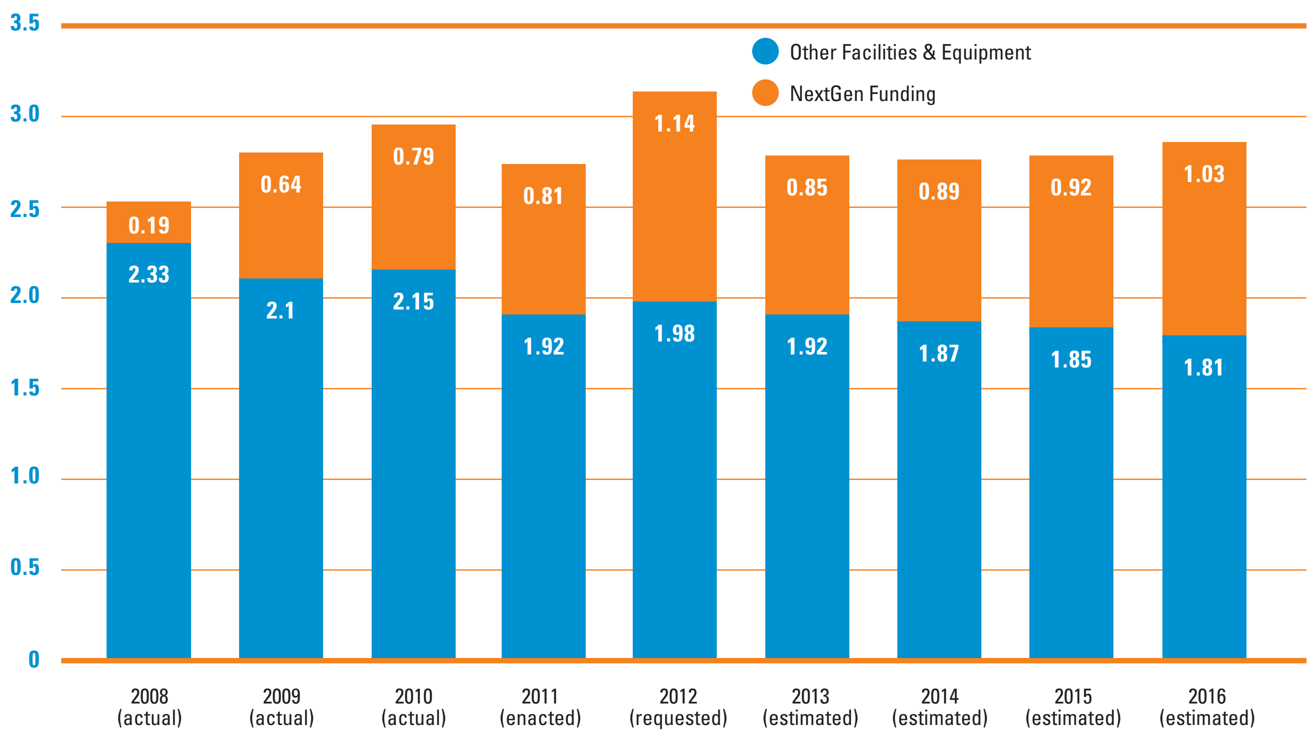
KEY CHALLENGES

- Setting realistic plans, budgets, and expectations for NextGen in a fiscally constrained environment
- Advancing NextGen's near-term goals and realizing benefits at already congested airports
- Resolving problems with the En Route Automation Modernization (ERAM) program that have cost and schedule implications for critical NextGen initiatives
- Completing an integrated master schedule for NextGen's transformational programs
- Controlling operating costs that could crowd out NextGen capital investments

Setting Realistic Plans, Budgets, and Expectations for NextGen in a Fiscally Constrained Environment The Department and FAA have struggled with defining NextGen and setting realistic expectations for what can reasonably be accomplished in the near, mid, and long term. FAA currently plans to spend almost $5 billion on all NextGen programs between fiscal years 2012 and 2016—a significant investment but billions less than FAA projected a year ago. The current constrained budget and problems with existing projects are forcing FAA to rethink its capital investments and NextGen priorities. Therefore, FAA will face challenges in sustaining existing projects and facilities while introducing new NextGen-related capabilities. Figure 5-1 illustrates FAA's current spending plans for its capital account.

FAA's most recent NextGen implementation plan provides a vision for NextGen in the 2015 to 2018 timeframe and broadly outlines linkages between FAA and stakeholder investments. However, FAA has yet to make critical decisions regarding (1) what new capabilities will reside in aircraft or in FAA's ground-based automation systems, (2) the level of automation for controllers that can realistically and safely be achieved, and (3) the number and locations of air traffic facilities needed to support NextGen. Finally, FAA has not identified clear goals for performance capabilities or metrics for NextGen initiatives.

FIGURE 5.1: FAA CAPITAL FUNDING FOR FISCAL YEARS 2008–2016, DOLLARS IN BILLIONS



ADVANCING NEXTGEN'S NEAR-TERM GOALS AND REALIZING BENEFITS AT ALREADY CONGESTED AIRPORTS While FAA is addressing recommendations from a Government-industry task force[17] on NextGen, most efforts are still in the planning, study, or design phases. In response to the task force's most critical recommendations, FAA launched its "metroplex" initiative—a 7-year effort to improve the flow of traffic and reduce delays at 21 congested airports in major metropolitan areas. FAA has completed studies[18] at 5 of the 21 metroplex locations and has 2 more sites underway. However, it has not established detailed milestones to complete initiatives at high-activity locations or a mechanism to integrate its metroplex initiative with other important initiatives, such as improving airport surface operations. As a result, airspace users are concerned about the pace and execution of the metroplex effort thus far as well as the lack of clearly defined expected benefits. FAA is working with industry to resolve these issues.

Enhancing capacity at already congested airports also depends on the timely deployment of more efficient flight procedures to alleviate congestion. However, as we noted in December 2010,[19] FAA's flight procedures have been mostly overlays of existing routes. Airlines advocate that FAA should develop procedures that achieve maximum benefits, such as shorter flight paths and fuel savings. FAA's metroplex initiative focuses primarily on adding area navigation (RNAV)[20] procedures and optimizing climb and descent profiles for existing routes. However, FAA's plans do not focus on the more advanced required navigation performance (RNP)[21] procedures to achieve maximum capacity enhancements.

RESOLVING PROBLEMS WITH THE ERAM PROGRAM THAT HAVE COST AND SCHEDULE IMPLICATIONS FOR CRITICAL NEXTGEN INITIATIVES FAA's long-term goals for NextGen depend on the successful implementation of the ERAM program—a $2.1 billion system for processing flight data. ERAM will replace all existing hardware and software at FAA's facilities that manage high-altitude traffic. FAA originally planned to complete ERAM by the end of 2010. However, ERAM continues to experience software-related problems that have pushed schedules well beyond original completion dates and increased costs by hundreds of millions of dollars. Although ERAM passed testing at FAA's Technical Center and was accepted by the Government,[22] testing at initial sites revealed significant software problems related to system core capabilities for safely managing and separating aircraft. These problems include errors that display incorrect flight data to controllers. FAA formally rebaselined the program in June 2011 and now plans to complete ERAM in 2014—a schedule slip of 4 years. FAA estimates that delays with ERAM will translate to an additional $330 million to complete deployment. However, if problems persist, the total cost growth could be as much as $500 million with potential delays stretching to 2016.

Delays with ERAM have required FAA to maintain aging systems longer, reprogram funds from other projects to cover the total cost overruns, and retrain controllers and maintenance technicians who must operate and maintain two different systems. Prolonged problems with ERAM will directly impact the overall cost and pace of NextGen. Without ERAM, the key benefits of several other programs, such as new satellite-based surveillance systems and data communications[23] for controllers and pilots, will not be possible.

COMPLETING AN INTEGRATED MASTER SCHEDULE FOR NEXTGEN'S TRANSFORMATIONAL PROGRAMS Between fiscal years 2012 and 2016, FAA plans to spend $2.3 billion on NextGen's six transformational programs,[24] including Automatic Dependent Surveillance-Broadcast (ADS-B), a new satellite-based system,[25] and System Wide Information Management (SWIM), a new information sharing system.However, FAA has not yet developed an integrated master schedule for implementing these programs or established total program costs, schedules, or performance baselines. In addition, the Agency has opted to approve these programs in shorter, more discrete segments to minimize risk. While FAA's approach of baselining smaller segments of larger programs may reduce risk in the short term, programs are left with no clear end-state, and decision makers in Congress and the Department lack sufficient information to assess progress as requirements continue to evolve. Moreover, the transformational programs have complex interdependencies and integration issues with automated systems that controllers rely on to manage traffic and FAA communications networks. Although FAA recognizes the need for an integrated master schedule to manage NextGen, it remains incomplete. Without a master schedule, FAA will continue to be challenged to assess progress with NextGen efforts, establish priorities, and make the necessary trade-offs between programs.

