U.S. Department of Transportation

AGENCY FINANCIAL REPORT

FISCAL YEAR 2012

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FOREWORD

FOREWORD

The United States Department of Transportation's (DOT or Department) Agency Financial Report (AFR) for fiscal year (FY) 2012 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 of the financial resources entrusted to us. Additionally, the report provides information about our performance as an organization, our achievements, initiatives, and 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 third year that the Department has prepared an AFR. The report provides readers with an overview of the Department's highest priorities, as well as our strengths and challenges.

The Department's FY 2012 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 including a new OMB requirement, the Schedule of Spending (SOS). The SOS presents an overview of how and where agencies are spending their money.

ANNUAL PERFORMANCE REPORT (APR) [AVAILABLE FEBRUARY 2013]

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 2012 summary of performance information will be found on page 16 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; and
- Improper Payments Information Act of 2002.

The reports will be available on the Department's website at: **http://www.dot.gov/budget.**

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 all statutory requirements, this material provides reliable and complete information on DOT's financial operations and performance for the fiscal year that ended September 30, 2012.

RAY LaHOOD

OVERVIEW OF FY 2012 FINANCIAL RESULTS

This report is presented together with our annual Performance Report that will be released in 2013. As we have for the past several years, I am very pleased that DOT again received an unqualified audit opinion on its financial statements.

Of note during 2012, DOT made significant progress in addressing an internal control weakness related to adequate monitoring of Undelivered Orders (UDOs). The UDOs are budget obligations that have not yet been fully liquidated by making a payment. The Department undertook major steps during the fourth quarter to review these transactions, confirm the validity of outstanding obligations, and correct balances that needed adjustment. In addition, to ensure the reliability of UDO reporting in the future, new Department-wide guidance concerning the periodic review of these balances will be implemented in early 2013.

Supported by the Department's successful financial performance, we made significant progress toward our strategic goals and objectives during 2012. Looking forward to the coming year, the Department will continue to lead in promoting safety and critical transportation investments that will strengthen our nation and help the economic recovery move forward.

STRATEGIC GOALS - In a time of great challenge and opportunity, the traveling public is calling for investment in all modes of transportation, and for policies that bring affordable housing closer to good schools and quality jobs. People from across the political spectrum recognize that our transportation system must become safer, more efficient, more outcome-based, more cost-effective, and more environmentally sustainable. To respond to these challenges, DOT's financial resources and programs have been carefully structured around the following five strategic goals:

- **SAFETY** - Improving transportation safety is DOT's top priority. Our goal is to bring a Department-wide focus on reducing transportation-related fatalities and injuries. Our key initiatives include: roadway safety for all users; combating distracted driving and other dangerous behaviors; pursuing a more effective Federal role in transit safety; and addressing the most serious safety risks in other surface transportation modes and in aviation.
- **STATE OF GOOD REPAIR** - Recent reports on the condition of key facilities-highways, bridges, transit systems, passenger rail and airport runways-reveal that many fall short of a state of good repair and thus compromise the safety, capacity, and efficiency of the U.S. transportation system. The DOT programs bring a strong emphasis on improving the condition of our infrastructure. The DOT encourages its government and industry partners to make optimal use of existing capacity, minimize life-cycle costs, and apply sound asset management principles throughout the system.

- **ECONOMIC COMPETITIVENESS** - With demand for both freight and passenger transportation expected to more than double by 2050, our goal is to support the U.S. economy by fostering smart, strategic investments that will serve the traveling public and facilitate freight movement. Our central strategies for achieving maximum economic returns on our policies and investments include leading the development of intercity, high-speed passenger rail and a competitive air transportation system; increasing travel time reliability in freight-significant highway corridors; improving the performance of freight rail and maritime networks; advancing transportation interests in targeted markets around the world; and expanding opportunities in the transportation sector for small businesses.
- **LIVABLE COMMUNITIES** - These are places where coordinated transportation, housing, and commercial development give people access to affordable and environmentally sustainable transportation. Our emphasis is a transformational policy shift for the Department. Over the last 50 years, transportation spending has often been poorly coordinated with other infrastructure investments resulting in auto-dependent residential communities where access to job opportunities and key amenities is inadequate and expensive. Now, we will pursue coordinated, place-based policies and investments that increase transportation choices and access to public transportation services for all Americans.
- **ENVIRONMENTAL SUSTAINABILITY** - Transportation is crucial to our economy and our quality of life, but building, operating, and maintaining transportation systems clearly have significant environmental impacts on our air, water, and natural ecosystems. The transportation sector is a significant source of greenhouse gas (GHG) emissions, accounting for 33 percent of total U.S. GHG emissions in 2009. The Department's programs address these challenges through strategies such as fuel economy standards for cars and trucks, more environmentally sound construction and operational practices, and by expanding opportunities for shifting freight from less fuel-efficient modes to more fuel-efficient modes.

INFRASTRUCTURE INVESTMENTS AND MAP-21

In July, President Obama signed into law the Moving Ahead for Progress in the 21st Century Act (MAP-21). The MAP-21 provides needed funds and represents a milestone for the U.S. economy. This is the first multi-year transportation authorization enacted since 2005. It funds surface transportation programs at over $105 billion for FY 2013 and FY 2014, and this legislation transforms the framework for investments to guide the growth and development of the country's vital transportation infrastructure.

This bipartisan Act will create jobs. It builds on our aggressive safety efforts, including our fight against distracted driving and our push to improve transit and motor carrier safety. This law also provides States and communities with 2 years of steady funding to build the roads, bridges, and transit systems they need.

While MAP-21 provides predictability in transportation funding in the near future, 2 years will pass quickly. We need to begin work on a 6-year bill to provide the long-term stability needed for transportation programs. After 56 years of steady funding increases fueled by Federal gas taxes, the Highway Trust Fund now faces shortfalls. A long-term surface transportation reauthorization bill with increased resources is urgently required to spur economic growth.

HIGHLIGHTS OF KEY INITIATIVES IN 2012

Our transportation infrastructure, much of which was built decades ago, is aging and in need of repair. The growing U.S. population, particularly in metropolitan areas, increasingly demands varied, accessible, affordable, and environmentally sustainable transportation options. Programs authorized under MAP-21 are a good start to achieving this new vision. The Department's key initiatives, formulated to support our strategic goals, have furthered these efforts in 2012 and will continue on this path in 2013.

INNOVATIVE FINANCING

The Transportation Infrastructure Financing and Innovation Act (TIFIA) program provides Federal credit assistance to eligible surface transportation projects. The TIFIA program includes Federal credit assistance in the form of direct loans, loan guarantees, and standby lines of credit to finance surface transportation projects of national and regional significance. The TIFIA credit assistance provides improved access to capital markets, flexible repayment terms, and potentially more favorable interest rates than can be found in private capital markets for similar instruments. The TIFIA program can help advance qualified, large-scale projects that otherwise might be delayed or deferred because of size, complexity, or uncertainty over the timing of revenues. Many surface transportation projects-highway, transit, railroad, intermodal freight, and port access-are eligible for assistance.

Since its launch, TIFIA has helped projects turn about $9 billion in DOT assistance into $36 billion in infrastructure investment across America. Now, MAP-21 has transformed TIFIA into the largest transportation infrastructure loan program in history. Under MAP-21, DOT can extend $1.7 billion in capital for TIFIA. But each dollar of Federal funds can actually provide approximately $10 billion in TIFIA credit assistance, meaning $17 billion in loans. Projects can then use this credit to leverage an additional $20 to $30 billion in investment from other sources. This means that, altogether, the expanded loan program could result in up to $50 billion in public and private investment in critical transportation infrastructure needs from coast to coast.

FUEL ECONOMY STANDARDS

In August 2012, the Administration finalized groundbreaking standards that will increase fuel economy to the equivalent of 54.5 miles per gallon for cars and light-duty trucks by Model Year 2025. When combined with previous standards set by this Administration, this move will nearly double the fuel efficiency of those vehicles compared to new vehicles currently on our roads. In total, the Administration's national program to improve fuel economy and reduce greenhouse gas emissions will reduce U.S. oil consumption by 12 billion barrels.

These fuel standards represent the single most important step we have ever taken to reduce our dependence on foreign oil and will strengthen our Nation's energy security. This historic agreement builds on the progress we have already made to save families money at the pump and cut our oil consumption. It is great news for middle class families, and it will help create an economy built to last.

NEXTGEN

The NextGen is an umbrella term for the ongoing transformation of the National Airspace System. At its most basic level, NextGen represents an evolution from a ground-based system of air traffic control to a satellite-based system of air traffic management. This evolution is vital to meeting future demand, and to avoiding gridlock in the sky and at our nation's airports.

The NextGen will open America's skies to continued growth and increased safety while reducing aviation's environmental impact. We will realize these goals through the development of aviation-specific applications for existing, widely-used technologies, such as the Global Positioning System, and technological innovation in areas such as weather forecasting, data networking, and digital communications. Hand-in-hand with state-of-the-art technology will be new airport infrastructure and new procedures, including the shift of certain decision-making responsibility from the ground to the cockpit.

The NextGen will be a better way of doing business. Travel will be more predictable because there will be fewer delays, less time sitting on the ground and holding in the air, with more flexibility to get around weather problems. Also, these improvements will reduce aviation's impact on the environment. Flying will be quieter, cleaner, and more fuel-efficient. We will use alternative fuels, new equipment, and operational procedures, which will lessen our impact on the climate. In addition, more precise flight paths will help us limit the amount of noise that communities experience. Further, with NextGen we will be even more proactive about preventing accidents with new technology that will help us to predict risks and resolve hazards.

DISTRACTED DRIVING

In our current era of advancing technology and access to smartphones, many think they can use these devices while driving, but the consequences can be dire. When someone takes his or her focus off the road-even if just for a moment-he or she puts the lives of all those around them in danger. Distracted driving is unsafe, irresponsible, and-in a split second-it can be devastating. Distracted driving is any activity that could divert a person's attention away from the primary task of driving. All distractions endanger driver, passenger, and bystander safety. These types of distractions include: texting, using a cell phone or smartphone, eating and drinking, talking to passengers, or using a navigation system. Because text messaging requires visual, manual, and cognitive attention from the driver, though, it is by far the most alarming distraction. Sending or receiving a text takes a driver's eyes from the road for an average of 4.6 seconds, the equivalent-at 55 mph-of driving the length of an entire football field blind. Text messaging creates a crash risk 23 times worse than driving while not distracted.

In 2010, 3,092 people were killed in crashes involving a distracted driver, and an estimated additional 416,000 were injured in motor vehicle crashes involving a distracted driver. The best way to end distracted driving is to educate all Americans about the danger it poses, and DOT will remain at the forefront of a campaign to inform the public about this hazard.

HIGH SPEED RAIL

The Administration has placed a new emphasis on building high-speed and intercity passenger rail to connect communities and economic centers across the country. A fully developed passenger rail system will complement highway, aviation and public transit systems. With the successful completion of the original phases of the Northeast Corridor (NEC) Improvement Project offering Amtrak's maximum 150 miles per hour (mph) Acela train service between Washington, New York, and Boston, efforts to develop high-speed intercity passenger rail service have expanded beyond NEC. However, just as the Interstate Highway System took 50 years to complete, the true potential of a fully integrated high-speed intercity passenger rail network will not be achieved or realized overnight.

The DOT is working with States to plan and develop high-speed and intercity passenger rail corridors that range from upgrades to existing services to entirely new rail lines exclusively devoted to 150 to 220 mph trains. Today, over 30 States are at work building this bold vision for 21st century rail. Our partners are moving forward with more than 150 high-speed and higher performing passenger rail projects. In 2012 alone, nearly $3 billion in Federal investments are scheduled to be underway or complete. Implementing these corridor projects and programs will serve as a catalyst to promote economic expansion (including new manufacturing jobs), create new choices for travelers in addition to flying or driving, reduce national dependence on oil, and foster livable urban and rural communities.

Once track is laid and stations are constructed, high-speed rail will spur economic development. It will generate quality jobs at small business all along its corridors. Our highways and airports simply cannot handle the substantial growth forecast over the next several decades. A new, modem, high-speed rail network must be an important part of the solution.

LOOKING AHEAD

This year has seen many achievements to improve our country's transportation systems. As we continue to move ahead in 2013, we look forward to working with the Congress and our public and private sector stakeholders to rebuild and strengthen America's roads, transit systems, airways, and waterways, creating the means by which we connect with one another, grow our economy, and pursue our dreams.

RAY LaHOOD

MANAGEMENT'S DISCUSSION AND ANALYSIS

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DOT 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, DOT employees exemplify the highest standards of excellence, integrity, and respect in the work environment.

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

CUSTOMER FOCUS DOT employees strive to understand and meet the needs of the Department's customers through service, innovation, and creativity. We are dedicated to delivering results that matter to the American people.

ORGANIZATION

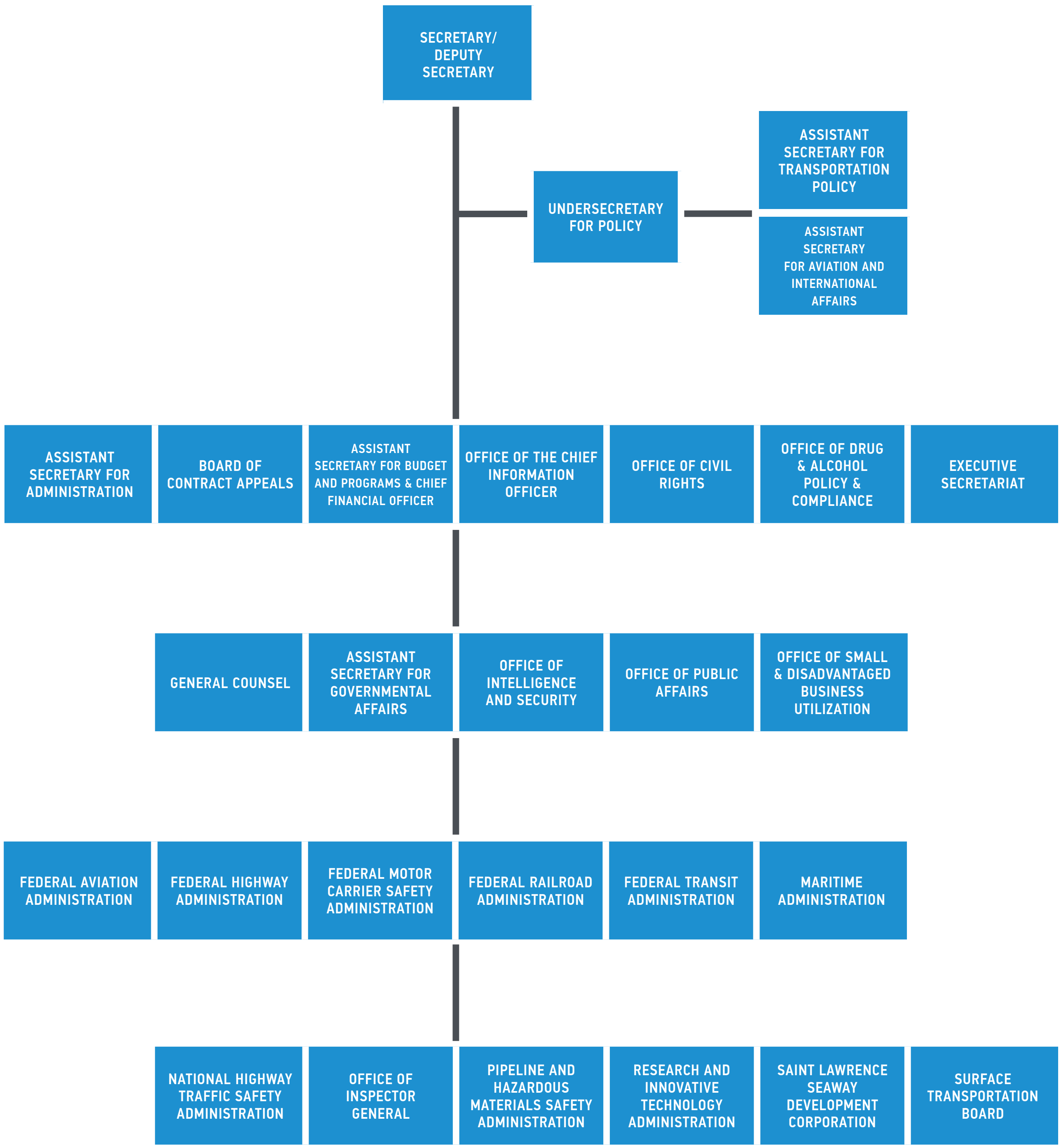
Established in 1967, DOT sets Federal transportation policy and works with State, local, and private-sector partners to promote a safe, secure, efficient, and interconnected National transportation system of roads, railways, pipelines, airways, and seaways. DOT's overall objective of creating a safer,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

HOW DOT IS ORGANIZED

DOT employs more than 57,000 people in the Office of the Secretary (OST) and through twelve Operating Administrations (OAs) and bureaus, each with its own management and organizational structure.

The Office of the Secretary 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 LEGISLATIVE AUTHORITY

The Secretary of Transportation, under the direction of the President, exercises leadership in transportation matters. Section 101 of Title 49 United States Code describes the United States Department of Transportation purposes as follows:

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

B. A Department of Transportation is necessary in the public interest and to—

   1. ensure the coordinated and effective administration of the transportation programs of the United States Government;
   2. make easier the development and improvement of coordinated transportation service to be provided by private enterprise to the greatest extent feasible;
   3. encourage cooperation of Federal, State, and local governments, carriers, labor, and other interested persons to achieve transportation objectives;
   4. stimulate technological advances in transportation, through research and development or otherwise;
   5. provide general leadership in identifying and solving transportation problems; and
   6. develop and recommend to the President and Congress transportation policies and programs to achieve transportation objectives considering the needs of the public, users, carriers, industry, labor, and national defense."

OPERATING ADMINISTRATIONS AND INDEPENDENT ORGANIZATIONS

OFFICE OF THE SECRETARY (OST)

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

FEDERAL AVIATION ADMINISTRATION (FAA)

The Federal Aviation Administration's mission is to provide the safest, most efficient aerospace system in the world.

FEDERAL HIGHWAY ADMINISTRATION (FHWA)

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 (FMCSA)

The Federal Motor Carrier Safety Administration's primary mission is to reduce crashes, injuries, and fatalities involving large trucks and buses.

FEDERAL RAILROAD ADMINISTRATION (FRA)

The mission of the Federal Railroad Administration is to enable the safe, reliable, and efficient transportation of people and goods for a strong America, now and in the future.

FEDERAL TRANSIT ADMINISTRATION (FTA)

The Federal Transit Administration's mission is to improve public transportation for passengers and America's communities.

MARITIME ADMINISTRATION (MARAD)

The Maritime Administration's mission is to improve and strengthen the U.S. marine transportation system to meet the economic, environmental, and security needs of the Nation.

NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION (NHTSA)

The National Highway Traffic Safety Administration's 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 (OIG)

The Inspector General Act of 1978, as amended, established the Office of Inspector General as an independent and objective organization within the DOT. The OIG is committed to fulfilling its statutory responsibilities and supporting members of Congress, the Secretary, senior Department officials, and the public in achieving a safe, efficient, and effective transportation system.

PIPELINE AND HAZARDOUS MATERIALS SAFETY ADMINISTRATION (PHMSA)

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 (RITA)

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

SAINT LAWRENCE SEAWAY DEVELOPMENT CORPORATION (SLSDC)

The Saint Lawrence Seaway Development Corporation's mission is to serve the marine transportation industries by providing a safe, secure, reliable, efficient, and competitive deep draft international waterway, in cooperation with the Canadian St. Lawrence Seaway Management Corporation.

SURFACE TRANSPORTATION BOARD (STB)

The Surface Transportation Board 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 first year that the Department of Transportation will report against "Transportation for a New Generation," DOT's Strategic Plan for Fiscal Years 2012 – 2016. Under this Strategic Plan, the Department continues to track many of the measures found in the previous plan, but as the agency builds upon progress in improving transportation and develops new strategic priorities, some new measures were developed.

An overview of the Department's strategic goals is provided below, and a complete analysis of DOT's successes and challenges related to FY 2012 performance targets will be included in the Annual Performance Report. A brief discussion of the Department's results by strategic goal follows.

SAFETY

Improving transportation safety remains DOT's top priority. The Department tracks the safe movement of Americans and products on the highways, in the air, on transit systems, on railroads, and through pipelines. The Department has estimated or final 2012 results for 11 of the 13 safety goals that will be included in the Annual Performance Report. Preliminary performance measure results show that the Department is on target or exceeding the target for all but one of the goals. DOT does not anticipate achieving its FY 2012 target for the number of fatal general aviation (GA) accidents per 100,000 flight hours, because the number of fatal GA accidents continues to decline more slowly than anticipated. Most of the fatalities occurred in the area of experimental aircraft, which are predominately amateur-built. These aircraft accounted for approximately 28 percent of GA fatal accidents while contributing to slightly less than 4 percent of GA flying hours. FAA continues to pursue multiple avenues for addressing this issue.

STATE OF GOOD REPAIR

Recent reports on the condition of key facilities – highways, bridges, transit systems, passenger rail, and airport runways – reveal that many fall short of a state of good repair and thus compromise the safety, capacity, and efficiency of the U.S. transportation system. DOT's role in achieving a state of good repair is through strong programmatic emphasis and new resources aimed at improving the condition of our infrastructure. DOT also encourages its government and industry partners to make optimal use of existing capacity, minimize life-cycle costs, and apply sound asset management principles throughout the system. In FY 2012, preliminary results show that the Department met or exceeded the target for each of the state of good repair goals for which data is currently available. The Department will work to finalize results for all state of good repair performance measures prior to the release of the Annual Performance Report.

ECONOMIC COMPETITIVENESS

DOT has established a goal to support the U.S. economy by fostering smart, strategic investments that serve the traveling public and facilitate freight movement. The Department's central strategies for achieving maximum economic returns on its policies and investments include leading the development of intercity, high-speed passenger rail and a competitive air transportation system; increasing travel time reliability in freight-significant highway corridors; improving the performance of freight rail and maritime networks; advancing transportation interests in targeted markets around the world; and expanding opportunities in the transportation sector for small businesses. In FY 2012, preliminary results show that the Department met or exceeded all 18 targets for the economic competitiveness goals.

LIVABLE COMMUNITIES

Fostering livable communities – places where coordinated transportation, housing, and commercial development gives people access to affordable and environmentally sustainable transportation – is a transformational policy shift for DOT. Through the principles established in the livable communities strategic goal, the Department will pursue coordinated, place-based policies and investments that increase transportation choices and access to public transportation services for all Americans. Based on preliminary data, DOT met or exceeded FY 2012 targets for five of six livable communities goals. The Department is awaiting final data for the two remaining goals and results will be discussed in the Annual Performance Report released in early 2013.

ENVIRONMENTAL SUSTAINABILITY

While the transportation sector is a significant source of greenhouse gas (GHG) emissions, the Department is working to address and mitigate this challenge through strategies such as fuel economy standards for cars and trucks, more environmentally sound construction and operational practices, and by expanding opportunities for shifting freight from less fuel-efficient modes to more fuel-efficient modes. A full discussion of the Department's FY 2012 environmental sustainability goals will be included in the Annual Performance Report.

PERFORMANCE SUMMARY TABLES

SAFETY PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2007	2008	2009	2010	2011	2012 TARGET	2012 ACTUAL	MET/NOT MET
Highway fatality rate per 100 million vehicle-miles traveled (VMT). (NHTSA, FHWA, FMCSA)	1.36	1.26	1.15	1.11	1.09*	1.05	N/A	Potentially Met (2011)
Passenger vehicle occupant fatality rate per 100 million VMT. (NHTSA, FHWA, FMCSA)	1.08	0.97	0.89	0.84	0.83–0.89*	0.85	0.83–0.89*	Potentially Met
Motorcyclist rider fatality rate per 100,000 motorcycle registrations. (NHTSA, FHWA, FMCSA)	72.48	68.52	56.36	54.82	56-58*	63	56-58*	Potentially Met
Non-occupant (pedestrian and bicycle) fatality rate per 100 million VMT. (NHTSA, FHWA, FMCSA)	0.18	0.18	0.17	0.17	0.16–0.17*	0.16	0.16–0.17*	Potentially Met
Large truck and bus fatality rate per 100 million total VMT. (NHTSA, FHWA, FMCSA)	0.169	0.155	0.123	0.131	0.117–0.134*	0.117	0.110–0.127*	Potentially Met
Number of commercial air carrier fatalities per 100 million persons onboard. (FAA)	N/A	0.4	6.7	0.3	0.0*	7.6	0.0*	Potentially Met
Number of fatal general aviation accidents per 100,000 flight hours. (FAA)	N/A	N/A	1.16	1.10	1.13*	1.07	1.10*	Potentially Not Met
Category A&B runway incursions per million operations. (FAA)	0.393	0.427	0.227	0.117	0.138	0.395	0.356	Met
Pipeline incidents involving death or major injury. (PHMSA)	47	40	49	39	39	43	32*	Potentially Met
Hazardous materials incidents involving death or major injury. (PHMSA)	36	24	29	19	33	34	33*	Potentially Met
Transit fatalities per 100 million passenger-miles traveled. (FTA) (r)	N/A	N/A	N/A	.533	.547	.543	N/A	Met (2011)
Rail-related accidents and incidents per million train-miles. (FRA)†	17.298	16.904	16.874	16.634	15.890	16.300	14.351*	Potentially Met
Cumulative number of States and localities that adopt roadway designs that accommodate all road users (complete streets). (OST)	N/A	N/A	15	22	26	26	27	Met

*(r) Revised Performance Measure; * Preliminary Estimate; † Actual results might differ from previous reports and are subject to change, due to subsequently obtained information. FY 2012 actuals are based on 9 months of preliminary data.*

STATE OF GOOD REPAIR PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2007	2008	2009	2010	2011	2012 TARGET	2012 ACTUAL	MET/ NOT MET
Percent of travel on the National Highway System (NHS) roads with pavement performance standards rated "good." (FHWA)	57	56	57	58	58	56.0	N/A**	---
Percent of deck area (i.e., the roadway surface of a bridge) on NHS bridges rated structurally deficient. (FHWA)	8.4 (r)	8.2 (r)	8.2 (r)	8.3 (r)	7.8	7.8	7.1*	Potentially Met
Backlog of transit capital assets in need of replacement or refurbishment (as defined by an estimated condition rating of 2.5 or lower). (FTA)	N/A	N/A	N/A	$77.7 Billion	N/A^	$77.6 Billion	N/A^	---
Percent of runway pavement in excellent, good, or fair condition for paved runways in the National Plan of Integrated Airport Systems. (FAA)	96.6%	96.9%	97.0%	97.2%	97.4%	93.0%	97.5%	Met

*(r) Revised; * Preliminary Estimate; ^ 2011 and 2012 Actuals Available Following Release of Conditions and Performance Report ** Results currently unavailable;will be reported in the Annual Performance Report;*

ECONOMIC COMPETITIVENESS PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2007	2008	2009	2010	2011	2012 TARGET	2012 ACTUAL	MET /NOT MET
Travel time reliability in urban areas as measured by the Travel Time Index. (FHWA)	1.24(r)	1.21(r)	1.19(r)	1.21	1.21	1.21	1.21*	Potentially Met
Travel time reliability in freight significant corridors. (FHWA)	15.0	14.4	13.8	13.7	13.8	15.0	13.2*	Potentially Met
Number of corridor programs that will achieve initial construction. (FRA)	N/A	N/A	N/A	N/A	3	1	1	Met
Number of individual construction projects that will achieve initial construction. (FRA)	N/A	N/A	N/A	N/A	8	14	19	Met
Average daily airport arrival and departure capacity at Core Airports. (FAA)	102,545	103,222	101,691	101,668	87,338	86,835	88,591*	Potentially Met
Percent of operational availability for the reportable facilities that support Core Airports. (FAA)	99.83%	99.82%	99.78%	99.79%	99.72%	99.70%	99.80%	Met
Initial operating capability on ERAM at continental U.S. En Route centers. (FAA)	N/A	N/A	N/A	N/A	2	7	7	Met
Percent of time the U.S. portion of the St. Lawrence Seaway system and locks are available. (SLSDC)	99.4%	98.8%	99.4%	99.8%	99.0%	99.0%	99.7%	Met
Ships available to meet DOD's requirements for commercial sealift capacity (as measured by the number of ships contractually enrolled in the maritime security program). (MARAD)	60	60	59	60	60	60	60	Met
Operating days in U.S. foreign commerce and available to meet DOD's requirements (as measured by the number of ship operating days that ships enrolled in the MSP were actually operating in U.S. foreign commerce). (MARAD)	N/A	N/A	N/A	21,436	21,557	19,200	21,593	Met
Number of Twenty Foot Equivalent (TEU) containers transported across America's Marine Highway corridors. (MARAD)	N/A	N/A	N/A	N/A	1,061	3,500	8,221	Met
Number of U.S. Merchant Marine Academy (USMMA) graduates. (MARAD)	210	219	198	198	205	210	219	Met
Number of State Maritime Academy graduates. (MARAD)	N/A	N/A	N/A	575	545	592	607*	Potentially Met
Percent of NAS on-time arrivals at Core Airports. (FAA)	86.96%	87.29%	88.98%	90.55%	90.41%	88.00%	92.50%	Met
Review air carriers to ensure they meet the requisite standards for obtaining or retaining economic authority to operate. (OST)	N/A	N/A	22	20	26	18	27	Met
Reach new or expanded bilateral and multilateral agreements to remove market-distorting barriers to trade in transportation. (OST)	3	4	4	7	4	3	4	Met
Percent of total dollar value of DOT direct contracts awarded to small, disadvantaged businesses. (OST)	19.30%	16.19%	13.36%	14.00%	19.50%	15.00%	19.50%*	Potentially Met
Percent of total dollar value of DOT direct contracts awarded to women-owned businesses. (OST)	10.40%	8.12%	10.94%	8.00%	11.10%	6.00%	10.40%*	Met

*(r) Revised; * Preliminary Estimate*

LIVABLE COMMUNITIES PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2007	2008	2009	2010	2011	2012 TARGET	2012 ACTUAL	MET/ NOT MET
States with policies that improve transportation choices for walking and bicycling. (FHWA)	N/A	N/A	N/A	21	24	26	26	Met
States that have developed an Americans with Disabilities Act (ADA) transition plan that is current and includes the public rights-of-ways. (FHWA)	N/A	N/A	N/A	N/A	13	12	17	Met
Number of calendar year transit boardings reported by urbanized area transit providers. (FTA)	9.9 Billion	10.3 Billion	9.9 Billion	9.9 Billion	10.1 Billion	10.1 Billion	10.3 Billion#	Potentially Met
Number of transit boardings reported by rural area transit providers. (FTA)	118 Million	128 Million	131 Million	138 Million	144 Million	144 Million	TBD^	Met (2011)
Transit "market share" among commuters to work in the 50 most-populous urbanized areas. (FTA)	N/A	N/A	N/A	0	1	4	TBD^	Not Met (2011)**
Number of key rail stations verified as accessible and fully compliant. (FTA)	N/A	N/A	N/A	513	522	531	567*	Potentially Met
Number of intercity rail passenger-miles traveled. (FRA)	5.65 Billion	6.16 Billion	5.90 Billion	6.33 Billion	6.53 Billion	6.60 Billion	6.80 Billion	Met
Percent of intercity passenger rail stations that comply with the requirements of the ADA. (FRA)	N/A	N/A	N/A	N/A	N/A	2%	0%	Not Met

** Preliminary Estimate; # Projection from Trends; ^ 2012 Actual Available Late 2013;*
*** 2011 Interim Target Developed Prior to 2012-2016 Strategic Plan Release*

ENVIRONMENTAL SUSTAINABILITY PERFORMANCE SUMMARY

PERFORMANCE MEASURE	2007	2008	2009	2010	2011	TARGET	2012 ACTUAL	MET/ NOT MET
NAS energy efficiency (measured by fuel burned per miles flown). (FAA)	(13.87%)	(13.52%)	(14.03%)	(15.25%)	(14.50%)	(14.00%)	(14.76%)	Met
U.S. population exposed to significant aircraft noise around airports. (FAA)	N/A	383,465	291,768	317,596	315,293	386,000	319,901	Met
Hazardous liquid pipeline spills with environmental consequences. (PHMSA)	97	128	111	88	99	99	114*	Potentially Not Met
Percent reduction of vehicle fleet petroleum use. (OST)	11%	8%	14%	5%	4.9%	14%	TBD**	---
Percent improvement in water efficiency. (OST)	N/A	2%	3.3%	(1.2%)	(9.7%)	10%	TBD**	---
Percent recycling and waste diversion. (OST)	N/A	N/A	N/A	##	##	6%	TBD**	---
Percent of all applicable contracts that meet sustainability requirements. (OST)	N/A	N/A	N/A	##	95%	95%	TBD**	---
Percent reduction in green-house gas emissions from facilities and fleets. (OST)	N/A	N/A	N/A	7.9%	15.4%	4%	TBD**	---
Percent reduction in green-house gas emissions from employee business travel and commuting. (OST)	N/A	N/A	N/A	(4.7%)	0.1%	2%	TBD**	---
Compliance with the April 2010 court-ordered consent decree for removal of Suisun Bay Reserve Fleet non-retention ships on an annual basis. (MARAD)	N/A	N/A	N/A	11	15	2	10	Met
Percent of alternative-fuel and hybrid vehicles in the transit revenue service fleet. (FTA)	39%	42%	43%	44%	45%*	46%	TBD^	Met (2011)

** Preliminary Estimate; ** Results available in Jan. 2013 and reported in Annual Performance Report; ## Data unavailable; ^ 2012 Actual Available Late 2013*

FINANCIAL HIGHLIGHTS

DOT has chosen to produce an Agency Financial Report (AFR) and an Agency Performance Report (APR) for FY 2012. The DOT will include its FY 2012 APR with its Congressional Budget Justification and will post it on DOT's website at **www.dot.gov** by February 15, 2013.

