CHARTING THE NEXT CENTURY OF FLIGHT

FEDERAL AVIATION ADMINISTRATION

PERFORMANCE AND ACCOUNTABILITY REPORT

FY 2003

Federal Aviation Administration
FY 2003 Performance and Accountability Report

MISSION/VISION STATEMENT

FAA provides a safe, secure, and efficient global aerospace system that contributes to national security and the promotion of U.S. aerospace safety. As the leading authority in the international aerospace community, FAA is responsive to the dynamic nature of customer needs, economic conditions, and environmental concerns.

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This report is also available on the FAA website at www1.faa.gov/aba/html_fm/files_pdf/2003_PAR.pdf.

FAA-AT-A-GLANCE

Established	1958
Headquarters	800 Independence Avenue, SW Washington, DC 20591 www.faa.gov
FY 2003 Budget	$13.506 billion
Total Employees	49,274
Headquarters Employees	4,148
Regional Offices	9
Technical Center *Atlantic City, NJ*	1,319 employees
Aeronautical Center *Oklahoma City, OK*	2,975 employees
Facilities Staffed by Air Traffic Controllers	395
Certificated Airports in the United States	633

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A MESSAGE FROM THE ADMINISTRATOR

FAA employees give America wings to fly. We maintain, operate, and oversee the largest and most complex aviation system in the world, with a safety record that is second to none. We not only set the regulatory and operational standards for the United States, we strive to enhance aviation safety around the world. International cooperation leads to international safety.

Aviation faces many new challenges in the years ahead. To help us meet these challenges and to ensure that aviation remains an engine of economic growth, we developed a new strategic plan to guide FAA into the next century of flight. FAA's Flight Plan 2004–2008, which was created around four ambitious goals, details how we will move forward into the future. Our goals for the coming years are:

- **Increased Safety.** Safety is not only a top public-interest priority; it is also an economic necessity. People will fly if they feel safe and will return to the skies if they trust the system.
- **Greater Capacity.** Aviation capacity is the backbone of air travel. Aviation can grow only if capacity grows. As we increase capacity, we will make sure we do so in an environmentally sound manner.
- **International Leadership.** Aviation safety is a vital national export. We will enhance America's leadership role by sharing our expertise and new technologies with our international partners.
- **Organizational Excellence.** To fulfill our mission, the FAA must operate as a world-class organization. This requires greater fiscal responsibility, stronger leadership, more cooperation, and performance-based management. With the right tools and training, our employees will bring this Flight Plan to life.

The Federal Aviation Administration's fiscal year (FY) 2003 Performance and Accountability Report is a detailed accounting of our service to the flying public. The financial and performance data contained in this report are reliable and complete. This year we met nine out of 12 performance goals in the areas of safety, system efficiency, and organizational excellence. We also achieved an unqualified opinion from our auditors on our financial statements and installed a new core financial system as of the beginning of FY 2004.

Improving our overall financial management performance is an element of our organizational excellence goal. Our independent auditors reported no material financial-related internal control weaknesses at FAA.

Internally, we assess management risk through the Federal Managers' Financial Integrity Act (FMFIA) of 1982 process. I am pleased to report that the management controls and financial management systems, taken as a whole, in effect during the period October 1, 2002, through September 30, 2003, provide reasonable assurance that the objectives of both Sections 2 and 4 of the FMFIA are being met, with one internal control weakness and one financial systems nonconformance. This internal review, using broader management-risk criteria, identified our oversight of cost reimbursable contracts as a material weakness, and property accounting, where our financial systems were not integrated to meet OMB requirements, as a financial systems nonconformance.

"FAA employees give America wings to fly."

Improvements to the oversight of cost reimbursable contracts are being aggressively pursued. Specific oversight goals have been incorporated into FAA's Flight Plan and will drive further progress in

this area. With the implementation of our new financial management system last November, FAA's property accounting and financial systems meet OMB requirements. The new financial management system also brought FAA into compliance with the Federal Financial Management Improvement Act of 1996 requirements. Our previous accounting system did not meet these requirements.

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

Marion C. Blakey
Administrator
December 18, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Next Century of Flight Begins

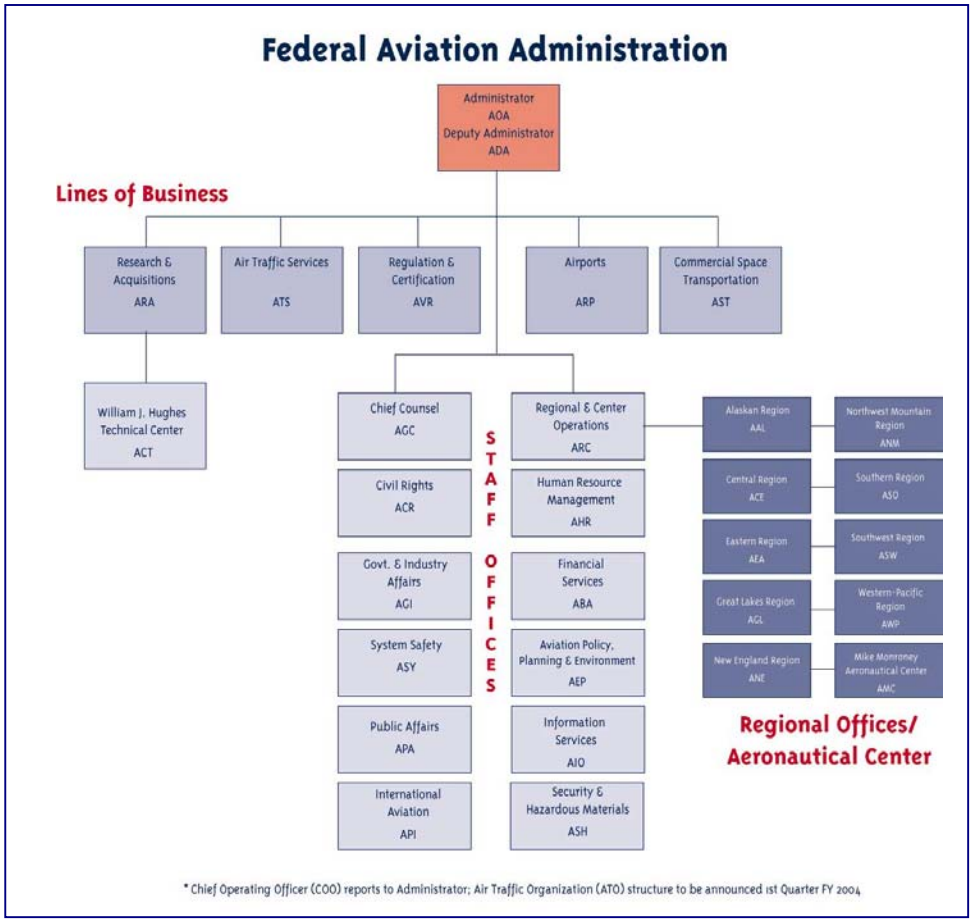
The Federal Aviation Administration (FAA) is responsible for overseeing the largest, most complex, and safest aviation system in the world. It not only sets the regulatory and operational standards for the United States, but also effectively sets the bar for aviation around the world—and has for almost a half-century.

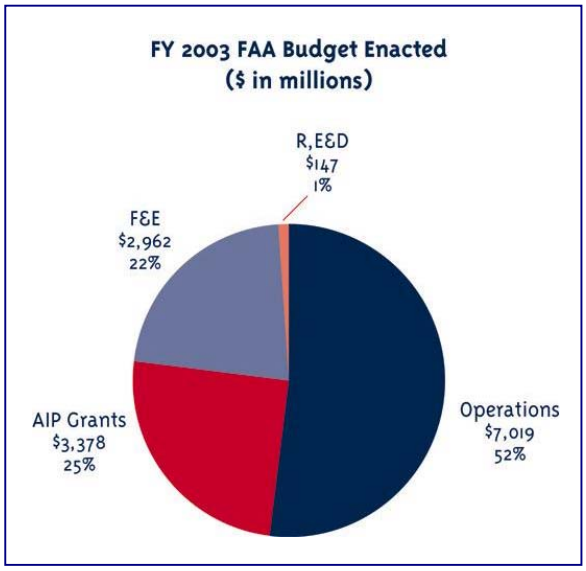
In the first decade of the 20th century, only visionaries could imagine that air travel would be a driving force behind the phenomenal growth of the American economy. But as we enter the 21st century, the future of aviation is just as hard to see. Aviation finds itself facing terrorism, structural change, and a weak global economy.

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

Today's FAA faces the challenges of the next century of flight with the help of more than 49,000 employees at its headquarters in Washington, DC, in regional offices, and in facilities around the country. We fulfill our mission through five lines of business that work together to create and maintain the world's preeminent national airspace system. These lines of business are:

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

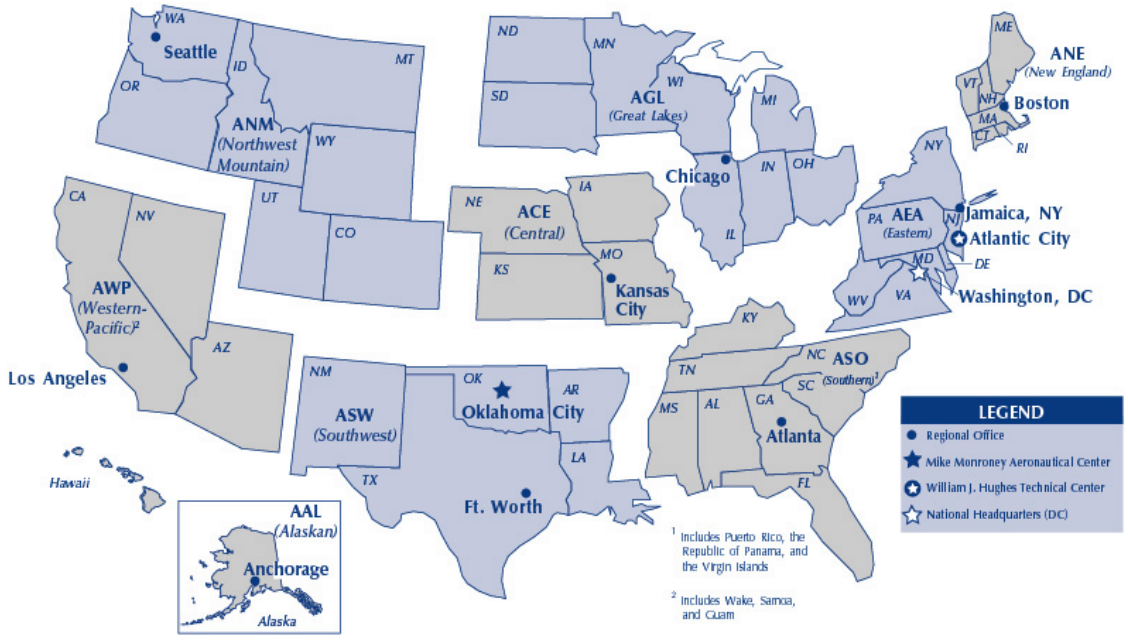




FAA is funded by four primary appropriation accounts—Operations; Facilities and Equipment (F&E); Grants-in-Aid for airports (AIP Grants); and Research, Engineering and Development (R,E&D). The $13.5 billion total budget for FY 2003 was about 2 percent less than the FY 2002 enacted level due to some security functions being shifted to the Department of Homeland Security and one-time supplemental funding for anti-terrorism. FAA's Operations account was funded at $7.019 billion. This account funds the operations, maintenance, communications, and logistical support of the air traffic control and air navigation system. It also covers administrative and managerial costs for FAA's regulatory, international, medical, engineering, and development programs as well as policy oversight and overall management functions.

For FAA's capital accounts, Facilities and Equipment was funded at $2.962 billion, Grants-in-Aid for Airports at $3.378 billion, and Research, Engineering and Development at $147 million. The Facilities and Equipment account is the principal means for modernizing and improving air traffic control and airway facilities. It also finances major capital investments required by other agency programs and other improvements to enhance the safety and capacity of the national airspace system. FAA's grants program funds airport planning and development, noise compatibility and planning, the military airport program, reliever airports, and airport program administration. Research, Engineering and Development funds long-term research programs to improve the air traffic control system.

FAA Regions


WA
Seattle
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(Southern)¹
Atlanta
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(New England)
Boston
NY
PA
AEA
(Eastern)
NJ
Jamaica, NY
Atlantic City
MD
DE
WV
VA
Washington, DC
AAL
(Alaskan)
Anchorage
Alaska
LEGEND
Regional Office
Mike Monroney Aeronautical Center
William J. Hughes Technical Center
National Headquarters (DC)
¹ Includes Puerto Rico, the Republic of Panama, and the Virgin Islands
² Includes Wake, Samoa, and Guam

A Year in Highlights

The Federal Aviation Administration (FAA), an agency of the U.S. Department of Transportation (DOT), is charged with promoting the safety and efficiency of our national airspace system. FAA establishes and enforces regulations and oversees inspections that maintain the integrity and reliability of that system, which has fueled our economy and helped ensure our Nation's prosperity for more than 50 years.

With a workforce of 49,274 professionals and an annual budget of approximately $13.5 billion, FAA operates and maintains the complex air traffic control system and the facilities and equipment that support it. Over 17,000 controllers manage more than half of the world's air traffic, helping to ensure ever-increasing levels of safety. The agency also conducts research to improve aviation safety and efficiency and provides grants to improve 3,400 public-use airports in the United States.

FAA Administrator Marion C. Blakey, who marked her first anniversary in office on September 15, 2003, led the agency to a number of significant milestones during FY 2003. Last year was one of continued improvement in aviation safety, with a rate of only .024 fatal commercial aviation accidents per 100,000 departures. This achievement represents a continued reduction in the commercial fatal accident rate, which keeps FAA on track to meet our ambitious goal of reducing these types of accidents by 80% from the 1994–1996 baseline. A number of FAA initiatives also contributed to a significant decrease in serious runway incursions—any occurrence at an airport involving an aircraft, vehicle, person, or object on the ground that creates a collision hazard—which were down more than 14% from last year.

During FY 2003, FAA also:

- Commissioned the Wide Area Augmentation System (WAAS) in July 2003. WAAS is a GPS-based navigation and landing system that provides precision guidance to aircraft at thousands of airports and airstrips that currently have no precision landing capability. WAAS is a critical component of the seamless satellite navigation system for civil aviation. This system improves the accuracy, availability, and integrity of global positioning system (GPS), thereby improving safety and capacity.
- Enabled airlines to meet the April 9, 2003, deadline for installing reinforced (hardened) cockpit doors in more than 10,000 aircraft serving the United States, making air travel safer for passengers and crews. This achievement was the result of extraordinary cooperation among FAA, its industry partners, and the international aviation community.
- Began testing an on-board fuel-inerting system designed to prevent fuel tank explosions, such as the one that destroyed TWA Flight 800 in 1996. The system, based on fuel-inerting technology devised by an FAA employee, uses an inert gas to displace oxygen in the fuel tank and thus reduces the risk of sparks that could ignite the fuel.
- Worked closely with the Transportation Security Administration (TSA) and pilots to publicize and enforce stricter temporary flight restrictions in the wake of the September 11, 2001, terrorist attacks on the United States.
- Transferred $623.6 million of civil aviation security-related property and equipment to TSA. This follows TSA's assumption of civil aviation security functions from FAA, effective February 13, 2002, in accordance with The Aviation and Transportation Security Act.
- Worked closely with TSA to provide $447 million in Airport Improvement Program (AIP) grants for projects to enhance security at our Nation's airports. Much of the AIP security funding approved in FY 2003 went toward terminal modifications and retrofitting baggage conveyor systems to support in-line explosive detection systems that screen baggage.
- Recruited a Chief Operating Officer to help FAA continue its progress in improving system efficiency, increasing capacity, and achieving organizational excellence.
- Released FAA's *Flight Plan 2004-2008*—a visionary strategic plan that engaged industry and stakeholders in setting FAA's future course. The plan, which is closely aligned with DOT's Strategic

Plan, includes four ambitious goal areas and detailed performance targets for measuring achievement.

- Commissioned new air carrier runways at Miami International, Cleveland Hopkins International Airport, and Denver International Airports. These three runways were included in FAA's Operational Evolution Plan (OEP), which aided in ensuring that instrumentation and procedures were in place when the construction of the runways was complete.
- Issued an Information Operations Condition (INFOCON) order that outlines those actions FAA will take to respond to threats to our information systems security. This order outlines an agencywide approach to defend against system attacks, to mitigate damage to the extensive information infrastructure, and to guard against the misuse of the agency's information technology infrastructure. This coordinated approach, combined with significant efforts to ensure that our information systems are properly certificated and accredited, helps to ensure that the agency's critical information systems are protected from cyber attack.

FAA continued to focus on aviation as a global system and worked closely with international organizations to seek global solutions to safety, routing, procedural, equipment, and environmental issues. In addition, FAA established a Joint Planning Office with the Departments of Defense, Homeland Security, Commerce, and the National Aeronautics and Space Administration to create a long-term strategic vision for our air transportation system.

We also worked with airports around the country to boost system capacity by analyzing chokepoints, commissioning new runways, and taking advantage of precise satellite navigation technologies to increase efficiency. Through such improvements, FAA was able to increase system capacity, maintain efficiency, and minimize delays.

Throughout FY 2003, FAA has commemorated the Wright brothers' magnificent achievement through numerous events across the country and around the world. As the year-long Centennial of Flight celebration culminates on December 17, 2003, we look forward to charting the next century of flight, which will be characterized by even higher levels of safety, system efficiency, innovation, and international cooperation.

Achieving Results

Performance-at-a-Glance

FAA is charged with promoting the safety and efficiency of the Nation's aviation system—the biggest, busiest, and most complex in the world. With broad authority to enforce safety regulations and conduct oversight of the civil aviation industry, FAA maintains the integrity and reliability of the system. A strategic plan, annual business plans, human capital plans, and our annual Performance and Accountability Report help FAA create a recurring cycle of planning, program execution, measurement, verification, and reporting. This strong link between resources and performance allows FAA to show what is being accomplished and reinforces accountability for the money being spent.

FAA's Strategic Plan (http://www1.faa.gov/AboutFAA/FlightPlan.cfm) provides the framework to match resources with initiatives for long-term change. It focuses on FAA activities, but also sets direction for FAA and the national air and space community in a global transportation environment. It sets forth the agency's goals and the performance measures to assess FAA's progress in meeting them. These are the goals that FAA must meet to address the challenges facing aviation as well as to maintain U.S. leadership in aviation. Our Strategic Plan is tightly aligned with the Department of Transportation's mission, vision, goals, and performance measures.

FAA has established 12 performance measures and targets that enable us to measure results in achieving enhanced aviation safety, increased system capacity, and organizational excellence. (See the table on page 11 for a description of these performance measures and targets.) These measures support FAA's mission of providing citizens with a safe, secure, and efficient global aviation system.

- **Safety.** Safety is not only a top public-interest priority, but is also an economic necessity. People will fly only if they feel safe and will return to the skies only if they trust the system. The DOT Office of Inspector General (OIG) specified that reducing the risk of aviation accidents due to operational errors and runway incursions was one of DOT's top management challenges for

calendar year 2003. A number of coordinated programs and safety initiatives enabled us to further reduce the commercial fatal aviation accident rate, the number of general aviation accidents, and the number of runway incursions. We did not achieve our goal of reducing operational errors.

- **Efficiency.** Aviation capacity is the backbone of air travel. The DOT OIG stated that improving aviation system capacity is one of the top management challenges for DOT during calendar year 2003. Aviation can grow only if capacity grows. As we increase capacity, we will make sure we do so in an environmentally sound manner. Initiatives designed to boost system efficiency were successful in improving on-time arrival and airport capacity and efficiency while reducing exposure to aircraft noise and emissions.
- **Organizational Excellence.** To fulfill our mission, FAA must be a world-class organization. This requires greater fiscal responsibility, stronger leadership, more cooperation, and performance-based management. The DOT OIG identified reversing FAA's spiraling operating costs as one of DOT's top management challenges in calendar year 2003. Further, GAO had indicated that two FY 2003 performance and accountability challenges facing FAA were enhancing the management of acquisitions and continuing progress in financial management, which GAO considers to be a high-risk area for FAA. Although FAA made great strides in improving the business processes that support efforts to improve aviation safety and system efficiency, we did not meet all of our organizational excellence goals. We were successful in meeting our customer satisfaction goal, but we missed some key milestones on our major acquisition projects and did not implement DELPHI, our new core accounting system, as originally scheduled. However, with the full implementation of DELPHI in November 2003, FAA is significantly closer to achieving success in this area.

Despite the challenges, FY 2003 was a year of impressive success for FAA. Although air traffic remains below pre-September 11, 2001, levels, passengers are regaining confidence in the system and are returning to the skies. As traffic increases, so do the challenges we face in building organizational excellence to improve safety and increase capacity. Through the combined efforts of our employees and industry partners, we were able to achieve 9 of our 12 goals—a 75% success rate. Our Performance-at-a-Glance chart provides a snapshot of the results we achieved.

PERFORMANCE-AT-A-GLANCE				
Performance Measure	**FY 2003 Target**	**FY 2003 Results**	**FY 2003 Status**	**FY 2004 Target**
SAFETY				
Commercial Air Carrier Fatal Accident Rate	**.033**	**.024***	●	**.028**
Number of General Aviation Fatal Accidents	**374**	**360***	●	**349**
Runway Incursions (number/rate)	**44/.067**	**32/.051**	●	**40/NA[1]**
Number of Air Traffic Operational Errors	**642**	**680**	◉	**629**
SYSTEM EFFICIENCY				
On-time Arrival	**78.20%**	**82.30%**	●	**82.10%**
Airport Daily Arrival Capacity	**49,120**	**49,537**	●	**51,332**
Airport Arrival Efficiency Rate	**95.49%**	**95.50%**	●	**95.67%**
Exposure to Noise	**437,000**	**289,000***	●	**400,000**
People Benefiting from Noise Projects	**12,500**	**13,287**	●	**NA[2]**
ORGANIZATIONAL EXCELLENCE				
Milestones/Budget Met for Major Acquisitions	**80%/80%**	**77%/88%**	◉	**80%/80%**
Customer Satisfaction - Commercial Pilots	**62**	**64**	●	**63**
President's Management Agenda (all 5 areas)	**Yellow**	**Red**	◉	**NA[3]**

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

Notes:

1 Not Applicable: Rate no longer being tracked at corporate level.
2 Not Applicable: No longer being tracked at corporate level.
3 Not Applicable: Being tracked at DOT level.

* *Numbers are preliminary. The National Transportation Safety Board (NTSB) will make final numbers for Commercial Air Carrier Fatal Accident Rate and Number of General Aviation Fatal Accidents available in March 2005. Final results for the Exposure to Noise performance target will be available in May 2004.*

Managing Performance

DOT and FAA must continue to improve the reliability and timeliness of performance data and provide a better linkage between human capital requirements, budgets, and performance results. We acknowledge that increasing the validity, reliability, timeliness, and comparability of performance data will be a challenging task. In FY 2002, DOT developed leading indicators for its strategic goals and most of its performance measures to help anticipate trends. DOT also completed an assessment of data quality for its major data collection systems and documented the major sources of error in all performance measures.

FAA faces a number of challenges in implementing our Strategic Plan and achieving results. These challenges include:

- The financial difficulties facing the airlines and aviation manufacturers affect their ability and willingness to equip aircraft with the new technologies that will enhance safety and capacity. The financial difficulties facing the industry also impact FAA, which is primarily funded by the Aviation Trust Fund from taxes on airline tickets. As long as the demand for air travel is down, so too are revenues available to FAA from the Trust Fund.
- Large capital investments in facility, infrastructure, and agency human capital needs will depend largely on our ability to closely link budget to performance and also in part on the ability and willingness of Congress to fund such operations and responsibilities.
- Our ability to improve safety or expand capacity here at home and in the international arena depends in part on the willingness of authorities at the state, local, and international levels to cooperate and collaborate in areas such as building new airports, expanding runways, or implementing new technologies.
- Emerging threats to national security may cause FAA priorities to shift to meet new responsibilities.

FAA Flight Plan 2004-2008

During FY 2003, FAA completed work on a new long-term strategic plan. The *FAA Flight Plan* is the result of the hard work and sustained commitment of everyone involved in the planning process, including FAA employees, members of Congress and their staff, our industry partners, and stakeholders.

The Flight Plan lays out four goals and describes FAA's strategies for achieving those goals. The Flight Plan is aligned with the Department of Transportation's Strategic Plan and is linked to FAA's budget requests. It will be used along with detailed business plans from all FAA organizations to align performance and ensure accountability at all levels of the agency. Key performance measures from the Flight Plan are reported annually through the issuance of the Performance and Accountability Report.

For the first time, every staff office and line of business has developed a plan that links directly to the Flight Plan. These business plans are designed to create a line of sight for our employees, laying out specific actions and performance measures that relate our work to the larger goals of the agency. In addition, we have begun using a web-based management tool to track the status of major initiatives tied to each objective in the Flight Plan.

Our senior management will regularly review progress against the performance measures contained in the plan. These measures may evolve over time as we work with our employees and external stakeholders to develop new ways to measure our actions.

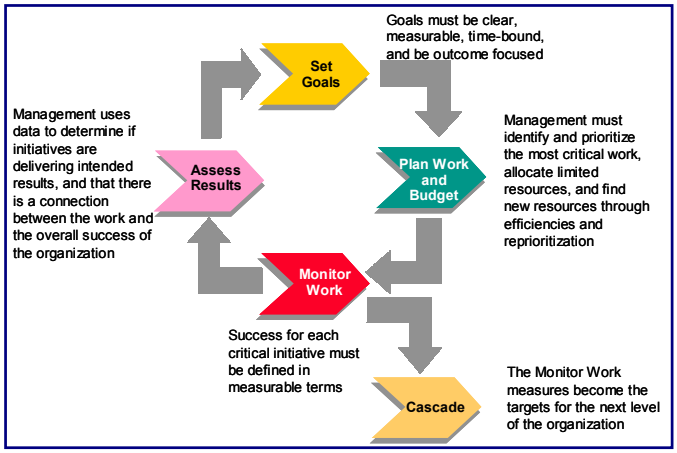
FAA manages performance using a four-step framework based on best practices used in a number of private and public sector organizations (see chart on next page). By using this framework and instilling management discipline into our processes, we anticipate that this will be a multi-year journey of learning and change.

The first step in the process is setting goals—consulting with management, stakeholders, and customers to determine success for the agency. This year, Administrator Blakey focused leadership's attention and resources to further improve organizational performance by launching a focused strategic planning effort. As part of that effort, the Administrator and FAA management developed a five-year plan called the Flight Plan. This Flight Plan shows the strategies, initiatives, and performance targets that FAA will accomplish and forms the foundation for all of FAA's performance efforts.

The Administrator appointed Goal Leads for each of the four major goal areas of the Flight Plan—Safety, Greater Capacity, International Leadership, and Organizational Excellence. Each Goal Lead is responsible for the performance targets in each goal area and for ensuring that initiatives and activities are coordinated across organizational lines.

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

The third step, "Monitor Work," develops measures of the work required to achieve our goals. FAA developed organizational business plans for each line of business and staff office. These business plans outline our FY 2004 initiatives, activities, and performance targets that link our work directly to the Flight Plan.



"Assess Results" is the last and most important step of the performance management process. This year, FAA continued its practice of reviewing and discussing FY 2003 performance goals on a monthly basis. In addition, we began the groundwork to deploy a new tool and business processes that will focus more on the discussion of performance results, root causes of performance issues, and reallocation of resources to correct performance during the fiscal year.

Verification and Validation of Performance Information

FAA uses strong management controls to ensure that data used to assess performance is accurate, timely, and complete. By exercising both internal and external review processes, FAA's verification and validation process strongly supports the confidence that the managers and Administrator have in their performance data.

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

Independent program evaluations are also an important part of the verification and validation process. Internally, FAA's Office of Configuration Management hires independent contractors to review and evaluate programs jointly run by the Air Traffic Services and Research and Acquisitions lines of business.

The Office of the Inspector General, General Accounting Office, and Office of Management and Budget also regularly review FAA programs and activities. These reviews help maintain the public's trust in FAA, as well as provide opportunities for FAA to improve. We work with each organization to address concerns and change how we do business. For example, FAA has focused more closely this year on tying budget to performance, as well as cascading performance measures from FAA to the lines of business and staff offices. This is a direct result of the Office of Management and Budget's Program Assessment Rating Tool (PART). Further explanations of OIG and GAO concerns can be found in the financial performance sections of this document.

Evaluating Our Programs

A critical component of managing performance is the periodic evaluation of programs. In FY 2003, FAA performed one program evaluation. This evaluation focused on the operational effectiveness of Free Flight Phase 1 (FFP1) tools in creating additional capacity, increasing en route efficiency, and in sharing existing data with customers to improve decision-making and directly supports our System Efficiency goal area. Key findings include:

- The Traffic Management Advisor (TMA), operational at all 7 sites planned under FFP1, improved capacity by 3% to 5% for traffic into Dallas/Ft. Worth, Los Angeles, Minneapolis, Denver, and Atlanta airports.
- The User Request Evaluation Tool (URET), operational at 6 of 7 en route centers planned under FFP1, increased direct routings by at least 15% at all 6 centers.
- The Surface Movement Advisor (SMA) program was operational at all 6 sites planned for FFP1 and customers reported reduced gate delays and diversions.

A detailed analysis of and results from the evaluation can be found at http://ffp1.faa.gov/approach/approach_ben_met.asp.

In FY 2004, FAA will develop a program evaluation approach for information systems security that protects information technology (IT) programs. FAA programs in physical facility security, operational errors, Safer Skies, and aircraft delay reductions are candidates for evaluations in FYs 2005–2008.

Tying Performance to Cost

FAA has begun a process to develop financial and other efficiency metrics in FY 2004. This process complements strategic and business planning efforts to create a new performance management process within FAA. We intend to develop financial efficiency metrics not just at the FAA level, but in FAA lines of business and staff offices as well.

