
Office of Inspector General

Audit Report

Fiscal Year 1998
Financial Statements
Federal Aviation Administration

Report Number: FE-1999-070
Date Issued: March 8, 1999





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

Memorandum

Subject: **INFORMATION: Report on Fiscal Year 1998
Financial Statements, Federal Aviation Administration
FE-1999-070**

Date: March 8, 1999

From: Kenneth M. Mead
Inspector General

Reply To
Attn Of: Meche:x61496

To: The Secretary
Thru: The Deputy Secretary

I respectfully submit the Office of Inspector General (OIG) report on the Federal Aviation Administration (FAA) Financial Statements for the Fiscal Year (FY) 1998 ended September 30, 1998. This report is required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

The audit report is the responsibility of the OIG. All other information--including the Management Discussion and Analysis, Financial Statements, Notes, and Supplemental Information--is the responsibility of FAA. Our audit was limited to the Financial Statements as of, and for the year ended, September 30, 1998.

Our efforts this year focused on actions taken on five previously reported material weaknesses that included real property (land, buildings, and structures), personal property (equipment), work-in-process, accounting for field spares, and inventory valuation. FAA also prepared, for the first time, and we audited the Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing.

During FY 1998, FAA completed significant corrective actions on its inventory. FAA revised inventory prices from standard cost to weighted average cost and performed a "wall to wall" inventory of spare parts at over 800 field units. As a result, FAA improved the accountability and overall management of its spare part inventories located throughout the country. FAA is establishing a perpetual accounting system for the field spares to correct its control weaknesses.

Real property, personal property, and work-in-process, reported at \$11.9 billion, still could not be substantiated. We were unable to substantiate the acquisition cost of real property reported at \$2.5 billion. For 117 real property items valued at

\$790 million, we found 41 items recorded at \$419 million were not properly valued; 34 items recorded at \$141 million could not be supported; and 4 items valued at \$50 million should be removed from property records. For example, a critical power system installed in 1992 was reported at \$20 million. FAA was only able to provide contracts, purchase orders, payment records, and other support for \$3.6 million. We also identified a building that was demolished over 10 years ago was still on FAA's records at \$1 million.

A comparison of contracts for new equipment to personal property records showed FAA's equipment account was understated by at least \$1 billion. The understatement of these assets primarily resulted from improper expensing of capital costs. For example, the voice switching control systems installed at 23 locations were recorded at \$234 million, instead of the true cost of \$1.1 billion. Unless FAA establishes supportable values for its substantial property investments, it will be unable to accurately compute depreciation and recoup its full cost through user fees.

FAA was unable to provide supporting cost documentation to substantiate the \$2.1 billion recorded in the work-in-process account. As property is acquired and buildings are constructed for specific projects, associated costs are charged to, and accumulated in, a work-in-process account until projects are completed and systems are placed in service. FAA estimates there was \$1.3 billion of completed projects in backlog as of September 30, 1998. For example, FAA completed construction of an air navigation facility in 1995 at a cost of \$746,000. As of December 31, 1998, the facility remained in the work-in-process account. This backlog causes an understatement of depreciation expenses.

We also reviewed 185 projects from 7,345 active projects in the work-in-process account, and found 34 percent did not have transaction histories. Without transaction histories, recorded amounts cannot be traced to supporting documentation, such as invoices or contracts. For example, FAA spent \$1.2 million on a flight service station during FY 1998. FAA could only provide transaction histories for costs of \$123,000, leaving \$1.1 million unsupported. As a result, we were unable to substantiate the accumulated costs for active projects.

FAA agrees property weaknesses exist, and initiated plans to correct these material weaknesses by September 30, 1999. We agree with FAA's corrective action plans, and we are closely monitoring resolution of the property issues.

We encountered problems with the new statements required for FY 1998. The presentation of the Statement of Net Cost by each FAA line of business was a giant step towards development of cost accounting information that would relate to operational data supporting performance measures. However, the Statement of Net Cost could not be substantiated because of delays in implementation of the cost

accounting system which led to the late completion of the statement. Since the system was in the development stage, we did not determine if expense transactions were charged to correct cost centers, whether total expenses charged to costs centers were accurately accumulated to the six lines of business, and whether administrative overhead expenses were accurately distributed.

We also could not substantiate material items on the Statement of Budgetary Resources and Statement of Changes in Net Position. The Statement of Financing showed an \$877 million unexplained difference between the Statement of Budgetary Resources and Statement of Net Cost.

Correction of these material weaknesses will improve FAA's accountability and financial credibility, and provide accurate financial data to support budget requests, management decisions, and user fees.

FAA also is required to include excise tax revenues (revenues) in its Financial Statements. However, the Department of Treasury (Treasury) has control over collecting and reporting of revenues for the Airport and Airway Trust Fund. Last year, we asked the General Accounting Office (GAO) to review Treasury procedures for estimating and certifying revenues. GAO found errors and internal control weaknesses related to reporting and certifying total government excise tax revenues, and estimated these revenues were potentially overstated by as much as \$571 million.

For FY 1998, we again asked GAO to review the Treasury's Office of Tax Analysis (OTA) estimating process and the Internal Revenue Service (IRS) quarterly certification process. GAO concluded internal control weaknesses still exist. Major weaknesses included IRS written procedures for certifying revenues and timely processing of tax returns. We again found significant variances between OTA estimates and IRS-certified revenues. For the five quarters ended June 1998, variances between estimated and actual revenues ranged from an understatement of \$598 million to an overstatement of \$276 million. This Treasury issue is totally outside the control of FAA and the Department of Transportation (DOT).

Because we could not determine the reliability of significant portions of the Financial Statements, we are unable to express, and we do not express, an opinion (commonly called a disclaimer of opinion) on the FAA Financial Statements as of, and for the year ended, September 30, 1998.

We identified three other significant issues. Although these issues are important, they would not necessarily prevent FAA from receiving an unqualified audit opinion.

- The National Civil Aviation Review Commission called for strong financial controls, including a reliable cost accounting system by October 1998, so that FAA could manage its resources in a businesslike manner, and allocate its cost correctly and fairly as the basis for a cost-based user fee system. FAA still lacks the detailed and reliable cost data to accurately distribute its cost. The FAA cost accounting system was scheduled to be operational by October 1, 1998, but will not be fully implemented until March 31, 2001. Consequently, FAA may not be able to realize the \$1.5 billion in user fees proposed in its FY 2000 budget.
- FAA was not in compliance with the Federal Financial Management Improvement Act of 1996 because the Department's accounting system was not used to prepare the Financial Statements, and the accounting system was not the only source of financial information. FAA made 349 closing and adjusting entries, totaling \$51 billion, outside the accounting system to prepare the Financial Statements.
- The performance measures presented in the Management Discussion and Analysis did not provide information about the cost effectiveness of FAA programs, and did not relate to the information presented in the Statement of Net Cost. Only two of the nine performance measures included FY 1998 performance data.

Our report on the FY 1997 FAA Financial Statements disclosed efforts were in process to complete corrective action on 21 prior recommendations. We are not making new recommendations this year because efforts are still underway on 17 recommendations. Since problems with the new statements and trust fund revenues are common to FAA and other DOT Operating Administrations, recommendations addressing these issues will be made in our report on the DOT Consolidated Financial Statements.

A draft of this report was provided to the FAA Assistant Administrator for Financial Services on February 24, 1999. We considered his comments in preparing this report. He agreed with the issues, and said FAA expects to have all corrective actions completed by September 30, 1999.

We appreciate the cooperation and assistance of FAA and DOT representatives. If we can answer questions or be of any further assistance, please call me at (202) 366-1959, or John Meche at (202) 366-1496.

Attachments

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**DEPARTMENT OF TRANSPORTATION
INSPECTOR GENERAL'S INDEPENDENT REPORT ON
FEDERAL AVIATION ADMINISTRATION
FISCAL YEAR 1998 FINANCIAL STATEMENTS**

To the Federal Aviation Administrator

The Department of Transportation (DOT), Office of Inspector General (OIG), audited the Federal Aviation Administration (FAA) Financial Statements as of, and for the year ended, September 30, 1998. We were unable to express an opinion on the Financial Statements because we could not substantiate the acquisition value for property, plant, and equipment reported at \$11.9 billion. The Statement of Net Cost could not be substantiated because of delays in the implementation of the cost accounting system which led to the late completion of the statement. We also could not substantiate material items on the Statement of Budgetary Resources and Statement of Changes in Net Position. The Statement of Financing showed there was an \$877 million unexplained difference between the Statement of Budgetary Resources and the Statement of Net Cost.

We also are reporting on internal accounting and administrative control systems, and compliance with laws and regulations, as applicable to the FAA Financial Statements. We performed the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin 98-08, Audit Requirements for Federal Financial Statements, as amended on January 25, 1999.

Our audit objectives for the FY 1998 Financial Statements were to determine whether (1) the principal Financial Statements are presented fairly in accordance with OMB Bulletin 97-01 as amended on November 20, 1998; (2) FAA has an adequate internal accounting and administrative control structure; (3) FAA has complied with laws and regulations which (a) could have a direct and material effect on the Financial Statements or (b) have been specified by OMB; (4) the information and manner of presentation in the Management Discussion and Analysis is materially consistent with the information in the Financial Statements; and (5) the internal control structure ensured the existence and completeness of reported data supporting performance measures.

This report presents our disclaimer of opinion on the FAA Financial Statements as of, and for the year ended, September 30, 1998. The financial information in the Management Discussion and Analysis and Supplemental Information was materially consistent with the Financial Statements. We are including our reports on the internal control structure, and compliance with laws and regulations, in Sections B and C of this report.

A. DISCLAIMER OF OPINION ON FINANCIAL STATEMENTS

Property, plant, and equipment, reported at \$11.9 billion on the Balance Sheet, could not be substantiated. We were able to determine that personal property (equipment) is significantly understated. The Statement of Net Cost could not be substantiated because of delays in the implementation of the cost accounting system which led to the late completion of the statement. Consequently, we did not determine if expense transactions were charged to correct cost centers, whether total expenses charged to costs centers were accurately accumulated, and whether administrative overhead expenses were accurately distributed. The understatement of equipment, and the backlog in the work-in-process account, cause an understatement of depreciation expense on the Statement of Net Cost.

We also could not substantiate material items on the Statement of Budgetary Resources such as Unobligated Balance (\$7.2 billion), and Statement of Changes in Net Position such as Increase (Decrease) in Unexpended Appropriations (\$380 million). We again found significant variances between the Department of Treasury estimated and certified excise tax revenues for the Airport and Airway Trust Fund. The Statement of Financing showed there was an \$877 million unexplained difference between the Statement of Budgetary Resources and the Statement of Net Cost.

Because we could not determine the reliability of significant portions of the Financial Statements, we are unable to express, and we do not express, an opinion on the FAA Financial Statements as of, and for the year ended, September 30, 1998.

B. REPORT ON INTERNAL CONTROL STRUCTURE

While the purpose of our work was not to express, and we do not express, an opinion on internal controls, we found material internal control weaknesses that contributed to reportable conditions. Our work would not necessarily disclose all material internal control weaknesses.

MATERIAL WEAKNESSES

The following sections describe material weaknesses we identified, and their effect on the Financial Statements and management of FAA operations. The financial statement weaknesses were reported to OMB and Congress as part of the Department's reporting under the Federal Managers' Financial Integrity Act.

Accounting for Property, Plant, and Equipment

Real Property

We were unable to substantiate the acquisition cost of real property (land, buildings, and structures) reported at \$2.5 billion. Improvements continue to be needed in the accuracy and reliability of real property records. The FAA Real Property Record System includes property that is not valued correctly or whose stated value is not supported. We also found unrecorded property during our site visits. As of April 30, 1998, real property records contained 11,132 property items, recorded at \$25,000 or greater. We sampled 117 items with a recorded value of \$790 million and found:

- 41 items, recorded at \$419 million, were not properly valued,
- 34 items, recorded at \$141 million, could not be supported, and
- 4 items, valued at \$50 million, should be removed from property records.

For example, a critical power system installed in 1992 was reported at \$20 million. FAA was only able to provide contracts, purchase orders, payment records, and other support for \$3.6 million. In another example, a building demolished over 10 years ago was still on FAA's records at \$1 million.

We also identified 52 items, owned by FAA, that were not recorded in the Real Property Record System. FAA could not provide documentation to support the value of these items.

Personal Property

FAA recognizes the reported \$4.1 billion acquisition value for its personal property (equipment) is materially understated as disclosed in Note 9 to its Financial Statements. The understatement of equipment is the result of years of expensing contract costs, associated with bringing equipment into operational status, that should have been added (capitalized) to the asset value. We have preliminarily identified that the value for five of the most costly equipment systems, currently in operation, needs to be increased by at least \$1 billion. For example, the voice switching control systems installed at 23 locations were recorded at a total cost of \$234 million, instead of the true cost of \$1.1 billion. Unless FAA establishes supportable values for its substantial property investments, it will be unable to accurately compute depreciation and recoup its full cost through user fees. The exact amount of the undervaluation for the five systems, and other less expensive systems, is unknown at this time. As a result,

personal property and its related accumulated depreciation are understated on the Balance Sheet, and depreciation expense is understated on the Statement of Net Cost.

Work-in-Process

FAA was unable to provide supporting cost documentation to substantiate the \$2.1 billion recorded in the work-in-process account. As property is acquired and buildings are constructed for specific projects, associated costs are charged to, and accumulated in, a work-in-process account until the projects are completed and systems are placed in service. When completed, the project costs should be transferred to the appropriate real or personal property accounts. Project costs are considered backlog if not removed from the work-in-process account within 6 months after project completion. FAA estimates there was \$1.3 billion in backlog as of September 30, 1998.

We statistically sampled 185 projects from 7,345 active work-in-process projects with accumulated costs estimated at \$887 million. We were unable to obtain transaction histories on 34 percent of the projects. Without transaction histories, recorded amounts cannot be traced to supporting documentation, such as invoices or contracts. For example, FAA spent \$1.2 million on a flight service station during FY 1998. FAA could only provide transaction histories for costs of \$123,000, leaving \$1.1 million unsupported. As a result, we were unable to substantiate the accumulated costs for active projects.

The remaining \$1.3 billion of accumulated project costs, determined by FAA as backlog, also could materially affect the Financial Statements. Depreciation of assets begins only when completed projects are transferred to the appropriate asset account (real or personal property). For example, FAA completed construction of an air navigation facility in 1995 at a cost of \$746,000. As of December 31, 1998, the facility remained in the work-in-process account. Consequently, the backlog in the work-in-process account causes an understatement of depreciation expenses on the Statement of Net Cost. For a sample of 251 backlog projects, we found unrecorded depreciation was at least \$62 million.

The Departmental Accounting and Financial Information System (DAFIS) does not provide detailed information and audit trails to trace transactions to source documents to support the work-in-process balance. Instead, FAA relies on a cost report that has two major deficiencies. The report captures costs which are expensed, and therefore should not be recorded in the work-in-process account. The report also contains costs associated with completed work that should be recorded in the personal or real property accounts. In our report on the FY 1996 Financial Statements, we recommended the cost report be reconciled to summary

account records, or a new database be created to support the work-in-process balance. FAA elected to reconcile the cost report to the work-in-process balance. Over the past 2 years, FAA has been unable to demonstrate that the cost report can be reconciled to the work-in-process balance. FAA has agreed to improve the work-in-process database.

Capitalization Process

FAA does not have an effective process for accumulating costs for acquiring property, and eventually recording these costs in the appropriate real and personal property accounts. This process is commonly referred to as the capitalization process. The most recent study of the capitalization process was conducted by an independent public accounting firm under contract to FAA. The study found FAA Regional Offices were not performing timely closeout of facilities and equipment projects, leaving projects open and accumulated costs in regional work-in-process accounts. The study included 89 recommendations. FAA has implemented some recommendations, but has no comprehensive plan in place to monitor corrective actions taken, to evaluate the impact on the capitalization process, or to evaluate other recommendations to automate this labor-intensive process. FAA has agreed to form a process improvement team to streamline capitalization procedures.

Corrective Action Plans on Property

Elimination of these material weaknesses in its property accounts is essential if FAA is to obtain an unqualified opinion on its FY 1999 Financial Statements. FAA agrees the material weaknesses exist, and has initiated corrective actions. Plans are developed to correct the real property, personal property, and work-in-process weaknesses by September 30, 1999. We agree with the corrective action plans, and we are closely monitoring the work to ensure resolution of issues with property, plant, and equipment.

Cost Accounting Information

The Statement of Net Cost is one of the new Financial Statements required by OMB Bulletin 97-01 for FY 1998. According to the Managerial Cost Accounting Implementation Guide, issued by the Joint Financial Management Improvement Program, the Statement of Net Cost is pertinent to reporting performance results, and provides financial information that can be related to outputs and outcomes of an entity's programs and activities. According to OMB Bulletin 97-01, an entity should report performance measures that provide information about the cost effectiveness of programs, and should be linked to the programs featured in the Statement of Net Cost.

The Federal Aviation Reauthorization Act of 1996 required FAA to establish a cost accounting system. The FAA cost accounting system was to be fully operational by October 1, 1998. However, as of March 1, 1999, the FAA cost accounting system is not expected to be fully operational for all lines of business until March 31, 2001.

FAA decided to present the Statement of Net Cost by its six lines of business. This was a giant step towards development of cost accounting information that relates to operational data supporting performance measures. However, the Statement of Net Cost could not be substantiated because of delays in implementation of the cost accounting system which led to late completion of the statement.

DAFIS does not perform cost accounting, the Department's Financial Statements Module does not produce the Statement of Net Cost, and the FAA cost accounting system was not operational. Although operating costs were distributed among the six lines of business, the statement did not present operating cost for major programs and activities under each line of business. Therefore, the Statement of Net Cost did not relate to the performance measures presented in the Management Discussion and Analysis.

The Statement of Net Cost included an accumulation of expenses for each line of business using an analysis of over one million expense transactions charged to about 9,000 cost centers by the FAA cost accounting system, which was still under development. Consequently, we did not determine if expense transactions were charged to correct cost centers, and whether total expenses charged to cost centers were accurately accumulated to the six lines of business.

