REVIEW OF MAJOR WESTERN CAPITAL PROJECTS
POINTS TO OVERALL IMPROVEMENTS NEEDED IN
FTA’S FINANCIAL GUIDANCE AND OVERSIGHT

Federal Transit Administration

Report Number: ST2017047
Date Issued: May 9, 2017
ACTION: Review of Major Western Capital Projects Points to Overall Improvements Needed in FTA’s Financial Guidance and Oversight

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

To: Federal Transit Administrator

The Federal Transit Administration (FTA) receives approximately $2 billion in annual appropriations for its discretionary Capital Investment Grant (CIG) program, with approximately $13.6 billion authorized for fiscal years 2015 through 2020. The program funds a range of fixed guideway projects, including heavy, commuter, and light rail. Overall, FTA’s Region 8 in Denver, Region 9 in San Francisco, and Region 10 in Seattle oversee New Starts projects with approved Federal investments of almost $8 billion.

We initiated this audit due to the large Federal investment in the New Starts program. Our objectives were to evaluate FTA’s (1) processes for identifying and assessing major capital (New Starts) projects’ financial risks, and reviewing and approving grantee financial plans and reports, and (2) oversight of grantees’ mitigation of financial risks.

We conducted our work in accordance with generally accepted Government auditing standards. To perform our work, we selected four New Starts projects from the three FTA western regions that were in construction at the time we began our audit and had total estimated costs over $1 billion each. These projects were the Regional Transportation District’s (RTD) Eagle Commuter Rail in Denver; the Honolulu Authority for Rapid Transportation’s (HART) (the City and County of

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1 Three categories of projects are eligible for Capital Investment Grants (CIG): New Starts, Small Starts, and Core Capacity.
2 Each New Starts project totals at least $300 million for new construction or seeks $100 million or more in funding for improvements to existing transit programs.
3 FTA considers all New Starts projects as major capital projects.
Honolulu) Honolulu Rail Transit; the San Francisco Municipal Transportation Agency’s (SFMTA) Third Street Light Rail, Phase 2, Central Subway; and the Central Puget Sound Regional Transit Authority’s (Sound Transit) University Link Light Rail Extension in Seattle. See exhibit A for further information on our scope and methodology and exhibit B for a glossary of terms used in this report.

BACKGROUND

When the projects we reviewed went through the New Starts selection process, the Safe Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users Act was in effect and established the program requirements. As shown in exhibit C, it required the following phases for New Starts projects: Alternatives Analysis, Preliminary Engineering, Final Design, and full funding grant agreement (FFGA). FTA uses an FFGA to provide New Starts funds to projects. For each project, this document establishes the contractual terms and conditions; defines the project; sets the maximum amount of New Starts Federal funding; covers the period of time for completion; and facilitates efficient management in accordance with applicable Federal statutes, regulations, and policy.

Prior to its FFGA approval for a New Starts project, FTA is required to evaluate and rate the applicant’s local financial commitment—high, medium-high, medium, medium-low, or low—as it progresses through the phases. FTA’s rating process includes evaluating an applicant’s local financial commitment, providing summary ratings based on the proposed non-CIG share of project costs and the stability and reliability of the capital and operating financing plans, and developing a summary project justification rating for each project (see exhibit D for details). An applicant must receive a local financial commitment summary rating and a project justification summary rating of at least medium to receive an approved FFGA. A project may receive an overall medium rating without having resolved all identified financial risks.

Prior to an FFGA award, FTA retains a financial management oversight contractor (FMOC) to provide a financial capacity assessment (FCA) report based on the applicant’s financial plan. The FMOC assesses a financial plan to (1) detect risks associated with the applicant’s required non-CIG share; (2) determine the

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4 The four projects were awarded New Starts funding totaling approximately $4.3 billion. See exhibit F for additional details on the projects.
7 When it awards an FFGA, FTA simultaneously records the award in its electronic grants management system.
8 The proposed share of total project costs from sources other than the CIG program include Federal formula and flexible funds, the local match required by Federal law, and any additional capital funding.
applicant’s ability to complete the project on-schedule in the face of delayed or reduced Federal appropriations, unanticipated conditions, or budget increases; and (3) assess the applicant’s ability to operate the existing system before and after completion of the new project. FTA requires the FMOC to provide an FCA report that presents the results of its financial evaluations, such as sensitivity tests, to assess the impact of financial risks that the applicant may face and to include its proposed local financial commitment rating in the FCA report. A project management oversight contractor (PMOC) also assesses an applicant’s readiness to execute an FFGA before its approval.

Following FFGA approval, FTA provides financial oversight through regional reviews of project Federal Financial Reports (FFR) and its oversight program, which includes financial management oversight, triennial, and indirect cost allocation plan (CAP) reviews. A PMOC provides ongoing project oversight throughout the New Starts process with focused assessments and project status reports.

RESULTS IN BRIEF

For the four projects we reviewed, FTA generally followed its processes to identify and assess financial risks. However, it did not ensure that each project’s FCA was fully documented. First, none of the FMOCs included the required proposed local financial commitment ratings and justifications in their FCA reports, making it difficult to assess the extent to which this information was considered in FTA’s final financial ratings before FFGA approval. For example, in its October 2012 FFGA approval memorandum for the Honolulu Rail Transit Project, FTA assigned a medium-high rating based on the FMOC’s conclusion that Honolulu had adequate cash reserves and debt capacity to complete the project on time even if Federal funding were delayed or project costs increased. However, the FMOC’s report had also identified that Honolulu may face challenges in funding the operation of the new rail system from 2020 onward because it would need a lower rate of growth in non-transit uses of revenues than it had historically. Because the FCA report did not include support for FTA’s rating in light of the identified risk, the basis for FTA’s final financial rating decision was unclear. Second, the FMOCs did not document their sensitivity testing decisions and use of different testing parameters. For example, the FMOC for the Honolulu project measured the applicant’s ability to provide funds for a 10 percent project cost increase, while the FMOC for the SFMTA Central Subway project did not test the

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9 In a December 2016 audit report (DOT Discretionary Grants, Problems with Hurricane Sandy Transit Grant Process Highlight the Need for Additional Accountability (GAO-17-20)), the Government Accountability Office (GAO) reported a similar finding for FTA funded competitive resilience projects that the Agency did not document why, when, or by whom changes were made to overall project ratings and individual criterion ratings.
applicant’s ability to fund any project cost increase. Lack of information on how or why these testing parameters and approaches were selected makes it difficult for FTA to determine if the testing performed for each project was appropriate and sufficient to inform its FFGA investment decision. Finally, FTA did not ensure the FMOC for the Sound Transit University Link project performed required sensitivity testing. As a result, FTA could not demonstrate that the impact of risks faced by Sound Transit were independently identified and assessed.

