



Federal Aviation
Administration

FY 2005

PERFORMANCE AND ACCOUNTABILITY REPORT

← AT AIR →

MOVING AMERICA SAFELY



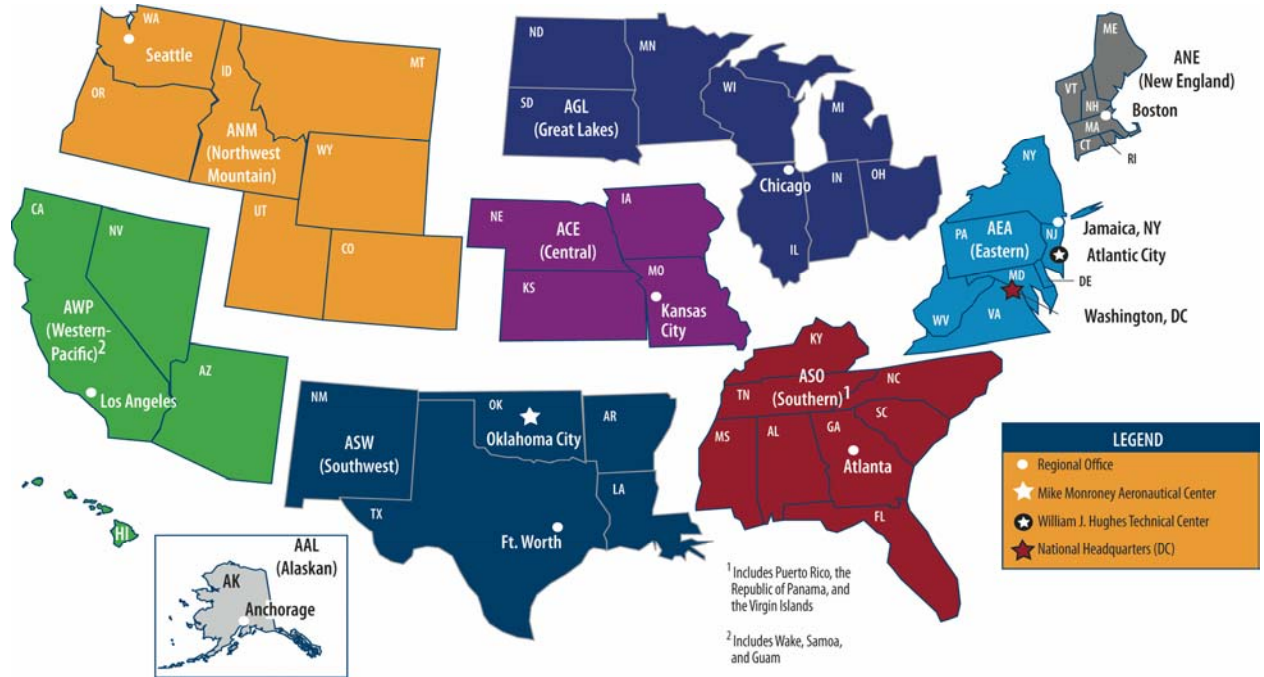
FEDERAL AVIATION ADMINISTRATION

FY 2005 PERFORMANCE AND ACCOUNTABILITY REPORT





FAA REGIONAL MAP





MISSION

To provide the safest, most efficient aerospace system in the world.

VISION

To improve continuously the safety and efficiency of aviation, while being responsive to our customers and accountable to the public.

VALUES

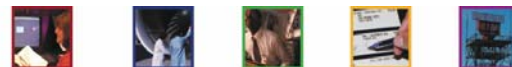
Safety is our passion. We are world leaders in aerospace safety.

Quality is our trademark. We serve our country, our customers, and each other.

Integrity is our character. We do the right thing, even if no one is looking.

People are our strength. We treat each other as we want to be treated.





FAA AT A GLANCE

Established	1958
Headquarters	800 Independence Avenue, SW Washington, DC 20591 www.faa.gov
FY 2005 Budget (Enacted)	\$13.828 billion
Total Employees	46,495
Headquarters	4,106 employees
Regional Offices	37,755 employees
Technical Center <i>Atlantic City, NJ</i>	1,244 employees
Aeronautical Center <i>Oklahoma City, OK</i>	3,390 employees
Passengers – U.S. Carriers	733.7 million (estimate)
Tower Operations	63 million arrivals and departures (estimate)





FOREWORD

The Federal Aviation Administration (FAA) is required by directives from the Office of Management and Budget (OMB), which implements the Chief Financial Officers Act of 1990 (CFO Act), to prepare financial statements separate from those of the Department of Transportation (DOT), of which FAA is a part. FAA is not required to prepare a separate Performance and Accountability Report (PAR). Instead, key FAA data and information are provided to DOT and consolidated into the required DOT PAR.

We recognize, however, that to demonstrate accountability, we should present performance, management, and financial information using the same statutory and guidance framework. To demonstrate that accountability, for the past several years we have elected to produce our own PAR. In some cases, however, we may depart from the format required of CFO Act agencies.

Last year, we were proud to receive our second consecutive Association of Government Accountants' prestigious Certificate of Excellence in Accountability Reporting award. This award is indicative of the progress we have made in reporting financial and program performance and in candidly assessing our results. In our effort to become a more results-oriented organization, we will continue to focus on performance and financial accountability and do our part to help DOT and the Federal Government excel in providing high-quality services and products to the taxpayers we serve.



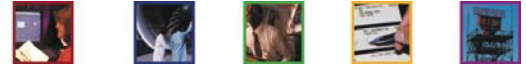


TABLE OF CONTENTS

FAA REGIONAL MAP	ii
MISSION, VISION, & VALUES STATEMENTS	iii
FAA AT A GLANCE	iv
FOREWORD	v
A MESSAGE FROM THE ADMINISTRATOR	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	3
FAA Organization Chart	4
A Year in Highlights	5
Integrating Performance and Financial Information	6
Efficiency and Cost-Effectiveness.....	6
Alignment of FAA Costs and Goals	9
Risks & Trends	10
Performance Highlights	10
Managing Performance.....	10
FAA FY 2005 Performance at a Glance	12
Verification & Validation of Performance Information	14
President’s Management Agenda	14
FAA Accomplishments	15
FY 2005 Management Challenges	16
Ensuring Aviation Safety in a Changing Environment.....	16
Aviation Capacity and Mitigating Delays.....	18
Reducing Fraud.....	18
Delivering Air Traffic Control Services & Fielding New Equipment While Controlling Costs	19
Financial Management.....	20
Secure and Cost Effective IT Investment	20
FY 2006 Management Challenges	21
DOT Management Challenges	21
Management Integrity: Controls and Compliance	21
Grants Management Policies and Practices	22
Financial Highlights	22
Financial Management Plans.....	22
Improper Payments Information Act of 2002	23
Discussion and Analysis of the Financial Statements	23
FY 2005 Financial Statement Audit	23
Understanding the Financial Statements	24
Balance Sheet	24
Statement of Net Cost.....	25
Statement of Changes in Net Position.....	26





Statement of Budgetary Resources 27

Statement of Financing..... 27

Stewardship Investments 27

Limitations of the Financial Statements 28

Budgetary Integrity: FAA Resources & How They Are Used..... 28

PERFORMANCE RESULTS 30

Safety..... 30

Performance at a Glance..... 30

Safety Results and Initiatives 31

Commercial Air Carrier Fatal Accident Rate 31

General Aviation Fatal Accidents & General Aviation Alaska Accidents 32

Runway Incursions 33

Composite Safety Index 34

Commercial Space Launch Accidents..... 34

Operational Errors 35

Safety Risk Management 36

Capacity 36

Performance at a Glance..... 36

Capacity Results and Initiatives 37

Average Daily Airport Capacity (35 OEP Airports)..... 37

Average Daily Airport Capacity (8 Metropolitan Areas)..... 37

Annual Service Volume..... 38

Adjusted Operational Availability..... 38

NAS On-Time Arrival..... 38

Noise Exposure 39

Aviation Fuel Efficiency..... 40

Oceanic En-route Change Requests..... 41

International Leadership 41

Performance at a Glance..... 42

International Leadership Results and Initiatives 42

Environmental Standards and Practices 42

Aviation Safety Leadership 43

Bilateral Agreements (Products and Services) 43

Intellectual and Financial Assistance..... 44

Support for ICAO..... 44

NAS Technologies 45

Organizational Excellence..... 45

Performance at a Glance..... 45

Organizational Excellence Results and Initiatives 46

Employee Attitude Survey 46

Cost Control..... 46





Critical Acquisition Budget & Schedule..... 47

Information Security 47

Customer Satisfaction 48

Performance Plans 48

Cost-Reimbursable Contracts..... 48

Mission Critical Positions..... 49

Flight Plan Targets 49

Completeness and Reliability of Performance Data 50

Commercial Air Carrier Fatal Accident Rate..... 50

General Aviation Fatal Accidents..... 50

Alaska Accidents 50

Operational Errors..... 50

Annual Service Volume..... 51

Adjusted Operational Availability 51

NAS On-Time Arrivals..... 51

Noise Exposure..... 51

Aviation Fuel Efficiency 52

Employee Attitude Survey (EAS)..... 52

Assessing Programs 52

Program Assessment Rating Tool Reviews 52

Program Evaluations 53

FINANCIAL STATEMENTS 55

A Message from the Chief Financial Officer 56

OIG Quality Control Review 58

Independent Auditors’ Report 60

Financial Statements..... 79

Notes to the Financial Statements 84

Required Supplementary Stewardship Information..... 109

Required Supplementary Information..... 113

Administrative Services Franchise Fund..... 120

Appendix: Improper Payment Information Act Reporting Details..... 125

Glossary of Acronyms 127

Internet Links..... 130

Acknowledgments..... 130

We Welcome Your Comments 130

This and prior year reports are available on the FAA website at www.faa.gov/about/plans_reports/





A MESSAGE FROM THE ADMINISTRATOR

This is the safest 3-year period in the history of aviation. The challenge for FAA remains not only maintaining this superb record, but also advancing our efforts to become a performance-based organization. This report details our specific achievements in raising the bar. Our goal is to pay immediate and continuous dividends on the taxpayer's investment.



Mike Melvill, SpaceShipOne pilot; Administrator Blakey; Doug Shane, SpaceShipOne Director of Flight Operations; and Burt Rutan, president of Scaled Composites, stand with SpaceShipOne to celebrate winning the Ansari X Prize in October 2004.

- ▶ **Safety.** Moving passengers safely remains our number one priority. In FY 2005, the commercial air carrier fatal accident rate dipped to 0.017 fatal accidents per 100,000 takeoffs—the equivalent of 1 fatal accident per 5.9 million flights. The fatal accident rate for general aviation remains a concern. FAA continues to educate the pilot community and deploy new technology to drop the numbers. Mistakes made when directing air traffic—also known as operational errors—were up in the past year. We are taking actions on a number of fronts to improve our performance in FY 2006. For the fourth year in a row, serious runway incursions, instances where a plane comes too close to another plane or vehicle on the ground, were below the target.
- ▶ **Capacity.** Long lines on the tarmac are bad news, no matter which side of the counter you're on. With air traffic back to pre-September 11 levels and on track to reach more than 1 billion passengers by 2015, FAA continues to make inroads into improving the capacity of the system. In the past 6 years, we have opened eight new runways: Philadelphia, Phoenix, Detroit, Cleveland, Denver, Miami, Houston, and Orlando. Another eight runway projects will be up and running by 2009.
- ▶ **International Leadership.** FAA sets the pace for aviation across the globe. We continue to use our most important export—safety—as a means to ensure that the global system mirrors our own. The list of countries to which we provide support has reached 100. We're working with the International Civil Aviation Organization (ICAO) and Eurocontrol to harmonize safety, efficiency, and technology. We increased our technical interactions with China, India, and Brazil, and we plan to open new offices in India, South America, and the Middle East in 2006. Our aim is simple: making international air travel safe for the American flying public, while enhancing the technical and economic stability of aviation across the globe.
- ▶ **Aviation for the Next Generation.** New types of aircraft are already here. Last year, SpaceShip One made the first flights designed to carry passengers into sub-orbit. Newer kinds of small aircraft, sometimes called “very light jets,” will soon take to the sky and make air taxis a way of life. FAA must be prepared to ensure the safety of the next generation of aviation.
- ▶ **Financial Planning.** Together with the Department of Transportation and our stakeholders, we are addressing the gap between FAA costs and revenues from the airline ticket taxes and fees that support our operations.
- ▶ **World Class Business Practices.** Continuous improvement in our business practices paid off in FY 2005 and will continue to benefit aviation and FAA for many years to come.





- ▶ **Competitive Sourcing.** In support of the President’s Management Agenda, we awarded an A-76 sourcing of 58 flight service stations to Lockheed Martin. This is the single largest nonmilitary outsourcing initiative in the Federal Government. Since its inception, this initiative is expected to result in an estimated savings of \$2.2 billion.
- ▶ **Labor Agreements.** Contract negotiations with FAA’s two largest unions are under way. The National Air Traffic Controllers Association and the Professional Airway System Specialists together represent more than 22,000 FAA employees. Our goal is to reach new contracts that are both fair and fiscally responsible.
- ▶ **Organizational Excellence.** The Association of Government Accountants (AGA) awarded us a second consecutive Certificate of Excellence in Accountability Reporting for our *FY 2004 Performance and Accountability Report*. We were honored to receive the award and are up to the challenge of continued improvement posed by AGA. In addition, we received a Gold Award for our *FY 2004 Performance and Accountability Highlights* from the League of American Communication Professionals. This award recognized our publication as one of the top annual reports in the country.

Our *FY 2005 Performance and Accountability Report* provides a detailed accounting of our service to both the flying public and the aviation industry. The financial and performance data contained in this report are reliable and complete. We improved our performance this year, attaining 28 out of 31 goals in the areas of safety, capacity, international leadership, and organizational excellence.

For the fifth consecutive year, we achieved an unqualified (clean) opinion from our auditors on our financial statements. However, this year we also received a material weakness in the area of timely processing of transactions and reconciliation of accounts. We have developed a plan to address this weakness, which will be implemented in phases during FY 2006.

Internally, we assess the vulnerability of our programs and systems through the Federal Managers’ Financial Integrity Act (FMFIA) of 1982. I am pleased to report that, taken as a whole, the management controls and financial management systems in effect from October 1, 2004, through September 30, 2005, provide reasonable assurance that the objectives of both sections 2 and 4 of FMFIA are being met. Management controls are in place and our financial systems conform to Government-wide standards.

Our mission is to provide the safest, most efficient aerospace system in the world.

We strive to improve continuously the safety and efficiency of aviation, while being responsive to our customers and accountable to the public.

As this report makes clear, our efforts to provide a safe, secure, and efficient global aerospace system, together with our commitment to the highest standards of efficiency and integrity, will ensure that FAA continues to move America safely and to deliver an exceptional return on the investment on behalf of the American taxpayer.

Marion C. Blakey
Administrator
November 8, 2005





MANAGEMENT'S DISCUSSION & ANALYSIS

The mission of the Federal Aviation Administration (FAA), an agency of the U.S. Department of Transportation (DOT), is to provide the safest, most efficient aerospace system in the world. FAA establishes and enforces regulations and oversees inspections that maintain the integrity and reliability of that system, which has fueled our economy and helped ensure our Nation's prosperity for more than 50 years.

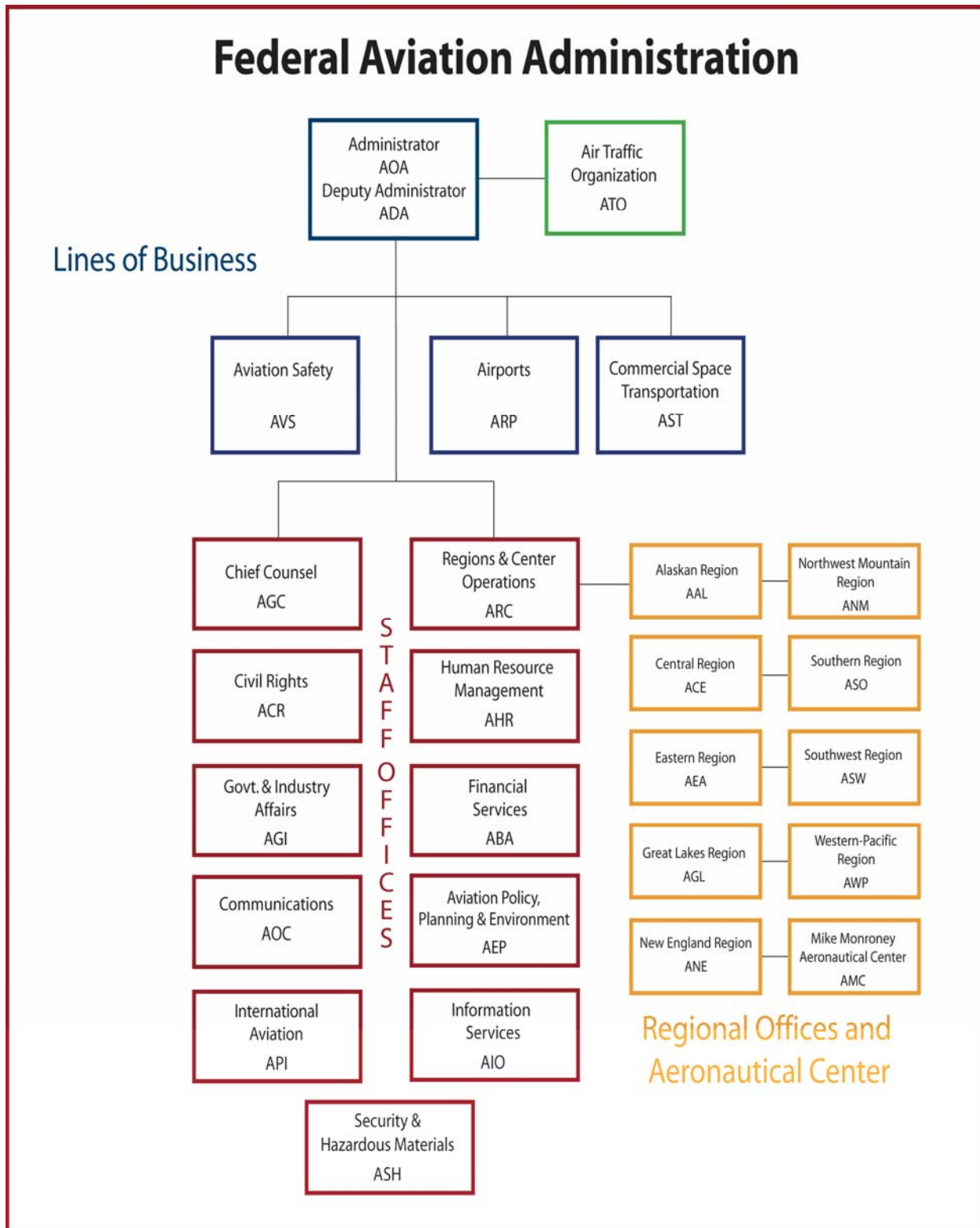
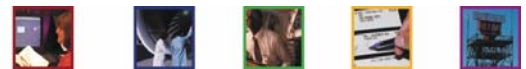
These are exciting times for aviation. Micro-jets and unmanned aerial vehicles (UAVs) are taking to the skies. Entrepreneurs are working to make space travel fast, reliable, and affordable. These are also challenging times for the industry. Fuel costs are on the rise. Low cost carriers now have a 43% share of the market, up from 30% just 5 years ago. Legacy carriers are struggling financially. FAA must evolve and adapt to the changing landscape while continuing to ensure historically unprecedented levels of safety.

From 1926, when President Calvin Coolidge initiated Federal oversight of air safety in the United States by signing the Air Commerce Act, to the creation of the Federal Aviation Agency in 1958, to our modern-day incarnation, FAA and the aviation community have grown and worked together. We have shaped an industry that—like shipping and rail before it—conquered distance in a new way, lowered transportation costs, and created new opportunities that transformed the commercial landscape.

Today's FAA faces the challenges of moving America safely with the help of dedicated employees at its headquarters in Washington, DC, in regional offices, and in facilities around the world. We fulfill our mission through four lines of business that work together to create and maintain the world's preeminent national airspace system. These lines of business are

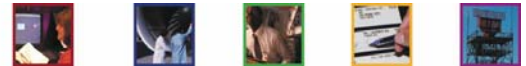
- ▶ **Air Traffic Organization (ATO):** Responsible for moving air traffic safely and efficiently. The customers of this performance-based organization are commercial, private, and military aviation. ATO is aligned around the services delivered to these customers. Approximately 36,000 ATO employees provide these services—the controllers, technicians, engineers, researchers, and support and management personnel whose daily efforts keep the airplanes moving.
- ▶ **Aviation Safety (AVS):** 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 one of the safest modes of transportation in history.
- ▶ **Airports (ARP):** Provides leadership in planning and developing a safe, secure, and efficient airport system; manages the Airport Improvement Program (AIP), which provides grants to State and local airport authorities; enhances environmental quality related to airport development; develops standards for the design and construction of airport facilities; and establishes regulations for the safe operation of commercial service airports and inspects airports for compliance.
- ▶ **Commercial Space Transportation (AST):** Oversees the safety of commercial space launches and regulates the commercial space industry.





FAA's organization chart shows how the agency is structured to achieve its mission and deliver results.





A YEAR IN HIGHLIGHTS

With a workforce of 46,495 professionals and an annual budget of approximately \$13.8 billion, FAA operates and maintains the complex air traffic control system and the facilities and equipment that support it. More than half of the world's air traffic is managed by 14,540 controllers, who ensure ever-increasing levels of safety. We conduct research to improve aviation safety and efficiency and provide grants to improve 3,344 eligible public-use airports in the United States. FAA also regulates commercial space launch activities to ensure public safety.

Administrator Marion C. Blakey led FAA to a number of significant accomplishments in FY 2005. Aviation safety continued to improve at an impressive pace, and we renewed our pledge for constant vigilance to safeguard the flying public. As a result, FAA remains on track to meet the ambitious goal of reducing commercial air carrier fatal accidents by 80% from the 1994–1996 baseline. We once again introduced new technologies to keep passengers safe both in the air and on the ground.

During FY 2005, FAA employees

- ▶ Achieved a record of aviation safety that sets the standard for countries throughout the world.
- ▶ Managed increased demands on the system while working to minimize delays and congestion. During the past 6 years, FAA has worked with local governments to commission eight new runways, which added more than 1 million operations (takeoffs and landings) at major airports. We are now planning for eight new runway projects, which will further increase capacity.
- ▶ Began work on proposed legislation for a new system for financing the FAA in the future. The excise taxes, which go to the Airport and Airway Trust Fund, are set to expire in 2007 without Congressional reauthorization. Aviation infrastructure and FAA's operations are funded, in part, by taxes on airline tickets, which are deposited in the Airport and Airway Trust Fund. Dramatic changes in the airline industry have caused a decline in ticket taxes and fees, which means less money for FAA. A troubling gap has grown between the revenue that comes in and what it costs to run the FAA. The Administrator hosted a Trust Fund Forum to elicit public input on reauthorization. FAA then developed and analyzed various options for closing and funding the gap. We developed and shared extensive data on who uses different parts of FAA services and what it costs to provide the services with the aviation community, who have and will continue to provide suggestions for how to shape a new financing system. In FY 2006, we will develop a specific legislative proposal for future revenue that is based on detailed cost and activity data and is informed by the advice of our stakeholders.

BEYOND 2007 THE TRUST FUND

The Airport and Airway Trust Fund, which is funded by the excise tax on airline tickets, pays a large share of the FAA's operating expenses. This system has worked well for much of FAA's history; however, a troubling gap has grown recently between the revenue that comes in and what it costs to run the agency. The taxes and fees that support the Trust Fund expire in 2007.

The drop in revenue is due, in large part, to changes in the aviation industry. In prior years, higher ticket prices helped keep the trust fund solvent, enabling FAA to make investments for the future while operating the world's safest transportation system. Competition between low-cost carriers has reduced ticket prices dramatically. Because over half of Trust Fund receipts come from the 7.5% tax on airline tickets, these lower fares decrease Trust Fund revenue—without any corresponding reduction in FAA workload. The increased workload is further compounded by the addition of next generation aircraft—unmanned aerial vehicles and very light jets—entering the system.

The Department of Transportation and FAA are working to address the problem. In April 2005, Secretary Norman Mineta and FAA Administrator Marion Blakey convened a forum of more than 150 leaders from government, industry, and Wall Street to discuss the issues and make recommendations. Over the coming months, FAA will continue to search for an equitable solution by reaching out to our stakeholders to help secure a consistent, stable revenue stream that is not tied to the price of an airline ticket but rather reflects the actual costs of maintaining the safest and most efficient aviation system in the world.

- ▶ **For More Information:**
www.faa.gov/airports_airtraffic/trust_fund/





- ▶ Continued to transform the system through the Joint Planning and Development Office (JPDO). JPDO—a joint venture of FAA, the Departments of Defense, Commerce, Transportation, and Homeland Security, the National Aeronautics and Space Administration (NASA), and the White House Office of Science and Technology—is a test bed for new ideas. During FY 2005, JPDO began work on a network-enabled operations (NEO) demonstration project. NEO is a communications link that will provide a shared picture of the National Airspace System (NAS) to enhance security and improve communications.
- ▶ Sponsored research through FAA's Center of Excellence for Noise and the Environment on technologies that will reduce both fuel consumption and noise.
- ▶ Continued airport, aircraft, human factors, and weather research and development activities, which are ensuring aviation safety and improving capacity today and for the future.
- ▶ Improved business practices to help control costs and increase efficiency, as described in the section that follows.
- ▶ Maintained a focus on aviation as a global system and worked closely with international organizations to seek global solutions to safety, routing, procedural, technology, and environmental issues.
- ▶ Continued to work with airports around the country to boost system capacity by analyzing chokepoints, commissioning new runways, and taking advantage of precise satellite navigation technologies to increase efficiency. Through such improvements, we were able to increase system capacity, maintain efficiency, and minimize delays.

RESPONDING TO KATRINA

Less than 24 hours after Hurricane Katrina made landfall in the Gulf Coast, the FAA mobilized employees and equipment and sent them to the hurricane-stricken region. Within 72 hours, all airports were open for business, with the exception of New Orleans Lakefront Airport, which suffered extensive water damage.

FAA employees supported Operation Air Care—the largest airlift operation ever undertaken in the United States. Over the course of five days, from September 2–7, nearly 400 civilian and military aircraft safely evacuated more than 23,000 people, while delivering much-needed relief supplies.

During that time, Louis Armstrong New Orleans International Airport became one of the nation's busiest airports. Guided by FAA air traffic controllers and on-ground personnel, 3,300 flights per day—four times the normal air traffic levels—were able to safely complete their missions.

FAA employees continue to work around the clock to staff air traffic facilities, repair navigational aids and infrastructure, and to provide safety oversight in support of ongoing evacuation and relief efforts.

▶ **For More Information**
www.faa.gov/news/disaster_response/

INTEGRATING PERFORMANCE & FINANCIAL INFORMATION

EFFICIENCY AND COST-EFFECTIVENESS

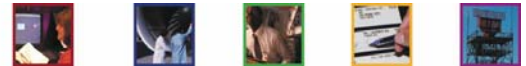
Over the past several years, we have made significant progress in making cost control a priority throughout the Agency. Our areas of focus include the following.

Consolidation of staffing and facilities addresses the synergies derived by cross-utilization of resources and facilities and the resulting reduction in the unit cost of services. This effort also includes benefits that are derived from outsourcing services to obtain cost efficiencies.

The single largest effort by FAA, and the largest nonmilitary outsourcing initiative in the Federal Government, involves the A-76 sourcing of 58 flight service stations to Lockheed Martin. This initiative will result in a cost savings of over \$2.2 billion from 2003 through 2015. Although there are implementation costs to complete the switchover, we will start realizing significant savings beginning in FY 2007.

Consolidation efforts undertaken by FAA include the centralization of all accounting offices. This initiative went from concept to reality in 2005 when two regional accounting offices were consolidated into the Oklahoma City Finance Center. This effort will ultimately result in payroll savings of \$3.5 million per year,





which will begin accruing in FY 2007. In addition to accounting operations, travel processing and human resource support operations have also been centralized. For human resource support, we are consolidating personnel processing in 3 locations rather than the 12 locations that previously performed the function. Further consolidations of facilities and excess space will be undertaken with the formation of a new centralized Real Property Management office that is the result of an internal reorganization of facility planning and real property management resources.

Consolidation of services in recent years has included web services, application software, servers and help desk consolidations in many organizations such as Information Services; Aviation Policy, Planning, and Environment; Regions and Center Operations; and Security and Hazardous Materials.

Labor cost management is a major area of focus, given the size of our payroll and benefits budget of approximately \$6 billion in FY 2005.

In the area of unionized employees, FAA has already renegotiated costly memoranda of understanding (MOUs) and strengthened the approval process for future MOUs. A major initiative is, however, the current renegotiation of labor agreements with the objective of establishing affordable agreements and maximizing cost efficiency. FAA has also established a goal to achieve air traffic controller staff savings of 10% by FY 2010 through productivity improvements. ATO achieved the first 3% of that goal in FY 2005 by establishing a staffing target 3% below the standard staffing level, avoiding the need to hire 459 controllers. We accomplished this by absorbing traffic increases without adding additional staffing and by several cost savings initiatives started in FY 2005. Cost avoidance in FY 2005 was \$23 million. In addition, we have implemented FAA's proposal to convert National Air Traffic Controllers Association (NATCA) Multi-Unit employees to the core compensation system, which provides a pay-for-performance system—a key FAA initiative—for non-controller 1,900 employees.

A reduction of over 510 overhead and nonsafety staff in ATO (through attrition) resulted in cost savings of \$34 million in FY 2005. In addition, many organizations are filling vacancies with employees at lower pay levels resulting in lower unit labor costs.

Strategic sourcing and demand management is an important area of focus given the cost reduction accomplishments in industry. Using industry best practices, FAA has already achieved strategic sourcing savings in selected areas such as centralizing wireless contracts to take advantage of volume discounts and improve management and usage. We now have a centralized ordering system, clear approval processes, and incentives for users to control costs. We are already realizing savings from this initiative. When it is fully implemented, we will save over \$4 million per year, 50% of what we previously spent.

In the same vein, FAA awarded an Oracle Enterprise License that is 24% less expensive than the General Services Administration (GSA) schedule and will reduce our costs by almost \$1 million per year. A similar blanket purchase agreement (BPA) with Dell that is significantly cheaper than the GSA schedule yielded cost

FAA ACKNOWLEDGED FOR ORGANIZATIONAL EXCELLENCE

Citing the FAA's high priority on cost accounting and the routine use of such information in FAA decision making, the Government Accountability Office (GAO) removed FAA from its high risk list for financial management in January 2005. This endorsement is a clear indication that FAA's cost accounting and financial tracking systems are helping to move FAA closer to the Administration's goal for Federal Government agencies to become examples of precision and excellence for the public sector.

GAO's recognition of our successful efforts to exert greater financial management and control follows a string of recent commendations the agency has received for improving overall organizational excellence.

In November 2005, FAA received its fifth consecutive clean opinion from our independent auditors based on the audit of our financial statements. In recognition of the clean audit, the DOT Inspector General noted the FAA's implementation of more disciplined financial management processes over the past 3 years.

Also in November, the Association for Strategic Planning awarded the prestigious 2004 Richard Goodman Strategic Planning Award to FAA for *Flight Plan 2004–2008*. The not-for-profit professional association honored FAA for its ability to enable individuals and organizations to succeed through strategic thinking, planning, and action.





avoidance of over \$3 million this year.

By the end of FY 2006 we will generate annualized savings of over \$10 million for the next 3 years through a Strategic Sourcing initiative. This program will result in major changes in the way we procure administrative commodities such as office supplies, office equipment, and Information Technology (IT) hardware and software through the use of private sector best practices. Savings for some items could exceed 30%.

FAA is also addressing nonproductive time and staffing inefficiencies as key areas for improvement in FY 2005 and beyond. We have strengthened our management of the Worker's Compensation program to insure that new claims are minimized and employees are returned to duty. Our proactive management has slowed the growth of this program and avoided \$5.4 million in costs.

Lost time reports that show the time recorded in the labor distribution system for leave, including vacation, sick time, and official time, are being distributed to FAA organizations to address potential abuse in this area.

We have also implemented **new information tools and processes to manage costs and productivity.**

New accounting, acquisition, cost accounting, and labor distribution systems have been implemented in the past few years enabling better availability of managerial cost information that helps users to better understand and manage unit costs and productivity. ATO has developed unit cost and productivity metrics, which have been incorporated into the strategic planning process. These metrics measure the cost to provide air navigation services to our users assessed on a "per flight" basis. They include the cost to provide en route services per flight hour, terminal costs per terminal operation, and flight service costs per customer contact. Furthermore, in June 2005, ATO deployed an enhanced version of its labor distribution system. This provided more visibility into tasks employees perform, including work performed by air traffic controllers when not "on position" controlling traffic.

This year we also instituted several key finance-related measures to determine financial trends and assess financial operations. These measures focus on issues arising from our primary business processes and have been incorporated into the business plan that implements FAA's strategic plan. These measures include

- ▶▶ Percent of invoices paid late,
- ▶▶ Bills issued within 30 days of month-end,
- ▶▶ Percent of collections achieved timely,
- ▶▶ Percent of suspense account items cleared timely, and
- ▶▶ Percent of assets capitalized timely.

A CONTRACT FOR THE FUTURE

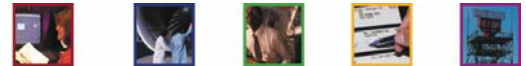
FAA and NATCA opened contract negotiations in July 2005. Before negotiations began, FAA Administrator Marion Blakey urged both sides to quickly reach an agreement that fairly compensates controllers and provides the flexibility needed to address changing air travel patterns. The Administrator was optimistic that the air traffic controllers share FAA's desire to seek fair and quick resolution to the contract talks.

Provisions in the current agreement have also delayed the introduction of certain new air traffic control systems and restricted our ability to staff its facilities to meet changes in air traffic volumes and patterns. FAA needs fundamental changes in the contract if the agency is to afford new systems and inspectors to improve safety and to modernize the air traffic control system to reduce delays and congestion. FAA called on the union to join in achieving a balanced labor agreement that allows the agency to finance the air traffic control system going forward while still providing a fair compensation package to its professional controllers—already among the highest paid civil servants.

Contract negotiations come during a critical time for FAA and the aviation industry, both of which are attempting to reduce costs and transform their operations to meet ever-increasing consumer demand with limited revenue—in FAA's case, a declining Airport and Airway Trust Fund. In December 2003, FAA and NATCA signed a 2-year extension of the 1998 agreement.

▶▶ **For More Information:**
www.faa.gov/ahr/policy/agree/agrees/term/index.cfm





Results from this year's performance will serve as the baseline for the future and will be the basis for establishing a service agreement with the Oklahoma City Finance Center.

In addition, FAA has strengthened its Capital Planning and Oversight with greater reliance on the use of OMB Exhibit 300s (Business Case Justification) with detailed discussions of economic measures such as Net Present Value (NPV), Return on Investment (ROI), and Earned Value Management (EVM), as well as alternatives to the proposed investment. After a program has been approved, there are processes that enable us to monitor cost and schedule variances to better manage the programs.

In the area of expense controls, FAA has improved its oversight of the contract approval process to avoid duplication of services and ensure optimal pricing. Other analytic tools have also been put in place to enable efficient manpower scheduling and monitoring of productivity within the organization.

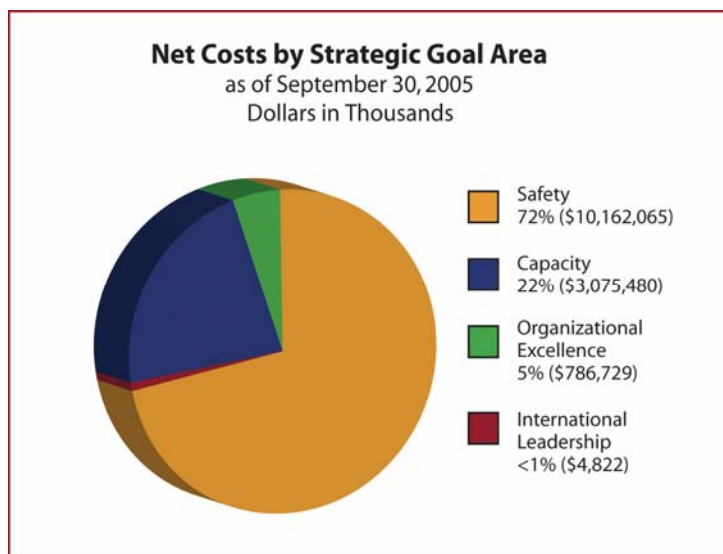
Many **other miscellaneous cost control actions** have been implemented and monitored through the cost control program, a key objective in the *Flight Plan*, FAA's strategic plan. Some examples of these initiatives include a review of guard service for the Orville and Wilbur Wright Federal Buildings provided by the Office of the Secretary that has resulted in cost savings of more than \$800,000. We have replaced 6,000 incandescent bulbs in lights used to identify obstructions with LED bulbs. The LED bulbs last 10 times longer, require less monitoring by technicians resulting in improved productivity, and use only 11% of the energy consumed by an incandescent bulb. The 6,000 bulbs replaced so far are saving \$5 million per year.

ALIGNMENT OF FAA COSTS & GOALS

The alignment of FAA's costs with its four strategic goal areas is captured in the cost accounting system (CAS).¹ More than \$10 billion, or 72% of the \$14.0 billion in total net cost for FY 2005, was devoted to our primary goal of ensuring a safe NAS. ATO spent \$7.5 billion, largely to support keeping aircraft safely separated in the air and on the ground. ARP directed over \$1.9 billion to establishing safe airport infrastructure. AVS spent slightly less than \$500 million on its programs to regulate and certify aircraft, pilots, and airlines, directly supporting the safety of commercial and general aviation. AST, FAA staff offices, and other programs spent the remaining amount of \$189 million to support the agency's safety performance targets and activities.

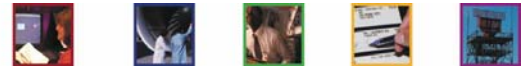
Just over \$3 billion, about 22% of total net costs, is primarily assigned to supporting FAA's goal of improving the capacity of the NAS. \$1.3 billion was spent by ATO, largely to support its facilities and equipment projects. ARP spent nearly \$1.7 billion to enhance the capacity of the country's airports, through runway projects and other efforts. AST directed almost \$4 million to its efforts to expand capacity.

The bulk of FAA's remaining net costs, over \$700 million, supported its Organizational Excellence goal. Nearly all the lines of businesses and staff offices contributed to this goal. The remainder, about \$4.8 million, was spent to promote FAA's International Leadership goal.



¹ See Note 11 to the financial statements, page 98.





RISKS & TRENDS

FAA faces a number of challenges in implementing the *Flight Plan* and achieving results. These challenges include the following.