CONTROLLING OPERATING COSTS THAT COULD CROWD OUT NEXTGEN CAPITAL INVESTMENTS On October 1, 2009, FAA entered into a 3-year collective bargaining agreement with the National Air Traffic Controllers Association (NATCA). FAA estimated that the agreement with NATCA would cost the Agency $669 million more than it would have cost to extend the work rules established in 2006 for 3 more years. However, costs have exceeded estimates, in part because fewer veteran controllers retired than anticipated. With fewer newly hired controllers—whose salaries and benefits are lower than veterans'—FAA's pay and benefits costs were $14 million higher than initially estimated for the first year of the contract.

FAA's negotiated memoranda of understanding (MOU) may also incur additional costs. FAA has had problems managing its MOUs in the past, resulting in millions of dollars in cost overruns. While FAA has established controls that it believes will prevent additional costs with MOUs associated with the 2009 agreement, some local air traffic managers and regional managers are not fully complying with these controls. It is critical that FAA consider these issues as well as its budgetary constraints when negotiating its next collective bargaining agreement—especially since these uncontained increases in operating costs could crowd out capital investments.

RELATED PRODUCTS The following related reports and testimonies can be found on the OIG Web site at **www.oig.dot.gov**.

- FAA Oversight Is Key for Contractor-Owned Air Traffic Control Systems That Are Not Certified, August 4, 2011
- FAA's Approach to SWIM Has Led to Cost and Schedule Uncertainty and No Clear Path for Achieving NextGen Goals, June 15, 2011
- FAA Needs To Strengthen Controls Over the 2009 FAA/NATCA Collective Bargaining Agreement, June 9, 2011
- FAA Must Improve Its Controller Training Metrics To Help Identify Program Needs, March 30, 2011
- FAA Needs To Implement More Efficient Performance-Based Navigation Procedures and Clarify the Role of Third Parties, December 10, 2010
- FAA Faces Significant Risks in Implementing the Automatic Dependent Surveillance – Broadcast Program and Realizing Benefits, October 12, 2010

CHAPTER 5 FOOTNOTES

17 NextGen Mid-Term Implementation Task Force Report, September 9, 2009.

18 FAA is using a two-phased approach to metroplex using study and design and implementation teams at each site.

19 OIG Report Number AV-2011-025, "FAA Needs To Implement More Efficient Performance-Based Navigation Procedures and Clarify the Role of Third Parties," December 10, 2010.

20 RNAV is a method of navigation in which aircraft use avionics, such as global positioning systems, to fly any desired flight path without the limitations imposed by ground-based navigation systems.

21 RNP is a form of RNAV that adds on-board monitoring and alerting capabilities for pilots, thereby allowing aircraft to fly more precise flight paths.

22 Government acceptance (GA) of ERAM by the FAA Technical Center requires meeting specific criteria established for the project baseline. These criteria include successfully completing developmental testing activities per the Statement of Work, listing all problem trouble reports, demonstrating that all contractual requirements are satisfied, and completing both functional and physical configuration audits. At GA, the Government (i.e., FAA and ERAM) assumes full responsibility of the system.

23 Data Communications (DataComm) will provide comprehensive data connectivity, including ground automation message generation and receipt, message routing and transmission, and aircraft avionics requirements.

24 FAA's NextGen Transformational Programs are Automatic Dependent Surveillance-Broadcast, Collaborative Air Traffic Management-Technologies, System Wide Information Management, DataComm, NextGen Network Enabled Weather, and NAS Voice Systems.

25 ADS-B offers surveillance, like radar, but with more precision. ADS-B provides air traffic controllers and pilots with more accurate information to help keep aircraft safely separated in the sky and on runways.

CHAPTER 6

MANAGING DOT ACQUISITIONS IN A MORE STRATEGIC MANNER TO MAXIMIZE LIMITED RESOURCES AND ACHIEVE BETTER MISSION RESULTS

In fiscal year 2010, the Department obligated approximately $5.8 billion on contracts for goods and services to build and support a transportation system that meets vital national interests.[26] Our audits continue to find weaknesses in how DOT plans, administers, and oversees its contracts and manages its acquisition workforce, resulting in missed opportunities for improving program performance and saving millions in taxpayer dollars. Severe budget constraints emphasize the need for DOT to approach acquisitions in a more strategic manner.

KEY CHALLENGES

- Strengthening DOT's acquisition functions and planning processes to manage acquisitions more strategically
- Equipping DOT to perform effective management oversight of its acquisitions
- Strengthening the acquisition workforce to manage DOT's contracts for goods and services
- Maintaining programs to help ensure high ethical standards among DOT's contractors, employees, and grant recipients

STRENGTHENING DOT'S ACQUISITION FUNCTIONS AND PLANNING PROCESSES TO MANAGE ACQUISITIONS MORE STRATEGICALLY The Office of the Secretary of Transportation (OST) and DOT Operating Administrations have not implemented an effective acquisition and planning framework—an essential element for achieving mission results. A key concern is that DOT's acquisition leaders and contracting officers do not have enough input into program planning and decision making to help ensure that the billions of dollars DOT spends on contracting each year are cost effective and tied to mission success.

OST's organizational structure diminishes the Senior Procurement Executive's (SPE) ability to effectively lead acquisition initiatives or play a significant role in the Department's senior management. Specifically, DOT's SPE reports to the Deputy Chief Acquisition Officer (CAO)—not directly to the CAO as envisioned by major acquisition reform legislation.[27] At the same time, the Office of the Senior Procurement Executive's (OSPE) strategic plan does not link its goals to DOT's strategic plan and therefore fails to place OSPE's work in a long-term strategic context. A challenge for DOT will be ensuring that the momentum created by its recently reestablished Strategic Acquisition Council is focused and fully leveraged to ensure the Department's acquisitions contribute to the success of its mission.

Similarly, organizational weaknesses within DOT Operating Administrations' acquisition functions hinder their ability to serve a strategic role in carrying out agency missions. For example, in 2010 we reported[28] that the Federal Motor Carrier Safety Administration (FMCSA) lacks the organizational alignment and leadership needed for an effective acquisition function. FMCSA's program officials viewed the acquisition function as administrative support rather than as a strategic partner for implementing the Agency's mission. Such deficiencies contribute to FMCSA's poor contracting award, administration, and oversight practices and challenge its ability to manage its contracts.

DOT also faces challenges in effectively planning its acquisitions, a critical part of the procurement process. For example, in 2011, we reported that the Federal Aviation Administration's (FAA) lack of planning in awarding sole-source, noncompetitive contract actions—which accounted for $541 million in fiscal year 2009 obligations—provided little assurance that prices were consistently fair and reasonable for the contracts we reviewed. In 2010, we similarly reported that because FAA did not take fundamental acquisition planning steps to properly design and execute its Air Traffic Controller Optimum Training Solution (ATCOTS) Program, acquisition contract costs and fees exceeded baseline estimates by 35 percent in the first year of the contract—from $81 million to $109 million.

A lack of planning to inform DOT's selection of contract type and resources needed to manage the chosen contract has also created risks. For example, DOT has used cost-plus award fee contracts without sufficient knowledge of their appropriateness for specific requirements. While these contracts can provide incentives to spur innovation and reduce costs, they require greater agency effort to document contractor performance and mitigate cost risks to the Government. In 2010, we estimated that DOT paid over $140 million in fees on these types of contracts without properly justifying their cost-effectiveness. Acquisition planning deficiencies have also created significant risk in FMCSA's contracts. FMCSA spends about 40 percent of its procurement dollars on contract types that tie contractor profits to the number of hours worked—an arrangement that imposes the risk of cost overruns on the Government.[29]

To ensure effective stewardship of taxpayer dollars, DOT needs to elevate the importance of its acquisition function and focus on improving its acquisition planning. OST has begun steps to strengthen its acquisition function, but the challenge is institutionalizing procurement reforms across the Department.

