

IMPROPER PAYMENTS IDENTIFIED IN FAA'S AIRPORT IMPROVEMENT PROGRAM

Federal Aviation Administration

Report Number: FI-2011-023
Date Issued: December 1, 2010

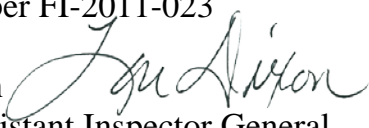


U.S. Department of
Transportation
Office of the Secretary
of Transportation
Office of Inspector General

Memorandum

Subject: **ACTION:** Report on Improper Payments in the
Airport Improvement Program, FAA
Report Number FI-2011-023

Date: December 1, 2010

From: Lou E. Dixon 
Principal Assistant Inspector General
for Auditing and Evaluation

Reply to
Attn. of: JA-20

To: Assistant Administrator for Financial Services/
Chief Financial Officer, FAA

In fiscal year 2008, the Federal Aviation Administration (FAA) provided over \$4 billion dollars to more than 1,500 Airport Improvement Program (AIP) grantees to enhance safety, capacity, and security at airports that are considered significant to national air transportation. In addition to the fiscal year 2009 \$3.5 billion appropriation, AIP received an additional \$1.1 billion under the American Recovery and Reinvestment Act of 2009 (ARRA). The Department of Transportation (DOT) has determined that AIP is susceptible to improper payments, such as payments for ineligible services or to ineligible recipients, duplicate and incorrect payment amounts, and payments based upon insufficient supporting documentation. The infusion of Federal dollars under ARRA increases the amount of AIP dollars subject to risk.

We assessed the sufficiency of FAA's internal controls to prevent and detect improper payments to AIP grant recipients. Specifically, we (1) determined the extent to which improper payments were made during the period reviewed, and (2) assessed FAA's approach to AIP grant oversight for preventing and detecting improper payments.

To conduct our work, we tested a sample of AIP payments to 26 grantees made between June 1, 2007, and September 30, 2008, and estimated the total amount of improper AIP payments for fiscal year 2008. In addition, we assessed FAA's risk-

based approach to AIP grant oversight, including the risk-assessment and payment review processes. This performance audit was conducted in accordance with generally accepted government auditing standards as prescribed by the Comptroller General of the United States and included such tests as we considered necessary to detect fraud, waste, or abuse. A detailed description of the scope and methodology used on this audit can be found in Exhibit A.

RESULTS IN BRIEF

Over \$13 million (more than 5 percent) of AIP payments made to 17 of the 26 AIP grantees we reviewed were improper.¹ Approximately \$7 million of the \$13 million was paid for work performed that grantees did not sufficiently document. Almost \$4 million was paid to grantees for ineligible or unallowable services. The remaining \$2 million was paid to ineligible recipients, in the incorrect payment amount, or as a duplicate payment. Overall, using statistical sampling techniques, we estimate that a total of about \$161 million of fiscal year 2008 payments to AIP grantees nationwide were improper.²

FAA's risk-based approach to AIP grant oversight is inadequate and does not effectively prevent or detect improper payments.³ FAA rated 24 of the 26 grantees in our sample as low-risk for making improper payments. However, we determined that 15 of these low-risk grantees met the agency's criteria for a moderate-risk rating, and 11 of them made improper payments totaling \$12.9 million—more than 98 percent of the improper payments we identified. Assigning a grantee an inaccurate low-risk status increases the potential for improper payments since low-risk grantees can receive funding without submitting documentation or obtaining prior approval from FAA as required for high-risk grantees. Furthermore, FAA's review of documentation submitted in support of payment requests to moderate-risk grantees is inadequate. We also found that one grantee did not perform an adequate cost or price analysis to determine the price reasonableness of an AIP funded, \$124.8 million contract award. As a result, this grantee may have overpaid for the work performed, and such overpayments constitute improper payments (incorrect amount). FAA also could not provide support that the contract costs were reasonable, and failed to notify the Office of Inspector General (OIG) of possible bid improprieties in this single-bid contract, per agency regulations.

¹ Improper AIP payments can represent FAA payments to grantees or grantee payments to contractors. With the latter, an improper payment determination was made only if AIP funds were requested by the grantee, and paid by FAA.

² The \$161 million best estimate is applicable to the \$3.2 billion in fiscal year 2008 electronic payments only, with an estimated range from \$88 million to \$233 million, at 90 percent confidence.

³ The primary oversight of the Federal grants funds expended under AIP is provided by the Associate Administrator for Airports office through 21 Airport District Offices (ADO) and three regional offices.

We are making a series of recommendations aimed at strengthening controls to prevent and detect improper payments, including improving FAA's risk-based assessments and AIP payment oversight.

BACKGROUND

In 2002, Congress passed the Improper Payments Information Act (IPIA),⁴ providing a framework for agencies to use in testing for improper payments, identifying their causes, and implementing solutions to reduce them. In August 2006, the Office of Management and Budget (OMB) established detailed requirements for complying with IPIA.⁵ OMB further clarified that improper payments include the following:

- payments to ineligible recipients;
- duplicate payments;
- payments in incorrect amounts;
- payments for ineligible services or services not received; or
- payments having insufficient documentation.

In November 2009, the President signed Executive Order 13520 to reduce improper payments and eliminate waste, fraud, and abuse in Federal programs. In coordination with Federal, state, and local governments, OMB is currently working to hold agencies accountable for misusing taxpayer dollars and is creating stronger incentives for reporting, reducing, and recovering these erroneous payments.

DOT has identified AIP as susceptible to improper payments. In fiscal years 2005 and 2006, we reported that FAA lacked (1) an effective, risk-based approach to oversee and monitor AIP grantee activities; (2) policies and procedures describing the roles and responsibilities for those charged with grant monitoring; and (3) front-end preventative and detective controls found in more reliable grant administration and monitoring processes.⁶ We also reported that FAA overly

⁴ Pub. L. No. 107-300 (2002).

⁵ OMB Circular A-123, Appendix C (August 2006), which requires, (1) reviewing all programs and identifying those susceptible to improper payments, (2) obtaining an estimate of the annual amount of such payments, (3) implementing a plan to reduce improper payments, (4) reporting annual estimates of the amount of improper payments in agency programs and progress made in reducing them, and (5) recovering improper payments.

⁶ *Quality Control Review of Audited Financial Statements for Fiscal Years 2005 and 2004, Federal Aviation Administration*, OIG Report QC-2006-010, November 14, 2005. *Quality Control Review of Audited Financial Statements for Fiscal Years 2006 and 2005, Federal Aviation Administration*, OIG Report QC-2007-009, November 14, 2006. OIG reports and testimony can be found on our Web page: www.oig.dot.gov.

relied on single audits performed by independent audit firms for assurance that Federal funds were properly administered.⁷

In January 2007, FAA responded to our recommendations by supplementing the AIP Handbook⁸ and implementing a risk-based approach to AIP grant oversight. Grantees were categorized into one of three risk-levels based upon a grantee's potential for the misuse of AIP funds: nominal (low), moderate, or elevated (high).⁹ Risk-level determines the extent of documentation grantees are required to submit to support payments and the intensity of FAA's payment and grant oversight. A brief description of AIP payment documentation requirements and FAA oversight by risk-categorization can be found in Exhibit B.

Since 2008, FAA has taken further action to improve its processes and procedures for detection of improper payments, and its oversight of AIP grants, including ARRA grant funds. For example, in response to an OIG audit advisory,¹⁰ FAA significantly increased its annual testing sample size, and began closely monitoring the execution of sampling methodology. Also, in an attempt to reduce improper payments in AIP, FAA has recently promoted improper payments education, and provided guidance and outreach to personnel in its field offices. For example, in December 2008, an e-mail alert was sent to field offices clarifying what constitutes an improper payment. Lastly, FAA has hired an independent contractor to evaluate its risk-based approach to grant oversight and to recommend enhancements to current risk-assessment methods based upon best practices.

