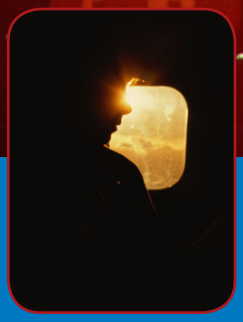
Federal Aviation
Aministration

Moving America Safely



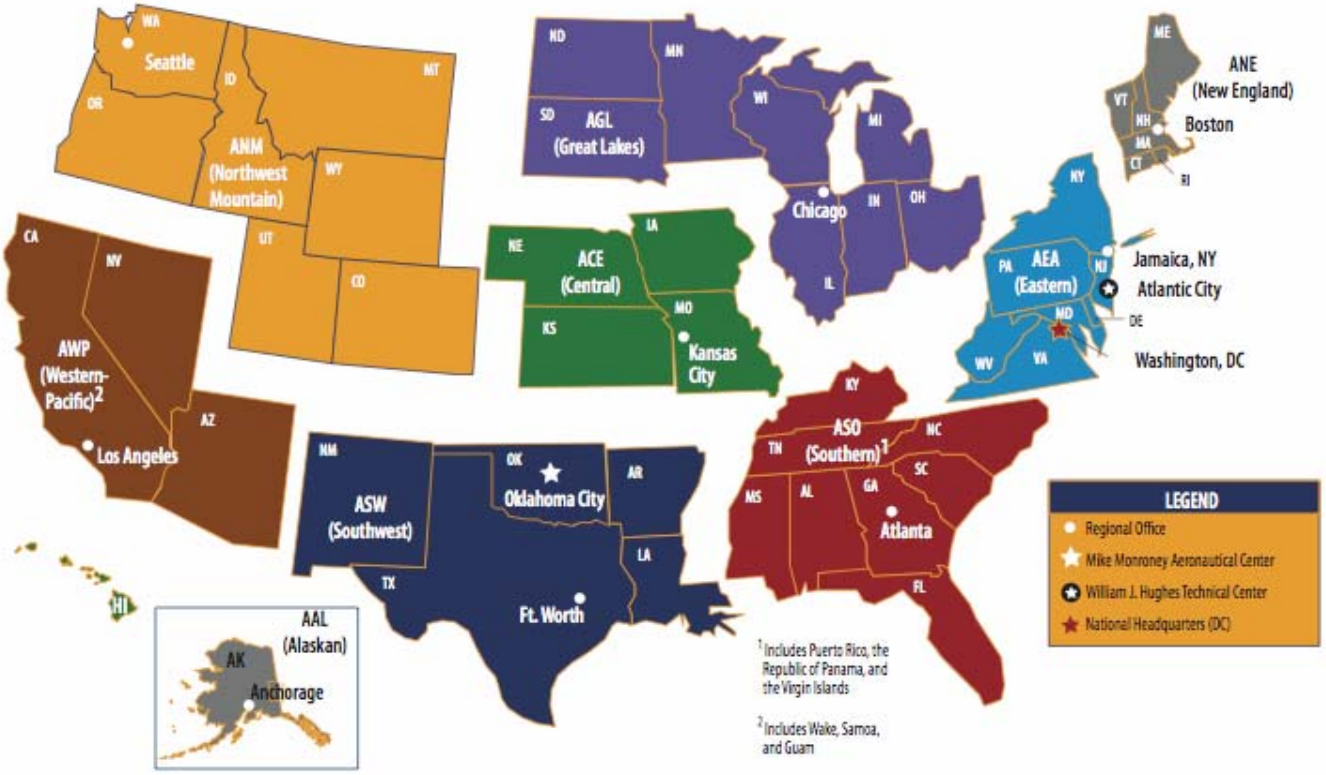
FY 2006

PERFORMANCE AND ACCOUNTABILITY REPORT

FEDERAL AVIATION ADMINISTRATION

FY 2006 PERFORMANCE AND ACCOUNTABILITY REPORT

Federal Aviation Administration 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 2006 Budget (enacted)	$14.269 billion
Total Employees	44,865
Headquarters	5,018 employees
Regional Offices	35,205 employees
Technical Center *Atlantic City, NJ*	1,204 employees
Aeronautical Center *Oklahoma City, OK*	3,438 employees
FY 2006 Passengers on U.S. Carriers	738 million (estimate)
FY 2006 Tower Operations	61 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 third 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.

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

A MESSAGE FROM THE ADMINISTRATOR

The United States requires an aviation system that is both safe and efficient, and Americans look to the FAA to make good on that demand. We continue to do so. Managing the world's most complex airspace and most complicated air traffic control system, the 44,865 men and women of the FAA help deliver the world's safest form of transportation on a 24/7/365 basis—50,000 flights per day, 700 million passengers per year. But the numbers alone do not tell the full story.

FAA Administrator Marion Blakey, center, commissioned a new runway at Atlanta's Hartsfield-Jackson International Airport on May 17, 2006. She is flanked by airport deputy manager Mario Diaz, left, and Atlanta mayor Shirley Franklin, right. Runway 10/28 cost $1.28 billion and is expected to reduce delays by increasing the airport's capacity to handle more flights.

Credit: AP / WIDE WORLD PHOTOS

FY 2006 Accomplishments

FAA made significant progress in achieving all four goals in our strategic plan—the *FAA Flight Plan*: ensuring safety, increasing capacity, demonstrating international leadership, and achieving organizational excellence.

- ***Safety.*** Safety remains our number one priority. Despite the tragic Comair accident on August 27, 2006, FAA's safety record continues to be a remarkable accomplishment. Our commercial fatal accident rate is at an all-time low. General aviation safety improved significantly over the past year, with a 16% reduction in general aviation accidents and a 20% reduction in Alaska accidents. Our entire workforce—inspectors, engineers, technicians, and controllers—shares this accomplishment with the aviation community.
- ***Capacity.*** Even with continued financial uncertainty in the airline industry, analysts predict that the demand for air travel will soon outstrip existing capacity if we fail to modernize the system. Air travel now exceeds pre-September 11 levels and should exceed 1 billion passengers by FY 2015. During FY 2006, we commissioned runways at four large airports and continued to lay the foundation for a Next Generation system that has the capacity to accommodate predicted growth.
- ***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 number of countries to which we provide support has reached 131. We are 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. We opened new offices in Abu Dhabi, United Arab Emirates, and Delhi, India, and are working to open an office in South America in 2007. Our aim is simple: spreading the net of aviation safety to the four corners of the globe.

- ***Organizational Excellence.*** Continuous improvement in our business practices paid off again this year as we realized significant cost savings and other efficiencies. In FY 2006, we transitioned the operation of Flight Service Stations to Lockheed Martin—the single largest civilian outsourcing in history—saving over $2.2 billion over the life of the program. Facility and service consolidation, as well as strategic outsourcing, have also contributed to cost efficiency this year. In addition, we have improved our oversight on major programs and now have 97% of our critical acquisitions on schedule and 100% on budget. Our focus on organizational excellence will continue to benefit the FAA's customers for many years to come. The Association of Government Accountants (AGA) awarded us a third consecutive Certificate of Excellence in Accountability Reporting for our *FY 2005 Performance and Accountability Report*. In addition, we received a third consecutive award for our *FY 2005 Performance and Accountability Highlights* from the League of American Communication Professionals (LACP). This award recognized our publication as one of the top annual reports in the country.

Future Challenges

While we can be justly proud of our accomplishments in FY 2006, we face a number of challenges in FY 2007 and beyond.

- Although we did not meet our very aggressive goal for further reducing the commercial air carrier fatal accident rate in FY 2006, in the coming year we will continue our focus on identifying the precursors to accidents and developing new technologies to ensure that commercial aviation remains one of the safest forms of transportation.
- Expanding capacity to meet increased demand poses another significant challenge to FAA and the aviation community. We will meet these needs by developing new technologies to support the *Integrated National Plan for the Next Generation Air Transportation System* (NextGen). This Plan, submitted to Congress in December 2004, brings together several cabinet-level agencies in the Joint Planning and Development Office (JPDO) to eliminate duplication and maximize resources. The Plan is a roadmap that will leverage Federal funds and allow us to deliver a national aviation system that can handle the safety, capacity, and security needs of our future.

Future Flight

This is the most dynamic period in the history of aviation.

In August, the Federal Aviation Administration (FAA) issued a Type Certificate to the Cessna Citation Mustang. This all-metal, six-place personal jet features state-of-the-art navigation systems and digital avionics with large, flat-panel glass cockpit displays. The avionics suite in this aircraft provides a level of situational awareness and sophistication that—until recently—was unheard of in this class of aircraft.

The Mustang is an entry level business jet that allows passengers to view weather at their destinations while en route. It is one of 20 light jet models that are in various stages of design and production. FAA forecasters project that up to 5,000 of these jets will be in operation by 2017. The number of Light Sport Aircraft—another new category of aircraft—could climb to 14,000 over the same time period.

From Light Sport Aircraft to unmanned aircraft to the thousands of air carrier flights to the wide range of general aviation flying—from recreational pilots to helicopter air ambulances and external load operators to business jets that are as or more sophisticated than commercial airliners. This is just a sampling of what is in our airspace today. The Mustang and Light Sport Aircraft are just two new classes of aircraft that will place increasing demands on the National Airspace System that FAA maintains.

- *For more information:* www.faa.gov/news/speeches/news_story.cfm?newsId=7434

- The Airport and Airway Trust Fund (AATF) was created in 1970 to provide a dedicated source of funding for the aviation system. AATF taxes are set to expire in FY 2007. FAA is working to establish a stable, cost-based revenue stream that will ensure funding for long-term capital needs. FAA needs a revenue stream that is related to the cost of operating the system. Greater stakeholder involvement can also help us ensure that we are concentrating on services that the customer wants and is willing to pay for.

Our *FY 2006 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 sustained our performance this year, attaining 27 out of 30 goals in the areas of safety, capacity, international leadership, and organizational excellence.

After five consecutive clean audits, we received a qualified opinion on our FY 2006 financial statements. The qualification was limited to the accuracy of the Construction in Progress account balance. Further, our auditors reported a related material weakness for lack of supporting documentation and a need to strengthen existing policies and procedures in the capitalization process. We have developed a plan to address this weakness and correct the qualification, which will be implemented in phases during FY 2007. Internally, we assess the vulnerability of our programs and systems through the Federal Managers' Financial Integrity Act (FMFIA) of 1982. I am reporting a qualified statement of assurance that, taken as a whole, the management controls and financial management systems in effect from October 1, 2005, through September 30, 2006, provide reasonable assurance that the objectives of both sections 2 and 4 of FMFIA are being met. The qualification is in respect to the material weakness in the capitalization process and the limited testing of 6 of 11 major business processes in accordance with our 2-year plan. The remaining five business processes will be tested in FY 2007. Management controls are in place and our financial systems conform to Government-wide standards.

Marion C. Blakey
Administrator

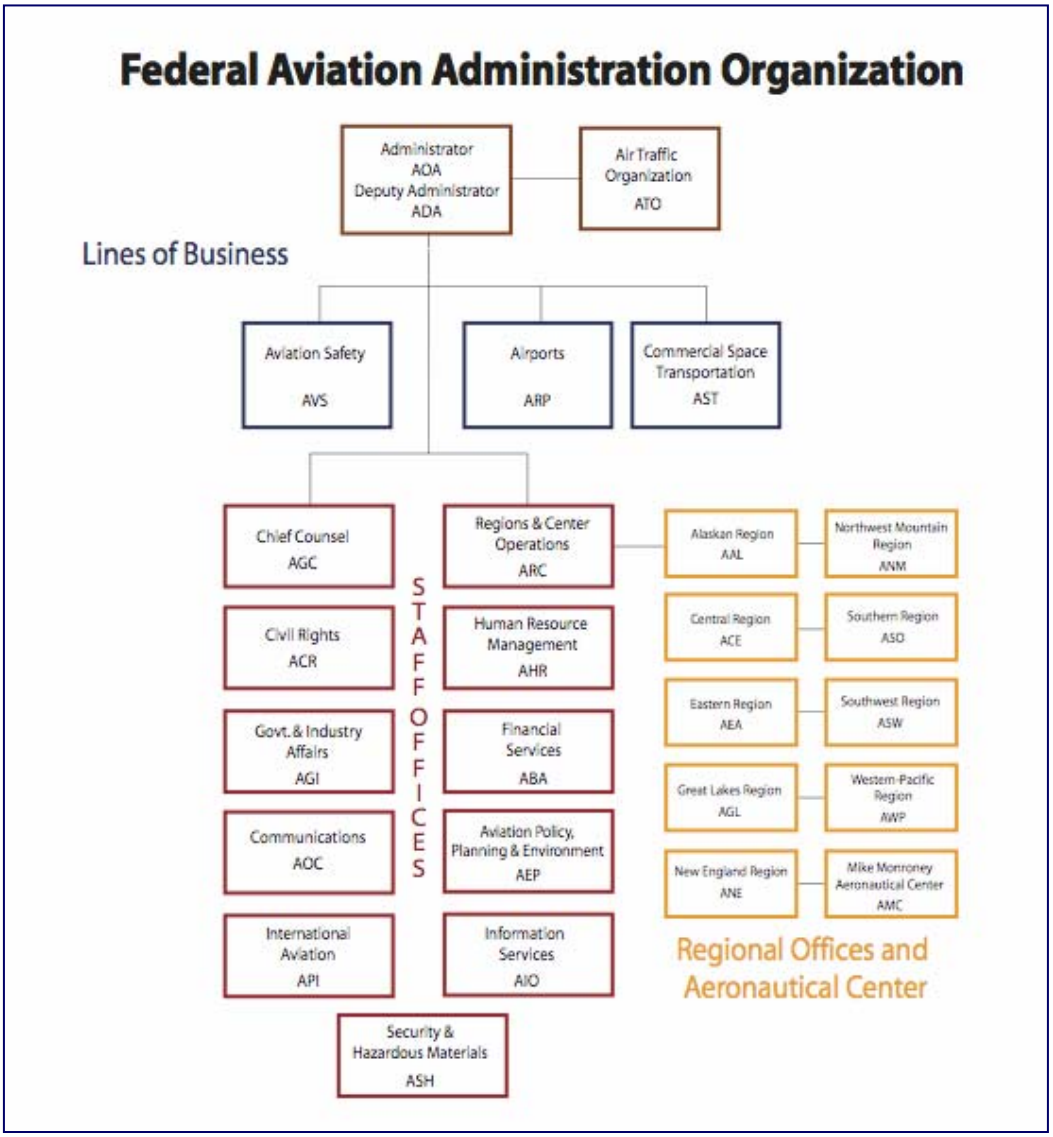
November 3, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

MANAGEMENT'S DISCUSSION AND ANALYSIS

FAA Organization

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 almost 60 years.



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 (NAS). 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 34,000 ATO employees provide these services—the controllers, technicians, engineers, researchers, and support and management personnel whose daily efforts keep the aircraft 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.

Safer Runways With ASDE-X

As airports have grown busier over the years, the potential for collisions on airport runways and taxiways has increased as well. To combat this trend, the Federal Aviation Administration has developed a new runway safety tool--Airport Surface Detection Equipment, Model X (ASDE-X).

ASDE-X enables air traffic controllers to detect potential runway conflicts by providing detailed coverage of movement on runways and taxiways. By collecting data from a variety of sources, ASDE-X can track vehicles and aircraft on airport surfaces and obtain identification information from aircraft transponders.

The data that ASDE-X uses comes from a surface-movement radar located on the air traffic control tower or remote tower, multilateration sensors, ADS-B (Automatic Dependent Surveillance-Broadcast) sensors, the terminal automation system, and from aircraft transponders. By combining the data from these sources, ASDE-X determines the position and identification of aircraft and vehicles on the airport surfaces, as well as of aircraft flying within five miles of the airport.

Controllers see this information presented as a color display of aircraft and vehicle positions overlaid on a map of the airport's runways/taxiways and approach corridors. The system creates a continuously updated map of all airport-surface operations that controllers can use to spot potential collisions. It will be especially useful at night or in bad weather when visibility is poor. We are in the process of enhancing ASDE-X with visual and audio alarms that will alert controllers to possible collisions.

- *For more information:* www.faa.gov/news/fact_sheets/news_story.cfm?newsId=6296

A Year in Highlights

With a workforce of 44,865 professionals and an annual budget of approximately $14.3 billion, FAA operates and maintains the most complex air traffic control system in the world. More than half of the world's air traffic is managed by 14,618 controllers, who ensure ever-increasing levels of safety. We conduct research to improve aviation safety and efficiency and provide grants to improve 3,364 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 2006.

- Achieved certification to the prestigious International Organization for Standardization ISO 9001:2000 quality management standard of a single corporate management system that covers multiple aviation safety services, including national and international sites encompassing 6,462 employees. FAA is the first and largest Federal business to achieve this world-class registration.
- Commissioned four new runways—in St. Louis, Atlanta, Cincinnati, and Minneapolis/St. Paul—adding 1.67% (or 655,000 takeoffs and landings) in new capacity. These new runways will help FAA manage increased demands on the system while working to minimize delays and congestion. We are now planning for six new runway projects, which will further increase capacity.
- Presented a legislative proposal for a new system for financing the FAA in the future. The excise taxes that go to the AATF are set to expire in FY 2007 without congressional reauthorization. Aviation infra-structure and FAA's operations are funded, in part, by taxes on airline tickets, which are deposited in the AATF.
- Began work under a new contract with air traffic controllers. Despite negotiations lasting 9 months, including 1 month of mediation, FAA and the National Air Traffic Controllers Association (NATCA) could not agree on the terms of a new contract that would allow necessary changes in the agency's personnel system. As provided by law, we sent our entire proposal, along with NATCA's proposal and objections, to Congress on April 5, 2006, for a

Safety in the Numbers

During FY 2006, the Federal Aviation Administration (FAA) finalized plans for a new initiative to help aircraft owners, pilots, and aviation maintenance technicians avoid mistakes that lead to accidents. Called the FAA Safety Team (FAASTeam), the program will be devoted to decreasing aircraft accidents by promoting a cultural change in the aviation community toward a higher level of safety.

The Team will use a coordinated effort to focus resources on particularly elusive accident causes. The program features data mining and analysis, teamwork, instruction in the use of safety management systems and risk management tools, and development and distribution of educational materials.

While there is an abundance of data on aircraft accidents, it is often difficult to determine exactly what the data say should be done to reduce accidents. The FAASTeam is developing a web-based Data Mart to give each FAASTeam program manager the correct data for his or her geographic area.

FAASTeam program managers are being trained to analyze the data and extract system and human factors problems. The issues identified will be combined with information from local FAA inspectors who certify and perform surveillance on pilots and air operators. Together, the data and information become the source data used to develop topics and tasks that will be woven into an annual plan of action. Regional FAASTeam managers will coordinate and prioritize the actions of their program managers into a cohesive and efficient regional plan. This effort is designed to make sure resources are devoted to activities that will have the biggest impact on the safety culture and accident rate.

- *For more information:* www.faa.gov/news/fact_sheets/news_story.cfm?newsId=7430

period of 60 days. That period for review ended without modification of FAA's proposal by Congress. Therefore, under the terms of our statute, our proposed change took effect on June 5, 2006.

- Released an updated Air Traffic Controller Workforce Plan designed to address anticipated retirement and replacement of air traffic controllers over the coming decade. The revised document outlines the agency's plans to hire more than 11,800 new air traffic controllers over the next 10 years.
- Introduced the Airspace Flow Program, which is designed to greatly reduce the number of flight delays and bring an estimated $900 million in cost savings to the airlines and the flying public.
- Issued new common Federal launch safety standards designed to create consistent, integrated space launch rules for the nation.
- Continued to transform the aviation 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); the White House Office of Science and Technology Policy; and industry partners—is a test bed for new ideas. During FY 2006, JPDO proposed targeted investments to accelerate the development of key Next Generation Air Transportation System (NextGen) projects. Two examples of such projects are the Automatic Dependent Surveillance-Broadcast (ADS-B), which will replace ground-based radar systems and revolutionize air navigation and surveillance, and the System Wide Information Management (SWIM), which will help make a network-enabled air traffic system possible, improving safety, efficiency, and security.
- 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 by working 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.

Integrating Performance and Financial Information

Efficiency and Cost-Effectiveness

Over the past several years, we have made significant progress in making cost control a priority throughout FAA. For the past 2 years, FAA has included a cost efficiency target among the 30 major *Flight Plan* goals we track each month. As a result of this emphasis, which is part of the broader effort to operate more like a business, we have been able to achieve $126 million in

recurring savings from efforts put in place in FY 2005 and $68 million from efforts that were initiated during FY 2006.

Consolidation of Services and Facilities

Our areas of focus include consolidation of staffing and facilities to address the synergies derived from cross-utilization of resources that will reduce the unit cost of services. This effort also includes benefits that are derived from outsourcing services to obtain cost efficiencies.

ATO Service Area Consolidation--In 2004, in an effort to maximize our resources, FAA decided to restructure the ATO service area offices and centralize the managerial, administrative, and business support functions. Continuing this restructuring in FY 2006, FAA consolidated administrative and staff support from 27 units in 9 regional offices to 3 units in 3 regional offices.

To accomplish the consolidation, quantitative and qualitative criteria for evaluating potential sites were established. The criteria were grouped under three factors: effects of restructuring on services, cost analyses, and quality of life/demographic factors.

Safer Skies

In October 2005, the Federal Aviation Administration (FAA) announced that a new system that allows air traffic controllers to better manage flights over the Pacific Ocean is now fully operational at the Oakland Air Route Traffic Control Center (Oakland Center).

The new Advanced Technologies and Oceanic Procedures (ATOP) system provides safe separation of aircraft in areas outside radar coverage or direct radio communication, such as over the ocean. The system, which detects conflicts between aircraft, sends data and aircraft position information via satellite to air traffic controllers at the Oakland Center. The system helps the airlines save fuel while maintaining the highest standards of safety for transoceanic flights. ATOP also reduces the workload of controllers by displaying aircraft information electronically instead of on paper strips, a labor-intensive method used for decades to track transoceanic aircraft.

More direct communications and reduced controller workload will allow controllers to reduce horizontal separation between aircraft from 100 nautical miles (nm) to 30 nm. With greater transoceanic capacity, more airlines will be able to fly preferred routes, saving fuel and allowing better on-time performance.

- *For more information:* www.faa.gov/news/press_releases/news_story.cfm?newsId=6553

The final service area locations were chosen after extensive research identified each as the optimal site for the activities to be performed, given the selection criteria utilized. Atlanta will support ATO in the eastern United States, Fort Worth will support the central states, and Seattle will support the West Coast. The net result is a decrease of approximately 266 full time support positions, which will yield cost efficiencies of over $360 million over the next 10 years after implementation costs. The restructuring will further enable FAA to reduce costs, maximize the use of our resources, streamline processes, and provide better, more consistent service to our customers.

ATO's service area consolidation made it necessary for ARC to realign significant regional activities in order to better support the ATO. Logistics Divisions currently in nine regions are being consolidated into three Logistics Service Areas that align with the ATO organization. A Logistics Service Area Manager (LSAM) will be located in Service Center Offices corresponding to the ATO in Atlanta, Fort Worth, and Seattle. The LSAMs will report to Regional

Administrators in Northwest Mountain, Southwest, and Southern Regions and will direct logistics work throughout the service area.

Through this realignment, ARC will be better able to position resources to support ATO. By consolidating three regional divisions into each service area, ATO staff will have one point of entry for logistics support, as opposed to interacting with three Regional Logistics Divisions. Efficiencies will be achieved through economies of scale and consistency in business practices. Through attrition it will be possible to reduce the number of managers and overhead staff and to shift those resources into direct frontline mission support.

Accounting Consolidation--Another consolidation effort undertaken by FAA was the centralization of all accounting offices. This initiative went from concept to reality in 2006, when the remaining six accounting offices were consolidated into the Oklahoma City Finance Center. This effort resulted in payroll savings of $3.5 million per year, which will begin accruing in FY 2007.

Human Resource Consolidation--In addition to accounting operations, travel processing and human resource support operations have also been centralized. For human resource support, we consolidated personnel processing in 3 locations rather than the 12 locations that previously performed the function.

Real Property Planning--During FY 2006, the DOT consolidated real property planning and management under a single Asset Management Plan and Three-Year Timeline for executing property initiatives. In addition, the entire Department's real property inventory was consolidated into a single database, including the more than 69,000 buildings, structures, and land parcels owned or operated by FAA. Oversight of the policy, planning, and performance goals of real property management have begun to merge into a single office within FAA.

IT Services--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.

A-76 Sourcing

The single largest effort by FAA, and the largest nonmilitary outsourcing initiative in the Federal Government, involved 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 were implementation costs to complete the changeover, we will start realizing significant savings in FY 2007.

Labor Cost Management

Managing our labor costs is a major area of focus, given the size of our payroll and benefits budget—approximately $6 billion in FY 2006.

A significant step toward that end is reforming how the agency compensates controllers, its largest single group of employees. In 2006, FAA negotiated a new labor contract with the controller workforce. As a result, the new work rules and pay plan provide substantial taxpayer savings and put into place a long-term affordable controller cost structure. The recent controller

contract establishes new compensation bands, phases out or eliminates two premium pay elements, and reestablishes management rights to optimally schedule and staff facilities.

In FY 2005, FAA established a goal to achieve air traffic controller staff savings of 10% by FY 2010 through productivity improvements. ATO achieved the second phase of that goal in FY 2006 by establishing a staffing target of an additional 2% below the standard staffing level, avoiding the need to hire 317 controllers, a savings of more than $15 million in labor costs. We accomplished this by absorbing traffic increases without additional staffing. In addition, a reduction of over 500 overhead and non-safety staff in ATO through attrition resulted in cost savings of approximately $28 million in FY 2006. Furthermore, many organizations are filling vacancies with employees at lower pay levels, resulting in lower labor unit costs.

FAA is also addressing nonproductive time and staffing inefficiencies as key areas for improvement in FY 2006 and beyond. We have strengthened our management of the Worker's Compensation program to ensure that new claims are minimized and employees are returned to duty. Our proactive management has slowed the growth of this program and avoided $7 million in costs. Reports that show sick leave usage, trends, and overages compared to the government-wide average, are periodically distributed to FAA organizations to address potential abuse in this area. Steps are being taken to better record, track, and manage Official Time using electronic systems and Human Resource Management Policy.

Strategic Sourcing and Demand Management

This 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 awarding an Oracle Enterprise license that is 24% less expensive than the license available through the General Services Administration (GSA) schedule and will reduce our costs by almost $1 million per year. In the same vein, a blanket purchase agreement (BPA) with Dell that is significantly cheaper than the GSA schedule yielded cost avoidance of over $7 million this year.

During FY 2006 we undertook a strategic sourcing initiative led by the Chief Financial Officer (CFO) that will generate annualized savings of over $6 million for the next 3 years. 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 through the use of private sector best practices. The CFO is accomplishing this strategic sourcing initiative through an innovative partnership with AT Kearney. AT Kearney provides expertise in strategic sourcing and will be compensated on a contingent basis out of the actual savings achieved. We have already awarded four national contracts: one with Office Depot for office supplies with savings of 30%; one with LEXMARK for printers and copiers/multi-function devices with savings of 30% and 20%, respectively and contracts with SDV Solutions and GTSI for IT hardware with savings of 16.5% and 24%, respectively.

In the area of expense controls, FAA has improved its oversight of the acquisition process to make sure the agency is being a responsible steward of the taxpayer's money. On August 11, 2005, the Administrator directed the CFO to exercise greater oversight and fiscal control over all agency procurements costing $10 million or more. A staff with significant acquisition and

financial controls experience was established to evaluate proposed acquisitions and make recommendations to the CFO. Since October 1, 2005, the CFO has evaluated 59 proposed acquisitions with an estimated contract value of $2.8 billion. In some cases, significant deficiencies were found, including inadequately planned cost control and contractor performance monitoring procedures, unclear statements of work, and unsubstantiated cost estimates. These deficiencies had to be remedied before the proposals were approved by the CFO. In conducting the reviews, the CFO worked with the requesting organization to ensure the FAA clearly defined the requirements, justified the expenditure of funds, accurately estimated the costs of the project, and placed proper controls to effectively monitor the contractor's performance.

The CFO's review is focused on ensuring adequate pre-award planning by assessing the FAA's business case, statement of work, and independent government cost estimate. Specifically, the:

- Business case is evaluated to determine
  - Whether the contract type is suited to the proposed work effort
  - What benefits FAA could obtain by the procurement of the proposed service or asset
  - What alternatives were considered
  - Whether contracts exist that could provide the service
  - What type of competition is planned
- Statement of work is evaluated to determine
  - Whether deliverables well-defined
  - Whether there are reasonable milestone dates
  - Whether there are acceptance criteria for the deliverables
  - What cost and performance monitoring procedures are planned
- Independent Government cost estimates are examined to verify
  - That they are dated and have been prepared or approved by Government employees
  - That a narrative summarizes the assumptions and supportable evidence
  - That rate comparisons are performed when appropriate

In addition to the CFO's review, FAA implemented two additional measures to better control expenditures and to ensure that FAA operates in a business-like manner. At the same time that the Administrator instituted the CFO reviews, she instructed that any proposed support service contract with a total value of $1 million or more where fewer than three bids were received must be approved by the Deputy Administrator. This approval process will ensure that the competitive market-place will be used to the maximum extent possible to obtain the best prices for the services that we buy. In order to better coordinate IT efforts, any IT-related spending in excess of $250,000 must be approved by the Chief Information Officer. Together, these three requirements represent a major effort to better manage the agency's resources and ensure that sound business decisions are made.

Cost Accounting System

During FY 2006, we completed the implementation of the Cost Accounting System (CAS) in our Airports and Aviation Safety lines of business. With CAS implemented across all lines of business, our management is able to obtain invaluable management information to assess operational performance and make critical business decisions.

The integration of the ATO labor distribution system with the CAS was also completed in FY 2006. An updated version of CAS was implemented in ATO, which uses actual ATO labor distribution data thereby eliminating the use of the less precise staffing standards to assign ATO labor costs. Tracking data indicate that FAA-wide, over 90% of labor distribution reporting hours are charged to valid projects and activities and that ATO has been achieving a compliance rate near 92%.

Financial information from CAS is also being used to determine past trends and future needs, and is coupled with operational data to determine unit costs. ATO managers are driving cost improvements and measuring those improvements using key financial performance metrics. For example, the ATO has identified economic drivers, such as controlled flights, and manages to a "full cost per controlled flight" performance target. The ATO also manages to an overall direct-to-indirect field employee staffing ratio to ensure resources are deployed to support the operational workforce in a cost-efficient manner.

Finance Measures

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

- Percentage of invoices paid late
- Bills issued within 30 days of month-end
- Percentage of collections achieved timely
- Percentage of suspense account items cleared timely
- Percentage of assets capitalized timely

Results from this year's performance will serve as the baseline for the future and will be the basis for establishing the FY 2007 service-level 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, its processes will enable us to monitor cost and schedule variances to better manage the programs.

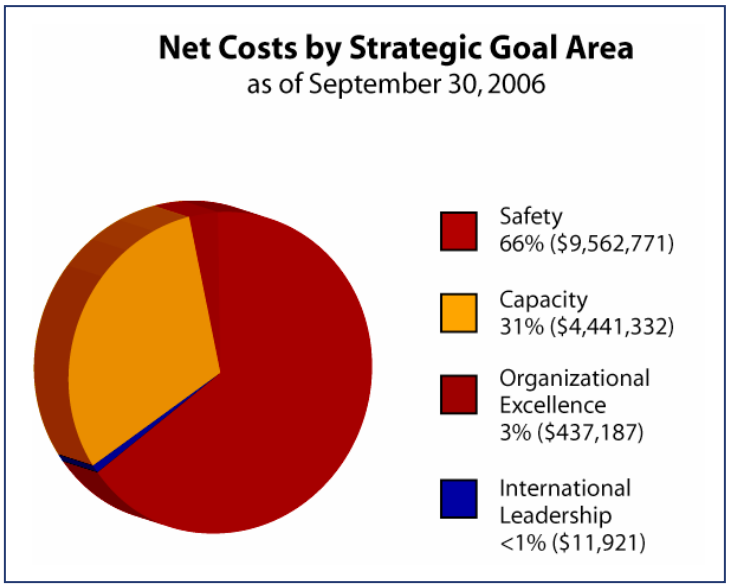
In the area of expense controls, FAA has improved its oversight of the contract approval process to avoid duplication of services and ensure optimal pricing. Other analytic tools have also been put in place to enable efficient manpower scheduling and monitoring of productivity within the organization.

Alignment of FAA Costs and Goals

The alignment of FAA's costs with its four strategic goal areas is captured in the CAS.[1] Projects entered into CAS by every organization are linked to one or more goals, and the percentage of funds that support each goal is identified. At the end of the fiscal year the total net costs for FAA's four lines of business and for its combined staff offices and other programs are divided into the amounts that supported each of the agency's goals: increased safety, greater capacity, international leadership, and organizational excellence.

Just under $9.6 billion, or 66% of the $14.5 billion in total net cost for FY 2006, was devoted to our primary goal of ensuring a safe NAS. ATO spent $6.9 billion, largely to support keeping aircraft safely separated in the air and on the ground. ARP directed over $2 billion to establishing safe airport infrastructure. AVS spent slightly more than $569 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 $33 million to support the agency's safety performance targets and activities.

Nearly $4.4 billion, about 31% of total net costs, was assigned primarily to support FAA's goal of improving the capacity of the NAS. ATO spent $2.6 billion, largely to support its facilities and equipment projects. ARP spent over $1.8 billion to enhance the capacity of the country's airports through runway projects and other efforts, and AST directed more than $2.5 million to the effort to expand capacity.



The bulk of FAA's remaining net costs, just over $437 million, supported its organizational excellence goal. Nearly all the lines of businesses and staff offices contributed to this goal. The remainder, about $11.9 million, was spent to promote FAA's international leadership goal.

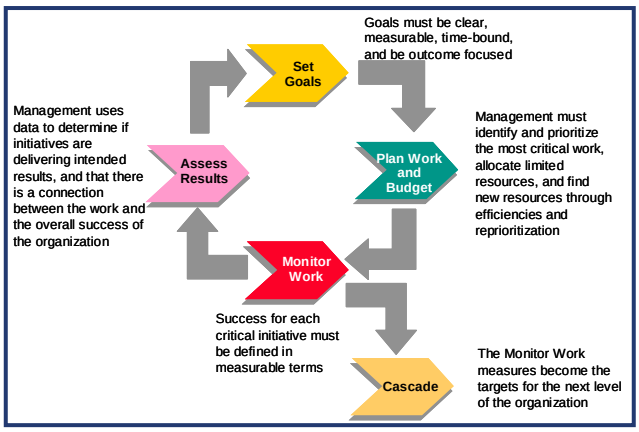
Risks and Trends

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

- Air traffic has surpassed pre–September 11, 2001, levels. More than 735 million people flew last year, and the number of passengers is expected to climb to 1 billion by 2015. Dealing

[1] See Note 11 to the financial statements, page 139.

with these increases will demand even more from FAA resources, which are already feeling the strain.



- Capacity must be expanded to meet increased demand. We will meet these needs by developing new technologies to support the I*ntegrated National Plan for the Next Generation Air Transportation System (NextGen)*. The Plan is a roadmap that will leverage Federal funds and allow us to provide a national aviation system that can handle the safety, capacity, and security needs into our future.
- 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 funded primarily by the AATF from taxes on airline tickets.
- The AATF taxes are set to expire in FY 2007. FAA is working to establish a stable, cost-based revenue stream that will ensure funding for long-term capital needs. FAA needs a revenue stream that is related to the cost of operating the system. Stakeholder involvement can help us ensure that we are concentrating on services that the customer wants and is willing to pay for.
- 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.

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 FY 2006—the third year of the *Flight Plan's* implementation—our goal was to meet at least 90% of our performance targets (27 out of 30).

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 2006, nearly 80% 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 at the right). As we use this framework and instill management discipline into the processes, we anticipate a multi-year 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 continues to produce a performance-based budget that links resource requirements to the *Flight Plan*. Our FY 2006 Budget in Brief is available at www.faa.gov/about/budget and the *Flight Plan* is 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 initiatives, activities, and performance targets that link our work directly to the *Flight Plan*. The business plans are available at www.faa.gov/about/plans_reports/business_plan2006/.
- "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 2006 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 2006, FAA marked the third 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 30 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 (see *How Are We Performing* at 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.** The safety of American aviation is unparalleled. Since 2001 and prior to the losses from the commuter jet crash in August 2006, there had been 50 million successful flights. This represents 2.7 billion passengers who have flown on commercial jet aircraft in the United States without an onboard fatality—nine times the population of our country. 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 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 2006, we achieved six of seven 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 2006, we achieved all seven 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 66 countries in improving aviation safety and efficiency. During FY 2006, we continued to promote safety by broadening the international network of partnerships with civil aviation authorities around the world. **In FY 2006, we achieved all four 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 2006, we continued to address challenges identified by DOT's Inspector General. 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. **In FY 2006 we achieved ten of twelve organizational excellence goals.**

Despite significant increases in air traffic during the year, FY 2006 proved to be another year of impressive success for FAA. We did, however, face continued challenges 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 27 of 30 goals—a 90% success rate. The Performance at a Glance chart on the following page provides a snapshot of our results.

