FEDERAL COMMUNICATIONS COMMISSION

Fiscal Year 2014
Agency Financial Report

(October 1, 2013 – September 30, 2014)

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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) 2014. 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 ninth consecutive year the FCC has obtained an unmodified opinion on its financial statements. The independent auditors' opinion addresses more than $436 million in FCC operating expenses and more than $ 9.3 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.

Since becoming Chairman in November of 2013, I have devoted my efforts to approaching the vast array of issues we face under our priorities – promoting economic growth and global leadership, protecting public interest goals, ensuring networks work for everyone, and promoting operational excellence. Thanks to the highly capable team of public servants at the Commission – including my fellow Commissioners Clyburn, Rosenworcel, Pai and O'Rielly – we have accomplished much over the past year and I am eager to build on this progress going forward. I would like to take the opportunity to highlight some of the Commission's notable accomplishments over the past fiscal year.

Process reform has been a priority since Day One of my Chairmanship when I tasked an intra-agency staff working group to develop specific recommendations to improve the efficiency and transparency of the FCC's processes. In February, the working group produced the *Report on FCC Process Reform.* Staff has made notable progress on the Report's many recommendations, including: (1) reworking the consumer complaint process entirely, with the new process and website launched in 2014; (2) raising the de minimis annual regulatory fee payment level to exclude those licensees owing less than $500 from having to pay a fee; (3) instituting a "consent agenda" process which enables the Commissioners to vote a group of items during the monthly Open Agenda meetings in an expedited way; (4) closing a large number of open dockets; (5) developing full inventories of backlogged items across the agency and pursuing plans to tackle these backlogs; (6) transitioning remaining paper filings at the FCC to electronic filing; and (7) revamping the Commission's Freedom of Information Act page to make data and filing information more readily available to the public.

On the Universal Service front, we have modernized the E-Rate program by targeting already available funds to meet the greatest current needs. Specifically, in July we adopted the *E-Rate Modernization Order* providing for a $1 billion annual funding target for Wi-Fi to meet the needs of all schools and libraries, while continuing to ensure the availability of funding for broadband connectivity to the school and library buildings as well. We are doing this in a manner that is consistent with the bedrock principle of prioritizing funding for those who need it most while ensuring a much more equitable distribution of funding among all eligible applicants. The *Modernization Order* also streamlines the program and takes steps to maximize the cost-effectiveness of all E-rate spending through greater pricing transparency, encouraging consortia and bulk purchasing, and better enforcement.

The FCC's independent auditors, KPMG, did identify one material weakness related to budgetary accounting procedures at the Universal Service Administrative Company (USAC) for the Universal Service Fund. As part of our work to modernize USAC's operations overall, the FCC is already working with USAC to ensure that it strengthens its budgetary accounting controls by improving communication within its organization.

This past year, the Commission also created the Universal Service Fund Strike Force – housed in the agency's Enforcement Bureau – which is dedicated to safeguarding the Universal Service Fund and the other funding programs the FCC oversees. The Strike Force responsibilities include investigating violations of the Communications Act, the Commission's rules, and other laws bearing on USF programs and contributions. In addition, the Strike Force coordinates with the FCC's Office of Inspector General, the U.S. Department of Justice, and other law enforcement agencies, which prosecute unlawful conduct.

We continue our efforts to restore Open Internet protections that were struck down in January. In doing so, we have undertaken a tremendous campaign to invite comments from the public on the fundamental question: "What is the right public policy to ensure that the Internet remains open?" Commission staff are now reviewing the more than three million comments received in response – the largest body of comments for any FCC rulemaking proceeding. In addition, in September and October we held a series of public roundtable forums through which we solicited the views of Americans, as well as expert advice from a wide array of stakeholders, about how best to craft enforceable rules of the road that will bring certainty to the marketplace and protect an Open Internet.

To promote wireless connectivity and competition, we have undertaken multiple actions to make more spectrum available for wireless broadband. In February, the Commission concluded its first major auction of mobile broadband spectrum since 2008, auctioning the 10 megahertz H-Block, which raised more than $1.5 billion, much of which will be put towards funding FirstNet's nationwide public safety broadband network. The Commission in March established service rules for our upcoming AWS-3 auction of 65 megahertz of highly desirable spectrum this November. In May, the Commission adopted a Report and Order that establishes ground rules for our historic Incentive Auction, as well as Mobile Spectrum Holdings policies to promote competition in our upcoming auctions.

The Commission is also working to make sure that the broadband networks are safe, secure, and reliable. For example, to ensure that all Americans benefit from the transition to next-generation networks, we are obtaining data on the impact of technology transitions in rural areas, including Tribal lands, where residential consumers, small businesses, and anchor institutions may not have access to advanced broadband services. The Commission is also working to address rural call completion problems, which can damage small and large businesses alike. Last year, the Commission adopted new data retention and reporting requirements, enhancing our ability to investigate this problem. Our Enforcement Bureau has issued three consent decrees to combat this problem, and we will continue to take action against carriers that fail to provide reliable communications. Further, to protect against cyber threats, our Public Safety and Homeland Security Bureau is working with the private sector and other government agencies to create a new paradigm for cyber readiness. We also have practical tools, like our Small Business Cyber Planner, which lays out a number of common-sense steps small businesses can take to improve security.

Again, I appreciate the opportunity to present this Financial Report and look forward to providing future updates on the Commission's efforts in accomplishing the critical work toward achieving my vision for the FCC.

Tom Wheeler
Chairman
November 14, 2014

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1. Management's Discussion and Analysis

(Unaudited)

Overview of the FCC

INTRODUCTION

Revised OMB Circular No. A-136, released on September 18, 2014, 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 Fiscal Year (FY) 2014 APR with its Congressional Budget Justification and will post it on the Commission's website at http://www.fcc.gov/encyclopedia/fcc-strategic-plan in February of 2015.

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 (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010, and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012, 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 the provisions of the Communications Act, the Commission's rules, orders, and various licensing terms and conditions. The Bureau's mission is to investigate and respond quickly to potential unlawful conduct to ensure: (1) consumer protection in an era of complex communications; (2) a level playing field to promote robust competition; (3) efficient and responsible use of the public airwaves; and (4) strict compliance with public safety-related rules.

- The International Bureau administers the Commission'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 Media Bureau oversees broadcast radio and television, as well as cable and satellite services on behalf of consumers. It also administers licensing and policy matters for broadcast services and cable, and handles post-licensing matters for satellite services.

- The Public Safety and Homeland Security Bureau is responsible for developing, recommending, and administering the agency's policies pertaining to public safety communications issues. The Bureau supports and advances initiatives that further strengthen and enhance the security and reliability of the nation's communications infrastructure and public safety and emergency response capabilities that will better enable the FCC to assist the public, first responders, 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 develops and executes policies and procedures for fast, fair licensing of all wireless services, from fixed microwave links to amateur radio to mobile broadband services. The Bureau oversees nearly two million licenses, conducts auctions to award licenses, and manages the tower registration process. The Bureau also produces an annual assessment of the wireless industry – the Mobile Wireless Competition Report – and manages interactive web tools such as the Spectrum Dashboard, which delivers to the public key information on wireless services in a simple, transparent fashion.

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

The Offices

- The Office of Administrative Law Judges is composed of one judge who presides over hearings and issues decisions on matters referred to him by the Commission. The hearing function includes acting on interlocutory requests filed in the proceedings such as petitions to intervene, petitions to enlarge issues, and contested discovery requests.

- The Office of Communications Business Opportunities serves as the principal advisor to the Chairman and the Commissioners on issues, rulemakings, and policies affecting small businesses, women, and minority-owned communications businesses. It also represents the FCC in various matters coordinated with the U.S. Small Business Administration, including those involving the Regulatory Flexibility and Small Business Acts.

- The Office of Engineering and Technology manages the spectrum and provides leadership to create new opportunities for competitive technologies and services for the American public.

- The Office of General Counsel serves as the chief legal advisor to the Commission and its various bureaus and offices. The Office of General Counsel also represents 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 objective and independent investigations, audits, and reviews of the FCC's 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 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 assists 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.

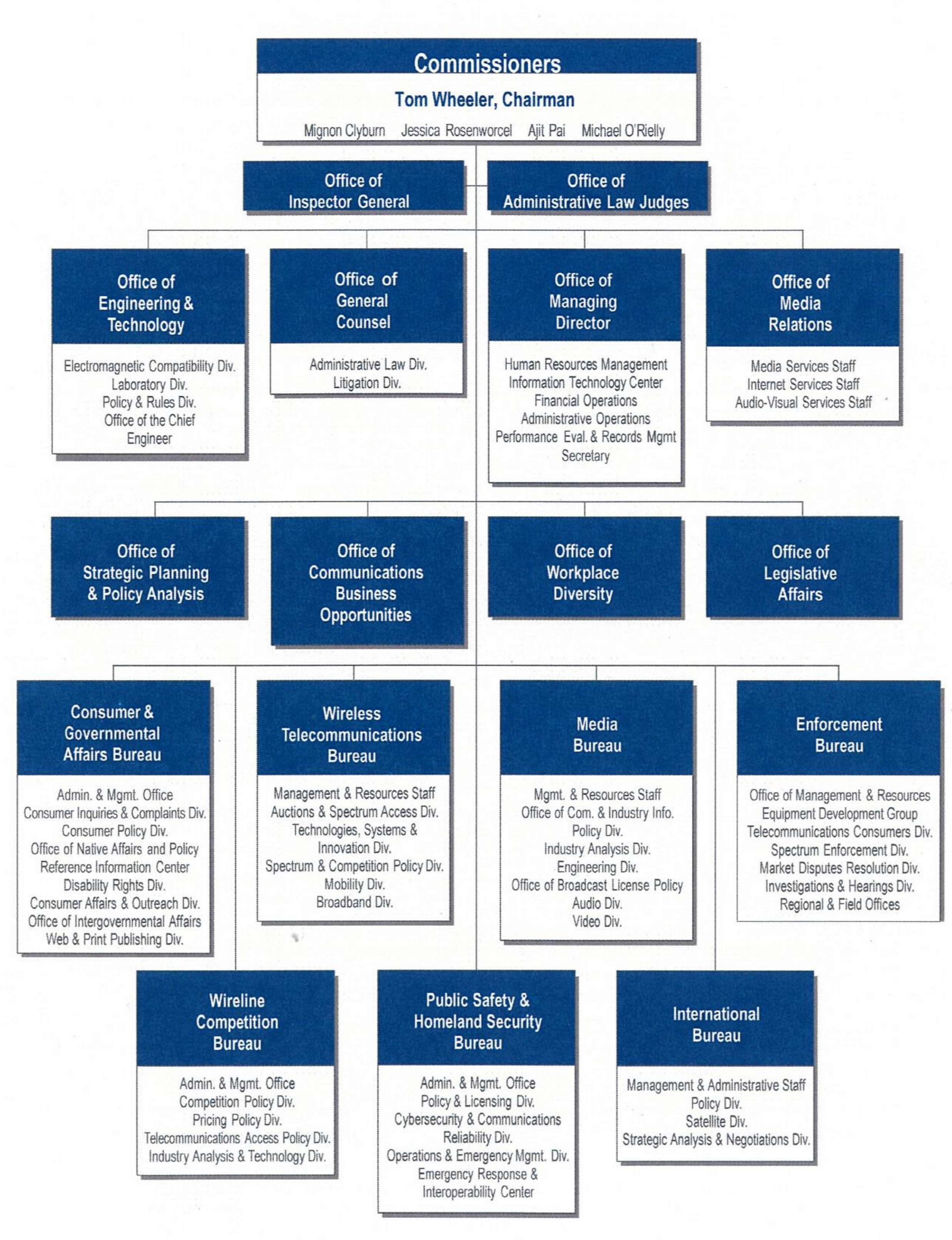
The Office also facilitates the release of all Commission announcements, orders, and other information. Furthermore, it manages the FCC Daily Digest and the FCC Audio Visual Center.

- The Office of Strategic Planning and Policy Analysis works with the Chairman, Commissioners, Bureaus, and Offices to develop strategic plans and identify the agency's policy objectives. It also provides research, advice, and analysis of advanced, novel, and non-traditional communications issues.

- The Office of Workplace Diversity ensures that the FCC provides employment opportunities for all persons regardless of race, color, sex, national origin, religion, age, disability, or sexual preference.

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

FCC ORGANIZATIONAL CHART



MAP OF FCC FIELD OFFICES

FCC STRATEGIC GOALS

The FCC is responsible to Congress and the American people for ensuring an orderly policy framework within which communications products and services can be efficiently and effectively provided to consumers and businesses. Equally important, the FCC must also address the communications needs of public safety, health, and emergency operations; ensure the universal availability of basic telecommunications service; make communications services accessible to all people; and protect and empower consumers in the communications marketplace. The FCC, in accordance with its statutory authority and in support of its mission, has established eight strategic goals. They are:

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 availability of spectrum in order to provide diverse and affordable communications services to consumers.

Strategic Goal 3: Protect and Empower Consumers

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

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

Ensure that all lawful content can be provided, and accessed, without artificial barriers; 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 basing 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.

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.[3]

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.[4]

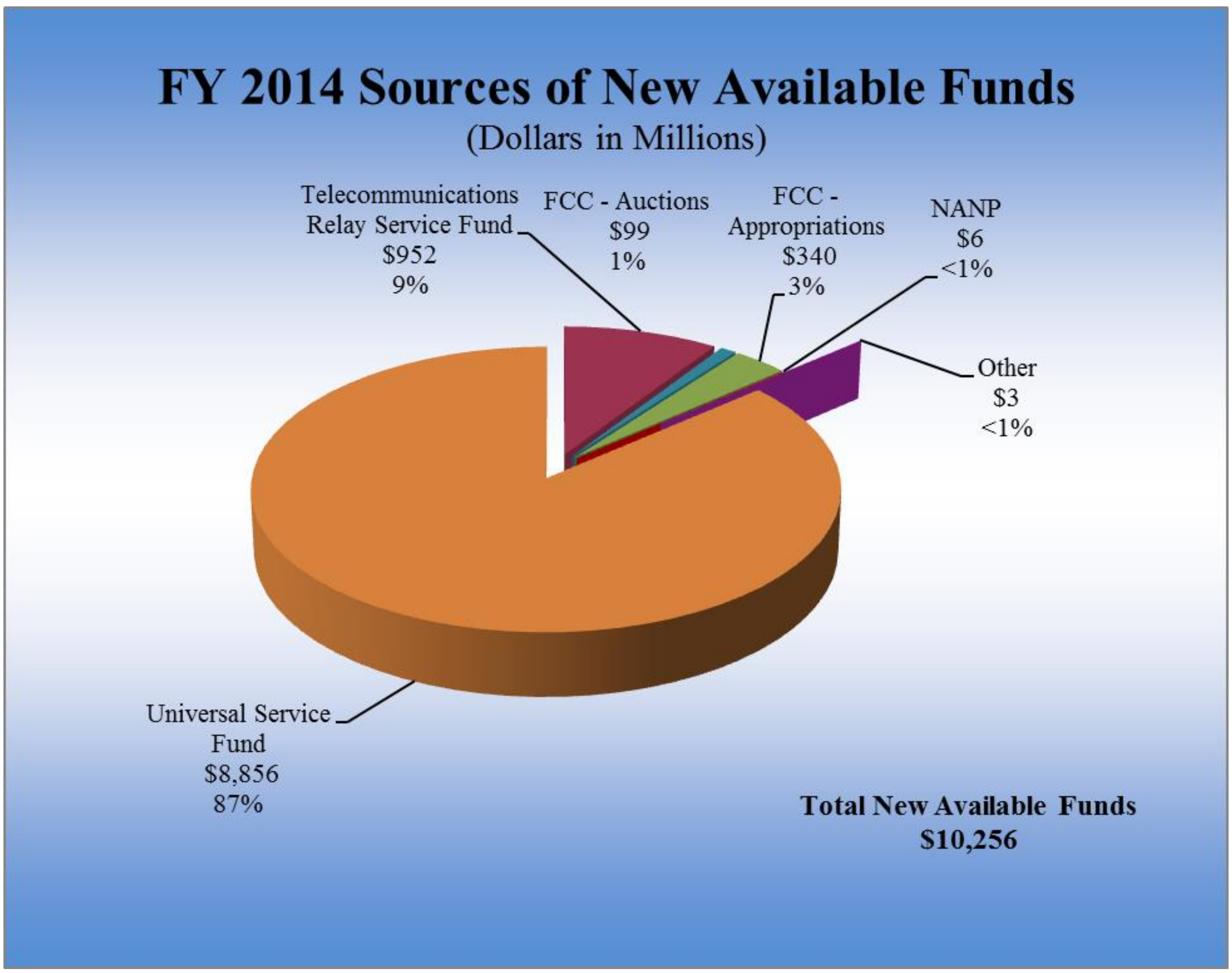
The Universal Service Administrative Company (USAC) administers the four universal service support mechanisms of the USF under the Commission's direction. These support mechanisms are funded through mandatory contributions from U.S. telecommunications service providers, including local and long distance 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 (also known as E-Rate). 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 2014, the USF accounted for approximately $8,856 million 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 2014, TRS accounted for approximately $952 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.

[3] 47 U.S.C. § 254.
[4] 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 2014, the NANP accounted for approximately $6 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 $340 million in the chart above reflects the authority for the Commission to collect regulatory fees.

ELIMINATING AND RECOVERING IMPROPER PAYMENTS

In accordance with the Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010, and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012, the Commission has made significant efforts to implement policies and procedures to strengthen internal controls that prevent 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 Commission'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 Commission's APR for FY 2014. The Commission will include the FY 2014 APR with its Congressional Budget Justification and will post it on the Commission web site at http://www.fcc.gov/ in February of 2015. 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.

The Commission took major steps to expand access to cutting-edge digital learning technologies by modernizing its E-rate program to widely support robust Wi-Fi networks in schools and libraries. Modernizing E-rate, the nation's largest program supporting communications technology in schools and libraries, is essential to closing the Wi-Fi gap in these institutions. While E-rate over its 18-year life has succeeded in connecting virtually all schools and libraries to the Internet, it was not geared for today's world of interactive, individualized digital learning. By continuing to support broadband connectivity to the building while significantly expanding support for robust Wi-Fi networks within classrooms and libraries, the FCC's reforms can deliver the benefits of customized learning to students over tablets and laptops and enable library patrons to fully participate in today's digital world. An *Order* and *Further Notice of Proposed Rulemaking* adopted by the FCC will accomplish three major goals:

- Significantly expand funding for Wi-Fi networks and distribute it fairly to all schools and libraries while recognizing the needs of the nation's rural and poorest school districts;
- Maximize the cost-effectiveness of E-rate spending through greater pricing transparency, encouraging consortia and bulk purchasing, and better enforcement of existing rules; and
- Streamline and simplify the E-rate application process and overall program administration.

The Order maintains E-rate's current budget of $2.4 billion (adjusted for inflation) and makes available an additional $2 billion to support Wi-Fi over the next two years through improved financial management practices that free up excess reserves. For the following three years, the program will target $1 billion annually to Wi-Fi – while continuing to ensure funding is available for broadband connectivity to schools and libraries – by phasing out support for non-broadband services such as pagers and phones, and through increased efficiencies. These program improvements will be sufficient to expand Wi-Fi networks in all schools and libraries. The effort will potentially provide a 75 percent increase in Wi-Fi funding for rural schools over the next five years and a 60 percent increase for urban schools, delivering Wi-Fi to an additional 10 million students in 2015 alone.

The Commission took significant steps toward implementing the next phase of its program for expanding robust broadband in rural America, the Connect America Fund. Phase I of the Connect America Fund has already invested over $438 million to deploy broadband service to 1.6 million previously unserved Americans. Phase I of the Mobility Fund also invested $220 million to expand advanced mobile wireless service and another $50 million for better mobile voice and broadband on Tribal lands. Phase II of the Connect America Fund will result in a nearly 70 percent increase in annual support for broadband and voice service in areas served by the nation's largest traditional local providers.

Experiments to explore how robust broadband can be expanded at lower costs in rural America were launched by the FCC. The experiments will inform the agency's broader effort to expand rural broadband through its Connect America Fund. They will also inform the FCC's efforts to ensure that consumers everywhere can benefit from the sweeping technological advances occurring now in the communications industry, while preserving consumer protection, competition, universal service and access to emergency services.

The FCC launched a database designed to eliminate waste from duplicative subscriptions in the Lifeline phone service subsidy program nationwide. The National Lifeline Accountability Database, a cornerstone of the FCC's comprehensive efforts to combat waste fraud and abuse in the Lifeline program, already has identified $169 million in annualized savings by flagging existing duplicates for elimination while preventing enrollment of new duplicates.

The Commission announced the creation of a Universal Service Fund (USF) Strike Force dedicated to combatting waste, fraud, and abuse in Commission programs. The USF Strike Force will focus on safeguarding the USF and other programs that the FCC oversees. The Strike Force will investigate violations of the Communications Act, the Commission's rules, and other laws bearing on USF programs and contributions. In addition to these activities, the Strike Force will coordinate with the FCC's Office of Inspector General, the U.S. Department of Justice, and other law enforcement agencies to prosecute unlawful conduct. The Strike Force's investigations and activities will promote future compliance, protect those who depend on the funds for access, and safeguard contributors to the funds from the unlawful acts of others.

The Commission released the results of its ongoing nationwide performance study of residential broadband service in its fourth "Measuring Broadband America" report. The report continues the Commission's efforts towards bringing greater clarity and competition to the home broadband services marketplace. This year's report revealed that most broadband providers continue to improve service performance by delivering actual speeds that meet or exceed advertised speeds, but some providers showed significant room for improvement particularly with respect to consistency of speeds.

The Commission announced the launch of the FCC Speed Test app for iOS devices in the iTunes App store. The FCC Speed Test app is an expansion of the Measuring Broadband America program from fixed to mobile broadband. Testing data will provide valuable information to consumers, industry, and the Commission on the deployment of networks across the United States. In November, the Commission unveiled its first public version of the FCC Speed Test app for Android smartphones in the Google Play store.

The FCC released its latest reports on Internet access service connections and local telephone services in the United States. Highlights from the reports include:

- The number of connections with downstream speeds of at least 10 Mbps increased by 118 percent over June 2012, to 103 million connections, including 58 million fixed connections and 45 million mobile connections;
- Growth is particularly high in mobile Internet subscriptions. The number of mobile subscriptions with speeds over 200 kbps in at least one direction grew to 181 million, up 18 percent from June 2012;
- In voice services, there were 90 million end-user switched access lines in service, 45 million interconnected VoIP subscriptions, and 306 million mobile voice subscriptions, or 441 million retail local telephone service connections in total as of June 30, 2013; and
- Over the three years between June 2010 and June 2013, interconnected VoIP subscriptions increased at a compound growth rate of 16 percent, mobile voice subscriptions increased at a compound annual growth rate of 3 percent, and retail switched access lines declined at 10 percent a year.

MAXIMIZE BENEFITS OF SPECTRUM

Maximize the availability of spectrum in order to provide diverse and affordable communications services to consumers.

The Commission adopted rules to implement the Broadcast Television Incentive Auction. The two-sided auction will use market forces to recover spectrum from television broadcasters who voluntarily choose to give up some or all of their spectrum usage rights in exchange for incentive payments, in order to auction new spectrum licenses to wireless providers. The Incentive Auction will help meet consumers' skyrocketing demand for mobile broadband services. Today, there are more connected devices than there are people in the U.S., and about 60 percent of Americans use data-hungry smartphones. By making additional spectrum available for mobile broadband use, the Incentive Auction will benefit consumers by easing congestion on wireless networks, expediting the development of new, more robust wireless services and applications and helping fill in coverage gaps particularly in rural America.

