
Office of Inspector General

Audit Report

**IMPROVEMENTS TO STEWARDSHIP AND OVERSIGHT
AGREEMENTS ARE NEEDED TO ENHANCE
FEDERAL-AID HIGHWAY PROGRAM MANAGEMENT**

Federal Highway Administration

Report Number: MH-2013-001

Date Issued: October 1, 2012





Memorandum

**U.S. Department of
Transportation**

Office of the Secretary
of Transportation
Office of Inspector General

Subject: ACTION: Improvements to Stewardship and Oversight Agreements Are Needed To Enhance Federal-aid Highway Program Management
Federal Highway Administration
Report No. MH-2013-001

Date: October 1, 2012

From: Joseph W. Comé *Joe Comé*
Assistant Inspector General for
Highway and Transit Audits

Reply to
Attn. of: JA-40

To: Federal Highway Administrator

The Federal Highway Administration (FHWA) oversees billions of dollars in Federal-aid Highway Program (FAHP) funds provided annually to the States and local public agencies (LPAs)¹ and American Recovery and Reinvestment Act (ARRA) funds for highway infrastructure investments.² To oversee this substantial investment, FHWA relies greatly on the States to monitor the thousands of projects receiving Federal funds. Stewardship and Oversight Agreements (Agreements), which are required by law, formalize the roles and responsibilities of FHWA Division Offices and the States to ensure adequate oversight of Federal funds, project quality, and safety.³ FHWA formalized its process for developing Agreements in its April 2006 and August 2011 Stewardship and Oversight Agreement Guidance.⁴

As part of our ongoing ARRA oversight, we conducted this audit to assess whether FHWA Stewardship and Oversight Agreements address Federal requirements and program risks, including those required by the Recovery Act. The objectives of this audit were to determine the extent to which FHWA (1) established Agreements that fully reflected Federal requirements and its own

¹ LPAs include counties and cities.

² Pub. L. No. 111-5 (2009).

³ FHWA has 55 Agreements nationwide, one with each State, the District of Columbia, the Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands. A current Agreement with Puerto Rico has not been executed.

⁴ FHWA's April 14, 2006, "Federal-aid Highway Program Stewardship/Oversight Agreement Guidance," was in effect when we started our review, and was revised on July 1, 2011, and transmitted to Division Administrators on August 16, 2011.

key program risks and priorities and (2) provided sufficient Headquarters guidance and oversight of the development and timely update of Agreements. To conduct our audit, we analyzed all 55 Agreements, interviewed Division Administrators from a random sample of 9 States, and evaluated FHWA's April 2006 and August 2011 Guidance. Exhibit A contains a detailed description of our scope and methodology.

We conducted this performance audit in accordance with generally accepted Government auditing standards.

RESULTS IN BRIEF

While FHWA fulfilled the statutory mandate to enter into Agreements with each State, the Agreements do not consistently reflect Federal requirements, or program risks and priorities that FHWA has identified and communicated to its Division Offices. Specifically, Agreements did not consistently address risks related to ARRA implementation and LPAs' management of FHWA funds, Federal highway safety priorities, and use of performance and compliance indicators to measure the impact of the FAHP. For example, only 9 of 55 Agreements refer to ARRA, despite it being major legislation that imposed extensive financial and reporting requirements. Also, we found that FHWA was not fully implementing its statutory oversight responsibilities on about 600 of 2,500 Interstate Highway System projects, which included about \$5 billion in Federal funds, by allowing States to assume project oversight responsibilities reserved to FHWA by law. For example, Texas was allowed to assume oversight of a bridge reconstruction project that included about \$110 million in Federal funds. Collectively, these exclusions and inconsistencies reduce the ability of the Division Offices and States to utilize the Agreements as an internal control tool to carry out ARRA and FAHP oversight responsibilities effectively.

FHWA Headquarters has not provided sufficient guidance and oversight to Division Offices for the development and update of Agreements to ensure that inconsistencies reflect valid differences among the States and to ensure that legal issues are identified. We found a wide variation in the detail included in each Agreement, ranging from high-level to more detailed descriptions of roles and responsibilities for overseeing federally funded projects, and none of the Agreements cited a clear systematic methodology for the inclusion or exclusion of certain program risk areas. FHWA's 2006 Guidance, which was used to develop the Agreements we reviewed, did not clearly state what Division Offices were expected to include in Agreements or when to update them. While FHWA Headquarters intended the Guidance to be more than suggestions, it only states that Division Offices were required to address 5 specific elements—environment, right-of-way, safety, systems operations and preservation, and design and construction; but even then, only 32 of the 55 Agreements included all 5 elements.

The Guidance did not require Division Offices to document their rationale for omitting certain elements. In comparison, the 2011 Guidance is even less prescriptive and does not contain requirements for including elements or updating Agreements. While we agree with FHWA that the Guidance should be flexible to allow Division Offices to tailor Agreements to meet the specific conditions in each State, we maintain that prescriptive guidance would provide FHWA with greater assurance that Agreements address key requirements and priorities, reflect current conditions in each State, and promote FHWA's commitment to a risk-based oversight approach. Furthermore, the Guidance does not address important control steps such as whether Agreements should be reviewed by Headquarters or legal experts before Agreements are signed, and it is not clear who in FHWA has the authority to sign an Agreement.

We are making a series of recommendations to strengthen FHWA's oversight of Stewardship and Oversight Agreements.

BACKGROUND

Agreements are one of several risk-based oversight tools FHWA employs to leverage Division Office resources by allowing States to assume oversight responsibility and approval authority to manage the great majority of FAHP projects. The Agreements between FHWA and the States cover oversight of the FAHP and formally communicate Federal requirements, policy concerns, Federal and State roles and responsibilities, and individualized priorities to each State—all in one document. In addition, the Agreements commit FHWA and the States to agreed-upon roles and responsibilities for an indefinite time period.