FTA did not ensure that the four grantees we reviewed mitigated key financial risks. First, because FTA’s guidance lacks specificity on which third party agreements are critical, and therefore must be completed prior to FFGA approval, FTA did not ensure that three of the four grantees completed critical third party agreements before FFGA award.\(^\text{10}\) The grant applicants completed a wide range of stakeholder agreements before FFGA award. For example, the Denver RTD Eagle project executed 27 of 45 agreements prior to this approval while the HART project executed 6 of 26. Second, FTA staff did not follow procedures that require regional staff to review all FFRs and document their reviews, a process which can help identify financial risks.\(^\text{11}\) For the 110 FFRs we reviewed, we found that 51 (46 percent) contained no evidence of FTA review and 39 (35 percent) contained drawdown discrepancies. For one grantee, SFMTA, FTA did not document its reviews of 33 of the 35 FFRs from the first quarter of Federal fiscal year 2007 through the third quarter of fiscal year 2015. Because FTA Region 9 staff did not review these FFRs, they also did not check SFMTA’s indirect cost rates—despite SFMTA’s history of problems with indirect cost rates. As a result, SFMTA’s use of an incorrect rate went undetected for several years. In a July 2016 triennial review of SFMTA, FTA’s financial oversight contractor reported that SFMTA overbilled approximately $15 million in indirect costs. Furthermore, we could not reconcile the support that SFMTA provided for the Federal share of expenditures reported in its FFRs, which totaled over $37 million.\(^\text{12}\) Consequently, FTA has put at least $37 million in Federal funds at risk of overpayment if it determines that it actually reimbursed SFMTA for ineligible or unsupported expenditures.

We are making recommendations to FTA for strengthening its discretionary New Starts program’s oversight and processes. While the results of this audit are based on the four western regional projects we reviewed, we identified issues with

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\(^{10}\) Third party agreements are agreements that grant applicants must execute with other entities that have stakes in their proposed projects. These agreements establish terms and conditions for requirements such as utility relocation; use of railroads’ track; use of gas and electricity; and public/private funding arrangements. Without them, projects can experience higher costs and schedule delays.

\(^{11}\) For the purposes of our audit, we based evidence of FTA review on whether the FTA reviewer’s comments or the reviewer’s sign-off were recorded in the Transportation Electronic Award and Management system.

\(^{12}\) We evaluated the Federal share of expenditures reported on four SFMTA FFRs: Federal fiscal year 2008, third quarter; fiscal year 2010, fourth quarter; fiscal year 2014, fourth quarter; and fiscal year 2015, second quarter.
FTA’s New Starts’ guidance and oversight procedures—such as not requiring FMOCs to report required proposed local financial commitment ratings and justifications and not establishing controls to ensure review of grantee FFRs. The guidance and oversight procedures are applicable to New Starts projects nationwide.

**FTA GENERALLY FOLLOWED ITS PROCESSES TO IDENTIFY AND ASSESS PROJECT FINANCIAL RISKS BUT DID NOT ENSURE FMOCS FULLY DOCUMENTED FINANCIAL CAPACITY ASSESSMENTS**

For the four projects reviewed, while FTA generally followed its processes to identify and assess financial risks, it did not ensure that FMOCs fully documented each project’s FCA. Specifically, FTA did not ensure that FMOCs’ FCAs included local financial commitment ratings and justifications or fully documented information on the sensitivity testing they performed.

**FTA Generally Followed Its Processes to Identify and Assess Financial Risks**

FTA generally followed its processes to identify and assess financial risks before making its final decision to award an FFGA for the four projects we reviewed. As part of its decision-making process, the Agency identifies a project’s financial risks and ensures that the applicant addresses these key risks before it receives an FFGA. It also assigns a financial rating to the project based on the applicant’s financial condition. We found that each project’s financial assessment performed before entry into final design contained details on the applicant’s financial condition and risks that could be encountered if not adequately addressed and FTA’s approval letters to the applicants included the key areas needing to be addressed. For example, in the Entry into Final Design letter for the University Link Light Rail project, FTA stated: “Although the financial plan submitted by Sound Transit is sufficient for entry into final design, Sound Transit will need to provide additional information before an FFGA can be signed so as to satisfy FTA’s financial capacity requirements. Sound Transit must update the financial plan to reflect changes in funding assumptions and FTA will need to re-evaluate the financial plan prior to the application for an FFGA.” The FMOC’s FCA report prior to the FFGA indicated that Sound Transit’s funding assumptions addressed this issue.

**FTA Did Not Ensure FMOCs Fully Documented FCAs**

Because FCA reports are intended to inform FTA’s investment decisions, we consider them a significant event in the grant-making process. As such, they are
subject to compliance with GAO’s *Standards for Internal Control in the Federal Government*, which calls for all transactions and other significant events to be clearly documented with the support readily available. In addition, FTA’s statement of work for the FCAs requires FMOCs to conduct sensitivity testing and to include proposed local financial commitment ratings and justifications in the FCA reports. However, FTA did not ensure that FMOCs fully documented this information in their FCA reports. Specifically, FTA did not ensure that FMOCs’ FCA reports included required proposed local financial commitment ratings and justifications. FMOCs also did not provide in their FCA reports rationales for the sensitivity testing they performed and the parameters they selected for those tests. In one case, FTA did not ensure that the FMOC performed any contractually-required sensitivity testing.

