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Subcommittee on Transportation, Treasury and
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Key Issues for the Federal Aviation Administration's FY 2005 Budget

**Statement of
The Honorable Kenneth M. Mead
Inspector General
U.S. Department of Transportation**



We appreciate the opportunity to testify today as the Subcommittee begins deliberations on the Fiscal Year (FY) 2005 appropriations for the Federal Aviation Administration (FAA). This year, we are facing an austere budgetary environment, one that will likely continue for at least the next several years. The Congressional Budget Office estimates that the Federal deficit will be \$477 billion this year.

Within this context, FAA must also be positioned for a rebound in air traffic. Domestic traffic levels still fall short of the peaks experienced in 2000, but there is no question that traffic is rebounding. In February 2004, the number of revenue passenger enplanements (35.1 million) was down 12 percent from February 2000, but this represents a 5 percent growth over enplanements in February 2003 (33.3 million).

While systemwide operations in February 2004 were slightly down from February 2000, the story is very different on an airport-by-airport basis. In 13 of the 31 largest airports, including some of those that experienced serious delays in 2000, the number of scheduled flights in March 2004 actually exceeded the number of scheduled flights in March 2000. However, in 11 of those 13 airports the number of available seats scheduled still lagged behind the number of available seats offered in March 2000. This is an indication, at least in part, of how network carriers are using regional jets in the place of narrow-body jets to connect traffic to the network hubs.

It is unlikely that the situation will reach the level of widespread system failures we experienced in the summer of 2000, but it is possible that some airports could experience disruptions in service. Airports that bear watching include Chicago O'Hare, Atlanta, and the three New York metropolitan airports.

At these five airports, arrival delays during the first 2 months of 2004 ranged between 20 and 35 percent of scheduled flights.

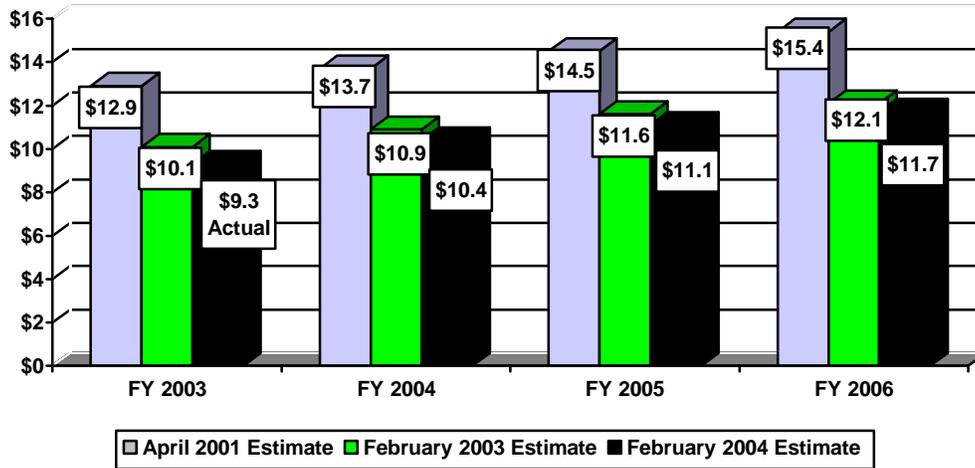
The FAA and the Department have been working with the industry to identify potential solutions to delays that might occur this summer such as creating high-altitude express lanes and voluntary schedule reductions. At Chicago O'Hare, arrival delays during March 2004 represented a 74 percent increase over delays in the same period in 2003 but down from triple digit increases during the period between November and January.

One situation that bears watching, in particular, is the expected service growth at Washington's Dulles airport. In June, when Independence Air is launched by former regional carrier Atlantic Coast Airlines as a new low-cost carrier, traffic at Dulles will increase significantly. Some estimates put that increase at over 50 percent by this summer. In addition to airside congestion, there are concerns with airport terminal services, including the resources needed to process a significantly increased number of passengers through security checkpoints.

While air traffic levels continue to show improvement from the sharp declines of 2001, there still remains a substantial decline in projected Aviation Trust Fund revenues. In 2001, FAA estimated that Trust Fund revenues in 2005 would be about \$14.5 billion. That estimate has now been reduced to \$11.1 billion.¹ FAA's FY 2005 budget request of \$14 billion exceeds those revenues by nearly \$3 billion.

¹ Even though air traffic operations are rebounding, Aviation Trust Fund revenues have not returned to previous levels partially because of lower enplanements, lower air fares, and more point-to-point service operations, all of which affect the amount of tax revenue collected.

Aviation Trust Fund: Comparison of Trust Fund Receipts \$ in billions



Clearly, a major focus for FAA this coming year, and for some time to come, must be controlling costs. FAA has not been accustomed to operating within this type of environment, and changing the organizational culture to reflect that focus will be a challenge. This past year, we have seen positive signs of leadership and commitment on the part of Administrator Blakey and her staff to address FAA's costs. For instance, there has been notable progress this past year in reining in FAA's unabated cost growth in its operations account. Progress is also being made toward restructuring the Air Traffic Organization into a performance-based organization. However, much more remains to be done to bring FAA's costs under control. Actions such as:

- developing realistic cost and schedule baselines for major acquisitions,
- avoiding long-term cost-plus contracts,
- improving contract oversight,
- implementing a cost accounting and labor distribution system, and
- identifying ways to increase workforce productivity

will be key to effectively manage the Agency's budget, and this will be the focus of our testimony today.

SAFETY. It is important to note that the U.S. aviation industry continues to be the safest in the world. The January 2003 Air Midwest crash in Charlotte was the only fatal commercial accident in the U.S. in the past 2 years. This past year, FAA has made progress in reducing runway incursions (potential collisions on the ground), but operational errors (when controllers allow planes to come too close together in the air) continue to increase. In FY 2003, runway incursions decreased 4 percent to 324, while operational errors increased 12 percent to 1,186, with an average of 3 operational errors each day and 1 serious error (those rated as high risk) every 7 days.

Additionally, a significant challenge for FAA will be to adjust its safety oversight to emerging trends in the aviation industry, such as outsourcing maintenance. While major air carriers outsourced 37 percent of their aircraft maintenance in 1996, the amount spent on outsourced maintenance increased to 47 percent of maintenance costs in 2002.

OPERATING COSTS. FAA is requesting \$7.849 billion for its FY 2005 operating budget, which is about \$370 million above the FY 2004 enacted amount of \$7.479 billion. Operating costs represent the largest portion of FAA's FY 2005 total budget, over 56 percent, whereas FAA's airports and capital accounts represent 25 percent and 18 percent, respectively. This past year Administrator Blakey and her staff have made notable progress in beginning the process of reining in FAA's history of operating cost growth.

Last year we reported that FAA and the National Air Traffic Controllers Association (NATCA) had entered into numerous sidebar agreements or Memoranda of Understanding (MOUs). Many of those MOUs had significant cost and/or operational impacts on the Agency, but we found that FAA had no controls over the process.

This past year, FAA developed new policies and procedures that, if properly implemented, should significantly improve controls over MOUs. As part of an agreement to extend the controllers' collective bargaining agreement for another 2 years, FAA and NATCA also rescinded or modified many of the most costly MOUs. For example,

- FAA and NATCA rescinded an MOU that allowed controllers transferring to larger consolidated facilities to begin earning the higher salaries associated with their new positions substantially in advance of their transfer or taking on new duties.

However, one costly MOU that we identified last year was not renegotiated. This MOU concerns "Controller Incentive Pay" (CIP), which provides controllers at 110 locations with an additional cost-of-living adjustment of between 1 and 10 percent, which is in addition to Government-wide locality pay. In FY 2003, this additional cost-of-living adjustment cost FAA about \$35.6 million.

FAA also made progress in linking pay and performance—a key tenet of FAA's personnel reform efforts. As part of the 2-year extension of the controllers' agreement, FAA and NATCA agreed to tie a portion of controllers' salary increases to meeting four national performance metrics, which include goals for reducing operational errors and runway incursions. It is important to note, however, that the performance increase represents a very small percentage of the controllers' total annual pay increase. For each goal reached, controllers will receive a pay increase of 0.2 percent. However, even if none of the performance goals are met, controllers will still receive an average increase of about 4.9 percent this year because of contractual requirements.

Achieving substantial reductions in operating costs represents a tremendous challenge because salaries and benefits make up approximately 73 percent of FAA's operating budget. Because FAA's salary base is relatively fixed, it is unlikely that significant reductions in operating cost growth can be achieved in the near term without substantial improvements in the Agency's workforce productivity.

Initiatives such as new air traffic systems, technological improvements, efforts to redesign the National Airspace System, and consolidating locations all have the potential to significantly improve productivity. In the past, FAA has embarked on similar initiatives on a limited basis but was unable to demonstrate any credible gains in productivity partially because FAA did not have systems to accurately capture reliable cost and workforce-related data.

Accurate cost and workforce data are particularly critical in light of the anticipated wave of controller retirements. FAA currently estimates that about 7,000 controllers could leave the Agency over the next decade. Whether FAA will need to replace all of them on a one-for-one basis depends on many factors, including future air traffic levels, new technologies, and initiatives that FAA undertakes in its hiring and training process. However, it is clear that as a result of the anticipated increases in attrition, FAA will begin hiring and training controllers at levels the Agency has not experienced since the early 1980s.