Administrative overhead expenses were manually distributed to the six lines of business. After we questioned the basis for distribution of these costs, FAA manually re-distributed nearly \$1.3 billion, increasing costs for Air Traffic Services and reducing costs for the five other lines of business by \$647 million. We did not determine if the administrative overhead expenses were accurately distributed to the lines of business because of the unavailability of the cost accounting system to test distribution of costs.

Using statistical sampling techniques, we estimated FAA overstated current year expenses for airport grants by \$146 million. This overstatement represented prior year grant expenses that were not presented to FAA for payment until FY 1998. For example, on May 20, 1998, the City and County of Denver requested reimbursement of expenses totaling \$30 million for the Denver International Airport, for January 1992 through December 1995. While these expenses were for prior periods, they were reported on the Statement of Net Cost as expenses of

FY 1998. Since the statement is to show cost components for the current reporting period, these expenses were distorting costs for the Airports line of business. FAA was aware of this problem and made the correct adjustment. Unless FAA establishes a process to estimate and report grant expenses at yearend, the Statement of Net Cost will continue to misstate current costs for Airports.

As discussed earlier, FAA continues to have property accounting weaknesses that impact the Statement of Net Cost. The understatement of equipment, and the backlog in work-in-process, cause an understatement of depreciation expense on the Statement of Net Cost.

Budgetary Accounting Information

Three of the new statements for FY 1998 are dependent on budgetary accounting information. The Statement of Budgetary Resources provides information about how budgetary resources were made available, as well as their status at yearend. The Statement of Changes in Net Position reports the beginning net position, the items which caused net position to change, ending net position, and reports on appropriations used as a financing source. The Statement of Financing is a reconciliation of the budgetary information in the Statement of Budgetary Resources and the operating expense information in the Statement of Net Cost. The reconciliation ensures there is a proper relationship between financial and budgetary accounts in the entity's financial management system.

FAA made the following disclosure in Footnote 24, Statement of Budgetary Resources Disclosures,

In an effort to accurately reflect the status of budgetary resources, FAA compiled data from the SF-132, Apportionment and Reapportionment Schedule, and the SF-133, Report on Budget Execution, to prepare the Statement of Budgetary Resources. Some of the budgetary account balances from the (DAFIS) general ledger were not accurate or were incomplete because the processes to record specific transactions were not available in the accounting system.

Consequently, the Department's accounting system was not the source of the budgetary accounting information reported in the Financial Statements.

We could not substantiate material items on the Statement of Budgetary Resources, such as Unobligated Balance (\$7.2 billion), and Statement of Changes in Net Position, such as Increase (Decrease) in Unexpended Appropriations (\$380 million). The Statement of Financing showed there was an \$877 million unexplained difference between the Statement of Budgetary Resources and the

Statement of Net Cost. FAA stated this discrepancy was identified during the reconciliation of the two statements, but could not provide any other information. Therefore, FAA was unable to determine if there was a proper relationship between its financial and budgetary records.

FAA is aware of these budgetary accounting issues, and has hired an independent contractor to assist in correcting them. We support this effort and will work with FAA and the contractor to correct this weakness.

Excise Tax Revenues

FAA is required to include excise tax revenues (revenues) in its Financial Statements. However, the Department of Treasury (Treasury) has control over collecting and reporting of revenues for FAA. The Internal Revenue Service (IRS) collects revenues and makes daily deposits into the General Fund of the United States (General Fund). Upon receipt, IRS cannot differentiate between revenues for the Airport and Airway Trust Fund (AATF) and other government trust funds. IRS places these funds in a "holding" account until tax returns are filed, usually several months later. IRS then uses tax returns to certify the amount of revenues that should have been distributed to the AATF.

Congress, recognizing that trust funds cannot wait months for revenues, directed the Secretary of the Treasury to make monthly transfers, based on estimated revenues, from the General Fund to the appropriate trust funds. Within Treasury, the Office of Tax Analysis (OTA) makes these monthly estimates, and the Bureau of Public Debt transfers estimated amounts to the AATF. Estimates are adjusted later based on actual tax returns.

Last year, we asked GAO to review the Treasury procedures for estimating and certifying revenues. The GAO contractor was unable to complete the review of the estimating process, and terminated its work because information on how estimates were made was not available. GAO also found errors and internal control weaknesses related to reporting and certifying of total government excise tax revenues, and estimated these revenues were potentially overstated by as much as \$571 million.

For FY 1998, we again asked GAO to review the OTA estimating process and the IRS quarterly certification process. GAO concluded internal control weaknesses still exist. Major weaknesses included IRS written procedures for certifying revenues and timely processing of tax returns.

We again found significant variances between OTA estimates and IRS-certified revenues. For the five quarters ended June 1998, variances between estimated and

actual revenues ranged from an understatement of \$598 million to an overstatement of \$276 million. Details follow:

Quarter Ending	OTA Estimate (Thousands)	IRS Certification (Thousands)	Difference (Thousands)
June 1997	\$1,433,442	\$1,533,890	\$(100,448)
September 1997	1,829,463	1,722,851	106,612
December 1997	2,016,322	1,980,573	35,749
March 1998	1,778,504	1,502,650	275,854
June 1998	2,212,434	2,810,497	(598,063)

During this year's audit, GAO found internal control weaknesses. For example, the December 1997 certification was understated by \$57 million because IRS omitted collections for aviation gas from its certification. IRS subsequently made adjustments and corrected the error in December 1998.

In the past, the transfer of revenues, based on estimates, to the AATF exceeded aviation tax revenues. On January 1, 1996, legislation authorizing collection of aviation taxes lapsed. The Small Business Job Protection Act of 1996 reinstated the aviation taxes from August 27 to December 31, 1996. Revenues were transferred to the AATF during this period, although airlines were not making deposits. Excess transfers totaled \$1.2 billion. Legislation was needed to avoid a shortfall in the AATF, and allow the trust fund to retain the \$1.2 billion.

Considering the internal control weaknesses, and the Treasury's past performance, one additional area causes concern. The AATF receives about nine percent of excise tax revenues collected by IRS. As of September 30, 1998, the IRS "holding" account has a \$9.2 billion balance awaiting the receipt of tax returns. If tax returns are not filed or otherwise matched to receipts, the money remains in the General Fund. We were concerned that this "holding" account might contain revenues for the AATF. At our request, GAO asked IRS to age this account. As of February 26, 1999, IRS had not responded.

OTA also has noticed a consistent residual amount of about \$1 billion annually in the "holding" account with no liability to trust funds. This "holding" account could contain revenues for the AATF.

C. REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Our objective was not to express, and we do not express, an opinion on overall compliance with laws and regulations. Our work would not necessarily disclose all material noncompliance.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 requires auditors to report whether agencies' financial management systems comply substantially with federal accounting standards, financial systems requirements, the government's standard general ledger at the transaction level, and Federal Financial Management Systems Requirements issued by the Joint Financial Management Improvement Program. FAA continues to be in noncompliance because (1) property, plant, and equipment amounts presented on the Balance Sheet were inaccurate and not supported by financial records, (2) DAFIS was not used for preparation of the Financial Statements, and (3) a cost accounting system had not been implemented.

Acquisition value of property and equipment could not be substantiated. For example, FAA was unable to provide supporting cost documentation to substantiate the \$2.1 billion recorded in the work-in-process account. Personal property reported at \$4.1 billion was materially understated. We also were unable to substantiate real property reported at \$2.5 billion.

DAFIS was not the only source of financial information used to prepare the FAA Financial Statements. OMB implementation guidance states that to be in substantial compliance with the Federal Financial Management Systems Requirements, the "agency core financial system, supported by other systems containing detail data summarized in the core financial system, is the source of information used in the preparation of the annual financial statements. . . ." Because the core accounting system did not contain the most current financial information, FAA made 349 closing and adjusting entries, totaling \$51 billion, outside DAFIS to prepare the Financial Statements. The 349 entries were recorded in the Financial Statement Module, a tool used to generate the Financial Statements. These adjustments, at a minimum, should be recorded in DAFIS at the summary level. However, FAA could not record these adjustments in DAFIS because FY 1998 records were closed within 5 days after yearend. DAFIS also did not account for Appropriations Used activity and was not in compliance with the Standard General Ledger. These issues will be addressed in the new Departmental accounting system currently expected to be fully operational by June 2001.

Federal Financial Accounting Standards Number 4 requires all Federal departments to have the capability in place, beginning in FY 1998, to meet requirements of the managerial cost accounting standards. Cost accounting is needed in the Federal Government to provide reliable and timely information on the full cost of Federal programs. The National Civil Aviation Review Commission called for strong financial controls, including a reliable cost

accounting system for FAA by October 1998, so that FAA could manage its resources in a businesslike manner, and allocate its cost correctly and fairly as the basis for a cost-based user fee system. FAA still lacks the detailed and reliable cost data to accurately distribute operating cost. The FAA cost accounting system was scheduled to be operational by October 1, 1998, but will not be implemented in all lines of business until March 31, 2001. Consequently, FAA may not be able to realize the \$1.5 billion in user fees proposed in its FY 2000 budget.

Performance Data

Under OMB Bulletin 98-08, our responsibility was to obtain an understanding of internal controls relating to the existence and completion of performance data. The nine performance measures presented by FAA in the Management Discussion and Analysis were consistent with the measures under development by FAA as part of its implementation of the Government Performance and Results Act. The performance measures also complied with requirements of OMB Bulletin 97-01 to report performance measures consistent with goals and objectives in the agency's strategic plan.

OMB Bulletin 97-01 also requires entities to strive to develop performance measures that provide information about cost effectiveness of programs, and link to the programs presented in the Statement of Net Cost. However, as we reported in our finding on Cost Accounting Information, FAA did not accumulate or report costs by major program under each line of business, or provide information about the cost effectiveness of FAA programs. Furthermore, the performance measures did not relate to the information presented in the Statement of Net Cost. The cost accounting information, needed to link the performance measures with the Statement of Net Cost and provide information on cost effectiveness of FAA's programs, was not available because the FAA cost accounting system was still under development.

The performance measures also were not based on current performance data. While only two of the nine performance measures were based on FY 1998 operational data, five were based on 1997 data, one was based on 1996 data, and one was based on 1995 data. For example, FAA presented a performance goal of reducing the number of residents exposed to significant aircraft noise by 60 percent. However, statistics were only presented through 1995, so current performance could not be evaluated. Five of the nine measures relied on data from sources outside the Department. Consequently, we could not determine if the data were complete.

As part of our Financial Statement audit, we did not test the validity or accuracy of the performance data. This will be accomplished as part of selected program

audits during FY 1999. The Department is in process of implementing a comprehensive system to control the quality of performance data. Without timely and complete data, FAA will be unable to compare performance results with current year financial data.

D. PRIOR AUDIT COVERAGE

The OIG has issued audit reports on the FAA Financial Statements for the past 6 years. The FYs 1992 and 1993 audits were limited to the Airport and Airway Trust Fund. The subsequent audits included all FAA funding and activities, but were limited to the Statements of Financial Position (Balance Sheet). The FY 1996 audit report included 35 recommendations to strengthen internal controls and establish the correctness of financial statement balances. The FY 1997 audit report stated efforts were still in process to complete corrective action on 21 recommendations. Efforts are still underway to complete action on 17 of our prior recommendations.

Since our report on the FY 1997 Financial Statements was issued, we issued five financial-related audit reports, three of which related to FAA inventory issues. The reports on inventory were:

Replenishing Logistics Center Inventory, Report Number FE-1998-136, dated May 15, 1998.

Valuation of Logistics Center Inventory, Report Number FE-1998-202, dated September 10, 1998.

Inventory of Field Spare Parts, Report Number FE-1998-209, dated September 29, 1998.

On July 6, 1998, in Report Number FE-1998-167, we reported that while FAA established automated fund control systems to track reprogramming of appropriated funding, FAA (1) exceeded Congressionally established internal reprogramming thresholds in FY 1997 for three budget line items by \$8.7 million, (2) processed reprogramming actions in FYs 1997 and 1998 that resulted in "assessments," (3) charged at least \$2 million to the wrong appropriation during FYs 1997 and 1998, and (4) permitted employees to work during FY 1998 on a program that did not receive FY 1998 funding.

On August 10, 1998, in Report Number FE-1998-186, we reported FAA needed to address four system design issues, potentially involving billions of dollars of transactions, in the development of its cost accounting system. We reported that FAA had not decided how to allocate facilities and equipment costs to operating

facilities throughout FAA. We also reported that much work needed to be done to meet the very ambitious goal of having a fully operational cost accounting system by March 31, 1999.

This report is intended for the information of FAA and DOT management. However, this report is a matter of public record, and its distribution is not limited.

Kenneth M. Mead
Inspector General

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U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED BALANCE SHEET
As of September 30, 1998

(Dollars in Thousands)

Assets

Entity Assets:

Intragovernmental	
Fund Balance with Treasury (Note 2)	\$ 1,569,580
Investments (Note 3)	8,752,638
Accounts Receivable, Net (Note 4)	54,894
Other Assets (Note 5)	160,330
Total Intragovernmental Assets	\$ 10,537,422

Accounts Receivable, Net (Note 4)	26,318
Loans Receivables and Related	-
Foreclosed Property, Net (Note 6)	394
Cash and Other Monetary Assets (Note 7)	59,710
Inventory and Related Property, Net (Note 8)	819,580
General Property, Plant, and Equipment, Net (Note 9)	8,375,113
Other Assets (Note 5)	8,462
Total Entity Assets:	\$ 19,826,999

Total Assets	\$ 19,826,999
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Liabilities

Liabilities Covered by Budgetary Resources:

Intragovernmental Liabilities:	
Accounts Payable	\$ 179,788
Other Intragovernmental Liabilities (Note 11)	89,097
Total Intragovernmental Liabilities	248,885

Accounts Payable	505,979
Lease Liability (Note 12)	687
Other Liabilities (Note 11)	189,008
Total Liabilities Covered by Budgetary Resources	\$ 944,559

Liabilities Not Covered by Budgetary Resources:

Intragovernmental Liabilities:	
Debt (Note 10)	\$ 24
Other Intragovernmental Liabilities (Note 11)	181,065
Total Intragovernmental Liabilities	181,089

Lease Liabilities (Note 12)	108,532
Environmental and Disposal Liabilities (Note 13)	3,244,300
Federal Employees and Veterans Benefits Payable (Note 14)	928,780
Contingent Liabilities (Note 15)	465,394
Other Liabilities (11)	408,072

Total Liabilities Not Covered by Budgetary Resources	\$ 5,329,167
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Total Liabilities	\$ 6,273,726
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Net Position Balances:

Unexpended Appropriations (Note 16)	\$ 386,470
Cumulative Results of Operations (Note 17)	13,216,803
Total Net Position	\$ 13,553,273

Total Liabilities and Net Position	\$ 19,826,999
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**U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED STATEMENT OF NET COST
For the year ended September 30, 1998**

(Dollars in Thousands)

Costs: (Notes 18 and 19)

Programs	
Air Traffic Services	
Intragovernmental	\$ 449,742
With the Public	5,299,603
Total	<u>5,749,345</u>
Less Earned Revenues	(21,149)
Net Air Traffic Services Costs	<u>\$ 5,728,196</u>
Regulation & Certification	
Intragovernmental	\$ 25,571
With the Public	664,827
Total	<u>690,398</u>
Less Earned Revenues	25
Net Regulation & Certification Costs	<u>\$ 690,423</u>
Research and Acquisition	
Intragovernmental	\$ 14,888
With the Public	1,078,509
Total	<u>1,091,397</u>
Less Earned Revenues	(47,015)
Net Research and Acquisition Costs	<u>\$ 1,044,382</u>
Airports	
With the Public	
Grant Program	\$ 1,384,466
Administration	52,075
Net Airports Costs	<u>\$ 1,436,541</u>
Civil Aviation Security	
Intragovernmental	\$ 4,144
With the Public	152,714
Total	<u>156,858</u>
Less Earned Revenues	(819)
Net Civil Aviation Security Costs	<u>\$ 156,039</u>
Commercial Space	
Intragovernmental	132
With the Public	\$ 6,895
Net Commercial Space Costs	<u>\$ 7,027</u>
Other Programs	
Intragovernmental	\$ 26,513
With the Public	23,398
Total	<u>49,911</u>
Less Earned Revenues	(33,950)
Net Other Program Costs	<u>\$ 15,961</u>
Costs Not Assigned to Programs	\$ 16,631
Less Earned Revenues Not Attributed to Programs	<u>\$ (13,388)</u>
Deferred Maintenance, unaudited (Note 20)	
Net Cost Of Operations	<u>\$ 9,081,812</u>

U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the year ended September 30, 1998

(Dollars in Thousands)

Net Cost of Operations	\$	(9,081,812)
Financing Sources		
Appropriations Used		3,312,612
Taxes and Other Non-Exchange Revenues (Note 21)		8,725,972
Donations (Non-Exchange Revenue)		(774)
Imputed Financing (Note 22)		355,732
Transfers-In		11,691
Transfers-Out		(64,268)
Total Financing Sources	\$	<u>12,340,965</u>
Net Results of Operations		3,259,153
Prior Period Adjustments (Note 23)		<u>(5,528,065)</u>
Net Change in Cumulative Results of Operations		(2,268,912)
Increase (Decrease) in Unexpended Appropriations (Note 24)		(380,032)
Change in Net Position		(2,648,944)
Net Position Beginning of Period		<u>16,202,217</u>
Net Position End of Period	\$	<u><u>13,553,273</u></u>

**U. S. Department of Transportation
 FEDERAL AVIATION ADMINISTRATION
 COMBINED STATEMENT OF BUDGETARY RESOURCES
 For the year ended September 30, 1998**

(Dollars in Thousands)

Budgetary Resources (Note 25)	
Budget Authority	\$ 11,184,553
Unobligated Balances - Beginning of Period	7,229,820
Spending Authority From Offsetting Collections	2,033,195
Adjustments	114,148
Total Budgetary Resources	\$ 20,561,716
Status Of Budgetary Resources	
Obligations Incurred	\$ 11,338,673
Unobligated Balances-Available	522,739
Unobligated Balances-Not Available	8,700,304
Total Status of Budgetary Resources	\$ 20,561,716
Outlays	
Obligations Incurred	\$ 11,338,673
Less: Spending Authority From Offsetting Collections and Adjustments	(2,161,115)
Obligated Balance, Net Beginning of Period	5,074,554
Obligated Balance Transferred, Net	-
Less: Obligated Balance, Net - End of Period	(5,038,337)
Total Outlays	\$ 9,213,775

**U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
COMBINED STATEMENT OF FINANCING
For the year ended September 30, 1998**

(Dollars in Thousands)

Obligations and Nonbudgetary Resources		
Obligations Incurred	\$	11,338,673
Less: Spending Authority for Offsetting		
Collections and adjustments		(2,161,115)
Donations not in the Budget		(774)
Financing Sources for Cost Subsidies		355,732
Transfers-in (out)		(52,577)
Exchange Revenue not in the Budget		(40)
Other		20,736
Total Obligations as Adjusted, and Nonbudgetary Resources	\$	<u>9,500,635</u>
 Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services, and Benefits		
Ordered but not yet Received or Provided	\$	(95,987)
Change in Unfilled Customer Orders		(26,288)
Costs Capitalized on the Balance Sheet (Note 26)		2,995,785
Financing Sources that Fund Costs of Prior Periods (Note 27)		(85,504)
Other - Identified Prior Period Adjustments		(3,517,446)
Reconciling Difference		(876,930)
Total Resources That Do Not Fund Net Cost of Operations	\$	<u>(1,606,370)</u>
 Costs That Do Not Require Resources		
Depreciation and Amortization	\$	180,059
Revaluation of Assets and Liabilities		(483,498)
Loss on Disposition of Assets		511,737
Cost of Goods Sold		133,222
Total Costs That Do Not Require Resources	\$	<u>341,520</u>
 Financing Sources Yet To Be Provided (Note 27)	\$	<u>846,027</u>
 Net Cost Of Operations	\$	<u>9,081,812</u>

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

These consolidated financial statements have been prepared to report the financial position, the net cost of operations, the changes in net position, the status and availability of budgetary resources and the reconciliation between proprietary and budgetary accounts of the Federal Aviation Administration (FAA), as required by 31 U.S.C. 3515, as added by the Chief Financial Officers Act of 1990 and as amended by the Federal Financial Management Act of 1994, which is title IV of the Government Management Reform Act of 1994. They have been prepared from the books and records of FAA in accordance with the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board, The Office of Management and Budget (OMB) Bulletin 97-01, Form and Content of Agency Financial Statement, the Department of Transportation (DOT) and the FAA's accounting policies which are summarized in this note. These statements with the exception of the statement of Budgetary Resources are therefore different from the financial management reports, also prepared by the FAA pursuant to OMB directives, that are used to monitor and control the FAA's use of budgetary resources.

