September 30, 2005

The Honorable Maria Cino  
Deputy Secretary of Transportation  
U.S. Department of Transportation  
400 Seventh Street SW  
Washington, DC 20590

The Honorable P. Lynn Scarlett  
Assistant Secretary—Policy, Management and Budget  
U.S. Department of the Interior  
1849 C Street NW, Suite 5110  
Washington, DC 20240

Dear Ms. Cino and Ms. Scarlett:

This report presents the results of our review of the cost-sharing arrangements for the airfield located at the Midway Atoll National Wildlife Refuge. The Federal Aviation Administration (FAA) is responsible for ensuring the continued operation of Midway’s airfield, which is owned by the Department of the Interior. This joint mission has led to a dispute over funding the airfield’s operating costs. Unless the two agencies want to operate independently of one another in “remote field camps” on Midway, they need to agree to control operating costs and equitably share these costs.

The Office of Management and Budget (OMB) requested that we review Midway operating costs to facilitate resolution of this dispute over airport cost-sharing arrangements. In November 2004, senior officials from both agencies also requested our assistance to determine a fair and equitable method to allocate costs. We are providing you with this report in response to that request.

Midway consists of three small islets in the northern Pacific Ocean, totaling 1,549 acres of land and about 297,000 acres of coral reefs, approximately mid-way between Los Angeles and Tokyo. Midway is best known for the pivotal role it
played in a June 1942 naval battle that turned the tide of World War II in the Pacific. Until 1996, the Atoll was under the control of the Department of Defense.

In 1996, Midway became a national wildlife refuge under the control of the Department of the Interior’s U.S. Fish and Wildlife Service (FWS). The primary purposes of the refuge are to maintain diverse wildlife, provide opportunities for research and education, and recognize and maintain the island’s historic significance. FWS also owns and operates Henderson Field Airport on Midway, which FAA has certificated as a commercial airport.¹

The underlying reason that the airport is certified as commercial is that commercial air carriers rely on Midway as a diversionary airport in the event of an emergency. Federal regulations, commonly referred to as ETOPS,² require that twin-engine aircraft, such as the Boeing 777, stay within 180 minutes of an airport adequate for landing safely in an emergency. About 38,000 twin-engine planes per year cross the Pacific Ocean. Those that cross the Northern Pacific rely on Midway as a diversionary airport. Without Midway, those aircraft would need to alter their routes, incurring additional flight time and fuel-related costs. Although the airlines that rely on Midway as a diversionary airport benefit from its continued certification, they are not currently charged for that benefit.

While commercial airlines benefit from the airport, Federal agencies are the primary airport users. For the 15-month period of January 2004 through March 2005, there were 136 aircraft landings at Midway airfield, one of which was an emergency landing for a commercial airline. Over the past year, Federal agencies have used Midway for the following purposes, all made operationally possible or less expensive by the airport.

- **FWS and Other Department of the Interior Agencies:** *Refuge operations, endangered species research, and maintenance of historical sites.* FWS, the primary user of the airport, regularly flies staff, volunteers, and supplies to support its refuge mission activities. The U.S. Geological Survey also conducts research, such as the translocation of endangered Laysan ducks on Midway.

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¹ As owner and operator (via a contractor) of the airfield, FWS’s responsibilities include maintaining the airfield, equipment, and facilities and funding airfield improvements (through Airport Improvement Program grants).

² ETOPS (Extended-Range Twin-Engine Operations) is an airplane/pilot operating requirement for two-engine aircraft. ETOPS requires that an adequate airport be available so that an airplane can land if an engine failure or other problems require a diversion. An adequate airport is defined as a certified airport or one that is found to be equivalent to a certified airport’s safety requirement. The fact that Midway is a certified airport makes it adequate for ETOPS.
• **Department of Defense**: Diversionary airport and national security. A Navy aircraft made an unscheduled landing on Midway to refuel. The Missile Defense Agency used Midway to support a test of the National Missile Defense System.

• **Department of Homeland Security**: Diversionary airfield, search and rescue, and national security. A U.S. Coast Guard (USCG) aircraft medically evacuated a foreign national from Midway. The Transportation Security Administration performs security oversight and aviation security at airports such as Midway.

• **Department of Commerce**: Monitoring geological events and endangered species research. Volcanic and earthquake-monitoring equipment are located on Midway, and the National Oceanic and Atmospheric Administration (NOAA) conducts research to monitor endangered Hawaiian monk seals.

Neither FWS nor FAA believes its mission includes maintaining Midway as a diversionary airport, and therefore, neither believes it should be responsible to pay the cost of meeting ETOPS requirements. According to Department of the Interior officials, FWS does not require a certified airport to carry out its mission on Midway. Therefore, FWS does not believe it should pay the costs to maintain Midway as a certified airport. Similarly, FAA officials do not believe FAA should be required to pay the cost to operate Midway’s airport because FAA does not operate or pay to operate any other airport. Instead, its mission is to provide the safest, most efficient aerospace system in the world, which it does by regulating civil aviation and U.S. commercial space transportation; encouraging and developing civil aeronautics; developing and operating a system of air traffic control; researching and developing the National Airspace System and civil aeronautics; and developing and carrying out programs to control aircraft noise and other environmental effects of civil aviation. In fact, FAA officials emphasized that typically its primary role relating to airports involves capital investment and safety rather than airport operations.

Congress, believing that Midway’s role as a diversionary airport is critical to safe and efficient air travel, has attempted on several occasions to get Federal agencies to work together to ensure the continued operation of the airport. In fiscal year (FY) 2003, Congress appropriated $3.5 million to the Department of Transportation (DOT) to maintain Midway airport.³ It also authorized FWS to collect fees from users to offset airport costs. In FY 2004 and FY 2005, Congress did not include funds for FAA to pay for the airfield. Instead, Congress called for FAA to pay the cost to operate the airport and called for other Federal agencies

³ FAA and FWS signed an interagency agreement that transferred the funds from FAA to FWS to operate the airport.
that use Midway to reimburse FAA. FAA funded the airport’s costs in FY 2004 and FY 2005, but to date, no Federal agency has provided any reimbursement because no formula has been established to allocate costs among Federal agencies.

In FY 2005, Congress directed OMB to establish an equitable formula for allocating the airport’s operational costs among appropriate Federal agencies. Congress called for the allocation to be based on potential airport use, interest in maintaining aviation safety, and applicability to Government operations and agency mission. The recently passed SAFETEA-LU law\(^4\) reaffirms congressional interest in an equitable allocation of Midway costs by emphasizing interagency funding from FY 2006 through FY 2009.

The purpose of this report is to provide OMB with an independent analysis to allocate costs among appropriate Federal agencies. Exhibit A contains additional background information and a photograph of the airfield. Our objectives were to identify (1) the costs of operating the Midway airfield, (2) a fair and equitable method for allocating costs among users, and (3) opportunities to reduce operating costs. We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards prescribed by the Comptroller General of the United States and performed such tests as we considered necessary to detect fraud, waste and abuse. Our scope and methodology are described in Exhibit B.

**RESULTS IN BRIEF**

Midway’s operating costs are higher than would be expected for such a small operation. Reasons for this are that Midway has:

- *An oversized infrastructure.* FAA and FWS are currently paying to maintain an infrastructure capable of supporting 5,000 people, although only about 50 people reside on Midway.

- *An aging and outdated infrastructure.* Much of the infrastructure (i.e., equipment and related buildings that provide electricity, water, sewer, and other support services) is obsolete and expensive to operate and maintain. For example, the wastewater treatment system relies on pumps that are over 60 years old and portions have been shut down and salvaged to keep the remaining system operational.

- *A fixed-price contract that includes a higher level of activity than has actually occurred.* FAA and FWS are paying for a fixed-price contract that has locked them into paying much more than is necessary to support Midway operations.

The agencies saved about $1.1 million in the second half of FY 2005 by modifying the existing contract to support only the activities currently necessary on Midway.

- A remote location. Midway’s remote location, about 1,250 miles from Honolulu, is a major cause for the high costs, as all supplies must be brought in either by plane or boat.

Based on our review, we believe that both FAA and FWS can operate the airfield and refuge for less: $4.4 million total annually for FY 2006 and beyond, which is slightly over half of the cost in FY 2004. We also determined a fair and equitable method for allocating costs between FAA and FWS for FY 2005. We provided our preliminary estimates and findings to the agencies on March 18, 2005, and they generally agreed with the results. Table 1 shows the operating costs of the airfield and the refuge by fiscal year.

### Table 1. Midway Operating Costs (in millions of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Airfield</th>
<th>Refuge</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2004</td>
<td>$3.7</td>
<td>$4.4</td>
<td>$8.1</td>
</tr>
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</table>
| FY 2005 (estimate)

<table>
<thead>
<tr>
<th>Year</th>
<th>Airfield</th>
<th>Refuge</th>
<th>Total</th>
</tr>
</thead>
</table>
| FY 2006 (estimate)

<table>
<thead>
<tr>
<th>Year</th>
<th>Airfield</th>
<th>Refuge</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2.0</td>
<td>4.4</td>
<td>$6.4</td>
</tr>
<tr>
<td></td>
<td>1.6</td>
<td>2.8</td>
<td>$4.4</td>
</tr>
</tbody>
</table>

\[a\] Subject to adjustment at year-end based on actual costs and revenues.

\[b\] Subject to significant uncertainty because the FY 2006 contract has not yet been awarded; therefore, the level of operations has not been determined.

FAA and FWS are working together to ensure the continuous operation of the airfield. They modified the existing contract to eliminate unnecessary functions and to reduce operating costs for FY 2005. They are also in the process of upgrading the infrastructure. What remains to be done is developing agreements for FY 2006 and beyond. The agencies need to complete negotiations for a new contract with the Island service provider, sign a memorandum of understanding for sharing costs based on actual usage,\(^5\) and develop an agreement for collecting reimbursements from other agencies using the airfield, such as USCG and NOAA. Having an equitable allocation of Midway costs is critical to holding agencies

\(^5\) Allocation based on actual usage and proper accounting is required by Federal accounting standards.
accountable for their usage, which is reaffirmed by the Congress in the recently passed SAFETEA-LU.

The following summarizes our results.

**The Present (FY 2005): Controlling and Allocating Costs**

We estimate that Midway operating costs should be about $6.4 million for FY 2005, down from about $8.1 million in FY 2004. Airfield operating costs should be about $2.0 million in FY 2005. After taking into account anticipated FY 2005 Midway revenues of $0.9 million, FAA’s payment should be about $1.8 million and FWS’s payment about $3.7 million. The airfield’s share of FY 2005 operating costs is substantially less than the $3.7 million FAA paid in FY 2004.

FAA agreed to pay the airfield’s share of costs through FY 2005 in compliance with current congressional direction that FAA ensure the continuous, uninterrupted operation of the airfield for the safety of commercial aircraft. Neither FWS nor FAA has a sound methodology to calculate how much other Federal agencies should reimburse FAA in FY 2005.

**FAA and FWS Agreed to a Fair and Equitable Method for Allocating FY 2005 Costs.** Recognizing that it was critical to reduce costs to an affordable level, FWS and FAA agreed to several immediate actions to lower costs substantially for the remainder of FY 2005 (from April to September), mainly by renegotiating the operations contract for Midway. The renegotiated contract has reduced the cost of operations for the second half of FY 2005 by approximately $1.1 million. FWS also agreed to apply all Midway revenues against Midway operating costs. Based on data provided and actions taken to reduce costs, we determined that Midway operating costs should total about $6.4 million in FY 2005. The airfield’s share of those costs is about $2.0 million ($1.8 million net, after the airfield’s share of revenues is applied). The remaining costs, $4.4 million ($3.7 million net), were assigned to refuge operations and will be paid by FWS.

Properly allocating costs and revenues was a challenge because FWS’s accounting systems had not been set up to track or allocate costs and revenues. As a result, some costs that should have been assigned as direct costs to one agency were included as indirect costs and shared by both agencies. For example, although FWS should pay the cost to support its volunteers, because FWS did not track the cost to fly its volunteers between Midway and Honolulu, the cost was considered indirect and was partially paid by FAA.
Because FWS had not established mechanisms to allocate indirect costs based on usage of indirect services, we allocated indirect costs based on the number of mission-related personnel on Midway. We estimated that there were 17 direct, mission-related personnel on Midway—5 assigned to the airfield and 12 assigned to the refuge. The refuge personnel consisted of four FWS employees, one FWS employee’s spouse, and the equivalent of seven staff-years of FWS volunteers. Although FWS agreed with our methodology, it disagreed with the number of mission-related personnel assigned to refuge operations, stating that FWS employed only eight mission-related personnel. The difference between the counts is, first, that FWS did not include family members (neither the Midway employee’s spouse, who lives on the island, nor the wife and child of the prior refuge manager, who left in December 2004, were considered by FWS). Second, the number of volunteers differed. FWS stated that volunteers visiting Midway averaged about four staff-years “for the past few years.” Our estimate of seven staff-years was based on the actual number of years volunteers spent on Midway in FY 2004. Despite FWS’s disagreement with the number of mission-related personnel, it agreed to allocate costs in FY 2005 on the basis we proposed.

