

**FEDERAL
COMMUNICATIONS
COMMISSION**



**FISCAL YEAR 1999
ANNUAL FINANCIAL REPORT**

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Federal Communications Commission
Washington, D.C. 20554

A MESSAGE FROM THE MANAGING DIRECTOR

I am pleased to present the Federal Communications Commission's (FCC) audited Balance Sheet for fiscal year 1999. This is the first year the FCC has generated auditable financial statements and we are very pleased with the results.

Because of the size of our budget, the Chief Financial Officers Act of 1990 (CFO Act) does not apply to the Commission. Therefore, the Commission is not required to produce financial statements. Late in fiscal year 1998, however, the Commission decided to undertake the effort voluntarily to strengthen financial reporting and to adopt the standards of the CFO Act. While the Commission's annual budget is small, its overall financial responsibilities have grown substantially since 1990. In addition to its annual budget, the Commission is responsible financially for administering the Spectrum Auction Program, the associated Installment Payment Program, and the Universal Service Fund. Since the auction program's inception in 1994, over \$14.9 billion in receipts have been deposited into the Treasury. In addition, the Spectrum Auction Installment Payment Program that is comprised of both direct installments and outstanding loan obligations had a net value in excess of \$5 billion on September 30, 1999. The Universal Service Fund maintained a portfolio balance in excess of \$1.3 billion at the close of the fiscal year, having collected in excess of \$3 billion for the year. The total assets under the agency's control were valued at slightly more than \$8.3 billion at the close of the reporting period.

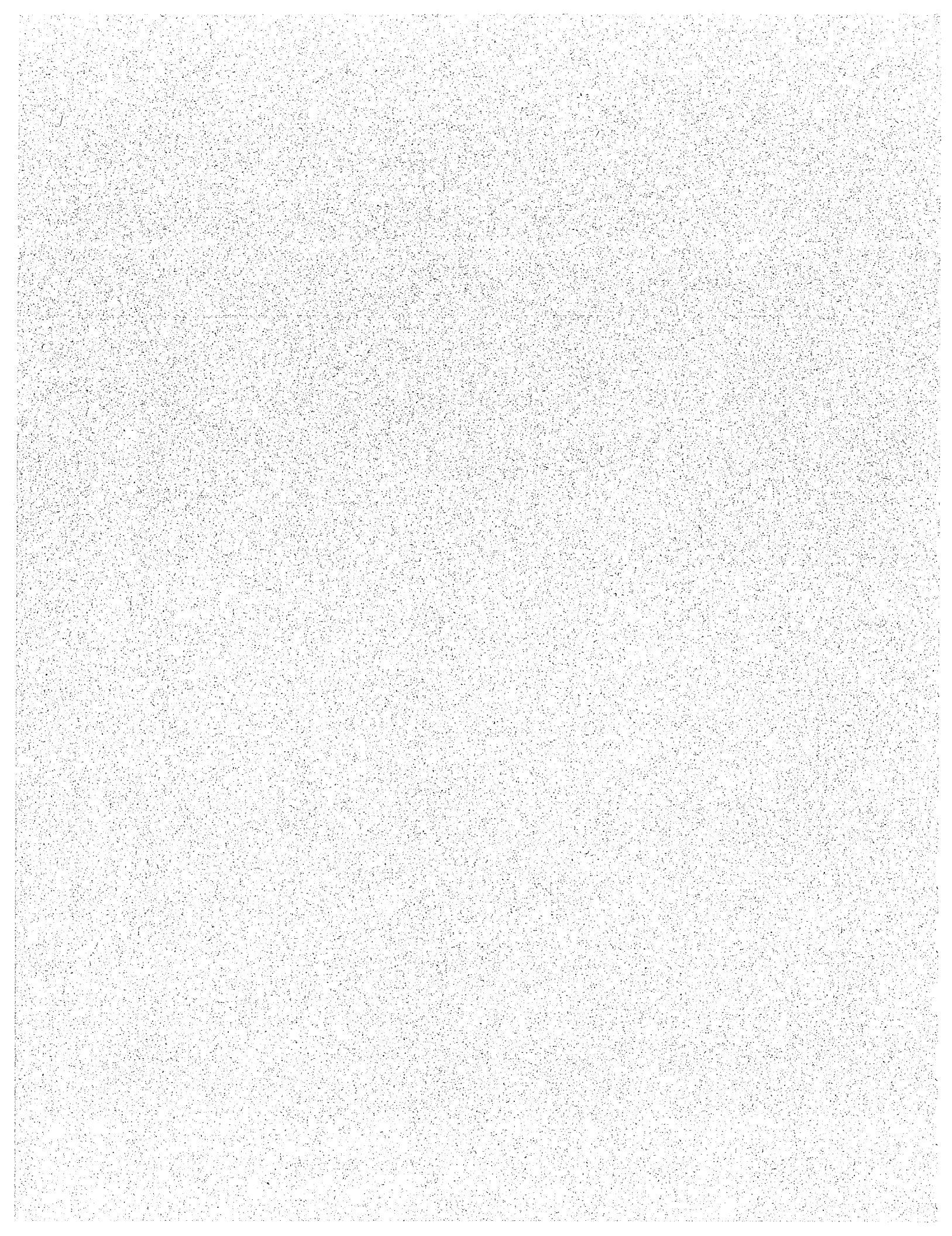
The agencies that were required to adopt the standards of the Chief Financial Officers Act of 1990 have learned through 10 years of effort that changes to accounting practices come only through years of intensive efforts. The FCC accomplished remarkable success in its first year creating a Balance Sheet and Notes that have received a qualified opinion by the external auditors hired by the agency's Inspector General. The sole qualification to the opinion related to the valuation and tracking the agency's capital assets. This was primarily the result of the consolidated move of headquarters staff to our new single facility in Southwest Washington. In order to receive an unqualified opinion in this area, the agency will have to fully implement Statement of Accounting Standards guidelines for asset valuation and documentation as well as quantify an outstanding liability to another federal agency resulting from the move.

There were numerous areas where the auditors did not qualify their opinion. These include the auctions loan portfolio, the calculation of cash, the value of USF investments, agency receivables, the value of forfeited property, the auction loan files and balances and the calculation of payables. While we intend to continue to improve our internal controls generally, the Commission's efforts to date have vastly improved the agency's financial systems. We will strive to be in a position to issue full statements for fiscal year 2000 in compliance with CFO Act guidelines.

The voluntary accomplishments of the FCC in financial reporting for fiscal year 1999 demonstrate this agency's commitment to the highest standards of professionalism in the performance of its financial management responsibilities. We are committed to achieving further improvements to our financial systems in order to provide reliable and timely financial information thereby demonstrating the responsible and efficient management of the assets entrusted to the Commission's oversight.



Andrew S. Fishel
Managing Director





Federal Communications Commission
Washington

Office of the
Inspector General

A MESSAGE FROM THE INSPECTOR GENERAL

Fiscal year 1999 was a truly a dynamic year at the Federal Communications Commission (Commission). To better serve its stakeholders, the agency consolidated its headquarters functions from various locations around Washington, DC to one central location. From a financial perspective, the agency committed to financial management reform by electing to prepare its first-ever financial statements in accordance with Federal accounting standards. In that regard, I am pleased to present the opinion on the Commission's Consolidating Balance Sheet for Fiscal Year (FY) 1999 and related reports.

This was the first audit of the Commission's financial statements prepared in accordance with the requirements of the Government Management Reform Act of 1994 (GMRA), which expanded the Chief Financial Officers Act of 1990 (CFO Act). Although not a "designated agency" under the CFO Act, the Commission elected to prepare financial statements based upon a request by the Department of the Treasury. With concurrence from the Office of Inspector General, Commission management limited the FY 1999 financial statements subjected to audit to a Consolidating Balance Sheet, Notes to the Consolidating Balance Sheet, and select Required Supplementary Information. An independent public accounting firm, Clifton Gunderson L.L.C, under contract with the Office of Inspector General audited the financial statement and accompanying information.

The audit results on the Commission's FY 1999 financial statement provide a baseline for gauging progress the Commission has made towards achieving the financial management objectives of GMRA and the CFO Act. Our ability to provide audit assurance for the financial statement presented is a clear indicator of that progress. However, many challenges remain. Material weaknesses exist in the internal control of the Commission and our report cites instances of noncompliance with laws and regulations required to be reported in accordance with *Government Auditing Standards* and other authoritative guidance. Additionally, the Commission's separate financial management systems preclude the integration of financial, budgetary, and performance information.

A key financial management objective is to produce timely, reliable financial information throughout the year which can be used for management decision making. The initial year qualified opinion on the Consolidating Balance Sheet was a major accomplishment, reflecting the commitment of Commission management to greater financial accountability. However, considerable effort was required by management, as well as the auditors, to compensate for internal control weaknesses and lack of integrated financial management systems. While this enabled accurate year-end reporting, except for any necessary adjustments had the auditors been able to examine evidence regarding property

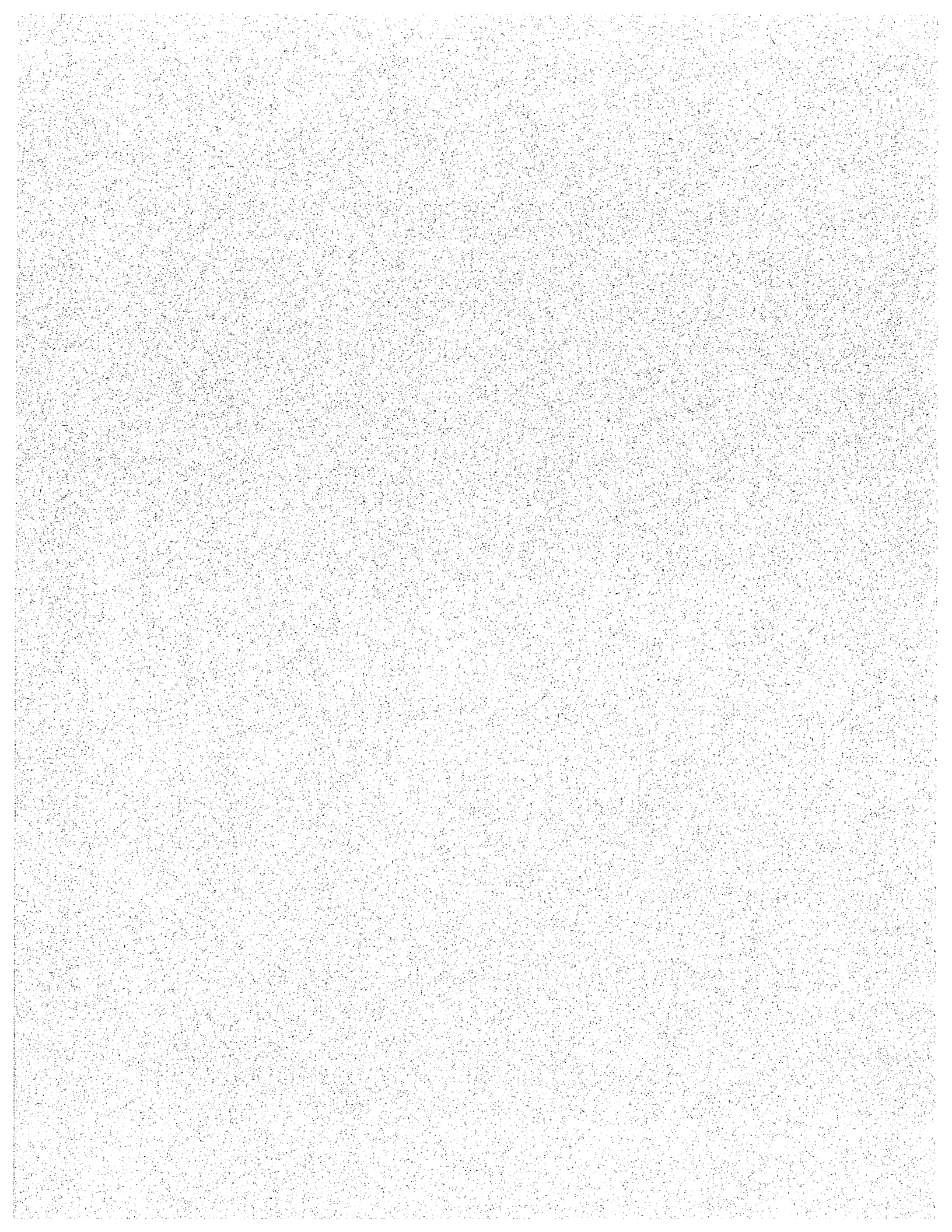
and unfunded liabilities, it did not provide for current financial information throughout the year.

Management's continued leadership and dedication to financial management is crucial. FY 2000 reporting will require the same diligence, and to some extent, increased effort and fortitude as the agency progresses to subjecting the additional Principal Statements to audit. My office looks forward to the challenges FY 2000 presents and fostering the partnership for sound financial management established during FY 1999. As always, we are committed to help achieve the Commission's financial management goals.

I want to thank the Chairman, his senior management team, and Commission staff for their hard work in relation to the compilation of the financial statement and the audit. We look forward to continuing our work together to achieve the highest level of integrity and accountability for Commission programs and operations.

A handwritten signature in black ink, reading "H. Walker Feaster, III". The signature is written in a cursive style with a large, stylized initial "H" and a flourish at the end.

H. Walker Feaster, III
Inspector General



Overview of FCC

The Federal Communications Commission (FCC or Commission) is an independent United States government agency, directly responsible to Congress. The FCC was established by the Communications Act of 1934 and is charged with regulating interstate and international communications by radio, television, wire, satellite and cable. The FCC's Headquarters is in Washington, DC and it has field site locations throughout the nation. The FCC's jurisdiction covers the 50 states, the District of Columbia, and U.S. possessions.

The FCC is directed by five Commissioners, appointed by the President, and confirmed by the Senate for 5-year terms, except when filling an unexpired term. The President designates one of the Commissioners to serve as Chairman. Only three Commissioners may be members of the same political party. None of them can have a financial interest in any FCC regulatee. The Chairman presides over all FCC meetings, and coordinates and organizes the work of the Commission and represents the agency in legislative matters and in relations with other government departments and agencies.

This document contains information about the FCC's FY 1999 principal financial statement, the consolidating balance sheet. It also serves as a guide to key FCC initiatives and activities taking place during 1999 or planned for future years that demonstrate the breadth of the Commission's work.

Mission and Vision Statements

FCC's Mission

The FCC's primary goals are to promote competition in communications, protect consumers and support access for every American to existing and advanced communications services.

FCC's Vision for the 21st Century

"A Vigorous Competitive Communications Market Providing Universal Access to all American Consumers"

The FCC's vision must be executed in a rapidly changing communications environment which many consider a "communications revolution". In five years, the U.S. communications markets will be characterized predominantly by:

- Vigorous competitions that will greatly reduce the need for direct regulation.
- The advent of Internet-based and other new technology-driven communications services that will continue to erode the traditional regulatory distinctions between different sectors of the communications industry.

The enactment of the Telecommunications Act of 1996 -- and the establishment of a new pro-competitive, deregulatory model for communications policy -- necessitates a reassessment of our core policy functions, structure, and processes.

The FCC as we know it today will be very different in both structure and mission. As a result, extensive planning and research in support of our strategic plan characterized FY 1999. Our strategic plan for the next five years recognizes that what will change are the means and mix of resources necessary to achieve these goals in an environment marked by greater competition and convergence of technology and industry sectors.

Pursuing these strategic objectives will require the identification of clear goals and the execution of year-by-year action plans. As we accomplish our transition goals, we set the stage for a competitive environment in which communications markets look and function like other competitive industries.

To execute our mission, we have identified a number of overall goals and objectives, which are summarized below:

- **Create A Model Agency for the Digital Age.**
- **Promote Competition in All Communications Markets.**
- **Promote Opportunities for All Americans to Benefit from the Communications Revolution.**
- **Manage The Electromagnetic Spectrum (The Nation's Airwaves) In The Public Interest.**

Create A Model Agency for the Digital Age.

Over the next five years, the FCC must wisely manage the transition from an industry regulator to a market facilitator. The Commission must significantly revamp its functions, processes, and structure agency-wide to meet the challenges of a rapidly progressing global information-age economy and an evolving global communications market.