The FAA applies accounting principles and standards and complies with operating policies and procedures established, issued, and implemented by the General Accounting Office (GAO), the OMB, and the Department of Treasury, as recommended by the Federal Accounting Standards Advisory Board (FASAB). The financial statements have been prepared in accordance with the following hierarchy of accounting principles and standards, which constitutes another comprehensive basis of accounting:

1. Individual Standards agreed to by the Director of OMB, the Controller General, and the Secretary of the Treasury and published by OMB and the General Accounting Office;

2. Interpretations related to the Statement of Federal Financial Accountings Standards (SFFAS) issued by OMB in accordance with the procedures outlined in OMB Circular A-134, "Financial Accounting Principles and Standards;"

3. Requirements contained in OMB Bulletin 97-01, Form and Content and its amendments in effect for fiscal year 1998.

4. The Department of Transportation (DOT) accounting policies and reporting requirements

5. FAA accounting policies summarized in this note and FAA Order No. 2700.31, Uniform Accounting Systems Operations Manual, and related documentation containing the FAA-specific accounting policy.

6. Accounting principles published by authoritative standard-setting bodies and other authoritative sources (1) in the absence of other guidance in the first five parts of this hierarchy, and (2) if the use of such accounting standards improve the meaningfulness of these financial statements.

B. Reporting Entity

The FAA was created in 1958. The FAA's mission is to operate the nation's air traffic control system and to regulate the aviation's safety and security. FAA is responsible to provide U.S. air travelers with an efficient, safe, secure and technically advanced airspace system.

The FAA activities as per Treasury designation can be grouped into four funds.

<u>Entity</u>	<u>Title</u>
1. Trust Fund	Airport and Airway Trust Fund Cash and Investments Grants-in-Aid Facilities and Equipment Research and Development Programs Administered by Other Agencies
2. Revolving Fund	Aviation Insurance Program
3. Franchise Fund	Administrative Services
4. All Others	Operations

(Unsegmented) Facility and Equipment
 Development
 Aircraft Purchase Loan
 Guarantee
 - Borrowing Authority for
 Program Expenses
 - Appropriation to Liquidate
 Borrowed Funds and
 Accrued Interest
 General Fund Miscellaneous
 Receipts
 Suspense Clearing
 Accounts
 Items Not Classified by
 Financing Source

The Airport and Airway Trust Fund (Trust Fund) financed approximately 62 percent of the fiscal year (FY) 1998 total budget. The only appropriations receiving General Fund financing are the Operations appropriation and, when enacted, the appropriation to liquidate debts to the Treasury incurred for the Aircraft Purchase Loan Guarantee Program. (No such liquidating appropriation was enacted in FY 1998.) Approximately 37 percent of the FY 1998 funding of the Operations appropriation was financed by the General Fund, and the remainder was funded by the Trust Fund. Infusing funds from the Trust Fund to the Operations appropriation is accomplished by periodic transfers. Once a transfer is made, the corresponding portion of the Operations account derived from the Trust Fund is accounted for under the General Fund Operations appropriation symbol, thus losing the identity of the source.

C. Budgets and Budgetary Accounting

Congress annually enacts appropriations to permit the FAA to incur obligations for specified purposes. For FY 1998, the FAA was accountable for Trust Fund appropriations, General Fund appropriations, a Revolving Fund, a Franchise Fund, and borrowing authority. The FAA recognizes budgetary resources as assets when cash (funds held by Treasury) is made available through Treasury General Fund warrants and Trust Fund transfers. See paragraph B above.

D. Basis of Accounting

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual

method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Trust Fund revenues derived from excise taxes are treated differently. They are recorded on the basis of cash transferred from the General Fund to the Trust Fund. Transactions are also classified by fund account. This is accomplished by assigning to each transaction a unique attribute (Treasury symbol) identifying the corresponding appropriation and its period of availability.

Budgetary accounting facilitates complying with legal controls on the use of Federal funds.

E. Revenues and Other Financing Sources

Congress enacts annual, multi-year, and no-year appropriations to be used, within statutory limits, for operating and capital expenditures. Additional amounts are obtained from service fees (e.g., landing and registry fees) and through reimbursements for services performed for domestic and foreign governmental entities.

The Trust Fund is sustained by excise taxes collected by the Internal Revenue Service (IRS) from airway system users. The IRS records excise tax revenues deposited in the General Fund on a cash basis; Treasury transfers an equivalent amount from the General Fund to the Trust Fund. The Trust Fund also earns interest from investments in Treasury securities. Interest income is recognized as revenue on the accrual basis.

Appropriations are recognized as a financing source when expended. Revenues from service fees and reimbursements are recognized concurrently with the recognition of accrued expenditures for performing the services.

F. Fund Balances with the U.S. Treasury and Cash

The U.S. Treasury processes cash receipts and disbursements. Funds at the Treasury are available to pay agency liabilities. The FAA maintains petty cash (imprest funds) outside the Treasury to facilitate small purchases. The FAA does not maintain cash in commercial bank accounts. The FAA does not

maintain any foreign currency balances. Foreign currency payments are made either by the Treasury or the Department of State and are reported by the FAA in the U.S. dollar equivalent.

G. Investment in U.S. Government Securities

Unexpended funds in the Trust Fund and Aviation Insurance Revolving Fund are invested in U.S. Government securities. A portion of the Trust Fund investments is liquidated semi-monthly in amounts needed to provide cash for the FAA appropriation accounts. The Revolving Fund investments are usually held to maturity. Investments, redemptions, and reinvestments are controlled and processed by the Treasury.

H. Accounts and Loans Receivable

The FAA's financial statement includes the activities and balances of relevant Treasury General Fund Miscellaneous Receipt accounts. The FAA maintains accountability for defaulted loans under the Aircraft Purchase Loan Guarantee Program. Upon default, the FAA established accounts receivable in the General Fund Miscellaneous Receipts account to reflect the amount due from the borrower for principal and interest. The FAA also established an intragovernmental liability to offset the accounts receivable which represents an asset of the Treasury, not the FAA.

I. Operating Materials and Supplies

Operating materials and supplies consist primarily of unissued materials and supplies that will be consumed in normal operations. In FY 1998, the FAA discontinued the use of standard cost and began valuing materials and supplies using moving weighted average. Other classifications of materials and supplies are valued on the basis of actual prices paid.

Adjustments for the proper valuation of repairable, excess, obsolete, and unserviceable items are made to the appropriate allowance account at fiscal yearend. The allowance for repairable items is recognized as a current period expense. The allowance for excess,

obsolete, and unserviceable items is recognized as a gain or a loss. Operating materials and supplies are reclassified as expenses or work in progress when consumed or issued.

J. Property, Plant and Equipment (PP&E)

In FY 1998 the FAA increased the capitalization threshold from \$5,000 to \$25,000 for all PP&E. Acquisitions with costs exceeding \$25,000 and a useful life exceeding 2 years are capitalized. Acquisitions not meeting these criteria are recorded as operating expenses. Capitalization thresholds differ from the thresholds for classifying property as accountable or sensitive. The FAA currently reports general PP&E at original acquisition cost.

In FY 1998, FAA fully implemented the depreciation of general PP&E. The depreciation expense is calculated using the straight-line method; except for aircraft that is depreciated to a 25% salvage value, the FAA does not recognize residual value for its PP&E. No depreciation expense is recognized on an asset during the fiscal year it is put in service. A full year's depreciation will be recognized during the asset's final year of use. The useful life classifications for capitalized assets are as follows:

<u>Asset Classification</u>	<u>Useful Life (years)</u>
Offices, Buildings, Warehouse	40
Buildings, Residential Properties, Air Traffic Control Towers and Enroute Air Traffic Control Centers	
Mobile Homes, Aircraft	20
Original Roads, Sidewalks, Parking Lots and All Other Structures	15
Printing, photographic and projection equipment	13
Capital Improvements, Facility Modifications, Leasehold Improvements (or expiration of lease which ever comes first), Portable and Installed Communications equipment excluding Air Navigation and Air Traffic Control Facilities and Avionics Equipment	10
Office Furniture and Equipment including the following categories: Prototype and Experimental, Research and Development Test, Shop, Emergency Readiness, Training,	7

Portable Test and Rack Mounted Test equipment for Air Navigation and Air Traffic Control Facilities, Aircraft Test Equipment and Other non-classified Equipment

Vehicles and Automatic Data Processing Equipment 5

The FAA has established two categories of economic service life for some of its personal property, and facilities and equipment assets. The two categories are based on whether the assets were in service prior to the full implementation of the depreciation policy or they were put in service in the year of the depreciation implementation, as follows:

<u>Functional Area</u>	<u>Economic Service Life (Range)</u>	
	<u>Existing</u>	<u>New</u>
Decision Support Systems	4-20	2-20
Communications	10-20	10
Weather	15-20	10-20
Navigation/Landing	20	15-20
Surveillance	20	10-20
Facilities	40	40
Facilities' Support	20	20
Equipment		
Mission Support	20	20
User Equipment	10-20	7-10

Buildings acquired under capital leases are amortized over the lease term. If the lease agreement contains a bargain purchase option or otherwise provides for transferring title of the asset to the FAA, the building is depreciated over a 40 year service life.

Construction in progress is valued at direct (actual) costs, plus applied overhead and other indirect costs as accumulated by the regional project materiel system.

The General Services Administration (GSA) receives payment for real property that is under its control and is used by the FAA. Payments are made from an appropriation to the Office of the Secretary of Transportation (OST), part of which (corresponding to the FAA costs) is derived from the Trust Fund.

K. Prepaid and Deferred Charges

Advance payments are generally prohibited by law; there are some exceptions, such as subscriptions. When permitted, payments made in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenses when the related goods and services are received.

L. Liabilities

A liability represents the amount to be paid by the FAA as the result of a transaction or event that has already occurred. However, the FAA absent of an appropriation can not liquidate any liabilities. Liabilities for which an appropriation has not yet been enacted are, therefore, classified as unfunded liabilities, and there is no certainty that such appropriation will be enacted.

M. Borrowing Payable to the Treasury

Borrowing involves loans from the Treasury to fund expenses in the Aircraft Purchase Loan Guarantee Program. Treasury renews the debt obligation until the FAA receives an appropriation to liquidate the principal and interest. No such appropriation was enacted for FY 1998.

N. Interest Payable to the Treasury

The FAA owes interest to the Treasury based on its debt to the Treasury as a result of borrowing for the

O. Annual, Sick, and Other Leave

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. At each bi-weekly pay period, the balance in the accrued annual leave account is adjusted to reflect the latest pay rates and unused hours of leave. Funding will be obtained from future financing sources to the extent that current or prior year appropriations are not available to fund annual leave earned but not taken. Sick leave and other types of nonvested leave are expensed when taken.

In FY 98, under the National Air Traffic Controller Association (NATCA) agreement, Article 25, Section 13, Air Traffic Controllers covered under the Federal Employees Retirement Systems (FERS) became eligible, upon retirement, for a sick leave buy back option.

P. Accrued Workers' Compensation

A liability is recorded for estimated and actual future payments to be made for workers' compensation pursuant to the Federal Employees' Compensation Act (FECA). The liability consists of the net present value of estimated future payments calculated by the U.S. Department of Labor (DOL) and the unreimbursed cost paid by DOL for compensation paid to recipients under FECA. The actual costs incurred are reflected as a liability because FAA will reimburse DOL two years after the actual payment of expenses. Future Appropriations will be used for DOL's reimbursement.

Q. Retirement Plan

The FAA employees who participate in the Civil Service Retirement System (CSRS) are beneficiaries

percent of pay to their annuity account in the Civil Service Retirement and Disability Fund.

On January 1, 1987, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. FERS and Social Security, automatically cover most employees hired after December 31, 1983. Employees hired prior to January 1, 1984, could elect either to join FERS and Social Security or to remain in CSRS. FERS offers a savings plan to which the FAA automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. For FERS participants, the FAA also contributes the employer's matching share for Social Security.

Beginning in fiscal year 1997, the FAA began to recognize the cost of pensions and other retirement benefits during the employees' active years of service. The Office of Personnel Management (OPM) actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future, and communicate these factors to the FAA for current period expense reporting. OPM also provides information regarding the full cost of health and life insurance benefits. The FAA recognized an offsetting revenue as imputed financing sources for the extent of these additional expenses that will be paid by OPM.

R. Contingencies

The FAA recognizes losses for contingent liabilities when such losses are probable and reasonably estimable. The FAA recognizes material contingent liabilities in the form of claims that have been brought to the attention of the Office of Chief Counsel (OCC) and: (1) have been asserted, or, if not yet asserted, in the opinion of the OCC are more likely to be asserted than not; (2) in the opinion of the OCC are more likely to be paid than not; and (3) for which the OCC can estimate the probable payment.

Note 2. Fund Balances with Treasury

	Obligated	& Available	& Restricted	Total
Trust Fund	\$2,174,366	\$ (1,049,195)	\$ (276,524)	\$ 848,647
Operations General Fund	676,299	(6,699)	30,753	\$ 700,353
Franchise Fund	3,954	2,178	-	6,132
Revolving Fund	189	73	-	262
Other Funds	390	13,776	-	14,166
Total	\$2,855,198	\$ (1,039,867)	\$ (245,771)	\$1,569,560

Unobligated and restricted fund balances represent balances of appropriations for which the period of availability for (voluntary) obligation has expired. These balances are only available for upward adjustments of obligations incurred during the period for which the appropriation was available for obligation, or for paying claims attributable to the appropriation. Pursuant to 31 USC 1552, appropriation accounts are canceled at the close of the fifth fiscal year following the last fiscal year for which they were available for obligation. Fund balances in the amount of \$27.6 million in canceled appropriations at fiscal yearend were removed from the balance sheet.

The amount withdrawn biweekly from the Trust Fund is based on cash outlays, not on obligational authority, to minimize interest costs. Negative unobligated balances are covered by invested funds in the Airport and Airway Trust Fund.

Note 3. Investments

(Dollars in Thousands)

	Cost	Amortization Method	Unamortized (Premium) Discount	Investments Net	Other Adjustments	Market Value Disclosure
Intragovernmental Securities:						
Non-Marketable, Par Value Trust Fund (1)	\$ 8,549,630		\$ -	\$ 8,549,630		\$ -
Non-Marketable, Market Based						
Aviation Insurance Revolving Fund (2)	71,029	Straight Line	(2,149)	68,880	-	-
Subtotal	8,620,659		(2,149)	8,618,510	-	-
Accrued Interest	134,128			134,128		-
Total	\$ 8,754,787			\$ 8,752,638		\$ -

A total of \$ 8.5 billion was invested in U.S. Treasury Certificates of Indebtedness as of September 30, 1998, at a rate of 6.5 percent, maturing June 30, 1999.