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 and other authoritative pronouncements prescribed by the Federal Accounting Standards Advisory Board (FASAB). Department management is responsible for the integrity and fair presentation of the financial information in these statements.

The American Recovery and Reinvestment Act of 2009 (ARRA or the Recovery Act) continues to have a significant, although reduced, impact on the Department's financial statements when comparing FY 2012 amounts to FY 2011 amounts for certain financial statement line items. Of the $48.1 billion in appropriations provided by ARRA in FY 2009, the Department obligated $47.6 billion, or 99 percent of the available funding, as of September 30, 2012, with $8 billion obligated in FY 2011 and a remaining $46 million obligated in FY 2012. The Department had disbursed $37 billion as of September 30, 2012, with $11.3 billion disbursed in FY 2011 and $5.3 billion disbursed in FY 2012.

Both the Airport and Airway Trust Fund (AATF) and the Highway Trust Fund (HTF) were granted extensions of authority to collect excise taxes and to make expenditures in FY 2012. In February, the FAA Modernization and Reform Act of 2012, Public Law (P.L.) 112-95, extended AATF authority through September 30, 2015. In July, Moving Ahead for Progress in the 21st Century (MAP-21), P.L. 112-141, infused the HTF with $2.4 billion in FY 2012 and extended its authority through September 30, 2014.

OVERVIEW OF FINANCIAL POSITION

ASSETS The Consolidated Balance Sheet reports a decrease in total assets to $76.1 billion at the end of FY 2012, compared with $85.7 billion at the end of FY 2011. The Fund Balance with Treasury line item decreased by $6.4 billion as ARRA funding provided in FY 2009 continued to be disbursed in FY 2012. Investments decreased by $4.4 billion, as greater drawdowns decreased the HTF investment balance by $6.3 billion, offset by an increase in the AATF investment balance of $1.9 billion from excise tax collections.

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

ASSETS BY TYPE

DOLLARS IN THOUSANDS	2012	%	2011	%
Fund Balance with Treasury	$33,356,274	43.8	$39,761,625	46.4
Investments	22,330,652	29.4	26,682,058	31.1
General Property, Plant & Equipment	14,030,366	18.4	13,740,507	16.0
Direct Loans and Guarantees, Net	5,022,807	6.6	4,187,635	4.9
Inventory and Related Property, Net	857,891	1.1	845,833	1.0
Accounts Receivable	271,457	.4	266,388	.3
Cash and Other Assets	239,348	.3	247,528	.3
Total Assets	**$76,108,795**	**100.0**	**$85,731,574**	**100.0**

LIABILITIES The Department's Consolidated Balance Sheet reported total liabilities of $18 billion at the end of FY 2012, as summarized in the table below. This represents a modest decrease from the previous year's total liabilities of $18.4 billion. The largest decrease was in the Accounts Payable line item as disbursements for ARRA programs continue to decline.

LIABILITIES BY TYPE

DOLLARS IN THOUSANDS	2012	%	2011	%
Grant Accrual	$6,315,689	35	$6,560,755	35.7
Debt	5,193,598	28.8	4,342,866	23.6
Other Liabilities	3,660,118	20.3	4,051,687	22.1
Federal Employee Benefits Payable	1,019,076	5.6	978,918	5.3
Environmental and Disposal Liabilities	1,010,818	5.6	1,068,076	5.8
Accounts Payable	643,997	3.6	1,208,245	6.6
Loan Guarantees	192,829	1.1	158,425	.9
Total Liabilities	**$18,036,125**	**100.0**	**$18,368,972**	**100.0**

NET POSITION The Department's Consolidated Balance Sheet and Consolidated Statement of Changes in Net Position report a Net Position of $58 billion at the end of FY 2012, a 13.8 percent decrease from the $67.4 billion from the previous fiscal year. The decline is mainly attributable to a return to pre-ARRA funding levels. Net Position is the sum of Unexpended Appropriations and Cumulative Results of Operations.

NET COSTS The Department's total net cost of operations for FY 2012 was $77 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 77.6 percent of the Department's net cost of operations. Air transportation is the next largest investment for the Department at 20.8 percent of total net cost of operations.

NET COSTS

DOLLARS IN THOUSANDS	2012	%	2011	%
Surface Transportation	$59,762,698	77.6	$60,319,117	77.2
Air Transportation	16,004,333	20.8	16,544,662	21.2
Maritime Transportation	493,519	.6	484,393	.6
Cross-Cutting Programs	391,458	.5	347,273	.5
Costs Not Assigned to Programs	384,545	.5	417,558	.5
Net Cost of Operations	**$77,036,553**	**100.0**	**$78,113,003**	**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 2012 fiscal year, the Department had total budgetary resources of $134.1 billion, which represents a 4.8 percent decline from FY 2011 levels of $140.8 billion. Budget Authority of $134.1 billion consisted of $51.5 billion in unobligated authority carried over from prior years, $19.7 billion in appropriations, $54.9 billion in borrowing and contract authority, and $8 billion in spending authority from offsetting collections. The Department's FY 2012 obligations incurred totaled $86.6 billion compared with FY 2011 obligations incurred of $90.3 billion.

Net Outlays reflect the actual cash disbursed against previously established obligations. For FY 2012, the Department had net outlays of $76 billion, compared to FY 2011 levels of $78.6 billion, a decrease of 3.3 percent. As expected, disbursements have decreased as the Recovery Act program nears completion (i.e. as lower levels of obligations from FY 2012 and FY 2011 are liquidated).

RESOURCES

DOLLARS IN THOUSANDS	2012	2011	(DECREASE)
Total Budgetary Resources	$134,107,279	$140,800,746	%(4.8)
Obligations Incurred	86,554,746	90,313,537	%(4.2)
Net Outlays	75,973,821	78,551,159	%(3.3)

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 in 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.

FY2012 FMFIA ASSURANCE LETTER TO THE PRESIDENT

THE FOLLOWING IS TEXT OF THE SECRETARY'S LETTER TO THE PRESIDENT

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) 2012. This report is based on our successful implementation of 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.

The DOT is able to provide reasonable assurance that the internal controls and financial management systems in effect during the period of October 1, 2011, through September 30, 2012, met the objectives of both Sections 2 and 4 of the FMFIA, except for two material weaknesses. One weakness is related to compliance with the Federal Information Security Management Act (FISMA), and a second weakness involves improper controls over the review and monitoring of grant "Undelivered Orders" (UDOs). The UDOs are budget obligations that have not yet been fully liquidated by making a payment. Closely associated with this UDO issue, we also are citing a non-conformance with accounting standards for reporting grant UDO balances. During FY 2012, 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 2011, the Office of Inspector General (OIG) 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, OIG made 5 specific recommendations, in addition to the recommendations that remained open from previous OIG FISMA reports.

As part of our commitment to resolve these deficiencies, DOT made improvements during 2012 through the issuance of new cybersecurity guidance for the majority of its components, and new cybersecurity policy specifically for the Office of the Secretary (OST). The DOT also made progress on Administration cybersecurity priority goals, deploying continuous monitoring capabilities across 66 percent of agency assets, consolidating 91 percent of its internet bandwidth through secured internet connections, and enabling use of Personal Identity Verification (PIV) Cards for secure network login for more than 70 percent of non-FAA personnel. Senior management and the Department's Chief Information Officer (CIO) have been monitoring these corrective actions.

Although progress has been made since 2011 to resolve outstanding FISMA matters, many of these conditions substantially existed during 2012, with corrective actions still in progress. We expect that the OIG's report on FISMA for 2012 will reach a similar conclusion. As a consequence, DOT's compliance with FISMA during 2012 again constituted a material weakness in internal control under Section 2 of FMFIA. To remediate further the Department's cybersecurity program issues in the coming year, DOT's corrective action plan contemplates additional progress in the following critical areas:

- Improving contingency planning and testing;
- Improving the oversight of component-level security programs and weaknesses;
- Further implementation of a continuous monitoring strategy and program across the Department; and
- Substantial progress in closing remaining open audit recommendations.

OMB CIRCULAR A-123, APPENDIX A INTERNAL CONTROL PROGRAM

During FY 2012, 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 2012, DOT assessed and tested controls over key identified business processes, including Budget; Inventory Management; Human Resources, Time and Attendance; Property Plant and Equipment; and Grants Management. The DOT used a risk-based approach to determine other material business processes that should be included in the testing.

The major OMB Circular A-123, Appendix A activities in FY 2012 included evaluating entity level, process level, and in-depth testing at the transaction level of internal controls over financial reporting for the 5 identified business processes. All deficiencies were communicated to senior management and mitigated using existing remediation procedures.

The DOT confirmed a material weakness in internal controls related to grant UDOs. Existing controls for the review and monitoring of grant UDOs needs to be strengthened to determine accurately if balances are still valid. Specifically, DOT determined that Federal Highway Administration's (FHWA) Financial Integrity Review and Evaluation tier review was not appropriately designed or operating effectively to timely identify unused obligation balances. The DOT also concluded that the Federal Transit Administration's (FTA) review was not appropriately designed to timely identify unused obligation balances, as the annual review only included grants that were originally obligated more than 5 years ago and had not recorded a disbursement within 18 months. Therefore, the DOT is reporting a material weakness in internal control under Section 2 of FMFIA.

The DOT is in the process of implementing corrective actions to mitigate this internal control weakness related to UDOs. Corrective actions include:

- In the fourth quarter of 2012, a clean-up effort was conducted which greatly reduced inactive UDOs across the Department;
- DOT initiated a training effort for key Agency staff on contract and grant closeout procedures. This should help ensure that UDO balances are reviewed timely and are accurately reflected in the Department's accounting records; and
- A Department-wide order is being developed, requiring all DOT components to conduct a quarterly review of UDOs. This guidance is expected to be issued by the second quarter of 2013.

Based on the overall results of this Circular A-123 evaluation, DOT can provide reasonable assurance that its internal control over financial reporting was operating effectively, except for the material weakness related to grant UDOs noted above.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)

The FFMIA states that each Agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level.

During FY 2012, DOT identified a non-conformance with Title 31, United States Code, Sections 1501 and 1554, and *The Standards for Internal Control in the Federal Government,* issued by the Government Accountability Office. These issues are related to grant UDOs within FHWA and FTA. Therefore, DOT is reporting a non-conformance under Section 4 of FMFIA. The DOT is in the process of implementing several actions to correct this non-conformance with established accounting standards. These remediation activities are highlighted in our discussion of UDOs under the Circular A-123, Appendix A section of this correspondence.

FMFIA INTERNAL CONTROL PROGRAM

For FY 2012, DOT utilized 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 5 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.

OMB A-123 ACQUISITION ASSESSMENT

In accordance with guidance from the Office of Federal Procurement Policy and OMB Circular A-123, DOT developed a 3-year assessment reporting cycle of the DOT's acquisition offices and programs, and in FY 2012, DOT is conducting an entity level top-down assessment for OST, the Pipeline and Hazardous Materials Safety Administration, and the Saint Lawrence Seaway Development Corporation. As of September 30, DOT has not identified any material weaknesses during this review.

As a result of our FMFIA reviews in FY 2012, 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 2013.

Sincerely yours,

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.

The Secretary of Transportation provided the President and Congress a Statement of Assurance for the fiscal year ended September 30, 2012, stating that the Department of Transportation (DOT) is able to provide reasonable assurance that its controls and systems met the objectives of the FMFIA, except for two material weaknesses and one material non-conformance. One weakness is related to compliance with the Federal Information Security Management Act (FISMA), and a second weakness involves improper controls over the review and monitoring of grant "Undelivered Orders" (UDOs). UDOs are budget obligations that have not yet been fully liquidated by making a payment. Closely associated with this UDO issue, we also are citing a non-conformance with accounting standards for reporting grant UDO balances.

As a subset of the FMFIA Statement of Assurance, the 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 follows 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; and
- Financial systems conform to government-wide standards.

Managers within the DOT, being in the best position to 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 (OA) and Departmental office submits an annual statement of assurance representing the overall adequacy and effectiveness of management controls within the organization to the DOT's Office of Financial Management. Any identified FMFIA material weaknesses and material non-conformances 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 DOT's Office of Financial Management.

CRITERIA FOR REPORTING MATERIAL WEAKNESSES AND NON-CONFORMANCES

A material weakness under the 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; and
- Would result in significant adverse effects on the credibility of the agency.

A material non-conformance under the 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 NON-CONFORMANCE

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

FY 2012 FMFIA MATERIAL WEAKNESSES

STATUS OF INTERNAL CONTROLS (FMFIA SECTION 2)

The DOT is reporting two material weaknesses in FY 2012. One weakness is related to compliance with the Federal Information Security Management Act (FISMA). The FISMA non-compliance material weakness was also reported in FY 2010 and FY 2011. Senior management and the DOT's Chief Information Officer have been collaborating and monitoring corrective actions. Although progress was made in FY 2011 and FY 2012, the same conditions substantially existed during FY 2012, with many corrective actions in progress.

A second weakness involves improper controls over the review and monitoring of grant UDOs. The DOT is in the process of implementing corrective actions to mitigate this internal control weakness related to UDOs.

STATUS OF FINANCIAL MANAGEMENT SYSTEMS (FMFIA, SECTION 4)

The DOT is reporting one material non-conformance with accounting standards related to the reporting of grant UDO balances. The DOT is in the process of implementing several actions to correct this non-conformance with established accounting standards.

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 DOT performed in-depth testing of the controls over six focus area business processes for each OA including Budget; Inventory Management; Human Resources, Time and Attendance; Property Plant and Equipment; and Grants Management. Additional testing of high-risk key controls from the remaining nine 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 compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA) for FY 2012, with the exception of one material non-conformance with accounting standards for reporting grant "Undelivered Orders" (UDO) balances. UDOs are budget obligations that have not yet been fully liquidated by making a payment. 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.

The DOT is able to provide reasonable assurance that the internal controls and financial management systems in effect during FY 2012 met the objectives of both Sections 2 and 4 of the FMFIA, except for two material weaknesses and one material non-conformance. One weakness is related to compliance with FISMA, and a second weakness involves improper controls over the review and monitoring of grant UDOs. Closely associated with this UDO issue, the DOT is also citing a non-conformance with accounting standards for reporting grant UDO balances.

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 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, 2012. In addition, FISMA requires that agencies have an independent evaluation performed of agency information security programs and practices. At the Department of Transportation (DOT), this annual evaluation is performed by the Office of the Inspector General (OIG). This year's (FY 2012) annual FISMA report will be finalized no later than November 15, as now required by the Department of Homeland Security.

The DOT has 13 Operating Administrations that for FY 2012 operated a total of 431 information systems, an increase of 12 systems over the FY 2011 adjusted inventory, of which 283 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 more than $78 billion in federal funds each year.

DOT's cybersecurity program continues to have significant deficiencies in its enterprise and systems controls. Specifically, DOT still needs to make progress in critical areas, such as: improving contingency planning and testing; improving the oversight of component-level security programs and weaknesses; and continued 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 these deficiencies, DOT made improvements during 2012 through the issuance of new cybersecurity guidance for the majority of its components, and new cybersecurity policy specifically for OST. DOT also made progress on Administration Cybersecurity priority goals, deploying continuous monitoring capabilities across 66% of agency assets, consolidating 91% of its Internet bandwidth through secured Internet connections, and enabling use of PIV Cards for secure network login for more than 70% of non-FAA personnel. DOT has also submitted evidence and requested closure of 25 open audit recommendations. The full FY 2012 FISMA report is anticipated to be available in early December 2012 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 a review 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 second 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 Securities and Exchange Commission, 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 KPMG LLP. KPMG concluded that management presented its description of ESC controls fairly in all material respects, and that the controls, as described, were suitably designed and operating effectively for all stated control objectives with the exception of controls surrounding the management of job processing errors.

ESC is in the process of implementing procedures to review, track, and remediate job processing errors identified in Delphi. Implementation will be completed in FY 2013.

IMPLEMENTATION OF eINVOICING FOR GRANTS

DOT'S ELECTRONIC INVOICING INITIATIVE

The Department is undergoing an effort to modernize and streamline financial management policies, processes, reports, and systems to better meet its mission and goals. The first objective of the effort is to implement electronic invoicing across the Department. The goal of the electronic invoicing initiative is to eliminate, as much as possible, paper invoice submissions by allowing users to submit invoices electronically through an online portal.

The DOT selected Oracle's iSupplier module, labeled the Delphi eInvoicing system, as the DOT's new payment processing system. Key benefits of this initiative include:

- A standard process for grant recipients to submit invoices to the Department;
- Improved funds control;
- The ability to review and approve payment requests electronically;
- A decrease in payment request review and processing time;
- The ability to view the status of all payment requests in real-time;
- A decrease in the volume of payment requests mailed, faxed, or e-mailed by grantees and vendors; and
- An improvement to the accuracy, timeliness, and transparency of transactions processed through the financial system.

The first phase of the Delphi eInvoicing deployment began in FY 2012 with the rollout of Delphi eInvoicing to the Department's grantee community. The primary stakeholders include Grantees/Sponsors, DOT Grant Managers, and DOT Program Managers. The Department is scheduled to complete the initial deployment of the Delphi eInvoicing system to grant recipients in November 2012. By offering this solution to grant recipients, the Department estimates that approximately 900 invoices will be submitted electronically per month, eliminating the need for grantees to mail, e-mail, or fax invoices.

INSPECTOR GENERAL'S FY 2012 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 2012.

In selecting the challenges for each year's list, the OIG continually focuses on the Department's key goals to improve transportation safety, capacity, and efficiency. In addition to the OIG's vigilant oversight of DOT programs, budgetary issues, and progress milestones, it also draws from several dynamic factors to identify key challenges. These include new 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 2012, the OIG identified the following nine significant challenges:

- 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 American Recovery and Reinvestment Act (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; and
- Utilizing Department Credit Programs To Leverage Limited Federal Transportation Infrastructure Resources.

The management challenges will be further discussed in the DOT Annual Performance Report to be issued in February 2013, which will be located on DOT's website, **http://www.dot.gov/budget.**

The significant challenges identified by the OIG for FY 2013 will be discussed in the Other Accompanying Information setion of this report.

FINANCIAL REPORT

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

CHRISTOPHER P. BERTRAM

I am pleased to issue the Department of Transportation's (DOT) Fiscal Year 2012 Agency Financial Report (AFR). In addition to this information, DOT is preparing our Annual Performance Report, which will be published in February 2013. For the accompanying AFR, we highlight our progress during 2012 on several fronts. We had a positive year, with notable achievements in many areas, including efforts to modernize our financial systems, a successful financial audit, and continuing success in limiting improper payments.

FINANCIAL SYSTEMS MODERNIZATION

DOT furthered its efforts to modernize and streamline financial management policies, processes, reports, and systems to meet its mission and goals. During 2012, we implemented an electronic invoicing portal and began deploying it to DOT grant recipients. The goals of this initiative are to:

- Provide a standard process for grant recipients to submit invoices to the Department;
- Eliminate as much as possible paper invoice submissions by allowing grantees to submit invoices electronically through an online portal; and
- Offer the ability to view the status of all invoices in real time, which improves transparency.

Initial deployment of the Delphi eInvoicing system to grantees will be completed in November 2012. By offering this solution to grant recipients, the Department estimates approximately 900 invoices will be submitted electronically per month, eliminating the need for grantees to mail, e-mail, or fax invoices.

In addition to the electronic invoicing initiative, the Department also completed an assessment to determine whether it is feasible to upgrade the Department's core accounting system, Delphi, to the next release of Oracle Federal Financials. The assessment provided the Department with information necessary to consider the resource and logistical requirements for a possible systems upgrade. Plans are being formulated for an upgrade, and we are preparing a business case analysis detailing the timeline and associated costs.

ANNUAL FINANCIAL AUDIT

During 2012, we continued our emphasis on improved financial management, which contributed substantially to another unqualified audit opinion – DOT's eleventh in the last twelve years. The Department had a material weakness associated with the oversight and proper recording of Undelivered Orders (UDOs), which are budget obligations that have not yet been fully liquidated by making a payment. We are already taking corrective actions to resolve this issue, which includes the development of a Departmental Order requiring the periodic review of UDO balances. In addition to this step, supplemental training opportunities for Departmental personnel related to grants monitoring and closeout was completed this fall. Overall in 2012, our annual financial audit provided a useful independent review of our processes and system of controls. It highlighted some issues, including UDOs and grants management, that will be a continuing focus for management in 2013. Consideration of these important annual audit results remains an important component of our efforts to continually strengthen our safeguards and stewardship of taxpayer dollars.

IMPROPER PAYMENTS

During 2012, we worked with our Operating Administrations to maintain low rates of improper payments. We tested for improper payments in 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. In addition, DOT proactively expanded the scope of this review to the Federal Railroad Administration's High Speed Rail Program. Together, these five programs represent more than 90 percent of DOT's grants. Our analysis found that estimated improper payment rates for these programs did not exceed 1 percent, which falls below the Office of Management and Budget's 2.5 percent criterion of what would constitute "significant improper payments." However, the estimated improper payments for the Federal-aid Highway Constructions and Planning Program was $103 million, which meets the OMB's criterion for "significant improper payments (greater than $100 million, regardless of error rate)." 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.

INTERNAL CONTROLS

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 2012, we continued to manage a sound internal controls program for the Department that focused on proactively identifying risks and improving our system of internal controls to meet these challenges.

In the coming year, we expect additional progress in modernizing our financial systems. We will build on our accomplishments, and maintain a strong program that supports the Department's strategic goals and critical investments.

Sincerely,

CHRISTOPHER P. BERTRAM

Memorandum

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

Subject: ACTION: Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2012 and 2011, Department of Transportation Report Number: QC-2013-020

Date: November 15, 2012

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 2012 and 2011.

The audit of DOT's consolidated financial statements as of and for the year ended September 30, 2012, was completed by KPMG LLP (see Attachment) under contract to the Office of Inspector General. The contract required the audit to 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.

KPMG LLP concluded that the consolidated financial statements present fairly, in all material respects, DOT's financial position as of September 30, 2012, and its net costs, changes in net position, and budgetary resources for the year ended, in conformity with U.S. generally accepted accounting principles. Clifton Gunderson LLP, under contract to the Office of Inspector General, audited DOT's fiscal year 2011 consolidated financial statements, and expressed an unqualified opinion on those statements.[1]

DOT substantially corrected two of three significant deficiencies in internal control reported in Clifton Gunderson LLP's fiscal year 2011 audit report, but the remaining significant deficiency in internal control is now a material weakness.

[1] Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2011 and 2010, Department of Transportation, Report Number QC-2012-009, November 15, 2011. OIG reports and testimony can be found on our Web site at: www.oig.dot.gov.

KPMG LLP's Fiscal Year 2012 Audit Report

KPMG LLP reported one material weakness and two significant deficiencies in internal control over financial reporting. In addition, KPMG LLP reported two instances of noncompliance with laws and regulations.

Material Weakness

Lack of Sufficient Controls over Undelivered Orders – KPMG LLP determined that DOT had a potential material misstatement in Undelivered Orders (UDO) as of March 31, 2012. Improperly designed internal controls contributed to this misstatement. To address KPMG LLP's finding, DOT conducted a review of UDOs and found over $2 billion that needed to be deobligated. DOT performed the necessary deobligations to correct its financial data. However, until DOT corrects the existing control deficiencies, there is a risk that material misstatements may occur and remain undetected.

Significant Deficiencies

1. **Lack of Sufficient Controls over Grant Accruals** – The Federal Aviation Administration, Federal Highway Administration (FHWA), and Federal Railroad Administration have weaknesses in the methodologies used to estimate grant accruals. As a result, the grant accruals are potentially understated.

2. **Lack of Sufficient Controls over Financial Statement Preparation and Review** – DOT's interim financial statements as of and for the period ended June 30, 2012, had numerous material errors due to deficiencies in the preparation and review processes. In addition, the fiscal year 2012 consolidated financial statements had errors in several note disclosures. Until the processes are corrected, there is a risk that misstatements will occur and remain undetected.

Instances of Noncompliance with Laws and Regulations

1. **Noncompliance with the Federal Financial Management Improvement Act of 1996** – DOT has a material weakness related to controls over UDOs that affects DOT's ability to prepare financial statements in accordance with Federal accounting standards.

2. **Noncompliance with the Anti-Deficiency Act** – Over the past decade, the U.S. Merchant Marine Academy, the Federal Motor Carrier Safety

Administration (FMCSA), and FHWA committed anti-deficiency violations. For example, FMCSA issued grant awards in excess of available funding by approximately $26 million.

We performed a QCR of KPMG 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. KPMG LLP is responsible for its report dated November 15, 2012, and the conclusions expressed in that report. However, our QCR disclosed no instances in which KPMG LLP did not comply, in all material respects, with generally accepted Government auditing standards.

KPMG LLP made 19 recommendations to strengthen DOT's financial, accounting, and system controls. DOT officials concurred with KPMG LLP's findings on the material weakness, significant deficiencies and instances of noncompliance with laws and regulations. The Department also committed to submitting to OIG, by December 31, 2012, 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.

We appreciate the cooperation and assistance of DOT representatives and KPMG LLP. If we can answer any questions, please call me at 202-366-1959, or Lou E. Dixon, Principal Assistant Inspector General for Auditing and Evaluation, at 202-366-1427.

Attachment

#

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheet of the U.S. Department of Transportation (DOT) as of September 30, 2012, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources (hereinafter referred to as "consolidated financial statements") for the year then ended. The objective of our audit was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our fiscal year 2012 audit, we also considered the DOT's internal control over financial reporting and tested the DOT's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these consolidated financial statements. The consolidated financial statements of the DOT as of September 30, 2011, and for the year then ended were audited by other auditors. Those auditors expressed an unqualified opinion on the fiscal year 2011 consolidated financial statements in their report dated November 11, 2011.

Summary

As stated in our opinion on the consolidated financial statements, we concluded that the DOT's consolidated financial statements as of and for the year ended September 30, 2012, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our opinion on the consolidated financial statements, the DOT changed its presentation for reporting the Combined Statement of Budgetary Resources in fiscal year 2012, based on new reporting requirements under Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*. As a result, certain balances on the DOT's Combined Statement of Budgetary Resources for fiscal year 2011 have been reclassified to conform to the current year presentation.

As discussed in our opinion on the consolidated financial statements, the consolidated financial statements reflect actual excise tax revenues deposited in the Highway Trust Fund and the Airport and Airway Trust Fund through June 30, 2012, and excise tax receipts estimated by the Department of Treasury's Office of Tax Analysis for the quarter ended September 30, 2012.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies that we consider to be a material weakness, and other deficiencies that we consider to be significant deficiencies, as defined in the Internal Control Over Financial Reporting section of this report, as follows:

A. Exhibit I – *Lack of Sufficient Controls over Undelivered Orders*

B. Exhibit II – *Lack of Sufficient Controls over Grant Accruals*

C. Exhibit II – *Lack of Sufficient Controls over Financial Statement Preparation and Review*

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instances of noncompliance and other matter that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended:

D. Exhibit III – *Noncompliance with the Federal Financial Management Improvement Act of 1996*

E. Exhibit III – *Noncompliance with the Anti-Deficiency Act*

We also reported an other matter related to potential compliance with the *Anti-Deficiency Act* in Exhibit III.

The following sections discuss our opinion on the DOT's consolidated financial statements; our consideration of the DOT's internal control over financial reporting; our tests of the DOT's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, and other matter; and management's and our responsibilities.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of the U.S. Department of Transportation (DOT) as of September 30, 2012 and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the year then ended.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the DOT as of September 30, 2012 and its net costs, changes in net position, and budgetary resources for the year then ended, in conformity with U.S. generally accepted accounting principles. The consolidated financial statements of the DOT as of September 30, 2011, and for the year then ended were audited by other auditors. Those auditors expressed an unqualified opinion on the fiscal year 2011 consolidated financial statements in their report dated November 11, 2011.

As discussed in Note 1 to the consolidated financial statements, the DOT changed its presentation for reporting the Combined Statement of Budgetary Resources in fiscal year 2012, based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*. As a result, certain balances on the DOT's Combined Statement of Budgetary Resources for fiscal year 2011 have been reclassified to conform to the current year presentation.

As discussed in Notes 1 and 20, the consolidated financial statements reflect actual excise tax revenues deposited in the Highway Trust Fund and the Airport and Airway Trust Fund through June 30, 2012, and excise tax receipts estimated by the Department of Treasury's Office of Tax Analysis for the quarter ended September 30, 2012.

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The information in the Other Accompanying Information, Forward, and Message from the Secretary sections as listed in the Table of Contents of the DOT Agency Financial Report are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Internal Control Over Financial Reporting

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, in our fiscal year 2012 audit, we identified certain deficiencies in internal control over financial reporting that we consider to be a material weakness and other deficiencies 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in Exhibit I to be a material weakness.

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 described in Exhibit II to be significant deficiencies.

Exhibit IV presents the status of prior year significant deficiencies and instances of non-compliance.

We noted certain additional matters that we have reported to management of the DOT in a separate letter dated November 15, 2012.

Compliance and Other Matters

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed two instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit III.

The results of our other tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed instances, described in Exhibit III, where the DOT's financial management systems did not substantially comply with applicable Federal accounting standards.

The results of our tests of FFMIA disclosed no instances in which the DOT's financial management systems did not substantially comply with (1) Federal financial management systems requirements and (2) the United States Government Standard General Ledger at the transaction level.

* * * * * * *

Responsibilities

Management's Responsibilities. Management is responsible for the consolidated financial statements; establishing and maintaining effective internal control over financial reporting; and complying with laws, regulations, contracts, and grant agreements applicable to the DOT.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2012 consolidated financial statements of the DOT based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DOT's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our fiscal year 2012 audit, we considered the DOT's internal control over financial reporting by obtaining an understanding of the DOT's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DOT's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the DOT's internal control over financial reporting. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

As part of obtaining reasonable assurance about whether the DOT's fiscal year 2012 consolidated financial statements are free of material misstatement, we performed tests of the DOT's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the DOT. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

The DOT's written response to the findings identified in our audit and presented herein was not subjected to the auditing procedures applied in the audit of the DOT's consolidated financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the DOT's management, the DOT's Office of Inspector General, OMB, the U.S. 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.

KPMG LLP

November 15, 2012

A. Lack of Sufficient Controls over Undelivered Orders

Criteria

US Code Title 31 Section 1501 states that an amount shall be recorded as an obligation of the United States Government only when supported by documentary evidence of a binding agreement between an agency and another person (including an agency) that is (a) in writing, in a way and form, and (b) for a purpose authorized by law, and executed before the end of the period of availability.

US Code Title 31 Section 1554 states that the head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed to support the certification required by section 1108 (c) of this title.

