



FEDERAL COMMUNICATIONS COMMISSION

Fiscal Year 2013 Agency Financial Report

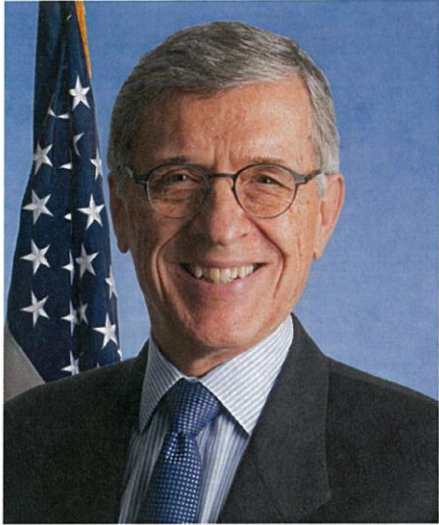
(October 1, 2012 – September 30, 2013)

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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) 2013. 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 eighth consecutive year, the FCC has obtained an unmodified 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 \$440 million in FCC operating expenses and more than \$9.1 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.

Recently sworn in as the 31st Chairman on November 4, I am pleased to provide my vision for the FCC. During my confirmation hearing I described myself as "an unabashed supporter of competition because competitive markets produce better outcomes than regulated or uncompetitive markets." Yet we all know that competition does not always flourish by itself; it must be supported and protected if its benefits are to be enjoyed. This agency is a pro-competition agency and we stand for the things that are important regardless of the network technology being used:

- **To promote economic growth** – technological innovation, growth, and national economic leadership have always been shaped by our networks; competition drives the benefits of those networks; and we have a responsibility to see to the expansion of those networks, including the appropriate allocation of adequate amounts of spectrum.
- **To maintain the historic compact between networks and users** – a change in technology may occasion a review of the rules, but it does not change the rights of users or the responsibilities of networks.
- **To make networks work for everyone** – it is not just that we expand high-speed Internet, but what we will be doing with that capacity. How networks enable a 21st century educational system, enable the expansion of capabilities for Americans with disabilities, and assure diversity, localism, and free speech are basic underpinnings of our responsibility.

In addition, improving agency processes and procedures to more efficiently and effectively serve the public interest is a top priority. We have already begun the process of developing a plan, to be completed within 60 days from the beginning date of my Chairmanship, that includes recommendations on how best to tackle the challenge of reforming FCC processes. As part of this effort, we have sought public input on improving the efficiency of how we conduct business here at the FCC, including concrete steps the FCC can take to: (1) streamline, update, and eliminate inefficient, outdated, or duplicative processes; (2) improve the effectiveness of communications between the public and the FCC; (3) make information collections and reports more focused, transparent, and relevant; (4) expand the overall transparency of the workings of the agency; and (5) we will look at any other ideas to improve the focus, speed, and

efficiency of the FCC's workflows. This is only the beginning of this round of process reform efforts at the FCC, which builds on the many steps taken in past years. We plan to have an ongoing dialogue both internally and externally about what the agency can do to be more responsive, efficient, and effective.

These are important days in determining the future of our networks and their effect on our commerce and our culture. Throughout the upcoming year, I look forward to reporting on the Commission's efforts in accomplishing the critical work toward achieving my vision for the FCC.

A handwritten signature in black ink, appearing to read 'Tom Wheeler', with a large, sweeping flourish extending to the right.

Tom Wheeler
Chairman
December 13, 2013

1. Management's Discussion and Analysis

(Unaudited)

Overview of the FCC

INTRODUCTION

Revised OMB Circular No. A-136, released on October 21, 2013, states that agencies may choose to produce either a consolidated Performance and Accountability Report or a separate Agency Financial Report (AFR) with 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 FCC will include its FY 2013 APR with its Congressional Budget Justification and will post it on the Commission's website at <http://transition.fcc.gov/omd/strategicplan/> by February 17, 2014.

The AFR includes three sections. AFR Section 1 contains Management's Discussion and Analysis (MD&A) which presents an overview of the FCC, including the agency's mission and organizational structure, map of field offices, strategic goals, strategies and resources to achieve goals, components for financial statement purposes, eliminating and recovering improper payments, performance highlights, management assurances, discussion of the financial management systems strategy, 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' reports, the Commission's response to the independent auditors' reports, the consolidated financial statements, the notes to the financial statements, and required supplementary information.

AFR Section 3 presents other 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 are:

- Chairman Tom Wheeler
- Commissioner Mignon Clyburn
- Commissioner Jessica Rosenworcel
- Commissioner Ajit Pai
- Commissioner Michael O’Rielly



Pictured from left to right are Commissioner Pai, Commissioner Clyburn, Chairman Wheeler, Commissioner Rosenworcel, and Commissioner O’Rielly.

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.”¹ 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.”²

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

¹ 47 U.S.C. § 151.

² *Id.*

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 policies affecting Tribal nations. 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** enforces FCC rules and the Communications Act. 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 promotes pro-competitive policies abroad, coordinates the Commission's global spectrum activities, and advocates 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** recommends, develops, and administers the policy and licensing programs relating to electronic media, including radio and broadcast, cable, and satellite television in the United States and its territories.
- **The Public Safety and Homeland Security Bureau** supports initiatives that strengthen public safety and emergency response capabilities to better enable the FCC to assist the public, law enforcement, hospitals, the communications industry, and all levels of government in the event of a natural disaster, pandemic, or terrorist attack.
- **The Wireless Telecommunications Bureau** is responsible for wireless telecommunications programs and policies in the United States and its territories, including licensing of wireless communications providers. Wireless communications services include cellular, paging, personal communications, and other radio services used by businesses and private citizens. The Bureau also conducts auctions of licenses for the communications spectrum.
- **The Wireline Competition Bureau** develops and recommends policy goals, objectives, programs, and plans concerning wireline telecommunications (e.g., telephone landlines, and fixed - as opposed to mobile - broadband), striving to ensure choice, opportunity, and fairness in promoting the development and widespread availability of such communications services. The Bureau has particular responsibility for the Universal Service Fund, a public-private partnership that helps connect all Americans to communications networks.

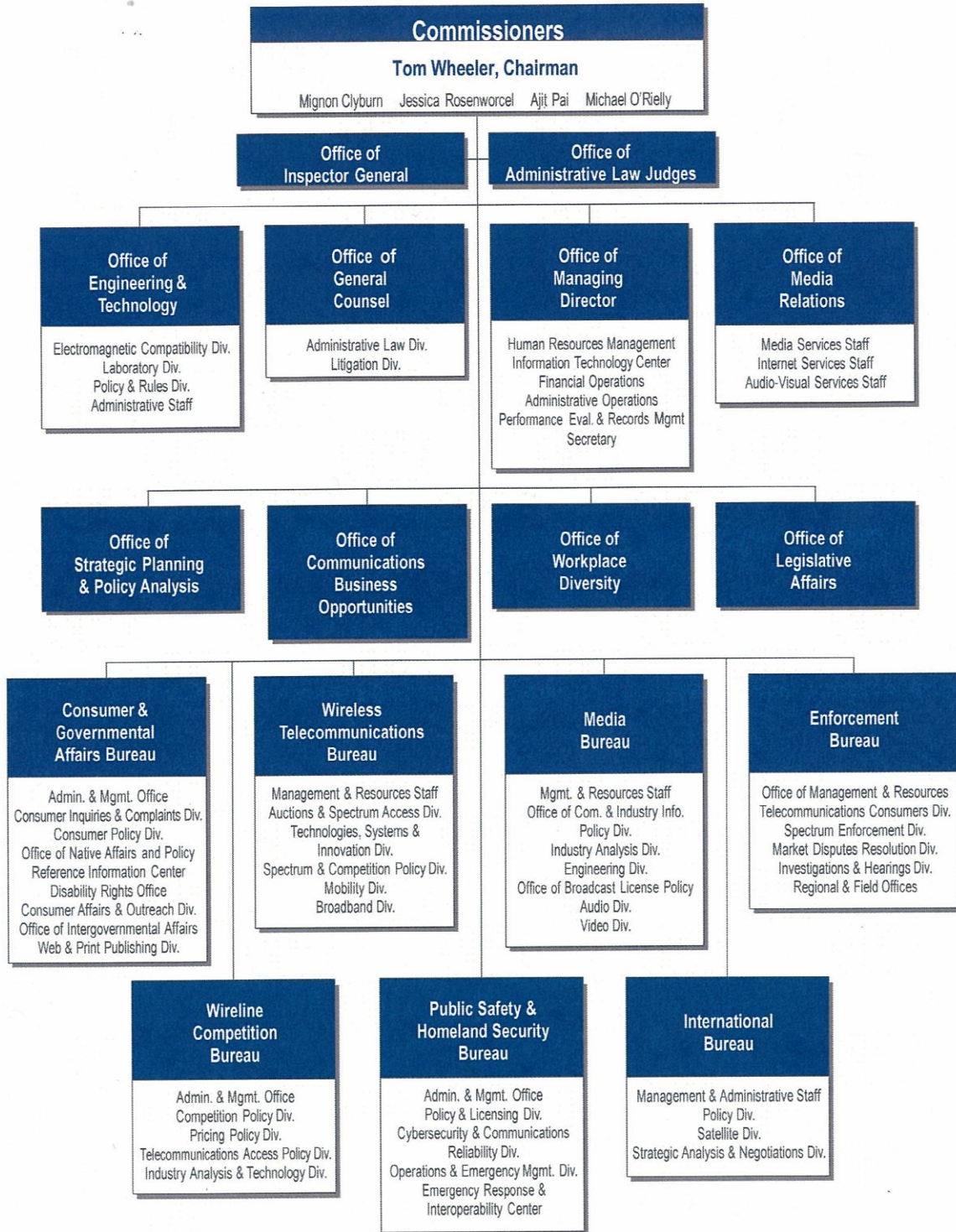
The Offices

- **The Office of Administrative Law Judges** is composed of judges who preside over hearings and issue decisions on matters referred to them 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** promotes competition and innovation in the provision and ownership of telecommunications services by supporting opportunities for small businesses as well as women- and minority-owned communications businesses.
- **The Office of Engineering and Technology** advises the Commission on technical and engineering matters. This Office develops and administers FCC decisions regarding spectrum allocations, and grants equipment authorizations and experimental licenses.
- **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 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 in strategic planning and policy development for the agency. It also provides research, advice, and analysis of complex, 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 FCC 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."³ 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."⁴ The FCC's strategic goals for FY 2013 are shown below.

Strategic Goal 1: Connect America

Maximize Americans' access to – and the adoption of – affordable fixed and mobile broadband where they live, work, and travel.

Strategic Goal 2: Maximize Benefits of Spectrum

Maximize the overall benefits of spectrum for the United States.

Strategic Goal 3: Protect and Empower Consumers

Empower consumers by ensuring that they have the tools and information they need to make informed choices; protect consumers from harm in the communications market.

Strategic Goal 4: Promote Innovation, Investment, and America's Global Competitiveness

Promote innovation in a manner that improves the nation's ability to compete in the global economy, creating a virtuous circle that results in more investment and in turn enables additional innovation.

Strategic Goal 5: Promote Competition

Ensure a competitive market for communications and media services to foster innovation, investment, and job creation, and to ensure consumers have meaningful choice in affordable services.

Strategic Goal 6: Public Safety and Homeland Security

Promote the availability of reliable, interoperable, redundant, rapidly restorable critical communications infrastructures that are supportive of all required services.

Strategic Goal 7: Advance Key National Purposes

Through international and national interagency efforts, advance the use of broadband for key national purposes.

Strategic Goal 8: Operational Excellence

Make the FCC a model for excellence in government by effectively managing the Commission's human, information, and financial resources; by making decisions based on sound data and analyses; and by maintaining a commitment to transparent and responsive processes that encourage public involvement and best serve the public interest.

³ 47 U.S.C. § 151.

⁴ *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/encyclopedia/fcc-strategic-plan>.

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.⁵

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.⁶

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 2013, the USF accounted for approximately \$9 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.

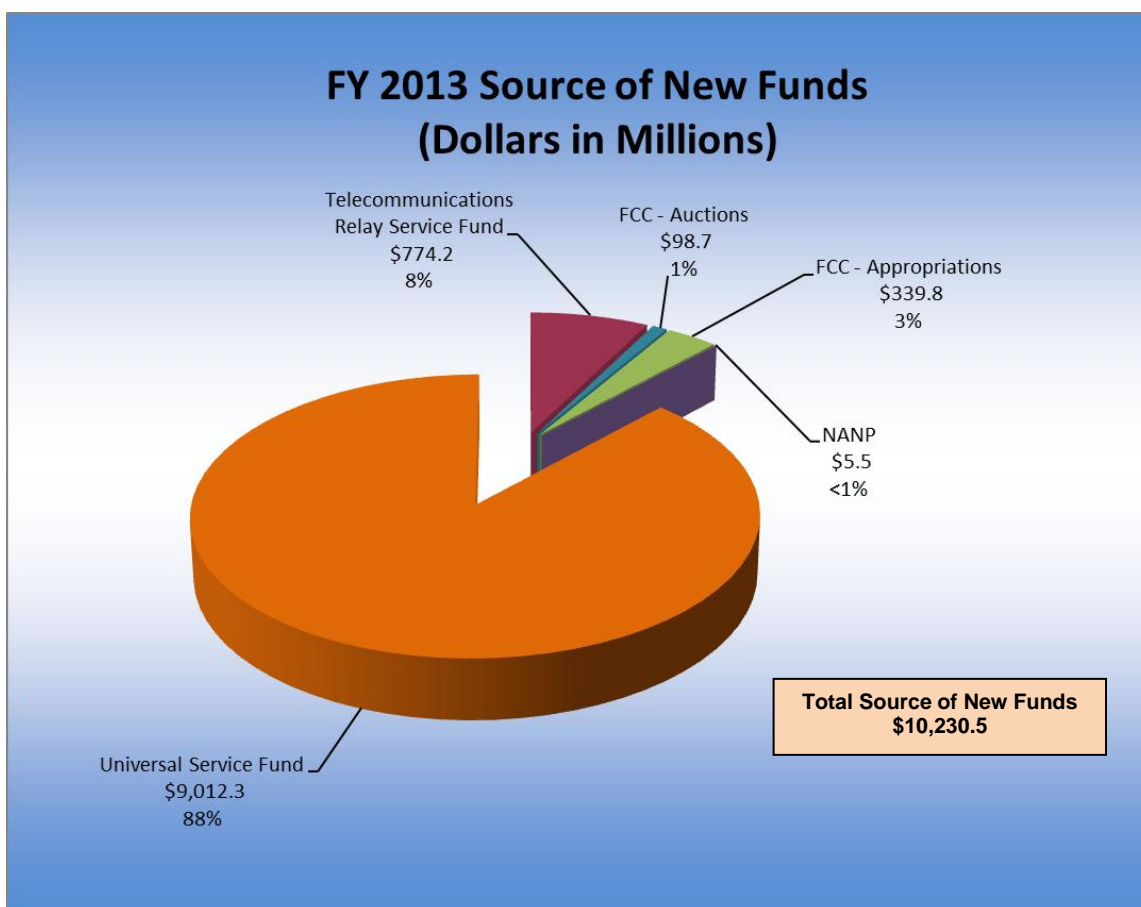
Rolka Loube Saltzer Associates, LLC (RLSA) is the administrator for the TRS Fund. The TRS Fund compensates TRS providers for the reasonable costs of providing interstate telephone transmission services that enable a person with a hearing or speech disability to communicate with a person without hearing or speech disabilities. The costs of providing interstate TRS are recovered from subscribers of interstate telecommunications services. In FY 2013, TRS accounted for approximately \$774.2 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.r-l-s-a.com/> and <http://www.fcc.gov/cgb/dro/trs.html>.

⁵ 47 U.S.C. § 254.

⁶ 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 2013, the NANP accounted for approximately \$5.5 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. The total appropriations amount available to the commission was reduced by \$17.1 million due to the FY 2013 sequestration order implemented on March 1, 2013, and required by the Budget Control Act of 2011. (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

The Federal Communications Commission's (FCC's) eight strategic goals serve as guidance directing the actions and performance of the agency. 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 2013. The Commission will include the FY 2013 APR with its Congressional Budget Justification and will post it on the Commission web site at <http://www.fcc.gov/> in February 2014. In the discussion below, we identify achievements in the Commission's major initiatives during the past fiscal year, organized by Strategic Goal.

CONNECT AMERICA

Maximize Americans' access to – and the adoption of – affordable fixed and mobile broadband where they live, work, and travel.

Robust, affordable broadband has become essential to access jobs, education, and economic opportunity. For jobs, over 80 percent of Fortune 500 companies today require online job applications. Also, students with broadband at home have a 7 percent higher graduation rate. However, low-income households adopt broadband at much lower rates than the average household. Fewer than 36 percent of families with incomes less than \$25,000 subscribe to broadband at home, compared to nearly 92 percent of families with incomes over \$75,000, according to the U.S. Census Bureau.

The FCC announced that savings from its comprehensive reform of its Lifeline program reached nearly \$214 million in 2012, surpassing the \$200 million target the FCC set when it reformed the program. The FCC also announced the selection of 14 pilot projects in 21 states and Puerto Rico that will field test approaches to using Lifeline to increase broadband adoption among low-income Americans, providing broadband for nearly 75,000 low-income consumers who now lack service.

Up to 600,000 homes and small businesses that lack broadband will get access as a result of additional support from the FCC's Connect America Fund. The Commission created the Connect America Fund to unleash the benefits of 21st century broadband communications in communities where there are insufficient market incentives to expand broadband service absent a joint public-private effort. Key reforms allowed Connect America to expand support to both broadband and voice without increasing universal service fees on consumers and businesses. Providers in 44 states and Puerto Rico requested over \$385 million from the Fund, which will be matched with hundreds of millions of their own dollars in many areas, to quickly expand broadband infrastructure to rural communities in every region of the nation. Deployment must be completed within three years.

FCC Chairman Julius Genachowski announced that the Commission will kick-off a government-wide effort to increase speeds and alleviate Wi-Fi congestion at major hubs, such as airports, convention centers, and large conference gatherings. In addition, this would also increase speed and capacity for Wi-Fi in the home where multiple users and devices are often on the network at the same time. This will increase and free up the unlicensed spectrum available for ultra-high-speed, high-capacity Wi-Fi - known as “Gigabit Wi-Fi” - by up to 35 percent. This effort will enable higher data speeds and greater capacity, most notably improved HD video distribution capability.

At the U.S. Conference of Mayors Winter Meeting, Chairman Genachowski called for at least one gigabit community in all 50 states by 2015. Gigabit communities spur innovators to create new businesses and industries, spark connectivity among citizens and services, and incentivize investment in high-tech industries. Today, approximately 42 communities in 14 states are served by ultra-high-speed fiber Internet providers, according to the Fiber to the Home Council.

The FCC released the results of its ongoing nationwide performance study of residential broadband service in its third “Measuring Broadband America” report. This year’s report reveals that most broadband providers continue to improve service performance by delivering actual speeds that meet, or exceed, advertised speeds during the past year and that consumers are subscribing to faster speed tiers and receiving faster speeds than ever before. FCC analysis indicates that the improvements of Internet Service Providers in meeting their advertised speeds were largely driven by improvements in network performance, and not downward adjustments to the speed tiers offered. Nearly half of consumers who subscribed to speeds of less than 1 Mbps six months ago have adopted higher speeds, and nearly a quarter of the users who subscribed to speeds between 1 Mbps and 3 Mbps have upgraded to faster speed tiers.

As the nation’s demand for wireless broadband service continues to grow at a rapid pace, the FCC continues its work to remove barriers to the deployment of infrastructure that supports such service. The Commission adopted a Notice of Proposed Rulemaking (NPRM) initiating a review of its wireless infrastructure policies. The NPRM builds upon the Broadband Acceleration Initiative, including a 2011 Notice of Inquiry seeking comment on measures needed to reduce obstacles to obtaining access to rights-of-way and locations for wireless facilities. The NPRM sought comment on (1) streamlining the environmental and historic preservation review processes for newer technologies; (2) removing barriers to the deployment of temporary towers that are used in cases of emergencies or to add capacity during short term events; (3) the meaning of terms included in a provision of the Middle Class Tax Relief and Job Creation Act of 2012 which states “a State or local government may not deny, and shall approve, any eligible facilities request for a modification of an existing wireless tower or base station that does not substantially change the physical dimensions of such tower or base station;” and (4) clarification of issues addressed in the Commission’s “shot clock” order which set time periods for state and local governments to complete review of wireless siting applications. Increasing certainty in the FCC’s processes and removing barriers to infrastructure deployment will spur public and private investment, while expanding wireless coverage and capacity throughout the nation.

MAXIMIZE BENEFITS OF SPECTRUM

Maximize the overall benefits of spectrum for the United States.

The Commission took actions significantly advancing the President’s goal of freeing up 500 MHz of spectrum for broadband by 2020. They approved freeing up 40 MHz of underutilized satellite spectrum for land-based mobile broadband, including 4G LTE. This was accomplished by removing regulatory barriers that limited this spectrum to satellite use. The Commission also unanimously approved a

proposal setting the stage for an auction of H Block spectrum (1915-1920 MHz and 1995-2000 MHz). Proceeds from this auction will help fund a nationwide Public Safety Network for first responders and reduce the deficit. Carefully balanced technical requirements will unlock tremendous value in both of these frequency bands, which Congress directed the FCC to auction.

The FCC adopted revised rules to enable Wireless Communications Service (WCS) licensees to use a total of 30 megahertz of underutilized spectrum in the 2.3 GHz band for wireless broadband services, while protecting the adjacent Satellite Digital Audio Radio Service (SDARS) operator, Sirius XM Radio, against harmful interference. The revised rules are consistent with a compromise proposal between AT&T Inc. and Sirius XM designed to facilitate the efficient deployment and coexistence of the WCS and SDARS.

The Commission proposed to make available 100 megahertz of shared spectrum in the 3.5 GHz Band using small cell and database technologies. The NPRM broadly reflects the innovative thinking of the President's Council of Advisors on Science and Technology, which issued a report recommending spectrum sharing and small cell use in the 3.5 GHz Band. It also builds upon the FCC's previous work to free up spectrum by promoting spectrum sharing and enabling innovative licensing techniques. The proposal lays the groundwork for the widespread deployment of small cell technologies and would spur significant innovation in wireless technologies and applications while protecting incumbent users in the band.

Chairman Genachowski announced the winners of America's first Mobility Fund auction. This market-based policy innovation was part of the Commission's once-in-a-generation reform of the Universal Service Program last year, which allocated \$300 million in savings from cutting waste and inefficiency to a new Mobility Fund aimed at closing gaps in mobile coverage across the country. As a result of the auction, new mobile infrastructure deployment will begin in 31 states with areas that currently lack access to 3G or 4G mobile service. In total, up to 83,000 U.S. road miles on which millions of Americans live, work, or travel will gain access to advanced mobile networks that significantly enhance opportunities for jobs, education, healthcare, and public safety. As part of the auction rules, winning companies must make their networks available to other providers for roaming so that as many consumers as possible can benefit from the new networks.