FHWA first introduced agreements with the States in response to the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA).⁵ However, formal agreements were not required until 1998, when the Transportation Equity Act for the 21st Century (TEA-21)⁶ required FHWA to enter into formal agreements with States—relating to the extent to which States assume FAHP oversight responsibilities. For these Agreements, FHWA defined “stewardship” as the efficient and effective management of the public funds entrusted to FHWA, and “oversight” as the act of ensuring that the FAHP is delivered consistent with applicable laws, regulations, and policies.

FHWA outlined its approach to Agreements in its 2006 Guidance, which was revised in its 2011 Guidance. Both versions of the Guidance refer to the Agreement as a “road map” for effective oversight and stewardship of the FAHP, and note that FHWA intended to outline basic stewardship concepts and

⁵ Pub. L. No. 102-240.

⁶ Pub. L. No. 105-178, Section 1305.

approaches, rather than mandate specific procedures. Both versions also provide Division Offices wide discretion in tailoring Agreements to meet the needs of individual States. According to the 2011 Guidance, with the passage of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU)⁷ in 2005 “...the overall program has evolved requiring a more comprehensive Agreement that covers project delivery and financial controls of the FAHP.”

FHWA is accountable for ensuring that FAHP projects meet Federal requirements and for performing responsibilities that by law cannot be assigned to States or LPAs. For example, under 23 United States Code 106, FHWA must perform certain roles and responsibilities, such as approval and oversight on certain types of projects. To help accomplish its oversight, each FHWA Division Office assesses State oversight accordingly and does this through annual risk assessments, program assessments, program reviews, certification reviews, recurring reviews, and project inspections to identify State oversight and program areas with the greatest risk.

FHWA AGREEMENTS WITH STATES DO NOT CONSISTENTLY REFLECT REQUIREMENTS, PROGRAM RISKS, AND FHWA PRIORITIES

While FHWA fulfilled the statutory mandate to enter into Agreements with States, the Agreements do not consistently reflect Federal requirements, program risks, and priorities. In particular, Agreements do not consistently reflect a comprehensive FHWA and State approach to oversight of the \$27.5 billion ARRA investment, oversight of multi-billion dollar LPA investments, critical Federal highway safety priorities, and the use of performance and compliance indicators. Agreements are a key internal control in managing the FAHP. Exclusions and inconsistencies in Agreements could reduce the ability of Division Offices and States to fully utilize the Agreements as a road map for carrying out ARRA and FAHP oversight responsibilities or risk-based management. Further, FHWA is not fully implementing its statutory oversight responsibilities for certain projects by allowing States to assume areas of project oversight that were mandated by law to FHWA.

Agreements Did Not Consistently Address ARRA, LPAs, Safety Priorities, and Performance and Compliance Indicators

FHWA has issued numerous regulations, policies, memoranda, studies, and guidance outlining program risks and priorities related to ARRA, LPAs, highway

⁷ Pub. L. No. 109-59.

safety, and performance and compliance indicators. However, these FHWA-identified risks and priorities were not reflected consistently in the Agreements between FHWA and the States. Table 1 below identifies four areas of Agreements that we reviewed in depth and summarizes the results found.

Table 1. Summary Results of 55 Agreements Reviewed

FHWA Program Risks and Priorities Reviewed	Agreement Did Not Include	Agreement Included But Not In Depth	Agreement Included In Depth	Not Applicable
ARRA Legislation	46	4	5	0
LPA Oversight	3	25	22	5 ^a
Safety Priorities	9	40	2	4 ^b
Performance and Compliance Indicators	27	0	28	0

Source: OIG analysis.

^a According to FHWA, there are no LPA-related activities.

^b According to FHWA, these safety priorities do not apply to the U.S. Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands.

Agreements frequently did not reflect the additional oversight risks and requirements that ARRA posed. Only a few of the Agreements we reviewed included any specific ARRA requirements that were statutorily imposed, such as new financial reporting requirements, even though ARRA presents an ongoing oversight risk for over a 6½-year period. Further, ARRA increased Division Office and State workloads—investing in about 13,000 highway infrastructure projects across the Nation. FHWA’s April 2009 ARRA Risk Management Plan identified potential risk areas in the oversight of ARRA projects, including, for example, LPA oversight, States’ oversight of contract administration, quality assurance, use of disadvantaged business enterprises, and improper payments.

Although ARRA imposed extensive certification, reporting, and financial requirements, 46 of the 55 Agreements we reviewed did not mention ARRA. Of the remaining nine Agreements, four mentioned ARRA, but only in a cursory manner. For example, the Agreement for California, which received about 10 percent of ARRA highway infrastructure grants, simply made a few brief background-related references to ARRA, while providing no detail of related FHWA and State roles and responsibilities. For the other five Agreements, the Division Offices responsible for Colorado, Louisiana, South Carolina, Virginia, and West Virginia recognized ARRA’s significant oversight risks and updated their Agreements accordingly.

FHWA did not agree that the Agreements should have been updated to reflect ARRA, believing that the 2009 Risk Management Plan was sufficient to address this new program since this document is used by the Division Offices to plan their

oversight actions. FHWA's Risk Management Plan, however, is an internal planning document that discusses risks associated with ARRA and risk mitigation strategies. The plan does not focus on how ARRA may have altered State roles and responsibilities, or whether ARRA may have resulted in the need to adjust Agreements accordingly. The lack of attention to ARRA in most Agreements also runs counter to FHWA's 2009 ARRA guidance on Federal-aid Program Stewardship and Oversight, which recommended that Division Offices adjust their stewardship and oversight activities "...to account for the high visibility and degree of risk that is associated with delivering this large infusion of funds." Furthermore, the 2011 Guidance now recognizes the necessity to update Agreements, stating that "...updates to an Agreement should be considered...when significant new legislation...occurs," which would certainly apply to ARRA. By not amending Agreements to address changes in FHWA and State roles and responsibilities due to ARRA, FHWA leaves itself vulnerable to misunderstandings on how risk mitigation strategies would be implemented and on each party's responsibilities in carrying out ARRA requirements.

