
Office of Inspector General
Audit Report

**Report on Design of the Cost
Accounting System for Research
and Acquisitions**

Federal Aviation Administration

Report Number: FI-2001-013
Date Issued: December 18, 2000





Memorandum


U.S. Department of
Transportation

Office of the Secretary
of Transportation

Office of Inspector General

Subject: **ACTION: Report on Design
of the Cost Accounting System for
Research and Acquisitions, FAA
FI-2001-013**

Date: December 18, 2000

From: Alexis M. Stefan, 
Assistant Inspector General for Auditing

Reply To
Attn Of: Meche:x61496

To: Assistant Administrator for Financial Services, FAA
Associate Administrator for Research and Acquisitions, FAA

This report is one in a series on implementation of the Federal Aviation Administration (FAA) cost accounting system. FAA initially planned to have a fully operational cost accounting system by October 1, 1998. FAA's current schedule for full implementation of its cost accounting system for all lines of business is by the end of Fiscal Year (FY) 2002. FAA's total appropriated funds will increase from about \$8 billion in FY 1996 to about \$12 billion in FY 2001, a 50 percent increase in 5 years. Thus, a cost accounting system compliant with accounting standards is essential for FAA to control its cost growth and improve the efficiency and performance of its operations.

On December 7, 2000, the President directed that the Secretary of Transportation establish within FAA a performance-based, results oriented, organization to improve the provision of air traffic service in ways that increase efficiency, take better advantage of new technologies, accelerate modernization efforts, and respond more effectively to the needs of the traveling public, while enhancing safety, security, and efficiency of the Nation's air transportation system. While our report addresses the cost accounting system being developed for FAA's Research and Acquisitions line of business, these findings and recommendations take on added significance because FAA's cost accounting system will form the foundation for developing financial data for the new Air Traffic Organization.

To be effective in evaluating a results-oriented organization, FAA's cost accounting system must meet accounting standards used by private industry and get reliable cost data from an effective labor distribution system. In an earlier report¹, we recommended that FAA develop a labor distribution system that would capture accurate data for the cost accounting system. About 52 percent of FAA's

¹Report on FAA Cost and Flight Data for Aircraft Overflights, Report Number FE-2000-024, December 17, 1999.

total reported costs are for labor. Unless FAA implements a labor distribution system, it cannot accurately track labor costs for specific activities and services. In order for its cost accounting system to have credibility, FAA needs a labor distribution system that can track labor costs by specific activities and services to aid FAA in controlling its growing costs and improve the efficiency and performance of its operations.

In this audit, we reviewed the portion of the FAA cost accounting system being designed and implemented for the Office of the Associate Administrator for Research and Acquisitions, which is one of FAA's six lines of business. Research and Acquisitions is implementing a pilot labor distribution reporting system to track labor cost. Research and Acquisitions designs and acquires property, plant, and equipment for all of FAA and incurred about \$1.2 billion of the \$9.2 billion in cost FAA reported for FY 1999.

The objective of this audit was to determine whether the FAA cost accounting system would accurately account for the operations cost of the Research and Acquisitions line of business and for the cost of facilities and equipment that it develops and acquires for all FAA lines of business. We also sought to determine whether amounts in the financial accounting system were recorded in the FAA cost accounting system.

The Federal Accounting Standards Advisory Board has developed managerial cost accounting standards for the Federal Government. These standards are basically the same as those used by private industry businesses, such as the Boeing Company, for (1) setting budgets for services; (2) establishing cost targets for controlling cost and measuring performance; (3) computing cost of services and setting fees; (4) evaluating programs; and (5) making business decisions. Congress and Federal executives need accurate cost information on agencies' programs and services to make policy decisions and to allocate resources. Accurate cost accounting data also alerts Government managers to potential waste and inefficiency.

RESULTS IN BRIEF

FAA currently is implementing the portion of its cost accounting system for the Research and Acquisitions line of business. We confirmed that the cost reported in the Department's financial accounting system is accurately recorded in the cost accounting system. FAA also has made progress accounting for the cost of materials and contracts. However, the cost accounting system will not collect and allocate cost to projects using acceptable industry practices or as required by Federal accounting standards. The labor cost data being entered into the cost accounting system also are inaccurate.

