

FEDERAL AVIATION ADMINISTRATION

**FY 2002** PERFORMANCE AND ACCOUNTABILITY REPORT



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## FAA AT-A-GLANCE

Established	1958
Headquarters	800 Independence Avenue, S.W. Washington, DC 20591 <a href="http://www.faa.gov">www.faa.gov</a>
FY 2002 Budget	\$14 billion
Employees	48,899
Regional Offices	9
Technical Center <i>Atlantic City, NJ</i>	1,456 employees
Aeronautical Center <i>Oklahoma City, OK</i>	2,122 employees
Staffed Air Traffic Control Facilities	677
Unstaffed Air Traffic Control Facilities	9,836

### FAA Takes Flight

A little more than two decades after Wilbur and Orville Wright took flight over Kill Devil Hills, North Carolina, in December 1903, the U.S. Congress passed the Air Commerce Act of 1926. The Act, which established an Aeronautics Branch within the Department of Commerce, was the cornerstone of the Federal government's regulation of civil aviation. This landmark legislation was passed at the urging of the aviation industry, which understood that the airplane could not reach its full commercial potential without Federal action to improve and maintain safety standards. In 1938, Congress passed the Civil Aeronautics Act to create an independent agency, the Civil Aeronautics Authority, with expanded authority to issue air carrier route certificates and regulate airfares.

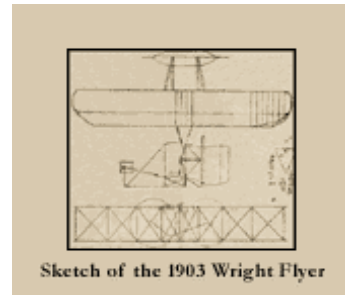
The introduction of jet airliners and a series of midair collisions spurred passage of the Federal Aviation Act of 1958. This legislation established a new independent body, the Federal Aviation Agency, which had broader authority to enforce safety regulations. The Aviation Act entrusted safety rulemaking to the new agency and gave it sole responsibility for developing and maintaining a common civil-military system of air navigation and air traffic control. In 1967, FAA became an agency of the newly created Department of Transportation and was renamed the Federal Aviation Administration.

Today's FAA has 48,899 employees at its headquarters in Washington, DC, in regional offices, and facilities around the country. This does not include civil aviation security personnel who are now under the administrative control of the Transportation Security Administration (TSA). FAA fulfills its mission through five lines of business that work together to create and maintain the world's preeminent national airspace system. These five lines of business are:



- **Air Traffic Services:** Manages civil and military air traffic by developing and recommending national policies and establishing national programs, regulations, standards, and procedures for management of the airspace; operates air navigation and communications systems and facilities; maintains separation and control of aircraft; and provides flight assistance to aircraft.
- **Regulation and Certification:** Oversees the safety of aircraft and the credentials and competency of pilots and mechanics, develops mandatory safety rules, and sets the standards that have helped make air travel among the safest modes of transportation in history.
- **Airports:** Provides leadership in planning and developing a safe, secure, and efficient airport system; enhances environmental quality and avoids or minimizes adverse environmental impacts that might result from a proposed FAA action in support of airport development; and develops standards for the design and construction of facilities that enhance the safety of aircraft operations and security of airline passengers.
- **Research and Acquisitions:** Supports and conducts research to meet increasing demands for higher levels of system safety, security, capacity, and efficiency; and plans, monitors, controls, schedules, and implements the acquisition of materiel, equipment, and services for the national airspace system and for interagency and international programs.
- **Commercial Space Transportation:** Oversees the safety of commercial space launches and regulates the commercial space industry.

The Aviation and Transportation Security Act (Public Law 107-71), enacted on November 19, 2001, established TSA. On February 13, 2002, responsibility for aviation security was transferred from FAA to TSA.



Sketch of the 1903 Wright Flyer

### 100 Years of Flight

“There is something quintessentially American about Orville and Wilbur Wright's historic achievement at Kitty Hawk on December 17, 1903. They worked independently, as most American heroes have done, free of the entanglements of large industrial or government organizations. Their intense preoccupation with their airplane was fueled not by economic necessity—income they already had, from their bicycle business—but mostly from their imaginative determination to cross one of the last technological barriers to human flight—stability in the air.

“The invention of the airplane was a fundamental turning point in history. It redefined the way we fought our wars; revolutionized travel and commerce; fueled the process of technological change; and helped to shape a world in which the very survival of a nation would depend on its scientific and technical prowess. Flight is, and will continue to be, one of humankind's most significant accomplishments.”

*The U.S. Centennial of Flight Commission*  
[www.centennialofflight.gov](http://www.centennialofflight.gov)

The Federal Aviation Administration's *FY 2002 Performance and Accountability Report* was prepared to meet the requirements of the Chief Financial Officers' Act of 1990 and its implementing guidelines, including guidance on form and content provided by the Office of Management and Budget (OMB).



January 31, 2003

## A MESSAGE FROM THE ADMINISTRATOR

I am pleased to present the Federal Aviation Administration's *FY 2002 Performance and Accountability Report*. This year we met nine out of ten performance goals in the areas of safety, security, system efficiency, and organizational excellence. We also achieved a clean opinion on our financial statements.

FAA's highest priority is safety. Safety is not only the top priority from the standpoint of the public's interest, but it is also an economic necessity. People will only fly if they feel safe.

Through initiatives like Safer Skies (the FAA's data-driven approach to establishing and evaluating safety priorities) and the Airport Movement Area Safety System, (which provides air traffic controllers with visual and audio alerts of potential runway accidents), we were able to make last year one of the safest in the history of commercial and general aviation. Although we have made tremendous strides in improving aviation safety, there is more that can and will be done in the coming years, and aviation security will continue to require attention. While aviation security is now under the direction of the new Transportation Security Administration (TSA), we will continue ongoing and close coordination to ensure our respective safety and security programs are interrelated and coordinated.

Enhancing the efficiency of our national aviation system remains a high priority for the FAA. Working together with the aviation community, we continue to refine FAA's Operational Evolution Plan (OEP), which is designed to increase system capacity by more than 30 percent over the next 10 years. Since first released in June 2001, we have achieved a total capacity increase of 5 percent—2 percent more than expected. We have recently issued Version 5.0 of the plan, which emphasizes collaborative decision-making and better matching of capacity supply with air travel demand.

New runways are critical in meeting our OEP goals. Nineteen of the 35 major U.S. airports are now at various stages of planning and development for expanding capacity. Last year, we opened a new runway in Detroit that increased the departure rate by as much as 30 percent. Twelve more runways will open by 2008, including four next year in Denver, Houston, Miami, and Orlando.

Last year, the FAA installed the Traffic Management Advisor (TMA), a software program that smoothes the flow of aircraft into congested airports at six locations around the country. TMA is already responsible for capacity increases of 3 to 5 percent. To illustrate the importance of this tool, in Minneapolis/St. Paul, a 5 percent capacity increase resulted in 3,000 more passengers boarding their connecting flights.

We also installed the User Request Evaluation Tool (URET), a conflict probe that provides controllers with advanced notice of potential in-flight conflicts, at six en route centers. Airlines are reporting savings of \$1.5 million a month from the more direct routings made possible by URET. We plan to expand use to the remaining 14 en route centers over the next two years.



Marion C. Blakey was sworn in September 13, 2002 as the 15th Administrator of the Federal Aviation Administration. At the FAA, Ms. Blakey, continues a long career of public service. In addition to serving as Chairman of the National Transportation Safety Board, Blakey served as Administrator of the National Highway Traffic Safety Administration and held key positions at the Department of Commerce, the Department of Education, the National Endowment for the Humanities, and the White House.



For improved flight performance in bad weather conditions, we installed the first Integrated Terminal Weather System (ITWS) in Atlanta. ITWS integrates information with forecasts from a host of sensors and sources, and provides a visual weather display to controllers.

The FAA is also expanding the use of satellite navigation. As we are deploying GPS (global positioning system) technologies, we are also redesigning the nation's airspace. Combining airspace redesign with new technologies will improve efficiency and capacity by allowing approaches that minimize noise and offer greater access to runways in all weather conditions.

The FAA faces many challenges. In FY 2003, we will redouble our efforts to become a better-managed, more responsive agency, with an even stronger linkage between our budget and our results. We are also sensitive to the problems facing the aviation industry in the aftermath of September 11<sup>th</sup>. Working together with the aviation community, I am confident that we can improve the aviation system to achieve greater capacity, more efficiency, and even safer skies.

A hundred years ago, Orville and Wilbur Wright returned home to Dayton, Ohio, exuberant about the results of their glider flights in Kitty Hawk. They realized powered, manned, controlled flight was possible. With the same kind of ingenuity and vision that propelled the Wright brothers from the sands of a North Carolina beach into the history books, FAA intends to build on the power of aviation and chart the next century of flight that is worthy of the first.

A handwritten signature in black ink, reading "Marion C. Blakey". The signature is written in a cursive, flowing style.

**Marion C. Blakey**  
Administrator





## MANAGEMENT'S DISCUSSION AND ANALYSIS

### A Vital Mission

The Federal Aviation Administration (FAA) is charged with providing a safe, secure, and efficient aviation system that contributes to national security and encourages civil aviation. To fulfill its mission, FAA establishes and enforces regulations and conducts oversight of the civil aviation industry.

FAA operates and maintains the nation's complex air traffic control system and the facilities and equipment that enable its optimal operation. FAA controllers supervise more than half of the world's air traffic—5,000 aircraft at any given moment and close to 7 million commercial, military, and general aviation aircraft each year. We conduct leading-edge research to continually improve safety and efficiency and assist in the development of a system of more than 5,000 public airports in the United States. FAA also regulates and licenses U.S. commercial space transportation activities.

Despite the many challenges that the aviation industry and the traveling public faced during fiscal year (FY) 2002—reduced traffic, increased security, and the uncertain future of many airlines—last year was one of the safest in aviation history. One challenge we faced was to provide war risk insurance to airlines that could no longer afford commercial policies, ensuring that these carriers could stay in the air. As of the end of FY 2002, 72 carriers had been extended \$114 billion in war risk coverage. We also provided \$57 million to 190 air carriers to pay for some of the added cost of war risk insurance bought from private insurers, helping carriers adjust to the new, higher insurance costs.

A phone call from the Pentagon spurred another singular achievement last year. The Department of Defense (DOD) had a simple question: Could FAA help establish a sophisticated radar net inside the United States, similar to the one the DOD maintains, to detect intruding aircraft crossing U.S. borders? In just 3 months, FAA and the DOD worked together to provide upgraded surveillance and radio communications capabilities equal to the most advanced systems used by the military.

While dealing with the aftermath of the attacks on the World Trade Center and the Pentagon, we continued to deliver on our commitments to improve system efficiency and deploy new technologies, to improve safety, and to develop and implement new security procedures. We accelerated investments in advanced computer systems, including state-of-the-art weather radar systems; introduced innovative control procedures; created new in-air routes to minimize delays; and supervised the construction and expansion of airports, runways, and air traffic facilities. FAA's commitment to our customers—the traveling public and the carriers that transport them—is clear and unchanging: to create and maintain the safest and most efficient air transportation system in the world.

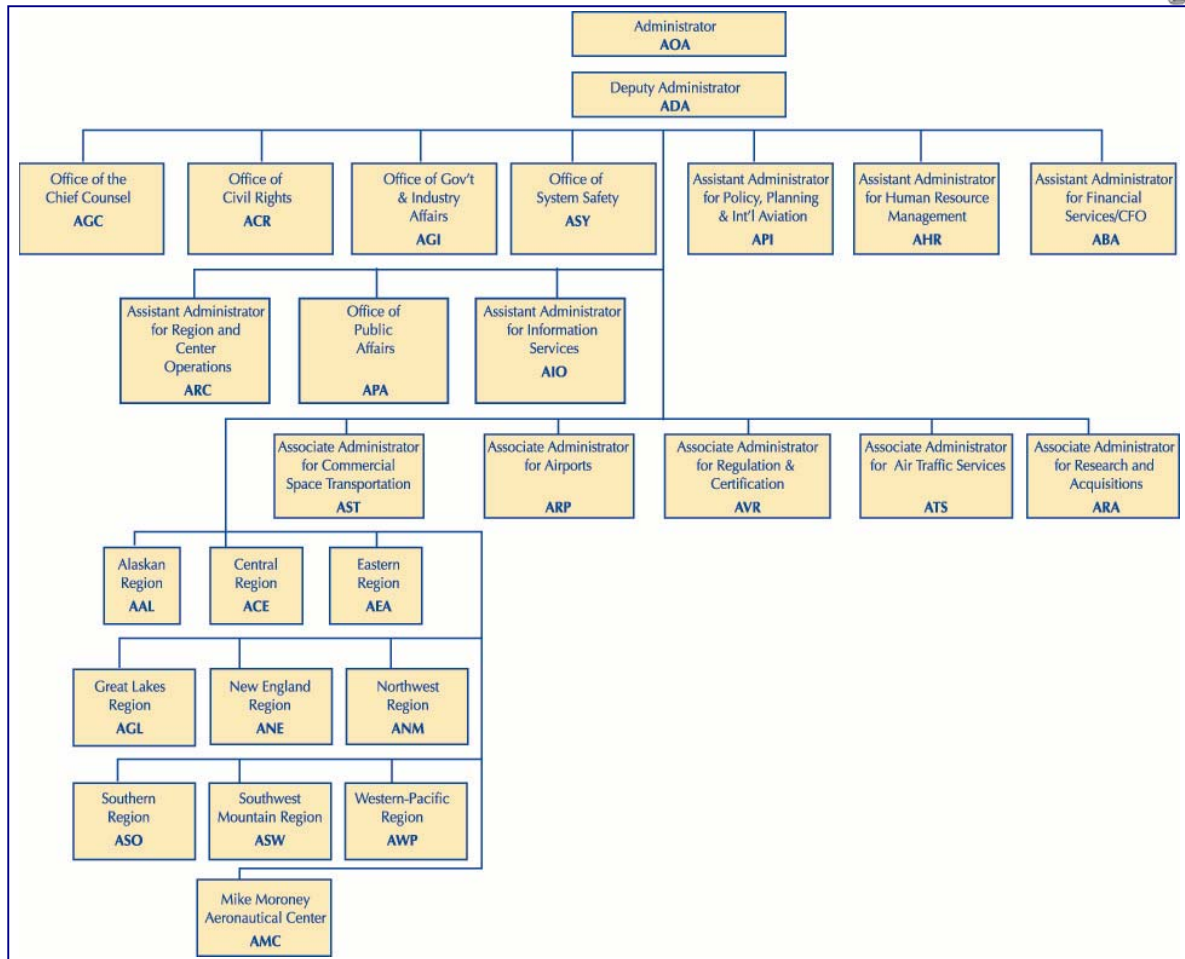
### Onward and Upward

Satellite technology makes it possible for us to enjoy live national or worldwide television and radio broadcasts, place international telephone calls, have high-speed Internet access and nationwide paging services, receive weather forecasts, respond to emergencies and disasters, and pay by credit card at a retail store. Getting those satellites into space is the responsibility of the commercial space transportation industry.

During FY 2002, FAA supervised 8 licensed launches, with up to 12 more expected next year. We also oversee the operation of four nonfederal spaceports, and at least five more such space launch and reentry sites are under development.

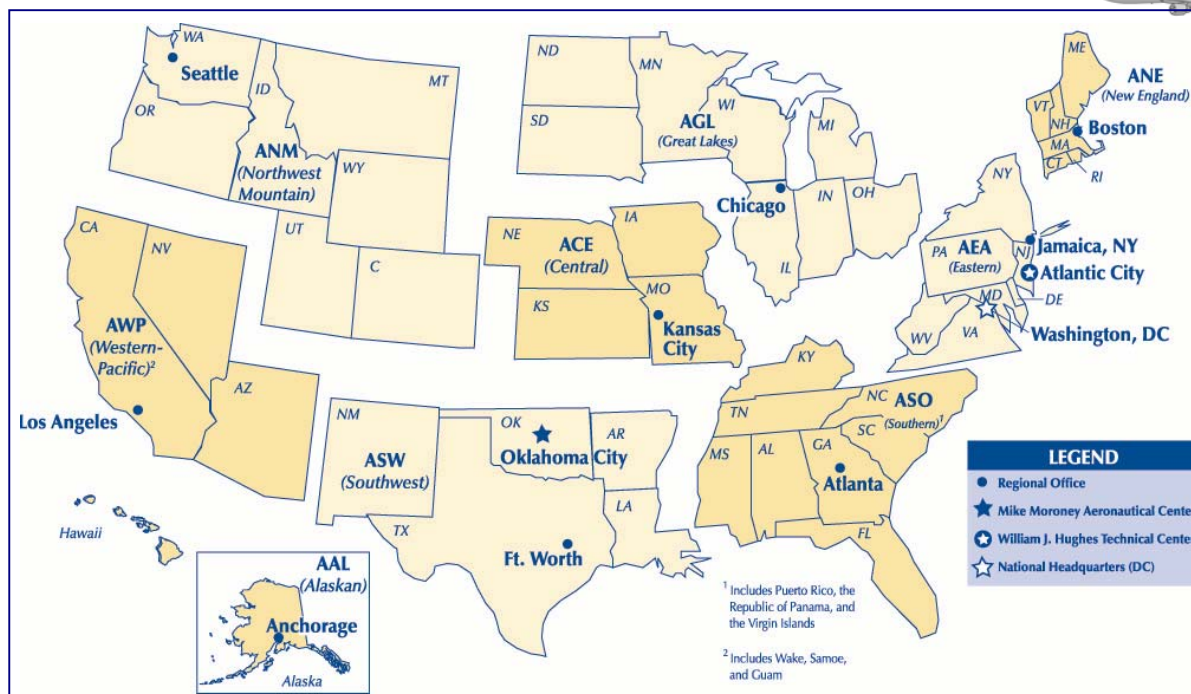
According to a 2001 study commissioned by FAA, commercial space transportation has already contributed more than \$61 billion to the U.S. economy through the manufacture of launch vehicles, the design and construction of satellites and satellite equipment, satellite services, and related space industries. In the coming decades, FAA expects the commercial space industry to grow, especially with the development of a new generation of both expendable and reusable launch vehicles that will reduce the cost of transporting satellites to orbit and carry human passengers on suborbital and orbital flights.

**Federal Aviation Administration  
FY 2002 Performance and Accountability Report**



*On September 13, 2002, Marion C. Blakey was sworn in as the head of the Federal Aviation Administration. Assisted by a Deputy Administrator, Administrator Blakey provides overall leadership and management direction. Both the Administrator and Deputy Administrator are appointed by the President and confirmed by the Senate. Five Associate Administrators direct the organizations that carry out the agency's principal mission.*





## A Year in Highlights

FAA values the enduring partnerships we have forged with our employees, unions, the airlines, general aviation and commercial pilots, commercial space launch companies and site licensees, manufacturers, airports, and hundreds of communities around the country. We work with these partners to mitigate risks, further reduce noise pollution, and minimize environmental hazards. Without the cooperation of these partners, we could not have achieved the many successes highlighted in this report.

## MAKING IT SAFER

Almost 100 years after the Wright brothers first took flight, FAA is proud to report that FY 2002 was one of the safest years in the history of commercial and general aviation. To achieve that milestone, we set and attained a number of ambitious safety goals. Despite our success, more must be done, and so we continue to focus on reducing the air carrier fatal accident rate still further—by 80 percent from the FY 1994–FY 1996 baseline—and limiting general aviation accidents involving fatalities to 331 per year by 2007.

### Commercial Aviation Safety

Several programs and initiatives were instrumental in helping FAA reach last year’s high level of aviation safety. The Runway Safety Program helped bring about a significant reduction in the number of high-risk runway incursions, which, in turn, lessened the probability of collisions that could involve fatalities, injuries, and significant property damage. We continued to install software that coordinates air traffic control radar with radar that monitors ground traffic. The Airport Movement Area Safety System (AMASS) was commissioned at 18 major airports and is now operating at 25 of 34 major airports, contributing to the reduction in runway incursions. FAA also undertook a number of runway improvements, including new markings and runway redesign to more efficiently direct departures and landings. To further enhance safety, FAA’s Safer Skies effort made significant progress in addressing a



number of the factors that cause air carrier accidents—controlled flights into terrain and uncontained engine failures.

While we were able to decrease operational errors by 9 percent from FY 2001, we did not achieve our target. An operational error is a failure to apply or follow the rules and procedures that ensure the safe separation of aircraft. In our ongoing efforts to reduce operational errors, we are aggressively seeking to identify the factors that cause those errors and to implement technology improvements, such as the deployment of modern displays, new decision support tools, and improved communication systems, to eliminate those factors. We are also providing additional training so that pilots and controllers have a common understanding of separation standards, policies, and procedures.

FAA recognizes that partnerships are key to identifying and addressing problems and achieving safety goals. With the National Aeronautics and Space Administration and DOD, for example, we are implementing interagency safety plans to reduce human error and improve system-wide safety. FAA's partnership with the aviation community has led to the voluntary establishment of the Advanced Qualification Program, under which more than 56,900 airline pilots were trained. In addition, the Aviation Safety Action Program, under which thousands of safety reports have been submitted by 31 employee groups from 20 airlines, and the Flight Operational Quality Assurance Program, under which 11 U.S. airlines routinely collect and analyze digital flight data, will enable the FAA to intervene and correct adverse safety trends.

### General Aviation Safety

FAA oversees the safety and operation of almost 300,000 general aviation aircraft in the United States. These aircraft include single-seat home-built airplanes, rotorcraft, balloons, and highly sophisticated extended-range turbojets. General aviation activities include student training, crop dusting, fire fighting, law enforcement, news coverage, sightseeing, industrial work, on-demand air taxi service, and corporate transportation, as well as personal use and recreational flying.

Our strategy for improving general aviation safety is to establish a proactive partnership with the general aviation community to identify problems and implement solutions. In 2002, we published and distributed educational materials to pilots, including information about instrument flight and how to find and use the latest weather information. We also upgraded general aviation-related equipment, such as automated flight service stations (air traffic facilities that provide pilot briefings, en-route communications, search and rescue services, assistance to lost aircraft and to aircraft in emergency situations), automated weather observation systems, and communications systems that provide weather and altimeter settings to pilots.

### Keeping It Safe

Last year, FAA continued installing the Airport Movement Area Safety System (AMASS) at 34 of the country's busy airports. AMASS helps prevent runway collisions by providing air traffic controllers with visual and audio alerts of conditions that might cause runway accidents.

AMASS enhances the Airport Surface Detection Equipment Model 3 (ASDE-3) radar. The system works by processing surveillance data from the ASDE-3 and the terminal automation system. It then determines conflicts between the position, velocity, and acceleration of arriving aircraft and other aircraft or vehicles on the ground. Developing AMASS into a useful, reliable warning system to meet user requirements has been an extremely complex technical challenge.

In its continuing effort to improve runway safety, the FAA is working closely with the aviation community to promote awareness and support increased education and training for pilots, controllers, airport personnel, and vehicle operators. We believe that education is the best way to improve runway safety and give passengers an extra margin of safety on the ground.



One example of a program designed to improve general aviation safety is Capstone in Alaska. Because of the state's unique geography, general aviation plays a key role in meeting the transportation needs of Alaska's citizens. Alaska's difficult terrain is a primary factor in the number of general aviation accidents that occur there. Capstone uses the latest in digital avionics and global positioning system (GPS) technology to significantly improve aviation safety in a part of the country where extreme weather and rugged, remote destinations can be a recipe for accidents. Under Capstone, installation of advanced equipment in general aviation aircraft operating in the Yukon-Kuskokwim Delta began in November 1999, and expansion of ground infrastructure and data collection will continue through December 2004. An interim analysis by the University of Alaska and the MITRE Corporation's Center for Advanced Aviation System Development indicates that Capstone-equipped aircraft have 40 percent fewer accidents than aircraft without the Capstone avionics.

### **ENHANCING SECURITY**

In February 2002 the job of overseeing the security of the aviation system became the responsibility of the newly created TSA. Except for employees working on internal FAA security and the Hazardous Material Program, all aviation security personnel will be transferred from FAA to TSA, marking one of the largest personnel transfers in FAA's history. FAA continues to supply equipment, advice, and training to TSA.

FAA and other agencies concerned with the threat of domestic and international terrorism also collaborated to determine how best to allocate security resources. Even before the September 11th terrorist attacks, FAA was working with commercial air carriers to voluntarily implement a computer-assisted passenger-screening program at more than 130 airports nationwide.

One notable security enhancement initiative last year was the fortification of cockpit doors, which required FAA to quickly formulate standards and implement new regulations. FAA will continue to collaborate with TSA on the development of technologies to benefit aircraft safety and security, such as structural and systems hardening. In the area of information systems security, or cybersecurity, FAA continued efforts to provide security certification and authorization packages for all new systems; built a state-of-the-art Computer Security Incident Response Center that operates 24 hours a day, 7 days a week; hardened Internet access points; and deployed boundary protection capability throughout its networks.

### **A Vision for Tomorrow**

Before September 11, 2001, our national airspace system handled almost 2 million passengers, 40,000 tons of cargo, and 60,000 nonscheduled flights each day. Congested airspace and demand at the busiest airports led to delays and a lack of efficiency, flexibility, and predictability throughout the system. Traffic and delays, which decreased immediately after the terrorist attacks, are now forecast to reach pre-September 11 levels by FY 2004.

To deal with the challenges presented by growing air travel demand, FAA worked with the entire aviation community to create a blueprint that will guide our efforts to enhance and modernize the airspace system. In June 2001, FAA released the Operational Evolution Plan (OEP)—a dynamic, comprehensive, and integrated document that uses an evolutionary, one-step-at-a-time approach to modernization. New runways, new routes, new tools, and airspace redesign are the core changes OEP addresses in this 10-year strategic plan. Each set of solutions outlined represents the aviation community's commitment to make investments and implement changes that will increase capacity and enhance efficiency to create an aviation system for the 21st Century.



## ELIMINATING BOTTLENECKS

Passengers are directly affected by delayed or cancelled flights, missed connections, and later-than-expected arrivals. To ensure that the national airspace system can meet increasing demand, FAA continued work on a number of fronts. A key component of our efforts to improve efficiency and increase system capacity is the Operational Evolution Plan (OEP), a detailed, comprehensive 10-year strategic plan developed in partnership with the aviation industry and other Federal agencies. Among the priorities outlined in the OEP are the modernization of on-ground and in-plane equipment, adoption of advanced routing procedures, and installation of state-of-the-art weather radar and navigational aids. Redesign of the system of spacing between planes is also under way. By 2010, FAA expects that OEP implementation will result in a 30 percent increase in system capacity.

The construction of new runways is one of the most effective methods of increasing capacity. In FY 2002, one large hub airport (Detroit Metropolitan–Wayne County Airport) commissioned a new runway and projected a 21 percent increase in airport capacity. In FY 2003, two large hub airports (Denver International Airport and Miami International Airport) are scheduled to commission new runways and 10 new runways at large hub airports are scheduled to open between FY 2004 and FY 2009.

Work is under way to consolidate various air traffic management activities into a performance-based organization led by a chief operating officer. This new organization will coordinate research and development, modernization, operation, and maintenance efforts to boost efficiency throughout the aviation system. In coming years, this new organization will help improve air travel by

- Removing roadblocks to innovation and quickening the pace of improvements.
- Involving air traffic controllers in developing and refining control systems to ensure rapid deployment.
- Providing pilots with more flexibility to choose the fastest, most economical routes.
- Reengineering America's airspace to handle more airplanes and reduce or eliminate delays and congestion.

One important initiative designed to help eliminate bottlenecks in the system is Free Flight. The idea is simple: establish a series of national and international corridors (much like our current system of interstate highways) through which aircraft can fly. Of course, flying an airplane is not as simple as driving from one city to the next, since airplanes occupy thousands of feet of vertical airspace and must avoid intense weather systems such as thunderstorms. Even so, given such constraints, allowing pilots to choose the most efficient routes should increase system capacity. Free Flight will rely on the latest technological advances to change airplane spacing, provide advanced weather information, allow more accurate navigation on board and on the ground, and free the national airspace system from slowdowns and congestion. Free Flight Phase 1, which was delivered on time and within budget, provided tools that

### Circling the Globe

FAA plays a vital role in improving aviation safety, security, and system efficiency around the world. FAA works directly with its counterparts in more than 188 countries and through the International Civil Aviation Organization (ICAO) headquartered in Montreal. FAA works with other nations to provide technical assistance and training to promote aviation safety worldwide. FAA also works with its foreign counterparts to improve and encourage compliance with international aviation safety standards in all aspects of the global aviation industry. In FY 2002, the agency was instrumental in establishing global standards for airport safety and security and for encouraging ICAO to adopt FAA standards for the fortification of cockpit doors. FAA also worked with countries on several continents to help their civil aviation officials meet ICAO requirements, thus improving safety and lowering the cost of travel to certain developing countries.





allowed people to succeed. FAA is using the success of Free Flight to design other programs that will help increase system capacity and efficiency.

## SAFEGUARDING THE ENVIRONMENT

FAA is committed to further reducing the number of people exposed to excessive airport noise levels. With the advent of quieter aircraft, improved airport planning, and funds for projects designed to minimize noise, we estimate that fewer than 379,000 people were exposed to excessive aircraft noise last year—a significant reduction from the 1975 level of 7.5 million people. Engine emissions also remain a concern, as projections indicate an increase in air traffic over the coming decade. One promising development is the increased use of newer, smaller, lower-emission jets, which will reduce the number of older, larger jets with more polluting engines. We are also working with industry and other government agencies to ensure that future engines, large or small, have a less detrimental environmental impact.

While research continues on quieter engine technology, other projects designed to minimize noise will be the principal means for reducing the numbers of people exposed to airport noise for the foreseeable future. In FY 2002, FAA approved the commitment of over \$600 million for these other projects. FAA proposed, and subsequently implemented, six environmental streamlining initiatives to expedite environmental impact statements for major airport projects. These initiatives, which tackle resource, process, product, and interagency coordination problems, can streamline environmental reviews and reduce project delays.

In cooperation with the National Park Service, FAA is also developing air tour implementation plans for each National Park unit. The plans include any adjacent tribal lands where commercial air tours operate. The objective is to mitigate or prevent any significant adverse effects on the park environment while ensuring aviation safety.

## A FOUNDATION FOR EXCELLENCE

FAA has made impressive strides in building a foundation for organizational excellence. The five management focus areas within the President's Management Agenda provide a framework for, and further impetus to, FAA's organizational excellence initiatives. During the past year, we made substantial progress in our efforts to modernize FAA management systems. In the coming year, we will continue our efforts to implement the DELPHI financial management system. Concurrent with DELPHI implementation, we will implement a new acquisition system with improved integration of the financial and acquisition functions.