**FCA Reports Did Not Include Required Proposed Local Financial Commitment Ratings and Justifications**

For the four projects reviewed, none of the FCA reports included the proposed local financial commitment ratings and justifications as stipulated in the statement of work between FTA and FMOCs. They did not include the ratings and justifications because FTA did not ensure that FMOCs adhered to their contractual requirements. As a result, we could not assess to what degree FTA used reports as intended—to evaluate the applicant’s ability to meet the FFGA’s terms and conditions and as the basis for its final financial rating decisions prior to FFGA approval.

In its October 2012 FFGA approval memorandum for the Honolulu Rail Transit Project, FTA assigned a medium-high rating based on the FMOC’s conclusion that Honolulu had adequate cash reserves and debt capacity to complete the project on time even if Federal funding were delayed or project costs increased. However, the FMOC did not provide proposed ratings in its FCA report as required by its statement of work. Furthermore, the FMOC stated in the FCA report that in order to fund the predicted transit operating subsidies required to operate the new rail system from 2020 onward, Honolulu would need to achieve a lower rate of growth in non-transit uses of revenues than it had historically or would incur a $112 million shortfall. The FCA report did not include support for FTA’s rating in light of the identified risk, and as a result, the basis for FTA’s final financial rating decision was unclear.

FTA officials informed us that the Agency communicates with each contractor throughout the FCA process and is therefore aware of the FMOC’s rating

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14 FTA Financial Capacity Assessments, DTFT60-08-D-00008.
determinations. However, this lack of documentation of the proposed financial ratings in FMOCs’ FCA reports makes it difficult for FTA to clearly demonstrate the basis (or rationale) for the final ratings for the projects it invests in. After learning of our finding, FTA officials told us they planned to take steps to ensure that FMOCs document proposed ratings in their FCA reports.

**FCA Reports Did Not Document FMOCs’ Rationales for the Sensitivity Testing They Chose to Perform**

For three of the four FCA reports we reviewed, the FMOCs used different tests and parameters to perform the sensitivity testing required in the statement of work, but they did not document their rationale for selecting those tests or parameters. For example, the FMOC for the Honolulu project tested the impact of simultaneous project cost increases and revenue reductions, while the FMOC for the Eagle project did not. Furthermore, the FMOC for the Honolulu project measured the applicant’s ability to provide funds for a 10 percent project cost increase, while the FMOC testing for the Eagle project used a 5 percent cost increase and the FMOC for the SFMTA Central Subway project did not test the applicant’s ability to fund any project cost increase. FTA officials stated that the FMOC for the SFMTA Central Subway project may have concluded, based on their professional judgment, that it was not necessary to include project cost increases in the stress test. FTA does not require FMOCs to document in FCA reports the sensitivity testing decisions made and basis for the testing parameters selected. However, lack of information on how or why an FMOC selected different testing parameters and approaches makes it difficult for FTA to determine if the FMOC’s testing for each project was appropriate and sufficient to inform FTA’s FFGA funding decision.

**One FMOC Did Not Perform Contractually-Required Sensitivity Testing**

The FMOC for the Sound Transit University Link project did not perform the sensitivity testing required in its statement of work. Although the FCA report states that the FMOC “[analyzed] the impact of changes,” the FMOC confirmed to FTA, in September 2016, that it did not perform any sensitivity testing, but instead reviewed the work performed by Sound Transit and concurred with its outcomes. FTA did not ensure that FMOCs adhered to its contractual requirements and, as a result, could not demonstrate that the impact of risks faced by Sound Transit were independently identified and assessed, as required by the statement of work.

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15 FTA’s FCA statement of work requires FMOCs to conduct sensitivity testing. FTA’s Financial Management Oversight Contractors’ Guide for Conducting Financial Capacity Assessments provides additional guidance related to sensitivity analyses and stress tests. In sensitivity analyses, the FMOC determines the impact of changes in specific sensitive or uncertain, assumptions on a financial projection. Once the sensitivity of individual assumptions is evaluated, the FMOC creates stress tests to determine the impact of the adverse changes on uncertain projections that can occur simultaneously.
FTA DID NOT ENSURE THAT GRANTEES MITIGATED KEY FINANCIAL RISKS

FTA did not ensure that the four grantees we reviewed mitigated key financial risks. For three of the four grantees, FTA did not ensure that the grantees completed critical third party agreements before FFGA awards. Furthermore, when reviewing the four grantees’ FFRs, FTA did not follow its procedures for reviewing FFRs. Finally, for one grantee—SFMTA—we could not reconcile the support provided with the Federal share of expenditures reported—over $37 million—on four FFRs in our sample.

FTA Did Not Ensure that Grantees Completed Critical Third Party Agreements Prior to FFGA Approval

While FTA’s CIG policy guidance requires that applicants complete critical third party agreements prior to FFGA approval, the policy guidance does not specify which agreements are critical or provide criteria for determining which types of agreements are critical. As part of the FFGA readiness reviews, PMOCs are required to ensure that applicants completed critical third party agreements. However, for three of the four projects we reviewed, we could not verify that all critical agreements had been completed as required prior to FFGA approval because neither FTA’s approval memoranda nor project related documentation identified which agreements were critical.

The grant applicants completed a wide range of stakeholder agreements before FFGA award. For example, FTA’s February 2011 FFGA approval memorandum for the Denver RTD Eagle project stated that 27 of 45 agreements were executed prior to this approval. Moreover, the PMOC’s 2012 FFGA readiness report for HART listed only 6 of HART’s 26 stakeholder agreements as completed, and acknowledged that many of the third party agreements had not been completed as required for an FFGA. Even with this acknowledgement, the PMOC did not identify which of the 20 remaining open agreements were critical to the project. In addition, the report noted that HART will need to negotiate, finalize, or update agreements with entities, including the U.S. Navy and various utility companies. The PMOC’s September 2016 monthly project report noted that four agreements, including one with the Navy, were critical and their lack of completion would have a negative impact on the project. The PMOC also noted that HART had open issues with a utility company. In a June 2016 risk report for the project, the PMOC stated that HART must memorialize in an agreement requirements with this utility to control costs and avoid scope creep.