FY 2006 Performance At A Glance

Performance Measure	FY 2006 Target	FY 2006 Results	FY 2006 Status	FY 2007 Target
SAFETY				
Commercial Air Carrier Fatal Accident Rate	0.018	0.020[1]	◎	0.010
General Aviation Fatal Accidents	337	297[1]	●	331
General Aviation Alaska Accidents	115	102[1]	●	110
Runway Incursions (rate)	0.551	0.458[2]	●	0.530

FY 2006 Performance At A Glance

Performance Measure	FY 2006 Target	FY 2006 Results	FY 2006 Status	FY 2007 Target
Commercial Space Launch Accidents	0	0	●	0
Operational Errors (rate)	4.27	4.09[2]	●	4.20
Safety Risk Management (number of changes)	3	4	●	3
CAPACITY				
Average Daily Airport Capacity (35 Operational Evolution Plan [OEP] airports)	101,191	101,932	●	101,595
Average Daily Airport Capacity (8 metropolitan areas)	68,750	69,630	●	68,750
Annual Service Volume	1.00% (4 runways)	1.67% (4 runways)	●	1.00% (1 runway)
Adjusted Operational Availability (35 OEP airports)	99.50%	99.78%[2]	●	99.50%
NAS On-Time Arrivals	87.40%	88.36%	●	87.40%
Noise Exposure	–4.00%	–27.00%[3]	●	–5.00%
Aviation Fuel Efficiency	–5.00%	–8.23%	●	–5.00%
INTERNATIONAL LEADERSHIP				
Aviation Safety Leadership	< 0.060 (in China)	0.054	●	TBD
Bilateral Safety Agreements	2	4	●	1
External Funding	20.00%	69.38%	●	20.00%
GPS-Based Technologies	1	1	●	1
ORGANIZATIONAL EXCELLENCE				
Employee Attitude Survey (cumulative percent increase)	3.00%	–1.00%	◎	TBD
Cost Control (number of activities per organization)	1	1	●	1
Critical Acquisitions on Budget	85.00%	100.00%	●	87.50%
Critical Acquisitions on Schedule	85.00%	97.44%	●	87.50%
Information Security	0	0	●	0
Customer Satisfaction (ACSI)	65	70	●	66
Cost-Reimbursable Contracts	85.00%	102.00%	●	85.00%

FY 2006 Performance At A Glance

Performance Measure	FY 2006 Target	FY 2006 Results	FY 2006 Status	FY 2007 Target
Mission-Critical Positions	–10.00%	–19.75%	●	–15.00%
Reducing Workplace Injuries	2.85 per 100	2.21[4]	●	TBD
Clean Audit With No Material Weaknesses (NMW)	Clean Audit w/NMW	Qualified Opinion	◎	Clean Audit w/NMW
Grievance Processing Time	Set Baseline	146 days	●	–10.00%
Air Traffic Controller Hiring Plan (within 5% of plan)	–5.00%	+20.00%[5]	●	–5.00%

● **Green:** Goal Achieved ◎ **Red:** Goal Not Achieved

Notes:

For a detailed description of the performance measure, see performance goal tables in the Performance Results section.

TBD: To be determined.

[1] Preliminary estimate. Final data will be available in May 2008.

[2] Preliminary estimate. Final data will be available in January 2007.

[3] Projection from trends. Final data will be available in May 2007.

[4] Projection from trends. Final data will be available in mid November 2006.

[5] Preliminary estimate. Final data will be available in November 2006.

Verification and 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 the performance data.

We use several internal review processes to ensure accurate data. At the beginning of each fiscal year, we review our *Portfolio of Goals* to ensure that each performance target has an accurate and detailed data sheet and includes data source information and completeness and reliability statements. Where the criteria for targets have changed, we note and explain the changes. DOT also independently verifies performance data. Several performance measures, such as the commercial airline 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. (See www.faa.gov/about/plans_reports/media/FY06_Portfolio_of_Goals_final.doc to review our FY 2006 goals.)

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).

DOT's Office of Inspector General (OIG), the Government Accountability Office (GAO), and 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, throughout the agency, resources are closely focused on tracking efficiency measures. As our CAS data improves with the expansion to all of our lines of business, we will be able to capitalize on a more robust analysis of how well we are doing or where we need to improve. Among the efficiency measures developed to track progress are measures for each program assessed through an OMB 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.

FY 2006 President's Management Agenda Scorecard for the Department of Transportation

Initiative	Status	Progress
Strategic Management of Human Capital: 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: Improve management through regular, systematic measurement and accountability for program performance compared to predetermined goals.	●	●
Real Property Asset Management: Improve the process for managing real property assets through increased management attention, the establishment of clear goals and objectives, improved policies, and levels of accountability.	♦	●
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.	◎	●

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

Strategic Management of Human Capital

FAA Human Resources partnered with the Office of Competitive Sourcing to support the Government's largest non-Defense competition.

Our Automated Flight Service Station (AFSS) Competitive Sourcing competition included 58 facilities in the continental United States, Puerto Rico, and Hawaii. On February 1, 2005, we awarded a 10-year contract (5-year base, with 5 option years) to Lockheed Martin, the winning bidder. Lockheed Martin assumed operations on October 4, 2005. Our Human Resources (HR) had a number of huge, critical tasks to support the transition of service and the employees affected by it.

Results—We achieved two significant milestones: issuing the RIF notices no later than July 29, 2005, and successfully separating all remaining AFSS employees from our rolls on October 3, 2005, to allow Lockheed Martin to augment their workforce with those former AFSS employees who applied for employment under the contract. Equally important, we provided extensive, multi-faceted placement and other support to affected employees through initiatives including

- Comprehensive information packets for AFSS employees describing the source selection process, their benefits and entitlements, and the many forms of support being provided.
- Additional information and support provided via an HR A-76 Homepage, on-site visits, dedicated Help Desks (which logged over 6,000 calls), and Employee Assistance Program (EAP) seminars/assistance to employees, their families, and household members.
- A Career Transition Assistance Center, established in partnership with FPMI Solutions, which provided a comprehensive program of career transition services custom designed for AFSS employees. The Center responded to almost 7,000 employee requests for assistance in resume writing, interviewing techniques, self-assessments, career counseling, steps for obtaining state benefits, such as unemployment compensation, and more.
- Internal placement programs, through which 456 AFSS employees competed and were selected for other FAA positions before the RIF. Our Selection Priority Program (SPP) will be available through October 2007 to provide those employees separated through RIF the opportunity to continue to bid on FAA positions under published vacancy announcements. We expanded our geographic locations where SPP eligible employees can receive consideration to FAA-wide, and extended the maximum entry age exemption program for the duration of the SPP to increase opportunities for selection.
- A Voluntary Early Retirement opportunity for all eligible employees, which was accepted by 17 employees.
- An agreement negotiated between FAA and the National Association of Air Traffic Specialists to fill vacant permanent air traffic control specialist positions located at the AFSSs in Alaska with AFSS employees facing displacement. Early retirement and voluntary separation incentive payments (also known as buyouts) were both offered as incentives to encourage AFSS Alaska employees to voluntarily separate and create permanent placement opportunities. Approximately 14 additional placements were achieved through that effort.

Competitive Sourcing

In FY 2006, we strengthened the Fair Act Inventory submission by ensuring the criteria used to determine function and reason codes for both "inherently governmental" and "commercial-exempt" were fully justified. The FY 2006 inventory for FAA totaled 45,700 full-time equivalents (FTEs). This amount is approximately 2,100 FTEs less than last year as a direct result of contracting out the Flight Service Station Program. We continue to evaluate our competitive positions in various functions and lines of business for competitive outsourcing opportunities.

Improved Financial Performance

During FY 2006, we completed the implementation of CAS in the last two lines of business—Airports and Aviation Safety. We are now providing cost accounting information to all lines of business. Labor distribution has been implemented in all of the lines of business and in most of the staff offices, covering over 44,000 employees. We plan to implement the remaining staff offices, approximately 1,500 employees, in FY 2007.

We also conducted testing of internal controls over financial reporting in support of the new DOT A-123 Program.

Expanded Electronic Government

Capital Planning

We submitted 29 FY 2007 business cases to DOT and OMB, all of which were determined to be acceptable, that is, compelling, business cases. We have submitted 30 FY 2008 business cases to DOT, which were determined to be acceptable and were forwarded to OMB in September 2006. We expect OMB review by November 2006. We assessed all major capital investments against the Earned Value Management (EVM) American National Standards Institute (ANSI) standard in FY 2005 and submitted the results and a set of plans of action with milestones to implement full EVM by the end of FY 2007 on all of those programs that had significant spending. FAA is on track to meet its milestone targets, with 51% of all assessed elements green as of October 2006 (up from 32% in August 2005).

IT Security

We certified and authorized 26 developmental (initial) systems, recertified 73 systems, and conducted self-assessments on the remaining IT systems. We participated in the DOT compliance review process and are responsible for keeping the DOT Enterprise Portal up to date with respect to our IT systems.

Enterprise Architecture

We continue to improve our enterprise architecture (EA). We refocused our efforts in FY 2006 to concentrate on the asset and application inventory where we mapped the applications to the server(s) on which they reside.

Government-wide Initiatives

We continued to participate in eGovernment initiatives thus contributing to DOT's successful eGovernment scorecard. We played a substantial role in the development of DOT's business case (Exhibit 300) for eGrants consolidation. Additionally, we took a leadership role in developing DOT's application to be a Grants Management Line of Business Center of Excellence on the architecture committee and the business committees. We worked closely with DOT to

review and refine the Geospatial-One-Stop business case and established processes for the continued support of the Geospatial initiative.

Budget and Performance Integration

The FY 2008 budget request, submitted to OMB in September 2006, was our fourth performance-based budget. In presenting the marginal cost of performance for five requests in two goal areas totaling nearly $50 million, we again went beyond DOT's minimum requirements. We also undertook a major revision of the largest section of our performance budget, which focused on the aviation safety goal. This revision was commended by DOT in its response to the budget request.

Real Property Asset Management

During FY 2006, we continued to lead DOT's actions in improving real property management. Specific accomplishments were the following:

- OMB approved DOT's Asset Management Plan.
- DOT submitted its 3-year timeline for eliminating surplus property, improving the condition of buildings and structures, and managing existing real property assets at the right cost.
- DOT submitted a list of real property assets that are candidates for disposal, transfer, or termination.
- DOT completed the collection and development of data reflecting a full inventory of its real property assets.

Eliminating Improper Payments

Our excellent record of keeping improper payments to an insignificant amount caused OMB and DOT to focus on grant payments made through the Airports Improvement Act. This process required researching payments made by grant sponsors to contractors to determine the methodology to use for future reviews. The result was the development of audit procedures to validate these payments in FY 2007. Initial review also determined that no improper payments were made.

DOT Management Challenges and Suggested Courses of Action

Working With Other Agencies to Respond to Disasters and Address Transportation Security

Responding to Hurricane Katrina and Other National Disasters

Progress Meter
Significant Progress

The attacks of September 11, 2001 along with the destruction of the Gulf Coast by Hurricanes Katrina and Rita highlighted the need for a well-defined, well-coordinated, interagency approach to preparing for and responding to catastrophic events. Under the Federal Government's National Response Plan, the DOT is responsible for coordinating and providing Federal and civil transportation support, as directed by the Federal Emergency Management Agency (FEMA) during times of national emergency.

To support DOT's responsibilities during national emergencies, FAA's Southern Region awarded a competitive contract in 2002 to provide the bulk of transportation services designated to the region by FEMA. To administer the contract, the FAA Southern Region, Eastern Logistics Service Area, assigned to the Emergency Transportation Center (ETC) two experienced, full-time senior Contracting Officers. These Contracting Officers have implemented procedures directly responsive to Inspector General recommendations. Specifically, they have implemented procedures to randomly evaluate costs and pricing tendered by the current contractor, by comparing relevant market prices for the same or similar assets or services to determine fair market value. The Contracting Officers, in conjunction with other ETC personnel, enter transactions into the acquisition and financial systems as soon as possible after terms of agreement are reached with the contractor for particular tasks.

FAA has also completed mitigating strategies to ensure the timeliness and tracking of credit card purchases through the use of the US Bank's computer system, Access Online. As of July 2006, all purchase card transactions in all FAA regions, centers, and headquarters offices are tracked with Access Online.

Addressing Transportation Security

Progress Meter
Moderate Progress

There is a growing interdependency among Federal agencies to work together to secure the U.S. transportation system and protect the users of the transportation system from criminal and terrorist acts. The imperative for DOT is to effectively integrate new security measures into its existing safety regimen and to do so in a way that promotes stronger security without degrading transportation safety and efficiency.

During times of crisis, the operational status of airports and the infrastructure that supports them is a critical component to meet the immediate needs of rescue, response, and recovery operations. To address this challenge, FAA focused on outreach, awareness, and improving communication procedures and methods.

Significant progress was made in providing timely and accurate information to support Federal, state, and local response activities. For example, FAA collaborated with many of our

stakeholders to design an airport status report that will be issued daily during periods of emergency. This report assists those responsible for the dispatch and operations of responding aircraft by providing specific information on the availability and usability of airport infrastructure, navigation aids, runways, and support facilities within a declared emergency or disaster area. This type of communication flow continues to increase the FAA's ability to help the first-responders make critical decisions that reduce the impact of natural disasters and other crisis events.

Under the National Response Plan adopted in December 2004, DOT is designated the lead agency for transportation. When FEMA activates emergency support functions, FAA is also called upon to provide support to DOT and FEMA. Additionally, at the onset of a crisis or disaster event, FAA is prepared to operate an Airspace/Tactical Aviation Desk (Airspace Desk) that will feed real-time situational information to responding Federal, state, and local authorities.

Along with the support provided to DOT and FEMA under the National Response Plan, FAA continues to participate with the Transportation Security Administration in national efforts to strengthen transportation security and—specifically for FAA—airspace security.

FAA also continues to collaborate with the Department of Homeland Security in preparing national security plans that establish programs and outline roles and responsibilities in deterring and responding to criminal and terrorist acts. These plans, such as the Transportation Sector Security Plan, examine and provide a mechanism to test our current capabilities and identify opportunities for future cooperation and partnership. By maintaining this outreach with other agencies, FAA remains able to provide the best support possible to our partners and the country when disasters happen.

With the experiences of Hurricanes Katrina and Rita behind us, along with our growing collaboration with the Department of Homeland Security and other Federal agencies, FAA has made great progress in its ability to respond to disasters and address transportation security. Although we may conclude that we have met the challenge presented by the Office of the Inspector General, the issue of disaster preparedness must be continually monitored and adjusted as needs dictate. FAA will take advantage of every opportunity to evaluate internal practices and partner with Federal, state, and local officials to improve our disaster response capabilities as well as our support to the security of the nation's transportation sector.

Mitigating Flight Delays and Relieving Congestion—Actions Needed To Meet Demand

- Taking Appropriate Action Against Growing Aviation Delays

Progress Meter
Significant Progress

In FY 2004, FAA completed a study analyzing system capacity. The study identified 21 non-Operational Evolution Plan (OEP) airports as potentially needing additional capacity. In FY 2005, phase two of the capacity study was undertaken to enhance the level of detail of the non-OEP airports identified. This included conducting annual service volume studies, developing capacity benchmarks, and conducting detailed national airspace simulation. In addition, potential solution sets were developed to improve airport capacity. In FY 2006, we

continued these efforts and analyzed the benefits of the potential solutions through detailed modeling.

FAA is increasing capacity by working with airports and local communities to build new runways. Four new runways opened at OEP airports in FY 2006—at Atlanta, St. Louis, Cincinnati, and Minneapolis/St. Paul—providing the airports with the potential to accommodate an additional 655,000 annual operations. Runways are under construction at six other airports—Boston, Philadelphia, Los Angeles, Seattle, Washington Dulles, and Chicago O'Hare. Eight projects are in the planning or environmental stage—one airfield reconfiguration, two runway extensions, two new runways, and three new airports—that are expected to provide significant capacity benefits through 2015.

FAA is also aggressively pursing improved system capacity through the use of technological advances. In June 2006, existing Flight Schedule Monitor technology was enhanced to allow implementation of the Airspace Flow Program (AFP). AFP is a traffic management initiative that identifies constraints in the en route system, develops a real-time list of flights that are filed into a constrained area, and distributes departure clearance times to meter demand through the area. AFP is expected to reduce the number of flight delays and bring an estimated $900 million in cost savings to the airlines and the flying public over 10 years.

As a result of this new program, the often crippling effects of thunderstorms that impact the NAS are minimized. With the AFP implementation, the number of required reroutes has declined and routes within the constrained airspace appear to remain useable for longer periods. In addition, with the deployment of the AFP, we have seen a decrease in the number of ground delays for flights destined to the Northeast.

Currently, AFPs are being used for severe weather events in the eastern half of the United States. As AFP technology and procedures improve, we expect to manage airspace constraints throughout the NAS. Possibly, they may be used to manage situations like increased seasonal demand into Florida, Mexico, and the Caribbean and for equipment failures that result in loss of radar coverage and/or radio frequencies.

As part of the Collaborative Air Traffic Management Technologies program, FAA is in the process of leveraging the deployment of surface surveillance assets by integrating the key information into the Traffic Flow Management infrastructure. The integration of these data will provide situational awareness and increased predictability within the NAS. Testing is currently ongoing at the Memphis and Louisville airports. Planned enhancements include additional integration with en route automation systems to reduce efforts associated with coordination of flows during severe weather events.

In addition to these decision support tools, we are continuing to explore and apply state-of-the-art weather forecasting information to improve services to our customers that mitigate the impact of weather on air traffic. Two systems are now in place to help—the Collaborative Convective Forecast Product and the Corridor Integrated Weather System.

The Collaborative Convective Forecast Product, available during the March-to-October severe weather season, is a graphical forecast of convection (winds, showers, and thunderstorms) developed specifically for use in strategic planning and management of air traffic. With this

product, collaborative activities occur more rapidly and traffic management decisions based on weather data are more accurate. The tool provides advance planning for long haul flights and allows for schedule predictability based on 2-, 4-, and 6-hour forecasts.

The Corridor Integrated Weather System provides a more accurate convective weather forecast out to 120 minutes in the future. The product is deployed on a limited basis at several ATC Centers as a prototype. Preliminary results indicate a reduction in time required for making and coordinating decisions that mitigate mounting delays as severe weather affects flows in the NAS. We expect that this prototype can be tested and integrated into the NAS in the near future.

Procedural changes have also been implemented to improve performance. In FY 2006, FAA created a new position at the Air Traffic Control Systems Command Center (ATCSCC) called the National En route Spacing Position (NESP). The goal of the NESP is to distribute en route volume efficiently during severe weather or other events that constrain the NAS. As such, the NESP is the focal point when implementing an Airspace Flow Program.

The NESP position was implemented as part of a larger concept change at the ATCSCC called the National System Strategy Team (NSST). The NSST was developed to clearly define areas of specific individual responsibility among personnel. Implementing individually assigned and recognized responsibilities in the NSST will improve the efficiency and effectiveness of system-wide planning, coordination, and responsiveness, including reroute generation and exit strategy planning.

Keeping Planned Infrastructure and Airspace Projects on Schedule To Relieve Congestion and Delays

Progress Meter
Moderate Progress

An integration team composed of representatives from all appropriate FAA organizations monitors the progress of each new runway construction project and is responsible for ensuring that the runway is commissioned on schedule with all necessary equipment and airspace procedures in place. The team provides quarterly updates to FAA executives on the status of each project. Issues relating to the runway project are discussed, assigned to an executive to resolve, and tracked by the integration team to ensure resolution.

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. To support improved investment decisions, FAA commissioned a study, which was completed in March 2006, to estimate the customer benefits of airspace redesign projects and then rank projects based on relative benefits. A prioritization index was developed based on each project's ability to meet FAA agency goals, provide customer and agency benefits, and mitigate risk factors.

In FY 2006, when the Airspace Management Program (AMP) budget experienced significant cuts, the airspace prioritization index was used to make difficult funding decisions. Along with this index, the AMP program office completed a quantified assessment of the operational benefits of all proposed projects. This assessment has been used to create an earned-value metric that measures the progress and projected value of a proposed airspace effort. The

Airspace Current Benefit State metric is defined as a weighted dollar value of the experienced and expected customer benefits of charted and funded airspace projects.

Exploring Alternatives for Managing Capacity Where Infrastructure and Airspace Redesign Initiatives Are Not Feasible

Progress Meter
Moderate Progress

Over the past several years, FAA has conducted extensive research into the feasibility of various market-based and administrative mechanisms to manage congestion at capacity-constrained airports where expansion is not a viable option. For example, FAA, in concert with the National Center of Excellence for Aviation Operations Research, has initiated research on auctions, congestion pricing, and various administrative solutions.

In FY 2006, FAA began to promote a more efficient allocation of resources through the use of market-based mechanisms. In August 2006, a congestion management Notice of Proposed Rulemaking (NPRM) for New York's LaGuardia Airport was published in the Federal Register. The proposed rule establishes an operational limit on the number of aircraft landing and taking off at the airport. To offset the effect of this limit, the rule would implement an airport-wide, average aircraft size requirement. The intent is to encourage the use of larger aircraft to increase the number of passengers who use the airport.

To maintain a level of service to small communities exempt from the aircraft size requirement, FAA proposes to permit a fixed number of operating authorizations for service to smaller airports. The proposed rule also announces the Administration's intent to use market-based mechanisms beginning in 2010. FAA is directing its efforts toward the publication of the final rule for LaGuardia and developing market-based language for the FAA Programmatic Reauthorization, which must be enacted by the end of FY 2007.

Similarly, FAA published a Final Congestion and Delay rule for Chicago O'Hare International Airport in August 2006. The rule will manage capacity at that airport until the O'Hare Modernization Plan (OMP) expansion yields additional capacity. The first OMP runway is expected to open in November 2008. Therefore, FAA adopted October 2008 as the sunset date for this rule.

Although the rule is temporary, FAA has included market-based elements for the secondary market allowing the purchase, sale, and lease of Arrival Authorizations by air carriers. FAA-operated market will be "blind," keeping the bidders' identities secret until the close of the sale and FAA has forwarded the highest bid to the seller. A blind market will advance the goals of promoting the most efficient use of the airspace and maximizing reliance on market forces. This will also ensure that new entrants and all other airlines have an equal opportunity to purchase/lease Arrival Authorizations.

Reauthorizing Aviation Programs—Establishing Requirements and Controlling Costs Are Prerequisites for Examining FAA Financing Options

- Control Major Acquisitions Costs - Delivering New Systems that Work on Time and Within Budget and Making Decisions about the Scope of Billion-Dollar Projects that Have Been Delayed

Progress Meter
Significant Progress

In an effort to better control major acquisition costs and schedules, FAA has implemented a series of executive and management reviews to oversee program progress. Currently, FAA acquisitions over $10 million require the approval of the CFO. In addition, FAA's Chief Information Officer now reviews any IT acquisition in excess of $250,000. The Associate General Counsel also provides a legal review for all procurement actions greater than $100,000.

In addition to the executive-level reviews, the agency has implemented acquisition management controls through the Joint Resources Council (JRC), the ATO Executive Council, and the Capital Investment Team (CIT). The JRC reviews and approves all major investments and the Facilities and Equipment (F&E) budget. It delegates to subordinate boards the authority to approve non-major investments in accordance with the FAA Acquisition Management System (AMS). It also conducts service-level reviews, which provide an FAA-wide overview of operations and investments by service organization.

The ATO Executive Council meets monthly to approve mission need statements of programs beginning the investment process. They review major investments prior to submitting these to the JRC for further reviews and approvals. They also provide review and approval of nonmajor investments to begin acquisitions. For the Executive Council to approve a program, the program must first successfully complete the ATO-Finance Capital Investment Team review process.

The CIT reviews both the benefits and costs of each ATO investment program, validates the methodology to determine if benefits are calculated properly, validates the requirements for major investments, and ensures that recipient benefits are correctly identified. They also validate the development costs and determine whether a proper alternatives analysis was conducted and whether ATO can afford to operate the system once it is developed. As a result of the CIT process, several projects have been restructured, had resources reallocated, or been terminated. Through these actions, the F&E budget baseline has been decreased by over $450 million dollars.

Further, FAA has strengthened its management processes. Recent changes to the AMS require major acquisition projects to meet OMB Exhibit 300 standards for business case justification before receiving program approval and funding. Key changes include limiting funding approvals to 3- to 5-year segments, training and certifying all project managers, and strengthening the investment analysis process.

In addition, a major earned value management (EVM) effort has been initiated across the agency. For all newly approved IT investments that have funding greater than $10 million, project personnel are required to track and measure program performance in accordance with EVM guidelines. By applying EVM methodologies to its acquisitions, FAA is able to ensure

project planning and control by effectively integrating the project scope of work with cost, schedule, and performance elements. Implementation of EVM within FAA is more than 50% complete.

Implementation of executive and management reviews and wide-ranging processes have resulted in positive, measurable, and dramatic changes in how FAA controls major acquisition costs. In FY 2006 FAA achieved 100% of the target in acquisition costs and 97.44% in the acquisition schedule. More importantly, FAA is beginning to efficiently and effectively deliver critical technology to the National Airspace System resulting in increased safety and system capacity for airline passengers.

Control Support Services Contracts

Progress Meter
Significant Progress

FAA support services contracts now undergo the same rigorous executive and management oversight as do other FAA acquisitions. In addition to the executive reviews discussed in the previous section on controlling major acquisition costs, FAA's Deputy Administrator also plays an important role in reviewing and managing FAA support services costs. For any support service contract where fewer than three bidders are competing for a contract exceeding $1 million, the Deputy Administrator's approval is required. This additional step in the review process ensures that adequate competition exists in awarding services contracts.

As discussed in the Inspector General's audit report on FAA's National Contracting Service, the agency has also implemented corrective actions to address a practice known as revolving employment—former FAA employees returning as contractor employees. In October 2005, AMS Clause 3.1.7-6, Disclosure of Certain Employee Relationships was implemented. This clause is intended to enforce the agency's policy of not conducting business with contractors, subcontractors, and consultants who have an unacceptable conflict of interest or an unacceptable appearance of a conflict of interest. Additional guidance was implemented in the October 2006 AMS update.

The IG also pointed out in the same audit report that a variety of mechanisms are used by different FAA organizations in carrying out procurement oversight responsibilities. In response, FAA is developing a uniform nationwide procedure for such oversight under FAA's Acquisition Executive. It will be incorporated into the AMS by January 31, 2007.

Establish Requirements for the Next Generation Air Transportation System

Progress Meter
Moderate Progress

The goal of the Next Generation Air Transportation System (NextGen) is the creation of a more flexible and scalable air transportation system through use of new technologies and capabilities. It will be a data-driven system capable of handling new types of aircraft, new industry business models, and growing demands on capacity expected in the years ahead. Achieving this requires a concerted focus and alignment of efforts in both Government and the aviation industry.

FAA has released an initial draft of the environmental assessment (EA) and its companion concept of operations (ConOps) for stakeholder comment. The concept of operations was

developed with the assistance of the private sector and member Federal agencies. The concept forms a baseline for initiating a dialogue with the aviation stakeholder community to develop the policy agenda and encourage the research needed to achieve NextGen.

An iterative process of defining the ConOps and EA will continue into early FY 2008, at which time the full breadth and depth of NextGen will have been addressed. However, the ConOps and EA will be further refined over time as research results are achieved, policy decisions are reached, and the impacts of technology breakthroughs are assessed.

To better understand the costs and benefits of NextGen, FAA asked the Next Generation Air Transportation System Institute to host a series of workshops with industry where the critical assumptions and uncertainties underlying future cost estimates can be reviewed, scrutinized, and validated for future use.

The workshops have been focused on three objectives. The first objective focused on specific cost drivers affecting the first 5 years of the NextGen initiative. The second is to develop the assumptions for research and development, facilities, and equipment for the 5- to 15-year timeframe. And finally, the third objective is to gain insight into how aviation service and equipment providers view the future of the global marketplace. The workshops have proven highly successful, and with this input FAA is in a much better position to offer an estimate of the future costs of NextGen. A completed cost benefit case will be developed in FY 2007.

On the basis of this early work, FAA proposed to accelerate key projects in FY 2007, including Automatic Dependent Surveillance-Broadcast (ADS-B) and System Wide Information Management. The ADS-B system has been tested in prototype phases for years in locations such as Louisville, Kentucky, and along the East Coast under the Safe Flight 21 program and in Bethel and Juneau, Alaska, under the Capstone Program. The program relies on Global Positioning System (GPS) satellites to give pilots more accurate information on traffic and weather, becoming an additional surveillance source for the NAS while providing additional pilot situational awareness applications that are not provided by today's ground-based radar. The program received approval for initial implementation in selected locations in 2006 and the business case for NAS-wide deployment is expected to be presented to the JRC for approval in February 2007. If approved, full implementation of the system is expected to be complete in approximately 2014.

- Establish Requirements To Address the Expected Surge in Air Traffic Controller Attrition and Negotiate an Affordable and Equitable Bargaining Agreement

Progress Meter
Moderate Progress

In August 2006, FAA released an updated air traffic controller workforce plan—*A Plan for the Future: The FAA's 10-Year Strategy for the Air Traffic Control Workforce*. The plan provides a comprehensive 10-year strategy to ensure FAA has an adequate number of controllers available, in the right places, to handle the coming decade's projected air traffic. These resource needs are then tightly aligned to the agency's performance budgets. The plan also outlines how we will hire these new controllers using a schedule designed to provide adequate training lead-time and to address changing air traffic demands over the coming decade.

In FY 2006, FAA hired and trained new controllers at the level consistent with the updated staffing plan. Controller staffing levels will need to increase each year through 2015 to ensure the number of certified professional controllers in the system stays ahead of expected retirements. Adequate funding requests to hire and train new staff in the future will continue to be consistent with targets set in the controller workforce plan.

Academy training and facility training capacity improvements have been implemented and further improvements are continuing with the goal of decreasing the time it takes a new hire to become a certified professional controller from 3 to 5 years down to 2 to 3 years. Even-flow hiring that links Academy training capacity and facility training capacity has avoided training bottlenecks at both the Academy and in-the-field facilities. Training classes at the Academy are full and two classes have been added to the FAA Academy course schedule for FY 2007 to meet hiring and training needs. Academy graduates will fill targeted air traffic facility vacancies that have been identified through the third quarter of FY 2007.

FAA has also undertaken several key initiatives to achieve significant reductions in operating costs by ensuring controller productivity measures are in place and monitored. Since the release of the first air traffic control workforce plan in December 2004, ATO has introduced methods to save $20,000 per FAA Academy trainee, achieved 1-year cost avoidances of $6.4 million, and reduced direct labor costs by almost $1 million.

FAA implemented new work rules for the nation's air traffic controller workforce that went into effect September 3, 2006, with all past practices and Memorandums of Understanding rendered null and void. The work rules associated with the new National Air Traffic Controllers Association (NATCA) contract ensure that the funding, technology, and people will be in place to ensure safe and seamless travel for the flying public and are fair to controllers.

The new contract restores basic management rights lost in the last agreement. Going forward, the agency will be in charge of daily schedules, work assignments, and decisions regarding the deployment of technology. Significant costs savings are achieved through a new controller pay scale and by eliminating two types of premium pay—Controller Incentive Pay, a second locality pay unique to some controllers, and Controller-in-Charge Pay premium, which had not reduced required supervision as originally intended.

Complete Implementation of the Cost Accounting System to Control Costs and Improve Operations

Progress Meter
Significant Progress

During FY 2006, FAA completed the implementation of the CAS in the last two lines of business—Airports and Aviation Safety. With the implementation of the CAS across all lines of business, FAA management is able to obtain invaluable management information to assess operational performance and make critical business decisions.

The integration of the ATO labor distribution system with the CAS was also completed in FY 2006. An updated version of CAS that uses actual ATO labor distribution data was implemented, eliminating the use of the less precise staffing standards to assign ATO labor costs. Tracking data indicate that organization-wide, over 90% of labor distribution reporting

hours are charged to valid projects and activities and that ATO has been achieving a compliance rate near 92%.

Financial information from CAS is also being used to determine past trends and future needs, and is coupled with operational data to determine unit costs. ATO managers are driving cost improvements and measuring those improvements using key financial performance metrics. For example, ATO has identified economic drivers, such as controlled flights, and manages to a "full cost per controlled flight" performance target. The ATO also manages to an overall direct-to-indirect field employee staffing ratio to ensure that resources are deployed to support the operational workforce in a cost-efficient manner.

A major component of FAA financing reauthorization is an ongoing study to allocate FAA's air traffic control costs to users of the system. In order to equitably allocate costs, cost accounting data are needed to determine appropriate cost allocation to users for cost recovery purposes. Cost allocation rules must be simple, transparent, and repeatable as well as consistent with U.S. and international standards. While FAA's CAS provides detailed source data, its cost accounting reports for managerial purposes allocate costs to facilities, not users. As a result, FAA has developed a set of allocation rules to determine what costs are imposed on the air traffic system by different types of users. In developing these allocation rules, FAA has sought stakeholder input and studied other U.S. Government and international models that employ cost allocation principles associated with marginal system use, use of congested airspace and scarce resources, aircraft weight, distance, and other criteria. FAA should complete ATO cost allocation early in FY 2007 and expects to use the results to form the basis for the financing reauthorization proposal that the Administration will submit to Congress.

Aviation Safety—Developing Effective Oversight Programs for Air Carrier Operations, Repair Station Maintenance, and Operational Errors

- Implement a Risk-Based Approach to Air Carrier and Repair Station Oversight

Progress Meter
Moderate Progress

FAA has continued implementation and expansion of the Air Transportation Oversight System (ATOS), a proven risk-based approach to air carrier oversight. ATOS enables FAA inspectors to look at the whole system, from pilots to maintenance facilities to flight dispatch to cabin safety. ATOS provides inspectors with the ability to continually adjust the focus of surveillance through the identification and prioritization of risks. Of the 116 major air carriers, 39 are under ATOS and the remaining 77 by December 2007.

Additionally, a significant part of air carriers' maintenance work is performed at night or on weekends. To fully address this circumstance, FAA adjusted its surveillance requirements to reflect the amount of maintenance performed during these hours. To support this adjustment, the agency issued new guidance that requires certificate management teams to identify and document how much maintenance is accomplished during off-hours and to develop surveillance plans to monitor risks associated with work performed during these times. The guidance also requires managers to ensure that inspectors assess risk and adjust surveillance plans accordingly, and that surveillance reports are annotated to indicate when inspections are accomplished during off-hours.

FAA issued new guidance and proposed rules for the oversight of both domestic and foreign repair stations. For domestic facilities, the guidance establishes a system safety oversight and risk assessment program. A notice of proposed rule making (NPRM) that revises standards for FAA to certify repair stations is also currently under review at the Department of Transportation.

To provide customers a better understanding of the capabilities of specific repair stations, FAA has prepared and sent to DOT a NPRM that revises the rating system for repair stations to better reflect evolving technologies and business practices. The proposed rule also requires repair stations to have a self-audit system to ensure that the repair station returns to service only those products that meet all airworthiness requirements.

FAA continues to conduct a repair station prototype program that uses an air carrier certificate management team structure to strengthen oversight. Advantages of this approach include standardization and control from a central FAA office. The program targets large repair stations and companies that operate multiple repair stations or satellite repair facilities. Based on the results, FAA will evaluate expanding this approach in FY 2008.

Ensure Reporting of Operational Errors

Progress Meter
Significant Progress

To ensure the reporting of operational errors, FAA issued a general notice to all air traffic control facilities to establish an incident audit process for all terminal facilities. This program was implemented in October 2005 and is fully operational. The incident audit review process contains a highly structured system of checks and balances to ensure the reporting of operational errors. The process requires reviews of Air Traffic Services using existing playback tools to identify operational errors. The playback tools recreate air traffic incidents by replaying recorded radar and voice data. FAA Headquarters is also conducting similar reviews to capture operational errors.

Further, FAA has added a requirement to its Air Traffic Quality Assurance Order that directs all facilities to conduct monthly audits of a random sampling of radar or other data. Each facility or Hub prepares a quarterly report of the findings for their respective Service Area Quality Assurance Manager. FAA data indicate the audit program is having the desired effect: facilities are more accurately reporting operational errors and deviations.

To automate this incident audit review process, FAA is currently developing and implementing a nationwide automated software prototype to depict separation conformance in both the terminal and en route environments called the Traffic Analysis Review Program (TARP). This detection technology applies separation logic to targets, identifies where applicable separation standards are not being maintained, and highlights incidents for further investigation. FAA is on schedule for initial implementation in the third quarter FY 2007.

Improving Information Technology Investment and Computer Security

Clarify the Departmental Investment Review Board's Role in Assisting the Secretary to Maximize the Value and Manage the Risk of Major Information Technology Investments

Progress Meter
Moderate Progress

With the cooperation of the DOT General Counsel and FAA's Chief Counsel offices, the role of the DOT Investment Review Board (IRB) in major IT investments has been more clearly defined. The IRB will continue its oversight role for the entire Department of Transportation, with FAA agreeing to voluntarily submit its major investment projects to the IRB for review. The IRB will continue to make recommendations to FAA with respect to major IT programs as a necessary part of developing DOT's IT portfolio in the budget process. If FAA chooses not to adopt the DOT's recommendations with respect to major IT investments, DOT retains the authority to exclude the project from its budget.

In FY 2006, the FAA made significant progress toward improving its IT investment management practices. In particular, the FAA improved its process of preparing and submitting quality business cases for its major capital investments and made significant progress in moving to full implementation of earned value management (EVM) for those same investments. FAA also made progress in attaining to stage three of GAO's IT Investment Model, particularly in the area of nonmajor IT investments and in the implementation of IT portfolio management.