The Commission proposed to modify its Part 15 rules to accommodate growing demand and encourage innovation in the provision of wireless broadband data services. The Commission's Part 15 rules permit devices to operate on unused "white space" spectrum between TV stations. Since the Commission finalized initial rules in 2010, unlicensed white space devices in the TV bands have been used primarily to provide broadband data and other services to schools and libraries. 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 but high data rate communications. The proposed changes to Part 15 rules are designed to allow for more robust service and efficient spectral use in the frequency bands that are now and will continue to be allocated and assigned to broadcast television services, while continuing to protect authorized users from harmful interference.

The FCC initiated a proceeding to address the long-term needs of wireless microphone users. The repurposing of broadcast television band spectrum for wireless services following the Commission's incentive auction will significantly alter the spectrum environment in which many wireless microphones currently operate. This proposal fulfills the FCC's commitment to initiate a proceeding to explore how best to accommodate the future needs of wireless microphone users.

The Commission took steps to recognize the important social, cultural, and economic benefits of low power auxiliary station operations, including wireless microphones, by expanding license eligibility for qualifying users. In new rules, the Commission expanded Part 74 license eligibility to include professional sound companies and venues where the use of wireless microphones is an integral part of the major productions or events they host. The Commission concluded that these users generally have the same need for interference protection as existing Part 74 licensees and the sophisticated knowledge and capability to manage use and coordination of a large number of wireless microphones.

The Canadian National Railway Company agreed to pay a civil penalty of $5.25 million to resolve an FCC Enforcement Bureau investigation into the company's acquisition and operation of hundreds of wireless radio facilities in the United States without prior FCC approval. Some of the unauthorized operations continued for more than two decades before the company disclosed its violations to the Commission.

The Commission took steps to provide more spectrum for general consumer use, carrier-grade small cell deployments, fixed wireless broadband services, and other innovative uses, through the creation of a new Citizens Broadband Radio Service. The proposed rules for the Citizens Broadband Radio Service advance the Commission's efforts to meet the growing demand for spectrum by proposing to make 150 megahertz available in the 3.5 GHz Band.

The Commission also provided for accelerated 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. The new rules will make 100 MHz of spectrum more accessible for use in homes and congested spaces like convention centers, parks, and airports and increase the potential for more unlicensed spectrum innovation. By its action the Commission significantly increased the utility of the 100 megahertz of spectrum, and streamlined existing rules and equipment authorization procedures for devices throughout the 5 GHz band.

The Commission adopted a *Report and Order* that advances ongoing efforts to make more spectrum available for flexible use wireless services, including mobile broadband. This action represents the largest amount of spectrum suitable for mobile broadband that the Commission has made available for auction since the 700 MHz band was auctioned in 2008. Access to these bands will help wireless companies meet growing consumer demand for mobile data by enabling faster wireless speeds and more capacity.

PROTECT AND EMPOWER CONSUMERS

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

Continuing its efforts to combat waste, fraud, and abuse in the Lifeline program, the FCC has released Notices of Apparent Liability proposing approximately $80 million in forfeitures against seven Lifeline service providers to combat waste, fraud and abuse in the Lifeline program and protect 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 intra-company duplicative Lifeline service. The Commission has also conducted pursuit of multiple, additional investigations against Lifeline service providers for possible violations of the Lifeline rules and related statutes and regulations.

The Commission repealed its sports blackout rules, which prohibited cable and satellite operators from airing any sports event that had been blacked out on a local broadcast station. The action removes Commission protection of the NFL's current private blackout policy, which requires local broadcast stations to black out a game if a team does not sell a certain percentage of tickets to the game at least 72 hours prior to the game. The Commission found that its sports blackout rules were no longer justified in light of the significant changes in the sports industry since these rules were first adopted nearly forty years ago. At that time, ticket sales were the primary source of revenue for the NFL and most NFL games failed to sell out. Today, television revenues have replaced ticket sales as the NFL's main source of revenue, and blackouts of NFL games are increasingly rare. The Commission also found that the NFL, whose current contracts with the broadcast networks extend through 2022, is unlikely to move its games from free, over-the-air broadcast television to satellite and cable pay TV as a result of elimination of the sports blackout rules. They therefore concluded that the sports blackout rules are no longer needed to ensure that sports programming is widely available to television viewers.

The FCC reached a $7.4 million settlement with Verizon to resolve an investigation into the company's use of personal consumer information for marketing purposes. The investigation uncovered that Verizon failed to notify approximately two million new customers, on their first invoices or in welcome letters, of their privacy rights, including how to opt out from having their personal information used in marketing campaigns. In addition to the $7.4 million payment, Verizon agreed to notify customers of their opt-out rights on every bill for the next three years.

Sprint Corporation will pay $7.5 million to resolve an FCC Enforcement Bureau investigation of the mobile wireless company's failure to honor consumer requests to opt out of phone and text marketing communications. This represents the largest Do-Not-Call settlement that the FCC has ever reached. In addition to the payment, Sprint will implement a two-year plan to ensure compliance with FCC requirements designed to protect consumer privacy and prevent consumers from receiving unwanted telemarketing calls.

Time Warner Cable (TWC) failed to file a substantial number of reports with respect to a series of reportable wireline and Voice over Internet Protocol network outages. TWC admitted that its failure to timely file the required network outage reports violated the Commission's rules. To resolve the FCC's investigation, TWC will pay a civil penalty of $1.1 million and implement a three-year compliance plan to ensure future compliance with the Commission's network outage reporting rules.

Deceptive marketing practices, changing consumers' preferred long distance carriers without their authorization, and billing consumers for unauthorized charges continues to be an issue leading to multiple FCC investigations. The Commission proposed fines and forfeitures for U.S. Telecom Long Distance, Inc. ($5.23 million), Central Telecom Long Distance, Inc. ($3.9 million), and Consumer Telcom, Inc. ($3.56 million) for allegedly deceiving consumers. Many of these actions victimized elderly and disabled consumers.

The FCC proposed to fine Optic Internet Protocol, Inc., a Roswell, GA telephone company, $7.62 million for allegedly switching consumers' long distance telephone services without their authorization, billing customers for unauthorized charges, and submitting falsified evidence to government regulatory officials as "proof" of consumers' authorizations. Optic allegedly switched consumers' preferred long distance carriers and also billed the consumers for long distance service by placing charges for its set-up fee and recurring monthly fee on their local telephone bills. The Enforcement Bureau reviewed more than 150 complaints against Optic that consumers filed with the Commission, the Federal Trade Commission, state regulatory agencies, and the Better Business Bureau.

The FCC also proposed to fine Net One International, Inc., a Florida telephone company, $1.6 million for allegedly billing consumers for unauthorized charges and late fees even though the customers had already closed their accounts and paid their final bills. Based on its review of over 100 consumer complaints, the FCC found that over a period of several years, Net One repeatedly billed consumers long after the consumers had affirmatively cancelled their service, paid their final bills, and switched to other carriers.

Assist 123, LLC, a Las Vegas, Nevada telecommunications carrier, will pay $1.3 million to resolve an FCC investigation into allegations that the company billed wireless telephone consumers for a "Concierge/Directory Assistance" subscription text messaging service, a service that they did not want or authorize.

The Commission took major steps to remedy the serious and unacceptable problem of long-distance calls failing to reach rural homes and businesses. New rules unanimously adopted by the FCC will provide immediate solutions and empower future agency enforcement efforts while giving providers incentives to improve their service. In addition, the FCC took significant action against telephone companies who failed to complete long-distance calls to rural areas on a just, reasonable, and non-discriminatory basis. These include Windstream Corp. ($2.5 million payment) and Matrix Telecom, Inc. ($875,000 payment).

The FCC cited Panasystem Corp., a California-based online electronics retailer, for importing and marketing counterfeit smartphones marked with unauthorized or invalid labels falsely indicating that the devices were certified by the FCC. The FCC investigation identified the smartphones imported by Panasystem as counterfeit Samsung models. Although these devices were labeled with seemingly-valid FCC Identifiers, the investigation showed that Samsung neither manufactured the devices nor authorized the FCC Identifier labels. The investigation also revealed that another set of smartphones imported by Panasystem contained counterfeit BlackBerry model 9790 devices. These smartphones were labeled with invalid FCC Identifiers, which rendered them illegal for sale in the United States.

The FCC planned to fine Dialing Services, LLC over $2.9 million for allegedly making numerous illegal "robocalls" to mobile phones. These robocalls contained artificial or prerecorded voice messages on behalf of political campaigns and candidates. The Commission had previously cited Dialing Services for making more than 4.7 million robocalls to mobile phones without consumer permission during the 2012 election cycle.

PROMOTE INNOVATION, INVESTMENT, AND AMERICA'S GLOBAL COMPETITIVNESS

Ensure that all lawful content can be provided, and accessed, without artificial barriers; 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.

The Commission launched a rulemaking seeking public comment on how best to protect and promote an open Internet. The *Notice of Proposed Rulemaking* posed a broad range of questions to elicit the broadest range of input from everyone impacted by the Internet, from consumers and small businesses to providers and start-ups. The FCC proposed to rely on a legal blueprint set out by the United States Court of Appeals for the District of Columbia Circuit in its January 2014 decision in *Verizon v. FCC*, using the FCC's authority to promote broadband deployment to all Americans under Section 706 of the

Telecommunications Act of 1996. At the same time, the Commission will seriously consider using its authority under the telecommunications regulation found in Title II of the Communications Act.

The FCC hosted a series of Open Internet Roundtable Discussions. The roundtables provide an opportunity for the Commission staff and interested parties to further examine the actions the Commission should take for its goal of determining the best approach to protecting and promoting Internet openness. Specifically, the roundtable discussions focus on public policy considerations and how they should be addressed to protect and promote Internet openness in both the fixed and mobile markets; the technological considerations involved in protecting the open Internet; how the competitive landscape and the economics of providing broadband and online services affects Internet openness; how the Commission can effectively enforce the current and proposed open Internet requirements; and the various legal theories underlying possible Commission actions in this area.

The FCC launched a broad set of voluntary experiments meant to ensure that the nation's communications networks continue to provide the services consumers want and need in this era of historic technological transformations. Driven by developments in the marketplace, technology transitions in communications networks are already well underway. They include, for example, the transition from plain old telephone service delivered over copper lines to feature-rich voice service using Internet Protocols, delivered over coaxial cable, fiber, or wireless networks. The FCC's experiments will focus on how the enduring values underlying operation of today's networks can be preserved and enhanced throughout technological change.

The Commission proposed to comprehensively simplify and streamline its rules governing satellite communications to make the regulatory approval process for satellite licenses easier and more efficient. This rulemaking was one of the key reforms called for by the Report on FCC Process Reform released earlier this year. Specifically, the Commission's Further Notice proposes changes that will:

- Facilitate international coordination of proposed satellite networks, by permitting early submissions to the International Telecommunication Union;
- Simplify showings associated with milestone requirements and eliminate some of the current milestone requirements;
- Revise the two-degree spacing requirements to better accommodate the use of small antennas; and
- Expand options for simplified routine earth station licensing.

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 a *Report and Order* that strengthens its rules governing retransmission consent negotiations. This will help curtail a practice that has put upward pressure on cable and Direct Broadcast Satellite programming costs as well as prices to consumers. The *Report and Order* prohibits a television broadcast station ranked among the top four stations (as measured by audience share) from negotiating retransmission consent jointly with another top four station if the stations are not commonly owned and serve the same geographic market. Joint negotiation by these stations leads to higher retransmission consent fees because the practice reduces competition between the stations.

The FCC took steps to close a loophole in its TV ownership rules, making sure that a party's interests in a market are properly counted. Removal of the loophole helps ensure competition, localism, and diversity in local broadcast markets by preventing a practice that previously resulted in consolidation in excess of what is permitted under the Commission's rules. A joint sales agreement (JSA) is between two stations in the same market in which one station is authorized to sell advertising time on the other station. The Commission's radio rules have long recognized that these agreements create an ownership interest when the JSA allows for the sale of 15 percent or more of the advertising time on a competing local station. This *Report and Order* applies this same standard to broadcast television.

The Commission clarified its policies and procedures for reviewing transactions in the broadcasting industry that would result in foreign ownership stakes exceeding a 25 percent benchmark set by statute. The ruling potentially removes obstacles to new capital investment, which will support small business, minority, and female broadcast ownership, and spur innovation.

The Commission approved new, more comprehensive rules for TV closed captioning to ensure that viewers who are deaf and hard of hearing have full access to programming. This action resolves decade-long concerns from deaf and hard of hearing communities to improve captioning quality and provides much needed guidance to video programming distributors and programmers. The new rules apply to all television programming with captions. Specifically, the Commission adopted quality standards for accuracy, synchronicity (timing), program completeness, and placement of closed captions.

The Commission also approved new rules that will enable people who are blind or visually impaired to have easier access to digital video programming on a wide range of electronic devices. The rules will also enable consumers who are deaf or hard of hearing to activate closed captioning on their devices with greater ease. This action represents the final major step in the FCC's implementation of the Twenty-First Century Communications and Video Accessibility Act of 2010 (CVAA), enacted in 2010 to provide people with disabilities access to the modern and innovative communications technologies. As a result of the FCC's implementation of the CVAA, more than 50 million Americans will have greater access to advanced communications. Devices covered under the rules include navigation devices used to access cable or satellite services, such as set-top boxes and TiVos, as well as other devices used to receive or play back digital video, ranging from televisions and computers to tablets and smartphones.

The FCC adopted a *Report and Order* revising rules for its mobile spectrum holding policies. Access to spectrum, particularly low-band spectrum, is essential for the provision of mobile wireless services. This action will promote more competition in more markets, and facilitate consumers having more choices of wireless providers, lower prices, and higher quality mobile service.

PUBLIC SAFETY AND HOMELAND SECURITY

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

The Commission adopted rules requiring text messaging providers to enable Americans to text 911 in an emergency. Building on commitments made by America's four largest wireless carriers to support text-to-911, the new rules will ensure that all remaining wireless carriers and certain IP-based text application providers are prepared to support text-to-911. If a 911 call center requests text-to-911, text messaging providers will have six months to deploy the service in that area. This action will make text-to-911 more uniformly available and keeps pace with how Americans communicate. Text messaging is also widely used by Americans who are deaf, hard of hearing, or have speech disabilities.

The FCC proposed fines against Viacom, ESPN, NBCUniversal, and Turner Broadcasting System for transmitting advertising or programming that misused the warning sounds of the nationwide Emergency Alert System (EAS). The FCC has long prohibited the transmission of actual or simulated EAS Attention Signals or tones in circumstances other than a real alert or an authorized test of the EAS system.

The Commission proposed rules to help emergency responders better locate wireless callers to 911. The proposed updates to the Commission's Enhanced 911 (E911) rules respond to Americans' increasing use of wireless phones to call 911, especially from indoors, and take advantage of technological developments that allow for more accurate location of information to be transmitted with 911 calls. Many Americans are replacing landlines with wireless phones, and calling patterns are changing. For example, reports indicate that nearly 73 percent of 911 calls in California are made from wireless phones, and approximately 80 percent of all smartphone use occurs indoors. In light of these trends, the Commission proposed changes to its E911 rules to include indoor location accuracy, particularly location accuracy in challenging indoor environments such as large multi-story buildings, where first responders are often unable to determine the floor or even the building where the 911 call originated.

The Commission adopted rules to help ensure that Americans' phone calls to 911 are delivered during disasters. The rules were designed to improve 911 communications networks nationwide by requiring 911 service providers to take reasonable measures to provide reliable and resilient 911 service, as evidenced by an annual certification. The FCC also strengthened its rules to ensure that 911 service providers give 911 call centers timely and useful notification of network outages.

The FCC adopted technical service rules to govern the spectrum that will be used for deployment of a nationwide public safety wireless broadband network by the First Responder Network Authority (FirstNet). The rules, which include power limits and other technical parameters for operating in this spectrum band, will provide a foundation for FirstNet's operations, help avoid harmful interference to spectrum users in adjacent bands, and expedite the availability of equipment for use on the public safety network.

Hinton, a local exchange carrier serving parts of Caddo and other counties in Oklahoma, apparently willfully and repeatedly violated the Commission's Rules by failing to use reasonable judgment when it knowingly routed 911 calls to an automated operator message, creating a significant threat to the life and property of the residents of those counties. The FCC proposed to fine Hinton $100,000.

ADVANCE KEY NATIONAL PURPOSES

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

The Commission announced the formation of a new Commission Task Force, CONNECT2HEALTH, that will bring together the expertise of the FCC on the critical intersection of broadband, advanced technology, and health. Specifically, the CONNECT2HEALTH Task Force will consider ways to accelerate the adoption of health care technologies by leveraging broadband and other next generation communication advancements. The Task Force will work with the leadership of the FCC and collaborate with public and private stakeholders in the health care and technology space.

Furthermore, in an effort advance the use of broadband for key national purposes, the FCC and the National Institute on Aging (NIA) entered into an agreement to partner on research into the use of modern

Internet Protocol (IP) technology to improve and make more accessible phone service to Americans who are deaf, deaf-blind, or hard of hearing. Under the joint agreement, the FCC will collaborate with the NIA to develop and support research plans for assessing IP technologies that can benefit older adults with hearing disabilities or deafness.

OPERATIONAL EXCELLENCE

Make the FCC a model for excellence in government by effectively managing the Commission's human, information, and financial resources; by basing decisions 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.

The FCC released a Report on FCC Process Reform. The Report was prepared by a staff working group led by the Chairman's Special Counsel and includes a comprehensive list of the group's proposed recommendations for process reform at the Commission. The Report seeks to further the goal of having the agency operate in the most effective, efficient and transparent way possible. It examines the agency's internal operations with the aim of improving the overall functioning of the agency and its service to the public. Based on both internal and external suggestions, the Report identifies initial steps in what will be an ongoing process of reexamining, and revising, the way the Commission does its work. The Report proposed more than 150 process reform recommendations covering a wide range of specific topics. These recommendations, when implemented, would enable the Commission to work faster, smarter, more efficiently, more transparently, and more inclusively.

One area of particular focus has been tackling matters that have been considered backlogged and – even more importantly – increasing speed of disposal for all matters. Two key internal process reform working groups have been examining ways to not only reduce the number of items currently pending at the Commission, but to also move incoming items through the system faster. A few examples of progress in this area include:

- Consent Agenda: One of the first recommendations implemented was to institute a "consent agenda" process, which enables the Commissioners to vote a group of items during the monthly Open Agenda Meeting in an expedited way, without staff presentations. Utilizing this process, the Media Bureau has disposed of 36 licensing applications for review so far this year, with more on course for adoption;
- Closing Dockets: So far this year, the Consumer & Governmental Affairs Bureau, working with other Bureaus and Offices, closed over 760 dockets and sought comment on another 750 dockets that appear to be eligible for closing by the end of the calendar year;
- Backlog Reduction Plans: Every Bureau and Office with responsibility for responding to requests from external petitioners and licensees has developed a backlog reduction plan. The plans focus both on how to reduce existing pending items at the Commission, and also process improvements for the future. Every Bureau and Office has ensured that their tracking systems include a complete inventory of all pending matters;
- Best Practices on Backlog Reduction: Based on the backlog reduction plans, a working group established "best practices" for management of pending items before the Commission, including suggestions for streamlining handling of matters. The best practices have been circulated internally and discussed in individual meetings with the Bureaus and Offices so useful methodologies can be shared across the Commission; and

- Bureau/Office Streamlining and Backlog Reduction Efforts:

  - The Enforcement Bureau has largely completed its review of pending complaints, clearing the way for the Media Bureau to grant almost 700 license renewals;
  - The Media Bureau revised the way it issues effective competition rulings, issuing omnibus rulings periodically instead of individual rulings on each request. In March, the Bureau released an order disposing of 55 such requests;
  - The International Bureau eliminated the effective competitive opportunities test for submarine cable landing licenses and 214 applications, streamlining the processing of those applications;
  - Between May and September, the Wireless Bureau resolved 2,046 applications older than 6 months, resulting in a 26 percent reduction in its applications backlog;
  - On September 15th, the Wireline Bureau released a public notice announcing a process for streamlining disposition of certain USF related appeals. Under this approach, the Bureau will release monthly notices detailing the resolution of those appeals. In the September notice, the Bureau disposed of 29 pending requests; and
  - In February, the Consumer & Governmental Affairs Bureau released an order which streamlined the process for receipt and processing of requests for closed captioning so that parties can file such requests electronically.

The Commission adopted a *Report and Order* to streamline and eliminate outdated provisions of rules governing the construction, marking, and lighting of antenna structures. As part of the Commission's ongoing process reform initiative, this item provided clarity and reduced the regulatory burden on tower owners and licensees. This is an important step in the FCC's efforts to facilitate wireless infrastructure deployment. It harmonizes Commission rules with FAA guidelines, recognizing that the FAA is the expert agency on matters of air safety. The Order also modernizes the Commission's lighting and marking requirements to reflect technological advancements and current industry standards.

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 2012 and FY 2013. 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 2012 and FY 2013.

The FY 2013 report identified no material weaknesses in internal controls but included significant deficiencies in the following areas: 1) Financial System Functionality and Integration; and 2) Information Technology Controls. During FY 2014, the FCC worked to develop corrective action plans and to remediate the recommendations associated with these findings. First, with regard to addressing the significant deficiency for Financial System Functionality and Integration related to the Commission and its reporting components, the Commission resolved and corrected this significant deficiency in FY 2014. Second, with respect to the significant deficiency related to Information Technology controls, the Commission has worked diligently to develop corrective action plans to fully address the auditors' recommendations, and remediate these findings in FY 2014. The Commission will make every effort in FY 2015 to complete and implement corrective actions for each of the recommendations associated with these findings 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 resolved and corrected these issues in FY 2014.

During FY 2014, 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 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 also has created a Compliance and Oversight Group under the CFO to make sure all audit recommendations are implemented and to oversee the three reporting components. This Group also is responsible for working with the Bureaus and Offices to obtain their annual assertion letters and any related risk assessments. During the fiscal year the Commission hired an independent audit firm to perform a risk assessment of the USF's Schools and Libraries Program, which was overseen by the Oversight Group. 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.

Finally, the Commission also completed the task to upgrade its current financial management system, known as Momentum, from release 6.3 to release 7.0. This upgrade enabled the FCC to remain current with baseline software releases, as well as provide the opportunity to enhance the user experience and streamline current business scenarios to support the FCC's continued goal of aligning information technology solutions with the FCC business environment, policy goals, and Federal guidance. The FCC analyzed the impact and the level of effort for the enhancements, identifying those features that provided a major benefit to FCC and enhanced operational efficiency and internal controls.

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 a qualified statement of assurance that its internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2014, were operating effectively, with the exception of one material weakness. In addition, the Commission can provide reasonable assurance that its financial management systems meet the objectives of FMFIA.

Tom Wheeler
Chairman
November 14, 2014

Status of Internal Controls – Section 2 of FMFIA

During FY 2014, 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 of internal controls to comply with OMB Circular No. A-123. Throughout FY 2014, the Commission continued to work diligently to close out audit findings from previous audits as well. The Commission was able to close out 71 audit findings in FY 2014. The Commission continues to tighten its controls over operations and improve its policies and procedures where necessary.