One of the challenges FAA faces with developing financial metrics is data availability. The agency recently installed a new financial management system, DELPHI. Cost accounting is not yet available for every line of business. However, FAA management has decided that rather than wait for perfect data, we will explore what we can measure, and then seek to improve from there.

In the future, FAA believes it will have in place a series of financial and other efficiency measures that will better guide our business decisions. FAA management will regularly inspect these measures to ensure that the agency is accomplishing its mission through the best use of its resources.

Safety

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

Safety is FAA's primary responsibility. Our dedication to keeping the skies safe is the single most important step we can take to revive the industry. Just as aviation is a key component in the economic health of our Nation, safety is central to the public's interest, as well as to the economic health of aviation.

FAA assesses safety through four performance measures. The chart below describes FAA's FY 2003 performance in improving safety through achievement of each of these measures.

FY 2003 SAFETY PERFORMANCE MEASURES AND RESULTS

Performance Measure	Target	Results	Status
Commercial Air Carrier Fatal Accident Rate: The goal is to reduce the U.S. fatal accident rates by 80% from the 1994–1996 baseline by FY 2007. The rate is calculated by determining the number of fatal accidents per 100,000 departures.	.033	.024*	
Number of General Aviation Fatal Accidents: FAA worked to reduce the number of general aviation fatal accidents to no more than 374. General aviation includes all segments of the aviation industry except commercial air carriers and the military. General aviation aircraft range from single-seat home-built aircraft, rotorcraft, and balloons to extended-range turbojets. Public and corporate aircraft provide a wide range of services, from crop dusting, fire fighting, law enforcement, and news coverage to sightseeing, industrial work, on-demand air taxi service, and corporate transportation. Not all general aviation pilots file flight plans, so FAA does not have the data on departures that would enable us to calculate the rate of general aviation fatal accidents.	374	360*	
Runway Incursions: Runway incursions create dangerous situations that can lead to serious accidents. A runway incursion is any occurrence at an airport involving an aircraft, vehicle, person, or object on the ground that creates a collision hazard or results in a loss of separation between aircraft taking off, intending to take off, landing, or intending to land at an airport. Incursions involve an aircraft with another aircraft, vehicle, person, or object on the ground. Reducing the number of runway incursions lessens the probability of accidents that potentially involve fatalities, injuries, and significant property damage. This performance measure focuses on the number of highest severity (Category A and B) incursions, which are characterized by conditions where separation has decreased to the point in which a significant risk of collision or an actual collision has occurred.	44/.067	32/.051	
Air Traffic Operational Errors: One of the fundamental principles of aviation safety is separation—the need to maintain a safe distance from other aircraft, terrain, obstructions, and certain airspace not designated for routine air travel. Air traffic controllers employ rules and procedures that define separation standards for the variety of environments in which aircraft operate. Pilots flying under visual flight rules operate under a "see and avoid" policy, while those using instrument procedures rely on controllers' instructions to guide them. An operational error occurs when controllers fail to apply or follow the rules and procedures that define separation standards and separation is less than required. This FAA performance measure focuses on the number of highest severity (Category A and B) operational errors.	642	680	

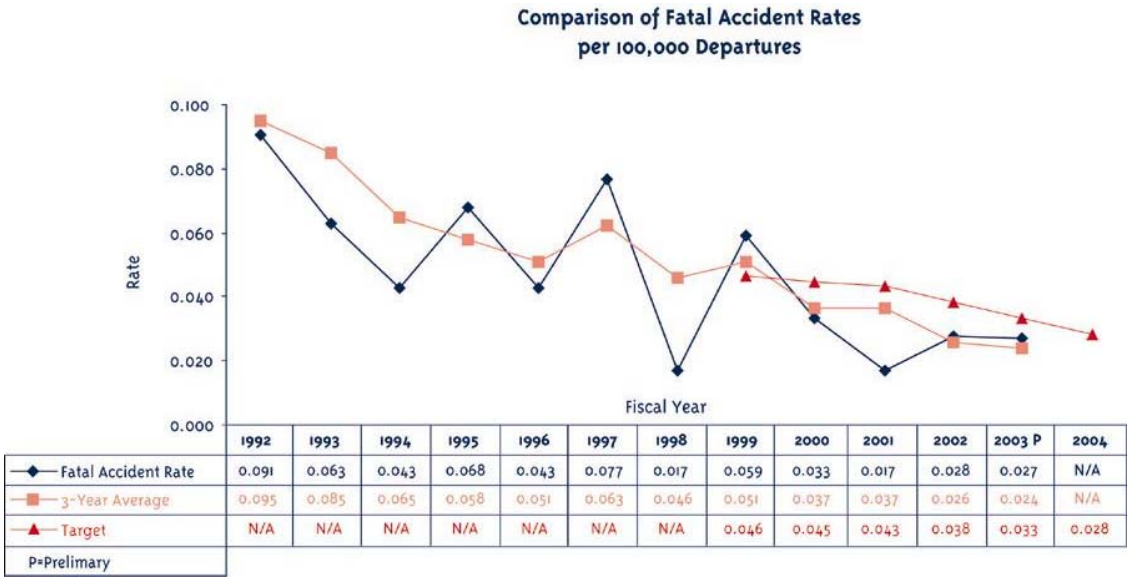
Green: Goal Achieved **Red:** Goal Not Achieved

* *Numbers are preliminary. Final numbers will be available in March, 2005.*

Safety Results and Initiatives

Commercial Air Carrier Fatal Accident Rate

FAA has adopted a focused safety agenda designed to bring about a five-fold reduction in fatal accidents in part through comprehensive reviews of fatal accident causes. In partnership with industry, Safer Skies uses the latest technology to help analyze U.S. and global data to find the primary causes of accidents and determine the best actions to break the chain of events that lead to accidents. The value of this program has been a great reduction or elimination of recurrent causes of commercial accidents.



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 P	2004
Fatal Accident Rate	0.091	0.063	0.043	0.068	0.043	0.077	0.017	0.059	0.033	0.017	0.028	0.027	N/A
3-Year Average	0.095	0.085	0.065	0.058	0.051	0.063	0.046	0.051	0.037	0.037	0.026	0.024	N/A
Target	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.046	0.045	0.043	0.038	0.033	0.028

P=Prelimary

FAA is helping to ensure safety by our coordinated efforts to move the United States from a ground-based navigation system to one located within the aircraft itself. Through the use of onboard technology, pilots will be able to navigate aircraft to any point in the world using only geographical coordinates. Required Navigation Performance (RNP) is an important step in this direction. Because of its high degree of precision, RNP allows for more efficient use of the airspace. Simply put, RNP will allow us to fly more planes, closer together, and more safely than ever before.

FAA commissioned the Wide Area Augmentation System (WAAS) in July 2003. WAAS is a GPS-based navigation and landing system that immediately provided precision guidance to aircraft at hundreds of airports and airstrips where there is currently no precision landing capability. Weather also plays a part in safety and system efficiency, and FAA has deployed advanced weather processing systems at all 20 air route traffic control facilities. The Weather and Radar Processor (WARP) allows air traffic controllers to see more accurate, timely weather information on the same display that shows aircraft position data. WARP lessens the impact of bad weather on capacity. By seeing the aircraft and the storm, where the aircraft is going, and when and where it will return to its original path, the controller is able to direct air traffic more efficiently. The system provides much more accurate and localized information than earlier sources of weather data and the system it replaces.

By working closely with the aviation community, FAA helped airlines meet the April 9, 2003, deadline for installing reinforced (hardened) cockpit doors in more than 10,000 aircraft serving the United States, making air travel safer for passengers and crews. This achievement was the result of extraordinary cooperation among FAA, its industry partners, and the international aviation community. FAA also worked closely with the Transportation Security Administration (TSA) and pilots to publicize and enforce stricter temporary flight restrictions in the wake of the September 11, 2001, terrorist attacks on the United States. FAA continues to work with TSA to train airline crews to better address security issues.

Recent technological advances also promise new safety gains. For example, we tested seats that help passengers better withstand strong and sudden forces in a plane. FAA is also emphasizing improvements to runway safety areas and makes our safety projects a funding priority.

We intensified our hazardous materials program in late 2002, after the Department of Transportation returned this responsibility to FAA. We are working hard to prevent accidents and incidents related to hazardous materials by redoubling our outreach to industry and the community. For instance, in June 2003, hazardous-materials agents visited fireworks retailers across the Southeast before the Independence Day holiday. During their visits, the agents distributed educational brochures and posters and met with local press to explain the dangers of bringing fireworks aboard aircraft. In the Southwest, hazardous-materials agents held press conferences at airports in Houston, New Orleans and Dallas/Ft. Worth to communicate the same message. We estimate that our "Fireworks Don't Fly" community outreach campaign reached millions of people this year.

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

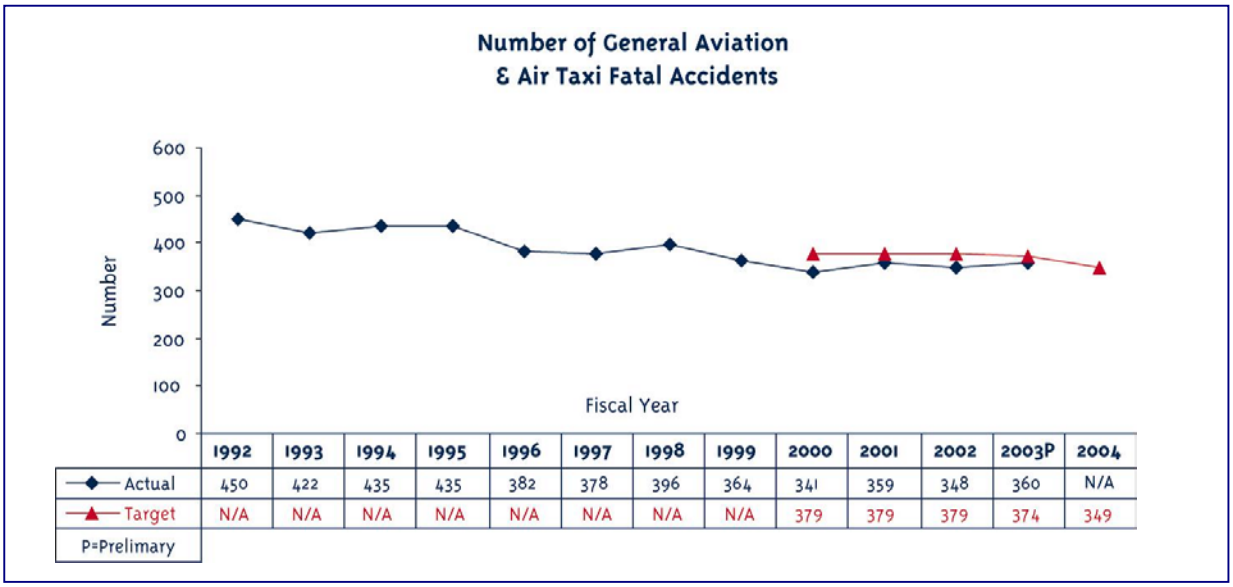
Results: Through these initiatives and strategies, FAA was able to exceed our goal of reducing the rate of commercial fatal aviation accidents, achieving a rate of .024 fatal accidents per 100,000 departures.

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

General Aviation Fatal Accidents

Although most people are familiar with FAA's role in commercial aviation, they may not be aware that we also oversee the safety of almost 300,000 general aviation aircraft in the United States. These aircraft include single-seat home-built airplanes, rotorcraft, balloons, and highly sophisticated extended-range turbojets. General aviation activities include student training, crop dusting, fire fighting, law enforcement, news coverage, sightseeing, industrial work, on-demand air taxi service, corporate transportation, as well as personal use and recreational flying.

A number of FAA safety initiatives are helping to reduce general aviation and air taxi fatal accidents. To further enhance general aviation safety, we introduced flight-training products for advanced small general aviation aircraft. The FAA/Industry Training Standards Program (FITS) helps pilots keep pace with new aircraft and avionics technology, new airspace, and air traffic technology emerging in the general aviation community.



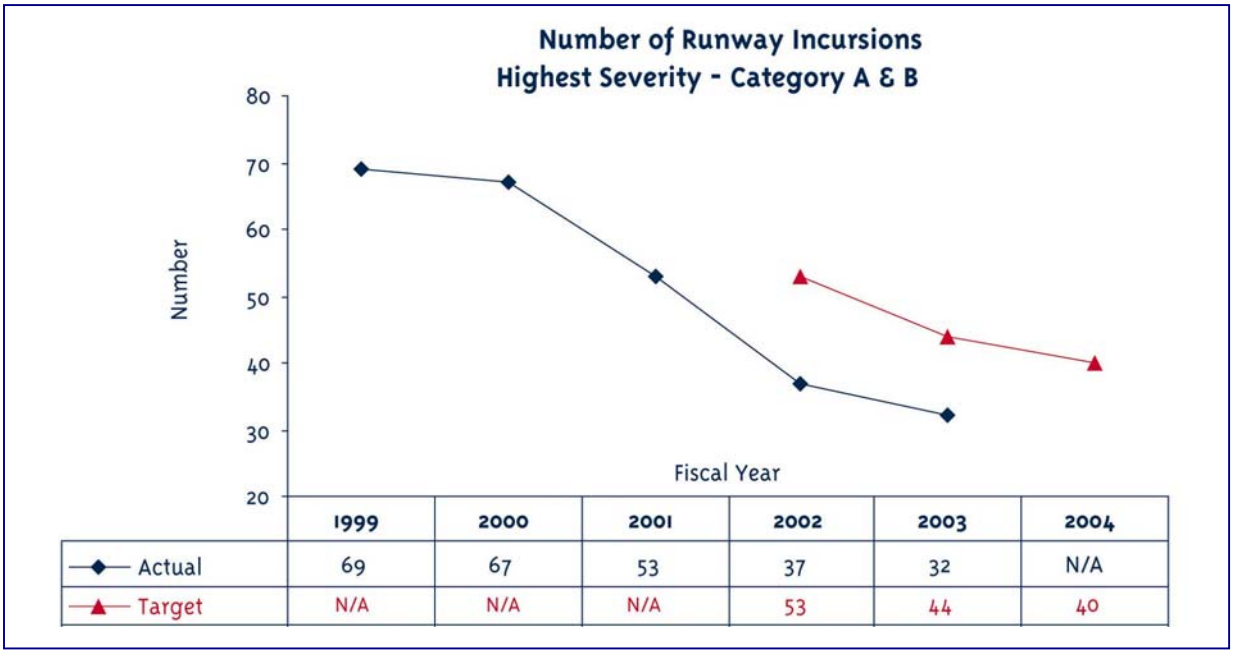
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003P	2004
Actual	450	422	435	435	382	378	396	364	341	359	348	360	N/A
Target	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	379	379	379	374	349

P=Prelimary

Results: FAA exceeded its goal of reducing the number of general aviation fatal aviation accidents by more than 4%, reducing the number of general aviation fatal accidents to 360. Although we met our FY 2003 goal, we are concerned about the upward trend in general aviation fatal accidents over the past several years. Reducing these types of accidents remains a challenge. We are examining accident data and stratifying it by group (e.g., recreational, instructional, agricultural). We see a particular problem in instructional flying and are looking at ways to develop and implement targeted interventions (e.g, through our programs that certify training schools and instructors).

Runway Incursions

A runway incursion is any occurrence in the airport runway environment involving an aircraft, vehicle, person or object on the ground that creates a collision hazard or results in a loss of required separation with an aircraft taking off, intending to take off, landing, or intending to land. Reducing the number of runway incursions reduces the likelihood of collisions that could involve fatalities, injuries, or significant property damage. The fact that FAA was able to further reduce the most serious types of incursions (Category A and B) in FY 2003 is a noteworthy achievement.



	1999	2000	2001	2002	2003	2004
Actual	69	67	53	37	32	N/A
Target	N/A	N/A	N/A	53	44	40

This measure was redefined in FY 2002. Actual performance reflecting the redefinition was calculated for prior years.

Results: In FY 2003, the number of the most serious types of runway incursions was reduced to 32, which was significantly lower than FAA's limit of 44 runway incursions for the year. This continues a downward trend that began 4 years ago, and resulted in a 14% decrease from last year.

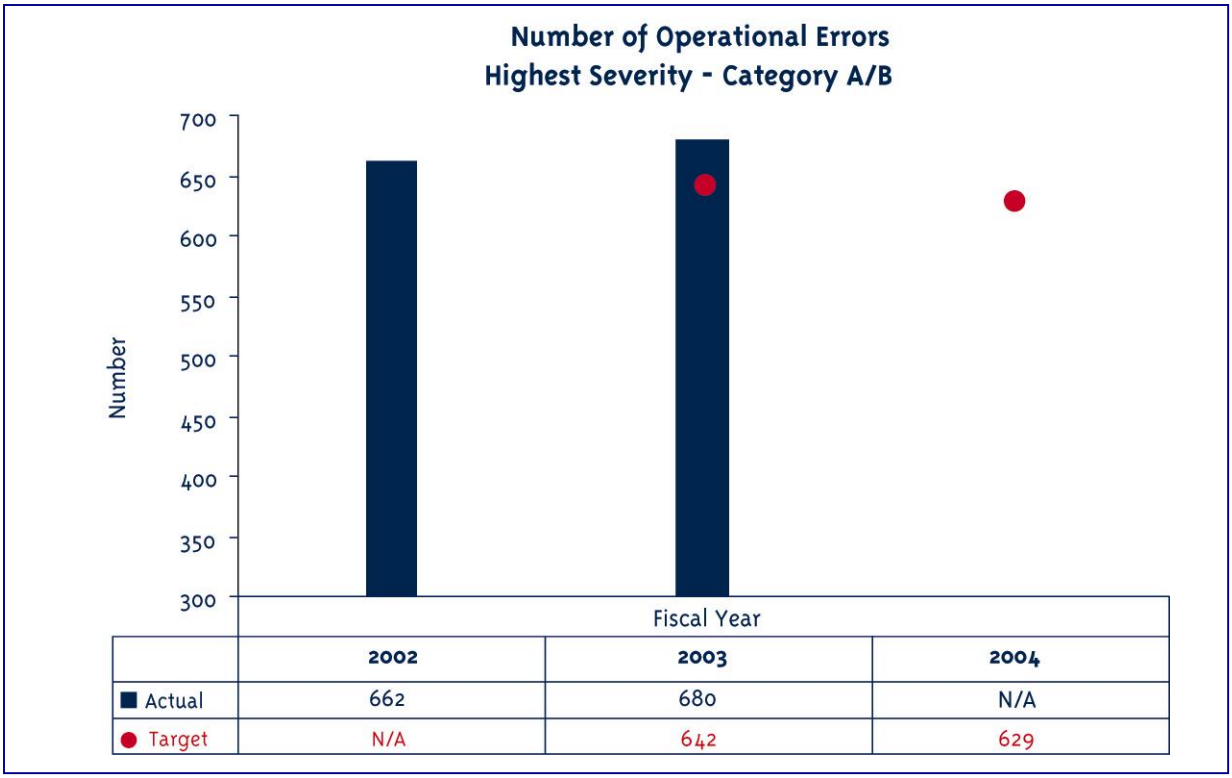
One significant factor contributing to the decrease in runway incursions is lower traffic volume. Lower traffic volume alone, however, does not fully explain the downward trend. This is evident since the decline in runway incursions began in 1999, when traffic volume was increasing.

An equally important contributing factor is that FAA has focused significant resources, time and effort to tackle the problem of runway incursions. FAA created the Office of Runway Safety to develop and coordinate efforts to improve runway safety. We created a variety of education and training programs focused on air traffic controllers, pilots and airports to help reduce the number of runway incursion incidents. Air traffic control memory aids, better airport surface markers, and public service announcements by Harrison Ford, plus other initiatives, have all contributed to a significant reduction in runway incursions.

More work is needed to understand the interactions of traffic volume, airport-specific factors, and runway incursions. For example, high-traffic volume, complex and high frequency communications, runway crossings, and traffic mix at the local level may influence the potential risk of runway incursions.

Operational Errors

An operational error is a failure to apply or follow the rules and procedures that ensure the safe separation of aircraft. In our ongoing efforts to reduce operational errors, we are aggressively seeking to identify the factors that cause those errors and to implement technology improvements, such as the deployment of modern displays, new decision support tools, and improved communication systems, to eliminate those factors. We are also providing additional training so that pilots and controllers have a common understanding of separation standards, policies, and procedures.



	2002	2003	2004
Actual	662	680	N/A
Target	N/A	642	629

Results: We exceeded our limit of 642 errors by almost 6%, reporting 680 Category A and B operational errors during FY 2003. Controller awareness was the largest contributor to operational errors, primarily from the inappropriate use of displayed data. The second largest factor was the lack of an adequate plan to ensure proper separation. Other factors include miscommunication between controllers and pilots, and adverse weather that caused pilots to deviate from or be unable to accept instruction from controllers.

FAA attempted to control operational errors through several programs that, due to budgetary constraints, were either not completed or cancelled. These programs focused on increasing management oversight and training. In FY 2004, FAA plans to devote considerable management attention to operational errors. We will reallocate resources to ensure that performance in this area improves.

Management oversight is one of the keys to reducing operational errors. Congress has mandated that FAA maintain 1,715 Operational Supervisors. Due to budget constraints and the difficulty in hiring qualified managers, FAA is short 126 supervisors. These budget challenges also reduced travel of FAA managers who oversee smaller facilities. Finally, FAA planned to conduct evaluations of its over 600 air traffic control facilities over the past two years. To date, we have only been able to evaluate 150.

Training was also curtailed. FAA developed a prototype best practices course designed to increase controllers' skills, teach new techniques, and help reduce operational errors. Further development ceased due to lack of funding.

FAA is studying the budgetary requirements to fund initiatives designed to reduce operational errors in FY 2004 and beyond. Meanwhile, we continue to focus on reducing operational errors through training controllers on a common understanding of procedures and policies, aligning managers' pay to this and

other performance targets. We are also developing and implementing JANUS, a tool designed to identify causal factors in air traffic-related incidents.

FAA has used several procedures in the past to measure operational errors. Prior to FY 2002, FAA used a straight count of all operational errors. This measure did not offer any differentiation between a technical violation and more severe operational errors. In FY 2002 only those operational errors with less than 80% separation were used as a control measure, with the presumption that this level of separation measured those with some degree of risk. Beginning in FY 2003, we redefined the criteria for operational errors and categorized them by risk area, focusing on the most severe (Category A and B). Therefore, FAA does not have actual results for Category A and B operational errors in previous years.

System Efficiency

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

As airspace systems become ever more interconnected, we have developed more partnerships within the national and international aviation community. FAA continues to focus on aviation as a global system and works closely with international organizations to seek global solutions to safety, routing, procedural, equipment, and environmental issues.

FAA assesses system efficiency through five performance measures. The chart below describes FAA's FY 2003 performance in improving efficiency through achievement of each of these measures.

FY 2003 SYSTEM EFFICIENCY PERFORMANCE MEASURES AND RESULTS

Performance Measure	Target	Results	Status
On-Time Arrival: This measure includes the percent of all flights arriving at the 35 Operational Evolution Plan (OEP) airports no later than 15 minutes after the scheduled arrival time. The airlines, FAA, and the Bureau of Transportation Statistics agreed to use 15 minutes with scheduled arrival time as a common measure of aviation delay.	**78.20%**	**82.30%**	
Airport Daily Arrival Capacity: This measure includes the sum of the daily hourly-called arrival rates at the 35 OEP airports per month, divided by the number of days in the month. The daily hourly-called rate is the number of arrivals an airport can handle for each hour of each day, depending on current conditions, including weather. In FY 2003, FAA expanded the scope of this measure of arrival capacity from 32 selected hub airports to the 35 OEP airports.	**49,120**	**49,537**	
Airport Arrival Efficiency Rate: This measure includes the weighted percentage of on-time arrivals greater than or equal to arrival demand or the facility-set arrival rate at the 35 OEP airports. The rate is determined by three factors on how well the demand for arrivals is met: arrivals during a given hour; arrival demand for a given hour; and airport arrival rate. While both arrival and departure efficiency are collected, this measure focuses on arrival efficiency, rather than overall airport efficiency since airborne flights and departures are generally delayed because of the lack of arrival capacity. In FY 2003, FAA changed the scope of this measure from 32 selected hub airports to the 35 OEP airports.	**95.49%**	**95.50%**	
Exposure to Noise: FAA's goal is to reduce the number of people exposed to significant noise through 2008, as measured by a three-year average from the baseline (2000-2002). The MAGENTA (Model Assessing Global Exposure from Noise of Transport Airplanes) population exposure methodology was used for the first time in FY 2000 to globally track this aircraft noise exposure goal. The targets for this goal are currently measured on an annual basis.	**437,000**	**289,000***	
Number of People Benefiting from Noise Projects: This measure represents an increase in the cumulative number of people in residential communities that are expected to benefit from noise compatibility projects funded under the Airport Improvement Program (AIP). The AIP provides funds for such noise reduction activities as residential sound insulation or relocation, sound insulation or relocation of buildings used for educational or medical purposes, land acquisition for compatible land use, installation of noise monitoring equipment, noise compatibility planning and the installation of noise barriers.	**12,500**	**13,287**	

Green: Goal Achieved **Red:** Goal Not Achieved

* *Number is preliminary. Final number will be available in May, 2004.*

System Efficiency Results and Initiatives

Commercial aviation delays are estimated to cost airlines over $3 billion per year. Missed flight connections, missed meetings, and loss of personal time directly affect passengers and affect our national system capacity to meet or exceed passenger demands on air travel. Air traffic density and adverse weather are generally the major causes of aviation delays, but other factors such as air carrier decisions on their flight operations, changes in consumer demand for air travel, rapid population growth in urban centers, and environmental considerations can either improve or limit the ability to meet on-time arrival expectations.

U.S. airspace has remained largely unchanged for decades while every other component of aviation has progressed significantly. Collaborative decision making, Required Navigation Performance (RNP), and shared information systems are the cornerstones of FAA's Operational Evolution Plan (OEP), which is designed to counter the increasing congestion, delays and inefficiencies that will result from increasing demand for air travel in our current system. The OEP is a detailed, comprehensive 10-year strategic plan developed in partnership with the aviation industry and other Federal agencies. Among the priorities outlined in the OEP are the modernization of on-ground and in-plane equipment, adoption of advanced routing procedures, and installation of state-of-the-art weather radar and navigational aids.

An Air Traffic Organization for the Future

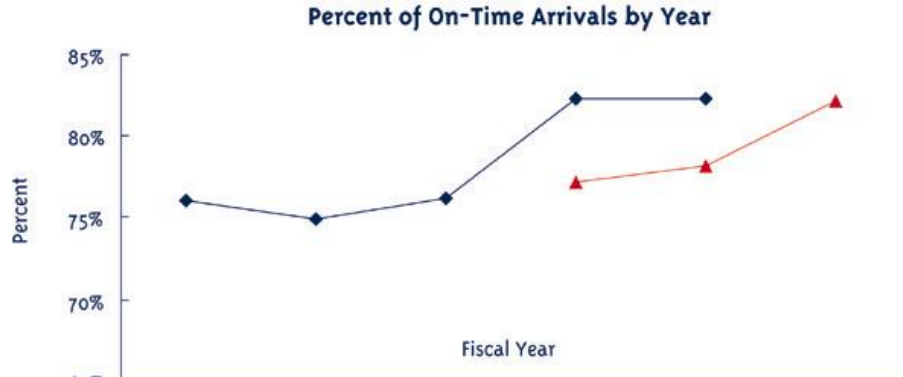
During FY 2003, FAA Administrator Marion C. Blakey filled the position of Chief Operating Officer by appointing Russell Chew to lead a new Air Traffic Organization (ATO). Prior to joining FAA, Chew was in charge of system operations at American Airlines. His job there was to move thousands of aircraft every day. Throughout his career, from when he flew light twin engine aircraft and Lear jets and talked with controllers, to when he headed American's operations control center, he has worked closely with FAA, which makes him exceptionally well qualified to build an ATO for the future.

His responsibility for ensuring that hundreds of thousands of passengers reached their destinations each day at American Airlines made Chew realize that the future of the airline industry—and all of aviation—depends on what happens with our Nation's air traffic system. Both Chew and Blakey believe that only FAA can provide the environment for aviation to flourish.

Chew is now in the process of realigning FAA lines of business, including Air Traffic Services (ATS), Research and Acquisitions (ARA), and the Free Flight Program Office to create a performance-based organization that supports the aviation system of the future.

On-Time Arrival

Traffic volume, adverse weather conditions and congestion at several large airports are significant causes of traffic delay. To address these issues, FAA employees at the National Command Center meet daily with airline industry representatives to coordinate traffic around known weather conditions and other factors that could potentially cause delays. By planning and agreeing to alternatives before the day begins, FAA and industry work together to ensure that aircraft land on time.