In response to the requirement to apply EVM to IT investments that have current year funding of $10 million or more we made important strides. Using EVM as a project management tool we are able to optimize project planning and control through integration of the project scope of work with cost, schedule, and performance elements. In support of EVM implementation, we revised the acquisition management system (AMS) to incorporate EVM policy and guidance.

In addition, the AMS policy and processes on cost estimation, procurement, system engineering, and risk management were changed to align with best practices in EVM. For each major capital program that was assessed in FY 2005, plans with action items and milestones were created and submitted. These plans focus on how that program will reach full EVM compliance by the end of FY 2007.

Ensure Better Security of Operational Air Traffic Control Systems

Progress Meter
Moderate Progress

In FY 2006 FAA adopted National Institute of Standards and Technology (NIST) guidelines and standards for certification, accreditation, and monitoring of its IT systems. The Security Certification and Accreditation (C&A) Program is an integral part of FAA's efforts to ensure the security of its information technology systems, including air traffic control systems. The C&A process provides FAA senior managers the most complete and accurate information possible on the security status of the agency's information systems so they can make timely, credible, risk-based decisions on whether to authorize operation of those systems.

FAA undertook several initiatives to maintain current certification and authorization (C&A) of its IT systems, which includes air traffic control systems. The FY 2006 goal was to complete C&As on 33% of its IT systems, or 95 total C&As. Of the 95 total C&As, 28 were planned to be

initial certifications and 67 recertifications. The agency completed initial C&As on 26 systems (rather than 28 as 2 developmental systems were not fielded) and recertified 73 systems in FY 2006. As required, self-assessments were completed on the remaining systems. The agency also established a FY 2006 goal to remediate 20% or 36 of the 180 high-risk weaknesses identified. To date, FAA has remediated 112 of the targeted 180 vulnerabilities, far exceeding the FY 2006 target.

FAA also took steps to improve its business continuity plan (BCP) to deal with the possibility of prolonged service disruptions at a major facility that would severely disrupt air traffic, cause significant economic losses, and subject travelers to delays and inconvenience. FAA has completed actions on recommendations developed in FY 2005 to mitigate a prolonged service disruption at an en route facility. The agency established an engineering team to support continuity plan activities. The BCP team completed an engineering analysis and developed proposed near-, mid-, and long-term solutions. The team briefed FAA senior executives who formalized BCP activity as a priority. By December 2006, the BCP team will develop a schedule and program management plan to support the proposed business continuity plan solutions.

FAA also designated a focal point for decision-making in long-term disaster recovery. This designation is reflected in an update to the Air Traffic Organization Operational Contingency Plan. The update also reflects the transition from short-term contingency to long-term continuity, which will enable FAA to deal more effectively with prolonged service disruptions at major facilities.

Management Integrity: Controls, Compliance, and Challenges

Every year, FAA program managers in the lines of business and staff offices assess the vulnerability of their program and activity management controls. On the basis of these assessments, reviews 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 potential 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 have developed a corrective action 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.

In a September 30, 2006, memorandum, the Administrator reported to the Secretary a qualified statement of assurance due to a material weakness in the capitalization process. Last year, we had one material weakness—timely processing of transactions and reconciliation of accounts. This year we were able to implement subsidiary to general ledger reconciliations, establish critical financial system integrity reports, reduce aged prepayments, dramatically reduce suspense account balances, improve accounting for support of hurricane response efforts, and create a new budgetary to propriety analysis process. We are still working the major challenge of timely capitalization and retirement of assets. Since January we have set up several

workgroups to improve capitalization of assets and contracted for an independent review of the capitalization process.

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 appropriately 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 5-year plan than 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. After a project has been identified, the airport sponsor can apply to the FAA regional or district office for a grant. We continue to support the development of 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. FAA continued to work with its stakeholders to consider various alternatives for successor legislation.

Financial Highlights

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 2006 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. 06–03, Audit Requirements for Federal Financial Statements. 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 2006 financial statements. This firm also audited FAA's FY 2002–FY 2005 financial statements.

In 2002, DOT's OIG and Chief Financial Officer, along with FAA's Chief Financial Officer, established an Audit Coordination 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 a qualified audit opinion on FAA's FY 2006 financial statements. The qualification is limited to FAA's Construction in Progress (CIP) balance.

Understanding the Financial Statements

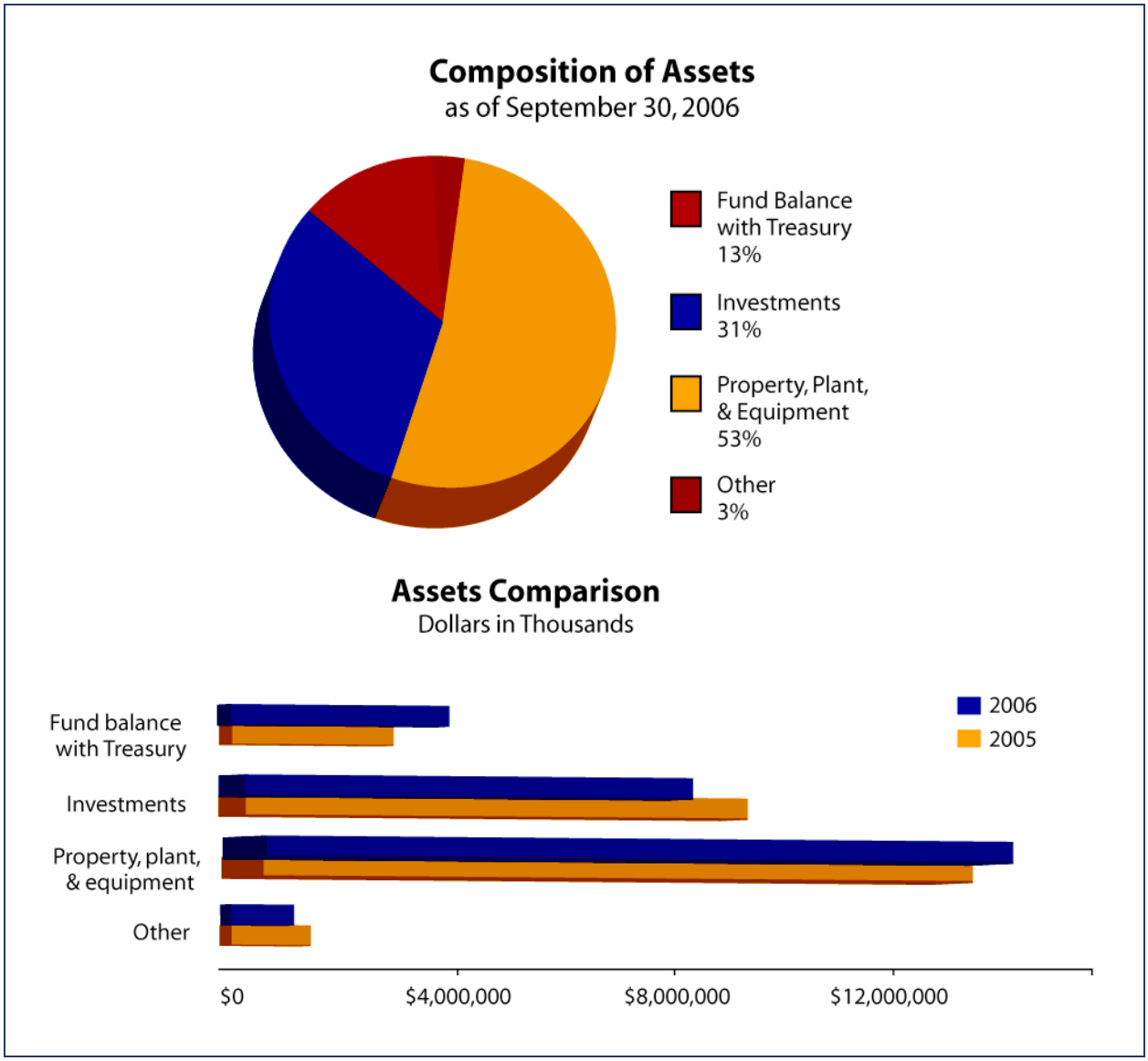
FAA's Consolidated Balance Sheets, Statements of Net Cost, Changes in Net Position and Financing, and Combined Statements of Budgetary Resources, have been prepared to report the financial position and results of operations of FAA, pursuant to the requirements of the Chief Financial Officers Act of 1990 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 2005 to FY 2006, 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 FAA (assets) against the amounts owed (liabilities) and amounts that comprise the difference (net position).

Assets

Total assets were $27.7 billion at the end of FY 2006. 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, 2005 and 2006.

Fund Balance with Treasury represents 13% 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 AATF but not yet invested. Fund balance with Treasury increased $1.1 billion from 2005 to 2006 primarily because FAA had less funds invested in the AATF at year-end than in the prior year.

At $8.7 billion, *Investments* represent 31% 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. While tax revenue collections remained consistent between FY 2006 and FY 2005, investments decreased $2.0 billion. The decrease was due to $1.3 billion more in redemptions of AATF investments in FY 2006 than in FY 2005 for operational funding. Additionally, excise tax collections of $700 million received at the end of FY 2006 had not yet been invested and thus reported as part of Fund Balance with Treasury.

At $14.6 billion, *General Property, Plant, and Equipment, net* (PP&E) represents 53% of FAA's assets as of September 30, 2006, and primarily comprises construction-in-progress related to the development of NAS assets and capitalized real and personal property. There was a negligible increase 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 2006.

Liabilities

At the end of FY 2006, FAA reported liabilities of $3.5 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.

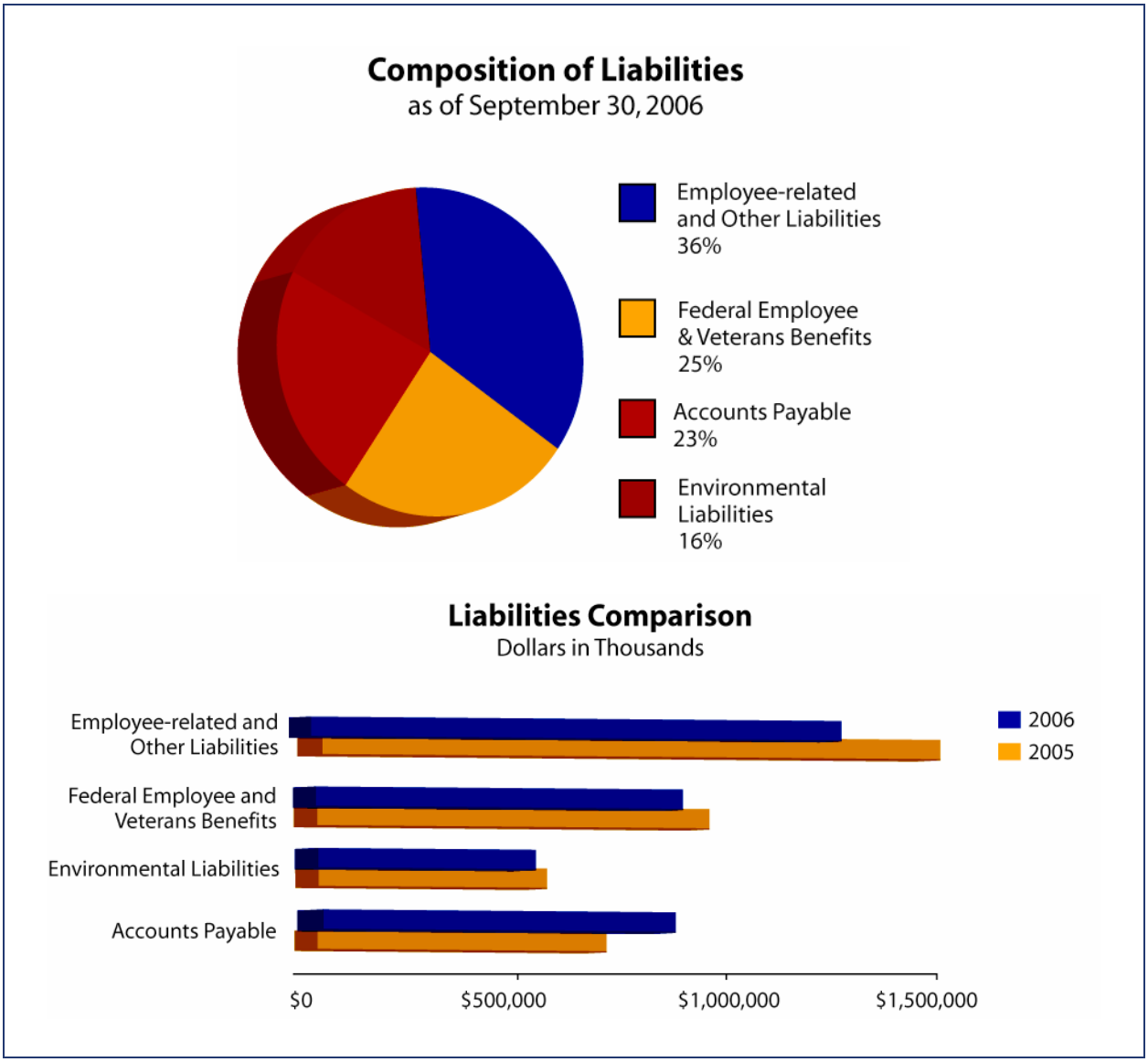
The *Liabilities Comparison* chart presents comparisons of major liability balances between FY 2005 and FY 2006. A discussion of the significant fluctuations between the 2 years follows.

At $1.3 billion, *Employee Related and Other Liabilities* represent 36% of FAA's total liabilities. These liabilities decreased $198.2 million from FY 2005 to FY 2006, mainly as a result of the FY 2006 payment of $166.0 million in accrued unfunded liabilities that were accrued at the end of FY 2005 related to the Hurricane Katrina relief efforts.

At $888.1 million, *Federal employee and veterans benefits* represent 25% of FAA's current year liabilities, and consist of FAA's 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 upon actual workers' compensation payments to FAA employees over the preceding four years.

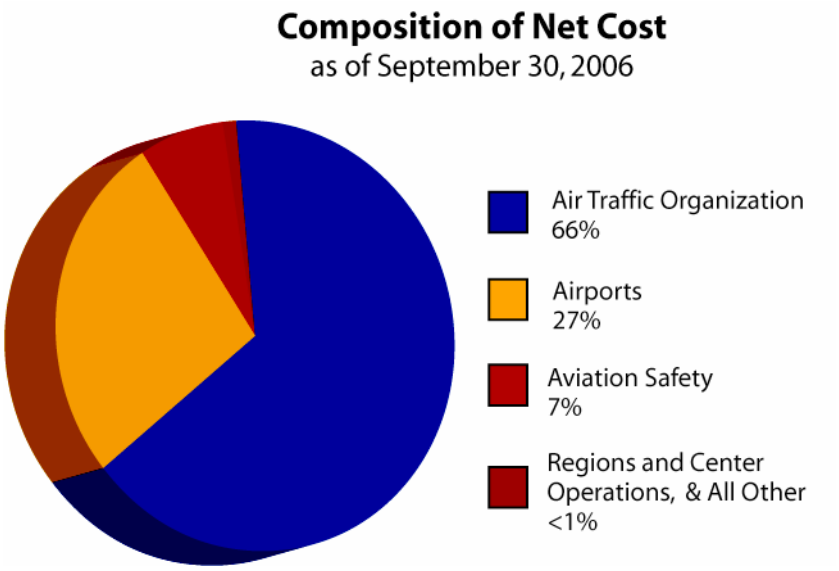
Environmental liabilities represent 16% of FAA's total liabilities, and were relatively stable at $573.3 million as of September 30, 2006, and $596.5 million a year earlier. Environmental liabilities include a component for remediation of known contaminated sites and the estimated environmental cost to decommission assets presently in service.

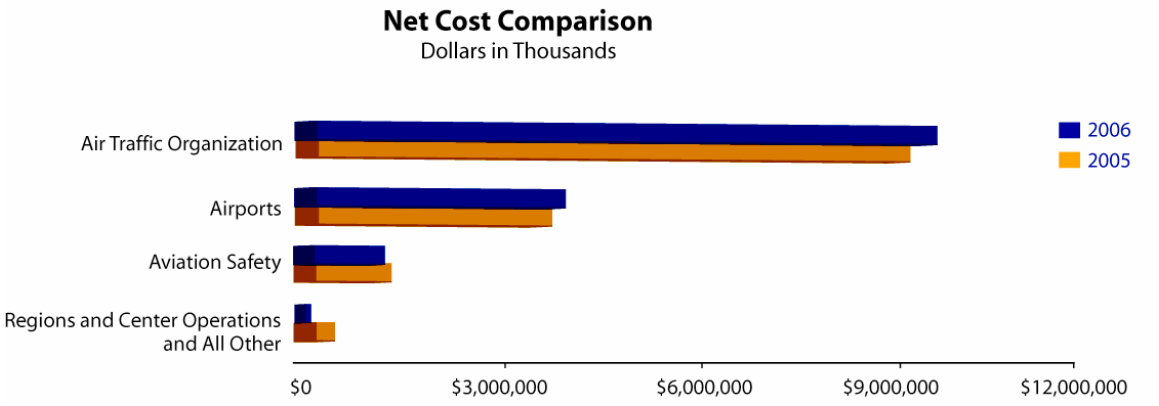
FAA's *accounts payable* represent 23% of liabilities and increased $151.8 million from FY 2005 to FY 2006 mainly due to a reclassification from other liabilities and increases in year end accruals for grants and for amounts owed to suppliers of services. Accounts payable are amounts FAA owes to other 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 expense less any earned revenue for each FAA program is used to arrive at the net cost of specific program operations. FAA has used its CAS to prepare the Statement of Net Cost since FY 1999.





In FY 2006, FAA's net costs were $14.5 billion, compared to $14.0 billion in FY 2005. The *Composition of Net Costs* chart illustrates the distribution of costs among FAA's lines of business.

The *Net Cost Comparison* chart compares FY 2005 and FY 2006 net costs.

With a net cost of $9.6 billion, the *Air Traffic Organization* is FAA's largest line of business, comprising 66% of total net costs. ATO's net costs increased in FY 2006 primarily from costs related to FAA's Telecommunication Infrastructure (FTI) project and a greater number of assets below the capitalization threshold were charged to expense in FY 2006 compared to FY 2005. FTI is a major telecommunications upgrade that provides efficient transmission of voice, data, radar, weather, and other information critical to the operations of FAA at a significant cost savings over time.

The net cost of *Aviation Safety* represents 7% of FAA's total net costs, while *Region and Center Operations and All Other* comprise less than 1% of total net costs. The net costs of *Region and Center Operations* were $269 million less in FY 2006 due primarily to the receipt of reimbursable revenue for Hurricane Katrina relief efforts while the expenses were reported in FY 2005. The net cost of *Aviation Safety* was relatively unchanged from 2005.

With a net cost of $3.9 billion in FY 2006, which is 27% of FAA's total net costs, *Airports* is FAA's second largest line of business. Net costs increased $140 million from FY 2005. The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (P.L. 106-181) increased AIP 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 Airport costs increased in FY 2006, 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. The agency's net cost of operations and net transfers to other Federal agencies serve to reduce net position.

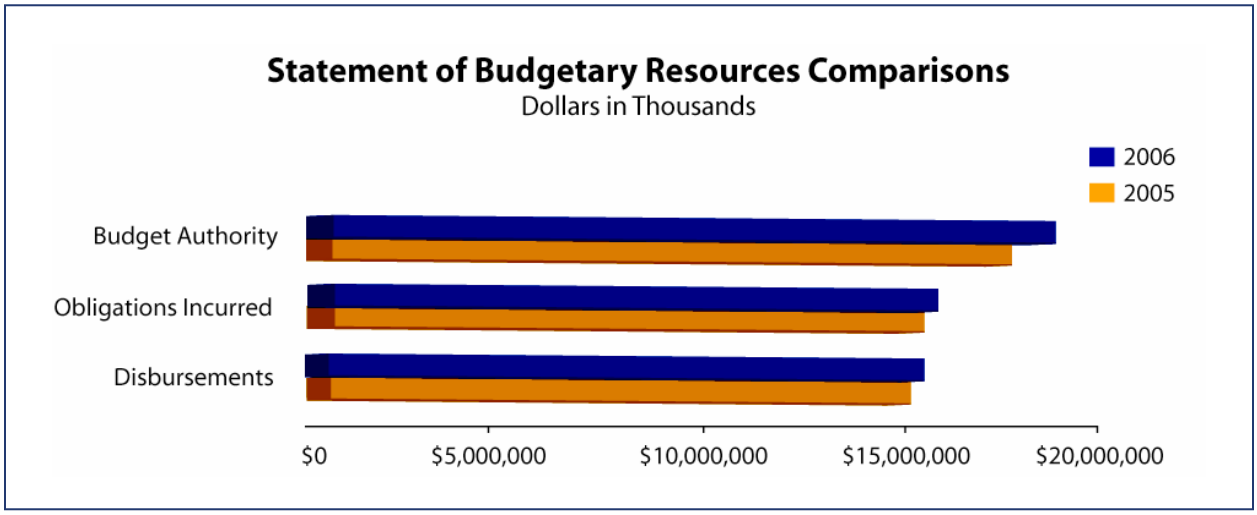
FAA's cumulative results of operations had a small increase of $61.9 million because total financing sources slightly exceeded the net cost of operations in FY 2006. While excise tax revenues remained stable from year to year, increases in appropriations used and imputed financing in FY 2006 were largely offset by a like increase in net cost of operations, causing cumulative results of operations to remain stable from FY 2005 to FY 2006. Unexpended appropriations decreased $839.5 million during FY 2006, primarily as a result of increased use of funds appropriated from the General Fund of the U.S. Treasury.

Statement of Budgetary Resources

This statement provides information on the budgetary resources available to FAA for FY 2006 and 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 following chart outlines the changes in the major categories of budgetary resources from FY 2005 to FY 2006.

Beginning in FY 2006, FAA reduced disbursements, as reported on the Combined Statement of Budgetary Resources, to eliminate the effect of transfers between the AATF and FAA general fund components. For comparative purposes, the elimination also has been applied to FY 2005 disbursements on this graph only. FY 2006 *Disbursements* increased $816 million over FY 2005 levels, as a result of a significant expansion of the AIP beginning in FY 2001. The increase was also a result of the costs associated with the upgraded telecommunications infrastructure project, FTI, compensation and other inflationary increases.

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, which will require payments during the same or a future period. FAA reported total budget authority of $18.5 billion and incurred obligations of $15.5 billion in FY 2006. These amounts were relatively constant from FY 2005 to FY 2006.



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 the FAA for the benefit of the nation, but do not result in physical ownership of assets by the FAA. When incurred, these amounts are treated as expenses in the Consolidated Statements of Net Cost. Our Required Supplementary Stewardship Information (RSSI) 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 2005 and FY 2006 increased largely as a result of a significant increase in grant funding levels in FY 2001. Because these AIP 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 2006 and FY 2005, FAA's research and development expenses increased as a result of, for example, the software development of the Terminal Convective Weather Forecast, funding for human factor research to improve simulation sessions for pilots, and development of pre-hire software to aid in the replacement of 12,500 retiring air traffic controllers over the next 10 years. Research and development expenses have followed a predictable trend of gradual increases over the last 5 years, with the exception of FY 2003, when reduced funding levels resulted in lower applied research expenses.

Limitations of the Financial Statements

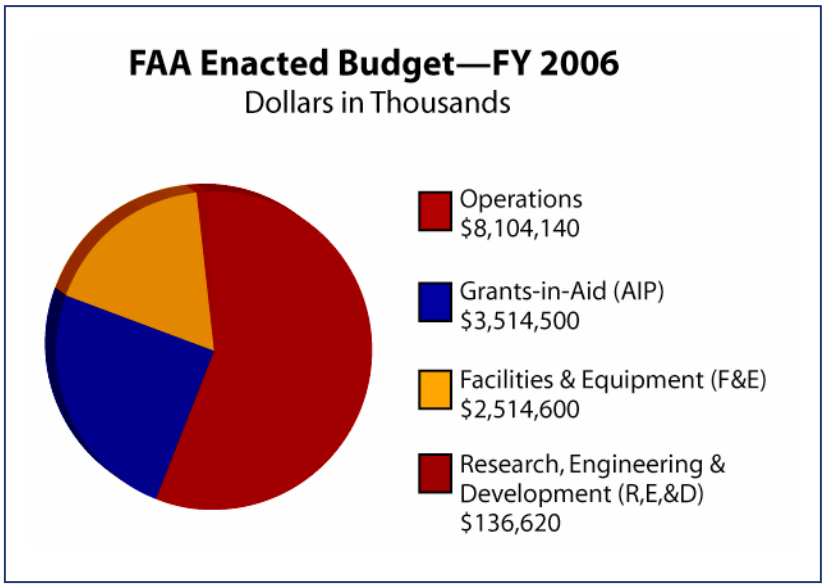
FAA has prepared its financial statements to report its financial position and results of operations, pursuant to the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994.

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 AATF provided approximately 82% of FAA's FY 2006 budget. Created by the Airport and Airway Revenue Act of 1970, the AATF 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, and interest earned is also 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 2006 enacted budget of $14.3 billion was approximately 3% higher than the FY 2005 enacted level.[2] The Combined Statement of Budgetary Resources reflects funding enacted by the FY 2006 Consolidated Appropriations Act, Public Law 109-115. The FY 2006 levels reflect an across-the-board rescission of 1%.

FAA has four appropriations. The largest, Operations, is funded by both the Treasury's General Fund and the AATF. In FY 2006, the AATF provided nearly 68% of the revenue for Operations. The AATF 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 2006 Operations appropriation was $8.1 billion, an approximately 5% increase over FY 2005, primarily attributable to payroll and inflation costs, as well as $148.5 million provided to cover one-time transition costs related to the A-76 Flight Service Station contract.

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 2006, approximately the same level as in FY 2005. Major systems included En Route Automation, Terminal Automation, Oceanic Automation, the Wide-Area Augmentation System (WAAS), ASDE-X, Airport Surveillance Radar, FTI, and Terminal Air Traffic Control Facilities replacement.

R,E,&D. The FY 2006 appropriation for R,E,&D was nearly $137 million, 5% more than in FY 2005. R,E,&D funds were applied to research programs to improve the safety and effectiveness of the air traffic control system. In FY 2006, 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

[2] This figure excludes hurricane supplemental appropriations enacted in December 2005 of $40.6 million in F&E (P.L. 109-148).

administration. FY 2006 funding for AIP was just over $3.5 billion, a 1.2% increase over the FY 2005 level. Funding for the Small Community Air Service program was reduced by 50% over the FY 2005 level of $19.8 million, to $9.9 million.

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 Airports Improvement Program was selected due to its high visibility and level of funding. Their results supported our past record of having improper payments well below reportable thresholds. The review was also to develop the methodology for testing the propriety of payments to be made by grant sponsors to their subcontractors in FY 2007. In addition, for the past four years, DOT has contracted with another company to recover improper payments, which for FAA have been nominal.

PERFORMANCE RESULTS

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 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 seven performance measures. The following chart describes our FY 2006 performance in improving safety through the achievement of all but one of these measures.

FY 2006 Safety Performance Measures and Results

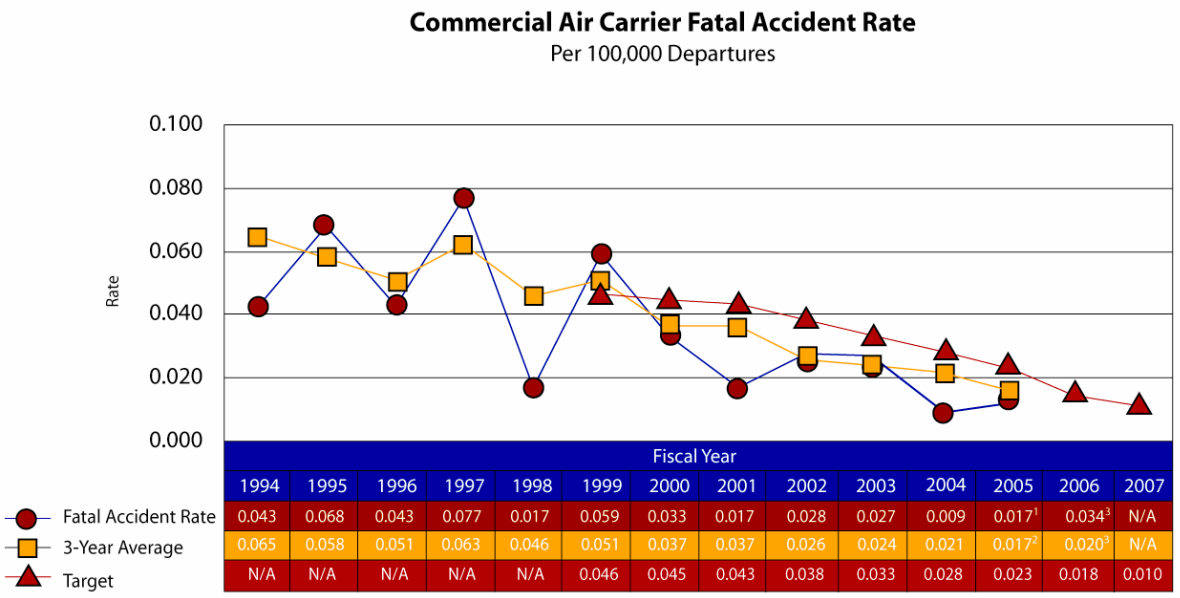
Performance Measure	FY 2006 Target	FY 2006 Results	FY 2006 Status	FY 2007 Target
Commercial Air Carrier Fatal Accident Rate Reduce the airline fatal accident rate by 80% from the 1994-1996 baseline to a 3-year rolling average rate of 0.010 per 100,000 departures by FY 2007. Reduce the 3-year rolling average fatal accident rate below 0.010 by FY 2010.	0.018	0.020*	◎	0.010
General Aviation Fatal Accidents By FY 2009, 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). (This measure will become a rate to be determined in FY 2010.)	337	297*	●	331
Alaska Accidents By FY 2009, 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. (This measure will become a rate (rate TBD) in FY 2010.)	115	102*	●	110
Runway Incursions By FY 2010, reduce Category A and B (most serious) runway incursions to a rate of no more than 0.450 per million operations.	0.551	0.458*	●	0.530
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	●	0
Operational Errors By FY 2010, reduce Category A and B (most serious) operational errors to a rate of no more than 3.18 per million activities.	4.27	4.09*	●	4.20
Safety Risk Management By FY 2010, apply Safety Risk Management to at least 22 significant	3	4	●	3

FY 2006 Safety Performance Measures and Results				
Performance Measure	**FY 2006 Target**	**FY 2006 Results**	**FY 2006 Status**	**FY 2007 Target**
changes in the National Airspace System.				
*Preliminary estimate. ● Goal Achieved ◎ Goal Not Achieved				

Commercial Air Carrier Fatal Accident Rate

In late August 2006, the commercial aviation industry experienced the tragic loss of a commuter jet with 49 fatalities in Lexington, Kentucky. Earlier in the fiscal year, two fatal accidents occurred on the ground. A fourth accident occurred when an aircraft crashed into the water shortly after take-off in Miami, killing 18 passengers and 2 crew members. Each of these fatalities is a sobering reminder for us to continue our focus on safety.

Despite these losses, this remains one of the safest periods in aviation history. Since 2001, there had been 50 million successful flights prior to the Miami accident. This represents 2.7 billion passengers who flew on commercial jet aircraft in the United States without an onboard fatality.



	Fiscal Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Fatal Accident Rate		0.043	0.068	0.043	0.077	0.017	0.059	0.033	0.017	0.028	0.027	0.009	0.017[1]	0.034[3]	N/A
3-Year Average		0.065	0.058	0.051	0.063	0.046	0.051	0.037	0.037	0.026	0.024	0.021	0.017[2]	0.020[3]	N/A
Target		N/A	N/A	N/A	N/A	N/A	0.046	0.045	0.043	0.038	0.033	0.028	0.023	0.018	0.010

[1] Preliminary estimate until May 2007. Revised from original estimate of 0.016.
[2] Preliminary estimate until May 2007.
[3] Preliminary estimate until May 2008.

The number of passengers flown safely is nine times the population of our country. The NAS operates 32,000 scheduled commercial flights daily. The actual figure of 0.020 fatal accidents per 100,000 departures translates to about one fatal accident per 5 million departures. Accidents involving passenger fatalities have a rate of about one every 18 million departures.

To further strengthen aviation safety, we continued to aid the movement of aircraft throughout the system through the use of required navigation performance (RNP). RNP is performance

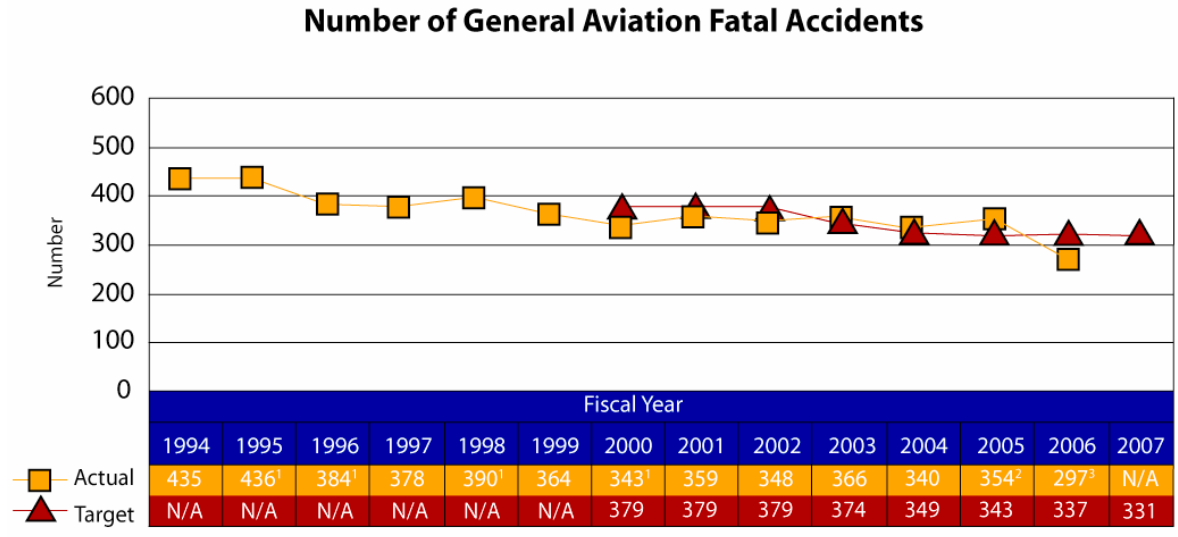
based and not dependent on a specific piece of equipment. RNP is not new hardware for the cockpit or new navaids. It is a statement of navigation position accuracy necessary for operation within a defined airspace. It establishes highly refined parameters for aircraft airspace containment and ensures aircraft containment 99.9% of the time. The accurate, repeatable path, integrity, and continuity ensure procedures will be flown in the same manner by all aircraft. Controllers can then expect aircraft to be at a specific position with a high degree of confidence, thus maximizing safety and the efficient flow of aircraft through airspace.

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.

Commercial Air Carrier Fatal Accident Rate: FY 2006 Target and Results		
Target	Reduce fatal accident rate to 0.018 per 100,000 departures.	
Results		**0.020** *(preliminary estimate)* We will not meet the FY 2006–2008 targets to reduce the commercial air carrier fatal accident rate. The current FY 2006 rate is 0.020 fatal accidents per 100,000 departures.

General Aviation Fatal Accidents

General Aviation (GA) is an important element of our transportation system and economy. FAA 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. GA activities include student training, crop dusting, fire fighting, law enforcement, news coverage, sightseeing, industrial work, on-demand air taxi service, corporate



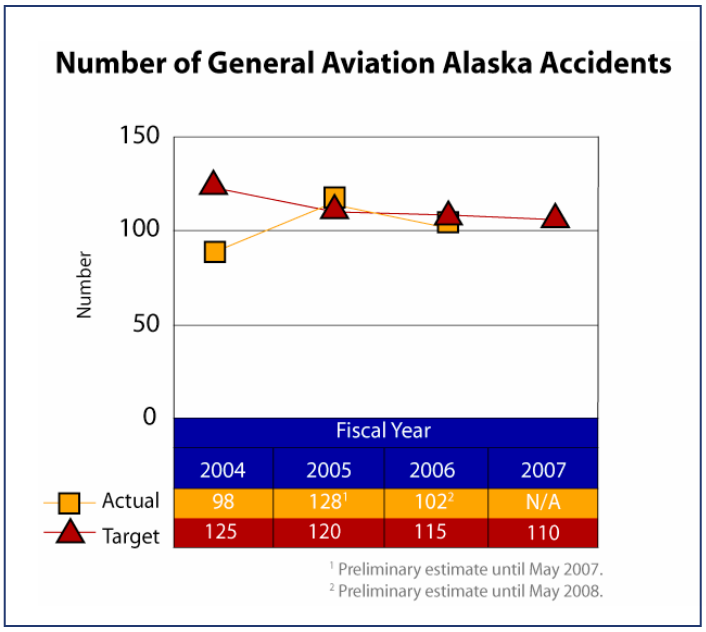
transportation, as well as personal use and recreational flying.

In FY 2006, we worked with various members of the GA community, including aeromedical evacuation, charter services, and others to focus education and training efforts on night landings, weather, and other areas of concern.

General Aviation Fatal Accidents: FY 2006 Target and Results		
Target	Reduce the number of general aviation and nonscheduled Part 135 fatal accidents to 337.	
Results		**297** *(preliminary estimate)* FAA met the FY 2006 target for reducing General Aviation (GA) fatal accidents. GA fatal accidents trended significantly lower each month compared to the previous year. Personal, agricultural, and amateur-built operations showed especially sharp improvements.

