

May 1996

LOS ANGELES RED LINE

Financing Decisions Could Affect This and Other Los Angeles County Rail Capital Projects





United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-270347

May 14, 1996

The Honorable Frank R. Wolf
Chairman, Subcommittee on Transportation
and Related Agencies
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

This report responds to your August 23, 1995, request that we review selected aspects of the Los Angeles County Metropolitan Transportation Authority's (Authority) Red Line subway project in California. The federal government has committed to fund \$2.8 billion, or about 51 percent, of the Red Line's final design and construction costs of \$5.5 billion. The costs were identified in grant agreements between the Federal Transit Administration (FTA) and the Authority.¹ These agreements commit federal funds, subject to appropriations, from FTA's "new starts" capital discretionary program.

The 23.4-mile Red Line project consists of three segments. Segment one—4.4 miles—is in service; construction of segment two—6.7 miles—is about 70 percent complete. The third segment—12.3 miles—is divided into three extensions: the construction of the North Hollywood extension is 18 percent complete, the final design of the East Side extension is 10 percent complete, and the design of the Mid-City extension is on hold while the Authority assesses other alignment options. In response to your request, we reviewed (1) the project's estimated cost and (2) the Authority's financing plans. We are also providing information on FTA's oversight of the project's quality control and quality assurance practices.

Results in Brief

As of February 1996, the Authority estimated the total cost of the Red Line project at \$5.9 billion, about 8 percent (\$427 million) above the \$5.5 billion estimated in the grant agreements. The project's cost has increased as a result of (1) construction problems, such as realignment of a station to avoid unanticipated groundwater and soil contamination; (2) new construction requirements, such as upgrading stations to comply with the Americans with Disabilities Act; and (3) enhancements to the project, such

¹These agreements are called full funding grant agreements. Most recently, the agreement for the third segment of the project was amended to provide additional funds and to lengthen the funding period so that an additional extension could be included. This amendment increased the project's total cost from \$5.2 to \$5.5 billion.

as an additional station entrance. The February 1996 cost estimate could increase because of the need to realign the Mid-City extension, additional design problems, and pending lawsuits.

The Authority plans to fund \$3.1 billion of the project's \$5.9 billion cost with federal funds and the remainder with state and local funds.² However, about \$380 million in federal, state, and local funds committed may not be realized. For example, the California state legislature recently diverted \$50 million in funds slated for the Authority's bus operations. To offset that loss, the Authority provided funds for bus operations that had been committed to the Red Line project. FTA officials believe that the Authority can use sales tax revenues that it has allocated to other rail capital projects to cover funding shortfalls. However, doing so could result in the need to reduce the funding or scope of other transit construction projects, defer or cancel projects, or extend the schedule for completing the Red Line, which could also increase the project's cost.

The Authority is implementing a plan to improve its overall management of the project's construction by, among other things, reorganizing its quality control and quality assurance programs and increasing the staffing levels for quality assurance and safety. FTA and the Authority agreed to the plan after FTA stopped tunneling under Hollywood Boulevard and suspended—from October 5 to November 10, 1994—future federal funding for the project. FTA took this step after the types of changes FTA had recommended over time were not made.

