



# **FEDERAL COMMUNICATIONS COMMISSION**

## **Fiscal Year 2012 Agency Financial Report**

(October 1, 2011 – September 30, 2012)



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# Message from the Chairman



I am pleased to present the Federal Communications Commission's (FCC or Commission) Financial Report for Fiscal Year (FY) 2012. The Financial Report provides key financial and performance information to Congress and the American people. As continuing evidence of the FCC's strong commitment to maintaining a culture of accountability for the funds it manages, I am pleased to report that for the seventh consecutive year, the FCC has obtained an unqualified or "clean" audit opinion on its financial statements. In addition, the FCC's independent auditors, KPMG, did not identify any material weaknesses in the FCC's operations. The independent auditors' opinion addresses more than \$450 million in FCC operating expenses and more than \$9 billion in outlays for the Universal Service Fund and Telecommunications Relay Service Fund. Despite the positive audit opinion, the independent auditors' report shows that work remains at the FCC to continue to improve the agency's operations so it can deliver on its

mission for the American people.

The FCC's mission centers on maximizing the opportunities of broadband and other communications networks and technologies. These have the potential to unleash new waves of innovation and massive private innovation, thereby increasing opportunity and prosperity, driving American competitiveness and leadership, connecting our country, strengthening our democracy – and transforming lives for the better. I welcome the opportunity to highlight how the FCC has fulfilled its important role in pursuing these goals on behalf of all Americans throughout FY 2012.

Some of the Commission's key accomplishments over the past year include:

## **Unleashing Spectrum for Broadband**

- We opened a proceeding to implement incentive auctions, making the U.S. the first country in the world to launch this new paradigm in spectrum policy. The incentive auction will use market forces to repurpose valuable spectrum in the broadcast television bands for licensed and unlicensed wireless broadband.
- We continued to remove outdated rules and restrictions on spectrum that prevented its use for broadband, including 30 megahertz in the long-troubled Wireless Communications band.

## **Connect America and Lifeline Reform**

- We continued implementing our landmark reforms to the Universal Service Fund, including launching the Connect America Fund and the Mobility Fund to extend wired and wireless broadband throughout the country. Through the Mobility Fund, we conducted the country's first-ever reverse auction for universal service support, efficiently using \$300 million to extend high-speed mobile broadband coverage to up to 83,000 road miles across 31 states.
- We overhauled the Lifeline program that assists low-income families in maintaining phone service. Building on recommendations from the Federal-State Joint Board on Universal Service, the Commission substantially strengthened protections against waste, fraud, and abuse. We are on track to save over \$200 million this year alone from these reforms.

## **Promoting Competition**

- We rigorously and expeditiously reviewed a number of proposed transactions to protect competition and the public interest, and approved over 250 wireless applications involving nearly 2,000 spectrum licenses, involving licenses valued at billions of dollars.

## **Empowering Consumers and Protecting Public Safety**

- We continued implementation of the Twenty-First Century Communications and Video Accessibility Act of 2010 to ensure that the 54 million Americans with disabilities are able to fully utilize and benefit from advanced communications services, including adoption of rules that require closed captioning of broadcast television video content posted on the Internet.
- We enhanced the ability of Tribal Nations to increase their ownership of broadcast facilities in their communities to provide radio services.
- The Commission's Communications Security, Reliability and Interoperability Council (CSRIC) approved voluntary, industry-based recommendations to secure the Domain Name System (DNS), to improve the security of Internet routing protocols and to defeat botnets.
- Through the Commission's Enforcement Bureau, we have issued forfeitures against crammers (\$11.5 million) and prepaid calling card companies using deceptive marketing practices (\$25 million), making clear that we will crack down on those who seek to prey on communications consumers through deceptive practices.

## **Agency and Regulatory Reform**

- We worked to improve regulatory processes consistent with President Obama's Executive Orders, including integration of more rigorous cost-benefit analysis into rulemaking proceedings; reduction of agency backlogs; and retrospective analysis and elimination of regulations that were overly burdensome, out of date, or otherwise impeded economic growth and development.
- We continued to expand the use of new technologies to improve the operations of the Commission and communicate more effectively with the public. We moved certain reporting requirements relating to television broadcasters online and made additional data available to empower app developers and consumers to use information in innovative ways.
- From January 1, 2010 through the end of FY 2012, we eliminated over 260 rules and regulations.

In closing, please note that a more comprehensive report about the FCC's FY 2012 accomplishments will be included in the FCC's FY 2012 Annual Performance Report, which will be released in February 2013 with the FCC's annual budget submission. The Agency Financial Report that follows contains the FCC's FY 2012 financial statements and other management highlights; the information contained therein is reliable and complete.



Julius Genachowski  
Chairman  
November 14, 2012

# 1. Management's Discussion and Analysis

## *Overview of the FCC*

### *INTRODUCTION*

The revised OMB Circular No. A-136, released on August 3, 2012, states that agencies may choose either to produce a consolidated Performance and Accountability Report, or a separate Agency Financial Report (AFR) and an Annual Performance Report (APR). The Federal Communications Commission (Commission or FCC) has chosen to produce the AFR as an alternative to the consolidated Performance and Accountability Report. The Commission will include its FY 2012 APR with its Congressional Budget Justification and will post it on the Commission website at <http://transition.fcc.gov/omd/strategicplan/> by February 4, 2013.

The AFR includes three sections. AFR Section 1 contains Management's Discussion and Analysis (MD&A) which presents an overview of the Commission, including the agency's organizational chart, map of the field offices, strategic goals and objectives, strategies and resources to achieve goals, components of the Commission for financial statement purposes, work on eliminating and recovering improper payments, performance highlights, management assurances, and a financial discussion and analysis.

AFR Section 2 contains the agency's financial information. This section contains the letter from the chief financial officer (CFO) summarizing planned timeframes for correcting audit weaknesses and non-compliances, major impediments to correcting audit weaknesses and non-compliances, and progress made in correcting previously reported problems. Additionally, this section contains the independent auditors' report, the Commission's response to the independent auditors' report, the financial statements, the notes to the financial statements, and required supplementary information.

AFR Section 3 presents other accompanying information such as a summary of financial statement audit results, a summary of management assurances, details on reporting improper payments pursuant to the Improper Payments Information Act (as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA)), management and performance challenges from the Office of Inspector General, and management's response to such challenges.

### *ABOUT THE FCC*

The FCC is an independent regulatory agency of the United States (U.S.) Government. The Commission was established by the Communications Act of 1934 and is charged with regulating interstate and international communications by radio, television, wire, satellite, and cable. The Commission also regulates telecommunications services for hearing-impaired and speech-impaired individuals, as set forth in Title IV of the Americans with Disabilities Act (ADA). The Commission's headquarters is located in Washington, D.C., with three regional offices, sixteen district offices, and eight resident agent offices throughout the nation.

Five Commissioners direct the work of the FCC. All five Commissioners are appointed by the President and confirmed by the Senate for five-year terms, except when filling the unexpired term of a previous Commissioner. Only three Commissioners can be of the same political party at any given time and none

can have a financial interest in any company or entity that has a significant interest in activities regulated by the Commission. The President designates one of the Commissioners to serve as Chairman.

The Chairman and the Commissioners at the end of FY 2012 were:

- Chairman Julius Genachowski
- Commissioner Robert M. McDowell
- Commissioner Mignon Clyburn
- Commissioner Jessica Rosenworcel
- Commissioner Ajit Pai



Pictured from left to right are Commissioner Rosenworcel, Commissioner McDowell, Chairman Genachowski, Commissioner Clyburn, and Commissioner Pai.

## ***MISSION AND ORGANIZATIONAL STRUCTURE***

As specified in section 1 of the Communications Act, the Commission’s mission is to “...make available, so far as possible, to all the people of the United States, without discrimination on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges.”<sup>1</sup> In addition, section 1 provides that the Commission was created “for the purpose of the national defense” and “for the purpose of promoting safety of life and property through the use of wire and radio communication.”<sup>2</sup>

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<sup>1</sup> 47 U.S.C. § 151.

<sup>2</sup> *Id.*



The FCC Chairman leads the Commission as head of the agency. In order to accomplish its strategic plan, the FCC is organized by function. There are seven Bureaus and ten Offices. The seven Bureaus and the Office of Engineering and Technology process applications for licenses to operate facilities and provide communication services (in specific locations and on specific radio frequencies), analyze complaints from citizens and other licensees, conduct investigations, develop and implement regulatory programs, and participate in hearings. Generally, the nine other Offices provide specialized support services. Bureaus and Offices regularly join forces and share expertise in addressing FCC-related issues.

## **The Bureaus**

- **The Consumer and Governmental Affairs Bureau** develops and implements the FCC's consumer policies, including disability access, and serves as the agency's connection to the American consumer. The Bureau serves as the public face of the Commission through outreach and education, as well as through the Consumer Center, which is responsible for responding to consumer inquiries and complaints. The Bureau also maintains collaborative partnerships with state, local, and tribal governments in such critical areas as emergency preparedness and implementation of new technologies.
- **The Enforcement Bureau** is the primary FCC unit for enforcing the provisions of the Communications Act, the Commission's rules, orders, and various licensing terms and conditions. The Bureau's mission is to investigate and respond quickly to potential unlawful conduct to ensure: (1) consumer protection in an era of complex communications; (2) a level playing field to promote robust competition; (3) efficient and responsible use of the public airwaves, and (4) strict compliance with public safety-related rules.
- **The International Bureau** administers the FCC's international telecommunications and satellite programs and policies, including licensing and regulatory functions. The Bureau also has a unique role in promoting pro-competitive policies abroad, coordinating the Commission's global spectrum activities, and advocating U.S. interests in international communications and competition. The Bureau works to promote a high quality, reliable, globally interconnected, and interoperable communications infrastructure.
- **The Media Bureau** oversees broadcast radio and television, as well as cable and satellite services, on behalf of consumers. It also administers licensing and policy matters for broadcast services and cable, and handles post-licensing matters for satellite services.
- **The Public Safety and Homeland Security Bureau** ensures public safety and homeland security by advancing state-of-the-art communications that are accessible, reliable, resilient, and secure, in coordination with public and private partners.
- **The Wireless Telecommunications Bureau** develops and executes policies and procedures for fast, fair licensing of all wireless service, from fixed microwave links to amateur radio to mobile broadband services. The Bureau oversees nearly two million licenses, conducts auctions to award services licenses, and manages the tower registration process. It also produces an annual assessment of the wireless industry – the Mobile Wireless Competition Report – and manages interactive web tools, such as the Spectrum Dashboard, which deliver to the public key information on wireless services in a simple, transparent fashion.

- **The Wireline Competition Bureau** works to ensure that all Americans have access to robust, affordable broadband and voice services. Its programs help ensure access to affordable communications for schools, libraries, health care providers, and rural and low-income consumers. It works to protect consumers and foster competition, especially for the services that small businesses need, and to ensure a sustainable policy framework for competitors that rely on the facilities of others. It reviews communications industry transactions, and conducts rulemakings and proceedings to ensure the availability of key inputs for communications providers, such as access to utility poles and rights of way. Also, it provides the public with accurate and comprehensive data about communications services, including broadband.

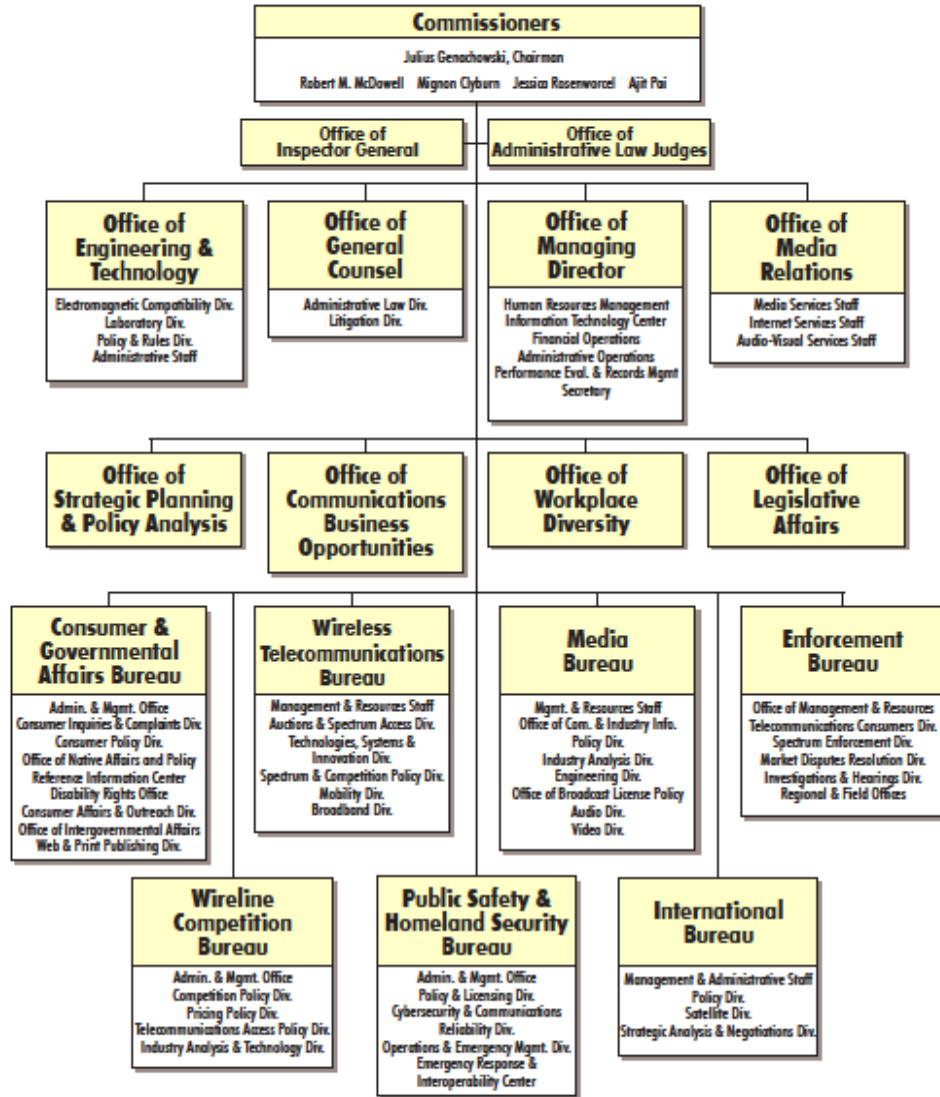
## **The Offices**

- **The Office of Administrative Law Judges** presides over hearings and issues decisions on matters referred to the Office by the Commission. The hearing function includes acting on interlocutory requests filed in the proceedings such as petitions to intervene, petitions to enlarge issues, and contested discovery requests.
- **The Office of Communications Business Opportunities** serves as the principal advisor to the Chairman and the Commissioners on issues, rulemakings, and policies affecting small, women, and minority-owned communications businesses. The Office also represents the FCC in various matters coordinated with the U.S. Small Business Administration, including those involving the Regulatory Flexibility and Small Business Acts.
- **The Office of Engineering and Technology** manages the spectrum and provides leadership to create new opportunities for competitive technologies and services for the American public.
- **The Office of General Counsel** serves as the Commission's chief legal advisor, and also advises its various bureaus and offices. The Office of General Counsel also represents the Commission in litigation, recommends decisions in adjudicatory matters before the Commission in litigation, recommends decisions in adjudicatory matters before the Commission, assists the Commission in its decision-making capacity, and performs a variety of legal functions regarding internal and other administrative matters.
- **The Office of Inspector General** provides independent investigations, audits, and reviews of the FCC programs and operations. The Office provides recommendations to detect and prevent fraud, waste, and abuse in FCC programs and operations. The Inspector General reports the results of the investigations, audits, and reviews semi-annually to the Chairman and to the Congress. These reports, in turn, assist the Chairman, Commissioners, and the United States Congress in becoming fully informed of all programmatic and operational deficiencies at the FCC. The Inspector General reports to, and is under the general supervision of, the FCC Chairman.
- **The Office of Legislative Affairs** serves as the liaison between the FCC and Congress, as well as other federal agencies. This Office provides lawmakers with the information regarding FCC regulatory decisions, answers to policy questions, and assistance with constituent concerns. The Office also prepares FCC witnesses for Congressional hearings, and helps create FCC responses to legislative proposals and Congressional inquiries.

- **The Office of Managing Director** is responsible for the administration and management of the Commission. Specifically, the Office manages: the Commission's budget and financial programs; human resources, contracts, and purchasing; communications and computer services; physical space; security; the Commission meeting schedule; and distribution of official FCC documents.
- **The Office of Media Relations** is responsible for disseminating information on Commission issues. It coordinates news media requests for information and interviews on FCC proceedings or activities. The Office also facilitates the release of all Commission announcements, orders, and other information. It manages the FCC Daily Digest, the FCC webpage, and the FCC Audio Visual Center.
- **The Office of Strategic Planning and Policy Analysis** works with the Chairman, Commissioners, Bureaus, and Offices to develop strategic plans and to identify the agency's policy objectives. It also provides research, advice, and analysis of advanced, novel, and non-traditional communications issues.
- **The Office of Workplace Diversity** ensures that the FCC provides employment opportunities for all persons regardless of race, color, sex, national origin, religion, age, disability, or sexual preference.

Detailed information on specific bureau and office responsibilities can be found in Title 47 of the Code of Federal Regulations and on the Commission's web site at: <http://www.fcc.gov>.

# FCC ORGANIZATIONAL CHART



**MAP OF FIELD OFFICES**



## ***FCC STRATEGIC GOALS***

As specified in section 1 of the Communications Act of 1934, as amended, the FCC's mission is to "make available, so far as possible, to all the people of the United States, without discrimination on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."<sup>3</sup> In addition, section 1 provides that the Commission was created "for the purpose of the national defense" and "for the purpose of promoting safety of life and property through the use of wire and radio communications."<sup>4</sup> The FCC's strategic and performance goals for FY 2012 are shown below.

### **BROADBAND**

Broadband is the major communications infrastructure priority of our time. Through our policies, rulemaking activities, citizen outreach, and education initiatives, we will seek to ensure that all Americans have access to reliable and affordable high-speed fixed and mobile broadband capability.

### **CONSUMERS**

Among the Commission's most important responsibilities is protecting and empowering consumers. Regulatory policies must take account of consumer interests; consumer protection and empowerment policies must apply consistently and reasonably across technologies; and information provided to consumers must be timely, accurate, and available on a variety of platforms.

### **COMPETITION AND INNOVATION**

Competition in the provision of communications services, both domestically and overseas, supports the Nation's economy. The Commission should promote a healthy competitive dynamic for communications services that fosters research and innovation and presents consumers with reliable, meaningful choice in affordable services.

### **CONTINUAL IMPROVEMENT**

The FCC is striving to become a model for excellence in government. We will be data-driven in our decision making and are committed to transparent and participatory processes that encourage public involvement and feedback. We will maintain an organizational culture that promotes innovation and accountability.

### **PUBLIC SAFETY AND HOMELAND SECURITY**

Communications during emergencies and crises are essential lifelines for public safety, health, defense, and emergency personnel, as well as all consumers in need. The Nation's critical communications infrastructure must be reliable, interoperable, redundant, supportive of all needed services, and rapidly restorable.

### **INTERNATIONAL**

We are committed to greater international engagement and cooperation in an interconnected world. The FCC will promote sound telecommunications policies globally and will strongly represent U.S. interests internationally.

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<sup>3</sup> 47 U.S.C. § 151.

<sup>4</sup> *Id.*

## ***STRATEGIES & RESOURCES TO ACHIEVE GOALS***

The Commission has identified strategies and resources to achieve its performance goals for each strategic goal. Details on the Commission's strategies and resources for achieving its strategic goals are included in the Commission's strategic plan at: <http://www.fcc.gov/omd/strategicplan>.

## ***COMPONENTS OF THE FCC FOR FINANCIAL STATEMENT PURPOSES***

In addition to the activities directly undertaken by the above bureaus and offices, the Commission components for financial statement purposes include:

*Universal Service Fund (USF)* - The Telecommunications Act of 1996 further amended the Communications Act of 1934 to codify and modify the Commission's longstanding policy of promoting universal telecommunications service throughout the nation. Pursuant to section 254, the Commission established rules and regulations governing how certain telecommunications service providers contribute to the USF and how those monies are disbursed.<sup>5</sup>

For budgetary purposes, the USF comprises five elements that consist of four universal service support mechanisms and the Telecommunications Relay Service (TRS) Fund. The TRS Fund represents a program established under section 225 of the Act. This statute provides for a mechanism to support relay services necessary for telecommunications access by speech or hearing impaired populations.<sup>6</sup>

The Universal Service Administrative Company (USAC) administers the four universal service support mechanisms of the USF under the Commission's direction. These support mechanisms are funded through mandatory contributions from U.S. telecommunications service providers, including local and long distance phone companies, wireless and paging companies, payphone providers, and providers of interconnected Voice over Internet Protocol (VoIP) services. The four universal service support mechanisms are: High Cost, Lifeline, Rural Health Care, and Schools and Libraries. These support mechanisms provide money directly to service providers to defray the cost of serving customers in high cost and rural areas, and to defray the costs of serving low income consumers as well. In addition, these mechanisms provide support for discounts to schools and libraries and rural health care providers. In FY 2012, the USF accounted for approximately \$9.3 billion in new available funds on the Commission's Combined Statement of Budgetary Resources. Additional information on USAC and the USF, respectively, can be found at <http://www.usac.org> and [http://www.fcc.gov/wcb/tapd/universal\\_service/welcome.html](http://www.fcc.gov/wcb/tapd/universal_service/welcome.html).

Rolka Loube Saltzer Associates, LLC (RLSA) was selected to be the administrator for the TRS fund during FY 2011. The TRS Fund compensates TRS providers for the reasonable costs of providing interstate telephone transmission services that enable a person with a hearing or speech disability to communicate with a person without hearing or speech disabilities. The costs of providing interstate TRS are recovered from subscribers of interstate telecommunications services. In FY 2012, TRS accounted for approximately \$712.5 million in new available funds on the Commission's Combined Statement of Budgetary Resources. Additional information on RLSA and TRS can be found at <http://www.rlsa.com/> and <http://www.fcc.gov/cgb/dro/trs.html>.

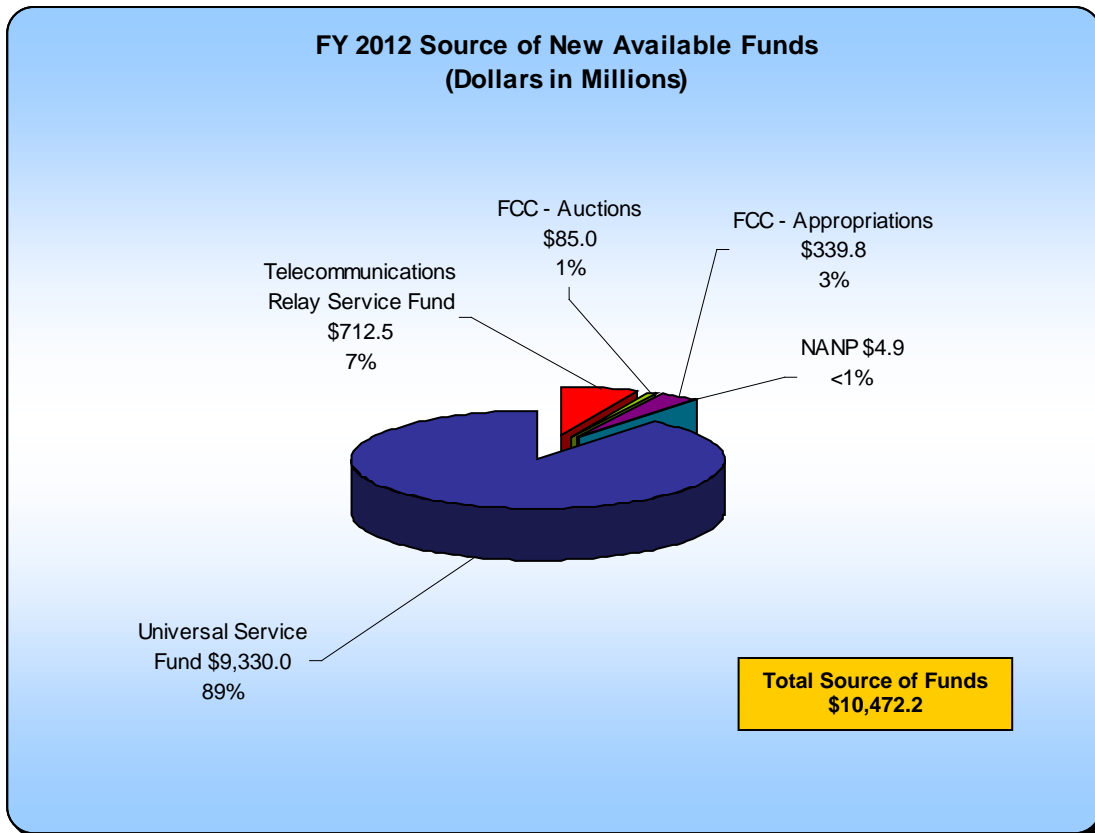
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<sup>5</sup> 47 U.S.C. § 254.

<sup>6</sup> 47 U.S.C. § 225.

*North American Numbering Plan (NANP)* - The NANP is the basic numbering scheme permitting interoperable telecommunications service within the U.S., Canada, Bermuda, and most of the Caribbean. Section 251(e)(1) of the Act requires the Commission to create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis. Section 251(e)(2) of the Act requires that the costs of number administration and number portability be borne by all telecommunications carriers on a competitively neutral basis, as determined by the Commission. In implementing section 251, the Commission appointed a NANP Administrator (NANPA), a national Pooling Administrator (PA) to administer thousands block number pooling, and a Billing and Collection Agent. The Commission selected Welch LLP to be the Billing and Collection Agent for the NANP effective October 1, 2004. In FY 2012, the NANP accounted for approximately \$4.9 million on the Commission’s Consolidated Statement of Net Cost. Additional information on the NANPA and the Billing and Collection Agent can be found at <http://www.fcc.gov/wcb/cpd/numbering/> and <http://www.nanpa.com>.

For further clarification on the financial relationships between the Commission and these components, see Note 1 of the financial statements in Section 2. Also, see the chart below which shows the relative size of the component funds in comparison to the major sources of funds for the Commission.



The Appropriations figure of \$339.8 million in the chart above reflects the authority for the Commission to collect regulatory fees. (For additional information, see Note 1 of the financial statements in Section 2.)



### ***ELIMINATING AND RECOVERING IMPROPER PAYMENTS***

In accordance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA), the Commission has performed risk assessments of its programs, formulated corrective action plans, and made significant efforts to reduce improper payments. In addition, the Commission initiated a payment recapture program, completing audits involving overpayments and testing transactions for overpayments. Section 3 provides further details on these efforts.

# *Performance Highlights*

Consistent with the objectives of the Communications Act as amended, as well as the Government Performance and Results Act, the Federal Communications Commission (FCC) identified six strategic goals. The strategic goals serve as guidance directing the actions and performance of the FCC. The Commission assesses the achievement of its performance through the accomplishment of its performance goals. Progress toward accomplishing these goals is measured by the progress and completion of various programs and initiatives during the fiscal year. There are external influences, including economic, legal, and organizational factors, beyond the Commission's programs and initiatives that may influence whether the Commission fully meets every performance goal.

During the past fiscal year, the Commission made significant progress toward accomplishing its performance goals. Greater detail on these accomplishments will be discussed in the FCC Annual Performance Report (APR) for FY 2012. The Commission will include the FY 2012 APR with its Congressional Budget Justification and will post it on the Commission web site at <http://www.fcc.gov/> in February 2013. In the discussion below, we identify achievements in the Commission's major initiatives during the past fiscal year, organized by Strategic Goal.

## **BROADBAND**

*Broadband is the major communications infrastructure priority of our time. Through our policies, rulemaking activities, citizen outreach, and education initiatives, we will seek to ensure that all Americans have access to reliable and affordable high-speed fixed and mobile broadband capability.*

Infrastructure, innovation and economic success have always been tied together in the United States. Railroads and highways connected people to each other, facilitating commerce, unleashing ingenuity, and fueling economic growth. Telephones did the same. In their time, those elements of infrastructure formed the connective tissue of a modernizing economy. Today it's broadband Internet. Our broadband infrastructure consists of the fiber, cables, cell towers, and airwaves that enable digital Internet traffic to travel anywhere in the world in a fraction of a second. The U.S. broadband economy that's being built around that infrastructure is a bright light in our struggling economy. Private investment in Internet infrastructure and applications is on the rise. Broadband providers invested tens of billions of dollars in wired and wireless networks in the first half of 2011, a double-digit increase from 2010. Capital investment at large tech companies is also robust, in the tens of billions of dollars, and experiencing very healthy increases.