Alaska Accidents

Because of the challenges weather and terrain present in Alaska and the broad use of general aviation (GA) 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.



The introduction of new technology has significantly improved the GA operating environment. Pilots in Alaska can now conduct Required Navigation Performance (RNP) approaches using sophisticated on-board equipment at runways that are normally not accessible in low visibility and bad weather conditions. Also, FAA's continuing development of the Automatic Dependent Surveillance-Broadcast (ADS-B) technology holds promise for this region. Unlike conventional radar, ADS-B works at low attitudes and on the ground so that it can be used to monitor traffic on the taxiways and runways of an airport. It is effective in remote areas or in mountainous terrain where there is no radar coverage or where radar coverage is limited.

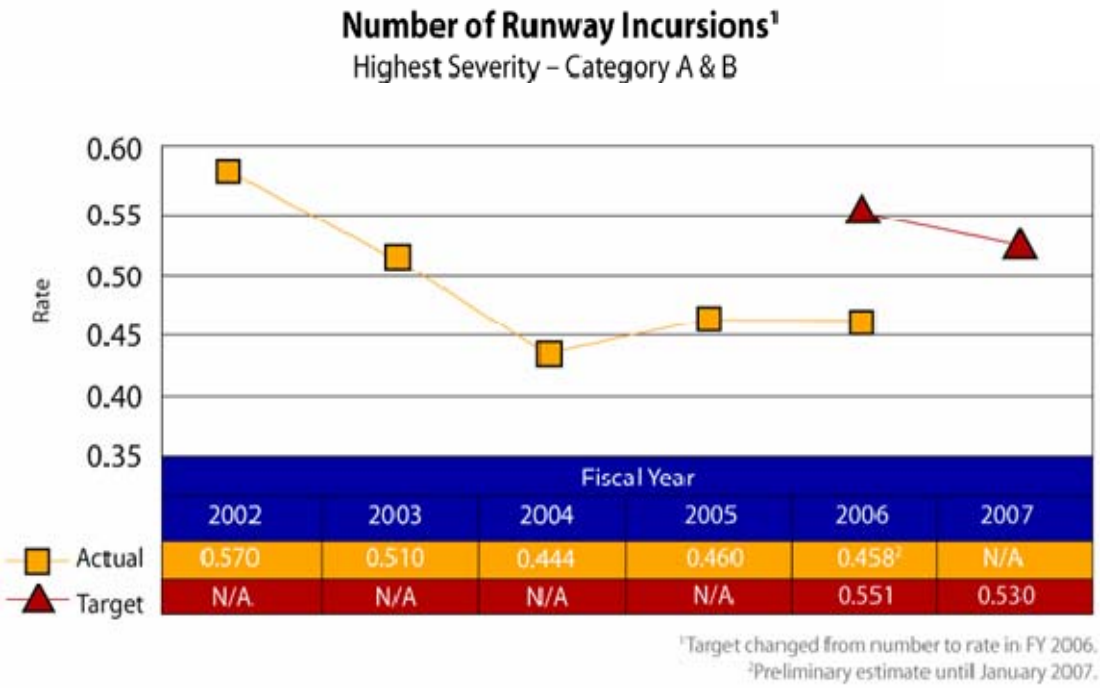
In FY 2006, there were 102 accidents in Alaska versus a not-to-exceed ceiling of 115. Based on preliminary data, Alaska experienced a total of nine fatal accidents this year. As a percentage of total accidents, Alaska continues to have one of the lowest proportions of fatal versus nonfatal accidents, 8.8%.

Alaska Accidents: FY 2006 Target and Results		
Target	Reduce accidents in Alaska for general aviation and all Part 135 operations to no more than 115 per year.	
Results		**102** *(preliminary estimate)* We exceeded our goal of reducing general aviation 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 involve potential fatalities, injuries, and significant property damage. Working together, FAA and the aviation community have reduced the number of serious runway incursions (Category A and B) by more than 50% from 5 years ago.

To continue the runway incursion downward trend and address errors committed by pilots, air traffic controllers, airport-authorized vehicle operators, and pedestrians, FAA focused on outreach, awareness, improved infrastructure, and technology. One such technological initiative to further enhance safety is the continuing deployment of the ASDE-X Program. ASDE-X is a traffic management system for the airport surface that provides seamless coverage and aircraft



identification to air traffic controllers. The system provides data with an accuracy, update rate, and reliability suitable for improving airport safety in all weather conditions. The first ASDE-X was commissioned at General Mitchell International Airport in Milwaukee, Wisconsin. In

FY 2006 we commissioned five ASDE-X systems. We expect to install this equipment at 21 additional U.S. airports by 2009.

Runway Incursions: FY 2006 Target and Results	
Target	Reduce the rate of Category A and B (most serious) runway incursions at towered airports to 0.551 per million operations.
Results	**0.458** *(preliminary estimate)* We met our goal of reducing the number of Category A and B (most serious) runway incursions. The runway incursion rate was 0.458 (preliminary estimate) per million operations, a significant improvement over the target rate of 0.551.

Commercial Space Launch Accidents

Protecting the public during launch operations is an FAA safety mission objective. Commercial space transportation is the means by which payloads such as satellites and remote sensing devices are carried to orbit. These payloads provide tremendous benefits to our society. Commercial space launch or reentry accidents can potentially have major catastrophic consequences, involving large losses of life and property.

The performance target for commercial space launch accidents is no fatalities, serious injuries, or significant property damage to the uninvolved public during licensed space launch and reentry activities. FAA continues to undertake safety initiatives to support industry's perfect record of no commercial space launch accidents.

Commercial Space Launch Accidents: FY 2006 Target and Results		
Target	Prevent fatalities, serious injuries, or significant property damage to the uninvolved public during licensed space launch and reentry activities.	
Results		**0** We achieved this goal for the third year in a row. There were seven licensed launches during the year. No member of the public was killed or injured, and no member of the public suffered any property damage related to commercial space launches.

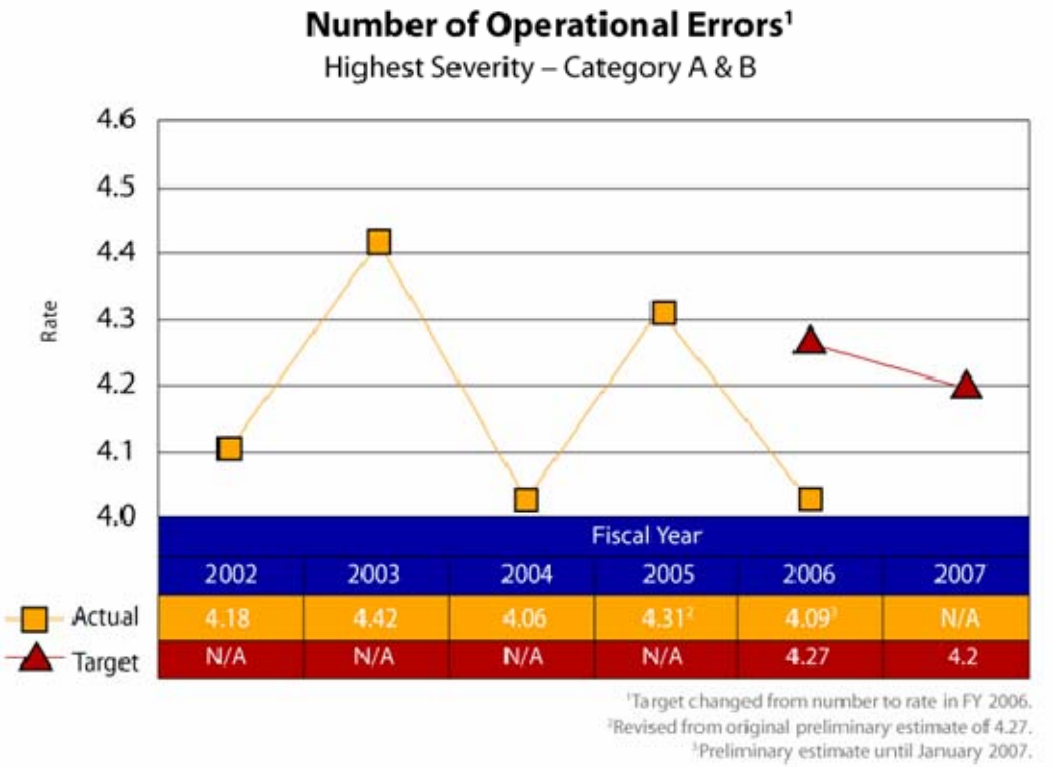
Operational Errors

One of the fundamental principles of aviation safety is the need for separation—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 (OE) occurs when controllers fail to apply or follow the procedures that enforce separation and allow aircraft to come too close to each other or to an obstruction.

As air traffic continues to increase, reducing the risk of operational errors is one of our top priorities. Pilots, air traffic controllers, and vehicle drivers share responsibility for reducing operational errors. To address this challenge, we focus on outreach, awareness, technology, and improved procedures and infrastructure. For example, we

- Continue our efforts in performance management and effective communications by refining the operational error severity classification process to ensure an accurate identification of the risk posed by an operational incident.

- Focus on communication problems around phraseology between pilots and controllers (the process of mutual verification of information passed between them).



- Continue to develop an additional measure for determining the quality of Air Traffic Control (ATC) services (e.g., role of ATC in conflict detection and resolution) that occurred during an operational error.
- Continue to develop safety promotion clips, to enhance air traffic supervisor and controller discussion of serious events during team briefings. Safety clips are developed using actual air traffic control incidents and media tools such as video re-recreations, replays of radar/voice, references and narration of safety enhancement messages. Subject matter is derived from areas such as daily reviews of operational errors and operational deviations, collisions, facility evaluations, and customer feedback.

Operational Errors: FY 2006 Target and Results		
Target	Reduce the rate of Category A and B (most serious) operational errors to no more than 4.27 per million activities.	
Results		**4.09** (*preliminary estimate*) The performance limit for FY 2006 is not to exceed a rate of 4.27 per million activities. There were 4.09 operational errors (preliminary estimate) per million activities, well below the performance limit.

Safety Risk Management

The essence of what FAA does is to improve safety and minimize risk. Recognizing that there will always be hazards and risks, we proactively identify hazards, assess risk, and reduce all known risks to an acceptable level. This process, known as Safety Risk Management (SRM), is a key element of FAA's Safety Management System (SMS).

SMS is defined as a systematic, explicit, and comprehensive approach for managing safety risk at all levels throughout the NAS. SMS includes a formal risk management process that describes the system, identifies hazards, and then analyzes, assesses, and controls the risk. FAA's SRM requires risk assessments for all activities or process changes to identify safety impacts.

In FY 2006, FAA applied safety risk management to four significant changes in the NAS. The four changes were

- *Las Vegas Right Turn,* which reduces frequency congestion, allows for more efficient use of airspace, and reduces pilot and controller workload. In addition, this change shortens by 28 miles the flight path of aircraft resulting in fuel savings for airlines, reduction of delays, and greater airport efficiency.
- *Taxi into Position and Hold,* which safely enhances airport efficiency and reduction in delays.
- *Advanced Technologies and Oceanic Procedures (ATOP),* which is significant because it is a first step toward ensuring that all changes to the NAS are quantified, understood, and certified as acceptable by appropriate FAA officials. The ATO operational service units continue to develop safety cases above and beyond the three identified in the FY 2006 performance target.
- *Infrastructure Failure Response* changes how response times are developed and allows for a collaborative process with all the entities involved in providing the service. Planned response times to NAS infrastructure failures are now based on operational need rather than pre-defined schedules, and field managers will have stronger planning and decision making roles. Collaboration is now also required between managers of affected service units. Real-time response decisions will minimize impact to NAS users, and field managers will use resources to safely, effectively, and efficiently meet operational need.

Safety Risk Management: FY 2006 Target and Results		
Target	Apply safety risk management to at least three significant changes in the national airspace system.	
Results		**4** FAA exceeded this performance target with the application of four safety risk management and hazard assessments to significant changes in the NAS. This performance target was new in FY 2006, so there are no trend data available.

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 greatly increased since then, returning to pre-September 11 levels. During FY 2006, 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 seven performance measures. The following chart describes our FY 2006 performance in improving capacity by achieving each measure.

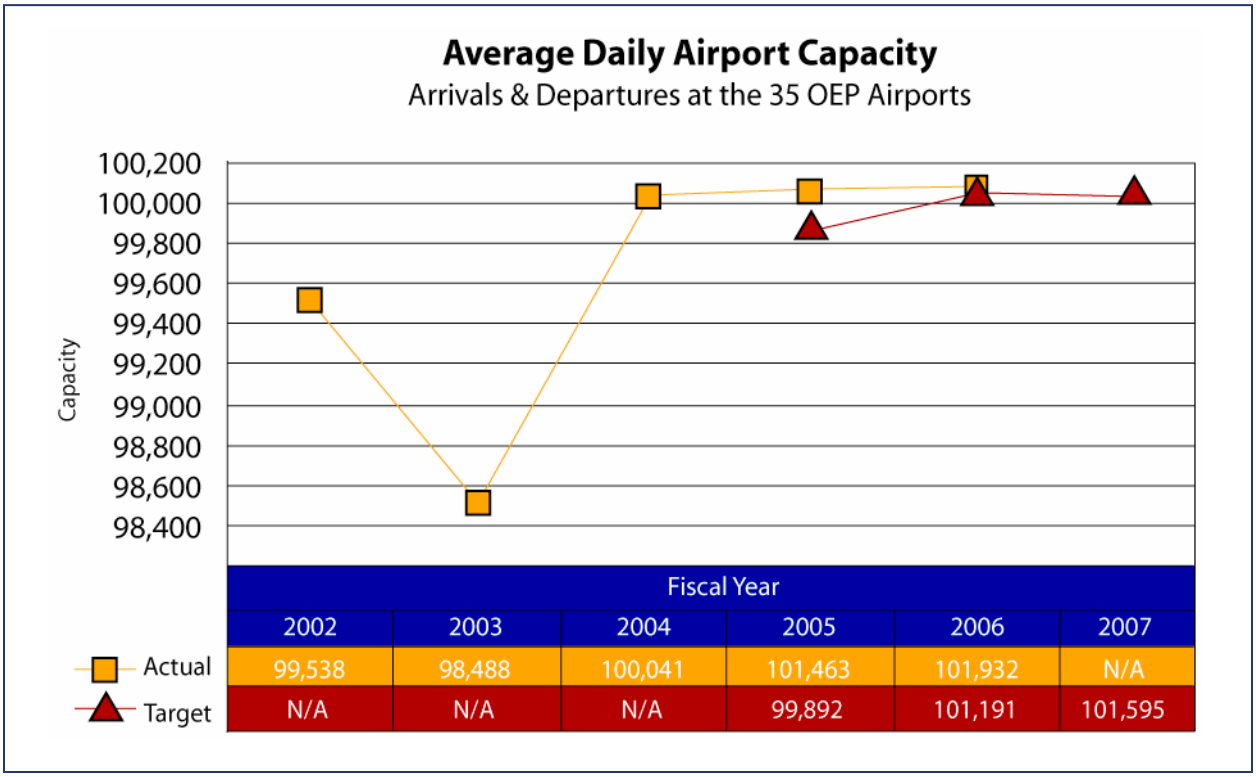
FY 2006 Capacity Performance Measures and Results

Performance Measure	FY 2006 Target	FY 2006 Results	FY 2006 Status	FY 2007 Target
Average Daily Airport Capacity (35 Operational Evolution Plan [OEP] airports) Achieve an average daily airport capacity of 104,338 arrivals and departures per day by FY 2008 and maintain through 2010 at the 35 OEP airports.	101,191	101,932	●	101,595
Average Daily Airport Capacity (8 metropolitan areas) Achieve an average daily airport capacity for the eight major metropolitan areas of 68,750 arrivals and departures per day by FY 2010.	68,750	69,630	●	68,750
Annual Service Volume Commission as many as eight new runway projects, increasing the annual service volume of the 35 OEP airports by at least 1% annually, measured as a 5-year moving average, through FY 2010.	1.00% (4 runways)	1.67% (4 runways)	●	1.00% (1 runway)
Adjusted Operational Availability (35 OEP airports) Sustain adjusted operational availability at 99.5% for the reportable facilities that support the 35 OEP airports through FY 2010.	99.50%	99.78%*	●	99.50%
NAS On-Time Arrivals Through FY 2010, maintain an 87.40% on-time arrival for all flights arriving at the 35 OEP airports (no more than 15 minutes late due to NAS-related delays).	87.40%	88.36%	●	87.40%
Noise Exposure Reduce the number of people exposed to significant noise by 1%	–4.00%	–27.00%**	●	–5.00%

FY 2006 Capacity Performance Measures and Results				
Performance Measure	**FY 2006 Target**	**FY 2006 Results**	**FY 2006 Status**	**FY 2007 Target**
per year through FY 2010, as measured by a 3-year moving average, from the 3-year average for calendar years 2000–2002.				
Aviation Fuel Efficiency Improve aviation fuel efficiency as indicated from the amount of fuel burned per revenue plane-mile by 5%, measured by a 3-year average for calendar years 2003–2005, from the 3-year average for calendar years 2000–2002, and maintain that level of achievement in the face of increased capacity and air traffic through FY 2010.	–5.00%	–8.23%	●	–5.00%
Notes: * Preliminary estimate. ** Projection from trends. ● Goal Achieved ◎ Goal Not Achieved				

Average Daily Airport Capacity (35 OEP Airports)

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 majority of air traffic delays can be traced to inadequate throughput (as measured by arrival and departure rates). Major factors affecting performance include weather, volume, and runway construction.



To increase capacity, we opened four new runways this year, in Minneapolis/St. Paul, Cincinnati, St. Louis, and most recently in Atlanta, the world's busiest airport. In the last 9 years, 13 new runways have opened at the 35 OEP airports, providing the airports with the potential to allow almost 1.7 million more annual operations.

Two tools that accommodate air growth and improve efficiency—Required Area Navigation (RNAV) Standard Instrument Departures (SID) and Standard Terminal Automation Replacement System (STARS)—are producing the most immediate impact towards near-term capacity gains and operator cost savings. Since FY 2005, FAA has published 128 RNAV–SID and STARS procedures, resulting in $8.5 million in reduced delay and capacity benefits.

STARS replaces capacity-constrained older technologies and accommodates air traffic growth and the introduction of new automation functions that greatly improve the safety and efficiency of the NAS. In FY 2006, FAA implemented three STARS at the Atlanta airport and continued the implementation of the STARS at Washington Reagan National Airport.

SIDs are published air traffic control departure procedures that provide obstacle clearance and a transition from the terminal area to the en route environment. SID simplifies the issuance of departure clearance by allowing air traffic control to specify the SID by name without having to describe the route in detail. In FY 2006, FAA implemented two SIDs at Seattle-Tacoma Airport and 16 SIDs at the Atlanta airport.

In FY 2006, FAA also

- Implemented daily use of a software tool, Traffic Management Advisor, at several locations. Using this tool in Oakland Oceanic Airspace, FAA reduced the separation standard from 100 nautical miles lateral to 30 nautical miles lateral. This first application allowed one of the aircraft to ascend 6 minutes sooner than with the previous standard. This reduction in spacing will result in fuel savings for the airlines and greater capacity for the NAS.
- Announced approval for the initial deployment of the ADS-B throughout the United States. Switching from our reliance on ground-based radar equipment to satellite-based operations enhances safety while providing increased capacity and efficiency. ADS-B will keep aircraft safely separated, provide better use of available airspace, and enable more direct aircraft routing, thus saving fuel.

Average Daily Airport Capacity (35 OEP Airports): FY 2006 Target and Results		
Target	Increase the average daily arrival plus departure called rates at the 35 Operational Evolution Plan (OEP) airports to 101,191.	
Results		**101,932** We met this performance goal, achieving an average daily capacity of 101,932 for the 35 OEP airports.

Average Daily Airport Capacity (8 Metropolitan Areas)

The eight selected major metropolitan areas—New York, Philadelphia, South Central Florida, Chicago, Baltimore/Washington, Atlanta, Los Angeles Basin, and San Francisco Bay Area—contain both the most congested airspace and 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 in these areas.

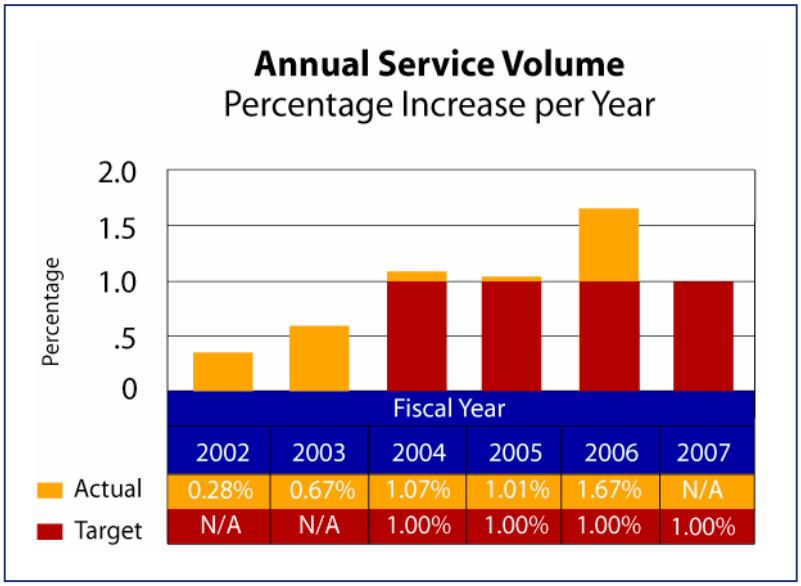
Growth in air travel has generally been accomplished by increasing the number of flights. Measuring the growth of airport capacity indicates the limit at which increased service can be accommodated without affecting delay. The ability of the system to respond to demand is a function of airport runway capacity, airspace capacity, status of air traffic control equipment, and weather conditions. Major factors affecting performance include weather, volume, and runway construction. Delays occur when the demand for air transport services exceeds the capacity of the system.

Every year after thorough data analysis, FAA updates the list of metropolitan areas that will most affect total system delays. For years, we have targeted eight major metropolitan areas. With FY 2006 improvements, we have achieved our capacity goals for Atlanta. In June 2006, we commissioned a new runway at Atlanta-Hartsfield Airport, allowing for 33% more operations a year. Therefore, our FY 2007 efforts will focus on the remaining seven major metropolitan areas that affect system delay. By redefining the metropolitan areas, our FY 2007 target has been reduced to 63,650 average daily arrival and departure rates.

Average Daily Airport Capacity (8 Metropolitan Areas): FY 2006 Target and Results		
Target	Increase the average daily arrival plus departure called rates at the eight metropolitan areas to 68,750. *Note:* This measure was changed in FY 2006, so no trend data is available. South Central Florida replaced Boston as one of the eight metropolitan areas.	
Results		**69,630** We exceeded our FY 2006 goal, achieving a rate of 69,630.

Annual Service Volume

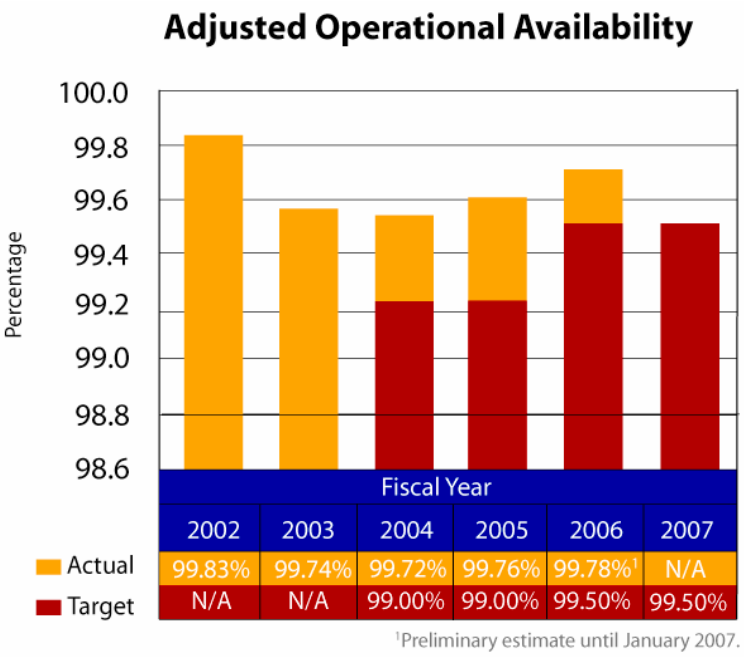
The annual service volume (ASV) goal is in place to prevent unreasonable delays at airports. The ASV measure estimates and tracks the increase in airport capacity at the 35 OEP airports and is calculated as a 5-year moving average with 1998 as its base year. FAA calculates ASV using the Runway Delay Simulation Model. The model simulates runway operations and provides both capacity and delay information. Delay curves are developed for each of the 35 OEP airports for the existing airport layout and with new runways where proposed. A consistent calculation technique is used to estimate capacity for all airports, based on demand schedules and fleet mixes. This is supplemented with flight counts and standard air traffic control procedures for each airport.



Annual Service Volume: FY 2006 Target and Results		
Target	Increase the Annual Service Volume (AVS) of the 35 OEP airports by at least 1%, measured as a 5-year moving average. Commission four new runway projects.	
Results		**1.67% (4 runways)** In FY 2006, four new runways were commissioned in Minneapolis/St. Paul, Cincinnati, St. Louis, and Atlanta. The new runways provided these airports with the potential to accommodate 655,000 more annual operations. These four runways increased the ASV by 3.27% for FY 2006. The 5-year rolling average for increase ASV is 1.67%, thus exceeding the Flight Plan performance target of 1% for FY 2006.

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. NAS on-time arrivals are affected by the airport and en route capacity, which are directly affected by the availability of the equipment and facilities supporting that capacity.



Adjusted Operational Availability: FY 2006 Target and Results		
Target	Sustain adjusted operational availability at 99.50% for the reportable facilities that support the 35 OEP airports.	
Results		**99.78%** (*preliminary estimate*) We met our FY 2006 goal for sustaining adjusted operational availability at 99.50% for the reportable facilities that support the 35 OEP airports, achieving a result of 99.78%.

NAS On-Time Arrivals

On-time performance is a measure of the ability of the FAA to deliver services. A flight is considered on time if it arrives no later than 15 minutes after its published, scheduled arrival time. The time of arrival of completed passenger flights to and from the OEP 35 airports is compared to their flight plan scheduled time of arrival. For delayed flights, delay minutes

attributable to extreme weather, carrier-caused delay, security delay, and a prorated share of delay minutes due to a late arriving flight at the departure airport are subtracted from the total minutes of delay. If the flight is still late, it is counted as a delayed flight attributed to the NAS and the FAA.

Major factors affecting NAS on-time arrivals include seasonal weather patterns, airport conditions, airport construction projects, and increases in traffic volume, which have surpassed pre-September 11, 2001, levels.

To address these issues, FAA employees at the Air Traffic Control System Command Center have daily meetings with airline industry representatives to coordinate traffic around factors that could potentially cause delays. Careful collaborative planning with our industry partners on the previous day ensures that aircraft land on time. In addition, our strategic programs and initiatives, such as airspace redesign, revised air traffic control procedures, and the introduction of new technology, are expected to further improve on-time arrivals.

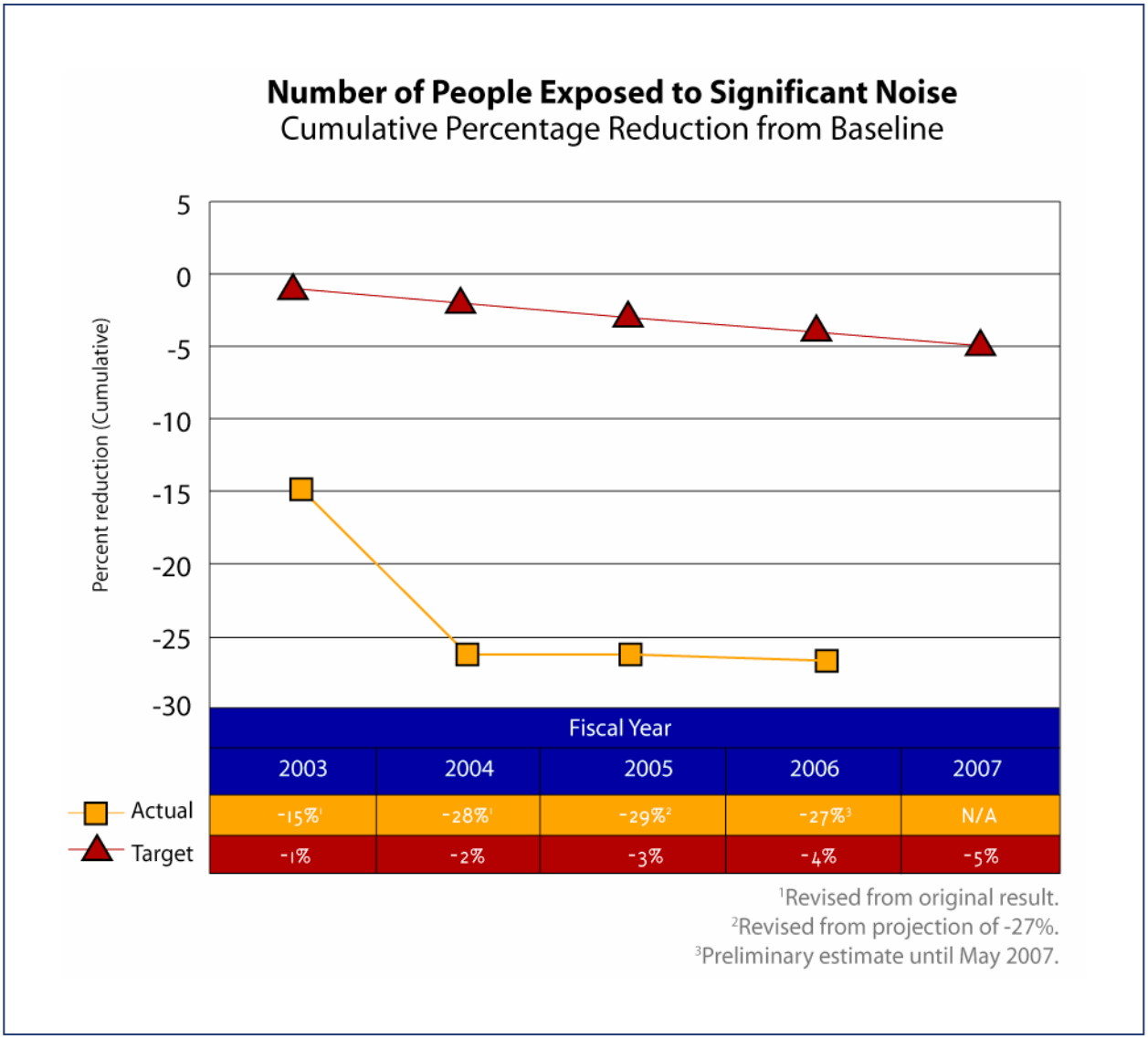
During FY 2006, we undertook several key activities and initiatives that contributed to achieving our goals. Specifically, we:

- Implemented daily use of a software tool, Traffic Management Advisor (TMA), at several locations. TMA is a decision support tool that provides controllers and traffic management coordinators with a single, coordinated spacing plan that maximizes traffic arrivals across multiple facilities. With the first use of this tool we reduced the separation standard from 100 nautical miles lateral to 30 nautical miles lateral, allowing one of the aircraft to ascend 6 minutes sooner than with the previous standard. Overall, reductions in the separation standards will result in fuel savings for the airlines and greater capacity for the NAS.
- Completed redesign efforts in several areas including Los Angeles, Houston, Miami, New York, Chicago, and Northern California. We continued the implementation of STARS at Washington Reagan National Airport. STARS replaces capacity-constrained older technologies, accommodates air traffic growth, and introduces new automation functions that greatly improve the safety and efficiency of the NAS.
- Implemented two SIDs at Seattle-Tacoma Airport. SIDs are published to expedite clearance delivery and to facilitate transition between takeoff and en route operations. SIDs simplify the issuance of departure clearance by allowing air traffic control to specify the SID by name without having to describe the route in detail. We also implemented 16 SIDs and 3 STARS at the Atlanta airport.

NAS On-Time Arrivals: FY 2006 Target and Results		
Target	Achieve a NAS On-Time Arrival percentage of 87.40% for all flights arriving at the 35 Operational Evolution Plan (OEP) airports due to NAS-related delays, where on-time is equal to no more than 15 minutes late. Note: This measure was redefined in FY 2005 to include only NAS-related delays; no trend data are available.	
Results		**88.36%** We exceeded our FY 2006 target of 87.40%, achieving an on-time arrival rate of 88.36%.

Noise Exposure

FAA is working to increase the number of flights at America's top airports to keep pace with forecasted demand. However, public concern and sensitivity to aircraft noise around airports continues to grow. Noise complaints increase even while quieter aircraft technology is introduced into the fleet. Aircraft noise is an undesired byproduct of mobility, and FAA seeks to reduce the public's exposure to unreasonable noise levels.



In the past decade, the phase-out of noisier commercial aircraft was principally responsible for the reduction in the number of people exposed to high levels of aircraft noise. In addition, compatibility projects, funded under the Airport Improvement Program (AIP), complemented these efforts. While the new international aircraft noise standard will continue to encourage the introduction of quieter aircraft into operations, AIP-funded noise compatibility projects will be the principal means employed by FAA to mitigate significant aircraft noise exposure in the near future.

DOT continues to pursue a program of aircraft noise control in cooperation with the aviation community through noise reduction at the source—development and adoption of quieter aircraft, soundproofing and buyouts of buildings near airports, operational flight control measures, and land use planning strategies. While FAA is authorized to provide funds for soundproofing and residential relocation, each project must be locally sponsored and be part of a noise compatibility program prepared by the airport sponsor and approved by the FAA.

The noise target is based on FAA's historical experience and reflects the relocation of people from significant noise areas through grant funding. The target is further affected by market forces that drive changes in commercial aircraft fleets and operations.

The significant improvement in noise reduction performance over the targeted goals results from a confluence of a number of external factors—an 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 three aircraft (B727s, DC-9s, and MD-80s). The combination of lower operations and the rapid reduction of the average age of the fleets produced the dramatic improvements in the noise exposure environment.

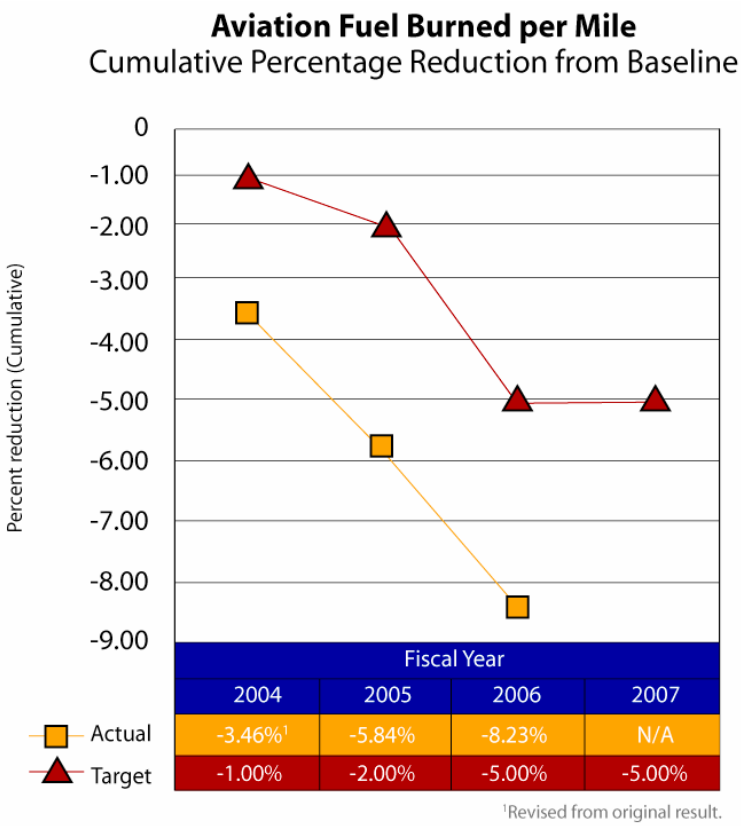
Achieving equally significant noise reduction results in the future will be a challenge. Operational levels which began to recover in FY 2004 continue to increase, and along with this we are experiencing a corresponding increase of associated noise. The NextGen Plan states that the demands on the system may triple from what they are today. In addition, available noise mitigation approaches currently at our disposal (i.e., regulatory noise limits, flight operational abatement procedures, and airport land use planning guidance) will affect our ability to continue such significant improvements.

Noise Exposure: FY 2006 Target and Results		
Target	Reduce the number of people exposed to significant noise, as measured by a 3-year moving average, to 4.00% below the 3-year average for calendar years 2000–2002.	
Results		**–27.00%** *(projection from trends)* We exceeded this performance target by reducing the number of people exposed to significant noise, as measured by a 3-year moving average, by 27%.

Aviation Fuel Efficiency

Concern over aviation's contribution to local air quality issues and potential impact on global climate change continues to grow. Measuring and tracking fuel efficiency from aircraft operations allow FAA to monitor improvements in aircraft/engine technology and operational procedures and enhancements in the airspace transportation system. We measure performance against this target using SAGE—the System for assessing Aviation Global Emissions. SAGE is a FAA-developed computer model that estimates aircraft fuel burn and emissions for variable year emissions inventories and for operational, policy, and technology-related scenarios.