	1999	2000	2001	2002	2003	2004
Actual	76.00%	74.90%	76.20%	82.26%	82.30%	N/A
Target	N/A	N/A	N/A	77.20%	78.20%	82.10%

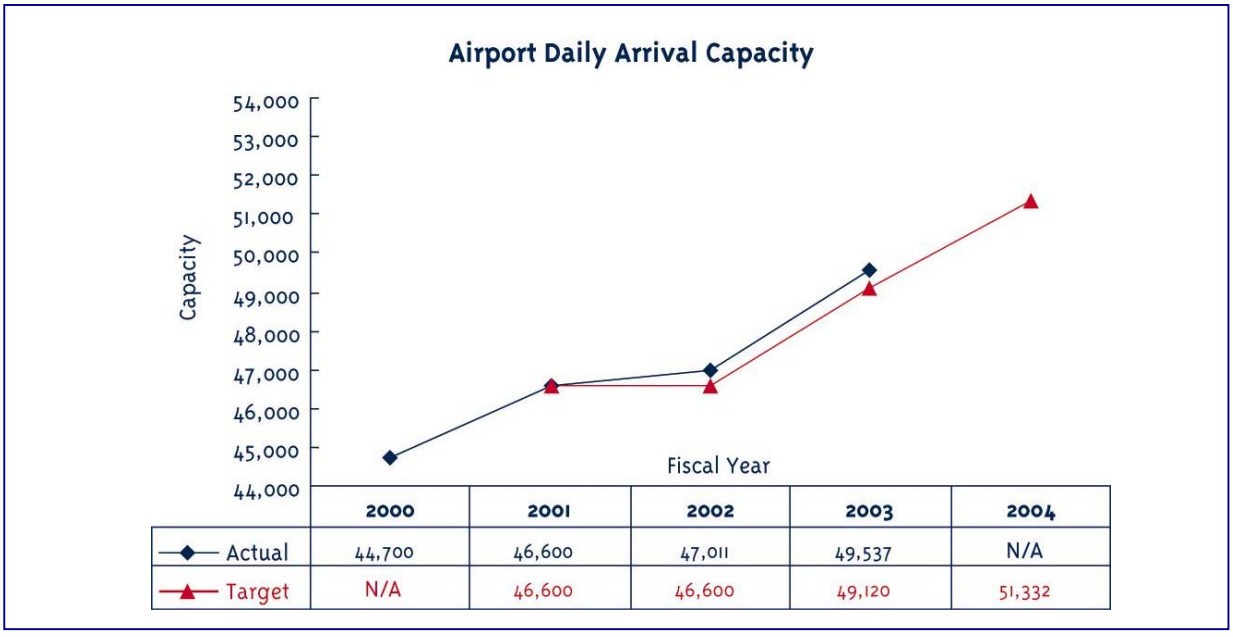
Control tower technology is another area in which FAA is working to improve on-time arrival rates. In some FAA control towers, the equipment is more than 20 years old and is becoming increasingly difficult to maintain. In addition, the older equipment will have difficulty handling the increase in traffic projected for coming years. The Standard Terminal Automation Replacement System (STARS) will modernize these computers and displays. STARS is a joint FAA and Department of Defense program that will replace systems at more than 300 civilian and military air traffic control facilities nationwide. STARS and the En Route Automation Modernization (ERAM) program are the centerpieces of FAA's efforts to modernize the national air traffic system. ERAM will replace flight data processing and radar/surveillance data processing components of air traffic control software at all air route traffic control centers. Together, ERAM and STARS will help improve on-time arrival rates and increase airport capacity and efficiency.

Finally, new navigational technologies, such as advanced area navigation (RNAV) and RNP, will allow suitably equipped aircraft to fly point-to-point as the pilots desire instead of following the current system of rigid routes from one position to another based on ground-based navigational aids.

Results: With an on-time arrival rate of 82.30%, we exceeded our FY 2003 goal of 78.20% by over 5%. While decreased volume may have contributed to the increase in on-time arrivals, our success in achieving our goal is also attributed to the continued cooperation and coordination at the National Command Center with airline industry representatives. Our new programs and technology further supported efforts in FY 2003 to increase on-time arrivals.

Airport Daily Arrival Capacity

Throughout FY 2003, we continued to work with airports around the country to boost capacity by analyzing chokepoints in the system. FAA studied chokepoints around Chicago, Boston, and New York and helped work out troublesome intersections in the flight paths. The New York area airports redesigned airspace and made small improvements that smoothed out bottlenecks. Although it is a national effort, resources are being applied to geographic areas where the need is greatest. Airports in eight metropolitan areas have been identified as causing the most delay in the national airspace system. These areas are Boston, New York/Newark, Philadelphia, Washington/Baltimore, Atlanta, Chicago, San Francisco, and Los Angeles.



	2000	2001	2002	2003	2004
Actual	44,700	46,600	47,011	49,537	N/A
Target	N/A	46,600	46,600	49,120	51,332

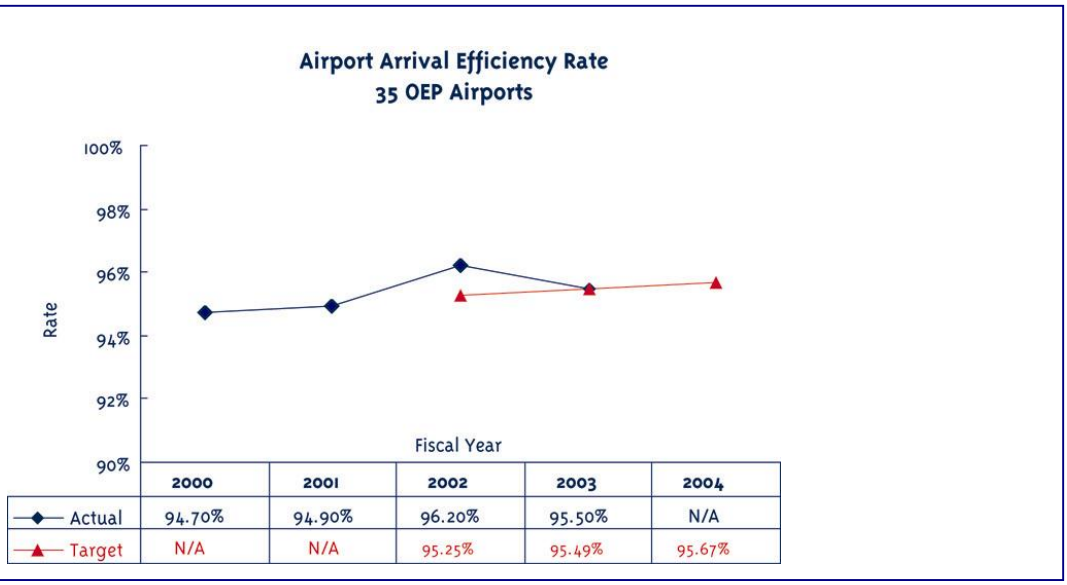
New runways opened in Denver, Cleveland, and Miami as part of FAA's efforts to increase capacity. The OEP identifies 10 additional air carrier runways to be commissioned through 2013. Because constructing new runways is the most effective way to add ground capacity, particularly at the Nation's larger airports, FAA is also improving the criteria for assessing the capacity of our larger airports and their ability to meet projected demand. This information, in turn, will be used to target efforts to use

pavement, procedures, and technology to add capacity at airports with the greatest need and with the most potential to reduce delays nationwide. In addition, FAA will implement airspace redesign to reduce congestion in busy high altitude airspace as well as in congested airspace in major metropolitan areas. FAA will also continue to develop and deploy technology that enables aircraft to safely take off and land in adverse weather.

Results: FAA met its FY 2003 target. FAA continues to focus on adding runways, new technologies, and improved data collection to meet its future capacity performance targets.

Airport Arrival Efficiency Rate

The Airport Arrival Efficiency Rate measures how well the OEP airports use the capacity they have. An efficient aviation system gets passenger and goods to their destinations safely and reliably. Aviation system improvements must be environmentally responsible, taking into consideration the impacts of aviation development on communities near airports and on sensitive natural resources. Our focus is on strategic expansion of our system capacity and other creative solutions to address our growing mobility needs and increase the reliability of our aviation system.



	2000	2001	2002	2003	2004
Actual	94.70%	94.90%	96.20%	95.50%	N/A
Target	N/A	N/A	95.25%	95.49%	95.67%

Results: FAA met its goal. Our success in achieving this goal stems from the continuing introduction of new technologies and procedures, as well as improvements in data collection and reporting.

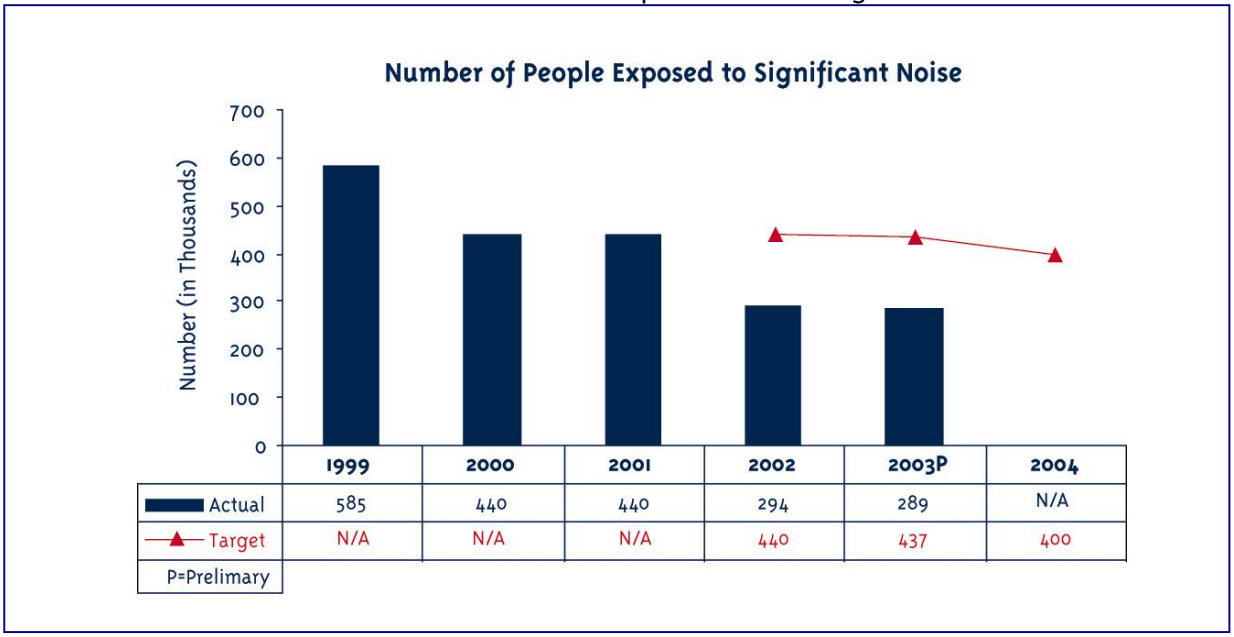
Exposure to Noise and People Benefiting from Noise Projects

Despite the economic benefits to industry and the public, aviation, like all industries, can have an unpleasant byproduct. Noise is the most "visible" downside. Helping the industry mitigate the effects of noise is one of our primary concerns. Noise exposure has a direct effect on our ability to expand the industry and the economy. New runways are the single largest action an airport can take to expand capacity and reduce delay. However, attempts to build new runways always meet with local opposition, primarily due to increased noise.

FAA takes this problem seriously. Our Centers of Excellence program created a new aviation research center for aircraft noise and aviation emissions mitigation. The Center's efforts will concentrate on a broad spectrum of noise and emissions mitigation issues, including socioeconomic effects, noise abatement flight procedures, compatible land use management, airport operational controls, and atmospheric and health effects. The Massachusetts Institute of Technology (MIT) will lead the center. The other members from academia are Boise State University, Florida International University, Pennsylvania State University, Purdue University, Stanford University, University of Central Florida, and University of Missouri—Rolla. Center team members represent academia, industry, and state, local, and other government agencies. The Center presently includes 18 industry partners. In addition, NASA plans to cosponsor the center with FAA. The center is legislatively required to match FAA grant funds with non-federal funding over the term of the cooperative agreement.

Results: For FY 2003, the number of people exposed to noise declined to 289,000. We are also revising our FY 2002 results from 379,000 to 294,000.

Two main factors related to the terrorist attack of September 11, 2001, account for the dramatic reduction. The first factor is the premature retirement from passenger service of older, noisier Stage 3 aircraft. The second factor is a decrease in aviation operations resulting from economic downturn.



	1999	2000	2001	2002	2003P	2004
Actual	585	440	440	294	289	N/A
Target	N/A	N/A	N/A	440	437	400

P=Prelimary

For FY 2004, FAA plans to measure this performance goal differently. Previously, FAA's model compared scheduled flights to the type of aircraft flown. Computer models calculated the noise exposure contours. FAA upgraded its noise model to access the Enhanced Traffic Management System (ETMS), which provides more accurate operations data. This new model includes not just scheduled flights, but also any aircraft filing a flight plan to or from 95 of the United States' busiest airports. FAA is now able to track unscheduled air traffic from general aviation, freight, and military operations at civilian airports. This new data reflects an increase in night operations, which carry a noise penalty in calculating noise contours and can significantly increase the noise exposure area.

Based on this new information, FAA plans to revise the target in FY 2004, pending approval from DOT.

FAA also increased the number of people benefiting from noise compatibility projects by 13,287, exceeding the goal of 12,500 by 6%. Installing residential sound insulation accounted for 10,420 people. Acquiring land and moving people accounted for an additional 2,778 people. Shifting aircraft flight tracks removed 89 people from significant noise exposure.

Organizational Excellence

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

Our goals for organizational excellence fall into three specific categories: meeting our milestones and budget for major acquisitions; focusing on customer satisfaction; and implementing the President's Management Agenda.

FY 2003 ORGANIZATIONAL PERFORMANCE MEASURES AND RESULTS

Performance Measure	Target	Results	Status
Milestones/Budget Met for Major Acquisitions: Achieve 80% of designated milestones and maintain 80% of critical program costs within 10% of the total budget as published in the Capital Investment Plan (CIP).	**80%/80%**	**77%/88%**	
Customer Satisfaction—Commercial Pilots: The National Quality Research Center at the University of Michigan Business School, the American Society for Quality, and the CFI Group conducted the American Customer Satisfaction Index (ACSI) to measure customer satisfaction of commercial pilots. As a major FAA customer user group that is central to our mission, we measured their satisfaction with air traffic control services, the clarity of our regulations, and pilot certification processes. A randomly selected sample of pilots was asked to rate FAA on a number of factors, including their level of overall satisfaction.	**62**	**64**	
President's Management Agenda (PMA): Achieve a "yellow light" status score for FY 2003 on all five initiatives of the PMA, as an interim performance measure to achieving "green" in FY 2004.	**Yellow**	**Red**	

Green: Goal Achieved **Red:** Goal Not Achieved

Organizational Excellence Results and Initiatives

Milestones/Budget Met for Major Acquisitions

In keeping with FAA's focus on organizational excellence, we have established a goal of achieving 80% of our designated milestones and maintaining 80% of critical program costs within 10% of the budget as published in the Capital Investment Plan. We were successful in managing our acquisitions within budget, but had mixed results in completing our projects on time.

Results: We did not meet our goal of achieving 80% of the milestones for major acquisition projects on time. While we did complete 36 out of 47 milestones on 33 major projects on time or ahead of schedule, FAA did not meet its milestones in 11 other instances. Several factors caused us to miss the milestones including delays due to union negotiations and technical complexities. FAA still managed to close out 77% of its major acquisition projects on time, despite missing interim milestones in some cases. In FY 2004 FAA is requiring monthly assessments from affected product teams. In these assessments, which are collected and updated using a new automated tool, managers are required to provide a red/yellow/green assessment on their confidence level that individual key milestones will be met. This allows corrective actions to be taken quickly and will enhance FAA's ability to meet this performance target.

We did, however, do a good job of keeping our projects within their budgets, with 88 percent of our programs within established budget limits.

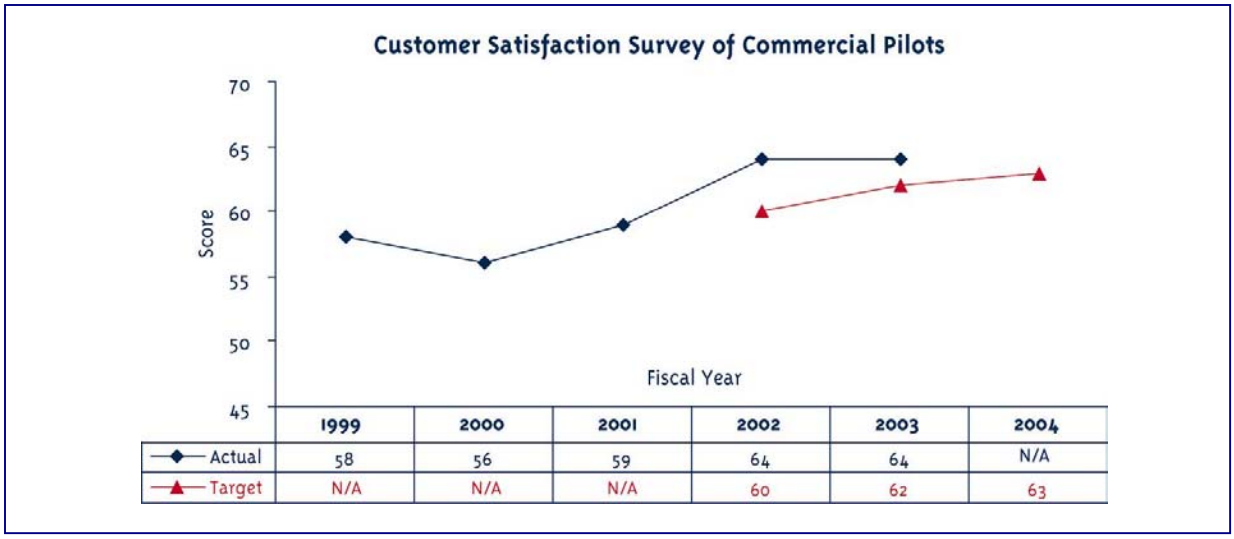
Customer Satisfaction – Commercial Pilots

We continued to focus on delivering better, more responsive service to our customers. FAA continued with a customer satisfaction initiative that provides written guidance and training to all managers and supervisors in our Regulation and Certification offices throughout the country on applying FAA rules and policies in a standard, consistent manner.

The program goals are promoting more consistency and fairness in applying FAA regulations, promoting earlier resolution of disagreements, providing better documented regulation and certification decisions, and making every FAA employee accountable for achieving the agency's mission. Through this new initiative, FAA customers can expect:

- Service that promotes a safe, secure and efficient aviation system;
- Considerate, respectful, and professional service;
- Clear explanation of the requirements, alternatives and possible outcomes associated with their inquiry or request;
- Timely and complete responses to inquiries and requests;
- Clear explanation of FAA decisions;
- Fair and careful consideration of their issue; and
- Clear guidance on elevating concerns to the next-highest level of FAA authority.

To measure customer satisfaction, FAA turned to the American Customer Satisfaction Index (ACSI) in FY 1999. The ACSI is a national indicator of the quality of goods and services available to the American public. The ACSI score is a weighted average measuring overall satisfaction, customer expectations, and perceived quality. Commercial pilots are asked about air traffic control personnel and services, pilot certification processes, the clarity of regulations, and how regulations contribute to aviation safety. FAA officially began measuring the score as a performance target in FY 2001. The baseline score in FY 1999 was 58.



	1999	2000	2001	2002	2003	2004
Actual	58	56	59	64	64	N/A
Target	N/A	N/A	N/A	60	62	63

Results: We exceeded our FY 2003 target of 62, achieving a score of 64 on this year's survey of commercial pilots. An important factor contributing to our success is FAA's Plain Language initiative, which seeks to rewrite all regulations clearly and concisely. Although FAA's ACSI remains significantly below the national ACSI of 71.6 for private sector services, the score of 64 is consistent with government agencies that have a regulatory and enforcement function.

President's Management Agenda

Throughout FY 2003, we have been working to implement the President's Management Agenda (PMA). The five initiatives in the PMA focus on the strategic management of human capital, competitive sourcing, improved financial performance, expanded electronic government, and budget and performance integration.

Results: FAA achieved a "yellow" status on three of five initiatives on the President's Management Agenda Scorecard. The status is reported in the chart below, followed by a more detailed description of the results for each initiative during FY 2003. Previous year's data does not exist for this initiative, as this was a new initiative for FY 2003.

Only DOT is graded officially by OMB. FAA scores mirror DOT's scores. As a result, FAA's scores depend on the results of the entire department, not just FAA. Because FAA cannot directly control its results for the PMA, and is dependent in a large measure on the results of other agencies within DOT, we have chosen not to report PMA results as an official FY 2004 performance goal. FAA and its management will, however, continue to track PMA results and contributions internally.

FY 2003 PRESIDENT'S MANAGEMENT AGENDA SCORECARD FOR DOT

INITIATIVE	STATUS	PROGRESS
Human Capital: Develop an FAA-wide human capital workforce plan to address future workforce gaps, eliminate skill gaps in critical occupations, develop performance-based incentives for the workforce, remove unneeded management layers, and develop the right mix of skills in the workforce that reflect the new emphasis on E-Government and Competitive Sourcing.	▲	●
Competitive Sourcing: Compete 50 percent of commercial positions at an undetermined future date. Each department must submit a Strategic Competition Plan and compete "commercial reimbursable support services" on a recurring basis.	▲	●
Financial Management: Develop financial management systems capable of producing more timely and accurate information, maintain a record of unqualified opinions on our financial statements, continue to improve accounting controls, and develop full cost accounting capability.	⊙	●
E-Government: Better justify and track cost and performance of information technology projects, as well as participate in government-wide initiatives that automate how the public deals with the Government, such as the FirstGov.gov initiative, E-Grants, standardization of data, and customer relationship management. In addition, properly secure major information technology systems used to meet the agency mission.	⊙	●
Budget/Performance Integration: Better integrate budget and performance functions by integrating budget and performance staff work; developing plans and budgets with outcome goals, output targets, and resources requested in the context of past results; charging full budgetary costs of programs; and documenting program effectiveness.	▲	●

KEY TO FY 2003 STATUS

"Status" measures where DOT is in meeting the initiative. "Progress" measures the rate at which DOT is moving toward green.

- ● Met all of OMB's core criteria.
- ▲ Met some but not all of OMB's core criteria and has no "red" conditions.
- ⊙ At least one of OMB's core criteria is in need of correction.

For a more detailed discussion of the President's Management Agenda, see the OMB website at www.whitehouse.gov/omb/budintegration/pma_index.html.

Strategic Management of Human Capital

The primary focus during FY 2003 was on the development of human capital plans throughout the Department to make sure that personnel in key occupations have the skills they need. These plans enable FAA to identify business challenges and workforce issues and develop human capital solutions to ensure our workforce achieves Agency goals. Development of the plans requires analysis of the demographics and size of our workforce and the skills our personnel need to address challenges and achieve the mission. Such plans enable FAA to recruit, develop, and retain the talented and diverse workforce necessary for accomplishing our objectives.

To create a strategic focus for FAA human capital, lines of business plans will serve as a foundation for developing a corporate FAA Human Capital Plan. The Plan will establish a systematic, agency-wide approach to human capital management that is aligned with the FAA Flight Plan, business plans, and budget. It will describe human capital goals, initiatives, and measures that will be used to improve FAA strategic management of human capital.

Part of our challenge is to strengthen the skills and knowledge of personnel at every level. FAA leaders must maintain high standards and serve as role models by promoting teamwork, communicating the organization's shared vision and goals, and seeking feedback from employees. Leaders foster a learning culture, provide opportunities for continuous development, and invest in training and development opportunities for themselves and the workforce to build critical competencies. FAA is working to enhance these skills in its leadership by implementing competency-based executive and managerial workforce plans, enhancing the skills of current FAA managers and supervisors, and selecting, developing, and retaining a new group of leaders.

Results: Our human capital goals are on target. In FY 2003, FAA launched a strategic human capital planning process in collaboration and partnership with DOT and FAA lines of business. This effort resulted in lines of business completing workforce plans for key mission-critical occupations. An FAA Executive Human Capital Board and FAA Human Capital Planning Council were established and charters developed that outlined shared responsibilities for FAA's Strategic Human Capital planning efforts. Results from this year's human capital planning activities advance the development of a corporate FAA Human Capital Plan to improve strategic management of the agency workforce.

FAA also continued efforts to strengthen leadership capabilities. We advanced the development of a diverse pool of internal candidates for executive positions through a successful Action Learning pilot involving 30 senior managers from various FAA offices. Using development strategies from corporate America, participants worked with senior executives, technical experts, and learning specialists to address real world issues facing our leadership team. We also successfully piloted coaching for newly appointed executives and high potential managers.

FAA played a key role in developing a DOT proposal on succession planning, which was reviewed and approved by OMB. An executive level steering group guided the extension of FAA's Executive Success Profile to managerial levels, identifying leadership competencies throughout FAA. The group also developed corporate policies and strategies to accomplish them, which have been incorporated in FAA's *Flight Plan*. As a result of these efforts, FAA is exceptionally well positioned to move ahead with new initiatives in FY 2004 to improve the alignment of leadership selection, development, and performance.

In the area of continuous learning, we have taken a leadership role within DOT to develop and transition to a department-wide Learning Management System (LMS) as part of the migration to the Department of Interior's Federal Personnel and Payroll System scheduled for FY 2004. The LMS will enable greater alignment of training with organizational requirements, provide more accurate training data, and support optimal use of e-Learning technologies. The new LMS is a critical component of our efforts to provide high quality, just-in-time training to the FAA workforce while controlling costs and improving quality.

FAA is also implementing two other major human resource initiatives designed to contain escalating agency costs. The first initiative is a new process for negotiating agreements with the unions representing FAA employees. The process places strict controls on the negotiation of union agreements by placing labor relations professionals in charge of negotiations and requiring a budget analysis for each negotiation. The second initiative involves pilot programs to reduce the workers' compensation costs. The initiative includes efforts to return employees on workers' compensation rolls to FAA duties and to cut down on the incidents resulting in workers' compensation claims.

Competitive Sourcing

OMB has moved away from numerical goals that were originally established for the competitive sourcing initiative of the PMA. With the publication of the revised A-76 circular on May 29, 2003, the rules and procedures for conducting competitive sourcing studies have been significantly changed, which has further affected the original goals. The primary focus during FY 2003 was to initiate action and make forward movement on agency competitive sourcing efforts.

***Results*:** Our competitive sourcing goals are on target. During FY 2003, FAA designated the Deputy Administrator as the Competitive Sourcing Official and established the Office of Competitive Sourcing Acquisitions. This office was established as a permanent organization to conduct all public-private competitions under the guidance of the Office of Management and Budget's Circular A-76.

Presently this office is conducting a competition of Automated Flight Service Stations (AFSS). This competition encompasses 2,700 employees at 58 facilities in the continental United States, Puerto Rico, and Hawaii. It is the largest competitive sourcing study currently being conducted in the government. We are nearing completion of the pre-planning phase of the acquisition and will soon publicly announce the competition.

In June 2003, we released a Request for Information (RFI) on FAA's *Contract Opportunities* website. In response, seventeen vendors and the Government responded with comments on the overall acquisition approach. One-on-one meetings with potential service providers were held later that month. We also convened an AFSS user group meeting in early July to gain additional feedback and insights. Additionally, we released a web-based survey in early August to gain input from general aviation pilots on the nature of services they currently receive.

In September 2003, we approved the scope of services currently provided by AFSS and recommended the scope of the competition. Later that month, the agency management council approved the acquisition strategy and incorporated changes into the acquisition policy to accommodate the use of Circular A-76. In addition, we approved waivers regarding the length of time required to complete the acquisition and permitting the use a "trade-off" approach in the evaluation.

Improving Financial Performance

One of our major PMA challenges has been on this initiative. During the past year our focus has been on the implementation of the new Department of Transportation core financial management system, DELPHI, and our ongoing efforts to maintain a clean audit opinion. Coupled with the DELPHI system is a new acquisition system, PRISM, that will streamline our acquisition process and better integrate financial and acquisition business processes.

Other focus areas that are underway include ongoing implementation of our cost accounting system, streamlining efforts on managing travel, and other related financial process improvements.

Managing Cost and Improving Performance

FAA continued to implement far-reaching changes to its financial management systems in FY 2003. In November 2003, we implemented DELPHI, the Department of Transportation's integrated financial management system. The use of DELPHI will give FAA more timely and accurate financial information, one of the five goals in the President's Management Agenda. DELPHI implementation also enables FAA to address the concerns of the General Accounting Office (GAO) about weaknesses in FAA accounting and financial management systems.

A key element in the new *FAA Flight Plan* that will help contribute to our progress in improving financial performance is a program to help focus management attention on controlling costs. In November 2003, FAA implemented DELPHI, its new core accounting system which will streamline and speed reporting, eliminate cumbersome manual entries and adjustments, and integrate property accounting with the core accounting system. DELPHI also includes PRISM, an acquisition system that will enable us to fully integrate our procurement activity with our core financial system.

Results: Our efforts to improve financial performance were not on target. Since we were not able to meet our original schedule for DELPHI and PRISM implementation during FY2003, we did not achieve a "yellow" on this PMA initiative.

The rescheduled implementation of DELPHI and PRISM has required careful planning and coordination not only within FAA, but also with the Department. Based on lessons learned from the delays we experienced in FY 2003, we realigned program management responsibilities for the PRISM program to the DELPHI program manager to improve the coordination across the programs. We have conducted numerous tests to ensure an orderly transition from the existing accounting and procurement systems. We have met all of our revised milestones for the implementation of DELPHI and PRISM and implemented the systems in November 2003.

FAA has made significant progress to date in the financial management areas identified by GAO in its High Risk report. FAA now has a record of three consecutive clean audit opinions. Our auditors

reported that FAA had no material internal control weaknesses for FY 2003. The auditors also reported that FAA had taken effective correction action to resolve a prior material internal control weakness related to its reporting of legal liabilities.

The ability to produce accurate financial statements is a key indicator of an agency's financial management capabilities. The financial statement audit opinion provides an objective third party determination upon the validity of the agency's accounting data and systems. Although FAA is part of DOT, we are required to prepare our own audited financial statements. FAA received an unqualified opinion on our FY 2003 financial statements.

FAA has also focused on improving underlying processes and controls during FY 2003. We continued to aggressively track and implement auditor recommendations with 97% of financial-related recommendations implemented in the past year. In addition, FAA successfully accelerated the issuance of our audited financial statements by 43 days and closed our accounting system in one day—a process that previously took almost two weeks. During the past year FAA formed agency-wide Accelerated Close Teams, led by the Assistant Administrator for Financial Services, to re-engineer processes and ensure that accelerated year-end closing milestones were met. In addition, we coordinated closely with our independent auditor and the DOT Inspector General to develop a plan of key milestones to meet the accelerated targets.