The FCC moved to significantly modify the Commission's Part 15 rules governing unlicensed communication equipment in the 57-64 GHz band. The new rules will enhance the use of unlicensed spectrum as a relatively low-cost, high-capacity short-range backhaul alternative to connect wireless broadband networks and for other wireless applications. Unlicensed spectrum technologies have the potential to encourage competition in the broadband market, promote efficient delivery of broadband services in residences and businesses, and improve user experience with consumer devices needing short-range, high data rate communications.

The FCC took the first steps to unleash significant additional spectrum to accelerate the growth and expansion of new Wi-Fi technology that can offer faster speeds of one gigabit per second or more, increase overall capacity, and reduce congestion at Wi-Fi hot spots. They proposed to make up to 195 megahertz of additional spectrum in the 5 GHz band available to unlicensed wireless devices. The Commission also made significant changes to its Part 5 Experimental Radio Service by creating a more flexible framework to support the rapid pace of technological innovation. These changes add three new types of experimental licenses and revise and streamline existing rules and procedures for experimenting, testing, and marketing radio frequency devices, while protecting incumbent licensees from interference.

The FCC and the U.S. Department of State have been engaged in on-going discussions with their counterparts in the Canadian and Mexican telecommunications authorities relating to the Commission's planned 2014 Broadcast Television Incentive Auction. The United States and its Canadian and Mexican counterparts have established government-to-government working arrangements that have been operating to help ensure optimal outcomes for all three countries.

The FCC and Industry Canada have agreed on three interim spectrum sharing arrangements covering a range of wireless communications operations along the U.S.-Canada border. The arrangements, which govern various spectrum bands, will enable greater wireless broadband deployment, improved general aviation air-to-ground communications services, and more efficient use of spectrum for specialized mobile radio services.

PROTECT AND EMPOWER CONSUMERS

Empower consumers by ensuring that they have the tools and information they need to make informed choices; protect consumers from harm in the communications market.

The Commission announced that participating U.S. wireless companies met or beat the deadline to provide wireless customers with free, automatic alerts when they approach or exceed plan limits for data, voice, and text, as well as alerts for international charges. This marks significant progress in the Commission's effort to eliminate 'bill shock.' Bill shock occurs when wireless customers experience a sudden, unexpected increase in their monthly bill as a result of unknowingly exceeding plan limits or incurring significant international charges.

On December 18, 2012, the FCC and its public and private sector partners released a new online tool, the "Smartphone Security Checker," to help consumers protect their mobile devices. The "Smartphone Security Checker" is a free, easy-to-use online tool that creates a 10-step action plan to help consumers protect their mobile devices from smartphone-related cybersecurity threats. Almost half of Americans now own a smartphone and close to 20% have been the victim of mobile cybercrime. The FCC worked with smartphone security experts from the U.S. Department of Homeland Security, the Federal Trade Commission, the National Cyber Security Alliance, CTIA-The Wireless Association, Lookout, and other public and private sector partners on these mobile security best practices.

The Commission took action to protect the privacy of consumers of wireless services by clarifying its customer proprietary network information (CPNI) policies in response to changes in technology and market practices in recent years. Specifically, the Commission made clear that when mobile carriers use their control of customers' devices to collect information about customers' use of the network, including using preinstalled apps, and the carrier or its designee has access to or control over the information, carriers are required to protect that information in the same way they are required to protect CPNI on the network. This sensitive information can include phone numbers that a customer has called and received calls from, the durations of calls, and the phone's location at the beginning and end of each call.

The FCC raised the standards for providers of Speech-to-Speech (STS) Relay Service in order to improve the experience for persons with a speech disability who need the service in order to make telephone calls using their own voice or an assistive voice device. Speech-to-speech uses specially trained operators, known as Communications Assistants, or "CAs," to relay conversations back and forth between the individual with the speech disability and the other party to the call. CAs are trained to understand a variety of speech disorders, which enables them to repeat what the caller says in a manner that makes the caller's words clear and understandable to the called party.

The FCC took long-overdue steps to ensure that the rates for interstate long-distance calls made by prison inmates are just, reasonable, and fair. The Commission's reforms adopt a simple and balanced approach that protects security and public safety needs, and ensures providers receive fair compensation while providing reasonable rates to consumers. The reforms require that all interstate inmate calling rates, including ancillary charges, be based on the cost of providing the inmate calling service; provide immediate relief for existing exorbitant rates; clarify that inmates or their loved ones who use Telecommunications Relay Services because of hearing and speech disabilities may not be charged higher rates; and require mandatory data collection, annual certification requirements, and enforcement provisions to ensure compliance.

The FCC's Enforcement Bureau took action against individuals for advertising and selling signal jamming devices on craigslist.org. These actions resulted from aggressive undercover operations. Signal jamming devices, or "jammers," are radio frequency transmitters that intentionally block, jam, or interfere with authorized communications, such as cell phone calls, text messages, GPS systems, and Wi-Fi networks. Jammers are indiscriminate. They can block critical public safety and other emergency communications along with the targeted transmissions. As a result, it is a violation of federal law to market, sell, or use a jammer in the United States.

The FCC proposed a five million dollar forfeiture against NobelTel, LLC, for deceptively marketing prepaid calling cards to consumers. Such cards are commonly sold in convenience stores and gas stations across the country. With this enforcement action, the FCC has now proposed forfeitures totaling \$30 million against six carriers within the past year to combat the deceptive marketing of prepaid calling cards. In each of the six enforcement actions, the FCC found that carriers targeted immigrant populations and claimed that buyers could make hundreds or thousands of minutes of telephone calls to their native countries for just several dollars. However, buyers could make calls for only a fraction of those minutes due to the carriers' assessment of various fees that were not clearly and conspicuously disclosed.

As a result of an FCC Enforcement Bureau investigation, AT&T agreed to pay \$700,000 as part of a consent decree to resolve complaints that the company switched certain consumers to its mandatory monthly wireless data plans even though it had promised they could retain their existing pay-as-you-go data plans. AT&T agreed to refund excess charges paid by individual customers, which could be as much as \$25 to \$30 a month, depending on data use. Consumer complaints prompted the FCC to launch an investigation last year.

A provider of Video Relay Services (VRS), which are used by people with hearing and speech disabilities to place telephone calls, has agreed to pay nearly \$1.4 million to settle two federal investigations. The settlement resolves allegations of improper payments from the federal Fund that supports VRS. The investigations by the FCC's Enforcement Bureau examined whether the provider, CSDVRS, LLC, improperly billed for VRS calls that were actually generated by its own employees. CSDVRS agreed to repay the Telecommunications Relay Service Fund more than \$480,000 in overpayments and interest. In addition, the company will make a \$900,000 voluntary contribution to the U.S. Treasury. The company also must implement a robust compliance plan including new operating procedures, comprehensive re-training of its employees and contractors, and periodic reporting requirements.

Two affiliated Oklahoma companies participating in the FCC's Lifeline program for low-income consumers, TerraCom, LLC, and YourTel America, Inc., have agreed to pay more than \$1 million in reimbursements and voluntary contributions to the U.S. Treasury. The payments resolve an FCC Enforcement Bureau investigation into whether the companies violated program rules.

The enforcement action was brought under the FCC's new Lifeline rules guarding against waste, fraud, and abuse, which made clear that only one Lifeline subscription is allowed per household and initiated a process to scrub carrier rolls for duplicate subscribers.

Level 3 Communications, LLC, resolving an investigation into the company's rural call completion practices, has agreed to meet rigorous, verifiable call completion standards and to provide extensive records that will assist FCC enforcement of rules protecting against failed calls to rural areas. Level 3 will also make a \$975,000 voluntary contribution to the U.S. Treasury, and has agreed to make additional \$1 million voluntary contributions going forward if it misses specified quarterly benchmarks.

Two providers of automatically dialed calls using prerecorded or artificial voice messages, known as "robocalls," were issued citations for making millions of robocalls to wireless phones without prior authorization from the call recipients. The FCC Enforcement Bureau conducted investigations and issued citations to Dialing Services, LLC, and Democratic Dialing. The citations require each company to certify within fifteen calendar days that it has ceased making robocalls to wireless phones without prior authorization, and that the calls it makes include the required identifications. Robocallers who make illegal calls to wireless phones may be liable for penalties of \$16,000 per call, resulting in fines that could reach tens of millions of dollars or more, depending on the volume of violations.

The FCC settled two wireless hearing aid compatibility investigations involving Airadigm Communications, Inc., and TeleGuam Holdings, LLC. The settlements include voluntary payments of more than \$500,000 as well as conditions designed to ensure future compliance. The hearing aid compatibility rules ensure that individuals with hearing loss can fully access advanced wireless phone service without excessive feedback or noise.

Wireless carrier NTT DOCOMO USA, Inc., has agreed to pay \$100,000 to settle an Enforcement Bureau investigation into whether the company complied with FCC rules designed to ensure the availability of hearing aid-compatible phones in the marketplace. The settlement with NTT DOCOMO USA, Inc. is the latest in a series of hearing aid compatibility enforcement actions taken during 2013, valued at more than \$1.4 million. Recent actions include: DOCOMO Pacific, Inc. (\$65,000); Kyocera Communications, Inc. (\$12,000); Airadigm Communications, Inc. (\$260,000); TeleGuam Holdings, LLC, and Pulse Mobile, LLC (\$280,000); Puerto Rico Telephone Company, Inc. (\$650,000); and Cordova Wireless Communications, LLC (\$35,000).

The FCC held a Senior Digital Literacy Day. Seniors, and those who work with or care for them, were invited to attend and learn about how high speed Internet service can benefit older Americans. Speakers emphasized safe and secure on-line practices, and there were interactive demonstrations of mobile phones, tablets, iPads, desktops, and e-readers, as well as user-friendly computer programs that can benefit seniors.

PROMOTE INNOVATION, INVESTMENT, AND AMERICA'S GLOBAL COMPETITIVENESS

Promote innovation in a manner that improves the nation's ability to compete in the global economy, creating a virtuous circle that results in more investment and in turn enables additional innovation.

As part of ongoing regulatory reform efforts, the Commission adopted a Report and Order to further modernize its international telephony rules, lower costs, and increase competition. The Report and Order

eliminates outdated regulations governing agreements between U.S. and foreign carriers for delivering international phone traffic, while strengthening the Commission's ability to protect U.S. consumers from the effects of anticompetitive conduct by foreign carriers where specific complaints arise.

The FCC adopted a Report and Order establishing rules to help speed the deployment of Internet services onboard aircraft. The Commission's action enables broadband providers to meet increasing consumer demands and promotes the economic growth and job-creating impacts of ubiquitous broadband. Since 2001, the Commission has authorized a number of companies, on an *ad hoc* basis, to operate Earth Stations Aboard Aircraft (ESAA), i.e., earth stations on aircraft communicating with Fixed-Satellite Service (FSS) geostationary-orbit (GSO) space stations. Installed on the exterior of the aircraft, the satellite antenna carries the signal to and from the aircraft, providing two-way, in-flight broadband services to passengers and flight crews. The Report and Order formalizes ESAA as a licensed application in the FSS and establishes a regulatory framework for processing applications while ensuring other radio service operations are protected from harmful interference.

FCC Chairman Genachowski announced the formation of an agency-wide Technology Transitions Policy Task Force. Among issues for its consideration, the Task Force will coordinate the Commission's efforts on IP interconnection, resiliency of 21st century communications networks, business broadband competition, and consumer protection with a particular focus on voice services. The Task Force will also consider recommendations from the Technological Advisory Committee on the Public Switched Telephone Network (PSTN) Transition, coordinate with the NARUC Presidential Task Force on Federalism and Telecommunications, and evaluate the feedback from the Commission's field hearings on Superstorm Sandy. The Task Force will conduct a data-driven review and provide recommendations to modernize the Commission's policies in a process that encourages the technological transition, empowers and protects consumers, promotes competition, and ensures network resiliency and reliability.

The FCC launched a new and improved Learn Everything About Reverse-Auctions Now (LEARN) website with enhanced online resources as a one-stop information resource for incentive auction stakeholders, particularly the nation's broadcasters. The new LEARN website provides easy access to a range of useful information and resources that will help broadcasters and other stakeholders make more informed business decisions about participating in the incentive auction, which the FCC anticipates holding in 2015. It also offers valuable information about the proposed incentive auction process and the unique business opportunities created by the incentive auction. The FCC's broadcast television spectrum incentive auction will be the first such auction ever attempted anywhere in the world. The auction will present a significant financial opportunity for many broadcasters, and it will enhance the ability of broadcasters who remain on the air to continue providing the public with diverse, local, free over-the-air television service. At the same time, the spectrum reclaimed through the incentive auction will promote economic growth and enhance America's global competitiveness by increasing the speed, capacity, and ubiquity of mobile broadband services such as 4G LTE and Wi-Fi-like networks.

The FCC unanimously adopted comprehensive reforms to further protect and strengthen the Video Relay Service (VRS) program that enables people with disabilities to do what most Americans take for granted: make a simple phone call. The VRS program permits people with hearing disabilities to use American Sign Language to communicate with other individuals over a broadband connection. The program is financed through the FCC's Telecommunications Relay Services (TRS) Fund. Building on a foundation of ongoing reforms and program improvements, the Order initiates fundamental restructuring of the program to support innovation and competition, drive down ratepayer and provider costs, eliminate incentives for waste that have burdened the TRS Fund in the past, and further protect consumers.

The FCC's International Bureau released its annual circuit status report for U.S facilities-based international common carriers. The report shows the use of U.S. - international facilities for international telephone calls, private line services, and other services from the United States grew by 18% in one year.

The Commission comprehensively modernized and streamlined its rules governing satellite communications to foster investment and innovation by removing unnecessary regulations and easing administrative burdens. Over the years, the Commission has updated the rules for space stations and earth stations, which transmit radio signals between the ground and satellites, to keep pace with industry developments. This action represents the most wide-ranging review of FCC rules and policies in nearly two decades. The Commission's Report and Order eliminates unneeded technical and information filing requirements, updates rules to better accommodate evolving technology, and simplifies existing requirements.

PROMOTE COMPETITION

Ensure a competitive market for communications and media services to foster innovation, investment, and job creation, and to ensure consumers have meaningful choice in affordable services.

The Commission adopted its 15th Report to Congress on the status of competition in the market for the delivery of video programming. The Report, which covers 2011 and 2012, measures the market's progress toward increasing competition and diversity in multichannel video programming distribution (MVPD), increasing the availability of satellite delivered programming, and spurring the development of communications technologies. Specifically, the Commission found that the number of MVPD subscribers grew from 100.8 million to 101.0 million households between year-end 2010 and June 2012. During this period, cable's share of MVPD subscribers fell from 59.3 percent of all MVPD video subscribers at the end of 2010 to 55.7 percent at the end of June 2012. Between year-end 2010 and June 2012, Direct Broadcast Satellite (DBS) MVPDs and telephone MVPDs gained both video subscribers and market share. DBS MVPDs accounted for 33.1 percent of all MVPD subscribers in 2010, increasing to 33.6 percent at the end of June 2012. Telephone MVPDs represented approximately 6.9 percent of all MVPD subscribers in 2010, increasing to an estimated 8.4 percent in 2011. At the end of June 2012, AT&T's U-Verse and Verizon's FiOS services combined had 8.6 million video subscribers. Since the last report, the number of households relying exclusively on over-the-air broadcast service remained steady at approximately 11.1 million households, although the percentage of all households they represent increased slightly from 9.6 percent in 2011 to 9.7 percent in 2012.

The FCC initiated a proceeding to consider eliminating a provision that gives special treatment to UHF channels under its national television ownership cap. Called the UHF discount, the provision was adopted nearly 30 years ago when UHF signals were regarded as technically inferior to VHF signals in analog television broadcasting. With the transition of full-power stations to digital broadcasting in 2009, the technical inferiority of UHF appears to be a thing of the past. Therefore, the technical justification for the UHF discount no longer seems to exist. The proceeding also furthers the Commission's mandate to evaluate its rules to make certain they continue to serve the public interest.

The FCC released a *Fifth Order on Reconsideration and Sixth Report and Order* that expands low power radio opportunities for diverse media voices nationwide. Processing approximately 6,000 FM translator applications and setting updated rules are the last steps necessary before opening a window for community groups to seek new low power FM licenses.

The Commission proposed a forfeiture of \$2.25 million against a company that operates a cable system in Houston, Texas, for retransmitting the signals of six television broadcast stations without their consent. The Commission's Media Bureau launched an investigation of TV Max, Inc. (doing business as "Wavevision"), and other related entities, based on complaints from four major television broadcasters alleging that TV Max retransmitted their stations' signals without permission. The Commission found TV Max's violations to be very serious, warranting a substantial penalty given the longstanding unauthorized carriage that continued even after the Bureau warned TV Max about its actions.

PUBLIC SAFETY AND HOMELAND SECURITY

Promote the availability of reliable, interoperable, redundant, rapidly restorable critical communications infrastructures that are supportive of all required services.

FCC Chairman Julius Genachowski announced that the nation's four largest wireless carriers – AT&T, Verizon, Sprint, T-Mobile – agreed to accelerate the availability of text-to-911, with a commitment to nationwide availability by May 15, 2014. Building on text-to-911 deployments and trials that are already underway, this agreement will accelerate progress and ensure that over 90 percent of the nation's wireless consumers, including millions of consumers with hearing or speech disabilities, will be able to access emergency services by sending a text message to 911, where local call centers are prepared to receive the texts. Text-to-911 will provide consumers with enhanced access to emergency communications in situations where a voice call could endanger the caller, or a person with disabilities is unable to make a voice call. In addition, to help eliminate consumer confusion while text-to-911 capability is being phased-in, the carriers have committed to provide an automatic "bounce back" text message to notify consumers if their attempt to reach 911 via text message was unsuccessful because this service is not yet available in their area. The Commission's proposed action also seeks to accelerate the nation's transition to a Next-Generation 911 system that will use cutting-edge communications technology to assist first responders in keeping our communities safe.

The FCC proposed action to improve the reliability and resiliency of America's 9-1-1 communications networks, especially during disasters, by ensuring that service providers implement vital best practices in network design, maintenance, and operation. The Commission also proposed amending its rules to clarify how service providers can more effectively and uniformly notify 9-1-1 call centers of communications outages and cooperate to restore service as quickly as possible.

In a Notice of Proposed Rulemaking, the Commission moved forward to implement four key recommendations for strengthening 9-1-1 service made by the FCC's Public Safety and Homeland Security Bureau. The Bureau's recommendations resulted from an in-depth inquiry into the widespread 9-1-1 service failures that occurred after a derecho storm hit portions of the Midwest and Mid-Atlantic in June 2012. A significant number of 9-1-1 systems and services were partially or completely down for several days after the derecho. In all, seventy-seven 9-1-1 call centers serving more than 3.6 million people lost some degree of connectivity, including vital information on the location of 9-1-1 calls. Seventeen 9-1-1 call centers lost service completely, leaving more than two million residents unable to reach emergency services.

The FCC proposed action to improve wireless network reliability during disasters by requiring wireless service providers to publicly disclose the percentage of cell sites within their networks that are operational during and immediately after disasters. By providing consumers with a yardstick for comparing wireless performance in emergencies, the FCC's proposal could in turn encourage competition in the wireless industry to improve network reliability. In a Notice of Proposed Rulemaking, the FCC said that some

wireless service disruptions may be unavoidable during emergencies, but the impact tends to vary among providers. For example, Superstorm Sandy disabled approximately 25 percent of cell sites in the affected region, with more than 50 percent of cell sites disabled in the hardest-hit counties, yet not all wireless networks were equally impaired. The FCC noted that the operational choices and practices of different wireless service providers may account for much of this variation. The FCC's proposal would require wireless service providers to submit to the FCC, for public disclosure on a daily basis during and immediately after disasters, the percentage of operational cell sites for each county within a designated disaster area. Information yielding these percentages is already included in voluntary reports that wireless service providers submit to the FCC daily during disasters.

As part of National Cybersecurity Month, the FCC unveiled an updated 2.0 version of the Commission's "Small Biz Cyber Planner," a free and easy-to-use online resource for any small business owner who wants to better protect their business from the growing threat of cybersecurity attacks. Launched in 2011, the tool has already been used by nearly 10,000 businesses across the country to create customized cybersecurity plans. New research by Symantec, an FCC Cybersecurity Outreach Partner, indicates that nearly 83% of U.S. small businesses have no cybersecurity protection plan, despite the fact that millions of cyber-attacks occur each year.

In recognition of National Cybersecurity Awareness Month, the FCC hosted a technology exhibition and presentations on mobile security on Wednesday, October 17, 2012. The day-long event is part of the FCC's ongoing effort to promote awareness of cybersecurity threats and solutions in partnership with industry and others in the public sector. Given America's growing reliance on mobile technology, and the importance of America's digital infrastructure to the economy, it is imperative that stakeholders work together to ensure the security, reliability, and resiliency of these tools and infrastructure.

ADVANCE KEY NATIONAL PURPOSES

Through international and national interagency efforts, advance the use of broadband for key national purposes.

Acting to expand access by health care providers to robust broadband networks, the Commission established the Healthcare Connect Fund. The FCC's existing Rural Health Care program, established by the 1996 Telecommunications Act, was not effectively structured to expand the reach of broadband health care networks. In 2006, the FCC launched its Rural Health Care Pilot Program to learn how to more effectively support these networks, and it now funds some 50 active pilots across the nation. The FCC highlighted lessons learned from these pilots, including a South Carolina consortium that saved \$18 million in Medicaid costs by using telepsychiatry, and a group of health care providers in the Midwest that saved \$1.2 million in patient electronic intensive care unit services. Informed by these and other success stories, the new Healthcare Connect Fund will help expand access by health care providers to the high-bandwidth connections they need for modern telemedicine by (1) removing artificial limitations on technology that hampered legacy universal service health care support; (2) encouraging consortia between smaller rural health care providers and urban medical centers to enable remote hospitals and clinics to draw on the medical, technical, and administrative resources of larger providers; and (3) covering upgrades to higher speed service required for health care applications. The Fund will allow thousands of new providers across the country to share in the benefits of connectivity and dramatically cut costs for both hospitals and the Universal Service Fund.

In addition, the reforms establish a new competitive pilot program to test expanding broadband healthcare networks to skilled nursing facilities. Because these facilities are often remote from doctors and

sophisticated lab and testing facilities, patients will benefit greatly from broadband services that can reduce the time, expense, and stress of travelling to receive medical care. Up to \$50 million over three years will be available from the Fund for these competitively-awarded pilots.

The FCC initiated a thorough review and modernization of the E-rate (schools and libraries) program built around three goals: increased broadband capacity, cost-effective purchasing, and streamlined program administration. The Commission's initiative today marks the first comprehensive update of the E-rate program since 1997. According to a survey of E-rate applicants, half had slower connection speeds than the average American home and 39% cited cost of service as the greatest barrier to better meeting their needs. One quarter of libraries still have broadband speeds of 1.5 Mbps or less, and only 9 percent of libraries have speeds of 100 Mbps or greater. In light of these findings, there is growing consensus that E-rate needs to be updated and revitalized with a renewed focus on ensuring that all schools and libraries have affordable access to high-capacity broadband.