The U.S. leads in broadband innovation overall, and has regained the lead in mobile, a fast-growing and critically important sector. Our nation has the world's largest number of 3G subscribers, and thanks to successful FCC auctions and a digital TV transition completed successfully in 2009, we're ahead of the world in deploying next-generation 4G networks that will offer the high speeds and low latency we're accustomed to on wireline networks. America's "apps economy" is the envy of the world. With U.S. software developers leading the way, there are now more than 500,000 mobile applications available, and apps sales are projected to approach \$38 billion by 2015.

Several challenges remain to maintaining U.S. leadership in broadband. One-third of all Americans – 100 million people – have not adopted broadband at home. To address this issue, the FCC began several initiatives.

As the fiscal year came to a close, on September 28, 2012, the FCC voted to officially launch the incentive auction process, making the United States the first nation in the world to implement this major policy innovation, which aims to repurpose excess broadcast television spectrum for mobile broadband use. With the FCC's vote to approve the Incentive Auction Notice of Proposed Rulemaking (formally called "Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions), the FCC asked for public comment from all stakeholders as well as the public on the incentive auction process. The concept was first introduced in the National Broadband Plan as part of the FCC's multi-pronged strategy to meet skyrocketing demand for mobile Internet in the United States, and became the foundation for legislation that was signed into law in February 2012. As mobile device adoption continues to grow around the world, this incentive auction will be a model for many countries facing similar spectrum challenges.

Furthermore, in one of the most significant policy steps ever taken to connect all Americans to high-speed Internet, wherever they live, the FCC voted unanimously to comprehensively reform its Universal Service Fund (USF) and intercarrier compensation systems. Those systems were widely viewed as broken and long overdue for reform.

The USF reforms create a new Connect America Fund (CAF) with an annual budget of no more than \$4.5 billion, which will extend broadband infrastructure to the millions of Americans who currently have no access to broadband. The FCC estimates that approximately 500,000 jobs will be created over the next six years by expanding high-speed Internet access to over seven million Americans living in rural areas, as well as increasing economic growth by \$50 billion over that period. The CAF will put America on the path to universal broadband and advanced mobile coverage without increasing costs to consumers. By eliminating waste and targeting support where it is most needed, these reforms put universal service funding on a firm budget, and they will impose strict new accountability on fund recipients.

The USF reforms cut waste and imposed strict fiscal responsibility standards on the CAF, preventing it from growing beyond its current size. Up to \$300 million in savings from these and prior reforms will be targeted to quickly extend high-speed Internet to up to 400,000 previously unserved homes, businesses, and anchor institutions in rural America. This is the first phase of funding from the CAF. Carriers have 90 days to accept the funding, as well as the aggressive buildout requirements that must begin in the coming months. In addition, the FCC implemented additional reforms that will make more effective use of existing funding to increase support for broadband for over two million rural lines across the country.

As part of the CAF, the Commission created the Mobility Fund, a universal service support mechanism dedicated exclusively to mobile services. Phase I of the Mobility Fund will provide one-time support to accelerate our nation's ongoing efforts to close gaps in mobile wireless service. The Mobility Fund helps improve coverage in these areas for mobile voice and broadband services. To help illustrate areas in the U.S. that currently lack access to advanced mobile networks, the FCC developed an interactive visual representation of the areas preliminarily identified as potentially eligible for Mobility Fund Phase I support and large pockets of our nation that lack access to 3G mobile service or better.

The FCC held the first auction to award high-cost universal service support through reverse competitive bidding. This auction will result in one-time support to carriers that commit to provide 3G or better mobile voice and broadband services in areas where such services are unavailable. This will accelerate delivery of advanced mobile services to tens of thousands of road miles that currently lack 3G or 4G service. Winning bidders must deploy either 3G service within two years or 4G service within three years of the award. The Mobility Fund will award up to \$300 million that was reserved out of savings from the Commission's USF reforms.

During FY 2012, the FCC continued to champion “Connect to Compete,” an initiative involving dozens of partners from the private sector and nonprofit groups. This is a first-of-its-kind national effort to address the barriers to broadband adoption, digital literacy, and the employment skills gap. In addition, FCC Chairman Julius Genachowski announced an FCC proposal to launch a Digital Literacy Corps, enabling thousands of additional libraries and schools to host in-person, basic digital literacy training programs.

The FCC advanced its wireless health care agenda by adopting rules that will enable Medical Body Area Networks (MBANs). MBAN devices free patients from cumbersome cables that tether them to their hospital beds. MBANs provide a cost effective way to monitor every patient in a healthcare institution, so clinicians can receive real-time and accurate data, allowing them to intervene and save lives. Wireless devices that operate on MBAN spectrum can be used to actively monitor a patient’s health, including blood glucose and pressure monitoring, delivery of electrocardiogram readings, and even neonatal monitoring systems. MBAN devices will be designed to be deployed widely within a hospital setting and will make use of inexpensive disposable body-worn sensors. MBAN technology will also make it easier to move patients to different parts of a health care facility for treatment and can dramatically improve the quality of patient care by giving health care providers the chance to identify life-threatening problems or events before they reach critical levels.

The FCC also advanced its mobile broadband agenda by adopting rules that will enable a new generation of wireless medical devices that could be used to restore functions to paralyzed limbs. Medical Micropower Networks (MMNs) are ultra-low power wideband networks consisting of multiple transmitters implanted in the body that use electric currents to activate and monitor nerves and muscles. Each year, millions of Americans suffer from spinal cord injuries, traumatic brain injuries, strokes, and various neuromusculoskeletal disorders. MMNs can provide effective therapy for these debilitating conditions by taking the place of damaged nerves to restore sensation, mobility, and other functions to limbs and other parts of the body.

Unused spectrum between television stations, known as “white spaces,” represents a valuable opportunity for provision of broadband data services in the changing wireless landscape. This unused TV spectrum provides a major new platform for innovation and delivery of service, with potential for both research and commercial applications. Development of unlicensed radio transmitting devices has already led to a wave of new consumer technologies, including Wi-Fi and other innovations like digital cordless phones and in-home video distribution systems. The FCC’s Office of Engineering and Technology approved Spectrum Bridge Inc.’s television white spaces database system, and also approved a device by Koos Technical Services Inc. as the first product allowed to operate on an unlicensed basis on unused frequencies in the TV bands. Commission rules require that unlicensed TV band devices contact an authorized database system to obtain a list of channels that are available for their operation (i.e., channels not occupied by authorized radio services) at their individual locations and must operate only on those channels.

At the first-ever Digital Learning Day Town Hall in Washington, D.C., the Digital Textbook Collaborative presented the “Digital Textbook Playbook,” a plan to help K-12 schools transition to digital textbooks. The Digital Textbook Collaborative, convened by the FCC and the U.S. Department of Education, is an effort by education technology leaders across private industry, school districts, and nonprofits to accelerate the deployment of digital textbooks and improve the quality and penetration of digital learning in K-12 education. While the United States spends more than \$7 billion a year on textbooks, too many students are using books that are 7-10 years old with outdated material. The Playbook will help educators tackle the major barriers to the adoption of digital textbooks, including the challenge of connectivity, at school, in the community, and at home; the challenge of device procurement; and the challenge of making the transition from paper to digital textbooks.

The FCC took steps to increase the nation's supply of spectrum for mobile broadband by removing unnecessary barriers to flexible use of 40 megahertz of additional spectrum assigned to the Mobile Satellite Service in the 2 GHz band. This proposal would carry out a recommendation in the *National Broadband Plan* that the Commission enable the provision of stand-alone terrestrial services in this spectrum. The proposed rules are designed to provide for flexible use of this spectrum, to encourage innovation and investment in mobile broadband, and to provide a stable regulatory environment in which broadband deployment can develop in the 2 GHz band.

The FCC launched a competition to discover the best ways to increase broadband adoption rates among low-income Americans. The competition builds on the Connect to Compete initiative. This competition uses \$25 million in savings from major reforms of the Lifeline program to launch pilot projects across the country to test best practices around issues of cost, digital literacy, and relevancy. The competition will gather high-quality data that will guide long-term efforts to increase broadband adoption among low-income Americans.

The FCC revised burdensome legacy regulation that unnecessarily constrained 800 MHz Specialized Mobile Radio licensees. This action amends the Commission's rules to allow geographically-based SMR licensees to operate across contiguous channels without a rigid channel spacing requirement or bandwidth limitation. Lifting the unduly restrictive limitations currently in place will enable licensees to fully and more efficiently utilize their licensed spectrum and transition their networks from legacy 2G technologies to 3G as well as other advanced technologies such as LTE. This action balances these benefits with the continuing need to protect 800 MHz public safety operations from interference and to maintain the significant strides made in the ongoing 800 MHz reconfiguration process, whereby 800 MHz operations are being relocated to protect public safety licensees against interference.

## **CONSUMERS**

*Among the Commission's most important responsibilities is protecting and empowering consumers. Regulatory policies must take account of consumer interests; consumer protection and empowerment policies must apply consistently and reasonably across technologies; and information provided to consumers must be timely, accurate, and available on a variety of platforms.*

Communications technologies are essential to our economic recovery and long-term competitiveness. Communications technologies are also at the core of consumer products used every day by hundreds of millions of Americans, and every one of those consumers deserves to be treated fairly. Empowering consumers with the tools and information they need to navigate the rapidly changing technology landscape is one of the FCC's top priorities.

The FCC launched a new 'bill shock' website (<http://fcc.us/billshocks>), an online tool to help consumers track implementation of recent commitments by wireless carriers to provide usage alerts before and after consumers exceed their plan limits. Bill shock is a sudden and unexpected increase in monthly wireless bills that happens when consumers' unknowingly exceed plan limits for voice, data and text. Bill shock can also happen when consumers travel abroad and get hit with unexpected international roaming charges. A recent FCC survey found that 30 million Americans – or one in six wireless users – have experienced bill shock.

The Commission took steps to protect Americans from difficult-to-detect fraudulent charges on their landline phone bills. The new rules combat “cramming,” the illegal placement of unauthorized charges on a consumer’s monthly phone bill. Specifically, the new rules require telephone companies to notify subscribers at the point of sale, on each bill, and on their websites of the option to block third-party charges from their landline telephone bills, if the carrier offers that option, and the new rules strengthen the Commission’s requirement that third-party charges be separated from the landline telephone company’s charges on phone bills.

Acting to reform and modernize a program vital to ensuring affordable communications for low-income consumers, the FCC approved a comprehensive overhaul of its Lifeline program. As a universal service program that fulfills Congress’ mandate to ensure the availability of communications to all Americans, Lifeline for the past 25 years has helped tens of millions of low-income Americans afford basic phone service. The percentage of low-income households with phone service increased from 80% in 1985, when Lifeline began, to nearly 92% last year.

But the program faces real challenges, including rules that have failed to keep pace as consumers increasingly choose wireless phone service, and that create perverse incentives for some carriers. The FCC’s Lifeline reforms address these and other challenges, including through changes to eliminate waste, fraud, and abuse, saving up to \$2 billion over 3 years; modernizing lifeline by adopting an express goal for the program of ensuring availability of broadband for all low-income Americans; and allowing Lifeline support for bundled services plans combining voice and broadband or packages including optional calling features.

As a result of comprehensive reforms of the Lifeline program over the last year, the FCC has begun to eliminate hundreds of thousands of duplicate subscriptions and save tens of millions of dollars. Further reforms are helping ensure that only eligible consumers are enrolled, and will step up audits of Lifeline providers. The FCC is also developing a comprehensive subscriber database that, when launched in 2013, will safeguard against duplicate subscriptions.

In addition, the FCC largely eliminated the “Link Up” program, which the Commission concluded had become wasteful and unnecessary. Link Up paid companies up to \$30 for initial phone connections even though other companies are now enrolling new subscribers for free. Elimination of Link Up on non-Tribal lands is expected to save \$100 million annually.

The FCC’s Enforcement Bureau issued 20 enforcement actions against online retailers in 12 states for illegally marketing more than 200 models of cell phone jammers, GPS jammers, Wi-Fi jammers, and similar signal jamming devices. These devices have the capacity to prevent, block, or otherwise interfere with authorized radio communications. The use of a jamming device could prevent someone in the vicinity of the jammer from making an emergency call to 9-1-1, the police, a fire department, or a family member in trouble. The Enforcement Bureau’s actions are intended to warn retailers and potential purchasers that marketing, selling, or using signal jamming devices in the U.S. is illegal and that the FCC will vigorously prosecute these violations.

The Commission adopted a *Report and Order* implementing provisions of the Twenty-First Century Communications and Video Accessibility Act of 2010 (CVAA). The CVAA was enacted to ensure that people with disabilities have access to the modern and innovative communications technologies of the 21<sup>st</sup>-century and represents the most significant accessibility legislation since the passage of the Americans with Disabilities Act in 1990. These rules are necessary steps towards ensuring that the 54 million Americans with disabilities are able to fully use and benefit from advanced communications services. The CVAA requires that providers of advanced communications services and manufacturers of equipment used for advanced communications services make their services and products accessible to

people with disabilities, unless it is not achievable to do so. Where it is not achievable to do so, these covered entities must make their services and equipment compatible with commonly used assistive technologies.

The FCC took a major step toward eliminating one of the most persistent problems of the television age – loud commercials. The Commission adopted a *Report and Order* that implements the 2010 Commercial Advertisement Loudness Mitigation Act (the CALM Act), in which Congress gave the Commission, for the first time, authority to address the problem of excessive commercial loudness. The new rules require that commercials have the same average volume as the programs they accompany. The rules also establish simple, practical ways for television providers to demonstrate their compliance with the rules.

Chairman Genachowski, with the support of major city police chiefs and the wireless industry, announced new initiatives by wireless carriers to deter theft of wireless devices and secure customer data. When Americans call their participating wireless provider and report their wireless devices stolen, their provider will block that device from being used again. This system will be rolled out using common databases across carriers over the next 18 months. Smartphone makers will notify and educate users in the most highly visible ways—through messages on the smartphone itself and through “Quick Start” user guides—about how to use passwords to deter theft and protect their data. Wireless providers will directly inform their customers about how to find and use applications that enable customers to lock/locate and wipe smartphones remotely. The wireless industry will also launch a campaign, with media buys, to educate consumers on how to protect their smartphones and themselves from crime.

## ***COMPETITION AND INNOVATION***

*Competition in the provision of communications services, both domestically and overseas, supports the Nation’s economy. The Commission should promote a healthy competitive dynamic for communications services that fosters research and innovation and presents consumers with reliable, meaningful choice in affordable services.*

The FCC took a major step toward modernizing the way television broadcasters inform the public about how they serve their communities. The Commission adopted a new approach that would require commercial and noncommercial television stations to submit documents to an online public file hosted by the Commission. Broadcasters have kept what are now known as “public files” on paper since 1965 as part of their longstanding obligation to disclose community-relevant information for public review. The public has been able to exercise its right to this information only by visiting a broadcast station and asking to see the public file. A *Further Notice of Proposed Rulemaking* seeks comment on proposals that would reduce burdens on the broadcast industry. The Further Notice proposes to streamline the information broadcasters will need to provide by requiring the Commission to import information already filed with the FCC, and exempts certain items from being posted online such as letters and emails from the public.

Consistent with the FCC’s regulatory reform agenda and its efforts to examine regulations that may have become ineffective, the Commission issued a *Notice of Proposed Rulemaking* (NPRM) initiating a review of the exclusive contract prohibition of the program access rules. Adopted approximately twenty years ago to promote competition in the video distribution market, this prohibition generally bans cable operators from entering into exclusive contracts with cable-affiliated programming vendors that deliver their programming to cable operators via satellite. The NPRM asks for input on various options, including retaining the prohibition, allowing the prohibition to sunset and relying instead on protections provided by the program access rules that do not sunset, or relaxing the prohibition

such as by considering petitions to remove the prohibition on a market-by-market basis or retaining the prohibition only for certain “must have” programming.

The Commission issued a NPRM to promote interoperability and encourage the efficient use of spectrum in the commercial Lower 700 MHz band (698-746 MHz). The rulemaking is designed primarily to examine the interference concerns should the Lower 700 MHz band utilize a single band class for devices operating across the Lower 700 MHz A, B, and C Blocks. The NPRM focuses on two interference concerns that can result with use of a single band class: (1) interference from adjacent DTV Channel 51 operations; and (2) blocking interference from neighboring high-powered operations in the Lower 700 MHz E Block. The NPRM also explores possible next steps that the FCC should take to promote interoperability in the Lower 700 MHz band should it find that there is limited or no harmful interference, or such interference can be reasonably mitigated through industry and/or regulatory measures.

The FCC invited comment on whether to allow public broadcasters to spend a modest amount of their total annual broadcast time, up to one percent or about 88 hours per year, to conduct on-air fundraising activities for charities and other nonprofits. The proposal gives viewers of public broadcasting the opportunity to raise funds for non-profit organizations in their communities and around the world. Under longstanding FCC policy, noncommercial educational (NCE) public broadcast stations can only conduct fundraising activities for the benefit of the station itself.

In anticipation of a future incentive auction to address the nation’s growing demand for wireless broadband, the Commission took steps toward making a significant portion of spectrum currently used by the broadcast television service available for new uses. The new rules allow multiple broadcast stations to elect to stream individual programming while sharing a single channel.

While stations will need to retain at least one standard definition programming stream to meet the FCC’s requirement of providing an over-the-air video broadcast at no direct charge to viewers, they will have the flexibility of tailoring their channel sharing agreements to meet their individual programming and economic needs.

## ***CONTINUAL IMPROVEMENT***

*The FCC is striving to become a model for excellence in government. We will be data-driven in our decision making and are committed to transparent and participatory processes that encourage public involvement and feedback. We will maintain an organizational culture that promotes innovation and accountability.*

The FCC worked to strengthen its procurement office by hiring a new senior procurement executive, a compliance officer, and additional contracting officers to facilitate FCC work efforts and to provide effective administration of Federal contracting requirements. Furthermore, the contracting team developed and implemented the FCC Federal Acquisition Certification for Contracting Officer’s Representatives (FAC-COR) Program, including providing new guidance for FCC CORs who oversee the FCC’s contractors and review contractor invoices. The contracting team also worked to implement an improved contract management system that is better integrated with the FCC’s financial management system.

The FCC took significant steps in moving the agency to digital solutions from existing paper processes, and continued to track these efforts. A web site was launched to provide information online about licensed television broadcast stations and access to each station’s “public inspection file.” A web form is now available on the web page for each rulemaking that allows users to comment without having to



navigate to the FCC's electronic comment filing system or to manually file written comments. The FCC began using RSS feed (instead of paper sent by mail) to provide service of copies of orders, pleadings, and other documents to parties in docketed proceedings. An Electronic Tariff Filing System was implemented by which Competitive Local Exchange Carriers are now required to submit official tariffs and associated documents electronically over a web based system.

The FCC planned, participated in, and developed an after action report on the annual government-wide continuity of operation planning exercise (Eagle Horizon). The agency conducted more frequent testing of its emergency procedures, implemented a new Emergency Notification System for its employees, and developed and implemented Occupant Emergency Plans and Procedures for FCC Headquarters and all 27 Field Offices.

The Commission issued the FY 2012 Regulatory Fee Notice of Proposed Rulemaking (NPRM) and FY 2012 Regulatory Fee Order, and the agency successfully collected regulatory fees for FY 2012. The FCC is self-funded through regulatory fees. The Commission also released a NPRM for regulatory fee reform for public comment on the regulatory fee regime.

In the fall of 2011, the FCC obtained a clean opinion on its FY 2011 financial statements for the sixth consecutive year. Through responses provided to an audit performed by the agency's Inspector General, the FCC was able to demonstrate that it is in compliance with the requirements of the Improper Payments Elimination and Recovery Act. The agency also completed and filed with Congress its first report under the Improper Payments Elimination and Recovery Act.

The FCC's Office of Managing Director conducted 17 risk assessments which were provided to the Commission's financial auditors. Through remediation efforts, the agency closed 57 recommendations from audits performed by the FCC Inspector General, and seven recommendations from audits performed by the Government Accountability Office.

The FCC completed the relocation of contractor personnel into its main headquarters building. This will result in a total rent savings of \$547,000 annually.

The Commission completed an annual report to the Office of Personnel Management (OPM) on the FCC's strategic human capital accomplishments and future direction. It established an agreement with OPM for the new Pathways Program for recruiting interns and developed draft FCC Pathways Program guidance. The agency also made efforts to improve its processes for making outside hires.

Throughout FY 2012, the FCC enhanced its information technology capabilities. Projects included the deployment of bidding software for the Mobility Fund Auction, the creation of several maps and other visualizations of FCC data, completion of FM Engineering software, launching the Accessibility Clearinghouse as required by the 21st Century Communications and Video Programming Accessibility Act, and completing a virtual desktop pilot program as well as a pilot of mobile computing devices integrating secure email service. The agency strengthened its IT security operations center efforts, moving from situational awareness to incident detection and response, and deploying integral cybersecurity detection technology.

The FCC continued to improve the tracking and completion of pending items in the FCC's Bureaus and Offices by working to standardize tracking of pending items using a single system. The FCC also improved the reporting capabilities of its tracking system to allow for better work load analysis of pending items.

The FCC issued its Strategic Plan for FY 2012 – 2016, defining the agency’s mission and vision. The Commission successfully issued several other performance plans and reports to meet the requirements of the Government Performance and Results Modernization Act of 2010.

## ***PUBLIC SAFETY AND HOMELAND SECURITY***

*Communications during emergencies and crises are essential lifelines for public safety, health, defense, and emergency personnel, as well as all consumers in need. The Nation’s critical communications infrastructure must be reliable, interoperable, redundant, supportive of all needed services, and rapidly restorable.*

The FCC took action to make the nation’s 9-1-1 systems more reliable and resilient by requiring interconnected Voice over Internet Protocol (VoIP) service providers to report significant network outages that meet specific criteria and thresholds. Interconnected VoIP services have become increasingly popular in recent years, and the number of consumers using these services in lieu of traditional telephone service is growing steadily. The new rules will help ensure that the country’s critical communications infrastructure remains available in times of crisis. The FCC will use outage reports to track and analyze information on interconnected VoIP outages affecting 9-1-1 service and determine if action is needed to prevent future outages. Public safety is a core mission of the FCC and this effort furthers the agency’s obligation to ensure the public is able to make emergency calls to summon help, particularly when facing life-threatening situations. With this action, all 9-1-1 voice calls will be covered.

Although the Emergency Alert System is decades old and often tested and used at the local level, it had never before been tested on a nationwide scale. This first-ever test was successfully held on November 9, 2011. The test occurred simultaneously across the U.S. and its territories and lasted approximately 30 seconds, after which regular programming resumed.

As part of an unprecedented collaboration with government experts and private IT and security companies, the FCC released the *Small Biz Cyber Planner*, a new easy-to-use online tool to help small businesses customize their own cybersecurity plans. The online tool is available at [www.fcc.gov/cyberplanner](http://www.fcc.gov/cyberplanner). The *Small Biz Cyber Planner* online resource enables any small business to create a customized guide tailored to its cybersecurity needs by answering a few basic questions. By using this tool and implementing the planning guide, businesses can protect themselves, their information, and their customers from cyber threats. An updated 2.0 version of the *Small Biz Cyber Planner* was unveiled in October 2012.

An industry advisory group for the FCC, the Communications, Security, Reliability, and Interoperability Council (CSRIC), unanimously adopted recommendations for voluntary action by Internet service providers to combat three major cyber security threats, including botnets, attacks on the Domain Name System, and Internet route hijacking. CSRIC is a federal advisory committee established at the direction of the FCC Chairman to provide recommendations regarding the security, reliability, and interoperability of the nation’s communications system. Currently, CSRIC is composed of more than 50 communications experts from the private sector, public safety, consumer organizations and tribal, local, state, and federal governments.

The FCC adopted a *Notice of Inquiry* to explore the use of Deployable Aerial Communications Architecture (DACA) technologies. DACA technologies are aerial technologies such as unmanned aerial vehicles, weather balloons, or existing aircraft that could provide emergency communications during or immediately after a major disaster when terrestrial communications infrastructures may be damaged or

disrupted. Federal, state, and local governments are constantly working to improve their emergency communications capabilities when a disaster strikes. Yet there remains a gap during the first 72 hours after a catastrophic event when communications may be disrupted or completely disabled due to damaged facilities, widespread power outages, and lack of access by restoration crews into the affected area. DACA could provide temporary emergency communications to emergency management officials, first responders, critical infrastructure industry personnel, and the public to use their day-to-day communications devices seamlessly during and immediately after an emergency.

The Commission proposed rules on a number of issues involved in improving spectrum efficiency and encouraging greater use of the 4940-4990 MHz (4.9 GHz) band for public safety broadband communications. Improved use of the 4.9 GHz band will facilitate wireless local area networks for incident scene management, fixed point-point surveillance, and support for dispatch operations and vehicular or personal communications.

## ***INTERNATIONAL***

*We are committed to greater international engagement and cooperation in an interconnected world. The FCC will promote sound telecommunications policies globally and will strongly represent U.S. interests internationally.*

For the first time since 1996, the FCC initiated a wholesale review of its Part 25 rules governing licensing and operation of space stations and earth stations which transmit radio frequency signals between the ground and satellites. This *Notice of Proposed Rulemaking* (NPRM) proposes to eliminate unnecessary technical and information filing requirements, update rules to better accommodate evolving technology, and simplify existing requirements. In proposing extensive changes to over 100 rule sections and subsections in Part 25, the Commission aims to give satellite licensees the flexibility to provide innovative services while ensuring an operating environment free from harmful interference.

FCC Chairman Julius Genachowski participated in high-level discussions with U.S. and Mexican telecommunications officials at the State Department where the United States signed two Protocols with Mexico for sharing spectrum in the 800 MHz and 1.9 GHz bands along the U.S.-Mexican border. The signing of these documents marks the beginning of the final phase for rebanding in the 800 MHz band across the country. These actions will help support commercial broadband services and public safety mission-critical voice communications along the U.S.-Mexico border and throughout the United States. The United States and Mexico also signed a high-level expression of support for continued coordination of spectrum along the border and cooperation on telecommunications policy issues as well as an ambitious work plan for 2012-2014.

On December 5 and 6, 2011, the FCC and Global Initiative for Inclusive Information and Communications Technology co-hosted the International M-Enabling Summit and Showcase. This event was designed to explore ways to promote and implement accessible mobile communications and services for senior citizens and persons with disabilities. FCC Chairman Julius Genachowski, International Telecommunication Union's Secretary General Hamadoun Touré, Mohammed Al-Tarawneh, Inaugural Chairperson of the United Nations Committee on the Rights of Persons with Disabilities, and Kareem Dale, Special Assistant to the President for Disability Policy, were among the speakers at the Summit. There were attendees from at least 30 countries at the Summit.

## *Management Assurances*

In accordance with Office of Management and Budget (OMB) Circular No. A-123, the Commission maintains internal control for financial and management reporting that provides reasonable assurance that the financial statements fairly present information related to assets, liabilities, and net position and do not contain material misstatements. Transactions are executed in accordance with budgetary and financial laws, consistent with the Commission's statutory requirements, and are recorded in accordance with Federal accounting standards.

Additionally, assets are properly acquired, used, and safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud. Further, the Commission's internal controls provide for the existence and completeness of its performance measures, as required by OMB Circular No. A-136.

The Commission received an unqualified opinion on its financial statements in FY 2010 and FY 2011. In conjunction with both of these opinions, the independent auditors provided the Commission with reports on internal control and compliance with laws and regulations. The independent auditors' report identified no material weakness in internal controls in FY 2010 and FY 2011.

