
Office of Inspector General

Audit Report

FHWA'S OVERSIGHT DOES NOT ENSURE DIVISION OFFICES FULLY COMPLY WITH PROJECT AGREEMENT AND MODIFICATION REQUIREMENTS

Federal Highway Administration

Report Number: ST2017024

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Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION:** FHWA's Oversight Does Not Ensure
Division Offices Fully Comply With Project
Agreement and Modification Requirements
Federal Highway Administration
Report No. ST2017024

Date: February 7, 2017

From: Barry J. DeWeese
Assistant Inspector General for
Surface Transportation Audits

Reply to
Attn. of: JA-30

To: Federal Highway Administrator

Each year, the Federal Highway Administration (FHWA) oversees the management of over \$37 billion in Federal financial assistance at State Departments of Transportation (State DOT). FHWA provides this assistance to State DOTs for the construction, preservation, and operation of the Nation's 3.9 million-mile highway network. To be eligible for Federal funding for a proposed highway or bridge construction project, a State DOT must first enter into a project agreement with FHWA. An FHWA Division official authorizes the project to begin construction when he or she signs the project agreement. Authorization allows construction to begin and the State to incur reimbursable costs, advertise for contract bids, and award construction contracts.

Because of the large amounts of Federal investment in State highway projects and our audit work in 2015¹ that identified weaknesses in project agreement authorizations, we self-initiated this audit. Our objective was to assess FHWA's policies and procedures for reviewing and authorizing project agreements and modifications to the project agreement. To address this objective, we specifically assessed FHWA's (1) procedures and compliance with Federal requirements for preparing, reviewing, authorizing, and modifying project agreements, and

¹ *Most FHWA ARRA Projects Will Be Closed Out Before Funds Expire, but Weaknesses in the Project Close-Out Process Persist*, OIG Audit Report ST-2015-029, March 2, 2015. OIG reports are available on our Web site: <https://www.oig.dot.gov/>

(2) oversight of compliance with applicable requirements of the Office of Management and Budget's (OMB) 2014 Uniform Guidance² for Federal awards.

We conducted this audit in accordance with generally accepted Government auditing standards. In conducting our work, we reviewed a statistical sample of 20 projects in each of 3 States—Alabama, Oregon, and Massachusetts. This gave us a total of 60 out of 1,669 projects in the 3 States that FHWA authorized between the start of fiscal year 2011 and March 2015, allowing us to project our findings. We reviewed the original project agreement for each of these 60 projects—20 in each State—as well as 105 modifications made to the agreements during our study period, for a total of 47 in Alabama, 52 in Oregon, and 66 in Massachusetts. Our sample of 60 projects totaled \$2.5 billion in costs out of \$7.8 billion for the 1,669 projects in our audit universe. We conducted site visits and interviews at FHWA Division Offices and State DOTs in each of the three States. See exhibit A for more information on our scope and methodology and exhibit B for a list of the projects in our sample.

RESULTS IN BRIEF

FHWA and its Division Offices ensured that State DOTs in our sample—Alabama, Massachusetts, and Oregon—generally complied with Federal requirements on record content and preauthorization for project agreements and modifications. However, due to insufficient controls, FHWA did not always ensure that its Division Offices complied with its requirements that at least two Division officials sign authorization requests and that the Division official that recommends project authorization cannot then authorize the same project. For example, 62 of 66 project agreements and modifications authorized by FHWA's Massachusetts Division Office did not have the required 2 signatures. In addition, FHWA policy on State signatures for project agreements and modifications, contrary to Federal Internal Control Standards, allows only one State DOT official to sign project agreement and modification requests. Furthermore, Federal regulations require that States do not advertise projects for bids prior to FHWA's authorization. However, we found that State DOTs advertised 15 of 60 sample projects prior to FHWA's authorization, and these 15 projects totaled \$281 million in Federal-aid funding. Based on this finding, we project that FHWA put an estimated \$1.1 billion³ in Federal-aid funds at risk in the 3 States we reviewed.

FHWA has not ensured States' compliance with OMB's Uniform Guidance, which went into effect in 2014, and requires States to add Catalogue of Federal Domestic Assistance (CFDA) information,⁴ indirect cost rates, and project end

² 2 C.F.R. Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, (2014), known as the Uniform Guidance.

³ Our \$1.1 billion projection has 90-percent confidence limits ranging from \$737 million to \$1.6 billion.

⁴ CFDA numbers are used in preparation of financial statements for Federal agencies under the Single Audit Act.

dates to their project agreement and modification requests. The States have not complied in part because FHWA's latest version of its Fiscal Management Information System (FMIS), implemented in 2015, does not include mandatory fields for this information. FHWA officials stated that they will eventually revise FMIS to include fields for these data but have not established a time frame for doing so. FHWA's lack of data fields in FMIS makes it difficult for the Division Offices to track State DOT periods of performance and to ensure that they do not reimburse costs incurred outside of the period of performance.

We are making recommendations to improve compliance with FHWA and Federal requirements for project agreements and modifications, and to ensure FHWA follows new requirements in OMB's Uniform Guidance.

BACKGROUND

Under Title 23, Section 106 of the U.S. Code (U.S.C.), State DOTs must enter into project agreements with FHWA for each Federal-aid highway project before beginning project construction or obligating funds. When complete, the project agreement becomes a contract between the State DOT and the Federal Government that sets project commitments, such as funding, which meet Federal requirements. FHWA issues an authorization to proceed with the construction phase of a Federal-aid project in response to a written State DOT request in the form of a project agreement or modification, submitted electronically in FMIS or manually in paper format. See exhibit C for a flow chart of the process.

Under Federal regulations,⁵ each project agreement must contain certain information (see exhibit D for a full description), including a description of the project, the Federal share of estimated costs, and a Federal project number. FHWA's Division Offices⁶ must ensure that each project agreement also includes statements from the State DOT stipulating that:

- It will comply with all applicable Federal laws, regulations, policies and procedures relative to the project; and
- Obligations of Federal-aid funds will not exceed the amount agreed to in the project agreement and extend only to project costs incurred by the State after the execution of the project agreement with FHWA.⁷

Before a project agreement can be authorized, FHWA Division Office personnel must determine whether the State DOT has completed all applicable preconstruction requirements and other preauthorization activities—such as

⁵ 23 C.F.R. § 630.108; 23 C.F.R. § 630.110.