- (1) Non-marketable par value Treasury securities are special series debt securities, issued by the Bureau of the Public Debt to Federal accounts and are purchased and redeemed at par (face value) exclusively through Treasury's Finance and Funding Branch. The securities are redeemed at face value on demand; thus, investing entities recover the full amount invested, plus interest. The Trust Fund investments are made by the Fund's trustee, the Secretary of the Treasury.
- (2) Non-marketable market-based Treasury securities are debt securities that the Treasury issues to Federal entities without statutorily fixed interest rates. Although the securities are not marketable, their terms (prices and interest rates) mirror the terms of marketable Treasury securities. FAA amortizes premiums and discounts on market-based Treasury securities over the life of the security using the interest method. The following amounts are invested in market-based Treasury securities:

	Maturity Date	Effective Interest Rate	Amount
1	12/10/98	5.17%	\$ 13,505
2	4/01/99	5.07%	23,565
3	6/24/99	5.12%	16,000
4	9/16/99	4.46%	17,959
			\$ 71,029

Note 4. Accounts Receivable

	<u>Gross Accounts Due</u>	<u>Allowance for Uncollectible Amounts</u>	<u>Net Amount Due</u>
Intragovernmental Receivables	\$ 54,894	\$ -	\$ 54,894
Other Receivables	32,186	(5,868)	26,318
Total Receivables	<u>\$ 87,080</u>	<u>\$ (5,868)</u>	<u>\$ 81,212</u>

Reconciliation of Uncollectible Amounts:

	<u>Intragovernmental</u>	<u>Other</u>
Beginning Balance	\$ -	\$ (5,012)
Additions	-	(3,151)
Reductions	-	2,295
Ending balance	<u>-</u>	<u>(5,868)</u>

Delinquency notices are sent to debtors when billings remain uncollected for 30 days. Follow-up notices are sent if the debtor does not respond. Additional actions, such as salary or retirement offset (when the debtor is a current or former Federal employee), as well as tax refund offset, consumer reporting, and referral to collection agencies may be taken, depending on the circumstances of each case. An allowance for uncollectible accounts receivable is established when, based upon a monthly review of outstanding accounts and the failure of all collection efforts, management determines that collection is unlikely to occur. Accounts receivable in appropriations canceled pursuant to 31 USC 1552 on September 30, 1998, are no longer FAA assets. An accounts receivable balance in the amount of \$235 thousand for canceled appropriations at fiscal yearend was removed from the balance sheet.

Note 5. Other Assets

(Dollars in Thousands)

Other Entity Assets Intragovernmental	
Advances and Prepayments	\$ 106,203 (1)
Undistributed Foreign Costs	191
Undistributed Costs - Treasury Clearing	1,098
Other Assets - Undistributed	<u>52,838 (2)</u>
Total Intragovernmental	<u>\$ 160,330</u>
Advances and Prepayments	<u>\$ 8,462 (3)</u>
Total Other Entity Assets	<u>\$ 168,792</u>

- (1) Represents advance payments to other Federal Government entities under the 31 USC, 1535 for agency expenses not yet incurred or for goods or services not yet received.
- (2) Includes assets transferred between FAA regions. Transferred items remain in the undistributed asset account until removed by the recipient region. Transfer transactions may include some expenses.
- (3) Represents advance payments to employees for agency expenses not yet incurred.

Note 6. Loans and Loan Guarantees, Non-Federal Borrowers

(Dollars in Thousands)

Defaults on Pre-1992 Guaranteed Loans:

Aircraft Purchase Loan Guarantee Program	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Defaulted Guaranteed Loans Receivable, Net
	<u>\$ 496</u>	<u>\$ 235</u>	<u>\$ (337)</u>	<u>\$ -</u>	<u>\$ 394</u>

FAA has no direct loan programs, but FAA administers the Aircraft Purchase Loan Guarantee Program. Authorization for issuing new loan guarantees expired in 1988. The only remaining program function is to maximize recoveries from defaulted loans.

Accounts receivable from debtors on account of defaulted guaranteed loans are reported net of an allowance for estimated uncollectible amounts. The Federal Credit Reform Act was enacted after the authority to issue new guarantees expired, and therefore does not apply to FAA's loan guarantees.

Administrative expenses to maintain residual values in this program are minimal. FAA has no full-time employees administering the program.

Note 7. Cash, Foreign Currency and Other Monetary Assets

(Dollars in Thousands)

Imprest Fund Cash	\$ 60
Undeposited Collection	<u>59,650</u>
Total Cash, Foreign Currency, and Other Monetary Assets	<u>\$ 59,710</u>

Note 8. Inventory and Related Property

Operating Materials and Supplies:

(Dollars in Thousands)

	<u>Value</u>	<u>Allowance</u>	<u>Net Value</u>	<u>Valuation Method</u>
Items Held For Use	\$ 732,137	\$ -	\$ 732,137	Moving Weighted Averag
Excess, Obsolete and Unserviceable	18,553	6,417	12,136	Moving Weighted Averag
Items Held for Repair	<u>215,160</u>	<u>139,854</u>	<u>75,306</u>	Moving Weighted Averag
Total Inventory and Related Property	<u>\$ 965,850</u>	<u>\$ 146,271</u>	<u>\$ 819,579</u>	

Inventory and related property consist of general operating material and supplies, aircraft parts, and spare parts located at field facilities. Effective in FY 1998, FAA began using the moving weighted average cost method to value operating materials and supplies. This change resulted in \$64.7 million decrease in the value of inventory. In FY 1998 FAA conducted an inventory of 100% of its spare parts, which resulted in an increase of \$118 million in spare parts recorded as a prior period adjustment. FAA currently expenses operating materials and supplies as issued or consumed.

- (1) In FY 1998, FAA recognized a \$21.9 million gain as a result of a decrease in the allowance for excess, obsolete, and unserviceable items.
- (2) Items are considered for repair based on condition levels and if the maximum repair cost does not exceed 65 percent of the original cost. The allowance method is used to account for operating materials and supplies held for repair, reducing the net carrying value of such items to 35 percent of their original cost. Current period expenses are recognized for the amount of the annual increase or decrease to the allowance account. In FY 1998, FAA recognized \$ 11.2 million decrease in the allowance for items held for repair.
- (3) FAA is in the process of analyzing \$146 million recorded in its inventory clearing account in order to assess whether the balance of the operating material and supplies needs to be adjusted.

Scrap and salvage items are written down to zero value and may be sold for nominal amounts. FAA transfers excess items for disposal into the Government-wide automated disposal system. Disposal proceeds may go to the General Fund or to a FAA appropriation, depending on the nature of the item and the disposal method. FAA may not donate items.

Note 9. Property, Plant and Equipment, Net

(Dollars in Thousands)

Classes of Fixed Assets	Depreciation Method	Service Life (yrs)	Acquisition Value	Accumulated Deprec.	Net Book Value
Land	None	None	\$ 76,742	-	\$ 76,742
Buildings and Structures	SL	15-40	\$ 2,480,938	(1,232,989)	1,247,949
Improvements	SL	*	27,861	-	27,861
Aircraft	SL	20	320,827	(69,159)	251,668
Aircraft Engines	SL	7	2,761	-	2,761
ADP Software	SL	*	33,419	-	33,419
Equipment	SL	5-13	4,149,372	(2,100,470)	2,048,902
Assets Under Capital Leas	SL	Term-4	192,008	(91,888)	100,120
Construction in Progress	None	None	4,497,220	-	4,497,220
Property Not in Use	*	*	88,471	-	88,471
Total			\$ 11,869,619	\$(3,494,506)	\$ 8,375,113

- (1) In FY 1998, FAA changed its real property capitalization threshold from \$5 thousand to \$25 thousand. This resulted in a prior period adjustment of \$238.8 million. In addition, FAA made a \$104.6 million prior period adjustment as a result of the change in the personal property capitalization threshold.
- (2) In FY 1998, FAA fully implemented depreciation of general PP&E. This implementation resulted in a prior period adjustment of \$3,171 million. The depreciation of aircraft and assets acquired under capital lease was implemented in FY 1996.
- (3) In FY 1998 a reconciliation of the property systems to the general ledger was performed. This reconciliation resulted in a prior period adjustment of \$228 million for real property and a \$13.9 million adjustment for personal property.
- (4) Currently FAA is in the process of reconciling its construction in progress accounts. This requires extensive reconciliation that includes identifying those items that are actually work in progress and those that have been commissioned. It also involves reconciliation of the purchases-in-transit account.
- (5) In FY 1998, FAA recognized a loss on fixed assets of \$14.8 million for excess and surplus property in Utilization Screening and Disposition (USD) system.
- (6) Documentation to support the historical costs of real property assets that were placed in use between 1960 and 1980 were not readily available, and what was available was inconsistent. Alternative methods to estimate historical costs, such as the use of modeling techniques, will be used when actual documentation cannot be found. Real property records will be adjusted in FY 1999 to reflect results of modeling/documentation efforts.

- (7) Personal property is understated by a significant amount as a result of FASAB requirements and change in the capitalization policy. Adjustments to personal property will be made in FY 1999, based on an analysis of related contract costs, e.g., common contract costs that were previously expensed because there was no applicable FAA capitalization policy. The understatement of personal property will also have a corresponding impact on accumulated depreciation.

Note 10. Debt

(Dollars in Thousands)

	Beginning Balance	Net Borrowing	Ending Balance
	_____	_____	_____
Other Debt:			
Aircraft Purchase Loan			
Guarantee Program			
Debt to the Treasury	\$ 21	\$ 3	\$ 24
	_____	_____	_____
Total Debt	\$ 21	\$ 3	\$ 24
	=====	=====	=====

Note 11. Other Liabilities

(Dollars in Thousands)

Other Liabilities Covered by Budgetary Resources

	Non- Current Liability	Current Liability	Total
	_____	_____	_____
Intragovernmental:			
Advances from Others	\$ -	\$ 24,315	\$ 24,315
Accrued Payroll & Benefits to Other Agencies	-	38,504	38,504
Proceeds From Replacement of Property	-	12	12
	_____	_____	_____
Total Intragovernmental	\$ -	\$ 69,097	\$ 69,097
	=====	=====	=====
Other Liabilities			
Advances from Others, Unclassified	\$ -	\$ 7,747	\$ 7,747
Accrued Payroll & Benefits to the Employees	-	165,462	165,462 (1)
Liability for Unapplied Collections	-	15,933	15,933
Other	-	(134)	(134)
	_____	_____	_____
Total Other Liabilities	\$ -	\$ 189,008	\$ 189,008
	=====	=====	=====

(Dollars in Thousands)

Other Liabilities Not Covered by Budgetary Resources

	Noncurrent Liability	Current Liability	Total
<u>Intragovernmental:</u>			
Federal Employees Compensation Act	\$ 102,978	\$ 78,087	181,065 (2)
Total Intragovernmental Liabilities	\$ 102,978	\$ 78,087	\$181,065
Accrued Unfunded Annual Leave & Assoc. Benefits	\$ 351,646	\$ -	\$351,646 (3)
Sick Leave Compensation Benefits for Air Traffic Controllers	56,426	-	56,426 (4)
Total	\$ 408,072	\$ -	\$408,072

- (1) Accrued payroll and employee benefits represent the unpaid pay period September 23 through September 30, 1998.
- (2) An unfunded liability is recorded for unreimbursed actual cost to be made for workers' compensation pursuant to the Federal Employees' Compensation Act (FECA) to the Department of Labor (DOL), who administers the Federal Employees' Compensation Fund. Funding for the amount charged to FAA is normally appropriated for the fiscal year ending 2 years after the FAA accounting period in which the expense was incurred. Therefore, FAA's FY 1998 accrued liability includes workers' compensation benefits paid by DOL for the periods July 1, 1996 through June 30, 1997; July 1, 1997 through June 30, 1998; and July 1, 1998 through September 30, 1998.
- (3) The estimated liability for accrued wages include annual, home, and military, and compensatory hours plus the agencies cost of employee benefits associated with such compensated absences for the period ending September 30, 1998.
- (4) In FY 1998, under the National Air Traffic Controller Association (NATCA) agreement, Article 25, Section 13, Air Traffic Controllers covered under the Federal Employees Retirement Systems (FERS) became eligible, upon retirement, for a Sick Leave Buy Back Option. Under this option, an employee who attains the required number of years of service for retirement shall receive a lump sum payment for forty (40) percent of the value of his or her accumulated sick leave as of the effective date of their retirement. The total estimated sick leave buy back contingency for FAA for those Air Traffic Controllers eligible for retirement, based on current sick leave balances, for FY 1998 is \$ \$56.4 million.

Note 12. Leases

FAA as Lessee:

Capital Leases:

(Dollars in Thousands)

Summary of Assets Under Capital Lease:

Land and Buildings:	\$ 192,008
Accumulated Amortization	<u>(91,888)</u>
Net Assets Under Capital Lease	\$ 100,120

Future Payments Due:	Land and
Fiscal Year	<u>Buildings</u>
Year 1 (FY 1999)	\$ 19,452
Year 2 (FY 2000)	14,308
Year 3 (FY 2001)	12,862
Year 4 (FY 2002)	12,867
Year 5 (FY 2003)	12,735
After 5 Years (FY 2004 to Contract End)	78,813
Less: Imputed Interest	<u>(46,818)</u>
Total Capital Lease Liability	\$ 104,219

Liabilities Covered by Budgetary Resources \$ 687

Liabilities Not Covered by Budgetary Resources \$ 103,532

Capital leases cover land and buildings at the MMAC in Oklahoma City, Oklahoma, and at the WJHTC in Pomona, New Jersey. (Operating leases discussed in the following section cover other real property.) FAA leases the MMAC land and buildings from the Oklahoma City Airport Trust at \$12 million per year. FAA leases real property, including the WJHTC technical building, from the Atlantic County Improvement Authority at \$4.8 million per year.

FAA's capital lease payments are funded annually. The following represents capital lease accounting treatment under generally accepted accounting principles:

- (1) Capital lease assets are recorded at the net present value of the total minimum lease payments over the lease duration, valued at the lease inception.
- (2) In FY 1996, FAA implemented the depreciation/amortization provision of SFFAS No. 6, which is applicable to assets acquired under capital lease. In FY 1998, FAA identified and recorded capital leases that represented a \$12.1 increase in Assets Under Capital Leases.
- (3) Amounts due within the current fiscal year corresponding to the principal portion of the lease payments are recorded as current year obligations. The remaining principal payments are recorded as unfunded lease liabilities. The imputed interest is funded and expensed annually. Interest amounts imputed to subsequent

years (aggregating \$46.8 million) are not recorded as unfunded liabilities in the Departmental Accounting and Financial Information System (DAFIS).

Operating Leases:

(Dollars in Thousands)

Future Payments Due:

Fiscal Year	Land & Buildings	Mach. & Equipment	Other	Total
Year 1 (1999)	\$ 44,762	\$ 322	\$ 2,708	\$ 47,792
Year 2 (2000)	39,038	228	1,909	41,175
Year 3 (2001)	32,628	235	1,905	34,768
Year 4 (2002)	27,465	242	1,877	29,584
Year 5 (2003)	21,495	249	1,885	23,629
After 5 Years (2004 to Contract End)	56,446	3,643	11,772	71,861 (1)
Total Future Operating Lease Payments	\$ 221,834	\$ 4,919	\$22,056	\$ 248,809

FAA leases property, aircraft, equipment, and telecommunications under operating leases. Such leases are funded annually and expensed as recurring charges in DAFIS. Unfunded liabilities and future funding requirements for operating lease payments due in future years are not recorded in DAFIS.

- (1) The cumulative amount due on operating leases after 5 years does not include estimated payments for leases with annual renewal options. Estimates of the lease termination dates are subjective, and any projection of future lease payments would be arbitrary.

FAA as Lessor:

Capital Leases:

In March 1998 FAA entered into a capital lease agreement with the South Jersey Transit Authority for the sum of \$1 for a term of 50 years. The properties under the lease will be transferred to SJTA at the end of the lease term or upon compliance with the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), Section 120. FAA recognized a loss \$ 27.4 million for buildings and other structures and \$.7 million for equipment as a result of this capital lease.

Operating Leases:

(Dollars in Thousands)

Future Projected Receipts:

Fiscal Year	Land & Buildings	Mach. & Equipment	Other	Total
Year 1 (1999)	\$ 4,193	\$ 90	\$ 2	\$ 4,285
Year 2 (2000)	4,279	90	2	4,371
Year 3 (2001)	4,297	90	2	4,389
Year 4 (2002)	4,712	90	2	4,804
Year 5 (2003)	5,169	90	2	5,261
After 5 Years (2004 to Contract End)	170,750	90	2	170,842
Total Future Operating Lease Receivables	\$ 193,400	\$ 540	\$12	\$ 193,952

FAA leases Ronald Reagan Washington National Airport and Washington Dulles International Airport to the Metropolitan Washington Airports Authority, the airports' sponsor. The lease took effect in March 1987 at

\$3 million per year for a 50-year term. Subsequent annual rental payments are adjusted by applying the Implicit Price Deflator for the Gross National Product published by the Department of Commerce. Additionally, the parties may renegotiate the level of lease payments attributable to inflation costs every ten years.

Upon lease expiration, the airports and facilities, originally valued at \$244 million, together with any improvements thereto, will revert to the Federal Government. In addition, FAA leases equipment to foreign governments and leases parcels of Government-owned land, generally for agriculture.

Note 13. Environmental and Disposal Liabilities

(Dollars in Thousands)

Environmental Remediation	\$ 828,900 (1)
OSHA & Environmental Compliance	512,200 (2)
Decommissioning Cleanup	1,900,000 (3)
Air Traffic Control at Closed DOD Bases	<u>3,200 (4)</u>
Total Environmental and Disposal Liabilities	<u>\$ 3,244,300</u>

- (1) Environmental remediation includes fuel storage tank program and environmental cleanup, associated with normal part of operations or a result of an accident, e.g., the superfund cleanup.
- (2) OSHA and environmental compliance includes environmental, occupational safety and health compliance, and energy conservation. In FY 1996, OSHA and environmental compliance were combined with environmental remediation.
- (3) SFFAS #6 defines cleanup costs as the "cost of removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consist of hazardous waste at permanent or temporary closure or shutdown of associated property, plant, or equipment. As of September 30, 1998, the total liability for the estimated cleanup costs was \$1.9 billion that will result from future decommissioning of FAA facilities and equipment. Of that amount, \$1.5 billion was recorded as prior period adjustment and \$376 million was previously recognized as a liability in FY 1997. FAA complies with the Federal Facilities Compliance Act, 40 CFR, specifically the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and RCRA, as well as all state and local environmental regulations.
- (4) Providing Air Traffic Control (ATC) services where needed is FAA's responsibility under 49 U.S.C. 44502(a)(1)(B). FAA will continue providing ATC functions for civilian users of the National Airspace System near certain DOD bases scheduled for closure. FAA's costs include those for National Air Space equipment, real property, and personnel relocation.

Note 14. Federal Employee and Veterans Benefits Payable

(Dollars in Thousands)

Other Post-Employment Benefits	
Federal Employees Compensation Act:	
Actuarial Liabilities	<u>\$ 926,780</u>
Total	<u>\$ 926,780</u>

The liability consists of the net present value of estimated future payments calculated by the DOL. The liability estimates include death, disability, medical, and miscellaneous costs for approved compensation cases.