While the Commission has continued to maintain its focus on identifying and mitigating risks, there is still work to be done. For the first time since FY 2008, the auditors identified a material weakness in their report on internal controls over financial reporting. The material weakness resulted from USAC's budgetary accounting activities for the USF. The auditors noted errors in non-routine, manual journal entries related to the implementation of new programs, as well as errors caused by a lack of formal communication between USAC's accounting department and the Schools and Libraries program managers.

The errors that the auditors noted were corrected by USAC during the course of the fiscal year and did not impact the Commission's FY 2014 financial statements. However, the auditors noted that without adequate internal controls in place, there is an increased risk that material errors could occur in the financial statements and not be detected and corrected in a timely manner. The Commission and USAC are very mindful of this risk as well. The independent auditor's conclusion underscores the need for effective communication between USAC's accounting department and Schools and Libraries program managers. The Commission has already discussed the auditor's recommendations with USAC and how the internal controls can be improved to avoid this situation recurring. The Commission will work to ensure that USAC takes the proper corrective action to resolve these recommendations and strengthen its internal 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-123. 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.

In FY 2014, the Commission's financial management systems were in compliance with government-wide requirements. The Commission is continuing to work to improve the performance of its financial management systems through continued improvements of its core financial system. The Commission also continues to work with its reporting components on their 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 for 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 continues to make improvements in the area of financial management system controls, business process engineering and best practices. The new financial system reduces and/or eliminates instances of duplicate transaction entry into multiple disparate systems, increasing data accuracy and allowing more time for value added functions such as data analysis. It provides a web enabled self-service capacity for the Bureaus and Offices to execute accounting functions, including business analytics for decision making. It supports green initiatives by piloting workflow processes that reduce the paper chain associated with document review, approval and manual distribution of documents. Additional benefits of Genesis include resolution of financial systems audit findings, along with a reduction in FTEs for contract support.

In January of 2014, the Commission successfully upgraded Genesis to the 7.03 release. With the addition of 140 plus new enhancements between Momentum 6.3.4 and 7.0.X, several of these new features assisted the FCC to streamline business processes, increasing efficiency and productivity. Additional improvements are scheduled during the first quarter of FY 2015 to comply with new requirements from Treasury (the Government-wide Treasury Account Symbol Adjusted Balance System (GTAS) and the Central Accounting Reporting System (CARS)) and the General Service Administration (the System for Awards Management (SAM)/Central Contractor Registration Connector (CCRC)).

The Commission's financial management system strategy continues to build on processes that improve internal controls; eliminate redundant data entry through increased integration; implement tools that enhance budget formulation and performance; and continuously partner 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. The Commission's management is responsible for the integrity and objectivity of the information presented in the financial statements. For nine 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 September 18, 2014.

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 2014 and FY 2013 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.

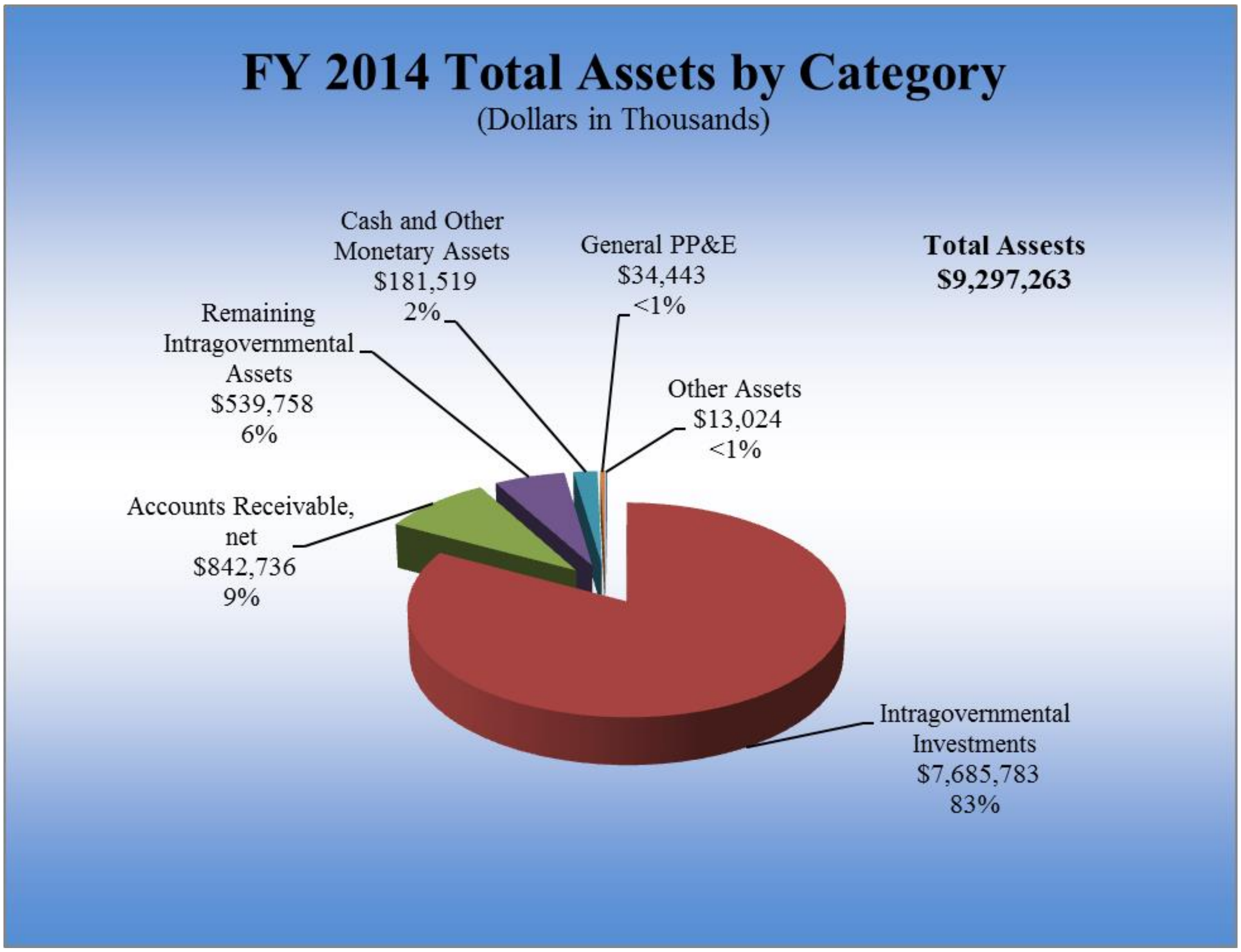
CHANGES IN FINANCIAL POSITION IN FY 2014 Consolidated (Dollars in Thousands)				
Net Financial Condition	**FY 2014**	**FY 2013**	**Increase (Decrease)**	**Percentage Change in Financial Position**
Intragovernmental				
Fund Balance with Treasury	$ 537,984	$ 279,163	$ 258,821	93%
Investments	7,685,783	7,200,600	485,183	7%
Accounts Receivable	711	1,235	(524)	-42%
Other	1,063	-	1,063	-
Total Intragovernmental	$ 8,225,541	$ 7,480,998	$ 744,543	10%
Cash and Other Monetary Assets	$ 181,519	$ 173,084	$ 8,435	5%
Accounts Receivable, net	842,736	852,026	(9,290)	-1%
Direct Loans Receivable, net	-	3,502	(3,502)	-100%
General Property & Equipment, net	34,443	47,590	(13,147)	-28%
Other	13,024	13,024	-	0%
Total Assets	**$ 9,297,263**	**$ 8,570,224**	$ 727,039	8%
Intragovernmental				
Accounts Payable	$ 1,575	$ 2,522	$ (947)	-38%
Debt	-	353	(353)	-100%
Custodial	325,448	81,444	244,004	300%
Other	4,831	8,114	(3,283)	-40%
Total Intragovernmental	$ 331,854	$ 92,433	$ 239,421	259%
Accounts Payable	$ 115,845	$ 134,727	$ (18,882)	-14%
Deferred Revenue	56,520	59,920	(3,400)	-6%
Prepaid Contributions	47,625	110,057	(62,432)	-57%
Accrued Liabilities for Universal Service	670,755	1,088,415	(417,660)	-38%
Other	33,338	35,036	(1,698)	-5%
Total Liabilities	**$ 1,255,937**	**$ 1,520,588**	$ (264,651)	-17%
Unexpended Appropriations - Other Funds	$ 3,059	$ 3,394	$ (335)	-10%
Cumulative Results of Operations	8,038,267	7,046,242	$ 992,025	14%
Total Net Position	**$ 8,041,326**	**$ 7,049,636**	$ 991,690	14%
Net Cost of Operations	**$ 8,824,009**	**$ 9,432,508**	$ (608,499)	-6%
Total Budgetary Resources	**$ 14,088,164**	**$ 14,373,177**	$ (285,013)	-2%

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 92 percent of total assets as of September 30, 2014.

The graph below presents the total assets of the Commission as of September 30, 2014. The large Investments balance of $7,686 million results from carryover in the USF Schools and Libraries Program and funds reserved for the High Cost support mechanisms that were ushered in by the *USF/ICC Transformation Order*.

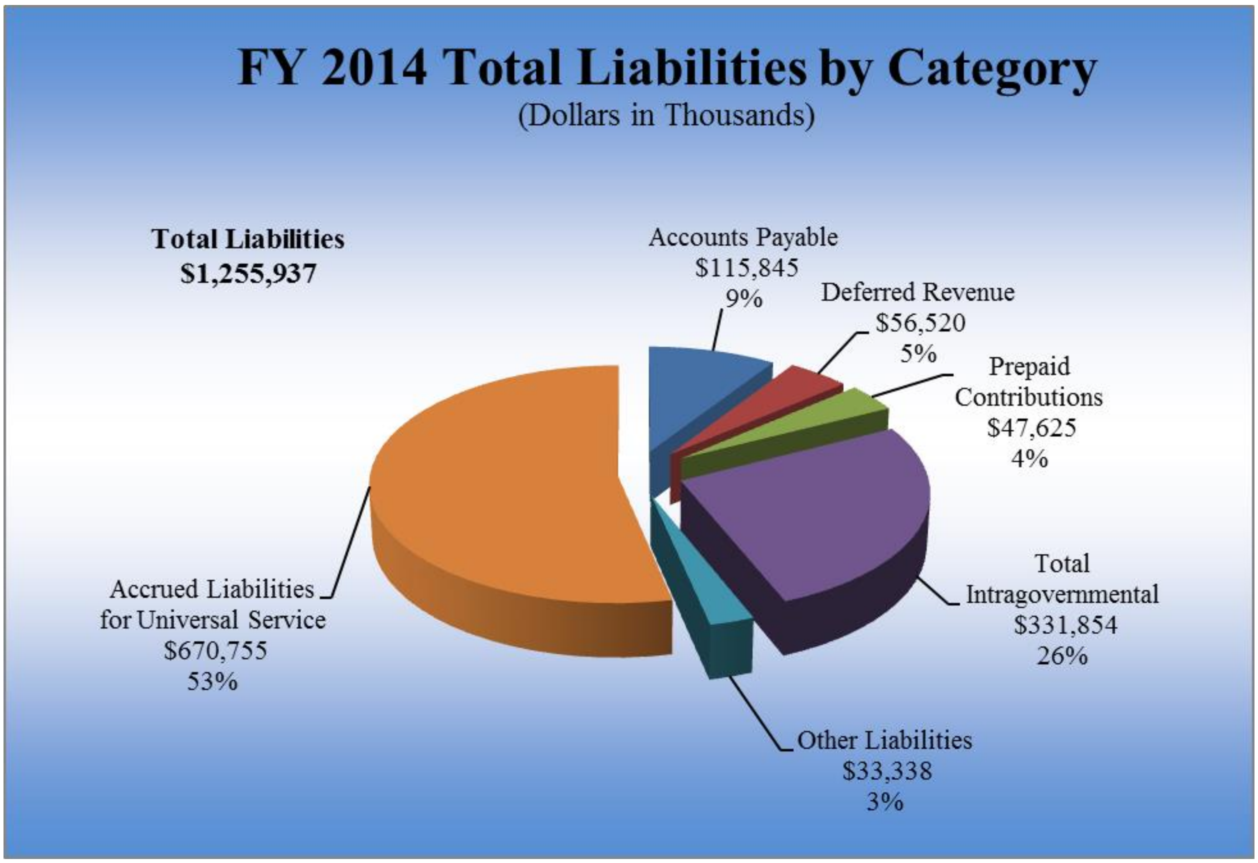
The Accounts Receivable balance of $843 million is primarily composed of USF receivables totaling $765 million.



The graph below presents the total liabilities of the Commission as of September 30, 2014. Other than the intragovernmental liabilities, the Commission's most significant liabilities are Accounts Payable of $116 million and Accrued Liabilities for Universal Service of $671 million, which alone accounted for 53 percent of total liabilities as of September 30, 2014.

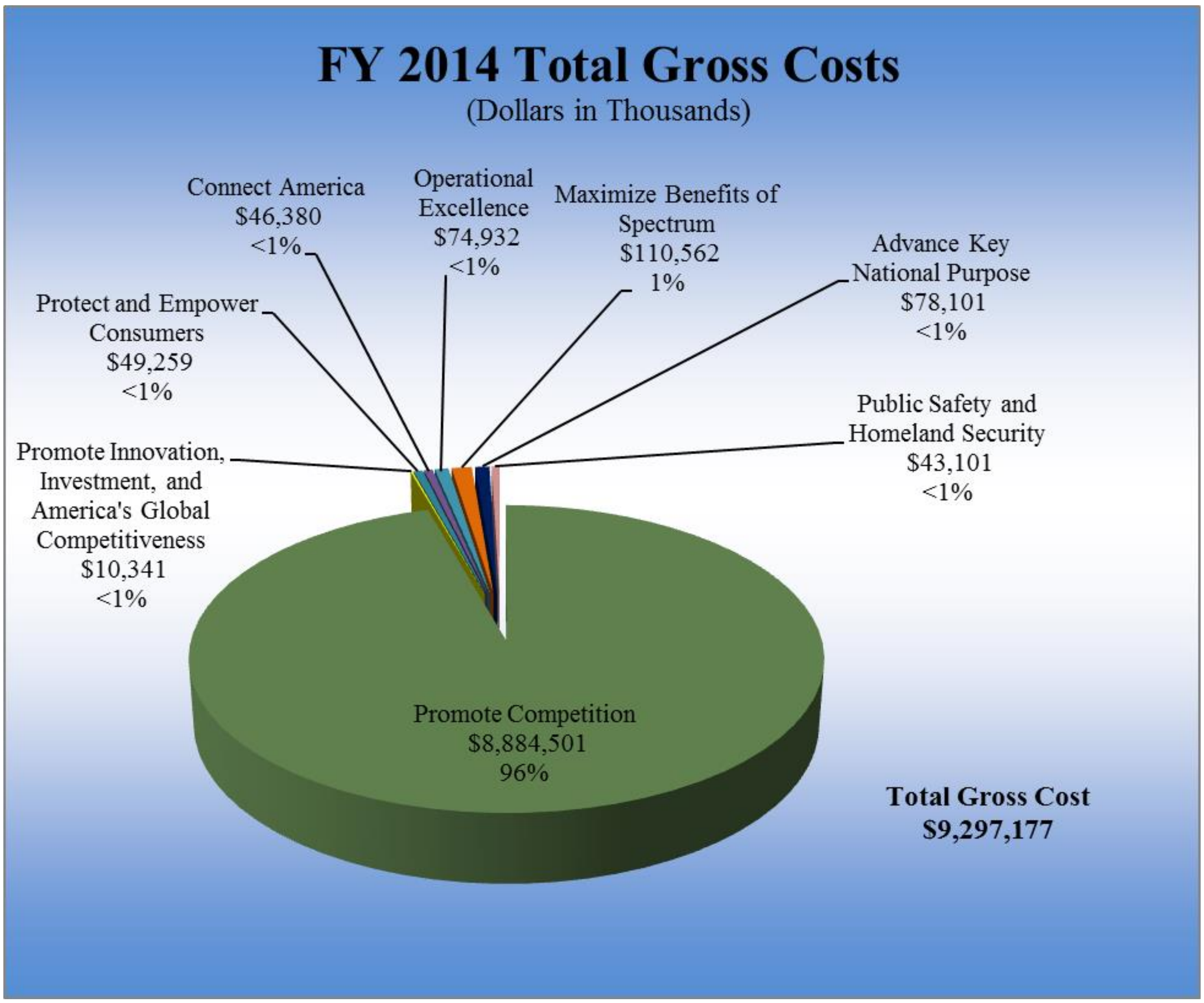
Total Intragovernmental is primarily composed of custodial collections earned on Spectrum auctions and miscellaneous receipts.

The Accrued Liabilities for Universal Service represent the expected October (FY 2015) payments for the Telecommunications Relay Service Program and the Universal Service Fund High Cost and Lifeline 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, Maximum Benefits of Spectrum, Protect and Empower Consumers, Promote Innovation, Investment, and America's Global Competitiveness, Promote Competition, 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 are allocated to strategic goals Connect America, Promote Competition, and Advance Key National Purposes, and the program costs for the TRS and NANP are allocated to the strategic goal Promote Competition. As a result of the accounting for these activities, the cost for some goals may be significantly higher than the cost of 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.

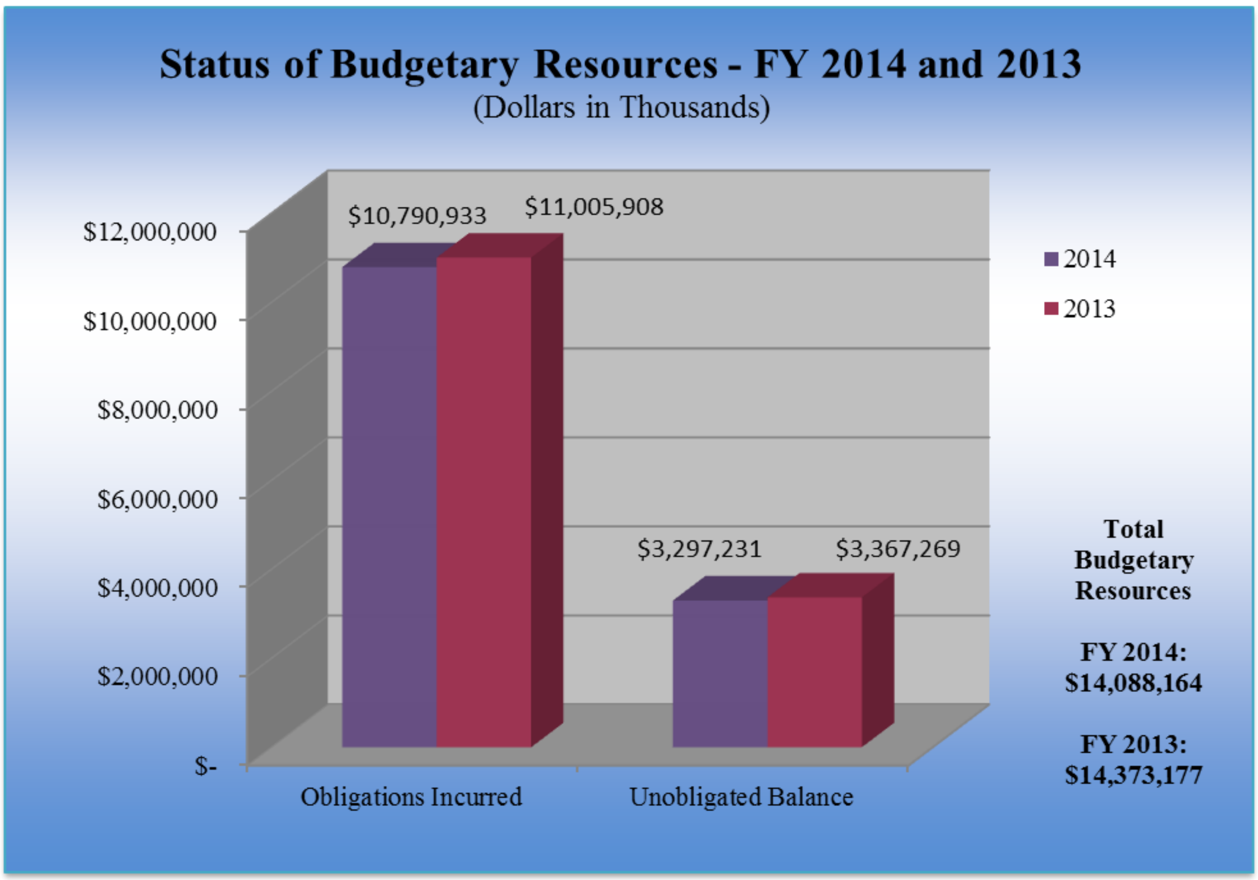
The graph below presents the total gross costs of each Commission program.



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. In FY 2014, the Commission's Net Position increased $991 million or 14 percent to $8,041 million compared to the net position of $7,050 for FY 2013. This increase is mostly attributable to the increase in High Cost – Connect America Fund reserve as the Commission works diligently to implement those support mechanisms ushered in by the *USF/ICC Transformation Order*.

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 $14,088 million in budgetary resources of which $10,791 million was for obligations incurred and $3,297 million remained unobligated.

The chart below presents the status of budgetary resources comparatively between FY 2014 and FY 2013.



*Consolidated Statement of Custodial Activity***:** The Commission recognized $1,605 million of custodial revenue during FY 2014. From this balance, $1,221 million in auction funds was transferred to the Public Safety Trust Fund that is managed by the National Telecommunications & Information Administration and $42 million in fines, forfeitures, and other miscellaneous fines was transferred to the Treasury. The $244 million increase in amounts yet to be transferred is a result of the FCC holding Auction Custodial Collections for future years at September 30, 2014.

OTHER KEY FINANCIAL STATEMENT HIGHLIGHTS

No-Year Budgetary Authority

In FY 2014, Congress authorized the Commission to retain its appropriation as available until expended. In prior fiscal years, the Commission received annual appropriations.

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 appropriations.

Regulatory fees are collected and warranted back to the Treasury to offset the Commission's appropriations for the current fiscal year. In FY 2014, the Commission was required to collect $340 million in regulatory fees. Actual collections were slightly less than $349 million.

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.

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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) 2014 and to report that the Commission's auditors issued an unmodified audit opinion on each of the Commission's financial statements for FY 2014. Furthermore, I am proud to say that this is the ninth straight year the Commission has received an unmodified opinion. The Commission is proud of the work of its staff over the last nine years to obtain and maintain an unmodified opinion.

Throughout FY 2014, the Commission worked diligently on closing audit findings from previous audits. As part of this effort, the Commission made progress on resolving matters raised by its auditors in their FY 2013 audit report. The Commission closed all findings related to financial system functionality and integration and reduced the number of open findings related to information technology controls.

The Commission is committed to improving its financial processes, demonstrating fiscal integrity, strengthening technology controls, minimizing the risk of improper payments, and 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 to the Commission. During FY 2014, the Commission successfully upgraded its core financial system to the latest version to remain a leader in system functionality that meets federal financial reporting requirements. Additionally, a new division, the Compliance and Oversight Group, was created within financial operations to oversee internal controls, risk assessments, laws and regulations impacting the Commission, and to manage responses to oversight and reporting requirements from other federal agencies, such as the Office of Management and Budget and the Government Accountability Office.