A substantial challenge for FAA will be to hire and train new controllers within a tightly constrained operating budget. FAA has recently made significant progress in this area by renegotiating several pay rules with NATCA that previously allowed some newly hired controllers to earn base salaries in excess of \$79,000 while in training. The renegotiated rules now allow FAA to set newly hired controllers' salaries at levels that are more commensurate with an entry-level

position (from \$25,000 to \$52,000), which should help FAA avoid higher costs as it begins hiring and training greater numbers of new controllers.

We have just completed an audit of this issue and will be issuing a report next month. We found that this is an area where management attention is needed to better prepare for the expected increase in retirements. For example, FAA has national estimates of expected attrition within the controller workforce, but those estimates do not take into account where vacancies will occur.

While most locations we visited had estimates of attrition over the next 2 years, they included different information in developing those estimates. One facility only projected mandatory retirements, another projected attrition for transfers but not retirements, and another provided estimates on all types of attrition (i.e., retirements, transfers, hardships, resignations, and removals).

In addition, FAA does not keep national statistics on the controller on-the-job training (OJT) process, which is the longest portion of controller training. At the locations we visited, we found that the overall time required for newly hired controllers to become certified averaged 3.1 years, but in some cases it took as long as 7 years. To effectively manage the OJT process as hiring increases, FAA will need data such as the time and costs required to complete OJT, the number of training failures, and any delays in the process to benchmark against and improve the time and costs associated with OJT.

The expected increase in controller attrition reinforces the need for FAA to have its cost accounting and labor distribution systems in place and operating effectively. This past year, FAA has made some progress with its cost accounting system, but there has been very little progress in fielding the labor distribution system planned for air traffic employees. That system is critical for managing the

expected wave of controller retirements. FAA is aware of this need and the Chief Operating Officer for the Air Traffic Organization has committed to putting both of these systems in place.

MAJOR ACQUISITIONS. FAA modernization projects have historically experienced considerable cost growth, schedule slips, and shortfalls in performance. In the current budget environment, cost growth and schedule slippages experienced in the past are no longer affordable or sustainable. Cost and schedule problems with ongoing modernization efforts have serious consequences because they result in postponed benefits, the crowding out of other modernization projects, costly interim systems, or a reduction in the number of units procured. In the past, the severity of these problems has been masked by the size of a modernization account that either grew or stayed constant.

We note that FAA has made downward adjustments in its FY 2005 request for a number of modernization projects. These projects have merit but they face fundamental problems with respect to misjudging technological maturity, unexpected cost growth, or concerns about how to move forward in a cost-effective way.

- The *Local Area Augmentation System* (LAAS) is a new precision approach and landing system. In December 2002, we reported that expectations for the cost, schedule, and performance of the new system needed to be reset because the new landing system was not as mature as FAA expected. Category I LAAS was planned for 2006, and more demanding Category II/ III performance is now a research and development effort with uncertain completion dates. After assessing contractor progress, FAA believes that it will take considerably longer, as much as 21 months, to complete just the first phase of LAAS.

- *Controller-Pilot Data Link Communications (CPDLC)* is a new way for controllers and pilots to share information that is analogous to wireless email. FAA is deferring plans for CPDLC because of concerns (1) about how quickly users would equip with new avionics, (2) that the approved program baseline of \$167 million was materially understated and no longer valid, and (3) about the impact on the operations account, which is already overburdened.
- *Next Generation Air-to-Ground Communications System (NEXCOM)* is an effort to replace aging analog radios and foster the transition to digital communications. The first segment of NEXCOM (new radios and new ground infrastructure for digital communications) was expected to cost \$986 million. However, the full cost of implementing NEXCOM throughout the National Airspace System was uncertain, but later segments were estimated to cost \$3.2 billion. In addition, NEXCOM was controversial with airlines because of FAA's preferred technology. While FAA will move forward with replacing older radios, it has postponed making decisions about NEXCOM ground system development.

While we see positive signs that the Administrator and her team are addressing fundamental problems with major acquisitions, additional steps are needed.

- Developing reliable cost and schedule estimates: Last year, we reported that despite the benefits of acquisition reform granted in 1996, cost growth and scheduled slips in modernization efforts are all too common. For example, we analyzed 20 major acquisition projects and found that 14 of these projects experienced cost growth of over \$4.3 billion (from \$6.8 billion to \$11.1 billion), which represents considerably more than the FAA's annual appropriation for modernizing the National Airspace System.

For example, the cost of the *Standard Terminal Automation Replacement System (STARS)*, which will supply new controller displays and related computer equipment for FAA's terminal facilities, has nearly doubled from \$940 million to \$1.69 billion.

FAA has already obligated \$1.1 billion through FY 2003 and has installed 20 STARS systems, of which 19 are operational. The Agency is currently reviewing its deployment plans. We reported in September 2003 that STARS is not the same program that was planned 8 years ago. The program has shifted from a commercial off-the-shelf procurement to one that has required more than \$500 million in development costs. Moreover, because of cost growth and a schedule slip to FY 2012, the benefits that supported the initial acquisition are no longer valid.

The FY 2004 Appropriations Conference Report directs our office to review and validate the Agency's revised STARS lifecycle cost estimates. We are encouraged that FAA has made recent changes in the STARS program. To control cost growth, FAA has developed a phased approach to STARS that will use a fixed price contract and consider contractor performance before moving to the next phase. Last Tuesday, FAA approved the first phase limiting STARS to 50 locations. FAA is also developing a business case to complete its terminal modernization program. When FAA has completed its business case, we will review and validate the cost estimates.

- Avoiding long-term cost-plus contracts: Our work on the cost, schedule, and performance problems of 20 major FAA acquisitions illustrates why the Agency needs to avoid entering into long-term cost-plus contracts before Agency requirements and user needs are fully understood. Cost growth associated with additional development work and changing requirements for

both STARS and the Wide Area Augmentation System was absorbed fully by the Government and ultimately the taxpayer.

FAA is now undertaking a large and complex automation effort through a long term, cost-plus contract called the *En Route Automation Modernization* (ERAM) program, which FAA estimates will cost about \$2 billion between now and 2011. FAA expects to spend over \$200 million annually on the project beginning in FY 2005. ERAM is designed to replace the Host Computer System, the central nervous system for facilities that manage high-altitude traffic.

One significant exception to programs with major cost overruns with cost-plus contracts is the *Advanced Technologies and Oceanic Procedures* program (ATOP), an effort to modernize FAA facilities that manage air traffic over the Atlantic and Pacific Oceans. Because FAA has relied on what is largely a fixed price contract and kept requirements stable, the costs associated with additional software development and correcting software problems discovered during testing, until recently, have been absorbed by the contractor.

Due to software development problems and pending delays, FAA modified the contract and increased its value by \$11 million in an effort to maintain the Agency's schedule for deploying the new system to Oakland by the end of June. This is a modest adjustment compared to what we have seen with other modernization projects that relied on cost-plus contracts.

While the \$11 million can be accommodated in the current ATOP cost baseline, the critical issue is what happens between now and February 2005. This time frame is important because the recent contract modification limits the contractor's responsibility for paying to fix software problems FAA finds

in ATOP after February 28, 2005. FAA expects to complete work on the initial version of ATOP software (required for Oakland) shortly and plans to test the more advanced version of ATOP software by the end of this year. Given the change in the contract and tight time frames, it will be critical for FAA to identify all software problems before February 28, 2005.

- Improving contract management: Last year, we reported that FAA's management of cost-reimbursable contracts was deficient, lacked accountability, and did not adequately protect against 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 reliable Government cost estimates were prepared and used in evaluating contracts, and (3) properly account for billing and expenditures to prevent overpayments. For example, our current audit work has identified that FAA officials did not obtain audits of 17 cost-reimbursable contracts with a total value of \$6.7 billion.

In January 2004, when we rendered our opinion on the Department's financial statements, we identified these deficiencies as a material weakness, and FAA is implementing a detailed action plan to correct the deficiencies. We are working with FAA to ensure that these actions are fully implemented. We do want to note that FAA achieved a "clean" opinion on its FY 2003 financial statements.

AIRPORTS. Finally, funding for the airport improvement programs (AIP) has seen substantial increases over the past several years. FAA's AIP account has increased from \$1.5 billion in 1996 to \$3.5 billion in 2005. This is on top of passenger facility charges (PFCs) that airports collect (up to \$4.50 per passenger)

that FAA estimates will generate over \$2 billion in fees in 2004. FAA projections suggest that a similar amount will be collected in 2005.

The increased amounts of AIP funding and PFC collections are directed by law toward airport-related projects, such as new runways. However, FAA also incurs costs to its other accounts in order to support many of the airport projects. For example, FAA's Facilities and Equipment (F&E) and Operations accounts bear the cost of air traffic related projects, such as new weather or instrument landing systems and the redesign of airspace to support new runways.

An emerging issue for FAA's budget is whether or not airport funds should be used to support some air traffic control related projects. In its budget request, FAA observes that new systems once considered beneficial to FAA air traffic operations have evolved to provide significant benefits to airport operators and users. FAA's budget submission identifies several systems that should be considered for AIP funding instead of funding from the F&E account.