At the end of the fiscal year, the agencies also agreed to determine actual costs and revenues and to allocate those costs between airfield operations and refuge operations based on the actual number of direct, mission-related personnel, including volunteers.

**FY 2006 and Beyond: Managing and Allocating Costs and Revenue Fairly and Equitably**

In the future, the agencies should apply generally accepted accounting principles to record financial transactions and allocate costs. This would involve assigning as many costs as possible as direct costs and then fairly allocating indirect costs and revenues. The agencies do not yet have a basis for allocating costs in FY 2006 using generally accepted accounting principles because they lack data on actual usage of services on Midway. Fees also did not fully recover the cost of providing the services and the resulting revenues were not applied to offset the costs of providing the services.

Although actual costs could differ substantially, we estimate that if the agencies operated at the same level of service and costs as in the second half of FY 2005, invested in downsizing the infrastructure as agreed, and used the same reasonable method as employed in FY 2005 to share costs, the cost for the airfield’s FY 2006 operations would be about $1.6 million (of Midway’s total operating costs of $4.4 million). The decrease in costs would primarily be the result of scheduled capital investments and a new contract with reduced operations (similar to the one
in place for the second half of FY 2005). This level of costs will not be achievable unless FWS and FAA carefully limit the scope of services under the new contract.

Both agencies provided us with cost estimates that indicate that they can each fulfill their respective missions at lower costs by reducing operations to minimum levels, which they referred to as their “remote field camp” scenarios. According to FAA, after making the initial investment to set up a stand-alone airport operation, the annual costs for the airfield would be about $1.5 million. Similarly, FWS estimates that its annual costs for the refuge would be about $1.7 million. Based on these cost estimates, we see no reason why they cannot work together to control costs.

**Costs and Revenues Need To Be Properly Tracked and Assigned.** Improvements are needed to properly account for costs and revenue and to allocate them fairly based on generally accepted cost accounting and cost allocation principles. Specifically:

- Whenever possible, costs should be directly assigned to the appropriate user.
- Costs that cannot be directly assigned (indirect costs) should be allocated based on usage.
- Fees should cover the costs of providing the service.
- Revenues (fees) should be properly recorded and applied to offset costs, subject to laws and regulations.

To illustrate, in coordination with FWS, we identified the following activities that should have been characterized as direct costs: airfield, refuge, fuel farm, visitor operations, national defense, historical buildings and memorials, environmental monitoring, and research. However, airfield and refuge were the only two activities that were assigned direct costs due to the limited availability of information. The airfield’s direct costs were derived using information from the current contractor, and the refuge’s direct costs were obtained from FWS’s budget for Midway. Information on visitor operations, such as landings, fuel sales, and paid lodging at “Hotel Midway,” were available from the contractor and FWS, but the documents provided did not indicate why the visitors were on Midway. In addition, costs that cannot be directly assigned (indirect costs) should be allocated based on each agency’s use of Midway services and facilities (e.g., the costs of electricity should be allocated according to the percentage of use, which can be measured using meters or other methods).

**A New Contract is Needed.** FWS plans to award a new contract for operating Midway for FY 2006 and beyond. The new contract should (1) tightly define the
scope of work to ensure that costs do not increase significantly from current levels, and (2) segregate direct costs so they can be assigned to the responsible agency. However, FWS has indicated that the reduced costs achieved by renegotiating the contract for the last 6 months of FY 2005 are not representative of the level of service necessary for FY 2006. In contrast, during our review, FWS indicated that it could complete its mission with as few as four people. Based on this statement, we believe that both agencies can continue their missions by working together and contracting for operations at levels no more than those that exist for the second half of FY 2005.

Operating Costs Should Be Kept at a Sustainable Level. The challenge for FWS and FAA will be to keep operating costs at a sustainable level in the future. FAA and FWS should continue the current level of operations (similar to the second half of FY 2005) with the contractor to operate the airfield and infrastructure and properly account for and track costs and revenues. This includes FWS’s refuge operations remaining constant. Additionally, all construction-related costs, such as fuel used for construction and transporting labor to Midway, need to be charged to the proper capital fund and not to indirect operating costs.

We estimate that if the same methodology for sharing costs in FY 2005 is used in FY 2006, the airfield’s FY 2006 operating costs should be no more than $1.6 million (of Midway’s total operating costs of $4.4 million); this amount, which includes indirect costs, carries the assumption that FAA and FWS will agree to:

- Assign all airfield-related costs as direct costs to the airfield and allocate indirect costs based on the airfield’s share of direct mission-related personnel on Midway. (However, we suggested they allocate indirect costs based on usage in accordance with generally accepted accounting principles.)
- Complete planned capital investments. The agencies also agreed to start construction in the summer of 2005 on capital investments to downsize and improve the infrastructure and the airfield. Midway’s new infrastructure will support 30 to 100 people, resulting in a more efficient operation. Midway can operate with as few as 8 to 10 people, which includes 4 to 5 people to operate a certified airfield and 4 to 5 people to manage the wildlife refuge. Designing the infrastructure to support more people than the 8 to 10 needed for basic operations is necessary to facilitate visitors to the refuge. FWS will fund all

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6 According to the statement of work for the new contract, in the event that a viable visitor services program is reestablished at Midway, the contractor shall have the means and personnel to perform the following: hotel services; food services; rental services; scuba center; educational programs; transportation; and morale, welfare, and recreation.
infrastructure capital improvements, and FAA will fund all airfield improvements using Airport Improvement Program grant funds. The savings from these investments will be realized in FY 2006 and beyond. We used FWS savings estimates from a FY 2004 report for similar infrastructure investments to estimate that the planned capital investments should reduce infrastructure operating costs by about $530,000 per year.

- Reduce both the airfield’s and refuge’s share of costs by having any agency with additional activities on Midway pay its fair share of costs.

**Agencies Need To Cooperate in Governing Midway Operations.** The agencies operating on Midway should operate in a more collaborative manner, sharing information and striving for consensus in Midway operations. They should enter into a memorandum of understanding that would establish an interagency working group to provide for Midway’s operational needs. This would be consistent with prior congressional direction that the agencies work together to improve Midway operations. The agencies that are being asked to contribute funds to support the continued operations currently have no insight into budgeted or actual costs of operations. None of the agencies that operate on Midway, except perhaps FWS, have even limited information about how funds are being used to support their operations. For example, FAA has never received a bill from FWS, yet has been charged for items such as a supply barge that never actually delivered goods to Midway. This occurred because FWS requested reimbursements from FAA based on the budget, rather than actual costs.

FWS’s limited ability to track costs and revenues and to properly allocate them is a significant impediment to establishing confidence among participating agencies. This has made it difficult to account for and present the results of Midway operations and may have contributed to several instances we identified in which funds were not properly accounted for. We believe a Midway-specific revolving fund should be established within the Department of the Interior to segregate Midway financial activity from other FWS operations. This would make financial decisions and cost allocations more transparent to the Federal agencies involved. The fund would be operated by a budget officer or business manager with an understanding of appropriations law and cost accounting principles. By working together to keep better track of the costs of operations, all users of Midway would have more confidence that their costs are reasonable, and no agency would be inappropriately subsidizing the costs of others.

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7 A revolving fund conducts continuing cycles of business-related activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations.
Summary of Recommendations

The Deputy Secretary of Transportation and the Assistant Secretary—Policy, Management and Budget, Department of the Interior, concurred with our recommendations that they work with OMB to ensure that FWS and FAA:

(1) apply generally accepted accounting principles as described in this report to equitably allocate costs and revenues; (2) tightly define the level of operations and scope of work for the new contract to control costs; (3) revise fees to recover the costs associated with the services provided; (4) establish an interagency agreement and an interagency working group to coordinate Midway operations; and (5) improve accounting practices to properly record and allocate costs and revenue associated with Midway operations. The parties should also consider establishing a revolving fund for Midway-specific activities only. This would make financial decisions and cost allocations more transparent to the Federal agencies involved. The full recommendations can be found starting on page 24.

If I may be of further assistance, please contact me at (202) 366-1959 or Theodore P. Alves, Principal Assistant Inspector General for Auditing and Evaluation, at (202) 366-1992.

Sincerely,

Kenneth M. Mead
Inspector General
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Costs To Operate Midway and Its Airfield

In FY 2004, total costs to operate the Island were about $8.1 million, of which FAA paid $3.7 million to fund operations of the airfield. The balance of about $4.4 million was paid from FWS appropriations ($3.8 million) and revenue ($0.6 million).\(^8\)

Recognizing that it was critical to reduce costs to an affordable level, FAA and FWS agreed to several immediate actions to lower costs substantially for the remainder of FY 2005 (April to September). Based on actions taken to reduce costs and data provided, we determined that Midway operating costs should be about $6.4 million in FY 2005. Funding requirements will be less than gross costs because revenue is available to offset costs. Table 2 shows a summary of expected FY 2005 net operating costs.

Table 2. Estimate of FY 2005 Funding Requirements for Midway Operations

<table>
<thead>
<tr>
<th>Budget</th>
<th>Amount</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Midway Operations (prepared by FWS)</td>
<td>$7,597,000</td>
<td></td>
</tr>
<tr>
<td>Additions: Fuel tank inspection/overhaul of generator</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Reductions: Assign fuel spill clean-up to remediation appropriation</td>
<td>(40,000)</td>
<td>$7,857,000</td>
</tr>
<tr>
<td>Revised Midway Operations Budget</td>
<td>7,857,000</td>
<td></td>
</tr>
</tbody>
</table>

**Adjustments**

| Capitalization of transportation costs     | (400,000)  |           |
| Reduction in operations contract           | (1,084,000) |           |
| **Total Adjustments**                      | (1,484,000) |           |
| **Gross Costs for FY 2005**                | $6,373,000  |           |

**Revenue Applied To Reduce Operations Costs**

| Anticipated revenue from fuel and miscellaneous | (190,000) |
| Anticipated visitor fees                        | (36,000)  |
| NOAA payment                                    | (39,000)  |
| Commitment from USCG to purchase excess fuel    | (450,000) |
| **Total Revenues To Be Applied**                | (715,000) |

| **Net Costs for FY 2005**                      | $5,658,000 |

**Adjustments From Other Periods**

| Cash available from prior-year revenue         | (216,000)  |
| **Net Amount Needed for Midway Operations**    | $5,442,000 |

\(^8\) This is available revenue. Total revenue collected in FY 2004 was about $0.9 million.
In comparing costs between FY 2004 and FY 2005, the primary difference is the decrease in the contract amount for the second half of FY 2005. The amended contract includes a reduction of about $1.1 million. Most of the reduction is attributable to the fact that the actual levels of Midway operations were significantly less than expected when the fixed-price contract was originally awarded. See Exhibit C for details describing the line items contained in Table 2.

**Allocation of Costs for FY 2005**

To determine the allocation of FY 2005 costs to various Midway activities, we worked with FAA and FWS to apply Federal cost accounting standards to FY 2005 costs and revenues. Because cost and revenue information was limited and anticipated revenues rely on future events, these amounts should be considered estimates. Better accounting information is needed in the future to ensure that costs and revenues are properly accounted for and fairly allocated.

We determined the costs and contribution level for each agency based on the information provided by FWS and the Midway contractor. Because FWS had awarded a fixed-price contract for operating the infrastructure and the airfield and fuel farm, the contractor was not required to provide detailed cost information or to allocate actual costs to specific activities. We requested this information, but the contractor declined to provide actual costs. Therefore, we worked with FWS officials and the contractor to apply alternative estimating methods to determine the costs and to attribute them directly to individual activities, such as airfield operations. We then directly assigned those costs to the activity. The remaining costs were either shared costs, such as generating power and water, or costs that should be direct but could not be separately identified, such as building maintenance for housing.

Working with FWS and FAA, we considered several methods for allocating indirect costs to each activity, and FWS and FAA agreed that the number of direct people assigned to each activity provided the best surrogate to reflect actual usage of indirect services, given the limited information available. We then allocated indirect costs to each activity based on the proportion of people assigned to each activity as compared with the total number of people assigned to all activities. For example, if an activity employed 25 percent of the total direct staff, 25 percent of the indirect costs were assigned to that activity.