While FY 2014 was a year in which the Commission took several positive steps towards strengthening its internal control environment, more work must be done in FY 2015 and beyond. For instance, the FY 2014 audit report points out one material weakness, one significant deficiency, and one instance of non-compliance with laws and regulations. The auditor's primary areas of concern relate to Universal Service Fund (USF) budgetary accounting, information technology controls, and non-compliance with the Debt Collection Improvement Act (DCIA).

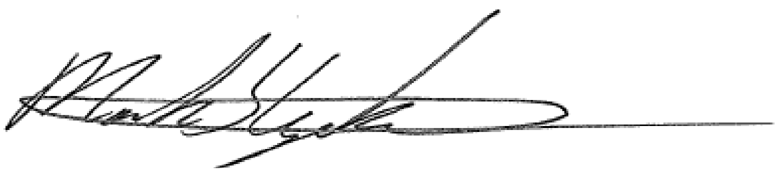
First, I would like to address the material weakness. For the first time since FY 2008, the independent auditor identified a material weakness in the control environment over financial and accounting operations. The independent auditors identified errors in non-routine, manual journal entries related to the implementation of new programs, as well as errors caused by a lack of formal communication between the Universal Service Administrative Company (USAC) accounting department and the Schools and Libraries (SLD) program managers.

The errors that the auditors noted were corrected by USAC during the course of the fiscal year and did not impact the Commission's FY 2014 financial statements. The Commission and USAC have already discussed this issue and have started to implement appropriate corrective action to ensure that this or similar breakdowns do not occur in the future.

Second, the Commission is committed to remediating information technology control deficiencies. The Commission's information technology team worked diligently throughout FY 2014 to make improvements and to resolve audit findings from previous year audits. For example, the FCC's information technology team focused on addressing the investment planning and configuration management issues identified in prior year reports and was able to successfully close out audit findings in these areas.

Finally, at the end of FY 2014, the Commission transferred 95.6%, of all eligible debt to the Department of the Treasury to comply with DCIA. The Commission has a plan in place to complete the transfer of the remaining 4.4% of eligible debt to the Treasury by the end of the first quarter in FY 2015.

I look forward to FY 2015 and to making every effort to continue to strengthen the Commission's and the reporting components' internal control environments. The Commission will work both to modernize its financial systems to improve the utilization of resources and accuracy of reporting and to improve the effectiveness of the Commission's and its reporting components' financial operations.



Mark Stephens
Chief Financial Officer
November 14, 2014

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: November 14, 2014

TO: Chairman

FROM: Inspector General

SUBJECT: Audit of the Federal Communications Commission's Financial Statements for Fiscal Year 2014

As required by 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 2014 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 was one material weaknesses in internal control related to USF's Budgetary Accounting.
- There was one repeat significant deficiency related to FCC's information technology controls.
- There was one repeat instance of noncompliance with laws and regulations related to requirements of the Debt Collection Improvement Act.

While management has made improvements as it relates to the repeated internal control significant deficiency noted above, this issue has been reported by financial statement auditors since FY 2005.

The OIG reviewed KPMG LLP's reports and related documentation and made necessary inquires of KPMG's representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards was not intended to enable us to express an opinion and we do not express an opinion on the FCC's financial statements, conclusions about the effectiveness of internal controls, or conclusions on compliance with laws and regulations. KPMG LLP is wholly responsible for the attached report dated November 14, 2014 and the conclusions expressed therein.

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

cc: Jon Wilkins, Managing Director
Ruth Milkman, Chief of Staff
Mark Stephens, Chief Financial Officer
Dr. David Bray, Chief Information 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, 2014 and 2013, 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.

Federal Communications Commission
November 14, 2014
Page 2

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, 2014 and 2013, 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 information in the *Message from the Chairman* and the *Other Information* sections are presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Federal Communications Commission
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Page 3

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2014, on our consideration of the FCC's internal control over financial reporting and our report dated November 14, 2014, 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

November 14, 2014

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, 2014 and 2013, 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 November 14, 2014.

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, 2014, 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*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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 have not been identified. However, as described in Exhibits I and II, we identified certain deficiencies in internal control that we consider to be a material weakness and significant deficiency.

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. We consider the deficiency described in Exhibit I to be a material weakness.

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. We consider the deficiency described in Exhibit II to be a significant deficiency.

Federal Communications Commission
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Page 2

FCC's Responses to Findings

The FCC's response to the significant deficiency and material weakness 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 2014." 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

November 14, 2014

EXHIBIT I

MATERIAL WEAKNESS

Universal Service Fund (USF) Budgetary Accounting

During our fiscal year (FY) 2014 audit, we noted improvements were needed in internal controls and processes related to USF budgetary accounting. Our audit identified errors in non-routine, manual journal entries related to the implementation of new programs, as well as errors caused by a lack of formal communication between certain Universal Service Administrative Company (USAC) accounting department and the Schools and Libraries (SLD) program managers.
Specifically, we noted the following:

- USAC management did not initially follow an FCC approved administrative change issued in February 2013 extending the invoice deadline and obligation expiration date for $581 million in SLD obligations. As a result, the obligations were incorrectly deobligated in November 2013. USAC management subsequently identified and corrected the error, but not until February 2014. The related control, as well as the compensating controls, were not adequate to detect and correct the error in a timely manner.

- An unusual transaction of $62 million existed in the population of new commitments provided by USAC for the High Cost Connect America Fund (CAF). This transaction was related to the deobligation of unclaimed CAF Phase 1 amounts. This transaction was the result of USAC incorrectly debiting the Exempt Undelivered Orders – Obligations, Unpaid (account 4801) instead of Downward Adjustments of Prior-Year Unpaid Undelivered Orders - Obligations, Recoveries (account 4871). This error was subsequently corrected as of September 30, 2014.

- USAC incorrectly recorded an obligation for the full amount of a High Cost Mobility fund winning bid, for which a portion in the amount of $48,400 was in default as of September 2013. The error was discovered during an informal review of transactions by USAC in September 2014 and reversed.

USAC management did not have formal lines of communication in place between the USAC accounting department and the SLD program managers regarding relevant FCC approved administrative changes in order to ensure the appropriate budgetary accounting treatment was applied to the affected transactions. SLD program managers updated their records to reflect the granted extension in their database but did not coordinate with the USAC accounting team to update their records for financial reporting purposes. As a result, the deobligation was recorded based on Data Insight reports using an outdated data table.

In addition, USAC management did not have sufficient controls in place to review the non-routine, manual journal entries recorded for the Connect America Fund or the Mobility Fund to ensure compliance with USSGL budgetary accounting guidance and that only valid obligations were recorded.

Without adequate internal controls in place, there is an increased risk that material errors could occur in the financial statements and not be detected and corrected in a timely manner.

Recommendations:

1. Develop more formal lines of communication between the USAC accounting department and the SLD program managers regarding relevant FCC approved administrative changes in order to implement the proper accounting treatment for the related transactions. **(New)**

2. Enhance the controls over the review of non-routine budgetary journal entries to ensure transactions are properly recorded. **(New)**

EXHIBIT II

SIGNIFICANT DEFICIENCY

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 Information Technology (IT) infrastructure and services. The Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, provides guidance to assist agencies complying with 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 circular No. A-123 to ensure the reliability of financial reporting.

In FY 2014, the 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 the FCC performed certain monitoring activities and initiatives, and made moderate improvements from the prior year, the FCC IT infrastructure still did not fully comply with certain requirements prescribed in National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53, Revision 4, *Recommended Security Controls for Federal Information Systems*, and OMB Circular No. A-123. In the current year, we identified additional deficiencies in the FCC's control environment, risk assessment process, control activities, and monitoring process related to securing FCC's IT infrastructure. The 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 current year IT deficiencies described below relate primarily to the FCC, which represents approximately $464.9 million of $9.3 billion of consolidated total program costs. We have previously reported these deficiencies to FCC management, including identified causes and recommendations, and provided further detail in the sections below on the reported 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 the FCC had not documented policies and procedures for actively directing and overseeing external third parties. In addition, the FCC's FY14 inventory of information systems did not include interfaces between certain information systems and subsystems, or contractor-operated systems.

While a procedure was in place for the periodic inventory and tracking of information systems, the FCC had not developed policies and procedures for actively directing and overseeing external third parties.

The FCC excluded existing contractor-operated systems and related interfaces from the FCC's inventory of information systems, which led to an incomplete inventory. An incomplete inventory may result in FCC management: a) not being aware of the existence of all relevant contractor systems; b) not being aware when significant changes occur that could impact the effectiveness of contractors' security controls; or c) not requiring a re-assessment and re-authorization of a relevant contractor system.

Control Environment Recommendation

Strengthen the control environment by:

1. Developing and implementing policies and procedures for actively directing and overseeing external third parties, and distributing them to contractor management. Additionally, a complete inventory should be maintained and updated at least annually to include information systems, subsystems, contractor-operated systems, and all related interfaces. **(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 and did not comply with relevant requirements in NIST SP 800-53, Revision 4 and NIST SP 800-37, Revision 1, *Guide for Applying the Risk Management Framework to Federal Information Systems*. The FCC's failure to meet the relevant requirements noted above led to the deficiencies discussed below.

The FCC's risk management activities were not fully implemented. Specifically, we noted that the Authorizations to Operate (ATOs) had expired for the two systems reviewed on July 11, 2014 and August 21, 2014, respectively. By not reassessing and reauthorizing information systems at least every three years, there is an increased risk that the system security plan will no longer accurately depict the system's current controls, and the security assessment report will no longer consider the full range of significant risks to which the system is subject. This could ultimately result in security control gaps remaining undetected.

Furthermore, we noted the security assessment testing and the assessment of risks for all tested major applications were incomplete. Specifically, we noted the security assessment testing did not include management and operational controls, as required by NIST 800-53, Revision 4. 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 Revision 4, is intended to drive the adoption of necessary IT security controls designed to achieve more secure information systems at federal agencies. However, for the three FCC systems tested, the security assessment report was incomplete as the vulnerabilities identified were largely limited to technical vulnerabilities as management and operational vulnerabilities were not included. Limiting the assessment of risks to vulnerabilities identified by incomplete security assessment testing may result in significant risks not being considered in the risk assessment. Further, utilizing incomplete risk assessments to assist in tailoring and scoping a system security plan (SSP) may result in an incomplete risk assessment and SSP's not documenting all appropriate controls and enhancements.

In addition, the FCC's Cyber Security Policy directed that security assessment testing be performed but did not reference to the applicable standards (e.g. NIST SP 800-53A, Revision 1) to prescribe the appropriate rigor and breadth of testing.

The FCC did not perform system security planning and assessments for the majority of its systems, and did not reassess and reauthorize its information systems in the last three years. As a result, two FCC systems had an expired ATO, as described above, and the majority of FCC systems had temporary ATOs issued by the FCC Chief Information Officer (CIO).

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

Incomplete system security plans increase the risk that security assessment testing may not include all required IT security controls for each system. Further, if security assessment testing of all required IT security controls, including management and operational controls, is not performed, there is an increased risk that control deficiencies will not be identified and corrected, or mitigated with effective compensating controls in a timely manner.

Risk Assessment Recommendations

Strengthen risk assessments by:

2. Assessing the risks of identified vulnerabilities (by considering both vulnerabilities and related threats), and adding mitigating controls to the system security plans. **(Reissued)**

3. Performing security assessment testing for applicable management, operational and technical controls in accordance with evaluation criteria from NIST SP 800-53a Revision 4 at least once every three years for FCC information systems. **(Reissued)**

4. Authorizing all FCC information systems to operate subsequent to planning and successfully testing the necessary IT security controls. Information systems considered to be major applications should be prioritized. (**Updated**)

5. Performing E-authentication risk assessments and updating system security plans to define the relevant authentication level and the required level of e-authentication controls to implement for each e-government application. **(Reissued)**

Control Activities Findings

OMB Circular A-123 requires internal control to be in place over information systems in the form of both general and application controls. General controls apply to all information systems such as servers, the FCC network and end-user environments, and also includes agency-wide security program planning, management, control over data center operations, and system software acquisition and maintenance. Control activities include policies, procedures, and mechanisms in place to help ensure that agency objectives are met.

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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.

Due to the rapid changes in information technology, controls must adjust to remain effective. Based on our procedures performed, we noted deficiencies in FCC's general control activities related specifically to the FCC security program, access controls, and change controls. The deficiencies are discussed in more detail below.

Security Program

The FCC did not update its system security plans to document controls that mapped to NIST SP 800-53 Revision 4, which are recommended minimum baseline controls. Additionally, security assessments of controls to support the FCC's information systems' ATOs were incomplete.

Access Controls

During our review, we found that access controls were not consistently implemented throughout the FCC environment, including documentation of access approvals, removal of access for terminated or inactive users; as well as periodically reviewing user access privileges. Specifically, we identified the following control weaknesses:

- Procedures for user account management functions were not consistently implemented for major applications. Inconsistent implementation of documented procedures led to instances where access was granted without documented authorization.

- User account management controls were not operating effectively to prevent logical or physical access from being granted to users who should not have access or to remove access from users who no longer needed it. The FCC also did not perform periodic reviews and recertification of network and infrastructure users.

- Accounts were not removed in a timely manner for separated users. As a result, there was an increased risk that data and resources were subject to unauthorized use, loss, or disclosure.

- Controls to limit privileged access were not operating effectively. In addition, the resolution of identified vulnerabilities was not documented and the FCC did not consistently use audit logs to monitor user actions. Further, the FCC's password policies were not clearly defined.

- FCC policies and procedures have not been implemented for vulnerability scanning of all FCC information systems and assets.

- Incidents were not accurately classified in the appropriate categories due to lack of training in the Network Security Operations Center (NSOC) group. Therefore, all required incidents were not being reported to United States Computer Emergency Readiness Team (US-CERT) to meet Federal requirements.

- There was not a documented process for FCC's contractor system application to perform periodic reviews of the database suspicious activity.

Change Controls

The FCC could not provide documentation to evidence that system configurations were monitored for unauthorized changes. Furthermore, the FCC did not periodically review configurations for server operating systems, server software, network devices and database management systems for compliance with baseline configurations.

Control Activities Recommendations

Security Program

Strengthen security program oversight and planning by:

6. Documenting system security plans across all components to clearly define system security controls for information systems that are equivalent to the NIST SP 800-53, Revision 4, 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)**

7. Ensuring that contractor deliverables (including the security authorization and assessment packages) are consistent with the NIST SP 800-53, Revision 4 and NIST SP 800-37, Revision 1. **(Reissued)**

Access Controls

Strengthen access controls by:

8. Consolidating all existing procedures related to adding users into one comprehensive document, and including a standardized process that specifies the appropriate access request form to be used for each information system. **(Updated)**

9. Establishing a process for retaining access authorization forms for new users to the FCC network domain, remote access and FCC applications. **(Reissued)**

10. Updating the applicable applications to possess the capability of having individual user access accounts for each external user. **(Reissued)**

11. Updating and implementing USAC procedures for adding users, removing users, and reviewing and recertifying users. **(Updated)**

12. Implementing the Cyber Security Policy and Application User Account Management Procedures by performing quarterly reviews of the FCC Network and FCC applications to ensure that user access 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. **(Reissued)**

13. Ensuring individuals are not granted computer room access without approval from the Chief of Network Operations and a signed Computer Room Access Acknowledgment of Responsibilities form. **(Updated)**

14. Ensuring network access is revoked within the two weeks-of the required deadline for any employees and contractors that fail to take annual security awareness training, in accordance with the FCC Cyber Security Policy. **(New)**

15. Revoking access of separated employees or contractors by using the monthly list of separated contractors distributed by the Security Operations Center, and the bi-weekly list of separated employees distributed by Human Resources. **(Updated)**

16. Defining agency-wide password strength and account lockout requirements, including the scope and applicability. Further, FCC should implement password strength and account lockout settings for FCC applications to be consistent with its policies. Any exceptions to the policies should be documented. **(Reissued)**

17. Configuring the Security Information and Event Management (SIEM) solution to encompass all platforms for monitoring and reporting purposes. Further, documenting and implementing procedures for security audit logging and review of UNIX platforms, remote connections, network domain controllers, intrusion detection systems, backend infrastructure, and FCC major applications to ensure users accessing FCC information systems are uniquely identified and their actions are auditable. **(Updated)**

18. Revising current vulnerability assessment program to include information and/or procedures, which at a minimum contain the following: the tools currently utilized configuration and licensing specifications, a list of all FCC devices and assets subject to periodic vulnerability scanning, reporting requirements, and how to document exceptions. **(Updated)**

19. Following US-CERT Federal Incident Reporting Guidelines for categorizing and documenting all security incidents from initial occurrence to resolution, and reporting all necessary security incidents to US-CERT in accordance with US-CERT Concept of Operations (CONOPS). **(Updated)**

20. Documenting a process to perform periodic reviews of the database audit log activity and implementing the documented process to periodically perform reviews on audit logs database as defined by NIST 800-53, Revision 4 criteria. **(Reissued)**

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Change Control

Strengthen change and configuration management controls by:

21. Implementing configuration management procedures for server operating systems, server software, network devices and database management systems. **(Reissued)**

22. Establishing baseline configurations for applicable systems supporting information technology (IT) infrastructures. **(Reissued)**

23. Establishing and documenting baseline configurations for applicable systems across all components for applicable systems and supporting information technology (IT) infrastructure environments across all components. **(Updated)**

24. Periodically reviewing configurations for applicable systems across all components against baselines to ensure that the applicable IT infrastructures are securely configured. **(Updated)**

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 the FCC had not fully implemented a process to test a subset of technical, operational, and management controls annually across FCC information systems. The FCC IT Continuous Monitoring and Enforcement Plan documented this requirement; however, the process was not fully implemented.

If annual security assessment testing is not performed to monitor the controls' effectiveness, there is an increased risk that ineffective controls or outdated security authorization packages may go undetected. OMB also requires that deficiencies found in internal control be reported to the appropriate personnel and management responsible for that area. Deficiencies identified through either internal review or by an external audit should be evaluated and corrected and a systematic process should be in place for addressing deficiencies. We noted Plan of Action & Milestones (POAM) tracking procedures had not been established for contractor systems operated on behalf of the FCC. In addition, the FCC agency-wide POA&M listing did not incorporate weaknesses discovered during reviews, including GAO audits, other audits, and critical infrastructure vulnerability assessments. Some weaknesses identified at the FCC did not include milestone or completion dates. Lastly, system-level POA&Ms were not updated for any FCC major systems tested in the current fiscal year.

Monitoring Recommendations

Strengthen monitoring controls by:

25. Ensuring that the FCC performs annual security assessment testing of a subset of controls to monitor the controls' effectiveness and such testing includes use of the NIST SP 800-53a assessment cases as well as assessing the controls at least once during the three-year authorization cycle. **(Updated)**

26. Developing and implementing procedures for tracking identified contractor system vulnerabilities into a POA&M. **(New)**

27. Implementing the Cyber Security Agency-Wide POA&M Management Plan, including that POA&Ms: include all security weaknesses found during any other review done by, for, or on behalf of the agency, including GAO audits, financial system audits, and critical infrastructure vulnerability assessments; include milestone and completion dates so weaknesses can be appropriately budgeted and remediated in a timely manner; and are updated at the system-level at least quarterly. **(New)**

KPMG

KPMG LLP
Suite 12000
1801 K Street, NW
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, 2014 and 2013, 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 November 14, 2014.

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 an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02, which is described in Exhibit I.

Management is reviewing two matters regarding potential violations of the Anti-Deficiency Act. As of the date of this report, the outcome of these matters, and any resulting ramifications, is not known.

FCC's Response to Findings

The FCC's response to the finding identified in our audit is included in the memorandum titled "Management's Response to Independent Auditors' Reports on Internal Control Over Financial Reporting and Compliance and Other Matters for Fiscal Year 2014." 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.

KPMG

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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

November 14, 2014

EXHIBIT I

Debt Collection Improvement Act of 1996 (DCIA)

FCC management informed us that the FCC had not transferred all eligible debt outstanding for more than 180 days to the U.S. Department of the Treasury (Treasury) in accordance with the DCIA during fiscal year 2014. FCC was in the process of transferring the eligible delinquent debt to Treasury or writing it off; however, as of September 30, 2014, this had not yet been completed. It was not completed because of the backlog related to prior year issues remitting debt, and current year issues with the overdue fee calculations performed in Genesis, the FCC's financial system.

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."

Recommendations:

1. Continue to write-off or transfer to Treasury the remaining debt over 180 days past due, as appropriate; and

2. Work with the Genesis vendor to correct the Genesis system issues related to overdue fee calculations in order to timely facilitate the transfer of eligible debt to Treasury.

Office of the Managing Director

M E M O R A N D U M

DATE: November 14, 2014

TO: David L. Hunt, Inspector General

FROM: Jon Wilkins, Managing Director
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 2014

Thank you for the opportunity to review and comment on the audit 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) 2014 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 2014 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 ninth straight year, the independent auditor provided an unmodified opinion and found that the Commission's consolidated financial statements for FY 2014 present fairly, in all material respects, the financial position of the Commission as of September 30, 2014. Nine straight years of clean audit opinions is an unprecedented accomplishment for the Commission. 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 2014 audit report points out one material weakness, one significant deficiency, and one instance of non-compliance with laws and regulations. The auditor's primary areas of concern relate to Universal Service Fund (USF) budgetary accounting, information technology controls, and non-compliance with the Debt Collection Improvement Act (DCIA). We concur with the recommendations made by the independent auditors in their reports.

First, we would like to address the material weakness. For the first time since FY 2008, the independent auditor identified a material weakness in the control environment over financial and accounting operations. The independent auditors identified errors in non-routine, manual journal entries related to the implementation of new programs, as well as errors caused by a lack of formal communication between the Universal Service Administrative Company (USAC) accounting department and the Schools and Libraries (SLD) program managers.

The errors that the auditors noted were corrected by USAC during the course of the fiscal year and did not impact the Commission's FY 2014 financial statements. The Commission and USAC have already discussed this issue and have started to implement appropriate corrective action to ensure that this or similar breakdowns do not occur in the future. The Commission will work to close out this audit finding during FY 2015 and will continue to monitor USAC's processes in this area in the future.

Second, the Commission is committed to remediating information technology control deficiencies. The Commission's information technology team worked diligently throughout FY 2014 to make improvements and to resolve audit findings from previous year audits. For example, the FCC's information technology team focused on addressing the investment planning and configuration management issues identified in prior year reports and successfully closed out audit findings in these areas. During the FY 2015, the information technology team plans to keep up their efforts from FY 2014 and will be focused on achieving additional successes in strengthening controls and closing audit findings.

Furthermore, at the end of FY 2014, the Commission transferred 95.6%, of all eligible debt to the Department of the Treasury in its ongoing efforts to comply with DCIA. The Commission has a plan in place to complete the transfer of the remaining 4.4% of eligible debt to the Treasury by the end of the first quarter in FY 2015. With these corrective actions already in motion, the FCC hopes that it will be able to have this non-compliance issue closed during the FY 2015 financial audit cycle.

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 2015 to resolve the FY 2014 audit findings and to enhance the culture of integrity, accountability, and excellence that exists here at the Commission.