AIP GRANTEES RECEIVED MILLIONS IN IMPROPER PAYMENTS

We tested \$251.3 million in AIP payments and found \$13.1 million (over 5 percent) in improper payments to 17 of 26 grantees. Using statistical sampling techniques, we estimate that approximately \$160.7 million of fiscal year 2008 payments made electronically to AIP grantees nationwide were improper.¹¹ For the improper payments we identified (see Table 1), over 51 percent were for

⁷ OMB Circular A-133 sets forth standards for obtaining consistency and uniformity among Federal agencies for the single audit of States, local governments, and non-profit organizations expending Federal awards.

⁸ The AIP Handbook provides FAA staff with guidance about the administration of the AIP. Between revisions of the Handbook, staff receives additional guidance in the form of Program Guidance Letters (PGLs).

⁹ Program Guidance Letter 07-1, *Revised and Updated Requirements for Airport Improvement Program Grant Management*, dated January 11, 2007.

¹⁰ OIG ARRA Advisory – Sampling of Improper Payments in Major DOT Grants Programs, Department of Transportation, Advisory No. AA-2009-002, June 22, 2009.

¹¹ AIP grantees (if approved) can receive funding electronically via a "Letter-of-Credit" (LOC) draw-down system or manually by submitting documentation as required by the FAA Handbook Order 5100.38C. Our statistical sampling resulted in a best estimate of \$160.7 million, which is 5 percent of the \$3.2 billion total "electronic or LOC" payments with ± 2.3 percent of precision at 90 percent confidence.

insufficient documentation of the work reimbursed from AIP.¹² Another 10 percent represent payments to ineligible recipients because of a lack of compliance with FAA guidance and FAA procurement regulations. Approximately 39 percent and the most likely to be recoverable were payments for ineligible or unallowable services, payments in the incorrect amount, and duplicate payments.

¹² Each of the improper payments was classified into one of five categories identified by OMB Circular A-123, Appendix C.

Table 1. Improper Payments Identified by OMB Category

Grantee	Insufficient Documentation	Ineligible Services	Ineligible Recipient	Incorrect Amount	Duplicate Payment	Total
Panama City-Bay County Airport and Ind. District (Florida)	4,419,134	2,120,971		121,501		6,661,606
Commonwealth Ports Authority (Mariana Islands)		442	1,284,635			1,285,077
City of Santa Barbara (California)	528,235	549,275		26,494		1,104,004
Memphis-Shelby County Airport Authority (Tennessee)	2,153	1,093,797			5,723	1,101,673
Wisconsin Dept. of Transportation, Bureau of Aeronautics (Wisconsin)	711,869					711,869
City of Los Angeles (California)	709,629					709,629
County of Sacramento (California)		4,309		675,165		679,474
City of Houston (Texas)	283,189	59,833		28,982		372,004
City of Phoenix (Arizona)		156,821		11,009		167,830
City of Jonesboro (Arkansas)	38,915			82,807		121,722
Illinois Dept. of Transportation, Division of Aeronautics (Illinois)				94,944		94,944
Barnwell County Airport Commission (South Carolina)	42,893					42,893
City of Dunsuir (California)			41,515			41,515
Port of Seattle (Washington)		288	8,268		118	8,674
Erie Regional Airport Authority (Pennsylvania)		3,515				3,515
City of Kansas City (Missouri)	2,624					2,624
Lancaster Airport Authority (Pennsylvania)		907		725		1,632
Cumulative Total^a	\$6,738,641	\$3,990,158	\$1,334,418	\$1,041,627	\$5,841	\$13,110,685
Percentage of Total Improper Amount:	51.40%	30.43%	10.18%	7.94%	0.04%	100%

^a Almost \$4 million in improper payments were identified outside of the statistical sample and were not included in the projection. On May 18, 2009, FAA concurred with the Office of Inspector General on \$1.015 million of these improper payments.

Grant Recipients Lacked Documentation to Support AIP Payments

FAA made \$6.7 million in AIP payments to grantees that failed to sufficiently document and maintain support for the work performed. An OIG engineer reviewed 23 construction line items from 11 grantees and found that 10 items from

6 grantees lacked required documentation on work quantity, and in some cases, quality. For example:

- Panama City-Bay County Airport and Industrial District, FL (Panama City) received over \$4 million for construction work on temporary pollution and erosion control. However, Panama City could not provide documentation demonstrating that the completed work met FAA and contract requirements. Under FAA's AIP regulations, grantees are required to perform and document daily inspections and tests to ensure that all work conforms to the project's technical specifications.
- The City of Santa Barbara, CA (Santa Barbara) received \$124,700 for pipe drain installations, but was unable to provide the OIG engineer inspection records to support claims for the completed work. FAA requires grantees to retain such records and a project engineer to verify that all construction invoices billed to a grantee reflect the actual work completed to date. However, the project engineer could not provide a breakdown of the specific length of pipe drains installed. Santa Barbara's progress and construction reports provided only a rough estimate of the percentage of work completed, which is insufficient to support a payment made on a linear foot basis as specified by the contract.
- Another four grantees received over \$1 million: three for construction items without maintaining documentation supporting that the installed items met contract specifications for quality and one that did not sufficiently document quantity of work.

Grantees Received Payments for Ineligible Services

FAA made almost \$4 million in improper payments to grantees that billed for expenses that were ineligible based on the terms of the grant agreement or FAA policy or regulation. For example:

- Panama City received payment for work that was not approved for reimbursement under the AIP grant agreement. Because Panama City was a low-risk grantee, there was no requirement for them to submit payment documentation for FAA review and approval. The grantee used \$784,000 to pay financing costs for a new airport, costs which are prohibited under AIP guidelines. The grantee also applied another \$1.3 million towards AIP eligible tasks that were not approved in the grant agreement. For more than 2 years, FAA was unaware that this grantee was receiving payments to fund these ineligible/unapproved tasks. When a state auditor brought the matter to FAA's attention, instead of taking action to recover the funds, FAA's Airport District

Office (ADO) modified the grant agreement by incorporating and approving AIP eligible tasks already billed, and identifying other eligible tasks to compensate for the \$784,000 paid for prohibited expenses.

- The Memphis-Shelby County Airport Authority, TN (MSCAA) received more than \$680,000 for performance bonuses, even though FAA regulations prohibit reimbursement of such bonuses. MSCAA also billed FAA more than \$264,000 for indirect costs without an approved Cost Allocation Plan, which is required by the AIP Handbook.¹³ Lastly, MSCAA billed FAA about \$16,000 for furnishing an Aircraft Fire Fighting and Rescue Station, which is prohibited by FAA policy.
- Santa Barbara billed for both eligible and ineligible services on the same AIP payment request and received \$549,300 for a hangar that was not eligible under the grant agreement. The City used one construction contract which included work for the hangar, as well as taxiways, which were eligible for AIP funding under the terms of the grant agreement. While using one contract for ineligible and eligible AIP services is not prohibited, the costs of ineligible items must be removed from payment requests to FAA.

Grantees Made Payments to Ineligible Recipients

We identified improper payments totaling \$1.3 million to contractors (ineligible recipients), by three AIP grantees: one that did not comply with FAA guidance and two that did not follow FAA small purchase procedures.¹⁴

- The Commonwealth Ports Authority (CPA) awarded a non-competitive AIP funded contract for security enhancements at the Saipan International Airport two weeks prior to receiving FAA's official approval--despite FAA instruction that procurement by non-competitive proposal should be approved prior to any contract awards.¹⁵ The resulting improper payment under this contract was \$1.3 million.

¹³ In accordance with the FAA AIP Handbook Order 5100.38C and OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," grantees are not authorized to charge for indirect costs, such as administrative fees that are not directly associated with work stated in the grant agreement unless there is an approved Cost Allocation Plan.

¹⁴ AIP Handbook, Chapter 9, Paragraph 904(c), pg. 150. Small Purchase Procedures. Oral solicitation is acceptable for very small purchases, but should be adequately documented. Except for very small purchases, a letter request should be issued as a minimum, and a written proposal should be solicited.

¹⁵ February 7, 2003 Letter from Airports Division Manager (AWP-600) to Manager, Honolulu Airports District Office (HNL-600): Security Enhancements to Meet Transportation Security Administration Requirements at Saipan International Airport.