Background

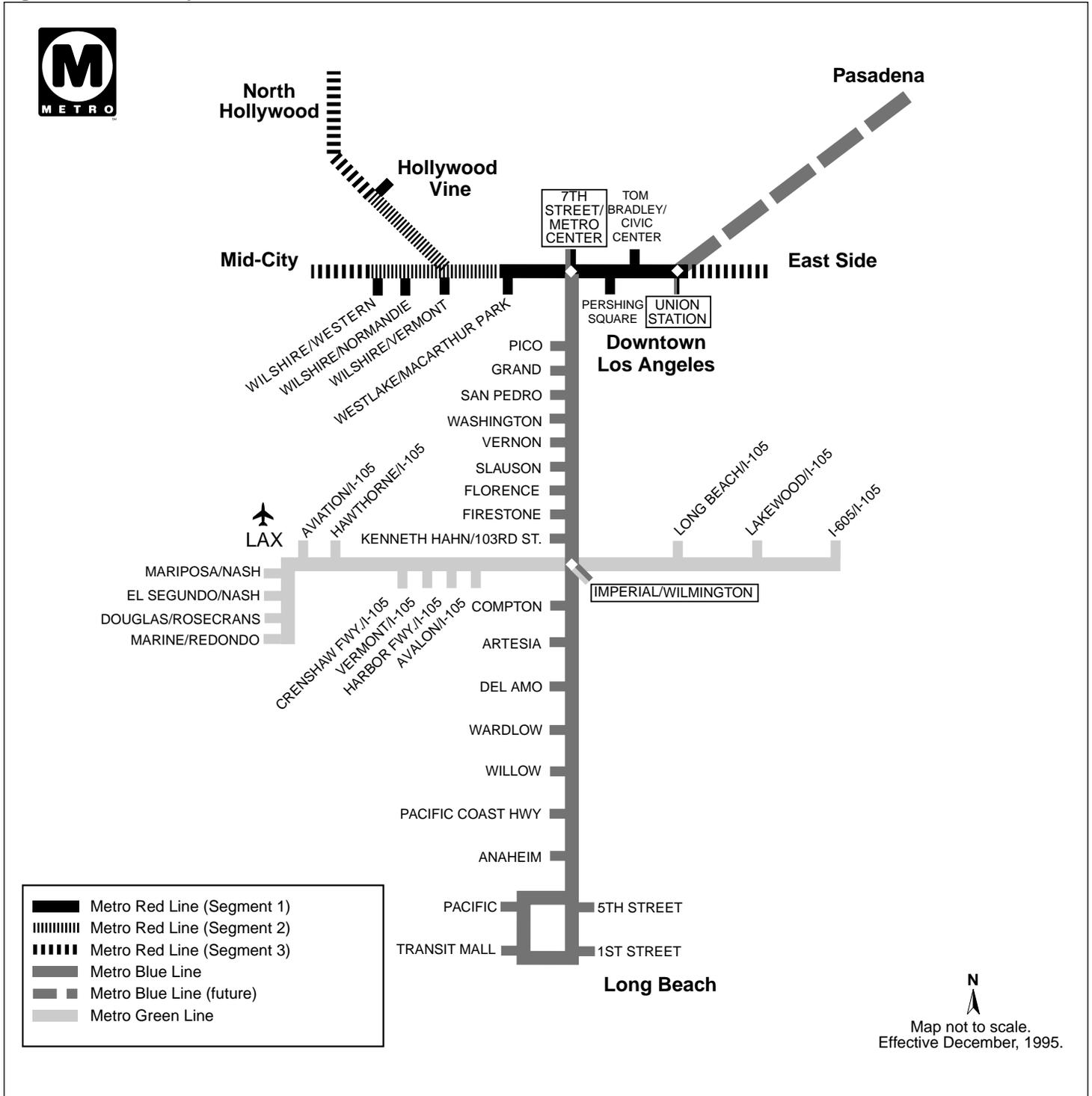
The Authority has designed an integrated transportation network for Los Angeles County called the Metro System. To develop part of that system, it has signed three grant agreements with FTA to help fund the final design and construction phases of a heavy rail system called the Red Line.³ As shown in figure 1, the Red Line links with other parts of the Metro System—the Blue and Green lines, which are light rail systems. The Green Line and part of the Blue Line are operational; both have relied solely on local funds to pay the construction costs. The Authority will use state and

²Although the grant agreements provide an upper limit of \$2.8 billion for funding this project with new start funds, other eligible federal funds from programs such as the Surface Transportation Program are also being used. When these funds are included, the total federal contribution to the project increases to about \$3.1 billion.