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17 The Sound Transit project had all agreements in place at the time it received its FFGA approval.
FTA officials informed us that it has not defined in its policy guidance which agreements are critical because the criticality of an agreement is determined on a project-by-project basis. Because FTA lacks specific policy guidance for applicants and PMOCs on how to determine which agreements are critical, FTA creates a risk that some critical agreements may not be identified and executed prior to FFGA approval, which could result in higher project costs and schedule delays.

**FTA Did Not Follow Its Procedures Requiring Review of Grantees’ FFRs**

For the four projects we reviewed, FTA staff did not follow procedures\(^\text{18}\) that require regional staff to review all FFRs and document their reviews. As a result, FTA did not identify the grantees’ lack of compliance with program requirements. For example, we found discrepancies in these reports between the amount actually drawn down and reported as Federal cash receipts.\(^\text{19}\)

A grantee’s FFR details the amounts of Federal funds the grantee has drawn down and shares of Federal expenditures through the end of the reporting period. These data help FTA determine whether the grantee is following the Agency’s requirements for documented and timely drawdowns and using funds for eligible expenses. The Agency also uses a grantee’s FFRs to evaluate elements of the grant’s status, including whether the grantee is achieving the project’s intended purposes; the project is progressing on time and within budget; and any problems are developing that could require FTA resources to resolve.

We reviewed the 110 FFRs that the four grantees submitted between the first quarter of Federal fiscal year 2007 and the third quarter of fiscal year 2015 and found that 51 reports (46 percent) contained no evidence of FTA review even though FTA’s procedures call for Agency staff to review all FFRs within the reporting quarter. As a result, FTA did not identify a lack of compliance with program requirements. For example, 22 of the 110 FFRs contained discrepancies between the amounts actually drawn down and reported as cash receipts and 17 reflected an impermissible balance at the end of the reporting period.\(^\text{20}\)

FTA officials attributed some of these errors to grantees’ misunderstanding of reporting requirements. Furthermore, a FTA regional staff person stated that


\(^{19}\) FTA Circular 5010.1D, Grant Management Requirements (2012) states that Agency payments are limited to drawdowns for eligible project costs and each grantee has committed to submitting timely reports of cash disbursements and balances.

\(^{20}\) Under FTA Circular 5010.1D, the grant recipient (a) will not withdraw Federal funds until actually needed for immediate payment of project expenses, and (b) will use those funds to pay for project expenses no later than 3 days after receipt.
because grantees are required to submit the reports within 30 days of the end of the quarterly reporting period, the reports do not accurately present project status. The staff person stated further that as an engineer, she is not familiar with accounting terminology and prefers to use the PMOC’s monthly reports and grantees’ monthly progress reports in addition to the FFRs to oversee the projects because they reflect the most up-to-date information on project obligations and disbursements.

In response to our findings, FTA regional officials informed us that staff will receive refresher training on FFR reviews. FTA headquarters officials informed us that they are considering a risk-based approach to FFR reviews because the Agency does not have the resources to review every report. According to OMB’s Uniform Guidance, this risk-based approach could consider such factors as a grantee’s history of performance, single audits, and earlier FTA oversight reviews.\(^\text{21}\)

FTA’s lack of FFR reviews also inhibits data accuracy and the Agency’s ability to successfully perform financial statement accruals and oversee accurate reporting and proper grantee stewardship of Federal funds. We recently reported\(^\text{22}\) that FTA used FFR data in validations of its grant accrual estimation methodology, but the data were not complete or accurate for that use. As a result, DOT’s financial statements reflected a significant deficiency in the amounts reported.

**FTA Did Not Review SFMTA’s Indirect Costs, Resulting in Unsupported Indirect Costs**

Insufficient FFR oversight may also have resulted in unsupported expenditures and the overpayment of Federal funds to SFMTA. Despite SFMTA having a history of non-compliance with FTA’s indirect cost rate requirements, FTA Region 9 did not review the grantee’s FFRs for indirect cost rate compliance. Furthermore, in their SFMTA oversight assessments for fiscal years’ 2013, 2015, and 2016, Region 9 staff rated the grantee’s CAP a low risk, and justified the rating with the comments “no concerns with adherence to CAP” and “none.”

According to FTA’s guidance,\(^\text{23}\) an FFR review should include determinations of whether the grantee charges indirect costs—such as grant related administrative costs—to the grant, and that the indirect cost rates are consistent with the grantee’s approved CAP.

\(^{21}\) 2 C.F.R. § 200.205 (c)(3) and (c)(4).

\(^{22}\) *Quality Control Review of the Department of Transportation’s Audited Consolidated Financial Statements for Fiscal Years 2016 and 2015* (OIG Report Number QC2017013), November 2016. OIG reports are available on our Web site: https://www.oig.dot.gov/

\(^{23}\) FTA Circular 5010.1D.
However, we found that FTA did not document its reviews of 33 of the 35 FFRs that SFMTA submitted from the first quarter of fiscal year 2007 through the third quarter of fiscal year 2015. We found that SFMTA’s FFRs from the first quarter of fiscal year 2013 through the fourth quarter of fiscal year 2015 included expenditures based on the application of two different indirect cost rates. FTA officials stated that in August 2015, SFMTA informed them that it did not calculate the indirect cost rates in a timely manner for fiscal years 2013 through 2015. SFMTA then completed its rate calculations and determined that the rates it should have used were less than the two rates that FTA previously approved. As a result of its miscalculated rates, SFMTA could not support the Federal share of indirect cost expenditures that FTA had reimbursed.