The cost accounting system being developed is not designed to properly collect the labor, overhead, or software-development cost associated with facilities and equipment projects. For example:

- For the first quarter of FY 2000, about \$16 million of \$44 million, or 36 percent of Research and Acquisitions' labor cost, could not be identified with projects in the cost accounting system due to computer programming and technical design flaws with the labor distribution system. Internal controls are not in place to offset design problems and identify reporting errors.
- Federal accounting standards require that different types of overhead cost (cost benefiting more than one project), such as production overhead and general and administrative expenses, be accumulated in separate cost pools. However, FAA combines all types of overhead into one pool. FAA also would incorrectly expense about \$63 million annually in overhead cost because the cost accounting system is not designed to identify the portion of overhead cost (production overhead) that should be capitalized and included in asset values.
- Federal accounting standards require that overhead cost be charged to projects using an appropriate allocation basis which should include the most significant cost incurred for projects. Instead of using total project expenditures to allocate overhead, FAA uses direct labor and benefits cost, which makes up less than four percent of Research and Acquisitions' cost. While Research and Acquisitions spends about \$46 million annually for labor and benefits charged to projects, it also spends about \$981 million in contracts, materials, and other direct cost for this effort, which are excluded from the allocation base.

As a result, an inappropriate amount of cost is being allocated to facilities and equipment projects. For example, FAA reported direct costs of about \$280,000, including \$230,000 in labor, for the first quarter of FY 2000 for one of several projects for the Wide Area Augmentation System. Because FAA allocated overhead costs using a direct labor basis, FAA overstated the total project costs by allocating about \$1 million of overhead cost to this project. However, only about \$59,000 in overhead cost should have been added to the project using the correct basis (total expenditures instead of direct labor) for allocating overhead costs.

- FAA is not including in asset accounts about \$27 million of software-development cost for its administrative systems. For example, under the current practice, the cost of designing and implementing the FAA Cost Accounting System would be understated by about \$20 million because FAA inappropriately expensed the software cost of this system, instead of including this cost in its asset accounts.

To accurately account for the cost of projects and activities, the data entered into the cost accounting system must be correct. Labor cost data for facilities and equipment and other projects are inaccurately reported and will be of limited use to management for decision-making purposes. Specifically:

- Research and Acquisitions has weak internal controls over timekeeping for labor charges. For example, 33 of 66 employees interviewed had blank timesheets for 2 to 10 days for the pay period we reviewed. Also, 12 employees had already completed their timesheets up to 2 weeks in advance and 5 employees did not have timesheets.
- Employees used outdated project numbers for timekeeping purposes. For example, employees charged about \$245,000 in labor cost to a project for the first quarter of FY 2000 although the project was completed in FY 1997. In another example, an employee was detailed to a different department for 180 days, but continued to charge an unrelated project from his old department.

The portion of the cost accounting system and cost accounting practices being designed and implemented for Research and Acquisitions will not provide FAA management with accurate information for its operations or facilities and equipment costs. Additionally, although expensing the \$63 million of annual overhead cost and excluding \$27 million in software cost from asset values would not materially misstate the annual financial statements initially, the cumulative practice would be material and could jeopardize unqualified audit opinions on future FAA financial statements. For example, unless changes are made now, FAA assets could be understated by as much as \$251 million by the time the cost accounting system is operational at the end of FY 2002.

For Research and Acquisitions to have an effective cost accounting system, FAA needs to:

- Modify the labor distribution system to assure that time is charged to appropriate projects or categories by making computer-programming changes to the existing system.
- Implement timekeeping procedures to ensure that hours worked are charged to proper projects.
- Create separate cost groupings for different types of common costs, such as production overhead and general and administrative expenses.

- Change the basis of allocating overhead to total expenditures, which includes all project cost including contracts and materials used to produce facilities and equipment projects.
- Include an applicable portion of production overhead in work-in-process or other asset accounts until the facilities and equipment projects are completed and put in use.
- Establish procedures to identify commercial and externally developed software costs incurred for administrative systems under development, and record the cost in work-in-process and other asset accounts in the financial and cost accounting systems.

FAA agreed with our recommendations. Specific corrective actions are planned for labor distribution reporting by June 30, 2001; for overhead costs by December 31, 2000; and for capitalizing costs in work-in-process accounts by October 31, 2001.