- The City of Dunsmuir, CA expended about \$42,000 in AIP funding for tree-cutting services without providing evidence that small purchase requirements were met. In a written response, FAA agreed with OIG that the \$42,000 payment was improper.
- The Port of Seattle could also not provide evidence they met small purchase requirements when retaining escrow services, for which they received \$8,300 in AIP funds.

FAA Made Payments for Incorrect Amounts

Another \$1 million in improper payments was for incorrect amounts billed by eight grantees. FAA AIP policy prohibits grantees from billing for goods and services that exceed costs incurred to date. However, the County of Sacramento billed FAA the full amount of construction invoices before the construction contractor received full payment--\$675,000 more than costs incurred.

The majority of the remaining payments in the incorrect amount were made by FAA to three grantees:

- On seven occasions, the Illinois DOT, Division of Aeronautics received payments for 100 percent of costs rather than the lower Federal share stated in grant agreements.
- Santa Barbara received AIP funds before all the work was completed, as many as 5 months before all vendors were paid.
- On one AIP payment request, Panama City overbilled FAA by \$122,000. The grant agreement specifically limited the Federal contribution on four specific construction lines at the City's Bay-County International Airport. The airport authority did not properly account for the Federal limitation, yet FAA disbursed the funds.

FAA Made Duplicate Payments to Grantees

MSCAA billed FAA for identical expenses under two separate AIP grant agreements which resulted in a duplicate payment amount of about \$6,000. We also found that more than \$400,000 in duplicate payments were made to two grantees outside of our sample. In one case, the City of Farmington, New Mexico, requested and received an electronic payment of \$434,000 for eligible AIP costs. One week later, the City requested a manual payment for the same amount, which FAA processed and paid. The duplicate payment went undetected for more than 2 months before the grantee informed FAA that the error had occurred; subsequent

draw-downs for reimbursement were reduced until the improper payment was recovered. Yolo County, California, similarly received a duplicate payment of about \$10,000. The grantee identified the improper payment 1 month later and notified FAA. The County agreed to reduce subsequent draw-downs until FAA recovered the improper payment. These examples are indicative of a lack of controls to prevent grantees from receiving both manual and electronic reimbursements for the same expenses.

FAA'S RISK-BASED APPROACH TO GRANT OVERSIGHT DOES NOT PREVENT OR DETECT IMPROPER PAYMENTS

FAA's risk-based approach to grant oversight is inadequate to effectively prevent or detect improper AIP payments. We found that a close relationship exists between the accuracy of a grantee's risk-rating and the potential for improper payments—more than 98 percent of the \$13.1 million of improper payments identified were applicable to 11 grantees inaccurately categorized as low-risk. We also found that the risk-based approach does not require a sufficient level of documentation to support electronic payments to low and moderate-risk grantees. Documentation review and payment approval is only required for those grantees presenting the highest risk for improper payments.

In addition, we found a lack of evidence that price or cost analysis was adequately performed prior to the Port of Seattle awarding a \$124.8 million AIP funded contract for embankment work during the construction of the third runway at the Seattle-Tacoma International Airport. In the absence of such an analysis, the Port of Seattle may have overpaid for the embankment work performed on the third runway. Such overpayments constitute improper payments (incorrect amount).

FAA Inaccurately Rated Grantees as Low-Risk

At the time of our review, all but 3 percent of FAA's 1,849 AIP grantees were assigned a low-risk rating.¹⁶ When the risk-based oversight process was originally implemented, FAA assumed the majority of grantees administered their grants in good faith and as a result, rated all pre-existing airport grantees as low-risk, allowing them to electronically draw-down payments with minimal documentation support and management oversight. The oversight concern is also apparent in that ADO management is overly accommodating of grantee needs, as illustrated in the example of the \$2.1 million of improper payments identified for Panama City and referenced on page 7. In that case, instead of raising the grantee's risk-rating for

¹⁶ In fiscal year 2009, FAA informed the OIG that there were 1,849 entities (grantees) with at least one open grant. Forty-three grantees were deemed "moderate-risk" and five "high-risk."

the improper use of grant funding, the ADO retroactively modified the grant agreement to make previously billed, but not approved, tasks eligible for AIP reimbursement. Such practices do not ensure the proper use of Federal funds.

Among the 26 grantees in our sample, 24 were rated by FAA to be at low-risk of making improper payments. However, 15 of these low-risk grantees met at least one criterion for a moderate-risk rating, and 11 of the 15 received improper payments totaling \$12.9 million (see Table 2).

Table 2. FAA AIP Low-Risk Grantees Meeting FAA's Criteria for Moderate Risk-Rating

Grantee (State)	FAA Criteria to Justify Raising Grantee's Level of Risk			Improper Payments Found (\$'s)
	One Criterion	Two Criteria	Three Criteria	
Panama City-Bay County Airport and Ind. District (Florida)	•			6,661,606
Commonwealth Ports Authority (Mariana Islands)		•		1,285,077
City of Santa Barbara (California)	•			1,104,004
Memphis-Shelby County Airport Authority (Tennessee)			•	1,101,673
Wisconsin DOT, Bureau of Aeronautics (Wisconsin)		•		711,869
City of Los Angeles (California)		•		709,629
County of Sacramento (California)		•		679,474
City of Houston (Texas)		•		372,004
City of Jonesboro (Arkansas)	•			121,722
Illinois DOT, Division of Aeronautics (Illinois)		•		94,944
Port of Seattle (Washington)		•		8,674
State of Alaska, DOT and Public Facilities (Alaska)	•			
Clark County Dept. of Aviation (Nevada)	•			
City of San Antonio (Texas)	•			
State of South Dakota, DOT (South Dakota)	•			
TOTALS	7	7	1	\$12,850,676

Based on FAA's risk-based approach to grant oversight, grantees receiving more than \$20 million in total annual grant project funding qualify at the moderate-risk level. We found that 12 of the 15 low-risk grantees that were incorrectly categorized had received more than \$20 million in funding for fiscal year 2008,¹⁷ and 8 of those 12 had improper payments. The failure to implement this particular criterion was not limited to the grantees in our sample. We analyzed the total fiscal year 2008 AIP payments and found that nationally only 1 of 34 low-risk grantees having received more than \$20 million was raised to a moderate-risk status.

¹⁷ Commonwealth Ports Authority, City of Santa Barbara, and the City of Jonesboro did not receive more than \$20 million in total annual grant funding for fiscal year 2008.

A number of grantees in our sample rated as low-risk met two criteria for a moderate-risk rating. For example, CPA met two moderate-risk criteria: a previous finding of noncompliance with grant assurances, and a single audit finding requiring payment to DOT in excess of \$100,000. Regarding the latter, a single audit report for fiscal year 2005 identified over \$706,000 of potentially non-reimbursable costs because CPA could not provide an approved Cost Allocation Plan, as required by the AIP Handbook and OMB Circular A-87, to demonstrate indirect administrative costs were allowable. While we reported this single audit finding to FAA in May 2007, FAA did not take action and recover the full amount of non-reimbursable costs until April of 2009.

MSCAA, which had a total of \$1.1 million in improper payments in our sample, met three criteria: (1) total grant funding in excess of \$20 million for fiscal year 2008, (2) a previous finding of non-compliance with grant assurances, and (3) repeated draw-down irregularities. For example, MSCAA was found to be in non-compliance with grant assurances because their cost allocation methodology did not comply with A-87 requirements. This resulted in improper payments totaling \$265,000. Despite meeting three criteria for a moderate-risk rating, MCSAA continues to be rated low-risk.

The accuracy of a grantee's risk-rating and the potential for improper payments is closely related because lower risk-ratings require less payment oversight. Although we found that more than 98 percent of the improper payments identified were applicable to 11 grantees with inaccurate risk-ratings, FAA does not require ADO management to review grantee risk-assessments at regular intervals. Performing such a review on a regular basis using the most current information available about a grantee would enable FAA to determine which grantees require additional payment oversight and would aid in preventing and detecting improper payments.