EQUIPPING DOT TO PERFORM EFFECTIVE MANAGEMENT OVERSIGHT OF ITS ACQUISITIONS Weaknesses in DOT's contract oversight and surveillance also limit its ability to achieve desired contract results and save taxpayer dollars. For example, during the first year of its $859 million ATCOTS contract, FAA authorized payment for 11 invoices totaling $45 million without verifying whether the services billed were actually provided. Weaknesses in FAA's oversight of its En Route Automation and Modernization program contract also led to poor contract outcomes. For example, FAA lacked acquisition assessments to verify whether contractor performance baselines were achievable, did not implement Earned Value Management[30] processes capable of identifying schedule and cost variances that plagued the program, relied on untrained technical representatives at a key implementation site, and accepted developmental software without sufficient testing to ensure it would successfully interface with existing systems at field locations. As a result, numerous errors during software implementation resulted in increased costs and schedule delays.

A lack of an effective workforce and reliable data underlie many of these weaknesses. DOT has not developed adequate training for performance monitors and other personnel involved in the award-fee process and has not ensured adequate separation of duties in evaluating contractor performance and awarding fees.[31] Poor data systems also undermine DOT's efforts to manage its acquisitions in the short and long term. Roughly one-third of OST's fiscal year 2008 and 2009 data in the Government-wide procurement information system[32] were inaccurate due to a lack of management controls. In some cases, DOT Operating Administrations cannot accurately account for all of their active contracts. For example, FAA cannot accurately account for its noncompetitive contract awards because of insufficient internal controls and its failure to fully implement Office of Management and Budget requirements that it have a contract writing system capable of electronically transferring its procurement data directly to the Government-wide procurement information system.

Oversight weaknesses compounded by poor acquisition data management systems hinder DOT's ability to strategically manage its contracts and contract spending, meet reporting and transparency requirements, and ensure the billions of dollars it spends on contracting each year are used efficiently and effectively. Sustained focus on developing reliable information and data management systems will position DOT to conduct more strategic acquisitions.

STRENGTHENING THE ACQUISITION WORKFORCE TO MANAGE DOT'S CONTRACTS FOR GOODS AND SERVICES

DOT relies on its acquisition workforce to negotiate and administer thousands of complex contracts valued at over $5 billion annually to ensure they provide maximum value and benefit to the Department. However, DOT has not made sufficient progress in implementing the strategies and goals in its Acquisition Workforce Strategic Human Capital Plan to increase the capability of the acquisition workforce through fiscal year 2014. To fulfill its procurement and contracting functions, it is critical that DOT adequately staff and train its acquisition workforce.

Between fiscal years 2008 and 2018, the percentage of DOT's contracting employees eligible to retire will more than triple to 63 percent—a rate about 10 percent higher than the average for civilian agencies. OST has been challenged in strengthening its acquisition workforce and needs to sustain recent improvements in this area. During the October 2009 to July 2010 timeframe, OSPE's attrition was almost 30 percent higher than the average attrition rate of the other offices that make up the Office of the Assistant Secretary for Administration.[33] DOT Operating Administrations also face challenges in strengthening their acquisition workforces. For example, FMCSA's April 2009 acquisition workforce succession plan found it lacked enough employees to carry out its duties and responsibilities. We found these weaknesses in FMCSA's acquisition workforce contributed to the poor contracting practices we reported in 2010.

Similarly, gaps in FAA's staff hiring and development processes contributed to poor contract administration—and substantial cost overruns—on critical FAA programs. FAA's billion-dollar Next Generation Air Transportation System program significantly increased FAA's acquisition workload and will require new skills and additional resources to ensure best value contracts. While FAA reported it met 99 percent of its overall acquisition workforce hiring target for fiscal year 2009, the percentage is misleading because three of its seven Air Traffic Organizations exceeded their overall hiring targets, while the remaining four fell short. Further, neither its 2009 nor its 2010 Acquisition Workforce Plan included contractor and Federal staff that perform acquisition functions. FAA's lack of adherence to its workforce plan—combined with inaccurate hiring data—suggests additional controls are needed to ensure it has a fully staffed acquisition workforce to smartly manage its contracts for goods and services, which totaled $3.7 billion in fiscal year 2010.

Addressing workforce challenges will help the Department provide the vision and direction necessary to have a strategic acquisition function and ensure planned improvements are sustainable.

MAINTAINING PROGRAMS TO HELP ENSURE HIGH ETHICAL STANDARDS AMONG THE DEPARTMENT'S CONTRACTORS, EMPLOYEES, AND GRANT RECIPIENTS

Our audits and investigations identified the need for more vigilant oversight to detect and prevent procurement and grant fraud, waste, and abuse within DOT and among its fund recipients. Grant and procurement fraud cases currently comprise about 50 percent of active OIG investigations. Between October 2010 and July 2011, procurement and grant fraud investigations resulted in 36 indictments, 22 convictions, and $239 million in recoveries. For example, in June 2011 top-level officials of a New York City area Disadvantaged and Minority Business Enterprise (DBE) pled guilty to using a "front" company on projects that received DOT grant funds, knowing their company lacked the required labor, equipment, and financial resources. Similarly, in 2011, Skanska USA Civil Northeast, Inc. paid $9.8 million each to the U.S. DOT and the New York Metropolitan Transit Authority as settlement for claims that it had engaged in DBE fraud since 1997.

In 2010 we reported and testified to Congress that DOT's ability to safeguard against awarding contracts and grants to improper parties was limited by delays in its suspension and debarment (S&D) decisions and reporting. Deficiencies in DOT's S&D policies, procedures, and internal controls compounded these risks. While DOT and FAA have initiated several actions in response to our recommendations—such as revising their S&D policies to require timely action on S&D decisions—sustained focus and demonstrated progress in this area are still needed. Until DOT fully implements an efficient and effective S&D Program, it will continue to risk awarding contracts and grants to parties that have been suspended or debarred. An additional challenge facing DOT is maximizing the protections of its S&D program for fund recipients. For example, our ongoing audit of FHWA's oversight of state contracting practices for projects funded by the American Recovery and Reinvestment Act (ARRA) has identified opportunities for FHWA to strengthen division office controls to ensure states do not make awards to improper parties. DOT's oversight of over $40 billion in ARRA funds heightens the importance of safeguarding against awarding funds to those with a record of wrongdoing and abuse.

RELATED PRODUCTS The following related reports, testimonies, and advisories can be found on the OIG Web site at **www.oig.dot.gov**.

- FAA Policies and Plans Are Insufficient To Ensure an Adequate and Effective Acquisition Workforce, August 3, 2011
- Weaknesses in the Office of the Secretary's Acquisition Function Limit Its Capacity To Support DOT's Mission, May 25, 2011
- FAA Must Strengthen Its Cost and Price Analysis Processes To Prevent Overpaying for Noncompetitive Contracts, May 19, 2011
- FAA's Air Traffic Controller Optimum Training Solution Program: Sound Contract Management Practices Are Needed To Achieve Program Outcomes, September 30 2010
- Improvements in Cost-Plus-Award-Fee Processes Are Needed To Ensure Millions Paid in Fees Are Justified, August 25, 2010

- Federal Motor Carrier Safety Administration Lacks Core Elements for a Successful Acquisition Function, August 24, 2010
- Weaknesses in DOT's Suspension and Debarment Program Limit Its Protection of Government Funds, March 18, 2010
- DOT's Suspension and Debarment Program Does Not Safeguard Against Awards to Improper Parties, January 7, 2010

CHAPTER 6 FOOTNOTES

26 DOT's fiscal year 2011 data were not available at the time of this report.

27 Service Acquisition Reform Act of 2003, Public Law 108-136, Section 1421(c).

28 OIG Report Number ZA-2010-093, "Federal Motor Carrier Safety Administration Lacks Core Elements for Successful Acquisition Function," August 24, 2010.

29 These include Time and Materials and Labor Hour contracts, as defined in Federal Acquisition Regulation Part 16. Government-wide, these types of contracts comprise only about 5 percent of agency contract dollars.

30 Earned Value Management (EVM) is a project management technique that combines measurements of scope, schedule, and cost in a single integrated system for measuring project performance and progress in an objective manner.

31 FAA has since established responsibilities for its evaluation team that prohibited the same official from performing multiple duties.

32 Federal Procurement Data System-Next Generation

33 In particular, the Office of the Senior Procurement Executive (OSPE) previously had several senior management vacancies which hindered the effectiveness of OSPE's acquisition function. Based on OIG recommendations, the OSPE has permanently filled the Chief of Contracting Office (COCO) position and anticipates filling the FPDS-NG Administrator position by March 30, 2012.

