

2003 STATUS ASSESSMENT OF COST ACCOUNTING SYSTEM AND PRACTICES

Federal Aviation Administration

Report Number: FI-2005-010

Date Issued: November 17, 2004



Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation
Office of Inspector General

Subject: ACTION: Report on 2003 Status Assessment
of Cost Accounting System and Practices
Federal Aviation Administration
FI-2005-010

Date: November 17, 2004

From: Alexis M. Stefani 
Principal Assistant Inspector General
for Auditing and Evaluation

Reply to
Attn. of: JA-20

To: Federal Aviation Administrator

The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR-21) directed the Office of Inspector General (OIG) to report annually on the Federal Aviation Administration's (FAA) progress in implementing its cost accounting system through calendar year 2004. AIR-21 requires an assessment of eight specific areas covering FAA's methods for calculating and assigning costs to specific users and whether those methods are appropriate, reasonable, and understandable. This is our fourth annual assessment. See Exhibit A for detailed results of the assessment areas. Our objectives were to determine the status of the system and to assess each area. Our audit objectives, scope, and methodology are presented in Exhibit B.

Cost accounting is a basic tool that private sector organizations use to improve operational efficiency and control costs. FAA needs to complete its cost accounting system to help find ways to meet its air traffic control modernization and growing operational needs within tight budgetary constraints. For example, the \$7.8 billion requested for fiscal year (FY) 2005 operations represents an 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. FAA's FY 2005 budget request exceeds estimated FY 2005 Aviation Trust Fund revenues by about \$3 billion.

A cost accounting system will provide FAA managers and executives with the information they need to identify and eliminate wasteful spending, hold or reduce operating costs, and better link financial performance to mission objectives. One key cost accounting system component is an accurate labor distribution system to

track workforce costs and improve productivity. For example, a labor distribution system would help FAA determine how many controllers it needs in total and at individual facilities. This information is particularly important in light of the pending wave of controller retirements.

RESULTS IN BRIEF

Since 1996, FAA has worked to implement its cost accounting system at a cost of about \$44 million. Significant progress occurred in FY 2002 when FAA implemented the system for Air Traffic Services,¹ its largest line of business, and Commercial Space Transportation, another of FAA's then five lines of business. Despite that progress, FAA still lacks accurate labor distribution information, and the Agency is unable to account for all costs associated with facilities and activities within its lines of business.

The FAA Administrator is committed to completing the implementation of an adequate cost accounting system to improve the overall financial management of FAA. In calendar year 2003, FAA did make some progress. It completed documenting the cost accounting system for Air Traffic Services and began assigning its FAA-wide general and administrative and Air Traffic Services overhead pools using a proper total cost allocation base.

Problems connecting the new Delphi financial management system to the cost accounting system prevented FAA from generating cost accounting information beginning in October 2003. This "interface" problem also delayed planned enhancements to the cost accounting system and prevented FAA from deploying the system to other lines of business. In June 2004, FAA was able to connect Delphi with the cost accounting system and began processing the backlog of cost accounting information. FAA expects to eliminate the backlog and resume production of current cost accounting information in early FY 2005.

In May 2004, FAA received an award for its FY 2003 Performance and Accountability Report. The award is given to agencies whose Performance and Accountability Reports (1) comply with requirements for report layout, and (2) are interesting and informative and achieve the goal of complete and fair reporting. FAA clearly addresses both its performance and financial accomplishments and weaknesses in its report. The award, however, is not based on the design or performance of the cost accounting system and should not be considered an endorsement of the system's capabilities.

¹ In January 2004, FAA established the Air Traffic Organization, which combined the former Air Traffic Services and the Research and Acquisitions lines of business. There are now four lines of business: Air Traffic Organization, Commercial Space Transportation, Regulation and Certification, and Airports.

Recent actions by the FAA Administrator provide a solid basis to expect significant progress to complete the system, including implementing an effective labor distribution system during FY 2005. In August 2003, the first FAA Chief Operating Officer (COO) reported for duty. The COO began a major reorganization in January 2004.

The organization changes associated with the creation of the Air Traffic Organization (ATO) are illustrated in Exhibit C. The reorganization is intended to improve air traffic services by increasing efficiency, taking advantage of new technologies, and accelerating modernization efforts. These actions provide an important opportunity to focus renewed attention on completing the cost accounting system, and the COO has both emphasized the importance of an effective cost accounting system and committed to fully implement the system. Further, at the conclusion of this audit, the FAA Administrator reaffirmed her commitment to implement the system, including deploying the labor distribution system during FY 2005.

The key remaining actions needed to implement an effective cost accounting system are as follows:

- Modifying the cost accounting system to reflect the new structure of the ATO organization so ATO can get the information it needs to truly become a performance-based organization.
- Assigning actual labor costs by activity and assigning air traffic services costs to facilities and activities because knowing the full, accurate operating costs of a facility or activity is essential to develop benchmarks or performance goals to reduce costs, improve services, and determine appropriate staffing levels.
- Deploying the system to other lines of business because FAA cannot know detailed information about its cost of all operations until it completes the cost accounting system for all lines of business.
- Documenting the cost accounting system and internal control procedures and periodically reviewing cost assignment methods to ensure that the data remain reliable.
- Linking performance measures to the cost accounting system, which is crucial to achieving performance efficiencies and cost savings.

Modify the Cost Accounting System To Reflect the New Organization. In January 2004, FAA established the performance-based ATO, which combined two large lines of business: Air Traffic Services and Research and Acquisitions. Their

combined resources include about 38,000 employees and \$9 billion. FAA needs to complete the cost accounting system for ATO, including altering it to reflect the new organization structure because the establishment of ATO will change overhead cost pools and allocation bases. For example, groups that use and maintain air traffic control equipment are combined with groups that purchase and develop air traffic control equipment, and the cost accounting system must be modified to account for the changes.

Assign Labor Costs to Facilities and Activities. Labor distribution is the process of associating labor costs directly with activities and services by requiring employees to record their time worked on specific activities. Accurate labor cost information by activity is critical for FAA to effectively manage its air traffic services and to determine proper staffing at air traffic control facilities. FAA is deploying a labor distribution reporting system in ATO, which will be used to manage about \$3.8 billion in annual labor costs of air traffic controllers and maintenance technicians.

Currently, the cost accounting system does not use information from the labor distribution system to account for labor costs for facilities and activities. Instead, labor costs in the cost accounting system are estimated based on allocation methodologies that approximate where labor costs are incurred. Replacing the allocation methods with actual labor costs by facility and activity from the labor distribution system would provide more accurate information to ATO management. The labor distribution system also requires enhancements before it can capture complete information about the activities worked on by employees. For example, it does not identify the off-scope activities or collateral duties that controllers perform. The FAA Administrator has advised us that she is committed to implementing a labor distribution system that meets the OIG recommendations by mid-2005.

FAA needs to interface the labor distribution system with the cost accounting system and redesign the labor distribution system to account for all employee activities.

Assign Other Air Traffic Services Costs to Individual Facilities and Activities. FAA could not assign all its Air Traffic Services costs to individual air traffic control facilities. Knowing the full operating cost for each facility is essential to develop benchmarks and performance goals that will reduce costs and improve services. For example, we previously reported² that FAA programmed its cost accounting system to assign data processing labor to only 21 of its 61 flight

² OIG Report FI-2002-065, "Flight Service Stations Cost Accounting Practices," December 11, 2001. OIG reports can be accessed on our website: www.oig.dot.gov.

service stations, even though all 61 flight service stations use data processing labor. This problem has not yet been corrected.

Deploy the System to Remaining Lines of Business. In FY 2003, FAA did not process or report any costs for the Regulation and Certification or Airports lines of business because the cost accounting system was not implemented in those lines of business. FAA had planned to do so during calendar year 2003. However, problems connecting the Delphi system to the cost accounting system caused a delay. FAA now plans to deploy cost accounting to the remaining lines of business by March 2006.

Document the Cost Accounting System and Internal Controls and Periodically Review Allocation Methods. FAA prepared a handbook documenting its cost accounting and internal control procedures for its Air Traffic Services line of business (now a major component of ATO), as we recommended in January 2002.³ FAA must now document the cost accounting system and internal control procedures for all of ATO and other lines of business and periodically review and update the handbook documentation.