The implementation of the model agency requires the execution/achievement of the actions and objectives summarized below:

- **Lead the Way in the Information Age.** As the FCC works to promulgate policies conducive to advances in information technology, it must lead the way in electronic government. Across the agency, we must invest in new technology that will allow us to be as responsive to the public as possible. Specifically, it must continue to automate our its processes and to make more information available to the public electronically and on an interactive basis.
- **Reorganize To Create an Agency Infrastructure Conducive to Convergence.** The FCC is currently structured along the traditional technology lines of wire, wireless, satellite, broadcast, and cable communications. As the lines between these industries merge and blur as a result of technological convergence and the removal of artificial barriers to entry, the FCC needs to reorganize itself in a way that recognizes these changes and prepares for the future. A reorganization of the agency along functional rather than technology lines will put the FCC in a better position to carry out its core responsibilities more productively and efficiently.
- **Create A Faster, Flatter, and More Functional Agency.** The FCC must be structured to react quickly to market developments, to work more efficiently in a competitive environment, and to focus on bottom-line results for consumers. Ultimately, throughout the agency, it must be structured to render decisions quickly, predictably, and without imposing needless costs on industry or consumers through unnecessary delay.
- **Preserve and Increase the Wealth of Knowledge and Expertise of FCC Staff.** It is critical that the FCC preserves the integrity of its employees and capitalizes on the wealth of knowledge and expertise at the Commission. It is the employees who have made the Commission a unique and vital organization and who will be at the forefront of defining how the FCC of the future responds to the dynamic changes in today's communications industry. Moreover, the FCC must minimize workplace disruption that may result from restructuring efforts through staff retraining, reassignment, and other methods. The FCC must ensure that it has a critical mass of trained personnel and that it empowers its staff to embark upon strategic thinking with clear policy direction.

Promote Competition in All Communications Markets.

The transition to a market facilitator cannot be achieved without a strong competitive environment. While new competitors and technological innovation are currently transforming communications markets, history has shown that markets that have been highly monopolistic often do not naturally become fully competitive. History has also shown that domestic markets that have been protected from foreign competition do not naturally open to global competition.

Specifically, the FCC is endeavoring to achieve the following objectives:

- **Eliminate Barriers to Entry in Domestic Markets.** Entry barriers (legal, economic, or operational) in communications markets are antithetical to the development of robust competition. Elimination or reduction of such barriers enables new competitors to enter communications markets easily and enhance consumer choice. In addition, over the next five years, a number of important policy steps will be required to ensure that competition continues to develop in communications markets. As competition becomes a reality, deregulation must occur.
- **Deregulate As Competition Develops.** Eliminating outdated rules will play an important role in accelerating the transition to fully competitive markets. Consumers ultimately pay the cost of unnecessary regulation. Thus, one of our primary objectives will be to deregulate as competition develops, and to substitute market-based approaches for direct regulation. In addition, the FCC must resist imposing legacy regulations on new technologies. The Commission's goal is to deregulate the old instead of regulating the new.
- **Enforce the Rules So That Businesses Compete Fairly.** An undesirable by-product of the rise of competition in various telecommunications markets has been an increase in fraudulent practices by certain providers of telecommunications services. In the fast-paced, newly developing world of communications competition, we must be able to respond swiftly and effectively to complaints that companies are taking advantage of other companies or consumers. Effective use of the Commission's enforcement resources is critical to ensuring full implementation of the Communications Act and the Commission's rules designed to open communications markets to competition, enhance choice for consumers, and maintain public support for deregulation.
- **Promote Competition in International Communications Markets.** Over the next five years, the Commission will pursue an aggressive agenda aimed at increasing competition in communications markets around the world. Increased international competition will benefit American consumers in the form of lower rates for international telecommunications and will open new market opportunities for American companies.

Promote Opportunities for All Americans to Benefit from the Communications Revolution.

Service to all Americans is and will always be at the core of the FCC's mission. In the execution of the five-year plan, the Commission will not lose sight of this overriding concern and the accomplishment of the objectives described below.

- **Ensure Access for All Americans to Existing And Future Communications Services.** Section 1 of the Communications Act of 1934 states that the purpose of the Act is to "make available to all the people of the United States, without discrimination . . . a rapid, efficient, nationwide, and worldwide wire and radio communication service . . . at reasonable charges." The 1996 Act reaffirmed that we must ensure the availability of affordable phone service to consumers in all regions of the nation. In addition, Section 706 of the 1996 Act directs the Commission to encourage the deployment of advanced services to all Americans on a reasonable and timely basis. Where competition cannot ensure such access, the FCC will continue to take action to support and promote universal service and other public interest policies specified in the Act.
- **Promote Opportunities To Expand Direct Participation In Existing And Future Communications Businesses.** As the nation's communications sector continues to undergo unprecedented growth, we must ensure that Americans of all backgrounds have the opportunity to benefit, not only as consumers of communications services, but also as employees or owners of communications businesses. In particular, we will open the doors of opportunity to women, minority, and small-scale entrepreneurs across all communications industries. This goal is critical to preserving diversity of viewpoints and a vibrant democracy, and to ensuring that all Americans are able to take advantage of the dynamic telecommunications market.
- **Foster a More Consumer Friendly Marketplace.** Competitive markets work only when consumers have the information required to make informed choices. The Commission is in the process of consolidating its consumer information functions into a Consumer Information Bureau that will provide consumers a one-stop shop for obtaining the information they need to make wise choices in a robust and competitive marketplace. The Bureau will encourage public participation in Commission activities by providing convenient ways for the public to make its views known. This feedback will help ensure that the Commission's rules are fair, effective, and sensible, and that they support competition while responding to consumer concerns.

Manage The Electromagnetic Spectrum (the Nation's Airwaves) In The Public Interest.

The Commission is charged with managing the use of the Nation's airwaves in the public interest for all non-Federal government users, including private sector, and state and local government users. Fundamental to this mandate is the difficult task of advancing the pro-competitive goals of the Communications Act, while at the same time ensuring that other public interest goals are met. We have started the implementation of two major initiatives to achieve this goal.

- **Create More Efficient Spectrum Markets.** Competing demands and changing technologies make spectrum management a unique challenge. Since spectrum is a finite public resource, it is important that it be allocated and assigned efficiently to provide the greatest possible benefit to the American public. It is also important to encourage the development and deployment of technology that will increase the amount of information that can be transmitted in a given amount of bandwidth. To meet these challenges, the Commission constantly strives to improve the way it both allocates and assigns spectrum.
- **Increase the Amount of Spectrum Available, Particularly for New Services.** The past few years have seen tremendous growth in information technology, particularly in the wireless industry. As markets become more competitive and new services are introduced, demand for spectrum will increase. The Commission will seek new methods to make spectrum available and ensure that it is put to the highest value use. Increasing the supply of spectrum will reduce the cost of using spectrum and thereby increase the output and reduce the price of spectrum-based services. It will also create new opportunities for competitive technologies and services for the American public.

FCC Organization and Mandate to Harness the Communications Revolution

The FCC's current focus is to enable the nation to capitalize on the on-going communications revolution to benefit all Americans as directed by the Telecommunications Act of 1996 (the 1996 Act). The 1996 Act embodies Congress' bold vision to reshape the telecommunications landscape by committing all of our telecommunications markets to competition and market forces instead of regulation; by renewing our national commitment to universal service policies designed to promote economic development for all Americans, and to ensure that children in America's classrooms, rural health care providers, and libraries have access to modern telecommunications technology; and by promoting the digitization of all media and the growth of advanced services such as the Internet, data networks, and digital television.

With the Act's repeal of prohibitions on competition in the local exchange market, we are beginning to see some competitive local exchange providers and other startups focused on penetrating the local loop. These startups include new wireline and wireless exchange access providers, transmission system builders, network integration software developers, advanced switch builders, chipmakers, and network component builders. Since the implementation of the Act's access reform provisions, residential long distance rates have fallen. Similarly, Congress' and the FCC's commitment to market-based spectrum policies has resulted in new wireless service offerings and dramatic declines in prices as new wireless competitors enter this market. The 1996 Act also served as a blueprint for the commitment to open global telecommunications markets embodied in the World Trade Organization Telecom Services Agreement. The Act's commitment to economic development for all Americans, including our nation's classrooms, libraries, and rural health care providers, ensures that all Americans will benefit from developments in telecommunications technology.

Facilitating the Communications Revolution – The FCC's Implementation of the Government Performance and Results Act

During 1999, the FCC continued its work in implementing the Government Performance and Results Act (GPRA). The Commission has assigned program oversight to a senior level official within the Office of the Managing Director and meetings have been held with representatives from all Commission bureaus and offices to educate them as to the components of GPRA and the related impact upon their offices and the Commission as a whole. These efforts culminated in the creation of a FCC framework for complying with GPRA reporting requirements. In turn, with this basic framework established, the FCC identified the means, strategies and resources required to meet specific goals and objectives for primary FCC activities. The FCC has complied with all required GPRA reporting dates and submitted a Strategic Plan, and is committed to the successful implementation of GPRA. In anticipation of FY 2000 reporting requirements, the strategic plan is being revised to incorporate additional clearly defined outcomes and measurement criteria.

Effective and Efficient Use of the Spectrum through the Use of Auctions

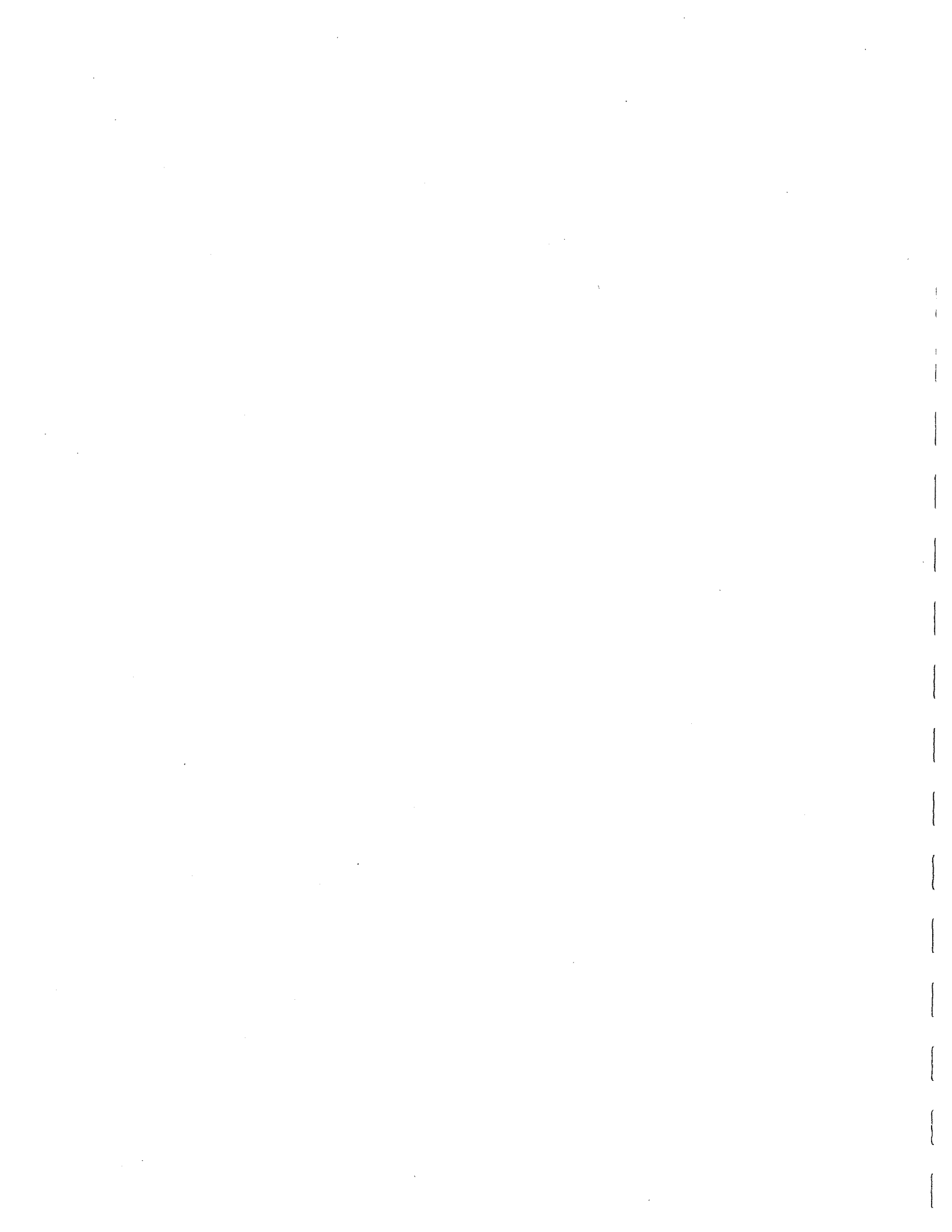
In the 1993 Budget Act, Congress added Section 309(j) to the Communications Act of 1934, authorizing the FCC to use competitive bidding to resolve mutual exclusivity among Spectrum License applicants. Auctions were intended to correct problems associated with prior licensing methodologies: the value of the spectrum would go to the Federal Treasury, and the auction winner who valued the spectrum most would implement services quickly.

The Commission is using auctions to promote efficient and intensive spectrum use as well as to promote the development and rapid deployment of new technologies, products and services for the public, including those residing in rural areas, without administrative or judicial delays. This subsection also requires the Commission to administer the auctions so as to promote economic opportunity and competition, avoid excessive concentration of licenses, and disseminate licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women. By statute, the FCC can use various means to facilitate expanded participation, including alternative payment schedules, tax certificates, bidding preferences, and other procedures.

As a result, the FCC provided installment financing in six of its Spectrum Auction events, including the broadband Personal Communications Services' (PCS), C Block broadband PCS, F Block PCS, narrowband PCS, Interactive Video and Data Service (IVDS), Multipoint Distribution Service (MDS), and 900MHz Specialized Mobile Radio (SMR). Under the installment-financing program, winning bidders have generally been given five or ten-year periods to repay their net judgement bid amount (less the down payment amount), with up to five-year interest-only initial payment periods. Interest rates varied by the type of borrower, but have generally been well below market rates.

By adding this subsection to the Communications Act, Congress ushered the telecommunications industry into a new era—an era in which competition; economic efficiency and innovation have become the “watch” words for both the public and private telecommunications sectors.

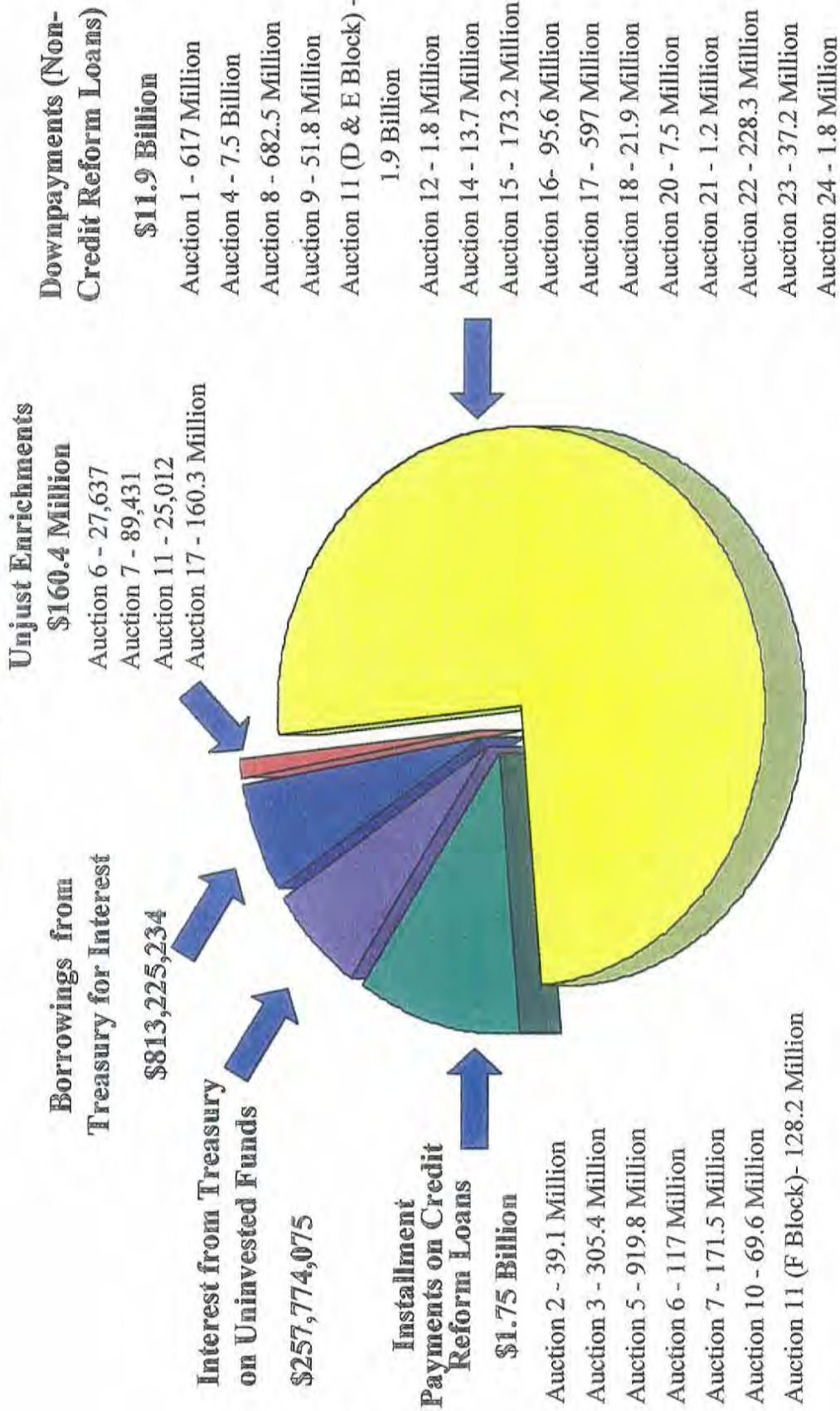
The FCC auctions program has been a success for the American people. The new auction design and automated system have won awards at home, and have been studied, licensed or copied worldwide. In most cases, experience has shown the FCC auctions have increased competition, provided opportunities for new entrants and benefited consumers.