BACKGROUND

This is our third report related to the development of FAA's cost accounting system. This report addresses the portion of the cost accounting system being implemented for the Office of the Associate Administrator for Research and Acquisitions. The first report² addressed accounting issues regarding the development of the system and issues requiring resolution before cost could be captured in the system. The second report³ addressed FAA's efforts to implement the portion of a cost accounting system within Air Traffic Services for overflights, which are aircraft that fly in U.S.-controlled airspace, but that do not take off or land in the United States.

The Federal Aviation Reauthorization Act of 1996 (Act) requires FAA to develop a cost accounting system that accurately reflects the asset values, operating and overhead cost, and other financial measurement and reporting aspects of its operations. The Statement of Federal Financial Accounting Standards (SFFAS) Number 4, Managerial Cost Accounting Standards, also requires that Federal entities establish managerial cost accounting practices effective October 1, 1997.

During FY 1997, FAA purchased commercial off-the-shelf cost accounting system software to design and implement a cost accounting system for its individual lines

²Report on Implementation of FAA Cost Accounting System, Report Number FE-1998-186, August 10, 1998.

³Report on FAA Cost and Flight Data for Aircraft Overflights, Report Number FE-2000-024, December 17, 1999.

of business. FAA initially planned to have a fully operational cost accounting system by October 1, 1998. FAA is designing its cost accounting system in phases for its organizations and activities. FAA's current schedule for full implementation of its cost accounting system for all lines of business is by the end of FY 2002.

The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century requires that the Department of Transportation (DOT) Office of Inspector General (OIG) perform an independent assessment of the adequacy and accuracy of FAA's cost data and cost allocations. In conducting the assessment, the OIG is to assess the reliability of source documents and the data collection process; the system for tracking assets; the basis for establishing asset values and depreciation rates; the indirect cost pools and allocation bases; and the progress FAA is making in cost and performance management.

The Act requires OIG to submit a report to Congress no later than December 31, 2000, and every year thereafter through FY 2004. Our audit work on the Research and Acquisitions cost accounting system will be used to satisfy some of OIG reporting requirements under the Act.

SCOPE AND METHODOLOGY

We reviewed written policies and procedures to obtain an understanding of the internal controls regarding the portion of FAA's cost accounting system related to Research and Acquisitions. We also verified the reconciliation of financial and cost accounting data. We examined supporting documentation for materials and other direct costs incurred for 32 facilities and equipment projects. To review labor charging practices, we conducted interviews with 66 statistically-selected employees of Research and Acquisitions and used nonstatistical sampling to select 45 additional managers and employees for interviews.

We also analyzed the characteristics of overhead and general and administrative cost pools and the basis used to allocate cost to projects and programs. We used that analysis to determine whether FAA's system design and practices met Federal accounting standards requirements.

The audit was conducted from April through October 2000, at FAA Headquarters in Washington, DC; the William J. Hughes Technical Center in Atlantic City, New Jersey; and the Southern Region in College Park, Georgia. We conducted the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

RESULTS

FAA is designing and implementing a portion of its cost accounting system to accumulate operating costs and the costs for facilities and equipment projects being developed by Research and Acquisitions. We identified several areas in which the cost accounting system and FAA practices, as being designed and developed, are not compliant with Federal accounting standards and are not consistent with good business practices.

Federal accounting standards provide guidance on accounting for cost of projects, such as labor and materials, and for identifying and assigning overhead cost to projects. These requirements are basically the same as those used by industry to determine the cost of products and services.

Labor Distribution Reporting System

The cost accounting system for Research and Acquisitions is designed to get its labor cost from a separate labor distribution reporting system. The labor distribution system currently being used by Research and Acquisitions will not produce accurate labor cost by project for use in the cost accounting system.

Labor Distribution System Design. The Research and Acquisitions labor distribution reporting system is not designed to ensure labor cost can be identified accurately with projects. For example, for the first quarter of FY 2000, about \$16 million of \$44 million in labor cost, or 36 percent, was reported in the labor distribution reporting system as "No Project." As a result, the labor cost could not be identified to any project. Under current practice, FAA records "No Project" cost as expenses. However, a significant part of this cost is direct labor for projects that should be accounted for as assets.