FAA has no policy requiring periodic review of its cost assignment methods to ensure that the methods accurately distribute costs to specific activities and facilities. Lack of such a procedure represents an internal control weakness. Without reviewing procedures for assigning costs, errors may not be prevented or corrected. For example, FAA could not assign about \$1.3 billion of its Air Traffic Services cost to individual facilities in part because it does not review and update its procedures. FAA should periodically review its cost accounting assignment methods to make certain it uses the best data available to assign costs in the cost accounting system, replaces manual processes with more efficient automated practices, and complies with Federal accounting standards.

Link Performance Measures to Cost Accounting Information. In FY 2003, FAA had not developed financial measures for any of its performance goals. In FY 2004, FAA developed a new strategic cost and performance management plan. The plan contains more detailed performance measures and goals to improve operations, but it still lacks financial measures.

To become a performance-based and results-oriented agency, FAA needs to develop financial measures that show the cost effectiveness of its programs and activities. For example, FAA cannot measure progress on one of its performance goals because it lacks the detailed labor cost information to tie costs to the goal of organizational excellence through air traffic control efficiency. FAA needs to link performance goals for programs and activities with the cost accounting system so

³ OIG Report FI-2002-072, "2001 Status Assessment of Cost Accounting System and Practices," January 10, 2002.

FAA can compare the benefits of programs and activities with their associated costs in order to make informed funding and management decisions.

Summary of Recommendations

To meet these challenges, we are recommending that FAA (1) design and implement cost accounting for ATO, (2) correct problems in the labor distribution system to be used by air traffic controllers and link it to the cost accounting system, (3) develop appropriate methods to assign substantially all costs to individual air traffic control facilities and activities, (4) document the cost accounting system and internal control procedures and periodically review the assignment methods for all lines of business, and (5) implement financial and performance goals and measures for all lines of business and all facilities and activities within each line of business.

We provided FAA with a draft of this report on September 20, 2004, and FAA provided a written response on September 30, 2004. FAA agreed with all our findings and recommendations and indicated the specific actions it plans to take for each recommendation (see Appendix). Overall, FAA's planned actions adequately address the recommendations and when implemented will help assure an effective cost accounting system. We are requesting that FAA provide additional information about its response to three recommendations.

First, FAA stated that it had defined the business requirements for ATO and developed a schedule to implement the needed changes. We are requesting a copy of the ATO business requirements and schedule. Second, although FAA agreed to our recommendation to implement financial and performance goals and measures for all lines of business and all facilities and activities within each line of business, FAA's response did not indicate whether it planned to implement goals and measures for all facilities and activities using data from the cost accounting system. Therefore, we are requesting that FAA provide additional information about its plans. Third, FAA concurred with our recommendation to document the entire cost accounting system and internal controls for the system. However, FAA's response indicates it plans to document the cost accounting system only when major software revisions occur. FAA has documented only a portion of the cost accounting system for ATO. Accordingly, we are requesting that FAA tell us whether it plans to document the cost accounting system and internal controls for the entire ATO and for other lines of business and provide milestones for accomplishing this effort.

RESULTS

FAA began developing its cost accounting system in 1996. Progress was slow until 2002, when FAA completed the basic implementation of the cost accounting system for Air Traffic Services, its largest line of business, and the Commercial Space Transportation line of business. Problems connecting the new Delphi financial management system to the cost accounting system prevented FAA from generating cost accounting information and making improvements to the system beginning in October 2003.

Information from the financial management system is used as the primary source data for the cost accounting system, and FAA experienced problems linking the Delphi financial management system with the cost accounting system. The loss of the cost accounting system data also contributed to a delay in implementing important cost accounting system enhancements and the deployment of the cost accounting system to other lines of business.

In June 2004, FAA began processing the cost accounting data backlog. When FAA resumes the production of current monthly data, FAA should focus on completing its cost accounting system as an essential tool for controlling or reducing operating costs and helping make FAA a performance-based organization.

For FAA to achieve its goal of operating in a businesslike manner, FAA needs to modify the cost accounting system to reflect the new ATO, use actual labor costs for activities, assign all air traffic service and airways facilities costs to air traffic control facilities, document the cost accounting system and internal control procedures and periodically review cost assignment methods, and link the cost accounting system to its financial and performance measures.

Cost Accounting System Needs To Be Modified To Reflect FAA's Change in Organization

In January 2004, FAA established ATO. It was created to be performance based and results oriented and to improve air traffic services by increasing efficiency, taking advantage of new technologies, and accelerating modernization efforts. Altering the cost accounting system to reflect the new organization is important because vast changes have occurred in FAA's basic organization structure.

ATO combines previously independent functions, which were the Air Traffic Services and the Research and Acquisitions lines of business. In FY 2003, Air Traffic Services had resources of about 35,000 employees and \$7.6 billion. It provided air traffic control services and maintained National Airspace System equipment. Research and Acquisitions had resources of about 3,000 employees

and \$1.4 billion, and its task was to obtain the equipment used in the National Airspace System.

The combined resources of ATO include about 38,000 employees and \$9 billion. The creation of ATO will cause changes in overhead costs. For example, groups that use and maintain air traffic control equipment were combined with groups that purchase and develop air traffic control equipment. The cost accounting system must be modified to account for the changes.

FAA also needs to complete the cost accounting system for ATO. ATO cannot fulfill its purpose of being a performance-based and results-oriented organization until it has adequate cost accounting information for all of its activities.

FAA Must Use Actual Labor Costs by ATO Activity

ATO's current air traffic services' labor costs in the cost accounting system are based on allocation methodologies that approximate where labor costs are incurred. Replacing the allocation methods with actual labor costs by activity from the labor distribution system would provide more accurate cost information to ATO management. To provide actual labor cost by activity, FAA needs to connect the labor distribution system with the cost accounting system. FAA plans to deploy the labor distribution system to air traffic facilities to record actual labor on a real-time basis nationwide by June 2005.

FAA estimates that about 7,000 controllers could retire from 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 and FAA initiatives in its hiring and training process. Information from the labor distribution system would help managers to determine appropriate staffing levels at each facility. For example, the labor distribution system to be used by the air traffic controllers is designed to capture data such as the mandatory retirement date and retirement eligibility date for all controllers by location. This information could be used at the national level to accurately identify when and where vacancies will occur.

Labor distribution is the process of associating labor cost directly with activities and services by requiring employees to record their time worked on specific activities. This information is an essential component of an effective cost accounting system. FAA is deploying the labor distribution reporting system in ATO, which when fully deployed will be used by about 35,000 employees and will include about \$3.8 billion in labor costs of air traffic controllers and maintenance technicians. Currently, the cost accounting system does not use information from the labor distribution system to account for labor costs for facilities and activities because the labor distribution system to be used by air traffic controllers is not fully deployed.

The labor distribution system to be used by air traffic controllers has significant problems. It does not require employees to enter actual start and stop times or record collateral duties by function. FAA has made a commitment to correct these deficiencies by June 2005.

FAA is currently testing the labor distribution system at four facilities. FAA estimates that it will correct the internal control weaknesses and deploy the system nationwide in June 2005.

Other Air Traffic Services Costs Must Be Assigned to Facilities and Activities

FAA cannot assign all its air traffic services costs to individual air traffic control facilities. Knowing the full operating costs for each facility is essential to developing benchmarks and performance goals that will reduce costs and improve services.

In FY 2003, the cost accounting system could not assign about 16 percent (or about \$1.3 billion) of the former Air Traffic Services costs to any of the approximately 400 facility locations. For example, significant amounts of depreciation, telecommunications, and other costs were not assigned to facility locations because FAA has not developed proper methods for assigning these costs. When FAA resumes the monthly production of current cost accounting information, it needs to focus attention on improving the assignment of costs to facilities.

Contributing to this problem is FAA's inability to collect all the source data it needs to accurately assign costs to individual facilities. FAA needs to collect and analyze useful data to know the full costs of facility locations and of activities so it can identify ways to increase efficiency and productivity. For example, FAA spent \$3.8 billion on air traffic controllers and airway facility technicians; however, it does not know how much it spent for specific activities, such as directing air traffic, because it has not collected this information. FAA should explore ways to use the new Delphi financial management system to improve the collection of source data, such as vendor invoices.