Over the past year, six more organizations within FAA began using cost accounting to better understand and track the costs of the products and services they provide. We also took aggressive action to improve control over property accounting and mitigate its financial risk, a long-standing material internal control



### Making the Grade

An article in the May 15, 2002, edition of *Government Executive* magazine gave FAA an improved grade on its Federal Performance Project report card. The project, a partnership between *Government Executive* and The George Washington University Department of Public Administration, is designed to determine how well Federal agencies are managed. FAA improved in four categories—human resources management, information management, financial management, and physical asset management—and maintained its rating in managing for results. FAA improved its overall grade to a “B,” making it one of the better-managed agencies in the Federal government.



weakness. Because of continuous improvement in financial management and reporting, FAA received an unqualified opinion on its financial statements, providing a solid foundation for further analysis and discussion of our performance and strategic investments in safety, security, and system efficiency.

FAA continues to work with the Department of Transportation (DOT) and the Office of Management and Budget (OMB) toward achieving a “green light” in each of the President’s Management Agenda initiatives. “Getting to green” in all five initiatives is one of FAA’s two organizational excellence goals for the coming year.

We continued to measure customer satisfaction by surveying commercial pilots. The survey helps us determine how we are viewed and what areas need improvement. One approach to improving customer satisfaction is our plain language initiative, which emphasizes clear, unambiguous communication to ensure that our regulations and procedures are understood. As the program matures, we will use focus groups to identify areas that need clarification and use a survey to track results.

President’s Management Agenda Scorecard for FAA		
INITIATIVE	FY 2002 STATUS	PROGRESS
<b>Human Capital:</b> Develop an FAA-wide human capital workforce strategy to address future workforce gaps, eliminate skill gaps in critical occupations, develop performance-based incentives for the workforce, remove unneeded management layers, and develop the right mix of skills in the workforce that reflect the new emphasis on E-Government and Competitive Sourcing.		
<b>Competitive Sourcing:</b> Compete 5 percent of eligible commercial positions in FY 2002, 10 percent in FY 2003 (for a cumulative 15 percent by the end of FY 2003), and to eventually compete 50 percent at an undetermined future date. In addition, each department must submit a Strategic Competition Plan and compete “commercial reimbursable support services” on a recurring basis.		
<b>Financial Management:</b> Develop financial management systems capable of producing more timely and accurate information, maintain a record of unqualified opinions on our financial statements, continue to improve accounting controls, and develop full cost accounting capability.		
<b>E-Government:</b> Better justify and track cost and performance of information technology projects, as well as participate in government-wide initiatives that automate how the public deals with the Government, such as the FirstGov.gov initiative, E-Grants, standardization of data, and customer relationship management.		
<b>Budget/Performance Integration:</b> Better integrate budget and performance functions by integrating budget and performance staff work; developing plans and budgets with outcome goals, output targets, and resources requested in the context of past results; charging full budgetary costs of programs; and documenting program effectiveness.		
<b>KEY TO FY 2002 STATUS</b> The “status” column measures where FAA/DOT are in meeting the initiative. Agencies get a green rating by reaching the required score. Agencies must maintain scores between evaluations to maintain a green. The “progress” column measures the rate at which FAA and DOT are moving toward green. Agencies get a green rating when implementation is advancing according to plan. <ul style="list-style-type: none"> <li> Indicates that the agency has met all of OMB’s core criteria for the initiative.</li> <li> Indicates achievement of some but not all of OMB’s core criteria for the initiative and that the agency has no “red” conditions.</li> <li> Indicates that at least one of the conditions identified by OMB for that initiative is in need of correction.</li> </ul> For a more detailed discussion of the President’s Management Agenda, see the Office of Management and Budget Website at <a href="http://www.whitehouse.gov/omb/budget/fy2002/pma_index.html">www.whitehouse.gov/omb/budget/fy2002/pma_index.html</a> .		





## FACING CHALLENGES

In a January 2001 report to Congress, the General Accounting Office (GAO) identified a number of challenges that FAA must address to improve safety, increase efficiency, and achieve organizational excellence. In addition, the DOT Inspector General identified his top management challenges facing DOT in FY 2003, listing several FAA-specific challenges. These include: (1) Reducing the risk of aviation accidents due to operational errors and runway incursions; (2) Reversing FAA's spiraling operating costs; (3) Improving system capacity; and (4) Reauthorizing the Wendell H. Ford Aviation Investment and Reform Act for the 21<sup>st</sup> Century (AIR-21). More information on the Inspector General's challenges is provided in the DOT *FY 2002 Performance and Accountability Report*.

### Safety

GAO recommended a number of improvements in the areas of aviation safety, airport security, and air traffic control computer security. These include more focused performance goals and evaluation procedures for Safer Skies initiatives, improved hiring and training of security checkpoint screeners, and further action to secure FAA's air traffic control computer systems to reduce the possibility of intrusion or attacks.

To address GAO's recommendations, we have revamped our safety performance goals to advance our annual goal of reducing fatal accidents and reducing the high-risk runway incursions and operational errors. We have met our goal of reducing fatal accidents for the past several years and are on track to achieve our long-term goal of reducing fatal accidents by 80 percent. To improve air traffic control computer system security, we standardized and upgraded eight Internet access points, deployed 40 network intrusion detection devices, and continued efforts to identify and address the vulnerabilities of our computer systems. We are also on target to meet the following milestones outlined in the report:

- Publish required navigation performance criteria by July 2003. These criteria will mandate the use of satellite-based navigation systems, including precision landings at airports, improved safety of approach and landing, and reduced controlled flight into terrain.
- Develop and implement a 3-year operational error prevention plan by September 2005.
- Develop and implement continuous, noninvasive monitoring of our information technology assets and services by September 2003.

### Safety Management Challenges

One of the most critical management challenges that we face is the increase in known safety risks such as runway incursions and operational errors. While we were able to reduce operational errors by 9 percent compared with FY 2001, we did not meet our target. We will continue to pursue a number of initiatives to address this problem, and we are currently identifying and evaluating technologies that can be put to use quickly in high-risk airports.

We are also studying the feasibility of expanding the Air Transportation Oversight System (ATOS) to include smaller commercial air carriers and providing complete system safety and risk analysis training for all ATOS-assigned field inspectors. Designed to identify safety trends in order to spot and correct problems before accidents occur, ATOS is now in place for the 10 largest airlines, which handle 95 percent of U.S. passengers, and will ultimately include all U.S. airlines.

With ATOS, FAA inspectors look at an airline as a whole to see how the many elements of its operations—from aircraft to pilots to maintenance facilities to flight dispatch—interact to meet Federal standards. By collecting and analyzing data on the many airline systems, inspectors are better able to



target areas for improvement. ATOS has already enabled us to create a targeted, more effective surveillance plan. As we expand ATOS, we will also continue to address deficiencies in aircraft maintenance programs at some major air carriers by publishing detailed requirements and delivering updated policies and procedures and training courses to the inspection work force.

### **Efficiency**

FAA has undertaken a comprehensive program to modernize the air traffic control system. This program includes replacing and updating voice communication systems and introducing enhanced automation aids and improved weather systems. We face significant management challenges in meeting the modernization schedule and controlling the costs of new technologies. The OEP will be key to our ability to meet those challenges. The OEP builds on successful Free Flight program techniques; includes objective, measurable results; and coordinates FAA modernization efforts with those of industry so that our investments yield timely benefits. We have assigned responsibility for delivering each new capability to an executive, who will coordinate both acquisition and operational integration performance. The performance measures for OEP projects are directly tied to organizational measures, ensuring that resources are aligned with our commitment to increase capacity.

### **Maximizing Investments**

The GAO recognized that FAA has made progress in addressing acquisition problems but said that reforms are not yet complete and recommended additional changes. We have instituted an Air Traffic Services Oversight Board and refined the OEP to establish agreement and understanding with the aviation community on modernization improvements. To demonstrate significant improvement in the acquisition arena, we will meet the following modernization milestones on time:

- Complete a successful independent operational test and evaluation on the first full production of the Standard Terminal Automation Replacement System at Philadelphia by September 2003.
- Install the Integrated Terminal Weather System, Weather System Processor, and Low-Level Wind Shear Alert System at identified OEP airports by September 2003.

### **Organizational Excellence**

#### **Strategic Human Resource Planning**

DOT and FAA, along with the entire Federal Government, face a wave of retirements. These retirements pose a large-scale planning challenge. While this exodus of talent will not happen overnight, we must plan now to maintain required levels of experience and expertise in our civilian and contract workforce. Succession planning, as well as managing and maintaining adequate institutional knowledge, will be crucial to our ability to carry out our functions during this high workforce turnover. DOT has developed a Strategic Human Capital Management Plan to address the President's Management Agenda and GAO's management challenge. As part of this effort, we are also developing a corporate Human Capital Plan, which is aligned with DOT's plan, the FAA budget, and our performance objectives.

#### **Financial Management**

We continued to implement far-reaching changes to FAA financial management during FY 2002. These changes demonstrate our commitment to the principles of sound financial management and to the goals articulated in the President's Management Agenda. To address GAO concerns about weaknesses in FAA accounting and financial management and to meet the challenge of producing accurate and timely financial information, we implemented five of the six auditor recommendations to establish greater controls in accounting for FAA property. When DELPHI, a new, integrated financial management



system, is implemented, the remaining auditor recommendation relating to property accounting will be implemented. DELPHI will streamline and speed reporting, eliminate cumbersome manual entries and adjustments, and integrate property accounting with the core accounting system.

Before implementing DELPHI, we established central control over property accounting by instituting an interim fixed asset system. New business processing rules for property transactions were also put into place during FY 2002. In addition, FAA's Administrator formed the National Capitalization Team, a cross-functional group responsible for enhancing oversight and control over property accounting.

To further underscore our commitment to financial management, we have made achieving a clean audit opinion a corporate performance goal. Achieving a clean audit and further improving agency accountability are goals that affect all employees. Finally, we have made substantial progress in implementing an agency cost accounting system, putting the FAA ahead of most other Federal agencies in the government-wide effort to identify the cost of managing its programs, and linking cost to performance.

### **Government Performance and Results Act**

The Government Performance and Results Act requires Federal agencies to develop five-year strategic plans, annual performance plans, and annual performance reports. DOT's strategic and performance plans have been recognized as among the best in the Federal Government. To build on this success, DOT and FAA must improve the reliability and timeliness of performance data and provide better linkage between budgets and performance results. We acknowledge that increasing the validity, reliability, timeliness, and comparability of performance data will be a challenging task. To improve our ability to provide timely and reliable performance data, the Bureau of Transportation Statistics is developing data standards, training people in the collection and interpretation of transportation data, and coordinating data series across the Department. In FY 2002, DOT developed leading indicators for its strategic goals and most of its performance measures to help anticipate trends in each of these outcomes. DOT also completed an assessment of data quality for its major data collection systems, and documented the major sources of error in all performance measures. By the end of FY 2004, consensus data standards will be in use throughout DOT.

Beginning with our FY 2002 performance plan, we have more closely linked the budget with each performance goal. This performance plan allocates the budget request to specific outcomes and performance goals. We will continue to refine our attribution process in subsequent plans to aid strategic decision-making.

### **FINANCIAL HIGHLIGHTS**

#### **Management Integrity: Controls, Compliance, and Challenges**

FAA conducts an annual review of the adequacy of FAA program and activity management controls in accordance with the Federal Managers' Financial Integrity Act of 1982 (FMFIA). The results of this review are included in the Secretary of Transportation's Statement of Assurance sent to the President on December 30, 2002.

For the FAA, there was one material weakness – the contract closeout process, and one material nonconformance—the lack of a fully, integrated property accounting system.

In a May 8, 2002 Office of Inspector General (OIG) report, *Oversight of Cost-Reimbursable Contracts*, it was found that the FAA was not properly administering closeout and final payment of cost-reimbursable contracts. To address this weakness the FAA will improve its procedures to ensure cost-reimbursable contracts are closed out more timely.



FAA nonconformance relating to property accounting systems was reported in FY's 2000 and 2001. Since a fully integrated fixed asset system will not be in place until the new core financial system (Delphi) is implemented, FAA has established additional controls to ensure that property data is correct.

### **Discussion and Analysis of the Financial Statements**

FAA prepares annual financial statements in conformity with accounting principles generally accepted in the United States. The financial statements are subject to an independent audit to ensure that they are free from material misstatement and that they can be used to assess FAA performance.

### **FY 2002 Financial Statement Audit**

The Chief Financial Officers' Act of 1990 (Public Law 101-576), as amended by the Government Management Reform Act of 1994, requires that financial statements be prepared by certain agencies and commercial-like activities of the Federal government, and that the statements be audited in accordance with Government Auditing Standards. FAA is required to prepare its own financial statements under OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, dated October 16, 2002. The DOT Inspector General is statutorily responsible for the manner in which the audit of FAA's financial statements is conducted. The DOT Inspector General selected KPMG LLP, an independent certified public accounting firm, to audit FAA's FY 2002 financial statements.

In February 2002, the DOT's Inspector General and Chief Financial Officer, along with the FAA Chief Financial Officer established an Audit Advisory Committee to promote and encourage open communications among the Office of Inspector General (OIG), FAA management, and the independent auditors; to resolve issues that arise during the course of the audit; and to monitor the implementation of audit recommendations. The Committee is chaired by the Director of the Office of Financial Management and includes representatives from the OIG, DOT's Office of Financial Management, and FAA's Assistant Administrator for Region and Center Operations, Associate Administrator for Air Traffic Services, and Associate Administrator for Research and Acquisitions.

FAA's independent auditor, KPMG LLP, rendered an unqualified audit opinion on FAA's FY 2002 financial statements. This means that the FAA's financial statements as of, and for the year ended, September 30, 2002, were presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. KPMG's audit report was presented by the OIG to the FAA Administrator.

KPMG identified one material weakness: the process for estimating liabilities for legal matters; and six reportable conditions: (1) Controls and processes over financial reporting and accounts reconciliation, (2) Process for estimating environmental liabilities, (3) Accounting methods and controls over field spares, (4) Controls over property, plant, and equipment, (5) Information-technology controls over third-party systems and applications, and (6) Information-technology controls over FAA systems.

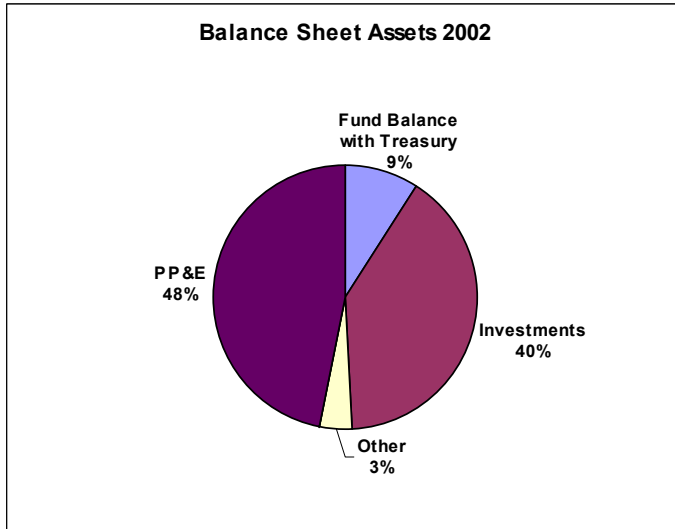
### **Understanding the Financial Statements**

FAA's Consolidated Balance Sheet and Consolidated Statement of Net Cost are presented in a two-year comparative format, as required by OMB Bulletin Number 01-09, *Form and Content of Agency Financial Statements*, dated September 25, 2001. The following section provides a brief description of (a) the nature of each required financial statement and its relevance to FAA, (b) an analysis of significant fluctuations from FY 2001 to FY 2002, and (c) other significant balances where necessary to help clarify their link to FAA operations.

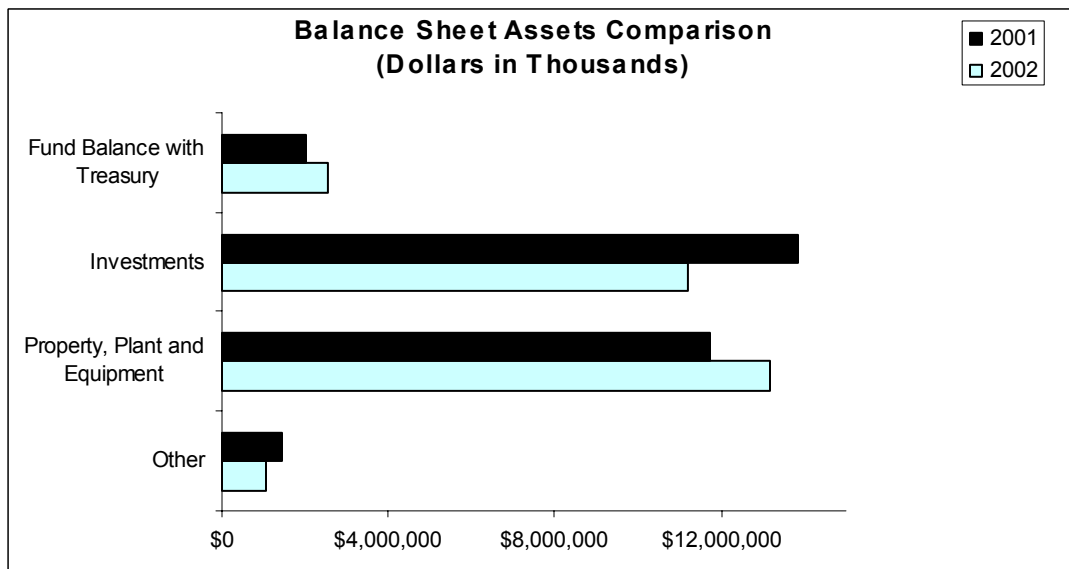


**Balance Sheet:**

**Assets** – At September 30, 2002, FAA’s assets totaled \$28 billion. FAA’s assets are the resources available to pay liabilities or satisfy future service needs. FAA’s major categories of assets, as a percentage of total assets are as follows:



The following chart presents comparisons of major asset balances as of FY 2001 versus FY 2002. A discussion of the significant accounts and fluctuations follows.





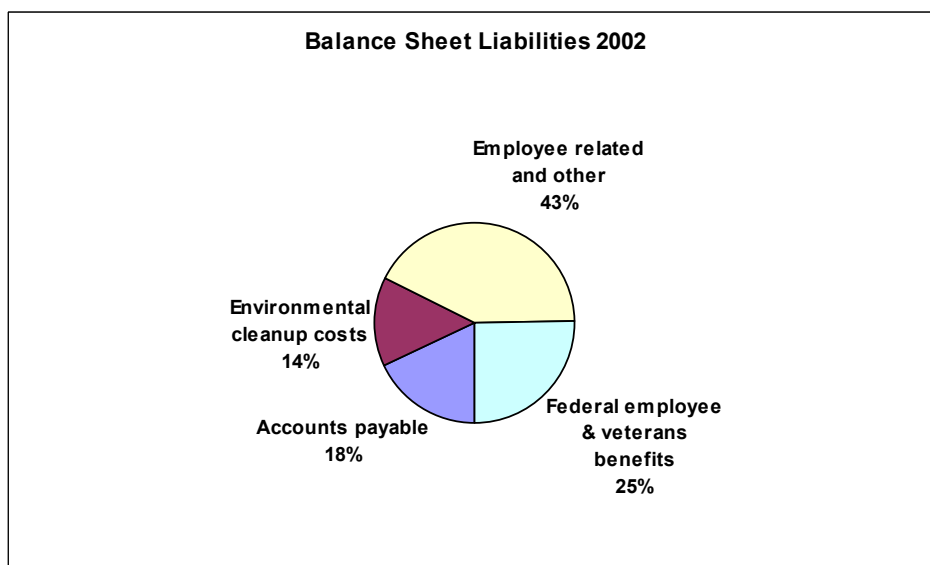
*Fund Balance with Treasury* represents resources from Department of Treasury accounts from which FAA is authorized to make expenditures to pay liabilities. It includes passenger ticket and other excise taxes deposited to the Airport and Airway Trust Fund (Trust Fund), but not yet invested. The September 30, 2002 Fund Balance with Treasury was \$541 million greater than the balance as of September 30, 2001. This resulted because the Trust Fund received \$589 million of excise taxes at the end of FY 2002, which were not yet invested as of September 30, 2002.

*Investments* represent 40 percent of FAA's current year assets, and are principally comprised of passenger ticket and other excise taxes deposited to the Trust Fund. These amounts can be used to finance FAA's operations to the extent authorized by Congress. Investments decreased \$2.7 billion, due to several factors: (a) FAA was authorized increased funding from the Trust Fund in FY 2002 as compared to FY 2001; (b) excise tax revenues decreased following the terrorist attacks of September 11, 2001; (c) investment interest revenue decreased during FY 2002; and (d) a greater amount of excise tax receipts was reported as Fund Balance with Treasury at the end of FY 2002 as compared to FY 2001, as these amounts awaited investment.

*General Property, Plant, and Equipment (PP&E)* represents 48 percent of FAA's assets as of September 30, 2002, and primarily comprises construction-in-progress related to the development of National Airspace System assets, and capitalized real and personal property. PP&E increased \$1.4 billion, substantially related to construction in progress, which correspondingly increased \$1.3 billion during the same time period, due to several factors including significant civil aviation security-related additions following the attacks of September 11, 2001, and a significant number of projects were under development during FY 2002, and thus not ready to be placed in use by year-end.

### **Liabilities**

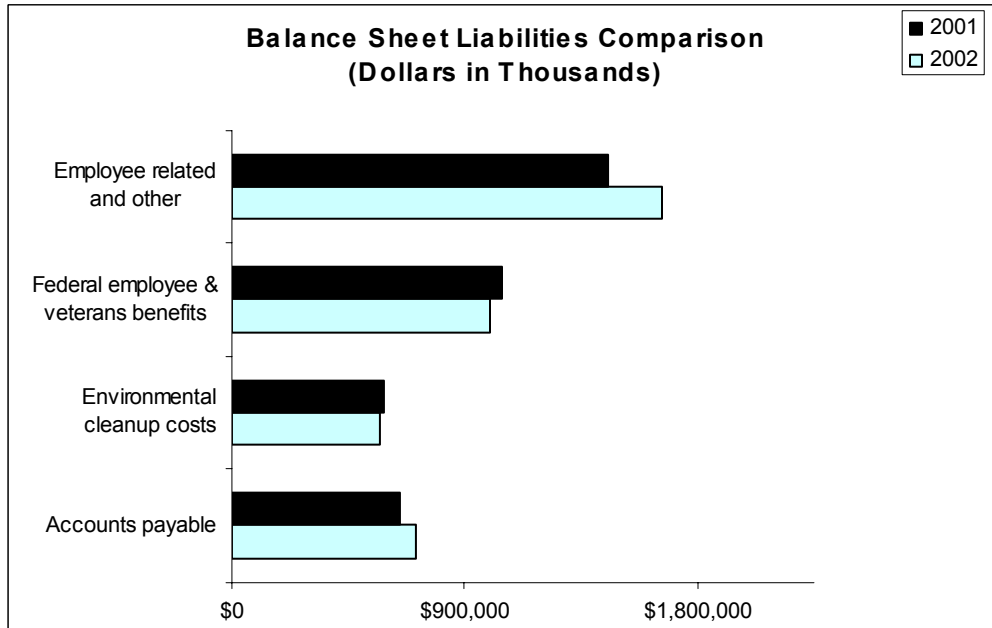
At the end of FY 2002, FAA reported liabilities of \$3.9 billion. Liabilities are probable and measurable future outflows of resources arising from past transactions or events. The chart below depicts FAA's major categories of liabilities, as a percentage of total liabilities.







The graph below presents comparisons of major liability balances between FY 2001 and FY 2002. A discussion of the significant fluctuations between the two years follows.



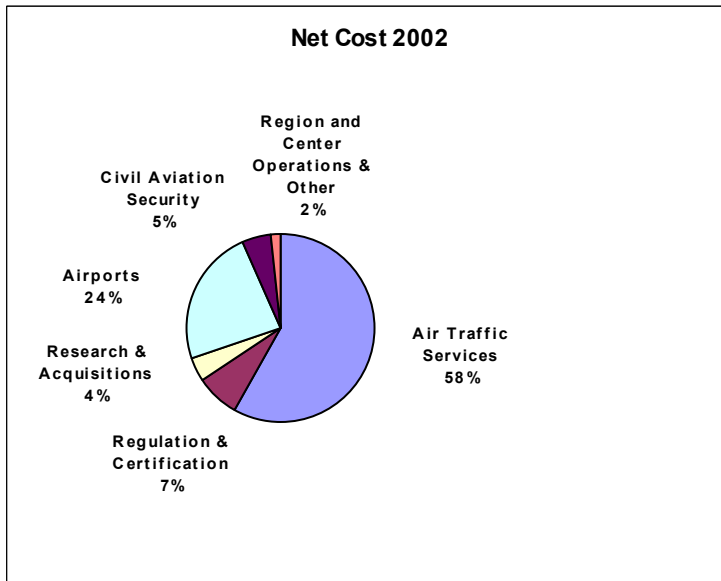
*Employee Related, Legal, and Other Liabilities* represent 48 percent of FAA’s total liabilities. Intragovernmental liabilities increased \$118.1 million, from \$367.4 million to \$485.5 million as of September 30, 2001 and 2002, respectively. Excise taxes are deposited to the Airport and Airway Trust Fund quarterly based on estimates by the Department of Treasury’s Office of Tax Analysis. The amounts are subsequently adjusted when the estimates are certified. The increased liability primarily results from a downward adjustment of FY 2002 excise taxes, following certification of the estimate. The prior year estimate was adjusted upward following certification, and thus there was no comparable liability as of September 30, 2001.

Non-intragovernmental *Employee Related, Legal, and Other Liabilities* increased \$92 million, from \$1,084 million to \$1,176 million as of September 30, 2001 and 2002, respectively. This change is primarily related to increases in accrued payroll and benefits to employees and the value of their accrued annual and other leave, such as compensatory time. These liabilities increased because of (a) increases in number of employee annual and other leave hours, (b) one additional day of unpaid payroll at the end of FY 2002 as compared to FY 2001, and (c) compensation increases.

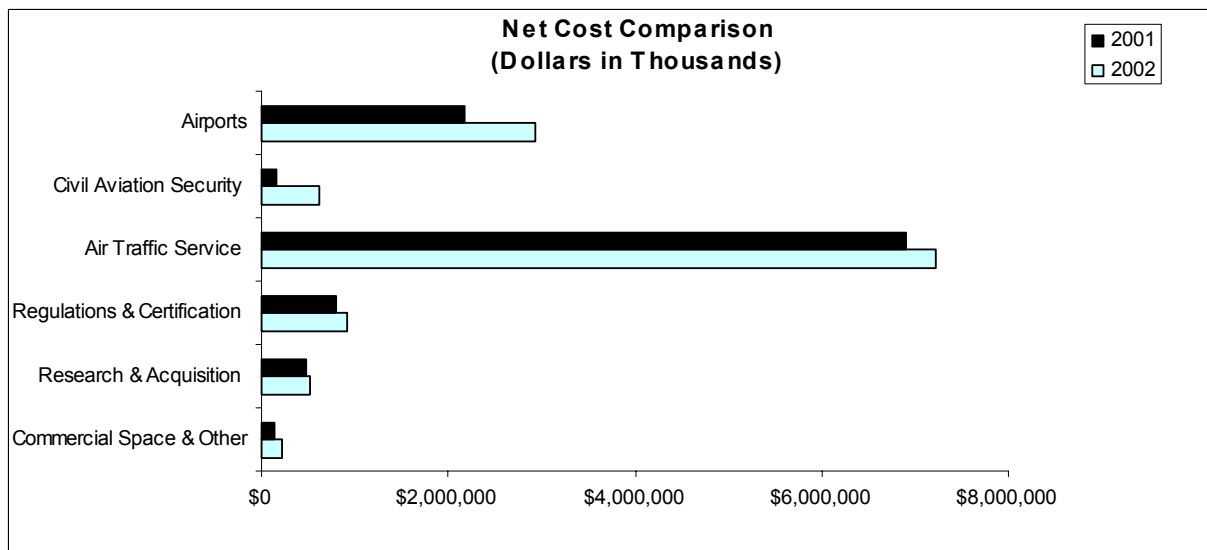


**Statement of Net Cost:** FAA has used its cost accounting system to prepare the Statement of Net Cost since FY 1999. This year, in the Other Accompanying Information section of this report, we have begun to link our net costs to agency strategic goal areas by responsibility segment.

For the fiscal year ending September 30, 2002, FAA's net costs were \$12.4 billion, compared to \$10.7 billion in FY 2001. The following chart illustrates the distribution of net costs among FAA's lines of business.



The graph below compares FY 2001 and FY 2002 net costs, followed by a discussion of the significant fluctuations between the two years.





*Airports* net costs increased \$755 million, from \$2,179 million in FY 2001 to \$2,934 million in FY 2002. The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (P.L. 106-181) increased Airport Improvement Program funding by more than \$1 billion in FY 2001. Airport improvement projects typically take two to three years to complete, and FAA reports the associated expense as the grant recipient accomplishes the improvement work. Thus, FAA's net Airports costs continued to increase in FY 2002, as the project lifecycle associated with these grants continued.

*Civil Aviation Security* net cost increased from \$160.4 million in FY 2001 to \$613.9 million in FY 2002 due to the increased security actions following the terrorist attacks of September 11, 2001. Although TSA assumed responsibility for civil aviation security functions on February 13, 2002, the FAA incurred substantially increased costs in this area through that date, and as disclosed in the Other Accompanying Information section of this report, FAA continued to fund certain of these security-related activities thereafter.

*Air Traffic Services* is FAA's largest line of business, comprising 58 percent of total net costs. Air Traffic net costs increased \$.3 billion (4.6 percent), from \$6.9 billion in FY 2001 to \$7.2 billion in FY 2002, primarily due to personnel compensation and benefits increases.

*Regulation and Certification* net cost increased \$124.7 million, from \$799.9 million in FY 2001 to \$924.6 million in FY 2002, principally as a result of (1) increased personnel compensation and benefits and (2) reimbursements to airlines for costs associated with the Enhanced Airplane Security Program (EASP). These costs include, for example, strengthening cockpit doors.

*Region and Center Operations and Other Programs* net cost increased \$97.1 million, from \$118.8 million in FY 2001 to \$215.9 million in FY 2002, primarily resulting from \$90 million of payments made by FAA in FY 2002 following the terrorist attacks of September 11, 2001. These payments included, for example, reimbursement to the Metropolitan Washington Airports Authority for revenue losses due to the temporary closure of Ronald Reagan National Airport.