Although AIP funds can be used for this purpose, the change would represent a shift in the allocation of budgetary resources. FAA estimates that this would impact the AIP account in FY 2005 by about \$30 million, but this number could grow as more capacity projects come on line. Accordingly, FAA needs to identify and quantify all the specific systems that will be needed to support new infrastructure projects and then identify the funding sources that will be used to pay for them.

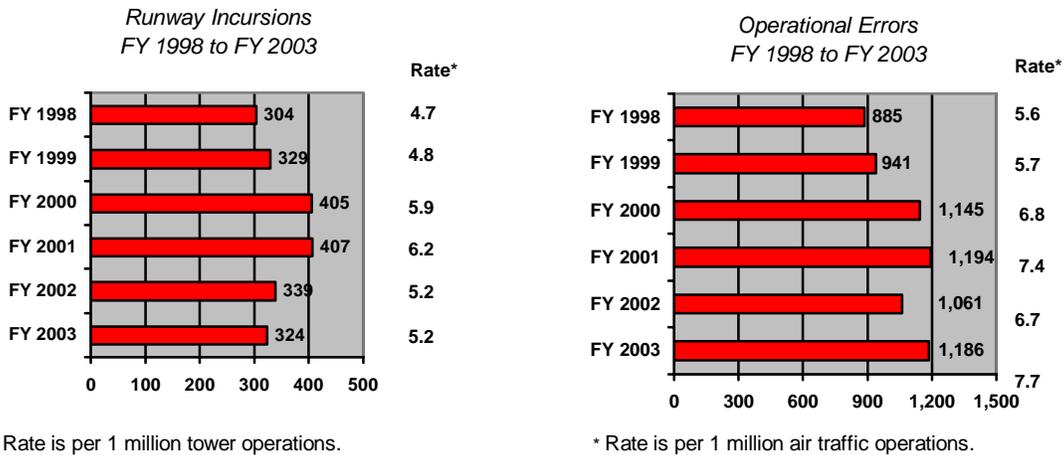
A longstanding problem that we continue to address through our work is diversion of airport revenues by airport sponsors or owners. We have been reviewing revenue diversions for over 13 years. Between 1991 and 2000, our audits disclosed over \$344 million in diverted revenue. Last year, we reported on

revenue diversions at five large airports, including one airport whose sponsor, a local government agency, diverted about \$40 million to projects not related to the airport.

Our work shows that FAA's oversight of revenue diversions is limited. In the past, FAA has maintained that it did not have the resources to devote to this issue. We recently met with the Associate Administrator for Airports and members of her staff to discuss FAA's specific plans to increase the Agency's oversight of revenue diversions. We plan to meet next month to review progress and discuss how we can coordinate efforts. These are steps in the right direction; the key now is follow-through.

AVIATION SAFETY ISSUES

In terms of safety, FAA and U.S. air carriers have maintained a remarkable safety record. The January 2003 Air Midwest crash in Charlotte was the only fatal commercial accident in the past 2 years. However, operational errors pose a significant safety risk, with an average of three operational errors per day and one serious error (those rated as high risk) 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. Additionally, while runway incursions have continued to decline for a second year in a row, there is still an average of nearly 1 runway incursion per day and an average of 1 serious runway incursion every 11 days (those incursions that barely avoided or had significant potential for a collision).



As shown in the following table, while the total number of runway incursions has decreased, during the first 6 months of FY 2004, the most serious runway incursions have increased. Also, the total number of operational errors continue to increase, even though the most serious, or high severity, operational errors decreased during this same time period.

Table. Runway Incursions and Operational Errors

	October 1, 2003 through March 31, 2004*					
	Total Incidents			Most Serious Incidents		
	FY 2003	FY 2004	Percent Change	FY 2003	FY 2004	Percent Change
Runway Incursions	165	157	(5%)	13	18	38%
Operational Errors	495	511	3%	27	21	(22%)

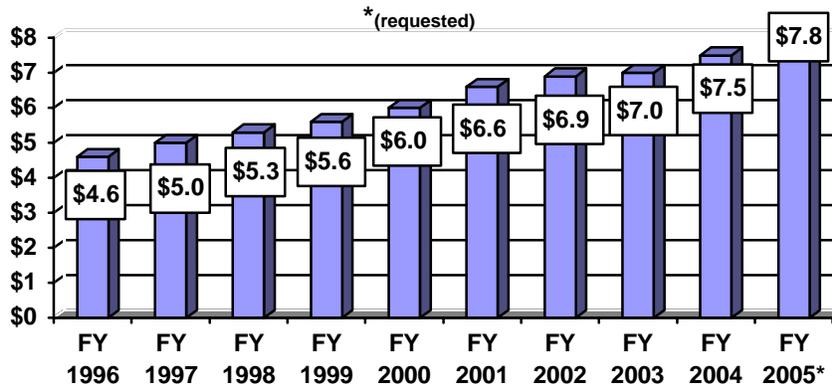
*FY 2004 information is preliminary as all incidents may not have received a final severity rating. Serious incidents for runway incursions include category A and B incidents. Serious incidents for operational errors include high-severity incidents.

This past year, we also reported that improvements are needed in FAA’s oversight of a growing trend toward air carrier use of outsourced maintenance facilities. 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.

ABATING A TREND OF OPERATING COST GROWTH

FAA is requesting \$7.849 billion for its FY 2005 operating budget, which is about \$370 million above the FY 2004 enacted amount of \$7.479 billion. Operating costs represent the largest portion of FAA’s FY 2005 total budget, over 56 percent, whereas FAA’s airports and capital accounts represent 25 percent and 18 percent respectively. As shown in the following graph, FAA’s operating costs have been increasing substantially over the past 9 years.

Figure 1. FAA's Operations Budget - FY 1996 to FY 2005*
\$ in Billions



This past year Administrator Blakey and her staff have made notable progress in beginning the process of reining in FAA’s history of operating cost growth. Several areas stand out in particular.

- **MOUs.** Last year, we reported that FAA and the National Air Traffic Controllers Association (NATCA) had entered into numerous sidebar agreements or Memoranda of Understanding (MOUs). Many of those MOUs had significant cost and/or operational impacts to the Agency, but we found that FAA had virtually no controls over the process. This past year, FAA developed new policies and procedures that, if properly implemented, should significantly improve controls over MOUs. As part of an agreement to extend the controllers’ collective bargaining agreement for another 2 years, FAA and

NATCA also rescinded or modified many of the most costly MOUs. For example,

- FAA and NATCA rescinded an MOU that allowed controllers transferring to larger consolidated facilities to begin earning the higher salaries associated with their new positions substantially in advance of their transfer or taking on new duties. At one location, controllers received their full salary increases 1 year in advance of their transfer (in some cases going from an annual salary of around \$55,000 to over \$99,000). During that time, they remained in their old location, controlling the same airspace, and performing the same duties. At three locations alone, we found FAA incurred over \$2.2 million in unnecessary one-time costs as a result of this MOU.
- FAA and NATCA also renegotiated another MOU for a new free flight tool that originally gave each controller two \$250 cash awards and a time-off award of 24 hours for meeting certain training milestones on the new system. The MOU contained no distinction of awards for individual contributions other than coming to work and attending training. At six facilities alone, this MOU resulted in FAA incurring approximately \$1.3 million in individual cash awards and 62,500 hours in time off, which is the equivalent of approximately 30 full-time positions.

However, one costly MOU that we identified last year was not renegotiated. This MOU concerns “Controller Incentive Pay” (CIP), which provides controllers at 110 locations with an additional cost-of-living adjustment of between 1 and 10 percent, in addition to Government-wide locality pay. For example, like all other Federal and FAA employees in the Washington Metropolitan area, controllers receive 14.63 percent in Government-wide locality pay (for CY 2004). However, as a result of this MOU:

- Controllers at Dulles International also receive 4.6 percent in CIP;
- Controllers at Reagan National also receive 3.3 percent in CIP;
- Controllers at Andrews Air Force Base also receive 5.9 percent in CIP; and
- Controllers at Baltimore Washington International also receive 1.7 percent in CIP.

In FY 2003, this additional cost-of-living adjustment cost FAA about \$35.6 million.

- **Flight Service Stations.** Another area of progress this past year is FAA’s A-76 study of its flight services functions, which provide general aviation pilots with aeronautical information and services such as weather briefings, flight planning assistance, and aeronautical notices. In December 2001, we issued a report

showing that FAA could save approximately \$500 million over 7 years by consolidating its automated flight service stations in conjunction with deployment of new flight services software. In response, FAA began an A-76 study to determine if flight services should be retained within the Government or contracted out.

FAA has made strides in the process this past year. FAA plans to review proposals from several contractors, as well as the Government's "More Efficient Organization" proposal, within the next several months and believes it will be ready to make a final determination by March 2005. A key challenge will be completing those actions under what are already tight timeframes. Keeping this process on track is important because the potential for cost savings is significant. FAA is requiring a 22 percent cost savings, or about \$478 million, over 5 years as a selection factor for determining if a proposal will be considered.

- **Pay for Performance.** FAA also made progress in linking pay and performance—a key tenet of FAA's personnel reform efforts. As part of the 2-year extension of the controllers' agreement, FAA and NATCA agreed to tie a portion of controllers' salary increases to meeting four national performance metrics: (1) a reduction in the number of operational errors, (2) a reduction in the number of runway incursions, (3) improvements in arrival efficiency rates, and (4) improvements in on-time performance.