Note 15. Contingent Liabilities

(Dollars in Thousands)

	Noncurrent Liability	Current Liability	Total
Contingent Liabilities for Legal Claims	\$ 433,444	\$ -	\$ 433,444
Contingent Liabilities for Return Rights Program	22,150	9,800	31,950
Total Contingent Liabilities	\$ 455,594	\$ 9,800	\$ 465,394

- (1) In FY 1997, FAA recognized contingent liabilities of \$438.3 million associated with claims that had been brought to the attention of the OCC and that: (a) had been asserted, or, if not yet asserted, in the opinion of the OCC were more likely to be asserted than not; (b) in the opinion of the OCC were more likely to be paid than not; and (c) for which the OCC could estimate probable payment. Such claims represent a variety of administrative proceedings and legal actions against which the OCC was then defending or then expected to defend. During FY 1998, contingent liabilities for legal claims decreased by the amount of \$4.8 million. Of the contingent liabilities recognized, approximately \$96.1 million could be payable from agency appropriations and approximately \$337.3 million could be payable from the permanent appropriation for judgments, awards, and compromise settlements (Judgment Fund) administered by the Department of Justice.

OMB issues official interpretations to provide agencies clarification on the SFFASs. OMB has issued Interpretation No. 2, on SFFAS Nos. 4 and 5 (effective for fiscal years beginning after September 30, 1996), which requires agencies to recognize an expense and a liability for the full amount of an expected loss, whether payable from agency appropriations or from the Judgment Fund. In accordance with Interpretation No. 2, "once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, liability should be removed from the financial statements of the entity that incurred the liability and another financing source amount (which represents the amount to be paid by the Judgment Fund) would be recognized." The amount of the legal liabilities recognized by FAA during FY 1998 known to be paid or payable from the Judgment Fund is contingent upon a final claim settlement or court assessment. FAA did recognize other financing sources in the amount of \$39 million for claims paid by the Judgment Fund during FY 1998.

- (2) Contingent liabilities for the Return Rights Program decreased by \$9.6 million from \$41.5 million in FY 1997 to \$31.9 million in FY 1998. The program covers temporary assignments for 2 to 4 years. At the beginning of FY 1998, approximately 854 employees who previously had accepted transfers to overseas or certain domestic locations were contractually entitled to a future return move at Government expense. The typical cost per move is \$50,000. The liability may be overstated because not every employee remaining in the program will exercise his or her right. If every employee in the program did exercise his or her right, the liability would be as follows:

FY 1999	9,800,000
FY 2000	8,600,000
FY 2001	<u>13,550,000</u>
	<u>\$31,950,000</u>

Note 16. Unexpended Appropriations

(Dollars in Thousands)

	<u>Operations General Fund</u>	<u>Other Funds</u>	<u>Total</u>
(1) Unobligated			
(a) Available	\$ 4,014	\$ 1,878	\$ 5,892
(b) Unavailable	42,853	-	42,853
(2) Undelivered Orders	<u>302,992</u>	<u>77</u>	<u>303,069</u>
Sub-total	\$ 349,859	\$ 1,955	\$351,814
Less: Other Differences	<u>(15,841)</u>	<u>497</u>	<u>(15,344)</u>
Total Unexpended Appropriations	<u>\$ 334,018</u>	<u>\$ 2,452</u>	<u>\$336,470</u>

The differences represents the amount of undelivered orders and accounts payable that exceeds the total amount of unrequisioned cash authority, the Treasury cash balance and the unobligated authority, and other differences carried forward from prior years.

Note 17. Cumulative Results of Operations

FAA's Cumulative Results of Operations is \$ 13,216,803,000 which includes unexpended appropriation amounts associated with the trust fund activity. Appropriations were issued for the Airport Improvement Program (grants) in the amount of \$ 1,640,000,000 for paying (liquidating appropriations) claims resulting from authorizations to enter into agreements (contract authority). Appropriations were also issued for the Facilities and Equipment, Research, Engineering and Development, and Operations programs in the amount of \$11,616,412,486. The unexpended appropriations included undelivered orders for \$4,080,237,911 and unobligated balances of \$9,176,174,575. Of the unobligated portion, \$518,724,722 is unavailable for obligation and \$ 8,657,450,053 is available for obligation.

Note 18. Total Cost and Earned Revenue by Budget Functional Classification

Total Cost by Budget Functional Classification

(Dollars in Thousands)

Functional Classification:	<u>Total Cost</u>	<u>Earned Revenue</u>	<u>Net Cost</u>
Transportation Programs	\$ 9,197,759	\$ (116,296)	\$ 9,081,463
Community and Regional Development Programs	302	-	302
General Government Programs	47	-	47
Total Cost	<u>\$ 9,198,108</u>	<u>\$ (116,296)</u>	<u>\$ 9,081,812</u>

Note 19. Net Cost by Programs

FAA's six lines of business represent the programs reported on the Statement of Net Cost. Assigned cost centers to each line of business permit the direct accumulation of costs. Other costs that are not directly traced to each line of business, such as agency overhead are allocated by applying ratios representing the cost for each line of business cost compared to total expenses excluding grants expenses.

Note 20. Deferred maintenance (unaudited)

Information on FAA's deferred maintenance is based on condition assessment survey (annual inspection). Standards (orders) are provided for evaluating the fixed assets condition. These standards are combined with FAA's technicians' knowledge, past experiences and judgment to provide the following:

- Minimum and desirable condition descriptions
- Suggested maintenance schedules
- Standard costs for maintenance actions
- Standardized condition codes

There have not been material changes in the standards in recent years.

FAA recognizes maintenance expense as incurred. However, maintenance was insufficient during the past several years and resulted in deferred maintenance on Buildings and Other Structure and Facilities. The following table presents information on deferred maintenance on major categories of the FAA's PP&E:

(Dollars in Thousands)

<u>Category</u>	<u>Method</u>	<u>Asset Condition</u>	<u>Cost to Return to * Acceptable Condition</u>	
Land				(1)
Buildings	Condition Assessment Survey	4 & 5	18,214	
Other Structures and Facilities	Condition Assessment Survey	4&5	1,231	
Aircraft and Aircraft Engines			-	(2)
National Airspace System (NAS) Equipment			-	(3)
General Purpose Equipment			-	(4)
Assets Under Capital Lease			-	
Total			19,445	

Condition Rating Scale

- 1: Excellent
- 2: Good
- 3: Fair
- 4: Poor
- 5: Very Poor

(1) No material maintenance was deferred on land.

- (2) Maintenance was not deferred on the FAA aircraft. The aircraft maintenance was ensured through the aircraft maintenance, inspection, preventive maintenance and alteration programs of the Flight Inspection Maintenance Division programs.
- (3) The FAA did not defer maintenance on NAS equipment. The maintenance of the Airway Facilities (AF) systems, subsystems, and equipment in the NAS is guided by the general principle of ensuring availability and reliability of air traffic control, navigation, and communication services. In order to minimize the quantity and duration of service interruption and outages, both planned and unplanned, AF does not generally defer the maintenance of the electronic equipment. Various reasons may cause a maintenance cycle to be skipped, but the maintenance is performed during the next cycle. FAA Order 6000.30 states the minimum standards for reliability and availability of NAS equipment. AF's following initiatives ensure the highest possible levels of performance of NAS equipment:
- Periodic and preventive maintenance programs
 - Maintenance of backup equipment for key services in case of equipment interruption or missed maintenance
 - Competent technical maintenance staff
- (4) The amount recorded as FAA's general-purpose equipment was not material; therefore, no material maintenance was deferred on these equipments.

Note 21. Taxes and Other Non-Exchange Revenue

(Dollars in Thousands)

Passenger Ticket Tax	\$ 6,190,226
Waybill Tax	313,503
International Departure Tax	947,775
Fuel Taxes	702,336
Tax Refunds and Credits	(43,191)
Investment Income	582,273
Other Non-Exchange Revenue	<u>33,050</u>
Total Taxes and Other Non-Exchange Revenue	<u>\$ 8,725,972</u>

Taxes are collected by the Department of the Treasury (Treasury) Internal Revenue Service for FAA's Airport and Airway Trust Fund. These taxes can be withdrawn only as authorized by various FAA appropriations. The amounts reflected above are taxes reported to FAA by Treasury. Treasury estimates taxes to be collected each quarter and adjusts the estimates by actual collections. The Taxpayer Act of 1997 (P.L. 105-34) delayed the collection date of excise taxes for the Airport and Airway Trust Fund until the first quarter of FY 1999. Because of the delayed deposit rule these receipts, otherwise due in the fourth quarter of FY 1998, were not included in the tax receipt amounts reported for FY 1998. The Treasury, Office of Tax Analysis (OTA) estimated the tax receipt amount as approximately \$1.1 billion for the tax quarter ending September 30, 1998 that would be due in October 1998.

Note 22. Imputed Financing:

Dollars in Thousands

Office of Personnel Management	316,853	(1)
Dept. of Justice Judgment Fund	<u>38,879</u>	(2)
Total Imputed Financing	<u>355,732</u>	

- (1) In FY 1998, FAA recognized as imputed financing the amount of accrued pension and post-retirement benefit expenses for current employees. The assets and liabilities associated with such benefits are the responsibility of the administering agency, OPM.
- (2) In FY 1998, amounts paid by the Judgment Fund in settlement of claims or court assessments against the FAA were recognized as imputed financing.

Note 23. Prior Period Adjustments

In FY 1998 FAA recorded the following prior period adjustments:

(Dollars in Thousands)

Implementation of Depreciation	\$ (3,171,304)
Change in Capitalization Threshold	(343,389)
Reconciliation of Property Systems to General Ledger	(241,955)
Operating Materials and Supplies Price Adjustment	(32,479)
Operating Materials and Supplies Field Spares Inventory	265,604
Cleanup Cost Implementation	(1,524,000)
Correction of Airport Improvement Program Grants	(145,602)
Judgment Fund Correction	(38,879)
Other	<u>(296,061)</u>
Total Prior Period Adjustment	<u>\$ (5,528,065)</u>

Note 24. Increase (Decrease) in Unexpended Appropriations

Upon receipt of the Apportionment and Reapportionment Schedule, SF-132, the Trust Fund activity is recorded in the FAA general ledger as appropriations. The Department of Treasury, who requested agencies *not* to report these amounts as unexpended appropriations, is in the process of working with OMB and FASAB to resolve the issue. In FY 1998, as directed by OMB and Treasury FAA reclassified these amounts from unexpended appropriations to cumulative results of operations. However, the year to date accounting of the trust fund activity (excluding closing entries) is included in the increase (decrease) of the unexpended appropriation amount.

Note 25. Statement of Budgetary Resources Disclosures

FAA reclassified 8.5 billion of Unobligated Balances-Available reported by the U.S. Department of Treasury for Airport and Airway Trust Fund (Corpus) to Unobligated Balances-Not-Available. These invested amounts cannot be utilized by FAA for program purposes unless appropriated by Congress.

As of September 30, 1998, FAA recorded 337.3 million as the net amount of budgetary resources obligated for undelivered orders.

The Aircraft Purchase Guarantee Program is funded under the authority to borrow from the U.S. Treasury granted by Congress in the DOT and Related Agencies Appropriation Act, 1983. Borrowing authority is implemented through a blanket promissory, which provides FAA with a line of credit for the full amount of borrowing authority granted by Congress. Because authorization for issuing new loan guarantees expired in 1988, FAA has not issued any new guaranteed loans. In FY 1998 FAA had an outstanding loan which they refinanced through an advance from Treasury, which is payable with interest on September 30, 2000. Although FAA does have borrowing authority it is seeking a liquidating appropriation to pay off the remaining note with Treasury and end the program.

Under Congressional legislation in FY 1998, FAA was authorized \$1.7 billion in contract authority and liquidating authority for \$1.6 billion, which is derived from the Airport and Airway Trust Fund and available until expended, for the Grants-in-Aid Programs. The contract authority available as of September 30, 1998 was \$75 million.

Congress mandated permanent indefinite appropriations for the Facilities and Equipment, Grants-in-Aid, and Research, Development and Engineering in order to fully fund special projects that were on-going and spanned several years.

FAA does not have any differences between the information reported on the statement and the amounts described as "actual" in the Budget of the United States Government for the FY 1998.

FAA incurred several adjustments to their budgetary resources in FY 1998. Contract authority for Grants-in-Aid program was reduced by a \$412 million rescission (PL 105-66), and \$295 million rescission for the Emergency Supplemental Bill (PL 105-174). The Operations appropriation was reduced by \$.9 million for services associated with the Transportation Administration Service Center and \$50 million for funds transferred to the Essential Air Service and Rural Airport Improvement Program Fund.

In an effort to accurately reflect the status of budgetary resources, FAA compiled data from the SF-132, Apportionment and Reapportionment Schedule, and the SF-133, Report on Budget Execution, to prepare the Statement of Budgetary Resources. Some of the budgetary account balances from the general ledger were not accurate or were incomplete because the processes to record specific transactions were not available in the accounting system.

Note 26. Costs Capitalized on the Balance Sheet

In FY 1998 FAA reported a decrease of \$2.9 billion in costs capitalized on the balance sheet. This decrease resulted from the implementation of the depreciation policy, the change in capitalization threshold, reconciliation of the property systems to the general ledger and the operating materials and supplies price adjustment.

Note 27. Financing Sources yet to be Provided

(Dollars in Thousands)

Liabilities Not Covered By Budgetary Resources (FY 98)	\$ 5,329,167	
Liabilities Not Covered By Budgetary Resources (FY 97)	3,061,782	
Financing Sources Yet to be Provided:		<u>\$ 2,267,385</u>
Decreases:		
Federal Employee Compensation Act (FECA Actuarial)	\$ (67,129)	
Contingent Liability for Legal Claims	(4,807)	
Contingent Liabilities for Return Rights	(9,600)	
Voluntary Separation	(3,968)	
Total Decreases		<u>\$ (85,504)</u>
Increases:		
Debt	\$ 3	
Federal Employee Compensation Act (FECA Actual)	5,811	
(Includes Prior Period Adjustment of \$19,138)		
Accrued Unfunded Annual Leave	7,373	
Sick Leave Buy- Out for Air Traffic Controllers	56,426	
Capital Lease Liability	1,876	
Environmental and Disposal Liability	2,279,400	
(Includes Prior Period Adjustment of \$1,524,000)		
Total Increases (Prior Period Adjustment Included)		<u>\$ 2,350,889</u>
Prior Period Adjustment (Cleanup Cost Implementation)	\$ (1,504,862)	
Financing Sources Yet To Be Provided (Increases less Prior Period Adjustment)		<u>\$ 846,027</u>

Note 28. Custodial Activity

Revenue Activity:

Sources of Cash Collections:

(Dollars in Thousands)

Miscellaneous Receipts	\$ 1,102
Fines	17,873
Penalties	<u>59</u>
Total Cash Collections	<u>19,034</u>
Accrual Adjustment	<u>1,105</u>
Total Custodial Revenue	<u>\$ 20,139</u>
Disposition of Collections:	
Transferred to Others (by Recipient):	
Treasury (General Fund)	\$ 19,034
Increase (Decrease) in Amounts Yet to be Tra	1,105
Collections Used for Refunds and Other Paym	-
Retained by the Reporting Entity	<u>-</u>
Total Disposition of Custodial Revenue	<u>\$ 20,139</u>
Net Custodial Activity	<u>\$ -</u>

Note 29. Other Disclosures

Legal Proceedings. FAA recognized contingent liabilities of \$433.4 million for certain claims. This represents an decrease in the amount of \$4.8 million from FY 1997. Such claims are those that have been brought to the attention of the OCC and that (a) have been asserted, or, if not yet asserted, in the opinion of the OCC are more likely to be asserted than not; (b) in the opinion of the OCC are more likely to be paid than not; and (c) for which the OCC can estimate the probable payment. The maximum exposure associated with such claims is \$81.4 billion. Therefore, FAA's exposure to loss for such contingent liabilities in excess of the amount recognized is \$81 billion.

Contract Negotiations. FAA had a total of \$73.1 million in commitments (funds reserved for possible future obligations) under unexpired Facilities and Equipment, and Research, Engineering, and Development appropriations, for purchases of goods and services for which contract negotiations have not been completed (i.e., agency obligations had not been incurred) at the end of FY 1998.

Contract Options. As of September 30, 1998, FAA had \$2.8 billion in contact options that, if exercised, would require the obligation of funds in future years.

Letter of Intent. FAA has authority under 49 U.S.C. 47110(e) to issue letter of intent (LOI) to enter into AIP grant obligations; but LOI's do not create obligations. FAA has issued LOIs covering FY 1998 through FY 2010 in the aggregate amount of \$2.930 billion. FAA had obligated \$1.655 billion of this total from FY 1988 through FY 1998, leaving \$1.275 billion unobligated as of September 30, 1998. FAA anticipates obligating \$183 million of this total in FY 1999.

AIP Grants. The FY 1998 AIP grant authority totaled \$1.7 billion, including \$989 million in entitlements to specific locations. The sponsors of these entitlements claimed all but \$66 million. This amount will be available from unused or newly enacted contract authority to those sponsors through FY 2000, or 2001 in case of non-hub primary airport locations.

Aviation Insurance program. FAA may issue aircraft hull and liability insurance under the Aviation Insurance Program for certain air carrier operations. FAA's authority to issue insurance is limited to situations where commercial insurance is not available on fair and reasonable terms and where the operation to be insured is necessary to carry out the U.S. Government's foreign policy. No claims for losses were pending as of September 30, 1998.

The categories of insurance issued by FAA are: (1) premium insurance, for which a risk-based premium is charged to the air carrier; and (2) non-premium insurance. Non-premium insurance, which represented all of the insurance issued by FAA in FY 1998, is issued for air carrier operations under contract to or on behalf of a U.S. Government agency, provided that the agency has an agreement with FAA to indemnify FAA against all losses covered by the insurance. FAA maintains standby non-premium war-risk insurance policies for 48 air carriers having approximately 936 aircraft available for Defense or State Department charter operations.