For FY 2006 performance, we used the SAGE model to update our historical database of yearly inventories using the full calendar year 2005 operational flight data. The 2005 inventory results will be averaged with the previously generated inventories from 2003 and 2004 and compared against the baseline 3-year average.



Under the *Flight Plan*, we initially set our FY 2006 performance target to 3%. We modified the FY 2006 target to 5% based on the accomplishments for FY 2004–FY 2005. Our FY 2006 performance target was to improve aviation fuel efficiency per revenue plane-mile by 5%, as measured by a 3-year moving average, from the 3-year average for calendar years 2000–2002.

Fuel efficiency for FY 2006, relative to the baseline established in FY 2003, has improved further and been calculated to be 8.23%. Since September 11, 2001, we have been successful in improving fuel efficiency. These improvements stem from a combination of operational changes including size of aircraft in the national fleet, flight duration, and airspace enhancements. These efficiency gains are expected to be sensitive to further operational changes, expected growth in air traffic, and improvements in aircraft technology and air traffic management. FAA is currently reviewing the impact of air traffic system enhancements and changes in operational trends to assess whether revised performance metrics and future targets will better represent and capture system performance.

Aviation Fuel Efficiency: FY 2006 Target and Results		
Target	Improve aviation fuel efficiency per revenue plane-mile by 5%, as measured by a 3-year moving average, from the 3-year average for calendar years 2000–2002.	
Results	●	**–8.23%** We achieved this performance target by improving aviation fuel efficiency per revenue plane-mile by 8.23%, as measured by a 3-year moving average, from the 3-year average for calendar years 2000–2002.

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 has provided direct and indirect aviation assistance to 131 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 four performance measures. The following chart describes our FY 2006 performance in improving international leadership through the achievement of all four measures.

FY 2006 International Leadership Performance Measures and Results

Performance Measure	FY 2006 Target	FY 2006 Results	FY 2006 Status	FY 2007 Target
Aviation Safety Leadership By FY 2010, continue to reduce the 5-year rolling average commercial air carrier fatal accident rate in key regions or countries experiencing substantial growth in aviation operations by 10% from the 2000–2005 baseline. (FY 2007–FY 2010 targets are TBD.)	<0.060 in China	0.054	●	TBD
Bilateral Safety Agreements Conclude at least eight new or expanded bilateral safety agreements that will facilitate an increase in the ability to exchange aviation products and services by FY 2010.	2	4	●	1
External Funding Secure a yearly increase of 20% in external funding for international aviation activities from the United States and international government organizations, multilateral banks, and industry.	20.00%	69.38%	●	20.00%
GPS-Based Technologies By FY 2010, expand the use of GPS-based technologies and procedures to five more priority countries.	1	1	●	1

● Goal Achieved

Aviation Safety Leadership

China is experiencing enormous growth in aviation, with a 20% increase in departures per year. The challenge is to maintain China's safety performance during rapid growth of the aviation system. In the past 10 years, China has had six fatal accidents involving its commercial air carrier fleet. In 3 of the past 5 years China experienced no fatal accidents.

There are several reasons China has been successful in this era of impressive growth. First, China's air carrier fleet consists almost entirely of new, Western-built aircraft. Older Eastern-built aircraft have been rapidly retired—no Eastern jets and just a handful of Eastern-built

turboprops remain. Second, current Chinese pilots are well trained. Third, China has agreed to implement safety enhancements from the Commercial Aviation Safety Team (CAST). These CAST enhancements can be shared across countries and can be measured for implementation. By focusing on the root causes of the most common kinds of fatal accidents, such as Controlled Flight into Terrain (CFIT), CAST provides a proven means of improving safety and fatal accident rates.

This focus on implementing CAST in China and other countries and in regions such as Latin America, as well as the volatility and lack of direct impact on international safety rates are the reasons FAA is changing this target in FY 2007. The new target will focus on the implementation of CAST safety enhancements in China to help them achieve their own commercial air carrier accident rate goal.

Aviation Safety Leadership: FY 2006 Target and Results		
Target	Reduce the 5-year rolling average commercial air carrier fatal accident rate in China to below 0.060 per 100,000 departures.	
Results		**0.054** For FY 2006, the target was a reduction of the 5-year rolling average commercial air carrier fatal accident rate in China below the FY 2000–2005 baseline of 0.060 per 100,000 departures. However, the measure is volatile and can be disproportionately affected by such circumstances as low departure volume associated with a fatal accident. In FY 2007, FAA is redefining this target to a more reliable and meaningful measure. This was a new performance measure in FY 2006, so no trend data are available.

Bilateral Safety Agreements

A Bilateral Aviation Safety Agreement (BASA) promotes aviation safety and environmental quality, enhances cooperation, and increases efficiency in civil aviation matters. The agreements are based on recognized comparability of U.S. and foreign systems for approval and surveillance of the aviation industry. By building a network of competent civil aviation authorities and concluding agreements with additional countries and/or regional authorities, FAA increases safety globally.

Improved global understanding of U.S. safety regulations, processes, and procedures leads to better international regulatory oversight. The BASAs allow FAA to focus on U.S. safety priorities by relying on capabilities and technical expertise of other civil aviation authorities and minimizing duplications of effort.

FAA is collaborating with partners in Europe and Asia to negotiate executive agreements and associated implementation procedures to support the transfer of aviation products and services. These agreements lay the essential groundwork for cooperation between the United States and the respective target country's aviation authorities. In FY 2006, we concluded

- An expanded Implementation Procedure for Airworthiness with New Zealand
- A revised Simulator Implementation Procedure with Switzerland
- A Maintenance Implementation Procedure and Implementation Procedures for Licensing with Canada.

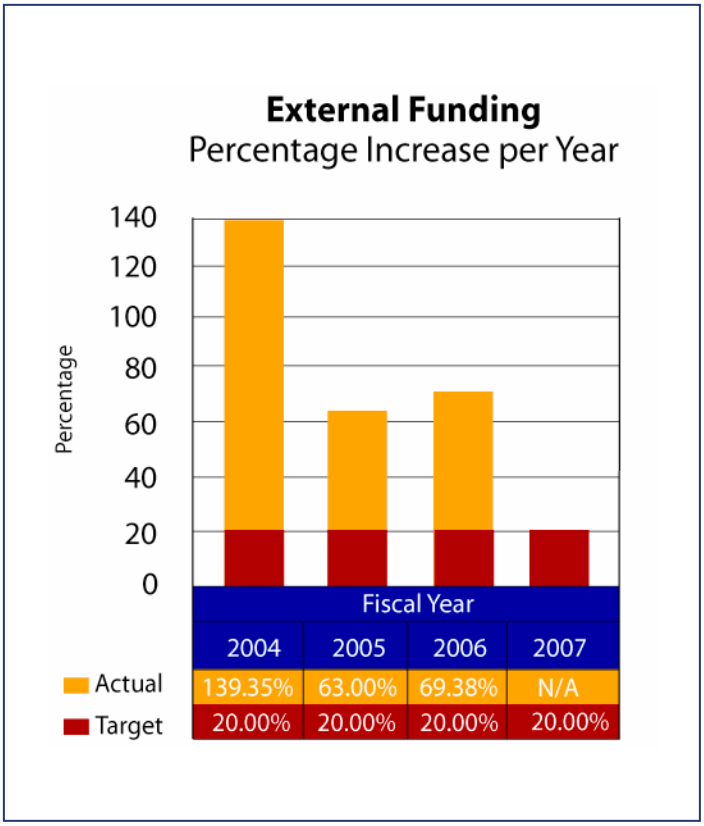
These implementation procedures will promote a safer aviation environment for U.S. travelers.

Bilateral Safety Agreements: FY 2006 Target and Results		
Target	Conclude at least two new or expanded bilateral safety agreements that will facilitate an increase in the ability to exchange aviation products and services.	
Results		**4** We met our FY 2006 target, concluding four implementation procedures: one with New Zealand, one with Switzerland, and two with Canada.

External Funding

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 external funding initiative seeks to leverage the limited resources we are able to contribute to international safety and capacity efforts by implementing a methodology to increase technical and financial assistance from U.S. Government organizations, multilateral banks, and industry to support global aviation system infrastructure projects.

FAA's outreach to U.S. and 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.



In FY 2006, we arranged more than $33 million in funds for technical assistance and infrastructure development programs, approximately $13.5 million more than FY 2005 and a six-fold increase over the $5 million secured in the base year of FY 2003. FAA secured $25 million from USAID to finance infrastructure and capacity building projects in Afghanistan. This unusually large program, which had more funding than all FY 2005 programs combined, was made necessary by the critical challenges facing Afghanistan. This increased funding was responsible for the large margin by which we exceeded our 20% target for this measure. We do not expect this increased margin in FY 2007. Other highlights included $3 million from the Department of State for the Safe Skies for Africa program, $1.9 million from the Asia Development Bank for establishment of the Pacific Aviation Safety Office, and $1.3 million from the U.S. Trade and Development Agency for the US/China Aviation Cooperation Project.

External Funding: FY 2006 Target and Results	
Target	Secure an increase of 20% in intellectual and financial assistance over the FY 2005 level.
Results	**69.38%** We exceeded our goal for FY 2006 of increasing funding by 20%, with an increase of 69.38% over the FY 2005 funding level.

GPS-Based Technologies

FAA continued its strong efforts to further the International Leadership goal through multiple technical assistance efforts related to GPS–based technologies and procedures. Throughout FY 2006, we completed many significant activities and bilateral projects designed to help other countries and regions increase their aviation system safety, capacity, and efficiency.

Considered the most important operational accomplishment in FY 2006, FAA successfully completed the initial installation of Wide Area Augmentation System (WAAS) reference stations in Merida and Puerto Vallarta, Mexico. WAAS provides service for all classes of aircraft in all flight operations—including en route navigation, airport departures, and airport arrivals. This includes precision landing approaches in all weather conditions at all locations throughout the NAS. Before WAAS, the NAS did not have the ability to provide horizontal and vertical navigation for precision approach operations for all users at all locations. With WAAS, such a capability is becoming a reality.

FAA continued its efforts to create a seamless operational GPS-based navigation system for North America through its cooperation with both Mexico and Canada. This seamless regional system will be achieved through further installations of five WAAS reference station installations—four in Mexico and one in Canada.

Cooperation with Mexico's air navigation service provider, SENEAM, and Nav Canada on the creation of a North American WAAS capability has been ongoing for over 5 years. This extended North American WAAS will provide numerous operational benefits to all users of the U.S. NAS, as well as those operating in Mexican and Canadian airspace.

GPS-based Technologies: FY 2006 Target and Results		
Target	Expand the use of Global Positioning System (GPS)-based technologies and procedures to one priority country.	
Results	**1** *(Mexico)* FAA achieved this goal by working with the Mexican government on the installation of multiple reference stations.	

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, shoring up the security of our information, and reducing costs.

FY 2006 Organizational Excellence Measures and Results

Performance Measure	FY 2006 Target	FY 2006 Results	FY 2006 Status	FY 2007 Target
Employee Attitude Survey (cumulative percentage increase) Increase Employee Attitude Survey scores in the areas of management effectiveness and accountability by at least 5% by FY 2010.	3%	-1%	◎	TBD
Cost Control (number of activities per organization) Each FAA organization will contribute at least one measurable and significant cost reduction and/or productivity improvement activity each year, including but not limited to cost efficiencies in the areas of strategic sourcing for selected products and services; complete consolidation of facilities and services such as accounting offices, real property management, helpdesks, and Web services; and elimination or reduction of FAA use of obsolete technology by either removing from service or transferring 100 Navaids from federal operation.	1	1	●	1
Critical Acquisitions on Budget By FY 2008, 90%of major system acquisition investments are within 10% of annual budget and maintain that level through FY 2010.	85.00%	100.00%	●	87.50%
Critical Acquisitions on Schedule By FY 2008, 90% of major system acquisition investments are on schedule and maintain through FY 2010.	85.00%	97.44%	●	87.50%
Information Security Achieve zero cyber security events that disable or significantly degrade FAA services.	0	0	●	0
Customer Satisfaction (ACSI) Increase scores on the American Customer Satisfaction Index (one point annually over the FY 2003 baseline target of 62).	65	70	●	66
Cost-Reimbursable Contracts Close out 85% of eligible cost reimbursable contracts during each fiscal year.	85.00%	102.00%	●	85.00%
Mission-Critical Positions By FY 2010, reduce the time to fill mission-critical positions by 25% over the FY 2003 baseline.	–10.00%	–19.75%	●	–15.00%
Reducing Workplace Injuries (case rate no more than 2.85 per 100 employees)	2.85 per 100	2.21*	●	TBD

FY 2006 Organizational Excellence Measures and Results				
Performance Measure	**FY 2006 Target**	**FY 2006 Results**	**FY 2006 Status**	**FY 2007 Target**
Reduce the total workplace injury and illness case rate to no more than 2.85 per 100 employees by the end of FY 2006, representing a cumulative 3% annual reduction from the FY 2003 baseline (3.12) set in the Safety, Health, and Return to Employment (SHARE) Presidential Initiative. (The target is TBD for FY 2007–2010.)				
Clean Audit With No Material Weaknesses Obtain an unqualified opinion on the agency's financial statements (clean audit with no material weaknesses [NMW]) each fiscal year.	Clean Audit w/NMW	Qualified Opinion	◎	Clean Audit w/NMW
Grievance Processing Time Reduce grievance processing time by 25% by FY 2010.	Set Baseline	146 days	●	–10.00%
Air Traffic Controller Hiring Plan Maintain air traffic controller annual hiring within 5% of Air Traffic Controller Workforce Hiring Plan.	–5.00%	+20.00%**	●	–5.00%

* Projection.
** Preliminary estimate.
● Goal Achieved
◎ Goal Not Achieved

Employee Attitude Survey

The Employee Attitude Survey (EAS) is the main tool we use to measure employees' perceptions of critical management processes and practices. The full EAS, administered in even years to the entire organization, contains more than 100 questions and includes 12 core questions focused on management effectiveness and accountability. A shorter EAS is administered in odd years to a random sample of the FAA employee population. This shorter version focuses specifically on the 12 core questions. 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 FY 2006 EAS was administered in August and September 2006, with a 42% response rate. The EAS metric value was 34% positive, which is below the FY 2006 target of 38%. More detailed information on the EAS results will become available in January 2007, at which time FAA will address why the target was not met and take appropriate action.

Employee Attitude Survey: FY 2006 Target and Results		
Target	Increase EAS scores in the areas of management effectiveness and accountability by at least 3%.	
Results	◎	**–1%** We did not meet the target of a 3% increase over the baseline of 35%. In FY 2006, EAS scores decreased by 1%. *Note:* Since no survey was conducted in FY 2004, no trend data are available for this measure.

Cost Control

FAA's operating costs have increased significantly over the past decade. Oversight authorities such as the DOT IG and the GAO have raised concern regarding our escalating operating costs. To address this concern, we are taking aggressive actions to stem the growth of operating costs.

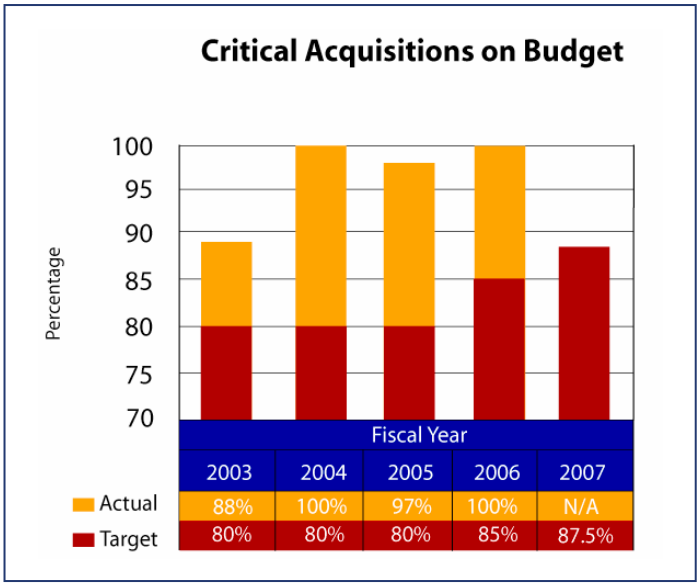
For FY 2006, we elected to expand the cost control performance target. As part of the revised FY 2006–2010 *Flight Plan*, each FAA organization was required to identify at least one cost savings activity/and or productivity improvement. We also improved the cost control process by instituting a rigorous front-end analysis exercise to gather activity descriptions and estimates to thoroughly understand each cost control activity. In FY 2006 we estimated accrued benefits of over $50 million. We also found that cross-organizational initiatives, primarily in information technology and human resources, provide the greatest impact.

In FY 2007, we will continue to strengthen our focus on financial management activities by requiring each organization to undertake a productivity and/or financial metric to measure efficiency. By increasing efficiency and productivity, we will be in a better position to reduce overall cost.

Cost Control: FY 2006 Target and Results	
Target	Ensure that each FAA organization contributes at least one measurable and significant cost efficiency and/or productivity improvement activity each year.
Results	FAA met this goal. Each organization contributed a cost reduction activity resulting in cost savings or cost avoidance. *Note:* This was a new performance target in FY 2005, so no trend data are available.

Critical Acquisitions on Budget / Critical Acquisitions on Schedule

FAA uses lifecycle acquisition management to determine and prioritize its needs, make sound investment decisions, implement solutions efficiently, and manage services and assets over their lifecycle. Such management is built around a logical sequence of phases and decision points and results in continuous improvement in the delivery of safe, secure, and efficient services over time. In this way, FAA ensures that taxpayer dollars spent through its acquisition programs achieve required performance outcomes by tracking cost and schedule milestones.

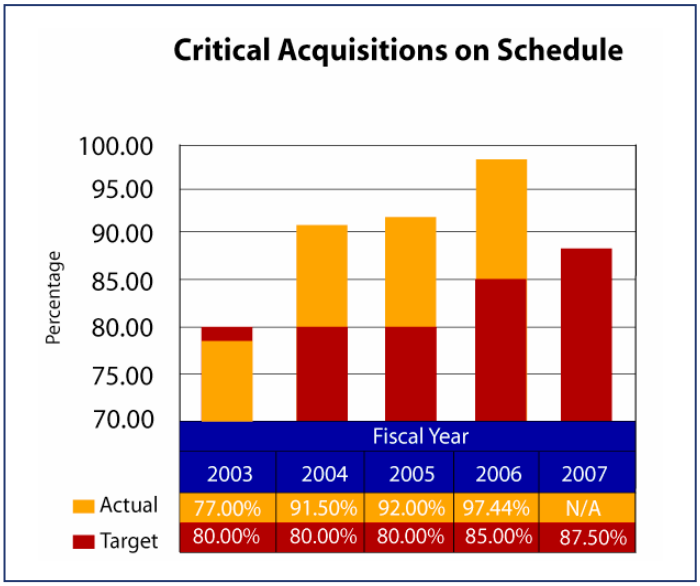


FAA exceeded the FY 2006 performance targets for major acquisitions cost and schedule. FAA tracked 39 milestones against 29 acquisition programs for this performance measure and has met the targets for both cost and schedule.

Our success in meeting these yearly acquisition goals is attributable to our continued efforts to incorporate and apply effective management control processes. We are segmenting large, complex investment programs into development, demonstration, or production phases, with the Joint Resources Council (JRC) approving each phase incrementally. Segmentation helps to clarify schedules for several useful segments and allows the JRC to assess how well work is

progressing before approving subsequent phases. This gives FAA better control of costs and schedules.

Also, we are using EVM techniques for contracts where there is significant risk to the Government. With EVM as a project management tool, we are able to optimize project planning and control through integration of the project scope of work with cost, schedule, and performance elements. In FY 2006, major programs were assessed against the industry standard for EVM compliance and action plans were put in place to achieve full compliance. Continued surveillance reviews will ensure continuity of program planning and the reliability of performance data.



Critical Acquisitions on Budget/Critical Acquisitions on Schedule: FY 2006 Target and Results		
Target	Make sure 85% of critical acquisition programs are on schedule and 85% of critical acquisition programs are within 10% of budget as reflected in the Capital Investment Plan.	
Results		**100.00% / 97.44%** FAA met its performance goals for both Critical Acquisitions on Budget and Critical Acquisitions on Schedule. We achieved 100.00% and 97.44% of goals for budget and schedule, respectively.

Information Security

FAA has an information security mandate to protect the agency's IT assets in accordance with numerous executive and legal requirements, including the Computer Security Act, Executive Order 13231, and the Federal Information Security Management Act (FISMA), and to be in accordance with DOT and FAA policy. Accordingly, FAA, whose mission is to ensure the safe and efficient movement of aircraft, must be protected against the threat of cyber attacks.

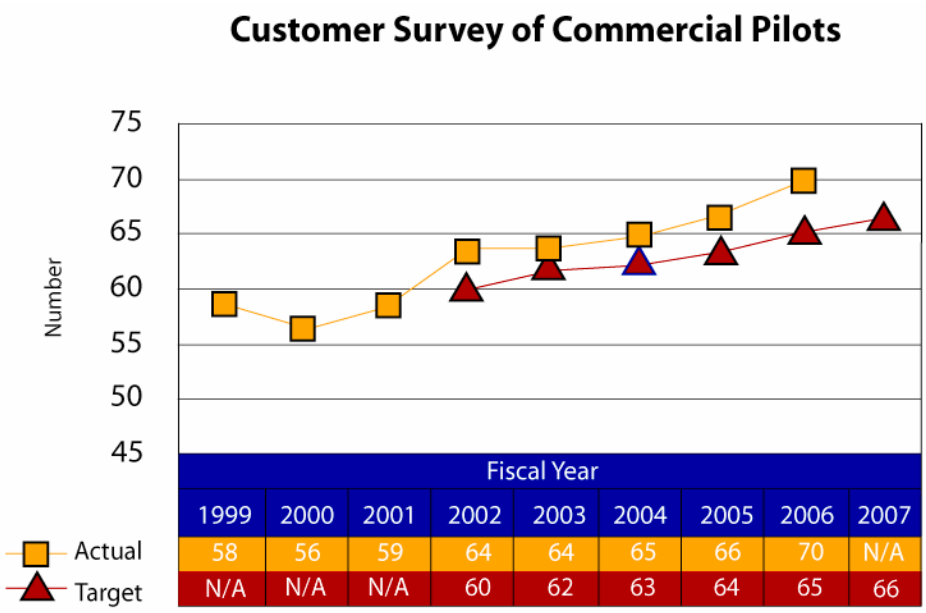
During FY 2006, there were about 5 million monthly cyber attack attempts made on our network. There were no successful cyber events that significantly disabled or degraded our service. We achieved 100% of the FY 2006 milestones for the information security program and embarked on several initiatives to maintain current certification and authorization of 100% of our IT systems, including air traffic control systems. We completed our target of 33% of security reviews of our IT systems and ensured that 33% of the IT systems inventoried targeted areas of highest risk and vulnerabilities. FAA's Cyber Security Incident Response Center provided us with greater situational awareness capability through near real time processing of information systems security alerts. In addition, the agency revised the *Certification and Accreditation* Handbook to reflect National Institute of Standards and Technology guidelines and standards.

Information Security: FY 2006 Target and Results		
Target	Protect FAA's IT assets, ensuring that there are zero cyber security events that significantly disable or degrade FAA services.	
Results		**0** FAA met its goal to achieve zero cyber security events that disable or significantly degrade services through the CSIRC. *Note:* This measure was redefined in FY 2005, so no trend data are available.

Customer Satisfaction

FAA works continuously to improve overall performance and customer satisfaction. To do this, we must gather and use reliable data to assess our performance and to make reasonable decisions on how to improve. Therefore, the agency uses the American Customer Satisfaction Index (ACSI) to measure customer satisfaction with commercial pilots. Commercial pilots, who hold current commercial certificates, are asked about air traffic control personnel and services, pilot certification processes, and the clarity of regulations and how they contribute to aviation safety.

The ACSI methodology combines survey input with cause and effect modeling to produce indices of satisfaction, and indices of the drivers and outcomes of satisfaction, on 100-point scales. This year's results show continued improvement in FY 2006 with a 4-point jump. Since



1999, the FAA has increased its score with commercial pilots by 12 points. Two items contributed most to the increased score: higher scores in whether regulations contribute to aviation safety and in regulations being easy to understand. Two other major areas—Air Traffic Control and Pilot Certification—continue to score highly.

Customer Satisfaction: FY 2006 Target and Results		
Target	Increase agency scores on the American Customer Satisfaction Survey to 65.	
Results		**70** FAA met its customer satisfaction FY 2006 target of 65 or higher, achieving an ACSI score of 70.

Cost-Reimbursable Contracts

It is important for FAA to close out contracts on a timely basis. By doing so, contracts are administered more efficiently and the agency's liability is reduced. We focus on maintaining high close-out rates to avoid such issues as the loss of expired funds, loss of file documents, loss of vendor's corporate knowledge, or changes in the contractor's business status. A high number of unclosed contracts can create potentially large liabilities where final amounts are due to or from the contractor and the agency loses the use of funds that could otherwise be recouped.

The FY 2006 target was based on the number of flexibly priced contracts that were eligible for close-out in the prior fiscal year (62). The target required close-out of 85% of that number, or 53 contracts, in FY 2006.

Cost-Reimbursable Contracts: FY 2006 Target and Results		
Target	Close out 85% of eligible cost-reimbursable contracts.	
Results		**102.00%** FAA exceeded its goal of closing out 53 (85% of 62 eligible contracts) flexibly priced contracts. We closed 63 contracts, one more than were eligible for close out in FY 2005, or 102% of that number. Our increased emphasis on timely close-out actions, specifically our tracking process and monthly status updates, contributed to the wide margin by which we exceeded this target. *Note:* This measure was redefined in FY 2005, so no trend data are available

Mission-Critical Positions

One crucial element of ensuring safety and greater efficiency through organizational excellence is an efficient and high-quality hiring process for filling mission-critical positions (MCPs). FAA's MCP includes Transportation Specialists, Engineers, Aviation Safety Inspectors, Engineering and Electronics Technicians, and Information Technology Specialists positions.[3] In anticipation of the large number of employees who will become retirement-eligible in the next few years, the agency must ensure that mission-critical hiring is accomplished in a timely manner and that we get the qualified individuals needed to achieve mission results.

[3] ATCs are not a part of the mix of positions for this goal. The hiring of ATCs is far more complex and time consuming and would disproportionately skew the overall results. A study of ATCs was recently completed, and these results along with other factors will be considered in determining how to set a challenging standard for filling ATC positions in FY 2007.

Mission-Critical Positions: FY 2006 Target and Results		
Target	Reduce the time to fill mission-critical positions by 10% over the FY 2003 baseline median of 81 days.	
Results		**–19.75%** We exceeded our target of filling MCPs within 73 days. In FY 2006, it took a median of 65 days to fill MCPs, excluding Air Traffic Controller (ATC) positions. This represents a 19.75% reduction over the FY 2003 baseline. Our performance to date has been consistently below the established performance target, which ultimately led to the decision in FY 2006 to revise the baseline for the performance target, excluding ATCs. The new performance target will become effective in FY 2007.

Reducing Workplace Injuries

The *Flight Plan* initiative to reduce workplace injuries involves a comprehensive program that includes the implementation of policy, oversight, program planning, work safety training, facility inspections, providing personal protective equipment, data analysis, mishap and hazard identification, and abatement. The measure addresses work-related injuries and illnesses to FAA employees only. This measure is important since reduction in the total case rate leads to improved productivity and quality of life for the FAA workforce and lowers costs related to workplace injuries.

Reductions in workplace injuries result when employee awareness and participation are high, leadership visibly supports Occupational Safety and Health (OSH) activities, and risks are identified and mitigated early. National OSH Program Evaluations conducted in 2006 and prior years identified opportunities to reduce injury and illness in the various FAA workplaces. As senior managers and employees become more aware of injuries and illnesses and how to prevent them, the number and severity of these mishaps should continue to decrease.

Reducing Workplace Injuries: FY 2006 Target and Results		
Target	Reduce the total workplace injury and illness case rate to no more than 2.85 per 100 employees by the end of FY 2006.	
Results		**2.21** *(projected)* We achieved a 2.21 rate (projected) per 100 employees. *Note:* This was a new performance measure in FY 2006, so no trend data are available.

Clean Audit With No Material Weaknesses

The clean audit target is a critical indicator of an agency's financial condition because it independently assesses the fair presentation of FAA's financial statements, and in connection with that process, considers the internal controls over financial reporting.

After 5 years of unqualified opinions, we received a qualified opinion on our FY 2006 financial statements. The qualification is limited to the Construction in Progress (CIP) account within our Property, Plant, and Equipment line on our Consolidated Balance Sheet. We made significant progress on last year's material weakness and resolved six of eight conditions that led to the lack of timely processing of transactions and reconciliation of accounts. We also made significant progress on clearing up the backlog of transactions in our CIP account and developing updated capitalization policies and procedures for implementation in FY 2007.

However, KPMG issued a material weakness this year for the lack of supporting documentation for our capitalization processes. Early in FY 2007, we will develop a corrective action plan to validate the CIP balance and institute long-term policy and procedure changes that will allow us to routinely monitor and measure the status of our capitalization efforts and our CIP balance.

Clean Audit With No Material Weaknesses: FY 2006 Target and Results		
Target	Obtain an unqualified opinion on the agency's financial statements (clean audit with no materials weaknesses) each fiscal year.	
Results		FAA received a qualified opinion on its FY 2006 financial statements and a material weakness due to the lack of supporting documentation on our capitalization process.

Grievance Processing Time

The goal of any grievance procedure is to resolve employee and union complaints at the lowest level possible, with the least amount of time, resources, and disruption to the work environment and mission. This FY 2006 performance target is a new measure and focuses on reducing grievance processing time. The *Flight Plan* calls for a 25% total reduction in grievance processing time to be reached between FY 2007 and FY 2010.

Prior to FY 2006, there were no procedures in place to determine the baseline. To address this issue, FAA deployed the Grievance Electronic Tracking System (GETS), a new database system that electronically collects, tracks, and reports on grievance information and processing time. The analysis performed using GETS produced a baseline report showing the average number of days (146) for all entries within GETS.

Grievance Processing Time: FY 2006 Target and Results		
Target	Determine a grievance processing baseline for grievance processing time performance measure.	
Results		**146 days** FAA established a baseline average of 146 days for processing grievances. *Note:* This was a new performance measure in FY 2006, so no trend data are available.

Air Traffic Controller Hiring Plan

In FY 2006 we completed the update of the *Air Traffic Controller Workforce Hiring Plan* designed to address anticipated retirement and replacement of ATCs over the coming decade. The revised document outlines the agency's plans to hire more than 11,800 new ATCs over the next 10 years. The controller workforce plan ensures that FAA will have the right number of controllers in place at the right time to address the controller retirement bubble. We are focusing on all aspects of the process, including recruitment, hiring, training, and staffing requirements.

Our hiring number takes into account air traffic growth and provides adequate training lead-time, depending on the position. As a result, the projected on-board staffing will exceed the annual staffing targets due to hiring in advance of when the controllers will actually be needed to allow time for training. The current pool of controller candidates from various hiring sources exceeds 3,700, which is sufficient to meet staffing needs for the next several years. To support our efforts, we developed and implemented an effective, integrated applicant tracking system

that provides an automated tracking tool for referral, selection, pre-hiring activities, and placement.

FAA is also studying controller staffing at the facility level to establish hiring ranges that better reflect the variability of factors that affect actual staffing levels at individual facilities. A nominal staffing target with an acceptable range may better match the reality of staffing at a facility. The staffing range would be established to allow for maintaining a safe operation at any point within the range.

To manage turnover, we are reducing the time required to hire and train a new controller. The goal is to decrease the time it takes a new hire to become a certified professional controller from 3 to 5 years, down to 2 to 3 years. FAA is also improving the training process for new controllers and has installed new high-fidelity tower simulators at the FAA Academy to help reduce training time and improve safety. We also instituted processes to create even-flow hiring to avoid training bottlenecks at the FAA Academy and field facilities.

In the summer of 2006, ATO experienced higher than expected attrition in the controller workforce. To maintain the overall level of the controller workforce, ATO accelerated its hiring. As a result of this balanced operational approach, ATO surpassed the hiring target by 20%.

Air Traffic Controller Hiring Plan: FY 2006 Target and Results		
Target	Maintain air traffic controller annual hiring within 5% of the *Air Traffic Controller Workforce Hiring Plan*.	
Results		FAA hired 1,116 controllers, 20% above our FY 2006 target of hiring 930 controllers. *Note:* This was a new performance measure in FY 2006, so no trend data are available.

Completeness and Reliability of Performance Data

Following are summaries of completeness and reliability processes for FAA 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.

Safety

Commercial Air Carrier Fatal Accident Rate

The data on commercial and general aviation fatal accidents come from the National Transportation Safety Board (NTSB) Aviation Accident Database. Aviation accident investigators under the auspices of the NTSB develop the data. Departure data are submitted by carriers to the Office of Airline Information (OAI) within the Bureau of Transportation Statistics (BTS).

FAA does comparison checking of the departure data collected by the 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 relies 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/Alaska Accidents

The data on general aviation fatalities come from the NTSB Aviation Accident Database. Aviation accident investigators under the auspices of the NTSB develop the data. Regarding 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.

NTSB and FAA's Office of Accident Investigation meet regularly to validate information on the number of accidents. Results are considered preliminary. NTSB continues to review accident results from FYs 2004 and 2005. Numbers are final when the NTSB releases its report each March. In March 2006, FY 2004 accident numbers were finalized. However, the number is not likely to significantly change from the end of each fiscal year to when the rate is finalized.

FAA uses performance data extensively for program management, personnel evaluation, and accountability. As with Commercial Aviation, most accident investigations are a joint undertaking: NTSB has the statutory responsibility but most of the accident investigations are conducted by FAA Aviation Safety Inspectors without the direct involvement of NTSB. FAA's own accident investigators and other FAA employees participate in all accident investigations led by NTSB investigators.

Runway Incursions

Runway incursion data are recorded in the FAA National Airspace Information Monitoring System. Preliminary incident reports are evaluated when received and can take up to 90 days to complete. Runway incursions are a subset of the incident data collected and the completeness of the data is based on the reporting requirements and completeness for each of the incident types.

FAA verifies and validates the accuracy of the data through reviews of preliminary and final reports. Reconciliation of the databases is conducted monthly and anomalies are explored and resolved. In cases where major problems are identified, a request to resubmit is issued. The FAA conducts annual reviews of reported data and compares it with data reported from previous years. The data are typically not finalized for 90 days following the close of the fiscal year.

FAA uses performance data extensively for program management, personnel evaluation, and accountability in prioritizing its facility evaluations and audits. Surface operational error/deviation, surface pilot deviation, and vehicle/pedestrian deviation reports are reviewed

on a daily basis to determine if the incident meets the definition of a runway incursion. The data are also used on a daily basis to track progress of achieving performance goals. Annual runway incursion incident data are used to provide a statistical basis for research and analysis and outreach initiatives.

Commercial Space Launch Accidents

FAA monitors all licensed launch operations and maintains documented reports of each licensed event. These reports include all relevant details pertaining to the outcome of the licensed launch or reentry operation as well as the occurrence of any public fatalities, injuries, or property damage. The reports are generated by assigned FAA field inspectors and duty officers. FAA also uses other sources of data such as the launch vehicle operator and Federal, state, and local government officials.

FAA's Licensing and Safety Division maintains and verifies reports regarding accidents resulting from a licensed launch operation. It also supports coordination with other Federal agencies such as the NTSB and the military on any subsequent investigations. In the event of an accident, FAA and NTSB complete official reports fully documenting circumstances associated with the event.

Operational Errors

FAA's Air Traffic Order 7210.56 requires all facilities to submit operational error reports within 3 hours of the event. In addition, 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 to determine if an operational error has occurred. The information is summarized in the FAA Air Traffic Operational Error and Deviation Database.

FAA uses performance data extensively for program management, personnel evaluation, and accountability in prioritizing its facility evaluations and audits. FAA has implemented procedures that require facilities to conduct random audits of radar data to identify potential unreported operational errors. FAA Headquarters also conducts random audits of selected facilities based on the identification of unreported events. Facility management and personnel are subject to punitive action for noncompliance in reporting operational errors.

The data are also used on a daily basis to track progress in achieving performance goals. Annual operational error incident data are used to provide a statistical basis for research and analysis. FAA verifies and validates the accuracy of the data through reviews or preliminary and final reports. Reconciliation of the databases is conducted monthly and anomalies are explored and resolved. In cases where major problems are identified, a request to re-submit is issued. FAA conducts an annual review of reported data and compares it with data reported from previous years. The data are typically not finalized for 90 days following the close of the fiscal year.

Safety Risk Management

FAA works to compile a repository of hazards associated with changes to the NAS in a database known as the FAA Hazard Tracking System. In addition, WebCM is being updated to require

Safety Risk Management (SRM) be applied to all NAS Change Proposals. The data are used to audit the application of SRM.

Each FAA service unit is responsible for ensuring safety analyses are documented, complete, and accurate. FAA approves certain SRM documents and checks for service unit compliance with SRM via an audit process that is currently in development.

Capacity

Daily Airport Capacity (35 OEP Airports/8 Metropolitan Areas)

The Aviation System Performance Metrics (ASPM) database, maintained by the FAA's Office of Aviation Policy and Plans, provides the data for this metric. By agreement with the FAA, ASPM flight data are filed by certain major air carriers for all flights to and from most large and medium hubs. These data are supplemented by flight records contained in the Enhanced Traffic Management System (ETMS) and flight movement times provided by Aeronautical Radio, Inc. (ARINC). Also included within ASPM are arrival and departure rates provided by the individual facilities.