This now means that 78 percent of FAA's workforce will be on a pay-for-performance plan, up from 36 percent last year at this time. It is important to note, however, that in the case of controllers, the performance increase represents a very small percentage of their total annual pay increase. For each goal reached, controllers will receive a pay increase of 0.2 percent. However, even if none of the performance goals are met, controllers will still receive an average increase of 4.9 percent this year because of contractual requirements.

Other FAA employees who are on other pay systems will receive different pay increases. For example, non-bargaining unit employees on the Agency's "core compensation plan" will receive a 4.5 percent average pay increase. However, those employees are still eligible to receive a performance increase, which averages about 0.6 percent, based on an individual's job performance and not on specific goals as in the case of controllers.

- **FAA Review of Overtime and Sick Leave Usage.** In the past, our office received several hotline complaints alleging that FAA employees at five large facilities were abusing credit hours and manipulating work schedules to increase overtime. When we made FAA aware of the allegations, the Agency

took little or no action. Recently, however, we met with senior FAA officials who briefed us on measures taken to identify and address the allegations at two of the cited locations. According to FAA managers, the actions taken during the previous fiscal year have resulted in a \$4 million reduction in personnel costs and a 19 percent reduction in overtime costs. These actions appear to be steps in the right direction, but it is unclear what measures have been taken at the other FAA facilities identified in the hotlines. Accordingly, we are initiating a review of the measures planned and taken at each location cited in the hotline complaints and will be issuing a report within the next few months.

Mr. Chairman, the actions taken by the Administrator and her staff this past year are encouraging. However, it is important to keep in mind that achieving significant reductions in operating costs represents a tremendous challenge. This is because salaries and benefits make up approximately 73 percent of FAA's operating budget or about \$5.7 billion in FY 2005.

FAA's operating costs are further compounded by the fact that FAA has a very high average salary base. For example, last year, the average base salary for all FAA employees was over \$87,000. We estimate that this year, the average base salary for controllers, FAA's largest workforce, will be about \$111,000,² which is exclusive of premium pay. Against FAA's high salary base, pay increases (which are a percentage of base pay) result in large dollar increases to FAA's operating costs. For example, FAA's FY 2005 budget request of \$7.8 billion for operations is a total increase of about \$370 million over FY 2004 appropriations. However, FAA estimates that approximately \$200 million of the \$370 million will be consumed by pay increases alone.

Because FAA's salary base is relatively fixed, it is unlikely that significant reductions in operating cost growth can be achieved without substantial improvements in the Agency's workforce productivity. Initiatives such as new air traffic systems, technological improvements, efforts to redesign the National Airspace System, and consolidating locations all have the potential to significantly improve productivity. In the past, FAA has embarked on similar initiatives on a limited basis, but it was unable to demonstrate any credible gains in productivity partially because FAA did not have systems to accurately capture reliable cost and workforce-related data.

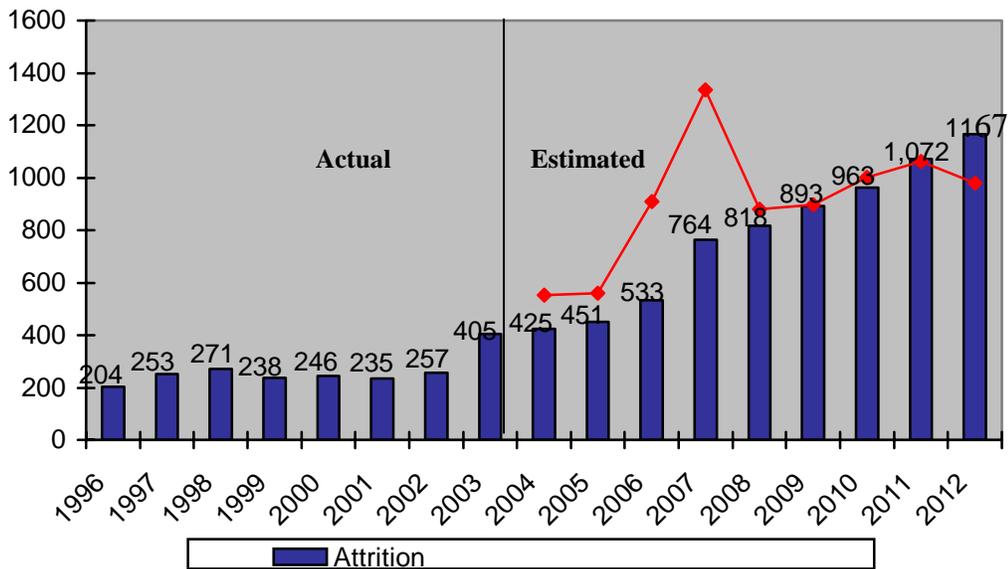
Expected Increases in Controller Attrition. A significant issue for FAA is the expected increase in controller attrition. Attrition in FAA's air traffic controller workforce is expected to rise sharply in upcoming years as controllers hired after

² Based on a 4.9 percent average increase, which does not take into account possible additional increases for meeting performance goals.

the 1981 Professional Air Traffic Controllers Organization controllers' strike become eligible for retirement. FAA currently estimates that nearly 7,100 controllers could leave the Agency over the next 9 years (FYs 2004-2012). In contrast, FAA has only experienced total attrition of about 2,100 controllers over the past 8 years (FYs 1996-2003).

Whether FAA will need to replace all 7,100 controllers on a one-for-one basis depends on many factors, including future air traffic levels, new technologies, and long-term initiatives that FAA undertakes. However, it is clear that as a result of the anticipated increases in attrition, FAA will begin hiring and training controllers at levels that the Agency has not experienced since the early 1980s.

Figure 2. FAA Air Traffic Controller Attrition Compared to Retirement Eligibility



* Attrition data are as of November 2003. The number of controllers becoming eligible includes only those controllers reaching retirement eligibility in that year and does not include prior years. Retirement eligibility estimates are as of December 31, 2003.

We have just completed an audit of FAA's process for placing and training air traffic controllers and will be issuing a report next month. We found that this is an area where additional management attention is needed. For example:

- FAA has national estimates of expected attrition within the controller workforce, but those estimates do not take into account where vacancies will occur. It is almost certain that many will be at some of the busiest and most critical facilities within the National Airspace System.

- While most locations we visited had estimates of attrition over the next 2 years, they included different information in developing those estimates. One facility only projected mandatory retirements, another projected attrition for transfers but not retirements, and another provided estimates on all types of attrition (i.e., retirements, transfers, hardships, resignations, and removals).
- In addition, FAA does not currently have a selection process for determining if newly hired controllers have the knowledge, skills, and abilities to complete training and become certified at the facility level of their assigned location.
- FAA does not keep national statistics on the controller on-the-job training (OJT) process, which is the longest portion of controller training. At the locations we visited, we found the overall time required for newly hired controllers to become certified averaged 3.1 years but in some cases took as long as 7 years. To effectively manage the OJT process as hiring increases, FAA will need data such as the time and costs required to complete OJT, the number of training failures, and delays in the process to benchmark against and improve the time and costs associated with OJT.

A substantial challenge for FAA will be to hire and train new controllers within a tightly constrained operating budget. FAA has recently made significant progress in this area by renegotiating several pay rules with NATCA that previously allowed some newly hired controllers to earn base salaries in excess of \$79,000 while in training. The renegotiated rules now allow FAA to set newly hired controllers' salaries at levels that are more commensurate with an entry-level position (from \$25,000 to \$52,000), which should help FAA avoid higher costs as it begins hiring and training greater numbers of new controllers.

One point worth noting, Mr. Chairman, is that new controllers will generally have lower base salaries than the retiring controllers they replace. Over time, this could help reduce FAA's average base salary and, in turn, help reduce FAA's operating cost growth. However, if FAA does not place new controllers where and when they are needed, the potential reductions in base salaries will be offset by lower productivity as a result of placing too many or too few controllers at individual facilities.

To effectively manage the expected increase in controller attrition, FAA needs accurate cost and workforce data, which underscores the urgency of getting the Agency's cost accounting and labor distribution systems in place and operating effectively. The Chief Operating Officer for the Air Traffic Organization has committed to putting both of these systems in place. This past year, FAA has made some progress with its cost accounting system, but there has been very little

progress in fielding the labor distribution system planned for air traffic employees. That system is critical for managing the expected wave of controller retirements.

- **Cost Accounting.** In 2003, FAA's cost accounting system was partially operational in two of FAA's five lines of business. FAA produced limited cost accounting information for the Air Traffic Services line of business, a major component of the new Air Traffic Organization, and for the Commercial Space Transportation line of business. FAA made progress during the year by assigning some overhead costs properly, but much more needs to be done. For example, FAA is unable to assign about \$1.3 billion of costs to individual facilities. Until these costs can be assigned, managers will lack the information they need to determine the true cost of facility operations.
- **Labor Distribution.** CRU-X is the labor distribution system FAA chose to track hours worked by air traffic employees. As designed, CRU-X could have provided credible workforce data for addressing concerns about controller staffing, related overtime expenditures, and help determine how many controllers are needed and where. However, CRU-X has not been deployed as designed because of a September 2002 agreement between FAA and NATCA that limited the system's capability to gather data regarding workforce productivity. Specifically, the agreement eliminated (1) requirements for controllers to sign in and out of the system when arriving or leaving work, and (2) tracking time spent by employees performing collateral duties.