The United States Standard General Ledger Supplement No. S2 Treasury Financial Manager defines an Undelivered Order (Obligation) as the amount of goods and/or services ordered, which have not been actually or constructively received and for which amounts have not been prepaid or advanced. This includes amounts specified in other contracts or agreements such as grants, program subsidies, undisbursed loans and claims, and similar events for which an advance or prepayment has not occurred.

Statement of Federal Financial Accounting Concepts (SFFAC) No 1, *Objective of Federal Financial Reporting* Issued by the Federal Financial Accounting Standards Advisory Board (FASAB), Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purpose authorized, and are recorded in accordance with federal accounting standards.

The Standards for Internal Control in the Federal Government (Standards) issued by the Government Accountability Office states that transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded.

Background

In carrying out its mission, the DOT incurs obligations by entering into contracts or agreements for the purchase of goods and services from other Federal agencies and the public, and for the execution of grant agreements with state and local governments and other grantees. These obligations are recorded as undelivered orders in the DOT consolidated financial statements on the statement of budgetary resources.

Once an obligation is satisfied and/or no longer required, funds are required to be de-obligated, which reduces the balance of undelivered orders and potentially releases the funds for other uses. As of September 30, 2012, the DOT reported $86.5 billion in obligations, which included an adjustment in the amount of $1.4 billion that was not properly supported by a new contract, grant agreement, or underlying financial event.

Condition

We noted a control deficiency in the monitoring of grant and non-grant undelivered orders, particularly those obligations that were aged over one year and had no recent activity (aged undelivered orders). Specifically, we noted that DOT has inadequate policies and/or does not consistently apply its policy of timely review and de-obligation of open obligations. The following conditions were identified during our audit:

1. As of March 31, 2012:

    - During our review of a statistical sample of 235 items, totaling $1.3 billion from a total of $7.5 billion of aged grant related undelivered orders, we noted that for 75 items, totaling $109 million, the related grant agreements' period of performance had either ended and/or the project funded by the grant was completed; however, the unused obligations for these items were not properly de-obligated by management.

    - In addition, during our review a statistical sample of 25 items, totaling $433 million from a total of $816 million of aged non-grant related undelivered orders, we noted that for 13 items, totaling $1.5 million, the related contracts/agreements had ended; however, the unused balances for these items were not properly de-obligated by management.

Based on these reviews, we determined that a potentially material amount of undelivered orders were reported as of March 31, 2012, which should have been deobligated. Subsequently, and as a result of our review, DOT conducted a review of aged grant related undelivered orders as of March 31, 2012 and de-obligated approximately $2.1 billion of grant agreements.

2. As of August 31, 2012:

    - During our review of a statistical sample of 232 items, totaling $2.3 billion from a total of $7.7 billion of aged grant related undelivered orders, we noted that for 15 items, totaling $39.3 million, the related grant agreements' period of performance had either ended and/or the project funded by the grant was completed; however, the unused obligations for these items were not properly de-obligated by management.

Cause

Existing controls for the review and monitoring of grant and non-grant related undelivered orders to determine if the obligation is still valid are not adequately designed, at the appropriate level of precision, to timely identify all unused obligation balances that may, in the aggregate, be material to the consolidated financial statements taken as a whole.

Specifically, under the DOT's Federal Highway Administration's (FHWA) existing process, the Financial Integrity Review and Evaluation (FIRE) program, grants with unexpended obligation balances of $50,000 to $500,000 are not included in the review until the grant has been inactive for 24 months and grants with unexpended obligation balances of less than $50,000 are not included in the review until the grant has been inactive for 36 months. In addition, the personnel executing the existing review process do not always properly identify amounts that should be de-obligated.

The DOT's Federal Transit Administration's (FTA) existing process to annually review and de-obligate funds is not appropriately designed to timely identify unused obligation balances as the review only includes grants that were originally obligated more than 5 years ago with no activity within 18 months.

Effect

Undelivered orders were potentially overstated as of September 30, 2012 by approximately $319.2 million and $131.3 million for grant and non-grant related undelivered orders, respectively. Furthermore, the lack of adequate processes to review undelivered orders increases the risk that material misstatements may occur and not be detected.

Recommendations

We recommend that DOT perform the following:

1. Develop a department-wide requirement for the periodic operating administration certification of the open obligation balance that is inactive for twelve or more months;
2. Develop and provide training department-wide related to grants management, including the monitoring and close-out process;
3. Revise the FHWA FIRE program and the FTA review process to require more timely identification and de-obligation of aged grant obligations; and
4. Implement a review process that requires all other DOT operating administrations to analyze and monitor grant and non-grant related undelivered orders to ensure that the undelivered orders represent goods and services ordered, but not yet received prior to the end of the reporting period, or potential amounts yet to be claimed under the grant agreement.

B. Lack of Sufficient Controls over Grant Accruals

Criteria

Statement of Federal Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government,* Issued by the Federal Accounting Standards Advisory Board (FASAB) states, a liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.

FASAB Technical Release 12: *Accrual Estimate for Grant Programs* states agencies must accumulate sufficient relevant and reliable data on which to base accrual estimates. Each agency should prepare grant accrual estimates based upon the best available data at the time the estimates are made. As part of the agencies' internal control procedures to ensure that grant accrual estimates for the basic financial statements were reasonable, agencies should validate grant accrual estimates by comparing the estimates with subsequent grantee reporting.

The DOT Financial Management Policies Manual requires that estimated accruals be carefully analyzed and compared with subsequent actual amounts to ensure that the accrual estimation process is continuously refined to improve accuracy. Further, the DOT Financial Management Policies Manual requires that accruals be as accurate as possible based on actual events.

Background

At fiscal year-end, the DOT calculates and records an estimated liability for amounts owed to its grantees for costs incurred under grant agreements (including any subcontractor costs), but not yet billed to or reimbursed by the DOT. Seventy-eight percent of the DOT's grant accrual balance as of September 30, 2012 is comprised of grant accruals related to the Federal Highway Administration (FHWA), the Federal Aviation Administration (FAA), Office of the Secretary (OST), and the Federal Railroad Administration (FRA). As the grants related to each of these operating administrations are vastly different in nature, each operating administration develops a unique grant accrual methodology.

Condition

During our review of the estimation methodology for the DOT's grant accruals, we noted the following weaknesses in the grant accrual estimation methodology for FHWA (including OST), FAA, and FRA:

<u>Federal Highway Administration and Office of the Secretary</u>

During our review of the estimation process for FHWA's grant accrual, we noted that while FHWA is responsible for managing certain grants on behalf of the DOT's OST, such as portions of the TIGER Grants Program, FHWA did not properly include these grants in the grant accrual calculation provided to OST for recording at period-end. In addition, we noted that FHWA had not performed an assessment to determine if a grant accrual was necessary for three of its grant programs with significant expense activity during fiscal year 2012.

Federal Aviation Administation

During our review of the estimation process for FAA's grant accrual, we noted that FAA had not performed an adequate retrospective review or look back analysis to validate the methodology used to calculate its grant accrual as of September 30, 2011, as required by generally accepted accounting principles and the DOT Financial Management Policies Manual. In addition, we noted that there was not a process in place to accumulate sufficient relevant and reliable data from grantees as a basis for preparing grant accrual estimates.

Federal Railroad Administration

During our review of the estimation process for FRA's grant accrual as of March 31, 2012, we noted that FRA had not performed a retrospective review or look back analysis to validate the methodology used to calculate its grant accrual as of September 30, 2011, as required by generally accepted accounting principles and the DOT Financial Management Policies Manual. In addition, we noted that FRA does not have a process in place to ensure that a complete population of grantees was included in its accrual calculation. Specifically, we noted that thirteen treasury fund symbols, which consisted of 226 grantees, with significant outstanding grant-related obligations, were omitted from the calculation.

FRA management subsequently updated its grant accrual methodology as of June 30, 2012 to include a retrospective review of the prior period accrual, however it does not include a process to ensure the completeness of the population of grantees used in the accrual calculation. Specifically, we noted that seven grantees were omitted from its grant accrual calculation as of June 30, 2012. In addition, we noted that data used to capture the incurred, but not yet billed costs, for nine of the twenty-five grantees selected for review was not based on current, relevant data as these grantees had not submitted current financial reports. Lastly, we noted that FRA did not perform an analysis to estimate the costs incurred by the grantees, but not yet submitted for payment.

Cause

Federal Highway Administration

There are not adequate controls in place at FHWA to ensure that all significant grantees and/or overall grant programs are properly included in the grant accrual estimate methodology.

Federal Aviation Administation

There are not adequate controls in place at FAA to require a retrospective review or look back analysis to validate its grant accrual methodology. In addition, FAA does not have a process in place to accumulate sufficient relevant and reliable data from its grantees that can be used as a basis for preparing future grant accruals.

Federal Railroad Administration

There are not adequate controls in place at FRA to require a retrospective review or look back analysis to validate its grant accrual methodology. In addition, the grant accrual methodology does not include the costs incurred by the grantees, but not yet submitted for payment as of period-end. Lastly, the controls in place at FRA are not adequate to ensure that all significant grantees are included in the grant accrual calculation.

Effect

The grant accrual is potentially understated in DOT's interim financial statements submitted to the Office of Management and Budget (OMB) and on the consolidated financial statements as of September 30, 2012.

Recommendations

We recommend that FHWA (in coordination with OST, where applicable):

1. Determine the appropriate grant accrual for the related FHWA TIGER grant programs; and
2. Perform a quarterly evaluation for applicable grant programs to determine if an accrual is required.

We recommend that FRA:

1. Perform the required retrospective review or look back analysis to validate its grant accrual methodology in accordance with generally accepted accounting principles and the DOT Financial Management Policies Manual;
2. Update its grant accrual methodology to include a thorough supervisory review to ensure all significant grant activity is properly included in the estimate and include an analysis for the costs incurred by the grantee, but not yet submitted for payment; and
3. Establish additional procedures to obtain current and relevant data for grants with outdated grantee reporting.

We recommend that FAA:

1. Perform the required retrospective review or look back analysis to validate its grant accrual methodology in accordance with generally accepted accounting principles and the DOT Financial Management Policies Manual; and
2. Develop a process to accumulate relevant and reliable data from grantees to use in estimating its grant accrual.

C. Lack of Sufficient Controls over Financial Statement Preparation and Review

Criteria

The *Federal Managers' Financial Integrity Act of 1982* (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General. These standards are established in the GAO's *Standards for Internal Control in the Federal Government (Standards)*. The GAO defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

Background

Financial reporting in the federal environment is a complicated and evolving process. In addition, the complex and varied operations of the DOT and its 13 operating administrations makes consolidated reporting, under standards issued by the Federal Accounting Standards Advisory Board (FASAB) and OMB, a challenge for the DOT.

Condition

During our fiscal year 2012 audit, we noted several areas for improvement in the DOT's consolidated financial statement preparation and review. Specifically, through our review of the DOT's interim consolidated financial statements as of and for the period ended June 30, 2012, we noted numerous material misclassifications in the notes to the financial statements. The misclassifications occurred within the following note disclosures:

- Fund Balance with Treasury;
- Property, Plant & Equipment;
- Liabilities Not Covered by Budgetary Resources;
- Other Liabilities;
- Earmarked Funds; and
- Reconciliation of Net Cost to Budget.

In addition, through our review of the DOT's consolidated financial statements as of and for the year ended September 30, 2012, we noted additional misclassifications in the following note disclosures, which were subsequently corrected:

- Earmarked Funds;
- Commitments and Contingencies;
- Combined Statement of Budgetary Resources – Available Contract Authority at Year-end;

- Reconciliation of Net Cost to Budget; and
- Fiduciary Activities.

Cause

Existing controls related to the DOT operating administration preparation and the consolidated review of the financial statements and notes are not adequately designed, at the appropriate level of precision, to prevent a misstatement in the financial statements or notes.

Effect

Misstatements and/or misclassifications may occur and not be detected in the consolidated financial statements and notes.

Recommendations

We recommend that DOT:

1. Develop financial statement and note disclosure preparation guidance for the operating administrations to ensure consistency across the Department;
2. Provide training, where necessary, to the operating administrations to ensure the financial statement and note disclosure guidance is implemented department-wide and to ensure the operating administrations understand the requirements of each line item on the financial statements and notes;
3. Develop a financial statement (including notes) review checklist (that includes a review of account mapping) to be completed by the operating administrations prior to submission of their financial statements and to be completed by the DOT after consolidation; and
4. Automate footnotes, where applicable, to ensure consistency across the Department.

D. Noncompliance with the Federal Financial Management Improvement Act of 1996 (FFMIA)

Criteria

The Federal Financial Improvement Management Act of 1996, Section 803(a) states that Federal financial management systems comply with (1) Federal accounting standards, (2) Federal system requirements, and (3) the United States Government Standard General Ledger at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

Condition

The DOT is required to prepare its financial statements in accordance with applicable Federal accounting standards. As discussed in the Internal Control over Financial Reporting section of this report, we identified a material weakness related to controls over undelivered orders that affected the DOT's ability to prepare its financial statements in accordance with Federal accounting standards.

Cause

There are not adequate policies and procedures over undelivered orders to establish and maintain financial management systems that comply with Federal accounting standards.

Effect

The DOT's financial management systems did not substantially comply with the applicable Federal accounting standards.

Recommendation

We recommend that the DOT improve its internal controls over undelivered orders, as noted above, to ensure that DOT's financial management systems comply with the Federal accounting standards.

E. Noncompliance with the Anti-Deficiency Act

Criteria

Title 31 U.S. Code (U.S.C.) Section 1517 states that an officer or an employee of the United States Government may not make or authorize an expenditure or obligation exceeding an apportionment or an amount permitted by regulations as specified by Title 31 U.S.C. Section 1514.

Condition

<u>Known Anti-Deficiency Act Violations:</u>

<u>Maritime Administration (MARAD)</u>

During fiscal years 2003 through 2008, the U.S. Merchant Marine Academy, a component of MARAD, committed Anti-Deficiency Act violations totaling approximately $5 million, as a result of charging user fees above the amounts allowable under the U.S.C and using these fees to pay for the Academy's operations. The DOT reported this violation to the Office of Management and Budget (OMB), the President, U.S. Senate, and U.S. Congress on July 6, 2012.

Federal Motor Carrier Safety Administration (FMCSA)

During the fiscal years 2005 through 2010, the FMCSA committed Anti-Deficiency Act violations totaling $25.6 million, as a result of issuing grant awards within the Commercial Vehicle Systems and Networks (CVISN) that exceeded available funding for this program, as well as reprogramming of funds within the CVISN, Performance Information Systems Management (PRISM), and Safety Improvement Program (SaDIP) grant programs, which resulted in grant awards exceeding the available funding. As of the date of our report, the DOT has drafted the final Anti-Deficiency Act report for OMB, the President, U.S. Senate, and U.S. Congress confirming the actual Anti-Deficiency Act violations by the FMCSA.

Federal Highway Administration (FHWA)

During fiscal year 2010, the FHWA committed Anti-Deficiency Act violations totaling $11.5 million, as a result of entering obligations in the American Reinvestment and Recovery Act (ARRA) appropriation(s) within the Tiger Grants Program ($10M), Refuge Roads Program ($1.0M), and the Puerto Rico Highway Program ($465K) that exceeded the amount apportioned in those program categories. As of the date of our report, the DOT has not yet drafted the final Anti-Deficiency Act report for OMB, the President, U.S. Senate, and U.S. Congress confirming the actual Anti-Deficiency Act violations by the FHWA.

Potential Anti-Deficiency Act Violations:

FMCSA

During fiscal years 2005 through 2010, the FMSCA may have committed further *Anti-Deficiency Act* violations in relation to grant awards under the CVISN program.

Cause

At the time when the violations occurred, there were not sufficient controls in place to require an appropriate level of oversight over fund status monitoring to prevent Anti-Deficiency Act violations.

Effect

The DOT is not in compliance with the Anti-Deficiency Act.

Recommendations

We recommend that DOT:

1. Report the known violations, in accordance with the Anti-Deficiency Act and the applicable implementation guidance;
2. Complete the investigation into potential additional Anti-Deficiency Act violations at the FMCSA; and
3. Implement appropriate policies and procedures to prevent future violations.

Prior Year Condition	As Reported as of September 30, 2011	Status as of September 30, 2012
Control Deficiencies		
Financial and Fund Status Monitoring and Reporting	Significant Deficiency: The DOT has weaknesses in the following areas: • Over-reliance of journal entries; • Implementation of Managerial Cost Accounting; and • Fund Status Monitoring and Reporting	No longer considered a Significant Deficiency.
Undelivered Orders	Significant Deficiency: The DOT has weaknesses in the management and monitoring of inactive obligations.	Elevated to a Material Weakness (Exhibit I).
Implementation of GrantSolutions Grants Management System	Significant Deficiency: The DOT (Federal Railroads Administration and Federal Motor Carrier Safety Administration) has weaknesses in the implementation of GrantSolutions.	No longer considered a Significant Deficiency.
Compliance and Other Matters		
Anti-Deficiency Act	Instance of Non-Compliance: The DOT management reported potential ADA matters in FY 2011.	Repeated as actual or potential non-compliance violations (Exhibit III).
Federal Managers' Financial Integrity Act (FMFIA)	Instance of Non-Compliance: The DOT has weaknesses in its processes and procedures for reporting material weaknesses in its FMFIA assurance statement as related to the effectiveness of the DOT's information security program and its compliance with FISMA requirements.	No longer considered an instance of Non-Compliance.

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 15, 2012

MEMORANDUM TO: Calvin L. Scovell, III
Inspector General, US DOT

M. Hannah Padilla
Partner, KPMG LLP

FROM: Christopher P. Bertram

SUBJECT: Management's Response to the Audit Report on the Consolidated Financial Statements for Fiscal Year (FY) 2012

The Department of Transportation (DOT) is pleased to respond to the unqualified audit report on our Consolidated Financial Statements for FY 2012. 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 one material weakness and two significant deficiencies contained in your report on internal controls over financial reporting, and with two instances of non-compliance found in certain provisions of selected laws and regulations that you reviewed. We concur with all recommendations. Corrective actions have already begun to address these issues. The Department plans to submit a detailed action plan along with estimated completion dates of the actions to the Inspector General no later than December 31, 2012, 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.

CONSOLIDATED BALANCE SHEETS

As of September 30:

DOLLARS IN THOUSANDS	2012	2011
ASSETS		
Intragovernmental:		
Fund balance with Treasury *(Note 2)*	$33,356,274	$39,761,625
Investments, net *(Note 3)*	22,330,652	26,682,058
Accounts receivable *(Note 4)*	116,550	97,516
Other *(Note 5)*	164,634	123,152
Total intragovernmental	**55,968,110**	**66,664,351**
Cash	8	34,289
Accounts receivable, net *(Note 4)*	154,907	168,872
Direct loan and loan guarantees, net *(Note 6)*	5,022,807	4,187,635
Inventory and related property, net *(Note 7)*	857,891	845,833
General property, plant and equipment, net *(Note 8)*	14,030,366	13,740,507
Other *(Note 5)*	74,706	90,087
Total assets	**$76,108,795**	**$85,731,574**
Stewardship property, plant and equipment *(Note 9)*		
LIABILITIES (NOTE 10)		
Intragovernmental:		
Accounts payable	$9,823	$21,451
Debt *(Note 11)*	5,193,598	4,342,866
Other *(Note 15)*	2,287,336	2,561,301
Total intragovernmental	**7,490,757**	**6,925,618**
Accounts payable	634,174	1,186,794
Loan guarantee liability *(Note 6)*	192,829	158,425
Federal employee benefits payable *(Note 12)*	1,019,076	978,918
Environmental and disposal liabilities *(Note 13)*	1,010,818	1,068,076
Grant accrual *(Note 14)*	6,315,689	6,560,755
Other *(Note 15)*	1,372,782	1,490,386
Total liabilities	**$18,036,125**	**$18,368,972**
Commitments and contingencies *(Note 17)*		
NET POSITION		
Unexpended appropriations - earmarked funds *(Note 18)*	$1,108,929	$1,127,600
Unexpended appropriations - other funds	21,652,656	25,654,071
Cumulative results of operations - earmarked funds *(Note 18)*	25,768,480	30,832,675
Cumulative results of operations - other funds	9,542,605	9,748,256
Total net position	**58,072,670**	**67,362,602**
Total liabilities and net position	**$76,108,795**	**$85,371,574**

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	2012	2011
Program Costs *(Note 19):*		
SURFACE TRANSPORTATION		
Gross costs	$60,988,807	$61,126,121
Less: earned revenue	1,226,109	807,004
Net program costs	**59,762,698**	**60,319,117**
AIR TRANSPORTATION		
Gross costs	16,632,500	17,214,141
Less: earned revenue	628,167	669,479
Net program costs	**16,004,333**	**16,544,662**
MARITIME TRANSPORTATION		
Gross costs	886,118	863,357
Less: earned revenue	392,599	378,964
Net program costs	**493,519**	**484,393**
CROSS-CUTTING PROGRAMS		
Gross costs	647,327	738,477
Less: earned revenue	255,869	391,204
Net program costs	**391,458**	**347,273**
Costs not assigned to programs	396,058	421,434
Less earned revenues not attributed to programs	11,513	3,876
Net cost of operations	**$77,036,553**	**$78,113,003**

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	EARMARKED FUNDS	ALL OTHER FUNDS	2012 TOTAL	EARMARKED FUNDS	ALL OTHER FUNDS	2011 TOTAL
CUMULATIVE RESULTS OF OPERATIONS						
Beginning balance	$30,832,675	$9,748,256	$40,580,931	$37,822,289	$10,455,592	$48,277,881
BUDGETARY FINANCING SOURCES						
Appropriations used	4,565,650	10,945,160	15,510,810	5,037,496	15,964,657	21,002,153
Non-exchange revenue (Note 20)	52,969,165	87,411	53,056,576	48,691,798	109,444	48,801,242
Donations/forfeitures of cash/cash equivalents	1,224	-	1,224	1,212	-	1,212
Transfers-in/(out) without reimbursement	2,451,721	5,395	2,457,116	58,921	5,196	64,117
Other	-	(2,160)	(2,160)	-	-	-
OTHER FINANCING SOURCES (NON-EXCHANGE)						
Donations and Forfeitures of Property	-	158,117	158,117	-	-	-
Transfers-in/(out) without reimbursement	(924,602)	1,020,788	96,186	(782,441)	788,803	6,362
Imputed financing	528,664	113,118	641,782	698,858	119,923	818,781
Other	(6,684)	(146,260)	(152,944)	(31,059)	(246,755)	(277,814)
Total financing sources	59,585,138	12,181,569	71,766,707	53,674,785	16,741,268	70,416,053
Net cost of operations	64,649,333	12,387,220	77,036,553	60,664,399	17,448,604	78,113,003
Net change	(5,064,195)	(205,651)	(5,269,846)	(6,989,614)	(707,336)	(7,696,950)
Cumulative Results of Operations	**25,768,480**	**9,542,605**	**35,311,085**	**30,832,675**	**9,748,256**	**40,580,931**
UNEXPENDED APPROPRIATIONS						
Beginning balance	1,127,600	25,654,071	26,781,671	1,211,520	37,001,417	38,212,937
BUDGETARY FINANCING SOURCES						
Appropriations received (Note 1U)	4,592,701	7,017,825	11,610,526	5,021,360	5,299,664	10,321,024
Appropriations transferred-in/(out)	14,819	5,070	19,889	9,240	20,265	29,505
Other adjustments	(60,541)	(79,150)	(139,691)	(77,024)	(702,618)	(779,642)
Appropriations used	(4,565,650)	(10,945,160)	(15,510,810)	(5,037,496)	(15,964,657)	(21,002,153)
Total budgetary financing sources	(18,671)	(4,001,415)	(4,020,086)	(83,920)	(11,347,346)	(11,431,266)
Total unexpended appropriations	**1,108,929**	**21,652,656**	**22,761,585**	**1,127,600**	**25,654,071**	**26,781,671**
Net position	**$26,877,409**	**$31,195,261**	**$58,072,670**	**$31,960,275**	**$35,402,327**	**$67,362,602**

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	2012		2011	
BUDGETARY RESOURCES (NOTE 21)	**BUDGETARY**	**NON-BUDGETARY CREDIT REFORM FINANCING ACCOUNTS**	**BUDGETARY**	**NON-BUDGETARY CREDIT REFORM FINANCING ACCOUNTS**
Unobligated balance, brought forward, October 1	$50,244,231	$242,978	$60,471,640	$226,795
Recoveries of prior year unpaid obligations	1,199,749	17	1,005,484	198
Other changes in unobligated balance	(156,094)	-	(125,917)	-
Unobligated balance from prior year budget authority, net	51,287,886	242,995	61,351,207	226,993
Appropriations (Note 1U)	19,743,813	-	17,323,090	-
Borrowing authority	-	1,734,768	175,000	1,181,282
Contract authority	53,108,963	-	53,306,399	-
Spending authority from offsetting collections	7,754,699	234,155	7,116,258	120,517
Total budgetary resources	**$131,895,361**	**$2,211,918**	**$139,271,954**	**$1,528,792**
Status of Budgetary Resources:				
Obligations incurred	$84,627,858	$1,926,888	$89,027,723	$1,285,814
Unobligated balance, end of year:				
Apportioned	29,066,936	105,393	33,552,539	39,047
Exempt from apportionment	352,571	-	317,713	-
Unapportioned	17,847,996	179,637	16,373,979	203,931
Total unobligated balance, end of year	**47,267,503**	**285,030**	**50,244,231**	**242,978**
Total budgetary resources	**$131,895,361**	**$2,211,918**	**$139,271,954**	**$1,528,792**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

COMBINED STATEMENTS OF BUDGETARY RESOURCES, Continued

For the Periods Ended September 30

DOLLARS IN THOUSANDS	2012		2011	
CHANGE IN OBLIGATED BALANCES	**BUDGETARY**	**NON-BUDGETARY CREDIT REFORM FINANCING ACCOUNTS**	**BUDGETARY**	**NON-BUDGETARY CREDIT REFORM FINANCING ACCOUNTS**
Unpaid obligations, brought forward, October 1 (gross)	$114,089,855	$3,815,207	$110,640,417	$4,194,500
Uncollected customer payments from Federal sources, brought forward, October 1	(1,192,857)	(238,553)	(1,102,192)	(325,263)
Obligated balance, start of year (net)	112,896,998	3,576,654	109,538,225	3,869,237
Obligations incurred	84,627,858	1,926,888	89,027,723	1,285,814
Outlays (gross)	(85,585,176)	(1,320,846)	(84,595,015)	(1,664,909)
Change in uncollected customer payments from Federal sources	(56,265)	15,847	(90,665)	86,710
Actual transfers, unpaid obligations	10,000	-	22,214	-
Recoveries of prior year unpaid obligations	(1,199,749)	(17)	(1,005,484)	(198)
Obligated balance, end of year				
Unpaid obligations, end of year (gross)	111,942,788	4,421,232	114,089,855	3,815,207
Uncollected customer payments from Federal sources, end of year	(1,249,122)	(222,706)	(1,192,857)	(238,553)
Obligated balance, end of year (net)	**$110,693,666**	**$4,198,526**	**$112,896,998**	**$3,576,654**
Budget and Authority and Outlays, Net:				
Budget authority, gross	$80,607,475	$1,968,923	$77,920,747	$1,301,799
Actual offsetting collections	(7,726,408)	(466,819)	(7,043,681)	(382,466)
Change in uncollected customer payments from Federal sources	(56,265)	15,847	(90,665)	86,710
Budget authority, net	**$72,824,802**	**$1,517,951**	**$70,786,401**	**$1,006,043**
Outlays, gross	$85,585,176	$1,320,846	$84,595,015	$1,664,909
Actual offsetting collections	(7,726,408)	(466,819)	(7,043,681)	(382,466)
Outlays, net	77,858,768	854,027	77,551,334	1,282,443
Distributed offsetting receipts	(2,738,974)	-	(282,618)	-
Agency outlays, net	**$75,119,794**	**$854,027**	**$77,268,716**	**$1,282,443**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

NOTES TO THE PRINCIPAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. REPORTING ENTITY

The United States (U.S.) Department of Transportation (DOT or Department) serves as the strategic focal point in the Federal Government's national transportation plan. It partners with cities and States to meet local and national transportation needs by providing financial and technical assistance, ensuring the safety of all transportation modes; protecting the interests of the American traveling public; promoting international transportation treaties; and conducting planning and research for the future.

The Department comprises the Office of the Secretary and the DOT Operating Administrations, each having its own management team and organizational structure. Collectively, they provide services and oversight to ensure that the best possible transportation system serves the American public. The Department's consolidated financial statements present the financial data for various trust funds, revolving funds, appropriations, and special funds of the following organizations (referred to as Operating Administrations):

- 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 U.S. Saint Lawrence Seaway Development Corporation (SLSDC) is a wholly-owned government corporation and an Operating Administration of the Department. However, SLSDC's financial data is not included in the DOT consolidated financial statements as it is subject to separate reporting requirements under the Government Corporation Control Act and the dollar value of its activities is not material to that of the Department taken as a whole. Condensed information about SLSDC's financial position is presented in Note 23.

B. BASIS OF PRESENTATION

The consolidated financial statements have been prepared to report the Department's financial position and 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. Material intra-departmental transactions and balances have been eliminated from the principal statements for presentation on a consolidated basis, except for the Statement of Budgetary Resources, which is presented on a combined basis in accordance with OMB Circular A-136, *Financial Reporting Requirements*, as revised, and as such, intra-entity transactions have not been eliminated. Unless otherwise noted, all dollar amounts are presented in thousands.

The Consolidated Balance Sheets present agency assets, liabilities, and net position (which equals total assets minus total liabilities) as of the reporting dates. Agency assets substantially consist of 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 for the reporting periods.

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 reporting periods. Recognition and measurement of budgetary information reported on these statements is based on budget terminology, definitions, and guidance presented in OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, dated August 2012.

A Statement of Custodial Activity is not presented since DOT custodial activity is incidental to Departmental operations and is not considered material to the consolidated financial statements taken as a whole.

Intragovernmental transactions 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 match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

DOT accounts for earmarked funds separately from other funds.

C. BUDGETS AND BUDGETARY ACCOUNTING

DOT follows standard Federal budgetary accounting policies and practices in accordance with OMB Circular A-11. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. Each year, the U.S. Congress (Congress) provides budget authority, primarily in the form of appropriations, to the DOT Operating Administrations to incur obligations in support of agency programs. For fiscal year FY 2012 and FY 2011, the Department was accountable for trust fund appropriations, general fund appropriations, revolving fund activity, borrowing authority, and contract authority. DOT recognizes budgetary resources as assets when cash (funds held by the U.S. 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 direct appropriations, borrowing authority, contract authority, and spending authority from offsetting collections. 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

The Department is required to be in substantial compliance with all applicable accounting principles and standards developed and issued 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.

Transactions are recorded on an accrual and a budgetary accounting 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.

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 liabilities and finance authorized purchases. Lockboxes have been established with financial institutions to collect certain payments, and these funds are transferred directly to the U.S. Treasury on a daily (business day) basis. DOT does not maintain any balances of foreign currencies.

F. INVESTMENTS IN U.S. GOVERNMENT SECURITIES

Investments that consist of 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 method. The Department also has the intent to hold investments to maturity. Investments, redemptions, and reinvestments are controlled and processed by the U.S. 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

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 RECEIVABLE

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 U.S. 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 organizations 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 estimable). 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 from the Judgment Fund administered by the U.S. Department of the Treasury (Treasury).

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 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 nonvested, 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, Federal Employee Retirement System (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 this 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.

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.

Q. FEDERAL EMPLOYEE COMPENSATION ACT BENEFITS

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 U.S. 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

The preparation of the principal financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amount of assets, liabilities, and contingent liability disclosures as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may 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. Additionally, the Federal Credit Reform Act of 1990 (FCRA) requires the Department to use estimates in determining the reported amount of direct loan and loan guarantees, the loan guarantee liability, and the loan subsidy costs associated with future loan performance.

T. ALLOCATION TRANSFERS

DOT is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and a recipient (child) entity. Allocation transfers are legal delegations by one Federal agency of its authority to obligate budget authority and outlay funds to another Federal agency. 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 agency, to the following non-DOT Federal agencies in accordance with applicable public laws and statutes: U.S. Bureau of Indian Affairs, U.S. Bureau of Reclamation, U.S. Forest Service, U.S. National Park Service, U.S.