- ▶ Air traffic has returned to pre–September 11, 2001, levels. More than 700 million people flew last year, and the number of passengers is expected to climb to 1 billion by 2015. Dealing with these increases will demand even more from FAA resources, which are already feeling the strain.
- ▶ The financial difficulties facing the airlines and aviation manufacturers affect their ability and willingness to equip aircraft with new technologies that will enhance safety and capacity. Those difficulties also affect FAA, which is primarily funded by the Airport and Airway Trust Fund from taxes on airline tickets.
- ▶ Large capital investments in facility, infrastructure, and Agency human capital needs will depend largely on the ability to closely link budget to performance and in part on the ability and willingness of Congress to fund such operations and responsibilities.
- ▶ The ability to improve safety or expand capacity in the United States and in the international arena depends in part on the willingness of authorities at the State, local, and international levels to cooperate and collaborate in areas such as building new airports, expanding runways, and implementing new technologies.
- ▶ Emerging threats to national or homeland security may cause FAA priorities to shift to meet new responsibilities.

PERFORMANCE HIGHLIGHTS

FAA is charged with promoting the safety and efficiency of the Nation’s aviation system. With broad authority to enforce safety regulations and conduct oversight of the civil aviation industry, we maintain the system’s integrity and reliability. A strategic plan, annual business plans, human capital plans, and the annual Performance and Accountability Report create a recurring cycle of planning, program execution, measurement, verification, and reporting. This strong link between resources and performance shows what is being accomplished and reinforces accountability for the taxpayer money being spent.

MANAGING PERFORMANCE

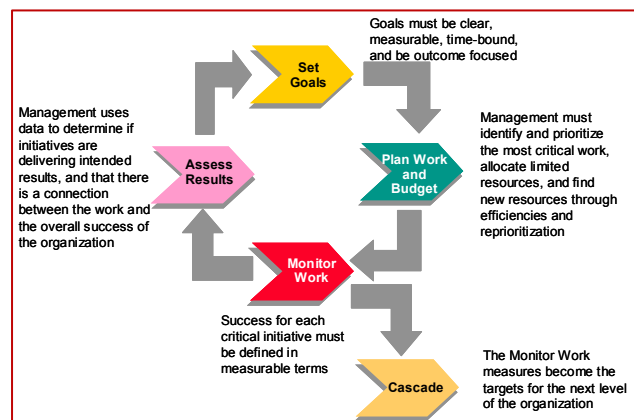
In FY 2004, we launched an ambitious strategic plan to help manage and measure performance. In the first year of the *Flight Plan’s* implementation, our goal was to meet at least 90% of our performance targets (28 out of 31).

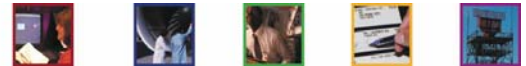
As part of our efforts to deliver results, we continued to phase-in a pay-for-performance system that is unlike traditional Government compensation systems. At the end of FY 2005, 82% of FAA employees were included in this new system, which provides pay increases for organizational success.

As the Agency continues to achieve our goals, employees included in the pay-for-performance system will get a pay increase.

FAA manages performance by means of a four-step framework based on best practices from a number of private and public sector organizations (see the chart above). As we use this framework and instill management discipline into the processes, we anticipate a multiyear journey of learning and change.

The first step in the process, “Set Goals,” includes consulting with management, stakeholders, and customers to determine our success.





The second step, “Plan Work and Budget,” focuses on the critical work and resources required to achieve the goals. Following the framework, FAA created a performance-based FY 2005 budget that linked resource requirements to our *Flight Plan*.

Our *FY 2005 Budget in Brief* is available at www.faa.gov/aba/html_budget/2005.html and our *Flight Plan* is available at www.faa.gov/about/plans_reports/.

The third step, “Monitor Work,” develops measurement of the work required to achieve the goals. FAA developed organizational business plans for each line of business and staff office. These plans outlined the FY 2005 initiatives, activities, and performance targets that linked our work directly to the *Flight Plan*. (Business plans are available at www.faa.gov/about/plans_reports/business_plan2005/).

“Assess Results” is the last and most important step in the performance management process. This year, we continued our practice of reviewing and discussing FY 2005 performance goals every month. In addition, we began to deploy a new tool and business processes that focus more on discussing performance results, root causes of performance issues, and reallocation of resources to correct performance.

In FY 2005, FAA marked the second year under its *Flight Plan*, a long-term strategic plan that charts the Agency’s goals through FY 2010. It provides the framework to match resources with initiatives for long-term change. It not only focuses on activities, but it also sets the direction for FAA and the national air and space community in a global transportation environment. It sets forth our goals and the performance measures to assess progress in meeting them. These are the goals that we must meet to address the challenges facing aviation, as well as maintain U.S. leadership in aviation. Our *Flight Plan* is tightly aligned with DOT’s mission, vision, goals, and performance measures.

This year, FAA had 31 performance measures and targets that focused our efforts to achieve enhanced aviation safety, increase system capacity, provide international leadership, and ensure organizational excellence. As part of our efforts to continuously improve reporting, we redesigned the FAA Website and added a section that provides easy access to *Flight Plan* performance and results (www.faa.gov/about/plans_reports/).

Our performance measures support FAA’s mission to provide citizens with a safe, secure, and efficient global aviation system.

- ▶ **Safety.** Safety is not only a top priority, it is also an economic necessity. People will fly only if they feel safe. They must trust the system and that trust must be earned. Reducing the risk of aviation accidents remains a top priority. To enhance safety, we continued to focus on the challenge of reducing operational errors and runway incursions. A number of coordinated programs, safety initiatives, and research and development activities enabled us

AVIATION’S NEXT GENERATION

Numerous studies and blue ribbon panels, including most recently the National Research Council and the Commission on the Future of the United States Aerospace Industry, concluded that today’s aviation system cannot meet 21st century needs. The current system is not equipped to tackle emerging safety and homeland security issues and cannot adequately address more efficient and enlarged capacity and changing market conditions. Given these challenges, piecemeal solutions or tinkering at the margins will not work. The future demands nothing less than the complete transformation of the U.S. air system.

To meet these challenges, FAA and DOT have launched the Next Generation Air Transportation System (NGATS) plan. This plan brings together the resources, plans, and programs from the private sector, academia, FAA and the Departments of Defense, Commerce, Transportation, and Homeland Security, the National Aeronautics and Space Administration (NASA), and the White House Office of Science and Technology. The Joint Planning and Development Office (JPDO), which is jointly managed by FAA and NASA and supported by staff from all the agencies involved, serves as a focal point for coordinating the research related to air transportation for all of the participating agencies.

At a time when tax dollars are stretched thin, NGATS is designed to make these groups work together, eliminating duplication, pooling resources, and making the best use of brainpower. We are confident that NGATS will take aviation to and through 2025. The plan incorporates the work of eight Integrated Product Teams—Agile Air Traffic, Airports, Environmental, Global Harmonization, Safety, Security, Situational Awareness, and Weather.

- ▶ **For More Information**
www.jpdo.aero





to further reduce the commercial air carrier fatal accident rate. In addition to these results, we were successful in ensuring that there were no commercial space launch accidents. In FY 2005, we achieved five of eight safety goals.

- ▶ **Capacity.** Capacity is the backbone of air travel. Aviation can grow only if capacity grows. We aim to achieve increases in capacity in an environmentally sound manner. Initiatives designed to boost system efficiency were successful in improving on-time arrival and airport capacity and efficiency while reducing exposure to aircraft noise and emissions. In FY 2005, we achieved all eight capacity goals.
- ▶ **International Leadership.** FAA's goal is to make the international aviation system as safe and efficient as the one enjoyed in the United States. This year, we provided technical assistance, staff, and funding to assist 27 countries in improving aviation safety and efficiency. During FY 2005, we continued to promote safety by broadening the international network of partnerships with civil aviation authorities around the world. In FY 2005, we achieved all six of our goals in this area.
- ▶ **Organizational Excellence.** To fulfill our mission, we must be a world-class organization. This requires greater fiscal responsibility, stronger leadership, more collaboration, and performance-based management. During FY 2005, we continued to address challenges identified by DOT's Inspector General (IG). We successfully reduced operating costs, enhanced acquisition management, and worked on stabilizing our new accounting and acquisition systems to improve financial management. We continue to make great strides in improving the business processes that support efforts to improve aviation safety and system efficiency, and in FY 2005 we were able to achieve all nine of our organizational excellence goals.

Despite the challenges, FY 2005 was a year of impressive success for FAA. As traffic increases, so do the challenges we face in building organizational excellence to improve safety and increase capacity. Through the combined efforts of our employees and industry partners, we were able to achieve 28 of 31 goals—a 90% success rate. The Performance at a Glance chart provides a snapshot of our results.

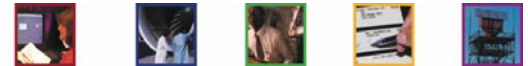
FAA FY 2005 PERFORMANCE AT A GLANCE				
Performance Measure	FY 2005 Target	FY 2005 Results	FY 2005 Status	FY 2006 Target
SAFETY				
Commercial Air Carrier Fatal Accident Rate	0.023	0.017 ¹	●	0.018
General Aviation Fatal Accidents	343	350 ¹	◎	337
General Aviation Alaska Accidents	120	128 ¹	◎	115
Runway Incursions (number/rate)	36/0.557	29/0.460 ²	●	0.551 ³
Composite Safety Index	Present Index	Index Presented	●	N/A
Commercial Space Launch Accidents	0	0	●	0
Operational Errors (number/rate)	637/3.92	680/4.27 ²	◎	4.20 ³
Safety Risk Management (number of changes)	3	3	●	3
CAPACITY				
Average Daily Airport Capacity (35 Operational Evolution Plan [OEP] airports)	99,892	101,463 ²	●	101,191





FAA FY 2005 PERFORMANCE AT A GLANCE				
Performance Measure	FY 2005 Target	FY 2005 Results	FY 2005 Status	FY 2006 Target
CAPACITY <i>(continued)</i>				
Average Daily Airport Capacity (8 metropolitan areas)	43,080	44,324 ²	●	43,338 ⁴
Annual Service Volume	1.00%	1.01%	●	1.00% (4 runways)
Adjusted Operational Availability (35 OEP airports)	99.00%	99.76% ²	●	99.50%
NAS On-Time Arrivals	87.40%	88.44% ²	●	87.40%
Noise Exposure	-3.00%	-27.00% ⁵	●	-4.00%
Aviation Fuel Efficiency	-2.00%	-5.84% ⁵	●	-3.00%
Oceanic En-route Change Requests	75.00%	76.24%	●	N/A
INTERNATIONAL LEADERSHIP				
Environmental Standards and Practices (number of milestones)	2	2	●	N/A
Aviation Safety Leadership (number of countries)	2	27	●	N/A
Bilateral Agreements (products and services)	2	2	●	1
Intellectual and Financial Assistance	20.00%	63.00%	●	20.00%
Support for International Civil Aviation Organization (new aviation authorities)	2	3	●	N/A
NAS Technologies (number of countries)	1	1	●	N/A
ORGANIZATIONAL EXCELLENCE				
Employee Attitude Survey (cumulative percent increase)	1.50%	2.00%	●	3.00%
Cost Control (number of activities per organization)	1	1	●	At least 1
Critical Acquisition Budget	80.00%	97.00%	●	85.00%
Critical Acquisition Schedule	80.00%	92.00%	●	85.00%
Information Security	0	0	●	0
Customer Satisfaction	64	66	●	65
Performance Plans	85.00%	94.29%	●	N/A
Cost-Reimbursable Contracts	85.00%	170.00%	●	85.00%





FAA FY 2005 PERFORMANCE AT A GLANCE				
Performance Measure	FY 2005 Target	FY 2005 Results	FY 2005 Status	FY 2006 Target
Mission Critical Positions	6.00%	35.00%	●	10.00%
<i>Flight Plan</i> Targets ⁶	90.00%	90.00% (28/31)	●	N/A
<p style="text-align: center;">● Green: Goal Achieved ⊙ Red: Goal Not Achieved</p> <p>Notes: N/A: Goal discontinued for FY 2006. 1) Preliminary estimate. Final data will be available in May 2007. 2) Preliminary estimate. Final data will be available by January 2006. 3) Target for FY 2006 has been changed from a number to a rate. 4) Measure was changed during FY 2005. South Central Florida replaced Boston as one of the eight metropolitan areas where arrival capacity is measured. 5) Preliminary estimate. Final data will be available in May 2006. 6) This target is not included when calculating the percentage of targets achieved.</p>				

VERIFICATION & VALIDATION OF PERFORMANCE INFORMATION

We employ strong management controls to ensure that data used to assess performance are accurate, timely, and complete. By exercising both internal and external reviews, our verification and validation process strongly supports the confidence that the managers and the Administrator have in their performance data.

We use several internal review processes to ensure accurate data. First, at the start of each year we review every performance target for data source and validity. Where the criteria for targets have changed, we note and explain the changes in performance-related materials. DOT also independently verifies performance data. Several performance measures, such as the Commercial Air Carrier Fatal Accident Rate, require independent verification by the National Transportation Safety Board (NTSB) and the Bureau of Transportation Statistics. Data for this measure are not considered final until NTSB gives its approval.

Independent program evaluations are also an important part of the verification and validation process. Program evaluations can be completed by independent outside research organizations such as MITRE (www.mitre.org/about/index.html).

The Office of the Inspector General (OIG), the Government Accountability Office (GAO), and the Office of Management and Budget (OMB) also regularly review FAA programs and activities. These reviews help maintain the public's trust, as well as provide opportunities for improvement. We work with each organization to address concerns and improve the way business is conducted. For example, we have focused more closely this year on tying budget to performance, as well as cascading performance measures from the Agency to the lines of business and staff offices. This is a direct result of using OMB's Program Assessment Rating Tool (PART).

Further explanations of OIG and GAO concerns can be found in the *Management Challenges* section of this report.

PRESIDENT'S MANAGEMENT AGENDA

The President's Management Agenda (PMA) is a set of initiatives designed to make the Federal Government more citizen centered, results oriented, and market based. To do this, agencies are asked to set targets and measure performance as a way to hold them accountable for results. The Organizational Excellence targets in the *Flight Plan* support DOT's goal to achieve "green" on the PMA. Following is a summary of the PMA initiatives.





<p align="center">FY 2005 PRESIDENT'S MANAGEMENT AGENDA SCORECARD FOR THE DEPARTMENT OF TRANSPORTATION</p>		
Initiative	Status	Progress
Strategic Management of Human Capital: Design a strategy to address workforce gaps, eliminate skill gaps, develop performance-based incentives, ensure citizen-centered organizations, and ensure a robust leadership pipeline.	●	●
Competitive Sourcing: Develop a competitive sourcing plan for activities designated commercial in nature, with the goal of providing higher quality, more cost-effective services to the public.	●	●
Improved Financial Performance: Implement financial management systems capable of producing more timely and accurate information for decision-making, and maintain unqualified opinions on financial statements.	◎	●
Expanded Electronic Government: Better justify and track IT projects, and participate in Government-wide initiatives to automate transactions, reduce redundancies and increase efficiencies.	●	●
Budget and Performance Integration: Develop budgets aligned with outcome goals, and present resource requests in the context of past results. Estimate the full costs of programs, and document program effectiveness.	●	●
Real Property Asset Management: Complete and maintain an inventory of Agency real property, and develop an asset management plan with deadlines for optimizing costs.	◎	●
Eliminating Improper Payments: Reduce improper payments through identification of at-risk programs and establishment of a plan for corrective action. Set recovery targets and, where appropriate, work to meet them.	◎	●
Research and Development Investment Criteria: Promote coordination of R&D management to ensure accountability, improve program quality, and align decisions and budget proposals with R&D investment criteria.	●	●
<p>Key "Status" indicates DOT's success in fulfilling the initiative. "Progress" indicates the rate at which DOT is moving toward success. ● Green: OMB's core criteria met. ◆ Yellow: Some but not all of OMB's core criteria met; no "red" conditions. ◎ Red: At least one of OMB's core criteria has not been met. For a more detailed description of the President's Management Agenda, see the OMB website at www.whitehouse.gov/omb/budintegration/pma_index.html.</p>		

FAA ACCOMPLISHMENTS

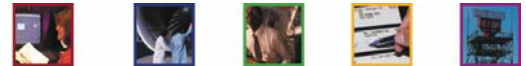
Strategic Management of Human Capital

In FY 2005, we strategically aligned workforce planning and analysis with the *Flight Plan* and Business Plans, restructured and centralized functions and organizations to standardize and improve business processes, and initiated efforts to close position and skill gaps in mission critical occupations. FAA also committed to build stronger leadership and to build a stronger Labor Relations Program, and worked to contain costs through improved management of workers' compensation, official time, and sick leave usage.

Competitive Sourcing

In FY 2005, FAA conducted the largest A-76 outsourcing competition at a nondefense agency in the Federal Government. The resulting contract with Lockheed Martin to provide automated flight services will result in reduced operating costs, modernized services, and continued high quality service that is more cost-effective. This competitive sourcing initiative is expected to produce \$2.2 billion in savings from 2003 through 2015.





Improved Financial Performance

In January 2005, GAO removed FAA from its high risk list for financial management, citing improvements in cost accounting and tracking systems. During the year, we began the process of consolidating our accounting operations and continued the implementation of an effective cost savings program. FAA received a fifth consecutive clean audit for FY 2005.

Expanded Electronic Government

FAA forwarded its portfolio of 28 FY 2007 IT business cases (Exhibit 300s) to OMB. We expect that all IT business cases will receive favorable scores by OMB. FAA participated in Government-wide e-government initiatives for Grants, Training, Personnel and Payroll, and the Business Gateway. The FAA Enterprise Architecture (EA) complies with all Federal Enterprise Architecture (FEA) guidance, and the Agency has completed security reviews on 100% of its information systems.

Budget and Performance Integration

The FY 2007 budget request, submitted to OMB in September 2005, was FAA's third performance-based budget. In presenting the marginal cost of performance for six requests in three goal areas totaling nearly \$47 million, the Agency went beyond DOT's requirement for only one goal. DOT commended this effort in its response to the budget request.

Real Property Asset Management

In FY 2005, FAA began centralizing and consolidating responsibilities for real property management. To assist DOT in reaching "green" on this initiative, FAA has taken the lead, since we have 99% of the real property assets within DOT. We will continue to enhance the Real Estate Management System (REMS) for tracking and managing all departmental real property assets.

Eliminating Improper Payments

We have historically had very low percentages of improper payments and continue to support the DOT in reducing the risks of such payments. FAA will continue to enhance and improve business processes that strengthen the internal controls on our payment process and result in even lower percentages.

Research and Development Investment Criteria

DOT was the first department to achieve green status on this initiative. FAA contributed to this success through its efforts to align its R,E&D programs with its strategic plan, as outlined in the *National Aviation Research Plan* (NARP). This plan supports DOT's department-wide *Research, Development, and Technology Plan* and is governed by the same investment criteria. FAA also incorporated these criteria into its FY 2007 budget request.

FY 2005 MANAGEMENT CHALLENGES

Last year the OIG identified a number of challenges facing FAA.

ENSURING AVIATION SAFETY IN A CHANGING AVIATION ENVIRONMENT

The U.S. aviation industry continues to be the safest in the world, with only two commercial fatal accidents occurring in FY 2005. However, FAA must adjust its safety oversight to emerging trends in the aviation industry and changing economic conditions. While air carriers have turned increasingly to outside, contracted repair stations, FAA continues to focus its inspection resources on air carriers' in-house maintenance work. The OIG recommended that FAA strengthen its procedures for oversight of foreign aviation authorities conducting inspections on its behalf. FAA has made considerable progress in reducing runway incursions (potential collisions on the ground); however, operational errors (when air traffic controllers allow planes to come too close together in the air) continue to increase. Corrective actions are imperative to address this ongoing safety problem.





FAA Actions

Adjust safety oversight to address increased maintenance outsourcing.

To address challenges at air carrier repair stations, FAA formed a Risk Assessment work group, which is developing a repair station prototype program. This program will bring together a team representing all areas of expertise to oversee aviation certificate holders of large repair stations or companies that own multiple repair stations and satellite repair stations.

The work group is developing guidance materials for inspectors and information databases to improve FAA oversight of repair stations. The work group has also developed a comprehensive surveillance program that requires repair stations to use elements of a system-safety approach, such as risk assessment and risk management tools. We have revised our guidance and anticipate training for the inspector workforce to begin in November 2005.

Additionally, we are revising our *Flight Standards Handbook Bulletin for Airworthiness* (14 CFR Part 43.17) to incorporate the pending Bilateral Aviation Safety Agreement with associated Maintenance Implementation Procedures (BASA/MIP) with Canada to ensure the standardization of maintenance on U.S. aircraft repaired in Canada. There are no FAA certificated repair stations in Canada. In lieu of FAA repair stations, the *Handbook* states that the United States accepts the work and return to service of U.S. registered aircraft and components that are located in Canada by a properly certificated Transport Canada Civil Aviation entity.

Finally, we are negotiating a BASA/MIP with the European Union that will be used to continuously verify European member states conducting surveillance/certification activities on behalf of the FAA to place adequate emphasis on the FAA regulations. We hope to finish negotiations and implement the agreement by FY 2008.

Reduce operational errors and runway incursions as traffic rebounds.

Reducing operational errors and runway incursions as traffic continues to increase is a shared responsibility among pilots, air traffic controllers, and vehicle drivers. To address this challenge, FAA focused on outreach, awareness, improved procedures and infrastructure, and technology.

Progress was made in reducing the severity, number and rate of pilot deviations—the most common type of runway incursion. To enhance pilot situational awareness, we released a new pilot guide and DVD that highlighted communication procedures for safe surface operations. In collaboration with industry, we also created an online course that educates general aviation pilots on runway safety.

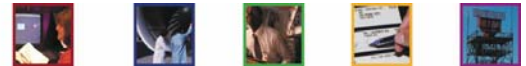
To enhance air traffic supervisor and controller discussion of serious events during team briefings, FAA developed a safety awareness campaign designed to help controllers visualize an event that actually happened and aid the development of strategies based on intuitive and experiential expertise for use in similar situations. Additionally, we have developed an operational error database to support identification of trends from which error reduction initiatives will be developed.

Improve operational error reporting from tower and TRACON facilities.

In July 2005, FAA issued a general notice (GENOT) instructing all air traffic control facilities to establish a facility audit process by September 1, 2005. This audit process allows for random reviews of air traffic services using playback tools to identify operational errors and operational deviations, and provides greater assurance that operational errors and operational deviations are being reported.

In addition to the facility audit process conducted each month, FAA identified select facilities—based on trends, analysis, intelligence, complaints, and statistics—and required them to review data. We reviewed the same data from these select facilities and addressed the issue by training or decertifying controllers, as appropriate. Our findings and supporting data are retained at the headquarters level for 2.5 years.





AVIATION CAPACITY AND MITIGATING DELAYS

After a few years of relative reprieve from aviation congestion, traffic and delays are once again returning. FAA's challenge is determining how and where traffic is likely to grow over the next decade and planning for adequate investment in facilities, technology, and operational improvements to address both long-range and short-term needs.

FAA Actions

Determine how and where traffic is likely to grow over the next decade

In FY 2004, FAA completed a study analyzing system capacity, taking into account the socioeconomic and demographic trends expected to occur in the United States through 2020. This study expanded the focus of the 35 major airports and evaluated nearly 300 commercial service airports nationwide. The study identified the airports that need additional capacity and the constraints to enhancing capacity. In FY 2005, we began a second phase of this study that will take a more detailed look at the airports outside major metropolitan areas and will begin to identify possible solutions to increase long-term capacity.

New runways and airspace redesign initiatives

FAA is increasing short-term capacity by working with airports and local communities to build new runways. While no new runways opened in FY 2005, eight runways are under construction—with four opening in FY 2006—providing the airports with the potential to accommodate an additional 665,000 annual operations. Two additional projects, a runway extension and a runway/taxiway relocation, are expected to begin construction in 2006. There are an additional nine projects, including three new airports, in the planning or environmental assessment stage that could provide significant capacity benefits through 2015.

Improving the efficiency of existing airport capacity by redesigning airspace is critical for taking full advantage of new runways and enhancing the flow of air travel around existing runways and airports.

The New York/New Jersey/Philadelphia Airspace Redesign project is on schedule to publish a draft Environmental Impact Statement in fall 2005. This is a critical step in moving to a final decision, after which airspace redesign may begin.

Chicago's O'Hare airport is one of the busiest in the Nation. Capacity problems at this airport can quickly cascade throughout the NAS. To address this critical hub in the aviation system, FAA is engaged in two separate, but related activities: the Chicago O'Hare Modernization Project and the Midwest Airspace Enhancement project. These projects will add and modify sectors and routes to increase traffic flow efficiencies in the Midwest by 2007.

Along the West Coast, a series of advanced navigation routes was implemented in 2005 to reduce the miles flown between Seattle and San Francisco or Los Angeles. The routes utilize the navigational capabilities of advanced avionics aboard the aircraft, permitting operations along the shortest path between the airports rather than flying over ground-based navigation aids.

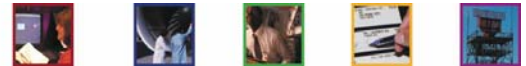
Potential market-based initiatives to more efficiently allocate existing capacity

FAA has conducted detailed simulation exercises in the past year to examine the effects of market-based alternatives like congestion pricing and slot auctions (of arrivals and departures) on airlines and airport operations. These simulations have provided stakeholders an opportunity to comment on these potential tools for managing congestion. We are committed to continue working toward a market-based solution for congested airports and are investigating these options for potential use at New York's LaGuardia Airport.

REDUCING FRAUD

The OIG recommended that FAA increase progress in strengthening the oversight of Disadvantaged Business Enterprise (DBE) programs to include site visits, DBE and prime contractor interviews, application/certification file reviews, and work site surveillance.





FAA Actions

FAA took a number of actions in FY 2005 to strengthen our oversight of the DBE program, including

- ▶ **Conducting on-site compliance reviews.** FAA staff conducted limited reviews of basic DBE compliance activities at airports. We are working with the Federal Highway Administration and the Federal Transit Administration to develop a standard methodology for conducting DBE self-assessments and compliance reviews. FAA also retained a contractor to conduct in-depth compliance reviews of airports identified via oversight and technical support mechanisms. We are in the planning stage and are coordinating with the OIG to determine which airports will be reviewed.
- ▶ **Computerizing DBE reporting.** We developed a web-based system for airports to report their DBE accomplishments. In addition to ensuring greater accuracy, the system will allow us to create specialized reports and trend analysis after the FY 2005 data are input beginning in December 2005. There are already over 300 airports have created user accounts for this system.
- ▶ **Revising regulations.** FAA issued a revised regulation for airport concession DBEs. We have developed guidance materials and conducted a number of training sessions on the revised regulation. This regulation contains items to assist in the prevention of DBE fraud, such as a personal net worth cap, required eligibility reviews, and increased emphasis on monitoring and compliance by airports.

DELIVERING AIR TRAFFIC CONTROL SERVICES & FIELDING NEW EQUIPMENT WHILE CONTROLLING COSTS

As FAA increasingly turns to the U.S. Treasury's General Fund to make up for revenue shortfalls in the Airport and Airway Trust Fund, the Agency will be competing with other critical Federal programs for funds during a period of fixed budgets.

Compounding the budget challenges it faces, FAA estimates that nearly half the controller workforce will leave the Agency between FY 2005 and FY 2012. To hire and train that many controllers within a severely constrained operating budget, FAA must identify ways to make every stage of its process for hiring, placing and training new controllers more efficient and cost effective.

FAA also faces significant challenges with respect to its major acquisition programs. We will need to control existing projects, determine priorities, and improve the overall management of major acquisitions in a constrained budget environment.

FAA Actions

In June 2005, a FAA/DOT team delivered the initial draft of a report on alternative financing options. This report will continue to be updated into FY 2006 to reflect the final recommendations from FAA and DOT officials and provide the basis for reauthorization legislation.

On December 21, 2004, we announced our Air Traffic Controller Staffing Plan. Over the next 10 years, FAA will hire and train 12,500 controllers to cover projected total retirement and nonretirement controller losses. The Plan is currently being updated, with the second version to be released in December 2005.

We are making significant strides in improving our capital investment acquisition and procurement oversight:

- ▶ At the end of FY 2005, there were 105 certified program managers for projects greater than \$50 million.
- ▶ Large and complex investments are segmented into phases to improve oversight and control.
- ▶ In developing the capital budget, the Agency prioritized programs and allocated resources using criteria such as strategic relevance, cost reduction and productivity increase, and benefits and risk.

The newly formed Capital Investment Team, which provides an independent and objective review of costs and benefits of investments, reviewed 79 programs, recommending restructuring of 15 and termination of 3.





FINANCIAL MANAGEMENT

FAA had pledged to have a fully operational cost accounting system and labor distribution system in place by the end of FY 2005. We, however, faced several challenges in reaching that goal. We had to revamp the system to account for recent significant organizational changes; get quarterly data processing back on track to resume reporting to business units; integrate labor distribution information into the core financial system; and stabilize interfaces between the core accounting system and the cost accounting system. These tasks pushed planned improvements into FY 2006.

FAA Actions

In January 2006, FAA will complete the revamping of its CAS to account for a recent significant organizational change. The system will replace labor assignment business rules with actual labor costs from the labor distribution system. This improvement will provide more accurate labor costs using actual maintenance time spent on NAS equipment, instead of current allocation rules based on staffing standards.

FAA plans to implement cost accounting for ARP and AVS by June 2006. This will complete the implementation of cost accounting and enable all FAA lines of business and staff offices to employ financial and performance measures to achieve performance efficiencies and cost savings.

SECURE AND COST EFFECTIVE IT INVESTMENT

DOT is responsible for one of the largest IT investment portfolios among civilian agencies. Over 80% of these investments are in the air traffic control system modernization projects, many of which have experienced significant cost overruns and delays. During FY 2005, FAA made strides in increasing departmental oversight of major IT investments, but these efforts are in an early stage of implementation and still present challenges.

During FY 2005, FAA also made a concerted effort to correct weaknesses in computer security. Continued improvements are needed, especially in the area of enhancing security of air traffic control systems.

FAA Actions

FAA has made significant progress in FY 2005 in addressing computer security weaknesses. In addition to required annual security reviews of information systems, we completed onsite security reviews of information systems at all Air Route Traffic Control Centers (ARTCCs) to assess the validity of the systems security certification and authorization process. Certification refers to the comprehensive evaluation of the technical and nontechnical security features of an information system. The evaluation establishes the extent to which a particular design and implementation meet a set of specified security requirements and that risk has been mitigated commensurate with magnitude of harm. Authorization refers to a formal declaration by the designated official who has fiscal and operational responsibility that an information system is approved to operate in a particular security mode using a prescribed set of countermeasures. This is the official management authorization for operation, and it is based on information provided in the Security Certification and Authorization Package (SCAP) as well as other management considerations. The authorization statement affixes security responsibility with the designated official and shows that due care has been taken for security. Similar reviews will occur for systems that are used in air traffic control terminals in FY 2006.

We completed a plan, including a set of alternatives, for restoring essential air service in the event of a prolonged disruption at an en-route facility. FAA senior management followed the planning activity with a "Tabletop Exercise" bringing together the necessary disciplines to address a specific scenario. The exercise resulted in recommendations for FAA action to be addressed in FY 2006.

We are currently planning for implementation of smart card technology for granting FAA personnel access to facilities and information systems, to meet the requirements of Homeland Security Presidential Directive-12 (HSPD-12). In concert with DOT, FAA developed initial requirements, a concept of operations, and an implementation plan for FAA logical access using the DOT Common Identification Standard mandated by HSPD-12. FAA also developed pilot project concepts for logical access to information systems to strengthen user authentication.





FY 2006 MANAGEMENT CHALLENGES

The OIG memorandum finalizing the most serious management challenges facing DOT in FY 2006 will be provided in the near future. Until its release, the OIG has tentatively identified five challenges for FAA:

- ▶ Aviation safety—developing effective oversight programs for air carrier operations, repair station maintenance, and operational errors
 - Follow through on its commitments to advance risk-based systems for air carrier operations and work performed by external repair facilities.
 - Continue efforts to identify and reduce operational errors.
- ▶ Mitigating flight delays and relieving congestion
 - Take appropriate action against growing aviation delays.
 - Keep planned infrastructure and airspace redesign projects on schedule while effectively implementing short-term initiatives to relieve congestion and delays
 - Explore alternatives for managing capacity where new initiatives are not feasible.
- ▶ Reauthorizing aviation programs—establishing requirements and controlling cost
 - Control costs with major acquisitions by delivering new systems that work, are on time, and are within budget by making long-overdue decisions on the scope of billion-dollar projects that have been delayed for years.
 - Gain control of support service contracts, reduce associated costs, and follow through on the implementation of new procedures.
 - Establish requirements for the next generation air traffic management system.
 - Address the expected surge in controller attrition and negotiating an affordable and equitable bargaining agreement.
 - Complete implementation of a cost accounting system to reduce costs and improve operations.
- ▶ Improving IT investment and computer security
 - Better secure operational air traffic control systems.
 - Eliminate redundant IT infrastructure to reduce operating costs.
- ▶ Working with other agencies to respond to disasters and address transportation security
 - Ensure that missions are performed in a well-coordinated and cost-effective manner to protect reconstruction funding from fraud, waste, and abuse.
 - Address security issues within the U.S. transportation system and protect users from criminal and terrorist acts.

DOT MANAGEMENT CHALLENGES

There were several DOT challenges identified by the OIG in which the FAA had a role in addressing. A detailed discussion of this second group of challenges appears in DOT's *FY 2005 Performance and Accountability Report* at www.dot.gov/perfacc2005.

MANAGEMENT INTEGRITY: CONTROLS AND COMPLIANCE

FAA program managers in the lines of business and staff offices assess the vulnerability of their program and activity management controls annually. These assessments are conducted to determine their compliance with sections 2 and 4 of FMFIA. The head of the line of business or staff office then identifies in writing to the Administrator any potentially material internal control weakness or system nonconformance. Those deemed material are consolidated in a memorandum with a Statement of Assurance signed by the Administrator and sent to the Secretary of DOT. Our response becomes a part of the DOT Statement of Assurance sent to the





President. To help resolve material weaknesses or nonconformances, we develop a plan with specific milestones and deadlines. The plan and the status of each action are reviewed monthly, with results reported to DOT's Office of the Secretary.

As reported by the Administrator to the Secretary in a memorandum dated November 8, 2005, we identified one internal control material weakness in the area of timely processing of transactions and reconciliation of accounts. We have developed a plan to address this weakness, which will be implemented in phases during FY 2006.

Since January 1999, FAA has been on GAO's high risk list due to concerns about financial management. GAO identified three areas of concern: (1) the lack of a system to account for property, plant, and equipment, (2) the need to make hundreds of adjustments to produce audit-quality financial information for financial reporting, and (3) the fact that the cost accounting system was not fully implemented and management was not using data to make business decisions. Progress on the implementation of our cost accounting system and the implementation of DELPHI, with its integrated property system, resulted in the FAA being removed from GAO's high risk list.

Our Information Security Program, as part of the overarching DOT program, did not report any significant deficiencies in the 2005 Federal Information Security Management Act Annual Report.

GRANTS MANAGEMENT POLICIES AND PRACTICES

Decisions on distributing AIP funds are centralized at FAA headquarters, with significant input from regional offices. While most of the day-to-day decisions for AIP project formulation are delegated to regional offices, FAA headquarters develops the policy to ensure that grants are implemented and that grantees are treated consistently. Policies for administering the program are included in an AIP Handbook, which is regularly updated through Policy Guidance Letters issued to grant recipients. FAA also ensures the consistent implementation of AIP by participating in airport industry trade conferences and training, posting statutory and policy changes on our public website, and requiring employees to attend annual training that focuses on improving business processes and updating personnel on policy changes.

We meet regularly with eligible airport sponsors to identify planning and development needs. Through this process, the Airport Capital Improvement Plan, a 3-year plan that identifies the planning and development needs for airports nationwide, is developed and eligible projects are prioritized. Only projects identified in this plan are awarded grants. Airport sponsors can apply to the FAA regional or district office for a grant. We continued coordination with Grants.gov to develop an electronic grant application process. Typically, large grants are coordinated with other Federal, State, and local government agencies, such as the Environmental Protection Agency, the Department of Defense, and State aviation agencies.

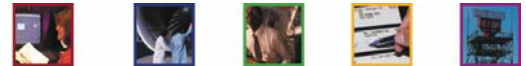
AIP administration, including the requirements for sponsor and project eligibility, is based on multiyear authorizing legislation. In FY 2003, we recommended statutory changes to AIP's authorizing legislation that were approved for FY 2005. Revisions included changes to funding levels for airports and projects, changes to the formula for determining funding levels, and revisions to the grant process to address environmental and construction issues and to give smaller airports more flexibility in qualifying for certain types of grants. This current authorizing legislation expires on September 30, 2007. Discussions have been initiated to consider various alternatives for successor legislation.

FINANCIAL HIGHLIGHTS

FINANCIAL MANAGEMENT PLANS

For the fifth consecutive year, we achieved an unqualified (clean) opinion from our auditors on our financial statements. However, this year we received a material weakness in the area of timely processing of transactions and reconciliation of accounts. While the clean opinion means that our financial statements are presented "fairly, in all material respects," at year-end, the material weakness highlights the fact that these





statements could not have been prepared timely, in a routine fashion, at interim points throughout the year. We have developed a plan to address this internal control weakness, which will be implemented in phases during FY 2006.

While we are not required to prepare a performance and accountability report, we have elected to do so. For the second year, we were awarded the Certificate for Excellence in Accountability Reporting (CEAR) for our FY 2004 *Performance and Accountability Report*. Our primary goal remains to provide the best possible internal and external financial reporting supported by the clean audit opinion.

Further steps were taken to replace our legacy systems and incorporate them with our integrated financial management system. With the maturation of business processes associated with our new primary financial management system, our financial reporting has improved significantly. These improvements included the interface of critical cost accounting labor information, incorporation of lease information, and improved visibility of assets information. We continue to work toward implementing a comprehensive grants management/payment system and instituting E-Travel, a paperless travel reservation and reimbursement system.

Two new financial organizations were established to focus on policy and internal controls, the Financial Policy Division and Internal Controls Division. The latter organization has been very involved in implementing the new OMB requirements for strengthening internal controls over financial reporting.

Additionally, the newly formed Financial Controls Office has focused efforts in cost control and efficiencies. See the section on Efficiency and Cost-Effectiveness on page 6.

IMPROPER PAYMENTS INFORMATION ACT OF 2002

This year, DOT engaged a contractor to work with each Operating Administration, including FAA, to conduct a review of payments for the largest DOT programs. FAA's Operations, Facilities and Equipment (F&E), and AIP were included in this review. Their results supported our past record of having improper payments well below reportable thresholds. In addition, for the past 3 years, DOT has contracted with another company to recover improper payments, which for FAA have been nominal. Details of the review are included in the *Appendix*.

DISCUSSION AND ANALYSIS OF THE FINANCIAL STATEMENTS

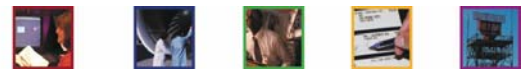
FAA prepares annual financial statements in conformity with accounting principles generally accepted in the United States. The financial statements are subject to an independent audit to ensure that they are free from material misstatement and that they can be used to assess FAA performance.

FY 2005 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 No. 01-02, *Audit Requirements for Federal Financial Statements*, dated October 16, 2002. DOT's OIG is statutorily responsible for the manner in which the audit of FAA's financial statements is conducted. The OIG selected KPMG LLP, an independent certified public accounting firm, to audit FAA's FY 2005 financial statements. This firm also audited FAA's FY 2002-FY 2004 financial statements.