The inaccurate labor reporting occurred because of a system design flaw which charges all hours to "No Project" if the labor hours are not entered by the required date, which is the Wednesday afternoon after each pay period. The system does not allow changes after the pay period ends.

Labor distribution accounting involves collecting the time that employees spend working on projects or activities, typically through the use of timesheets. Statement of Federal Financial Accounting Standards (SFFAS) Number 4 provides that the appropriate detail for cost accounting procedures for items such as labor be based on several factors, including the level of precision that is needed. A high precision level for labor accounting is required for FAA to effectively analyze its spending, accurately identify the costs of its investment programs and operate more efficiently. High precision also is needed because FAA is proposing

to recover some of its costs through user fees. Research and Acquisitions incurs about \$167 million of labor cost annually.

Timekeeping Procedures. The Research and Acquisitions line of business does not have adequate timekeeping policies and practices to ensure that labor is accurately recorded in the labor distribution system. Timekeeping procedures should be in writing and provided to all employees, and procedures should be in place to monitor timekeeping and labor distribution reporting practices. It is important for any organization to maintain adequate timekeeping procedures to ensure that its labor cost is properly recorded. The proper recording of labor cost enables management to identify pockets of inefficiency and to make informed decisions regarding use of its resources.

Our review of Research and Acquisitions' timekeeping procedures and resulting practices disclosed areas that need attention. Examples of weaknesses in the labor system, which can result in inaccurate reporting of cost, are shown in the following paragraphs.

We conducted interviews with employees and managers to determine actual timekeeping practices. We examined timesheets used to record employees' labor hours and found adequate internal controls over timekeeping were not in place. For example, 33 of the 66 employees had blank timesheets on the date of interview. Five additional employees did not have timesheets and one person completed timesheets for several employees. Additionally, 12 other employees had completed their timesheets up to 2 weeks in advance. Consequently, FAA cannot accurately identify the actual labor cost for projects because employees were estimating time charges instead of recording actual hours worked.

We also found employees charged time to the wrong project or to completed projects. For example, an employee was detailed to another department for 180 days, but continued to charge the same project although the assignment was unrelated to the project being charged. In another example, for the first quarter of FY 2000, employees charged about \$245,000 in labor cost to a project that had been completed since FY 1997. Timekeeping reporting problems and errors were not detected because supervisors approved few timesheets. Written procedures do not require supervisory approval.

Cost Accounting Procedures for Overhead Cost

Research and Acquisitions has been developing procedures to account for common cost, referred to as overhead cost. SFFAS Number 4 defines overhead cost as any cost not directly identified with a specific project but that is commonly used to produce or benefit more than one project. As designed, the cost

accounting system will not capture the appropriate amount of overhead cost for projects and activities for Research and Acquisitions.

Accumulating Overhead Cost. SFFAS Number 4 states that overhead cost should be accumulated into two or more groups, and that each group should be composed of similar types of cost. This ensures that the types of overhead cost are accurately assigned to appropriate projects. Research and Acquisitions accumulates all overhead cost in one group and has no method for identifying the portion of overhead, called production overhead, that should be included in asset values. Cost of the departments associated with producing assets should be included in production overhead cost and added to asset values. Production overhead cost includes supervision and technical support that is provided to employees who work directly on facilities and equipment projects. Because the cost accounting system puts no production overhead in asset values, FAA would understate its asset values and overstate its operating cost in the financial statements by about \$63 million annually.

To comply with Federal accounting standards, Research and Acquisitions should accumulate overhead cost in at least two cost groupings. Creating two overhead accounts will allow Research and Acquisitions the ability to segregate overhead cost that should be included in the cost of assets from cost that should be appropriately expensed each year. Overhead cost that do not relate to the production of assets should be collected in a separate cost grouping, representing general and administrative cost for functions such as budget, contract administration, and financial management.

Allocating Overhead Cost. SFFAS Number 4 requires that overhead cost be allocated to projects using an allocation base that is "relevant." To be relevant, the allocation base should include the most significant cost of projects. As designed, FAA plans to allocate its overhead cost to projects on the basis of direct labor and benefits of about \$46 million, which is less than 4 percent of Research and Acquisitions' project cost. Contracts, materials, and other direct costs make up about \$981 million or about 73 percent of Research and Acquisitions' total cost, but these costs are not in the base for allocation.