Furthermore, FTA’s triennial review oversight program requires the Agency and its FMOCs to ensure that grantees’ FFRs present information on the correct application of CAPs and indirect cost rates. A July 2016 triennial review final report identified that SFMTA overbilled FTA for approximately $15 million in indirect costs from 2013 through 2015. The report recommended that SFMTA work with the FTA regional office to reimburse FTA for incorrect indirect rate amounts charged to grants. According to the report, since July 1, 2016, FTA has not permitted SFMTA to charge indirect costs until it refunds the overbilled amount to FTA and FTA has approved SFMTA’s CAPs for fiscal years 2016 and 2017. This report also recommended that SFMTA submit corrected FFRs that reflect approved indirect rate expenditures for all open grants.

Based on our previous work, we found SFMTA had the following history of indirect cost issues:

- In fiscal year 2003, a financial management review of SFTMA’s predecessor, the San Francisco Municipal Railway (MUNI) found an increase of over 10 percent in MUNI’s indirect cost rate for fiscal year 2000 for which MUNI did not receive FTA’s approval.

- In 2007, a contractor conducted a review of SFMTA’s indirect cost rate for fiscal year 2004 and found that: (1) the rate was too high; (2) the methodology used to calculate the rate did not comply with OMB’s and other Federal regulations; and (3) FTA should suspend funding of indirect charges until SFMTA complied.

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25 In 1999, MUNI consolidated with SFMTA.
• In 2008, FTA suspended funding of indirect charges from fiscal year 2005 until SMFTA became compliant.

In 2009, FTA found that SFMTA’s fiscal year 2004 approved indirect cost rate was lower than its billed rate. As a result, FTA required SFMTA to repay FTA for overbilling indirect costs on the Central Subway project. FTA and SFMTA then developed indirect cost rates for SFMTA’s fiscal year 2007 through fiscal year 2010.

FTA’s guidance also requires grantees to base their FFRs on supporting documentation. We reviewed the four grantees’ support for expenditures reported in a sample of their FFRs. Three of the four grantees provided documentation supporting the expenditures they reported in their FFRs. However, for SFMTA, we could not reconcile the support provided with the Federal share of expenditures reported on four of the FFRs in our sample, which totaled over $37 million. For example, in the documentation SFMTA provided to support the over $16 million it reported as the Federal share of expenditures in its FFR for the fourth quarter of Federal fiscal year 2014, the amount included project expenditures that represented indirect cost expenses, such as mandatory fringe benefits, overhead, and salaries. SFMTA also applied an indirect cost rate and reported $541,110 as the Federal share of its indirect expenses—an amount that may represent a duplicate recovery. Consequently, FTA has put at least $37 million in Federal funds at risk of overpayment if it determines that it actually reimbursed SFMTA for ineligible or unsupported expenditures.

CONCLUSION

Given FTA’s significant investment in its New Starts discretionary grant program, sound financial planning is critical. FTA’s processes for addressing financial risks identified on its New Starts projects can help provide effective stewardship of its significant investment in these projects. However, weaknesses in documenting its decision-making throughout the capital investment program’s phases reduce the transparency of the Agency’s actions needed for a competitive funding program. In addition, the lack of adequate reviews of FFRs increases the risk that incorrect or inaccurate reporting of expenditures will go undetected, resulting in the overpayment of Federal funds. It is critical that FTA ensures consistency in the scope and quality of the financial capacity assessments performed to address any scrutiny its final decisions may face from Congress and the public in order to show that it can fairly and expertly administer its fiduciary responsibility of the multi-billion dollar discretionary grant program.
RECOMMENDATIONS

We recommend that the Federal Transit Administrator:

1. Establish and implement controls to ensure the FMOCs meet contractual requirements to include in all Financial Capacity Assessment reports:
   a. Complete project ratings that are in accordance with all elements of FTA’s rating criteria; and
   b. Sensitivity testing performed.

2. Require that FMOCs include in their Financial Capacity Assessment reports the rationales for all testing decisions and parameters selected for testing.

3. Establish and implement controls to ensure FTA regional staff follow the existing Federal Financial Report review procedures which require reviewing the reports and documenting the reviews.

4. Complete a financial analysis of all SFMTA’s Federal expenditures incurred on the Central Subway project, including its indirect expenses, as reported in the Federal Financial Reports to quantify the amount of Federal funds to be reimbursed to FTA. Implementation of this recommendation could put at least $37 million in Federal funds to better use.

5. Revise FTA’s policy guidance to include requirements identifying which project’s third party agreements are critical versus those that are not, and which agreements are required to be completed and in place prior to FFGA approvals, to mitigate risks to project cost and schedule due to uncompleted third party agreements.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided FTA with our draft report on February 9, 2017, and received its response, dated March 16, 2017, which is included as an appendix to this report. FTA concurred with recommendations 1 and 4 and provided appropriate planned actions and completion dates. While the Agency concurred with recommendation 4, FTA neither agreed nor disagreed with our conclusion that implementation of the action would put at least $37 million in Federal funds to better use. FTA stated that we had not provided the basis for our calculation, which we have done in this final report. Specifically, our calculation represented the Federal share of expenditures reported in four SFMTA FFRs we evaluated.
FTA partially concurred with recommendation 2, which contained four parts in the draft report denoted by (a), (b), (c), and (d). In its response, FTA agreed to implement part (b) as written. However, FTA did not concur with the other parts of the recommendation that contained additional actions to revise the contractor’s statement of work and financial capacity assessment guidance. After reviewing FTA’s technical comments and formal response, we recognize that other controls are in place to address the concerns we presented to FTA in our draft report. Therefore, we have removed parts (a), (c), and (d) from this final report. Accordingly, we consider recommendation 2 resolved but open pending completion of the planned action.

FTA also partially concurred with recommendations 3 and 5. Although it did not concur with the recommendations as written, the Agency agreed with the intent and proposed acceptable alternative actions and completion dates.

**ACTIONS REQUIRED**

We consider all five recommendations resolved but open pending completion of the planned actions. In accordance with DOT Order 8000.1C, we request that FTA provide our office with information documenting the actions taken for these recommendations upon completion, as well as its position on the funds identified for better use once it completes its financial analysis in response to recommendation 4.

We appreciate the courtesies and cooperation of the Federal Transit Administration’s representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-5630, or Tiffany Mostert, Program Director, at (202) 366-0625.