In 2002, DOT's OIG and Chief Financial Officer, along with FAA's Chief Financial Officer, established an Audit Advisory Committee to promote and encourage open communication among the OIG, FAA management, and the independent auditors to resolve issues that arise during 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; FAA's Assistant Administrator for Regions and Center Operations; and ATO's Chief Operating Officer. Last





year, committee participation was expanded to include representatives from the Chief Counsel's Office, the Assistant Administrator for Human Resources Management, Information Services, and Airports.

KPMG LLP rendered an unqualified (clean) audit opinion on FAA's FY 2005 financial statements. This means that FAA's financial statements as of, and for the year ended, September 30, 2005, were presented fairly in all material respects in conformity with accounting principles generally accepted in the United States. KPMG identified one material weakness, three reportable conditions, and three instances of noncompliance with the Federal Financial Management Improvement Act and the Anti-Deficiency Act.

Understanding the Financial Statements

FAA's Consolidated Balance Sheets, Statements of Net Cost, Changes in Net Position and Financing, and Combined Statements of Budgetary Resources have been prepared to report the financial position and results of operations of FAA, pursuant to the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The following section provides a brief description of (a) the nature of each financial statement and its relevance to FAA, (b) significant fluctuations from FY 2004 to FY 2005, and (c) certain significant balances where necessary to help clarify their link to FAA operations.

Balance Sheet

The Balance Sheet presents the amounts available for use by the FAA (assets) against the amounts owed (liabilities) and amounts that comprise the difference (net position).

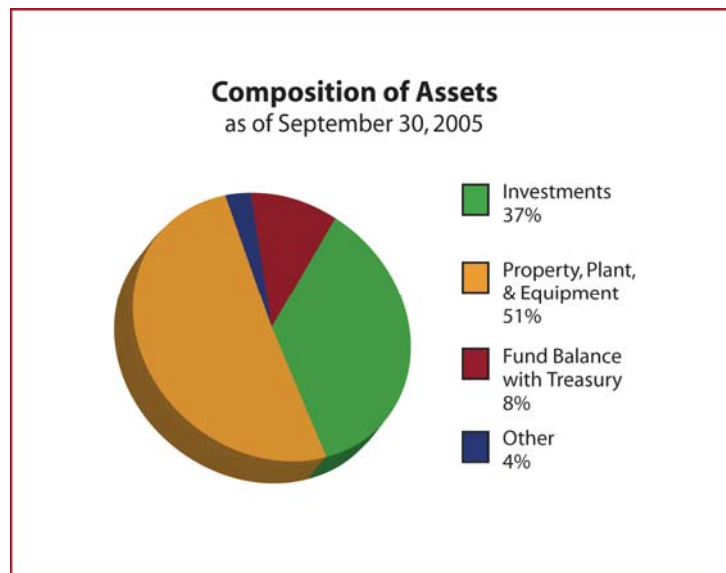
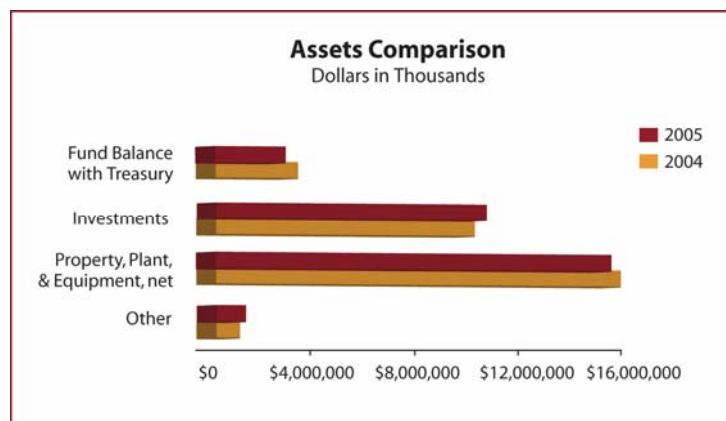
Assets

Total assets were \$28.6 billion at the end of FY 2005. FAA's assets are the resources available to pay liabilities or satisfy future service needs. The *Composition of Assets* chart depicts major categories of assets as a percentage of total assets.

The *Assets Comparison* chart presents comparisons of major asset balances as of September 30, 2004 and 2005.

Fund balance with Treasury represents 8% of FAA's current year assets and consists of funding available through Department of Treasury accounts from which FAA is authorized to make expenditures to pay liabilities. It also includes passenger ticket and other excise taxes deposited to the Airport and Airway Trust Fund (AATF), but not yet invested. Fund balance with Treasury decreased \$427.6 million, primarily because FAA left more funds invested in the AATF at year-end than in the prior year.

At \$10.7 billion, *Investments* represent 37% of FAA's current year assets and are principally derived from passenger ticket and other excise taxes deposited to the AATF. These amounts are used to finance FAA's operations to the extent authorized by Congress. Investments increased \$347.5 million due to an increase in tax revenues deposited into the AATF in FY 2005.

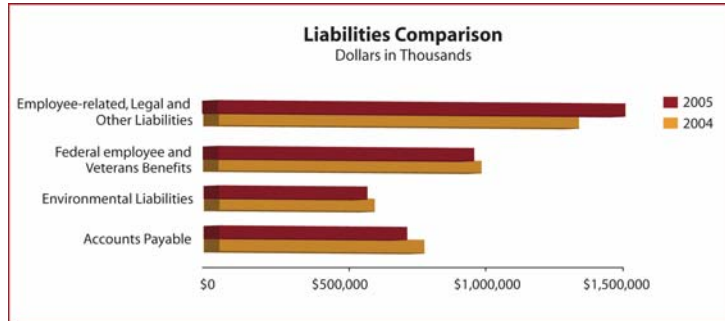




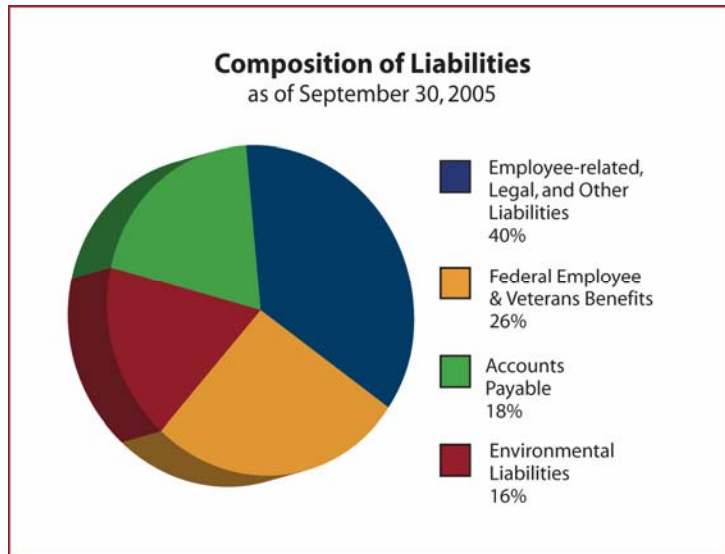
At \$14.4 billion, *Property, plant, and equipment, net* (PP&E) represents 51% of FAA's assets as of September 30, 2005, and consists primarily of construction projects related to the development of NAS assets, and capitalized real and personal property. There was a negligible decrease in the total composition of PP&E as purchases of equipment and additions to construction-in-progress through the normal course of business were offset by retirements and depreciation expense during FY 2005.

Liabilities

At the end of FY 2005, FAA reported liabilities of \$3.7 billion. Liabilities are probable and measurable future outflows of resources arising from past transactions or events. The *Composition of Liabilities* chart depicts FAA's major categories of liabilities as a percentage of total liabilities.



The *Liabilities Comparison* chart presents comparisons of major liability balances between FY 2004 and FY 2005. A discussion of the significant fluctuations between the two years follows.



At \$1.5 billion, *Employee related, legal, and other liabilities* represent 40% of FAA's total liabilities. These liabilities increased \$211.0 million from FY 2004 to FY 2005, partly as a result of accrued unfunded liabilities related to Hurricane Katrina relief efforts. Also, accrued payroll, benefits, and annual leave increased because there was a greater number of unpaid days of payroll at the end of FY 2005 and employee leave balances grew.

At \$942.3 million, *Federal employee and veterans benefits* represent 26% of FAA's current year liabilities and consist of expected liability for death, disability, and medical costs for approved workers compensation cases, plus a component for incurred but not reported claims. The Department of Labor (DOL) calculates the liability for DOT, and DOT attributes a proportionate amount to FAA based on actual workers' compensation payments to FAA employees over the preceding 4 years.

Environmental liabilities represent 16% of FAA's total liabilities and were relatively stable at \$596.5 million as of September 30, 2005, and \$606.3 million a year earlier. Environmental liabilities include a component for remediation of known contaminated sites, and the estimated environmental cost to decommission assets presently in service.

FAA's *Accounts payable* represent 18% of liabilities and were relatively constant from FY 2004 to FY 2005. Accounts payable are amounts FAA owes to other entities for unpaid goods and services and estimated amounts incurred but not yet claimed by Airport Improvement Program grant recipients.

Statement of Net Cost

The Statement of Net Cost presents the annual cost of operating FAA programs. The gross cost less any offsetting revenue for each FAA program is used to arrive at the net cost of specific program operations. FAA has used its cost accounting system to prepare the Statement of Net Cost since FY 1999.



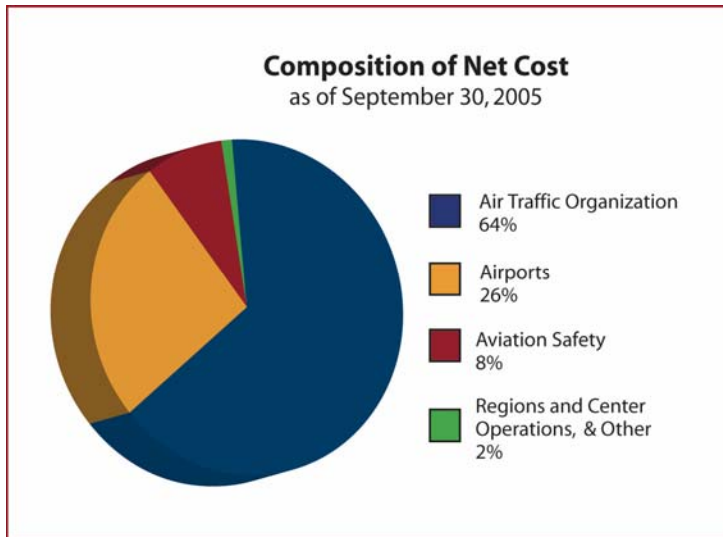
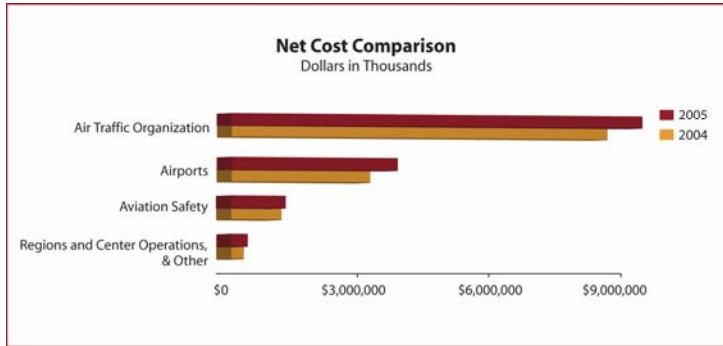
In FY 2005, FAA's net costs were \$14.0 billion, compared to \$12.2 billion in FY 2004. The *Composition of Net Costs* chart illustrates the distribution of costs among FAA's lines of business.

The *Net Cost Comparison* chart compares FY 2004 and FY 2005 net costs.

With a net cost of \$8.9 billion, the *Air Traffic Organization* is FAA's largest line of business, comprising 64% of total net costs. Air Traffic Organization's net costs increased in FY 2005 primarily from increased depreciation expense as additional National Airspace System assets moved from construction-in-progress status to in-service; a greater number of assets below the capitalization threshold were charged to expense in FY 2005; and accrued payroll, benefits and leave expenses increased due to increased employee leave balances and a greater number of unpaid days of payroll at the end of FY 2005 than in FY 2004.

The net cost of *Aviation Safety* represents 8% of FAA's total net costs, while *Regions and Center Operations and Other* comprise the remaining 2% of total net costs. The net costs of these components were relatively unchanged from FY 2004 to FY 2005.

With a net cost of \$3.7 billion in FY 2005, 26% of FAA's total net costs, *Airports* is our second largest line of business. Net costs increased \$734.9 million, from \$3.0 billion in FY 2004. 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. Funding levels for Airports programs have continued to increase by \$100 million or more each year since. Airport improvement projects typically take several years to complete, and FAA reports the associated expense as the grant recipient accomplishes the improvement work. Thus, FAA's net *Airports* costs increased in FY 2005 as the project lifecycle associated with these grants continued.



Statement of Changes in Net Position

The *Statement of Changes in Net Position* presents those accounting items that caused the net position section of the balance sheet to change from the beginning to the end of the reporting period. Various financing sources increase net position. These financing sources include appropriations received and non-exchange revenue, such as excise taxes and imputed financing from costs absorbed on FAA's behalf by other Federal agencies. Our net cost of operations and net transfers to other Federal agencies serve to reduce net position.

FAA's cumulative results of operations decreased \$398.4 million because the net cost of operations exceeded net financing sources in FY 2005. Primary financing sources include excise tax revenues, which were \$1.0 billion greater in FY 2005 than in FY 2004. At the same time, however, net cost increases surpassed these additional financing sources. Net cost increases in FY 2005 included Hurricane Katrina relief efforts; grants expenses resulting from the expansion of the Airports program; accrued payroll expenses resulting from a greater number of unpaid days of payroll at the end of FY 2005 and increased employee leave balances; increased depreciation expense as additional NAS assets moved from construction-in-progress

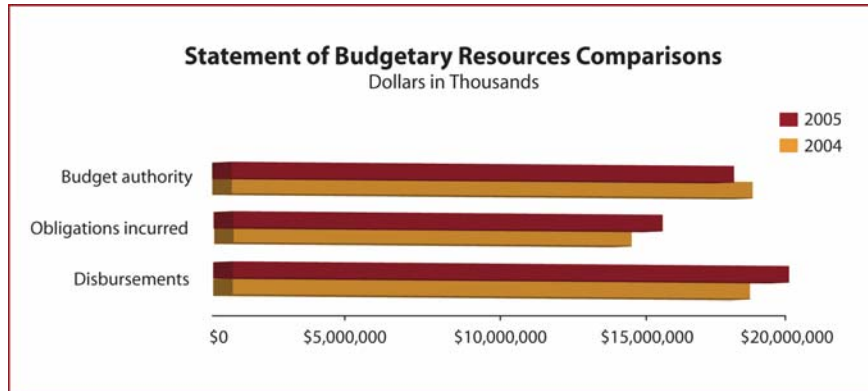


status to in-service; and a greater number of assets below the capitalization threshold charged to expense in FY 2005.

Unexpended appropriations increased \$269.7 million during FY 2005, compared to \$436.6 million during FY 2004. This lesser increase in FY 2005 resulted primarily because we received \$176.0 million less in general fund appropriations in FY 2005 than in FY 2004.

Statement of Budgetary Resources

This statement provides information on the budgetary resources available to FAA for FY 2005 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 Treasury for FAA obligations. The *Statement of Budgetary Resources Comparisons* chart outlines the changes in the major categories of budgetary resources from FY 2004 to FY 2005.



Disbursements increased 9.7%, from \$17.8 billion in FY 2004 to \$19.5 billion in FY 2005. These increased disbursements result from the completion of long-term AIP projects, following from the significant expansion of this program beginning in FY 2001. Operations disbursements also increased as a result of pay and other inflationary increases, as well as the operational costs associated with newly deployed NAS equipment.

Budget authority is the authority provided to FAA by law to enter into obligations that will result in outlays of Federal funds. *Obligations incurred* result from an order placed, contract awarded, service received, or similar transaction that will require payments during the same or a future period. FAA reported total budget authority of \$17.2 billion and incurred obligations of \$15.0 billion in FY 2005. These amounts were relatively constant from FY 2004 to FY 2005.

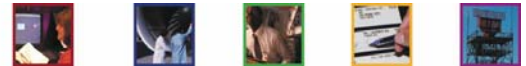
Statement of Financing

This statement reconciles the resources available to FAA to finance operations and the net cost of operating FAA programs. The *change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided* includes the change in undelivered orders and unfilled customer orders. *Resources that finance the acquisition of assets* are additions and reductions to capital and other asset balances during the fiscal year. *Components requiring or generating resources in future periods* discloses the net increase in liabilities that are not covered by current budgetary resources. *Components not requiring or generating resources in future periods* include depreciation, the operating gains or losses recognized upon the disposition of FAA capital assets, and cost of goods sold.

Stewardship Investments

Stewardship investments are substantial investments made by FAA for the benefit of the Nation, but do not result in physical ownership of assets by FAA. When incurred, these amounts are treated as expenses in the Consolidated Statements of Net Cost. FAA's Required Supplementary Stewardship Information (RSSI), beginning on page 109, includes disclosure of stewardship investments over the last five years. These are disclosures of Airport Improvement Program grants by State/territory, and research and development investments.

The distribution of total grants expense by State/territory has been relatively stable over the past 5 years. However, expenses recognized in FY 2004 and FY 2005 increased largely as a result of a significant



increase in grant funding levels in FY 2001. Because these Airport Improvement Program projects are typically long-term, and FAA recognizes the grants expense as the recipient accomplishes the improvement work, the substantial expansion of this program in FY 2001 is resulting in increased expenses in more recent years.

In FY 2005 and FY 2004, FAA's research and development expenses increased as a result of, for example, expanded research in the areas of fire and cabin safety, research supporting a new standard for testing nondestructive pavement (e.g., runways), development of a new human factors analysis tool, and enhancements to Aviation Digital Data Service (ADDS), which provides faster and expanded access to weather information.

LIMITATIONS OF THE FINANCIAL STATEMENTS

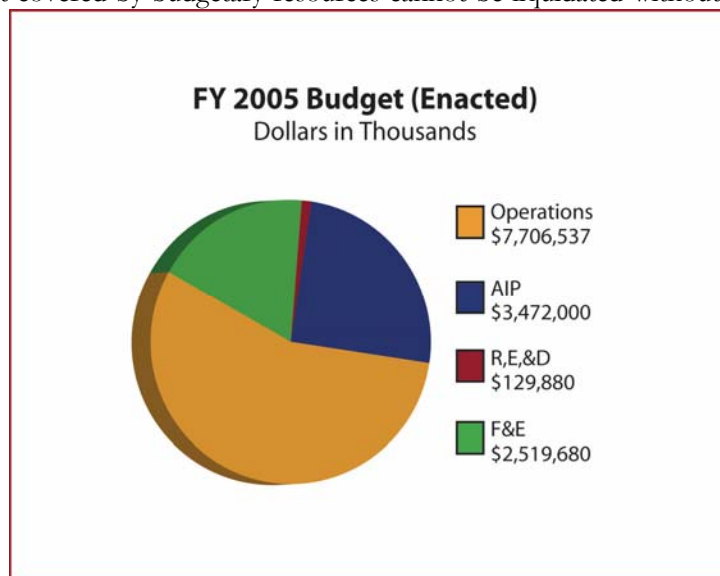
FAA has prepared its financial statements to report its financial position and results of operations, pursuant to the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994.

While the FAA statements have been prepared from its books and records in accordance with the formats prescribed by OMB, 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.

BUDGETARY INTEGRITY: FAA RESOURCES & HOW THEY ARE USED

The Airport and Airway Trust Fund provides approximately 80% of FAA's FY 2005 budget. Created by the Airport and Airway Revenue Act of 1970, the trust fund derives its monies from excise taxes and earned interest. It provides a stable source of revenue to finance investments in the airport and airway system. To the extent funds are available, the fund also 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, and international departures and arrivals, are deposited into the fund. The Department of the Treasury maintains the fund and invests its monies in government securities. Interest earned is deposited into the fund. Monies are withdrawn as needed and transferred into each FAA appropriation to cover obligations.

FAA is financed through annual and multiyear appropriations authorized by Congress. The FY 2005 enacted budget of \$13.8 billion is 1% less than the FY 2004 level.² The Combined Statement of Budgetary Resources reflects funding enacted by the FY 2005 Consolidated Appropriations Act, Public Law 108-447. The FY 2005 levels include an across-the-board rescission of 0.8%.

² This figure excludes hurricane supplemental appropriations enacted in October 2004 of \$5.1 million in F&E and \$25 million in AIP.



FAA has four appropriations. The largest, Operations, is funded by both the Treasury's General Fund and the Airport and Airway Trust Fund. In FY 2005, the Trust Fund provided 63% of the revenue for Operations. The Trust Fund is the sole revenue source for FAA's three capital investment appropriations:

- ▶ Facilities and Equipment (F&E)
- ▶ Research, Engineering and Development (R,E&D)
- ▶ Grants-in-Aid for Airports (AIP)

Operations. The Operations appropriation finances operating costs, maintenance, communications, and logistical support for the air traffic control and air navigation systems. It funds the salaries and costs associated with carrying out FAA's safety inspection and regulatory responsibilities as well. The account also covers administrative and managerial costs for FAA's international, medical, engineering, and development programs, and for policy oversight and overall management functions. The FY 2005 Operations appropriation was \$7.7 billion, a 3% increase over FY 2004 primarily attributable to payroll and inflation costs.

F&E. The programs funded by the F&E appropriation are FAA's principal means of modernizing and improving air traffic control and airway facilities. The account also finances major capital investments required by other Agency programs as well as other improvements to enhance the safety and capacity of the national airspace system. F&E was funded at \$2.5 billion in FY 2005, about 12% less in FY 2004. Major systems included En Route Automation, Terminal Automation, Oceanic Automation, the Wide-Area Augmentation System (WAAS), Airport Surface Detection Equipment, Model X (ASDE-X), Airport Surveillance Radar, and Free Flight Phase 2.

R,E&D. The FY 2005 appropriation for R,E&D was \$130 million, 9% more than in FY 2004. R,E&D funds long-term research programs to improve the air traffic control system. In FY 2005, programs focused on the environment and energy, weather initiatives, JPDO activities, human factors, and aircraft safety.

AIP. The Secretary of Transportation is authorized to award grants for planning and development to maintain a safe and efficient nationwide system of public airports. These grants fund approximately one-third of all capital development at the Nation's public airports. Grants are issued to maintain and enhance airport safety, preserve existing infrastructure, and expand capacity and efficiency throughout the system. The program also supports noise compatibility and planning, the military airport program, reliever airports, and airport program administration. FY 2005 funding for AIP was \$3.5 billion, a 2.7% increase over the FY 2004 level, and for the fourth consecutive year it included approximately \$20 million for the Small Community Air Service program. Besides the Government-wide rescission of 0.8%, the bill rescinded \$265 million in contract authority added to AIP in FY 2004.





PERFORMANCE RESULTS

SAFETY

GOAL: Achieve the lowest possible accident rate and constantly improve safety.

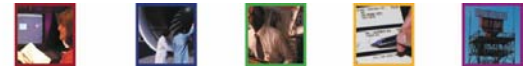
Safety is our primary responsibility. It is central to the public’s interest and the economic health of aviation. Although commercial aviation continues to be one of the safest forms of transportation, the public demands continued improvement in safety. General aviation also plays an important role in both the U.S. transportation system and the economy. We continue to focus our efforts on reducing the incidence of all types of general aviation accidents.

FAA’s *Flight Plan* establishes eight specific objectives and outlines numerous initiatives to maintain the lowest aviation accident rates ever recorded. We recognize that complacency will undermine the gains in this area, and we therefore make continuous improvement in overall safety an essential task.

We assess safety through eight performance measures. The following chart describes our FY 2005 performance in improving safety through the achievement of each of these measures.

FY 2005 SAFETY PERFORMANCE MEASURES AND RESULTS			
Performance Measure	FY 2005 Target	FY 2005 Results	Status
Commercial Air Carrier Fatal Accident Rate: Reduce the commercial air carrier fatal accident rate by 80% from the 1994–1996 baseline to a 3-year rolling average rate of 0.010 per 100,000 departures by FY 2007. Reduce the 3-year rolling average fatal accident rate below 0.010 by FY 2009.	0.023	0.017 ¹	●
General Aviation Fatal Accidents: Reduce the number of general aviation and nonscheduled Part 135 fatal accidents to no more than 319 (from 385, which represents the average number of fatal accidents for the baseline period of 1996–1998) by FY 2009.	343	350 ¹	⊙
General Aviation Alaska Accidents: Reduce accidents in Alaska for general aviation and all Part 135 operations from the 2000–2002 average of 130 accidents per year to no more than 99 accidents per year by FY 2009.	120	128 ¹	⊙
Runway Incursions: Reduce the number of Category A and B (most serious) runway incursions to no more than 27, equivalent to a rate of 0.390 per million operations by FY 2009.	36/0.557	29/0.460 ²	●
Composite Safety Index: Implement a single, comprehensive index that provides a meaningful measure of the safety performance of the U.S. civil aviation system.	Present Index	Index Presented	●
Commercial Space Launch Accidents: No fatalities, serious injuries, or significant property damage to the uninvolved public during licensed space launch and reentry activities.	0	0	●
Operational Errors: Reduce the number of Category A and B (most serious) operational errors to no more than 563, equivalent to a rate of 3.18 per million activities.	637/3.92	680/4.27 ²	⊙
Safety Risk Management: Apply safety risk management to at least 30 significant changes in the National Airspace System by FY 2009.	3	3	●
<p>● Green: Goal Achieved ⊙ Red: Goal Not Achieved</p> <p>1) Preliminary estimate. Final data will be available in May 2007. 2) Preliminary estimate. Final data will be available by January 2006.</p>			

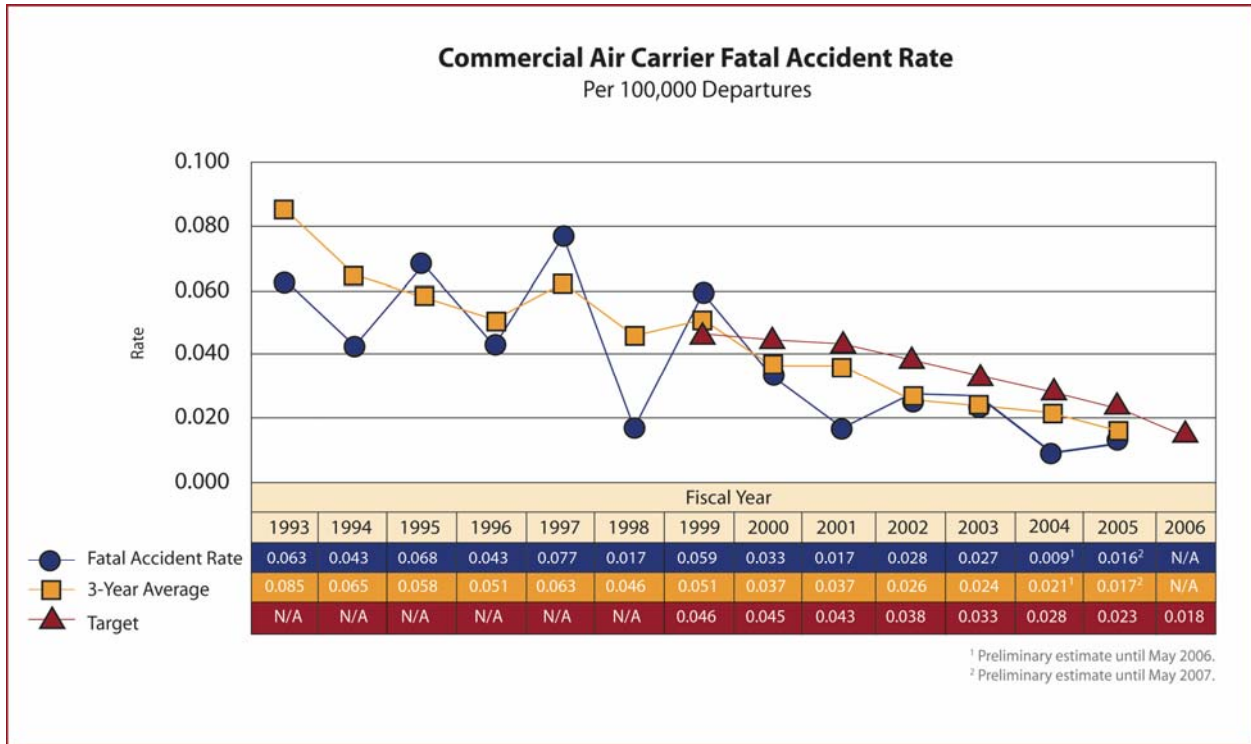




SAFETY RESULTS AND INITIATIVES

COMMERCIAL AIR CARRIER FATAL ACCIDENT RATE³

Commercial aviation is one of the safest forms of transportation. While rare, aviation accidents can have catastrophic consequences, with large loss of life. The public demands a high standard of safety and expects continued improvement.



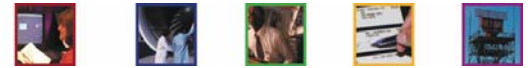
This is one of the safest periods in aviation history. The NAS operates 32,000 scheduled commercial flights daily. FAA is currently exceeding its FY 2005 goal of reducing the commercial air carrier fatal accident rate to a 3-year rolling average rate of 0.023 per 100,000 departures. The actual figure of 0.017 fatal accidents per 100,000 departures translates to about 1 fatal accident per 5.9 million departures. Since the last fatal jet airliner accident involving passengers in November 2001, more than two billion airline passengers have safely reached their destination.

While maintaining its regulatory and enforcement role, FAA continues to partner with the aviation community in improving safety, which is reflected in three basic long-term strategies: (1) prevent accidents by addressing recurrent causes; (2) improve certification and surveillance; and (3) share safety data and information with aviation partners. These strategies are at the heart of most of FAA's significant and long-term safety programs.

FAA also worked in FY 2005 to increase aviation safety by preventing fuel tank explosions. We submitted a Notice of Proposed Rulemaking to require reducing the level of flammable vapors in fuel tanks to the level achieved when fuel tanks are made chemically unreactive—a process called inerting. This rule would apply to current aircraft in service, new production aircraft, and new kinds of aircraft designs in the transport category.

³ Since the 1970s, the NTSB has not included fatal crashes caused by criminal or terrorist actions when calculating the commercial fatal accident rate. DOT follows 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, DOT would not have met the 2001 target.





FAA continued efforts to improve use of onboard technology that can enable pilots to navigate aircraft to any point in the world using only geographical coordinates. Required Navigation Performance (RNP) is an important step in moving the United States from an exclusively ground-based navigation system to one located within the aircraft itself. By providing pilots precise guidance to all runways, RNP can help prevent two major types of accidents—controlled flight into terrain and accidents that occur during the approach and landing phase of flight. In addition, RNP will enable pilots to land in weather conditions that would ordinarily require diversion to alternate airports.

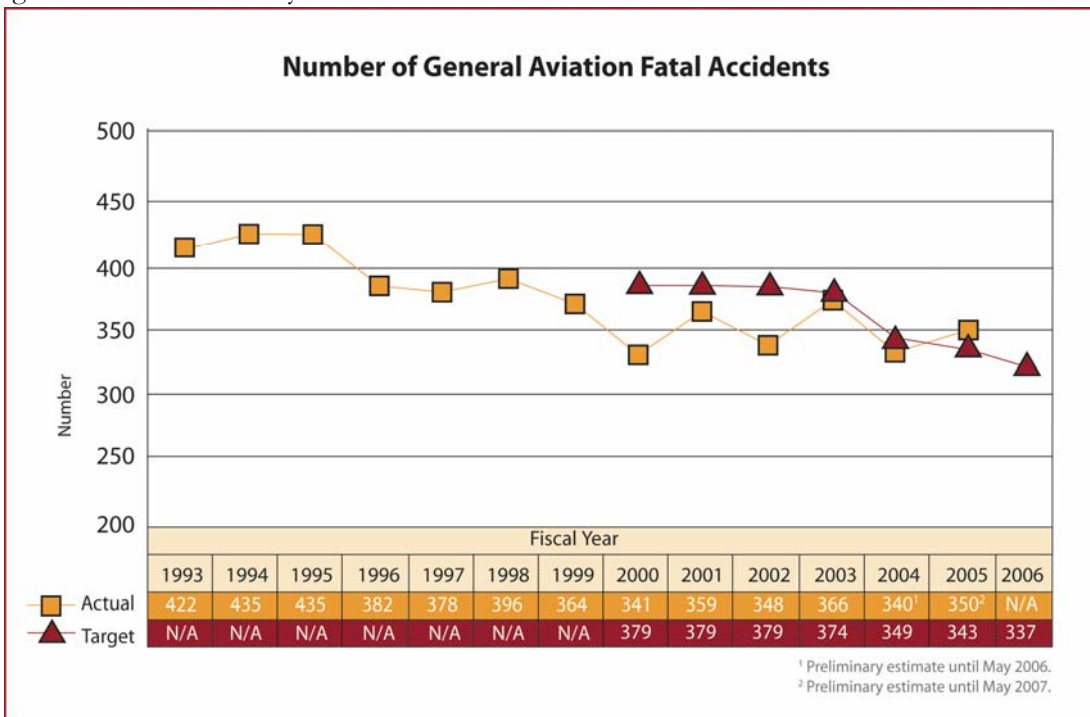
In addition to these safety initiatives, FAA also engaged in hands-on preventive measures in FY 2005, such as increased security screening of cargo to root out fireworks and other hazardous materials. Those efforts aided in the detection of many undeclared hazardous materials, allowing us to safeguard airline passengers through increased investigation of violations of hazardous material regulations.

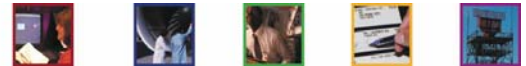
- **Results:** Through these initiatives and strategies, we were able to exceed our goal of reducing the rate of commercial air carrier fatal accidents, achieving a rate of 0.017 fatal accidents per 100,000 departures.

GENERAL AVIATION FATAL ACCIDENTS & GENERAL AVIATION ALASKA ACCIDENTS

FAA was challenged to meet the target this year for reducing General Aviation Fatal Accidents. General aviation fatal accidents trended higher each month than the previous year. We believe that increased flight activity, the increased use of turbine aircraft, and pilots exceeding their limitations contributed to a higher number of accidents this year.

Although most people are familiar with FAA’s role in commercial aviation, they may not be aware that it also oversees the safety 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. The majority of aviation fatalities have occurred in this segment of aviation. Since 1988, there has been a gradual trend downward in the number of general aviation accidents, but progress has not been steady.





To improve safety awareness and training, FAA works collaboratively with the general aviation community, while continuing to enhance the Aviation Safety Program. The General Aviation Joint Steering Committee (JSC), a partnership of FAA and major general aviation associations, recently created a Turbine Operations Subgroup. The group identified actions to encourage charter and corporate operators to adopt safety management systems. In addition, the JSC continues its work to improve safety for operators of single-engine airplanes.

FAA has continued to work proactively to meet its goal of reducing general aviation accidents. Because of the challenges weather and terrain present in Alaska and the broad use of general aviation as a means of transportation, FAA's *Flight Plan* focuses specifically on reducing general aviation accidents in Alaska. Two programs in particular, Circle of Safety and CAPSTONE, appear to be making a difference. Circle of Safety is a consumer education program that works with passengers and organizations to share responsibility and take a more active role in their own flight safety. CAPSTONE helps provide pilots information on their positions relative to terrain, as well as real-time weather information in the cockpit. FAA worked with various members of the general aviation community in FY 2005, including aeromedical evacuation, charter services, and other members of the community, to push education and training on night landings, weather, medical evacuation and other areas of concern.

- ⊙ **Results:** We did not achieve our goal of reducing general aviation fatal accidents and general aviation accidents in Alaska. We continue to work with the general aviation community to improve safety awareness and continue to advance FAA's Aviation Safety Program. The General Aviation Joint Steering Committee (JSC), a partnership of FAA and major general aviation associations, develops programs, training, and outreach to the many major stakeholders. The JSC recently commissioned three major workgroups to focus on the most critical areas currently in general aviation—light sport aircraft, technically advanced aircraft, and turbine aircraft. Each of these new subgroups will develop initiatives in the next fiscal year designed to reduce risk and lower the number of fatal accidents.

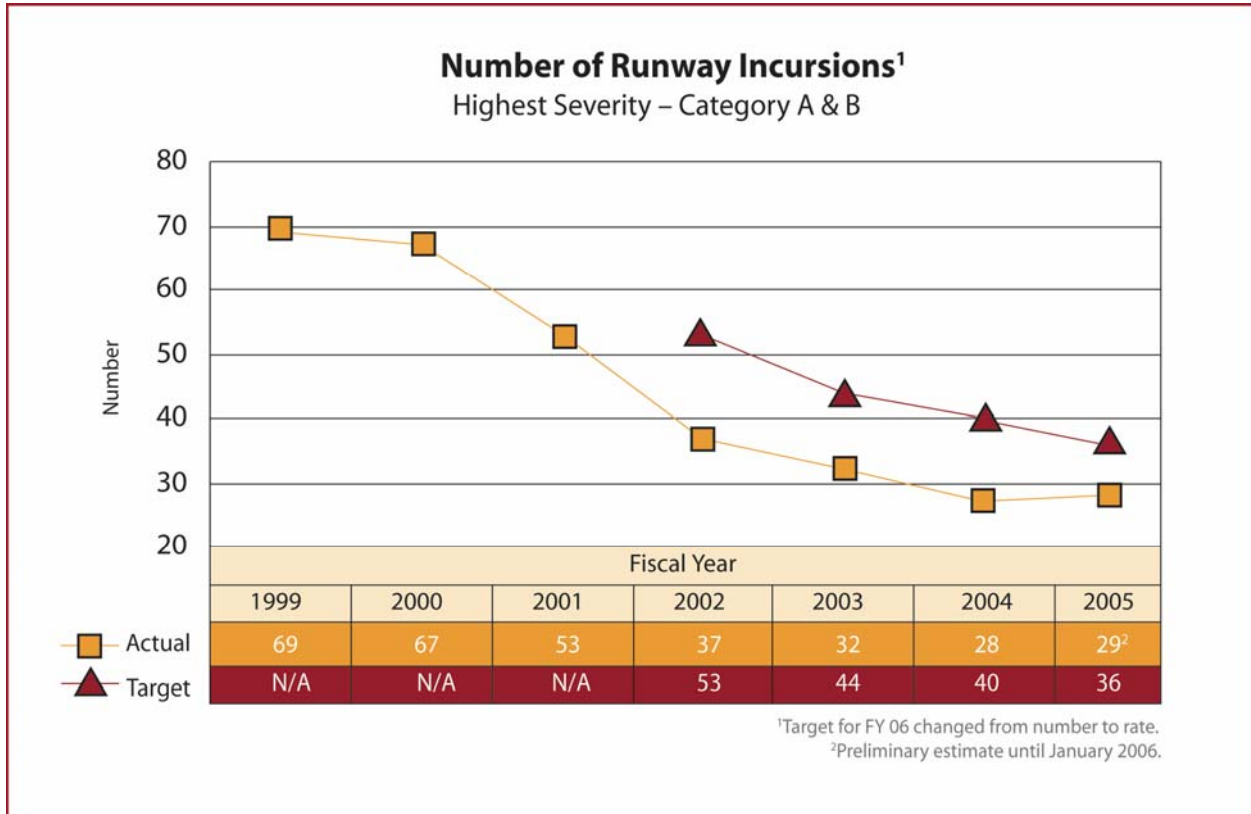
RUNWAY INCURSIONS

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 with an aircraft taking off, intending to take off, landing, or intending to land. Reducing runway incursions lessens the probability of accidents that potentially involve fatalities, injuries, and significant property damage.