Using the current practice, too much cost will be allocated to some projects and too little will be allocated to others. Research and Acquisitions' planned labor and benefits base would inequitably assign overhead cost to projects. For example, FAA reported direct cost of about \$280,000 for the first quarter of FY 2000 for Project 11270101, one of the Wide Area Augmentation System projects related to the Global Positioning System. FAA's method inappropriately allocate about \$1 million of overhead cost for the same period or about 357 percent of direct project cost because this project was more labor-intensive than others.

In this example, FAA incurred \$230,000 for labor out of \$280,000 total costs. Since FAA was using labor cost as its basis to allocate overhead, this project got an inappropriate share. If FAA had used a total expenditures base, which includes all project costs such as labor, materials, and contracts, the correct amount of overhead allocated to this project for the same period would have been only about \$59,000. This example shows that use of an inequitable allocation base results in a significant distortion of cost assigned to projects, which can mislead management and contribute to poor decision making.

In summary, Research and Acquisitions is not accurately accounting for overhead cost in the cost accounting system. As a result, about \$63 million in annual overhead cost will be expensed instead of reported as assets on the FAA financial statements. By the time the cost accounting system is operational at the end of FY 2002, FAA assets could be understated by about \$189 million. Although this would not materially misstate the financial statements initially, the cumulative effect of the proposed practice would be material, and could jeopardize an unqualified audit opinion on future FAA financial statements.

Software Cost for Administrative Systems

SFFAS Number 6 generally requires Federal agencies to account for software cost as part of property or other asset accounts. The accounting standards require this so the cost of assets can be charged to future accounting periods over the life of assets, and prevents the overstating of expenses in the year costs are incurred. SFFAS Number 10, Accounting for Internal Use Software, effective October 1, 2000, reemphasizes that commercial off-the-shelf software and associated contractor implementation cost are to be accounted for as property or other assets under SFFAS Number 6.

While FAA was properly recording software-development cost for its mission systems, it was not doing the same for its administrative systems. FAA is developing three administrative systems, and has procured commercial software for the Cost Accounting System, the Real Estate Management System, and the Acquisition System. FAA has incurred about \$27 million of software-development cost and expects to spend an additional \$35 million to complete these three systems. Based on FAA's current practice, total software assets would be understated by about \$27 million on the financial statements as of September 30, 2000, because FAA has been charging the software cost to expenses as they were incurred.

RECOMMENDATIONS

We recommend that, in coordination and cooperation with the Associate Administrator for Research and Acquisitions, the Assistant Administrator for Financial Services:

1. Modify the labor distribution reporting system and procedures to prevent hours from being charged to “No Project.”
2. Implement written timekeeping procedures to ensure that hours worked are charged to the proper projects.
3. Design the cost accounting system for Research and Acquisitions to create separate cost groupings for different types of common cost, such as overhead and general and administrative expenses.
4. Change the basis for allocating overhead cost to projects to a total expenditure base that includes all project costs.
5. Until the cost accounting system is implemented, estimate the portion of overhead cost associated with producing facilities and equipment assets, and include the cost in work-in-process or other asset accounts until the assets are placed in use.
6. Establish procedures to identify commercial and externally developed software cost incurred for all administrative systems under development, and record the cost in work-in-process or other asset accounts in the financial and cost accounting systems.

MANAGEMENT COMMENTS

A draft of this report was provided to the FAA Assistant Administrator for Financial Services and the Associate Administrator for Research and Acquisitions on November 22, 2000. FAA concurred with all recommendations and provided target completion dates for corrective actions. FAA also agreed that our estimate of \$63 million of annual overhead cost and the \$27 million of administrative software-development cost to be capitalized was based on sound methodology and appeared to be reasonable. The complete text of management comments is the Appendix to this report.

OFFICE OF INSPECTOR GENERAL COMMENTS

Actions taken and planned by FAA are reasonable, subject to successful implementation on schedule. We will continue to monitor implementation and followup on these corrective actions. These recommendations are subject to the audit follow-up requirements of DOT Order 8000.1C.