The FY 2011 report identified no material weaknesses in internal controls but included significant deficiencies in the following areas: 1) the financial reporting process, and 2) information technology control deficiencies. During FY 2012, the FCC worked to remediate risks associated with these findings and to take corrective action to close them. First, with regard to addressing the significant deficiency for the financial reporting process related to the Commission and its reporting components, the Commission took additional steps in FY 2012 to resolve the auditors' findings and improve the performance of its financial reporting process through the implementation of a new acquisition system and improvements to its core financial system. The Commission's new core financial system was launched in October 2010 and the Commission in FY 2012 continued working to efficiently deploy the functionality of that system. Also in FY 2012, the Commission continued to work closely with its reporting components in their efforts to modernize their financial systems. Second, with respect to the significant deficiency related to information technology control weaknesses, the Commission formed a team to fully assess the auditors' recommendations, develop corrective action plans, and remediate these findings. Some findings have already been corrected and the Commission will make every effort in FY 2013 to complete corrective actions for each of the recommendations associated with these findings so as to avoid any repeat findings in this area.

In both fiscal years the Commission also received findings of non-compliance with the Federal Managers' Financial Integrity Act (FMFIA). With respect to the instances of noncompliance with FMFIA, the Commission and its reporting components are committed to implementing financial systems that are fully integrated, and that provide efficient and effective processing and reporting of accounting transactions and financial information. As noted above, the Commission's new core financial system was launched in October 2010 and the Commission in FY 2012 continued working to efficiently deploy the functionality of that system. Also in FY 2012, the Commission continued to work closely with its reporting components in their efforts to modernize their financial systems. The Commission continues to work diligently on closing all findings from prior year audits and has made significant progress on resolving most recommendations presented.

During FY 2012, the Commission has continued its efforts to assess and improve internal controls as it works within the requirements of OMB Circular No. A-123. The Commission's Senior Management Council continues to meet regularly to strengthen its efforts and efficiencies overseeing Commission operations. During the current fiscal year, the Commission also continued to work with the administrators of its three reporting components, USF, TRS, and NANP, to implement an OMB Circular No. A-123 framework and take the appropriate steps to strengthen their internal control frameworks. The Commission continues to receive unqualified opinions over its financial statements; however, the Commission will continue to focus its efforts to make its internal controls over operations more effective and efficient as it moves forward.

**MANAGEMENT ASSURANCES – FEDERAL MANAGERS’ FINANCIAL INTEGRITY  
ACT OF 1982 (FMFIA)**

The Federal Managers’ Financial Integrity Act of 1982 (FMFIA) establishes overall requirements with regard to internal control. FMFIA requires agencies to establish controls that reasonably ensure that: (i) obligations and costs are in compliance with applicable laws; (ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and (iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over assets. Pursuant to FMFIA’s requirements, agencies must annually evaluate their system of internal controls and report on the results of those evaluations through management assurance statements.

**Statement of Assurance**

The Commission’s management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of FMFIA. The Commission conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular No. A-123, *Management’s Responsibility for Internal Control*. Based on the results of this evaluation, the Commission can provide reasonable assurance that its internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2012 were operating effectively and no material weaknesses were found in the design or operation of internal controls. In addition, with the exception of the instances of non-conformances with government-wide financial systems requirements discussed below, the Commission can provide reasonable assurance that its financial management systems meet the objectives of FMFIA.



Julius Genachowski  
Chairman  
November 14, 2012

## **Status of Internal Controls – Section 2 of FMFIA**

During FY 2012, the Commission continued its efforts to improve and strengthen its internal controls over operations and financial reporting. In addition to its own risk assessments over its operations, the Commission worked with USAC and RLSA to strengthen their frameworks on internal controls to comply with OMB Circular No. A-123. Throughout FY 2012, the Commission continued to work diligently to close out audit findings from previous audits. The Commission was able to close out 85 audit findings in FY 2012. The Commission continues to tighten its controls over operations and improve its policies and procedures where necessary.

Despite recent success, the Commission needs to finish the work at hand. The FY 2012 audit report identified significant deficiencies that still need to be resolved. The primary areas of concern relate to the financial system functionality and integration at the Commission and its reporting components, and information technology controls.

## **Financial Management Systems – Section 4 of FMFIA**

Section 4 of FMFIA requires agencies to annually evaluate whether the agency's financial management systems conform to government-wide requirements. These financial systems requirements are included in OMB Circular No. A-127, *Financial Management Systems*. If the agency's systems do not substantially conform to financial systems requirements, agencies must report the non-conformances and discuss the agency's plan to bring the systems into substantial compliance.

As previously noted by the Commission's auditors, the Commission's financial systems did not substantially conform to government-wide requirements. Specifically, the Commission lacked a fully integrated financial system. In October, 2010, the Commission launched a new core financial system and in FY 2012 the Commission continued working through the process to fully launch all functionality of its new system. The Commission continues to work with its reporting components to launch their new financial systems and to improve the Commission's financial systems.

# *Financial Discussion and Analysis*

## *UNDERSTANDING THE FINANCIAL STATEMENTS*

The Commission is committed to excellence and accuracy in financial reporting, transparency, and financial management. Preparing the Commission financial statements is part of the goal to improve financial management and provide accurate and reliable financial information that is useful for assessing performance and allocating resources. The Commission's management is responsible for the integrity and objectivity of the information presented in the financial statements. For seven consecutive years, the financial statements have received an unqualified audit opinion from the external auditors.

The principal financial statements have been prepared to report the financial position and results of operations of the Commission. The statements have been prepared from the books and records of the Commission, in accordance with U.S. generally accepted accounting principles (GAAP) for Federal entities. The financial statements and notes are presented in accordance with OMB Circular No. A-136, *Financial Reporting Requirements*, dated August 3, 2012.

This section presents a summary analysis of key financial statement core business activities. The principal financial statements include the Consolidated Balance Sheet, Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources and Consolidated Statement of Custodial Activity. This section also summarizes the financial activity and net position of the Commission. The complete set of principal financial statements is included in section 2 of this report.

A summary of the Commission's major financial activities in FY 2012 and FY 2011 is presented in the table on the next page. This table represents the resources available for use (assets) against the amount owed (liabilities) and the amount that comprises the difference (net position). The net cost represents the gross cost of operating the Commission's lines of business less earned revenue. Budgetary resources represent funds made available to the Commission.



**CHANGES IN FINANCIAL POSITION IN FY 2012**

**Consolidated**

(Dollars in Thousands)

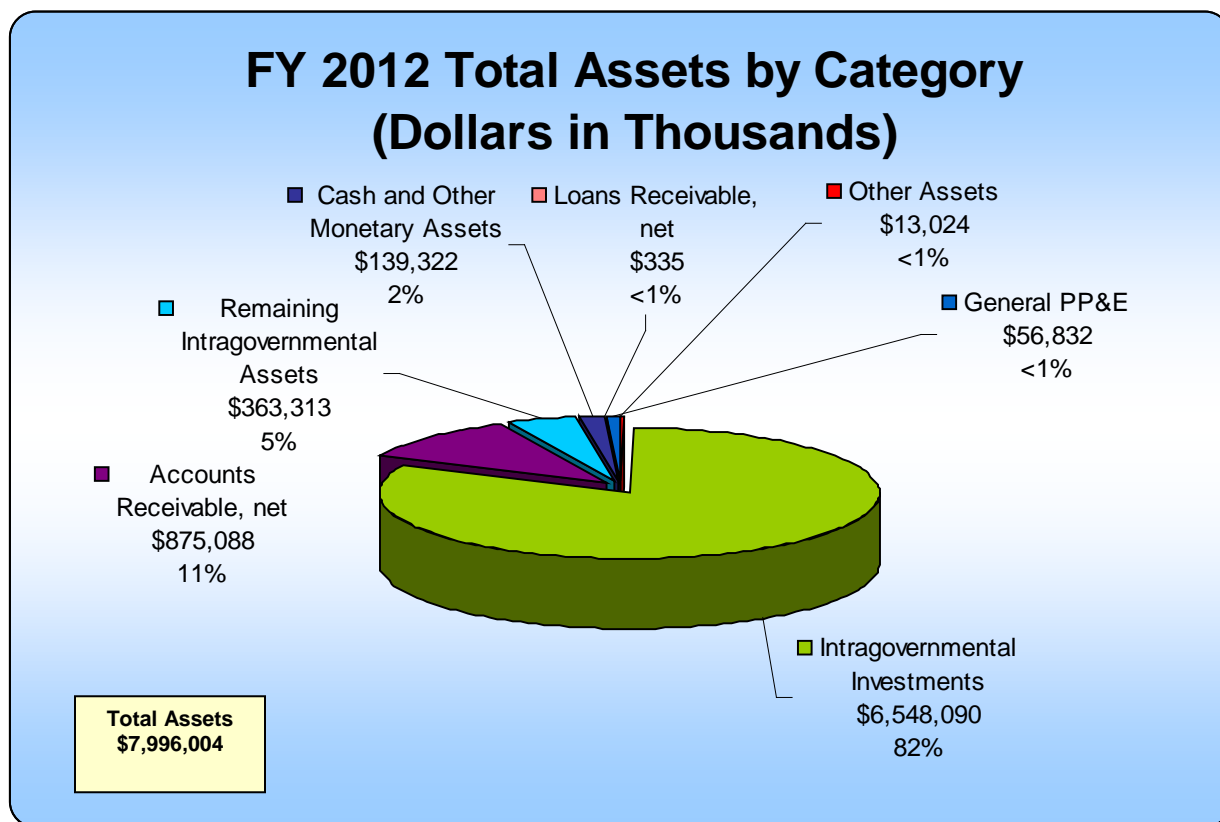
<b>Net Financial Condition</b>	<b>2012</b>	<b>2011</b>	<b>Increase (Decrease)</b>	<b>Percentage Change in Financial Position</b>
<b>Intragovernmental</b>				
Fund Balance with Treasury	\$ 361,739	\$ 494,340	\$ (132,601)	(27)%
Investments	6,548,090	5,822,843	725,247	12%
Accounts Receivable	1,574	1,097	477	43%
Other	-	2,436	(2,436)	(100)%
<b>Total Intragovernmental</b>	<b>\$ 6,911,403</b>	<b>\$ 6,320,716</b>	<b>\$ 590,687</b>	<b>9%</b>
Cash and Other Monetary Assets	139,322	213,944	\$ (74,622)	(35)%
Accounts Receivable, net	875,088	831,072	44,016	5%
Loans Receivable, net	335	4	331	8275%
General Property & Equipment, net	56,832	60,461	(3,629)	(6)%
Other	13,024	13,053	(29)	<1%
<b>Total Assets</b>	<b>\$ 7,996,004</b>	<b>\$ 7,439,250</b>	<b>\$ 556,754</b>	<b>7%</b>
<b>Intragovernmental</b>				
Debt	\$ -	\$ 50,300	\$ (50,300)	(100)%
Other	168,897	220,249	(51,352)	(23)%
<b>Total Intragovernmental</b>	<b>\$ 168,897</b>	<b>\$ 270,549</b>	<b>\$ (101,652)</b>	<b>(38)%</b>
Accounts Payable	110,523	92,976	17,547	19%
Deferred Revenue	62,971	93,053	(30,082)	(32)%
Prepaid Contributions	85,849	77,362	8,487	11%
Accrued Liabilities for Universal Service	752,423	633,967	118,456	19%
Other	39,578	35,804	3,774	11%
<b>Total Liabilities</b>	<b>\$ 1,220,241</b>	<b>\$ 1,203,711</b>	<b>\$ 16,530</b>	<b>1%</b>
Unexpended Appropriations	\$ 4,251	\$ 15,105	\$ (10,854)	(72)%
Cumulative Results of Operations	6,771,512	6,220,434	551,078	9%
<b>Total Net Position</b>	<b>\$ 6,775,763</b>	<b>\$ 6,235,539</b>	<b>\$ 540,224</b>	<b>9%</b>
<b>Net Cost of Operations</b>	<b>\$ 9,536,699</b>	<b>\$ 8,820,764</b>	<b>\$ 715,935</b>	<b>8%</b>
<b>Total Budgetary Resources</b>	<b>\$ 14,297,518</b>	<b>\$ 12,904,395</b>	<b>\$ 1,393,123</b>	<b>11%</b>

The following is a brief description of the nature of each required financial statement and its relevance, including a description of certain significant balances on Commission operations.

**Consolidated Balance Sheet:** The Consolidated Balance Sheet presents the total amounts available for use by the Commission (total assets) and the amounts owed by the Commission (total liabilities). Investments and Accounts Receivable represent over 93% of total assets as of September 30, 2012.

The graph below presents the total assets of the Commission as of September 30, 2012. The large Investments balance of \$6,548.1 million results from carryover in the USF Schools and Libraries and Rural Healthcare programs that has grown since the programs' inception as a result of annual contributions that have exceeded annual distributions.

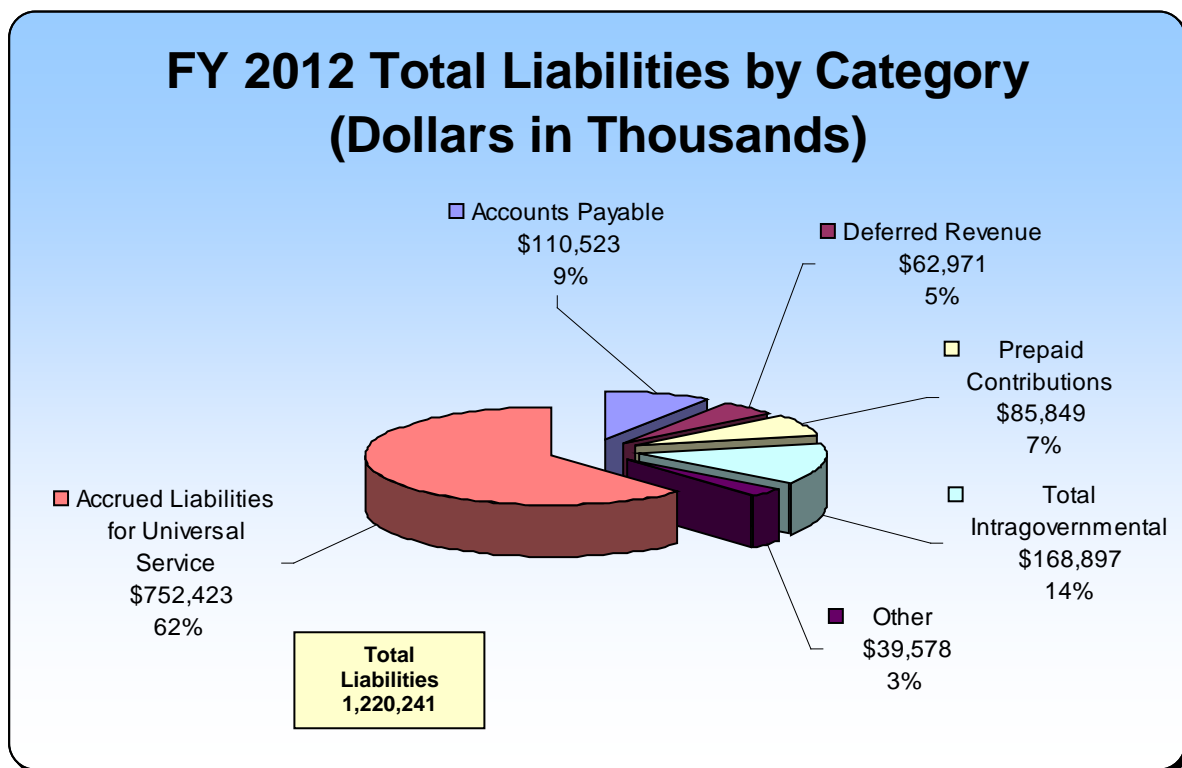
The Accounts Receivable balance of \$875.1 million is primarily composed of USF receivables totaling \$791.9 million.



The graph below presents the total liabilities of the Commission as of September 30, 2012. The Commission's most significant liabilities are Intragovernmental of \$168.9 million and Accrued Liabilities for Universal Service of \$752.4 million, which accounted for over 75% of total liabilities as of September 30, 2012.

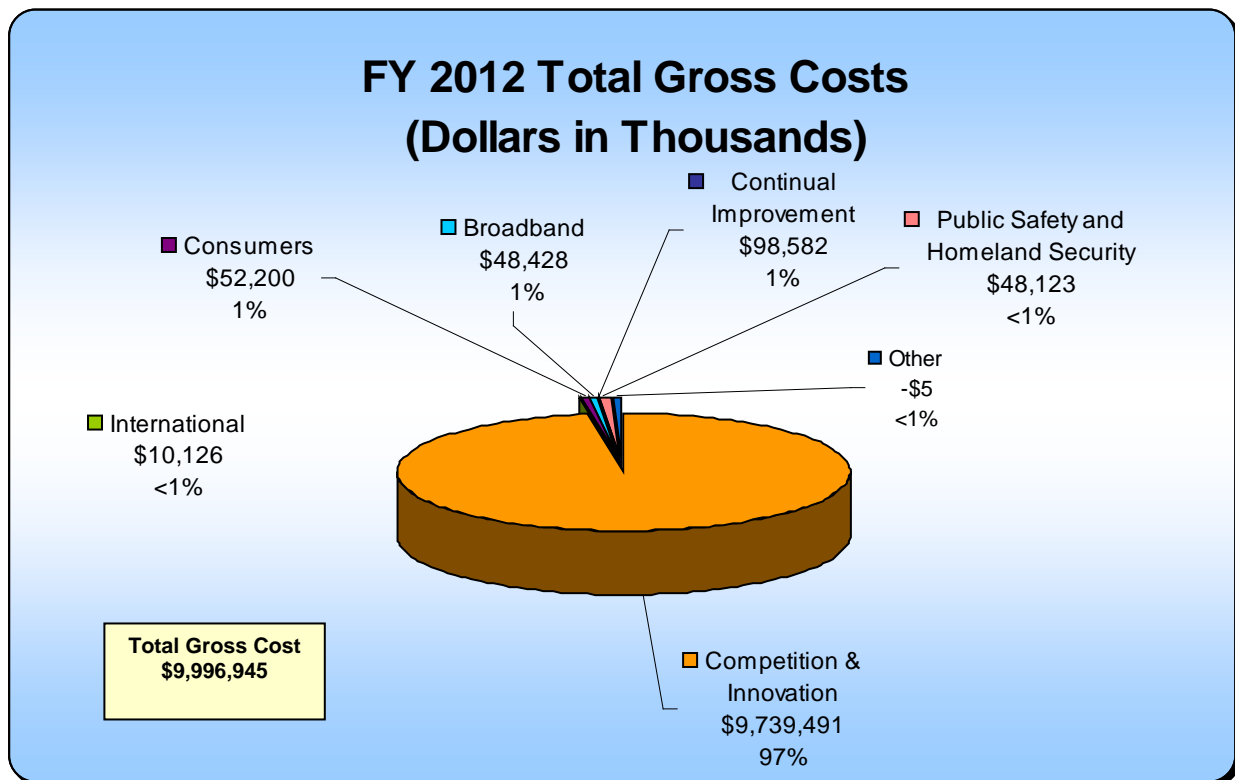
Total Intragovernmental is primarily composed of custodial collections earned on Spectrum auctions and miscellaneous receipts.

The Accrued Liabilities for Universal Service represent the expected October (FY 2013) payments for the Telecommunications Relay Service Program and the Universal Service Fund High Cost and Low Income Programs.



**Consolidated Statement of Net Cost:** This statement presents the annual cost of operating Commission programs. The Consolidated Statement of Net Cost is aligned with the six strategic goals of the Commission: Broadband, Competition and Innovation, International, Consumers, Public Safety and Homeland Security, and Continual Improvement. Gross costs for each goal are presented individually while revenue is presented in total rather than by goal. The program costs for the USF, TRS, and NANP are included within the Competition and Innovation strategic goal. The Commission’s subsidy costs for the Spectrum Auction Loan Program are included with the Competition and Innovation strategic goal. As a result of the accounting for these activities, the cost for these goals may be significantly higher than the cost of the five other goals. Contributions received for the USF and TRS programs are shown on the Statement of Changes in Net Position and do not directly offset the costs of these programs on the Statement of Net Cost.

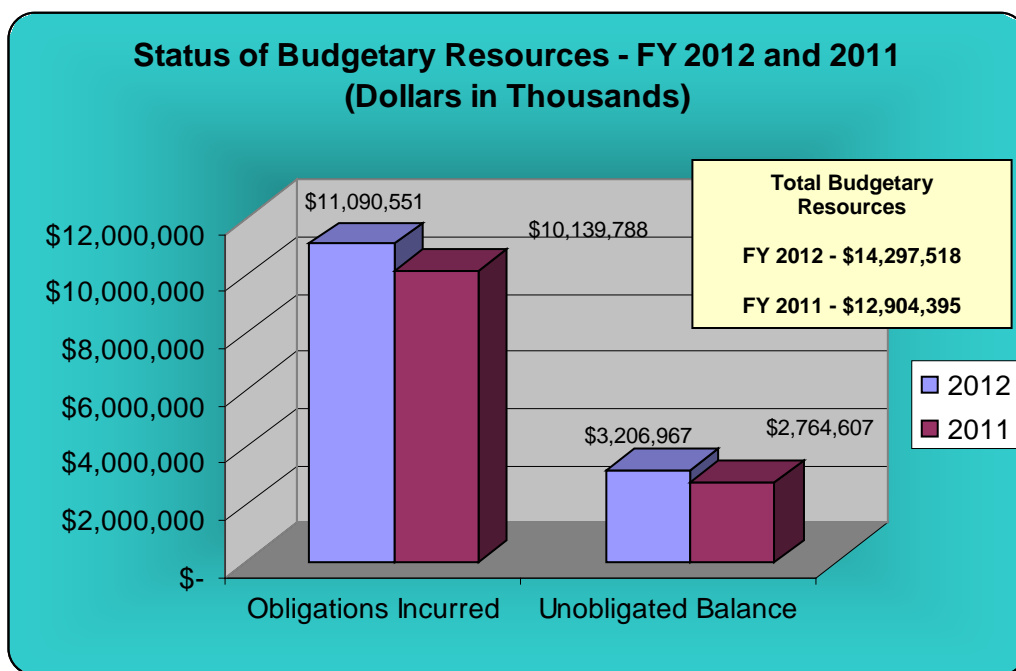
The graph below presents the total gross costs of each Commission program.



***Consolidated Statement of Changes in Net Position:*** This statement presents the cumulative net results of operations and total unexpended appropriations in order to understand the nature of changes to the net position as a whole. The Commission’s Net Position increased to \$6,776 compared to net position of \$6,236 for FY 2011, an increase of \$540 million or an 8.7% net increase in FY 2012.

***Combined Statement of Budgetary Resources:*** This statement provides information on how budgetary resources were made available to the Commission for the year and the status of those budgetary resources at the end of the year. The Commission receives most of its budgetary authority from appropriations. Budgetary resources consist of the resources available to the Commission at the beginning of the year, plus appropriations, spending authority from offsetting collections, and other budgetary resources received during the year. The Commission had \$14.3 billion in budgetary resources of which \$11.1 billion was obligations incurred and \$3.2 billion remained unobligated.

The chart below presents the status of budgetary resources comparatively between FY 2012 and FY 2011.



***Consolidated Statement of Custodial Activity:*** The Commission recognized \$51.5 million of custodial revenue during FY 2012. From this balance, \$10.4 million was transferred to Treasury. The \$43.9 decrease in amounts yet to be transferred is a result of the FCC not holding as much in Auction Custodial Collections for future years at September 30, 2012. The remaining Auctions revenues were retained by the Commission.

## ***OTHER KEY FINANCIAL STATEMENT HIGHLIGHTS***

The Commission must annually adjust its allowance for losses on the credit portfolio. In accordance with OMB guidance, the Commission calculates its subsidy reestimate based on the most recent economic and technical assumptions of current portfolio performance.

The Commission's FY 2012 subsidy reestimate was completed to reflect the actual loan performance through September 30, 2012. The reestimate resulted in a net downward adjustment, including interest on the reestimate, of \$1.5 million in the Spectrum Auction program.

This reestimate is reported in the Commission's FY 2012 financial statements, but will not be reported in the budget until FY 2013. For more details, see financial statement Footnote 7.

### **Regulatory Fee Collections**

Section 6003(a) of the Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, added a new section 9 to the Communications Act. The law requires that the Commission annually collect fees and retain them to offset certain costs incurred by the Commission. The fees collected are intended to recover the non-licensing costs attributable to the Commission's competition, enforcement, consumer information, and spectrum management activities. The amount the Commission is required to recover is included in the Commission's annual appropriations.

Regulatory fees are collected and warranted back to the Treasury to offset the Commission's appropriations for the current fiscal year. In FY 2012, the Commission was required to collect \$339.8 million in regulatory fees. Actual collections were slightly over \$344.7 million.

### **Possible Future Effects of Existing Events and Conditions**

The last active loans in the Commission's spectrum auction loan program matured during FY 2007. In compliance with OMB requirements, the Commission calculated a subsidy reestimate for FY 2012. The generation of the remaining cash flows is dependent upon the outcome of bankruptcy proceedings, settlement efforts, and Treasury collection efforts on remaining loans, which are all either in a bankruptcy or default status.

In addition to the discussion of the loan program above, the Commission addresses the possible future effects of existing claims, commitments, and major unfunded liabilities in the notes to the financial statements as well as required supplementary information.

### **Limitations on the Financial Statements**

The principal financial statements have been prepared to report the financial position and results of operations of the Federal Communications Commission, pursuant to the requirements of 31 U.S.C. § 3515(b). While the principal financial statements have been prepared from the books and records of the Commission in accordance with U.S. generally accepted accounting principles (GAAP) for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity.

## 2. Financial Statements and Auditors' Reports

### *Message from the Chief Financial Officer*

I am pleased to present the Commission's financial statements for fiscal year (FY) 2012 and to report that the Commission's auditors issued an unqualified opinion on each of the Commission's financial statements for FY 2012. Furthermore, I am proud to say that this is the seventh straight fiscal year the Commission has received an unqualified opinion. The Commission is proud of the work of its staff to obtain and maintain an unqualified opinion.

During FY 2012, the Commission launched a new Office of Management and Budget Circular No. A-123 internal controls process that distributes responsibility down to each Bureau and Office. This new process enables Commission managers to be more involved in and responsible for the internal controls established throughout the Commission, and requires the Bureau and Office chiefs to provide attestations to the Managing Director and the Chairman.

Throughout FY 2012, the Commission worked diligently on closing audit findings from previous audits. As a part of this effort, the Commission made progress on resolving matters raised by its auditors in their FY 2011 audit report. The Commission closed findings relating to its information technology control deficiencies and made progress in resolving findings related to its financial management systems; however, there is still work to be done. In addition, the Commission successfully launched a new mechanized Acquisitions process that is incorporated into its core financial system. The new Acquisitions process will assist the Commission by providing more timely procurements and better tracking of obligations.

Significantly, for FY 2012 the Commission's independent auditor did not report any material weaknesses for the Commission or its reporting components. Despite these successes, work remains here at the Commission. The FY 2012 audit reports point out two significant deficiencies related to internal controls and note two instances of non-compliance that still need to be resolved. The primary areas of concern relate to financial system functionality and integration, information technology controls, and compliance with the Federal Managers' Financial Integrity Act and the Debt Collection Improvement Act.

The Commission is committed to improving its financial processes, fiscal integrity, minimizing the risk of improper payments, and to reducing improper payments to the customers and beneficiaries of its reporting components. The Commission continues to make improvements to the fiscal management, administration, and oversight of funds reported by the Commission.

I look forward to FY 2013 and to making every effort to continue to strengthen the Commission's and its reporting components' internal control environments, and to improve the effectiveness of the Commission's and its reporting components' financial operations.



Mark Stephens  
Chief Financial Officer  
November 14, 2012



OFFICE OF INSPECTOR GENERAL

MEMORANDUM

**DATE:** November 14, 2012  
**TO:** Chairman  
**FROM:** Inspector General *[Signature]*  
**SUBJECT:** Audit of the Federal Communications Commission's Financial Statements for Fiscal Year 2012

In accordance with the Accountability of Tax Dollars Act of 2002 (Pub. L. 107-289), the Office of Inspector General (OIG) engaged the independent certified public accounting firm of KPMG LLP to audit the fiscal year 2012 financial statements of the Federal Communications Commission (FCC) in accordance with generally accepted government auditing standards.