FAA normally insures only a small number of air carrier operations at any time. Airspace and airport capacity in areas where FAA insurance coverage would apply is usually very limited, so that FAA expects to be able to terminate insurance coverage and/or insured air carrier operations in high-risk areas after the loss of no more than two aircraft. Thus, probably no more than two FAA-insured aircraft could be lost before the FAA exercises its regulatory authority to stop flights to the area of loss. FAA establishes maximum liability for losing one insured aircraft at the limit of commercial insurance that applied to that aircraft before FAA issued its insurance. This liability covers third party losses. In many cases, FAA's maximum liability is \$1 billion; usually it is less. Assuming a loss of not more than two aircraft per year, the maximum expected insurance liability for any year would be \$2 billion. Therefore, the range of possible liability to FAA is assumed to be between zero and \$2 billion. Since inception of the program (including the predecessor Aviation War Risk Insurance Program, dating back to 1951), only four claims, ranging from \$626 to \$122,469, respectively have been paid.

MANAGEMENT DISCUSSION AND ANALYSIS

INTRODUCTION

The Federal Aviation Administration (FAA) operates the Nation's air traffic control system and regulates aviation safety, security, and the U.S. commercial space industry. In its position on the front line of aviation safety, the FAA works with the air transportation industry, other agencies at the Federal, State, and local level, the academic community, and with its international counterparts. The goal of this wide-ranging collaboration is to provide a technically advanced airspace system that meets the highest attainable levels of safety, security and efficiency.

In each year of its four-decade history, the FAA has undergone significant change. An account of this continuous change parallels the story of American aviation, as this dynamic industry has rapidly evolved in response to calls for higher levels of safety, technological innovation, and surging growth. To deal effectively with each new challenge, the FAA has always adapted - incrementally whenever possible or with bold decisiveness when required. Change has been a constant — as persistent as the FAA's uncompromising commitment to the highest standards of aviation safety.

The 1998 Annual Report adds to the cumulative record of the FAA's progressive adaptation to the demands of the time. Prepared in conformity with the Chief Financial Officers Act of 1990, it contains the financial statements of the agency and presents a comprehensive overview of the FAA's stewardship of its resources. It also documents the FAA's prodigious workload — around the clock and border to border:

- in managing the safe, efficient flow of air travel through the nation's airspace;
- in performing the thousands of regulatory actions and inspections which are necessary to maintain the integrity and reliability of the U.S. aviation system;
- in carrying out aggressive security measures to protect air travelers from acts of terrorism and criminal misconduct; in promoting global aviation safety in collaboration with the International Civil Aviation Organization (ICAO) and other civil aviation authorities abroad;
- in upgrading facilities and expanding the capacity of U.S. airports;
- in speeding the transition to the next generation of air traffic control technology;
- in minimizing the environmental impact of aviation; and
- in licensing and regulating the commercial space industry.

Year 2000 (Y2K) Compliance

FAA Y2K readiness:

The FAA has established an aggressive program to ensure that all its computer systems will properly recognize the year 2000 data codes. The FAA has identified 645 systems, 430 mission critical and 215 non-mission critical, all of which have been assessed. The FAA determined that 233 of the 430 mission critical systems did not require renovation, 48 will be replaced with compliant systems, 5 will be retired, and 151 require renovation. As of December 31, 1998, 100 percent of FAA systems had successfully completed the renovation phase. Of the 215 non-mission critical systems, 109 were found to be compliant, 6 will be replaced, 16 will be retired, and 84 needed repair. All of the 84 non-mission critical systems that were found to be non-compliant had been renovated as of the end of December 1998. Independent validation and verification of the renovated systems is underway.

The FAA is currently in the fourth phase of the project, which is validation. This will be the largest single effort within the Y2K five-phase repair process. This is due to the need to test all applications and the complex interactions between scores of converted or replaced computer platforms, operating systems, utilities, applications, databases, and interfaces. The FAA has developed an overall end-to-end testing strategy and will oversee its implementation. The agency is on schedule to complete the validation phase by March 31, 1999, and the implementation phase by June 30, 1999.

The costs to address the agency's Y2K issues:

The FAA Y2K program cost estimates (data as of December 31, 1998) are as follows:

\$6.3 M	\$105.8 M	\$184 M	\$4 M	\$300.1 M
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The risks of Y2K issues to the agency, including any anticipated effects on agency operations:

The Y2K problem could have an impact on the following major business processes:

Air Traffic Services (such as Navigation, Surveillance, Flight Services, Weather, Air Traffic Control And Management, and Communications)

Industry Regulation and Certification

Airport Regulation and Certification

Administrative Services

Commercial Space Transportation

Research and Acquisition

Civil Aviation Security and

System and Safety Analysis.

The worst-case scenario is wide-area loss of communications. Business impact analysis indicates that loss of communications has the greatest potential for disruption of NAS operations because so many of the NAS Air Traffic Control systems are dependent on communications, especially ground to air communications.

Impact of non-readiness of third parties:

The FAA could be impacted by systems that use COTS software or hardware which, according to the information provided by the manufacturer, are not fully compliant (e.g. compliant with minor issues, not tested, no statements at all.) In the instance of Microsoft, the impact of compliance with exceptions could create extra effort during the Validation Phase to ensure that there are no Y2K-related impacts to systems or application-based exceptions declared by the manufacturers.

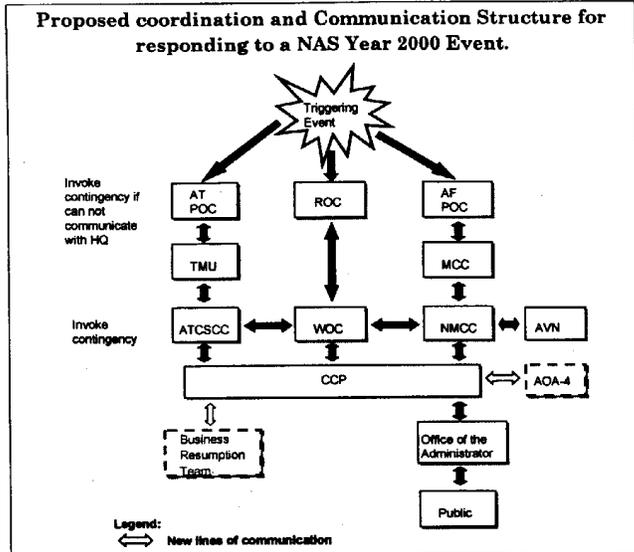
The agency's contingency plan(s), including how the agency is preparing to handle most likely worst case scenarios:

Because communications systems are so important to the NAS there are several backup communication

alternatives available. The figure below presents the proposed coordination and communication structure. As stated earlier, the existing structure for responding to a contingency has proven to be effective and efficient for reporting and resolving system interruptions. This structure will be utilized to communicate and resolve Year 2000 contingencies as well. Since the Year 2000 Program Office is responsible for all Year 2000 related events, they will participate with problem restoration and return to normal procedures for all Year 2000 contingencies.

When a trigger occurs such as a communications interruption, Air Traffic (AT) personnel and Airways Facility (AF) personnel are usually the first to become aware of the interruption. They will communicate the interruption to their respective Traffic Management Unit (TMU) and Maintenance Control Center (MCC). The Regional Operations Center (ROC) is also made aware of the interruption by either AF or AT. The ROC communicates the interruption information to the Washington Operations Center (WOC). Also, the TMU and the MCC will notify the Air Traffic Control Systems Command Center (ATCSCC) and National Maintenance Control Center (NMCC), respectively. The NMCC will notify Aviation System Standards (AVN). Once systems are repaired, AVN is available to perform rapid response flight checks. The ATCSCC and the NMCC also contact the WOC to ensure headquarters level coordination is complete. The WOC in turn informs the CCP of the problem. For interruptions that are believed to originate from Year 2000 problems, the appropriate Business Resumption Team (one for each core business process) is responsible for invoking the contingency plan, monitoring problem status, and declaring return to normal operations. For NAS outages the CCP informs the Year 2000 Program Office of the problem. For non-NAS outages, the Business Resumption Team manager is responsible for informing the Year 2000 Program Office of the problem. The Year 2000 Program Office will track problems and assist in reporting information on outages to upper management.

We have developed an FAA-wide Y2K Draft Business Continuity and Contingency Plan that builds on existing local facility contingency plans, system Y2K contingency plans, and agency emergency operations plans. The development of the BCCP involved the efforts of dozens of FAA subject matter experts to brainstorm and identify specific Y2K vulnerabilities, mitigating strategies, and modifications to current



contingency plans. The resulting risk matrices comprise 176 pages of the draft BCCP. Special attention was paid to problems perceived to be characteristic of Y2K events, such as widespread power and communications failure, and simultaneous failure of identical systems.

FAA ORGANIZATION

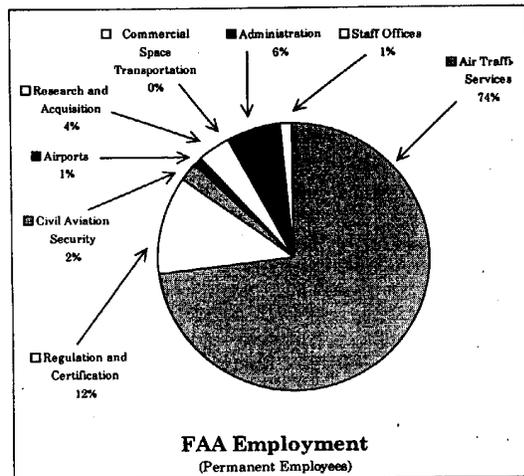
The FAA team includes nearly 49,000 employees concentrated in seven strategically focused lines of business. Together, they administer the world's busiest civil aviation system. In FY 1998, 590 million passengers flew in the Nation's skies, and the number continues to grow. The FAA annual aviation forecast, released in March 1998, predicts that U.S. commercial air carrier enplanements will reach 924 million in 2009 - an annual growth rate of 3.5 percent over the next dozen years. During the same period, the number of aircraft operations handled is forecast to grow 1.5 percent annually, for a projected total of 75.4 million in 2009.

In fulfilling its responsibilities to the American people, the FAA is focusing its attention and concentrating its resources on those opportunities with the greatest potential to bring the greatest benefits. One goal, in particular, takes precedence over all others: by the year 2007, the FAA, in collaboration with other Federal agencies and its

industry partners, aims to reduce the U.S. commercial aviation fatal accident rate by 80 percent from the 1996 levels.

Air Traffic Services

From the time pilots begin pre-flight activities until they shut down the aircraft at their destination, Air Traffic Services employees provide an integrated set of services to ensure that each aircraft operation is safe. Air traffic controllers at local airports direct airplanes that are taking off, landing, or flying within the visual range of their tower - usually about 5 miles. Controllers in terminal radar control (TRACON) facilities handle aircraft for one or more airports in a large metropolitan area, generally within 30 to 40 miles of the area's major airport. Controllers at 21 air route traffic control centers (ARTCC) centers guide airplanes in flight from one city to another. Flight service stations (FSS) provide flight plan filing, weather data, and information briefings to pilots. On a typical day, FAA controllers will handle over 174,000 takeoffs and landings, moving some 1.6 million passengers. Services are available 24-hours a day, 365 days a week. A staff of highly skilled engineers and system specialists maintain and troubleshoot over 39,000 items of equipment, software, and hardware; assign and protect more than 40,000 aeronautical radio frequencies; and conduct some



11,000 flight inspections annually to ensure the safe operation of the Nation's air traffic control systems.

In FY 1998, FAA established the Free Flight Phase 1 (FFP1) program to speed the deployment of automation and decision making tools that will increase system safety and capacity, and bring benefits to users in the form of fuel and crew cost savings. These include tools to aid controllers in aircraft sequencing, conflict detection, and collaborative decision making. The tools will be introduced incrementally, at selected locations, from the present to the end of 2001.

Regulation and Certification

The FAA oversees the safety of planes and the credentials and competency of pilots and mechanics, develops mandatory safety rules, and sets high standards for civil aviation. Each year, the FAA performs more than 347,000 inspections and investigations and takes approximately 12,000 enforcement actions, helping to make air travel among the safest modes of transportation. The FAA also evaluates foreign governments' oversight of their airlines serving U.S. airports. These results are published in FAA press releases so that the public can know which countries meet international safety standards.

Two new initiatives were announced during FY 1998 to raise the bar on safety. *Safer Skies*, a focused data-driven safety agenda, seeks out the root cause of accidents then targets resources to find and apply the right interventions. The Air Transportation Oversight System (ATOS), announced on October 1, 1998, complements the *Safer Skies* agenda, and will change how the FAA oversees and inspects air carriers. As part of the *Safer Skies* agenda, the FAA, in July 1998, provided expanded guidance for passengers and airlines on carry-on baggage regulations. The agency also announced that, at the close of FY 1998, it had doubled the number of cabin safety inspectors, assigning, for the first time, one for each of the major carriers. Also, in July, the FAA proposed eight airworthiness directives that call for the industry to inspect engine parts more closely, using new methods developed through FAA and industry research. Early that month, the FAA proposed new measures to reduce potential ignition sources in Boeing 747 center wing tanks. And, in August 1998, the FAA announced a proposed rule that will require all airplanes with turbine engines and six

or more passenger seats to carry a terrain awareness warning system.

Civil Aviation Security

The FAA works with local security, intelligence, and law enforcement agencies to protect passengers, personnel, aircraft, and critical national airspace facilities against terrorist and other criminal acts. Threats are monitored continuously and, when necessary, the FAA orders heightened precautions. As part of a massive overhaul of the U.S. aviation security system, the FAA has deployed nearly 400 trace detection devices and 62 certified explosive detection systems at airports nationwide. In addition, the number of canine teams, trained to search out hidden explosives, has grown from 87 teams at 26 airports in 1996 to 140 teams at 38 airports. For the first time in the history of this program, FAA K-9 explosive detection teams now are stationed at each of the nation's largest airports.

In January 1998, Secretary Slater announced additional surveillance of commercial air courier shipments. The announcement followed an intensive inspection and tests of accompanied commercial air courier shipments presented for flight aboard passenger aircraft. In addition, in May 1998, the FAA announced that the introduction of a new computer-based tool to help airlines improve the selection and training of employees who operate the X-ray screening checkpoints at the Nation's busiest airports. The new system will be available in up to 79 airports by year-end 1998.

Along with these initiatives, the FAA has a cadre of 130 security inspectors who oversee the movement of hazardous materials by air. Trained both in hazardous materials regulations and cargo security procedures, these agents work to prevent the transportation of dangerous goods in a manner that could jeopardize flight safety.

Airports

Airports, like the airlines, are vital links in the air transportation network. The FAA works in partnership with airport authorities, local units of government, metropolitan planning organizations, and states to revitalize and expand the Nation's airports. As part of its safety oversight mission, the FAA certifies airports serving air carrier operations

and inspects those airports for compliance with established safety standards.

In FY 1998, airport planning personnel awarded an estimated \$1.7 billion in grants to eligible airports to enhance capacity, improve safety and security, and mitigate noise. The collection of passenger facilities charges (PFC) provides an additional source of funding for airport expansion and preservation. PFC's, which must be approved by the FAA, currently produce revenue for airports totaling approximately \$1.2 billion each year. In order to increase the investment options available to airports, the Clinton Administration has proposed raising the cap on PFC's from \$3 to \$4.

The level of noise at the Nation's airports and surrounding areas continues to decline as airlines take older, noisier airplanes out of service. In a Report to Congress released in September 1998, the FAA reported that the proportion of quieter airplanes used by U.S. airlines increased from 75.5 percent to 79.8 percent. The improvement reflects compliance by the airlines with legislation passed in 1990 requiring that older, noisier airplanes be replaced by quieter airplanes by the year 2000.

Research and Acquisition

The FAA conducts research and invests in essential infrastructure to meet increasing demands for higher levels of system safety, security, capacity, and efficiency. Research priorities include explosive detection, weather, aircraft structures, noise mitigation, human factors, and satellite navigation. The FAA is in the midst of major acquisitions to replace complex equipment such as computer systems, radios, distance-measuring, long-range, and airport surveillance radar at en route and airport terminal facilities. In FY 1998, over 2,300 pieces of new equipment - ranging from basic equipment such as radios and distance-measuring equipment to systems as new and complex as the long-range and airport surveillance radar. The agency also completed hardware and software installations for the wide area augmentation system (WAAS). This milestone marks an essential step toward using the global positioning system (GPS) for precision approaches at U.S. airports. The replacement of aging display equipment at the FAA's 21 air route traffic control centers (ARTCC) also continued to move forward. At the close of FY 1998 the display system replacement (DSR) had been installed at 12 ARTCC's.

Commercial Space Transportation

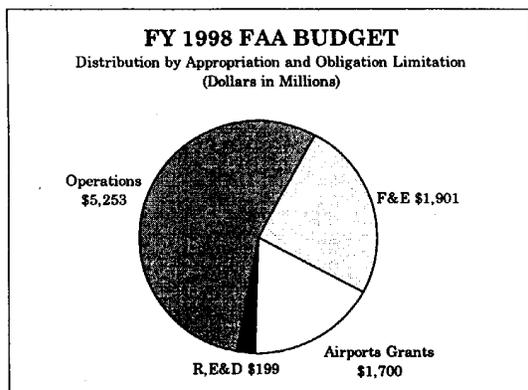
The Office of the Associate Administrator for Commercial Space Transportation licenses commercial space launches and sites to protect public health and safety of property. During FY 1998, the U.S. commercial space transportation industry conducted its 100th DOT/FAA-licensed launch when Boeing successfully launched its sixth Delta II vehicle of the year. The landmark launch carried five satellites for the Iridium global wireless telephone system into low earth orbit. Lockheed Martin launched an Athena-2 carrying Lunar Prospector to lunar orbit from Spaceport, Florida. The Athena-2 was the first FAA-licensed launch beyond earth orbit as well as the first launch from an FAA-licensed site. The office issued two launch site operator licenses: the Virginia Space flight Center and the Alaska Spaceport at Kodiak Island joined the Florida and California spaceports as FAA-licensed facilities. Also during FY 1998, the office monitored 22 licensed launches, issued four license renewals, and issued five license amendments.