The reliability of ASPM is verified on a daily basis by the execution of a number of audit checks, comparison to other published data metrics, and use of ASPM by over 1500 registered users. Fiscal year data are finalized approximately 90 days after the close of the fiscal year.

Annual Service Volume

Demand schedules and fleet mixes are developed from recent *Official Airline Guide* (OAG) information and flight counts are obtained from airport traffic control tower logs. In addition, standard air traffic control procedures are used for each airport.

FAA's NAS Advanced Concept Branch provides technical support to develop a consistent method of calculating the individual airport ASV through the FAA Technical Center, Atlantic City, NJ. Recalculations of the original ASV studies have not been necessary. Once developed, the delay curves remain accurate unless a major change in fleet mix or operational characteristics occurs at an airport.

Adjusted Operational Availability

The National Airspace System Performance Analysis System (NASPAS) is the official source of equipment and service performance data for the FAA. The NASPAS was developed to analyze outages of the Air Traffic Control Facilities in the NAS. NASPAS receives monthly updates of outage data from the National Outage Database (NODB). The Maintenance Management System (MMS) contains individual equipment outage data as recorded by the system specialist.

The FAA's Quality Assurance and Performance Team conducts monthly reviews of all Log Interrupt Reports entered into the MMS to ensure the data, which reside in the NODB, are as complete and accurate as possible.

NAS On-Time Arrivals

The FAA's Aviation System Performance Metrics (ASPM) database, supplemented by DOT's Airline Service Quality Performance (ASQP) causation database, provides the data for this metric. By agreement with the FAA, ASPM flight data are filed by certain major air carriers for all flights to and from most large and medium hubs. The data are further augmented by flight records contained in the ETMS and flight movement times provided by ARINC.

Fiscal year data are finalized approximately 90 days after the close of the fiscal year. The reliability of ASPM is verified on a daily basis by the execution of a number of audit checks, comparison to other published data metrics, and use of ASPM by over 1500 registered users. ASQP data are 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.

Noise Exposure

FAA uses the Model for Assessing Global Exposure to the Noise of Transport Aircraft (MAGENTA) to track the aircraft noise exposure goal. The U.S. version of MAGENTA uses updated population data from the 2000 Census. The data source for airport traffic is the ETMS database, which includes unscheduled air traffic and allows for more accurate modeling of freight, general aviation, and military operations. Local traffic utilization data are collected from individual airports and updated periodically.

The noise studies obtained from U.S. airports have gone through a thorough public review process, either under the National Environmental Policy Act requirements or as part of a land use compatibility program. The Integrated Noise Model (the core of the MAGENTA model) has been validated with actual acoustic measurements both at airports and in neighborhoods under the flight path of the aircraft. External forecast data are from primary sources. The MAGENTA population exposure methodology has been thoroughly reviewed by the International Civil Aviation Organization task group and was most recently validated for a sample of airport-specific cases.

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 between 1990 and 1997, with many of them now over 9 years old. Changes in airport layout, including expansions, may not be reflected. FAA continues to update these databases as they become available. The benefits of federally funded mitigation, such as buyout, are accounted for.

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. The SAGE system uses radar-based data from the ETMS and OAG schedule information to generate annual inventories of fuel burn and total distance flown data for all U.S. commercial operations.

Data used to measure performance against the target are assessed for quality control purposes. Input data for the SAGE model are validated before proceeding with model runs. Radar data from the ETMS are assessed to remove any anomalies, check for completeness, and preprocessed for input to the SAGE model. ETMS data are verified against the OAG information to avoid any duplication of flights in the annual inventory.

Full documentation of this target is determined when the annual inventories have been completed and the post-processing calculations have been done, resulting in a percentage reduction in fuel efficiency relative to the baseline. The standard for this documentation is set

by FAA and is separate from the DOT Volpe National Transportation Systems Center responsible for input and output associated with the SAGE model runs and annual inventories.

The measuring procedure used for this performance target is highly reliable. The processing of data through the SAGE model, including the performance of algorithms, is not subject to random factors that could influence the results. However, the performance target is potentially influenced by factors outside the control of the FAA. For example, a major sustained disruption or enhancement in air traffic and/or a significant shift in commercial operations among airlines, including changes in fleet composition and missions, could have a profound impact on the performance target.

International Leadership

Aviation Safety Leadership

International accident and departure data come from Airclaims of London, a provider of accident investigation services to aviation insurance companies around the world. It also tracks air fleet activities in nearly every country, including international and domestic operations for all business jets and all air carrier jets and turboprops certificated for 15 or more seats. Airclaims receives its data from a combination of aircraft manufacturers, national authorities, insurance claims, and the company's representatives in various parts of the world. FAA subscribes to the Airclaims database and gets monthly downloads from Airclaims.

The data are very reliable. Airclaims tracks data for every aircraft in the Chinese fleet, where the data are not as reliable data available from Western-built aircraft. However, their activity as a percentage of the total fleet is so small that the departure data will do little to affect change.

Airclaims compiles a very complete set of accident data from the various sources outlined above. Departure data comes from aircraft manufacturers, including aircraft built in China through joint ventures. Departure data for the small number of Eastern built turboprop jet aircraft still in use in China is not available. However, this is not a statistically significant issue.

Bilateral Safety Agreements

FAA monitors this performance measure through the execution of executive agreements and implementation procedures. Executive agreements are negotiated and maintained by the Department of State and implementation procedures are negotiated and concluded by FAA. The official signed documents are maintained at FAA. This performance target is monitored monthly by tracking interim negotiation steps leading to completion of a BASA and tracking FAA internal coordination of the negotiated draft text.

The final signing of executive agreements is generally out of FAA's control. Many sovereign nations view these agreements as treaties that require legislative approval. FAA and the U.S. Government cannot control the timing of legislatures in other countries. Therefore, FAA will count executive agreements only when signed. The negotiation of implementation procedures is more within FAA's control.

The signed executive agreement document constitutes evidence of completion. For implementation procedures, evidence will be some form of agreement between both parties that material negotiations are concluded. This can take the form of a signed agreement stating that fact, e-mail, meeting minutes, or other mutual agreement between the two parties that the implementation procedures agreement has been concluded.

External Funding

Often countries that could benefit the most from FAA technical assistance are the least able to afford it. This *Flight Plan* initiative seeks to leverage the limited resources that FAA is able to contribute and provides program management of additional support from third party providers. FAA develops the funding proposals, puts forward recommendations to funding organizations, and works closely with these sources to finalize the funding for each project.

FAA tracks the progress of all funding proposals that it develops and supports. The funding secured from these proposals is the basis for measuring success. Public documents (press releases, letters, contracts, memorandums of agreement) are used to verify the figures for this *Flight Plan* initiative.

GPS-Based Technologies

By working with international civil aviation agencies, organizations, and States, FAA continues to enhance its international leadership role by further encouraging the adoption of U.S. GPS-based technologies and procedures. FAA monitors activity progress and then determines which activity closes out this performance target for the fiscal year. Data are then collected to document completeness.

The FAA ATO Operations Planning International Office, as the owner of this initiative and performance target, collects all pertinent documentation related to the completion of this performance target and then assesses if the target was successfully achieved. This office also coordinates with other supporting FAA offices to cross-check and validate the successful completion of this performance target.

Organizational Excellence

Employee Attitude Survey

FAA employees complete the EAS. FAA's Civil Aerospace Medical Institute analyzes EAS data, and FAA's Assistant Administrator for Human Resource Management coordinates the application of the results.

A confidence interval is calculated to assess how well the respondent sample result estimates the true population value. The reliability of the EAS metric is assessed by the standard coefficient alpha method. FAA uses internal research and analyses of best practices, including a contract with the Corporate Leadership Council, to ensure the metric's appropriateness. Comparisons between EAS results and Government surveys, such as the Federal Human Capital Survey, provide converging data.

FAA has a longitudinal EAS database back to 1984 that allows the assessment of measurement qualities. However, it must be recognized that there are myriad factors that can affect employees' perceptions and there is no way to statistically account for all of the factors. Still, FAA trend results do indicate that when FAA takes effective actions on an issue, survey results can improve. Also, the body of research on employee surveys indicates that the EAS measures are important factors for organizational effectiveness.

Cost Control

Each FAA organization proposes a cost saving, cost avoidance, and/or productivity improvement activity. This proposed cost control measure undergoes thorough management review to validate the viability of the proposal and associated computations. Once accepted, FAA organizations provide monthly updates on progress toward achieving the stated goals) and the organizations' activities, milestones, and dollars saved/avoided are verified. The individual organizations are responsible for maintaining files containing supporting documentation on their activity to ensure verification by audit. Risk for inaccurate reporting is minimal.

The data are subjected to a four-layer data verification process to ensure accuracy and reliability. First, the report information is checked against original templates submitted by FAA organizations. Second, the accuracy and reliability of the data are independently confirmed. Third, FAA management checks the information before it is submitted to FAA's Chief Financial Officer. Lastly, the CFO and senior financial management staff conduct a final data verification review prior to final approval of the cost control report.

Critical Acquisitions on Budget / Critical Acquisitions on Schedule

FAA tracks and reports the status of all schedule and cost performance targets using an automated database, Simplified Program Information Reporting and Evaluation (SPIRE). Once the program is selected and approved for tracking purposes it is reported on with detailed commentary each month and assigned a red, yellow, or green confidence indicator to specify whether the cost is within the 10% threshold and whether it is on schedule. Associated comments detail problems, issues, and corrective actions and ensure milestones and costs are maintained within the established performance target. The performance status is reported through the SPIRE database and discussed with FAA's Administrator during the monthly FAA *Flight Plan* meetings.

Each DOT organization maintains its own quality control checks for cost, schedule, and technical performance data of each major systems acquisition in accordance with OMB Circulars A-11, A-109, and A-130, Federal Acquisition Regulations, and Departmental orders implementing those directives and regulations. DOT organizations with major system acquisitions use the data during periodic acquisition program reviews to make decisions on resource requests. The data are also used during the annual budget preparation process for reporting progress made in the President's budget and for making key program management decisions.

Information Security

The data on cyber security attacks comes from data collected by FAA's Cyber Security Incident Response Center (CSIRC). The CSIRC and DOT's Transportation Cyber Incident Response Center (TCIRC) work collaboratively to validate cyber incidents on FAA and departmental systems. This process provides the most accurate and up-to-date measure. FAA and DOT use current and historical data to validate trends indicating an increase in the number and complexity of cyber attacks.

FAA has sensors on selected FAA administrative networks and on Air Traffic Organization's NAS and administrative networks. The FAA Office of Information Services is responsible for FAA incident reporting via its CSIRC, the primary focal point of incident reporting to the DOT and U.S. Computer Emergency Response Team.

FAA's CSIRC and DOT TCIRC work together in collaboration with other information systems security components in the Federal government. As outlined in FAA Order 1370.82, the CSIRC is the focal point for all cyber incidents in FAA.

Customer Satisfaction

To collect and report the customer satisfaction data, FAA uses the ACSI survey. The ACSI combines survey input from U.S. commercial pilots to produce indices of satisfaction, and indices of the drivers and outcomes of satisfaction. ACSI is produced by the National Quality Research Center at the University of Michigan Business School and provides a recognized, independent source of customer satisfaction information. According to ACSI, differences of 3 points or more between companies/agencies or between two scores for the same company/agency are typically greater than could be caused by sampling error.

Cost Reimbursable Contracts

PRISM is used to identify cost reimbursable-type contracts for which performance has ended. On a monthly basis, closed contracts are reported by either the contracting officer who closed out the contract(s) or the contractor tasked with closing out FAA contracts.

FAA's Contract Support Systems branch maintains a database of all closed contracts. In addition, closed contract files are received in the branch for distribution to central archives. It is possible that closed contracts are not reported and do not get entered into the database. Therefore, there is a slight risk of underreporting the number of closed contracts. Only contracts that are closed out completely (no outstanding issues) are entered into the database.

Mission-Critical Positions

FAA staffing specialists across the country enter data throughout the year into the Time-to-Fill website database. The database provides a secure record of the time it takes to fill positions and allows optimal flexibility in managing and analyzing the stored information. FAA collects additional descriptive information that enables the agency to locate delays in the process steps and allows the examination of Time-to-Fill data by Region, Line of Business, and hiring vehicle (i.e., via announcement or direct hire authority). Maintaining annual records allows performance to be compared year by year.

FAA has implemented several practices to ensure the integrity of data in the Time-to-Fill system. For example, monthly teleconferences provide a forum for discussions about efficiencies in hiring processes, resulting in more standardization and streamlined practices. In addition, monthly and quarterly monitoring of the Time-to-Fill mission critical positions ensures more proactive management of hiring processes.

The Time-to-Fill system is a dynamic system, with hiring actions entered continually by field and headquarters staffing specialists. Because the system is constantly updated, monthly reports only reflect the fill-time for hiring actions entered before the report's cut-off date. The median fill time numbers are finalized and stabilized for the year-end status report.

Reducing Workplace Injuries

The data source for the number of workplace injury cases is the Department of Labor SHARE Initiative website (www.dol.gov/esa/owcp/share/), which summarizes injuries and illnesses reported by the various agencies. The data source for the number of employees is the DOT

Workforce Demographics website (http://dothr.ost.dot.gov/workforceinfo/index.htm). The SHARE data reports are available quarterly, with an approximate 1-month lag time. FAA reports the case rates quarterly, with a 1-month lag time.

Data quality is high because the computation follows a well-established formula from the DOL and the data sources for each variable in the formula are Federal department-level databases. The key source of possible inaccuracy is the data entry for the injury and illness reports. FAA has consolidated Workers' Compensation case management for Headquarters, six Regions and both Centers and will extend the consolidation to the remaining Regions by the end of calendar year 2006, further increasing data accuracy. In addition, some FAA safety professionals use the Safety Management Information System (SMIS) to cross-check mishap reports against Workers' Compensation claims to improve data accuracy.

Clean Audit With No Material Weaknesses

FAA chooses this measure because it is an independent assessment of FAA's internal control environment over financial reporting, FAA's compliance with relevant laws and regulations, and FAA's ability to fairly present the results of its financial position and activities during the year. The data used to evaluate FAA's measure against this target comes from the independent auditors' report, issued as a result of an audit of FAA's annual financial statements. The auditors' report is published annually in FAA's *Performance and Accountability Report.*

This measure includes FAA's annual audited financial statements, related footnotes, and required supplementary information—all of which are published by FAA in its annual *Performance and Accountability Report.*

Grievance Processing Time

To ensure a consistent corporate labor management program, FAA focuses on providing effective and efficient processes to train managers and supervisors to handle grievances, negotiations, and contract administration. FAA uses GETS for tracking and processing grievances. The data are entered and updated by authorized labor relations users in Regions, Centers and Headquarters.

GETS verifies data completeness, accuracy, consistency, and timeliness. A periodic review of the data serves to validate the appropriateness of the measure. This method allows continuous monitoring and ensures the viability of the data. The GETS database has built-in control elements that must be correctly populated before a record can be accepted into the database. Completed records are not deleted and can be used for multiple purposes. Newly discovered data can be measured not only on current records, but also on legacy completed records.

Air Traffic Controller Hiring Plan

The goal to maintain annual ATC hiring was established after publication of the December 2004 report, *A Plan for the Future: The Federal Aviation Administration's 10-year Strategy for the Air Traffic Control Workforce*.

The hiring targets and data on air traffic controller hiring are collected and compiled monthly by FAA's Office of Finance for the Air Traffic Organization. Completeness is guaranteed by contacting each facility monthly to determine the number of controllers hired. Field facilities submit monthly hiring numbers to the Financial Metrics group. The reliability of these reports is ensured since the facility is the level at which the controllers are assigned.

Assessing Programs

Program Assessment Rating Tool (PART) Reviews

The PART was developed to assess and improve program performance so that the Federal Government can achieve better results. A PART review helps identify a program's strengths and weaknesses to inform funding and management decisions aimed at making the program more effective. The PART therefore looks at all factors that affect and reflect program performance including program purpose and design; performance measurement, evaluations, and strategic planning; program management; and program results. Because the PART includes a consistent series of analytical questions, it allows programs to show improvements over time, and allows comparisons between similar programs.

As a component of the PART review recommendations, FAA organizations that have undergone PART reviews have developed and use efficiency measures. For example, ATO has determined a cost per controlled flight and uses that metric to determine efficiency in handling Instrument Flight Rule (IFR) flights.

In FY 2004, as part of the development of the FY 2006 budget request, we reviewed Aviation Safety and Facilities and Equipment using PART. The Aviation Safety program provides safety and regulatory oversight of the aviation industry by issuing regulations and safety directives and licensing aircraft. The Facilities and Equipment program develops and acquires the products and services that enable the FAA to enhance the safety of the national airspace system and satisfy current and future operational needs of the system for national and international operations.

FY 2006 OMB PART Program for DOT	
Program Name: FAA—Aviation Safety	
Strategic Goal(s) Affected	Safety
Score	**84%—Moderately Effective** In general, a program rated Moderately Effective has set ambitious goals and is well-managed. Moderately Effective programs likely need to improve their efficiency or address other problems in the programs' design or management in order to achieve better results.
Major Findings/ Recommendations	The program received very good scores across-the-board with no major deficiencies noted.
Actions Planned/Taken	FAA Office of Aviation Safety developed a metric to provide cost per rule. In addition, FAA completed three post-regulatory "look-back" reviews and has one currently underway. The completed reviews are (1) Revised Standards for Cargo or Baggage Compartments in Transport Category Airplanes (Class D to Class C Compartments) (FY 2004); (2) Fatigue Evaluation of Structure (FY 2004); and (3) Revisions of Digital Flight Data Recorder (DFDR) Rules (FY 2006). FAA is performing a review of the Terrain Awareness Warning System rule.
Program Name: FAA—Facilities and Equipment	
Strategic Goal(s) Affected	Safety and Capacity
Score	**55%—Adequate** This rating describes a program that needs to set more ambitious goals, achieve better results, improve accountability, or strengthen its management practices.

FY 2006 OMB PART Program for DOT	
Program Name: FAA—Aviation Safety	
Major Findings/ Recommendations	Facilities and Equipment supports the major capital project acquisitions for the Federal Aviation Administration. The primary reason for the relatively low score was that this "program" is actually a compilation of separate projects and is developed using a zero based budget approach, making it a less than ideal candidate for a PART review.
Actions Planned/Taken	The capital investment team (CIT) is an established group and will continue to function in the review and oversight of major capital project acquisitions to ensure better financial management standards. The CIT's reviews have led to the restructuring or termination of several programs. BY FY 2007, FAA will adopt standard cost estimation guidelines to improve accuracy of cost estimates. Improved procurement oversight has enabled FAA to meet its acquisition goals for cost and schedule for FY 2004–FY 2006. FAA has adopted the capital asset plan and business case process recommended by OMB as its own internal process for major IT acquisitions. The Joint Resource Committee (JRC) for major acquisition approved the OMB business case, now the Acquisition Program Baseline (APB). FAA is tracking the ATO overhead rate comparing nonfacility labor dollars divided by total labor dollars. Targets have been established and provide a compass for future decision-making.

Program Evaluation

A critical component of managing our performance is the periodic evaluation of FAA programs. Performance measures show if intended outcomes are occurring and assess any trends. Program evaluation uses analytic techniques to assess the extent to which our programs are contributing to those outcomes and trends. In FY 2006, the DOT OIG conducted an independent evaluation to assess the adequacy of physical security at FAA facilities.

Managing the Physical Security of FAA Facilities

FAA operates systems and facilities, including Air Traffic Control Centers (ARTCCs), Terminal Radar Approach Control (TRACON) facilities, air traffic control towers, and supporting facilities that collectively make up the NAS. The President, through the publication of Homeland Security Presidential Directive (HSPD) -7, dated December 17, 2003, designated the NAS as part of the nation's critical infrastructure because of commercial aviation's role in fostering and sustaining the national economy and ensuring the safety and mobility of air travelers.

FAA has established physical security requirements that are designed to help ensure the safety and security of the NAS, FAA personnel, and assets. These security requirements are implemented through the FAA's Facility Security Management Program. All staffed NAS facilities are periodically assessed and inspected for program compliance. Security shortfalls or "findings" are aggressively tracked until corrected. Once all required security measures are implemented at a facility, the facility receives security "accreditation." The FAA has completed assessments at all of its staffed facilities and continues to work toward completing accreditation.

The DOT OIG conducted an independent evaluation to assess the adequacy of physical security at FAA facilities. The OIG concluded that the FAA has continued to improve its security measures since the September 11 attacks and has taken steps to strengthen its physical security

environment. Nevertheless, improving the physical security of these facilities in response to a changing threat environment is an ongoing process, and the OIG made recommendations for improvement that the FAA is actively pursuing.

The OIG's report is protected as Sensitive Security Information and is not released to the public.

FINANCIAL STATEMENTS

FINANCIAL STATEMENTS

A Message from the Chief Financial Officer

This has been another year of significant accomplishments for FAA. We continue to make great strides in our efforts to provide the traveling public with the safest national airspace system in the world, while focusing on operating like a business and achieving excellence in financial management. In FY 2006, there have been significant accomplishments that are outlined below.

FAA's Chief Financial Officer, Ramesh Punwami, above, described FAA's efforts to improve its financial management in an article that appeared in the July 15, 2006, edition of *Government Executive* magazine. FAA was recognized in a March 2006 Government Accountability Office as an example of how performance, budgeting, and financial information can enhance performance monitoring.

Photo credit: Patrice Gilbert

- After 5 consecutive years of clean audits, we received a narrow qualified opinion on our financial statements. The qualification was related to the accuracy of the Construction in Progress (CIP) account, with a related material weakness for lack of supporting documentation and a need for strengthened policies and procedures in the capitalization process. The circumstances of the qualification of the CIP balance occurred late in the fiscal year, and we were unable to satisfy ourselves and our auditors on the accuracy of the balance because of the complexity of the CIP process and the need for a more comprehensive review of financial transactions. However, we are addressing this situation aggressively and are implementing a corrective action plan that will encompass the immediate preparation of the necessary documentation to support the CIP balance. In addition, we will implement changes in policies and procedures, financial organizational structure, and performance metrics to improve accountability for all capital asset tracking going forward.
- We received the Certificate of Excellence in Accountability Reporting from the Association of Government Accountants for our *FY 2005 Performance and Accountability Report.* This represents the third consecutive year that FAA has won this prestigious award, and we were one of only nine Federal Government agencies to receive this distinction. FAA also received its third consecutive award from the League of American Communication Professionals for its *FY 2005 Performance and Accountability Highlights*, recognizing it as one of the top annual reports in the country.
- We received ISO 9001 certification for our safety oversight processes. ISO 9001 is a set of standards that provide quality management guidance. To continue our focus on ensuring the safest aviation system in the world, FAA now documents what we do to ensure safety and we do what we document.
- We controlled costs by reducing nonsafety staff by almost 10% and executive level staff by more than 20%. The largest

outsourcing effort in the Federal Government (FAA Flight Service Stations) is starting to realize benefits that will $1.7 billion over the next 10 years. In addition, a recent consolidation in the Air Traffic Organization—FAA's largest line of business—will save $450 million over 10 years.

- We implemented a new contract with air traffic controllers that will result in anticipated cost savings/avoidance of $1.9 billion over 5 years. FAA also released its annual update of the Air Traffic Controller Workforce Plan designed to address anticipated retirement and replacement of controllers over the next 10 years.
- We continued to implement our pay-for-performance system. The compensation of more than 83% of our workforce is now tied to the achievement of FAA performance goals.
- We consolidated services and facilities by centralizing accounting, real property management, and human resources support.
- We aggressively introduced cost efficiencies through strategic sourcing and consolidation of web services, application software, servers, and help desks.

FAA has received three consecutive Certificate of Excellence in Accountability Reporting awards from the Association of Government Accountants.

We have come a long way in a short time. Seven years ago, FAA's financial management was placed on the Government Accountability Office's (GAO) high risk list. This year, GAO cited FAA as an example for other Federal agencies in reporting performance, budget, and financial information to Congress. Our record of excellence in financial management is a result of the efforts of our dedicated staff who work to ensure the accuracy of our financial data and the efficiency of our processes. Our focus on excellence in all aspects of our operations is the foundation of our commitment the business of safety.

Ramesh K. Punwani
Assistant Administrator for Financial Services/Chief Financial Officer

November 3, 2006

Memorandum

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

Subject: ACTION: Quality Control Review of Audited Financial Statements for FY 2006 and FY 2005, Federal Aviation Administration
Report Number: QC-2007-009

Date: November 14, 2006

From: Calvin L. Scovel III
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, 2006 and September 30, 2005, was completed by KPMG LLP 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 Office of Management and Budget Bulletin 06-03, "Audit Requirements for Federal Financial Statements."

KPMG concluded that, except for the Construction in Progress[1] (CIP) balance and transactions, the consolidated financial statements present fairly, in all material respects, the financial position of FAA as of September 30, 2006 and September 30, 2005, 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.

KPMG qualified its opinion because FAA was unable to provide sufficient evidence to support the accuracy and completeness of the CIP account balances or related transactions that may have occurred affecting net cost. In addition, because of the significance of the CIP balance, and adjustments that might result from management's review of CIP, FAA was unable to represent that the CIP account balance totaling $4.7 billion, reported as a component of Property, Plant,

[1] Construction in Progress is a component of the Property, Plant, and Equipment line, and represents assets that are under construction or that have not yet been placed into service.

and Equipment in the footnote disclosure to the FAA Balance Sheet, was fairly stated as of September 30, 2006.

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

Material Weakness

1. Timely Processing of Transactions and Accounting for the Construction in Progress Account

Reportable Conditions

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

Noncompliance with Laws and Regulations

1. *Federal Financial Management Improvement Act of 1996* (*FFMIA*)
2. *Antideficiency Act*

KPMG made 28 recommendations for corrective actions; we agree with them and, therefore, are making no additional recommendations. FAA concurred with the material weakness, reportable conditions, and noncompliance; agreed with the recommendations; and committed to implementing corrective actions during fiscal year 2007. 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, Office of Financial Management, and KPMG representatives. If we can answer any questions, please call me at (202) 366-1959, or Rebecca C. Leng, Assistant Inspector General for Financial and Information Technology Audits, at (202) 366-1496.

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, 2006 and 2005, and the related statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources (herein referred to as "consolidated financial statements") for the years then ended. 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, required supplementary stewardship information, and performance measures, and tested the FAA's compliance with certain provisions of applicable laws, regulations, contracts, grant agreements, and other matters that could have a direct and material effect on these consolidated financial statements.

SUMMARY

As stated in our opinion on the consolidated financial statements, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence related to certain financial statement balances, the accompanying consolidated financial statements, as of and for the years ended September 30, 2006 and 2005, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1, *Summary of Significant Accounting Policies*, and Note 12, *Earmarked Funds*, the accompanying financial statements reflect actual excise tax revenues deposited in the Airport and Airway Trust Fund through March 31, 2006 and excise tax receipts estimated by the Department of Treasury's Office of Tax Analysis for the quarters ended June 30, 2006 and September 30, 2006.

As discussed in Notes 1 and 12, the FAA changed its method of accounting for and reporting earmarked funds in fiscal year 2006 to adopt the provisions of the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 27, *Identifying and Reporting Earmarked Funds*.

Our consideration of internal controls over financial reporting, required supplementary stewardship information, and performance measures resulted in the following conditions being identified as reportable conditions:

Reportable Condition Considered To Be A Material Weakness

A. Timely Processing of Transactions and Accounting for the Construction in Progress (CIP) Account (Update)

Other Reportable Conditions

B. Monitoring of Grants (Repeat)
C. Information Technology Controls over FAA and Third-Party Systems and Applications (Update)
D. Management Oversight and Reporting of Inventory (New)

The results of our tests of compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters disclosed the following instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 06-03.

E. *Federal Financial Management Improvement Act of 1996* (FFMIA)
F. *Anti-Deficiency Act*

The results of our tests of FFMIA disclosed instances, described in Exhibit III, where the FAA's financial management systems did not substantially comply with Federal financial management information systems requirements, and applicable Federal accounting standards. The results of our tests of FFMIA disclosed no instances in which the FAA's financial management systems did not substantially comply with use of the U.S. Government Standard General Ledger at the transaction level.

The following sections discuss our opinion on the FAA's consolidated financial statements, our consideration of the FAA's internal controls over financial reporting, required supplementary stewardship information, and performance measures; our tests of the FAA's compliance with certain provisions of applicable laws, regulations, contracts, grant agreements, and other matters, and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the Federal Aviation Administration as of September 30, 2006 and 2005, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources, for the years then ended.

During fiscal year 2006, the FAA initiated a detailed review of its Construction in Progress (CIP) financial statement balance. The purpose of the review was to determine the status of transactions included in CIP, and, if necessary, to make adjustments to its financial statements to properly classify those transactions as either property in-use, in CIP, or to remove the transactions from CIP and record an associated expense if the item had no future value. Such adjustments may change the capitalized value of assets, enter into the determination of net cost, or affect the FAA's net position. As a result, the FAA made adjustments totaling $336 million of expense to its fiscal year 2006 consolidated statement of net cost. However, the FAA was unable to fully complete its review of CIP, and make all of the adjustments necessary to properly state its CIP balance as of September 30, 2006, prior to the completion of the FAA's *FY 2006 Performance and Accountability Report*. Consequently, management was unable to provide us with sufficient evidence to support the accuracy and completeness of CIP, or related transactions that may have occurred during the year affecting net cost. In addition, because of the significance of the CIP balance and adjustments, if any, that might result from management's continued review of CIP, the FAA was unable to represent that the CIP account balance totaling $4.7 billion, reported as a component of Property, Plant, and Equipment (PP&E) on the accompanying consolidated balance sheet, is fairly stated as of September 30, 2006.

In our opinion, except for the effects on the fiscal year 2006 consolidated financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply sufficient procedures, and received management's representations, supporting CIP balances and transactions, as discussed in the second paragraph of this section, the consolidated financial statements referred to above, present fairly, in all material respects, the financial position of the FAA as of September 30, 2006 and 2005, 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 U.S. generally accepted accounting principles.

As discussed in Notes 1 and 12, the accompanying financial statements reflect actual excise tax revenues deposited in the Airport and Airway Trust Fund through March 31, 2006 and excise tax receipts estimated

by the Department of Treasury's Office of Tax Analysis for the quarters ended June 30, 2006 and September 30, 2006.

As discussed in Notes 1 and 12, the FAA changed its method of accounting for and reporting earmarked funds in fiscal year 2006 to adopt the provisions of the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 27, *Identifying and Reporting Earmarked Funds*.

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 consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. 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 consolidated financial statements taken as a whole. The information in the fiscal year 2006 Performance Results Section is presented for purposes of additional analysis and is not required as part of the consolidated financial statements. This information has not been subjected to 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 consolidated 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 caused by error or fraud, in amounts that would be material in relation to the consolidated 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. Because of inherent limitations in internal controls, misstatements due to error or fraud may nevertheless occur and not be detected.

In our fiscal year 2006 audit, 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 reportable condition A presented in Exhibit I is a material weakness. Exhibit II presents the other reportable conditions B through D. Exhibit IV presents the status of prior year reportable conditions and instances of non-compliance with laws, regulations, contracts, grant agreements, and other matters.

We also noted certain additional matters that we will report to the management of the FAA in a separate letter dated November 3, 2006.

INTERNAL CONTROLS OVER REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION AND PERFORMANCE MEASURES

Under OMB Bulletin No. 06-03, the definition of material weaknesses is extended to other controls as follows. 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 caused by error or fraud, in amounts that would be material in relation to the Required Supplementary Stewardship

Information or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

Our consideration of the internal control over the Required Supplementary Stewardship Information and the design and operation of internal control over the existence and completeness assertions related to key performance measures would not necessarily disclose all matters involving the internal control and its operation related to Required Supplementary Stewardship Information or the design and operation of the internal control over the existence and completeness assertions related to key performance measures that might be reportable conditions.

In our fiscal year 2006 audit, we noted no matters involving the internal control and its operation related to Required Supplementary Stewardship Information that we considered to be material weaknesses as defined above.

Further, in our fiscal year 2006 audit, we noted no matters involving the design and operation of the internal control over the existence and completeness assertions related to key performance measures that we considered to be material weaknesses as defined above.

COMPLIANCE AND OTHER MATTERS

The results of our tests of compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters disclosed the following instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 06-03.

- *Federal Financial Management Improvement Act of 1996* (FFMIA)
- *Anti-Deficiency Act*

The results of our tests of FFMIA disclosed instances, described in Exhibit III, where the FAA's financial management systems did not substantially comply with Federal financial management information systems requirements, and applicable Federal accounting standards. The results of our tests of FFMIA disclosed no instances in which the FAA's financial management systems did not substantially comply with use of the U.S. Government Standard General Ledger at the transaction level.

* * * * *

RESPONSIBILITIES

Management's Responsibilities. The United States Code Title 31 Section 3515 and 9106 require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, the FAA prepares and submits financial statements in accordance with OMB Circular No. A-136.

Management is responsible for the consolidated financial statements, including:

- Preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles;

- Preparing the Management's Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information;

- Establishing and maintaining effective internal control; and

- Complying with laws, regulations, contracts, grant agreements, and other matters, applicable to the FAA, 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.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2006 and 2005 consolidated 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, issued by the Comptroller General of the United States; and OMB Bulletin No. 06-03. Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements;

- Assessing the accounting principles used and significant estimates made by management; and

- Evaluating the overall consolidated financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2006 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 consolidated 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. 06-03. 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 an opinion on the FAA's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 06-03, in our fiscal year 2006 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. We limited our testing to those controls necessary to test and report on the internal control over Required Supplementary Stewardship Information in accordance with OMB Bulletin No. 06-03. However, our procedures were not designed to provide an opinion 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. 06-03, in our fiscal year 2006 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 internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We limited our testing to those controls necessary to test and report on the internal control over key performance measures in accordance with OMB Bulletin No. 06-03. However, our procedures were not designed to provide an opinion 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 2006 consolidated financial statements are free of material misstatement, we performed tests of the FAA's compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 06-03, 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, grant agreements, and other matters applicable to the FAA. However, providing an opinion on compliance with laws, regulations, contracts, grant agreements, and other matters was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 06-03 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.

RESTRICTED USE

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 U.S. 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 3, 2006

MATERIAL WEAKNESS

A. Timely Processing of Transactions and Accounting for the Construction in Progress (CIP) Account

Background: The FAA is a significant component of the Department of Transportation (DOT) of the U.S. Government, with primary responsibility for the safety of civil aviation.

To fulfill its mission, among other important roles, the FAA undertakes significant radar, navigational, communications, and other technology projects to maintain the national aviation infrastructure. The FAA manages an on-going portfolio of projects totaling approximately $4.7 billion. CIP consists of thousands of projects, which range in size from a few thousand dollars to hundreds of millions of dollars. CIP balances include both direct and internal indirect costs. Most of the projects involve highly advanced and sophisticated technologies, such as radars, runway guidance systems, in-flight monitors, aviation safety, and security systems, which take several years to develop from concept to deployment. In some cases, projects begin as research and development (R&D), and once determined to be technologically feasible, costs are prospectively recorded to CIP. Most of the CIP is deployed in multiple units and locations, causing FAA to allocate accumulated CIP to in-use assets as each asset is deployed to multiple units or locations. The allocation of cost to a single deployed asset can involve complex calculations of incurred and projected costs. Alternatively, the rapid advancement of technology and the changing direction of the FAA's programs sometimes cause the FAA to abandon once viable projects resulting in an expense of capitalized amounts before deployment.

In our fiscal year 2005 audit report, we reported a material weakness on the lack of *timely processing of transactions* and *reconciliation of accounts*. The account most affected was the CIP element of the financial statement line item, *Property, Plant, and Equipment, net* (PP&E). We reported that FAA did not have effective procedures to capitalize headquarters-based projects in a timely manner. To correct the problem for year-end financial reporting in fiscal year 2005, the FAA committed substantial resources to capitalize approximately $1.1 billion during the last month of the fiscal year, and an additional $180 million during the first two weeks after fiscal year-end. In general, the FAA had not established policies, procedures, and internal controls to ensure that property and equipment is consistently and accurately capitalized within 30 days after the date placed in service in the operating location. Management concurred with KPMG's assessment of the control weakness in fiscal year 2005.

During fiscal year 2006, the FAA implemented a corrective action plan to resolve the elements of the material weakness in control that existed in fiscal year 2005. The FAA's Chief Financial Officer worked jointly with the Air Traffic Organization (ATO) on a comprehensive review of old CIP balances totaling $1.7 billion of the $4.5 billion balance as of September 30, 2005. The focus of management's review was to evaluate the status of the assets in CIP and to properly classify those assets as either commissioned to in-use, remaining in CIP, or recorded to expense.

Throughout the year, the FAA conducted a review and recorded significant adjustments to CIP and the related PP&E and expense. However, management did not obtain sufficient evidence to fully justify its conclusions, and our audit procedures resulted in management making a material change to their adjustment. Inquiries into the composition of remaining CIP balances, not included in management's original population for review, identified the potential for additional material error, which management could not fully investigate before the due date of the FAA's fiscal year 2006 *Performance and Accountability Report*. Consequently, management was unable to represent that the CIP balance as of September 30, 2006 is fairly stated, and that the effect of any adjustments, if necessary, to the FAA's net cost and net position are properly recorded. We are unable to complete our audit until management fully completes their review of CIP.