For the third year in a row, serious runway incursions were below target. The number of the most serious types of runway incursions is projected at 29, which is lower than the FY 2005 performance target of 36.

We continue to develop and coordinate efforts to improve runway safety including a variety of education and awareness materials focused on air traffic controllers, pilots, and airport drivers to help reduce the number of serious runway incursion incidents. Other tools, such as air traffic control memory aids, better airport surface markers, and public service announcements, have contributed to the reduction of runway collisions at major U.S. airports. ASDE-X was first commissioned at General Mitchell International Airport in Milwaukee, WI. This equipment maps moving objects on the airport grounds or those approaching by air, which helps controllers detect potential runway collisions. In FY 2005, FAA deployed ASDE-X at three additional locations. The Agency expects to install this equipment at 14 additional U.S. airports by 2009.





- **Results:** FAA and industry have made significant progress in reducing runway incursions. There were 29 (preliminary estimate) of the most serious types of runway incursions, significantly lower than our FY 2005 goal of 36. This performance continues a downward trend that began 5 years ago.

COMPOSITE SAFETY INDEX (CSI)

FAA’s target for FY 2005 was to complete development of a single, comprehensive index that can provide the public with a general indication of the safety of the U.S. civil aviation system. The completed index was to be presented to the Administrator for approval. The proposed CSI is a 3-year rolling average of the yearly values for fatalities per “person departures.” These departures are defined as the number of persons on board each flight, including the crew, which then accounts for all potential exposure. FAA can use this index to work with the aviation community to assess the overall level of aviation safety.

- **Results:** With the help of our stakeholders, we achieved our goal. The CSI was presented to the Administrator for review in August 2005 and will be included in the updated FY 2006 *Flight Plan*.

COMMERCIAL SPACE LAUNCH ACCIDENTS

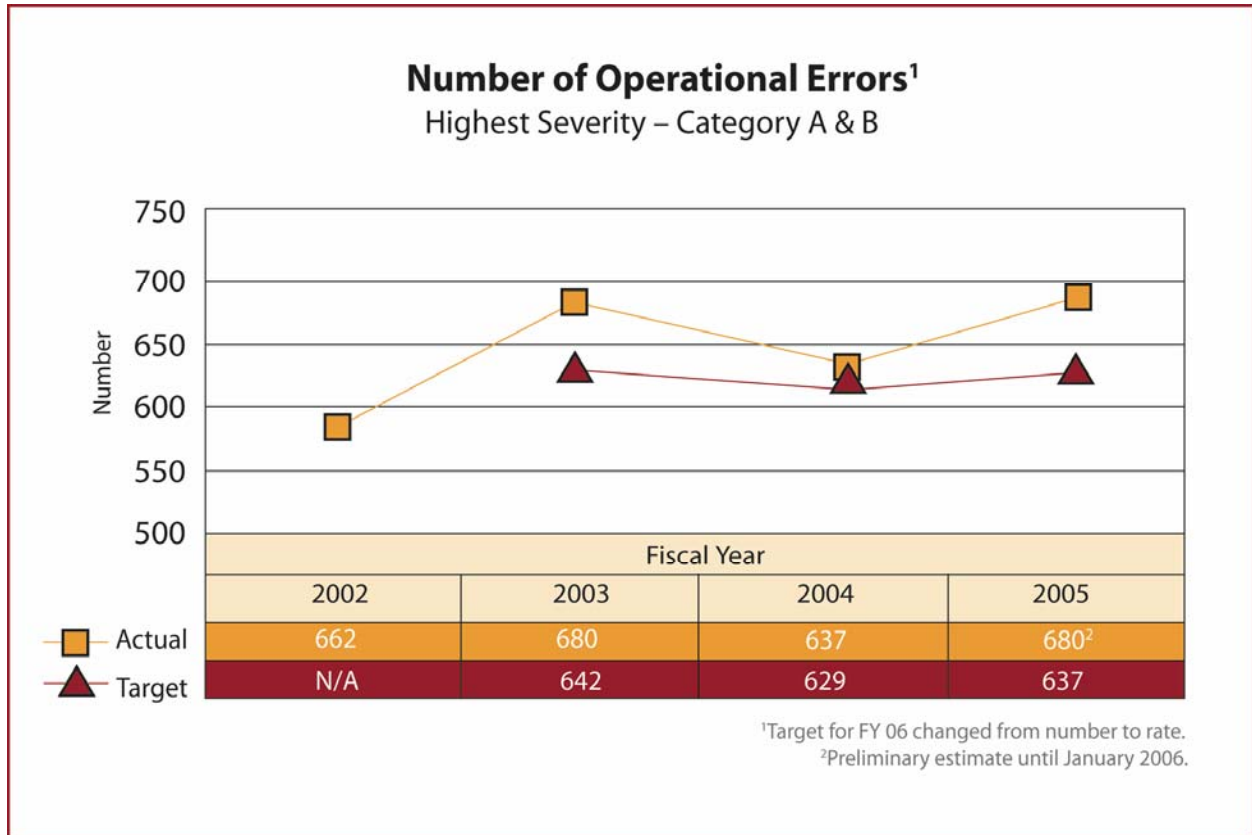
Commercial space launches generate tremendous benefits to society by delivering payloads such as telecommunications satellites and remote-sensing devices to orbit. FAA continues to maintain its perfect record of no commercial space launch accidents while safeguarding the public from the potential consequences of such an accident.

- **Results:** We achieved this goal in FY 2005. There were six licensed launches during the year, of which one involved a reusable launch vehicle. No member of the public was killed or injured, and no member of the public suffered any property damage related to commercial space launches.



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 restricted airspace. Air traffic controllers employ rules and procedures that define separation standards for this environment. An operational error occurs when controllers fail to apply or follow these procedures that enforce separation and allow aircraft to end up too close to each other or to an obstruction.



FAA estimates that it will exceed the FY 2005 performance limit of 637 most serious operational errors by more than 6% (680 operational errors). Although we missed our target, we have seen improvements in overall performance. These improvements, which were due to much of the work done in FY 2005, included

- ▶▶ Conducting checks of certification skills, focusing on operational error causal factors, on all control room personnel.
- ▶▶ Scheduling regular quality assurance teleconferences with air traffic facilities and producing a regular newsletter for controllers to highlight causal factors and trends and discuss solutions, procedures, and training.
- ▶▶ Encouraging collaboration between two ATO units—En Route and Oceanic Services, and Terminal Services—and the Controller Training Division to improve training content and identify simulation solutions to enhance the performance of developmental air traffic control specialists and the current full-performance level workforce.
- ▶▶ In FY 2006, we will continue our performance management and communications initiatives, refine the operational error severity classification process to ensure an accurate identification of the risk posed by an operational incident, and review a procedural change for aircraft operating on crossing and diverging courses to provide additional operational efficiency while maintaining safety.





- ⊙ **Results:** We did not meet our goal of reducing Category A and B operational errors to 637 or fewer, reporting instead 680 (preliminary estimate).

SAFETY RISK MANAGEMENT

In FY 2004, FAA developed the *Safety Management System (SMS) Manual*, which describes the requirements for the various components/functions of the SMS, including safety risk management. Safety risk management is a systematic, explicit, and comprehensive approach for managing safety risk at all levels and throughout the entire scope of an operation and lifecycle of a system. It requires the disciplined assessment and management of safety risk. The safety risk management process ensures that safety-related changes are documented; risk is assessed and analyzed; unacceptable risk is mitigated; hazards are identified and tracked to resolution; the effectiveness of the risk mitigation strategies is assessed; and the performance of the change is monitored throughout its lifecycle.

- **Results:** FAA met this goal. In FY 2005, we were successful in applying Safety Risk management in the following three areas:
 - ▶▶ East St. Louis Air Traffic Control Tower (ATCT)
 - ▶▶ ASDE-X Safety
 - ▶▶ EnRoute Software Modification (URET)

CAPACITY

GOAL: Work with local governments and airspace users to provide capacity that meets projected demand in the U.S. airspace system in an environmentally sound manner.

After the terrorist attacks of September 11, 2001, the demand for air travel decreased dramatically. Traffic has increased over the past 3 years and has returned to pre-September 11 levels. While the airlines continue to struggle with the effects of September 11 and to reinvigorate their industry, we are preparing for a return to heavy demand. During FY 2005, work continued with local governments and airspace users to improve the design and performance of both aircraft and ground systems. These improvements will accommodate more traffic while easing delays; increase safety and security while addressing noise and air quality; and foster efficient, predictable, and flexible domestic and international air travel.

As airspace systems become ever more interconnected, additional partnerships have been developed within the national and international aviation community. We continue to focus on aviation as a global system and work closely with international organizations to seek global solutions to safety, routing, procedural, equipment, and environmental issues. We assess system capacity through eight performance measures. The following chart describes our FY 2005 performance in improving efficiency by achieving of each measure.

FY 2005 CAPACITY PERFORMANCE MEASURES AND RESULTS			
Performance Measure	FY 2005 Target	FY 2005 Results	Status
Average Daily Airport Capacity (35 OEP airports): Achieve an average daily airport capacity of 104,338 arrivals and departures per day by 2009 at the 35 Operational Evolution Plan (OEP) airports.	99,892	101,463 ¹	●
Average Daily Airport Capacity (eight metropolitan areas): Achieve an average daily airport capacity for the eight major metropolitan areas of 44,428 arrivals and departures per day by 2009.	43,080	44,324 ¹	●
Annual Service Volume: Open as many as seven new runways, increasing the annual service volume (ASV) of the 35 OEP airports by at least 1% annually, measured as a 5-year moving average, through 2009.	1.00%	1.01%	●



FY 2005 CAPACITY PERFORMANCE MEASURES AND RESULTS			
Performance Measure	FY 2005 Target	FY 2005 Results	Status
Adjusted Operational Availability: Sustain adjusted operational availability at 99% for the reportable facilities that support the 35 OEP airports.	99.00%	99.76% ¹	●
NAS On-Time Arrivals: Through FY 2009, achieve an 88.4% on-time arrival rate for all flights arriving at the 35 OEP airports. Arrivals are considered on time if they are less than 15 minutes late due to NAS-related delays.	87.40%	88.44% ¹	●
Noise Exposure: Reduce the number of people exposed to significant noise by 1% per year through FY 2009, as measured by a 3-year moving average, from the 3-year average for calendar years 2000–2002.	–3.00%	–27.00% ²	●
Aviation Fuel Efficiency: Improve aviation fuel efficiency per revenue plan-mile by 1% per year through 2009, as measured by a 3-year moving average, from the 3-year average for calendar years 2000–2002.	–2.00%	–5.84% ²	●
Oceanic En-route Change Requests: Increase the number of oceanic en-route altitude change requests that are granted through the end of FY 2009 to 80%.	75.00%	76.24%	●
● Green: Goal Achieved Ⓧ Red: Goal Not Achieved			
1) Preliminary estimate. Final data will be available by January 2006. 2) Preliminary estimate. Final data will be available in May 2006.			

CAPACITY RESULTS AND INITIATIVES

AVERAGE DAILY AIRPORT CAPACITY (35 OEP AIRPORTS)

In FY 2005, FAA’s capacity measure was modified to include both arrival and departure capacity (replacing the daily arrival capacity measure and arrival efficiency rate used previously). Therefore, trend information is not available. Each airport facility determines the number of arrivals and departures it can handle for each hour of each day. These numbers are the airport’s called arrival and departure rates for that hour. This metric is determined by computing the sum of the arrivals and departures that facilities can land and depart per month divided by the number of days in the month. (This is a dynamic measure that changes daily based on factors such as weather and runway availability.) The annual capacity level for the 35 OEP airports is the weighted sum of the monthly capacity levels.

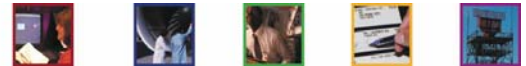
The *Flight Plan* performance target was to increase average daily capacity for the 35 OEP airports to 99,892 in FY 2005 and to 101,191 by FY 2006.

- **Results:** We met our FY 2005 target. Preliminary data indicate that the average for the year was 101,463 flights.

AVERAGE DAILY AIRPORT CAPACITY (8 METROPOLITAN AREAS)

Similar to the measure above, FAA’s capacity measure for the 8 metropolitan areas was modified in FY 2005. Therefore, trend information is not available. Growth in air travel has generally been accomplished by increasing the number of flights. Measuring the growth of airport capacity indicates the limit at which increased service can be accommodated without affecting delay. The selected eight metropolitan areas contain both the most congested airspace and the airports with the greatest constraints on airport expansion. Airport improvements, measured by increases in capacity at these airports, are likely to contribute the most to reduce the causes of system delay.





The *Flight Plan* performance target was to increase average daily capacity for the eight metropolitan areas to 43,080 in FY 2005 and to 43,338 by FY 2006.

- **Results:** We met our FY 2005 target. Preliminary data indicate that the average for the year was 44,324 flights.

ANNUAL SERVICE VOLUME

The annual service volume goal is in place to prevent unreasonable delays at airports. Since this measure was new in FY 2004, trend data will not be available until next year. In FY 2005, we increased capacity at the 35 OEP airports by 1.01%.

- **Results:** For the second year in a row, we met this goal. Even though we did not open any new runways in FY 2005, 8 new runways have opened over the past 6 years, resulting in the 1.01% increase last year, measured as a 5-year moving average. Additionally, we extended the runway at Cleveland, which supported the incremental increase in capacity.

ADJUSTED OPERATIONAL AVAILABILITY

The availability of the equipment necessary to provide service directly affects the performance of the NAS. Loss of radar or communications equipment will affect the speed and number of aircraft that can be handled where that loss occurs. The ability of the NAS to provide continuous guidance is crucial and affects both safety and capacity. The adoption of this metric has the additional advantage of linking three capacity measures. On-Time NAS Arrivals are affected by the airport and en-route capacity, which are directly impacted by the availability of the equipment and facilities supporting that capacity. Since this measure was redefined in FY 2005, trend data will not be available until FY 2007.

- **Results:** We exceeded our FY 2005 target to sustain operational availability at 99% for the reportable facilities that support the 35 OEP airports with a result of 99.76%.

NAS ON-TIME ARRIVALS

The Air Traffic Control System Command Center (ATCSCC) confers daily with airline industry representatives to coordinate traffic around factors that could potentially cause delays. By planning before the day begins, FAA and industry work together to ensure that aircraft operate on time. FAA programs and initiatives outlined in the Operational Evolution Plan (OEP), such as airspace redesign, revised air traffic control procedures, and the introduction of new technology, are expected to further improve on-time arrivals. Terminal Airspace redesign efforts are one such way we are improving our on-time performance.

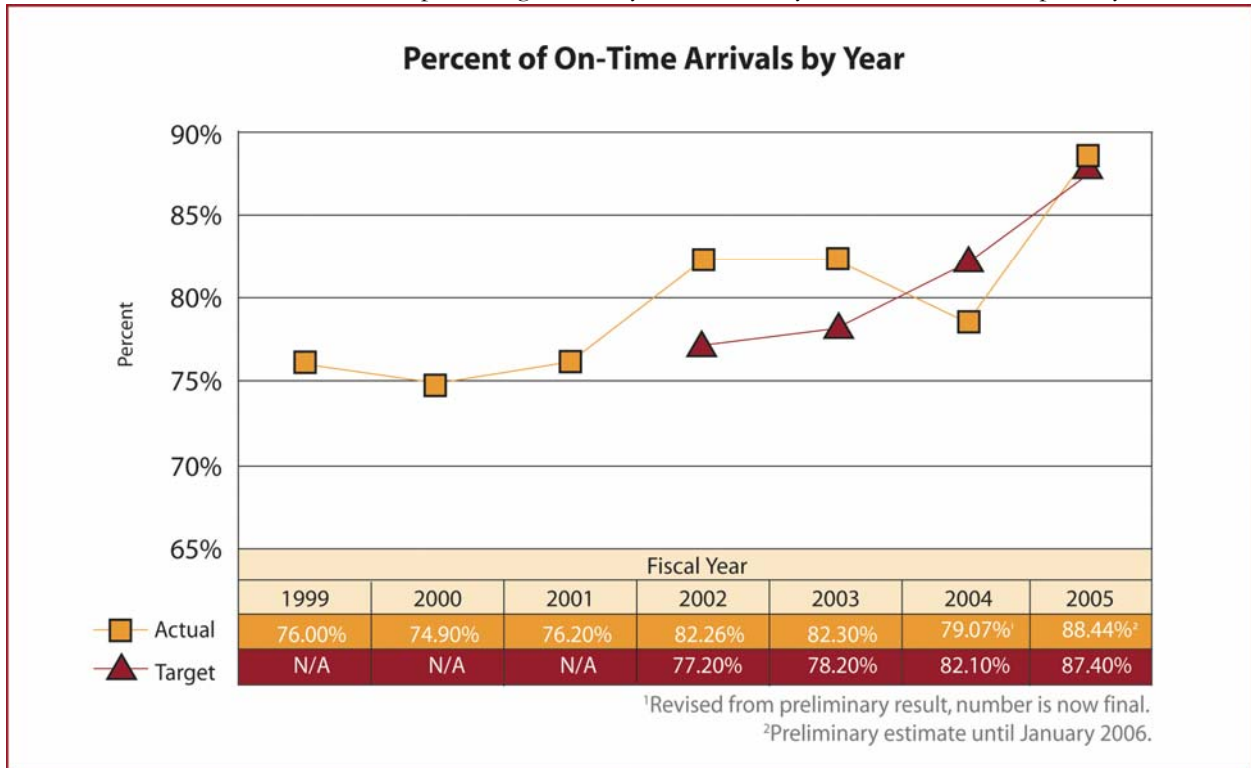
Since FY 2000, several new runways at major metropolitan airports have been commissioned. In order to maximize the capacity of the new runways, FAA redesigned the surrounding airspace. These changes include new improvements, routes, and sector structure to allow aircraft to use the new runways. Redesigned airspace included Las Vegas Redesign, Great Lakes Integrated Design Plan Short-term Initiatives, and the National Choke Points Initiative. The airspace changes reduced delays and reduced flight distances. Departure delays for several Great Lakes corridor airports, including Cleveland and Detroit, were significantly reduced, contributing to the overall improvements in on-time performance. In Southern California, revised departure routes and climb procedures coupled with airspace changes provided more fuel efficient departures and reduced the number of leveled-off departures by over 70%.

FAA continues to develop criteria and guidance materials that will be used for new area navigation (RNAV) and required navigation performance (RNP) routes and procedures. Use of RNP permits greater flexibility and standardizes airspace performance requirements. By adopting RNAV and RNP and leveraging existing and emerging cockpit capabilities, the FAA in collaboration with the aviation community will be able to improve airspace and procedures design, leading to increased capacity and improved efficiency. We published RNP special approach procedures for Palm Springs, Portland, and San Francisco. We also published the first





public RNP procedure in the world at Washington Reagan National Airport in September 2005. FAA implemented 58 RNAV arrival and departure procedures including major implementations at Atlanta Hartsfield and Dallas-Fort Worth. We also implemented 24 RNAV routes during FY 2005, including 20 high altitude and four low-altitude routes providing flexibility and efficiency in the National Airspace System.

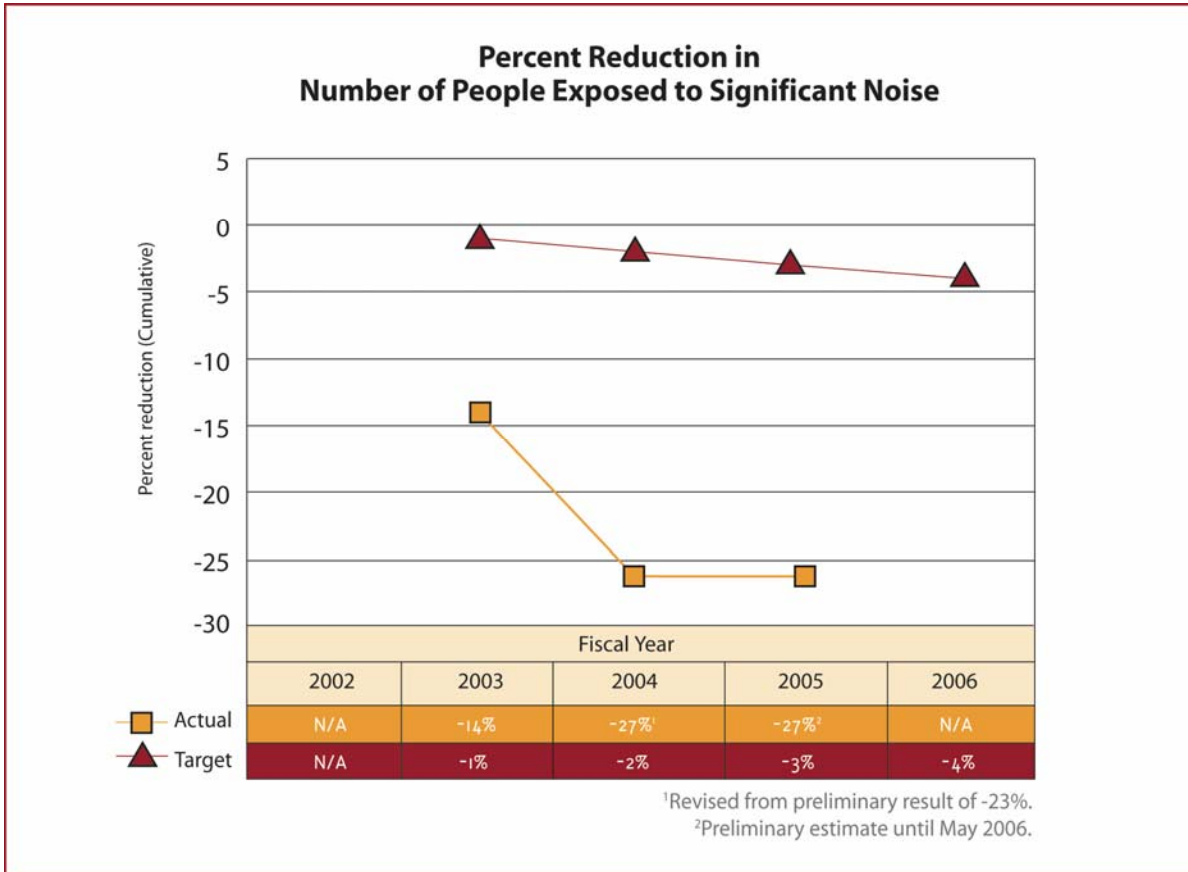


● **Results:** We exceeded our FY 2005 target of 87.40%, achieving an on-time rate of 88.44%.

NOISE EXPOSURE

In cooperation with the aviation community, we pursue a program involving noise reduction at the source (development and adoption of quieter aircraft), soundproofing and buyouts of buildings near airports, flight control measures, and land use planning. We are authorized to provide funds for soundproofing and residential relocation, but each project must be locally sponsored and be a part of a noise compatibility program prepared by the airport sponsor and approved by FAA. This noise target is based on our experience and reflects the relocation of people from the DNL (day/night sound level) 65 dB contour through grant funding, but is also affected by market forces that drive changes in commercial aircraft fleets and operations.





The estimates of the number of people exposed to significant noise are calculated from a U.S. version of the Model for Assessing Global Exposure to the Noise of Transport Aircraft (MAGENTA). The original MAGENTA model development was done in conjunction with the Committee on Aviation Environmental Protection (CAEP) under the International Civil Aviation Organization (ICAO) to assess aviation noise worldwide. The 2005 estimate is based on an updated version of MAGENTA, combining improvements in data sources and acoustic algorithms that produce significant improvement in measuring the number of people exposed to significant noise levels around U.S. airports.

- **Results:** We exceeded this performance target by reducing the number of people exposed to significant noise by 27% (preliminary estimate). The performance improvement between FY 2003 and FY 2005 over the targeted goals grew out of a confluence of external factors—the economic downturn, the impact of September 11th on the industry, and the severe acute respiratory syndrome (SARS) outbreak. These factors produced a dramatic downturn in operations as well as a large-scale premature retirement of older Stage 3 aircraft. This combination of lower operations and the rapid reduction of the average age of the fleets resulted in improvements in noise exposure. As the industry continues to recover from these events, and taking into account the Next Generation Air Transportation System (NGATS) goal of increasing capacity threefold, the improvements witnessed over the past 2 years will not be sustained.

AVIATION FUEL EFFICIENCY

Concern over aviation’s contribution to both global climate change and local air quality continues to grow. Our FY 2005 performance target was to improve aviation fuel efficiency per revenue plan-mile by 1% per year through FY 2009, as measured by a 3-year moving average, from the 3-year average for calendar years 2000 through 2002. We measure this target using SAGE—the System for Assessing Aviation Global Emissions—a computer model that estimates aircraft fuel burn and emissions for variable year emissions inventories and for operational, policy, and technology-related scenarios. For FY 2004, performance was





calculated using operational data from one representative week during the month of May to be a 4.51% improvement in fuel efficiency for the 3-year efficiency average (2001–2003) compared to the baseline. For FY 2005 performance, we used an enhanced SAGE model that allowed analysis of full year operational data. For comparative consistency, we re-computed the analysis completed under the FY 2004 *Flight Plan* including the baseline fuel efficiency.

- **Results:** We achieved our goal for improving aviation fuel efficiency. The calculated fuel efficiency for FY 2005 was a 5.84% improvement over FY 2004. However, this year’s performance results should not be used as an indicator of future performance. Air carrier fleet and operational changes that took place in the aftermath of September 11th continue to influence fuel efficiency improvements. We expect that a return to more typical fleet compositions and flight mission length distributions, along with air traffic growth, will result in decreased fuel efficiency that may not be fully offset by improvements in airframe and engine technologies.

OCEANIC EN-ROUTE CHANGE REQUESTS

Air carriers and pilots want to change their altitude to minimize fuel burn and flight time. When fuel load or traffic patterns change, it is beneficial for flights to be able to change their altitude in real time. Additionally, the amount of fuel burned on the long oceanic flights is very dependent on whether aircraft can fly at their optimal altitude. If oceanic air traffic facilities are getting more requests to change altitudes and can accommodate those requests, that means the system is flexible and responsive to user needs.

This measure was newly introduced this year, and as the year progressed, we found that oceanic operational metrics require better oceanic data, modeling, and analysis to forecast how increases in traffic volume affect performance. Rather than have this measure serve as a major objective for the Agency, we will focus instead on implementation of the Advanced Techniques and Oceanic Procedures (ATOP) software and develop sound, base-lined metrics. We achieved full operational use of ATOP at the New York ARTCC in June 2005 and at the Oakland oceanic facility in October 2005. Implementation is planned at the Anchorage ARTCC in March 2006.

- **Results:** We exceeded the target of granting at least 75% of requests for route changes with a result of 76.24%. Although ATOP was only partially implemented in September, we succeeded in granting 75.86% of change requests that month, including those received via High Frequency and Datalink communication. This was despite the fact that the total number of requests had increased by 66.94%. Our measurement capabilities did not allow us to include Datalink requests until mid-year, but we achieved our FY 2005 target for the entire year even without counting the additional requests.

INTERNATIONAL LEADERSHIP
GOAL: Increase the safety and capacity of the global civil aerospace system in an environmentally sound manner.

The United States has long been a leader in the global civil aviation system. In addition to controlling nearly half the world’s air traffic, FAA provides direct and indirect aviation assistance to 129 countries. As a leader, we must promote safety by broadening the international network of partnerships with civil aviation authorities around the world to make air travel as safe and efficient abroad as it is at home.

We assess international performance through six performance measures. The following chart describes our FY 2005 performance in improving efficiency through the achievement of all six measures.



FY 2005 INTERNATIONAL LEADERSHIP PERFORMANCE MEASURES AND RESULTS			
Performance Measure	FY 2005 Target	FY 2005 Results	Status
Environmental Standards and Practices: Achieve milestones to ensure that international environmental standards, recommended practices, and guidance material adopted by the International Civil Aviation Authority (ICAO) are globally and uniformly applied, reflect the best available technology that can be integrated into the fleet, provide real environmental benefit, are economically sound, and take interdependencies between environmental parameters into account.	2	2	●
Aviation Safety Leadership: Advance U.S. aviation safety leadership in developing regions by significantly increasing safety infrastructure in 10 priority countries by FY 2009 through implementation of model law and regulations for safety oversight, providing extensive technical assistance and training, and concluding bilateral agreements.	2	27	●
Bilateral Agreements: Execute new or expanded bilateral agreements with current partners.	2	2	●
Intellectual and Financial Assistance: Secure a yearly increase of 20% in intellectual and financial assistance for international aviation activities from the United States and international government organizations, multilateral banks, and industry.	20.00%	63.00%	●
Support for ICAO: Promote the creation of four new regional aviation authorities or organizations capable of meeting globally accepted safety standards by FY 2009.	2	3	●
NAS Technologies: Expand the use of U.S. NAS technologies and procedures to six priority countries by FY 2009.	1	1	●
● Green: Goal Achieved ⊙ Red: Goal Not Achieved			

INTERNATIONAL LEADERSHIP RESULTS AND INITIATIVES

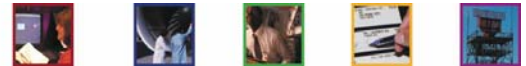
ENVIRONMENTAL STANDARDS AND PRACTICES

FAA established two milestones to measure progress in achieving this goal:

- ▶ Reach agreement with other members of the ICAO Committee on Aviation Environmental Protection (CAEP) on an approach for evaluating the use of existing models and potential models under development (e.g., Aviation Environmental Design Tool and Aviation Portfolio Management Tool [AEDT-APMT] for the analysis of trade-offs between noise and emissions and among emissions).
- ▶ Determine the feasibility of building upon the draft ICAO Circular on Operational Opportunities to Minimize Fuel Use and Reduce Emissions to expand the use of the most cost-effective practices industry-wide and to explore their use as a basis for future voluntary agreements.

The establishment of global environmental standards promotes seamless international operations in cooperation with bilateral, regional, and multilateral aviation partners. The lack of international agreement on environmental standards and practices creates significant difficulties to the effective operation of an industry in which an aircraft takes off somewhere in the world every few seconds. It also can result in misapplication of limited regulatory and financial resources in a manner that fails to achieve cost-effective solutions to aviation’s environmental impacts. It is important as well to ensure that internationally agreed standards and practices are acceptable to the United States. In addition, there is renewed recognition that complex interdependencies exist among aircraft noise and emissions and among various emissions, and that to achieve effective mitigation we must take these interdependencies into account. Meaningful progress relies on





enhanced analytical tools and supporting databases. Agreement with other ICAO CAEP members on an approach for evaluating the use of existing models and potential models under development to analyze these interdependencies was an essential first step.

- **Results:** We achieved both outcomes associated with this goal.

AVIATION SAFETY LEADERSHIP

Technical assistance to improve aviation safety abroad is the very core of FAA’s international program. A primary focus of this effort is to transfer knowledge and skills to help developing countries comply with international aviation safety standards. FAA’s technical assistance activities thereby provide greater safety for U.S. citizens and air carriers traveling and operating abroad. Another focus of our technical assistance effort is to support an interoperable and seamless global aviation system based on common use of the latest technologies. Such a system will not only be safer, but also more efficient.

The European Union has launched ambitious technical assistance efforts in developing countries to influence the future direction of aviation in the developing world. Continuation of FAA’s technical assistance activities is essential to maintain FAA’s role as a global leader in aviation standards and procedures. The technical assistance program supports international aviation safety and efficiency improvements attainable through enhanced interoperability, promotes FAA’s global leadership position, and strengthens U.S. foreign trade.

Technical assistance is delivered under government-to-government agreements. The measure of success and baseline are the number of agreements concluded between FAA and other governments to provide technical assistance and training to improve the level of safety overseas.

- **Results:** We exceeded our FY 2005 goal to provide new or expanded technical assistance to two key countries by concluding agreements with 27 countries. In setting our target for this year, we underestimated our expected progress. We will review this target and establish a different measure for FY 2006.

BILATERAL AGREEMENTS (PRODUCTS AND SERVICES)

The purpose of a Bilateral Aviation Safety Agreement (BASA) is to promote aviation safety and environmental quality and to enhance cooperation and increase efficiency in matters related to civil aviation. By building a network of competent civil aviation authorities and concluding agreements with additional countries and regional authorities, FAA can increase safety globally. Improved global understanding of U.S. safety regulations, processes, and procedures leads to better international regulatory oversight. Since BASAs are based on recognized comparability of U.S. and foreign systems for approval and surveillance of the aviation industry, they allow us to rely on the capabilities and technical expertise of other civil aviation authorities in particular areas of aviation safety, thereby minimizing duplication of effort as well as opening new lines of communication between authorities.

BASAs benefit the aviation industry by reducing duplication and streamlining the reciprocal acceptance of products and services. With the increasing globalization of aircraft manufacturing and airline operations, interdependency between the United States and foreign industry is outpacing FAA’s ability to conduct oversight throughout the globe. By entering into agreements with other authorities, we can better focus on U.S. safety priorities, as described earlier in the *Safety* section of this report, and rely on competent civil aviation authorities for certain safety oversight activities.

Depending on their scope, BASAs

- ▶▶ Enable FAA to certify foreign-manufactured aircraft, engines, and parts efficiently;
- ▶▶ Facilitate the renewal of certificates for repair stations that conduct maintenance on U.S. registered aircraft operating overseas;
- ▶▶ Facilitate the acceptance of foreign simulator facilities for the training of pilots; and





- ▶ Streamline the process for recognizing flight crew licenses issued by the FAA or another aviation authorities.
- **Results:** FAA achieved its goal by concluding two BASAs, recognizing safety certification and approval systems with Australia and China.

INTELLECTUAL AND FINANCIAL ASSISTANCE

Often countries that could benefit the most from FAA technical assistance are the least able to afford our help. FAA has no grant program to finance international technical assistance. This initiative seeks to leverage the limited resources we are able to contribute to international safety and capacity efforts by implementing a methodology to increase intellectual and financial assistance from U.S. Government organizations, multilateral banks, and industry to support global aviation system infrastructure projects.

FAA’s role in lobbying international funding organizations has significantly increased the level of technical assistance provided to other countries for aviation safety improvements. Our efforts represent an important opportunity to influence the development of global safety standards and procedures, particularly in developing countries and regions.

- **Results:** We exceeded our goal for FY 2005 of increasing funding by 20% over last year, arranging \$19.5 million in funds for technical assistance and infrastructure development programs, an increase of 63% over the FY 2004 funding level of nearly \$12 million.⁴ FAA’s increased focus on multilateral development bank funding for aviation resulted in World Bank approval of a \$10 million loan to Kenya to increase aviation safety. This single activity represents more than 50% of our FY 2005 funding level, and helped us boost our results to over three times the targeted increase for the year.

SUPPORT FOR ICAO

FAA conducts extensive activities with ICAO. We support several on-going ICAO safety and technical programs, including the Universal Safety Aviation Oversight (USAO) program and numerous ICAO panels that address a range of aviation activities.

We have also promoted increased U.S. representation at ICAO through a special Fellowship program that loans FAA employees to ICAO Headquarters on a temporary basis for various safety, technical, and legal assignments. In FY 2005, two FAA Fellows were placed in the Air Navigation Bureau and one Fellow in the Legal Bureau. We were also able to place two FAA employees and one private sector individual into permanent ICAO positions. In addition, we placed a FAA senior executive as the ICAO Air Navigation Commissioner, a key ICAO executive-level position.

To support the ICAO goals of fostering the development of regional safety organizations, FAA cooperated with the East African Community (EAC), the Regional Aviation Safety Oversight System (RASOS) in the Caribbean, the Latin American Civil Aviation Commission (LACAC) in South America, and regional Cooperative Development of Operational Safety and Continuing Airworthiness Project (COSCAP) organizations and the Pacific Aviation Safety Office (PASO) organization in the Asia-Pacific region.

- **Results:** FAA was instrumental in supporting an Asian Development Bank grant of \$1.95 million to help establish the PASO, a new aviation safety and security organization in the Pacific that will be operational by 2010. PASO members include Australia, Fiji, Kiribati, New Zealand, Papua New Guinea, Samoa, Solomon Islands, and Vanuatu. In Latin America, FAA organized the first senior-level

⁴ The FY 2004 funding level has been revised from the \$13.8 million reported in last year’s PAR, which was based on projected data. The revised level of \$12 million also produces a reduction in last year’s reported percentage increase over the FY 2003 level of \$5 million, from 177% to 139%. For FY 2005, projected data are no longer used. This year’s results are final numbers.



meeting with the LACAC in February 2005. We provided training to LACAC member countries to enhance the region’s capabilities in the area of airworthiness certification. In Africa, we supported the development of a regional safety and air navigation authority for the East African Community (Kenya, Tanzania, and Uganda).

NAS TECHNOLOGIES

Throughout the year in support of all NAS Technologies initiatives and supporting target activities, ATO continued to support its international counterparts in planning for and implementation of technologies and systems that are interoperable with those in the NAS. Specific to meeting the FY 2005 target, ATO conducted a critical technical meeting with the Japan Civil Aviation Bureau (JCAB) in Tokyo on July 11–14, 2005, to address the future direction and content of our cooperation related to satellite navigation. Japan is building a system that augments the Global Positioning System (GPS) with two Multi-function Transport Satellites (MTSATs). This system is known as the MTSAT Satellite Augmentation System (MSAS). MSAS is based primarily on U.S. Wide Area Augmentation System (WAAS) technology. During the July 2005 meeting, ATO presented and discussed its assessment of an operational certification roadmap for the MSAS. As the only organization in the world to certify a satellite-based augmentation system for operational use, ATO’s assistance is critical in enabling JCAB to prepare MSAS for timely operational certification. The ATO and JCAB committed to plan additional joint activities to support JCAB efforts to provide safety, capacity, and efficiency enhancements for civil aviation. The activities leading up to this meeting, and the discussions at the meeting, mark the completion of the FY 2005 performance target to assist one country with the implementation of a U.S. NAS technology.

- **Results:** FAA succeeded in expanding the use of U.S. NAS technologies and procedures in one priority country during FY 2005.

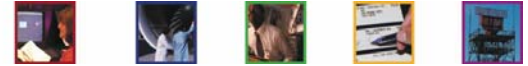
ORGANIZATIONAL EXCELLENCE

GOAL: Ensure the success of FAA’s mission through stronger leadership, a better trained workforce, enhanced cost-control measures, and improved decision making based on reliable data.

Organizational excellence is an ongoing challenge. Our performance measures this year continued with an external focus on improving customer satisfaction and the launch of a more concerted internal effort to improve our business processes. These internal improvements included better management of our acquisitions, faster hiring for mission critical positions, strengthening the linkage between employee performance and Agency goals, shoring up the security of our information, and reducing costs.