We reviewed the results with FWS and FAA officials, and they agreed that the results represent an imprecise but reasonable approximation of FY 2005 costs to perform each activity. Based on these results, FAA agreed to reimburse FWS $1.8 million in FY 2005 to ensure the continuous operation of the airfield. This is a budgeted amount and will need to be adjusted to reflect actual costs at year’s
end. The resulting funding that both principal agencies should contribute to Midway operations during FY 2005 is shown in Table 3. See Exhibit D for additional details about the cost allocation methodology for FY 2005.

### Table 3. Funding Requirements by Agency To Support Midway Island Operations, FY 2005 (in millions of dollars)

<table>
<thead>
<tr>
<th>Contributing Agency</th>
<th>Funding Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Aviation Administration</td>
<td>$1,789,225</td>
</tr>
<tr>
<td>U.S. Fish and Wildlife Service</td>
<td>3,652,775</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$5,442,000</strong></td>
</tr>
</tbody>
</table>

**Reasons for FY 2005 Cost Reductions**

The $1.8 million for airport costs in FY 2005 represents a reduction of more than half (FAA reimbursed $3.7 million to FWS in FY 2004). The reasons for the reduction are that (1) FAA reimbursed FWS for more than the airfield’s share of costs in FY 2004; (2) FWS negotiated a $1 million reduction in the contract to operate all Midway facilities for the last 6 months of FY 2005; and (3) all available revenue, both for prior years and the current year, will be used to offset infrastructure costs. Specifically:

- In FY 2004, FAA paid more than the airfield’s share of costs on Midway. First, FAA paid the fuel farm operations direct costs. It also paid for services provided to other Federal agencies on Midway, such as fuel sold to other agencies. In addition, FAA did not receive a reduction in airfield costs for other sources of airfield-specific funding, such as a $500,000 emergency appropriation that was designated to reduce airfield costs. This occurred, at least in part, because the interagency agreement between FAA and FWS (1) specified that FAA would pay for the fuel farm and some fuel, (2) was unclear about what was included in the airfield, and (3) did not specify how revenue and other funding should be treated.

- For the second half of FY 2005, FWS renegotiated the contract for the operation of Midway airfield and infrastructure with its contractor. This
action, which included reducing services to a minimum level, saved about $1.1 million.

- For FY 2005, FAA and FWS agreed that all available revenue, both for prior years and the current year, would be used to offset infrastructure costs. We identified about $255,000 of available revenue collected for both the prior and current years that should have been applied to Midway operations. This include a $191,000 payment; FWS told us that it had inadvertently credited the payment to the wrong organization. There was also a $25,000 payment from NOAA that was not credited to Midway in FY 2004. In addition, a $39,000 receipt had not been collected from NOAA for support costs associated with National Marine Fisheries personnel working on the island.

We anticipate about $715,000 in current-year revenue collections during FY 2005. FWS also agreed to consider increasing fees from other agencies that use Midway to offset FY 2005 operating costs. These fees include housing, landing fees, special permits, and fuel sales for aircraft and sea vessels. The largest anticipated revenue is the sale of fuel to USCG for $450,000. In summary, it will be incumbent upon FWS and FAA to carefully manage operations, costs, and revenue. At the end of the year, FWS should adjust agency contributions based on actual costs and revenues using the actual number of volunteers.

**Sustaining Cost Reductions in FY 2006 and Beyond**

The actions taken by FWS in FY 2005 reduced costs by over $1 million for the second half of the year. Services to support refuge, airfield, and fuel farm operations were reduced. The challenge will be to sustain those reductions in FY 2006 and beyond.

To meet this challenge, FWS agreed to revise the contract’s scope of work and re-compete the contract for FY 2006. Additionally, FWS will make capital improvements to the infrastructure and airfield using its own funds and Airport Improvement Program funds from FAA. If Congress authorizes FAA to fund the airfield, FWS and FAA should develop a new interagency agreement to limit FAA’s participation in costs to maintain the airfield, including the airfield’s share of infrastructure costs.

**FWS Will Award a New Contract for FY 2006**

By tightly defining and limiting the scope of work required and obtaining competition, FWS can ensure that contract costs do not increase significantly.
However, until the new contract is negotiated, FY 2006 costs will remain uncertain.

It is important that the scope of work for the contractor be appropriately defined. For example, in the past, the contractor was responsible for the maintenance of over 30 buildings (almost 1 building per person). The number of buildings to be maintained should be limited, and the maintenance standards need to be clearly defined.

The contract also needs to provide more visibility into costs in order to directly attribute, as much as possible, the costs of operating activities to the responsible agency. At a minimum, direct airfield operating costs and infrastructure support costs need to be clearly identified and tracked. The costs of common services, such as housing for the cooks, the water treatment plant, and the power plant, should be shared based on a reasonable measure of usage. The housing for airfield staff should be direct costs of airfield operations (which are paid by FAA) and housing for FWS staff, family, and volunteers should be direct costs of refuge operations. In past years, costs were not clearly segregated by activity. For example, the operating costs of the airfield and fuel farm costs were reported together. More information is needed on activity levels on the island to better allocate costs. For instance, we had difficulty determining the number of people on the island and their activities, information that will be needed to allocate costs fairly in the future.

**FWS Plans To Make Capital Investments To Reduce Operating Costs**

FWS plans to make several infrastructure investments totaling $5.3 million that should reduce Midway operating costs. These investments will replace oversized and inefficient infrastructure equipment, including generators for electricity, water treatment facilities, and the sewage system. Reducing these shared infrastructure costs should also reduce the costs to operate the airfield. An FWS study estimated that these investments would reduce operating costs by about $530,000 annually, but the actual savings will depend on the level of Midway operations. Also, FAA plans to provide $5 million in capital to FWS to improve airfield operations and mitigate current deficiencies in the airfield certification.

One additional investment that could reduce operating costs is the replacement of oversized, obsolete, and deteriorating fuel tanks. FWS estimates that it needs $3 million to replace the fuel farm. The FWS study also estimates that this investment would reduce infrastructure costs by about $275,000 beginning in FY 2007. As of now, this project is not funded. One complication is that we estimate that FWS needs to sell or consume about 800,000 gallons of excess fuel
before it can dismantle the older tanks. See Exhibit G for further discussion of capital investments.

Determining a Fair and Equitable Method For Allocating Costs and Revenues

Before an agreement on FY 2006 operations is reached, the parties need to agree on how to allocate costs and revenues fairly and equitably. An agreement must be reached because it is improper for one agency to augment the appropriations of another. According to appropriations law:

…a cost allocation in which some customers are paying excessive amounts and effectively subsidizing others is improper….so is an allocation based on the availability of appropriations….or a per capita funding arrangement not related to the goods or services actually received.

According to Federal cost accounting standards, cost assignments should be performed by the following methods, listed in order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

Accounting for Costs

Federal cost accounting standards call for costs of shared operations to be distributed fairly among participating agencies. Direct costs to perform an activity should be directly assigned to the activity (and the agency responsible for the activity). Indirect costs are those that support more than one activity and so cannot be directly assigned. These costs should be distributed among the activities that benefit on an equitable basis. For example, the costs associated with providing food and housing to the contractors who support the infrastructure benefit all agencies operating on Midway, and therefore those costs should be shared.

To improve accountability and comply with accounting standards, the new contract that FWS plans to award for FY 2006 should require more detailed cost

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9 In 2003, a corrosion-related 100,000-gallon fuel spill occurred on Midway Atoll. FWS must continue cleaning up the fuel spill until recovery and incineration are complete. An incinerator was installed to burn the recovered JP-5 fuel after it has been through a filtration system. To date, the cleanup has cost about $4.3 million.


and usage information, which would provide sufficient data to identify costs or allocate costs or revenues to the activity being supported. In the past, information was not provided on who used the flights to Midway. Consequently, all of the costs of the flights were considered indirect costs. These transportation costs should be charged based on usage directly to mission activities where possible. To illustrate, the full cost of the flights that carried the personnel and supplies to Midway was allocated as overhead and shared between FAA and FWS in FY 2004. Based on the contractor’s records, none of the FWS volunteers and only certain visitors, such as FAA technicians, paid the $1,500 airfare for flights to and from Midway in FY 2004. We could not determine the rationale used to decide who pays and who does not. Each agency should cover the costs of its own employees’ travel.

To appropriately assign Midway costs in the future, more detailed information on costs and usage is needed. Specifically:

- **Transportation Flights.** These flights are an example of how costs could be directly assigned to activities. Past practice has been to consider the entire transportation amount (about $800,000 per year) an indirect cost. The contractor should collect flight usage information for both passengers and cargo. Because the flights support both direct activities and shared support services (indirect costs), a portion of the flight costs still need to be shared. For instance, all Island residents and visitors benefit from food supplies transported to Midway.

- **Building Maintenance.** The agencies using Midway need to identify which buildings are being used and for what purpose. Currently, more than 30 buildings are being maintained. Building maintenance is a fairly expensive activity (about $1 million in FY 2004). It is also important to identify which buildings are used for activities and which buildings are only being maintained for historical preservation. Some buildings serve multiple activities, while others have a specific purpose. For example, we reviewed the use of the hangar building on Midway. We observed and were informed that the hangar building served multiple purposes.

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Figure 1. Hangar Room Used For Third-Party Experiment
In addition to serving as the airfield operations center, the building is also used for religious services, a visitor’s center, research, an emergency shelter for Island residents, and storage for communications equipment for the Island and research equipment for third parties. To better allocate the cost of maintaining buildings, the contractor should allocate building maintenance costs based on the activity sponsor.

- **Construction Support and Capital Projects.** Construction activities will be taking place on Midway over the next several years that will place major demands on the Island’s infrastructure (i.e., use of power, equipment, lodging for construction staff, food services, and transportation). Accounting principles dictate that the cost of property, plant, and equipment include all costs to complete installation or construction. Therefore, the support costs related to construction need to be identified and included in construction costs rather than operations costs. The agencies should budget for these costs and plan for how to identify, track, and record them. About $10 million has already been budgeted by FWS and FAA for capital projects to be completed during the next 2 to 3 years (see Exhibit G for a summary of capital projects).

- **FWS Administrative Fee.** FWS indicated that it wants to charge FAA an administrative fee of approximately 22 percent to the FAA portion of the contract for services at Midway Atoll. FAA considers the payment of an administrative fee inappropriate because the airfield is owned by FWS. FAA contends it is helping FWS by providing funding for the airfield, not procuring services from FWS. According to appropriations law, the amount of an administrative fee must be agreed upon and based on a reasonable approximation of the cost of providing the administrative services.\(^\text{12}\)

### Accounting for Revenues

Currently, Midway operations are mostly funded through FWS and FAA appropriations. Other Government agencies use Midway for various purposes. Examples include USCG search and rescue operations, various Department of Defense flight activities, Missile Defense Agency projects, and NOAA and U.S. Geological Survey research activities. These agencies pay various fees, such as landing fees, fuel, lodging, food, and special permits. Non-Government users also pay for these services. However, fees charged Government and non-Government users do not always recover the cost of providing the services. Congress authorized FWS to charge reasonable fees for services provided on the

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Island and retain them to be used toward costs specific to non-refuge activities.\textsuperscript{13} About $1.8 million in revenues was collected in total during FY 2003 and FY 2004. Those revenues should have been used for the operation and maintenance of infrastructure and staffing required for non-refuge-specific needs, including meeting the terms necessary for an airport operating certificate and the purchase of fuel supplies, but they were not always used for those purposes. According to documents provided by FWS, some of the revenues ($160,000 in FY 2004) were used for refuge operations, such as salaries and benefits, and support costs clearly not non-refuge-specific activities. According to appropriations law, public funds may be used only for the purpose or purposes for which they were appropriated.\textsuperscript{14} We plan to issue a separate letter to management on this issue.

Congress also directed DOT, the Department of Defense, the Department of the Interior, and the Department of Homeland Security to enter into memoranda of understanding to facilitate the sale of aircraft fuel at a price that will generate sufficient revenue to improve the ability of the airfield to operating on a self-sustaining basis.\textsuperscript{15}

- **Fuel Sales.** The major source of revenue has been fuel sales (about $1.2 million for FY 2003 and FY 2004). FWS has indicated that the USCG has verbally agreed to purchase 150,000 gallons of fuel during the second half of FY 2005. To the best of our knowledge, neither USCG nor any of the other agencies has ever entered into written agreements or memoranda of understanding on this issue. However, if they obtain written agreements for major commitments, the agencies would be following both congressional direction and prudent business practices.