The FCC's Office of Native Affairs and Policy (ONAP) released a report detailing its engagement with more than 400 Tribal Nations and travel to 42 federal Indian Reservations since the Office's inception in the summer of 2010. ONAP's work with Tribes is focused on bringing modern communications infrastructure and the resulting benefits to Tribal Nations and Native communities throughout the United States. ONAP is responsible for developing and driving a Commission-wide Tribal agenda and ensuring Tribal voices are taken into account in Commission proceedings. Significant accomplishments, the report states, "are reflected in the Commission's new rules, proposed rules, and new policies with respect to Tribal Nations. These indicators of success include new levels of dialogue and reporting, new licensing priority opportunities, and increased support and investment through universal service support mechanisms."

OPERATIONAL EXCELLENCE

Make the FCC a model for excellence in government by effectively managing the Commission's human, information, and financial resources; by making decisions based on sound data and analyses; and by maintaining a commitment to transparent and responsive processes that encourage public involvement and best serve the public interest.

As part of its Data Innovation Initiative, the Federal Communications Commission continued its modernization of its international reporting requirements. In 2011, the Commission adopted a *First Report and Order*, FCC 11-76, which eliminated a number of outdated international reporting requirements and reduced the number of international reports to just two: the Traffic and Revenue Report and the Circuit Status Report. The *Second Report and Order*, adopted during the past year, further streamlines these two reports by eliminating reporting requirements for over a thousand small carriers and reducing the level of detail submitted by international service providers by over 75 percent. Taken together, the Commission estimates these changes will reduce overall burdens industry-wide by nearly 30 percent.

The FCC unanimously voted to modernize and improve its collection of data about broadband and voice service in the U.S., while at the same time taking measures to streamline and reduce the burden on providers. These changes will improve the data the agency uses to effectuate policies and programs for expansion of access for all Americans to broadband and voice service. The FCC initiated its most comprehensive collection of broadband deployment data, which will be used to populate and update the National Broadband Map, a key resource on broadband deployment for consumers, policymakers, researchers, economists, and others. Reliable and accurate deployment data are also critical to the

expansion of broadband to consumers in unserved rural areas through the FCC's Connect America Fund and universal service program, and for the FCC's annual report to Congress on broadband availability.

The FCC planned, participated in, and developed an after action report on the annual government-wide continuity of operation planning exercise. The agency conducted more frequent testing of its emergency procedures and updated and implemented Occupant Emergency Plans and Procedures for FCC Headquarters.

The Commission issued the FY 2013 Regulatory Fee Notice of Proposed Rulemaking and FY 2013 Regulatory Fee Order, and the agency successfully collected regulatory fees for FY 2013. The FCC is self-funded through regulatory fees.

The FCC obtained a clean opinion on its FY 2013 financial statements for the eighth 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.

Management Assurances

In accordance with Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, 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 reliability and completeness of its financial and performance data.

The Commission received an unmodified opinion on its financial statements in FY 2011 and FY 2012. 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 2011 and FY 2012.

The FY 2012 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 2013, 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 2013 to resolve the auditors' findings and improve the performance of its financial reporting process through continued improvements of its new core financial system. The Commission's new core financial system was launched in October 2010 and since then management has progressively worked towards identifying more efficiencies to improve the business processes. Also in FY 2013, 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 were corrected in FY 2013 and the Commission will make every effort in FY 2014 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 compliant, 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 2013 continued working to efficiently deploy the functionality of that system. Also in FY 2013, 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 2013, 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 unmodified 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, 2013, 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.

A handwritten signature in black ink, appearing to read 'Mark Stephens', with a long horizontal line extending to the right.

Mark Stephens
Chief Financial Officer
December 13, 2013

Status of Internal Controls – Section 2 of FMFIA

During FY 2013, 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 2013, the Commission continued to work diligently to close out audit findings from previous audits. The Commission was able to close out 74 audit findings in FY 2013. 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 2013 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 2013 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 Management Systems Strategy

The Commission's financial management system, Genesis, is a Momentum-based product that serves as the financial accounting system of record and provides all the core accounting services to the Commission. These services include funds control, budget execution, general ledger, accounts payable, accounts receivable, financial system and access controls, and financial system reports. Since its initial implementation in October 2010, Genesis has facilitated compliance with the Federal Managers' Financial Integrity Act (FMFIA) and the maintenance of an unmodified financial audit opinion. The Commission expects to continue its improvements in the area of financial management system controls and practices which include validation rules to prevent erroneous accounting transactions from being processed, and financial system reporting capabilities that continue the ability to respond quickly to internal and external financial information inquiries. The Commission's financial system goals are to increase functionality for improved effectiveness and efficiency of financial business processes, and enhance accountability, data integrity, reliability, and consistency.

In an effort to achieve these goals, the Commission is upgrading Genesis to the latest 7.0 release. The upgrade, which is scheduled for January 2, 2014, will upgrade Genesis from the current 6.3.4. Release to the 7.0.X Release. With the addition of 140+ new enhancements between Momentum 6.3.4 and 7.0.X, several of these new features will allow the FCC to streamline their processes, increasing efficiency and productivity. As the Commission prepared for the technical upgrade, there was also a review of the potential enhancements available for use in Momentum 7.0.X in relation to the FCC's current business processes in order to leverage as many improvements as possible. Improvements to system performance and additional reporting capabilities were also identified with the new release. The upgrade will provide functionality for implementation of the Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS) and other Treasury requirements.

Financial management system accomplishments include the Commission upgrading its time and attendance process to a web-based system called WebTA. The Commission required a paperless, more efficient, and user-friendly way to report time and attendance. The WebTA system provides FCC employees and supervisors with a self-service web-based solution that simplifies and automates the entire process of timesheet creation, validation, and management, along with improving the accuracy, management, and reporting of time keeping records. Implementation of the new system also facilitated stronger internal controls and significantly reduced the amount of time spent on processing timecards. The Commission also realized savings from decreased archival and record retrieval costs. In addition, the Commission is actively working with the Bureau of Fiscal Service (BFS) to participate in the OMB mandated Do Not Pay (DNP) initiative to reduce improper payments. The Commission's goal is to begin utilizing the DNP Analytics Service to pre-scan the Genesis daily payment file that is sent to the Department of the Treasury for disbursement. We will also provide the DNP Business Center, on a monthly basis, our existing vendor payee file from Genesis in order for them to match payee information against their available data sources. The Genesis vendor file contains vendors for the FCC services and the reporting components. The reporting components will also provide, on a monthly basis, to the DNP Business Center their existing vendor payee file of vendors that are not in Genesis. Output from this analysis will allow the Commission to flag and intercept payments made via credit card, contract award, or miscellaneous payments, and support the reduction of improper payments. The DNP solution also complements the Commission's existing policies and procedures for contract award management by enforcing pre-award eligibility of federal benefits and contract awards in order to protect taxpayer resources from waste, fraud, and abuse.

Going forward, the Commission's financial management system strategy includes building on processes that improve internal controls; eliminating redundant data entry through increased integration; implementing tools that enhance budget formulation and performance; and continuously partnering with our Administrators for the three reporting funds (the Universal Service Fund, the Telecommunications Relay Service Fund, and the North American Numbering Plan) as they modernize their 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. Commission management is responsible for the integrity and objectivity of the information presented in the financial statements. For eight consecutive years, the financial statements have received an unmodified 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 October 21, 2013.

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 2013 and FY 2012 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.

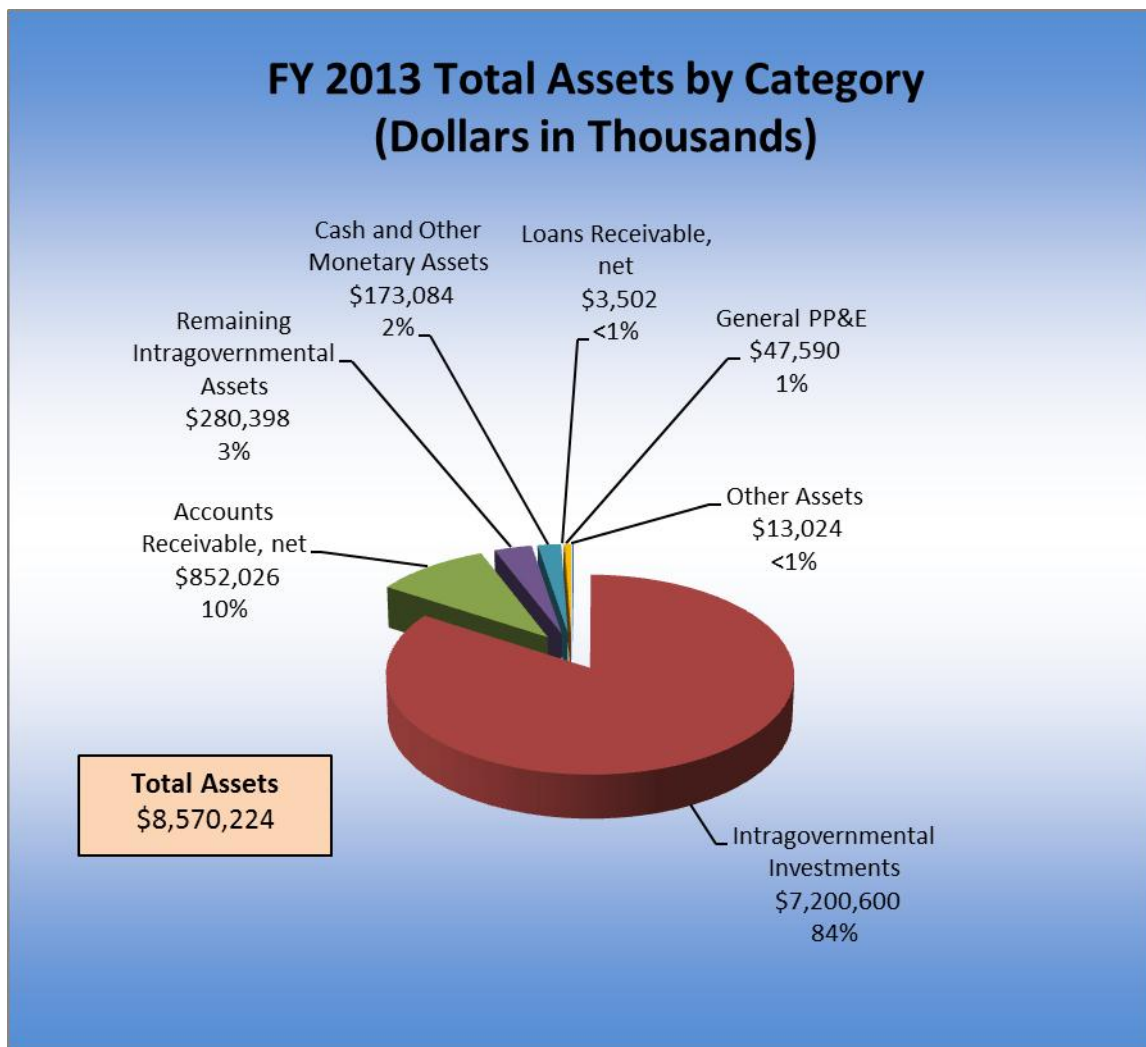
CHANGES IN FINANCIAL POSITION IN FY 2013				
Consolidated				
(Dollars in Thousands)				
Net Financial Condition	2013	2012	Increase (Decrease)	Percentage Change in Financial Position
Intragovernmental				
Fund Balance with Treasury	\$ 279,163	\$ 361,739	\$ (82,576)	(23)%
Investments	7,200,600	6,548,090	652,510	10%
Accounts receivable	1,235	1,574	(339)	(22)%
Total Intragovernmental	\$ 7,480,998	\$ 6,911,403	\$ 569,595	8%
Cash and other monetary assets	173,084	139,322	33,762	24%
Accounts Receivable, net	852,026	875,088	(23,062)	(3)%
Direct loans receivable, net	3,502	335	3,167	945%
General property, plant, and equipment, net	47,590	56,832	(9,242)	(16)%
Other	13,024	13,024	-	%
Total Assets	\$ 8,570,224	\$ 7,996,004	\$ 574,220	7%
Intragovernmental				
Accounts payable	\$ 2,522	\$ -	\$ 2,522	100%
Debt	353	-	353	100%
Other	89,558	168,897	(79,339)	(47)%
Total Intragovernmental	\$ 92,433	\$ 168,897	\$ (76,464)	(45)%
Accounts payable	134,727	110,523	24,204	22%
Deferred revenue	59,920	62,971	(3,051)	(5)%
Prepaid contributions	110,057	85,849	24,208	28%
Accrued liabilities for Universal Service	1,088,415	752,423	335,992	45%
Other	35,036	39,578	(4,542)	(11)%
Total Liabilities	\$ 1,520,588	\$ 1,220,241	\$ 300,347	25%
Unexpended appropriations - other funds	\$ 3,394	\$ 4,251	\$ (857)	(20)%
Cumulative results of operations	7,046,242	6,771,512	274,730	4%
Total Net Position	\$ 7,049,636	\$ 6,775,763	\$ 273,873	4%
Net Cost of Operations	\$ 9,432,508	\$ 9,536,699	\$ (104,191)	(1)%
Total Budgetary Resources	\$ 14,373,177	\$ 14,297,518	\$ 75,659	1%

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, 2013.

The graph below presents the total assets of the Commission as of September 30, 2013. The large Investments balance of \$7,200.6 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 Remaining Intragovernmental Assets balance of \$280 million consists of Intragovernmental balances from Fund Balance with Treasury and Accounts Receivable.

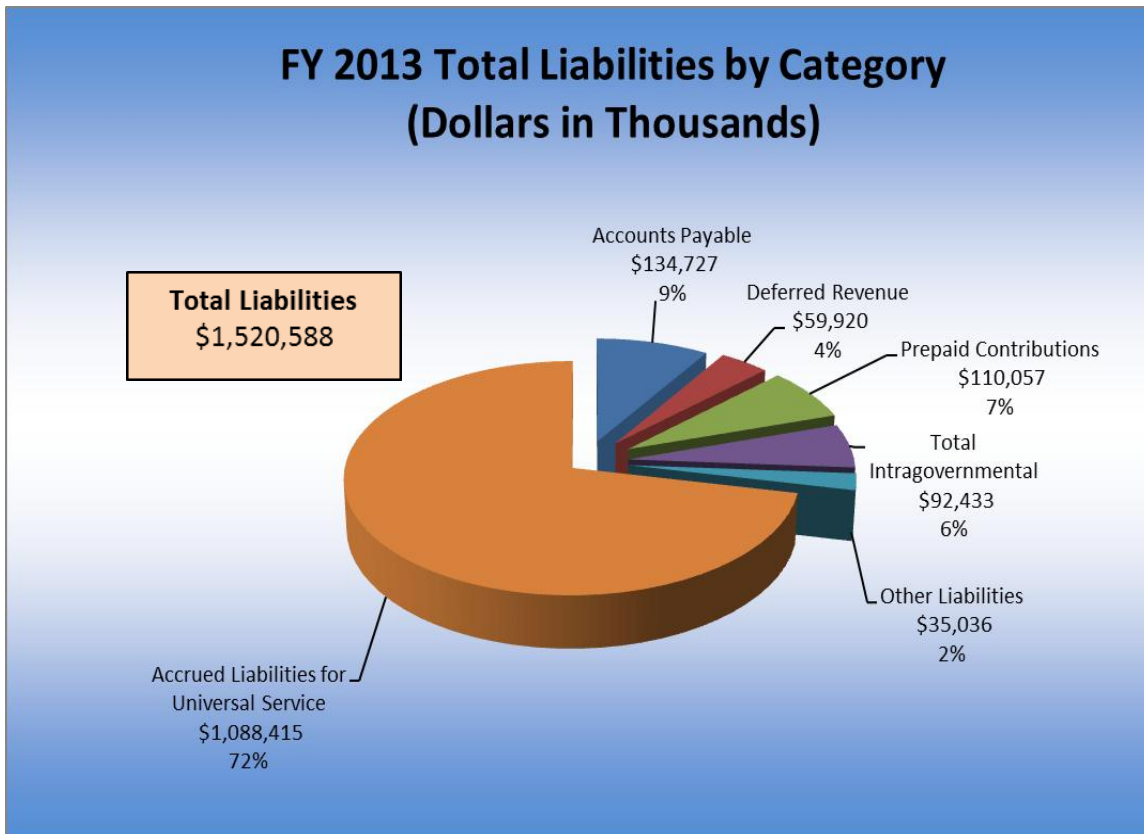
The Accounts Receivable balance of \$852 million is primarily composed of USF receivables totaling \$749.6 million.



The graph below presents the total liabilities of the Commission as of September 30, 2013. The Commission's most significant liabilities are Accounts Payable of \$134.7 million and Accrued Liabilities for Universal Service of \$1,088.4 million, which accounted for over 80% of total liabilities as of September 30, 2013.

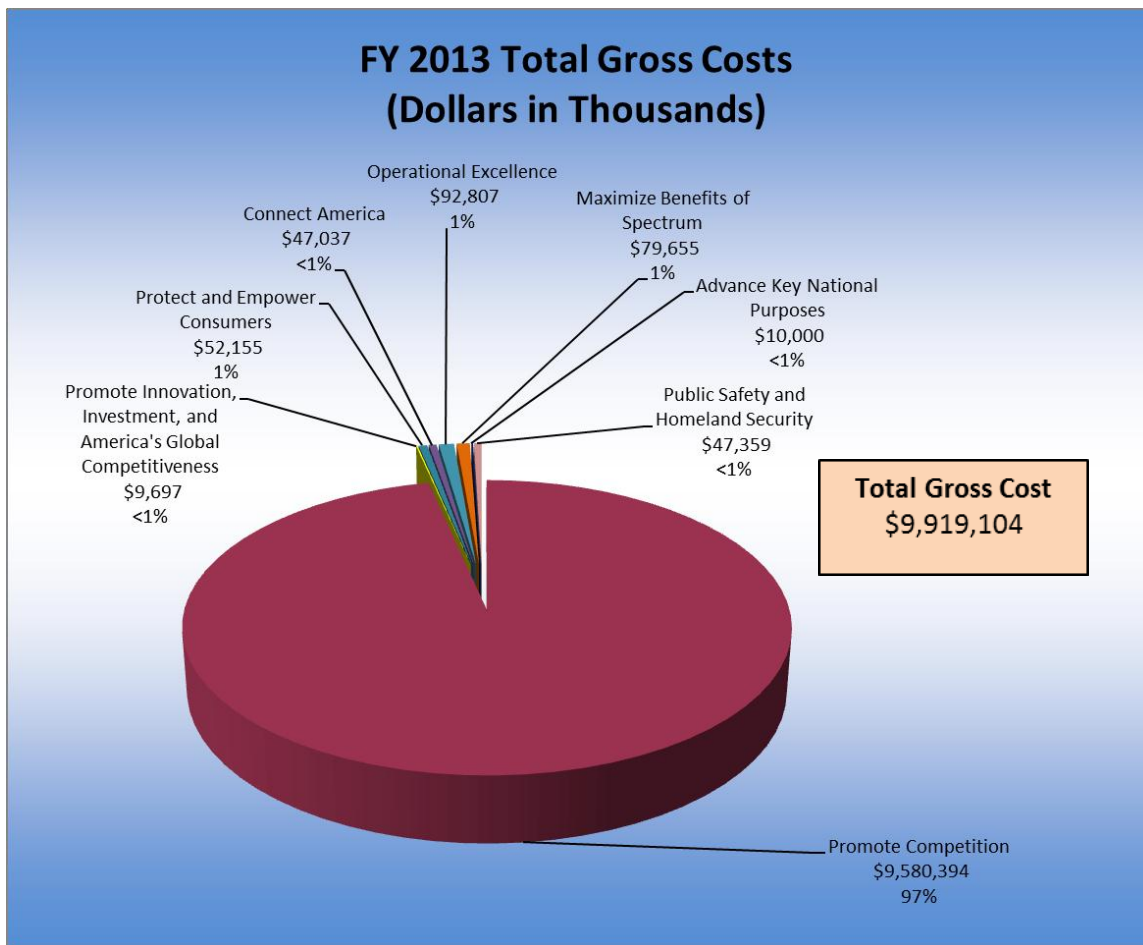
Total Intragovernmental is primarily composed of custodial collections earned on Spectrum auctions and miscellaneous receipts.

The Accrued Liabilities for Universal Service represent the expected October (FY 2014) 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 eight strategic goals of the Commission: Connect America; Maximize Benefits of Spectrum; Promote Innovation; Investment; and America’s Global Competitiveness; Promote Competition; Protect and Empower Consumers; Public Safety and Homeland Security; Advance Key National Purposes; and Operational Excellence. 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 Promote Competition strategic goal. As a result of the accounting for these activities, the cost for this goal may be significantly higher than the cost of the seven 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.

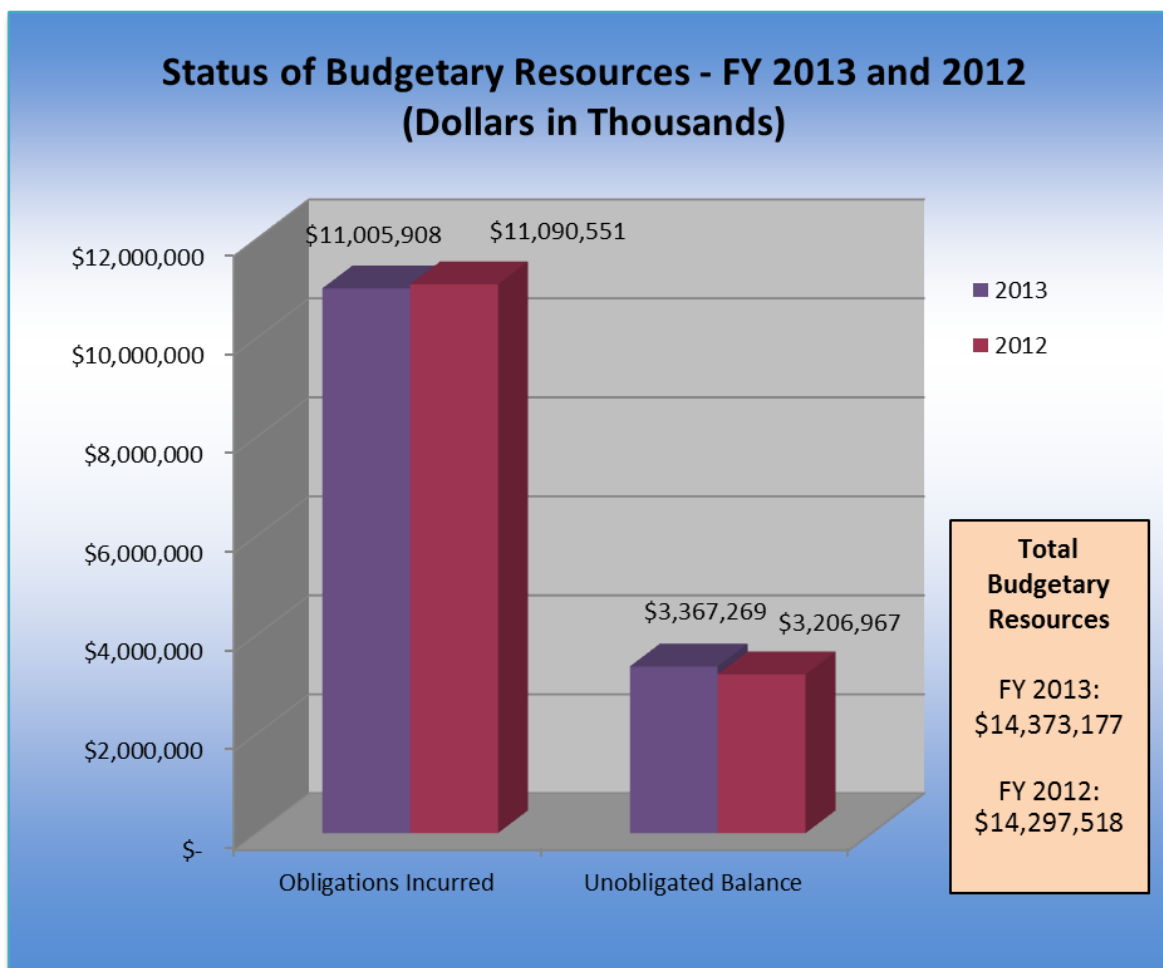
The graph below presents the total gross costs of each Commission program.