We found instances where FAA has used inappropriate methods to assign cost to individual facilities. We previously reported⁴ that FAA programmed its cost accounting system to assign data processing labor to only 21 of its 61 flight service stations, even though all 61 flight service stations use data processing labor. This problem has not yet been corrected. FAA needs to collect the best

⁴ OIG Report FI-2002-065, "Flight Service Stations Cost Accounting Practices," December 11, 2001.

source data available to ensure accurate cost assignments to facilities and activities and ensure its cost assignments comply with Federal accounting standards.

Cost Accounting System Must Be Completed

In FY 2003, FAA did not process or report any costs for the Regulation and Certification, Airports, and Research and Acquisitions (now a major component of ATO) lines of business because the cost accounting system was not implemented in those lines of business.

FAA plans to implement the cost accounting system for the Regulation and Certification and the Airports lines of business by March 31, 2006, and to implement the system for ATO by March 31, 2005. Until FAA completes the cost accounting system for all lines of business, it cannot know detailed information about its cost of operations.

Cost Accounting and Internal Control Procedures Must Be Documented and Periodically Reviewed

In January 2002, we recommended that FAA prepare a handbook documenting its cost accounting and internal control procedures for its Air Traffic Services line of business. FAA agreed with our recommendation and prepared the handbook for Air Traffic Services (now a major component of ATO). FAA must now prepare a handbook of documentation for all of ATO and the other lines of business. In addition to preparing the handbook documentation, FAA must also periodically document internal controls and periodically review and update the handbook documentation.

FAA also has no policy requiring periodic review of its cost assignment methods to ensure that the methods accurately distribute costs to specific activities and facilities. Lack of such a procedure represents an internal control weakness. Without reviews to update procedures for assigning costs, errors may not be detected, prevented, or corrected. For example, FAA could not assign about \$1.3 billion of its air traffic service cost (about 16 percent of the total) to individual facilities in part because it does not review and update its procedures. FAA should review its cost accounting assignment methods to make certain it uses the best data available to assign costs in the cost accounting system, replaces manual processes (such as entering source data) with more efficient automated practices, and complies with Federal accounting standards.

Performance Measures Should Be Linked to the Cost Accounting System

Cost and performance management measures the productivity of activities and links activities to mission performance, allowing executives to tie performance goals to the cost of achieving the goals. Using cost and performance management enables managers to set goals and benchmarks and determine the proper resources needed for each activity.

In FY 2003, FAA had no financial measures. In FY 2004, FAA developed a new strategic cost and performance management plan. The plan contains performance measures and goals to measure and improve its operations—but not financial measures. A performance-based and results-oriented agency needs to develop financial measures to determine the cost effectiveness of its programs and activities. For example, FAA could measure the cost of air traffic control at one facility and compare that cost to another facility. FAA needs to identify the costs of activities performed within facilities and set goals to perform the activities more efficiently, reducing the overall costs of facilities, air traffic operations, and other essential programs. Linking FAA's cost accounting system with its cost and performance management practices for all lines of business is crucial to achieving performance efficiencies and cost savings and providing useful performance information for FAA managers.

In addition to developing financial measures, FAA needs to develop performance benchmarks and measures for its operational activities in more detail. Performance measures should be developed for all organizations within each line of business and for each air traffic control facility. Together, financial and performance goals and measures can transform FAA into an efficient, businesslike organization.

RECOMMENDATIONS

We recommend that the FAA Administrator direct:

1. The Chief Operating Officer, ATO, to:
 - a. Define the ATO cost accounting business requirements, prepare a plan with milestones to revamp the cost accounting system to account for organizational and overhead allocation changes resulting from the creation of ATO, and complete the system for all ATO activities.
 - b. Connect the labor distribution system to be used by air traffic controllers, with adequate internal controls, with the cost accounting system by June 30, 2005.

2. The Chief Financial Officer to:
 - a. Implement data collection processes and cost assignment methods to assign substantially all costs to all lines of business and to all individual facility locations and activities, as appropriate, within each line of business.
 - b. Document the cost accounting system and internal controls for the entire Agency and periodically review cost assignment methods to ensure the system uses the best available data, replaces manual processes with automated processes where appropriate, and complies with Federal accounting standards.
 - c. Implement financial and performance goals and measures for all lines of business and all facility locations and activities within each line of business and link the goals and measures to the cost accounting system.

MANAGEMENT COMMENTS AND OIG RESPONSE

On September 20, 2004, we requested that FAA provide comments on a draft of this report. The Assistant Administrator for Financial Services and Chief Financial Officer, FAA, provided a written response on September 30, 2004 (see Appendix). The Assistant Administrator agreed with all recommendations and provided additional information about specific actions FAA would take to implement the recommendations. Overall, FAA's planned actions adequately address the recommendations and, when implemented, will help assure an effective cost accounting system. We are requesting that FAA provide additional information about its response to three recommendations. First, FAA stated that it had defined the business requirements for ATO and developed a schedule to implement the needed changes. We are requesting a copy of the ATO business requirements and schedule. Second, although FAA agreed to our recommendation to implement financial and performance goals and measures for all lines of business and all facilities and activities within each line of business, FAA's response did not indicate whether it planned to implement goals and measures at the facilities and activities level using data from the cost accounting system. Third, FAA concurred with our recommendation to document the entire cost accounting system and internal controls for the system; however, FAA's response did not indicate whether it plans to document the cost accounting system and internal controls for the entire Agency.

Specific comments by the Assistant Administrator and FAA's planned actions on our recommendations are provided below.

Recommendation 1(a): FAA concurred. FAA stated that ATO defined its cost accounting system business requirements during FY 2004. ATO and the FAA Office of Cost and Performance Management (APF) also worked together to identify changes to the cost accounting system and defined necessary modifications to the overhead allocations. Further, FAA stated that it has established detailed activities and milestones to implement the planned changes in the cost accounting system. The expected completion date for implementing the cost accounting system for ATO is March 31, 2005.

OIG Response: We are pleased to hear that FAA completed developing business requirements for ATO. At our exit conference in June 2004, FAA staff indicated that the requirements had not been developed nor had they begun to identify the changes that were necessary to properly design the system for ATO. Therefore, we are requesting that FAA provide us with a copy of the ATO business requirements and plan so that we can better understand the planned changes.

Recommendation 1(b): FAA concurred. According to FAA, ATO is testing and implementing an enhanced version of the labor distribution system for air traffic controllers to correct identified internal control weaknesses associated with air traffic controller time reporting. The new system will also report air traffic controller off-position time in more detail. The expected completion date is June 30, 2005. The response also noted that the labor distribution system for air traffic controllers provides labor hour data to the Integrated Personnel Payroll System, which computes the labor costs associated with the hours. FAA responded that, beginning in FY 2005, the payroll system will pass the labor costs to the Delphi Financial Management System.

OIG Response: FAA's proposed action is acceptable. FAA agrees to complete implementation of an adequate labor distribution system with proper internal controls for controllers and link the system to the cost accounting system by June 30, 2005. The enhanced version of the labor distribution system for air traffic controllers should improve the accuracy of labor hours reporting.

Recommendation 2(a): FAA concurred. FAA stated that during FY 2004, APF gathered all cost accounting requirements for individual lines of business. According to the response, APF is working with ATO to make changes to the cost accounting system to resolve all OIG recommendations related to cost assignment methodologies and cost assignment at lower reporting levels. The expected completion date is March 31, 2006.

OIG Response: FAA's planned actions meet the intent of our recommendation. FAA needs to identify all costs of individual facilities and activities within its lines of business to understand the costs attributable to each facility and understand whether the facility is operating efficiently.

Recommendation 2(b): FAA concurred. FAA responded that as part of any major software program revision, FAA reviews cost accounting allocation steps and standard operating procedures and performs updates as necessary. In the future, FAA stated it will annually review cost accounting system business rules and cost assignment methodologies with the lines of business and document the reviews. This will help FAA identify areas requiring modification to comply with recent laws and regulations, meet customers' evolving needs, and provide accurate and valid cost data. The expected completion date for implementing this process is March 31, 2005.