By the end of FY 2003, all employees in our lines of business began to record their time in labor distribution, which includes capturing the work of air traffic controllers in the Cru-X system. Having this new information on our labor costs across agency projects and activities will help us evaluate the effectiveness and efficiency of our programs. FAA is also working hard to make the cost accounting system compatible with DELPHI by February 2004.

Expanded Electronic Government

The President's Management Agenda states that the administration will "create easy-to-find single points of access to government services for individuals" and "automate internal processes to reduce costs internally." The main objective under this goal is to provide the capability for external customers and employees to transact business with FAA electronically, primarily using the Internet. Key components of the E-Government agenda are the development of an Enterprise Architecture, the adoption of a Capital Planning and Investment Control (CPIC) process, and properly securing our major operational information technology (IT) systems. Based on best practices, these elements serve as essential tools for managing IT infrastructure and guiding future IT investment decisions.

Results: Our efforts to expand electronic government did not meet the target. We received a "red" on this PMA initiative due to problems in completing our security certification and accreditation packages (SCAP) on a sufficient quantity of our IT systems.

Even though we were challenged in completing our security certifications, FAA has done groundbreaking work in setting the strategic direction for how we plan to tackle securing our systems. We have evolved our overall approach on IT security from the more simplistic approach of policy, education, and system-by-system certifications, to a holistic approach involving security engineering, intrusion prevention and quarantine/system recovery. Through this more robust and strategic direction, we plan to position FAA to proactively protect ourselves from and efficiently respond to any cyber attacks.

Recent OMB attention to the business cases for our IT systems has caused us to redouble our efforts in this area. Executives in charge of FAA lines of business have become personally involved in ensuring we present the best possible business case on our IT investments. Existing investment board processes are being revamped to include the OMB Exhibit 300 as part of the regular review of major IT programs.

FAA has made substantial progress in implementing the administration's E-Government agenda. Through a team effort under the leadership of the Chief Information Officer, the mission support area of the Enterprise Architecture will be completed on schedule. FAA also completed Phase I of its plan for implementing the Government Paperwork Elimination Act (GPEA). This step enhances FAA's level of service to citizens by making all of FAA's public use forms available in a single, easy to use, Internet application. This project also moves FAA closer to being integrated with the other Federal E-Government initiatives such as E-Grants and E-Authentication.

Harnessing the opportunities provided by the Internet, FAA is integrating the use of web-based applications into financial management business practices. In FY 2003, FAA implemented the DIY ("Do It Yourself") system, which offers FAA customers the capability to pay for registrations, filings, and debts over the Internet with a credit card. FAA also uses the system to collect airline user fees. In FY 2004, FAA is working on expanding the use of the system for other types of payments.

Budget and Performance Integration

The primary focus for the year was on the delivery of a performance-based FY 2005 budget and the completion of the Program Assessment Rating Tool for our Operations appropriation in the Air Traffic Services lines of business and for our Research, Engineering and Development (RE&D) appropriation in the Research and Acquisitions line of business.

Results: Our budget-to-performance integration efforts were on target. FAA made major improvements in its alignment of budget and performance. This year we succeeded in aligning our FY 2005 budget to over 30 performance targets within 4 goal areas in the FAA Flight Plan. FAA lines of business and staff offices then developed individual business plans for FY 2004 that tracked with the Flight Plan, providing line of sight to all FAA employees on how their work contributes directly to our Strategic Plan.

In addition, FAA has incorporated the results of OMB's Program Assessment and Rating Tool (PART) within the budget request. The PART is a program that OMB is using to evaluate the effectiveness of all government programs. This year, OMB evaluated the RE&D appropriation and the Air Traffic Services Operations appropriation. The RE&D evaluation achieved the second highest score in government. Air Traffic Services also did well.

We have much more work to do before our budget and performance are truly integrated. We plan to better justify our base requirements and establish more meaningful context and connections between resource requests and performance goals in the FY 2006 budget submission. Our budget and performance staffs are learning to work more closely together at all levels of the organization. FAA continues to lead the Department of Transportation in working towards a seamless integration of budget and performance.

Because our Organizational Excellence goals are relatively new, trend data is not available beyond that depicted in the charts in the preceding pages.

Financial Highlights

Management Integrity: Controls, Compliance, and Challenges

Every year, FAA's lines of business and staff offices review the adequacy of their program and activity management controls to assess their compliance with Sections 2 and 4 of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). Based on their review, the head of the line of business or staff office identifies in writing to the Chief Financial Officer, potential material internal control weaknesses and system nonconformances. Those deemed material, are consolidated in a memorandum with a Statement of Assurance signed by the Administrator and sent to the Secretary of the Department of Transportation. FAA's response becomes a part of the DOT's Statement of Assurance sent to the President. To help resolve identified material weaknesses or nonconformances, a plan is developed, with specific milestones and deadlines. The plan, and the status of each action, is reviewed monthly, with results reported to the DOT's Office of the Secretary.

As reported to the Secretary in a December 2003 memorandum, in FY 2003, the FAA had one material weakness—oversight of cost reimbursable contracts, and one material nonconformance—the lack of a fully integrated property accounting system.

Last year, we reported the closeout of cost reimbursable contracts as a material weakness. In the OIG's May 2002 audit report FA-2002-092, they reported that the backlog of over-aged cost reimbursable contracts awaiting closeout was 1,400 with a value of $6 billion. As of September 30, 2003, FAA has reduced this backlog to 180 contracts with a value of $3.45 billion. We have also closed out a significant number of cost reimbursable contracts that are not considered over-aged and have established a target of closing out the entire backlog of the completed contracts by September 2004. FAA has developed standard operating procedures and reminded contracting officers of procurement requirements to strengthen the administration of contracts. Finally, in November 2003 FAA

implemented PRISM, the agency's new procurement system, which is integrated with DELPHI, the Department's new core accounting system. These systems will greatly improve the payment process for cost reimbursable contracts.

Lack of a fully integrated property accounting system was originally reported as a material nonconformance in the FY 2001 FMFIA statement. The nonconformance was a result of the temporary use of the Interim Fixed Assets System (IFAS) to establish control over FAA's property accounting until DELPHI was implemented. IFAS was not fully integrated with the accounting system used in FY 2003. In November 2003 FAA implemented DELPHI, which includes an integrated property accounting module. This should bring the FAA into conformance with Section 4 of FMFIA.

OIG Management Challenges

The DOT Inspector General identified his top management challenges facing DOT in FY 2004. In his report dated December 5, 2003 (available at www.oig.dot.gov/show_pdf.php?id=1217), he identified several FAA-specific challenges, which are summarized below. The Appendix to this report is the transmittal memorandum and extracts relating to FAA-specific challenges.

- **Aviation Safety:** Ensure FAA safety oversight keeps pace with industry and economic changes such as significant increases in contracting aircraft maintenance to third parties. Also, while there has been real progress in the last year on runway incursions, operational errors continue to increase. Corrective actions are imperative to address this problem.
- **Improving Fiscal Discipline:** Address growth in operations, and problems with delays and cost increases for major acquisitions. With the expected decline in Aviation Trust Fund revenues, salary increases experienced over the last few years are not sustainable. To abate the growth in operating costs, the IG states that FAA needs to have both the cost accounting and labor distribution systems in place and operating effectively. Also, the FAA needs to renegotiate memorandums of understanding between FAA and labor that have extensive cost considerations.
- **Financial Accountability.** Improve oversight of cost-reimbursable contracts, and fully implement the new DELPHI financial management system.

Erroneous Payments

Since 2001, FAA has been required to report on grant payments paid erroneously under the Airport Improvement Program (AIP). Based on FAA's reviews, the estimated rates of erroneous payments have been insignificant and below minimum thresholds established by OMB. These are high dollar amounts/low volume payments, paid to grantees that are primarily states and political subdivisions. In FY 2001, when an estimated 2,000 grants were issued to approximately 1,500 grant recipients, 0.05% of payments were paid erroneously, amounting to $349,000 of the $3.35 billion paid in grants. In FY 2002, FAA had an erroneous payment rate of 0.06%, amounting to $766,000 of the $3.33 billion paid out in grants. In FY 2003, $3.89 billion was paid in grants. Forty-seven out of 29,830 payments, (0.16%) were paid erroneously, amounting to $14 million. Out of the 47 transactions paid erroneously, 19 payments were paid from one accounting office and paid erroneously because grantees charged the wrong project or grant number. Once the errors were realized, the funds were deposited back to the system.

Discussion and Analysis of the Financial Statements

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

FY 2003 Financial Statement Audit

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

independent certified public accounting firm, to audit FAA's FY 2003 financial statements. KPMG also audited FAA's FY 2002 financial statements.

In 2002, the DOT's Inspector General and Chief Financial Officer, along with the FAA Chief Financial Officer established an Audit Advisory Committee to promote and encourage open communications among the Office of Inspector General (OIG), FAA management, and the independent auditors; to resolve issues that arise during the course of the audit; and to monitor the implementation of audit recommendations. The Committee is chaired by the Director of the Office of Financial Management and includes representatives from the OIG, DOT's Office of Financial Management, and FAA's Assistant Administrator for Region and Center Operations, Associate Administrator for Air Traffic Services, and Associate Administrator for Research and Acquisitions. For FY 2003, participation on the Committee was expanded to include representatives from the Chief Counsel's office, Assistant Administrator for Human Resources Management, Information Services, and Airports.

FAA's independent auditor, KPMG LLP, rendered an unqualified audit opinion on FAA's FY 2003 financial statements. This means that the FAA's financial statements as of, and for the year ended, September 30, 2003, were presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. KPMG's audit report was presented by the OIG to the FAA Administrator.

KPMG identified no material weaknesses and three reportable conditions: (1) Controls over property, plant, and equipment, (2) Process for estimating environmental liabilities, and (3) Information technology controls over FAA and third party systems and applications.

Further, KPMG identified instances of noncompliance with the Federal Financial Management Improvement Act and the Anti-Deficiency Act.

Understanding the Financial Statements

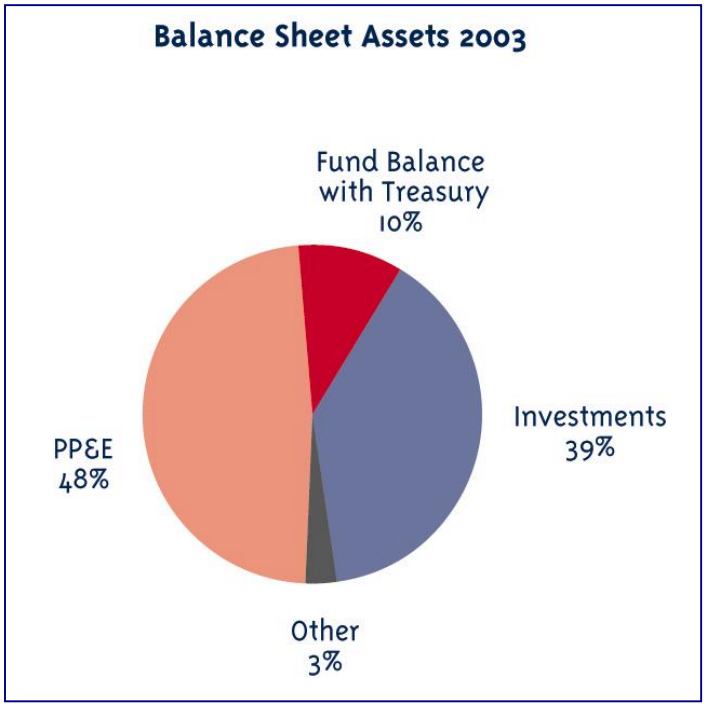
FAA's Consolidated Balance Sheets, Statements of Net Cost, Changes in Net Position and Financing and Combined Statement of Budgetary Resources are presented in a two-year comparative format. The following section provides a brief description of (a) the nature of each financial statement and its relevance to FAA, (b) significant fluctuations from FY 2002 to FY 2003, and (c) certain significant balances where necessary to help clarify their link to FAA operations.

Balance Sheet

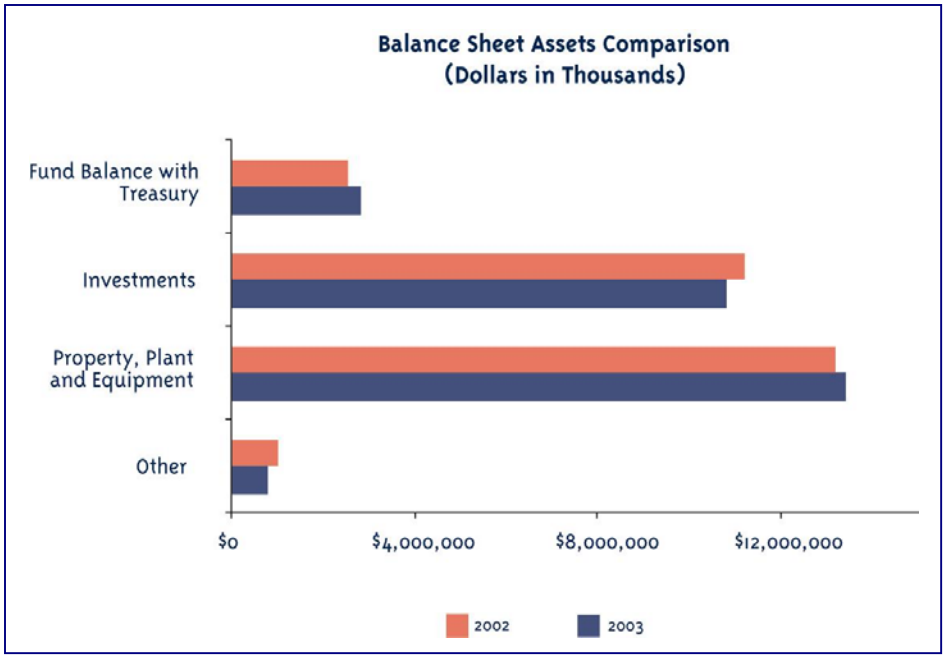
The Balance Sheet presents the amounts available for use by the FAA (assets) against the amounts owed (liabilities) and amounts that comprise the difference (net position).

Assets

As of fiscal year end, FAA's total assets were $27.9 billion. The assets of the FAA are the resources available to pay liabilities or satisfy future service needs. FAA's major categories of assets, as a percentage of total assets are as shown in the chart on to the right.



The graph at the right presents comparisons of major asset balances as of September 30, 2002 versus 2003. A discussion of the significant accounts and fluctuations follows.



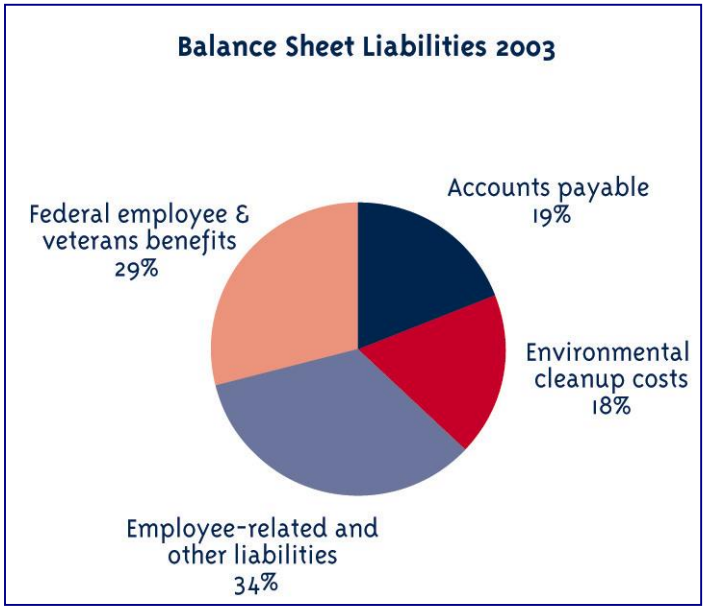
Fund Balance with Treasury represents 10 percent of FAA's current year assets and consists of funding available through Department of Treasury accounts from which FAA is authorized to make expenditures to pay liabilities. It also includes passenger ticket and other excise taxes deposited to the Airport and Airway Trust Fund (Trust Fund), but not yet invested. Fund Balance with Treasury increased 12 percent ($294 million) due primarily to collection of accounts receivable balances.

At $10.8 billion, *Investments* represent 39 percent of FAA's current year assets, and are principally derived from passenger ticket and other excise taxes deposited to the Trust Fund. These amounts are used to finance FAA's operations to the extent authorized by Congress. Investments decreased slightly due to a reduction in tax revenues deposited into the Trust Fund in FY 2003.

At $13.4 billion, *General Property, Plant, and Equipment, net* (PP&E) represents 48 percent of FAA's assets as of September 30, 2003, and primarily comprises construction-in-progress related to the development of National Airspace System assets, and capitalized real and personal property. PP&E increased slightly due to the acquisition of real and personal property assets offset by current year property retirements and depreciation.

Liabilities

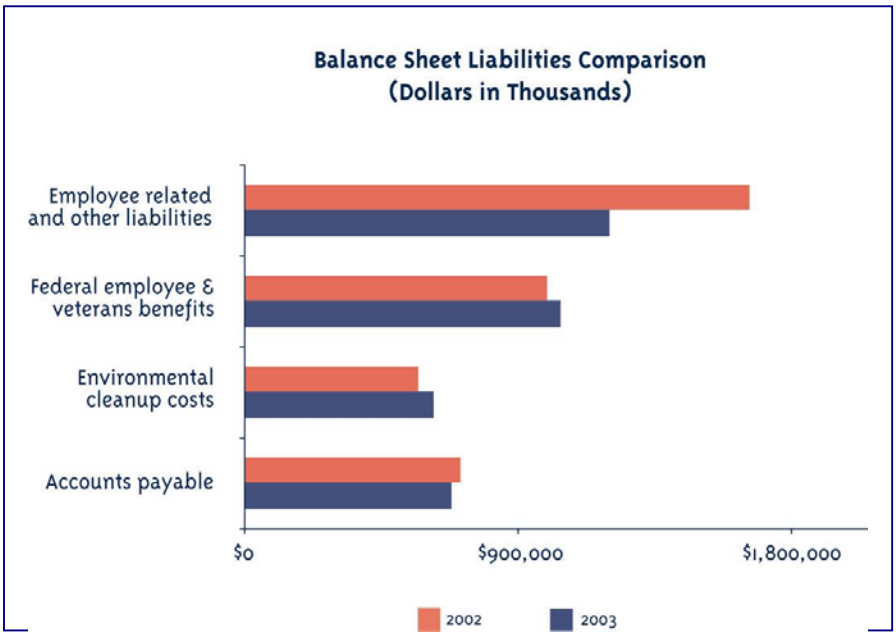
At the end of FY 2003, FAA reported liabilities of $3.5 billion. Liabilities are probable and measurable future outflows of resources arising from past transactions or events. The chart below depicts FAA's major categories of liabilities, as a percentage of total liabilities.



The graph presents comparisons of major liability balances between FY 2002 and FY 2003. A discussion of the significant fluctuations between the two years follows.

At $1.2 billion, *Employee Related, Legal, and Other Liabilities* represent 34 percent of FAA's total liabilities. The intragovernmental component decreased from $485.5 million to $344.8 million as of September 30, 2002 and 2003, respectively. The decrease is attributable to the settlement of an

FY 2002 $105.0 million excise tax liability. Estimated excise tax revenues are deposited to the Trust Fund quarterly, and are subsequently adjusted when Treasury's Office of Tax Analysis (OTA) validates its estimates approximately six months later. The FY 2002 $105.0 million liability resulted from this validation process.



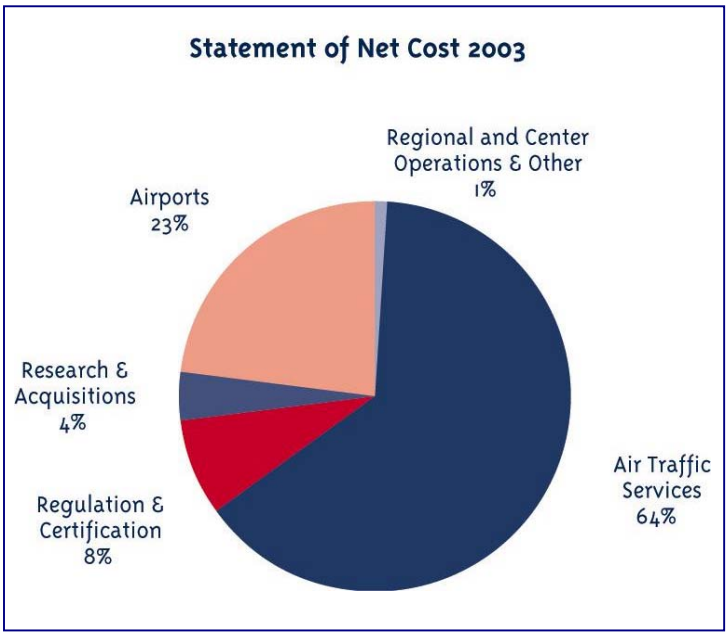
The public component of these liabilities decreased from $1,176.1 million to $859.1 million as of September 30, 2002 and 2003, respectively. The decrease occurred since accrued payroll and benefits to employees was lower as the payroll was paid on the last day of the fiscal year, and legal liabilities were lower due to settlements of several claims.

At $1.04 billion, *Federal employee and veterans benefits* comprise 29 percent of FAA's current year liabilities, and consist of FAA's expected liability for death, disability, and medical costs for approved workers compensation cases, plus a component for incurred but not reported claims. The Department of Labor (DOL) calculates the liability for DOT, and DOT attributes a proportionate amount to FAA based upon actual workers' compensation payments to FAA employees over the preceding four years.

Statement of Net Cost

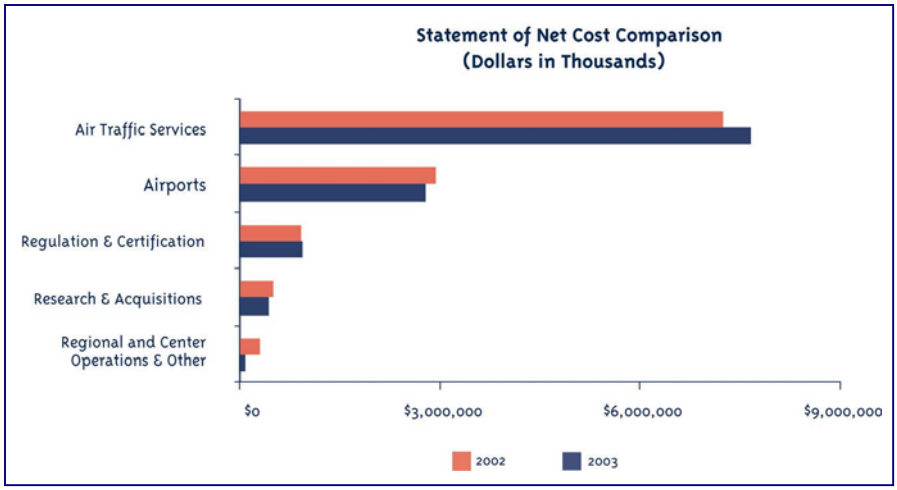
The Statement of Net Cost presents the annual cost of operating FAA programs. The gross cost less any offsetting revenue for each FAA program is used to arrive at the net cost of specific program operations. FAA has used its cost accounting system to prepare the Statement of Net Cost since FY 1999.

In the Other Accompanying Information section of this report, net costs are linked to agency strategic goal areas by responsibility segment (line of business). In FY 2003, FAA's net costs were $12.0 billion, compared to $12.4 billion in FY 2002. The following chart illustrates the distribution of net costs among FAA's lines of business.



The graph below compares FY 2002 and FY 2003 net costs, followed by a discussion of the significant fluctuations between the two years.

With a net cost of $7.6 billion, *Air Traffic Services* is FAA's largest line of business, comprising 64.0 percent of total net costs. Net costs increased by 6 percent, from $7.2 billion in FY 2002, primarily due to personnel compensation and benefits, as the general schedule of federal salaries increased by 4.3 percent on January 1, 2003.



With a net cost of $2.8 billion in FY 2003, *Airports* is the FAA's second largest line of business. Net costs decreased $147.0 million, from $2.93 billion in FY 2002. This is attributed to the one-time security-related grant costs paid to the Transportation Security Administration (TSA) in FY 2002, and not incurred in FY 2003.

With a net cost of $443 million, *Research and Acquisitions* decreased $72 million due primarily to a decrease in a variety of contract costs.

Region and Center Operations and Other Programs decreased $207 million, from $297 million in FY 2002 to $90 million in FY 2003. This decrease is principally attributable to the following: (a) a non-recurring FY 2002 Aviation War Risk Insurance payment of $50.0 million, and (b) a non-recurring FY 2002 payment of $40.0 million to reimburse Metropolitan Washington Airports Authority for revenue losses due to the temporary closure of Ronald Reagan National Airport following the terrorist attacks of September 11, 2001.

In accordance with Federal Accounting Standards Advisory Board Technical Bulletin 2003-1, FAA disclosed the net cost of Civil Aviation Security operations transferred to the Department of Homeland Security. The FY 2003 and FY 2002 net cost was $47 million and $533 million, respectively.

Statement of Changes in Net Position

The *Statement of Changes in Net Position* presents those accounting items that caused the net position section of the balance sheet to change from the beginning to the end of the reporting period. Various financing sources increase net position, including appropriations received and non-exchange revenue. The agency's net cost of operations serves to reduce net position.

FAA's cumulative results of operations increased slightly (approximately 1%) to $23.8 billion in FY 2003. The change is primarily attributed to the increase in financing sources.

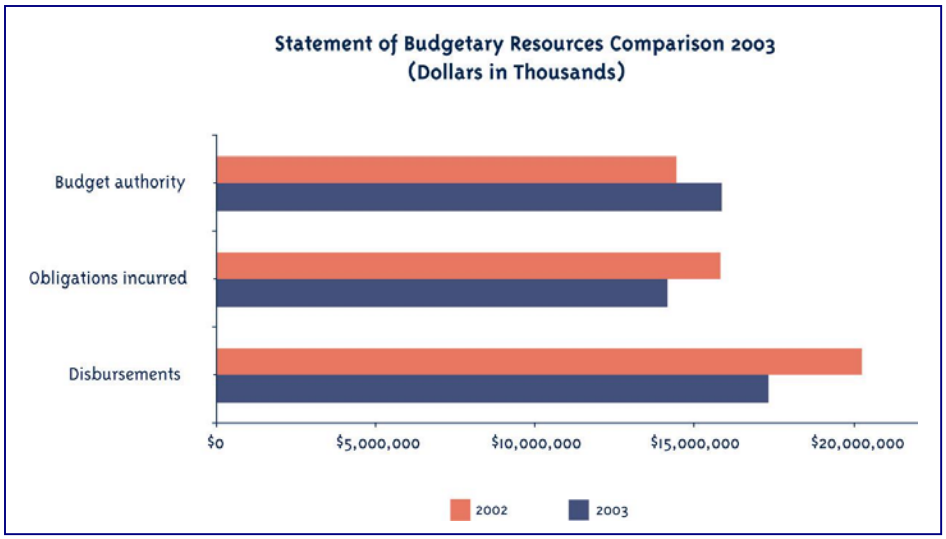
Statement of Budgetary Resources

This statement provides information on the budgetary resources available to FAA for FY 2003 and the status of those budgetary resources at year-end. The outlays reported on this statement reflect the actual cash disbursed for the year by Treasury for FAA obligations. The following chart outlines the changes in the major categories of budgetary resources from FY 2002 to FY 2003.

Budget Authority increased 10 percent to $15.8 billion in FY 2003. The change in Budget Authority is attributable to an increase in the request for liquidating cash of $1.3 billion in the FY 2003 President's Budget. The request was based on an estimated increase in outlays for FY 2003.

Obligations Incurred decreased 10 percent to $14.2 billion in FY 2003. The majority of this difference is attributable to reimbursable agreements with TSA for airport screener contracts utilized in FY 2002.

Disbursements decreased $2.9 billion primarily as a result of a decline of reimbursable activity with TSA.



Statement of Financing

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

Total resources used to finance FY 2003 activities decreased by $1.3 billion comprised of: (a) a decrease in *Obligations Net of Offsetting Collections* of $659.6 million, and (b) an increase in transfers out, which also reduces available financing resources, of $702.8 million. The increased transfers out in FY 2003 were primarily of security-related equipment to the TSA. The resources used to finance items not part of the net cost of operations decreased from $2.9 billion in FY 2002 to $2.1 billion in FY 2003. The decrease was caused mainly by reductions of $417.6 million in budgetary resources obligated for goods, services and benefits ordered but not yet provided and $507.0 million in the acquisition of agency real and personal property fixed assets. The third section of the Statement of Financing, *Components of Net Cost of Operations that will not Require or Generate Resources* in the Current Period, remained constant at $1.0 billion for FY 2002 and FY 2003.

Stewardship Investments

FAA conducts research and provides the essential air traffic control infrastructure to meet increasing demands for higher levels of system safety, capacity, and efficiency. Research priorities include aircraft structures and materials, fire and cabin safety, crash injury-protection, explosive detection systems, and improved in-flight and ground de-icing operations. Research priorities also include better tools to predict and warn of weather hazards, turbulence, and wake vortices; pavement design and airport safety; aviation medicine; and human factors.

Budgetary Integrity: FAA Resources and How They Are Used

Airport and Airway Trust Fund. Approximately 76 percent of the FAA's FY 2003 budget was provided by the Airport and Airway Trust Fund, which derives its funds from excise taxes and interest generated by the Fund. The Airport and Airway Trust Fund, created by the Airport and Airway Revenue Act of 1970, provides a stable source of funding to finance investments in the airport and airway system and, to the extent funds are available, covers the operating costs of the airway system. Aviation excise taxes, which include taxes on domestic passenger tickets, freight waybills, general and commercial aviation fuel/gas, and international departures and arrivals, are deposited into the Trust Fund. The Department of the Treasury maintains the Trust Fund and invests its monies in Government securities.