**Statement of Changes in Net Position:** FAA's net position decreased \$1.3 billion, from \$25.3 billion in FY 2001 (after restatement) to \$24.0 billion in FY 2002. FAA's \$12.4 billion net cost of operations exceeds financing sources by \$1.1 billion, resulting in a reduction of net position. FAA's net position also decreased by \$152.7 million, the cumulative effect of a change in accounting principle related to accounting for field spares. These factors collectively resulted in a \$1.3 billion net decrease of FAA's net position during FY 2002.

**Statement of Budgetary Resources:** This statement provides information on how budgetary resources were made available to FAA for the year and the status of those budgetary resources at year-end. The outlays reported on this statement reflect the actual cash disbursed for the year by the Department of the Treasury for FAA obligations. This statement is consistent with information presented in the Budget of the United States Government.

**Statement of Financing:** This statement reconciles the net budgetary obligations used to finance FAA operations and the net fully accrued cost of operating FAA programs. The reconciling amounts displayed in this statement represent timing differences related to the way accounting events are recorded under budgetary (obligations) accounting and accrual accounting.

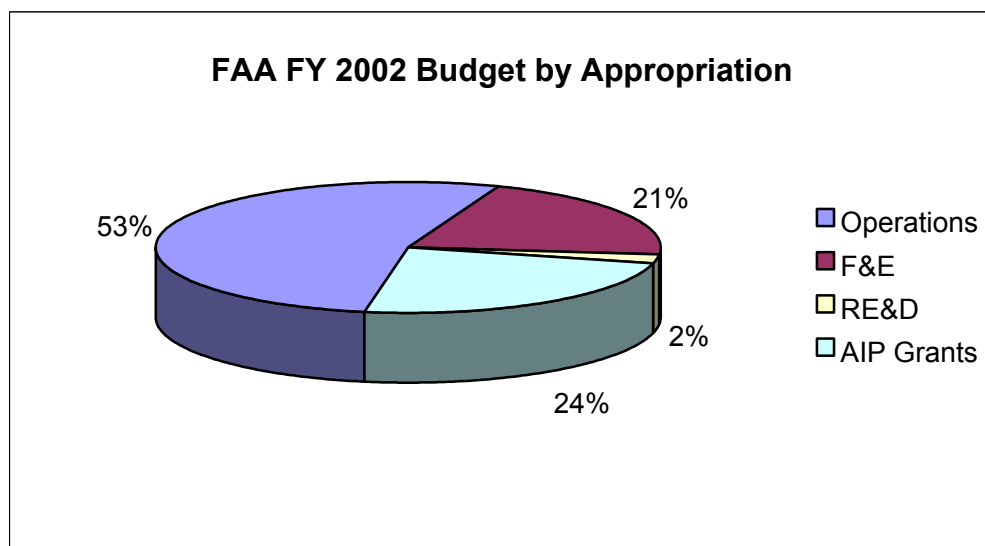


### Budgetary Integrity: FAA Resources and How They Are Used

**Airport and Airway Trust Fund.** Approximately 92 percent of the FAA's FY 2002 budget was provided by the Airport and Airway Trust Fund, which derives its funds from excise taxes and interest generated by the Fund. The Airport and Airway Trust Fund, created by the Airport and Airway Revenue Act of 1970, provides a stable source of funding to finance investments in the airport and airway system and, to the extent funds are available, covers the operating costs of the airway system. Aviation excise taxes, which include taxes on domestic passenger tickets, freight waybills, general and commercial aviation fuel/gas, and international departures and arrivals, are deposited into the Trust Fund. The Department of the Treasury maintains the Trust Fund and invests its monies in Government securities. Any interest earned is deposited into the Trust Fund. As needed, funds are withdrawn from the Trust Fund and transferred into each FAA appropriation to cover obligations. At the end of FY 2002, the uncommitted balance was approximately \$4.8 billion, as compared to \$7.3 billion at the end of FY 2001. This decrease resulted from a reduction in air travel and the associated revenue from excise taxes.

FAA is financed through annual and multi-year appropriations authorized by the Congress. Its FY 2002 enacted budget was \$13.528 billion. The Combined Statement of Budgetary Resources reflects funding enacted by the FY 2002 Department of Transportation Appropriations Act (Public Law 107-87), and two Emergency Supplemental Appropriations Acts (Public Laws 107-117 and 107-206). Total budgetary resources, however, are not adjusted for rescissions and reductions required by these appropriations acts. FAA has four appropriations, the largest—Operations—is funded by Treasury's General Fund and the Airport and Airway Trust Fund (Trust Fund). The Trust Fund is the sole revenue source for the FAA's three capital investment appropriations: (1) Facilities and Equipment; (2) Research, Engineering, and Development, and (3) Airport Improvement Program.

### FY 2002 ENACTED BUDGET



**Operations.** The Operations appropriation funds the salaries and associated costs to operate and maintain the air traffic control system and to carry out FAA's safety inspection and regulatory responsibilities. Funding for Operations in FY 2002 increased \$475 million over FY 2001, including \$200 million in an emergency supplemental appropriation. Much of the increase was attributable to mandatory pay increases



and growth in the controller workforce. In FY 2002, Congress imposed separate funding levels for individual organizations funded by the Operations appropriations.

**Facilities and Equipment (F&E).** Funds from the F&E appropriation are used to modernize, expand, and replenish the air traffic control infrastructure. Between FY 2001 and FY 2002, there was a 13 percent increase in funding, which includes \$108.5 million in the emergency supplemental appropriation. Funding increases supported major systems, such as the en route and terminal automation programs, next generation weather radar, the oceanic automation program, communications, and satellite navigation.

**Airport Improvement Program (AIP).** The Secretary of Transportation is authorized to award grants for airport planning and development to maintain a safe and efficient nationwide system of public airports. These grants make it possible to fund one-fourth to one-third of all capital development at the Nation's public airports. Grants are issued to maintain and enhance airport safety, preserve existing airport infrastructure, and expand capacity and efficiency throughout the airport system. An increase of \$579 million over the FY 2001 enacted level was for airport improvement projects to enhance capacity, improve safety and security, and mitigate noise.

The increase included an emergency supplemental appropriation of \$175 million to reimburse airports for the direct costs of meeting new security requirements imposed after September 11<sup>th</sup>. Congress directed FAA to distribute the funds in a manner that would assist airports facing the greatest financial challenges in complying with the new security directions. FAA received 317 applications that requested a total of \$445 million in assistance. We found that smaller airports suffered the greatest effects, while medium-sized and large airports had a greater capacity to absorb the additional costs. Our fund allocations reflected these findings. Almost 200 non-hub airports received \$35.6 million to fund 100 percent of their eligible costs, while 67 small hub airports received \$28.3 million to fund 50 percent of their eligible project costs. Almost 70 medium/large hub airports received \$111.1 million in assistance.

For FY 2003, we are working with TSA and the Office of the Secretary, DOT, to develop a plan to use AIP funds to finance security capital requirements, targeting AIP expenditures for security at the same level as in FY 2002. Funding security at this level will assure that sufficient AIP resources are available to finance other national priorities including safety, environmental initiatives and major capacity projects. To fund long-term security requirements, such as modifying airport terminals to accommodate screening equipment, and purchasing and installing surveillance cameras, TSA is working with Congress and the FAA to establish a TSA-administered grant program.

**Research, Engineering, and Development (RE&D).** Funding for RE&D increased \$58 million from the prior year and included \$50 million in an emergency supplemental appropriation. This additional funding allowed for an increased focus on security, environment and energy, human factors, and aircraft safety, which supports the Safer Skies initiative.



## Looking to the Future

As FAA attempts to identify the broad trends shaping flight, we anticipate future needs to more effectively guide present planning. Although we may not be able to predict the precise contours of our aviation future, we are working on several fronts to advance aviation technology and improve safety and system efficiency.

Aircraft manufacturers are already experimenting with new composite materials that will reduce aircraft weight by as much as 30 percent. Lighter planes will fly faster, burn less fuel, and produce fewer emissions. Cockpits are being redesigned to incorporate the latest communication, navigation, and surveillance equipment. This new equipment will maximize efficiency and help pilots cope with severe weather. Within the next two decades, airplanes will become even more automated, allowing commercial pilots to concentrate on monitoring complex aircraft systems to ensure optimum performance. In such advanced vehicles, security, and especially cyberterrorism, will be a concern. Airplanes will need computer diagnostics, a quick fix for viruses, and manual backup systems that will allow pilots to bypass automated systems and fly the airplane the old-fashioned way.

As we look to the future, FAA will build on past successes to face the challenges ahead. While we made great strides in improving safety, enhancing security, and increasing efficiency, we must persist in our efforts to build an aviation system for the next 100 years of flight. As the aviation community adjusts to changes in demand and economic conditions, so FAA must make mid-course corrections to address new realities.

Charles Lindbergh saw aviation as part of the continuum of human endeavor. The men and women of FAA will work with our partners around the globe to realize the enormous potential of flight for fostering economic growth and enriching our lives.

### Future Flight

Imagine an airplane with an immune system that allows it to automatically heal its skin or one that flies with curved control surfaces that could adjust thousands of times per minute, like feathers on the wings of a bird. Consider an aircraft that can seat 600 people, weighs half as much as today's planes, and can fly three times as far. While this may sound like science fiction, it may, in fact, be the future of flight.

Rapid advances in microelectronics and materials are bringing us closer to airplanes that are more like living organisms than machines. The emerging field of nanotechnology promises to revolutionize air travel. Manufacturers will be able to routinely incorporate "smart" materials with built-in information processing into devices the size of molecules that can be controlled by equally miniaturized electronics. Tomorrow's airplanes could self-repair or self-correct in flight and contain redundant systems to handle almost any airborne emergency. These airplanes of the future will be faster and more maneuverable, enabling airlines to transport more passengers and cargo more safely and efficiently.

FAA's research, engineering, and development program has historically provided a solid foundation for advances in aviation. Our strong commitment to research is vital to future flight, and we will continue developing new technologies to help ensure the safety and efficiency of the global aviation system.





## Achieving Results

This section of FAA's FY 2002 Performance and Accountability Report provides a detailed discussion of our efforts to improve the safety and efficiency of our national airspace system. In this section, we present a detailed analysis of our performance in achieving three strategic and two organizational excellence goals, present our FY 2002 results, and describe ongoing efforts to improve our effectiveness in serving our customers—the public and the aviation industry.

<b>Strategic Goals</b>		
<b>SAFETY</b>	<b>SECURITY</b>	<b>SYSTEM EFFICIENCY</b>
<p><b><i>Reduce fatal aviation accident rates by 80 percent in 10 years (2007)</i></b></p> <p><b>Annual Performance Goals</b></p> <ul style="list-style-type: none"> <li>• Reduce the commercial air carrier fatal accident rate to .038 per 100,000 departures.</li> <li>• Limit the number of fatal general aviation accidents to 379.</li> <li>• Reduce the number of category A and B runway incursions to 53.</li> <li>• Reduce the rate of category A and B runway incursions to .084 per 100,000 operations.</li> <li>• Reduce the number of operational errors where less than 80 percent of required separation between aircraft is maintained to 568 (a rate of 4.0 per million activities).</li> </ul> <p><b>Corporate Projects</b></p> <ul style="list-style-type: none"> <li>• Safer Skies – Runway Safety</li> <li>• Safer Skies – Commercial Aviation</li> <li>• Safer Skies – General Aviation</li> <li>• Global positioning system (GPS) implementation</li> <li>• Air Transportation Oversight System (ATOS)</li> <li>• Aviation Safety Action Program (ASAP)</li> <li>• Space Transportation Safety</li> </ul>	<p><b><i>Prevent security incidents in the aviation system</i></b></p> <p><b>Corporate Projects</b></p> <ul style="list-style-type: none"> <li>• Transition security functions to the Transportation Security Administration</li> <li>• Information security</li> </ul>	<p><b><i>Provide an aerospace transportation system that meets the needs of users and is efficient in applying resources</i></b></p> <p><b>Annual Performance Goals</b></p> <ul style="list-style-type: none"> <li>• Increase the percentage of flights that arrive no more than 15 minutes after the scheduled arrival time at the 32 large hub airports to 77.2 percent.</li> <li>• Limit the number of people in the United States who are exposed to significant aircraft noise levels to 440,000.</li> <li>• Increase the sum of the arrival rates at the 32 large hub airports to 46,600 (average daily capacity).</li> <li>• Increase the percentage of time arrival demand is satisfied at the 32 large hub airports to 95.25 percent.</li> </ul> <p><b>Corporate Projects</b></p> <ul style="list-style-type: none"> <li>• Develop the Air Traffic Organization (ATO)</li> <li>• Implement the Operational Evolution Plan (OEP). Core areas include:             <ul style="list-style-type: none"> <li>- Arrival/Departure Rates</li> <li>- En Route Congestion</li> <li>- Airport Weather Conditions</li> <li>- En-route Severe Weather</li> </ul> </li> <li>• Standard Terminal Automation Replacement System (STARS)</li> <li>• Revitalize existing structures, technology, and operational resources (RESTORE)</li> <li>• En-Route Automation Modernization (ERAM)</li> </ul>



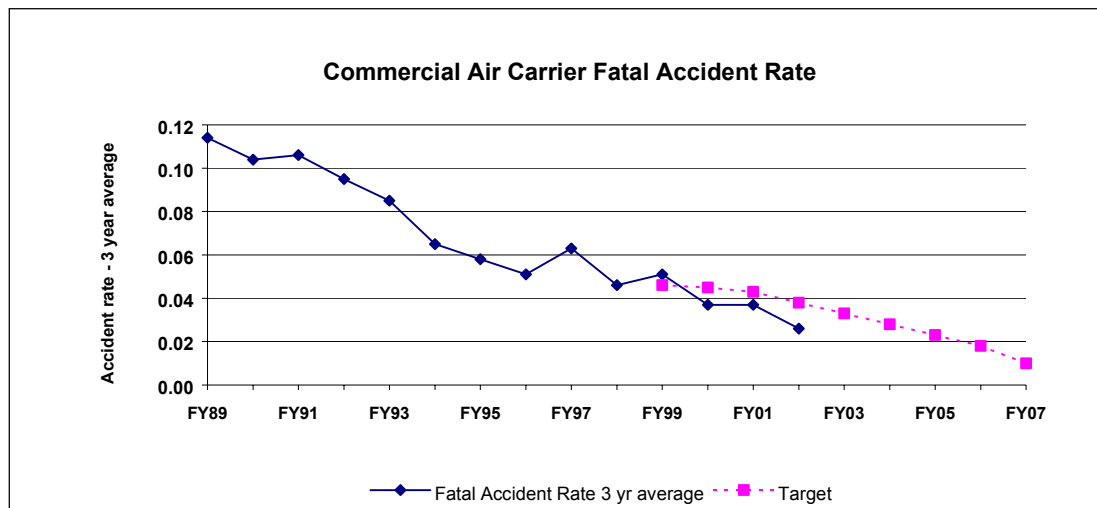
<b>Organizational Excellence Goals</b>			
<b>PEOPLE</b>	<b>REFORM</b>	<b>ENVIRONMENT</b>	<b>GLOBAL LEADERSHIP</b>
<p><i>Prepare the workforce for the demands of the 21<sup>st</sup> Century</i></p>	<p><i>Become more businesslike while increasing customer responsiveness</i></p> <p><b>Annual Performance Goals</b></p> <ul style="list-style-type: none"> <li>• Increase the score received on the American Customer Satisfaction Index Survey of U.S. commercial pilots to 60.</li> <li>• Achieve an unqualified audit opinion for FY 2001.</li> </ul>	<p><i>Maintain the number of people exposed to aircraft noise at current levels</i></p> <p>(Corresponds to System Efficiency goals.)</p>	<p><i>Improve the safety and security of the international aviation system</i></p>
<p><b>Corporate Projects</b></p> <ul style="list-style-type: none"> <li>• Labor-management cooperation</li> <li>• Workforce planning</li> </ul>	<p><b>Corporate Projects</b></p> <ul style="list-style-type: none"> <li>• Compensation implementation</li> <li>• Clean audit</li> <li>• Cost accounting/cost and performance management</li> <li>• Achieve major procurement program goals</li> </ul>	<p><b>Corporate Project</b></p> <ul style="list-style-type: none"> <li>• Airplane noise</li> </ul>	<p><b>Corporate Projects</b></p> <ul style="list-style-type: none"> <li>• GPS implementation</li> </ul>



## Safety

### AIR CARRIER FATAL ACCIDENT RATE

While commercial aviation remains one of the safest forms of transportation available, the public demands a high standard of safety and expects continued improvement. As demand for commercial air transportation grows, government and industry must meet the new challenges and maintain and improve the current level of safety.



**Results:** Preliminary data indicate that FAA met its target of further reducing the fatal accident rate in FY 2002. We remain on target for an 80 percent reduction in the commercial air carrier fatal accident rate by 2007.

In addition to the programs and initiatives described earlier in this report, FAA continued to implement an integrated research plan with NASA. The purpose of this plan is to effectively leverage our combined safety research and development resources to reduce the fatal aviation accident rate. The plan specifies how the two agencies

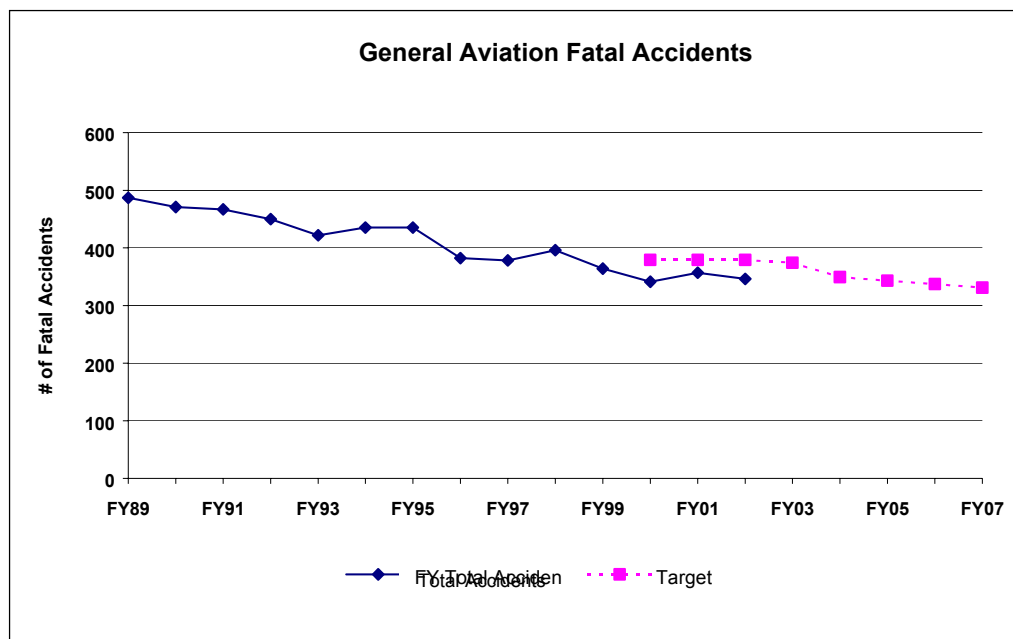
- Articulate common goals that tie research programs to “real world” outcomes in focus areas: accident prevention, precursor identification, mitigation, and safety risk analysis.
- Consolidate all aviation safety research.
- Improve coordination and communication between the agencies.
- Establish an investment strategy that coordinates assessments of accomplishments and investment plans, synchronizes communication based on budget cycles, and integrates planning and implementation.

**Note:** Since the 1970s, the National Transportation Safety Board (NTSB) has not included fatal crashes caused by criminal or terrorist actions when calculating the commercial fatal accident rate. DOT follows the NTSB methodology in quantifying FAA performance in commercial aviation safety. Therefore, the commercial fatal accident rate for FY 2001 did not include the four fatal crashes that occurred on September 11, 2001. If those incidents had been included, the Department would not have met the 2001 target.



## GENERAL AVIATION FATAL ACCIDENTS

General aviation includes all segments of the aviation industry except commercial air carriers and the military. General aviation aircraft range from single-seat home-built aircraft, rotorcraft, and balloons to extended-range turbojets. Public and corporate aircraft provide a wide range of services, from crop dusting, fire fighting, law enforcement, and news coverage to sightseeing, industrial work, on-demand air taxi service, and corporate transportation. Privately owned aircraft provide personal transportation and recreation. Levels of risk vary, as does regulatory oversight. Some general aviation aircraft operate in hazardous environments, such as agricultural application, external-load operations, fire fighting, and the patrol of pipelines/power lines. The majority of aviation fatalities are related to general aviation.



**Results:** Preliminary data for FY 2002 indicate that FAA met its target of reducing general aviation fatal accidents during the year.

We continue to work with the general aviation community to achieve further improvements in safety and further reductions in fatal accidents through the Safer Skies initiative. During FY 2002, FAA and the general aviation community

- Developed a new Advisory Circular, *Controlled Flight into Terrain (CFIT) Awareness*.
- Published the Aeronautical Information Manual (AIM) for pilots on the use of advanced weather products.
- Developed a checklist of weather scenarios/operations for pilots.
- Analyzed the factors that contribute to general aviation fatal accidents to determine which interventions would be most effective. FAA is preparing a report that evaluates the effectiveness of various interventions to improve pilot decision-making.

Together with the aviation industry, FAA initiated a new program, System Safety Approach for General Aviation, to foster aviation safety and awareness. This collaboration is designed to encourage the use of new technology and to provide training and education to enhance safety. We also worked to upgrade safety equipment such as the flight service station automation system, automated weather observation



systems, and communications systems that provide weather and altimeter settings to pilots. Our partnership with NASA included general research on aviation safety programs, which will help reduce the general aviation fatal accidents.

## RUNWAY INCURSIONS

Runway incursions create dangerous situations that can lead to serious accidents. A runway incursion is any occurrence at an airport involving an aircraft, vehicle, person or object on the ground that creates a collision hazard or results in a loss of separation between aircraft taking off, intending to take off, landing, or intending to land at an airport. Incursions involve an aircraft with another aircraft, vehicle, person, or object on the ground. Reducing the number of runway incursions lessens the probability of accidents that potentially involve fatalities, injuries, and significant property damage.

Anticipated increases in activity make runway incursions more likely. Other factors that contribute to the occurrence of runway incursions are

- Pilots unfamiliar with an airport.
- Complex and varied airport configurations.
- Aircraft of different types and capabilities in close proximity.
- Weather changes that impact visibility and conceal normal visual cues.
- Unclear signs and surface markings.

Although preventing all incursions is important, FAA research has determined that all runway incursions may not pose the same level of risk. In light of that analysis, we have developed ways of categorizing risk to better understand the problem and to target our resources more effectively to reduce risk. By categorizing and analyzing the risk of incursions, we can better evaluate our effectiveness in improving runway safety.

### Categorizing Risk

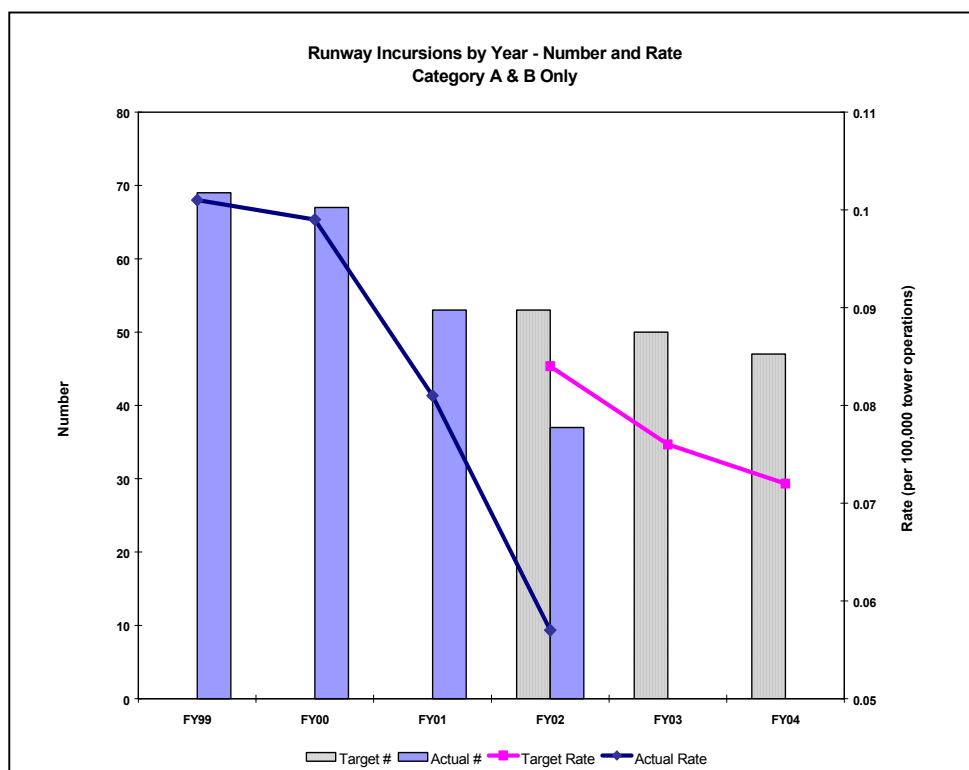
FAA tracks Category A, B, C and D runway incursions. Category C and D incursions are not included in this performance measure.

**Category A runway incursion:** Separation decreases and participants take extreme action to narrowly avoid a collision, or the event results in a collision.

**Category B runway incursion:** Separation decreases and there is a significant potential for a collision.

**Category C runway incursion:** Separation decreases, but there is ample time and distance to avoid a potential collision.

**Category D runway incursion:** Little or no chance of collision, but meets the definition of a runway incursion.



**Results:** FAA met its FY 2002 targets for reducing the number and rate of the most serious runway incursions.

To help further reduce the number and rate of runway incursions, we

- Conducted education and training on awareness of runway incursions for pilots, and controllers/vehicle operators and distributed more than 250,000 program materials (brochures, videotapes, CDs, and other visual aids).
- Published two runway safety reports that analyzed FAA performance for the periods 1997–2000 and 1998–2001.
- Completed and distributed the *Runway Safety Blueprint: 2002–2004*, which presents data collection results and analyses and defines objectives to be achieved during the next 2 years.
- Reviewed pilot/controller communications and conducted Air Traffic Teamwork Enhancement Training for tower controllers.
- Developed and distributed training videotapes for airport vehicle operators and aircraft mechanics.
- Published and distributed two advisory circulars for airport surface operations and, with industry, developed an advisory circular for vehicle operations.
- Conducted runway incursion “callbacks”—collecting information that may reveal key factors that caused a particular incursion—through the NASA Aviation Safety Reporting System Program.

In addition, we

- Continued participation in the Commercial Aviation Safety Team (CAST) and runway incursion Joint Safety Implementation Teams (JSIT) process.
- Conducted 102 Airport Runway Safety Action Team site visits.



- Conducted a second round of 12 regional runway safety workshops designed to raise awareness and report on the progress of runway safety efforts.
- Performed the first operational Airport Movement Area Safety System (AMASS) installation. AMASS systems are now operational in 25 of 34 planned locations.
- Awarded the contract for Airport Surface Detection Equipment–Model X, which depicts aircraft vehicle position and identification information overlaid on a color map of the airport surface. The contract provides airport surface surveillance systems at the two busiest non-ASDE-3/AMASS airports. The program is on schedule.
- Conducted 7 of 14 scheduled airport technology needs assessments by June 30, 2002.
- Published human factors and runway safety booklet, *Runway Safety: It's Everybody's Business*.

Several other efforts are helping to reduce runway incursions. Based on radar images, the Department of Defense has developed software that detects aircraft and other vehicular movement and reduces runway incursions at military airports. NASA and FAA are also working on aviation safety research and technology development for runway safety and other areas. The NTSB investigates runway accidents and determines causal factors that help us refine our safety program design.

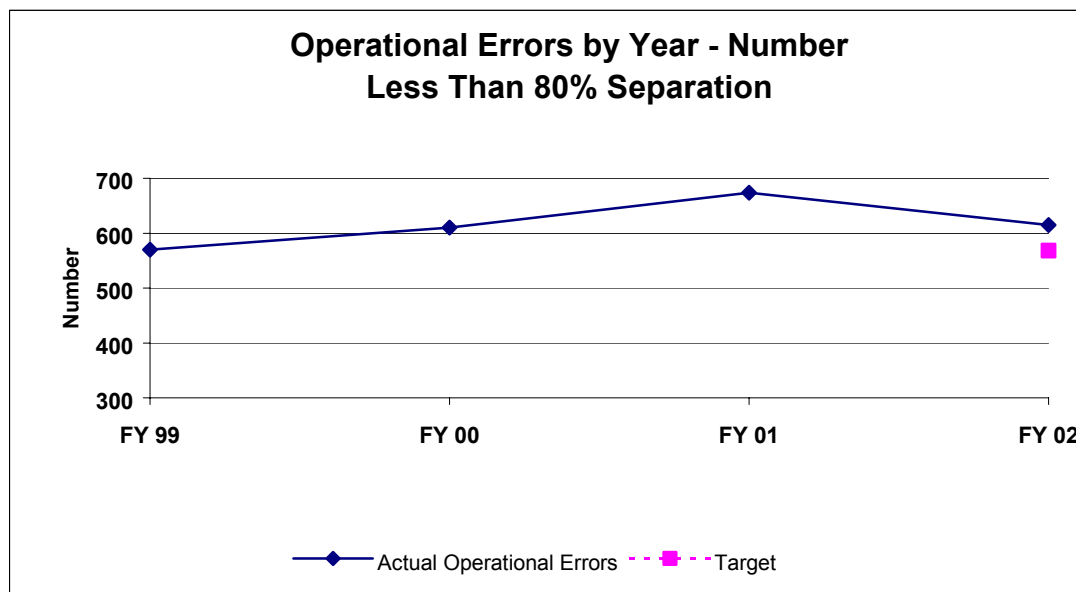
**Note:** The runway safety measure was changed in 2002 to the number and rate of Category A and B (highest risk) runway incursions per 100,000 operations; i.e., those runway incursions where there is higher potential for a collision. As a result, the measure focuses on reducing the risks from runway incursions that pose the greatest risk to the flying public.





## OPERATIONAL ERRORS

One of the fundamental principles of aviation safety is separation—the need to maintain a safe distance from other aircraft, terrain, obstructions, and certain airspace not designated for routine air travel. Air traffic controllers employ rules and procedures that define separation standards for the variety of environments in which aircraft operate. Pilots flying under visual flight rules operate under a “see and avoid” policy, while those using instrument procedures rely on controllers’ instructions to guide them. An operational error occurs when controllers fail to apply or follow the rules and procedures that define separation standards and separation is less than required. FAA seeks to reduce operational errors.