During our review, we noted that the selling price of fuel on Midway ($2.75 per gallon) did not include all of the costs. We also noted that the previous contractor charged $5 per gallon while the Department of Defense was charging less than $2.00 per gallon on Wake Island. We pointed this out to FWS officials, who then

\textsuperscript{13} Public Law 107-206 Section 703, “In fiscal year 2002 and thereafter, the Secretary of the Interior may charge reasonable fees for services provided at Midway Atoll National Wildlife Refuge, including fuel sales, and retain those fees, to be credited to the United States Fish and Wildlife Service, “Resource Management” account and remain available until expended for operation and maintenance of infrastructure and staffing required for non-refuge specific needs, including meeting the terms necessary for an airport operating certificate and the purchase of fuel supplies.”


\textsuperscript{15} Public Law 108-176 Section 186(b), “(b) MEMORANDUM OF UNDERSTANDING ON SALE OF AIRCRAFT FUEL.-The Secretaries of Transportation, Defense, Interior, and Homeland Security shall enter into a memorandum of understanding to facilitate the sale of aircraft fuel on Midway Island at a price that will generate sufficient revenue to improve the ability of the airport to operate on a self-sustaining basis in accordance with the standards of the Federal Aviation Administration applicable to commercial airports. The memorandum shall also address the long-range potential of promoting tourism as a means to generate revenue to operate the airport.”
committed to price fuel at full cost, which would include the cost of the product, its storage, and its delivery.

**Landing Fees.** Landing fees also present an opportunity to increase revenues. We noted that the fees charged for night landings are less than the additional cost charged by the contractor for night landings plus servicing the aircraft. We also noted that not all aircraft are charged the landing fee. These fees should be increased to cover costs and be applied to all landings to reduce the direct costs of running the airfield.

Other fees, such as lodging and food, represent a majority of the remaining revenues. FWS should consider increasing the fees charged for these services to possibly increase revenues in conjunction with determining the costs of providing these services. FWS has indicated that it will review the fee schedule to consider appropriate changes.

**Recreation Fees and Quarters Account Revenue Should Be Used To Offset FWS Housing and Visitor Costs.** The recreation fees collected are authorized for use to offset costs related to the visitation program. Currently, the costs of visitor operations on Midway are considered indirect costs and are allocated between FWS and FAA. These costs include or have included (1) the contractor assisting with incoming vessels, (2) hotel accommodations for visitors, and (3) maintenance of buildings (museum and refuge headquarters) and grounds for visitors.

Department of the Interior officials believe that revenue collected as recreation fees cannot be used to offset general operating expenses because its use is limited to:

(A) repair, maintenance, and facility enhancement related directly to visitor enjoyment...; (B) interpretations, visitor information, visitor service...; (C) habitat restoration...; (D) law enforcement...; (E) direct operating or capital cost associated with the recreation fee program...; and (F) a fee management agreement...

per the Federal Lands Recreation Enhancement Act. In our opinion, the funds can be used to offset visitor costs. Visitor operations are supported by the contractor, and related costs, as described above, are included in indirect costs and shared with FAA. We also note that FWS records indicate that recreation fee monies were used for non-visitor activities (e.g., fuel purchases and fuel spill remediation) in FY 2004.

Additionally, funds collected and deposited in FWS’s Quarters account should offset housing costs. Currently, the contractor maintains FWS housing, and
associated costs are considered indirect costs rather than direct FWS costs. In neither cases were revenues used to offset the costs.

Revenue and Other Collections Need To Be Used To Reduce the Costs of the Activity That Generated Them. According to FWS records, in FY 2003 and FY 2004, FAA paid 90 percent of the direct costs of operating the airfield and fuel farm. However, none of the proceeds from landing fees or fuel sales were used to offset FAA’s share of operating costs. See Exhibit E for further discussion of cost assignment and a suggested cost assignment and revenue sharing methodology.

FWS Needs To Improve Its Accounting Methods

FWS needs to better account for costs, revenue, and billings to users of Midway to provide assurance that costs charged are reasonable. The disagreement about cost sharing between FWS and FAA has been difficult to resolve because Midway operations were not set up to track actual costs or revenues or to allocate costs and revenues to activities on the Island based on generally accepted cost accounting and cost allocation principles. As a result, while both agencies struggled to lower costs, they lacked the information needed to determine whether costs were reasonable and whether the share of costs they contributed was fair. This situation created a significant amount of tension and distrust at both agencies. The following are examples of issues that we noted.

- FWS had not recorded all costs and revenues on an accrual basis. For example, revenue had been recorded based on receipt of cash rather than date earned.

- FWS had not tracked reimbursements from other agencies. For example, FAA had not paid $2.4 million for FY 2004’s operating costs. This went unnoticed by both FWS and FAA officials.

- Revenues were not recorded in the appropriate account. For example, a revenue payment from the contractor for $191,000 was credited to the wrong FWS organization.

- FWS could not readily provide us with complete financial information on the actual costs and revenues for Midway.

FWS’s limited ability to track costs and revenues and to properly allocate them is a significant impediment to establishing confidence among participating agencies. This has made it difficult to account for and present the results of Midway operations, and may have contributed to several instances we identified in which funds were not properly accounted for. We believe a Midway-specific revolving
fund is needed to segregate Midway financial activity from other FWS operations. This would make financial decisions and cost allocations more transparent to the Federal agencies involved. The fund would be operated by a budget officer or business manager with an understanding of appropriations law and cost accounting principles. By working together to keep better track of the costs of operations, all users of Midway would have more confidence that their costs are reasonable and no agency would be inappropriately subsidizing the costs of others.

An Interagency Working Group and a Midway-Specific Fund Need To Be Established

The agencies operating on Midway should enter into memoranda of understanding that will establish an interagency working group to provide for Midway’s operational needs. This would be consistent with prior congressional direction that the agencies work together to improve Midway operations. Additionally, a Midway-specific revolving fund should be established within the Department of the Interior to segregate Midway financial activity from other FWS operations. This would make financial decisions and cost allocations more transparent to the Federal agencies involved because the revolving fund would report its financial activity to OMB. In contrast, Midway operating costs are now one sub-account of many within refuge operations, and consequently, there is no visibility of costs and revenues to other agencies nor is there any assurance that financial activity is recorded to the appropriate sub-account. The agencies would equitably share in the administrative costs of maintaining the revolving fund. By working together to keep better track of the costs of operations, all users of Midway would have more confidence that their costs are reasonable, and no agency would be inappropriately subsidizing the costs of others.

RECOMMENDATIONS

We recommend that the Deputy Secretary of Transportation and the Assistant Secretary—Policy, Management and Budget, Department of the Interior, work with OMB to ensure that FWS and FAA:

1. Properly account for costs and revenue and allocate them equitably based on generally accepted cost accounting and cost allocation principles. Specifically, whenever possible, costs should be directly assigned to the appropriate user;

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16 A revolving fund conducts continuing cycles of business-related activity in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations.
costs that cannot be directly assigned (indirect costs) should be allocated based on usage; fees should cover the costs of providing the service; and revenues (fees) should be properly recorded and applied to offset costs, subject to laws and regulations.

2. Ensure that the new contract to support Midway operations tightly defines the level of operations and scope of work to ensure that costs do not increase significantly from current levels and allows direct costs to be tracked and assigned to the responsible agency.

3. Develop a revised fee schedule that recovers the cost associated with the services provided. The new fee schedule should be coordinated with affected users to allow them to determine if they want to continue operating on Midway.\textsuperscript{17}

4. Establish an interagency agreement and an interagency working group to provide for Midway’s operational needs. This would be consistent with prior congressional direction that the agencies work together to improve Midway operations.

5. Improve accounting practices to properly record costs and revenues associated with Midway operations. This should include periodically preparing financial status reports based on the accounting records that can be provided to other agencies.

In addition, the agencies should consider coordinating with Congress to provide the Department of the Interior with the authority to establish an interagency revolving fund for Midway Island. The revolving fund should have the authority to charge administrative fees, receive advances, and retain an annual reserve amount for emergencies. This would make financial decisions and cost allocations more transparent to the Federal agencies involved.

\textbf{AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE}

We provided the Deputy Secretary of the Department of Transportation and the Assistant Secretary—Policy, Management and Budget of the Department of the Interior with a draft of this report on September 1, 2005. We considered their comments in preparing the final report. DOT’s Deputy Secretary provided a

\textsuperscript{17} These other agencies include the USCG (within the Department of Homeland Security); NOAA (within the Department of Commerce); and the Navy, Air Force, Army, and Missile Defense Agency (all within the Department of Defense).
written response on September 15, 2005 and the Interior’s Director of Budget provided a verbal response on September 16, 2005. Both agencies agreed with our findings, concurred with all recommendations, and stated that they look forward to continuing to work together to implement the recommendations. The response of DOT’s Deputy Secretary is reproduced in the Appendix.

**ACTIONS REQUIRED**

Actions taken and planned by FAA and the Interior for all recommendations are reasonable; however, both agencies need to agree to a date for resolving these issues. We appreciate the courtesies and cooperation of officials from FAA and FWS officials, as well as representatives of Chugach Alaska Corporation, during this review. If you have any questions concerning this report, please call me at (202) 366-1959 or Theodore P. Alves, Principal Assistant Inspector General for Auditing and Evaluation, at (202) 366-1992.
For the first 6 years that FWS controlled Midway, FY 1996 to FY 2002, the U.S. Government paid nothing toward the operation of the Midway airfield and related infrastructure, with the exception of $2 million of fuel provided to generate revenue. During that period, the airfield, infrastructure, and visitor operations were supported by a cooperative agreement with Midway Phoenix Corporation and by subsidies totaling about $5.5 million from Boeing Corporation. After Midway Phoenix Corporation discontinued its operations on the island in May 2002, FWS was responsible for all Midway operations. From May 2002 through May 2003, FWS entered into emergency “very limited operations” contracts with Geo Engineers, Inc., and American Airports Corporation for the infrastructure, airfield, and refuge operations. From May 2003 to the present, FWS has operated
Midway with its own staff, a volunteer program, and a performance-based contract with Chugach McKinley Incorporated (for airfield and infrastructure).

Under the May 2003 agreement, FAA reimbursed FWS for both airfield and fuel farm operating costs, including related infrastructure, system, and staff support service costs. The agreement was needed to allow FAA to transfer $3.5 million to FWS, which Congress had appropriated in FY 2003 to the Secretary of Transportation to keep the airfield open. Because Congress required the Secretary to transfer the full amount of the appropriation to FWS, the cost-sharing arrangement established in the agreement simply reflected the ratio of monies appropriated to each of the agencies for Midway operations in FY 2003. Although the cost-sharing arrangement was based on the funds appropriated in FY 2003, it was not revised in FY 2004 or in FY 2005 when Congress did not appropriate additional funds for FAA to keep the airfield open.

Subsequently, the Consolidated Appropriations Act for FY 2005 required the OMB Director to establish an equitable formula to allocate the costs to operate the Midway airfield. In our view, the Act established a logical and reasonable mechanism to resolve the dispute among executive agencies about the proper allocation of costs to operate the airfield.

Because the continued operation of Midway Island airfield is critical to the safety of commercial, military, and general aviation crews and passengers in the mid-Pacific Ocean Region, Congress included provisions in various laws to finance the continued operations of the airfield and supporting infrastructure. Specifically:

- **P.L. 107-63 115 STAT 420, November 5, 2001.** Congress appropriates $650,000 for hangar roof replacement. (Conference Report)

- **P.L. 107-206 Section 703, August 2, 2002.** Congress authorizes the Secretary of the Interior to charge reasonable fees for services provided on the island and retain those fees to be used toward non-refuge-specific costs.

- **P.L. 108-7 Section 147, February 20, 2003.** Congress authorizes the transfer of funds previously made available for hangar roof replacement for operational needs at Midway.

- **P.L. 108-7 Section 371, February 20, 2003.** Congress appropriates $3.5 million to DOT to pay for the continued operations of the airfield.

- **P.L. 108-83 Title 1, Chapter 4, September 30, 2003.** Congress appropriates $5 million for “Resource Management” where $4.5 million is to be used for oil spill cleanup and the remaining $500,000 for airfield operations.
Exhibit A. Historical Financing of Midway Operations

- **P.L. 108-176 Section 186, December 12, 2003.** Congress directs DOT, the Department of Defense, the Department of the Interior, and the Department of Homeland Security to establish a memorandum of understanding regarding the sale of aircraft fuel at a price that would generate enough revenue to improve the ability of the airfield to operate on a self-sustaining basis. The memorandum should also address the long-range potential of promoting tourism as a means to generate revenue for airfield operations. Additionally, Congress directs FAA to take over the navigational aids on Midway and make $10 million of the Aviation Trust Fund monies available to the Department of the Interior for airport improvements.