Any interest earned is deposited into the Trust Fund. As needed, funds are withdrawn from the Trust Fund and transferred into each FAA appropriation to cover obligations.

FAA is financed through annual and multi-year appropriations authorized by the Congress. Its FY 2003 enacted budget was $13.5 billion. The Combined Statement of Budgetary Resources reflects funding enacted by the Consolidated Appropriations Resolution, 2003, Public law 108-7. The enacted FY 2003 levels include an across the board rescission of 0.65 percent and a $3.5 million earmark for Midway Island Airfield under GP Sec. 371 included in Operations. FAA has four appropriations; the largest—Operations—is funded by Treasury's General Fund and a portion from the Airport and Airway Trust Fund. The Trust Fund is the sole revenue source for the FAA's three capital investment appropriations: (1) Facilities and Equipment; (2) Research, Engineering and Development, and (3) Airport Improvement Program.

Operations. The Operations appropriation funds the salaries and associated costs to operate and maintain the air traffic control system and to carry out FAA's safety inspection and regulatory responsibilities. Funding for Operations in FY 2003 represents only a 2.1 percent increase excluding the $200 million for the emergency supplemental from FY 2002. The increase is attributable to mandatory pay increases.

Facilities and Equipment (F&E). Funds from the F&E appropriation are used to modernize, expand, and replenish the air traffic control infrastructure. Between FY 2002 and FY 2003, there was no increase after excluding the $108.5 million from emergency supplemental funding in FY 2002. Funding increases supported major systems, such as the en route and terminal automation programs, next generation weather radar, the oceanic automation program, communications, and satellite navigation.

Airport Improvement Program (AIP). The Secretary of Transportation is authorized to award grants for airport planning and development to maintain a safe and efficient nationwide system of public airports. These grants make it possible to fund one-fourth to one-third of all capital development at the Nation's public airports. Grants are issued to maintain and enhance airport safety, preserve existing airport infrastructure, and expand capacity and efficiency throughout the airport system.

While the original obligation limitation was $100 million higher in FY 2003, a decrease of $97 million from the FY 2002 enacted level reflects the $175 million supplemental in FY 2002, as well as the across-the-board 0.65% rescission in FY 2003. Grants for airport improvement projects to enhance capacity, improve safety and security, and to mitigate noise increased by approximately $72 million.

Research, Engineering and Development (R,E&D). Funding for R,E&D decreased $97 million from the prior year, which included $50 million in an emergency supplemental appropriation and a transfer of $47 million for system security technology to the Department of Homeland Security. The R,E&D funding allows for an increased focus on environment and energy, weather initiatives, human factors, and aircraft safety, in support of the Safer Skies initiative.

Research and Development Highlights

FAA's Research, Engineering and Development (R,E&D) program is developing the technologies, tools, and procedures to ensure critical safety, efficiency, and environmental goals. In FY 2003, FAA's R,E&D program made significant contributions to achieving the Agency's mission and goals, including:

- **Developing and successfully testing a fuel tank inerting system.** Following the 1996 TWA Flight 800 accident, in which the center fuel tank caught fire, fuel tanks became a critical safety issue. With the FAA system, sparks will no longer ignite the fuel vapors, causing an explosion. This prototype is a low cost alternative to past, experimental inerting systems.
- **Conducting the fourth in a series of commuter airplane drop tests.** Through projects, such as the drop test, FAA is working to establish cabin interior standards that will protect passengers and crew in the unlikely event of an accident.
- **Establishing the Air Transportation Center for Excellence for Aircraft Noise and Emissions Mitigation.** Through a collaborative, cost-sharing effort among Federal, industry, and university researchers, this new Center is concentrating efforts on mitigating the impact of aviation noise and emissions, which represent major constraints on the growth of aviation.

- **Issuing the *Human Factors Design Standard*.** This comprehensive human factors reference provides a common source for FAA-specific design standards for air traffic and airway facilities systems.
- **Deploying the Graphical Turbulence Guidance.** This product provides a color forecast of upper level clear-air turbulence.
- **Developing and validating a new method for determining the origin of post-mortem ethanol in the body.** This method can now predict pre-death alcohol consumption. Until this groundbreaking work, accident investigators had difficulty determining if the ethanol present in the body was the result of alcoholic beverages or the result of normal postmortem ethanol formation in the body.

Charting the Next Century of Flight

The creative spark and can-do attitude that drove the Wright brothers to accomplish the seemingly impossible goal of flight also drives FAA. As FAA charts its course into the next century, the challenges met today lay the groundwork for the future success of the aviation community in the United States and around the world.

As we enter the 21st century, the challenges facing aviation demand nothing less than transforming the system. We are confronted with the challenges of reducing an already low commercial accident rate, building an air traffic control system capable of efficiently meeting future demand, and modernizing our own organization. Today, securing safe air travel, navigating industry uncertainties, and managing new technologies require that we embrace change as never before.

Looking farther into the future, the aviation community needs to develop a shared vision for the future of aviation. This is the assignment of FAA's Joint Planning Office, which is currently developing a national plan through the year 2025 with NASA, and the Departments of Defense, Homeland Security, and Commerce.

Several factors affect our ability to meet our ambitious goals for the future, some of which are outside the control of FAA. We plan to aggressively pursue the needed coordination with our partners to ensure success in addressing the following factors:

Economic State of the Industry

The financial difficulties facing airlines and manufacturers affect their ability and willingness to equip aircraft with new technologies to increase safety and capacity. The financial difficulties facing the industry also affect FAA, which is funded primarily by the Aviation Trust Fund from taxes on airline tickets, fuel, and air freight. As long as airline travel remains depressed, so too will the revenues available to FAA.

Fiscal Priorities of the Nation

Large capital investments in facilities, infrastructure, and staff will in part depend on the ability and willingness of Congress to fund those investments.

Cooperation With State, Local, and International Agencies

FAA's ability to increase safety and expand capacity also depends in part on authorities at the local, state, and international levels collaborating with FAA to build new airports, to expand runways, and to implement new technologies.

National Security

FAA works closely with and supports agencies such as the Departments of Defense and Homeland Security, and the Transportation Security Administration (TSA). We will coordinate closely with TSA and key stakeholders on security issues and activities related to aircraft design and operations. FAA will also work to ensure that the roles of FAA, TSA, and DOT, along with other government and industry stakeholders, are clearly understood. Should new threats arise, priorities may need to shift to counter them.

Our goals are not easy to attain, but then, we have a long history of meeting big challenges. The safety record and the air travel system that FAA and the aviation community have built together are not only the envy of the world, but also a model for our collective future. Working together, we will exercise leadership in setting standards and expectations so the global aviation industry can flourish.

As FAA attempts to identify the broad trends shaping flight, we anticipate future needs to more effectively guide present planning. Although we may not be able to predict the precise contours of our aviation future, we are working on several fronts to advance aviation technology and build on past successes to face the challenges ahead. While we made great strides in improving safety, enhancing security, and increasing efficiency during FY 2003, we must persist in our efforts to build an aviation system for the next century of flight. As the aviation community adjusts to changes in demand and economic conditions, so FAA must make mid-course corrections to address new realities.

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FY 2003 PRINCIPAL FINANCIAL STATEMENTS

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A MESSAGE FROM THE CHIEF FINANCIAL OFFICER

This past year, we made significant progress in financial and performance management. We are now in a good position to achieve the goals of the President's Management Agenda in financial management and to embark on the next century of flight. We have worked hard to develop and implement the financial tools we need to control rising operating costs and to give our managers the information they need to transform the FAA into a performance-based organization. In FY 2003, we:

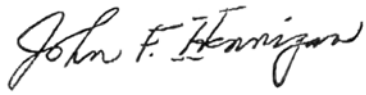
- Received an unqualified opinion on our financial statements, without any material internal control weaknesses.
- Closed our books and prepared our audited financial statements more quickly, finishing in mid-December.
- Completed our final tests and preparations to use DELPHI, the Department of Transportation's integrated financial management system.
- Aligned our budget more closely with our goals and performance measures to support the President's Management Agenda.
- Implemented labor distribution systems to give managers the data they need to make cost-effective decisions.

This year's opinion marks the third year in a row we have received an unqualified opinion. Last year our auditors identified the process for estimating liabilities for legal matters to be a material weakness. In 2003, we worked closely with the Office of General Counsel to ensure that estimates of legal liabilities were accurate, correct, and reported on time. This year, for the first time, our auditors identified no material weaknesses.

Throughout 2003, we worked on our new procurement and financial management systems, with a goal of implementing them in November 2003. Our efforts paid off. We eliminated our legacy financial system, which was not compliant with the U.S. Standard General Ledger, and our stand-alone property accounting system. We replaced both with a modern financial management system that fully integrates property accounting. Over 42,000 employees now report time on project and activities, giving our managers better information about the labor cost of our work. Our cost accounting system provides managers with the full cost of FAA services, helping them understand and control their costs better. All these steps help us address concerns previously raised by the General Accounting Office and the DOT Inspector General about our ability to prepare accurate, reliable financial information. In the year to come, one of our greatest challenges will be to manage our business more effectively while meeting even tighter reporting deadlines on our financial statements.

In FY 2003, we developed an approach to control our costs that will be a cornerstone for how we operate in FY 2004 and beyond. This multiyear effort will track and use financial and operational information to control costs and achieve savings. Russ Chew, the head of our new Air Traffic Organization, plans to use our accounting and cost accounting systems as the key to controlling operating costs.

We have made significant strides in improving financial and performance management through the collaborative effort and hard work of the financial staff at headquarters, regional offices and centers, and staff from all the lines of business. We have laid the groundwork for greater success in the years to come, as FAA helps chart the next century of flight.



John F. Hennigan
Acting Chief Financial Officer
December 18, 2003

Memorandum

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

Subject: ACTION: Quality Control Review of Audited Financial Statements for Fiscal Years 2003 and 2002, FAA QC-2004-008

Date: December 19, 2003

From: Kenneth M. Mead
Inspector General

Reply To Attn Of: JA-20:x61496

To: The Secretary
Federal Aviation Administrator

The audit of the Federal Aviation Administration's (FAA) Financial Statements as of and for the years ended September 30, 2003, and September 30, 2002, was completed by KPMG LLP (KPMG) of Washington, D.C. (See Attachment.) We performed a quality control review of the audit work to determine compliance with applicable standards. These standards include the Chief Financial Officers Act; Government Auditing Standards; and Office of Management and Budget Bulletin 01-02, Audit Requirements for Federal Financial Statements.

The KPMG audit report presented an unqualified opinion, also known as a "clean" opinion, on the FAA financial statements, and we concur with this opinion. The report presented no material internal control weaknesses but did present the following three reportable internal control conditions:

1. Controls over property, plant, and equipment;
2. Process for estimating environmental liabilities; and
3. Information technology controls over FAA and third-party systems and applications.

The report also identified instances of noncompliance with the Federal Financial Management Improvement Act of 1996, and the Anti-Deficiency Act, as amended.

KPMG made eight recommendations for corrective actions. We agree with the KPMG recommendations. In accordance with the Department of Transportation Order 8000.1C, we would appreciate receiving your written comments within

15 days. If you concur with the recommendations, for each recommendation, please indicate the specific actions taken and planned, along with estimated completion dates for planned actions.

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

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

Attachment

#

2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

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

We have audited the accompanying balance sheets of the Federal Aviation Administration (FAA) as of September 30, 2003 and 2002, and the related statements of net cost, changes in net position, financing, and budgetary resources for the years then ended (herein referred to as "financial statements"). The objectives of our audits were to express an opinion on the fair presentation of these financial statements.

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

SUMMARY

As stated in our opinion on the financial statements, we concluded that the FAA's financial statements as of, and for the years ended, September 30, 2003 and 2002, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

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

1. Controls over property, plant, and equipment
2. Process for estimating environmental liabilities
3. Information technology controls over FAA and third-party systems and applications

However, none of the reportable conditions are believed to be material weaknesses.

The results of our tests of compliance with certain provisions of laws and regulations disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin number 01-02, *Audit Requirements for Federal Financial Statements*.

1. *Federal Financial Management Improvement Act of 1996 (FFMIA)*
2. *Anti-Deficiency Act, as amended (ADA)*

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

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying balance sheets of the FAA as of September 30, 2003 and 2002, and the related statements of net cost, changes in net position, financing, and budgetary resources for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FAA as of September 30, 2003 and 2002, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Other Accompanying Information is presented for purposes of additional analysis, and also is not a required part of the fiscal year 2003 and 2002 financial statements. Such information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

In our fiscal year 2003 audit, we noted certain matters, described in Exhibit 1, involving internal control over financial reporting and its operation that we consider to be reportable conditions. However, none of the reportable conditions are believed to be material weaknesses.

A summary of the status of prior year reportable conditions is included in Exhibit 2.

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

COMPLIANCE WITH LAWS AND REGULATIONS

Our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report disclosed two instances of noncompliance with the laws and regulations that are

are required to be reported under *Government Auditing Standards* and OMB Bulletin number 01-02, and are described below.

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

2. *Anti-Deficiency Act*

The results of our tests of FFMIA disclosed instances, described in Exhibit 3, where the FAA's accounting system does not comply with the United States Standard General Ledger at the transaction level and Federal financial management system requirements, which call for a single, integrated financial system. The FAA has not fully implemented managerial cost accounting and its Statement of Net Cost does not present costs by strategic goal.

In addition, as discussed in Exhibit 3, we noted that certain transactions associated with the Aviation Insurance Revolving and Emergency Response Funds constituted violations of the Anti-Deficiency Act.

RESPONSIBILITIES

Management's Responsibilities

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

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;

- Establishing and maintaining internal controls over financial reporting, and preparation of the Management Discussion and Analysis (including the performance measures), the Required Supplementary Information, and Required Supplementary Stewardship Information, and

- Complying with laws and regulations, including FFMIA.

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

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2003 and 2002 financial statements of the FAA based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin Number 01-02. Those standards and OMB Bulletin Number 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;

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

- Evaluating the overall financial statement presentation.

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

In planning and performing our fiscal year 2003 audit, we considered the FAA's internal control over financial reporting by obtaining an understanding of the FAA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin Number 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin Number 01-02, we considered the FAA's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the FAA's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin Number 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the FAA's fiscal year 2003 financial statements are free of material misstatement, we performed tests of the FAA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin Number 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the FAA. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin Number 01-02 and FFMIA, we are required to report whether the FAA's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

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

KPMG LLP

December 5, 2003

Exhibit 1

REPORTABLE CONDITIONS

Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the FAA's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

We consider the following to be reportable conditions.

1. Controls over Property, Plant, and Equipment

Condition

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

- *Non-Integrated Systems* – During FY 2003, the FAA's PP&E subsidiary ledger (Interim Fixed Asset System, or IFAS) was not integrated with the general ledger system (the Departmental Accounting and Financial Information System or DAFIS). As a result, property transactions must be entered separately from those entered into the general ledger accounting system. Transactions related to real property are entered directly into IFAS, but personal property (i.e., equipment) transactions are first entered into a legacy property management system and then transferred to IFAS. The lack of electronic interface between IFAS and the general ledger greatly increases the likelihood that the two systems will, from time-to-time, not agree due to a backlog of input to either system or errors that occur in entering the data. The initial transaction (disbursement or receipt related to a property transaction) is recorded in the general ledger system, however depreciation is computed from data in IFAS. If IFAS is not updated timely, the financial statements will not accurately reflect depreciation expense.

- *Additions and disposals* – The FAA does not have effective controls to prevent or detect errors when costs associated with Construction-in-Progress (CIP) assets are capitalized. Specifically, the FAA failed to detect a $49.6 million overstatement in the transfer of assets from DAFIS into IFAS by regional personnel. Further, regional personnel did not record property disposals in a timely manner. This situation affected the FAA's ability to produce accurate interim financial statements and management reports. It also resulted in a substantial effort to research property transactions to prepare an accurate trial balance at year-end. Also, several Office of Inspector General (OIG) reports have indicated that the FAA has inadequate management and oversight controls over cost-reimbursable contracts, which is one method that the FAA uses to acquire PP&E.

- *CIP transfers* – The FAA did not record all of its transfers of completed construction projects in a timely manner after the assets were placed in service. We noted that the primary reason for the delay is that responsible personnel in the regional offices are often focused on clearing older, completed CIP projects as there was little incentive to transfer costs for newly completed projects. This situation could result in an understatement of depreciation expense, which is not recognized until assets are capitalized in IFAS and an in-service date has been established. This situation has been a longstanding, recurring problem for the FAA that impacts financial management. However, the FAA implemented changes in its policies, which have significantly reduced the number of older, completed projects that had not been transferred to in-use assets.

- *Leases* – The FAA's controls were not fully effective in ensuring appropriate documentation is maintained to support the FAA real estate office's determination whether the lease is capital or operating. Also, the FAA does not have a central database or location for maintaining detailed lease information.

- *Purchases of Non-CIP Assets* – The FAA does not have adequate controls to ensure purchases of non-CIP assets are recorded at the correct amount in IFAS. The FAA initially records the cost for the purchase of non-CIP assets in DAFIS and then subsequently enters the cost into IFAS. In one instance, FAA personnel recorded costs associated with a non-CIP asset at $2.2 million in IFAS although the actual recorded in DAFIS was only $22,000. This data entry error was not detected as the FAA did not have effective reviews over these transactions.

These discrepancies occurred principally because the FAA's property subsidiary system is not integrated with the general ledger system. In November 2003, the FAA implemented the Department of Transportation's new core accounting system, DELPHI, which has an integrated property subsidiary system.

Criteria

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

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

Statement of Federal Financial Accounting Standards (SFFAS) Number 6, *Accounting for Property, Plant and Equipment,* requires that constructed PP&E be recorded as construction work in progress until the asset is placed in service, at which time it is to be transferred to general PP&E, and depreciation expense should be taken over the estimated useful life of the asset.

Recommendations

We recommend that the FAA:

- Perform a FY 2003 yearend reconciliation of capitalized costs reported in the accounting system to those costs capitalized in IFAS.

- Reemphasize the need for regional accounting offices to follow procedures related to recording leases consistent with the determination made by the real estate office; and maintain appropriate supporting documentation.

- Give appropriate consideration to the effects on the timeliness, completeness, and accuracy of financial reporting as it takes corrective actions in response to the OIG's cited deficiencies related to management and oversight controls for cost-reimbursable contracts.

2. Process for Estimating Environmental Liabilities

Condition

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

Although the FAA made significant improvements in this area during the current year, the Investment Analysis and Operations Research Division does not have adequate policies and procedures to consistently and accurately determine the estimated liability for cleanup and decommissioning. Specifically, FAA personnel:

- Do not use actual cost information to help ensure the accuracy of the environmental clean-up and decommissioning cost model; and

- Do not have an effective process in place to ensure all facilities are included in the estimate for environmental clean-up and decommissioning. Specifically, 29 different types of facilities (a total of 1,480 facilities) were not included in the initial cost estimate.

Criteria

SFFAS Number 5, *Accounting for Liabilities of the Federal Government*, defines a liability as a probable future outflow or other sacrifice of resources as a result of past transactions or events. SFFAS Number 6 defines cleanup costs as the costs of removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated property, plant and equipment. Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and post closure costs. Federal Financial Accounting and Auditing Technical Release Number 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*, states that an agency is responsible for recognizing a liability for government-related environmental cleanup costs resulting from past transactions or events when a future outflow or other sacrifice of resources is probable and can be reasonably estimated.

Recommendations

To improve the reliability of the environmental clean-up and decommissioning estimates, we recommend that the FAA:

- Establish a routine and systematic process for capturing actual cost data and incorporate this information into the cost models supporting the Environmental Cleanup and Decommissioning (EC&D) liability. Actual cost information should also be used to improve cost models by incorporating area cost factors and similar factors based upon site-specific considerations.

- Develop and implement a policy to ensure that all facility quantities and types are submitted as part of the EC&D liability and that submissions are reviewed by management for completeness.

(Continued)

3. Information Technology Controls over FAA and Third-party Systems and Applications

Condition

Certain general controls related to the FAA's primary financial applications owned by the FAA and the Department of Transportation need to be strengthened. Specifically, there were weaknesses in network information security management and host-based application security controls, including system level access issues, application level operational access controls for sensitive and critical functions, separation of duties, and change management. In addition, there were weaknesses in network and application controls.

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

- Departmental Accounting and Financial Information System (DAFIS)
- Integrated Personnel and Payroll System (IPPS)
- Consolidated Uniform Payroll System (CUPS)
- Consolidated Personnel Management Information System (CPMIS)
- Interim Fixed Asset System (IFAS)
- Acquire
- Logistics Information System (LIS)

At the general support level, certain controls needed improvement related to system access and integrity issues for IFAS, and Acquire host based systems. Additionally, there were weaknesses in the areas of application operational access control for appropriate segregation of duties issues and application software development and change control for DAFIS, Acquire, IPPS, and IFAS. Due to the sensitive nature of these issues, we provided the detailed results of our review, along with specific recommendations, separately to management.

Criteria

Appendix III, OMB Circular Number A-130, *Management of Federal Information Resources*, requires Federal agencies to establish application security plans to assure that adequate security is provided for information collected, processed, transmitted, stored, or disseminated through the system.

National Institute of Standards and Technology (NIST) Special Publication Number 800-18, *Guide for Developing Security Plans for Information Technology Systems*, states the purpose of security plans are to provide an overview of the security requirements of the system and describe the controls in place or planned for meeting those requirements; and delineate responsibilities and expected behavior of all individuals who access the system.

Recommendation

We recommend that the FAA improve its information technology by implementing the specific recommendations previously provided.

Exhibit 2

STATUS OF PRIOR YEAR REPORTABLE CONDITIONS AND COMPLIANCE WITH LAWS AND REGULATIONS

Condition	As Reported at September 30, 2002	Status as of September 30, 2003
Process for Estimating Liabilities for Legal Matters	**Material Weakness:** The FAA did not have adequate controls to ensure that the basis for the estimated liability for legal matters pending against the FAA, both those recorded as liabilities and disclosed in the notes to the financial statements, were accurate.	**No longer deemed a reportable condition:** The FAA implemented procedures to resolve this issue.
Controls and Processes over Financial Reporting and Account Reconciliations	**Reportable Condition:** The FAA's financial statements initially produced by its financial reporting processes and systems required substantial review and adjustment in the post-closing process to produce materially correct financial statements.	**No longer deemed a reportable condition:** The FAA implemented procedures to resolve this issue.
Process for Estimating Environmental Liabilities	**Reportable Condition:** The FAA lacks adequate policies and procedures to consistently and accurately determine the estimated liability for financial statement purposes.	**Continue as a Reportable Condition:** Although improvements were made, weaknesses still remain over FAA's ability to produce accurate environmental liability estimates.
Accounting Methods and Controls over Field Spares	**Reportable Condition:** The FAA did not have adequate controls to ensure all recorded field spares existed and that all items on hand were recorded.	**No longer deemed a reportable condition:** The FAA implemented procedures to resolve this issue.
Controls over Property, Plant and Equipment	**Reportable Condition:** The FAA did not fully adhere to its policies and procedures designed to ensure that PP&E is stated in accordance with accounting principles generally accepted in United States of America.	**Continue as a Reportable Condition:** Although improvements were made, weaknesses still remain in FAA's controls over property, plant and equipment.
Technology Controls over Third-Party Systems and Applications	**Reportable Condition:** Certain general controls related to the FAA's primary financial applications owned by Department of Transportation (DOT) need to be strengthened.	**Continue as a Reportable Condition:** Although improvements were made, weaknesses still remain in FAA's information technology controls. Combined with Technology Controls over FAA Systems.
Technology Controls over FAA Systems	**Reportable Condition:** Certain general controls associated with key FAA-owned financial systems needed improvement.	**Continue as a Reportable Condition:** Although improvements were made, weaknesses still remain in FAA's information technology controls. Combined with Controls over Third-Party Systems and Applications.

Exhibit 3

COMPLIANCE WITH LAWS AND REGULATIONS

This section discusses instances of non-compliance with significant laws and regulations.

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

Condition

The FAA was not in substantial compliance with FFMIA.

Discussion

During FY 2003, the FAA used the DOT's core accounting system, DAFIS, to process and record financial transactions. DAFIS does not comply with the United States Standard General Ledger (USSGL) at the transaction level and Federal financial management system requirements, which call for a single, integrated financial system. As reported last year, the FAA still has not fully implemented managerial cost accounting, however, progress was made during FY 2003. Also, the FAA's Statement of Net Cost does not breakout costs by strategic goal. The FAA converted to DOT's new core accounting system, DELPHI, during November 2003. DOT believes the new system processes transactions at the USSGL level, and meets Federal systems requirements.

Criteria

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

Recommendation

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

2. Anti-Deficiency Act

Condition

During FY 2003 the Chief Counsel's office determined that certain transactions associated with the Aviation Insurance Revolving and the Emergency Response Funds constituted violations of the Anti-Deficiency Act.

Discussion

For the Aviation Insurance Revolving Fund, the Chief Counsel's office noted that the following transactions constituted violations:

- Valid allotments were not established for FY 2003, thus all expenditures, which totaled approximately $10.9 million, violated DOT and FAA regulations and therefore the Anti Deficiency Act (31 USC 1517).
- Payments of approximately $10.0 million, made during FY 2003, exceeded the amount apportioned.
- An allotment made in late FY 2003 exceeded the amount apportioned.

(Continued)

In addition, the Chief Counsel determined that several payments made during the second half of FY 2002 may have been made after the authority to make such payments had expired. The Chief Counsel is continuing its review of these transactions.

For the Emergency Response Fund, the FAA obligated $1.3 million in September 2003, which was in excess of the FY 2003 allotment and the annual apportionment.

Both the Aviation Insurance Revolving and Emergency Response Funds involve a relatively small number of transactions. Also, the Emergency Response Fund is a special account related to the recovery from and response to terrorist attacks on the United States. FAA determined that the violations occurred due to a lack of communication and a lack of knowledge related to obtaining apportionments from the Office of Management and Budget and DOT and FAA regulations related to making allotments.

FAA reported the violations to the DOT and was in the process of reporting the violations to the President and the Congress as required by 31 USC 1517.

Criteria

31 USC 1517 states that an officer or an employee of the United States Government may not make or authorize an expenditure or obligation exceeding an apportionment or an amount permitted by regulations as specified by 31 USC 1514.

Recommendation

We recommend that the FAA provide training to personnel responsible for requesting apportionments and making allotments and strengthen controls to prevent further violations.