Bureau of Land Management, U.S. Fish and Wildlife Service, U.S. Department of the Army, Appalachian Regional Commission, Tennessee Valley Authority, U.S. Army Corps of Engineers, Internal Revenue Service, U.S. Department of Housing and Urban Development, Denali Commission, U.S. Department of Navy, and the U.S. Department of Energy.

DOT receives allocations of funds, as the child agency, from the following non-DOT Federal agencies in accordance with applicable laws and statutes: U.S. Department of Agriculture, U.S. Department of the Interior, U.S. Department of the Navy, U.S. Department of the Army, U.S. Department of the Air Force, and the U.S. Department of Defense.

U. REVENUES AND OTHER FINANCING SOURCES

EARMARKED EXCISE TAX REVENUES (NON-EXCHANGE)

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 Internal Revenue Service (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 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 the U.S. Treasury to the HTF and AATF accounts.

The DOT September 30, 2012 financial statements reflect excise taxes certified by the IRS through June 30, 2012 and excise taxes estimated by OTA for the period July 1, 2012 to September 30, 2012 as specified by FASAB Statement of Federal Financial Accounting Standard (SFFAS) Number 7, *Accounting for Revenue and Other Financing Sources*. Actual tax collections data for the quarter ended September 30, 2012 will not be available from the IRS until January 2013.

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., overflight fees and registry certification 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 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 U.S. President (President) on August 5, 2011, reauthorizing FAA to again collect excise tax revenue through September 15, 2011.

On September 16, 2011, the President signed the U.S. House of Representatives (H.R.) 2887, P.L. 112-30, the Surface and Air Transportation Extension Act of 2011, provided the HTF with a temporary extension of authority to collect excise taxes and to make expenditures through March 31, 2012 and provided the AATF with a temporary extension of authority through January 31, 2012. The Surface Transportation Extension Act of 2012 granted the HTF another temporary extension of authority through June 30, 2012. Effective February 18, 2012, the FAA Modernization and Reform Act of 2012, P.L. 112-95, extended AATF authority to collect excise taxes and make expenditures through September 30, 2015.

On July 6, 2012, the President signed into law P.L. 112-141, Moving Ahead for Progress in the 21st Century (MAP-21), which extended the preceding law, the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, through September 30, 2012, and provided new authorization for surface transportation from October 1, 2012, through September 30, 2014. The law infused $2.4 billion into the HTF from the Leaking Underground Storage Tank (LUST) trust fund in FY 2012, and provides another $6.2 billion in FY 2013 and $12.6 billion in FY 2014 from the general fund. The new and existing programs in MAP-21 create a streamlined, performance-based, and multimodal program to address the many challenges facing the U.S. transportation system.

On September 28, 2012, the President signed the Continuing Appropriations Resolution, 2013, P.L. 112-175, to continue government operations through March 27, 2013, predominantly at FY 2012 spending levels.

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 FHWA, FAA, FTA, FRA, OST, and MARAD. 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, 2012, the Department had obligated $47.6 billion and disbursed $37 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 FASAB SFFAS Number 31, *Accounting for Fiduciary Activities*, this activity is reported separately in a note disclosure. The Maritime Administration Title XI Escrow Fund contains fiduciary activity as detailed in Note 24 to the Consolidated Financial Statements.

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 since the present value of the notes, discounted according to rates published in OMB M-11-12 Appendix C, *Discount Rates for Cost-Effectiveness, Lease Purchase, and Related Analyses*, with maturity dates of 2975 and 2082, was immaterial at September 30, 2012.

In addition, the Secretary of Transportation has possession of all the preferred stock shares (109,396,994) of Amtrak. Congress, through the Department, has continued to fund Amtrak since approximately 1972; originally through grants, then, beginning in 1981, through the purchase of preferred stock, and then, through grants again after 1997. The Amtrak Reform and Accountability Act of 1997 changed the structure of the preferred stock by rescinding the voting rights with respect to the election of the Board of Directors and by eliminating the preferred stock's liquidation preference over the common stock. The Act also eliminated further issuance of preferred stock to the Department. The Department does not record the Amtrak preferred stock in its financial statements because, under the Corporation's current financial structure, the preferred shares do not have a liquidation preference over the common shares, the preferred shares do not have any voting rights, and dividends are neither declared nor in arrears.

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 FRA Administrator to represent the Secretary at Board meetings (See Note 17).

X. RECLASSIFICATIONS

In FY 2012, changes to the presentation of the Combined Statements of Budgetary Resources were made in accordance with guidance provided in OMB Circular A-136 and as such, activity and balances reported on the FY 2011 Combined Statement of Budgetary Resources have been reclassified to conform to the presentation in the current year. Certain other prior year amounts have also been reclassified to conform with the current year presentation.

NOTE 2. FUND BALANCE WITH TREASURY

Fund Balances with Treasury at September 30

	2012	2011
FUND BALANCES		
Trust Funds	$6,243,944	$7,142,146
Revolving Funds	1,116,895	747,954
General Funds	25,635,140	31,455,847
Other Fund Types	360,295	415,678
Total	**$33,356,274**	**$39,761,625**
STATUS OF FUND BALANCE WITH TREASURY		
Unobligated balance:		
Available	$14,384,053	$16,979,464
Unavailable	2,750,400	2,313,572
Obligated balance not yet disbursed	15,608,159	20,360,093
Non-Budgetary Fund Balance with Treasury	613,662	108,496
Total	**$33,356,274**	**$39,761,625**

Fund Balances with Treasury are the aggregate amounts of the Department's accounts with Treasury for which the Department is authorized to make expenditures and pay liabilities. 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. These investments and contract authority amounts offset the Obligated balance not yet disbursed, therefore the unobligated and obligated balances presented above may not equal related amounts reported on the Combined Statements of Budgetary Resources.

NOTE 3. INVESTMENTS:

	COST	AMORTIZED DISCOUNT	INVESTMENTS (NET)	MARKET VALUE
INTRAGOVERNMENTAL SECURITIES:				Investments as of September 30, 2012
Marketable	$28,735	$179	$28,914	$28,950
Non-Marketable Par Value	20,395,163	-	20,395,163	20,395,163
Non-Marketable Market-Based	1,818,209	28,377	1,846,586	1,860,331
Subtotal	**22,242,107**	**28,556**	**22,270,663**	**22,284,444**
Accrued Interest Receivable	59,989	-	59,989	
Total Intragovernmental Securities	**$22,302,096**	**$28,556**	**$22,330,652**	**$22,284,444**
INTRAGOVERNMENTAL SECURITIES:				Investments as of September 30, 2011
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 Receivable	52,775	-	52,775	
Total Intragovernmental Securities	**$26,670,257**	**$11,801**	**$26,682,058**	**$26,656,788**

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

	GROSS AMOUNT DUE	ALLOWANCE FOR UNCOLLECTIBLE AMOUNTS	NET AMOUNT DUE
			Accounts Receivable at September 30, 2012
INTRAGOVERNMENTAL			
Accounts Receivable	$116,545	$-	$116,545
Accrued Interest	5	-	5
Total Intragovernmental	**116,550**	**-**	**116,550**
PUBLIC			
Accounts Receivable	174,794	(22,205)	152,589
Accrued Interest	2,395	(77)	2,318
Total Public	**177,189**	**(22,282)**	**154,907**
Total Receivables	**$293,739**	**$(22,282)**	**$271,457**
			Accounts Receivable at September 30, 2011
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**

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.

Other assets consist of the following at September 30

	2012	2011
INTRAGOVERNMENTAL		
Advances and Prepayments	$164,634	$123,152
Total Intragovernmental other assets	**$164,634**	**$123,152**
PUBLIC		
Advances to States for Right of Way	$19,363	$43,956
Other Advances and Prepayments	54,784	46,031
Other	559	100
Total Public other assets	**$74,706**	**$90,087**

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 with 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 re-estimates associated with direct loans and loan guarantees is provided in the following sections:

DIRECT LOANS

OBLIGATED PRIOR TO FY 1992 (ALLOWANCE FOR LOSS METHOD)	2012 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	$151	$-	$-	$151

OBLIGATED AFTER FY 1991	2012 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	$710,932	$1,512	$(47,219)	$665,225
(2) TIFIA Loans	4,696,784	-	(350,654)	4,346,130
Total	**$5,407,716**	**$1,512**	**$(397,873)**	**$5,011,355**

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 COSTS (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**

TOTAL AMOUNT OF DIRECT LOANS DISBURSED (POST-1991)

	2012	2011
DIRECT LOAN PROGRAMS		
(1) Railroad Rehabilitation Improvement Program	$285,694	$108,031
(2) TIFIA Loans	643,609	1,309,906
Total	**$929,303**	**$1,417,937**

SUBSIDY EXPENSE FOR DIRECT LOANS BY PROGRAM AND COMPONENT

SUBSIDY EXPENSE FOR NEW DIRECT LOANS DISBURSED

	2012 INTEREST DIFFERENTIAL	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER SUBSIDY COSTS	TOTAL
DIRECT LOAN PROGRAMS					
(1) Railroad Rehabilitation Improvement Program	$-	$13,969	$(13,969)	$-	$-
(2) TIFIA Loans	-	68,491	-	-	68,491
Total	**$-**	**$82,460**	**$(13,969)**	**$ -**	**$ 68,491**

	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**

MODIFICATIONS AND RE-ESTIMATES

	2012 TOTAL MODIFICATIONS	INTEREST RATE RE-ESTIMATES	TECHNICAL RE-ESTIMATES	TOTAL RE-ESTIMATES
DIRECT LOAN PROGRAMS				
(1) Railroad Rehabilitation Improvement Program	$-	$27,177	$(6,198)	$20,979
(2) TIFIA Loans	-	-	(36,886)	(36,886)
Total	**$-**	**$27,177**	**$(43,084)**	**$(15,907)**

	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**

TOTAL DIRECT LOAN SUBSIDY EXPENSE

	2012	2011
DIRECT LOAN PROGRAMS		
(1) Railroad Rehabilitation Improvement Program	$20,979	$1,128
(2) TIFIA Loans	31,605	99,917
Total	**$52,584**	**$101,045**

BUDGET SUBSIDY RATES FOR DIRECT LOANS FOR THE CURRENT YEAR COHORT

	2012 INTEREST DIFFERENTIAL	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER	TOTAL
DIRECT LOAN PROGRAMS					
(1) Railroad Rehabilitation Improvement Program	0.00%	0.89%	-0.89%	0.00%	0.00%
(2) TIFIA Loans	0.07%	8.76%	0.00%	0.00%	8.83%
Total	**0.07%**	**9.65%**	**-0.89%**	**0.00%**	**8.83%**

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)

	2012	2011
BEGINNING BALANCE, CHANGES, AND ENDING BALANCE		
Beginning balance of the subsidy cost allowance	$322,357	$222,072
Add: subsidy expense for direct loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	82,460	107,538
Fees and other collections	(13,969)	(8,625)
Total of the above subsidy expense components	**$68,491**	**$98,913**
Adjustments:		
Subsidy allowance amortization	8,963	(9,385)
Other	13,969	8,625
Ending balance of the subsidy cost allowance before re-estimates	413,780	320,225
Add or subtract subsidy re-estimates by component:		
Interest rate re-estimate	27,177	-
Technical/default re-estimate	(43,084)	2,132
Total of the above reestimate components	(15,907)	2,132
Ending balance of the subsidy cost allowance	**$397,873**	**$322,357**

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 Railroad Rehabilitation Improvement Program's upward reestimate 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.

DEFAULTED GUARANTEED LOANS FROM POST-1991 GUARANTEES

	2012 DEFAULTED GUARANTEED LOANS RECEIVABLE, GROSS	INTEREST RECEIVABLE	FORECLOSED PROPERTY	ALLOWANCE FOR SUBSIDY	VALUE OF ASSETS RELATED TO DEFAULT GUARANTEED LOANS RECEIVABLE, NET
LOAN GUARANTEE PROGRAMS					
(3) Federal Ship Financing Fund (Title XI)	**$97,312**	**$2,061**	**$6,500**	**$(94,572)**	**$11,301**

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

GUARANTEED LOANS OUTSTANDING

	2012 OUTSTANDING PRINCIPAL OF GUARANTEED LOANS, FACE VALUE	AMOUNT OF OUTSTANDING PRINCIPAL GUARANTEED
LOAN GUARANTEE PROGRAMS		
(3) Federal Ship Financing Fund (Title XI)	$1,966,363	$1,966,363
(4) OST Minority Business Resource Center	5,749	4,312
Total	**$1,972,112**	**$1,970,675**

NEW GUARANTEED LOANS DISBURSED

	2012 OUTSTANDING PRINCIPAL OF GUARANTEED LOANS, FACE VALUE	AMOUNT OF OUTSTANDING PRINCIPAL GUARANTEED
LOAN GUARANTEE PROGRAMS		
(3) Fed Ship Financing Fund (Title XI)	$593,976	$593,976
(4) OST Minority Business Resource Center	3,449	2,586
Total	**$597,425**	**$596,562**

	2011 OUTSTANDING PRINCIPAL OF GUARANTEED LOANS, FACE VALUE	AMOUNT OF OUTSTANDING PRINCIPAL GUARANTEED
LOAN GUARANTEE PROGRAMS		
(3) Fed Ship Financing Fund (Title XI)	$-	$-
(4) OST Minority Business Resource Center	3,130	2,348
Total	**$3,130**	**$2,348**

	2012 LIABILITIES FOR POST-1991 GUARANTEES, PRESENT VALUE
LIABILITY FOR LOAN GUARANTEES (PRESENT VALUE METHOD POST-1991 GUARANTEES):	
(3) Fed Ship Financing Fund (Title XI)	$192,382
(4) OST Minority Business Resource Center	447
Total	**$192,829**

SUBSIDY EXPENSE FOR LOAN GUARANTEES BY PROGRAM AND COMPONENT

SUBSIDY EXPENSE FOR NEW LOAN GUARANTEES DISBURSED

LOAN GUARANTEE PROGRAMS	2012 INTEREST SUPPLEMENTS	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER	TOTAL
(3) Federal Ship Financing Fund (Title XI)	$-	$48,520	$(34,732)	$-	$13,788
(4) OST Minority Business Resource Center	-	77	-	-	77
Total	**$-**	**$48,597**	**$(34,732)**	**$-**	**$13,865**

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

MODIFICATIONS AND RE-ESTIMATES

LOAN GUARANTEE PROGRAMS	2012 TOTAL MODIFICATIONS	INTEREST RATE RE-ESTIMATES	TECHNICAL RE-ESTIMATES	TOTAL RE-ESTIMATES
(3) Federal Ship Financing Fund (Title XI)	$-	$-	$(38,769)	$(38,769)
(4) OST Minority Business Resource Center	-	-	278	278
Total	**$-**	**$-**	**$(38,491)**	**$(38,491)**

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**

TOTAL LOAN GUARANTEE SUBSIDY EXPENSE

LOAN GUARANTEE PROGRAMS	2012	2011
(3) Federal Ship Financing Fund (Title XI)	$(24,981)	$2,318
(4) OST Minority Business Resource Center	355	(1)
Total	**$(24,626)**	**$2,317**

BUDGET SUBSIDY RATES FOR LOAN GUARANTEES FOR THE CURRENT YEAR COHORT

	2012 INTEREST SUPPLEMENTS	DEFAULTS	FEES AND OTHER COLLECTIONS	OTHER	TOTAL
LOAN GUARANTEE PROGRAMS					
(3) Federal Ship Financing Fund (Title XI)	0.00%	12.15%	-4.89%	0.00%	7.26%
(4) OST Minority Business Resource Center	0.00%	1.79%	0.00%	0.00%	1.79%
Total	**0.00%**	**13.94%**	**-4.89%**	**0.00%**	**9.05%**

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)

	2012	2011
BEGINNING BALANCE, CHANGES, AND ENDING BALANCE		
Beginning Balance of the loan guarantee liability	$158,425	$237,739
Add: subsidy expense for guaranteed loans disbursed during the		
reporting years by component:		
Default costs (net of recoveries)	48,597	86
Fees and other collections	(34,732)	-
Total of the above subsidy expense components	**13,865**	**86**
Adjustments:		
Fees Received	53,418	1,035
Foreclosed Property and Loans Acquired	39,456	(212,214)
Interest accumulation on the liability balance	(6,756)	125,494
Other	(27,088)	4,054
Ending balance of the loan guarantee liability before re-estimates	**231,320**	**156,194**
Add or subtract subsidy re-estimates by component:		
Technical/default reestimate	(38,491)	2,231
Total of the above reestimate components	**(38,491)**	**2,231**
Ending balance of the loan guarantee liability	**$192,829**	**$158,425**

In January 2012, MARAD transferred two vessels prevously acquired through foreclosure proceedings to the U.S. Department of the Navy for $35 million. MARAD retains one vessel in its inventory of foreclosed property.

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 re-estimates 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, 2012, will largely depend on future economic and market conditions and could differ from current estimates.

NOTE 7. INVENTORY AND RELATED PROPERTY

Inventory and Related Property as of September 30, 2012

	COST	ALLOWANCE FOR LOSS	NET
INVENTORY			
Inventory Held for Current Sale	$93,855	$-	$93,855
Excess, Obsolete, and Unserviceable Inventory	8,956	(8,956)	-
Inventory Held for Repair	582,567	(135,234)	447,333
Other	51,030	(10,591)	40,439
Total Inventory	**$736,408**	**$(154,781)**	**$581,627**
OPERATING MATERIALS AND SUPPLIES			
Items Held for Use	$233,293	$(1,075)	$232,218
Items Held in Reserve for Future Use	29,664	-	29,664
Excess, Obsolete and Unserviceable Items	1,888	(1,043)	845
Items Held for Repair	25,730	(12,193)	13,537
Total Operating Materials & Supplies	**$290,575**	**$(14,311)**	**$276,264**
Total Inventory and Related Property			**$857,891**

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**

Inventory consists of supplies and materials used to support FAA National Airspace System (NAS) located at the Mike Monroney Aeronautical Center in Oklahoma City.

Primarily, operating supplies and materials consist of unissued materials and supplies that will be 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, NET

General Property, Plant and Equipment at September 30, 2012

MAJOR CLASSES	SERVICE LIFE	ACQUISITION VALUE	ACCUMULATED DEPRECIATION AMORTIZATION	BOOK VALUE
Land and Improvements	10-40	$102,717	$(2,251)	$100,466
Buildings and Structures	20-40	6,213,974	(3,418,667)	2,795,307
Furniture and Fixtures	7-10	3,199	(1,619)	1,580
Equipment	5-15	17,460,914	(10,712,215)	6,748,699
ADP Software	3-10	722,683	(539,726)	182,957
Assets Under Capital Lease	6-10	127,661	(49,902)	77,759
Leasehold Improvements	3	147,821	(84,400)	63,421
Aircraft	20	407,579	(327,059)	80,520
Ships and Vessels	15-25	1,945,001	(1,753,241)	191,760
Small Boats	10-18	27,701	(22,131)	5,570
Construction-in-Progress	NA	3,780,846	-	3,780,846
Other Miscellaneous Property	NA	7,202	(5,721)	1,481
Total		**$30,947,298**	**$(16,916,932)**	**$14,030,366**

General Property, Plant and Equipment at September 30, 2011

MAJOR CLASSES	SERVICE LIFE	ACQUISITION VALUE	ACCUMULATED DEPRECIATION AMORTIZATION	BOOK VALUE
Land and Improvements	10-40	$102,630	$(1,997)	$100,633
Buildings and Structures	20-40	5,844,963	(3,167,777)	2,677,186
Furniture and Fixtures	7-10	71,881	(68,900)	2,981
Equipment	5-15	16,848,561	(9,979,207)	6,869,354
ADP Software	3-10	649,129	(412,916)	236,213
Assets Under Capital Lease	6-10	184,777	(90,139)	94,638
Leasehold Improvements	3	135,623	(71,136)	64,487
Aircraft	20	407,579	(314,378)	93,201
Ships and Vessels	15-25	1,949,078	(1,716,857)	232,221
Small Boats	10-18	23,980	(17,082)	6,898
Construction-in-Progress	NA	3,361,052	-	3,361,052
Other Miscellaneous Property	NA	8,664	(7,021)	1,643
Total		**$29,587,917**	**$(15,847,410)**	**$13,740,507**

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, 2012, construction in progress includes $2.11 billion related to the ERAM system.

While the deployment schedule for ERAM is not finalized and will depend upon results of continued testing of the system, FAA expects to deploy the ERAM system at 20 air route traffic control centers over the next several years. When fully deployed and operational, the ERAM system will replace three legacy air traffic systems currently being depreciated over service lives ranging from 5 to 20 years.

The net acquisition cost of the three air traffic legacy systems in use at September 30, 2012, and September 30, 2011, was unchanged at $2.14 billion with a net book value of $634 million and $745 million, respectively. Depreciation on these air traffic legacy systems was $111 million and $121 million in FY 2012 and 2011, respectively. As the ERAM deployment schedule becomes more certain, FAA will re-evaluate the remaining service lives of the legacy air traffic systems and their estimated value at disposal. Adjustments will then be made to the DOT accounting records in accordance with applicable accounting standards.

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 of a heritage asset. 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. The table below shows the number of physical units added and withdrawn at September 30, 2012.

REAL PROPERTY HERITAGE ASSETS

Washington's Union Station support 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 (NRC) (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.

The Maritme Administration also has twelve buildings that encircle the central quadrangle of the U.S. Merchant Marine Academy and the William S. Barstow house, which are eligible for listing on the National Register of Historic Places.

HERITAGE ASSETS

	UNITS AS OF 9/30/2011	ADDITIONS	WITHDRAWALS	UNITS AS OF 9/30/12
PERSONAL PROPERTY				
Artifacts	584	131	(15)	700
Other Collections	11,091	2,037	(6,288)	6,840
TOTAL PERSONAL PROPERTY				
Heritage Assets	**11,675**	**2,168**	**(6,303)**	**7,540**

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

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.

Liabilities Not Covered by Budgetary Resources at September 30

	2012	2011
INTRAGOVERNMENTAL		
Other Liabilities	$628,524	$545,975
Total Intragovernmental	**628,524**	**545,975**
Federal Employee Benefits Payable	1,019,076	978,918
Environmental and Disposal Liabilities (Note 13)	1,010,818	1,068,076
Other Liabilities	752,946	811,775
Total Liabilities Not Covered by Budgetary Resources	3,411,364	3,404,744
Total Liabilities Covered by Budgetary Resources	14,624,761	14,964,228
Total Liabilities	**$18,036,125**	**$18,368,972**

NOTE 11. DEBT

Debt activities during fiscal year ended September 30

	2011 BEGINNING BALANCE	2011 NET BORROWING	2011 ENDING BALANCE	2012 NET BORROWING	2012 ENDING BALANCE
INTRAGOVERNMENTAL DEBT					
Debt to the Treasury	$3,075,730	$1,265,899	4,341,629	$851,033	$5,192,662
Debt to the Federal Financing Bank	1,709	(472)	1,237	(301)	936
Total Intragovernmental Debt	**$3,077,439**	**$1,265,427**	**$4,342,866**	**$850,732**	**$5,193,598**

In accordance with Credit Reform Accounting, DOT borrows from the U.S. Treasury when cash is needed in its financing accounts. Borrowings are needed to transfer the credit subsidy related to downward re-estimates from the financing account to the receipt account or when available cash is less than claim payments.

During fiscal year 2012, DOT's U.S. Treasury borrowings carried interest rates ranging from .13 percent to 7.19 percent. The maturity dates for these borrowings occur from October 2012 to September 2051. Loans may be repaid in whole or in part without penalty at any time. The borrowing from the Federal Financing Bank has an interest rate of 6.4% and matures in May 2015. Borrowings from the U.S. Treasury and the Federal Financing Bank are considered covered by budgetary resources as no congressional action is necessary to pay the debt.

NOTE 12. FEDERAL EMPLOYEE BENEFITS PAYABLE

	2012	2011
Expected Future Liability for FECA	**$1,019,076**	**$978,918**

FEDERAL EMPLOYEES COMPENSATION ACT (FECA)

The FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from DOT for these paid claims.
The FECA liability consists of two components. The first component is based on actual claims paid by DOL but not yet reimbursed by DOT. DOT reimburses DOL for the amount of the actual claims as funds are appropriated for this purpose. There is generally a two-year lag between payment by DOL and reimbursement by DOT. As a result, DOT recognizes a liability for the actual claims paid by DOL and to be reimbursed by DOT.

The second component is the estimated liability for future benefit payments as a result of past events. This liability includes death, disability, medical, and miscellaneous costs. DOL determines this component annually, as of September 30, using a method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. DOT recognizes an unfunded liability to DOL for these estimated future payments. The projected annual benefit payments are discounted to present value using OMB's economic assumptions for 10-year Treasury notes and bonds. To provide for the effects of inflation on the liability, wage inflation factors (i.e., cost of living adjustments) and medical inflation factors (i.e., consumer price index medical adjustments) are applied to the calculation of projected future benefit payments. These factors are also used to adjust historical benefit payments to current-year constant dollars. A discounting formula is used to recognize the timing of benefit payments as 13 payments per year rather than an annual lump sum.

In addition, Other Liabilities (Note 15) includes $221,841 and $223,842 at September 30, 2012 and 2011, 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

	2012	2011
PUBLIC		
Environmental Remediation	$613,448	$597,629
Asset Disposal	397,370	470,447
Total Public	**$1,010,818**	**$1,068,076**

ENVIRONMENTAL REMEDIATION

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. Estimating the Department's cost estimates for environmental cleanup and asset disposal liabilities requires making assumptions about future activities and is inherently uncertain. These 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, 2012 and 2011, DOT's environmental remediation liability primarily includes the removal of contaminants on the Nuclear Ship Savannah and remediation at various sites managed by the FAA and MARAD. In addition to the amount recorded and disclosed, 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. There were no amounts recorded related to the MARAD site.

ASSET DISPOSAL

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, 2012, includes the estimated cost of disposing 121 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 DOT Operating Administrations at September 30

	2012	2011
Federal Highway Administration	$4,193,169	$4,456,561
Federal Transit Administration	1,297,590	1,331,012
Federal Aviation Administration	640,646	653,432
Other	184,284	119,750
Total Grant Accrual	**$6,315,689**	**$6,560,755**

NOTE 15. OTHER LIABILITIES

Other Liabilities as of September 30, 2012

	NON-CURRENT	CURRENT	TOTAL
INTRAGOVERNMENTAL			
Advances and Prepayments	$256,725	$1,296,796	$1,553,521
Accrued Pay and Benefits	-	135,401	135,401
FECA Billings (Note 12)	123,890	97,951	221,841
Uncleared Disbursements and Collections	-	2,868	2,868
Other Accrued Liabilities	24,410	349,295	373,705
Total Intragovernmental	**$405,025**	**$1,882,311**	**$2,287,336**
PUBLIC			
Other Accrued Unbilled Payments	$-	$27,815	$27,815
Advances and Prepayments	-	138,837	138,837
Accrued Pay and Benefits	65,264	951,914	1,017,178
Deferred Credits	-	47,821	47,821
Legal Claims (Note17)	-	34,634	34,634
Capital Leases (Note 16)	73,452	9,490	82,942
Other Custodial Liability	-	1,179	1,179
Other Accrued Liabilities	-	22,376	22,376
Total Public	**$138,716**	**$1,234,066**	**$1,372,782**

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 were destroyed during the World Trade Center attacks on September 11, 2001. The $257 million 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 $914 million.

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 (Note 17)	-	66,537	66,537
Capital Leases (Note 16)	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**

NOTE 16. LEASES

ENTITY AS LESSEE: Capital Leases at September 30

SUMMARY OF ASSETS UNDER CAPITAL LEASE BY CATEGORY	2012	2011
Land, Buildings & Machinery	$126,629	$184,777
Software	1,032	-
Accumulated Amortization	(49,902)	(90,139)
Net Assets Under Capital Lease	**$77,759**	**$94,638**

FUTURE PAYMENTS DUE

FISCAL YEAR	
2013	$9,046
2014	8,906
2015	8,867
2016	8,639
2017	8,640
2018+	70,601
Total Future Lease Payments	**$114,699**
Less: Imputed Interest	31,757
Net Capital Lease Liability	**$82,942**

The capital lease payments disclosed above primarily 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
2013	$278,773
2014	216,915
2015	195,301
2016	173,854
2017	160,182
2018+	585,643
Total Future Lease Payments	**$1,610,668**

Operating lease expenses incurred were $325.2 million and $294.9 million for the years ended September 30, 2012 and 2011, 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

LEGAL CLAIMS

As of September 30, 2012 and 2011, DOT's contingent liabilities, in excess of amounts accrued (Note 15), for asserted and pending legal claims with a reasonably possible of loss were estimated at $117.7 million and $86.6 million, respectively. DOT does not have material amounts of known unasserted claims. As of September 30, 2012 and 2011, DOT's contingent liabilities for asserted and pending legal claims with a probable loss were estimated at $35 million and $67 million, respectively.

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, 2012 and 2011, FHWA has pre-authorized $44.3 billion and $41.4 billion, respectively, under these arrangements. These commitments have not been recognized in the DOT consolidated financial statements at September 30, 2012 and 2011.

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, 2012, and September 30, 2011, FTA had approximately $1.96 billion and $1.6 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, 2012 and 2011.

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. As of September 30, 2012, FAA had letters of intent extending through FY 2028 totaling $7.4 billion. As of September 30, 2012, FAA had obligated $5.8 billion of this total amount, leaving $1.6 billion unobligated. As of September 30, 2011, FAA had letters of intent extending 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.

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 the foreign policy of the United States. FAA may issue non-premium insurance and premium insurance for which a risk-based premium is charged to the air carrier, to the extent practical.

During FY 2012, FAA provided premium war-risk insurance to 53 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 37 carriers with 2,387 aircraft for Department of Defense charter operations for Central Command.

As of September 30, 2012, there are pending aviation insurance claims in the amount of $10 million. There is approximately $1.8 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 2012, 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 $64 million to $83 million to cover hull liability and vessel's crew. 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. 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 $47 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.

ENVIRONMENTAL LIABILITIES

As of September 30, 2012, FAA has estimated contingent liabilities, categorized as reasonably possible of $190.2 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 approximately 1972. For FY 2012 and FY 2011, the Department issued grants to Amtrak for $1.7 billion and $2 billion, respectively. These grants were for both operating and capital improvements. Refer to Note 1W (Significant Accounting Policies) for additional information.

HURRICANE SANDY DISASTER RELIEF

In October 2012, Hurricane Sandy significantly impacted certain areas within the northeastern United States. Currently, DOT, in conjunction with other federal entities, is assessing the estimated financial impact of the affected areas. DOT is expecting states impacted by Hurricane Sandy to apply for emergency relief in the near future, however; the amounts are unknown as of the date of this report.

Additional commitments are discussed in Note 6, Direct Loans and Loan Guarantees, Non-Federal Borrowers, and Note 16, Leases.

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. Descriptions of the significant earmarked funds are as follows:

HIGHWAY TRUST FUND

The Highway Trust Fund (HTF) comprises 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.

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.

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 excise tax revenues and 20 percent from the Treasury general receipts account. These funds are considered earmarks 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. On July 6, 2012, the President signed PL112-141 Moving Ahead Progress in the 21st Century (MAP-21), which provides current SAFETEA-LU programs and funding through September 30, 2012.

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

OTHER EARMARKS:

- Aviation Insurance Revolving Fund
- Pipeline Safety
- Emergency Preparedness Grant
- Aviation User Fees
- Aviation Operations
- Grants-in-Aid for Airports
- Aviation Facilities and Equipment
- Aviation Research, Engineering and Development
- 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

For the years ended September 30, 2012 and 2011, respectively, earmarked funds are summarized in the following charts. Intra-agency transactions have not been eliminated in the amounts presented.