CHAPTER 7

IMPROVING THE DEPARTMENT'S CYBER SECURITY

In this year alone, computer hackers have placed a number of major entities at risk, including the Central Intelligence Agency and Google. DOT's operations rely on more than 400 information systems—nearly two-thirds of which belong to the Federal Aviation Administration (FAA). These systems represent an annual investment of approximately $3 billion. To protect these systems from increasingly aggressive and technically proficient cybercriminals, the Department is working to incorporate new technologies and meet the Administration's cyber security goals.

KEY CHALLENGES

- Establishing a robust information security program
- Strengthening air traffic control system protections
- Increasing protection of personally identifiable information (PII)
- Creating an effective Department-wide enterprise architecture(EA) program

ESTABLISHING A ROBUST INFORMATION SECURITY PROGRAM Last year, we reported that the Department's information security program did not meet key Office of Management and Budget (OMB) and Federal Information Security Management Act (FISMA) requirements to establish an information security program to protect agency information and systems. As a result, DOT declared its information security deficiencies a material weakness in its annual assurance statement, as required by the Federal Managers' Financial Integrity Act (FMFIA).

DOT made limited progress toward correcting these weaknesses during fiscal year 2011, and security deficiencies still exist in key control areas. These include management of information security weaknesses, contingency planning, software configuration, system controls testing, and network user accounts. To build a strong information security program, the Department must continue to address these deficiencies in a sustainable and flexible manner so it can quickly adapt to and avert new cyber threats.

The Department's Office of the Chief Information Officer (OCIO) could do more to guide and oversee DOT Operating Administrations in building and sustaining strong information security practices. In 2011, OCIO revamped its information security policy for all Operating Administrations except the Office of the Secretary (OST). The next steps for OCIO are to finalize the OST policy and issue Department-wide procedural guidance. In addition, OCIO needs to improve its quality assurance reviews of modal cyber security efforts and assess the use of technology to facilitate timely management of the Department's cyber security. At present, the Department does not have central, automated systems to enable the timely assessment of its information security program. Until OCIO can better guide and oversee Operating Administrations' information security, the Department cannot verify that its policy is properly implemented or deploy automated tools to quickly and continuously monitor its cyber security state.

STRENGTHENING AIR TRAFFIC CONTROL SYSTEM PROTECTIONS FAA's planned Next Generation Air Transportation System (NextGen) relies on a number of new technologies to achieve its goals—which may introduce significant cyber security risks. For example, NextGen's use of satellite-based surveillance technologies to provide precise aircraft tracking makes some DOT agencies vulnerable to certain types of cyber attack. To efficiently facilitate air traffic control services, NextGen also relies on the use of Internet Protocol-based commercial products and web applications, which are inherently more vulnerable to security risks than proprietary software.[34] In addition, FAA is outsourcing more of its operations to contractors. NextGen's Automatic Dependent Surveillance-Broadcast system is the first operational air traffic control system to be owned and operated by a contractor. Because FAA only owns the data, not the system, it may have little control over security challenges that could arise.

A separate OIG report of the FAA's Air Traffic Control System addressed FAA's mission-support network and identified weaknesses, including an information disclosure vulnerability, inadequate system patch levels, unsupported operating systems, improper network configurations, and communication system vulnerabilities.

As FAA develops NextGen, it must continue to protect its current air traffic control and related systems, located at hundreds of operational facilities.

INCREASING PROTECTION OF PERSONALLY IDENTIFIABLE INFORMATION To safeguard against PII breaches, OMB requires agencies to reduce the volume of information collected and maintained, restrict access, and implement other security controls such as encryption to prevent unauthorized access. The main goal of information security management is to protect the confidentiality, availability, and integrity of information, of which PII is a critical piece. As such, nearly any weakness in security controls on systems containing PII increases the risk of sensitive data being exposed. Failure to properly protect PII for unauthorized uses would be detrimental to the Department's mission and credibility.

In fiscal year 2011, the Department provided plans for reducing PII and the use of Social Security numbers and is still working to establish the required privacy protections. Although the Department is committed to providing privacy protections by securing personally identifiable information, the associated reductions in the volume of PII will not be complete until 2013.

Our ongoing audit of the United States Merchant Marine Academy's (USMMA) network identified and exploited a critical vulnerability providing full access to the network, including databases containing sensitive midshipmen information. While USMMA corrected this identified vulnerability, we also identified numerous internal administrative and technical control deficiencies that continue to place staff and midshipmen PII at risk of unauthorized access.

CREATING AN EFFECTIVE DEPARTMENT-WIDE ENTERPRISE ARCHITECTURE PROGRAM An agency's EA program is necessary to assist management in understanding its current technology infrastructure, defining what its future infrastructure should be to accomplish its mission, and developing a plan to transition from the current to the future infrastructure. This process should incorporate the necessary planning and related spending to ensure that information systems remain protected at all times. Despite its $48 million investment and years of effort, DOT has no program to establish a Department-wide EA and relies on each Operating Administration to develop its own EA. Therefore, the Department has only limited oversight in this area. In response to an OMB request, the Department recently began efforts to plan for the development a DOT-wide EA. However, until OCIO can better guide and oversee Operating Administrations' EA programs, the Department cannot verify that security controls are properly considered in acquisition of new technology or identify information technology redundancies that exist or may occur as a result of the absence of this program.

RELATED PRODUCTS The following related reports can be found on the OIG Web site at **www.oig.dot.gov**.

- Quality Control Review on the Vulnerability Assessment of FAA's Operational Air Traffic Control System, April 15, 2011
- Timely Actions Needed To Improve DOT's Cyber Security, November 15, 2010
- ARRA Websites Vulnerable to Hackers and Carry Security Risks, October 22, 2010

CHAPTER 7 FOOTNOTES

34 Internet Protocol is a system of digital message formats and rules for exchanging messages over the internet. It is used in conjunction with a separate protocol to enable the sending of messages between a source and a destination over the Internet.

CHAPTER 8

DEFINING CLEAR GOALS TO GUIDE THE FEDERAL RAILROAD ADMINISTRATION IN ITS TRANSFORMATION

The 2008 Rail Safety Improvement Act (RSIA) and Passenger Rail Investment and Improvement Act (PRIIA) dramatically realigned and expanded the Federal Railroad Administration's (FRA) roles and responsibilities. In addition, the American Recovery and Reinvestment Act (ARRA) infused an unprecedented amount of new capital into new passenger rail programs and drastically accelerated timeframes for implementation. However, 3 years later, FRA has yet to establish specific goals to guide its transformation and measure progress.

KEY CHALLENGES

- Completing a National Rail Plan with clearly defined national goals and roles for stakeholders in the vision for intercity passenger rail
- Balancing and prioritizing resources to address responsibilities by using established goals for measuring program performance

COMPLETING A NATIONAL RAIL PLAN WITH CLEARLY DEFINED NATIONAL GOALS AND ROLES FOR STAKEHOLDERS IN THE VISION FOR INTERCITY PASSENGER RAIL FRA has yet to complete a long-range National Rail Plan as required by PRIIA. A complete rail plan—one that is consistent with approved state plans—would provide a blueprint for an efficient national system of passenger and freight rail corridors. While FRA has issued a Preliminary National Rail Plan and Progress Report—in October 2009 and September 2010, respectively—neither defines specific goals to guide states' intercity passenger rail planning and encourage private sector support of state programs. Instead, they include broad themes and potential goals, such as establishing community connections in areas where population densities and competitive trip times create strong high-speed and intercity passenger rail markets. Even to achieve these broad goals, however, states need criteria for identifying population densities and trip times.

At the same time, the roles various stakeholders will play in intercity passenger rail remain unclear. Although FRA's progress report states that successfully implementing high-speed intercity passenger rail requires participation from a number of industry stakeholders—from equipment manufacturers to service operators—it does not specify what their roles will be. Rail industry stakeholders have expressed optimism about increased public investment in intercity passenger rail, but without a complete National Rail Plan there is uncertainty about how effectively private stakeholders can participate in the intercity passenger rail market.

BALANCING AND PRIORITIZING RESOURCES TO ADDRESS RESPONSIBILITIES BY USING ESTABLISHED GOALS FOR MEASURING PROGRAM PERFORMANCE
FRA has been challenged to implement PRIIA and RSIA requirements and tasks while continuing to carry out its traditional responsibilities. According to FRA officials, delays in finalizing certain rulemakings, policies, and procedures—including many associated with the High Speed Intercity Passenger Rail program (HSIPR)—are primarily due to the Agency's need to focus on safety, FRA's top priority. Safety initiatives, including rulemakings, have had first claim on FRA resources.