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 \$7,050 million compared to net position of \$6,776 million for FY 2012, an increase of \$274 million or a 4% net increase in FY 2013.

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 \$14.4 billion in budgetary resources of which \$11 billion was obligations incurred and \$3.4 billion remained unobligated.

The chart below presents the status of budgetary resources comparatively between FY 2013 and FY 2012.



Consolidated Statement of Custodial Activity: The Commission recognized \$42.9 million of custodial revenue during FY 2013. From this balance, \$25.3 million was transferred to Treasury. The \$81.2 million decrease in amounts yet to be transferred is a result of the FCC holding less in Auction Custodial Collections for future years at September 30, 2013. 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 2013 subsidy reestimate was completed to reflect the actual loan performance through September 30, 2013. The reestimate resulted in a net downward adjustment, including interest on the reestimate, of \$3.3 million in the Spectrum Auction program.

This reestimate is reported in the Commission's FY 2013 financial statements, but will not be reported in the budget until FY 2014. 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 2013, the Commission was required to collect \$339.8 million in regulatory fees. Actual collections were slightly over \$350.7 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 2013. 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) 2013 and to report that the Commission's auditors issued an unmodified audit opinion on each of the Commission's financial statements for FY 2013. Furthermore, I am proud to say that this is the eighth straight fiscal year the Commission has received an unmodified opinion. The Commission is proud of the work of its staff to obtain and maintain an unmodified opinion.

Throughout FY 2013, 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 2012 audit report. The Commission closed findings relating to its information technology control deficiencies and made progress in resolving issues related to its financial management systems; however, there is still work to be done. The Commission significantly completed transfer of most delinquent debts to Treasury. A large backlog had accumulated in FY 2011; most of the issues associated with transferring debt were finally resolved in FY 2013. We expect all of the delinquent debt to be referred to Treasury during FY 2014. Of special note, the Commission also implemented a new time and attendance system which improved the user –friendliness, efficiency, and controls around time keeping records.

Significantly, for FY 2013 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 2013 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 2014 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. The Commission will continue to modernize its financial systems to improve the utilization of resources and accuracy of reporting.



Mark Stephens
Chief Financial Officer
December 13, 2013



OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: December 13, 2013

TO: Chairman

FROM: *DAE*
Inspector General

SUBJECT: Audit of the Federal Communications Commission's Financial Statements for Fiscal Year 2013

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 2013 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 repeat 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.

While management has made improvements as it relates to both of the repeated internal control significant deficiencies noted above, these issues have been reported by financial statement auditors since FY 2005.

The OIG reviewed KPMG LLP's reports and related documentation and made necessary inquiries 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 13, 2013 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.

The Office of Inspector General appreciates the cooperation and courtesies to our staff and the staff of KPMG, LLP during audit.

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Federal Communications Commission (FCC), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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("KPMG International"), a Swiss entity.



Federal Communications Commission
December 13, 2013
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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

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, 2013 and 2012, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

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 consolidated financial statements. Such information, although not a part of the basic consolidated 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 consolidated 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 consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated 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.

Other Information

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



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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2013, on our consideration of the FCC's internal control over financial reporting and our report dated December 13, 2013, on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements 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* in considering FCC's internal control over financial reporting and compliance.

KPMG LLP

December 13, 2013



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

**Independent Auditors' Report on Internal Control Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With *Government Auditing Standards***

Managing Director
Federal Communications Commission

Inspector General
Federal Communications Commission

We have audited, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of the Federal Communications Commission (FCC), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 13, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2013, we considered the FCC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the FCC's internal control. 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 possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we did identify certain deficiencies in internal control, described in Exhibit I that we consider to be significant deficiencies.

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FCC's Response to Findings

The FCC's response to the significant deficiencies identified in our audit is included in the memorandum from management titled, "Management's Response to Independent Auditors' Reports on Internal Control Over Financial Reporting and Compliance and Other Matters for Fiscal Year 2013." The FCC's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the FCC's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FCC's internal control. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 13, 2013

EXHIBIT I

SIGNIFICANT DEFICIENCIES

Financial System Functionality and Integration

The Federal Communication Commission (FCC or Commission) consolidated financial statements present the financial results of its three reporting components. The components include the Commission headquarters and field offices, the Universal Service Fund (USF) and the North American Numbering Plan (NANP), hereafter referred to as the components. The FCC has oversight responsibilities over the USF and NANP funds, which are administered by other organizations independent of the FCC. The USF reports the results of the four Universal Service support mechanisms and the results of the Telecommunications Relay Service (TRS) Fund. 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.

Since FY 2009 we have reported that FCC needs to implement an integrated system that complies with the requirements set forth in OMB Circular No. A-127, *Financial Management Systems*. In October of fiscal year 2011, the FCC implemented a new financial system. As reported in FY 2012 and noted during the FY 2013 audit the following issues still existed as they related to reporting functionality and integration:

- FCC continued to manually consolidate the financial information from the components and generate the FCC consolidated financial statements and related financial information using Microsoft Excel.
- FCC does not fully utilize system functionality to age receivables or remit debt to the Department of Treasury. During FY 2013 FCC utilized a manual process to identify and transfer the eligible delinquent debt to Treasury (or write it off, as appropriate); however, as of September 30, 2013 this had not yet been fully completed.
- Significant transactions were tracked in Microsoft Excel spreadsheets and then recorded in the general ledger at a summary level via journal entry. Significant examples of this include (amounts in thousands as of September 30, 2013):
 - Investment Transactions for USF and TRS – \$7,200,600
 - Accounts Receivable Subledgers for USF – \$749,633
 - Total Budgetary Resources for USF and TRS – \$13,910,643

As outlined in the FSIO Core Financial System Requirements, OMB Circular No. A-127 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 lack of automated integration between the component’s financial systems caused the FCC to continue using manual processes to ensure the general ledger was materially correct. Additional resources were required to maintain the accuracy of the financial system data as a result of additional reconciliations resulting from non-integrated processes, and to perform reviews over the manually generated financial statements.

Recommendations

1. Identify and implement an automated integration of the component financial information to generate consolidated financial statements and related financial information efficiently and effectively. **(Reissued)**
2. Utilize an automated process to assist with remittance of debts to Treasury to eliminate excess manual processing. **(New)**
3. Record and track significant transactions within financial systems. **(Reissued)**

Information Technology (IT) Controls

Since fiscal year (FY) 2009, we have reported that the FCC needed 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. Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, defines the standards 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.

In FY 2013, FCC continued to progress in maintaining an entity-wide security program that provided for an internal control environment that included the components of continuous monitoring, risk assessment, control activities, and information and communication in order to prevent and detect unauthorized access to agency information resources. Although FCC performed certain ongoing monitoring activities and initiatives, we noted moderate improvements from the prior year, the FCC IT infrastructure still did not fully comply with certain OMB standards. We continued to identify deficiencies in the FCC's control environment, risk assessment, control activities, and monitoring related to securing FCC's IT infrastructure. The application of IT was pervasive throughout the FCC and, as a result, these deficiencies prevented the FCC from complying with OMB's internal control objectives for financial reporting. FCC's consolidated financial statements are comprised of three reporting components; FCC headquarters and field offices, the Universal Service Fund (USF), and the North American Numbering Plan (NANP). However, the noted IT deficiencies described below relate primarily to the FCC, which represents approximately \$457.9 million of \$9.4 billion of consolidated net cost of operations. We have previously reported these deficiencies to FCC management in more detail. Each of the sections below provides additional detail on 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 and completed development of an oversight plan for its contractor-operated information systems, which includes the Universal Service Administrative Company's (USAC) IT security program. However, the FCC had not reviewed or approved the procedures for maintaining the FCC IT system inventory.

By not maintaining a detailed inventory of systems operated on behalf of the FCC by contractors, the FCC's system inventory was incomplete. An incomplete system inventory may result in FCC management not being aware when significant changes occur that could impact the effectiveness of contractors' security controls or that require a re-assessment and re-authorization of a relevant contractor's system.

Control Environment Recommendation

Strengthen the control environment by:

4. Completing the development of the Procedure for Maintaining FCC IT System Inventory and implementing it. The approved procedure should also be distributed to contractor management including CGI Federal, USAC, Rolka Loubé Saltzer Associates, and Welch LLP. **(Updated)**

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 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 in the National Institute of Standards and Technology (NIST) Special Publication (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*. The following paragraphs provide more details regarding the deficiencies noted.

The FCC's risk management activities were behind schedule. Specifically, we noted that the authorizations to operate 18 of the 23 FCC systems, including 11 of 14 major applications that expired on October 31, 2012. Without an updated Authorization To Operate (ATO), the system security plan may no longer describe the system's current controls, and the security assessment report may no longer consider the full range of significant risks to which the system is subject. This may result in security control gaps remaining undetected.

Furthermore, we noted the security assessment testing and the assessment of risks for two major applications were incomplete and did not include a full range of technical, operational and management controls and the related vulnerabilities. More specifically, we noted the security assessment testing was incomplete and did not include management and operational controls, as required by NIST 800-53 rev 3. Additionally, testing did not include all technical controls because security assessment testing was limited to technical vulnerability scans of relevant servers. The security assessment and authorization process as required by NIST 800-53, rev 3 is intended to drive the adoption of necessary IT security controls designed to achieve more secure information systems at federal agencies. However, for two out of the four major FCC systems that we tested, the security assessment report was incomplete as the vulnerabilities identified were largely limited to technical vulnerabilities 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.

The FCC had not performed a system security planning and assessment consistent with NIST 800-53, rev 3 requirements and did not reassess and reauthorize its information systems every three years, at a minimum, because of competing operational priorities. However, the FCC did make certain progress during FY 2013. For example, FCC implemented a tool called Xacta, which provides guidance and templates to assist in security authorization efforts. FCC also selected a new Chief Information Security Officer (CISO), Security Architect, and a team of contractors (C-CAP) that were dedicated to planning, implementing and monitoring the FCC's Security Program. Due to the majority of FCC systems having expired Authorizations to Operate, the CISO believes that updating each Certification & Accreditation package will be a long-term process due to operational priorities and limited resources.

We also noted that risk assessments for two 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*.

If all necessary, IT security controls are not planned and complete security assessment testing is not performed, there is an increased risk that control gaps or weaknesses will not be detected and corrected, or mitigated with compensating controls. Additionally, incomplete security assessment testing limits the FCC's ability to perform risk assessments that consider a full range of relevant vulnerabilities and risks.

Risk Assessment Recommendations

Strengthen the approach to performing risk assessments by:

5. Ensuring when security assessment testing identifies vulnerabilities, the FCC assesses the risks (by considering both vulnerabilities and related threats), and adds mitigating controls to the system security plans. These recommendations should be applied to upcoming system security assessment and authorization projects. **(Re-issued)**
6. Planning and successfully testing the necessary IT security controls, and then authorizing for operation its currently 18 unauthorized information systems, prioritizing the 11 systems that are considered major applications. **(Updated)**
7. Performing e-authentication risk assessments and updating system security plans for the remaining two major applications to define for each e-government application the relevant authentication level and the required level of e-authentication controls to implement. **(Updated)**

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. For instance, 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. Two major applications lacked documented guidance on the assignment of access privileges. In addition, FCC did not consistently document and implement procedures for user account management functions for

major applications. Furthermore, inconsistent implementation of the procedures that were documented led to instances where access was granted without documented authorization.

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. FCC also did not perform periodic reviews and recertification of network and infrastructure users.

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. Documenting system security plans in detail sufficient to plan system security controls for information systems that are equivalent to the NIST SP 800-53 Revision 3 minimum baseline controls (including required enhancements), that categorize controls as common, hybrid or system-specific, and that describe controls in sufficient detail to identify the system components to which they are applicable. **(Updated)**
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 systems. **(Re-issued)**

Access Controls

Strengthen access controls by:

10. Consolidating its numerous procedures for adding users to information systems into a comprehensive document with a standardized process that specifies the correct access request form to be used for each system. Systems for which approval for access should be documented include the FCC network, remote access systems (i.e., VPN, and dial-up), FCC applications, and backend infrastructure including servers and databases. **(Updated)**
11. Establishing a process for retaining access authorization forms for new users granted access to the FCC network domain, remote access and FCC applications. **(New)**
12. Documenting a process that informs supervisors how to approve their supervisees' user roles on the new recertification SharePoint site for applications including Commissions Registration System

(CORES) and Genesis. In addition, access should be disabled for application users lacking a supervisor recertification approval after a set timeframe. **(New)**

13. Reviewing, finalizing, and implementing its Application User Account Management Procedures, and ensuring that user's access to the FCC Network and major applications is reviewed and recertified by management. Access should be promptly revoked for users found to no longer need access or whose access is not recertified. **(Updated)**
14. Ensuring individuals are not granted computer room access without prior management approval. **(Re-issued)**
15. Documenting and approving the Chief of Systems', and any other users, access to the WebTA "Admin" account, and setting up mitigating controls to include the monitoring and review of this account's activity. **(New)**
16. Documenting policies and procedures that only allow access to root passwords in emergency situations. **(New)**
17. Revising current vulnerability assessment program to include information and/or procedures, which at a minimum contains the following: the tools currently utilized for configuration and licensing specifications, a list of all FCC devices and assets subject to periodic vulnerability scanning, reporting requirements for vulnerabilities that are identified, and how to document exceptions and establish mitigating security controls when vulnerabilities cannot be remediated.. **(Updated)**
18. Documenting and implementing procedures for security audit logging and review. **(Re-issued)**
19. Documenting policy to define requirements for password strength and account lockout, including the scope and applicability of password policies. **(Re-issued)**
20. Performing E-File user access reviews every 30 days and ensuring prompt action is taken on results of the reviews. **(New)**
21. Documenting in greater detail the E-File policies and procedures for access recertification. **(New)**
22. Documenting an E-File process to perform periodic reviews of the database audit log activity and implementing the documented process to periodically perform reviews on E-File audit logs database as defined by NIST 800-53 criteria. **(New)**
23. Purchasing an E-File audit log reporting tool to formalize the access review process for the current USAC resources. **(New)**

Change Control

Strengthen change and configuration management controls by:

24. Enforcing policy and procedures to restrict developers' access to the production environment and to ensure that where such access is deemed necessary, any developer actions within production are logged and reviewed in a timely manner. **(Updated)**

25. 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)**
26. Documenting and implementing configuration management procedures for server operating systems, server software, network devices and database management systems. **(Updated)**
27. Ensuring and Infrastructure Change Control Board (ICCB) E-File approval is sought before changes to application code or after every urgent change to the application code to comply with NIST 800-53 and USAC Infrastructure Change Control Board Processes. **(New)**

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 finalized and implemented its IT Continuous Monitoring and Enforcement Plan, and did not include certain items referenced in NIST SP 800-37. NIST 800-37 states an effective organization-wide continuous monitoring program includes: "Configuration management and control processes for organizational information systems; Security impact analyses on...changes to organizational information systems and environments of operation; Security status reporting to appropriate organizational officials; and an assessment of selected security controls (including system-specific, hybrid, and common controls) based on the organization-defined continuous monitoring strategy."

In addition, 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. During FY 2013, the FCC did not finalize its process for tracking and remediating identified vulnerabilities into a Plan Of Action & Milestone (POA&M). When security weaknesses are not centrally tracked and prioritized, appropriate resources may not be assigned, and remediation of security weaknesses may not be accomplished in a timely manner, if at all.

Monitoring Recommendations

Strengthen monitoring controls by:

28. Documenting and implementing procedures for the creation, maintenance, and review of POA&Ms for every program and system for which weaknesses were discovered during reviews, including Government Accountability Office audits, financial system audits, and critical infrastructure vulnerability assessments. **(Updated)**
29. Updating and finalizing its IT Continuous Monitoring and Enforcement Plan based on the guidance provided in NIST Special Publication 800-37, and enforcing the plan through the FCC Cyber Security Policy. **(New)**

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30. Ensuring 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. All controls should be assessed at least once during the three-year authorization cycle.
(Updated)



KPMG LLP
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Washington, DC 20006

Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Managing Director
Federal Communications Commission

Inspector General
Federal Communications Commission

We have audited, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of Federal Communications Commission (FCC), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 13, 2013.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FCC's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. 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 our tests disclosed two instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02, and which are described in Exhibit I.

Management is currently reviewing a matter regarding a potential violation of the Anti-Deficiency Act. As of the date of this report, the outcome of this matter, and any resulting ramifications, is not known.

FCC's Response to Findings

The FCC's response to the findings identified in our audit is included in the memorandum from management titled "Management's Response to Independent Auditors' Reports on Internal Control Over Financial Reporting and Compliance and Other Matters for Fiscal Year 2013". The FCC's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the responses.

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.



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Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the FCC's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FCC's compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 13, 2013

EXHIBIT I

The Federal Managers' Financial Integrity Act (FMFIA) – Office of Management and Budget (OMB) Circular No. A-127

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.

The FMFIA requires Federal agencies to establish controls in accordance with standards prescribed by the Comptroller General and evaluate such controls using guidelines established by the Office of Management and Budget (OMB). As outlined in 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."

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The FCC reporting component entities' current financial systems and processes were not capable of achieving the financial system integration requirements.

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 Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards* dated December 13, 2013.

Debt Collection Improvement Act of 1996 (DCIA)

FCC had not transferred all eligible debt outstanding for more than 180 days to the Department of Treasury in accordance with the DCIA during fiscal year 2013. FCC was in the process of transferring the eligible delinquent debt to Treasury or writing it off; however, as of September 30, 2013 this had not yet been completed.

The DCIA, 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;"

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 Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards* dated December 13, 2013.



Office of the Managing Director

MEMORANDUM

DATE: December 13, 2013

TO: David L. Hunt, Inspector General

FROM: 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 2013

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) 2013 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 2013 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 eighth straight year, the independent auditor provided an unmodified opinion and found that the Commission's consolidated financial statements for FY 2013 present fairly, in all material respects, the financial position of the Commission as of September 30, 2013. Eight 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 2013 audit reports point out two significant deficiencies related to internal controls, and notes 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 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 2013 to resolve the auditors' findings and improve the performance of its financial reporting process. The Commission's core financial system was launched in October 2010, and during

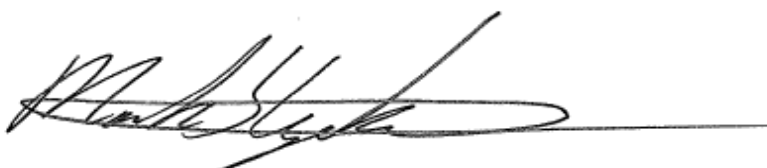
FY 2013 the Commission worked to further deploy all the functionality of that system. In December, 2013, the Commission will upgrade its core financial system, and this system upgrade will address even more of the auditors' concerns. Also in FY 2013, the Commission continued to work closely with its 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 2014, 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 committed to resolving this issue in FY 2013. By the end of FY 2013, the Commission was close to being current on its referrals to Treasury of all overdue outstanding debt. The Commission plans to be completely current with referrals in FY 2014.

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 2014 to resolve the FY 2013 audit findings and to enhance the culture of integrity, accountability, and excellence that exists here at the Commission.

A handwritten signature in black ink, appearing to read 'Mark Stephens', with a long horizontal line extending to the right.