Balance Sheet as of September 30, 2012

	HIGHWAY TRUST FUND	AIRPORT & AIRWAY TRUST FUND	MASS TRANSIT	OTHER EARMARKED FUNDS	FY 2012 TOTAL EARMARKED FUNDS
ASSETS					
Fund Balance with Treasury	$4,954,662	$442,965	$546,897	$2,596,036	$8,540,560
Investments, Net	9,970,201	10,473,786	-	1,886,665	22,330,652
Accounts Receivable, Net	17,391	-	809	4,660,338	4,678,538
Property, Plant & Equipment	162,686	-	-	3,721,693	3,884,379
Other	271,608	-	766	285,616	557,990
Total Assets	**$15,376,548**	**$10,916,751**	**$548,472**	**$13,150,348**	**$39,992,119**
LIABILITIES AND NET POSITION					
Accounts Payable	$88,441	$4,532,545	$-	$416,722	$5,037,708
FECA Liabilities	27,943	-	-	1,152,896	1,180,839
Grants Accrual	4,976,013	-	20,067	640,646	5,636,726
Other Liabilities	215,117	-	1,445	1,042,875	1,259,437
Unexpended Appropriations	-	-	38,446	1,070,483	1,108,929
Cumulative Results of Operations	10,069,034	6,384,206	488,514	8,826,726	25,768,480
Total Liabilities and Net Position	**$15,376,548**	**$10,916,751**	**$548,472**	**$13,150,348**	**$39,992,119**

STATEMENT OF NET COST		**FOR THE PERIOD ENDED SEPTEMBER 30, 2012**			
Program Costs	$49,731,576	$-	$164,208	$15,327,141	$65,222,925
Less: Earned Revenue	131,146	-	-	638,791	769,937
Net Program Costs	49,600,430	-	164,208	14,688,350	64,452,988
Costs Not Attributable to Programs	-	-	-	196,345	196,345
Net Cost of Operations	**$49,600,430**	**$-**	**$164,208**	**$14,884,695**	**$64,649,333**

STATEMENT OF CHANGES IN NET POSITION		**FOR THE PERIOD ENDED SEPTEMBER 30, 2012**			
Beginning Net Position	$16,964,550	$5,092,201	$690,431	$9,213,093	$31,960,275
Budgetary Financing Sources	42,646,717	1,292,005	737	16,029,630	59,969,089
Other Financing Sources	58,197	-	-	(460,819)	(402,622)
Net Cost of Operations	49,600,430	-	164,208	14,884,695	64,649,333
Change in Net Position	(6,895,516)	1,292,005	(163,471)	684,116	(5,082,866)
Net Position End of Period	**$10,069,034**	**$6,384,206**	**$526,960**	**$9,897,209**	**$26,877,409**

Balance Sheet as of September 30, 2011

	HIGHWAY TRUST FUND	AIRPORT & AIRWAY TRUST FUND	MASS TRANSIT	OTHER EARMARKED FUNDS	FY 2011 TOTAL EARMARKED FUNDS
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 Appropriation	-	-	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	$-	$194,847	$15,748,110	$61,159,301
Less Earned Revenue	121,766	-	-	574,584	696,350
Net Program Costs	45,094,578	-	194,847	15,173,526	60,462,951
Costs Not Attributable to Programs	-	-	-	201,448	201,448
Net Cost of Operations	**$45,094,578**	**$-**	**$194,847**	**$15,374,974**	**$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	618,937	-	16,137,237	53,705,507
Other Financing Sources	21,579	-	-	(136,221)	(114,642)
Net Cost of Operations	45,094,578	-	194,847	15,374,974	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 19. INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUES

For the period ended September 30, 2012

	INTRA-GOVERNMENTAL	WITH THE PUBLIC	TOTAL
SURFACE TRANSPORTATION			
Federal-Aid Highway Program:			
Gross Costs	$159,178	$39,992,665	$40,151,843
Less: Earned Revenue	35,555	50,769	86,324
Net Program Costs	**123,623**	**39,941,896**	**40,065,519**
Mass Transit Program			
Gross Costs	37,034	12,032,237	12,069,271
Less: Earned Revenue	366,209	640	366,849
Net Program Costs	**(329,175)**	**12,031,597**	**11,702,422**
Other Surface Transportation Programs:			
Gross Costs	402,540	8,365,153	8,767,693
Less: Earned Revenue	376,458	396,478	772,936
Net Program Costs	**26,082**	**7,968,675**	**7,994,757**
Total Surface Transportation Program Costs	**(179,470)**	**59,942,168**	**59,762,698**
AIR TRANSPORTATION			
Gross Costs	2,605,520	14,026,980	16,632,500
Less: Earned Revenue	258,871	369,296	628,167
Net Program Costs	**2,346,649**	**13,657,684**	**16,004,333**
MARITIME TRANSPORTATION			
Gross Costs	174,211	711,907	886,118
Less: Earned Revenue	352,093	40,506	392,599
Net Program Costs	**(177,882)**	**671,401**	**493,519**
CROSS-CUTTING PROGRAMS			
Gross Costs	56,674	590,653	647,327
Less: Earned Revenue	251,386	4,483	255,869
Net Program Costs	**(194,712)**	**586,170**	**391,458**
Costs not assigned to programs	49,566	346,492	396,058
Less: Earned Revenues not attributed to programs	15,755	(4,242)	11,513
Net Cost of Operations	**$1,828,396**	**$75,208,157**	**$77,036,553**

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**
Cost not assigned to a program	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 20. EXCISE TAXES AND OTHER NON-EXCHANGE REVENUE

The Internal Revenue Service (IRS) collects various excise taxes that are deposited in the Highway Trust Fund (HTF) and Airport and Airway Trust Fund (AATF). Treasury's Office of Tax Analysis (OTA) estimates the amount collected/revenue recognized monthly, 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 include actual excise tax revenue certified through June 30, 2012, and excise tax revenue estimates for the quarter ended September 30, 2012. As a result, total taxes recognized in the DOT FY 2012 financial statement include the OTA estimate of $13.3 billion for the quarter ended September 30, 2012, and the actual amounts certified through June 30, 2012 of $37.4 billion. The total taxes recognized for the fiscal years ended September 30, 2011 and 2010 include OTA estimates which are certified by the IRS in January of the subsequent fiscal years, as follows:

	SEPT 30, 2011	SEPT 30, 2010
Actual	$12,923,016	$13,067,434
Estimate	11,618,526	11,578,829
Under (Over) accrual	**$1,304,490**	**$1,488,605**

For the years ended September 30, 2012 and 2011, respectively, excise taxes and associated nonexchange revenue, which are reported on the Statement of Changes in Net Position, were as follows:

NON-EXCHANGE REVENUE

	2012	2011
HIGHWAY TRUST FUND		
Excise Taxes and Other Non-Exchange Revenue		
Gasoline	$25,529,900	$24,986,425
Diesel and Special Motor Fuels	9,796,891	9,801,522
Trucks	5,994,309	3,226,317
Investment Income	7,228	15,812
Fines and Penalties	22,103	18,170
Total Taxes	**41,350,431**	**38,048,246**
Less: Transfers	**(1,174,706)**	**(1,125,811)**
Net Highway Trust Fund Excise Taxes	**40,175,725**	**36,922,435**
Other Non-Exchange Revenue	97	173
Net Highway Trust Fund Excise Taxes & Other Non-Exchange Revenue	**40,175,822**	**36,922,608**
FEDERAL AVIATION ADMINISTRATION		
Excise Taxes and Other Non-Exchange Revenue		
Passenger Ticket	8,711,445	8,084,593
International Departure	2,728,594	2,508,289
Fuel (Air)	622,794	530,572
Waybill	491,845	426,703
Investment Income	244,912	223,011
Tax Refunds and Credits	(22,464)	(8,432)
Other	24,460	21,917
Net Federal Aviation Administration Excise Taxes & Other Non-Exchange Revenue	**12,801,586**	**11,786,653**
Other Miscellaneous Net Non Exchange Revenue	79,168	91,981
Total Non-Exchange Revenue	**$53,056,576**	**$48,801,242**

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 A-11, Part 4, Instructions on Budget Execution, are as follows:

			2012			2011
	DIRECT	REIMBURSABLE	TOTAL	DIRECT	REIMBURSABLE	TOTAL
Category A	$6,706,233	$800,786	$7,507,019	$6,111,514	$496,567	$6,608,081
Category B	76,800,423	1,923,743	78,724,166	82,022,600	1,341,001	83,363,601
Exempt from apportionment	48,735	274,826	323,561	78,797	263,058	341,855
Total	**$83,555,391**	**$2,999,355**	**$86,554,746**	**$88,212,911**	**$2,100,626**	**$90,313,537**

	2012	2011
Available Contract Authority at year-end	$23,391,628	$26,852,717
Available Borrowing Authority at year-end	$1,734,768	$1,356,282
Undelivered Orders at year-end	$108,814,519	$109,518,183

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 drawdowns 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 budgetary authority for use in their credit programs, that is provided from and more details are available in the Federal Credit Reform Act of 1990. This funding is available for re-estimates and interest on re-estimates. DOT's credit programs are explained in detail in Note 6.

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. Unobligated balances of budgetary resources that are unapportioned primarily represent contract authority which has no limitation and are not available for obligation.

STATEMENT OF BUDGETARY RESOURCES VS BUDGET OF THE UNITED STATES GOVERNMENT

The reconciliation for the year ended September 30, 2011, is presented below. The reconciliation for the fiscal year ended September 30, 2012, is not presented, because the submission of the Budget of the United States (Budget) for FY 2014, which presents the execution of the FY 2012 budget, occurs after publication of these financial statements. The U.S. Department of Transportation Budget Appendix can be found on the OMB website (**http://www.gpoaccess.gov/usbudget**) and will be available in early February 2013.

DOLLARS IN MILLIONS	BUDGETARY RESOURCES	OBLIGATIONS INCURRED	DISTRIBUTED OFFSETTING RECEIPTS	NET OUTLAYS
Combined Statement of Budgetary Resources	$140,801	$90,314	$(283)	$78,551
Funds not Reported in the Budget				
Expired Funds	(511)	-	-	-
Undelivered Orders Adjustment	(1,500)	(100)		
Distributed Offsetting Receipts	-	-	283	279
Other	(5)	(6)	-	2
Budget of the United States Government	**$138,785**	**$90,208**	**$-**	**$78,832**

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 Undelivered Orders Adjustment of $1.5 billion is caused by a reversal of an adjustment recorded at the end of FY 2010.

NOTE 22. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

The objective of this information is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and non-budgetary resources available to the reporting entity with its net cost of operations.

	2012	2011
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated		
Obligations Incurred	$86,554,746	$90,313,537
Less: Spending Authority from Offsetting Collections, Recoveries and Other Changes to Obligated Balances	9,200,514	8,436,394
Obligations Net of Offsetting Collections and Recoveries	77,354,232	81,877,143
Less: Distributed Offsetting Receipts	(2,738,974)	(282,618)
Net Obligations	74,615,258	81,594,525
Other Resources		
Donations and Forfeitures of Property	158,117	-
Transfers In/Out Without Reimbursement	96,186	(8,872)
Imputed Financing From Costs Absorbed by Others	641,782	818,781
Other	(152,944)	(277,814)
Net Other Resources Used to Finance Activities	743,141	532,095
Total Resources Used to Finance Activities	**$75,358,399**	**$82,126,620**
RESOURCES 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	$(735,543)	$2,694,348
Resources That Fund Expenses Recognized in Prior Periods	263,392	188,689
Credit Program Collections That Increase Liabilities for Loan Guarantees or Allowances for Subsidy	(466,944)	(395,673)
Other/Change in Unfilled Customer Orders	508,098	23,189
Special Transfers from the U. S. Treasury	(2,471,408)	-
Anticipated Resources not yet realized	-	135,321
Resources That Finance the Acquisition of Assets	3,059,374	2,984,042
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	(168,516)	(28,227)
Total Resources Used to Finance Items Not Part of the Net Cost Of Operations	**(11,547)**	**5,601,689**
	$75,369,946	**$76,524,931**

NOTE 22 (CONT.)

	2012	2011
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	$99,959	$36,563
Increase in Environment and Disposal Liability	53,010	3,332
Upward/Downward Re-estimates of Credit Subsidy Expense	6,257	(83,330)
Change in exchange revenue receivable from the public	(1,005)	(96,607)
Change in Other Liabilities	160,217	166,462
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	**318,438**	**26,420**
COMPONENTS NOT REQUIRING OR GENERATING RESOURCES		
Depreciation and Amortization	1,217,178	1,122,529
Revaluation of Assets or Liabilities	7,907	62,585
Other Expenses and Adjustments not Otherwise Classified Above	123,085	376,538
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	1,348,170	1,561,652
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	1,666,608	1,588,072
Net Cost of Operations	**$77,036,553**	**$78,113,003**

NOTE 23. REPORTING ON DOT AFFILIATED 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 23 CONDENSED INFORMATION

	2012	2011
Cash and Short-Term Time Deposits	$37,410	$33,164
Long-Term Time Deposits	2,036	1,836
Accounts Receivable	172	459
Inventories	277	274
Other Current Assets	11	26
Property, Plant and Equipment	90,734	84,784
Deferred Charges	4,588	4,242
Other Assets	727	514
Total Assets	**$135,955**	**$125,299**
Current Liabilities	$4,628	$6,904
Actuarial Liabilities	4,588	4,242
Total Liabilities	**$9,216**	**$11,146**
Invested Capital	$105,879	$99,921
Cumulative Results of Operations	20,860	14,232
Total Net Position	**126,739**	**114,153**
Total Liabilities and Net Position	**$135,955**	**$125,299**
Operating Revenues	$25,249	$22,319
Operating Expenses	21,552	29,987
Operating Income (loss)	3,697	(7,668)
Other Financing Sources	2,931	2,781
Operating revenues and other financing sources over (under) operating expenses	6,628	(4,887)
Beginning cumulative results of operations (deficit)	14,232	19,119
Ending cumulative results of operations (deficit)	**$20,860**	**$14,232**

MARAD NON-APPROPRIATED FUND INSTRUMENTALITY (NAFI)

The Non-Appropriated Fund Instrumentalities (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, 2012, and September 30, 2011, NAFI operating revenues and proceeds from midshipmen fees included $6.7 million and $7.6 million, respectively.

NOTE 24. 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.

SCHEDULE OF FIDUCIARY ACTIVITY

For the year ended September 30

	2012	2011
Fiduciary Net Assets, beginning of year	$18,845	$28,194
Contributions	596,976	-
Investment earnings	242	60
Disbursements to and on behalf of beneficiaries	(258,957)	(9,409)
Increases/(Decreases) in fiduciary net assets	338,261	(9,349)
Fiduciary net assets, end of year	**$357,106**	**$18,845**

FIDUCIARY NET ASSETS

As of September 30

	2012	2011
Fiduciary Fund Balance with Treasury	$291	$286
Investments in Treasury Securities	353,815	18,559
Total Fiduciary Net Assets	**$354,106**	**$18,845**

REQUIRED SUPPLEMENTARY INFORMATION (RSI)

DEFERRED MAINTENANCE (Unaudited)

DOT ENTITY	MAJOR CLASS OF ASSET	METHOD OF MEASUREMENT	ASSET CONDITION*	2012 COST TO RETURN TO ACCEPTABLE CONDITION**	2011 COST TO RETURN TO ACCEPTABLE CONDITION**
FAA	Buildings	Condition Assessment Survey	4 & 5	$56,166	$61,607
	Other Structures and Facilities	Condition Assessment Survey	4 & 5	243,295	229,240
MARAD	Vessels, Ready Reserve Force (Various Locations)	Condition Assessment Survey	2	12,521	9,753
	Real Property, Buildings (Anchorage)	Condition Assessment Survey	3	-	150
	Real Property, Structure U.S. Merchant Marine Academy, NY	Condition Assessment Survey	2&3	16,110	20,062
	Real Property, Structure U.S. Merchant Marine Academy, NY	Condition Assessment Survey	4&5	64,750	60,750
	Other (Fleet Craft)	Condition Assessment Survey	3	11,350	3,254
Total				**$404,192**	**$384,816**

*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 habitable.
MARAD Real Property, Structures	3	Fair Adequate water depth, shore power, and mooring capabilities.
	4	Poor Structure needs major repairs. The majority of the components are marginally functional or jeopardized.
	5	Very Poor Age and/or condition is such that the item should be replaced or undergo major renovation. Structure 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 (Unaudited)

For the Period Ended September 30, 2012

Dollars in Thousands	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
BUDGETARY RESOURCES						
Unobligated balance brought forward, Oct. 1	$30,728,090	$3,556,211	$10,777,895	$640,840	$4,784,173	$50,487,209
Recoveries of prior year unpaid obligations	-	413,890	205,555	57,652	522,669	1,199,766
Other changes in unobligated balance	-	(116,841)	(7,127)	(1,427)	(30,699)	(156,094)
Unobligated balance from prior year budget authority, net	**30,728,090**	**3,853,260**	**10,976,323**	**697,065**	**5,276,143**	**51,530,881**
Appropriations	7,382	12,552,370	2,179,126	362,520	4,642,415	19,743,813
Borrowing authority	-	-	-	18,000	1,716,768	1,734,768
Contract authority	38,657,065	3,350,000	9,889,067	-	1,212,831	53,108,963
Spending authority from offsetting collections	192,112	5,969,879	21,118	493,685	1,312,060	7,988,854
Total budgetary resources	**$69,584,649**	**$25,725,509**	**$23,065,634**	**$1,571,270**	**$14,160,217**	**$134,107,279**
STATUS OF BUDGETARY RESOURCES						
Obligations incurred	$39,566,993	$22,205,831	$13,010,518	$984,588	$10,786,816	$86,554,746
Unobligated balance, end of year:						
Apportioned	14,877,106	1,430,914	10,011,591	304,785	2,547,933	29,172,329
Exempt from apportionment	-	-	-	3,812	348,759	352,571
Unapportioned	15,140,550	2,088,764	43,525	278,085	476,709	18,027,633
Total unobligated balance, end of year	**30,017,656**	**3,519,678**	**10,055,116**	**586,682**	**3,373,401**	**47,552,533**
Total budgetary resources	**$69,584,649**	**$25,725,509**	**$23,065,634**	**$1,571,270**	**$14,160,217**	**$134,107,279**

REQUIRED SUPPLEMENTARY INFORMATION COMBINING STATEMENTS OF BUDGETARY RESOURCES BY MAJOR ACCOUNT (Unaudited)

For the Period Ended September 30, 2012

DOLLARS IN THOUSANDS	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
CHANGE IN OBLIGATED BALANCES						
Unpaid obligations, brought forward, October 1 (gross)	$68,014,555	$9,243,110	$18,716,473	$383,813	$21,547,111	$117,905,062
Uncollected customer payments from Federal sources, brought forward, October 1	(430,928)	(288,053)	(58,900)	(155,567)	(497,962)	(1,431,410)
Obligated balance, start of year (net)	67,583,627	8,955,057	18,657,573	228,246	21,049,149	116,473,652
Obligations incurred	39,566,993	22,205,831	13,010,518	984,588	10,786,816	86,554,746
Outlays (gross)	(40,119,771)	(21,766,301)	(12,291,099)	(932,409)	(11,796,442)	(86,906,022)
Change in uncollected customer payments from Federal sources	(90,231)	(42,652)	737	31,885	59,843	(40,418)
Actual transfers, unpaid obligations (net) (+ or -)	-	-	-	-	10,000	10,000
Recoveries of prior year unpaid obligations	-	(413,890)	(205,555)	(57,652)	(522,669)	(1,199,766)
Obligated balance, end of year						
Unpaid obligations, end of year (gross)	67,461,777	9,268,750	19,230,337	378,340	20,024,816	116,364,020
Uncollected customer payments from Federal sources, end of year	(521,159)	(330,705)	(58,163)	(123,682)	(438,119)	(1,471,828)
Obligated balance, end of year (net)	**$66,940,618**	**$8,938,045**	**$19,172,174**	**$254,658**	**$19,586,697**	**$114,892,192**
BUDGET AND AUTHORITY AND OUTLAYS, NET						
Budget authority, gross	$38,856,559	$21,872,249	$12,089,311	$874,205	$8,884,074	$82,576,398
Actual offsetting collections	(101,881)	(5,927,228)	(21,854)	(610,572)	(1,531,692)	(8,193,227)
Change in uncollected customer payments from Federal sources	(90,231)	(42,652)	737	31,885	59,843	(40,418)
Budget authority, net	**$38,664,447**	**$15,902,369**	**$12,068,194**	**$295,518**	**$7,412,225**	**$74,342,753**
Outlays, gross	$40,119,771	$21,766,301	$12,291,099	$932,409	$11,796,442	$86,906,022
Actual offsetting collections	(101,881)	(5,927,228)	(21,854)	(610,572)	(1,531,692)	(8,193,227)
Outlays, net	40,017,890	15,839,073	12,269,245	321,837	10,264,750	78,712,795
Distributed offsetting receipts	-	(11,559)	(773)	(54,533)	(2,672,109)	(2,738,974)
Agency outlays, net	**$40,017,890**	**$15,827,514**	**$12,268,472**	**$267,304**	**$7,592,641**	**$75,973,821**

REQUIRED SUPPLEMENTARY INFORMATION COMBINING STATEMENTS OF BUDGETARY RESOURCES BY MAJOR ACCOUNT (Unaudited)

For the Period Ended September 30, 2011

DOLLARS IN THOUSANDS	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
BUDGETARY RESOURCES						
Unobligated balance brought forward, October 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
Other changes in unobligated balance	12,368	(66,041)	(2,443)	(1,915)	(67,886)	(125,917)
Unobligated balance from prior year budget authority, net	**32,537,726**	**3,742,286**	**10,583,972**	**507,843**	**14,206,373**	**61,578,200**
Appropriations	(1,178,819)	12,416,672	2,860,387	471,490	2,753,360	17,323,090
Borrowing authority	-	-	-	195,000	1,161,282	1,356,282
Contract authority	40,217,002	3,515,000	8,360,565	-	1,213,832	53,306,399
Spending authority from offsetting collections	202,546	5,427,894	3,324	499,512	1,103,499	7,236,775
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	$41,050,365	$21,545,641	$11,030,353	$1,033,005	$15,654,173	$90,313,537
Unobligated balance, end of year:						
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
Unapportioned	14,072,810	1,885,698	25,232	252,749	341,421	16,577,910
Total unobligated balance, end of year	30,728,090	3,556,211	10,777,895	640,840	4,784,173	50,487,209
Total budgetary resources	**$71,778,455**	**$25,101,852**	**$21,808,248**	**$1,673,845**	**$20,438,346**	**$140,800,746**

REQUIRED SUPPLEMENTARY INFORMATION COMBINING STATEMENTS OF BUDGETARY RESOURCES BY MAJOR ACCOUNT (Unaudited)

For the Period Ended September 30, 2011

DOLLARS IN THOUSANDS	FEDERAL-AID	FAA	FTA	MARAD	ALL OTHER	TOTAL
CHANGE IN OBLIGATED BALANCES						
Unpaid obligations, brought forward, October 1 (gross)	$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, October 1	(334,747)	(342,944)	(66,614)	(73,274)	(609,876)	(1,427,455)
Obligated balance, start of year (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
Outlays (gross)	(36,242,104)	(21,102,064)	(11,943,323)	(986,679)	(15,985,754)	(86,259,924)
Change in uncollected customer payments from Federal sources	(96,181)	54,891	7,714	(82,293)	111,914	(3,955)
Actual transfers, unpaid obligations (net) (+ or -)	-	-	-	-	22,214	22,214
Recoveries of prior year unpaid obligations	-	(486,422)	(85,560)	(31,774)	(401,926)	(1,005,682)
Obligated balance, end of year						
Unpaid obligations, end of year (gross)	68,014,555	9,243,110	18,716,473	383,813	21,547,111	117,905,062
Uncollected customer payments from Federal sources, end of year	**(430,928)**	**(288,053)**	**(58,900)**	**(155,567)**	**(497,962)**	**(1,431,410)**
Obligated balance, end of year (net)	**$67,583,627**	**$8,955,057**	**$18,657,573**	**$228,246**	**$21,049,149**	**$116,473,652**
BUDGET AND AUTHORITY AND OUTLAYS, NET						
Budget authority, gross	$39,240,728	$21,359,566	$11,224,275	$1,166,003	$6,231,974	$79,222,546
Actual offsetting collections	(106,364)	(5,482,785)	(11,037)	(501,611)	(1,324,350)	(7,426,147)
Change in uncollected customer payments from Federal sources	(96,181)	54,891	7,714	(82,293)	111,914	(3,955)
Anticipated offsetting collections	-	-	-	-	-	-
Budget authority, net	**$39,038,183**	**$15,931,672**	**$11,220,952**	**$582,099**	**$5,019,538**	**$71,792,444**
Outlays, gross	$36,242,104	$21,102,064	$11,943,323	$986,679	$15,985,754	$86,259,924
Actual offsetting collections	(106,364)	(5,482,785)	(11,037)	(501,611)	(1,324,350)	(7,426,147)
Outlays, net	**36,135,740**	**15,619,279**	**11,932,286**	**485,068**	**14,661,404**	**78,833,777**
Distributed offsetting receipts	-	(10,742)	43,322	(41,841)	(273,357)	(282,618)
Agency outlays, net	**$36,135,740**	**$15,608,537**	**$11,975,608**	**$443,227**	**$14,388,047**	**$78,551,159**

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION (RSSI)

NON-FEDERAL PHYSICAL PROPERTY: ANNUAL STEWARDSHIP INFORMATION

Transportation Investments (Unaudited) — As of September 30

DOLLARS IN THOUSANDS	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
SURFACE TRANSPORTATION					
Federal Highway Administration					
Federal Aid Highways (HTF)	$34,470,595	$37,860,105	$29,649,943	$34,556,573	$39,048,865
Other Highway Trust Fund Programs	481,762	216,263	155,061	148,271	99,127
General Fund Programs	31,740	3,228,009	11,616,036	7,906,180	3,203,055
Appalachian Development System	185,316	321,480	90,091	243,853	288,473
Federal Motor Carrier	144,455	837	-	-	(15,998)
Total Federal Highway Administration	**$35,313,868**	**$41,626,694**	**$41,511,131**	**$42,854,877**	**$42,623,522**
Federal Transit Administration					
Discretionary Grants	$27,174	$16,424	$17,171	$25,068	$12,682
Formula Grants	1,329,811	743,604	428,696	220,047	171,134
Capital Investment Grants	2,473,141	2,175,758	1,930,185	1,924,741	2,439,812
Washington Metro Area Transit Authority	46	33	-	110,321	91,153
Interstate Transfer Grants	360	316	-	-	-
Formula and Bus Grants	5,968,651	7,264,278	7,345,804	7,182,145	8,197,321
Total Federal Transit Administration	**9,799,183**	**10,200,413**	**9,721,856**	**9,462,322**	**10,912,102**
Total Surface Transportation Nonfederal Physical Property Investments	**$45,113,051**	**$51,827,107**	**$51,232,987**	**$52,317,199**	**$53,535,624**

AIR TRANSPORTATION	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Federal Aviation Administration					
Airport Improvement Program	$3,753,840	$4,034,970	$4,015,463	$3,388,712	$3,139,685
Total Air Transportation Nonfederal Physical Property Investments	$3,753,840	$4,034,970	$4,015,463	$3,388,712	$3,139,685
Total Nonfederal Physical Property Investments	**$48,866,891**	**$55,862,077**	**$55,248,450**	**$55,705,911**	**$56,675,309**

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 10 percent for the Interstate System and 20 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
ANNUAL STEWARDSHIP INFORMATION (Unaudited)

As of September 30

DOLLARS IN THOUSANDS	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
SURFACE TRANSPORTATION					
Federal Highway Administration					
National Highway Institute Training	$1,205	$375	$109	$133	$508
Federal Motor Carrier Safety Administration					
California Highway Patrol	722	-	-	-	-
Safety Grants	426	1,230	845	636	1,342
Idaho Video	302	399	9	-	-
Kentucky IT Conference	-	-	-	-	-
Massachusetts Training Academy	-	-	-	-	-
Minnesota Crash Investigation	-	-	-	-	-
New York Crash Reconstruction	180	-	-	-	-
Tennessee Crash Investigation	167	-	-	-	-
Federal Transit Administration					
National Transit Institute Training	4,577	3,440	3,886	3,246	3,550
National Highway Safety Administration					
Section 403 Highway Safety Programs	171,836	143,639	138,221	123,340	118,169
Highway Traffic Safety Grants	485,721	566,790	565,787	576,063	514,816
Pipeline and Hazardous Materials Safety Administration					
Hazardous Materials (Hazmat) Training	13,263	13,263	13,153	16,974	17,808
Total Surface Transportation Human Capital Investments	**678,399**	**729,136**	**722,010**	**720,392**	**656,193**
MARITIME TRANSPORTATION					
Maritime Administration					
State Maritime Academies Training(1)	9,406	11,041	10,810	11,459	13,746
Additional Maritime Training	800	1,751	2,365	2,146	-
Total Maritime Transportation Human Capital Investments	**10,206**	**12,792**	**13,175**	**13,605**	**13,746**
Total Human Capital Investments	**$688,605**	**$741,928**	**$735,185**	**$733,997**	**$669,939**

(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 Traffic Safety Administration (NHTSA) 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

ANNUAL STEWARDSHIP INFORMATION (Unaudited) As of September 30

DOLLARS IN THOUSANDS	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
SURFACE TRANSPORTATION					
Federal Highway Administration					
Intelligent Transportation Systems	$128,931	$111,219	$129,993	$98,694	$100,467
Other Applied Research and Development	63,906	28,259	159,389	244,156	12,042
Federal Railroad Administration					
Railroad Research and Development Program	2,259	3,349	5,647	6,027	13,742
Federal Transit Administration					
Applied Research and Development					
Transit Planning and Research	6,076	6,914	7,228	13,751	21,700
Pipeline and Hazardous Materials Safety Administration					
Applied Research and Development					
Development Research and Development Pipeline Safety					
Applied Research and Development Pipeline Safety	12,762	9,198	7,362	2,365	8,073
Applied Research and Development Hazardous Materials	1,084	1,593	1,622	2,855	1,636
Research and Innovative Technology Administration Applied Research and Development					
Research and Technology	1,036	1,936	6,137	6,134	5,792
Total Surface Transportation Research and Development Investments	**$216,054**	**$162,468**	**$317,378**	**$373,982**	**$163,452**
AIR TRANSPORTATION					
Federal Aviation Administration					
Research and Development Plant	$3,498	$3,381	$5,590	$5,848	$18,974
Applied Research	88,114	95,764	103,042	129,954	133,932
Development	814	1,102	2,008	2,238	1,311
Administration	33,519	35,055	36,723	35,875	37,482
Total Air Transportation Research and Development Investments	**125,945**	**135,302**	**147,363**	**173,915**	**191,699**
Total Research and Development Investments	**$341,999**	**$297,770**	**$464,741**	**$547,897**	**$355,151**

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 Federal Railroad Administration (FRA) research and development projects contribute vital inputs to its safety regulatory processes, to railroad suppliers, to railroads involved in the transportation of freight, intercity passengers, commuters, and to railroad employees and their labor organizations. FRA-owned facilities provide the infrastructure necessary to conduct experiments and test theories, concepts, and new technologies in support of the R&D program.

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

SCHEDULE OF SPENDING (Unaudited)

SCHEDULE OF SPENDING

For the Period Ended September 30, 2012

DOLLARS IN THOUSANDS	BUDGETARY	NON-BUDGETARY CREDIT REFORM FINANCING ACCOUNTS
WHAT MONEY IS AVAILABLE TO SPEND?		
Total Resources	$131,895,361	$2,211,918
Less Amount Available but Not Agreed to be Spent	29,419,507	105,393
Less Amount Not Available to be Spent	17,847,996	179,637
Total Amounts Agreed to be Spent	**$84,627,858**	**$1,926,888**
HOW WAS THE MONEY SPENT?		
Surface Transportation		
1. Personnel Compensation and Benefits	$932,121	$-
2. Contractual Services and Supplies	2,321,876	-
3. Acquisition of Assets	123,219	1,224,077
4. Grants and Fixed Charges	57,595,464	35,622
5. Other	52,965	-
Air Transportation		
1. Personnel Compensation and Benefits	7,534,257	-
2. Contractual Services and Supplies	5,639,734	-
3. Acquisition of Assets	479,138	-
4. Grants and Fixed Charges	3,053,590	-
5. Other	5,059,582	-
Maritime Transportation		
1. Personnel Compensation and Benefits	98,429	50
2. Contractual Services and Supplies	470,488	1,494
3. Acquisition of Assets	11,662	-
4. Grants and Fixed Charges	291,514	59,533
5. Other	(760)	-
Cross-Cut Transportation		
1. Personnel Compensation and Benefits	153,075	-
2. Contractual Services and Supplies	570,045	-
3. Acquisition of Assets	18,787	-
4. Grants and Fixed Charges	2	-
5. Other	(46,516)	-
Not Assigned		
1. Personnel Compensation and Benefits	140,425	-
2. Contractual Services and Supplies	82,978	-
3. Acquisition of Assets	6,048	-
4. Grants and Fixed Charges	203,905	71
5. Other	793,147	-
Total Spending	**$85,585,176**	**$1,320,846**
Amounts Remaining to be Spent	**$(957,318)**	**$606,042**
Total Amounts Agreed to Be Spent	**$84,627,858**	**$1,926,888**

NET COST BY DOT GOAL

The Schedule of Net Cost by Strategic Goal reports the DOT operational net cost to reflect the net cost of operations by each of the Department's six goals in its FY 2012 Budget submission to provide the linkage between cost and performance as related to each goal. DOT programs are generally complex and incorporate significant projects within multiple Operating Administrations (OA) and organizations within the OAs. These projects are linked to multiple organizational and department–wide strategic goals. This complexity makes it difficult to track the costs related to the department-wide strategic goals. Additionally, in order to determine the costs by strategic goals, OAs would need to analyze each project and determine allocation of costs to appropriate strategic goals.