We appreciate the courtesies and cooperation of FAA representatives. If you have questions or require additional information concerning this report, please call me at (202) 366-1992 or John Meche at (202) 366-1496.

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PRIOR AUDIT COVERAGE

Audit Report Number: FE-2000-060, *FAA Fiscal Year 1999 Financial Statements*, February 29, 2000

OIG concluded that the FY 1999 FAA Financial Statements were fairly presented, in all material respects, in conformance with generally accepted accounting principles.

FAA was able to support the cost of its property, plant, and equipment accounts as of September 30, 1999. However, labor-intensive efforts were required to arrive at estimates for the acquisition cost of property. These manual and labor-intensive methods are expensive and prone to errors, mistakes, and inaccuracies, and cannot be sustained. The existing FAA property systems were not integrated to accurately account for property cost and to compute depreciation. The lack of sufficient internal controls over the \$10.8 billion account represented a material internal control weakness.

Audit Report Number: FE-2000-058, *FAA Property, Plant, and Equipment*, February 28, 2000

OIG concluded that FAA was able to provide sufficient supporting evidence for the acquisition cost of its property, plant, and equipment by using alternative procedures. However, FAA's current property systems were not designed as integrated systems to accurately account for property cost and compute depreciation. The lack of sufficient controls over the property accounts represented a material internal control weakness. FAA is in the process of implementing an integrated accounting and property records system. This system is due to be implemented during FY 2001.

Audit Report Number: FE-2000-024, *FAA Cost and Flight Data for Aircraft Overflights*, December 17, 1999

OIG identified issues affecting the accuracy and integrity of the cost accounting system, the overflight fees, or both. OIG made several recommendations including the establishment of a labor distribution reporting system to capture cost for the air traffic controller and airway facilities work force. FAA agreed, and is in the process of developing labor distribution reporting system policies and procedures, with a planned implementation date during FY 2003.

Audit Report Number: FE-1998-186, *FAA Implementation of Cost Accounting System, August 10, 1998*

OIG identified several significant cost accounting design issues, including that FAA had not established a method to identify and charge the correct labor cost to appropriate projects. We made several recommendations including that FAA develop edit checks and devise procedures to ensure that records without valid project numbers be corrected for reprocessing. FAA agreed and has completed the actions or is in process of taking corrective action associated with these findings and recommendations.



U.S. Department of
Transportation
**Federal Aviation
Administration**

Subject: **ACTION:** Response to Draft Report on
Design of the Cost Accounting System for
Research and Acquisition, FAA

Date: DEC 11 2000

From: Assistant Administrator for Financial
Services/CFO

Reply to
Attn. of:

To: Deputy Assistant Inspector General for
Financial, Information Technology, and
Departmentwide Programs

Please find attached to this memo the Federal Aviation Administration response to the Draft Report. We concur with your recommendations and provided dates when corrective actions will be taken.

In your transmittal letter, you requested that we comment on the validity of the \$63 million of annual overhead cost and \$27 million of administrative software-development cost being expensed under current practice. With respect to the \$63 million of annual overhead cost, we were unable to validate that figure, as it was not derived directly from either the Cost Accounting System (CAS) or the Departmental Accounting and Financial Information System. After discussing the methodology used to arrive at that figure with your auditors, we do, however, believe that the methodology used was sound. With respect to the \$27 million of administrative software-development cost, while we were again unable to validate that total, we believe that the total appears to be reasonable.

Our responses to recommendations 3 and 6, respectively, address how we plan to resolve these two items in the future.

We appreciate the courtesy and professionalism, exhibited by your auditors during the conduct of this audit. If you have any questions about this response or any other matter concerning the CAS, please contact Ray Morris at (202) 267-7580.

A handwritten signature in black ink, appearing to read "John F. Hennigan".

Donna R. McLean

Attachment

FAA'S COMMENTS ON THE OIG'S "DRAFT REPORT ON
DESIGN OF THE COST ACCOUNTING SYSTEM FOR RESEARCH AND
ACQUISITIONS, FAA"

The FAA has the following comments to offer on the OIG's "Draft Report on Design of the Cost Accounting System for Research and Acquisitions, FAA" dated November 22, 2000.