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cc: The Secretary  
DOT Audit Liaison (M-1)  
FTA Audit Liaison (TBP-30)
EXHIBIT A. SCOPE AND METHODOLOGY

We conducted our work from August 2015 through February 2017 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 our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit objectives were to evaluate FTA’s (1) processes for identifying and assessing major capital (New Starts) projects’ financial risks, and reviewing and approving grantee financial plans and reports, and (2) oversight of grantees’ mitigation of financial risks.

FTA has 10 regional offices, and we have previously audited FTA’s oversight of major projects in Region 2 (New York, NY) and Region 3 (Philadelphia, PA including Washington, DC). To perform our work of FTA’s oversight of major projects in other regions, we concentrated on the following three western regions: (1) Region 8 in Denver CO, (2) Region 9 in San Francisco, CA, and (3) Region 10 in Seattle, WA. These three regions had eight projects that met our evaluation criteria: (1) FTA awarded an FFGA; (2) estimated costs exceeded $1 billion; and (3) construction work remained. We then decided to focus on four of these projects based on their proximity to the three western regional offices, the amount of New Starts funding provided to the projects, and the ability to meet with both FTA regional staff and grantee project management personnel. We reviewed each of these four major projects as a case study. See exhibit E for a list of entities visited or contacted and exhibit F for project summaries (for informational use only).

To evaluate FTA’s processes for identifying and assessing major capital (New Starts) projects’ financial risks and reviewing and approving grantee financial plans and reports, we interviewed FTA staff and collected and reviewed FTA’s applicable guidance and policies. We also interviewed grantee staff and reviewed financial plans and financial assessment reports.

To evaluate FTA’s oversight of grantees’ mitigation of financial risks, we analyzed FTA’s oversight of grantee FFRs. We interviewed FTA staff to evaluate FTA’s controls for reviewing and approving grantees’ FFRs. Using FTA’s Transportation Electronic Award and Management (TEAM) system, we evaluated FTA’s oversight of grantee FFRs.

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26 For the purpose of this audit, we considered a medium-low or below rating assigned by FTA during each phase of its financial evaluation processes until FFGA approval as a risk.

27 Data related to project funds awarded and project disbursements, as of August 2016, were developed from FTA’s Transit Award Management System.
identified and reviewed all 110 FFRs that the four grantees submitted between the first quarter of Federal fiscal year 2007, and the third quarter of fiscal year 2015, to evaluate FTA’s compliance with these controls and to determine the accuracy of data submitted. Also using FTA’s TEAM system, we obtained a universe of 261 disbursement transactions, with a total transaction amount of $1.9 billion, from the third quarter of Federal fiscal year 2008 through the third quarter of fiscal year 2015 related to New Starts funds provided for the five grants to the four transit projects we had selected: the RTD Eagle Commuter Rail, the HART Honolulu Rail Transit, the SFMTA Central Subway, and two grants for the Sound Transit University Link Light Rail Extension—an ARRA and a New Starts grant. We aggregated the drawdown amounts by fiscal year and quarter for each of the four transit projects to develop a universe of 84 quarters for which drawdowns were posted. From that universe, we selected a stratified probability proportional to size with replacement sample of 45 quarters where size was the drawdown amount in a quarter. We requested documentation for these 45 quarters from the four grantees to determine if the amounts reported were supported and eligible under the FFGA.
EXHIBIT B. GLOSSARY

**application**: All explanatory, supporting, and supplementary documents and written submissions filed for an FFGA that FTA relied upon in making a determination to obligate and award Federal funds.

**baseline cost estimate (BCE)**: The total estimated costs to complete a project at the time of FFGA approval derived from cost estimates by individual third party contracts and force account work that constitute the project. It is not modified during the projects’ construction or implementation phases.

**Federal cash disbursements**: Disbursements include the sum of actual cash disbursements for direct charges for goods and services, the amount of indirect expenses charged to the grant, and the amount of payments made to sub-recipients and contractors. The cumulative amount of Federal funds disbursed as of the Federal financial report reporting period end date.

**Federal cash drawdown**: the cumulative amount of actual cash received from the Federal agency as of the reporting period end date.

**Federal financial report (FFR)**: A quarterly report that provides a current, complete, and accurate financial picture of the grant, prepared on the accrual basis of accounting—income is recorded when earned instead of when received and expenses are recorded when incurred instead of when paid. The FFR includes Federal cash receipts (drawdowns) and disbursements.

**financial capacity assessment (FCA) and report**: FCAs entail the FMOC’s review of the financial plan to evaluate the applicant’s financial condition and capacity, and the level and stability of local financial commitment for the project FTA is considering for a New Starts investment. The FMOC then prepares and submits a report that includes the results of its evaluations.

**financial plan**: The plan that each applicant for an FFGA must submit in support of its application. The plan describes the grantee’s financial condition and demonstrates the grantee’s capacity to construct, operate, and maintain the project with its existing transit system.

**financial rating**: A rating that FTA assigns to an applicant’s financial plan based on the three financial elements in the FMOC’s proposed ratings. These ratings are then combined into a local financial commitment summary rating.

**full funding grant agreement (FFGA)**: The instrument that defines a project’s scope, Federal financial contribution, and other terms and conditions.
**local share**: A grantee’s contractually required share of the net project cost.

**major capital project**: A project that: (1) involves the construction of a new fixed guideway or extension of an existing fixed guideway or the rehabilitation or modernization of an existing fixed guideway with a total project cost in excess of $100 million; or (2) the Federal Transit Administrator determines is a major capital project because the project management oversight program will benefit the recipient or FTA.

**maximum Federal New Starts financial contribution**: The limit on the amount of New Starts funds available for a project and is the only source of funding for which the total amount is explicitly limited upon award of the FFGA.

**New Starts project**: A new fixed guideway system or extension to an existing fixed guideway system referenced as a major capital investment by FTA under 49 C.F.R. Part 611.