KPMG LLP's reports include an opinion on FCC's financial statements, report on internal control over financial reporting, and report on compliance and other matters. In summary, KPMG LLP found that:

- The financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles.
- There were no material weaknesses in internal control.
- There were two repeat significant deficiencies related to FCC's financial system functionality and integration and FCC's information technology controls.
- There were two instances of noncompliance with laws and regulations, the first related to requirements of the Federal Managers' Financial Integrity Act and the second is a noncompliance with the requirements of the Debt Collection Improvement Act.

The OIG reviewed KPMG LLP's reports and related documentation and made necessary inquires of KPMG's representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards was not intended to enable us to express an opinion and we do not express an opinion on the FCC's financial statements, conclusions about the effectiveness of internal controls, or conclusions on compliance with laws and regulations. KPMG LLP is wholly responsible for the attached report dated November 14, 2012 and the conclusions expressed therein.



However, our review, while still ongoing, disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

cc: Managing Director  
Chief of Staff  
Chief Financial Officer



KPMG LLP  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

### Independent Auditors' Report

Managing Director  
Federal Communications Commission

Inspector General  
Federal Communications Commission

We have audited the accompanying consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements" or "basic financial statements") for the years then ended. These consolidated financial statements are the responsibility of the FCC's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the FCC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Federal Communications Commission as of September 30, 2012 and 2011, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 20 to the consolidated financial statements, the FCC changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012 based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting*

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("KPMG International"), a Swiss entity.



Federal Communications Commission  
November 14, 2012  
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*Requirements.* As a result, the FCC's combined statement of budgetary resources for fiscal year 2011 has been adjusted to conform to the current year presentation.

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary Information sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information in the Other Accompanying Information section is presented for purposes of additional analysis and is not required as part of the basic financial statements. Such information has not been subjected to the auditing procedures applied during our audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 14, 2012, on our consideration of the FCC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

November 14, 2012



KPMG LLP  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

## Independent Auditors' Report on Internal Control Over Financial Reporting

Managing Director  
Federal Communications Commission

Inspector General  
Federal Communications Commission

We have audited the consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended, and have issued our report thereon dated November 14, 2012. As discussed in Note 20 to the consolidated financial statements, the FCC changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012 based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

The management of the FCC is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our fiscal year 2012 audit, we considered the FCC's internal control over financial reporting by obtaining an understanding of the FCC's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the FCC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FCC's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable

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possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2012 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting described in Exhibit I that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

The FCC's written response to the significant deficiencies identified in our audit and presented in the Agency Financial Report was not subjected to the auditing procedures applied in the audit of the FCC's consolidated financial statements and, accordingly, we express no opinion on it.

Exhibit II presents the status of prior year's significant deficiencies.

We noted certain additional matters that we have reported to management of the FCC in a separate letter dated November 14, 2012.

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

KPMG LLP

November 14, 2012

## SIGNIFICANT DEFICIENCIES

### Financial System Functionality and Integration

The FCC consolidated financial statements present the financial results of the Commission (FCC) and three components: the Universal Service Fund (USF), the Telecommunications Relay Services Fund (TRS), and the North American Numbering Plan (NANP). The FCC has oversight responsibilities over the three components which are administered by other organizations independent of the FCC. Each component entity is responsible for preparing its trial balance. The FCC's Office of the Managing Director, Division of Financial Operations, is responsible for reviewing the components' trial balances before including that financial data in the FCC consolidated financial statements.

In October of fiscal year 2011, the FCC implemented a new financial system. During the FY 2012 audit, we noted the following issues still existed as they relate to reporting functionality:

- The FCC was unable to properly age receivables and generate dunning letters in order to transfer overdue receivables to the U.S. Department of Treasury until June 2012. FCC is still unable to properly refer debt to Treasury for servicing.
- Throughout the fiscal year ended September 30, 2012, the FCC was unable to generate a system allocation of costs for the Statement of Net Cost, and continued to manually generate the FCC consolidated financial statements using Microsoft Excel.

Certain of the components' significant transactions are tracked on Microsoft Excel spreadsheets and recorded into the general ledger at a summary level. Significant examples of this include (amounts in thousands as of September 30, 2012):

- Investment Transactions for USF and TRS – \$6,548,090
- Accounts Receivable Subledgers for USF – \$791,882
- Total Budgetary Resources for USF and TRS – \$13,799,794

As outlined in the GAO Standards for Internal Control in the Federal Government and the FSIO Core Financial System Requirements, "OMB Circular A-127, *Financial Management Systems*, sets forth general policies for Federal financial management systems. Each agency is required to establish and maintain a single integrated financial management system ... All financial management systems must deliver the following:

- Demonstrate compliance with accounting standards and requirements
- Provide timely, reliable, and complete financial management information for decision making at all levels of government
- Meet downstream information and reporting requirements with transaction processing data linked to transaction engines
- Accept standard information integration and electronic data to and from other internal, governmentwide, or private-sector processing environments

- Provide for “one-time” data entry and reuse of transaction data to support downstream integration, interfacing, or business and reporting requirements
- Build security, internal controls, and accountability into processes and provide an audit trail
- Be modular in design and built with reusability as an objective
- Meet the needs for greater transparency and ready sharing of information
- Scale to meet internal and external operational, reporting, and information requirements for both small and large entities.”

The financial system’s lack of integration continued to require manual processes and other intervention to ensure the general ledger was materially correct. Additional resources were required to maintain the accuracy of the financial system data due to the need for additional reconciliations resulting from non-integrated processes.

**Recommendations**

1. Record and track significant component level proprietary and budgetary transactions within the component financial systems in accordance with the requirements set forth in the GAO Standards for Internal Control in the Federal Government. **(Updated)**
2. Utilize the electronic integration of the component financial information to generate consolidated financial statements efficiently and effectively with the requirements set forth in the GAO Standards for Internal Control in the Federal Government. **(Updated)**

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### **Information Technology (IT) Controls**

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As we reported in fiscal year 2011, the FCC needs to improve its entity-wide security program. An effective security program embodies the organization's internal control responsibilities with respect to securing its IT infrastructure and services. OMB has defined standards within OMB Circular No. A-123, *Management's Responsibility for Internal Control*, related to control environment, risk assessment, control activities, monitoring, and information and communication. For purposes of financial reporting, management is responsible for developing and maintaining internal control activities that comply with OMB standards to ensure the reliability of financial reporting.

We identified deficiencies in the FCC's control environment, risk assessment, control activities, and monitoring as it relates to securing FCC's information technology infrastructure. The application of IT is pervasive throughout the FCC and as a result these deficiencies may impact the FCC's ability to comply with OMB's internal control objectives for financial reporting. FCC consolidated financial statements are comprised of three reporting components; Commission headquarters and field offices, the Universal Service Fund (USF), and the North American Numbering Plan (NANP). However, the noted IT deficiencies described below relate to the Commission, which represents approximately \$339.8 million of \$9.9 billion of consolidated Statement of Net Cost. We have previously reported these deficiencies to FCC management in more detail. Each of the sections below summarizes the reported control deficiencies.

#### **Control Environment Findings**

OMB Circular A-123 requires management to clearly identify areas of authority and responsibility and appropriately delegate the authority and responsibility throughout the agency. We noted that the FCC had commenced, but not completed, development of an oversight plan for Universal Service Administrative Company's (USAC) IT security program. For other (i.e., not operated by USAC) contractor-operated systems that collect and maintain FCC data, the FCC has not documented or implemented plans for directing and overseeing the contractors' information security programs. The FCC has not documented policies and procedures to define the scope, frequency, methodology, and documentation requirements for the FCC's assessment activities related to the oversight of information systems that collect and maintain FCC data but are not operated by the FCC.

#### **Control Environment Recommendation**

Strengthen the control environment by:

3. Completing the development of and implementing policies and procedures for overseeing the information security programs for contractor information systems that collect and maintain FCC data, but are not operated by the FCC, to ensure that they are administered consistently with all relevant FCC, National Institute of Standards and Technology (NIST) and OMB requirements and instructions. Policies and procedures should define the scope, frequency, methodology, and documentation requirements for the FCC's assessment activities for contractors' information security programs. **(Re-issued)**



### **Risk Assessment Findings**

OMB Circular A-123 requires management to identify internal and external risks that may prevent the organization from meeting its objectives. We noted that the FCC had performed procedures to assess the effectiveness of its IT security controls and to assess related risks. However, the FCC's assessment procedures were incomplete, falling short of relevant requirements from NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, and NIST SP 800-37 Revision 1, *Guide for Applying the Risk Management Framework to Federal Information Systems*. System-specific controls and the related risks were assessed for the FCC's network. However, for one other major FCC system that we tested, the security assessment report was incomplete, as the vulnerabilities identified were largely limited to technical vulnerabilities of the type detected by a vulnerability scan and did not encompass management and operational vulnerabilities. We further noted that the system security plan for one major system was not used to plan controls to mitigate risks identified in the security assessment report.

Furthermore, we noted that the FCC's risk management activities were behind schedule. Specifically, the authorization to operate was expired for ten of the twelve FCC information systems that the FCC defines as major applications. Re-assessment activities were in progress for four of the ten systems, but for the other six unauthorized systems no progress had been made. Not reassessing risks and control effectiveness and then reauthorizing an information system at a minimum of every three years, increases the risk that since the previous security authorization, the current state of a system, its controls or the environment it operates in will have changed to the point that the system security plan no longer describes the system's current controls and the security assessment report no longer considers the full range of significant risks to which the system is subject.

We also noted that risk assessments for three applications that authenticate users outside of the FCC did not map to the required assurance levels in OMB Memorandum 04-04, *E-Authentication Guidance for Federal Agencies*, and the required e-authentication controls in NIST SP 800-63, *Electronic Authentication Guideline*.

### **Risk Assessment Recommendations**

Strengthen the approach to performing risk assessments by:

4. Ensuring that when vulnerabilities are identified through security assessment testing, the FCC evaluates the risks and related threats and adds necessary mitigating controls to the System Security Plans (SSP). **(Re-issued)**
5. After planning and successfully testing the necessary IT security controls and assessing the residual risks, the FCC makes authorization decisions for its currently ten unauthorized information systems. **(New)**
6. Performing e-authentication risk assessments and updating system security plans to define for each e-government application the relevant authentication level and the required level of e-authentication controls to implement. **(Re-issued)**
7. Documenting e-authentication policies and procedures for ensuring the FCC's compliance with OMB Memorandum 04-04, *E-Authentication Guidance for Federal Agencies*. **(Re-issued)**

### **Control Activities Findings**

OMB Circular A-123 requires internal control to be in place over information systems in the form of general and application controls. General controls applies to all information systems such as servers, the network and end-user environments, and includes agency-wide security program planning, management, control over data center operations, and system software acquisition and maintenance. Due to the rapid changes in information technology, controls must also adjust to remain effective. Required control activities include policies, procedures and mechanisms in place to help ensure that agency objectives are met. Several examples of such mechanisms include: proper segregation of duties (separate personnel with authority to authorize a transaction, process the transaction, and review the transaction); physical controls over assets; proper authorization; and appropriate documentation and access to that documentation. Based on our procedures performed, we noted the following deficiencies in FCC's general control activities related to the FCC security program, access controls, and change controls:

#### *Security Program*

The FCC's controls to monitor and assess systems' security had a number of deficiencies. System security plans for several systems did not document controls that mapped to NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, which are recommended minimum baseline controls. Additionally, security assessments of controls to support the security authorization of the FCC's information systems were incomplete.

#### *Access Controls*

The FCC's controls to restrict physical and logical access to FCC systems had a number of deficiencies. One major application lacked documented guidance on the assignment of access privileges. Controls for limiting physical access to computer rooms were not sufficiently formalized. The FCC's user account management controls were not operating effectively to prevent logical or physical access from being granted to users who should not have access and to remove access from users who no longer needed it. Controls to limit privileged access were not operating effectively. The resolution of identified vulnerabilities was not consistently documented and the FCC did not consistently use audit logs to monitor user actions. Finally, the FCC's password policies were not clearly defined.

#### *Change Control*

Access of developers to production was not properly restricted and changes were not consistently tested and approved before their migration to production. Additionally, the FCC could not provide documentation to evidence that system configurations were monitored for unauthorized changes.

### **Control Activities Recommendations**

#### *Security Program*

Strengthen security program oversight and planning by:

8. Implementing tools to provide structure for security assessment and authorization projects and to help ensure that the tasks included in these projects are performed consistent with

requirements from NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, and NIST SP 800-53a Revision 1, *Guide for Assessing the Security Controls in Federal Information Systems*. **(Re-issued)**

9. Performing security assessment testing for applicable management, operational and technical controls in accordance with evaluation criteria from NIST SP 800-53a Revision 1, *Guide for Assessing the Security Controls in Federal Information Systems*, at least once every three years for FCC information system. **(Re-issued)**
10. Documenting system security plans in detail sufficient to plan system security controls for FCC information systems that are equivalent to the NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, which are minimum baseline controls. **(Re-issued)**

#### *Access Controls*

Strengthen access controls by:

11. For newly hired employees and contractors, limiting logical access to FCC systems pending a favorable result from a preliminary background check. **(Re-issued)**
12. Implementing procedures to help ensure that users are not granted access to FCC information systems without documented approval. **(Re-issued)**
13. Requiring that user's system access be reviewed and recertified by management and promptly revoking access for those users who are found to no longer need access or whose access is not recertified. **(Re-issued)**
14. Reviewing and updating procedures to ensure that access badges are collected and physical access is disabled when individuals leave the FCC. **(Re-issued)**
15. Granting individuals computer room access only after management approval. **(Re-issued)**
16. Revising current vulnerability assessment procedures to be more broadly applied and to have more consistent reporting requirements. **(Re-issued)**
17. Documenting and implementing procedures for security audit logging and review. **(Re-issued)**
18. Documenting policy to define requirements for password strength and account lockout, including the scope and applicability of password policies. **(Re-issued)**

#### *Change Control*

Strengthen change and configuration management controls by:

19. Restricting developer access to the production environment. **(Re-issued)**
20. Documenting and implementing change control procedures for testing and approving changes prior to changes being moved into production and for maintaining records of changes to facilitate management's review of changes made to FCC systems. **(Re-issued)**
21. Documenting and implementing configuration management procedures for maintaining securely configured applications, databases, and infrastructure components. **(Re-issued)**

### Monitoring Findings

OMB Circular A-123 requires that monitoring of the effectiveness of internal control should occur in the normal course of business. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations. We noted that FCC management had not implemented procedures to create a continuous monitoring program. Consequently, for systems that were not being re-authorized in the current year, the FCC did not perform annual security assessment testing of a representative subset of technical, operational and management controls to support its annual Federal Information Security Management Act of 2002 (FISMA) report to OMB and to satisfy FISMA's ongoing monitoring requirements.

OMB also requires that deficiencies found in internal control be reported to the appropriate personnel and management responsible for that area. Deficiencies identified, whether through internal review or by an external audit, should be evaluated and corrected. A systematic process should be in place for addressing deficiencies. The FCC did not provide evidence of tracking and planning for the remediation of IT Security weaknesses. Specifically, the FCC documented neither agency-wide Plans of Action and Milestones (POA&Ms) nor system-level POA&Ms.

### Monitoring Recommendations

Strengthen monitoring controls by:

22. Revising as necessary and implementing its Cyber Security Policy to create a continuous monitoring program and ensure that, at least annually, the FCC performs security assessment testing of a subset of controls to monitor the controls' effectiveness. This testing should use the assessment cases provided by NIST SP 800-53a Revision 1, *Guide for Assessing the Security Controls in Federal Information Systems*. All controls should be assessed at least once during the three-year authorization cycle. **(Re-issued)**
23. Documenting and implementing procedures for the creation, maintenance, and review of both agency and system-level POA&Ms. The FCC should document, prioritize, track and review, at least quarterly, all security weaknesses identified by external and internal reviews at the FCC and at outside organizations which meet the FISMA reporting requirement definition of a contractor. Quarterly reviews should include reporting to the CIO. POA&Ms should include resources required to accomplish elements of the plan, any milestones in meeting the tasks, scheduled completion dates for milestones and a current status. When milestones are adjusted, the rationale for adjusting milestones should be documented. **(Re-issued)**

**STATUS OF PRIOR YEAR'S SIGNIFICANT DEFICIENCIES**

As required by *Government Auditing Standards* issued by the Comptroller General of the United States, and by OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, we have reviewed the status of FCC's corrective actions with respect to the findings and recommendations included in the prior year's report on FCC's internal control over financial reporting dated November 10, 2011. The following table provides our assessment of the progress the FCC has made through September 30, 2012, in correcting the significant deficiencies identified in the fiscal year 2011 Independent Auditors' Report.

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
I. Financial Systems Functionality & Integration			
1	FCC Entity	Implement the planned stabilization efforts on the new financial system so that it is fully integrated and has the ability to record proprietary and budgetary transactions on a transactional basis and complies with the requirements set forth in the GAO Standards for Internal Control in the Federal Government.	Updated Finding #1
2	FCC Entity	Develop a standard set of transaction codes to process all routine transactions and to allow automated, timely, and accurate recording for all recurring entries that are currently entered manually.	Closed
3	FCC Entity	Implement an electronic integration with FCC systems and component financial systems, enabling FCC entities to report financial data efficiently and effectively with the requirements set forth in the GAO Standards for Internal Control in the Federal Government.	Updated Finding #2
II. Information Technology Controls			
4	FCC Entity	The FCC strengthens its control environment by:  Completing the development of and implementing policies and procedures for overseeing the information security programs for all information systems that collect and maintain FCC data, but are not operated by the FCC, to ensure that they are administered consistently with all relevant FCC, NIST and OMB requirements and instructions. Policies and procedures should define the scope, frequency, methodology, and documentation requirements for the FCC's assessment activities for contractors' information security programs.	Reissued Finding # 3
5	FCC Entity	The FCC strengthens its approach to performing risk	Reissued

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
		assessments by: Ensuring that when vulnerabilities are identified through security assessment testing, the FCC evaluates the risks and related threats and adds necessary mitigating controls to the System Security Plans (SSP).	Finding # 4
6	FCC Entity	The FCC strengthens its approach to performing risk assessments by: Documenting e-authentication policies and procedures for ensuring the FCC's compliance with OMB Memorandum 04-04, E-Authentication Guidance for Federal Agencies.	Reissued Finding # 7
7	FCC Entity	The FCC strengthens its approach to performing risk assessments by: Performing e-authentication risk assessments and updating system security plans to define for each e-government application the relevant authentication level and the required level of e-authentication controls to implement.	Reissued Finding # 6
8	FCC Entity	The FCC strengthens its security program oversight and planning by: Implementing tools to provide structure for security assessment and authorization projects and to help ensure that the tasks included in these projects are performed consistent with requirements from NIST SP 800-53 Revision 3, Recommended Security Controls for Federal Information Systems, and NIST SP 800-53a Revision 1, Guide for Assessing the Security Controls in Federal Information Systems.	Reissued Finding # 8
9	FCC Entity	The FCC strengthens its security program oversight and planning by: Performing security assessment testing for applicable management, operational and technical controls in accordance with evaluation criteria from NIST SP 800-53a Revision 1, Guide for Assessing the Security Controls in Federal Information Systems, at least once every three years for FCC information system.	Reissued Finding # 9
10	FCC Entity	The FCC strengthens its security program oversight and planning by: Documenting system security plans in detail sufficient to plan system security controls for FCC information systems that are equivalent to the NIST SP 800-53 Revision 3, Recommended Security Controls for Federal Information Systems, minimum baseline controls.	Reissued Finding # 10

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
11	FCC Entity	The FCC strengthens its access controls by: For newly hired employees and contractors, limiting logical access to FCC systems pending a favorable result from a preliminary background check.	Reissued Finding # 11
12	FCC Entity	The FCC strengthens its access controls by: Implementing procedures to help ensure that users are not granted access to FCC information systems without documented approval.	Reissued Finding # 12
13	FCC Entity	The FCC strengthens its access controls by: Requiring that all user access be reviewed and recertified by management and promptly revoking access for those users who are found to no longer need access or whose access is not recertified.	Reissued Finding # 13
14	FCC Entity	The FCC strengthens its access controls by: Reviewing and updating procedures to ensure that access badges are collected and physical access is disabled when individuals leave the FCC.	Reissued Finding # 14
15	FCC Entity	The FCC strengthens its access controls by: Granting individuals computer room access only after management approval	Reissued Finding # 15
16	FCC Entity	The FCC strengthens its access controls by: Documenting the roles and permissions used within major applications.	Closed
17	FCC Entity	The FCC strengthens its access controls by: Identifying and documenting conflicting privileges within major applications and documenting procedures to help ensure separation of duties and to address developer access.	Closed
18	FCC Entity	The FCC strengthens its access controls by: Revising current vulnerability assessment procedures to be more broadly applied and to have more consistent reporting requirements.	Reissued Finding # 16
19	FCC Entity	The FCC strengthens its access controls by: Documenting and implementing procedures for security audit logging and review.	Reissued Finding # 17
20	FCC Entity	The FCC strengthens its access controls by: Documenting policy to define requirements for password strength and account lockout, including the scope and	Reissued Finding # 18

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
		applicability of password policies.	
21	FCC Entity	The FCC strengthens its change and configuration management controls by:  Restricting developer access to the production environment.	Reissued Finding # 19
22	FCC Entity	The FCC strengthens its change and configuration management controls by:  Documenting and implementing change control procedures for testing and approving changes prior to changes being moved into production and for maintaining records of changes to facilitate management's review of changes made to FCC systems.	Reissued Finding # 20
23	FCC Entity	The FCC strengthens its change and configuration management controls by:  Documenting and implementing configuration management procedures for maintaining securely configured applications, databases, and infrastructure components.	Reissued Finding # 21
24	FCC Entity	The FCC strengthens its monitoring controls by:  Revising as necessary and implementing its Cyber Security Policy to create a continuous monitoring program and ensure that, at least annually, the FCC performs security assessment testing of a subset of controls to monitor the controls' effectiveness. This testing should use the assessment cases provided by NIST SP 800-53a Revision 1, Guide for Assessing the Security Controls in Federal Information Systems. All controls should be assessed at least once during the three-year authorization cycle..	Reissued Finding # 22
25	FCC Entity	The FCC strengthens its monitoring controls by:  Documenting and implementing procedures for the creation, maintenance, and review of both agency and system-level POA&Ms. The FCC should document, prioritize, track and review, at least quarterly, all security weaknesses identified by external and internal reviews at the FCC and at outside organizations (e.g., USAC) which meet the FISMA reporting requirement definition of a contractor. Quarterly reviews should include reporting to the CIO. POA&Ms should include resources required to accomplish elements of the plan, any milestones in meeting the tasks, scheduled completion dates for milestones and a current status. When milestones are adjusted, the rationale for adjusting milestones should be documented.	Reissued Finding # 23





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### Independent Auditors' Report on Compliance and Other Matters

Managing Director  
Federal Communications Commission

Inspector General  
Federal Communications Commission

We have audited the consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended, and have issued our report thereon dated November 14, 2012. As discussed in Note 20 to the consolidated financial statements, the FCC changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012 based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

The management of the FCC is responsible for complying with laws, regulations, and contracts applicable to the FCC. As part of obtaining reasonable assurance about whether the FCC's consolidated financial statements are free of material misstatement, we performed tests of the FCC's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in OMB Circular A-127, *Financial Management Systems*. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the FCC. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of certain of our tests of compliance described in the preceding paragraph disclosed two instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit I.

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Federal Communications Commission  
November 14, 2012  
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The results of our other tests of compliance discussed in the third paragraph of this report disclosed no instances of noncompliance and one other matter that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and is described in the following paragraph.

Management has identified a matter that may be reported as a violation of the Anti-Deficiency Act. The outcome of this matter, and any resulting ramifications, is not presently known.

The FCC's written response to the instances of noncompliance and other matter identified in our audit and presented in Exhibit I and the preceding paragraph was not subjected to the auditing procedures applied in the audit of the FCC's consolidated financial statements and, accordingly, we express no opinion on it.

We noted certain additional matters that we have reported to management of the FCC in a separate letter dated November 14, 2012.

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

KPMG LLP

November 14, 2012

EXHIBIT I

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**The Federal Managers' Financial Integrity Act (FMFIA)**

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The FMFIA establishes overall requirements with regard to internal control. The agency head must establish controls that reasonably ensure that: "(i) obligations and costs are in compliance with applicable law; (ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and (iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets."

In addition, the agency head annually must evaluate and report on the control and financial systems that protect the integrity of Federal programs (Section 2 and Section 4 of FMFIA, respectively).

- Section 2 seeks to assess internal controls necessary to ensure that obligations and costs are in compliance with applicable law; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports, and to maintain accountability of assets.
- Section 4 seeks to assess nonconformance of the agency's accounting system with the principles, standards, and related requirements prescribed by the Comptroller General.

As outlined in the GAO Standards for Internal Control in the Federal Government and the FSIO Core Financial System Requirements, "OMB Circular A-127, *Financial Management Systems*, sets forth general policies for Federal financial management systems. Each agency is required to establish and maintain a single integrated financial management system... All financial management systems must deliver the following:

- Demonstrate compliance with accounting standards and requirements
- Provide timely, reliable, and complete financial management information for decision making at all levels of government
- Meet downstream information and reporting requirements with transaction processing data linked to transaction engines
- Accept standard information integration and electronic data to and from other internal, governmentwide, or private-sector processing environments
- Provide for "one-time" data entry and reuse of transaction data to support downstream integration, interfacing, or business and reporting requirements
- Build security, internal controls, and accountability into processes and provide an audit trail
- Be modular in design and built with reusability as an objective
- Meet the needs for greater transparency and ready sharing of information
- Scale to meet internal and external operational, reporting, and information requirements for both small and large entities."

The FCC reporting component entities' current financial systems and processes are not capable of achieving the financial system integration standards set within GAO Standards for Internal Control in the Federal Government.

Federal Communications Commission  
November 14, 2012  
Page 4 of 5

Findings and recommendations were issued under the Financial System Functionality and Integration Significant Deficiency noted in the *Independent Auditors' Report on Internal Control Over Financial Reporting* dated November 14, 2012.

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**Debt Collection Improvement Act of 1996 (DCIA)**

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In fiscal year 2011, the FCC implemented a new financial system. As a result of the implementation, FCC management encountered challenges with processing transactions and creating reports from the system. During our fiscal year 2012 control walkthrough procedures, we were informed that the FCC had not yet transferred to the Department of Treasury any fiscal year 2011 or 2012 FCC or component debt outstanding for more than 90 days per FCC policy, or 180 days in accordance with the Debt Collection Improvement Act. The new financial system was unable to facilitate timely identification of delinquent accounts and produce the required dunning letters because the automated aging capability in the GL System was not functioning until June 2012. However, FCC is still unable to properly refer debt to treasury for servicing.

The Debt Collection Improvement Act of 1996, as cited at 31 U.S.C. 3711(g)(1), states that: "If a nontax debt or claim owed to the United States has been delinquent for a period of 180 days – (A) the head of the executive, judicial, or legislative agency that administers the program that gave rise to the debt or claim shall transfer the debt or claim to the Secretary of the Treasury;"

In addition to the DCIA requirements, FCC policy states that: "If a debt is more than 90 days past due, and it is a legally enforceable non-tax debt, the debt will be referred to the Treasury for either administrative offset and/or cross servicing."

Findings and recommendations were issued under the Financial System Functionality and Integration Significant Deficiency noted in the *Independent Auditors' Report on Internal Control Over Financial Reporting* dated November 14, 2012.



*Office of the Managing Director*

MEMORANDUM

**DATE:** November 15, 2012

**TO:** David L. Hunt, Inspector General

**FROM:** David B. Robbins, Managing Director and Mark Stephens, Chief Financial Officer

**SUBJECT:** Management's Response to Independent Auditors' Reports on Internal Control Over Financial Reporting and Compliance and Other Matters for Fiscal Year 2012

Thank you for the opportunity to review and comment on the draft reports entitled *Independent Auditors' Report on Internal Control Over Financial Reporting* and *Independent Auditors' Report on Compliance and Other Matters*. We appreciate the efforts of your team and the independent auditor, KPMG LLP, to work with the Federal Communications Commission (Commission) throughout the fiscal year (FY) 2012 audit process. This year's audit opinion was the result of the commitment and professionalism that both of our offices as well as the independent auditors demonstrated during the FY 2012 audit process. During the entire audit process, the Commission worked closely with your office and the independent auditors' team to provide necessary and timely information to facilitate an efficient audit process.