Agreements did not consistently reflect LPA oversight risks. Each year, States entrust approximately \$8 billion in FAHP funds to LPAs. In addition to the annual FAHP funding, ARRA invested an estimated \$8 billion in LPA projects over a 6½-year period. FHWA has identified, and our prior work has pointed out,⁸ key LPA program oversight risks, including inadequate contract administration, quality assurance processes, and noncompliance with Federal requirements. Despite the risks FHWA identified and the long history of internal control weaknesses in the management of LPAs, only 22 of the 55 Agreements we reviewed addressed State and LPA roles and responsibilities in depth, while an additional 25 only cursorily included LPA oversight. The Connecticut Agreement, for example, included a detailed matrix of the roles and responsibilities of LPAs in the administration of the FAHP. In contrast, the Illinois Agreement makes a general reference to State responsibilities to ensure Federal requirements are met on locally administered projects, but no specifics are provided.

Additionally, in December 2006, FHWA's Office of Professional and Corporate Development recommended that States implement Local Project Stewardship Agreements with LPAs, but we found that only 12 States had done so. Accordingly, Agreements did not consistently detail how LPA oversight risks should be addressed, despite being a concern of FHWA management for many years.

Agreements did not consistently reflect FHWA's safety priorities. FHWA considers safety of such importance that FHWA's National Highway Institute

⁸ OIG Report Number MH-2011-146, "Federal Highway Administration's Oversight of Federal-aid and Recovery Act Projects Administered by Local Public Agencies Needs Strengthening," July 15, 2011. OIG reports are available on our Web site: www.oig.dot.gov.

training emphasizes that stewardship and oversight responsibilities, especially as related to "...the Highway Safety Improvement Program, as well as other critical safety considerations, should be reflected in the stewardship and oversight agreements developed by each Division."⁹ FHWA's Office of Safety guidance to Division Offices identified five critical safety areas to be included in Agreements, including the Highway Safety Improvement Program (HSIP), Strategic Highway Safety Plan, Crash Data Systems and Analysis, Required Safety Program, and Focused Safety Program. FHWA also provided a fully worded, ready-to-use "Sample Agreement" template addressing elements within each of the five safety areas that could be incorporated into Agreements. For example, the HSIP template section includes agreement language that the "State will annually submit required reports on the effectiveness of the HSIP program..." Although safety is one of FHWA's priorities and FHWA emphasized the importance of it in Agreements in a separate memorandum, our review found that only 2 of the 51 Agreements included all of the 5 critical safety areas, while 40 Agreements (78 percent) included some elements, and 9 Agreements (18 percent) did not include any.¹⁰ The two Agreements that included all five safety areas, Indiana and North Carolina, closely followed the template provided by FHWA's Office of Safety and included most of the recommended language in each safety area.

Agreements did not consistently provide performance and compliance indicators. FHWA's 2006 and 2011 Guidance recommend that the States and Division Offices use indicators, such as project cost escalation, level of oversight, or project delivery, to assess the effectiveness of State-assumed responsibilities, and evaluate performance and compliance with Federal requirements. FHWA envisioned a joint State and Division Office examination and discussion of performance data at least annually to effectively manage and improve program delivery. Further, the establishment and review of performance measures and indicators help ensure that actions are taken to address risks. Yet, we found that only 28 of the 55 Agreements we reviewed included some form of data-driven performance and compliance indicators to track whether FAHP processes are working as intended. By not establishing such indicators in Agreements, FHWA limits its ability to carry out a risk-based oversight approach and assess performance.

FHWA's agreement with Georgia provides an example of an Agreement that included performance indicators. The Georgia Agreement identified 38 performance indicators, such as "Percent of contracts (completed) with less than 10 percent cost increase" and "Value engineering annual cost savings." Indicators such as the ones identified in the Georgia Agreement are necessary to

⁹ Module 10 from the National Highway Institute course, Federal-aid 101, "Safety."

¹⁰ According to FHWA, these critical safety considerations do not apply to the following 4 of the 55 Agreements: the U.S. Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands.

support FHWA's risk-based oversight approach, alerting Division Offices and States to implement countermeasures or adjust oversight when performance data are not moving in the desired direction.

FHWA Had Not Fully Implemented Its Statutory Oversight Responsibilities for Projects on the Interstate Highway System

In 1998, TEA-21 required FHWA to enter into agreements with States regarding the extent to which each State can assume FAHP oversight responsibilities.¹¹ Based on our review, the language of TEA-21 did not extend oversight authority to States on new or reconstruction projects on the Interstate Highway System that cost \$1 million or more. Oversight for these projects was the responsibility of the Federal Government. However, we found that FHWA had agreed to a practice of pre-approving projects in lieu of States assuming full oversight responsibilities, and nine Division Offices had entered into Agreements that allowed States to assume such responsibility.

In regard to the Agreements, FHWA explained that it had simply pre-approved projects that it considered "inherently low-risk" projects, in advance of actual delivery of the projects' designs, plans, specifications, estimates, contract awards, contract administration, and inspections. FHWA stated that pre-approving inherently low-risk projects fulfilled FHWA's oversight responsibilities through risk management.¹² While FHWA's policy of pre-approving "inherently low-risk" projects might be consistent with its risk-based approach to oversight, we are still concerned that FHWA's practice of entering into Agreements that substitute State oversight for FHWA oversight was inconsistent with Federal law. We do not agree with FHWA's position, as we found no practical difference between FHWA's pre-approval approach and States' assumption of oversight responsibilities reserved to FHWA by law. Regardless of how this practice was labeled, FHWA is relinquishing significant oversight responsibility to the States.