In February 2004, FAA provided NATCA with substantive changes planned for the system and began negotiations with the union in March. FAA and NATCA need to complete actions to resolve internal control deficiencies with CRU-X and implement the system as quickly as possible so the Agency and union have objective data to determine how many controllers are needed and where.

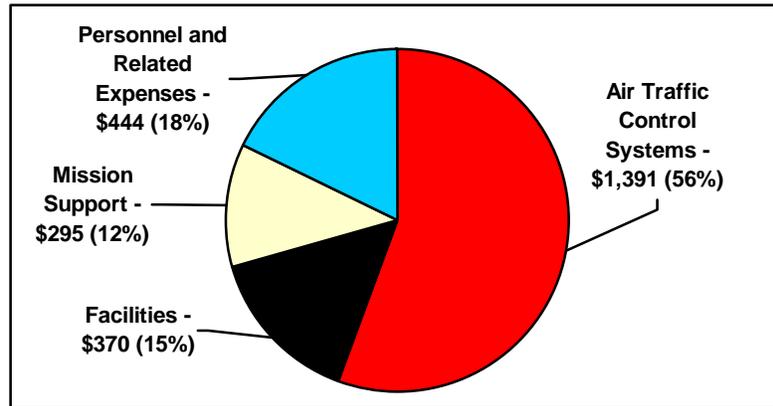
BRINGING FISCAL DISCIPLINE AND ACCOUNTABILITY TO FAA MODERNIZATION EFFORTS

FAA is requesting \$2.5 billion for the Facilities and Equipment account for FY 2005. This represents a reduction of over \$350 million from last year's appropriated level of \$2.86 billion and nearly \$500 million less than the authorized level. Historically, FAA's modernization projects have experienced considerable cost growth, schedule slips, and shortfalls in performance.

In the current budget environment, cost growth and schedule slippages experienced in the past are no longer affordable or sustainable. As the following chart shows, only 56 percent of FAA's \$2.5 billion budget request for Facilities

and Equipment is for developing and acquiring air traffic control modernization projects. The remaining funds are for salaries, FAA facilities, and mission support.

Figure 3. FAA's FY 2005 Facilities and Equipment Budget Request
\$ Millions



Source: FAA

(Percentages may not add up to 100% due to rounding)

Cost and schedule problems with ongoing modernization efforts have serious consequences because they result in postponed benefits (in terms of safety and capacity), the crowding out of other modernization projects, costly interim systems, or a reduction in units procured. In the past, the severity of these problems has been masked by the size of a modernization budget that either grew or stayed constant.

Adjustments to FAA Modernization Projects. FAA has reduced or eliminated funding in its FY 2005 request for a number of modernization projects, including, the *Local Area Augmentation System*, *Controller-Pilot Data Link Communications*, and the *Next Generation Air to Ground Communications System*. These efforts were longer-term in nature and called for airspace users to purchase and install new avionics. Funding reductions also reflect an emphasis on near-term FAA infrastructure projects.

These projects have merit but they face problems irrespective of funding that needed to be addressed with respect to misjudging technological maturity, unexpected cost growth, or concerns about how to move forward.

- *The Local Area Augmentation System (LAAS)*—is a new precision landing and approach system. It was expected to cost \$696 million and to be deployed in 2006, 4 years later than originally planned. FAA is not requesting funds for LAAS in FY 2005 and will use funds from FY 2004 to

continue work on the new system. In December 2002, we reported that expectations with respect to cost, schedule, and performance needed to be reset because the new landing system was not as mature as FAA expected.³ Category I LAAS was planned for 2006 and the more demanding CAT II/III LAAS is now a research and development effort with uncertain completion dates.⁴

Considerably more development work is required for LAAS than FAA expected just a year ago. The key issue is how to ensure the system will work as safely as intended. After assessing contractor progress, FAA estimated that it could take up to 21 months and an additional \$37 million for the contractor to recover and complete just the first phase for LAAS.

- *Next Generation Air-to-Ground Communications System (NEXCOM)*—is an effort to replace aging analog radios and foster the transition to digital communications. The first segment of NEXCOM (new radios and new ground infrastructure for digital communications) was expected to cost \$986 million. FAA is requesting \$31 million for NEXCOM in FY 2005, \$54 million less than last year's appropriated level of \$85 million. FAA will move forward with replacing older radios (the least complex element of the NEXCOM effort) but has postponed making decisions about NEXCOM ground system development and is re-evaluating its approach for modernizing the air to ground communications. The full cost of implementing NEXCOM throughout the NAS was uncertain but later segments were estimated to cost \$3.2 billion. Also, NEXCOM has been controversial with the airlines because of FAA's preferred technology.

FAA's decision to postpone decisions about NEXCOM gives the Agency opportunities to develop a cost-effective approach for meeting the air-to-ground communications needs of the National Airspace System. While FAA replaces older radios, the Agency needs to determine how it will (1) sustain existing communications infrastructure, and (2) address frequency congestion problems in the short term, (3) meet the communications needs of FAA and airspace users in the most cost-effective way.

- *Controller-Pilot Data Link Communications (CPDLC)*—is a new way for controllers and pilots to share information that is analogous to wireless

³FAA Needs to Reset Expectations for LAAS Because Considerable Work Is Required Before It Can Be Deployed for Operational Use (Av-2003-006, December 16, 2002).

⁴ CAT I precision approach has a 200 foot ceiling/decision height and visibility of ½ mile. CAT II precision approach has a 100 foot ceiling/decision height and visibility of ¼ mile. CAT III precision approach and landing has a decision height and visibility of less than 100 feet down to the airport surface.

email and considered an enabling technology for Free Flight. FAA began using CPDLC at Miami Center in October 2002 and planned to deploy the system to other facilities that manage high altitude traffic at a cost of \$167 million. FAA deferred these plans for expanding CPDLC last year. The Conference report for the FY 2004 Appropriations Act directed our office to look into, among other things, the circumstances leading to termination of the CPDLC program and what control could have been put in place to avoid a program failure of this type.

We found that a number of factors contributed to FAA's decision, including concerns about how quickly users would equip with new avionics and the fact the approved program baseline of \$167 million was no longer valid. FAA estimates that it would cost \$236.5 million for eight locations—an increase of \$69 million for fewer than half the locations initially planned.

Another factor was the impact on the operations account, which is already overburdened. CPDLC would have added \$63 million in cost to the operations account for, among other things, controller training and overtime (for just eight locations), and \$20 million annually for the cost of data link messages. We are continuing our work on CPDLC and will report back to this Committee later this year.

We see positive signs that the Administrator and her team are addressing problems with major acquisitions. However, there should be no mistake that FAA's efforts are in the early stages and a number of fundamental steps are needed. They include:

- Developing reliable cost and schedule estimates,
- Avoiding long-term cost-plus contracts, and
- Establishing controls to prevent waste and abuse.

Developing Reliable Cost and Schedule Estimates. Last year, we reported that despite the benefits of acquisition reform granted in 1996, cost growth and scheduled slips in modernization efforts are all too common. For example, we analyzed 20 major acquisition projects and found that 14 of these projects experienced cost growth of over \$4.3 billion (from \$6.8 billion to \$11.1 billion), which represents considerably more than the FAA's annual appropriation for modernizing the National Airspace System. Also, 13 of the 20 projects accounted for delays ranging from 1 to 7 years. FAA recognizes these problems and the Agency's strategic plan—Flight Plan 2004-2008—establishes a performance target so that 80 percent of critical acquisitions are both on schedule and within 10 percent of budget. This is an important step.

A number of key modernization projects that have been delayed still do not have reliable cost and schedule baselines. Without better information, FAA cannot effectively plan, manage the modernization portfolio, or determine what is affordable. The following table provides information on selected acquisitions that do not have reliable cost and schedule baselines.

**Table. Four Key Projects Needing Updated Cost and Schedule Baselines
(\$ in Millions)**

Program	Estimated Program Costs (Dollars in Millions)		Percent Cost Growth	Implementation Schedule		Schedule Delay
	Original	Current		Original	Current	
Wide Area Augmentation System	\$892.4	\$2,922.4*	227%	1998-2001	2003-TBD**	5 years
Standard Terminal Automation Replacement System	\$940.2	\$1,690.2	80%	1998-2005	2002-2012**	7 years
Airport Surveillance Radar-11	\$743.3	\$1,040.0	39.9%	2000-2005	2003-2013	8 years
Integrated Terminal Weather System	\$276.1	\$283.7	3%	2002-2003	2003-2008	5 years

* This includes the cost to acquire geostationary satellites.

** Costs and schedules are under review.

Mr. Chairman, I would like to discuss three of these projects.

- *Standard Terminal Automation Replacement System (STARS)* will supply new controller displays and related computer equipment for FAA's terminal facilities. FAA's official STARS acquisition cost estimate has nearly doubled from \$940 million to \$1.69 billion.