⁶ FHWA has 52 Division Offices that provide Federal-aid program assistance to State DOTs and other grantees.

⁷ Under 23 C.F.R. § 1.9(b), FHWA can waive this requirement upon request from a State.

inclusion of the project in an approved Statewide Transportation Improvement Plan⁸—to ensure that the project meets all content, preauthorization, and authorization requirements under the Federal-aid Highway Program,⁹ and verify the status of the State’s plans, specifications, and cost estimates (see exhibit D for a list of all Federal requirements).

State satisfaction of Federal content and construction preauthorization requirements provide FHWA with assurance that the State is ready to proceed to a project’s construction phase. FHWA’s initial authorization of a project indicates the Agency’s agreement that the project serves a public need and is eligible for Federal funds. Once executed, all project agreements define:

- Funding amounts and sources;
- Scope of construction work;
- Project start and end dates, which establish the State’s performance period for incurring reimbursable costs; and
- Other project-related State commitments to meet Federal requirements.

Each State DOT must prepare a modification to its project agreement whenever a change—such as an increase or decrease in construction costs due to a major change order or the addition of a new work phase—occurs in a project. FHWA must authorize the project agreement’s modification before the State can incur costs in additional phases.

Prior to 1997, FHWA and State DOTs executed project agreements in paper format. Some State DOTs, including Alabama, still submit paper requests to FHWA Division Offices to authorize project agreements, but all FHWA Divisions now authorize project agreements and modifications electronically in FMIS.¹⁰ FHWA maintains data on and tracks all Federal-aid highway projects in FMIS. The system’s controls¹¹ prevent FHWA’s Division officials from completing project authorizations unless:

- All mandatory data fields, many required under FHWA regulations, are populated;

⁸ These plans identify all Federal-aid highway projects that will be funded during the next 4 years, the timeframe for implementation, and the sources of funding.

⁹ Titles 23 of the U.S. Code and Code of Federal Regulations.

¹⁰ In October 2015, FHWA implemented FMIS.5 but has not yet revised the 2003 FMIS.4 Users’ Manual.

¹¹ These controls are also meant to ensure compliance with the Anti-Deficiency Act of 1982, which prohibits Federal employees from involving the Government in any obligation to pay money before funds have been appropriated for that purpose.

- The Division Office’s authorizing official has electronically signed the agreement in FMIS; and
- Requested Federal-aid program funds are available to the State for obligation.

On December 26, 2014, OMB codified new regulations in the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, referred to as the Uniform Guidance. The Uniform Guidance consolidates requirements of the Common Rule and eight OMB Circulars covering cost principles and grant administration. It applies to Federal grant awards authorized on or after the effective date of December 26, 2014, and modifications made to the terms and conditions of the agreement after the effective date.¹² It emphasizes State DOTs’ establishment of strong internal controls over Federal awards to ensure that awards are managed in compliance with Federal laws and regulations.

FHWA ENSURED THAT DIVISION OFFICES MET REQUIREMENTS FOR PREAUTHORIZATION BUT NOT FOR PROJECT AUTHORIZATIONS

FHWA and its Division Offices ensured that State DOTs in our sample—Alabama, Massachusetts, and Oregon—generally complied with Federal requirements on record content and preauthorization for project agreements and modifications. However, the Agency did not always ensure that Division Offices complied with its authorization policy, policy for authorizers’ signatures, and other requirements. Furthermore, FHWA’s policy on State officials’ authorization signatures does not conform to Federal recommendations. Lastly, State DOTs advertised some projects for contract Awards before receiving FHWA Divisions’ project authorizations.

FHWA and Its Division Offices Ensured that State DOTs Complied with Federal Content and Preauthorization Requirements

The FHWA Division Offices for the States we reviewed ensured that State DOTs generally complied with Federal content and preauthorization requirements. Our sample of 60 project agreements and 105 modifications generally complied with these Federal regulations.¹³ The FHWA Division Offices we reviewed approved State DOT project authorization requests by signing project agreements or modifications only after certifying the State DOTs had met record-content requirements and completed and documented preauthorization activities. Furthermore, FHWA’s FMIS protocols prevented the system from accepting

¹² Federal awards that do not receive funding with new terms and conditions continue to be governed by the terms and conditions in effect prior to December 26, 2014.

¹³ 23 C.F.R. Part 630.

project agreements or modifications that did not have mandatory fields populated with required information and a FHWA Division Office reviewing official's certification that preauthorization requirements had been met.

FHWA Did Not Always Ensure Division Office Compliance with Its Authorization Policies and Other Federal Requirements

In its oversight of project agreements and modifications, FHWA did not always ensure that its Division Office personnel complied with the Agency's and other Federal project authorization requirements.

Division Offices Did Not Always Comply with FHWA's Project Authorization Policy for Federal Signatures in FMIS

Officials in FHWA's Division Offices in Massachusetts and Oregon did not always sign and date project agreement and modification authorizations in FMIS as required because: (1) FMIS controls do not prevent the same individual from signing to recommend project approval and then authorizing the project; (2) FHWA has not revised its 2003 FMIS User's Manual to agree with its project authorization policy; and (3) not all Division Offices were aware of FHWA's project authorization policy.¹⁴

Federal agencies are required to implement internal controls, including segregation of duties, designed to reasonably ensure compliance with Federal laws, regulations, and program requirements. The Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*¹⁵ (Internal Control Standards) requires Federal agencies to segregate duties and responsibilities for authorizing Federal financial transactions among different individuals to reduce the risks of error, misuse, or fraud. FHWA's authorization policy¹⁶ requires at least two responsible individuals in Division Offices to review and certify completion of preauthorization requirements, recommend project approval, and approve and authorize the project. FHWA's policy further states that, on any one project, a Division Office should not allow the same individual to recommend project approval and approve and authorize a project or project phase and a State's obligation of Federal-aid funding.

¹⁴ FHWA Memorandum, *Project Authorization Responsibility*, HFC-30, September 25, 2006.

¹⁵ GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G, September 2014.

¹⁶ FHWA's Chief Financial Officer Memorandum HCF-30, *Project Authorization Responsibility*; Attachment, *Project Authorization Process, Fiscal Information Management System*, in effect between September 2006 and July 2015, defines responsibilities for each electronic signatory to a project agreement or modification. FHWA reiterated this policy in its revision issued in July and August of 2015. In October 2015, the Agency issued a new version of FMIS (FMIS.5), but the projects we reviewed were authorized under FHWA's 2006 policy and its 2003 manual of requirements for FMIS.4.

