

**AIR CARRIER COMPENSATION CLAIMS  
AIR TRANSPORTATION SAFETY AND  
SYSTEM STABILIZATION ACT**

*Office of the Secretary*

*Report No: CR-2003-092  
Date Issued: September 30, 2003*



# Memorandum

**U.S. Department of  
Transportation**

Office of the Secretary  
of Transportation

Office of Inspector General

Subject: ACTION: Report on Air Carrier Compensation  
Claims, Air Transportation Safety and System  
Stabilization Act, Office of the Secretary  
Report No: CR-2003-092

Date: September 30, 2003

From: Alexis M. Stefani   
Principal Assistant Inspector General for  
for Auditing and Evaluation

Reply to JA-1  
Attn. of:

To: Acting Assistant Secretary for Aviation and  
International Affairs

This consolidated report summarizes the results of our reviews of financial and operational data submitted by 19 non-major air carriers<sup>1</sup> in support of compensation claims filed under the Air Transportation Safety and System Stabilization Act (Act). Our objective in these reviews was to evaluate the reasonableness of the air carriers' compensation claims. The results of the reviews were previously provided to the Claims Review Team, within the Secretary's Office of the Assistant Secretary for Aviation and International Affairs, in a series of individual advisories that we issued from April 2002 through September 2003. Based on the findings and recommendations contained in those advisories, the Department has concurred with and realized savings of \$28.5 million. The Department could realize additional savings of \$10.5 million if the Claims Review Team concurs with our findings and recommendations concerning three additional air carriers.

The reviews were performed in accordance with the Department's procedures, which state that all air carrier claims are subject to audit by the Office of Inspector General (OIG), and included testing of claimed amounts to source documents. Exhibit A provides details on the results of our reviews. Our scope, methodology, and prior audit coverage are described in Exhibit B. The scope of our review was limited to non-major air carriers because Congress requested the General Accounting Office to report on the major airlines' September 11-related losses and the compensation payments they received for those losses.

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<sup>1</sup> Due to the proprietary nature of the information contained in this report, we did not identify each carrier by name and provided an alphabetical identity instead.

## BACKGROUND

The terrorist attacks on September 11, 2001, and the temporary shutdown of civil aviation that followed resulted in severe financial losses to the U.S. commercial aviation industry and placed the financial survival of many air carriers at risk. The Act was intended to provide emergency financial relief to preserve the continued viability of the U.S. air transportation system.

Section 101(a)(2) of the Act provided \$5 billion in compensation for:

(A) direct losses incurred beginning on September 11, 2001, by air carriers as a result of any Federal ground stop order issued by the Secretary of Transportation or any subsequent order which continues or renews such stoppage; and

(B) the incremental losses incurred beginning September 11, 2001 and ending December 31, 2001, by air carriers as a direct result of such attacks.

Section 103(b) of the Act established the maximum compensation the Department could pay an air carrier:

. . . the lesser of- (1) the amount of such air carrier's direct and incremental losses described in section 101(a)(2); or

(2) in the case of- (A) flights involving passenger-only or combined passenger and cargo transportation, the product of- (i) \$4,500,000,000; and (ii) the ratio of- (I) the available seat miles of the air carrier for the month of August 2001 as reported to the Secretary; to (II) the total available seat miles of all such air carriers for such month as reported to the Secretary; and (B) flights involving cargo-only transportation, the product of- (i) \$500,000,000; and (ii) the ratio of- (I) the revenue ton miles or other auditable measure of the air carrier for cargo for the latest quarter for which data is available as reported to the Secretary; to (II) the total revenue ton miles or other such auditable measure of all such air carriers for cargo for such quarter as reported to the Secretary.<sup>2</sup>

The Department distributed a draft program guidance letter to the air carrier industry the same day the President signed the Act. The guidance letter sets forth the Department's request for information in order to distribute up to one-half of

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<sup>2</sup> Revenue ton miles for the quarter ending June 2001 were used.

the estimated compensation amounts. In addition, the Department's draft program guidance letter outlined claim information required from air carriers, and provided a form air carriers were required to complete in order to receive an initial compensation payment.