OIG Response: Although FAA agreed with the recommendation, the response indicates it would review allocation procedures only when software revisions occur. FAA's response does not indicate whether it plans to document the cost accounting system and internal controls for the entire Agency. FAA needs to document the system for all of ATO and for the three other lines of business. Accordingly, we are requesting that FAA tell us whether it plans to document the cost accounting system and internal controls for each of its lines of business and major staff offices and provide milestones for accomplishing this effort.

Recommendation 2(c): FAA concurred. FAA stated that in FY 2003, it developed a 5-year strategic plan titled "The Flight Plan." The Flight Plan contains four major strategic goals—safety, capacity, organizational excellence, and international leadership. FAA also said it developed some financial efficiency and performance metrics in support of the Flight Plan during FY 2004. For FY 2005, financial efficiency and performance measures will be included in business plans for all lines of business and major staff offices. For example, the ATO business plan includes "Total ATO Cost per Controlled Flight Hour," an air traffic efficiency measure.

Finally, FAA's response noted that the Office of Management and Budget has reviewed many FAA programs using the Program Assessment Rating Tool. These programs included the Airports Grant Program and Certification and Regulation programs. These reviews indicated that each of the rated programs has developed financial efficiency measures that use data from the cost accounting system, demonstrating linkage between efficiency measures and the cost accounting system. FAA said it plans to link cost with existing financial efficiency measures in its programs by September 30, 2006.

OIG Response: In FY 2004, FAA developed a few financial management efficiency measures for individual lines of business. These high-level measures, however, are not based on data provided by the cost accounting system. The financial measures that FAA designed are at too high a level to help it improve the efficiency of its daily operations. FAA needs more detailed cost accounting information for its activities and facilities and needs to design financial and

performance goals and measures for its activities and facilities that use the cost accounting data to better manage its operations.

Although FAA agreed with the recommendation, the response did not indicate whether it intends to implement financial and performance goals and measures for all facilities and activities within each line of business and link the goals and measures to the cost accounting system. Therefore, we are requesting that FAA provide more information describing the specific actions it will take to establish goals and to measure the productivity and efficiency of individual facilities and activities and the milestones associated with this effort.

ACTION REQUIRED

In accordance with DOT Order 8000.1C we request that within 30 days FAA provide additional information. Specifically, we request a copy of the ATO business requirements that FAA cited in its response; its plans to document the cost accounting system and internal controls for the entire Agency, with milestone dates; and additional information about FAA's plans to implement performance and efficiency goals for facilities and activities within its lines of business using data from the cost accounting system, including implementation milestones. The actions taken or planned on the other recommendations are reasonable and no further response is necessary.

We appreciate the cooperation and assistance provided by FAA representatives. If you have any questions concerning this report, please call me at (202) 366-1992 or Theodore Alves, Assistant Inspector General for Financial and Information Audits, at (202) 366-1496.

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cc: Anthony Williams, ABU-100
Martin Gertel, M-1

EXHIBIT A. RESULTS OF ASSESSMENTS

The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR-21) requires the OIG to perform eight specific assessments annually to determine whether FAA's methods for calculating amounts in the cost accounting system and assigning costs to specific users are appropriate, reasonable, and understandable. The following sections present the results of our assessments as of December 31, 2003. The statuses of our prior recommendations on FAA's cost accounting system are presented in Exhibit D, and a chronological list of significant OIG reports and testimonies related to AIR-21 assessment areas is presented in Exhibit E.

Assessment Area 1. Assessment To Ensure That the Method for Calculating the Overall Costs of FAA and Attributing These Costs to Specific Users Is Appropriate, Reasonable, and Understandable

FAA's methods for calculating its overall costs are reasonable, and amounts reported in the cost accounting system equal amounts in the financial accounting system. The cost accounting system uses a combination of data from the financial accounting and operational data systems to determine overall costs. The cost accounting system is unable to assign all costs to specific facilities and activities. Knowing the full cost of operation for each facility is essential to develop benchmarks and performance goals to control costs and improve services.

In FY 2003, the cost accounting system could not assign about 16 percent (or about \$1.3 billion) of costs of Air Traffic Services (now part of ATO) to facility locations or associated activities performed within the facilities. For example, significant amounts of depreciation, telecommunications, and other costs were not assigned to facility locations because FAA has not developed proper methods for assigning these costs. FAA needs to focus attention on improving the assignment of costs to individual facilities.

Assessment Area 2. FAA Cost Input Data, Including the Reliability of the Administration's Source Documents and the Integrity and Reliability of the Administration's Data Collection Process

FAA has adequate source documents and cost input data, such as vendor invoices, for determining the total cost of operations, but the cost accounting system and the labor distribution system to be used by air traffic controllers cannot collect the

information at the detailed level needed to properly assign all costs to facilities and activities.

Information from the financial management system is the primary source data for the cost accounting system. In October 2003, FAA's cost accounting system lost access to its primary source data when FAA installed a new financial management system named Delphi. FAA had problems linking the two systems. In June 2004, FAA began processing the cost accounting data backlog. FAA anticipates resuming production of current monthly cost accounting data beginning in early FY 2005.

Besides the temporary loss of source data from the financial management system, FAA has problems with its data collection process for cost accounting information about its facilities and activities. Data collection is important so FAA has the information it needs to accurately assign cost to facilities and activities. For example, FAA spent \$3.8 billion on air traffic controllers and airway facility technicians; however, it does not know how much it spent for specific activities such as directing air traffic because FAA has not collected this information.

We have previously recommended that FAA improve its data collection procedures to ensure that users can rely on the information produced by the cost accounting system. We made three recommendations to improve data collection for the Flight Services. FAA has completed corrective action on one recommendation and anticipates completing corrective action on the other two in early FY 2005. FAA's actions have improved its data collection processes, but, in our opinion, additional effort is necessary to have adequate data collection processes for all lines of business.

Assessment Area 3. FAA's System for Tracking Assets

The Chief Financial Officers Act of 1990 requires the preparation and audit of commercial-like financial statements for major Federal agencies. The Government Management Reform Act of 1994 expanded the requirement for audited financial statements and established the requirement for the acquisition cost of property, plant, and equipment to be reported in agencies' financial statements and certified by their auditors. Prior to this legislation, agencies were primarily concerned with knowing what property they owned, where it was located, and its condition. Records supporting the acquisition cost of property were frequently not available.

During FY 2003, FAA continued to improve internal controls over its property system. Under contract with the OIG, KPMG LLP (KPMG) audited the FY 2003 FAA financial statements. KPMG found that FAA substantially implemented recommendations associated with KPMG's FY 2002 property findings, and

Exhibit A. Results of Assessments

KPMG did not identify any new internal control weaknesses associated with tracking property. However, KPMG identified additional internal control weaknesses related to property valuation and depreciation, as is discussed in the next assessment area.

Assessment Area 4. FAA's Methods for Establishing Asset Values and Depreciation

Beginning with FY 1998, Federal agencies were required to compute depreciation expense. When FAA implemented the depreciation requirements, many asset values were established using estimating procedures, and depreciation expense was computed manually.¹

Our report on the FY 2000 FAA financial statements expressed a qualified opinion. FAA was unsuccessful in implementing a commercially acquired property tracking system called the Interim Fixed Assets System, and the Agency could not substantiate the net book value and depreciation expense for its property. In FY 2001, FAA corrected reporting errors by reducing the net book value of its recorded property by \$322 million.

For FY 2003, FAA substantially implemented prior year audit recommendations but did not fully adhere to policies and procedures designed to ensure assets were recorded in accordance with accounting principles. KPMG identified deficiencies related to non-integrated systems, additions and disposals, Construction-in-Progress transfers, leases, and purchases of non-Construction-in-Progress assets. As a result, KPMG made three additional recommendations in its audit report on the FY 2003 financial statements designed to strengthen internal controls over the valuation of assets. As of October 2004, corrective action for two of the three recommendations has been completed, and the corrective action for the third recommendation is anticipated to be completed during FY 2005.