Independent Auditors' Report
Material Weakness in Internal Control

EXHIBIT I

Conditions: Based on our review of the FAA's policies and procedures, as well as our evaluation of the operating effectiveness of controls over property accounting, we noted a material weakness in internal controls over the accounting for CIP. The process of ensuring accurate and timely reporting of CIP originates with a comprehensive set of policies and procedures, is followed by timely and accurate recording the CIP activity in the accounting system, documenting the factors considered when recording the transactions, and monitoring the operating effectiveness of the underlying controls. In this sequence of the process, we noted that the FAA:

- Needs to strengthen accounting policies and procedures to provide comprehensive guidance to program managers, engineers, and accountants, and provide clear instruction and guidance on accounting for certain CIP activities or condition. For example, we noted that policies and procedures did not clearly describe how to:
  - Determine when R&D expenses should be capitalized;
  - Treat bulk purchases;
  - Allocate costs to multiple unit deployments;
  - Capitalize costs of a long-term project in which deployment will occur over a number of years;
  - Account for agency prototypes;
  - Address recognition of operational feasibility; and
  - Expense costs of delayed or postponed projects.
- Does not have front-end and in-process controls that ensure that all CIP projects are accurately and completely accounted for in a timely manner. For example, the FAA:
  - Has not established adequate processes, policies, procedures, and internal controls to ensure that, per the FAA's policy, CIP is consistently and accurately capitalized to PP&E within 30 days after the date the assets are placed in service in the operating location. During the fiscal year 2006 audit, we noted that for 267 of the 277 (96%) items tested, the assets were not capitalized within 30 days after being placed in service.
  - Does not have adequate policies and procedures to identify errors and make timely corrections to the underlying accounting records. We noted instances in which errors were cited on project activity reports (known as Application Desktop Integrator, or ADI, spreadsheets), but were not investigated and resolved in a timely manner. These errors included erroneous in-service dates, lack of standardized data elements, insufficient separation of costs by asset, and erroneous number of assets to be deployed. Significant errors in the ADI spreadsheets went unresolved, were not reported to senior management, and did not appear to be in process of resolution until reported by us during our audit.
  - Does not have routine and effective processes to identify and correct projects that are improperly set up, either as "expense" or "capital" activities. As such, the FAA had several instances of undetected CIP projects that should have been expensed from the inception of the project. For example, we noted one project, with a CIP balance of $101 million, which should have been recorded to expense from the on-set of the project.
- Does not have a process to ensure that documentation is adequate, supports management's decisions and Delphi transactions, and is properly maintained for management and auditor review. For example, we noted that:
  - Documentation was not readily available and could not be located without several days spent locating supporting evidence.

- Documentation provided to us showed clear inconsistencies with the classification of the assets in the accounting system. We noted a 50% error rate when comparing support provided by management to the existing classification of assets in the general ledger.
- Documentation that was key to the decision process was not always available. In numerous instances, Joint Acceptance Inspections (JAIs) or Contractor Acceptance Inspections (CAIs) were not available to support the dates recognized by the FAA in the property accounting records. The JAI/CAI forms represent the point in time an asset transfers from CIP to in-use, and create the foundation of the proper accounting treatment for these assets.
- Decisions regarding asset classification were made by the FAA without adequate supporting documentation. Over $200 million related to eight projects was expensed from CIP in fiscal year 2006, but was subsequently reversed by the FAA when documentation was provided to us that contradicted the initial entry recorded by the FAA.

- Does not have adequate monitoring and supervision or IT system functionality controls to ensure that the CIP balance, as stated in the general ledger, is routinely reconciled to subsidiary listings and supporting detail. In addition, we noted that clear lines of authority and communication do not exist between accounting affiliates of ATO, the Office of Financial Management (AFM), and Regions and Center Operations (ARC), which has led directly to inaccurate or untimely accounting for CIP activity. We noted that:
  - The FAA's accounting system, Delphi, relies on modules that may contain timing differences. As of September 30, 2006, we noted differences of $117 million between the FAA's subsidiary and general ledgers for its CIP account.
  - The FAA's management does not have processes or resources in place to be able to routinely identify and reconcile differences in an effective fashion throughout the year.
  - There is not adequate attention by senior management of ATO, AFM, and ARC when documentation and supporting information cannot be readily located or provided.

Cause: The FAA lacks adequate policies, procedures, and controls to monitor its CIP activity and balances in a routine and timely fashion. The FAA's policies and procedures do not provide sufficient guidance to the FAA's accountants and program managers to accurately and consistently record CIP activity, such as detailed guidance on R&D costs, the timing and recognition of capitalized activity, and the organizational responsibility for managing the accounting of CIP activity. Further, programmatic and operating personnel do not adhere to policies and procedures to enable the timely recording of PP&E placed in service. Historically, communication has been weak between the FAA's accounting offices and project managers, and effective processes and monitoring controls are lacking over large-scale headquarters' managed PP&E projects. Finally, the FAA's senior management personnel have not placed sufficient resources and priority on the monitoring of CIP activity.

Effect: The FAA was unable to complete its review of CIP in fiscal year 2006, and make all of the adjustments necessary to properly state its CIP balance as of September 30, 2006, prior to the completion of the FAA's *Fiscal Year 2006 Performance and Accountability Report*. Management was unable to obtain and provide us with sufficient evidence to support the accuracy and completeness of CIP or related transactions that may have occurred during the year affecting net cost or net position. The FAA was unable to represent that the CIP account balance totaling $4.7 billion, reported as a component of PP&E on the accompanying consolidated balance sheet, is fairly stated as of September 30, 2006. Consequently, the CIP balances may be misstated as of

September 30, 2006, and we are unable to complete our audit of CIP balances and related fiscal year 2006 transactions that could affect the FAA's net cost and net position.

Criteria: Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, requires that:

- Constructed PP&E be recorded as CIP 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;
- PP&E be recorded at historical cost with an adjustment recorded for depreciation. In the absence of such information, estimates may be used based on a comparison of similar assets with known values or inflation-adjusted current costs; and
- PP&E accounts be adjusted for disposals, retirements and removal of PP&E, including associated depreciation.

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, states that transactions should be promptly recorded, properly classified and accounted for in order to prepare timely and reliable financial and other reports. Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

GAO's *Standards for Internal Control in the Federal Government* (GAO's *Standards*) states that internal controls should generally be designed to assure that on-going monitoring occurs in the course of normal operations. Management is responsible for developing control activities, which are the policies, procedures, techniques, and mechanisms that enforce management's directives and help ensure actions address risks. The activities include reviews by management at the functional or activity level, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control.

Section 803(a) of the *Federal Financial Management Improvement Act (FFMIA) of 1996* requires that each Agency to implement and maintain a system that complies substantially with Federal financial management system requirements as stipulated in OMB Circular A-127, *Financial Management Systems.* This Circular requires an Agency's system design to have certain characteristics, including consistent internal controls over data entry, transaction processing, and reporting throughout the system to ensure the validity of the information.

Recommendations: We recommend that the FAA:

1. Conduct a comprehensive evaluation of the CIP balance, and make appropriate adjustments if necessary.
2. Review business processes to determine whether changes are needed in the organizational responsibility and oversight of property capitalization efforts.
3. Evaluate whether additional resources are necessary to ensure proper, accurate, and timely capitalization of CIP projects.
4. Improve policies and procedures to ensure that adequate guidance is provided to all personnel affecting the accounting process of CIP. Improved policies and procedures should be adopted in the regions and headquarters to ensure capitalized assets are complete, accurate, and properly valued during close-out of completed projects, and that asset deployments are recorded properly and in a timely manner.

5. Develop and provide a training program once new policies and procedures are implemented to explain procedural enhancements and the importance of accurate and timely capitalization of CIP projects.
6. Implement appropriate internal controls to ensure that all assets are capitalized within the timeframe established by the FAA's policy, errors are identified and corrected in a timely manner, and to ensure that CIP projects are properly monitored and adjustments made to the accounts when appropriate.
7. Ensure that supporting documentation for capitalization of fixed assets be properly managed and maintained. Further, documentation should be readily available for examination upon request.
8. Implement policies and procedures to ensure that CIP accounts include all allocable costs, such as direct and indirect labor.
9. Implement quality control procedures, and oversight and supervision controls to ensure that policies and procedures are followed.
10. Consider making IT system functionality improvements to help prevent errors, and improve the reliability of CIP balances throughout the year.

FAA's Response: The FAA has reviewed the material weakness related to CIP and agrees with KPMG's recommendations. The FAA recognizes the importance of maintaining sufficient documentation to support CIP transactions and balances and of establishing and maintaining adequate controls over related policies and procedures. We agree to implement KPMG's recommendations in fiscal year 2007. In addition, we have already drafted a comprehensive corrective action plan and, when finalized, will implement that plan.

Independent Auditors' Report
Reportable Conditions in Internal Control

EXHIBIT II

REPORTABLE CONDITIONS

B. 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 the 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 most 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.

Conditions: We noted the following internal control weaknesses in the grants management process during fiscal year 2006. 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, which is directly related to inadequate and overly discretionary policies and procedures for grant monitoring. For example, we noted at one district office that the FAA project manager did not regularly attend biweekly or 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 No. 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 relying on front-end preventative and early detective controls found in more effective grant administration and monitoring processes.

We noted that the FAA has developed a policy that is designed to monitor grants, and seeks to resolve the conditions cited above. However, this approach was not implemented during fiscal year 2006, and will be implemented by the FAA beginning on October 1, 2006.

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 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, which sometimes spans several years until the grant is closed by the FAA's 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: GAO's *Standards* lists 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 the FAA:

1. Implement an effective, risk-based approach to oversee and monitor AIP grant sponsor activities. Further, for each sponsor, we recommend establishing oversight and monitoring procedures that are based the sponsor's potential risks, and determining the level of reliance placed upon that sponsor. For example, the FAA could assign a risk rating of low, medium, or high to each sponsor.
2. Implement 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 sponsor's 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. Implement policies and procedures describing the roles and responsibilities of regional grant project managers for grant monitoring, including, if necessary, specific training programs.
4. 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: The FAA reviewed the reportable condition related to monitoring of grants and agrees with KPMG's recommendations. We have already developed and accepted a risk-based approach, and implemented that approach on October 1, 2006.

C. 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 DOT, including Delphi, need to be improved. The elements of the FAA's information technology (IT) and financial management systems environment that were evaluated in this fiscal year's audit include:

- Delphi, the DOT core accounting system used by the FAA;
- PRISM, the FAA's procurement system;
- Electronic Clearing House Operations system (ECHO);
- System of Accounting and Reporting (SOAR), one of the FAA's grants management systems;
- Cost Accounting System (CAS);
- CASTLE, one of the FAA's timekeeping systems; and
- Capital Budget Management System (CBMS).

Independent Auditors' Report
Reportable Conditions in Internal Control

EXHIBIT II

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

- Weaknesses in the CASTLE and ECHO applications were not fully identified or mitigated.
- Instances where the FAA did not have sufficient controls in place to monitor or prevent changes made to the CAS, CASTLE, ECHO, and SOAR applications. In addition, priority changes proposed to the Delphi application were not made to the system in a timely fashion.
- Instances in which the CAS, CASTLE, ECHO, PRISM, and SOAR applications, and the related workstations, were not configured in the most secure manner available, resulting in potential vulnerabilities to improper access, use, loss, or modification.
- Instances of poor user administration within the CAS, CASTLE, ECHO, PRISM, and SOAR applications.
- Potentially high-risk combinations of functions where individuals may be able to exceed or abuse their assigned authorities within the ECHO application.
- Inconsistent or inadequate procedures to ensure the timely removal of user access upon separation or termination of the FAA's contractors and employees.
- Poor physical controls related to the CAS, ECHO, and SOAR applications.
- Contingency plans that have not been documented, tested, or appropriately communicated to necessary employees related to the CAS, ECHO, PRISM, and SOAR applications.
- Inadequate documentation to support user training on CAS policies and procedures ("rules of behavior").
- No mechanism to require training on technology security awareness for all of the FAA's employees and contractors.

Cause: The FAA's Chief Information Officer (CIO) organization does not hold sole oversight authority over the FAA's IT infrastructure. In addition, the necessary policies and procedures to detect and correct control and functionality weaknesses have not been documented, implemented, or enforced. Finally, there is a lack of resources dedicated to perform the required security and maintenance responsibilities of smaller information technology systems, such as CAS and SOAR.

Effect: The FAA implemented sufficient manual processes and compensating controls for weaknesses in network information security management and application security controls. Manual processes increase the burden on accounting personnel, and contribute to delays in the timely preparation of accurate and complete financial statements during the year and at year-end.

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 No. 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. Ensure weaknesses in the CASTLE and ECHO applications are fully identified and mitigated.
2. Improve change management controls in the CAS, CASTLE, Delphi, ECHO, and SOAR applications.
3. Correct vulnerabilities in the CAS, CASTLE, ECHO, PRISM, and SOAR applications, and the related workstations.
4. Improve controls over user account administration in the CAS, CASTLE, ECHO, PRISM, and SOAR applications.
5. Review potentially high-risk combinations identified to ensure that appropriate segregation of duties exists in the ECHO system. When segregation of duties shortfalls exist, compensating controls should formally be defined and established to mitigate the associated risk.
6. Develop and implement procedures to ensure the timely removal of user access upon separation or termination of the FAA's contractors and employees.
7. Improve controls over the physical access of CAS, ECHO, and SOAR applications.
8. Implement procedures to ensure that documentation of user training on CAS policies and procedures are readily available for review and inspection.
9. Develop mechanisms to require certification of completion of technology security awareness training for all of the FAA's employees and contractors.

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: The FAA has reviewed the reportable condition related to information technology controls over the FAA's and third-party systems applications and agrees with KPMG's recommendations. The FAA, through the Chief Information Officer, is committed to maintaining system security and thus will implement KPMG's recommendations in fiscal year 2007. We will work with third parties that operate systems for the 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.

D. Management Oversight and Reporting of Inventory

Background: The FAA maintains certain inventory to support the operation of radars, communication equipment, and other electronic devices that a part of the National Airspace System (NAS).

Independent Auditors' Report
Reportable Conditions in Internal Control

EXHIBIT II

Conditions: We noted a lack of clear organizational responsibility and routine monitoring and reporting of the inventory accounts of the FAA. Specifically, we noted:

- Some inventory accounts were not classified in accordance with Federal accounting standards.
- Some inventory accounts were included in both the inventory accounts and a property general ledger account, and therefore were double-counted in the FAA's accounting system.
- Some inventory allowances were not associated with the proper inventory account.
- Counts of some inventory locations had not been completed to support the accuracy, valuation, or classification of the inventory items.

Cause: The FAA has not clearly defined organizational responsibility for management and reporting of the FAA's inventory accounts. Further, the FAA has not implemented controls, such as periodic reviews or item counts, to ensure the accuracy of inventory accounts in terms of quantity, valuation, and classification.

Effect: We noted that $218 million of "held for use" inventory and inventory allowance accounts should have been classified as "raw material" inventory. Further, the FAA's inventory accounts were overstated by $18 million.

Criteria: SFFAS No. 3, *Accounting for Inventory and Related Property,* states "inventory shall be categorized as (1) inventory held for sale, (2) inventory held in reserve for future sale, (3) excess, obsolete and unserviceable inventory, or (4) inventory held for repair." SFFAS 3 further states "operating materials and supplies consist of tangible personal property to be consumed in normal operations and excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory."

GAO's *Standards* states that controls should be designed to assure that ongoing monitoring occurs in the course of normal operations. Further, internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. In addition, all documentation and records should be properly managed and maintained

Recommendations: We recommend that the FAA:

1. Assign ownership responsibility to the appropriate organization and entity;
2. Ensure proper controls are implemented for these inventory accounts; and
3. Properly classify and report the FAA's inventory amounts.

FAA's Response: The FAA has reviewed the reportable condition related to management oversight and reporting of inventory and agrees with KPMG's recommendations. In fiscal year 2007, the FAA will assign ownership responsibility and ensure that proper controls are implemented over its inventory accounts.

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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:

- Management was unable to provide representation that the CIP balance and activity was fairly stated, in all material respects and in accordable with applicable accounting standards, as of and for the year ended, September 30, 2006.
- Five of the key financial systems used by the FAA (ECHO, PRISM, CAS, CASTLE, and SOAR), 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	CASTLE	SOAR
Does not Adhere to Established Functional Requirements	X				
Does not Adhere to Computer Security Act Requirements	X	X	X	X	X
Lacks Adequate Systems and Processing Documentation	X				
Lacks Adequate Internal Controls	X	X	X	X	X
Lacks Effective Training and User Support	X	X	X	X	X
Lacks Adequate Maintenance Support	X		X	X	X

Effect: The conditions cited here could adversely affect the financial results and financial operations of the FAA in the areas of grants (due to ECHO and SOAR matters), procurement (due to PRISM matters), and internal management reporting (due to the CAS and CASTLE matters). Further, management's inability to represent to the accuracy of the CIP balance indicates that CIP balances as of, and for the fiscal year ended, September 30, 2006 may be misstated.

Recommendations: We recommend that the FAA address and resolve the weaknesses noted above, and fully comply with FFMIA in fiscal year 2007.

FAA's Response: The FAA has reviewed KPMG's analysis of FAA's compliance with FFMIA and agrees with KPMG's recommendations. The FAA recognizes the importance of complying with Federal financial management systems requirements, adequate internal controls, effective training and user support and maintenance support. The FAA will implement KPMG's recommendations in fiscal year 2007 related to the FAA's systems and will work with third

parties that operate systems for the FAA to ensure that the third parties comply with KPMG's recommendations.

F. *Anti-Deficiency Act*

Background/Criteria: In our fiscal year 2005 report, we noted that the FAA had obligated $1.9 million more than had been appropriated to the Small Community Air Development Service Program. 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. The FAA determined that the violations occurred due to a lack of training of program officials within the DOT's Office of the Secretary, which manages the program. Specifically, obligations were established in fiscal year 2004 that exceed the apportioned amounts.

The FAA reported the violations to the DOT, but has not yet completed the reporting requirements as specified in the *Anti-Deficiency Act* and applicable regulations.

Effect: The FAA and DOT is not in compliance with the *Anti-Deficiency Act*.

Recommendations: In fiscal year 2007, we recommend that the FAA and DOT complete the notifications required by the *Anti-Deficiency Act* and applicable regulations.

FAA's Response: The FAA has reviewed and agrees with KPMG's recommendation regarding *Anti-Deficiency Act* notification. The FAA is working with the Office of the Secretary of the Department of Transportation to complete the necessary notification to the President and Congress.

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

Prior Year Condition	As Reported At September 30, 2005	Status As Of September 30, 2006
Timely Processing of Transactions and Reconciliation of Accounts	**Material weakness:** There were certain internal control weaknesses related to the timeliness of transaction processing and reconciliation of significant financial statement accounts during the year.	**Continue as a material weakness:** Although the FAA was successful in closing out five of the six elements of the condition, weaknesses still remaining in the timely recording of property, plant, and equipment transactions.
Management and Oversight of Contracts	**Reportable condition:** 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).	**No longer a reportable condition:** The FAA implemented sufficient controls to correct this matter.
Monitoring of Grants	**Reportable condition:** The FAA has weaknesses in the oversight and monitoring of grantees.	**Continue as a reportable condition:** Although policies were developed to correct this matter, these policies were not implemented during fiscal year 2006.
Information technology controls over FAA and third-party systems and applications	**Reportable condition:** Certain general controls related to the FAA's primary financial applications owned by the FAA and the DOT need to be strengthened.	**Continue as a reportable condition:** Although improvements were made, weaknesses still remain in controls over FAA and third-party systems and applications.
Non-compliance with the *Federal Financial Management Improvement Act*	**Instance of non-compliance:** The FAA's financial systems did not substantially comply with Federal financial management information systems requirements, and did not use the U.S. Government Standard General Ledger at the transaction level.	**Continue reporting as an instance of non-compliance:** Although the FAA was able to resolve the matters involving use of the U.S. Government Standard General Ledger at the transaction level, we noted that instances still exist in which FAA's systems do not substantially comply with Federal financial management systems requirements, and applicable Federal accounting standards.

Independent Auditors' Report
Status of Prior Year Findings

EXHIBIT IV

Prior Year Condition	As Reported At September 30, 2005	Status As Of September 30, 2006
Non-compliance with the *Department of Transportation and Related Agencies Appropriations Act, 1997*	**Instance of non-compliance:** The FAA's Franchise Fund routinely performed work for its customers without being paid in advances for these services, as required by the *Department of Transportation and Related Agencies Appropriations Act, 1997.*	**No longer considered an instance of non-compliance:** The FAA implemented sufficient controls to be considered in substantial compliance with this law.
Non-compliance with the *Anti-Deficiency Act*	**Instance of non-compliance:** The FAA committed a violation of the *Anti-Deficiency Act* related to transactions associated with the Small Community Air Service Development Program.	**Continue as an instance of non-compliance:** The FAA has not yet provided documentation to satisfy the reporting requirements of known violations under the *Anti-Deficiency Act.*

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

Assets	2006	2005
Intragovernmental		
Fund balance with Treasury (Notes 2 & 12)	$ 3,494,227	$ 2,413,102
Investments (Notes 3 & 12)	8,674,729	10,665,560
Accounts receivable, prepayments, and other (Notes 4 & 12)	172,207	304,437
Total intragovernmental	12,341,163	13,383,099
Accounts receivable, prepayments, and other, net (Note 4)	122,220	183,493
Inventory, operating materials, and supplies, net (Note 5)	628,110	626,086
Property, plant, and equipment, net (Notes 6 & 9)	14,632,035	14,432,466
Total assets	$ 27,723,528	$ 28,625,144
Liabilities		
Intragovernmental liabilities		
Accounts payable	$ 49,911	$ 106,693
Employee related and other (Notes 8 and 10)	293,556	294,566
Total intragovernmental liabilities	343,467	401,259
Accounts payable	773,117	564,575
Environmental (Note 7)	573,264	596,536
Employee related and other (Notes 8, 9 & 16)	965,806	1,163,022
Federal employee benefits (Note 10)	888,082	942,276
Total liabilities	3,543,736	3,667,668
Commitments and contingencies (Notes 9 & 16)		
Net position		
Unexpended appropriations	-	1,268,894
Unexpended appropriations- earmarked funds (Note 12)	426,474	-
Unexpended appropriations- other funds	2,877	-
Cumulative results of operations	-	23,688,582
Cumulative results of operations- earmarked funds (Note 12)	12,775,897	-
Cumulative results of operations- other funds	10,974,544	-
Total net position	24,179,792	24,957,476
Total liabilities and net position	$ 27,723,528	$ 28,625,144

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)	2006	2005
Air Traffic Organization		
Expenses	$ 9,815,642	$ 9,354,459
Less earned revenues	(200,409)	(423,041)
Net costs	9,615,233	8,931,418
Aviation Safety		
Expenses	948,495	1,079,171
Less earned revenues	(5,253)	(4,053)
Net costs	943,242	1,075,118
Airports		
Expenses	3,852,141	3,712,423
Less earned revenues	(239)	(496)
Net costs	3,851,902	3,711,927
Commercial Space Transportation		
Expenses	15,249	14,073
Net costs	15,249	14,073
Non line of business programs		
Regions and center operations and other programs		
Expenses	617,589	696,029
Less earned revenues	(590,004)	(399,469)
Net costs	27,585	296,560
Net cost of operations		
Total expenses	15,249,116	14,856,155
Less earned revenues	(795,905)	(827,059)
Total net cost	**$ 14,453,211**	**$ 14,029,096**

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)

	2006 **Earmarked** Cumulative results of operations	2006 **Other funds** Cumulative results of operations	2006 **Totals** Cumulative results of operations	2005 **Totals** Cumulative results of operations
Beginning balances	$ 12,366,274	$ 11,322,308	$ 23,688,582	$ 24,086,935
Budgetary financing sources				
Appropriations used	3,446,225	-	3,446,225	2,559,750
Non-exchange revenue - excise taxes (Note 12)	10,701,709	-	10,701,709	10,700,024
Transfers-in/out without reimbursement	(107,212)	-	(107,212)	(106,549)
Other	-	-	-	(8,079)
Other financing sources				
Transfers-in/out without reimbursement	(1,032,131)	1,011,625	(20,506)	-
Imputed financing from costs absorbed by others (Note 13)	431,280	63,574	494,854	485,597
Total financing sources	13,439,871	1,075,199	14,515,070	13,630,743
Net cost of operations	13,030,248	1,422,963	14,453,211	14,029,096
Net change	409,623	(347,764)	61,859	(398,353)
Ending balances	$ 12,775,897	$ 10,974,544	$ 23,750,441	$ 23,688,582

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)

	2006 **Earmarked** Unexpended appropriations	2006 **Other funds** Unexpended appropriations	2006 **Totals** Unexpended appropriations	2005 **Totals** Unexpended appropriations
Beginning balances	$ 1,266,017	$ 2,877	$ 1,268,894	$ 999,146
Budgetary financing sources				
Appropriations received (Note 14)	2,645,000	-	2,645,000	2,856,927
Appropriations transferred-in/out	19,000	-	19,000	564
Rescissions, cancellations and other	(57,318)	-	(57,318)	(27,993)
Appropriations used	(3,446,225)	-	(3,446,225)	(2,559,750)
Total financing sources	(839,543)	-	(839,543)	269,748
Ending balances	$ 426,474	$ 2,877	$ 429,351	$ 1,268,894

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)	**2006**	**2005**
Budget authority	$ 18,459,775	$ 17,176,957
Unobligated balance brought forward, transfers and other	2,358,825	1,830,252
Spending authority from offsetting collections	1,222,097	1,034,126
Recoveries of prior year obligations	371,319	486,921
Nonexpenditure transfers, net	(22,216)	-
Temporarily not available pursuant to public law	(82,190)	(60,712)
Permanently not available	(4,521,512)	(3,125,905)
Total budgetary resources	$ 17,786,098	$ 17,341,639
Status of budgetary resources		
Obligations incurred	$ 15,480,876	$ 14,982,814
Unobligated balance available	1,209,311	1,067,338
Unobligated balance not available	1,095,911	1,291,487
Total status of budgetary resources	$ 17,786,098	$ 17,341,639
Change in obligated balance		
Obligated balance, net, beginning of period	$ 8,795,904	$ 9,173,060
Obligations incurred	15,480,876	14,982,814
Gross outlays	(15,420,860)	(19,483,934)
Recoveries of prior years unpaid obligations, actual	(371,319)	(486,921)
Change in uncollected customer payments from Federal sources	9,909	4,610,885
Obligated balance, net, end of period	$ 8,494,510	$ 8,795,904
Unpaid obligations	$ 9,151,262	$ 9,462,565
Uncollected customer payments from Federal sources	(656,752)	(666,661)
Obligated balance, net, end of period	$ 8,494,510	$ 8,795,904
Outlays		
Disbursements	$ 15,420,860	$ 19,483,934
Collections, net of offsetting receipts	(1,232,005)	(5,645,011)
Net outlays	$ 14,188,855	$ 13,838,923

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)

Resources used to finance activities	2006	2005
Budgetary resources obligated		
Obligations incurred	$ 15,480,876	$ 14,982,814
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	1,593,416	1,521,063
Obligations, net of offsetting collections	13,887,460	13,461,751
Other resources		
Transfers in/(out) without reimbursement	(20,506)	-
Imputed financing from costs absorbed by others	494,854	485,597
Net other resources used to finance activities	474,348	485,597
Total resources used to finance activities	14,361,808	13,947,348
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	(675,564)	(160,018)
Resources that fund expenses recognized in prior periods (decreases in unfunded liabilities) (Note 15)	325,646	46,833
Resources that finance the acquisition of assets	1,430,354	1,485,838
Other resources or adjustments to net obligated resources that do not affect net cost of operations	(8,163)	11,523
Total resources used to finance items not part of net cost of operations	1,072,273	1,384,176
Total resources used to finance net cost of operations	**13,289,535**	**12,563,172**
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)	20,362	207,229
Increase in exchange revenue receivable from the public	-	-
Other	2,314	-
Components not requiring or generating resources in future periods		
Depreciation and amortization	1,083,836	1,190,277
Cost of goods sold	55,149	68,418
Other	2,015	-
Total components of net cost of operations that will not require or generate resources	1,141,000	1,258,695
Total components of net cost of operations that will not require or generate resources in the current period	**1,163,676**	**1,465,924**
Net cost of operations	**$ 14,453,211**	**$ 14,029,096**

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 the Federal Aviation Administration (FAA). The statements are a requirement of the Chief Financial Officers Act of 1990, and the Government Management Reform Act of 1994. 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) Office of Management and Budget (OMB) Circular Number A-136, *Financial Reporting Requirements*, and (3) Department of Transportation (DOT) and FAA accounting policies which are summarized in this note. These statements, with the exception of the Statement of Budgetary Resources, are different from financial management reports, which are also prepared pursuant to OMB directives that are used to monitor and control FAA's use of budgetary resources. The statements are subjected to audit, as required by OMB Bulletin Number 06-03, *Audit Requirements for Federal Financial Statements*.

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. The FAA reporting entity is comprised of the following major funds:

- Airport and Airway Trust Fund (AATF). The AATF is funded by excise taxes that the Internal Revenue Service (IRS) collects from airway system users. These receipts are unavailable until appropriated by the U.S. Congress. Once appropriated for use, FAA transfers AATF receipts necessary to meet cash disbursement needs to several other funds, from which expenditures are made. The AATF fully finances the following additional FAA funds:
  - Grants-in-Aid to Airports - AATF. As authorized, grants are awarded with Grants-in-Aid to Airports funding, 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, and are administered through the Airport Improvement Program.

- Facilities and Equipment - AATF. The Facilities and Equipment funds are FAA's principal means of modernizing and improving air traffic control and airway facilities. These funds also finance major capital improvements required by other FAA programs as well as other improvements to enhance the safety and capacity of the national airspace system.
- Research, Engineering and Development - AATF. Research, Engineering, and Development funds finance long-term research programs to improve the air traffic control system.

- Operations General Fund and Operations - AATF. Operations finances operating costs, maintenance, communications, and logistical support for the air traffic control and air navigation systems. It also finances the salaries and costs associated with carrying out FAA's safety and inspection and regulatory responsibilities. Operations - AATF is financed through transfers from the Airport and Airway Trust Fund. For administrative ease in obligating and expending for operational activities, those funds are then in turn transferred to the Operations General Fund, which is supplemented by appropriations from the U.S. Treasury. Expenditures for operational activities, whether originally funded by the AATF or the General Fund of the U.S. Treasury, are generally made from the Operations General Fund.
- Aviation Insurance Revolving Fund. 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. The Aviation Insurance Revolving Fund provides products that address the insurance needs of the U.S. domestic airline industry not adequately met by the commercial insurance market. The FAA is currently providing war risk hull loss and passenger, crew, and third-party liability insurance as required by the Homeland Security Act of 2002 as amended by the Consolidated Appropriations Act, 2005, and subsequently, the Transportation Appropriations Act of 2006 through December 31, 2006.
- Administrative Services Franchise Fund (Franchise Fund). The Franchise Fund is a revolving fund designed to create competition within the public sector in the performance of a wide variety of support services.
- Other Funds. The consolidated financial statements include other funds such as (a) Aviation Overflight User Fees, which is a special fund in which receipts are earmarked by law for a specific purpose; (b) Facilities, Engineering & Development General Fund, and (c) General Fund Miscellaneous Receipts 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 2006 and 2005, FAA was accountable for amounts made available 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 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 16), 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, 2006 financial statements reflect excise taxes certified by IRS through March 31, 2006, and excise taxes estimated by OTA for the period April 1 to September 30, 2006 as specified by SFFAS Number 7, *Accounting for Revenue and Other Financing Sources.* Actual tax collections data for the quarters ended June 30, 2006 and September 30, 2006 will not be available from the IRS until December 2006 and March 2007, 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, 2006 and September 30, 2006 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 Aviation Insurance 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 cost method or on the basis of actual prices paid. Operating materials and supplies are expensed 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 thousand and the useful life equals or exceeds two years. FAA records PP&E at original acquisition cost. The FAA purchases some capital assets in large quantities, which are known as "bulk purchases." If the cost per unit is below the capitalization threshold of the FAA, then these items are expensed.

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, en route 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 DOT from the General Services Administration. Payments made by the FAA are based on the fair market value for similar rental properties.

The FAA conducts a significant amount of research and development into new technologies to support the NAS. Until such time as the research and development project reaches "technological feasibility," the costs associated with the project are expensed in the year incurred.

M. 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 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, including the AATF. 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 an employee's 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 during the year. 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, (see note 16), 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. Earmarked Funds Reporting

FAA adopted Statement of Federal Financial Accounting Standards (SFFAS) Number 27, *Identifying and Reporting Earmarked Funds*, effective October 1, 2005. SFFAS Number 27 defines "earmarked funds" as those being financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues. FAA's financial statements include the following funds, considered to be "earmarked."

- Airport and Airway Trust Fund (AATF)
- Operations - AATF
- Operations General Fund
- Grants-in-Aid for Airports - AATF

- Facilities and Equipment - AATF
- Research, Engineering, and Development - AATF
- Aviation Insurance Fund
- Aviation User Fees

The AATF is funded by excise taxes that the IRS collects from airway system users. These receipts are unavailable until appropriated by the U.S. Congress. Once appropriated for use, FAA transfers AATF receipts necessary to meet cash disbursement needs to several other funds, from which expenditures are made. Those funds that receive transfers from the AATF are the Operations Trust Fund, Grants-in-Aid for Airports, Facilities and Equipment, and Research, Engineering and Development, all of which are funded exclusively by the AATF. In addition, the Operations General Fund is primarily funded through transfers from Operations - AATF, but is also supplemented by funding from the General Fund of the U.S. Treasury through annual appropriations. Because the Operations General Fund is primarily funded from the AATF, and because it is not reasonably possible to differentiate cash balances between those originally flowing from the AATF versus General Fund appropriations, the Operations General Fund is presented as an earmarked fund.

SFFAS Number 27 establishes the requirement to report earmarked and nonearmarked fund separately on the Consolidated Statement of Changes of Net Position and in cumulative results of operations on the Balance Sheet. Additional disclosures concerning earmarked funds can be found in Notes 1.B. and 12.

X. Adoption of Accounting Principle

As disclosed in Notes 1.W. and 12, effective October 1, 2005, the FAA adopted the provisions of SFFAS Number 27, *Identifying and Reporting Earmarked Funds*.

Y. Reclassifications

Certain FY 2005 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, 2006 and 2005 were:

	2006	2005
Earmarked and other funds, excluding AATF	$ 2,576,381	$ 1,556,784
Franchise fund	219,060	122,907
Aviation Insurance Revolving Fund	53,328	41,100
AATF (Note 12)	645,458	692,311
Total	$ 3,494,227	$ 2,413,102

Status of fund balance with Treasury

Unobligated balance		
Available	$ 1,209,311	$ 1,067,338
Not available	1,095,911	1,291,487
Obligated balance not yet disbursed	1,189,005	54,277
Total	$ 3,494,227	$ 2,413,102

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, 2006 and 2005, FAA's investment balances were as follows:

	2006	2005
Intragovernmental securities		
Nonmarketable, par value - AATF	$ 7,893,312	$ 10,047,363
Nonmarketable, market based - Aviation Insurance Fund	696,667	527,453
Interest receivable	84,750	90,744
Investments at cost	$ 8,674,729	$ 10,665,560
Market value disclosure		
Nonmarketable, par value - AATF	$ 7,893,312	$ 10,047,363
Nonmarketable, market based - Aviation Insurance Fund	698,055	528,116
Unamortized discount - nonmarketable, market based	(1,388)	(663)
Nonmarketable, market based, net	696,667	527,453
Market value disclosure	$ 8,589,979	$ 10,574,816

The Secretary of the Treasury invests AATF funds on behalf of FAA. FAA investments are considered investment authority and available to offset the cost of operations, to the extent authorized by Congress. As of September 30, 2006 and 2005, approximately $7.9 billion and $10.0 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, 2006 mature on various dates through June 30, 2007, and investments as of September 30, 2005 matured on various dates through June 30, 2006. 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 2006 and FY 2005 was 4.5% and 3.9%, 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 invests Aviation Insurance Fund collections in nonmarketable, market-based securities, and amortizes premiums and discounts over the life of the security using the interest method. As of September 30, 2006, these nonmarketable, market-based securities had maturity dates ranging from October 2006 to June 2010, and have an average rate of return of approximately 4.2%.

The U.S. Treasury does not set aside assets to pay the future expenditures of the AATF and the Aviation Insurance Fund. Instead, the cash collected from the public for the AATF and the Aviation Insurance Fund is deposited to the U.S. Treasury, and used for general Government purposes. Treasury securities are issued to the FAA as evidence of the collections by the AATF and Aviation Insurance Fund. Treasury securities are an asset to the FAA and a liability to the U.S. Treasury. Because the FAA and the U.S. Treasury are both parts of the U.S. Government,

these assets and liabilities offset each other from the standpoint of the U.S. Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

To the extent authorized by law, FAA has the ability to redeem its Treasury securities to make expenditures. When the FAA requires redemption of these securities, the U.S. Government finances those expenditures out of accumulated cash balances by raising tax or other receipts, borrowing from the public, repaying less debt, or curtailing other expenditures. This is the same way that the U.S. Government finances all other expenditures.