Mark Stephens, Chief Financial Officer
Office of Managing Director

PRINCIPAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION CONSOLIDATED BALANCE SHEET

As of September 30, 2013 and 2012

(Dollars in thousands)

	FY 2013	FY 2012
Assets (Note 2):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 279,163	\$ 361,739
Investments (Note 5)	7,200,600	6,548,090
Accounts receivable (Note 6)	1,235	1,574
Total intragovernmental	<u>7,480,998</u>	<u>6,911,403</u>
Cash and other monetary assets (Note 4)	173,084	139,322
Accounts receivable, net (Note 6)	852,026	875,088
Direct loans receivable, net (Note 7)	3,502	335
General property, plant, and equipment, net	47,590	56,832
Other	13,024	13,024
Total assets	<u>\$ 8,570,224</u>	<u>\$ 7,996,004</u>
Liabilities (Note 8):		
Intragovernmental:		
Accounts payable	\$ 2,522	\$ -
Debt (Note 9)	353	-
Other (Note 10)		
Custodial	81,444	162,657
Other	8,114	6,240
Total other	<u>89,558</u>	<u>168,897</u>
Total intragovernmental	92,433	168,897
Accounts payable	134,727	110,523
Other (Note 10)		
Deferred revenue	59,920	62,971
Prepaid contributions	110,057	85,849
Accrued liabilities for Universal Service	1,088,415	752,423
Other	35,036	39,578
Total other	<u>1,293,428</u>	<u>940,821</u>
Total liabilities	<u>\$ 1,520,588</u>	<u>\$ 1,220,241</u>
Commitments and Contingencies (Note 11)		
Net position		
Unexpended appropriations - All Other Funds	\$ 3,394	\$ 4,251
Cumulative results of operations - Funds from Dedicated Collections (Note 12)	6,884,853	6,622,985
Cumulative results of operations - All Other Funds	161,389	148,527
Total net position	<u>\$ 7,049,636</u>	<u>\$ 6,775,763</u>
Total liabilities and net position	<u>\$ 8,570,224</u>	<u>\$ 7,996,004</u>

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	<u>FY 2013</u>	<u>FY 2012</u>
Program costs (Note 13):		
Connect America:		
Total Gross Cost	\$ 47,037	\$ -
Maximize Benefits of Spectrum:		
Total Gross Cost	79,655	-
Broadband:		
Total Gross Cost	-	48,428
Promote Innovation, Investment, and America's Global Competitiveness:		
Total Gross Cost	9,697	-
Promote Competition:		
Total Gross Cost	9,580,394	-
Competition and Innovation:		
Total Gross Cost	-	9,739,491
International:		
Total Gross Cost	-	10,126
Protect and Empower Consumers:		
Total Gross Cost	52,155	-
Consumers:		
Total Gross Cost	-	52,200
Public Safety and Homeland Security:		
Total Gross Cost	47,359	48,123
Advance Key National Purposes:		
Total Gross Cost	10,000	-
Operational Excellence:		
Total Gross Cost	92,807	-
Continual Improvement:		
Total Gross Cost	-	98,582
Total Program Costs	<u>\$ 9,919,104</u>	<u>\$ 9,996,950</u>
Cost not assigned to programs:		
Other expenses	-	(5)
Less: earned revenues not attributed to programs	<u>(486,596)</u>	<u>(460,246)</u>
Net cost of operations	<u>\$ 9,432,508</u>	<u>\$ 9,536,699</u>

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	FY 2013			FY 2012		
	Funds from Dedicated Collections (Note 12)	All Other Funds	Total	Funds from Dedicated Collections (Note 12)	All Other Funds	Total
Cumulative Results of Operations:						
Beginning Balances	\$ 6,622,985	\$ 148,527	\$ 6,771,512	\$ 6,089,350	\$ 131,084	\$ 6,220,434
Budgetary Financing Sources:						
Other adjustments	-	(1)	(1)	-	-	-
Appropriations used	-	661	661	-	20,301	20,301
Non-exchange revenue (Note 12)	9,722,967	-	9,722,967	10,078,791	-	10,078,791
Other (Note 12)	67	-	67	-	-	-
Other Financing Sources (Non Exchange):						
Imputed financing	-	15,146	15,146	-	15,487	15,487
Other	-	(31,602)	(31,602)	-	(26,802)	(26,802)
Total Financing Sources	9,723,034	(15,796)	9,707,238	10,078,791	8,986	10,087,777
Net Cost of Operations	9,461,166	(28,658)	9,432,508	9,545,156	(8,457)	9,536,699
Net Change	261,868	12,862	274,730	533,635	17,443	551,078
Cumulative Results of Operations	6,884,853	161,389	7,046,242	6,622,985	148,527	6,771,512
Unexpended Appropriations:						
Beginning Balances	-	4,251	4,251	-	15,105	15,105
Budgetary Financing Sources:						
Appropriations received	-	-	-	-	18,432	18,432
Other adjustments	-	(196)	(196)	-	(8,985)	(8,985)
Appropriations used	-	(661)	(661)	-	(20,301)	(20,301)
Total Budgetary Financing Sources	-	(857)	(857)	-	(10,854)	(10,854)
Total Unexpended Appropriations	-	3,394	3,394	-	4,251	4,251
Net Position	\$ 6,884,853	\$ 164,783	\$ 7,049,636	\$ 6,622,985	\$ 152,778	\$ 6,775,763

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	FY 2013		FY 2012	
	Budgetary	Non-Budgetary Credit Reform Financing Account	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources:				
Unobligated balance brought forward, October 1	\$ 3,202,610	\$ 4,357	\$ 2,727,599	\$ 37,008
Recoveries of prior year unpaid obligations	927,684	-	1,065,292	-
Other changes in unobligated balance (+ or -)	(1)	-	(8,987)	(32,724)
Unobligated balance from prior year budget authority, net	4,130,293	4,357	3,783,904	4,284
Appropriations (discretionary and mandatory)	9,786,362	-	10,060,594	-
Borrowing authority (discretionary and mandatory) (Note 14)	-	1,496	-	856
Spending authority from offsetting collections (discretionary and mandatory)	448,153	2,516	445,864	2,016
Total budgetary resources	<u>\$ 14,364,808</u>	<u>\$ 8,369</u>	<u>\$ 14,290,362</u>	<u>\$ 7,156</u>
Status of Budgetary Resources:				
Obligations incurred	\$ 11,004,372	\$ 1,536	\$ 11,087,752	\$ 2,799
Unobligated balance, end of year:				
Apportioned	11,041	32	14,537	1,005
Exempt from apportionment	3,173,822	-	3,055,396	-
Unapportioned	175,573	6,801	132,677	3,352
Total unobligated balance, end of year	<u>3,360,436</u>	<u>6,833</u>	<u>3,202,610</u>	<u>4,357</u>
Total status of budgetary resources	<u>\$ 14,364,808</u>	<u>\$ 8,369</u>	<u>\$ 14,290,362</u>	<u>\$ 7,156</u>
Change in Obligated Balance:				
Unpaid obligations:				
Unpaid obligations, brought forward, Oct 1	\$ 3,581,685	\$ -	\$ 3,416,789	\$ -
Obligations incurred (Note 15)	11,004,372	1,536	11,087,752	2,799
Outlays (gross) (-)	(9,606,177)	(1,536)	(9,857,564)	(2,799)
Recoveries of prior year unpaid obligations (-)	(927,684)	-	(1,065,292)	-
Unpaid obligations, end of year	4,052,196	-	3,581,685	-
Uncollected payments:				
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(5,616)	-	(382)	-
Change in uncollected pymts, Fed sources (+ or -)	1,198	-	(5,234)	-
Uncollected pymts, Fed sources, end of year (-)	(4,418)	-	(5,616)	-
Memorandum (non-add) entries				
Obligated balance, start of year (+ or -)	\$ 3,576,069	\$ -	\$ 3,416,407	\$ -
Obligated balance, end of year (net)	<u>\$ 4,047,778</u>	<u>\$ -</u>	<u>\$ 3,576,069</u>	<u>\$ -</u>
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	\$ 10,234,515	\$ 4,012	\$ 10,506,458	\$ 2,872
Actual offsetting collections (discretionary and mandatory) (-)	(477,380)	(3,658)	(445,504)	(20,448)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)	1,198	-	(5,234)	-
Budget Authority, net (discretionary and mandatory)	<u>\$ 9,758,333</u>	<u>\$ 354</u>	<u>\$ 10,055,720</u>	<u>\$ (17,576)</u>
Outlays, gross (discretionary and mandatory)	\$ 9,606,177	\$ 1,536	\$ 9,857,564	\$ 2,799
Actual offsetting collections (discretionary and mandatory) (-)	(477,380)	(3,658)	(445,504)	(20,448)
Outlays, net (discretionary and mandatory)	9,128,797	(2,122)	9,412,060	(17,649)
Distributed offsetting receipts (-)	(13,356)	-	(54,772)	-
Agency outlays, net (discretionary and mandatory)	<u>\$ 9,115,441</u>	<u>\$ (2,122)</u>	<u>\$ 9,357,288</u>	<u>\$ (17,649)</u>

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	<u>FY 2013</u>	<u>FY 2012</u>
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	\$ 15,183	\$ 38,477
Fines and Penalties	25,287	8,656
Credit Reform	62	1,761
Total Cash Collections	<u>40,532</u>	<u>48,894</u>
Accrual Adjustments (+/-)		
Spectrum Auctions	(1,564)	1,560
Fines and Penalties	3,907	1,096
Total Accrual Adjustments	<u>2,343</u>	<u>2,656</u>
Total Custodial Revenue	42,875	51,550
Disposition of Collections:		
Transferred to Others:		
U.S. Treasury	(25,349)	(10,417)
Decrease in Amounts Yet to be Transferred	81,213	43,867
Retained by the Reporting Entity	<u>(98,739)</u>	<u>(85,000)</u>
Total Disposition of Collections	(42,875)	(51,550)
Net Custodial Activity	<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, 2013 AND 2012

(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*. Custodial activity reported on the Statement of Custodial Activity is prepared on the modified cash basis.

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 third party deposits and demand deposits at several commercial banks which are maintained by Universal Service Administrative Company (USAC), Rolka Loube Saltzer Associates, LLC (RLSA), and Welch LLP, serving as administrators and/or billing and

Note 1 - Summary of Significant Accounting Policies (continued)

D. Cash and Other Monetary Assets (continued)

collection agents. Demand deposits 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.

E. Investments

Investments are reported at their acquisition cost, adjusted for amortization of 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. In FY 2012 and prior years, 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, were capitalized. Bulk purchases of similar items, individually worth less than \$25 but collectively worth more than \$250, were also capitalized using the same equipment categories and useful lives as capital acquisitions. Beginning in FY 2013, the FCC increased its capitalization threshold to \$100 for all PP&E and \$200 for all internally developed software. The FCC also no longer capitalizes bulk purchases of similar items. The impact of these changes has no material effect on the Commission's financial position or results of operations. The capitalized PP&E and software have an estimated useful life of two years or greater. 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.

Note 1 - Summary of Significant Accounting Policies (continued)

I. Other Assets

Other Assets with the public represent the balance of transfers less expenses made by the USF to 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

Debt represents amounts due to the U.S. Treasury’s Bureau of the Fiscal Service (BFS) to support the spectrum auction loan program. Borrowings from BFS 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 BFS 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 portion 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), the Federal Employee Retirement

Note 1 - Summary of Significant Accounting Policies (continued)

M. Retirement Plans and Other Benefits (continued)

System (FERS), or the FERS-Revised Annuity Employee (RAE). Under CSRS, the Commission makes matching contributions equal to seven percent of basic pay. Under both FERS plans, the Commission contributes the employer's matching share for Social Security. All employees are eligible to contribute to the Thrift Saving Plan (TSP) which is a defined contribution retirement savings and investment plan. For those employees covered by the FERS plans, a TSP account is automatically established to which the commission is required to contribute 1% of gross pay and match dollar-for-dollar on the first 3% of pay contributed each pay period and 50 cents on the dollar for the next 2% of pay contributed. No government contributions are made to the TSP accounts established by CSRS employees. Most employees hired after December 31, 1983, are covered by the FERS plans.

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

The actuarial liability for future workers' compensation benefits payable includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, as well as a component for incurred but not reported claims. The liability is determined using historical benefit payment patterns related to injury years to predict the ultimate payment. 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: Connect America; Maximize Benefits of Spectrum; Promote Innovation, Investment, and America's Global Competitiveness; Promote Competition; Protect and Empower Consumers; Public Safety and Homeland Security; Advance Key National Purposes; and Operational Excellence. These are different from the strategic goals in FY 2012: 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

Note 1 - Summary of Significant Accounting Policies (continued)

O. Revenues and Other Financing Sources (continued)

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 2013 and \$339,844 for FY 2012 were achieved. The Commission collected \$10,933 above the required regulatory level in FY 2013 and \$4,874 in FY 2012. The cumulative amount collected above the required annual regulatory level is \$81,977 at September 30, 2013. In addition, the cumulative amount collected above the required annual regulatory level has been temporarily precluded from obligation since FY 2008.

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 were capped at \$98,739 in FY 2013 and \$85,000 in FY 2012.

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 \$13,619 in FY 2013 and \$40,036 in FY 2012.

Application Fees (Exchange) – Congress authorized the Commission (47 U.S.C. § 8) to collect application processing fees and directed the Commission to prescribe charges for certain types of application processing or authorization services over which the Commission has jurisdiction. Section 8(b) of the Act, as amended, requires the Commission to review and amend its application fees every two years. The amended fees (Schedule of Application Fees 14 U.S.C. § 1.1102 *et seq.*) reflect the net change in the Consumer Price Index for all Urban Consumers calculated over a specific period of time, and the Commission's cost of processing applications and associated filings. Application fees are deposited in the Treasury and are not available for the Commission's use. Application fee revenue totaled \$27,985 in FY 2013 and \$24,804 in FY 2012.

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 2013, the Commission executed agreements totaling \$4,168. In FY 2012, the Commission executed agreements totaling \$661, and 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.

Note 1 – Summary of Significant Accounting Policies (continued)

O. Revenues and Other Financing Sources (continued)

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.

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 dedicated collections and are accounted for as a budgetary financing source.

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 for FY 2013 is \$339,844, which includes a temporary reduction of \$17,096 due to the FY 2013 sequestration order implemented on March 1, 2013 and required by the Budget Control Act of 2011. The annual appropriation for FY 2012 was \$339,844. Regulatory fee collections fully fund the annual appropriation for FY 2013 and FY 2012.

Subsidy Estimates and Reestimates (Financing Source) – In accordance with the FCRA of 1990 and as amended, the Commission receives permanent-indefinite authority for its credit reform program account, unless otherwise prescribed by OMB, to fund its subsidy estimates and reestimates. This account records the subsidy costs associated with the direct loans after FY 1991, as well as administrative expenses of the loan program. In FY 2013, the Commission did not receive an appropriation since there was no upward reestimate component. In FY 2012, the Commission received an appropriation of \$18,432. The appropriation is available until used.

P. Reprogramming

In FY 2013, the Commission received approval to reprogram \$8,433 of prior year de-obligations to fund a number of projects. The projects include settling legal claims, compensation and benefits, and capital improvements and information technology investments. In FY 2012, the Commission received approval to reprogram \$12,100 of prior year de-obligations to implement certain initiatives. The initiatives included cyber security and incentive spectrum auctions.

Q. 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 USAC, which is both the administrator and B&C agent for the four USF support mechanisms, RLSA, which is both the administrator and B&C agent for TRS, Neustar which is the administrator for NANP, and Welch LLP which is the B&C agent for NANP.

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

Note 1 - Summary of Significant Accounting Policies (continued)

Q. Transactions with Related Parties (continued)

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, 2013 and 2012 are listed below:

Administrative Fees:

	<u>USF</u>	<u>TRS</u>	<u>NANP</u>	<u>Total</u>
FY 2013	\$ 111,112	\$ 1,107	\$ 5,762	\$ 117,981
FY 2012	\$ 105,358	\$ 1,094	\$ 5,409	\$ 111,861

R. 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.

S. Reclassification and Other

The FY 2012 financial statements were reclassified to conform to the FY 2013 OMB financial statement presentation requirements. The changes to the presentation of the Combined Statements of Budgetary Resources were made in accordance with guidance provided in OMB Circular No. A-136, *Financial Reporting Requirements*, and as such, activity and balances reported on the FY 2012 Combined Statement of Budgetary Resources have been reclassified to conform to the presentation in the current year. Certain other prior year amounts have also been reclassified to conform to the presentation in the current year. The reclassifications have no material effect on total assets, liabilities, net position, change in net position, or budgetary resources as previously reported.

Effective for FY 2013, the Commission began accounting for costs under new strategic goals as presented in the FY 2013 Performance Plan. The FY 2012 strategic goals are listed separately from the FY 2013 strategic goals in the Statement of Net Costs since they cannot be easily crosswalked to the new goals.

The Commission implemented in FY 2013 Statement of Federal Financial Accounting Standards 43, *Funds from Dedicated Collections*, amending Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Earmarked Funds*. No restatement was necessary as a result of this change. The only impact on the financial statements and accompanying notes was the term “earmarked funds” was changed to “Funds from Dedicated Collections.”

Note 2 - Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2013 and 2012:

	<u>FY 2013</u>	<u>FY 2012</u>
Intragovernmental:		
Fund Balance with Treasury	\$ 78,415	\$ 179,007
Accounts Receivable, Net	433	439
Total Intragovernmental	<u>78,848</u>	<u>179,446</u>
Accounts Receivable, Net	<u>25,620</u>	<u>21,565</u>
Total Non-entity Assets	<u>104,468</u>	<u>201,011</u>
Total Entity Assets	<u>8,465,756</u>	<u>7,794,993</u>
Total Assets	<u>\$ 8,570,224</u>	<u>\$ 7,996,004</u>

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for \$76,432 in FY 2013 and \$166,489 in FY 2012. 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, 2013 and 2012:

<u>FY 2013</u>	<u>Appropriated Funds</u>	<u>Revolving Funds</u>	<u>Deposit Funds</u>	<u>Total</u>
Unobligated Balance				
Available	\$ 19,378	\$ 6,833	\$ -	\$ 26,211
Unavailable	103,329	-	-	103,329
Obligated Balance not yet Disbursed	71,208	-	-	71,208
Non-Budgetary FBWT	-	-	78,415	78,415
Total	<u>\$ 193,915</u>	<u>\$ 6,833</u>	<u>\$ 78,415</u>	<u>\$ 279,163</u>
<u>FY 2012</u>				
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
Total	<u>\$ 178,375</u>	<u>\$ 4,357</u>	<u>\$ 179,007</u>	<u>\$ 361,739</u>

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

Note 3 – Fund Balance with Treasury (continued)

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 non-budgetary and 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, 2013 and 2012:

	<u>FY 2013</u>	<u>FY 2012</u>
Cash and Other Monetary Assets	<u>\$ 173,084</u>	<u>\$ 139,322</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.

In FY 2013, Cash and Other Monetary Assets included \$170,085 in USF contributions and related accrued interest being held for distribution, and \$2,999 in NANP deposits and related accrued interest. 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.

Note 5 - Investments

The following summarizes Investments as of September 30, 2013 and 2012:

<u>FY 2013</u>	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	\$ 1,287,513	EI	\$ 29	\$ -	\$ 1,287,542	\$ 1,287,533
Treasury Notes	5,913,637	EI	(7,179)	6,600	5,913,058	5,901,937
Total	<u>\$ 7,201,150</u>		<u>\$ (7,150)</u>	<u>\$ 6,600</u>	<u>\$ 7,200,600</u>	<u>\$ 7,189,470</u>
<u>FY 2012</u>						
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>

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 Funds from Dedicated Collections in Note 12.

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, 2013 and 2012:

	<u>Intragovernmental</u>	<u>Public</u>	<u>Total</u>
<u>FY 2013</u>			
Gross Accounts Receivable	\$ 1,235	\$ 1,617,710	\$ 1,618,945
Allowance for Doubtful Accounts	-	(765,684)	(765,684)
Net Accounts Receivable	<u>\$ 1,235</u>	<u>\$ 852,026</u>	<u>\$ 853,261</u>
<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>

Accounts receivable are recorded net of any related allowance for doubtful accounts. The Commission's portion of the allowance for doubtful accounts is determined by applying predetermined percentages against the respective date the receivable was established. The 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 of the allowance 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 95% allowance in FY 2013 and 96% allowance in FY 2012.

Note 6 - Accounts Receivable, Net (continued)

The following summarizes accounts receivable by type as of September 30, 2013 and 2012:

	FY 2013			FY 2012		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	\$ 1,303,849	\$ (483,749)	\$ 820,100	\$ 1,289,562	\$ (442,926)	\$ 846,636
COMAD - Schools and Libraries	123,145	(117,357)	5,788	148,896	(142,345)	6,551
Regulatory Fees	40,708	(28,771)	11,937	38,369	(28,147)	10,222
Spectrum Auction	21,568	(21,568)	-	24,194	(22,630)	1,564
Forfeitures	114,125	(104,776)	9,349	100,549	(97,849)	2,700
Other	15,550	(9,463)	6,087	17,830	(8,841)	8,989
Total	<u>\$ 1,618,945</u>	<u>\$ (765,684)</u>	<u>\$ 853,261</u>	<u>\$ 1,619,400</u>	<u>\$ (742,738)</u>	<u>\$ 876,662</u>

Note 7 – Direct 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. In FY 2013, the Commission wrote off all remaining loan balances.

Note 7 – Direct Loans Receivable, Net (continued)

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 in September, 2013. The reestimate resulted in a net downward adjustment, including interest on the reestimate, of \$3,265 reported in FY 2013 financial statements.

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 Auction:					
FY 2013	\$ -	\$ -	\$ -	\$ 3,502	\$ 3,502
FY 2012	\$ 111,074	\$ 7,883	\$ 857	\$ (119,479)	\$ 335

Interest accrued on bankrupt and defaulted loans totaled \$- in FY 2013 and \$7,883 in FY 2012.

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

Total Amount of Direct Loans Disbursed

No new loans were issued in FY 2013 and FY 2012.

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 2013 (Net)	\$ -	\$ -	\$ (3,265)	\$ (3,265)
FY 2012 (Net)	\$ -	\$ -	\$ (1,473)	\$ (1,473)

Note 7 – Direct Loans Receivable, Net (continued)

Schedule for Reconciling Subsidy Cost Allowance Balances

	<u>FY 2013</u>	<u>FY 2012</u>
Beginning Balance of the Subsidy Cost Allowance	\$ 119,479	\$ 140,656
Adjustments:		
Loans written off	(119,810)	(20,599)
Other	-	810
Subsidy allowance amortization	94	85
Ending balance before reestimates	<u>(237)</u>	<u>120,952</u>
Subsidy reestimates:		
Technical/default reestimate	<u>(3,265)</u>	<u>(1,473)</u>
Ending balance of the subsidy cost allowance	<u>\$ (3,502)</u>	<u>\$ 119,479</u>
Administrative Expense – Spectrum Auctions	\$ 555	\$ 1,837

Note 8 - Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2013 and 2012:

	<u>FY 2013</u>	<u>FY 2012</u>
Intragovernmental:		
FECA Liability	\$ 441	\$ 342
GSA Real Estate Taxes	2,357	1,922
Other:		
Unfunded Leave	20,734	20,452
Accrued Liabilities for Universal Service	1,088,415	752,423
Total liabilities not covered by budgetary resources	<u>1,111,947</u>	<u>775,139</u>
Total liabilities covered by budgetary resources	<u>408,641</u>	<u>445,102</u>
Total Liabilities	<u>\$ 1,520,588</u>	<u>\$ 1,220,241</u>

Liabilities not covered by budgetary resources are liabilities incurred that are not covered by realized budgetary resources as of the Balance Sheet date.

Note 9 - Debt

	FY 2012 Beginning Balance	Net Borrowing	FY 2012 Ending Balance	Net Borrowing	FY 2013 Ending Balance
Debt to the Treasury	\$ 50,300	\$ (50,300)	\$ -	\$ 353	\$ 353

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, 2013 and 2012:

<u>FY 2013</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
Intragovernmental			
Custodial Liability	\$ -	\$ 81,444	\$ 81,444
Other	-	8,114	8,114
Total Intragovernmental	<u>\$ -</u>	<u>\$ 89,558</u>	<u>\$ 89,558</u>
Deferred Revenue	\$ 35,400	\$ 24,520	\$ 59,920
Prepaid Contributions	-	110,057	110,057
Accrued Liabilities for Universal Service	-	1,088,415	1,088,415
Other	-	35,036	35,036
Total Other	<u>\$ 35,400</u>	<u>\$ 1,258,028</u>	<u>\$ 1,293,428</u>
<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	<u>\$ -</u>	<u>\$ 168,897</u>	<u>\$ 168,897</u>
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	<u>\$ 33,392</u>	<u>\$ 907,429</u>	<u>\$ 940,821</u>

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 the opinion of Commission management, early contract termination will not materially affect the Commission's financial statements.

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. In FY 2013 the Commission entered into an agreement with the National Treasury Employee Union (NTEU) to settle overtime claims. The Commission and its payroll partner, National Finance Center (NFC), are determining the amounts and processes for payment. Since the amount cannot be calculated at this time, it does not materially affect the financial statements.

Note 12 – Funds from Dedicated Collections

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 12 – Funds from Dedicated Collections (continued)

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program as of September 30, 2013 and 2012:

Balance Sheet	FY 2013	FY 2012
Assets		
Investments	\$ 7,200,600	\$ 6,548,090
Cash and other monetary assets	170,085	136,475
Accounts receivable, net	827,903	866,813
General property, plant, and equipment, net	3,999	2,678
Other assets	13,024	13,024
Total assets	<u>\$ 8,215,611</u>	<u>\$ 7,567,080</u>
Liabilities		
Accounts payable	\$ 125,046	\$ 98,743
Deferred revenue	7,262	7,149
Prepaid contributions	110,035	85,780
Accrued liabilities	1,088,415	752,423
Total liabilities	<u>\$ 1,330,758</u>	<u>\$ 944,095</u>
Cumulative results of operations	<u>\$ 6,884,853</u>	<u>\$ 6,622,985</u>
Total liabilities and net position	<u>\$ 8,215,611</u>	<u>\$ 7,567,080</u>
Statement of Net Cost		
Net cost of operations	<u>\$ 9,461,166</u>	<u>\$ 9,545,156</u>
Statement of Changes in Net Position		
Net position beginning of period	\$ 6,622,985	\$ 6,089,350
Non-exchange revenue	9,722,967	10,078,791
Other financing sources	67	-
Net cost of operations	9,461,166	9,545,156
Change in net position	261,868	533,635
Net position end of period	<u>\$ 6,884,853</u>	<u>\$ 6,622,985</u>

Note 13 – Intragovernmental Costs and Exchange Revenue

Intragovernmental costs primarily represent goods and services purchased by the Commission from other Federal agencies. Effective for FY 2013, the Commission began accounting for costs under new strategic goals as presented in the FY 2013 Performance Plan.