Assessment Area 5. FAA's System of Internal Controls for Ensuring the Consistency and Reliability of Reported Data

Labor distribution is the process of associating labor cost directly with activities and services by requiring employees to record their time worked on specific activities. This information is an essential component of an effective cost accounting system. FAA is deploying a labor distribution reporting system in ATO, which when fully deployed will be used by about 35,000 employees and will include about \$3.8 billion in annual labor costs of air traffic controllers and

¹ OIG Report Number FE-2000-058, "FAA Property, Plant, and Equipment," February 28, 2000, provides details on FAA's basis for establishing its asset values for those assets acquired before October 1994.

maintenance technicians. Currently, the cost accounting system does not use information from the labor distribution system to be used by air traffic controllers to account for labor costs for facilities and activities because the labor distribution system is not fully deployed.

Status of the Labor Distribution System

ATO's current labor costs in the cost accounting system are based on allocation methodologies that approximate where labor costs are incurred. Replacing the allocation methods that estimate labor costs with actual labor costs from the labor distribution system would provide more accurate information to ATO management about where controllers spend their time and whether productivity improvements can be achieved. To provide actual labor costs, FAA needs to interface the labor distribution system with the cost accounting system.

FAA estimates that about 7,000 controllers could retire from 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 and FAA initiatives in its hiring and training process. Information from the labor distribution system would help managers to determine appropriate staffing levels at each facility. For example, the labor distribution system is designed to capture data such as the mandatory retirement date and retirement eligibility date for all controllers by location. This information could be used at the national level to more accurately identify when and where vacancies will occur.

The labor distribution system has significant problems. It does not require employees to enter actual start and stop times or record collateral duties by function.

- The labor distribution system, as implemented, allows air traffic controllers to record any start or stop work time, regardless of actual arrival or departure time. The labor distribution system also automatically records employees' scheduled start and stop times unless the employee or supervisor makes manual entries. In October 2001, we recommended FAA use the labor distribution system's internal clock to record the actual start and stop times and provide flexibility for the supervisor to approve variations in the scheduled work times as appropriate. FAA agreed with our recommendation and anticipates completing corrective action by June 2005.
- The labor distribution system restricts the ability to measure employee productivity because the system does not record collateral or off-scope activities by function, such as training and briefings. Productivity information from the labor distribution system could help managers determine appropriate

staffing levels. FAA agreed to collect collateral duty information by function by June 2005.

FAA is currently testing the labor distribution system at four facilities. FAA's scheduled date for full national deployment of the labor distribution system, with the internal control weaknesses corrected, is June 30, 2005. In our opinion, until these problems are corrected, FAA's labor distribution system will not identify how ATO employees spend their time, help identify adequate staffing requirements, or provide an adequate method of accounting for labor in the cost accounting system.

FAA Accomplishes Improvements in Internal Control Documentation But Additional Effort Is Needed for Other Lines of Business

In January 2002, we recommended that FAA prepare a handbook documenting its cost accounting and internal control procedures for its Air Traffic Services line of business. FAA agreed with our recommendation and prepared the handbook of documentation for Air Traffic Services (now a major component of ATO). FAA must now prepare a handbook of documentation for all of ATO and the other lines of business. In addition to preparing the handbook documentation, FAA must also finalize draft policies, establish effective dates for internal control procedures, and periodically review and update the handbook documentation.

Periodic Review of Cost Accounting Assignment Methods Are Needed for Good Internal Controls

FAA has no written policy requiring periodic review of its cost accounting assignment methods to ensure that its methods accurately distribute its costs to specific activities and facilities. This is an internal control weakness. Periodic review of assignment methods could improve the assignment of costs to individual facilities. Without reviews to update procedures for assigning costs, errors may not be detected, prevented, or corrected. For example, significant organizational and cost allocation changes are needed as a result of the creation of ATO. Groups that use and maintain air traffic control equipment were combined with system acquisition groups, which purchase and develop air traffic control equipment. The cost accounting system must be modified to account for the changes. FAA should review its cost accounting assignment methods to make certain it uses the best data available to assign costs in the cost accounting system, replaces manual processes with more efficient automated processes, and complies with Federal accounting standards.

Assessment Area 6. FAA's Definition of the Services to Which It Ultimately Attributes Its Cost

In calendar year 2003, FAA's definitions of services, which it uses to attribute its costs, were reasonable for the Air Traffic Services and Commercial Space Transportation lines of business. FAA defined four services within its Air Traffic Services line of business: En Route, Oceanic, Terminal, and Flight Service Stations. FAA's services are similar to the services described in the International Civil Aviation Organization standards and recommended practices. FAA's defined services are also comparable to those of NavCanada, Canada's provider of air traffic control services.

In January 2004, the Air Traffic Services line of business became a major component of ATO. We do not anticipate significant changes in FAA's *definition of services* for providing air traffic services because FAA's current definitions comply with International Civil Aviation Organization standards. However, FAA also needs to revamp its systems to account for organization changes resulting from the creation of ATO and complete the cost accounting system for ATO. FAA needs to update its definition of services to reflect the new ATO business.

FAA's Commercial Space Transportation line of business has also defined its services for cost accounting purposes. These services include issuing licenses for commercial space launches and re-entries and promoting commercial space transportation with other Government agencies and private industry. These services are available to the public, but no user fees are charged. We compared the Commercial Space Transportation's defined services, for cost accounting purposes, with the services it provides to users and determined the defined cost accounting services to be reasonable.

FAA has not defined its services for the other lines of business, which are Regulation and Certification, Airports, and ATO other than the former Air Traffic Services. FAA plans to implement the cost accounting system for ATO by December 2004 and Regulation and Certification and Airports by March 2005. FAA should define the services of the lines of business when the cost accounting system is implemented for them.

Assessment Area 7. Cost Pools FAA Used and the Rationale for and Reliability of the Bases It Proposes To Use in Allocating Costs of Services to Users

FAA collected its Agency-wide general and administrative costs and Air Traffic Services overhead costs into cost pools in compliance with Federal accounting standards.

During FY 2003, FAA began assigning its general and administrative and Air Traffic Services overhead pools using a proper total cost allocation base. FAA took satisfactory corrective action on two prior audit recommendations by changing to a proper total cost allocation base to assign its Agency-wide general and administrative and Air Traffic Services overhead costs. FAA's change resulted in correctly assigning about \$93 million of overhead costs to services each year.

FAA needs to program the cost accounting system to group the production overhead and general and administrative costs into separate pools for ATO. Currently, FAA manually segregates and compiles the unique overhead pools after the fiscal year ends. However, this process should be programmed in the cost accounting system to produce the information in a timely and accurate manner and better manage operations. Three years after we recommended that FAA create overhead pools for production costs and general and administrative costs, FAA has not implemented our recommendation. Separating production overhead from general and administrative costs is critical because production overhead must be added to asset values while general and administrative cost is a current-year expense.

Assessment Area 8. Assess the Progress of FAA in Cost and Performance Management, Including the Use of Internal and External Benchmarking in Improving the Performance and Productivity of the Administration

Cost and performance management measures the productivity of activities, enabling managers to set goals and benchmarks, allocate the proper resources, and determine the number of employees needed for each activity. These practices would help FAA determine the most efficient practices and establish them at all its locations. FAA cannot achieve the full benefit of its \$44 million investment in its cost accounting system without implementing cost and performance management practices linked to the cost accounting system.

Results of FAA's FY 2003 Efforts Implementing Cost and Performance Management

Cost and performance management measures the productivity of activities and links activities to mission performance, thereby allowing executives to tie performance goals to the cost of achieving the goals. Using cost and performance management enables managers to set goals and benchmarks and determine the proper resources needed for each activity.

During FY 2003, FAA had 12 high-level, corporate performance goals related to safety, system efficiency, and organizational excellence. FAA did not have detailed performance measures and goals for facility locations and activities within each line of business and did not link financial information to its performance measures. As a result, during FY 2003, performance goals were not an effective tool to measure or reduce the cost of operations.

In FY 2003, FAA achieved success in 75 percent (9 of 12) of its performance goals. Most of goals were related to improving performance and system efficiency (for example, increasing on-time arrivals at airports). None of the goals was related to financial efficiency, such as reducing facility or activity costs. FAA agrees it had only begun a process to develop financial and other efficiency metrics in FY 2004. Without full cost accounting capability, FAA cannot develop adequate financial efficiency measures.