Administration

FAA strives to make its operations more efficient and responsive by employing sound business practices, introducing advanced information technology, maintaining a highly skilled work force, and operating a model workplace. An effort is underway to put in place a comprehensive cost-accounting system, with phased implementation beginning October 1, 1998. In June 1998, the FAA began testing an innovative compensation plan designed to provide more flexibility in hiring, pay and placement, and the recognition of employee contributions. The new plan will replace the traditional grade-and-step base pay method with a simplified structure of pay bands whose value is determined by comparison with similar jobs in government and private industry. The test directly links compensation with the performance of employees and the success of the organization as a whole. About 1,200 employees in the FAA's Research and Acquisitions organization will be the first group to operate under the compensation pilot, which is expected to run for 18 months.

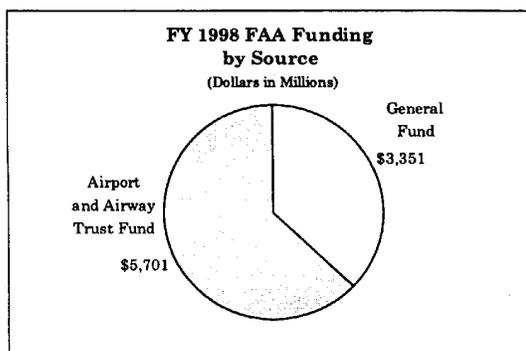
FAA BUDGET

The greatest part of the FAA's budget is used for salaries and associated costs to operate and maintain



the air traffic control system and to carry out its safety inspection, regulatory, and security responsibilities. The FAA budget also includes three capital investment programs: (1) the Facilities and Equipment (F&E) appropriation authorizes funds to modernize and expand the air traffic control system; (2) the Airport Improvement Program (AIP) provides grants funding to expand and improve the Nation's public-use airports; and (3) the Research, Engineering, and Development appropriation provides funds to develop new aviation technology and systems.

Congress approves the FAA budget through annual, multi-year, and no-year appropriations. The Airport and Airway Trust Fund, maintained through the deposit of aviation excise taxes, finances 100 percent of the F&E, AIP, and R,E&D capital investment programs. The Trust Fund also covers a portion of the costs to operate the air traffic control system. In FY 1998, the Trust Fund financed nearly 62 percent of the FAA's total budget.



Airport and Airway Trust Fund. The Airport and Airway Revenue Act of 1970 created the Aviation Trust Fund to provide a stable source of funding to finance investments in the airport and airway system and, to the extent funds were available, cover the operating costs of the airway system. The Act provided for the deposit of aviation excise taxes into the Trust Fund. Since its establishment, various changes have been made to the rate structure supporting the Trust Fund. The most recent changes were centered in the Taxpayer Relief Act of 1997 (P.L. 105-34), effective October 1, 1997:

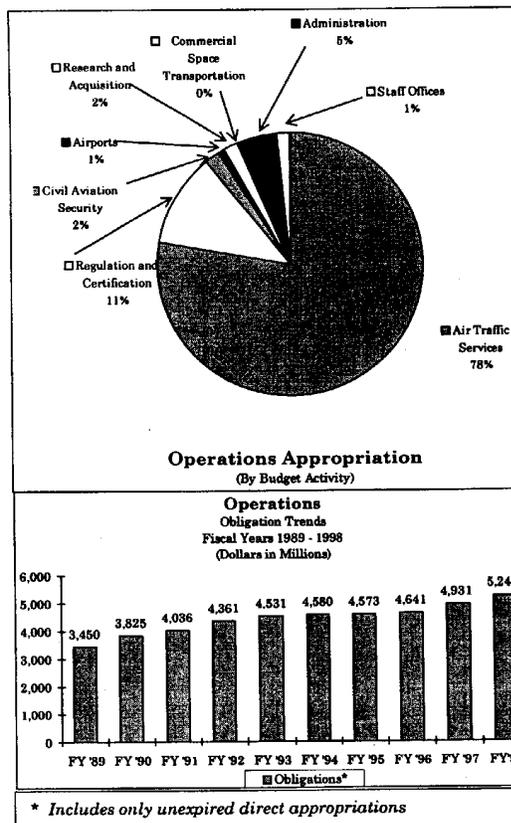
- Extends aviation taxes for 10 years (through September 30, 2007).
- Retains existing freight weighbill, GA fuel/gas taxes, and \$6 departure tax on domestic flights to and from Alaska and Hawaii.
- Converts the 10 percent ad valorem tax on domestic passenger tickets to a combination ad valorem/flight segment tax over 3 years beginning October 1, 1997, where a domestic flight segment is a flight involving a single takeoff and a single landing. The timetable for these taxes is as follows:
 - 9% plus \$1 per segment from Oct.1, 1997, through Sept. 30, 1998;
 - 8% plus \$2 per segment from Oct.1, 1998, through Sept. 30, 1999;
 - 7.5% plus \$2.25 per segment from Oct.1, 1999, through Dec. 31, 1999;
 - 7.5% plus \$2.5 per segment from Jan.1, 2000, through Dec. 31, 2000;
 - 7.5% plus \$2.75 per segment from Jan.1, 2001, through Dec. 31, 2001;
 - 7.5% plus \$3 per segment from Jan.1, 2002, through Dec. 31, 2002.
- Imposes a new 7.5 percent tax on payments to airlines for frequent flyer and similar awards by banks and credit card companies, merchants, frequent flyer program partners - other airlines, hotels, or rental car companies, and other businesses.
- Increases the current \$6 international departure tax to \$12 per passenger and adds a \$12 international arrival tax. If an intermediate stop exceeds 12 hours, subsequent domestic segments are taxed as domestic transportation. These taxes will be indexed to the Consumer Price Index beginning on January 1, 1999.

- Lowers tax rate on flights to certain rural airports to 7.5 percent, omits flight segment tax component.
- Transfers revenues from the 4.3 cents-per-gallon aviation fuel tax formerly dedicated to reduce the national U.S. deficit from the General Fund to the Airport and Airway Trust Fund.

The FAA's three capital programs—Facilities & Equipment (F&E), Research, Engineering & Development (R,E,&D), and the Airport Improvement Program (AIP)—receive 100 percent of their funding from the Trust Fund. These critical capital investment programs are described in three regularly issued plans: the Aviation System Capital Investment Plan (CIP); the FAA Plan for Research, Engineering and Development; and the National Plan of Integrated Airport Systems (NPIAS). In addition to funding the capital programs, the Trust Fund pays a portion of the FAA's operating cost. Since 1995, the Operations appropriation has received approximately 57 percent of its funding from the Trust Fund and the balance from the General Fund.

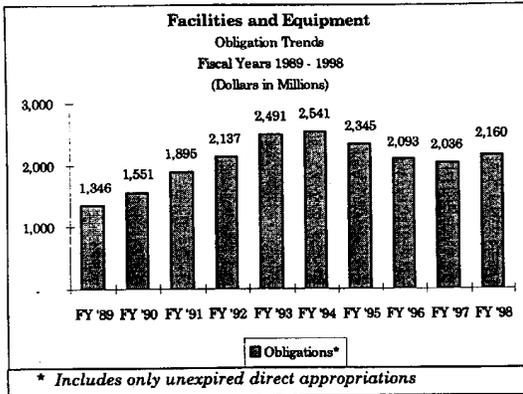
While held by Treasury, Trust Fund monies are invested in Government securities. Any interest earned is deposited into the Trust Fund. Amounts are withdrawn from the Trust Fund as it is needed and transferred into each FAA appropriation to cover necessary outlays. The uncommitted balance in the trust fund, which was \$4.34 billion at the end of FY 1998 is expected to increase to \$6.76 billion in FY 1999.

Operations. Funds from the Operations appropriation are used to pay salaries and other costs required to operate and maintain the ATC system on a 24-hour basis. Other mission-critical expenses financed by this appropriation include salaries and associated costs for: (1) the planning, direction, and evaluation of FAA programs; (2) engineering for the establishment of air navigation facilities; (3) the development and enforcement of flight standards and civil air regulations; (4) the promulgation and enforcement of standards, rules, and regulations governing the physical fitness of airmen and the direction and administration of aviation research and development programs; (5) the administration of research and development programs; (6) the protection of the traveling public in commercial U.S. air transportation against terrorist and other criminal acts; (7) the licensing and operation of commercial space launch sites; and (8) national



integrated airport planning and the supervision of grants-in-aid for airport construction.

Facilities and Equipment (F&E). Funds from the F&E appropriation are used to modernize, expand, and replenish the ATC infrastructure. Examples of F&E programs underway include the next generation air/ground communications system to provide digital communications capabilities between pilots and air traffic controllers NAS users, the replacement of aging ATC computer hardware and software; the installation of advanced radar for airport surveillance to help prevent runway incursions and to warn of hazardous weather; the augmentation of GPS; the further expansion of data link services; deployment of automated decision support tools that will enable controllers to allow users greater freedom to fly more direct routes; deployment of explosive detection systems and devices to ensure passenger safety; and



the sustainment of current infrastructure facilities. The Aviation System Capital Investment Plan (CIP) is the agency's primary mechanism for documenting current and future F&E requirements. It describes some 100 near-, mid-, and long-term capital investment projects that will require funding from the Airport and Airway Trust Fund. Implementation of the projects defined in the CIP will improve safety, security and efficiency while accommodating increased demands on the NAS.

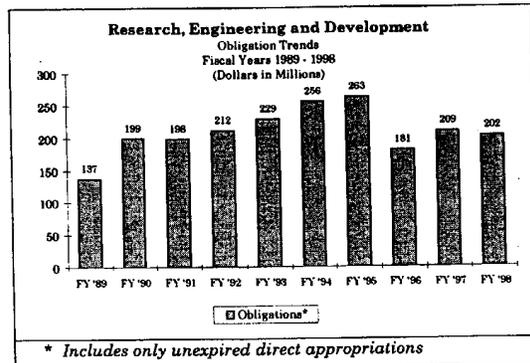
In the fall of 1997, Administrator Jane Garvey established a NAS Modernization Task Force to identify the critical issues associated with the NAS Architecture and to recommend realistic strategies on how to implement system improvements. The task force was able to achieve consensus on a human-centered, incremental approach designed to bring significant benefits to airspace users by 2002. The program, called Free Flight Phase 1, is meant to give controllers better tools that will help them perform critical air traffic duties even more effectively.

During FY 1998, Congress authorized \$1,900 million for the F&E program. The FAA obligated 85 percent of the FY 1998 appropriation. This is the highest obligation rate ever recorded during the first year of availability. The personnel and related expenses portion achieved a 99 percent first-year obligation rate while the project portion achieved an 84 percent rate. For the sixth consecutive year, total obligations exceeded the new current year budget authority, thus significantly reducing the unobligated balance brought forward from prior years.

Research, Engineering and Development (R,E&D). The FAA's R,E&D programs are directed toward improving safety, security, capacity, and efficiency in the NAS. Areas of primary focus include advanced air traffic management systems, human factors and aviation medicine research to improve efficiency and reduce the risk of human error by agency personnel and air crewmembers; development and testing of aircraft safety and fire protection methods; aviation weather research to develop advance forecasting and weather dissemination products; development and testing of explosives and weapons detection activities, and studies to improve the environment through quieter engines and reduced aircraft emissions. In FY 1998, Congress authorized \$199 for the R,E&D program.

The obligation rate was 98 percent. The FAA publishes an annual R,E&D Plan which describes initiatives for NAS service improvements and development of the next generation air traffic management system. The NAS architecture is the principal framework of NAS infrastructure investment decisions. This rationale includes criteria for selection of R,E&D programs that exploit technologies and techniques compatible with validated architectural alternatives.

Airport Improvement Program (AIP). Section 47104 of Title 49, U.S.C., authorizes the Secretary of Transportation to make project grants for airport planning and development under the AIP to maintain a safe and efficient nationwide system of public-use airports that meets both present and



future needs of civil aeronautics. The payment of user taxes to the Federal Government by air travelers and shippers contributes to the Airport and Airway Trust

Fund and makes it possible to fund one-fourth to one-third of all capital development at the Nation's public-use airports. Consequently, no Federal monies are withdrawn from the General Fund for federally assisted projects to maintain and enhance airport safety, preserve existing airport infrastructure, and expand capacity and efficiency throughout the airport system.

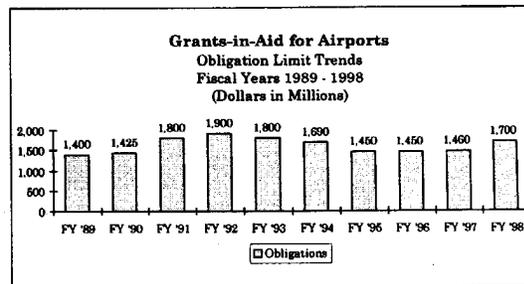
The National Plan of Integrated Airport Systems (NPIAS) draws selectively from local, regional, and state planning studies to estimate the costs associated with establishing a system of airports adequate to meet the needs of civil aviation. Costs identified in the NPIAS are nominally eligible for Federal grants-in-aid. Over the next 5 years, the cost of development needed to keep pace with growing aviation demands is estimated to be approximately \$30 billion.

In FY 1998, FAA awarded approximately \$1.70 billion in new AIP grants-in-aid obligations to improve and expand the Nation's airports. New grants awarded this fiscal year included the following: 503 grants totaling \$1,036.7 billion for primary airports; 48 grants and \$39.1 million for nonprimary commercial service airports; 122 grants totaling \$127.8 million for reliever airports; 304 grants and \$185.5 million for general aviation airports; 43 grants worth \$9.3 million for airport system planning; and \$105 million in 20 State Block Grant Program grants. In addition, \$211.9 million was awarded for 81 grants to achieve noise compatibility for communities near airports. This amount included \$84.2 million for the purchase of noise-impacted land adjacent to airports, \$88.7 million for soundproofing residences and schools, and \$39 million for other efforts to reduce noise.

The Passenger Facility Charge (PFC) program, authorized by the Aviation, Safety and Capacity Expansion Act of 1990, provides an additional source of capital funding for the expansion and preservation of airport infrastructure in the national air transportation system. This legislation allows public agencies controlling commercial service airports, after receiving approval from the FAA, to charge enplaning passengers a \$1, \$2, or \$3 facility charge.

PFC collections and AIP funds are complementary in the overall funding of airport improvements. The majority of PFC approved projects are also eligible for further funding under the AIP. As of September 30, 1998, authorized collections for the 296 approved locations since 1992 totaled over \$21.9 billion. As of September 30, 1998, 69 percent of those primary airports eligible to collect PFC's were approved to do so. Collections, which first began on June 1, 1992, now produce revenue for airports at a rate exceeding \$1.3 billion per year.

Although these revenues are not considered Federal funds, the public agency's application to impose a PFC must be approved by the FAA. During FY 1998, the FAA's airport personnel processed over 100 PFC



applications, approving over \$5.8 billion in PFC collections to fund approximately 900 projects.

FAA Budget Request for FY 1999. The Fiscal Year 1999 budget agreement reached on October 15, 1998, included more than \$7.3 billion for aviation, including air traffic operations, capital improvements, and research, and more than \$1.9 billion for airport improvement grants. The agreement included a short-term reauthorization of some FAA programs to improve aviation safety and security, to modernize the air traffic control system, and to improve airports. It is hoped that the Congress will act swiftly to send a bill to the President to ensure that these crucial programs are continued.

Special Challenges: The fatal accident rate is very low, as most of the major causes of accidents have been identified, and FAA has either issued

THE FAA'S STRATEGIC GOALS

In May 1998, the Administrator and her senior management team completed work on the goals that will carry the FAA and aerospace into the next century, from 1998 through 2003 and beyond. The 1998 FAA Strategic Plan lays out these goals, areas for strategic focus, projects to implement them, and outcome measures. The Strategic Plan is focused around three mission goals:

MISSION	GOAL
Safety	Reduce U.S. aviation fatal accident rates by 80 percent from 1996 levels by 2007.
Security	Prevent security incidents in the aviation system.
System Efficiency	Provide an aerospace transportation system that meets the needs of users and is efficient in the application of FAA and aerospace resources.

The 1998 Strategic Plan also includes four enabling goals that are not directly a part of the core FAA mission, but are critical to accomplishing the mission. These enabling goals and the strategic focus areas supporting them cut across all three of the mission goals:

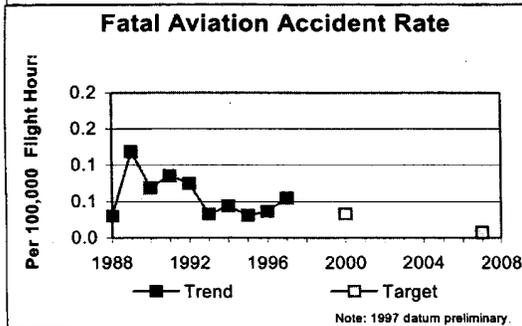
- People:** The foundation of accomplishment.
- Reform:** The framework for accomplishment.
- The Environment:** Our responsibility.
- Global Leadership:** Commitment to Worldwide Improvements.

In FY 1998, the FAA continued to channel its resources in directions dictated by its strategic plan and efforts by both the FAA and the Department of Transportation (DOT) under the Government Performance and Results Act of 1993. The performance measures on the next pages underscore the agency's commitment to each of its mission-based goals.

PROGRAM GOALS, MEASURES, AND PERFORMANCE

Air Carrier Fatal Accident Rate

Goal: By 2007, reduce the number of fatal aviation accidents by 80 percent.



accordingly to prevent potential causes of future accidents.

Current/Ongoing Activities:

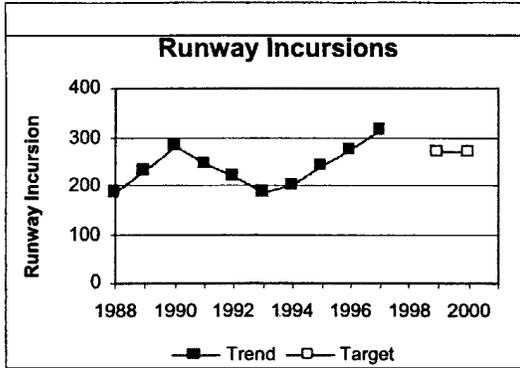
- *Safer Skies* - conduct further research into the causal factors of accidents and identify and implement intervention strategies.
- Implement the new Air Transportation Oversight System (ATOS), which changes how the agency oversees and inspects air carriers.
- Issue a final rule on the terrain awareness and warning system (TWAS).
- Issue a policy statement for Flight Operations Quality Assurance (FOQA) programs.

regulations or provided system improvements to reduce the accident risk.