**project management oversight contractor (PMOC)**: A contractor that FTA retains to evaluate a grantee’s technical capacity to build, operate, and maintain a project and to monitor the grantee’s project implementation.

**recovery plan**: A grantee’s plan for minimizing delays in achieving the FFGA’s baseline schedule and mitigating increases in the total project costs. The grantee must identify any difference between the total project cost and the BCE that it cannot recover and secure additional resources to meet the additional costs and complete the project without further financial assistance from the New Starts program.
EXHIBIT C. NEW STARTS FINANCIAL EVALUATION AND RATING PROCESS UNDER SAFETEA-LU

Note: See FTA’s CIG Website for the current process.
Source: FTA.
EXHIBIT D. MEASURES AND PERCENTAGES THAT FTA USED TO DEVELOP FINANCIAL RATINGS UNDER SAFETEA-LU

Local Financial Commitment Summary Rating (100%)

Capital Finance Plan Rating (50%)
Non-Section 5309 New Starts Share Rating (20%)
Operating Finance Plan Rating (30%)

Sub-Factor Ratings
Capital Condition (25%)
Commitment of Capital Funds (25%)
Capital Cost Estimates, Assumptions and Financial Capacity (50%)

Sub-Factor Ratings
Operating Condition (25%)
Commitment of Operating & Maintenance Funds (25%)
Operating Cost Estimates, Assumptions and Financial Capacity (50%)

Note: See FTA’s CIG Website for the current rating process.
Source: OIG analysis of FTA’s guidance.
EXHIBIT E. ENTITIES VISITED OR CONTACTED

FTA Headquarters, Washington, DC:
Office of Planning and Environment
Office of Program Management

FTA Regional Offices:
Region 8, Denver, CO
Region 9, San Francisco, CA
Region 10, Seattle, WA

Grantees:
Honolulu Area Rapid Transportation (HART), Honolulu HI
San Francisco Municipal Transportation Agency (SFMTA), San Francisco, CA
Regional Transit District (RTD), Denver CO
Central Puget Sound Regional Transit Authority (Sound Transit), Seattle, WA
EXHIBIT F. SUMMARIES OF MAJOR CAPITAL PROJECTS REVIEWED

Honolulu Rapid Transit

HART is constructing a 20-mile rail line, project to serve the south shore of Oahu from Kapolei to Ala Moana Center. The rail line will be almost entirely elevated in existing public rights-of-way, primarily arterial streets. The scope includes 21 stations, 80 light metro rail vehicles, 4 park and ride facilities, and a maintenance and storage facility. As of August 2016, FTA awarded $806 million for the project and the grantee drew down $576 million of those funds. FTA’s current risk assessment projected estimated costs to between $7.7 and $8.0 billion and a revised revenue operations date of December 2024. Because the project will significantly exceed its baseline cost estimate of $5.1 billion, FTA requested that the grantee prepares a recovery plan. Furthermore, FTA is requiring an updated finance plan to match the higher estimated cost and is withholding additional authorized funds until these actions are completed and approved.

Project Funding (in millions)

Federal:
- Section 5309 $1,550
- FHWA Flexible Funds 5307 210
- ARRA 4

Local Funding:
- General Excise Tax (GET) 3,358
Total $5,122

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<td>10/2009</td>
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<td>12/2011</td>
<td>Approval Entry into Final Design</td>
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<td>02/2012</td>
<td>Letter of No Prejudice - Early Construction</td>
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<td>Revenue Service Date</td>
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Exhibit F. Summaries of Major Capital Projects Reviewed
Eagle Commuter Rail

RTD is constructing a 13-station, 30.2-mile, commuter rail project consisting of two lines—the East Corridor from Denver International Airport to Denver Union Station (DUS), and the Gold Line from DUS to Wheat Ridge. The project includes purchase of 44 vehicles and construction of a maintenance facility. It is part of FTA’s public-private partnership (P3) pilot program. The P3, between RTD and a concessionaire team, is a design-build-finance-operate-maintain project delivery method contract. The concessionaire team will operate and maintain the project for 28 years. As of August 2016, FTA had awarded $667 million for the project and the grantee had drawn down $667 million of those funds.

Project Funding (in millions)

Federal:
- Section 5309 $1,030
- FHWA Flexible Funds 5307 62

Local Funding:
- Bond Sales, Use Tax, Local Cities, Transportation Infrastructure Finance
- Innovation Act Loan 463
- Concessionaire Financing 488

Total $2,043

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<td>09/2011</td>
<td>Construction Gold Line</td>
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<td>04/2016</td>
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University Link Light Rail

Now in revenue service, the project is a 3.15-mile extension of the Central Link Light Rail Project. The entire alignment is below grade in twin tunnels with excavated and cut-and-cover stations. The alignment extends from the Pine Street Stub Tunnel to the University of Washington campus and includes two underground stations. Twenty-seven light rail vehicles support the demand derived from the U Link Extension and revenue service system-wide. As of August 2016, FTA had awarded $768 million for the project and the grantee had drawn down $602 million of those funds.

Project Funding (in millions)
Federal:
Section 5309 $813
FHWA Flexible Funds 5307 9
Fixed GuideWay
Modernization Funds 4

Local Funding:
Bonds 1,123
Total $1,948

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Exhibit F. Summaries of Major Capital Projects Reviewed
Third Street Light Rail, Phase 2, Central Subway

The project includes design and construction of a 1.7-mile light rail transit extension of the existing Third Street Light Rail Phase 1 line in San Francisco. The project is Phase 2 of the SFMTA’s Third Street Light Rail Transit Project extending the Third Street Line from the 4th Street Caltrain Station to Chinatown, providing a direct, rapid transit link from the Bayshore and Mission Bay areas to South of Market, Union Square, and downtown. Four new stations are being constructed and four light rail vehicles will be procured. As of August 2016, FTA had awarded $599 million for the project and the grantee drawn down $408 million.