Within 6 days after the Act was signed, the Department had authorized \$2.3 billion in emergency payments to eligible air carriers. After authorizing the emergency payments, the Department issued formal procedures and four amendments to those procedures for air carriers to follow regarding compensation under the Act. Payments to air carriers were based on the lower of the carrier's actual direct and incremental losses or a formula amount calculated from their operational data.

The Department ultimately made payments in three rounds, which helped to expedite release of the initial funds, develop a clearer understanding of the collective losses of air carriers, and avoid overpayments to air carriers. As of September 2003, the Department had made payments in excess of \$4.6 billion to more than 400 air carriers.

## RESULTS

We reviewed financial and operational data that 19 non-major air carriers submitted in support of their compensation claims. Our reviews were either self-initiated or requested by the Department's Claims Review Team. We previously issued individual advisories that reported the results of our reviews to the Department. We found 3 of the 19 air carriers were able to support their compensation claims, and for 15 of the 19 air carriers, we recommended cost adjustments representing potential savings of \$45.9 million to the Department.<sup>3</sup> As of September 2003, the Department concurred with and realized \$28.5 million of these savings. The Department could realize an additional \$10.5 million of savings if the Claims Review Team concurs with our findings and its discussions with three additional air carriers result in lower compensation.

Our reviews of air carrier claims found that:<sup>4</sup>

- 11 air carriers claimed incremental losses that were not directly related to the events of September 11. These claims included costs incurred for an air carrier's reorganization under bankruptcy protection, uncollectible bad debts, or costs incurred outside the eligible compensation period;

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<sup>3</sup> Our review of one air carrier was not used because the results were on the second round claim and final payment was based on a significantly different claim.

<sup>4</sup> Reviews of air carrier claims may have identified more than one deficiency for each air carrier.

- 9 air carriers could not provide adequate support for their claimed expenses;
- 4 air carriers submitted unacceptable pre-September 11 forecasts; and
- 4 air carriers submitted unsupported operational data.

### **Incremental Losses Not Directly Related to September 11**

Of the 19 air carriers we reviewed, 11 submitted claims that included incremental losses not directly related to September 11. The Department defined an “incremental loss” as a loss incurred by an air carrier from September 11 through December 31, 2001, as a result of the terrorist attacks, and does not include any loss that would have been incurred had the attacks not occurred.

Carrier L, for example, in its \$20.3 million request, claimed \$14.6 million in bad debt allowances that it recorded for unpaid expenses by two of its code-share partners.<sup>5</sup> After an evaluation, we concluded that these unpaid expenses were not compensable losses because the charges represented expenses incurred before the compensation period. The non-payment was related to issues existing between Carrier L and its code-share-partners before September 11. The Claims Review Team’s settlement with the air carrier included a disallowance related to \$12.0 million of bad debts.

In another example, Carrier M began operating under Chapter 11 bankruptcy protection prior to September 11, 2001, and successfully emerged from bankruptcy as a reorganized company before December 31, 2001. Based on our review of Carrier M’s supporting documentation for its \$2.1 million claim, we concluded that four expense accounts included expenses resulting from filing for bankruptcy protection in August 2001, and were not related to the events of September 11. The Claims Review Team concurred with our review and disallowed more than \$1 million of claimed costs.

### **Unsupported Expenses**

We identified nine air carriers that could not adequately support their reported expenses. Title 14 Code of Federal Regulations (CFR) Part 330 requires that air carrier expenses be properly supported before they are paid. The CFR also requires air carriers applying for compensation to retain for verification all books, records, and other source and summary documentation supporting their claims for compensation of direct and incremental losses.

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<sup>5</sup> Code-sharing is an arrangement between two air carriers whereby one carrier makes reservations and issues tickets and the second carrier operates the flights.