LIMITATIONS OF THE FINANCIAL STATEMENTS

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

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

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

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

Assets	2003	2002
Intragovernmental		
Fund balance with Treasury (Note 2)	$ 2,833,723	$ 2,539,304
Investments (Note 3)	10,819,257	11,213,447
Accounts receivable, advances, and other (Note 4)	168,722	299,428
Total Intragovernmental	13,821,702	14,052,179
Accounts receivable, advances, and other, net (Note 4)	63,411	113,295
Inventory and related property, net (Note 5)	581,766	605,695
Property, plant, and equipment, net (Note 6 & 9)	13,397,607	13,175,768
Total Assets	$ 27,864,486	$ 27,946,937
Liabilities		
Intragovernmental liabilities		
Accounts payable	$ 9,324	$ 36,182
Employee related, legal and other (Notes 8 & 9)	344,868	485,511
Total Intragovernmental Liabilities	354,192	521,693
Accounts payable	669,693	677,182
Environmental cleanup costs (Note 7 & 19)	621,953	574,676
Employee related, legal, and other (Notes 8 & 9)	859,124	1,176,106
Federal employee benefits (Note 10)	1,041,568	997,103
Total Liabilities	3,546,530	3,946,760
Commitments and contingencies (Notes 9 & 19)		
Net Position		
Unexpended appropriations	562,595	481,919
Cumulative results of operations	23,755,361	23,518,258
Total Net Position	24,317,956	24,000,177
Total Liabilities and Net Position	$ 27,864,486	$ 27,946,937

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

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

Line of Business Programs (Note 12)	2003	2002
Air Traffic Services		
Expenses	$ 7,718,928	$ 7,313,772
Less Earned Revenues	(67,890)	(77,107)
Net Costs	7,651,038	7,236,665
Regulation & Certification		
Expenses	943,135	924,614
Less Earned Revenues	(1,126)	(1,121)
Net Costs	942,009	923,493
Research & Acquisitions		
Expenses	498,778	586,991
Less Earned Revenues	(55,856)	(72,129)
Net Costs	442,922	514,862
Airports		
Expenses	2,786,717	2,933,542
Less Earned Revenues	(224)	-
Net Costs	2,786,493	2,933,542
Commercial Space Transportation		
Expenses	11,725	11,361
Net Costs	11,725	11,361
Non Line of Business Programs		
Regional and Center Operations and Other Programs		
Expenses	346,843	425,832
Less Earned Revenues	(256,386)	(129,211)
Net Costs	90,457	296,621
Not Assigned to Programs		
Expenses	61,486	50,622
Less Earned Revenues	(34,794)	(56,411)
Net Costs	26,692	(5,789)
Net Cost of Continuing Operations	**11,951,336**	**11,910,755**
Transferred Operations - Civil Aviation Security (Note 15)		
Expenses	124,705	719,973
Less Earned Revenues	(77,455)	(186,809)
Net Costs	47,250	533,164
Net Cost of Operations		
Total Expenses	12,492,317	12,966,707
Less Total Earned Revenue	(493,731)	(522,788)
Total Net Cost	**$ 11,998,586**	**$ 12,443,919**

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

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

(Dollars in Thousands)

	2003		2002	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	$ 23,518,258	$ 481,919	$ 24,575,189	$ 551,139
Budgetary Financing Sources				
Appropriations received	-	3,273,241	-	1,112,481
Appropriations transferred-in/out	-	250	-	112,858
Other adjustments	-	(42,269)	-	(3,325)
Appropriations used	3,150,546	(3,150,546)	1,291,234	(1,291,234)
Excise taxes and associated revenue (Note 13)	9,360,469	-	9,625,942	-
Transfers-in/out without reimbursement	(123,169)	-	(25,500)	-
Other Financing Sources				
Donations and forfeitures of property and other	32,218	-	11,901	-
Transfers-in/out without reimbursement (Note 15)	(680,078)	-	22,675	-
Imputed financing from costs absorbed by others (Note 14)	495,703	-	460,736	-
Total Financing Sources	12,235,689	80,676	11,386,988	(69,220)
Net Cost of Operations	11,998,586	-	12,443,919	-
Ending Balances	$ 23,755,361	$ 562,595	$ 23,518,258	$ 481,919

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

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

(Dollars in Thousands)

Budgetary Resources (Note 16)	2003	2002
Budget authority	$ 15,846,546	$ 14,446,568
Unobligated balance brought forward, transfers and other	9,682,455	11,425,240
Spending authority from offsetting collections	726,484	1,641,929
Recoveries of prior year obligations	249,157	310,925
Permanently not available	(3,229,132)	(2,362,392)
Total Budgetary Resources	$ 23,275,510	$ 25,462,270
Status of Budgetary Resources		
Obligations incurred	$ 14,166,146	$ 15,796,838
Unobligated balance	8,627,893	9,454,968
Unobligated balance not available	481,471	210,464
Total Status of Budgetary Resources	$ 23,275,510	$ 25,462,270
Relationship of Obligations to Outlays		
Obligated balance, net, beginning of period	$ 7,998,136	$ 7,249,535
Cancelled appropriations and other	15,702	-
Obligations incurred	14,166,146	15,796,838
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	(975,738)	(1,952,959)
Less: Obligated balance, net end of period	(8,644,480)	(7,998,136)
Net Outlays	$ 12,559,766	$ 13,095,278
Outlays		
Disbursements	$ 17,322,760	$ 20,264,114
Collections, net of offsetting receipts	(4,762,994)	(7,168,836)
Net Outlays	$ 12,559,766	$ 13,095,278

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

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

Resources Used to Finance Activities	2003	2002
Budgetary Resources Obligated		
Obligations incurred	$ 14,166,146	$ 15,796,838
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	975,738	1,952,959
Obligations net of offsetting collections	13,190,408	13,843,879
Other Resources		
Donations and forfeitures of property and other	32,218	11,901
Transfers in/(out) without reimbursement	(680,078)	22,675
Imputed financing from costs absorbed by others	495,703	460,736
Net other resources used to finance activities	(152,157)	495,312
Total resources used to finance activities	13,038,251	14,339,191
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	464,695	882,286
Resources that fund expenses recognized in prior periods (decreases in unfunded liabilities) (Note 17)	158,858	85,644
Resources that finance the acquisition of assets	1,534,555	2,041,577
Other resources or adjustments to net obligated resources that do not affect net cost of operations	(71,408)	(115,237)
Total resources used to finance items not part of net cost of operations	2,086,700	2,894,270
Total resources used to finance net cost of operations	**10,951,551**	**11,444,921**
Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increases in annual leave liability, exchange revenue receivable from the public, and other unfunded liabilities (Note 17)	103,051	167,555
Components not Requiring or Generating Resources in Future Periods		
Depreciation and amortization	911,337	835,139
Revaluation of assets or liabilities	(18,320)	(20,579)
Cost of goods sold	34,987	23,897
Other	15,980	(7,014)
Total components of Net Cost of Operations that will not require or generate resources	943,984	831,443
Total components of Net Cost of Operations that will not require or generate resources in the current period	**1,047,035**	**998,998**
Net Cost of Operations	**$ 11,998,586**	**$ 12,443,919**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The financial statements have been prepared to report the financial position, net cost of operations, changes in net position, status and availability of budgetary resources, and the reconciliation between proprietary and budgetary accounts of the Federal Aviation Administration (FAA). The statements are a requirement of the Chief Financial Officers Act of 1990, Government Management Reform Act of 1994, and the Office of Management and Budget's (OMB) Bulletin Number 01-02, *Audit Requirements for Federal Financial Statements.* They have been prepared from the books and records of FAA in accordance with (1) the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board (FASAB), (2) the OMB Bulletin Number 01-09, *Form and Content of Agency Financial Statements*, and (3) Department of Transportation (DOT) and FAA accounting policies which are summarized in this note. These statements, with the exception of the Statement of Budgetary Resources, are different from financial management reports, which are also prepared by FAA pursuant to OMB directives that are used to monitor and control FAA's use of budgetary resources.

In accordance with OMB Bulletin Number 01-09, the financial statements and associated notes are presented on a comparative basis.

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

B. Reporting Entity

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

- Trust Fund - Airport and Airway Trust Fund (Corpus), including (a) Grants-in-Aid for Airports, (b) Facilities and Equipment, and (c) Research, Engineering and Development
- Revolving Funds – Aviation Insurance, and Administrative Services Franchise Fund
- Special Fund – Aviation User Fees
- General Funds – Operations and Facilities, Engineering & Development
- Other – General Fund Miscellaneous Receipts

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

C. Budgets and Budgetary Accounting

Congress annually enacts appropriations to permit FAA to incur obligations for specified purposes. In FY 2003 and 2002, FAA was accountable for Trust Fund appropriations, Revolving Funds, a Special Fund, General Fund appropriations, and borrowing authority. FAA recognizes budgetary resources as assets when cash (funds held by Treasury) is made available through the Department of Treasury General Fund warrants and Trust Fund transfers.

D. Basis of Accounting

Transactions are recorded on both an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements on the use of Federal funds. All material intra-agency transactions and balances have been eliminated for presentation on a consolidated basis. However, the Statement of Budgetary Resources is presented on a combined basis in accordance with OMB Bulletin Number 01-09.

E. Revenues and Other Financing Sources

Congress enacts annual, multi-year, and no-year appropriations to be used, within statutory limits, for operating, capital and grant expenditures. Additional amounts are obtained from service fees (e.g., landing, registry, and overflight fees), war risk insurance premiums (see note 19), and through reimbursements for products and services provided to domestic and foreign governmental entities.

The Airport and Airway Trust Fund (Trust Fund) is sustained by excise taxes that the Internal Revenue Service (IRS) collects from airway system users. Excise taxes collected are initially deposited to the general fund of the Treasury. IRS does not receive sufficient information at the time the taxes are collected to determine how these payments should be distributed to specific trust funds. Therefore, Treasury makes initial distributions to trust funds semi-monthly, based on estimates prepared by its Office of Tax Analysis (OTA). These estimates are based on historical excise tax data applied to current excise tax receipts. When actual amounts are available from the IRS, generally six months after each quarter-end, adjustments are made to the estimated amounts and the difference is accrued as an intragovernmental receivable or payable. FAA's September 30, 2003 financial statements reflect excise taxes certified through June 30, 2003, and excise taxes estimated by OTA for the quarter July 1 to September 30, 2003 as specified by Statement of Federal Financial Accounting Standards (SFFAS) Number 7, *Accounting for Revenue and Other Financing Sources.* FAA management does not believe that the estimated distribution made to the trust fund will be materially different from the September 30, 2003 certified amount.

The Trust Fund also earns interest from investments in Treasury securities. Interest income is recognized as revenue on the accrual basis.

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

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

F. Taxes

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

G. Fund Balance with the U.S. Treasury

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

H. Investment in U.S. Government Securities

Unexpended funds in the Trust Fund and Aviation Insurance Revolving Fund are invested in U.S. Government securities. A portion of the Trust Fund investments is liquidated semi-monthly in amounts needed to provide cash for FAA appropriation accounts. The Revolving Fund investments are usually held to maturity. Investments, redemptions, and reinvestments are held and managed under the direction of FAA by the Treasury.

I. Accounts Receivable

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

J. Inventory

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

FAA field locations trade non-operational repairable components with the Franchise Fund. These components are classified as "Held for Repair." An allowance is established for repairable inventory based on the average historical cost of such repairs. Once repaired, these items are reclassified as "Held for Sale."

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

K. Operating Materials and Supplies

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

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

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

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

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

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

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

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

Buildings and equipment acquired under capital leases are amortized over the lease term. If the lease agreement contains a bargain purchase option or otherwise provides for transferring title of the asset to FAA, the building is depreciated over a 40-year service life.

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

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

M. Prepaid and Deferred Charges

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

N. Liabilities

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

O. Accounts Payable

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

P. Annual, Sick, and Other Leave

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

Q. Accrued Workers' Compensation

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

R. Retirement Plan

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

FERS went into effect on January 1, 1987, pursuant to Public Law 99-335. FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees hired prior to January 1, 1984 could elect either to join FERS and Social Security, or to remain in CSRS. FERS offers a savings plan to which FAA automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. For FERS participants, FAA also contributes the employer's matching share for Social Security.

Beginning in FY 1997, FAA began to recognize the imputed cost of pensions and other retirement benefits during the employees' active years of service. OPM actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future and communicates these factors to FAA for current period expense reporting. OPM also provides information regarding the full cost of health and life insurance benefits. FAA recognized the offsetting revenue as imputed financing sources to the extent these expenses will be paid by OPM.

S. Use of Estimates

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

T. Environmental Liabilities

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

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

U. Contingencies

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

V. Reclassifications

Certain FY 2002 balances have been reclassified, retitled, or combined with other financial statement line items for consistency with current year presentation.

NOTE 2. FUND BALANCE WITH TREASURY

Fund balance with Treasury account balances as of September 30, 2003 and 2002 were:

	2003	2002
Trust Fund	$ 1,250,801	$ 1,023,246
Operations General Fund	738,852	775,014
Franchise Fund	170,862	127,297
Revolving Fund	22,848	12,485
Corpus and Other Funds	650,360	601,262
Total	$ 2,833,723	$ 2,539,304

Status of Fund Balance with Treasury

Unobligated Balance		
Available	$ 1,072,492	$ 1,017,806
Restricted	700,605	665,933
Obligated Balance Not Yet Disbursed	1,060,626	855,565
Total	$ 2,833,723	$ 2,539,304

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

NOTE 3. INVESTMENTS

As of September 30, 2003 and 2002, respectively, FAA's investment balances were as follows:

	2003	2002
Intragovernmental Securities		
Nonmarketable, Par Value - Trust Fund	$ 10,517,891	$ 10,996,847
Nonmarketable, Market Based - Aviation Insurance Fund	196,187	91,733
Accrued Interest	105,179	124,867
Investments at Cost	$ 10,819,257	$ 11,213,447
Market Value Disclosure		
Nonmarketable, Par Value - Trust Fund	$ 10,517,891	$ 10,996,847
Nonmarketable, Market Based - Aviation Insurance Fund	196,693	92,187
Unamortized Discount - Nonmarketable, Market Based	(506)	(454)
Nonmarketable, Market Based, net	196,187	91,733
Market Value Disclosure	$ 10,714,078	$ 11,088,580

Nonmarketable par value Treasury Certificates of Indebtedness are special series debt securities issued by the Bureau of the Public Debt to Federal accounts, and are purchased and redeemed at par (face value) exclusively through Treasury's Federal Investment Branch. The securities are held to maturity and redeemed at face value on demand; thus, investing entities recover the full amount invested plus interest. The Fund's trustee, the Secretary of the Treasury, makes Trust Fund investments on behalf of FAA. As of September 30, 2003 and 2002, approximately $10.5 billion and $11.0 billion, respectively, were invested in U.S. Treasury Certificates of Indebtedness. FY 2003 amounts mature June 30, 2004, and FY 2002 amounts matured June 30, 2003. The annual rate of return on Certificates of Indebtedness is established in the month of issuance. The average rate for certificates issued during FY 2003 and FY 2002 was 4.125% and 5.125%, respectively.

Nonmarketable, market-based Treasury securities are debt securities that the Treasury issues to Federal entities without statutorily fixed interest rates. Although the securities are not marketable, their terms (prices and interest rates) mirror the terms of marketable Treasury securities. FAA amortizes premiums and discounts on market-based Treasury securities over the life of the security using the interest method.

As of September 30, 2003, these nonmarketable, market-based securities have maturity dates ranging from two to fourteen months and an effective market rate of approximately 1 percent.

NOTE 4. ACCOUNTS RECEIVABLE, ADVANCES AND OTHER ASSETS

Accounts receivable, advances, prepayments, and other assets as of September 30, 2003 and 2002 were comprised of the following:

	2003	2002
Intragovernmental		
Accounts Receivable	$ 59,924	$ 270,155
Advances, Prepayments and Other	108,798	29,273
Subtotal, Intragovernmental	168,722	299,428
With the Public		
Accounts Receivable, net	42,058	58,047
Advances and Prepayments	2,359	35,413
Deposits in Transit and Other	18,994	19,835
Subtotal, With the Public	63,411	113,295
Total Accounts Receivable, Advances, Prepayments and Other	$ 232,133	$ 412,723

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

Accounts receivable from the public are shown net of allowances for uncollectible amounts of $15.0 million and $5.6 million, as of September 30, 2003 and 2002, respectively.

NOTE 5. INVENTORY AND RELATED PROPERTY

As of September 30, 2003 and 2002, inventory and operating materials and supplies were:

Operating Material and Supplies	2003	2002
Held For Use, net	$ 147,879	$ 140,168
Excess, Obsolete, and Unserviceable, net	14,567	24,817
Subtotal, Operating Material and Supplies	162,446	164,985
Inventory		
Held for Sale	$ 61,457	$ 65,164
Held for Repair, net	330,189	348,300
Raw Materials, Finished Goods, and Other	13,632	13,643
Excess, Obsolete, and Unserviceable, net	14,042	13,603
Subtotal, Inventory	419,320	440,710
Total Inventory and Related Property, net	$ 581,766	$ 605,695

Inventory and related property are shown net of the following allowances:

Operating Materials and Supplies	2003	2002
Held For Use	$ (12,167)	$ (12,167)
Excess, Obsolete, and Unserviceable	(57,294)	(47,044)
Operating Materials and Supplies Allowances	(69,461)	(59,211)
Inventory		
Held for Repair	(83,849)	(70,796)
Excess, Obsolete, and Unserviceable	(4,760)	(11,129)
Inventory Allowances	(88,609)	(81,925)
Total Allowances	$ (158,070)	$ (141,136)

Inventory is considered held for repair based on condition levels, and the allowance for repairable inventory is based on the average historical cost of such repairs. During FY 2003 and FY 2002, FAA recognized increases of $13.1 million and $27.8 million, respectively, to its allowance for inventory held for repair.

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

NOTE 6. PROPERTY, PLANT, AND EQUIPMENT, NET

Property, plant, and equipment balances at September 30, 2003 and 2002 were:

			2003		
Class of Fixed Asset	Deprec. Method	Service Life	Acquisition Value	Accumulated Depreciation	Net Book Value
Real Property, Including Land	[1]	[2]	$ 3,874,055	$ (1,828,212)	$ 2,045,843
Personal Property	SL	3-20	12,643,046	(5,881,286)	6,761,760
Assets Under Capital Lease (Note 9)	SL	Term-40	125,923	(63,328)	62,595
Construction in Progress	-	-	4,513,496		4,513,496
Property Not in Use	-	-	18,292	(4,379)	13,913
Total Property, Plant, and Equipment			$ 21,174,812	$ (7,777,205)	$ 13,397,607

			2002		
Class of Fixed Asset	Deprec. Method	Service Life	Acquisition Value	Accumulated Depreciation	Net Book Value
Real Property, Including Land	[1]	[2]	$ 3,536,010	$ (1,675,322)	$ 1,860,688
Personal Property	SL	3-20	12,041,260	(5,275,361)	6,765,899
Assets Under Capital Lease (Note 9)	SL	Term-40	126,142	(55,397)	70,745
Construction in Progress	-	-	4,477,425	-	4,477,425
Property Not in Use	-	-	2,283	(1,272)	1,011
Total Property, Plant, and Equipment			$ 20,183,120	$ (7,007,352)	$ 13,175,768

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

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

FAA's Construction in Progress (CIP) primarily relates to national airspace system assets, which are derived from centrally funded national systems development contracts, site preparation and testing, raw materials, and internal labor charges.

Assets temporarily not in use, including decommissioned assets awaiting disposition, are reflected in FAA financial records as Property Not in Use. FAA reported disposition losses of $10.4 million and $82.8 million in FY 2003 and FY 2002, respectively.

NOTE 7. ENVIRONMENTAL CLEANUP COSTS

FAA's environmental liabilities as of September 30, 2003 and 2002 were:

	2003	2002
Environmental Remediation	$ 372,125	$ 311,914
Environmental Cleanup and Decommissioning	249,828	262,762
Total Environmental Liabilities	$ 621,953	$ 574,676

Additional information on environmental projects is disclosed in Note 19.

NOTE 8. EMPLOYEE RELATED, LEGAL, AND OTHER LIABILITIES

As of September 30, 2003 and 2002, FAA's employee related, legal and other liabilities were:

	2003		
Intragovernmental	Non-Current Liabilities	Current Liabilities	Total
Advances Received	$ -	$ 42,448	$ 42,448
Accrued Payroll & Benefits Payable to Other Agencies	-	29,101	29,101
Other	-	72,384	72,384
Liabilities Covered by Budgetary Resources	-	143,933	143,933
Federal Employees Compensation Act	113,063	87,842	200,905
Debt	-	30	30
Liabilities Not Covered by Budgetary Resources	113,063	87,872	200,935
Subtotal, Intragovernmental	113,063	231,805	344,868
With the Public			
Advances Received and Other	-	9,089	9,089
Accrued Payroll & Benefits Payable to Employees	-	130,060	130,060
Liabilities Covered by Budgetary Resources	-	139,149	139,149
Accrued Unfunded Annual & Other Leave & Assoc. Benefits	451,199	-	451,199
Sick Leave Compensation Benefits for Air Traffic Controllers	57,006	6,194	63,200
Capital Leases (Note 9)	59,685	9,159	68,844
Legal Claims	53,900	25,000	78,900
Return Rights	4,400	3,150	7,550
Other Accrued Liabilities	50,282	-	50,282
Liabilities Not Covered by Budgetary Resources	676,472	43,503	719,975
Subtotal, With the Public	676,472	182,652	859,124
Total Employee Related, Legal, and Other Liabilities	$ 789,535	$ 414,457	$ 1,203,992

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

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

An unfunded liability is recorded for the actual cost of workers' compensation benefits to be reimbursed to the DOL, pursuant to the FECA. FAA's liability accrued as of September 30, 2003 includes workers' compensation benefits paid by DOL during the periods July 1, 2001 through June 30, 2003 and accrued liabilities for the quarter July 1, 2003 through September 30, 2003. FAA's liability accrued as of September 30, 2002, included workers' compensation benefits paid by DOL during the period July 1, 2000 through June 30, 2002, and accrued liabilities for the quarter July 1, 2002 through September 30, 2002.

The estimated liability for accrued unfunded leave and associated benefits includes annual and other types of vested leave, and sick leave under the terms the National Air Traffic Controllers Association agreement, Article 25, Section 13. This agreement gives air traffic controllers, who are covered under

FERS, the option to receive a lump sum payment for 40 percent of their accumulated sick leave as of their retirement effective date. Based on sick leave balances, this liability was $63.2 million and $53.0 million as of September 30, 2003 and 2002, respectively.

FAA estimated that 100 percent of its $78.9 million and $169.9 million legal claims liabilities as of September 30, 2003 and 2002, respectively, would be paid from the permanent appropriation for judgments, awards, and compromise settlements (Judgment Fund) administered by the Department of Treasury.

FAA's Return Rights Program pertains to employees who accepted transfers to overseas or certain domestic locations for a period of two to four years, and entitles them to a future return move at Government expense. As of September 30, 2003 and 2002, there were 151 and 154 employees, respectively, entitled to these return rights.

Other Accrued Liabilities with the Public is comprised primarily of accruals for utilities, leases and travel obligations. Total liabilities not covered by budgetary resources are presented in note 17.

NOTE 9. LEASES

FAA has both capital and operating leases.

Capital Leases

Following is a summary of FAA's assets under capital lease as of September 30, 2003 and 2002:

	2003	2002
Land, Buildings, and Machinery	$ 125,923	$ 126,142
Accumulated Depreciation	(63,328)	(55,397)
Assets Under Capital Lease, net	$ 62,595	$ 70,745

As of September 30, 2003, FAA's future payments due on assets under capital lease were:

Future Payments Due by Fiscal Year (Liabilities Not Covered By Budgetary Resources)	
Year 1	$ 13,698
Year 2	13,620
Year 3	11,603
Year 4	9,380
Year 5	8,973
After 5 Years	41,125
Less: Imputed Interest	(29,555)
Total Capital Lease Liability	$ 68,844

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

Operating Leases

FAA has operating leases for real property, aircraft, and telecommunications equipment. Future operating lease payments due as of September 30, 2003 were:

Fiscal Year	Land & Buildings	Other	Total
Year 1 (FY 2004)	$ 50,051	$ 829	$ 50,880
Year 2 (FY 2005)	43,310	654	43,964
Year 3 (FY 2006)	36,596	374	36,970
Year 4 (FY 2007)	33,802	369	34,171
Year 5 (FY 2008)	32,313	366	32,679
After 5 Years	51,012	2,322	53,334
Total Future Operating Lease Payments	$ 247,084	$ 4,914	$ 251,998

Operating lease expense incurred during the years ended September 30, 2003 and 2002 was $53.3 million and $60.0 million, respectively. The operating lease amounts due after 5 years does not include estimated payments for leases with annual renewal options. Estimates of the lease termination dates are subjective, and any projection of future lease payments would be arbitrary.

NOTE 10. FEDERAL EMPLOYEE AND VETERANS BENEFITS PAYABLE

As of September 30, 2003 and 2002, FECA actuarial liabilities were $1,041.6 million and $997.1 million respectively. The DOL calculates the FECA liability for DOT, and DOT allocates the liability amount to FAA based upon actual workers' compensation payments to FAA employees over the preceding four years. FECA liabilities include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The estimated liability is not covered by budgetary resources and thus will require future appropriated funding.

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

In FY 2003, all expenses, earned revenues, and intragovernmental transactions were related to Transportation Programs. In FY 2002, $163 thousand of FAA's expenses related to Community and Regional Development Programs.

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

FAA's five lines of business represent the programs reported on the Statement of Net Cost. Cost centers assigned to each line of business permit the direct accumulation of costs. Other costs that are not directly traced to each line of business, such as agency overhead, are allocated by applying ratios representing the cost for each line of business divided by the total cost (excluding grant payments) for all lines of business.

Following is FAA's distribution of FY 2003 and FY 2002 net costs by intragovernmental-related versus with the public.

Line of Business Programs	For the Year Ended September 30, 2003 Intra-governmental	With the Public	Total
Air Traffic Services			
Expenses	$ 1,082,494	$ 6,636,434	$ 7,718,928
Less: Earned revenues	(24,392)	(43,498)	(67,890)
Net Costs	1,058,102	6,592,936	7,651,038
Regulation & Certification			
Expenses	128,755	814,380	943,135
Less: Earned revenues	(250)	(876)	(1,126)
Net Costs	128,505	813,504	942,009
Research & Acquisitions			
Expenses	121,210	377,568	498,778
Less: Earned revenues	(12,394)	(43,462)	(55,856)
Net Costs	108,816	334,106	442,922
Airports			
Expenses	8,959	2,777,758	2,786,717
Less: Earned revenues	(50)	(174)	(224)
Net Costs	8,909	2,777,584	2,786,493
Commercial Space Transportation			
Expenses	-	11,725	11,725
Net Costs	-	11,725	11,725
Non Line of Business Programs			
Regional and Center Operations and Other Programs			
Expenses	162,154	184,689	346,843
Less: Earned revenues	(179,475)	(76,911)	(256,386)
Net Costs	(17,321)	107,778	90,457
Not Assigned to Programs			
Expenses	-	61,486	61,486
Less: Earned revenues	(7,720)	(27,074)	(34,794)
Net Costs	(7,720)	34,412	26,692
Net Cost of Continuing Operations	1,279,291	10,672,045	11,951,336
Transferred Operations - Civil Aviation Security			
Expenses	94,413	30,292	124,705
Less Earned Revenues	(17,186)	(60,269)	(77,455)
Net Costs	77,227	(29,977)	47,250
Net Cost of Operations			
Total Expenses	1,597,985	10,894,332	12,492,317
Less Total Earned Revenue	(241,467)	(252,264)	(493,731)
Total Net Cost	$ 1,356,518	$ 10,642,068	$ 11,998,586

Line of Business Programs	For the Year Ended September 30, 2002 Intra-governmental	With the Public	Total
Air Traffic Services			
Expenses	$ 993,362	$ 6,320,410	$ 7,313,772
Less: Earned revenues	(56,860)	(20,247)	(77,107)
Net Costs	936,502	6,300,163	7,236,665
Regulation & Certification			
Expenses	122,368	802,246	924,614
Less: Earned revenues	(568)	(553)	(1,121)
Net Costs	121,800	801,693	923,493
Research & Acquisitions			
Expenses	146,683	440,308	586,991
Less: Earned revenues	(36,549)	(35,580)	(72,129)
Net Costs	110,134	404,728	514,862
Airports			
Expenses	8,547	2,924,995	2,933,542
Net Costs	8,547	2,924,995	2,933,542
Commercial Space Transportation			
Expenses	-	11,361	11,361
Net Costs	-	11,361	11,361
Non Line of Business Programs			
Regional and Center Operations and Other Programs			
Expenses	115,207	310,625	425,832
Less: Earned revenues	(92,379)	(36,832)	(129,211)
Net Costs	22,828	273,793	296,621
Not Assigned to Programs			
Expenses	-	50,622	50,622
Less: Earned revenues	(28,585)	(27,826)	(56,411)
Net Costs	(28,585)	22,796	(5,789)
Net Cost of Continuing Operations	1,171,226	10,739,529	11,910,755
Transferred Operations - Civil Aviation Security			
Expenses	265,838	454,135	719,973
Less Earned Revenues	(108,141)	(78,668)	(186,809)
Net Costs	157,697	375,467	533,164
Net Cost of Operations			
Total Expenses	1,652,005	11,314,702	12,966,707
Less Total Earned Revenue	(323,082)	(199,706)	(522,788)
Total Net Costs	$ 1,328,923	$ 11,114,996	$ 12,443,919

NOTE 13. EXCISE TAXES AND ASSOCIATED REVENUE

The IRS collects various excise taxes on behalf of FAA's Airport and Airway Trust Fund. These taxes can be withdrawn only as authorized by FAA appropriations. Twice a month, Treasury estimates the amount collected, and adjusts the estimates by actual collections quarterly. Accordingly, the total taxes recognized for the year ended September 30, 2003 and 2002 included OTA's estimate of $2.9 billion and $2.5 billion for the quarters ending September 30, 2003 and 2002, respectively. For the years ended September 30, 2003 and 2002, respectively, excise taxes and associated nonexchange revenue, which is reported on the Statement of Changes in Net Position, was as follows:

	2003	2002
Passenger Ticket Tax	$ 6,065,763	$ 6,300,562
International Departure Tax	1,517,807	1,410,234
Investment Income	570,873	777,693
Fuel Taxes	850,950	802,749
Waybill Tax	399,396	394,317
Tax Refunds and Credits	(44,320)	(59,613)
Total Excise Taxes and Associated Revenue	$ 9,360,469	$ 9,625,942

NOTE 14. IMPUTED FINANCING SOURCES

FAA recognizes as imputed financing the amount of accrued pension and post-retirement benefit expenses for current employees. The assets and liabilities associated with such benefits are the responsibility of the administering agency, the OPM. Amounts paid from the Treasury Judgment Fund in settlement of claims or court assessments against FAA are also recognized as imputed financing. For the fiscal years ended September 30, 2003 and 2002, respectively, imputed financing was as follows:

	2003	2002
Office of Personnel Management	$ 465,868	$ 394,826
Treasury Judgment Fund	29,835	65,910
Total Imputed Financing Sources	$ 495,703	$ 460,736

NOTE 15. TRANSFERRED OPERATIONS

The Aviation and Transportation Security Act (Public Law 107-71) established the Transportation Security Administration (TSA) and transferred FAA's civil aviation security functions to the TSA. The TSA assumed responsibility for these functions on February 13, 2002. Subsequently, the Homeland Security Act of 2002 (Public Law 107-296) established the Department of Homeland Security (DHS) and transferred TSA from the DOT to DHS effective March 1, 2003.

FASAB Technical Bulletin (TB) 2003-1, *Certain Questions and Answers related to the Homeland Security Act of 2002*, requires Federal agencies to segregate the net costs of continuing and transferred operations, and recognize a transfer-out for assets and liabilities transferred to the DHS. Although the guidance in TB 2003-1 applies to DHS, the guidance is relevant to the transfer of the civil aviation security function to the TSA. Accordingly, on the Statement of Net Cost, the FAA has segregated and reported as "transferred operations," the net costs incurred related to civil aviation security functions that transferred to TSA. Net costs of internal security functions, which remained with FAA, are

reported under Region and Center Operations and Other Programs.

In addition, the Statement of Changes in Net Position includes $680.1 million in Other Financing Sources – net transfers out without reimbursement. Of this amount, $623.6 million pertains to civil aviation security-related PP&E that the FAA transferred to the TSA during FY 2003.

NOTE 16. STATEMENT OF BUDGETARY RESOURCES DISCLOSURES

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

Differences exist between the FY 2003 Statement of Budgetary Resources and the Report on Budget Execution and Budgetary Resources (SF-133) due to corrections of prior year errors. Consistent with Statement of Federal Financial Accounting Standards No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles,* because the errors were considered immaterial, the effects of the corrections are reflected as FY 2003 activity in the Statement of Budgetary Resources. However, for purposes of reporting the SF-133 to Treasury, certain beginning of year balances were restated based upon Treasury guidance. The net effect of all beginning balance adjustments to the SF-133 is less than $1 million.