- **P.L. 108-199 Section 648, January 23, 2004.** Congress directs the head of each executive agency, with the approval of OMB and in agreement with the Department of the Interior, to transfer or reimburse to FAA funds to ensure the continuous operation of the airfield. Total funds should not exceed $6 million.

- **P.L. 108-447 Section 127, December 8, 2004.** Congress authorizes necessary fund transfers from “Departmental Management, Salaries and Expenses” to FWS for operational needs.

- **P.L. 108-447, 118 STAT. 3044, December 8, 2004.** Congress appropriates $2,700,000 and $500,000 for replacement of Midway’s electrical system and wastewater treatment system, respectively. (Conference Report)

- **P.L. 108-447 Section 644, December 8, 2004.** Congress directs the head of each executive agency to transfer or reimburse to FAA funds to ensure the continuous operation of the airfield. Total funds should not exceed $6 million in a 12-month period. OMB should establish an equitable formula to allocate the cost of operating the airfield.

- **P.L. 109-59 Section 10209, August 10, 2005.** Congress authorizes USCG, in consultation with the Secretary of Transportation and the Undersecretary of Commerce for Oceans and Atmosphere, to fund the operation of Midway airfield. Congress also authorizes appropriations to USCG, DOT, and NOAA to operate the airfield from FY 2006 through FY 2009.
EXHIBIT B. OBJECTIVES, SCOPE, AND METHODOLOGY

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards prescribed by the Comptroller General of the United States. Our review included such tests as we considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

The purpose of this report is to provide OMB with an independent analysis for allocating costs among appropriate Federal agencies. Our objectives were to identify (1) the costs of operating the Midway airfield, (2) a fair and equitable method to allocate costs among users, and (3) opportunities to reduce operating costs through capital investments.

We conducted the review using a methodology agreed upon with OMB to determine an equitable method to allocate costs among users and identify opportunities to reduce operating costs through capital investments. The specific agreed-upon procedures with OMB that we completed in this review include:

1. Identify Federal requirements and best practices related to (a) cost accounting and cost allocation principles, (b) interagency agreements, and (c) FAA regulations governing airports.

2. Determine the actual FY 2004 and estimated FY 2005 costs for each agency that operates or uses Midway facilities, including identifying specific cost elements and the purpose of the expenditures.

3. Determine the methods or formulas used to allocate FY 2004 costs among agencies.

4. Develop formulas to equitably allocate costs among users using generally accepted Federal cost accounting and cost allocation criteria.

5. Evaluate FY 2005 cost estimates for operating the airport and infrastructure of the island, including any capital investments, based on the following scenarios (FWS and FAA engineers assisted in determining infrastructure needs and operating costs):

   FAA assisted in identifying:
   
   - Minimum costs to run an airfield and house and feed related staff using FAA-provided infrastructure to support the minimum staff.
   
   - Minimum cost to run an airfield and cover its fair share of FWS-provided infrastructure costs.
**FWS** assisted in identifying:

- Minimum costs to maintain remote field camp.
- Costs to resize the infrastructure to support planned FWS and airfield operations, including plans to maintain the wildlife refuge as a visitor center.

6. Provide a report to DOT, the Department of the Interior, and OMB that presents a fair and equitable cost allocation formula to distribute estimated FY 2005 operating costs and revenues. (OMB will then determine an equitable cost sharing arrangement, direct agencies to transfer or reimburse appropriate costs, and communicate its decision to the Appropriations committees.)

To meet our objectives, our review procedures included inquiries, analytical procedures, and tests of transactions, including reviewing contracts, invoices, accounting records, revenue data, and other documents and books and records. We met with officials from DOT’s Office of the Secretary and FAA and from the Department of the Interior’s Office of the Secretary, FWS, and its Office of Inspector General. We also met with representatives from Chugach Alaska Corporation and its subsidiary, Chugach McKinley Incorporated, FWS’s contractor on Midway.

Further, we:

- Reviewed budgetary information, invoices, and capital investment proposals prepared by FWS and FAA.
- Reviewed laws and regulations governing Midway and the interagency agreement between FWS and FAA, which included appropriations acts, executive orders, and the Economy Act.
- Discussed the costs of various scenarios for current and future operations with Department of the Interior and DOT officials.
- Discussed findings with officials from the Department of the Interior’s Office of Inspector General.
We conducted our review from December 2004 through August 2005. We made field visits to the Department of the Interior and FAA locations in Washington, DC; Honolulu; Portland, Oregon; and Midway Island.
EXHIBIT C. EXPLANATIONS OF FY 2005 COSTS AND CASH FLOWS FOR MIDWAY ISLAND OPERATIONS

Recognizing that it was critical to reduce costs to an affordable level, the parties agreed to several immediate actions to lower costs substantially for the remainder of FY 2005 (April thru September). In March 2005, FWS reduced the scope of contractor activities and renegotiated the contract to lower costs by about $1.1 million for the remainder of FY 2005. FWS also agreed to consider increasing fees from other agencies and identified revenues available from prior years that could offset FY 2005 operating costs, which should total about $6,373,000.

Table 4 shows the resulting FY 2005 summary of operating costs for Midway operations. Because both cost and revenue estimates rely heavily on future events and on estimates of costs associated with specific activities rather than actual costs, results may be different. We also worked with FWS officials, including the Department of the Interior Office of Inspector General to identify revenues available to finance FY 2005 costs. It will be incumbent on FWS and FAA to manage operations, costs, and revenue carefully. At the end of the year, FWS should adjust each agency’s contribution based on actual costs and revenues and the number of mission-related personnel.
Table 4. Estimate of FY 2005 Funding Requirements for Midway Operations

<table>
<thead>
<tr>
<th>Budget</th>
<th>Amount</th>
<th>Total</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Midway Operations (prepared by FWS)</td>
<td>$7,597,000</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Additions: Fuel tank inspection/overhaul of generator</td>
<td>300,000</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Reductions: Assign fuel spill clean-up to remediation appropriation</td>
<td>(40,000)</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Revised Midway Operations Budget</td>
<td>7,857,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Adjustments**

- Capitalization of transportation costs | (400,000) | 4     |      |
- Reduction in operations contract | (1,084,000) | 5     |      |
- Total Adjustments | (1,484,000) |      |      |

**Gross Costs for FY 2005**

- $6,373,000

**Revenue Applied To Reduce Operations Costs**

- Anticipated revenue from fuel and miscellaneous | (190,000) | 6     |      |
- Anticipated visitor fees | (36,000) | 7     |      |
- NOAA payment | (39,000) | 8     |      |
- Commitment from USCG to purchase excess fuel | (450,000) | 9     |      |
- Total Revenues To Be Applied | (715,000) |      |      |

**Net Costs for FY 2005**

- $5,658,000

**Adjustments From Other Periods**

- Cash available from prior-year revenue | (216,000) | 10    |      |

**Net Amount Needed for Midway Operations**

- $5,442,000

**Note 1: Midway Operations Budget.** This represents the FY 2005 FWS budget adjustment (expected total costs) for Midway Island operations that was provided to us at the March 3, 2005, meeting in Portland, Oregon.

**Note 2: Fuel Tank Inspection/Generator Overhaul.** At the March 3, 2005, Portland meeting, FWS requested that costs to fund a fuel tank inspection for Fuel Farm Operations ($150,000) and costs to overhaul the generator ($150,000) be added to the FY 2005 costs. FAA agreed that these costs were appropriate.

**Note 3: Assign Fuel Spill Cleanup Costs to Remediation Fund.** Based on our review of Island operations, a significant amount of the costs to operate the fuel farm during the first half of FY 2005 was associated with cleaning and burning unusable fuel associated with a spill. FWS has a separate appropriation with

Exhibit C. Explanations of FY 2005 Costs and Cash Flows For Midway Island Operations
which to pay the costs to remediate the fuel spill. We estimate that approximately $40,000 of overhead associated with these remediation efforts should be paid from the fuel spill remediation appropriation rather than Midway operations. The contractor eliminated this fuel spill cleanup effort from its revised proposal to operate the Island for the second half of FY 2005 and eliminated one of the three staff performing fuel operations. We estimate the costs associated with the cleanup in the first half of FY 2005 based on the staff reduction of one person the contractor proposed for the second half of FY 2005.

Note 4: Capitalization of Construction Transportation. FWS and FAA agreed that the cost for a barge to transport construction materials to Midway this summer should be treated as part of the capital investment rather than as an operating cost. We agree that this is appropriate because almost all of the material being transported will be used for capital investments (e.g., generator, water treatment, and airfield improvements paid for from capital accounts). Therefore, the transportation costs should be capitalized to reflect the true cost of completing the capital investments. Those costs were included in the annual operating costs.

Note 5: Reduction in Operations Contract. The current operations contract was awarded fixed-price at a cost of $5,569,000. FWS paid the contractor $2,784,000 for the first 6 months of FY 2005. To reduce costs during the second half of FY 2005, FWS and FAA agreed to renegotiate the contract for operating Midway Island. The renegotiated contract reduced costs for the second 6 months of FY 2005 to $1,700,430, saving $1,084,000. (The savings from the renegotiated contract represents the difference between the budgeted amount for the second 6 months and the renegotiated amount: $2,784,000 – $1,700,430 = $1,083,570).

Note 6: Anticipated Revenue From Fuel and Miscellaneous Receipts. This represents an estimate of actual receipts for small fuel sales to airplanes and small vessels visiting the Island, landing fees for aircraft, and numerous other small fees charged to visitors. Exhibit F lists the types of fees collected. We doubled the amount of collections for the first 3 months of FY 2005 and rounded up to the next $10,000 to estimate revenue for the entire year. This was a conservative estimate to take into account any decrease in activity for the second half of the year. Although the number of visitors may decline during the second half of FY 2005 because the island will operate with fewer amenities for visitors, we believe fees can and should be increased, potentially offsetting the reduced volume. For example, when planes land at Midway after normal operating hours, FWS charges a $400 landing fee. That landing fee, however, does not even cover the $750 in direct costs that the contractor charged FWS under its contract for extended airfield operations. FWS agreed to reexamine its fees and to increase fees as appropriate.

Exhibit C. Explanations of FY 2005 Costs and Cash Flows For Midway Island Operations
Note 7: Anticipated Visitor Fees. FWS charges cruise ship visitors a fee of $25 for touring the Island. We recommend that the fees be used to reduce the overhead costs of Midway.

Note 8: Record NOAA’s FY 2005 Payment. Our review discovered that a $39,000 receipt had not been collected from NOAA for support costs associated with the National Marine Fisheries Service personnel working on the island.

Note 9: Commitment from the USCG To Purchase Excess Fuel. Previously, large amounts of fuel were required to support island operations and to refuel planes landing at Midway, USCG cutters operating in the Midway area, and smaller private vessels visiting the island. To provide this service, Midway stores over 1 million gallons of fuel. Because the fuel farm activities are very expensive, FWS, in conjunction with FAA, decided that the commercial aspects of fuel operations were not economically viable. (To recover the full costs of acquiring the fuel and maintaining the fuel operations, FWS would have had to sell the fuel at about $5 per gallon per its own calculations. In contrast, the Department of Defense sells fuel in the Pacific at less than $2 per gallon.)

In addition, USCG officials told FWS that in the future, USCG would not need to refuel routinely at Midway because it planned to cut back on its operations in the Midway area. However, USCG did commit to buying at least 150,000 gallons to refuel one cutter in FY 2005. FWS plans to charge USCG $3 per gallon. USCG also indicated that it might refuel a second cutter at Midway in FY 2005. Because the Island now has much more fuel than is needed to sustain operations and refuel planes, FWS can reduce the amount of fuel stored on the island. FWS can apply funds generated by liquidating this asset to reduce the costs of current operations in FY 2005. FWS and FAA have agreed to do so. We applied the $450,000 in revenue obtained from selling fuel to USCG against FY 2005 overhead costs.

Over the longer term, however, FWS will need to retain enough revenue from fuel sales to replace a smaller amount of fuel (about 100,000 gallons). Some revenue from future fuel sales may also be available to defer some of the costs of operating the fuel farm.