FY 2005 ORGANIZATIONAL EXCELLENCE PERFORMANCE MEASURES AND RESULTS			
Performance Measure	FY 2005 Target	FY 2005 Results	Status
Employee Attitude Survey: Increase Employee Attitude Survey scores in the areas of management effectiveness and accountability by at least 5% by FY 2008.	1.50%	2.00%	●
Cost Control: Develop and implement a centrally managed and highly visible cost control program to lead the Agency in reducing costs. Each FAA organization will contribute at least one cost reduction activity each year to its Business Plan with measurable, significant cost savings.	1 activity / organization	1 activity / organization	●
Critical Acquisition Budget: By FY 2009, 90% of major system acquisition investments are within 10% of budget.	80.00%	97.00%	●
Critical Acquisition Schedule: By FY 2009, 90% of major system acquisition investments are on schedule.	80.00%	92.00%	●





FY 2005 ORGANIZATIONAL EXCELLENCE PERFORMANCE MEASURES AND RESULTS			
Performance Measure	FY 2005 Target	FY 2005 Results	Status
Information Security: Achieve zero cyber security events that significantly disable or degrade FAA services.	0	0	●
Customer Satisfaction: Increase Agency scores on the American Customer Satisfaction Index (ACSI) survey of commercial pilots.	64	66	●
Performance Plans: Directly relate 100% of all employee performance plans to FAA strategic goals and their organization's performance plans.	85.00%	94.29%	●
Cost-Reimbursable Contracts: Close out 85 percent of eligible cost reimbursable contracts during each fiscal year.	85.00%	170.00%	●
Mission Critical Positions: Reduce the time it takes to fill mission critical positions by 20% over the FY 2003 baseline.	6.00%	35.00%	●
Flight Plan Targets: Achieve 90% of all performance targets in the <i>Flight Plan</i> .	90.00%	90.00%	●
● Green: Goal Achieved ⊙ Red: Goal Not Achieved			

ORGANIZATIONAL EXCELLENCE RESULTS AND INITIATIVES

EMPLOYEE ATTITUDE SURVEY (EAS)

This performance metric measures employees' perceptions of critical management processes and practices using 12 specific survey items. Meeting the target requires the percentage of positive results for these items to be 40% by FY 2008, 5 points above the FY 2003 baseline. The interim FY 2005 target was a 1.5% increase, or 36.5%.

- **Results:** The EAS FY 2005 performance metric result was 37% positive (2% over the baseline), a half percentage point above the target. We consider the FY 2005 target to be met given that the metrics' confidence interval included the target value of 36.5%. The results and the recently available results from the Government's Federal Human Capital Survey will be used to improve FAA's ability to meet the FY 2008 target. We expect to meet this performance target in FY 2006.

COST CONTROL

For FY 2005 we elected to develop better ways to control costs. Our original Cost Control target, to use cost savings to fund *Flight Plan* initiatives, was largely achieved in FY 2004 but has been replaced. As part of the revised FY 2005–2009 *Flight Plan*, each line of business and staff office was directed to identify at least one cost savings activity. Additionally, the Office of Financial Controls was established and charged with overseeing the FAA's cost reduction ideas and activities. Also noteworthy was the establishment of a Strategic Sourcing initiative in which an outside firm will assist FAA in reducing expenditures in certain procurement categories. The firm's fee will be a percentage of the savings achieved.

As the year progressed, the cost savings and cost avoidance activities proposed by the lines of business were tracked and reported at the monthly *Flight Plan* meetings. Cross-organizational initiatives, primarily in information technology, provided a wide impact. Benefits of over \$80 million accrued, with many cost savings activities added as the year progressed.

In FY 2006, we will continue to focus on financial management activities within each line of business and staff office. Each organization must provide a productivity and/or financial metric to measure its efficiency. By increasing efficiency and productivity, we will be in a better position to reduce overall cost.

- **Results:** FAA met this goal. Each organization contributed a cost reduction activity for the year resulting in cost savings or cost avoidance.





CRITICAL ACQUISITION BUDGET & SCHEDULE

Thirty-five critical acquisition programs are tracked against these performance measures and they have positively exceeded targets for both cost and schedule variance in FY 2005. In the past 3 years, FAA has implemented processes for variance tracking and reporting that have strengthened control over major acquisitions and resulted in significant performance gains. Maintaining and meeting critical program schedules and cost targets for equipment and technical solutions ensure the operational efficiency of the NAS.

- **Results:** FAA succeeded in meeting the goal of ensuring that 80% of major system acquisition investments are within 10% of budget, achieving 97% compliance. We also met our goal of completing 80% of acquisition schedule milestones, achieving 92% compliance.

INFORMATION SECURITY

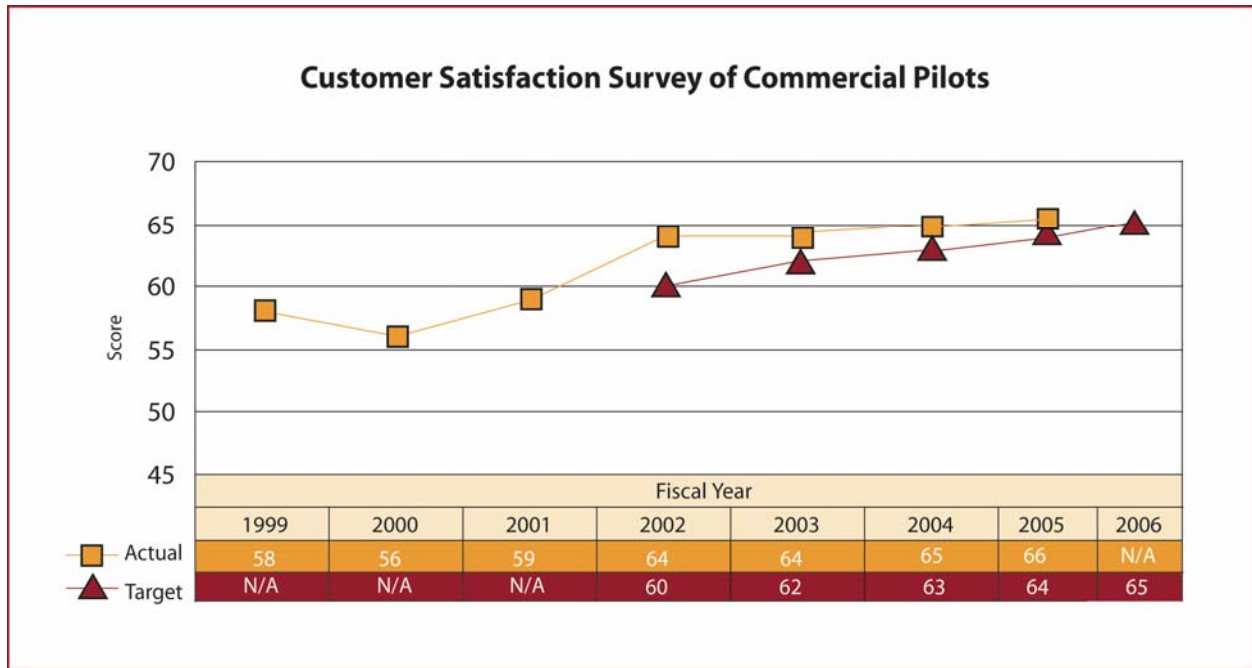
During FY 2005 FAA completed development and implementation of an IT Business Plan to protect IT assets in accordance with numerous executive and legal requirements. The plan has 25 targets, 8 of these specific to information systems security (ISS) performance. In addition, information security is one of the PMA goals that are tracked by OMB. As a result of FAA’s support, DOT obtained a rating of “green” in IT Security and we are on track to maintain our green score from OMB for the year. During FY 2005, we completed 100% of security reviews of our IT Systems (96% were reviewed in FY 2004), eliminated 20% of targeted vulnerabilities, maintained an average of no more than 0.10 or fewer vulnerabilities as measured against SANS (SysAdmin, Audit, Network, Security) Institute top 20, expanded the vulnerability scanning and intrusion detection capabilities for the FAA enterprise, planned for implementation of smart card technology to comply with Homeland Security Presidential Directive 12, and signed a memorandum of cooperation with Eurocontrol to share cyber-security data and procedures and to work cooperatively toward better business practices.

- **Results:** We achieved 100% of the FY 2005 milestones for the information security program and succeeded in meeting our target of zero cyber security events that significantly disable or degrade FAA services.





CUSTOMER SATISFACTION



Over the past 7 years, we have used the American Customer Satisfaction Index (ACSI) to measure satisfaction with U.S. commercial pilots. The ACSI is a national indicator of the quality of goods and services available to the American public. It is a weighted average measuring overall satisfaction, customer expectations, and perceived quality. Commercial pilots are asked about air traffic control personnel and services, pilot certification processes, and the clarity of regulations and how they contribute to aviation safety. This year’s results show continued improvement in 2005.

- **Results:** FAA succeeded in increasing its ASCI score to 66.

PERFORMANCE PLANS

This target requires 100% of employee performance plans to be directly related to FAA strategic goals and the performance plans of employees’ organizations by FY 2009. The FY 2005 target was 85%, with a 5% increase for each succeeding fiscal year. FAA’s Office of Human Resource Management (AHR) distributed guidance to FAA line and staff offices on assessing the current level of compliance to performance plan alignment.

- **Results:** The final analysis of the reports shows that 94.29% of FAA employees, managers, and executives had individual performance plans linked to the strategic goals in the *Flight Plan* and organizational business goals. This exceeds the 85% goal for FY 2005. Individual organizations that fell short of the 85% goal for FY 2005 have been provided assistance from the Office of Human Resource Management in establishing FY 2006 individual performance plans that provide the required linkage to *Flight Plan* goals. This performance target was removed from the FY 2006–2010 *Flight Plan*, but was retained in AHR’s FY 2006 and FY 2007 Business Plans.

COST-REIMBURSABLE CONTRACTS

The Headquarters Contracts Division, along with significant support provided by the FAA closeout contractor, greatly exceeded FAA’s goal of closing 85% of eligible flexibly priced contracts. FAA uses its Global Contracts List database, as well as its procurement/acquisition management system, to track contracts becoming eligible for closeout as well as actual closeouts accomplished by its contracting officers. The target required the closeout of 82 contracts in FY 2005, which were completed three months ahead of schedule. By





the end of the fiscal year, the Contracts Division had successfully closed a total of 140 flexibly priced contracts.

- **Results:** We exceeded this goal, closing 58 more contracts than required, or 170% of the FY 2005 target.

MISSION CRITICAL POSITIONS

This performance target measures the time to fill FAA mission critical positions (MCPs), including Air Traffic Controller, Transportation Specialist, Engineer, Aviation Safety Inspector, Engineering and Electronics Technician, and IT Specialist positions. Our FY 2005 target for filling MCPs was 76 days, which represents a 6% reduction from the baseline of 81 days established in FY 2003. The *Flight Plan* goal is to achieve a 20% reduction in the number of days required to fill MCPs by FY 2008—from 81 days to 65 days. The time-to-fill measure for MCPs is the total number of days from the date an action to fill a position is requested by the hiring organization to the date that the job is offered to the individual who fills the job. The measure includes positions filled internally and externally.

In FY 2004, FAA decided to eliminate Air Traffic Controllers from the performance target because the hiring process for these positions was far more complex and time consuming than for the other mission critical positions. Air Traffic Controllers also accounted for 37% of the mission critical hiring activity in FY 2004. A comprehensive study of hiring practices for the Air Traffic Controller position was recently completed, and these results along with other factors will be considered in determining how to set a challenging standard for filling Air Traffic Controller positions. Upon completion of study analyses, we will consider whether Air Traffic Controllers should be analyzed separately or reintroduced into the analysis of the other mission critical positions.

- **Results:** We exceeded our target of filling MCPs within 76 days. In FY 2005, it took a median of 53 days to fill MCPs, excluding Air Traffic Controller positions. This represents a 35% reduction over the FY 2003 baseline. Retrospectively, we recalculated the FY 2003 baseline without air traffic controllers and it was 62 days. We decided to retain the original targets, because the hiring process for MCPs is unstable and affected by changes in the relative number of MCPs filled, budget considerations, and internal policies and procedures. Our performance data in FY 2005 show improvement over FY 2004 performance, thus indicating stabilization of hiring practices for MCPs. However, it is very important that we continue to collect performance data by occupation to determine a balanced, efficient goal for hiring processes that will deliver high-quality candidates. Therefore, we believe that our implementation of monthly and quarterly monitoring of the time-to-fill MCPs ensures more proactive management of our mission critical hiring processes. We expect to meet this performance target in FY 2006.

FLIGHT PLAN TARGETS

FAA achieved 28 of its 31 performance targets—a 90% success rate. The three targets missed included 350 (preliminary estimate) general aviation fatal accidents, 7 (2%) above the not-to-exceed target of 343; 128 (preliminary estimate) accidents in Alaska, 8 above the not-to-exceed target of 120; and 680 (preliminary estimate) operational errors, 43 above the target of 637.

Among performance targets achieved, the commercial air carrier fatal accident rate, at 0.017 per 100,000 departures, is the lowest annual rate in the history of aviation. NAS on-time arrivals, at 88.44%, were much stronger than expected, exceeding the target of 87.40%.

For information on why individual targets are not being met and what is being done to bring them back on track, see the notes under the individual target.

- **Results:** We achieved our goal of achieving 90% (28 of 31) of our performance goals this year.





COMPLETENESS AND RELIABILITY OF PERFORMANCE DATA

Following are summaries of completeness and reliability issues for selected performance measures. For a discussion of the management controls established by FAA to ensure the quality of performance data, see “Verification and Validation of Performance Information” in the *Performance Highlights* section of this report.

Commercial Air Carrier Fatal Accident Rate

The FAA does comparison checking of the departure data collected by the Bureau of Transportation Statistics (BTS). However, FAA has no independent data sources against which to validate the numbers submitted to BTS. FAA compares its list of carriers to the DOT list to validate completeness and then places the carriers in the appropriate category (i.e., Part 121 or Part 135). NTSB and FAA’s Office of Accident Investigation meet regularly to validate the accident count.

To overcome reporting delays of 60 to 90 days, FAA must rely on historical data, partial internal data sources, and Official Airline Guide (OAG) scheduling information to project at least part of the fiscal year activity data. Due to reporting procedures in place, it is unlikely that calculation of future fiscal year departure data will be markedly improved. Lacking complete historical data on a monthly basis and independent sources of verification increases the risk of error in the activity data.

Results are considered preliminary based on projected activity data. Most accident investigations are a joint undertaking: NTSB has the statutory responsibility, but, in fact, most of the accident investigations related to general aviation are conducted by FAA Aviation Safety Inspectors without direct involvement of NTSB. FAA’s own accident investigators and other FAA employees participate in all accident investigations led by NTSB investigators.

General Aviation Fatal Accidents

NTSB and FAA’s Office of Accident Investigation meet regularly to validate information on the number of accidents. It would be preferable to use fatal accident rates rather than number of fatal accidents as the performance measure. However, general aviation flight hours are based on an annual survey conducted by FAA. Response to the survey is voluntary, and as such the accuracy of the flight hours collected is suspect and there is no readily available way to verify or validate the data. For this reason, the general aviation community is unwilling to use a rate measure until the validity and reliability of the survey data can be assured. Results are considered preliminary. NTSB continues to review accident results from FY 2004.

Alaska Accidents

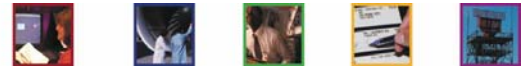
The data on Part 135 and general aviation accidents come from the NTSB Aviation Accident Database. Aviation accident investigators under the auspices of the NTSB develop the data. Numbers are final when the NTSB releases its report each March; however, the number is not likely to significantly change from the end of each fiscal year to the time the rate is finalized.

Operational Errors

FAA air traffic facilities have a software program called Operational Error Detection Patch (OEDP) that detects possible operational errors and sends alert messages to supervisory personnel. Facility management reviews OEDP alerts and data provided from the National Track Analysis Program (NTAP) to determine if an operational error has occurred. Controllers are required to report operational errors. The information is summarized in the FAA Air Traffic Operational Error and Deviation Database.

An OIG report released in September 2004 (AV-2004-085) found evidence of underreporting of operational errors at facilities where errors are self-reported, and recommended that FAA “take more aggressive steps to ensure that [they] are more accurately reported.” As of September 2005, all facilities were required to establish a facility audit process that allows for random reviews of services. For more detail, see the discussion of operational errors in the Management Challenges section under *Ensuring Aviation Safety in a Changing Aviation Environment*.





Annual Service Volume

The NAS Advanced Concept Branch at the FAA Technical Center in Atlantic City, NJ, through the Office of System Capacity provides technical support to develop a consistent method of calculating the individual airport Annual Service Volume (ASV). Delay curves were developed for each of the 35 OEP airports for the existing airport layout and with new runways where proposed. Based on an acceptable level of delay, the number of operations that can reasonably be expected to occur at each airport was determined. A consistent calculation technique to estimate capacity was used for all airports. Demand schedules and fleet mixes were developed from recent OAG information, supplemented with flight counts from airport traffic control tower logs. In addition, standard air traffic control procedures were used for each airport. FAA selected the Runway Delay Simulation Model (RDSIM) to calculate ASV. Once developed, the delay curves should remain accurate unless a major change in fleet mix or operational characteristics occurs at the airport.

Adjusted Operational Availability

The NAS Performance Analysis System (NASPAS) was developed to analyze outages of the Air Traffic Control Facilities in FAA-maintained NAS. NASPAS receives monthly updates of outage data from the National Outage Database. The Maintenance Management System contains individual equipment outage data as recorded by the system specialist. Adjusted Operational Availability is the ratio of maximum facility/service hours, minus all outage time except for improvements, to maximum facility/service hours, expressed as a percentage.

NAS On-Time Arrivals

Flight Plan data are extracted from carrier records supplied from the Aviation System Performance Metrics database, which is maintained by the FAA’s Office of Aviation Policy and Plans. To ensure reliability, summary data are compared and supplemented with data filed monthly with DOT under 14 CFR Part 234, Airline Service Quality Performance Reports, which separately requires reporting by major air carriers on flights to and from all large hubs. FY 2005 data will not be finalized until approximately 90 days after the end of the fiscal year.

Noise Exposure

This measure is derived from model estimates that are subject to errors in model specification. A statistical modeling technique (Model for Assessing Global Exposure to the Noise of Transport Aircraft or MAGENTA) is applied using U.S. population data from the Department of Commerce, locally developed traffic distribution, and aircraft distributions developed using the Enhanced Traffic Management System (ETMS) and current aircraft registration databases. The local traffic utilization data is available for the busiest U.S. airports in the form of studies developed for the Integrated Noise Model (INM). For smaller airports, a generic statistical procedure was employed.

No actual count is made of the number of people exposed to aircraft noise. Aircraft type and event level are current. However, some of the databases used to establish route and runway utilization were developed from 1990 to 1997, with many of them now more than 7 years old. The plans may not reflect changes in airport layout, including expansions. The benefits of federally funded mitigation, such as buyout, are accounted for.

FAA reports the percentage decrease in the number of people exposed to significant noise, measured from the 3-year average for calendar years 2000–2002. The 3-year average stabilizes noise trends, which can fluctuate from year to year and are affected by unusual events.

The reporting of percentages helps avoid confusion over U.S. noise exposure trends caused by annual improvements to the noise exposure model. Until recently, the scope of the measure included only scheduled commercial jet transport airplane traffic at major U.S. airports. With access to better operational data sources, the scope has expanded to include unscheduled freight, general aviation, and military traffic. The increase in the estimated number of people exposed to significant noise is a result of improvements in measurement, not a worsening in aviation noise trends. Use of the percentage change in aircraft noise exposure shows the trend in aircraft noise exposure.





To ensure reliability, the Integrated Noise Model (the core of the MAGENTA model) has been validated with actual acoustic measurements at both airports and other environments. External forecast data are from primary sources. The MAGENTA population exposure methodology has been thoroughly reviewed by an ICAO task group and was most recently validated for a sample of airport-specific cases.

Aviation Fuel Efficiency

FAA measures this target using SAGE (System for Assessing Aviation Global Emissions), a computer model that estimates aircraft fuel burn and emissions for variable-year emissions inventories and for operational, policy, and technology-related scenarios. For this target, SAGE is used annually to generate fuel burn and total distance flown for all U.S. commercial operations.

Employee Attitude Survey (EAS)

The percent positive value is based on the number of “agree” or “strongly agree” ratings for 12 performance culture EAS items divided by the total number of ratings. Given that FAA measures relatively small differences in percent positive, census surveys are used (i.e., all employees are surveyed for our primary performance target assessments, such as in 2006 and 2008). However, for practical reasons we may use samples in some years and estimate our progress. The 2005 interim Employee Attitude Survey was administered in May 2005 to a stratified, random sample of about 6,500 employees and the results have been reported to the Administrator. Despite the large sample, there is a potential for measurement error.

ASSESSING PROGRAMS

PROGRAM ASSESSMENT RATING TOOL REVIEWS

In FY 2003, we reviewed ATO, known then as Air Traffic Services, and Research, Engineering, and Development using PART. ATO is the largest line of business within FAA and is responsible for safely moving air traffic throughout the national air space system. R,E&D conducts aviation safety research to support high priority FAA goals.

The assessment indicated that ATO’s overall purpose is clear and that performance goals are well defined. The program, which was rated adequate, is working to improve its efficiencies under the new ATO alignment.

OMB recommended that ATO

- ▶▶ Resolve the air traffic controller staffing and efficiency concerns, as raised by the OIG and GAO.
- ▶▶ Work to consistently achieve long-term goals.
- ▶▶ Continue efforts to improve efforts and contain costs.
- ▶▶ Develop an efficiency measure and target for the 2006 President’s Budget.

In response to the recommendations, we have established a 10-year strategy for the air traffic control workforce that details efficiencies from cost savings and productivity improvements. The *Flight Plan* provides a strategic framework for a safe, efficient and sound air transportation system. Current performance against expected outcomes and cost cutting efforts are outlined in the *Flight Plan* and reported monthly.

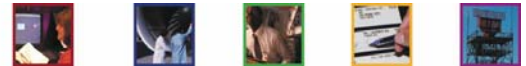
Additionally, ATO implemented a strategic management process in FY 2005. Preliminary targets for ATO efficiency measures related to unit cost and productivity were established.

The OMB PART assessment indicated R,E&D’s overall purpose is clear and that the program has specific long-term performance measures tied to specific research programs. R,E&D received a rating of effective, the highest possible.

OMB recommended that R,E&D

- ▶▶ Work with NASA to ensure no duplication of effort in research programs exist.
- ▶▶ Include efficiency measure and targets in the FY 2005 President’s Budget.





- ▶ Implement a new cost accounting system that will allow viewing of financial plans at various reporting levels in real-time.

We completed action on the recommendations. FAA continues cooperative R&D efforts with NASA. An R&D efficiency measure is now part of the FAA’s annual R,E&D budget requests and is included in strategic and business planning documents. DELPHI financial reports are used in conjunction with the FAA cost accounting system as part of the R,E&D funds management and tracking.

PROGRAM EVALUATIONS

Both air carriers and passengers play a critical role in the transportation of hazardous materials by air. Air carriers (including shippers and repair stations that ship hazardous materials) are required to transport the material in accordance with the existing Federal regulations. Passengers are prevented from carrying unauthorized hazardous materials onto scheduled commercial flights if discovered during the security screening. To ensure compliance, Special Agents periodically inspect and conduct investigations of violations by air carriers, shippers, and repair stations that ship by air. DOT’s Pipelines and Hazardous Materials Safety Administration (PHMSA) promulgates these hazardous materials regulations.

DOT’s OIG conducted an evaluation to assess the effectiveness of our efforts to ensure compliance with existing hazardous materials regulations. To improve the management of this effort, OIG recommendations included the following:

- ▶ Institute guidelines and timeframes for conducting hazardous materials investigations, conducting legal reviews, and issuing Notices of Proposed Civil Penalties through the coordinated efforts of the Hazardous Materials Division and the Office of the Chief Counsel.
- ▶ Develop and implement alternate means of administering hazardous materials enforcement cases, such as the ticketing system used by PHMSA.
- ▶ Finalize and implement the voluntary disclosure reporting program. FAA needs to take a systematic approach in effectively managing the program, to include disseminating all useful information to the air carriers, hazardous material shippers, and DOT Operating Administrations with hazardous materials oversight and enforcement responsibilities.
- ▶ Implement a pilot project with the Transportation Security Administration (TSA) and one or more air carriers to determine the effectiveness and cost on an automated operating system to record and process violations of hazardous materials regulations discovered during screening of passenger carry-on and checked baggage. In the interim, collaborate with TSA to implement procedures for notifying FAA of hazardous materials incidents associated with passenger carry-on baggage.
- ▶ Issue an Advisory Circular notifying all air carriers that they must report to FAA all unauthorized hazardous materials found in passenger-checked baggage and take enforcement actions against those air carriers not complying with the reporting requirements.

In response to the OIG recommendations, FAA

- ▶ Issued written field guidance on the timeliness of civil penalty cases that reduces the time allowed for civil penalty enforcement investigative reports to be submitted for legal review from 120 to 90 days. In addition, the Chief Counsel’s Office expects to revise Order 2150.3A by the end of the calendar year to provide more consistent guidance to all FAA inspectors.
- ▶ Expects to publish an initial notice in the *Federal Register* by March 30, 2006, that will implement a notice of violation process similar to both the Pipelines and Hazardous Material Safety Administration “ticketing” process and the process we previously used to administer certain aviation security violations.
- ▶ Completed a review of the draft Voluntary Disclosure Advisory Circular for certain hazardous materials violations, in cooperation with the Chief Counsel’s Office. The draft Voluntary Disclosure Advisory Circular has been circulated for notice and comment from air carrier associations. We expect to publish this Advisory Circular by December 2005.





- ▶ Developed a department-wide intermodal shipper database that contains DOT's hazardous materials inspections, penalties, incidents, exemptions, and registrations information. The system will help set shipper inspection priorities based on prior penalties and incidents on record.
- ▶ Arranged with the Air Transport Association (ATA) to provide its member air carriers with summary results of FAA hazardous materials inspections of their operations. We have conducted over 3,000 outreach visits to hazardous materials shippers in the past 12 months and FAA field agents will provide a summary of a shipper's prior incident records to the shipper during inspections. We also provided our inspection and penalty records for the DOT intermodal database system so they will be available for the other DOT Operating Administrations.
- ▶ Drafted a revision to our Memorandum of Agreement (MOA) with the TSA. This revised MOA will be the basis for a mechanism to share TSA data on security checkpoint seizures of hazardous materials with the FAA. We will evaluate and prioritize the information in terms of the risks posed by the abandoned hazardous materials. Lower risk items will be entered into FAA's system to generate an automated outreach notification to the relevant passenger, higher risk items will be forwarded to the relevant Regional Office for investigation. Concerning unauthorized hazardous materials discovered during checked baggage screening, the TSA Standard Operating Procedure advises screeners to refer their discoveries to the air carrier that checked the bag. The air carrier would have to notify FAA. We initiated the system to generate automated outreach notices in January 2005, and by the end of FY 2005 we had mailed more than 4,000 outreach notices to passengers.





FINANCIAL STATEMENTS





A MESSAGE FROM THE CHIEF FINANCIAL OFFICER

FY 2005 has been a year of significant accomplishments for FAA. Building on last year's successes, we were able to achieve 28 of 31 performance goals—this is an improvement over our FY 2004 performance. I am particularly proud of our continued success in meeting our Organizational Excellence goals, which support our ability to provide the traveling public with safe, secure, and efficient air travel.

Notable accomplishments included the following:

- ▶ Honored with our second consecutive Certificate of Excellence in Accountability Reporting from the Association of Government Accountants for our *FY 2004 Performance and Accountability Report*. FAA was 1 of only 10 Federal Government agencies to receive this distinction. We are all justly proud of this accomplishment. In addition, our *FY 2004 Performance and Accountability Highlights* publication received a Gold Award from the League of American Communication Professionals, recognizing it as one of the top annual reports in the country.
- ▶ Received an unqualified opinion on our financial statements. FY 2005 marks the fifth consecutive year that FAA has received an unqualified audit opinion.
- ▶ Implemented quality control processes to address FY 2004 findings from the OIG and our independent auditors, to ensure improved financial statement integrity.
- ▶ Awarded a contract for the operation of 58 Flight Service Stations to Lockheed Martin. We estimate that this competitive sourcing initiative—one of the largest ever undertaken by a Federal Government agency—will save FAA \$2.2 billion from FY 2003 through 2015.
- ▶ Improved our financial management systems. The new DELPHI general ledger system has been stabilized and we have focused on enhancing our cost accounting system that produces fully allocated cost information for operating departments. With this tool, we will be able to provide managers with meaningful managerial cost data to make better resource allocation decisions.
- ▶ Neared completion on our ISO 9001 certification in our AVS line of business. We expect this to be awarded next year. By implementing a quality management system, FAA will have achieved a standard of operational excellence that is recognized and respected throughout the world.
- ▶ Implemented a major initiative to achieve cost efficiencies within FAA operations. Each line of business has undertaken specific cost reduction and cost avoidance actions that we track monthly at *Flight Plan* status meetings. We have developed a plan to expand this initiative to include productivity measurement and improvement in FY 2006. FAA has also begun contract negotiations with FAA's largest unions.
- ▶ Revised and updated our *Flight Plan* to reflect the new realities facing both FAA and its industry partners.



Chief Financial Officer Ramesh Punwami accepted FAA's second consecutive Certificate of Excellence in Accountability Reporting from the Association of Government Accountants on September 14, 2005.



Although we received an unqualified opinion on our financial statements for the fifth consecutive year, we received an internal control material weakness in the area of timely processing of





transactions and reconciliation of accounts. We have already established a quality control team and are proactively assigning resources to correct the processes that resulted in the internal control material weakness. I continue to be impressed by FAA's high levels of performance and accountability. Because of our hard work throughout the year, FAA has a modern financial management system that provides our managers with better information about the real costs of our programs and initiatives, which, in turn, has led to greater success. The firm foundation we have built will enable us to meet the greatest challenges we face in moving America safely—improving safety, increasing capacity, and managing our business more effectively while facing a shrinking budget and the changing aviation industry.

Ramesh K. Punwani
Assistant Administrator for Financial Services/Chief Financial Officer
November 8, 2005



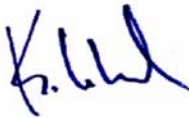


U.S. Department of Transportation
Office of the Secretary of Transportation
Office of Inspector General

Memorandum

Subject: ACTION: Quality Control Review of Audited Financial Statements for FY 2005 and FY 2004 Federal Aviation Administration QC-2006-010

Date: November 14, 2005

From: Kenneth M. Mead
Inspector General 

Reply to Attn. of: JA-20

To: The Secretary
Federal Aviation Administrator

The audit of the Federal Aviation Administration's (FAA) Financial Statements as of and for the years ended September 30, 2005, and September 30, 2004, was completed by KPMG LLP (KPMG) of Washington, DC (see Attachment). We performed a quality control review of the audit work to ensure that it complied with applicable standards. These standards include the Chief Financial Officers Act; Generally Accepted Government Auditing Standards; and the Office of Management and Budget Bulletin 01-02, "Audit Requirements for Federal Financial Statements."

The KPMG audit report concluded that the financial statements presented fairly, in all material respects, the financial position of the FAA as of September 30, 2005, and September 30, 2004, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, for the years then ended, in conformity with accounting principles generally accepted in the United States.

In fiscal year 2005, FAA continued to refine its Delphi-related processing, procedures, and controls but experienced difficulties in the timely processing of transactions and the reconciliations of significant financial accounts. As a result, FAA was not able to prepare reliable financial statements in a timely manner during the year and at year-end. It was necessary for FAA to make over \$2.0 billion of adjustments to year-end balances to prepare complete and accurate financial statements, and these statements were not available until 4 weeks after the end of the fiscal year.





The report presented the following material internal control weakness, three reportable conditions, and three instances of noncompliance with laws and regulations.

Material Weakness

1. Timely Processing of Transactions and Reconciliation of Accounts.

Reportable Conditions

1. Management and Oversight of Contracts.
2. Monitoring of Grants.
3. Information Technology Controls over FAA Third-Party Systems and Applications.

Noncompliances With Laws and Regulations

1. Federal Financial Management Improvement Act of 1996 (FFMIA).
2. Department of Transportation and Related Agencies Appropriations Act of 1997 (Public Law 104-205).
3. Anti-deficiency Act, as amended.

KPMG made 18 recommendations for corrective actions in its report. We agree with the KPMG recommendations, and therefore, we are not making any additional recommendations. FAA concurred with the material weakness, reportable conditions, and noncompliances, and agreed with the recommendations. FAA committed to implement corrective actions during fiscal year 2006. In accordance with DOT Order 8000.1C, the corrective actions taken in response to the recommendations are subject to follow-up.

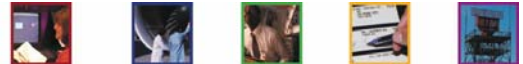
In our opinion, the audit work performed by KPMG complied with applicable standards.

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 Ted Alves, the Principal Assistant Inspector General for Auditing and Evaluations, at (202) 366-1992.

Attachment

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KPMG LLP
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 balance sheets of the U.S. Department of Transportation – Federal Aviation Administration (FAA) as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources, for the years then ended (herein referred to as “financial statements”). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered the FAA’s internal control over financial reporting and tested the FAA’s compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these 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 years ended September 30, 2005 and 2004, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

Reportable Condition Considered To Be A Material Weakness

- A. Timely Processing of Transactions and Reconciliation of Accounts

Other Reportable Conditions

- B. Management and Oversight of Contracts
- C. Monitoring of Grants
- D. Information Technology Controls over FAA and Third-Party Systems and Applications

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following 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*:

- E. *Federal Financial Management Improvement Act of 1996 (FFMIA)*
- F. *Department of Transportation and Related Agencies Appropriations Act, 1997*
- G. *Anti-deficiency Act*

KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is a member of KPMG International, a Swiss association.





The results of our tests of FFMIA disclosed instances where the FAA’s financial management systems did not substantially comply with Federal financial management information systems requirements, and the U.S. Government Standard General Ledger at the transaction level.

The following sections discuss our opinion on the FAA’s 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, regulations, contracts, and grant agreements, and management’s and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying balance sheets of the Federal Aviation Administration as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources, for the years 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, 2005 and 2004, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, *Summary of Significant Accounting Policies*, and Note 12, *Airport and Airway Trust Fund Earmarked Collections*, the accompanying financial statements reflect actual excise tax revenues deposited in the Airport and Airway Trust Fund through March 31, 2005 and excise tax receipts estimated by the Department of Treasury’s Office of Tax Analysis for the quarters ended June 30, 2005 and September 30, 2005.

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 Circular No. A-136, *Financial Reporting Requirements, Part A, Form and Content of the Performance and Accountability Report*. 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 audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Performance section, and other accompanying information on pages i to 2, pages 30 to 57, and pages 123 to 130, are an integral part of the FAA’s *Fiscal Year 2005 Performance and Accountability Report*. However, this information is not a required part of the financial statements and is presented for purposes of additional analysis. The information in the Performance section and other accompanying information on pages i to 2, pages 30 to 57, and pages 125 to 130, have not been subjected to the same auditing procedures and, accordingly, we express no opinion on it.

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.

We noted certain matters, described in Exhibits I and II, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable condition A presented in Exhibit I is a material weakness. Exhibit II presents the other reportable conditions B – D.

A summary of the status of prior year reportable conditions is included in Exhibit IV.

We also noted certain additional matters that we will report to the management of the FAA in a separate letter dated November 8, 2005.

COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed two instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and are described in Exhibit III.

The results of our tests of FFMIA disclosed instances in which the FAA’s financial management systems did not substantially comply with two of the three requirements discussed in the Responsibilities section of this report, and are described in Exhibit III.

RESPONSIBILITIES

Management’s Responsibilities. The *Government Management Reform Act of 1994* (GMRA), *Accountability of Tax Dollars Act*, and *Government Corporation Control Act* require agencies subject to the CFO Act of 1990 and those designated by OMB, 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 Department of Transportation in meeting these reporting requirements, the FAA prepares annual financial statements in accordance with OMB Circular No. A-136.

Management is responsible for the financial statements, including:

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

In fulfilling this responsibility, management is required to make estimates and judgments 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 fiscal year 2005 and 2004 financial statements of the FAA based on our audits. We conducted our audits 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the FAA’s internal control over financial reporting. Accordingly, we express no such opinion.

An audit also 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 audits provide a reasonable basis for our opinion.

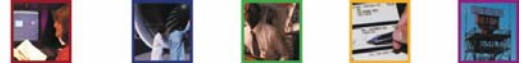
In planning and performing our fiscal year 2005 audit, we considered the FAA’s internal control over financial reporting by obtaining an understanding of the FAA’s internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls 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 *Federal Managers’ Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on the FAA’s internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, 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 the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management’s Discussion and Analysis and Performance Results sections, 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 reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the FAA’s fiscal year 2005 financial statements are free of material misstatement, we performed tests of the FAA’s compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, regulations, contracts, and grant agreements applicable to the FAA. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements 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 solely for the information and use of the FAA's management, the Department of Transportation's Office of Inspector General, OMB, the Government Accountability Office, 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

November 8, 2005





**Independent Auditors' Report
Material Weakness in Internal Control**

EXHIBIT I

MATERIAL WEAKNESS

A. Timely Processing of Transactions and Reconciliation of Accounts

Background: In November 2003 the FAA began using the Department of Transportation's Delphi financial accounting system, retiring the use of the Departmental Accounting and Financial Information System (DAFIS) legacy system. Delphi, an Oracle-based financial system, was FAA's core integrated general ledger during fiscal year 2005. Several feeder and subsidiary systems (e.g., grants, human resources, logistics, labor distribution, cost accounting, procurement, etc.) interface transactional data with Delphi.

During the first year of implementation – fiscal year 2004 – FAA management was faced with a variety of challenges typically found in the first year of implementation of a new system. Several of those challenges resulted in temporary lapses in control and other system-related deficiencies that required manual workarounds, additional personnel, and management attention during the year in order to produce accurate financial statements. The implementation of Delphi also interfered with FAA's ability to report financial information timely and accurately during fiscal year 2004. We reported this matter as a reportable condition in our 2004 *Independent Auditors' Report*.

During fiscal year 2005, FAA continued to refine its Delphi-related financial processes, procedures, and controls to ensure the reliability of financial data and reports. FAA made improvements to its monthly and year-end closing processes and availability of the system to its users. In addition, FAA launched a restructuring of its financial accounting operations, in part to centralize processing of certain transactions from regional centers to facilities in Oklahoma City, Oklahoma.