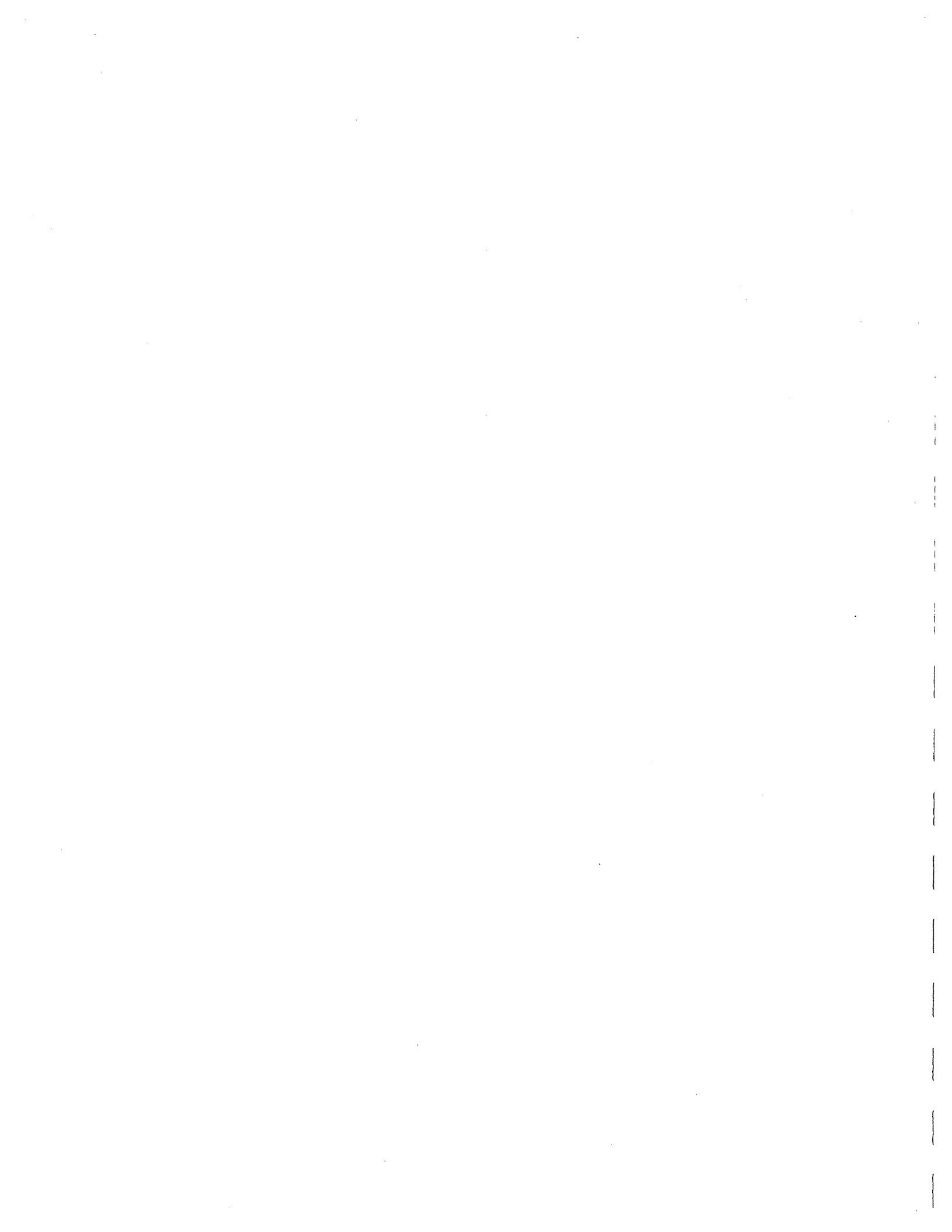


Auction Revenue as of September 30, 1999

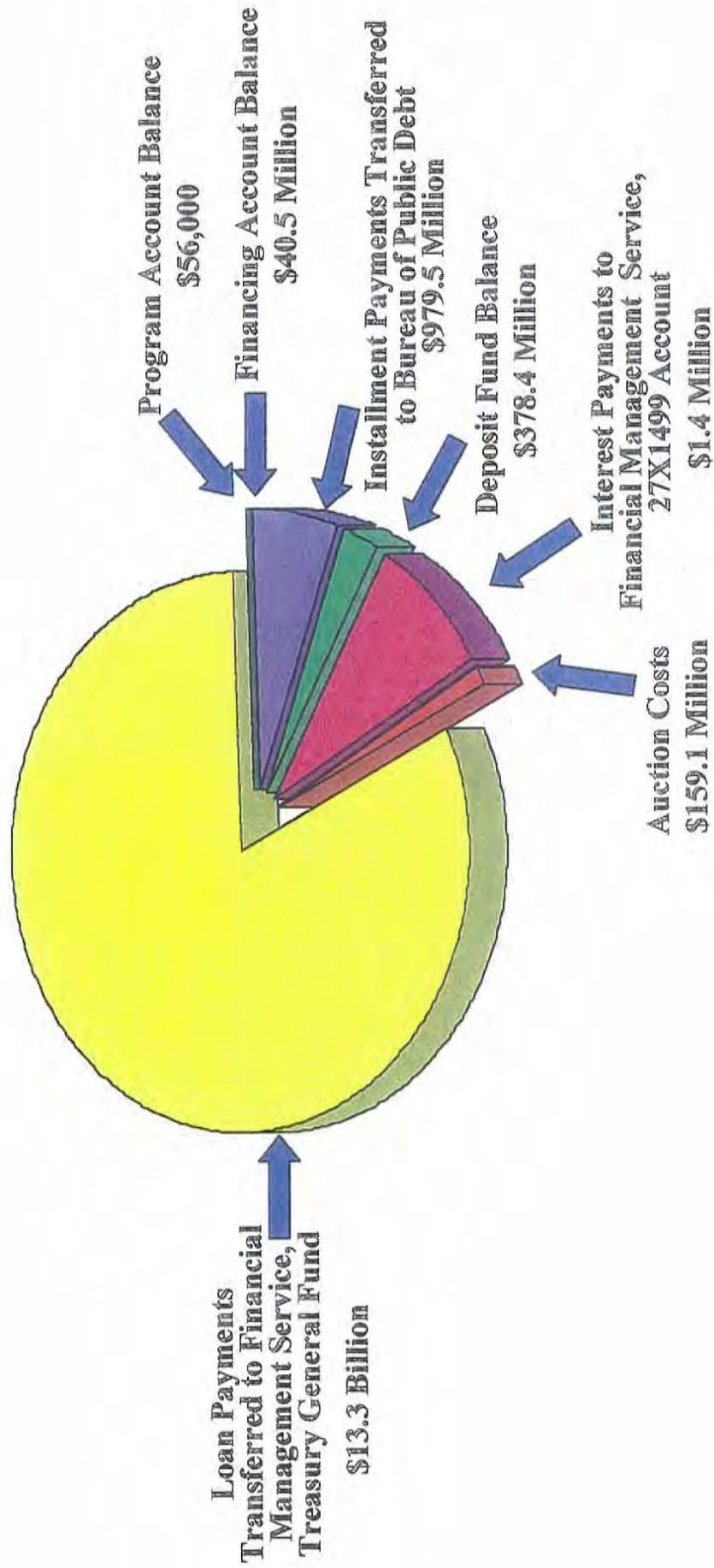
Since Inception

\$14.9 Billion





Disposition of Auction Revenue as of September 30, 1999 Since Inception \$14.9 Billion





Clearly, all evidence shows that the FCC has succeeded in disseminating licenses to a wide variety of recipients. The FCC can attribute its overall auction success in meeting these goals to its willingness to improve and change auction mechanisms on an ongoing basis. As with any new program, there are issues that need to be refined. Ultimately, however, the benefits of FCC auctions outweigh its pitfalls. For the future, the Commission will continue to address problems, improve processes where necessary, and implement new auctions.

Universal Service Fund

The Communications Act of 1934 first codified the FCC's goal as: "To make available, so far as possible, to all the people of the United States ... a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." The Telecommunications Act of 1996 reaffirmed this goal, establishing policies for the "preservation and advancement of Universal Service," and establishing a federal mechanism for providing universal service support, known as the Universal Service Fund (USF).

The USF is generated through mandatory contributions from all telecommunications companies in the United States, including local and long distance phone companies, wireless and paging companies and payphone providers. The Fund is support for access to affordable communications services for high cost areas, low income consumers, schools and libraries, and rural health care providers. The Universal Service Administrative Company (USAC) administers the USF under the direction of the FCC. While consumers benefit from the USF, only service providers may draw money directly out of the USF, which defrays the cost of delivering service to customers.

The Universal Service Fund as designated in the U.S. Budget consists of the four universal service support mechanisms described above and the Telecommunications Relay Service Fund (TRS). The purpose of TRS, established pursuant to section 255 of the Communications Act of 1934, is to compensate TRS providers for the reasonable costs of providing interstate telephone transmission services that enable persons with hearing or speech disabilities to use wireline or wireless telecommunications services.

Human Resources

The FCC has approximately 1981 employees. Our workforce includes individuals with a telecommunications focus, including attorneys, statisticians, economists, engineers and social and other scientists. This workforce is well positioned to serve the American public, to implement the FCC's communications goals for our nation as set forth in our Strategic Plan and to respond to the evolving issues characteristic of the ongoing communications revolution.

Limitations of the Financial Statements

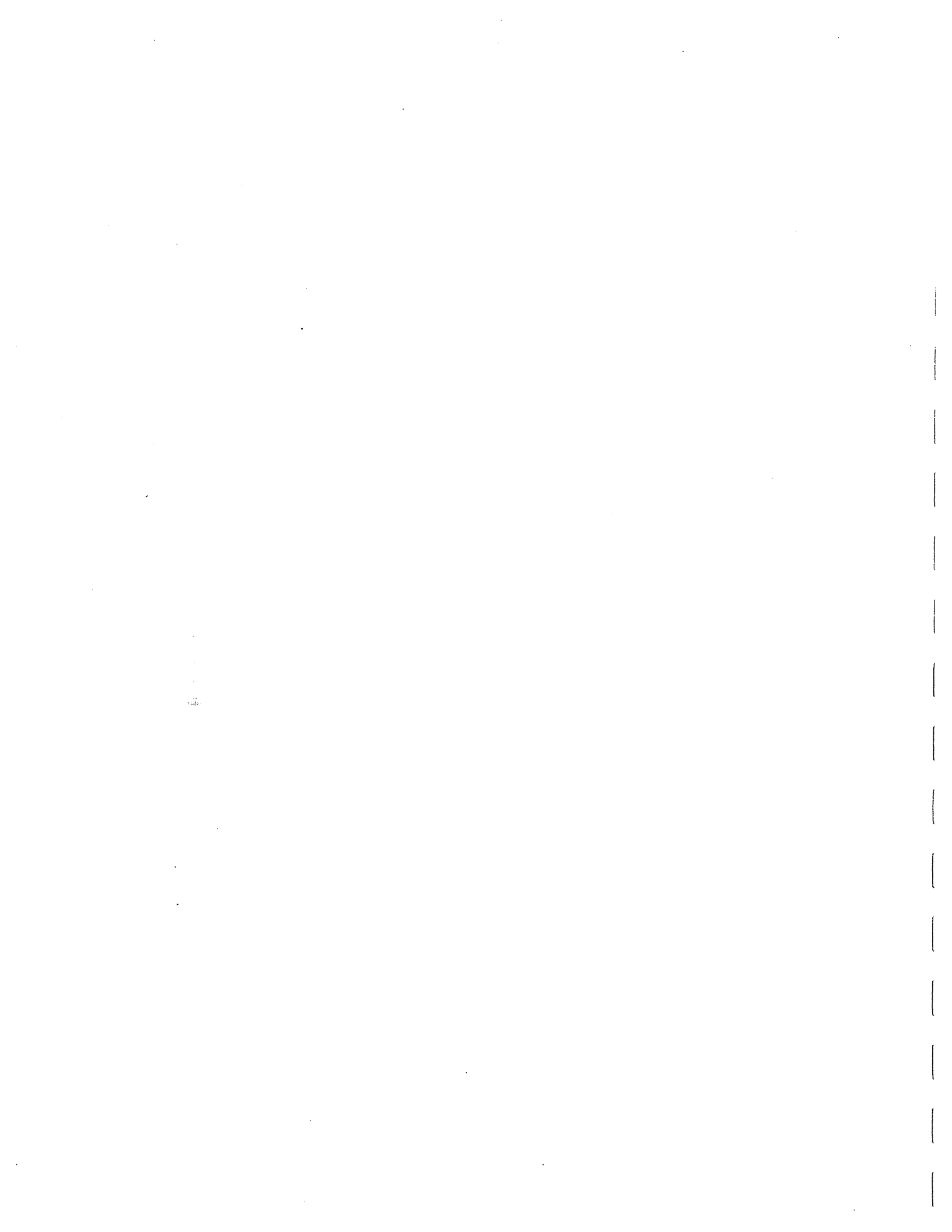
The principal financial statements have been prepared to report the financial position and results of operations of the FCC pursuant to the requirements of the Chief Financial Officers Act of 1990 (31 U.S.C. 3515 (b)), as amended. While the financial statements have been prepared from FCC's books and records in accordance with the format prescribed by the Office of Management and Budget, 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 principal financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities reported in the financial statements cannot be liquidated without legislation that provides resources to do so.

Federal Communications Commission
Consolidating Balance Sheet
As of September 30, 1999
(dollars in thousands)

ASSETS	FCC	USF	TOTAL
Entity Assets:			
<u>Intragovernmental</u>			
Fund Balance with Treasury (Note 2)	280,345	-	280,345
Investments (Note 4)	-	52,873	52,873
Accounts Receivable (Note 5)	406	-	406
Total Intragovernmental	<u>280,751</u>	<u>52,873</u>	<u>333,624</u>
Cash and Other Monetary Assets (Note 3)	64	109,788	109,852
Investments (Note 4)	-	1,347,981	1,347,981
Accounts Receivable, net (Note 5)	2,330	370,603	372,933
Loans Receivable, net (Note 6)	5,078,926	-	5,078,926
Forfeited Property (Note 7)	48	-	48
Property, Plant, and Equipment, net (Note 8)	35,205	1,220	36,425
Total Entity Assets	<u>5,397,324</u>	<u>1,882,465</u>	<u>7,279,789</u>
Non-Entity Assets:			
<u>Intragovernmental</u>			
Fund Balance with Treasury (Note 2)	225,877	-	225,877
Accounts Receivable (Note 5)	435,060	-	435,060
Total Intragovernmental	<u>660,937</u>	<u>-</u>	<u>660,937</u>
Cash and Other Monetary Assets (Note 3)	23,853	-	23,853
Accounts Receivable, net (Note 5)	386,821	-	386,821
Total Non-Entity Assets	<u>1,071,611</u>	<u>-</u>	<u>1,071,611</u>
Total Assets	<u><u>6,468,935</u></u>	<u><u>1,882,465</u></u>	<u><u>8,351,400</u></u>
 LIABILITIES			
Liabilities Covered by Budgetary Resources:			
<u>Intragovernmental</u>			
Liability for Borrowings from Treasury (Note 9)	3,938,605	-	3,938,605
Other Accrued Liabilities (Note 11)	603,850	-	603,850
Total Intragovernmental	<u>4,542,455</u>	<u>-</u>	<u>4,542,455</u>
Accounts Payable (Note 10)	6,122	354,620	360,742
Other Accrued Liabilities (Note 11)	45,452	138	45,590
Total Liabilities Covered by Budgetary Resources	<u>4,594,029</u>	<u>354,758</u>	<u>4,948,787</u>
Liabilities not Covered by Budgetary Resources:			
<u>Intragovernmental</u>			
Other Unfunded Liability (Note 11)	74,473	-	74,473
Payable to Contributors	-	1,527,707	1,527,707
Accrued Unfunded Leave	12,039	-	12,039
Total Liabilities not Covered by Budgetary Resources	<u>86,512</u>	<u>1,527,707</u>	<u>1,614,219</u>
Total Liabilities	<u><u>4,680,541</u></u>	<u><u>1,882,465</u></u>	<u><u>6,563,006</u></u>
 NET POSITION			
Unexpended Appropriations (Note 12)	28,904	-	28,904
Cumulative results of Operations	1,759,490	-	1,759,490
Total Net Position	<u>1,788,394</u>	<u>-</u>	<u>1,788,394</u>
Total Liabilities and Net Position	<u><u>6,468,935</u></u>	<u><u>1,882,465</u></u>	<u><u>8,351,400</u></u>

The Accompanying Notes are an integral part of these statements



**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 1 - Summary of Significant Accounting Policies:

Reporting Entity

The FCC is an independent United States government agency, directly responsible to Congress. The FCC was established by the Communications Act of 1934, amended, and is charged with regulating interstate and international communications by radio, television, wire, satellite and cable. The FCC's jurisdiction covers the 50 states, the District of Columbia, and U.S. possessions.