We are pleased that, for the seventh straight year, the independent auditor provided an unqualified opinion and found that the Commission's consolidated financial statements for FY 2012 present fairly, in all material respects, the financial position of the Commission as of September 30, 2012. Seven straight years of clean audit opinions is an unprecedented accomplishment for the Commission. We are also pleased that the independent auditor did not identify any material weaknesses in the Commission's financial reporting. We have worked very hard to continue strengthening the Commission's internal controls and improving its financial management.

Despite these successes, work remains here at the Commission. The FY 2012 audit reports point out two significant deficiencies related to internal controls, note two instances of non-compliance that still need to be resolved, and mention one matter that is currently under review. The primary areas of concern relate to financial system functionality and integration, information technology control weaknesses, and noncompliance with the Federal Managers' Financial Integrity Act and the Debt Collection Improvement Act. We concur with the recommendations made by the independent auditors in their reports.

First, with regard to addressing the significant deficiency for financial system functionality and integration related to the Commission and its reporting components, the Commission has taken significant steps throughout FY 2012 to resolve the auditors' findings and improve the performance of its financial reporting process. The Commission's new core financial system was launched in October 2010, and during FY 2012 the Commission worked to further deploy all the functionality of that system. Also in FY

2012, the Commission continued to work closely with its reporting components in their efforts to modernize their financial systems.

Second, with respect to the significant deficiency related to information technology control weaknesses, the Commission is already working to fully assess the auditors' recommendations and to develop corrective action plans. Some findings are already in the process of being addressed. During FY 2013, the Commission will make every effort to complete corrective action for each of the recommendations associated with these findings to avoid any repeat findings in this area.

Third, with respect to the instance of noncompliance with the Federal Managers' Financial Integrity Act, the Commission and its reporting components are committed to implementing financial systems that are fully integrated, and that provide efficient and effective processing and reporting of accounting transactions and financial information.

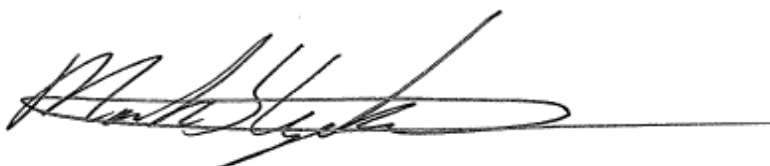
Fourth, with respect to the instance of noncompliance with the Debt Collection and Improvement Act, the Commission is committed to resolving this issue in FY 2013.

Fifth, the Other Matters reported under review as a possible violation of the Anti-Deficiency Act will be fully investigated in FY 2013. If any violations of the Anti-Deficiency Act are identified after the investigation, they will be reported to the President and Congress as required by statute and implementing guidance.

Finally, we are committed to continually strengthening the internal controls of the Commission and its reporting components. This commitment includes developing timely, accurate, and useful performance and financial information to ensure the most effective stewardship of both the funds that the Commission oversees and the funds that the Commission uses to finance its operations. We look forward to working in FY 2013 to resolve the FY 2012 audit findings and to enhance the culture of integrity, accountability, and excellence that exists here at the Commission.



David B. Robbins, Managing Director  
Office of Managing Director



Mark Stephens, Chief Financial Officer  
Office of Managing Director

## PRINCIPAL STATEMENTS

### FEDERAL COMMUNICATIONS COMMISSION CONSOLIDATED BALANCE SHEET

As of September 30, 2012 and 2011  
(Dollars in thousands)

	<u>FY 2012</u>	<u>FY 2011</u>
<b>ASSETS</b> (Note 2):		
<b>Intragovernmental:</b>		
Fund balance with Treasury (Note 3)	\$ 361,739	\$ 494,340
Investments (Note 5)	6,548,090	5,822,843
Accounts receivable (Note 6)	1,574	1,097
Other	-	2,436
<b>Total intragovernmental</b>	<u>6,911,403</u>	<u>6,320,716</u>
Cash and other monetary assets (Note 4)	139,322	213,944
Accounts receivable, net (Note 6)	875,088	831,072
Loans receivable, net (Note 7)	335	4
General property, plant, and equipment, net	56,832	60,461
Other	13,024	13,053
<b>Total assets</b>	<u>\$ 7,996,004</u>	<u>\$ 7,439,250</u>
<b>LIABILITIES</b> (Note 8):		
<b>Intragovernmental:</b>		
Debt (Note 9)	\$ -	\$ 50,300
Other (Note 10)		
Custodial	162,657	206,524
Other	6,240	13,725
<b>Total other</b>	<u>168,897</u>	<u>220,249</u>
<b>Total intragovernmental</b>	168,897	270,549
Accounts payable	110,523	92,976
Other (Note 10)		
Deferred revenue	62,971	93,053
Prepaid contributions	85,849	77,362
Accrued liabilities for Universal Service	752,423	633,967
Other	39,578	35,804
<b>Total other</b>	<u>940,821</u>	<u>840,186</u>
<b>Total liabilities</b>	<u>\$ 1,220,241</u>	<u>\$ 1,203,711</u>
Commitments and Contingencies (Note 11)		
<b>NET POSITION</b>		
Unexpended appropriations - other funds	\$ 4,251	\$ 15,105
Cumulative results of operations - earmarked funds (Note 17)	6,622,985	6,089,350
Cumulative results of operations - other funds	148,527	131,084
<b>Total net position</b>	<u>\$ 6,775,763</u>	<u>\$ 6,235,539</u>
<b>Total liabilities and net position</b>	<u>\$ 7,996,004</u>	<u>\$ 7,439,250</u>

The accompanying notes are an integral part of these statements.



**FEDERAL COMMUNICATIONS COMMISSION  
CONSOLIDATED STATEMENT OF NET COST**

For the Periods Ended September 30, 2012 and 2011

(Dollars in thousands)

	<u>FY 2012</u>	<u>FY 2011</u>
<b>Program costs (Note 12):</b>		
<b>Broadband:</b>		
Total Gross Cost	\$ 48,428	\$ 54,536
<b>Competition and Innovation:</b>		
Total Gross Cost	9,739,491	9,099,922
<b>International:</b>		
Total Gross Cost	10,126	6,753
<b>Consumers:</b>		
Total Gross Cost	52,200	46,156
<b>Public Safety and Homeland Security:</b>		
Total Gross Cost	48,123	35,576
<b>Continual Improvement:</b>		
Total Gross Cost	98,582	50,626
<b>Total Program Costs</b>	<u>\$ 9,996,950</u>	<u>\$ 9,293,569</u>
<b>Cost not assigned to programs:</b>		
Other expenses	(5)	25
<b>Less: earned revenues not attributed to programs</b>	<u>(460,246)</u>	<u>(472,830)</u>
<b>Net cost of operations</b>	<u><u>\$ 9,536,699</u></u>	<u><u>\$ 8,820,764</u></u>

The accompanying notes are an integral part of these statements.

**FEDERAL COMMUNICATIONS COMMISSION**  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**

For the Periods Ended September 30, 2012 and 2011

(Dollars in thousands)

	FY 2012			FY 2011		
	Earmarked Funds	All Other Funds	Total	Earmarked Funds	All Other Funds	Total
<b>Cumulative Results of Operations:</b>						
Beginning Balances	\$ 6,089,350	\$ 131,084	\$ 6,220,434	\$ 6,135,941	\$ 93,773	\$ 6,229,714
<b>Budgetary Financing Sources:</b>						
Other adjustments	-	-	-	-	1,041	1,041
Appropriations used	-	20,301	20,301	-	45,266	45,266
Non-exchange revenue (Note 17)	10,078,791	-	10,078,791	8,771,949	-	8,771,949
<b>Other Financing Sources (Non Exchange):</b>						
Imputed financing	-	15,487	15,487	-	17,457	17,457
Other	-	(26,802)	(26,802)	-	(24,229)	(24,229)
Total Financing Sources	10,078,791	8,986	10,087,777	8,771,949	39,535	8,811,484
Net Cost of Operations	9,545,156	(8,457)	9,536,699	8,818,540	2,224	8,820,764
Net Change	533,635	17,443	551,078	(46,591)	37,311	(9,280)
<b>Cumulative Results of Operations</b>	6,622,985	148,527	6,771,512	6,089,350	131,084	6,220,434
<b>Unexpended Appropriations:</b>						
Beginning Balances	-	15,105	15,105	-	21,183	21,183
<b>Budgetary Financing Sources:</b>						
Appropriations received	-	18,432	18,432	-	40,267	40,267
Other adjustments	-	(8,985)	(8,985)	-	(1,079)	(1,079)
Appropriations used	-	(20,301)	(20,301)	-	(45,266)	(45,266)
Total Budgetary Financing Sources	-	(10,854)	(10,854)	-	(6,078)	(6,078)
<b>Total Unexpended Appropriations</b>	-	4,251	4,251	-	15,105	15,105
<b>Net Position</b>	<u>\$ 6,622,985</u>	<u>\$ 152,778</u>	<u>\$ 6,775,763</u>	<u>\$ 6,089,350</u>	<u>\$ 146,189</u>	<u>\$ 6,235,539</u>

The accompanying notes are an integral part of these statements.

**FEDERAL COMMUNICATIONS COMMISSION  
COMBINED STATEMENT OF BUDGETARY RESOURCES**

For the Periods Ended September 30, 2012 and 2011

(Dollars in thousands)

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary Credit Reform Financing Account	Budgetary	Non-Budgetary Credit Reform Financing Account
<b>Budgetary Resources:</b>				
Unobligated balance brought forward, Oct 1	\$ 2,727,599	\$ 37,008	\$ 2,567,572	\$ 4,387
Recoveries of prior year unpaid obligations	1,065,292	-	1,062,160	-
Other changes in unobligated balance (+ or -)	(8,987)	(32,724)	(38)	-
Unobligated balance from prior year budget authority, net	3,783,904	4,284	3,629,694	4,387
Appropriations (discretionary and mandatory)	10,060,594	-	8,785,026	-
Borrowing authority (discretionary and mandatory) (Note 14)	-	856	-	2,843
Spending authority from offsetting collections (discretionary and mandatory)	445,864	2,016	444,602	37,843
Total budgetary resources	<u>\$ 14,290,362</u>	<u>\$ 7,156</u>	<u>\$ 12,859,322</u>	<u>\$ 45,073</u>
<b>Status of Budgetary Resources:</b>				
Obligations incurred (Note 13)	\$ 11,087,752	\$ 2,799	\$ 10,131,723	\$ 8,065
Unobligated balance, end of year:				
Apportioned	14,537	1,005	21,134	1
Exempt from apportionment	3,055,396	-	2,550,957	-
Unapportioned	132,677	3,352	155,508	37,007
Total unobligated balance, end of year	3,202,610	4,357	2,727,599	37,008
Total budgetary resources	<u>\$ 14,290,362</u>	<u>\$ 7,156</u>	<u>\$ 12,859,322</u>	<u>\$ 45,073</u>
<b>Change in Obligated Balance:</b>				
Unpaid obligations, brought forward, Oct 1	\$ 3,416,789	\$ -	\$ 3,736,251	\$ -
Uncollected customer payments from Federal sources, brought forward, Oct 1 (-)	(382)	-	-	-
Obligated balance, start of year (net), as adjusted	3,416,407	-	3,736,251	-
Obligations incurred	11,087,752	2,799	10,131,723	8,065
Outlays (gross) (-)	(9,857,564)	(2,799)	(9,389,025)	(8,065)
Change in uncollected customer payments from Federal sources (+ or -)	(5,234)	-	(382)	-
Recoveries of prior year unpaid obligations (-)	(1,065,292)	-	(1,062,160)	-
Obligated balance, end of year				
Unpaid obligations, end of year (gross)	3,581,685	-	3,416,789	-
Uncollected customer payments from Federal sources, end of year (-)	(5,616)	-	(382)	-
Obligated balance, end of year (net)	<u>\$ 3,576,069</u>	<u>\$ -</u>	<u>\$ 3,416,407</u>	<u>\$ -</u>
<b>Budget Authority and Outlays, Net:</b>				
Budgetary authority, gross (discretionary and mandatory)	\$ 10,506,458	\$ 2,872	\$ 9,229,628	\$ 40,686
Actual offsetting collections (discretionary and mandatory) (-)	(445,504)	(20,448)	(450,467)	(78,111)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(5,234)	-	(382)	-
Budgetary authority, net (discretionary and mandatory)	<u>\$ 10,055,720</u>	<u>\$ (17,576)</u>	<u>\$ 8,778,779</u>	<u>\$ (37,425)</u>
Outlays, gross (discretionary and mandatory)	\$ 9,857,564	\$ 2,799	\$ 9,389,025	\$ 8,065
Actual offsetting collections (discretionary and mandatory) (-)	(445,504)	(20,448)	(450,467)	(78,111)
Outlays, net (discretionary and mandatory)	9,412,060	(17,649)	8,938,558	(70,046)
Distributed offsetting receipts (-)	(54,772)	-	(59,041)	-
Agency outlays, net (discretionary and mandatory)	<u>\$ 9,357,288</u>	<u>\$ (17,649)</u>	<u>\$ 8,879,517</u>	<u>\$ (70,046)</u>

The accompanying notes are an integral part of these statements.

**FEDERAL COMMUNICATIONS COMMISSION**  
**CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY**

For the Periods Ended September 30, 2012 and 2011

(Dollars in thousands)

	<u>FY 2012</u>	<u>FY 2011</u>
<b>Revenue Activity:</b>		
Sources of Cash Collections:		
Spectrum Auctions	\$ 38,477	\$ 66,871
Fines and Penalties	8,656	43,061
Credit Reform	1,761	7,831
Total Cash Collections	<u>48,894</u>	<u>117,763</u>
Accrual Adjustments (+/-)		
Spectrum Auctions	1,560	4
Fines and Penalties	1,096	(1,751)
Total Accrual Adjustments	<u>2,656</u>	<u>(1,747)</u>
<b>Total Custodial Revenue</b>	51,550	116,016
<b>Disposition of Collections:</b>		
Transferred to Others:		
U.S. Treasury	(10,417)	(50,892)
(Increase)/Decrease in Amounts Yet to be Transferred (+/-)	43,867	19,876
Retained by the Reporting Entity	<u>(85,000)</u>	<u>(85,000)</u>
<b>Total Disposition of Collections</b>	(51,550)	(116,016)
<b>Net Custodial Activity</b>	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of these statements.

**NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011**  
(DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED)

**Note 1 - Summary of Significant Accounting Policies**

**A. Reporting Entity**

The Federal Communications Commission (Commission) is an independent United States Government agency, established by the Communications Act (Act) of 1934, as amended. The Commission is charged with regulating interstate and international communications by radio, television, wire, satellite, and cable. The Commission's jurisdiction spans the 50 states, the District of Columbia, and the U.S. possessions. Five commissioners direct the Commission; they are appointed by the President of the United States and confirmed by the Senate for five-year terms, except when filling an unexpired term or serving in holdover status.

The Commission is comprised of three reporting components. The primary component consists of Commission headquarters and field offices. The two additional components are the Universal Service Fund (USF) and the North American Numbering Plan (NANP). The USF reports the results of the four Universal Service support mechanisms (established pursuant to section 254 of the Act, as amended) and the results of the Telecommunications Relay Service (TRS) Fund (established by the Americans with Disabilities Act of 1990, Title IV). The NANP reports the results of billing and collection activities conducted to support the NANP (47 U.S.C. § 251(e); 47 C.F.R. § 52.16, 52.17, 52.32, and 52.33).

**B. Basis of Accounting and Presentation**

The consolidated financial statements (financial statements) have been prepared from the accounting records of the Commission in conformity with U.S. generally accepted accounting principles (GAAP) and the form and content for Federal entity financial statements specified by the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

**C. Fund Balance with Treasury**

Funds with the U.S. Department of the Treasury (Treasury) primarily represent appropriated, revolving, and deposit funds. The Commission may use the appropriated and revolving funds to finance expenditures, depending on budgetary availability. The deposit accounts are used to hold funds temporarily until they can be properly disbursed or distributed.

**D. Cash and Other Monetary Assets**

Cash and Other Monetary Assets represent cash on deposit and money market funds at several commercial banks. Accounts are maintained by the Universal Service Administrative Company (USAC), Rolka Loube Saltzer Associates, LLC (RLSA), and Welch LLP, serving as administrators and/or billing and collection agents for their respective programs. The accounts bear the names of those entities, as well as the Commission or the fund for which they serve as administrator and/or billing and collection agent. Cash on deposit is collateralized by the Federal Reserve.

## **Note 1 - Summary of Significant Accounting Policies (continued)**

### **D. Cash and Other Monetary Assets (continued)**

As of July 1, 2011, RLSA became the new administrator for the TRS fund. Prior to July 1, 2011, the TRS fund was administered by the National Exchange Carrier Association (NECA).

### **E. Investments**

Investments are reported net of the unamortized premium or discount. All investments are in Treasury securities.

### **F. Accounts Receivable, Net**

Accounts Receivable consists of claims made for payment from the public and other Federal entities. Gross receivables are reduced to net realizable value by an allowance for doubtful accounts.

### **G. Loans Receivable, Net**

The Federal Credit Reform Act (FCRA) of 1990, as amended, governs the reporting requirements for direct loan obligations made after FY 1991. The FCRA requires that the present value of the subsidy costs associated with direct loans be recognized as a cost in the year that the loan is obligated. The present value is calculated as the estimated cash outflows over the life of the loans, less the present value of the estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term. Direct loans are reported net of an allowance for subsidy at the present value.

### **H. Property, Plant and Equipment**

The basis for recording purchased general Property, Plant, and Equipment (PP&E) is full cost, including all costs incurred to bring the PP&E to and from a location suitable for its intended use. All PP&E with an initial acquisition cost of \$25 or more and all internally developed software with a development cost of \$50 or more, and with an estimated useful life of two years or greater, are capitalized. Bulk purchases of similar items, individually worth less than \$25 but collectively worth more than \$250, are also capitalized using the same equipment categories and useful lives as capital acquisitions. PP&E are depreciated on a straight-line basis over the estimated useful lives of the items. The useful lives used are: forty years for buildings, seven years for non-computer equipment, five years for computers and vehicles, and three years for software. Neither land, including permanent improvements, nor software in development is depreciated. Normal maintenance and repair costs are expensed as incurred.

Leasehold improvements include all costs incurred during the design and construction phase of the improvement. These costs are amortized over the remaining life of the lease, or the useful life of the improvements, whichever is shorter.

### **I. Other Assets**

Other Assets – Intragovernmental represent funds related to Auction #73 licenses that have not been granted. These funds were transferred to the National Telecommunications and Information Administration (NTIA) in FY 2008 as required by the Digital Television Transition and Public Safety Act of 2005.

## **Note 1 - Summary of Significant Accounting Policies (continued)**

### **I. Other Assets (continued)**

Other Assets with the public represent the balance of transfers less expenses made by the USF to the USAC to fund administrative costs in advance. Advances are drawn down as expenses are incurred.

### **J. Accounts Payable and Accrued Liabilities**

Accounts Payable and Accrued Liabilities represent a probable future outflow or other sacrifice of resources as a result of past transactions or events. Liabilities are recognized when they are incurred, regardless of whether they are covered by available budgetary resources. Liabilities cannot be liquidated without legislation that provides resources to do so. As a component of the U.S. Government, a sovereign entity, payments of all liabilities other than contracts can be abrogated by the sovereign entity.

### **K. Deferred Revenue**

The Commission collects proceeds from the sale of communications spectrum on behalf of the U.S. Government. All proceeds collected up to the amount of the net winning bid are recognized as deferred revenue until a “prepared to grant” or “grant” public notice is issued. In addition, the Commission collects multi-year regulatory fees for five and ten-year periods that are recorded as deferred revenue and amortized over the period of the fee.

The USF and NANP collect contributions from U.S., Canadian, and Caribbean carriers to cover the costs of the programs. Some carriers have the option of paying monthly or annually. The unearned portion of annual contributions is recognized as deferred revenue.

### **L. Debt**

This account represents amounts due to the U.S. Treasury’s Bureau of Public Debt (BPD) to support the spectrum auction loans program. Borrowings from BPD are determined based on subsidy estimates and reestimates in accordance with the FCRA of 1990, as amended, and OMB guidance. Interest payments on debt are calculated annually and remitted to BPD at the end of the fiscal year. These payments are recorded in a receipt account maintained by the Commission.

### **M. Retirement Plans and Other Benefits**

Federal employee benefits consist of the actuarial portions of future benefits earned by Federal employees, including pensions, other retirement benefits, and other post-employment benefits. The Office of Personnel Management (OPM) administers these benefits. The Commission does not recognize any liability on the Balance Sheet for pensions, other retirement benefits, and other post-employment benefits. The Commission recognizes and allocates the imputed costs on the Statement of Net Cost and recognizes imputed financing related to these costs on the Statement of Changes in Net Position.

Pensions provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. Most Commission employees participate in the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). Under CSRS, the Commission makes matching contributions equal to seven percent of basic pay. For FERS employees, the Commission contributes the employer’s matching share for Social Security, contributes an amount equal to one percent of employee pay to a savings plan, and

## **Note 1 - Summary of Significant Accounting Policies (continued)**

### **M. Retirement Plans and Other Benefits (continued)**

matches up to an additional four percent of pay. Most employees hired after December 31, 1983, are covered by FERS.

The OPM reports on CSRS and FERS assets, accumulated plan benefits, and unfunded liabilities, if any, applicable to Federal employees.

The actuarial liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined by using historical benefit payment patterns related to a specific incurred period to predict the ultimate payment related to that period. The Department of Labor (DOL) determines no actuarial liability for the Commission due to the immateriality to the Federal Government as a whole.

The unfunded Federal Employees' Compensation Act (FECA) liability covers unemployment compensation and medical benefits. The calculation takes the amount of benefit payments over the last nine to twelve quarters and then calculates the annual average of payments. The compensation and medical payments can be found in the chargeback reports that are issued by DOL.

### **N. Leave**

Annual leave is accrued as earned, and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current leave balances and pay rates. Annual leave is reflected as a liability not covered by current budgetary resources. Sick leave and other types of non-vested leave are expensed as taken.

### **O. Revenue and Other Financing Sources**

Regulatory Fee Offsetting Collections (Exchange) – The Omnibus Budget Reconciliation Act of 1993 directed the Commission to assess and collect regulatory fees to recover the costs incurred in carrying out certain provisions of its mission. Section 9(a) of the Act, as amended, authorizes the Commission to assess and collect annual regulatory fees to recover the costs, as determined annually by Congress, incurred in carrying out its strategic goals of Broadband, Competition and Innovation, International, Consumers, Public Safety and Homeland Security, and Continual Improvement. These fees were established by congressional authority, and consistent with OMB Circular No. A-25 revised, *User Charges*, the Commission did not determine the full costs associated with its regulatory activity in establishing regulatory fees. Since 1993, Congress has annually reviewed the regulatory fee collection requirements of the Commission and established the total fee levels to be collected. Fees collected up to the level established by Congress are applied against the Commission's annual appropriation at the close of each fiscal year. The regulatory fee levels of \$339,844 for FY 2012 and \$335,794 for FY 2011 were achieved. The Commission collected \$4,874 above the required regulatory level in FY 2012 and \$6,247 in FY 2011. The total cumulative amount collected above the required regulatory level since 1997 was \$71,044 at September 30, 2012, which is temporarily precluded from obligation.



## **Note 1 - Summary of Significant Accounting Policies (continued)**

### **O. Revenues and Other Financing Sources (continued)**

Competitive Bidding System Offsetting Collections (Exchange) – One of the Commission’s primary functions is managing the spectrum auction program. Proceeds from the auctions are initially remitted to the Commission and are later transferred to the U.S. Treasury, net of anticipated auction related costs (under 47 U.S.C. § 309, the Commission may retain a portion of the spectrum auction proceeds to offset the cost of performing the auction function). Collections used to offset the cost of performing auctions-related activity are capped at \$85,000 in FY 2012 and FY 2011.

Radio Spectrum Auction Proceeds (Exchange) – In accordance with the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources*, the Commission accounts for this exchange revenue as a custodial activity. Revenue from spectrum auctions is recognized when a “prepared to grant” or “grant” public notice is issued. The value of available spectrum is determined in the market place at the time of auction. The Commission recognized total custodial revenue related to spectrum auctions net of accrual adjustments of \$40,036 in FY 2012 and \$66,875 in FY 2011.

Application Fees (Exchange) – Congress authorized the Commission (47 U.S.C. § 8) to impose and collect application processing fees and directed the Commission to prescribe charges for certain types of application processing or authorization services it provides to communications entities over which the Commission has jurisdiction. The Commission amends its Schedule of Application Fees (47 C.F.R. § 1.1102 *et seq.*) to adjust the fees for processing applications and other filings. Section 8(b) of the Act, as amended, requires the Commission to review and adjust its application fees every two years. The adjusted or increased fees reflect the net change in the Consumer Price Index for all Urban Consumers, calculated over a specific period of time. Application fees are deposited in the Treasury and are not available for the Commission’s use. Application fee revenue totaled \$24,804 in FY 2012 and \$23,892 in FY 2011.

Reimbursable Work Agreements (Exchange) – The Commission recognizes reimbursable work agreement revenue when earned, i.e., goods that have been delivered or services rendered. In FY 2012, the Commission executed agreements totaling \$661. The Commission also returned \$3,621 in unobligated funds from the American Recovery and Reinvestment Act for Broadband Technology Opportunities Program, which ended in FY 2010, to the appropriate Federal agencies. In FY 2011, the Commission executed agreements totaling \$3,893 and no unobligated funds were returned in FY 2011.

Annual Appropriations (Financing Source) – The Commission receives an annual Salaries and Expense appropriation from Congress. These funds are used to pay for operations during the fiscal year and are repaid to the Treasury once regulatory fees are collected. The annual appropriation of \$339,844 for FY 2012 and \$335,794 for FY 2011 is fully funded by regulatory fee collections.

Subsidy Estimates and Reestimates (Financing Source) – The Commission receives permanent-indefinite authority for its credit reform program account in accordance with the FCRA of 1990, as amended, to fund its subsidy estimates and reestimates, unless otherwise prescribed by OMB. This account records the subsidy costs associated with the direct loans after FY 1991, as well as administrative expenses of the loan program. The Commission received an appropriation for an upward subsidy of \$18,432 in FY 2012 and \$40,267 in FY 2011. These appropriations are available until used.

**Note 1 - Summary of Significant Accounting Policies (continued)**

**O. Revenues and Other Financing Sources (continued)**

USF (Nonexchange) – Carriers conducting interstate telecommunications are required to contribute a portion of their revenues to fund the cost of providing universal service. These contributions represent appropriated and earmarked receipts and are accounted for as a budgetary financing source.

Allocation of Exchange Revenues

The Commission reports the entire balance of exchange revenue on line "Less: earned revenues not attributed to programs" since there is no direct relationship between earned revenues and specific programs.

Reprogramming

In FY 2012, the Commission received approval to reprogram \$12,100 of prior year obligations that were deobligated to enable the Commission to implement certain initiatives. The initiatives included \$10,000 for cyber security and \$2,100 to implement the incentive spectrum auctions provisions included in the *Middle Class Tax Relief and Job Creation Act of 2012*. In FY 2011, the Commission did not submit any requests for reprogramming.

**P. Transactions with Related Parties**

The Commission has a direct oversight relationship with the administrators and Billing and Collection agents (B&C agents) of funds that are components under the overall Commission entity. These organizations are the Universal Service Administrative Company (USAC), which is both the administrator and B&C agent for the four Universal Service Fund (USF) support mechanisms; Rolka Loube Saltzer Associates (RLSA), which is both the administrator and B&C agent for the Telecommunications Relay Service (TRS) Fund; Neustar, which is the administrator for the North American Numbering Plan (NANP) Fund; and Welch LLP, which is the B&C agent for the NANP Fund. As of July 1, 2011, RLSA became the new administrator for the TRS Fund. Prior to July 1, 2011, the TRS Fund was administered by the National Exchange Carrier Association (NECA).