FAA has already obligated \$1.1 billion through FY 2003 but has only installed 20 systems, of which 19 are operational. The Agency is currently reviewing its deployment plans. We reported in September 2003 that STARS is not the same program that was planned 8 years ago. The program has shifted from a commercial off-the-shelf procurement to one that has required more than \$500 million in development costs. Moreover, because of cost growth and a schedule slip to FY 2012, the benefits that supported the initial acquisition are no longer valid.⁵ Due to STARS delays, FAA deployed Common Automated

⁵ FAA Needs to Reevaluate STARS Costs and Consider Other Alternatives, AV-2003-058, September 9, 2003.

Radar Terminal System (Common ARTS) hardware and software to 141 terminal facilities over the past 5 years.

In our 2003 report, we recommended that FAA select the most cost-effective and affordable strategy to complete terminal modernization by augmenting STARS deployment with Common ARTS. We estimated that implementing this approach would allow FAA to put at least \$220 million to better use. To date, the Agency has not ruled out keeping some Common ARTS as an alternative if STARS proves to be unaffordable or does not perform as expected.

FAA officials maintain that STARS has important capabilities, such as “Sensor Fusion,” which is designed to merge data from multiple radars on controllers’ displays. However, FAA continues to experience problems with the Sensor Fusion software. We have not yet seen sufficient evidence to justify FAA’s conclusion that the capabilities of STARS are far superior to the capabilities of Common ARTS, and both systems are certified for use in the National Airspace System.

The FY 2004 Appropriations Conference Report directs our office to review and validate the Agency’s revised STARS lifecycle cost estimates. We are encouraged that FAA has made recent changes in the STARS program. To control cost growth, FAA has developed a phased approach to STARS that will use a fixed price contract and consider contractor performance before moving to the next phase. Last Tuesday, FAA approved the first phase, limiting STARS to 50 locations. FAA is also developing a business case to complete its terminal modernization program. When FAA has completed its business case, we will review and validate the cost estimates.

- *The Wide Area Augmentation System (WAAS)* is a new satellite-based navigation system to enhance all phases of flight. The program has a long history of uncertainty regarding how much the system will cost, when it will be delivered, and what benefits can be obtained. Limited WAAS services became available in July 2003, but additional work is needed to expand WAAS coverage through additional ground stations. FAA has obligated over \$800 million on WAAS and expects to spend \$100 million on the new system in FY 2005.

WAAS was expected to provide Category I performance to the majority of the Nation’s airports but will provide something less when the system is deployed. Based on our discussions with FAA, the Subcommittee should expect to see a reduction in overall WAAS baseline costs in the \$300 to \$400 million range to reflect the fact that Agency will not pursue Category I performance.

- *The Integrated Terminal Weather System (ITWS)* - provides air traffic managers with a 20-minute forecast of weather conditions near airports and can help the National Airspace System recover from periods of bad weather. FAA initially planned to complete deployment of 38 systems by 2003 at a cost of about \$276 million, but production costs increased significantly from \$360,000 to \$1 million per system. According to FAA officials, the Agency now plans to establish new cost and schedule parameters this April, and accelerate an ITWS enhancement (the Convective Weather Forecast product) in response to our December 2002 report.

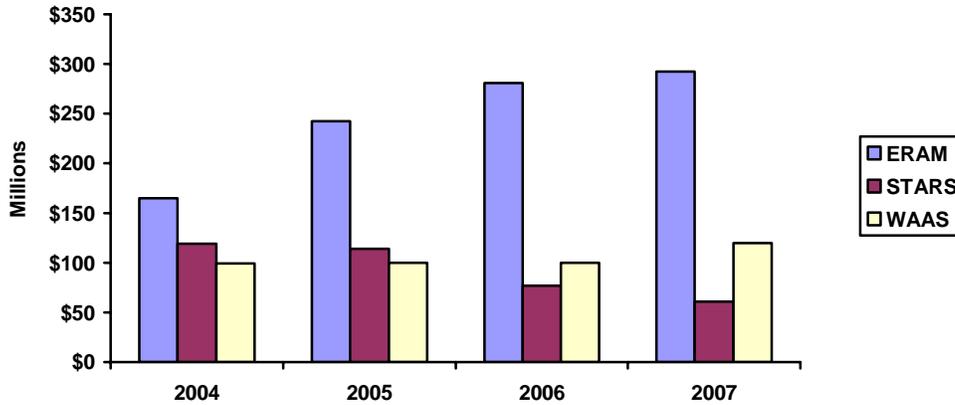
Avoiding Long-Term Cost-Plus Contracts. Our work on the cost, schedule, and performance problems of 20 major FAA acquisitions illustrates why the Agency needs to avoid entering into long-term cost-plus contracts before Agency requirements and user needs are fully understood. Cost growth associated with additional development work and changing requirements for both STARS and WAAS was absorbed fully by the Government. In the future, FAA needs to use a more incremental approach to complex long-term efforts until the scope of work and development are clearly defined and rely more on fixed price contracts.

FAA is now undertaking a large and complex automation effort through a long term, cost-plus contract called the *En Route Automation Modernization (ERAM)* program, which FAA estimates will cost about \$2 billion between now and 2011. FAA expects to spend over \$240 million annually on the project beginning in FY 2005. ERAM is designed to replace the Host Computer System, the central nervous system for facilities that manage high altitude traffic. The FY 2004 Appropriations Conference Report directs our office to look at executability of the program and identify program risks, including security.

The following chart illustrates planned funding for ERAM and as well as funding profiles for STARS and WAAS, two projects that have been delayed for years and do not have reliable cost estimates.⁶ Any cost increases with these programs will have a cascading effect on other efforts and limit FAA's flexibility to begin new projects.

⁶ STARS and WAAS funding profiles are currently under review by FAA.

**Figure 4. Planned Funding for ERAM, STARS and WAAS
Fiscal Years 2004 to 2007
\$ in Millions**



Source: FAA's January 2004 Draft Capital Investment Plan.

Note: Cost and schedule plans for STARS and WAAS are under review.

ERAM is the largest and most complex automation effort FAA has embarked on since the Advanced Automation System. We anticipate completing our first review of this complex program this year. At this stage, we see key ERAM program risks as: (1) an aggressive schedule, (2) complex software development and integration, and (3) successfully managing a long-term cost-plus contract that is already valued at close to \$1 billion. As FAA moves closer to the production phases of ERAM, the Agency should seek opportunities to use fixed-price contracting mechanisms.

One significant exception to programs with major cost overruns is the *Advanced Technologies and Oceanic Procedures* program (ATOP), an effort to modernize FAA facilities that manage air traffic over the Atlantic and Pacific Oceans.⁷ This effort has experienced some serious and unexpected software development and testing problems. Problems are traceable to the fact that the contractor relied on non-development software that could not meet FAA requirements.

In June 2001, FAA awarded a \$217 million contract for ATOP to provide oceanic air traffic systems. Since the contract was awarded, the contractor has experienced problems with software development and testing. As a result, the first phase of testing, known as factory acceptance testing, was completed 12 months behind schedule. In October 2003, FAA began operational testing to determine whether the new automation system would perform as intended. This testing uncovered further software problems that forced FAA to halt testing of ATOP's air traffic

⁷ For additional details on ATOP, see Status Report on FAA's Advanced Technologies and Oceanic Procedures (report number AV-2004-037, March 31, 2004).

management functions. FAA subsequently resumed and completed that round of testing and begin site acceptance testing in April 2004.

FAA has relied on what is largely a fixed price contract and kept requirements stable. Consequently, the costs associated with additional software development and correcting software problems discovered during testing have been absorbed by the contractor—not the Government. However, due to the software problems and pending delays, FAA decided to modify the contract in an effort to maintain the schedule to install the system in Oakland. The modification will expand the use of cost-plus contract elements (including time and materials) and increase the value of the contract by approximately \$11 million.

While this \$11 million adjustment is modest and can be accommodated in the current ATOP cost baseline, the critical issue is what happens between now and February 2005. This time frame is important because the recent contract modification limits the contractor's responsibility for paying to fix software problems FAA finds in ATOP after February 28, 2005. According to FAA, after work on the initial version of ATOP software (required for Oakland) is complete, the Agency will test the more advanced version at its Atlantic City Technical Center by the end of this year. Given the change in the contract and tight time frames, it will be critical for FAA to identify all software problems before February 28, 2005.

We will continue to monitor progress with ATOP. The Conference report accompanying the Appropriations Bill for FY 2004 directed our office to compare FAA's pursuit of oceanic automation capabilities to the experiences of NAVCanada and other oceanic air traffic service providers. We intend to begin work on this later this year.

Improving Contract Management. Last year, we reported that FAA's management of cost-reimbursable contracts was deficient, lacked accountability, and did not adequately protect against 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 reliable Government cost estimates were prepared and used in evaluating contracts, and (3) properly account for billing and expenditures to prevent overpayments.

For example, our current audit work has identified that FAA officials did not obtain audits of 17 cost reimbursable contracts with a total value of \$6.7 billion. In addition, we reported that FAA officials did not ensure that contractor employees were qualified to do the work. For example, a contractor employee charged approximately \$255,000 as a senior systems engineer, even though that

individual had only a Bachelors of Arts Degree in Psychology, and his past work history indicated no experience in engineering.

When we rendered our opinion on the Department's financial statements we identified these deficiencies as a material weakness, and FAA has developed and begun implementation of a detailed action plan to correct the deficiencies. For example, FAA has made progress in reducing the backlog of 459 completed contracts by closing out 279 contracts valued at \$2.55 billion. In addition, FAA is providing adequate funding to perform cost-incurred audits of contract expenditures. Congress provided \$3 million in FY 2004 funds for this purpose, and FAA is establishing procedures to ensure the funds are applied effectively by focusing on larger contracts.