SCHEDULE OF NET COST BY STRATEGIC GOAL (DOLLARS IN THOUSANDS) Unaudited

For the Year Ended September 30, 2012

STRATEGIC GOAL AREAS	SAFETY	STATE OF GOOD REPAIR	LIVABLE COMMUNITIES	ENVIRONMENTAL SUSTAINABILITY	ECONOMIC COMPETITIVENESS	ORGANIZATION EXCELLENCE	TOTAL
SURFACE TRANSPORTATION							
Federal Highway Administration	$12,501,186	$17,190,423	$4,318,248	$5,617,651	$5,051,364	$16,097	$44,694,969
Federal Transit Administration	122,320	5,627,770	2,025,648	68,489	3,819,324	70,279	11,733,831
Federal Railroad Administration	273,344	283,593	403,060	353,128	599,014	85,284	1,997,423
Federal Motor Carrier Safety Administration	502,431	-	-	-	2,963	14,743	520,137
National Highway Safety Administration	705,512	-	-	61,349	-	6,728	773,589
Pipeline and Hazardous Materials Safety Administration	112	-	-	-	-	-	112
Research and Innovative Technology Administration	8,518	406	355	1,821	329	3,014	14,444
Surface Transportation Board	-	-	-	-	-	28,192	28,192
Subtotal	**14,113,423**	**23,102,192**	**6,747,311**	**6,102,438**	**9,472,995**	**224,337**	**59,762,698**
AIR TRANSPORTATION							
Federal Aviation Administration	7,812,879	1,581,208	-	551,990	4,439,756	1,618,500	16,004,333
Subtotal	**7,812,879**	**1,581,208**	**-**	**551,990**	**4,439,756**	**1,618,500**	**16,004,333**
MARITIME TRANSPORTATION							
Maritime Administration	-	-	-	29,527	422,164	41,827	493,519
Subtotal	**-**	**-**	**-**	**29,527**	**422,164**	**41,827**	**493,519**
OTHER PROGRAMS:							
Office of the Secretary	117,890	117,135	169,846	118,412	123,316	38,452	685,052
Volpe National Transportation System Center	2,193	105	91	469	85	776	3,718
Office of Inspector General	-	-	-	-	-	87,234	87,234
Subtotal	120,083	117,240	169,938	118,881	123,400	126,462	776,003
Total Net Cost	**$22,046,386**	**$24,800,640**	**$6,917,249**	**$6,802,835**	**$14,458,315**	**$2,011,126**	**$77,036,553**

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
	0					0
Lack of Sufficient Controls over Undelivered Orders		1				1
Total	**0**	**1**	**0**	**0**	**0**	**1**

TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES

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

Statement of Assurance	QUALIFIED

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
Lack of Sufficient Controls over Undelivered Orders	0	1				1
Total Material Weaknesses	0	**1**				**1**

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

Statement of Assurance	QUALIFIED

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	QUALIFIED

NON-CONFORMANCES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
Total Non-Conformances	**0**	**1**				**1**

CONFORMANCE WITH FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)

	AGENCY	AUDITOR
Overall Substantial Compliance	Yes	Yes
1. System Requirements	Yes	Yes
2. Accounting Standards	No	No
3. USSGL at Transaction Level	Yes	Yes

OFFICE OF INSPECTOR GENERAL'S TOP MANAGEMENT CHALLENGES FOR FISCAL YEAR 2013

MEMORANDUM

U.S. Department of Transportation

OFFICE OF THE SECRETARY OF TRANSPORTATION

Subject:	INFORMATION: DOT's Fiscal Year 2013 Top Management Challenges Department of Transportation Report Number PT-2013-011	**Date:**	November 15, 2012
		Reply to Attn. of:	**J-1**
From:	Calvin L. Scovel III Inspector General		
To:	The Secretary Deputy Secretary		

v/R
C. L. Scovel III

As required by law, we have identified the Department of Transportation's (DOT) top management challenges for fiscal year 2013. A safe and well-managed transportation system is key for the U.S. economy and the quality of life for the traveling public. To maintain and modernize all modes of transportation, the Department spends over $70 billion annually on a wide range of programs. Consequently, it is critical for the Department to carry out its mission within a framework of rigorous stewardship of taxpayer funds, and we continue to support the Department's efforts through our audits and investigations.

Global and domestic travel are projected to significantly increase the demand on our transportation system, and the Department faces considerable challenges in improving the Nation's surface infrastructure and airspace. A key issue is the Next Generation Air Transportation System—a multibillion-dollar effort to modernize the U.S. air traffic control system. The Department is working diligently to address numerous challenges we have identified over the years with this highly complex undertaking. However, much work remains to move from planning to implementation, tighten cost and schedule controls, and better define benefits and an end state for users.

It is also critical that the Department take every opportunity to make efficient use of funds through improved acquisition and grant management—an ongoing challenge with multi-modal impact. This past year, our work also highlighted the need for the Department to better safeguard its investments in key assets to support or expand transportation. These challenges include enforcing reforms to business practices, closely overseeing financing plans, and protecting critical information systems.

Improving air and surface safety continues to be the Department's overarching priority. This past year, the Department has made important progress toward meeting new airline safety regulations to advance voluntary safety programs at air carriers and improve pilot rest requirements. To maintain the Nation's excellent aviation safety record, the Department must address a number of challenges. These include maximizing existing data to identify trends and root causes of safety issues, enhancing risk-based oversight at carriers and repair stations, and mitigating air traffic controller fatigue.

In terms of surface safety, fatalities on the Nation's highways have generally declined over the last several years; however, the safety of the Nation's highways, railroads, and pipelines remains an ongoing concern. The Department must implement a number of safety requirements enacted in 2012 to identify defective vehicles, better protect motor coach passengers, enhance mass transit safety, and develop a national tunnel inspection program.

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:

- Ensuring the Next Generation Air Transportation System Advances Safety and Air Travel
- Enhancing FAA's Oversight and Use of Data To Identify and Mitigate Safety Risks
- Overseeing Administration of Key Transportation Assets To Ensure Their Success and Sustainability
- Strengthening Existing Surface Safety Programs and Effectively Implementing New Safety Requirements
- Maximizing Surface Infrastructure Investments With Effective Program Oversight and Execution of New Legislative Requirements
- Adequately Overseeing Administration of High Speed Intercity Passenger Rail Grant Funds
- Strengthening Financial Management Over Grants To Better Use Funds, Create Jobs, and Improve Infrastructure
- Ensuring Effective Management of DOT's Acquisitions To Maximize Value and Program Performance
- Managing and Securing Information Systems To Efficiently Modernize Technology Infrastructure and Protect Sensitive Data From Compromise

We are committed to keeping decision makers informed of issues identified through our audits and investigations. We appreciate the Department's commitment to taking prompt corrective action in response to our findings and recommendations. 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 this report, please contact me at (202) 366-1959. You may also contact Lou E. Dixon, Principal Assistant Inspector General for Audits and Evaluation, at (202) 366-1427.

#

cc: DOT Audit Liaison, M-1

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CHAPTER 1

ENSURING THE NEXT GENERATION AIR TRANSPORTATION SYSTEM ADVANCES SAFETY AND AIR TRAVEL

The National Airspace System (NAS) handles almost 50,000 flights per day and more than 700 million passengers per year. Air travel is expected to nearly double over the next 2 decades, and the Federal Aviation Administration (FAA) has been working for 8 years to develop the Next Generation Air Transportation System (NextGen). NextGen is intended to modernize aging equipment, systems, and facilities and improve airspace efficiency. While FAA has made some progress toward improved air traffic management, our work continues to find longstanding problems with cost increases, schedule slips, and performance shortfalls with key FAA modernization projects—challenges that have been exacerbated by the fiscally constrained Federal environment.

KEY CHALLENGES

- Realizing benefits from NextGen capabilities at congested airports in the near term
- Mitigating risks that delays with the En Route Automation Modernization program pose to critical NextGen initiatives
- Making decisions on facility consolidation and modernization
- Completing an integrated master schedule for NextGen transformational programs
- Achieving expected outcomes from reorganization to improve NextGen management
- Integrating Unmanned Aircraft Systems in the National Airspace System

REALIZING BENEFITS FROM NEXTGEN CAPABILITIES AT CONGESTED AIRPORTS IN THE NEAR TERM In response to recommendations by a Government-industry task force in 2009, FAA launched its "metroplex" initiative—a 7-year effort to improve the flow of traffic and efficiency at congested airports in 13 major metropolitan areas. FAA completed initial studies to identify and recommend airspace and procedure improvements at 7 of the 13 metroplex locations and is performing design work at 6. However, FAA continues to face challenges with shifting from planning to implementation. The expected completion date for all metroplex sites is now 15 months later than FAA planned. Further, industry representatives are concerned that the effort may not deliver all desired benefits since FAA has focused on limited airspace and procedure improvements rather than maximizing new technologies and advanced procedures, as recommended by the task force. According to FAA officials, the Agency has taken this approach to avoid potentially extensive environmental reviews and accommodate all airspace users, not just those equipped to fly advanced procedures. However, nearly half of all active commercial aircraft are currently equipped to fly advanced procedures, and representatives from air carriers who are equipped stated that FAA›s approach offers little operational and financial benefits to airlines. In addition, FAA has not yet integrated efforts from other related initiatives, such as better managing airport surface operations, into the metroplex initiative. As a result, airspace users are concerned about the pace and execution of the metroplex effort, as well as the lack of clearly defined expected benefits, and remain reluctant to equip with new avionics.

FAA also has not yet resolved various barriers to its metroplex effort—which have slowed other NextGen initiatives. These include working across diverse Agency lines of business, updating policies, streamlining the process for implementing new flight procedures, applying environmental regulations, upgrading controller automation tools, and training controllers on new advanced procedures. FAA is working to address our August 2012 recommendations to effectively implement the task force's recommendations and resolve these barriers in a timely manner.

MITIGATING RISKS THAT DELAYS WITH THE EN ROUTE AUTOMATION MODERNIZATION PROGRAM POSE TO CRITICAL NEXTGEN INITIATIVES Increasing airspace capacity and reducing flight delays depend on the successful implementation of the En Route Automation Modernization program (ERAM)—a $2.1 billion system to replace hardware and software at FAA's facilities that manage high-altitude traffic. FAA originally planned to complete ERAM by the end of 2010. However, software problems have impacted the system's ability to safely manage and separate aircraft and raised questions as to what capabilities ERAM will ultimately deliver. FAA rebaselined the program in 2011, which pushed its expected completion to 2014 and increased cost estimates by $330 million. FAA is taking steps to get ERAM on track and is using the system on a full-time basis at several sites—a significant step forward given the extensive software problems during testing at the two initial sites. Recent progress at those two sites has allowed FAA to phase out their legacy air traffic control systems. However, other facilities continue to identify software problems, and FAA will likely encounter these and other issues when it implements ERAM at some of the Nation's busiest facilities. If software problems persist, the program's cost growth could exceed $500 million, and delays could stretch out to 2016. Prolonged delays with ERAM will directly impact the overall cost and pace of NextGen. Without ERAM, the benefits of several other programs, such as a new satellite-based surveillance system and data communications for controllers and pilots, will not be possible.

MAKING DECISIONS ON FACILITY CONSOLIDATION AND MODERNIZATION FAA has not made key decisions on the number and locations of air traffic facilities needed to support NextGen or on the level of automation that can be realistically and safely achieved to manage traffic. In November 2011, FAA formalized an initial plan for consolidating en route centers and

Terminal Radar Approach Control facilities (TRACON)[1] into large, integrated facilities in six geographic segments across the country. Since then, the Agency has focused on plans in the New York area but has delayed a final decision until May 2013 on where to build the integrated facility. Ultimately, successfully implementing FAA's plans will require the Agency to address challenges with cost estimates, funding sources, and workforce issues.

Consolidation will likely be a long-term challenge for FAA, as its NextGen modernization plans were based on the traditional facility set-up of en route centers and TRACONs—not integrated facilities. Integrating facilities will also require cost and schedule changes to modernization programs that already have established baselines. The Terminal Automation Modernization and Replacement program alone involves about $1 billion through 2018 to replace aging displays and processors that controllers rely on to manage takeoffs and landings, the most critical phases of flight. FAA recently approved plans to begin transitioning to a new terminal automation system at 11 large TRACON facilities through 2017. However, the Agency has yet to determine whether its consolidation efforts will impact these facilities.

COMPLETING AN INTEGRATED MASTER SCHEDULE FOR NEXTGEN TRANSFORMATIONAL PROGRAMS FAA has not established total program costs, schedules, or performance baselines for any of the NextGen six transformational programs.[2] Rather, the Agency plans to approve these programs in shorter, discrete segments to minimize risks in the short term. However, as requirements continue to evolve, programs are left with no clear end-state, and decision makers lack sufficient information to assess progress. Further, FAA has not completed an integrated master schedule for deploying the transformational programs in response to our April 2012 recommendation. Due to these programs' complex interdependencies, it will therefore be difficult to fully address operational, technical, and programmatic challenges without a master schedule. While FAA is beginning to capture the critical activities required to deliver the six programs' operational capabilities, the Agency is still working to identify what type of data it needs, such as key system dependencies, to complete the master schedule.

ACHIEVING EXPECTED OUTCOMES FROM REORGANIZATION TO IMPROVE NEXTGEN MANAGEMENT Many of FAA's difficulties with implementing NextGen stem from underlying management challenges, such as assigning responsibility, accountability, and authority. In 2011, FAA commissioned an internal study to examine how the Agency's internal structure, processes, and management culture could be improved to support NextGen. Based on the study's recommendations, FAA announced a major reorganization in 2011 to better position NextGen for success. FAA elevated the former NextGen office—creating an Assistant Administrator for NextGen who reports directly to the FAA Deputy Administrator—and established a new Program Management Office. This new office will also work to bridge the gap between strategic requirements and program implementation. FAA is still in the early stages of this reorganization, and work remains to establish best practices and institutionalize changes.

INTEGRATING UNMANNED AIRCRAFT SYSTEMS IN THE NATIONAL AIRSPACE SYSTEM The application of Unmanned Aircraft Systems (UAS)[3] in the United States for research, law enforcement, private sector, and State government needs continues to grow. FAA predicts there will be roughly 10,000 active commercial UAS in 5 years, with industry investing over $89.1 billion in UAS technology over the next 10 years. The FAA Modernization and Reform Act of 2012[4] requires the Secretary of Transportation to develop a comprehensive plan that will safely and fully integrate UAS into the NAS no later than September 30, 2015. The law also requires FAA to establish a program to integrate UAS into the NAS at six test ranges by late summer 2012, but FAA has not completed this requirement. This will be a challenge for FAA as, historically, UAS have mainly supported military and security operations overseas, and FAA has approved operations in the United States on a limited, case-by-case basis. Additionally, according to FAA officials, concerns over individual privacy (e.g., collecting information for commercial and law enforcement purposes) have contributed to delays in implementing the law's requirements, such as issuing a rulemaking to allow use of small UAS. With increased usage of UAS comes increased risk to the NAS. While UAS capabilities have improved, their ability to detect, sense, and avoid other air traffic is limited. FAA must continue to work with other Federal agencies and the aerospace industry to address challenges such as certification standards and privacy concerns. Given the growing interest and unresolved safety issues associated with UAS flights, FAA and DOT will need to act quickly to safely integrate them into the NAS and align those changes carefully with NextGen implementation.

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

- Challenges With Implementing Near-Term NextGen Capabilities at Congested Airports Could Delay Benefits, August 1, 2012

1 En route centers guide airplanes flying at high altitudes through large sections of airspace, while TRACONs guide aircraft as they approach or leave airspace within 40 miles of an airport.

2 These six programs are Automatic Dependent Surveillance Broadcast (ADS-B), System Wide Information Management (SWIM), Data Communications (DataComm), NextGen Network Enabled Weather (NNEW), NAS Voice System (NVS), and Collaborative Air Traffic Management Technologies (CATM-T).

3 An Unmanned Aircraft System (UAS) is comprised of a pilotless aircraft, satellite or radio link, and ground control station where an operator controls the movements of the aircraft. UAS aircraft range in size from those with a wingspan as large as a Boeing 737 to smaller than a radio-controlled model airplane. UAS can serve diverse purposes, such as conducting military operations, enhancing border security, and monitoring forest fires.

4 FAA Modernization and Reform Act of 2012, Pub. L. No. 112-95 (2012).

- The Success of FAA's Long-Term Plan for Air Traffic Facility Realignments and Consolidations Depends on Addressing Key Technical, Financial, and Workforce Challenges, July 17, 2012
- Status of Transformational Programs and Risks to Achieving NextGen Goals, April 23, 2012
- The Federal Aviation Administration's Progress and Challenges in Developing and Transitioning to the Next Generation Air Transportation System, October 5, 2011

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT JEFFREY B. GUZZETTI, ASSISTANT INSPECTOR GENERAL FOR AVIATION AND SPECIAL PROGRAM AUDITS, AT (202) 366-0500.

CHAPTER 2

ENHANCING FAA'S OVERSIGHT AND USE OF DATA TO IDENTIFY AND MITIGATE SAFETY RISKS

The U.S. air transportation system continues to be among the safest in the world, due in part to the efforts of the Federal Aviation Administration (FAA) and the aviation industry. To help sustain that record, it will be important to constantly improve how key data are reported, analyzed, and used to enhance safety, oversight, and efficiency. Our audit work shows a number of areas where FAA can make improvements to bolster these and other oversight efforts.

KEY CHALLENGES

- Identifying trends in operational errors and determining their root causes
- Advancing oversight by implementing the Airline Safety Act of 2010
- Providing more rigorous risk-based oversight of repair stations and identifying inspector staffing requirements
- Identifying the effects of air traffic controller scheduling on safety, cost efficiency, and controller performance

IDENTIFYING TRENDS IN OPERATIONAL ERRORS AND DETERMINING THEIR ROOT CAUSES FAA must make better use of data on operational errors[5] to investigate incidents, identify trends, and mitigate their risks. Reported operational errors increased by 53 percent (1,234 to 1,887) between fiscal years 2009 and 2010. This number remained relatively unchanged between fiscal years 2010 and 2011 (rising to 1,895), but the most serious reported errors[6] continued to increase. FAA reports that these rose by 49 percent from fiscal year 2009 to fiscal year 2011 (from 37 to 55, respectively). What remains unclear is whether reported increases are due to more errors being committed, improved reporting, or both. FAA attributes the increase between fiscal years 2009 and 2010 to increased reporting through programs such as the Air Traffic Safety Action Program (ATSAP)[7] and greater use of automated reporting tools. However, FAA facilities that manage high-altitude traffic (Air Route Traffic Control Centers) had a 39-percent spike in operational errors during that time. These centers have had an automated system[8] in place for years to detect and investigate each reported error, which suggests that at least a portion of the increase is likely due to actual errors occurring.

To identify root causes of safety problems and mitigate their risk, FAA needs to fine-tune its approach to how it collects, verifies, and uses safety data. In July 2012, we identified control and oversight weaknesses in how FAA reports and investigates operational errors associated with ATSAP. FAA fully deployed ATSAP at all air traffic control facilities in 2010. However, to realize ATSAP's full potential, FAA must close program gaps, such as a lack of formal processes to review committee decisions on errors, and enforce key ATSAP guidelines and requirements. Failure to address these and other deficiencies not only undermines efforts to improve safety in the National Airspace System but also may lead to the perception that ATSAP is an amnesty program that automatically accepts reports of serious incidents, regardless of whether they qualify.

In January 2012, FAA issued new policies and procedures for collecting, investigating, and reporting separation losses, but their effectiveness is limited by incomplete data and implementation challenges. Specifically, FAA lacks an accurate baseline on the number of separation losses due to its limited use and review of the Traffic Analysis and Review Program[9] data, gaps in ATSAP reporting,[10] and inconsistent classification of separation losses. Moreover, FAA's new policies transfer the function of investigating operational errors from the facilities where they occur to the three Air Traffic Organization Service Areas. Facility managers raised concerns about whether the Service Areas have enough staff and knowledge of local flight procedures to successfully carry out this responsibility. Finally, the mitigation strategy for operational errors included in the new policies lacks previously identified causal factors, trends, and follow-up actions to address them—all considered to be key elements for mitigating the highest safety risks.

ADVANCING OVERSIGHT BY IMPLEMENTING THE AIRLINE SAFETY ACT OF 2010 The fatal Colgan Air crash in 2009

5 Losses of standard separation between aircraft due to air traffic controller error.
6 Before fiscal year 2011, FAA tracked operational errors in terms of an A, B, C severity rating-with A being the highest or "severe" risk and C the lowest. An "A" rating meant that less than 34 percent of separation standards were met.

7 ATSAP is a voluntary non-punitive reporting program to encourage FAA air traffic employees to report safety events and safety concerns, with the intent of capturing all events that might lead to a breakdown in safety.
8 The Operational Error Detection Program (OEDP) at air route traffic control centers automatically generates an alert when a potential loss of separation is detected.
9 TARP is an automated system that detects losses of separation that occur in terminal airspace.
10 Due to ATSAP provisions designed to protect controller confidentiality, much of the ATSAP data that FAA collects are not validated.

highlighted the need for improvements in pilot training, hiring and qualification programs as well as consistent safety standards between carriers. Congress and FAA took swift action following the crash to address these issues, culminating in the August 2010 passage of the Airline Safety and FAA Extension Act.[11] FAA has made important progress on many of the Act's requirements, such as advancing voluntary safety programs, improving pilot rest requirements, and establishing better processes for managing safety risks. Despite this progress, FAA has not met the Act's timelines for raising pilot training standards, implementing mentoring programs, or providing enhanced leadership skills to captains. FAA also missed the Act's deadline to substantially raise airline pilot qualifications by August 2012. Effectively implementing this new rule will require FAA to ensure carriers are ready to transition to the Act's enhanced pilot qualification requirements before August 2013, when they automatically take effect. FAA also faces challenges in establishing a pilot records database—an important component to enhance the air carrier screening process for pilot applicants. In addition, FAA has yet to provide sufficient guidance and assistance to industry—especially smaller carriers—in developing and managing new safety programs.

PROVIDING MORE RIGOROUS RISK-BASED OVERSIGHT OF REPAIR STATIONS AND IDENTIFYING INSPECTOR STAFFING REQUIREMENTS Major air carriers increased spending on contracts for aircraft maintenance by more than $1.7 billion over the past decade. This trend is expected to grow as carriers continue to shift away from in-house maintenance to save costs. In 2007, FAA implemented a risk-based oversight system to help inspectors target surveillance to repair facilities with higher risks. However, our ongoing work shows that this system does not include accurate or timely risk assessments of foreign and domestic repair stations. In addition, FAA has yet to provide inspectors with comprehensive data needed for analytical reviews of repair station performance. Instead, FAA inspectors typically rely on their personal knowledge of repair stations to conduct oversight, rather than using comprehensive and standardized procedures for conducting and communicating the results of inspections. As a result of these weaknesses, FAA's oversight lacks the rigor needed to identify deficiencies and verify corrective actions.

At the same time, FAA has not developed a reliable process for placing 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 its 4,300 aviation safety inspectors was ineffective and recommended that FAA develop a new approach. In response, FAA completed a new staffing model in October 2009. Our ongoing work shows that FAA's model does not effectively project staffing needs due largely to incomplete and inaccurate data. While FAA has reported the results of the model five times since 2009, the Agency has not fully relied on the model results when requesting additional inspectors during the annual budget process. FAA must further refine this tool so that it more effectively allocates inspector resources.

11 Airline Safety and Federal Aviation Administration Extension Act of 2010, Pub. L. No. 111-216 (2010).

IDENTIFYING THE EFFECTS OF AIR TRAFFIC CONTROLLER SCHEDULING ON SAFETY, COST EFFICIENCY, AND CONTROLLER PERFORMANCE A series of high-profile incidents in early 2011 involving controllers who were sleeping on duty sparked public concern about controller fatigue. As a result, in April 2011, FAA instituted a series of policy changes, including placing an additional air traffic controller on the midnight shift at certain facilities and mandating a minimum of 9 hours off between evening and day shifts. As directed by the FAA Modernization and Reform Act of 2012,[12] we are assessing these new controller scheduling practices. The Act mandated that our assessment include an analysis of how air traffic controller schedules are determined, how safety was considered when schedules are developed, the cost effectiveness of scheduling practices, and how scheduling practices impact air traffic controller performance. The implementation of this new policy is an important watch item for DOT, FAA, and Congress.

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

- Long Term Success of ATSAP Will Require Improvements in Oversight, Accountability, and Transparency, July 19, 2012
- The State of Aviation Safety and FAA's Oversight of the National Airspace System, April 25, 2012
- Progress and Challenges in Responding to Key Provisions of the Airline Safety Act, March 20, 2012
- Progress and Challenges With FAA's Call to Action for Airline Safety, February 4, 2010
- Air Carriers' Outsourcing of Aircraft Maintenance, September 30, 2008
- Review of Air Carriers' Use of Aircraft Repair Stations, July 8, 2003

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT JEFFREY B. GUZZETTI, ASSISTANT INSPECTOR GENERAL FOR AVIATION AND SPECIAL PROGRAM AUDITS, AT (202) 366-0500.

12 FAA Modernization and Reform Act, Pub. L. No. 112-95 (2012).

CHAPTER 3

OVERSEEING ADMINISTRATION OF KEY TRANSPORTATION ASSETS TO ENSURE THEIR SUCCESS AND SUSTAINABILITY

The Department owns or invests in several key transportation assets. These include the Metropolitan Washington Airports Authority (MWAA), which operates the region's two largest airports[13]—Ronald Reagan Washington National and Dulles International—and is also responsible for a massive public transportation expansion; Union Station, the main multi-modal transportation hub in Washington, DC; and the United States Merchant Marine Academy (the Academy) in New York. We have recent and ongoing work evaluating DOT's management practices for these critical assets due to recent concerns raised by Congress or other stakeholders to our office. Our audits highlight the need for the Department to improve its oversight of these assets to ensure their success and sustainability.

KEY CHALLENGES

- Enforcing reforms to MWAA's operating and contracting practices
- Overseeing the management of Washington, DC's Union Station
- Protecting the Academy's sensitive information and systems

ENFORCING REFORMS TO MWAA'S OPERATING AND CONTRACTING PRACTICES MWAA operates two major federally owned airports and is also responsible for designing, constructing, and partially financing the Dulles Corridor Metrorail Project—a two-phased, multibillion-dollar effort to expand DC Metrorail service in Northern Virginia and provide easier access to Dulles Airport.[14] Therefore, MWAA's decisions greatly impact the DC region and its residents. Since its creation, MWAA and its Board of Directors have made substantial improvements to the region's airports. Yet, MWAA has recently been the subject of controversy and debate regarding its policies, contracting practices, and governance issues. In a May 2012 letter to Congressmen Wolf and Latham, we raised concerns that MWAA's accountability to Congress, stakeholders, and the public—as well as compliance with the Act transferring operation of the airports—has been limited by weaknesses in its internal policies and oversight of those policies. In particular, policies and procedures for Board travel, ethics, and transparency were found to be insufficient to ensure fiduciary and ethical responsibility in the Board's expenses and activities. For example, MWAA's policy does not provide suggested limits or thresholds for business-related Board travel expenses, such as food, beverages, and flights. We identified one instance in which Board members and their guests spent $4,800 on meals during a trip to Hawaii for a conference.

Similarly, MWAA's contracting policies and practices do not ensure compliance with laws and MWAA's procedures, resulting in contracts that are not subject to full and open competition and may not represent best value. For example, MWAA's Board of Directors authorized categorical exceptions to full and open competition for items such as legal services, urgent need, or financial services.[15] MWAA awarded almost two-thirds (64 percent) of its 190 contracts that exceeded $200,000 with less than full and open competition during the period of our review.[16] Of these, 117 contracts were awarded using categorical exceptions, which amounted to more than $220 million.

In response to our letter, the Secretary, the Governors of Maryland and Virginia, and the Mayor of the District of Columbia issued a letter to MWAA's Chairman and Board members[17] mandating immediate reform to MWAA's business practices. Reforms include tightening Board travel procedures to eliminate wasteful spending, strengthening MWAA's ethics code to guard against conflicts of interest and provide annual ethics training to Board members and employees, and terminating all existing contracts with former Board members that were not competitively bid. In addition, the Secretary appointed an Accountability Officer to ensure those reforms would be instituted immediately. As stated in our November 2012 report, while MWAA has taken positive steps to correct the deficiencies we identified—including revising its travel and ethics policies and suspending contracts with former Board members—significant weaknesses remain that leave the Authority vulnerable to criticism for its contracting practices and management oversight. Our work found, among other things, that the Authority's existing ethics-related procedures[18] have been insufficient to detect violations of anti-nepotism and gift provisions. For example, one senior official indirectly supervised family members despite the code's explicit provision prohibiting such relationships. Another senior official regularly accepted inappropriate gifts from an MWAA contractor—including Super Bowl tickets, travel, and accommodations worth almost $5,000. Enhanced policies, strong internal controls, and robust oversight in the areas of procurement,[19] ethics, hiring and compensation, and transparency will be critical to maintain and improve the

13 MWAA operates these airports, their access highways, and other related facilities under the terms of a lease agreement with DOT authorized by the Metropolitan Washington Airports Act of 1986 (Pub. L. No. 99-591) and an interstate compact between the Commonwealth of Virginia and the District of Columbia.

14 This Project entails adding a 23-mile extension to DC's Metrorail system. This extension, to be known as the "Silver Line," will connect the Metrorail system to the Washington Dulles International Airport and Loudon County, Virginia.

15 The six categorical exceptions established in section 1.2 of MWAA's Contracting Manual include (1) limited competition for urgent needs; legal, financial, audit, or legislative representation professional services; and local business set asides; (2) airport security controlled distribution RFP; (3) utility supplies and services; (4) Government purchasing agreements; (5) airline tenant procured projects; and (6) proprietary equipment and software. Use of these exceptions requires no further Board approval.

16 We reviewed contracts awarded between January 2009 and June 2011.

17 Letter to Michael A. Curto, Chairman and Members of the Board of Directors, Metropolitan Washington Airports Authority, August 14, 2012.

18 MWAA recently approved a new employee code of ethics that will go into effect on January 1, 2013.

19 Based on FTA's Procurement System Review, MWAA's Board of Directors recently adopted changes to its Procurement Manual to be in line with FTA procurement requirements. However, we have not reviewed MWAA's implementation of these FTA-required changes because they are so recent. Also, our audit review and findings are broader than the FTA grant rules and apply to MWAA contract policies and practices for all of its contracts.

Authority's operations and restore public trust in the soundness of its current and future activities. The Department will also need to consider devising and adopting enforcement mechanisms to ensure that the remaining weaknesses we identified are addressed.