The FCC is directed by five Commissioners appointed by the President and confirmed by the Senate for five-year terms, except when filling an unexpired term. The President designates one of the Commissioners to serve as Chairperson. Only three Commissioners may be members of the same political party. None of them can have a financial interest in any Commission-related business.

The FCC is considered a separate reporting entity of the Executive Branch of the United States Government.

The Universal Service Fund (USF), as designated in the U.S. Budget, consists of five elements. Four of these are the universal service support mechanisms and the fifth is the Telecommunications Relay Service (TRS) Fund. The universal service support mechanisms were established pursuant to Section 254 of the Communications Act of 1934, as amended. The Universal Service Administrative Company (USAC) was appointed by the FCC to administer the four universal service support mechanisms: high cost areas, low income consumers, schools and libraries, and rural health care providers. It also submits to the FCC projections of demand and administrative expenses for each of these mechanisms and submits quarterly universal service contribution data to the FCC. Two corporate subsidiaries of USAC, previously formed to administer the schools and libraries and rural health care mechanisms, were merged into USAC on January 1, 1999.

The TRS Fund is administered by the National Exchange Carriers Association (NECA). The purpose of the TRS Fund is to compensate TRS providers for the reasonable costs of providing interstate telephone transmission services that enable persons with hearing or speech disabilities to use wireline or wireless telecommunications services.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

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

Basis of Accounting

The consolidating balance sheet has been prepared from the accounting records of FCC in conformity with generally accepted accounting principles (GAAP), and the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 97-01, *Form and Content of Federal Agency's Financial Statements*, as amended. GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which was designated the official accounting standards-setting body for the Federal Government by the American Institute of Certified Public Accountants. The consolidating balance sheet is different from the financial reports, also prepared by FCC pursuant to OMB directives, that are used to monitor and control FCC's use of budgetary resources.

Basis of Presentation

The accompanying consolidating balance sheet has been prepared to report the financial position of the FCC for fiscal year 1999. The consolidating balance sheet has been prepared from the books and records of the FCC in accordance with the OMB Bulletin No. 97-01, as amended, and generally accepted accounting principles of the Federal government.

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Fiscal Year (FY) 1999 represents the first time that the FCC has undertaken the financial statement preparation process. The FCC is not a designated Agency in the Chief Financial Officer's Act of 1990 (CFO Act), as amended, and therefore, has not been subject to the financial statement preparation requirements of the CFO Act in the past. Financial statements were prepared for the first time in FY 1999 to assist the Department of the Treasury's Financial Management Service (FMS), in meeting its government-wide financial statement preparation effort. FCC's financial statements consolidate the balances contained in 12 Treasury symbols and one outside commercial account. For FY 1999 reporting purposes only the consolidating balance sheet is presented and subject to audit.

The financial statements include all funds and programs for which the FCC is responsible. All significant intra-entity balances and transactions have been eliminated in consolidation. A distinction has been made in the financial statements between asset and liability balances arising from transactions with other Federal government agencies and all other asset and liability balances. These balances are specifically identified under the heading Intragovernmental.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

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

Assets

Assets are tangible or intangible items owned by the FCC that would have probable economic benefits that can be obtained or controlled by FCC. The consolidating balance sheet presents assets in one of two categories: entity or non-entity. Entity assets are those assets which the reporting entity holds and has the authority to use in its operations. Non-entity assets are assets the entity holds but does not have the authority to use in its operations.

Funds with the U.S. Treasury

The FCC maintains three types of accounts with the U.S. Treasury: appropriated, revolving, and deposit. The appropriated and revolving accounts may be used by the FCC to finance expenditures depending on budgetary availability. The deposit accounts are used to hold either spectrum auctions, international telecommunications settlement, or regulatory fee monies until they can be distributed to the proper account. There are no Treasury balances maintained by the USF.

Cash and Other Monetary Assets

Unrestricted – Unrestricted cash represents USF cash on deposit at several commercial banks. It is cash that can be used for any authorized program purpose. The commercial accounts are in the form of money market mutual funds. Interest proceeds are reinvested and remain available for USF use.

Restricted – Restricted cash consists of cash deposits held at Mellon bank. FCC has custodial responsibility for these funds. These funds represent third party advances made pursuant to the FCC Spectrum Auction Activities. Upon conclusion of individual auctions, funds on deposit are offset against amounts due from successful bidders or returned to unsuccessful bidders. The funds are held in an interest bearing account, the Telecommunications Development Account (TDA), during and for a 45 day period after the close of a given auction.

The Telecommunications Act of 1996 established the Telecommunication Development Fund (TDF), the purpose of which is to: (1) promote access to capital for small businesses in order to enhance competition in the telecommunications industry; (2) stimulate new technology development, and promote employment and training; and (3) support universal service and promote delivery of telecommunications to underserved rural and urban areas. According to 47 U.S.C. Section 309(j)(8), the FCC is authorized to transfer interest accrued on deposits from the TDA to the TDF.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET.**

September 30, 1999

(dollars in thousands unless otherwise stated)

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

Cash on deposit typically exceeds federally insured limits. The Federal Reserve requires the bank to collateralize all funds on deposit from FCC at 110 percent.

Accounts Receivable

Accounts receivable are recorded net of any related allowance for doubtful accounts. Allowance amounts are only determined for FCC Fines and Forfeitures receivables and USF Contributor receivables. In both cases, the allowance is determined based on analysis of individual accounts.

Loans

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

Investments

Investments are reported net of any unamortized premium or discount. The USF's investments include intragovernmental securities, commercial paper and repurchase agreements. All commercial investments are considered to be short term with maturity dates that do not exceed three months.

Property, Plant and Equipment

The basis for recording purchased general Property, Plant and Equipment (PP&E) is full cost, including all costs incurred to bring the PP&E to a form and location suitable for its intended use. The cost of PP&E acquired through donation is the estimated fair value when acquired. The cost of PP&E transferred from other Federal entities is the net book value of the transferring entity.

All PP&E with an initial acquisition cost of \$25,000 or more and an estimated useful life of two years or greater are capitalized. Bulk purchases of similar items, which individually are not worth \$25,000, but collectively are greater than \$250,000 are also capitalized using the same equipment categories and lives as capital acquisitions. PP&E are depreciated on a straight-line

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

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

basis over the estimated useful life of the item. The useful lives used are: twenty years for buildings and patents, seven years for equipment, five years for computers and peripherals, and three years for software. Land and land rights, including permanent improvements, are not depreciated. Normal maintenance and repair costs are expensed as incurred.

The FCC's authority relative to seized and forfeited property is found in 47 USC Section 510. Seized property consists of property seized in illegal telecommunication operations. The property is considered prohibited and held pending an outcome of court proceedings. Seized assets that are monetary instruments shall be recognized as an asset when seized and a corresponding liability shall be reported equal to the seized asset value. FCC has no seized assets that are monetary instruments. Forfeited property consists of seized property legally turned over to the FCC and disposed of through GSA surplus process or destroyed. The values assigned to the seized and forfeited property are determined by FCC engineers and are based on current market values for comparable property.

Liabilities

Liabilities represent a probable future outflow or other sacrifice of resources as a result of past transactions or events. FCC liabilities cannot be liquidated without legislation that provides resources to do so. Since the FCC is a component of the U.S. Government, a sovereign entity, payments of all liabilities other than contracts can be abrogated by the sovereign entity.

Liabilities Covered by Budgetary Resources are those liabilities funded by available budgetary resources including: (1) new budget authority, (2) spending authority from offsetting collections, (3) recoveries of unexpired budget authority, (4) unobligated balances of budgetary resources at the beginning of the year, and (5) permanent indefinite appropriations or borrowing authority, as of the consolidating balance sheet date.

Liabilities Not Covered by Budgetary Resources are incurred when funding has not yet been made available through Congressional appropriations or current earnings. FCC recognizes such liabilities for employee annual leave earned but not taken, and amounts billed by the Department of Labor for Federal Employee's Compensation Act (disability) payments.

Liability for Borrowings to Treasury

This account represents amounts due the U.S. Department of Treasury to support the Spectrum Auction Loans Program. Borrowings are determined based on the FCC's subsidy estimate and re-estimate in accordance with the FCRA.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

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

Payable to Contributors

This account contains amounts awaiting approval for payment to USF programs (Schools and Libraries, Rural Healthcare, High Cost and Low Income) and has not been disbursed as of September 30, 1999.

Retirement Plans and Other Benefits

Federal Employee benefits consist of the actuarial portions of future benefits earned by Federal employees, but not yet due and payable. These costs include pensions, other retirement benefits, and other post-employment benefits. These benefits are normally administered by OPM and not by FCC. Since FCC does not administer the benefit plans, FCC does not recognize any liability on the Consolidating Balance Sheet for pensions, other retirement benefits. FCC does, however, recognize the imputed costs and imputed financing related to these benefits in the Statement of Net Cost and the Statement of Changes in Net Position, respectively.

Retirement Plans and Other Benefits (continued):

Pensions provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. Most FCC employees participate in the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). Under CSRS, FCC makes matching contributions equal to seven percent of basic pay. For FERS employees, FCC contributes the employer's matching share for Social Security and contributes an amount equal to one percent of employee pay to a savings plan and matches up to an additional four percent of pay. Most employees hired after December 31, 1983, are covered by FERS. The Office of Personnel Management reports on CSRS and FERS assets, accumulated plan benefits, unfunded liabilities, if any, applicable to Federal employees.

The actuarial liability for future workers' compensation benefits includes the expected liability for death, disability, medical and miscellaneous costs for approval compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payment related to that period. No actuarial liability is determined by DOL for the FCC, due to the immateriality to the Federal Government as a whole.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

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

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 leave balances and current pay rates. Annual leave is reflected as a liability that is not covered by current budgetary resources. Sick leave and other types of non-vested leave are expensed as taken.

Revenues and Other Financing Sources

Regulatory Fee Collections - The Omnibus Budget Reconciliation Act of 1993 directed the FCC to assess and collect regulatory fees to recover the costs incurred in carrying out certain provisions of the agency mission. Regulatory fees are intended to offset costs associated with the FCC enforcement, policy and rulemaking, international, and user information activities. Since 1993, the Congress has annually reviewed the regulatory fee collection requirements of the Commission and established the total fee levels to be collected. Fees collected up to the level established by Congress are applied against the FCC's annual appropriation via a negative warrant processed at the close of each fiscal year, fees collected in excess of the established level are available for use by the FCC until expended. Only once, in FY 1998, have fee attainments been less than the established level. In FY 1999, regulatory fee collections exceeded the established level of \$172,523 by \$4,586 (unaudited).

Annual Appropriations - Because the majority of its regulatory fees are not collected until the final month of the fiscal year, the FCC receives an annual Salaries and Expense appropriation from Congress. These funds are used to fund operations during the course of the fiscal year and are then repaid to the Treasury once Regulatory fees have been collected. The final annual appropriation for FY 1999 was \$19,452.

Subsidy Estimates and Re-estimates - The FCC receives permanent-indefinite authority in accordance with the Federal Credit Reform Act (FCRA) of 1990 to fund its Subsidy Estimates and Re-estimates. This authority funds repayment to Treasury for the portion of Spectrum Auction loans that will not be recovered from the borrower.

Offsetting Collections - One of FCC's primary functions is the management of the Auction Spectrum Loan Program on behalf of the U.S. Government. Proceeds from the auctions are initially remitted to the FCC and later transferred to the U.S. Treasury as Federal collections. Under U.S.C 47 Chapter 5 Section 309, a portion of the Spectrum auction proceeds may be retained by the FCC to offset the cost of performing the auction function. These collections are available until expended. FY 1999 collections used to offset the cost of performing the auctions funding totaled \$50,076 (unaudited).

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET.**

September 30, 1999

(dollars in thousands unless otherwise stated)

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

Reimbursable Work Agreements – The FCC recognizes reimbursable work agreement revenue when earned, i.e. goods have been delivered or services rendered. The FCC has established twelve agreements with other agencies totaling approximately \$1.1 million (unaudited) for FY 1999.

Exchange and Non-exchange Revenue - Exchange Revenue is the amount of money earned for goods and services provided to other agencies and the public, reimbursable agreements are treated as exchange revenue by the FCC. Non-exchange revenue is recorded for transactions where revenue is earned at no substantial cost to the provider. Spectrum auction sales are considered exchange revenue to the Federal Government and are recorded as a custodial liability on the part of the FCC.

Net Position

Net position account balances consist of the following components:

Unexpended Appropriations - Represents amounts of spending authority that are unobligated and available to the Commission, or obligated but not expended.

Cumulative results of operations – Represents the Commission’s net results of operations since inception, including (1) the cost of property and equipment acquired that has been financed by appropriations, less accumulated depreciation, (2) the amount of appropriated funding that will be needed in future periods to liquidate liabilities incurred through the current fiscal year, and (3) future proceeds from downward reestimates of mandatory loan programs used to fund future loan costs. Funding for these items is generally received in the year that amounts become due and payable.

Note 2 - Fund Balances with Treasury:

	<u>Entity</u>	<u>Non-Entity</u>	<u>Total</u>
Appropriated Fund	\$ 87,841	\$ -	\$ 87,841
Revolving Fund	192,261	-	192,261
Deposit Funds	<u>243</u>	<u>225,877</u>	<u>226,120</u>
Total Fund Balance	<u>\$280,345</u>	<u>\$225,877</u>	<u>\$506,222</u>

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 2 - Fund Balances with Treasury (continued):

Appropriated Funds - These funds consist of salaries and expense appropriation accounts used to fund agency operations and capital expenditures.

Revolving Funds - The financing account used to process the subsidy cost for credit reform loans is considered to be a revolving fund by Treasury. This is the only revolving fund maintained by the FCC.

Deposit Funds - These funds are maintained to account for receipts awaiting proper classification or are in escrow until proper distribution can be made. The three deposit accounts used by FCC hold spectrum auction, international telecommunications settlement, and regulatory fee monies. Deposit funds are not available for use by the FCC unless they are properly identified or reclassified as FCC funds otherwise, these funds will be returned to the depositor or transferred to Treasury.

Note 3 - Cash and Other Monetary Assets:

	<u>Entity Assets</u>	<u>Non-Entity Assets</u>	Total
<u>FCC</u>			
Imprest Fund	\$ 64	\$ -	\$ 64
Cash on deposit with commercial banks	<u>-</u>	<u>23.853</u>	<u>23.853</u>
Total FCC cash	<u>\$ 64</u>	<u>\$23.853</u>	<u>\$ 23.917</u>
 <u>USF</u>			
Money Market Funds	\$104,200	\$ -	\$104,200
Cash on deposit with commercial banks	<u>5,588</u>	<u>-</u>	<u>5,588</u>
Total USF Cash	<u>\$109,788</u>	<u>\$ -</u>	<u>\$109,788</u>

FCC cash on deposit with commercial banks represents amounts deposited by bidders as upfront money for auction number 25 and related interest. None of the money held on deposit is available to the FCC for use in its operations. Upon completion of the auction process, deposits from unsuccessful bidders will be returned while successful bidder deposits will be transferred to a FCC deposit symbol at the U.S. Treasury.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 3 – Cash and Other Monetary Assets (continued):

USF cash on deposit with commercial banks represents payments received from contributors that have not yet been distributed to the program recipients. All money held in commercial accounts by USF is deposited in a money market type fund earning interest between 5.2 and 5.3 percent.

Note 4 – Investments:

	<u>Cost</u>	<u>Amortization Method</u>	<u>Unamortized (Premium) Discount</u>	<u>Investments, Net</u>
A. Intragovernmental Securities:				
(1) Marketable	\$ 52,873	SL	\$ -	\$ 52,873
B. Other Securities:				
(1) Notes and Bonds	\$ 24,680	NA	\$ -	\$ 24,680
(2) Commercial Paper	825,195	SL	-	825,195
(3) Repurchase Agreements	489,130	NA	-	489,130
(4) Interest Receivable	<u>8,976</u>	NA	<u>-</u>	<u>8,976</u>
 Total Other Securities	 <u>\$1,347,981</u>		 <u>\$ -</u>	 <u>\$1,347,981</u>

Investment balances represent funds that have been invested by USF in Federal and Commercial securities and agreements. Marketable Federal securities are securities that can be bought and sold on the open market. All Commercial securities are typically purchased with maturity dates of 3 months or less and held until maturity.

All losses associated with USF investments are considered temporary, therefore, net investments is the same as market value.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 5 - Accounts Receivable, Net:

	<u>Entity</u>	<u>Non-Entity</u>	<u>Total</u>
<u>FCC</u>			
Intragovernmental:			
Gross Accounts Receivable	\$ 406	\$435,060	\$435,466
Allowance For Doubtful Accounts	(-)	(-)	(-)
Net Accounts Receivable	<u>\$ 406</u>	<u>\$435,060</u>	<u>\$435,466</u>
With the Public:			
Gross Accounts Receivable	\$ 2,330	\$400,768	\$403,098
Allowance For Doubtful Accounts	(-)	(13,947)	(13,947)
Net Accounts Receivable	<u>\$ 2,330</u>	<u>\$386,821</u>	<u>\$389,151</u>
<u>USF</u>			
With the Public:			
Gross Accounts Receivable	\$383,562	\$ -	\$383,562
Allowance For Doubtful Accounts	(12,959)	(-)	(12,959)
Net Accounts Receivable	<u>\$370,603</u>	<u>\$ -</u>	<u>\$370,603</u>

The FCC intragovernmental non-entity receivable for \$435 million is the result of an overpayment of funds to Treasury for FCRA loans. This amount will be collected in FY 2000 through a reduction in the amount paid to Treasury instead of a direct repayment by Treasury.

The FCC non-entity receivables include an amount of \$377 million for the Broadband Personal Communications Services Pioneer Installment Financed Licenses. The Pioneer licensees were permitted to pay for their licenses in installment payments over a five-year period. A subsequent agreement was reached by OMB, Congressional Budget Office (CBO), Department of the Treasury, and the FCC that installment financed purchases of Spectrum Licenses should fall under FCRA requirements. In FY 1999 this agreement was applied retroactively to earlier installment financed licenses with the exception of Pioneer. A decision was made by FCC and OMB not to bring the Pioneer installments under FCRA because they are fully performing and there is no expected cost to the Federal government. Installment payments for Pioneer will be completed in FY 2001.

In addition to the Pioneer receivables, the FCC has \$22 million in receivables related to fines and forfeitures. Although we have included this amount as receivables for financial reporting purposes, none of this amount constitutes a debt owed to the federal government. Of the \$22 million, \$13.1 million represents proposed forfeitures which may, based on the record that is

FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 5 - Accounts Receivable, Net (continued):

developed before the Commission, lead to imposition of forfeiture for a lower amount, or no forfeiture at all. In addition, of the \$8.9 million in forfeitures, some of these may be reduced or eliminated by the Commission based on a further record. In any event, under the Communications Act, unpaid forfeitures do not constitute a debt unless and until the target agrees to pay or the Department of Justice successfully enforces the forfeiture in the federal district court.

USF receivables represent amounts due from contributors. The \$12.9 million reserve related to these balances was determined at the individual account level based upon a detail analysis of aged receivables and bankruptcy status.

Note 6 - Direct Loans, Non-Federal Borrowers:

Under Section 309(j)(4) of the Communications Act of 1934, Congress directed the FCC to expand economic opportunity, promote competition, and facilitate the development and delivery of new and improved telecommunications services to the public. Specifically, the FCC was given a mandate to provide small businesses, rural telephone companies, and women and minority-owned businesses with an opportunity to participate in the provision of spectrum-based services. By statute, the FCC can use various means to facilitate expanded participation, including alternative payment schedules, tax certificates, bidding preferences, and other procedures.

As a result, the FCC provided installment financing in six of its Spectrum Auction events, including the C Block broadband Personal Communications Services' (PCS), F Block PCS, narrowband PCS, Interactive Video and Data Service (IVDS), Multipoint Distribution Service (MDS), and 900MHz Specialized Mobile Radio (SMR). Under the installment financing program, winning bidders have generally been given five or ten-year periods to repay their net winning bid amount (less the down payment amount), with up to five-year interest-only initial payment periods. Interest rates varied by the type of borrower, but have generally been well below market rates. Retention of licenses granted at auction was strictly conditional on making full and timely payment of amounts as they become due.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET.**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 6 - Direct Loans, Non-Federal Borrowers (continued):

FCC's first auction was conducted in 1994, and starting in 1996, installment payment mechanisms were used to finance portions of some of the winning bid amounts. In 1997, OMB, CBO, the Department of the Treasury and FCC concluded that installment financed arrangements would be set up as direct loans and reported in accordance with FCRA. The FCC complied with this arrangement. After the FCC completed the fiscal year 1998 subsidy reestimate, it began a comprehensive review of its loan portfolio data. In fiscal year 1999, FCC agreed with OMB to reclassify earlier installment arrangements and bring all such arrangements under FCRA with the exception of Pioneer. The Pioneer installments mature in 2001. Therefore, they represent no cost to the Government. The FCC's installment plans that were reclassified as loans are arranged in 8 cohorts.

The loans receivable balance and value of the assets related to the direct loans, is not the same as the proceeds FCC would expect to receive from selling their loans.

Loan Receivable - Loan Receivables for post 1995 Spectrum Auctions (with the exception of Pioneer Licenses) are recorded at the principal outstanding, net of allowances for subsidy. Allowance for subsidy costs represent the difference between the present values of estimated net cash inflows and outflows of the Spectrum Auction Loans. The allowance for subsidy cost is amortized using the effective interest method based on the Department of the Treasury's interest rate at the time loans were disbursed. These funds are used to offset the annual interest expense to Treasury on outstanding FCC borrowings. The allowance for subsidy also provides for write-offs on defaults and other costs that may affect cashflows.

Accrued Interest - FCC accrues interest on loans as it is earned. Current FCC policy automatically grants Spectrum Auction loans two 90-day grace periods for which borrowers are charged late fees. At the end of the 180-day period, loans are considered to be in default and the license may be revoked. It is the FCC's policy to discontinue accruing interest on loans that are beyond the 180-day grace period. These loans are considered non-performing and the interest is not likely to be received. Therefore, it is the FCC policy to accrue and record interest only on the performing loans.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET.**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 6 - Direct Loans, Non-Federal Borrowers (continued):

Direct Loans Obligated After FY 1991

<u>Loan Program</u>	<u>Gross Loans Receivable</u>	<u>Interest Receivable</u>	<u>Suspension Interest*</u>	<u>Allowance for Subsidy</u>	<u>Net Loans Receivable</u>
Spectrum Auctions	\$8,243,032	\$ 44,097	\$566,385	(\$3,774,588)	\$5,078,926

Subsidy Expense for Post-FY 1991 Direct Loans (unaudited)

1. Current Year's Direct Loans

<u>Loan Program</u>	<u>Interest Differential</u>	<u>Defaults</u>	<u>Fees</u>	<u>Other</u>	<u>Total</u>
Spectrum Auctions	\$7,802	\$228,531	(\$156)	\$12,303	\$248,480

2. Direct Loan Modification and Reestimates

<u>Loan Program</u>	<u>Modification</u>	<u>Reestimates</u>
Spectrum Auctions	\$ -	(\$ 522,002)

3. Total Direct Loan Subsidy Expenses

Total Current Year Direct Loans	\$ 248,480
Modifications	-
Reestimates	(522,002)
Total	<u>(\$ 273,522)</u>

4. Administrative Expense:

Spectrum Auction Total	<u>\$ 6,300</u>
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*The required interest payments on certain loan groups were suspended pending FCC rulings. This suspension interest will be paid in 8 equal installments at the end of the suspension period.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 7 - Seized and Forfeited Property:

Seized Property

FCC seizes property from illegally operated radio and other communication operations. The property is held pending the outcome of court proceedings. The property is comprised of prohibited property, radio frequency, audio equipment and other. The values assigned to the property are determined by FCC engineers based on current market values for comparable property. Because this is the first year that the FCC is tracking seized property in this manner, an analysis of change in seized property during the period was not possible. The following information will provide a baseline from which we will analyze changes in seized property during FY 2000:

Seized Property as of September 30, 1999:

	<u>Number</u>	<u>Amount</u>
Prohibited (a)	36	\$ -
Radio Frequency	66	3
Audio	2,363	49
Other	<u>163</u>	<u>8</u>
Total	<u>2,628</u>	<u>\$ 60</u>

(a) Prohibited items are those with no legal market in the United States. At the FCC, prohibited items are typically radio transmitters, the marketing of which would be in violation of the Communications Act.

Forfeited Property

Forfeited property consists of seized property legally turned over to the FCC. FCC does not resell the items. Forfeited items are either disposed of through the GSA surplus process or destroyed. The property is comprised of prohibited property, radio frequency, audio equipment and other. The values assigned to the property are determined by FCC engineers based on current market values for comparable property. Because this is the first year that the FCC is tracking forfeited property in this manner, an analysis of change in forfeited property during the period was not possible. The following information will provide a baseline from which we will analyze changes in forfeited property during FY 2000.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET.**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 7 - Seized and Forfeited Property (continued):

Forfeited Property as of September 30, 1999:

	<u>Number</u>	<u>Amount</u>
Prohibited (a)	17	\$ -
Radio Frequency	86	3
Audio	397	39
Other	<u>121</u>	<u>6</u>
Total	<u>621</u>	<u>\$ 48</u>

(a) Prohibited items are those with no legal market in the United States. At the FCC, prohibited items are typically radio transmitters, the marketing of which would be in violation of the Communications Act.

Note 8 - Property, Plant and Equipment:

FCC

<u>Classes of PP&E</u>	<u>Acquisition Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>	<u>Service Life in Years</u>
Land	\$ 1,292	\$ -	\$ 1,292	N/A
Buildings	4,091	3,809	282	20
Furniture	19,158	9,579	9,579	7
Non-Computer Equip.	4,103	2,120	1,983	7
Computer Equip.	12,622	5,940	6,682	5
Bulk Purchases	3,968	1,051	2,917	5 - 7
Vehicle Systems	2,689	762	1,927	7
Broadcast Station Equipment	1,796	1,502	294	7
Patent	800	97	703	17
ADP Software	11,181	3,314	7,867	3
ADP Software, In Process	<u>1,679</u>	<u>-</u>	<u>1,679</u>	N/A
Total	<u>\$ 63,379</u>	<u>\$ 28,174</u>	<u>\$ 35,205</u>	

USF

The USF has \$1,220 in net capitalized property which is immaterial to the total reported on the consolidating balance sheet.

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 9 - Borrowings from the U.S. Treasury:

The FCC borrows from the U.S. Treasury for costs associated with its Spectrum Auction Loan Program. Borrowings are determined upon calculation of the subsidy estimates and re-estimates in accordance with the FCRA. The borrowings pertain to all loan cohorts.

Beginning Balance	\$4,501,520
Net Borrowing	<u>(562,915)</u>
Ending Balance	<u>\$3,938,605</u>

The weighted average interest rate on borrowings from the U.S. Treasury for FY 1999 was 6.57 percent. The calculation was made in accordance with OMB Circular A-34, *Budget Execution*. Total interest paid on borrowings from the U.S. Treasury was \$529 million (unaudited) for FY 1999.

Note 10 – Accounts Payable

FCC's balance of \$6 million in Accounts Payables reflects amounts owed for goods and services that have been received, but not liquidated. The \$354 million in the USF relates to amounts owed for goods and services provided in the administration of the USF, and the commitments to providers not yet distributed.

Note 11 - Other Liabilities:

<u>FCC</u>	<u>Intragovernmental</u>	<u>With the Public</u>	<u>Total</u>
Covered By Budgetary Resources:			
Liability for Custodial Receivable	\$ 385,534	\$ -	\$ 385,534
Liability for Custodial Receipts	218,316	-	218,316
Auction Deposits	-	24,476	24,476
Accrued Payroll	-	9,021	9,021
Miscellaneous	<u>-</u>	<u>11,955</u>	<u>11,955</u>
Total Covered Budgetary Resources	<u>\$ 603,850</u>	<u>\$ 45,452</u>	<u>\$ 649,302</u>
Not Covered By Budgetary Resources:			
Intragovernmental Liability	\$ 74,132	\$ -	\$ 74,132
FECA Liability	<u>341</u>	<u>-</u>	<u>341</u>
Total Not Covered By Budgetary Resources	<u>\$ 74,473</u>	<u>-</u>	<u>\$ 74,473</u>

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 11 - Other Liabilities (continued):

<u>USF</u>	<u>Intragovernmental</u>	<u>With the Public</u>	<u>Total</u>
Covered By Budgetary Resources:			
Accrued Payroll	\$ -	\$ 68	\$ 68
Miscellaneous	<u>-</u>	<u>70</u>	<u>70</u>
Total Covered Budgetary Resources	<u>\$ -</u>	<u>\$ 138</u>	<u>\$ 138</u>

The FCC liability for custodial receivables represents an offset to non-entity receivables that when collected, will be deposited into the U.S. Treasury General Fund. The majority of this balance is for receivables related to the Pioneer Licenses in the amount of \$377 million.

The liability for custodial receipts represents spectrum auction monies being held by FCC for transfer to the Treasury General Fund. A portion of these funds may be used to cover the cost of FY 2000 auctions. It is anticipated that all custodial receipts currently held will be transferred to Treasury or used as offsetting collection in FY 2000.

All liabilities covered by budgetary resources are classified as current. Current liabilities represent amounts that are expected to be paid within the fiscal year following the reporting date.

Note 11 - Leases: (unaudited)

Operating Leases:

The FCC has operating leases for rental of office space and office equipment. The copier lease arrangements are renewable annually with five possible annual renewal periods.

Future lease obligations under operating leases are as follows:

Fiscal Year	Bldg	Copier	Total
2000	\$ 26,405	\$ 329	\$ 26,734
2001	26,349	329	26,678
2002	26,272	329	26,601
2003	26,242	329	26,571
2004	<u>26,305</u>	<u>329</u>	<u>26,634</u>
Total Future Lease Payments	<u>\$131,573</u>	<u>\$1,645</u>	<u>\$133,218</u>

**FEDERAL COMMUNICATIONS COMMISSION
NOTES TO CONSOLIDATING BALANCE SHEET**

September 30, 1999

(dollars in thousands unless otherwise stated)

Note 12 – Net Position:

Net position is the difference between assets and liabilities. The section contains two line items: Unexpended Appropriations, including unobligated appropriations and undelivered orders, and Cumulative Results of Operations. Unobligated appropriations are either available for obligation or not available (permanently or temporarily) pursuant to a specific provision in law. Undelivered orders represents appropriations obligated (i.e. legally reserved) for the amount of goods or services ordered but not yet received.

Cumulative results of operations include the following:

- The net accumulated difference between expenses consuming budgetary resources and financing sources providing budgetary resources.
- Investment in capitalized assets, which increases as capital assets are acquired and decreases as capital assets are consumed (depreciated) or disposed of; and
- The excess of certain liabilities not covered by budgetary resources, net of certain assets not providing budgetary resources, whose liquidation will require funding from future congressional appropriations or other budgetary resources.

	<u>FCC</u>	<u>USF</u>	<u>TOTAL</u>
Unexpended Appropriations:			
Unobligated:			
Available	\$ 4,644	\$ -	\$ 4,644
Unavailable	\$ 5,264	\$ -	\$ 5,264
Undelivered Orders	\$ 22,814	\$ -	\$ 22,814
Non-Budgetary Accruals	<u>(\$ 3,818)</u>	<u>\$ -</u>	<u>(\$ 3,818)</u>
Subtotal	\$ 28,904	\$ -	\$ 28,904
Cumulative Results			
Of Operations	<u>\$1,759,490</u>	<u>\$ -</u>	<u>\$1,759,490</u>
Net Position	<u>\$1,788,394</u>	<u>\$ -</u>	<u>\$1,788,394</u>

Note 13 - Contingencies

On September 10, 1999, the FCC undertook a comprehensive examination of its regulations governing the licensing and use of frequencies in the 218-219 MHz band. As a result of this examination, the FCC amended Part 95 of the Commission's Rules to Provide Regulatory Flexibility in the 218-219 MHz Service. The FCC is unable to reasonably estimate and predict the impact that the amendment will have to the financial statements at this time. Such a determination is contingent upon certain events that are anticipated to occur in FY 2000.