FHWA has entered into Agreements that allow States to assume oversight authority on new or reconstruction projects on the Interstate Highway System that cost well in excess of \$1 million. For example, FHWA's Agreement with Texas allowed the State to assume "FHWA's responsibilities for all project approval and oversight for Federal-aid projects...except those designated as Federal oversight projects." The Agreement states that the established threshold for designating an Interstate project as a Federal oversight project is that the project costs are equal to or greater than \$4 million, \$10 million, or \$30 million, depending on the project's location in Texas. With FHWA overseeing only those projects with costs that far

¹¹ Our work was performed prior to the July 6, 2012, Moving Ahead for Progress in the 21st Century Act (Pub. L. No. 112-141).

¹² FHWA's February 22, 2007, memorandum, "Inherently Low-Risk Oversight Projects on the Interstate System - Programmatic Agreement," defines for the Division Offices inherently low-risk projects.

exceeded the statutory threshold of \$1 million, FHWA's Agreement allowed Texas to assume oversight authority beyond that allowed by law.

Furthermore, based on data in the FHWA Fiscal Management Information System (FMIS), we identified about 600 of 2,500 new or reconstruction projects on the Interstate Highway System, receiving \$5 billion of Federal funds, that cost \$1 million or more each.¹³ FHWA improperly allowed States to assume oversight responsibilities on these projects. For example, Texas was allowed to assume oversight of a bridge reconstruction project even though it included about \$110 million in Federal funds. We also found that FHWA was not consistently applying its approach of limiting pre-approval to inherently low-risk projects. For instance, FHWA allowed States to assume oversight of 23 "design-build" Interstate projects, totaling \$302 million in Federal funds, which are specifically excluded from being defined as inherently low-risk in FHWA's 2007 guidance.¹⁴

FHWA GUIDANCE AND OVERSIGHT ARE NOT SUFFICIENT FOR DEVELOPMENT AND UPDATE OF AGREEMENTS

FHWA Headquarters did not give sufficient guidance to Division Offices or adequately oversee the development and update of Agreements. Neither the 2006 nor the 2011 Guidance is sufficiently clear as to what the Agreements are required to contain. Additionally, FHWA oversight has not been sufficient to make sure Agreements are updated when conditions change and that Agreements reflect FHWA's commitment to its risk-based oversight approach.

Guidance for the Development of Agreements Was Not Clear

FHWA's 2006 Guidance was not clear as to what elements were expected to be included in the Agreements. An FHWA Headquarters official responsible for the development of the Guidance stated that that the Guidance is intended to be more than suggestions and expects Division Offices to follow the Guidance to the maximum extent applicable, consistent with the unique conditions in their States. However, this intent was not stated in either the 2006 or the 2011 Guidance, which gave Division Offices wide discretion in determining the level of information to include in Agreements, as well as the process for developing them. As a result, individual Agreements varied widely in how key program areas and program risk areas were included. Specifically:

- FHWA's 2006 Guidance required that Agreements contain five program areas—environment, right-of-way, safety, systems operations and preservation, and design and construction. Of the 55 Agreements we reviewed, 23 (about

¹³ Includes new and reconstruction projects in FMIS designated as "active" projects, as of October 24, 2011.

¹⁴ The design-build approach is an innovative construction technique that allows a single procurement for the design and construction of projects.

42 percent) did not address all of the 5 required program areas, which reflects the limited oversight FHWA provided over Agreements. FHWA's 2011 Guidance identifies 11 program areas, but no longer requires that any of them be included in Agreements. Furthermore, neither the 2006 nor the 2011 Guidance clearly describes what elements of the program areas Division Offices should address in Agreements, or requires Division Offices to document their rationale for including certain areas in their Agreements or for excluding others.

- None of the Agreements we reviewed cited a clear systematic methodology for including or excluding program risk areas. Program risk areas could reflect actual oversight conditions and management priorities in a particular State, or could simply be the negotiated result of what was acceptable to the State. In addition, neither the 2006 nor the 2011 Guidance required Division Offices to directly link the results of their annual risk assessments to their Agreements, despite FHWA's considerable emphasis on its risk assessment process and commitment to ensuring risk-based oversight.
- We found a wide variation in the level of detail Division Offices included in their Agreements. For example, while the number of pages in an Agreement is not an indicator of the quality of an Agreement, the 9-page Agreements with Montana and Rhode Island provided only high-level descriptions of Division and State roles and responsibilities, compared with the more detailed descriptions provided in the nearly 200 pages in the Agreement with South Dakota.

While we recognize that Division Offices should have flexibility to tailor Agreements based on individual State oversight programs and processes, the 2011 Guidance lacks a clear methodology for developing consistent Agreements that would specify required program areas and priorities that must be included in Agreements.

Guidance for Updating Agreements Was Not Clear

Neither the 2006 nor the 2011 Guidance were clear as to when Division Offices are required to update Agreements to reflect changes in the FAHP and State oversight. The 55 Agreements we reviewed were executed between calendar years 2004 and 2011, with most executed in 2009 or earlier. The Michigan Agreement was the oldest agreement, which dated back to 2004, had not been revised at the time of our review despite FHWA's instructions to the Divisions to update the Agreements to conform to the 2006 Guidance as appropriate, and to reflect major legislation enacted in 2005 (SAFETEA-LU) and 2009 (ARRA). In contrast, Colorado and Florida each updated their Agreements three times after the passage of SAFETEA-LU to reflect changing circumstances.

In another instance, FHWA set aside its 2001 Agreement with Puerto Rico¹⁵ in 2003, due to ongoing problems with administering the FAHP. Since then, all FAHP projects have been under FHWA's full oversight. In 2005, FHWA designated Puerto Rico a "high-risk" grantee, but when it lifted the designation in 2008, it did not execute a revised Agreement. A "high-risk" designation increased the importance of a revised Agreement to make sure Puerto Rico had clearly identified oversight roles and responsibilities. However, Puerto Rico still has critically important project roles and responsibilities that have not been identified in an updated Agreement, based on the 2006 Guidance.