**Results:** Although FAA did not meet its target for reducing operational errors in FY 2002, we were successful in reducing operational errors by 9 percent from the prior year.

Training designed to provide a common understanding of procedures and policies among controllers and pilots is central to our strategy for reducing operational errors. We are aggressively seeking to identify the factors that cause these errors and are implementing technology improvements, such as modern displays, new decision support tools, and improved communication systems. These improvements will allow controllers to more effectively determine aircraft location and reduce miscommunication between pilots and controllers.

In addition to controller and pilot training and risk factor analysis, FAA

- Investigated the utility of the User Request Evaluation Tool (URET), a prototype conflict probe that provides controllers with more advanced notification of potential in-flight conflicts.
- Investigated the initial deployment of Controller Pilot Data Link Communications to improve pilot and controller communications, thereby reducing operational errors caused by miscommunication.
- Continued to conduct quality assurance review audits to identify and correct deficiencies in controller

### New Severity Index

Based on our success in reducing runway incursions, we plan to apply a Severity Index to operational errors in FY 2003. The Severity Index will be used to determine the gravity of an in-flight operational error or the degree to which the separation standard was violated. The categories of operational errors are

- Category A: High
- Category B: Moderate—Uncontrolled
- Category C: Moderate—Controlled
- Category D: Low

The severity classifications are based on the vertical and lateral distances between aircraft, their closure rates and flight paths, and the level of air traffic control.



performance before an operational error or deviation occurs. We continued to resolve performance deficiencies through corrective training.

- Worked with the National Air Traffic Controllers Association to develop and implement a system to classify operational errors based on risk.

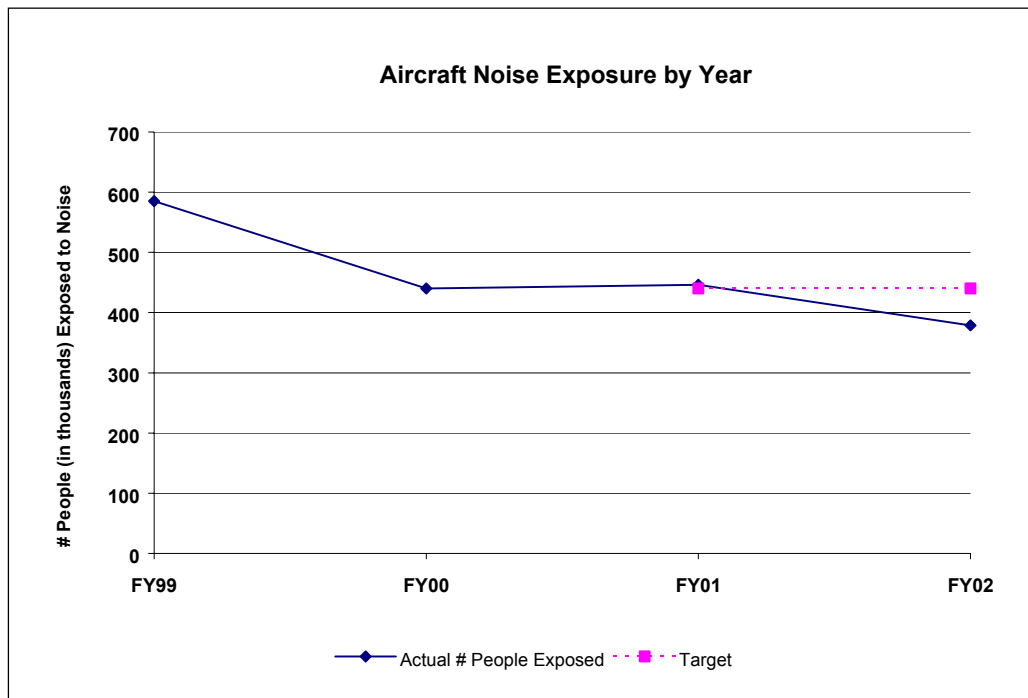
We expect to meet our goal for reducing operational errors next year. We have started collecting data for the Severity Index and are developing a 3-year operational error prevention plan relating to the Severity Index. As part of these efforts to improve safety, we have proposed changing separation standards to reflect the level of risk.

**Note:** The operational errors measure was changed in 2002 to the number of operational errors in which less than 80 percent of required aircraft separation was maintained. This change was made to focus the measure on the highest risks associated with in-flight operational safety and to focus results on the most serious violations. For FY 2003, the goal will focus on Category A/B operational errors to reduce the number of these errors to 642. In addition, we will collect data on Category C and D operational errors.

## System Efficiency

### NOISE

The public is concerned about and sensitive to aircraft noise around airports. In recent years, noise complaints have increased, despite the introduction of quieter aircraft. Population growth around airports and increasing flight activity can negatively impact FAA's ability to reduce the public's exposure to aircraft noise.



**Results:** Preliminary data indicate that FAA met its target for reducing exposure to noise in FY 2002.

We achieved our goal by working with the aviation community to implement a noise control program. The program includes noise reduction through the development of quieter aircraft, soundproofing and



buyouts of houses and buildings near airports, operational flight control measures, and land use planning strategies. During FY 2002, we

- Continued to provide funds for such noise reduction activities as the soundproofing of residences and buildings used for educational or medical purposes near airports, purchase of buffer zones around airports, and noise reduction planning through our Airport Improvement Program.
- Continued to develop noise research and assessment technologies.
- Implemented flight control measures to help reduce neighborhood exposure.
- Continued to examine and validate the methodologies used to assess aircraft noise exposure.
- Developed a research plan and program for international noise standards certification for turbojet airplanes that will be more stringent than current standards.
- Worked in cooperation with the National Park Service to assess noise exposure and develop Air Tour Implementation Plans for each national park.

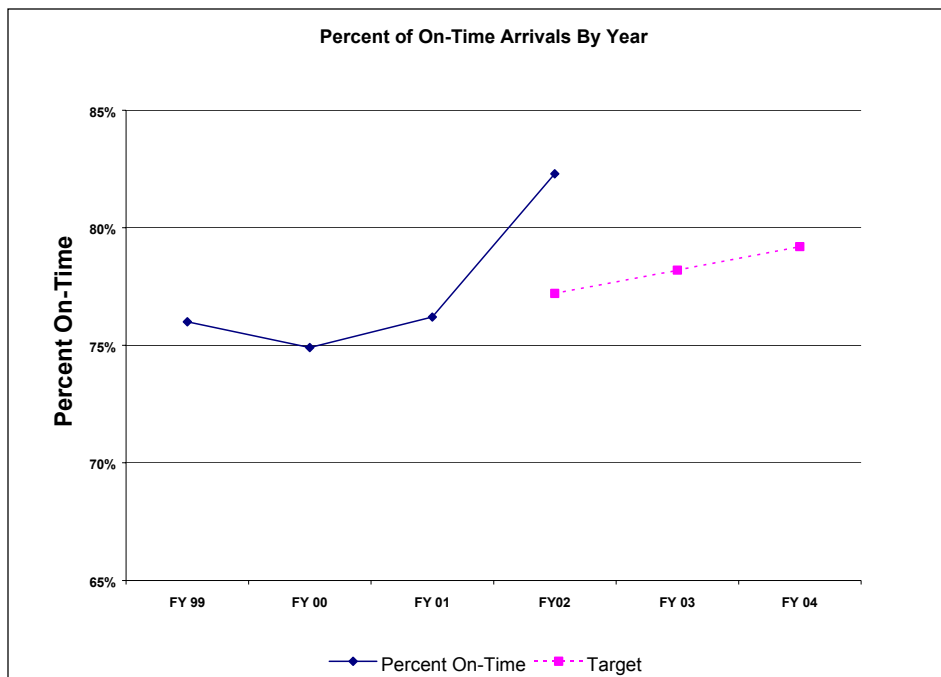
We are also working with NASA to conduct noise reduction technology research. We hope to identify concepts that will reduce the noise impact of future subsonic jet airplanes by half (7 to 10 decibels), relative to 1992 technology.



## ON-TIME ARRIVAL

Commercial aviation delays cost the airlines and the traveling public both time and money. Delays, which are projected to increase as passenger travel demand recovers and continues to rise, are usually caused by air traffic congestion and adverse weather. Other factors that contribute to delays are

- Decisions by air carriers to concentrate operations in one or more hub airports.
- Changing demand for air travel.
- Rapid population growth in urban centers.
- Physical configurations of airports and terminals.
- Environmental considerations.
- Increased security.



**Results:** FAA met its target for reducing delays and increasing the rate of on-time arrivals.

We continue to work with the aviation community to improve on-time arrivals. Over the long term, increased airport capacity, as a result of all-weather access to runways, and runway construction, will provide the best means for reducing delays. In the near term, service delivery improvements designed to reduce delays focus on Free Flight Phase 1 tools, continued modernization of air traffic management capital asset systems, and improvements in the aviation weather system. In 2002, we

- Completed installation of air traffic automation enhancements such as the Traffic Management Advisor at major hubs (Dallas–Ft. Worth, Los Angeles, Atlanta, Minneapolis, Oakland, Miami, and Denver).
- Developed two major systems to improve weather reporting, processing, and dissemination. The Integrated Terminal Weather System consolidates information from several sources and provides it to FAA TRACONs and airport towers. The Weather and Radar Processor reports weather information and integrates weather radar data provided to the FAA Centers.



- Continued to implement and improve existing weather sensors such as Next Generation Weather Radar, Terminal Doppler Weather Radar, the Low-Level Wind Shear Alert System and a wind shear detection channel for the terminal radar, and the Automated Surface Observation System.
- Implemented and evaluated the Collaborative Convective Forecast Product (CCFP), an experimental demonstration program from the National Weather Service, at the Air Traffic Control System Command Center. The CCFP provides a single convective forecast for use in coordinating a system-wide approach to severe weather events.

As part of the collaborative efforts to reduce delays, we have created a special data system, Aviation System Performance Metrics (ASPM), to compare actual versus scheduled performance by flight phase. ASPM data contain, among other things, actual and scheduled arrivals and departures by air carriers by airport, and the actual acceptance and departure rates by airport. Acceptance and departure rates reflect the arrivals and departures that can occur, based on standard air traffic management practices. Aviation industry demand for arrivals or departures at an airport, divided by the practical capacity of the airport, gives a utilization rate for that airport. By studying utilization rates, we can evaluate the effectiveness of our delay reduction programs.

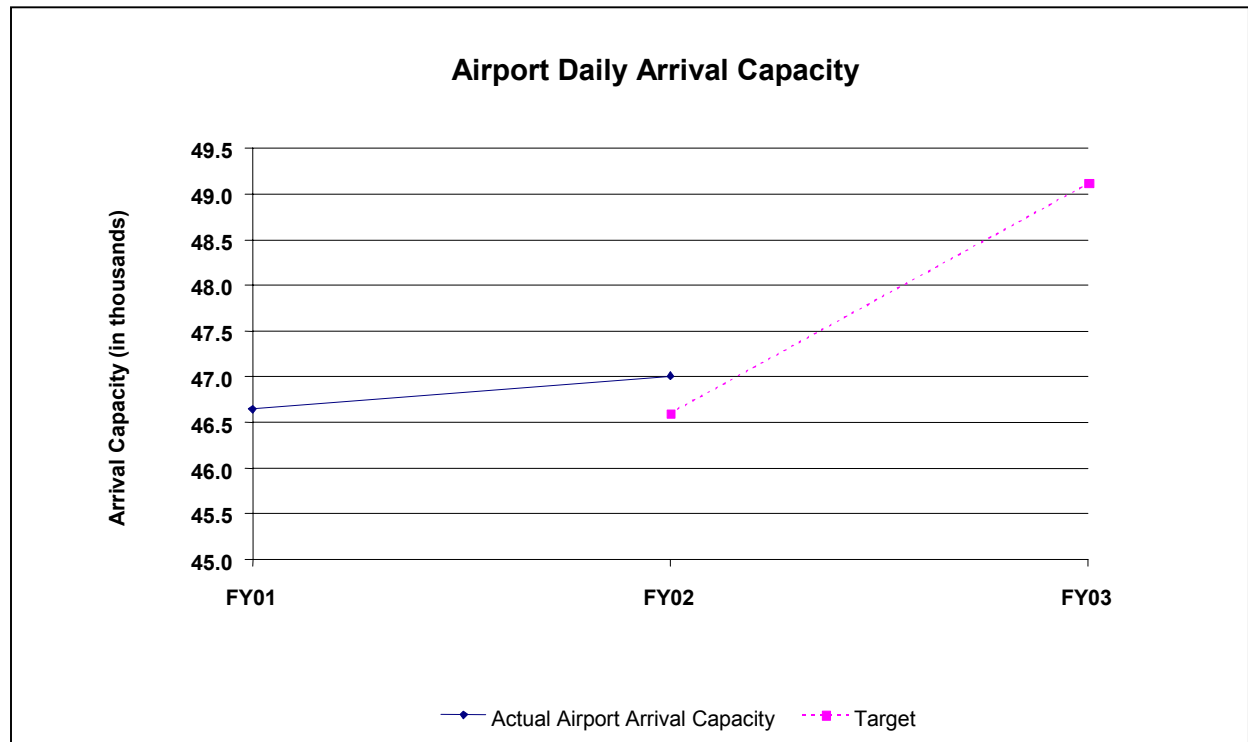
In a further effort to reduce delays and increase efficiency, FAA and NASA developed enhanced software tools for air traffic control. Our aviation weather research program, conducted with the National Weather Service and other government agencies, invests in improved models to provide more detailed and timely detection and forecasting of hazardous weather. Improved de-icing, turbulence, oceanic convection, and national ceiling and visibility forecast programs provide the tools for improved flight planning and collaborative decision making.

**Note:** The airlines, FAA, and the Bureau of Transportation Statistics have agreed to use the percentage of flights arriving no more than 15 minutes after the scheduled arrival time as a common measure of aviation delay.



## AIRPORT ARRIVAL CAPACITY LEVEL

System capacity is one of many measures that we use to determine the effectiveness of our national airspace system's ability to manage demand. One of the metrics used to assess system capacity is average daily arrival capacity, which is the sum of the arrival rates at 32 large hub airports.



**Results:** FAA exceeded its target for maintaining airport arrival capacity.

Continued education is being provided and an increased focus is being placed on all factors that affect airport performance. Such efforts will continue to increase airport capacity. In addition, we continue to develop projects to increase usable capacity, flexibility, and efficiency. These projects include

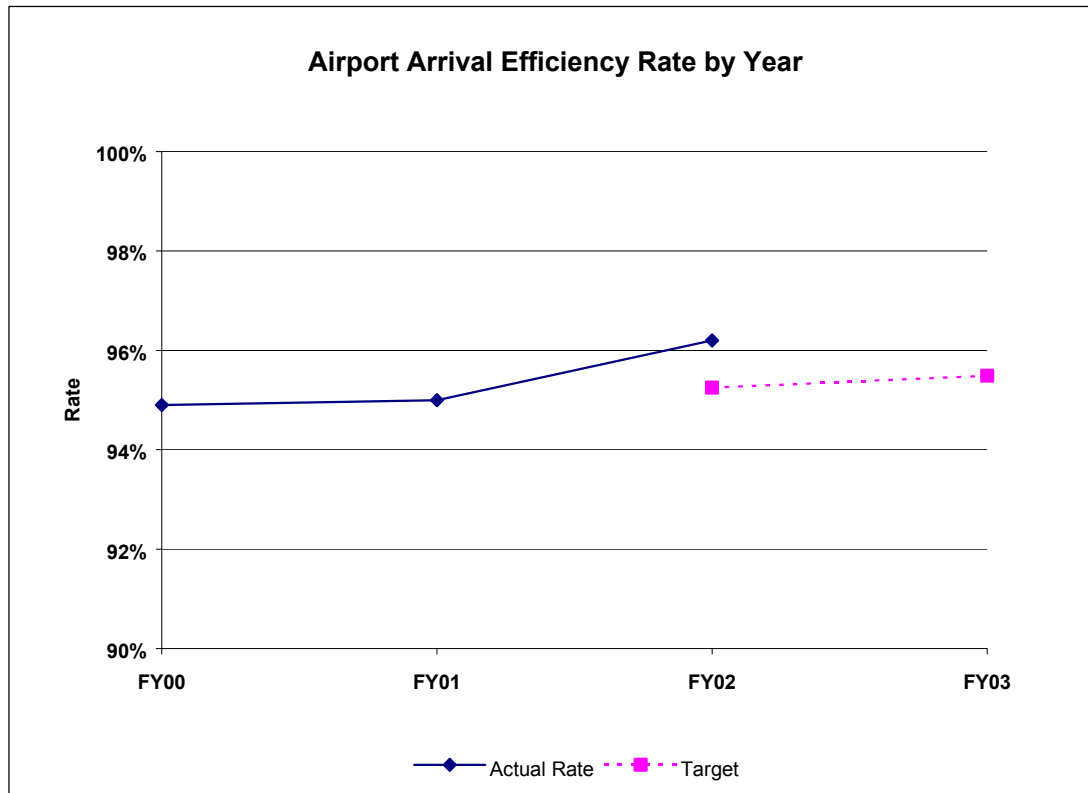
- Center TRACON Automation System (CTAS), a decision support tool for air traffic controllers that enables a more efficient arrival flow into terminal airspace and onto runways.
- URET, a conflict probe that enables controllers to more quickly approve user requests in en route airspace by identifying potential aircraft-to-aircraft conflicts up to 20 minutes in advance.

**Note:** In FY 2003, the measure will be changed to arrival rates at the 35 airports designated in the OEP, rather than the 32 large hubs that were used in FY 2001 and FY 2002.



## AIRPORT ARRIVAL EFFICIENCY RATE

The airport arrival efficiency rate measures the percentage of the time that arrival demand is satisfied given the minimum of facility set arrival rate or arrival demand. Factors that influence airport arrival efficiency include airport capabilities, as determined by runway configuration, and weather conditions.



**Results:** FAA exceeded its target for maintaining the airport arrival efficiency rate.

At each air traffic control tower, FAA will continue to emphasize the importance of reflecting and meeting real time airport capabilities. We continue to undertake projects, such as CTAS and URET, which will increase usable capacity, flexibility, and efficiency.

## Organizational Excellence

FAA has two organizational excellence goals, Clean Audit and American Customer Satisfaction Index (ASCI).








### CLEAN AUDIT

While FAA is part of DOT, we are required to prepare our own audited financial statements. FAA has received unqualified opinions (clean audit) on the FY's 2001 and 2002 financial statements, and we have taken steps to ensure that those results are sustained in the years to come. An independent auditor's unqualified opinion means that FAA's financial statements are prepared in accordance with accounting principles generally accepted in the United States and are free from material misstatements. In prior years, FAA did not receive unqualified opinions because of a material internal control weakness in accounting and reporting for FAA property, plant, and equipment (PP&E). These assets, valued at over \$13 billion in FY 2002, account for 48 percent of FAA's total assets. To address this issue, we established





an Interim Fixed Asset System (IFAS) to centrally account for, and control, PP&E. FAA's commitment to achieving a clean audit and improved financial management is underscored by the inclusion of the clean audit goal in both short-term incentives for FAA executives and organization success increases for all employees who are part of the core compensation plan.

FAA Clean Audit Results					
Fiscal Year Financial Statements	1998	1999	2000	2001	2002
Results					
<b>KEY:</b>  Indicates that the agency received an unqualified opinion on its financial statements.  Indicates that the agency did not receive an unqualified opinion on its financial statements.					

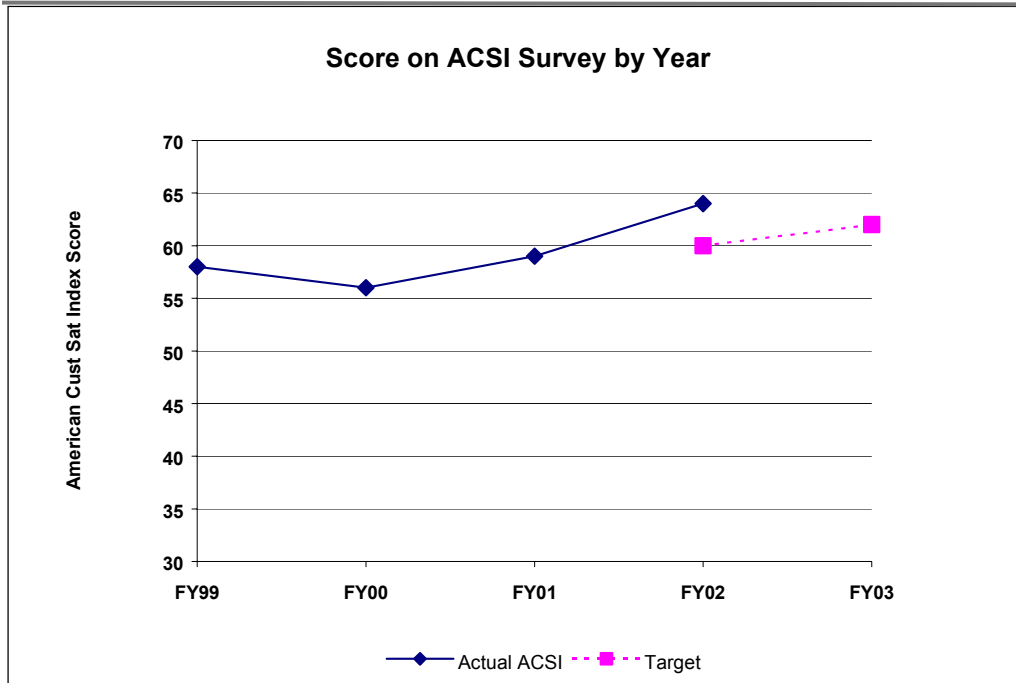
**Results:** FAA received an unqualified opinion for its financial statements.

In FY 2002, we instituted new rules for processing property transactions in IFAS and in May 2002, the FAA Administrator established the National Capitalization Team to improve oversight and control of FAA property accounting. We implemented five of the six auditor recommendations for improving control of FAA property, plant, and equipment during FY 2002. The remaining recommendation will be implemented with the launch of DELPHI, the new, integrated financial management system.

**AMERICAN CUSTOMER SATISFACTION INDEX (ACSI)**

The National Quality Research Center at the University of Michigan Business School, the American Society for Quality, and the CFI Group have conducted the ACSI survey each year since 1994. The survey measures customer satisfaction with products and services of both private sector companies and government agencies. ACSI currently surveys customer satisfaction with about 190 private sector companies and about 70 Federal agencies. FAA has participated in the survey for the past 4 years.

We survey commercial pilots, a major customer user group that is central to our mission, on their satisfaction with air traffic control services and the clarity of our regulations. Randomly selected samples of pilots are called each year and asked to rate FAA on a number of factors. The questions address the level of overall satisfaction, the level of satisfaction relative to expectations, and the level of satisfaction relative to an ideal.



**Results: FAA met its target for increasing customer satisfaction.**

Historically, we have received a high score on pilot satisfaction with air traffic control services and a low score on the clarity of our regulations. To help increase customer satisfaction, we introduced an initiative to make plain language part of our culture. FAA hired a plain language advocate to coordinate activities under the initiative. We provided training to about 600 FAA employees and contractors and plan to offer additional training next year. We also maintained a website that provides employees and interested members of the public with information on regulatory developments and allows them to find resources and obtain copies of the latest plain language documents.



## FINANCIAL STATEMENTS

January 31, 2003

### A Message From the Chief Financial Officer

The Federal Aviation Administration is pleased to issue its *FY 2002 Performance and Accountability Report*. This report is an integrated presentation of programmatic and management performance, including how we have responded to our financial management and management control responsibilities. The report, which describes our business priorities and accomplishments during FY 2002, is based on data that are complete and reliable. We remain committed to the highest standards of management integrity, and we pledge to continue improving our management and accountability processes.



We have made tremendous progress in our efforts to modernize management systems and practices, and to improve internal controls. Our FY 2002 accomplishments include:

- An unqualified opinion on our financial statements, providing a solid foundation for a discussion of agency performance and strategic investments in safety, security, and aviation system efficiency.
- Improved control over property accounting by instituting new business rules for property transactions and creating a National Capitalization Team responsible for enhancing oversight and control over property accounting.
- Substantial progress in implementing DELPHI—a new, integrated core accounting system. When operational, DELPHI will be a fully integrated, state-of-the-art financial management system.
- Implementation of cost accounting in six new organizations and 21 percent of employees tracking their time by project and activity in labor distribution reporting.

In the year to come, we will continue to build a solid foundation for organizational excellence. Our most significant challenge will be to bring DELPHI online. Last year we made major strides in implementing the new system. The DELPHI team completed solution design activities to ensure the system would meet the FAA's business requirements. In addition, the team provided formal process-based training on the functionality of DELPHI to over 900 end users. Although we made progress, we encountered problems in our efforts to convert old systems. Despite the technical issues we face, we are committed to resolve the problems and modernize our management systems.

In addition to improving financial management, our areas of focus in FY 2003 will be the other government-wide initiatives outlined in the President's Management Agenda—human capital, competitive sourcing, e-government, and budget and performance integration. We will also address the material weakness and reportable conditions identified during the annual independent audit of our financial statements. Our auditors identified one material internal control weakness related to the process for determining legal liabilities, which will be corrected in 2003.

Thanks to the men and women of FAA, the United States has the safest, most efficient aviation system in the world. In 2003, we will continue to invest in innovations to our business operations to ensure that the agency is prepared for the next century of flight.

A handwritten signature in black ink, appearing to read "C. Bertram".

**Chris Bertram**  
Chief Financial Officer



# Memorandum

U.S. Department of  
Transportation

Office of the Secretary  
of Transportation

Office of Inspector General

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Subject: INFORMATION: Quality Control Review  
of Audited Financial Statements  
for Fiscal Year 2002, FAA  
QC-2003-017

Date: January 27, 2003

From: Kenneth M. Mead  
Inspector General

Reply To

Attn Of: Meche:x61496

To: The Secretary  
Federal Aviation Administrator

The audit of the Federal Aviation Administration (FAA) Financial Statements as of and for the year ended September 30, 2002, was completed by KPMG LLP (KPMG) of Washington, D.C. We performed a quality control review of the audit work to determine compliance with applicable standards. These standards include the Chief Financial Officers Act, *Government Auditing Standards*, and Office of Management and Budget Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

The KPMG audit report rendered an unqualified opinion on the FAA financial statements. The report included one material internal control weakness, six reportable internal control conditions, and one material noncompliance with accounting laws and regulations. KPMG made 14 recommendations for corrective actions (see Attachment). We agree with the KPMG recommendations. We are requesting that, within 15 days, FAA specify actions taken and planned, along with estimated completion dates for planned actions.

In our opinion, the audit work performed by KPMG complied with applicable standards. Therefore, we are not making any additional recommendations.

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

Attachment



2001 M Street, NW  
Washington, DC 20036

## Independent Auditors' Report

Administrator, Federal Aviation Administration  
Inspector General, U.S. Department of Transportation:

We have audited the accompanying consolidated balance sheet of the Federal Aviation Administration (FAA) as of September 30, 2002, the related consolidated statements of net cost, changes in net position, and financing, and the related combined statement of budgetary resources for the year ended September 30, 2002 (herein referred to as financial statements). The objective of our audit was to express an opinion on the fair presentation of these financial statements.

In connection with our audit, we also considered the FAA's internal control over financial reporting and tested the FAA's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

### SUMMARY

As stated in our opinion on the financial statements, we concluded that the FAA's financial statements as of and for the year ended September 30, 2002, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. The accompanying consolidated balance sheet and consolidated statement of net cost of the FAA as of and for the year ended September 30, 2001, were audited by other auditors whose report expressed an unqualified opinion before the adjustments, audited by us and discussed in Note 15 to the financial statements. As discussed in note 5 to the financial statements, the FAA implemented a change in accounting principle related to the classification and accounting for field spares. Also, as discussed in Note 16, the FAA restated its beginning of the year obligated and unobligated balances in the combined statement of budgetary resources.

Our consideration of internal control over financial reporting resulted in the identification of reportable conditions in the following areas:

1. Process for estimating liabilities for legal matters
2. Controls and processes over financial reporting and account reconciliations
3. Process for estimating environmental liabilities
4. Accounting methods and controls over completeness of field spares
5. Controls over property, plant, and equipment
6. Information technology controls over third-party systems and applications
7. Information technology controls over FAA systems

We consider the first reportable condition, regarding the process for estimating liabilities for legal matters, to be a material weakness.

The results of our tests of compliance with certain provisions of laws and regulations, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and





Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The results of our tests of compliance with the FFMIA disclosed instances where the FAA's financial management systems did not substantially comply with Federal financial management system requirements and the use of the United States Standard General Ledger at the transaction level.

The material weakness, reportable conditions, and the FFMIA compliance issue, along with our recommendations, have been discussed with, and agreed to, by key FAA management officials. FAA management has indicated that corrective actions have been or will be implemented during fiscal year 2003.

The following sections discuss our opinion on the FAA's fiscal year 2002 financial statements, our consideration of the FAA's internal control over financial reporting, our tests of the FAA's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

## **OPINION ON THE FINANCIAL STATEMENTS**

We have audited the accompanying consolidated balance sheet of the FAA as of September 30, 2002, the related consolidated statements of net cost, changes in net position, and financing, and the related combined statement of budgetary resources for the year then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FAA as of September 30, 2002, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the year then ended, in conformity with accounting principles generally accepted in the United States of America. The consolidated balance sheet and statement of net cost of the FAA as of and for the year ended September 30, 2001, were audited by other auditors whose report dated February 27, 2002, expressed an unqualified opinion on those statements before the adjustments discussed in Note 15 to the financial statements. We audited the adjustments described in Note 15 that were applied to the fiscal year 2001 consolidated balance sheet and statement of net cost, and in our opinion, such adjustments are appropriate and have been properly applied.

As discussed in note 5 to the financial statements, the FAA implemented a change in accounting principle related to the classification and accounting for field spares. Also, as discussed in Note 16, the FAA restated its beginning of the year obligated and unobligated balances in the combined statement of budgetary resources.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the fiscal year 2002 financial statements taken as a whole. The Other Accompanying Information is presented for purposes of additional analysis and is not a required part of the fiscal year 2002 financial statements. Such



information has been subjected to the auditing procedures applied in the audit of the fiscal year 2002 financial statements and, in our opinion, is fairly stated in all material respects in relation to the fiscal year 2002 financial statements taken as a whole.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the FAA's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

In our fiscal year 2002 audit, we noted certain matters, described in Exhibits 1 and 2, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the reportable condition presented in Exhibit 1 is a material weakness. Exhibit 2 presents the other reportable conditions. A summary of the status of the prior year reportable condition is included as Exhibit 3.

We also noted other matters involving internal control over financial reporting and its operation that we will report to the management of the FAA.