Consequently, as of August 2011 FRA had obligated $7.4 billion to 102 projects without final guidance or regulations for application procedures and qualification requirements. Although FRA has developed interim guidance that describes possible factors for the evaluation of applications—such as organizational capacity, thoroughness of management plans, and reasonableness of project completion schedules—these factors are largely qualitative, which make it difficult to compare potential benefits across project proposals. The interim guidance also lacks information on how the factors should be weighted, increasing the subjectivity of the evaluation process. Without more quantitative metrics and specific grant-related regulations, FRA cannot be sure that its award decisions are based on sound ridership and revenue forecasts, public benefits valuations, and operating cost estimates. Moreover, it cannot ensure that its investments are based on competing projects' relative value.

According to FRA staff, the lack of a complete National Rail Plan has also delayed FRA's efforts to develop a schedule for achieving specific, measurable performance goals that include estimated funds and staff resources needed to accomplish each goal. PRIIA requires FRA to submit the schedule to Congress with the President's budget each fiscal year starting with fiscal year 2010, along with an assessment of progress towards achieving the performance goals. Completing the schedule could provide the basis for FRA to prioritize its ongoing and outstanding responsibilities, such as completing policies and procedures related to HSIPR; help allocate resources to accomplish the work planned; and report on progress.

RELATED PRODUCTS The following related reports and testimonies can be found on the OIG Web site at **www.oig.dot.gov**.

- Federal Railroad Administration Progress Implementing the Passenger Rail Investment and Improvement Act, September 14, 2011
- The Federal Railroad Administration Faces Challenges in Carrying Out Expanded Role, April 29, 2010
- DOT's Implementation of the American Recovery and Reinvestment Act: Continued Management Attention Is Needed To Address Oversight Vulnerabilities, November 30, 2009
- American Recovery and Reinvestment Act of 2009: Oversight Challenges Facing the Department of Transportation, March 31, 2009

CHAPTER 9

UTILIZING DEPARTMENT CREDIT PROGRAMS TO LEVERAGE LIMITED FEDERAL TRANSPORTATION INFRASTRUCTURE RESOURCES

The National Surface Transportation Infrastructure Financing Commission[35] estimates that nearly $100 billion in Federal investments is needed annually to preserve and enhance our Nation's surface transportation infrastructure. However, the Highway Trust Fund (HTF) typically devotes less than $45 billion per year on roadways and transit systems. In recent years, HTF receipts have fallen significantly short of HTF outlays, further straining the Nation's ability to meet its increasing surface transportation infrastructure needs. Given the current fiscal environment, it is critical that the Department maximize the effectiveness of its credit programs and expand the use of innovative financing techniques such as public private partnerships (PPP), where appropriate, to ensure the viability of our surface transportation infrastructure.

KEY CHALLENGES

- Increasing participation in credit programs with significant excess capacity
- Expanding the capacity of credit programs that are oversubscribed

INCREASING PARTICIPATION IN CREDIT PROGRAMS WITH SIGNIFICANT EXCESS CAPACITY To date, only a small percentage of authorized funds for the Department's Railroad Rehabilitation and Infrastructure Financing (RRIF), Title XI Federal Ship Financing (Title XI), and Tax-Exempt Private Activity Bond (PAB) credit programs[36] have been utilized. The significant excess lending capacity of these programs could help finance surface transportation infrastructure improvements.

Since RRIF was established in 1998, the Federal Railroad Administration (FRA) has made loans to railroads totaling approximately $1.6 billion—roughly 4.5 percent of RRIF's total authorization of $35 billion. Application costs and lengthy application review periods appear to contribute to RRIF's underutilization. Historically, loan recipients have had to pay a credit risk premium (CRP),[37] ranging between 2 percent and 8 percent of total loan value.[38] In addition, applications can take as long as 14 months to process.

The Title XI Loan Guarantee Program (Title XI), established in 1936, currently has over $60 million in appropriations available that can be leveraged as much as twentyfold to guarantee up to an additional $1.2 billion in loans.[39] However, the program has a history of borrowers defaulting on their loans. Specifically, between February 1998 and April 2002, five Title XI borrowers defaulted on nine loan guarantees totaling roughly $490 million. Between fiscal years 2008 and 2010, an additional six borrowers defaulted on loan guarantees totaling $305 million. After our 2003 and 2004 reports outlined concerns about potential increases in defaults due to program administration weaknesses, Congress cut off program funding from fiscal year 2003 through fiscal year 2007. In 2010 and 2011, Congress provided only $5 million for new loan guarantees. In December 2010, following up on the Maritime Administration's (MARAD) implementation of our recommendations arising from the prior audits, we raised continued concerns regarding MARAD's oversight and monitoring of the Title XI program.

The Department's PAB obligations total $15 billion, but only $2.2 billion in bonds have been issued to date, with an additional $2.4 billion approved but not yet issued. Even though the opportunity for low-cost, tax-exempt financing under the PAB credit program is intended to increase private sector investment in transportation infrastructure projects, demand for PAB financing remains relatively low for surface transportation projects. As with RRIF, the cost associated with issuing PABs may be contributing to the program's underutilization. PAB borrowers have to pay underwriting fees averaging just under 0.6 percent of the total bond issuance proceeds.[40] PABs are also subject to the Alternative Minimum Tax, which makes them less attractive to municipal bond investors because the interest income they receive through PABs may in some circumstances be taxable.

Reducing the application timeline for RRIF and properly monitoring the Title XI program could result in expanding the use of these programs and further leverage Federal support of surface transportation infrastructure projects.

EXPANDING CAPACITY OF CREDIT PROGRAMS THAT ARE OVERSUBSCRIBED The Transportation Infrastructure Finance and Innovation Act (TIFIA) credit program, established in 1998, uses innovative financing mechanisms to provide loans, loan guarantees, and lines of credit to support surface transportation projects, making them more appealing to private investors. Unlike the Department's other credit programs, TIFIA funds infrastructure projects across surface transportation modes, including highways, transit, railroads, intermodal freight, and port access. TIFIA received an annual appropriation of $122 million—as authorized by the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users. Unlike other programs, such as RRIF, the Department has used these funds to pay 100 percent of the CRP—the most significant component of the application cost—associated with TIFIA financing. To date, TIFIA has provided credit assistance totaling $8.3 billion for 22 highway and transit projects through 21 loans and 1 loan guarantee and has provided funding for projects totaling $30.7 billion. Additionally, beginning in fiscal year 2008, the total credit requests have exceeded the program's available annual CRP appropriation. Presently, TIFIA has a backlog of 34 applications for projects totaling $48.2 billion.

Recognizing the significant demand for TIFIA, both the House and Senate versions of the next surface transportation authorization propose an increase in TIFIA's annual CRP appropriation to $1 billion from the current $122 million. Furthermore, regulations[41] permit the Department to accept a fee from applicants to reduce the CRP associated with their projects. This would allow the Department to expand the breadth of the program by shifting a portion of the CRP expense to borrowers. However, doing so would increase the need for upfront capital, which may deter certain applicants. Increasing TIFIA's program capacity could also strain the administrative resources to monitor and manage the program.

TIFIA provides a platform that combines PPPs with a number of other Federal and state funding sources in a manner that makes PPPs more financially attractive to private investors. TIFIA's ability to leverage Federal spending[42] makes it a powerful tool for channeling future Federal investment in the Nation's surface transportation infrastructure.

RELATED PRODUCTS The following related reports and testimonies can be found on the OIG Web site at **www.oig.dot.gov.**

- Financial Analysis of Transportation Related Public Private Partnerships, July 28, 2011
- Title XI Loan Guarantee Program: Actions Are Needed To Fully Address OIG's Recommendations, December 7, 2010
- Letter to Senate Budget Committee Ranking Member Gregg Regarding DOT's Projections of Highway Trust Fund Solvency, June 24, 2009
- Growth in Highway Construction and Maintenance Costs, September 26, 2007
- Report on Highway Administrations Oversight of Load Ratings and Postings on Structurally Deficient Bridges on the National Highway System, March 21, 2006
- Title XI Loan Guarantee Program, September 28, 2004
- Title XI Loan Guarantee Program, March 27, 2003

CHAPTER 9 FOOTNOTES

35 Paying Our Way: A New Framework for Transportation Finance, Report of the National Surface Transportation Infrastructure Financing Commission, February 26, 2009.