Note 4. Accounts Receivable, Prepayments, and Other Assets

Accounts receivable, prepayments, and other assets as of September 30, 2006 and 2005 were comprised of the following:

	2006	2005
Intragovernmental		
Accounts receivable	$ 142,822	$ 100,283
Prepayments and other	29,385	204,154
Subtotal, intragovernmental	172,207	304,437
With the public		
Accounts receivable, net	89,881	106,017
Prepayments	4,710	36,913
Deposits in transit and other	27,629	40,563
Subtotal, with the public	122,220	183,493
Total accounts receivable, prepayments, and other	$ 294,427	$ 487,930

Intragovernmental 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 $71.9 million and $76.8 million, as of September 30, 2006 and 2005.

Note 5. Inventory, Operating Materials, and Supplies

As of September 30, 2006 and 2005, inventory, operating materials, and supplies were:

Inventory	2006	2005
Held for sale, net	$ 52,346	$ 61,661
Held for repair, net	288,751	328,161
Raw materials, finished goods and other	188,878	223,802
Excess, obsolete, and unserviceable, net	41,793	12,462
Subtotal, inventory	571,768	626,086
Operating materials and supplies		
Held for use, net	41,476	-
Held for repair, net	14,866	-
Excess, obsolete, and unserviceable, net	-	-
Subtotal, operating materials and supplies	56,342	-
Total inventory, operating materials, and supplies, net	$ 628,110	$ 626,086

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

Inventory	2006	2005
Held for repair	$ (87,615)	$ (86,148)
Raw materials, finished goods and other	(35,774)	-
Excess, obsolete, and unserviceable	(11,845)	(78,201)
Subtotal, inventory allowances	(135,234)	(164,349)
Operating materials and supplies		
Held for use	-	-
Held for repair	(14,866)	(21,295)
Excess, obsolete, and unserviceable	(758)	-
Subtotal, operating materials and supplies allowances	(15,624)	(21,295)
Total allowances	$ (150,858)	$ (185,644)

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, 2006 and 2005 were:

	2006		
Class of fixed asset	Acquisition value	Accumulated depreciation	Net book value
Real property, including land	$ 4,348,824	$ (2,259,124)	$ 2,089,700
Personal property	16,241,315	(8,423,232)	7,818,083
Assets under capital lease (Note 9)	127,024	(89,181)	37,843
Construction in progress	4,655,957	-	4,655,957
Property not in use	117,050	(86,598)	30,452
Total property, plant, and equipment	$ 25,490,170	$ (10,858,135)	$ 14,632,035

	2005		
Class of fixed asset	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

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.

In FY 2006 FAA reclassified approximately $1.2 billion from CIP to in-use assets. A portion of the assets had been previously placed in service and consequently, an associated adjustment was recorded to recognize accumulated depreciation totaling $75 million on those assets. This amount was recorded with other current year depreciation charges in the FY 2006 Consolidated Statement of Net Cost.

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 $17.7 million and $28.4 million in FY 2006 and FY 2005, respectively.

Note 7. Environmental Liabilities

FAA's environmental liabilities as of September 30, 2006 and 2005 were:

	2006	2005
Environmental remediation	$ 330,035	$ 358,296
Environmental cleanup and decommissioning	243,229	238,240
Total environmental liabilities	$ 573,264	$ 596,536

Note 8. Employee Related and Other Liabilities

As of September 30, 2006 and 2005, FAA's employee related and other liabilities were:

	2006		
Intragovernmental	Non-current liabilities	Current liabilities	Total
Advances received	$ -	$ 46,658	$ 46,658
Accrued payroll & benefits payable to other agencies	-	43,750	43,750
Other liabilities	-	4,666	4,666
Liabilities covered by budgetary or other resources	-	95,074	95,074
Federal Employees' Compensation Act (FECA) payable	111,953	86,529	198,482
Liabilities not covered by budgetary or other resources	111,953	86,529	198,482
Subtotal, intragovernmental	111,953	181,603	293,556
With the public			
Advances received and other	-	70,871	70,871
Accrued payroll & benefits payable to employees	-	175,510	175,510
Liabilities covered by budgetary or other resources	-	246,381	246,381
Accrued unfunded annual & other leave & assoc. benefits	61,733	440,155	501,888
Sick leave compensation benefits for air traffic controllers	68,194	10,306	78,500
Capital leases (Note 9)	34,199	8,607	42,806
Legal claims	-	8,000	8,000
Other accrued liabilities	88,231	-	88,231
Liabilities not covered by budgetary or other resources	252,357	467,068	719,425
Subtotal, with the public	252,357	713,449	965,806
Total employee related and other liabilities	$ 364,310	$ 895,052	$ 1,259,362

	2005		
Intragovernmental	Non-current liabilities	Current liabilities	Total
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
With the public			
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 16)	-	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 and other liabilities	$ 436,123	$ 1,021,465	$ 1,457,588

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, and Social Security.

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, 2006 includes workers' compensation benefits paid by DOL during the periods July 1, 2004 through June 30, 2006 and accrued liabilities for the quarter July 1, 2006 through September 30, 2006. FAA's liability accrued as of

September 30, 2005 included workers' compensation benefits paid by DOL during the period July 1, 2003 through June 30, 2005, and accrued liabilities for the quarter July 1, 2005 through September 30, 2005.

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 $78.5 million and $73.8 million as of September 30, 2006 and 2005, respectively.

FAA estimated that 100% of its $8.0 million and $6.6 million legal claims liabilities as of September 30, 2006 and 2005, respectively, would be paid from the permanent appropriation for judgments, awards, and compromise settlements (Judgment Fund) administered by the Department of Treasury.

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, 2006 and 2005:

	2006	2005
Land, Buildings, and Machinery	$ 127,024	$ 125,923
Accumulated Depreciation	(89,181)	(80,732)
Assets Under Capital Lease, net	$ 37,843	$ 45,191

As of September 30, 2006, 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 2007)	$ 11,541
Year 2 (FY 2008)	9,948
Year 3 (FY 2009)	9,656
Year 4 (FY 2010)	8,978
Year 5 (FY 2011)	7,951
After 5 Years	16,945
Less: Imputed interest	(22,213)
Total capital lease liability	$ 42,806

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, 2006 were:

Fiscal year	
Year 1 (FY 2007)	$ 132,839
Year 2 (FY 2008)	109,578
Year 3 (FY 2009)	96,093
Year 4 (FY 2010)	78,665
Year 5 (FY 2011)	66,916
After 5 Years	278,371
Total future operating lease payments	$ 762,462

Operating lease expense incurred during the years ended September 30, 2006 and 2005 was $201.7 million and $172.8 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, 2006 and 2005, FECA actuarial liabilities were $888.1 million and $942.3 million, respectively. The DOL calculates the FECA liability for DOT, and DOT allocates the liability amount to FAA based upon actual workers' compensation payments to FAA employees over the preceding four years. FECA liabilities include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The estimated liability is not covered by budgetary 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, 2006 and 2005 by strategic goal.

For the Year Ended September 30, 2006

Line of business programs	Strategic Goal Areas: Safety	Capacity	Organizational Excellence	International Leadership	Total
Air Traffic Organization	$ 6,947,006	$ 2,617,266	$ 39,422	$ 11,539	$ 9,615,233
Aviation Safety	569,435	377	373,052	378	943,242
Airports	2,013,004	1,820,794	18,104	-	3,851,902
Commercial Space Transportation	12,773	2,476	-	-	15,249
Non line of business programs					
Regions and center operations and other	20,553	419	6,609	4	27,585
Net cost	$ 9,562,771	$ 4,441,332	$ 437,187	$ 11,921	$ 14,453,211

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	$ 10,162,065	$ 3,075,480	$ 786,729	$ 4,822	$ 14,029,096

The following is FAA's distribution of FY 2006 and FY 2005 net costs by intragovernmental-related activity versus with the public.

	For the Year Ended September 30, 2006		
Line of business programs	**Intra-governmental**	**With the Public**	**Total**
Air Traffic Organization			
Expenses	$ 2,111,536	$ 7,704,106	$ 9,815,642
Less earned revenues	(198,032)	(2,377)	(200,409)
Net costs	1,913,504	7,701,729	9,615,233
Aviation Safety			
Expenses	147,736	800,759	948,495
Less earned revenues	(1,439)	(3,814)	(5,253)
Net costs	146,297	796,945	943,242
Airports			
Expenses	17,814	3,834,327	3,852,141
Less earned revenues	-	(239)	(239)
Net costs	17,814	3,834,088	3,851,902
Commercial Space Transportation			
Expenses	2,138	13,111	15,249
Net costs	2,138	13,111	15,249
Non line of business programs			
Regions and center operations and other programs			
Expenses	95,957	521,632	617,589
Less earned revenues	(279,751)	(310,253)	(590,004)
Net costs	(183,794)	211,379	27,585
Net cost of operations			
Total expenses	2,375,181	12,873,935	15,249,116
Less earned revenues	(479,222)	(316,683)	(795,905)
Net costs	$ 1,895,959	$ 12,557,252	$ 14,453,211

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

Note 12. Earmarked Funds

SFFAS Number 27 requires agencies to identify and report earmarked funds on a comparative basis beginning in FY 2006. FAA's earmarked funds are presented among two classifications: the first classification is comprised of the AATF and all related funds that receive funding from the AATF. These include the Operations Trust Fund, Grants-in-Aid for Airports, Facilities and Equipment, and Research Engineering and Development, all of which are funded exclusively by the AATF. The AATF classification also includes the Operations General Fund, which is primarily funded through transfers from the Operations - AATF, but is additionally supplemented by the General Fund of the U.S. Treasury through annual appropriations. Because the Operations General Fund is primarily funded from the AATF, and because it is not reasonably possible to differentiate cash balances between those originally flowing from the AATF versus general fund appropriations, the Operations General Fund is presented as an earmarked fund. The second classification of earmarked funds includes the Aviation Insurance Revolving Fund, and Aviation User Fees.

Airport and Airway Trust Fund

FAA's consolidated financial statements include the results of operations and financial position of the AATF. The U.S. Congress created the AATF with the passage of the Airport and Airway Revenue Act of 1970. The Act provides a dedicated source of funding to the nation's aviation system through the collection of several aviation-related excise taxes. The IRS collects these 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 to reflect actual collections quarterly. Accordingly, the total taxes recognized in FY 2006 included OTA's estimate of $5.2 billion for the six months ended September 30, 2006. The total taxes recognized in FY 2005 included OTA's estimate of $5.0 billion for the six months ended September 30, 2005.

Other Earmarked Funds

- The FAA has authority under the Aviation Insurance Program to insure commercial airlines that may be called upon to perform various services considered necessary to the foreign policy interests of the United States, when insurance is not available commercially or is available only on unreasonable terms and conditions. The insurance issued, commonly referred to war-risk insurance, covers losses resulting from war, terrorism or other hostile acts. FAA reported premium insurance revenues of $168.4 million and $157.5 million for the periods ended September 30, 2006 and 2005, respectively. The Aviation Insurance Program activity is reported below as other earmarked funds. The Aviation Insurance Program is discussed further at Notes 1.W. and 16.
- Aviation User Fees, commonly referred to as overflight fees, are charged to commercial airlines that fly in U.S. controlled air space, but neither take off or land in the U.S. FAA reported overflight fees of $66.5 million and $109.7 million for the periods ended September 30, 2006 and 2005, respectively. The large variance in aviation user fee revenue between FY06 and FY05 was due to litigation. As a result of unresolved litigation, FAA ceased billing for overflight fees in FY 04. The litigation was completed in FY05 permitting FAA to resume billing for FY05 and retrospectively for FY04. Aviation User Fees activity is reported below as other earmarked funds.

Fiscal data as of, and for the year ended September 30, 2006 is summarized below. Intra-agency transactions have not been eliminated in the amounts presented below.

	2006		
Balance Sheet	**AATF**	**Other Earmarked Funds**	**Total Earmarked Funds**
Assets			
Fund balance with Treasury	$ 645,458	$ 2,597,692	$ 3,243,150
Investments, net	7,893,312	781,417	8,674,729
Accounts receivable, net	74,227	2,395,852	2,470,079
Other assets	-	3,455,833	3,455,833
Total assets	$ 8,612,997	$ 9,230,794	$ 17,843,791
Liabilities and net position			
AATF amounts due to FAA	$ 2,214,186	$ -	$ 2,214,186
Other liabilities	-	2,427,234	2,427,234
Unexpended appropriations	-	426,474	426,474
Cumulative results of operations	6,398,811	6,377,086	12,775,897
Total liabilities and net position	$ 8,612,997	$ 9,230,794	$ 17,843,791
Statement of net cost			
Program costs	$ 11,604,263	$ 2,066,167	$ 13,670,430
Less earned revenue:			
Aviation insurance premiums	-	168,449	168,449
Overflight user fees	-	66,541	66,541
Other revenue	-	405,192	405,192
Net cost of operations	$ 11,604,263	$ 1,425,985	$ 13,030,248
Statement of changes in net position			
Net position beginning of period	$ 7,317,573	$ 5,048,701	$ 12,366,274
Non-exchange revenue:			
Passenger ticket tax	7,423,272	-	7,423,272
International departure tax	1,993,697	-	1,993,697
Investment income	483,363	-	483,363
Fuel taxes	419,439	-	419,439
Waybill tax	478,614	-	478,614
Tax refunds and credits	(112,909)	-	(112,909)
Other revenue	26	16,207	16,233
Budgetary financing sources	-	3,446,225	3,446,225
Other financing sources	-	(708,063)	(708,063)
Unexpended appropriations	-	426,474	426,474
Net cost of operations	(11,604,263)	(1,425,985)	(13,030,248)
Change in net position	(918,761)	1,754,858	836,097
Net position end of period	$ 6,398,812	$ 6,803,559	$ 13,202,371

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, 2006 and 2005, imputed financing was as follows:

	2006	2005
Office of Personnel Management	$ 473,053	$ 458,617
Treasury Judgment Fund	21,801	26,980
Total imputed financing sources	$ 494,854	$ 485,597

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:

	2006	2005
Combined Statement of Budgetary Resources - budget authority	$ 18,459,775	$ 17,176,957
Less amounts made available to FAA from AATF dedicated collections	(15,788,090)	(14,323,881)
Net transfers of budget authority and other	22,216	54,794
Less special fund aviation user fees	(48,901)	(50,943)
Consolidated Statement of Changes in Net Position - appropriations received	$ 2,645,000	$ 2,856,927

In FY 2006, FAA had rescissions of budgetary resources to Grants-in-Aid to Airports of $1.06 billion; Operations of $26.5 million; and other non-AATF earmarked funds of $82.2 million.

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.

Obligations incurred, budgetary resources, disbursements and the offsetting collections 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 2005 Combined Statement of Budgetary Resources includes expired funds of $2.8 billion that are not presented in the Budget of the United States Government. Also, obligations incurred on the FY 2005 Combined Statement of Budgetary Resources includes $77.0 million of expired funds and $762.0 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 2005 Combined Statement of Budgetary Resources differs from FY 2005 "actuals" reported in the appendix of the *FY 2007 Budget of the United States Government*. The Budget of the United States Government is available on the Internet at www.whitehouse.gov/omb/budget/fy2007/. As of the date of issuance of FAA's FY 2006 Combined Statement of Budgetary Resources, the Budget of the United States Government for FY 2008, which will contain "actual" FY 2006 amounts, was not yet published. The Office of Management and Budget is expected to publish this information early in calendar year 2007.

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 2006 and FY 2005, 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:

	2006		2005	
	Direct	Reimbursable	Direct	Reimbursable
Category A	$ 6,044,220	$ 409,800	$ 5,402,794	$ 449,209
Category B	8,503,766	523,090	8,817,715	313,096
Total	$ 14,547,986	$ 932,890	$ 14,220,509	$ 762,305

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 2005, $39.1 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 2006. Additionally, transfers in FY 2006 to DOT for Essential Air Services also reduced balances available for obligation.

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, 2006 and 2005, 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.

	2006	2005	Change
Unfunded annual & other leave & associated benefits (Note 8)	$ 501,888	$ 481,526	$ 20,362
Legal claims (Note 8)	8,000	6,570	1,430
FECA payable (Note 8)	198,482	197,598	884
Increases - components of net cost of operations requiring or generating resources in future periods			22,676
Sick leave compensation benefits and return rights (Note 8)	78,500	79,481	(981)
Capital leases (Notes 8 & 9)	42,806	50,790	(7,984)
Environmental liabilities (Notes 7 & 16)	573,264	596,536	(23,272)
FECA actuarial liability (Note 10)	888,082	942,276	(54,194)
Other accrued liabilities (Note 8)	88,231	327,446	(239,215)
Decreases - resources that fund expenses recognized in prior periods			(325,646)
Total liabilities not covered by budgetary resources	2,379,253	2,682,223	(302,970)
Total liabilities covered by budgetary resources	1,164,483	985,445	179,038
Total liabilities	$ 3,543,736	$ 3,667,668	$ (123,932)

Note 16. Commitments, Contingencies, and Other Disclosures

Contract Options. As of September 30, 2006 and 2005, FAA had contract options of $3.35 billion and $10.0 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, 2006, FAA issued letters of intent covering FY 1988 through FY 2020 totaling $5.3 billion. As of September 30, 2006, FAA had obligated $3.8 billion of this total amount, leaving $1.5 billion unobligated.

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 $1.1 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 1,634 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, 2006. The Secretary of Transportation has extended coverage through December 31, 2006, 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. During this year there were 75 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 2006 and FY 2005, FAA recognized insurance premium revenue of $168.4 million and $157.5 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, 2006 or 2005. 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.

Legal Claims. As of September 30, 2006 and 2005, FAA's contingent liabilities for asserted and

pending legal claims reasonably possible of loss were estimated at $23.5 million and $16.3 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 Unites States at the end of FY 2005. As of September 30, 2005, FAA incurred $166.7 million of obligations in excess of OMB apportioned budget authority. 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 approximately $166.7 million of obligations related to these FY 2005 hurricanes in FY 2006.

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

State/Territory	2006	2005	2004	2003	2002
Alabama	$ 75,753	$ 59,571	$ 55,527	$ 59,760	$ 58,506
Alaska	182,020	210,446	153,237	158,950	121,640
Arizona	100,235	85,226	52,286	75,247	54,737
Arkansas	48,454	42,342	23,198	35,530	32,937
California	330,255	322,128	236,031	216,981	243,720
Colorado	90,421	61,916	101,792	57,872	91,495
Connecticut	9,154	9,991	8,511	7,011	10,420
Delaware	7,127	9,707	2,813	2,577	5,838
District of Columbia	-	5,657	555	447	71
Florida	210,656	181,151	145,690	166,066	157,878
Georgia	70,484	128,053	96,081	48,147	67,957
Hawaii	45,815	33,097	21,020	24,767	15,846
Idaho	30,687	24,855	22,677	30,721	19,925
Illinois	111,302	152,307	106,145	74,202	165,518
Indiana	69,098	45,537	49,219	47,288	43,099
Iowa	32,866	34,064	24,282	37,521	30,765
Kansas	32,497	25,864	24,118	22,694	15,655
Kentucky	70,784	64,216	51,904	67,031	48,192
Louisiana	59,783	79,747	59,438	45,394	47,915
Maine	16,960	26,324	45,987	18,143	14,456
Maryland	54,956	38,864	39,450	22,933	26,370
Massachusetts	70,894	27,907	23,495	65,930	30,348
Michigan	120,606	137,814	125,928	84,030	85,851
Minnesota	88,144	67,267	50,472	58,826	85,675
Mississippi	40,229	41,696	39,061	30,289	25,929
Missouri	92,826	116,612	89,848	59,642	71,910
Montana	45,161	27,877	36,754	34,273	24,506
Nebraska	31,567	28,633	25,280	19,423	25,181
Nevada	95,972	56,148	58,418	57,506	45,204
New Hampshire	17,327	22,245	7,996	35,082	40,351
New Jersey	94,207	53,960	55,174	29,402	26,391
New Mexico	27,799	19,761	12,756	17,336	13,106

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

State/Territory	2006	2005	2004	2003	2002
New York	$ 124,315	$ 118,853	$ 86,382	$ 122,675	$ 109,798
North Carolina	79,245	102,669	44,668	75,317	73,493
North Dakota	17,530	23,074	29,007	15,458	16,562
Ohio	126,327	100,776	118,138	68,717	112,015
Oklahoma	43,459	42,941	31,272	34,351	39,238
Oregon	43,946	53,329	33,793	34,687	46,605
Pennsylvania	135,097	126,833	105,293	112,761	109,388
Rhode Island	16,085	11,901	10,861	13,736	12,409
South Carolina	43,391	38,246	23,772	22,531	39,194
South Dakota	18,489	22,065	20,915	16,841	15,440
Tennessee	78,238	45,678	47,298	62,412	46,373
Texas	260,496	235,495	174,336	159,929	192,738
Utah	38,669	41,200	26,008	24,804	21,396
Vermont	7,325	4,333	6,657	2,310	2,767
Virginia	97,613	82,330	70,688	45,240	76,647
Washington	97,519	168,764	73,153	53,351	62,798
West Virginia	35,917	26,991	20,637	24,373	18,562
Wisconsin	55,632	53,074	60,615	48,264	39,971
Wyoming	25,509	38,536	33,544	21,158	25,679
American Samoa	4,792	9,615	6,328	18,903	17,845
Guam	12,428	11,137	2,244	5,937	368
Northern Mariana Island	13,302	10,274	8,014	10,227	13,017
Puerto Rico	26,024	16,209	9,323	7,419	9,022
Virgin Islands	1,114	4,702	2,726	8,959	20,094
Administration	75,640	82,415	86,485	65,336	64,731
Totals	$ 3,852,141	$ 3,712,423	$ 2,977,300	$ 2,786,717	$ 2,933,542

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	2006	2005	2004	2003	2002
Applied Research	$ 106,390	$ 103,659	$ 91,743	$ 29,406	$ 59,150
Development	587	547	478	251	603
Administration	30,566	29,163	28,643	31,669	44,480
R&D Plant	3,821	5,287	4,230	2,903	3,020
Total	**$ 141,364**	**$ 138,656**	**$ 125,094**	**$ 64,229**	**$ 107,253**

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; ground de-icing operations and decreased in-flight ice buildup; better tools to predict and warn of weather hazards, turbulence, and wake vortices; aviation medicine; and human factors. Human factors refer 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.

Some of FAA's top FY 2006 research and development accomplishments were:

- The Aviation Weather Research Program funded the multi-year software development of the Terminal Convective Weather Forecast. By 2008, when fully deployed at all Integrated Terminal Weather System airports, the FAA estimates an annual benefit of $524 million.
- New Aviation Research and Development Office software called BAKFAA (back calculation-FAA) allowed widening of three runways and avoided an immediate cost of $15 million.
- Researchers conducted severe weather avoidance investigations showing that when controllers had access to dynamic storm forecasting tools at their workstation, they increased the average sector throughput by 6-10 percent and handled more traffic with no corresponding workload increase.

- Providing funding for human factor researchers at the University of Central Florida to create an easy to use simulation session for pilots, called the Rapidly Reconfigurable Line-Oriented Evaluation software tool. Scenarios are developed and created by inputting a few pieces of key information allowing the FAA inspectors to review the scenarios significantly faster. Annually, this will save FAA up to $25 thousand and the private sector about $4.6 million. A much higher savings will be achieved when all scenario-based airline training is considered industry-wide.
- In preparation for FAA to replace approximately 12,500 retiring controllers over the next decade, researchers developed a 6.5 hour pre-hire computerized Air Traffic Selection and Training test battery. FAA invested about $6.9 million in development over eight years through 2006. The expected reduction in administrative costs is estimated to be $11 million per year with an added benefit of lower training attrition.

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				
			2006	2005	2004	2003	2002
Buildings	Condition assessment	4&5	$ 74,751	$ 63,875	$ 53,359	$ 50,534	$ 73,741
Other structures and facilities	Condition assessment	4&5	$ 23,605	$ 19,984	$ 16,543	$ 29,785	$ 13,843

* 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
Schedule of Budgetary Resources by Major Fund Type
As of September 30, 2006
(Dollars in Thousands)

	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development	Aviation Insurance Revolving	Franchise Fund	Operations	Other Funds	Combined Total
Budgetary Resources								
Budget authority	$ 7,537,400	$ 2,553,260	$ 137,260	$ -	$ -	$ 8,182,501	$ 49,354	$ 18,459,775
Unobligated balance brought forward and transfers	482,386	968,088	24,945	564,296	95,771	221,078	2,261	2,358,825
Spending authority from offsetting collections	847	97,477	457	183,997	455,522	483,797	-	1,222,097
Recoveries of prior year obligations	194,821	34,884	2,942	272	10,567	127,833	-	371,319
Nonexpenditure transfers, net	-	-	-	-	-	19,621	(41,837)	(22,216)
Temporarily not available pursuant to public law	-	(25,400)	(1,380)	-	-	(55,410)	-	(82,190)
Permanently not available	(4,466,500)	-	-	-	-	(55,012)	-	(4,521,512)
Total Budgetary Resources	$ 3,748,954	$ 3,628,309	$ 164,224	$ 748,565	$ 561,860	$ 8,924,408	$ 9,778	$ 17,786,098
Status of Budgetary Resources								
Obligations incurred	$ 3,709,241	$ 2,590,936	$ 135,419	$ 6,002	$ 402,558	$ 8,636,720	$ -	$ 15,480,876
Unobligated balances available	834	934,673	24,409	400	141,108	107,887	-	1,209,311
Unobligated balances not available	38,879	102,700	4,396	742,163	18,194	179,801	9,778	1,095,911
Total Status of Budgetary Resources	$ 3,748,954	$ 3,628,309	$ 164,224	$ 748,565	$ 561,860	$ 8,924,408	$ 9,778	17,786,098
Change in Obligated Balances								
Obligated balance, net, beginning of period	$ 6,062,824	$ 1,737,713	$ 157,889	$ 5,657	$ 27,137	$ 804,684	$ -	$ 8,795,904
Obligations incurred	3,709,241	2,590,936	135,419	6,002	402,558	8,636,720	-	15,480,876
Gross Outlays	(3,843,926)	(2,613,611)	(141,451)	(3,091)	(410,719)	(8,408,062)	-	(15,420,860)
Recoveries of prior year obligations, actual	(194,821)	(34,884)	(2,942)	(272)	(10,567)	(127,833)	-	(371,319)
Change in uncollected customer payments from Federal sources	530	9,426	269	-	51,350	(51,666)	-	9,909
Obligated balance, net, end of period	$ 5,733,848	$ 1,689,580	$ 149,184	$ 8,296	$ 59,759	$ 853,843	$ -	$ 8,494,510
Unpaid obligations	$ 5,732,092	$ 1,951,663	$ 152,734	$ 8,296	$ 142,451	$ 1,164,026	$ -	$ 9,151,262
Uncollected customer payments from Federal sources	1,756	(262,083)	(3,550)	-	(82,692)	(310,183)	-	(656,752)
Obligated balance, net, end of period	$ 5,733,848	$ 1,689,580	$ 149,184	$ 8,296	$ 59,759	$ 853,843	$ -	$ 8,494,510
Outlays								
Disbursements	$ 3,843,926	$ 2,613,611	$ 141,451	$ 3,091	$ 410,719	$ 8,408,062	$ -	$ 15,420,860
Collections, net of offsetting receipts	(1,376)	(106,902)	(726)	(183,997)	(506,871)	(432,133)	-	(1,232,005)
Net Outlays	$ 3,842,550	$ 2,506,709	$ 140,725	$ (180,906)	$ (96,152)	$ 7,975,929	$ -	$ 14,188,855

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	Franchise Fund	Operations	Other Funds	Combined Total
Budgetary Resources									
Budget Authority	$ 6	$ 6,793,320	$ 2,506,394	$ 124,890	$ -	$ -	$ 7,751,404	$ 943	$ 17,176,957
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

This presentation conforms to the format presented in the FY 2005 Performance and Accountability Report. However, the format of this schedule was revised in FY 2006. Thus, the FY 2005 Combined Statement of Budgetary Resources on page 119 has been reclassified for consistency with the current year presentation.

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 FAA's Franchise Fund is comprised of several programs, within which it offers a wide variety of services. These services include accounting, travel, duplicating, multi-media, information technology, logistics and material management, aircraft maintenance, international training and management training. The Franchise Fund's major customers are FAA lines of business programs. Other customers include Department of Transportation (DOT) entities, non-DOT government agencies, and international government entities.

Description of Programs and Services

Several programs within the Franchise Fund are organized around an **Enterprise Services Center** (ESC) concept, 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 further reduces the cost of providing the services by spreading the fixed cost of operations over a larger customer base. There are three components of the ESC; all falling within the single Franchise Fund:

- 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, OMB selected ESC as a Financial Management Center of Excellence (COE). 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 for the Arts, Commodity Futures Trading Commission, Institute of Museum and Library Services, the United States Government Accountability Office and also 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 started in FY 2004 and was completed in August 2006. The ESC committed to providing an improved level of service, meeting all Joint Financial Management Improvement Program (JFMIP) requirements, while at the same time reducing overall expenses by 10%, which will be realized in FY 2008.

The Franchise Fund also includes the following program areas:

The **Aircraft Maintenance and Engineering Group** in the office of Aviation System Standards is located at the Mike Monroney Aeronautical Center (Aeronautical Center) in Oklahoma City. It provides total aircraft support including maintenance, quality assurance and overall program management. This service includes preventative as well as repair/overhaul and/or modification requirements and reliability and maintainability studies. The Aircraft Maintenance and Engineering Group can provide full or partial support depending on customer requirements, from short-term preventative maintenance or one time engineering tasks to more involved activities such as a full compliment of maintenance services with quality assurance and engineering support.

The **Center for Management and Executive Leadership** (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 both onsite and at field locations while students also 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 **International Training Division** (ITD) in the FAA Academy at the Aeronautical Center in Oklahoma City 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.

The **FAA Logistics Center** also 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.

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

	As of September 30	
	2006	2005
Assets		
Fund balance with Treasury	$ 223,694	$ 122,907
Accounts receivable, net	19,221	69,106
Inventory and related property, net	382,898	383,482
General property, plant, and equipment, net	9,649	2,748
Other	240	578
Total assets	$ 635,702	$ 578,821
Liabilities		
Accounts payable	$ 20,370	$ 22,432
Advances from others	174,989	99,923
Employee related	16,087	15,514
Other	8,231	5,741
Total liabilities	219,677	143,610
Net position		
Cumulative results of operations	416,025	435,211
Total net position	416,025	435,211
Total liabilities and net position	$ 635,702	$ 578,821

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

		For the years ended September 30	
		2006	Unaudited 2005
Office of Enterprise Systems	Revenues	$ 41,949	44,477
	Expenses	38,041	39,663
	Profit/(loss)	3,908	4,814
Office of Information Technology	Revenues	36,667	19,892
	Expenses	45,455	40,703
	Profit/(loss)	(8,788)	(20,811)
Office of Financial Operations	Revenues	30,222	26,229
	Expenses	31,118	24,165
	Profit/(loss)	(896)	2,064
Aircraft Maintenance and Engineering	Revenues	40,916	36,928
	Expenses	46,310	48,018
	Profit/(loss)	(5,394)	(11,090)
Center for Management and Executive Leadership	Revenues	1,735	2,543
	Expenses	1,604	1,857
	Profit/(loss)	131	686
International Training Division	Revenues	2,489	5,923
	Expenses	4,465	3,828
	Profit/(loss)	(1,976)	2,095
FAA Logistics Center	Revenues	257,232	239,363
	Expenses	298,268	280,469
	Profit/(loss)	(41,036)	(41,106)
Total Consolidated	Revenues	411,210	375,355
	Expenses	465,261	438,703
	Profit/(loss)	$ (54,051)	$ (63,348)

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

	Cumulative results of operations	
	2006	Unaudited 2005
Beginning balance, net position	$ 435,211	$ 438,807
Financing sources		
Transfers-in/out without reimbursement	(21,638)	4,318
Imputed financing from costs absorbed by others	56,503	55,421
Other	-	13
Total financing sources	34,865	59,752
Profit (loss)	(54,051)	(63,348)
Ending balance, net position	$ 416,025	$ 435,211

Glossary of Acronyms

Acronym	Name
AATF	Airport and Airway Trust Fund
ACSI	American Customer Satisfaction Index
ADS-B	Automatic Dependent Surveillance Broadcast
AFP	Airspace Flow Program
AFSS	Automated Flight Service Station
AGA	Association of Government Accountants
AIP	Airport Improvement Program
AMP	Airspace Management Program
AMS	Acquisition Management System
ANSI	American National Standards Institute
APB	Acquisition Program Baseline
ARINC	Aeronautical Radio Incorporated
ARP	Office of Airports (FAA line of business)
ARTCC	Air Route Traffic Control Center
ASDE-X	Airport Surface Detection Equipment Model X
ASPM	Aviation System Performance Metrics
ASQP	Air Service Quality Performance
AST	Commercial Space Transportation
ASV	Annual Service Volume
ATC	Air Traffic Control
ATCSCC	Air Traffic Control System Command Center
ATO	Air Traffic Organization (FAA line of business)
ATOS	Air Traffic Oversight System
ATOP	Advanced Techniques and Oceanic Procedures
AVS	Aviation Safety (FAA Line of Business)
BASA	Bilateral Aviation Safety Agreement
BCP	Business Continuity Plan
BPA	Blanket Purchase Agreement
BTS	Bureau of Transportation Statistics
C&A	Certification and Accreditation
CAS	Cost Accounting System
CAST	Commercial Aviation Safety Team
CSRS	Civil Service Retirement System
CEAR	Certificate of Excellence in Accountability Reporting

Acronym	Name
CFIT	Controlled Flight into Terrain
CFO	Chief Financial Officer
CFO Act	Chief Financial Officers Act of 1990
CIO	Chief Information Officer
CIP	Construction in Progress
CIT	Capital Investment Team
CMEL	Center for Management and Executive Leadership
COE	Center of Excellence
ConOps	Concept of Operations
CSIRC	Cyber Security Incident Response Center
DFDR	Digital Flight Data Recorder
DOL	Department of Labor
DOT	Department of Transportation
EA	Enterprise Architecture
EAC	East African Community
EAP	Employee Assistance Program
EAS	Employee Attitude Survey
ESC	Enterprise Services Center
ETC	Emergency Transportation Center
ETMS	Enhanced Traffic Management System
EVM	Earned Value Management
F&E	Facilities and Equipment
FAA	Federal Aviation Administration
FAR	Federal Acquisition Regulation
FEA	Federal Enterprise Architecture
FECA	Federal Employee's Compensation Act
FEMA	Federal Emergency Management Agency
FERS	Federal Employees Retirement System
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act
FTE	Full-time Equivalent
FTI	FAA Telecommunications Infrastructure
GA	General Aviation
GAO	Government Accountability Office
GENOT	General Notice
GETS	Grievance Electronic Tracking System
GMLob	Grants Management Line of Business

Acronym	Name
GPS	Global Positioning System
GSA	General Services Administration
HR	Human Resources
HSPD	Homeland Security Presidential Directive
ICAO	International Civil Aviation Organization
IFR	Instrument Flight Rule
IG	Inspector General
IRB	Investment Review Board
IRS	Internal Revenue Service
ISO	International Organization for Standardization
ITD	International Training Division
JFMIP	Joint Financial Management Improvement Program
JPDO	Joint Planning and Development Office
JRC	Joint Resources Council
LSAM	Logistics Service Area Manager
MAGENTA	Model for Assessing Global Exposure to the Noise of Transport Aircraft
MCP	Mission-Critical Positions
MMS	Maintenance Management System
NAS	National Airspace System
NASA	National Aeronautics and Space Administration
NASPAS	Nation Airspace System Performance Analysis System
NATCA	National Air Traffic Controllers Association
NextGen	Next Generation Air Transportation System
NESP	National En route Spacing Position
NIST	National Institute of Standards and Technology
NMW	No Material Weakness
NODB	National Outage Database
NPRM	Notice of Proposed Rulemaking
NPV	Net Present Value
NSST	National System Strategy Team
NTSB	National Transportation Safety Board
OAG	Official Airline Guide
OAI	Office of Airline Information
OEP	Operational Evolution Plan
OEDP	Operational Error Detection Patch
OIG	Office of the Inspector General

Acronym	Name
OMB	Office of Management and Budget
OMP	O'Hare Modernization Plan
OPM	Office of Personnel Management
OSH	Occupational Safety and Health
OTA	Office of Tax Analysis
PAR	Performance and Accountability Report
PART	Program Assessment Rating Tool
PMA	President's Management Agenda
PP&E	Property, Plant and Equipment
PRISM	Procurement Acquisition Management System
R,E,&D	Research, Engineering, and Development
RIF	Reduction in Force
RNAV	Required Area Navigation
RNP	Required Navigation Performance
ROI	Return on Investment
RSSI	Required Supplementary Stewardship Information
SAGE	System for Assessing Aviation Global Emissions
SARS	Severe Acute Respiratory Syndrome
SFFAS	Statement of Federal Financial Accounting Standards
SID	Standard Instrument Departures
SMS	Safety Management System
SMIS	Safety Management Information System
SPIRE	Simplified Program Information Reporting and Evaluation
SPP	Selection Priority Program
SRM	Safety Risk Management
STARS	Standard Terminal Automation Replacement Systems
SWIM	System Wide Information Management
TARP	Traffic Analysis Review Program
TCIRC	Transportation Cyber Incident Response Center
TMA	Traffic Management Advisor
TRACON	Terminal Radar Approach Control
WAAS	Wide-Area Augmentation System

Acknowledgments

This *FY 2006 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 2006 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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