The Commission approves the administrative costs paid to these entities from the respective funds that they manage. The administrative costs cover expenses such as the salaries and benefits for the employees dedicated to managing the funds; rent and utilities for office space used; accounting and other financial reporting related services; and other management activities. All related party balances for the years ended September 30, 2012 and 2011 are listed below:

Administrative Fees:

	<u>USF</u>	<u>TRS</u>	<u>NANP</u>	<u>Total</u>
FY 2012	\$ 105,358	\$ 1,094	\$ 5,409	\$ 111,861
FY 2011	\$ 102,118	\$ 2,082	\$ 4,587	\$ 108,787

## Note 1 - Summary of Significant Accounting Policies (continued)

### Q. Net Position

Net Position is the residual difference between assets and liabilities, and is comprised of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations represents the amount of unobligated and unexpended budget authority. Unobligated Balance is the amount of appropriations or other authority remaining after deducting the cumulative obligations from the amount available for obligation. Cumulative Results of Operations is the net difference since the inception of the Commission of (1) expenses and losses and (2) financing sources including appropriations, revenues, and gains.

### R. Mobility Fund Phase I Auction

On September 27, 2012, the Commission completed the Mobility Fund Phase I Auction. In this auction, designated as Auction 901, there were a total of 33 winning bidders. The winning bidders have a binding obligation to file a post-auction long-form application by the applicable deadline and consistent with other requirements of the long-form application process. After the deadline, the Commission will issue a public notice identifying the winning bids that are authorized to receive support. The Mobility Fund Phase I Auction did not have any financial impact in FY 2012.

### Note 2 - Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2012 and 2011:

	<u>FY 2012</u>	<u>FY 2011</u>
Intragovernmental:		
Fund Balance with Treasury	\$ 179,007	\$ 266,981
Accounts Receivable, Net	439	1,081
Other	-	2,436
Total Intragovernmental	<u>179,446</u>	<u>270,498</u>
Accounts Receivable, Net	<u>21,565</u>	<u>19,304</u>
Total Non-entity Assets	<u>201,011</u>	<u>289,802</u>
Total Entity Assets	<u>7,794,993</u>	<u>7,149,448</u>
Total Assets	<u>\$ 7,996,004</u>	<u>\$ 7,439,250</u>

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for \$166,489 in FY 2012 and \$238,425 in FY 2011. Non-entity Cash and Other Monetary Assets also consist of deposits made by spectrum auction bidders that are held outside of Treasury. Receivables considered non-entity are for regulatory fees, application fees, fines and forfeitures, spectrum auction receivables, and International Telecommunications Settlement (ITS) charges.

**Note 3 - Fund Balance with Treasury**

The following summarizes Fund Balance with Treasury (FBWT) as of September 30, 2012 and 2011:

<u>FY 2012</u>	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	\$ 15,814	\$ 4,357	\$ -	\$ 20,171
Unavailable	78,777	-	-	78,777
Obligated Balance not yet Disbursed	83,784	-	-	83,784
Non-Budgetary FBWT	-	-	179,007	179,007
<b>Total</b>	<b>\$ 178,375</b>	<b>\$ 4,357</b>	<b>\$ 179,007</b>	<b>\$ 361,739</b>
<u>FY 2011</u>				
Unobligated Balance				
Available	\$ 28,782	\$ 37,008	\$ -	\$ 65,790
Unavailable	80,990	-	-	80,990
Obligated Balance not yet Disbursed	80,579	-	-	80,579
Non-Budgetary FBWT	-	-	266,981	266,981
<b>Total</b>	<b>\$ 190,351</b>	<b>\$ 37,008</b>	<b>\$ 266,981</b>	<b>\$ 494,340</b>

Appropriated Funds – Includes the salaries and expense appropriation used to fund agency operations, the auction and reimbursable accounts, the credit reform program account, and the no-year accounts used to carry over spectrum auction funds, offsetting collections, excess regulatory fees, and the Office of Inspector General USF funds.

Revolving Funds – Includes the credit reform financing account used to record cash flows associated with the Commission’s spectrum auction loan program.

Deposit Funds – Includes monies being held for spectrum auctions, ITS, and regulatory fees. Deposit funds are not available for use by the Commission unless they are properly identified or reclassified as Commission funds. Otherwise, these funds are returned to the depositor or transferred to the U.S. Treasury.

**Note 4 – Cash and Other Monetary Assets**

The following summarizes Cash and Other Monetary Assets as of September 30, 2012 and 2011:

	<u>FY 2012</u>	<u>FY 2011</u>
Cash and Other Monetary Assets	<u>\$ 139,322</u>	<u>\$ 213,944</u>

USF and NANP contributions and third party deposits made pursuant to spectrum auction activities are the source of funds for these balances. Third-party deposits, unless refunded, are held until 45 days after the close of a given auction and then transferred to the Commission’s Treasury account. Interest earned on cash and other monetary assets is reinvested.

Effective February 17, 2012, interest earned on third-party deposits is transferred to the Treasury’s General Fund. Prior to February 17, 2012, interest earned on third-party deposits was transferred to the Telecommunications Development Fund.

#### Note 4 – Cash and Other Monetary Assets (continued)

In FY 2012, Cash and Other Monetary Assets included \$136,475 in USF contributions and related accrued interest being held for distribution, and \$2,847 in NANP deposits and related accrued interest. In FY 2011, Cash and Other Monetary Assets included \$210,948 in USF contributions and related accrued interest being held for distribution, and \$2,996 in NANP deposits and related accrued interest.

#### Note 5 - Investments

The following summarizes Investments as of September 30, 2012 and 2011:

	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
<b>FY 2012</b>						
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	\$ 2,269,876	EI	\$ 233	\$ -	\$ 2,270,109	\$ 2,270,170
Treasury Notes	4,274,042	EI	(4,086)	8,025	4,277,981	4,277,414
Total	<u>\$ 6,543,918</u>		<u>\$ (3,853)</u>	<u>\$ 8,025</u>	<u>\$ 6,548,090</u>	<u>\$ 6,547,584</u>
<b>FY 2011</b>						
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	\$ 1,462,490	EI	\$ 36	\$ -	\$ 1,462,526	\$ 1,462,532
Treasury Notes	4,358,452	EI	(4,735)	6,600	4,360,317	4,371,790
Total	<u>\$ 5,820,942</u>		<u>\$ (4,699)</u>	<u>\$ 6,600</u>	<u>\$ 5,822,843</u>	<u>\$ 5,834,322</u>

EI - Effective Interest Method

All Treasury securities, regardless of the maturity date, are reported as investments. The Commission expects to hold all investments to maturity; therefore, no adjustments have been made to present market values. All investments are held by USF and are also recognized as part of earmarked funds in Note 17.

The cash receipts collected from the public for the USF are used to purchase federal securities. U.S. Treasury securities are an asset to the USF and a liability to the U.S. Treasury. Because the USF and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the USF with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the USF requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

## Note 6 - Accounts Receivable, Net

The following summarizes Accounts Receivable, Net as of September 30, 2012 and 2011:

	Intragovernmental	Public	Total
<u>FY 2012</u>			
Gross Accounts Receivable	\$ 1,574	\$ 1,617,826	\$ 1,619,400
Allowance for Doubtful Accounts	-	(742,738)	(742,738)
Net Accounts Receivable	<u>\$ 1,574</u>	<u>\$ 875,088</u>	<u>\$ 876,662</u>
<u>FY 2011</u>			
Gross Accounts Receivable	\$ 1,097	\$ 1,431,499	\$ 1,432,596
Allowance for Doubtful Accounts	-	(600,427)	(600,427)
Net Accounts Receivable	<u>\$ 1,097</u>	<u>\$ 831,072</u>	<u>\$ 832,169</u>

Accounts receivable are recorded net of any related allowance for doubtful accounts. The Commission's portion is determined by applying predetermined percentages against the respective date the receivable was established. The current formula for the Commission's allowance is 25% for receivables 91-180 days outstanding, 75% for those 181-365 days outstanding, and 100% for anything greater than 365 days outstanding. An additional analysis of higher dollar value receivables is also performed on individual account balances. The USF portion is determined by calculating an estimated general allowance for doubtful accounts receivable. The general allowance is calculated by multiplying the receivable amounts by the percentage of the estimated uncollectible amount as determined by a review of historical collection rates by type of receivable.

The Notice of Apparent Liabilities (NAL) receivables represent notifications of forfeiture, subject to final determination. The NAL receivables are included under the Forfeitures category in the table below. While these receivables are included on the Treasury Report on Receivables at the request of Treasury, the ability to collect these receivables is not determined until a final judgment is issued. A 100% allowance is made for all NAL receivables. Similarly, the Commitment Adjustment (COMAD) for Schools and Libraries audit receivables are subject to appeal and are not considered final until the appeals period has lapsed or a final determination has been issued. The COMAD audit receivables for Schools and Libraries have a 96% allowance in FY 2012 and 93% allowance in FY 2011.

	FY 2012			FY 2011		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	\$ 1,289,562	\$ (442,926)	\$ 846,636	\$ 1,065,218	\$ (268,724)	\$ 796,494
COMAD - Schools and Libraries	148,896	(142,345)	6,551	200,342	(185,717)	14,625
Regulatory Fees	38,369	(28,147)	10,222	35,740	(24,194)	11,546
Spectrum Auction	24,194	(22,630)	1,564	21,258	(21,254)	4
Forfeitures	100,549	(97,849)	2,700	95,102	(88,399)	6,703
Other	17,830	(8,841)	8,989	14,936	(12,139)	2,797
Total	<u>\$ 1,619,400</u>	<u>\$ (742,738)</u>	<u>\$ 876,662</u>	<u>\$ 1,432,596</u>	<u>\$ (600,427)</u>	<u>\$ 832,169</u>

## Note 7 – Loans Receivable, Net

Under section 309(j)(3) of the Act, as amended, Congress directed the Commission to implement a competitive bidding (auctions) system for licensing spectrum to expand economic opportunity, promote competition, and facilitate the development and delivery of new and improved telecommunications services to the public. Section 309(j)(4) of the Act gave the Commission certain instructions for implementing regulations for this system, including a directive to ensure that small businesses, rural telephone companies, and women and minority-owned businesses have an opportunity to participate in providing spectrum-based services. The Commission can use various means to facilitate expanded participation, including alternative payment schedules, tax certificates, bidding preferences, and other procedures.

To address the mandate, the Commission provided installment financing in connection with its spectrum auction events, including the C Block Broadband Personal Communications Services (PCS), F Block PCS, Narrowband PCS, Interactive Video and Data Service (IVDS), Multichannel Distribution Service (MDS), and 900MHz Specialized Mobile Radio (SMR). Under the installment financing program, winning bidders were generally given five or ten years to repay their net winning bid amount (less the down payment), with up to five-year, interest-only initial payment periods. Interest rates varied by the type of borrower. Retention of licenses granted at auction was strictly conditioned on making full and timely payment of amounts as they became due. The return or repossession of auctioned licenses, which may have previously been associated with installment payment plans, does not directly or immediately affect the amount of the outstanding debt recorded in the agency's financial records. Outstanding debt adjustments are subject to a separate process.

The Commission's first auction was conducted in 1994, and starting in 1995 installment payment mechanisms were used to finance portions of some winning bids. The Commission's installment loan portfolio is tracked under ten cohorts. The last active loan matured in April 2007.

As required under the FCRA of 1990, as amended, the Commission coordinates with OMB in developing estimation guidelines, regulations, and the criteria used in calculating the subsidy estimates and reestimates. The most recent subsidy reestimate was completed as of September 30, 2012. The reestimate resulted in a net downward adjustment, including interest on the reestimate, of \$1,473.

### Direct Loans

<u>Loan Program</u>	<u>Loans Receivable Gross</u>	<u>Interest Receivable</u>	<u>Other Receivable</u>	<u>Allowance for Subsidy Cost (Present Value)</u>	<u>Value of Assets Related to Direct Loans</u>
Spectrum Auctions:					
FY 2012	\$ 111,074	\$ 7,883	\$ 857	\$ (119,479)	\$ 335
FY 2011	\$ 130,533	\$ 8,932	\$ 1,195	\$ (140,656)	\$ 4

Interest accrued on bankrupt and defaulted loans totaled \$7,883 in FY 2012 and \$8,932 in FY 2011.

Other Receivables is composed of outstanding late fees on the loans receivable.

### Total Amount of Direct Loans Disbursed

No new loans were issued in FY 2012 and FY 2011.

**Note 7 – Loans Receivable, Net (continued)****Subsidy Expense for Direct Loans by Program and Component**

Direct Loan Modifications and Reestimates:

<u>Loan Program</u>	<u>Modifications</u>	<u>Interest Rate Reestimates</u>	<u>Technical Reestimates</u>	<u>Total Reestimates</u>
Spectrum Auctions:				
FY 2012 (Net)	\$ -	\$ -	\$ (1,473)	\$ (1,473)
FY 2011 (Net)	\$ -	\$ -	\$ 17,629	\$ 17,629

**Schedule for Reconciling Subsidy Cost Allowance Balances**

Beginning Balance of the Subsidy Cost Allowance	FY 2012 \$ 140,656	FY 2011 \$ 166,260
Adjustments:		
Loans written off	(20,599)	(42,711)
Other	810	-
Subsidy allowance amortization	85	(522)
Ending balance before reestimates	<u>120,952</u>	<u>123,027</u>
Subsidy reestimates:		
Technical/default reestimate	<u>(1,473)</u>	<u>17,629</u>
Ending balance of the subsidy cost allowance	<u>\$ 119,479</u>	<u>\$ 140,656</u>
Administrative Expense – Spectrum Auctions	\$ 1,837	\$ 4,884

**Note 8 - Liabilities Not Covered by Budgetary Resources**

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2012 and 2011:

<u>Intragovernmental:</u>	<u>FY 2012</u>	<u>FY 2011</u>
Other:		
FECA Liability	\$ 342	\$ 482
GSA Real Estate Taxes	1,922	2,357
Other:		
Unfunded Leave	20,452	20,108
Accrued Liabilities for Universal Service	<u>752,423</u>	<u>633,967</u>
Total liabilities not covered by budgetary resources	<u>775,139</u>	<u>656,914</u>
Total liabilities covered by budgetary resources	<u>445,102</u>	<u>546,797</u>
Total Liabilities	<u>\$ 1,220,241</u>	<u>\$ 1,203,711</u>



**Note 9 - Debt**

	FY 2011 Beginning Balance	Net Borrowing	FY 2011 Ending Balance	Net Borrowing	FY 2012 Ending Balance
Debt to the Treasury	\$ 87,726	\$ (37,426)	\$ 50,300	\$ (50,300)	\$ -

The Commission borrows from the Treasury for costs associated with its spectrum auction loan program. Borrowings, pertaining to all loan cohorts, are determined by calculating the subsidy estimates and reestimates in accordance with the FCRA of 1990, as amended.

**Note 10 - Other Liabilities**

The following summarizes Other Liabilities as of September 30, 2012 and 2011:

<u>FY 2012</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
Intragovernmental			
Custodial Liability	\$ -	\$ 162,657	\$ 162,657
Other	-	6,240	6,240
Total Intragovernmental	\$ -	\$ 168,897	\$ 168,897
Deferred Revenue	\$ 33,392	\$ 29,579	\$ 62,971
Prepaid Contributions	-	85,849	85,849
Accrued Liabilities for Universal Service	-	752,423	752,423
Other	-	39,578	39,578
Total Other Public	\$ 33,392	\$ 907,429	\$ 940,821
<u>FY 2011</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
Intragovernmental			
Custodial Liability	\$ -	\$ 206,524	\$ 206,524
Other	-	13,725	13,725
Total Intragovernmental	\$ -	\$ 220,249	\$ 220,249
Deferred Revenue	\$ 30,144	\$ 62,909	\$ 93,053
Prepaid Contributions	-	77,362	77,362
Accrued Liabilities for Universal Service	-	633,967	633,967
Other	-	35,804	35,804
Total Other Public	\$ 30,144	\$ 810,042	\$ 840,186

The Custodial Liability includes both cash collected and receivables being held for transfer to the Treasury's General Fund. The Commission collects the following types of custodial revenue: spectrum auction revenue, fines and forfeitures revenue, penalty revenue on regulatory fees, ITS processing fees, and interest revenue on auction deposits. Deferred revenue represents regulatory fees, spectrum auction revenue, or contributor payments that have been received but not earned by the Commission.

**Note 10 - Other Liabilities (continued)**

Prepaid Contributions include USF and NANP contribution overpayments that may be refunded or used to offset future payments. Accrued Liabilities for Universal Service represent liabilities recorded by the USF for anticipated subsidies in the High Cost, Low Income, and TRS programs. The obligation for these subsidies is not recognized until payment files are approved in the subsequent month. Remaining Other Liabilities primarily represent anticipated payments for services received but not billed, and Deposit/Unapplied Liability which represents upfront deposits made by auction bidders as well as funds received that are being held until proper application is determined.

**Note 11 - Commitments and Contingencies**

The Commission, USAC, and the Department of Justice are investigating several cases and prosecuting others related to disbursements of USF funds from the Schools and Libraries, High Cost, and Low Income programs which might result in future proceedings or actions. Similarly the Commission, RLSA, and the Department of Justice are investigating several cases related to the TRS funds. The complexity of these future actions precludes management from estimating the total amount of recovery that may result.

The Commission is a party in various administrative proceedings, legal actions, and claims brought by or against the agency. In addition, there is one bankruptcy proceeding related to the loan portfolio. In the opinion of Commission management, the ultimate resolution of proceedings, actions, and claims will not materially affect the Commission's financial position or results of operations.

The Commission has examined its obligations related to cancelled authority and believes it has no outstanding commitments requiring future resources other than those as disclosed in Note 8. In addition, there are certain operating leases that may contain provisions regarding contract termination costs upon early contract termination.

In September 2007, a grievance was filed with the Commission under the Federal Labor Standards Act alleging that certain Commission bargaining unit employees were not sufficiently compensated for overtime work. Management in consultation with legal counsel has determined that it is "probable" that some issues presented by this pending grievance will result in payments to some employees, but an estimate of the range of the payments cannot be reasonably measured at this time.

**Note 12 – Intragovernmental Costs and Exchange Revenue**

Intragovernmental costs primarily represent goods and services purchased by the Commission from other Federal agencies.

FY 2012

<b>Program Costs</b>	<b>Intragovernmental</b>	<b>Public</b>	<b>Total</b>
Broadband	\$ 12,417	\$ 36,011	\$ 48,428
Competition and Innovation	48,435	9,691,056	9,739,491
International	2,597	7,529	10,126
Consumers	13,385	38,815	52,200
Public Safety and Homeland Security	12,339	35,784	48,123
Continual Improvement	25,277	73,305	98,582
<b>Total</b>	<b>\$ 114,450</b>	<b>\$ 9,882,500</b>	<b>\$ 9,996,950</b>

<b>Total Earned Revenue</b>	<b>\$ 6,065</b>	<b>\$ 454,181</b>	<b>\$ 460,246</b>
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FY 2011

<b>Program Costs</b>	<b>Intragovernmental</b>	<b>Public</b>	<b>Total</b>
Broadband	\$ 14,595	\$ 39,941	\$ 54,536
Competition and Innovation	74,057	9,025,865	9,099,922
International	1,807	4,946	6,753
Consumers	12,353	33,803	46,156
Public Safety and Homeland Security	9,521	26,055	35,576
Continual Improvement	13,549	37,077	50,626
<b>Total</b>	<b>\$ 125,882</b>	<b>\$ 9,167,687</b>	<b>\$ 9,293,569</b>

<b>Total Earned Revenue</b>	<b>\$ 18,624</b>	<b>\$ 454,206</b>	<b>\$ 472,830</b>
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**Note 13 - Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations**

The following summarizes Apportionment Categories of Obligations Incurred for the years ended September 30, 2012 and 2011:

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Direct:				
Category A	\$ 1,148,054	\$ -	\$ 1,098,682	\$ -
Category B	33,934	2,799	49,304	8,065
Exempt from Apportionment	9,896,697	-	8,979,531	-
<b>Total Direct</b>	<b>\$11,078,685</b>	<b>\$ 2,799</b>	<b>\$10,127,517</b>	<b>\$ 8,065</b>
Reimbursable:				
Category A	\$ 9,067	\$ -	\$ 4,206	\$ -

Category A – Apportioned by Quarter

Category B – Apportioned by Purpose

#### **Note 14 - Terms of Borrowing Authority Used**

Maturity Dates:	<u>Borrowing Authority Used</u>	
	<u>FY 2012</u>	<u>FY 2011</u>
September 30, 2012	\$ 856	\$ -
September 30, 2013	-	50,449
Total Borrowing Authority Used	<u>\$ 856</u>	<u>\$ 50,449</u>

In FY 2012, the Commission used \$856 in borrowing authority to fund the FY 2011 Credit Reform Downward Subsidy. The Commission used \$50,449 in FY 2011 borrowing authority to extend the maturity dates of the debt owed to BPD. In FY 2012, the entire debt was repaid.

#### **Note 15 – Legal Arrangements Affecting Use of Unobligated Balances**

Pursuant to Public Law 111-8, offsetting collections received in excess of \$339,844 in FY 2012 shall not be available for obligation. Also, any offsetting collections received in prior years that otherwise become available on or after October 1, 2011, are not available for obligation.

#### **Note 16 - Explanation of Differences Between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government**

The only material difference between the Combined Statement of Budgetary Resources (SBR) for FY 2011 and the amounts presented in the 2013 President’s Budget was the presentation of the unapportioned balance of \$176,000. OMB Circular No. A-136, *Financial Reporting Requirements*, requires all unapportioned balances to be reflected as “Unobligated balance – Exempt from Apportionment” and “Unapportioned” on the SBR. The President’s Budget determines availability based on the fund type and legislation, and places the unapportioned balance for the Commission, including USF, on line “Unexpired unobligated balance, end of the year.”

The FY 2014 *Budget of the United States Government* (President’s Budget) with actual numbers for FY 2012 has not been published. Pursuant to 31 USC § 1105, the *Budget of the United States Government* will be released the first Monday in February, and will be available at the following website: <http://www.whitehouse.gov/omb>.

#### **Note 17 – Earmarked Funds**

U.S. telecommunications companies are obligated to make contributions to the USF and the TRS. These contributions are accounted for in the Budget of the U.S. Government as the “Universal Service Fund.” The Commission currently recognizes the contributions collected under the USF Program as non-exchange revenue on its Statement of Changes in Net Position, and the related disbursements as program expenses on the Statement of Net Cost.

**Note 17 – Earmarked Funds (continued)**

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program as of September 30, 2012 and 2011:

<b>Balance Sheet</b>	<b>FY 2012</b>	<b>FY 2011</b>
<b>ASSETS</b>		
Investments	\$ 6,548,090	\$ 5,822,843
Cash and other monetary assets	136,475	210,948
Accounts receivable, net	866,813	842,768
General property, plant, and equipment, net	2,678	6,330
Other assets	13,024	13,024
Total assets	<u>\$ 7,567,080</u>	<u>\$ 6,895,913</u>
<b>LIABILITIES</b>		
Accounts payable	\$ 98,743	\$ 82,113
Deferred revenue	7,149	13,161
Prepaid contributions	85,780	77,322
Accrued liabilities	752,423	633,967
Total liabilities	<u>\$ 944,095</u>	<u>\$ 806,563</u>
Cumulative results of operations	<u>\$ 6,622,985</u>	<u>\$ 6,089,350</u>
Total liabilities and net position	<u>\$ 7,567,080</u>	<u>\$ 6,895,913</u>
<b>Statement of Net Cost</b>		
Net cost of operations	<u>\$ 9,545,156</u>	<u>\$ 8,818,540</u>
<b>Statement of Changes in Net Position</b>		
Net position beginning of period	\$ 6,089,350	\$ 6,135,941
Non-exchange revenue	10,078,791	8,771,949
Net cost of operations	<u>9,545,156</u>	<u>8,818,540</u>
Change in net position	<u>533,635</u>	<u>(46,591)</u>
Net position end of period	<u>\$ 6,622,985</u>	<u>\$ 6,089,350</u>

**Note 18 – Undelivered Orders at the End of the Period**

The amount of budgetary resources obligated for undelivered orders totaled \$3,463,190 as of September 30, 2012 and \$3,314,084 as of September 30, 2011.

**Note 19 – Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)**

As of September 30, 2012 and 2011:

	<u>FY 2012</u>	<u>FY 2011</u>
Budgetary Resources Obligated:		
Obligations incurred	\$ 11,090,551	\$ 10,139,788
Less: spending authority from offsetting collections and recoveries	1,536,478	1,591,120
Obligations net of offsetting collections and recoveries	9,554,073	8,548,668
Less: offsetting receipts	54,772	59,041
Net obligations	9,499,301	8,489,627
Other Resources	(11,315)	(6,772)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Undelivered Orders	(149,106)	271,372
Resources that fund expenses recognized in prior periods	-	(691)
Budgetary offsetting collections and receipts that do not affect net cost of operations	75,220	137,152
Resources that finance the acquisition of assets	(16,182)	(13,089)
Other	37,200	145,253
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Increase in annual leave liability	344	(583)
Upward/Downward reestimates of credit subsidy (+/-)	(1,473)	17,629
Increase in exchange revenue receivable from the public	5,277	3,872
Depreciation and amortization	19,810	17,797
Other (+/-)	77,623	(240,803)
Net Cost of Operations	<u>\$ 9,536,699</u>	<u>\$ 8,820,764</u>

**Note 20 – Comparability of the Financial Statements**

Statement of Budgetary Resources

The presentation used for the Statement of Budgetary Resources (SBR) prior to FY 2012 has been revised to reflect a new format required pursuant to the OMB Circular No. A-136, *Financial Reporting Requirements*. OMB Circular No. A-136 requires agencies to present both the FY 2012 and 2011 SBR in the same format. Accordingly, certain reclassifications were made to the previously issued FY 2011 SBR to conform to the new format.

## REQUIRED SUPPLEMENTARY INFORMATION

### REQUIRED SUPPLEMENTARY INFORMATION – STATEMENT OF BUDGETARY RESOURCES

For the Year Ended September 30, 2012  
(Dollars in thousands)

OMB Circular No. A-136, *Financial Reporting Requirements*, requires additional disclosure of an entity's budgetary information by major budgetary accounts if the information was aggregated for presentation purposes on the Statement of Budgetary Resources. Major budgetary accounts of the Commission include Salaries and Expenses (S&E), Credit, Auctions, and USF. S&E represents general salaries and expenses of the Commission. Credit reflects the program and financing accounts related to the direct loan program. Auctions include salaries and expenses of the spectrum auction program. USF includes Universal Service and Telecommunications Relay Service Funds.

Reflected in the chart below are the major budgetary accounts of the Commission that are aggregated and presented in the September 30, 2012 Combined Statement of Budgetary Resources.