OVERSEEING THE MANAGEMENT OF WASHINGTON, DC'S UNION STATION Washington's historic Union Station, built over a century ago, provides rail, bus, and Metro access into the heart of the city and is a major tourist destination. In 1983, after years of neglect, the Department created the non-profit Union Station Redevelopment Corporation (USRC) to oversee and complete facility rehabilitation.[20] While DOT's Federal Railroad Administration (FRA) owns the Station, USRC is charged with managing and protecting Federal interests in the property. For the past 25 years, USRC has successfully funded basic maintenance and improvements with revenue from the Station's parking facilities and leased space. However, Union Station and USRC now face financial challenges that may exceed USRC's ability to self-finance and require the Department's intervention. These challenges include projecting expected outlays and developing a financing plan to ensure payment of the following:

- DC Possessory Interest Taxes totaling approximately $9 million in back taxes and almost $1 million annually thereafter
- outstanding debt from financing a garage expansion project totaling $29 million
- damages from the August 2011 earthquake currently estimated between $10 million and $12 million
- planned repairs and improvements through 2016 estimated at $40 million or more
- other structural issues and safety and security upgrades under consideration

USRC and FRA need to take a thorough look at the condition and emerging needs of Union Station; develop a comprehensive master plan that includes the needed repairs, upgrades, and improvements; and develop funding streams for these requirements before the facility deteriorates or becomes a safety concern.

PROTECTING THE ACADEMY'S SENSITIVE INFORMATION AND SYSTEMS The Academy—operated by the Department's Maritime Administration (MARAD)—is responsible for training shipboard officers for the U.S. Merchant Marine. As an institution of higher education, the Academy possesses sensitive information, including personally identifiable information (PII).[21] For example, the Academy uses a local area network (LAN) and Web site for several purposes, including the acceptance of student applications and maintenance of student grade records. Federal law and DOT policy require the Academy to implement security controls to protect the information and systems.[22]

In our May 2012 audit, we reported that the Academy's security controls were insufficient to protect its Web site and LAN from compromise, as the Academy had not implemented Federal and DOT security requirements. For example, the Academy's databases containing PII had poor user access controls. As a result, the Academy ran the risk of intruders gaining unauthorized access to a large amount of sensitive information stored in its system without detection or response from the Academy. We also identified a need for increased accountability and culture change as it pertains to information security. For example, we noted that the Academy did not enforce controls over student laptops connected to its LAN and did not discipline students for using the LAN in ways that increased security risks, such as accessing adult content. The Department will need to increase oversight of MARAD and the Academy to protect their information and systems.

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

- MWAA's Weak Policies and Procedures Have Led to Questionable Procurement Practices, Mismanagement, and a Lack of Overall Accountability, November 1, 2012
- The U.S. Merchant Marine Academy's Security Controls Were Not Sufficient To Protect Sensitive Data from Unauthorized Access, May 30, 2012
- Interim Response Letter to Congressmen Wolf and Latham Regarding MWAA, May 15, 2012

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT LOUIS C. KING, ASSISTANT INSPECTOR GENERAL FOR FINANCIAL AND INFORMATION TECHNOLOGY AUDITS, AT (202) 366-1407; JEFFREY B. GUZZETTI, ASSISTANT INSPECTOR GENERAL FOR AVIATION AND SPECIAL PROGRAM AUDITS, AT (202) 366-0500; OR MARY KAY LANGAN-FEIRSON, ASSISTANT INSPECTOR GENERAL FOR ACQUISITION AND PROCUREMENT AUDITS, AT (202) 366-5225.

20 Total rehabilitation costs were approximately $200 million.

21 PII is any information about an individual maintained by an agency, including, but not limited to, education, financial transactions, medical history, and criminal or employment history and information that can be used to distinguish or trace an individual's identity, such as their name, and social security number.

22 As required by the Federal Information Security Management Act of 2002 and the Departmental Cybersecurity Policy, DOT Order 1351.37, July 7, 2011.

CHAPTER 4

STRENGTHENING EXISTING SURFACE SAFETY PROGRAMS AND EFFECTIVELY IMPLEMENTING NEW SAFETY REQUIREMENTS

The Department's top priority is to make our transportation system safer. While fatalities on the Nation's highways have declined by over 25 percent since 2005,[23] the safety of highways, railroads, and pipelines remains an ongoing concern. The Department faces a significant challenge to continually improve and oversee the Nation's surface transportation systems that are critically important to efficiently move people and energy sources, promote interstate commerce, and grow the U.S. economy. A key component of departmental oversight will be implementation of new safety requirements enacted in the Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21).[24]

KEY CHALLENGES

- Following through on initiatives to improve the National Highway Traffic Safety Administration's oversight of vehicle safety defects
- Enhancing motor carrier safety oversight
- Implementing new rail transit safety oversight requirements
- Developing a new national tunnel safety program
- Effectively addressing expanded railroad safety oversight responsibilities
- Providing more rigorous oversight of pipeline safety programs

FOLLOWING THROUGH ON INITIATIVES TO IMPROVE THE NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION'S OVERSIGHT OF VEHICLE SAFETY DEFECTS Vehicle defects, particularly unintended acceleration, have brought significant public, media, and congressional attention to the National Highway Traffic Safety Administration's (NHTSA) oversight of vehicle safety. Our 2011 audit work found the need for process improvements within NHTSA's Office of Defects Investigation, particularly with establishing standard operating procedures for storing investigative records and documenting evidence. NHTSA also needs to assess its workforce to determine if it has enough staff and expertise to operate effectively. A key component of these efforts should be a formal training program for investigative staff to keep them apprised of defect identification processes and new technologies that could impact their work. NHTSA must also take specific steps to meet MAP-21 requirements, which include publishing motor vehicle safety recall information and developing regulations that direct manufacturers to affix guidance on passenger motor vehicles on how to submit defect complaints to NHTSA.

ENHANCING MOTOR CARRIER SAFETY OVERSIGHT Large truck and bus crashes and fatalities have increased and therefore remain a key safety issue.[25] Over the past year, the Federal Motor Carrier Safety Administration (FMCSA) took actions to remove unsafe commercial drivers and carriers, including motor coach companies. FMCSA also implemented a more stringent safety assurance process that new entrants must complete. However, it has yet to address two action items raised by our office and the National Transportation Safety Board (NTSB): (1) implement promised checks on whether U.S.-based commercial vehicles display proof of compliance with manufacturing standards and (2) issue a new regulation tightening controls over the leasing of buses. FMCSA should also collaborate with NHTSA on new MAP-21 provisions to strengthen motor coach safety and carry out MAP-21 provisions on safety reviews, commercial driver's license endorsements, and inspections.

MAP-21 also provided FMCSA with a critical new oversight tool by allowing it to revoke the registration of reincarnated carriers[26]—a safety concern we reported in April 2012. FMCSA revised its vetting process to identify reincarnated carriers applying for authority to transport passengers and household goods. However, before FMCSA expands the vetting process to all new motor carrier applicants, it will need to implement a risk-based approach to best target its limited vetting resources. FMCSA must also effectively implement its newly updated policies on placing reincarnated carriers out of service and reviewing and approving applications for operating authority.

IMPLEMENTING NEW RAIL TRANSIT SAFETY OVERSIGHT REQUIREMENTS MAP-21 enhanced the Federal Transit Administration's (FTA) authority to oversee the safety of the Nation's public transportation systems. By October 1, 2013, FTA must initially determine whether to certify that each State that has a State Safety Oversight agency has a State safety oversight plan in compliance with MAP-21 requirements. This will require FTA to establish safety performance criteria, vehicle safety performance standards, safety certification training for covered personnel, and plans for each transit agency to reduce safety risks.

FTA will face significant challenges in carrying out these new requirements. As our prior work shows, FTA should obtain sufficient data on attributes such as fatalities, injuries, and transit assets. It should also work expeditiously to establish rail transit-specific goals and performance measures to assess the impact of its new safety efforts. Additionally, FTA should issue timely guidance to State Safety Oversight agencies, prioritize the greatest safety risks for any rulemakings, enlist leadership

23 Based on September 2012 NHTSA data on actual or projected fatalities through 2011. NHTSA also reported that its statistical projection of traffic fatalities for the first half of 2012 shows an estimated 9-percent increase in fatalities over the number projected to have occurred in the first half of 2011.

24 Moving Ahead for Progress in the 21st Century, Pub. L. No. 112-141 (July 2012), §32701-32711.

25 From 2009 to 2011, large truck and bus crashes increased by 8.4 percent and associated fatalities increased by 5.7 percent.

26 Motor carriers that attempt to operate as a different entity in an effort to evade enforcement action, out-of-service orders, or both.

commitment to expedite these rulemakings, and periodically review and revise regulations.

DEVELOPING A NEW NATIONAL TUNNEL SAFETY PROGRAM The Federal Highway Administration (FHWA) must meet new MAP-21 requirements to establish a national tunnel inspection program and a tunnel inventory. This program would mirror the national bridge inspection program and bridge inventory and would require States to inspect and periodically report on the condition of the Nation's tunnels. FHWA has begun developing tunnel inspection standards, which were included in a proposed rule issued in 2010.[27] FHWA also developed guidance for tunnel design, construction, rehabilitation, and inspection that may be adopted as standards.

To fully implement the MAP-21 provisions and promote consistent application of tunnel safety standards, FHWA must take a number of steps. These include issuing regulations that clearly specify what constitutes a tunnel, ensuring its baseline inventory of highway tunnels is accurate, and establishing a process to assess inspection data. Finally, tunnel inspections may demand specialized engineering skills not readily available in FHWA and State DOT offices. Therefore, it will be critical for FHWA to develop a training and certification program to help FHWA and State DOT offices recruit and train the staff needed to implement new tunnel safety standards.

EFFECTIVELY ADDRESSING EXPANDED RAILROAD SAFETY OVERSIGHT RESPONSIBILITIES The Federal Railroad Administration (FRA) faces an ongoing challenge in carrying out its expanded regulatory role under the Rail Safety Improvement Act of 2008 (RSIA).[28] Congress passed RSIA after several high-profile railroad accidents between 2002 and 2008 and projections of rail traffic increases that could result in higher accident rates over the next 10 years. RSIA was the first reauthorization of the Federal Rail Safety program since 1994.

RSIA requires FRA to undertake a variety of actions, ranging from development of a long-term safety strategy to completion of scientific studies. The largest subset of these requirements directs FRA to develop 17 new safety regulations for the railroad industry. These new regulations govern a wide variety of areas, such as hours of service requirements for railroad workers, automated collision-prevention technology, standards for track inspections, and safety at highway-rail grade crossings. As of July 1, 2012, FRA had completed 9 of the 17 regulations required by RSIA. In addition to completing these, FRA faces the challenge of developing guidance for its oversight staff to oversee industry compliance with the new safety regulations. FRA publishes compliance manuals to provide guidance to its inspectors and the railroad industry on the application of safety regulations. However, the Agency failed to finalize compliance manuals for the new RSIA regulations before its inspectors initiated oversight activities for those regulations.

27 FHWA plans to issue a supplemental proposed rule in 2013 incorporating MAP-21 changes.
28 Pub. L. No. 110-432 (2008).

PROVIDING MORE RIGOROUS OVERSIGHT OF PIPELINE SAFETY PROGRAMS Several tragic pipeline accidents over the past few years have highlighted the need for the Pipeline and Hazardous Materials Safety Administration (PHMSA) to enhance its oversight of pipeline operators. Of particular concern are operators' integrity management programs, intended to reduce the likelihood and severity of pipeline accidents in highly populated or otherwise sensitive areas (known as High Consequence Areas).[29]

NTSB and our office have reported on weaknesses in this aspect of PHMSA oversight. In its investigation of the 2010 San Bruno, CA, pipeline explosion,[30] NTSB questioned the operator's implementation of its integrity management programs. NTSB raised concerns as to the effectiveness of inspection protocols PHMSA used to assess operators' compliance with their performance-based safety programs. NTSB recommended that the Secretary perform a top-to-bottom review of PHMSA's processes and procedures used to oversee operators' integrity management program compliance. In response, the Secretary and PHMSA agreed that PHMSA's Senior Policy Advisor would conduct this review, which is now underway.

In June 2012, we similarly reported vulnerabilities in PHMSA's oversight and enforcement of operators' compliance with their integrity management programs, specifically in regard to hazardous liquid pipelines. While PHMSA has several efforts underway to enhance its integrity management inspection program, the Agency faces challenges that impact its oversight. These include managing a growing backlog of inspections, identifying integrity management weaknesses through field inspections and onsite accident investigations, and transitioning to a new risk-based inspection program. In addition, PHMSA's integrity management requirements for operators' facilities (such as valves, pump and meter stations, and storage tanks) have not kept pace with recent technological advances that would enhance oversight at such facilities. Finally, the Agency has not yet resolved key data management deficiencies, such as insufficient quality checks for pipeline data, or established meaningful performance measures for its integrity management program.

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

- Hazardous Liquid Pipeline Operators' Integrity Management Programs Need More Rigorous PHMSA Oversight, June 18, 2012

29 High Consequence Areas include unusually sensitive areas (defined as drinking water or ecological resource areas), urbanized and other populated places, and commercially navigable waterways.
30 On September 9, 2010, a 54-year old gas pipeline exploded in San Bruno, CA, killing 8 people and destroying 38 homes.

- Timely and Targeted FMCSA Action Is Needed To Fully Address National Transportation Safety Board Recommendations for Improving Passenger Carrier Oversight, April 17, 2012
- Challenges to Improving Oversight of Rail Transit Safety and Implementing an Enhanced Federal Role, January 31, 2012
- 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

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT JOSEPH W. COMÉ, ASSISTANT INSPECTOR GENERAL FOR HIGHWAY AND TRANSIT AUDITS, AT (202) 366-5630; JEFFREY B. GUZZETTI, ASSISTANT INSPECTOR GENERAL FOR AVIATION AND SPECIAL PROGRAM AUDITS, AT (202) 366-0500; OR MITCH BEHM, ASSISTANT INSPECTOR GENERAL FOR RAIL, MARITIME, AND ECONOMIC ANALYSIS, AT (202) 366-9970.

CHAPTER 5

MAXIMIZING SURFACE INFRASTRUCTURE INVESTMENTS WITH EFFECTIVE PROGRAM OVERSIGHT AND EXECUTION OF NEW LEGISLATIVE REQUIREMENTS

The Federal Highway Administration (FHWA) and the Federal Transit Administration (FTA) face challenges in overseeing the billions in Federal funds provided annually to construct and maintain the Nation's vast network of roadways and transit systems. In addition, both agencies must implement new initiatives enacted in the Moving Ahead for Progress in the 21st Century (MAP-21) Act of 2012—the first surface transportation authorization since 2005. MAP-21 places priority on accelerating project delivery and employing performance-based investment management. Implementing MAP-21 will require FHWA and FTA to make fundamental changes in the way they currently do business.

KEY CHALLENGES

- Strengthening existing highway and transit project oversight mechanisms
- Expediting and reforming highway and transit project delivery
- Transitioning to a system of performance-based and data-driven surface transportation investments

STRENGTHENING EXISTING HIGHWAY AND TRANSIT PROJECT OVERSIGHT MECHANISMS FHWA and FTA have taken actions to improve oversight of highway and transit projects. These include adopting processes from FHWA's National Review Teams—an innovation of the American Recovery and Reinvestment Act (ARRA)[31]—for future assessments across FHWA Division offices and reviewing FTA's regional oversight practices. However, both agencies remain challenged to ensure projects meet Federal requirements and maximize the return on Federal dollars.

For highway and bridge investments, States assume much of the oversight responsibility for about $40 billion in annual Federal-aid, but FHWA is ultimately responsible for making sure that projects meet Federal requirements. However, our work has found a number of areas where FHWA can do more to hold States accountable. First, FHWA must follow through on promised actions to correct States' insufficient oversight of local public agency (LPA) programs—federally funded projects managed by cities, counties, and other local entities. For example, more uniform FHWA assessments of LPA deficiencies would help curb persistent risks, such as noncompliance with Federal labor requirements and improper processing of contract changes. Second, FHWA's Division Offices can more clearly define Federal and State oversight roles and responsibilities and identify program risks and priorities within the Stewardship and Oversight Agreements they have with States. Finally, FHWA will be challenged to ensure States effectively implement new regulations on performing value engineering studies during a project's planning or design phase to improve project performance, cost, and quality.

FHWA must also continue to exercise proper stewardship of ARRA funds, which provided over $27 billion for highway infrastructure projects in 2009 and established tight time frames for using these funds. Last year, the Office of Management and Budget (OMB) directed Federal agencies to expedite use of ARRA funds to advance ARRA's major goal of stimulating economic activity well before the final deadline of September 30, 2015. As of July 1, 2012, the bulk of FHWA's ARRA funds have been spent, but the remaining portion of the approximately $2 billion (7.6 percent of ARRA highway funds) may be returned to the Treasury if not spent in time.

FTA has oversight responsibility for approximately $10 billion it provides annually to more than 1,300 States and localities, including a large portfolio of major infrastructure projects across the country. Our work, done at FTA's request, has identified areas where FTA can improve its oversight tools—which rely heavily on contractors—to maximize the return on investment. For example, FTA Headquarters must provide its regional offices and oversight contractors with enhanced guidance to ensure they consistently identify and accurately track deficiencies found during key audits of FTA grantees. Additionally, after our assessment of the Dulles Corridor Metrorail Project, FTA

31 American Recovery and Reinvestment Act, Pub. L. No. 111-5 (2009).

recognized that issues we identified merited an internal review of its project management oversight contractor processes. Timely implementation of these reforms is essential to ensure transit funds are appropriately spent.

EXPEDITING AND REFORMING HIGHWAY AND TRANSIT PROJECT DELIVERY A key challenge for DOT is to meet new MAP-21 requirements to expedite and reform highway and transit projects. Reducing project delivery time has become a national priority, as a typical highway project takes an average of 13 years to complete. In addition to tying up resources, long project delivery times delay opportunities to reduce highway congestion and improve traffic safety. MAP-21 incorporates a specific set of initiatives, such as broadening States' ability to acquire or preserve the property needed for a project before completion of lengthy environmental impact reviews. To meet MAP-21 requirements, it will be essential that DOT build on its agencies' existing initiatives, such as FHWA's "Every Day Counts." This initiative focuses on identifying proven project delivery processes and market-ready technologies, and encouraging widespread use among States.

TRANSITIONING TO A SYSTEM OF PERFORMANCE-BASED AND DATA-DRIVEN SURFACE TRANSPORTATION INVESTMENTS MAP-21 requires DOT to move toward more performance-based investment management of its highway and transit programs. Accordingly, DOT must establish new rules and performance standards, link performance data collection to project selection and funding processes, and modify oversight mechanisms. DOT will be challenged to put performance management into actual practice, as demonstrated by its difficulties deploying a performance-based program for its multi-modal Transportation Investment Generating Economic Recovery (TIGER) discretionary grant program. Since 2009, DOT has worked to require each TIGER grantee to develop and report on outcome-based performance measures. However, DOT has yet to develop the methods to make meaningful comparisons across diverse transportation modes and assess project impacts.

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

- Improvements to Stewardship and Oversight Agreements Are Needed To Enhance Federal-Aid Highway Program Management, October 1, 2012
- DOT Established Timely Controls for the TIGER Discretionary Grant Program, but Opportunities Exist To Strengthen Oversight, September 20, 2012
- Improvements Needed in FTA's Grant Oversight Program, August 2, 2012
- Actions Needed To Improve FTA's Oversight of the Dulles Corridor Metrorail Project's Phase 1, July 26, 2012
- FHWA's Oversight of Federal-Aid and Recovery Act Projects Administered by Local Public Agencies Needs Strengthening, July 15, 2011

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT JOSEPH W. COMÉ, ASSISTANT INSPECTOR GENERAL FOR HIGHWAY AND TRANSIT AUDITS, AT (202) 366-5630.

CHAPTER 6

ADEQUATELY OVERSEEING ADMINISTRATION OF HIGH SPEED INTERCITY PASSENGER RAIL GRANT FUNDS

The Passenger Rail Investment and Improvement Act of 2008[32] (PRIIA) directed the Federal Railroad Administration (FRA) to establish a grant program to fund various types of intercity passenger rail improvements. FRA has awarded and obligated over 95 percent of $10.1 billion in grant funds—$8 billion of which was appropriated by the American Recovery and Reinvestment Act of 2009 (ARRA)—to develop and implement the High Speed Intercity Passenger Rail Program (HSIPR). While FRA has developed parameters for funding grants, it has only disbursed 8 percent of funds to date due to a number of challenges. As more HSIPR grantees move to begin project construction, FRA will need to provide clear program guidance, comprehensive training, and cohesive program goals and performance measures.

KEY CHALLENGES

- Approving completed stakeholder agreements to disburse obligated HSIPR funds
- Addressing staffing needs to provide effective HSIPR Program oversight
- Overseeing HSIPR Program progress with comprehensive goals, performance measures, and monitoring

APPROVING COMPLETED STAKEHOLDER AGREEMENTS TO DISBURSE OBLIGATED HSIPR FUNDS FRA issued interim HSIPR guidance for grantees and freight companies to outline the terms and conditions they must agree on before receiving any Federal funds. These agreements cover passenger rail service improvements, construction, and maintenance responsibilities. FRA approved completed agreements related to service improvements prior to obligation of project funds. Many agreements related to construction and maintenance responsibilities are incomplete because stakeholders cannot agree on required terms, and FRA's interim guidance does not specify how these terms should be addressed. This has required FRA to be more involved in negotiating the agreements to clarify its expectations and address disputes among stakeholders, resulting in a more time consuming process. If delays with projects' agreements continue, obligated funds will sit idle instead of being freed up for projects with completed agreements. As the HSIPR Program progresses,

32 P.L. No. 110-432, Div. B.

FRA will need finalized guidance that provides clear direction to grantees on completing required agreements and to applicants on developing project grant applications to enable proper evaluations of project viability. FRA plans to issue a Notice of Proposed Rulemaking to finalize the guidance within 4 months of receiving new appropriated funds from Congress for the HSIPR program.

ADDRESSING STAFFING NEEDS TO PROVIDE EFFECTIVE HSIPR PROGRAM OVERSIGHT FRA has not fully addressed HSIPR Program staffing and training needs. To date, FRA has filled 91 percent of the staff positions allocated for its division primarily responsible for HSIPR. The Agency recognizes its need to fill remaining vacancies, but it has experienced difficulty in recruiting qualified candidates for specialized roles, such as grant managers. Effective integration of personnel into these key positions is critical to build the Agency's expertise to adequately manage the growing HSIPR program. FRA's recently completed Grants Management Manual includes Program policies that will be the basis for a full training curriculum, which will focus on grant management practices for project-based staff. The Agency plans to issue the curriculum by December 2012.

OVERSEEING HSIPR PROGRAM PROGRESS WITH COMPREHENSIVE GOALS, PERFORMANCE MEASURES, AND MONITORING FRA's HSIPR program lacks clear goals and meaningful performance measures needed for decision makers to understand FRA's expectations for the Program and FRA's progress in achieving them. For example, one HSIPR goal is to upgrade existing intercity passenger rail corridors to improve reliability, speed, and frequency of existing services. However, the goal does not include measures that indicate progress, such as anticipated trip time improvements, additional trains, and ridership gains. In addition, many goals are inconsistent across FRA's planning documents, and some cannot be reconciled. It is therefore difficult for FRA to effectively set priorities and plan best use of resources. A key step to better define HSIPR program goals—and what their outcomes should be—is completion of the congressionally mandated National Rail Plan (NRP). The NRP is intended to help States determine how to integrate interstate rail planning and address national transportation needs through high speed rail corridors. Therefore, once complete, the NRP could greatly aid FRA's efforts to make HSIPR goals more cohesive at the State and national levels. To date, however, FRA has been slow in implementing the NRP due largely to its focus on obligating funds to grantees.

FRA also faces challenges with aspects of HSIPR program monitoring. In March 2012, FRA finalized its monitoring plan, which defines timeframes and personnel responsibilities for completing scheduled reviews of HSIPR grantees' compliance with grant terms. However, FRA still lacks an effective tool to help grant managers accurately track and manage grantees' compliance with key documentation requirements, such as those for ARRA reporting and certification.

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

- FRA's Requirements for High Speed Rail Stakeholder Agreements Mitigated Risk but Delayed Some Projects' Benefits, November 1, 2012
- Completing a Grants Management Framework Can Enhance FRA's Administration of the HSIPR Program, September 11, 2012
- FRA Has Made Progress in Implementing PRIIA Responsibilities, but Challenges for Long-Term HSIPR Remain, March 6, 2012

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT MITCH BEHM, ASSISTANT INSPECTOR GENERAL FOR RAIL, MARITIME, AND ECONOMIC ANALYSIS, AT (202) 366-9970.

CHAPTER 7

STRENGTHENING FINANCIAL MANAGEMENT OVER GRANTS TO BETTER USE FUNDS, CREATE JOBS, AND IMPROVE INFRASTRUCTURE

Over the past 5 years, the Department has successfully maintained a clean opinion on its financial statements—a commendable step towards good financial management. However, DOT could do more to maximize the return on investment for its grants, many of which are used to create jobs and improve transportation infrastructure. Our audit work has identified financial management weaknesses that allow available grant funds to remain committed to projects where they are no longer needed, permit improper payments, and limit the benefits of single audits[33] in improving controls over grant spending. Until it addresses these weaknesses, DOT will be unable to make the most of its increasingly limited grant resources.

KEY CHALLENGES

- Identifying idle grant funds that can be used for transportation projects
- Enhancing controls to reduce and recover improper payments
- Making better use of single audit findings to improve grantees' financial management practices

IDENTIFYING IDLE GRANT FUNDS THAT CAN BE USED FOR TRANSPORTATION PROJECTS For the past 4 years, the Department's financial statement auditors have recommended that DOT strengthen internal controls, de-obligate and close out

33 All non-Federal entities that expend $500,000 or more of Federal awards in a year are required to obtain an annual audit in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133. OIG performs quality control reviews of selected Single Audits covering expenditures of DOT funds in order to determine (1) the adequacy of the independent auditors' work, (2) whether the work complied with relevant auditing standards, and (3) the extent to which we can rely on the auditors' work.

inactive funds from completed projects in a timely manner, and make them available for other priority projects. In particular, the financial statement reports and our audit work have identified a significant deficiency in DOT's internal controls over Undelivered Orders (UDO).[34] For example, our tests of inactive[35] grant UDOs on record as of March 31, 2012, disclosed an estimated $1.2 billion in UDOs that the Department can de-obligate. Most of these obligations were identified within the Federal Highway Administration (FHWA) and Federal Transit Administration (FTA) grant programs. Further, FHWA and FTA policies and procedures for monitoring grant obligations use thresholds (e.g., age of obligation) that do not enable timely identification of unneeded obligations. We also found many cases where personnel did not evaluate obligations that met the policy thresholds.

On July 11, 2012, the DOT Chief Financial Officer directed all Operating Administrations to immediately begin a 60-day, resource-intensive remediation effort to identify and de-obligate unneeded UDOs where possible or quantify unneeded UDOs for future corrective action. While this is a positive step, it serves only as a short-term solution to correct the financial statements as of September 30, 2012. To create a permanent solution to this persistent problem, the Department will have to revisit its policies and procedures for monitoring grant obligations, identify potential training needs for personnel who monitor grants, and enforce compliance with internal controls to enable timelier identification and resolution of unneeded obligations. To avoid the need for another short-term, resource-intensive remediation effort, the Department must also continually monitor Operating Administrations' efforts to reprogram unneeded obligations to projects that will benefit job creation and infrastructure development.

ENHANCING CONTROLS TO REDUCE AND RECOVER IMPROPER PAYMENTS Reduction and recovery of improper payments are longstanding challenges for DOT. The 2010 Improper Payments and Elimination and Recovery Act (IPERA)[36] encourages the elimination of payment error, waste, fraud, and abuse in Federal programs. Annually, DOT programs provide more than $60 billion in grants to over 3,300 grantees. While DOT has identified significant improper payments[37] in FHWA's Federal-Aid Highway Program totaling an estimated $450 million, we continue to find additional recoverable improper payments that DOT did not identify. For example:

- In 2010, we reported that the Federal Aviation Administration's (FAA) risk-based grant oversight for its Airport Improvement Program (AIP) was not sufficient to prevent or detect improper payments. We estimate that there are more than $31 million in recoverable improper payments. In October 2012, FAA began implementing a new risk-based grant oversight process. FAA anticipates this process will take at least 3 years to complete.
- In 2011, during our audit of FAA's American Recovery and Reinvestment Act (ARRA) grants, FAA agreed to recover $2.1 million from the San Francisco International Airport for construction that was not authorized in the grant agreement.

Improvements to DOT's payment recapture program[38] would help it detect and recover improper payments. In particular, DOT needs to increase its coverage of payments included in this program and implement follow-up actions. To illustrate, in 2011, DOT tested only $26 billion of its reported net costs of $78 billion. Although the recapture program identified improper payments totaling $266,000 that year, no changes were made to correct their causes. DOT plans to implement additional procedures to improve its next payment recapture audit.

MAKING BETTER USE OF SINGLE AUDIT FINDINGS TO IMPROVE GRANTEES' FINANCIAL MANAGEMENT PRACTICES DOT faces challenges in making better use of single audit findings to improve its grantees' financial management practices. One reason is the increased volume of single audit findings associated with the infusion of ARRA funds into the grant management pool. To illustrate, in fiscal year 2010, we issued 89 action memoranda conveying deficiencies in grantees' procedures or operations to oversee grant funds. In fiscal years 2011 and 2012, this number grew to more than 125 action memoranda.[39] Single audit findings identified in these action memoranda included deficiencies such as improper reporting of ARRA funds spent and inadequate monitoring of subrecipients. In addition to procedure and oversight deficiencies, action memoranda also contained over $27.7 million in questioned costs during fiscal year 2012 alone.

Another impediment to DOT's use of single audit findings is ineffective tracking systems intended to identify grantees with unresolved findings and problematic single audit histories. We found this to be the case at FHWA, FAA, and the National Highway Traffic Safety Administration; the Federal Railroad Administration did not have a tracking system. In addition, DOT policy did not establish criteria for tracking such grantees or prescribing actions when appropriate. As a result, it was difficult for DOT to take suitable actions (e.g., withholding payments) against these grantees, which are necessary to help keep grant funds out of the wrong hands.

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

- DOT's Improper Payment Reporting Generally Complies

34 UDOs represent goods or services ordered, which have not been received prior to the end of the reporting period. Grant UDOs represent funding obligated through grantee agreements that have not been disbursed prior to the end of the reporting period.

35 Our testing focused on grants that had been inactive for at least a year.

36 Public Law Number 111-204 (2010).

37 IPERA's term 'significant' means that improper payments in the program or activity in the preceding fiscal year may have exceeded $100,000,000.

38 A payment recapture program consists of the review of financial records to identify overpayments that can be recovered.

39 For fiscal year 2012, 122 action memoranda have been issued as of July 31, 2012. The National Single Audit Program Office projects at least seven more before fiscal year-end.

with IPERA, March 15, 2012

- DOT Needs To Improve Its Tracking and Monitoring of All Single Audit Findings in Order To Effectively Manage Grants, December 28, 2011
- Improper Payments Identified in FAA's Airport Improvement Program, December 1, 2010

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT LOUIS C. KING, ASSISTANT INSPECTOR GENERAL FOR FINANCIAL AND INFORMATION TECHNOLOGY AUDITS, AT (202) 366-1407.

CHAPTER 8

ENSURING EFFECTIVE MANAGEMENT OF DOT'S ACQUISITIONS TO MAXIMIZE VALUE AND PROGRAM PERFORMANCE

In fiscal year 2011, DOT obligated approximately $68 billion on contracts and grants.[40] Minimizing waste and abuse through acquisition management is an ongoing challenge for DOT and particularly critical given current budget limitations and recent Office of Management and Budget (OMB) and congressional initiatives emphasizing more accountability in Federal contracting. Our audits have found weaknesses in DOT's acquisition planning and oversight, resulting in missed opportunities to improve program performance and save taxpayer dollars.