Each electronic project agreement and modification form in the project record in FMIS has three signature lines that must be electronically signed by designated FHWA Division Office officials. See exhibit E for visual depictions of these signature lines. FHWA’s policy describes which officials are qualified to sign each line and what each signature certifies. The policy also describes signature lines 2 and 3 and signatures as follows:

- **Approval recommended (line 2).** A Division Office project manager or functional area staff member’s signature certifies that project information from the State DOT—such as environmental requirements, rights-of-way and utility requirements—complies with Federal requirements. The signature also certifies the project is ready to go to construction and recommends authorization of work or obligation of Federal funds.
- **Approved and authorized (line 3).** A Division Office Financial Manager or Specialist signs each project authorization or modification. The signature on this line approves the date of project authorization and allows the State to begin work or obligate Federal funds.

We found that 62 of 66 authorizations by FHWA’s Massachusetts Division Office and 15 of 52 authorizations by Oregon Division Offices did not have the required signatures from 2 qualified individuals. See table 1 for details. Personnel in the Oregon Division Office informed us that they were unaware of FHWA’s 2006 policy on authorization signatures.

Table 1. Compliance With Required Signatures for Project Agreements and Modifications

	Alabama	Oregon	Massachusetts	Totals
No. of projects agreements reviewed	20	20	20	60
No. of project modifications reviewed	27	32	46	105
Total authorizations reviewed	47	52	66	165
Same individual signed lines 2 and 3 of project agreements and modifications	0	15	62	77

Source: OIG analysis of project agreement and modification authorizations.

Furthermore, guidance contained in FHWA’s FMIS.4 User’s Manual conflicts with FHWA’s authorization policy because it states that the individual recommending project approval may also authorize the project. The manual also says that an individual may have authority to sign all three lines. A Division level authorizing official could sign the bottom line, and FMIS would automatically

populate the other two signature lines with the same signature. In FHWA's 2006 guidance on project authorizations, FHWA announced that it would implement controls in FMIS to require a minimum of two individual signatures to conform to FHWA's delegation of authorization duties, but we did not find these controls in place. While FHWA had controls to prevent the same person from signing all three signature lines, we found no evidence that it had controls to monitor and ensure compliance with its two-signature authorization policy. FHWA moved from FMIS.4 to FMIS.5 in October 2015. FHWA officials told us the Agency would eventually issue a revised User's Manual but, as of September 2016, could not provide a target date for doing so.

FHWA's lack of controls in FMIS for preventing the same individual to both recommend authorization and authorize a project (i.e., signing lines 2 and 3), lack of coordination between its authorization policy and the FMIS.4 Users' Manual, and some Division Offices' lack of awareness of the Agency's project authorization policy led to non-compliance with the policy and consequently increased the risk of error, misuse, and fraud in project agreement and modification authorizations.

FHWA Policy on State Signatures for Authorizations Does Not Conform to Federal Requirements

FHWA's policy on State signatures does not comply with Federal requirements and Internal Control Standards, because it does not require more than one State DOT official's signature on project agreement and modification authorization requests. It also allows Division Offices to make minor administrative modifications to agreements without State DOT officials' signatures. Federal regulations¹⁷ require FHWA Division Office officials to verify that State DOT officials have signed project agreement and modification authorization requests. The regulations also require FHWA Division officials to ensure that Federal grant recipients, such as State DOTs maintain effective internal controls for managing Federal grants. Internal Controls Standards state that Federal agencies should segregate duties and responsibilities and the Office of Management and Budget also suggests it as a best practice to help non-Federal grantees, such as State DOTs, to reduce the risks of error, misuse, or fraud.

FMIS includes three signature lines for State DOT approving officials. The signatories for each line certify that: (1) requested program funds are available to pay for the project or modification; (2) the project is ready to proceed and the signatory recommends approval; and (3) the State DOT authorizes the project or modification request. However, FHWA's policy does not require State DOTs to have more than one State official sign authorization requests. Consequently, one

¹⁷ 23 C.F.R. § 630.108(b)(8); 23 C.F.R. § 630.110(b)(7).

State official can certify the availability of project funds for obligation, recommend obligation approval, and authorize the obligation of Federal funds—contrary to the segregation of duties that the Internal Control Standards recommend. For States that do not sign documents electronically, FHWA Division officials certify that the State signatures are on file in the Division when they approve project agreements or modifications. The FMIS.4 User’s Manual allows Division Office personnel to make minor administrative changes to project agreements and modifications with one or no State signatures. See exhibit E for a visual depiction of the State authorization field in FMIS.4 that includes a “State Signatures not required” option.

Among our sample of 60 project agreements and 105 modifications, 108 had only one State DOT signature and 5 had no State DOT official’s signature. For example:

- FHWA’s Alabama Division Office authorized 47 project agreements and modifications that had only 1 Alabama DOT official’s signature, because the Division accepted a single signature. Officials in FHWA’s Alabama Division Office informed us that they also made minor administrative changes to authorizations, such as correcting a program funding code that did not require a State DOT approving official’s signature.
- FHWA’s Massachusetts Division Office authorized 61 of 66 project agreement and modification requests from Massachusetts DOT (MassDOT) officials that had only 1 State signature because the Division Office accepted one signature. The other five were authorized by FHWA Division Officials who indicated that they had “State Signatures on File,” even though no signatures were on file and the modifications were signed without FHWA’s Division Office notifying MassDOT officials.
- In contrast, Oregon DOT had at least 2 signatures as recommended on all 52 authorization requests in our sample because the Division Office does not accept a single State signature.

Because its signature policy allows Division Offices to authorize project agreements and modifications that have only one State DOT official’s signature, FHWA cannot be sure that the State DOTs have mitigated the risk of error, noncompliance, collusion, or fraud in the State DOT project authorization processes.