FY 2013

Program Costs	Intragovernmental	Public	Total
Connect America	\$ 12,563	\$ 34,474	\$ 47,037
Maximize Benefits of Spectrum	21,275	58,380	79,655
Promote Innovation, Investment, and America's Global Competitiveness	2,590	7,107	9,697
Promote Competition	30,288	9,550,106	9,580,394
Protect and Empower Consumers	13,930	38,225	52,155
Public Safety and Homeland Security	12,649	34,710	47,359
Advance Key National Purposes	2,671	7,329	10,000
Operational Excellence	24,789	68,018	92,807
Total	\$ 120,755	\$ 9,798,349	\$ 9,919,104
Total Earned Revenue	\$ 4,491	\$ 482,105	\$ 486,596

FY 2012

Program Costs	Intragovernmental	Public	Total
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
Total	\$ 114,450	\$ 9,882,500	\$ 9,996,950
Total Earned Revenue	\$ 6,065	\$ 454,181	\$ 460,246

Note 14 - Terms of Borrowing Authority Used

Maturity Dates:	Borrowing Authority Used	
	FY 2013	FY 2012
September 30, 2012	\$ -	\$ 856
September 30, 2020	1,496	-
Total Borrowing Authority Used	<u>\$ 1,496</u>	<u>\$ 856</u>

In FY 2013, the Commission used \$1,496 in borrowing authority to fund the FY 2012 Credit Reform Downward Subsidy, pay FY 2013 interest expense, and to extend the maturity date of the debt owed to BFS. In FY 2012, the Commission used \$856 in borrowing authority to fund the FY 2011 Credit Reform Downward Subsidy. All borrowing authority was from the BFS.

Note 15 - Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations

The following summarizes Apportionment Categories of Obligations Incurred for the years ended September 30, 2013 and 2012:

	FY 2013		FY 2012	
	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Direct:				
Category A	\$ 422,882	\$ -	\$ 424,746	\$ -
Category B	739,994	1,536	757,242	2,799
Exempt from Apportionment	9,838,207	-	9,896,697	-
Total Direct	<u>11,001,083</u>	<u>1,536</u>	<u>11,078,685</u>	<u>2,799</u>
Reimbursable:				
Category A	3,289	-	9,067	-
Total Obligations Incurred	<u>\$ 11,004,372</u>	<u>\$ 1,536</u>	<u>\$ 11,087,752</u>	<u>\$ 2,799</u>

Category A - Apportioned by Quarter

Category B - Apportioned by Purpose

Note 16 – Undelivered Orders at the End of the Period

The amount of budgetary resources obligated for undelivered orders totaled \$3,917,916 as of September 30, 2013 and \$3,463,190 as of September 30, 2012.

Note 17 – Permanent Indefinite Appropriations

The Commission has permanent indefinite appropriations available to fund its universal service programs and subsidy costs incurred under credit reform programs.

Pursuant to 47 U.S.C §§ 254 and 225, the FCC has a permanent indefinite appropriation to fund its universal service programs (including Telecommunications Relay Service (TRS)). These programs operate by collecting mandatory contributions from telecommunications carriers providing interstate telecommunications services, and from other providers of interstate telecommunications required to contribute if the public interest so requires. These contributions are accounted for federal budgetary purpose as a special fund known as the Universal Service Fund.

The permanent indefinite appropriations for credit reform are mainly available to finance any disbursements incurred under the liquidating accounts. These appropriations become available pursuant to standing provisions of law without further action by Congress after transmittal of the Budget for the year involved. They are treated as permanent the first year they become available, as well as in succeeding years. However, they are not stated as specific amounts but are determined by specified variable factors, such as cash needs for liquidating accounts, and information about the actual performance of a cohort or estimated changes in future cash flows of the cohort in the program accounts.

Note 18 – Legal Arrangements Affecting Use of Unobligated Balances

Pursuant to Public Law 111-8, offsetting collections received in excess of \$339,844 in FY 2013 and \$339,844 in FY 2012 are temporarily precluded from obligation. In addition, the cumulative amount collected above the required annual regulatory level has been temporarily precluded from obligation since FY 2008. (Refer to Note 1. O)

Note 19 - Explanation of Differences Between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

There were no material differences between the Combined Statement of Budgetary Resources (SBR) for FY 2012 and the amounts presented in the 2014 President's Budget. The FY 2015 *Budget of the United States Government* (President's Budget) with actual numbers for FY 2013 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 20 – Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)

As of September 30, 2013 and 2012:

	<u>FY 2013</u>	<u>FY 2012</u>
Budgetary Resources Obligated:		
Obligations incurred	\$ 11,005,908	\$ 11,090,551
Less: spending authority from offsetting collections and recoveries	<u>1,407,524</u>	<u>1,536,478</u>
Obligations net of offsetting collections and recoveries	9,598,384	9,554,073
Less: offsetting receipts	<u>13,356</u>	<u>54,772</u>
Net obligations	9,585,028	9,499,301
Other Resources	(16,389)	(11,315)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Undelivered Orders	(454,726)	(149,106)
Budgetary offsetting collections and receipts that do not affect net cost of operations	17,014	75,220
Resources that finance the acquisition of assets	(9,822)	(16,182)
Other	(30,067)	37,200
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Increase in annual leave liability	282	344
Upward/Downward reestimates of credit subsidy (+/-)	(3,265)	(1,473)
Increase in exchange revenue receivable from the public	758	5,277
Depreciation and amortization	19,064	19,810
Other (+/-)	<u>324,631</u>	<u>77,623</u>
Net Cost of Operations	<u>\$ 9,432,508</u>	<u>\$ 9,536,699</u>

REQUIRED SUPPLEMENTARY INFORMATION

(Unaudited)

REQUIRED SUPPLEMENTARY INFORMATION – STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2013 and 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, 2013 and 2012 Combined Statement of Budgetary Resources.

STATEMENT OF BUDGETARY RESOURCES

FY 2013

Budgetary Resources:

	S&E	Credit	Auctions	USF	Total
Unobligated balance brought forward, October 1	\$ 18,418	\$ 8,281	\$ 479	\$ 3,179,789	\$ 3,206,967
Recoveries of prior year unpaid obligations	3,897	6	710	923,071	927,684
Other changes in unobligated balance (+ or -)	381	-	(382)	-	(1)
Unobligated balance from prior year budget authority, net	22,696	8,287	807	4,102,860	4,134,650
Appropriations (discretionary and mandatory)	-	(196)	-	9,786,558	9,786,362
Borrowing authority (discretionary and mandatory)	-	1,496	-	-	1,496
Spending authority from offsetting collections (discretionary and mandatory)	327,819	2,516	99,109	21,225	450,669
Total budgetary resources	\$ 350,515	\$ 12,103	\$ 99,916	\$ 13,910,643	\$ 14,373,177

Status of Budgetary Resources:

Obligations incurred	\$ 332,574	\$ 2,006	\$ 99,179	\$ 10,572,149	\$ 11,005,908
Unobligated balance, end of year:					
Apportioned	10,644	339	90	-	11,073
Exempt from apportionment	-	-	-	3,173,822	3,173,822
Unapportioned	7,297	9,758	647	164,672	182,374
Total unobligated balance, end of year	17,941	10,097	737	3,338,494	3,367,269
Total status of budgetary resources	\$ 350,515	\$ 12,103	\$ 99,916	\$ 13,910,643	\$ 14,373,177

Change in Obligated Balance:

Unpaid obligations:

Unpaid obligations, brought forward, Oct 1	\$ 66,584	\$ 268	\$ 23,273	\$ 3,491,560	\$ 3,581,685
Obligations incurred	332,574	2,006	99,179	10,572,149	11,005,908
Outlays (gross) (-)	(351,884)	(2,163)	(87,907)	(9,165,759)	(9,607,713)
Recoveries of prior year unpaid obligations (-)	(3,897)	(6)	(710)	(923,071)	(927,684)
Unpaid obligations, end of year	43,377	105	33,835	3,974,879	4,052,196

Uncollected payments:

Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(5,616)	-	-	-	(5,616)
Change in uncollected pymts, Fed sources (+ or -)	1,198	-	-	-	1,198
Uncollected pymts, Fed sources, end of year (-)	(4,418)	-	-	-	(4,418)

Memorandum (non-add) entries

Obligated balance, start of year (+ or -)	\$ 60,968	\$ 268	\$ 23,273	\$ 3,491,560	\$ 3,576,069
Obligated balance, end of year (net)	\$ 38,959	\$ 105	\$ 33,835	\$ 3,974,879	\$ 4,047,778

Budget Authority and Outlays, Net:

Budget authority, gross (discretionary and mandatory)	\$ 327,819	\$ 3,816	\$ 99,109	\$ 9,807,783	\$ 10,238,527
Actual offsetting collections (discretionary and mandatory) (-)	(357,046)	(3,658)	(99,109)	(21,225)	(481,038)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)	1,198	-	-	-	1,198
Budget Authority, net (discretionary and mandatory)	\$ (28,029)	\$ 158	\$ -	\$ 9,786,558	\$ 9,758,687
Outlays, gross (discretionary and mandatory)	\$ 351,884	\$ 2,163	\$ 87,907	\$ 9,165,759	\$ 9,607,713
Actual offsetting collections (discretionary and mandatory) (-)	(357,046)	(3,658)	(99,109)	(21,225)	(481,038)
Outlays, net (discretionary and mandatory)	(5,162)	(1,495)	(11,202)	9,144,534	9,126,675
Distributed offsetting receipts (-)	(35,403)	-	-	22,047	(13,356)
Agency outlays, net (discretionary and mandatory)	\$ (40,565)	\$ (1,495)	\$ (11,202)	\$ 9,166,581	\$ 9,113,319

See accompanying auditor's report

STATEMENT OF BUDGETARY RESOURCES

FY 2012

	S&E	Credit	Auctions	USF	Total
Budgetary Resources:					
Unobligated balance brought forward, October 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)	-	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 status of budgetary resources	\$ 381,571	\$ 30,488	\$ 85,665	\$ 13,799,794	\$ 14,297,518
Change in Obligated Balance:					
Unpaid obligations:					
Unpaid obligations, brought forward, Oct 1	\$ 55,594	\$ 1,572	\$ 24,255	\$ 3,335,368	\$ 3,416,789
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)
Recoveries of prior year unpaid obligations (-)	(5,411)	(411)	(979)	(1,058,491)	(1,065,292)
Unpaid obligations, end of year	66,584	268	23,274	3,491,559	3,581,685
Uncollected payments:					
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(382)	-	-	-	(382)
Change in uncollected pymts, Fed sources (+ or -)	(5,234)	-	-	-	(5,234)
Uncollected pymts, Fed sources, end of year (-)	(5,616)	-	-	-	(5,616)
Memorandum (non-add) entries					
Obligated balance, start of year (+ or -)	\$ 55,212	\$ 1,572	\$ 24,255	\$ 3,335,368	\$ 3,416,407
Obligated balance, end of year (net)	\$ 60,968	\$ 268	\$ 23,274	\$ 3,491,559	\$ 3,576,069
Budget Authority and Outlays, Net:					
Budget 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)
Budget 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

3. Other Information

(Unaudited)

Summary of Financial Statement Audit

Audit Opinion	Unmodified				
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

See accompanying auditor's report

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	1	0	0	0	0	1
<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 and the Improper Payments Information Act (henceforth referred to collectively as IPERA), the Federal Communications Commission (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, which are 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 or High Cost Program)**
- **Universal Service Fund Schools and Libraries Program (USF-S&L or Schools and Libraries Program)**
- Universal Service Fund Lifeline Program (USF-Lifeline or Lifeline)
- Universal Service Fund Rural Health Care Program (USF-RHC or Rural Health Care Program)
- Universal Service Fund Administrative Costs (USF-Admin)
- **Interstate Telecommunications Relay Services Fund (TRS)**
- North American Numbering Plan (NANP)
- FCC Operating Expenses (FCC-OE)

In FY 2013, 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 (or periodically if significant changes occur), the Commission conducted a risk assessment of the five programs above that were not previously identified as susceptible to significant improper payments.

In conducting the analysis, the Commission used the methodology described in OMB Circular No. A-123, Appendix C. Specifically, the Commission reviewed any quantitative data that would indicate a risk of significant improper payments that would exceed both 2.5 percent of program outlays and \$10 million of all program or activity payments made during fiscal year 2013 or \$100 million (regardless of the improper payment percentage of total program outlays). In addition, the Commission analyzed each program's risk taking into account the following eight factors identified by the OMB: (1) whether the program or activity is new to the agency; (2) the complexity of the program or activity reviewed, particularly with respect to determining correct payment amounts; (3) the volume of payments made annually; (4) whether payments or payment eligibility decisions are made outside of the agency, for example, by a state or local government, or a regional Federal office; (5) recent major changes in program funding, authorities, practices or procedures; (6) the level, experience, and quality of training for personnel responsible for making program eligibility determinations or certifying that payments are accurate; (7) significant deficiencies in the audit reports of the agency including, but not limited to, the agency Inspector General or the Government Accountability Office report on audit findings, or other relevant management finds that might hinder accurate payment certification; and (8) results from prior improper payment work.

During those reviews, the Commission determined that Lifeline should be added to the list of programs that are susceptible to significant improper payments. The Commission found no indication that the other programs are susceptible to significant improper payments. The Commission will continue to monitor risks in the other programs and will continue to perform risk assessments consistent with OMB Circular No. A-123.

II. STATISTICAL SAMPLING PROCESS

Universal Service Fund. In FY 2013, the Commission used a statistical sampling process to obtain a statistically valid estimate of the annual amount of improper payments in USF-HC and USF-S&L using an alternative sampling method approved by OMB. This process, called the Payment Quality Assurance (PQA) assessment plan, tested disbursements made in calendar year 2012 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 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-Lifeline. As noted above, the Commission determined that Lifeline is susceptible to significant improper payments during fiscal year 2013. Now that such a determination has been made, the Commission will establish and implement a sampling methodology for Lifeline by September 30, 2014.

USF-HC. In FY 2013, the Commission used stratified simple random sampling based on calendar year 2012 disbursements. The sampling design was not changed from fiscal year 2012. 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. In addition, no carrier was assessed more than once during the year. Assessments of calendar year 2012 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 2012. The disbursement strata based on annual disbursements were: less than \$1 million; greater than or equal to \$1 million but less than \$5 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 – eight within each stratum – and the total number tested for fiscal year 2013 was 288, which represented \$99 million in disbursements. Improper payments of \$255,201 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 0.26% for fiscal year 2013. The total extrapolated amount of improper payments for fiscal year 2013 was \$10.6 million out of approximately \$4.1 billion in actual disbursements in calendar year 2012.

USF-S&L. In FY 2013, the Commission used stratified simple random sampling based on calendar year 2012 disbursements. The sampling design was not changed from fiscal year 2012. Samples from USF-S&L disbursements were randomly selected on a monthly basis. Assessments of calendar year 2012 transactions were conducted monthly and included testing or confirmation of: (1) the accuracy of payments and other invoicing data; (2) program applicants' eligibility; (3) whether the proper discount was applied and calculated; (4) whether services were delivered within the funding year; (5) technology plans for certified approval and timing of approval; (6) service eligibility; (7) whether the beneficiary was eligible to receive funding for internal connections; (8) the competitive bidding process, including review of the bid evaluation process and contract verification; (9) compliance with the Children's Internet Protection Act; and (10) the beneficiary's payment of its non-discount share. The last three areas represent new topics that were added for testing in FY 2013.

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 total number of invoice lines that were tested for fiscal year 2013 was 780, which represented \$35.4 million in disbursements. Improper payments of \$419,566 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 2.21% for fiscal year 2013. The total extrapolated amount of improper payments for FY 2013 was \$49.4 million out of approximately \$2.2 billion in actual disbursements in calendar year 2012.

TRS. The Commission has worked closely with OMB to create an IPERA testing program for FY 2013 that was more robust than that of FY 2012. Rolka Loubé Saltzer Associates, LLC (RLSA), the TRS Fund Administrator, in coordination with OMB and consistent with OMB Circular No. A-123, employed a methodology for calculation of an error rate that relied, in part, on an alternative statistical sampling methodology approved by OMB.

Nine attributes were tested for 100% of distributions for the program funding period of July 1, 2012, through June 30, 2013, totaling \$786.3 million. Based on these nine attributes, the resulting error rate for improper payments was zero percent and \$0 in improper payments. Furthermore, two additional attributes included in this year's test that contributed the most to making the testing more robust were related to the Video Relay Service (VRS) Call Detail Records (CDRs). The testing approach included identifying the total number of VRS CDRs submitted for compensation. The result was a total of 47,414,523 CDRs for minutes incurred during the program year. This results in an average of 3,951,210 submitted CDRs per month. Using a 90% confidence interval (CI) and a 2.5% error rate, the sample size generation program <http://www.raosoft.com/samplesize.html> resulted in a sample size of 1,082. Because there were some changes in the rules during the program year, the TRS Fund administrator's contractor performed a stratified sample (records per month) and selected the sample based upon the total number of VRS CDRs submitted. A total of 12,990 VRS CDRs were analyzed and tested, resulting in a 0% improper payment rate for these attributes.

III. CORRECTIVE ACTION PLANS

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

USF

USAC has examined the results of the audits and assessment programs conducted in FY 2013, and has implemented corrective action plans to address any findings, consistent with OMB Circular No. A-123 and OMB Circular No. A-50 (which provide 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 FY 2013, USAC identified \$853,631 in improper payments (both underpayments and overpayments) across all of the programs, including Lifeline and RHC, under the PQA process. The recoverable amounts are detailed by program in Table 6. Of these improper payments, \$684,415 were non-de minimis overpayments that are subject to recovery. By September 30, 2013, USAC had recovered \$261,167. Of the \$423,248 outstanding, USAC has issued notification letters for \$92,910. The remaining \$330,338 was under internal review at USAC as of September 30.

USF-HC. In FY 2013, 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.

High-Cost Errors Identified in PQA Process	Improper Payment Amount Totals	Number of Instances
Total Administrative and Documentation Errors	\$0	0
Total Authentication and Medical Necessity Errors	\$0	0
Verification Errors		
Phase down support incorrect calculation	\$172,561	5
Ineligible carrier	\$ 42,604	1
Part 36 reporting exception	\$ 34,353	43
SLC revenue	\$ 3,910	26
LSS incorrect reporting.	\$ 1,773	2
Total Verification Errors	\$255,201	77
Total	\$255,201	77

USF S&L. In FY 2013, the PQA process identified the following improper payment issues and amounts for the schools and libraries program. The Commission is currently working with USAC to recover these funds and to make additional improvements to the USF-S&L program. Note: The actual amount of improper payments was \$419,565.51; we have rounded the total up to \$419,566 for the table below.

Schools and Libraries Errors Identified in PQA Process	Improper Payment Amounts	Number of Instances
Administrative and Documentation Errors		
Incomplete documentation	\$20,536	9
Total Administrative and Documentation Errors	\$20,536	9
Total Authentication and Medical Necessity Errors	\$0	\$0
Verification Errors		
Competitive bidding/28-day waiting period	\$156,526	1
Invoicing error	\$114,303	20
Funding received by entities not on Form 471	\$64,024	17
Ineligible goods/services funded	\$30,707	4
Goods/services received by ineligible entity	\$26,849	24
No approved tech plan	\$5,774	1
Discount calculation - urban/rural classification	\$457	3
Payment received prior to goods/services delivery	\$389	1
Total Verification Errors	\$399,029	71
Total	\$419,566	80

In addition to the individual corrective action plans and outreach detailed above, USAC conducts an extensive pre-commitment review of applications, called the Program Integrity Assurance (PIA) process, to reduce improper payments in the USF-S&L program. In addition, USAC selects some requests for invoicing for additional reviews. In conjunction with the Commission, USAC annually reviews its PIA process to determine how to improve those procedures.

USF-LI. The Commission identified Lifeline as a program that is susceptible to significant improper payments during FY 2013. Although the Commission did not conduct a statistically valid sampling in FY 2013, the Commission has identified improper payments in the Lifeline program through targeted procedures known as in-depth data validations (IDVs). In 2011, the Commission directed USAC to begin conducting state-specific IDVs to detect duplicative Lifeline support. Through this process, USAC matches carriers' subscriber records within a state to determine if a subscriber is receiving Lifeline support from multiple carriers, assigns a single default carrier to each subscriber receiving multiple support (the subscriber can override this choice), and instructs the subscriber's other carriers to de-enroll that subscriber from Lifeline support. Through the IDV process, the Commission has identified \$8.2 million in improper payments in FY 2013, and eliminated approximately 2 million duplicate Lifeline subscriptions since the IDV process began in 2011. The \$8.2 million in improper payments, however, represented only one data month, not the entire fiscal year. In addition, the IDVs tested subscription data in 31 states, not every jurisdiction. Furthermore, the Commission took enforcement action against more than 300 Lifeline customers who had been receiving more than one Lifeline service at a time, focusing first on the most egregious offenders.

To address the issue of multiple lines of support for a single subscriber in the future, the Commission adopted a Report and Order in 2012 that directed USAC to create a National Lifeline Accountability Database (NLAD). The NLAD is intended to significantly reduce the possibility that a subscriber can have multiple Lifeline accounts. As USAC has announced, the NLAD will begin accepting Lifeline subscriber data in December 2013 for the first set of five states that will be loaded into the database. After this initial phase, data from the remaining states and jurisdictions will be loaded into the database. After USAC has loaded the data for each set of states, USAC and ETCs will engage in several weeks of testing before the ETCs in those states start using the NLAD. The database is expected to be operational for all states and jurisdictions by the end of the first quarter of 2014.

In the 2012 Report and Order, the Commission took additional steps to identify and reduce improper payments in the Lifeline program. In addition to the establishment of the NLAD, these intensified efforts to protect against improper payments include: (i) requiring consumers to provide proof of eligibility at enrollment; (ii) requiring consumers to certify that they understand key program rules and to recertify annually their continued eligibility for support; (iii) limiting the Lifeline benefit to one-per-household; (iv) eliminating Link Up support for all providers on non-Tribal lands; and (v) putting in place a robust audit requirement for providers entering the Lifeline program and an ongoing independent audit requirement for providers drawing \$5 million or more from the Lifeline program annually.

Additional Efforts to Reduce Future Improper Payments in USF Programs. The Commission continues to expand its efforts to strengthen oversight of the entire USF program and reduce improper payments. At the direction of the Commission, USAC has developed a comprehensive set of measures to reduce improper payments arising from the findings identified in the tables above. Specifically, USAC has expanded outreach to funding recipients designed to prevent the errors identified above from re-occurring, enhanced its 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.