OTHER
SUPPLEMENTAL
INFORMATION

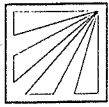
FEDERAL COMMUNICATIONS COMMISSION
SCHEDULE OF INTRAGOVERNMENTAL TRADING PARTNERS
Ended September 30, 1999
(dollars in thousands unless otherwise stated)

Intra-Governmental Assets

<u>Trading Partner</u>	<u>Fund</u> <u>Balance</u>	<u>Accounts</u> <u>Receivable</u>	<u>Investments</u>
Entity			
Department of Treasury	\$ 280,345	\$ -	\$ -
Other	<u>-</u>	<u>406</u>	<u>52.873</u>
Sub-Total	<u>\$ 280.345</u>	<u>\$ 406</u>	<u>\$ 52.873</u>
Non-Entity			
Department of Treasury	<u>\$ 225.877</u>	<u>\$ 435.060</u>	<u>\$ -</u>
Total	<u><u>\$ 506.222</u></u>	<u><u>\$ 435.466</u></u>	<u><u>\$ 52.873</u></u>

Intra-Governmental Liabilities

<u>Trading Partner</u>	<u>Borrowings</u> <u>From</u> <u>Treasury</u>	<u>Other</u> <u>Liabilities</u>
Funded		
Department of Treasury	<u>\$3,938,605</u>	<u>\$ 603,850</u>
Unfunded		
Other	\$ -	\$ 74,132
Department of Labor	<u>-</u>	<u>341</u>
Sub-Total	<u>\$ -</u>	<u>\$ 74,473</u>
Total	\$3,938,605	\$ 678,323



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Independent Auditor's Report

To the Inspector General of the
Federal Communications Commission

We have audited the accompanying consolidating balance sheet (financial statement) of the Federal Communications Commission (FCC) as of September 30, 1999. This financial statement is the responsibility of FCC's management. Our responsibility is to express an opinion on this financial statement based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with generally accepted auditing standards; the standards applicable to the 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. 98-08, "*Audit Requirements for Federal Financial Statements*," as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

FCC's financial statement contains property, plant and equipment of \$35.2 million and an unfunded liability of \$74.4 million at September 30, 1999. FCC was unable to provide sufficient documentation to fully support these balances, and we were unable to satisfy ourselves by other auditing procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding property, plant and equipment and unfunded liabilities, the financial statement referred to above presents fairly, in all material respects, the financial position of FCC at September 30, 1999, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated January 18, 2000 on our consideration of FCC's internal control over financial reporting, and on our tests of FCC's compliance with certain provisions of laws and regulations.

Our audit was made for the purpose of forming an opinion on the basic financial statement taken as a whole. The accompanying supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statement. Such information has been subjected to the auditing procedures applied in the audit of the financial statement taken as a whole, and in our opinion, except for the effects of adjustments explained above, is presented fairly, in all material respects, in relation to the basic financial statement taken as a whole. The information in the Overview of FCC is not a required part of the basic financial statement. We assessed whether this information is materially inconsistent with the information, and the manner of its presentation, in FCC's financial statement. However, we did not audit this information and express no opinion on it.

Clifton Sunderson L.L.C.

Greenbelt, Maryland
January 18, 2000



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Independent Auditor's Report On Internal Control

To the Inspector General of the
Federal Communications Commission

We have audited the accompanying consolidating balance sheet of the Federal Communications Commission (FCC) as of September 30, 1999, and have issued our report thereon dated January 18, 2000. The report includes a qualified opinion on the consolidating balance sheet of FCC at September 30, 1999, relating to certain scope limitations. Except as discussed in the preceding sentence, we conducted our audit in accordance with generally accepted auditing standards, the standards applicable to the 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. 98-08, "*Audit Requirements for Federal Financial Statements*," as amended (OMB Bulletin 98-08, as amended).

In planning and performing our audit, we considered FCC's internal control over financial reporting by obtaining an understanding of FCC's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives in OMB Bulletin 98-08, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the FCC's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or

operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, we noted certain matters discussed in the following section involving the internal control and its operation that we consider to be reportable conditions and material weaknesses.

FCC did not report any performance measures in its Overview of the Reporting Entity. We noted certain significant deficiencies in internal control over performance measures discussed in the following section that, in our judgment, could adversely affect the agency's ability to collect, process, record, and summarize performance information and report performance measures in accordance with management's criteria. Accordingly, we were not able to obtain an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

MATERIAL WEAKNESSES

I. Financial Reporting

The Chief Financial Officers (CFO) Act of 1990 assigned responsibility for developing and operating financial management systems to each Federal agency. OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended (OMB Bulletin 97-01, as amended), was issued which defined the form and content of financial statements to be prepared by each agency to assist them in fulfilling this responsibility. In addition, the Federal Accounting Standards Advisory Board (FASAB) has established generally accepted accounting principles for federal financial agencies. To accomplish the objective of complying with the CFO Act, the agency is required to develop a system to prepare a complete set of financial statements on a timely basis in accordance with generally accepted accounting principles. The statements are to result from an accounting system that is an integral part of a total financial management system containing sufficient structure, effective internal control, and reliable data.

Financial reporting consists of policies and procedures related to the processing and summarizing of accounting entries, and the preparation of financial statements. Transactions have to be properly recorded and accounted for to permit the preparation of reliable financial statements.

FCC undertook a significant challenge this year in preparing its first ever financial statement. Prior to this year the focus of FCC's financial operations has been budgetary accounting and reporting. FCC needs to expand this focus and develop an effective system for financial accounting and reporting.

FCC's financial reporting weaknesses are detailed as follows:

FCC Was Unable To Complete Principal Statements Other Than A Consolidating Balance Sheet, Notes To The Consolidating Balance Sheet And Some Required Supplementary Information

FCC prepared its first annual financial statement in fiscal year 1999. The financial statement includes an Overview, a Consolidating Balance Sheet and Notes to the Consolidating Balance Sheet (financial statement) and the supplementary information on intra-governmental assets and liabilities. It does not, however, include a Statement of Net Cost, a Statement of Changes in Net Position, a Statement of Budgetary Resources, a Statement of Financing, a Statement of Custodial Activities, or the supplementary information for Deferred Maintenance which are required principal statements and supplementary information per OMB Bulletin 97-01, as amended. Although FCC provided us with a draft financial statement by its deadline, the unadjusted financial statement contained significant errors, omissions and was incomplete.

Management Comments

FCC prepared required financial statements for FY 1999. However, due to resource constraints, a mutual decision was made between OMD and OIG to concentrate efforts solely on the Consolidating Balance Sheet, Notes, and Required Supplementary Information aforementioned. For FY 2000, all statements and supplementary schedules will be prepared and subjected to audit.

FCC Does Not Have A Formalized Financial Reporting Process To Provide For The Preparation Of Financial Statements To Meet The Requirements Of The CFO Act, Hence, There Is No Written Documentation Of This Process

Preparation of the annual financial statements is the responsibility of agency management. In carrying out that responsibility, each agency CFO should prepare a policy memorandum that guides agency fiscal management personnel in the preparation

of the annual financial statements. FCC does not have a formalized financial reporting process to provide for the preparation of financial statements to meet the requirements of the CFO Act nor does it have written documentation that provides an integrated view of the procedures, personnel and systems employed in preparation of the financial statements. The existence of written procedures will provide structure to the preparation and review process.

Management Comments

FCC does have formalized budgetary accounting policies and procedures to include the generation of financial reports. Management concurs these do not include aforementioned financial reporting requirements of the CFO Act. Currently, management is updating policy and procedural manuals to include such reports. Additionally, management is updating existing policies and procedures to include any new requirements.

FCC Does Not Prepare And Analyze Interim Financial Activity In Certain Areas To Provide For Preparation Of The Annual Financial Statements To Meet Requirements Of The CFO Act

Account analyses and reconciliations were not periodically performed during the entire year but performed once at year-end in preparation for financial statement reporting. Year-end balances for Loans Receivable; Allowance for Subsidy; Property, Plant and Equipment; Accounts Payable; Undelivered Orders; Cumulative Results of Operations; and Unexpended Appropriations, contained errors and inconsistencies because account activity had not been reviewed or monitored in past years. Certain accounting transactions were not consistently and adequately supported by reliable and conclusive documentation. Thus, significant adjustments as part of a general account "clean-up" for the year-end were identified and posted. Regular financial statement preparation and analysis on a monthly or quarterly basis may eliminate the need for many of these adjustments during the year-end closing process and reduce the risk that material errors or irregularities in general ledger accounts could go undetected until after the end of the fiscal year.

Management Comments

Management concurs. FY 1999 was FCC's first year of preparing financial statements in accordance with the CFO Act. FCC did not prepare interim statements; however, management is prepared to generate interim statements as of June 30, 2000, for FY 2000 and quarterly thereafter.

Supervisory Review For All Stages Of Financial Reporting Needs Strengthening

During the year, FCC supervisors have not consistently reviewed journal vouchers prior to posting to FCC's core accounting system, the Federal Financial System (FFS). At year-end, we reviewed 26 post-closing journal vouchers. Thirteen of the 26 journal vouchers did not show evidence of supervisory review. Each journal voucher could contain one to twelve journal entries. Of the 26 journal vouchers, 14 contained correcting entries for errors in current and prior years. The number of errors in adjusting entries that were identified and corrected by FCC evidenced the need for more review and improvements in the level and depth of its review.

Additionally, these post-closing journal entries had not been posted to the general ledger when the financial statements were prepared. The journal entries were posted to a working spreadsheet to arrive at the financial statement balances.

Furthermore, we noted that selected account analyses performed during the year and for the preparation of the financial statements did not have adequate supervisory or management review and approval. Many of these areas are documented and discussed throughout the remainder of this report.

Management Comments

Following a reorganization in mid-FY 1999, formal procedures were established requiring signatures from the Fund Manager and Chief, Research, Reconciliation, and Reporting Group prior to entry of journal vouchers into FFS. The 26 journal vouchers mentioned relate to post closing transactions which were grouped and planned for entry in FFS once all adjustments were identified. The auditors were aware of our intentions to hold these entries until all the entries associated with the new process were complete. These documents would not be signed until management released them for processing. The procedure for reviewing these types of documents is still in place.

FCC Has Not Reviewed Its Cost Allocation Methodology And Formulas

FCC's cost accounting system has not been a fundamental part of the financial management system. Although cost reports are generated and distributed to various FCC Bureaus and Offices, the reliability of these reports is questionable due to the lack of review of the cost allocation methodology and formulas. Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards*, states that cost accounting information must rely on a consistent and uniform terminology for concepts, practices and techniques to be useful. Reliable information on the costs of the federal programs and activities is crucial for effective management of government operations. In managing federal government programs, cost information is essential in (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees and prices, (4) program evaluations, and (5) making economic choice decisions.

Management Comments

Management concurs. Plans are being made to review the methodology of the cost allocation system for areas of improvement to possibly include implementation of a completely new system.

Inadequate Staff With The Substantive Knowledge Necessary To Address The Financial Accounting Issues Common To The Current Financial Environment

Employees require a higher level of financial management knowledge, skill and abilities to perform effectively in today's rapidly changing government environment. In April 1999, FCC reorganized its Financial Operations to strengthen internal controls, to instill structured organization and to match responsibilities with capabilities, among other reasons. Personnel duties and responsibilities were outlined in the reorganization documentation. However, reorganized functions and responsibilities were implemented or fully implemented at various stages. A lack of implementation coordination created some confusion among FCC personnel. This confusion of duties and responsibilities among the staff led to no auction related journal entries being recorded during the period of May 1999 through July 1999. For a few months there was not a complete understanding of the accounting entries that needed to be prepared and followed and there was no supervisory review. This too was a result of the confusion between the areas of responsibility.

On several occasions, FCC staff could not explain and did not seem to understand routine accounting entries for coded transaction types entered into FFS. FCC management told us that some of the accounting entries associated with the transaction types were incorrect and a review was being undertaken to ensure that the transaction types represent correct accounting entries.

FCC relied heavily on too few employees to prepare the financial statements. The FCC financial statement preparation process was manually intensive and provided for limited resources being available for financial analysis and related research of account relationships. The employees have many duties including activities related to auctions and credit reform accounting as well as researching and correcting data from prior years. This over-reliance on these few employees limited FCC's ability to prepare all principal statements.

Management Comments

Management concurs. Hiring experienced staff, current formal in-house training, participation in intergovernmental workgroups, and regular interoffice meetings are all contributing to a thorough and coordinated effort to increase the knowledge and skills of all FCC staff in the financial area.

Combination Of Reportable Conditions May Materially Impact Financial Statements

Reportable conditions noted in this report are internal control weaknesses relating to reconciliation procedures which could collectively have a material impact on FCC's ability to produce reliable financial statements in an efficient and timely manner and to comply with the intent of the CFO Act.

Based on the circumstances described above, we do not believe that FCC's accounting systems, policies, procedures and practices, and resources are sufficient to identify and resolve reporting and accounting issues that should be addressed during and at the end of the year for preparation of financial statements to meet the requirements of the CFO Act.

Management Comment

While acknowledging these conditions may exist, management does not feel they impact the financial statement as evidenced by the audit opinion.

Recommendations:

FCC has accomplished a significant feat by preparing its first ever-financial statement. The "CFO Act learning process," including the implementation of OMB Bulletin 97-01, as amended, the scarcity of personnel resources, and other pressing issues such as planning for Y2K readiness have affected FCC's ability to effectively carry out the intention of the CFO Act. However, we believe that strong CFO oversight is needed to ensure that financial statements are prepared accurately and timely. We recommend the following:

- a) Develop and implement written policies and procedures on the financial reporting process. The written policies and procedures should provide sufficient guidance for the year-end closing of the general ledger as well as interim and annual financial statement preparation and analysis. The procedures should also address the following issues:
 - Preparing and reviewing a complete set of financial statements to be presented in accordance with generally accepted accounting principles;
 - Establishing milestones by setting dates for critical phases such as general ledger closing, preparation of statements, notes, and accountability report, quality control reviews, etc.;
 - Collecting common closing and adjusting entries in a formal listing, which is used when the general ledger is closed and financial statements are prepared;

- Identifying the individuals who will be involved in the financial reporting process and establishing clearly defined roles and responsibilities for the staff involved in the preparation of interim and year-end financial statements;
- Preparing and retaining all journal entries in sufficient detail with supporting documentation, and posting all entries in the general ledger;
- Retaining all documentation supporting the request, purpose and approval of all object class designations. Also, a listing of all current object codes including a statement of the purpose of each code should be maintained and provided to all personnel with the responsibility to initiate, prepare and approve accounting transactions to ensure that object codes are used appropriately;
- Requiring supervisory review for all entries posted to the general ledger and consolidating financial statements. A supervisor should review revisions to previously approved entries. All reviews should be evidenced in writing;
- Preparing and analyzing formal monthly reconciliations of subsidiary and summary account balances and preparing financial statements on a quarterly basis. FCC should also consider a “formal closing” of all accounts at an interim date, which will reduce the level of accounting activity and analysis required at year-end. This “formal closing” entails ensuring that all transactions are recorded in the proper period through the month end. With complete and timely transaction recording, analysis of all major accounts can be performed effectively; and
- Preparing and retaining a comprehensive set of files, working papers and other documentation in support of all information included in the financial statements.

Management Comments

Management concurs. Management is preparing a detailed plan to incorporate updates to existing policies and procedures and the inclusion of new policies and procedures on the financial statement and reporting process. The plan will address specific deficiencies identified in this report.

- b) Reemphasize duties and responsibilities within the Financial Operations area to address CFO Act accounting and reporting requirements. Re-evaluate internal resource distribution to accomplish this objective. Provide training to staff especially in regard to financial reporting policies and procedures related to meeting the requirements of the CFO Act.

Management Comments

Management concurs. Roles and responsibilities for all operations within Financial Operations will be identified and formalized.

- c) Review the propriety of the cost allocation methodology and currency of allocation data. Document the cost allocation process methodology. The documentation will be useful in FCC's review of the Statement of Net Cost allocation of appropriate costs and revenues to relevant programs in the future.

Management Comments

Management concurs. A draft requirements document is being prepared for the implementation of a new cost accounting system which would address the current inefficiencies of the existing system. Upgrading the system is a multi-year task; certain steps will be initiated to improve the usefulness of the existing system until a more comprehensive replacement can be implemented.

II. Universal Service Fund (USF) Financial Reporting

FCC management concluded in August 1999 that USF is a reporting entity to be consolidated with FCC. This conclusion was based on criterion from the Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, that USF appears in FCC's Federal budget section entitled *Federal Programs by Agency and Account*. This late decision created some difficulty for FCC. USF is administered by Universal Service Administrative Company (USAC), a not for profit corporation. USAC also maintains the USF accounting records and sends reports -- SF-224 monthly and Adjusted Trial Balance (FACTS data) annually -- directly to the Department of the Treasury. Although USAC has provided monthly USF financial reports to FCC, the Financial Operations area has not reviewed these reports for their adequacy and propriety.

The Consolidating Balance Sheet at September 30, 1999 includes a consolidated USAC Balance Sheet (USAC and USF), instead of reporting USF financial data only. Although USAC balances were not material to FCC's financial statement, FCC should exclude non-FCC balances in its financial statement. Moreover, FCC's Office of Managing Director (OMD) included USAC's financial data in its financial statement without reviewing the reasonableness, accuracy, and propriety of these amounts and without assurance that USF activities are in compliance with laws and regulations.

We believe FCC management is responsible for obtaining reasonable assurance on the reliability of the USF financial reporting and its compliance with laws and regulations.

Recommendations:

FCC management became aware of the issue of oversight of USF financial reporting by the end of the fiscal year and has started a plan to address this issue.

- a) We recommend that management obtain an explicit understanding of what the FCC reporting entity encompasses by clearly defining the legal, financial and operational boundaries of the FCC, USF and USAC. With the assistance of FCC's Office of General Counsel, FCC, and USAC (on behalf of USF), FCC management needs to formally define in writing each financial management role and responsibilities to avoid confusion and misunderstanding.

Management Comments

Management concurs. The relationship between FCC, USF, and USAC is clearly defined in the extensive regulations and Commission orders governing the operations of USAC and the USF. However, FCC and USAC will research instances where USAC's roles and responsibilities may be unclear and will seek guidance and clarification, if necessary.

- b) Ensure that USF financial activities are in compliance with laws and regulations by defining in writing, as part of the written document to be developed in (a) above, and reviewing these activities periodically.

Management Comments

Management concurs. Management believes USAC's financial management activities are in full compliance with all applicable laws. There has been no findings or suggestions to the contrary. The FCC and USAC will further research compliance and make modifications, if necessary.

- c) Assign one or more staff from the Financial Operations area that will acquire or have an in-depth understanding of USF operations and who will work in coordination with Common Carrier Bureau (CCB) to comprehensively review financial information provided by USAC.

Management Comments

Management concurs. Management noted oversight is currently conducted by the Accounting Safeguards Division and the Accounting Policy Division of CCB. There already exists a working relationship between CCB and USAC, which includes but is not limited to, Bureau oversight of the annual financial audits. FCC and USAC will study the relationship and take whatever steps are necessary to ensure Financial Operations has sufficient knowledge of USF.

- d) Review monthly financial reports provided by USAC. Request additional information from USAC as necessary to obtain reasonable assurance that the financial data is reliable.

Management Comments

Management concurs. The auditor's report correctly recognizes that USAC currently provides a significant amount of financial data to FCC on a monthly basis, and, USAC frequently provides additional information to FCC staff in response to specific requests.

- e) Segregate USAC financial information from USF for financial statement reporting purposes. USAC is not a FCC reporting entity.

Management Comments

Management concurs. The financial data for USAC will not be included in the financial statements for FY 2000 and thereafter.

III. Loans Receivable and Allowance for Subsidy

The Omnibus Budget Reconciliation Act of 1993 (Act) required FCC to auction portions of the electromagnetic spectrum (Nation's airwaves) to the public. This Act also required FCC to ensure that small businesses, women, minorities, and rural telephone companies have an opportunity to participate in the competitive bidding process. As a result, FCC provided installment financing in six auctions.

The Federal Credit Reform Act (FCRA) requires that the cost of direct loans be estimated at present value for the budget. "Cost" or the allowance for subsidy is defined as the estimated long-term cost to the Government of direct loans calculated on a net present value basis, excluding administrative costs and incidental effects of receipts and outlays. OMB Circular A-11, *Preparation and Submission of Budget Estimates (Part 1)*, establishes criteria for when agencies should calculate credit subsidy reestimates for the budget. Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*, states that "the subsidy cost allowance for direct loans are reestimated each year as of the date of the financial statements."

FCC's first auction was conducted in 1994, and starting in 1996, installment payment mechanisms were used to finance the sale of spectrum to successful and qualifying bidders. The FCC, however, did not report these loans under the FCRA until fiscal year 1997 when OMB, Congressional Budget Office, and the Department of the Treasury concluded that these installment-financing arrangements should be reported under FCRA.

After FCC completed the fiscal year 1998 subsidy reestimate, it began a comprehensive review of its loan portfolio data. As part of this process, the FCC identified additional loans that had not previously been reported under FCRA. In fiscal year 1999, FCC agreed with OMB to report all installment financing arrangements, except for the Pioneer Block, under FCRA. The FCC's inexperience in loan servicing and FCRA requirements have resulted in material weaknesses in the loan servicing and reporting controls as follows:

FCC Does Not Have An Effective Direct Loan System To Account For All Events In A Loan Cycle

FCC relies on various systems and spreadsheet applications to account and report direct loan transactions. As a result, there is a higher risk of human error resulting in inconsistent and/or unidentical data in various systems and programs. *Direct Loan System Requirements* issued by Joint Financial Management Improvement Program (JFMIP) states that a direct loan system must interact with the core financial system to perform fund control checks, initiate or record payments, record the results of other direct loan-related financial transactions, and acknowledge receipt of financial information exchange. It must be able to perform automatic system balancing to ensure that direct loan partners are able to agree on transaction number and dollar values passed, processed and rejected. This automated balancing includes cumulative subsidiary account balancing to the general ledger. It should be able to support managerial accounting. These internal management information requirements are those required to establish credit management and financial reporting systems that are in compliance with the standards provided in OMB Circulars A-34, *Instructions on Budget Execution*; A-123, *Management Accountability and Control*; A-127, *Financial Management Systems*; and A-129, *Managing Federal Credit Programs*. See also Auditor's Report on Compliance with Laws and Regulations.

Management Comments

FCC had outsourced the loan program to the Department of the Treasury, Financial Management Service (FMS), Birmingham, Alabama. In FY 1999, FMS and FCC decided to discontinue this arrangement and FCC brought all aspects of the loan servicing program in-house. The system used by the Department of the Treasury, Nortridge Loan Servicing System, was transferred and implemented. Management concurs the existing system, Nortridge, does not meet management information and financial reporting requirements and is not in compliance with standards. In recognition of its limitations, management is finalizing a procurement action for a loan servicing provider. Expected selection and conversion of all loan servicing aspects will be accomplished during FY 2000.

Current FCC Subsidiary Ledger System Is Inadequate And FCC Did Not Review The Results Of Contractor Subsidiary Spreadsheets

In fiscal year 1999, FCC discontinued using the Nortridge Loan Servicing System (NLS) as its subsidiary ledger system. FCC management made this decision in acknowledgement of problems such as incorrect application of loan payments and incorrect calculation of initial interest. FCC's lack of periodic reconciliation of the subsidiary records maintained in the NLS with FFS, the general ledger, aggravated these problems. In addition, there was no assurance that data entered into NLS was proper and accurate until data input controls were implemented in February 1999. The NLS, however, is still being used for other processes such as billings, collections, installment payment amounts and dates received.

FCC hired a public accounting firm (accountants) to create a loan database and ensure that FCC loans exist, are valid, and are auditable. The accountants created elaborate and complex spreadsheets with configuration settings and information for original and adjusted loan principal, daily earned interest, suspension interest, payment data, and application of payments, among others. These spreadsheets (1) document the loan terms as determined by FCC's rules and official loan documents; (2) recalculate loan balances for financial statement reporting purposes; and, (3) document the results of a process to confirm the existence of the loans. Our review of the spreadsheets disclosed that the configuration settings are easily changed manually. Alteration of relevant configuration settings used in loan balance calculation could produce significantly different results. Once one user alters a setting, it would be difficult for another user to know what changes were made unless the user is notified. Also, initial copies of the spreadsheets we tested showed that the loan principal and calculated interest on the loan spreadsheets ledger were different from the amount shown on the loan subsidiary list. This discrepancy was due to errors in the spreadsheets' formula. Issues were further complicated by the fact that the spreadsheets process lacked documented and approved policies and procedures for its use and review of key input and output data.

FCC could have discovered these discrepancies through a thorough review of the spreadsheets and formulaic processes prior to relying on their output. The risk of error is lower when a review is performed prior to implementation and periodically after implementation. FCC management has to ensure that the spreadsheet formulas are protected to prevent inadvertent or unintentional modifications, that users of the spreadsheets are trained, and that enter/modify access to the spreadsheets process is limited to authorized staff. In addition, it is FCC management's responsibility to physically maintain an official and back-up soft copy of the spreadsheets with updated information at least monthly until a new system is implemented.

Management Comments

FCC hired a public accounting firm to ensure that installment loan balances were valid, accurate, and auditable. In consultation with management, the contractors created spreadsheets for each loan within seven loan blocks. Prior to calculation of the loan balances, the CPA firm obtained management approval on the configuration settings for each of the loan blocks in the spreadsheets.

FCC Loan Files Were Found To Be Incomplete And Documents In Files Were Inconsistent

FCC management informed us that loan documents were not kept in files and were not organized prior to June 1, 1999. In preparation for the move of loan documents to FCC headquarters in June 1999, FCC engaged the accountants to assist FCC in creating loan files. When we were informed that we could test loan files in June 1999, we conducted our test and found that files were inconsistent and incomplete.

Management Comments

Management recognized the inadequacies of its loan files prior to reclaiming them from the Department of the Treasury. FCC contracted with a CPA firm to research, validate, and ensure the existence of valid loan documents and supporting files. The project was initiated and completed during FY 1999. While some files still lack sufficient documentation, the files in aggregate adequately document the outstanding balances.

FCC Encountered Difficulties In Providing Sufficient Documentation And Rationale To Support A Change In Key Cash Flow Assumptions That Resulted In A Material Downward Subsidy Reestimate

FCC reestimated the subsidy costs of the credit program in September 1999 and December 1999 using June 1999 and September 1999 data, respectively. The reestimate for the 1997 C Block loans, which is approximately 90 percent of FCC's credit reform program, resulted in a significant change. This was due to a change in the recovery rate from 40 percent to 75 percent of the loan volume that resulted in reduced default rate from 71 percent to 54 percent which required a downward reestimate of \$1.7 billion. FCC provided historical performance data input to the OMB subsidy model to calculate the June 1999 credit program subsidy cost. However, it was extremely difficult to obtain the rationale and documentation to support the significant change in key assumptions for the September 30, 1999 reestimate. Initially, no one within FCC management could provide a clear rationale and support for the change in the December 18, 1999 C Block reestimate. We were referred to credit analysts at OMB and a number of discussions occurred. After a period of time we were able to obtain rationale and support at a meeting with OMB and FCC representatives. Accounting and Auditing Policy

Committee (AAPC), *Federal Financial Accounting and Auditing, Technical Release 3, Preparing and Auditing Direct Loan and Loan Guarantee Subsidiary under the FCRA* dated July 31, 1999, states in Appendix I to its guidance on Acceptable Sources of Documentation for Subsidy Estimates and Reestimates that “Documentation must be provided to support the assumptions used by the agency in the subsidy calculations.”

Management Comments

The reestimate performed in December 1999 represented actual performance through September 30, 1999 along with the original assumptions about recovery possibilities. OMB recommended FCC modify these assumptions for the reestimate for the 1997 C Block loans, which are approximately 90 percent of FCC’s credit program. This modification of assumptions resulted in a significant change to the reestimate. Initially, no one within FCC management could provide clear written rationale and support for the change. After consultation with OMB and FCC management, adequate explanations were provided and accepted. For FY 2000, FCC is documenting all agreements with OMB regarding estimates and reestimates.

Recommendations:

Even though FCC management has implemented controls since it took over the loan servicing operations, more controls are needed. Also, while expert accountants were hired to assist in the credit reform program, the accuracy, reliability and reasonableness of source data or key assumptions are still FCC management’s responsibility.

We recommend the following:

- a) Ensure that the integrated credit reform accounting system currently being developed is capable of interfacing with other financial management systems.
- b) Ensure that the direct loan system can support the following functions:
 - loan extension,
 - account servicing,
 - Treasury cross-servicing,
 - portfolio management,
 - delinquent debt collection, and
 - other reporting requirements.
- c) Ensure that access to subsidiary spreadsheets is limited to authorized staff. These employees should be trained to have adequate knowledge for use and review of the spreadsheets. If an independent public accounting firm is responsible for updating

- d) the spreadsheets, FCC employees should review, at least monthly, the configuration settings and formulas of the spreadsheets to ensure they were not changed. In addition, FCC employees should review the outputs of the spreadsheets. Written policies and procedures should be developed for the use and review of the spreadsheets and related output.
- e) Hardcode or lock cells with formulas in the spreadsheets to prevent inadvertent or unintentional changes.
- f) Perform monthly reconciliation of the loans general ledger and subsidiary ledger balances.
- g) Physically obtain and keep an official copy of the spreadsheets updated at least monthly since the spreadsheets are the FCC's subsidiary ledger system and are being maintained by independent public accounting firm outside of FCC financial management systems. A back-up copy should also be maintained.
- h) Ensure that support for subsidy estimates and reestimates are adequately documented, reviewed and approved on a timely basis. Ensure that applicable documentation listed below is available to support subsidy estimates and reestimates:
- Cash reports on historical performance;
 - Historical data and trends, citing sources of information and relevant time frame;
 - Sensitivity analysis or other analysis that identifies the most critical factors;
 - Reports from the accounting or management systems showing trends;
 - Actuarial studies;
 - Experience of other agencies with similar programs; and
 - Economic and/or industry data and subsequent analyses, including industry studies, journal articles, trade papers, and third party studies.
- i) Compare actual cash flows with projected cash flows and actual costs of direct loans with their estimated costs. The efforts to make accurate projections should begin with establishing and using reliable records of historical credit performance data, and should take into consideration current and forecasted economic conditions.
- j) Ensure that all loan files are kept up-to-date, have consistent information, and contain relevant loan documents.
- k) Reconcile with all trading partners, i.e., Department of the Treasury Financial Management Service and Bureau of Public Debt, on a timely and periodic basis. Obtain and maintain evidence from trading partners to support all transactions.

- l) Establish effective controls for transfer of loan data files to the new loan system, and ultimately to the loan servicer, if employed.

IV. Information Technology

Our review and testing of controls related to Information Technology identified the following conditions:

FCC Is Not In Compliance With OMB Circular A-130 Requirement For A Comprehensive Security Plan

Some of the key components of an entity-wide security program are the performance of risk assessments and the development of a comprehensive security plan. Each organization needs a set of management procedures for identifying and assessing risks, and deciding what policies and controls are needed to achieve effective security controls.

OMB Circular A-130, *Management of Federal Information Resources*, Appendix III, "Security of Federal Automated Information Resources," as revised in February 1996, established a minimum set of controls for federal agencies, including risk assessments, assigning responsibility for security, security planning, periodic review of security controls, and management authorization of systems to process information.

Deficiencies in security controls that, in our view, significantly impact FCC's ability to protect its sensitive or critical resources include the following:

- FCC does not have a comprehensive and integrated security management structure. For example, FCC's Computer Security Officer was not aware of the other personnel performing security functions within FCC. In such an environment, responsibilities could be unclear leading to the possibility of applying security controls inconsistently throughout the agency. As a result, certain vulnerabilities may be overlooked. In addition, monitoring the effectiveness of procedures for security controls throughout the agency will be ineffective.
- FCC has not performed risk assessments for its major application systems and its mission-critical general support systems.
- FCC does not have security plans for any of its major application systems and mission-critical general support systems.
- There is no periodic review of security controls over FCC's systems. In addition, FCC has not performed any formal certification and accreditation of its major application systems and mission-critical general support systems.

Recommendations:

- a) Establish a comprehensive and integrated security management structure to ensure that FCC's security policy is consistently applied.

Management Comments

Management concurs. FCC's Information Technology Center (ITC) has developed a comprehensive and integrated security management structure, which is being enhanced to ensure more consistent application of policies throughout FCC. Further, management will continue to work with all Bureau/Office application custodians to ensure compliance with security directives and procedures.

- b) Conduct risk assessments for the FCC networks and its major applications.

Management Comments

Management concurs. The most recent FCC network risk assessment was completed in April 1995. Several major application reviews were also completed prior to the initiation of the audit. ITC has prepared a schedule for future application reviews and is in the process of completing a new network risk analysis. Estimated completion date of the network risk analysis is June 2000. Major application reviews will be done in FY 2001.

- c) Develop and implement a FCC-wide security plan as prescribed by OMB Circular A-130.
- d) Develop and implement security plans for FCC's major application systems and mission-critical general support systems.

Management Comments

Management concurs to both recommendations c) and d). Major application security plans are being developed and implemented in conjunction with associated security reviews and application certification and accreditation. Estimated completion date of these reviews is FY 2001.

- e) Certify and accredit FCC's major applications and mission-critical general support systems, based on the security plans developed and implemented.

Management Comments

Management concurs. ITC has completed several major application system certifications and accreditations as of this audit. The remaining application reviews have been scheduled with completion dates in FY 2001.

- f) Establish a system to periodically review security controls over FCC's computer systems in accordance with OMB Circular A-130 Appendix III.

Management Comments

Management concurs. ITC plans to establish a more formal process to periodically review controls of computer systems in accordance with OMB Circular A-130, Appendix III. Estimated completion date is FY 2001.