New Plan for Implementing Cost and Performance Management

As part of FAA's September 2003 *Flight Plan FY 2004-2008*, FAA developed a new strategic cost and performance management plan that has 36 corporate performance goals for its 4 strategic goals (that is, increasing aviation safety, developing greater capacity, enhancing international leadership, and improving organizational excellence). The goals are to be achieved by cost control initiatives and management decision-making based on reliable cost accounting information. FAA's new strategic plan is a good start, and FAA is moving in the right direction by developing detailed cost and performance management plans for each line of business.

We examined FAA's FY 2004 cost and performance business plans, including the one for the former Research and Acquisitions line of business that is now a component of ATO. The Research and Acquisitions cost and performance management plan is a good start and a good example to follow because it has performance measures for its organizations and activities within Research and Acquisitions, but it lacks integration with the cost accounting system.

FAA has developed cost and performance management plans for each line of business. FAA needs to extend these plans to include detailed cost and performance management goals and measures for all organizations within each line of business at the level of programs, activities, and facility locations to improve resource use FAA-wide and reduce costs. Linking FAA's cost accounting system with its cost and performance management practices for all lines of business is crucial to achieving system efficiencies and cost savings.

EXHIBIT B. OBJECTIVES, SCOPE, AND METHODOLOGY

The OIG assessment of FAA progress in this report responds to the congressional mandate defined in Section 309 of AIR-21. AIR-21 requires that OIG perform eight specific assessments to determine whether FAA's methods for calculating amounts in the cost accounting system and assigning costs to specific users are appropriate, reasonable, and understandable. This report summarizes key findings concerning FAA's cost accounting and labor distribution systems as of December 31, 2003.

Our objectives were to provide the status of FAA's cost accounting system and our results on specific assessments of each area required by AIR-21. These areas were: (1) the method for calculating and assigning costs to users, (2) the integrity and reliability of cost input data, including source documents and the data collection process, (3) the system for tracking assets, (4) methods for establishing asset values and depreciation, (5) internal controls over cost data, (6) the definition of services to which it attributes costs, (7) overhead pools and the reliability of the bases used for assigning common costs, and (8) FAA's use of cost and performance management for improving performance and productivity.

We assessed control risk and tested for compliance with applicable laws and regulations. Our assessment of control risk takes into account that we did not specifically examine all internal controls that may be applicable to FAA's cost accounting system because the system is still under development. The analyses we performed of internal controls provided (1) an understanding of the design of the internal controls, (2) whether the internal controls had been placed in operation, and (3) whether the internal controls were sufficient to assess the control risk associated with the cost accounting system.

Our audit work was not an audit of FAA's compliance with the overflight fee statute, and our audit results should not be used as a basis to evaluate those fees.

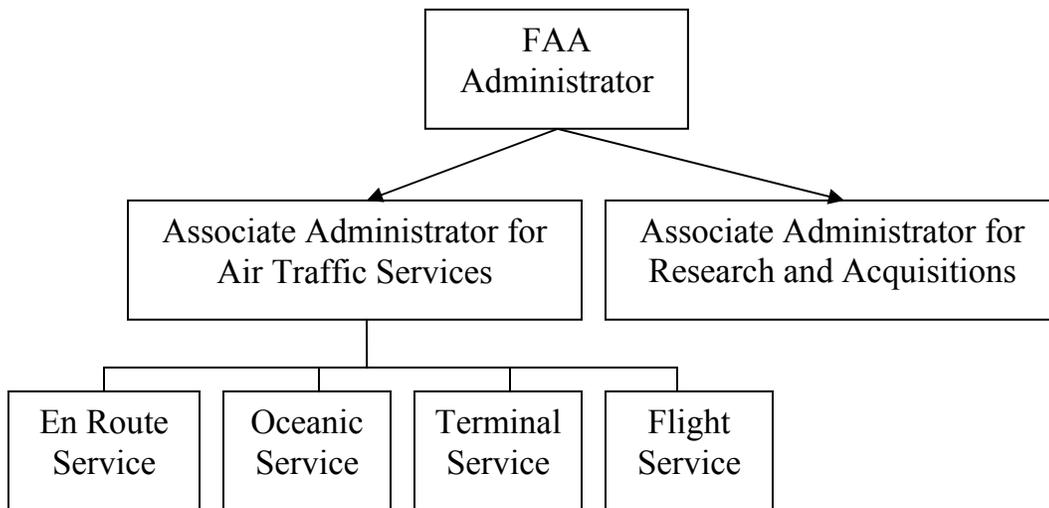
This report also relies on interviews, evaluations of financial records, and prior work we performed on FAA's cost accounting system and annual financial statements. FAA is developing its cost accounting and labor distribution systems in phases. As additional portions of the systems are developed, we will report on their adequacy and compliance with Federal accounting standards.

We performed our audit from June 2003 through July 2004 at FAA Headquarters in Washington, D.C. The audit was conducted in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States

and included such tests as we considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

EXHIBIT C. AIR TRAFFIC ORGANIZATION CHARTS

2003 Air Traffic Services and Research and Acquisitions Lines of Business



2004 Air Traffic Organization

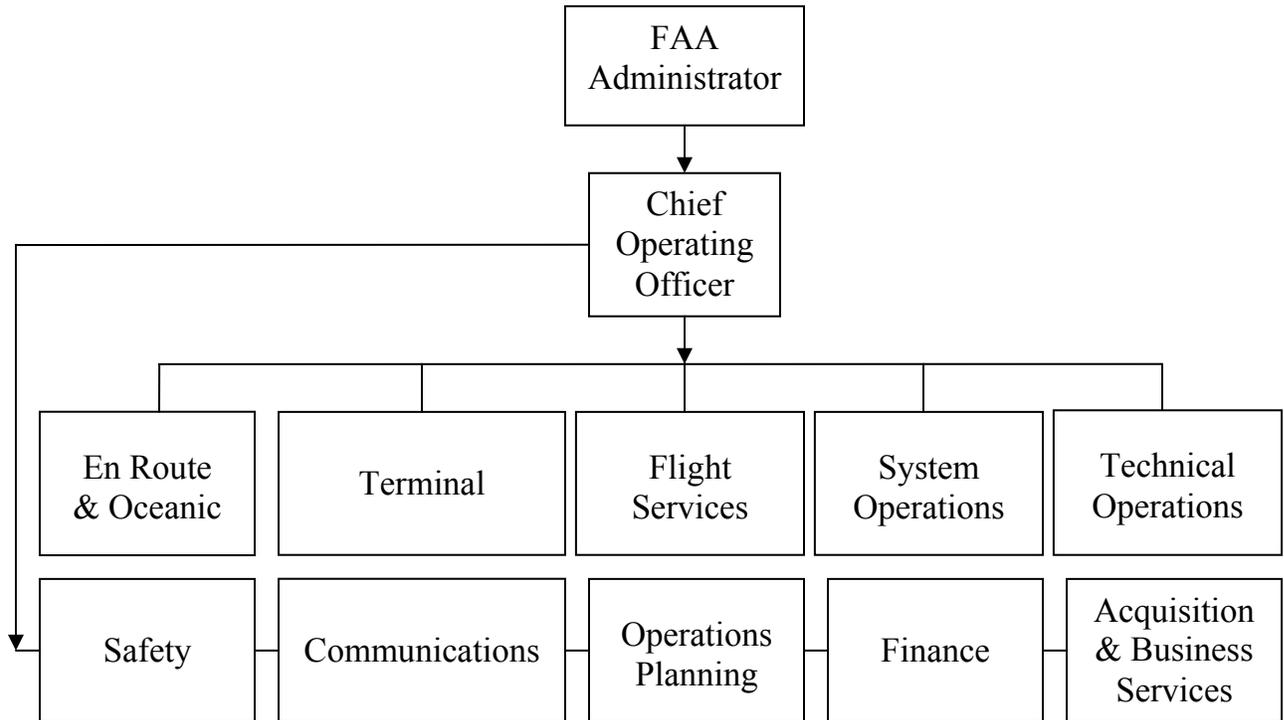


EXHIBIT D. PRIOR RECOMMENDATIONS ON THE FAA COST ACCOUNTING SYSTEM

We have issued nine reports related to the development of FAA's cost accounting system. A listing of those reports and the 30 recommendations follow.