KEY CHALLENGES

- Increasing Departmentwide management attention on the importance of acquisitions and governance
- Strengthening DOT's acquisition planning, oversight, and workforce
- Improving management oversight of recipients' contract practices to ensure program integrity and the efficient use of limited funds

INCREASING DEPARTMENTWIDE MANAGEMENT ATTENTION ON THE IMPORTANCE OF ACQUISITIONS AND GOVERNANCE To effectively safeguard taxpayer dollars and meet OMB requirements, DOT must strengthen its processes for approving and overseeing major acquisitions, such as its $2.2 billion information technology (IT) investment portfolio. While DOT has developed a proposal for an IT acquisition and investment governance structure, it still lacks a Departmentwide implementation plan. Institutionalizing IT procurement reform across DOT will remain a significant challenge given the longstanding oversight, statutory, and organizational barriers our work has identified. For example, even though the Federal Aviation Administration's (FAA) IT investments account for 94 percent ($2.07 billion) of DOT's investment portfolio, DOT provides limited acquisition oversight, with reviews of only two FAA IT programs over the last 2 years. While FAA's Joint Resources Council (JRC) is charged with ensuring the Agency's investments and acquisitions fulfill program priorities and maximize resources, FAA does not always follow its approval and oversight processes. For example, the JRC has not consistently held program offices accountable for submitting critical investment information prior to JRC decisions, which jeopardizes the success of billion-dollar investments.

Another ongoing challenge is that DOT's acquisition leaders and contracting officers lack sufficient input and authority into program planning and decision making to help ensure the billions of dollars DOT spends on contracting annually are cost effective and support program results. In 2011 we reported that DOT's Office of the Senior Procurement Executive (OSPE) was not included in top-level management decisions and that the procurement structure did not play a strategic role in supporting DOT's missions. However, OSPE recently updated its strategic plan covering fiscal years 2013 through 2016 and reports that it now provides policy and operational support to parts of DOT responsible for carrying out the Department's mission. OSPE will need to work diligently to implement its strategic goals and recent revisions to its strategic plan to ensure that acquisition management is fully integrated into its decision making. Organizational weaknesses within various Operating Administrations' acquisition functions similarly limit their strategic roles in achieving program results. For example, in 2010 we reported that the Federal Motor Carrier Safety Administration relegated its acquisition function to an administrative support role rather than a partner for implementing the Agency's mission. As a result, the Agency did not maximize competition when awarding contracts and had inadequate contract oversight. FMCSA has begun to focus attention on its acquisition function in response to our recommendations, but sustained efforts will be needed to fully address them.

STRENGTHENING DOT'S ACQUISITION PLANNING, CONTRACT OVERSIGHT, AND WORKFORCE Ineffective acquisition planning and oversight make DOT's contract spending less cost effective and undermine the success of DOT's acquisitions. Our work has continually identified such weaknesses within some of DOT's most critical—and costly—acquisitions. For example:

- **Systems Engineering 2020 (SE-2020):** FAA's SE-2020 contracts, with a cumulative maximum value of $7.3 billion, are the largest awards in FAA's history and are intended to help it develop the Next Generation Air Transportation System (NextGen). However, FAA lacked clear requirements for ensuring fair and reasonable labor rates. FAA awarded the contracts using the contractors' proposed labor rates, which were 29 percent lower than FAA's estimated rates, without submitting a required explanation for these significant differences. FAA also included 18 million more labor hours than needed in the contracts' ceilings. As a

40 DOT's fiscal year 2012 data were not available at the time of this report.

result, the contract values are overstated by as much as $2 billion. FAA is taking action to address our recommendations to strengthen its SE2020 program and contract management. While FAA is in the early stages of using its SE-2020 contracts, it must continually focus on improving its contracting to manage and monitor future SE-2020 performance—especially given the billions of dollars the Agency may yet award.

- **En Route Automation Modernization (ERAM):** FAA will be challenged to resolve shortcomings in the ERAM contract structure and execution to effectively manage costs and achieve desired program outcomes. The ERAM contract follows a traditional, large-scale approach with contract tasks that span several years instead of a modular approach, which would divide the contract into manageable segments for better control. As a result, it is difficult for FAA to track individual factors driving cost overruns. In addition, FAA did not effectively use two cost management tools. First, FAA's use of contract incentives did not motivate the contractor to manage costs because, when requirements grew, FAA simply increased the targeted ceiling for the contractor. At the time of our review, FAA had paid the contractor over $150 million of the total available cost incentives even though ERAM was as much as $500 million over budget. Second, FAA did not correctly implement earned value management (EVM)[41] to forecast performance trends and identify problems early on. As a result, the EVM system did not detect significant schedule and cost variances, which started when ERAM experienced software problems at the initial test site.

FAA is beginning to address our recommendations on revising the contract structure for ERAM. It will now separately track costs for new software releases to better control spending. It will also establish five separate performance targets for each release, each with mandatory award criteria to encourage improved performance. FAA also recently agreed to restructure its EVM system to better align with program milestones and account and report on some authorized work.

A key component of addressing challenges with DOT's acquisition processes will be strengthening the workforce DOT relies on to negotiate and administer its contracts. FAA's acquisition workforce is of particular concern as its billion-dollar NextGen program significantly increased the Agency's acquisition workload and will require more resources and new skills to ensure sound acquisition management. For example, in reviewing SE-2020 contracts, we found that FAA did not require its oversight staff to receive training in contractor surveillance methods or use oversight plans, resulting in oversight plans that did not detail how to assess the contractor's work.

IMPROVING MANAGEMENT OVERSIGHT OF RECIPIENTS' CONTRACT PRACTICES TO ENSURE PROGRAM INTEGRITY AND THE EFFICIENT USE OF LIMITED FUNDS Our work continues to identify the need for more vigilant DOT oversight of taxpayer dollars distributed through the Department's grant programs, including over $48 billion in American Recovery and Reinvestment Act (ARRA) funds. Within DOT, the Federal Highway Administration (FHWA) is responsible for the largest share of grants, including $27 billion in ARRA funds for highway projects. In 2012, we reported that FHWA's oversight does not ensure that State Departments of Transportation (State DOT) effectively obtain competition prior to awarding contracts. FHWA's guidance to State DOTs promoting competition is optional and therefore unenforceable. FHWA also lacks sound performance measures and monitoring tools to evaluate State DOT contract competition and award activity. Our review found that even minimal increases in the number of bids could significantly impact contract prices. Specifically, 19 percent of the 8,365 ARRA contracts that State DOTs awarded through March 31, 2010, received only 1 or 2 bids—and their prices were on average 11 percent higher than those with 3 bids.[42] When projected over all FHWA ARRA funds, the average price difference between contracts with 1 or 2 bids and those with 3 bids was at least $179 million.[43] Although FHWA's ARRA funds have already been awarded, the Agency needs to leverage the lessons learned from its oversight of ARRA contracts to foster better competition and maximize States' use of Federal-aid funds for future contracts.

DOT also faces challenges in administering its Disadvantaged Business Enterprises (DBE) program. The DBE program is intended to help socially and economically disadvantaged individuals who own or control small businesses to participate in contracting opportunities under DOT financial assistance programs. DOT, through its recipients, distributed $4.4 billion to DBEs in fiscal year 2011. Our investigations have seen an increase in DBE fraud and abuse cases, which now represent 29 percent of our active procurement and grant fraud investigations. For example, in April 2012, the president of a Pennsylvania-based bridge beam manufacturer was convicted of fraud and money laundering in conjunction with a $136 million DBE fraud scheme, the largest reported DBE fraud scheme in the Nation's history. Our audit work shows that the Department needs to improve its management, recipient communication, and training for the DBE program. DOT has not issued standardized guidance or provided sufficient training to States responsible for implementing the DBE program. It also has a fragmented management approach; no single DOT entity is accountable for overall program management. Instead, limited aspects of program management are assigned to three separate DOT offices. As a result, Operating Administrations' oversight of recipients' DBE

41 Earned Value Management is a project management planning, monitoring, and control technique that integrates scope, schedule, and resources in such a way as to provide for the objective measurement of project performance and progress.

42 Based on responses to our survey of 52 FHWA Division Offices for States that received ARRA funds.

43 This difference should not be construed as potential savings. Rather, it highlights the importance of increasing competition because our results show that even minimal increases in the number of bids could have a significant impact on contract prices. Our projection has a 90-percent confidence level.

programs is neither consistent nor comprehensive, leaving weaknesses in DBE practices unaddressed. For example, during our review, 14 of 15 randomly selected States reported the Department had not provided them with comprehensive, standardized guidance on DBE regulations. Areas of concern included how to verify a DBE owner's personal net worth, which could allow unqualified DBEs to be certified. We found that two firms certified in a State failed to meet DBE eligibility requirements in fiscal year 2009, but they collectively received over $5.4 million in DBE awards and payments that year.

DOT's responsibility for billions of dollars in contract awards and ARRA funds heightens the importance of protecting those funds from individuals with a record of wrongdoing and abuse. In 2010 we reported and testified to Congress that DOT could not effectively prevent contract and grant awards to improper parties due to delays in its suspension and debarment (S&D) decisions and reporting. DOT and FAA are revising their policies to require timely action on S&D decisions. However, DOT can do more to leverage the protections of its S&D program. For example, our 2012 audit of FHWA's oversight of State contracting practices for ARRA-funded projects found that FHWA Division Offices needed better controls to prevent States' awards to improper parties. These include written confirmation from State DOTs that they checked the suspension and debarment database before granting an award.

Finally, our investigations continue to identify 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 our active investigations. Between October 2011 and August 2012, procurement and grant fraud investigations resulted in 49 indictments, 19 convictions, and $24 million in fines and other recoveries. Our investigations also pointed to DOT's challenges in ensuring that its grantees' contractors' expenses are proper. For example, in November 2011, the former chief executive officer of EV Worldwide LLC was ordered to pay $4.25 million to the Federal Transit Administration as a result of his participation in a scheme to submit fraudulent invoices for ineligible and questionable expenses on a transit authority project.

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

- Weaknesses in Program and Contract Management Contribute To ERAM Delays and Put Other NextGen Initiatives at Risk, September 13, 2012
- Lessons Learned From ARRA: Improved FHWA Oversight Can Enhance States' Use of Federal-Aid Funds, April 5, 2012
- FAA's Contracting Practices Are Insufficient To Effectively Manage Its Systems Engineering 2020 Contracts, March 28, 2012
- 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
- 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

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT MARY KAY LANGAN-FEIRSON, ASSISTANT INSPECTOR GENERAL FOR ACQUISITION AND PROCUREMENT AUDITS, AT (202) 366-5225 OR TIMOTHY BARRY, PRINCIPAL ASSISTANT INSPECTOR GENERAL FOR INVESTIGATIONS, AT (202) 366-1967.

CHAPTER 9

MANAGING AND SECURING INFORMATION SYSTEMS TO EFFICIENTLY MODERNIZE TECHNOLOGY INFRASTRUCTURE AND PROTECT SENSITIVE DATA FROM COMPROMISE

DOT faces the ongoing challenge of modernizing its systems to keep pace with new technologies that change how DOT entities conduct business and create complex information security issues. Departmental operations rely on more than 400 information systems—nearly two-thirds of which belong to the Federal Aviation Administration (FAA). However, DOT currently lacks a blueprint, known as an enterprise architecture (EA), to effectively guide changes to its infrastructure. Security is a top priority since breaches by computer hackers have placed a number of major entities at risk and have exposed individuals' personal information to unauthorized access. In 2010 and 2011, the Department declared the deficiencies in its information security program to be a material weakness.

KEY CHALLENGES

- Creating an effective Departmentwide EA program
- Establishing a robust information security program
- Protecting sensitive information

CREATING AN EFFECTIVE DEPARTMENTWIDE EA PROGRAM Creating a functional EA will remain a major challenge for the Department in the years to come. An agency's EA program is necessary to help management understand its current technology infrastructure, define how future infrastructure should accomplish its mission, and develop a transition plan. Despite its $48 million investment and years of effort towards creating an EA, DOT still lacks adequate EA policy and procedures, direction in the selection of EA development tools, performance measures, and an approved plan to build a Departmentwide EA. Absent this blueprint, the Department faces significant challenges in maximizing its returns on IT investments through cost savings, reduced duplicative systems, aligned information technology and mission, and effective information security spending—all critical elements in an environment of dwindling resources.

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 protect agency information and systems. As a result, in 2011, DOT again declared its information security deficiencies a material weakness in its annual assurance statement, as required by the Federal Managers' Financial Integrity Act.[44] DOT has made limited progress in fiscal year 2012 toward correcting weaknesses in key control areas.

The Department's Office of the Chief Information Officer (OCIO), the modal Administrators, and their CIOs are collectively responsible for implementing and maintaining a robust computer security program. Our work has found that OCIO could do more to guide and oversee Operating Administrations in building and sustaining strong information security practices. For example, OCIO has yet to issue Departmentwide procedural guidance or improve quality assurance reviews of modal cyber security efforts. The Department recently deployed an automated software tool that, when fully implemented, will monitor the cyber security status of a limited number of information technology devices (e.g., desktop computers). However, DOT has not provided a plan to address the remaining devices. In addition, our work continues to identify mode-specific security deficiencies. For example, our ongoing work on air traffic control systems has identified weaknesses in access controls and incident reporting that FAA needs to remediate. To build a strong information security program, the Department and the Operating Administrations must work together to continue addressing these deficiencies in a sustainable and flexible manner so that DOT can quickly adapt to and avert new cyber threats.

PROTECTING SENSITIVE INFORMATION To safeguard against the breach of personally identifiable information (PII), OMB requires agencies to reduce the volume of information collected and maintained, restrict access, and implement other security controls (e.g., 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, almost any weakness in security controls on systems containing PII increases the risk that sensitive data could be exposed, which 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 for establishing the required privacy protections. Although the Department is committed to providing privacy protections by securing PII, the associated reductions in the volume of PII will not be complete until 2013. Vigilant follow through is critical, given some of the weaknesses our work has identified. For example, our ongoing review of the Civil Aviation Registry, which contains PII of airmen and aircraft owners, found that PII data were not adequately protected from compromise. We identified numerous deficiencies in the configuration of the Registry system's software that render it vulnerable to attacks that can lead to unauthorized access. According to FAA, the upgrades to correct these vulnerabilities are slated for implementation during fiscal year 2013.

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

- The U.S. Merchant Marine Academy's Security Controls Were Not Sufficient To Protect Sensitive Data from Unauthorized Access, May 30, 2012
- DOT Does Not Have an Effective Enterprise Architecture Program for Management of Information Technology Changes, April 17, 2012
- FISMA 2011: Persistent Weaknesses in DOT's Controls Challenge the Protection and Security of Its Information Systems, November 14, 2011

FOR MORE INFORMATION ON THE ISSUES IDENTIFIED IN THIS CHAPTER, PLEASE CONTACT LOUIS C. KING, ASSISTANT INSPECTOR GENERAL FOR FINANCIAL AND INFORMATION TECHNOLOGY AUDITS, AT (202) 366-1407

44 Federal Managers' Financial Integrity Act, Pub. L. No. 97–255 (1982).

EXHIBIT

COMPARISON OF FISCAL YEAR 2013 AND 2012 TOP MANAGEMENT CHALLENGES

FISCAL YEAR 2013 CHALLENGES	FISCAL YEAR 2012 CHALLENGES
► Ensuring the Next Generation Air Transportation System Advances Safety and Air Travel	► Managing the Next Generation Air Transportation System Advancement While Controlling Costs
► Enhancing FAA's Oversight and Use of Data To Identify and Mitigate Safety Risks	► Ensuring Effective Oversight on Key Initiatives That Can Improve Aviation Safety
► Overseeing Administration of Key Transportation Assets To Ensure Their Success and Sustainability	
► Strengthening Existing Surface Safety Programs and Effectively Implementing New Safety Requirements	► Enhancing DOT's Oversight of Highway, Bridge and Transit Safety ► Ensuring Effective Oversight of Hazardous Liquid and Natural Gas Pipeline Safety
► Maximizing Surface Infrastructure Investments With Effective Program Oversight and Execution of New Legislative Requirements	► Ensuring Effective Oversight of ARRA Projects and Applying Related Lessons Learned To Improve DOT's Infrastructure Programs
► Adequately Overseeing Administration of High Speed Intercity Passenger Rail Grant Funds	► Defining Clear Goals To Guide the Federal Railroad Administration in Its Transformation
► Strengthening Financial Management Over Grants To Better Use Funds, Create Jobs, and Improve Infrastructure	
► Ensuring Effective Management of DOT's Acquisitions To Maximize Value and Program Performance	► Managing DOT Acquisitions in a Smarter and More Strategic Manner To Maximize Limited Resources and Achieve Better Mission Results
► Managing and Securing Information Systems To Efficiently Modernize Technology Infrastructure and Protect Sensitive Data From Compromise	► Improving the Department's Cyber Security
	► Utilizing Department Credit Programs To Leverage Limited Federal Transportation Infrastructure Resources

APPENDIX. DEPARTMENT RESPONSE

MEMORANDUM

U.S. Department
of Transportation

OFFICE OF THE SECRETARY
OF TRANSPORTATION

Subject: ACTION: Management Comments on OIG Draft Report on Top Management Challenges

Date: November 9, 2012

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

To: Calvin L. Scovel, III
Inspector General

The Department is fully engaged in each of the issues enumerated in the OIG report and has actions underway throughout the organization to effectively address these and the myriad other policy and programmatic responsibilities of the Department. Notably, the Department is aggressively addressing the challenges of implementing the recently enacted P.L. 112-141, the Moving Ahead for Progress in the 21st Century Act (MAP-21). MAP-21 introduces substantial new programs and responsibilities for the Department of Transportation. For example, it enables the Federal Transit Administration to, for the first time, create a nationwide framework for enhanced rail transit safety. MAP-21 also creates a streamlined, performance-based, and multimodal approach for investing in surface transportation infrastructure. Enhanced performance management requirements will transform Federal highway programs and enable more efficient Federal investment in transportation by focusing on national transportation goals, increase accountability and transparency for Federal highway programs, and improve transportation investment decision making. In addition, the new law vastly expands the use of innovative financing through the TIFIA program which leverages Federal investment in transportation, by attracting private and other non-Federal co-investment in critical improvements to the Nation's surface transportation system.

Most of the remaining challenges enumerated in the OIG report are familiar recurring issues. For example, Air Traffic Modernization is a continuous effort to maintain and improve the Nation's exceptionally strong aviation safety record through the judicious application of state-of-the- art technology. As technology continues to change and enable improved capabilities, the Department has harnessed these capabilities to enhance safety with considerable success over the last few decades. The Department has carefully structured new programs to serve continued growth in the Nation's economy and provide additional good paying jobs. For example, our efforts in high speed intercity passenger rail are already making a difference throughout the nation and will continue to do so for years to come thanks to careful planning, a performance-oriented, data-driven selection process, and carefully structured oversight.

Beyond the familiar recurring issues in the management challenges report we note the section on key transportation assets. There are several points in this regard that merit particular attention, notably: our efforts to ensure the Metropolitan Washington Airport Authority (MWAA) is run in a manner commensurate with the public trust; efforts to ensure that Union Station is run in a manner consistent with its role as a vital transportation hub and landmark within the City of the District of Columbia; and our work to ensure that investment in the Nation's Merchant Marine Academy is well planned, prioritized, and executed to serve the needs of its students, and the nation.

The Department took swift action to the full extent of its statutory authority, to address the deeply troubling issues that have come to light with regard to the personnel, contracting, and business practices at MWAA. DOT has been working with MWAA to ensure it acts quickly to adopt policies and procedures that establish a strong and appropriate framework guiding the actions of its officers and staff. The Department has taken the extraordinary measure of appointing a Federal Accountability Officer to provide guidance to MWAA as it revises its policies and procedures, bringing them in line with Federal agency best practices. As this work continues, it is vitally important that strong oversight and internal controls are established to ensure MWAA adheres to its new policies. As established by statute, MWAA is a public entity with considerable autonomy. While the Department will continue to hold MWAA accountable in its management and operation of vitally important Federal assets, it is primarily incumbent on MWAA to institute the reforms needed to regain the public's trust.

At Union Station, the Department is exercising its authority on the Board of Directors of the Union Station Redevelopment Corporation (USRC) to provide strong and effective leadership and to take the actions necessary to protect this iconic structure, while carefully planning its role as an intermodal transportation hub. The Department is fully engaged in activities to ensure that the Board is led by highly qualified individuals with the vision and authority necessary to provide effective management of this important transportation asset. We are also working to ensure that appropriate policies and procedures are in place to ensure the organization functions effectively. Detailed analysis is ongoing with regard to cost centers to ensure that every dollar is well and constructively spent. The Department is working with the Board of Directors and actively monitoring progress as the newly appointed President of the USRC continues to sort through issues, obtain stakeholder input and identify priorities.

The Department has implemented comprehensive and detailed processes to help ensure the United States Merchant Marine Academy can continue training a dependable cadre of highly capable merchant mariners to serve the country in times of war and helping to maintain a viable U.S. maritime industry in times of peace. Specifically, the Department has put in place a capital investment process that provides a data driven approach to identifying and prioritizing investments in the Academy. This process is led by an executive committee, with representatives from the Office of the Secretary, the Maritime Administration, and the Academy.

Finally, the Department continues to ensure that it provides strong and effective financial management. In particular, the Department made progress this year in addressing a new challenge identified by the OIG to strengthen financial management over grants in order to better use funds. Late in FY 2012, Operating Administrations (OAs) undertook a major effort to review, verify, and correct as necessary outstanding grant obligations for significant projects. These balances are categorized as "Undelivered Orders" (UDOs) for these programs in our annual Statement of Budgetary Resources. Further, we have completed intensive day-long training sessions for key OA grants and acquisitions staff in proper grant close-out procedures, which will greatly improve the financial management of these critical programs. Also, we have developed a new Departmental Order that will be issued shortly governing the quarterly review of all UDO balances, with a primary emphasis on outstanding grant obligations. This too will strengthen our financial management of grants throughout the Department.

With prospects for continued operation in an increasingly resource constrained environment, the Department is looking for new approaches to facilitate effective programmatic performance. This will require new perspectives beyond the traditional approaches that call for adding new oversight, additional programs, or increased spending to address problems. The Department intends to explore new approaches that make better use of technology and use more efficient processes to function effectively in an era of diminishing resource availability. We look to the Office of Inspector General as a partner in this endeavor, by keeping this imperative in mind in addressing issues, making recommendations for management action, and conducting its interactions with us in an effective and efficient manner.

IMPROPER PAYMENTS INFORMATION ACT (IPIA) (AS AMENDED BY IPERA) REPORTING DETAILS

RISK ASSESSMENT

As part of the FY 2012 Improper Payments Review, a risk assessment was conducted by the Department of Transportation (DOT) in accordance with the requirements of the *Improper Payments Elimination and Recovery Act (IPERA) of 2010* and *OMB Circular A-123, Appendix C. This* Programmatic Improper Payment Risk Assessment was used to determine which DOT Programs required 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*.

DOT incorporated the improper payment risk factors outlined in Part I of OMB Circular A-123, Appendix C, and 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 Grants (FG) Program
- Federal Rail Administration (FRA) High-Speed Intercity Passenger Rail (HSIPR) Program

FWHA FEDERAL-AID HIGHWAY PROGRAM. This program consists of numerous AU internal control risk averages with "low" or "medium" risk ratings, and the prior year's improper payment point estimate percentage was below the 2.5% threshold. However, 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 2012 individual improper payment estimate.

FAA AIRPORT IMPROVEMENT PROGRAM. This program consisted of "low" or "medium" risk ratings, and the prior year's improper payment point estimate percentage was below the 2.5% threshold. However, DOT 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.

FTA FORMULA GRANTS AND CAPITAL INVESTMENT GRANTS PROGRAMS. These programs' AU risk were identified as a "high" level of internal control risk due to the combination of a high volume of payments and externally administered payments. This combination resulted in the need to develop individual improper payment estimates.

FRA HIGH-SPEED INTERCITY PASSENGER RAIL. This program's AU risk was identified as a "high" level of internal control risk since this is a new program to the DOT, and the dollar amount of funds appropriated to the program, in excess of $10 billion, represents a significant portion of DOT grant funds.

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 which are 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.

STATISTICAL SAMPLING

In an effort to adhere to the IPERA requirements, DOT engaged a contractor to develop nationwide sampling plans, test sampled invoice line items for improprieties, and extrapolate nationwide improper payments estimates for the DOT's major grant programs.

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

The reviewed grant program samples 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. DOT 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 and included a secondary review by a contractor. The sample of tested line items originated from Federal disbursements to grantees within the twelve-month period April 1, 2011 through March 31, 2012.

The IPERA sampling methodology involved a risk-based, multi-staged statistical approach that included the selection of 82 Federal disbursements totaling $230.7 million and 146 line items from supporting invoices totaling $184.8 million. DOT 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.

Testing yielded 3 improper payments within the sample totaling $8,241.80. The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $103.2 million +/- $129.1 million at the 90% confidence interval. The estimated improper payment rate is 0. 22% +/- 0.28% at the 90% confidence interval. This projection meets IPERA'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. 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, 2011 through March 31, 2012.

The IPERA sampling methodology involved a multi-staged statistical approach that included the selection of 73 Federal disbursements totaling $112.8 million and 142 line items from supporting invoices totaling $11.3 million. DOT 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.

Testing yielded 4 improper payments within the sample totaling $839.74 The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $2.2 million +/- $3.4 million at the 90% confidence interval. The estimated improper payment rate is 0.06% +/- 0.1% at the 90% confidence interval. This projection does not meet IPERA'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, 2011 through March 31, 2012.

The IPERA sampling methodology involved a risk-based, multi-staged statistical approach that included the selection of 39 Federal disbursements totaling $310.0 million and 73 line items from supporting invoices totaling $23.0 million. DOT 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 3 improper payments within the sample totaling $630.07. The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $38.1 million +/- $50.2 million at the 90% confidence interval. Likewise, the estimated improper payment rate is 0.44% +/- 0.58% at the 90% confidence interval. This projection does not meet IPERA'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, 2011 through March 31, 2012.

The IPERA sampling methodology involved a risk-based multi-staged statistical approach that included the selection of 33 Federal disbursements totaling $431.0 million and 64 line items from supporting invoices totaling $40.5 million. DOT 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.

Testing yielded no improper payments in the sample. This projection does not meet IPERA's definition of significant improper payments ($10 million and 2.5 percent of total program payments or $100 million, regardless of error rate).

FRA HIGH-SPEED INTERCITY PASSENGER RAIL: FRA 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, 2011 through March 31, 2012.

The IPERA sampling methodology involved a multi-staged statistical approach that included the selection of 19 Federal disbursements totaling $249.6 million and 38 line items from supporting invoices totaling $766,813. DOT designed the sample to extrapolate a nationwide estimate of improper payments. While this sample provides an improper payment estimate for the HSIPR program as a whole, this sample does not support an estimate for the railroad authorities.

Testing yielded 3 improper payments within the sample totaling $839.43 The projection of known improper payments to the population of program payments for the twelve-month period results in an improper payment estimate of $4.3 million +/- $6.8 million at the 90% confidence interval. The estimated improper payment rate is 0.96% +/- 1.51% at the 90% confidence interval. This projection does not meet IPERA'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 Financial Integrity Review and Evaluations (FIRE) Program to review grantees not selected within the IPERA sample, and 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. Reported improper payments resulted from misunderstanding of the grant agreement requirements. FTA, in coordination with DOT's Office of Financial Management, will update and distribute a Best Practices Guide, including suggestions for grant agreement compliance. 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. Despite the lack of identified errors, 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. 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.

FRA HIGH-SPEED INTERCITY PASSENGER RAIL. The identified improper payments, from one grantee, were the result of missing information from the vendor contract – a non-systemic administrative oversight. FRA, 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, FRA will advise grantees regarding the importance of thorough contract reviews and audits.

B. FUND STEWARDSHIP. Although DOT identifies its five largest grant programs as susceptible to significant improper payment rates, none of these five programs reported significant rates of improper payments, as defined by OMB, in FY 2011 or FY 2012. 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.

FHWA. Under its FIRE program, FHWA subjects states and territories not selected as part of the IPERA 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.

FTA. The State Management Reviews and Triennial Reviews are utilized 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. Through a grant and sponsor oversight process, continuous throughout the duration of the grant, FAA promotes proper fund stewardship. 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.

FRA. Under a comprehensive risk-based oversight program, FRA conducts routine monitoring, including periodic reviews applicable to projects as part of the management and administration of the High-Speed Intercity Passenger Rail (HSIPR) Program. The routine monitoring activities center on recipient compliance with the FRA agreement, as well as the approved budget, schedule and fund stewardship. Routine monitoring highlights potential areas of concern and opportunities for training and technical assistance.

IMPROPER PAYMENT REPORTING

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	$48,142	0.94%	$450.3	$45,897	0.22%	$103.2	$42,465	.25%
FAA Airport Improvement Program	$3,906	0.89%	$34.6	$3,459	0.064%	$2.2	$3,619	.50%
FTA Capital Investment Grants	$2,421	0.00%	$0.0	$2,369	0.00%	$0.0	$2,062	.50%
FTA Formula Grants Program	$8,938	0.00%	$0.0	$8,594	0.44%	$38.1	$9,237	.25%
FRA HSIPR	N/A	N/A	N/A	$452.2	0.96%	$4.3	$1,768	.75%

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	$106.2	$43,732	.25%	$109.3	$44,552	.25%	$111.4
FAA Airport Improvement Program	$18.1	$3,446	.50%	$17.2	$3,412	.50%	$17.1
FTA Capital Investment Grants	$10.3	$2,140	.50%	$10.7	$2,201	.50%	$11
FTA Formula Grants Program	$23.1	$9,063	.25%	$22.7	$8,864	.25%	$22.2
FRA HSIPR	$13.3	$1,665	.75%	$12.5	$1,594	.75%	$12

TABLE 1B, EXTRAPOLATED FAA AND FRA OVERPAYMENT / UNDERPAYMENT PROGRAMMATIC ESTIMATE

	IMPROPER PAYMENT $ (M)	IMPROPER PAYMENT %
FAA Overpayment Estimate	$2.16	0.06%
FAA Underpayment Estimate	$0.04	0.001%
FAA Total Point Estimate	**$2.20**	**0.06%**
FRA Overpayment Estimate	$1.56	0.34%
FRA Underpayment Estimate	$2.79	0.62%
FRA Total Point Estimate	**$4.35**	**0.96%**

RECAPTURE OF IMPROPER PAYMENTS REPORTING. DOT contracted with a Recovery Audit firm to conduct the annual recovery audit. The contractor worked to both recover identified Departmental overpayments, and identify opportunities for Departmental payment process improvements. The contractor, 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 input errors, sales tax billing errors, open credit on statements, and other miscellaneous overpayments.

TABLE 2. PAYMENT RECAPTURE AUDIT REPORTING

PROGRAM OR ACTIVITY	DOT TOTAL
Type of Payment	**Contracts and Grants**
Amount Subject to Review for CY Reporting	$113.7 Billion
Actual Amount Reviewed and Reported (CY)	$113.7 Billion
Amount Identified for Recovery (CY)	$536,840
Amount Recovered (CY)	$395,086
% of Amount Recovered out of Amount Identified (CY)	73.6%
Amount Outstanding (CY)	$141,754
% of Amount Outstanding out of Amount Identified (CY)	26.4%
Amount Not Collectable (CY)	$0
% of Amount Not Collectable out of Amount Identified (CY)	0.0%
Amounts Identified for Recovery (PY)	$266,403
Amount Recovered (PY)	$235,749
Cumulative Amounts Identified for Recovery (CY + PY)	$803,243
Cumulative Amounts Recovered (CY + PY)	$630,835
Cumulative Amounts Outstanding (CY + PY)	$172,408
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	$536,840	$395,086	73.6%	90.0%	90.0%	90.0%

TABLE 4, AGING OF OUTSTANDING OVERPAYMENTS

TYPE OF PAYMENT	CY AMOUNT OUTSTANDING (0 – 6 MONTHS)	CY AMOUNT OUTSTANDING (6 MONTHS TO 1 YEAR)	CY AMOUNT OUTSTANDING (OVER 1 YEAR)
N/A	$141,754	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	$395,086	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	$10,550	$0	$140,607	$0	$151,157	$0

TABLE 3 NOTES. DOT's Recovery Auditor completed its identification of overpayments in November 2012. Recovery of overpayments occurs throughout the audit process and will continue into 2013. DOT expects the current recovery rate of 74% to increase and mirror past recovery rates of 85 to 90%.

TABLE 6 NOTES. Overpayments identified during DOT's Post Payment Review were identified during the audit process ending in November 2012. DOT is in the process of continuing with the recovery of these payments.

ACCOUNTABILITY. DOT has implemented various Grantee review programs, as highlighted in PART III of this IPERA 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 DOT 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 DOT 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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