State DOTs Advertised Some Projects for Contract Award Before FHWA Divisions had Authorized Them

For 15 of the 60 projects we reviewed, the State DOTs advertised for construction bids before FHWA Division Offices authorized the projects. These 15 projects totaled \$281 million in Federal-aid funds. FHWA Division officials authorized the projects by signing project agreements in FMIS between 2 and 101 days after the State DOTs advertised the projects. In addition, in at least two instances, State DOTs awarded construction contracts before FHWA authorization. Federal regulations¹⁸ preclude FHWA from reimbursing any cost incurred and grantees from starting work on any Federal-aid project or advertising any project for construction bids prior to FHWA's authorization. For example:

- FHWA's Massachusetts Division Office authorized 14 of 20 sampled projects after MassDOT had advertised them for construction bids. The Division Office's stewardship and oversight agreement¹⁹ with MassDOT requires that, prior to advertising, MassDOT contact FHWA to verify that the project has been authorized, and states that the Division Office will not authorize a project after it has been advertised. However, the Division Office had not authorized 14 out of our 20 sampled projects in FMIS when it approved the State's request to advertise the projects. The Massachusetts Division Office informed us that it routinely approved Mass DOT's weekly project advertising schedule so MassDOT could advertise projects over the upcoming weekend. A Massachusetts Division Office official acknowledged to us that he knew that the execution of the project agreement in FMIS, not the Division's email authorization, is the actual authorization to proceed and that the procedure of sending email approvals did not meet Federal authorization requirements.
- In contrast, FHWA's Oregon Division Office had only a minor infraction. One project was authorized after Oregon DOT advertised it. The Oregon Division Office conducts annual project reviews that include reviews of project advertisement in relation to project authorization. Though it did not discover this instance of authorization after project advertisement, the Division believed the project had been authorized in error and provided us its review results to support its contention.
- FHWA's Oregon Division Office also authorized one construction project after Oregon DOT awarded a contract. This was the same project that Oregon DOT had previously advertised before FHWA authorization. As a result of our audit,

¹⁸ 23 C.F.R. § 1.9; 23 C.F.R. § 635.112.

¹⁹ Under 23 U.S.C. § 106, a stewardship and oversight agreement between FHWA and a State DOT, documents and formalizes the extent to which the State DOT assumes responsibilities for administration of the Federal-aid highway program in the State.

the Division Office and Oregon DOT determined that this mistake occurred because the project was originally approved as a State-funded project to be managed under State rules. Consequently, the Oregon Division Office requested and received a reimbursement of about \$10.5 million from Oregon's DOT, and FHWA removed the project from FMIS.

- FHWA's Massachusetts Division Office authorized one construction project with an estimated total cost of \$291 million and at least \$9.5 million in Federal-aid funding, after MassDOT had awarded a contract. A Division official said that although the contract had been awarded, the Division had delayed authorizing the project because the State had not completed all preauthorization requirements.

According to FHWA officials, authorization is the Agency's internal control mechanism to ensure that projects are authorized only after Federal and State laws, regulations, policies and procedures have been met and before costs are incurred. Allowing State DOTs to advertise for bids and award contracts for projects before Division authorization put Federal funds at risk because the projects may be ineligible to receive these funds. Furthermore, as shown in Oregon where our audit prompted the reimbursement of \$10.5 million by the State DOT, Federal regulations require that if FHWA determines that a State has not complied with requirements, the Agency is to withhold payment or project approval.²⁰ Because insufficient internal controls allowed State DOTs to advertise for construction bids before FHWA authorized \$281 million in Federal-aid for 15 of the 60 construction projects in our sample, we project that FHWA put an estimated \$1.1 billion²¹ in Federal-aid funds at risk²² in the 3 States we reviewed²³.

FHWA DOES NOT COMPLY WITH SEVERAL UNIFORM GUIDANCE REQUIREMENTS RELATED TO PROJECT AGREEMENTS AND MODIFICATIONS

FHWA does not comply with the Uniform Guidance's requirements for the recording of CFDA numbers, indirect cost rates, and project end dates in project

²⁰ 23 C.F.R. § 1.36.

²¹ Our \$1.1 billion projection has 90-percent confidence limits ranging from \$737 million to \$1.6 billion.

²² Our sample of 60 of 1,669 projects had \$281 million in Federal-aid obligations. We project that FHWA could have authorized as many as 161 of the 1,669 projects in our sample after the State DOT advertised for bids or awarded a contract. Our 161 project projection has 90-percent confidence limits ranging from 59 to 427 projects.

²³ FHWA agreed that four projects in Massachusetts either advertised for bids or awarded contracts prior to FHWA's authorization, but disagreed with the remaining sample projects we questioned because the Massachusetts Division authorized the projects first by e-mail and then completed the project agreements in FMIS. We do not agree because FMIS documents are FHWA's official record of agreement, and FMIS does not indicate that FHWA used e-mail-to authorize Federal funds for these projects. Even based on FHWA's position regarding the use of email and the documentation it provided, we would project that FHWA has put an estimated \$194 million in Federal-aid funds at risk.

agreements and modifications. The period between a project's start date and end date defines the period of performance for Federal-aid projects during which costs can be incurred. Costs incurred after a period of performance are not eligible for reimbursement. As seen in table 2, FHWA Division Offices authorized 5 of our 60 sampled project agreements after the Uniform Guidance requirements were in effect. One of the 5 project agreements did not include all 3 components. In addition, the Division Offices authorized 27 of the 105 project modifications subject to the Uniform Guidance, but 22 of the 27 project modifications did not include all 3 components.

Table 2. Project Agreement and Modifications' Compliance with OMB's Uniform Guidance

	Oregon DO	Alabama DO	Massachusetts DO	Totals
PROJECT AGREEMENTS				
Number of project agreements reviewed	20	20	20	60
Number of project agreements authorized on or after 12/26/2014	2	3	0	5
Number of project agreements in compliance with 3 required elements	1	3	N/A	4
Number of project agreements missing 1 or more of the 3 elements	1	0	N/A	1
PROJECT MODIFICATIONS				
Number of modifications reviewed	32	27	46	105
Number of modifications authorized on or after 12/26/14	6	7	14	27
Number of project modifications in compliance with 3 required elements	5	0	0	5
Number of project modifications missing 1 or more of the 3 elements	1	7	14	22

Source: OIG analysis of project agreement and modification authorizations.

FHWA officials stated that they will eventually revise FMIS.5 to include mandatory fields for this information, but the Agency has not established a time frame for doing so. FHWA's lack of data fields in FMIS.5 makes it difficult for the Division Offices to track State DOT periods of performance and to ensure that they do not reimburse costs incurred outside of the period of performance.