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

- FAA does not have any significant differences between the information reported on the Statement of Budgetary Resources and the amounts described as FY 2003 "actual" in the Budget of the United States Government for FY 2005.
- Congress mandated permanent indefinite appropriations for the Facilities and Equipment, Grants-in-Aid, and Research, Development and Engineering to fully fund special projects that were ongoing and spanned several years.
- FAA does not have obligations classified as "exempt from apportionment." However, during FY 2003 and FY 2002, direct and reimbursable obligations incurred against amounts apportioned under categories A and B, as defined in OMB Circular No. A-11, Part 4, Instructions on Budget Execution, were as follows:

	2003 Obligations Incurred		
	Category A	Category B	Total
Direct	$ 10,376,768	$ 3,524,631	$ 13,901,399
Reimbursable	264,743	4	264,747
Total	$ 10,641,511	$ 3,524,635	$ 14,166,146

	2002 Obligations Incurred		
	Category A	Category B	Total
Direct	$ 14,446,516	$ 299,149	$ 14,745,665
Reimbursable	1,051,173	-	1,051,173
Total	$ 15,497,689	$ 299,149	$ 15,796,838

Total available contract authority at the end of FY 2003 and FY 2002 was $4.2 billion and $4.0 billion, respectively.

Public Laws 106-181 and 108-7 authorized FAA $3.4 billion and $3.1 billion in contract and liquidating authority, respectively, which are derived from the Airport and Airway Trust Fund and available until expended, for the Grants-in-Aid programs. The unobligated balance at the end of FY 2003 and FY 2002 was $9.0 million and $.9 million respectively.

Unobligated balances of budgetary resources for unexpired accounts are available in subsequent years until expiration, upon receipt of an apportionment from OMB. Unobligated balances of expired accounts are not available. At the end of FY 2002 $1.6 million of obligated balances, were in appropriations cancelled at year-end, pursuant to 31 USC 1552, and thus have not been brought forward to FY 2003.

The net obligated balance, end of period, is comprised of the following components as of September 30, 2003 and 2002:

2003

Obligated balance, net, end of period	Amount
Accounts receivable	$ (62,775)
Unfilled customer orders from Federal sources	(113,350)
Undelivered orders	7,926,575
Accounts payable	894,030
Total obligated balance, net end of period	$ 8,644,480

2002

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

NOTE 17. FINANCING SOURCES YET TO BE PROVIDED

The following table shows liabilities not covered by budgetary resources as of September 30, 2003 and 2002, as well as the relationship between liabilities not covered by budgetary resources on the balance sheet and the change in components of net cost of operations that will require or generate resources in future periods.

	2003	2002	Change
Environmental Liabilities (Notes 7 and 19)	$ 621,953	$ 574,676	$ 47,277
FECA - Intragovernmental (Actual) (Note 8)	200,905	199,639	1,266
Sick Leave Compensation Benefits and Return Rights (Note 8)	70,750	60,707	10,043
Debt - Intragovernmental (Note 8)	30	30	-
FECA (Actuarial) (Note 10)	1,041,568	997,103	44,465
Increases - Components of Net Cost of Operations Requiring or Generating Resources in Future Periods			103,051
Unfunded Annual & Other Leave & Assoc. Benefits (Note 8)	451,199	451,341	(142)
Legal Claims (Note 8)	78,900	169,900	(91,000)
Capital Leases (Notes 8 & 9)	68,844	78,096	(9,252)
Other Accrued Liabilities (Note 8)	50,282	108,746	(58,464)
Decreases - Resources that Fund Expenses Recognized in Prior Periods			(158,858)
Liabilities Not Covered by Budgetary Resources	$ 2,584,431	$ 2,640,238	$ (55,807)

NOTE 18. CUSTODIAL ACTIVITY

FAA collects certain non-exchange (custodial) revenue on behalf of the General Fund of the Treasury. During FY 2003 and FY 2002, FAA's Statement of Changes in Net Position included custodial revenue totaling $21.8 million and $29.2 million, respectively. The primary source of custodial activity is revenue from the Metropolitan Washington Airport Authority for its leases of Ronald Reagan National Airport and Washington Dulles International Airport. Custodial activity also includes the collection of miscellaneous fines and penalties.

NOTE 19. COMMITMENTS, CONTINGENCIES, AND OTHER DISCLOSURES

Contract Options. As of September 30, 2003 and 2002, FAA had contract options of $32.8 billion and $19.9 billion, respectively. These contract options give FAA the unilateral right to purchase additional equipment or services or to extend the contract terms. Exercising this right would require the obligation of funds in future years.

Contract Negotiations. As of September 30, 2003 and 2002, FAA had a total of $21.6 million and $42.1 million, respectively, in commitments (funds reserved for possible future obligations) under unexpired Facilities and Equipment, and Research, Engineering, and Development appropriations. The commitments were for purchases of goods and services for which contract negotiations have not been completed (i.e., agency obligations had not been incurred) at the end of each respective fiscal year.

Letters of Intent. FAA has authority under Title 49 U.S.C. 47110(e) to issue letters of intent (LOIs) to enter into AIP grant agreements. Through September 30, 2003, FAA issued LOIs covering FY 1988 through FY 2014 totaling $4.5 billion. As of September 30, 2003, FAA had obligated $3.0 billion of this total amount, leaving $1.5 billion unobligated.

As of September 30, 2002, LOIs covering FY 1988 through FY 2014 totaled $4.3 billion. Of this amount, FAA had obligated $2.7 billion, leaving $1.6 billion unobligated as of September 30, 2002.

AIP Grants. FY 2003 AIP grant authority totaled $3.3 billion, including $2.1 billion in entitlements to specific locations. Of entitlements to specific locations, sponsors have claimed $1.8 billion, and $336 million remains available from unused or newly enacted contract authority to those sponsors through FY 2005, or in the case of non-hub primary airport locations, through FY 2006.

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

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

FAA maintains standby non-premium war-risk insurance policies for 38 air carriers having approximately 975 aircraft available for Defense or State Department charter operations.

On September 22, 2001, the premium insurance program was expanded by the Air Transportation Safety and System Stabilization Act (Public Law 107-42) to include all scheduled domestic air carriers. Under this program, FAA has provided temporary war-risk insurance, for typically 60-day periods, to U.S. carriers whose coverage was cancelled following the terrorist attacks on September 11, 2001. Insured air carrier per occurrence limits, for combined hull and liability coverage, range from $100 million to $4 billion. Total insurance in force for hull coverage as of September 30, 2003 was $172.7 billion. Public Law 108-11 mandated FAA to extend policies in effect on June 19, 2002, until August 31, 2004. The period of coverage in effect as of September 30, 2003 was from August 13 to October 11, 2003. There are 76 FAA war-risk policies.

The issuance of temporary war-risk coverage to all scheduled domestic carriers provides necessary insurance to qualifying carriers while allowing time for the commercial insurance market to stabilize. Premiums under this program are established by FAA and are assessed per departure. During FY 2003 and FY 2002, FAA recognized insurance premium revenue of $124.0 million and $74.6 million, respectively. Premiums are recognized as revenue on a straight-line basis over the period of coverage. Premium revenue is reported on the Consolidated Statement of Net Cost, under "Regional and Center Operations and Other Programs."

In the past, FAA has insured a small number of air carrier operations and establishes a maximum liability for losing one aircraft. Typically, the maximum liability for both hull loss and liability, per aircraft, is $1.75 billion. No claims for losses were pending as of September 30, 2003 or 2002. Since the inception of the Aviation Insurance Program (including the predecessor Aviation War Risk Insurance Program dating back to 1951) only four claims, all involving minor dollar amounts, have been paid. Because of the unpredictable nature of war risk and the absence of historical claims experience on which to base an estimate, no reserve for insurance losses has been recorded.

Overflight User Fees. FAA issued an interim final rule (IFR), effective on August 1, 2000, followed by a Final Rule, effective on August 20, 2001, that required certain aircraft operators to pay fees for air traffic control and related services provided by FAA to aircraft that operate in U.S.-controlled airspace but neither takeoff nor land in the United States. The authority to charge these fees is contained in the Federal Aviation Reauthorization Act of 1996, as amended. Several airlines and an air carrier association challenged the IFR in the U.S. Court of Appeals. FAA issued the Final Rule while the IFR litigation was still pending. The same group of plaintiffs then brought suit against the Final Rule, and the Court combined the two cases.

FAA had recognized $79.7 million in revenue, including $19.8 million and $27.6 million in FY 2003 and FY 2002, respectively, before it ceased billing in light of an adverse decision in the U.S. Court of Appeals on April 8, 2003. The period for appealing that decision to the Supreme Court expired on October 31, 2003. Congress has since enacted, in the FAA Reauthorization Act signed by the President on December 12, 2003, a provision on overflight fees that affects past and future fee collections. FAA's ability to retain these fees in light of the new legislation is under review.

Environmental. FAA is a party to two major environmental remediation projects in which the extent of liability is unknown. A study is in process to determine the magnitude and scope of the remediation required at the two sites. Of the total environmental liability reported as of September 30, 2003 and 2002, the amount related to these two sites is $61.6 million and $67.7 million, respectively. This liability includes FAA's share of the known remediation cost and the cost to complete the study.

Legal Claims. As of September 30, 2003 and 2002, FAA's contingent liabilities for asserted and pending legal claims reasonably possible of loss were estimated at $325.5 million and $499.8 million, respectively. FAA does not have material amounts of known unasserted claims.

REQUIRED SUPPLEMENTARY

STEWARDSHIP INFORMATION

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

State/Territory	2003	2002	2001	2000	1999
Alabama	$ 59,760	$ 58,506	$ 27,421	$ 19,653	$ 18,134
Alaska	158,950	121,640	83,563	51,788	70,802
Arizona	75,247	54,737	51,783	58,381	53,135
Arkansas	35,530	32,937	32,412	17,534	21,694
California	216,981	243,720	179,447	87,617	106,161
Colorado	57,872	91,495	26,340	29,860	43,452
Connecticut	7,011	10,420	3,480	1,788	4,971
Delaware	2,577	5,838	4,704	2,515	197
District of Columbia	447	71	61	83	54
Florida	166,066	157,878	110,428	64,694	71,746
Georgia	48,147	67,957	33,652	43,911	43,556
Hawaii	24,767	15,846	34,569	6,567	12,131
Idaho	30,721	19,925	25,477	13,106	15,578
Illinois	74,202	165,518	85,566	66,003	63,596
Indiana	47,288	43,099	30,544	24,141	27,467
Iowa	37,521	30,765	35,159	16,169	30,450
Kansas	22,694	15,655	7,587	7,378	7,451
Kentucky	67,031	48,192	46,166	26,205	32,741
Louisiana	45,394	47,915	32,841	29,200	24,442
Maine	18,143	14,456	7,496	3,828	4,943
Maryland	22,933	26,370	18,953	14,900	18,136
Massachusetts	65,930	30,348	20,709	14,560	15,259
Michigan	84,030	85,851	99,278	27,363	50,995
Minnesota	58,826	85,675	49,143	30,561	27,902
Mississippi	30,289	25,929	28,203	9,281	14,393
Missouri	59,642	71,910	62,701	35,137	30,089
Montana	34,273	24,506	19,254	13,157	16,727
Nebraska	19,423	25,181	22,983	8,534	14,240
Nevada	57,506	45,204	57,332	32,106	22,981
New Hampshire	35,082	40,351	16,173	8,582	8,789
New Jersey	29,402	26,391	18,047	10,012	25,906
New Mexico	17,336	13,106	10,882	7,671	10,149

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

State/Territory	2003	2002	2001	2000	1999
New York	$ 122,675	$ 109,798	$ 118,792	$ 57,671	$ 86,754
North Carolina	75,317	73,493	60,908	26,084	50,572
North Dakota	15,458	16,562	25,221	11,490	8,263
Ohio	68,717	112,015	51,601	45,691	46,374
Oklahoma	34,351	39,238	19,780	8,678	14,949
Oregon	34,687	46,605	31,655	9,847	16,138
Pennsylvania	112,761	109,388	62,343	34,011	57,544
Rhode Island	13,736	12,409	9,547	11,705	10,813
South Carolina	22,531	39,194	18,895	11,792	22,926
South Dakota	16,841	15,440	10,466	12,301	8,893
Tennessee	62,412	46,373	58,638	39,237	36,477
Texas	159,929	192,738	127,046	111,585	103,308
Utah	24,804	21,396	39,235	14,328	8,808
Vermont	2,310	2,767	5,487	1,157	4,141
Virginia	45,240	76,647	75,555	41,109	31,069
Washington	53,351	62,798	34,023	35,498	44,454
West Virginia	24,373	18,562	18,564	7,400	12,592
Wisconsin	48,264	39,971	27,541	26,278	25,512
Wyoming	21,158	25,679	16,446	14,972	7,871
American Samoa	18,903	17,845	5,374	241	676
Guam	5,937	368	3,653	3,399	10,341
Northern Mariana Island	10,227	13,017	5,455	1,610	4,027
Puerto Rico	7,419	9,022	6,399	9,179	7,163
Trust Territory of Pacific	-	-	-	138	27
Virgin Islands	8,959	20,094	5,056	2,411	9,231
Administration	65,336	64,731	58,542	55,196	75,680
Totals	**$ 2,786,717**	**$2,933,542**	**$2,178,576**	**$ 1,375,293**	**$ 1,612,870**

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

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

Expenditures	2003	2002	2001	2000	1999
Applied Research	$ 29,406	$ 59,150	$ 120,395	$ 99,777	$ 118,834
Development	251	603	3,419	7,175	18,358
R&D Plant	2,903	3,020	10,130	12,800	14,290
Administration	31,669	44,480	46,988	46,219	36,466
Total	$ 64,229	$ 107,253	$ 180,932	$ 165,971	$ 187,948

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

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

NOTE: The FY 1999 amounts reported above are based on actual amounts. They differ from the numbers reported in FY 1999 financial statements, which were based on estimates.

REQUIRED SUPPLEMENTARY INFORMATION

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

Category	Method	Asset Condition*	Costs to Return to Acceptable Condition				
			FY2003	FY 2002	FY 2001	FY 2000	FY 1999
Buildings	Condition Assessment Survey	4&5	$50,534	$73,741	$50,568	$30,971	$17,539
Other Structures and Facilities	Condition Assessment Survey	4&5	29,785	13,843	22,928	59,290	37,442
Total			$80,319	$87,584	$73,496	$90,261	$54,981

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

Information on FAA's deferred maintenance is based on condition assessment survey (annual inspection). Standards (orders) are provided for evaluating the fixed assets condition. These standards are combined with FAA technicians' knowledge, past experiences, and judgment to provide the following:

- Minimum and desirable condition descriptions
- Suggested maintenance schedules
- Standard costs for maintenance actions
- Standardized condition codes

There have not been material changes to the standards in recent years. FAA recognizes maintenance expense as incurred. However, maintenance was insufficient during the past several years and resulted in deferred maintenance on Buildings and Other Structures and Facilities. FAA reports deferred maintenance only on assets with condition ratings of 4 and 5 in compliance with the Statement of Federal Financial Accounting Standard (SFFAS) Number 6, "Accounting for Property, Plant and Equipment".

U.S. Department Of Transportation
FEDERAL AVIATION ADMINISTRATION
Supplementary Information
Intragovernmental Balances
As of September 30, 2003

Intragovernmental Assets

Agency	Accounts Receivable, Advances, Prepayments, and Other	Fund Balance with Treasury	Investments
Department of the Treasury	$ 313	$ 2,833,723	$ 10,819,257
General Accounting Office	1		
Department of Agriculture	46		
Department of Commerce	580		
Department of the Interior	3,947		
Department of Justice	14		
Department of State	46		
Department of Labor	4		
Department of the Army	6,228		
Department of the Navy	4,747		
General Services Administration	330		
Department of the Air Force	25,133		
National Aeronautics & Space Admin.	4,125		
Social Security Administration	23		
Federal Emergency Management Agency	20		
Social Security Administration	1		
Department of Homeland Security	12,490		
Department of Health and Human Services	2		
Department of Defense	2,606		
Department of Transportation	84,098		
Department of Energy	16		
Independent Agencies	2		
Other Agencies	23,950		
Total	$ 168,722	$ 2,833,723	$ 10,819,257

U.S. Department Of Transportation
FEDERAL AVIATION ADMINISTRATION
Supplementary Information
Intragovernmental Balances
As of September 30, 2003

Intragovernmental Liabilities

Agency	Employee Related and Other	Accounts Payable
Department of the Treasury	$ 20,868	$ -
Department of Agriculture	3,170	9
Department of Commerce	3,053	-
Department of the Interior	89	-
Department of State	120	-
Department of Labor	200,905	-
Department of the Army	4	3
Department of the Navy	116	84
United States Postal Service	-	-
General Services Administration	7,142	-
Department of Justice	68	-
Department of the Air Force	1,690	41
National Aeronautics & Space Admin.	453	-
Social Security Administration	4,835	-
Office of Personnel Management	21,127	-
Federal Emergency Management Agency	49	-
National Science Foundation	9	-
Department of Homeland Security	8,961	-
Department of Health and Human Services	20	-
Department of Defense	3,362	6
Department of Transportation	11,840	9,179
Department of Energy	-	2
Department of Education	60	-
Environmental Protection Agency	100	-
Other Agencies	56,827	-
Total	$ 344,868	$ 9,324

U.S. Department Of Transportation
FEDERAL AVIATION ADMINISTRATION
Supplementary Information
Intragovernmental Transactions
For the Fiscal Year Ended September 30, 2003

Intragovernmental Expenses and Revenues

Agency	Expenses	Revenues
Department of the Treasury*	$ 33,334	$ 3,115
Department of Agriculture	2	2
Department of Commerce	1,978	1,978
Department of Energy	58	58
Department of Education	5	5
Department of the Interior	777	777
Department of Justice	43	43
Department of Labor	9	9
Department of Labor - FECA*	87,631	-
Department of the Navy	3,178	3,178
Department of State	39	39
Office of Personnel Management*	1,247,460	-
Social Security Administration	100	100
Department of the Army	5,729	5,729
General Services Administration	119	119
Department of the Air Force	14,511	14,511
Fed. Emergency Mgmt. Agency	2,381	2,381
Department of Homeland Security	53,027	53,027
Department of Health and Human Services	62	62
National Aeronautics & Space Admin.	12,545	12,545
Department of Defense	7,929	7,929
Independent Agencies	154	154
Department of Transportation	117,561	117,561
Tennesee Valley Authority	4	4
Other Agencies	9,349	18,141
Total Expenses	$ 1,597,985	$ 241,467

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

Intragovernmental Non-Exchange Revenue

	Transfers-Out	Transfers-In
General Services Administration	$ 14,991	$ 15,082
Office of Personnel Management	5	5
Department of Army	81	-
Department of Homeland Security	643,621	-
Department of Agriculture	6	-
National Aeronautics & Space Admin.	43,904	-
Department of Transportation	103,168	-
Department of Commerce	15	-
Other Agencies	14,625	2,082
Total Revenues	$ 820,416	$ 17,169

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

Intragovernmental Assets

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

Intragovernmental Liabilities

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

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

Intragovernmental Expenses and Revenues

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

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

Intragovernmental Non-Exchange Revenue

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

U. S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
Schedule of Budgetary Resources by Major Fund Type
As of September 30, 2003

Budgetary Resources	Airport & Airway Trust Fund Corpus	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development	Aviation Insurance Revolving	Franchise Fund	Operations	Other Funds	Combined Total
Budget Authority	$ (797,917)	$ 6,500,000	$ 2,931,899	$ 141,444	$ -	$ -	$ 7,071,120	$ -	$ 15,846,546
Unobligated Balance brought forward and transfers	8,749,608	894	541,486	21,187	102,361	56,581	152,833	57,505	9,682,455
Spending Authority From Offsetting Collections	-	686	104,312	(2,644)	129,426	353,862	140,810	32	726,484
Recoveries of prior year obligations	-	121,908	45,179	21,422	-	-	60,647	1	249,157
Permanently not available	-	(3,122,100)	(39,376)	(964)	-	-	(66,692)	-	(3,229,132)
Total Budgetary Resources	$ 7,951,691	$ 3,501,388	$ 3,583,500	$ 180,445	$ 231,787	$ 410,443	$ 7,358,718	$ 57,538	$ 23,275,510
Status of Budgetary Resources									
Obligations Incurred	$ 3	$ 3,491,899	$ 2,908,322	$ 160,006	$ 13,933	$ 331,454	$ 7,261,223	$ (694)	14,166,146
Unobligated Balances-Available	7,951,688	8,635	612,302	17,321	6,314	-	31,633	-	8,627,893
Unobligated Balances-Not Available	-	854	62,876	3,118	211,540	78,989	65,862	58,232	481,471
Total Status of Budgetary Resources	$ 7,951,691	$ 3,501,388	$ 3,583,500	$ 180,445	$ 231,787	$ 410,443	$ 7,358,718	$ 57,538	$ 23,275,510
Relationship of Obligations to Outlays									
Obligated Balance, net beginning of period	$ -	$ 4,992,702	$ 1,988,809	$ 205,948	$ 5,144	$ 70,802	$ 762,286	$(27,555)	$ 7,998,136
Cancelled appropriations and other	-	-	9	-	-	-	15,693	-	15,702
Obligations Incurred	3	3,491,899	2,908,322	160,006	13,933	331,455	7,261,222	(694)	14,166,146
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	(97)	(122,594)	(149,491)	(18,778)	(129,426)	(353,862)	(201,457)	(33)	(975,738)
Less: Obligated balance, net end of period	-	(5,681,104)	(1,952,717)	(198,907)	(5,201)	(91,873)	(694,909)	(19,769)	(8,644,480)
Net Outlays	$ (94)	$ 2,680,903	$ 2,794,932	$ 148,269	$ (115,550)	$ (43,478)	$ 7,142,835	$(48,051)	$ 12,559,766
Outlays									
Disbursements	$ 3	$ 2,681,540	$ 2,884,966	$ 151,652	$ 13,876	$ 312,235	$ 11,326,505	$(48,017)	$ 17,322,760
Collections, net of offsetting receipts	(97)	(637)	(90,034)	(3,383)	(129,426)	(355,713)	(4,183,670)	(34)	(4,762,994)
Net Outlays	$ (94)	$ 2,680,903	$ 2,794,932	$ 148,269	$ (115,550)	$ (43,478)	$ 7,142,835	$(48,051)	$ 12,559,766

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

Budgetary Resources	Airport & Airway Trust Fund Corpus	Trust Fund Grants-in-Aid to Airports	Trust Fund Facilities & Equipment	Trust Fund Research, Eng. & Development	Aviation Insurance Revolving	Franchise Fund	Operations	Other Funds	Combined Total
Budget Authority	$ (1,378,427)	$ 5,425,000	$ 3,026,595	$ 245,000	$ -	$ -	$ 7,128,400	$ -	$ 14,446,568
Unobligated Balance brought forward and transfers	10,111,046	302,331	553,845	19,400	88,241	28,620	291,897	29,860	11,425,240
Spending Authority From Offsetting Collections	-	-	170,915	3,969	75,566	318,068	1,045,815	27,596	1,641,929
Recoveries of prior year obligations	-	84,936	148,600	8,374	2	-	68,961	52	310,925
Permanently not available	-	(2,251,720)	(44,317)	(161)	-	-	(66,194)	-	(2,362,392)
Total Budgetary Resources	$ 8,732,619	$ 3,560,547	$ 3,855,638	$ 276,582	$ 163,809	$ 346,688	$ 8,468,879	$ 57,508	$ 25,462,270
Status of Budgetary Resources									
Obligations Incurred	$ 36	$ 3,559,653	$ 3,314,151	$ 255,395	$ 61,448	$ 290,106	$ 8,316,046	$ 3	$ 15,796,838
Unobligated Balances-Available	8,732,583	277	489,095	16,039	59,389	56,582	100,921	82	9,454,968
Unobligated Balances-Not Available	-	617	52,392	5,148	42,972	-	51,912	57,423	210,464
Total Status of Budgetary Resources	$ 8,732,619	$ 3,560,547	$ 3,855,638	$ 276,582	$ 163,809	$ 346,688	$ 8,468,879	$ 57,508	$ 25,462,270
Relationship of Obligations to Outlays									
Obligated Balance, net beginning of period	$ -	$ 4,378,147	$ 1,730,817	$ 163,192	$ 127	$ 45,993	$ 930,987	$ 272	$ 7,249,535
Obligations Incurred	36	3,559,653	3,314,151	255,395	61,448	290,106	8,316,046	3	15,796,838
Less: Spending authority from offsetting collections and receipts and recoveries of prior year obligations	(105)	(84,936)	(319,515)	(12,343)	(75,568)	(318,068)	(1,114,776)	(27,648)	(1,952,959)
Less: Obligated balance, net end of period	-	(4,992,702)	(1,988,809)	(205,948)	(5,144)	(70,802)	(762,286)	27,555	(7,998,136)
Net Outlays	$ (69)	$ 2,860,162	$ 2,736,644	$ 200,296	$ (19,137)	$ (52,771)	$ 7,369,971	$ 182	$ 13,095,278
Outlays									
Disbursements	$ 36	$ 2,860,162	$ 2,900,203	$ 204,339	$ 56,429	$ 263,472	$ 13,951,695	$ 27,778	$ 20,264,114
Collections, net of offsetting receipts	(105)	-	(163,559)	(4,043)	(75,566)	(316,243)	(6,581,724)	(27,596)	(7,168,836)
Net Outlays	$ (69)	$ 2,860,162	$ 2,736,644	$ 200,296	$ (19,137)	$ (52,771)	$ 7,369,971	$ 182	$ 13,095,278

ADMINISTRATIVE SERVICES FRANCHISE FUND

Background

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

Objective

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

Services

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

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

	As of September 30	
	2003	2002
Assets		
Intragovernmental		
Fund Balance with Treasury	$ 170,862	$ 127,297
Accounts Receivable, Net	1,165	2,676
Other	13	-
Total Intragovernmental Assets	172,040	129,973
Accounts Receivable, Net	2,896	1,914
Inventory and Related Property, Net	386,886	402,336
General Property, Plant, and Equipment, Net	1,080	4,011
Other Assets	5	4
Total Assets	$ 562,907	$ 538,238
Liabilities		
Intragovernmental Liabilities:		
Accounts Payable	$ -	$ 5
Other Intragovernmental Liabilities	97,780	67,088
Total Intragovernmental Liabilities	97,780	67,093
Accounts Payable	7,410	10,380
Other Liabilities	15,104	16,366
Total Liabilities	120,294	93,839
Net Position Balances:		
Cumulative Results of Operations	442,613	444,399
Total Net Position	442,613	444,399
Total Liabilities and Net Position	$ 562,907	$ 538,238

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

	For the Years Ended September 30	
	2003	2002
Programs		
Earned Revenues	$ 320,846	$ 284,220
Intragovernmental Costs	(321,159)	(306,827)
Profit (Loss)	$ (313)	$ (22,607)

U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
FRANCHISE FUND
STATEMENT OF CHANGES IN NET POSITION

	Cumulative Results of Operations	
	2003	2002
Beginning Balance	$ 444,399	$ 465,401
Other Financing Sources		
Transfers-in/out without reimbursement	(8,448)	(4,328)
Imputed financing from costs absorbed by others	6,251	5,387
Other	724	6
Total Financing Sources	(1,473)	1,065
Profit (Loss)	(313)	(22,067)
Ending Balance	$ 442,613	$ 444,399

OTHER ACCOMPANYING INFORMATION

NET COST BY STRATEGIC GOAL AREA

In an effort to better link actual costs to performance goals, in FY 2002 FAA began presenting a supplemental schedule of net cost, in which costs by program are allocated to agency strategic goals. In FY 2004, FAA plans to link costs to projects, and projects to goals, to improve understanding of the cost associated with FAA mission and programs.

Following are net costs for the year ended September 30, 2003 and 2002, allocated to agency strategic goals.

U.S. Department of Transportation
FEDERAL AVIATION ADMINISTRATION
CONSOLIDATED SCHEDULE OF NET COST BY STRATEGIC GOAL AREA
For the Year-Ended September 30, 2003

	Strategic Goal Areas					
Line of Business Programs	**Safety**	**Capacity**	**Organizational Excellence**	**Homeland Security**	**Other**	**Total**
Air Traffic Services	$ 6,560,007	$ 565,613	$ 450,299	$ 75,119	$ -	$ 7,651,038
Regulation & Certification	882,868	2,849	56,292	-	-	942,009
Research & Acquisitions	178,936	235,374	22,174	6,438	-	442,922
Airports	766,369	1,533,507	26,124	460,493	-	2,786,493
Commercial Space Transportation	11,250	-	475	-	-	11,725
Non Line of Business Programs						
Region and Center Operations and Other	-	-	-	-	90,457	90,457
Not Assigned To Programs	-	-	-	-	26,692	26,692
Net Cost of Continuing Operations	$ 8,399,430	$ 2,337,343	$ 555,364	$ 542,050	$ 117,149	$ 11,951,336
Transferred Operations-Civil Aviation Security	14,553	1	-	32,696	-	47,250
Net Cost of Operations	$ 8,413,983	$ 2,337,344	$ 555,364	$ 574,746	$ 117,149	$ 11,998,586

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

	Strategic Goal Areas					
Line of Business Programs	**Safety**	**Capacity**	**Organizational Excellence**	**Homeland Security**	**Other**	**Total**
Air Traffic Services	$ 6,566,283	$ 552,982	$ 110,411	$ 6,989	$ -	$ 7,236,665
Regulation & Certification	923,493	-	-	-	-	923,493
Research & Acquisitions	128,306	318,073	-	68,483	-	514,862
Airports	809,005	1,725,897	-	398,640	-	2,933,542
Commercial Space Transportation	11,361	-	-		-	11,361
Non Line of Business Programs						
Region and Center Operations and Other	10,932	-	-	69,814	215,875	296,621
Not Assigned To Programs	-	-	-	-	(5,789)	(5,789)
Net Cost of Continuing Operations	$ 8,449,380	$2,596,952	$ 110,411	$ 543,926	$ 210,086	$ 11,910,755
Transferred Operations-Civil Aviation Security	72,186	-	-	460,978	-	533,164
Net Cost of Operations	$ 8,521,566	$2,596,952	$ 110,411	$ 1,004,904	$ 210,086	$ 12,443,919

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APPENDIX: DEPARTMENT OF TRANSPORTATION MEMORANDUM ON TOP MANAGEMENT CHALLENGES

TOP MANAGEMENT CHALLENGES

Department of Transportation
Report Number: PT-2004-006
Date Issued: December 5, 2003

Memorandum

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

Subject: ACTION: DOT's Top Management Challenges
PT-2004-006

Date: December 5, 2003

From: Kenneth M. Mead
Inspector General

Reply to Attn. of: J-1

To: The Secretary
The Deputy Secretary Designate

The Office of Inspector General (OIG) has identified 10 top management challenges for the Department of Transportation (DOT) for fiscal year (FY) 2004. In considering the items for the FY 2004 list, we continue our focus on the Department's key responsibilities for transportation safety and efficiency.[1]

These management challenges are complicated by the current Government and transportation environment: we have entered a period of deficit spending; trust fund revenues are down; program needs are up; and the Department has pending reauthorizations in intercity passenger rail, highways, motor carriers, and transit. The exhibit to the report compares this year's list of management challenges with the list we published in FY 2003.