Finally, according to the 2006 Guidance, the State and FHWA Division Office should sign the Agreement to signify that it constitutes a Memorandum of Agreement regarding how the FAHP will be administered in the State. However, the 2006 Guidance did not require the update of an Agreement when leadership changes or a formal assessment as to whether leadership changes in a State warrant modifications to the existing agreement, which we found frequently led to Agreements that did not reflect changes in State leadership. While changes in leadership do not necessarily negate the validity of an Agreement, a change in leadership could significantly impact State controls and the oversight roles and responsibilities addressed in an Agreement.

As shown in table 2 on the following page, our review of a random sample of 9 Agreements out of 55 found that 6 of the Division Administrators and 8 of their State transportation counterparts who had signed the Agreements no longer hold those positions. According to the 2011 Guidance, Division Offices are now to consider updating an Agreement when leadership changes or priorities shift as a result of changes in staffing at the State or FHWA Division Office. However, FHWA Headquarters has not provided a mechanism by which to determine whether a Division Office assessed the effect a leadership change would have on the State's program.

¹⁵ Puerto Rico Highway and Transportation Authority.

Table 2. Review of Sample of Agreements for FHWA and State Signatory Approvals

Division/State	Year of Agreement	Agreement Length (Pages)	FHWA Division Administrator Signatory Still Present	State Transportation Signatory Still Present
California	2010	76	No	No
Colorado	2010	99	Yes	No
Georgia	2008	55	Yes	No
Kansas	2007	14	Yes	Yes
Maine	2007	40	No	No
Michigan	2004	15	No	No
Minnesota	2007	100	No	No
Rhode Island	2006	9	No	No
Tennessee	2006	45	No	No

Source: OIG analysis.

Guidance Does Not Detail a Role for Headquarters in Overseeing the Development and Review of Agreements

FHWA Headquarters does not routinely review individual Agreements, even though these reviews could serve as a key control to ensure that Agreements reflect the intent of the Guidance, address FHWA's oversight priorities, and are updated based on changes in oversight conditions. Specifically, while the Directors of Field Services (DFS) are responsible for monitoring Division Offices and representing FHWA Headquarters, neither the 2006 nor the 2011 Guidance defines roles for the DFS in overseeing Division Offices' implementation of the Guidance. Because they report directly to Headquarters, the three DFS are uniquely positioned to take an active role in monitoring Agreements to increase the likelihood that they are properly developed and implemented, in accordance with the intent of the Guidance.

We also found that Division Administrators are signing agreements, but FHWA has contradictory guidance for Agreement signature authority. Both the 2006 and 2011 Guidance specify that Agreements be signed at the Division Office level for FHWA, which is contrary to guidance in FHWA's Delegation and Organization Manual.¹⁶ The Manual authorizes DFS, but not Division Administrators, to sign Agreements with States, thereby providing an appropriate level of executive review. By not requiring DFS to sign Agreements, or to formally document elsewhere their review and approval of Agreements, FHWA bypassed an

¹⁶ FHWA's Delegations and Organization Manual documents the official, approved delegations of authority vested in FHWA by law, regulation, or delegation from the Secretary of Transportation.

important internal control to review Agreements from an FHWA-wide perspective for appropriate stewardship and oversight of Federal funds.

Finally, Agreements are usually prepared by a team consisting of Division Office management, subject matter experts, and technical staff, along with State personnel. Two Division Offices stated they used on occasion an FHWA attorney to review Agreements, even though neither the 2006 nor the 2011 Guidance requires that Agreements receive a legal expert review before signature. While there are no specific requirements to have a legal expert review Agreements, in our opinion, it would be beneficial for FHWA to employ this type of control process in developing Agreements since these are binding agreements between the Federal Government and States that could involve billions of dollars in FAHP funds and have no defined concluding date. The scrutiny that would be applied by a legal expert would ensure Agreements consistently contain appropriate language regarding States' assumption of Federal oversight authority and are written in accordance with Federal law.

CONCLUSION

A key to effective stewardship and oversight of the billions of dollars provided under ARRA and the FAHP is the establishment of clearly defined Federal and State oversight roles and responsibilities, which address program risks and priorities. As Division Offices are just starting to implement the recently issued, expanded Guidance on preparing Agreements, FHWA has an opportunity to further strengthen its Agreements with the States. Our review identified elements that FHWA could add to its Guidance to promote nationwide consistency in Agreements and ensure that higher risk programs and priorities are addressed. If FHWA's intent is to support its risk-based approach to oversight, inclusion of key requirements into the Guidance will standardize FHWA's approach and help to better target its limited resources.

RECOMMENDATIONS

We recommend that the Federal Highway Administrator:

1. Establish basic Agreement requirements and standards that:
 - a. Include Federal requirements, FHWA program risks, and priorities;
 - b. Require Division Offices to document their rationale for not addressing significant requirements, risks, and priorities in their Agreements; and
 - c. Require DFS approval for such actions.

2. Modify FHWA's policy of pre-approval of new or reconstruction projects on the Interstate Highway System that cost \$1 million or more, to meet statutory requirements for FHWA to perform oversight of these projects.
3. Implement a coordinated and effective data-driven, risk-based approach for Division Offices and Directors of Field Services to review Agreements annually and make timely revisions, when appropriate.
4. Enforce the requirement for Directors of Field Services to sign Agreements, as specified in FHWA's Delegation and Organization Manual, or change the Delegation and Organization Manual to allow Division Administrators to sign the Agreements and require Directors of Field Services to formally document elsewhere that they reviewed and approved the Agreements.
5. Develop and implement a process for FHWA to conduct a legal expert review of Agreements, before they are signed, to determine whether Agreements are in accordance with Federal law.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided FHWA our draft report on July 3, 2012, and received its response on September 13, 2012. FHWA's response is included in its entirety in the appendix to this report. In its response, FHWA indicated that it was conducting a national scan of Division-level management approaches to oversight, including the effectiveness of Stewardship and Oversight Agreements. Based on the issues we encountered in the course of our audit, we agree with this action. In addressing our recommendations, FHWA concurred with recommendation 5 and concurred in part with our remaining 4 recommendations. We consider recommendations 4 and 5 to be resolved but open pending receipt of documentation supporting the actions taken.