CONCLUSION

FHWA's authorization of Federal-aid highway and bridge construction projects is the first step in sound stewardship of over \$37 billion in Federal financial assistance. FHWA and its Division Offices ensure that State DOTs comply with Federal requirements for record content and preauthorization requirements for project agreements—a significant challenge given the number of project agreements and modifications that FHWA reviews and authorizes annually. However, weaknesses in FHWA's procedures and controls could result in State DOTs' noncompliance with some Federal requirements. Strengthening its procedures and controls will allow FHWA to more consistently adhere to Federal requirements, prevent State DOTs from advertising or awarding construction contracts for projects prior to FHWA authorization, and reduce the amount of Federal funds at risk.

RECOMMENDATIONS

We recommend that the Federal Highway Administrator:

1. Develop controls to prevent the same FHWA official from signing lines 2 and 3 on project agreements and modifications and develop a plan, procedures, and time frame for FHWA from its headquarters office to monitor Division Offices' authorization processes and verify that they comply with FHWA authorization policy.
2. Revise existing controls to require more than one State DOT official signature on project agreement and modification requests consistent with Federal Internal Control Standards.
3. Develop and implement internal controls to prevent FHWA authorization of construction projects after State DOT advertisement for bid or contract award to ensure compliance with Federal regulations. Implementation of internal controls could have put an estimated \$1.1 billion in Federal funds to better use.
4. Add mandatory data fields for project end dates, CFDA numbers, and indirect costs to FMIS as quickly as possible to ensure compliance with Uniform Guidance.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided FHWA with our draft report on September 1, 2016, and received its formal management response on October 18, 2016, which is included as an appendix to this report. FHWA also provided us with technical comments that we

have addressed where appropriate. In its management response, FHWA concurred with our recommendation 4 and agreed to implement the actions as written by September 30, 2017. We therefore consider recommendation 4 resolved but open pending FHWA's completion of the planned actions.

For recommendation 1, FHWA did not concur with the recommendation and disagreed with our finding related to internal controls. However, the Agency proposed an alternate action of relying on its annual independent internal control testing of project agreements that they assert operates effectively. We disagree, since, as discussed in our report, we found that 62 of 66 authorizations by FHWA's Massachusetts Division Office, and 15 of 52 authorizations by Oregon's Division Office, did not comply with FHWA policy for Federal signatures in FMIS. Consequently, FHWA's alternative action does not address the lack of controls in FMIS to prevent one individual from both recommending authorization and authorizing a project, which led to non-compliance with FHWA policy and increased the risk of error, misuse and fraud in project agreements and modification authorizations. Therefore, we consider recommendation 1 open and unresolved and request that the Agency reconsider its position.

For recommendation 2, FHWA also did not concur with the recommendation and noted in its response that there is no Federal regulation that requires State DOTs to sign their project agreements in FMIS. However, the Agency proposed an alternative action of reliance on its annual independent internal control testing to ensure that segregation of duties at the State level would be evident in project files. We disagree since, as reported, we found five project agreements and modifications that had no State DOT official's signature at all. Furthermore, we found no evidence in the project files of segregation of duties by State DOT officials in 2 of the 3 States we reviewed (40 of the 60 projects we reviewed). In addition, GAO suggests segregation of duties as a best practice to help State DOTs reduce the risk of error, misuse, and fraud. Consequently, FHWA's alternative action does not address how its controls would prevent project agreements and modification authorizations with no State DOT official signatures or ensure compliance with segregation of duties in their project files. Therefore, we consider recommendation 2 open and unresolved, and request that the Agency reconsider its position.

FHWA also did not concur with our recommendation 3 and noted that while a State must meet several requirements for the Agency to authorize its project and allow bid advertisements and contract awards, none of these is the execution of a project agreement. Instead, FHWA cites a regulation that it believes permits authorization to occur through email. Title 23 of the Code of Federal Regulation, Section 635.112(a) specifically states that no work shall be undertaken on any Federal-aid project or any project advertised for bids prior to authorization.

However, FHWA is silent in its response regarding what final action actually authorizes its Federal-aid funds for construction projects.

During the audit, we found that the working understanding of authorization within FHWA is synonymous with the execution of a project agreement. Specifically, FHWA officials at headquarters and in the Division Offices repeatedly told us that for a project to be authorized, FHWA and the State DOT must execute a project agreement. Moreover, FHWA's standard operating procedure for project action review and approval defines project authorization as FHWA's act of authorizing the project and executing the project agreement. In addition, the FMIS 4.0 Manual explains that the FHWA Division official's signature of a project agreement in FMIS recommends project approval and authorization. Although FHWA may have a legal basis for authorizing a project through some means other than an executed project agreement, the Agency has not implemented sufficient internal controls to ensure that Division officials properly understand what is required to authorize and execute a project agreement.

As we discuss in the report, we found 15 projects totaling \$281 million in Federal-aid funds that the State DOTs either advertised for bids or awarded contracts for prior to FHWA's authorizations. In its technical comments, FHWA concedes that based on its definition of project authorization in its management response, four projects in Massachusetts either advertised for bids or awarded contracts prior to receipt of FHWA's project authorizations. Accordingly, there were at least five projects in our sample—the four in Massachusetts plus the one in Oregon in our sample for which FHWA received reimbursement from Oregon DOT—totaling \$53 million in Federal-aid funds that State DOTs either advertised for bids or awarded contracts prior to authorization by FHWA. Therefore, regardless of what definition of project authorization is used, State DOTs advertised for bids and awarded contracts before authorization, putting Federal funds at risk because the projects may be ineligible to receive these funds. As a result, we consider recommendation 3 open and unresolved and request that the Agency reconsider its position.

ACTIONS REQUIRED

We consider recommendation 4 resolved but open pending completion of the planned actions. We consider recommendations 1, 2 and 3 open and unresolved. We request that FHWA reconsider its position and provide us with its revised response for recommendations 1, 2 and 3 within 30 days of the date of this report in accordance with DOT Order 8000.1C.

We appreciate the courtesies and cooperation of Federal Highway Administration representatives during this audit. If you have any questions concerning this report,

please call me at (202) 366-5630, or Anthony Zakel, Program Director, at (202) 366-0202.