Note 10: Cash Available From Prior Year Revenues. All collections from prior years should be used to reduce Midway operating costs. FWS officials agreed. We identified $216,000 in prior year revenues that were improperly recorded and therefore are available for use on Midway. We recommend that they be used to reduce overhead costs for FY 2005.
EXHIBIT D. METHODOLOGY FOR IDENTIFYING DIRECT AND INDIRECT COSTS FOR MIDWAY OPERATIONS

Statement of Federal Financial Accounting Standards No. 4, “Managerial Cost Accounting Standards,” requires that entities report the full costs of outputs (we will use the term “activities” in this summary).\textsuperscript{18} The full cost of an activity produced by an agency or segment is the sum of the resources that directly or indirectly contribute to the activity and the identifiable costs contributed by other agencies.

- \textit{Direct costs} are those that can be specifically identified with the production of the goods or services produced. The direct costs in the production of the good or service include salaries and benefits of employees of agencies who work directly on the activity, materials and supplies used in the work, and costs of goods and services provided by other entities.

- \textit{Indirect costs} are resources used to support two or more activities (or used to produce two or more outputs). Because these costs cannot be directly associated with an individual activity, cost accounting standards call for them to be assigned on a cause-and-effect basis or, if this cannot be done, allocated on a reasonable and consistent basis. Typical examples of indirect costs are administrative services, research and technical support, security, rent, operating and maintenance costs for buildings, and utilities. Midway indirect costs (sometimes referred to as infrastructure costs) include the costs to provide support to all activities on the island, such as electricity, water, medical support, and sewage treatment facilities. Indirect costs on Midway also include significant amounts that might, if adequate records were maintained, be identified as direct costs. We did not have enough insight into these costs to trace them directly to activities but, in the future, it may be possible to directly trace more costs. For example, in the past, the cost of flights (about $800,000 per year) has been included in overhead. In the future, flights should be charged to the appropriate party based upon actual use.

Because neither FWS nor the contractor tracked actual costs or determined direct and indirect costs, our analysis relied on estimates developed in conjunction with FWS service and contractor personnel. As a result, the presentation of direct and indirect costs should be viewed as rough estimates rather than actual costs based on accounting records.

\textsuperscript{18} SFFAS No. 4 defines outputs as products and services generated from the consumption of resources (April 26, 2004).
The following sections describe the various methodologies used to develop these estimates.

**Computing Direct Costs of Midway Island Operations**

In consultation with FWS and FAA, we identified four missions that are performed by FWS, FAA, and NOAA on Midway. We identified these as the activities for purposes of assigning costs. They are airfield operations (FAA), refuge operations (FWS), environmental monitoring (NOAA), and historic building and war memorial maintenance (FWS). Initially, we considered fuel farm operations to be an activity but based on FWS’s determination that the fuel farm was not economically viable, the parties agreed that fuel farm operations should instead be considered an indirect cost. Even if the fuel farm was broken out as a separate activity, a large portion of the costs of the fuel farm would still be assigned to the activities described because the Island is one of the largest users of the fuel farm (fuel for generators and flights to support the Island).

We also did not separately identify as an activity the cost of providing visitor services (primarily lodging and food) because we could not readily identify the direct costs of providing visitor services. Estimated direct costs are shown in Table 5.

<table>
<thead>
<tr>
<th>Major Island Activity</th>
<th>FY 2005 Direct Costs</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airfield (FAA)</td>
<td>$335,031</td>
<td>$442,621</td>
</tr>
<tr>
<td>Refuge (FWS)</td>
<td>612,500</td>
<td>612,500</td>
</tr>
<tr>
<td>Environmental Monitoring (NOAA, U.S. Geological Survey)</td>
<td>unknown</td>
<td>unknown</td>
</tr>
<tr>
<td>Historic Buildings and Memorials (FWS)</td>
<td>unknown</td>
<td>unknown</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$947,531</strong></td>
<td><strong>$1,055,121</strong></td>
</tr>
</tbody>
</table>

Early in the review, we determined that the fixed-price contract, which was the vehicle used to manage Island operations, was not designed to track costs or allocate them to specific activities. In addition, the contractor was not willing to disclose its actual costs by activity with FWS.

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19 Even if the fuel farm was broken out as a separate activity, a large portion of the costs of the fuel farm would still be assigned to the activities described because the Island is one of the largest users of the fuel farm (fuel for generators and flights to support the Island).
**Note 1: Airfield Direct Costs.** The direct costs for operating the airfield totaled about $780,000 and consisted of contracted services. There were no FAA employees directly working at the airfield. The airfield cost for the second half of the year was based upon the contractor’s proposed amount. For the first half of the year, the airfield and fuel farm were combined in a single contract line item. We used the total contract line item amount and estimated the amounts related to the airfield and fuel farm based upon the amounts for the fuel farm for the second half of the year. Because the number of employees for the fuel farm decreased, we adjusted the estimate for this change.

**Note 2: Refuge Operations Direct Costs.** The direct costs of refuge operations consisted of FWS’s FY 2005 budgeted amount of $1,225,000.

**Note 3: Environmental Monitoring (NOAA) Direct Costs.** We did not identify direct costs for operations and activities for NOAA or the U.S. Geological Survey activities.

**Note 4: Memorials and Buildings (FWS).** We were not able to calculate direct costs for activities related to maintaining historical structures and memorials, although we believe some costs are incurred for these activities. For example, using amounts from FWS’s FY 2005 budget and a methodology provided by FWS and the contractor to estimate FY 2004 costs, we calculated that it spent $471,000 on building maintenance during the first 6 months of FY 2005. The contractor did not provide us with its actual costs for maintaining historical structures. This should be tracked and properly allocated in the future.

**Identifying and Accounting for the Indirect Costs of Midway Operations**

Indirect costs are higher on Midway than would be expected because the operations rely on aging, inefficient, and oversized infrastructure and because of the Island’s remote location. The infrastructure was designed years ago to support up to 5,000 people, although today only about 50 individuals live on Midway. In addition, the Island’s remote location (about 1,250 miles from Honolulu) means all supplies have to be brought in either by flight or by ship. As a result, unlike most continuing operations, indirect costs for Midway greatly exceed direct costs.

The indirect costs are associated with several sources. These include indirect activities performed by the contractor; activities performed by FWS to support overall Midway operations; and other indirect costs, such as fuel consumed for operating the infrastructure.

**Exhibit D. Methodology for Identifying Direct and Indirect Costs for Midway Operations**
Indirect costs were separately computed for each half of FY 2005. For the first half of the year, indirect costs largely consisted of contract costs totaling about $2.5 million. This included costs of operating the infrastructure and fuel farm and other costs, such as transportation flights, of about $416,000. The major indirect cost not included in the contract is Island fuel consumption, estimated by FWS at $202,000. We believe some of these costs may represent direct costs that could be assigned directly to either FWS or FAA’s mission. However, the data were not available to determine what portion of the cost was direct.

For the second half of FY 2005, we used the renegotiated contract with the contractor to determine indirect costs, which totaled about $1.3 million from April through September 2005. These include costs associated with maintaining infrastructure and operating the fuel farm and other contract costs, such as transportation flights ($300,000). Indirect costs for the second half of FY 2005 also included estimated fuel usage ($201,500) and $300,000 that FWS estimated as being needed to overhaul the power plant generator and inspect the fuel tanks. The indirect costs are identified in Table 6.

Table 6. Indirect Costs Attributable to Midway Island Operations

<table>
<thead>
<tr>
<th></th>
<th>FY 2005 Costs and Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1st Half</td>
</tr>
<tr>
<td></td>
<td>2005</td>
</tr>
<tr>
<td>Overhead Costs</td>
<td></td>
</tr>
<tr>
<td>Contract-Related Overhead</td>
<td>$2,449,304</td>
</tr>
<tr>
<td>Overhead Costs</td>
<td></td>
</tr>
<tr>
<td>Other Overhead Costs</td>
<td></td>
</tr>
<tr>
<td>Fuel Tank Inspection</td>
<td></td>
</tr>
<tr>
<td>Overhaul</td>
<td>300,000</td>
</tr>
<tr>
<td>Fuel Spill Reclassification</td>
<td>-$40,000</td>
</tr>
<tr>
<td>Fuel Consumption</td>
<td>201,500</td>
</tr>
<tr>
<td>Total Other Overhead Costs</td>
<td>$161,500</td>
</tr>
<tr>
<td>Total Overhead Costs</td>
<td>$2,610,904</td>
</tr>
<tr>
<td>Direct Costs</td>
<td></td>
</tr>
<tr>
<td>FAA</td>
<td>$335,031</td>
</tr>
<tr>
<td>FWS Direct Costs (Non-Contract)</td>
<td>612,500</td>
</tr>
<tr>
<td>Total Direct Costs</td>
<td>$947,531</td>
</tr>
<tr>
<td>Total Direct and Indirect Costs</td>
<td>$3,558,435</td>
</tr>
<tr>
<td>Revenue To Apply Against Overhead</td>
<td></td>
</tr>
<tr>
<td>Total Funding Required</td>
<td></td>
</tr>
</tbody>
</table>
Note 1: Contract-Related Overhead Costs. For the first part of FY 2005, the amounts are based on the charges from the contractor adjusted to include fuel farm costs included in airfield costs (See Note 1 to Table 5 for method of splitting the airfield and fuel farm costs). The contract-related indirect costs include infrastructure, fuel farm, transportation flights, food, small parts, and demobilization. ²⁰ With improved tracking of costs, some of these costs should be classified as direct in the future.

Note 2: Total Other Overhead Costs. Other overhead costs are not included in the contract. They include estimated fuel consumption costs from the FWS budget of $403,000. FWS also proposed $300,000 for fuel tank inspection and a major overhaul of the generator, and FAA accepted that this investment should be made.

We also reduced overhead costs by $40,000, which represents an estimate of the amount spent for fuel spill cleanup during the first half of the fiscal year. We deducted this amount because FWS has a separate appropriation and budget to pay for remediation of the fuel spill. These costs should be funded by the Department of the Interior’s environmental remediation budget.

Note 3: Revenue To Apply Against Overhead Costs. We applied available revenue for FY 2005 to reduce the total overhead costs. FWS agreed that revenue generated on Midway should be used to defray expenses on Midway. Revenue sources and uses are described in Table 4 of Exhibit C, footnotes 6, 7, 8, 9, and 10.

Allocating Overhead to Mission-Related Activities and Agencies

Federal cost accounting standards call for costs of shared operations to be distributed fairly among participating agencies. Direct costs to perform an activity should be directly assigned to the activity (and the agency responsible for the activity). Indirect costs are those that support more than one activity and therefore cannot be directly assigned. For example, having electricity available benefits all agencies operating on Midway and so the cost needs to be shared. These costs should be distributed among the activities that benefit on an equitable basis.

We estimated the costs and contribution level for each agency based on the limited information available at FWS and the contractor. Because FWS had awarded a fixed-price contract, the contractor was not required to provide detailed cost information or to allocate actual costs to specific activities. Therefore, we worked

²⁰ If the current contractor is awarded the new contract, a portion of the demobilization costs would not be incurred.

The proposal did not break out the portion associated with the partial demobilization in April 2005 from demobilization at the end of the contract.

Exhibit D. Methodology for Identifying Direct and Indirect Costs for Midway Operations
with FWS officials and the contractor to apply alternative estimating methods to determine the costs to attribute directly to individual activities, such as operating the airfield. We then directly assigned those costs to the activity.

The remaining costs supported all the activities on the Island and therefore could not be directly attributed to any specific activity. These indirect costs included generating power and water and providing meals, housing, and other supplies. Accounting standards call for overhead allocations to be based on a relevant common denominator, such as numbers of employees, square footage of office space, or the proportion of direct costs incurred.

We searched for the most reasonable method to allocate overhead costs to each of the agencies’ activities performed on the Island. Midway does not use meters to track power, water, and other utilities’ costs, and officials did not know how many square feet of office space was used to support the various direct activities. We concluded, and FWS and FAA officials agreed, that the most appropriate basis for assigning overhead costs was to use the number of individuals that benefited from these costs. Each of the employees or volunteers that are typically on the island benefits from and shares the infrastructure costs. Accordingly, we used actual headcounts during FY 2004 to allocate overhead costs. The numbers of employees and allocated costs for FY 2005 and FY 2006 are provided in Table 7 respectively.
**Table 7. Estimated Allocation of Direct and Indirect Costs, By Agency, Fiscal Years 2005 and 2006 (in Thousands of Dollars)**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Number of People</th>
<th>FY 2005 Direct</th>
<th>FY 2006 Direct</th>
<th>FY 2005 Overhead&lt;sup&gt;b&lt;/sup&gt;</th>
<th>FY 2006 Overhead&lt;sup&gt;b&lt;/sup&gt;</th>
<th>FY 2005 Total</th>
<th>FY 2006 Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airfield (FAA)</td>
<td>5&lt;sup&gt;c&lt;/sup&gt;</td>
<td>$778</td>
<td>$885</td>
<td>$1,012</td>
<td>$671</td>
<td>$1,789</td>
<td>$1,556</td>
</tr>
<tr>
<td>Refuge (FWS)</td>
<td>12&lt;sup&gt;d&lt;/sup&gt;</td>
<td>1,225</td>
<td>1,225</td>
<td>2,428</td>
<td>1,610</td>
<td>3,653</td>
<td>2,835</td>
</tr>
<tr>
<td>Total, FY 2005</td>
<td>17</td>
<td>$2,003</td>
<td>--</td>
<td>$3,439</td>
<td>--</td>
<td>$5,442</td>
<td>--</td>
</tr>
<tr>
<td>Total, FY 2006</td>
<td>17</td>
<td>--</td>
<td>$2,110</td>
<td>--</td>
<td>$2,281</td>
<td>--</td>
<td>$4,391</td>
</tr>
</tbody>
</table>

<sup>a</sup> Totals do not always add due to rounding.

<sup>b</sup> Overhead costs assigned represent the percentage of direct people by agency applied to the total estimated overhead costs for FY 2005. For example, FAA’s overhead costs are computed as follows: (5/17 x $3,439,348 = $1,011,573).

<sup>c</sup> The number of people for FAA is the number of contractors assigned to the airfield.

<sup>d</sup> The number of people for FWS includes full-time staff (four) and the annualized equivalent for volunteers (seven). In addition, it also includes the spouse of the FWS biologist. The number of volunteer equivalents is an estimate based on the best information available for FY 2004 and the time of our visit to the Island.
EXHIBIT E. PROPOSED MIDWAY COST ALLOCATION

We are recommending that FWS, FAA, and other members of a governing board, if it is established, agree on a usage-based allocation method for future fiscal years.

Description of Terms and Concepts

Cost Object – An activity, output, or item whose cost is to be measured (Federal Accounting Standards Advisory Board [FASAB] Codification of Accounting Standards Appendix E).

Direct Cost – The cost of resources directly consumed by an activity. Note: Which costs are direct depends upon the activity being discussed. (FASAB Codification of Accounting Standards Appendix E). A direct cost of a particular activity may be an indirect cost of an output. For example, wages of building maintenance employees would be a direct cost of building maintenance, but building maintenance could be an indirect cost to products and services produced.

Indirect Cost – Costs of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs (Statements of Federal Financial Accounting Standards [SFFAS] #4 par. 91).

Output – Products and services generated from the consumption of resources. (SFFAS #4 par. 89) Within SFFAS #4, output is used to refer to final products or services; however, output can also be used to refer to an intermediate product or service.

Outputs/Product Activities

The outputs (products and services) for Midway can be broken down into the following:

1. Airfield – maintaining and operating a Part 139 compliant airfield.
2. Refuge Operations – supporting refuge mission related activities.
3. Refuge Operations (Other) – supporting recurring or nonrecurring, refuge-related activities not funded by Refuge Operations funds.
4. Historical Preservation – maintaining the monuments and historical structures.
5. Fuel Sales – providing fuel to others.

6. Visitor Services – providing lodging, food, transportation, and other services to nonessential personnel, including refuge volunteers, inspectors, visitors, and other nonresidents of Midway.

7. Special Projects – catchall for other uses to be defined. Examples: support for equipment placed on the Island by others, equipment rental, use for construction activity.

These will be referred to hereafter as programs, program activities, or direct activities. Other breakdowns by program are possible.

The costs of these programs will consist of both a direct element, such as the salaries and benefits of refuge personnel, and an indirect portion.

**Indirect Costs/Support Costs/Infrastructure**

Indirect costs are costs that cannot be specifically identified with any of the outputs. Indirect costs may also be referred to as shared costs or common, service, or support costs. Indirect costs should be assigned to outputs by, in order of preference, (1) assigning costs on a cause-and-effect basis, or (2) allocating costs on a reasonable and consistent basis.

The processes for assigning and allocating indirect costs are similar. Costs are accumulated or identified by different support activities, such as maintenance or utilities. These costs are then allocated (or assigned) to outputs based upon some relevant common denominator, such as the number of employees or square footage. This may involve one or more intermediate steps.

There are a multitude of ways to divide indirect costs into different cost pools or centers.

The attempt was to capture the major support cost areas with sufficient detail. Some of these could, in theory, be wholly or partially included in direct costs. For example, the costs of airfield and refuge equipment maintenance could be included with those respective direct costs.

**Interdependence of Support Activities**

A difficult issue in allocating the support activities on Midway is that support activities rely on one another to function. Examples include:

1. Power Generation – The operation of the electrical generator and distribution system depends upon the fuel farm for its fuel. The full cost of

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**Exhibit E. Proposed Midway Cost Allocation**
operating the electrical generator would also include the cost to feed, house, and transport the power generation staff.

2. Food – Similarly, the full cost of providing food includes more than the direct cost of the food and food preparation staff. It also includes the costs of running and maintaining the food preparation equipment, housing food staff, transporting food and food staff to the island, and other indirect costs.

There are two main methods to address this issue.

1. Ignore interservice costs and allocate only based upon direct activities (also referred to as direct apportionment). For example, if a support activity were used 10 percent by the airfield, 20 percent by refuge, and 70 percent by other support services, then allocate one-third to the airfield (.1/.3) and two-thirds to the refuge. Although this method is fairly easy to apply, its drawback is that it does not reflect indirect usage of support activities.

2. Include cross-servicing costs by one of these methods:
   a. Sequential allocation – allocating support activities to other support activities in a sequence. The drawback to this approach is that the sequence used will affect the final allocation.
   b. Reciprocal allocation – identifying all of the cross-service uses and solving with matrix algebra. The drawbacks are (i) determining all of the cross-service proportions can be difficult, and (ii) setting up the equations can be difficult. This will be especially true if there are more than a few support activities.
   c. Combination/other – designing a hybrid method combining some of the aspects of full reciprocal allocation without all of the complexities.

**Framework for Possible Cost Allocation Model**

We have developed a framework for a possible cost allocation model for Midway. In general, the model involves allocation of indirect contractor support costs, direct costs and other indirect costs, and revenue.

**Allocation of Indirect Contractor Support Costs**

1. Identifying the direct activities on Midway (e.g., airfield, refuge operations, construction, etc.).
2. Identifying the indirect cost centers supporting the direct activities. This would include how the direct costs of these will be measured.

3. Identifying how the costs will be allocated to both the direct and indirect activities. To simplify, all support service usage of indirect activities are combined instead of being split out. See Outputs/Product Activities above for suggested indirect cost centers, cost measurement, and cost allocation base.

4. Determining the cost to be allocated from each indirect cost center, which will be its direct costs plus its share of the total support costs. We suggest using the indirect cost center’s share of total labor hours to allocate support costs. For example, if 2 of 20 contractor staff were assigned to the fuel farm, it would be allocated 10 percent of the support costs.

5. Allocating the fully allocated cost of each indirect cost center to the direct activities and support based upon the usage percentages. This will involve solving circular (reciprocal) equations (e.g., the cost of the fuel farm includes its share of the support costs, which includes a portion of the fuel farm).

6. Comparing the total of the allocated indirect costs assigned to direct activities to the total of the indirect costs to ensure that they agree.

**Direct Costs and Other Indirect Costs**

7. Adding the direct costs to arrive at the total for each direct activity. For fuel sales, this would include the cost of fuel sold.

8. Including any significant indirect costs not accounted for above. For example, FWS will incur indirect costs related to contract and financial administration, which should be allocated on some reasonable basis.

**Revenue**

9. Crediting revenue against the relevant direct activity. For most cases, the relevant direct activity should be obvious. Revenue from fuel sold should be applied against fuel sales and food and lodging against visitor services (unless for airfield- or refuge-related personnel). Landing fees should be credited against the airfield, and refuge entrance fees against refuge operations or historical preservation.

10. Developing a method for allocating profit and loss. There is a question of what to do about any profit or loss in the revenue-supported programs
(visitor services or fuel sales). Any loss on these activities would need to be absorbed by the agency whose mission it is to perform the activity. A method for allocating the profit and loss on these programs needs to be developed.

11. Paying for fee-based services. Fee-based services such as visitor lodging and air transportation to Midway should be charged to every user and tracked. The agencies also need to determine the timing of payments and collection method. Currently, the contractor collects payments, but not everyone pays. The contractor forwards to FWS only the amounts collected and does not provide FWS with a listing of accounts receivable.
# EXHIBIT F. MIDWAY FEE SCHEDULE

**Midway Atoll National Wildlife Refuge**  
Schedule of Fees for Services Rendered  
November 1, 2004

## Aircraft Services Fees

<table>
<thead>
<tr>
<th>Service</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aircraft Landing and Handling Fee</td>
<td>$100.00</td>
</tr>
<tr>
<td>Arrivals (max 2 per day)</td>
<td></td>
</tr>
<tr>
<td>Departures (max 2 per day)</td>
<td></td>
</tr>
<tr>
<td>Parking Space Fee</td>
<td>$400.00</td>
</tr>
<tr>
<td>0-1,000 lbs. NGLW</td>
<td>$100.00/day</td>
</tr>
<tr>
<td>1,000-3,000 lbs. NGLW</td>
<td>$150.00/day</td>
</tr>
<tr>
<td>3,000-5,000 lbs. NGLW</td>
<td>$200.00/day</td>
</tr>
<tr>
<td>5,000-7,000 lbs. NGLW</td>
<td>$250.00/day</td>
</tr>
<tr>
<td>Airplane (3,000 lbs or less)</td>
<td>$500.00</td>
</tr>
<tr>
<td>Airplane (3,001-5,000 lbs)</td>
<td>$750.00</td>
</tr>
<tr>
<td>Airplane (5,001-7,000 lbs)</td>
<td>$1,000.00</td>
</tr>
<tr>
<td><strong>Minimum charge applies one hour per day.</strong></td>
<td></td>
</tr>
</tbody>
</table>

## Refuge Administration Fees

<table>
<thead>
<tr>
<th>Service</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special Use Permit</td>
<td>$9,000.00</td>
</tr>
<tr>
<td>Compensatory Determination</td>
<td>$10,000.00</td>
</tr>
<tr>
<td>Environmental Assessment</td>
<td>$15,000.00</td>
</tr>
</tbody>
</table>

## Chartered Aircraft Transportation Fees

<table>
<thead>
<tr>
<th>Service</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Round trip out (San francisco-Midway)</td>
<td>$1,200.00</td>
</tr>
<tr>
<td>Cargo</td>
<td>$7.00/lb</td>
</tr>
</tbody>
</table>

## Guest Services Fee

<table>
<thead>
<tr>
<th>Service</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lodging (per night)</td>
<td>$200.00</td>
</tr>
<tr>
<td>Meals</td>
<td>$12.00/day</td>
</tr>
<tr>
<td>Medical and Medical Services</td>
<td>$40.00</td>
</tr>
<tr>
<td>Ambulance Service</td>
<td>$50.00</td>
</tr>
<tr>
<td>Vis. Nurse, Bandage</td>
<td>$25.00</td>
</tr>
<tr>
<td>Vis. Nurse, Walker</td>
<td>$25.00</td>
</tr>
<tr>
<td>Emergency Room</td>
<td>$300.00</td>
</tr>
<tr>
<td>Lodging (per night)</td>
<td>$100.00</td>
</tr>
<tr>
<td>Meals</td>
<td>$35.00</td>
</tr>
<tr>
<td>Transportation</td>
<td>$5.00</td>
</tr>
<tr>
<td>Transportation (air)</td>
<td>$100.00</td>
</tr>
<tr>
<td>Golf Cart</td>
<td>$25.00</td>
</tr>
<tr>
<td>Laundry (per load)</td>
<td>$13.00</td>
</tr>
<tr>
<td><strong>Required for camping</strong></td>
<td>$100.00</td>
</tr>
</tbody>
</table>