36 RRIF provides direct Federal loans and loan guarantees to finance the development of railroad infrastructure; Title XI provides loan guarantees to promote the growth and modernization of the U.S. merchant marine fleet and U.S. shipyards; and PABs authorize state and local government authorities to issue bonds on behalf of private entities that will invest the proceeds of the bond issue in highway and freight transfer infrastructure projects.

37 CRP equals the net present value of expected losses due to default, delinquency, or prepayment. The CRP is based primarily on two factors: the financial viability of the applicant and the value of the collateral provided to secure the debt.

38 The average RRIF loan to date is approximately $53 million.

39 Under the Federal Credit Reform Act of 1990, the Title XI program must have funds on hand for each loan guarantee it issues equal to the estimated long-term cost of that guarantee to the Federal Government if the borrower defaults. Because the Maritime Administration estimated this loan loss reserve to approximate 5 percent, the program's current authorized balance of $62.2 million would support loans of $1.24 billion ($62.2 million ÷ 5 percent).

40 The average PAB amount to date is approximately $565 million.

41 In any given year, if there is insufficient budget authority to fund the credit instrument for a qualified project that has been selected to received assistance under TIFIA, 49 CFR 80.17 permits the Department and approved applicant to agree upon a supplemental fee to be paid by the applicant to reduce the CRP associated with that project.

42 Every Federal dollar spent under the program could provide up to $10 in TIFIA credit assistance and be leveraged into $30 in transportation infrastructure investment.

COMPARISON OF FISCAL YEAR 2012 AND 2011 TOP MANAGEMENT CHALLENGES

FISCAL YEAR 2012 CHALLENGES	FISCAL YEAR 2011 CHALLENGES
Enhancing DOT's Oversight of Highway, Bridge, and Transit Safety	Maintaining Momentum in the Department's Oversight of Highway, Motor Vehicle, Hazardous Materials, and Transit Safety
Ensuring Effective Oversight on Key Initiatives That Can Improve Aviation Safety	Maintaining Momentum in Addressing Human Factors and Improving Safety Oversight of the Aviation Industry
Ensuring Effective Oversight of Hazardous Liquid and Natural Gas Pipeline Safety	Improving the Department's Oversight of Highway, Transit, and Pipeline Infrastructure
Ensuring Effective Oversight of ARRA Projects and Applying Related Lessons Learned To Improve DOT's Infrastructure Programs	Ensuring Transparency and Accountability in the Department's Recovery Act Programs Improving the Department's Oversight of Highway, Transit, and Pipeline Infrastructure
Managing the Next Generation Air Transportation System Advancement While Controlling Costs	Advancing the Next Generation Air Transportation System While Ensuring the Safe and Efficient Operation of the National Airspace System
Managing DOT Acquisitions in a More Strategic Manner To Maximize Limited Resources and Achieve Better Mission Results	Implementing Processes To Improve the Department's Acquisitions and Contract Management
Improving the Department's Cyber Security	Improving the Department's Cyber Security
Defining Clear Goals To Guide the Federal Railroad Administration in Its Transformation	Transforming the Federal Railroad Administration To Address Significantly Expanded Oversight Responsibilities
Utilizing Department Credit Programs To Leverage Limited Federal Transportation Infrastructure Resources	Identifying Sufficient Funding Sources To Support Future Federal Investment in Surface Transportation Infrastructure

MEMORANDUM

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

Subject: Action: Management Response to OIG Draft Report on Top Management Challenges

From: Christopher P. Bertram
Assistant Secretary for Budget and Programs,
and Chief Financial Officer

November 2, 2011

To: Calvin L. Scovel
Inspector General

Reply to
Attn of:

The Department has strengthened its processes for reviewing and responding to Office of Inspector General (OIG) reports to ensure that findings are carefully reviewed, differences are identified, and commonalities addressed so that policies are effectively developed, programs produce positive and meaningful results, and taxpayer funds are invested wisely. Thanks to this process, management has had an opportunity to weigh in on most of the issues identified in the OIG's report as top management challenges. Similarly, because we have effective systems and communicate thoroughly and regularly with the OIG, there are no surprises here. We are particularly pleased to note that this year, the OIG report cites not only the findings from its reporting, but also recognizes the actions taken by management to address challenges throughout the Department.

Transportation safety is our absolute priority. The Department's efforts are broad in scope from new approaches to optimizing the use of safety inspectors by the Federal Aviation Administration to ensuring that the Federal Highway Administration has sound processes for working with states to identify bridges in need of attention. We are working to ensure the Pipeline and Hazardous Materials Safety Administration has effective policies and procedures for guiding its workforce and operating with its state partners. This Administration is also working to provide a more effective system to provide consistent oversight for rail transit systems that makes best use of state and Federal resources as described in pending legislation. These efforts are guided by the common theme of making the transport of people and goods, so vital to this Nation's economy, as safe as is humanly possible.

Ensuring that every dollar spent on airports, roads, and transit is used to the maximum benefit of the taxpayer is also a top priority. While it has always been a priority to ensure that Federal funds are used wisely, the need to make every dollar count in these challenging economic times is more important than ever. We are strengthening procurement systems using comprehensive strategic intermodal approaches to build better, stronger, faster systems. FAA's efforts to keep its air traffic control system up to date, safe and efficient is a constant challenge that requires vigilant and judicious investment in its infrastructure.

The Department has also taken on the difficult challenge of bringing high speed intercity passenger rail to the Nation at an accelerated timescale. While still early in the process, FRA has demonstrated its commitment to establishing and fulfilling clear investment criteria. Finally, we continue to innovate with new approaches to leveraging Federal investment in transportation infrastructure. The National Infrastructure Bank (I-Bank) is a particularly important new approach that can leverage Federal dollars and focus on investments of National and regional significance that often fall through the cracks between the traditional transportation programs. The I-Bank would encourage private, state, and local entities to invest capital in projects that are most critical to our economic progress. It would also base its investment decisions on clear analytical measures of performance, competing projects against each other to determine which would produce the greatest return for American taxpayers.

Gaining constructive input from the OIG's oversight is critical to our efforts across the Department. While the challenges identified in the OIG report are known and well recognized, solutions continue to evolve along with the world around us. The OIG's constructive insights, offered from an informed, yet arms-length perspective, provides important information that can be extremely useful to helping ensure that we are effective as possible.

IMPROPER PAYMENTS INFORMATION ACT (IPIA) REPORTING

As amended by IPERA

RISK ASSESSMENT

As part of the FY 2011 Improper Payments Review, conducted in compliance with the *Improper Payments Elimination and Recovery Act (IPERA)* and *OMB Circular A-123, Appendix C*, the Department of Transportation (DOT) performed a Programmatic Improper Payment Risk Assessment to determine which DOT Programs require a statistically valid extrapolated improper payment estimate.

DOT's Programmatic Improper Payment Risk Assessment leverages Departmental Assessable Unit (AU) Risk Profiles compiled as part of ongoing compliance with the Federal Managers Financial Integrity Act (FMFIA) of 1982.

While the Department incorporated all improper payment risk factors outlined in Part I of OMB Circular A-123, Appendix C, the following criteria, in combination with AU Risk Profiles, weighed heavily in determining which Programs required extrapolated estimates:

- Whether the program or activity reviewed is new to the agency
- The volume of payments made annually
- Whether payments or payment decisions are made outside of the agency, for example, by a State or local government, or a regional Federal office
- Results from prior improper payment work

The Department's AU Risk Profiles rate the various areas of internal control either "high," "medium," or "low." After assigning numerical values to the "high," "medium," and "low" risk ratings, DOT determined that programs with AU Risk Profiles that reported average internal control risk ratings of "low" or "medium" did not warrant additional review except for the following programs:

- Federal Highway Administration (FHWA) Federal-Aid Highway Program
- Federal Aviation Administration (FAA) Airport Improvement Program (AIP)
- Federal Transit Administration (FTA) Capital Investment Grants (CIG) Program
- Federal Transit Administration (FTA) Formula and Bus Grants Program

Although FHWA's Federal-Aid Highway Program consisted of numerous AU internal control risk averages with "low" or "medium" risk ratings, and the prior year improper payment estimate fell below 2.5%, the size of the Federal-Aid Highway Program resulted in prior year improper payment estimates in excess of $100 million. This "significant" rate of improper payments ($10 million and 2.5 percent of total program payments or $100 million regardless of error rate.) results in the requirement of a FY 2011 individual improper payment estimate.

In the case of FAA's Airport Improvement Program, none of FAA's numerous AU internal control risk averages identified a "high" level of internal control risk. However, the Department determined that the volume of payments made annually, approximately $4 billion for FAA AIP, coupled with the fact that federal funds within these programs are further administered outside the agency by local governments or airport sponsors, necessitated an individual improper payment estimate.