Conditions: We noted the following internal control weaknesses related to the timeliness of transaction processing and reconciliation of significant financial statement accounts during the year:

Timely recording of transactions:

- **Property, plant and equipment:** The FAA's headquarters offices did not have effective processes to capitalize headquarters-based projects in a timely manner. Assets that had been placed in-service during the year remained classified as "construction in-process", causing errors in interim financial statements, including the understatement of depreciation expense totaling approximately \$83 million. To correct the problem for year-end reporting, the FAA committed substantial resources during the last month of the fiscal year to capitalize approximately \$1.1 billion, and an additional \$180 million during the first two weeks after year-end. Further, the FAA has not established adequate processes, procedures, and internal controls to ensure that property, plant and equipment is consistently and accurately capitalized within 30 days after the date placed in service in the operating location (outside of headquarters) per FAA policy. During the fiscal year 2005 audit, we noted that for 131 of the 142 (92%) items tested, the assets were not capitalized within 30 days after being placed in service. In addition, the FAA has not always removed retired assets from Delphi in a timely manner, and documentation was not readily available to support retirements of some assets. Of 55 retirement transactions reviewed during fiscal year 2005, we noted 19 assets had not been removed from the accounting records in a timely manner. These 19 retired assets should have been removed from the system in fiscal year 2004.
- **Obligations:** One FAA regional office did not record obligations in a timely manner. We noted instances where the Southern Region procured services from a contractor, pursuant to several hurricane disaster mission assignments received from the Federal Emergency Management Agency (FEMA), did not timely record the related obligations, and did not confirm that adequate funding was available. More than \$222 million of contract support obligations were not recorded at September 30, 2005, of which funding was





**Independent Auditors' Report
Material Weakness in Internal Control**

EXHIBIT I

available for only \$60 million of those obligations. Involvement of FAA and DOT legal counsel was needed to determine if FAA had violated the *Anti-deficiency Act*. The FAA and DOT legal counsel determined that the FAA did not commit a violation of the *Anti-deficiency Act* in this case.

- **Advances and Prepayments:** Of the FAA's \$242.8 million balance of advances and prepayments as of September 30, 2005, approximately \$24.8 million relates to activity that took place prior to October 2003, and is likely unsupported. As one example, one advance was recorded in October 2003 totaling approximately \$12.6 million, and FAA was unable to provide supporting documentation since the contract files had been shipped to an off-site records storage facility (a strong indication that the contract had been completed and closed).

Timely reconciliation of accounts:

- **Suspense accounts:** The FAA did not complete accurate and timely clearing of transactions held in suspense. As of June 30, 2005, we noted that the suspense account balance was \$235.2 million. Further, we noted the suspense account balance was \$347.8 million at August 31, 2005 of which \$193.8 million was more than 60 days old.
- **Budgetary and proprietary account relationships:** The FAA has not established effective processes to investigate timely the cause of abnormal balances and account relationship discrepancies, e.g., budgetary to proprietary reconciliations, and investigate potential information technology system functionality concerns. In March 2005, FAA identified financial statement discrepancies in excess of \$600 million between certain proprietary balances, e.g., accounts receivable, payable and prepayments, and the corresponding budgetary accounts. These differences persisted throughout the year. While the FAA took some actions to resolve these differences, they did not link the cause to a Delphi system transaction posting error until after year-end, more than 9 months after discovery of the out-of-balance conditions. The resolution of this matter began October 2005, and required a substantial manual effort by management and accounting experts. Consequently, the interim financial statements were materially misstated throughout fiscal year 2005. This situation caused substantial delays in the preparation of accurate financial statements for audit.
- **Subsidiary records and the general ledger:** The FAA did not perform timely reconciliations of subsidiary systems and supporting records to the general ledger balances in Delphi. Consequently, the FAA's financial statements were not accurately and completely supported by detail records at the transaction level during the year. For example, of the seven subsidiary ledger reconciliations that should be performed by FAA, only two reconciliations were performed consistently during fiscal year 2005. The other five reconciliations had not been completed until June 30, 2005, nine months after the beginning of the fiscal year. At times we noted that aggregate differences between subsidiary records and the general ledger exceeded \$122 million, representing potential misstatements in the financial statements.

Cause: The FAA has adopted policies that, if fully adhered to by the programmatic and operating personnel, would enable the timely recording of PP&E placed in service, obligations into FAA's accounting system, and liquidations of advances and prepayments. Historically, communication has been weak between FAA's accounting offices and project managers, and effective processes and monitoring controls are lacking over large-scale headquarters' managed PP&E projects. Field personnel did not follow established policy to record obligations for contract services, which would have identified a lack of budgetary authority if obligations were properly and timely entered into the accounting system. Also, lack of timely review and monitoring of advances and prepayments in the accounting system resulted in unsupported balances on the FAA's financial statements as of September 30, 2005.





**Independent Auditors' Report
Material Weakness in Internal Control**

EXHIBIT I

The FAA cited resource constraints as the primary causes for the weaknesses in the reconciliation of accounts, and clearing of suspense account transactions. In addition to resource constraints, FAA also has not fully utilized automated data integrity reports in Delphi to identify and resolve questionable or erroneous transactions, which would have helped identify and resolve the Delphi posting logic error, and likely would have prevented the differences in the budgetary and proprietary account relationships, and between the subsidiary records and the general ledger.

Effect: Consequently, FAA was unable to prepare reliable financial statements in a timely manner during the year and at year-end. After material modifications to the year-end balances, including \$2.1 billion in adjustments discussed above, complete and accurate financial statements were not available until late October, or four weeks after the end of the fiscal year. Due to the requirements to submit audited financial statements within 45 days after the end of the fiscal year, FAA's ability to meet this deadline in future years is questionable without substantial changes to FAA's processes and controls over recording of transactions and reconciling accounts throughout the fiscal year. Failure to implement timely and effective reconciliation processes could increase the risks of fraud, abuse, undetected violations of appropriation laws, and mismanagement of funds, including instances of undiscovered anti-deficiencies; which lead to inaccurate financial reporting; and affect the Government's ability to effectively monitor the status of its budget.

Criteria: OMB Circular Number A-123, *Management Accountability and Control*, 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.

Statement of Federal Financial Accounting Standards (SFFAS) Number 6, *Accounting for Property, Plant and Equipment*, 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.

The Department of Transportation's *Financial Management Policies Manual, Section 3.04.3-Reconciliations*, states that each operating administration in the DOT is responsible for reconciling all transactions posted to all clearing accounts monthly. The agency should reclassify all clearing account transactions to the correct Treasury account symbol on the next reporting cycle, but no later than two months after the accomplished date.

GAO *Standards for Internal Control in the Federal Government (Standards)* state internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. All documentation and records should be properly managed and maintained.

OMB Circular No. A-127, *Federal Financial Systems*, prescribes policies and standards for Federal agencies to follow in developing, operating, evaluating and reporting on financial management systems and specifies the need for integrated financial systems.

The TFM, Supplement 1, Chapter 2-5100 (November 1999), states that agencies must reconcile clearing and receipt accounts. When resolving differences, agencies should maintain detailed reconciliation worksheets that, if needed, can be reviewed by the Agency's auditors or Treasury.





**Independent Auditors' Report
Material Weakness in Internal Control**

EXHIBIT I

Recommendations: We recommend that FAA:

1. Implement quality control review procedures to ensure that all assets are capitalized within 30 days of the "placed in-service" date. Improved procedures should be adopted in the regions and headquarters to ensure capitalized assets are complete, accurate, and properly valued during close-out of completed construction projects, and that asset retirements are recorded properly and in a timely manner.
2. Provide additional training for program personnel, and improve monitoring controls over the recording of obligations, and use of the system edit checks to verify funding availability. Controls should be "preventative" in nature, e.g., will prevent personnel from obligating or legally committing the FAA before sufficient funding is available, such that FAA is in full compliance with the Anti-deficiency Act at all times.
3. Perform timely clearing of all transactions held in suspense, in compliance with policies and procedures as documented in the Department of Transportation's *Financial Management Policies Manual*. Typically, significant balances should not be held in suspense more than 30 days.
4. Perform timely reconciliations of proprietary to budgetary accounts – at least quarterly, but ideally monthly; investigate unexplained discrepancies and record adjusting journal entries, as necessary to accurately state periodic financial statements. When discrepancies are identified, perform a timely root cause analysis and make appropriate modification in accounting processes, classification of transactions, and/or accounting system improvements to resolve the issue. Further, integrate into the routine operations of the FAA the use of automated exception and edit reports from the accounting system to identify questionable or erroneous transactions in a timely fashion.
5. Implement procedures to record transactions and perform account reconciliations in a timely manner. Perform subsidiary ledger to general ledger reconciliations more timely during the year – at least on a quarterly basis, but ideally monthly. Correct all significant Delphi system and subsidiary ledger interface weaknesses to develop a fully integrated financial management system as required by OMB Circular No. A-127.

FAA's Response: FAA has reviewed the material weakness related to timely processing of transactions and reconciliations of accounts and agrees with KPMG's recommendations. FAA recognizes the importance of recording financial data timely and routine processes that allow the preparation of timely and reliable financial statements. We agree to implement KPMG's recommendations in fiscal year 2006. This includes, for example, implementing improved processes to ensure that assets are capitalized timely, clearing suspense balances timely, continuing the monthly analysis and reconciliation processes that we have now put into place, and developing new processes to detect potential data integrity issues more timely.





**Independent Auditors' Report
Reportable Conditions in Internal Control**

EXHIBIT II

REPORTABLE CONDITIONS

B. Management and Oversight of Contracts

Background: The FAA has weaknesses in the management and oversight of cost reimbursable and support service contracts, two significant contracting vehicles used by FAA to support the operation of the National Airspace System (NAS).

The DOT OIG reported in fiscal year 2002 that the FAA was not properly administering cost reimbursable contracts. Specifically, the DOT OIG found that contracting officers exercised little effective oversight and lacked the basic information needed to properly manage, pay, and close contracts. In fiscal year 2001 the FAA had more than \$6 billion in contract backlog pending close-out. In recent years, management has engaged the services of the Defense Contract Audit Agency (DCAA), placed an emphasis on reducing contract close-out backlog, and made substantial progress since 2001 to reduce the backlog to \$318 million as of September 30, 2005.

The FAA recently conducted an internal review of controls over the FAA's management of its support service contracts, which are currently valued at approximately \$1.3 billion. The FAA concluded that weaknesses exist in the FAA's controls that prevent waste, fraud, and abuse in these contracts.

Conditions: We noted that the FAA:

- Has a backlog of \$340 million in completed contracts awaiting closeout as of September 30, 2005.
- Lacks an adequate tracking system to identify and monitor cost reimbursable contracts. Further, the FAA has not formally analyzed the results of the results of contract audits performed by the U.S. Department of Defense's Defense Contract Audit Agency (DCAA) for the FAA, to improve the close-out process.
- Did not always follow its own contract administration and procurement policies by awarding some support service contracts with little to no competition.

Cause: In October 1995, Congress exempted FAA from the Federal Acquisition Regulation (FAR) provisions applicable to most Federal agencies, and directed that FAA develop a new procurement system to provide the FAA with more flexibility in how to acquire equipment and services. FAA implemented its new Acquisition Management System (AMS) in April 1996. The issues we noted in our audit stemmed from inadequate policies and procedures in AMS to ensure strong accountability and oversight of taxpayers' money.

Effect: Poor contract management processes and controls increase the risks of fraud, abuse, undetected violations of appropriation laws and contract clauses, and mismanagement of funds; which may lead to inaccurate financial reporting by the FAA.

Criteria: FAA's *Procurement Toolbox Guidance – Contract Administration* provides guidance to management and contracting officers on the procedures that should be followed for proper oversight of cost reimbursable contracts. Further, GAO's *Standards for Internal Control in the Federal Government (Standards)* states that monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved. Managers are to: (1) promptly evaluate findings from audits and other reviews, including those showing deficiencies and recommendations reported by auditors and others who evaluate agencies' operations; (2) determine proper actions in response to findings and recommendations from audits and reviews; and (3) complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management's attention. The resolution process begins when audit or other review results are reported to management, and is completed only after action has been taken that (1) corrects identified deficiencies; (2) produces improvements; or (3) demonstrates the findings and recommendations do not warrant management action.





**Independent Auditors' Report
Reportable Conditions in Internal Control**

EXHIBIT II

Recommendation: We recommend that the FAA:

1. Complete the audits and close-out of the \$340 million backlog of completed contracts as of September 30, 2005.
2. Utilize the information obtained from contract audits performed by DCAA to effectively implement policy, procedural, and control improvements to the contracting process.
3. Implement policies and controls to ensure that FAA contract administration and procurement policies are followed when awarding and overseeing service contracts.

FAA's Response: FAA has reviewed the reportable condition related to management and oversight of contracts and agrees with KPMG's recommendations. FAA is committed to completing the closeout of the backlog of completed cost reimbursable contracts in fiscal year 2006. In addition, FAA has instituted and will maintain a tracking system for monitoring the results of DCAA audits, and will use that information to improve the contracting process.

Regarding the awarding and oversight of service contracts, through the direction of the Administrator, FAA established necessary policies and procedures, and a "review board" that is responsible for reviewing the cost estimates and business cases for each proposed contract over \$10 million. These actions were taken before September 30, 2005.

C. Monitoring of Grants

Background: The FAA has a responsibility to establish and maintain a system of accounting and internal controls over the expenditures related to the Airport Improvement Program (AIP). Due to size of the AIP, availability of resources, reliance placed upon sponsor activities, and other risks associated with the grants programs; the potential exists for fraud, waste and abuse of Federal funds. We found these risks to be more prevalent within the oversight and monitoring phases of the grants process. The DOT OIG has published several reports related to its investigation of revenue diversions, embezzlement, and other malfeasances committed by grant sponsors and related contractor entities. Since the beginning of fiscal year 2003, the OIG has issued ten reports related to the actual or possible misuse of approximately \$314 million of airports revenue and funding.

Conditions: We noted the following internal control weaknesses in the grants management process: The FAA:

- Lacks an effective, risk-based approach to oversee and monitor AIP grant sponsor activities.
- Has inadequate policies and procedures describing the roles and responsibilities of regional grant project managers for grant monitoring. We noted inconsistencies in decisions by project managers in the level of sponsor reliance, directly related to inadequate and overly discretionary policies and procedures for grant monitoring. For example, at one district office we noted that the FAA project manager did not regularly attend biweekly and monthly meetings held by the sponsor; at another district office, we noted no documented evidence of regular site visits being conducted.
- Places disproportional reliance on the OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, for assurances that AIP grant recipients are properly administering Federal funds and have sufficient internal controls, instead of front-end preventative and early detective controls found in more reliable grant administration and monitoring processes.

Cause: Regional FAA project managers have the discretion to determine their level of involvement and how much project oversight is needed. Determining factors considered by the project managers include availability of personnel, proximity and complexity of a project, and if the project is considered "high profile." Over time, the FAA has increased reliance placed on sponsors to provide project oversight ("self-certification"), including





**Independent Auditors’ Report
Reportable Conditions in Internal Control**

EXHIBIT II

inspections and fiscal adherence. The FAA has essentially placed reliance on internal controls at the sponsor for fiscal integrity and compliance with laws and regulations. In addition, an expansion of the AIP without an equal increase in regional administrative resources has contributed to the gradual increased reliance on sponsor oversight.

Effect: The increased responsibility that is placed on sponsors subjects the AIP program to an increased risk of the unlawful diversion of airport revenues and program funds. This creates an environment where the misuse may go undetected until after the incident occurs – sometimes spanning several years until the grant is closed by FAA personnel. Consequently, the FAA cannot directly manage related risks that may arise; such as over-expenditures and the inappropriate or misuse of AIP funds by sponsors.

Criteria: The GAO’s *Standards* defines five standards that define the minimum level of quality acceptable for internal control in government. Two applicable components include risk assessment, which “provides for an assessment of the risks an agency faces from both external and internal sources;” and, internal control monitoring, which is “designed to assure that ongoing monitoring occurs in the course of normal operations.” GAO’s *Standards* further states, “Internal control should provide reasonable assurance regarding the prevention of or the prompt detection of unauthorized acquisition, use, or disposition of an agency’s assets.”

Recommendations: We recommend that FAA:

1. Implement an effective, risk-based approach to oversee and monitor AIP grant sponsor activities. Further, we recommend establishing oversight and monitoring procedures that are based on the sponsors’ potential risks, and determining the level of reliance placed upon each sponsor. For example, the FAA could assign a risk rating of low, medium or high to each sponsor.
2. Develop a program which ranks or assesses new and existing grant sponsors that is based on their potential risks to the AIP, and considers the limited resources available to the FAA. Factors to consider in the assessments could include, but should not be limited to, the size of the operation and its potential impact on the financial integrity of the program (including the cumulative materiality of small airport grants); the sponsor’s affiliation with the local municipality, and whether they are a separate authority; the sponsor’s history of and adherence to the FAA’s grants policies and procedures; and the results of Single Audits and other compliance reviews.
3. Improve policies and procedures describing the roles and responsibilities of regional grant project managers for grant monitoring, including, if necessary, specific training programs.
4. The FAA should conduct periodic on-site file reviews, contractor interviews, and early examination of contractor selection procedures at airports to complement the control benefits of the OMB Circular No. A-133.

FAA’s Response: FAA has reviewed the reportable condition related to monitoring of grants and agrees with KPMG’s recommendations. FAA acknowledges that limited resources, as identified by the auditors, have resulted in prioritizing elements of the AIP grants management process. FAA agrees to develop and implement an appropriate risk-based approach to more closely align resources with potential for misuse of AIP funds during the grant oversight and monitoring phase.

FAA has already established a Grants Management Oversight Working Group comprised of appropriate headquarters and field personnel. The Working Group will review alternative approaches to establishing a risk-based approach, including the suggestions made by KPMG, as well as additional alternatives, including an automated Program Manager module, statistical sampling, financial exposure with any particular sponsor, an assessment of the technical, administrative and financial skills of the individual sponsor, role and resources of the





Independent Auditors' Report
Reportable Conditions in Internal Control

EXHIBIT II

State government, and FAA observations of sponsor and/or sponsor's representative during the project planning and pre-procurement phase.

The Working Group will make recommendations regarding the risk-based program, and the recommendations that are adopted will be implemented beginning in fiscal year 2006.

D. Information Technology Controls over FAA and Third-Party Systems and Applications

Background: General controls related to the FAA's primary financial applications owned by either the FAA or the Department of Transportation, including Delphi, need to be improved. FAA's information technology (IT) and financial management systems environment include:

- Delphi, the DOT core accounting system used by FAA;
- PRISM, the FAA's procurement system;
- AIP system;
- Electronic Clearing House Operations system (ECHO);
- System of Accounting and Reporting (SOAR);
- Cost Accounting System (CAS);
- Integrated Personnel and Payroll System (IPPS);
- Consolidated Uniform Payroll System (CUPS);
- Consolidated Personnel Management Information System (CPMIS);
- Capital Budget Management System (CBMS); and
- Logistics Information System (LIS).

Conditions: We noted the following IT and financial system control and functionality weaknesses at FAA:

- Potentially high-risk combinations of functions where individuals may be able to exceed or abuse their assigned authorities within the PRISM, IPPS, and Delphi applications.
- Instances of poor user administration within the PRISM and Delphi applications.
- Instances of configuration management and change request process documentation for PRISM, CAS, and CBMS were not updated or were in draft form only.
- Instances where the FAA did not always adequately document changes made to the PRISM, CAS, and CBMS applications, including change approvals and testing. Procedures for documenting, approving, and implementing application changes were not consistently in place and applied.
- Instances in which CAS database and CBMS servers were not configured in the most secure manner, resulting in potential vulnerabilities to improper access, use, loss, or modification.

Cause: The DOT and FAA are in a period of significant IT upgrade with the recent and continuing implementation of Dephi – a new core accounting system. New system implementations of this scale typically take several years to complete, particularly with respect to system interfaces of subsidiary systems, which must be reconfigured in some cases to fully integrate systems and establish a secure processing environment.





Independent Auditors' Report
Reportable Conditions in Internal Control

EXHIBIT II

Effect: The FAA implemented sufficient manual processes and compensating controls for weaknesses in network information security management and application security controls, including system-level access issues, application-level operational access controls for sensitive and critical functions, separation of duties, change management and application controls. Manual processes increase the burden on accounting personnel, and contribute to delays in posting timely preparation of accurate and complete financial statements during the year and at year-end, as described above in Comment A – *Timely Processing of Transactions and Reconciliation of Accounts*.

Criteria: Controls over IT and related financial systems are essential elements of financial reporting integrity. Effective general controls in an IT and financial systems environment are typically defined in six key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, and service continuity. In addition to reliable controls, Federal financial management system functionality is important to program monitoring, increasing accountability of financial and program managers, providing better information for decision-making, and increasing the efficiency and effectiveness of services provided by the Federal government.

OMB Circular No. A-130, *Management of Federal Information Resources*, Appendix III, requires Federal agencies to establish adequate security controls for information collected, processed, transmitted, stored, or disseminated in general support and application systems commensurate with the risk and magnitude of harm resulting from the loss, misuse, or unauthorized access to or modification of information.

National Institute of Standards and Technology Special Publication Number 800-53, *Recommended Security Controls for Federal Information Systems*, addresses minimum security control requirements that Federal agencies should implement in their general support and application systems that are consistent with the control issues addressed in this report.

Recommendations: We recommend that the FAA, in coordination with the DOT:

1. Review potentially high-risk combinations identified to ensure that appropriate segregation of duties exists (including role assignment matrix). When segregation of duties shortfalls exist, compensating controls should formally be defined and established to mitigate the associated risk.
2. Improve controls over user account management, including disabling all user accounts never used in PRISM.
3. Finalize the configuration management and enhance change request process and test process documentation in PRISM, CAS, and CBMS.

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

FAA's Response: FAA has reviewed the reportable condition related to information on technology controls over FAA and third-party systems applications and agrees with KPMG's recommendations. FAA, through the Chief Information Officer, is committed to maintaining data integrity and system security. FAA has already completed corrective actions for eight of nine identified conditions, and will fully implement the remaining recommendations in fiscal year 2006. We will also work with third parties that operate systems for FAA to ensure that the third party complies with KPMG's recommendations. We will also work with DOT toward accomplishing these goals for DOT sponsored systems.





**Independent Auditors' Report
Compliance and Other Matters**

EXHIBIT III

COMPLIANCE AND OTHER MATTERS

E. Federal Financial Management Improvement Act of 1996 (FFMIA)

Background/Criteria: FFMIA requires that an agency's financial management systems substantially comply with Federal financial management systems requirements, accounting standards issued by the Federal Accounting Standards Advisory Board, and use of the U.S. Government Standard General Ledger at the transaction level.

Condition: The FAA was not in substantial compliance with FFMIA because five of the key financial systems used by FAA (ECHO, PRISM, CAS, IPPS, and CUPS), which feed or support financial data into Delphi, do not comply substantially with the categories of FFMIA compliance listed in OMB Circular No. A-127, Section 7 – *Financial Management System Requirements*. Specifically, we noted weaknesses in the following:

Category of Non-Compliance	ECHO	PRISM	CAS	IPPS	CUPS
Lacks Agency-wide Financial Information Classification Structure				X	X
Does not apply the U. S. Government Standard General Ledger at the Transaction Level				X	X
Lacks Effective Financial Reporting	X				
Lacks Effective Budget Reporting	X			X	X
Does not Adhere to Established Functional Requirements	X			X	X
Does not Adhere to Computer Security Act Requirements	X	X	X		
Inadequate systems and processing documentation	X				
Lacks Adequate Internal Controls	X	X	X	X	

Effect: These conditions may adversely affect the FAA's ability to accurately report the results of its financial operations, in a timely manner, to the Department of Transportation.

Recommendations: We recommend that the FAA address and resolve the weaknesses noted in the five key financial systems mentioned above and fully comply with FFMIA in fiscal year 2006.

FAA's Response: FAA has reviewed KPMG's analysis of FAA's compliance with FFMIA and agrees with KPMG's recommendations. FAA recognizes the importance of complying with Federal financial management systems requirements, applicable Federal accounting standards, and processing transactions in accordance with the U.S. Government Standard General Ledger. FAA will fully implement all of KPMG's recommendations in fiscal year 2006 related to FAA's systems and will work with third parties that operate systems for FAA to ensure that the third party complies with KPMG's recommendations.





**Independent Auditors' Report
Compliance and Other Matters**

EXHIBIT III

F. Department of Transportation and Related Agencies Appropriations Act, 1997

Background/Criteria: *The Department of Transportation and Related Agencies Appropriations Act, 1997* (Public Law 104-205) requires that the FAA's Administrative Services Franchise Fund (the Franchise Fund) shall be paid in advance of the performance of services by the Franchise Fund. We noted that the Franchise Fund routinely performed work for its customers without being paid in advance for these services.

Condition: During fiscal year 2005, the Logistics Center was the only one of the Franchise Fund's seven lines of business that consistently received advanced funding before performing services. The other six lines of business did not have effective processes or controls to ensure that the Franchise Fund receives advanced funding before beginning work for its customers. Specifically, we noted that the Franchise Fund did not receive advance funds for agreements that total approximately 40%, or approximately \$150 million, of the Franchise Fund's total revenues for fiscal year 2005.

Effect: The FAA has violated the provisions of Public Law 104-205 since funding is received after work has begun, rather than paid in advance of the performance of services.

Recommendations: We recommend that FAA implement a policy in fiscal year 2006 to ensure that customer payments are received in advance of services being performed by Franchise Fund personnel, in accordance with the *Department of Transportation and Related Agencies Appropriations Act, 1997*.

FAA's Response: FAA has reviewed KPMG's analysis of FAA's compliance with the *Department of Transportation and Related Agencies Appropriations Act*, and agrees with KPMG's recommendations. The Franchise Fund will write a policy to specifically address the process of advancing funds for agreements, and will re-implement taking advances in fiscal year 2006.

G. Anti-deficiency Act

Background / Criteria: In fiscal year 2004, the amount appropriated for the Small Community Air Service Development Program was \$20 million, minus a small rescission, leaving a total of \$19.9 million appropriated and apportioned. During fiscal year 2004, \$1.9 million was deobligated from the AIP funds, and six new grants were awarded totaling \$1,929,901. Although sufficient funds remained from the AIP appropriations for this amount (due to the deobligations), these six grants brought the total amount obligated in fiscal year 2004 for the Small Community Air Development Service Program to \$21,811,901, or \$1,929,901 more than had been apportioned. Title 31 U.S.C. Section 1517 states that an officer or an employee of the United States Government may not make or authorize an expenditure or obligation exceeding an apportionment or an amount permitted by regulations as specified by Title 31 U.S.C. Section 1514.

Condition: During fiscal year 2005, the Chief Counsel's office determined that the transactions described above, associated with the Small Community Air Service Development Program, constituted violations of the *Anti-deficiency Act*. Although this violation occurred in fiscal year 2004, it was not detected by management until after these transactions were recorded into the accounting system during fiscal year 2005. FAA determined that the violations occurred due to a lack of training of program officials within the Department of Transportation's Office of the Secretary, which manages the program. Specifically, obligations were established in FY 2004 that exceed the apportioned amounts. FAA reported the violations to the DOT and was in the process of reporting the violations to the President and the Congress as required by Title 31 U.S.C. Section 1517.





**Independent Auditors' Report
Compliance and Other Matters**

EXHIBIT III

Effect: FAA incurred obligations in excess of apportionments, which constituted a violation of the Anti-deficiency Act.

Recommendations: We recommend that the FAA and the DOT strengthen controls to prevent further violations of the *Anti-deficiency Act* in the Small Community Air Service Development Program in fiscal year 2006.

FAA's Response: FAA has reviewed KPMG's analysis of this instance of noncompliance with the Anti-deficiency Act, and agrees with KPMG's recommendations. We will work with the DOT Office of the Secretary to ensure that its program officials who manage the Small Community Air Service Development Program receive necessary training, and we will strengthen controls to prevent further violations. These actions will be completed by December 31, 2005.





Independent Auditors' Report
 Status of Prior Year Findings

EXHIBIT IV

**STATUS OF PRIOR YEAR REPORTABLE CONDITIONS, AND NON-COMPLIANCE
 WITH SIGNIFICANT LAWS AND REGULATIONS**

Prior Year Condition	As Reported At September 30, 2004	Status As Of September 30, 2005
Implementation of a new financial accounting system	Reportable condition: The FAA's implementation of the new financial accounting system, Delphi, resulted in lapses in control, other system-related deficiencies requiring manual workarounds, and interfered with FAA's ability to report financial information timely and accurately during the year.	Elevated to a material weakness: During fiscal year 2005, FAA demonstrated progress in improving controls within Delphi with regard to training, preventing interface errors with feeder and subsidiary systems, and not making transactions outside of the accounting system. However, we noted that FAA was not able to implement sufficient controls to ensure that transactions were processed timely, and that reconciliations were completed throughout the year. This matter is included in Comment A in Exhibit I.
Cost accounting information	Reportable condition: The FAA's was unable to provide comprehensive internal management cost reports from the Cost Accounting System due primarily to issues related to implementation of a new financial accounting system.	No longer a reportable condition: The FAA implemented sufficient controls to correct this matter.
Reconciliation of Fund Balance with Treasury	Reportable condition: The FAA's fund balance with Treasury reconciliations were not adequately performed in a timely fashion during fiscal year 2004, and the FAA did not clear items carried in suspense accounts timely during the year. Further, there were weaknesses in the reconciliation process.	Elevated to a material weakness: Although improvements were made in the reconciliation of fund balance with Treasury, weaknesses still remain in controls over the FAA's timely clearing of suspense accounts. This matter is included in Comment A in Exhibit I.





Independent Auditors' Report
Status of Prior Year Findings

EXHIBIT IV

Prior Year Condition	As Reported At September 30, 2004	Status As Of September 30, 2005
Information technology controls over FAA and third-party systems and applications	<u>Reportable condition:</u> Certain general controls related to the FAA's primary financial applications owned by the FAA and the DOT need to be strengthened.	<u>Continue as a reportable condition:</u> Although improvements were made, weaknesses still remain in controls over FAA and third-party systems and applications.
Cost reimbursable contracts	<u>Reportable condition:</u> There were weaknesses in the FAA's oversight and management of cost reimbursable contracts. As an example, the FAA had a \$1.5 billion backlog of completed contracts awaiting audit.	<u>Continue as a reportable condition:</u> Although improvements were made, weaknesses still remain in controls over cost reimbursable contracts.
Non-compliance with the <i>Federal Financial Management Improvement Act</i>	<u>Instance of non-compliance:</u> FAA was not in substantial compliance with FFMIA because: (1) conversion-related challenges in implementation of the new financial accounting system prevented the FAA from recording a significant number of transactions in a timely fashion; and (2) six of the FAA's key financial systems did not comply with the categories of FFMIA compliance.	<u>Continue reporting as an instance of non-compliance:</u> Although improvements were made (such as the recording of transactions in a timely fashion in the FAA's new financial accounting system), five of the FAA's key financial systems do not comply with the categories of FFMIA compliance.





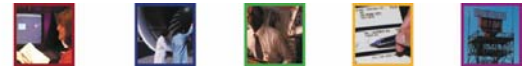
**U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED BALANCE SHEETS**

**As of September 30
(Dollars in Thousands)**

Assets	2005	2004
Intragovernmental		
Fund balance with Treasury (Notes 2 & 12)	\$ 2,413,102	\$ 2,840,663
Investments (Notes 3 & 12)	10,665,560	10,318,029
Accounts receivable, advances, and other (Notes 4 & 12)	304,437	215,989
Total intragovernmental	13,383,099	13,374,681
Accounts receivable, advances, and other, net (Note 4)	183,493	173,283
Inventory, operating materials, and supplies, net (Note 5)	626,086	585,709
Property, plant, and equipment, net (Notes 6 & 9)	14,432,466	14,469,731
Total assets	\$ 28,625,144	\$ 28,603,404
Liabilities		
Intragovernmental liabilities		
Accounts payable	\$ 106,693	\$ 61,041
Employee related, legal, and other (Note 8)	294,566	287,026
Total intragovernmental liabilities	401,259	348,067
Accounts payable	564,575	649,005
Environmental cleanup costs (Notes 7 & 17)	596,536	606,261
Employee related, legal, and other (Notes 8, 9 & 17)	1,163,022	959,527
Federal employee benefits (Note 10)	942,276	954,463
Total liabilities	3,667,668	3,517,323
Commitments and contingencies (Notes 9 & 17)		
Net position		
Unexpended appropriations	1,268,894	999,146
Cumulative results of operations (Note 12)	23,688,582	24,086,935
Total net position	24,957,476	25,086,081
Total liabilities and net position	\$ 28,625,144	\$ 28,603,404

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



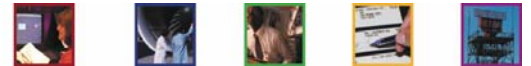


U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED STATEMENTS OF NET COST
For the Years Ended September 30
(Dollars in Thousands)

Line of business programs (Note 11)	2005	2004
Air Traffic Organization		
Expenses	\$ 9,354,459	\$ 8,214,526
Less earned revenues	(423,041)	(135,515)
Net costs	8,931,418	8,079,011
Aviation Safety		
Expenses	1,079,171	942,377
Less earned revenues	(4,053)	(2,649)
Net costs	1,075,118	939,728
Airports		
Expenses	3,712,423	2,977,300
Less earned revenues	(496)	(232)
Net costs	3,711,927	2,977,068
Commercial Space Transportation		
Expenses	14,073	12,527
Net costs	14,073	12,527
Non line of business programs		
Regions and center operations and other programs		
Expenses	696,029	389,954
Less earned revenues	(399,469)	(240,866)
Net costs	296,560	149,088
Not assigned to programs		
Expenses	-	36,572
Net costs	-	36,572
Net cost of operations		
Total expenses	14,856,155	12,573,256
Less earned revenues	(827,059)	(379,262)
Total net cost	\$ 14,029,096	\$ 12,193,994

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



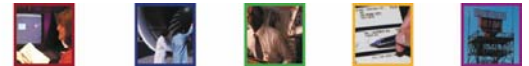


U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30
(Dollars in Thousands)

	2005		2004	
	Cumulative results of operations	Unexpended appropriations	Cumulative results of operations	Unexpended appropriations
Beginning balances	\$ 24,086,935	\$ 999,146	\$ 23,755,361	\$ 562,595
Budgetary financing sources				
Appropriations received (Note 14)	-	2,856,927	-	3,032,925
Appropriations transferred-in/out	-	564	-	-
Rescissions, cancellations and other	-	(27,993)	-	(64,644)
Appropriations used	2,559,750	(2,559,750)	2,531,730	(2,531,730)
Excise taxes (Note 12)	10,700,024	-	9,674,509	-
Transfers-in/out without reimbursement	(106,549)	-	(101,662)	-
Other	(8,079)	-	-	-
Other financing sources				
Transfers-in/out without reimbursement	-	-	(72,508)	-
Imputed financing from costs absorbed by others (Note 13)	485,597	-	493,499	-
Total financing sources	13,630,743	269,748	12,525,568	436,551
Net cost of operations	14,029,096	-	12,193,994	-
Net change	(398,353)	269,748	331,574	436,551
Ending balances	\$ 23,688,582	\$ 1,268,894	\$ 24,086,935	\$ 999,146

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





U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
COMBINED STATEMENTS OF BUDGETARY RESOURCES
 For the Years Ended September 30
 (Dollars in Thousands)

Budgetary resources (Note 14)	2005	2004
Budget authority	\$ 17,176,957	\$ 17,615,716
Unobligated balance brought forward, transfers and other	1,830,252	1,107,702
Spending authority from offsetting collections	1,034,126	675,454
Recoveries of prior year obligations	486,921	190,918
Temporarily not available pursuant to public law	(60,712)	(78,874)
Permanently not available	<u>(3,125,905)</u>	<u>(3,451,054)</u>
Total budgetary resources	<u>\$ 17,341,639</u>	<u>\$ 16,059,862</u>
Status of budgetary resources		
Obligations incurred	\$ 14,982,814	\$ 14,230,011
Unobligated balance available	1,067,338	1,113,378
Unobligated balance not available	<u>1,291,487</u>	<u>716,473</u>
Total status of budgetary resources	<u>\$ 17,341,639</u>	<u>\$ 16,059,862</u>
Relationship of obligations to outlays		
Obligated balance, net, beginning of period	\$ 9,173,060	\$ 8,644,471
Obligations incurred	14,982,814	14,230,011
Less: Spending authority from offsetting collections and recoveries of prior year obligations	(1,521,047)	(866,372)
Less: Obligated balance, net, end of period	<u>(8,795,904)</u>	<u>(9,173,060)</u>
Net outlays	<u>\$ 13,838,923</u>	<u>\$ 12,835,050</u>
Outlays		
Disbursements	\$ 19,483,934	\$ 17,756,831
Collections, net of offsetting receipts	<u>(5,645,011)</u>	<u>(4,921,781)</u>
Net outlays	<u>\$ 13,838,923</u>	<u>\$ 12,835,050</u>

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



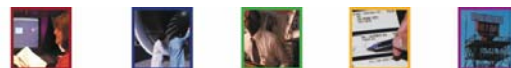


U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED STATEMENTS OF FINANCING
For the Years Ended September 30
(Dollars in Thousands)

	2005	2004
Resources used to finance activities		
Budgetary resources obligated		
Obligations incurred	\$ 14,982,814	\$ 14,230,011
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	1,521,063	866,372
Obligations net of offsetting collections	<u>13,461,751</u>	<u>13,363,639</u>
Other resources		
Transfers in/(out) without reimbursement	-	(72,508)
Imputed financing from costs absorbed by others	485,597	493,499
Net other resources used to finance activities	<u>485,597</u>	<u>420,991</u>
Total resources used to finance activities	13,947,348	13,784,630
 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 received	(160,018)	385,476
Resources that fund expenses recognized in prior periods (decreases in unfunded liabilities) (Note 15)	46,833	171,597
Resources that finance the acquisition of assets	1,485,838	1,985,245
Other resources or adjustments to net obligated resources that do not affect net cost of operations	11,523	18,863
Total resources used to finance items not part of net cost of operations	<u>1,384,176</u>	<u>2,561,181</u>
 Total resources used to finance net cost of operations	12,563,172	11,223,449
 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 and other unfunded liabilities (Note 15)	207,229	108,993
Increase in exchange revenue receivable from the public	-	(82,812)
Components not requiring or generating resources in future periods		
Depreciation and amortization	1,190,277	952,969
Cost of goods sold	68,418	47,589
Other	-	(56,194)
Total components of net cost of operations that will not require or generate resources	<u>1,258,695</u>	<u>944,364</u>
Total components of net cost of operations that will not require or generate resources in the current period	1,465,924	970,545
Net cost of operations	\$ 14,029,096	\$ 12,193,994

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

The 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 FAA. The statements are a requirement of the Chief Financial Officers Act of 1990, the Government Management Reform Act of 1994, and the OMB's Bulletin Number 01-02, *Audit Requirements for Federal Financial Statements*. They have been prepared from, and are fully supported by, the books and records of FAA in accordance with (1) the hierarchy of accounting principles generally accepted in the United States of America and standards approved by the principals of the Federal Accounting Standards Advisory Board (FASAB), (2) OMB Circular Number A-136, *Financial Reporting Requirements*, and (3) 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 pursuant to OMB directives that are used to monitor and control FAA's use of budgetary resources.

Notes 4 and 8 include the necessary information to present "other assets" and "other liabilities" as defined by OMB Circular Number A-136. This presentation is used to support the preparation of the consolidated financial statements of the U.S. Government.

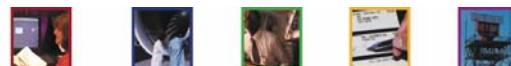
Unless specified otherwise, all dollar amounts are presented in thousands.

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 Earmarked Funds, Revolving Funds, Special Funds, General Funds, and General Fund Miscellaneous Receipts.