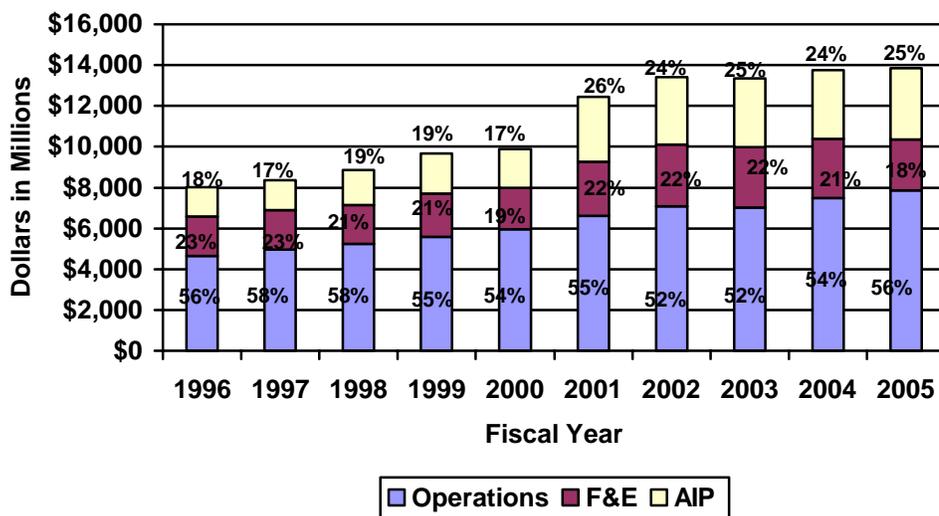
FAA is also establishing a centralized control in FAA headquarters to track the status of all completed and ongoing cost reimbursable contracts in order to meet Congressional direction to audit 100 percent of contracts over \$100 million and 15 percent of contracts less than \$100 million. We are working with FAA to ensure that these plans are implemented.

AIRPORT FUNDING ISSUES

Funding for the airport improvement programs (AIP) has seen substantial increases over the past several years. FAA's AIP account has increased from \$1.5 billion in 1996 to \$3.5 billion in 2005. This is on top of passenger facility charges (PFCs) that airports collect. The maximum amount allowed has increased from \$3.00 to \$4.50 per passenger, and FAA estimates that PFCs will generate over \$2 billion in fees in 2004. FAA projections suggest that a similar amount will be collected in 2005.

The following chart illustrates funding levels for FAA's airports, operations, and facilities and equipment accounts from FY 1996 through FY 2005. It shows that AIP is taking up an increasing share of FAA's overall budget. For example, in FY 1996 AIP made up 18 percent of FAA's total budget whereas in FY 2005 AIP represents 25 percent of the Agency's total budget.

Figure 5. FAA's Budget By Program (FYs 1996-2005)



Emerging Issue for AIP. The increased amounts of AIP funding and PFC collections are directed by law toward airport-related projects, such as new runways. However, FAA also incurs costs to its other accounts in order to support many of the airport projects. For example, FAA's Facilities and Equipment (F&E) and Operations accounts bear the cost of air traffic related projects such as new weather or instrument landing systems and redesigning airspace in order to support new runways.

An emerging issue for FAA's budget is whether or not airport funds should be used to support some air traffic control related projects. In its budget request, FAA observes that new systems once considered beneficial to FAA air traffic operations have evolved to provide significant benefits to airport operators and users. FAA's budget submission identifies several systems that should be considered for AIP funding instead of funding from the F&E account.

Although AIP funds can be used for this purpose, the change would represent a shift in the allocation of budgetary resources. FAA estimates that this would affect the AIP account in FY 2005 by about \$30 million but this number could grow as more capacity projects come on line. Accordingly, FAA needs to identify and quantify all the specific systems that will be needed to support new infrastructure projects and then identify the funding sources that will be used to pay for them.

Revenue Diversions. A longstanding problem that we continue to address through our work is diversion of airport revenues by airport sponsors or owners and a lack of effective FAA oversight. It is a matter of law that all airports receiving Federal

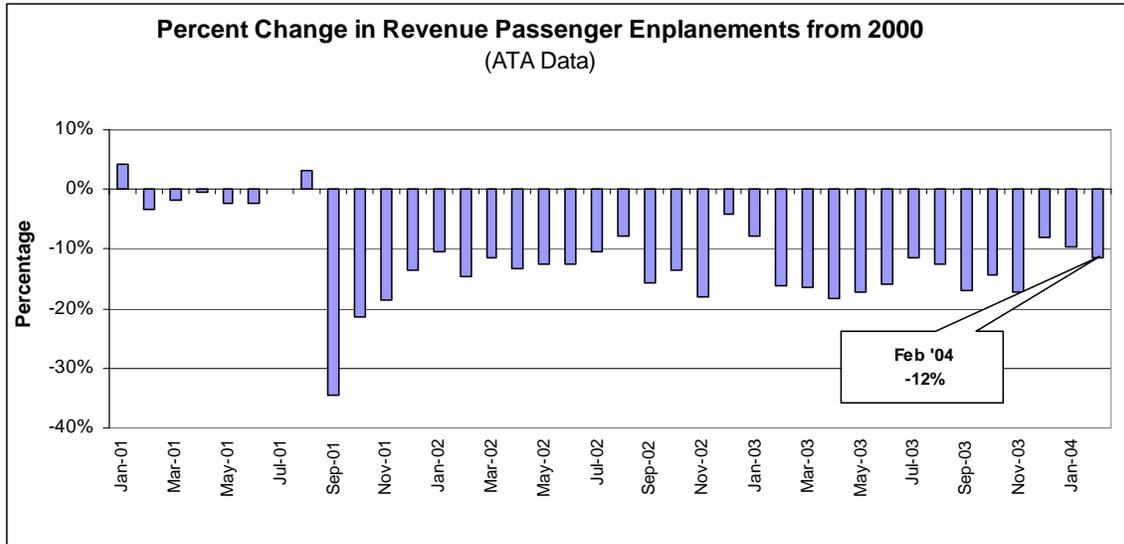
assistance use airport revenues for the capital or operating costs of an airport. Any other use of airport revenue is considered a “revenue diversion.” Examples of common revenue diversions include charges to the airport for property or services that were not provided, indirect costs such as promotional activities that were improperly allocated to the airport, and payments of less than fair market value for use of airport property.

We have been reviewing revenue diversions for over 13 years. Between 1991 and 2000, our audits disclosed over \$344 million in diverted revenue. Last year, we reported on revenue diversions at five large airports, including one airport whose sponsor, a local government agency, diverted about \$40 million to other projects not related to the airport. We also just completed an audit at San Francisco International last month which disclosed about \$12 million in diverted revenue. Additionally, we have begun reviews regarding potential revenue diversion and contracting irregularities at Los Angeles International Airport.

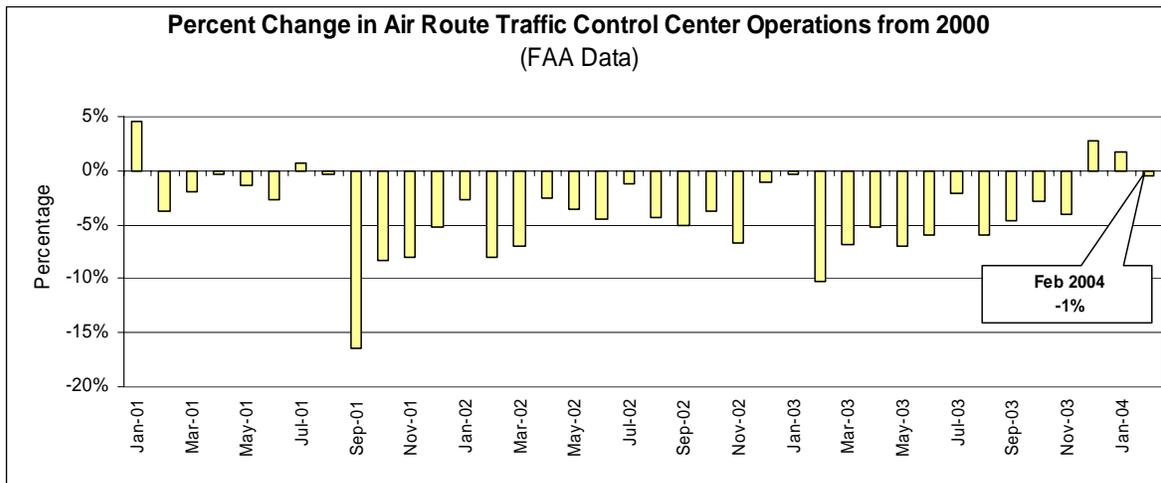
Our work shows that FAA’s oversight of revenue diversions is limited. In the past, FAA has maintained that it did not have the resources to devote to this issue. We recently met with the Associate Administrator for Airports and members of her staff to discuss FAA’s specific plans to increase the Agency’s oversight of revenue diversions. We plan to meet next month to review progress and discuss how we can coordinate efforts. Clearly, these are steps in the right direction, but the key now is follow-through.