Regarding recommendations 1 and 3, FHWA partially concurred, but stated that, in its opinion those recommendations were overly prescriptive and did not adequately address the differences between States. According to FHWA, no further actions are needed because other oversight documents, methods, and tools, particularly each Division Office's Program of Oversight Initiatives (POI), address the issues raised in our report. While we disagree that our recommendations would impose a "one size fits all" set of prescriptive requirements, we recognize that alternative approaches exist for improving the development and implementation of Agreements. However, FHWA's response emphasizes a much larger role for POIs than the Agency previously described to us, and we have no evidence that FHWA has effectively spelled out the relationship between POIs and Agreements or ensured that POIs are integrated into the Agreement process for all States. For

example, the 2011 Agreement Guidance has only a cursory reference to POIs. Thus, while we accept FHWA's increased emphasis on the use of POIs as a key oversight mechanism in lieu of making changes to its Agreement process, we require additional evidence to support the claims FHWA made in its response. Accordingly, we consider recommendations 1 and 3 unresolved until FHWA has provided an action plan that (1) further clarifies the intended relationship between Agreements and POIs, and (2) identifies the criteria to be used by the DFS for approving POIs. We also request that FHWA demonstrate it has integrated POIs into the Agreement process by providing us with FHWA guidance that reflects this process and copies of POIs executed for all Division Offices. The POIs should reflect FHWA's emphasis on the role of POIs in the guidance and show the DFS have appropriately approved them.

For recommendation 2, FHWA partially concurred, stating that the Moving Ahead for Progress in the 21st Century Act (MAP-21) now allows the States to assume authority for projects on the Interstate Highway System and clarified congressional intent to be consistent with FHWA's existing practices. MAP-21, which became law on July 6, 2012, revised FHWA's statutory oversight framework. However, it requires that FHWA define high-risk categories and prohibits States from assuming FHWA responsibilities within that category of projects. Given that we found FHWA previously developed policies inconsistent with Federal law, we are concerned similar issues may arise as FHWA develops policies to implement MAP-21 oversight requirements. As a result, we consider this recommendation to be unresolved until FHWA provides us a date when it will update its policy that defines high-risk Interstate projects.

ACTIONS REQUIRED

In accordance with follow-up provisions in Department of Transportation Order 8000.1C, we request that FHWA provide documentation demonstrating completion of its planned actions for recommendations 4 and 5 within 30 days after they are completed. For recommendation 2 we request a target action date within 30 days. For recommendations 1 and 3 we request that FHWA provide the additional information requested and target action dates within 30 days.

We appreciate the courtesies and cooperation of FHWA representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-5630 or David Pouliott, Program Director, at (202) 366-1844.

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cc: DOT Audit Liaison (M-1)

EXHIBIT A. SCOPE AND METHODOLOGY

We conducted this performance audit from May 2011 through June 2012, 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.

To assess the extent to which Agreements fully reflected Federal requirements, FHWA risks, priorities, and appropriate monitoring and timely update, we reviewed all of the current 55 Agreements. In this review, we performed a descriptive analysis of the Agreements, compared the content of the Agreements, and evaluated whether Agreements included selected FHWA oversight program risks and priorities. Our analysis also focused on risk areas relating to (1) the implementation of ARRA, which added new FHWA and State oversight roles and responsibilities for administering funds, transparency, and reporting; (2) LPA oversight, which FHWA has identified as a significant ARRA oversight challenge and had received significant ARRA funds; (3) the Highway Safety Improvement Program, which FHWA separately identified as a major element of Agreements and established specific areas to be addressed; and (4) the use of performance and compliance indicators to manage the FAHP and improve program delivery.

Further, to assess the extent to which States may have improperly assumed oversight over certain Interstate highway projects, we performed a legal review of pertinent legislation, laws, and FHWA policy, supported with an analysis of data obtained from FHWA's FMIS.

To assess the extent to which FHWA's guidance and oversight were sufficient for the development and update of Agreements, we interviewed FHWA Headquarters staff and the three DFS. In addition, we randomly selected nine Agreements for review and interviewed the Division Administrators and their staff involved in developing and reviewing those nine Agreements. We also interviewed other Division Offices, when necessary, to clarify information contained in Agreements. Additionally, we examined FHWA's Stewardship and Oversight Guidance and compared it to actual Agreements. We also reviewed other FHWA and Office of Management and Budget guidance and memoranda relating to ARRA and stewardship and oversight.

EXHIBIT B. MAJOR CONTRIBUTORS TO THIS REPORT

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APPENDIX. AGENCY COMMENTS



U.S. Department
of Transportation

**Federal Highway
Administration**

Memorandum

Subject: **INFORMATION**: Federal Highway
Administration Response to Office of Inspector
General (OIG) Draft Report on Stewardship and
Oversight Agreements

Date: September 13, 2012

From: Victor M. Mendez
Administrator

In Reply Refer To:
HIF/HCF

To: Calvin L. Scovel III
Inspector General (J-1)

Over the past 2 decades, Congress has shifted the oversight approach of the Federal Highway Administration (FHWA) away from the individual project level to a broader program-based model. The Intermodal Surface Transportation Efficiency Act of 1991 assigned many FHWA responsibilities to the States, an initiative furthered in 1998 by the Transportation Equity Act for the 21st Century, which also required FHWA and the States to enter into an agreement relating to the extent to which the State assumes the responsibilities of FHWA. In response, FHWA required Stewardship and Oversight Agreements (Agreements) to formalize the respective roles and responsibilities of FHWA and the State departments of transportation (DOT) for the federally assisted, State-administered Federal-aid highway program (FAHP). The FHWA continues to evaluate the recent changes enacted within the most recent surface transportation funding authorization, Moving Ahead for Progress in the 21st Century Act (MAP-21).