FAA's Insufficient Requirements and Procedures Contributed to Improper Payments

FAA's documentation requirements and payment review procedures under the risk-based approach to grant oversight are insufficient to prevent and detect improper payments to low- and moderate-risk grantees.¹⁸ FAA's July 2006 guidance outlines the minimum financial documentation and review requirements for low-, moderate-, and high-risk grantees' AIP payment requests (see Table 3).

¹⁸ Manual payment requests at any risk-level will generally require the submission of payment specific support such as a SF-271 and invoices prior to FAA approval. High-risk grantees are permitted to make only manual payment requests.

Table 3. Required Payment Documentation and Review Requirements by Risk-Level (PGL 07-1)

Requirement	Low-Risk	Moderate-Risk	High-Risk
Payment documentation submitted to FAA	None	Invoices or listing of invoices	Invoices
Documentation review prior to payment	No	No	Yes
Documentation review after payment	No	Not Clear	N/A

While the July 2006 guidance requires moderate-risk grantees to submit either invoices or a listing of invoices to substantiate payment requests, we found examples where payment documentation was not adequately reviewed by an FAA program manager. Specifically, we reviewed 22 payments to four moderate-risk grantees and found that invoices for 8 payment requests from one grantee were not reviewed—2 of the payments, totaling \$152,000, were improper because they were applied to the wrong grant. This happened because FAA does not require ADO staff to review and determine if payment requests to moderate-risk grantees are proper. Further, FAA provides limited instruction to program managers on the purpose and use of the invoices and the listings of invoices requested for moderate-risk grantees. To significantly reduce and detect improper payments, a timely review and approval of supporting documents submitted by moderate-risk grantees for each payment request is warranted.

Grantees determined to be low-risk that request AIP funds electronically—which comprise all but 2 of the 24 low-risk AIP grantees we reviewed—were not required to submit invoices or a listing of invoices for each payment request. Instead, these grantees submitted on a quarterly basis a standard document (SF-272), which identified the payment amount requested for the period and other general information, such as the number of AIP payments received during the quarter.¹⁹ Because the SF-272 captures quarterly data, it does not provide enough detail to support each request. Specifically, the SF-272 does not include payment specific information such as a summary of the work performed, vendor names, amounts billed, date of services, or the Federal share of costs.

We found that even basic summary level information can be useful to determine if an AIP payment is proper. To initiate our sample item review, we requested a summary level listing of invoices and other eligible costs to substantiate the

¹⁹ In October 2009, FAA issued Program Guidance Letter 10-01, replacing the SF-272 with a new SF-425 Federal Financial Report. The SF-425 is also required quarterly and does not contain any payment specific information.

payment amount. Prior to an in-depth review of the associated invoices and other supporting documentation, we used these spreadsheets to identify improper amounts totaling over \$200,000 made by three grantees. For example, at the State of Illinois, we easily determined that on seven separate billing requests, FAA was billed at 100 percent of the project costs rather than the eligible lower Federal participation rate stated in the grant agreements. At Santa Barbara, we found that FAA was billed up to 5 months before the eligible services were received.

The Port of Seattle Received AIP Funding for a \$124.8 Million Contract without Performing Adequate Cost or Price Analysis

We found that the Port of Seattle did not perform an adequate cost or price analysis for a \$124.8 million AIP funded contract award to a sole bidder for embankment work on the third runway at the Seattle-Tacoma International Airport. We reviewed an independent audit report and a special investigative report that addressed the procurement in detail,²⁰ and we conducted our own review into this contract procurement. In the absence of an adequate cost or price analysis, the Port of Seattle was unable to determine if the final contract price was reasonable, and the Port may have overpaid for the third runway embankment work. Such overpayments constitute improper payments (incorrect amount). At the time of our review, FAA had already reimbursed the Port of Seattle about \$46 million in AIP funds, and according to FAA, AIP payments to fund this contract will be made until 2015.²¹ We also found that FAA did not satisfy itself that the contract costs were reasonable, including a questionable \$9.4 million change order, and FAA did not notify OIG of the possibility of bid improprieties for this sole-bid contract, in accordance with AIP Handbook procedures.²²

An adequate cost or price analysis would have determined the reasonableness of the bid accepted for contract award. The accepted bid for the embankment work--which was also the only bid received--was for \$124.8 million, but the Port of

²⁰ Report of the Special Investigative Team, December 3, 2008 (McKay); Performance Audit of the Port of Seattle's Construction Management, Cotton and Company, November 27, 2007 (Cotton). The special investigation was requested by the Port's Board of Commissioners as a result of the Cotton findings.

²¹ The third runway project was funded by FAA under a Letter of Intent (LOI). The LOI program was established to fund large-scale airport projects. Under an LOI, FAA reimburses a grantee according to a given schedule as funds become available from Congress each year over the term of the LOI.

²² AIP Handbook, Chapter 10, Paragraph 1052(b)(3), pg. 183. If there are less than five bidders and the low bid exceeds the engineer's estimate by 10 percent, the grant should not be issued unless the FAA satisfies itself that the costs are reasonable. AIP Handbook, Chapter 10, Paragraph 1053(a)(4), pg. 184. Field Office should notify the OIG when — (1) there are fewer than five bidders, the low bid is 95 percent or more of the engineer's estimate and the bid is \$500,000 or more; or (2) there is only a single bidder on a construction contract, and the bid is \$250,000 or more.

Seattle's, engineer's estimate to complete the work was approximately \$105 million, a difference of about \$19.8 million, or almost 19 percent.²³

Although we found that the Port did compare schedule totals between the estimate and the bid,²⁴ it did not perform sufficient additional procedures to verify price reasonableness. FAA's guidance for performing an adequate cost or price analysis as stated in the AIP Handbook does not identify best practices used by FAA for their procurements. For example, the Port could have performed additional analyses including, 1) obtaining more current prices from the contractor; 2) an evaluation of the subcontractors' bids; 3) documenting research of current market prices; 4) a review of historical costs for individual cost elements, such as labor and overhead rates; and 5) a review of the contractor's proposed profit.²⁵ Based on discussions with the Port and with FAA staff, there is no documentation which states that either the Port or FAA determined that the price was fair and reasonable. Lastly, the special investigative team reported that the contractor's profit on this contract was approximately \$28.9 million, a markup on job costs of more than 30 percent, which is far beyond typical industry markups.²⁶

FAA Did Not Verify Price Reasonableness and Failed to Notify OIG of Possible Bid Improprieties

FAA could not provide support that the contract costs for the embankment work performed on the third runway project at the Sea-Tac International Airport were reasonable as required by the AIP Handbook, prior to issuing AIP grants in support of this contract. Furthermore, FAA did not notify OIG regarding possible bid improprieties related to this sole-bid contract, even though this procurement met the criteria for doing so as stated in the AIP Handbook. As a result, OIG did not have an opportunity to review the propriety of the contract before it was awarded.

²³ In negotiations between the Port and the contractor, the Port's CEO directed 3rd runway personnel to negotiate with the contractor to bring the contract price within 10 percent of the revised Engineer's Estimate. A deductive change order was subsequently developed, reducing the contractor's bid by \$9.4 million to approximately \$115.4 million. The negotiations for the \$9.4 million change order also did not involve an adequate cost or price analysis, and the conclusions reached did not ensure that cost reductions would actually occur. The special investigative team reported, and the Port confirmed, that the realized cost reduction that resulted from the negotiated \$9.4 million change order was closer to \$2 million. Furthermore, the contractor did not agree to sign the deductive change order until 5 months after the negotiations occurred and the contract had already been awarded.

²⁴ AIP Handbook, Chapter 9, Paragraph 906(a), pg. 153. "Required Analysis. Sponsors are required to perform some form of a cost or price analysis for every procurement, including change orders. This analysis is needed for FAA review to determine the reasonableness of cost...."

²⁵ Title 49 - Code of Federal Regulations, Part 18.36(f), Contract Cost and Price, states that "a cost analysis will be necessary when adequate price competition is lacking.....unless price reasonableness can be established on the basis of a catalog or market price..."