## **COMPLIANCE WITH LAWS AND REGULATIONS**

The results of our tests of compliance with certain provisions of laws and regulations described in the Responsibilities section of this report, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02. In accordance with the *Federal Managers' Financial Integrity Act of 1982* (FMFIA), the Secretary of Transportation reported to the President that Department of Transportation (DOT) was not in full compliance with FFMIA, as DOT's core accounting system, which FAA uses, does not meet Federal systems requirements. In addition, the Secretary reported that FAA's property systems also did not conform with Federal systems requirements and that there were weaknesses in the area of information systems security within DOT and the FAA's process for closing out cost-reimbursable contracts.

The results of our tests of compliance with FFMIA disclosed instances where the FAA was not in substantial compliance with Federal financial management system requirements and the use of the United States Standard General Ledger at the transaction level. Details of the compliance matters are included in Exhibit 4.





## RESPONSIBILITIES

### *Management's Responsibilities*

The *Government Management Reform Act of 1994* (GMRA) requires each federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To assist the DOT in meeting the GMRA reporting requirements, FAA prepares annual financial statements.

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal control over financial reporting, and preparation of the Management's Discussion and Analysis (including the performance measures), the Required Supplementary Information, and the Required Supplementary Stewardship Information; and
- Complying with laws and regulations, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

### *Auditors' Responsibilities*

Our responsibility is to express an opinion on the FAA's fiscal year 2002 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our fiscal year 2002 audit, we considered the FAA's internal control over financial reporting by obtaining an understanding of the FAA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the



FMFIA. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, we considered the FAA's internal control over the Required Supplementary Stewardship Information by obtaining an understanding of the FAA's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No.01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the FAA's fiscal year 2002 financial statements are free of material misstatement, we performed tests of the FAA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the FAA. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether the FAA's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

## **DISTRIBUTION**

This report is intended for the information and use of the FAA's management, the Department of Transportation's Office of the Inspector General, OMB, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

**KPMG LLP**

January 24, 2003

## **Material Weakness**

Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the FAA's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

This section contains our discussion of the reportable condition that we believe is a material weakness.

### **1. Process for estimating liabilities for legal matters**

#### ***Condition***

The FAA did not have adequate controls to ensure that the basis for the estimated liability for legal matters pending against the FAA, both those recorded as liabilities and disclosed in the notes to the financial statements, were accurate. The Office of General Counsel's (AGC) initial estimate was overstated by approximately \$514 million as cases deemed to be *reasonably possible* of loss were incorrectly included with those deemed to be *probable* of loss. Additionally, the AGC incorrectly reported those cases where the likelihood of loss was deemed to be *remote*. As a result, the notes to the fiscal year 2001 financial statements incorrectly stated that the FAA had legal contingencies totaling \$20 billion. These errors occurred because the AGC did not have an adequate comprehensive understanding of financial reporting requirements, and the Office of Financial Management (AFM) had not established a process to review information developed by the AGC.

In addition, the AGC is not providing the AFM with the necessary information to make quarterly adjustments to the estimated accrued liability related to legal matters. The FAA, as with other Federal government organizations, must rely on its legal counsel to provide information to record estimated and actual legal liabilities in the financial statements. In the past, the AGC has generally only provided this information in response to the annual independent auditors request, which will not be sufficient to comply with the new OMB interim reporting requirements for fiscal years 2003 and beyond. As of 75 days after year-end (December 15, 2002) the FAA was still making inquiry and receiving relevant information needed to produce materially correct financial statements.

We noted the following matters related to legal liabilities and communications with the AGC:

- *Communications with the AGC* – the FAA has not established a plan of communication that would ensure timely periodic (at least quarterly) material updates be provided to the AFM;
- *Quality and consistency of information received from the AGC* – The information provided by the AGC is fragmented, inconsistent, often incomplete, and in some cases erroneous – requiring substantial follow-up to resolve questions and determine proper case status and dollar estimates.

***Criteria***

Statement of Federal Financial Accounting Standard (SFFAS) No. 5, *Accounting for Liabilities in the Federal Government* has defined pending or threatened litigation and possible claims and assessments as a loss contingencies. The Standard states that contingent future outflows of resources as a result of past transactions or events may be recognized, may be disclosed, or may not be reported at all, depending on the circumstances. Legal contingencies should be recognized as a liability when the likelihood of loss is *probable* and *reasonably estimable* or measurable. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss may have been incurred. Disclosures should include the nature of the contingency and an estimate of the possible liability, and estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

The Office of Management and Budget (OMB), Circular A-123, *Management Accountability and Control*, states “management controls are the organization, policies and procedures used by agencies to reasonably ensure that... reliable and timely information is obtained, maintained, reported and used for decision making. In addition, the Joint Financial Management Improvement Program’s (JFMIP) *Framework for Federal Financial Management Systems*, Chapter 3, states that processing covers those mechanisms necessary to properly process and track data on financial events.”

***Recommendation***

We recommend that the FAA develop a communication and coordination plan to ensure timely, complete, accurate information regarding legal matters is routinely provided to and reviewed by the AFM. The information must be sufficiently complete to allow the AFM to properly state legal liabilities in the financial statements and the notes thereto, in compliance with applicable accounting standards.

## Reportable Conditions

We consider the following to be reportable conditions.

### 2. Controls and processes over financial reporting and account reconciliations

#### *Condition*

The financial statements initially produced by FAA's financial reporting processes and systems required substantial review and adjustment in the post-closing process to produce materially correct financial statements. The current financial reporting process places significant reliance on the AFM's manual reviews and reconciliations that increase the likelihood that error or oversight could occur. Also, a number of account analyses and reconciliation procedures were not performed routinely during fiscal year 2002, resulting in a significant number of material post-closing adjustments. Controls over the financial reporting process should be improved to ensure related budgetary and proprietary accounts are in agreement, abnormal account balances are minimized, promptly identified and investigated, intra entity transactions are correctly eliminated, unearned revenue is properly recorded as deferred revenue, and reimbursable activity is correctly recorded.

We noted the following matters that affected the FAA's ability to produce accurate financial statements:

- Fiscal year 2001 audit adjustments were incorrectly allocated to the lines of business on the statement of net cost based on the financial activity that occurred in the month of September instead of activity for the entire year. The FAA revised the fiscal year 2001 statement of net cost to reflect the proper allocation of audit adjustments to the entire year. The revision did not have an effect on fiscal year 2001 total net costs.
- Fiscal year 2002 earned revenue of \$116 million was not properly classified on the statement of net cost, resulting in revenue that significantly exceeded expenses in the *Costs Not Assigned to Programs*.
- Fiscal year 2002 intra-entity expenses of \$260 million related to Franchise Fund operations were incorrectly eliminated against the FAA's lines of business.
- Related budgetary and proprietary general ledger accounts did not agree. Specifically, collections of advance payments totaling \$35 million were recorded in proprietary, but not corresponding budgetary general ledger accounts. Reimbursable expenses totaling \$45 million were incorrectly recorded as appropriations used. Also, revenue totaling \$46 million for reimbursable activities was recorded against the incorrect budgetary general ledger account.
- The FAA has not assessed the financial reporting impact, if any, of its FMFIA reported control weakness related to its process for closing-out cost reimbursable contracts. In its report dated May 8, 2002, the OIG reported control weaknesses in this process and identified approximately \$130 million of potential unallowable costs that could be identified by incurred costs audits.
- The Franchise Fund did not correctly record \$6.6 million of unearned revenue as deferred. As a result, fiscal year 2002 revenue was overstated.

- The Franchise Fund did not properly record the receipt of inventory delivered without an invoice. As a result, both accounts payable and expenses were misstated by approximately \$3 million.

Upon investigation the AFM made appropriate adjustments to the fiscal year 2002 financial statements to correct the discrepancies noted above. In addition during the post-closing review process and in response to our audit inquires, the AFM detected and corrected the following additional discrepancies:

- Although the statement of budgetary resources is presented on a combined basis and therefore intra-entity transactions are not eliminated, certain intra-entity transactions distorted budgetary resources and obligations by \$5.8 billion and required an adjustment to offset the balances for financial statement presentation purposes.
- Note 2, Status of fund balance with Treasury related to fiscal year 2001, misstated the *Available Unobligated Balance* and *Obligated Balance Not Yet Disbursed* by \$3.2 billion.
- The beginning unobligated balance in the budgetary resources section of the statement of budgetary resources required a retroactive adjustments to increase the balance by \$302 million to properly account for fiscal year 2001 grant contract authority previously reported as temporarily unavailable and decrease the balance by \$113 million to correctly report unfilled customer orders.

***Criteria***

OMB Circular A-123 states that financial managers must incorporate certain specific management controls standards and ensure that transactions are promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports.

Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, states that Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that:

- Transactions are executed in accordance with budgetary and financial laws and other requirements are consistent with the purpose authorized, and are recorded in accordance with federal accounting standards;
- Assets are properly safeguarded to deter fraud waste, and abuse; and
- Performance measurement information is adequately supported.

The three objectives should be accomplished in conjunction with the fact that accounting supports both effective management and control of organizations and the process of reporting useful information. Accounting processes are an integral part of the management control system. The ability to prepare financial reports that report all transactions, classified in appropriate ways that reliably represent the underlying events, is itself an indication that certain essential controls are in place and operating effectively. The preparation of reliable financial reports also helps to ensure that reporting entities have early warning systems to indicate potential problems and take actions to correct material weaknesses or problems.

***Recommendation***

Since the FAA will be converting to DOT's new accounting system in the near future, we recommend that the AFM establish compensating controls to detect and correct the discrepancies identified and other matters of this nature. In conjunction with this effort, we recommend that the FAA routinely reconcile and resolve budgetary and proprietary account differences, and perform account and subledger analyses and reconciliations on other key accounts throughout the year, in order to produce reliable interim financial reports and reduce the number of post-closing adjustments at year-end. We also recommend that FAA assess the financial reporting impact related to weaknesses in its process for closing-out cost reimbursable contracts.

**3. Process for estimating environmental liabilities**

***Condition***

The FAA's estimate for environmental liabilities is comprised of two components – the costs to remediate known contaminated sites and the costs to cleanup and decommission active facilities at a future date. Within the FAA, there are two different offices involved with developing and documenting the costs associated with these two components. The Environmental, Energy, and Safety Division (AFZ-800) is the primary office responsible for environmental remediation and the Investment Analysis and Operations Research Division (ASD-400) is the primary office responsible for environmental cleanup and decommissioning. Together they compile a summary listing of estimated environmental cleanup liabilities, which is needed to produce timely, reliable financial statements.

Although improvements were made during the current year, both offices lack adequate policies and procedures to consistently and accurately determine the estimated environmental liability for financial statement purposes. Specifically, within the Environmental, Energy and Employee Safety Division, we noted a lack of:

- Periodic reporting of adjustments to the AFM during the year to refine estimates and to facilitate accurate interim reporting;
- Completeness of listed liabilities (for both known and unknown clean-up);
- Comprehensiveness of instructions provided to regional personnel; and
- Documentation of planning assumptions that will ensure consistency in application of estimating methods and applicable accounting standards.

Within the Investment Analysis and Operations Research Division, we noted a lack of:

- Documentation of planning assumptions on contaminate type and quantity; and
- Cost estimating models for each type of facility that includes appropriate financial statement criteria (e.g. conditions necessary to estimate and accrue a liability).

***Criteria***

SFFAS No. 5 defines a liability as a probable future outflow or other sacrifice of resources as a result of past transactions or events. SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, defines cleanup costs as the costs of removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated property, plant and equipment. Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and post closure costs. Federal Financial Accounting and Auditing Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*, states that an agency is responsible for recognizing a liability for environmental cleanup costs resulting from past transactions or events when a future outflow or other sacrifice of resources is probable and can be reasonably estimated.

***Recommendations***

To improve the reliability, relevance and timeliness of information received by the AFM regarding environmental remediation, we recommend that the AFM, in conjunction with the Environmental, Energy, and Safety Division:

- Establish a process to provide periodic reporting for environmental liabilities;
- Develop and report estimates in current year dollars;
- Consider a risk-based evaluation of uninspected facilities to determine if any environmental remediation exists. This evaluation should focus on those facilities that are similar in function and design as other facilities in which the FAA has determined contamination exists;
- Develop guidance for Environmental Site and Cleanup Report (ESCR) preparation and documentation requirements; and
- Improve documentation and quantification of planning assumptions.

Regarding the environmental cleanup and decommissioning estimate, we recommend that the AFM, in conjunction with Airways Facilities and the Investment Analysis and Operations Research Division:

- Establish a process to provide quarterly reporting for environmental liabilities;
- Improve the planning assumption documentation to include information on the contaminate type and quantity;
- Develop cost estimating models for each facility type; and
- Establish a cost/schedule baseline estimate for the environmental cleanup and decommissioning scope of work.



#### **4. Accounting Methods and Controls over Field Spares**

##### ***Condition***

The FAA did not have adequate controls to ensure all recorded field spares existed and that all items on hand were recorded.

Prior to fiscal year 2002, the FAA recorded field spares as operating materials and supplies using the consumption method as outlined in SFFAS No. 3, *Accounting for Inventory and Related Materials*. Under the consumption method, field spares were maintained at full value until the FAA disposed of the item. At that time the full cost of the item was treated as an expense. During fiscal year 2002, the FAA reevaluated its accounting treatment for field spares and determined that treating the spares as a component of property, plant and equipment (PP&E) in accordance with SFFAS No. 6 better represented actual operations as the cost of the field spares would be recorded as an expense, through depreciation, over the period of time that the field spares support the respective equipment. Accordingly, for financial statement presentation in fiscal year 2002, the FAA reclassified field spares from operating materials to PP&E, and recognized the retroactive accumulated depreciation that would have occurred prior to fiscal year 2002. This change in accounting method will require that the FAA design and implement a new method of accounting for field spares that are sent to the Franchise Fund for repair and/or replacement. Presently, the Franchise Fund records incoming field spares at weighted average cost – the same as new inventory held for sale. The new accounting method will result in recognition of periodic depreciation expense on those assets and any adjustment to carrying value, other than through depreciation, may result in a financial statement misstatement.

The FAA uses the Field Spares Inventory (FSI) module of the Logistics Inventory System as a subsidiary ledger to support field spare balances presented in the financial statements. The FSI module does not have an adequate transaction history and is not a perpetual inventory system. To ensure completeness of field spare quantities in FSI, the FAA must rely on periodic physical inventories and other controls. Our tests of control indicated that the periodic inventories and other controls may not be properly designed to ensure recorded quantities exist, and that actual quantities on hand are recorded. Further, tests of balances showed that errors occurred, and were not detected, as some locations did not properly report field spares in the correct inventory location. In addition, at some locations, the recorded quantities were incorrect due to confusion when both components and subcomponents were involved. We also noted a lack of supporting documentation related to new issuances and the commissioning of new equipment. Accurate tracking of field spare quantities will be especially important since depreciation expense will now be recognized on the balance. It will also be important to properly match the field spare as a component of the asset it supports to ensure proper matching of depreciation with useful life and to properly record disposals as they occur.

##### ***Criteria***

SFFAS No. 6 defines general property, plant, and equipment as any property, plant, and equipment used by an entity in providing goods or services. The standard further states that depreciation expense for PP&E is calculated through the systematic and rational allocation of the cost, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Any adjustment in carrying value other than through depreciation, or other impairment, will be inconsistent with FAA's newly adopted accounting policy. Therefore field spares received by the

Franchise Fund in exchange for new or refurbished spares, can not be inventoried at weighted average cost, for financial statement purposes, as was done in the past

OMB Circular A-123, states that proper stewardship of Federal resources is a fundamental responsibility of agency managers and staff. Federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Resources must be used consistent with agency mission, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement. The Circular further states that transactions should be promptly recorded, and properly classified and accounted for, in order to prepare timely accounts and reliable financial and other reports. Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

***Recommendations***

We recommend that the AFM:

- Implement procedures to ensure that field spare quantities are adequately recorded and tracked as a component of PP&E.
- Evaluate the accounting methodology used by the Franchise Fund to account for returned field spares to ensure that the financial statements properly reflect depreciation and do not include adjustments for changes in value (other than depreciation expense) once the field spare is issued by the Franchise Fund.

**5. Controls over Property, Plant and Equipment**

***Condition***

The FAA did not fully adhere to its policies and procedures designed to ensure that PP&E is stated in accordance with accounting principles generally accepted in United States of America. We noted deficiencies in the following areas:

- *Reconciliations* – The FAA did not reconcile its PP&E sub-ledger (IFAS) to the general ledger throughout the year. Since IFAS is not integrated with the FAA’s general ledger, property transactions must be entered separately from those entered into the general ledger accounting system. Transactions related to real property are entered directly into IFAS, but personal property (i.e., equipment) transactions are first entered into a legacy property management system, which is then transferred to IFAS. The lack of electronic interface between IFAS and the general ledger greatly increases the likelihood that the two systems will, from time-to-time, not agree due to a backlog of input to either system or errors that occur in entering the data. The initial transaction (disbursement or receipt related to a property transaction) is recorded in the general ledger system, however depreciation is computed from data in IFAS. If IFAS is not updated timely, the financial statements will not accurately reflect depreciation expense.

In addition, we noted that the FAA had difficulty preparing a year-end roll-forward of fixed asset additions and disposals by category and thus unable to clearly support composition of changes in PP&E.

- *Additions and disposals* – Regional personnel did not record property disposals in a timely manner. This situation negatively affected the AFM’s ability to produce accurate interim financial statements and management reports. It also resulted in a substantial effort to research months-old data to prepare an accurate closed trial balance at year-end. If uncorrected, this situation will likely put in jeopardy the FAA’s ability to adhere to new OMB reporting requirements for interim reporting during fiscal years 2003 and beyond.
- *Construction-in-process (CIP) transfers* – The FAA has not recorded the transfer of completed construction projects in a timely manner after the asset has been placed –in service. We noted that the primary reason for the delay is that: (i) responsible personnel in the regional offices often focused on clearing older completed CIP projects as there was little incentive to transfer costs for newly completed projects (within 180 days of date that an asset is commissioned), or (ii) costs could not be transferred until the requirement to have 97 percent of the supporting documentation was met. This situation could result in an understatement of depreciation expense, since assets classified as CIP will not begin to depreciate in IFAS until an in-service date has been established. This situation has been a longstanding, recurring problem for the FAA that impacts financial management. Also, projected commissioning dates were not updated when changes occurred.
- *Capitalization of labor and travel costs* – Technical Support Service Contractor (TSSC) labor and travel costs related to PP&E was not properly processed as some costs were incorrectly capitalized as stand alone assets.

***Criteria***

JFMIP’s *Core Financial System Requirements*, states that the core financial system must maintain detailed information by account sufficient to provide audit trails and support managerial cost accounting. It further states that costs should be captured at the lowest level to reflect actual costs incurred by the agency in providing goods and services. The detail transactions should be timely recorded in subsidiary ledgers and interfaced or timely reconciled with the general ledger. Cost tracking should be sufficiently detailed to explain the change in account balances during any period of time need.

OMB Circular A-123 states that transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

SFFAS No. 6 requires that constructed PP&E be recorded as construction work in progress until the asset is placed in service, at which time it is to be transferred to general PP&E, and depreciation expense should be taken over the estimated useful life of the asset.

SFFAS No. 6 also states that all general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include: amounts paid to vendors; transportation charges to the point of initial use; handling and storage costs; labor and other direct or indirect production costs (for assets produced or constructed); engineering, architectural, and other outside services for designs, plans, specifications, and surveys; etc.

***Recommendations***

We recommend that the AFM:

- Develop and implement formal periodic financial reporting processes to reconcile the PP&E recorded in IFAS to the general ledger and record additions and disposals in a timely manner;
- Ensure that there is appropriate staffing to complete and review these periodic month-end reporting procedures, and that regional offices fully cooperate in providing information to the AFM in a timely manner;
- Prepare a roll-forward of fixed assets on a regular basis, at least quarterly, as a high level review of the activity in PP&E and help ensure that all transactions have been properly coded and recorded;
- Improve its policy regarding accounting for construction-in-progress and to ensure a timely matching of depreciation expense with assets placed in-service; and.

In conjunction with the Assistant Administrator for Regions and Center, reemphasize the need to follow procedures related to recording property disposals timely and ensuring TSSC labor, travel and other costs necessary to put an asset in place are correctly capitalized.

**6. Information Technology Controls over Third-party Systems and Applications**

***Condition***

Certain general controls related to the FAA's primary financial applications owned by Department of Transportation (DOT) need to be strengthened. Specifically, security program planning and management related to the development, certification, and accreditation of security programs for these applications were not effectively coordinated with the FAA Information Systems Security Officers, who have a shared responsibility to ensure that risk factors were appropriately known and considered. Also, application software development practices did not provide for effective and sustainable maintenance of these financial applications. Additionally, access controls for sensitive and critical functions were not based on least privilege principles.

As part of our audit, we performed a limited scope general controls review of information technology controls over the following key systems that support FAA's financial transactions and reporting:

- Departmental Accounting and Financial Information System (DAFIS)
- Integrated Personnel and Payroll System (IPPS)
- Consolidated Uniform Payroll System (CUPS)
- Consolidated Personnel Management Information System (CPMIS)

The development, certification, and accreditation of security programs for these four applications needed improvement. Also, there were weaknesses in the areas of access control and application software development and change control for all four applications. Due to the sensitive nature of

these issues, we provided the detailed results of our review, along with specific recommendations, separately to management.

To operate these key financial systems, the FAA contracted with NITC, located in Kansas City, Missouri, to provide information technology resources for the operation of key FAA financial systems. Accordingly, NITC is responsible for establishing and maintaining effective internal controls. In coordination with the DOT's Office of Inspector General, the USDA's OIG conducted a review of NITC in accordance with Statement of Auditing Standards No. 70, *Service Organizations*. The USDA OIG identified weakness in the areas of security program planning and management, access controls, and system software concerning FAA operations at NITC. The report identified controls that were (1) properly designed and operating effectively, (2) properly designed, but not operating effectively, and (3) not properly designed. However, the report was not issued to DOT OIG until January 13, 2003, limiting its usefulness for planning and executing the FAA's fiscal year 2002 consolidated financial statement audit.

In addition, the FAA has an agreement with the Federal Transit Administration (FTA) to use the Electronic Clearinghouse Operation (ECHO) system to process payment requests and disbursements for the majority of the FAA's grants under the Airport Improvement Program. Accordingly, FTA is responsible for establishing and maintaining an effective internal control structure. FTA did not have an independent assessment of its control structure as discussed in SAS 70 or any other type of independent review of its control structure. Without a SAS 70 or other type of independent review, there is an increased risk that control weaknesses may exist at FTA that may not be known to the FAA.

***Criteria***

Appendix III, OMB Circular No.A-130, *Management of Federal Information Resources*, requires Federal agencies to establish application security plans to assure that adequate security is provided for information collected, processed, transmitted, stored, or disseminated through the system.

National Institute of Standards and Technology (NIST) Special Publication No. 800-18, *Guide for Developing Security Plans for Information Technology Systems*, states the purpose of security plans are to provide an overview of the security requirements of the system and describe the controls in place or planned for meeting those requirements; and delineate responsibilities and expected behavior of all individuals who access the system.

SAS 70 states: "When a user organization uses a service organization, transactions that affect the user organization's financial statements are subjected to controls that are, at least in part, physically and operationally separate from the user organization. The significance of the controls of the service organization to those of the user organization depends on the nature of the services provided by the service organization, primarily the nature and materiality of the transactions it processes for the user organization and the degree of interaction between its activities and those of the user organization."

***Recommendations***

We recommend that the AFM improve information technology controls over third-party systems and applications by:

- Monitoring the progress of the FAA organizations responsible for implementing the specific recommendations previously provided – not repeated here due to the sensitive nature of the recommendations content;
- In conjunction with the DOT OIG, request that the USDA OIG complete its review of the FAA operations at NITC sooner; and
- In conjunction with DOT, request FTA to have an independent review performed, preferably in accordance with SAS 70, and prepare a report on controls placed in operation and tests of operating effectiveness related to the ECHO system.

## **7. Information technology controls over FAA systems**

### ***Condition***

Certain general controls associated with a key FAA-owned financial system, the Logistics Inventory System (LIS), needed improvement. Specifically, improvements were needed in overall security program planning and management, access controls and applications software development and change control.

As part of our audit, we performed a limited scope general controls review of information technology controls over LIS, which is a key FAA financial and logistical system. The FAA had designated LIS as a mission critical system as it provides control and distribution of logistical material for the National Airspace System. The FAA has not developed an information systems security program for LIS. Also, there were weaknesses in the areas of access controls and application software development and change control. Due to the sensitive nature of these issues, we provided the detailed results of our review along with specific recommendations separately.

### ***Criteria***

Appendix III, OMB Circular No. A-130, requires Federal agencies to establish application security plans to assure that adequate security is provided for information collected, processed, transmitted, stored, or disseminated through the system.

NIST Special Publication No. 800-18, states the purpose of security plans are to provide an overview of the security requirements of the system and describe the controls in place or planned for meeting those requirements; and delineate responsibilities and expected behavior of all individuals who access the system.

### ***Recommendation***

We recommend that the AFM monitor the progress of those within FAA who are responsible for implementation of the specific recommendations associated with LIS.

**Status of Prior Year Reportable Conditions, and  
Compliance with Laws and Regulations**

<b>Prior Year Conditions</b>	<b>As Report at September 30, 2001</b>	<b>Status as of September 30, 2002</b>
<b>Property, Plant, and Equipment</b>	<b><u>Material Weakness:</u></b> FAA was unsuccessful in implementing an integrated property accounting system, calculated depreciation expense and the net book value of its property, plant, and equipment using electronic spreadsheets outside the existing property system, and these amounts could not be substantiated.	<b><u>Reportable condition:</u></b> FAA implemented five of the six recommendations and substantially improved controls over PP&E. Thus, this reportable condition is no longer deemed a material weakness. However, additional improvements are needed.
<b>Inactive Obligations</b>	<b><u>Reportable Condition:</u></b> FAA did not perform sufficient reviews to identify inactive obligations.	<b><u>No longer deemed a reportable condition:</u></b> FAA implemented procedures to resolve this issue.
<b>Personal Property Acquisitions</b>	<b><u>Reportable Condition:</u></b> FAA yearend review procedures of personal property transactions did not include regional offices.	<b><u>No longer deemed a reportable condition:</u></b> FAA revised its yearend procedures to include review of regional property transactions.
<b>Non-Compliance with FFMIA</b>	<b><u>Non-Compliance with Laws and Regulations:</u></b> FAA was not in substantial compliance with FFMIA because: (1) DOT's core accounting system, DAFIS, cannot produce auditable financial statements and is not compliant with the U.S. Standard General Ledger at the transaction level; (2) security over financial information systems needed to be improved; (3) managerial cost accounting standards were not fully implemented; and (5) the financial management systems are not fully integrated.	<b><u>Continue as an instance of non-compliance with laws and regulations:</u></b> The FAA continues to remain substantially non-compliant with FFMIA. FAA continues to make progress in implementing managerial cost accounting, however, full implementation has not yet been achieved.

**Compliance with Laws and Regulations**

This section discusses an issue related to the Federal Financial Management Improvement Act of 1996 (FFMIA).

***Condition***

The FAA was not in substantial compliance with FFMIA.

***Discussion***

The FAA uses the DOT's core accounting system DAFIS to process and record financial transactions. DAFIS does not comply with the United States Standard General ledger (USSGL) or Federal financial management system requirements, which call for a single, integrated financial system. The FAA is planning to convert to DOT's new core accounting system during fiscal year 2003. DOT considers the new system to meet Federal systems requirements and process transactions at the USSGL level. As reported last year, the FAA has not fully implemented managerial cost accounting, however, additional progress was made during fiscal year 2002.

***Criteria***

FFMIA requires that an agency's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level.

***Recommendation***

We recommend that the FAA work aggressively to implement the new DOT accounting system.





## **LIMITATIONS OF THE FINANCIAL STATEMENTS**

FAA has prepared its financial statements to report its financial position and results of operations, pursuant to the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994.

While the FAA statements have been prepared from its books and records in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

These statements should be read with the understanding that they are for a component of the United States Government, a sovereign entity. Liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation by Congress, and payment of all liabilities, other than for contracts, can be abrogated by the Federal Government.



**FINANCIAL STATEMENTS**  
 U.S. Department of Transportation  
**FEDERAL AVIATION ADMINISTRATION**  
**CONSOLIDATED BALANCE SHEETS**  
 As of September 30  
 (Dollars in Thousands)

	2002	2001 As Restated
<b>Assets</b>		
Intragovernmental		
Fund balance with Treasury (Note 2)	\$ 2,539,304	\$ 1,998,297
Investments (Note 3)	11,213,447	13,866,780
Accounts receivable, advances, and other (Note 4)	299,428	173,522
Total Intragovernmental	14,052,179	16,038,599
Accounts receivable, advances, and other, net (Note 4)	113,295	163,149
Inventory and related property, net (Notes 5 & 15)	605,695	1,086,986
Property, plant, and equipment, net (Note 6)	13,175,768	11,726,534
<b>Total Assets</b>	<b>\$ 27,946,937</b>	<b>\$ 29,015,268</b>
<b>Liabilities</b>		
Intragovernmental liabilities		
Accounts payable	\$ 36,182	\$ 49,930
Employee related and other (Notes 8 & 9)	485,511	367,420
Total Intragovernmental Liabilities	521,693	417,350
Accounts payable	677,182	602,482
Environmental cleanup costs (Notes 7 & 15)	574,676	587,781
Employee related, legal, and other (Notes 8 & 9)	1,176,106	1,084,331
Federal employee and veterans benefits (Note 10)	997,103	1,044,259
<b>Total Liabilities</b>	<b>3,946,760</b>	<b>3,736,203</b>
Commitments and contingencies (Notes 9 & 19)		
<b>Net Position</b>		
Unexpended appropriations	481,919	551,139
Cumulative results of operations (Note 15)	23,518,258	24,727,926
<b>Total Net Position</b>	<b>24,000,177</b>	<b>25,279,065</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 27,946,937</b>	<b>\$ 29,015,268</b>

The accompanying notes are an integral part of these financial statements.