³The Red Line has been redesigned several times. In 1983, it was 18.6 miles long with 18 stations. In 1988, it was redesigned to 17.3 miles long with 16 stations to avoid areas where methane gas was found. In 1993 and 1994, the system was expanded to include two additional extensions, increasing the total length of the system to 23.4 miles.

local funds for the Pasadena Blue Line, which is under construction. In contrast, the Red Line project is being designed and constructed using federal, state, and local funds. As of February 1996, about \$3.3 billion had been appropriated for the project: \$1.8 billion from the federal government; \$393 million from the state government; and \$1.1 billion from local governments.

Figure 1: The Metro System



(Figure notes on next page)

Source: Los Angeles County Metropolitan Transportation Authority.

The Authority is responsible for the design, construction, and operation of the Red Line project. Day-to-day design activities are managed by an engineering management consultant, while construction activities are managed by several construction management consultants, all under contract to the Authority. FTA approves and oversees expenditures of federal funds for the project and has hired a contractor, Hill International, Inc., to help ensure that the Authority maintains a reasonable process for successfully designing and constructing the project and to monitor the Authority's development and implementation of the project.

Costs Have Not Grown Significantly Since Funding Agreements but Could Continue to Increase

As of February 1996, the Authority estimated the project's total cost at \$5.9 billion, an 8 percent (\$427 million) increase over the \$5.5 billion estimated in the grant agreements. As shown in table 1, this increase was the result of construction problems, new construction requirements, and enhancements of the project. For example, on segment one, unanticipated groundwater and soil contamination resulted in costs for cleanup as well as for purchasing property on the right-of-way for a new station alignment that avoided the contaminated area. In addition, on segment two, the Authority's Board of Directors approved \$65 million to add a new station entrance and make some modifications to stations for commercial development. Furthermore, during the construction of segment two, a small part of Hollywood Boulevard collapsed into the subway tunnel being dug under the roadway, creating a 70-by-70-foot-wide sinkhole. As a result of this and prior problems, the Authority fired the contractor. Contract costs resulting from the firing and from the rebidding of the remaining work will add about \$67 million to the project's costs. The Authority believes its cost containment program has helped to keep cost increases to a minimum.

Table 1: Estimated Cost Growth for the Red Line, as of February 1996

Dollars in millions

	Total cost in grant agreements	Current forecast	Estimated growth in cost (percentage)	Reason for estimated growth in cost
Segment 1	\$1,250	\$1,450 ^a	\$200 (16)	Additional real estate purchased, \$49 M Realignment to avoid contaminated soil and groundwater, \$61 M Higher engineering costs due to redesign, delays, and redundancies in scope, \$90 M
Segment 2	\$1,446	\$1,641	\$195 (13)	Americans with Disabilities Act requirements, \$6 M Station enhancements, \$65 M Earthquake program, \$1 M Sinkhole repair and completion of contract, \$67 M Increased costs for engineering, insurance, real estate, handling of hazardous wastes, and utilities, \$56 M
Segment 3	\$2,781	\$2,813 ^b	\$32 (1)	Delay in awarding final design contract for the East Side extension, \$29 M Artwork for stations, \$2.4 M Study of the impact of earthquakes, \$0.3 M Connector for future expansion, \$0.3 M
Total	\$5,477	\$5,904	\$427 (8)	

^aActual cost (segment is complete).^bAs of April 1996, the estimated cost growth for the East Side extension has decreased from \$29 to \$8 million as a result of cost mitigation measures such as revised packaging and sequencing of the construction work.

Source: Based on data from the Authority.

The project's cost could increase beyond the \$5.9 billion estimate. For example, on segment three, the design of the Mid-City extension was suspended following the discovery of high concentrations of hydrogen

sulfide gas on the planned tunnel alignment. The Authority is considering two alternatives: (1) constructing shallow underground stations and a tunnel, estimated to cost an additional \$190 million, or (2) constructing a subway with aboveground stations, estimated to cost an additional \$130 million. A third option—constructing a deep tunnel with a different alignment—is being studied because of public opposition to the proposed aboveground stations and the estimated costs of the first two alternatives. Authority officials estimate that it could take up to 8 years to complete the Mid-City extension after the Authority's board chooses an alternative.⁴

The Authority has made management decisions that may increase costs in the short term but that could provide better quality design work and forestall costly water damage to the tunnel. For instance, the final design of the East Side extension is behind schedule because the Authority is requiring the design contractor to, among other things, implement new quality control and cost containment procedures and perform additional geotechnical studies of fault areas before proceeding. In addition, the Authority has implemented some mitigation measures for the North Hollywood extension that are delaying construction, including performing additional grouting to stabilize the soil and prevent water from flowing into the tunnel.

Pending lawsuits could also increase costs. For example, tunneling under Runyon Canyon Park is scheduled to begin at the end of May 1996. However, a lawsuit filed by two environmental groups seeks to prevent digging and tunneling below the canyon until federal, state, and local agencies develop a supplement to the 1989 environmental impact statement. If the tunneling is delayed, the project's schedule would be extended, thereby increasing costs. Other lawsuits could also increase costs because they include financial claims against the Authority. The lawsuits are by retail establishment owners affected by settlement on Hollywood Boulevard and the construction contractor fired by the Authority for inadequate construction techniques.⁵ Depending on the outcome of the lawsuits and the ability of the Authority's existing insurance to cover any awards against the Authority, the risk remains that the project's cost will increase.

⁴The Authority's board was tentatively scheduled to select the preferred alternative at its June 1996 board meeting. A proposal to explore the third option was approved at the April 1996 board meeting; selection of an option is expected in April 1997.

⁵The Authority has filed a cross complaint against the construction contractor for breach of contract, among other things.

Financing Potential Funding Shortfalls May Result in Difficult Decisions

The Authority estimates that it has secured sufficient federal, state, and local funding to finance \$5.9 billion, its current estimate of the project's total cost. However, about \$380 million in financing commitments may not be realized. Furthermore, as noted earlier, the cost could increase beyond the current estimate. Therefore, to cover current and future funding shortfalls, the Authority may have to make difficult decisions, such as reducing the funding or scope of other rail capital projects; deferring or cancelling planned transit projects; or extending the schedule for completing the Red Line, which could further increase the project's cost.

Financing the Project's Current Estimated Cost

The Authority plans to fund \$3.1 billion of the project's \$5.9 billion total cost with federal funds and the remainder from state and local funding sources.⁶ Most of the federal funds—\$2.8 billion—are from FTA's new starts discretionary capital program. An additional \$300 million has been provided from other federal programs, including the Surface Transportation and Congestion Mitigation and Air Quality programs—highway programs that provide states with the flexibility to use these funds for transit projects.

California has committed about \$539 million of the project's funding.⁷ The majority of these state funds, about \$500 million, are being provided from state gas tax revenues, which are allocated to both highway and transit projects. The remainder of the state's share of the cost of the project will come from revenues generated from general obligation bonds for rail capital projects.

Local funding for the project—about \$2.3 billion—comes from three sources: Los Angeles County, the city of Los Angeles, and assessments levied on properties adjacent to the planned stations. Los Angeles County dedicates revenues from a 1-cent sales tax to the Authority for existing transit systems and new transit projects in the Los Angeles area; the Authority has allocated about \$1.6 billion of these revenues to the Red Line. Some funds from the county's dedicated sales tax are returned to the surrounding cities. The city of Los Angeles uses a portion of these funds to finance the 7 percent of the project's costs that it has committed. The Authority estimates that the remainder of the local funding for the project will be derived from assessments levied on the retail properties adjacent to planned Red Line stations on all three segments because the Authority

⁶The sources of funding for the project are shown in detail in appendix I.

⁷This figure does not include federal funds from the Surface Transportation and Congestion Mitigation and Air Quality programs that the state has dedicated to the Red Line project.

has or will designate the areas to be taxed as “benefit assessment districts,” since these areas may derive benefits from the project.

Funding Commitments May Not Be Realized

About \$380 million committed by federal, state, and local governments toward the current cost estimate of \$5.9 billion may not be realized. On the federal level, there is currently a \$94 million shortfall. Under the grant agreements for the Red Line, the federal government committed, subject to annual appropriations, \$2.8 billion for the expected life of the project. The agreement breaks this total down into yearly amounts that are also contingent upon congressional action to appropriate funds. In fiscal years 1995 and 1996, the Congress did not provide the annual commitments identified in the grant agreements, resulting in the funding shortfall. While the grant agreements allow the federal government to provide additional funds at a later date to cover any annual shortfalls, and the Authority’s long-range plan assumes that the shortfalls will be made up, federal budget constraints could make it difficult to make up existing or additional shortfalls in the future. Authority officials indicated that they could absorb an additional small shortfall in fiscal year 1997 but may not be able to complete the Red Line as scheduled if there are future shortfalls in the federal funding.

In 1995, the state legislature diverted \$50 million in state sales tax revenues that had been committed to the Authority for its bus operations.⁸ Since the legislature specified that the shortfall could not be allowed to affect the bus program, the Authority provided to bus operations \$50 million in county sales tax revenues that had been slated for segment three. Authority officials told us that they must offset this loss through operating efficiencies over the next 4 years and may delay segment three by 1 year.

Some of the Authority’s local revenue commitments may also not be realized. The Authority is currently working with the city to reach agreement on its commitment to contribute \$200 million for segment three. The Authority’s long-range plan indicates that if the city’s contribution to the project does not materialize, funds slated for current and planned rail construction projects, such as the Pasadena Blue Line and further extensions to the Red Line, would be needed to make up the shortfall. Diverting these funds could delay the affected projects by up to 3 years. Furthermore, the Authority’s long-range plan also states that \$36 million of the expected \$75 million in estimated revenues from

⁸The funds were transferred to the county’s general fund to be used for health care programs.

assessments levied on retail properties adjacent to the planned stations for segments two and three may not be realized because retail property owners oppose the assessment.

Funding Future Cost Increases May Require Difficult Decisions

Apart from the revenues from the county's dedicated sales tax, the Authority's funding sources for cost increases beyond the \$5.9 billion estimate are somewhat limited. Federal funds will likely not be forthcoming to finance further cost increases for the Red Line project. The grant agreements essentially limit the federal government's exposure to increased costs for the project by capping the federal share from the new starts discretionary grant program at \$2.8 billion.⁹ However, an extraordinary cost provision in the agreements allows the Authority to seek additional federal funds under certain circumstances, such as higher-than-estimated inflation. In 1995, the Authority requested an additional \$30 million in federal funds under this provision for segment one. While FTA has not formally responded to the Authority's request, FTA officials told us that because of the amount of competition for new starts discretionary grant funds, FTA is unlikely to grant this or future requests for funds above the level in the grant agreements. In fact, FTA has approved only one of several requests for extraordinary costs from grantees in the new starts program—for the St. Louis Metrolink—in the last 5 years.

Without increased federal funds, the Authority will have to turn to state and local funding sources. However, the state will provide funds only in the case of extraordinary costs. On the other hand, the city of Los Angeles will pay 50 percent of the cost increase for segment one—up to \$100 million—and has committed to pay up to \$90 million for segment two. The city has made no commitment to fund cost increases for segment three.

The remaining local funding source is the county's dedicated sales tax. FTA and Hill International officials believe that one way the Authority can absorb increases above the current cost estimate is by using revenues that the Authority currently allocates to other rail capital projects. However, Authority officials told us that the amount of flexibility the Authority has in a given year is limited, in part because about 70 percent of discretionary sales tax revenues are allocated to the bus program and the Authority does not plan to use these funds for the Red Line project. Therefore, any decision to use sales tax revenues could adversely affect other rail capital

⁹The Authority could also draw on FTA's urbanized area formula funds and work with the state to tap other federal programs, such as the Surface Transportation Program and the Congestion Mitigation and Air Quality Program.

projects. For example, when the recent recession reduced planned revenues, the Authority allocated these losses to the Pasadena Blue Line project. This delayed the project, which was not yet under construction, for 3 years.¹⁰ This decision meant that the Red Line would not lose revenues and could maintain its construction schedule.