The Commission has directed USAC to separate the USF IPERA efforts into two distinct programs with two objectives – one focused on improper payment assessment (PQA, as noted above) and the second on auditing compliance with the rules for all four USF programs and contribution collections (known as the Beneficiary and Contributor Audit Program, or BCAP). These two programs serve as a deterrent to waste, fraud, and abuse, and provide an additional incentive for beneficiaries to comply with program rules and therefore to decrease improper payments. The Commission seeks recovery of overpayments identified in both programs. In FY 2013, the Commission reviewed and revised the procedures for the PQA program. The Commission also is in the process of reviewing each of the program’s audit procedures. The reviews of the PQA assessments and audit procedures will ensure that USAC is testing and analyzing the relevant Commission rules and requirements for the programs.

In addition to the actions listed above, key actions undertaken in FY 2013 by the Commission and USAC to reduce future improper payments in the USF programs include:

- Schools and Libraries: The Commission 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 Commission is reviewing USAC’s selection of vendor for the risk assessment.

- Schools and Libraries: On July 19, 2013, the Commission adopted a Notice of Proposed Rulemaking (NPRM) that seeks to reform and modernize the S&L program. As part of the NPRM, the Commission sought to identify additional policies and procedures to protect against waste, fraud, and abuse. For example, the NPRM contained proposed measures or sought comments on ways to: ensure the integrity of the applicant competitive bidding process; extend the recordkeeping requirements; increase certification requirements; and strengthen audit procedures. The Commission also sought comment on specific performance goals and measures applicable to the S&L program.
- High Cost (Connect America Fund): The Commission continued activities to implement the 2011 *USF/ICC Transformation Order* that comprehensively reformed and modernized the High Cost universal service program. The order provides fiscally responsible, accountable, incentive-based policies to transition an outdated and inefficient High Cost program into the Connect America Fund.
- High Cost (Mobility Fund Phase I): The Commission continued implementation of the Mobility Fund, which was established as a part of the Connect America Fund. Phase I of the Mobility Fund will provide up to \$350 million in USF high-cost universal service support to fund, on a one-time basis, the expansion of current-generation wireless services. Initial Mobility Fund support was awarded through a nationwide reverse auction held in September 2012, in which support was awarded based on the lowest per-unit bid amounts. Auction 901 winning bidders were required to submit post-auction “long-form” applications by November 5, 2012. Since April 2013, the Commission has authorized initial disbursements for more than \$256 million in winning bids and announced \$20 million in auction defaults. Of the authorized winning bids, one winning bidder subsequently defaulted on bids totaling more than \$45 million. The remaining five applications for support totaling \$15 million are being actively processed. Mobility Fund Phase I was designed as a performance-based program under which USF support is conditioned upon the recipient’s compliance with its performance obligations. In adopting rules for Mobility Fund Phase I, the Commission decided that it would require recipients of Mobility Fund support to provide an irrevocable stand-by letter of credit as financial security to secure the return of the USF funds disbursed if the recipient fails to fulfill its obligations. The letter of credit is required to be in an amount equal to the amount of support received plus an additional percentage of the amount of support as a performance default payment. Support payments are provided in three installments. Each party receiving support will be eligible to receive from USAC a disbursement of one-third of the total amount of support once its application for support is granted. A party will receive the remainder of its support after filing with USAC a report with the required data that demonstrates that it has met its performance requirements.
- High Cost (Connect America Fund): The Commission investigated compliance with its rules for determining high-cost support and coordinated with OIG regarding similar OIG-initiated investigations.
- Lifeline: The Commission took aggressive enforcement action against Lifeline providers who unlawfully sought and received duplicate Lifeline support. The resulting Notices of Apparent Liability proposed more than \$14.4 million in forfeitures against five Lifeline service providers and were designed to combat waste, fraud, and abuse in the Lifeline program and protect the integrity of the Universal Service Fund. The apparent violations involve thousands of consumers who had more than one Lifeline subscription from the same provider, resulting in duplicative support requests and payments. The proposed forfeitures are in addition to recovery of universal service funds paid to the carriers for this duplicative intra-company Lifeline service.

- Lifeline: The Commission executed consent decrees requiring two Lifeline service providers to reimburse the Lifeline program \$416,000 plus interest for duplicative payments, and to make voluntary contributions totaling \$600,000 to the U.S. Treasury. The consent decrees also required the providers to adhere to a robust three-year compliance plan designed to deter, prevent, and detect future instances of non-compliance.
- Lifeline: The Commission pursued multiple, additional investigations against Lifeline service providers for possible violations of the Lifeline program rules, and coordinated with OIG on specific investigations that may implicate potential fraud or False Claim Act violations by Lifeline service providers.
- Rural Health Care/Healthcare Connect Fund: In December 2012, the Commission adopted an order creating a new Healthcare Connect Fund. It incorporated in the new program measures intended to safeguard against potential waste, fraud, and abuse, including many measures found effective in the existing rural health care programs. For example, the Healthcare Connect Fund contains measures to ensure the integrity of the applicant competitive bidding process; measures to prevent duplicative support; and recordkeeping, audit, and certification requirements. The Commission also adopted performance goals and measures applicable to all of the Commission's rural health care programs.
- Rural Health Care/Healthcare Connect Fund: Beginning in 2012, USAC developed and deployed a new IT system for the Rural Health Care program. The new system, which is intended to improve the efficiency and effectiveness of the commitment and payment processes, permits end-to-end processing of requests for service, requests for funding, and payments.
- USF Administrator Actions: 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.
 - 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.

TRS

Efforts to Reduce Future Improper Payments in the TRS Program. During the past fiscal year, the Commission engaged with the TRS Fund administrator to enhance development of policies designed to reduce fraud and abuse of TRS Fund monies (e.g., worked with the administrator to identify ways to analyze data submitted by providers in their requests for reimbursement, in order to better detect improper requests and thereby ensure that the fund pays only for intended services). These activities are on-going. In addition, the Commission has taken the following steps to identify, reduce, and deter future improper payments in the TRS program:

- As described above, the TRS Fund administrator has calculated an error rate for improper payments under an alternative statistical sampling methodology consistent with OMB Circular No. A-123, and in coordination with OMB. In the next program year, the Commission will work with the TRS Fund Administrator and OMB to further strengthen the IPERA testing plan and move toward a non-alternative sampling methodology.

- The TRS Fund Administrator has completed audits of all TRS providers receiving reimbursement from the TRS Fund. Audits were conducted on 12 service providers receiving TRS reimbursements totaling \$605.9 million. Two of those audits were not completed because the companies ceased operations before the audits could be finalized. For the other audits, the auditors issued 15 findings related to non-compliance with Commission rules. The companies issued findings have all submitted responses of non-agreement, or agreement and corrective action plans. The TRS Fund Administrator has determined that the non-compliance findings in these audits did not result in improper payments. These findings are generally non-monetary in nature because they are not related to submissions to the TRS Fund for reimbursement. Instead, the findings are related to internal controls and procedures of the providers. Although providers have been asked to detail their corrective action plans in response to the findings, the findings are not related to a specific dollar amount subject to recovery. However, 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.
- On June 10, 2013, the Commission released an Order and Further Notice of Proposed Rulemaking (FCC 13-82) that reformed the regulation of Video Relay Service (VRS) and proposed additional reforms, including applying all reforms to the other IP-based services: IP Relay and IP Captioned Telephone Service (IP CTS). This order transferred TRS Fund oversight to the Office of Managing Director. The Commission named a TRS Fund Program Coordinator to oversee all contracts and audits associated with the TRS Fund and reform efforts, and to coordinate Commission TRS oversight.
- The Commission also adopted an Order and Further Notice of Proposed Rulemaking (FCC 13-118) that reformed the regulation of IP CTS. Among other measures to prevent waste, fraud, and abuse in this service, the Commission required registration and certification of users, prohibited providers from offering or providing improper financial and other incentives to users and third-party professionals to register or use the service, prohibited distribution of IP CTS equipment and software for less than \$75, and required providers to ensure IP CTS devices have a default setting of captions-off.
- The Commission executed four consent decrees with TRS providers to resolve investigations about questionable requests for reimbursement from the TRS Fund. The consent decrees require the providers to pay almost \$12 million back to the TRS Fund, and to pay more than \$23 million to the US Treasury. Additionally, each of the consent decrees includes provisions designed to deter, prevent, and identify future instances of non-compliance (e.g., provisions requiring providers to train employees, review requests for reimbursement with greater scrutiny, report discoveries of noncompliance with TRS rules and the consent decree).
- The Commission pursued multiple enforcement investigations against TRS providers to monitor and assess compliance with the Commission's rules and orders. Information used in enforcement reviews/investigations may include data referred to the Enforcement Bureau by whistleblowers, other bureaus and offices, and the TRS Fund Administrator.
- The Commission coordinated with the TRS Fund Administrator to provide information to help enhance data analysis efforts and reduce improper reimbursements.
- The Commission coordinated with the OIG and DOJ on specific investigations that may implicate False Claims Act violations or potential fraud by a TRS provider.

IV. IMPROPER PAYMENT REPORTING

Table 1 below reports the improper payment rates 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. Consistent with OMB guidance, no error measurement is provided for Lifeline, as this is the first year that Lifeline has been deemed susceptible to significant improper payments and such error measurement is not yet available. As directed by OMB Circular No. A-123, the Commission plans to have an error measurement for Lifeline by September 30, 2014. As noted above, the USF PQA process tests the calendar year, not fiscal year, so the USF current year outlays noted below are for calendar year 2012 and the past year outlays are for calendar year 2011. For TRS, the time period tested is the program year, which is July 1, 2012 to June 30, 2013 for the current year, so the current year outlays included reflect that time period. The past year outlays for TRS are from the previous program year, July 1, 2011 to June 30, 2012. The CY IP \$, CY overpayment \$, and CY underpayment \$ are the extrapolated amounts for USF-HC and USF-S&L.

The Commission plans to add more transaction points to its USF testing during the next few years of assessments. As a result, the Commission does not expect the error rate to decrease because we anticipate additional procedures will result in an increased number of errors that are identified.

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

Program or Activity	USF-HC	USF-S&L	USF-Lifeline	TRS
PY Outlays	4,154,399	2,265,649	n/a	\$606,857
PY IP %	0.30%	1.91%	n/a	0.00%
PY IP \$	12,612	43,355	n/a	0.00
CY Outlays	\$4,119,737	\$2,232,284	n/a	786,332
CY IP %	0.26%	2.21%	n/a	0%
CY IP \$	\$10,563	\$49,354	n/a	\$0
CY Overpayment \$	\$7,128	\$49,354	n/a	n/a
CY Underpayment \$	\$3,434	n/a	n/a	n/a
CY+1 Est. Outlays	\$4,583,739	\$2,515,667	\$1,993,625	\$816,100
CY+1 IP %	0.26%	2.21%	n/a	0%
CY+1 IP \$	\$11,918	\$55,596	n/a	\$0
CY+2 Est. Outlays	\$4,867,289	\$2,155,094	\$1,912,933	\$832,600
CY+2 IP %	0.26%	2.21%	n/a	0%
CY+2 IP \$	\$12,655	\$47,628	n/a	\$0
CY+3 Est. Outlays	\$4,806,669	\$2,362,036	\$1,934,082	\$849,400
CY+3 IP %	0.26%	2.21%	n/a	0%
CY+3 IP \$	\$12,497	\$52,201	n/a	\$0

V. RECAPTURE OF IMPROPER PAYMENTS REPORTING

The following discussion is a summary of the Commission's payment recapture audits in FY 2013 for programs with more than \$1 million in annual outlays.

USF

In the previous USF audit program, a dual-objective audit approach was utilized which tested beneficiary compliance with Commission rules and simultaneously addressed the requirements of the IPIA. The Commission has since directed USAC to separate the two objectives into distinct programs – one focused on auditing compliance with all four of the USF beneficiary programs and to fulfilling the mandate for payment recapture audits (called the Beneficiary and Contributor Audit Program, or BCAP) and the second on improper payment assessment (known as the Payment Quality Assurance program, or PQA, and described further below under “Other Efforts”). The program summarized below outlines the BCAP designed to evaluate USF beneficiary and contributor compliance with Commission rules. The FY 2013 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 when compared to overall program disbursements, when compared to the amounts disbursed to the beneficiary being audited, and when compared to overall 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 Commission, and/or law enforcement entities.

USAC has examined the results of the audits and assessment programs conducted for FY 2013 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 2013 USF Payment Recapture Audits. The Commission and USAC continued to examine audits and provided recommendations on how to mitigate conditions giving rise to overpayments in the USF in FY 2013. The USAC Internal Audit group continued to perform targeted and randomly selected independent audits. Specifically, USAC completed 79 audits of USF beneficiaries in FY 2013, of which 43 involved overpayments. Of these, the auditors or USAC identified \$15,273,123 to be recovered. USAC has completed recoveries from 13 percent of these audits by September 30, 2013, and is in the process of recovering the remainder.

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

Program / Area	# Audits	# Audits with Overpayments	Estimated Recovery
High Cost	15	11	\$7,163,007
Schools and Libraries	26	12	\$6,391,144
Lifeline	27	20	\$1,718,972
Rural Health Care	11	0	n/a
Total	79	43	\$15,273,123

USF Admin. USAC is a not-for-profit corporation designated as the administrator of the USF by the Commission. 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 2012 calendar year audit demonstrated that there were no findings of improper payments.

For calendar year 2012, USAC's independent auditors selected a sample of 45 administrative non-payroll expenses totaling \$610,878.46 and found no overpayments. Moreover, for the same time period, the USAC Internal Controls team reviewed a sample of 38 administrative non-payroll expenses totaling \$745,619.83 and found no improper payments. USAC-Admin outlays for calendar year 2012 totaled approximately \$110.9 million.

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 Commission and under its oversight, is responsible for the collections and disbursements from the TRS Fund. The fiscal year 2013 outlays for TRS were \$733.9 million.

The TRS Fund Administrator has completed audits of all TRS providers receiving reimbursement from the TRS Fund. Audits were conducted on 12 service providers receiving TRS reimbursements totaling \$605.9 million. Two of those audits were not completed because the companies ceased operations before the audits could be finalized. For the other audits, the auditors issued 15 findings related to non-compliance with Commission rules. The companies issued findings have all submitted responses of non-agreement, or agreement and corrective action plans. The TRS Fund Administrator has determined that the non-compliance findings in these audits did not result in overpayments and therefore the Administrator will not seek recovery of any funds based on these audits. As of October 2013, however, the TRS Fund Administrator has withheld approximately \$22.8 million in payments to providers pending additional documentation supporting claims for payment.

NANP

NANP is the basic numbering scheme permitting interoperable telecommunications services within the U.S., Canada, Bermuda, and most of the Caribbean. NeuStar, Inc. is the NANP Administrator, and Welch LLP is the billing and collection agent. NANP Fund outlays for FY 2013 totaled approximately

\$5.8 million. Welch, as 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. Welch tested 89 percent of the transactions – representing \$5.2 million – for improper payments in FY 2013 and found no improper payments made during the period. In addition, in connection with the NANP Fund annual financial statement audit for FY 2012, an independent auditor tested about \$1.4 million – which represented 25 percent of the approximately \$5.4 million expenditures for FY 2012 – for improper payments and found no overpayments. Nonetheless, to further safeguard against overpayments, Welch reviews each transaction for completeness and to ensure compliance with Commission requirements and relevant regulations, as part of Welch’s internal control measures. Moreover, disbursements to NeuStar and other service providers are based on fixed price contract awards by the Commission requiring approval by the Commission’s contracting officer. Also, an annual Agreed-Upon Procedures (AUP) engagement was conducted to assess internal controls and compliance with the Fund’s requirements and Commission rules.

FCC

FCC Operating Expenses. Overseen by the Office of Managing Director (OMD), the Commission’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 Commission’s financial statements. For FY 2013, Commission operating expenses continue to have no identified overpayments. Commission outlays for FY 2013 totaled approximately \$452 million.

Commission staff conducted a payment recapture audit program, testing Commission non-salary operating expenses, excluding intergovernmental payments. Under this examination, Commission staff selected 50 transactions for review representing \$3,075,563. The sample that the staff used came from a universe of 5,811 transactions that were recorded on the Commission’s books in FY 2013. The OMD staff tested transactions to determine if: (1) payments were made to ineligible recipient, (2) payment was made to ineligible service, (3) duplicate payments were made, (4) payment was made for services not rendered, (5) prompt payments were made, (6) all signatures required were made, and (7) all payment amounts were correct.

Payment Recapture Audit Reporting. The Commission reports in Table 2 the results of FY 2013 payment recapture audits, and also reports prior year payment recapture audits for FY 2004 through FY 2012 as prior year results. All of the current year amounts are reported using data from fiscal year 2013, except USF-Admin is from calendar year 2012. For USF programs, audits are reported when they are completed and approved by the USAC Board of Directors; they are not reported for the time period being audited. In addition, auditees in USF programs have the right to appeal audit findings to USAC and the Commission. If an auditee’s appeal is granted, that amount is removed from this reporting as it is no longer considered an overpayment and therefore is also not able to be recovered. In addition, the chart does not include in “amount identified for recovery” those de minimis amounts that are not cost-effective to recover. 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. For the S&L program, low current year recovery rates are due to the high percentage of audit findings on appeal or that are undergoing the commitment adjustment process. See note prior to Table 3 for more information.

Table 2 Payment Recapture Audit Reporting
(Dollars in thousands)

Program or Activity	USF-HC	USF-Lifeline	USF-RHC	USF-S&L	USF-Admin	TRS	NANP	FCC-OE
Type of Payment (contract, grant, benefit, loan, or other)	Benefit	Benefit	Benefit	Benefit	Other	Benefit	Contract	Other
Amount Subject to Review for CY Reporting	\$4,021,371	\$1,973,971	\$149,620	\$2,147,436	\$110,880	\$733,937	\$5,777	\$452,109
Actual Amount Reviewed and Reported (CY)	\$37,763	\$10,805	\$1,711	\$8,294	\$610	\$605,900	\$5,158	3,076
Amount Identified for Recovery (CY)	\$7,163	\$1,719	n/a	\$6,391	n/a	n/a	n/a	n/a
Amount Recovered (CY)	\$308	\$1,719	n/a	\$35	n/a	n/a	n/a	n/a
% of Amount Recovered out of Amount Identified (CY)	4.30%	100%	0.0%	.55%	0.0%	0.0%	0.0%	0.0%
Amount Outstanding (CY)	\$6,855	\$0	n/a	\$6,356	n/a	n/a	n/a	n/a
% of Amount Outstanding out of Amount Identified (CY)	95.70%	0.0%	n/a	99.45%	n/a	n/a	n/a	n/a
Amount Determined Not to be Collectable (CY)	\$0	\$0	n/a	\$0	n/a	n/a	n/a	n/a
% of Amount Determined Not to be Collectable out of Amount Identified (CY)	0.0%	0.0%	n/a	0.0%	n/a	n/a	n/a	n/a
Amounts Identified for Recovery (PYs)	\$120,877	\$9,962	\$149	\$64,933	n/a	n/a	n/a	n/a
Amounts Recovered (PYs)	\$78,660	\$3,309	\$147	\$22,468	n/a	n/a	n/a	n/a
Cumulative Amounts Identified for Recovery (CY + PYs)	\$128,040	\$11,681	\$149	\$71,324	n/a	n/a	n/a	n/a
Cumulative Amounts Recovered (CY + PYs)	\$78,968	\$5,028	\$147	\$22,503	n/a	n/a	n/a	n/a
Cumulative Amounts Outstanding (CY+PYs)	\$49,072	\$6,653	\$2	\$48,822	n/a	n/a	n/a	n/a
Cumulative Amounts Determined Not to be Collectable (CY+PYs)	\$0	\$0	\$0	\$0	n/a	n/a	n/a	n/a

In Table 3 below, the Commission has established targets for recovery of funding for its payment recapture audit program. The targets for USF-Lifeline and USF-RHC are included as “not applicable” because either there were no overpayments to recover (USF-RHC) or the Commission has recovered 100 percent of the amounts determined so far to be recoverable (USF-Lifeline).

For USF-HC, the recovery rate targets are less than 85 percent annually primarily due to the audit findings that are appealed. Auditees often appeal negative audit findings where recovery is sought. After an initial appeal order is released, carriers have the right to seek reconsideration or further review by the full Commission. If carriers avail themselves of the right to appeal audit findings to the Commission, it is unlikely the Commission will be able to recover the funding within the fiscal year or, in many cases, even within the next fiscal year.

For USF-S&L, the recovery rate targets are less than 85 percent annually, primarily because, given the timing of audits and related appeals, it is unlikely that all identified overpayments can be recovered within the same fiscal year they are identified. This is explained thusly: First, USAC performs audits throughout the year. After an audit is completed and approved by the USAC Board of Directors, the audit findings go to the Schools and Libraries Division (SLD) of USAC for further review. If an overpayment is identified, SLD is responsible for sending school and library beneficiaries a letter adjusting their commitments for the funding years audited. In addition, prior to adjusting the commitment based on the audit finding, SLD may perform additional work to determine if an error identified in one funding year can exist in other funding years. After this commitment adjustment is issued, applicants and service providers have 60 days to appeal to USAC or the Commission. If the appeal is to USAC, petitioners are afforded an additional opportunity to appeal USAC’s decision to the Commission. After an initial appeal order is released by the Commission, petitioners have the right to seek reconsideration or further review by the full Commission. The full appeals process, therefore, can take a significant amount of time, which then affects the time period by which recoveries can be completed. If applicants and service providers avail themselves of the right to appeal audit findings to the Commission, it is unlikely the Commission will be able to recover the funding within the fiscal year.

**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	\$7,163	\$308	4.3%	50%	75%	95%
USF-LI	Benefit	\$1,719	\$1,719	100%	n/a	n/a	n/a
USF-RHC	Benefit	\$0	n/a	n/a	n/a	n/a	n/a
USF-S&L	Benefit	\$6,391	\$35	0.55%	25%	40%	50%
USF-Admin	Contract	\$0	n/a	n/a	n/a	n/a	n/a
TRS	Benefit	\$0	n/a	n/a	n/a	n/a	n/a
NANP	Contract	\$0	n/a	n/a	n/a	n/a	n/a
FCC-OE	Contract	\$0	n/a	n/a	n/a	n/a	n/a

The Commission reports in Table 4 the aging of its outstanding overpayments from the payment recapture audits performed in FY 2013.

**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	\$27	\$6,828	n/a
USF-LI	Benefit	\$0	\$0	n/a
USF-RHC	Benefit	n/a	n/a	n/a
USF-S&L	Benefit	\$6,242	\$114	n/a

The Commission reports in Table 5 the disposition of recaptured funds from FY 2013 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	\$0	\$0	\$0	\$308	\$0	\$0
USF-LI	Benefit	\$0	\$0	\$0	\$1,719	\$0	\$0
USF-RHC	Benefit	n/a	n/a	n/a	n/a	n/a	n/a
USF-S&L	Benefit	\$0	\$0	\$0	\$35	\$0	\$0

The Commission reports in Table 6 those improper payments identified through and recovered through sources other than payment recapture audits. Note that 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, the Commission has included these amounts in Table 6 out of an abundance of caution. In addition, the Lifeline IDV amounts are included in this table, although the Commission has not yet established whether those amounts are collectible. In the “amount identified” column, the chart does not include those de minimis amounts that have been determined not cost-effective for which to seek recovery.