#### STATEMENT OF BUDGETARY RESOURCES

##### FY 2012

##### Budgetary Resources:

	S&E	Credit	Auctions	USF	Total
Unobligated balance brought forward, Oct 1	\$ 37,051	\$ 41,497	\$ 1,603	\$ 2,684,456	\$ 2,764,607
Recoveries of prior year unpaid obligations	5,411	411	979	1,058,491	1,065,292
Other changes in unobligated balance (+ or -)	(6,824)	(32,724)	(2,163)	-	(41,711)
Unobligated balance from prior year budget authority, net	35,638	9,184	419	3,742,947	3,788,188
Appropriations (discretionary and mandatory)	-	18,432	-	10,042,162	10,060,594
Borrowing authority (discretionary and mandatory) (Note 14)	-	856	-	-	856
Spending authority from offsetting collections (discretionary and mandatory)	345,933	2,016	85,246	14,685	447,880
Total budgetary resources	\$ 381,571	\$ 30,488	\$ 85,665	\$ 13,799,794	\$ 14,297,518

##### Status of Budgetary Resources:

Obligations incurred	\$ 363,153	\$ 22,207	\$ 85,186	\$ 10,620,005	\$ 11,090,551
Unobligated balance, end of year:					
Apportioned	11,039	4,501	2	-	15,542
Exempt from apportionment	-	-	-	3,055,396	3,055,396
Unapportioned	7,379	3,780	477	124,393	136,029
Total unobligated balance, end of year	18,418	8,281	479	3,179,789	3,206,967
Total budgetary resources	\$ 381,571	\$ 30,488	\$ 85,665	\$ 13,799,794	\$ 14,297,518

##### Change in Obligated Balance:

Unpaid obligations, brought forward, Oct 1	\$ 55,594	\$ 1,572	\$ 24,255	\$ 3,335,368	\$ 3,416,789
Uncollected customer payments from Federal sources, brought forward, Oct 1 (-)	(382)	-	-	-	(382)
Obligated balance, start of year (net), as adjusted	55,212	1,572	24,255	3,335,368	3,416,407
Obligations incurred	363,154	22,206	85,186	10,620,005	11,090,551
Outlays (gross) (-)	(346,753)	(23,099)	(85,188)	(9,405,323)	(9,860,363)
Change in uncollected customer payments from Federal sources (+ or -)	(5,234)	-	-	-	(5,234)
Recoveries of prior year unpaid obligations (-)	(5,411)	(411)	(979)	(1,058,491)	(1,065,292)
Obligated balance, end of year	66,584	268	23,274	3,491,559	3,581,685
Unpaid obligations, end of year (gross)	66,584	268	23,274	3,491,559	3,581,685
Uncollected customer payments from Federal sources, end of year (-)	(5,616)	-	-	-	(5,616)
Obligated balance, end of year (net)	\$ 60,968	\$ 268	\$ 23,274	\$ 3,491,559	\$ 3,576,069

##### Budget Authority and Outlays, Net:

Budgetary authority, gross (discretionary and mandatory)	\$ 345,934	\$ 21,304	\$ 85,245	\$ 10,056,847	\$ 10,509,330
Actual offsetting collections (discretionary and mandatory) (-)	(345,574)	(20,448)	(85,245)	(14,685)	(465,952)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(5,234)	-	-	-	(5,234)
Budgetary authority, net (discretionary and mandatory)	\$ (4,874)	\$ 856	\$ -	\$ 10,042,162	\$ 10,038,144
Outlays, gross (discretionary and mandatory)	346,753	23,099	85,188	9,405,323	9,860,363
Actual offsetting collections (discretionary and mandatory) (-)	(345,574)	(20,448)	(85,245)	(14,685)	(465,952)
Outlays, net (discretionary and mandatory)	1,179	2,651	(57)	9,390,638	9,394,411
Distributed offsetting receipts (-)	(26,900)	-	-	(27,872)	(54,772)
Agency outlays, net (discretionary and mandatory)	\$ (25,721)	\$ 2,651	\$ (57)	\$ 9,362,766	\$ 9,339,639

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### 3. Other Accompanying Information

#### *Summary of Financial Statement Audit*

Audit Opinion	Unqualified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
	0	0	0	0	0
<i>Total Material Weaknesses</i>	0	0	0	0	0

#### *Summary of Management Assurances*

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Unqualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
	0	0	0	0	0	0
<i>Total Material Weaknesses</i>	0	0	0	0	0	0

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Unqualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
	0	0	0	0	0	0
<i>Total Material Weaknesses</i>	0	0	0	0	0	0

**Conformance with financial management system requirements (FMFIA § 4)**

Statement of Assurance	Systems do not conform to financial management system requirements					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
System is not fully integrated	✓					✓
Perform functional requirement reviews						
<i>Total Non-Conformances</i>	1	0	0	0	0	1

# ***Improper Payments Elimination and Recovery Act Reporting Details***

As required by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and the Improper Payments Information Act ((IPIA) (henceforth referred to collectively as IPERA), the Commission reports the following information.

## ***I. RISK ASSESSMENTS***

The Commission has eight components with funding disbursements that are under the direction of the Commission and its Administrators. Of these programs listed below, the Commission had previously identified the three programs highlighted in bold as susceptible to significant improper payments.

- **Universal Service Fund High Cost Program (USF-HC)**
- **Universal Service Fund Schools and Libraries Program (USF-S&L)**
- Universal Service Fund Lifeline Program (USF-Lifeline) or (USF-LI)
- Universal Service Fund Rural Health Care Program (USF-RHC)
- Universal Service Fund Administrative Costs (USF-Admin)
- **Interstate Telecommunications Relay Services Fund (TRS)**
- North American Numbering Plan (NANP)
- FCC Operating Expenses (FCC)

In FY 2011, pursuant to Office of Management and Budget (OMB) Circular No. A-123, Appendix C, which requires a risk assessment once every three years for these programs, the Commission conducted a risk assessment of the five programs above that were not previously identified as susceptible to significant improper payments. In FY 2012 the FCC implemented a number of additional steps to monitor risk factors and strengthen processes for identification of improper payments in these programs, including assessment of audit findings, site visits to examine program compliance, and investigations of whistleblower complaints. The Commission will continue to monitor risk through these and other measures until another risk assessment is performed consistent with OMB Circular No. A-123.

## ***II. STATISTICAL SAMPLING PROCESS***

***Universal Service Fund*** In FY 2012, the Commission used a statistical sampling process to obtain a statistically valid estimate of the annual amount of improper payments in the USF-HC fund and the USF-S&L fund using an alternative sampling method approved by OMB. This process, called the Payment Quality Assurance (PQA) assessment plan, tested disbursements made in calendar year 2011 and tested compliance with those Commission rules that had the highest error rates from previous years' audits. This plan was not designed to extrapolate an improper payment error rate for these programs as a whole. Rather, the goal was to only estimate an improper payment error rate for the Commission rules that were previously identified in these programs as subject to the highest improper payments. In accordance with OMB guidance, a brief description of the sampling processes follows below.

**USF-HC** In FY 2012, the Commission used stratified simple random sampling based on calendar year 2011 disbursements. Samples from USF-HC disbursements were randomly selected simultaneously from all twelve months to ensure that no study area would be assessed more than once during the year. Assessments of calendar year 2011 transactions were conducted monthly and included: 1) steps to measure the accuracy of payments; 2) evaluation of program applicants' eligibility; 3) testing of high level information obtained from program participants; and, 4) testing for line count duplicates and summary schedule variances.

The sampling units for USF-HC were study area codes that were divided into three strata according to disbursement amounts. The strata were defined based on total disbursement amount to the beneficiary for all of calendar year 2011. The disbursement strata based on annual disbursements were: less than \$1.0 million; \$1.0 million to \$4.99 million; and \$5 million or more. Using stratified simple random sampling, the Commission determined the total number of study area codes to be tested each month was 24 and the total number for fiscal year 2012 was 288 or \$94 million in disbursements. Improper payments of \$179,322 were identified in the sample. Weights were used to extrapolate estimates of total improper payments and total disbursements from the sample to the population, commonly referred to as simple expansion estimators. The combined ratio estimator was used to estimate the improper payment rate by dividing the extrapolated total improper payments by the total extrapolated disbursements. Using this methodology, the estimated improper payment rate for USF-HC was .3% for fiscal year 2012. The total extrapolated amount of improper payments for fiscal year 2012 is \$12.6 million out of disbursements of \$4.1 billion.

**USF-S&L** The Commission used stratified simple random sampling in FY 2012 based on calendar year 2011 disbursements. Samples from USF-S&L disbursements were randomly selected on a monthly basis. Assessments of calendar year 2011 transactions were conducted monthly and included: 1) steps to measure the accuracy of payments; 2) evaluation of program applicants' eligibility; 3) testing of high-level information obtained from program participants; 4) review of technology plans for certified approval and timing of approval; and 5) verification of service eligibility.

The sampling units for USF-S&L were invoice lines that were divided into five strata according to disbursement amounts. The strata were defined based on the amounts disbursed for beneficiaries each month. After the exclusion of a de minimis category in which the disbursement amount was less than \$35, the disbursement strata were based on four invoice payment categories: \$35 to \$999; \$1,000 to \$9,999; \$10,000 to \$99,999; and \$100,000 or more. Using stratified simple random sampling, the Commission determined the total number of invoice lines to be tested for fiscal year 2012 was 738 or \$35.6 million in disbursements. Improper payments of \$648,710 were identified in the sample. Weights were used to extrapolate estimates of total improper payments and total disbursements from the sample to the population, commonly referred to as simple expansion estimators. The combined ratio estimator was used to estimate the improper payment rate by dividing the extrapolated total improper payments by the total extrapolated disbursements. Using this methodology, the estimated improper payment rate for USF-S&L is 1.91% for fiscal year 2012. The total extrapolated amount of improper payments for fiscal year 2012 was \$43.4 million out of approximately \$2.2 billion in disbursements.

**TRS** The Commission also worked closely with OMB in FY 2012 to strengthen the process to identify improper payments in the TRS fund. In response to these efforts, Rolka Loube Saltzer Associates, LLC (RLSA), the TRS Fund Administrator, has calculated a baseline error rate for improper payments under an alternative statistical sampling methodology in coordination with OMB and consistent with OMB Circular No. A-123. This plan was not designed to test recipient compliance with Commission rules or to extrapolate an improper payment error rate for the TRS program as a whole; rather, the goal was to estimate an improper payment error rate for the internal controls administered by RLSA. This is the first

year that a baseline error rate was required for the TRS Fund. Therefore, the plan included a robust testing of internal controls. Attributes were tested for 100% of distributions for the period of July 1, 2011 through June 30, 2012, which included 148 distributions to service providers totaling \$606,856,572.86. The resulting error rate for improper payments is 0%. A root cause analysis was not performed because no errors were found in the testing attributes.

### ***III. CORRECTIVE ACTION PLANS***

The following discussion describes the corrective action plans for USF-HC and USF-S&L, and includes, where available, root cause information (error amount) and ongoing corrective actions to reduce improper payments. Also included below is an update on the implementation of the TRS corrective action plan.

USAC has examined the results of the audits and assessment programs conducted for FY 2012, and has implemented a corrective action plan in response to any findings, consistent with OMB Circular No. A-123 and OMB Circular No. A-50 (provides policies and procedures for use by executive agencies when considering reports issued by the Inspectors General, other executive branch audit organizations, the General Accounting Office, and non-Federal auditors where follow up is necessary).

**USF-HC** In FY 2012, the PQA process identified the following improper payment issues and amounts. The Commission is currently working with USAC to recover these funds and to make additional improvements to the USF-HC program.

<b>High-Cost PQA issues by Improper Payment Amount</b>	<b>Improper Payment Amount Totals</b>	<b>Number of Instances</b>
Line Counts	\$169,596.23	44
Subscriber line count revenue	\$5,825.91	29
Part 36 reporting exception	\$3,453.57	6
Average schedule line count	\$269.84	1
Line count duplicates	\$176.77	6
<b>Total</b>	<b>\$179,322.32</b>	<b>86</b>

**USF S&L** In FY 2012, the PQA process identified the following improper payment issues and amounts. The Commission is currently working with USAC to recover these funds and to make improvements to the USF-S&L program.

<b>Schools and Libraries PQA issues and Improper Payment Amount</b>	<b>Improper Payment Amounts</b>	<b>Number of Instances</b>
Payment for recurring services delivered outside of the funding year	\$235,983.28	1
Technology plan approved after service start date	\$143,981.62	11
No approved technology plan	\$129,068.22	3
Services received by ineligible entity	\$84,331.62	10
Incomplete documentation	\$52,579.38	18
Failure to utilize the services funded	\$2,724.25	1
Invoicing error	\$42.11	1
<b>Total</b>	<b>\$648,710.48</b>	<b>45</b>

**Efforts to Reduce Future Improper Payments in USF programs** The Commission has taken several actions to further strengthen oversight of the USF and reduce improper payments. At the direction of the FCC, USAC has developed a comprehensive set of measures to reduce improper payments arising from the errors identified in the tables above which include outreach, oversight and management, audits, and information technology resources. USAC has expanded outreach designed to prevent the errors identified above from reoccurring, enhanced internal controls and data collection to gain greater visibility into payment operations, calibrated audit and audit follow-up activities to gain greater certainty about beneficiary support, and modernized information technology systems to achieve greater efficiencies and improve reporting capabilities. Key actions undertaken by the FCC and USAC to reduce future improper payments in the High Cost and Schools and Libraries programs include:

- The FCC directed USAC to separate the USF IPERA efforts into two distinct programs with two objectives – one focused on improper payment assessment and the second on auditing compliance with the rules for all four USF programs. In the previous FCC USF audit program, an audit approach was utilized which tested beneficiary compliance with FCC rules and simultaneously addressed the requirements of IPERA.
- The FCC directed USAC, in response to a recommendation from the Government Accountability Office (GAO), to conduct a robust risk assessment of the S&L program. The assessment must consider, among other things, the top five findings from the last five rounds of S&L audits and their impact on meeting program objectives. The RFP for the risk assessment has been released to the public.
- On October 27, 2011, the Commission adopted an Order and Further Notice of Proposed Rulemaking (*USF/ICC Transformation Order*) that comprehensively reforms and modernizes the High Cost universal service program. The order adopts fiscally responsible, accountable, incentive-based policies to transition an outdated and inefficient High Cost program into the Connect America Fund. One specific action the Commission took was to establish a uniform national framework for information that eligible telecommunications carriers (ETCs) must report to their respective states and to the Commission to improve accountability from companies receiving High Cost support to ensure that public investments are used wisely to deliver intended results.

- In June 2011, the Commission directed USAC to initiate in-depth data validations (IDVs) to eliminate duplicative Lifeline support. As of September 30, 2012, USAC has completed duplicate IDVs in 19 states. Overall, USAC analyzed more than 7 million Lifeline subscriber records. Among these, approximately 630,000 or 8% were duplicates, i.e., subscribers who received Lifeline service from more than one eligible telecommunications carrier. These subscribers were notified and were asked to select a single Lifeline provider. The carrier that was not selected as the consumer's Lifeline service provider was required to de-enroll that consumer from Lifeline-discounted service. In total, USAC has directed carriers to de-enroll more than 700,000 accounts. This action will result in a savings to the federal Universal Service Fund of \$6.8 million per month, or \$82 million annually.
- In response in part to recommendations from the GAO and the Federal-State Joint Board Recommended Decision, the Commission adopted several specific measures to improve program integrity and ensure that the Lifeline program is meeting its objectives, including performance goals and measures, revised certification and verification rules, and revised audit requirements.
- In the *Lifeline Reform Order*, the Commission directed USAC to transition the Lifeline program from projected disbursements to actual disbursements. The transition to actual disbursements was completed in October 2012.
- The USAC internal controls team continued the required internal control related documentation and testing to ensure the company's internal controls program and internal controls framework are in compliance with best practices consistent with the internal controls process defined in OMB Circular No. A-123. Corrective action plans have been developed by the Commission and USAC, and are currently being implemented to remediate all identified control deficiencies.
- USAC increased the number of employees and resources dedicated to review audit findings and seek recovery of improper payments.
- Under the Commission's oversight and review, USAC has conducted extensive and multiple training sessions and webinars to educate program beneficiaries about program rules and other requirements.

**Efforts to Reduce Future Improper Payments in TRS program** During the past fiscal year, the Commission has increased efforts to improve the TRS program and has taken the following steps to strengthen the TRS program administration:

- The TRS Fund administrator has calculated a baseline error rate for improper payments under an alternative statistical sampling methodology consistent with OMB Circular No. A-123, and in coordination with OMB. This is the first year that the TRS Fund must calculate a baseline error rate. Therefore, the plan includes a robust testing of internal controls. The following attributes were tested for 100% of distributions for the period of July 1, 2011 through June 30, 2012. This included 148 distributions to service providers, totaling \$606,856,572.86. The resulting error rate for improper payments is 0%.
- In addition, the TRS Fund Administrator is currently conducting compliance audits of all service providers eligible to receive reimbursement from the TRS Fund. Each audit will be a risk-based performance audit driven by the inherent risks for the service provider and service category. The Commission will follow up on all findings and recommendations to improve the TRS program in order to reduce improper payments to providers due to issues of waste, fraud, and abuse, rather than issues with the internal controls of the administrator.

- For FY 2012, OIG issued ten audit reports of TRS Fund Program Video Relay Service (VRS) providers conducted by an independent audit firm. The objective of these audits was to determine whether the cost data submitted by VRS providers to the TRS Fund Administrator for calendar years 2008, 2009, and 2010 were in compliance with the Commission's rules and supported by adequate documentation. The audits found that the VRS providers did not fully comply with the applicable rules and regulations, however, no monetary recovery was recommended because the amount was determined to be de minimus. Corrective actions have been taken by the VRS providers to report true and accurate data, and the Commission staff continues to implement structural reforms in the TRS Fund Program. Moreover, OIG has completed five more audits of VRS providers that focus on the use of VRS revenue received by providers to determine whether funds were spent on activities and cost objectives that were related to the VRS program. The Commission intends to follow up on these audits as well.
- On October 17, 2011, the Commission released a Memorandum Opinion and Order, Order, and Further Notice of Proposed Rulemaking clarifying and further strengthening the certification process for VRS provider applicants (FCC 11-155).
- On June 29, 2012, the Commission released a Report and Order to curb the misuse of Internet Protocol Relay Service (IP Relay). Specifically, the Commission now prohibits IP Relay providers from handling non-emergency calls made by new IP Relay registrants prior to taking reasonable measures to verify their registration information (FCC 12-71).
- In addition, the U.S. Department of Justice has successfully prosecuted multiple individuals for fraudulent submissions to the TRS Fund for payment. As of September 4, 2012, 13 individuals and one corporation have been sentenced to penalties including jail, probation, and \$80.5 million dollars in restitution to be paid to the U.S. government. Several other defendants have been similarly convicted and are awaiting sentencing.



#### **IV. IMPROPER PAYMENT REPORTING**

Table 1 below reports the initial baseline improper payment rate for USF-HC, USF-S&L and TRS programs. As required by OMB reporting and reported in Table 1 below, the Commission provided the fiscal year outlays (CY Outlays) by each of the programs deemed to be susceptible to significant improper payments.

**Table 1 Improper Payment Reduction Outlook  
(Dollars in thousands)**

<b>Program or Activity</b>	<b>USF-HC</b>	<b>USF-S&amp;L</b>	<b>TRS</b>
PY Outlays	n/a	n/a	n/a
PY IP%	n/a	n/a	n/a
PY IPS	n/a	n/a	n/a
CY Outlays	\$4,087,770	\$2,224,878	\$713,000
CY IP%	.30%	1.91%	0.0%
CY IPS	\$12,611	\$43,354	-
CY Overpayment \$	\$11,722	\$43,354	-
CY Underpayment \$	\$889	-	-
CY+1 Est. Outlays	\$4,226,400	\$2,247,600	n/a
CY+1 IP%	.30%	1.91%	n/a
CY+1 IPS	\$12,679	\$42,929	n/a
CY+2 Est. Outlays	\$4,873,400	\$2,324,900	n/a
CY+2 IP%	.30%	1.91%	n/a
CY+2 IPS	\$14,620	\$44,406	n/a
CY+3 Est. Outlays	\$4,808,400	\$2,249,600	n/a
CY+3 IP%	.30%	1.91%	n/a
CY+3 IPS	\$14,425	\$42,967	n/a

## ***V. RECAPTURE OF IMPROPER PAYMENTS REPORTING***

The following discussion is a summary of the Commission's payment recapture audits for FY 2012 for programs with over \$1 million in annual outlays.

**USF** In the previous FCC USF audit program, a dual-objective audit approach was utilized which tested beneficiary compliance with FCC rules and simultaneously addressed the requirements of the IPIA. The FCC has since directed USAC to separate the two objectives into distinct programs – one focused on improper payment assessment (known as the Payment Quality Assurance program, or PQA, and described further below under “Other Efforts”) and the second on auditing compliance with all four USF programs. The program summarized below outlines the payment recapture audit program (called the Beneficiary and Contributor Audit Program, or BCAP) designed to evaluate USF beneficiary and contributor compliance with FCC rules. The FY2012 BCAP was developed with the following objectives:

- Covering all four USF programs and contributors;
- Tailoring audit type and scope to program risk elements, size of disbursement, audit timing, and other specific factors (i.e., recognizing that the programs and beneficiary types are different; the audits do not adopt a “one size fits all” approach);
- Keeping costs of the program reasonable in relation to overall program disbursements, to the amounts disbursed to beneficiary being audited, and as a part of USF administrative costs;
- Spreading audits throughout the year to balance workload, improve efficiencies, control costs, reduce unnecessary burdens on beneficiaries, and maintain a pool of trained auditors; and
- Retaining capability and capacity for targeted and risk-based audits to be conducted as recommended by USAC management, the FCC, and/or law enforcement entities.

USAC has examined the results of the audits and assessment programs conducted for FY 2012 and has implemented a corrective action plan in response to any findings and consistent with OMB Circular No. A-123 and OMB Circular No. A-50 (provides policies and procedures for use by executive agencies when considering reports issued by the Inspectors General, other executive branch audit organizations, the General Accounting Office, and non-Federal auditors where follow up is necessary). In addition, USAC has incorporated the lessons learned from each recommendation into future audit and assessment efforts. USAC also is ensuring that auditors receive proper training on the telecommunications industry and the USF rules and requirements.

**Completed FY 2012 Payment Recapture Audits** The FCC and USAC continued to examine audits and provided recommendations on how to mitigate conditions giving rise to overpayments in the USF for FY 2012. The USAC Internal Audit group continued to perform targeted and randomly selected independent audits. Specifically, USAC has completed 83 audits in FY 2012, of which 34 involved overpayments. Of these, the auditor has identified \$3,352,607 to be recovered. USAC has completed recoveries from 13 of the 34 audits, and is in the process of recovering the remainder.

Below are the number of audits performed and the estimated recovery amounts, by program:

<b>Program / Area</b>	<b># Audits</b>	<b># Audits with Overpayments</b>	<b>Estimated Recovery</b>
High Cost	19	11	\$286,235
Schools and Libraries	29	15	\$3,062,835
Lifeline	25	8	\$3,537
Rural Health Care	10	0	\$0
<b>Total</b>	<b>83</b>	<b>34</b>	<b>\$3,352,607</b>

**FY 2012 USF Admin Outlays** USAC is an independent, not-for-profit corporation designated as the administrator of the USF by the FCC. Each year, an independent audit of USAC is conducted to determine, among other things, whether USAC is properly administering the Universal Service Fund to prevent waste, fraud, and abuse. Included in this examination is whether any overpayments have been made concerning fund administration. Examination of the 2011 calendar year audit continues to demonstrate that USAC Administrative (Admin) outlays are low-risk and there were no findings of improper payments. In addition, the Commission closely follows the USAC Admin outlays through review of USAC's quarterly program demand filings and monthly administrative expense statements. In response to these findings and other reviews performed by the Commission, the Commission continues to examine whether it is cost effective pursuant to OMB Circular No. A-123 to conduct a payment recapture audit of USAC Admin outlays. Finally, as required by law, the Commission reviews each of its programs to identify whether they are susceptible to significant improper payments, to determine whether there has been any significant change in legislation, and whether there has been any significant increase in the funding levels. If any of these situations occurs next fiscal year, the Commission will perform the required risk assessment prior to the FY 2014 three year cycle. USAC Admin outlays for FY 2012 totaled approximately \$106 million compared to \$101 million for FY 2011.

**TRS** The TRS Fund compensates telecommunications relay service providers for the reasonable costs of offering services, in compliance with Commission rules, that enable individuals who are deaf, blind, or have a hearing or speech disability to communicate in a manner that is functionally equivalent to voice telephone users. RLSA, the TRS Fund Administrator, appointed by the FCC and under its oversight, is responsible for the collections and disbursements from the TRS Fund.

For FY 2012, the FCC Office of Inspector General (OIG) issued ten audit reports of TRS Fund Program Video Relay Service (VRS) providers conducted by an independent audit firm. The objective of these audits was to determine whether the cost data submitted by VRS providers to the TRS Fund Administrator for calendar years 2008, 2009, and 2010 were in compliance with Commission's rules and supported by adequate documentation. The audits found that the VRS providers did not fully comply with the applicable rules and regulations, however, no monetary recovery was recommended because the amount was determined to be de minimus. In general, corrective actions have been taken by the VRS providers to report true and accurate data, and the Commission staff continues to implement structural reforms in the TRS Fund Program. Moreover, OIG has completed five more audits of VRS providers that focus on the use of VRS revenue received by providers to determine whether funds were spent on activities and cost objectives that were related to the VRS program.

In addition, RLSA is currently conducting compliance audits of all service providers eligible to receive reimbursement from the TRS Fund. These audits plan to test compliance with Commission rules concerning the TRS program. In addition, each audit will be a risk-based performance audit driven by the inherent risks for the service provider and service category. The Commission will follow up on all findings and recommendations to improve the TRS program in order to reduce improper payments to providers due to issues of waste, fraud, and abuse.

The TRS Fund administrator successfully recovered \$1,711,339.07 (deposited in the TRS Fund June 26, 2012) from a settlement in a bankruptcy proceeding of one of the service providers. In addition, as of September 2012 the administrator has withheld \$24,728,468.92 in payments to providers pending additional documentation supporting claims for payment.

TRS outlays for FY 2012 totaled approximately \$713 million.

**NANP** NANP is the basic numbering scheme permitting interoperable telecommunications services within the U.S., Canada, Bermuda, and most of the Caribbean. Neustar administers NANP and Welch LLP is the billing and collection agent. In FY 2012, an independent auditor conducted a financial statement audit which examined transactions incurred by the NANP Fund. Specifically, this audit tested about \$1.1 million or 23 percent of the approximately \$4.6 million in expenditures made from the NANP Fund in FY 2011. Also, an annual Agreed Upon Procedures (AUP) engagement is conducted to assess internal controls and compliance with the Fund's requirements and FCC rules. Welch, the billing and collection agent of the NANP Fund, oversees disbursements for the NANP program, and submits the NANP Fund audited annual financial statements and AUP reports to the FCC. As a further safeguard, as part of its internal control measures, each transaction is reviewed by the paying agent for completeness and ensures compliance with FCC requirements and relevant regulations. Moreover, disbursements to Neustar and other service providers require approval by the FCC contracting officer. Welch tested 64% of the transactions for improper payments for FY 2012 and found no improper payments made during the period. Inasmuch as the disbursements are based on fixed price contract awards by the Commission, and based on the above audit, AUP, additional safeguards and assessments, the NANP fund was determined to be a low risk program with no identified overpayments for FY 2011 and FY 2012. At present, it is not cost effective to conduct a payment recapture audit pursuant to OMB Circular No. A-123; however, the Commission staff continues to monitor the situation. NANP Fund outlays for FY 2012 totaled approximately \$5.4 million.

**FCC Operating Expenses** Overseen by the Office of Managing Director (OMD), the FCC's operating expenses are separated into two categories, Compensation and Benefits, and Non-salary or Operating Expenses. Each year an independent audit is performed for the FCC's financial statements. For FY 2012, FCC operating expenses continue to be low risk with no identified overpayments. Based on these findings, the Commission will continue to examine whether it is cost effective pursuant to OMB Circular No. A-123 to conduct payment recapture audits. As required by law, the Commission conducted a risk assessment in FY 2011 in accordance with OMB Circular No. A-123 guidance. It was determined that this program is not susceptible to significant improper payments. In addition, there were no significant changes in legislation and no significant increase in the funding level for this program. If either of the two situations occurs next fiscal year, the Commission will perform the required risk assessment prior to the FY 2014 three year cycle. FCC Non-salary Operating Expenses for FY 2012 totaled approximately \$179.7 million compared to last year's expenses of \$111 million.

In FY 2012, FCC staff conducted a quality control examination to ensure that operating expenses continue to be a low risk program. Under this examination, FCC staff selected 50 transactions for review through a random sample generated program. The sample that the staff used came from a universe of 35,525 non-salaries or operating expenses that were recorded on the FCC's books in FY 2012. This

review was conducted to determine if segregation of duties were followed according to FCC policy, if the prompt payment rules were followed, if purchase orders were approved and matched the transactions selected, if the service was rendered for the service paid, if payments were made that should not have been made, and if payment was made in error to a duplicate vender.

As part of this review, the FCC staff used the formula included in OMB Circular No. A-123, Appendix C, to determine if compliance was met in its review of its operating expenses. The results of this quality control examination concluded that the improper payment rate for the FCC's Non-salary Operating Expenses is less than 2.5%, that the FCC's Disbursement Program should remain low risk, and that it is in compliance with all applicable laws and the Office of Management and Budget's (OMB) guidance, including the President's Executive Order. Further, the FCC is considering contracting with an auditing firm that specializes in payment recapture audits. These audits would be based on a contingency arrangement in which a portion of the recovered amount compensates the auditing firm.