Strategies: FAA will continue to work with the aviation community and other governmental agencies to identify root causes of accidents, and intervene

RUNWAY INCURSIONS

Goal: Reduce the number of runway incursions by 15%



runways; multiple taxiway/runway intersections; complex traffic patterns; and the need for traffic to cross active runways.

Strategies: FAA aims to reduce incursions by providing technologies that use multiple sensors including ground radars and automatic position reporting systems to detect the location of aircraft and vehicles, airport surface navigation aids, and enhanced software for detecting conflicts between aircraft on the runway and approaching aircraft, and signals at key points to warn pilots and ground equipment operators not to cross active runways.

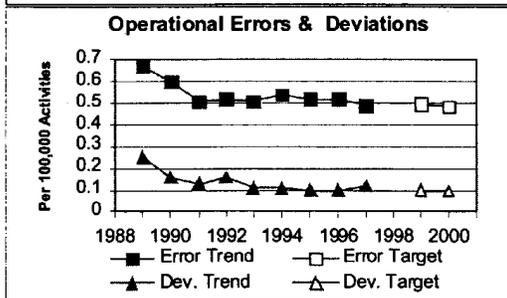
Current/Ongoing Activities:

- Complete deployment of airport surface detection radar (ASDE)
- Deploy the airport movement area safety system (AMASS)

Special Challenges: Growth in aviation operations has averaged over 1% per year. With an increased tempo of operations, the risk of incursions increases. Runway incursions are most likely to occur at complex, high volume airports. These airports are characterized by multiple parallel or intersecting

Operational Errors and Deviations (Air Traffic)

Goal: Reduce the rate of operational errors and deviations to 0.496 or less and 0.099 or less, respectively, in 1999, from a 1994 baseline of 0.541 (errors) and 0.108 (deviations).



continue to be the focus of Air Traffic service safety strategy. Technological improvements such as deployment of modern displays, new software automation and decision tools, and improved communication systems will support better determination of aircraft location and resolution of potential conflicts between aircraft.

Current/Ongoing Activities:

- Continued focus on training for controllers and cross-educational programs between pilots and controllers to provide a common level of understanding of procedures and policies among NAS operators and users that ensure safe operations.
- Conduct operational error workshops to address those areas where performance trends show increases.
- Deployment of modern displays, automation tools, decision support tools, and communications to support better determination of aircraft location and resolution of potential conflicts both in the air and on the airport surface. These include the User

Special Challenges: Operational errors and deviations are a result of human error. Studies have shown that five factors are significant: traffic management relationships, quality assurance programs, training, management involvement, and control room environment.

Strategies: One of the major approaches to reducing operational errors and deviations is to provide a common level of understanding of procedures and policies among controllers and users. Training for controllers and pilots is central to this and will

Request Evaluation Tool (URET)—one of the first phases of a conflict probe capability that is now in research and development - and the deployment of

AMASS to provide information on airport surface safety hazards.

Aviation Security

Goal: Increase the detection of explosive devices and weapons that may be brought aboard aircraft. (Detection rates are sensitive information protected under 14 CFR Part 191. The 1998 baseline and targeted increases will be made available to appropriate parties upon request).

Special Challenges: Technology and human vigilance must keep pace with the increasing sophistication of explosive devices and other dangerous articles and techniques terrorists or criminals may use to threaten a flight. At the same time, the speed of processing passengers and baggage through screening checkpoints and other security measures must improve to accommodate the rapid growth in passenger traffic. These challenges must be met while protecting civil liberties.

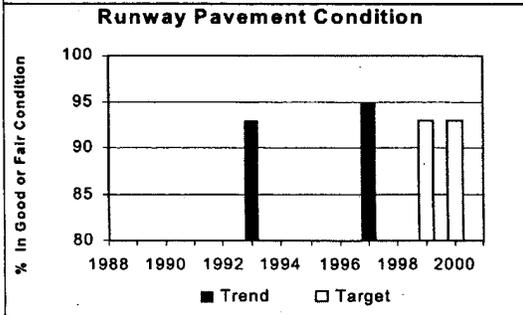
Strategies: FAA will conduct research to develop better technology and procedures to prevent weapons and explosive devices from being taken aboard aircraft. FAA will continue to purchase and deploy advanced aviation security equipment and monitor its use (and airline and airport security performance) through testing and assessments. The planned certification of screening companies is expected to increase levels of screener professionalism. A new performance-based approach to industry compliance with security requirements will encourage partnering to improve aviation security

Current/Ongoing Activities:

- In cooperation with the airlines, plan and deploy additional aviation security equipment, including trace detection devices, explosive detection systems, automated operator-assisted X-ray devices and advanced passenger screening units.
- Continue efforts leading to the purchase and installation of second-generation FAA-certified explosive detection systems to scan for explosives in checked baggage.
- Implement automated passenger profiling and bag match using the computer-assisted passenger screening (CAPS) system.
- In cooperation with the airlines, purchase and test hardened cargo containers designed to withstand bomb blasts.
- Increase the number of K-9 explosive detection teams at major airports.

Runway Pavement Condition

Goal: Maintain at least 93 percent of runway pavement in satisfactory condition.



AIP grants may use those federal dollars for purposes other than runways. In addition, airports are reluctant to spend their own funds for runway maintenance, when grants are available to rehabilitate deteriorated runways.

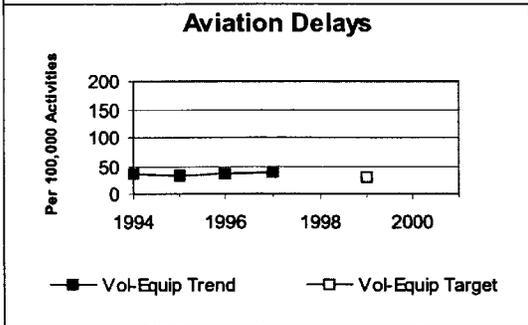
Strategies: Maintaining and rehabilitating runways costs less than total reconstruction of runways. Since FY 1995, AIP grant recipients have been required to show evidence of an airport maintenance management program, including pavement maintenance.

Current/Ongoing Activities:

Special Challenges: Although runway rehabilitation is among the highest priorities of FAA's Airport Improvement Program (AIP), recipients of

Aviation Delays

Goal: Reduce the number of volume- and equipment-related delays to 30.7 per 100,000 flight operations, from a 1994 base level of 36.9.



- Replace the aging computer equipment at all en route centers with the display system replacement (DSR), and in terminal facilities with the standard terminal automation replacement system (STARS). This new equipment will further reduce the number of outages, reduce delays, and allow optimum use of capacity to accommodate growth in operations.
- (GPS) satellite navigation.
- Implement, at various locations, new procedures that take advantage of additional runway and airport capacity increases.
- Deploy prototype automation tools, such as the passive final approach spacing tool (pFAST), to provide sequencing of departures, and increase airport acceptance rates.
- Replace obsolete long range radar with an all solid-state system that offers enhanced range, extended coverage, and vastly improved weather detection.
- Develop the integrated terminal weather system (ITWS) to link all relevant weather data available in the terminal area.
- Deploy improved weather systems, such as the terminal Doppler weather radar (TDWR), automated surface observing system (ASOS), and the weather radar processor (WARP) to detect and mitigate the impacts of weather.

Special Challenges: Capacity-related delays are most prevalent at large hub airports that have significant constraints on increasing runway capacity. Equipment failures, volume of air traffic, and runway closures are other significant causes of delays.

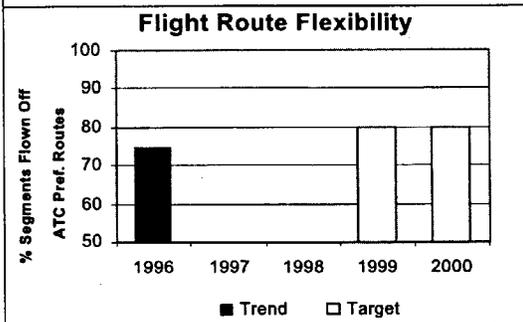
Strategies: With Free Flight Phase I, FAA is aiming to improve the spacing of traffic streams into major airports and maximize the use of available capacity. FAA is also developing improved weather reporting.

Current/Ongoing Activities:

- Bring on-line and make operational air traffic control (ATC) equipment and aeronautical navigation equipment now being delivered as part of the modernization of the ATC system.

Flight Route Flexibility

Goal: Increase the number of flights flown off ATC-preferred routes to 80% from a 1996 baseline of 75%. The 1999 goal is 80%.



software allows controllers to better project future flight paths and maintain separation for flights off the preferred routes.

Current/Ongoing Activities:

- Implement, by the year 2002, the core capabilities of Free Flight Phase 1 in partnership with the users and FAA labor organizations.
- Begin evaluation of two-way probe capability at both Indianapolis and Memphis centers.
- Award the hardware procurement contract for the pFAST to aid controllers in making decisions more efficiently regarding the sequencing and runway assignment of terminal arrival aircraft.
- Award the hardware procurement contracts for the traffic management advisor (TMA) to aid controllers in the sequencing and spacing of en route arrival aircraft.
- Deploy the surface management advisor (SMA) at Detroit Metro and Philadelphia airports to facilitate the sharing of information to airlines and to enhance decision making regarding the surface movement of aircraft.

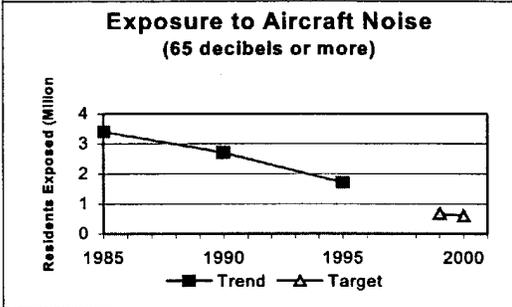
Goal: Increase the number of flights flown off ATC-preferred routes to 80% from a 1996 baseline of 75%. The 1999 goal is 80%.

Special Challenges: There are significant savings for longer routes, but the shorter routes are not as likely to benefit because of the limitations while climbing from or descending to an airport. Growth in aviation increases the complexity of air traffic control and makes it more difficult to allow flights off the preferred routes.

Strategies: FAA is implementing the Free Flight Phase I program to allow greater use of direct routes. The enhanced software tools and the Conflict Probe

Aircraft Noise Exposure

Goal: Reduce by 60 percent the number of residents exposed to significant aircraft noise (65 dB or greater), from an estimated baseline of 1.7 million in 1995.



Special Challenges: Much of the recent progress has been achieved by legislatively mandated transition of airplane fleets to newer-generation aircraft that produce less noise. Most of the gains from this change will have been achieved by FY 2000. The Airport Noise and Capacity Act of 1990 set December 31, 1999 as the deadline for elimination of Stage 2 (older, noisier) aircraft weighing more than

75,000 pounds. Growth in aviation activity also works against easy progress.

Strategies: FAA pursues a program of aircraft noise control in cooperation with the aviation community through noise reduction at the source (development and adoption of buildings near airports, operational flight control measures, and land use planning strategies).

Current/Ongoing Activities:

- Administer the grants-in-aid program to make funds available for projects mitigating the impacts of air transportation on communities.
- Continue research programs with NASA to achieve significant noise reduction technology advances.

Monitor compliance by the airlines with legislation passed in 1990 requiring that older, noisier (Stage 2) airplanes be replaced by quieter (Stage 3) airplanes by the year 2000

U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
 Stewardship Investment
 Non Federal Physical Property
 Airport Improvement Program
 For the Fiscal Year Ended September 30, 1998

(Dollars in Thousands)

State/Territory	\$
Alabama	15,556
Alaska	77,949
American Samoa	1,329
Arizona	47,243
Arkansas	19,291
California	101,897
Colorado	44,768
Connecticut	1,348
Delaware	284
District of Columbia	206
Florida	60,752
Georgia	41,604
Guam	1,260
Hawaii	7,142
Idaho	12,532
Illinois	74,514
Indiana	21,213
Iowa	16,983
Kansas	11,250
Kentucky	43,116
Louisiana	20,338
Maine	5,505
Maryland	9,765
Massachusetts	22,615
Michigan	47,890
Minnesota	23,430
Mississippi	9,788
Missouri	35,996
Montana	13,367
Nebraska	13,015
Nevada	30,420
New Hampshire	11,743
New Jersey	9,918
New Mexico	5,327
New York	67,664
North Carolina	31,226
North Dakota	10,980
Northern Mariana	3,272
Ohio	33,843
Oklahoma	5,240
Oregon	17,682
Pennsylvania	63,025
Puerto Rico	10,482
Rhode Island	2,692
South Carolina	15,419
South Dakota	10,112
Tennessee	34,885
Texas	98,154
Trust Territory of Pacific	479
Utah	12,910
Vermont	5,219
Virgin Islands	2,384
Virginia	21,733
Washington	18,405
West Virginia	19,564
Wisconsin	30,406
Wyoming	9,337
Administration	52,075
Grand Total.....	\$ 1,436,541

Stewardship Investment

Non Federal Physical Property.

Airport Improvement Program. The FAA makes project grants for airport planning and development to maintain a safe and efficient nationwide system of public-use airports that meets both present and future needs of civil aeronautics. The FAA works in partnership with airport authorities, local units of government, metropolitan planning organizations, and states.

In FY 98 FAA awarded a total of 1,040 new grants to improve and expand Nation's airports. In FY 98 the FAA focused to award grants to eligible airports to enhance capacity, improve safety and security, and mitigate noise.

U.S. Department Of Transportation
Federal Aviation Administration
Stewardship Investment
Research and Development
For the Fiscal Year Ended September 30, 1998

(Dollars in Thousands)

Expenses

Applied Research	\$ 103,274
Development	48,237
Research and Development Plant	54,179
Administration	11,254
Total	\$ <u>216,944</u>

The classification of Applied and Development expenses were calculated using percentages from the National Science Foundation's fiscal year 1997 Survey of Federal Funds for Research and Development Table II.

Stewardship Investment

Research and Development.

Research. The FAA conducts research and invests in essential infrastructure to meet increasing demands for higher levels of system safety, security, capacity, and efficiency. Critical areas of research and development include explosive detection, weather, aircraft structures, noise mitigation, human factors and satellite navigation. For air-traffic control, the FAA is introducing new technologies such as satellite navigation using the global positioning system (GPS), data link communications, and collaborative decisionmaking tools.

**U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
SUPPLEMENTARY STATEMENT OF BUDGETARY RESOURCES
As Of September 30, 1998**

(Dollars in Thousands)

	Airport & Airway Trust Fund Corpus	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development
Budgetary Resources				
Budget Authority	\$ 2,191,405	\$ 1,640,000	\$ 1,900,477	\$ 199,183
Unobligated Balances - Beginning of Period	6,358,301	72,333	638,660	8,035
Spending Authority From Offsetting Collections Adjustments	-	24,279	32,494 79,587	9,312 2,659
Total Budgetary Resources	\$ 8,549,706	\$ 1,736,612	\$ 2,651,218	\$ 219,189
Status Of Budgetary Resources				
Obligations Incurred	\$ 75	\$ 1,661,227	\$ 2,201,874	\$ 211,249
Unobligated Balances-Available	-	75,385	361,099	7,940
Unobligated Balances-Not Available	8,549,631	-	88,245	-
Total Status of Budgetary Resources	\$ 8,549,706	\$ 1,736,612	\$ 2,651,218	\$ 219,189
Outlays				
Obligations Incurred	\$ 75	\$ 1,661,227	\$ 2,201,874	\$ 211,249
Less: Spending Authority From Offsetting Collections and Adjustments	-	(36,612)	(112,081)	(11,971)
Obligated Balance, Net Beginning of Period	-	2,388,645	1,780,526	187,647
Obligated Balance Transferred, Net	-	-	-	-
Less: Obligated Balance, Net - End of Period	-	(2,502,678)	(1,643,899)	(184,340)
Total Outlays	\$ 75	\$ 1,510,582	\$ 2,226,419	\$ 202,584

**U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
SUPPLEMENTARY STATEMENT OF BUDGETARY RESOURCES
As Of September 30, 1998**

(Dollars in Thousands)

Aviation Insurance Revolving	Franchise Fund	Operations	Other Funds	Combined Total
\$ -	\$ -	\$ 5,253,488	\$ -	\$ 11,184,553
69,111	426,348	81,423	1,531	7,229,820
3,672	22,292	1,965,425	-	2,033,195
-	-	8,121	(498)	114,147
<u>\$ 72,782</u>	<u>\$ 22,719</u>	<u>\$ 7,308,458</u>	<u>\$ 1,032</u>	<u>\$ 20,561,716</u>
\$ 355	\$ 21,767	\$ 7,242,015	\$ 111	\$ 11,338,674
72,428	951	4,014	921	522,739
-	-	62,428	-	8,700,304
<u>\$ 72,783</u>	<u>\$ 22,719</u>	<u>\$ 7,308,458</u>	<u>\$ 1,032</u>	<u>\$ 20,561,716</u>
\$ 355	\$ 21,767	\$ 7,242,015	\$ 111	\$ 11,338,674
(3,672)	(22,292)	(1,974,486)	(2)	(2,161,115)
94	1,414	715,911	318	5,074,554
(189)	(3,953)	(702,892)	(385)	(5,038,337)
<u>\$ (3,412)</u>	<u>\$ (3,065)</u>	<u>\$ 5,280,549</u>	<u>\$ 42</u>	<u>\$ 9,213,775</u>

**U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
AVIATION INSURANCE REVOLVING FUND
STATEMENT OF CHANGES IN NET POSITION**

Net Cost of Operations	\$ (288)
Financing Sources	
Taxes and Other Non-Exchange Revenues	3,704
Net Results of Operations	<u>3,416</u>
Net Change in Cumulative Results of Operations	<u>3,416</u>
Change in Net Position	3,416
Net Position Beginning of Period	<u>65,702</u>
Net Position End of Period	<u>\$ 69,118</u>

U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
FRANCHISE FUND

Net Cost of Operations	\$ 3,603
Financing Sources	<u> </u>
Net Results of Operations	3,603
Prior Period Adjustments	<u>(685)</u>
Net Change in Cumulative Results of Operations	2,918
Change in Net Position	2,918
Net Position Beginning of Period	<u>1,636</u>
Net Position End of Period	<u>\$ 4,554</u>