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cc: The Secretary
DOT Audit Liaison (M-1)
FHWA Audit Liaison (HAIM-13)

EXHIBIT A. SCOPE AND METHODOLOGY

We conducted our work between March 2015 and September 2016 in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To conduct our work, we reviewed Federal laws, regulations, policies, procedures, and other Federal and State guidance to understand the requirements for authorizing and modifying Federal-aid project agreements. We assessed FHWA's policies and procedures that were in effect when the projects in our audit universe were authorized. We also considered the Acting FHWA Chief Financial Officer's *FMIS Project Agreement Signature Responsibility Guidance* (HCFB-31), issued July 2015, which now governs signature authorization responsibilities, in formulating our findings, conclusions, and recommendations. We evaluated whether the project agreements and modifications included the data elements of end date, indirect cost rate, and CFDA number. We reviewed advertising and contract award documentation and compared it to authorization dates on project agreements and agreement modifications. We reviewed signatures on project agreements and modifications to assess compliance with FHWA's signature guidance. We also reviewed project agreements and modifications to determine whether they included all components required by Federal regulations. See exhibit D for list of compliance requirements found in FHWA's regulations.

We reviewed project documentation at three FHWA Division Offices and at the State DOTs. In Oregon, we also reviewed project documentation at Project Manager Offices in Salem, Astoria, Clackamas, and Troutdale, because project files were maintained onsite. We selected Project Manager Offices for project file reviews based on their proximity to the Salem and Portland area and the availability of officials.

We conducted our audit work at FHWA Headquarters and at three Division Offices. We excluded Division Offices that had been sampled by the OIG on recent, prior audits. We incorporated State DOTs in our review that had a direct interface with FMIS and electronically enter and authorize project agreement and modification requests directly in FMIS (Oregon and Massachusetts) and one (Alabama) that did not directly interface with FMIS at the time of our visit. Alabama submitted paper project agreement and modification authorization requests to the Division Office by mail. Division Office personnel entered the project information provided by the State DOT into FMIS. After conducting administrative and compliance reviews, designated Division Office officials

Exhibit A. Scope and Methodology

recommended approval and authorized the projects and the Federal share of project costs.

We obtained a universe of 1,669 projects from FHWA that were authorized by FHWA in FMIS during the period October 1, 2011, to March 1, 2015, for three states, Alabama, Massachusetts, and Oregon. We reviewed sampled projects in those three states because they had not been selected for review on previous OIG audits. We selected a stratified statistical sample of 20 projects from each of the three states for a total of 60, or 3.6 percent, of 1,669 projects with a total cost amount of \$2.5 billion or 31.5 percent out of \$7.8 billion. Our sample design allowed us to estimate the number of projects and the amount of Federal funds obligated for projects that were advertised before they were authorized for the three States we reviewed with a precision of +266/-102 and +\$467 million/- \$390 million, respectively at the 90-percent confidence level. The results of our sample allowed us to project the amount of Federal funds put at risk by advertising and awarding contracts for construction projects before FHWA had authorized them. Our projection of \$1.1 billion in Federal funds at risk was conservatively determined using only the Federal share identified in the initial project authorization. For projects with advance construction, we only used the amount that had been converted to Federal aid at the time of our review.

We also interviewed officials from the FHWA Office of Infrastructure, Office of Chief Financial Officer, Division Offices, and officials at State DOT offices. In general, we discussed with FHWA and State officials their roles and responsibilities and policies and procedures for authorization of project agreements and modifications. We used this information to accomplish our audit objectives and identify program weaknesses.

EXHIBIT B. FEDERAL-AID HIGHWAY AND BRIDGE CONSTRUCTION PROJECTS IN OIG SAMPLE

Sample No.	State	Federal Project No.	Total Costs
1	Oregon	C051092	\$250,700,000.00
2	Oregon	S140045	\$39,121,345.09
3	Oregon	S006126	\$50,527,641.00
4	Oregon	S001457	\$35,973,697.00
5	Oregon	S081057	\$1,195,634.00
6	Oregon	S009374	\$8,403,217.00
7	Oregon	S004195	\$14,522,120.00
8	Oregon	C029072	\$746,759.00
9	Oregon	C057063	\$1,226,319.00
10	Oregon	S172007	\$1,592,373.00
11	Oregon	S009397	\$3,829,322.00
12	Oregon	S002160	\$27,372,192.00
13	Oregon	S002128	\$3,637,922.00
14	Oregon	S000724	\$689,950.00
15	Oregon	S001460	\$11,705,704.00
16	Oregon	S039047	\$54,312,820.00
17	Oregon	S171028	\$939,525.00
18	Oregon	S009420	\$10,447,727.00
19	Oregon	C057059	Withdrawn
20	Oregon	S006120	\$874,191.00
21	Alabama	0059512	\$354,210.00
22	Alabama	6702201	\$31,300.00
23	Alabama	0123508	\$1,126,214.00
24	Alabama	8980905	\$248,304.00
25	Alabama	0013579	\$3,112,814.00
26	Alabama	0013591	\$1,616,821.00
27	Alabama	9027600	\$303,463.00
28	Alabama	0017561	\$2,494,234.00
29	Alabama	0123507	\$1,849,335.00
30	Alabama	0003586	\$145,991.12
31	Alabama	CN12201	\$318,003.00
32	Alabama	0417201	\$1,904,074.00

Exhibit B. Federal-Aid Highway and Bridge Construction Projects in Sample

Sample No.	State	Federal Project No.	Total Costs
33	Alabama	0714250	\$1,284,295.00
34	Alabama	0119504	\$3,865,000.00
35	Alabama	0094500	\$3,258,005.00
36	Alabama	10AL003	\$388,711.00
37	Alabama	0008578	\$3,411,607.00
38	Alabama	0215503	\$842,451.00
39	Alabama	0139503	\$662,440.00
40	Alabama	3421201	\$1,021,519.00
41	Massachusetts	002S421	\$345,599,248.00
42	Massachusetts	002S386	\$334,656,419.00
43	Massachusetts	002S483	\$3,882,797.00
44	Massachusetts	002S772	\$6,453,893.00
45	Massachusetts	0911173	\$255,119,519.00
46	Massachusetts	002S560	\$3,817,163.00
47	Massachusetts	0952122	\$168,946,618.00
48	Massachusetts	4955081	\$17,701,754.00
49	Massachusetts	002S372	\$290,959,615.25
50	Massachusetts	002S637	\$12,697,586.00
51	Massachusetts	002S425	\$277,790,115.00
52	Massachusetts	002S580	\$10,415,323.00
53	Massachusetts	002S611	6,156,173.00
54	Massachusetts	0931528	\$70,338,706.00
55	Massachusetts	002S760	\$86,546,471.00
56	Massachusetts	0952120	\$59,147,330.00
57	Massachusetts	002S462	\$45,675,136.00
58	Massachusetts	0952119	\$12,936,266.00
59	Massachusetts	002S552	Withdrawn
60	Massachusetts	0932125	Withdrawn