Project Funding (in millions)

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<td>Prop 1A High-Speed Rail</td>
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<td>Prop 1B Infrastructure Bond</td>
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<td>CA Traffic Congestion Relief Program</td>
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<td>CA Regional Transportation Improvement</td>
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<td>Prop K Sales Tax</td>
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### EXHIBIT G. MAJOR CONTRIBUTORS TO THIS REPORT

<table>
<thead>
<tr>
<th>Name</th>
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</thead>
<tbody>
<tr>
<td>Anthony Zakel</td>
<td>Program Director</td>
</tr>
<tr>
<td>Tiffany Mostert</td>
<td>Program Director</td>
</tr>
<tr>
<td>George Lavanco</td>
<td>Project Manager</td>
</tr>
<tr>
<td>Luke Brennan</td>
<td>Project Manager</td>
</tr>
<tr>
<td>Linda Major</td>
<td>Senior Auditor</td>
</tr>
<tr>
<td>Rosa Scalice</td>
<td>Auditor</td>
</tr>
<tr>
<td>Michael Dzandza</td>
<td>Auditor</td>
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<tr>
<td>Petra Swartzlander</td>
<td>Senior Statistician</td>
</tr>
<tr>
<td>Makesi Ormond</td>
<td>Statistician</td>
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<tr>
<td>Fritz Swartzbaugh</td>
<td>Associate Counsel</td>
</tr>
<tr>
<td>Susan Neill</td>
<td>Writer-Editor</td>
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APPENDIX. AGENCY COMMENTS

Memorandum

U.S. Department of Transportation
Federal Transit Administration


Date: March 16, 2017

From: Matthew Welbes
Executive Director, Federal Transit Administration

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

The Federal Transit Administration’s (FTA) Capital Investment Grants (CIG) program has a 40-year record of investment in over 100 major transit capital projects across the United States. CIG projects enable public transportation systems to carry more passengers and to meet the demand for high-capacity transit and for new places built around transit. The CIG program is authorized in federal law at $2.3 billion annually through Fiscal Year 2020 to build new rail, bus rapid transit, and core capacity expansion projects. Currently, there are over 70 projects either under construction with an FTA Full Funding Grant Agreement (FFGA) or in the project development process. The process for advancing projects that are ready for a federal investment to an FFGA is well-defined and effective.

The FTA has reviewed the draft report and offers the following comments in response to the OIG’s findings and recommendations:

- Following the framework established in federal public transportation law, FTA evaluates every project seeking CIG funding against several criteria for project justification and local financial commitment. This includes a review of each project sponsor’s financial ability to construct the project and to continue to operate and maintain the existing transit system.
• Once CIG funding is awarded, FTA protects the federal investment in a project through the terms and conditions of an FFGA and the agency’s Project Management Oversight (PMO) Program. Before FTA can make a CIG investment, the statute requires FTA to determine that “the project is supported by an acceptable degree of local financial commitment and shows evidence of stable and dependable financing sources.” The statute provides the ability to determine the required financial commitment based on FTA’s evaluation of each project sponsor’s unique circumstances.

• The FTA conducts a financial assessment for each project to determine the risks in the project sponsor’s financial plan that may jeopardize the federal interest.

• Under the longstanding program framework, FTA commits to providing only a fixed CIG dollar amount to each project - not an overall percentage of the project cost. Under the FFGA, the project sponsor, not the Federal Government, assumes the risk for any and all cost overruns on a project, which significantly mitigates the federal funding risk. The record of projects constructed and in revenue service today demonstrates the success of this model. Once a project receives a funding agreement and is under construction, FTA’s PMO program ensures that federal dollars are directed towards delivering the project scope and service defined in the grant award.

• The FTA’s risk-based oversight of the CIG program complies with statutory requirements and is tailored to the variety of projects in the CIG program. The FTA has refined the CIG program over time, and has developed CIG regulations, policy guidance, reporting instructions, and other technical assistance materials that define the financial requirements with which project sponsors must comply. The program framework reflects the project-specific analysis required to assess and evaluate the financial and technical capacity of each project sponsor. In addition, FTA has established guidance for the financial contractors that support FTA’s CIG investment decisions to ensure accurate and consistent project reviews of all CIG projects.

Based upon our review of the draft report, FTA concurs with recommendations 1 and 4 as written. The target action date for these two recommendations is April 30, 2018. However, at this time we can neither agree nor disagree with the OIG’s conclusion that by implementing recommendation 4, Federal funds could be put to better use, since the OIG has not yet provided us the basis for its calculation. Further, we cannot verify whether any funds could be put to better use until we complete our financial analysis, which is expected to be completed by April 30, 2018, as cited above (see recommendation 4).
The FTA partially concurs with recommendation 2. The FTA will revise the current financial capacity assessment (FCA) guidance to require that its contractors include the rationale for all testing decisions and parameters selected for testing in the FCAs. The target action date is October 31, 2017. The FTA does not concur with the rest of the recommendation. The financial capacity assessments performed by FTA must take into consideration the unique financial structure and funding sources of each project sponsor. Thus, FTA’s CIG financial review procedures, processes, and guidance must be designed to account for the innumerable variations associated with major capital project financial plans and funding sources. While the rigorous framework for evaluating projects is critical, overly simple and prescriptive evaluation guidance would weaken the quality of financial assessments and suppress important findings.

The FTA partially concurs with recommendation 3 since we do not concur with the recommendation as written, but agree with its intent. As described in the OIG’s report, FTA has very limited resources to review the over 50,000 quarterly reports submitted annually. As an alternate action to address the finding, FTA will establish a risk-based approach to quarterly Federal Financial Report reviews. The FTA will complete this action by October 31, 2017.

The FTA partially concurs with recommendation 5 since we do not concur with the recommendation as written, but agree with its intent. As described in the OIG’s report, because each project involves distinct circumstances, FTA must retain discretion to determine which third party agreements are major or critical for a specific project. As an alternative to revising FTA’s policy guidance, we will develop standard operating procedures to establish criteria for identifying critical third-party agreements. The FTA will complete this action by October 31, 2017.

We appreciate this opportunity to comment on the OIG draft report. Please contact Natalie Wowk, Audit Liaison, at (202) 366-2514, with any questions.