Jon Wilkins

Jon Wilkins, Managing Director
Office of Managing Director

Mark Stephens, Chief Financial Officer
Office of Managing Director

PRINCIPAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED BALANCE SHEET

As of September 30, 2014 and 2013
(Dollars in thousands)

	FY 2014	FY 2013
Assets (Note 2):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 537,984	$ 279,163
Investments (Note 5)	7,685,783	7,200,600
Accounts receivable (Note 6)	711	1,235
Other	1,063	-
Total intragovernmental	8,225,541	7,480,998
Cash and other monetary assets (Note 4)	181,519	173,084
Accounts receivable, net (Note 6)	842,736	852,026
Direct loans receivable, net	-	3,502
General property, plant, and equipment, net	34,443	47,590
Other	13,024	13,024
Total assets	$ 9,297,263	$ 8,570,224
Liabilities (Note 7):		
Intragovernmental:		
Accounts payable	$ 1,575	$ 2,522
Debt	-	353
Other (Note 8)		
Custodial	325,448	81,444
Other	4,831	8,114
Total other	330,279	89,558
Total intragovernmental	331,854	92,433
Accounts payable	115,845	134,727
Other (Note 8)		
Deferred revenue	56,520	59,920
Prepaid contributions	47,625	110,057
Accrued liabilities for Universal Service	670,755	1,088,415
Other	33,338	35,036
Total other	808,238	1,293,428
Total liabilities	$ 1,255,937	$ 1,520,588
Commitments and contingencies (Note 9)		
Net position:		
Unexpended appropriations - All Other Funds	$ 3,059	$ 3,394
Cumulative results of operations - Funds from Dedicated Collections (Note 10)	7,880,477	6,884,853
Cumulative results of operations - All Other Funds	157,790	161,389
Total net position	$ 8,041,326	$ 7,049,636
Total liabilities and net position	$ 9,297,263	$ 8,570,224

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST
For the Years Ended September 30, 2014 and 2013
(Dollars in thousands)

	FY 2014	FY 2013
Program costs (Note 11)**:**		
Connect America:		
Total Gross Cost	$ 46,380	$ 47,037
Maximize Benefits of Spectrum:		
Total Gross Cost	110,562	79,655
Protect and Empower Consumers:		
Total Gross Cost	49,259	52,155
Promote Innovation, Investment, and America's Global Competitiveness:		
Total Gross Cost	10,341	9,697
Promote Competition:		
Total Gross Cost	8,884,501	9,580,394
Public Safety and Homeland Security:		
Total Gross Cost	43,101	47,359
Advance Key National Purposes:		
Total Gross Cost	78,101	10,000
Operational Excellence:		
Total Gross Cost	74,932	92,807
Total Program Costs	$ 9,297,177	$ 9,919,104
Less: earned revenues not attributed to programs	(473,168)	(486,596)
Net cost of operations	$ 8,824,009	$ 9,432,508

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, 2014 and 2013
(Dollars in thousands)

	FY 2014			FY 2013		
	Funds from Dedicated Collections (Note 10)	**All Other Funds**	**Total**	**Funds from Dedicated Collections** (Note 10)	**All Other Funds**	**Total**
Cumulative Results of Operations:						
Beginning Balances	$ 6,884,853	$ 161,389	$ 7,046,242	$ 6,622,985	$ 148,527	$ 6,771,512
Budgetary Financing Sources:						
Appropriations used	-	661	661	-	661	661
Non-exchange revenue	9,821,685	-	9,821,685	9,722,967	-	9,722,967
Other	1	-	1	67	(1)	66
Other Financing Sources (Non Exchange):						
Imputed financing	-	16,195	16,195	-	15,146	15,146
Other	-	(22,508)	(22,508)	-	(31,602)	(31,602)
Total Financing Sources	9,821,686	(5,652)	9,816,034	9,723,034	(15,796)	9,707,238
Net Cost of Operations	8,826,062	(2,053)	8,824,009	9,461,166	(28,658)	9,432,508
Net Change	995,624	(3,599)	992,025	261,868	12,862	274,730
Cumulative Results of Operations	7,880,477	157,790	8,038,267	6,884,853	161,389	7,046,242
Unexpended Appropriations:						
Beginning Balances	-	3,394	3,394	-	4,251	4,251
Budgetary Financing Sources:						
Appropriations received	-	351	351	-	-	-
Other adjustments	-	(25)	(25)	-	(196)	(196)
Appropriations used	-	(661)	(661)	-	(661)	(661)
Total Budgetary Financing Sources	-	(335)	(335)	-	(857)	(857)
Total Unexpended Appropriations	-	3,059	3,059	-	3,394	3,394
Net Position	$ 7,880,477	$ 160,849	$ 8,041,326	$ 6,884,853	$ 164,783	$ 7,049,636

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2014 and 2013
(Dollars in thousands)

	FY 2014	FY 2013
Budgetary Resources:		
Unobligated balance brought forward, October 1	$ 3,367,269	$ 3,206,967
Recoveries of prior year unpaid obligations	461,521	927,684
Other changes in unobligated balance (+ or -)	(3,618)	(1)
Unobligated balance from prior year budget authority, net	3,825,172	4,134,650
Appropriations (discretionary and mandatory)	9,808,739	9,786,362
Borrowing authority (discretionary and mandatory)	3,616	1,496
Spending authority from offsetting collections (discretionary and mandatory)	450,637	450,669
Total budgetary resources	$ 14,088,164	$ 14,373,177
Status of Budgetary Resources:		
Obligations incurred (Note 12)	$ 10,790,933	$ 11,005,908
Unobligated balance, end of year:		
Apportioned	22,325	11,073
Exempt from apportionment	3,074,850	3,173,822
Unapportioned	200,056	182,374
Total unobligated balance, end of year	3,297,231	3,367,269
Total status of budgetary resources	$ 14,088,164	$ 14,373,177
Change in Obligated Balance:		
Unpaid obligations:		
Unpaid obligations, brought forward, Oct 1	$ 4,052,196	$ 3,581,685
Obligations incurred	10,790,933	11,005,908
Outlays (gross) (-)	(9,746,042)	(9,607,713)
Recoveries of prior year unpaid obligations (-)	(461,521)	(927,684)
Unpaid obligations, end of year	4,635,566	4,052,196
Uncollected payments:		
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(4,418)	(5,616)
Change in uncollected pymts, Fed sources (+ or -)	148	1,198
Uncollected pymts, Fed sources, end of year (-)	(4,270)	(4,418)
Memorandum (non-add) entries		
Obligated balance, start of year (+ or -)	$ 4,047,778	$ 3,576,069
Obligated balance, end of year (net)	$ 4,631,296	$ 4,047,778
Budget Authority and Outlays, Net:		
Budget authority, gross (discretionary and mandatory)	$ 10,262,992	$ 10,238,527
Actual offsetting collections (discretionary and mandatory) (-)	(459,857)	(481,038)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)	148	1,198
Budget Authority, net (discretionary and mandatory)	$ 9,803,283	$ 9,758,687
Outlays, gross (discretionary and mandatory)	$ 9,746,042	$ 9,607,713
Actual offsetting collections (discretionary and mandatory) (-)	(459,857)	(481,038)
Outlays, net (discretionary and mandatory)	9,286,185	9,126,675
Distributed offsetting receipts (-)	(67,396)	(13,356)
Agency outlays, net (discretionary and mandatory)	$ 9,218,789	$ 9,113,319

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2014 and 2013
(Dollars in thousands)

	FY 2014	FY 2013
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	$ 1,568,559	$ 15,183
Fines and Penalties	42,099	25,287
Loan Payments	-	62
Total Cash Collections	1,610,658	40,532
Accrual Adjustments (+/-)		
Spectrum Auctions	-	(1,564)
Fines and Penalties	(4,855)	3,907
Total Accrual Adjustments	(4,855)	2,343
Total Custodial Revenue	1,605,803	42,875
Disposition of Collections:		
Transferred to Others:		
U.S. Treasury	(42,099)	(25,349)
Public Safety Trust Fund	(1,221,000)	-
(Increase)/Decrease in Amounts Yet to be Transferred (+/-)	(244,004)	81,213
Retained by the Reporting Entity	(98,700)	(98,739)
Total Disposition of Collections	(1,605,803)	(42,875)
Net Custodial Activity	$ -	$ -

The accompanying notes are an integral part of these statements.

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2014 AND 2013
(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 of 1934 (Act), 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 and combined 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 general, revolving, and deposit funds. The Commission may use the general and revolving funds to finance expenses, depending on budgetary availability. The deposit accounts are used to hold funds temporarily until they can be properly disbursed or distributed.

Note 1 - Summary of Significant Accounting Policies (continued)

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 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 premiums or discounts using the Effective Interest Method. 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. The Commission's portion of the allowance for doubtful accounts is determined by applying predetermined percentages against the respective date the receivable was established. An additional analysis of higher dollar value receivables is also performed on individual account balances.

The following chart summarizes the formula for the allowance with related outstanding days:

Accounts Receivable Age	Allowance
90 Days and Less	0%
91 - 180 Days	25%
181 - 365 Days	75%
Over 365 Days	100%

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.

G. 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. The capitalization threshold is $100 for PP&E and $200 for internally developed software with an estimated useful life of two years or more. There is no capitalization of bulk purchases of similar items. PP&E are depreciated on a straight-line basis over the estimated useful lives of the items.

Note 1 - Summary of Significant Accounting Policies (continued)

G. Property, Plant and Equipment (continued)

The following chart summarizes the PP&E classifications with related estimated useful lives:

PP&E Classification	Estimated Useful Lives (years)
Building	40
Non-Computer Equipment	7
Computer & Vehicle Equipment	5
Software	3

Land, including permanent improvements, and software in development are not depreciated. Normal maintenance and repair costs are expensed as incurred.

Leasehold improvement, which includes all cost incurred during the design and construction phase of the improvement, are either amortized over the remaining life of the lease or the useful life of the improvement, whichever is shorter.

H. Other Assets

Other Assets with agencies represent advance payments for intragovernmental agreements. 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.

I. 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. Accrued Liabilities for Universal Service mostly represent liabilities recorded by the USF for anticipated subsidies in the High Cost, Lifeline (formerly known as Low Income), and TRS programs. The obligation for these subsidies is not recognized until payment files are approved in the subsequent month.

J. 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.

Note 1 - Summary of Significant Accounting Policies (continued)

J. Deferred Revenue (continued)

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.

K. 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 Federal Credit Reform Act (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. The spectrum auction loan program has been discontinued.

L. 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 separations from 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 System (FERS), the FERS-Revised Annuity Employee (RAE), or the FERS-Further Revised Annuity Employee (FRAE). Under CSRS, the Commission makes matching contributions equal to seven percent of basic pay. Under all 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.

Note 1 - Summary of Significant Accounting Policies (continued)

L. Retirement Plans and Other Benefits (continued)

The OPM reports on CSRS, FERS, FERS-RAE, and FERS-FRAE 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 compensation and medical benefits for work related injury. 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.

M. 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.

N. Revenue and Other Financing Sources

<u>Regulatory Fee Offsetting Collections (Exchange)</u> – 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; Protect and Empower Consumers; Promote Innovation, Investment, and America's Global Competitiveness; Promote Competition; Public Safety and Homeland Security; Advance Key National Purposes; and Operational Excellence. These fees were established by congressional authority, and consistent with OMB Circular No. A-25 revised, *User Charges*, the Commission did not determine the full costs associated with its regulatory activity in establishing regulatory fees. Since 1993, Congress has annually reviewed the regulatory fee collection requirements of the Commission and established the total fee levels to be collected. Fees collected up to the level established by Congress are applied against the Commission's appropriation at the close of each fiscal year. The regulatory fee levels of $339,844 for FY 2014 and FY 2013 were achieved. The Commission collected $8,720 above the required regulatory level in FY 2014 and $10,933 in FY 2013. The cumulative amount collected above the required annual regulatory level is $90,697 at September 30, 2014. In addition, the

Note 1 – Summary of Significant Accounting Policies (continued)

N. Revenue and Other Financing Sources (continued)

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 either the U.S. Treasury or the appropriate agency required by Public Law, 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 appropriated at $98,700 in FY 2014 and $98,739 in FY 2013.

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 $1,568,559 in FY 2014 and $13,619 in FY 2013. In FY 2014, the Commission transferred recognized custodial revenue of $1,221,000 to the Public Safety Trust Fund that is managed by the National Telecommunications and Information Administration.

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 $22,509 in FY 2014 and $27,985 in FY 2013.

Reimbursable Work Agreements (Exchange) – The Commission recognizes reimbursable work agreement revenue when earned, i.e., goods that have been delivered or services rendered. The Commission executed agreements totaling $2,782 in FY 2014 and $4,168 in FY 2013.

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.

Note 1 – Summary of Significant Accounting Policies (continued)

N. Revenue and Other Financing Sources (continued)

USF (Nonexchange) – Carriers conducting interstate telecommunications are required to contribute a portion of their revenues to fund the cost of providing universal service. These contributions represent dedicated collections and are accounted for as a budgetary financing source. Total contributions of $9,783,416 and $9,676,818 were received in FY 2014 and FY 2013, respectively.

Appropriations (Financing Source) – The Commission receives a 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. In FY 2014, Congress authorized the Commission to retain its appropriation as available until expended. The no-year appropriation for FY 2014 is $339,844 and the annual appropriation for FY 2013 was $339,844, which included a temporary reduction of $17,096 due to the sequestration order implemented on March 1, 2013 and required by the Budget Control Act of 2011. Regulatory fee collections fully fund the no-year appropriation for FY 2014 and the annual appropriation for FY 2013.

Subsidy Estimates and Reestimates (Financing Source) – The FCRA of 1990, as amended, governs the reporting requirements for direct loan obligations made after FY 1991. As required, the Commission coordinates with OMB in developing estimation guidelines, regulations, and the criteria used in calculating the subsidy estimates and reestimates. In FY 2014 the Commission received an appropriation of $351, of which $25 was permanently sequestered and the remainder was available until used. In FY 2013, the Commission did not receive an appropriation since there was no upward reestimate component. The last active loan matured in April 2007 and the Commission wrote off all remaining loans in FY 2013. As result, there was no material activity related to direct loans in FY 2014, and the Commission is working with OMB to close-out the Credit Reform Program.

O. Reprogramming

In FY 2014, the Commission did not reprogram any funds. 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 settlements of legal claims, compensation and benefits, capital improvements, and information technology investments.

P. Transactions with Related Parties

The Commission has a direct oversight relationship with the administrators and Billing and Collection agents (B&C agents) of funds that are components under the overall Commission entity. These organizations are 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.

Note 1 – Summary of Significant Accounting Policies (continued)

P. Transactions with Related Parties (continued)

The Commission approves the administrative costs paid to these entities from the respective funds that they manage. The administrative costs cover expenses such as the salaries and benefits for the employees dedicated to managing the funds; rent and utilities for office space used; accounting and other financial reporting related services; and other management activities. All related party balances for the fiscal years ended September 30, 2014 and 2013 are listed below:

Administrative Fees:

	USF	TRS	NANP	Total
FY 2014	$ 116,771	$ 1,302	$ 6,205	$ 124,278
FY 2013	$ 111,112	$ 1,107	$ 5,762	$ 117,981

Q. Net Position

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

R. Comparability of the Financial Statements

Consolidated Statement of Net Cost – In FY 2014, with significant reforms made in USF programs, the Commission developed a more comprehensive methodology that better aligns USF program costs with the strategic goals of the Commission. In FY 2013 and prior, all USF program costs were allocated to the strategic goal - Promote Competition. Allocation of TRS program costs to the strategic goal - Promote Competition did not change.

Accounts Receivable, Net (Note 6) – Prior to FY2014, Notice of Apparent Liabilities (NAL) receivables were included in the second table in Note 6 - Accounts Receivable, Net, under the Forfeiture category. The ability to collect these receivables was not determinable until a final judgment was issued. As such, a 100% allowance was established for all NAL receivables. In FY 2014, the Commission implemented a new policy to exclude NAL receivables from the Accounts Receivable balance until their collectability is determined by one of the following events: a final judgment is issued and the NAL becomes either a Forfeiture Order or a Consent Decree, the violator has made either a partial or full payment on the NAL, or the violator has signed an installment plan for the NAL. All new and existing NAL receivables will continue to be tracked by the Commission. For comparability purposes, the FY 2013 amount excludes NAL

Note 1 – Summary of Significant Accounting Policies (continued)

R. Comparability of the Financial Statements (continued)

receivables. Because NAL receivables were presented with a 100% allowance, the net effect on the balance sheet from this change is $0.

Note 2 - Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2014 and 2013:

	FY 2014	FY 2013
Intragovernmental:		
Fund Balance with Treasury	$ 322,815	$ 78,415
Accounts Receivable	377	433
Total Intragovernmental	323,192	78,848
Cash and Other Monetary Assets	17	-
Accounts Receivable, Net	14,914	25,620
Total Non-entity Assets	338,123	104,468
Total Entity Assets	8,959,140	8,465,756
Total Assets	$ 9,297,263	$ 8,570,224

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for $321,851 in FY 2014 and $76,432 in FY 2013. 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, 2014 and 2013:

FY 2014	General Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	$ 23,116	$ 3,230	$ -	$ 26,346
Unavailable	109,934	-	-	109,934
Obligated Balance not yet Disbursed	78,889	-	-	78,889
Non-Budgetary FBWT	-	-	322,815	322,815
Total	$ 211,939	$ 3,230	$ 322,815	$ 537,984
FY 2013				
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	$ 193,915	$ 6,833	$ 78,415	$ 279,163

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

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

Deposit Funds – Includes monies being held for spectrum auctions, ITS, and regulatory fees. Deposit funds are 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, 2014 and 2013:

	FY 2014	FY 2013
Cash and Other Monetary Assets	$ 181,519	$ 173,084

Note 4 – Cash and Other Monetary Assets (continued)

USF and NANP contributions and third party deposits made pursuant to spectrum auction activities are the sources 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 USF and NANP contribution is reinvested. Interest earned on third-party deposits is transferred to the Treasury's General Fund.

In FY 2014, Cash and Other Monetary Assets included $17 in upfront spectrum auctions payments, $177,834 in USF contributions and related accrued interest being held for distribution, and $3,668 in NANP deposits and related accrued interest. 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.

Note 5 - Investments

The following summarizes Investments as of September 30, 2014 and 2013:

FY 2014	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	$ 728,577	EI	$ 12	$ -	$ 728,589	$ 728,586
Treasury Notes	6,974,719	EI	(26,155)	8,630	6,957,194	6,951,496
Total	$ 7,703,296		$ (26,143)	$ 8,630	$ 7,685,783	$ 7,680,082
FY 2013						
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	$ 7,201,150		$ (7,150)	$ 6,600	$ 7,200,600	$ 7,189,470

EI - Effective Interest Method

All Treasury securities, regardless of the maturity date, are reported as investments. The Commission expects to hold all investments to maturity; therefore, no adjustments have been made to present market values. All investments are held by USF and are also recognized as part of Funds from Dedicated Collections in Note 10.

The cash receipts collected from the public for the USF are used to purchase federal securities. Treasury securities are an asset to the USF and a liability to the Treasury. Because the USF and the Treasury are both part 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.

Note 5 – Investments (continued)

Treasury securities provide the USF with authority to draw upon the 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, 2014 and 2013:

	Intragovernmental	Public	Total
FY 2014			
Gross Accounts Receivable	$ 711	$ 1,445,662	$ 1,446,373
Allowance for Doubtful Accounts	-	(602,926)	(602,926)
Accounts Receivable, Net	$ 711	$ 842,736	$ 843,447
FY 2013			
Gross Accounts Receivable	$ 1,235	$ 1,531,446	$ 1,532,681
Allowance for Doubtful Accounts	-	(679,420)	(679,420)
Accounts Receivable, Net	$ 1,235	$ 852,026	$ 853,261

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 91% allowance in FY 2014 and 95% allowance in FY 2013.

The following summarizes accounts receivable by type as of September 30, 2014 and 2013:

	FY 2014			FY 2013		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	$ 1,219,144	$ (403,950)	$ 815,194	$ 1,303,849	$ (483,749)	$ 820,100
COMAD - Schools and Libraries	133,391	(121,119)	12,272	123,145	(117,357)	5,788
Regulatory Fees	35,644	(28,901)	6,743	40,708	(28,771)	11,937
Spectrum Auction	21,081	(21,081)	-	21,568	(21,568)	-
Civil Monetary Penalties	26,247	(19,106)	7,141	27,861	(18,512)	9,349
Other	10,866	(8,769)	2,097	15,550	(9,463)	6,087
Total	$ 1,446,373	$ (602,926)	$ 843,447	$ 1,532,681	$ (679,420)	$ 853,261

Note 7 - Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2014 and 2013:

	FY 2014	FY 2013
Intragovernmental:		
FECA Liability	$ 521	$ 441
Unemployment Liability	42	-
GSA Real Estate Taxes	2,184	2,357
Other:		
Unfunded Leave	20,427	20,734
Accrued Liabilities for Universal Service	670,755	1,088,415
Total liabilities not covered by budgetary resources	693,929	1,111,947
Total liabilities covered by budgetary resources	562,008	408,641
Total Liabilities	$ 1,255,937	$ 1,520,588

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

Note 8 - Other Liabilities

The following summarizes Other Liabilities as of September 30, 2014 and 2013:

FY 2014	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 325,448	$ 325,448
Other	-	4,831	4,831
Total Intragovernmental	$ -	$ 330,279	$ 330,279
Deferred Revenue	$ 35,763	$ 20,757	$ 56,520
Prepaid Contributions	-	47,625	47,625
Accrued Liabilities for Universal Service	-	670,755	670,755
Other	-	33,338	33,338
Total Other	$ 35,763	$ 772,475	$ 808,238

FY 2013	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 81,444	$ 81,444
Other	-	8,114	8,114
Total Intragovernmental	$ -	$ 89,558	$ 89,558
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	$ 35,400	$ 1,258,028	$ 1,293,428

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.

Prepaid Contributions include USF and NANP contribution overpayments that may be refunded or used to offset future payments. Accrued Liabilities for Universal Service mostly represent liabilities recorded by the USF for anticipated subsidies in the High Cost, Lifeline (formerly known as 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 related to payroll and other services, and upfront deposits made by auction bidders as well as funds received that are being held until proper application is determined.

Note 9 - 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 Lifeline 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 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 7. 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.

As of September 30, 2014, there exist contingent liabilities against the Commission with a reasonable possibility of an unfavorable outcome. The amount that will ultimately be paid, if any, totals less than $4,000. We have determined that the resolution of these reportable contingent liabilities should not have a material effect on the 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 the overtime claims. Based on the raw data provided by the NTEU, the Commission determined the total back pay and liquidated damage to be $1,170. In FY 2014, a total amount of $1,103 was paid to the employees. There are several employees who are contesting the accuracy of their back pay calculations. Any resulting amount should not have a material effect on the financial statements.