- ▶▶ Earmarked funds are credited with receipts that are generated by the terms of a trust agreement or statute. These receipts are unavailable until appropriated by the U.S. Congress. The earmarked funds included in FAA's consolidated financial statements include the Airport and Airway Trust Fund (AATF), which is managed by the U.S. Treasury's Bureau of Public Debt. Once appropriated for use, FAA transfers AATF receipts necessary to meet cash disbursement needs to its other earmarked fund accounts, from which expenditures are then made. These additional earmarked funds are (a) Grants-in-Aid for Airports, (b) Facilities and Equipment, and (c) Research, Engineering and Development, all of which are funded by the AATF.
- ▶▶ Revolving funds are accounts established by law to finance a continuing cycle of operations with receipts derived from such operations usually available in their entirety for use by the fund without further action by the U.S. Congress. FAA's revolving funds include the Aviation Insurance Fund and the Administrative Services Franchise Fund (Franchise Fund).
- ▶▶ Special funds are used for receipts earmarked by law for a specific purpose. Unlike Revolving Funds, the law does not authorize Special Funds to conduct a cycle of business-type operations. FAA's consolidated financial statements include aviation overflight user fees, which are earmarked Special Fund receipts.
- ▶▶ General Funds are accounts used to record financial transactions arising under Congressional appropriations or other authorizations to spend general revenues. FAA manages Operations and Facilities, Engineering & Development General Fund accounts.





- ▶ General Fund Miscellaneous Receipts are accounts established for receipts of non-recurring activity, such as fines, penalties, fees, and other miscellaneous receipts for services and benefits.

FAA has rights and ownership of all assets reported in these financial statements. FAA does not possess any non-entity assets.

C. Budgets and Budgetary Accounting

Congress annually enacts appropriations to permit FAA to incur obligations for specified purposes. In FY 2005 and 2004, FAA was accountable for amounts made available to us in appropriations laws from the AATF, Revolving Funds, a Special Fund, and General Fund appropriations. FAA recognizes budgetary resources as assets when cash (funds held by the U.S. Treasury) is made available through the Department of Treasury General Fund warrants and transfers from the AATF.

D. Basis of Accounting

Transactions are recorded on both an accrual accounting basis and a budgetary accounting 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 Circular A-136.

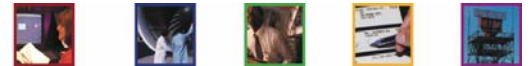
Intragovernmental transactions and balances result from exchange transactions made between FAA and another Federal government reporting entity, while those classified as “with the public” result from exchange transactions between FAA and non-Federal entities. For example, if FAA purchases goods or services from the public and sells them to another Federal entity, the costs would be classified as “with the public,” but the related revenues would be classified as “intragovernmental.” This could occur, for example, when FAA provides goods or services to another Federal government entity on a reimbursable basis. The purpose of this classification is to enable the Federal government to prepare consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

E. Revenues and Other Financing Sources

Congress enacts annual, multi-year, and no-year appropriations to be used, within statutory limits, for operating, capital and grant expenditures. Additional amounts are obtained from service fees (e.g., landing, registry, and overflight fees), war risk insurance premiums (see note 17), and through reimbursements for products and services provided to domestic and foreign governmental entities.

The AATF is sustained by excise taxes that the Internal Revenue Service (IRS) collects from airway system users. Excise taxes collected are initially deposited to the General Fund of the U.S. Treasury. The IRS does not receive sufficient information at the time the taxes are collected to determine how these payments should be distributed to specific earmarked funds. Therefore, the U.S. Treasury makes initial semi-monthly distributions to earmarked funds based on estimates prepared by its Office of Tax Analysis (OTA). These estimates are based on historical excise tax data applied to current excise tax receipts. FAA’s September 30, 2005 financial statements reflect excise taxes certified by OTA through March 31, 2005, and excise taxes estimated by OTA for the period April 1 to September 30, 2005 as specified by Statement of Federal Financial Accounting Standards (SFFAS) Number 7, *Accounting for Revenue and Other Financing Sources*. Actual tax collections data for the quarters ended June 30, 2005 and September 30, 2005 will not be available from the IRS until December 2005 and March 2006, respectively. When actual 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. FAA management does not believe that the actual tax collections for the quarters ended June 30, 2005 and September 30, 2005 will be materially different than the OTA estimate based on historical results.





The AATF also earns interest from investments in U.S. Government securities. Interest income is recognized as revenue on the accrual basis of such collections for those quarters.

Appropriations are recognized as a financing source when expended. Revenues from services provided by FAA 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. Aviation overflight user fees are recognized as revenue in the period in which the flights took place.

FAA recognizes as an imputed financing source 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 U.S. Treasury Judgment Fund in settlement of claims or court assessments against 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 Balance with the U.S. Treasury

The U.S. Treasury processes cash receipts and disbursements. Funds held 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 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 AATF and Aviation Insurance Revolving Fund (war risk premiums) are invested in U.S. Government securities at cost. A portion of the AATF investments is liquidated semi-monthly in amounts needed to provide cash for FAA appropriation accounts, to the extent authorized. The Revolving Fund investments are usually held to maturity. Investments, redemptions, and reinvestments are held and managed under the direction of FAA by the U.S. Treasury.

I. Accounts Receivable

Accounts receivable consists 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 foreign governments. These amounts due from the public are presented net of an allowance for loss on uncollectible accounts, based on historical collection experience or an analysis of the individual receivables.

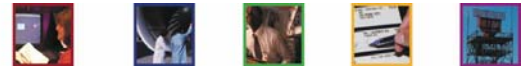
FAA reports deposits in transit when the U.S. Treasury has not yet recognized FAA's collections received from the public or other Federal entities.

J. Inventory

Within the FAA's Franchise Fund, inventory is held for sale to FAA field locations and other domestic entities and foreign governments. Inventory consists of materials and supplies used to support the National Airspace System (NAS), and is predominately 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 trade non-operational repairable components with the Franchise Fund. These components are classified as "held for repair." An allowance is established for repairable inventory based on the average historical cost of such repairs. The cost of repair is capitalized and 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.

K. 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 (e.g., electronic components and wiring) that will be used in the construction of 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 using the consumption method of accounting.

Operating materials and supplies "held for use" are those items that are consumed on a regular and ongoing basis.

Operating materials and supplies 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 "held for use" and 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.

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

FAA capitalizes acquisitions of PP&E when the cost equals or exceeds \$25,000 and the useful life equals or exceeds two years. FAA records PP&E at original acquisition cost.

Depreciation expense is calculated using the straight-line method. Depreciation commences the first month after the asset is placed in service. FAA does not recognize residual value of its PP&E.

Real property assets such as buildings, air traffic control towers, enroute air traffic control centers, mobile buildings, roads, sidewalks, parking lots, and other structures are depreciated over a useful life of up to 40 years.

Personal property assets such as aircraft, decision support systems, navigation, surveillance, communications and weather related equipment, office furniture, internal use software, vehicles, and office equipment are depreciated over a useful life of up to 20 years.

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.

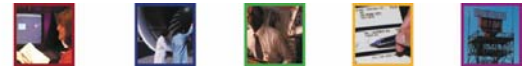
Construction in Progress (CIP) is valued at actual direct costs, plus applied overhead and other indirect costs.

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 AATF.

M. Advances and Prepaid Charges

FAA generally does not pay for goods and services in advance, except for certain reimbursable agreements, 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 or other 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 agencies.

O. Accounts Payable

Accounts payable are amounts FAA owes to other Federal agencies and the public. Accounts payable to Federal agencies generally consist of amounts due under inter-agency reimbursable agreements. Accounts payable to the public primarily consists of unpaid goods and services received by FAA in support of the NAS, and estimated amounts incurred but not yet claimed by Airport Improvement Program grant recipients.

P. 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, 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.

Q. 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 by the DOL. 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.

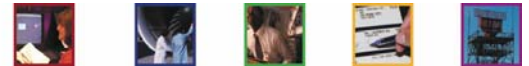
R. Retirement Plan

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 FAA's matching contribution, equal to 7% of pay, distributed to their annuity account in the Civil Service Retirement and Disability Fund.

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

FAA recognizes 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 communicate these factors to FAA for current period expense reporting. OPM also provides information regarding the full cost of health and life insurance benefits. FAA recognizes the offsetting revenue as imputed financing sources to the extent these expenses will be paid by OPM.





S. Grants

FAA records an obligation at the time a grant is awarded. As grant recipients conduct eligible activities under the terms of their grant agreement, they request payment by FAA, typically via an electronic payment process. Expenses are recorded at the time of payment approval. FAA also recognizes an accrued liability and expense for estimated eligible grant payments not yet requested by grant recipients. Grant expenses, including associated administrative costs, are classified on the Consolidated Statements of Net Cost under the line of business program “Airports.”

T. Use of Estimates

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

U. Environmental Liabilities

FAA recognizes two types of environmental liabilities: environmental remediation, and cleanup and decommissioning. The liability for environmental remediation is an estimate of 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 materials when an asset presently in service is shutdown. 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 increase or decrease in the estimated environmental cleanup liability is charged to expense over the life of the associated asset. Assets placed in service in FY 1999 and after do not have associated environmental liabilities.

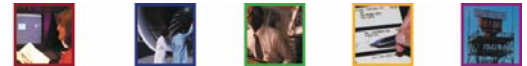
V. Contingencies

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, in the accompanying balance sheet and statement of net cost, when they are 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 or when a loss from the outcome of future events is more than remote. In some cases, once losses are certain, payments may be made from the Judgment Fund maintained by the U.S. Treasury rather than from the amounts appropriated to FAA for agency operations. Payments from the Judgment Fund are recorded as an “Other Financing Source” when made.

W. Reclassifications

Certain FY 2004 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 balance with Treasury account balances as of September 30, 2005 and 2004 were:

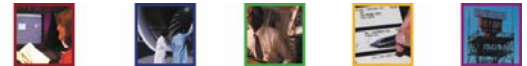
	<u>2005</u>	<u>2004</u>
Earmarked and other funds, excluding AATF	\$ 536,478	\$ 898,023
Operations general fund	1,020,306	1,042,208
Franchise fund	122,907	208,776
Revolving funds	41,100	49,649
AATF funds (Note 12)	<u>692,311</u>	<u>642,007</u>
 Total	 <u><u>\$ 2,413,102</u></u>	 <u><u>\$ 2,840,663</u></u>

Status of fund balance with Treasury

Unobligated balance		
Available	\$ 1,067,338	\$ 1,113,378
Not available	1,291,487	716,473
Obligated balance not yet disbursed	<u>54,277</u>	<u>1,010,812</u>
 Total	 <u><u>\$ 2,413,102</u></u>	 <u><u>\$ 2,840,663</u></u>

Unobligated fund balances are either available or not available. Amounts are reported as not available when they are no longer legally available to FAA for obligation. However, balances that are not available can change over time, because they can be used for upward adjustments of obligations that were incurred during the period of availability or for paying claims attributable to that time period.





NOTE 3. INVESTMENTS

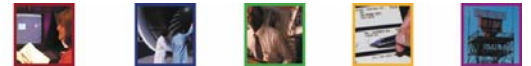
As of September 30, 2005 and 2004, FAA’s investment balances were as follows:

	2005	2004
<u>Intragovernmental securities</u>		
Nonmarketable, par value - AATF	\$ 10,047,363	\$ 9,891,592
Nonmarketable, market based - Aviation Insurance Fund	527,453	351,146
Interest receivable	90,744	75,291
Investments at cost	<u>\$ 10,665,560</u>	<u>\$ 10,318,029</u>
 <u>Market value disclosure</u>		
Nonmarketable, par value - AATF	\$ 10,047,363	\$ 9,891,592
Nonmarketable, market based - Aviation Insurance Fund	528,116	351,488
Unamortized discount - nonmarketable, market based	(663)	(342)
Nonmarketable, market based, net	<u>527,453</u>	<u>351,146</u>
Market value disclosure	<u>\$ 10,574,816</u>	<u>\$ 10,242,738</u>

The Secretary of the Treasury makes AATF investments on behalf of FAA. FAA investments are considered investment authority and available to offset the cost of operations, to the extent authorized. As of September 30, 2005 and 2004, approximately \$10.0 billion and \$9.9 billion, respectively, were invested in U.S. Treasury Certificates of Indebtedness. Nonmarketable par value Treasury Certificates of Indebtedness are special series debt securities issued by the Bureau of Public Debt to Federal accounts, and are purchased and redeemed at par (face value) exclusively through the Federal Investment Branch of the U.S. Treasury’s Bureau of Public Debt. The securities are held to maturity and redeemed at face value on demand; thus, investing entities recover the full amount invested plus interest. Investments as of September 30, 2005 mature on various dates through June 30, 2006, and investments as of September 30, 2004 matured on various dates through June 30, 2005. The annual rate of return on Certificates of Indebtedness is established in the month of issuance. The average rate of return for certificates issued during FY 2005 and FY 2004 was 3.9% and 3.6%, 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. As of September 30, 2005, these nonmarketable, market-based securities had maturity dates ranging from October 2005 to June 2009, and have an average rate of return of approximately 3.5%.





NOTE 4. ACCOUNTS RECEIVABLE, ADVANCES, AND OTHER ASSETS

Accounts receivable, advances, and other assets as of September 30, 2005 and 2004 were comprised of the following:

	<u>2005</u>	<u>2004</u>
<u>Intragovernmental</u>		
Accounts receivable	\$ 100,283	\$ 67,146
Advances, prepayments and other	204,154	148,843
Subtotal, intragovernmental	<u>304,437</u>	<u>215,989</u>
 <u>With the public</u>		
Accounts receivable, net	106,017	124,757
Advances and prepayments	36,913	20,869
Deposits in transit and other	40,563	27,657
Subtotal, with the public	<u>183,493</u>	<u>173,283</u>
 Total accounts receivable, advances, and other	 <u>\$ 487,930</u>	 <u>\$ 389,272</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 \$76.8 million and \$57.0 million, as of September 30, 2005 and 2004.





NOTE 5. INVENTORY, OPERATING MATERIALS, AND SUPPLIES

As of September 30, 2005 and 2004, inventory, operating materials, and supplies were:

<u>Operating materials and supplies</u>	2005	2004
Held for use, net	\$ 210,170	\$ 166,628
Excess, obsolete, and unserviceable, net	-	11,619
Subtotal, operating materials and supplies	210,170	178,247
 <u>Inventory</u>		
Held for sale	61,661	59,357
Held for repair, net	328,161	321,511
Raw materials, finished goods, and other	13,632	13,632
Excess, obsolete, and unserviceable, net	12,462	12,962
Subtotal, inventory	415,916	407,462
 Total inventory, operating materials, and supplies, net	 \$ 626,086	 \$ 585,709

Inventory, operating materials, and supplies are shown net of the following allowances:

<u>Operating materials and supplies</u>	2005	2004
Held for use	\$ (21,295)	\$ (16,873)
Excess, obsolete, and unserviceable	(71,862)	(60,242)
Subtotal, operating materials and supplies allowances	(93,157)	(77,115)
 <u>Inventory</u>		
Held for repair	(86,148)	(83,660)
Excess, obsolete, and unserviceable	(6,339)	(5,839)
Subtotal, inventory allowances	(92,487)	(89,499)
 Total allowances	 \$ (185,644)	 \$ (166,614)

Inventory is considered held for repair based on the condition of the asset or item, and the allowance for repairable inventory is based on the average historical cost of such repairs.

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





NOTE 6. PROPERTY, PLANT, AND EQUIPMENT, NET

Property, plant, and equipment balances at September 30, 2005 and 2004 were:

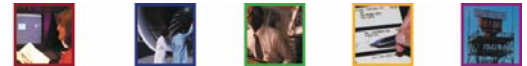
Class of fixed asset	2005		
	Acquisition value	Accumulated depreciation	Net book value
Real property, including land	\$ 4,193,366	\$ (2,113,256)	\$ 2,080,110
Personal property	15,398,241	(7,598,204)	7,800,037
Assets under capital lease (Note 9)	125,923	(80,732)	45,191
Construction in progress	4,502,428	-	4,502,428
Property not in use	7,706	(3,006)	4,700
Total property, plant, and equipment	\$ 24,227,664	\$ (9,795,198)	\$ 14,432,466

Class of fixed asset	2004		
	Acquisition value	Accumulated depreciation	Net book value
Real property, including land	\$ 4,086,616	\$ (1,966,495)	\$ 2,120,121
Personal property	13,894,962	(6,622,389)	7,272,573
Assets under capital lease (Note 9)	125,923	(71,807)	54,116
Construction in progress	5,011,586	-	5,011,586
Property not in use	19,202	(7,867)	11,335
Total property, plant, and equipment	\$ 23,138,289	\$ (8,668,558)	\$ 14,469,731

FAA's CIP primarily relates to NAS assets, which are derived from centrally funded national systems development contracts, site preparation and testing, raw materials, and internal labor charges.

Assets temporarily not in use, including decommissioned assets awaiting disposal, are reflected in FAA financial records as Property Not in Use. FAA reported disposal losses of \$28.4 million and \$11.0 million in FY 2005 and FY 2004, respectively.





NOTE 7. ENVIRONMENTAL CLEANUP COSTS

FAA's environmental liabilities as of September 30, 2005 and 2004 were:

	2005	2004
Environmental remediation	\$ 358,296	\$ 366,762
Environmental cleanup and decommissioning	238,240	239,499
Total environmental liabilities	\$ 596,536	\$ 606,261

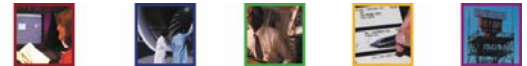
Additional information on environmental projects is disclosed in note 17.

NOTE 8. EMPLOYEE RELATED, LEGAL, AND OTHER LIABILITIES

As of September 30, 2005 and 2004, FAA's employee related, legal and other liabilities were:

	2005		
	Non-current liabilities	Current liabilities	Total
<u>Intragovernmental</u>			
Advances received	\$ -	\$ 50,055	\$ 50,055
Accrued payroll & benefits payable to other agencies	-	41,464	41,464
Liabilities covered by budgetary or other resources		91,519	91,519
Federal Employees' Compensation Act (FECA) payable	110,785	86,813	197,598
Other	-	5,449	5,449
Liabilities not covered by budgetary or other resources	110,785	92,262	203,047
Subtotal, intragovernmental	110,785	183,781	294,566
<u>With the public</u>			
Advances received and other	-	28,032	28,032
Accrued payroll & benefits payable to employees	-	194,626	194,626
Liabilities covered by budgetary or other resources	-	222,658	222,658
Accrued unfunded annual & other leave & assoc. benefits	59,228	422,298	481,526
Sick leave compensation benefits for air traffic controllers	65,156	8,664	73,820
Capital leases (Note 9)	42,597	8,193	50,790
Legal claims	-	6,570	6,570
Return rights	3,060	2,601	5,661
Hurricane related emergency support (Note 17)	-	166,700	166,700
Other accrued liabilities	155,297	-	155,297
Liabilities not covered by budgetary or other resources	325,338	615,026	940,364
Subtotal, with the public	325,338	837,684	1,163,022
Total employee related, legal, and other liabilities	\$ 436,123	\$ 1,021,465	\$ 1,457,588





	2004		
	Non-current liabilities	Current liabilities	Total
<u>Intragovernmental</u>			
Advances received	\$ -	\$ 52,427	\$ 52,427
Accrued payroll & benefits payable to other agencies	-	33,754	33,754
Liabilities covered by budgetary or other resources	-	86,181	86,181
Federal Employees' Compensation Act (FECA) payable	111,987	88,320	200,307
Other	-	538	538
Liabilities not covered by budgetary or other resources	111,987	88,858	200,845
Subtotal, intragovernmental	111,987	175,039	287,026
<u>With the public</u>			
Advances received and other	-	24,388	24,388
Accrued payroll & benefits payable to employees	-	174,881	174,881
Liabilities covered by budgetary or other resources	-	199,269	199,269
Accrued unfunded annual & other leave & assoc. benefits	57,932	413,063	470,995
Sick leave compensation benefits for air traffic controllers	68,009	1,354	69,363
Capital leases (Note 9)	46,909	13,663	60,572
Legal claims	-	19,000	19,000
Return rights	4,481	3,290	7,771
Other accrued liabilities	132,557	-	132,557
Liabilities not covered by budgetary or other resources	309,888	450,370	760,258
Subtotal, with the public	309,888	649,639	959,527
Total employee related, legal, and other liabilities	<u>\$ 421,875</u>	<u>\$ 824,678</u>	<u>\$ 1,246,553</u>

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. Because DOL bills FAA two years after it pays such claims, FAA's liability accrued as of September 30, 2005 includes workers' compensation benefits paid by DOL during the periods July 1, 2003 through June 30, 2005 and accrued liabilities for the quarter July 1, 2005 through September 30, 2005. FAA's liability accrued as of September 30, 2004 included workers' compensation benefits paid by DOL during the period July 1, 2002 through June 30, 2004, and accrued liabilities for the quarter July 1, 2004 through September 30, 2004.

The estimated liability for accrued unfunded leave and associated benefits includes annual and other types of vested leave, and sick leave under the terms of certain collective bargaining agreements, including the National Air Traffic Controllers Association (NATCA) agreement, Article 25, Section 13. For example, the NATCA agreement gives air traffic controllers, who are covered under FERS, the option to receive a lump sum payment for 40% of their accumulated sick leave as of their effective retirement date. Based on sick leave balances, this liability was \$73.8 million and \$69.4 million as of September 30, 2005 and 2004, respectively.





FAA estimated that 100% of its \$6.6 million and \$19.0 million legal claims liabilities as of September 30, 2005 and 2004, respectively, would be paid from the permanent appropriation for judgments, awards, and compromise settlements (Judgment Fund) administered by the Department of Treasury.

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 them to a future return move at FAA's expense. As of September 30, 2005 and 2004, there were 111 and 137 employees, respectively, entitled to these return rights.

Other Accrued Liabilities with the Public is comprised primarily of accruals for utilities, leases and travel obligations. Total liabilities not covered by budgetary resources are presented in note 15.

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, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Land, Buildings, and Machinery	\$ 125,923	\$ 125,923
Accumulated Depreciation	<u>(80,732)</u>	<u>(71,807)</u>
Assets Under Capital Lease, net	<u>\$ 45,191</u>	<u>\$ 54,116</u>

As of September 30, 2005, FAA's future payments due on assets under capital lease were:

Future payments due by fiscal year (Liabilities not covered by budgetary or other resources)	
Year 1 (FY 2006)	\$ 11,620
Year 2 (FY 2007)	11,469
Year 3 (FY 2008)	9,680
Year 4 (FY 2009)	9,387
Year 5 (FY 2010)	8,709
After 5 Years	24,498
Less: Imputed interest	<u>(24,573)</u>
Total capital lease liability	<u>\$ 50,790</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, 2005 were:

Fiscal year	
Year 1 (FY 2006)	\$ 147,033
Year 2 (FY 2007)	122,204
Year 3 (FY 2008)	102,011
Year 4 (FY 2009)	85,748
Year 5 (FY 2010)	72,128
After 5 Years	<u>260,821</u>
Total future operating lease payments	<u><u>\$ 789,945</u></u>

Operating lease expense incurred during the years ended September 30, 2005 and 2004 was \$172.8 million and \$170.7 million, respectively, including General Services Administration (GSA) leases that have a short termination privilege, but FAA intends to remain in the lease. The operating lease amounts due after five years do 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

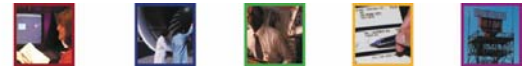
As of September 30, 2005 and 2004, FECA actuarial liabilities were \$942.3 million and \$954.5 million respectively. The DOL calculates the FECA liability for DOT, and DOT allocates the liability amount to FAA based upon actual workers' compensation payments to FAA employees over the preceding four years. 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 or other resources and thus will require future appropriated funding.

NOTE 11. NET COST BY PROGRAM AND OTHER STATEMENT OF NET COST DISCLOSURES

FAA's four 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.

The following are net costs for the years ended September 30, 2005 and 2004 by strategic goal.





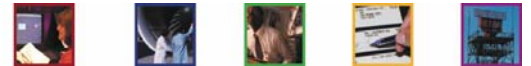
For the Year Ended September 30, 2005

Line of business programs	Strategic Goal Areas				
	Safety	Capacity	Organizational Excellence	International Leadership	Total
Air Traffic Organization	\$ 7,539,010	\$ 1,318,277	\$ 69,665	\$ 4,466	\$ 8,931,418
Aviation Safety	503,370	-	571,748	-	1,075,118
Airports	1,930,944	1,746,462	34,521	-	3,711,927
Commercial Space Transportation	10,034	4,039	-	-	14,073
Non line of business programs					
Regions and center operations and other	178,707	6,702	110,795	356	296,560
Net cost	<u>\$ 10,162,065</u>	<u>\$ 3,075,480</u>	<u>\$ 786,729</u>	<u>\$ 4,822</u>	<u>\$ 14,029,096</u>

For the Year Ended September 30, 2004

Line of business programs	Strategic Goal Areas				
	Safety	Capacity	Organizational Excellence	International Leadership	Total
Air Traffic Organization	\$ 6,113,865	\$ 1,513,989	\$ 450,909	\$ 248	\$ 8,079,011
Aviation Safety	859,372	218	71,423	8,715	939,728
Airports	1,729,468	1,213,208	33,992	400	2,977,068
Commercial Space Transportation	10,900	1,627	-	-	12,527
Non line of business programs					
Regions and center operations and other	101,738	4,085	43,012	253	149,088
Not assigned to programs	20,963	2,249	13,360	-	36,572
Net cost	<u>\$ 8,836,306</u>	<u>\$ 2,735,376</u>	<u>\$ 612,696</u>	<u>\$ 9,616</u>	<u>\$ 12,193,994</u>

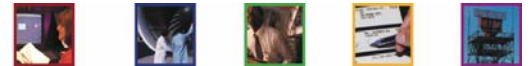




The following is FAA's distribution of FY 2005 and FY 2004 net costs by intragovernmental-related activity versus with the public.

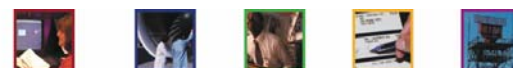
Line of business programs	For the Year Ended September 30, 2005		
	Intra-governmental	With the Public	Total
Air Traffic Organization			
Expenses	\$ 1,844,976	\$ 7,509,483	\$ 9,354,459
Less earned revenues	(282,342)	(140,699)	(423,041)
Net costs	1,562,634	7,368,784	8,931,418
Aviation Safety			
Expenses	206,930	872,241	1,079,171
Less earned revenues	(1,871)	(2,182)	(4,053)
Net costs	205,059	870,059	1,075,118
Airports			
Expenses	17,287	3,695,136	3,712,423
Less earned revenues	(387)	(109)	(496)
Net costs	16,900	3,695,027	3,711,927
Commercial Space Transportation			
Expenses	320	13,753	14,073
Net costs	320	13,753	14,073
Non line of business programs			
Regions and center operations and other programs			
Expenses	166,920	529,109	696,029
Less earned revenues	(85,669)	(313,800)	(399,469)
Net costs	81,251	215,309	296,560
Net cost of operations			
Total expenses	2,236,433	12,619,722	14,856,155
Less earned revenues	(370,269)	(456,790)	(827,059)
Net costs	\$ 1,866,164	\$ 12,162,932	\$ 14,029,096





	For the Year Ended September 30, 2004		
Line of business programs	Intra- governmental	With the Public	Total
Air Traffic Organization			
Expenses	\$ 2,016,981	\$ 6,197,545	\$ 8,214,526
Less earned revenues	(65,889)	(69,626)	(135,515)
Net costs	<u>1,951,092</u>	<u>6,127,919</u>	<u>8,079,011</u>
Aviation Safety			
Expenses	230,547	711,830	942,377
Less earned revenues	(432)	(2,217)	(2,649)
Net costs	<u>230,115</u>	<u>709,613</u>	<u>939,728</u>
Airports			
Expenses	18,336	2,958,964	2,977,300
Less earned revenues	(87)	(145)	(232)
Net costs	<u>18,249</u>	<u>2,958,819</u>	<u>2,977,068</u>
Commercial Space Transportation			
Expenses	336	12,191	12,527
Net costs	<u>336</u>	<u>12,191</u>	<u>12,527</u>
Non line of business programs			
Regions and center operations and other programs			
Expenses	180,195	209,759	389,954
Less earned revenues	(84,152)	(156,714)	(240,866)
Net costs	<u>96,043</u>	<u>53,045</u>	<u>149,088</u>
Not assigned to programs			
Expenses	-	36,572	36,572
Net costs	<u>-</u>	<u>36,572</u>	<u>36,572</u>
Net cost of operations			
Total expenses	2,446,395	10,126,861	12,573,256
Less earned revenues	(150,560)	(228,702)	(379,262)
Net costs	<u>\$ 2,295,835</u>	<u>\$ 9,898,159</u>	<u>\$ 12,193,994</u>





NOTE 12. AIRPORT AND AIRWAY TRUST FUND EARMARKED COLLECTIONS

FAA’s consolidated financial statements include the results of operations and financial position of the Airport and Airway Trust Fund (AATF). The AATF was created by the Airport and Airway Revenue Act of 1970 to provide a dedicated source of funding to the nation’s aviation system through several aviation-related excise taxes. The IRS collects these excise taxes on behalf of FAA’s AATF. These taxes can be withdrawn only as appropriated by the U.S. Congress. Twice a month, Treasury estimates the amount collected, and adjusts the estimates by actual collections quarterly. Accordingly, the total taxes recognized in FY 2005 included OTA’s estimate of \$5.0 billion for the six months ended September 30, 2005. The total taxes recognized in FY 2004 included OTA’s estimate of \$4.7 billion for the six months ended September 30, 2004.

The IRS has informed us that the estimated excise tax collections and the amount credited to the AATF for the benefit of the FAA, for the quarter ended June 30, 2005, may be understated by as much as \$166.1 million. FAA has not recognized the potential understatement of \$166.1 million since it is not legally enforceable until certified by the IRS. Therefore, this represents a potential gain contingency at September 30, 2005. The estimated taxes and deposits to the AATF will be adjusted to equal actual tax collections in December 2005.

Fiscal data of the AATF as of, and for the years ended, September 30, 2005 and 2004 is summarized below. Intra-agency transactions have not been eliminated in the amounts presented below.

	2005	2004
Assets		
Fund balance with Treasury	\$ 692,311	\$ 642,007
Investments, net (Note 3)	10,047,363	9,891,592
Accounts receivable, net	85,624	129,487
Total assets	\$ 10,825,298	\$ 10,663,086
Liabilities and net position		
AATF amounts due to FAA	\$ 3,507,725	\$ 3,704,148
Cumulative results of operations	7,317,573	6,958,938
Total liabilities and net position	\$ 10,825,298	\$ 10,663,086
Revenue		
Passenger ticket tax	\$ 7,007,134	\$ 6,554,599
International departure tax	1,922,368	1,455,529
Investment income	439,793	446,956
Fuel taxes	970,794	774,150
Waybill tax	460,563	498,871
Tax refunds and credits	(100,628)	(55,596)
Total revenue	\$ 10,700,024	\$ 9,674,509
Expenses		
Nonexpenditure transfer out and other	10,341,404	\$ 10,838,828
Total expenses	\$ 10,341,404	\$ 10,838,828





NOTE 13. IMPUTED FINANCING SOURCES

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 U.S. Treasury's Judgment Fund in settlement of claims or court assessments against FAA are also recognized as imputed financing. For the fiscal years ended September 30, 2005 and 2004, imputed financing was as follows:

	<u>2005</u>	<u>2004</u>
Office of Personnel Management	\$ 458,617	\$ 482,253
Treasury Judgment Fund	<u>26,980</u>	<u>11,246</u>
Total imputed financing sources	<u><u>\$ 485,597</u></u>	<u><u>\$ 493,499</u></u>

NOTE 14. STATEMENT OF BUDGETARY RESOURCES DISCLOSURES

The Required Supplementary Information section of this report includes a schedule of budgetary resources by each of FAA's major fund types.

Budget authority as reported in the Combined Statements of Budgetary Resources includes amounts made available to FAA from general, earmarked and special funds. In contrast, appropriations received as reported in the Consolidated Statements of Changes in Net Position pertain to only amounts made available to FAA from general funds. The following is a reconciliation of these amounts:

	<u>2005</u>	<u>2004</u>
Combined Statement of Budgetary Resources - budget authority	\$ 17,176,957	\$ 17,615,716
Less amounts made available to FAA from AATF dedicated collections	(14,323,881)	(14,582,668)
Net transfers of budget authority and other	54,794	-
Less special fund aviation user fees	<u>(50,943)</u>	<u>(123)</u>
Consolidated Statement of Changes in Net Position - appropriations received	<u><u>\$ 2,856,927</u></u>	<u><u>\$ 3,032,925</u></u>





In FY 2005, FAA had rescissions of budgetary resources to Grants-in-Aid to Airports of \$296.8 million; Operations of \$29.1 million; and other non-AATF earmarked funds of \$60.7 million.

In FY 2004, FAA had rescissions of budgetary resources to Grants-in-Aid to Airports of \$20.1 million; Operations of \$20.8 million; and other non-AATF earmarked funds of \$65.0 million.

Obligations incurred and budgetary resources of FAA’s Operations appropriation were reduced on the Combined Statements of Budgetary Resources to eliminate the effect of transfers between the AATF and FAA general fund components.

Budget authority on the FY 2004 Combined Statement of Budgetary Resources includes expired funds of \$3,506.0 million that are not presented in the Budget of the United States Government. Also, obligations incurred on the FY 2004 Combined Statement of Budgetary Resources includes \$23.0 million of expired funds and \$510.0 million of certain reimbursable and revolving fund obligations incurred that are not presented in the Budget of the United States Government. As a result, FAA’s FY 2004 Combined Statement of Budgetary Resources differs from FY 2004 “actuals” reported in the appendix of the *FY 2006 Budget of the United States Government*. The *Budget of the United States Government* is available on the Internet at www.whitehouse.gov/omb/budget/fy2006/. As of the date of issuance of FAA’s FY 2005 Combined Statement of Budgetary Resources, the Budget of the United States Government for FY 2007, which will contain “actual” FY 2005 amounts, was not yet published. The Office of Management and Budget is expected to publish this information early in calendar year 2006.

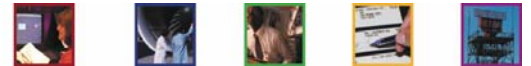
OMB Circular A-136 requires the following additional Combined Statement of Budgetary Resources disclosures

- ▶ Congress mandated permanent indefinite appropriations for the Facilities and Equipment, Grants-in-Aid, and Research, Development and Engineering to fully fund special projects that were ongoing and spanned several years.
- ▶ FAA does not have obligations classified as “exempt from apportionment.” However, during FY 2005 and FY 2004, direct and reimbursable obligations incurred against amounts apportioned under categories A and B, as defined in OMB Circular No. A-11, Part 4, *Instructions on Budget Execution*, were as follows:

	2005		2004	
	Direct	Reimbursable	Direct	Reimbursable
Category A	\$ 5,402,794	\$ 449,209	\$ 5,487,783	\$ 509,509
Category B	8,817,715	313,096	8,230,998	1,721
Total	<u>\$ 14,220,509</u>	<u>\$ 762,305</u>	<u>\$ 13,718,781</u>	<u>\$ 511,230</u>

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 2004, \$16.7 million of obligated balances were in appropriations cancelled at year-end pursuant to 31 U.S.C. 1552, and thus have not been brought forward to FY 2005. Additionally, transfers in FY 2005 to DOT for Essential Air Services also reduced balances available for obligation.





The net obligated balance, end of period, is comprised of the following components as of September 30, 2005 and 2004:

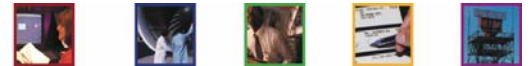
Obligated balance, net, end of period	2005	2004
Accounts receivable and advances	\$ (430,059)	\$ (178,862)
Unfilled customer orders from Federal sources	(236,602)	(219,936)
Undelivered orders	8,396,340	8,660,222
Accounts payable and other liabilities	1,066,225	911,636
Total obligated balance, net, end of period	<u>\$ 8,795,904</u>	<u>\$ 9,173,060</u>

NOTE 15. FINANCING SOURCES YET TO BE PROVIDED

The following table shows the relationship between liabilities not covered by budgetary or other resources as reported on the balance sheets as of September 30, 2005 and 2004, and the change in components of net cost of operations that will require or generate resources in future periods, as reported on the statements of financing.

	2005	2004	Change
Unfunded annual & other leave & associated benefits (Note 8)	481,526	470,995	10,531
Sick leave compensation benefits and return rights (Note 8)	79,481	77,134	2,347
Other accrued liabilities (Note 8)	<u>327,446</u>	<u>133,095</u>	<u>194,351</u>
Increases - components of net cost of operations requiring or generating resources in future periods			<u>207,229</u>
Legal claims (Note 8)	6,570	19,000	(12,430)
Capital leases (Notes 8 & 9)	50,790	60,572	(9,782)
FECA payable (Note 8)	197,598	200,307	(2,709)
Environmental liabilities (Notes 7 & 19)	596,536	606,261	(9,725)
FECA actuarial liability (Note 10)	<u>942,276</u>	<u>954,463</u>	<u>(12,187)</u>
Decreases - resources that fund expenses recognized in prior periods			<u>(46,833)</u>
Liabilities not covered by budgetary resources	<u>\$ 2,682,223</u>	<u>\$ 2,521,827</u>	<u>\$ 160,396</u>





NOTE 16. CUSTODIAL ACTIVITY

FAA collects certain non-exchange (custodial) revenue on behalf of the General Fund of the Treasury. During FY 2005 and FY 2004, FAA's Statement of Changes in Net Position included custodial revenue totaling \$20.8 million and \$19.0 million, respectively. The primary source of custodial activity is revenue from the Metropolitan Washington Airport Authority for its leases of the Ronald Reagan National Airport and the Washington Dulles International Airport. Custodial activity also includes the collection of miscellaneous fines and penalties. The U.S. Treasury withdraws custodial receipts from FAA's accounts immediately following each year-end.

NOTE 17. COMMITMENTS, CONTINGENCIES, AND OTHER DISCLOSURES

Contract Options. As of September 30, 2005 and 2004, FAA had contract options of \$10.0 billion and \$10.9 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.

Airport Improvement Program. The Airport Improvement Program provides grants for the planning and development of public-use airports that are included in the National Plan of Integrated Airport Systems. Eligible projects generally include improvements related to enhancing airport safety, capacity, security, and environmental concerns. FAA's share of eligible costs for large and medium primary hub airports is 75% with the exception of noise program implementation, which is 80%. For remaining airports (small primary, reliever, and general aviation), FAA's share of eligible costs is 95%.

FAA has authority under 49 U.S.C. 47110(e) to issue letters of intent to enter into Airport Improvement Program grant agreements. FAA records an obligation when a grant is awarded. Through September 30, 2005, FAA issued letters of intent covering FY 1988 through FY 2017 totaling \$4.7 billion. As of September 30, 2005, FAA had obligated \$3.6 billion of this total amount, leaving \$1.2 billion unobligated.

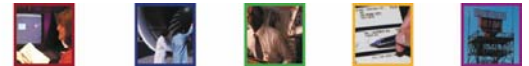
Through September 30, 2004, FAA issued letters of intent covering FY 1988 through FY 2014 totaling \$4.7 billion. As of September 30, 2004, FAA had obligated \$3.3 billion of this total amount, leaving \$1.4 billion unobligated.

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, to the extent practical.

FAA maintains standby non-premium war-risk insurance policies for 37 air carriers having approximately 1,433 aircraft available for Defense or State Department charter operations.

On September 22, 2001, the Air Transportation Safety and System Stabilization Act (Public Law 107-42) expanded premium insurance program authority to permit insurance of domestic operations. Under this program, FAA initially provided third party liability war-risk insurance to U.S. carriers whose coverage was cancelled following the terrorist attacks of September 11, 2001. Public Law 108-11 (and subsequent amendments) required us to extend policies in effect on July 19, 2002, until August 31, 2005. The Secretary of Transportation has extended coverage through December 31, 2005, as allowed by Public Law 108-11. It also mandated provision of hull loss and passenger and third party war risk liability insurance for those policies. There are 77 FAA premium war-risk policies. Insured air carrier per occurrence limits for combined hull and liability coverage range from \$100 million to \$4 billion.





Current war risk coverage is intended as a temporary measure to provide insurance to qualifying carriers while allowing time for the commercial insurance market to stabilize. Premiums under this program are established by FAA and are based on the value of policy coverage limits and aircraft activity. However, airlines' total charge for coverage is subject to a cap mandated by Congress. During FY 2005 and FY 2004, FAA recognized insurance premium revenue of \$157.5 million and \$145.6 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 "Region and Center Operations and Other Programs."

The maximum liability for both hull loss and liability, per occurrence, is \$4.0 billion. No claims for losses were pending as of September 30, 2005 or 2004. In the past, FAA has insured a small number of air carrier operations and establishes a maximum liability for losing one aircraft. Since the inception of the Aviation 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.

Aviation Overflight User Fees. FAA's aviation overflight user fees were the subject of litigation for several years. As a result, FAA suspended these billings in April 2003 and had no collections during FY 2004. The litigation ended in the latter part of FY 2004, and FAA resumed billing in FY 2005. Aviation overflight user fee revenue was \$109.7 million in FY 2005. Also in FY 2005, the FAA Administrator appointed an Aviation Rulemaking Committee. The Committee is studying FAA's fee-setting procedures with a view to making recommendations in FY 2006 as to how procedures might be improved and the fees updated. Depending on the outcome of the Committee's deliberations and the Administrator's assessment of its recommendations, the fee structure may change accordingly.

Environmental. 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, 2005 and 2004, the amount related to these two sites is \$50.3 million and \$49.3 million, respectively. This liability includes FAA's share of the known remediation cost and the cost to complete the study.

Legal Claims. As of September 30, 2005 and 2004, FAA's contingent liabilities for asserted and pending legal claims reasonably possible of loss were estimated at \$16.3 million and \$76.7 million, respectively. FAA does not have material amounts of known unasserted claims.

Hurricane-Related Emergency Support. During FY 2005, the Federal Emergency Management Agency (FEMA) engaged DOT and, in turn, FAA, for transportation-related relief efforts associated with several hurricanes that struck the continental United States. Through September 30, 2005, contractors provided relief efforts as follows:

Obligations incurred and amount of services provided by contractors	\$ 294,000
Amounts paid prior to September 30, 2005	(71,300)
Amounts unpaid as of September 30, 2005	<u>222,700</u>
Less: Budgetary authority available for relief efforts	(56,000)
Excess of obligations incurred over budget authority	<u><u>\$ 166,700</u></u>

As of September 30, 2005, FAA incurred \$166.7 million of obligations in excess of OMB apportioned budget authority. FAA did not have available funding from other sources to offset the excess obligations. FAA and DOT legal counsels evaluated the matter and based on an interpretation of contract clauses with the vendor, concluded that FAA should record obligations only to the extent of available OMB apportioned authority. Consequently, FAA recorded obligations equal to OMB apportioned authority of \$56.0 million and based on the opinion of FAA and DOT counsels, FAA was not in violation of laws





governing overspending by Federal agencies. Beginning October 1, 2005, FAA has sufficient no-year appropriated funds to cover the excess obligations. For financial reporting purposes, FAA recorded a liability in the accompanying balance sheet for services received but unpaid at September 30, 2005, equal to \$222.7 million, and recorded obligations incurred equal to available apportioned authority of \$56.0 million in the accompanying fiscal year 2005 Combined Statement of Budgetary Resources.

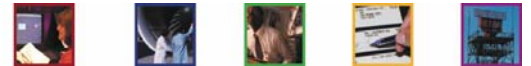
As of September 30, 2005, FAA received additional tasks from FEMA totaling an estimated \$61.4 million for work to be performed in FY 2006 related to ongoing hurricane relief efforts.





**REQUIRED SUPPLEMENTARY
STEWARDSHIP INFORMATION**

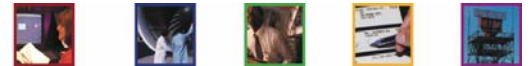




U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
Stewardship Investment
Non Federal Physical Property
Airport Improvement Program
For the Fiscal Years Ended September 30
(Dollars in Thousands)

State/Territory	2005	2004	2003	2002	2001
Alabama	\$ 59,571	\$ 55,527	\$ 59,760	\$ 58,506	\$ 27,421
Alaska	210,446	153,237	158,950	121,640	83,563
Arizona	85,226	52,286	75,247	54,737	51,783
Arkansas	42,342	23,198	35,530	32,937	32,412
California	322,128	236,031	216,981	243,720	179,447
Colorado	61,916	101,792	57,872	91,495	26,340
Connecticut	9,991	8,511	7,011	10,420	3,480
Delaware	9,707	2,813	2,577	5,838	4,704
District of Columbia	5,657	555	447	71	61
Florida	181,151	145,690	166,066	157,878	110,428
Georgia	128,053	96,081	48,147	67,957	33,652
Hawaii	33,097	21,020	24,767	15,846	34,569
Idaho	24,855	22,677	30,721	19,925	25,477
Illinois	152,307	106,145	74,202	165,518	85,566
Indiana	45,537	49,219	47,288	43,099	30,544
Iowa	34,064	24,282	37,521	30,765	35,159
Kansas	25,864	24,118	22,694	15,655	7,587
Kentucky	64,216	51,904	67,031	48,192	46,166
Louisiana	79,747	59,438	45,394	47,915	32,841
Maine	26,324	45,987	18,143	14,456	7,496
Maryland	38,864	39,450	22,933	26,370	18,953
Massachusetts	27,907	23,495	65,930	30,348	20,709
Michigan	137,814	125,928	84,030	85,851	99,278
Minnesota	67,267	50,472	58,826	85,675	49,143
Mississippi	41,696	39,061	30,289	25,929	28,203
Missouri	116,612	89,848	59,642	71,910	62,701
Montana	27,877	36,754	34,273	24,506	19,254
Nebraska	28,633	25,280	19,423	25,181	22,983
Nevada	56,148	58,418	57,506	45,204	57,332
New Hampshire	22,245	7,996	35,082	40,351	16,173
New Jersey	53,960	55,174	29,402	26,391	18,047
New Mexico	19,761	12,756	17,336	13,106	10,882





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

State/Territory	2005	2004	2003	2002	2001
New York	\$ 118,853	\$ 86,382	\$ 122,675	\$ 109,798	\$ 118,792
North Carolina	102,669	44,668	75,317	73,493	60,908
North Dakota	23,074	29,007	15,458	16,562	25,221
Ohio	100,776	118,138	68,717	112,015	51,601
Oklahoma	42,941	31,272	34,351	39,238	19,780
Oregon	53,329	33,793	34,687	46,605	31,655
Pennsylvania	126,833	105,293	112,761	109,388	62,343
Rhode Island	11,901	10,861	13,736	12,409	9,547
South Carolina	38,246	23,772	22,531	39,194	18,895
South Dakota	22,065	20,915	16,841	15,440	10,466
Tennessee	45,678	47,298	62,412	46,373	58,638
Texas	235,495	174,336	159,929	192,738	127,046
Utah	41,200	26,008	24,804	21,396	39,235
Vermont	4,333	6,657	2,310	2,767	5,487
Virginia	82,330	70,688	45,240	76,647	75,555
Washington	168,764	73,153	53,351	62,798	34,023
West Virginia	26,991	20,637	24,373	18,562	18,564
Wisconsin	53,074	60,615	48,264	39,971	27,541
Wyoming	38,536	33,544	21,158	25,679	16,446
American Samoa	9,615	6,328	18,903	17,845	5,374
Guam	11,137	2,244	5,937	368	3,653
Northern Mariana Island	10,274	8,014	10,227	13,017	5,455
Puerto Rico	16,209	9,323	7,419	9,022	6,399
Virgin Islands	4,702	2,726	8,959	20,094	5,056
Administration	82,415	86,485	65,336	64,731	58,542
Totals	\$ 3,712,423	\$ 2,977,300	\$ 2,786,717	\$ 2,933,542	\$ 2,178,576

FAA makes project grants for airport planning and development under the Airport Improvement Program 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.





**Department of Transportation
FEDERAL AVIATION ADMINISTRATION
Stewardship Investment
Research and Development
For the Fiscal Years Ended September 30
(Dollars in Thousands)**

Expenses	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Applied Research	\$ 103,659	\$ 91,743	\$ 29,406	\$ 59,150	\$ 120,395
Development	547	478	251	603	3,419
Administration	29,163	28,643	31,669	44,480	46,988
R&D Plant	5,287	4,230	2,903	3,020	10,130
Total	<u>\$ 138,656</u>	<u>\$ 125,094</u>	<u>\$ 64,229</u>	<u>\$ 107,253</u>	<u>\$ 180,932</u>

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

Research priorities include aircraft structures and materials; fire and cabin safety; crash injury-protection; explosive detection systems; decreased in-flight ice buildup and ground de-icing operations; better tools to predict and warn of weather hazards, turbulence, and wake vortices; aviation medicine; and human factors. Human factors refers to the research of how people (e.g., air traffic controllers and pilots) perform when interacting with, for example, technology and equipment, under various conditions. Optimizing this interaction contributes toward higher levels of safe air travel.

A few of FAA’s top FY 2005 research and development accomplishments were:

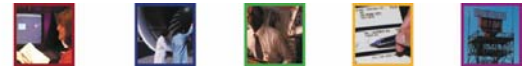
- ▶▶ Developed an easy-to-use Web-based human factors analysis tool that is assisting FAA engineers in determining future air traffic control tower heights and location. Use of this tool poses savings of approximately \$5 million in new airport tower construction costs per year.
- ▶▶ Conducted the research necessary for the publication of a new standard for nondestructive pavement (e.g., runways) testing. The standard is based on use of FAA research-developed software called BAKFAA (back calculation-FAA). BAKFAA provides more uniform and accurate measurement of pavement properties. When used together with pavement design improvements previously published, it can save up to 3% in annual Airport Improvement Program expenditures for runway maintenance.
- ▶▶ Conducted fire safety research that supported the development and publication of an advisory circular on “Thermal Acoustic Insulation Flame Propagation Test Method Details.” This advisory circular simplifies and further standardizes a new flammability test for insulation. It also includes flammability test procedures for insulation blanket components.





REQUIRED SUPPLEMENTARY INFORMATION





U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
 Supplementary Information
 Deferred Maintenance
 For the Fiscal Years Ended September 30
 (Dollars in Thousands)

Category	Method	Asset condition*	Costs to return to acceptable condition				
			2005	2004	2003	2002	2001
Buildings	Condition assessment	4&5	\$ 63,875	\$ 53,359	\$ 50,534	\$ 73,741	\$ 50,568
Other structures and facilities	Condition assessment	4&5	\$ 19,984	\$ 16,543	\$ 29,785	\$ 13,843	\$ 22,928

* Condition Rating Scale 4--Poor; 5--Very Poor

Deferred maintenance is maintenance that was not performed when it should have been, or was scheduled to be performed but was delayed until a future period.

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 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 to 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. FAA reports deferred maintenance only on assets with condition ratings of 4 and 5 in compliance with the Statement of Federal Financial Accounting Standard (SFFAS) Number 6, "Accounting for Property, Plant, and Equipment."



U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
 Supplementary Information
 Intragovernmental Balances
 As of September 30
 (Dollars in Thousands)

Intragovernmental Assets

Agency	2005		2004	
	Accounts receivable, advances, and prepayments, and other	Fund balance with Treasury	Accounts receivable, advances, and prepayments, and other	Fund balance with Treasury
Department of the Treasury	-	\$ 2,413,102	\$ 54,045	\$ 2,840,663
Department of the Air Force	7,904	-	12,417	-
Department of Agriculture	51	-	51	-
Department of the Army	18,207	-	6,647	-
Department of Commerce	526	-	78	-
Department of Defense	19,441	-	2,097	-
Department of Energy	-	-	88	-
Federal Trade Commission	152	-	94	-
General Services Administration	911	-	1,542	-
Central Intelligence Agency	233	-	-	-
Independent Agencies	184	-	8	-
Department of Homeland Security	385	-	715	-
Department of Health and Human Services	2	-	-	-
Department of the Interior	907	-	-	-
Department of Justice	535	-	456	-
National Aeronautics and Space Administration	2,995	-	2,015	-
Department of the Navy	-	-	4,406	-
Office of Personnel Management	6	-	6	-
Department of State	736	-	4,201	-
Tennessee Valley Authority	5	-	-	-
Agency For International Development	56	-	-	-
Department of Education	5	-	-	-
U.S. Army Corps of Engineers	9	-	-	-
Department of Transportation	251,187	-	127,103	-
Other Agencies	-	-	20	-
Total	\$ 304,437	\$ 2,413,102	\$ 215,989	\$ 2,840,663
				\$ 10,318,029





U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
 Supplementary Information
 Intragovernmental Balances
 As of September 30
 (Dollars in Thousands)

Intragovernmental Liabilities

Agency	2005		2004	
	Employee related and other	Accounts payable	Employee related and other	Accounts payable
Department of the Treasury	\$ 6,750	\$ 30,972	\$ 7,098	\$ -
Department of Defense	5,342	33,103	2,413	21,833
Department of Agriculture	-	29	-	29
Department of the Air Force	1,106	-	700	1,228
Department of the Army	261	801	258	140
Department of Commerce	598	5,949	1,652	-
Department of Education	60	-	60	-
Department of Energy	8,473	147	4	1
Environmental Protection Agency	72	-	300	-
Federal Trade Commission	90	-	93	-
General Services Administration	-	22,521	-	6,889
Government Printing Office	-	81	-	83
Department of Health and Human Services	8,502	85	33	-
Department of Veterans Affairs	-	6	-	-
Department of Homeland Security	6,203	-	7,128	-
Department of the Interior	230	1,880	85	13
Department of Justice	-	150	68	54
Department of Labor	197,598	-	200,307	-
Tennessee Valley Authority	8,473	-	-	-
National Aeronautics and Space Administration	2,443	2,987	1,429	2,063
National Archives and Records Administration	-	137	-	-
Department of the Navy	-	358	-	212
Office of Personnel Management	41,752	452	29,527	512
Smithsonian Institution	-	-	-	7
Department of State	106	-	115	547
Department of Transportation	6,507	6,669	11,029	26,718
United States Postal Service	-	341	-	693
U.S. Army Corps of Engineers	-	25	-	19
Independent Agencies	-	-	5	-
Other Agencies	-	-	24,722	-
Total	\$ 294,566	\$ 106,693	\$ 287,026	\$ 61,041



U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
 Supplementary Information
 Intragovernmental Transactions
 For the Fiscal Years Ended September 30
 (Dollars in Thousands)

	2005		2004	
	Transfers-out	Transfers-in	Transfers-out	Transfers-in
Intragovernmental non-exchange revenue				
Department of Transportation	\$ 106,549	-	\$ 165,755	-
Other Agencies	297,598	297,598	361,881	353,466
Total non-exchange revenue	\$ 404,147	\$ 297,598	\$ 527,636	\$ 353,466



U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
 Schedule of Budgetary Resources by Major Fund Type
 As of September 30, 2005
 (Dollars in Thousands)

	Airport & Airway Trust Fund Corpus	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development	Aviation Insurance Revolving Fund	Franchise Fund	Operations	Other Funds	Combined Total
Budgetary Resources									
Budget Authority	\$ 6	\$ 6,793,320	\$ 2,506,394	\$ 124,890	\$ -	\$ -	\$ 7,751,404	\$ 943	\$ 17,176,937
Unobligated balance brought forward and transfers	-	285,047	1,064,646	23,715	218,561	73,238	163,727	1,318	1,830,252
Spending authority from offsetting collections	-	537	92,551	2,752	168,378	438,622	331,286	-	1,034,126
Recoveries of prior year obligations	-	173,568	67,754	5,399	180,886	-	59,314	-	486,921
Temporarily not available	-	-	(20,320)	(1,047)	-	-	(39,345)	-	(60,712)
Permanently not available	-	(3,096,787)	-	-	-	-	(29,118)	-	(3,125,905)
Total Budgetary Resources	\$ 6	\$ 4,155,685	\$ 3,711,025	\$ 155,709	\$ 567,825	\$ 511,860	\$ 8,237,268	\$ 2,261	\$ 17,341,639
Status of Budgetary Resources									
Obligations incurred	\$ 6	\$ 3,673,299	\$ 2,742,937	\$ 130,764	\$ 3,529	\$ 416,089	\$ 8,016,190	\$ -	\$ 14,982,814
Unobligated balances-available	-	1,147	895,677	20,805	471	95,771	51,206	2,261	1,067,338
Unobligated balances-not available	-	481,239	72,411	4,140	563,825	-	169,872	-	1,291,487
Total Status of Budgetary Resources	\$ 6	\$ 4,155,685	\$ 3,711,025	\$ 155,709	\$ 567,825	\$ 511,860	\$ 8,237,268	\$ 2,261	\$ 17,341,639
Relationship of Obligations to Outlays									
Obligated balance, net beginning of period	\$ -	\$ 6,093,262	\$ 1,672,086	\$ 173,610	\$ 186,254	\$ 135,538	\$ 912,310	\$ -	\$ 9,173,060
Obligations incurred	6	3,673,299	2,742,937	130,764	3,529	416,089	8,016,190	-	14,982,814
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	-	(174,105)	(160,305)	(8,151)	(349,264)	(438,622)	(390,600)	-	(1,521,047)
Less: Obligated balance, net end of period	-	(6,062,824)	(1,737,713)	(157,889)	(5,657)	(27,137)	(804,684)	-	(8,795,904)
Net Outlays	\$ 6	\$ 3,529,632	\$ 2,517,005	\$ 138,334	\$ (165,138)	\$ 85,868	\$ 7,733,216	\$ -	\$ 13,838,923
Outlays									
Disbursements	\$ -	\$ 3,531,452	\$ 2,600,515	\$ 139,949	\$ 3,240	\$ 396,101	\$ 12,812,677	\$ -	\$ 19,483,934
Collections, net of offsetting receipts	(16)	(1,820)	(83,510)	(1,615)	(168,378)	(310,233)	(5,079,439)	-	(5,645,011)
Net Outlays	\$ (16)	\$ 3,529,632	\$ 2,517,005	\$ 138,334	\$ (165,138)	\$ 85,868	\$ 7,733,238	\$ -	\$ 13,838,923



U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
 Schedule of Budgetary Resources by Major Fund Type
 As of September 30, 2004
 (Dollars in Thousands)

	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development	Aviation Insurance Revolving Fund	Franchise Fund	Operations	Other Funds	Combined Total
Budgetary Resources								
Budget Authority	\$ 7,069,128	\$ 2,895,677	\$ 119,863	\$ -	\$ -	\$ 7,530,925	\$ 123	\$ 17,615,716
Unobligated balance brought forward and transfers	9,489	675,178	20,439	217,854	78,989	97,495	8,258	1,107,702
Spending authority from offsetting collections	578	168,413	(2,176)	1,446	362,231	144,962	-	675,454
Recoveries of prior year obligations	127,112	26,792	4,257	-	-	12,989	19,768	190,918
Temporarily not available	-	(47,169)	(706)	-	-	(30,999)	-	(78,874)
Permanently not available	(3,420,072)	-	-	-	-	(30,843)	(139)	(3,451,054)
Total Budgetary Resources	\$ 3,786,235	\$ 3,718,891	\$ 141,677	\$ 219,300	\$ 441,220	\$ 7,724,529	\$ 28,010	\$ 16,059,862
Status of Budgetary Resources								
Obligations incurred	\$ 3,501,188	\$ 2,654,246	\$ 117,963	\$ 739	\$ 367,982	\$ 7,561,202	\$ 26,691	\$ 14,230,011
Unobligated balances-available	7,884	968,754	17,956	460	73,238	43,767	1,319	1,113,378
Unobligated Balances-not available	277,163	95,891	5,758	218,101	-	119,560	-	716,473
Total Status of Budgetary Resources	\$ 3,786,235	\$ 3,718,891	\$ 141,677	\$ 219,300	\$ 441,220	\$ 7,724,529	\$ 28,010	\$ 16,059,862
Relationship of Obligations to Outlays								
Obligated balance, net, beginning of period	\$ 5,681,104	\$ 1,952,708	\$ 198,907	\$ 5,201	\$ 91,873	\$ 694,909	\$ 19,769	\$ 8,644,471
Obligations incurred	3,501,188	2,654,246	117,963	739	367,982	7,561,202	26,691	14,230,011
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	(127,690)	(195,205)	(2,081)	(1,446)	(362,231)	(157,951)	(19,768)	(866,372)
Less: Obligated balance, net, end of period	(6,093,262)	(1,672,086)	(173,610)	(186,254)	(135,538)	(912,310)	-	(9,173,060)
Net Outlays	\$ 2,961,340	\$ 2,739,663	\$ 141,179	\$ (181,760)	\$ (37,914)	\$ 7,185,850	\$ 26,692	\$ 12,835,050
Outlays								
Disbursements	\$ 2,961,911	\$ 2,773,790	\$ 141,541	\$ (180,314)	\$ 322,323	\$ 11,710,859	\$ 26,721	\$ 17,756,831
Collections, net of offsetting receipts	(571)	(34,127)	(362)	(1,446)	(360,237)	(4,525,009)	(29)	(4,921,781)
Net Outlays	\$ 2,961,340	\$ 2,739,663	\$ 141,179	\$ (181,760)	\$ (37,914)	\$ 7,185,850	\$ 26,692	\$ 12,835,050





ADMINISTRATIVE SERVICES FRANCHISE FUND

BACKGROUND

Public Law 104-205, “Department of Transportation and Related Agencies Appropriation Act, 1997”, authorized the FAA to establish an Administrative Services Franchise Fund (Franchise Fund). The Franchise Fund 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.

The Franchise Fund offers a wide variety of services. These include accounting, payroll, travel, duplicating, multi-media, information technology, logistics and material management, aircraft maintenance and international and management training. The Franchise Fund’s major customers are FAA Line of Business Programs as shown on the consolidated Statement of Net Cost. Other customers include DOT entities, non-DOT government agencies, and the airport authorities and militaries of other countries.

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 Fund are directed toward identifying the most efficient and cost effective methods to provide support services, and this is consistent with the current President’s Management Agenda initiative relating to competitive sourcing.

DESCRIPTION OF AVAILABLE PRODUCTS AND SERVICES

Early in 2003, the Aeronautical Center reorganized certain Franchise Fund programs around an **Enterprise Services Center (ESC)** concept. This concept is designed to integrate the key components necessary to be a full service financial management provider. The efficiencies and economies of scale created by this integration offer the opportunity to compete for customers seeking a provider of financial management services. As new customers come on board, this will further reduce the cost of providing the services by spreading the fixed cost of operations over a larger customer base. The ESC is comprised of the following three service components:

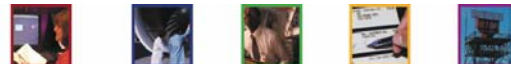
- ▶ Enterprise System – configuration and support of application software and databases;
- ▶ Financial Operations – transaction processing, financial reporting, and analysis services;
- ▶ Information Technology – hosting, telecommunications, information system security, and end user support services.

During FY 2005, the Office of Management and Budget (OMB) conducted a competition among interested agencies to become a Financial Management Center of Excellence (COE). Following from the competition, OMB selected four providers of financial management services, with the ESC being one of those selected. As a COE, the ESC now has the ability to compete to provide financial management services for other government agencies. The ESC currently provides financial management services to all DOT agencies, the National Endowment of the Arts, and has several proposals out to other agencies.

In addition to being selected as a COE, the ESC was chosen by the FAA Administrator to serve as the consolidated provider of all financial management services for all FAA organizations. The consolidation was begun in FY 2004 and is targeted for completion in FY 2006. The ESC committed to providing an improved level of service, meeting all requirements of the Joint Financial Management Improvement Program, while at the same time reducing overall expenses by 10%.

The **FAA Logistics Center** located at the Aeronautical Center provides comprehensive logistics support and a highly sophisticated level of maintenance and repair services to ensure the safety of the flying public and to satisfy the critical needs of the national airspace system and related requirements. Services include materiel management (e.g., provisioning, cataloging, acquisition, inventory management, inventory supply), reliable





and cost-effective depot-level repair of line replaceable units, life cycle and performance cost analysis, logistics automation, distribution services, disposal of items no longer required, and technical support in the repair and maintenance of national airspace and related equipment.

The **Flight Inspection Maintenance Division** in the Office of Aviation System Standards provides total aircraft support including maintenance, logistics management, quality assurance, and overall program management. This service includes preventive as well as repair/overhaul and/or modification requirements, and reliability and maintainability studies.

The services presented under the caption “other lines of business” in the accompanying schedule of condensed information on revenues and expenses of the Franchise Fund include the **Center for Management and Executive Leadership (CMEL)** and the **International Training Division (ITD)**.

The **CMEL**, located at Palm Coast, Florida, provides non-technical training in support of the FAA mission. The center designs and delivers face-to-face centralized training at CMEL and field locations to over 4,700 students annually and students complete more than 5,000 distance learning programs each year. CMEL is fully accredited with commendations by the Commission on Occupational Education, and additionally the American Council on Education has determined that CMEL courses are worthy of upper division college credit. The Federal, professional, and local communities also recognize CMEL as a premier resource for leadership and teambuilding training.

The **ITD** in the FAA Academy at the Aeronautical Center in Oklahoma City, Oklahoma, delivers technical assistance and training to enhance international aviation safety and security while promoting U.S. aviation system technologies, products, and services overseas. The products and services of the ITD include training program management, instructional services, training design/development/revision, technical training evaluations, and consulting services tailored to meet specifically defined needs of the FAA and its international customers.



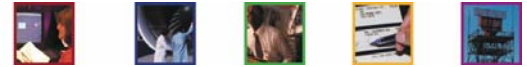


U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
FRANCHISE FUND
CONDENSED INFORMATION
ASSETS, LIABILITIES, AND NET POSITION
(Dollars in Thousands)

As of September 30

	<u>2005</u>	<u>2004</u>
Assets		
Fund balance with Treasury	\$ 122,907	\$ 208,776
Accounts receivable, net	69,106	4,951
Inventory and related property, net	383,482	375,027
General property, plant, and equipment, net	2,748	2,130
Other	578	1,121
Total assets	<u><u>\$ 578,821</u></u>	<u><u>\$ 592,005</u></u>
Liabilities		
Accounts payable	\$ 22,432	\$ 15,872
Advances received and other	121,178	137,326
Total liabilities	<u><u>143,610</u></u>	<u><u>153,198</u></u>
Net position		
Cumulative results of operations	435,211	438,807
Total net position	<u><u>435,211</u></u>	<u><u>438,807</u></u>
Total liabilities and net position	<u><u>\$ 578,821</u></u>	<u><u>\$ 592,005</u></u>





U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
FRANCHISE FUND
CONDENSED INFORMATION
REVENUES AND EXPENSES
(Dollars in Thousands)

		For the years ended	
		September 30	
		2005	2004
Office of Enterprise Systems	Revenues	\$ 44,477	51,915
	Expenses	<u>42,501</u>	<u>42,664</u>
	Profit/(loss)	<u>1,976</u>	<u>9,251</u>
Office of Financial Operations	Revenues	26,229	25,847
	Expenses	<u>24,358</u>	<u>24,675</u>
	Profit/(loss)	<u>1,871</u>	<u>1,172</u>
Office of Information Technology	Revenues	23,378	41,907
	Expenses	<u>41,037</u>	<u>30,417</u>
	Profit/(loss)	<u>(17,659)</u>	<u>11,490</u>
FAA Logistics Center	Revenues	239,629	167,480
	Expenses	<u>280,531</u>	<u>198,825</u>
	Profit/(loss)	<u>(40,902)</u>	<u>(31,345)</u>
Flight Inspection Maintenance Division	Revenues	36,928	50,524
	Expenses	<u>48,334</u>	<u>38,710</u>
	Profit/(loss)	<u>(11,406)</u>	<u>11,814</u>
Other lines of business	Revenues	8,505	2,404
	Expenses	<u>5,733</u>	<u>4,643</u>
	Profit/(loss)	<u>2,772</u>	<u>(2,239)</u>
Total Consolidated	Revenues	379,146	340,077
	Expenses	<u>442,494</u>	<u>339,934</u>
	Profit/(loss)	<u>\$ (63,348)</u>	<u>\$ 143</u>





U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
FRANCHISE FUND
CONDENSED INFORMATION
FINANCING SOURCES AND NET POSITION
 (Dollars in Thousands)

	Cumulative results of operations	
	2005	2004
Beginning balance, net position	\$ 438,807	\$ 442,613
Financing sources		
Transfers-in/out without reimbursement	4,318	(10,906)
Imputed financing from costs absorbed by others	55,421	6,954
Other	13	3
Total financing sources	59,752	(3,949)
Profit (loss)	(63,348)	143
Ending balance, net position	\$ 435,211	\$ 438,807





APPENDIX

IMPROPER PAYMENTS INFORMATION ACT REPORTING DETAILS

RISK ASSESSMENT(S)

AOC Solutions, Inc., under contract with the Department of Transportation (DOT), conducted a review of FY 2004 payments in 10 DOT programs selected by DOT as susceptible to improper payments. The objective of the review was to determine the amounts and causes of improper payments made by the 10 programs; to identify programs with significant improper payments (as defined by OMB); and to identify action plans for reducing improper payments for each program identified as having significant improper payments.

AOC Solutions, Inc., reviewed payments made by 10 DOT programs identified by Operating Administration (OA), which included the following FAA programs:

- ▶ Airport Improvement Program (Grants)^{A-1}
- ▶ Operations (excluding payroll)
- ▶ Facilities and Equipment

AOC Solutions, Inc. conducted interviews with program representatives to discuss program history and any program changes or other issues that may have occurred over the past fiscal year following selection by DOT of the three FAA programs to be reviewed.

AOC Solutions, Inc. then performed a risk analysis of each of the 10 programs to determine the appropriate sample size of payments to review based on the program's relative risk rating. Risk criteria used to assess the programs included gross expended amount, volume of payments, complexity of payments, established controls and oversight, and type and number of program recipients. Each criteria factor was scaled from high to low and had a numerical score assigned to each level. Programs were assessed on each criteria factor and scores were summed to achieve a total risk score. A high (low) total score indicated a high (low) level of risk associated with the program.

The following table shows the final risk ratings of each of the three FAA programs reviewed, along with the risk rating of each program from the FY 2003 review for comparison.

Program	FY 2003 Risk Rating	FY 2004 Risk Rating
Airport Improvement Program (Grants)	Moderate	Moderate
Operations (excluding Payroll)	High	Moderate
Facilities and Equipment	High	Moderate

Program risk ratings for FY 2004 either improved or remained the same as FY 2003 ratings. Improvements were noted in FAA Operations and Facilities and Equipment programs due to improvements in established controls and program oversight.

STATISTICAL SAMPLING PROCESS

Following risk assessment of each program, the potential error rate (potential rate of improper payments) for each program was estimated. The potential error rate for each program was then applied to the formula for determining minimum sample size cited in the implementation guidance of OMB 03-13. The sample size calculated for each program was based on this formula.

^{A-1} Identified in the former Section 57 of OMB A-11 as a program that requires reporting of improper payments.





The minimum sample amount calculated from the formula was used for those programs with relatively high potential error rates because the effect of the high error rate produced a larger sample size in the calculation. Potential error rates and sample sizes are shown in the following table.

Program	Estimated Error Rate (%)	Sample Size
Airport Improvement Program (Grants)	1.20	50
Operations (excluding Payroll)	1.40	50
Facilities and Equipment	1.40	60
Total Sample Size		160

A stratified sampling design that took into account payment amounts as well as the assessed risk of each program was used in the review. The sampling plan was designed with a 90% confidence level, which indicates a 90% likelihood that the true population value is within the results of the sample value. For the projected improper payment rate (derived from the sample) of \$8,125.00, it is 90% likely that the true population improper payment rate is within the range \$7,922.00–\$8,328.00 (\$8,125.00 ±2.5%).

This statistical approach is recommended in the implementation guidance of OMB 03-13.

According to the guidance,

The estimates shall be based on the equivalent of a statistical random sample with a precision requiring a sample of sufficient size to yield an estimate with a 90% confidence interval of plus or minus 2.5% around the estimate of the percentage of erroneous payments. And because the margin of error of a percentage estimate is related to the size of that estimate, the agency may use their initial determination of the potential error...to determine their sample size.

CORRECTIVE ACTION PLAN

FAA’s low rate of improper payments precludes the need for a corrective action plan.

IMPROPER PAYMENT REDUCTION OUTLOOK FY 2004–FY 2008

A table presenting the reduction outlook is not warranted due to FAA’s low improper payments rate.

RECOVERY AUDITING EFFORTS

For the past 4 years, DOT has used PRG-Schultz for recovery audit services. During that time PRG-Shultz reviewed payments made by DOT Operating Administrations (OA) to commercial vendors for fiscal years 2000, 2001, 2003, and 2004. Due to our low rate of improper payments, PRG-Shultz has recovered only nominal amounts for FAA.

MANAGERS AND HEAD ACCOUNTABILITY

The DOT CFO has required the CFOs of all OAs to certify the results of improper payments reviews. In addition, we have incorporated financial management training, which will include payment policies, and in-house training provided to managers. Finally, we converted to the DELPHI financial system, which provides increased system controls over payments. In addition, we established an internal control division to direct the activities related to internal controls and compliance with OMB Circular A-123, *Management’s Responsibility for Internal Control*. This division provides oversight and leads development, implementation, and operation of internal control activities.

INFORMATION SYSTEMS AND INFRASTRUCTURE

FAA has the information systems and infrastructure needed to measure improper payments.

STATUTORY OR REGULATORY BARRIERS LIMITING CORRECTING ACTIONS

Not applicable due to FAA’s low rate of improper payments.





GLOSSARY OF ACRONYMS

AATF	Airport and Airway Trust Fund
ACSI	American Customer Satisfaction Index
AEDT-APMT	Aviation Environmental Design Tool and Aviation Portfolio Management Tool
AFSS	Automated Flight Service Stations
AGA	Association of Government Accountants
AHR	Office of Human Resource Management (FAA Line of Business)
AIP	Airport Improvement Program
AMASS	Airport Movement Area Safety System
ARP	Airports (FAA line of business)
ARTCC	Air Route Traffic Control Center
ASDE-X	Airport Surface Detection Equipment Model X
AST	Commercial Space Transportation (FAA Line of Business)
ASV	Annual Service Volume
ATA	Air Transport Association
ATCSCC	Air Traffic Control System Command Center
ATCT	Air Traffic Control Tower
ATO	Air Traffic Organization (FAA Line of Business)
ATOP	Advanced Techniques and Oceanic Procedures
AVS	Aviation Safety (FAA Line of Business)
BASA	Bilateral Aviation Safety Agreement
BPA	Blanket Purchase Agreement
BTS	Bureau of Transportation Statistics
CAEP	Committee on Aviation Environmental Protection
CAS	Cost Accounting System
CEAR	Certificate of Excellence in Accountability Reporting
CFO	Chief Financial Officer
CFO Act	Chief Financial Officers Act of 1990
COSCAP	Cooperative Development of Operational Safety and Continuing Airworthiness Project
CSI	Composite Safety Index
DBE	Disadvantaged Business Enterprise
DOL	Department of Labor
DOT	Department of Transportation
EA	Enterprise Architecture
EAC	East African Community
ETMS	Enhanced Traffic Management System
EVM	Earned Value Management
F&E	Facilities and Equipment
FAA	Federal Aviation Administration
FEA	Federal Enterprise Architecture





FMFIA	Federal Managers' Financial Integrity Act
GAO	Government Accountability Office
GENOT	General Notice
GPS	Global Positioning System
GSA	General Services Administration
HSPD-12	Homeland Security Presidential Directive-12
ICAO	International Civil Aviation Organization
INM	Integrated Noise Model
IT	Information Technology
JCAB	Japan Civil Aviation Bureau
JPDO	Joint Planning and Development Office
JSC	Joint Steering Committee
LACAC	Latin American Civil Aviation Commission
MAGENTA	Model for Assessing Global Exposure to the Noise of Transport Aircraft
MCP	Mission Critical Position
MIP	Maintenance Implementation Procedure
MOA	Memorandum of Agreement
MSAS	MTSAT Satellite Augmentation System
MTSAT	Multi-function Transport Satellite
NARP	National Aviation Research Plan
NAS	National Airspace System
NASA	National Aeronautics and Space Administration
NASPAS	National Airspace System Performance Analysis System
NATCA	National Air Traffic Controllers Association
NEO	Network-enabled Operations
NFR	Notification of Findings and Recommendations
NGATS	Next Generation Air Transportation System
NPV	Net Present Value
NTAP	National Track Analysis Program
NTSB	National Transportation Safety Board
OA	Operating Administration
OAG	Official Airline Guide
OE	Operational Error
OEP	Operational Evolution Plan
OEDP	Operational Error Detection Patch
OIG	Office of the Inspector General
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
PART	Performance Assessment Rating Tool
PASO	Pacific Aviation Safety Office
PHMSA	Pipeline and Hazardous Materials Safety Administration
PMA	President's Management Agenda





R&D	Research and Development
RASOS	Regional Aviation Safety Oversight System
RD&TP	Research, Development and Technology Plan
RDSIM	Runway Delay Simulation Model
R,E&D	Research, Engineering, and Development
REMS	Real Estate Management System
RNAV	Area Navigation
RNP	Required Navigation Performance
ROI	Return on Investment
RVSM	Required Vertical Separation Minimum
SAGE	System for Assessing Aviation Global Emissions
SARS	Severe Acute Respiratory Syndrome
SMS	Safety Management System
TCCA	Transport Canada Civil Aviation
TRACON	Terminal Radar Approach Control
UAV	Unmanned Aerial Vehicles
URET	User Request Evaluation Tool
WAAS	Wide-Area Augmentation System





INTERNET LINKS

Federal Aviation Administration: www.faa.gov

FAA Offices: http://faa.gov/about/office_org/

FAA Regional Offices and Centers: http://faa.gov/about/office_org/regions_centers/

FAA Operational Evolution Plan (OEP): <http://faa.gov/programs/oep/>

National Transportation Library: <http://ntl.bts.gov>

U.S. Department of Transportation: www.dot.gov

ACKNOWLEDGMENTS

This *FY 2005 Performance and Accountability Report* is a collaborative endeavor on the part of many FAA employees and contractors. We would like to acknowledge and thank them for their hard work and commitment in successfully preparing this report and supporting the audit of the financial statements.

WE WELCOME YOUR COMMENTS!

Thank you for your interest in FAA's *FY 2005 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 and prior year reports are available on the FAA website at www.faa.gov/about/plans_reports/





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