FAA agreed with all of our recommendations and has taken corrective actions, but not all FAA's actions resulted in correcting the problems and not all corrective actions have been completed.

OIG Report FI-2003-043, "2002 Status Assessment of Cost Accounting System and Practices," June 3, 2003

- Establish an agency performance goal to implement cost accounting and labor distribution systems that are compliant with Federal standards by October 1, 2004. FAA should:
 - Provide the resources necessary and designate a person to be accountable for accomplishing the goal. (FAA anticipates completing corrective action by March 31, 2005.)
 - Make successful implementation of the cost accounting system a precondition to the awarding of annual performance bonuses for senior executives and program managers within the affected lines of business. (FAA anticipates completing corrective action by March 31, 2005.)
- Specify and implement the internal controls to be added in the Cru-X labor distribution system to ensure that employees accurately record their start and stop work times for hours worked and report air traffic controller duties by position and collateral duties by function. (FAA anticipates completing corrective action by June 30, 2005.)
- Make FAA-wide cost and performance management practices an Agency priority and commit appropriate funding to fully establish these practices by October 1, 2004. (FAA anticipates completing corrective action by September 30, 2005.)

**OIG Report FI-2003-013, “Terminal Service Cost Accounting Practices,”
January 21, 2003**

- Distribute costs to each Terminal Service facility location and report the results to FAA management. (FAA anticipates completing corrective action by March 31, 2005.)
- Change the cost accounting system to assign costs using an acceptable method as required by Federal accounting standards. (FAA anticipates completing corrective action by March 31, 2005.)
- Allocate the Air Traffic Services headquarters, Air Traffic Operations, and Airway Facilities Operations administrative overhead cost pools using a total cost basis. (FAA corrective action completed.)

**OIG Report FI-2002-072, “2001 Status Assessment of Cost Accounting
System and Practices,” January 10, 2002**

- Revise the target date for having a fully functional cost accounting system considering the interface requirements of the labor distribution and Delphi accounting systems. (FAA revised the target date for interfacing the systems. FAA has not accomplished interfacing the systems.)
- Increase monetary and personnel resources to achieve implementation of cost and performance management in FY 2003. (FAA anticipates completing corrective action by March 31, 2005.)
- Modify the cost accounting system to allocate the administrative overhead costs for FAA Headquarters to lines of business using a total cost base. (FAA corrective action completed.)
- Prepare a handbook of comprehensive and well-documented policies and procedures for an adequate system of internal controls for the cost accounting system. (FAA corrective action completed.)

**OIG Report FI-2002-065, “Flight Service Stations Cost Accounting
Practices,” December 11, 2001**

- Improve the accuracy of the data produced by the telecommunication systems by correcting inaccurate and missing telecommunication cost data. (FAA corrective action completed.)

**Exhibit D. Prior Recommendations on the FAA Cost Accounting
System**

- Use detailed vendor billing information to assign actual contract maintenance costs to each of the flight service stations. (FAA anticipates completing corrective action by March 31, 2005.)
- Compute and assign data processing labor costs automatically to each of the 61 flight service stations. (FAA anticipates completing corrective action by March 31, 2005.)

OIG Report FI-2002-016, “Air Traffic Services Planned Labor Distribution Reporting,” October 30, 2001

- Improve the internal controls within the Cru-X labor distribution system by directing that software programs be modified to use the system’s internal clock to automatically record the employee’s actual start and stop times and provide flexibility for the supervisor to approve variations in the scheduled work times as appropriate. (FAA anticipates completing corrective action by June 30, 2005.)

OIG Report FI-2001-023, “Status Assessment of FAA’s Cost Accounting System and Practices,” February 28, 2001

- Establish the cost accounting and labor distribution systems as a top priority and establish the estimated completion date when both systems are fully implemented. FAA’s goal should be to have both systems fully implemented by September 30, 2002. (FAA established the cost accounting system and labor distribution systems as a top priority and established the estimated completion date when both systems would be fully implemented. It expects to complete implementation by March 2006.)
- Increase allocation of monetary and personnel resources to meet the established completion date for both systems. (FAA corrective action completed.)
- Review the cost accounting system processes to determine whether more efficient methods can be used without a loss of system effectiveness. (FAA corrective action completed.)

OIG Report FI-2001-013, “Design of the Cost Accounting System for Research and Acquisitions,” December 18, 2000

- Modify the labor distribution reporting system and procedures to prevent hours from being charged to “No Project.” (FAA corrective action completed.)
- Implement written timekeeping procedures to ensure that hours worked are charged to the proper projects. (FAA corrective action completed.)
- Design the cost accounting system for Research and Acquisitions to create separate cost groupings for different types of common cost, such as overhead and general and administrative expenses. (FAA anticipates completing corrective action by March 31, 2005.)
- Change the basis for allocating overhead cost to projects to a total expenditure base that includes all project costs. (FAA corrective action completed.)
- Until the cost accounting system is implemented, estimate the portion of overhead cost associated with producing facilities and equipment assets and include the cost in work-in-process or other asset accounts until the assets are placed in use. (FAA corrective action completed.)
- Establish procedures to identify commercial and externally developed software costs incurred for all administrative systems under development and record the cost in work-in-process or other asset accounts in the financial and cost accounting system. (FAA corrective action completed.)

OIG Report FE-2000-024, “Cost and Flight Data for Aircraft Overflights,” December 17, 1999

- Use FY 1999 cost, including property depreciation cost, and FY 1999 flight data to determine overflight costs and compute user fees. (FAA corrective action completed.)
- Update labor standards as a short-term improvement to estimate airway facilities labor costs. (Rather than update standards, FAA opted to install labor distribution reporting; this recommendation is closed.)
- Establish a labor distribution system to capture costs for the air traffic controller and airway facilities workforces. As part of this process, establish a method to assign non-labor airway facilities costs directly to

Exhibit D. Prior Recommendations on the FAA Cost Accounting System

projects. (FAA has not taken corrective action; FAA anticipates completing corrective action by September 30, 2005.)

**OIG Report FE-1998-186, "Implementation of Cost Accounting System,"
August 10, 1998**

- Collect appropriate accounting adjustments and project cost. (FAA corrective action completed.)
- Develop procedures to ensure that labor costs are accurately assigned to projects. (FAA corrective action completed.)
- Determine cost incurred by other agencies and factor into FAA's full cost of operations. (FAA corrective action completed.)
- Revise the implementation plan for the cost accounting system by specifying time and resources necessary to obtain performance data, resolve schedule conflicts, and perform critical tasks. (FAA corrective action completed.)

EXHIBIT E. TESTIMONIES AND REPORTS RELATED TO AIR-21 ASSESSMENT AREAS

Statement of Alexis M. Stefani before the Committee on Transportation and Infrastructure Subcommittee on Aviation, U. S. House of Representatives, “Addressing Controller Attrition: Opportunities and Challenges Facing the Federal Aviation Administration,” June 15, 2004.

Statement of Kenneth M. Mead before the Committee on Appropriations Subcommittee on Transportation, Treasury and General Government, U. S. Senate, “Key Issues for the Federal Aviation Administration’s FY 2005 Budget,” April 22, 2004.

Statement of Kenneth M. Mead before the Committee on Appropriations Subcommittee on Transportation, Treasury and Independent Agencies, U. S. House of Representatives, “FAA’s FY 2005 Budget: Opportunities to Control Costs and Improve Effectiveness of Programs,” March 17, 2004.

“Consolidated Financial Statements for Fiscal Years 2003 and 2002, DOT,” OIG Report FI-2004-031, January 30, 2004.

“DOT’s Top Management Challenges,” OIG Report PT-2004-006, December 5, 2003.

Statement of Kenneth M. Mead before the Committee on the Budget, U. S. House of Representatives, “Opportunities to Control Costs and Improve the Effectiveness of Department of Transportation Programs,” July 9, 2003.

Statement of Kenneth M. Mead before the Committee on Appropriations Subcommittee on Transportation, Treasury and General Government, U. S. Senate, “The State of the Aviation Industry and the Federal Aviation Administration,” April 2, 2003.