Exhibit B. Federal-Aid Highway and Bridge Construction Projects in Sample

EXHIBIT C. FLOW CHART OF THE PROJECT AGREEMENT AUTHORIZATION PROCESS IN FMIS

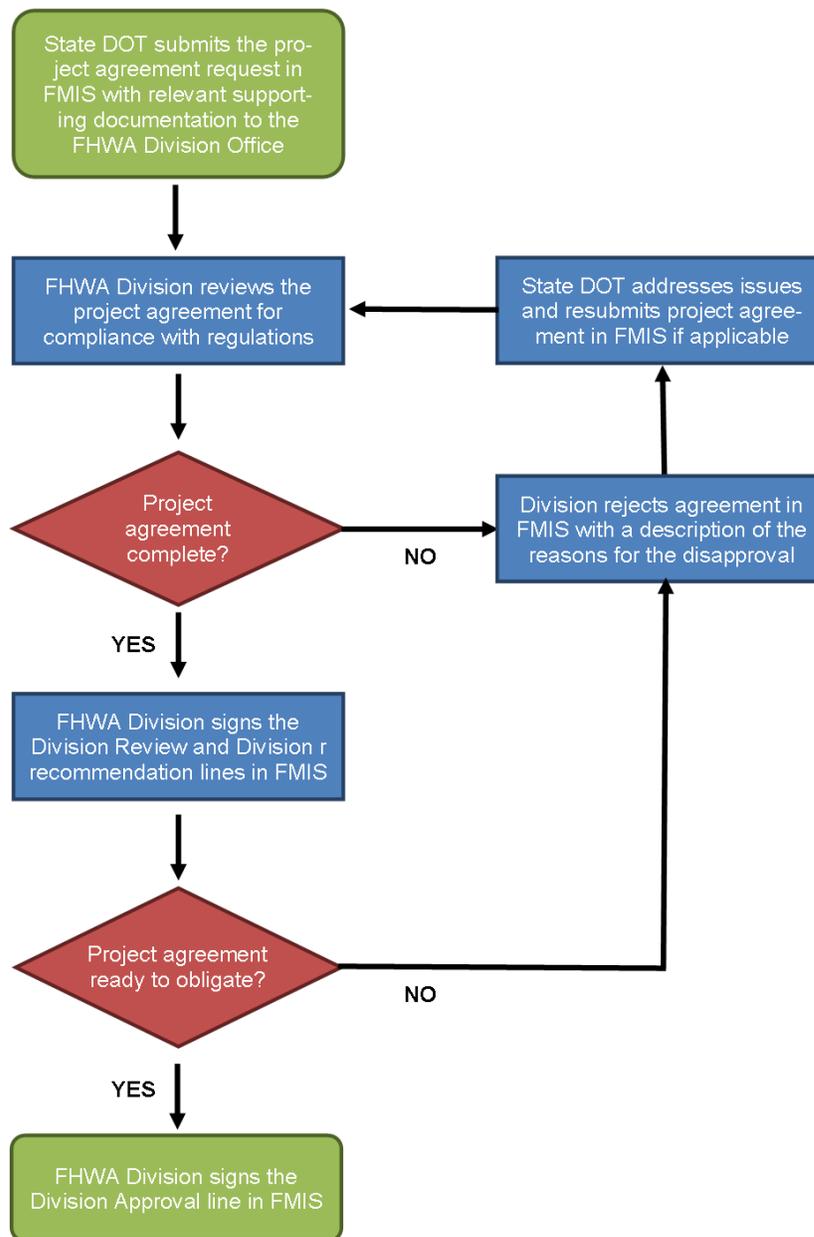


Exhibit C. Flow Chart of the Project Agreement Authorization Process in FMIS

EXHIBIT D. FEDERAL REQUIREMENTS FOR PROJECT AGREEMENT AND MODIFICATION CONTENT

<i>Project Agreement Content Requirements</i>	<i>Modification Content Requirements</i>
1. Description of each project location including State and project termini (end of project)	Sequential number identifying the modification, i.e., modification 1
2. Federal-aid project number	Federal-aid project number and State
3. Work covered by the agreement	Reference to the date of the original project agreement to be modified
4. Total project cost and amount of Federal-aid funds under agreement	Original total project costs and the original amount of Federal funds under agreement
5. Federal-aid share of eligible project costs expressed as either a pro rata percentage or lump sum as set forth in 23 C.F.R. § 630.106(f)	Revised total project cost and the revised amount of Federal funds under agreement
6. State statement that it accepts and will comply with project agreement provisions set forth in 23 C.F.R. § 630.112	Reason for modification (for example, additional work or change in the scope of work being requested)
7. State statement stipulating its signature on project agreement constitutes making of certifications under 23 C.F.R. § 630.112	
8. Signatures of both State and Federal officials and the date executed	Signatures of State and FHWA officials and date executed
9. Federal funds obligated for this project must not exceed the amount agreed to on the project agreement. Obligations of Federal funds extend only to project costs incurred by the State after the execution of a formal project agreement with FHWA.	
10. The State through its transportation department, accepts and agrees to comply with the terms and conditions set forth in 23 U.S.C. <i>et seq</i> , the policies and procedures promulgated by FHWA relative to the designated project covered by the agreement, and all others applicable laws and regulations.	

Source: 23 C.F.R. § 630.108; 23 C.F.R. § 630.110; 23 C.F.R. § 630.112.

EXHIBIT E. VISUAL DEPICTIONS OF FMIS SCREENS

Federal Signature Lines in FMIS.4

The screenshot shows the FMIS 4.0 interface for project information. The title bar reads "FMIS 4.0" and the menu bar includes "Print", "Quit", "Help", and "Window". The main window title is "(FSPR0013) PROJECT INFORMATION". A toolbar contains buttons for "Open", "NewPrj", "Save", "PickLst", "Hst", "Clse", "Reopn", "Withdrw", "Reestab", "Conv", "Doc", "Sign", "Home", and "Detl".