Note 10 – 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 10 – 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, 2014 and 2013:

Balance Sheet	**FY 2014**	**FY 2013**
Assets:		
Investments	$ 7,685,783	$ 7,200,600
Cash and other monetary assets	177,834	170,085
Accounts receivable, net	828,493	827,903
General property, plant, and equipment, net	4,988	3,999
Other assets	13,024	13,024
Total assets	$ 8,710,122	$ 8,215,611
Liabilities:		
Accounts payable	$ 105,080	$ 125,046
Deferred revenue	6,224	7,262
Prepaid contributions	47,586	110,035
Accrued liabilities	670,755	1,088,415
Total liabilities	$ 829,645	$ 1,330,758
Cumulative results of operations	$ 7,880,477	$ 6,884,853
Total liabilities and net position	$ 8,710,122	$ 8,215,611
Statement of Net Cost		
Net cost of operations	$ 8,826,062	$ 9,461,166
Statement of Changes in Net Position		
Net position beginning of period	$ 6,884,853	$ 6,622,985
Non-exchange revenue	9,821,685	9,722,967
Other financing sources	1	67
Net cost of operations	8,826,062	9,461,166
Change in net position	995,624	261,868
Net position end of period	$ 7,880,477	$ 6,884,853

Note 11 – Intragovernmental Costs and Exchange Revenue

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

FY 2014

Program Costs	Intragovernmental	Public	Total
Connect America	$ 10,990	$ 35,390	$ 46,380
Maximize Benefits of Spectrum	28,356	82,206	110,562
Protect and Empower Consumers	12,634	36,625	49,259
Promote Innovation, Investment, and America's Global Competitiveness	2,652	7,689	10,341
Promote Competition	26,819	8,857,682	8,884,501
Public Safety and Homeland Security	11,054	32,047	43,101
Advance Key National Purposes	7,505	70,596	78,101
Operational Excellence	19,218	55,714	74,932
Total	$ 119,228	$ 9,177,949	$ 9,297,177
Total Earned Revenue	$ 2,964	$ 470,204	$ 473,168

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
Protect and Empower Consumers	13,930	38,225	52,155
Promote Innovation, Investment, and America's Global Competitiveness	2,590	7,107	9,697
Promote Competition	30,288	9,550,106	9,580,394
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

Note 12 - Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations

The following summarizes Apportionment Categories of Obligations Incurred for the years ended September 30, 2014 and 2013:

	FY 2014	FY 2013
Direct:		
Category A	$ -	$ 422,882
Category B	1,370,430	741,530
Exempt from Apportionment	9,417,463	9,838,207
Total Direct	10,787,893	11,002,619
Reimbursable:		
Category A	-	3,289
Category B	3,040	-
Total Obligations Incurred	$ 10,790,933	$ 11,005,908

Category A - Apportioned by Quarter
Category B - Apportioned by Purpose

Note 13 – Undelivered Orders at the End of the Period

The amount of budgetary resources obligated for undelivered orders totaled $4,518,678 as of September 30, 2014 and $3,917,916 as of September 30, 2013.

Note 14 – Permanent Indefinite Appropriations

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 Fund. 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 purposes as a special fund known as the Universal Service Fund.

Note 15 – Legal Arrangements Affecting Use of Unobligated Balances

Pursuant to Public Laws, offsetting collections received in excess of $339,844 in FY 2014 and in FY 2013 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. For more information, refer to Note 1-N.

Note 16 - 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 2013 and the amounts presented in the 2015 President's Budget. The FY 2016 *Budget of the United States Government* (President's Budget) with actual numbers for FY 2014 has not been published. Pursuant to 31 USC § 1105, the *Budget of the United States Government* will be released the first Monday in February, and will be available at the following website: http:/www.whitehouse.gov/omb.

Note 17 – Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)

As of September 30, 2014 and 2013:

	FY 2014	FY 2013
Budgetary Resources Obligated:		
Obligations incurred	$ 10,790,933	$ 11,005,908
Less: spending authority from offsetting collections and recoveries	921,230	1,407,524
Obligations net of offsetting collections and recoveries	9,869,703	9,598,384
Less: offsetting receipts	67,396	13,356
Net obligations	9,802,307	9,585,028
Other Resources	(6,312)	(16,389)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Undelivered Orders	(600,762)	(454,726)
Budgetary offsetting collections and receipts that do not affect net cost of operations	67,899	17,014
Resources that finance the acquisition of assets	(6,170)	(9,822)
Other	(38,975)	(30,067)
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Increase in annual leave liability	(265)	282
Upward/Downward reestimates of credit subsidy (+/-)	-	(3,265)
Increase in exchange revenue receivable from the public	5,945	758
Depreciation and amortization	20,029	19,064
Other (+/-)	(419,687)	324,631
Net Cost of Operations	$ 8,824,009	$ 9,432,508

REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION – SCHEDULE OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

For the Years Ended September 30, 2014 and 2013
(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), Auctions, and USF. S&E represents general salaries and expenses of the Commission. Auctions include salaries and expenses of the spectrum auction program. USF includes Universal Service Fund and Telecommunications Relay Service Funds.

In FY 2014, there is minimal activity related to the Credit Reform account. As a result, it is no longer considered a major budgetary account of the Commission. Non-major budgetary accounts are aggregated under Other.

Reflected in the charts on the next two pages are the major budgetary accounts of the Commission that are aggregated and presented in the September 30, 2014 and 2013 Combined Statement of Budgetary Resources.

SCHEDULE OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

FY 2014	S&E	Auctions	USF	Other	Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 17,942	$ 737	$ 3,338,493	$ 10,097	$ 3,367,269
Recoveries of prior year unpaid obligations	2,956	4,951	453,600	14	461,521
Other changes in unobligated balance (+ or -)	3,852	(3,852)	-	(3,618)	(3,618)
Unobligated balance from prior year budget authority, net	24,750	1,836	3,792,093	6,493	3,825,172
Appropriations (discretionary and mandatory)	-	-	9,808,413	326	9,808,739
Borrowing authority (discretionary and mandatory)	-	-	-	3,616	3,616
Spending authority from offsetting collections (discretionary and mandatory)	343,237	98,788	8,458	154	450,637
Total budgetary resources	$ 367,987	$ 100,624	$ 13,608,964	$ 10,589	$ 14,088,164
Status of Budgetary Resources:					
Obligations incurred	$ 346,340	$ 97,139	$ 10,343,006	$ 4,448	$ 10,790,933
Unobligated balance, end of year:					
Apportioned	17,784	1,761	-	2,780	22,325
Exempt from apportionment	-	-	3,074,850	-	3,074,850
Unapportioned	3,863	1,724	191,108	3,361	200,056
Total unobligated balance, end of year	21,647	3,485	3,265,958	6,141	3,297,231
Total status of budgetary resources	$ 367,987	$ 100,624	$ 13,608,964	$ 10,589	$ 14,088,164
Change in Obligated Balance:					
Unpaid obligations:					
Unpaid obligations, brought forward, Oct 1	$ 43,377	$ 33,834	$ 3,974,879	$ 106	$ 4,052,196
Obligations incurred	346,340	97,139	10,343,006	4,448	10,790,933
Outlays (gross) (-)	(339,706)	(92,833)	(9,309,091)	(4,412)	(9,746,042)
Recoveries of prior year unpaid obligations (-)	(2,956)	(4,951)	(453,600)	(14)	(461,521)
Unpaid obligations, end of year	47,055	33,189	4,555,194	128	4,635,566
Uncollected payments:					
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(4,418)	-	-	-	(4,418)
Change in uncollected pymts, Fed sources (+ or -)	148	-	-	-	148
Uncollected pymts, Fed sources, end of year (-)	(4,270)	-	-	-	(4,270)
Memorandum (non-add) entries					
Obligated balance, start of year (+ or -)	$ 38,959	$ 33,834	$ 3,974,879	$ 106	$ 4,047,778
Obligated balance, end of year (net)	$ 42,785	$ 33,189	$ 4,555,194	$ 128	$ 4,631,296
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	$ 343,237	$ 98,788	$ 9,816,871	$ 4,096	$ 10,262,992
Actual offsetting collections (discretionary and mandatory) (-)	(352,105)	(98,789)	(8,458)	(505)	(459,857)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)	148	-	-	-	148
Budget Authority, net (discretionary and mandatory)	$ (8,720)	$ (1)	$ 9,808,413	$ 3,591	$ 9,803,283
Outlays, gross (discretionary and mandatory)	$ 339,707	$ 92,832	$ 9,309,091	$ 4,412	$ 9,746,042
Actual offsetting collections (discretionary and mandatory) (-)	(352,105)	(98,789)	(8,458)	(505)	(459,857)
Outlays, net (discretionary and mandatory)	(12,398)	(5,957)	9,300,633	3,907	9,286,185
Distributed offsetting receipts (-)	(28,342)	-	(39,054)	-	(67,396)
Agency outlays, net (discretionary and mandatory)	$ (40,740)	$ (5,957)	$ 9,261,579	$ 3,907	$ 9,218,789

SCHEDULE OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

FY 2013	S&E	Auctions	USF	Other	Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 18,418	$ 479	$ 3,179,789	$ 8,281	$ 3,206,967
Recoveries of prior year unpaid obligations	3,897	710	923,071	6	927,684
Other changes in unobligated balance (+ or -)	381	(382)	-	-	(1)
Unobligated balance from prior year budget authority, net	22,696	807	4,102,860	8,287	4,134,650
Appropriations (discretionary and mandatory)	-	-	9,786,558	(196)	9,786,362
Borrowing authority (discretionary and mandatory)	-	-	-	1,496	1,496
Spending authority from offsetting collections (discretionary and mandatory)	327,819	99,109	21,225	2,516	450,669
Total budgetary resources	$ 350,515	$ 99,916	$ 13,910,643	$ 12,103	$ 14,373,177
Status of Budgetary Resources:					
Obligations incurred	$ 332,574	$ 99,179	$ 10,572,149	$ 2,006	$ 11,005,908
Unobligated balance, end of year:					
Apportioned	10,644	90	-	339	11,073
Exempt from apportionment	-	-	3,173,822	-	3,173,822
Unapportioned	7,297	647	164,672	9,758	182,374
Total unobligated balance, end of year	17,941	737	3,338,494	10,097	3,367,269
Total status of budgetary resources	$ 350,515	$ 99,916	$ 13,910,643	$ 12,103	$ 14,373,177
Change in Obligated Balance:					
Unpaid obligations:					
Unpaid obligations, brought forward, Oct 1	$ 66,584	$ 23,273	$ 3,491,560	$ 268	$ 3,581,685
Obligations incurred	332,574	99,179	10,572,149	2,006	11,005,908
Outlays (gross) (-)	(351,884)	(87,907)	(9,165,759)	(2,163)	(9,607,713)
Recoveries of prior year unpaid obligations (-)	(3,897)	(710)	(923,071)	(6)	(927,684)
Unpaid obligations, end of year	43,377	33,835	3,974,879	105	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	$ 23,273	$ 3,491,560	$ 268	$ 3,576,069
Obligated balance, end of year (net)	$ 38,959	$ 33,835	$ 3,974,879	$ 105	$ 4,047,778
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	$ 327,819	$ 99,109	$ 9,807,783	$ 3,816	$ 10,238,527
Actual offsetting collections (discretionary and mandatory) (-)	(357,046)	(99,109)	(21,225)	(3,658)	(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)	$ -	$ 9,786,558	$ 158	$ 9,758,687
Outlays, gross (discretionary and mandatory)	$ 351,884	$ 87,907	$ 9,165,759	$ 2,163	$ 9,607,713
Actual offsetting collections (discretionary and mandatory) (-)	(357,046)	(99,109)	(21,225)	(3,658)	(481,038)
Outlays, net (discretionary and mandatory)	(5,162)	(11,202)	9,144,534	(1,495)	9,126,675
Distributed offsetting receipts (-)	(35,403)	-	22,047	-	(13,356)
Agency outlays, net (discretionary and mandatory)	$ (40,565)	$ (11,202)	$ 9,166,581	$ (1,495)	$ 9,113,319

3. Other Information

(Unaudited)

Summary of Financial Statement Audit

Audit Opinion	Unmodified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Universal Service Fund – Budgetary Accounting	0	1	0	0	1
Total Material Weaknesses	0	1	0	0	1

See accompanying auditor's report

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
Universal Service Fund – Budgetary Accounting	0	1	0	0	0	1
Total Material Weaknesses	0	1	0	0	0	1

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
Total Material Weaknesses	0	0	0	0	0	0

Conformance with financial management system requirements (FMFIA § 4)						
Statement of Assurance	Systems do not conform to financial management system requirements					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
System is not fully integrated	1	0	1	0	0	0
Total Non-Conformances	1	0	1	0	0	0

Improper Payments Elimination and Recovery Act Reporting Details

To comply with the Office of Management and Budget (OMB) Circular A-123 Appendix C, *Requirements for Effective Estimation and Remediation of Improper Payments*, Improper Payments Information Act (IPIA) of 2002, Improper Payments Elimination and Recovery Act (IPERA) of 2010, and Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012 (henceforth referred to collectively as Appendix C), the Federal Communications Commission (FCC or Commission) incorporated improper payments testing into processes implemented in Fiscal Year (FY) 2014. Appendix C states, "significant improper payments" are defined as gross annual improper payments (i.e., the total amount of overpayments and underpayments) in the program exceeding (1) both 1.5% of program outlays and $10 million of all program or activity payments made during the fiscal year reported or (2) $100 million (regardless of the improper payment percentage of total program outlays).

I. RISK ASSESSMENTS

The Commission has eight components with funding disbursements that are under the direction of the Commission and its Administrators. The Commission is utilizing these grouping as listed below as that is how the programs are organized and structured programmatically by statute and Commission rules. Of these programs, which are listed below, the Commission had previously identified the four programs highlighted in bold as susceptible to significant improper payments.

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

In FY 2014, pursuant to 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 four programs above that were not previously identified as susceptible to significant improper payments.

In conducting the analysis, the Commission used the methodology described in Appendix C. Specifically, the Commission reviewed any quantitative data that would indicate a risk of significant improper payments that would exceed both 1.5% of program outlays and $10 million of all program or activity payments made during the fiscal year 2014 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 nine factors identified by Appendix C: (1) whether the program or activity reviewed 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) inherent risks of improper payments due to the nature of agency programs or operations; (8) significant deficiencies in the audit reports of the agency including, but not limited to, the agency Inspector General or the Government Accountability Office audit report findings, or other relevant management findings that might hinder accurate payment certification; and (9) results from prior improper payment work.

II. STATISTICAL SAMPLING PROCESS

Universal Service Fund: In FY 2014, the Commission used a statistical sampling process to obtain a statistically valid estimate of the annual amount of improper payments in USF-HC, USF-S&L, and USF-LL using an alternative sampling method approved by OMB. This process, called the Payment Quality Assurance (PQA) assessment plan, tested disbursements made in calendar year 2013. The PQA plan used in FY 2014 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 process follows below.

USF-HC: In FY 2014, the Commission used stratified simple random sampling on a sample of transactions selected from calendar year 2013. The sampling design was unchanged from the prior year. Samples from USF-HC disbursements were randomly selected simultaneously from all twelve months to ensure that no study area would be assessed more than once during the year. Assessments of calendar year 2013 transactions were conducted monthly and included: 1) steps to measure the accuracy of payments; 2) evaluation of carrier 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 the total disbursement amount to the beneficiary for all of calendar year 2013. After the exclusion of a *de minimis* category in which the disbursement amount was less than $40, 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 that the total number of disbursements to be tested was 24 per month. The total number of transactions tested during the fiscal year 2014 was 288, ($92.3 million) out of a universe of 22,860 transactions ($4.2 billion).

Improper payments of $43,532 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 0.06% for fiscal year 2014. The total extrapolated amount of improper payments for fiscal year 2014 was $2.6 million.

USF-S&L: In FY 2014, the Commission used stratified simple random sampling based on calendar year 2013 disbursements. Samples from USF-S&L disbursements were randomly selected on a monthly basis. Assessments of calendar year 2013 transactions were conducted monthly and included procedures to: 1) measure the accuracy of payments; 2) evaluate program applicants' eligibility; 3) test high-level information obtained from program participants; 4) review technology plans for certified approval and timing of approval; 5) verify service eligibility; 6) confirm lowest corresponding price; and 7) physically inspect installation and use of equipment.

In FY 2014, two separate samples were used to perform the above procedures to determine the improper payment. The results from each sample were combined for a reported improper payment estimate. Listed below is the information for these two samples.

All Procedures Except Equipment Inventory – The sampling units for USF-S&L were invoice lines that were divided into four strata according to disbursement amounts. The strata were defined based on the amounts disbursed to the 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 categories: $35 to $999; $1,000 to $9,999; $10,000 to $99,999; and $100,000 or more. Sample sizes varied by stratum and month, ranging from 56 to 90 per month. Using stratified simple random sampling, the total number of invoice lines tested for FY 2014 was 766, representing $38.6 million, from a universe of 439,965 lines representing $2.2 billion. Improper payments of $713,301 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 this sample for USF-S&L is 3.47% for fiscal year 2014. The total extrapolated amount of improper payments for fiscal year 2014 was $77.1 million out of total disbursements of approximately $2.2 billion.

Equipment Inventory Pilot – In FY 2014, an inventory assessment sampling process was added to the PQA program for USF-S&L to estimate the amount of improper payments made to beneficiaries for the purchase of equipment that was not installed or in use. On-site inspections were conducted for a pilot sample of 33 invoices for equipment from the sub-universe of 10,332 invoices for equipment selected nationwide, mostly from school districts. These inspections were used to assess whether or not payment was improper due to failure to install or use the equipment. This inventory sample was independent of the sample of 766 invoices chosen from the entire universe of invoices that were subject to the other procedures. There were 92 equipment invoices among these 766 which were subject to all PQA procedures except for inventory assessment. The estimated improper payment amount among the sub-universe of all equipment invoices based solely on this new inventory exception was $7.6 million out of the total $571.1 million disbursed for equipment purchases. The corresponding estimated improper payment rate was 1.32% with a margin of error of plus or minus 1.23%.

Both Samples' Results Combined – The sum of the estimated improper payment amounts from the main sample ($77.1 million) and the pilot sample ($7.6 million) is $84.7 million, or 3.81% of total disbursements. However, as an estimator of the improper payments from all PQA exceptions, the sum has an upward bias since the same disbursements for equipment purchases could be deemed improper by both an inventory and non-inventory exception. For this reason, we are reporting the results from both samples separately in this discussion.

<u>USF-LL:</u> In FY 2014, the Commission used stratified simple random sampling on a sample of transactions selected from calendar year 2013. Samples from USF-LL disbursements were randomly selected on a monthly basis. *De minimis* disbursements of $40 or less were excluded from the universe for sampling. Assessments of calendar year 2013 transactions included: 1) steps to measure the accuracy of disbursements, including information on the FCC Form 497; 2) evaluation of carrier eligibility; 3) testing of subscriber detail and certifications; and, 4) toll limitation service support calculations.

The sampling units for USF-LL were divided into three strata according to disbursement amounts. USF-LL monthly disbursement strata were: $40 to $9,999; $10,000 to $99,999; and $100,000 or more. Using stratified simple random sampling, the Commission determined the total number of disbursements to be tested each month was 10 per stratum per month or 30 each month. The total number of disbursements tested for FY 2014 was 359 or $87 million from a universe of 20,515 ($1.8 billion).

Improper payments of $214,443 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-LL was 0.32% for fiscal year 2014. The total extrapolated amount of improper payments for fiscal year 2014 is $5.9 million.

Telecommunications Relay Service: The TRS Fund Administrator, Rolka Loube Saltzer, Associates (RLSA) LLC hired an independent auditing firm to conduct testing for the TRS Fund utilizing an alternative sampling methodology approved by OMB. The contractor relied on the guidance issued by OMB. The scope of this review included processes performed by the TRS Fund Administrator to determine whether the minutes presented by TRS Service Providers meet the criteria for reimbursement based on the Commission's rules. The error rate is calculated for minutes paid during the program year July 1, 2013 through June 30, 2014. The following identifies the risk areas or attributes (ATT) associated with improper payment to TRS Service Providers:

- ATT 1 – Payments made to TRS Service Providers on the "red light" list.
- ATT 2 – Payments are made to Video Relay Service (VRS), Internet Protocol (IP) Relay, or IP Captioned Telephone Service (CTS) service providers who did not submit a complete Speed of Answer (SOA) report.
- ATT 3 – Payments are made to VRS, IP Relay, or IP CTS service providers for days where the SOA daily performance standards are not met.
- ATT 4 – TRS funds are disbursed without proper authorization from RLSA to the bank and/or amounts do not reflect the approved rate.
- ATT 5 – Payments are made to VRS, IP Relay, or IP CTS service providers when Call Detail Records (CDRs) do not contain the required information in the required format.
- ATT 6 – Payments are made to VRS, IP Relay, or IP CTS service providers when the CDRs are not in compliance with the applicable FCC rules.
- ATT 7 – Payment to an ineligible TRS Service Provider due to non-submission or improper submission of the Intent to Participate.
- ATT 8 – RLSA does not comply with the requirement to provide a written response or email to the service provider within sixty (60) days of receipt of the initial reimbursement request submission.
- ATT 9 – Payment made to TRS Service Provider whose Chief Executive Officer, Chief Financial Officer, or other senior officer did not certify the submission of minutes.
- ATT 10 – Payment made for filings without investigation or reporting to the FCC when a notable variance in minutes from the projected demand occurs. A notable variance is a subjective assessment made by the President of RLSA based upon his knowledge of the trends and industry changes related to each of the TRS services.
- ATT 11 – Payments made to TRS service providers when there is a notable variance between the minutes reported on the TRS Fund Request for Compensation and the supporting CDR detail for VRS, IP CTS, or IP Relay with no discussion with the service provider or explanation of the variance. A notable variance is a subjective assessment made by the President of RLSA based upon his knowledge of the TRS service and service provider.

The testing approach included identifying the unique population and pulling a statistically valid sample from the defined population. Due to the small sample size, the plan called for a 100% test for Attributes 1, 2, 4, and 7 through 11. The total amount tested for these Attributes was $868.5 million.

The remaining three (3) attributes (3, 5, and 6) have large populations resulting in the development of a statistically valid sample. Since two of the attributes were tested together, the plan recommended two populations and resulting statistical samples. The first population relates to the calculation of reimbursable days based upon compliance with daily SOA requirements for the three IP-based services. The second population is related to reimbursement based upon the individual CDRs submitted for reimbursement for the three (3) IP-based services. The samples were selected randomly using actual values and the formula recommended in the statisticians approved statistical plan.

The sample size for attribute three was 5,301,392 records or $33,036,528 and the sample size for attribute five and six was 141,412 records or $1,031,778.

Upon complete analysis of the exceptions, only those payments determined to result in an improper payment are included in the calculation of the error rate. It should also be noted that the error rate is the absolute value of all erroneous payments during the program year July 1, 2013 through June 30, 2014 regardless of whether the payments were corrected. The calculated improper payment error rate for the testing period is 0.08%. Attribute 4 was the only Attribute with improper payments and it included $706,141 in improper payments.

III. CORRECTIVE ACTION PLANS

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

The Universal Service Administrative Company (USAC) has examined the results of the audits and PQA program conducted for FY 2014, and has implemented corrective action plans, as appropriate, in response to any findings, consistent with OMB guidance.

USF-HC: In FY 2014, the PQA process identified the following improper payment issues and amounts. The Commission is currently working with USAC to recover these funds and to make improvements to the USF-HC program.

Reasons for High-Cost Improper Payments Identified in PQA Process	Improper Payment Amount Totals		Number of Instances
	Overpayments	Underpayments	
Total Administrative and Documentation Errors	**$0**	**$0**	**0**
Total Authentication and Medical Necessity Errors	**$0**	**$0**	**0**
Verification Errors			
Part 36 reporting exception	$11,069	$27,830	41
Subscriber line count revenue	$2,837	$1,796	28
Total Verification Errors	**$13,906**	**$29,626**	**69**
Total	**$13,906**	**$29,626**	**69**

USF-S&L: In FY 2014, the PQA process identified the following improper payment issues and amounts. The Commission is currently working with USAC to recover these funds and to make improvements to the USF-S&L program.