For example, Carrier B, in its \$19.3 million claim, noted that its fuel expenses were \$8,023,000 less than in its forecast and that these savings were not related to September 11, and, therefore, should be excluded in calculating compensable losses. However, the Department's Final Rule, Section 330.39, states:

The Department generally does not accept claims by air carriers that cost savings should be excluded from the calculation of incurred losses. Consequently, the Department will generally not allow such claims to be used in a way that has the effect of increasing the compensation for which an air carrier is eligible.

We found that the fuel cost savings Carrier B claimed met the Department's criteria for disallowance. The Claims Review Team partially concurred with our finding and reduced the final amount of compensation paid to Carrier B by \$6.9 million out of the \$8.0 million recommended disallowance.

In another example, our review of \$4.7 million in claimed losses and supporting documentation for Carrier F found \$624,057 of reported expenses that were not adequately supported. Included in this amount were expenses for aircraft preparation of \$272,602 that the air carrier did not normally expense and \$351,455 in aircraft engine repair costs that erroneously were included twice in the air carrier's accounting system. Based on our findings, we recommended that the air carrier's claimed losses be reduced to \$1,379,514, and, therefore, the Department had over-compensated the carrier by \$3,338,017. We are awaiting the Department's decisions on this review.

### **Unacceptable Pre-September 11 Forecasts**

Under the compensation program, pre-September 11 forecasts served as the basis on which incremental losses were calculated. Losses were estimated as the difference between the forecasted and actual results for the period September 11 through December 31, 2001. We determined that the pre-September 11 forecasts submitted by four air carriers were unacceptable because they were revised after September 11, were not supported by the air carrier's historical performance, or were lacking supporting documentation.

- **Forecast revisions made after September 11.** As part of its \$9.6 million request, Carrier C increased its pre-September 11 forecast revenue by \$3,067,000 in November 2001, to recognize higher fees payable by another air carrier under an April 2001 fee per departure agreement that became effective September 1, 2001. According to Carrier C management, the \$3,067,000 was inadvertently omitted from the pre-September 11 forecast revenues. However, the air carrier realized only \$618,000 in forecasted higher fees through

December 31, 2001. These circumstances demonstrated that Carrier C's agreement with the other air carrier did not guarantee the higher fees and the forecast revenue should not have been increased. The Department's final compensation payment to Carrier C reflected concurrence with our finding by reducing the air carrier's incremental losses by \$3.1 million.

- **Forecasts unsupported by carrier's historical performance.** Carrier N could not support its pre-September 11 forecast for operating revenue and income. Carrier N informed the Claims Review Team that its compensation claim's pre-September 11 forecast was based on its prior year's actual results. We found, however, that Carrier N's actual fourth quarter operating income in 2000 of \$1,666,860 was not comparable to the operating income in the pre-September 11 forecast of \$4,025,271. In fact, the actual fourth quarter operating income in 2001 of \$1,653,608 was comparable to the prior year's results. Accordingly, because there were no material changes to the air carrier's operations, the pre-September 11 forecast submitted was not supported by the air carrier's prior financial performance.

We recommended that the Department deny Carrier N's total incremental losses claimed of \$3,731,333. As a result of the disallowance, the Department had overcompensated Carrier N by \$2,448,058, the total amount of compensation payments made to the air carrier. However, the Claims Review Team concluded that its methodology in arriving at a representative incremental loss was reasonable and decided not to recover the compensation paid. We requested that the Department reconsider its determination and have not received a response. Therefore, we are now recommending that the Department provide a formal response to our request.

- **Forecast lacking supporting documentation.** Title 14 CFR Part 330 requires each air carrier applying for compensation to retain documentation verifying that its pre-September 11 forecast was the most recent one available at the time of application. As part of Carrier I's \$6.5 million request, it could not substantiate the data in its pre-September 11 forecast, claiming that the supporting documentation was accidentally destroyed, and its forecasts in the first and second rounds of payments were prepared after September 11. Although Carrier I produced a third-round pre-September 11 forecast that was documented, it was neither accurate nor supported by the air carrier's prior financial performance. We recommended that the Claims Review Team deny the carrier's claim based on either incremental losses or the formula compensation amount. We are awaiting their final determination.