U.S. Department of Transportation  
**FEDERAL AVIATION ADMINISTRATION**  
**CONSOLIDATED STATEMENTS OF NET COST**  
 For the Years Ended September 30  
 (Dollars in Thousands)

Line of Business Programs (Note 12)	2002	2001 As Restated
<b>Air Traffic Services</b>		
Expenses	\$ 7,313,772	\$ 6,988,124
Less Earned Revenues	(77,107)	(81,157)
<b>Net Air Traffic Services Costs</b>	<u>7,236,665</u>	<u>6,906,967</u>
 <b>Regulation &amp; Certification</b>		
Expenses	924,614	799,964
Less Earned Revenues	(1,121)	(1,276)
<b>Net Regulations &amp; Certification Costs</b>	<u>923,493</u>	<u>798,688</u>
 <b>Research &amp; Acquisitions</b>		
Expenses	586,991	525,261
Less Earned Revenues	(72,129)	(38,966)
<b>Net Research &amp; Acquisitions Costs</b>	<u>514,862</u>	<u>486,295</u>
 <b>Airports</b>		
Expenses	2,933,542	2,178,576
<b>Net Airports Costs</b>	<u>2,933,542</u>	<u>2,178,576</u>
 <b>Civil Aviation Security</b>		
Expenses	804,822	161,434
Less Earned Revenues	(190,912)	(1,031)
<b>Net Civil Aviation Security Costs</b>	<u>613,910</u>	<u>160,403</u>
 <b>Commercial Space Transportation</b>		
Expenses	11,361	9,580
<b>Net Commercial Space Transportation Costs</b>	<u>11,361</u>	<u>9,580</u>
 <b>Non Line of Business Programs</b>		
<b>Regional and Center Operations and Other Programs</b>		
Expenses	340,983	162,723
Less Earned Revenues	(125,108)	(43,940)
<b>Net Other Program Costs</b>	<u>215,875</u>	<u>118,783</u>
 <b>Not Assigned to Programs</b>		
Expenses	50,622	56,508
Less Earned Revenues	(56,411)	(42,485)
<b>Net Costs Not Assigned to Programs</b>	<u>(5,789)</u>	<u>14,023</u>
 <b>Net Cost of Operations</b>		
Total Expenses	12,966,707	10,882,170
Less Total Earned Revenue	(522,788)	(208,855)
<b>Net Cost of Operations</b>	<u><u>\$ 12,443,919</u></u>	<u><u>\$ 10,673,315</u></u>

The accompanying notes are an integral part of these financial statements.



U. S. Department of Transportation  
 FEDERAL AVIATION ADMINISTRATION  
 CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION  
 For the Year Ended September 30, 2002

(Dollars in Thousands)

	Cumulative Results of Operations	Unexpended Appropriations	Total
<b>Beginning Balances</b>	\$ 23,105,205	\$ 551,139	\$ 23,656,344
Prior period adjustments (Notes 1 & 15)	1,622,721	-	1,622,721
Beginning balance after restatement	24,727,926	551,139	25,279,065
Cumulative effect of change in accounting principle (Notes 1 & 5)	(152,737)	-	(152,737)
 <b>Budgetary Financing Sources</b>			
Appropriations received	-	1,112,481	1,112,481
Appropriations transferred-in/out	-	112,858	112,858
Other adjustments	-	(3,325)	(3,325)
Appropriations used	1,291,234	(1,291,234)	-
Taxes and non-exchange revenue (Note 13)	9,625,942	-	9,625,942
Transfers-in/out without reimbursement	(25,500)	-	(25,500)
 <b>Other Financing Sources</b>			
Donations and forfeitures of property and other	11,901	-	11,901
Transfers-in/out without reimbursement	22,675	-	22,675
Imputed financing from costs absorbed by others (Note 14)	460,736	-	460,736
 Total Financing Sources	11,386,988	(69,220)	11,317,768
 <b>Net Cost of Operations</b>	12,443,919	-	12,443,919
<b>Ending Balances</b>	\$ 23,518,258	\$ 481,919	\$ 24,000,177

The accompanying notes are an integral part of these financial statements.



U. S. Department of Transportation  
**FEDERAL AVIATION ADMINISTRATION**  
**COMBINED STATEMENT OF BUDGETARY RESOURCES**  
 For the Year Ended September 30, 2002

(Dollars in Thousands)

<b>Budgetary Resources</b>	
Budget authority	\$ 14,446,568
Unobligated balance brought forward and transfers (Note 16)	11,425,240
Spending authority from offsetting collections	1,641,929
Recoveries of prior year obligations	310,925
Permanently not available	<u>(2,362,392)</u>
<b>Total Budgetary Resources</b>	<b><u><u>\$ 25,462,270</u></u></b>
<b>Status of Budgetary Resources</b>	
Obligations incurred	\$ 15,796,838
Unobligated balance	9,454,968
Unobligated balance not available	<u>210,464</u>
<b>Total Status of Budgetary Resources</b>	<b><u><u>\$ 25,462,270</u></u></b>
<b>Relationship of Obligations to Outlays</b>	
Obligated balance, net, beginning of period (Note 16)	\$ 7,249,535
Obligations incurred	15,796,838
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	(1,952,959)
Obligated balance, net end of period	<u>(7,998,136)</u>
<b>Net Outlays</b>	<b><u><u>\$ 13,095,278</u></u></b>
<b>Outlays</b>	
Disbursements	\$ 20,264,114
Collections net of offsetting receipts	<u>(7,168,836)</u>
<b>Net Outlays</b>	<b><u><u>\$ 13,095,278</u></u></b>

The accompanying notes are an integral part of these financial statements.



**U. S. Department of Transportation  
 FEDERAL AVIATION ADMINISTRATION  
 CONSOLIDATED STATEMENT OF FINANCING  
 For the Year Ended September 30, 2002  
 (Dollars in Thousands)**

**Resources Used to Finance Activities**

Budgetary Resources Obligated	
Obligations incurred	\$ 15,796,838
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	<u>1,952,959</u>
Obligations net of offsetting collections	<u>13,843,879</u>
Other Resources	
Donations and forfeitures of property and other	11,901
Transfers in/out without reimbursement	22,675
Imputed financing from costs absorbed by others	<u>460,736</u>
Net other resources used to finance activities	<u>495,312</u>
Total resources used to finance activities	14,339,191

**Resources Used to Finance Items not Part of the Net Cost of Operations**

Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	882,286
Resources that fund expenses recognized in prior periods (decreases in other unfunded liabilities)	85,644
Resources that finance the acquisition of assets	2,041,577
Other resources or adjustments to net obligated resources that do not affect net cost of operations	<u>(115,237)</u>
Total resources used to finance items not part of net cost of operations	<u>2,894,270</u>

**Total resources used to finance net cost of operations** **11,444,921**

**Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period:**

Components Requiring or Generating Resources in Future Periods	
Increases in annual leave liability, exchange revenue receivable from the public, and other unfunded liabilities	167,555
Components not Requiring or Generating Resources in Future Periods	
Depreciation and amortization	835,139
Revaluation of assets or liabilities	(20,579)
Cost of goods sold	23,897
Other	<u>(7,014)</u>
Total components of Net Cost of Operations that will not require or generate resources	<u>831,443</u>
<b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b>	<b><u>998,998</u></b>

**Net Cost of Operations** **\$ 12,443,919**

The accompanying notes are an integral part of these financial statements.



## NOTES TO THE FINANCIAL STATEMENTS

### NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### ***A. Basis of Presentation***

These consolidated financial statements have been prepared to report the financial position, net cost of operations, changes in net position, status and availability of budgetary resources, and the reconciliation between proprietary and budgetary accounts of the Federal Aviation Administration (FAA). The statements are required by the Chief Financial Officers Act of 1990 and Government Management Reform Act of 1994. They have been prepared from the books and records of FAA in accordance with (1) the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board (FASAB), (2) the Office of Management and Budget's (OMB) Bulletin Number 01-09, *Form and Content of Agency Financial Statements*, and (3) Department of Transportation (DOT) and FAA accounting policies which are summarized in this note. These statements, with the exception of the Statement of Budgetary Resources, are different from financial management reports, which are also prepared by the FAA pursuant to OMB directives that are used to monitor and control the FAA's use of budgetary resources.

In accordance with OMB Bulletin Number 01-09, the Consolidated Balance Sheet and Consolidated Statement of Net Cost and associated notes are presented on a comparative basis with the prior year as restated.

Unless specified otherwise, all dollar amounts are presented in thousands.

#### ***B. Reporting Entity***

FAA, which was created in 1958, is a component of the DOT, a cabinet-level agency of the Executive Branch of the United States Government. FAA's mission is to provide a safe, secure, and efficient global aerospace system that contributes to national security and the promotion of United States aerospace safety. As the leading authority in the international aerospace community, FAA is responsive to the dynamic nature of customer needs, economic conditions, and environmental concerns. FAA reporting entity is comprised of the following primary types of funds:

Trust Fund - Airport and Airway Trust Fund, including (a) Grants-in-Aid for Airports, (b) Facilities and Equipment, and (c) Research, Engineering and Development

Revolving Funds – Aviation Insurance, and Administrative Services Franchise Fund

Special Fund – Aviation User Fees

General Funds – Operations and Facilities, Engineering & Development

Other – General Fund Miscellaneous Receipts

#### ***C. Budgets and Budgetary Accounting***

Congress annually enacts appropriations to permit FAA to incur obligations for specified purposes. In FY 2002 and 2001, FAA was accountable for Trust Fund appropriations, Revolving Funds, a Special Fund, General Fund appropriations, and borrowing authority. FAA recognizes budgetary resources as assets when cash (funds held by Treasury) is made available through the Department of Treasury General Fund warrants and Trust Fund transfers.

#### ***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. Budgetary accounting facilitates compliance with legal requirements



on the use of Federal funds. All material intra-agency transactions and balances have been eliminated for presentation on a consolidated basis. However, the Statement of Budgetary Resources is presented on a combined basis in accordance with OMB Bulletin Number 01-09.

***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, registry, and overflight fees), war risk insurance premiums (see note 19), and through reimbursements for products and services provided to domestic and foreign governmental entities.

The Airport and Airway Trust Fund (Trust Fund) is sustained by excise taxes collected by the Internal Revenue Service (IRS) from airway system users. Excise taxes collected by the IRS are initially deposited to the general fund of the Treasury. IRS does not receive sufficient information at the time the taxes are collected to determine how these payments should be distributed to specific trust funds. Therefore, Treasury makes initial distributions to trust funds based on semi-monthly estimates prepared by its Office of Tax Analysis (OTA). These estimates are based on historical excise tax data applied to current excise tax receipts. When certified amounts are available from the IRS, generally six months after each quarter-end, adjustments are made to the estimated amounts and the difference is accrued as an intragovernmental receivable or payable. The FAA's September 30, 2002 financial statements reflect excise taxes certified through June 30, 2002, and excise taxes estimated by OTA for the quarter July 1 to September 30, 2002 as specified by Statement of Federal Financial Accounting Standards (SFFAS) Number 7, *Accounting for Revenue and Other Financing Sources*. FAA management does not believe that the estimated distribution made to the trust fund will be materially different from the September 30, 2002 certified amount.

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 associated with reimbursable agreements are recognized concurrently with the recognition of accrued expenditures for performing the services. War-risk insurance premiums are recognized as revenue on a straight-line basis over the period of coverage. Overflight fees are recognized as revenue in the period in which the flights take place.

The FAA recognizes as imputed financing the amount of accrued pension and post-retirement benefit expenses for current employees paid on FAA's behalf by the Office of Personnel Management (OPM), as well as amounts paid from the Treasury Judgment Fund in settlement of claims or court assessments against the FAA.

***F. Taxes***

FAA, as a Federal entity, is not subject to Federal, State, or local income taxes, and, accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

***G. Fund Balances with the U.S. Treasury***

The U.S. Treasury processes cash receipts and disbursements. Funds at the Treasury are available to pay agency liabilities. FAA does not maintain cash in commercial bank accounts or foreign currency balances. Foreign currency payments are made either by the Treasury or the Department of State and are reported by FAA in the U.S. dollar equivalent.

***H. 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 FAA appropriation accounts. The Revolving Fund investments are usually held to maturity. Investments, redemptions, and reinvestments are held and managed under the direction of FAA by the Treasury.





***I. Accounts Receivable***

Accounts receivable consist of amounts owed to FAA by other Federal agencies and the public. Amounts due from Federal agencies are considered fully collectible. Accounts receivable from the public include, for example, overflight fees, fines and penalties, reimbursements from employees, and services performed for sovereign entities. An allowance for uncollectible accounts receivable from the public is established when either (1) based upon a monthly review of outstanding accounts and the failure of all collection efforts, management determines that collection is unlikely to occur considering the debtor's ability to pay, and payment history or (2) an account for which no allowance has been established is submitted to the Department of the Treasury for collection, which takes place when it becomes 180 days delinquent.

***J. Operating Materials and Supplies***

In contrast to inventory, which is held for sale by the Franchise Fund, operating materials and supplies are used in the operations of the agency. Operating materials and supplies primarily consist of unissued materials and supplies that will be used in the construction of National Airspace System (NAS) assets. They are valued based on the weighted moving average method or on the basis of actual prices paid. Operating materials and supplies are expensed or reclassified as equipment or work in process when consumed or issued.

Operating materials and supplies "held for use" are those items that are consumed on a regular and ongoing basis. Items "held in reserve" are additional stocks that FAA determined must be on hand to ensure that operations will continue unabated because, for example, these items may not be readily available on the open market.

An allowance is established for excess, obsolete, and unserviceable operating materials and supplies based on the condition of various asset categories as well as FAA's historical experience disposing such assets.

***K. Inventory***

Under the Franchise Fund basis of operations, inventory is held for sale to FAA field locations and other domestic entities and foreign governments. Inventory consists of spare parts, materials, and supplies used in support of the NAS that are located at the FAA Mike Monroney Aeronautical Center in Oklahoma City. Inventory cost includes material, labor and applicable manufacturing overhead, and is determined using the weighted moving average cost method.

FAA field locations exchange with the Franchise Fund inventory in need of repair, which is classified as "Held for Repair." An allowance is established for repairable inventory based on the average historical cost of such repairs. Once repaired, these items are reclassified as "Held for Sale."

Inventory may be classified as excess, obsolete, and unserviceable if, for example, the quantity exceeds projected demand for the foreseeable future, or if the item has been technologically surpassed. An allowance is established for excess, obsolete, and unserviceable inventory based on the condition of various inventory categories as well as FAA's historical experience disposing such inventory.

***L. Property, Plant and Equipment (PP&E)***

FAA capitalizes acquisitions of PP&E when the cost equals or exceeds \$25 thousand and the useful life equals or exceeds two years. The FAA records PP&E at original acquisition cost.

Depreciation expense is calculated using the straight-line method. Depreciation commences the first month of the fiscal year after the asset is placed in service. The FAA does not recognize residual value of its PP&E. The useful life classifications for capitalized assets are as follows:



<u>Asset Classification – Real Property</u>	Useful Life (years)
Offices, buildings, warehouse buildings, residential properties, air traffic control towers, and enroute air traffic control centers	40
Mobile buildings	20
Roads, sidewalks, parking lots, and all other structures	15
Capital improvements, facility modifications, leasehold improvements	10*
 <u>Asset Classification - Personal Property</u>	
Aircraft, navigation, and surveillance equipment	20
Decision support systems, including computer operating systems, FAA developed hardware, mainframe and mini computers, high-end workstations, and displays	4-20
Communications-related equipment, including voice switches, air-ground radios, and microwave network	10-20
Weather-related equipment, including general purpose weather sensors, weather radars, radar transmitters, and radar receivers	15-20
Printing and projection equipment	13
Portable and installed communications equipment excluding air navigation and air traffic control facilities, and avionics equipment	10
Office furniture and equipment	7
Vehicles and automatic data processing equipment	5
Internal use software	3

\*Depreciated over the remaining life of the “parent” asset; if the parent asset is fully depreciated, then the useful life of improvement or modification is considered to be 10 years. For leasehold improvements, the useful life is 10 years or the expiration of the lease, whichever comes first.

Buildings and equipment 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 FAA, the building is depreciated over a 40-year service life.

Construction in progress is valued at actual (direct) costs, plus applied overhead and other indirect costs. FAA analyzes centrally funded capital expenditures annually and allocates these costs to the related CIP projects and/or in-use assets as appropriate.

FAA occupies certain real property, which is leased by the Department of Transportation from the General Services Administration. Payments for these leases are from an appropriation of the Office of the Secretary of Transportation; FAA’s portion is derived from the Trust Fund.

***M. Prepaid and Deferred Charges***

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



***N. Liabilities***

Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available, congressionally appropriated funds or other amounts. The liquidation of liabilities not covered by budgetary or other resources is dependent on future congressional appropriations or other funding. Intragovernmental liabilities are claims against FAA by other Federal entities.

***O. Annual, Sick, and Other Leave***

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. For 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. Liabilities associated with other types of vested leave, including compensatory, credit hours, restored leave, and sick leave in certain circumstances, are accrued at year-end, based on latest pay rates and unused hours of leave. Sick leave is generally nonvested, except for sick leave balances at retirement under the terms of certain union agreements. Funding will be obtained from future financing sources to the extent that current or prior year appropriations are not available to fund annual and other types of vested leave earned but not taken. Nonvested leave is expensed when used.

***P. Accrued Workers' Compensation***

A liability is recorded for actual and estimated future payments to be made for workers' compensation pursuant to the Federal Employees' Compensation Act (FECA). The actual costs incurred are reflected as a liability because FAA will reimburse the Department of Labor (DOL) two years after the actual payment of expenses. Future appropriations will be used for the reimbursement to DOL. The liability consists of (1) the net present value of estimated future payments calculated by the DOL, and (2) the unreimbursed cost paid by DOL for compensation to recipients under the FECA.

***Q. Retirement Plan***

FAA employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The employees who participate in CSRS are beneficiaries of the FAA's matching contribution, equal to seven percent of pay, distributed to their annuity account in the Civil Service Retirement and Disability Fund.

FERS went into effect on January 1, 1987, 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 FAA automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. For FERS participants, FAA also contributes the employer's matching share for Social Security.

Beginning in FY 1997, FAA began to recognize the imputed cost of pensions and other retirement benefits during the employees' active years of service. OPM actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future and communicates 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 the offsetting revenue as imputed financing sources to the extent these expenses will be paid by OPM.

***R. Use of Estimates***

Management has made certain estimates and assumptions when reporting assets, liabilities, revenue, and expenses, and in the footnote disclosures. Actual results could differ from these estimates. Significant estimates underlying the accompanying financial statements include (a) the allocation of trust fund receipts by the OTA, (b) contingent legal and environmental liabilities, (c) year-end accruals of accounts and grants payable, (d) accrued workers' compensation, (e) allowance for doubtful accounts receivable, and (f) allowances for repairable and obsolete inventory balances, and (g) allocations of common costs to construction in progress.



### ***S. Environmental Liabilities***

The FAA recognizes two types of environmental liabilities: environmental remediation and cleanup and decommissioning. The liability for environmental remediation is an estimate of all costs necessary to bring a known contaminated site into compliance with applicable environmental standards. The increase or decrease in the annual liability is charged to current year expense.

Environmental cleanup and decommissioning is the estimated cost that will be incurred to remove, contain, and/or dispose of hazardous waste when an asset presently in service is shutdown. The FAA estimates the environmental cleanup and decommissioning costs at the time an FAA-owned asset is placed in service. For assets placed in service through FY 1998, the annual increase or decrease in the estimated environmental cleanup liability is charged to expense. Although assets placed in service in FY 1999 and after generally do not have associated environmental liabilities, FAA's accounting policy is to charge any such environmental cleanup liability to expense over the life of the associated asset.

### ***T. Contingencies***

Liabilities are deemed contingent when the existence or amount of the liability cannot be determined with certainty pending the outcome of future events. FAA recognizes contingent liabilities when it is both probable and can be reasonably estimated. FAA discloses contingent liabilities in the notes to the financial statements when the conditions for liability recognition are not met and when the outcome of future events is more than remote. In some cases, once losses are certain, payments may be from the Judgment Fund maintained by Treasury rather than from the amounts appropriated to FAA for agency operations. Payments for the Judgment Fund are recorded as an "Other Financing Source" when made.

### ***U. Changes in Accounting Principle, Prior Period Adjustments, and Restatements***

In FY 2002, the FAA changed its method of accounting for its exchange and repair spare parts (see note 5). In connection with this change, exchange and repair spare parts were reclassified from operating materials and supplies to PP&E, and FAA recognized accumulated depreciation equal to \$152.7 million on these spare parts through October 1, 2001 as a cumulative effect adjustment in the 2002 Consolidated Statement of Changes in Net Position.

Effective October 1, 2001, the FAA adopted the provisions of SFFAS number 21, *Reporting Corrections of Errors and Changes in Accounting Principles*. As discussed in notes 5 and 15, the FAA has restated operating materials and supplies as of September 30, 2001, by reclassifying slow-moving items from "held for use" to "excess, obsolete, and unserviceable" and establishing an allowance for these items to reflect net realizable value in accordance with SFFAS number 3, *Accounting for Inventory and Related Property*. In addition, parts and components used to service FAA's fleet of aircraft were reclassified from "held for reserve" to "held for use."

As discussed in notes 7 and 15, FAA has restated and reduced its environmental liabilities as of September 30, 2001 by \$1,168.2 million to account for a correction in the application of relevant accounting standards.

As discussed in notes 8, 12, and 15, FAA has restated its legal claims liability as of September 30, 2001 to correct an overstatement of those claims considered probable of loss in accordance with SFFAS Number 5, *Accounting for Liabilities of the Federal Government*.

The FY 2001 Consolidated Statement of Net Cost has been restated to reflect an improved method of allocating certain costs among FAA lines of business, and for a component of the restatement of legal claims liability (see notes 8, 12, and 15).

As disclosed in note 16, instances in which ending balances on the FY 2001 Statement of Budgetary Resources differ from reported FY 2002 beginning balances include (a) unobligated balances in the Grants-in-Aid program, and (b) a correction of beginning net obligated balances resulting from overstated unfilled customer orders from Federal sources as of September 30, 2001.

As disclosed in notes 2 and 15, FAA has restated the unobligated balance available and obligated balance not yet disbursed, of its FY 2001 fund balance with the U.S. Treasury. This restatement among the status classifications did not affect the total reported fund balance with the U.S. Treasury as of September 30, 2001.



***V. Reclassifications***

Certain FY 2001 balances have been reclassified, retitled, or combined with other financial statement line items for consistency with current year presentation.

**NOTE 2. FUND BALANCE WITH TREASURY**

Fund balances with Treasury as of September 30, 2002 and 2001, respectively, were:

	<u>2002</u>	<u>2001</u>
Trust Fund	\$ 1,023,246	\$ 698,763
Operations General Fund	775,014	1,036,548
Franchise Fund	127,297	74,525
Revolving Fund	12,485	85,081
Corpus and Other Funds	<u>601,262</u>	<u>103,380</u>
Total	<u><u>\$ 2,539,304</u></u>	<u><u>\$ 1,998,297</u></u>

**Status of Fund Balance with Treasury**

Unobligated Balance		
Available (2001 restated)	\$ 1,017,806	\$ 1,168,136
Restricted	665,933	96,998
Obligated Balance Not Yet Disbursed (2001 restated)	<u>855,565</u>	<u>733,163</u>
Total	<u><u>\$ 2,539,304</u></u>	<u><u>\$ 1,998,297</u></u>

Restricted unobligated fund balances represent the amount of appropriations for which the period of availability for obligation has expired. These balances are available for upward adjustments of obligations incurred only during the period for which the appropriation was available for obligation or for paying claims attributable to the appropriation.

The September 30, 2001 unobligated balance available and obligated balance not yet disbursed have been revised to correct a previously reported error. This restatement does not affect the total reported fund balance with Treasury as of September 30, 2001.



**NOTE 3. INVESTMENTS**

As of September 30, 2002 and 2001, FAA's investment balances were:

	<u>2002</u>	<u>2001</u>
<u>Intragovernmental Securities</u>		
Nonmarketable, Par Value - Trust Fund	\$ 10,996,847	\$ 13,659,804
Nonmarketable, Market Based - Aviation Insurance Fund	91,733	-
Accrued Interest	124,867	206,976
Investments at Cost	<u>\$ 11,213,447</u>	<u>\$ 13,866,780</u>
 <u>Market Value Disclosure</u>		
Nonmarketable, Par Value - Trust Fund	\$ 10,996,847	\$ 13,659,804
Nonmarketable, Market Based - Aviation Insurance Fund	91,733	-
Unamortized Premium - Nonmarketable, Market Based	454	-
Nonmarketable, Market Based, net	<u>92,187</u>	<u>-</u>
 Market Value Disclosure	 <u>\$ 11,089,034</u>	 <u>\$ 13,659,804</u>

Nonmarketable par value Treasury Certificates of Indebtedness 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 Federal Investment Branch. The securities are held to maturity and redeemed at face value on demand; thus, investing entities recover the full amount invested plus interest. The Fund's trustee, the Secretary of the Treasury, makes Trust Fund investments on behalf of FAA. As of September 30, 2002 and 2001, approximately \$11.1 billion and \$13.7 billion, respectively, were invested in U.S. Treasury Certificates of Indebtedness. FY 2002 amounts mature June 30, 2003, and FY 2001 amounts matured June 30, 2002. The annual rate of return on Certificates of Indebtedness is established in the month of issuance. The average rate for certificates issued during FY 2002 and FY 2001 was 5.125 percent and 6.375 percent, respectively.

Nonmarketable, 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. Following the terrorist attacks of September 11, 2001, all market-based Treasury securities were redeemed so they would be available for use in various initiatives related to the Aviation Insurance Program (see note 19). Thus, FAA reported no nonmarketable, market-based securities as of September 30, 2001. During FY 2002, FAA again began investing in nonmarketable, market-based Treasury securities.

As of September 30, 2002 the following amounts were invested in market-based Treasury securities:

<u>Maturity</u>	Effective	Net
Date	Interest	Investments
	Rate	
12/19/02	1.73%	\$ 28,175
01/16/03	1.71%	40,687
02/13/03	1.61%	23,325
		<u>\$ 92,187</u>



**NOTE 4. ACCOUNTS RECEIVABLE, ADVANCES, AND OTHER ASSETS**

Accounts receivable, advances, prepayments, and other assets as of September 30, 2002 and 2001 were comprised of the following:

	<u>2002</u>	<u>2001</u>
<u>Intragovernmental</u>		
Accounts Receivable	\$ 270,155	\$ 127,429
Advances and Prepayments	28,524	40,442
Other	749	5,651
Subtotal, Intragovernmental	<u>299,428</u>	<u>173,522</u>
<u>With the Public</u>		
Accounts Receivable, net	58,047	51,280
Advances and Prepayments	35,413	67,204
Deposits in Transit and Other	19,835	44,665
Subtotal, With the Public	<u>113,295</u>	<u>163,149</u>
Total Accounts Receivable, Advances, Prepayments and Other	<u>\$ 412,723</u>	<u>\$ 336,671</u>

Intragovernmental advances and prepayments represent advance payments to other Federal Government entities for agency expenses not yet incurred or for goods or services not yet received.

Accounts receivable from the public are shown net of allowances for uncollectible amounts of \$5.6 million and \$5.4 million, as of September 30, 2002 and 2001, respectively.

**NOTE 5. INVENTORY AND RELATED PROPERTY**

Effective October 1, 2001, FAA changed its method of accounting for exchange and repair (E&R) spare parts kept at field locations. This reclassification of the E&R spare parts to equipment is a change to a preferable method of accounting because it enables FAA to associate the cost of these items more properly with the periods benefited (via depreciation). In connection with this change, \$416.4 million in gross value of operating materials and supplies (items held for use) as of September 30, 2001 was reclassified to personal property – equipment on October 1, 2001. The accumulated depreciation on these spare parts through September 30, 2001, had they been originally classified as personal property – equipment, was \$152.7 million. This amount is reported on the Consolidated Statement of Changes in Net Position as the cumulative effect of the change in accounting method. The remaining operating materials and supplies consist primarily of unissued materials and supplies that will be utilized in the construction of NAS assets.

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As of September 30, 2002 and 2001, inventory and operating materials and supplies were:

<u>Operating Material and Supplies</u>	<u>2002</u>	<u>2001</u>
Held For Use (Restated, Note 15)	\$ 152,335	\$ 604,699
Excess, Obsolete, and Unserviceable, net (Restated, Note 15)	24,817	21,482
Subtotal, Operating Material and Supplies	<u>177,152</u>	<u>626,181</u>
 <u>Inventory</u>		
Held for Sale	\$ 65,164	\$ 63,154
Held for Repair, net	336,133	362,770
Raw Materials, Finished Goods, and Other	13,643	14,297
Excess, Obsolete, and Unserviceable, net	13,603	20,584
Subtotal, Inventory	<u>428,543</u>	<u>460,805</u>
 Total Inventory and Related Property, net	 <u>\$ 605,695</u>	 <u>\$ 1,086,986</u>

Excess, obsolete, and unserviceable, and inventory held for repair are shown net of the following allowances:

<u>Operating Materials and Supplies</u>	<u>2002</u>	<u>2001</u>
Excess, Obsolete, and Unserviceable (Restated, Note 15)	\$ (47,044)	\$ (40,797)
 <u>Inventory</u>		
Held for Repair	(82,963)	(55,167)
Excess, Obsolete, and Unserviceable	(11,129)	(15,528)
Total Allowances	<u>\$(141,136)</u>	<u>\$ (111,492)</u>

As discussed in note 15, FAA has restated operating materials and supplies as of September 30, 2001 by reclassifying \$48.4 million of slow-moving items from “held for use” to “excess, obsolete, and unserviceable” and establishing an allowance of \$34.7 million for these items to reflect net realizable value in accordance with SFFAS number 3, *Accounting for Inventory and Related Property*. In addition, \$96.2 million of parts and components used to service FAA’s fleet of aircraft were reclassified from “held for reserve” to “held for use.”

Inventory is considered held for repair based on condition levels, and the allowance for repairable inventory is based on the average historical cost of such repairs. During FY 2002 and FY 2001, FAA recognized increases of \$27.8 million and \$55.2 million, respectively, to its allowance for inventory held for repair.

FAA transfers excess items for disposal into the Government-wide automated disposal system. Disposal proceeds, recognized upon receipt, may go to the General Fund or to an FAA appropriation, depending upon the nature of the item and the disposal method.