²⁶ Report of the Special Investigative Team, December 3, 2008 (McKay).

CONCLUSION

Deterring improper payments has been identified as a Governmentwide priority to ensure the responsible use of Federal funds in today's tight economic environment. In DOT, FAA has more grantees to manage than any other Operating Administration. Overseeing billions of dollars of annual AIP payments is a major challenge by any account. The infusion of \$1.1 billion of ARRA funds further increases the amount of AIP funds subject to risk. While FAA has taken steps to strengthen its oversight and annual testing for improper payments,²⁷ further action is needed to meet the level of accountability required. Until FAA takes the necessary actions to ensure that AIP grantees have been assigned an accurate risk-rating and administers sufficient payment oversight, millions of taxpayer dollars provided under AIP and ARRA will be at risk for improper payments.

RECOMMENDATIONS

To strengthen controls over improper payments to AIP grantees, we recommend that the Acting Associate Administrator for Airports, in consultation with the FAA Chief Financial Officer:

1. Re-enforce FAA guidance to AIP grantees for preparing "construction" payment requests, including supporting documentation to be maintained for both the quantity and quality of the work/materials reimbursed under AIP.
2. Identify the funds that can be recovered from the improper payments identified in this report and develop and implement a plan to maximize the recovery of these payments.
3. Develop a procedure to prevent duplicate AIP payments to grantees that submit manual payment requests and draw-down funds electronically under the same grant.
4. Revise risk-management procedures to require:
 - a. ADO program managers to review annually the risk-assessments for their grantees and provide written confirmation to the associate administrator that the assessment was done in compliance with the risk-management criteria specified in the risk-management procedures.

²⁷ On June 22, 2009, we reported that the Department needs to increase its oversight and expand its sample sizes for the annual improper payments testing required under OMB Circular A-123, Appendix C. The Department responded by significantly increasing the sample sizes tested.

- b. ADO program managers to review and approve payment support documents submitted by moderate-risk grantees within 30 days of payment.
 - c. All low-risk grantees requesting payment to prepare and have on file for FAA review, as needed, a summary listing of invoices and other eligible charges for each payment request to include: (1) a brief work summary, (2) vendor names, (3) dates of service, (4) billed amounts, (5) applicable payment dates, and (6) a calculation of the Federal share.
 - d. ADO program managers to review on a periodic basis the invoices or a summary listing of invoices and eligible charges for AIP payments to low-risk grantees.
5. Initiate a review to determine if the final contract price for the third runway embankment contract at the Seattle-Tacoma International Airport was fair and reasonable. Within 30 days, provide a report to the Office of Inspector General detailing the results of this review and planned actions.
 6. Revise the AIP Handbook to clarify what information is required to assist grantees in determining contract cost or price reasonableness, and further outline the responsibility for FAA ADO program managers to verify that contract costs are reasonable. Develop training for grantees and program managers to reinforce these revisions, if needed.
 7. Re-emphasize to ADO management the AIP Handbook requirement for contacting OIG when conditions warrant a "Review for Bid Improprieties."

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided FAA a draft of this report on September 2, 2010, and received its written comments on October 5, 2010. FAA's complete response is included as an appendix to this report. In addressing our recommendations, FAA fully concurred with five recommendations and partially concurred with two recommendations. We consider the proposed actions for recommendations 3, 4, 5, and 7 responsive and sufficient to resolve pending action dates.

For recommendation 1, FAA stated that it will re-emphasize to AIP grant sponsors the requirements in the AIP Handbook and relevant Advisory Circulars on the quality and quantity of necessary documentation they should maintain for AIP grant projects. We do not take issue with the quantity of and quality of

documentation, but the lack of required documentation to support the quantity and quality of work or materials billed to FAA.

For recommendation 2, FAA did not agree with the amount OIG deemed improper (\$13.1 million). Our analysis of the improper payments included in Exhibit C details the facts supporting our conclusion regarding the payments tested. Neither FAA's response nor the multiple requests made during the audit have disclosed facts or documents to refute these conclusions.

The amount of \$13.1 million in improper payments includes an OIG engineer's review of records provided in support of construction line items to ensure that the quantity and quality of work completed was sufficiently documented. Initial findings were discussed with FAA on July 8, 2009. FAA provided additional documentation, which was reviewed by our engineer, and items were cleared if the documentation adequately supported the payments made for the construction items. The items still lacking sufficient documentation were again discussed with FAA on August 28, 2009. FAA provided further documentation, which was considered by the engineer. On May 13, 2010, we met again with FAA, and with OIG's engineer, to review the summarized items that OIG's engineer had identified as improper.

FAA did not agree with our projected estimate of \$160.7 million in improper payments made in fiscal year 2008. FAA indicated that its estimate of fiscal year 2008's improper payments could be as low as \$46.6 million. On May 11, 2010, OIG's statistician provided an in-depth presentation to FAA on our sampling methodology and projection, and addressed all questions posed by FAA officials and their contractors. Neither at the conclusion of that presentation nor in its response, did FAA provide a basis for its position on the projected estimate of improper payments.

For recommendation 6, while FAA concurred, it does not acknowledge the need to revise current procedures when a cost or price analysis is required. The AIP Handbook does not indicate the circumstances in which sponsors are required to perform a cost analysis. Additional clarifying information is needed to determine price reasonableness of contracts reimbursed by FAA.

ACTIONS REQUIRED

FAA provided acceptable actions and timeframes for recommendations 3, 4, 5, and 7, and we consider the actions resolved but open until the planned actions are complete. In accordance with Department of Transportation Order 8000.1C, we request FAA to re-evaluate its position on recommendations 1, 2, and 6 and provide a written response within 30 days of this report. We also ask FAA to

reconsider its position on the \$13.1 million in improper payments identified by OIG and its position on our estimate of \$160.7 million in improper payments made in fiscal year 2008.

We appreciate the courtesies and cooperation of Department of Transportation, Federal Aviation Administration's Office of Airports representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-1427 or Earl Hedges, Program Director at (410) 962-1729.

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cc: Assistant Secretary for Budget and Programs, and Chief Financial
Officer, DOT
Acting Associate Administrator for Airports, FAA
Martin Gertel, M-1
Anthony Williams, AAE-001

EXHIBIT A. SCOPE AND METHODOLOGY

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted this audit between June 2008 and July 2010. Our objectives for this audit were to assess the sufficiency of FAA's internal controls to prevent and detect improper payment to AIP grant recipients. To address our audit objectives, we interviewed FAA headquarters and ADO officials on their procedures used to prevent and detect improper payments. FAA ADOs provided us with a walk through of their processes for: (1) approving grants, (2) identifying and monitoring high-risk AIP grantees, and (3) approving payment requests from grantees. We interviewed AIP grant recipients on controls used to prevent and detect improper payments.

During the survey phase, we tested a judgmental sample of 7 manual payments and 69 electronic (letter-of-credit or LOC) payments, valued at \$44.4 million and made to 9 AIP grantees. Manual payments require grantees to submit payment requests and documentation to ADOs for pre-payment approval, whereas LOC payments, allow grantees to draw funds automatically without prepayment approval. The sample was drawn from the universe of processed payments recorded in the Department's Delphi accounting system.

For the verification phase, the OIG statistician selected a 3-stage statistical probability proportional to size sample with replacement to determine the extent of improper payments made during fiscal year 2008. 'With replacement' meant a payment had a chance of being selected more than once because it was returned to the pool of eligible's after being selected. This methodology resulted in a statistically valid sample of 18 out of 873 grantees, 116 out of 18,368 AIP payments, and 470 vouchers with a value of \$204 million out of a universe total of \$3.2 billion.

We also reviewed an additional \$2.9 million of AIP payments not directly in the survey or verification phase samples. These AIP payments were made to two grantees, both of whom had associated payments that were tested in the verification sample. The additional payments were to the Panama City-Bay County International Airport and Industrial District and the City of Houston.