## **Unsupported Operational Data**

We found that four air carriers did not have support for the operational data they claimed, as required by Title 14 CFR Part 330. For example, our review of Carrier P's claim of \$2.1 million disclosed that the air carrier based its available seat miles (ASM) on anticipated flights and did not maintain flight or reservation logs documenting actual flights flown during August 2001. Because Carrier P could not provide support for its actual flights, we questioned its methodology for calculating ASMs and the \$717,132 compensation payments it received. The Claims Review Team is considering our finding that the Department has overcompensated Carrier P.

Our review of Carrier G's \$2.5 million submission and its August 2001 ASM data identified a revised total of 14,220,416 ASMs, a reduction of 2,706,595 ASMs. Our analyses found that the actual number of seats on some helicopters was different from the number of seats used in the ASM calculation, the average cruising speed used in the calculation did not represent the actual speed flown during flights because of their short duration, and the revenue miles calculated were not representative of the actual mileage flown. The Claims Review Team based its final compensation payment to Carrier G on our revised total ASMs, resulting in savings of \$132,388.

## **CONCLUSION AND RECOMMENDATIONS**

We forwarded the results of our previous reviews to the Department for its consideration and action. Our advisories contained findings and recommendations totaling \$45.9 million in disallowances, for which the Department concurred with \$28.5 million and was able to realize savings in this amount. The Department could realize additional savings of \$10.5 million if the Claims Review Team concurs with our findings and recommendations concerning three additional air carriers. We recommend that the Assistant Secretary for Aviation and International Affairs (1) notify us of the final settlement with the remaining three air carriers and (2) provide a response to our previous request to the Claims Review Team to reconsider its findings for Carrier N.

## **MANAGEMENT RESPONSE AND ACTIONS REQUIRED**

On September 30, 2003, we received comments to a draft of this report from Departmental officials. They noted, appropriately, that the Claims Review Team and the OIG had worked together to ensure that proper payments were made in this program and that taxpayers' interests were protected. We evaluated the incremental losses claimed by 16 air carriers at the request of the Claims Review Team and provided our findings to the Team. Based on their internal reviews and



the additional information provided by our evaluations, the Team negotiated settlements.

In accordance with Department of Transportation Order 8000.1C, we would appreciate receiving your written response within 30 calendar days. If you concur with the recommendations, please indicate the specific actions taken or planned and the target dates for action. If you do not concur, please provide an explanation of your position. In addition, please provide a statement indicating whether you concur with our \$39 million estimate of savings related to the final settlements with the 19 air carriers. We welcome any alternative courses of action that could resolve the issues.

We appreciate the courtesies and cooperation of the Department's representatives. If you have any questions concerning this report, please call me at (202) 366-1992 or Mark R. Dayton, Assistant Inspector General for Competition and Economic Analysis at (202) 366-9970.

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cc: Audit Liaison, DOT/OST, M-1