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**NOTE 6. PROPERTY, PLANT, AND EQUIPMENT, NET**

Property, plant, and equipment balances at September 30, 2002 and 2001, respectively, were:

2002					
Class of Fixed Asset	Deprec. Method	Service Life	Acquisition Value	Accumulated Depreciation	Net Book Value
Real Property, Including Land	[1]	[2]	\$ 3,536,010	\$ (1,675,322)	\$ 1,860,688
Personal Property (Note 5)	SL	3-20	12,041,260	(5,275,361)	6,765,899
Assets Under Capital Lease (Note 7)	SL	Term-40	126,142	(55,397)	70,745
Construction in Progress	-	-	4,477,425	-	4,477,425
Property Not in Use	-	-	2,283	(1,272)	1,011
<b>Total Property, Plant, and Equipment</b>			<b>\$ 20,183,120</b>	<b>\$ (7,007,352)</b>	<b>\$ 13,175,768</b>
2001					
Class of Fixed Asset	Deprec. Method	Service Life	Acquisition Value	Accumulated Depreciation	Net Book Value
Real Property, Including Land	[1]	[2]	\$ 3,300,694	\$ (1,552,988)	\$ 1,747,706
Personal Property	SL	3-20	11,174,613	(4,486,094)	6,688,519
Assets Under Capital Lease (Note 7)	SL	Term-40	110,432	(38,769)	71,663
Construction in Progress	-	-	3,218,646	-	3,218,646
Property Not in Use	-	-	966	(966)	-
<b>Total Property, Plant, and Equipment</b>			<b>\$ 17,805,351</b>	<b>\$ (6,078,817)</b>	<b>\$ 11,726,534</b>

[1] Land is not depreciated; other real property as defined in Note 1 is depreciated using the straight line method.

[2] The service life disclosed pertains to real property other than land and leasehold improvements. Leasehold improvements are depreciated over the lesser of the remaining life of the "parent" asset or 10 years.

FAA's Construction in Progress (CIP) primarily relates to its NAS assets, which are derived from centrally funded national systems development contracts, site preparation and testing, raw materials, and internal labor charges. Some centrally funded payments are initially recorded as expenses; therefore, FAA routinely reviews these payments to determine those that are capitalizable. In FY 2002 and FY 2001, these reviews resulted in the identification of additional CIP costs totaling \$482 million and \$605 million, respectively. After these reviews, FAA then performs an analysis to determine that amount of centrally funded CIP costs that should be transferred to assets that are in-use. As a result of this analysis, FAA transferred \$313 million and \$1,072 million of centrally funded CIP costs to its in-use assets in FY 2002 and FY 2001, respectively.

Assets temporarily not in use, including decommissioned assets awaiting disposition, are reflected in the FAA financial records as Property Not in Use. FAA reported disposition losses of \$82.8 million and \$139.1 million in FY 2002 and FY 2001, respectively.



**NOTE 7. ENVIRONMENTAL CLEANUP COSTS**

As discussed in note 15, FAA's financial statements as of September 30, 2001 have been restated to reflect a reduction in environmental remediation and cleanup and decommissioning liabilities. FAA's environmental liabilities as of September 30, 2002 and 2001 as restated, respectively, were:

	2002	2001 As Restated
Environmental Remediation	\$ 311,914	\$ 325,019
Environmental Cleanup and Decommissioning	262,762	262,762
<b>Total Environmental Liabilities</b>	<b>\$ 574,676</b>	<b>\$ 587,781</b>

**NOTE 8. EMPLOYEE RELATED, LEGAL, AND OTHER LIABILITIES**

As of September 30, 2002 and 2001, respectively, FAA's employee related, legal, and other liabilities were:

	2002		
	Non-Current Liabilities	Current Liabilities	Total
<u>Intragovernmental</u>			
Advances Received	\$ -	\$ 30,995	\$ 30,995
Accrued Payroll & Benefits Payable to Other Agencies	-	71,654	71,654
Excise Taxes Payable to Treasury	-	105,188	105,188
Other	-	78,005	78,005
Liabilities Covered by Budgetary Resources	-	285,842	285,842
Federal Employees Compensation Act	113,274	86,365	199,639
Debt	30	-	30
Liabilities Not Covered by Budgetary Resources	113,304	86,365	199,669
Subtotal, Intragovernmental	113,304	372,207	485,511
<u>With the Public</u>			
Advances Received and Other	820	7,302	8,122
Accrued Payroll & Benefits Payable to Employees	-	299,194	299,194
Liabilities Covered by Budgetary Resources	820	306,496	307,316
Accrued Unfunded Annual & Other Leave & Assoc. Benefits	451,341	-	451,341
Sick Leave Compensation Benefits for Air Traffic Controllers	52,138	869	53,007
Capital Leases (Note 9)	64,398	13,698	78,096
Legal Claims	93,650	76,250	169,900
Return Rights	5,250	2,450	7,700
Other Accrued Liabilities	104,605	4,141	108,746
Liabilities Not Covered by Budgetary Resources	771,382	97,408	868,790
Subtotal, With the Public	772,202	403,904	1,176,106
<b>Total Employee Related, Legal, and Other Liabilities</b>	<b>\$ 885,506</b>	<b>\$ 776,111</b>	<b>\$ 1,661,617</b>

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	2001		
	Non-Current Liabilities	Current Liabilities	Total
<u>Intragovernmental</u>			
Advances Received	\$ -	\$ 22,537	\$ 22,537
Accrued Payroll & Benefits Payable to Other Agencies	-	55,478	55,478
Other	-	95,059	95,059
Liabilities Covered by Budgetary Resources	-	173,074	173,074
Federal Employees Compensation Act	109,981	84,337	194,318
Debt	28	-	28
Liabilities Not Covered by Budgetary Resources	110,009	84,337	194,346
Subtotal, Intragovernmental	110,009	257,411	367,420
<u>With the Public</u>			
Advances Received and Other	-	(15,509)	(15,509)
Accrued Payroll & Benefits Payable to Employees	-	249,063	249,063
Liabilities Covered by Budgetary Resources	-	233,554	233,554
Accrued Unfunded Annual & Other Leave & Assoc. Benefits	412,590	-	412,590
Sick Leave Compensation Benefits for Air Traffic Controllers	47,850	811	48,661
Capital Leases (Note 9)	65,015	15,256	80,271
Legal Claims (Restated, Note 15)	123,900	65,909	189,809
Return Rights	4,050	6,050	10,100
Other Accrued Liabilities	109,346	-	109,346
Liabilities Not Covered by Budgetary Resources	762,751	88,026	850,777
Subtotal, With the Public	762,751	321,580	1,084,331
Total Employee Related, Legal, and Other Liabilities	\$ 872,760	\$ 578,991	\$ 1,451,751

Accrued payroll and benefits to other agencies consists of FAA contributions payable to other Federal agencies for employee benefits. These include FAA's contributions payable toward life, health, retirement benefits, Social Security, and matching contributions to the Thrift Savings Plan.

An unfunded liability is recorded for the actual cost of workers' compensation benefits to be reimbursed to the DOL, pursuant to the FECA. FAA's liability accrued as of September 30, 2002 includes workers' compensation benefits paid by DOL during the period July 1, 2000 through June 30, 2002, and accrued liabilities for the quarter July 1, 2002 through September 30, 2002. FAA's accrued liability as of September 30, 2001 was for the corresponding period July 1, 1999 through September 30, 2001.

The estimated liability for accrued unfunded leave and associated benefits includes annual and other types of vested leave, and sick leave under the terms the National Air Traffic Controllers Association agreement, Article 25, Section 13. This agreement gives air traffic controllers, who are covered under the FERS, the option to receive a lump-sum payment for 40 percent of their accumulated sick leave as of the date of retirement eligibility. Based on sick leave balances, this liability was \$53.0 million and \$48.7 million as of September 30, 2002 and 2001, respectively.

As discussed in note 15, legal claims liabilities as of September 30, 2001 have been restated because the originally stated amount included certain claims that are not considered probable of loss in accordance with SFFAS Number 5. The correction of this overstatement as of September 30, 2001 reduces the originally stated \$679.0 million legal claims liability by \$489.2 million to \$189.8 million, and correspondingly reduces the balance sheet line within which legal claims is reported, "Employee Related, Legal, and Other Liabilities."

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FAA estimated that \$1.7 million of its \$169.9 million legal claims liability as of September 30, 2002, would be paid from FAA appropriations, and \$168.2 million would be paid from the permanent appropriation for judgments, awards, and compromise settlements (Judgment Fund) administered by the Department of Treasury. Of its \$189.8 million legal claims liability as of September 30, 2001, FAA estimated that \$2.1 million would be paid from FAA appropriations, and \$187.7 million would be paid from the Judgment Fund.

FAA's Return Rights Program pertains to employees who accepted transfers to overseas or certain domestic locations for a period of two to four years, and entitles the employees to a future return move at Government expense. As of September 30, 2002 and 2001, there were 154 and 202 employees, respectively, entitled to these return rights.

**NOTE 9. LEASES**

FAA has both capital and operating leases.

**Capital Leases**

Following is a summary of FAA's assets under capital lease as of September 30, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
Land, Buildings, and Machinery	\$ 126,142	\$ 110,432
Accumulated Depreciation	<u>(55,397)</u>	<u>(38,769)</u>
Assets Under Capital Lease, Net	<u>\$ 70,745</u>	<u>\$ 71,663</u>

As of September 30, 2002, FAA's future payments due on assets under capital lease were:

Future Payments Due by Fiscal Year (Liabilities Not Covered By Budgetary Resources)	
Year 1	\$ 13,698
Year 2	13,698
Year 3	13,041
Year 4	10,722
Year 5	10,525
After 5 Years	43,128
Less: Imputed Interest	<u>(26,716)</u>
Total Capital Lease Liability	<u>\$ 78,096</u>

FAA's capital lease payments are funded annually. The remaining principal payments are recorded as unfunded lease liabilities. The imputed interest is funded and expensed annually.



**Operating Leases**

FAA has operating leases for real property, aircraft, and telecommunications equipment. Future operating lease payments due as of September 30, 2002 were:

Fiscal Year	Land &		Total
	Buildings	Other	
Year 1 (FY 2003)	\$ 51,875	\$ 1,428	\$ 53,303
Year 2 (FY 2004)	47,277	1,193	48,470
Year 3 (FY 2005)	44,661	956	45,617
Year 4 (FY 2006)	40,626	686	41,312
Year 5 (FY 2007)	35,822	683	36,505
After 5 Years	63,276	2,820	66,096
Total Future Operating Lease Payments	<u>\$ 283,537</u>	<u>\$ 7,766</u>	<u>\$ 291,303</u>

Operating lease expense incurred during the years ended September 30, 2002 and 2001 was \$60.0 million and \$48.8 million, respectively. The operating lease amounts due 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.

**NOTE 10. FEDERAL EMPLOYEE AND VETERANS BENEFITS PAYABLE**

As of September 30, 2002 and 2001, FECA actuarial liabilities were \$997.1 million and \$1,044.3 million respectively.

The DOL calculates the FECA liability for DOT, and DOT allocates the liability amount to FAA based upon actual workers' compensation payments to FAA employees over the preceding four years. FECA liabilities include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The estimated liability is not covered by budgetary resources and thus will require future appropriated funding.

**NOTE 11. TOTAL COST AND EARNED REVENUE BY BUDGET FUNCTIONAL CLASSIFICATION**

In FY 2002 and FY 2001, a total of \$163 thousand and \$2 thousand of FAA's expenses, respectively, related to Community and Regional Development Programs. All other expenses, earned revenues, and intragovernmental transactions related to Transportation Programs.

**NOTE 12. NET COST BY PROGRAM AND OTHER STATEMENT OF NET COST DISCLOSURES**

FAA's six lines of business represent the programs reported on the Statement of Net Cost. Cost centers assigned 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 divided by the total cost (excluding grant payments) for all lines of business.

The FY 2001 Consolidated Statement of Net Cost has been restated to reflect an improved method of allocating certain costs among the FAA lines of business. While this restatement does not impact FY 2001 total net costs, net costs of several FAA lines of business are restated. Also, FAA's correction of its legal claims liability as of September 30, 2001 correspondingly impacts its Consolidated Statement of Net Cost for the year then ended. The effects of these restatements are shown in note 15.

Following is FAA's distribution of FY 2002 net costs by intragovernmental-related versus with the public.

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Line of Business Programs	For the Year Ended September 30, 2002		
	Intra- governmental	With the Public	Total
<b>Air Traffic Services</b>			
Expenses	\$ 993,362	\$ 6,320,410	\$ 7,313,772
Less: Earned revenues	(56,860)	(20,247)	(77,107)
<b>Net Air Traffic Services Costs</b>	936,502	6,300,163	7,236,665
<b>Regulation &amp; Certification</b>			
Expenses	122,368	802,246	924,614
Less: Earned revenues	(568)	(553)	(1,121)
<b>Net Regulation &amp; Certification Costs</b>	121,800	801,693	923,493
<b>Research &amp; Acquisitions</b>			
Expenses	146,683	440,308	586,991
Less: Earned revenues	(36,549)	(35,580)	(72,129)
<b>Net Research &amp; Acquisitions Costs</b>	110,134	404,728	514,862
<b>Airports</b>			
Expenses	8,547	2,924,995	2,933,542
<b>Net Airports Costs</b>	8,547	2,924,995	2,933,542
<b>Civil Aviation Security</b>			
Expenses	297,168	507,654	804,822
Less: Earned revenues	(110,516)	(80,396)	(190,912)
<b>Net Civil Aviation Security Costs</b>	186,652	427,258	613,910
<b>Commercial Space Transportation</b>			
Expenses	-	11,361	11,361
<b>Net Commercial Space Transportation Costs</b>	-	11,361	11,361
<b>Non Line of Business Programs</b>			
<b>Regional and Center Operations and Other Programs</b>			
Expenses	83,877	257,106	340,983
Less: Earned revenues	(90,004)	(35,104)	(125,108)
<b>Net Other Program Costs</b>	(6,127)	222,002	215,875
<b>Not Assigned to Programs</b>			
Expenses	-	50,622	50,622
Less: Earned revenues	(28,585)	(27,826)	(56,411)
<b>Net Costs Not Assigned to Programs</b>	(28,585)	22,796	(5,789)
<b>Net Cost of Operations</b>			
Total expenses	1,652,005	11,314,702	12,966,707
Less: Total earned revenues	(323,082)	(199,706)	(522,788)
<b>Net Cost of Operations</b>	<u>\$ 1,328,923</u>	<u>\$ 11,114,996</u>	<u>\$ 12,443,919</u>

Comparative Statement of Net Cost information is presented in Note 15.



**NOTE 13. TAXES AND OTHER NONEXCHANGE REVENUE**

The IRS collects various taxes on behalf of the FAA's Airport and Airway Trust Fund. These taxes can be withdrawn only as authorized by FAA appropriations. Treasury estimates the taxes to be collected each quarter and adjusts the estimates by actual collections. Accordingly, the total taxes recognized for the year ended September 30, 2002 included OTA's estimate of \$2.5 billion for the quarter ending September 30, 2002. For the year ended September 30, 2002, Treasury reported to FAA the following taxes collected:

	<u>2002</u>
Passenger Ticket Tax	\$ 6,300,562
International Departure Tax	1,410,234
Investment Income	777,693
Fuel Taxes	802,749
Waybill Tax	394,317
Tax Refunds and Credits	<u>(59,613)</u>
Total Taxes and Other Nonexchange Revenue	<u>\$ 9,625,942</u>

**NOTE 14. IMPUTED FINANCING SOURCES**

The FAA recognizes 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, the OPM. Amounts paid from the Treasury Judgment Fund in settlement of claims or court assessments against the FAA are also recognized as imputed financing. For the fiscal year ended September 30, 2002, imputed financing was as follows:

	<u>2002</u>
Office of Personnel Management	\$ 394,826
Treasury Judgment Fund	<u>65,910</u>
Total Imputed Financing Sources	<u>\$ 460,736</u>

**NOTE 15. PRIOR PERIOD ADJUSTMENTS – RESTATEMENTS**

FAA's environmental liabilities as of September 30, 2001 have been restated and reduced by \$1,168.2 million to correct the application of relevant accounting standards. The restatement is comprised of reductions of \$57.2 million in environmental remediation and \$1,111.0 million in environmental cleanup and decommissioning. The restatement results from three primary factors: (1) the 2001 restated liability is reported in constant dollars, while the originally stated liability was determined using inflation factors to approximate the future payments; (2) the restated 2001 liability considers reduced costs associated with cleanup of assets that are co-located within a single facility, while the FY 2001 estimate was without regard to co-locations; and (3) the restated 2001 liability is based on asset counts from the Interim Fixed Asset System (IFAS), which FAA implemented in FY 2001. Asset counts within IFAS differ from the source used in estimating the originally stated FY 2001 liability.

As discussed in note 8, the FAA has restated its legal claims liability as of September 30, 2001 because the originally stated amount included claims that were not probable of loss in accordance with SFFAS Number 5. As a result, the originally stated \$679.0 million legal claims liability (as a component of Employee Related, Legal, and Other Liabilities) was reduced by \$489.2 million to \$189.8 million. This correction of the legal claims liability also reduced FY 2001 expenses by \$141.3 million.

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As discussed in note 5, the FAA has restated its operating materials and supplies as of September 30, 2001 by reclassifying \$48.4 million of slow-moving items from “held for use” to “excess, obsolete, and unserviceable,” and establishing a \$34.7 million allowance for these items to reflect net realizable value in accordance with SFFAS number 3, *Accounting for Inventory and Related Property*. In addition, \$96.2 million of parts and components used to service FAA’s fleet of aircraft were reclassified from “held for reserve” to “held for use.” As a result, the originally stated \$660.9 million balance of operating materials and supplies, net, (as a component of Inventory and Related Property) was reduced by \$34.7 million to \$626.2 million.

The FY 2001 Consolidated Statement of Net Cost has also been restated to reflect an improved method of allocating certain costs among the FAA lines of business (see note 12).

As disclosed in note 2, the FAA has restated the unobligated balance available and obligated balance not yet disbursed, of its FY 2001 fund balance with Treasury. This restatement among the status classifications did not affect the total reported fund balance with Treasury as of September 30, 2001.

The effects of these restatements on the Consolidated Balance Sheet as of September 30, 2001 are follows:

	2001 Originally Stated	Effect of Restatement	2001 As Restated
Inventory and Related Property, net	\$ 1,121,698	\$ (34,712)	\$ 1,086,986
Environmental Cleanp Costs	\$ 1,756,000	\$ (1,168,219)	\$ 587,781
Employee Related, Legal, and Other	\$ 1,573,545	\$ (489,214)	\$ 1,084,331
Cumulative Results of Operations	\$ 23,105,205	\$ 1,622,721	\$ 24,727,926

Restatements of certain FY 2002 opening balances affecting the Combined Statement of Budgetary Resources are discussed in Note 16.



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The effects of the restatements on the Consolidated Statement of Net Cost for the year ended September 30, 2001 are as follows:

<b>U.S. Department of Transportation FEDERAL AVIATION ADMINISTRATION CONSOLIDATED STATEMENTS OF NET COST</b>				
<b>Line of Business Programs</b>	2001 Originally Stated	Effect of Reallocations	Effect of Legal Claims Restatement	2001 As Restated
<b>Air Traffic Service</b>				
Intragovernmental expenses	\$ 991,401	\$ -	\$ -	\$ 991,401
Public expenses	6,083,177	54,800	(141,254)	5,996,723
Total expenses	7,074,578	54,800	(141,254)	6,988,124
Less earned revenues	(112,832)	31,675	-	(81,157)
<b>Net Air Traffic Service Costs</b>	<b>6,961,746</b>	<b>86,475</b>	<b>(141,254)</b>	<b>6,906,967</b>
<b>Regulations &amp; Certification</b>				
Intragovernmental expenses	110,027	-	-	110,027
Public expenses	690,212	(275)	-	689,937
Total expenses	800,239	(275)	-	799,964
Less earned revenues	(1,276)	-	-	(1,276)
<b>Net Regulations &amp; Certification Costs</b>	<b>798,963</b>	<b>(275)</b>	<b>-</b>	<b>798,688</b>
<b>Research &amp; Acquisitions</b>				
Intragovernmental expenses	121,041	-	-	121,041
Public expenses	581,605	(177,385)	-	404,220
Total expenses	702,646	(177,385)	-	525,261
Less earned revenues	(38,966)	-	-	(38,966)
<b>Net Research &amp; Acquisitions Costs</b>	<b>663,680</b>	<b>(177,385)</b>	<b>-</b>	<b>486,295</b>
<b>Airports</b>				
Intragovernmental expenses	8,080	-	-	8,080
Public expenses	2,170,496	-	-	2,170,496
<b>Net Airports Costs</b>	<b>2,178,576</b>	<b>-</b>	<b>-</b>	<b>2,178,576</b>
<b>Civil Aviation Security</b>				
Intragovernmental expenses	32,425	-	-	32,425
Public expenses	195,130	(66,121)	-	129,009
Total expenses	227,555	(66,121)	-	161,434
Less earned revenues	(1,031)	-	-	(1,031)
<b>Net Civil Aviation Security Costs</b>	<b>226,524</b>	<b>(66,121)</b>	<b>-</b>	<b>160,403</b>
<b>Commercial Space</b>				
Intragovernmental expenses	1,329	-	-	1,329
Public expenses	8,243	8	-	8,251
<b>Net Commercial Space Costs</b>	<b>9,572</b>	<b>8</b>	<b>-</b>	<b>9,580</b>
<b>Non Line of Business Programs</b>				
<b>Regional and Center Operations and Other Programs</b>				
Intragovernmental expenses	77,880	-	-	77,880
Public expenses	101,676	(16,833)	-	84,843
Total expenses	179,556	(16,833)	-	162,723
Less earned revenues	(11,560)	(32,380)	-	(43,940)
<b>Net Other Program Costs</b>	<b>167,996</b>	<b>(49,213)</b>	<b>-</b>	<b>118,783</b>
<b>Not Assigned to Programs</b>				
Public expenses	(149,298)	205,806	-	56,508
Total expenses	(149,298)	205,806	-	56,508
Less earned revenues	(43,190)	705	-	(42,485)
<b>Net Costs Not Assigned to Programs</b>	<b>(192,488)</b>	<b>206,511</b>	<b>-</b>	<b>14,023</b>
<b>Net Cost of Operations</b>				
Intragovernmental expenses	1,342,183	-	-	1,342,183
Public expenses	9,681,241	-	(141,254)	9,539,987
Total expenses	11,023,424	-	(141,254)	10,882,170
Less earned revenues	(208,855)	-	-	(208,855)
<b>Net Cost of Operations</b>	<b>\$ 10,814,569</b>	<b>\$ -</b>	<b>\$ (141,254)</b>	<b>\$ 10,673,315</b>



#### NOTE 16. STATEMENT OF BUDGETARY RESOURCES DISCLOSURES

The amounts reported in the Statement of Budgetary Resources are in agreement with the summary totals presented in the Budget of the United States Government. Amounts reported for the Operations appropriation were adjusted to eliminate the effect of transfers between the Trust Fund and the General Fund components of this account because they overstated budgetary resources and obligations. The Required Supplementary Information section of this report includes a schedule of budgetary resources by each of FAA's major fund types.

FAA incurred several rescissions of budgetary resources in FY 2002, including reductions to the Facilities & Equipment Fund of \$16.7 million and Grants-in-Aid for Airports contract authority of \$301.7 million.

There are two significant instances in which ending balances on the FY 2001 Statement of Budgetary Resources differ from reported FY 2002 beginning balances:

- The FY 2002 Grants-in-Aid program beginning unobligated balance is \$301.9 million higher than the FY 2001 ending unobligated balance. At the end of FY 2001, this amount was classified as "Temporarily Not Available" rather than "Unobligated Balance Not Available." If this amount had been reclassified as unobligated not available, the FY 2001 ending and FY 2002 beginning balances would have been in agreement.
- The FY 2002 beginning net obligated balance is \$109.3 million less than the FY 2001 ending balance. This adjustment was necessary to correct the balance of "Unfilled customer orders from Federal sources," which was correspondingly overstated as of September 30, 2001.

In FY 2001, there was \$36 million appropriated and reported as budget authority for user fees. In FY 2002, \$29.6 million in user fees were collected and reported on the SF 132 Apportionment and Reapportionment Schedule as an unobligated balance. The \$6.4 million balance that was appropriated but not collected was not carried forward to FY 2002.

OMB Bulletin Number 01-09 requires the following additional Statement of Budgetary Resources disclosures:

- FAA does not have any significant differences between the information reported on the Statement of Budgetary Resources and the amounts described as FY 2002 "actual" in the Budget of the United States Government for FY 2004. Subsequent to the final FY 2001 FACTS II submission, however, audit adjustments to deobligate \$36.3 million were reported in the FY 2001 Statement of Budgetary Resources. The beginning balances of the FY 2002 Statement of Budgetary Resources reflect these audit adjustments. Since the Budget of the United States Government is derived from final FACTS II data, the Budget of the United States Government does not reflect these adjustments.
- FAA does not have obligations classified as "exempt from apportionment." However, during FY 2002, direct and reimbursable obligations incurred against amounts apportioned under categories A and B, as defined in OMB Circular A-34, Instructions on Budget Execution, were as follows:

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	Obligations Incurred		
	Category A	Category B	Total
Direct	\$ 14,446,516	\$ 299,149	\$ 14,745,665
Reimbursable	1,051,173	-	1,051,173
	<u>\$ 15,497,689</u>	<u>\$ 299,149</u>	<u>\$ 15,796,838</u>

Total available contract authority at the end of FY 2002 was \$4 billion.

Public Laws 106-181 and 107-87 authorized FAA \$3.3 billion and \$1.8 billion in contract and liquidating authority, respectively, which are derived from the Airport and Airway Trust Fund and available until expended, for the Grants-in-Aid programs. The unobligated balance at the end of FY 2002 was \$.9 million.

Unobligated balances of budgetary resources for unexpired accounts are available in subsequent years until expiration, upon receipt of an apportionment from OMB. Unobligated balances of expired accounts are not available. At the end of FY 2001, \$15.9 million of unobligated balances, and \$.4 million of obligated balances, respectively, were in appropriations cancelled at year-end, pursuant to 31 USC 1552, and thus have not been brought forward to FY 2002.

The net obligated balance, end of period, is comprised of the following components:

Obligated balance, net, end of period	Amount
Accounts receivable	\$ (345,878)
Unfilled customer orders from Federal sources	(92,074)
Undelivered orders	7,445,017
Accounts payable	991,071
Total obligated balance, net end of period	<u>\$ 7,998,136</u>

**NOTE 17. FINANCING SOURCES YET TO BE PROVIDED**

The following table shows the relationship between liabilities not covered by budgetary resources on the balance sheet and the change in components of net cost of operations that will require resources in future periods.

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For the Year Ended September 30, 2002

Liabilities Not Covered by Budgetary Resources, Beginning of Period, as restated	\$ 2,677,163
Components Requiring Resources in Future Periods:	
Increases:	
Unfunded Annual & Other Leave & Assoc. Benefits (Note 8)	38,751
FECA (Actual) (Note 8)	5,321
Sick Leave Buy-Back Option for Air Traffic Controllers (Note 8)	4,346
Debt (Note 8)	2
Decreases:	
Environmental Liabilities (Notes 7 and 15)	(13,105)
Legal Claims (Note 8)	(19,909)
Return Rights (Note 8)	(2,400)
Capital Leases (Notes 8 & 9)	(2,175)
Other Accrued Liabilities (Note 8)	(600)
FECA (Actuarial) (Note 10)	<u>(47,156)</u>
Total Components of Net Cost of Operations that will Require Resources in Future Periods	<u>(36,925)</u>
Liabilities Not Covered by Budgetary Resources, End of Period	<u><u>\$ 2,640,238</u></u>

The FY 2001 ending balance of liabilities not covered by budgetary resources was \$4,379.9 million, which was \$1,702.7 million greater than the beginning balance of \$2,677.2 million brought forward. This difference was attributable to three factors: (a) environmental liabilities were restated and reduced by \$1,168.2 million, (b) legal claims liabilities were restated and reduced by \$489.2 million, and (c) certain accounts have been reclassified between covered versus not covered by budgetary resources, resulting in a net decrease of \$45.3 million.

**NOTE 18. CUSTODIAL ACTIVITY**

FAA collects certain non-exchange (custodial) revenue on behalf of the General Fund of the Treasury. During FY 2002, FAA's Statement of Changes in Net Position included custodial revenue totaling \$29.2 million. The primary source of custodial activity is revenue from the Metropolitan Washington Airport Authority for its leases of Ronald Reagan National Airport and Washington Dulles International Airport. Custodial activity also includes the collection of miscellaneous fines and penalties.

**NOTE 19. COMMITMENTS, CONTINGENCIES, AND OTHER DISCLOSURES**

**Contract Options.** As of September 30, 2002 and 2001, FAA had contract options of \$19.9 billion and \$17.9 billion, respectively. These contract options give FAA the unilateral right to purchase additional equipment or services or to extend the contract terms. Exercising this right would require the obligation of funds in future years.



**Contract Negotiations.** As of September 30, 2002 and 2001, FAA had a total of \$42.1 million and \$106.4 million, respectively, in commitments (funds reserved for possible future obligations) under unexpired Facilities and Equipment, and Research, Engineering, and Development appropriations. The commitments were 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 each respective fiscal year.

**Letters of Intent.** FAA has authority under Title 49 U.S.C. 47110(e) to issue letters of intent (LOI) to enter into AIP grant agreements. Through September 30, 2002, FAA issued LOI's covering FY 1988 through FY 2014 totaling \$4.3 billion. As of September 30, 2002, FAA had obligated \$2.7 billion of this total amount, leaving \$1.6 billion unobligated. FAA anticipates obligating an additional \$293 million in FY 2003.

As of September 30, 2001, LOI's covering FY 1988 through FY 2014 totaled \$3.9 billion. Of this amount, FAA had obligated \$2.4 billion, leaving \$1.5 billion unobligated as of September 30, 2001.

**AIP Grants.** FY 2002 AIP grant authority totaled \$3.5 billion, including \$1.7 billion in entitlements to specific locations. Of entitlements to specific locations, sponsors have claimed \$1.4 billion, and \$355 million remains available from unused or newly enacted contract authority to those sponsors through FY 2004, or in the case of non-hub primary airport locations, through FY 2005.

In FY 2001, AIP grant authority was \$3.1 billion, including \$1.4 billion in entitlements to specific locations. Of entitlements to specific locations, the sponsors had claimed \$1.1 billion, and \$298 million remained available from unused or newly enacted contract authority to those sponsors through FY 2003, or in the case of non-hub primary airport locations, through FY 2004.

**Aviation Insurance Program.** FAA is authorized to issue hull and liability insurance under the Aviation Insurance Program for air carrier operations for which commercial insurance is not available on reasonable terms and when continuation of U.S. flag commercial air service is necessary in the interest of air commerce, national security, and the foreign policy of the United States. FAA may issue (1) non-premium insurance, and (2) premium insurance for which a risk-based premium is charged to the air carrier.

FAA maintains standby non-premium war-risk insurance policies for 38 air carriers having approximately 974 aircraft available for Defense or State Department charter operations.