To determine how much flexibility it has to address a cost increase and/or revenue loss, the Authority assesses the magnitude of the increase and/or loss, the Red Line's completion schedule, the available bonding capacity based on sales tax revenues, other potential sources of funding, and the impact on other rail capital projects. For example, the Authority recently determined that it had enough bonding capacity to provide \$40 million toward the cost increase for segment two and still maintain the Red Line's construction schedule. However, Authority officials acknowledge that if the bonding capacity is not sufficient and no other funding sources are available, the Red Line's completion schedule would have to be extended and the project's cost could increase.

According to Authority officials, the Red Line is their number-one rail priority and the decision on the new alignment for Mid-City—not expected for about a year—is the single most costly increase currently expected for the project. They stated that the project would have to be assessed at that time to determine whether revenues are available to fund construction or whether that extension will have to be delayed. Depending on how long the Mid-City extension is delayed, funding slated for other projects, such as the San Fernando extension, scheduled to begin in 2003, could be used for Mid-City. FTA's monitoring of financing capacity for the project, particularly once the cost of the Mid-City extension is determined, will be critical to help ensure that funding is available to proceed with design and construction.

FTA's Oversight of the Project's Quality Control and Quality Assurance Practices

In November 1994, the Authority and FTA agreed to a plan to improve the overall management of construction of the Red Line project. However, this plan did not come about until FTA took action to stop tunneling under Hollywood Boulevard for the Red Line and temporarily suspended federal funding for the project to compel the Authority to address long-standing problems.

¹⁰The Authority's board recently agreed to an \$804 million budget for the Pasadena Blue Line, which is scheduled to be completed in May 2001.

Among these long-standing problems was the lack of a mechanism for elevating safety and quality assurance concerns to the appropriate level within the Authority's and the construction management contractor's organization. For example, during 1993 and 1994 several inspection reports alerted the resident engineer about weaknesses in the installation of the initial tunnel lining under Hollywood Boulevard. However, the issue was not elevated to the Authority's Director of Quality until excessive surface settlement occurred on Hollywood Boulevard in the summer of 1994. The tunnel lining support was cited as a possible cause. Because of concerns about the management attention given to quality assurance, FTA recommended that this function be placed sufficiently high in the Authority's and the construction management contractor's organization to help ensure independence and adequate attention to deficiency reports by quality control inspectors.¹¹ Because corrective actions were not taken, on this and other issues, FTA took action to stop tunneling under Hollywood Boulevard for the Red Line and suspended federal funding—from October 5 to November 10, 1994—for the project.

As a condition for resuming federal funding, the Authority and FTA agreed to a plan in November 1994 that called for transferring quality assurance, quality control, and safety from the construction management contractor to the Authority and increasing staffing for quality assurance.¹² These actions are now being implemented. For example, the Authority increased the number of quality assurance positions from 4.5 staff years in 1994 to 6 staff years in 1995, and it plans further increases.

Also, in September 1995 FTA increased the number of permanent Hill International staff, from 5 to 7; provided 3 temporary staff, who have been extended at least through May 1996; and increased the frequency of interactions between Hill International, FTA, and the Authority. With more staff, according to Hill International, four rather than one staff members are present on the construction sites daily.

Our past work has shown that FTA has rarely exercised the enforcement tool of withholding funds to compel grant recipients to fix long-standing

¹¹Quality assurance includes designing the appropriate checks and balances and ensures that the proper quality processes and procedures are being followed. Quality control is the actual inspection of in-process, partially completed, or fully completed work to confirm that the standards have been met.

¹²As a result of recommendations made in an April 1995 report by Arthur Andersen Co. on the Authority's management practices, the Authority, with FTA's agreement, transferred the quality control function from the Authority to the construction manager, thereby ensuring independence.

problems.¹³ With its action on the Red Line project, FTA has seen the success of withholding funds to compel change. Given the cost and potential risks of underground tunneling and a history of resistance to certain quality control recommendations made in the past, timely enforcement actions could help to ensure that the Authority addresses key recommendations in the future.