Stewardship and Oversight Agreements Delineate Roles and Responsibilities

The OIG draft report does not accurately portray the role of Stewardship and Oversight Agreements, or how Agreements fit within FHWA's overall oversight context. Stewardship and Oversight Agreements with the States are intended to delineate oversight responsibilities among the FAHP participants. They are not intended to provide a one-stop-shop for all matters relating to the working relationship between FHWA and the States, nor are they expected to provide comprehensive guidance with regard to the FAHP. In order to provide a more accurate understanding of what the Agreements are and what they are not, it is necessary to examine FHWA's oversight actions from the overall context of its complete system of internal controls.

With the general devolution of authority for the conduct of highway projects moving from the Federal Government to the States over a series of surface transportation authorizations at Congress' direction, these documents are intended to suit the needs of unique State

circumstances and the FHWA Division Offices with which they interact. These Agreements were intended to simply outline roles and responsibilities in whatever way was most useful to the States and Division Offices based on each State's needs – they were not intended to be consistent from State to State or enforce requirements that do not add value to the program. For example, it is not constructive to require the States to explain the rationale for not including discussion of requirements that are not applicable to their given circumstances, such as including locally administered projects when a State does not normally allow them. As a result, it is important to understand and expect that for example, the Stewardship and Oversight Agreement with California is different from the Agreement with Delaware.

Stewardship and Oversight Agreements are just one of many documents outlining the detailed requirements, risks, and priorities involved in administering the FAHP. Agreements therefore serve as a compendium of elements that go beyond statutory requirements, making reference to the many other control documents that are continually reviewed and updated – such as Leadership Dashboard targets, Unit Plans, the Risk Register, Financial Integrity Review and Evaluation reports – along with State DOT manuals and procedures reviewed by FHWA. Together, these documents enable FHWA to assess how State DOTs fulfill their respective responsibilities.

Since Stewardship and Oversight Agreements are intended to serve the direct needs of the States and the FHWA offices providing oversight, they are afforded flexibility under guidance to address those needs important to State and local conditions. While the OIG draft report cites as an inconsistency the fact that 9 of 55 Agreements referenced the American Recovery and Reinvestment Act (Recovery Act), FHWA considers it a demonstration of the strength of the Agreements and their inherent flexibility. From a national perspective, it was not necessary to adjust oversight requirements due only to the source of project funding. Recovery Act funds, by statute, were to be spent within the context of existing programs, which have established internal controls. The fact that 9 States and FHWA Division Offices considered their programs and saw it useful to adjust their Stewardship and Oversight Agreements demonstrates the utility and resiliency of these Agreements. The OIG draft report does not include an evaluation of the rationale behind these decisions, nor does it evaluate States' reasons for not revising Agreements, which likely saw existing systems as sound and adequate for Recovery Act implementation. Further, by not conveying a sense of the context in which these Agreements function, particularly in the Recovery Act environment, the report does not acknowledge FHWA's enhanced internal controls for the Recovery Act, such as the FHWA National Review Teams.

Stewardship and Oversight Agreements Are Only One Element of FHWA Oversight Planning

The utility and effectiveness of Stewardship and Oversight Agreements should be considered within the context of each Division Office's Program of Oversight Initiatives (POI). The POI conveys the oversight schema describing how each FHWA Division Office implements oversight within an overall context of national and State requirements, risks, and priorities.

Much of the specific content that the OIG draft report concluded was missing from Agreements is included in the POI, risk registers, and the unit plans. The POI references identified risks and oversight initiatives and is updated annually in accordance with established guidance. The POI's linkage to Stewardship and Oversight Agreements and other key oversight documents provide clear traceability between the Division Offices' risk analysis and planned program management initiatives—including progress tracking systems, national and division-level reviews, results of performance indicator trend analyses, and comprehensive lists of priority risks and progress toward mitigation. Agreements provide the outline of responsibilities between the State DOT and FHWA and should not be considered independent of all the other aspects of FHWA's comprehensive, risk-based oversight approach, such as the POI, risk registers, and the unit plans.

FHWA Refining Stewardship Agreement Requirements, Implementation, and Oversight Due to New Authorizing Legislation

The FHWA has conducted periodic reviews to ensure that Stewardship and Oversight Agreements fulfill their role as effectively as possible, resulting most recently in the 2011 revision of FHWA's Stewardship and Oversight guidance, which called for more comprehensive Agreements covering project delivery and financial controls of the FAHP. The revisions implemented in 2011 are increasing the utility of these Agreements and providing greater clarity for them. At a minimum, Agreements updated since the release of the guidance should cover how the Division Office and the State DOT will develop and implement program reviews to evaluate compliance with established procedures and policies, including documentation of States' internal controls and pre-determined schedules for regular reviews of specific programs or components, such as project management plans, initial and annual finance plan submissions, cost estimate reviews, internal evaluations, and risk assessments. For projects where oversight is assumed by the State DOT, FHWA retains authority for submission of risk assessment materials, sharing of reviews and strategic performance information, and reviewing the adequacy of the documentation to support the appropriate expenditure of Federal-aid funds.