We tested AIP payments for compliance with the Improper Payments Information Act of 2002 (IPIA) and in particular, OMB Circular A-123, Appendix C. Payments were also tested for compliance with OMB Circulars: A-87 and A-133; Code of Federal Regulation (CFR) Title 49: “Transportation, Part 18 – Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; FAA Order 5100.38C, “AIP Handbook”; and FAA Advisory Circulars 150/5370-10C and 150/5370-12A.

An OIG engineer reviewed 23 sample payment items to determine whether: (1) payment items complied with contract-specified quantities and prices, (2) payment quantities were properly measured and correctly calculated by the grantee’s engineer, and (3) material quality tests indicated that materials met contractual requirements.

We estimated the total amount of improper AIP payments made during the period reviewed and classified these payments into one of the five categories of improper payments as outlined in OMB Circular A-123, Appendix C. The categories are: (1) payments to ineligible recipients; (2) duplicate payments; (3) payments in incorrect amounts; (4) payments for ineligible services or services not received; and (5) payments having insufficient documentation. We statistically projected the amount of improper payments made in fiscal year 2008. We also assessed FAA's risk-based approach to AIP grant oversight (PGL 07-1) including the risk-assessment and payment review processes. Lastly, we examined FAA and other procurement requirements (as applicable) for approving construction contracts to further evaluate the overall adequacy of FAA AIP grant oversight.

EXHIBIT B. REQUIRED PAYMENT DOCUMENTATION AND FAA OVERSIGHT BASED ON RISK-CATEGORIZATION (PGL 07-1)

High-risk grantees are those that have committed a blatant or reckless violation of a grant agreement or have repeated any of the moderate-level infractions. Low-risk grantees are those that do not meet the criteria for a moderate-risk rating.

Grantees with high-risk ratings must provide for FAA's approval project invoices before receiving reimbursement payments from AIP funding. Furthermore, high-risk grantees are not allowed to receive AIP funds electronically. On the other hand, grantees with low-risk ratings are not required to provide evidence of work completed for each payment request and can receive AIP funds electronically without prior FAA approval. Moderate-risk grantees are required to submit invoices or a listing of invoices for each payment request, although FAA's guidance is unclear as to the level of review required.

A moderate-risk rating is applied to first-time airport grantees, grantees with an annual total grant project funding amount that exceeds \$20 million, grantees with deviations from grant management processes resulting in criminal proceedings, and grantees with other documented occurrences such as: 1) a finding of fraud waste or abuse, 2) repeated grant draw-down irregularities, 3) single audit findings requiring payments to the Federal Government in excess of \$100,000, 4) previous finding of noncompliance with grant assurances, and 5) a lack of conformance to plans and specifications.

EXHIBIT C. ANALYSIS OF PAYMENTS DEEMED IMPROPER

Commonwealth Ports Authority, Mariana Islands - \$1,284,635

The sole source contract award was not properly approved. The Boeing contract was signed on February 12, 2004. A letter dated February 7, 2003 from the Airports Division Manager (AWP-600) to the Manager, Honolulu Airports District Office (HNL-600) states that a pre-award review for the procurement by non-competitive proposal should be approved by your office prior to any contract award. However, the contract award was approved by FAA on February 20, 2004, eight days after the contract was awarded without evidence of a pre-award review.

City of Phoenix, Arizona - \$156,821

This improper payment amount represents interest earned on ineligible payments to the grantee. The grantee provided a spreadsheet identified as "Schedule of Amounts Returned to FAA." The spreadsheet identified amounts of AIP funds drawn-down during the life of the grant to reimburse the City for costs to acquire properties surrounding the airport; the amounts totaled \$1,413,058. The City notified us that these properties were not eligible for AIP reimbursement since AIP funds were previously used to sound mitigate the same properties. The City reported the \$1,413,058 amount was returned to FAA via the last draw-down of the grant. In an April 13, 2009 teleconference with a City official, we were notified that the City was not made aware for over three years that these funds had been incorrectly drawn-down, until the City was notified by its contractor. Once they were made aware, they corrected the situation by returning the funds to FAA. We determined that the interest earned of \$156,821 on AIP funds should be considered improper.

Memphis-Shelby County Airport Authority, Tennessee - \$1,093,797

The \$1,093,797 amount is comprised of four improper payment amounts (\$264,999; \$15,789; \$687,645 and \$125,364). In the May 18, 2009 response to our survey results, FAA agreed \$264,999 was improper because the Airport lacked an approved cost allocation methodology, and the \$15,789 was for ineligible furnishings. We also identified \$687,645 in ineligible bonuses. The Airport billed FAA without removing the bonus amounts in May 2008. In April 2010, we presented to FAA that the Airport spent \$125,364 for decorative landscaping, which is prohibited by the AIP Handbook.

City of Santa Barbara, California, OIG Engineer Review - \$528,235

The \$528,235 is comprised of three payments for construction line items at the Santa Barbara Municipal Airport. An OIG engineer found that these payments lacked sufficient documentation to demonstrate the amount of work completed. For two of the payments, the City of Santa Barbara could only provide a rough estimate of the percentage of work completed; however, FAA specifications

required these items to be measured and recorded on a linear foot basis. The third payment was not required to be measured on a linear foot basis; however, the City of Santa Barbara did not provide documentation to demonstrate any approximate measurement of the work completed.

Memphis Shelby County Airport Authority, Tennessee - \$2,153

In the May 18, 2009 response to our survey results, FAA agreed insufficient documentation existed for stored materials in the amount of \$2,153.

Wisconsin Department of Transportation, Bureau of Aeronautics, OIG Engineer Review - \$711,869

Documentation provided did not support the payment made for construction work completed at the Austin-Straubel International Airport. An OIG engineer identified a discrepancy between the amount of work completed as stated in the weekly progress reports and the invoiced amount. In addition, documentation was not provided to demonstrate that required field tests and inspections were performed, and that the quality of work performed and materials used met specifications.

City of Los Angeles, California, OIG Engineer Review - \$709,629

The \$709,629 consists of three payments for construction line items at the Los Angeles International Airport. All three line items lacked documentation to support the quantity of work completed, and one line item lacked documentation to demonstrate the quality of work performed. The City of Los Angeles submitted documentation with contradicting quantities to support the amounts of work completed. The quantity of work performed stated on the contractor's quantity sheets was not supported by the supplemental documentation provided such as worksheets, a field memo, and bid item payment sheets. Also, sufficient documentation was not provided for one payment to demonstrate that various required field tests and inspections were performed, and that the quality of work performed and materials used met specifications.

City of Jonesboro, Arkansas, OIG Engineer Review - \$38,915

Construction work completed at the Jonesboro Municipal Airport was not sufficiently documented. An OIG engineer found discrepancies between the amount of work completed as shown in the measurement documentation and the project totals provided by the City of Jonesboro. In addition, the measurement documentation provided was not dated, did not contain calculations, and in several cases was not legible.

Barnwell County Airport Commission, South Carolina - \$42,893

The Barnwell County Airport Commission lacked adequate construction documentation for the installation of medium intensity taxiway lights. The

Exhibit C. Analysis of Payments Deemed Improper

supporting documentation from the Commission was a parts invoice, which did not support the quantities or item descriptions shown on the invoice for this construction line item.

Kansas City, Missouri - \$2,624.

This payment was improper because of lack of documentation at the time of payment. On January 15, 2009, we received the requested documentation from a Kansas City official. Our review of invoice #32 from a contractor included an engineer listed without an attached timesheet for this person. We contacted the Kansas City official on February 20, 2009, to obtain the missing timesheet. We were given a new invoice # 32 that replaced the original engineer with another engineer and timesheet.

City of Phoenix, Arizona, OIG Engineer Review - \$11,009

Documentation provided by this grantee demonstrated that a contractor was improperly paid for incomplete work on a pavement construction line item at the Phoenix Sky Harbor International Airport. The contract specification stated that payments shall only be made for pavement work that is completed and accepted. However, the City of Phoenix paid the contractor in advance for preparatory work. As a result, this improper payment was categorized as a payment in the incorrect amount. The OIG did not identify this amount as an alleged duplicate payment, as stated in FAA's Response Memorandum.