Reasons for Schools and Libraries Improper Payments Identified in PQA Process	Improper Payment Amounts		Number of Instances
	Overpayment	**Underpayment**	
Administrative and Documentation Errors			
Incomplete Documentation	$18,957	$0	9
Total Administrative and Documentation Errors	**$18,957**	$0	**9**
Total Authentication and Medical Necessity Errors	$0	$0	$0
Verification Errors			
Competitive bidding/28-day waiting period	$6,908	$0	1
Competitive Bidding/Incomplete Documentation	$32,576	$0	3
Discount Calculation - Urban/Rural Classification	$248	$0	4
Discount Calculation/Block 5 Error	$71	$0	1
Ineligible Goods/Services Funded	$6,710	$0	2
SP LCP Confirmation	$14,612	$0	2
Competitive Bidding/Price as the Primary Factor	$4,380	$0	2
Failure to Pay Non-Discounted Share	$337,951*	$0	1
Funding received by entities not on Form 471	$56,121	$0	11
Invoicing Errors	$142,323	$0	33
CIPA Compliance	$11,388	$0	3
Goods/services received by ineligible entity	$81,056	$0	16
Invoicing – **Pilot**	$8,151	$0	1
Internal Connections Not Installed –**Pilot**	$15,552	$0	4
Internal Connections Not in Use – **Pilot**	$22,590	$0	1
Total Verification Errors	**$740,637**	$0	**85**
Total	**$759,549**	**$0**	**94**

*There were three, independent reasons for this improper amount. In addition to failure to pay non-discount share, the disbursement also had an invoicing error and a failure to certify to the lowest corresponding price. Each of the three errors would have required us to report the entire amount as an improper payment.

USF-LL: In FY 2014, the PQA process identified the following improper payment issues and amounts. The Commission is currently working with USAC to recover these funds and to make improvements to the USF-LL program.

Reasons for Lifeline Improper Payments Identified in PQA Process	Improper Payment Amount Totals		Number of Instances
	Overpayments	Underpayments	
Total Administrative and Documentation Errors	**$0**	**$0**	
Missing incomplete subscriber data	$48,011	$0	27
Incomplete documentation	$7,290	$0	1
Incomplete documentation – TLS	$2,348	$0	2
Inadequate/missing certifications	$14,630	$0	98
Unsupported lines	$112,108	$0	26
Total Administrative and Documentation Errors	**$184,387**	**$0**	**154**
Total Authentication and Medical Necessity Errors	**$0**	**$0**	**0**
Verification Errors		**$0**	
Duplicate phone numbers	$1,076	$0	7
Duplicate – same name/address	$28,980	$0	49
Total Verification Errors	$30,056	**$0**	**56**
Total	**$214,443**	**$0**	**210**

Corrective Action Plans, by Program

USF-HC

- USAC issues quarterly newsletters that list common audit findings, provides tips on how to avoid issues, and encourages carriers to review policies and procedures for compliance. For example, the July 2014 newsletter addressed the FCC's guidance regarding document retention. In addition, USAC holds webinars to assist beneficiaries with program compliance.

- USAC will create a website page that references rules established by orders, such as specific direction regarding documentation requirements, including the 10 year retention requirement. Going forward, both the website and newsletters will reference specific Rules and Regulations concerning systems for collecting, reporting and monitoring data and provide guidance regarding steps carriers can take to ensure accuracy of data and form submissions. For example, these references will address the proper way to determine Subscriber Line Charge revenue and call attention to the relevant rules including Parts 32 and 36 of the Commission rules, and how they relate to source data that carriers use for data and form submissions.

USF-S&L

- On July 11, 2014, the Commission adopted the *E-Rate Modernization Order*, which seeks to identify additional policies and procedures to protect against waste, fraud, and abuse. The order contains measures to determine the integrity of the applicant competitive bidding process, extend recordkeeping requirements, increase certification requirements, and strengthen audit procedures and performance goals. For example, beginning in FY 2015, the FCC Form 471 will capture additional detail around product and service requests. This detail will help USAC commit and disburse funds for the most cost-effective products and services.

- In addition, in the *E-rate Modernization Order*, the Commission directed its Enforcement Bureau to devote additional resources to enforcement of the lowest corresponding price rule, by emphasizing service providers must offer and charge the lowest corresponding price, and provided additional clarification regarding what constitutes a "cost-effective" selection of services.

- To further address the issue of the program's efficient and effective administration, the Commission adopted in the *E-rate Modernization Order* the goal of making the E-rate application process and other E-rate process fast, simple and efficient. In the *Order*, the Commission simplified the application process, simplified the invoicing and disbursement process, and directed USAC to take steps to reduce the administrative burden on applicants by processing and managing applications more efficiently, modernizing its E-rate information technology systems, timely publishing all non-confidential E-rate data in an open and standardized format, and communicating more clearly with E-rate applicants and service providers.

- The Schools and Libraries Program conducts extensive outreach activities to help program audiences successfully participate in the program. The outreach addresses issues identified through application reviews, invoice processing, and audits with the goal of increasing participants' knowledge of and compliance with program rules. Specifically, the Schools and Libraries Program holds applicant trainings in the form of video-conferences as well as in-person trainings and conducts monthly constituent conference calls. In addition, outreach materials are published in the form of electronic and printed materials which are provided to organizations that represent applicants and service providers and are posted to USAC's website along with online learning tools. Finally, USAC conducts one-on-one guidance through its HATS (Helping Applicants to Succeed) program which is designed to assess how USAC's processes work from the perspective of an applicant with the goal of providing guidance that is tailored to solve an applicant's specific challenges.

- USAC conducts an extensive pre-commitment review of applications, called the Program Integrity Assurance (PIA) process. The PIA process includes internal control activities designed to prevent improper payments.

- Annually, USAC and the Commission review the PIA procedures to determine how to improve the application review process. The results of audit findings are considered during the PIA procedure review process in an effort to improve program compliance.

- USAC conducts manual reviews for a portion of the invoices submitted to USAC for reimbursement and requires the applicant and/or service provider to provide support for the requested invoice.

- In an effort to detect improper payments, USAC conducts post-disbursement reviews of the invoices that underwent pre-disbursement automated reviews. The post-disbursement review obtains support for the requested reimbursement and verifies payments were properly issued.

- In response to a recommendation from the Government Accountability Office (GAO), the Commission directed USAC to conduct a robust risk assessment of the Schools and Libraries program. The risk assessment, which is being performed by an external contractor, is currently underway. The final report will be issued by May 2015. The assessment team is evaluating program and process risks and will make recommendations for ways that USAC and the

Commission can strengthen internal controls to reduce improper payments and increase the effectiveness and efficiency of processes.

<u>USF-LL</u>

- USAC issues a quarterly newsletter which includes a section listing common audit findings and encourages carriers to review their internal policies and procedures to ensure compliance. USAC plans to improve upon this listing by including links to specific Rules and Regulations relevant to the issues and to create a website page which will include items which specifically address issues in an effort to reduce improper payments.

- The Lifeline Reform Order established and clarified rules specifically addressing data collection and reporting as well as documentation and data retention. These items will be included in quarterly newsletters and on the USAC webpage. In addition, USAC holds bi-weekly webinars as well as specific topic webinars to assist carriers with program compliance.

- USAC notifies state commissions of situations that may require the state commissions to conduct outreach to carriers.

- The implementation of the National Lifeline Accountability Database (NLAD) has addressed and helped minimize instances of duplicate support claims.

<u>Efforts to Reduce Future Improper Payments in TRS Program</u>

During the past fiscal year, the Commission has increased efforts to further reduce improper payments in the TRS program and has taken the following steps to strengthen the TRS program administration:

- The Consumer and Governmental Affairs Bureau (CGB) conducted site inspections of internet telecommunications relay service (iTRS) providers that were conditionally certified to receive reimbursement from the TRS Fund. These inspections were designed to confirm the accuracy of the statements made in providers' applications for certification, as well as to confirm providers' compliance with Commission rules. The Commission has followed up on inspectors' findings with letters to providers asking for explanations, and by extending certain providers' conditional certifications, rather than granting full certifications.

- CGB also conducted testing for the ability for iTRS providers to connect 911 calls through mobile and web applications in compliance with Commission rules. Providers with deficiencies have been notified, and money for the period on non-compliance has been withheld from providers. CGB will conduct follow-up testing to ensure that all providers are in compliance with emergency call handling rules.

- The Enforcement Bureau (EB) executed three consent decrees and one with providers of TRS to resolve investigations regarding non-compliant registration and verification processes. The consent decrees require the providers to pay $11.7 million back to the TRS Fund, and to pay $23.7 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.). EB also issued a Notice of Apparent Liability (NAL) to a TRS provider for their non-compliant registration and verification process. The recommended forfeiture in the NAL is $11.9 million.

IV. IMPROPER PAYMENT REPORTING

Table 1 below reports the improper payment rates for USF-HC, USF-S&L, USF-LL and TRS using an approved alternative methodology for each program. As required by OMB 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. Additionally, the USF PQA process tests the calendar year, not the fiscal year; accordingly, the USF current year outlays noted below are for calendar year 2013 and the past year outlays are for calendar year 2012. For TRS the time period tested is the program year, which is July 1, 2013 to June 30, 2014 for the current year; accordingly, the current year outlays included reflect that time period. The past year outlays for TRS are from the previous program year, July 1, 2012 to June 30, 2013. The CY IP $, CY Overpayment $, and CY Underpayment $ are the extrapolated amounts for USF-HC, USF-S&L, and USF-LL.

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 the anticipated additional procedures will result in an increased number of errors that are identified.

In Table 1 below, we combined the results of two samples analyzed in USF-S&L for presentation purposes to conform to the OMB guidance; however, it should be noted, as previously mentioned that the sum has an upward bias. See Section II, USF-S&L for a full discussion of the separate improper payment amounts and percentages for the two samples for USF-S&L.

Table 1 Improper Payment Reduction Outlook
(Dollars in thousands)

Program or Activity	USF-HC	USF-S&L	USF-LL	TRS
PY Outlays	$4,119,737	$2,232,284	$2,196,418	$786,332
PY IP%	0.26%	2.21%	0.18%	0.0%
PY IP$	$10,563	$49,354	$3,935	$0
CY Outlays	$4,161,036	$2,225,674	$1,819,433	$868,530
CY IP%	0.06%	3.81%	0.32%	.08%
CY IP$	$2,635	$84,711	$5,883	$706
CY Overpayment $	$1,084	$84,711	$5,883	$109
CY Underpayment $	$1,551	n/a	n/a	$597
CY+1 Est. Outlays	$4,707,700	$2,709,000	$1,537,600	$969,100
CY+1 IP%	.06%	3.25%	.32%	.08%
CY+1 IP$	$2,825	$88,043	$4,920	$775
CY+2 Est. Outlays	$4,808,300	$2,388,600	$1,554,600	$988,700
CY+2 IP%	.06%	3.0%	.32%	.08%
CY+2 IP$	$2,885	$71,658	$4,975	$791
CY+3 Est. Outlays	$4,575,900	$2,393,300	$1,571,800	$1,005,700
CY+3 IP%	.06%	2.75%	.32%	.08%
CY+3 IP$	$2,746	$65,816	$5,030	$805

V. RECAPTURE OF IMPROPER PAYMENTS REPORTING

The following discussion is a summary of the Commission's payment recapture audits for FY 2014 for programs with over $1 million in annual outlays.

USF

Completed FY 2014 Payment Recapture Audits

In 2010, the FCC directed USAC to separate the payment recapture audits and the determination of improper payment rates into distinct programs – one focused on improper payment assessment (known as the Payment Quality Assurance (PQA) program, and described further below under "Other Efforts") and the second on auditing compliance with all four USF programs (called the Beneficiary and Contributor Audit Program (BCAP)). The program summarized below outlines the payment recapture audit program, BCAP, which is designed to evaluate USF beneficiary and contributor compliance with FCC rules and to recover funding that was improperly disbursed. The FY 2014 BCAP was developed with the following objectives:

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

USAC has examined the results of the audits and assessment programs conducted for FY 2014 and has implemented a corrective action plan in response to any findings and consistent with Appendix C and OMB Circular A-50 (provides policies and procedures for use by executive agencies when considering reports issued by the Inspectors General, other executive branch audit organizations, the General Accountability 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.

USAC has completed 64 audits in FY 2014, of which 36 involved overpayments. Of these, the auditor has identified $2,804,112 to be recovered and is in process of recovering the remainder.

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

Program or Activity	# Audits	# Audits with Overpayments	Estimated Recovery
USF-HC	4	2	$62,734
USF-S&L	9	7	$1,438,632
USF-LL	35	25	$1,051,432
USF-RHC	16	2	$251,314
Total	**64**	**36**	**$2,804,112**

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 2013 calendar year audit demonstrated that there were no findings of improper payments.

For calendar year 2013, USAC's independent auditor selected a random sample of 45 administrative expenses (non-payroll) totaling $810 thousand and found no improper payments. The USAC Internal Controls team performed testing of administrative and payroll expenses disbursed during FY 2014. The Internal Control team pulled three different samples: 1) a sample of 30 disbursements totaling $566 thousand; 2) a sample of 30 corporate charge card expenses totaling $13 thousand; and 3) a sample of 30 out-of-pocket expense reimbursements totaling $6 thousand. The internal controls team found no improper payments in all three samples. USF-Admin disbursements for calendar year 2013 totaled approximately $106.9 million and USF-Admin disbursements for FY 2014 totaled approximately $116 million.

In addition to the above testing of disbursements, both the USAC external auditor and the USAC Internal Control team reviewed payroll information to determine whether payroll costs were proper. The results of these tests noted no exceptions.

TRS

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

RLSA conducted audits focusing on iTRS providers' user registration processes. The audits covered the period of July 1, 2012 to April 30, 2014. All iTRS providers were audited, totaling nine audits. The reports include a total of 33 findings and observations with recommendations. There were seven findings regarding the call detail records submitted to RLSA for payment each month, and one finding regarding the process for user-self certification of a qualifying disability. There were 25 observations regarding the following: management of access to registration databases, management of changes in user information, controls, password administration, policies and procedures, registration, segregation of duties, and senior officer certification. The audit reports were sent to providers on September 19, 2014 with a requested response to each finding by October 19, 2014. The Commission will work with RLSA to ensure that all findings and observations are addressed and remediated by providers and that RLSA drafts a corrective action plan for each of the findings. TRS outlays for FY 2014 totaled approximately $925 million.

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 disbursements, excluding bank fees, totaled approximately $6.1 million in FY 2014. 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 Agreed Upon Procedures (AUP) reports to the FCC. In FY 2014, Welch tested 92% of the transactions representing $5.7 million for improper payments and found no improper payments.

In addition, in connection with the NANP Fund annual financial statement audit for FY 2013, an independent auditor tested approximately $1.4 million in disbursements, which represented 24% of the approximately $5.8 million in total disbursements, and found no improper payments. 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 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: (1) Payroll expenses, *i.e.*, Compensation and Benefits related to employees' pay; and (2) Non-salary disbursements such as travel expense, rent, building maintenance, training, and contractor expense. Each year an independent audit is performed on the FCC's financial statements. For FY 2014, the Commission operating expenses continue to have no identified overpayments. The Commission's outlays for FY 2014 totaled approximately $437 million, excluding intra-governmental custodial payments of approximately $1.2 billion as allowed by OMB requirements.

Commission staff conducted a payment recapture audit program testing Commission non-salary and salary operating expenses, excluding custodial intra-governmental custodial payments.

Under the non-salary testing process the Commission staff selected 50 transactions for review representing $175 thousand from the universe of payments made from October 1, 2013 to May 31, 2014 totaling $213 million. The Commission staff tested the disbursement of non-salary transactions to determine if: (1) payments were made to an ineligible recipient, (2) payment was made for an 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.

Under the salary testing process the Commission staff selected 50 transactions for review representing $219 thousand from the universe of payments made October 20, 2013 to September 6, 2014. The Commission staff tested the disbursement of salary transactions to determine if any employee's salary, and compensation and benefits were improper payments.

Payment Recapture Audit Reporting: The Commission reports in Table 2 the results of FY 2014 payment recapture audits, and also reports prior year payment recapture audits for FY 2004 through FY 2013 as prior year results. Also, Table 2 provides for the dollar amounts for the High Cost (HC), Lifeline (LL), Rural Health Care (RHC), and Schools and Libraries (S&L) programs in terms of calendar year while the dollar amounts for USF Admin, TRS, NANP, and FCC Operating are reported as fiscal year amounts. The amount identified for recovery and reported below for the USF programs is determined by USF Program Management.

Table 2 Payment Recapture Audit Reporting
(Dollars in thousands)

Program or Activity	USF-HC	USF- LL	USF-RHC	USF-S&L	USF-Admin	TRS	NANP	FCC
Type of Payment (contract, grant, benefit, loan, or other)	Benefit	Benefit	Benefit	Benefit	Contract & Other	Benefit & Contract	Contract	Contract & Other
Amount Subject to Review for CY Reporting	$4,065,334	$1,656,494	$181,021	$2,313,827	$106,869	$1,501,274	$6,142	$436,951
Actual Amount Reviewed and Reported (CY)	$5,377	$19,677	$8,229	$7,659	$810	1,433,273	$5,702	$394
Amount Identified for Recovery (CY)	$63	$1,047	$220	$1,134	n/a	$11,740	n/a	n/a
Amount Recovered (CY)	$63	$335	$111	$193	n/a	$11,740	n/a	n/a
% of Amount Recovered out of Amount Identified (CY)	100.00%	32.05%	50.30%	17.06%	0.0%	100%	0.0%	0.0%
Amount Outstanding (CY)	$0	$711	$109	$940	n/a	$0	n/a	n/a
% of Amount Outstanding out of Amount Identified (CY)	0.00%	67.95%	49.70%	82.94%	n/a	0.0%	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)	0.00%	0.00%	0.00%	0.00%	n/a	n/a	n/a	n/a
Amounts Identified for Recovery (PYs)	$87,953	$11,579	$149	$68,033	n/a	n/a	n/a	n/a
Amounts Recovered (PYs)	$85,495	$5,028	$147	$21,123	n/a	n/a	n/a	n/a
Cumulative Amounts Identified for Recovery (CY + PYs)	$88,016	$12,626	$369	$69,167	n/a	n/a	n/a	n/a
Cumulative Amounts Recovered (CY + PYs)	$85,558	$5,364	$258	$21,316	n/a	n/a	n/a	n/a
Cumulative Amounts Outstanding (CY+PYs)	$2,458	$7,262	$111	$47,850	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

The Commission is currently establishing targets for the payment recapture audit program. Listed below in Table 3 are the preliminary targets for the program using historical results. The target for USF-RHC is included as "not applicable" because the Commission has recovered 100 percent of the amounts determined so far to be recoverable. The targets for USAC-Admin, TRS, NANP, and FCC are "not applicable" because no audit findings were identified.

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. 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	$63	$63	100.00%	n/a	n/a	n/a
USF-LL	Benefit	$1,047	$335	32.05%	90%	95%	100%
USF-RHC	Benefit	$220	$111	50.30%	85%	90%	95%
USF-S&L	Benefit	$1,134	$193	17.06%	40%	50%	60%
USF-Admin	Contract & Other	$0	n/a	n/a	n/a	n/a	n/a
TRS	Benefit & Contract	$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	Contract & Other	$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 2014.

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	$0	$0	n/a
USF-LL	Benefit	$432	$279	n/a
USF-RHC	Benefit	$0	$109	n/a
USF-S&L	Benefit	$170	$770	n/a

The Commission reports in Table 5 the disposition of recaptured funds from FY 2014 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	$63	$0	$0
USF-LL	Benefit	$0	$0	$0	$335	$0	$0
USF-RHC	Benefit	$0	$0	$0	$111	$0	$0
USF-S&L	Benefit	$0	$0	$0	$193	$0	$0

The Commission reports in Table 6 those improper payments identified through and recovered through sources other than payment recapture audits. The PY numbers shown in Table 6 includes all PYs. Note that the PY entry for USF-RHC Non-Audits includes dollars associated with potential overpayments in the Rural Health Care Pilot Program. 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, certain amounts, such as a significant forfeiture, are included in the Lifeline IDV category in this table, although the Commission has not yet established the exact amount of the improper payments or whether some of those amounts are collectible. In the "amount identified" column, the chart does not include those *de minimis* amounts for which the Commission has determined recovery would not be cost-effective.

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	$111	$111	$20	$20	$131	$131
USF-HC PQA	$121	$1	$496	$437	$617	$438
USF-LL IDV	$46,823	$6,373	$24,194	$1,749	$71,017	$8,122
USF-LL PQA	$208	$0	$169	$169	$377	$169
USF-RHC PQA	$1	$1	$50	$50	$51	$51
USF-RHC Non-Audits	$160	$160	$12,936	$1,549	$13,096	$1,709
USF-S&L PQA	$793	$18	$869	$650	$1,662	$668
USF-S&L Non-Audits	$6,942	$148	$212,186	$21,415	$219,128	$21,563

Implementation of the Do Not Pay Initiative to Prevent Improper Payments

1. No report submitted for October - no matches identified for this month, so no report was necessary.
2. No report submitted for November - matches were identified but no report was submitted.
3. No report submitted for February - matches were identified but no report was submitted.
4. No report submitted for March - matches were identified but no report was submitted.
5. No report submitted for April - matches were identified but no report was submitted.
6. No report submitted for May - matches were identified but no report was submitted.
7. No report submitted for June - matches were identified but no report was submitted.

A reviewing our summary reports, we discovered the following:

- FCC rarely has matches on the Death Master File.
- FCC has very few payments on SAM Exclusion Public.
- FCC has identified travel or salary payments for current employees.

The reconciliation of matches all proved to be false positives.

Table 7 Implementation of the Do Not Pay Initiative to Prevent Improper Payments

	Number (#) of payments reviewed for improper payments	Dollars ($) of payments reviewed for improper payments	Number (#) of payments stopped	Dollars ($) of payments stopped	Number (#) of improper payments reviewed and not stopped	Dollars ($) of improper payments reviewed and not stopped
Reviews with the DMF only (Required for FY 2014)	5,065	$70,004,110	n/a	n/a	0	$0
Reviews with SAM Exclusions Public (Optional for FY 2014)	5,095	$70,096,825	n/a	n/a	0	$0

- Payments reviewed for improper payments includes the total number of payments disbursed by the agency through the PACER payment system minus any payments that were excluded from matching due to (1) a missing or unmatchable TIN (DMF only) or (2) a missing name.

- Payments stopped are currently not applicable since the Do Not Pay matching and adjudication process is based on post payment results.

- Improper payments reviewed and not stopped include the total number of matches identified by the Do Not Pay Initiative that were adjudicated as improper by the agency.

VI. ACCOUNTABILITY

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

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 universal service programs. In its fiscal year 2015 budget, the Commission requested an additional $10,877,000 to support the Commission's work to modernize the four USF support 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.

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 online experience.

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

TRS: As the TRS administrator, RLSA implemented a payment recapture audit program as part of its overall program of effective internal control over disbursements. The payment recapture audit program includes preventive and detective controls to ensure payments are legal, accurate, and consistent with IPERA. The Commission is working with the TRS administrator to ensure sufficient information systems and infrastructure is in place to effectively carry out the program. 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. RLSA has implemented a service provider audit program intended to verify the policies and procedures supporting reimbursement requests. Audits are being conducted for all IP enabled services including a capture of user registration data for user validity analysis.

VIII. BARRIERS

<u>TRS:</u> 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. RLSA has revised provider reporting to clarify existing requirements, identify the serial numbers of IP CTS equipment, and to identify emerging service delivery technologies. RLSA is suggesting consideration of eligibility certification be by application and device type, to ensure FCC requirements are met prior to permitting reimbursable usage.