On September 22, 2001, the premium insurance program was expanded by the Air Transportation Safety and System Stabilization Act (Public Law 107-42) to include all scheduled domestic air carriers. Under this program, the FAA provided temporary war-risk insurance to U.S. carriers whose coverage was cancelled following the terrorist attacks on September 11, 2001. As of September 30, 2001, \$121.68 billion of war risk insurance was extended to 74 carriers for a period of 30 days, and coverage has been subsequently extended, typically for 60-day periods. As of September 30, 2002, \$114 billion of war risk coverage was extended to 72 carriers until October 16, 2002. The most recent period of coverage is December 16, 2002 to February 13, 2003, in which \$112.5 billion of war risk coverage is extended to 71 carriers. The issuance of temporary war-risk coverage to all scheduled domestic carriers provides necessary insurance to qualifying carriers while allowing time for the commercial insurance market to stabilize. Premiums under this program are established by the FAA and are assessed per departure. During FY 2002 and FY 2001, the FAA recognized insurance premium revenue of \$74.6 million and \$4.6 million, respectively. Premiums are recognized as revenue on a straight-line basis over the period of coverage. Premium revenue is reported on the Consolidated Statement of Net Cost, under "Regional and Center Operations and Other Programs."

In the past, the FAA has insured a small number of air carrier operations and establishes a maximum liability for losing one aircraft. Typically, the maximum liability for both hull loss and liability, per aircraft, is \$1.75 billion. No claims for losses were pending as of September 30, 2002. Since the inception of the Aviation Insurance Program (including the predecessor Aviation War Risk Insurance Program dating



back to 1951) only four claims, all involving minor dollar amounts, have been paid. Because of the unpredictable nature of war risk and the absence of historical claims experience on which to base an estimate, no reserve for insurance losses has been recorded.

**Overflight User Fees.** FAA issued an interim final rule (IFR) on August 1, 2000, that required certain aircraft operators to pay fees for air traffic control and related services provided by the FAA to aircraft that operate in U.S.-controlled airspace but neither takeoff nor land in the United States. The authority to charge these fees is contained in the Federal Aviation Reauthorization Act of 1996, as amended. Several airlines and an air carrier association challenged this IFR in the U.S. Court of Appeals. On July 13, 2001, the Court, in a preliminary opinion, ruled in favor of the airlines. The FAA ceased all billing and collection activities under the IFR. In August 2001, the FAA issued a Final Rule on overflight fees, thereby allowing the agency to resume charging fees and collecting fees. The same group of plaintiffs brought suit against the Final Rule. The FAA filed a motion for reconsideration of the Court's ruling on the IFR. The Court granted this motion on December 28, 2001, allowing the IFR to remain in place. The FAA continued to collect fees throughout FY 2002, while litigation under both the IFR and the Final Rule continued. The financial statements include \$27.6 million and \$29.3 million in Overflight Fee revenue for the years ended September 30, 2002 and 2001, respectively. While the FAA believes it will prevail, those revenues remain at risk until the litigation has come to a final resolution.

**Environmental.** The FAA is a party to two major environmental remediation projects in which the extent of liability is unknown. A study is in process to determine the magnitude and scope of the remediation required at the two sites. Of the total environmental liability reported as of September 30, 2002, the amount related to these two sites is \$67.7 million. This liability includes the FAA's share of the known remediation cost and the cost to complete the study.

**Legal Claims.** As of September 30, 2002 and 2001, FAA's contingent liabilities for asserted and pending legal claims reasonably possible of loss were estimated at \$499.8 million and \$445.8 million, respectively. The FAA does not have material amounts of known unasserted claims.



## **REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION**



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

<u>State/Territory</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Alabama	\$ 58,506	\$ 27,421	\$ 19,653	\$ 18,134	\$ 15,556
Alaska	121,640	83,563	51,788	70,802	77,949
Arizona	54,737	51,783	58,381	53,135	47,243
Arkansas	32,937	32,412	17,534	21,694	19,291
California	243,720	179,447	87,617	106,161	101,896
Colorado	91,495	26,340	29,860	43,452	44,768
Connecticut	10,420	3,480	1,788	4,971	1,348
Delaware	5,838	4,704	2,515	197	284
District of Columbia	71	61	83	54	206
Florida	157,878	110,428	64,694	71,746	60,752
Georgia	67,957	33,652	43,911	43,556	41,604
Hawaii	15,846	34,569	6,567	12,131	7,142
Idaho	19,925	25,477	13,106	15,578	12,532
Illinois	165,518	85,566	66,003	63,596	74,514
Indiana	43,099	30,544	24,141	27,467	21,213
Iowa	30,765	35,159	16,169	30,450	16,983
Kansas	15,655	7,587	7,378	7,451	11,250
Kentucky	48,192	46,166	26,205	32,741	43,116
Louisiana	47,915	32,841	29,200	24,442	20,338
Maine	14,456	7,496	3,828	4,943	5,505
Maryland	26,370	18,953	14,900	18,136	9,765
Massachusetts	30,348	20,709	14,560	15,259	22,615
Michigan	85,851	99,278	27,363	50,995	47,890
Minnesota	85,675	49,143	30,561	27,902	23,430
Mississippi	25,929	28,203	9,281	14,393	9,788
Missouri	71,910	62,701	35,137	30,089	35,996
Montana	24,506	19,254	13,157	16,727	13,367
Nebraska	25,181	22,983	8,534	14,240	13,015
Nevada	45,204	57,332	32,106	22,981	30,420
New Hampshire	40,351	16,173	8,582	8,789	11,743
New Jersey	26,391	18,047	10,012	25,906	9,918
New Mexico	13,106	10,882	7,671	10,149	5,327





U.S. Department of Transportation  
**FEDERAL AVIATION ADMINISTRATION**  
 Stewardship Investment  
 Non Federal Physical Property  
 Airport Improvement Program  
 For the Fiscal Years Ended September 30 (continued)

State/Territory	2002	2001	2000	1999	1998
New York	\$ 109,798	\$ 118,792	\$ 57,671	\$ 86,754	\$ 67,664
North Carolina	73,493	60,908	26,084	50,572	31,226
North Dakota	16,562	25,221	11,490	8,263	10,980
Ohio	112,015	51,601	45,691	46,374	33,843
Oklahoma	39,238	19,780	8,678	14,949	5,240
Oregon	46,605	31,655	9,847	16,138	17,682
Pennsylvania	109,388	62,343	34,011	57,544	63,025
Rhode Island	12,409	9,547	11,705	10,813	2,692
South Carolina	39,194	18,895	11,792	22,926	15,419
South Dakota	15,440	10,466	12,301	8,893	10,112
Tennessee	46,373	58,638	39,237	36,477	34,885
Texas	192,738	127,046	111,585	103,308	98,154
Utah	21,396	39,235	14,328	8,808	12,910
Vermont	2,767	5,487	1,157	4,141	5,219
Virginia	76,647	75,555	41,109	31,069	21,733
Washington	62,798	34,023	35,498	44,454	18,405
West Virginia	18,562	18,564	7,400	12,592	19,564
Wisconsin	39,971	27,541	26,278	25,512	30,406
Wyoming	25,679	16,446	14,972	7,871	9,337
American Samoa	17,845	5,374	241	676	1,329
Guam	368	3,653	3,399	10,341	1,260
Northern Mariana Island	13,017	5,455	1,610	4,027	3,272
Puerto Rico	9,022	6,399	9,179	7,163	10,482
Trust Territory of Pacific	-	-	138	27	479
Virgin Islands	20,094	5,056	2,411	9,231	2,384
Administration	64,731	58,542	55,196	75,680	52,075
<b>Totals</b>	<b>\$ 2,933,542</b>	<b>\$ 2,178,576</b>	<b>\$ 1,375,293</b>	<b>\$ 1,612,867</b>	<b>\$ 1,436,541</b>

FAA makes project grants for airport planning and development under the Airport Improvement Program (AIP) to maintain a safe and efficient nationwide system of public-use airports that meets both present and future needs of civil aeronautics. FAA works to improve the infrastructure of the nation's airports, in cooperation with airport authorities, local and state governments, and metropolitan planning authorities.



**U.S. Department of Transportation  
 Federal Aviation Administration  
 Stewardship Investment  
 Research and Development  
 For the Fiscal Years Ended September 30**

<b>Expenditures</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
Applied Research	\$ 59,150	\$ 120,395	\$ 99,777	\$ 118,834	\$ 103,274
Development	603	3,419	7,175	18,358	48,237
R&D Plant	44,480	46,988	12,800	14,290	11,254
Administration	3,020	10,130	46,219	36,466	54,179
<b>Total</b>	<b>\$ 107,253</b>	<b>\$ 180,932</b>	<b>\$ 165,971</b>	<b>\$ 187,948</b>	<b>\$ 216,944</b>

FAA conducts research and provides the essential air traffic control infrastructure to meet increasing demands for higher levels of system safety, security, and efficiency.

Research priorities include aircraft structures and materials; fire and cabin safety; crash injury-protection; explosive detection systems; improved in-flight icing and ground de-icing operations; better tools to predict and warn of weather hazards, turbulence, and wake vortices; aviation medicine; and human factors.

NOTE: The FY 1999 amounts reported above are based on actual amounts and differ from those reported in FY 1999, which were based on estimates.



## **REQUIRED SUPPLEMENTARY INFORMATION**



**U.S. Department of Transportation  
 FEDERAL AVIATION ADMINISTRATION  
 Supplementary Information  
 Deferred Maintenance  
 For the Fiscal Years Ended September 30**

Category	Method	Asset Condition*	Costs to Return to Acceptable Condition				
			FY 2002	FY 2001	FY 2000	FY 1999	FY 1998
Buildings	Condition Assessment Survey	4&5	\$ 73,741	\$ 50,568	\$ 30,971	\$ 17,539	\$ 18,214
Other Structures and Facilities	Condition Assessment Survey	4&5	13,843	22,928	59,290	37,442	1,231
Total			<u>\$ 87,584</u>	<u>\$ 73,496</u>	<u>\$ 90,261</u>	<u>\$ 54,981</u>	<u>\$ 19,445</u>

\* Condition Rating Scale: 1: Excellent; 2: Good; 3: Fair; 4: Poor; 5: Very Poor

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 Structures and Facilities.

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**U.S. Department of Transportation  
FEDERAL AVIATION ADMINISTRATION  
Supplementary Information  
Intragovernmental Balances  
As of September 30, 2002**

**Intragovernmental Assets**

Agency	Accounts Receivable, Advances, Prepayments, and Other	Fund Balance with Treasury	Investments
Department of the Treasury	\$ 27	\$ 2,539,304	\$ 11,213,447
Department of Agriculture	141	-	-
Department of Commerce	258	-	-
Department of the Interior	5,498	-	-
Department of Justice	65	-	-
Department of State	4,750	-	-
Department of the Army	5,574	-	-
Department of the Navy	6,075	-	-
General Services Administration	334	-	-
Department of the Air Force	12,098	-	-
National Aeronautics & Space Admin.	1,585	-	-
Department of Energy	20	-	-
Department of Defense	3,634	-	-
Department of Transportation	228,028	-	-
US Secret Service	170	-	-
Other Agencies	31,171	-	-
<b>Total</b>	<b>\$ 299,428</b>	<b>\$ 2,539,304</b>	<b>\$ 11,213,447</b>

**Intragovernmental Liabilities**

Agency	Employee Related and Other	Accounts Payable
Department of the Treasury	\$ 105,428	\$ -
Department of Agriculture	7,225	-
Department of Commerce	931	-
Department of the Interior	99	23
Department of Justice	99	-
Department of Labor	199,639	-
Department of State	126	-
Department of the Navy	347	60
General Services Administration	816	3,109
Department of the Air Force	3,441	40
National Aeronautics & Space Admin.	807	-
National Science Foundation	9	-
Office of Personnel Management	52,033	32
Department of Energy	42	-
Department of Education	42	-
Department of Health and Human Services	15	15
Department of Defense	205	1,076
Department of Transportation	22,752	3,387
Federal Emergency Management Agency	220	-
Social Security Administration	12,462	-
US Secret Service	-	214
Other Agencies	78,773	28,226
	<b>\$ 485,511</b>	<b>\$ 36,182</b>



**U.S. Department of Transportation  
 FEDERAL AVIATION ADMINISTRATION  
 Supplementary Information  
 Intragovernmental Transactions  
 For the Fiscal Year Ended September 30, 2002**

**Intragovernmental Expenses and Revenues**

<u>Agency</u>	<u>Expenses</u>	<u>Revenues</u>
Department of the Treasury*	\$ 68,427	\$ 2,518
Department of Agriculture	98	98
Department of Commerce	8,024	8,024
Department of Energy	18	18
Department of Education	22	22
Department of the Interior	1,066	1,066
Department of Justice	1,303	1,303
Department of Labor - FECA*	89,022	-
Department of the Navy	10,883	10,883
Department of State	62	62
Office of Personnel Management*	1,174,790	798
Department of the Army	5,321	5,321
General Services Administration	508	508
Department of the Air Force	17,436	17,436
Environmental Protection Agency	1,422	1,422
Federal Emergency Management Agency	3,166	3,166
Department of Health and Human Services	91	91
National Aeronautics and Space Administration	5,044	5,044
Department of Defense	40,277	40,277
Department of Transportation	224,019	224,019
U.S. Secret Service	400	400
Other Agencies	606	606
<b>Total Expenses</b>	<b>\$ 1,652,005</b>	<b>\$ 323,082</b>

\* Represents imputed costs funded by other agencies on behalf of FAA and/or employee-related expenses.

**Intragovernmental Non-Exchange Revenue**

	<u>Transfers-Out</u>	<u>Transfers-In</u>
Executive Office of the President	\$ -	\$ 87,500
General Services Administration	26,970	-
Department of Transportation	67,482	(16,123)
Other Agencies	-	20,250
<b>Total</b>	<b>\$ 94,452</b>	<b>\$ 91,627</b>



**U. S. Department of Transportation  
FEDERAL AVIATION ADMINISTRATION  
Schedule of Budgetary Resources by Major Fund Type  
As of September 30, 2002**

<b>Budgetary Resources</b>	Airport & Airway Trust Fund Corpus	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development	Aviation Insurance Revolving	Franchise Fund	Operations	Other Funds	Combined Total
<b>Budget Authority</b>									
Appropriations Received	\$ (1,378,427)	\$ 2,125,000	\$ 3,026,595	\$ 245,000	\$ -	\$ -	\$ 7,128,000	\$ -	\$ 11,146,168
Contract Authority	-	3,300,000	-	-	-	-	-	-	3,300,000
Net Transfers	-	-	-	-	-	-	400	-	400
<b>Unobligated Balances</b>									
Beginning of period	10,111,046	302,331	553,845	19,400	88,241	28,620	173,897	29,860	11,307,240
Net transfers, actual	-	-	-	-	-	-	118,000	-	118,000
<b>Spending Authority From Offsetting Collections</b>									
<b>Earned</b>									
Collected	-	-	141,068	4,043	75,566	293,167	775,344	27,596	1,316,784
Receivable from Federal sources	-	-	37,508	(987)	-	958	211,674	-	249,153
<b>Change in unfilled customer orders</b>									
Advanced received	-	-	22,492	-	-	23,076	-	-	45,568
Without advance from Federal sources	-	-	(30,153)	913	-	867	25,797	-	(2,576)
Transfers from trust funds	-	-	-	-	-	-	33,000	-	33,000
<b>Subtotal</b>	<u>8,732,619</u>	<u>5,727,331</u>	<u>3,751,355</u>	<u>268,369</u>	<u>163,807</u>	<u>346,688</u>	<u>8,466,112</u>	<u>57,456</u>	<u>27,513,737</u>
Recoveries of prior year obligations	-	84,936	148,600	8,374	2	-	68,961	52	310,925
Permanently not available	-	(2,251,720)	(44,317)	(161)	-	-	(66,194)	-	(2,362,392)
<b>Total Budgetary Resources</b>	<u>\$ 8,732,619</u>	<u>\$ 3,560,547</u>	<u>\$ 3,855,638</u>	<u>\$ 276,582</u>	<u>\$ 163,809</u>	<u>\$ 346,688</u>	<u>\$ 8,468,879</u>	<u>\$ 57,508</u>	<u>\$ 25,462,270</u>

**U. S. Department of Transportation  
FEDERAL AVIATION ADMINISTRATION  
Schedule of Budgetary Resources by Major Fund Type  
As of September 30, 2002  
(continued)**

	Airport & Airway Trust Fund Corpus	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development	Aviation Insurance Revolving	Franchise Fund	Operations	Other Funds	Combined Total
<b>Status of Budgetary Resources</b>									
Obligations Incurred									
Direct	\$ 36	\$ 3,559,653	\$ 3,230,733	\$ 251,426	\$ 61,448	\$ 290,106	\$ 7,352,260	\$ 3	\$ 14,745,665
Reimbursable	-	-	83,418	3,969	-	-	963,786	-	1,051,173
Subtotal	<u>36</u>	<u>3,559,653</u>	<u>3,314,151</u>	<u>255,395</u>	<u>61,448</u>	<u>290,106</u>	<u>8,316,046</u>	<u>3</u>	<u>15,796,838</u>
Unobligated Balances-Available									
Apportioned	-	277	489,095	16,039	59,389	56,582	100,921	82	722,385
Exempt from apportionment	8,732,583	-	-	-	-	-	-	-	8,732,583
Unobligated Balances-Not Available	-	617	52,392	5,148	42,972	-	51,912	57,423	210,464
<b>Total Status of Budgetary Resources</b>	<u><u>\$ 8,732,619</u></u>	<u><u>\$ 3,560,547</u></u>	<u><u>\$ 3,855,638</u></u>	<u><u>\$ 276,582</u></u>	<u><u>\$ 163,809</u></u>	<u><u>\$ 346,688</u></u>	<u><u>\$ 8,468,879</u></u>	<u><u>\$ 57,508</u></u>	<u><u>\$ 25,462,270</u></u>
<b>Relationship of Obligations to Outlays</b>									
Obligated Balance, net Beg. Of Period	<u>\$ -</u>	<u>\$ 4,378,147</u>	<u>\$ 1,730,817</u>	<u>\$ 163,192</u>	<u>\$ 127</u>	<u>\$ 45,993</u>	<u>\$ 930,987</u>	<u>\$ 272</u>	<u>\$ 7,249,535</u>
Obligated Balance, Net-End of period									
Accounts receivable	\$ -	\$ -	\$ (80,029)	\$ (7,579)	\$ -	\$ (4,644)	\$ (253,626)	\$ -	\$ (345,878)
Unfilled customer orders from Federal sources	-	-	(33,864)	(3,667)	-	(867)	(53,676)	-	(92,074)
Undelivered orders	-	4,988,837	1,683,975	181,915	49	66,150	524,052	39	7,445,017
Accounts payable	-	3,865	418,728	35,278	5,094	10,164	545,536	(27,594)	991,071
Total obligated balance, net, end of period	<u>\$ -</u>	<u>\$ 4,992,702</u>	<u>\$ 1,988,810</u>	<u>\$ 205,947</u>	<u>\$ 5,143</u>	<u>\$ 70,803</u>	<u>\$ 762,286</u>	<u>\$ (27,555)</u>	<u>\$ 7,998,136</u>
Outlays									
Disbursements	\$ 36	\$ 2,860,162	\$ 2,900,203	\$ 204,339	\$ 56,429	\$ 263,472	\$ 13,951,695	\$ 27,778	\$ 20,264,114
Collections	-	-	(163,559)	(4,043)	(75,566)	(316,243)	(6,581,724)	(27,596)	(7,168,731)
Subtotal	<u>36</u>	<u>2,860,162</u>	<u>2,736,644</u>	<u>200,296</u>	<u>(19,137)</u>	<u>(52,771)</u>	<u>7,369,971</u>	<u>182</u>	<u>13,095,383</u>
Less: Offsetting receipts	<u>105</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>105</u>
<b>Net Outlays</b>	<u><u>\$ (69)</u></u>	<u><u>\$ 2,860,162</u></u>	<u><u>\$ 2,736,644</u></u>	<u><u>\$ 200,296</u></u>	<u><u>\$ (19,137)</u></u>	<u><u>\$ (52,771)</u></u>	<u><u>\$ 7,369,971</u></u>	<u><u>\$ 182</u></u>	<u><u>\$ 13,095,278</u></u>







## **ADMINISTRATIVE SERVICES FRANCHISE FUND**

### **Background**

The FAA Administrative Services Franchise Fund (Franchise Fund) was authorized under Public Law 104-205, Department of Transportation and Related Agencies Appropriation Act, 1997. The franchise program is designed to create competition within the public sector in the performance of a wide variety of support services. It allows for the establishment of an environment to maximize the use of internal resources through the consolidation and joint-use of like functions and the recognition of economies of scale and efficiencies associated with the competitive offering of services to other Government agencies.

### **Objective**

The objective of the Franchise Fund is to enhance the support provided to the core programmatic mission functions within FAA. Benefits of the franchise fund are derived incrementally over time through efficiencies and economies of scale associated with development of partnerships and consolidation of like functions plus the addition of new customers. Efforts in the franchise are directed toward identifying the most efficient and cost effective methods to provide support services, and this is consistent with the current Presidents' Management Agenda initiative relating to competitive sourcing.

### **Services**

The Franchise Fund offers a wide variety of services. These include accounting, payroll, travel, duplicating, multi-media, information technology, and international and management training. In FY 2001, the fund was expanded to include logistics and materiel management functions at the FAA Logistics Center and aircraft maintenance functions in the Office of Aviation System Standards. The customer base includes both DOT and non-DOT government agencies.

### **Prior Period Adjustments**

The Franchise Fund financial statements as of, and for the year ended, September 30, 2001 have been restated to reduce earned revenue by \$11.7 million because it represents future (unearned) revenue. This restatement increased Other Liabilities and Net Cost of Operations, and decreased Earned Revenues and Cumulative Results of Operations. The effect of this restatement has been eliminated in the consolidated financial statements of the FAA.



**U. S. Department of Transportation  
 FEDERAL AVIATION ADMINISTRATION  
 FRANCHISE FUND  
 BALANCE SHEET**

	<b>As of September 30</b>	
	<u>2002</u>	<u>2001</u> <u>As Restated</u>
<b>Assets</b>		
Intragovernmental		
Fund Balance with Treasury	\$ 127,297	\$ 74,525
Accounts Receivable, Net	2,676	3,686
Other	-	93
<b>Total Intragovernmental Assets</b>	<u>129,973</u>	<u>78,304</u>
Accounts Receivable, Net	1,914	(60)
Inventory and Related Property, Net	402,336	438,101
General Property, Plant, and Equipment, Net	4,011	48,260
Other Assets	4	17
<b>Total Assets</b>	<u>\$ 538,238</u>	<u>\$ 564,622</u>
<b>Liabilities</b>		
Intragovernmental Liabilities:		
Accounts Payable	\$ 5	\$ -
Other Intragovernmental Liabilities	67,088	74,884
<b>Total Intragovernmental Liabilities</b>	<u>67,093</u>	<u>74,884</u>
Accounts Payable	10,380	10,340
Other Liabilities	16,366	13,997
<b>Total Liabilities</b>	<u>93,839</u>	<u>99,221</u>
<b>Net Position Balances:</b>		
Cumulative Results of Operations	444,399	465,401
<b>Total Net Position</b>	<u>444,399</u>	<u>465,401</u>
<b>Total Liabilities and Net Position</b>	<u>\$ 538,238</u>	<u>\$ 564,622</u>



**U. S. Department of Transportation  
FEDERAL AVIATION ADMINISTRATION  
FRANCHISE FUND  
STATEMENT OF NET COST**

	<b>For the Years Ended September 30</b>	
	<b>2002</b>	<b>2001 As Restated</b>
	<u>                    </u>	<u>                    </u>
<b>Programs</b>		
Intragovernmental Costs	\$ 306,287	\$ 203,470
Less Earned Revenues	<u>(284,220)</u>	<u>(197,245)</u>
<b>Net Program Costs</b>	<u>22,067</u>	<u>6,225</u>
<b>Net Cost of Operations</b>	<u>\$ 22,067</u>	<u>\$ 6,225</u>



**U.S. Department of Transportation  
FEDERAL AVIATION ADMINISTRATION  
FRANCHISE FUND  
STATEMENT OF CHANGES IN NET POSITION  
For the Fiscal Year Ended September 30, 2002**

	<u>Cumulative Results of Operations</u>
<b>Beginning Balance</b>	\$ 477,101
Prior period adjustment	(11,700)
<b>Other Financing Sources</b>	
Transfers-in/out without reimbursement	(4,328)
Imputed financing from costs absorbed by others	5,387
Other	<u>6</u>
Total Financing Sources	1,065
<b>Net Cost of Operations</b>	<u>22,067</u>
<b>Ending Balance</b>	<u><u>\$ 444,399</u></u>



## **OTHER ACCOMPANYING INFORMATION**



**NET COST BY STRATEGIC GOAL AREA**

In an effort to better link actual costs to performance goals, the FAA is presenting a supplemental schedule of net cost for the first time in FY 2002, in which costs by program are allocated to agency strategic goals. FAA's long-term plan is to link costs to projects, and projects to goals, to improve understanding of the cost associated with FAA mission and programs.

Following are net costs for the year ended September 30, 2002, allocated to agency strategic goals.

U.S. Department of Transportation  
 FEDERAL AVIATION ADMINISTRATION  
 CONSOLIDATED SCHEDULE OF NET COST BY STRATEGIC GOAL AREA  
 For the Year-Ended September 30, 2002

Line of Business Programs	Strategic Goal Areas					Total
	Safety	System Efficiency	Organizational Excellence	Security	Other	
Air Traffic Services	\$ 6,566,283	\$ 552,982	\$ 110,411	\$ 6,989	\$ -	\$ 7,236,665
Regulation & Certification	923,493	-	-	-	-	923,493
Research & Acquisitions	128,306	318,073	-	68,483	-	514,862
Airports	809,005	1,725,897	-	398,640	-	2,933,542
Civil Aviation Security	83,118	-	-	530,792	-	613,910
Commercial Space Transportation	11,361	-	-	-	-	11,361
<b>Non Line of Business Programs</b>						
Regional and Center Operations and Other Programs	-	-	-	-	215,875	215,875
Costs Not Assigned to Programs	-	-	-	-	50,622	50,622
Earned Revenues Not Assigned To Programs	-	-	-	-	(56,411)	(56,411)
<b>Net Cost of Operations</b>	<u>\$ 8,521,566</u>	<u>\$ 2,596,952</u>	<u>\$ 110,411</u>	<u>\$ 1,004,904</u>	<u>\$ 210,086</u>	<u>\$ 12,443,919</u>



## TRANSPORTATION SECURITY ADMINISTRATION

The Aviation and Transportation Security Act (Public Law 107-71) was enacted on November 19, 2001. It established the Transportation Security Administration (TSA) and transferred the Civil Aviation Security functions and responsibilities of the FAA to the TSA not later than 3 months after the date of enactment. The TSA assumed responsibility for the Civil Aviation Security functions from the FAA on February 13, 2002.

The Civil Aviation Security program within FAA's Statement of Net Cost includes \$611.6 million of net cost for the period February 13 to September 30, 2002, related to security functions that were transferred to the TSA on February 13, 2002, but continued to be funded from FAA's direct appropriations.

In addition, equipment and construction in progress associated with Civil Aviation Security functions have been earmarked for transfer from FAA to the TSA. September 30, 2002 balances associated with this equipment and construction in progress included on FAA's Consolidated Balance Sheets, were as follows:

<u>Future Equipment Transfers to TSA</u>	<u>Amount</u>
Acquisition value	\$635,617
Accumulated depreciation	<u>87,778</u>
Net book value	<u>\$547,839</u>
Equipment count (unaudited)	2,475

Of the acquisition and net book values reported above, \$184.5 million represents construction in progress.



## GLOSSARY OF ACRONYMS

### A

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AIP	Airport Improvement Program
AMASS	Airport Movement Area Safety System
ASAP	Aviation Safety Action Program
ASDE	Airport Surface Detection Equipment
ATCSCC	ATC Systems Control Center
ATOS	Air Transportation Oversight System
ATS	Air Traffic Services

### C

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CAS	Cost Accounting System
CFIT	Controlled Flight Into Terrain
CFO	Chief Financial Officer
CTAS	Center/TRACON Automation System

### D

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DOT	Department of Transportation
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### E

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EIS	Environmental Impact Statement
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### F

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F&E	Facilities and Equipment
FAA	Federal Aviation Administration
FAST	Final Approach Spacing Tool
FFP1	Free Flight Phase 1
FFP2	Free Flight Phase 2
FOQA	Flight Operations Quality Assurance
FY	Fiscal Year

### G

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GA	General Aviation
GAO	General Accounting Office
GPS	Global Positioning System

### I

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ICAO	International Civil Aviation Organization
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### N

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NAS	National Airspace System
NASA	National Aeronautics and Space Administration

### O

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OEP	Operational Evolution Plan
OIG	Office of the Inspector General, Department of Transportation
OMB	Office of Management and Budget





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**P**

PFAST	Passive Final Approach Spacing Tool
PFC	Passenger Facility Charge
PP&E	Property, Plant, and Equipment

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**Q**

QAR	Quality Assurance Review Process
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**R**

RE&D	Research, Engineering, and Development
RESTORE	Revitalizing Existing Structures, Technology, and Operational Resources

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**S**

STAR	Standard Terminal Arrival Route
STARS	Standard Terminal Automation Replacement System

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**T**

TRACON	Terminal Radar Approach Control
TSA	Transportation Security Administration

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**U**

URET	User Request Evaluation Tool
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**INTERNET LINKS**

Federal Aviation Administration: [www.faa.gov](http://www.faa.gov)  
FAA Offices: [www1.faa.gov/index.cfm/1038](http://www1.faa.gov/index.cfm/1038)  
FAA Regional Offices and Centers: [www1.faa.gov/index.cfm/1040](http://www1.faa.gov/index.cfm/1040)  
FAA Operational Evolution Plan (OEP): [www1.faa.gov/programs/oeop](http://www1.faa.gov/programs/oeop)  
National Transportation Library: <http://ntl.bts.gov>  
U.S. Department of Transportation: [www.dot.gov](http://www.dot.gov)

**ACKNOWLEDGMENTS**

This Performance and Accountability Report is the culmination of the hard work and sustained commitment of hundreds of individuals involved in the audit and financial statement preparation process, and in monitoring and reporting on the status of FAA's performance results. The Office of Financial Services would like to acknowledge and convey our sincere thanks to these individuals, and to those throughout the FAA who reviewed this report and provided their comments and suggestions.



## **WE WELCOME YOUR COMMENTS!**

Thank you for your interest in FAA's *FY 2002 Performance and Accountability Report*. We welcome your comments on how we can make this report more informative for our readers. Please send your comments to

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This report is also available on the Internet at [www2.faa.gov/aba/html\\_fm/finst.html](http://www2.faa.gov/aba/html_fm/finst.html)