Panama City- Bay County Airport and Industrial District, Florida, OIG Engineer Review - \$4,031,200

Required documentation was not provided to support a construction payment at the Panama City-Bay County International Airport. No documentation was provided to demonstrate that required field tests and inspections were performed to ensure that the quality of work performed and materials used met specifications.

City of Houston, Texas, OIG Engineer Review - \$77,495

Required documentation was not provided to support a construction payment at the William P. Hobby Airport. The documentation provided used a different material than stated in the contract; however, the City of Houston could not provide documentation to demonstrate the substituted material was of acceptable quality or that the substitution was approved. In addition, documentation to support the quantity of work completed did not contain source documentation of field measurements and calculations, which are necessary to verify the quantity of work performed. Also, documentation was not provided to demonstrate that various required field tests and inspections were performed, and that the quality of work performed and materials used met specifications.

Exhibit C. Analysis of Payments Deemed Improper

City of Houston, Texas - \$152,521

Neither the City nor FAA officials could explain why the City drew-down funds for \$152,521 only to return the funds on a subsequent draw-down. The OIG contacted the City of Houston about this drawdown on April 14, 2009. The issue was discussed with the ADO on May 27, 2009. The issue was also discussed and documentation was provided to FAA Airports representatives on June 11, 2009. However, no documentation was provided to demonstrate that this payment was proper.

City of Houston, Texas - \$53,172

This improper payment amount of \$53,172 is based on a lack of documentation for improvements at the Ellington Field. In February 2009, we requested documentation for a \$335,061 payment. After three months, we received support for \$281,889. It was not until May, 12, 2009 that the City of Houston provided an explanation for the remaining \$53,172. The City claimed that there were significant overages that could be used to support this amount. However, the documentation provided by this grantee identified work that was performed at another airport, William P. Hobby Airport. Documents supporting our conclusion were provided and discussed with the ADO on May 27, 2009 and FAA Airports representatives on June 11, 2009. In its response, FAA states that the payment amount is proper based on a preliminary review. The OIG disagrees with FAA's preliminary conclusion when a grantee provides support for work at an airport not identified in the grant agreement.

Panama City- Bay County Airport and Industrial District, Florida - \$2,508,905

The \$2,508,905 is comprised of two improper payment amounts (\$387,934 and \$2,120,971) that resulted from a referral by the Florida Department of Transportation, Office of Inspector General. The \$387,934 payment amount is improper based on a lack of documentation. The \$2,120,971 improper payment occurred because the grantee received AIP funds for tasks not approved in the initial grant agreement. We discussed these issues with Orlando ADO officials on meetings held on February 23, 2010, March 5, 2010 and March 11, 2010. We asked the ADO to obtain supporting documentation for the \$387,934. In the March 11, 2010 meeting, ADO Manager stated that the documentation was not available and it is unlikely that the grantee could provide it. Also, the ADO acknowledged that this grantee received payments of \$2,120,971 for tasks not approved in the initial grant agreement. On February 19, 2010, the ADO modified the grant agreement to replace the tasks initially outlined in the original grant agreement with the other AIP eligible task work items that the grantee had already received payments for. Also, ineligible items that the grantee received payment for were replaced with other AIP eligible work. We determined that \$2,120,971 is

improper under AIP grant #35 as an ineligible service because the costs billed were clearly not approved under the initial grant agreement.

EXHIBIT D. MAJOR CONTRIBUTORS TO THIS REPORT

<u>Name</u>	<u>Title</u>
Earl Hedges	Program Director
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Brian Frist	Senior Analyst
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Lakarla Lindsay	Senior Auditor
Stephen Berkeridge	Auditor
Allison Sturges	Analyst
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Karen Sloan	Communications Officer
Aron Wedekind	Engineer
Amy Berks	Senior Counsel
Terrence Letko	Program Director
Susan Neill	Writer-Editor

APPENDIX. AGENCY COMMENTS



Federal Aviation Administration

Memorandum

Date: **OCT 05 2010**

To: Louis King, Acting Assistant Inspector General for Financial and Information Technology Audits

From: Clay Foushee, Director, Audit and Evaluation

Prepared by: Anthony Williams, x79000

Subject: OIG Draft Report: Improper Payments in the Airport Improvement Program, FAA

Federal Aviation Administration (FAA) Works Aggressively to Prevent and Address Improper Payments

Utilizing multiple levels and types of programmatic controls, the FAA judiciously applies approximately \$3.5 billion per year to maintain and improve the Nation's airport infrastructure to ensure that airports are safe and effectively service the aviation needs of American taxpayers. These expenditures are a result of extensive and careful planning, prioritization, and programmatic oversight by both technical and financial experts.

Strong financial internal controls are essential to prevent, detect, and as necessary, quickly remediate improper payments. FAA has implemented such a system. Every year, FAA performs a management review of its grant payment process in compliance with the Improper Payment Act of 2002 (IPIA). In 2009, FAA self-identified improper payments totaling \$2.2 million in the sample of 431 tested items. The projection of these identified improper payments resulted in a statistically valid estimate indicating that less than 1 percent of the programs payments could be categorized as improper. This error rate of less than 1 percent is well below the threshold of significance as defined by the Office of Management and Budget (OMB).

Fiscal Year (FY) 2010 testing is underway and to date, the results look even stronger. Following the Department's mandated review methodology, which will result in a similar sample size and approach as used in the FY 2009 review, findings have been very encouraging. With 99 locations visited, to date we have identified an overpayment of \$553.50 and three underpayments totaling \$786.27.

FAA Continues to Fine Tune Controls over Improper Payments

While the percentage of improper payments found in 2009 was below the percentage threshold established by OMB and FAA's work for 2010 looks encouraging, we continue to fine-tune

FAA's controls. For example, in 2009, FAA significantly increased its sample size and carefully monitored all phases of sampling to ensure statistical validity. FAA also modified its sample design to add an initial stratification based on project size. FAA also continued education, guidance, and outreach efforts to airport sponsors by issuing alerts and resource bulletins on actions required to prevent or detect such payments, including articles on improper payments in regional newsletters sent to sponsors and consultants and discussing improper payments at regional conferences. The FAA continues to closely monitor the IPIA testing process and results and will continue to take those actions necessary to ensure that the process is effective.

FAA Fine Tuning Its Risk Based Approach for IPIA Testing of American Recovery and Reinvestment Act (ARRA) Funds

FAA's oversight of ARRA grant funds has been particularly aggressive. For example, FAA issued several program guidance letters in 2009 and 2010 that included oversight and inspection of ARRA funded construction projects. We are also evaluating, through an independent contractor, the existing risk-based approach to ARRA grantee oversight. FAA is considering steps to further strengthen the current risk-based framework for overseeing Airport Improvement Program (AIP) grants, including ARRA grants. This includes enhancements to the existing FAA risk assessment methods based on best practices and performing on-site monitoring that will assess the sufficiency of the grants management process, including the completeness of grantee files.

In addition, FAA is also considering potential revisions to further strengthen the entire AIP oversight process. It has committed to reviewing the ARRA risk analysis model for potential application to the overall AIP program. We are also developing an initial pilot program to support a sustainable AIP Quality Assurance Oversight Group based on best practices. The group would be responsible for developing and implementing a program to periodically review AIP grant payments based on a risk-based methodology.

Finally, FAA is significantly revising the AIP Handbook, the principal policy manual for administering AIP, to ensure that all statutory and regulatory requirements are clearly delineated and up-to-date. This revision process will give careful consideration to the Office of Inspector General's (OIG) findings and recommendations as well as findings and recommendations from internal reviews.

FAA Results Differ from OIG Findings.

FAA is carefully reviewing the results of OIG's analysis of improper payments in FY 2008. Based on results to date, it disagrees with \$4.6 million of the total \$13.1 million identified by OIG as improper payments. The largest portion of the amounts deemed improper by the OIG relate to payments categorized as improper due to insufficient documentation (51 percent). We found upon further review that many of these payments were properly documented and, accordingly, proper. Our review of transactions, which included site visits, showed that \$4.6 million of the \$13.1 in payments the OIG deemed improper, were in fact valid as described in the table below.