**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	\$12	\$12	\$7	\$7	\$19.5	\$19.5
USF-HC PQA	\$167	\$0	\$551	\$173	\$817	\$213
USF-Lifeline IDV	\$8,234	\$0	\$11,135	\$0	\$24,034	\$1,749
USF-Lifeline PQA	\$69	\$69	\$36	\$36	\$169	\$169
USF-RHC PQA	\$14	\$14	\$34	\$34	\$48	\$48
USF-RHC Non-Audits	\$627	\$324	\$6,895	\$166	\$12,885	\$1,466
USF-S&L PQA	\$434	\$178	\$494	\$320	\$959	\$521
USF-S&L Non-Audits	\$8,034	\$428	\$92,771	\$6,588	\$217,375	\$21,307

VI. ACCOUNTABILITY

The Commission continues to work internally and with the program administrators to assess the effectiveness of program management necessary to ensure accountability over operations and senior leadership. For USF, USAC managers involved in the collections or disbursements processes are held accountable for reducing improper payments through USAC's performance evaluation process. Every manager involved in the process has goals set for them by their supervisor that address the prevention and reduction of improper payments, and waste, fraud, and abuse. These goals are monitored throughout the year and the manager is evaluated against the goals at year end. Promotions and merit increases are based upon these evaluations. For TRS, the Commission named a TRS Fund Program Coordinator to oversee all contracts and audits associated with the TRS Fund and reform efforts, and to coordinate Commission TRS oversight.

VII. AGENCY INFORMATION SYSTEMS AND INFRASTRUCTURE

USF. The Commission believes that additional resources are necessary for optimal policy making, oversight, and enforcement of the universal service programs. In its fiscal year 2014 budget, the Commission requested an additional \$10,877,000 to support the Commission's work to modernize and reform USF programs. Since 2009, the Commission has taken major steps to modernize the four USF support programs with a particular emphasis on improving broadband connectivity nationwide. However, more resources are required to continue the Commission's work to modernize USF, implement reforms, and increase its oversight and enforcement of the newly reformed programs. This request will support funding for additional staff, including attorneys, economists, IT specialists, program managers, and technologists.

USF-S&L. The Schools and Libraries program's information systems and technology are near the end of their useful life. The programs' systems are critical to the operation and integrity of the program as schools and libraries apply for funding through the system, submit documentation, and review the status of their applications. In addition, USAC uses the systems to perform automated checks of applicant eligibility and the accuracy of their requests for commitment and disbursement of funding. The current system was developed more than 10 years ago. The costs to develop new functionalities and to maintain the system are high. In addition, hardware and software components are no longer supported by the manufacturer. USAC is currently working with the Commission to develop and implement an improved system that will be able to implement new program rules, maintain and improve program integrity, shorten application review times, reduce administrative costs, and improve customer service and online experience.

TRS. 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. For example, the TRS Fund Administrator has implemented more robust queries of the data received from providers seeking reimbursement based on their own experience, as well as information received from the Commission on what to look for in the data to avoid improper payments. In addition, the order mentioned above (FCC 13-82) requires the Commission to contract with an entity to develop a neutral platform and a user database for VRS that will allow for a more robust registration process of VRS users, as well as more transparency for the Commission and the TRS Fund Administrator of VRS provider and user practices.

VIII. BARRIERS

Below is a description of potential statutory and regulatory barriers, which may limit the Commission's corrective actions in reducing improper payments, and the Commission's efforts to mitigate the barriers' effects.

TRS. The current TRS rules were designed for the original PSTN-based version of TRS. In FCC 13-82, the Commission sought comment on a reorganization of the TRS rules, which would allow an update to the rules to address new and emerging technologies- particularly IP and mobile technologies currently utilized by many TRS users.

IX. ADDITIONAL COMMENTS

None.



OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: October 29, 2013
TO: Chairman
FROM: *Silvana Olivieri*
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") 2013 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.

In particular, the USF Lifeline program has required significant OIG resources to combat waste, fraud and abuse. The USF Lifeline program started in 1985 to ensure the low-income consumers have access to affordable phone service. In 2012, the Commission disbursed over \$2 billion in Lifeline support. Although the Commission comprehensively reformed the Lifeline program in 2012 to require stricter oversight including promulgating changes to the ways the Commission confirms consumer eligibility for support, many of these reforms have not yet taken full effect. We believe that assuring the reforms have their intended effect, and continuing to resolve outstanding investigations, remain significant management and performance challenges.

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. Most recently, Internet Protocol Captioned Telephone Service (IP CapTel) has experienced extraordinary growth.

OIG is in the process of completing its support of ongoing criminal investigations into allegations of fraud in the VRS program, and we continue to provide input to the Commission as it addresses programmatic shortcomings and works towards implementing reforms.

Over two years ago, 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 the Commission has taken many positive remedial steps thus far, and as a result, the size of the IP Relay Fund has decreased substantially. Nevertheless determining whether the program is sustainable, free from abuse and not wasteful, 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.

The FCC's current financial reporting system lacks required integration with the FCC reporting components Universal Service Fund, Telecommunications Relay Service Fund, and the North American Numbering Plan. This issue has been reported by financial statement auditors since FY 2005. The lack of integration causes the Commission to be non-compliant with the 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. The Commission should continue to commit resources to address these weaknesses and non-compliances.

cc: Dan Daly, Chief of Staff
Mark Stephens, Acting Managing Director
Lynn Moaney, Acting Chief Financial Officer



Office of the Managing Director

MEMORANDUM

DATE: December 13, 2013

TO: David L. Hunt, Inspector General

FROM: 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) memorandum, dated October 29, 2013, assessing the most serious management challenges facing the Federal Communications Commission (Commission or FCC) for fiscal year (FY) 2013 and beyond.

First, OIG states that establishing direction and policy, managing transition, and ensuring that all Universal Service Fund (USF) program rules and regulations contribute to effective and efficient programs is a significant management challenge. In particular, OIG states that assuring that the comprehensive reforms of the USF Lifeline program have the intended effect remain significant management and performance challenges. Second, OIG states that determining whether the Telecommunications Relay Services Fund (TRS) is sustainable, free from abuse and waste, remains a significant management and performance challenge. Third, OIG states that proper implementation, management, and oversight of new technologies, which have inherent, and constantly evolving information security risks, are major challenges at the Commission.

As described below, strides have been made in a number of these very important areas, such as the notably robust enforcement actions the Commission has taken and the reforms the Commission has adopted. Management concurs with the OIG's conclusion that significant challenges remain in certain respects, however, and the Commission 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 the Commission's USF reform 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 2013 to address the challenges identified by OIG, including those related to the Lifeline program, of establishing direction and policy, managing transition, and ensuring all Universal Service Fund (USF) program rules and regulations contribute to effective and efficient programs.

- Completion by USAC of 79 audits of USF beneficiaries in FY 2013, which is indicative of the heavy emphasis that is placed on resolving management and performance challenges.
- Expansion and intensification of efforts to identify, reduce, and recapture improper payments, consistent with the Improper Payments Elimination and Recovery Act (IPERA), the Improper Payments Information Act, and Office of Management and Budget Guidance. First, the Commission has expanded the number of procedures assessed as part of USF testing for improper payments. Second, the Commission is finalizing a new two-year plan to audit program beneficiaries and contributors. The plan directs USAC to increase the focus of audit resources on those recipients with higher disbursements and elevated risks, and increases the dollar amounts reviewed in the audits.
- Examination by USAC, per Commission direction, of the results of the audits and assessment programs conducted for FY 2013 and implementation of 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).
- In coordination with USAC and the Department of Justice (DOJ), pursuit of wrongdoers who sought to defraud the USF. In FY 2013, these efforts yielded cash recoveries of approximately \$18.25 million for TRS violations and \$400,000 for E-rate violations. The Commission continues to support DOJ in seeking criminal convictions and civil judgments against defendants charged with E-rate and other USF fraud and TRS fraud. The FY 2013 caseload consisted of several active cases. In addition, the Commission monitored five parties participating in USF programs under compliance agreements.

High-Cost

- Continued activities to implement the *USF/ICC Transformation Order*, which comprehensively reformed and modernized the High Cost universal service program. The order provides fiscally responsible, accountable, incentive-based policies to transition an outdated and inefficient High Cost program into the Connect America Fund.
- Continued implementation of the Mobility Fund established as part of the Connect America Fund in the *USF/ICC Transformation Order*. Phase I of the Mobility Fund will provide up to \$350 million in USF high-cost universal service support to fund, on a one-time basis, the expansion of current-generation wireless services. Initial Mobility Fund support was awarded through a nationwide reverse auction held in September 2012, in which support was awarded based on the lowest per-unit bid amounts. Auction 901 winning bidders were required to submit post-auction “long-form” applications by November 5, 2012. Since April 2013, the Commission has authorized initial disbursements for over \$256 million in winning bids and announced \$20 million in auction defaults. Of the authorized winning bids, one winning bidder subsequently defaulted on bids totaling over \$45 million. The remaining five applications for support totaling \$15 million are being actively processed. Mobility Fund Phase I was designed as a performance-based program under which USF support is conditioned upon the recipient’s compliance with its performance obligations. In adopting rules for Mobility Fund Phase I, the Commission decided that it would require recipients of Mobility Fund support to provide an irrevocable stand-by letter of credit as financial security to secure the return of the USF funds disbursed if the recipient fails to fulfill its obligations. The Letter of Credit is required to be in an amount equal to the amount of support received plus an additional percentage of the amount of support as a performance default payment. Support payments are provided in three installments. Each party receiving support will be eligible to receive from USAC a disbursement of one-third of the total amount of support once its application for support is granted. A party will receive the remainder of its support after filing with USAC a report with the required data that demonstrates that it has met its performance requirements.

- Investigating compliance with the Commission’s rules for determining high-cost support.

Lifeline

- Commission adoption of an Order and Further Notice of Proposed Rulemaking (*Lifeline Reform Order*) that resulted in a complete overhaul of the Lifeline program to combat waste, fraud, and abuse in the program. The reforms unanimously adopted by the Commission have already resulted in hundreds of millions of dollars in savings to the Universal Service Fund as the Commission continued its implementation of the reforms in fiscal year 2013. Some of the reforms include: (i) requiring consumers to provide proof of eligibility at enrollment; (ii) requiring consumers to certify that they understand key program rules and to recertify annually their continued eligibility for support; (iii) limiting the Lifeline benefit to one-per-household; (iv) eliminating Link Up support for all providers on non-Tribal lands; and (v) putting in place a robust audit requirement for providers entering the Lifeline program and an ongoing independent audit requirement for providers drawing \$5 million or more from the Lifeline program annually. Additionally, through targeted audits known as In-Depth Data Validations (IDVs) initiated in June 2011 and continuing through fiscal year 2013, the Commission has eliminated approximately 2 million duplicate Lifeline subscriptions. The Commission has also identified \$8.2 million in overpayments for FY 2013 as part of its IDV process. The Commission is currently in the process of determining whether the amounts identified as improper payments are collectible. The Commission will report on any payment recoveries after that determination is made.
 - To address this issue in the future, the FCC and USAC are in the process of establishing a National Lifeline Accountability Database (NLAD), which will significantly reduce the possibility that a subscriber can have multiple Lifeline accounts. As USAC has announced, the NLAD will begin accepting Lifeline subscriber data in December 2013 for the first set of five states that will be loaded into the database. After this initial phase, data from the remaining states and jurisdictions will be loaded into the database. After USAC has loaded the data for each set of states, USAC and Eligible Telecommunications Carrier (ETCs) will engage in several weeks of testing before the ETCs in those states start using the NLAD. The database is expected to be operational for all states and jurisdictions by the end of the first quarter of 2014.
- Release of Notices of Apparent Liability proposing more than \$14.4 million in forfeitures against five Lifeline service providers to combat waste, fraud, and abuse in the Lifeline program and protect the Universal Service Fund (shortly after the end of FY 2013, the Commission released three additional Notices of Apparent Liability proposing nearly \$33 million in forfeitures against other Lifeline service providers). The apparent violations involve thousands of consumers who had more than one Lifeline subscription from the same provider, resulting in duplicative support requests and payments. The proposed forfeitures are in addition to recovery of universal service funds paid to the carriers for intra-company duplicative Lifeline service.
- Execution of Consent Decrees requiring two Lifeline service providers to reimburse the Lifeline program \$416,000 plus interest for duplicative payments, and to make voluntary contributions totaling \$600,000 to the U.S. Treasury. The Consent Decrees also required the providers to adhere to robust three-year compliance plans designed to deter, prevent, and detect future instances of non-compliance.

- Issuance of citations to more than 300 Lifeline customers who had been receiving more than one Lifeline service from multiple different Lifeline service providers.
- Pursuit of multiple, additional investigations against Lifeline service providers for possible violations of the Lifeline rules and related statutes and regulations.

Schools and Libraries

- Commission direction to 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 Commission is reviewing USAC's selection of vendor for the risk assessment.
- Commission adoption of a Notice of Proposed Rulemaking (NPRM) that seeks to reform and modernize the E-rate program. As part of the NPRM, the Commission sought to identify additional policies and procedures to protect against waste, fraud, and abuse. For example, the NPRM contained proposed measures or sought comments on ways to: ensure the integrity of the applicant competitive bidding process; extend the recordkeeping requirements; increase certification requirements; and strengthen audit procedures. The Commission also sought comment on specific performance goals and measures applicable to the E-rate program.
- Pursuit of multiple investigations against E-Rate fund recipients for possible violations of the E-Rate program rules.
- Three-year suspensions and debarments from the E-Rate program of individuals convicted of criminal conduct in connection with that program.

Rural Health Care

- Adoption by the Commission of an order creating a new Healthcare Connect Fund. The order incorporated in the new program measures intended to safeguard against potential waste, fraud, and abuse, including many measures found effective in the existing rural health care programs. For example, the Healthcare Connect Fund contains measures to ensure the integrity of the applicant competitive bidding process; measures to prevent duplicative support; and recordkeeping, audit, and certification requirements. The Commission also adopted performance goals and measures applicable to all of the Commission's rural health care programs.

Contributions

- Adoption by the Commission 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.
- Execution of Consent Decrees requiring payment to the U.S. Treasury of over \$1.7 million by companies that had failed to comply with universal service contribution and filing rules.

USF Administrator Actions

- Continuance of testing by the USAC internal controls team 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.
- Provision by USAC, under the Commission's oversight and review, of extensive and multiple training sessions and webinars to educate program beneficiaries about program rules and other requirements.

Telecommunications Relay Services Fund

Second, with regard to the significant management and performance challenge of determining whether the TRS program is sustainable, free from abuse and waste, the Commission has further strengthened its efforts. These efforts include:

- Collaboration with the Office of Management and Budget (OMB) to create an IPERA testing program for FY 2013 that was more robust than that of FY 2012. There were no improper payments found in the 2013 IPERA test for TRS. Rolka Loube Saltzer Associates (RLSA), the TRS Fund Administrator, in coordination with OMB and consistent with OMB Circular No. A-123, employed a methodology for calculation of an error rate that relied, in part, on an alternative statistical sampling methodology approved by OMB. Nine attributes were tested for 100 percent of distributions for the program funding period of July 1, 2012 through June 30, 2013, totaling \$786,332,442.68. The resulting error rate was 0 percent which equates to no improper payments.
 - Two additional attributes included in this year's test that contributed the most to making the testing more robust were related to the Video Relay Service (VRS) Call Detail Records (CDRs). CDRs are the records for each minute of calls in a month that providers handle, which are submitted to the TRS Fund Administrator for reimbursement on a per-minute basis. CDRs are signed under penalty of perjury that the calls were handled in compliance with Commission rules. The testing approach included identifying the total number of VRS CDRs submitted for compensation. The result was a total of 47,414,523 CDRs for minutes incurred during the program year. This results in an average of 3,951,210 submitted CDRs per month. Using a 90% confidence interval (CI) and a 2.5% error rate, the sample size generation program resulted in a sample size of 1,082. Since there were some changes in the rules during the program year, the TRS Fund administrator's contractor performed a stratified sample (records per month) and selected the sample based upon the total number of VRS CDRs submitted. A total of 12,990 VRS CDRs were analyzed and tested, resulting in a 0 percent improper payment rate for these attributes.
- Completion of audits of all TRS providers receiving reimbursement from the TRS Fund. Audits were conducted on 12 service providers receiving TRS reimbursements totaling \$605.9 million. The auditors issued 15 findings related to non-compliance with Commission rules. The companies issued findings have all submitted responses of non-agreement, or agreement and corrective action plans. The TRS Fund Administrator has determined that the non-compliance findings in these audits did not result in overpayments and therefore the Administrator will not seek recovery of any funds based on these audits. As of October 2013, however, the TRS Fund Administrator has withheld approximately \$64 million in payments to providers pending additional documentation supporting claims for payment.

- Adoption of an Order and Further Notice of Proposed Rulemaking (FCC 13-82) reforming the regulation of Video Relay Service (VRS), and proposing additional reforms, including applying certain of the reforms to the other IP-based services: IP Relay and IP Captioned Telephone Service (IP CTS). Among numerous anti-fraud measures, including the establishment of a central user data base to improve the oversight of VRS user registration and use, this Order transferred TRS Fund financial oversight to the Office of Managing Director. The Commission named a TRS Fund Program Coordinator to oversee all contracts and audits associated with the TRS Fund and reform efforts, and to coordinate with the Consumer and Governmental Affairs Bureau (CGB), the Managing Director, and all other relevant Bureaus and Offices as needed to appropriately oversee management of the TRS Fund, and to establish and oversee appropriate processes for coordination of Commission staff with the contracting staff who oversee TRS contracted entities in accordance with their prescribed contractual duties.
- Adoption of an Interim Order and Notice of Proposed Rulemaking (FCC 13-13) and a Report and Order and Further Notice of Proposed Rulemaking (FCC 13-118) reforming the regulation of IP CTS. Among other measures to prevent waste, fraud, and abuse, in this service, the Commission required registration and certification of users, prohibited providers from offering or providing improper financial and other incentives to users and third party professionals to register or use the service, prohibited distribution of IP CTS equipment and software for free or for less than \$75, and required providers to ensure that IP CTS devices have a default setting of captions-off.
- Execution of four consent decrees with providers of telecommunications relay services (TRS) to resolve investigations about questionable requests for reimbursement from the TRS Fund. The consent decrees require the providers to pay almost \$12 million back to the TRS Fund, and to pay more than \$23 million to the US Treasury. Additionally, each of the consent decrees includes provisions designed to deter, prevent, and identify future instances of non-compliance (e.g., provisions requiring providers to train employees, review requests for reimbursement with greater scrutiny, report discoveries of noncompliance with TRS rules and the consent decree, etc.).
- Pursuit of multiple enforcement investigations against TRS providers to monitor and assess compliance with the Commission's rules and orders. Information used in enforcement reviews/investigations may include data referred to the Enforcement Bureau by whistleblowers, other bureaus and offices, and the TRS Fund Administrator.
- Enhancement and development of policies designed to limit fraud and abuse of TRS Fund (e.g., working with the TRS Fund Administrator to identify ways to analyze data submitted by providers in their requests for reimbursement in order to better detect improper requests and thereby ensure that the fund pays only for intended services).

FCC Information Technology

OIG states that proper implementation, management, and oversight of new technologies, which have inherent and constantly evolving information security risks, are a major challenge. Within the fiduciary limits imposed by sequestration, the Commission continues its efforts to transition to new technologies with proper implementation, management, and oversight. Almost all of the activities conducted by the FCC depend on information systems connected to the Internet, and the information within these systems to effectively and efficiently accomplish FCC's mission.

The FCC possesses an estimated 200 plus different information technology (IT) systems of different configuration and design, developed in support of varying Bureau and Office needs. Approximately 40 percent of these systems are more than 10 years old, often using software platforms and code no longer supported by mainstream developers. The continued fiduciary pressures, including cost reduction and higher levels of productivity from existing resources, have translated, over a series of years, to a prolonged postponement of activities to update these systems.

OIG, in reference to “Innovation at the FCC,” notes: “[f]or 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.” The FCC must modernize its legacy IT systems and security as soon as possible.

OIG further states FCC Management must prioritize remediation of security weaknesses in the Commission's IT infrastructure to ensure adequate protection of data and systems. Within the fiduciary limits imposed by sequestration, this is the time to make a move towards modular modernization of FCC IT systems leading to reduced cost, reduced exposure, increased participation, and data transparency as well as creating a solid foundation for the future. In particular, the FCC has the opportunity with the proposed IT renewal efforts on the planning boards to become a model of excellence for the next wave of technological innovation in IT security and services. By utilizing available cloud development technologies, the FCC can greatly decrease out time to delivery, and provide for better predictability of costs, reusable modular code across initiatives, and a platform for the future that is a standard of excellence for security and accessibility.

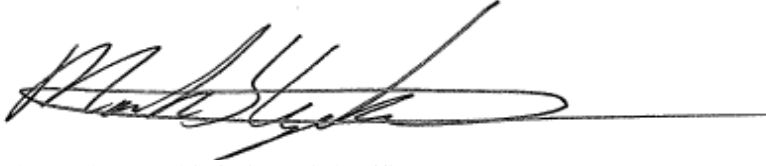
Also, by linking end-to-end IT service liaisons – “intrapreneurs” – to each of the Bureaus and Offices, the FCC will link programmatic and IT efforts together as strategic partners to understand the workflows requiring modernization, understand opportunities for modular updates to legacy systems, and intentionally “bake-in” security and privacy protections and alerts for abnormal activities from the start of developing updated solutions.

Accomplishing these efforts will require both time and a strong reinvestment in the FCC IT infrastructure to remediate existing IT infrastructure issues and ensure that we protect the Commission's systems and data prudently - especially in an age of increasing external internet cyber threats. In the meantime, the FCC will utilize the best available resources to reduce its exposure to both external and internal threats, working to identify and protect critical and personal data, while providing accessibility with the highest degree of assurance as to the credentials and authenticity of the people on the network.

FCC Financial Systems

Finally, OIG stated that the FCC's current financial system lacks required integration with the FCC reporting components (i.e., Universal Service Fund, Telecommunications Relay Services Fund, and North American Numbering Plan). This lack of integration means that the Commission's financial system does not substantially conform to government-wide requirements under the Federal Manager's Financial Integrity Act (FMFIA). The FCC remains committed to identifying efficiencies and improvements to its financial reporting process. With the upgrade of the core financial system in fiscal year 2014, the FCC is examining how best to deploy functionality to resolve this issue. The FCC also plans to incorporate proposed changes to the OMB Circular No. A-127 requirements to ensure the most effective approach is selected. In addition, the Commission will continue to closely coordinate and collaborate with the administrators of the reporting components to assist with efforts to modernize their financial systems.

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.

A handwritten signature in black ink, appearing to read 'Mark Stephens', with a long horizontal line extending to the right.

Mark Stephens, Chief Financial Officer
Office of Managing Director