Likewise, although none of FTA's AU internal control risk averages identified a "high" level of internal control risk, the combination of a high volume of payments and externally administered payments, necessitated individual improper payment estimates.

Separately, AU Risk Profiles identified six programs as possessing a "high" level of internal control risk. However, the total outlays for these six programs amounted to less than $50 million. At a total outlay amount of $50 million, the identified programs would need to report an average minimum improper payment rate of 20% to achieve a nominal value of improper payments deemed "significant" by OMB.

Further, roughly 13% of the cumulative $50 million represent federal salary payments, exempt from improper payment review. In comparison to improper payment rates across the Federal Government, DOT determined that a 20% improper payment rate is highly unlikely and that these programs do not require individual improper payment estimates.

Lastly, DOT reviewed the Federal Railroad Administration's (FRA) High Speed Rail program and found that the program was 1) a program relatively new to the Department, 2) numerous payment decisions are made outside of the agency at the local level, and 3) the dollar amount of funds appropriated to the program, in excess of $10 billion, represents a significant portion of DOT grant funds.

However, a review of outlays revealed that less than 2.5% of program funds had been expended. Due to the low dollar amount of outlays, the High Speed Rail program would need to report a minimum improper payment rate of 4% to achieve a nominal value of improper payments deemed "significant" by OMB.

DOT determined that in light of the fact that the High Speed Rail is neither an entitlement program nor a formula grant program, it is unlikely that the High Speed Rail program would reach a 4% improper payment rate. For this reason, DOT excluded the High Speed Rail program from obtaining an extrapolated improper payment estimate in FY 2011. Moving forward, with further progress expected on projects within the FRA program, it is expected that the Department will require an extrapolated High Speed Rail improper payment estimate during the FY 2012 review.

STATISTICAL SAMPLING

In an effort to adhere to IPIA requirements, the Department engaged Deloitte & Touche, LLP to develop nationwide sampling plans, test sampled invoice line items for improprieties, and extrapolate nationwide improper payments estimates for the Department's major grant programs.

Similar to FY 2010, and in direct response to the Office of the Inspector General's (OIG) recommendations, the Department obtained all data extracts from a single source, DOT's financial system of record. Additionally, to ensure both sample validity and the accuracy of extrapolated programmatic improper payment estimates, the Department collaborated closely with OIG's IPIA statistician to develop sampling and extrapolation methodologies mutually agreed upon by both parties.

Samples for all reviewed grant programs are of sufficient size to yield an estimate with a minimum 90 percent confidence interval within 2.5 percentage points above and below the estimated percentage of erroneous payments, as prescribed by OMB. The following sections discuss the results of these efforts.

FHWA FEDERAL-AID HIGHWAY PROGRAM. The Department developed and executed a sampling methodology and test plan to review project payments and estimate the dollar amount of the Federal-aid Highway Planning and Construction Grant Program's improper payments. FHWA executed the nationwide testing program using FHWA division office personnel. The sample of tested line items originated from Federal disbursements to grantees within the twelve-month period April 1, 2010 through March 31, 2011.

The IPIA sampling methodology involved a risk-based multi-staged statistical approach that included the selection of 131 Federal disbursements totaling $706.1 million and 221 line items from supporting invoices totaling $466.1 million. The Department designed the sample to extrapolate a nationwide estimate of improper payments. While this sample provides an improper payment estimate for the Federal-Aid Highway Program as a whole, this sample does not support an estimate for individual states or territory grantees.

Improper payments totaling $125,962 were found within the sample. The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $450.3 million +/- $464.0 million. The estimated improper payment rate is 0.94% +/- 0.96%. This projection meets OMB's definition of significant improper payments ($10 million and 2.5 percent of total program payments or $100 million regardless of error rate).

FTA FORMULA GRANTS PROGRAM. FTA executed the nationwide testing program using contractor personnel. The sample of tested line items originated from Federal disbursements to grantees within the twelve-month period April 1, 2010 through March 31, 2011.

The IPIA sampling methodology involved a risk-based multi-staged statistical approach that included the selection of 48 Federal disbursements totaling $617.1 million and 69 line items from supporting invoices totaling $47.3 million. The Department designed the sample to extrapolate a nationwide estimate of improper payments. While this sample provides an improper payment estimate for the Formula Grants Program as a whole, this sample does not support an estimate for individual states or transit agencies.

Testing yielded no improper payments within the sample. The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $0.00 with no applicable confidence interval. Likewise, the estimated improper payment rate is 0.00% with no applicable confidence interval. This projection meets OMB's definition of significant improper payments ($10 million and 2.5 percent of total program payments or $100 million regardless of error rate).

FTA CAPITAL INVESTMENT GRANTS PROGRAM. FTA executed the nationwide testing program using contractor personnel. The sample of tested line items originated from Federal disbursements to grantees within the twelve-month period April 1, 2010 through March 31, 2011.

The IPIA sampling methodology involved a risk-based multi-staged statistical approach that included the selection of -38 Federal disbursements totaling $902.9 million and 59 line items from supporting invoices totaling $153.0 million. The Department designed the sample to extrapolate a nationwide estimate of improper payments. While this sample provides an improper payment estimate for the Capital Investment Grants Program as a whole, this sample does not support an estimate for individual states or transit agencies.

An improper payment for the amount of $153 was found in the sample. The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $9,797 +/- $16,117. The estimated improper payment rate is effectively 0.00% +/- 0.00%. This projection does not meet OMB's definition of significant improper payments ($10 million and 2.5 percent of total program payments or $100 million regardless of error rate).

FAA AIRPORT IMPROVEMENT PROGRAM (AIP). FAA executed the nationwide testing program using contractor personnel. The sample of tested line items originated from Federal disbursements to grantees within the twelve-month period April 1, 2010 through March 31, 2011.

The IPIA sampling methodology involved a multi-staged statistical approach that included the selection of 102 Federal disbursements totaling $175.9 million and 177 line items from supporting invoices totaling $41.2 million. The Department designed the sample to extrapolate a nationwide estimate of improper payments. While this sample provides an improper payment estimate for the Airport Improvement Program as a whole, this sample does not support an estimate for individual states or airport sponsors.

Improper payments totaling $13,814 were found in the sample. The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $34.6 million +/- $56.8 million. The estimated improper payment rate is 0.89% +/- 1.46%. This projection does not meet OMB's definition of significant improper payments ($10 million and 2.5 percent of total program payments or $100 million regardless of error rate).

CORRECTIVE ACTIONS

A. FHWA FEDERAL-AID HIGHWAY PROGRAM. Reported improper payments resulted from non-systemic administrative, clerical, and documentation errors. FHWA, in coordination with DOT's Office of Financial Management, will update and distribute a Best Practices Guide for grantees in an effort to work towards a reduced programmatic improper payment rate. Furthermore, FHWA will continue to review for improper payments within its FIRE Program which ensures all grantees, including grantees not selected within the IPIA sample, test for improper payments annually. Additionally, FHWA will advise grantees regarding the importance of proper documentation maintenance for programmatic reviews and audits.

FTA FORMULA GRANTS PROGRAM. Despite the lack of identified improper payments, FTA, in coordination with DOT's Office of Financial Management, will update and distribute a Best Practices Guide. Additionally, FTA will advise grantees regarding the importance of proper documentation maintenance for programmatic reviews/audits, and will continue to review grantee compliance with statutory/administrative requirements via its Triennial Review process.

FTA CAPITAL INVESTMENT GRANTS PROGRAM. The identified improper payment resulted from a non-systemic administrative/clerical error. FTA, in coordination with DOT's Office of Financial Management, will update and distribute a Best Practices Guide for grantees in an effort to maintain its low programmatic improper payment rate. Additionally, FTA will advise grantees regarding the importance of proper documentation maintenance for programmatic reviews and audits.

FAA AIRPORT IMPROVEMENT PROGRAM (AIP). Reported improper payments resulted from non-systemic administrative, and documentation errors. FAA, in coordination with DOT's Office of Financial Management, will update and distribute a Best Practices Guide for grantees in an effort to work towards a reduced programmatic improper payment rate. Additionally, FAA will advise grantees regarding the importance of proper documentation maintenance for programmatic reviews and audits.