In addition, based on our preliminary reviews, we are not in agreement with an additional amount of \$4.7 million deemed improper by the OIG. The OIG report identified payments totaling \$6.5 million by the Panama City – Bay County Airport and \$0.3 million by the city of Houston as improper. Our preliminary review of payments totaling \$4.4 million by the Panama City–Bay County Airport and \$0.3 million by the city of Houston indicated that these payments are proper. The OIG reported an additional amount of \$2.1 million as improper for Panama City –Bay County Airport as the result of a Hotline call. We are in the process of completing our review of the documentation in support of all of the foregoing, and cannot yet make a determination as to whether they should be considered improper.

As a consequence, FAA also does not concur with the projected \$160.7 million estimate of FY 2008 improper payments. While we do not have the specific algorithms that the OIG used, we have determined, based on proportional analysis, that the maximum total projection could be as low as \$46.6 million.

Results of FAA’s Detailed Review of OIG Findings

Improper Payment Category & Recipient	Non-Concur Amount	FAA Review Findings
Alleged Ineligible Recipient		
Commonwealth Port Authority, Marianna Islands	\$1,284,635	Sole source award was properly approved
Alleged Ineligible Services		
Phoenix, Arizona	\$ 156,821	Draw-down was for eligible properties and occurred after payment to property owners
Memphis-Shelby County Airport Authority, Tennessee	\$1,093,797	All invoices predated the date of the draw-downs and Federal payment was net of the bonuses
Alleged Insufficient Documentation		
Santa Barbara, California	\$ 528,235	FAA’s engineers found that the documentation provided the OIG is in accord with normal business practices and contract requirements
Memphis – Shelby County Airport Authority, Tennessee	\$ 2,153	
Wisconsin Department of Transportation	\$ 711,835	
Los Angeles, California	\$ 709,629	
Jonesboro, Arkansas	\$ 38,915	
Barnwell County Airport Commission, South Carolina	\$ 42,893	
Kansas City, Missouri	\$ 2,624	
Alleged Duplicate Payment		
City of Phoenix, Arizona	\$ 11,009	Work billed was performed. FAA review showed no duplicate payment
Total	\$4,582,546	

Appendix. Agency Comments

Recommendations and Responses

Recommendation 1: Re-enforce FAA guidance to AIP grantees for preparing "construction" payment request, including supporting documentation to be maintained for both the quantity and quality of the work/materials reimbursed under the AIP.

FAA Response: Concur The FAA will re-emphasize to AIP grant sponsors the requirements in the AIP handbook and relevant Advisory Circulars on the quality and quantity of necessary documentation they should maintain for AIP grant projects. This action will be completed by December 31, 2011.

Recommendation 2: Identify the funds that can be recovered from the improper payments identified in this report and develop and implement a plan to maximize the recovery of these payments.

FAA Response: Partial Concurrence. While the FAA does agree to review in detail the report's findings with regard to improper payments, and make appropriate recoveries, based on the results of FAA's detailed reviews to date, it does not agree with the amount the OIG deemed improper (\$13.1 million). As discussed above, based on our reviews, the FAA does not agree with at least \$4.6 million of the OIG's findings.

In addition, the OIG's list of improper payments included payments totaling \$6.5 million by the Panama City-Bay County Airport and \$0.3 million by the city of Houston. These payments are in addition to those included in the schedule and discussed above. FAA's review of documentation in support of these payments is ongoing, and until its review is complete FAA cannot concur with this finding or amounts.

Specifically, moving forward FAA will:

- Take no further action on the amounts included in the schedule above totaling \$4.6 million with which we do not concur.
- Complete reviews of supporting documentation for Panama City – Bay County payments totaling \$6.5 million and the city of Houston totaling \$0.3 million and take action, if and as appropriate. Planned review completion date: December 31, 2010.
- Review the activities associated with the balance of the amount cited by the OIG and make a final recoverability determination. Planned completion date: December 31, 2010.

Recommendation 3: Develop a procedure to prevent duplicate AIP payments to grantees that submit manual payment requests and drawdown funds electronically under the same grant.

FAA Response: Concur. FAA staff will be reminded of the procedures requiring them to check for electronic payment before approving manual payment requests. Regional and Airport District Office (ADO) staff will be reminded not to approve any manual payment if the grantee is approved for electronic payments. We are also working with the Department's Chief Financial Officer to design and implement a Department wide grants payment system with additional controls. These FAA actions will be completed by December 31, 2010.

Appendix. Agency Comments

Recommendation 4: Revise risk-management procedures to require:

- a. ADO program managers to review annually the risk-assessments for their grantees and provide written confirmation to the associate administrator that the assessment was done in compliance with the risk-management criteria specified in the risk-management procedures.
- b. ADO program managers to review and approve payment support documents submitted by moderate-risk grantees within 30 days of payment.
- c. All low-risk grantees requesting payment to prepare and have on file for FAA review, as needed, a summary listing of invoices and other eligible charges for each payment request to include: (1) a brief work summary, (2) vendor names, (3) dates of service, (4) billed amounts, (5) applicable payment dates, and (6) a calculation of the Federal share.
- d. ADO program managers to review on a periodic basis the invoices or a summary listing of invoices and eligible charges for AIP payments to low-risk grantees.

FAA Response: Partial concurrence. While FAA recognizes the need to ensure its risk management processes are effective, it will address this recommendation through alternative action. Since FAA's risk assessment process was started in 2007, it has already evolved to strengthen its efficacy. As part of its efforts to ensure effective oversight of the ARRA funds in particular, in October 2009, the Office of Airports (ARP) initiated a review of its risk assessment methodology; a review of selected grant, contract and payment files; and a process to identify guidance elements that should be updated. This effort focused on the payments issued against grants funded by ARRA.

While this review is still underway, it is looking at expanding the factors considered during the risk assessment process and identifying best practices. Using the information gathered from all phases of this review, recommendations for a systematic review process will be developed. A report summarizing the results of this work is expected in October 2010.

The FAA understands the intent of this OIG recommendation to improve the risk assessment process in order to prevent and detect improper payments. Rather than implement a piecemeal approach, the FAA prefers to incorporate the concepts presented in the recommendation in the larger process we are undertaking as a result of our recent review. We do acknowledge the need to periodically review and improve the process and will, based on the result of the ARRA review, make improvements in the process. FAA anticipates completing this process by June 1, 2011.

Recommendation 5: Initiate a review to determine if the final contract price for the third runway embankment contract at the Seattle-Tacoma International Airport was fair and reasonable. Within 30 days, provide a report to the OIG detailing the results of the review and planned action dates.

FAA Response: Concur. The FAA acknowledges this matter requires further review. The FAA will establish a team with members from FAA's Office of Airports and contracting offices to determine if the final contract price for the contract at Seattle-Tacoma International Airport was fair and reasonable. Because of the complexity of this issue and the need to work with the airport sponsor, we expect the review to be completed by February 1, 2011.

Recommendation 6: Revise the AIP Handbook to clarify what information is required to assist grantees in determining contract cost or price reasonableness, and further outline the responsibility for FAA ADO program managers to verify that contract costs are reasonable. Develop training for grantees and program managers to reinforce these revisions, if needed.

FAA Response: Concur. The FAA acknowledges the need to review the AIP Handbook to determine if additional clarifying information is required to assist grantees in determining contract price reasonableness. As part of this review, we will look at other available guidance provided to grantees for this purpose. If revisions are required, they will be completed by April 1, 2011 with appropriate training to ADO staff and airport sponsors within 3 months of the handbook or other guidance revision.

Recommendation 7: Re-emphasize to ADO management the AIP Handbook requirement for contacting the OIG when conditions warrant a "Review for Bid Improprieties."

FAA Response: Concur. We will re-emphasize the existing AIP Handbook requirement to ADO management the AIP handbook requirement by December 31, 2010. It had been our understanding that because of OIG workload concerns, the practice of providing such notice had been discontinued. The FAA will work with the OIG to establish a reasonable and supportable process (with due consideration of OIG workload and the timing requirements involved with administration of AIP grants), and incorporate the resulting criteria in the AIP handbook.