## Labor and Equipment Fee

<table>
<thead>
<tr>
<th>Equipment</th>
<th>Daily Rate</th>
<th>Weekly Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-foot truck</td>
<td>$100.00</td>
<td>$600.00</td>
</tr>
<tr>
<td>40-foot trailer</td>
<td>$125.00</td>
<td>$750.00</td>
</tr>
<tr>
<td>50-foot trailer</td>
<td>$150.00</td>
<td>$900.00</td>
</tr>
<tr>
<td>60-foot trailer</td>
<td>$200.00</td>
<td>$1,200.00</td>
</tr>
<tr>
<td>70-foot trailer</td>
<td>$250.00</td>
<td>$1,500.00</td>
</tr>
<tr>
<td>80-foot trailer</td>
<td>$300.00</td>
<td>$1,800.00</td>
</tr>
<tr>
<td>90-foot trailer</td>
<td>$400.00</td>
<td>$2,400.00</td>
</tr>
<tr>
<td>100-foot trailer</td>
<td>$500.00</td>
<td>$3,000.00</td>
</tr>
<tr>
<td>110-foot trailer</td>
<td>$600.00</td>
<td>$3,600.00</td>
</tr>
<tr>
<td>120-foot trailer</td>
<td>$700.00</td>
<td>$4,200.00</td>
</tr>
<tr>
<td>130-foot trailer</td>
<td>$800.00</td>
<td>$4,800.00</td>
</tr>
<tr>
<td>140-foot trailer</td>
<td>$900.00</td>
<td>$5,400.00</td>
</tr>
<tr>
<td>150-foot trailer</td>
<td>$1,000.00</td>
<td>$6,000.00</td>
</tr>
<tr>
<td>160-foot trailer</td>
<td>$1,100.00</td>
<td>$6,600.00</td>
</tr>
<tr>
<td>170-foot trailer</td>
<td>$1,200.00</td>
<td>$7,200.00</td>
</tr>
<tr>
<td>180-foot trailer</td>
<td>$1,300.00</td>
<td>$7,800.00</td>
</tr>
<tr>
<td>190-foot trailer</td>
<td>$1,400.00</td>
<td>$8,400.00</td>
</tr>
<tr>
<td>200-foot trailer</td>
<td>$1,500.00</td>
<td>$9,000.00</td>
</tr>
<tr>
<td>210-foot trailer</td>
<td>$1,600.00</td>
<td>$9,600.00</td>
</tr>
<tr>
<td>220-foot trailer</td>
<td>$1,700.00</td>
<td>$10,200.00</td>
</tr>
<tr>
<td>230-foot trailer</td>
<td>$1,800.00</td>
<td>$10,800.00</td>
</tr>
<tr>
<td>240-foot trailer</td>
<td>$1,900.00</td>
<td>$11,400.00</td>
</tr>
<tr>
<td>250-foot trailer</td>
<td>$2,000.00</td>
<td>$12,000.00</td>
</tr>
<tr>
<td>260-foot trailer</td>
<td>$2,100.00</td>
<td>$12,600.00</td>
</tr>
<tr>
<td>270-foot trailer</td>
<td>$2,200.00</td>
<td>$13,200.00</td>
</tr>
<tr>
<td>280-foot trailer</td>
<td>$2,300.00</td>
<td>$13,800.00</td>
</tr>
<tr>
<td>290-foot trailer</td>
<td>$2,400.00</td>
<td>$14,400.00</td>
</tr>
<tr>
<td>300-foot trailer</td>
<td>$2,500.00</td>
<td>$15,000.00</td>
</tr>
</tbody>
</table>

**Additional fees for special equipment**

### Exhibits

- **Exhibit F. Midway Fee Schedule**
EXHIBIT G. CAPITAL IMPROVEMENTS BY FISCAL YEAR FUNDED

Table 9 contains FWS and FAA funded capital plans for Midway. All the assets, including the airfield property, belong to FWS.

Table 9. Funded Capital Improvement for Midway

<table>
<thead>
<tr>
<th>Year Funded</th>
<th>Description</th>
<th>Estimated Costs</th>
<th>Subtotal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Infrastructure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>Domestic Water System</td>
<td>$900,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Septic System</td>
<td>493,000</td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>Communications</td>
<td>634,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Radios</td>
<td>218,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Electricity Generation and Distribution</td>
<td>2,660,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Cathodic Protection (Fuel Tanks)</td>
<td>385,000</td>
<td>$5,290,000</td>
</tr>
<tr>
<td></td>
<td><strong>Airfield</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>ARFF21 Vehicle (Fire truck)</td>
<td>750,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Main Generator</td>
<td>150,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Command Center/Office Quarters</td>
<td>275,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Vehicle Shelter</td>
<td>150,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Barge (Transportation)</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>Rehabilitate Runway</td>
<td>700,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Rehabilitate Runway</td>
<td>400,000</td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>Back-Up Generator</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>Runway Resurfacing</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>Runway Drainage</td>
<td>350,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Runway Drainage</td>
<td>600,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Truck</td>
<td>35,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Sweeper</td>
<td>150,000</td>
<td></td>
</tr>
<tr>
<td>FY 2005</td>
<td>Master Plan</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>FY 2004</td>
<td>Visual Approach Slope Indicator</td>
<td>150,000</td>
<td>$4,910,000</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td>$10,200,000</td>
</tr>
</tbody>
</table>

Capital Improvement Plan – We verified the capital improvements that each agency plans to make on Midway. FWS has committed to infrastructure improvements of $1.5 million in FY 2004 and $3.8 million in FY 2005. FAA has identified airfield improvements of $2.4 million in FY 2004 and $2.5 million in

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21 Aircraft rescue and firefighting
FY 2005. In addition, FWS has identified the need for $3 million in capital improvements to downsize and replace the existing fuel tanks. The present 4.2 million-gallon system is grossly oversized and needs significant repair. FWS would need to maintain the current fueling system until all fuel spill waste is recovered and burned and until 1 million-gallons of fuel on hand is depleted from the old tanks.22

Currently, NOAA and the U.S. Geological Survey perform environmental monitoring on Midway, which requires support from existing facilities. The capital improvements to infrastructure do not include any building or facilities improvements.

Executive Order 13022 requires FWS to recognize and maintain the historical significance of Midway Atoll. FWS officials told us they have no specific funding to support historic preservation.23 However, this activity is a function of refuge operations and covered by refuge operations funding; e.g., some buildings are being maintained for historical preservation purposes only.

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22 In 2003, a corrosion-related fuel spill of 100,000 gallons occurred on Midway. FWS must continue fuel spill cleanup operations until recovery and incineration is complete. An incinerator was installed to burn the recovered JP-5 fuel after it had been filtered. To date, the fuel spill cleanup has cost FWS $4.4 million.

23 Midway Atoll was officially transferred from the Navy to FWS on October 31, 1996. Currently, 78 structures, buildings, or objects are eligible for inclusion in the National Register of Historic Places. To guide the historic preservation, the Navy entered into a programmatic agreement with FWS, the Hawaii State Historic Preservation Office, and the Advisory Council on Historic Preservation. The 78 historic structures are to be treated as follows: reuse, secure, leave as is, fill, demolish, or relocate.
EXHIBIT H. MAJOR CONTRIBUTORS TO THIS REPORT

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terrence Letko</td>
<td>Program Director</td>
</tr>
<tr>
<td>Leonard Meade</td>
<td>Project Manager</td>
</tr>
<tr>
<td>Seth Kaufman</td>
<td>Associate Counsel</td>
</tr>
<tr>
<td>Dormayne Dillard-Christian</td>
<td>Senior Auditor</td>
</tr>
<tr>
<td>Bernard Fishman</td>
<td>Senior Auditor</td>
</tr>
<tr>
<td>Stacie Seaborne</td>
<td>Analyst</td>
</tr>
<tr>
<td>Edith Makoge</td>
<td>Analyst</td>
</tr>
<tr>
<td>Leslie Mitchell</td>
<td>Auditor</td>
</tr>
</tbody>
</table>

We also want to acknowledge the significant contributions of Stephen Jones, Project Manager, Office of Inspector General, Department of the Interior, to this report.
APPENDIX. MANAGEMENT COMMENTS

MEMORANDUM TO: Kenneth M. Mead
Inspector General

FROM: Maria Cino
Deputy Secretary

SUBJECT: Response to Department of Transportation Office of Inspector General Draft Report, “Review of Costs of the Airfield on Midway Island”

The Department appreciates the work done by the Office of Inspector General (OIG) for this draft report addressing the cost allocation issues involved with the joint operation of facilities on Midway Atoll by multiple Federal agencies. We agree with OIG’s finding that operating costs for this facility must be kept to a sustainable level and that fiscal year (FY) 2006 operating costs for the airfield should be no more than $1.6 million. Over the longer term it is critical that we clearly delineate cost sharing mechanisms and a sound fee structure to ensure that each agency contributes appropriately to the cost of maintaining facilities on the island. We look forward to working with representatives from the Department of Interior and other Federal agencies, involved with Midway Island to finalize such an arrangement. Also, the recently-enacted Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) specified additional agencies as key players involved with this issue, including the United States Coast Guard and the Department of Commerce. It will be necessary to work with each organization, the Office of Management and Budget, and the Congress to clarify roles and responsibilities and associated cost sharing allocation methodologies.

Recommendations and Responses

Recommendation 1: Properly account for costs and revenue and allocate them equitably based on generally accepted cost accounting and cost allocation principles. Specifically, whenever possible, costs should be directly assigned to the appropriate activity; costs that cannot be directly assigned (indirect costs) should be allocated based on usage; fees should
cover the costs of providing the service; and revenues (fees) should be properly recorded and applied to offset costs, subject to laws and regulations.

**Response:** Concur. The Department is ready to work with each of the agencies involved with the use and operation of Midway Atoll to fully and properly allocate costs and revenues. We will also coordinate with the Congress to ensure that our actions fully comport with Congressional intent as expressed in SAFETEA-LU and recent appropriation acts. The Department supports and encourages the use of an independent costs and revenue audit jointly funded by the agencies involved to provide a sound basis for subsequent decision-making. We anticipate completing such an audit prior to the end of FY 2006.

**Recommendation 2:** Ensure that the new contract to support Midway operations tightly defines the level of operations and scope of work to ensure that costs do not increase significantly from current levels and allows direct costs to be tracked and assigned to the responsible agency.

**Response:** Concur. The Department continues to consult with the Department of the Interior with regard to the new contract. DOT is anxious to ensure that the Department of the Interior uses all available mechanisms, including full and open competition, to ensure that the price paid to the contractor for operating the facilities on Midway Atoll is fair and reasonable. Further, we would like to see the Department of the Interior consider whether a fixed priced contract offers the most economical approach in this situation, or whether a cost type contract would be more appropriate. Even if the Department of the Interior chooses to continue using the fixed priced contracting mechanism, we would urge them to structure the contract with line items for the various cost centers as the OIG suggests. Our consultations with the Department of the Interior will continue throughout the course of the contracting effort.

**Recommendation 3:** Develop a revised fee schedule that recovers the cost associated with the services provided. The new fee schedule should be coordinated with affected users to allow them to determine if they want to continue operating on Midway.

**Response:** Concur. The Department agrees that a revised fee schedule should be developed and coordinated with all users of the airfield. The revised fee structure should fully recover the cost associated with services provided. The fee schedule should be derived from the cost accounting audit discussed in response to recommendation 1. We anticipate that the fee schedule would be completed within 6 months after the final audit is issued.

**Recommendation 4:** Establish an interagency agreement and an interagency working group to provide for Midway’s operational needs.

**Response:** Concur. The Department agrees that a memorandum of agreement should be completed to document each agency’s role and responsibilities with regard to maintaining airport services on Midway Atoll. An interim agreement covering FY 2006 is being discussed, while a longer-term agreement, based on the results of the cost allocation audit discussed in response to recommendation 1, could be implemented within 12 months of completing the audit.

**Appendix. Management Comments**
**Recommendation 5:** Improve accounting practices to properly record costs and revenues associated with Midway operations. This should include periodically preparing financial status reports based on the accounting records that can be provided to other agencies.

**Response:** Concur. We agree that enhanced ability to identify and understand costs and revenue streams relating to the operation of the airfield would be beneficial to all agencies involved. Conducting the costs and revenue audit discussed in response to recommendation 1 is the critical first step in achieving this understanding. It is also important that the agencies apply, as appropriate, the full range of available procurement mechanisms to ensure that services are obtained in a manner that provides the taxpayer with an efficient and effective use of funds.

We appreciate this opportunity to comment on the draft report and respond to the recommendations. Please contact Michael Reynolds, Deputy Assistant Secretary for Aviation and International Affairs, on 202-366-4551 with any questions or if we may be of further assistance.

cc: Mr. Swaney, ADA-02  
   Mr. Reynolds, X-3  
   Mr. Gertel, M-