B. FUND STEWARDSHIP. Although DOT identifies its four largest grant programs as susceptible to significant improper payments, none of these four programs reported significant rates of improper payments, as defined by OMB, in FY 2010 or FY 2011. In order to maintain these low rates of improper payments, DOT's Operating Administrations stress the importance of proper fund stewardship with its Grant recipients via various Grantee review programs.

Under its Financial Integrity Review and Evaluations (FIRE) program, FHWA subjects states and territories not selected as part of the IPIA sample to a similar billing review process. The FIRE program also incorporates reviews regarding various topics such as inactive projects, grant administration at the local level, and procurement at the local level using Federal funds. Additionally, FHWA incorporated improper payment training into its FY 2011 Financial Discipline Seminar, presented to all regional State and Territory Offices.

FTA utilizes both State Management Reviews and Triennial Reviews to ensure proper compliance with Federal Grant regulations. In addition to stressing proper financial oversight, FTA Grantee reviews delve into various topics such as legal compliance, technical compliance, and procurement processes at the State and local level.

FAA promotes proper fund stewardship through a grant and sponsor oversight process, continuous throughout the duration of the grant. FAA receives quarterly reports on each grant to assess sponsor performance under every grant agreement. On a broader level, FAA utilizes a risk-based approach that increases the level of review of sponsor documentation depending on the risk level of the Grantee and their prior performance.

TABLE 1A, IMPROPER PAYMENT REDUCTION OUTLOOK

PROGRAM	PY OUTLAYS (M)	PY IP%	PY IP$ (M)	CY OUTLAYS (M)	CY IP%	CY IP$ (M)	CY+1 EST. OUTLAYS (M)	CY+1 IP%
FHWA Highway Planning / Construction	$44187	1.40%	$616.8	$48142	0.94%	$450.3	$43552	0.75%
FAA Airport Improvement Program	$4024	0.03%	$1.3	$3906	0.89%	$34.6	$3613	0.75%
FTA Capital Investment Grants	$3251	0.00%	$0.0	$2421	0.00%	$0.0	$2037	0.25%
FTA Formula Grants Program	$8868	0.16%	$14.3	$8938	0.00%	$0.0	$9481	0.25%

TABLE 1A, IMPROPER PAYMENT REDUCTION OUTLOOK, CONTINUED

PROGRAM	CY+1 IP$ (M)	CY+2 EST. OUTLAYS (M)	CY+2 IP%	CY+2 IP$ (M)	CY+3 EST. OUTLAYS (M)	CY+3 IP%	CY+3 IP$ (M)
FHWA Highway Planning / Construction	$326.6	$48989	0.75%	$367.4	$52321	0.75%	$392.4
FAA Airport Improvement Program	$27.1	$3018	0.50%	$22.6	$2572	0.50%	$12.9
FTA Capital Investment Grants	$5.1	$1557	0.25%	$3.9	$1201	0.25%	$3.0
FTA Formula Grants Program	$23.7	$8823	0.25%	$22.1	$8433	0.25%	$21.1

TABLE 1B, EXTRAPOLATED FHWA OVERPAYMENT / UNDERPAYMENT PROGRAMMATIC ESTIMATE*

	IMPROPER PAYMENT $ (M)	IMPROPER PAYMENT %
Overpayment Estimate	$448.3	0.93%
Underpayment Estimate	$2.0	0.004%
Total Point Estimate	**$450.3**	**0.94%****

** No underpayments identified for FTA or FAA*

***Table accounts for rounded figures*

RECAPTURE OF IMPROPER PAYMENTS REPORTING.

DOT's Recovery Auditor, Horn and Associates, worked to both recover identified Departmental overpayments, and identify opportunities for Departmental payment process improvements. The Recovery Auditor, working closely with DOT's internal shared service provider, did not identify any systemic payment process weaknesses. Overpayments resulted from individual cases of duplicate payments due to human data entry errors, sales tax billing errors, and open credits on statements.

TABLE 2. PAYMENT RECAPTURE AUDIT REPORTING

PROGRAM OR ACTIVITY	DOT TOTAL
Type of Payment	**CONTRACTS AND GRANTS**
Amount Subject to Review for CY Reporting	$26.3 BILLION
Actual Amount Reviewed and Reported (CY)	$26.3 BILLION
Amount Identified for Recovery (CY)	$266,403
Amount Recovered (CY)	$152,980
% of Amount Recovered out of Amount Identified (CY)	57.4%
Amount Outstanding (CY)	$113,423
% of Amount Outstanding out of Amount Identified (CY)	42.6%
Amount Not Collect-able (CY)	$0
% of Amount Not Collectable out of Amount Identified (CY)	0.0%
Amounts Identified for Recovery (PY)	$961,178
Amount Recovered (PY)	$961,178
Cumulative Amounts Identified for Recovery (CY + PY)	$1,227,581
Cumulative Amounts Recovered (CY + PY)	$1,114,158
Cumulative Amounts Outstanding (CY + PY)	$113,423
Cumulative Amounts Not Collectable (CY + PY)	$0

TABLE 3. PAYMENT RECAPTURE AUDIT TARGETS

TYPE OF PAYMENT	CY AMOUNT IDENTIFIED	CY AMOUNT RECOVERED	CY RECOVERY RATE (AMOUNT RECOVERED /AMOUNT IDENTIFIED)	CY +1 RECOVERY RATE TARGET	CY + 2 RECOVERY RATE TARGET	CY + 3 RECOVERY RATE TARGET
Contract	$266,403	$152,980	57.4%	90.0%	92.5%	95%

TABLE 4. AGING OF OUTSTANDING OVERPAYMENTS

TYPE OF PAYMENT	CY AMOUNT OUTSTANDING (0–6 MONTHS)	CY AMOUNT OUTSTANDING (6 MONTHS–1 YEAR)	CY AMOUNT OUTSTANDING (OVER 1 YEAR)
N/A	$113,423	N/A	N/A

TABLE 5. DISPOSITION OF RECAPTURED FUNDS

TYPE OF PAYMENT	AGENCY EXPENSES TO ADMINISTER THE PROGRAM	PAYMENT RECAPTURE AUDITOR FEES	FINANCIAL MANAGEMENT IMPROVEMENT ACTIVITIES	ORIGINAL PURPOSE	OFFICE OF INSPECTOR GENERAL	RETURNED TO TREASURY
Contract	N/A	$0	N/A	$152,980	N/A	$0

TABLE 6. OVERPAYMENTS RECAPTURED OUTSIDE OF PAYMENT RECAPTURE AUDITS

AGENCY SOURCE	AMOUNT IDENTIFIED (CY)	AMOUNT RECOVERED (CY)	AMOUNT IDENTIFIED (PY)	AMOUNT RECOVERED (PY)	CUMULATIVE AMOUNT IDENTIFIED (CY+PY)	CUMULATIVE AMOUNT RECOVERED (CY+PY)
Post-Payment Review	$140,607	$0	$554,380	$332,328	$694,987	$332,328

A. TABLE 3 NOTES. DOT's Recovery Auditor completed its identification of overpayments in October, 2011, later than in years past. Recovery of overpayments also began in October, 2011, and DOT expects the current recovery rate of 57.4% to increase and mirror pas recovery rates in excess of 85.0%.

B. TABLE 6 NOTES. Overpayments identified during DOT's Post-Payment Improper Payment Review were identified in October 2011, after the fiscal year end. DOT is in the process of initiating the recovery of these payments.

In regards to overpayments identified, but not recovered, in the previous fiscal year, 98% of these payments are non-recoverable. These payments are non-recoverable, as they represent instances where the correct amount of Federal funds was disbursed to the correct recipient for an eligible expense, but identified as "improper" due to documentation or payment timing issues.

ACCOUNTABILITY.

DOT has implemented various Grantee review programs, as highlighted in PART III of this IPIA Reporting Details Section, to hold States and local agencies accountable for improper payments. All review programs stress the importance of reducing and recapturing improper payments, and focus on improper payments is now an ongoing concern, and not just an annual review exercise.

DOT's various Operating Administrations use a vast network of regional offices to ensure that the Department maintains regular communication with Grantees as well as State and local officials. Operating Administrations ensure that Grantees understand the purpose of Grant reviews during each step of the review process. This constant communication, along with the aid of Grantee staff, has allowed the Department to not only maintain a low rate of improper payments, but also achieve success in recapturing payments identified as both improper and recoverable.

AGENCY INFORMATION SYSTEMS AND OTHER INFRASTRUCTURE.

DOT currently possesses the internal controls, human capital, and information systems necessary to maintain improper payments levels at the targeted programmatic rates.

U.S. Department
of Transportation

Office of the Secretary of Transportation

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