**Payment Recapture Audit Reporting** The Commission reports in Table 2 the results of FY 2012 payment recapture audits, and also reports prior year payment recapture audits for FY 2004 through FY 2011 as prior year results. Also, Table 2 provides for the dollar amounts for the High Cost (HC), Lifeline (LI), Rural Health Care (RHC), and Schools and Libraries (S&L) programs in terms of calendar year while the dollar amounts for USF Admin, TRS, NANP, and FCC Operating are reported as fiscal year amounts. For the High Cost program, the current year recovery rate is low primarily due to amounts on appeal. Estimates for future recoveries are based upon historical rates and the fact that some findings will be overturned on appeal. For the S&L program, low current year recovery rates are due to the high percentage of audit findings on appeal or undergoing the commitment adjustment process.

**Table 2 Payment Recapture Audit Reporting**  
(Dollars in thousands)

<b>Program or Activity</b>	<b>USF-HC</b>	<b>USF-Lifeline</b>	<b>USF-RHC</b>	<b>USF-S&amp;L</b>	<b>USF-Admin</b>	<b>TRS</b>	<b>NANP</b>	<b>FCC</b>
Type of Payment (contract, grant, benefit, loan, or other)	Benefit	Benefit	Benefit	Benefit	Other	Benefit	Contract	Other
Amount Subject to Review for CY Reporting	\$4,087,770	\$2,072,570	\$159,812	\$2,224,878	\$106,000	\$713,000	\$5,400	\$179,711
Actual Amount Reviewed and Reported (CY)	\$28,031	\$2,651	\$2,483	\$2,486	-	-	-	-
Amount Identified for Recovery (CY)	\$286	\$3	-	\$3,063	-	-	-	-
Amount Recovered (CY)	\$8	\$.552	-	\$50	-	-	-	-
% of Amount Recovered out of Amount Identified (CY)	2.91%	15.61%	0.0%	1.62%	0.0%	0.0%	0.0%	0.0%
Amount Outstanding (CY)	\$278	\$3	-	\$3,013	-	-	-	-
% of Amount Outstanding out of Amount Identified (CY)	97.09%	84.39%	-	98.38%	0.0%	0.0%	0.0%	0.0%
Amount Determined Not to be Collectable (CY)	-	-	-	-	-	-	-	-
% of Amount Determined Not to be Collectable out of Amount Identified (CY)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Amounts Identified for Recovery (PYs)	\$113,664	\$10,059	\$149	\$65,022	-	-	-	-
Amounts Recovered (PYs)	\$78,597	\$934	\$147	\$22,003	-	-	-	-
Cumulative Amounts Identified for Recovery (CY + PYs)	\$113,950	\$10,063	\$149	\$68,085	-	-	-	-
Cumulative Amounts Recovered (CY + PYs)	\$78,605	\$935	\$147	\$22,053	-	-	-	-
Cumulative Amounts Outstanding (CY+PYs)	\$35,345	\$9,128	\$2	\$46,032	-	-	-	-
Cumulative Amounts Determined Not to be Collectable (CY+PYs)	-	-	-	-	-	-	-	-

The Commission is currently establishing targets for the payment recapture audit program. Listed below in Table 3 are the preliminary targets for the program using historical results.

**Table 3 Payment Recapture Audit Targets  
(Dollars in thousands)**

Program or Activity	Type of Payment (contract, grant, benefit, loan, or other)	CY Amount Identified	CY Amount Recovered	CY Recovery Rate (Amount Recovered/ Amount Identified)	CY+1 Recovery Rate Target	CY + 2 Recovery Rate Target	CY + 3 Recovery Rate Target
USF-HC	Benefit	\$286	\$8	3%	50%	60%	70%
USF-LI	Benefit	\$4	\$.552	15.61%	30%	40%	50%
USF-RHC	Benefit	\$0	N/A	N/A	N/A%	N/A	N/A
USF-S&L	Benefit	\$3,063	\$50	1.62%	30%	40%	50%

The Commission reports in Table 4 the aging of its outstanding overpayments from the payment recapture audits performed in FY 2012.

**Table 4 Aging of Outstanding Overpayments  
(Dollars in thousands)**

Program or Activity	Type of Payment (contract, grant, benefit, loan, or other)	CY Amount Outstanding (0-6 months)	CY Amount Outstanding (6 months to 1 year)	CY Amount Outstanding (over 1 year)
USF-HC	Benefit	\$21	\$257	-
USF-LI	Benefit	\$3	-	-
USF-RHC	Benefit	-	-	-
USF-S&L	Benefit	\$3,012	-	-

The Commission reports in Table 5 the disposition of recaptured funds from FY 2012 payment recapture audits.

**Table 5 Disposition of Recaptured Funds  
(Dollars in thousands)**

Program or Activity	Type of Payment (contract, grant, benefit, loan, or other)	Agency Expenses to Administer the Program	Payment Recapture Auditor Fees	Financial Management Improvement Activities	Original Purpose	Office of Inspector General	Returned to Treasury
USF-HC	Benefit	\$553	\$4	-	\$8	-	-
USF-LI	Benefit	\$696	-	-	\$.552	-	-
USF-RHC	Benefit	\$276	-	-	-	-	-
USF-S&L	Benefit	\$801	-	-	\$50	-	-



The Commission reports in Table 6 those improper payments identified through and recovered through sources other than payment recapture audits. Note, the entry for USF-RHC Non Audits includes dollars associated with potential overpayments in the Rural Health Care Pilot Program during FY 2010 and 2011. Although the final determination concerning whether these payments constitute overpayments is pending, out of an abundance of caution the FCC has included these amounts in Table 6. Following final determination on this issue, this table may be adjusted in the FY 2013 AFR submission.

**Table 6 Overpayments Recaptured Outside of Payment Recapture Audits  
(Dollars in thousands)**

Source of Recovery	Amount Identified (CY)	Amount Recovered (CY)	Amount Identified (PY)	Amount Recovered (PY)	Cumulative Amount Identified (CY+PYs)	Cumulative Amount Recovered (CY+PYs)
USF-HC IDV	\$7	7	-	-	\$7	\$7
USF-HC PQA	\$552	-	\$99	\$40	\$651	\$40
USF-LI IDV	-	-	\$53	\$53	\$1,749	\$1,749
USF-LI PQA	\$62	-	\$64	\$40	\$126	\$40
USF-RHC PQA	\$46	\$7	-	-	\$46	\$7
USF-RHC Non-Audits	\$170	\$146	\$4,027	\$195	\$12,234	\$1,098
USF-S&L PQA	\$580	\$236	\$31	\$23	\$612	\$259
USF-S&L Non-Audits	\$95,293	\$6,325	\$37,606	\$3,813	\$213,622	\$19,144

## ***VI. ACCOUNTABILITY***

The Commission continues to work with USAC's management to assess the effectiveness of program management necessary to ensure accountability over USAC's operations and senior leadership. In prior years, efforts to implement a performance-based compensation program that links executive compensation and bonuses to efforts to reduce and prevent improper payments resulted in extensive discussion and review of the performance criteria used for determination of executive compensation. The Commission is actively working with USAC's management to review and assess the effectiveness of current financial reporting requirements and to further efforts to reduce and prevent improper payments.

## ***VII. AGENCY INFORMATION SYSTEMS AND INFRASTRUCTURE***

**USF** Under the Commission's oversight, USAC has expanded outreach designed to prevent the errors identified in the PQA process from reoccurring, enhanced internal controls and data collection to gain greater visibility into payment operations, calibrated audit and audit follow-up activities to gain greater certainty about beneficiary support, and modernized information technology systems to achieve greater efficiencies and improve reporting capabilities. As discussed above, USAC has also increased the number of employees and resources to perform reviews of audit findings and recovery of funds.

**TRS** As the new TRS administrator, RLSA implemented a payment recapture audit program as part of its overall program of effective internal control over disbursements. The payment recapture audit program includes preventive and detective controls to ensure payments are legal, accurate, and consistent with IPERA. The Commission is working with the TRS administrator to ensure sufficient information systems and infrastructure is in place to effectively carry out the program.

## ***VIII. BARRIERS***

No barriers to be reported at this time.



## OFFICE OF INSPECTOR GENERAL

### MEMORANDUM

**DATE:** October 12, 2012  
**TO:** Chairman  
**FROM:** *Sharon A. Quinn*  
for Inspector General  
**SUBJECT:** Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000, the Office of Inspector General ("OIG") is submitting its annual statement summarizing our assessment of the most serious management challenges facing the Federal Communications Commission ("FCC") in Fiscal Year ("FY") 2012 and beyond.

During our audits and investigations we have worked with managers in the FCC in recommending actions that best address these challenges. More information on this can be found in our last Semiannual Report to Congress.

#### Universal Service Fund ("USF") Program

The Telecommunications Act of 1996 created the framework for the Universal Service Fund, ("Fund") which consists of support mechanisms for: (1) providing financial support to eligible telecommunications carriers that serve high-cost areas; (2) assisting schools and libraries with telecommunications and internet services; (3) assisting low-income consumers with being able to afford telephone service; and (4) assisting rural health care providers with access to telecommunications and internet services. The Fund is administered by the Universal Service Administrative Company. The Office of Inspector General has ongoing audits and is supporting investigations addressing allegations of fraudulent activity involving the Fund.

Changes in all of the USF programs, including contributions, along with implementation of the Connect America Fund will require a significant investment of Commission resources. Establishing direction and policy, managing transition, and ensuring that all USF program rules and regulations contribute to effective and efficient programs is a significant management challenge.

### **Telecommunications Relay Service ("TRS") Fund**

The TRS Fund, which encompasses video relay services ("VRS") was established to compensate service providers for their estimated costs of providing interstate telephone transmission services that enable a person with a hearing or speech disability to communicate with a person who does not have a hearing or speech disability. Distributions from the TRS Fund have grown substantially over the years, with especially significant increases in more recent years.

The OIG continues to receive allegations of fraud and is supporting investigations and audits to address these allegations. The OIG has also provided input to the Commission as they continue to address fraudulent activity and programmatic shortcomings. Over the last year, OIG (and the Commission) became aware of problems in the provision of IP Relay service. A significant amount of IP Relay calls billed to the TRS Fund were calls by hearing people (many of them not located in the United States) attempting to purchase merchandise using stolen credit cards. We recognize that many positive steps have been taken to address issues in the provision of VRS and IP Relay. We recognize that the Commission has taken many positive remedial steps thus far. As the program remedies are on-going, however, fraud prevention remedies are the subject of petitions for reconsideration and waivers. As we continue to receive new allegations of fraudulent TRS activity, we believe much remains to be done. In addition, as a result of our audits and evaluations, we find that VRS providers are non-compliant in reporting actual costs in their annual filing statements as well as abusing the program. Accordingly, we believe that improving the oversight of the TRS program remains a significant management and performance challenge.

### **Innovation at the FCC**

The FCC depends upon its information systems and the information within them to effectively and efficiently accomplish its mission. Additionally, The FCC, along with the rest of the federal government, is being asked to use technology to a greater extent in order to reduce costs and, at the same time, achieve greater productivity, for example, moving to cloud computing. Expectations are high that the use of Web 2.0 technologies will increase citizen participation in government through better communication, along with providing greater government transparency. This all reflects rapid technological change, which introduces both risks and rewards. One of the major challenges with this rapid change is the proper implementation, management, and oversight of these new technologies, which have inherent, and constantly evolving, information security risks.

For several years, the FISMA evaluations conducted by our independent auditors have repeatedly reported numerous security weaknesses in the Commission's information technology infrastructure. Management must prioritize the remediation of these issues to ensure that the Commission's systems and data are adequately protected.

During FY 2012 the Commission substantially completed the majority of issues encountered during the implementation of its core financial management system, GENESIS. GENESIS has significantly improved the Commission's financial reporting structure by integrating key

FCC systems. However, it did not remedy the long standing internal control weaknesses and non-compliance issues regarding the lack integration with the FCC reporting components (i.e., the Universal Service Fund, the Telecommunications Relay Service Fund, and the North American Numbering Plan). Additionally, after the completion of the GENESIS implementation certain functionality issues with the accounts receivable portion of the revenue module continue to exist. The lack of integration and the accounts receivable functionality issue causes the Commission to be non-compliant with Federal Manager's Financial Integrity Act (FMFIA) as it relates to section 4 non-compliance with GAO's standards for Internal Control in the Federal Government and OMB Circular A-127 Financial Management Systems and the Debt Collection Improvement Act (DCIA). The commission should continue to commit resources to address these weaknesses and non-compliances.

cc: Zachary Katz, Chief of Staff  
David B. Robbins, Managing Director  
Mark Stephens, Chief Financial Officer



*Office of the Managing Director*

**MEMORANDUM**

**DATE:** November 14, 2012

**TO:** David L. Hunt, Inspector General

**FROM:** David B. Robbins, Managing Director and Mark Stephens, Chief Financial Officer

**SUBJECT:** Management's Response to Inspector General's Management and Performance Challenges

Management appreciates the Office of the Inspector General's (OIG) assessment of the most serious management challenges facing the Federal Communications Commission (Commission or FCC) for fiscal year (FY) 2012 and beyond. In its October 12, 2012 memorandum, the OIG identifies several management challenges facing the Commission. First, OIG states that establishing direction and policy, managing transition, and ensuring all Universal Serviced Fund (USF) program rules and regulations contribute to effective and efficient programs is a significant management challenge. Second, OIG states that oversight of the Telecommunications Relay Services (TRS) program remains a significant management and performance challenge. Third, OIG states that proper implementation, management, and oversight of new technologies are major challenges at the Commission. Finally, OIG reports that, although that the FCC's new core financial management system – GENESIS – has significantly improved the Commission's financial reporting structure, the new system did not remedy internal control weaknesses and non-compliance issues regarding the lack of integration with FCC reporting components (*e.g.*, universal service fund, TRS, and North American Numbering Plan).

While, as described below, strides have been made in a number of these very important areas, management concurs with the OIG's conclusion that these areas remain significant challenges, and will continue its efforts in the upcoming year to address and resolve these challenges.

First, the Commission continues to work closely in its role as overseer of the Universal Service Administrative Company (USAC) to monitor its implementation of these and other initiatives. The Commission also coordinates with state commissions, consumer groups, tribal governments, and telecommunications providers to provide feedback to better implement its directives. Below is a list of actions taken by the Commission throughout FY 2012 to address the challenges identified by OIG of establishing direction and policy, managing transition, and ensuring all USF program rules and regulations contribute to effective and efficient programs.

- Completion of 99 audits by USAC, which is indicative of the heavy emphasis that is placed on resolving management and performance challenges.
- Expansion and intensification of efforts to recapture improper payments. Specifically, the FCC is implementing a plan which separates improper payment assessment from the USF compliance audit program, and which both improves and streamlines the audit review process. The revised recapture plan is consistent with the Improper Payments Elimination and Recovery Act, the Improper Payments Information Act, and Office of Management and Budget (OMB) guidance. The Commission's Office of the Managing Director (OMD) oversees these efforts.
- Examination by USAC, per Commission direction, of the results of the audits and assessment programs conducted for FY 2012 and implementation of a corrective action plan in response to any findings, consistent with OMB Circular A-123 and OMB Circular A-50 (provides policies and procedures for use by executive agencies when considering reports issued by the Inspectors General, other executive branch audit organizations, the General Accounting Office, and non-Federal auditors where follow up is necessary).
- Pursuit of wrongdoers who sought to defraud the USF in coordination with USAC and the Department of Justice (DOJ). In FY 2011, these efforts yielded cash recoveries of approximately \$215,000 and the relinquishing of \$400,000 in commitments that had not yet been paid out. The Commission continues to support DOJ in seeking criminal convictions and civil judgments against defendants charged with E-rate and other USF fraud. The FY 2012 caseload consisted of several active cases. In addition, the Commission monitored five parties participating in USF programs under compliance agreements.

#### High-Cost

- Adoption of an Order and Further Notice of Proposed Rulemaking (USF/ICC Transformation Order) that comprehensively reforms and modernizes the high-cost universal service system. The order adopts fiscally responsible, accountable, incentive-based policies to transition an outdated and inefficient high-cost program into the Connect America Fund. Among other matters, in the USF/ICC Transformation Order the Commission took the following action:
  - Adoption of the following performance goals in the Commission's efforts to preserve and advance service in high cost, rural, and insular areas: (1) preservation and advancement of universal availability of voice service; (2) ensuring universal availability of modern networks capable of providing voice and broadband service to homes, businesses, and community anchor institutions; (3) ensuring universal availability of modern networks capable of providing mobile voice and broadband service where Americans live, work, and travel; (4) ensuring that rates are reasonably comparable in all regions of the nation, for voice as well as broadband services; and (5) minimization of the universal service contribution burden on consumers and businesses. The Commission also adopted performance measures for the first, second, and fifth of these goals, and sought comment on measures for the other goals.
  - Establishment of a uniform national framework for information that eligible telecommunications carriers (ETCs) must report to their respective states and to the Commission, to improve accountability from companies receiving high-cost support to ensure that public investments are used wisely to deliver intended results. The Commission modified and extended its existing federal reporting requirements to all ETCs, whether designated by a state or this Commission, to reflect the new public interest obligations adopted in the order. The Commission also simplified and consolidated its existing

certification requirements and adopted new certifications relating to the public interest obligations adopted in the order

- Adoption of four orders on reconsideration and four orders by the Wireline Competition Bureau (WCB), subsequent to the USF/ICC Transformation Order, which, among other things, clarified, amended, and eliminated several high-cost rules. These orders have ensured that the high-cost rules contribute to an effective and efficient program.
- Completion of the Mobility Fund Phase I auction, in which carriers became eligible to receive nearly \$300 million in one-time support to provide 3G or better mobile voice and broadband services in 31 states.
- Establishment of regularly scheduled coordination meetings with USAC to discuss implementation of high-cost reforms.
- Increasing the number of staff and managers working on implementing reform of the high-cost program.

#### Low Income

- Adoption of the Lifeline Reform Order in January, 2012 to reform and modernize the Lifeline program. The Order is in response to a November 2010 Federal-State Joint Board Recommended Decision and subsequent March 2011 Notice of Proposed Rulemaking. The Bureau estimates that the reforms adopted in the Lifeline Reform Order will save the Universal Service Fund \$200 million in 2012.
- Direction to USAC to initiate in-depth data validations (IDVs) to eliminate duplicative Lifeline support. As of September 30, 2012, USAC has completed duplicate IDVs in 19 states. Overall, USAC analyzed more than 7 million Lifeline subscriber records. Among these, approximately 630,000 or 8% were duplicates, i.e., subscribers who received Lifeline service from more than one eligible telecommunications carrier. These subscribers were notified and were asked to select a single Lifeline provider. The carrier that was not selected as the consumer's Lifeline service provider was required to de-enroll that consumer from Lifeline-discounted service. In total, USAC has directed carriers to de-enroll more than 700,000 consumers. This action will result in a savings to the federal universal service fund of \$6.8 million per month, or \$82 million annually.
- Instruction to USAC to continue the IDV process until USAC put in place the National Lifeline Accountability Database to eliminate duplicative support and prevent incidences of duplicative support in the future. The database will prevent multiple carriers from receiving support for the same subscriber and streamline the process of verifying consumers' initial and ongoing eligibility for the program, significantly reducing burdens on carriers and improving protections against waste and fraud. It will also reduce burdens on consumers participating in the program. It is expected that this database will be operational in FY 2013.
- Adoption, in response to recommendations from the Government Accountability Office (GAO) and the Federal State Joint Board Recommended Decision, of several specific measures to improve program integrity and ensuring that the Lifeline program is meeting its objectives including performance goals and measures, revised certification and verification rules and revised audit requirements.



- Direction to USAC, pursuant the Lifeline Reform Order, to transition the Low Income Fund from projected disbursements to actual disbursements. The transition to actual disbursements was completed in October 2012.
- Direction to USAC, pursuant to the Lifeline Reform Order, to review and revise the Beneficiary Contributor Compliance Audit Program (BCAP) and Payment Quality Assurance Program (PQA) to take into account changes made in the Order.
- Establishment of regularly scheduled coordination meetings with USAC to discuss implementation of low income reforms.

### Schools and Libraries

- Expansion and intensification efforts to resolve outstanding E-rate appeals, resulting in the release of more than 80 orders addressing almost 700 outstanding appeals.
- Provision of guidance to USAC and E-rate applicants on how schools that are piloting the new Community Eligibility Option in the National School Lunch Program will qualify for E-rate funding.
- Release of a public notice seeking comment on the bundling of non-eligible products or services with products or services eligible for E-rate discounts.
- Release of an order in December 2011 clarifying that the Commission's competitive bidding rules prohibit applicants from including a particular manufacturer's name, brand, product or service in an FCC Form 470 or request for proposals (RFPs) unless they also use the words "or equivalent" in such a description.
- Release of an order in September 2012, simplifying and clarifying the Eligible Services List for the E-rate program.
- Issuance by the Commission of five suspension orders and six debarment orders against seven individuals regarding the E-rate program after they were convicted of engaging in fraud or similar criminal acts related to the schools and libraries support mechanism.
- Attendance by Commission staff at all eight of the USAC E-rate trainings for applicants and service providers to ensure that guidance given during the training sessions was consistent with Commission rules and orders.
- Instruction to USAC, in response to a recommendation from the GAO, to conduct a robust risk assessment of the E-rate program. The assessment must consider, among other things, the top five findings from the last five rounds of E-rate audits and their impact on meeting program objectives. The RFP for the risk assessment is now pending.
- Analyzed the operational support contract for schools and libraries and rural health care programs, and directed USAC to implement changes to save \$4.1 million in administrative costs (about 10% of the total contract).

### Rural Health Care

- Issuance of a Staff Report evaluating the Rural Health Care Pilot Program in August 2012. The Commission stated publicly that it expects to issue a Report and Order in the Rural Health Care reform rulemaking by the end of 2012.

### Contributions

- Issuance of a Further Notice of Proposed Rulemaking (FNPRM) seeking comment on various proposals for reforming the universal service contribution system. The FNPRM included potential rule changes that would reduce the costs associated with complying with contribution obligations and promote the transparency and clarity of the contribution system. The FNPRM also sought comment on ways to improve administration of the contribution system, such as setting performance goals for timely reporting by contributors and prompt payment of contributions.
- The FNPRM also tees up resolution of various USAC requests for guidance on how to treat certain service offerings for USF contributions purposes.
- Resolution of several contributor appeals clarifying contribution requirements, including issues involving revenue reporting for universal service assessment purposes.
- Issuance of five enforcement actions against companies that failed to comply with universal service filing and contribution payment rules. These actions included issuing a Notice of Apparent Liability that imposed a monetary forfeiture in excess of \$960,000 against Kajeet Inc. and Airlink, LLC. In addition, the Commission issued a Notice of Apparent Liability imposing a monetary forfeiture in excess of \$1.7 million against Telseven.
- Implementation of two consent decrees with USF contributors Bay Springs, Inc. and Telrite. These two agreements resulted in \$541,000 in voluntary contributions to the U.S. Treasury.

Second, with regard to the significant challenge of oversight of the TRS program, during the past fiscal year, the Commission has further strengthened its efforts to improve oversight the TRS program, which include

- Calculation by the TRS Fund administrator of a baseline error rate for improper payments under an alternative statistical sampling methodology consistent with Circular A-123, and in coordination with OMB. This is the first year that the TRS Fund must calculate a baseline error rate. Therefore, the plan includes a robust testing of internal controls. The following attributes were tested for 100% of distributions for the period of July 1, 2011 through June 30, 2012. This included 148 distributions to service providers, totaling \$606,856,572.86. The resulting error rate for improper payments is 0%.
- Initiation by the TRS Fund Administrator of compliance audits of all service providers eligible to receive reimbursement from the TRS Fund. Each audit will be a risk-based performance audit driven by the inherent risks for the service provider and service category. The Commission will follow-up on all findings and recommendations to improve the TRS program in order to reduce improper payments to providers due to issues of waste, fraud, and abuse, rather than issues with the internal controls of the administrator.

- Issuance by the OIG for FY 2012 of ten audits reports of TRS Fund Program Video Relay Service (VRS) providers conducted by an independent audit firm. The objective of these audits was to determine whether the cost data submitted by VRS providers to the TRS Fund Administrator for calendar years 2008, 2009, and 2010 were in compliance with Commission's rules and supported by adequate documentation. The audits found that the VRS providers did not fully comply with the applicable rules and regulations, however, no monetary recovery was recommended because the amount was determined to be de minimus. Corrective actions have been taken by the VRS providers to report true and accurate data, as well as the Commission staff continues to implement structural reforms in the TRS Fund Program. Moreover, OIG has completed five more audits of VRS providers that focus on the use of VRS revenue received by provider to determine whether funds were spent on activities and cost objectives that were related to the VRS program. The Commission intends to follow up on these audits as well.
- Release of a Memorandum Opinion and Order, Order, and Further Notice of Proposed Rulemaking in October 2011, clarifying and further strengthening the certification process for VRS provider applicants (FCC 11-155).
- Adoption of a Report and Order in June 2012, which curbs the misuse of Internet Protocol Relay Service (IP Relay). Specifically, the Commission now prohibits IP Relay providers from handling non-emergency calls made by new IP Relay registrants prior to taking reasonable measures to verify their registration information (FCC 12-71).
- Prosecution of multiple individuals for fraudulent submissions to the TRS Fund for payment. As of September 4, 2012, 13 individuals and one corporation have been sentenced to penalties including jail, probation, and \$80.5 million dollars in restitution to be paid to the U.S. government. Several other defendants have been similarly convicted and are awaiting sentencing.

Third, in addressing the challenges of proper implementation, management, and oversight of new technologies the Commission continues its efforts to transition to new technologies with proper implementation, management, and oversight. For example, to effectively and efficiently transition to Web 2.0, the Commission has, among other things, formed a multi-bureau team to review and assess the new and developing Web 2.0 technologies, implemented Web 2.0 tools such as blogs, Facebook, Twitter, and Userve to encourage public involvement and feedback, and implemented the use of cloud computing to help manage costs.

As noted by the OIG, new technologies are not without information security risks. The FCC's Cyber Security program must, therefore, keep pace with the adversary's technological advances or face egregious harm to its network and reputation. To keep pace, the FCC has developed a comprehensive, risk-based approach to protect and support our missions, including protections against information technology (IT) risks associated with cyber security, IT culture change, and technology roll out. Efforts under this initiative include implementation of an IT audit tracking and accountability system designed to examine, identify, and correct information security risks. To support this audit tracking and accountability system, the FCC has also assembled a new IT audit team, including a program manager with extensive cyber security experience. The FCC has further increased its investment in IT infrastructure security, programming services security, and cyber security tools, such as data leak detection and blocking, web surfing blocking, and real time virus protection. Moreover, the FCC has added to its IT staffing, creating 8 new IT positions and hiring an experienced chief information security officer to assist with implementing the FCC's comprehensive cyber security initiatives. In addition, the

FCC has conducted rigorous cyber security instruction to its employees throughout the year, including agency-wide training and participation in training events with other agencies, such as the Department of Homeland Security.

Although, as OIG found, the FCC's new core financial management system, GENESIS, has significantly improved the Commission's financial reporting structure, internal control weaknesses and non-compliance issues remain concerning the lack of integration with FCC reporting components (*e.g.*, Universal Service Fund, Telecommunications Relay Service Fund, and the North American Numbering Plan) and accounts receivable functionality. Concerning integration with other FCC components, OMD has made progress in implementing a standard format that each reporting component uses to submit financial data to the FCC. These files are integrated into Genesis for use in financial reporting. In FY 2013, OMD will increase efforts to develop a reporting solution that will automate the compilation of financial data in an efficient and effective manner that is compliant with both OMB and GAO standards. OMD has also continued to make progress in resolving accounts receivable functionality issues related to Debt Collection Improvement Act (DCIA) compliance. Genesis is now able to create the proper dunning letters and we are successfully printing and mailing letters that were in our backlog, and will resolve all outstanding letters by calendar year end. Further, upon completion of testing the Genesis FedDebt file with the Department of Treasury (Treasury Department), debt referral compliance will be finalized. Lastly, OMD established a new Agency Location Code solely for the use of FCC reporting components so their debts can be referred to the Treasury Department in a timely and efficient manner as well.

Management looks forward to working with OIG to continue to address challenges to the Commission's operations and to further strengthen the culture of integrity, accountability, and excellence that exists at the Commission.



David B. Robbins, Managing Director  
Office of Managing Director



Mark Stephens, Chief Financial Officer  
Office of Managing Director