BEING POSITIONED FOR A REBOUND IN AIR TRAFFIC

Mr. Chairman, our testimony this morning has focused primarily on cost issues within FAA’s budget. However, an important issue for this Subcommittee is the fact that air traffic levels are beginning to rebound. While domestic traffic levels still fall short of the peaks experienced in 2000, there is no question that traffic is rebounding. In February 2004, the number of revenue passenger enplanements (35.1 million) was down 12 percent from February 2000, but this represents a 5 percent growth over enplanements in February 2003 (33.3 million). While this is good news for the airlines, the increased traffic levels are bringing pressure to bear on our nation’s airports, air traffic control systems, and the traveling public.



Aircraft operations have also increased significantly since September 2001. In February 2004, domestic operations handled by Air Route Traffic Control Centers were less than 1 percent below the operations handled in February 2000. The 3.63 million February 2004 operations represented nearly 11 percent growth over operations handled in February 2003.



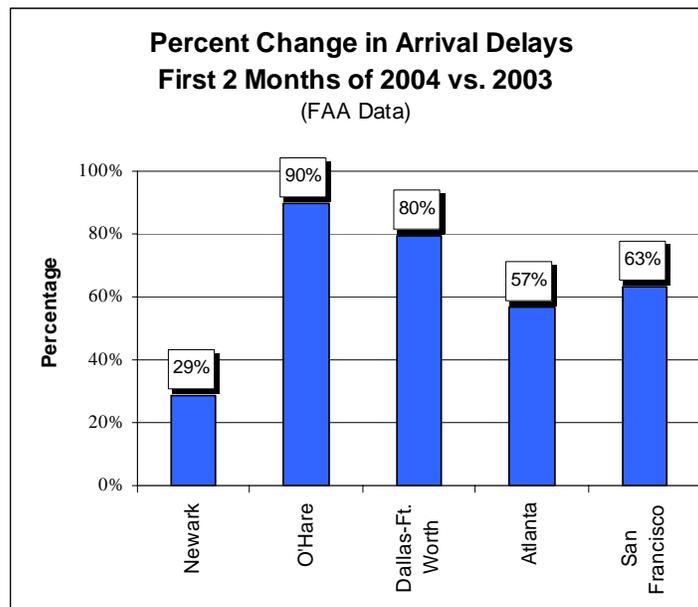
While systemwide operations in February 2004 were slightly down from February 2000, the story is very different on an airport-by-airport basis. In 13 of the 31 largest airports, including some of those that experienced serious delays in 2000, the number of scheduled flights in March 2004 actually exceeded the number of scheduled flights in March 2000. For example, at Denver International, the number of flights scheduled for March 2004 exceeded March 2000 schedules by 10 percent and at Chicago O'Hare, scheduled flights in March exceeded 2000 levels by 9 percent.

In 11 of the 13 airports where March 2004 scheduled flights exceeded March 2000 levels, the number of available seats scheduled still lagged behind the number of available seats offered in March 2000. This is an indication, at least in part, of how network carriers are using regional jets in the place of narrow-body jets to connect traffic to the network hubs.

For example, in Cincinnati, a major Delta hub, scheduled flights in March 2004 were 11.5 percent higher than in March 2000, while available seats were down 7.7 percent. During this same period, regional jets, as a percentage of all aircraft operations in Cincinnati, grew from 53.8 percent to 72.3 percent. Overall, the number of flights scheduled to be operated by regional jets in March 2004 was 134 percent greater than in March 2000.

The growth in aircraft operations, especially at some of what have historically been our nation's busiest airports creates a situation that merits careful monitoring. Although systemwide arrival delays in January and February 2004 were still 22 percent below those experienced in the first 2 months of 2000, the number is up 33 percent from the same period in 2003.

In some individual markets, the growth is particularly pronounced. At Chicago O'Hare, arrival delays during the month of March 2004 represented a 74 percent increase over delays during the same period in 2003, down from the 90 percent increase during the first 2 months of 2004. At Dallas-Fort Worth, arrival delays in January and February combined were up 80 percent over the same period in 2003.



The Department and FAA are aware of this growth in delays and the potential near-term affects on the quality of air transportation service if the growth goes unchecked. The Subcommittee should also follow the situation closely. It is unlikely that the situation will reach the level of widespread system failures we experienced in the summer of 2000, but it is possible that some airports could experience disruptions in service. The FAA and the Department have been working with the industry to identify potential solutions to delay problems that might occur this summer such as high-altitude express lanes and voluntary schedule reductions.

One situation that bears watching, in particular, is the expected service growth at Washington's Dulles Airport. In June, when Independence Air is launched by former regional carrier Atlantic Coast Airlines as a new low-fare carrier, traffic at Dulles will increase significantly. Executives at Independence Air anticipate operating between 200 and 300 daily departures primarily between Dulles and East Coast destinations.

Assuming that United does not reduce service in any of the markets it had previously served using Atlantic Coast Airlines as a regional partner – and it has made no indications that it plans to do so – daily aircraft operations at Dulles could increase by more than 50 percent this summer. In addition to airside congestion, there are concerns with airport terminal services, including the resources needed to process a significantly increased number of passengers through security checkpoints.

That concludes my statement,⁸ Mr. Chairman. I would be pleased to address any questions you or other members of the Subcommittee might have.

⁸ This testimony was conducted in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States. The work supporting this testimony was based on prior and ongoing audits conducted by the Office of Inspector General. We updated material to reflect current conditions or to reflect FY 2005 budget requests as necessary.

RELATED OFFICE OF INSPECTOR GENERAL REVIEWS 1998 - 2004

Operations

- Using CRU-X to Capture Official Time Spent on Representational Activities – AV-2004-033, February 13, 2004
- FAA’s Management of Memorandums of Understanding with the National Air Traffic Controllers Association – AV-2003-059, September 12, 2003
- Safety, Cost and Operational Metrics of the Federal Aviation Administration’s Visual Flight Rule Towers – AV-2003-057, September 4, 2003
- FAA’s Oversight of Workers’ Compensation Claims in Air Traffic Services – AV-2003-011, January 17, 2003
- FAA’s National Airspace System Implementation Support Contract – AV-2003-002, November 15, 2002
- FAA’s Air Traffic Services’ Policy of Granting Time Off Work to Settle Grievances – CC-2002-048, December 14, 2001
- Subcontracting Issues of the Contract Tower Program – AV-2002-068, December 14, 2001
- Automated Flight Service Stations: Significant Benefits Could be Realized by Consolidating AFSS Sites in Conjunction with Deployment of OASIS – AV-2002-064, December 7, 2001
- Compensation Issues Concerning Air Traffic Managers, Supervisors, and Specialists – AV-2001-064, June 15, 2001
- Technical Support Services Contract: Better Management Oversight and Sound Business Practices Are Needed – 2000-127, September 28, 2000
- Contract Towers: Observations on FAA’s Study of Expanding the Program – AV-2000-079, April 12, 2000
- Staffing: Supervisory Reductions will Require Enhancements in FAA’s Controller-in-Charge Policy – AV-1999-020, November 16, 1998
- Personnel Reform: Recent Actions Represent Progress but Further Effort is Needed to Achieve Comprehensive Change – AV-1998-214, September 30, 1998
- Liaison and Familiarization Training – AV-1998-170, August 3, 1998

Acquisition and Modernization

- FAA's Advanced Technologies and Oceanic Procedures – AV-2004-037, March 31, 2004
- FAA Needs to Reevaluate STARS Costs and Consider Other Alternatives – AV-2003-058, September 10, 2003
- Status of FAA's Major Acquisitions – AV-2003-045, June 27, 2003
- Integrated Terminal Weather System: Important Decisions Must Be Made on the Deployment Strategy – AV-2003-009, December 20, 2002
- FAA's Progress in Developing and Deploying the Local Area Augmentation System – AV-2003-006, December 18, 2002
- Follow-up Memo to FAA on STARS Acquisition – CC-2002-087, June 3, 2002
- Letter Response to Senator Richard Shelby on FAA's Advanced Technologies and Oceanic Procedures (ATOP) – CC-2001-210, April 12, 2002
- Status Report on the Standard Terminal Automation Replacement System – AV-2001-067, July 3, 2001
- Efforts to Develop and Deploy the Standard Terminal Automation Replacement System – AV-2001-048, March 30, 2001

Aviation Safety

- Review of Air Carriers' Use of Aircraft Repair Stations - AV-2003-047, July 8, 2003
- Operational Errors and Runway Incursions - AV-2003-040, April 3, 2003
- Air Transportation Oversight System (ATOS) - AV-2002-088. April 8, 2002
- Oversight of FAA's Aircraft Maintenance, Continuing Analysis, and Surveillance Systems - AV-2002-066, December 12, 2001
- Further Delays in Implementing Occupational Safety and Health Standards for Flight Attendants Are Likely - AV-2001-102, September 26, 2001
- Despite Significant Management Focus, Further Actions Are Needed To Reduce Runway Incursions - AV-2001-066, June 26, 2001

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- Revenue Diversions at San Francisco International Airport - SC-2004-038, March 31, 2004
- Oversight of Airport Revenue - AV-2003-030, March 20, 2003

These reports can be reviewed on the OIG website at <http://www.oig.dot.gov>: