FEDERAL COMMUNICATIONS COMMISSION

Agency Financial Report

Fiscal Year 2018

(October 1, 2017 – September 30, 2018)

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1. MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Message from the Chairman

As Chairman of the Federal Communications Commission (FCC or Commission), I am pleased to present the FCC's fiscal year (FY) 2018 Agency Financial Report. This report provides useful financial and performance information about the FCC's activities over the course of FY 2018.

Under my leadership, the Commission has acted to link the FCC's mission to its strategic goals, which include: Closing the Digital Divide, Promoting Innovation, Protecting Consumers and Public Safety, and Reforming the FCC's Processes. Included here are just a few examples of the Commission's substantial efforts to carry out its mission during the past fiscal year.

To accelerate the deployment of 5G, the next generation of wireless connectivity, the FCC has worked to free up spectrum, promote wireless infrastructure, and modernize its regulations to promote investment. To further promote digital inclusion in rural areas, the FCC concluded a reverse auction that will award approximately $1.5 billion to over 100 bidders to help provide broadband to more than 700,000 unserved homes and small businesses in rural America. The Commission also overturned the FCC's 2015 decision to heavily regulate the Internet and instead adopted a consistent national policy for broadband providers that protects the free and open Internet and simultaneously encourages infrastructure investment. In support of hurricane response efforts, the FCC has worked in close coordination with our federal and state partners to restore communications, which can have a critical impact for the safety of both the public and first responders. The FCC also approved additional funding to accelerate the restoration of the communications networks in Puerto Rico and the U.S. Virgin Islands that were damaged and destroyed by hurricanes.

To protect consumers, the Commission has acted aggressively to target unlawful robocalls, which are the number one topic of complaints to the FCC from the public. To help combat this problem, the FCC adopted new rules allowing phone companies to proactively block calls that appear to be from telephone numbers that do not or cannot make outgoing calls. The Commission has also hit back hard against illegal spoofing schemes with major enforcement actions, assessing over $200 million in fines.

In addition, I am pleased to report that for the thirteenth straight year the FCC has received an "unmodified" opinion on its financial statements from the FCC's Office of Inspector General's independent auditors. Maintaining proper stewardship over the Commission's resources is a team effort, and I am grateful to the FCC's staff for ensuring the FCC's continued financial management success this year. As noted by the auditors, the FCC still can make improvements, and I welcome the findings from the independent auditors' report as well as the management challenges from the Office of Inspector General. The Commission will work to address these findings and concerns. Moving forward, I remain focused on promoting the public interest by taking actions that result in more innovation, more investment, better products and services, lower prices, more job creation, and faster economic growth.

Ajit Pai
Chairman
November 15, 2018

Overview of the Federal Communications Commission

Introduction

Office of Management and Budget (OMB) Circular No. A-136, released on July 30, 2018, states that agencies may choose to produce either a consolidated Performance and Accountability Report (PAR) or a separate Agency Financial Report (AFR) with an Annual Performance Report (APR). The Federal Communications Commission (FCC, Agency, or Commission) has chosen to produce the AFR. The FCC will include its Fiscal Year (FY) 2018 APR with its Congressional Budget Justification and will post it on the Commission's website at https://www.fcc.gov/about/strategic-plans-budget as required by OMB.

The Commission's AFR includes three sections:

Section 1 consists of Management's Discussion and Analysis (MD&A) that presents a message from the Chairman, an overview of the FCC, including the senior leadership, Agency's mission and vision statements, organizational structure, organizational chart, map of field offices, strategic goals and objectives, strategies and resources to achieve goals, entity components for financial statement purposes, eliminating and recovering improper payments, performance highlights, overall status of audit recommendations, management assurances, financial management systems strategy, financial discussion and analysis, and other key financial statement analysis.

Section 2 contains the Commission's financial information. This section contains the independent auditor's reports, Commission's response to the independent auditor's reports, consolidated financial statements, notes to the financial statements, and required supplementary information.

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, management's response to such challenges, fraud reduction report, and a schedule of civil monetary penalties.

About the Federal Communications Commission

The FCC is an independent regulatory agency of the United States (U.S.) Government. The FCC is charged with regulating interstate and international communications by radio, television, wire, satellite, and cable. The Commission also regulates telecommunications, advanced communication services, and video programming for people with disabilities, as set forth in various sections of the Communications Act.

The Commission's headquarters is located in Washington, D.C. It has 13 field offices throughout the nation, including three regional offices located in Atlanta, GA, Columbia, MD, and Los Angeles, CA.

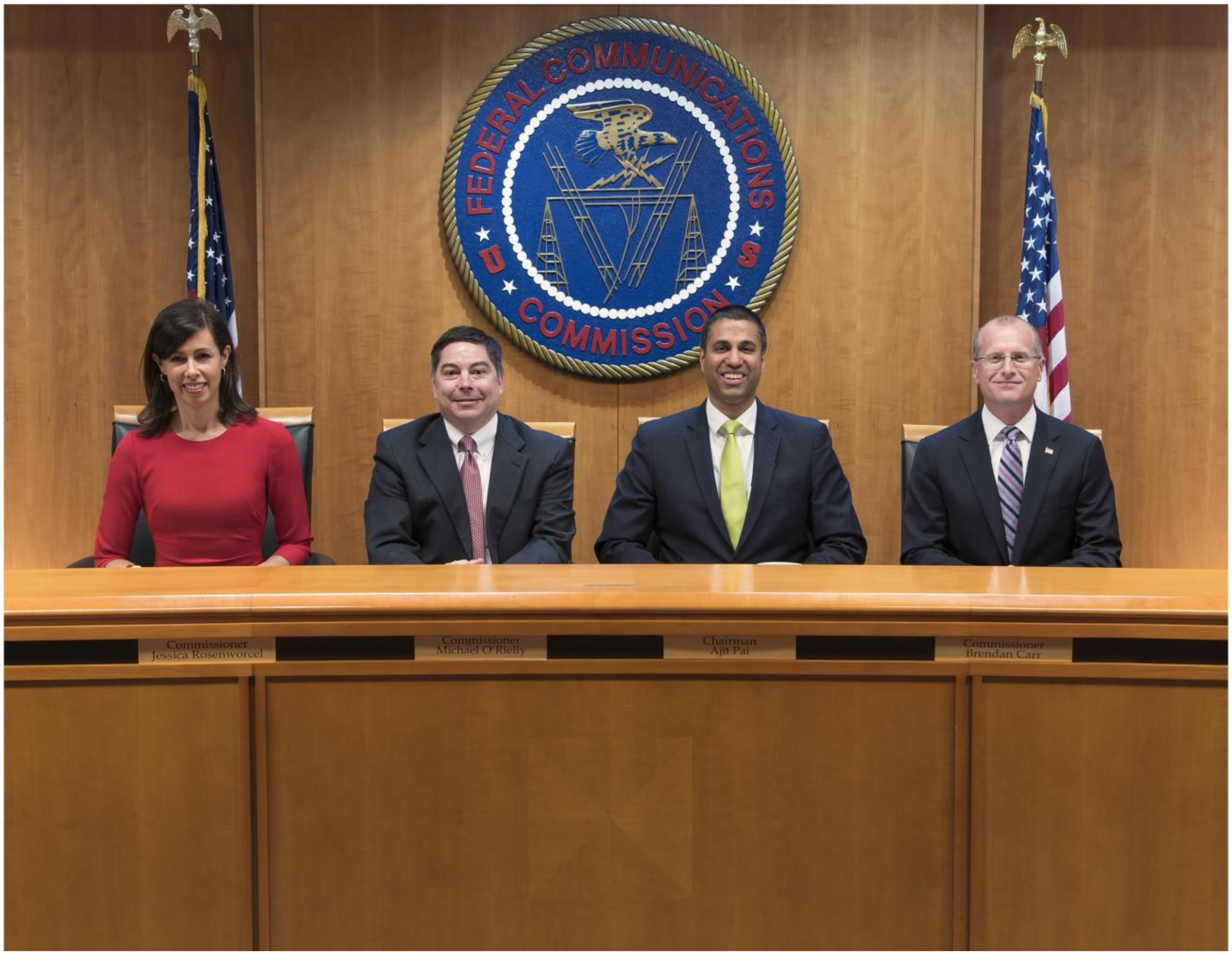
Senior Leadership

The FCC is directed by five Commissioners who 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 serves as the Chief Executive Officer of the Commission, supervising all FCC activities, delegating responsibilities to Offices and Bureaus, and formally representing the Commission before the Congress and the Administration.

The current Chairman and the Commissioners are:

- Chairman Ajit Pai
- Commissioner Michael O'Rielly
- Commissioner Brendan Carr
- Commissioner Jessica Rosenworcel



Pictured from left to right are Commissioner Jessica Rosenworcel, Commissioner Michael O'Rielly, Chairman Ajit Pai, and Commissioner Brendan Carr.

Mission

As specified in section one of the Communications Act of 1934, as amended, 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, rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[1] In addition, section one provides that the Commission was created "for the purpose of the national defense" and "for the purpose of promoting safety of life and property through the use of wire and radio communications."[2]

Vision Statement

The FCC's vision is to develop a regulatory environment to encourage the private sector to build, maintain, and upgrade next-generation networks so that the benefits of advanced communications services are available to all Americans. The FCC will work to foster a competitive, dynamic and innovative market for communications services through policies that promote the introduction of new technologies and services and ensure that Commission actions promote entrepreneurship and remove barriers to entry and investment. The Commission will also strive to develop policies that promote the public interest, improve the quality of communications services available to those with disabilities, and protect public safety.

Organizational Structure

In order to accomplish its strategic plan, the FCC is organized by function. There are seven Bureaus and ten Offices. The Bureaus and the Office of Engineering and Technology process applications for licenses to operate facilities and provide communication services, analyze complaints from consumers and other licensees, conduct investigations, develop and implement regulatory programs, and participate in hearings and workshops. Generally, the Offices provide specialized support services. The 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 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 responding to consumer inquiries and informal 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. In addition, the Bureau's Disability Rights Office provides expert policy and compliance advice on accessibility with respect to various forms of communications for persons with disabilities.

- **The Enforcement Bureau** enforces the Communications Act and the FCC's rules. It protects consumers, ensures efficient use of spectrum, furthers public safety, promotes competition, resolves intercarrier disputes, and protects the integrity of FCC programs and activities from fraud, waste, and abuse.

- **The International Bureau** administers the FCC's international telecommunications and satellite programs and policies, including licensing and regulatory functions. The Bureau promotes pro-competitive policies abroad, coordinating the FCC's global spectrum activities and advocating U.S. interests in international communications and competition. The Bureau works to promote a high-quality, reliable, interconnected, and interoperable communications infrastructure on a global scale.

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[1] 47 U.S.C. § 151.
[2] *Id.*

- **The Media Bureau** recommends, develops, and administers the policy and licensing programs relating to electronic media, including broadcast, cable, and satellite television in the United States and its territories.

- **The Public Safety and Homeland Security Bureau** develops and implements policies and programs to strengthen public safety communications, homeland security, national security, emergency management and preparedness, disaster management, and network reliability. These efforts include rulemaking proceedings that promote more efficient use of public safety spectrum, improve public alerting mechanisms, enhance the nation's 911 emergency calling system, and establish frameworks for communications prioritization during crisis. The Bureau also maintains 24/7 operations capability and promotes Commission preparedness to assist the public, first responders, the communications industry, and all levels of government in responding to emergencies and major disasters where reliable public safety communications are essential.

- **The Wireless Telecommunications Bureau** is responsible for wireless telecommunications programs and policies in the United States and its territories, including licensing and regulatory functions. Wireless communications services include cellular, paging, personal communications, mobile broadband, and other radio services used by businesses and private citizens. The Bureau also conducts auctions of spectrum licenses and reverse auctions that award support from the Universal Service Fund for broadband deployment.

- **The Wireline Competition Bureau** develops, recommends, and implements policies and programs for wireline telecommunications, including fixed (as opposed to mobile) broadband and telephone landlines, striving to promote the widespread development and availability of these services. The Bureau has primary responsibility for the Universal Service Fund which helps connect all Americans to communications networks.

The Offices

- **The Office of Administrative Law Judges** is composed of one judge (and associated staff) who presides over hearings and issues decisions on matters referred by the FCC.

- **The Office of Communications Business Opportunities** promotes competition and innovation in the provision and ownership of telecommunications services by supporting opportunities for small businesses as well as women and minority-owned communications businesses.

- **The Office of Engineering and Technology** advises the FCC on technical and engineering matters. This Office develops and administers FCC decisions regarding spectrum allocations and grants equipment authorizations and experimental licenses.

- **The Office of General Counsel** serves as the FCC's chief legal advisor.

- **The Office of Inspector General** conducts and supervises audits and investigations relating to FCC programs and operations.

- **The Office of Legislative Affairs** serves as the liaison between the FCC and Congress, as well as other Federal agencies.

- **The Office of Managing Director** administers and manages the FCC.

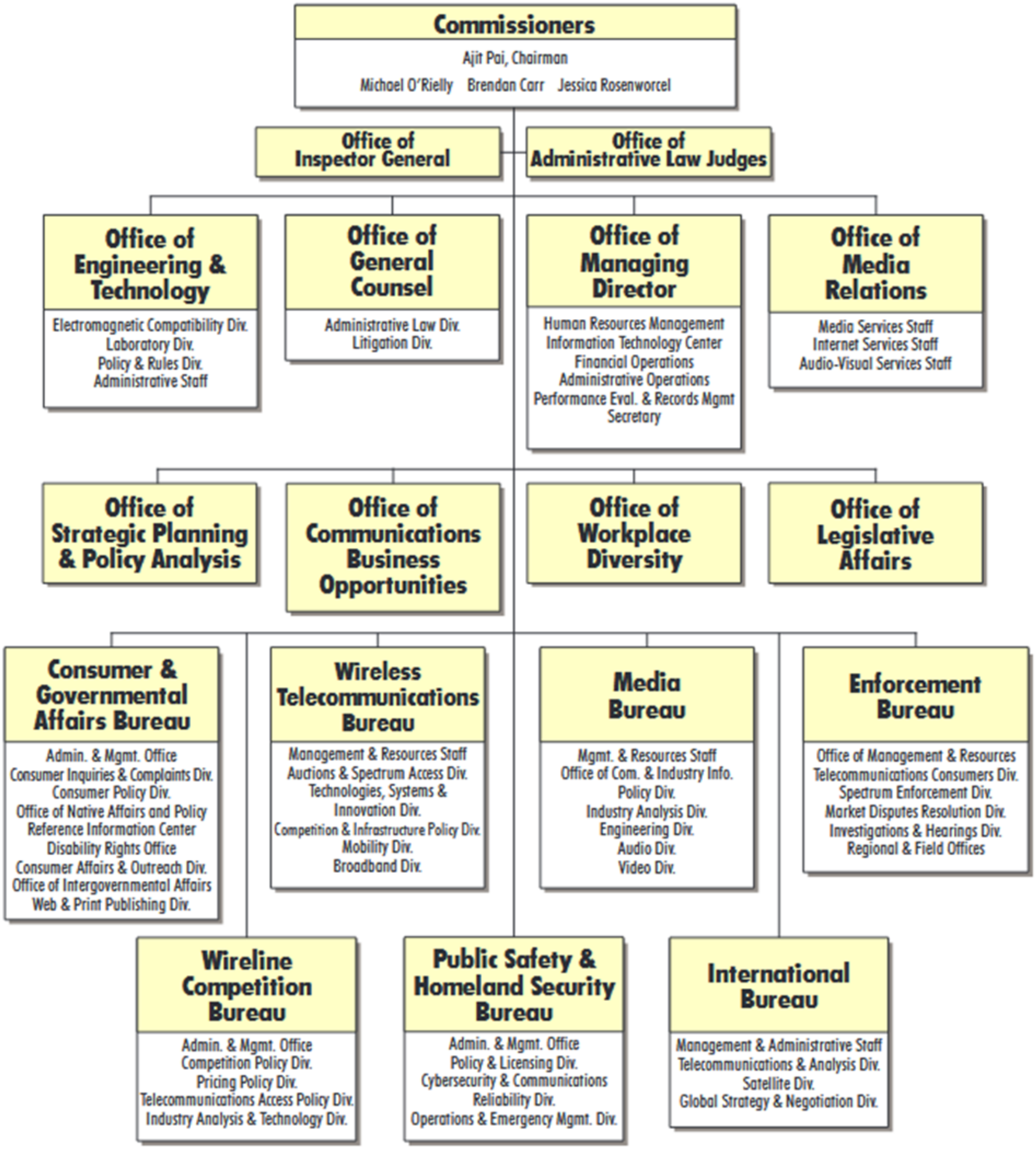
- **The Office of Media Relations** informs the media of FCC decisions and serves as the FCC's main point of contact with the media.

- **The Office of Strategic Planning and Policy Analysis** works with the Chairman, Commissioners, Bureaus, and Offices in strategic planning and policy development for the agency. It also provides research, advice, and analysis of complex, novel, and non-traditional economic and technological communications issues.

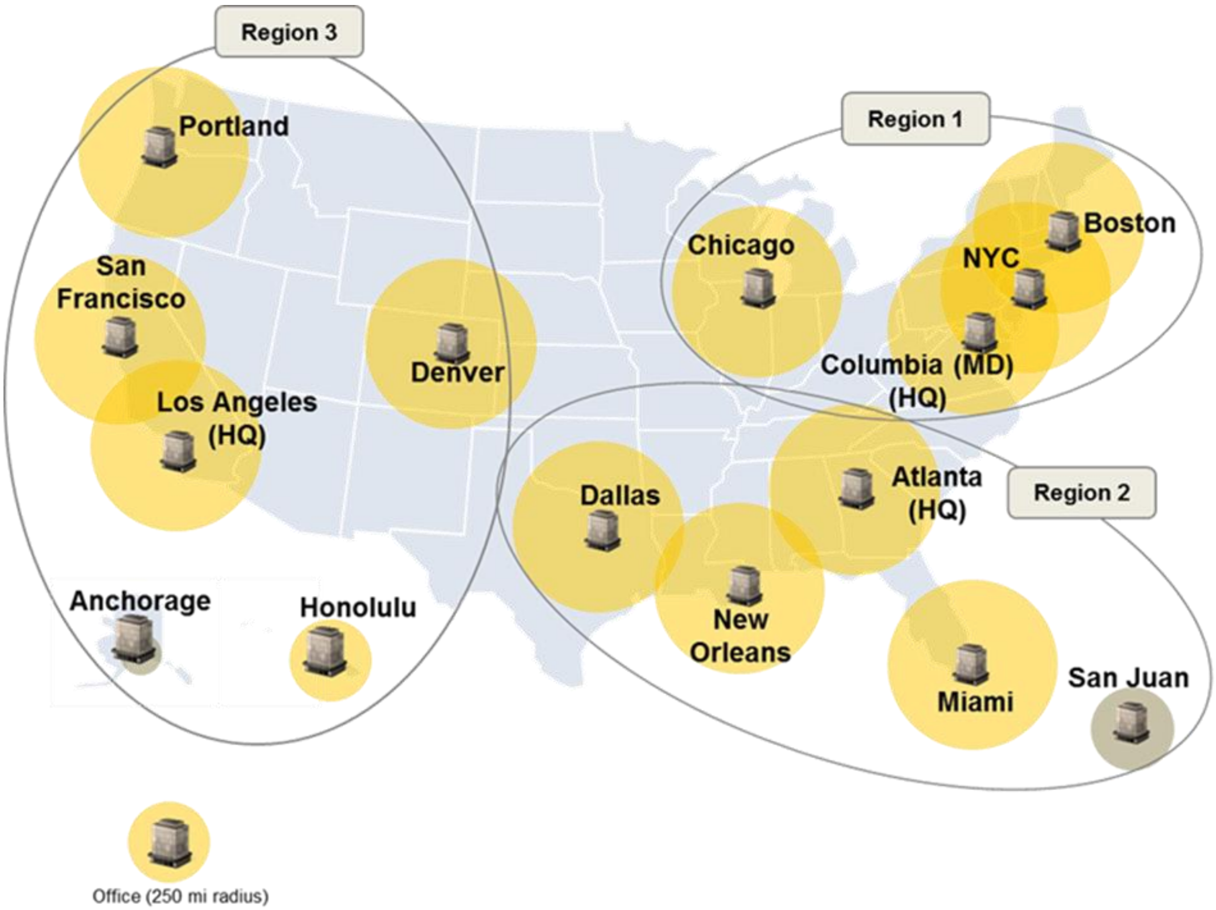
- **The Office of Workplace Diversity** ensures that the FCC provides employment opportunities for all persons regardless of race, color, sex, national origin, religion, age, disability, or sexual orientation.

Additional 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.

Organizational Chart



Map of FCC Enforcement Bureau's Field Offices



Note: The San Juan and Anchorage offices are not staffed by Full-Time Equivalents (FTEs) on a regular basis.

Strategic Goals and Objectives

The FCC is responsible to Congress and the American people for ensuring a vibrant competitive marketplace driven by principles and policies that create an environment for innovation and investment, better products and services for consumers, lower prices, more job creation, and faster economic growth. The FCC must also provide leadership to ensure that the communications needs of public safety officials are met; promote the universal availability and deployment of broadband and telecommunications services; 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 four strategic goals. They are:

Strategic Goal 1: Closing the Digital Divide

Develop a regulatory environment to encourage the private sector to build, maintain, and upgrade next-generation networks so that the benefits of advanced communications services are available to all Americans.

Where the business case for infrastructure investment doesn't exist, employ effective and efficient means to facilitate deployment and access to affordable broadband in all areas of the country.

Strategic Goal 2: Promoting Innovation

Foster a competitive, dynamic, and innovative market for communications services through policies that promote the introduction of new technologies and services. Ensure that the FCC's actions and regulations reflect the realities of the current marketplace, promote entrepreneurship, expand economic opportunity, and remove barriers to entry and investment.

Strategic Goal 3: Protecting Consumers and Public Safety

Develop policies that promote the public interest by providing consumers with freedom from unwanted and intrusive communications, improving the quality of communications services available to those with disabilities, and protecting public safety.

Strategic Goal 4: Reforming the FCC's Processes

Modernize and streamline the FCC's operations and programs to increase transparency, improve decision-making, build consensus, reduce regulatory burdens, and simplify the public's interactions with the agency.

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: https://www.fcc.gov/about/strategic-plans-budget.

Components of the FCC for Financial Statements Purposes

In addition to the activities directly undertaken by the above Bureaus and Offices, the Commission's 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]

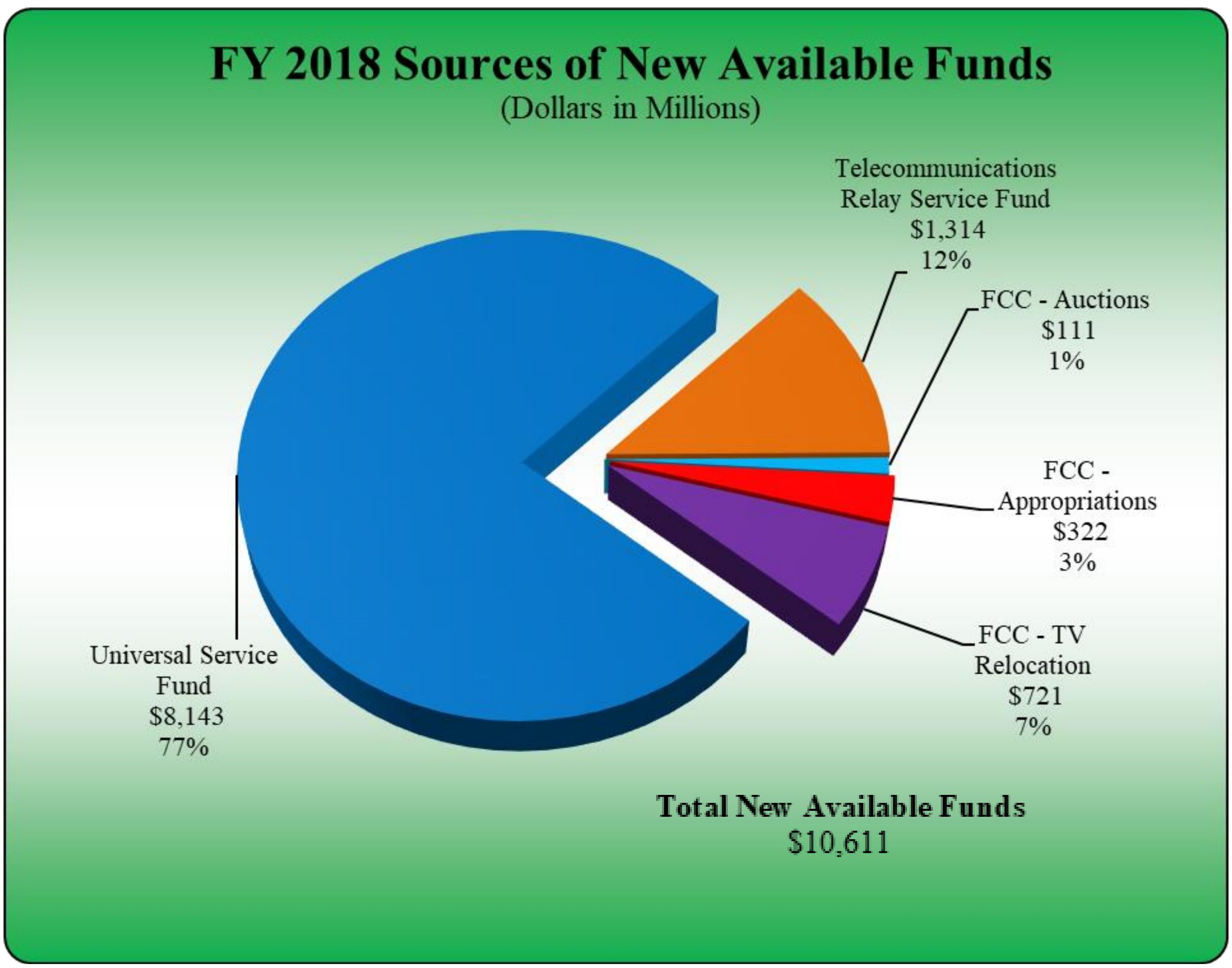
The Universal Service Administrative Company (USAC) administers the four universal service support mechanisms of the USF under the Commission's direction. These support mechanisms are funded through mandatory contributions from U.S. telecommunications service providers, including local and long-distance 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,

[3] 47 U.S.C. § 254.
[4] 47 U.S.C. § 225.

Lifeline, Rural Health Care, and Schools and Libraries. These support mechanisms provide money directly to service providers to defray the cost of serving customers in high cost and rural areas, and to offset 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 2018, the USF accounted for approximately $8,143 million in new available funds reported 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 https://www.fcc.gov/general/universal-service.

Rolka Loube, LLC (RL) 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 2018, TRS accounted for approximately $1,314 million in new available funds on the Commission's Combined Statement of Budgetary Resources. Additional information on RL and TRS can be found at http://www.rolkaloube.com/and https://www.fcc.gov/general/telecommunications-relay-services-trs.

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 $322 million in the chart above reflects the authority for the Commission to collect regulatory fees. The $721 million for the TV Broadcasters Relocation Fund represents an additional $600 million appropriated in Section 511 of Title V of Division E of the Consolidated Appropriations Act, 2018 (P.L. 115-141) and $121 million sequestered in FY 2017 and made available in FY 2018. The $600 million additional appropriation is allocated as follows: $350 million for Full Power, Class A and multichannel video program distributors; $150 million for Translators and Low Power Television stations; $50 million for FM Radio Stations; and $50 million for consumer education. The $111 million appropriation in the chart above represents collections from auctions used to offset the cost of performing auctions related activity.

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 oversees a payment recapture program that includes both audits and transaction testing to search for and recapture overpayments. Section 3 of the AFR provides further details on these efforts.

Performance Highlights

CLOSING THE DIGITAL DIVIDE

Develop a regulatory environment to encourage the private sector to build, maintain, and upgrade next-generation networks so that the benefits of advanced communications services are available to all Americans. Where the business case for infrastructure investment doesn't exist, employ effective and efficient means to facilitate deployment and access to affordable broadband in all areas of the country.

A key priority for the FCC is to close the digital divide in rural America. The FCC continued to use auction mechanisms to increase broadband service in rural areas.

- The FCC conducted the Connect America Fund Phase II (CAF-II) reverse auction which will award $1.49 billion in support to be distributed over the next 10 years to expand rural broadband service in unserved areas in 45 states. Over 700,000 rural homes and small businesses will gain access to high-speed Internet service for the first time as a result.
- The Commission is also working toward the launch of a $4.53 billion Mobility Fund Phase II (MF-II) auction to expand 4G LTE wireless coverage over 10 years to primarily rural areas. The FCC released a map showing areas presumed eligible and announced procedures for the challenge process to eligibility determinations.

The FCC is providing additional funding for rural broadband and is taking steps to reduce, refine, and clarify existing rules. As part of this additional funding, the FCC will provide $180 million in one-time funding for small, rural carriers. The FCC is also moving to strengthen the Universal Service Fund by devoting over $360 million toward additional broadband deployment by carriers currently participating in the Alternative Connect America Cost Model.

The FCC adopted the *Restoring Internet Freedom Order,* which restored the classification of broadband Internet access service as an "information service" under Title I of the Communications Act. The FCC adopted robust transparency requirements to empower consumers and facilitate effective government oversight of broadband providers' conduct, while restoring the jurisdiction of the Federal Trade Commission to act when broadband providers engage in anticompetitive, unfair, or deceptive acts or practices. The FCC reinstated the classification of mobile broadband Internet access service as a private mobile service and found that the regulatory uncertainty and overreach created by Title II regulation reduced Internet service provider (ISP) investment in networks, and hampered innovation, particularly among small ISPs serving rural consumers.

The FCC required that ISPs disclose information about their practices to consumers, entrepreneurs, and the Commission, including any blocking, throttling, paid prioritization, or affiliated prioritization. The FCC also eliminated the Internet Conduct Standard, under which the FCC could micromanage innovative business models.

The FCC's *2018 Broadband Deployment Report* found that removing barriers to infrastructure investment, promoting competition, and restoring a light-touch regulatory framework for broadband have put the Commission back on the right track, but concluded that too many Americans still lack access to high-speed Internet service, including those in rural areas, on Tribal lands, and in schools and libraries. The report maintained the current speed standard for fixed service of 25 Megabits per second (Mbps) download/3 Mbps upload and concluded that mobile services are not currently full substitutes for fixed services.

The FCC eliminated unnecessary regulatory hurdles for carriers moving from legacy voice and lower speed data services to next-generation networks. The FCC streamlined grandfathering of lower-speed data services where the carrier already provides fixed replacement data services at download speeds of 25 Mbps and 3 Mbps for uploads. The FCC also eliminated burdensome education and outreach requirements for carriers discontinuing legacy voice services in the transition to next-generation IP services.

The FCC updated and modernized its National Broadband Map, a source of broadband deployment information for consumers, policymakers, researchers, and others. The new, cloud-based map supports more frequent data updates and display improvements.

The FCC increased the annual cap on its Rural Health Care (RHC) Program spending to $571 million, to address immediate and long-term funding shortages driven by growing demand for rural telemedicine services. The FCC also decided to adjust the cap annually for inflation and allow unused funds from prior years to be carried forward. The FCC is also exploring ways to more efficiently distribute RHC Program funds and to combat potential waste, fraud and abuse in the RHC Program.

The FCC sought comment on creating a Universal Service Fund pilot program to promote broadband-enabled telehealth services among low-income families and veterans. The Notice of Inquiry sought comment on the goals of, statutory authority for, and design of a "Connected Care Pilot Program" including the budget, application process, and types of telehealth pilot projects that should be funded.

PROMOTING INNOVATION

Foster a competitive, dynamic, and innovate market for communications services through policies that promote the introduction of new technologies and services. Ensure that the FCC's actions and regulations reflect the realities of the current marketplace, promote entrepreneurship, expand economic opportunity, and remove barriers to entry and investment.

The FCC adopted items to remove regulatory barriers and promote wireless infrastructure deployment and the rollout of next generation services:

- The FCC streamlined the wireless infrastructure siting review process to reduce regulatory impediments and facilitate the deployment of next-generation wireless facilities. The FCC excluded small wireless facilities deployed on non-Tribal lands from National Historic Preservation Act (NHPA) and National Environmental Policy Act (NEPA) review; those deployments continue to be subject to currently applicable state and local government approval requirements. The FCC also clarified and made improvements to the process for Tribal participation in historic preservation reviews for large wireless facilities where NHPA/NEPA review is still required.

- The FCC removed barriers to wireless infrastructure deployment by determining that replacement utility poles that have no potential effect on historic properties do not need to complete historic preservation review. The FCC also consolidated the Commission's historic preservation review rules and procedures into a single rule.
- The FCC reformed the permitting process for small cells, the physical building blocks of 5G, by limiting the fees state and local regulators can charge for reviewing small cells, setting shot clocks on reviews, and affirming that they can apply reasonable aesthetic considerations. The new wireless infrastructure enabled by the FCC's actions will provide coverage for nearly two million more homes and businesses in rural and suburban communities.
- The FCC reformed the framework governing pole attachments by adopting a process in which the new "attacher" moves existing attachments and performs all other work required to make the pole ready for a new attachment. This new policy will make it easier for companies to deploy broadband networks.
- The FCC enacted changes governing access to utility poles and conduits to better enable providers to invest in next-generation networks. Changes included: rules to reduce costs faced by broadband providers by barring pole owners from charging for certain costs they have already recovered from others; a resolution of pole attachment disputes through use of a 180-day shot clock; and allowing local providers equal access to each other's poles.

The FCC took several actions to increase spectrum flexibility for use in 5G deployment as part of its comprehensive strategy to Facilitate America's Superiority in 5G Technology (the 5G FAST Plan):

- The FCC established application and bidding procedures for the Spectrum Frontiers auctions of Upper Microwave Flexible Use Service licenses in the 28 GHz (27.5-28.35 GHz) and 24 GHz (24.25-24.45, 24.75-25.25 GHz) bands to speed the deployment of 5G services. The FCC will offer the 28 GHz and 24 GHz band licenses through two auctions with separate application and bidding processes for each auction. The 28 GHz auction commenced on November 14, 2018.
- The FCC sought comment on new opportunities for flexible use in up to 500 megahertz of mid-band spectrum between 3.7 and 4.2 GHz to make more mid-band spectrum available for terrestrial fixed and mobile broadband use and included a proposal to add a mobile (except aeronautical mobile) allocation to the band. The FCC sought comment on proposals for transitioning part or all of the band for flexible use.
- The FCC took steps to make spectrum above 24 GHz available to help support innovative new uses enabled by fiber-fast wireless speeds. The items adopted made available an additional 1700 megahertz of millimeter wave spectrum for terrestrial 5G wireless use, maintained the unlicensed use of the 64-71 GHz band, and modified the FCC's Part 15 rules to allow unlicensed operation on board most aircraft during flight in the 57-71 GHz band.
- The FCC sought comment on actions to promote more flexible and intensive use of the 4.9 GHz band, a segment of spectrum designated for public safety communications.
- The FCC adopted revisions to its rules in the 3.5 GHz band to promote investment, encourage more efficient spectrum use, promote robust network deployments, keep up with technological advancements, and maintain U.S. leadership in the deployment of next-generation services.
- The FCC proposed next steps to prepare the upper 37 GHz, 39 GHz, and 47 GHz bands for auction, presenting an opportunity for 5G deployment. The FCC proposed to transition existing spectrum holdings in the 39 GHz band (38.6-40 GHz) to the new flexible-use band plan to promote the efficient use of spectrum by incumbents and new licensees for new wireless services.

The FCC adopted rules to let television broadcasters use the Next Generation broadcast television transmission standard, Advanced Television Systems Committee (ATSC) 3.0, on a voluntary, market-driven basis. The Next Generation TV standard will let broadcasters provide consumers with more vivid pictures and sound, including Ultra High Definition television and superior reception, mobile viewing capabilities, advanced emergency alerts, better accessibility features, localized content, and interactive educational children's content.

The FCC streamlined, consolidated, and harmonized the rules governing earth stations used to provide satellite-based services on ships, airplanes and vehicles. The FCC integrated the three types of earth stations in motion into a single regulatory category, reducing the burden on applicants leading to a more efficient licensing process.

The FCC adopted requirements to govern an incubator program for full-service AM and FM broadcast stations to assist new, small, or struggling voices, including women and minorities, in overcoming barriers to entry into the broadcast sector. Under the program, an established broadcaster will provide financial and operational support to a new or small broadcaster. At the end of a successful incubation relationship, the new or small broadcaster will either own and operate a new station independently, or the previously struggling broadcaster's station will be on a firmer footing. Once an incubation relationship is completed successfully, the established broadcaster will be eligible to receive a waiver of the Commission's Local Radio Ownership Rule, subject to certain requirements.

PROTECTING CONSUMERS AND PUBLIC SAFETY

Develop policies that promote the public interest by providing consumers with freedom from unwanted and intrusive communications, improving the quality of communications services available to those with disabilities, and protecting public safety.

The FCC has acted aggressively to target and eliminate unlawful robocalls, which are the number one consumer complaint to the FCC from the public.

- The FCC adopted rules allowing phone companies to proactively block calls likely to be fraudulent because they come from certain types of phone numbers. The FCC authorized voice service providers to block robocalls from telephone numbers that do not or cannot make outgoing calls, without running afoul of the FCC's call completion rules.
- The FCC proposed to reduce calls placed by businesses and other legitimate callers to numbers no longer assigned to the consumers who previously consented to receive those calls. The FCC sought comment on ways to address this reassigned numbers problem, including databases to provide callers with the information they need to avoid calling reassigned numbers, and sought feedback on alternative ideas for service providers to report reassigned number information.

The FCC took the following enforcement actions to protect consumers against illegal robocalls:

- The FCC issued a $120 million fine for malicious spoofing that was part of a massive robocalling operation selling timeshares and travel packages. The caller ID spoofing operation made almost 100 million spoofed robocalls and tricked consumers into answering and listening to advertising messages, a practice known as "neighbor spoofing," where calls appear to be local to increase the likelihood that consumers answer the calls.
- The FCC fined a telemarketer more than $82 million for illegal caller ID spoofing. The telemarketer made more than 21 million robocalls to market health insurance. By spoofing its caller ID information,

the telemarketer made it difficult for consumers to register complaints and for law enforcement entities to track and stop the illegal calls.

- The FCC proposed a more than $37.5 million fine against a telemarketer for apparently making millions of illegally-spoofed calls appearing to originate from consumers and other numbers not assigned to the company. The company apparently made more than 2.3 million maliciously-spoofed telemarketing calls to sell home improvement services and apparently manipulated caller ID information.

The FCC's Enforcement Bureau undertook a number of actions and investigations in fulfilling its mission to enforce the Commission's rules and protect consumers from illegal or unfair practices. Results of those actions and investigations included:

- A $2.8 million fine against a company for marketing devices used to relay audio and video from drones to drone operators that could apparently transmit in unauthorized radio frequency bands. Such unlawful transmissions could interfere with key government and public safety services like aviation systems and weather radar systems.
- A civil penalty of $614.3 million paid on behalf of a telecommunications company to the U.S. Treasury in connection with a settlement resolving allegations that the company failed to use the spectrum it was awarded, and thus violated the Commission's buildout and discontinuance rules. The settlement required the company to previously return a portion of its licenses to the Commission (and pay an earlier $15 million civil penalty) and sell its remaining licenses and remit 20 percent of the overall proceeds of the transaction to the U.S. Treasury, which the buyer paid to the U.S. Treasury on behalf of the company. The buyer and the company entered into an agreement to transfer the licenses, and the Commission's Wireless Telecommunications Bureau approved the transfer.
- Settlements with two telecommunications companies – a mobile voice and data service provider and an infrastructure company – in separate but related investigations into whether the companies completed proper tower registration as well as environmental and historic impact reviews prior to construction of wireless infrastructure facilities. The service provider agreed to pay $10 million, and the infrastructure company agreed to pay $1.6 million to the U.S. Treasury and to enhance their internal environmental and historic preservation review compliance procedures.
- A settlement in which a telecommunications company agreed to pay $40 million to the U.S. Treasury to end an investigation by the FCC into whether the company violated the Communications Act when it failed to correct problems with the delivery of calls to rural consumers as well as whether it violated the FCC rule that prohibits providers from inserting false ringtones for hundreds of millions of calls.
- A Notice of Apparent Liability and proposed penalty of $5.3 million to a phone company which apparently switched consumers from their preferred carrier to this company without permission, misled consumers into believing that telemarketing calls were from the consumer's current carrier, and added unauthorized charges to bills.
- A proposed $18.7 million fine against a telecommunications company for apparent violations involving the Universal Service Fund Rural Health Care Program. The telecommunications services provider was charged with violating the Communications Act, the program's competitive bidding rules, and using forged, false, misleading, and unsubstantiated documents to improperly seek funding from the Universal Service Fund.
- A proposed $13.4 million fine against a broadcast company for apparently failing to make required disclosures in connection with the Commission's sponsor identification rules.

- Completion of 348 public safety investigations, which include resolving interference to first responder communications systems and to federally authorized communications and radar systems, as well as investigating obstruction lighting issues related to antenna supporting structures (towers).
- More than 130 enforcement actions against unauthorized broadcast "pirate" radio operators, including 129 Notices of Unauthorized Operation, three Notices of Apparent Liability for Forfeiture totaling more than $184,000, two Forfeiture Orders for $18,800, and one Consent Decree for $2,500.

The FCC proposed rules to implement Kari's Law, requiring that multi-line telephone systems that serve consumers in office buildings, campuses, and hotels enable users to dial 911 directly, without having to dial a prefix to reach an outside line, and providing for notification to a front desk or security office when a 911 call is made. Pursuant to the RAY BAUM'S Act (Division P of P.L. 115-141), the FCC also sought comment on whether the Commission should adopt rules to ensure that "dispatchable location" is conveyed with 911 calls, regardless of the technological platform used.

The FCC set forth procedures for authorized state and local officials to conduct "live code" tests of the Emergency Alert System (EAS), using the same alert codes and processes as would be used in actual emergencies. The action also required EAS equipment to be configured to help prevent false alerts and required an EAS participant to inform the Commission if it discovers that it has transmitted a false alert.

The FCC approved additional immediate funding to accelerate the restoration of communications networks in Puerto Rico and the U.S. Virgin Islands that were damaged and destroyed during the 2017 hurricane season. The FCC provided an immediate infusion of approximately $64.2 million for short-term restoration efforts and conversion of $65.8 million in advanced funding to new funding. The FCC also sought comment on allocating approximately $444.5 million in medium and long-range funding for Puerto Rico and $186.5 million for the U.S. Virgin Islands over the next decade for the expansion of fixed broadband connectivity.

The FCC established the Alert Reporting System (ARS), an online filing system for the Emergency Alert System (EAS), by combining the existing EAS Test Reporting System (ETRS) with a new, streamlined electronic system for the filing of State EAS Plans. ARS will replace paper-based filing requirements, minimize the burdens on State Emergency Communications Committees, and allow the FCC, the Federal Emergency Management Agency, and other authorized entities to better access and use up-to-date information about the EAS.

The FCC approved emergency assistance to restore connectivity in schools and libraries affected by Hurricanes Harvey, Irma, and Maria through the agency's E-rate program. Schools and libraries directly impacted by the storms were able to request additional funding for restoration of broadband services and receive the maximum E-rate discount on services and increased program flexibility as they worked to restore services. The FCC also enacted measures to protect against waste, fraud, and abuse during the recovery effort.

The FCC added a "Blue Alert" option to the nation's emergency alerting systems which can be used by state and local authorities to notify the public of threats to law enforcement and to help apprehend dangerous suspects. The FCC created a dedicated Blue Alert event code in the EAS so that state and local agencies have the option to send these warnings to the public through broadcast, cable, satellite, and wireline video providers or through the Wireless Emergency Alerts (WEA) system to consumers' wireless phones.

On January 13, the Hawaii Emergency Management Agency initiated a false ballistic missile alert, using the WEA system and the EAS. The Public Safety and Homeland Security Bureau investigated the circumstances that led to this error and issued a report with their findings and recommendations. The Bureau found that a combination of human error and inadequate safeguards contributed to the transmission of the false alert. The Bureau made several recommendations to provide guidance to state, local, Tribal, and territorial emergency alert originators and managers about "lessons learned" from the Bureau's investigation.

The FCC adopted an Order to improve the geographic targeting of WEA. The Order requires participating wireless providers to deliver WEA alerts in a more geographically precise manner so that the alerts reach the communities impacted by an emergency without disturbing others.

The FCC voted to allow law enforcement authorities – under specific circumstances – to access blocked caller ID information when needed to identify and thwart threatening callers. The Commission's action created an exemption to a rule prohibiting carriers from disclosing blocked caller ID information. Previously, a school, religious institution, or other organization which received threatening calls had to request a case-by-case waiver from the Commission.

The FCC sought comment on reforms to the system governing intercarrier payments for toll free calling, and to eliminate the financial incentive for abusive calling practices, including fraudulent or unnecessary robocalling to toll free numbers. The FCC sought comment on transitioning the toll free intercarrier compensation system to a "bill-and-keep" regime under which each carrier recovers revenues from its own subscribers rather than other carriers.

The FCC proposed rules to prevent the fraudulent use of toll free numbers in text messaging and clarified that a text messaging provider may not text-enable a toll-free number without first obtaining authorization from the subscriber. The FCC clarified that messaging providers must disable toll free texting upon request by the subscriber.

The FCC approved new rules to protect consumers from slamming, the unauthorized change of a consumer's preferred telephone company, and cramming, the placement of unauthorized charges on a consumer's phone bill. The Commission's rules now include a clear ban on misrepresentations made during sales calls and provide that such material misrepresentations invalidate any authorization given by a consumer to switch telephone companies. The Commission's rules also now include an explicit prohibition against placing unauthorized charges on consumers' phone bills.

With the initial implementation of the Improving Rural Call Quality and Reliability Act of 2017, the FCC adopted rules to tackle the problem of rural call completion and ensure the integrity of the nation's telephone network and prevent unjust or unreasonable discrimination in the delivery of telephone service. The FCC also established a registry for intermediate providers to register with the Commission before offering to transmit covered voice communications.

The FCC sought comment on the regulatory and technological changes required to implement complete nationwide number portability between all service providers, regardless of size or type. Number portability enables consumers and businesses to keep their current phone number when changing providers or, in some instances, when moving to a new location.

The FCC sought comment on a proposal to prohibit the use of Universal Service Funds on the purchase of equipment or services from any company that poses a national security threat to the integrity of U.S. communications networks or the communications supply chain. The FCC also sought comment on what types of equipment and services should be covered and the costs and benefits of the proposed rule.

The FCC updated its rules for hearing aid compatibility and volume control on wireline and wireless telephones. The FCC also implemented a provision of the Twenty-First Century Communications and Video Accessibility Act to apply all of the Commission's hearing aid compatibility requirements to wireline telephones used with advanced communication services, including phones used with Voice-over-Internet-Protocol services, with compliance to be achieved within two years.

The FCC adopted reforms to Internet Protocol Captioned Telephone Service (IP CTS), a form of telecommunications relay service (TRS) that allows individuals with hearing loss to both read captions and use their residual hearing to understand a telephone conversation. The Commission modernized IP CTS by allowing service providers to use fully automated speech recognition to produce captions, if providers meet the agency's minimum TRS standards.

REFORMING THE FCC'S PROCESSES

Modernize and streamline the FCC's operations and programs to increase transparency, improve decision-making, build consensus, reduce regulatory burdens, and simplify the public's interactions with the agency.

The FCC took actions to modernize and streamline the FCC's operations and programs to increase transparency, improve decision-making, build consensus, modernize or eliminate outdated rules, reduce regulatory burdens, and simplify the public's interactions with the agency.

The FCC continued its Modernization of Media Regulation Initiative, to reduce unnecessary regulation in the media marketplace by identifying rules that are outdated, unnecessary, or unduly burdensome. This effort included the following proceedings by the FCC:

- Eliminated Form 325, which annually collected information about cable systems, finding that the form had become increasingly obsolete.
- Eliminated the broadcast main studio rule requiring each AM radio, FM radio, and television broadcast station to have a main studio located in or near its local community.
- Eliminated rules requiring low power TV, TV and FM translators, TV and FM booster stations, cable television relay station licensees, and certain cable operators to maintain paper copies of the Commission's regulations.
- Sought comment on updating its leased access rules, which require cable operators to set aside channel capacity for commercial use by unaffiliated video programmers. Also sought input on the state of the leased access marketplace, and ways to modernize existing leased access rules.
- Proposed eliminating the rule requiring cable operators to maintain a current listing of cable television channels at their local office and tentatively concluded that the requirement is no longer necessary now that channel lineup information is available through websites, on-screen electronic program guides, and paper guides. Also sought comment on eliminating the requirement that certain cable operators make their channel lineup available via their online public inspection file.
- Proposed streamlining the process for reauthorizing television satellite stations when they are assigned or transferred in combination with their previously approved parent station.
- Proposed eliminating the Broadcast Mid-Term Report (Form 397) and instead relying on publicly available information. Tentatively concluded that the requirement to file Form 397 is unnecessary for the FCC to conduct its mid-term Equal Employment Opportunity reviews.
- Proposed allowing multichannel video programming distributors to communicate with their subscribers in more efficient and less costly ways, such as sending general written notices and subscriber notifications to subscribers by email, subject to certain consumer safeguards.
- Adopted rules eliminating the requirement that broadcasters file paper copies of station contracts with the FCC. Based on the Commission's action, broadcasters now have the option of either posting these documents online in their public inspection file or maintaining an up-to-date list in their online file and providing copies to any requesting party within seven days.
- Adopted rules to require only those digital television (DTV) stations that have provided feeable ancillary or supplementary services to report to the FCC annually on those activities. Previously, the

FCC required all DTV stations to file this report, regardless of whether they had provided ancillary or supplementary services or received revenue from those services. The FCC's action will allow the Commission to continue to fulfill its statutory obligations while sparing thousands of DTV stations from expending time and resources to file this report.

- Sought comment on proposed revisions to the children's television programming rules, including the criteria that children's programming must meet to be considered Core Programming, which require that programming be at least 30 minutes in length and regularly scheduled. Also sought comment on whether to update the three-hour per week processing guideline to determine compliance with the children's programming rules and sought comment on streamlining reporting requirements.
- Proposed streamlining FM translator interference complaint and remediation procedures to: provide greater certainty to full-power stations regarding complaint requirements, limit contentious factual disputes, and ensure prompt and consistent relief.

The FCC streamlined and consolidated procedural rules governing formal complaints against common carriers, formal complaints regarding pole attachments, and formal complaints concerning the accessibility of telecommunications and advanced communications services and equipment for people with disabilities. The Commission committed to the goal of meeting a 270-day shot clock for resolution of formal complaints (except for complaints already subject to a shorter deadline).

The FCC eliminated obsolete and unnecessary regulatory burdens applicable to the Cellular Service and other Part 22 licensees. Licensees no longer need to retain hard copies of station authorizations and other station records or maintain station control points and personnel on duty at those control points.

The FCC eliminated the requirement that U.S. providers of international telecommunications services file annual Traffic and Revenue Reports. The FCC also streamlined the requirements for filing Circuit Capacity Reports.

The FCC adopted an Order lifting outdated payphone industry rules that are no longer necessary as payphone revenues have plummeted due to a changing communications marketplace. The Commission also eliminated costly payphone audit requirements.

The FCC voted to create an Office of Economics and Analytics (OEA) to help ensure that economic analysis is consistently incorporated as part of the agency's regular operations. The OEA will bring into one office existing FCC economists, attorneys, and data professionals who work on economic analysis, data policy and management, and research. The new office will provide economic analysis for rulemakings, transactions, adjudications, and other Commission actions and will manage the FCC's auctions program and significant FCC data collections.

The FCC voted to move the audit and enforcement responsibilities associated with the Equal Employment Opportunity rules from the Media Bureau to the Enforcement Bureau. Transferring enforcement of these rules to the Enforcement Bureau can better ensure that the communications companies subject to these rules give all qualified individuals an opportunity to apply and be considered as job candidates.

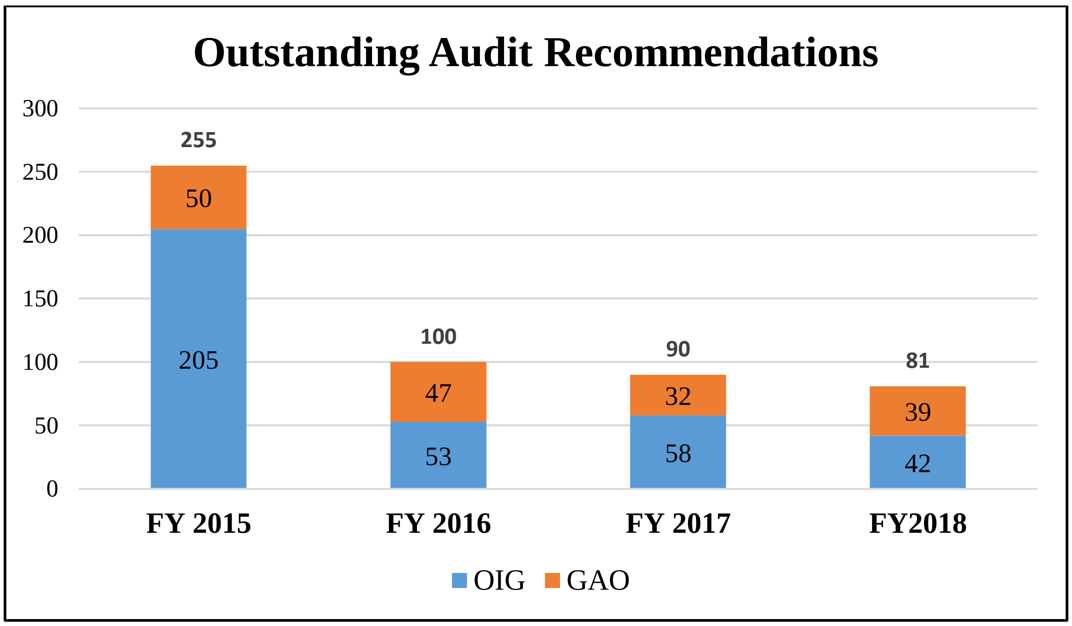
The FCC adopted rules eliminating an outdated list of services meeting the statutory definition of commercial mobile radio service, eliminated unnecessary filings, and harmonized the Commission's licensing rules across spectrum bands. The FCC also allowed licensees to identify the nature and regulatory treatment of their mobile services based on how they use spectrum, rather than based on the specific spectrum band used to provide such service.

The FCC launched an online dashboard to provide the public with more information on the agency's work. The dashboard helps consumers access reports and graphics on FCC workloads, pending applications, petitions, complaints, license renewals, and other accountability matrices.

The FCC also improved accessibility to its Freedom of Information Act (FOIA) materials by making it easier for the public to access and navigate search tools for reviewing FCC FOIA responses and to file requests for information.

Overall Status of Audit Recommendations

The chart below shows the number of audit recommendations outstanding from various audits conducted by FCC's Office of Inspector General (OIG) and the Government Accountability Office (GAO). In FY 2018, the Commission closed 102 outstanding recommendations, received 93 new recommendations and finished the fiscal year with a total of 81 open recommendations.



Management Assurances

MANAGEMENT ASSURANCES PURSUANT TO THE 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.

In accordance with Office of Management and Budget (OMB) guidance related to FMFIA, OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, the Commission maintains internal controls for financial and management reporting that provide reasonable assurance that the consolidated 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. Furthermore, the Commission's internal controls provide for the reliability and completeness of its financial and performance data.

The FY 2017 auditors' report identified no material weaknesses in internal controls but included significant deficiencies in the following areas: 1) Universal Service Fund Budgetary Accounting and 2) Information Technology. During FY 2018, the FCC worked to develop corrective action plans to remediate the recommendations associated with these findings. First, with regard to addressing the significant deficiency for Universal Service Fund Budgetary Accounting, the Commission made progress, but more work remains to correct this issue. Second, with respect to the significant deficiency related to Information Technology, the Commission has worked diligently in FY 2018 to develop corrective action plans to fully address the auditors' recommendations and remediate this finding. The Commission will make every effort in FY 2019 to implement corrective action plans for each of the recommendations associated with these findings to avoid any repeat findings in these areas.

Status of Internal Controls – Section 2 of FMFIA

During FY 2018, the Commission continued its efforts to improve and strengthen its internal controls over operations and financial reporting by building upon continuing improvements to its risk assessment processes. Beginning in FY 2015, the Commission implemented new risk assessment tools to update its pre-existing processes for internal control evaluation. The FCC made this improvement both at the FCC and at its reporting components, including USF and TRS. The FCC's updated risk assessment process integrates the latest versions of the Government Accountability Office's (GAO), *Standards for Internal Control in the Federal Government* (Green Book), as well as OMB's Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. Utilizing GAO's Green Book as a blueprint, the FCC implemented an entity level risk assessment tool that is completed each fiscal year by its largest Bureaus and Offices as well as its reporting components. Furthermore, the Commission uses an additional program risk assessment tool for higher risk areas, such as the USF programs, TRS, and NANP, as well as functions related to auctions, contracts, financial operations, human resources, and information technology. In FY 2017, building upon the FCC's improvements from recent years, the FCC updated the entity level risk assessment process to include enterprise risk management (ERM), pursuant to OMB Circular A-123. In FY 2018, the FCC revised its oversight of its ERM implementation by establishing the FCC ERM Performance Council (FERMPerC). The

FERMPerC includes representatives from across the FCC's Bureaus and Offices. The FERMPerC is working to more fully integrate the FCC's internal control assessment processes into the operations of the FCC's Bureaus and Offices while also identifying, monitoring, and mitigating risks throughout the year. While the Commission has received unmodified opinions over its consolidated financial statements for several consecutive years, the Commission understands that maintaining proper internal controls requires continuous review of its internal controls and implementing improvements to them on an ongoing basis.

Financial Management Systems – Section 4 of FMFIA

Section 4 of FMFIA requires agencies to evaluate annually whether the agency's financial management systems conform to government-wide requirements. In FY 2018, the Commission's financial management systems were in compliance with government-wide requirements. The Commission continues to work with its reporting components on their financial systems.

Statement of Assurance

FCC management is responsible for managing risks and maintaining effective internal controls to meet the objectives of Sections 2 and 4 of FMFIA. The FCC conducted its assessment of risk and internal control in accordance with OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. Based on the results of the assessment, the FCC can provide reasonable assurance that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2018, with the exception of one material weakness in Universal Service Fund Budgetary Accounting.

Ajit Pai
Chairman
November 15, 2018

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 reports, and access controls. 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 implementation of best practices.

The financial management system continues to support the accounting for the auctions programs at the FCC, including the activities under the Spectrum Act, which provided for the relocation of the broadcast television spectrum in conjunction with an incentive auction in which television licensees voluntarily relinquish spectrum usage rights ("reverse auction") in exchange for a share of the proceeds from the sale of repurposed spectrum to wireless providers ("forward auction"). In FY 2018, additional financial systems support included accounting for the reimbursements made from the $1.75 billion TV Broadcaster Relocation Fund for costs incurred by eligible entities in order to continue to carry the signals of stations relocating to a new channel as a result of the repacking process or a winning reverse auction bid.

The Genesis financial system supports paperless and efficiency initiatives by reducing the paper chain associated with the document review process and by reducing, and/or eliminating, instances of duplicate data entry into multiple disparate systems. Genesis provides a web enabled self-service capability for the Bureaus and Offices to execute accounting functions, including business analytics for decision making. The results of these continued modernization initiatives have facilitated a continued reduction in contract support.

The FCC's vision for the future of Genesis is to maintain a steady state and optimize Genesis to fully benefit from the previous large-scale level of effort required to configure, design, develop, test, and implement Genesis. This approach supports the FCC's ongoing continuous monitoring review of Genesis, allowing for system stability and for better aligning financial system activities with the Commission's business management goals. In September 2018, the FCC awarded a multiple option year follow-on contract which meets the Commission's requirements for the continued optimization of the current financial system configuration and continued system maturity and stability.

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 allow financial coordination with our reporting components.

In support of the incentive auction program and the reimbursement of the TV Broadcaster Relocation Fund, the financial operations team continues to improve its payment systems to be more efficient and to eliminate paper-based processes. For example, the Commission updated the Commission Registration System (CORES) system to allow reimbursement eligible entities the ability to enter their payment banking information into CORES and to view the entity's available balance for reimbursement and the history of payments made to the entity.

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's financial statements is part of the continual process 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 thirteen 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 July 30, 2018.

This section presents a summary analysis of key information from the financial statements. 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 2018 and FY 2017 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 2018

Consolidated

(Dollars in Thousands)

Net Financial Condition		**FY 2018**		**FY 2017**		**Increase (Decrease)**	**Percentage Change in Financial Position**
Intragovernmental							
Fund Balance with Treasury	$	11,097,827	$	12,790,101	$	(1,692,274)	-13%
Investments		2,886,961		7,101,239		(4,214,278)	-59%
Accounts Receivable		429		491		(62)	-13%
Other		1,866		4,373		(2,507)	-57%
Total Intragovernmental	$	13,987,083	$	19,896,204	$	(5,909,121)	-30%
Cash and Other Monetary Assets	$	1,698	$	113,743	$	(112,045)	-99%
Accounts Receivable, net		783,380		718,905		64,475	9%
General Property & Equipment, net		78,013		62,117		15,896	26%
Other		18,024		13,024		5,000	38%
Total Assets	**$**	**14,868,198**	**$**	**20,803,993**	$	(5,935,795)	-29%
Intragovernmental							
Accounts Payable	$	3,186	$	534	$	2,652	497%
Custodial		3,511,422		8,637,202		(5,125,780)	-59%
Other		2,620		5,665		(3,045)	-54%
Total Intragovernmental	$	3,517,228	$	8,643,401	$	(5,126,173)	-59%
Accounts Payable	$	551,499	$	264,016	$	287,483	109%
Federal Employee and Veteran Benefits		2,984		2,978		6	0%
Deferred Revenue		1,205,713		2,114,141		(908,428)	-43%
Prepaid Contributions		36,252		42,852		(6,600)	-15%
Accrued Liabilities for Universal Service		524,358		515,910		8,448	2%
Other		38,971		32,163		6,808	21%
Total Liabilities	**$**	**5,877,005**	**$**	**11,615,461**	$	(5,738,456)	-49%
Unexpended Appropriations - Funds from Dedidcated Collections	$	600,000			$	600,000	100%
Unexpended Appropriations - All Other Funds		2,816		2,820		(4)	0%
Cumulative Results of Operations - Funds from Dedicated Collection		8,077,259		8,907,714		(830,455)	-9%
Cumulative Results of Operations - All Other Funds		311,118		277,998		33,120	12%
Total Net Position - Funds from Dedicated Collections	$	8,677,259	$	8,907,714	$	(230,455)	-3%
Total Net Position - All Other Funds	$	313,934	$	277,998	$	35,936	13%
Total Net Position	**$**	**8,991,193**	**$**	**9,188,532**	$	(197,339)	-2%
Total Liabilities and Net Position	**$**	**14,868,198**	**$**	**20,803,993**	$	(5,935,795)	-29%
Net Cost of Operations	**$**	**10,326,473**	**$**	**10,156,667**	$	169,806	2%
Total Budgetary Resources	**$**	**5,741,165**	**$**	**10,918,374**	$	(5,177,209)	-47%

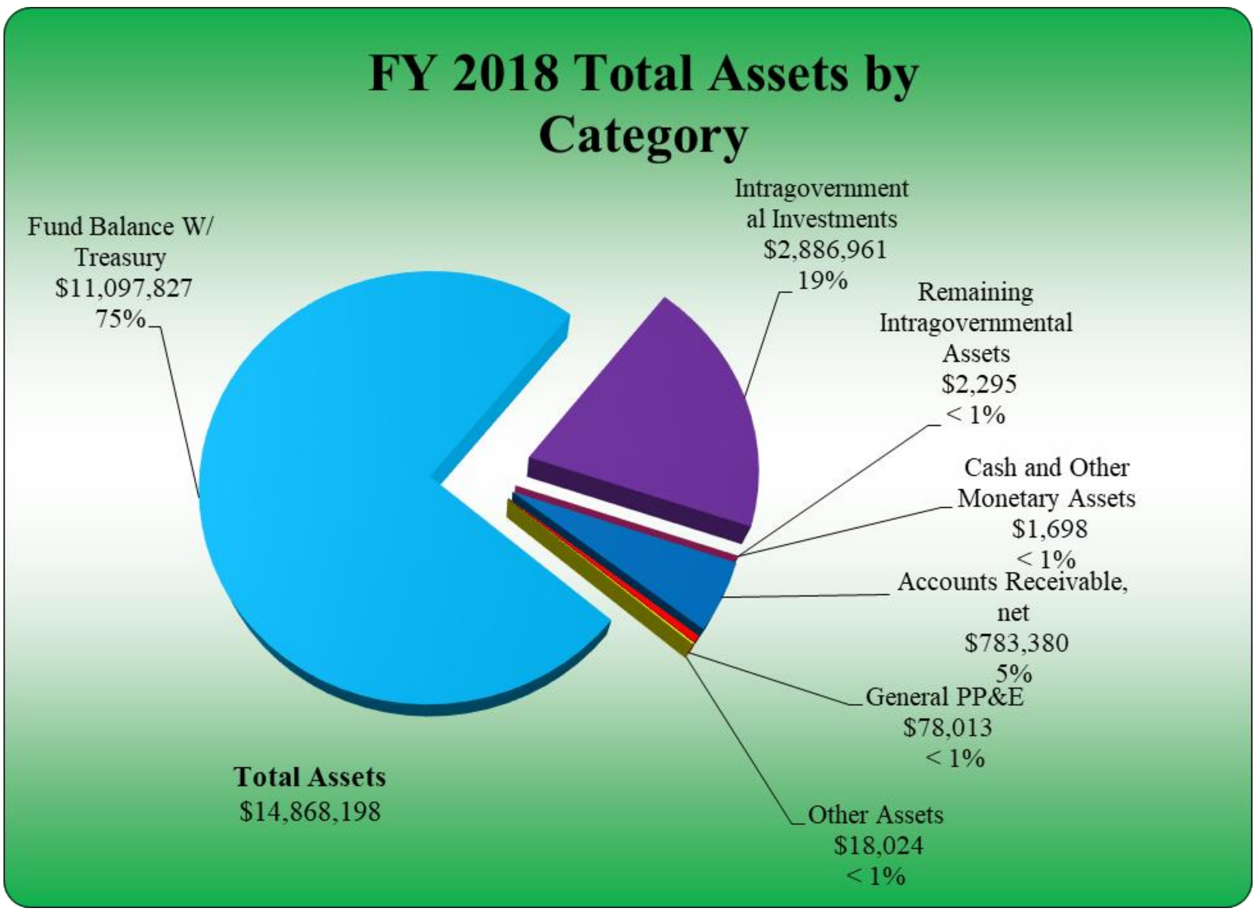
The following is a brief description of the nature of each required financial statement and its relevance, including a description of certain significant balances on Commission operations.

*<u>Consolidated Balance Sheet</u>***:** 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). Fund Balance with Treasury and Investments represent 94 percent of total assets as of September 30, 2018.

The graph below presents the total assets of the Commission as of September 30, 2018. The Fund Balance with Treasury balance of $11,098 million, mainly results from the auction and USF activities. During FY 2018, USAC began moving the USF funds held by a private banking institution to a newly established account within the Treasury.

The Intragovernmental Investment balance of $2,887 million mainly results from carryover in the USF School and Libraries Program and funds reserved for the High Cost support mechanisms.

The Accounts Receivable balance of $783 million is primarily composed of USF receivables totaling $663 million.

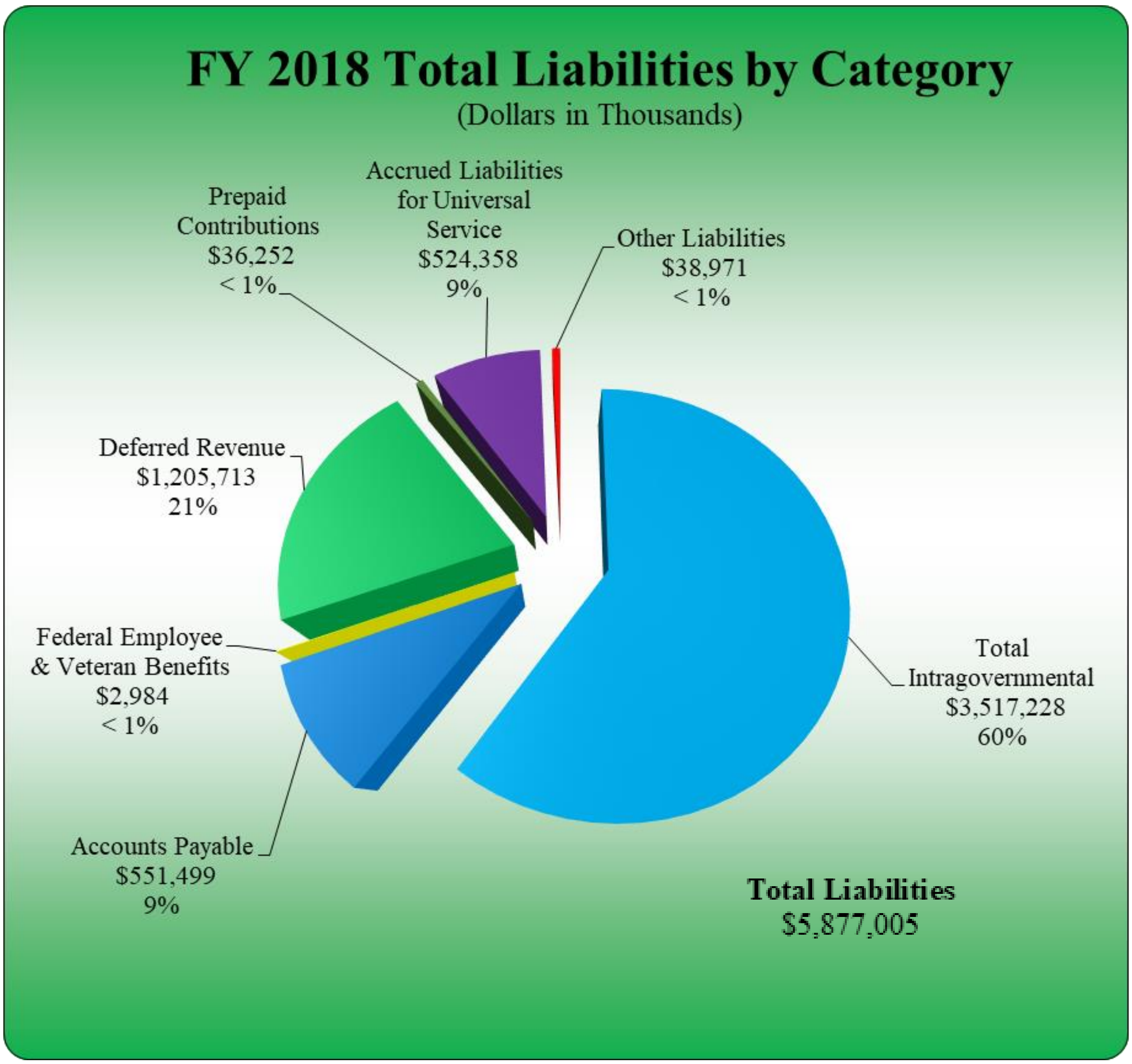


The graph below presents the total liabilities of the Commission as of September 30, 2018. The Commission's most significant liabilities are Total Intragovernmental of $3,517 million, and Deferred Revenue of $1,206 million, which combined account for 81 percent of total liabilities as of September 30, 2018.

The Total Intragovernmental amount is primarily composed of custodial collections earned on spectrum auctions and miscellaneous receipts.

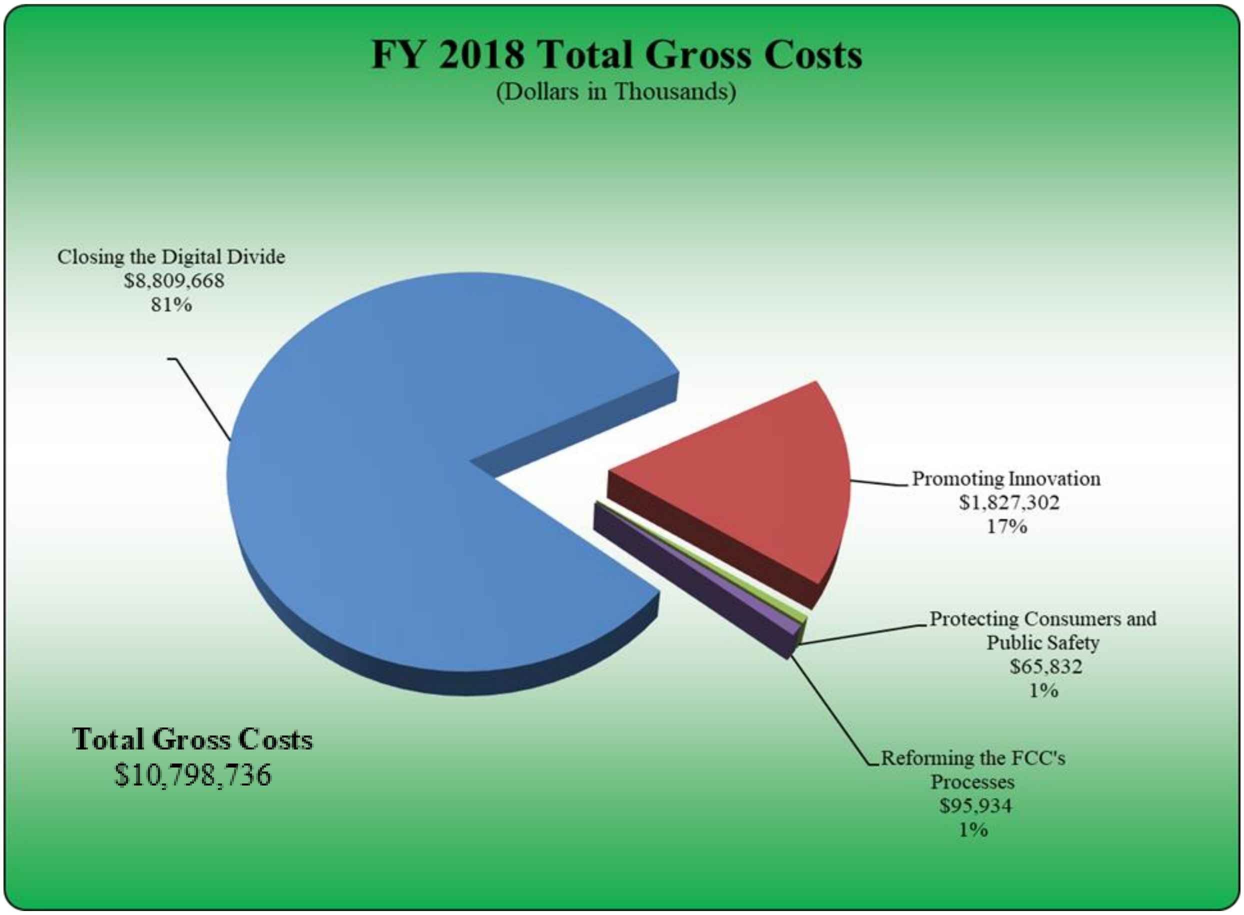
The Deferred Revenue balance is mainly due to a few remaining licenses from the forward auction of the Incentive Auction that have not been granted as of September 30, 2018.

The Accrued Liabilities for Universal Service represent the expected October (FY 2019) payments for the TRS Program and the USF's High Cost and Lifeline Programs.



Consolidated Statement of Net Cost: This statement presents the annual cost of operating the Commission's programs. The Consolidated Statement of Net Cost is aligned with the four strategic goals of the Commission: Closing the Digital Divide; Promoting Innovation; Protecting Consumers and Public Safety; and Reforming the FCC's Processes. Gross costs for each goal are presented individually while revenue is presented in total rather than by goal. The program costs for USF are allocated to two strategic goals, Closing the Digital Divide and Promoting Innovation, and the program costs for TRS are allocated to the strategic goal of Closing the Digital Divide. Due to 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.

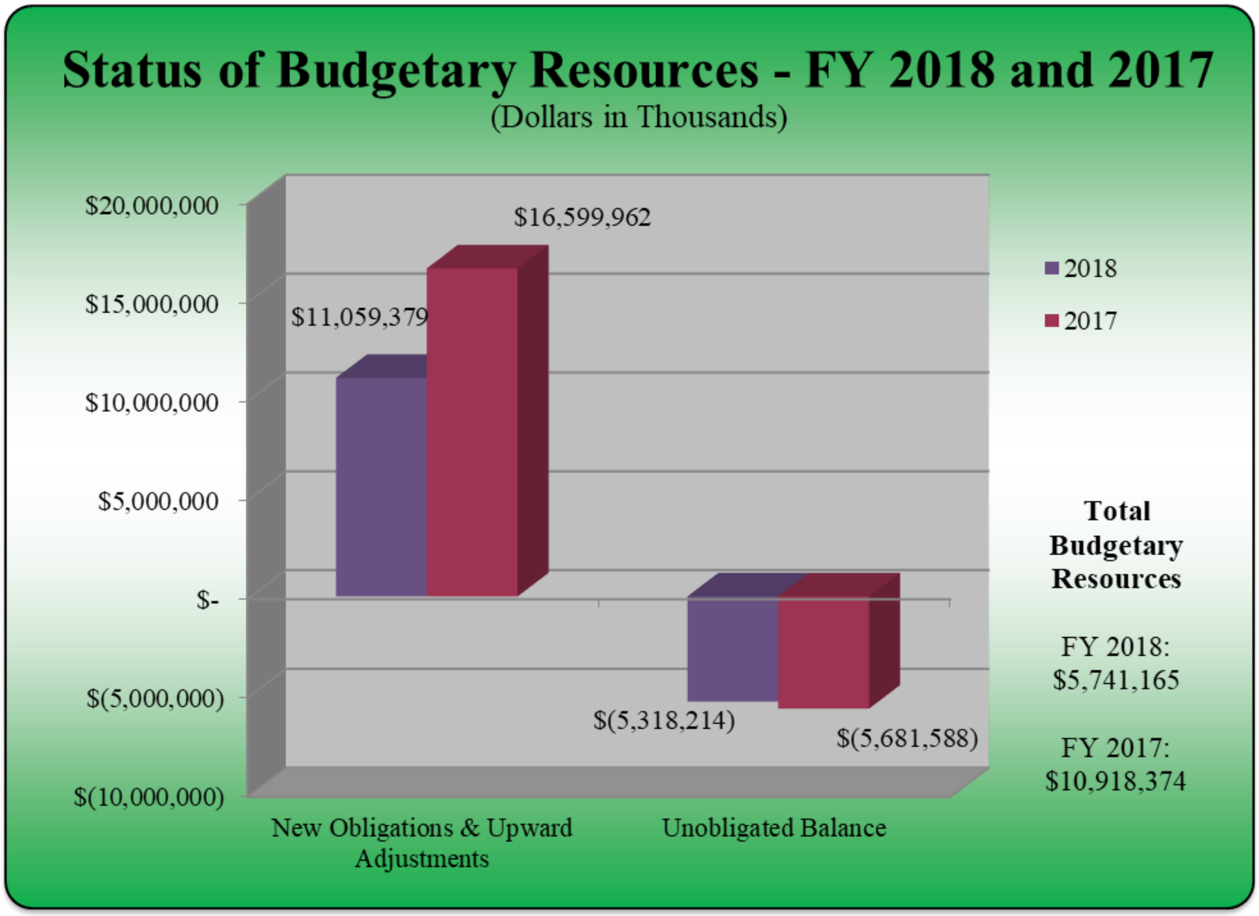
The graph below presents the total gross costs of each Commission program.



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 2018, the Commission's Net Position decreased $198 million or two percent to $8,991 million compared to the net position of $9,189 million for FY 2017.

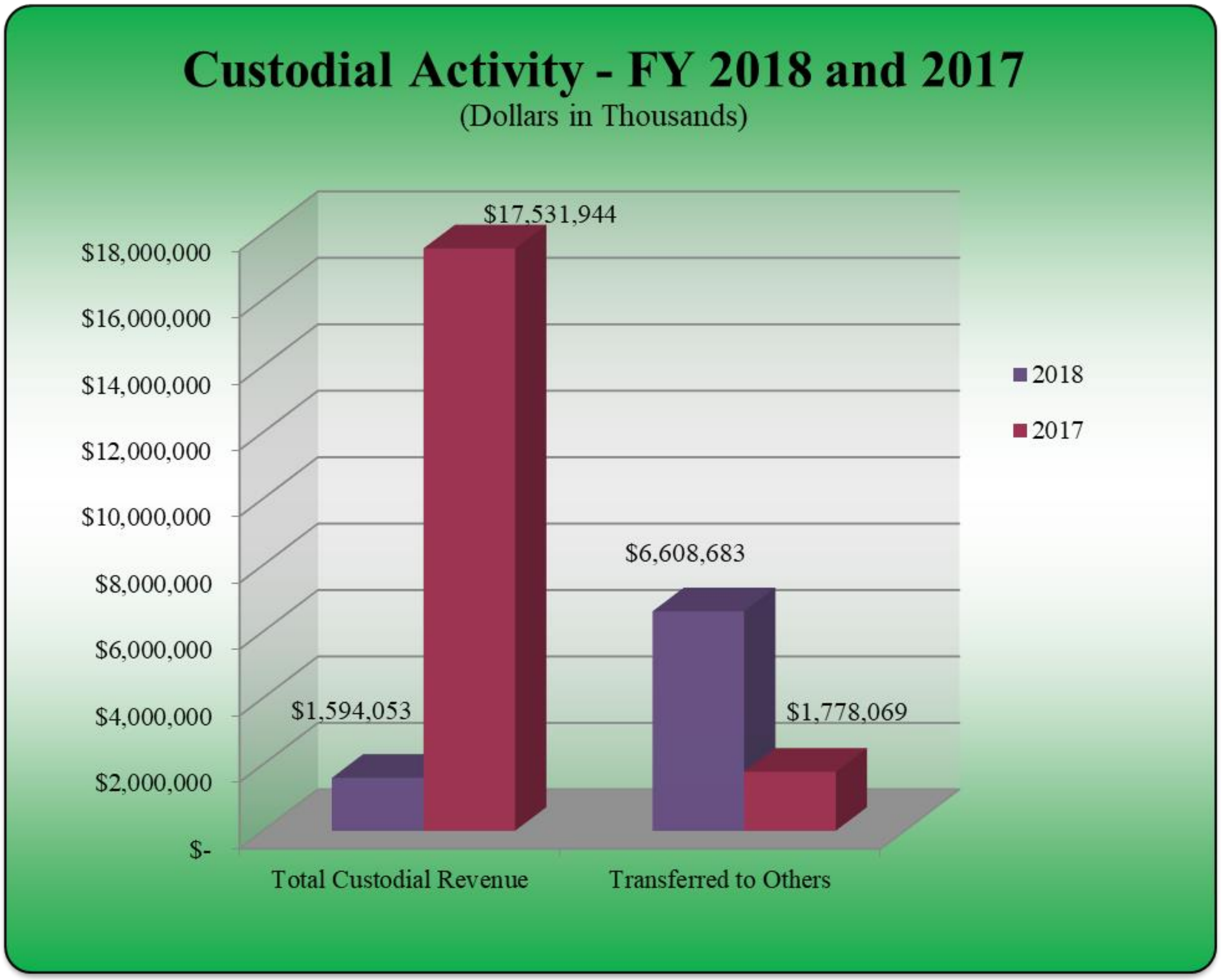
Combined Statement of Budgetary Resources: This statement provides information on how budgetary resources were made available to the Commission for the year and the status of those budgetary resources at the end of the year. The Commission receives most of its budgetary authority from appropriations. 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. At the end of FY 2018, the Commission had $5,741 million in budgetary resources, based on $11,059 million in new obligations and upward adjustments and $(5,318) million in unobligated funds. The abnormal balances in FY 2018 and FY 2017 are related to the Connect America Fund (CAF) Phase II and Rate of Return obligations. However, CAF and Rate of Return are programs within USF and exempt by Congress from the provisions of the Antideficiency Act through December 31, 2019.

The chart below presents the status of budgetary resources comparatively between FY 2018 and FY 2017.



Consolidated Statement of Custodial Activity: The Commission recognized $1,594 million of custodial revenue during FY 2018. In FY 2017, the Commission recognized $17,532 million of custodial revenue. From this balance, $10,033 million in auction funds was paid for incentive payments to winning bidders in the reverse auction of the Incentive Auction, and $1,750 million in auction funds was transferred to the TV Broadcaster Relocation Fund. In FY 2018, the Commission transferred $5,895 million of Incentive Auction and Auction 97 proceeds to the Public Safety Trust Fund managed by the National Telecommunication and Information Administration, and $1 million from other spectrum auctions to the Treasury General Fund.

The chart below presents the total amount of custodial revenue and amounts transferred to others comparatively between FY 2018 and FY 2017.



Other Key Financial Statement Highlights

Regulatory Fee Collections

Pursuant to 47 U.S.C. § 159, the Commission annually collects regulatory fees and retains them to offset certain costs incurred by the Commission. 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 2018, the Commission was required to collect $322 million in regulatory fees. Actual collections were slightly over $331 million. The RAY BAUM'S Act requires the Commission to transfer all excess collections for FY 2018 and prior years to the General Fund of the Treasury for the sole purpose of deficit reduction. That RAY BAUM'S Act also requires transferring any excess collections in FY 2019 and in subsequent years to the General Fund of the Treasury for the sole purpose of deficit reduction.

Limitations on the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the FCC, 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. 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 U.S. Government, a sovereign entity.

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2. FINANCIAL STATEMENTS AND AUDITOR'S REPORT

Transmittal from Office of Inspector General

UNITED STATES GOVERNMENT
FEDERAL COMMUNICATIONS COMMISSION
Office of Inspector General

MEMORANDUM

DATE: November 15, 2018

TO: Chairman

FROM: Inspector General FOR AM

SUBJECT: Audit of the Federal Communications Commission's Financial Statements for Fiscal Year 2018

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 Kearney & Company, P.C. (Kearney) to audit, in accordance with generally accepted government auditing standards, the fiscal year 2018 financial statements of the Federal Communications Commission (FCC).

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

- The financial statements were fairly presented in all material respects, in conformity with U.S. generally accepted accounting principles.
- A material weakness exists related to Universal Service Fund Budgetary Accounting.
- A significant deficiency exists related to information technology controls at FCC and USAC.

The OIG reviewed Kearney's reports and related documentation and made necessary inquires of Kearney's representatives. Kearney is wholly responsible for the attached report, dated November 15, 2018, and the conclusions expressed therein. Our review, while still ongoing, did not disclose any instances where Kearney did not comply, in all material respects, with Government Auditing Standards.

The Office of Inspector General appreciates the cooperation and courtesies you extended to our staff and the staff of Kearney & Company, P.C. during the audit.

cc: Managing Director
Chief of Staff
Chief Financial Officer
Chief Information Officer

KEARNEY&
COMPANY

INDEPENDENT AUDITOR'S REPORT

To the Chairman, Managing Director, and the Inspector General of the 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 sheet as of September 30, 2018 and 2017, the related consolidated statements of net cost, changes in net position, and custodial activity, and the combined statement of budgetary resources (hereinafter referred to as the "financial statements") for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these 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. 19-01, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 19-01 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 financial statements to design audit procedures that are appropriate under 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 financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FCC as of September 30, 2018 and 2017, and its net costs, changes in net position, custodial activities, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Budgetary Resources by Major Account (hereinafter referred to as the "required supplementary information") sections to be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by OMB and the Federal Accounting Standards Advisory Board, which consider it to be an essential part of financial reporting for placing the 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 it for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the 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 financial statements as a whole. The information in the *Message from the Chairman* and the *Other Information* sections is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements; accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards* and OMB Bulletin No. 19-01, we have also issued reports, dated November 15, 2018, on our consideration of FCC's internal control over financial reporting and on our tests of FCC's compliance with provisions of applicable laws, regulations, and contracts for the year ended September 30, 2018. 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 internal control over financial reporting or on compliance.

Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-01, and they should be considered in assessing the results of our audits.

Kearney & Company

Alexandria, Virginia
November 15, 2018

KEARNEY& COMPANY

INDEPENDENT AUDITOR’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Chairman, Managing Director, and the Inspector General of the Federal Communications Commission

We have audited the consolidated financial statements of the Federal Communications Commission (FCC) as of and for the year ended September 30, 2018, and we have issued our report thereon dated November 15, 2018. We conducted our audit 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. 19-01, *Audit Requirements for Federal Financial Statements*.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered 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 financial statements, but not for the purpose of expressing an opinion on the effectiveness of FCC’s internal control. Accordingly, we do not express an opinion on the effectiveness of FCC’s internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-01. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers’ Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the following sections, we identified certain deficiencies in internal control that we consider to be a material weakness and a significant deficiency.

We noted certain additional matters involving internal control over financial reporting that we will report to FCC’s management in a separate letter.

Material Weakness

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 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.

I. Universal Service Fund Budgetary Accounting

Through the Universal Service Fund's (USF) Schools and Libraries (S&L) program, FCC helps schools and libraries obtain affordable broadband internet. This includes help paying for recurring costs, such as monthly internet bills, and non-recurring costs, such as the purchase and installation of equipment. The Universal Service Administrative Company (USAC), with the assistance of a third-party service provider, administers the S&L program on behalf of FCC. We found several control deficiencies relating to USAC and FCC's ability to ensure that S&L program budgetary accounting entries were complete and accurate. In aggregate, we consider the deficiencies described in this section to be a material weakness.

Eligible schools, school districts, and libraries apply to participate in the S&L program. Once accepted into the program, USAC issues a Funding Commitment Decision Letter (FCDL). The FCDL communicates acceptance into the program and relevant conditions, including the type of services USAC will reimburse, the maximum amount eligible for reimbursement, and the date by which the invoices must be submitted. When USAC issues a FCDL, accounting personnel record an obligation in USAC's accounting system. As invoices are paid, USAC's accounting personnel reduce the obligated balance. The applicant submits Form 486, *Receipt of Service Confirmation and Children's Internet Protection Act Certification Form*, to USAC. Form 486 communicates to USAC that services have started (or, in certain circumstances, will start) and authorizes the payment of invoices which reduces the obligated balance. For FCDLs issued with a prior fund year, if USAC does not approve and process Form 486 in E-Rate Productivity Center (EPC) prior to the FCDL's expiration, the FCDL would be erroneously de-obligated.

Subsequent to the issuance of a FCDL, eligible applicants are able to request updates to their FCDLs through a FCC Form 500, *Funding Commitment Adjustment Request*. Form 500 is used to submit various types of changes to funding requests after USAC has issued commitments for those requests. Applicants file a FCC Form 500 to adjust the contract expiration date listed on FCC Form 471, *Description of Services Ordered and Certification Form*, cancel a Funding Request Number (FRN), reduce the commitment amount of a FRN, or request a service delivery extension for non-recurring services. Additionally, changes to the FCDL may occur when program officials grant an applicant's request for funding commitment adjustments through FCC's appeals process.

Beginning in fiscal year (FY) 2016, USAC began transitioning from its Simplified Tracking and Review System (STARs) to EPC, an account and application management system for the S&L E-rate Program. E-rate Program applicants use EPC to submit documentation related to funding commitment adjustments, receive notifications, and contact customer service. USAC and its third-party service provider also use EPC to support their daily operations, including tracking appeals,[1] post-commitment adjustments,[2] and FCC Form 500 submissions.

[1] Appeals can include funding requests, invoice extensions, and requests to extend service start and end dates.
[2] Post-commitment adjustments include any adjustments made to the FCDL after recording the initial commitment, including changes to the months of services reimbursed.

<u>Incorrect Budgetary Amounts Due to EPC Design Issues</u> – We selected a sample of 14 transactions recorded to the United States Standard General Ledger (USSGL) Account 4881, *Upward Adjustments of Prior-Year Undelivered Orders - Obligations, Unpaid*. For each sampled item, we obtained documentation to support the adjustment to an obligation recorded in the prior year. Kearney & Company, P.C. (Kearney) noted the following control weaknesses:

1. Two of the samples Kearney selected were for corrections to obligations that were understated in FY 2017. For these two samples, S&L program officials approved post-commitment changes to the service start date; however, EPC did not reflect the revisions to the months of service, a key input for calculating the appropriate funding amount and recording an accurate obligation. Upon our inquiry, the S&L program office confirmed that there was an issue with EPC's system workflow[3] that impacted post-commitment changes for both service start and end dates. Although the S&L program stated that it fixed the EPC issue on January 24, 2018, USAC accounting was not aware that the post-commitment change resulted in a prior-period misstatement. Kearney requested that USAC analyze the total impact of the misstatement and noted that USAC overstated 243 FCDLs and understated 64 FCDLs.

2. One of the samples Kearney selected was for a FRN that was erroneously de-obligated and subsequently re-obligated because EPC did not process the approval of the Form 486 in a timely manner. Upon our inquiry, the S&L program office confirmed that there was a deficiency with EPC's system workflow that impacted the timely processing of Form 486 approval transactions. Kearney requested that USAC analyze the total impact of the misstatement; however, USAC was unable to quantify the impact of the error.

In FY 2016, USAC implemented EPC. USAC did not effectively test the functionality of EPC to ensure it met the needs of its users and posted complete and accurate transactions. In addition, the program office did not have controls in place to ensure the accuracy of the total months of service reimbursed when it made changes to the service start date. Further, accounting personnel did not have the ability to effectively review the accuracy of post commitment changes. Lastly, USAC did not have adequate lines of communication in place to ensure accounting personnel were aware of the EPC issue.

Because EPC recorded post-commitment changes inaccurately, USAC both understated and overstated Undelivered Orders – Obligations in FY 2017 by $65 million and $13.9 million, respectively. This resulted in a total net error of $51.1 million. In FY 2018, USAC overstated Upward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations by $9.9 million[4] and Downward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations, Recoveries by $9.4 million.[5]

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[3] System workflow refers to how an application is set up to perform a defined sequence of processes and tasks within the system itself.

[4] Because many of the FCDLs expired prior to correcting the obligation, the understatements in FY 2017 do not match the overstatements in FY 2018. USAC Accounting monitors irregular activity, such as an entry to both 4871 and 4881 on the same day for the same amount and adjusts these entries.

[5] See Footnote 1 above.

USAC was unable to quantify the impact of the Forms 486 that were not processed timely; therefore, Kearney performed our own analysis to quantify the impact. We estimate that USAC overstated Upward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations by $12.3 million and Downward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations, Recoveries by $12.3 million.

Further, because USAC did not comprehensively test EPC prior to its implementation, additional systemic errors may occur, go undetected, and result in material accounting errors.

<u>Inappropriate USAC De-Obligation Policy Over Canceled FRNs</u> – Kearney selected a sample of 43 transactions recorded to the USSGL Account 4871, *Downward Adjustments of Prior-Year Unpaid Undelivered Orders - Obligations, Recoveries*. For each sampled item, we obtained documentation to support the adjustment to an obligation recorded in the prior year. One of the samples Kearney selected was for a cancellation requested by the applicant in FY 2017; however, USAC recorded the de-obligation in FY 2018. Kearney requested that USAC analyze the S&L population to identify similar situations. USAC's analysis, which Kearney reviewed, noted that applicants canceled 849 FRNs in prior years that were de-obligated in FY 2018.

USAC's cancellation accounting policy does not align with accounting standards issued by OMB. USAC Accounting agreed that an adjustment should be recorded to the financial statements to account for cancellation requests received as of September 30 but not processed in the same FY (pending cancellations). However, the S&L program's system of record, EPC, was unable to provide USAC Accounting the information necessary to quantify the materiality of pending cancellations that could cross FYs. As a result, USAC accounting did not develop an accrual methodology or develop a threshold for recording an accrual.

Because USAC did not record an accrual in FY 2017, USAC overstated Undelivered Orders – Obligations in FY 2017 by $21.5 million and overstated Downward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations, Recoveries in FY 2018 by $24.2 million. Further, because USAC did not record an accrual in FY 2018, Kearney performed an independent analysis of the potential error and estimated a FY 2018 understatement in Downward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations by $5.9 million and a FY 2019 overstatement of Downward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations, Recoveries by $7.8 million.

Recommendations:

Kearney recommends that FCC and USAC strengthen processes and internal controls surrounding the reporting of budgetary accounting activity. Specifically:

1. Ensure policies and procedures adequately address recording obligations and de-obligations in accordance with accounting standards issued by OMB. *[Repeat]*

2. Develop and implement test scenarios to ensure EPC functionality is operating effectively, meets the needs of its users, and posts complete and accurate transactions. The test

scenarios should consider proper application of USAC's business rules and the design of the system's workflow. *[Updated]*

3. Ensure that quality review procedures adequately address recording obligations and de-obligations in the appropriate FY. *[Repeat]*

4. Enhance the lines of communication between Accounting personnel and the program offices, to include formal and detailed communication of operational and application issues as they arise. *[Updated]*

5. Coordinate with the S&L program, including their information technology (IT) support, and determine whether an EPC programming change can be made to provide the reporting functionality needed to quantify the materiality of pending cancellations that could cross FYs. *[New]*

6. Develop policies and procedures to monitor pending cancellation balances and establish accrual thresholds. *[New]*

Significant Deficiency

A significant deficiency is a deficiency, or 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.

I. Information Technology

FCC uses information systems to compile information for financial reporting purposes, including its core financial management and accounting system, Genesis. Genesis is accessed through FCC's general IT support system. In addition, because FCC's financial statements include financial transactions relating to the USF programs, FCC relies upon general IT support systems and specific applications utilized by the administrator of the USF programs.

We have separately performed an evaluation of FCC's Information Security Program as required by the Federal Information System Modernization Act of 2014 (FISMA) and issued a separate report. In addition to the work performed during our FISMA evaluation, we performed risk-based procedures focused on IT controls that could lead to significant misstatements of or corruption to the financial data needed for FCC's consolidated financial statements. We performed this work in accordance with the Government Accountability Office's (GAO) Federal Information System Controls Audit Manual (FISCAM). Many of the IT control areas of FISMA overlap with those in FISCAM, such as risk management, access controls, configuration management, and contingency planning. Other IT controls areas are unique to FISCAM due to their relevance to financial management and reporting, such as segregation of duties and application controls. We performed risk-based procedures related to segregation of duties within Genesis. Additionally, we performed risk-based procedures related to the general IT support system and financial application, Great Plains, utilized by USAC to administer the USF programs. The control deficiencies noted during our FISMA evaluation and our financial statement audit are summarized below. In aggregate, we consider these control deficiencies to be a significant deficiency.

FCC General IT Support System – Kearney noted that FCC took corrective actions to improve certain processes and remediate deficiencies identified in the FY 2017 FISMA evaluation. Most notably, FCC maintained an up-to-date and readily available systems inventory, enhanced its collection and reporting of qualitative and quantitative metrics, and developed information system contingency plans. Despite the progress made during FY 2017, we identified control deficiencies in multiple IT control areas, including Identity and Access Management and Information Security Continuous Monitoring (ISCM). These control deficiencies impacted FCC's general IT support system. FCC management stated that these efforts continue to require significant resources, delaying full implementation of information security policies and procedures. While these changes provide the FCC with an opportunity to improve its information security posture, management must prioritize and devote significant resources to implement its information security policies and procedures and resolve deficiencies in the FCC Information Security Program and systems.

FCC Financial Management System – FCC's financial management and accounting system, Genesis, is hosted by an external service provider. The external service provider is responsible for maintaining a number of IT controls. However, FCC's general IT support system is the gateway for all of FCC's systems, including Genesis. Therefore, IT deficiencies noted in the general IT support system, as described above, may impact Genesis as well. Further, we noted additional control deficiencies impacting Genesis beyond those inherited from FCC's general IT support system. Specifically, we noted that the FCC ineffectively designed the Genesis segregation of duties matrix, which we found was incomplete and contained inconsistencies.

USAC Systems Utilized in Administering the USF Programs – USAC administers the USF programs. Similar to FCC, USAC's general IT support system is the gateway for USAC's financial application, Great Plains. Kearney noted that USAC failed to properly manage user accounts with access to both the general IT support system and Great Plains.

In general, we noted that FCC had not implemented effective policies, procedures, and processes over its general support system, FCCNet, and its financial management system, Genesis. Additionally, Kearney determined that USAC had not implemented effective account management policies, procedures, and processes over its general support system and financial application, Great Plains. We consider the aggregation of these control deficiencies to be a significant deficiency.

Poor controls over IT security can affect the integrity of financial applications, which increases the risk that sensitive financial information could be accessed by unauthorized individuals or that financial transactions could be altered, either accidentally or intentionally. IT deficiencies increase the risk that FCC will be unable to report financial data in an accurate and timely manner.

Recommendations: Our full FY 2018 FISMA evaluation report included 19 recommendations intended to improve the effectiveness of FCC's Information Security Program controls in the areas of Risk Management, Configuration Management, Identity and Access Management, ISCM, Incident Response, and Contingency Planning. Fourteen of the recommendations related to FCC and five of the recommendations related to USAC. Of the 14 FCC recommendations, 12 related to FISCAM control areas. All five of the USAC recommendations related to FISCAM control areas.

Status of Prior-Year Findings and Recommendations

In the *Independent Auditor's Report on Internal Control Over Financial Reporting* included in the audit report on the FCC's FY 2017 financial statements,[6] Kearney noted two issues that were related to internal control over financial reporting. The status of the FY 2017 internal control findings is summarized in ***Exhibit 1***.

Exhibit 1: Status of Prior-Year Findings

Control Deficiency	FY 2017 Status	FY 2018 Status
USF Budgetary Accounting	Significant Deficiency	Material Weakness
IT	Significant Deficiency	Significant Deficiency

During the FY 2017 financial statement audit, Kearney made specific recommendations to FCC related to the control deficiencies noted above to strengthen FCC's internal control environment over financial reporting. The status of the FY 2017 internal control recommendations is summarized in Table 2.

Exhibit 2: Status of Prior-Year Recommendations

Related Control Deficiency	Recommendation Description	FY 2018 Status
USF Budgetary Accounting	Test scenarios for USAC business rules in EPC	Open
	Policies and procedures for recording de-obligations	Open
	Quality control reviews for proper recording of de-obligations in the appropriate FY	Open
	Lines of communication between Accounting personnel and the program offices	Open
IT[7]	Kearney issued 24 IT-related recommendations in FY 2017	12 Open 12 Closed

FCC's Responses to Findings

[6] The *Independent Auditor's Report on Internal Control Over Financial Reporting* was published in the Federal Communications Commission's Fiscal Year 2017 Agency Financial Report.

[7] Kearney issued 24 recommendations in the FY 2017 FISMA evaluation report. During FY 2018, FCC took appropriate action to close 12 recommendations, and we either updated or re-issued the 12 recommendations that remain open. The FY 2018 FISMA evaluation report includes additional, detailed information on each of the 24 prior-year recommendations.

FCC's response to the findings identified in our audit is included in the memorandum from management titled *Commission's Response to Independent Auditor's Reports* included in FCC's Agency Financial Report. FCC's response was not subjected to auditing procedures applied in the audit of the consolidated financial statements; accordingly, we express no opinion on it.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of FCC's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-01 in considering the entity's internal control over financial reporting. Accordingly, this report is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
November 15, 2018

Independent Auditor's Report on Compliance with Laws, Regulations, and Contracts

KEARNEY & COMPANY

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS, REGULATIONS, AND CONTRACTS

To the Chairman, Managing Director, and the Inspector General of the Federal Communications Commission

We have audited the consolidated financial statements of the Federal Communications Commission (FCC) as of and for the year ended September 30, 2018, and we have issued our report thereon dated November 15, 2018. We conducted our audit 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. 19-01, *Audit Requirements for Federal Financial Statements*.

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 provisions of applicable laws, regulations, and contracts which could have a direct and material effect on the financial statements. We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, and contracts applicable to FCC. However, providing an opinion on compliance with those provisions was not an objective of our audit; accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-01. Although our audit procedures did not identify any instances of noncompliance in fiscal year (FY) 2018, FCC management communicated a potential instance of noncompliance with the Antideficiency Act[1] that was identified in 2011. This potential noncompliance was still being researched by FCC as of September 30, 2018.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the effectiveness of FCC's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and

[1] The Antideficiency Act prohibits the FCC from obligating or expending Federal funds in advance or in excess of an appropriation, as well as from accepting voluntary services.

OMB Bulletin No. 19-01 in considering FCC's compliance. Accordingly, this report is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
November 15, 2018

Commission's Response to Independent Auditor's Reports

Office of the Managing Director

DATE: November 15, 2018

TO: David L. Hunt, Inspector General

FROM: Mark Stephens, Managing Director
Kathleen Heuer, Chief Financial Officer
Christine Calvosa, Acting Chief Information Officer

SUBJECT: Management's Response to Independent Auditor's Reports on Internal Control over Financial Reporting and Compliance with Applicable Provisions of Laws and Regulations for Fiscal Year 2018

Thank you for the opportunity to review and comment on the draft reports entitled *Independent Auditor's Report on Internal Control over Financial Reporting and Independent Auditor's Report on Compliance with Applicable Provisions of Laws and Regulations*. As always, the Federal Communications Commission (FCC or Commission) appreciates the efforts of the Office of Inspector General and its independent auditor, Kearney and Company, to work with the FCC throughout the annual financial statement audit process.

We are pleased that, for the thirteenth straight year, the independent auditor provided an unmodified ("clean") opinion and found that the Commission's consolidated financial statements for Fiscal Year (FY) 2018 present fairly, in all material respects, the financial position of the Commission as of September 30, 2018. These results demonstrate the Commission's commitment to effective internal controls and financial management.

Despite these successes, work remains here at the Commission. The FY 2018 audit report points out one material weakness related to Universal Service Fund (USF) budgetary accounting and one significant deficiency related to information technology (IT) controls. We concur with the recommendations made by the independent auditors in their reports.

With respect to the material weakness related to the control environment over USF budgetary accounting, this weakness relates to the potential risk of the Universal Service Administrative Company (USAC) incorrectly recognizing deobligations for the USF's Schools and Libraries program due to control issues with implementation of a funding system. The FCC will continue to work to fully remediate the auditor's recommendations related to this material weakness as quickly as possible.

With respect to the significant deficiency related to the FCC's and USAC's controls over their general support and financial systems, the FCC's and USAC's IT teams will both work to address the recommendations identified by the auditors. The FCC's commitment to addressing the auditors' concerns was demonstrated this year when the auditors closed 12 previous IT related recommendations during the FY 2018 audit process.

We look forward to working in FY 2019 to resolve the FY 2018 audit findings and to enhance the culture of integrity, accountability, and excellence that exists here at the Commission.

Mark Stephens
Managing Director
Office of Managing Director

Kathleen Heuer
Chief Financial Officer
Office of Managing Director

Christine Calvosa
Acting Chief Information Officer
Office of Managing Director

PRINCIPAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED BALANCE SHEET

As of September 30, 2018 and 2017
(Dollars in thousands)

	FY 2018	FY 2017
Assets (Note 2):		
Intragovernmental:		
Fund balance with Treasury (Note 3)	$ 11,097,827	$ 12,790,101
Investments (Note 5)	2,886,961	7,101,239
Accounts receivable (Note 6)	429	491
Other	1,866	4,373
Total intragovernmental	13,987,083	19,896,204
Cash and other monetary assets (Note 4)	1,698	113,743
Accounts receivable, net (Note 6)	783,380	718,905
General property, plant, and equipment, net	78,013	62,117
Other	18,024	13,024
Total assets	$ 14,868,198	$ 20,803,993
Liabilities (Note 7):		
Intragovernmental:		
Accounts payable	$ 3,186	$ 534
Other (Note 8)		
Custodial	3,511,422	8,637,202
Other	2,620	5,665
Total other	3,514,042	8,642,867
Total intragovernmental	3,517,228	8,643,401
Accounts payable	551,499	264,016
Federal employee and veteran benefits	2,984	2,978
Other (Note 8)		
Deferred revenue	1,205,713	2,114,141
Prepaid contributions	36,252	42,852
Accrued liabilities for Universal Service	524,358	515,910
Other	38,971	32,163
Total other	1,805,294	2,705,066
Total liabilities	$ 5,877,005	$ 11,615,461
Commitments and contingencies (Note 9)		
Net position:		
Unexpended appropriations - Funds from dedicated collections (Note 10)	$ 600,000	$ -
Unexpended appropriations - All other funds	2,816	2,820
Cumulative results of operations - Funds from dedicated collections (Note 10)	8,077,259	8,907,714
Cumulative results of operations - All other funds	311,118	277,998
Total net position - Funds from dedicated collections (Note 10)	8,677,259	8,907,714
Total net position - All other funds	313,934	280,818
Total net position	8,991,193	9,188,532
Total liabilities and net position	$ 14,868,198	$ 20,803,993

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST
For the Years Ended September 30, 2018 and 2017
(Dollars in thousands)

	FY 2018	FY 2017
Gross Program costs (Note 1 R):		
Closing the Digital Divide		
Total Gross Cost	$ 8,809,668	
Promoting Innovation		
Total Gross Cost	1,827,302	
Protecting Consumers and Public Safety		
Total Gross Cost	65,832	
Reforming the FCC's Processes		
Total Gross Cost	95,934	
Promoting Economic Growth and National Leadership:		
Total Gross Cost		$ 5,891,473
Protecting Public Interest Goals:		
Total Gross Cost		74,314
Making Networks Work for Everyone		
Total Gross Cost		4,590,446
Promoting Operational Excellence:		
Total Gross Cost		118,497
Total Program Costs	$ 10,798,736	$ 10,674,730
Cost not assigned to programs:		
Other expenses	-	-
Less: earned revenues not attributed to programs	(472,263)	(518,063)
Net cost of operations	$ 10,326,473	$ 10,156,667

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, 2018 and 2017
(Dollars in thousands)

	FY 2018			FY 2017		
	Funds from Dedicated Collections (Note 10)	**All Other Funds**	**Consolidated Total**	**Funds from Dedicated Collections** (Note 10)	**All Other Funds**	**Consolidated Total**
Unexpended Appropriations:						
Beginning Balances	$ -	$ 2,820	$ 2,820	$ -	$ 2,832	$ 2,832
Budgetary Financing Sources:						
Appropriations received	600,000	-	600,000	-	-	-
Appropriations used	-	(4)	(4)	-	(12)	(12)
Total Budgetary Financing Sources	600,000	(4)	599,996	-	(12)	(12)
Total Unexpended Appropriations	600,000	2,816	602,816	-	2,820	2,820
Cumulative Results from Operations:						
Beginning Balances (Note 1 R)	8,907,714	277,664	9,185,378	8,279,799	214,539	8,494,338
Budgetary Financing Sources:						
Appropriations used	-	4	4	-	12	12
Nonexchange revenue	9,543,325	-	9,543,325	9,111,745	-	9,111,745
Transfers in/out without reimbursement	-	-	-	1,750,000	-	1,750,000
Other	(6)	-	(6)	(242)	-	(242)
Other Financing Sources (Nonexchange):						
Imputed financing	-	13,691	13,691	-	9,974	9,974
Other	-	(27,542)	(27,542)	-	(23,448)	(23,448)
Total Financing Sources	9,543,319	(13,847)	9,529,472	10,861,503	(13,462)	10,848,041
Net Cost of Operations	10,373,774	(47,301)	10,326,473	10,233,588	(76,921)	10,156,667
Net Change	(830,455)	33,454	(797,001)	627,915	63,459	691,374
Cumulative Results of Operations	8,077,259	311,118	8,388,377	8,907,714	277,998	9,185,712
Net Position	$ 8,677,259	$ 313,934	$ 8,991,193	$ 8,907,714	$ 280,818	$ 9,188,532

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2018 and 2017
(Dollars in thousands)

	FY 2018	FY 2017
Budgetary Resources:		
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	(4,869,982)	(409,063)
Appropriations (discretionary and mandatory)	10,177,230	10,853,696
Spending authority from offsetting collections (discretionary and mandatory)	433,917	473,741
Total budgetary resources	$ 5,741,165	$ 10,918,374
Status of Budgetary Resources:		
New obligations and upward adjustments (total) (Note 11)	$ 11,059,379	$ 16,599,962
Unobligated balance, end of year:		
Apportioned, unexpired accounts	883,329	1,939,386
Exempt from apportionment, unexpired accounts (Note 1 A)	(6,209,089)	(7,628,102)
Unapportioned, unexpired account	7,091	6,441
Unexpired unobligated balance, end of year	(5,318,669)	(5,682,275)
Expired unobligated balance, end of year	455	687
Unobligated balance, end of year (total)	(5,318,214)	(5,681,588)
Total status of budgetary resources	$ 5,741,165	$ 10,918,374
Outlays, Net:		
Outlays, net (total) (discretionary and mandatory)	10,047,317	10,125,172
Distributed offsetting receipts (-)	(93,049)	(96,232)
Agency outlays, net (discretionary and mandatory)	$ 9,954,268	$ 10,028,940

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2018 and 2017
(Dollars in thousands)

	FY 2018	FY 2017
Total Custodial Revenue:		
Sources of Cash Collections:		
Spectrum Auctions	$ 895,646	$ 17,562,170
Fines and Penalties	712,281	28,069
Total Cash Collections	1,607,927	17,590,239
Accrual Adjustments (+/-)		
Spectrum Auctions	-	(21,321)
Fines and Penalties	(13,874)	(36,974)
Total Accrual Adjustments	(13,874)	(58,295)
Total Custodial Revenue (Note 16)	1,594,053	17,531,944
Disposition of Collections:		
Transferred to Others:		
U.S. Treasury	(713,525)	(28,069)
Public Safety Trust Fund (NTIA)	(5,895,158)	-
TV Broadcasters Relocation Fund (FCC)	-	(1,750,000)
(Increase)/Decrease in Amounts Yet to be Transferred (+/-)	5,125,780	(5,603,519)
Refunds and Other Payments		
Auctions Salaries & Expenses (FCC) (Note 13)	(111,150)	(117,000)
Reverse Incentive Auction Winners	-	(10,033,356)
Retained by the Reporting Entity	-	-
Total Disposition of Collections	(1,594,053)	(17,531,944)
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, 2018 and 2017
(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. The Commission is directed by five Commissioners who 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 two reporting components. The primary component consists of Commission headquarters and field offices. The additional component is the Universal Service Fund (USF). 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). Section 201 of Division P of the Consolidated Appropriations Act, 2018, P.L. 115–141, amended Section 302 of the Universal Service Antideficiency Temporary Suspension Act, Title III of P.L. 108-494, to extend the four universal service support mechanisms' exemption from the application of the provisions of the Antideficiency Act until December 31, 2019. Accordingly, these funds are not subject to apportionment by the Office of Management and Budget (OMB). The TRS Fund is not exempt from the Antideficiency Act and must be apportioned by OMB before funds are available for use.

B. Basis of Accounting and Presentation

The consolidated and combined financial statements (financial statements) have been prepared from the accounting records of the Commission and its components, in conformity with U.S. generally accepted accounting principles (GAAP) and the form and content for Federal entity financial statements specified by 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, special, and deposit funds. The Commission may use the general and revolving funds to finance expenses, depending on budgetary availability. The special funds are used to account for dedicated collections. The deposit funds are used to hold amounts 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 the Universal Service Administrative Company (USAC) and Rolka Loube, LLC (RL), serving as administrators. Demand deposits bear the names of those entities, as well as the Commission or the fund (TRS or USF), for which they serve as administrators. Cash on deposit for USF held outside of Treasury is collateralized by the Federal Reserve. Beginning in the third quarter of FY 2018, under the Commission's authorization, USAC started to use an account within Treasury for collection and disbursement. For more information, refer to Note 4.

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. As such, an additional allowance for doubtful accounts for the higher dollar value receivables may be recorded considering inherent uncertainties and risks.

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. General Property, Plant and Equipment, Net

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 is depreciated on a straight-line basis over the estimated useful lives of the items.

Note 1 – Summary of Significant Accounting Policies (continued)

G. General Property, Plant and Equipment, Net (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 and building improvements, which includes all cost incurred during the design and construction phase of the improvement, are either amortized over the remaining life of the lease and building 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 and a balance typically remains in this account for future expenses.

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. Payments of all liabilities other than contracts can be abrogated by the U.S. Government, which is a sovereign entity, and its components, which includes the Commission. Accrued Liabilities for Universal Service mostly represent liabilities recorded by the USF for anticipated subsidies in the Lifeline program, and certain programs within High Cost and TRS. The obligations are recognized for subsidies related to certain programs, including: the Mobility Fund Phase I, the Connect America Fund (CAF) Phase II, Rural Broadband Experiment, Alternative Connected America Model (A-CAM), Alaska Plan, Frozen Support in high cost areas, and the National Deaf-Blind Equipment Distribution Program in TRS. For these programs, an accrual is made to Accounts Payable instead of Accrued Liabilities. The Commission does not accrue for payments under the Schools & Libraries or Rural Health Care programs until potentially eligible costs pass through a thorough review process and the costs are approved for disbursement.

Note 1 – Summary of Significant Accounting Policies (continued)

I. Accounts Payable and Accrued Liabilities (continued)

Accrued Liabilities for the TV Broadcaster Relocation Fund (TVF) represent liabilities for invoices received but not processed and for costs incurred but not invoiced related to relocation costs incurred by full power and Class A television licensees that were reassigned to new channels as a result of the Incentive Auction, as well as certain costs incurred by multichannel video program distributors (MVPDs) to continue to carry such stations signals. For this program, an accrued liability for invoices received but not processed and for costs incurred but not invoiced is made to Accounts Payable.

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.

The USF collects contributions from telecommunications 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. 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 (FERS-RAE), or the FERS-Further Revised Annuity Employee (FERS-FRAE). Under CSRS, the Commission makes matching contributions equal to seven percent (7%) 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 Savings 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 one percent (1%) of gross pay, match dollar-for-dollar on the first three percent (3%) of pay contributed each pay period, and match 50 cents on the dollar for the next two percent (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)

K. Retirement Plans and Other Benefits (continued)

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 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 the Department of Labor.

L. 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.

M. Exchange Revenue and Financing Sources

<u>Regulatory Fee Offsetting Collections (Exchange)</u> – Pursuant to 47 U.S.C. § 159, the Commission assesses and collects regulatory fees to recover the costs incurred in carrying out its mission through its strategic goals: Closing the Digital Divide; Promoting Innovation; Protecting Consumers and Public Safety; and Reforming the FCC's Processes. Since 1993, Congress has annually reviewed the regulatory fee collection requirements of the Commission and established the total fee levels to be collected in annual Appropriations Acts. Fees collected up to the level established by Congress are applied against the Commission's appropriation at the close of each fiscal year. The Commission collected the appropriated regulatory fee levels of $322,035 for FY 2018 and $356,711 for FY 2017. The Commission also collected $9,233 above the required regulatory level in FY 2018 and $9,379 above the required level in FY 2017. The cumulative amount collected above the required annual regulatory level was $121,228 as of September 30, 2018. In addition, the cumulative amount collected above the required annual regulatory level has been precluded from obligation since FY 2008. Furthermore, the RAY BAUM'S Act of 2018, Division P of P.L. 115-141, requires the Commission to transfer all excess collections for FY 2018 and prior years to the General Fund of the Treasury for the sole purpose of deficit reduction. The RAY BAUM'S Act also requires the Commission to transfer any excess collections in FY 2019 and in subsequent years to the General Fund of the Treasury for the sole purpose of deficit reduction. For more information, refer to Note 18.

<u>Competitive Bidding System Offsetting Collections (Exchange)</u> – One of the Commission's primary functions is managing the spectrum auctions program. Proceeds from the auctions are initially remitted to the Commission and are later transferred either to the Treasury or to the appropriate agency as required by applicable laws. Pursuant to 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 $111,150 for FY 2018 and $117,000 for FY 2017.

Note 1 – Summary of Significant Accounting Policies (continued)

M. Exchange Revenue and Financing Sources (continued)

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 $895,646 of custodial revenue (net of accrual adjustments) related to spectrum auctions in FY 2018 and $17,540,849 in FY 2017. In FY 2018, the Commission transferred $5,895,158 of custodial revenue from the Incentive Auction and Auction 97 to the Public Safety Trust Fund that is managed by the National Telecommunications and Information Administration (NTIA), and $1,244 from other spectrum auctions to the Treasury General Fund. In FY 2017, the Commission paid $10,033,356 of Incentive Auction proceeds to reverse auction winners and transferred $1,750,000 to the TVF.

Application Fees (Exchange) – Pursuant to 47 U.S.C. § 158, the Commission collects application processing fees at such rates as the Commission establishes in a schedule of application fees to recover the costs of the Commission to process applications. Subparagraph b of section 158 requires the Commission to review and amend its schedule of application fees every two years based on the net change in the Consumer Price Index calculated over a specific period of time. Application fees are deposited in the Treasury and are not available for the Commission's use. Application fee revenue totaled $27,542 in FY 2018 and $23,449 in FY 2017. The RAY BAUM'S Act of 2018 amended 47 U.S.C. § 158 with an effective date of October 1, 2018 for the amendments. Congress provided that application fees in effect before the effective date of the RAY BAUM'S Act shall remain in effect until the Commission adjusts or amends such fees. The Commission's next amendment of the schedule of application fees will be based on the recently updated requirements in 47 U.S.C. § 158.

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 $841 in FY 2018 and $676 in FY 2017.

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

USF (Financing Source) – 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 $9,476,789 and $9,039,570 were received in FY 2018 and FY 2017, respectively. For more information, refer to Note 10.

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. Since FY 2014, Congress has authorized the Commission to retain its appropriation as available until expended. The Commission's no-year appropriations were $322,035 for FY 2018 and $356,711 for FY 2017. Regulatory fee collections fully funded the no-year appropriations for FY 2018 and FY 2017.

Note 1 – Summary of Significant Accounting Policies (continued)

M. Exchange Revenue and Financing Sources (continued)

Subsidy Estimates and Reestimates (Financing Source) – The Fair Credit Reporting Act (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. The most recent subsidy reestimate was completed in September 30, 2015; OMB waived the requirement to perform a subsidy reestimate in FY 2018 and FY 2017. The last active loan matured in April 2007, and the Commission wrote off all remaining loans in FY 2013. As a result, no material activity related to direct loans has occurred in FY 2018 and FY 2017, and the Commission is working with OMB to close-out the Credit Reform Program.

N. Reprogramming

In FY 2018, $6,082 of prior year de-obligations were approved for reprogramming. The funds were requested to address a shortage in compensation and benefits as well as to provide necessary funding for information technology and security projects. In FY 2017, $4,970 of prior year de-obligated non-auction and auction funds were approved for reprogramming to fund a retroactive increase in the transit subsidy benefit as well as various information technology projects.

O. Disclosure Entities

The Commission is responsible for the overall management and oversight of the USF, including all USF policy decisions. USAC was established in 1997 as a not-for-profit subsidiary of the National Exchange Carrier Association (NECA), and that same year, the FCC appointed USAC as the permanent administrator, under the Commission's direction, of the USF and the four universal service support mechanisms. The four universal service support mechanisms are High Cost, Lifeline, Rural Health Care, and School and Libraries. USAC as the administrator of the USF is responsible for the effective administration of the programs, including billing, collection, and disbursement. Beginning in the third quarter of FY 2018, under the Commission's authorization, USAC started to use an account within Treasury for collection and disbursement.

NECA was established as a non-stock Delaware corporation, which, pursuant to FCC rules, files interstate access tariffs and administers interstate access revenue pools for local telephone companies throughout the United States of America and its territories. NECA performs data collection functions for the High Cost program and bills USAC for the associated costs. NECA is compensated by USAC in accordance with NECA's Cost Accounting and Procedures Manual. NECA has no management control over USAC and derives no economic benefits from this subsidiary relationship. NECA does not consolidate USAC since it does not meet the criteria for consolidation in accordance with the accounting standards for consolidation of all majority-owned subsidiaries. The investment in USAC, which is carried at cost, is insignificant to these financial statements.

Note 1 – Summary of Significant Accounting Policies (continued)

O. Disclosure Entities (continued)

Beginning in FY 2018, the Commission reported USAC and NECA as disclosure entities in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 47, *Reporting Entity*. Neither USAC or NECA substantially meet the requirements to be considered consolidated entities. As of September 30, 2018, the likelihood is considered remote of any potential financial and non-financial risks or benefits for the Commission associated with the control of or involvement with USAC and NECA. Both USAC and NECA are not-for-profit corporations. USAC's Annual Reports are available at https://www.usac.org, while NECA's Annual Reports are available at https://www.neca.org.

The following table summarizes the balances and activities recognized in the Commission's financial statements due to transactions with USAC and NECA for the fiscal year ended September 30, 2018:

FY 2018	Universal Service Adminstrative Company (USAC)	National Exchange Carrier Association, Inc. (NECA)	Total Balances Associated with Disclosure Entities
Balance Sheet			
Other assets (Note 1 H)	$ 18,024	$ -	$ 18,024
Accounts payables[1]	9,602	66	9,668
Statement of Net Cost			
Net cost of operations[2]	$ 188,846	$ 455	$ 189,301
Statement of Changes in Net Position			
Net cost of operations[2]	$ 188,846	$ 455	$ 189,301

P. 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. Net position of funds from dedicated collections is separately disclosed in Note 10.

[1]This portion in the accounts payable consists of the USF administrative fees due to USAC and NECA.
[2]This portion of the operation expenses includes the administrative fees incurred in USF. The Commission approves the administrative costs to 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.

Note 1 – Summary of Significant Accounting Policies (continued)

Q. Incentive Auction

The Broadcast Incentive Auction was authorized by provisions in Title VI of the Middle Class Tax Relief and Job Creation Act of 2012, P.L. 112-96 (Spectrum Act). The Spectrum Act established the funding of the TVF at $1,750,000. The Spectrum Act states that the Commission shall reimburse relocation costs reasonably incurred by TV broadcasters (Full Power, Class A and MVPDs) that were involuntarily reassigned to new channels because of the repacking process. Obligations, expenses, and liabilities relating to approved reimbursements began in FY 2018, after the release of a Public Notice, DA 17-1015, on October 16, 2017 by the FCC setting the initial reimbursement allocation of the TVF for eligible broadcasters and MVPDs. In this Public Notice, the Commission established a total allocation slightly over $1 billion to reimburse eligible entities for expenses related to the construction of station facilities on reassigned channels. On April 16, 2018 the Commission issued another Public Notice, DA 18-372, which provided for the release of a further reimbursement allocation of $741,567.

Section 511 of Title V of Division E of the Consolidated Appropriations Act, 2018, P.L. 115-141, provided the TVF with additional funding, which increased the cap of the TVF to $2,750,000 and allowed new industry segments to be reimbursed. The additional $1,000,000 in funding will be appropriated over two years. In FY 2018, $600,000 was appropriated in the following manner: $350,000 for Full Power, Class A, and MVPDs; $150,000 for Translators and Low Power Television stations; $50,000 for FM Radio Stations; and $50,000 for consumer education. The remaining $400,000 of the increase will be appropriated in FY 2019.

R. Comparison and Other

In FY 2018, the Commission implemented Statement of Federal Financial Accounting Standards (SFFAS) 47, *Reporting Entity*. Per paragraph 5 of SFFAS 47, this standard does not need to be applied to immaterial items. Starting in FY 2018, the Commission is excluding the North America Numbering Plan (NANP) from the Agency Financial Report due to its immateriality. The Commission will continue to monitor and review NANP's financial activity for the foreseeable future in order to ensure that the Commission is applying the appropriate accounting treatment. No restatement was necessary as a result of this change; however, the line item on the Consolidated Statement of Changes in Net Position Cumulative Results of Operations: Beginning Balances (FY 2018) excludes the NANP balance from the prior year (FY 2017) Cumulative Results of Operations.

Effective with FY 2018, the Commission began accounting for costs under its new strategic goals, covering FY 2018 through FY 2022, as presented in the FCC's FY 2018 Performance Plan. The FY 2017 strategic goals are listed separately from the FY 2018 strategic goals in the Statement of Net Costs since the prior year strategic goals are not readily comparable to the new strategic goals.

Beginning in the third quarter of FY 2018, under the Commission's authorization, USAC started to move the USF funds held outside of the Treasury to a newly established account within the Treasury. The USF funded securities that had not yet matured at the time of the USF's transition to Treasury will remain with the private banking institution until their maturity date, at which time, the remaining funds will be moved to the Treasury. Starting in May 2018, USF began using an account within Treasury for collections and disbursements.

Note 1 – Summary of Significant Accounting Policies (continued)

R. Comparison and Other (continued)

The presentation used for the Consolidated Statement of Changes in Net Position and the Combined Statement of Budgetary Resources prior to FY 2018, has been revised to reflect the new format prescribed in OMB Circular No. A-136.

Note 2 – Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2018 and 2017:

	FY 2018	FY 2017
Intragovernmental:		
Fund Balance with Treasury	$ 4,692,333	$ 10,710,394
Accounts Receivable	351	457
Total Intragovernmental	4,692,684	10,710,851
Accounts Receivable, Net	9,551	24,410
Total Non-entity Assets	4,702,235	10,735,261
Total Entity Assets	10,165,963	10,068,732
Total Assets	$ 14,868,198	$ 20,803,993

Non-entity Fund Balance with Treasury (FBWT) primarily represents auction deposits. Accounts receivable considered non-entity include regulatory fees, application fees, fines and forfeitures, spectrum auctions, and International Telecommunications Settlement (ITS) charges.

Note 3 – Fund Balance with Treasury

The following summarizes FBWT as of September 30, 2018 and 2017:

	FY 2018	FY 2017
Unobligated Balance		
Available	$ (2,957,023)	$ 1,741,482
Unavailable	145,870	256,971
Obligated Balance not yet Disbursed	9,216,647	81,254
Non-Budgetary FBWT	4,692,333	10,710,394
Total	$ 11,097,827	$ 12,790,101

Note 3 – Fund Balance with Treasury (continued)

The FBWT includes general funds, revolving funds, special funds, and deposit funds.

General Funds – Includes the salaries and expense appropriation used to fund agency operations, the auction and reimbursable accounts, the credit reform program account, and other 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.

Special Funds – Includes funds from TVF and USF. TVF is for relocation costs reasonably incurred by broadcasters and MVPDs who are involuntarily reassigned to new channels or incur reimbursable expenses as a result of the Incentive Auctions post-auction repacking process. USF funds are for the four Universal Service support mechanisms. These four mechanisms are exempt from the application of the provisions of the Antideficiency Act by Congress through December 31, 2019, and are not subject to an apportionment by OMB. Starting in May 2018, USAC began moving USF funds held in a private banking institution to an account within Treasury.

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 Treasury General Fund or other Federal agencies.

Note 4 – Cash and Other Monetary Assets

The following summarizes Cash and Other Monetary Assets as of September 30, 2018 and 2017:

	FY 2018	FY 2017
Cash and Other Monetary Assets	$ 1,698	$ 113,743

TRS contributions and related accrued interest being held for distribution are the sources of funds for these balances. Upfront payments, unless refunded, are held until 45 days after the close of a given auction and then transferred to the Commission's Treasury account. The RAY BAUM'S Act of 2018 requires upfront payments of auction bidders to be deposited directly into the Treasury instead of an interest bearing commercial bank account starting October 1, 2018. For more information, refer to Note 18. Interest earned on TRS contributions is reinvested. During FY 2018, any interest earned on auction upfront payments was transferred to the Treasury General Fund.

In FY 2018, Cash and Other Monetary Assets included $1,698 in TRS contributions and related accrued interest being held for distribution.

In FY 2017, Cash and Other Monetary Assets included $111,066 in USF contributions and related accrued interest being held for distribution as well as $2,677 in other deposits and related accrued interest.

Note 5 – Investments

The following summarizes Investments as of September 30, 2018 and 2017:

FY 2018	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	$ 172,621	EI	$ 240	$ -	$ 172,861	$ 172,853
Treasury Notes	2,702,984	EI	5,232	5,884	2,714,100	2,682,338
Total	$ 2,875,605		$ 5,472	$ 5,884	$ 2,886,961	$ 2,855,191
FY 2017						
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	$ 1,959,505	EI	$ 1,631	$ -	$ 1,961,136	$ 1,961,232
Treasury Notes	5,124,411	EI	4,597	11,095	5,140,103	5,104,783
Total	$ 7,083,916		$ 6,228	$ 11,095	$ 7,101,239	$ 7,066,015

EI - Effective Interest Method

All Treasury securities, regardless of their maturity date, are reported as investments. The Commission expects to hold all investments to maturity; therefore, no adjustments have been made to present market value in FY 2018 and FY 2017. All investments are held by USF and are also recognized as part of Note 10 – Funds from Dedicated Collections.

Beginning in the third quarter of FY 2018, USAC started to move the USF funds held outside of Treasury to a newly established account within the Treasury. The USF funded securities that had not yet matured at the time of the USF's transition to Treasury will remain with the private banking institution until their maturity date, at which time, the funds will be moved to the account within Treasury.

In the second quarter of FY 2018 and prior, the cash receipts collected from the public for the USF were used to purchase Federal securities. Therefore, the Commission expects decreases in the portfolio balances as the securities mature and the funds are moved to the account within Treasury instead of being used for the purchase of 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 U.S. Government, these assets and liabilities offset each other from the standpoint of the U.S. 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 6 – Accounts Receivable, Net

The following summarizes Accounts Receivable, Net as of September 30, 2018 and 2017:

	Intragovernmental	Public	Total
FY 2018			
Gross Accounts Receivable	$ 429	$ 1,582,711	$ 1,583,140
Allowance for Doubtful Accounts	-	(799,331)	(799,331)
Accounts Receivable, Net	$ 429	$ 783,380	$ 783,809
FY 2017			
Gross Accounts Receivable	$ 491	$ 1,339,811	$ 1,340,302
Allowance for Doubtful Accounts	-	(620,906)	(620,906)
Accounts Receivable, Net	$ 491	$ 718,905	$ 719,396

The following summarizes accounts receivable by type as of September 30, 2018 and 2017:

	FY 2018			FY 2017		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	$ 1,102,606	$ (333,352)	$ 769,254	$ 986,993	$ (299,472)	$ 687,521
COMAD - Schools and Libraries	162,998	(158,434)	4,564	151,246	(148,085)	3,161
Regulatory Fees	30,540	(24,348)	6,192	30,890	(23,725)	7,165
Spectrum Auction	8,707	(8,707)	-	8,707	(8,707)	-
Civil Monetary Penalties	267,769	(266,885)	884	148,190	(133,228)	14,962
Other	10,520	(7,605)	2,915	14,276	(7,689)	6,587
Total	$ 1,583,140	$ (799,331)	$ 783,809	$ 1,340,302	$ (620,906)	$ 719,396

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 receivables for Schools and Libraries recorded an allowance rate of 97% in FY 2018 and 98% in FY 2017.

Note 7 – Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2018 and 2017:

	FY 2018	FY 2017
Intragovernmental:		
FECA Liability	$ 561	$ 536
Unemployment Liability	-	48
GSA Real Estate Taxes	-	2,995
Total Intragovernmental	561	3,579
Actuarial FECA Liability	2,984	2,978
Other:		
Unfunded Leave	17,467	17,540
Engery Savings Performance Contract	7,607	-
Accrued Liabilities for Universal Service	524,358	515,910
Total liabilities not covered by budgetary resources	552,977	540,007
Total liabilities covered by budgetary resources	626,984	11,075,454
Total liabilities not requiring budgetary resources	4,697,044	-
Total Liabilities	$ 5,877,005	$ 11,615,461

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

Liabilities not requiring budgetary resources are liabilities that have not in the past required, and will not in the future require, the use of budgetary resources. In FY 2018, OMB Circular No. A-136, *Financial Reporting Requirements,* required agencies to include a separate line for Total liabilities not requiring budgetary resources. OMB's guidance also provided that the prior year information did not need to be reported for this new requirement. As such, the information related to Total liabilities not requiring budgetary resources for FY 2017 was not calculated.

Note 8 – Other Liabilities

The following summarizes Other Liabilities as of September 30, 2018 and 2017:

FY 2018	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 3,511,422	$ 3,511,422
Other	-	2,620	2,620
Total Intragovernmental	$ -	$ 3,514,042	$ 3,514,042
Deferred Revenue	$ 26,188	$ 1,179,525	$ 1,205,713
Prepaid Contributions	-	36,252	36,252
Accrued Liabilities for Universal Service	-	524,358	524,358
Other	6,880	32,091	38,971
Total Other	$ 33,068	$ 1,772,226	$ 1,805,294

FY 2017	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 8,637,202	$ 8,637,202
Other	-	5,665	5,665
Total Intragovernmental	$ -	$ 8,642,867	$ 8,642,867
Deferred Revenue	$ 28,576	$ 2,085,565	$ 2,114,141
Prepaid Contributions	-	42,852	42,852
Accrued Liabilities for Universal Service	-	515,910	515,910
Other	-	32,163	32,163
Total Other	$ 28,576	$ 2,676,490	$ 2,705,066

The Custodial Liability includes both cash collected and net accounts receivable being held for transfer to the Treasury General Fund or other Federal agencies. The Commission collects the following types of custodial revenue: spectrum auction revenue, fines and forfeitures revenue, penalty revenue on regulatory fees, and ITS processing fees. Deferred revenue represents multi-year regulatory fees, spectrum auction revenue, or contributor payments that have been received but not earned by the Commission.

Prepaid Contributions include USF contribution overpayments that may be refunded or used to offset future payments. Accrued Liabilities for Universal Service primarily represent anticipated future payments for the Lifeline program, and certain support mechanisms within the High Cost program and TRS. The obligations for these subsidies are not recognized until payment files are approved in the subsequent month. Remaining Other Liabilities primarily represent anticipated payments related to payroll and other services, Energy Saving Performance Contract, and funds received that are being held until proper application is determined.

Note 9 – Commitments and Contingencies

The Commission is a party in various administrative proceedings, legal actions, and claims brought by or against the agency. The Commission, USAC, and the Department of Justice are investigating several cases and prosecuting others related to disbursements of USF funds from its support mechanisms which might result in future proceedings or actions. Similarly, the Commission, RL, 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's current headquarters lease expired on October 17, 2017. On December 18, 2016, the General Services Administration (GSA) signed a lease with a new lessor contemplating the Commission's occupancy of a newly built facility. The FCC's current lessor, a bidder on the solicitation for the new lease, had filed protests of the lease solicitation, first with GSA, and then with the U.S. Government Accountability Office (GAO). The protests were denied. The current lessor thereafter filed a solicitation protest with the U.S. Court of Federal Claims (COFC), which was supplemented with other pre-award protest issues, and that protest was denied in November 2016. Upon award of the new lease to a different lessor, the current lessor sought an injunction against performance of the new lease while it pursued an appeal in the U.S. Court of Appeals for the Federal Circuit against the COFC decision. Subsequently, the parties suspended the appeal. The construction of the new building is ongoing, and the FCC is anticipating to move in 2020. GSA is negotiating the construction schedule which will allow the FCC to refine the timing of the move. GSA negotiated a lease extension until November 2020 for the FCC's existing headquarters.

In accordance with the Department of Energy's Federal Energy Management Program's Energy Savings Performance Contracts, the Commission entered into a contract with Honeywell Building Solutions, Inc. (HBS) in the third quarter of FY 2017 to construct and install infrastructure in four facilities (Livermore CA, Waipahu HI, Powder Springs GA, and Columbia MD). The contract with HBS is a fixed price, performance-based contract that is paid over time through generated energy cost and operational savings. The contract enables the FCC to fund energy saving projects with up-front capital and a financing arrangement with HBS through the remaining implementation period. In the event of cancelling the task order before the end of FY 2037, the Commission shall remain liable for the project's outstanding principal balance along with a two percent (2%) termination premium. The likelihood of termination is remote as of September 30, 2018.

The $1,750,000 TVF was created by Congress in the Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96) to reimburse costs reasonably incurred by TV broadcasters that are involuntarily reassigned to new channels as a result of the Incentive Auctions post-auction repacking process. Section 511 of Title V of Division E of the Consolidated Appropriations Act, 2018, P.L. 115-141, provided the TVF with additional funding, which increased the cap of the TVF to $2,750,000 and allowed additional industry segments to be reimbursed. In FY 2018, the Commission has made a total of $1,742,852 in fund allocations for eligible recipients. Accrued Liabilities are recorded in the TVF for invoices received but not processed and for costs incurred but not invoiced pertaining to reimbursements for broadcasters and MVPDs. Since FY 2018 is the first year for reimbursements under the TV relocation program, the Commission had limited historical data to use when calculating its accrued liabilities. According to SFFAS 5, *Accounting for Liabilities*: ". . . the estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized and the range and a description of the nature of the contingency should be disclosed." While the Commission was able to estimate the low-end of the range in the amount of $218,906, the Commission determined that the high-end of the range could not be reliably measured based on historical events or information provided by the broadcasters and MVPDs. An accrued liability of $218,906 has been recorded for invoices received but not processed and for costs incurred but not invoiced as of September 30, 2018.

Note 9 – Commitments and Contingencies (Continued)

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, 2018, the likelihood of an unfavorable outcome on all current legal cases is considered remote and no additional disclosure is needed.

Note 10 – Funds from Dedicated Collections

U.S. telecommunications companies are obligated to make contributions to the USF and the TRS Funds. 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 Fund 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.

As previously discussed, pursuant to the Spectrum Act, the Commission shall reimburse relocation costs reasonably incurred by TV Broadcasters and MVPDs who are involuntarily reassigned to new channels or incur costs as a result of the Incentive Auctions post-auction repacking process. In FY 2018, Congress provided additional funding and allowed additional industry segments to be reimbursed. These reimbursement costs are accounted for in the U.S. Budget as the "TV Broadcaster Relocation Fund" which is funded by forward auction proceeds and direct appropriations. The Commission recognized the transfer to TVF as Transfers in without reimbursement on its Statement of Changes in Net Position, and the reimbursement costs as program expenses on the Statement of Net Cost.

The Commission had no activity related to Gifts and Bequests in FY 2018 and FY 2017.

The following pages summarize the significant assets, liabilities, and related costs incurred related to the USF and TVF as of September 30, 2018 and 2017:

Note 10 – Funds from Dedicated Collections (Continued)

FY 2018	TVF	USF	Total Funds from Dedicated Collections
Balance Sheet as of September 30, 2018			
Assets:			
Fund Balance with Treasury	$ 2,134,077	$ 3,929,106	$ 6,063,183
Investments	-	2,886,961	2,886,961
Cash and other monetary assets	-	1,698	1,698
Accounts receivable, net	-	774,734	774,734
General property, plant, and equipment, net	-	26,737	26,737
Other assets	-	18,024	18,024
Total assets	$ 2,134,077	$ 7,637,260	$ 9,771,337
Liabilities:			
Accounts payable	$ 222,563	$ 297,810	$ 520,373
Deferred revenue	-	13,095	13,095
Prepaid contributions	-	36,252	36,252
Accrued liabilities	-	524,358	524,358
Total liabilities	$ 222,563	$ 871,515	$ 1,094,078
Unexpended Appropriations	$ 600,000	$ -	$ 600,000
Cumulative results of operations	1,311,514	6,765,745	8,077,259
Total liabilities and net position	$ 2,134,077	$ 7,637,260	$ 9,771,337
Statement of Net Cost for the Period Ended September 30, 2018			
Net cost of operations	$ 438,486	$ 9,935,288	$ 10,373,774
Statement of Changes in Net Position for the Period Ended September 30, 2018			
Unexpended Appropriations			
Appropriations received	$ 600,000	$ -	$ 600,000
Cumulative results from operations			
Beginning Balances	1,750,000	7,157,714	8,907,714
Non-exchange revenue	-	9,543,325	9,543,325
Other financing sources	-	(6)	(6)
Net cost of operations	438,486	9,935,288	10,373,774
Change in net position	(438,486)	(391,969)	(830,455)
Cumulative results of operations	1,311,514	6,765,745	8,077,259
Net position	$ 1,911,514	$ 6,765,745	$ 8,677,259

Note 10 – Funds from Dedicated Collections (Continued)

FY 2017	TVF	USF	Total Funds from Dedicated Collections
Balance Sheet as of September 30, 2017			
Assets:			
Fund Balance with Treasury	$ 1,750,000	$ -	$ 1,750,000
Investments	-	7,101,239	7,101,239
Cash and other monetary assets	-	111,066	111,066
Accounts receivable, net	-	691,607	691,607
General property, plant, and equipment, net	-	36,670	36,670
Other assets	-	13,024	13,024
Total assets	$ 1,750,000	$ 7,953,606	$ 9,703,606
Liabilities:			
Accounts payable	$ -	$ 229,878	$ 229,878
Deferred revenue	-	7,268	7,268
Prepaid contributions	-	42,836	42,836
Accrued liabilities	-	515,910	515,910
Total liabilities	$ -	$ 795,892	$ 795,892
Unexpended Appropriations		$ -	$ -
Cumulative results of operations	$ 1,750,000	$ 7,157,714	$ 8,907,714
Total liabilities and net position	$ 1,750,000	$ 7,953,606	$ 9,703,606
Statement of Net Cost for the Period Ended September 30, 2017			
Net cost of operations	$ -	$ 10,233,588	$ 10,233,588
Statement of Changes in Net Position for the Period Ended September 30, 2017			
Cumulative results from operations			
Beginning Balances	$ -	$ 8,279,799	$ 8,279,799
Non-exchange revenue	-	9,111,745	9,111,745
Transfers in/out without reimbursement	1,750,000	-	1,750,000
Other financing sources	-	(242)	(242)
Net cost of operations	-	10,233,588	10,233,588
Change in net position	1,750,000	(1,122,085)	627,915
Cumulative results of operations	1,750,000	7,157,714	8,907,714
Net position	$ 1,750,000	$ 7,157,714	$ 8,907,714

Note 11 – Apportionment Categories of New Obligations and Upward Adjustments: Direct vs. Reimbursable

The following summarizes Apportionment Categories of New Obligations and Upward Adjustments for the years ended September 30, 2018 and 2017:

	FY 2018	FY 2017
Direct:		
Category B	$ 3,537,223	$ 1,598,981
Exempt from Apportionment	7,521,244	15,000,278
Total Direct	11,058,467	16,599,259
Reimbursable:		
Category B	912	703
New obligations and upward adjustments (total)	$ 11,059,379	$ 16,599,962

Category B - Apportioned by Purpose

Note 12 – Undelivered Orders at the End of the Period

The amount of budgetary resources obligated for undelivered orders totaled $13,936,671 as of September 30, 2018 and $14,466,783 as of September 30, 2017. The following summarizes Undelivered Orders as of September 30, 2018:

FY 2018	Federal	Non-Federal	Total
Undelivered Orders-Unpaid	$ 4,823	$ 13,911,958	$ 13,916,781
Undelivered Orders-Paid	1,866	18,024	19,890
Total	$ 6,689	$ 13,929,982	$ 13,936,671

Note 13 – Permanent Indefinite Appropriations

The Commission has permanent indefinite appropriations available to fund its universal service programs, subsidy costs incurred under credit reform programs, and the development and implementation costs related to the competitive auction program.

Pursuant to 47 U.S.C. §§ 254 and 225, the FCC has a permanent indefinite appropriation to fund its universal service programs, including the TRS 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. For Federal budgetary purposes, these contributions are accounted for as a special fund known as the Universal Service Fund.

Note 13 – Permanent Indefinite Appropriations (Continued)

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

Pursuant to 47 U.S.C. § 309(j)(8)(B), the FCC can retain proceeds from spectrum auctions for amounts that may be necessary for the costs of developing and implementing the competitive auction program.

These retained proceeds are offsetting collections that remain available until expended. Notwithstanding 47 U.S.C. § 309(j)(8)(B), for FY 2018 Congress limited the amount of the auction proceeds that may be retained and made available for obligation to $111,150.

Note 14 – Legal Arrangements Affecting Use of Unobligated Balances

Offsetting collections received in excess of $322,035 in FY 2018 and $356,711 in FY 2017 are precluded from obligation. In addition, the cumulative amount collected above the required annual regulatory level from prior years has been temporarily precluded from obligation since FY 2008. The RAY BAUM'S Act of 2018 requires the Commission to transfer all excess regulatory fee collections for FY 2018 and prior years to the General Fund of the Treasury for the sole purpose of deficit reduction. The RAY BAUM'S Act also requires the Commission to transfer any excess collections in FY 2019 and in subsequent years to the General Fund of the Treasury for the sole purpose of deficit reduction. For more information, refer to Note 1 M and Note 18.

Note 15 – Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

There were no material differences between the Combined Statement of Budgetary Resources (SBR) for FY 2017 and the amounts presented in the FY 2019 Budget of the United States Government. The FY 2020 Budget of the United States Government, which will include actual numbers for FY 2018, has not been published at this time. Pursuant to 31 USC § 1105, the Budget of the United States Government will be released not later than the first Monday in February, and will be available at the following website: https://www.whitehouse.gov/omb/budget/.

Note 16 – Custodial Revenues

In accordance with the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue & Other Financing Sources*, the Commission collects non-exchange revenues related to miscellaneous receipts and fines and forfeitures to be deposited in the Treasury General Fund. Fines and Forfeitures are made up of consent decrees and forfeiture orders. Forfeiture orders are probable, measurable, and legally enforceable claims, but need to result in a judgement issued by a Federal court before they become legally collectible debts. Consent decrees are legally collectible debts. Additionally, the Commission reports exchange revenue associated with radio spectrum auction proceeds on the Statement of Custodial Activity. For more information, refer to Note 1 M.

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

As of September 30, 2018 and 2017:

	FY 2018	FY 2017
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
New obligations and upward adjustments	$ 11,059,379	$ 16,599,962
Less: spending authority from offsetting collections and recoveries	1,245,522	1,370,426
Obligations net of offsetting collections and recoveries	9,813,857	15,229,536
Less: offsetting receipts	93,049	96,232
Net obligations	9,720,808	15,133,304
Imputed financing	13,691	9,974
Other Resources	(27,542)	(23,690)
Total Resources Used to Finance Activities	9,706,957	15,119,588
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Undelivered Orders	530,112	(5,051,024)
Resources that fund expenses recognized in prior periods	(97)	(1,065)
Budgetary offsetting collections and receipts that do not affect net cost of operations	93,058	96,236
Resources that finance the acquisition of assets	(36,169)	(29,217)
Other	(32,071)	1,255
Total Resources Used to Finance Items not Part of the Net Cost of Operations	554,833	(4,983,815)
Total Resources Used to Finance the Net Cost of Operations	10,261,790	10,135,773
Components of the Net Cost of Operations that Will Not Require or Generate Resources in the Current Period:		
Increase in annual leave liability	(121)	(1,040)
Increase in exchange revenue receivable from the public	(1,457)	(4,767)
Depreciation and amortization	20,868	17,008
Revaluation of assets or liabilities (+/-)	(6)	-
Other (+/-)	45,399	9,693
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	64,683	20,894
Net Cost of Operations	$ 10,326,473	$ 10,156,667

Note 18 – Subsequent Event

The RAY BAUM'S Act of 2018 requires the Commission to transfer all excess collections above the required annual regulatory level for FY 2018 and prior years to the General Fund of the Treasury for the sole purpose of deficit reduction. The RAY BAUM'S Act also requires the Commission to transfer any excess offsetting collections in FY 2019 and in subsequent years to the General Fund of the Treasury for the sole purpose of deficit reduction. On October 1, 2018, the Commission transferred the cumulative amount of $121,228 of excess offsetting collections to the Treasury General Fund. For more information, refer to Note 1 M.

Starting in FY 2019, the RAY BAUM'S Act of 2018 requires that upfront payments of auction bidders be deposited directly in the Treasury instead of in an interest bearing commercial bank account. Upfront payments for Auction 101 which is scheduled to begin on November 14, 2018 will be deposited into the Treasury in October 2018.

Required Supplementary Information

REQUIRED SUPPLEMENTARY INFORMATION – SCHEDULE OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

For the Years Ended September 30, 2018 and 2017
(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, TVF, and USF. S&E represents general salaries and expenses of the Commission. Auctions include salaries and expenses of the spectrum auction program. The TVF represents reimbursements for Incentive Auction relocation costs for TV broadcasters and MVPDs. USF includes the USF and TRS Funds. Non-major budgetary accounts are aggregated under the Other column.

Reflected in the chart below are the major budgetary accounts of the Commission that are aggregated and presented in the September 30, 2018 and 2017 Combined Statement of Budgetary Resources.

SCHEDULE OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

FY 2018	S&E	Auctions	TVF	USF	Other	Total
Budgetary Resources:						
Unobligated balance from prior year budget authority, net	92,535	33,593	1,629,250	(6,628,197)	2,837	(4,869,982)
Appropriations (discretionary and mandatory)	-	-	720,750	9,456,480	-	10,177,230
Spending authority from offsetting collections (discretionary and mandatory)	322,758	111,150	-		9	433,917
Total budgetary resources	$ 415,293	$ 144,743	$ 2,350,000	$ 2,828,283	$ 2,846	$ 5,741,165
Adjustment to unobligated balance brought forward, October 1						
Status of Budgetary Resources:						
New obligations and upward adjustments (total)	$ 333,071	$ 107,692	$ 1,742,852	$ 8,875,756	$ 8	$ 11,059,379
Unobligated balance, end of year:						
Apportioned, unexpired accounts	78,030	33,755	607,148	161,616	2,780	883,329
Exempt from apportionment, unexpired accounts	-	-	-	(6,209,089)	-	(6,209,089)
Unapportioned, unexpired accounts	3,737	3,296	-	-	58	7,091
Unexpired unobligated balance, end of year	81,767	37,051	607,148	(6,047,473)	2,838	(5,318,669)
Expired unobligated balance, end of year	455	-	-	-	-	455
Unobligated balance, end of year (total)	82,222	37,051	607,148	(6,047,473)	2,838	(5,318,214)
Total status of budgetary resources	$ 415,293	$ 144,743	$ 2,350,000	$ 2,828,283	$ 2,846	$ 5,741,165
Outlays, Net:						
Outlays, net (discretionary and mandatory)	(3,992)	(8,607)	215,923	9,843,999	(6)	10,047,317
Distributed offsetting receipts (-)	(29,276)	-	-	(63,773)	-	(93,049)
Agency outlays, net (discretionary and mandatory)	$ (33,268)	$ (8,607)	$ 215,923	$ 9,780,226	$ (6)	$ 9,954,268

SCHEDULE OF BUDGETARY RESOURCES BY MAJOR ACCOUNT

FY 2017	S&E	Auctions	TVF	USF	Other	Total
Budgetary Resources:						
Unobligated balance from prior year budget authority, net	$ 73,560	$ 18,369	$ -	$ (503,736)	$ 2,744	$ (409,063)
Appropriations (discretionary and mandatory)	-	-	1,629,250	9,224,446	-	10,853,696
Spending authority from offsetting collections (discretionary and mandatory)	356,737	117,000	-	-	4	473,741
Total budgetary resources	$ 430,297	$ 135,369	$ 1,629,250	$ 8,720,710	$ 2,748	$ 10,918,374
Adjustment to unobligated balance brought forward, October 1						
Status of Budgetary Resources:						
New obligations and upward adjustments (total)	$ 343,028	$ 105,995	$ -	$ 16,150,908	$ 31	$ 16,599,962
Unobligated balance, end of year:						
Apportioned, unexpired accounts	83,181	26,372	1,629,250	197,904	2,679	1,939,386
Exempt from apportionment, unexpired accounts	-	-	-	(7,628,102)	-	(7,628,102)
Unapportioned, unexpired accounts	3,412	2,991	-	-	38	6,441
Unexpired unobligated balance, end of year	86,593	29,363	1,629,250	(7,430,198)	2,717	(5,682,275)
Expired unobligated balance, end of year	676	11	-	-	-	687
Unobligated balance, end of year (total)	87,269	29,374	1,629,250	(7,430,198)	2,717	(5,681,588)
Total status of budgetary resources	$ 430,297	$ 135,369	$ 1,629,250	$ 8,720,710	$ 2,748	$ 10,918,374
Outlays, Net:						
Outlays, net (discretionary and mandatory)	$ (37,870)	$ (14,774)	$ -	$ 10,177,807	$ 9	$ 10,125,172
Distributed offsetting receipts (-)	(25,999)	-	-	(70,233)	-	(96,232)
Agency outlays, net (discretionary and mandatory)	$ (63,869)	$ (14,774)	$ -	$ 10,107,574	$ 9	$ 10,028,940

3. OTHER INFORMATION (UNAUDITED)

Summary of Financial Statement Audit

Financial Statement 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	Modified					
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	Unmodified					
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	Federal Systems conform to financial management system requirements					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
	0	0	0	0	0	0
Total Non-Conformances	**0**	**0**	**0**	**0**	**0**	**0**

Payment Integrity

The Federal Communications Commission (FCC or Commission) incorporated improper payment analysis and testing into its processes in Fiscal Year (FY) 2018 in compliance with Federal statutes[1] and guidance detailed in the Office of Management and Budget's (OMB) Circular A-123, Appendix C, *Requirements for Payment Integrity Improvement* (Appendix C). Appendix C defines "significant improper payments" 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).

The following link contains additional information on improper payments reported across the Federal government, including information reported by the FCC in prior fiscal years: https://paymentaccuracy.gov/.

The Commission has nine components with funding disbursements that are under the direction of the Commission and its Administrators. The Commission categorizes the components as listed below.

- 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)
- TV Broadcaster Relocation Fund (TVF)

I. Payment Reporting

Table 1 below reports the improper payment rates for USF-HC, USF-S&L, USF-LL and TRS. The USF-HC and USF-LL programs established base line error rates in FY 2017. USF-S&L established a baseline error rate in FY 2015, and TRS is using an OMB-approved alternative methodology.

Table 1 below provides total outlays, estimated amounts of payments improperly paid (broken down by overpayments and underpayments), estimated total improper payments, estimated improper payment percentages, estimated amount of proper payments, estimated proper payment percentages, and reduction targets for FY 2019.

Besides the programs listed in Table 1, the FCC has not identified any of its other programs as being susceptible to significant improper payments for FY 2018 reporting purposes. Furthermore, the Commission did not make payments to beneficiaries who then redistributed the Federal money to other recipients; as such, the Commission does not have any improper payments to report based on payments made by its beneficiaries.

[1] Improper Payments Information Act (IPIA) of 2002, Improper Payments Elimination and Recovery Act (IPERA) of 2010, and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012.

Table 1
Improper Payment (IP) for Current Year and Reduction Targets for FY 2019
($ in millions)

Program	Outlays[2]	Estimated Over-payments	Estimated Under-payments	Estimated Improper Payments	Estimated Improper Payment %	Estimated Proper Payments	Estimated Proper Payment %	Reduction Targets FY 2019
USF-HC	$4,603.94	$0.05	$1.15	$1.20	0.03%	$4,602.74	99.97%	0.024%
USF-S&L	$2,626.37	$67.99	$0.00	$67.99	2.59%	$2,558.38	97.41%	2.20%
USF-LL	$1,228.90	$227.02	$0.00	$227.02	18.47%	$1,001.88	81.53%	15.00%
TRS	$1,287.00	$.29	$.05	$.34	0.03%	$1,286.66	99.97%	0.00%
TOTAL[3]	$9,746.21	$295.35	$1.20	$296.55	0.03%	$9,449.66	96.96%	2.60%

2 In the case of Outlays for USF-HC, USF-S&L, and USF-LL, the numbers shown are calendar year numbers because the USF program fund year runs on a calendar year basis. In the case of TRS, the numbers shown are for the TRS fund year which runs from July 1 through June 30.

3 Please note as mentioned on the first page of this section, the FCC has established baseline error rates for USF-HC, USF-S&L, and USF-LL. The FCC is still working towards establishing a baseline error rate for TRS. As such, the improper payment error rate for TRS in this table does not represent the baseline error rate for that FCC program yet. The FCC should have a baseline error rate for TRS in its FY 2019 report.

Root Cause for Overpayments and Underpayments

Table 2 below categorizes the improper payments by root cause categories. The FCC has also provided a separate chart for USF-LL below Table 2 to detail the root causes for the "Insufficient Documentation to Determine IP" category. Many of the USF improper payments do not fit logically into the improper payment root cause categories established by OMB. Therefore, these payments are categorized under an "Other Reason" category. The "Other Reason" categories are defined in Table 2 below and detailed in the subsequent charts.

Table 2
Root Cause for Overpayments and Underpayments
($ in millions)

Reason for Improper Payment		USF-HC		USF-S&L		USF-LL		TRS	
		Overpayments	Underpayments	Overpayments	Underpayments	Overpayments	Underpayments	Overpayments	Underpayments
Administrative or Process Error Made by:	Other Party (e.g., participating lender, health care provider, or any other organization administering Federal dollars)	$0.00	$0.00	$19.67	N/A	$0.00	N/A	$.29	$.05
Insufficient Documentation to Determine IP (see table below)		$0.00	N/A	$0.00	N/A	$222.20	N/A	N/A	N/A
Other Reason (a) (Incorrect Part 36 and Incorrect Revenues)		$0.05	$1.15	N/A	N/A	N/A	N/A	N/A	N/A
Other Reason (b) (USF-LL see table below)		N/A	N/A	N/A	N/A	$4.82	N/A	N/A	N/A
Other Reason (c) (USF-S&L see table below)		N/A	N/A	$48.32	N/A	N/A	N/A	N/A	N/A
Other Reason (d) (Confirmed Fraud)		$0.00	$0.00	$0.00	N/A	$0.00	N/A	N/A	N/A
TOTAL		$0.05	$1.15	$67.99	N/A	$227.02	N/A	$.29	$.05

Table 2.1
Insufficient Documentation to Determine IP - USF-LL ($ in millions)

Insufficient Documentation to Determine IP (USF-LL)	Improper Payments Amounts	
	Overpayments	**Underpayments**
Unsupported Subscriber Count	$0.05	N/A
Missing Certifications	$7.68	N/A
Inadequate Certifications	$214.03	N/A
One Per Household Rule	$0.44	N/A
Total Insufficient Documentation to Determine IP	$222.20	N/A

Table 2.2
Other Reason (b) - USF-LL ($ in millions)

Other Reason (b) - (USF-LL)	Improper Payments Amounts	
	Overpayments	**Underpayments**
Ineligible Subscribers	$3.12	N/A
Intercarrier Duplicates	$1.18	N/A
Duplicate Subscribers	$0.52	N/A
Total Other Errors	$4.82	N/A

Table 2.3
Other Reason (c) - USF-S&L ($ in millions)

Other Reason (c) - USF-S&L	Improper Payments Amounts	
	Overpayments	**Underpayments**
Competitive Bidding	$16.23	N/A
Failure to Pay Non-Discounted Share	$0.97	N/A
Goods/Services Received by Ineligible Entity	$0.71	N/A
Recipient of Service Errors	$11.28	N/A
Internal Connections/Not Installed	$18.72	N/A
Service Provider Lowest Corresponding Price Confirmation/No Certification Billed Entity Applicant Reimbursement/No Certification Service Provider Invoice	$0.41	N/A
Total Other Errors	$48.32	N/A

Corrective Action Plans for Reducing the Estimated IP Rate and Amount

USF-LL

Insufficient Documentation to Determine IP, which includes unsupported subscriber count, missing certifications, inadequate certifications, and one per household rule violations. Other Reasons includes ineligible subscribers, intercarrier duplicates, and duplicate subscribers.

To reduce the incidence of improper payments and guard against fraud, the Universal Service Administrative Company (USAC) has established the Lifeline National Eligibility Verifier (National Verifier) along with the Lifeline Claims System (LCS). The Commission directed USAC to create the National Verifier to determine eligibility for subscribers in all U.S. states and territories to receive USF benefits. The National Verifier will become the singular authoritative source to determine eligibility for potential USF beneficiaries thereby reducing instances of ineligible subscribers. Furthermore, the National Verifier and LCS include multiple checks and validations to identify duplicate subscribers and ensure that proper supporting documentation is provided for enrollment. Starting in six states on November 2, 2018, Eligible Telecommunications Carriers (ETCs) are required to use the National Verifier to make eligibility determinations for all consumers applying for Lifeline service. Once a state has transitioned to the National Verifier, USAC will have the required Lifeline certification and recertification forms for the Lifeline subscribers in that state. This requirement will apply to ETCs in the remaining states/territories by the end of 2019. In conjunction with the rollout of the National Verifier, effective July 1, 2018, all ETCs must now use the eligibility certification language exactly as it is written on the universal form or established state certification form. The FCC and USAC expect the implementation of the National Verifier and the updated universal form requirement to assist in preventing improper payments.

USF-S&L

Administrative or Process Error Made by Other Party and Other Reasons, which includes competitive bidding, failure to pay non-discounted share, goods/services received by ineligible entity, and recipient of service errors, internal connections not installed, service provider lowest corresponding price confirmation, no certification billed entity applicant reimbursement, and no certification service provider invoice.

USAC is implementing a two-phase approach to better identify and address the root causes for the "Other Reason" category.

Phase 1:
USAC plans to enhance its outreach approach surrounding common findings, including updates to the website training materials, conducting a webinar(s) focused on common findings, and communicating best practices based on the observations made during the 2018 Payment Quality Assurance (PQA) reviews. USAC is developing an approach for delivering additional training and outreach with the applicant and service provider community to reduce the frequency of improper payments related to these findings. USAC plans to finalize the Phase 1 Plan before December 31, 2018.

Phase 2:
USAC's Schools and Libraries Program is performing a comprehensive assessment of its operational processes and procedures to determine areas where improvements can be made, and efficiencies maximized. Once this assessment is complete, USAC will determine the appropriate steps to modify or enhance its operational processes and procedures to help mitigate these types of errors. USAC will finalize its Phase 2 Plan for this assessment by March 31, 2019.

II. Recapture of Improper Payments Reporting

The Commission performed payment recapture audits on all programs. For those programs for which improper payments were identified, the Commission has either recovered or is in the process of recovering the payments. All improper payments are deemed to be collectible. For any improper payments identified, the Commission is assessing the reason for the improper payment and will take corrective actions to prevent such improper payments from re-occurring, such as changing a business process, strengthening an internal control, or improving an existing rule.

USF-Admin

A total of $17,668 of improper payments related to USF Administrative Costs were identified in FY 2018 through various reviews of financial transactions. In 2018, independent auditors conducted the annual Agreed Upon Procedures (AUP) review of USAC. During the AUP review, an exception was noted for one former employee whose final paycheck included a duplicate payment for vacation pay. This duplicate payment resulted in an improper payment of $296, which USAC is working to recover. In addition, USAC's finance team identified three improper payments totaling $13,655. These three payments consisted of the following: 1) an overpayment for education reimbursement of $2,775, 2) a duplicate payment to a vendor, resulting in a $7,326 improper payment, and 3) an overpayment to a terminated employee for $3,554. USAC has recovered all of the $13,655 in improper payments identified by its finance team. Finally, improper payments in the amount of $3,717 were identified related to improper corporate credit card use. USAC considers it improper to use corporate credit cards for payment of expenses unrelated to customary and reasonable expenses incurred on behalf of USAC while performing authorized business activities. USAC's expense policy requires that an expense report indicating that the charge was a personal expense be submitted within two weeks of incurring the charge. Amounts owed are deducted from the employee's next paycheck. USAC has recovered the $3,717 related to corporate credit card use. The Commission will work with USAC to avoid a repeat of the issues described above. The Commission continues to identify this program as not susceptible to significant improper payments.

USF-HC, USF-LL, USF-RHC, & USF-S&L

USAC has completed 79 audits in FY 2018; 45 of those audits involved overpayments. Of the audits with overpayments, the auditors identified $6,843,870 for recovery. USAC has completed recovery for more than 38% of these overpayments as of September 30, 2018 and is in process of recovering the remainder. Below is a summary chart that provides the total number of audits performed and the estimated recovery amounts, by program for FY 2018:

Program / Area	# Audits	# Audits with Overpayments	Total Estimated Amount to be Recovered
USF-HC	10	7	$2,713,801
USF-S&L	39	20	$3,557,486
USF-LL	28	18	$572,583
USF-RHC	2	0	$0
Total	79	45	$6,843,870

TRS

Rolka Loube LLC (RL) serves as the TRS Administrator under a contract with the FCC. RL continued to conduct TRS Internet-based Certification Application audits, in alignment with the requirements in 47 C.F.R. § 64.606(a)(2). The scope of the audit program included four remaining providers that were not audited in the scope of the prior year audit program. The audits covered the period of July 1, 2017 through June 30, 2018. Across the audits of the four providers, RL reported 40 findings. All findings have been or are currently being remediated by the providers including the creation and implementation of corrective action plans. For all audits, the Commission works with RL to ensure that all findings and observations are addressed and remediated by providers. No improper payments were found during the FY 2018 audit process. In addition, RL performed a remediation analysis of prior year audit findings during FY 2018 to ensure corrective actions were implemented.

North American Numbering Plan (NANP)

Welch LLP, who serves as the billing and collection agent for the NANP fund under a contract with the FCC, conducted an audit of the NANP fund to determine whether any improper payments were made. This audit did not identify any improper payments, and the Commission continues to identify this program as not susceptible to significant improper payments.

FCC Operating Expenses

The FCC conducted a payment recapture audit of its FY 2018 operating expenses of $430 million. The FCC selected 55 non-salary expenditures totaling $13,398,910 for review. The FCC also selected 50 payments amounting to $258,924 in salary expenditures for review. The FCC selected the samples from the time period of October 1, 2017 to July 31, 2018. This review did not identify any improper payments, and the Commission continues to identify this program as not susceptible to significant improper payments.

TV Broadcaster Relocation Fund (TVF)
The Commission used an outside contractor to test the Commission's processes and controls associated with payments from the TVF to eligible entities to identify any improper payments. A sample of 75 payments was randomly selected and tested for improper payments, and no improper payments were identified. While there were no improper payments identified in the sample, the contractor recommended areas where adherence to process and documentation could be improved. The Commission is committed to taking corrective actions to mitigate these recommendations.

In addition to the testing of payments described above, the Commission performed additional procedures to identify any potential improper payments, and through these reviews, the Commission identified 15 improper payments totaling $572,137. The Commission has recovered all these improper payments, except for $62,515. The Commission plans to collect the remaining amount of improper payments in the near future.

Improper Payment Recapture with and without Audit Programs
In Table 3 below, the FCC reports the amounts identified in the FY 2018 payment recapture audits. Overpayments identified and recaptured outside of the payment recapture audits may include, but are not limited to, the following sources of information: improper payments identified through testing of statistical samples of payments conducted under IPERIA, known as the PQA program for USF; internal review processes (i.e. commitment adjustments, in-depth validations, etc.); FCC Office of Inspector General audits; self-reporting; or investigations. As directed by OMB, the chart includes overpayments identified and recovered in FY 2018, regardless of the period an audit covered or when the overpayment occurred.

The targets for USF-Admin, NANP, FCC, TRS, and TVF are "not applicable" because no audit findings were identified through payment recapture audits. For USF programs, the recovery rates can vary extensively from year to year. Because participants in the programs have the right to appeal the improper payment findings, the recovery rates, and therefore future targets, may vary annually. Moreover, participants may appeal multiple times at different levels of the process (e.g., to USAC and then to the FCC's Wireline Competition Bureau). As such, it is unlikely that all identified overpayments can be recovered within the same fiscal year that the overpayments are identified.

Table 3
Improper Payment Recaptures with and without Audit Programs
($ in millions)

Program or Activity	Contracts			Benefits							
	Amount Identified	Amount Recapture	CY Recapture Rate	Amount Identified	Amount Recaptured	CY Recapture Rate	Total		Overpayments Recaptured Outside of Payment Recapture Audits		
							Amt Identified	Amt Recaptured	Amt Identified	Amt Recaptured	CY Recapture Rate
USF-HC	N/A	N/A	N/A	$2.714	$1.551	57.16%	$2.714	$1.551	$0.080[4]	$0.005	6.25%
USF-S&L	N/A	N/A	N/A	$3.557	$2.746	77.20%	$3.557	$2.746	$40.759[5]	$6.717	16.48%
USF-LL	N/A	N/A	N/A	$0.573	$0.022	3.84%	$0.573	$0.022	$1.442[6]	$2.211	153.33%
USF-RHC	N/A	N/A	N/A	$0.000	$0.113	0.00%	$0.000	$0.113	$7.770[7]	$1.509	19.42%
USF-Admin	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	$0.018[8]	$0.017	94.44%
FCC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
NANP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
TRS	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	$1.000[9]	$0.000	0.00%
TVF	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	$0.572[10]	$0.510	89.16%
TOTAL	N/A	N/A	N/A	$6.844	$4.432	64.76%	$6.844	$4.432	$51.641	$10.969	21.24%

[4] The USF-HC Amount Identified Outside of Payment Recapture Audits includes the following item: a late penalty was assessed to the incorrect service provider.

[5] The USF-S&L Amount Identified Outside of Payment Recapture Audits includes the following items: (1) system errors where edit checks and validations were not designed to prevent improper payments, and (2) calculation errors resulting from an incorrect understanding of the program requirements.

[6] The USF-LL Amount Identified Outside of Payment Recapture Audits includes the following items: (1) results from USAC analysis to identify and recover improper payments to deceased or duplicate subscribers, and (2) payments to two service providers where the service providers did not comply with the requirement to register subscribers in the National Lifeline Accountability Database.

[7] The USF-RHC Amount Identified Outside of Payment Recapture Audits includes the following items: results from USAC analysis that identified ineligible providers.

[8] The USF-Admin Amount Identified Outside of Payment Recapture Audits includes the following items: (1) amounts paid with the USAC corporate card that were deemed not for USAC business activities, (2) results of the AUP review, which identified an exception for one employee whose final paycheck included a duplication of vacation pay, and (3) amounts identified by USAC's Finance department related to: an overpayment for education reimbursement, a duplicate payment to a vendor, and an overpayment to a terminated employee.

[9] The Commission entered into a consent decree in February 2017 with a TRS provider and its parent company to resolve pending enforcement matters. One million is still outstanding and will be returned to the TRS fund once the initial interest payments are made. Per the consent decree, the TRS fund will be reimbursed starting in May 2019.

[10] During an internal review the Commission found the following: six duplicate payments, one payment with the wrong invoice amount, and eight payments for non-reimbursable expenses. The Commission is in the process of recovering all of these payments

Table 4
Disposition of Funds Recaptured Through Payment Recapture Audits
($ in millions)

Program or Activity	Amount Recovered *(This amount will be identical to the "Amount Recovered" in Table 3)*	Type of Payment *(contract, grant, benefit, loan, or other)*	Original Purpose
USF – HC	$1.551	Benefit	$1.551
USF - S&L	$2.746	Benefit	$2.746
USF – LL	$0.022	Benefit	$0.022
USF – RHC	$0.113	Benefit	$0.113
USF – Admin	N/A	Contract	N/A
FCC	N/A	Contract	N/A
NANP	N/A	Contract	N/A
TRS	N/A	Benefit	N/A
TVF	N/A	Contract	N/A
TOTAL	$4.432		$4.432

Table 5
Aging of Outstanding Overpayments Identified in the Payment Recapture Audits
($ in millions)

Program or Activity	Type of Payment *(contract, grant, benefit, loan, or other)*	Amount Outstanding (0 – 6 months)	Amount Outstanding (6 months to 1 year)	Amount Outstanding (over 1 year)	Amount determined to not be collectable *(include justification in Payment Recapture Narrative))*
USF-HC	Benefit	$2.052	$0.000	$2.650	$0.000
USF-S&L	Benefit	$1.255	$0.286	$14.401	$0.000
USF-LL	Benefit	$0.430	$0.125	$0.080	$0.000
USF-RHC	Benefit	$0.000	$0.000	$0.002	$0.000
USAC Admin	Contract	N/A	N/A	N/A	N/A
NANP	Contract	N/A	N/A	N/A	N/A
FCC	Contract	N/A	N/A	N/A	N/A
TRS	Benefit	N/A	N/A	N/A	N/A
TVF	Contract	N/A	N/A	N/A	N/A
TOTAL		$3.737	$0.411	$17.133	$0.000

III. Agency Improvement of Payment Accuracy with the Do Not Pay Initiative

FCC

Pursuant to the Do Not Pay (DNP) Initiative, the FCC has incorporated the use of the DNP databases and continuous monitoring into the FCC's existing business processes. Each month, the FCC generates an updated vendor file to be placed on the U.S. Treasury's server. This file is matched with the Death Master File of the Social Security Administration (DMF), List of Excluded Individuals and Entities (LEIE), Office of Foreign Assets Control (OFAC), and the System for Award Management's (SAM) Entity Registration and Exclusion Records. If any payments are stopped, the FCC will research the item and contact the vendor. Also, when there is a positive match, the FCC will tell the vendor to contact Treasury for details regarding the stopped payment. If the match is a false positive, the FCC will submit an adjudication report to Treasury.

USF
USAC generates an updated vendor file to be placed on the U.S. Treasury's server. This file is matched with the DMF, LEIE, OFAC, and SAM. If any payments are stopped, USAC will research the item and contact the vendor. Also, when there is a positive match, USAC will tell the vendor to contact Treasury for details regarding the stopped payment. If the match is a false positive, USAC will submit an adjudication report to Treasury.

TRS
RL frequently sends a master vendor file to the U.S. Treasury for comparison with data such as OFAC, SAM, and the Treasury Offset Program (TOP) Debt Check. Additionally, within the DNP portal, TRS uses two functions in order to reduce improper payments: batch matching and online single sign-on. RL uses the DNP portal prior to payment and award.

IV. Barriers

At this time, the FCC has not identified any statutory, regulatory, or other barriers that may limit the agency's corrective actions in reducing improper payments for its programs.

V. Accountability

In FY 2016, USAC, in conjunction with the FCC, implemented a strategic management framework with objectives at the corporate, division, and program levels. For FY 2018, USAC established strategic initiatives that will contribute to the achievement of those objectives, including initiatives that address efficient and effective program execution with an emphasis on program integrity and outcomes. USAC continues to utilize an enterprise-wide risk register to track risks that may prevent the successful achievement of the corporate objectives. In addition, each division at USAC has a unique risk register to identify program and division specific risks. The goal of USAC's Enterprise Risk Management (ERM) effort is to integrate risk management into USAC's operations, resulting in a continuous process of identification, assessment, response, and reporting of risk that may threaten achieving project, program, and strategic objectives. Any major risk that may impact strategic initiatives is escalated and reported to USAC's senior leadership. Regularly providing managers and decision-makers with timely feedback allows leadership to make course corrections to achieve USAC's strategic objectives. In addition, USAC has established leadership councils for each of the USF programs as well as integrated project teams for strategic projects. USAC employs operational meetings to review performance of program objectives and progress of strategic projects. USAC, in consultation with the FCC, defines performance metrics that are routinely reported to USAC's senior leadership and relevant leadership councils. Both the leadership council and operational meetings provide an opportunity to analyze and respond to identified changes and related risks to maintain an effective internal control system as well as effective enterprise systems management.

VI. Agency Information Systems and Other Infrastructure

The FCC, in conjunction with its reporting components, has worked to ensure that both the FCC and its reporting components maintain information systems that have the necessary controls in place to prevent, detect, and recover improper payments. In the case of USF S&L, information technology system enhancements were identified and deployed to improve operational efficiency and reduce improper payments. Several enhancements were implemented to accurately calculate program timelines associated with establishing the service start date, service delivery date, and invoice deadline date. Furthermore, in the case of USF-LL, the FCC's FY 2016 *Lifeline Modernization Order* directed USAC, in cooperation with the FCC, to establish an external third-party verifier. The FCC's deadline for the establishment of a third-party verifier is the end of calendar year 2019. Prior to the verifier, service providers were required to verify eligibility for potential subscribers. USAC is using a phased approach to roll out the National Verifier. When the National Verifier is fully implemented, it will determine program eligibility for subscribers in all U.S. states and territories. Starting on November 2, 2018, ETCs in six states are required to use the National Verifier to make eligibility determinations for all consumers applying for Lifeline service. This requirement will apply to ETCs in the remaining states/territories by the end of 2019. The FCC and USAC expect the implementation of the National Verifier to assist in preventing improper payments. The National Verifier will also improve upon existing means for resolving duplicates in the Lifeline program through the National Lifeline Accountability Database (NLAD).

In addition, under the Commission's oversight, USAC has made the following improvements:

- 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.

VII. Sampling and Estimation

USF-HC, USF-S&L & USF-LL

In FY 2018, the Commission utilized statistical sampling methodology to estimate the annual amount of improper payments in the USF-HC, USF-S&L, and USF-LL programs. This process, called the PQA assessment plan, tested disbursements made in calendar year 2017. The goal of the PQA plan was to estimate an improper payment error rate based on non-compliance with the Commission rules. As approved by OMB, the PQA plan was designed to extrapolate an improper payment error rate for each program as a whole. In accordance with OMB guidance, a brief description of the sampling process follows below.

USF-HC

A baseline improper payment rate was established for USF-HC for the first time in FY 2017. In FY 2018, the Commission used stratified simple random sampling to select a sample of monthly transactions from calendar year 2017. The sample consisted of 1,696 Study Area Codes (SACs) that had absolute disbursement totals of at least $900 in calendar year 2017.

Assessments of calendar year 2017 transactions were conducted monthly and included: 1) steps to measure the accuracy of payments; 2) evaluation of carrier eligibility; and 3) testing of high-level information obtained from program participants.

The estimated improper payment amount for USF-HC in FY 2018 is $1.20 million with a margin of error of plus or minus $1.67 million. The estimated improper payment rate for FY 2018 is 0.03% with a margin of error of plus or minus 0.04%. The rate is obtained by dividing the improper payment amount by the actual total disbursements of $4,603.94 million.

USF-S&L

A baseline improper payment rate was established for USF-S&L for the first time in FY 2015. The Commission maintained the same stratified sampling design in FY 2018 that was used in the prior year, while also decreasing the overall sample size from 478 to 443 invoice lines. The separate ratio estimator was used for these estimates. The smaller sample size was more than adequate to maintain a margin of error well below the OMB mandate of plus or minus 3% at the 95% confidence level.

The FY 2018 procedures used for the assessments of calendar year 2017 transactions were similar to those used in FY 2017. The FY 2018 procedures included the following: 1) measuring the accuracy of payments; 2) evaluating program applicants' eligibility; 3) testing high-level information obtained from program participants; 4) reviewing technology plans for certified approval and timing of approval, where applicable; 5) verifying service eligibility; 6) confirming lowest corresponding price; and 7) physically inspecting installation and use of equipment.

The estimated improper payment amount for USF-S&L in FY 2018 is $67.99 million with a margin of error of plus or minus $40.63 million. The improper payment amount is obtained by multiplying the sample improper payment rate in each stratum by the actual total disbursement amount for the stratum and then totaling the strata. The estimated improper payment rate for FY 2018 is 2.59% with a margin of error of plus or minus 1.55%. The rate is obtained by dividing the improper payment amount by the actual calendar year 2017 disbursements of $2,626.37 million.

USF-LL

A baseline improper payment rate was established for USF-LL for the first time in FY 2017. In FY 2018, the Commission used stratified simple random sampling to select a sample of monthly transactions from calendar year 2017. The sample universe consisted of 1,719 SACs that had absolute disbursement totals of at least $900 in the prior calendar year 2017.

Assessments of calendar year 2017 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) testing for intercarrier duplicates.

Three different classes of improper payments were identified in the sample of 365 disbursements.

1. Class 1 consisted of exceptions tested on all subscribers. Class 1 included the following: improper rate, unsupported lines, missing or incomplete subscriber data (name, address, date of birth, and last four digits of social security number), duplicate subscriber, or incomplete documentation.
2. Class 2 consisted of exceptions that could only be tested on a sample of subscribers. Class 2 consisted of inter-carrier duplicates, missing eligibility documentation, missing enrollment certification or re-certification forms, and submitted forms that lacked a name, date, or signature. Class 2 exceptions were tested on random samples of 25 to 60 subscribers for each case. The sample results were then extrapolated to obtain an estimate of improper payments for the entire invoice due to Class 2 exceptions.
3. Class 3 consisted of those cases subject to the One Per Household (OPH) criterion. Subsamples of individuals were used to estimate the total amount of improper payments arising from OPH exceptions. In households with two to four beneficiaries, sample sizes ranged from 25 to 60 subscribers. In households with more than 4 beneficiaries, sample sizes ranged from 20 to 35 subscribers. Improper OPH payments from a sample of subscribers listed on an invoice were extrapolated to estimate the total improper payment due to OPH exceptions for the entire invoice.

The three classes of improper payments were combined to obtain the total improper payment made for an invoice. These improper payments were then extrapolated to estimate the total improper payment amount for the Lifeline program.

The estimated improper payment amount for USF-LL in FY 2018 is $227.02 million with a margin of error of plus or minus $15.40 million. The estimated improper payment rate for FY 2018 is 18.47% with a margin of error of plus or minus 1.25%. The rate is obtained by dividing the improper payment amount by the actual total disbursements of $1,228.90 million. The estimated margin of error of the improper payment rate was below the minimum of plus or minus 3.0% at the 95% confidence level specified by OMB.

TRS

The TRS Fund Administrator hired an independent auditing firm to conduct testing for TRS utilizing an alternative sampling methodology previously approved by OMB. The independent audit firm relied on the guidance issued by OMB. The plan used in FY 2018 for TRS was not designed to extrapolate an improper payment error rate for the program as a whole. Rather, the goal was to estimate an improper payment error rate for non-compliance with the Commission rules. The Commission is using an alternative sampling methodology because the Commission is continuing work to establish a user registration database that will allow it to test all payments and establish a baseline error rate.

The scope of review by the independent auditing firm included reviewing processes performed by the Administrator to determine whether the billable minutes presented by TRS providers met the criteria for reimbursement based on the FCC's rules. The error rate was calculated for minutes paid during the program year of July 1, 2017 through June 30, 2018.

The auditor conducted a risk assessment related to disbursement of TRS Funds to TRS providers. Based upon this assessment, risk factors associated with improper payment to TRS providers were identified. The auditor then used these risk factors as the basis for the attributes and tests incorporated into their test steps for the statistically valid sample of payments. The risk factors included both over and underpayment risks.

The list below identifies the risk areas or attributes associated with improper payments to TRS Service Providers. These risks were tested for improper payments and the test results were utilized to develop the improper payment rate.

1. Payments are made to TRS providers on the FCC's "red-light" list, which shows whether an entity currently has a delinquent debt pending at the FCC.
2. Payments are made to Video Relay Service (VRS), Internet Protocol Relay, or Internet Protocol Captioned Telephone Service (CTS) providers who did not submit a complete Speed of Answer (SOA) report.
3. Payments are made to VRS, Internet Protocol Relay, or Internet Protocol CTS providers for days where the SOA daily performance standards are not met.
4. TRS Funds are disbursed without proper authorization from the Administrator to the bank and/or amounts do not reflect the approved rate.
5. Payments are made to VRS, Internet Protocol Relay, or Internet Protocol CTS providers when Call Detail Records (CDRs) do not contain the required information in the required format.
6. Payments are made to VRS, Internet Protocol Relay, or Internet Protocol CTS providers when the CDRs are not in compliance with applicable FCC rules.
7. Payment to an ineligible TRS provider due to non-submission or improper submission of the Intent to Participate.

Upon completion of these tests, the TRS program was determined to have an improper payment rate of 0.03% for FY 2018. As previously noted, TRS does not yet have a baseline error rate as not all of the components of the program are being tested at this time.

VIII. Risk Assessment

The Commission has nine components with funding disbursements that are under the direction of the Commission and its Administrators. The Commission categorizes the components as listed below.

- 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)
- Telecommunications Relay Services (TRS)
- North American Numbering Plan (NANP)

- Operating Expenses (FCC)
- TV Broadcaster Relocation Fund (TVF)

From the programs listed above, the Commission previously identified the USF-HC, USF-S&L, USF-LL, and TRS programs as susceptible to significant improper payments. In FY 2018, pursuant to Appendix C, which requires a risk assessment once every three years for programs not susceptible to significant improper payments (or periodically if significant changes occur), the Commission conducted risk assessments of the USF-RHC, USAC-Admin, FCC operating expenses, and NANP programs. These programs all continue to be low risk, except for USF-RHC, which the Commission has determined should be added to the list of programs that are susceptible to significant improper payments. The TVF is a new program and will need to be assessed for improper payment risk in FY 2019.

In conducting its risk assessment 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 FY 2018, or $100 million of improper payments (regardless of the improper payment percentage of total program outlays). In addition, the Commission analyzed each program's risk by taking into account all the factors identified by Appendix C.

Other Agency-Specific Statutorily Required Reports

Fraud Reduction Report

Pursuant to the Fraud Reduction and Data Analytics Act of 2015, Public Law 114-186, the FCC is providing the following information to report on its fraud reductions efforts, including the implementation of strengthened internal controls, fraud risk assessment, and fraud risk management. Beginning in FY 2015, the Commission implemented new risk assessment tools to update its pre-existing processes for internal controls evaluation. The FCC implemented this improvement both at the FCC and at its reporting components, which assist the FCC in managing the funds the FCC has the authority to oversee, including USF, TRS, and NANP.

The FCC's updated risk assessment process integrates the latest versions of the Government Accountability Office's (GAO), Standards for Internal Control in the Federal Government (Green Book), as well as OMB's Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control. Utilizing GAO's Green Book as a blueprint, the FCC implemented an entity level risk assessment tool that is completed each fiscal year by its largest Bureaus and Offices as well as its reporting components in alignment with the Enterprise Risk Management framework for the Commission.

The entity level tool includes all seventeen principles from GAO's Green Book, and as such, each organizational unit is asked to assess its fraud risk pursuant to Principle 8 of the Green Book. Furthermore, the Commission uses an additional program risk assessment tool for higher risk areas, such as the USF programs, TRS, and NANP, as well as functions related to auctions, contracts, financial operations, human resources, and information technology. Like the entity level tool, the program risk assessment tool also includes fraud risk as an assessment area that program managers evaluate annually for these higher risk functions. Finally, the FCC's EB and OIG also coordinate with relevant Commission Bureaus and Offices, as well as the Department of Justice (DOJ) as necessary, to share information and take appropriate action as fraud related issues arise.

Building upon the FCC's improvements to these processes, the FCC has updated the entity level risk assessment process to include ERM pursuant to OMB Circular A-123. The integration of ERM into the risk assessment process reinforced the fraud risk analysis already present in the entity level tool. The ERM related updates require entities to evaluate the risks that they are facing, including fraud risk, to achieving their strategic, operational, compliance, and reporting objectives.

In summary, the FCC has put processes in place to gather and analyze information about the fraud risks it is facing. The FCC's sources of information include:

- fraud risk analyses in the entity level assessments and the program level assessments,
- investigations supporting enforcement actions,
- audits of beneficiaries of the USF and TRS programs, and
- testing of payments to USF and TRS beneficiaries as well as testing of FCC payroll and contract payments.

Utilizing this information, the FCC is able to incorporate an enterprise level view of the fraud risks into its operations as well as those facing the USF, TRS, and NANP funds.

From one fiscal year to the next, the Commission takes these risks into account as it conducts its operations, implements new programs, or alters existing programs. If issues are detected that require mitigation, the FCC can pivot towards the problem, make course corrections, and take action as necessary, including withholding payments, seeking recovery of funds, amending existing processes, updating policies and procedures, and referring cases to the OIG as necessary for potential prosecution in conjunction with DOJ.

USF
During the course of conducting audits and potentially through whistleblower complaints, USAC may identify instances of potential fraudulent activity. Any such instances are reported to the USAC Office of General Counsel (OGC), which collects information about the potential fraudulent activity. USAC OGC provides this information to the FCC's Enforcement Bureau (EB) and Office of Inspector General (OIG). The FCC will investigate and provide direction to USAC for recovery of USF support, if warranted. The PQA reviews used by USAC to test for improper payments are not designed to perform testing for fraud; however, if anomalies are identified through PQA, USAC will perform additional investigation.

TRS
RL has various fraud prevention measures in place with regards to improper payments to providers. In addition, RL hired a certified fraud examiner who reviews CDR submissions and payments for potentially fraudulent activity and anomalies within the data submitted by the providers or data compiled by RL staff to generate distribution requests for reimbursement. Also, the RL senior internal advisory council, which is comprised of executive level employees, a third-party risk assessor, and a subcontractor, meets annually to review the TRS risk assessment performed as well as outline the expectations for the upcoming service period. The internal RL risk assessment policy is reviewed annually at that meeting as well.

Other payments from the TRS fund follow a similar process as that outlined above, the only difference being that the Red-Light Verification report is not necessary for non-FCC registered vendors. No confirmed fraud has been identified in this program for the FY 2018 reporting period.

Schedule of Civil Monetary Penalties

On November 2, 2015, the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 ("the 2015 Act"), which was included as Section 701 of the Bipartisan Budget Act of 2015, was signed into law. The 2015 Act amended the Federal Civil Penalties Inflation Adjustment Act of 1990 to improve the effectiveness of civil monetary penalties and to maintain their deterrent effect.

The 2015 Act required agencies use an interim final rulemaking (IFR) to adjust the level of civil monetary penalties in 2016 with an initial "catch-up" adjustment. The 2015 Act also requires agencies to continue to make annual inflation adjustments in future years and to report on these adjustments annually.

On December 15, 2017, OMB provided its annual inflation adjustment update to agencies through OMB Memorandum M-18-03, *Implementation of Penalty Inflation Adjustments for 2018*. On January 5, 2018, the FCC's Enforcement Bureau adopted and released an order, DA 18-12, which adjusted the Commission's forfeiture penalties for inflation for 2018.

The following table shows various civil monetary penalties that may be used by the Commission in carrying out its mission as well as additional information about the FCC's statutory authority for these penalties and the location of the FCC's most recent action to adjust these penalties for inflation.

Statutory Authority	Penalty (Name or Description)	Year Enacted	Latest year of adjustment (via statute or regulation)	Current Penalty Level ($ Amount or Range)	Sub-Agency/ Bureau/Unit	Location for Penalty Update Details
Communications Act of 1934, as amended	Willful or Repeated Violation	1954 - 2010	2018	Up to $3,666,930	Enforcement Bureau (EB)	Federal Register 83 No. 22 (1 February 2018): 82 FR 4600. https://www.gpo.gov/fdsys/pkg/FR-2018-02-01/pdf/FR-2018-02-01.pdf; https://www.fcc.gov/document/2018-adjustment-civil-monetary-penalties-reflect-inflation
47 U.S.C. 202 (c)	Discrimination	1989	2018	$11,784 $589/day	EB	Same as above
47 U.S.C. 203 (e)	Schedules of Charges	1989	2018	$11,784 $589/day	EB	Same as above
47 U.S.C. 205 (b)	Commission Charges	1989	2018	$23,566	EB	Same as above
47 U.S.C. 214 (d)	Extension of lines	1989	2018	$2,356	EB	Same as above
47 U.S.C. 219 (b)	Annual Report	1989	2018	$2,356	EB	Same as above
47 U.S.C. 220 (d)	Failure to maintain records	1989	2018	$11,784	EB	Same as above
47 U.S.C. 223 (b)	Obscene/ harassing telephone calls	1983	2018	$122,110	EB	Same as above
47 U.S.C. 227 (e)	Telephone equipment restrictions	2010	2018	$11,278/violation $33,833/day for each day of continuing violation up to $1,127,799 for any single act or failure to act	EB	Same as above
47 U.S.C. 364 (a)	Radio on board ships – Forfeitures	1989	2018	$9,819	EB	Same as above
47 U.S.C. 364 (b)	Radio on board ships - Forfeitures	1989	2018	$1,964	EB	Same as above
47 U.S.C. 386 (a)	Radio on board ships - Forfeitures	1989	2018	$9,819	EB	Same as above
47 U.S.C. 386 (b)	Radio on board ships - Forfeitures	1989	2018	$1,964	EB	Same as above
47 U.S.C. 503 (b)(2)(A)	Penalty provisions	1989	2018	$49,096/violation or each day of a continuing violation up to $490,967 for any single act or failure to act	EB	Same as above

Statutory Authority	Penalty (Name or Description)	Year Enacted	Latest year of adjustment (via statute or regulation)	Current Penalty Level ($ Amount or Range)	Sub-Agency/ Bureau/Unit	Location for Penalty Update Details
47 U.S.C. 503 (b)(2)(B)	Penalty provisions	1989	2018	$196,387/violation or each day of a continuing violation up to $1,963,870 for any single act or failure to act	EB	Same as above
47 U.S.C. 503 (b)(2)(C)	Penalty provisions	2006	2018	$397,251/violation or each day of a continuing violation up to $3,666,930 for any single act or failure to act	EB	Same as above
47 U.S.C. 503(b)(2)(D)	Penalty provisions	1989	2018	$19,639/violation or each day of a continuing violation up to $147,290 for any single act or failure to act	EB	Same as above
47 U.S.C. 503(b)(2)(F)	Penalty provisions	2010	2018	$112,780/violation or each day of a continuing violation up to $1,127,799 for any single act or failure to act	EB	Same as above
47 U.S.C. 507 (a)	Payment disclosure	1954	2018	$1,945	EB	Same as above
47 U.S.C. 507 (b)	Payment disclosure	1954	2018	$285	EB	Same as above
47 U.S.C. 554(f)	Equal employment opportunity	1992	2018	$870	EB	Same as above

Office of Inspector General's Management and Performance Challenges

UNITED STATES GOVERNMENT
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: October 23, 2018

TO: Chairman Ajit Pai
Commissioner Michael O'Rielly
Commissioner Brendan Carr
Commissioner Jessica Rosenworcel

FROM: Inspector General FOR RM

SUBJECT: Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000, the Office of Inspector General (OIG) is submitting the annual statement summarizing its assessment of the most serious management and performance challenges facing the Federal Communications Commission (FCC) in Fiscal Year 2018 and beyond. During its audits and investigations, OIG has recommended actions that best address these challenges. Additional information on OIG audits and investigations can be found in our most recent Semiannual Reports to Congress.

Information Security

The FCC continues to undertake significant information technology (IT) initiatives that support FCC *Strategic Objective 4.3: Effectively manage and modernize the FCC's information technology, financial, record keeping, facilities and human capital resources to best achieve the FCC's mission.* The FCC seeks to leverage newer technologies such as cloud computing, to enhance services to its stakeholders. While the FCC focuses on achieving its strategic objectives, the challenge lies in striking an acceptable balance between the implementation of new technologies and a sustainable information security program that complies with federal mandates.

The Commission has made progress in its information security program in the areas of risk management and information security continuous monitoring. However, significant work is needed before FCC achieves compliance with the Federal Information Security Modernization Act (FISMA). The FY 2018 FISMA evaluation report identifies two significant deficiencies in IT security - identity and access management, and information security continuous monitoring. Both significant deficiencies represent repeat or updated findings and recommendations identified in prior year evaluations. Two of the most significant recommendations repeated from prior years are implementation of HSPD-12 PIV cards for logical access, and installation of patches and remediation of vulnerabilities within the required timeframes. Balancing implementation of information technology initiatives with improving compliance with information security standards remains a significant management challenge.

Universal Service Fund Programs

The Telecommunications Act of 1996 created the framework for the Universal Service Fund (USF or Fund), consisting of support mechanisms for: l) providing financial support to eligible telecommunications carriers that serve high-cost areas; 2) assisting schools and libraries with obtaining telecommunications and internet services; 3) assisting low-income consumers with obtaining affordable telephone service; and 4) assisting rural health care providers in gaining access to telecommunications and internet services. Under the direction of the Commission, the Fund is administered by the Universal Service Administrative Company (USAC). The OIG has ongoing audits to identify program risks, ensure compliance with program rules, and provide recommendations to reduce waste and abuse of program resources. OIG has also devoted significant assets to investigating allegations of fraudulent activity involving USF programs.

Within *Strategic Objective 3, Making Networks Work for Everyone*, FCC has recognized the need to ensure that universal service programs keep up with changing technologies and are well managed, efficient and fiscally responsible. We have observed the Commission's efforts supporting this objective and believe the FCC's comprehensive reforms in the USF programs, including implementation of the Connect America Fund, will require a significant investment of Commission resources, as well as effective USAC administration. Establishing direction and policy, managing transition, and ensuring that all USF program rules and regulations foster effective and efficient programs are significant management challenges.

High Cost Program

The USF High Cost program provides $4.5 million annually to ensure robust, affordable voice and broadband service, both fixed and mobile, are available to Americans throughout the nation. Under the USF Intercarrier Compensation (ICC) Transformation Order, issued in 2011, and Rate-of-Return Carriers Reform Order, issued in 2016, the High Cost program is transitioning to support multi-purpose networks capable of broadband and voice, while phasing out support for voice-only networks. During this transition, the High Cost program will utilize separate support mechanisms for the legacy High Cost program and the new Connect America Fund. The Connect America Fund will rely on incentive-based, market-driven policies, utilizing methodologies such as competitive bidding, to distribute universal service funds in a more efficient and effective manner.

FCC's challenge is to ensure the USF Transformation and Reform Orders are implemented timely and accomplish their intended purposes. One of the goals of these orders is to provide high-speed broadband to underserved areas. To address this challenge, USAC is in the process of developing a system, the High Cost Universal Broadband Portal (HUBB), to help USAC management determine if carriers meet their obligations to provide high-speed internet to specific underserved locations. HUBB incorporates latitude and longitude coordinates for every location where service is available, and USAC will eventually display this information on a public-facing map to show the impact of High Cost program resources on broadband expansion throughout rural America. Most carriers were obligated to provide high-speed internet to underserved areas by the end of 2016 or 2017. Because HUBB is not scheduled to be fully operational until this year, there is a risk carriers will not meet their obligation to provide high-speed broadband to specific underserved locations by the required program milestones.

Schools and Libraries (E-rate) Program

In 2017, the Schools and Libraries program, often called E-rate, provided $2.65 billion in support to over 104,722 schools and 11,475 libraries. In 2014, the Commission released two E-rate Modernization Orders. The first Order, effective in funding year 2015, adopted three program goals: 1) ensure schools and libraries have access to affordable high-speed broadband internet services; 2) maximize the cost-effectiveness of spending for E-rate supported purchases; and 3) ensure the E-rate application process is fast, simple and efficient.

The second Order aimed to close the connectivity gap by making more funding available for schools and libraries to purchase broadband connectivity capable of delivering gigabit service over the next five years. The Order increased the program funding cap from $2.4 to $3.9 billion and established a performance management system to evaluate the effectiveness of the modernization orders and identify program improvements.

To meet the Commission's program goal of ensuring a fast, simple and efficient E-rate application process, USAC developed and deployed the E-rate Productivity Center (EPC). EPC was originally scheduled to be fully operational by funding year 2016. However, EPC was not fully functional by the milestone date, resulting in delays in processing applications for program funding. There continue to be challenges, particularly with the application process. A May 2018 letter from the FCC's Office of Managing Director (OMD) to USAC addressed inconsistencies with the FCC Form 470 available to applicants in the E-rate Productivity Center (EPC) online portal. Specifically, the letter noted the drop-down menu options for seeking competitive bids for services may have conflicted with USAC guidance and, consequently, created confusion for many applicants and ultimately resulted in the denial of FY 2018 applications for E-rate support.

In addition, OIG and USAC audits and investigations continue to identify several risks to the E-rate program that continue to be management challenges:

- Missing or inadequate documentation to demonstrate compliance with FCC rules;
- Invoicing of the Fund for ineligible products or services;
- Inadequate documentation to substantiate compliance with competitive bidding rules;
- Insufficient Internet Safety Policies; and
- Products and/or services being received by ineligible entities.

Lifeline Program

The USF Lifeline program was established in 1985 to ensure that low-income consumers have access to affordable wireline phone service. In 2008, the program was expanded to provide support for wireless phone service, and in 2016 the program was expanded to provide broadband support. In 2017, the Commission disbursed about $1.3 billion in Lifeline support to over 10 million low-income households.

The Lifeline program continues to require significant resources to combat waste, fraud and abuse. The Commission comprehensively reformed the Lifeline program in 2012 and 2016 to require stricter oversight, including promulgating changes to the ways service providers must confirm consumer eligibility. However, some of these reforms have not yet been fully implemented. Moreover, in recent years, reports of fraud (largely involving the provision of service to ineligible individuals or the provision of multiple phones to eligible consumers) have increased significantly. Multiple federal criminal cases have been filed and several have resulted in guilty pleas. Audits and investigations have identified the following ongoing risks for the Lifeline program:

- Subscribers receiving duplicate service from two or more carriers;
- Carriers and their agents enrolling minors and other ineligible subscribers;
- Carriers having no evidence to support enrollment and de-enrollment of subscribers
- Carriers or their agents enrolling deceased subscribers; and
- A lack of accountability over sales agents and payment structures that incentivize fraud.

The OIG's 2017 Improper Payments Elimination and Recovery Improvement Act (IPERIA) audit found that the Lifeline program was non-compliant with the improper payment reporting requirements. Specifically, the estimated gross improper payment rate for the Lifeline program exceeded the OMB statutory limit of less than 10 percent of the program's gross outlay. The audit reported that the estimated gross improper payments for the Lifeline program was $336.39 million per year and the improper payment rate was 21.93 percent. Accordingly, FCC management reported that Lifeline improper payments were 11.93 percent above the OMB threshold. Ensuring that the Commission is compliant with the requirements of IPERIA is considered a significant management challenge.

USAC has several initiatives in process that should, over time, improve its Lifeline program controls. However, many of the initiatives will not be fully implemented until 2019. One of the initiatives that USAC has implemented to mitigate fraud, waste and abuse is the Lifeline National Eligibility Verifier (National Verifier), a system developed to determine whether subscribers are eligible for Lifeline benefits. Initially, the system's roll-out was delayed because of data privacy and security concerns. USAC recently begun the implementation of the system in 11 states and Guam. Continued, expeditious implementation of the National Verifier in all jurisdictions is essential to ensuring that it effectively serves to safeguard the integrity of the Lifeline Program. Ensuring Lifeline program initiatives have their intended effect and continuing to resolve open OIG audit and investigations team recommendations remain significant management and performance challenges.

Rural Health Care

The Rural Health Care (RHC) program, while previously undersubscribed since its inception, reached its $400 million annual funding cap in 2016. Logic dictates that when resources are scarcer, the likelihood for fraud increases. Although OIG investigators have seen evidence of millions of dollars of fraud in recent years, they have been unsuccessful in their attempts to prosecute these matters either civilly or criminally. It was the view of several US attorneys that RHC cases are fraught with problems and thus too risky to pursue, citing the difficulty in applying arguably ambiguous Commission rules and low dollar amounts (under $1 million) as obstacles. Determining ways to tighten RHC rules in a manner that would reduce fraud, waste and abuse, generally, as well as facilitate effective enforcement is a significant management challenge.

TV Broadcaster Relocation Fund

The Commission held an incentive spectrum auction in April 2017, to help improve and expand wireless services across the country and meet the needs of American consumers for faster, higher capacity mobile broadband services. The TV Broadcaster Relocation Fund was established by the Middle Class Tax Relief and Job Creation Act of 2012 (Spectrum Act of 2012) to reimburse costs reasonably incurred by broadcasters who are being relocated to new channels because the broadcast spectrum was repacked as a result of the 2017 incentive auction. The Commission determined that 957 stations, as well as multichannel video programing distributors, are eligible for reimbursement from the fund for costs incurred as a result of the repacking process.

The initial funding authorized by Congress for the reimbursing costs under the Spectrum Act of 2012 was $1.75 billion. In FY 2018, the RAY BAUM'S Act expanded the eligible providers to include additional broadcasters and increased the authorized funding by $600 million in FY 2018 and another $400 million anticipated in FY 2019. Thus, the total amount authorized for the fund is now $2.75 billion.

Since the creation of the fund, the Commission has established a fund administrator, Ernst and Young, and taken several additional actions to establish effective internal controls, minimize risk to ensure the best use of resources. Some examples of the actions taken include, establishing the Catalog of eligible reimbursable expenses, requiring relocation cost estimates from broadcasters, and establishing audits and other data validation techniques to verify compliance with program rules. Throughout the life of the fund, the Commission must ensure that risk is appropriately managed to protect the TV Broadcaster Relocation Fund against waste, fraud, and abuse.

cc: Managing Director
Chief of Staff
Chief Financial Officer
Chief Information Officer

Commission’s Response to Inspector General’s Management and Performance Challenges

Office of the Managing Director

MEMORANDUM

DATE: November 15, 2018

TO: David L. Hunt, Inspector General

FROM: Mark Stephens, Managing Director;
Kathleen Heuer, Chief Financial Officer
Christine Calvosa, Acting Chief Information Officer

SUBJECT: Management’s Response to Inspector General’s Management and Performance Challenges

Management has reviewed the Office of the Inspector General’s (OIG) memorandum, dated October 23, 2018, assessing the most serious management and performance challenges facing the Federal Communications Commission (Commission or FCC) for fiscal year (FY) 2018 and beyond. Management is pleased to report on its continued efforts, summarized below, to resolve the management challenges identified by OIG.

I. INFORMATION SECURITY

OIG identifies the FCC’s initiatives to leverage new technologies (*e.g.*, cloud computing) to support *FCC Strategic Objective 4.3: Effectively manage and modernize the FCC'S information technology, financial, record keeping, facilities and human capital resources to best achieve the FCC's mission*. OIG states that “while the FCC focuses on achieving its strategic objectives, the challenge lies in striking an acceptable balance between the implementation of new technologies and a sustainable information security program that complies with federal mandates.” The FCC Information Technology (IT) Group acknowledges this challenge and remains committed to balancing new technologies with a federally mandated information security program.

As the FCC continues to leverage new cloud technologies to support its mission and business functions, FCC IT ensures that compliance with security is included in the development, operation, and maintenance of the cloud technology that is being implemented. FCC IT requires that all Cloud Service Providers (CSP) are either: (1) compliant with Fedramp Risk and Authorization Management Program (FedRAMP); (2) in the process of achieving FedRAMP compliance; or (3) sponsored by the FCC. Doing so ensures that security controls are incorporated into the CSP before it goes live in production on the FCC network. FCC IT is also working on plans to modernize its legacy technologies and systems to ensure that all systems are compliant with federal mandates.

OIG further recognizes the progress made by the FCC in information security risk management and risk monitoring. Nevertheless, OIG states, "[b]alancing implementation of information technology initiatives with improving compliance with information security standards remains a significant management challenge." In doing so, OIG states additional work concerning identity/access management and information security continuous monitoring is needed to comply with the Federal Information Security Modernization Act (FISMA). OIG further identifies past recommendations concerning implementation of Homeland Security Presidential Directive (HSPD) -12 Personal Identify Verification (PIV) cards for logical access, and installation of patches and remediation of vulnerabilities within the required timeframes.

FCC IT acknowledges management and resource availability challenges associated with delivering modern, secure technology solutions to support the missions of the agency. The FCC IT infrastructure is currently comprised of many legacy systems, and it is a priority of FCC IT to modernize these systems to reduce their operational costs as well as improve their cybersecurity posture. Along with implementing modern technologies, FCC IT implemented enhanced processes and procedures which resulted in the reduction of open audit recommendations by 43 percent. In FY 2018, FCC IT closed 86 percent of the Office of Management and Budget (OMB) Circular A-130 audit recommendations, reduced OIG Website Assessment recommendations by 45 percent and reduced FISMA audit recommendations by 29 percent. FCC IT remains committed to address the deficiencies in the areas of risk management, information security continuous monitoring, and identity/access management. FCC IT is currently working on corrective action plans to remediate its existing FISMA findings in FY 2019, which include:

- Implementing an automated process to replace the existing manual account management of privileged and non-privileged users.
- Exploring alternative solutions for logical access using multi-factor authentication that is compliant with HSPD-12.
- Development of a three-year plan to obtain the Authority to Operate (ATO)s for all FCC systems. Included in this plan is the goal to remediate all delayed Plan of Action and Milestones by the end of FY 2019.
- Reducing system vulnerabilities through a mature patch-management process and by continuing to modernize the FCC's legacy applications. FCC IT will also enhance management visibility into the cybersecurity health of the application portfolio by providing improved and meaningful metrics on a regular basis.

II. UNIVERSAL SERVICE FUND

OIG recognizes the FCC's need to ensure that universal service fund (USF) programs keep up with changing technologies and are well managed, efficient, and fiscally responsible. As such, OIG believes comprehensive reforms in all the USF programs require a significant investment of Commission resources, as well as effective USAC administration. OIG states that establishing direction and policy, managing transition, and ensuring that all USF program rules and regulations contribute to effective and efficient programs are significant management challenges. Management concurs with the OIG's assessment and is pleased to report on its continued efforts, summarized below, to combat and resolve this management challenge.

<u>High-Cost.</u> OIG states the "FCC's challenge is to ensure the USF Transformation and Reform Orders are implemented timely and accomplish their intended purposes." One of the goals of these orders is to preserve and advance voice and broadband service to high-cost areas. As OIG notes, the Commission directed USAC to develop an online system (later named the High Cost Universal Broadband (HUBB) Portal) to accept high-cost recipients' broadband deployment information to track carriers' progress towards their broadband deployment milestones and to provide a means to collect Connect America Fund (CAF) supported broadband information for public distribution. Carriers began submitting data into the HUBB in 2017, and by each March 1, will report data as of the prior calendar year. Of those carriers with measurable interim deployment milestones in 2017, all reported meeting or coming close to meeting the 2017 milestone. USAC will

independently verify a sample of reported locations each year to monitor carriers' compliance with their deployment milestones.

On October 9, 2018, the Wireline Competition Bureau (WCB) announced that an interactive Connect America Fund Broadband Map (CAF Map) is now available that shows locations reported in the HUBB where funding recipients have already reported CAF-funded broadband deployment to fixed locations, as well as the public availability of HUBB data. The CAF Map illustrates both areas eligible for funding and the specific fixed locations where funding recipients have reported deployment by address and geographic latitude and longitude, including the maximum speed offered and the date of deployment. The map will be a key source of CAF-supported broadband deployment information for consumers, policymakers, researchers, and others. The map currently displays broadband deployment as of December 31, 2017, as certified by carriers by March 1, 2018. The map will be updated with additional information as it is certified by carriers.

On August 28, 2018, the Rural Broadband Auctions Task Force (Task Force), Wireless Telecommunications Bureau (WTB), and WCB announced that bidding in the Connect America Fund Phase II (Phase II) auction concluded, part of the Commission's decision to provide support in areas served by price cap carriers using a combination of a forward-looking model of the cost of constructing modern multi-purpose networks and a competitive bidding process. The auction unleashed robust price competition that means more locations will be served at less cost to Americans who pay into the Fund. Although the 713,176 locations in 45 states assigned had an initial reserve price of $5 billion over the next decade, the final price tag to cover these locations is now only $1.488 billion. The CAF is already in the process of providing over $9 billion in model-based support over a six-year period for rural broadband in areas served by price cap carriers.

Further, during 2018, the Task Force, in conjunction with WTB and WCB, has been overseeing a challenge process to determine the areas that will be eligible to receive support through a Mobility Fund Phase II and Tribal Mobility Fund Phase II auction. The auction will award up to $4.53 billion over 10 years to mobile service providers to advance the deployment of long-term evolution service to unserved areas and to preserve such service where it might not exist absent a subsidy. On August 21, 2018, the Commission extended the window to submit challenges by 90 days, and the window is currently scheduled to close on November 26, 2018.

<u>Schools and Libraries Program</u>**.** OIG identifies challenges with the E-rate Productivity Center (EPC), which it indicates was not fully functional by its funding year (FY) 2016 milestone date, resulting in delays in processing applications for program funding. The *2014 First E-rate Order* required the submission of all filings and notifications electronically beginning in FY 2017, which started July 1, 2017. While the Universal Service Administrative Company (USAC) was behind in deploying according to the *2014 First E-rate Order* required schedule, the key functionality that applicants use to seek competitive bids and apply for E-rate funding (*i.e*., FCC Forms 470 and 471) had been deployed in the system by July 1, 2017. The functionality that USAC deployed in the latter half of 2017, consisted of "post-commitment functions" such as Service Provider Identification Number (SPIN) changes, commitment adjustments and recovery actions. With the enhancements that have been deployed in the system since 2017, in 2018, USAC was able to process applications more efficiently. As of Sept. 30, 2018, USAC completed 95 percent of FY 2018 applications - two months ahead of its FY 2017 pace.

OIG also references the Office of Managing Director (OMD) and WCB's letter to USAC which addresses applicant concerns with the FCC Form 470.[1] Specifically, the letter identified concerns from applicants that

[1] *See* Letter from Kris Anne Monteith, Chief, Wireline Competition Bureau, and Mark Stephens, Managing Director, Office of the Managing Director, Federal Communications Commission, to Radha Sekar, Chief Executive Officer, Universal Service Administrative Company, DA 18-444 (dated May 1, 2018), *available at* https://www.fcc.gov/edocs/search-results?t=quick&fccdaNo=18-444.

USAC guidance regarding FCC Form 470 drop-downs were confusing. To remedy this confusion, WCB and OMD instructed USAC to implement measures in FY 2018 and FY 2019 to correct drop-down issues. These measures included direction to USAC not to deny certain FY 2018 and FY 2019 applications which were due to confusion associated with the drop-downs. In addition, USAC provided clear guidance on the use of the drop-downs to stakeholders both in its in-person training materials, and on its website.[2]

Additionally, OIG reports that both OIG and USAC audits and investigations identify several risks in the Schools and Libraries Program that continue to be management challenges. These risks were also identified by OIG in the *2017 Management Challenges Memorandum* and the FCC's reply delineated actions taken to mitigate these risks.[3] The FCC remains committed to addressing these issues. Below are examples of efforts taken in 2018 to address these findings, in addition to those already underway.[4] To the extent OIG would like more information on the Commission's plan to remediate these risks, please contact the Managing Director.

Missing or inadequate documentation to demonstrate compliance with FCC rules. During the annual training that USAC provides to applicants and service providers, USAC now highlights the FCC's document retention requirements, provides specific examples of document retention timeframes, and explains the categories of documentation that should be retained.

Invoicing of the Fund for ineligible products or services. USAC now conducts additional review of invoices submitted for Category 2 maintenance services to ensure only eligible services were received by eligible entities. In addition, if the customer bill is ambiguous or vague, USAC initiates additional outreach to an applicant.

Inadequate documentation to substantiate compliance with competitive bidding rules. USAC provides additional competitive bidding guidance via one-on-one training sessions to applicants who were previously denied for failure to comply with the FCC's competitive bidding rules.

Insufficient Internet safety policies. Consistent with the Commission's rules and directives, USAC continues to ensure compliance with the Children's Internet Protection Act (CIPA). In particular, USAC: (1) explains, reviews, and discusses the program CIPA rules with E-rate eligible entities during applicant trainings; (2) provides an overview of the CIPA requirements on the USAC website, as well as examples of documents that demonstrate a school or library is complying with CIPA; and (3) conducts webinars with information on how to comply with CIPA requirements. USAC's Tribal liaison provides similar resources and training to the Tribal community, and USAC's weekly news briefs educate applicants on program rules and procedures.

Products and/or services being received by ineligible entities. USAC continues to maintain a comprehensive outreach strategy designed to instruct schools, libraries and service providers on the E-rate rules, including rules related to entity eligibility. In addition to webinars, USAC conducts multiple annual in-person trainings for applicants and at least two service provider-specific trainings, which include slide decks on eligible services, eligible entities, competitive bidding and other core E-rate requirements. USAC's Tribal liaison provides similar resources and training to the Tribal community.

Lifeline. OIG states the Lifeline program continues to require significant resources to combat waste, fraud, and abuse. In doing so, OIG recognizes the Commission comprehensively reformed the Lifeline program in 2012 and 2016 to require stricter oversight, including promulgating changes to the ways service providers must

[2] *See* https://www.usac.org/_res/documents/sl/pdf/handouts/FCC-Form-470-C1-Dropdown-Table.pdf.

[3] *See* Federal Communications Commission, *Agency Financial Report*, Fiscal Year 2017 (FY 2017 AFR), pp. 92, 98-101, *available at* https://docs.fcc.gov/public/attachments/DOC-347780A1.pdf.

[4] *See* FY 2017 AFR at pp. 98-101.

confirm consumer eligibility. OIG also states audits and investigations have identified the ongoing risks for the Lifeline program. These risks were also identified by OIG in the *2017 Management Challenges Memorandum* and the FCC's reply delineated actions taken to mitigate these risks.[5] The FCC remains committed to addressing these issues. Below are examples of efforts taken in 2018, to address these findings, in addition to those already underway.[6] To the extent OIG would like more information on the Commission's plan to remediate these risks, please contact the Managing Director.

Subscribers receiving duplicate service from two or more carriers. As part of duplicate prevention, the National Lifeline Accountability Database (NLAD) is the system of record associating enrollments of consumers to the carriers. In doing so, the NLAD validates identities and addresses of Lifeline subscribers. In 2017, USAC made enhancements to NLAD that prevent: (1) enrollments using the Supplemental Security Income (SSI) program in territories where SSI is unavailable; (2) the use of United States Post Office Boxes as the residential address; and (3) a subscriber from being enrolled as Tribal in areas with no Tribal lands. In 2018, USAC made an additional enhancement to NLAD to further prevent duplicates that are caused by manipulating subscriber data.

Carriers and their agents enrolling minors and other ineligible subscribers. Launched in six states and territories by September 30, 2018, the National Eligibility Verifier (National Verifier) directly reviews eligibility documentation and prohibits program enrollment of any person under the age of 18 without documentation that they are an emancipated minor. During annual re-certification, subscriber eligibility is re-checked through the National Verifier's available sources of data. If no data sources are available, USAC requires each subscriber to certify their continued eligibility through self-attestation directly to USAC, pursuant to the FCC's rules. The Commission has directed USAC to expand the National Verifier to all states and territories by December 2019. As states are added to the National Verifier, USAC will reverify the ongoing eligibility of existing subscribers in those states.

Carriers having no evidence to support enrollment and de-enrollment of subscribers. USAC initiated monthly reviews to test a statistically valid sample of enrolled or recertified subscribers for the ten eligible telecommunications carriers (ETCs) with the most potentially ineligible subscribers identified by the Government Accountability Office (GAO). Following USAC's first review, USAC determined that ETCs failed to provide adequate eligibility or recertification documentation for approximately 5 percent of the subscribers sampled. USAC will pursue monetary recovery where appropriate and refer ETCs with substantial oversubscribe addresses to the FCC's Enforcement Bureau and OIG.

Carriers or their agents enrolling deceased subscribers. USAC reviewed a statistically valid risk-based sample of recently enrolled or recertified subscribers against the Social Security Master Death Index database. In September 2018, USAC completed review and de-enrolled all subscribers who were identified by GAO as deceased. During its review, USAC determined that 96 percent of those subscribers had subsequently been de-enrolled. USAC is coordinating with OIG on how to address the remaining 4 percent of subscribers that are identified as deceased and still enrolled in NLAD. USAC pursued monetary recovery where appropriate.

A lack of accountability over sales agents and payment structures that incentivize fraud. The National Verifier requires any sales agent that assists a consumer in applying for Lifeline to be registered and to have an account with unique login credentials, including a user name and password. For a sales agent to register, the ETC will first need to grant access to the agent. The sales agent then must go into the system to create an account used to track activity. As USAC considers how to track activity in non-National Verifier states and in non-National Verifier systems, USAC is developing requirements for a sales agent registry. USAC plans to require sales

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[5] *See* FY 2017 AFR at pp. 92-93, 101-105.

[6] *See* FY AFR at pp. 101-105.

agents to provide identifying information, including their full names, date of birth, and the last four digits of the agent's social security number.

OIG states that compliance with the requirements of the Improper Payment Elimination and Recovery Improvement Act is a significant management challenge. In the *2016 Lifeline Order*, the Commission delegated to WCB the objective of creating uniform, standardized Lifeline forms for all subscribers receiving Lifeline benefits, if WCB, "believes that doing so will aid program administration."[7] On February 20, 2018, WCB announced the implementation of mandatory universal forms for the Lifeline program that consumers and eligible ETCs must use to verify and recertify subscriber eligibility for the federal Lifeline benefit beginning on July 1, 2018.[8] As stated by WCB, universal forms foster greater consistency in the Lifeline eligibility determination and recertification processes, thereby aiding in program administration and reducing improper payments due to errors in application and recertification forms.[9] OMD believes the changes to the Forms will address the finding that insufficient documentation is available to determine an improper payment rate. Specifically, by requiring ETCs to use the universal forms, unless required to use an existing state agency's form, ETCs will be prevented from enrolling or recertifying subscribers using forms that fail to make the required disclosures or collect the correct information. In addition, other completed and ongoing actions to address the improper payment rate include: (1) improvements to duplicate detection logic in the NLAD; (2) implementation of the Lifeline Claims System to require ETCs to make reimbursement claims directly based on their subscribers enrolled in NLAD; (3) the initial launch of the National Verifier in eleven states and one federal territory; (4) forensic and holding company audits; and (5) ongoing reviews pursuant to the July 11, 2017 directive to the USAC to implement safeguards and reviews to protect against waste, fraud, and abuse.[10]

The Commission will continue to take actions, including those referenced above, to ensure the Lifeline program initiatives have their intended effect and resolve open OIG audit and investigations team recommendations.

Rural Health Care. OIG states that determining ways to improve Rural Health Care program rules in a "manner that would reduce fraud, waste and abuse, generally, as well as facilitate effective enforcement is a significant management challenge." In December 2017, the Commission released a Notice of Proposed Rulemaking and Order (NPRM) to initiate a rulemaking to review the RHC Program. The NPRM acknowledged the need to address waste, fraud, and abuse in the Program, and sought comment on a number of measures to do so. For instance, the NPRM sought comment on proposed rules that would refine support calculations in the RHC Telecom Program, improve the efficiency of competitive bidding, require a higher standard for cost-effective purchasing, establish clear program deadlines for invoicing and other program requirements, promote arms-length transactions through increased transparency and gift restrictions, and take additional steps to improve program oversight. The window for submitting comments in response to the NPRM has closed, and the Commission is in the process of reviewing the record.

In November 2016, the Commission released its first enforcement action for apparent violations of the RHC Program rules when it proposed an approximately $21.7 million fine against a RHC service provider and its chief executive, for apparently committing wire fraud, receiving contracts in violation of competitive bidding

[7] *See Lifeline and Link Up Reform and Modernization et al.*, Third Report and Order, Further Report and Order, and Order on Reconsideration, 31 FCC Rcd 3962, 4017, 4119, paras. 150, 429 (2016) (*2016 Lifeline Order*).

[8] *See Wireline Competition Bureau Provides Guidance on Universal Forms for the Lifeline Program*, Public Notice, DA 18-161 (rel. Feb. 20, 2018), available at https://docs.fcc.gov/public/attachments/DA-18-161A1.pdf (*Lifeline Universal Forms Public Notice*).

[9] *See* Lifeline Universal Forms Public Notice at 1.

[10] *See* https://docs.fcc.gov/public/attachments/DOC-345729A1.pdf.

rules, and using forged and false documents to support its claims from the USF in connection with the RHC Program. The proposed forfeiture was amended in June 2017 and increased to $22.4 million.

In January 2018, the Commission released an enforcement action against another RHC service provider for apparent violations of the RHC Program rules and sections 254(h)(1)(A) and 201(b) of the Communications Act of 1934. This Notice of Apparent Liability found, among other things, that the service provider engaged in an undisclosed multiyear financial relationship with an RHC Program consultant through which the service provider gained an unfair advantage in the competitive bidding process; used documents containing forged, false, misleading, and unsubstantiated information; and submitted payment requests based upon service contracts tainted by violations of the Commission's competitive bidding and urban rates rules. The Commission proposed a forfeiture penalty of $18.7 million against the service provider.

These enforcement actions were the result of extensive investigations by the Commission's Enforcement Bureau (EB) led by its Anti-Fraud Team. After the release of these items, USAC began a heightened scrutiny review of the rural and urban rates charged by service providers to rural health care providers participating in the RHC Telecommunications Program. EB continues to vigorously investigate possible violations of Commission rules concerning the RHC Program and will bring enforcement actions where warranted.

III. TV BROADCASTER RELOCATION FUND

OIG provides an overview of the TV Broadcaster Relocation Fund (TVF) established by the Middle Class Tax Relief and Job Creation Act of 2012 (Spectrum Act of 2012) to reimburse costs reasonably incurred by broadcasters who are being relocated to new channels because the broadcast spectrum was repacked as a result of the 2017 incentive auction. Since the creation of the fund, the Commission has established a fund administrator and taken several additional actions to establish effective internal controls, minimize risks to ensure the best use of resources. Some examples of the actions taken include, establishing the catalog of eligible reimbursable expenses, requiring relocation cost estimates from broadcasters, and establishing audits and other data validation techniques to verify compliance with program rules. OIG recommends that "[t]hroughout the life of the fund, the Commission must ensure that risk is appropriately managed to protect the TVF against waste, fraud, and abuse."

The incentive auction closed on April 13, 2017, with the release of the Closing and Channel Reassignment Public Notice, which announced the winning bidders in both the forward and reverse auctions and the channel reassignments for broadcast TV stations that will be "repacked" in the new Broadcast TV Band. The release of that notice started the 39-month transition period during which the Incentive Auction Task Force, the Media Bureau, and OMD's Financial Operations team are charged by the Commission with reviewing and administering the distribution of the TVF to the 957 full power and Class A television stations, and multichannel video programming distributors (MVPDs) who carry their channels, that the 2012 Act provided would be eligible for reimbursement from the TVF for their costs incurred as a result of that channel reassignment. Meeting the Commission's 39-month timetable requires that the reimbursement procedures efficiently process reimbursement requests while also ensuring that effective internal controls are in place to safeguard the fund by preventing fraud, waste, and abuse.

In March 2018, Congress passed the 2018 Reimbursement Expansion Act (2018 Act) which expanded the group of entities eligible to receive money from the TVF to include reimbursement of the costs reasonably incurred by low power TV and TV translator stations and FM radio stations (together LPTV and FM Stations) as a result of the post-auction transition of full power and Class A stations. The 2018 Act appropriated additional money to the TVF to augment the original funding for full power and Class A stations and MVPDs who carry their channels, to reimburse LPTV and FM stations, and specified that $50 million be made available to make payments for the purposes of consumer education relating to the reorganization of the TV spectrum. In August 2018, the Commission released a Notice of Proposed Rulemaking and Order (LPTV/FM

Reimbursement NPRM) in which it proposed to adopt eligibility criteria and procedures for reimbursing LPTV and FM Stations. The 2018 Act also provided extending the deadline for the FCC to make reimbursement payments from the TVF until July 3, 2023, although the timeline for full power and Class A television stations to transition to new channel assignments remains 39-months.

The Commission recognizes the challenge of administering the TVF and is pleased to report on the FCC's effort to establish effective procedures and internal controls to minimize risks and ensure the best use of resources to successfully implement its objectives while safeguarding TVF assets. In the *Incentive Auction Report and Order*, the Commission mandated, and the staff has implemented, a plan for disbursements from the TVF to safeguard the Fund assets. Most notably, these safeguards include the following procedures and controls:

<u>Cost Catalog</u>. The Commission delegated authority to the Media Bureau to develop a catalog of eligible reimbursement expenses to facilitate the process of reimbursing full power and Class A stations, and MVPDs who carry their channels. The cost catalog was initially prepared and subsequently updated by a contractor with expertise in broadcast engineering who surveyed the industry to identify these types of expenses and obtain pricing information concerning the costs commonly anticipated to be incurred as a result of the post-incentive auction broadcast transition. The cost catalog provides guidance to full power/Class A stations and MVPDs regarding reimbursable expenses and facilitates the identification of cost outliers that may require further scrutiny by the Commission. The cost catalog has been fully integrated into the Commission's processes and procedures for such entities to submit information regarding reimbursement to the FCC. Subsequent to the 2018 Act, the Media Bureau commissioned a second cost catalog of eligible reimbursement expenses to facilitate the process of reimbursing LPTV and FM Stations who are eligible for reimbursement under the 2018 Act. That catalog was prepared by an outside contractor with expertise in broadcast engineering in a similar manner to that described above and was released for public comment on October 22, 2018.

<u>Fund Administrator</u>. In January 2017, the Media Bureau formally engaged a professional services team to begin work as Fund Administrator to assist in the administration of the TVF for full power/Class A stations and MVPDs. The Commission is currently in the process of adjusting the scope of the Fund Administrator to cover the expansion of the TVF under the 2018 Act. The contract, which was awarded after an open, competitive procurement, is comprised of professionals with experience in the fields of funds administration, accounting, government auditing, and broadcast engineering. As required by the contract, the Fund Administrator drafted, and the Media Bureau approved, key programmatic documentation requirements, including business process workflows, internal controls documentation, methods and procedures, and a program monitoring and compliance plan.

<u>Third- Party Review of Internal Controls</u>. The FCC hired a professional services contractor to perform a review of the internal controls put in place by the Fund Administrator and Media Bureau for reviewing estimates and requests for reimbursement. The contractor concluded that the "process supporting payments for reimbursing eligible entities appears to be robust and provides adequate controls." However, the contractor identified two design control deficiencies (one as low risk and the other as very low risk), and deficiencies related to undefined processes (two as medium risk and one as low risk) which have been addressed by the Media Bureau, in consultation with the Fund Administrator.

<u>Allocation Process</u>. The Commission's *Incentive Auction Report and Order* required the Media Bureau to review the initial estimates submitted by full power/Class A stations and MVPDs and make an initial reimbursement allocation for each entity that filed cost estimates. The allocated amount is the dollar amount that stations and MVPDs will have to draw down against as they incur approved expenses. Pursuant to the Commission's Order, once an entity incurs actual costs, it must file actual reimbursement claims along with supporting invoices and other cost documentation. A station must provide a detailed explanation if an actual cost exceeds the estimated cost for a line item. Entities may submit multiple reimbursement requests as they

incur expenses throughout the reimbursement period. The Commission decided in the *Incentive Auction Report and Order* to allocate funding in tranches, including an initial allocation to help stations cover upfront expenditures (such as planning, engineering studies, etc.), equipment down payments, and other ancillary charges. This approach seeks to provide stations with access to the funding necessary to timely begin their relocation work while avoiding an undue financial burden. Making allocations in more than one tranche also takes into account that the estimates of many stations may be refined and change over time as they move forward with planning, provisioning, and construction. This approach also allows the Media Bureau to review such changes and make additional allocations based upon the most accurate and complete information available. Issuing multiple allocations also provides the Media Bureau with flexibility to monitor closely the draw-down of funds and make any necessary adjustments prior to a subsequent allocation. This staged process will therefore permit the Media Bureau to make timely allocations to keep the process moving forward, while reducing the likelihood that excess funds are allocated that would require the Commission to reduce future allocations or claw-back payments that have already been drawn down.

Prior to the calculation and release of the initial allocation in October 2017, the Fund Administrator conducted a detailed review of the initial cost estimates submitted by full power/Class A stations and MVPDs, including requests for additional information from more than 80 percent of entities, in order to provide the Media Bureau with sufficient confidence that the estimates submitted could be deemed "reasonable" under the statutory standard for reimbursement. The Media Bureau reviewed the Fund Administrator's evaluations and verified each cost estimate prior to making its initial allocation. A similar review and verification process was used to make a second allocation in April 2018.

Consistent with the 2018 Act, the LPTV/FM Reimbursement NPRM sought comment on proposed criteria for determining the eligibility of LPTV and FM Stations for reimbursement and procedures for making such reimbursements, including, the use of an allocation system similar to that used for full power/Class A stations and MVPDs. Like the ongoing reimbursement program for full power/Class A stations and MVPDs, the NPRM seeks to adopt reimbursement procedures that efficiently process reimbursement requests while also ensure that effective internal controls are in place to safeguard the fund by preventing fraud, waste, and abuse. As required by the 2018 Act, a decision in that proceeding is expected by March 23, 2019.

Site Visits. The Commission also prescribed the use of site visits, audits and data validations in the *Incentive Order Report and Order* to verify compliance with program rules. In 2017, the Media Bureau and OMD directed a series of sixty site visits in order to validate the baseline equipment reported by Eligible Entities. These site visits determined that the risk, if any, is minimal that stations and MVPDs have misreported the type or operational status of equipment in use prior to the repack which might inflate the reimbursement amount to which a station or MVPD is eligible.

Payment Process. Once a station's request for reimbursement has been reviewed by the Fund Administrator to assure that it contains the necessary cost justification and meets the requisite eligibility criteria, and the Media Bureau verifies the Fund Administrator's finding, the request is then submitted to the Commission's Financial Operations group for payment. Financial Operations has established a series of internal controls to ensure that the banking information submitted by the station is valid, and that payments are made only to the appropriate station. These controls include, among other things, verification of banking information, Media Bureau authorization, signature name, reimbursement amount, and vendor name.

IV. CONCLUSION

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

Mark Stephens
Managing Director
Office of Managing Director

Kathleen Heuer
Chief Financial Officer
Office of Managing Director

Christine Calvosa
Acting Chief Information Officer
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