Statement of Kenneth M. Mead before the Committee on Appropriations Subcommittee on Transportation, Treasury, and Independent Agencies, U. S. House of Representatives, “Appropriation Issues for the Department of Transportation FY 2004 Budget,” March 13, 2003.

Statement of Kenneth M. Mead before the Committee on Transportation and Infrastructure, Subcommittee on Aviation, U. S. House of Representatives, “Re-authorization of the FAA,” February 12, 2003.

Statement of Kenneth M. Mead before the Committee on Commerce, Science and Transportation, U. S. Senate, "The State of the FAA," February 11, 2003.

"DOT Consolidated Financial Statements for Fiscal Years 2002 and 2001," OIG Report FI-2003-018, January 27, 2003.

"Quality Control Review of Audited Financial Statements for Fiscal Year 2002, FAA," OIG Report QC-2003-017, January 27, 2003.

"FAA Terminal Service Cost Accounting Practices," OIG Report FI-2003-013, January 21, 2003.

"Major Management Challenges and Program Risks," General Accountability Office Report Number 03-108, January 2003.

"2001 Status Assessment of FAA Cost Accounting System and Practices," OIG Report FI-2002-072, January 10, 2002.

"Flight Service Stations Cost Accounting Practices," OIG Report FI-2002-065, December 11, 2001.

"Air Traffic Services Planned Labor Distribution Reporting," OIG Report FI-2002-016, October 30, 2001.

"Status Assessment of FAA's Cost Accounting System and Practices," OIG Report FI-2001-023, February 28, 2001.

"Design of the FAA Cost Accounting System for Research and Acquisitions," OIG Report FI-2001-013, December 18, 2000.

"FAA Cost and Flight Data for Aircraft Overflights," OIG Report FE-2000-024, December 17, 1999.

"Implementation of FAA Cost Accounting System," OIG Report FE-1998-186, August 10, 1998.

EXHIBIT F. MAJOR CONTRIBUTORS TO THIS REPORT

THE FOLLOWING INDIVIDUALS CONTRIBUTED TO THIS REPORT.

<u>Name</u>	<u>Title</u>
Terrence J. Letko	Program Director
Michael Weisz	Project Manager
Michael Veverka	Senior Auditor
Kathleen Huycke	Editor

APPENDIX. MANAGEMENT COMMENTS



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

Memorandum

Subject: **ACTION:** Comments on Draft Report on 2003
Status Assessment of Cost Accounting
System and Practices, FAA

Date: SEP 30 2004

From: Assistant Administrator for Financial Services
and Chief Financial Officer

Reply to
Attn. of:

To: Assistant Inspector General for Financial and
Information Technology Audits

Attached is our response to the subject Draft Cost Accounting System Report. We concurred with all findings and recommendations, and indicated the specific actions that we plan to take for each recommendation and target dates for completion.

We appreciate the courtesy and professionalism of your audit staff. If you have any questions, please call Ray Morris at (202) 267-7580.

A handwritten signature in black ink, appearing to read "R. Punwani".

Ramesh Punwani

Attachment

**FAA RESPONSE TO OFFICE OF INSPECTOR GENERAL (OIG) DRAFT
REPORT ON
2003 STATUS ASSESSMENT OF COST ACCOUNTING SYSTEM AND
PRACTICES
PROJECT No. 03F3025F000**

October 1, 2003

OIG Recommendations.

OIG Recommendation: We recommend that the FAA Administrator direct:

1. The Chief Operating Officer, Air Traffic Organization, to:
 - a. Define the ATO cost accounting business requirements and prepare a plan with milestones to revamp the cost accounting system to account for organizational and overhead allocation changes resulting from the creation of ATO, and complete the system for all ATO activities.
 - b. Interface the labor distribution system to be used by air traffic controllers, with adequate internal controls, with the cost accounting system by June 30, 2005.

FAA Response:

1.a. Concur. During FY2004, the ATO defined its cost accounting business requirements. To meet the ATO management needs, ATO and APF worked together to identify changes to the cost accounting system and defined necessary modifications to the overhead allocations. APF documented all changes. Currently APF monitors the progress of this project through a detailed project plan that includes detailed activities and specific milestones. The expected completion date of the implementation of the cost accounting system for ATO is March 31, 2005.

1.b. Concur. During FY2003, the ATO organization used two systems to collect labor hours - CruSupport (a module of the Cru-X system) for former Air Traffic Services (ATS) employees and the Web LDR system for former Research and Acquisition (ARA) employees. Currently, ATO is testing and implementing an enhanced version of CruSupport, called Air Traffic Organization Reporting Tool (ART) to improve its labor distribution system and remedy identified internal control weaknesses. This new system will remedy internal control weaknesses associated with air traffic controller time reporting that the OIG reported in previous audit reports. It will also report air traffic controller off-position time in more detail, as recommended by the OIG in previous reports. The expected completion date of this effort is June 30, 2005.

CruSupport provides labor hour data to the Integrated Personnel Payroll System (IPPS). IPPS costs the hours and, beginning in FY05, will pass the labor costs to DELPHI. DELPHI, in turn, will provide the labor cost data to the CAS. We will complete the

change to the CAS to enable us to interface this data by March 31, 2005. ATO's conversion from CruSupport to ART will not require any additional CAS development work.

OIG Recommendation: We recommend that the FAA Administrator direct:

2. The Chief Financial Officer to:

- a. Implement data collection processes and cost assignment methods to assign substantially all costs to all lines of business and to all individual facility locations and activities, as appropriate, within each line of business.
- b. Document the cost accounting system and internal controls for the entire agency and periodically review cost assignment methods to ensure the system uses the best available data, replaces manual processes with automated processes where appropriate, and complies with federal accounting standards.
- c. Implement financial and performance goals and measures for all lines of business and all facility locations and activities within each line of business and link the goals and measures to the cost accounting system.

FAA Response:

2.a. Concur. During FY2004, APF gathered all LOB cost accounting requirements. During this process LOBs identified their management needs and the level at which cost information need be reported. APF ensures the accumulation of all costs and their assignment at reporting levels identified by LOBs, and that satisfy managerial cost accounting standards. APF is working with ATO to make changes to the CAS to resolve all previous OIG recommendations related to cost assignment methodologies and cost assignment at lower reporting levels. The expected completion date for implementing these changes is September 30, 2005.

2.b. Concur. Currently, as part of any major release, FAA reviews CAS allocation steps and Standard Operating Procedures and performs updates as necessary. In the future, FAA will annually review CAS business rules and cost assignment methodologies with the LOBs as a regular Quality Assurance activity and document that review. This will help FAA to identify areas requiring modification to comply with the most recent laws and regulations, to meet customers' evolving needs and to provide accurate and valid cost data. The expected date to complete implementing this process is March 31, 2005.

2.c. Concur. In FY2003, FAA developed a 5-year strategic plan titled "The Flight Plan." The Flight Plan contains four major strategic goal areas – Safety, Capacity, Organizational Excellence and International Leadership. In FY2004, FAA developed some financial efficiency and performance metrics in support of the Flight Plan. One example is percent of major acquisition programs on schedule and within budget. For FY2005, all lines of business and major staff offices have developed financial efficiency and performance measures that were reviewed and approved by ABA. These measures

will be contained in FY2005 business plans, currently in final stages of development. For example, the ATO business plan includes "Total ATO Cost per Controlled Flight Hour," an air traffic control efficiency measure. Cost per flight hour is a measure of how much it costs the ATO to provide its services. Unit cost comparisons by region or facility can determine where cost disparities exist and where improvements need to be made. This will aid in determining where to allocate resources, including new equipment, other technological advances, or personnel.

Additionally, the OMB has reviewed many FAA programs using the Program Assessment Rating Tool (PART). These programs included the Airports Grant Program, Certification and Regulation programs funded by the Operations appropriation, and programs funded by the Facilities and Equipment and Research, Engineering and Development appropriations. The PART reviews indicated that each of the rated programs has developed financial efficiency measures. These measures, approved by ABA, OST, and OMB, use data obtained from either the CAS or associated LDR systems demonstrating the linkage between efficiency measures and the CAS. As a further step, we plan to programmatically link cost with existing financial efficiency measures by September 30, 2006.