General Comments

As stated in the draft report, the primary objective of the OIG audit "was to determine whether the FAA cost accounting system would accurately account for the operations cost of the Research and Acquisitions line of business (LOB) and for the cost of facilities and equipment that it develops and acquires for all FAA LOB's." While the Cost Accounting System (CAS) collects costs for all FAA LOB's, the Associate Administrator for Research and Acquisitions, ARA, has not fully implemented the CAS. ARA has only implemented business rules sufficient to ensure that ARA costs are properly and appropriately allocated to the Air Traffic Services LOB. To date, ARA has implemented only a pilot Labor Distribution Reporting (LDR) system. This pilot LDR system will provide lessons-learned for implementation of FAA's corporate LDR program. We had previously identified many of the deficiencies specified in the OIG report, and are addressing them in the agency-wide LDR program.

In summary, FAA is in agreement with the findings and recommendations outlined in the draft report. Many of the recommendations will be addressed in the ARA implementation of the agency-wide LDR system. The remaining recommendations will be addressed through either changes to processes and procedures, or through system changes.

Recommendations

In response to the "Recommendations" in the report, the following is provided:

1. Modify the labor distribution reporting system and procedures to prevent hours from being charged to "No Project."

Concur. We agree that changes must be made to LDR charging practices and procedures to reduce the occurrence of hours being charged to "no project/no activity." We feel strongly that when employees do not comply in charging time to projects and activities, that non-compliance must be flagged. With full LDR implementation, we will have in place processes, procedures, training, and new functional assignments to better monitor LDR compliance. These include a change within IPPS to allow prior period adjustments to correct LDR data, as well as a change within IPPS to use "no project/no activity" as the "standing project" for employees so that they are forced to identify the appropriate projects and activities that they are working on rather than depending on a default project. We will also have a quality assurance function at both the corporate level and each LOB and staff office that will be responsible for monitoring compliance reports and working with management to correct LDR data. The "No Project" code will be used as one of the primary measures of compliance for the labor distribution system. The quality assurance resources and managers need to be able to monitor the charges to "No Project." Procedures will be put into place to ensure that managers submit amendments to change "No Project" to a valid project to minimize charges to this code. These actions will be completed by June 30, 2001.

2. Implement written timekeeping procedures to ensure that hours worked are charged to the proper projects.

Concur. Timekeeping procedures are part of agency-wide LDR implementation. These procedures will be documented in writing and will be provided to all employees. All employees will also receive training and communications on these procedures to ensure their common understanding and application. These actions will be completed by June 30, 2001.

3. Design the cost accounting system for Research and Acquisitions to create separate cost groupings for different types of common cost, such as overhead and general and administrative expenses.

Concur. When ARA's cost accounting requirements are implemented, we will ensure that projects are appropriately classified as direct, production, or general and administrative (G&A). This will allow us to accumulate the appropriate costs in separate cost pools. At that time, we will be able to allocate production costs to work-in-process and provide the results to the Office of Financial Management, AFM, to make the appropriate adjusting entries in DELPHI. These actions will be completed by November 30, 2001.

4. Change the basis for allocating overhead cost to projects to a total expenditure base that includes all project costs.

Concur. This action will be completed by December 31, 2000.

5. Until the cost accounting system is implemented, estimate the portion of overhead cost associated with producing facilities and equipment assets, and include the cost in work-in-process or other asset accounts until the assets are placed in use.

Concur. Working with the OIG, we will develop a methodology to estimate the portion of overhead cost associated with producing facilities and equipment assets, and will provide those costs to AFM for transfer from expense to work-in-process. These actions will be completed by October 31, 2001.

6. Establish procedures to identify commercial and externally developed software cost incurred for all administrative systems under development, and record the cost in work-in-process or other asset accounts in the financial and cost accounting systems.

Concur. For FY00 and FY01, we will identify the commercial and externally developed software costs for administrative systems under development. Once these costs have been identified, we will make Financial Statement Adjustments to move these costs from either expense or equity to work-in-process. Once DELPHI is implemented, administrative systems under development will be identified as capital projects. Having been identified as capital projects, commercial and externally developed software costs incurred will be recorded in work-in-process or other asset accounts. Since DELPHI will replace DAFISMIR as the input source for financial transactions, these costs will be automatically charged to the appropriate asset accounts in the CAS. These actions will be completed by October 31, 2001.