The main content area is titled "PROJECT HEADER INFORMATION" and contains the following fields:

- Cost Center: 00 (dropdown), AL (dropdown)
- Proj #: 0002(019)
- Suffix: (empty)
- St Proj #: (empty)
- Version: PENDING (dropdown)

Below this is a section titled "SIGNATURES" with the following fields:

- Project First Updated By: (redacted)
- Date: 11/14/2002
- Modification #: 1

There are two signature sections:

State Signatures		Date
Available Funds Certified By	(text box)	(text box)
Approval Recommended By	(text box)	(text box)
Authorization / Modification Requested By	(text box)	(text box)

Division Signatures		Date
Project Info Reviewed By	(text box)	(text box)
Approval Recommended By	(text box)	(text box)
Approved and Authorized By	(text box)	(text box)

Source: FHWA's FMIS.4 Manual.

State Signature Options in FMIS.4

The screenshot shows a dialog box titled "STATE APPROVAL" with the following text:

State Approval

State Approval of this Pending Project has not been performed in FMIS. Please choose from the following, then click OK:

- State Signatures are on File, Division Signature may be Performed.
- State Signatures not required, Division Signature may be Performed.
- State Signature is outstanding, Division Signature may not be Performed.

At the bottom of the dialog is an "OK" button.

Source: FHWA's FMIS.4 Manual.

EXHIBIT F. ENTITIES VISITED OR CONTACTED

FHWA Office of Program Administration in Washington, DC

FHWA Office of Chief Financial Officer, Fiscal Management Information System Team in Washington, DC

FHWA Oregon Division Office in Salem

Oregon Department of Transportation in Salem

- Oregon Department of Transportation Region 2 Project Manager Office in Astoria
- Oregon Department of Transportation Region 1 Project Manager Office in Clackamas
- Oregon Department of Transportation Region 2 Project Manager Office in Salem
- Oregon Department of Transportation Region 1 Project Manager Office in Troutdale

FHWA Alabama Division Office in Montgomery

- Alabama Department of Transportation in Montgomery

FHWA Massachusetts Division Office in Cambridge

- Massachusetts Department of Transportation in Boston

EXHIBIT G. MAJOR CONTRIBUTORS TO THIS REPORT

Name	Title
Anthony Zakel	Program Director
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William Savage	IT Specialist
Fritz Swartzbaugh	Associate Counsel
Susan Neill	Writer-Editor

APPENDIX. AGENCY COMMENTS



U.S. Department
of Transportation
Federal Highway
Administration

Memorandum

Subject: **INFORMATION:** Federal Highway Administration (FHWA) Response to Office of Inspector General (OIG) Draft Report, “FHWA’s Oversight Does Not Ensure Division Offices Fully Comply With Project Agreement and Modification Requirements”

Date: October 18, 2016

From: Gregory G. Nadeau
Administrator

In Reply Refer To:
HCFB-30

To: Barry J. DeWeese
Assistant Inspector General for
Surface Transportation Audits

We appreciate the OIG’s recognition that FHWA generally complied with the Federal requirements on project agreement record content and preauthorization, and we note that OIG found no evidence of fraud, waste, or abuse. The FHWA has implemented multiple internal controls to comply with Federal requirements and to provide oversight over the annual \$40 billion in the Federal-aid highway program (FAHP). While we shared information with OIG on our comprehensive internal control about how project transactions are processed, the draft report does not reflect these controls. We disagree with some of the OIG’s findings and recommendations and our concerns are listed below:

- The FHWA regulations do not require the execution of a project agreement before a project for construction is advertised. The applicable regulations provide that no project will be advertised for bids prior to authorization by FHWA, but the regulations do not specify that this authorization is required to be provided through or even at the same time as the project agreement for construction.²⁴ Several conditions must be met prior to authorizing the advertisement for bids – such as listing the project on the State Transportation Improvement Plan, obtaining right-of-way and environmental approvals, and reviewing plans and specifications – none of which include the execution of a project agreement.
- Projects advertised prior to authorization did not put Federal funds at risk. A critical control that FHWA uses to mitigate any potential risk is that it may determine not to authorize the project agreement and obligate funds if there are any concerns that the requirements for

²⁴ 23 CFR 635.112(a) and 23 CFR 635.309.

advertisement were not met. Further, FHWA may withdraw a project agreement if Federal requirements were not met.

- Appropriate segregation of duties exists at the division level. All of the projects in OIG's sample contained signatures from at least two different division officials, demonstrating that the key duties and responsibilities associated with the execution of a project agreement are in place and met Federal and FHWA requirements. Further, our annual independent internal control testing of the project agreement approval and authorization signatures found that FHWA's internal controls are operating effectively and in compliance with Federal internal control requirements.²⁵
- FHWA's policy on State Department of Transportation (DOT) signatures conforms to Federal requirements and internal control standards. The FAHP is jointly delivered and funded by the FHWA and State DOTs.²⁶ Given shared responsibility of the FHWA and State DOTs to deliver the FAHP, the controls of both entities must be considered to properly evaluate their effectiveness. Since there is no Federal regulation requiring State DOTs to sign the project agreement in FMIS, segregation of duties at the State level would be evidenced in the project files – not solely on the FMIS signature page.

We disagree with the basis for OIG's recommendations related to internal controls and therefore do not concur with recommendations 1, 2, and 3. As an alternate action for recommendations 1 and 2, FHWA will continue to use its annual independent OMB Circular No. A-123 internal control testing or Compliance Assessment Program to monitor, verify, and evaluate the Division office's project agreement authorization process and oversight of State DOT's segregation of duties for those activities. Federal regulations do not require a project agreement before advertisement for bids, therefore we do not agree with recommendation 3. The FHWA concurs with recommendation 4, and plans to add the required fields to FMIS. The FHWA will complete actions for recommendations 1, 2, and 4 by September 30, 2017.

We appreciate the opportunity to comment on the draft report. Please contact Thomas D. Everett, Associate Administrator for Infrastructure, at (202) 366-5530 or Brian R. Bezio, Chief Financial Officer, at (202) 366-0622 with any questions.

²⁵ Office of Management and Budget (OMB) Circular No. A-123 and Government Accountability Office's Standards for Internal Control in the Federal Government requirements.

²⁶ 23 U.S.C. §145. Additionally, the Stewardship & Oversight (S&O) Agreement between FHWA and the State DOT sets forth the framework relating to project approvals, FHWA oversight, and approval responsibilities assumed by the State DOT that Congress directed to be delegated under 23 U.S.C. §106. The S&O Agreements contain key preconstruction and preauthorization requirements the State DOT completes prior to entering into a project agreement with FHWA to proceed with construction.

Appendix. Agency Comments