Since FHWA issued the 2011 guidance, 34 FHWA Division Offices, in coordination with their respective States, have identified a need to update their Stewardship and Oversight Agreements and plan to complete the updated Agreements by 2013. All 7 completed Agreements to date conform to the guidance template, including reference to performance measures and internal control documents such as risk assessments, program reviews, quality assurance reviews, project and process evaluations, and performance management indicators. The OIG draft report, in its call for prescriptive requirements and national uniformity, seems somewhat retrospective in its perspective, and ignores the Federal Government's overall movement away from one-size-fits-all requirements and toward more functional requirements that enable locally appropriate solutions that can be fulfilled in a manner that makes sense to those doing the work. The utility of these Agreements is measured by whether they include elements useful to Division Offices and States in fulfilling overall national requirements, and not in counting the presence or absence of specific elements.

To ensure that Division Offices and States are effectively implementing requirements for Stewardship and Oversight Agreements, and to best position FHWA to be able to accommodate the continued evolution of Federal and State roles envisioned in MAP-21, the FHWA Program Management Improvement Team (PMI Team) is conducting a national scan of division-level management approaches to oversight, including the effectiveness of Agreements. Specifically, it will review relevant strategic planning and risk management documents, Agency and division-level guidance, and external audit reports; interview leadership and staff to gauge how they implement and measure oversight initiatives and track the implementation of planned initiatives presented in the POI; and assess the use of Agreements and Agreement guidance in providing an oversight framework for State and locally administered activities. Upon completion of this review, the PMI Team will identify recommendations to help improve future FHWA oversight.

OIG Recommendations and FHWA Responses

Recommendation 1: Establish basic Agreement requirements and standards that:

- a. Include Federal requirements, FHWA program risks, and priorities;
- b. Require Division Offices to document their rationale for not addressing significant requirements, risks, and priorities in their Agreements; and
- c. Require Director of Field Service (DFS) approval for such actions.

FHWA Response: Concur in Part. The FHWA does not agree that these Agreements should be based on a one-size-fits-all set of prescriptive requirements. In other words, one should expect that for example, the Stewardship and Oversight Agreement with California is different from the Agreement with Delaware. Stewardship and Oversight Agreements, as required by Federal statute, are an outline of roles and responsibilities for administering the FAHP; they are not required to contain specific requirements, risks, or priorities. Rather, Agreements reference documents that do contain this information or methods that will be considered, such as the POI, unit plans, risk assessments, and review programs. The POIs require the DFS' agreement and approval and are used by the DFSs to monitor and assess the Division Offices proposed oversight activities over FAHP recipients. Since the Agreements include reference to the POI and other oversight planning tools, which serve as more practical means to capture requirements, program risks and priorities, they fulfill the actions and intent outlined in the OIG recommendation. Based on actions already taken by FHWA relating to this recommendation, FHWA requests OIG close the recommendation upon receipt of this response.

Recommendation 2: Modify FHWA's policy of preapproval of new or reconstruction projects on the Interstate Highway System that cost \$1 million or more, to meet statutory requirements for FHWA to perform oversight of these projects.

FHWA Response: Concur in Part. Section 1503 in the MAP-21 legislation allows States to assume FHWA's authority for projects on the Interstate System at the discretion of the Secretary. As this legislation clarified congressional intent, which is consistent with FHWA's

practice, FHWA requests OIG close the recommendation upon receipt of this response.

Recommendation 3: Implement a coordinated and effective data-driven, risk-based approach for Division Offices and Directors of Field Services to review Agreements annually and make timely revisions, when appropriate.

FHWA Response: Concur in Part. The FHWA already does this through the POIs, which is a data-driven, risk-based approach for annually reviewing FHWA Division Offices' oversight initiatives. To identify opportunities for improvement, POIs are reviewed by the DFSs and Division Offices. The FHWA guidance encourages Agreement revisions according to these identified opportunities as appropriate when priorities change. Based on FHWA already having completed the work necessary to satisfy the recommendation and for reasons exemplified in response to recommendation 1, FHWA requests OIG close the recommendation upon receipt of this response.

Recommendation 4: Enforce the requirement for Directors of Field Services to sign Agreements, as specified in FHWA's Delegation and Organization Manual, or change the Delegation and Organization Manual to allow Division Administrators to sign the Agreements and require Directors of Field Services to formally document elsewhere that they reviewed and approved the Agreements.

FHWA Response: Concur in part. The FHWA Delegations and Organization Manual provides the authority for Division Administrators to sign Stewardship and Oversight Agreements. Though Agreements are not explicitly mentioned, Chapter 5 of the Manual on the FAHP authorizes Division Administrators to approve projects at all levels of development, and Chapter 1 regarding "Residual Authorities" asserts that "authorities not specifically delegated to FHWA officials...may be exercised by...Division Administrators."

While FHWA's practices have been consistent with our current delegations of authorities, FHWA recognizes the benefit of being more explicit in our FHWA Order regarding the signature level of Stewardship and Oversight Agreements. Therefore, FHWA plans to clarify the authority of Division Administrators to sign Agreements with State DOTs in the Manual or through issuance of a guidance memo. To allow for adequate review of the results and recommendations from the PMI Team's national efforts, the FHWA plans to perform this update by December 31.

Recommendation 5: Develop and implement a process for FHWA to conduct a legal expert review of Agreements, before they are signed, to determine whether Agreements are in accordance with Federal law.

FHWA Response: Concur. The Stewardship and Oversight Agreement Guidance developed in 2011 received legal review, and FHWA intends to formalize a process to include a legal

review to ensure that Agreements are consistent with laws, regulations, and policies, especially in light of MAP-21. To allow for adequate review of the results and recommendations from the PMI Team's national efforts, by December 31, FHWA will establish through guidance or memo procedures to include a legal review as part of the concurrence process before Agreements are signed by the Division Administrator and the State DOT.

The FHWA appreciates the opportunity and time afforded to respond to the draft report. If you have any questions or comments regarding this response, please contact David Nicol, Director of Program Administration, Office of Infrastructure, at 202-366-5530.