## EXHIBIT A. SUMMARY OF RESULTS FROM ISSUED OIG ADVISORIES AND RESULTING SAVINGS

<b>Carriers Reviewed</b>	<b>Carrier's Claimed Incremental Losses</b>	<b>OIG Recommended Disallowance</b>	<b>OST Final Disallowance</b>
Carrier A	\$ 8,150,742	\$ 792,510	\$ 665,000
Carrier B	19,277,000	8,023,000	6,927,000
Carrier C	9,598,617	2,059,230	2,059,230
Carrier D	4,761,905	0	0
Carrier E	5,461,201	250,000	250,000
Carrier F	4,717,531	3,338,017	Open
Carrier G <sup>1</sup>	2,484,000	132,388	132,388
Carrier H	4,272,017	20,228	20,228
Carrier I	6,460,244	6,460,244	Open
Carrier J <sup>2</sup>	N/A <sup>2</sup>	N/A	N/A
Carrier K <sup>1</sup>	19,631,277	186,172	186,172
Carrier L	20,316,694	18,693,962	16,550,499
Carrier M	2,090,012	2,090,012	1,046,892
Carrier N	3,731,333	2,448,058	0 <sup>3</sup>
Carrier O	20,915,093	0	0
Carrier P	2,062,619	717,132	Open
Carrier Q	14,423,000	0	0
Carrier R	913,149	639,678	639,678
Carrier S	89,213	8,066	8,066
<b>Total</b>	<b><u>\$ 149,355,647</u></b>	<b><u>\$ 45,858,697</u></b>	<b><u>\$ 28,485,153</u></b>

<sup>1</sup>Represents the results of two reviews.

<sup>2</sup>Not applicable because review was on the second round claim and final payment was based on a significantly different claim.

<sup>3</sup>We previously requested that the Department reconsider its decision not to recover any of the questioned costs.

## **EXHIBIT B. SCOPE, METHODOLOGY, AND PRIOR AUDIT COVERAGE**

### **SCOPE AND METHODOLOGY**

The scope of our reviews included the operational and financial data that non-major air carriers submitted as part of their claims for compensation payments under the Act. We conducted our reviews of air carrier claims between January 2002 and August 2003.

This summary report was prepared in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States, and included a compilation of the results of the 19 individual advisories issued since April 2002.

As of September 2003, the Department had made payments in excess of \$4.6 billion to more than 400 air carriers. For our reviews, we selected an initial universe of all 51 non-major air carriers that were each scheduled to receive more than \$2 million in compensation payments, based on the available seat miles/revenue ton mile formula amount.<sup>1</sup> We reviewed each air carrier's final claim application and the independent public accountant's report to identify any concerns or questionable costs. Based on this review, we identified five air carriers that required additional scrutiny.

We also reviewed 16 air carrier claims as a result of requests from the Claims Review Team. The requests involved questions on operational data, pre-September 11 forecasts, and costs reported. We visited 16 air carriers and contacted 3 additional air carriers to obtain documentation supporting the claims submitted.

Through our field visits and desk reviews, we determined whether the claims and their supporting financial and operational documentation were in accordance with the Department's procedures for the compensation program detailed in Title 14 CFR Part 330. Additionally, we reviewed the supporting documentation provided by the air carriers, such as forecasts, revenue and expense schedules, accounting records, Federal tax returns, financial statements, invoices, aircraft lease agreements, Security and Exchange Commission filings, and sales histories.

### **PRIOR AUDIT COVERAGE**

On October 3, 2002, the OIG issued Report Number CR-2003-001, Review of Midway Airlines—Air Carrier Compensation Payments. After filing for Federal bankruptcy

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<sup>1</sup> Two of the air carriers in our initial universe did not submit final claims.

protection in August 2001, Midway Airlines ceased operations, but resumed flights in December 2001 after receiving Federal compensation assistance under the Act, subject to a bankruptcy court order. Our initial review of disbursements made through December 2001 found that \$687,143 was for payment of expenses not directly related to resumption of operations, and therefore not allowable. After discussion with the OIG, Midway Airlines agreed to return these funds to the Federal compensation account. Our subsequent review found that the air carrier had received \$12,120,995 of Federal compensation payments as of August 2002. We concluded that, after the adjustments cited above, Midway Airlines had disbursed this entire amount from December 2001 through August 2002 in accordance with the terms of the bankruptcy court order.

## EXHIBIT C. CONTRIBUTORS TO THIS REPORT

### THE FOLLOWING INDIVIDUALS CONTRIBUTED TO THIS REPORT.

<u>Name</u>	<u>Title</u>
Mark R. Dayton	Assistant Inspector General for Competition and Economic Analysis
Michael E. Goldstein	Program Director
James Diecker	Project Manager
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