In our opinion, the Department is making real progress on most of its management challenges, either through implementing changes or by developing detailed plans to do so in the near future.

The OIG's list of DOT's top management challenges for FY 2004 are summarized below and presented in greater detail beginning on page 5. This report will be incorporated into the DOT Accountability Report, as required by law.

[1] We removed items related to the Coast Guard and the Transportation Security Administration, since those agencies left DOT in 2003.

- **Highway Safety.**[2] Taking aggressive action to prevent drivers from obtaining Commercial Driver's Licenses (CDLs) through kickbacks or other fraudulent schemes (of the over 40,000 annual highway fatalities, 11 percent involve large trucks); strengthening the system used to identify high-risk motor carriers for review; implementing the Transportation Recall Enhancement, Accountability, and Documentation (TREAD) Act to facilitate proactive identification of vehicle safety defects; and continuing to support programs for primary enforcement of seat belt laws and prevention of drug-impaired driving (page 5).

- **Aviation Safety.** Ensure Federal Aviation Administration (FAA) safety oversight keeps pace with industry and economic changes such as significant increases in contracting of aircraft maintenance to third parties. Also, there has been real progress in the last year on runway incursions (potential collisions on the ground), but operational errors (when air traffic controllers allow planes to come too close together in the air) continue to increase. Corrective actions are imperative to address this ongoing safety problem (page 7).

- **Hazardous Materials Safety and Security.** For safety and cost-effectiveness reasons, the Department needs to take aggressive steps to coordinate hazardous materials (HAZMAT) inspection and enforcement efforts among the modal administrations in order to leverage limited HAZMAT inspection resources. This would include an education program and inspection/enforcement strategies for dealing with a common shipper who causes problems across several of the Department's modes, such as a noncompliant HAZMAT shipment that uses motor carrier, rail, and air to move from origin to destination (page 10).

- **Protecting Taxpayer Investments in Highway and Transit Infrastructure Projects.** Improve the taxpayers' return on highway and infrastructure investments by: imposing meaningful debarment sanctions on firms that provide substandard materials or in other ways defraud highway and transit infrastructure projects; aggressively fighting motor fuel tax evasion—a drain on highway and transit revenues; and strengthening oversight of infrastructure projects to ensure they are delivered on-time and within budget. Even if these steps result in only a 1 percent savings, they could have a dramatic impact on the taxpayers' bottom line. For instance, if the efficiency with which the Federal Government and the states invested $700 billion in highway projects

[2] We removed the related item from last year's list on "Ensuring Highway Safety as the Southern Border Is Opened to Mexican Motor Carriers Under the North American Free Trade Agreement." The Department geared up sufficiently to provide safety oversight at the border, but then the border opening was delayed pending completion of an Environmental Impact Statement (EIS) and a Clean Air Act analysis being done as a result of an order by the Ninth Circuit Court of Appeals. Additionally, the Department of Justice filed a certiorari petition seeking Supreme Court review of the Appeals Court decision. We took this item off the top management challenges list because there is little the Department can do to address this matter until completion of the EIS and the Clean Air Act analysis and resolution of the legal issues.

over the last 6 years had been improved by only 1 percent, an additional $7 billion would have been made available—enough to fund 8 of the 15 active major highway projects (page 12).

- **Improve Fiscal Discipline at FAA.** FAA plans to address cost growth in operations and fundamental problems in major acquisitions. These actions are urgently needed, given an expected multi-billion-dollar decline in Aviation Trust Fund revenues. Continued salary increases on the scale experienced over the last few years are simply unsustainable in light of these revenue losses. The budget situation also makes it imperative that FAA act promptly to address fundamental weaknesses in its modernization acquisitions. Of the 20 major acquisitions we reviewed, 13 projects experienced schedule slips of 1 to 7 years and 14 projects experienced cost growth of over $4.3 billion—significantly more than FAA's entire FY 2004 request for modernization (page 15).

- **Intercity Passenger Rail.** DOT and Congress have required much greater financial accountability from Amtrak this year. However, Amtrak's authorization expired over a year ago. Without a new structure for the governance of intercity passenger rail agreed to by the interested parties, Amtrak will continue the *status quo* limp-along system that is financially dysfunctional and fails to satisfy mobility needs in corridors between city pairs. The Administration currently has a reauthorization proposal on Capitol Hill; however, achieving agreement among the Administration, the Congress, the states, and other interested parties on a final reauthorization measure is a tremendous challenge only partly under DOT's control (page 19).

- **MARAD Loan Guarantee Program.** The Maritime Administration (MARAD) is in the process of implementing a series of recommendations we made to the Secretary and the Congress on how best to minimize financial loss to the Government from MARAD's $3.8 billion Title XI Loan Guarantee Program, which is designed to assist private companies in obtaining financing for the construction of ships or the modernization of U.S. shipyards. Congress has linked MARAD's ability to issue further guarantees to its successful implementation of our recommendations (page 21).[3]

- **Financial Accountability.** There has been progress in the last year in this area, but DOT still has a long way to go to strengthen three important financial management activities. First, DOT needs to free up millions in inactive

[3]In the FY 2003 list, we removed the item related to MARAD's disposal of obsolete vessels. MARAD has made progress in contracting for the disposal of obsolete vessels from the National Defense Reserve Fleet; however, environmental concerns and legal proceedings have hindered these efforts. If these concerns are not resolved and additional progress is not made in meeting the legislative mandate to dispose of obsolete vessels by the end of FY 2006, we will consider including this issue as a top management challenge in the FY 2005 report.

obligations or idle funds, especially at the Federal Highway Administration (FHWA). Second, improve oversight of cost-reimbursable contracts which have few inherent protections against cost overruns. Third, complete implementation of the new Delphi financial management system, which will enable DOT to strengthen financial controls and generate reliable financial reports (page 23).

- **Disadvantaged Business Enterprise Program.** The Disadvantaged Business Enterprise (DBE) Program suffers from a high level of fraud and abuse as well as significant gaps in the Department's oversight. We are currently investigating 40 DBE fraud schemes in 19 states. Over the last 5 years, our DBE investigations have resulted in 29 convictions. We have also found areas where the DBE regulations need strengthening. For instance, the DBE regulations covering airport concessions need to prescribe a personal net worth limit for the owner of a DBE. The Secretary established a senior level DBE task force this year, but the task force must now make tangible and prompt progress in strengthening the DBE Program (page 26).

- **Information Technology Management.** This past year, the Department made progress in protecting its critical Information Technology (IT) systems against Internet intrusions. However, DOT is still behind in securing individual systems and must do more to protect critical IT systems (especially air traffic control systems) from attack and enhance contingency planning to ensure business continuity in an emergency. In addition, DOT must strengthen its new Investment Review Board to improve the Board's ability to oversee high-risk modal IT acquisitions and maximize returns on the Department's $2.7 billion in annual IT investments (page 28).

Another area we wish to mention is the issue of human resources management. In the coming year, the Department's senior management needs to consider whether it will be at serious risk of not being able to recruit and retain top talent. Our concern is based not only on the large percentage of DOT staff expected to retire or reach retirement eligibility in the next few years, but the fact that none of the DOT agencies, except FAA, have personnel rules and pay flexibility that have been granted to the Department of Homeland Security and the Department of Defense. This may place DOT at a disadvantage at the very time the Department is expected to lose large numbers of experienced staff and needs to recruit top talent to replace them.

If you have any questions concerning this report, please call me at (202) 366-1959; Todd J. Zinser, my Deputy, at (202) 366-6767; or Alexis M. Stefani, Principal Assistant Inspector General for Auditing and Evaluation, at (202) 366-1992.

2 **Aviation Safety.** Ensure Federal Aviation Administration (FAA) safety oversight keeps pace with industry and economic changes while maintaining a focus on long-standing safety issues.

The U.S. aviation industry continues to be the safest in the world, with only one commercial accident occurring in the past year. However, FAA must adjust its safety oversight to emerging trends in the aviation industry and changing economic conditions. Also, there has been real progress in the last year on runway incursions (potential collisions on the ground), but operational errors (when air traffic controllers allow planes to come too close together in the air) continue to increase. Corrective actions are imperative to address this ongoing safety problem.

Repair Station Oversight Needs to Be Enhanced. In a July 2003 report, we identified three ways that FAA needs to enhance its inspections of airline maintenance.

- While air carriers have turned increasingly to outside, contracted repair stations, FAA continues to focus its inspection resources on air carriers' in-house maintenance work. Air carriers have outsourced portions of their maintenance work for years, but this practice has recently become more pronounced. While major air carriers outsourced 37 percent of their aircraft maintenance expense in 1996, the amount spent on outsourced maintenance increased to 47 percent of maintenance costs in 2002. Yet, over 90 percent of FAA's inspections are still focused on in-house maintenance—leaving contract repair stations inadequately reviewed. In response to our audit, FAA agreed to develop a new process to identify repair stations that air carriers use to perform safety-critical repairs and target inspector resources to those facilities.

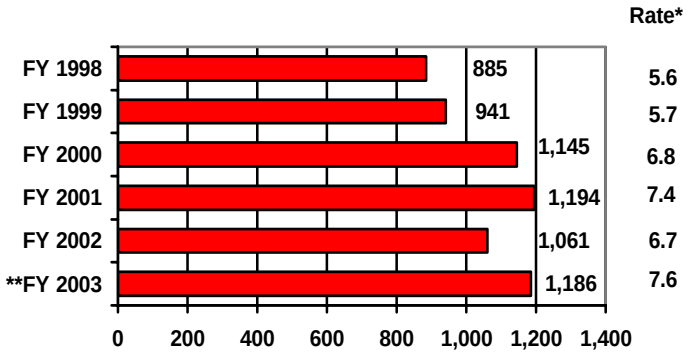
- Although widely used by some air carriers, some FAA-certified foreign repair stations are not inspected by FAA inspectors at all because other civil aviation authorities review these facilities on FAA's behalf. This arrangement helps prevent duplicative inspections and reduce the financial burden on foreign repair stations. However, in 14 of 16 (88 percent) files we reviewed, we found that foreign inspectors did not provide FAA with sufficient information to determine what was inspected, what problems were found, and how they were corrected. This occurred because FAA had not implemented adequate oversight procedures for ensuring the quality of inspections conducted on its behalf. FAA has agreed to conduct follow-up reviews with the three foreign aviation authorities conducting inspections on its behalf and develop a procedure to verify that the authorities place adequate emphasis on FAA regulations when conducting their inspections.

- Our review of repair stations disclosed weaknesses in repair station operations at 18 of the 21 (86 percent) facilities we visited. For example, we identified repair stations that did not: (1) use the parts required by the maintenance manual; (2) properly calibrate tools and equipment; (3) have information on file to show that mechanics approving completed repairs were qualified to do so; or (4) correct deficiencies previously identified by FAA inspectors. These weaknesses went undetected by FAA surveillance because of the weaknesses in FAA's oversight structure and the process inspectors used during repair station inspections. In response to our audit, FAA agreed to develop a more comprehensive approach to repair station surveillance.

When implemented, FAA's proposed changes to address our audit findings should enhance its oversight of aircraft repair stations. The key will be follow-through.

FAA Must Reduce the Number of Operational Errors. Operational errors (when air traffic controllers allow planes to come too close together in the air) pose a significant safety risk, with an average of three operational errors per day and one serious error every 7 days. In FY 2003, the number of operational errors increased 12 percent to 1,186, or 125 more than the number of incidents that occurred in FY 2002, as shown in Figure 1. Further, the most serious errors (those in which a collision was barely averted) increased 25 percent, from 44 in FY 2002 to 55 in FY 2003. Moreover, the system FAA uses to rate errors may understate the number of serious errors that occur. FAA classifies the seriousness of operational errors as high, moderate, or low. However, we found that errors FAA classified as moderate could result in catastrophic consequences. For example, FAA rated one error as moderate that was less than 12 seconds from a midair collision.

Figure 1. Operational Errors FY 1998—FY 2003



* Rate is per 1 million air traffic operations.
** FY 2003 numbers are preliminary and will be finalized in January 2004.

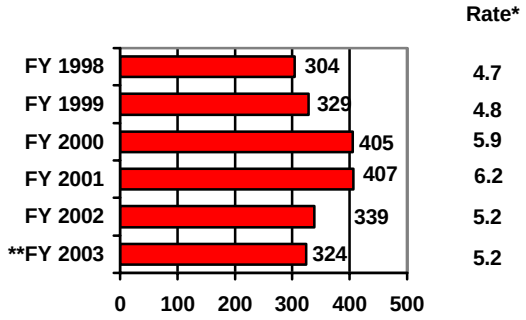
FAA needs to ensure that air traffic controllers who make operational errors receive training. FAA also should closely evaluate the impact of its Controller-in-Charge (CIC) Program on the increase in operational errors. Operational errors that occurred while a CIC was on duty increased 43 percent

from 174 in FY 2002 to 248 in FY 2003. Finally, FAA must modify its rating system to more accurately identify the most serious operational errors, focus on reducing them, and ensure that controllers receive the appropriate training after they have experienced a high risk error.

In response to our April 2003 report, FAA agreed to re-evaluate its severity rating system for operational errors. However, to date, FAA has not completed that evaluation. FAA also agreed to take steps to more closely monitor its CIC Program, improve its oversight of regional efforts to reduce operational errors, and provide training to controllers.

FAA Must Continue to Reduce Runway Incursions. For the second year in a row, runway incursions (potential collisions on the ground) continued to decline, from 339 in FY 2002 to 324 in FY 2003, as shown in Figure 2. FAA also reduced the number of close calls (those runway incursions in the 2 highest categories) from 37 in FY 2002 to 32 in FY 2003. While this represents significant progress, there is still an average of almost one runway incursion per day and an average of one close call every 11 days.

Figure 2. Runway Incursions FY 1998—FY 2003



* Rate is per 1 million tower operations.
** FY 2003 numbers are preliminary and will be finalized in January 2004.

In view of the potential loss of life in a runway accident, FAA must continue its aggressive approach to reduce runway incursions. Specifically, FAA needs to follow through on its plans to train pilots to avoid runway incursions and use technology to warn pilots and controllers of potential incidents.

For further information, the following reports and testimonies can be seen on the OIG web site at http://www.oig.dot.gov:

- *Review of Air Carriers' Use of Aircraft Repair Stations*
- *Operational Errors and Runway Incursions: Progress Made, but the Numbers of Incidents is Still High and Presents Serious Safety Risks*
- *Air Transportation Oversight System*
- *FAA Oversight of Passenger Aircraft Maintenance*
- *Oversight of FAA's Aircraft Maintenance, Continuing Analysis and Surveillance Systems*

5 Improve Fiscal Discipline at FAA. Controlling operations cost growth and addressing fundamental problems with major acquisitions.

FAA's FY 2005 authorization of $14.6 billion currently exceeds estimated Aviation Trust Fund FY 2005 revenues by $3.5 billion. Over the next 4 years, the Fund is expected to collect about $12.5 billion less in taxes than was anticipated in April 2001. Within this context, it is imperative that FAA contain the trend of continued cost growth in its operations and address long-standing and fundamental problems with major acquisitions.

Abating Operating Cost Growth. FAA's operations budget, which primarily covers salaries, has increased from $4.6 billion in FY 1996 (the first year of personnel reform) to $7.7 billion requested for FY 2005, a 67 percent increase. Given the substantial decline in Aviation Trust Fund revenues, a sizeable challenge for the Agency will be to manage within an operating budget that is relatively flat. For instance, the $7.7 billion requested for FY 2005 operations represents an increase of $141 million over FY 2004 levels; however, estimated pay increases for FY 2005 alone are expected to be nearly $180 million.

Further, within the proposed $7.7 billion, FAA will incur additional costs to hire and train new controllers as the Agency begins to address the anticipated wave of controller retirements. FAA estimates that about 7,100 controllers could leave the Agency by the end of 2012. A key challenge for FAA will be to reduce the time and cost required to train new controllers—in some cases this process can take up to 7 years. FAA will also need to renegotiate existing work rules that allow some newly hired controllers to earn base salaries of up to $94,000 while in training.

To abate the growth in operating costs, FAA needs to have both its cost accounting and labor distribution systems in place and operating effectively, and it needs to renegotiate memorandums of understanding (MOUs) between FAA and labor that have extensive cost implications.

- FAA must have its cost accounting system in place and operating effectively to accurately know when and where costs are incurred. FAA also needs an accurate labor distribution system to track the costs and productivity of its workforces. An accurate labor distribution system is critical for determining how many controllers FAA will need and where they are needed—information that is particularly important in light of the pending wave of controller retirements. FAA is planning on implementing a labor distribution system called CRU-X for the Air Traffic line of business (FAA's largest workforce). However, in September 2002, FAA entered into an MOU with the controllers'

union that eliminated many of the system's internal controls and severely limited the system's ability to track employee productivity. In our June 3, 2003 assessment of FAA's cost accounting system, we cited the lack of those fundamental procedures as a serious internal control weakness. In response, FAA agreed to implement satisfactory internal controls for CRU-X and has begun correspondence with the controllers' union to reopen negotiations concerning the CRU-X MOU. The new Chief Operating Officer (COO) for the Air Traffic Organization has committed to putting FAA's cost accounting and labor distribution systems in place.

- FAA will also need to address provisions of MOUs with labor that have extensive cost implications. In our September 2003 report "FAA's Management and Controls Over MOUs," we found that under the flexibility of personnel reform, FAA managers and union representatives entered into numerous memorandums of understanding that had substantial cost implications, but managers had not adequately considered the impact on future budgets. For example, one MOU we reviewed provides controllers with a cost-of-living differential of between 1 and 10 percent that is in addition to Government-wide locality pay. In FY 2002, this additional premium pay cost FAA over $35 million. In response to our audit, FAA implemented new controls over its MOU processes, and is currently in negotiations with the controllers union to modify or rescind several problematic MOUs identified during our audit.

Addressing Fundamental Problems in Major Acquisitions. In June 2003, we reported that of 20 major acquisitions reviewed, 13 projects had experienced schedule slips of 1 to 7 years, and 14 projects had experienced cost growth of over $4.3 billion (increasing from $6.8 billion to $11.1 billion). This growth represents significantly more than FAA's FY 2004 $2.9 billion request for modernization. Continued growth of this magnitude is unsustainable, given the multi-billion-dollar declines in projected Aviation Trust Fund receipts and the projected fund levels authorized in FAA's Facilities and Equipment account, which will remain essentially flat ($3 billion to $3.1 billion range) for FYs 2004 to 2007.

Table 1 provides cost and schedule information on three projects largely managed since FAA was granted acquisition reform in 1996. Cost and schedule problems with modernization efforts have serious consequences because they result in costly interim systems, a reduction in units procured, postponed benefits (in terms of safety and efficiency), or crowding out other modernization projects.

Table 1. Cost and Schedule Growth in Three Major Modernization Programs

Program	Estimated Program Costs (Dollars in Millions)		Percent Cost Growth	Implementation Schedule		Schedule Delay
	Original	Current		Original	Current	
Wide Area Augmentation System (WAAS)	$892.4	$2,922.4*	227%	1998-2001	2003-TBD**	5 years
Standard Terminal Automation Replacement System (STARS)	$940.2	$1,690.2	80%	1998-2005	2002-2012**	7 years
Local Area Augmentation System (LAAS)	$530.1	$696.1	31%	2002-TBD	2006-TBD**	4 years

* This includes the cost to acquire geostationary satellites.
** TBD—To Be Determined (costs and schedules are under review).

Our work has identified a number of systemic problems of major acquisitions that will require sustained management attention. These problems include: committing to major acquisitions and entering into cost-reimbursable contracts before user needs and requirements are fully understood; misleading and unreliable cost and schedule estimates; lack of centralized control over acquisitions and lack of basic contract oversight; lack of performance measures for assessing progress; and not holding managers and contractors accountable for cost growth and schedule slips. We have seen positive signs that the FAA Administrator and the COO are committed to making changes—the key will be follow through.

Additionally, FAA is beginning new, costly, and complex programs while still funding programs that are significantly behind schedule. This stretches out program schedules, impacts other efforts, and has cash-flow implications for the entire modernization account. One new effort is the En Route Automation Replacement (ERAM) Program, which provides new hardware and software for facilities that manage high altitude traffic. Another new project is the Next Generation Air-to-Ground Communications (NEXCOM) Program, which will provide new radios and related systems to transition to digital communications. Together, ERAM and NEXCOM are estimated to cost more than $3 billion.

Any cost increases with these programs will have a cascading effect on other efforts and limit FAA's flexibility to begin other projects. FAA will need to watch this situation and may have to rearrange priorities, modify contract instruments, and modify requirements.

For further information, the following reports and testimonies can be seen on the OIG web site at http://www.oig.dot.gov:

- *FAA's Management of Memorandums of Understanding with the National Air Traffic Controllers Association*
- *FAA Needs to Reevaluate STARS Costs and Consider Other Alternatives*
- *Status of FAA's Major Acquisitions*
- *Cost Control Issues for the Federal Aviation Administration's Operations and Modernization Accounts*
- *FAA's National Airspace System Implementation Support Contract*

8 Financial Accountability. Build on financial management progress in the last year by freeing up hundreds of millions of dollars in idle funds, improving oversight of billions of dollars in cost-reimbursable contracts, and fully implementing the new Delphi financial management system.

There has been progress in the last year in this area, but DOT still has a long way to go to strengthen three important financial management activities. First, DOT needs to free up millions in inactive obligations or idle funds, especially at the Federal Highway Administration. Second, improve oversight of cost-reimbursable contracts, which have few inherent protections against cost overruns. Third, complete implementation of the new Delphi financial management system, which will enable DOT to strengthen financial controls and generate reliable financial reports.

DOT must identify and deobligate hundreds of millions of dollars that have sat idle on completed, canceled, or modified projects, and use those funds productively on active projects. In FY 1999, we identified $672 million of inactive obligations that were no longer needed or valid. In FY 2001, we identified $293 million, including $238 million in FHWA. (Our current audit work indicates that this problem continues.) For example, we found one case where $25.5 million sat idle for 10 years on a project to build a garage, even though the state decided not to build the garage years earlier. We have repeatedly recommended that FHWA aggressively identify funds that can be deobligated from completed or canceled projects, and redeploy those funds to active projects. This is especially important in this time of tight budget constraints.

DOT must significantly strengthen—especially at FAA—management of billions of dollars in cost-reimbursable contracts, which have few inherent protections against cost overruns. In FY 2002's Financial Statement Audit report, we reported that FAA's management of cost-reimbursable contracts was deficient, lacked accountability, and did not adequately protect against fraud, waste, and abuse. Our audits have found that FAA officials did not: (1) obtain audits of billions of dollars in expenditures on cost-reimbursable contracts; (2) ensure that reliable Government cost estimates were prepared and used in evaluating contracts; (3) ensure that contractor employees were qualified to do the work; and (4) properly account for billings and expenditures to prevent overpayments.

Although FAA has taken some steps to improve its contract management, it has not yet implemented all our recommendations, including obtaining necessary interim and final audits of costs incurred for large contracts. Without these basic

management practices, FAA will not be in a position to monitor and control costs over the life of these contracts or ensure that the Government does not pay for unallowable costs.

Congress is also concerned about FAA's performance in this area and, in FY 2001, required FAA "to request the DCAA [Defense Contract Audit Agency] audits on all acquisition contracts in excess of $100,000,000, and audits on at least 15 percent of all contracts under $100,000,000". However, our work as of November 2003 shows that FAA has requested audits for only 15 of 33 contracts that FAA identified as being over $100 million—leaving over $8 billion of existing cost-reimbursable contracts over $100 million unaudited.

DOT must successfully convert all accounting operations to the new Delphi financial system and use the system to strengthen financial controls and generate reliable financial reports. In order to produce audited financial statements in time to meet the Office of Management and Budget's (OMB) accelerated deadline of November 15, 2004, FAA must complete the transition and evaluate the effectiveness of its recent conversion to Delphi. A flawed FHWA conversion this year means that DOT is now undertaking heroic efforts to meet the current January 2004 deadline for issuing audited financial statements. Next year, Delphi will have to produce reliable statements (including for FAA), without massive manual adjustments, for DOT to meet OMB's accelerated deadline.

As part of Delphi implementation, DOT needs to strengthen financial controls to ensure that funds are only spent for authorized uses and within appropriation limits set by Congress. During the last year, we reported three separate instances where DOT officials diverted a total of more than $612 million to unauthorized uses. In two cases, the diversions resulted in Antideficiency Act violations. While the largest portion of these diversions occurred over 20 years ago and none of the funds were diverted for personal use, and although senior DOT officials acted aggressively to deal with the problems, the existence of multiple fund diversions proves the need for more effective financial management controls.

DOT has set a goal date and the modal administrations must make significant strides to implement cost accounting systems, with appropriate labor distribution processes. Such systems will enable DOT modes to more effectively measure the performance of their programs, thus allowing DOT to identify inefficient activities, reduce costs, and increase productivity. Cost accounting and labor distribution systems are key to FAA's successful implementation of its new Air Traffic Organization. These systems are fundamental tools for the new organization to accurately measure the efficiency of its programs and the productivity of its workforce. During the last 3 years, we have issued annual reports on FAA's cost accounting system and the system implementation progress.

We cited problems with the treatment of costs, the lack of a labor distribution system, and the need to interface the cost accounting system with the new Delphi financial accounting system. The FAA Administrator has made correcting these deficiencies a top priority. Successful implementation of these cost accounting systems—crucial to gauging and lowering FAA operations costs and dealing with other financial challenges facing the Department—must not be further delayed.

For further information, the following reports and testimonies can be seen on the OIG web site at http://www.oig.dot.gov:

- *Inactive Obligations, DOT, September 1999*
- *Inactive Obligations, FHWA, September 2001*
- *DOT Consolidated FY 2001 Financial Statements*
- *DOT Consolidated FY 2002 Financial Statements*
- *Implementing a New Financial Management System*
- *Oversight of Cost-Reimbursable Contracts, FAA*
- *2002 Status Assessment of Cost Accounting System and Practices*

GLOSSARY OF ACRONYMS

A	
ACSI	American Customer Satisfaction Index
AFSS	Automated Flight Service Station
AIP	Airport Improvement Program
ATO	Air Traffic Organization
ATS	Air Traffic Services
C	
CFO	Chief Financial Officer
CPIC	Capital Planning and Investment Control
D	
DELPHI	Financial Management System
DOC	Department of Commerce
DOD	Department of Defense
DOT	Department of Transportation
E	
ERAM	En Route Automation Modernization
F	
F&E	Facilities and Equipment
FAA	Federal Aviation Administration
FFMIA	Federal Financial Management Improvement Act of 1996
FITS	FAA/Industry Training Standards Program
FMFIA	Federal Managers' Financial Integrity Act of 1982
FY	Fiscal Year
G	
GA	General Aviation
GAO	General Accounting Office
GPEA	Government Paperwork Elimination Act
GPS	Global Positioning System
I	
INFOCON	Information Operations Condition
IT	Information Technology
L	
LMS	Learning Management System
N	
NASA	National Aeronautics and Space Administration
NTSB	National Transportation Safety Board
O	
OEP	Operational Evolution Plan
OIG	Office of the Inspector General, Department of Transportation
OMB	Office of Management and Budget
OTA	Department of the Treasury's Office of Tax Analysis

P

PART	Program Assessment Rating Tool
PMA	President's Management Agenda
PP&E	Property, Plant, and Equipment
PRISM	Acquisition System

R

R,E&D	Research, Engineering and Development
RNP	Required Navigation Performance

S

STARS	Standard Terminal Automation Replacement System

T

TRACON	Terminal Radar Approach Control
TSA	Transportation Security Administration

U

URET	User Request Evaluation Tool

W

WARP	Weather and Radar Processor
WAAS	Wide Area Augmentation System

INTERNET LINKS

Federal Aviation Administration: www.faa.gov

FAA Offices: http://www1.faa.gov/aboutfaa/Organizations.cfm

FAA Regional Offices and Center: http://www1.faa.gov/aboutfaa/Regional.cfm

FAA Operational Evolution Plan (OEP): www1.faa.gov/programs/oep

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

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

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This FY 2003 Performance and Accountability Report is a collaborative endeavor on the part of many FAA employees and contractors. We would like to acknowledge and thank them for their hard work and commitment in successfully preparing this report and in supporting the audit of the financial statements.

WE WELCOME YOUR COMMENTS!

Thank you for your interest in FAA's *FY 2003 Performance and Accountability Report*. We welcome your comments on how we can make this report more informative for our readers. Please send your comments to

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This report is also available on the FAA website at
www1.faa.gov/aba/html_fm/files_pdf/2003_PAR.pdf

Prior year Performance and Accountability Reports are available at
www1.faa.gov/aba/html_fm/finst.html

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