Agency Comments and Our Evaluation

We provided copies of a draft of this report to FTA and Los Angeles County Metropolitan Transportation Authority officials for their review and comment. We met with FTA officials, including the Director, Office of Oversight, and the Program Manager for the Project Management Oversight Program in Headquarters and with the Director of the Office of Program Management in FTA's Region IX. We also met with Authority officials, including the Deputy Executive Officer for Program Management, Director for Strategic Funding Analysis and Director for Grants Management. FTA and the Authority generally agreed with the facts as presented. However, both suggested that the report's presentation of FTA's oversight of the project's quality assurance and quality control practices heavily emphasized past problems rather than focused on recent positive changes. We have revised that section of the report to clearly describe the actions FTA and the Authority have taken to improve construction management of the Red Line project. FTA and the Authority also commented that our discussion of the project's future growth and potential financing issues are speculative. We agree that future projections are speculative, but the report describes clear examples of potential reasons for cost increases, such as the decision to realign the Mid-City extension and design delays for the East Side extension, as well as the Authority's potential solutions to financing these increases. The Authority was also concerned that our discussion of cost growth, particularly in table 1, could be misconstrued because the cost growth for segment three is an estimate. To address their comments, we changed the title of the table to reflect that the figures are estimates and added a footnote stating that cost mitigation measures have reduced the estimated cost growth for the East Side extension from \$29 million to \$8 million. Both FTA and the Authority offered technical comments to clarify information in the report, and we have incorporated these comments, as appropriate.

Scope and Methodology

To prepare this report, we reviewed the Authority's February 1996 Project Manager's Status and Construction Reports for each segment of the Red

¹³High-Risk Series: An Overview (GAO/HR-95-1, Feb. 1995).

Line. We reviewed supporting documentation and discussed costs, financing, and oversight issues with officials at FTA's headquarters in Washington, D.C.; FTA's Regional Office in San Francisco; Hill International, Inc. in Los Angeles; and the Los Angeles County Metropolitan Transportation Authority. We also reviewed the Authority's 20-year transportation plan and February 1996 financial update and discussed them with officials at FTA, Hill International, and the Authority. We performed our work from October 1995 through April 1996 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary of Transportation, the Administrator of the Federal Transit Administration, the Chief Executive Officer of the Authority, and cognizant congressional committees. We will also make copies available to others upon request.

Please call me at (202) 512-2834 if you or your staff have any questions. Major contributors to this report are listed in appendix II.

Sincerely yours,

A handwritten signature in cursive script that reads "Phyllis F. Scheinberg for". The signature is written in black ink and is positioned above the typed name of the signatory.

John H. Anderson, Jr.
Director, Transportation and
Telecommunication Issues

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Abbreviations

CMAQ	Congestion Mitigation and Air Quality Program
FTA	Federal Transit Administration
GAO	General Accounting Office
STP	Surface Transportation Program

Project Financing Plan by Segment, as of February 1996

Dollars in millions				
Funding source	Segment 1	Segment 2	Segment 3	Total
FTA new starts capital	696	667	1,416	2,779
FTA formula/ STP/CMAQ ^a	0	55	240	295
Total federal	\$696	\$722	\$1,656	\$3,074
State	214	133	192	539
Total nonfederal match	754	919	1,157	2,830
Authority's 1-cent county sales tax	276	549	751	1,576
Authority's capital reserve account ^b	0	22	0	22
City of Los Angeles	134	157	200	491
Benefit assessment districts	130	58	14	202
Total local	540	786	965	2,291
Total	\$1,450	\$1,641	\$2,813	\$5,904

^aThe Surface Transportation Program (STP) and the Congestion Mitigation and Air Quality Program (CMAQ) are both highway programs whose funds can be used to finance transit projects.

^bThe grant agreements required that the Authority establish a capital reserve account to fund cost increases.

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