IX. ADDITIONAL COMMENTS

None.

UNITED STATES GOVERNMENT
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: October 23, 2014

TO: Chairman

FROM: 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 and performance challenges facing the Federal Communications Commission (FCC) in Fiscal Year (FY) 2014 and beyond.

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

Universal Service Fund (USF) Programs

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.

Comprehensive reforms 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.

High Cost Program

Under the USF/ICC (Intercarrier Compensation) Transformation Order issued in 2011, and subsequent clarifying orders, the High Cost program is transitioning to support multi-purpose networks capable of broadband and voice, while phasing out support for voice-only networks. The Transformation Order mandates will have a significant impact on the telecommunications companies that receive about $4.5 billion in annual USF High Cost support. During this transition period, the High Cost program will consist of separate support mechanisms for the legacy program and the new Connect America Fund. The Connect America Fund will rely on incentive-based, market-driven policies, including competitive bidding, to distribute universal service funds as efficiently and effectively as possible. We believe that assuring the reforms have their intended effect and continuing to resolve outstanding investigations remain significant management and performance challenges.

Schools and Libraries Program

In 2013 the Schools and Libraries program, often called E-rate, provided $2.2 billion in support to about 32,000 eligible entities. In its 2014 Modernization Order, the Commission adopted program goals and measures to ensure schools and libraries have access to affordable high speed broadband internet services. The order simplified the application process, and promotes transparency by sharing of cost and connectivity data among E-rate recipients and vendors; encourages use of bulk-buying methods, such as state master contracts and consortia purchasing; and reemphases that service providers must offer the lowest corresponding price when offering competitive bids and providing E-rate services. Recent audits showed service providers continue to overcharge entities for ineligible services and facilities, and are charging more than the lowest corresponding price to schools with similar customers; and schools did not always use competitive bidding when contracting for services. Additionally, there is a risk that consultants may manipulate the discount rate in order to boost the school's funding, as well as its own commissions. Ensuring that the E-rate program accomplishes its modernization goals in an efficient and cost effective manner remains a significant management challenge.

Lifeline Program

The USF Lifeline program has required significant OIG resources to combat waste, fraud and abuse. The USF Lifeline program started in 1985 to ensure that low-income consumers have access to affordable phone service. In 2013, the Commission disbursed about $1.8 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 been fully implemented. 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. The Commission adopted a funding requirement of over $793 million for the 2014-2015 fund year. Most recently, Internet Protocol Captioned Telephone Service (IP CapTel) has experienced extraordinary growth.

OIG has essentially completed its support of ongoing criminal investigations into allegations of fraud in the VRS program, but 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 made 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, evidence obtained in recent site visits to providers of IP Relay conducted by agency personnel supported OIG's concern that significant problems still exist and that the program is not free from abuse. Determining how to further strengthen the rules, or whether to continue to support the program in light of seemingly intractable problems, 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 Commission has undertaken a major effort to address these numerous security weaknesses, and there are noticeable improvements. Nevertheless, this remains an ongoing effort that will require continuous Commission attention.

cc: Jon Wilkins, Managing Director
Ruth Milkman, Chief of Staff
Mark Stephens, Chief Financial Officer
Dr. David Bray, Chief Information Officer

Office of the Managing Director

M E M O R A N D U M

DATE: November 14, 2014

TO: David L. Hunt, Inspector General

FROM: Jon Wilkins, Managing Director
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 23, 2014, assessing the most serious management challenges facing the Federal Communications Commission (Commission or FCC) for fiscal year (FY) 2014 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. Second, OIG states that determining whether the Telecommunications Relay Services Fund (TRS) is sustainable and 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 2014 to address the challenges identified by OIG, including those related to the Lifeline program, of establishing direction and policy, managing transition, and ensuring all USF program rules and regulations contribute to effective and efficient programs.

- Completion by USAC of 64 audits of USF beneficiaries in FY 2014, 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 Improvement Act (IPERIA) 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 2014 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.
- Creation of a USF Strike Force—housed in the agency's Enforcement Bureau—dedicated to combating waste, fraud, and abuse in Commission funding programs. The USF Strike Force is focused on safeguarding the USF and the other funding programs the FCC oversees. The Strike Force will investigate violations of the Communications Act, the Commission's rules, and other laws bearing on USF programs and contributions. In addition to leading the FCC's enforcement activities in these areas, the Strike Force will coordinate with the FCC's OIG, the U.S. Department of Justice, and other law enforcement agencies to prosecute unlawful conduct. The Strike Force's investigations and activities will promote future compliance, protect those who depend on the funds for access, and safeguard contributors to the funds from the unlawful acts of others.

High-Cost

In its Memorandum, OIG identifies the reforms in the 2011 USF/ICC Transformation Order (*2011 USF/ICC Transformation Order*), and subsequent clarifying orders, as significant management challenges. Specifically, OIG states, "[t]he Connect America Fund will rely on incentive-based, market driven polices, including competitive bidding, to distribute universal service funds as efficiently as possible." In doing so, OIG states that to ensure these reforms have their intended effect and continuing to resolve outstanding investigations, remain significant management and performance challenges." The Commission continues to take action to address the implementation of reforms to the high-cost program and remains committed to resolving investigations. These actions are summarized below.

- 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 the winning bidders were eligible to receive a total of up to $299,998,632 in support 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 $270 million in winning bids and announced $27 million in auction defaults. Of the authorized winning bids, two winning bidders subsequently defaulted on bids totaling over $47 million. The remaining application for support totaling $2 million is being actively processed. On February 25, 2014, the Federal Communications Commission completed the Tribal Mobility Fund Phase I Auction. The five winning bidders are eligible to receive a total of up to $49,806,874 in one-time Tribal Mobility Fund Phase I universal service support. In June 2014, the Bureaus announced that they were prepared to authorize support to three winning bidders with $8 million in winning bids and in July authorized the initial disbursement of support for one of those winning bidders. The Bureaus are actively processing the remaining applications for support. 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.

- In the *April 2014 Connect America Fund Order and Further Notice (2014 CAF Order/FNPRM)*, the Commission took significant steps to continue the implementation of the *2011 USF/ICC Transformation Order*, which comprehensively reformed and modernized the High Cost universal service program. The 2011 reforms provided fiscally responsible, accountable, incentive-based policies to transition an outdated and inefficient High Cost program into the Connect America Fund. The 2014 reforms have built on that foundation, taking into account what the Commission has learned to date and new marketplace developments. Additional steps taken in the *2014 CAF Order/FNPRM* include:

    - Adoption of several rules to establish the foundation for the award of support in price cap areas where the price cap carrier declines the offer of model-based support.

    - Requiring recipients of support through the competitive bidding process or the Remote Areas Fund to certify as to their financial and technical capabilities to provide the required services within the specified timeframe in the geographic area for which they seek support.

    - Clarifying the obligations of rate-of-return carriers considering their obligations to extend broadband service upon reasonable request.

    - Modifying the *2011 USF/ICC Transformation Order* to improve efficiencies in the Commission's reforms and create the appropriate incentives to invest and operate modern voice and broadband-capable networks. Included in these actions are:

    -
        - Adoption of a more measured transition for rate-of-return carriers that would have qualified under the prior rules for certain support known as Safety Net Additive (SNA) based on their significant network investment.
        - Elimination of the high-cost loop support (HCLS) benchmarking rule so that rate-of-return carriers' support will no longer be limited by benchmarks calculated using quantile regression analysis (QRA).

    - Adoption of a Further Notice of Proposes Rulemaking proposed measures to update and implement further the framework adopted by the Commission in 2011.

- In July, 2014, the Commission adopted a $100 million budget for Connect America rural broadband experiments and established an objective methodology for selecting projects among formal applications form those carriers that would deploy new, robust broadband of consumers in price cap areas. The rural broadband experiments will help the Commission explore the mechanics of conducting this type of competitive bidding process and help inform the Commission's decisions regarding the design of the Phase II auction that will occur after the offer of model-based support to price cap carriers.

- Implementation of an electronic filing system for FCC Form 481, which includes annual eligible telecommunication carriers (ETC) operational and financial information. This electronic filing system will improve the ability to oversee ETC program participation and compliance.

- ETCs continue to file five-year service quality improvement plans and annual progress reports in a manner consistent with the Commission's rules.

- Additionally, the Commission remains committed to resolving investigations into compliance with the Commission's rules for determining high-cost support. In particular, in FY 2014, the USF Strike Force was created, which is committed to safeguarding the USF and the other funding programs the FCC oversees. The Strike Force duties include investigating violations of the Communications Act, the Commission's rules, and other laws bearing on USF programs and contributions.

Schools and Libraries Program

In its Memorandum, OIG references the achievements of the *2014 E-Rate Modernization Order*, including adopting program goals and measures, simplification of the application process, promoting transparency of cost and connectivity data among Schools and Libraries program (more commonly known as the E-rate program) rate recipients and vendors. OIG identifies challenges remain in preventing service providers from overcharging entities for eligible services, charging more than the lowest corresponding price rule, ensuring schools bid competitively for services, and preventing manipulation of the discount rate. The FCC recognizes these challenges and is pleased to report the strides made by the Commission to address these issues and other challenges as it continues to modernize the E-rate program. These actions are summarized below.

- As recognized by OIG, the *E-rate Modernization Order* further modernizes and streamlines the Schools and Libraries program. First, the Commission adopted specific performance goals and measures for the E-rate program. Second, as noted in OIG's Memorandum, recent audits have demonstrated findings related to the lowest corresponding price rule and the applicant competitive bidding process. In the *E-rate Modernization Order*, the Commission took steps to address these issues by directing the Enforcement Bureau to devote additional resources to enforcement of the lowest corresponding price rule, by emphasizing service providers must offer and charge the lowest corresponding price, by creating mechanisms to promote pricing transparency, by establishing budgets for the purchase of internal connections (category 2) services, and by providing additional clarification regarding what constitutes a "cost-effective" selection of services. Third, the Commission extended the recordkeeping requirements and strengthened efforts to support enforcement investigations. Furthermore, the Commission also established a school district-wide discount rate so that districts could not manipulate their rates to obtain the highest funding.

- The Commission and USAC initiated a comprehensive program risk assessment conducted by an independent consultant, pursuant to a recommendation made by the Government Accountability Office (GAO). In a 2010 report, GAO found that E-rate's internal control structure centers around USAC's complex, multilayered application review process. GAO further stated that USAC has expanded the program's internal control structure over time to address the program's complexity and to address risks as they became apparent, but had not systematically reviewed the internal controls to ensure they are the most effective and efficient method to address programmatic risks. As a result, GAO recommended that FCC conduct a robust risk assessment of the E-rate program and a thorough examination of the overall design of E-rate's internal control structure. This risk assessment will also assist USAC and the Commission in identifying processes and procedures that can be eliminated, consolidated or performed more efficiently.

- To further address the issue of the program's efficient and effective administration, the Commission adopted in the *E-rate Modernization Order* the goal of making the E-rate application process and other E-rate processes fast, simple and efficient. In the *Order*, the Commission simplified the application process, simplified the invoicing and disbursement process, and directed USAC to take steps to reduce the administrative burden on applicants by processing and managing applications more efficiently, modernizing its E-rate information technology systems, timely publishing all non-confidential E-rate data in an open and standardized format, and communicating more clearly with E-rate applicants and service providers.

- Pursuit of multiple investigations against E-Rate fund recipients for possible violations of the E-Rate program rules.

- Audits of 120 applicants and service providers during the two-year term of the current audit plan.

- Three-year suspensions and debarments by the Commission of individuals convicted of criminal conduct in connection with the E-Rate program, from participating in that program.

- Additionally, the Commission remains committed to resolving investigations into compliance with the Commission's rules for determining schools and libraries funding. In particular, in FY 2014, the USF Strike Force was created, which is committed to safeguarding the USF and the other funding programs the FCC oversees. The Strike Force duties include investigating violations of the Communications Act, the Commission's rules, and other laws bearing on USF programs and contributions.

<u>Lifeline</u>

In its Memorandum, OIG further recognizes the comprehensive reform by the Commission of the Lifeline program in 2012 to require stricter oversight – especially actions taken by the Commission to confirm consumer eligibility to participate in the program. OIG further states that many reforms have not been fully implemented, therefore, assuring these reforms have their intended effect and continuing to resolve outstanding investigations remain significant management and performance challenges. The Commission continues to take action to address the implementation of reforms to the Lifeline program and resolve investigations. These actions are summarized below.

- Continuation of implementation of the reforms in the *Lifeline Reform Order*, which reformed and began to modernize the Lifeline program by substantially strengthening protections against waste, fraud, and abuse. First, the Commission has improved program administration and accountability by requiring ETCs to provide data related to the annual Lifeline recertification efforts as well as subscriber de-enrollment data. Pursuant to the *Lifeline Reform Order*, the Commission also requires consumers to present proof of income or program-based eligibility for the Lifeline program and requires ETCs to provide information about the rules of the program to potential subscribers; thereby improving enrollment and consumer disclosures. Subscribers are required to certify their understanding and compliance with the rules of the Lifeline program, including but not limited to, the requirement that there can be only one Lifeline benefit per household. By adopting new rules to further ensure that only eligible low-income consumers may obtain a Lifeline benefit, the Commission constrained the growth of the program and reduced the burden on all who contribute to the USF.

- Through targeted audits known as In-Depth Data Validations (IDVs) initiated in June 2011 and continuing through FY 2014, the Commission has eliminated 2.2 million duplicate Lifeline subscriptions. The Commission has 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.

- In May of 2014, the National Lifeline Accountability Database (NLAD) went live for all participating states. The FCC and USAC established the NLAD to eliminate additional duplicates and also to prevent new duplicates from obtaining Lifeline benefits. Pursuant to the *Lifeline Reform Order*, prior to accepting a new subscriber, an ETC must check the NLAD to determine if the potential subscriber already receives a Lifeline benefit from another ETC. The NLAD has significantly reduced the possibility that a subscriber can have multiple Lifeline benefits. The NLAD is now live in 52 states and territories. There are four states and one territory that were granted opt out status by the Commission after they provided information about their own rigorous duplicates databases. These opt-out states and territory includes Texas, Oregon, California, Vermont, and Puerto Rico. The NLAD eliminated over 1.2 million duplicate Lifeline accounts during the loading process.

- The NLAD not only acts as duplicate detection and prevention, but it also verifies the identity of the consumer seeking enrollment using a third party identification verification service from Lexis-Nexis. The NLAD's identity check verifies whether the information given by an applicant for the Lifeline benefit identifies a real person based on Lexis-Nexis's search and evaluation. The NLAD also verifies addresses using the U.S. Post Office's address matching system and checks whether the address already exists in the NLAD. The address check performed by the NLAD ensures that subscribers are adhering to the Commission's one-per-household rule.

- Pursuant to the *Lifeline Reform Order*, ETCs have additional audit responsibilities. Currently, there are three components to the audit plan, which will review 2013 data: (1) the Biennial Audit; (2) the first-year ETC audits; and (3) audits of medium and small disbursements. First, in April 2014, the Commission released procedures for the Lifeline Biennial Audit. This audit will be undertaken by ETCs who receive more than five million a year in reimbursement from USF. There are 28 ETCs who will undertake this audit, which will test the ETC's policies and procedures and certain key components of the program such as certification. The Biennial Audit will cover approximately 94 percent of all the disbursements in the Lifeline program. Second, carriers who have been newly designated as ETCs will have within the first year of their designation, an audit to review compliance of the ETC's procedures and practices with the Lifeline rules. Thus far, USAC has completed 15 first year audits. Finally, there are 40 other audits of medium to small disbursements that will test compliance with the rules.

- Additionally, the Commission remains committed to resolving investigations into compliance with the Commission's rules for determining Lifeline funding. In particular, in FY 2014, the USF Strike Force was created, which is committed to safeguarding the Universal Service Fund and the other funding programs the FCC oversees. The Strike Force duties include investigating violations of the Communications Act, the Commission's rules, and other laws bearing on USF programs and contributions.

Telecommunications Relay Services Fund

OIG recognizes that the Commission has taken positive steps to address issues concerning provision of Internet Protocol (IP) Relay Service in the TRS fund. However, OIG, in its Memorandum, states that, "[d]etermining how to further strengthen the rules, or whether to continue to support the program in light of the seemingly intractable problems, remains a significant management and performance challenge." The FCC recognizes these challenges and below is a summary of actions taken to address these challenges.

- The TRS Fund Administrator, Rolka Loube Saltzer Associates (RLSA) conducted audits focusing on Internet Telecommunications Relay Service (iTRS), which includes Video Relay Service (VRS), Internet Protocol Relay (IP Relay), and Internet Protocol Captured Telephone Service (IP CTS). In particular, auditors focused on iTRS providers' registration processes, because investigations by the Commission's Enforcement Bureau and related actions indicated that many iTRS providers had not been in compliance with the Commission's registration rules. The audits covered the period of July 1, 2012 to April 30, 2014. All iTRS providers were audited, totaling nine audits. The reports include a total of 33 findings and observations with recommendations. There were seven findings regarding the call detail records submitted to RLSA for payment each month, and one finding regarding the process for user-self certification of a qualifying disability. There were 25 observations regarding the following: management of access to registration databases, management of changes in user information, controls, password administration, policies and procedures, registration, segregation of duties, and senior officer certification. The findings were determined to be non-monetary because the non-compliance was not associated with specific minutes submitted to the TRS Fund for reimbursement. The audit reports were sent to providers on September 19, 2014 with a requested response to each finding by October 19, 2014. The Commission is working with RLSA to ensure that all findings and observations are addressed and remediated by providers and that RLSA drafts a corrective action plan for each of the findings

- Execution of three consent decrees with providers of TRS to resolve investigations regarding non-compliant registration and verification processes. The consent decrees require the providers to pay $11,740,000 back to the TRS Fund, and to pay $23,666,000 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.). EB also issued a Notice of Apparent Liability (NAL) to a TRS provider for their non-compliant registration and verification process. The recommended forfeiture in the NAL is $11,937,549.

- Additionally, the Commission remains committed to resolving investigations into compliance with the Commission's rules for determining TRS funding. In particular, in FY 2014, the USF Strike Force was created, which is committed to safeguarding the Universal Service Fund and the other funding programs the FCC oversees. The Strike Force duties include investigating violations of the Communications Act, the Commission's rules, and other laws bearing on USF programs and contributions.

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. In particular, Federal Management Information Security and Management Act (FISMA) evaluations conducted by OIG have identified security weaknesses in the Commission information technology (IT) infrastructure. To address these issues, OIG states that management must prioritize remediation of these issues. OIG also recognizes the FCC's efforts to address these issues and notes that there have been noticeable improvements. However, OIG states addressing such weaknesses remains an ongoing effort. The FCC recognizes these challenges and is pleased to report the following efforts to address these challenges.
Specifically, the Managing Director (MD) and FCC Chief Information Officer (CIO) are both committed to stabilization and modernization of the Commission's aging legacy systems. Upon their arrival last year, the CIO and MD both emphasized to staff the urgency of these transformative actions given the need to dramatically improve IT security stemming from the Commission's accumulated aging and non-compliant system hardware and software applications. Additionally the CIO and MD commissioned an independent assessment of the FCC's infrastructure and security, and both concurred that innovation at the FCC should include: (1) the need to deliver better IT services and more transparency to the work of the FCC; (2) the need to address the accelerating costs of maintaining out-of-date systems; and (3) a mandate to reduce the infrastructure "on site" footprint of the FCC by 50 percent by 2017. With server rooms occupying parts of three floors at the FCC, the need to maintain these aging systems in a secure environment outside of the confines of the FCC building is critical.

To start the IT Transformation at the FCC, in FY 2014, the CIO: (1) migrated FCC desktops to a "virtual desktop infrastructure" that better supported telework; (2) enabled the servers to be migrated off-site with minimal impact on the users; and (3) placed additional IT experts in place along with a plan to commence the stabilization and modernization of the FCC's IT. Following best practices from the commercial IT community, the FCC's IT Transformation efforts focus on cost-effectively delivering high impact solutions to the FCC's Bureaus and Offices, through the development of a solution-driven business service catalog, to quickly implement agile, resilient, and efficient solutions.

For FY 2015, the CIO plans to implement a first phase of stabilization that includes removing all hardware and associated networks devices out of the FCC's Headquarters, followed by a second modernizing phase that will involve re-writing the necessary applications into a cloud based environment in order to become independent of obsolete software and hardware on which these applications presently operate. Utilizing a commercial provider will enable the IT system to support a migration to IPv6, and will allow on-site FCC IT resources to focus on re-writing the FCC's aging legacy IT applications for the cloud.

As part of its goals for innovation at the FCC, the Commission will transition to a cloud-based service orientation for the IT enterprise. The FCC IT Transformation, over a period of 24 months following the server lift and stabilization, will include work on providing on-demand computing and modular development platforms to meet the needs of the different FCC Bureaus and Offices. This transformation also will include development in late FY 2015 and FY 2016 of a service catalog as a functional representation of the FCC enterprise's core mission efforts. This service catalog when paired with effective technology delivery, will allow for the reuse of common processes and components across the Commission's enterprise.

Through this FCC IT Transformation, including (1) the server lift and stabilization in FY 2015; (2) re-write of applications in FY 2016-FY 2017; and (3) development of the service catalog starting in late FY 2015 and into FY 2016, the FCC will improve IT security dramatically, which has been an issue due to aged and non-compliant systems hardware and software applications.

In the interim, the FCC is placing adaptive solutions around its aging IT infrastructure, which drastically requires modernization and transformation. For FY 2014, current progress on FCC's Privacy and FISMA actions included:

Privacy

- FY 2014 Goal: Ensure 85 percent of FISMA systems undergo a Privacy Impact Assessment: Met, 32 of 37 for an 86 percent success rate.
- FY 2014 Goal: Ensure 85 percent of systems with Personally Identifiable Information (PII) have a System of Records Notice: Exceeded, 39 of 42 for a 93 percent success rate.
- FY 2014 Goal: Publish a new Breach Notification Policy to reference social media/web: Met, published June, 2014.
- FY 2014 Goal: Incorporate social media/web into Cyber Security Policy (CSP): Met, included in new, updated rewrite of the CSP.
- Other Notable FY 2014 Privacy Accomplishments:
  - Realigned privacy function within the information management technology organization;
  - Included privacy/PII content in the annual security awareness training (best ever participation at 98 percent for FY 2014 – previous record of 96 percent in FY 2013); and
  - Continued robust activities to enhance the Data Integrity Board function/program;

FISMA

- FY 2014 Goal: Resolve 50 percent of Audit Concerns: Exceeded, 42 of 68 for a 62 percent success rate.
- FY 2014 Goal: Reduce FY 2014 findings versus FY 2013: Met, 68 to 49 findings for a 28 percent improvement.
- Other Notable FY 2014 FISMA Accomplishments:
  - Almost doubled improvement percentage in reducing audit findings: 15 percent from FY 2013 to FY 2014 versus 28 percent from FY 2014 to FY 2015;
  - Reduced "reissued" findings by 51 percent; and
  - Reduced "new" findings by 71 percent.

In addition, in FY 2014, the FCC retired the previously used dial-up server due to the risk involved with the use of dial-up connections to access the FCC production network, network services, and major applications. The FCC's Disaster Recovery Plan (DRP) also has been updated to include more specifics regarding the number of applications to be recovered in the event of a disaster. The Commission also developed and implemented a training based on DRP IT roles, responsibilities, and team organization.

Conclusion

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.

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