FCC Needs Improved Controls To Protect Its Information

For a computerized organization like FCC, achieving an adequate level of information protection is highly dependent upon maintaining consistently effective access controls and system software controls. Access controls should limit and monitor access to computer resources (i.e., data files, application programs, and computer-related facilities and equipment) to the extent necessary to provide reasonable assurance that these resources are protected against waste, loss, unauthorized modification, disclosure, or misappropriation. Such controls include logical/technical controls, for example, security software programs designed to prevent or detect unauthorized access to sensitive data. Similarly, system software controls should limit and monitor access to powerful programs and sensitive files that (1) control computer processing and (2) secure the application and data supported by the system.

Our limited internal control testing identified information protection-related weaknesses in FCC's information systems environment. Impacted areas included FCC's distributed computer system as well as the mainframe computers used in processing FCC sensitive data by its service providers. These vulnerabilities expose FCC and its computer systems to risks of external and internal intrusion, subject sensitive FCC information related to its major applications to potential unauthorized access, modification, and/or disclosure, and increase the risks of fraud, waste and abuse.

FCC is not in compliance with FCC Directive 1479.1, *FCC Computer Security Program*. Commission-wide computer security objectives and goals have not been established. Sensitive FCC computer systems have not been certified by the Security Officer prior to implementation in a production processing environment. Appropriate administrative and technical procedures to conform to this directive and other related Federal regulations, have not been developed. The FCC computer system topology which clearly illustrates the entire network, including server locations, communication links, firewalls, etc, has not been maintained. Periodic risk analysis of FCC sensitive systems has not been performed. Security plans and contingency plans have not been developed for FCC's sensitive systems. Security reviews (i.e. OMB Circular A-130 Appendix III reviews) have not been conducted for FCC's computer systems and applications. FCC has not

established administrative and technical procedures to ensure that external computer resource services comply with FCC Directive 1479.1, as required by the directive.

Recommendations:

- a) Strengthen controls over access to protect all mainframe and client server based resources.

Management Comments

Management concurs. ITC is continually working to enhance and strengthen access controls to protect FCC's computer based resources. The most recent efforts include conducting a risk analysis of the FCC network and utilizing several off-the-shelf security software packages to help ensure effective controls are in place. This is an on-going effort.

- b) Address inadequacies and inconsistencies in the mainframe and network access request process.

Management Comments

Management concurs. OMD has structured a network access request process, which is both consistent and viable. The process, stipulated in FCC Instruction 1479.1, *FCC Computer Security Program*, allows ease of use by employees and contractors and also allows for granting network access in a consistent fashion. We will continue to monitor on an on-going basis the process to ensure consistent application.

- c) Require periodic review of user privileges to ensure that capabilities are in line with job responsibilities.

Management Comments

Management concurs. ITC will reiterate the Commission's policy on notifying ITC when a person's position description or job function is modified. In addition, ITC will periodically coordinate with Bureaus/Offices to ensure that system access is consistent with current job functions.

- d) Enhance audit trail facility utilization and review.

Management Comments

Management concurs. ITC is currently evaluating audit log analysis software capabilities, which will enable a compressed and more manageable review process. Estimated completion is expected during the third quarter of FY 2001.

FCC Needs To Accelerate Efforts To Develop And Test Its Contingency Plans

Losing the capability to process, and protect information maintained on FCC's computer systems can significantly impact FCC's ability to accomplish its mission to serve the American public. The purpose of service continuity controls is to ensure that, when unexpected events occur, critical operations continue without interruption or are promptly resumed. To achieve this objective FCC should have (1) procedures in place to protect information resources and minimize the risk of unplanned interruptions and (2) a plan to recover critical operations should interruptions occur. These plans should consider activities performed at FCC's general support facilities, as well as the activities performed by users of specific applications. To determine whether the disaster recovery plans will work as intended, FCC should establish and periodically test the capability to perform its functions in disaster simulation exercises.

Our review of FCC's service continuity controls identified deficiencies that could affect FCC's ability to respond to a disruption in business operations as a result of a disaster or other long-term emergency. The deficiencies were as follows:

- FCC has not formally identified and prioritized all critical data and operations on its major applications and the resources needed to recover them if there is a major interruption or disaster.
- FCC has not formally identified and prioritized all critical data and operations on its networks and the resources needed to recover them if there is a major interruption or disaster. In addition, we could not determine whether FCC had established emergency processing priorities that will help manage disaster situations more effectively for the network.
- FCC has not integrated the contingency plans of its data centers, networks and telecommunication facilities in a comprehensive disaster recovery plan.

Recommendations:

- a) Develop and test contingency plans for its major applications, networks and telecommunications facilities.
- b) Obtain written documentation from its data centers of developed and tested contingency plans, and participate in the scheduled tests of the plans.
- c) FCC management should immediately develop a comprehensive contingency plan that integrates the individual plans of its data centers, networks and telecommunications facilities.

Management Comments

Management concurs to all recommendations. It is an ITC planned objective to develop and test an FCC-wide contingency plan at the conclusion of the network risk analysis. The analysis is currently underway and will be completed during FY 2001.

V. Controls Over Property, Plant And Equipment (PPE)

FCC did not maintain adequate controls over acquiring, accounting, maintaining and disposing PPE. As a result, FCC had to conduct a physical inventory at all locations and revalue PPE to establish its September 30, 1999 balances. Detailed weaknesses are discussed below:

- Reconciliation of general ledger control to subsidiary records was not being performed. The Administrative Office, an office within OMD, maintains FCC PPE subsidiary records. FCC acquired a new property management system and was in the process of converting data from the old to the new system in fiscal year 1999. Controls over conversion to the new system were not adequate. We were informed that some old records were left in the old system and new records were being entered into the new system. However, we could not obtain a clear answer from FCC as to the status of the conversion. Nevertheless, the Administrative Office has started anew by entering the results of the physical inventory into the new system at September 30, 1999.
- Although FCC took a physical inventory, there was no assurance of completeness for PPE. The "final" physical inventory results provided to us were changed on at least three occasions. Items that were observed by the Office of Inspector General (OIG) during the physical inventory were not on the inventory list. In addition, we could not verify whether transferred properties from the Federal Emergency Management Agency (FEMA) are properly accounted for and are complete due to lack of documentation.
- FCC could not provide adequate documentation to support the cost valuation included in the financial statement of certain PPE items. Ten out of 14 items reviewed did not have adequate documentation.
- Our tests also disclosed FCC incorrectly depreciated some of its PPE. For example, furniture acquired in 1998 was being depreciated since 1996 overstating accumulated depreciation by about \$5.5 million. These items of furniture were acquired for the Washington, D. C. office building, occupied in December 1998. In addition, 5 of the 14 items were being depreciated based on purchase dates which were much later than the invoice date. We noted purchase dates were changed several times.

- There was no assurance that all accountable PPE are tracked. Bureaus and offices make small purchases up to \$25,000 directly with vendors. Since delivery could be made directly to the bureaus and offices, such purchases are not tracked in the property management system unless the Contracts and Purchasing Center is notified and provided with supporting documentation.
- FCC was not properly accounting for the following until the need was highlighted during the September 30, 1999 financial statement reporting process:
 - Capitalization of software acquisition
 - Patents
 - Seized and forfeited assets.
- Although FCC has drafted a revised Property Management Policies and Procedures manual, written PPE policies and procedures in effect for fiscal year 1999 were incomplete and outdated. For example, the policies and procedures document does not discuss capitalization of software, accounting for seized property, and FCC depreciation policy. Also, FCC changed its capitalization policy from \$50,000 to \$25,000 at year-end.
- FCC does not have documented policies and procedures for the evaluation, calculation and presentation of deferred maintenance for financial reporting purposes.

Recommendations:

FCC has started implementing corrective actions for some of the weaknesses noted above. However, we would like to emphasize the following:

- a) Reconcile the general ledger control to subsidiary records at least monthly for now and at least quarterly once both offices are comfortable with the process and the data.

Management Comments

Management concurs. In coordination with Financial Operations, reconciliations between both offices will be performed quarterly.

- b) Improve coordination and communication between Financial Operations and Administrative Operations.

Management Comments

Management concurs. Administrative Operations has initiated the design and implementation of formal and regular communication with Financial Operations concerning matters related to record keeping and controls over property, plant, and equipment.

- c) Review certain expense accounts (repairs and maintenance, EDP, and other related accounts) periodically to ensure that FCC meets FASAB standards for capitalization.

Management Comments

Management concurs. In coordination with Financial Operations, both offices will ensure FCC meets FASAB standards.

- d) Ensure that information entered into the current property management system is proper and supported by adequate documentation. Acquisition dates and life of assets should be reviewed to ensure that depreciation is properly calculated.

Management Comments

Management concurs. The "Property Management Policies & Procedures" (PMP&P) (final, pre-distribution copy, dated March 3, 2000) reflects a process of information capture that includes all acquisition, receipt, storage and delivery activities by means of an integrated automated inventory system (AIS). AIS produces reports reflecting acquisition dates and costs, enabling the calculation of depreciation. The AIS record and resulting reports, combined with the hard-copy Property File, can provide a complete history of any piece of specific property.

- e) Maintain all copies of supporting documentation in an organized manner and in a centralized location, including documentation from field offices. Supporting documentation should be easily retrievable for management and others' review.

Management Comments

Management concurs. The PMP&P requires the creation and maintenance of a Property File, currently being implemented among the responsible entities. Warehouse personnel have already begun incorporating these activities preliminary to the imminent promulgation of the PMP&P.

- f) Assign a property custodian to each office or bureau, including field offices. Require the property custodian to certify that he/she has read and understood the duties and responsibilities of the position as documented in the property management policies and procedures. Provide training to property custodians and ensure that the Contracts and Purchasing Center maintain a current list of property custodians at all times. This will reduce the risk that property may not be recorded and tracked in the property management system.

Management Comments

Management believes Bureau/Office specific Property Custodians were necessary when FCC was spread out among different buildings when located in NW

Washington, but are not required in the Portals HQ. Many of the responsibilities and duties of Bureau/Office specific Property Custodians have been shifted to Administrative Operations personnel as described in the PMP&P manual. In any event, the Contracts & Purchasing Center would not be involved in any aspect of asset management unrelated to the acquisition process. Training in property management responsibilities and procedures for the appropriate agency staff will commence shortly after release of the PMP&P.

- g) Perform a complete annual physical inventory until FCC is assured that its property management system has accurate and up-to-date information. Perform the annual physical inventory on a cycle or selective basis only after this assurance is obtained.

Management Comments

Management concurs. The requirement for an annual 100% physical property inventory was included in the PMP&P. Implementation is subject to the availability of funds.

- h) Ensure that the draft Property Management Policies and Procedures manual is complete, facilitates compliance with generally accepted accounting principles, and is issued promptly to provide guidance to FCC staff. Control all updates or changes to the manual by a sequential tracking numbering system and update the entire manual on an annual basis, if necessary.

Management Comments

Management concurs. Administrative Operations is prepared to release the PMP&P, organized as suggested.

- i) Implement policies and procedures to provide for review and evaluation of deferred maintenance to permit proper presentation for financial reporting purposes.

Management Comments

Management concurs. The new PMP&P reflects provisions to capture the appropriate deferred maintenance information in the property management process.

VI. Unfunded Liability

At September 30, 1999, FCC recorded an unfunded liability not covered by budgetary resources of \$74 million. Management was unable to provide documentation to support the terms or validity of this payable. There have been no subsequent payments or any other evidence that a liability exists.

Management Comments

Management concurs. FCC did record an amount for an unfunded liability. Later, FCC determined it was not fully supported, but due to the late timing of this decision, it was not possible to reverse it within this year's financial statement. This issue will be further researched and corrected during FY 2000.

Recommendation:

We recommend that FCC obtain sufficient evidence to support the amount recorded as a liability or reverse this liability. In addition, FCC management should review the validity and accuracy of supporting documentation prior to agreeing to and recording any such liability.

REPORTABLE CONDITIONS

VII. Lack Of Written Internal Control Documentation For Financial Operations

FCC does not have complete or current written internal control policies and procedures for its financial operations outside of procedures for budgetary reporting nor does it have an organized and centralized area where all financial policies and procedures are physically maintained, updated and controlled. Existing written policies and procedures, if any, are either outdated or can not be found. Documented internal control and financial policies and procedures are a major part of managing an agency. It comprises the plans, methods, and procedures used to meet missions, goals, and objectives and, in doing so, support performance-based management. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. Documentation of control policies and procedures reduces the risk of misunderstanding, confusion, and inconsistent actions taken.

Recommendations:

We recommend that FCC:

- a) Formalize its financial and internal control policies and procedures in writing. Design internal controls to provide reasonable assurance regarding prevention of, or prompt detection of unauthorized acquisition, use, or disposition of an agency's assets. Internal control is a series of actions and activities that occur throughout the operations and on an ongoing basis.

- b) Physically maintain the written control policies and procedures in a central location within the Office of the CFO. All changes or updates to the written policies and procedures should be controlled.
- c) Ensure that FCC employees responsible for internal controls are provided with a copy of the internal control policies and procedures manual and are knowledgeable of its contents.

Management Comments

Management concurs with all three recommendations. Within Administrative Operations, a task group has been established to review existing policies and procedures, make necessary updates, and write new policies and procedures. Included within each policy and procedure will be the controls established to provide reasonable assurance regarding unauthorized use, acquisitions, or disposal of agency assets.

VIII. Accounts Receivable (Regulatory Fees And Application Processing Fees)

Regulatory Fees

The Omnibus Budget Reconciliation Act of 1993 requires FCC to collect regulatory fees to offset certain costs incurred in regulating its industry. The legislation also gives FCC the authority to review the regulatory fees and adjust the fees to reflect changes in its appropriation from year to year. It also authorizes FCC to charge a 25 percent late payment penalty and to dismiss applications or revoke licenses for non-payment of the fees, and waive, reduce, or defer payment of a fee for good cause.

The regulatory fee was implemented in fiscal year 1994. Five years later, in fiscal year 1999, FCC still does not have a system to identify if all required fees are collected. As a result, FCC could not estimate the potential uncollected revenue and does not accrue receivables for the uncollected fees. The U. S. General Accounting Office's (GAO) report dated August 31, 1999 entitled *TELECOMMUNICATIONS: FCC Does Not Know If All Required Fees Are Collected* (RCED-99-216) states that FCC does not know if it is collecting all its required fees. It relies heavily on the telecommunications industry to comply voluntarily with its fee payment schedule because it does not have a system in place to ensure that all appropriate fees are being paid. Specifically the report also states that FCC does not have sufficient information to (1) identify all entities that should pay regulatory fees, and (2) determine whether these entities have paid the full amounts required. In addition, FCC's fee collection database is not linked to its licensing

databases, making it difficult for FCC to perform routine automated checks on whether all licensees have paid their regulatory fees. Also, bureaus' databases do not always have the current status of a licensee.

In addition to the above, FCC's organization structure is so decentralized that each bureau (program operation) has its own licensee database or is developing its own database, and these databases do not interface with each other or with the financial management systems. Since the bureaus maintain the databases and are more familiar with the licensees, communication between the bureaus and the Financial Operations should be increased.

Licensees are required to pay regulatory fees in a one-week window, usually in mid to late September each year. Since FCC could not identify those who are not paying, an account receivable for late fee assessment was made only on those licensees who paid after the due date of September 22, 1999. FCC initially recorded a receivable for late fees of \$8.8 million, which was 25 percent of all deposits received at the third party bank from September 23rd to September 30th. FCC subsequently determined that the basis used in estimating the late fee assessment was overstated. As a result, FCC had to reverse \$7 million of the amounts initially recorded as late fee receivable. FCC management explained that the error in estimating the initial late fees was due to incorrect base data used in the estimation process. The base data were not processed timely for FCC management to determine the propriety of the amounts in estimating the late fees. GAO Standards for Internal Control states that transactions should be promptly processed and recorded to maintain their relevance and value to management controlling operations and making decision.

Application Fees

As authorized under Section 8 of the Communications Act of 1934, as amended, FCC collects application fees from applicants applying for certain licenses. Applicants submit a completed FCC application form with a "Remittance Advice" to a specific bank lock box. The bank stamps the documentation with a received date, assigns a fee control number, deposits the payment with the Department of the Treasury, enters data from the application into the fee collection database, and forwards the application documentation, and copies of proof of payments to Financial Operations. Financial Operations, without opening the application documentation package, forwards the package to the bureaus for processing. While FCC officials told us that bureau staff are to check each application for proof that the fee has been paid prior to taking action on the application, our interviews with bureau officials disclosed that some of them assumed that payment had been verified by Financial Operations. Others explained that their database does not have the financial information and they do not have access to Financial Operations collection

system database to verify the payment. The GAO report states that its review with the bureaus identified many cases in which adequate documentation did not exist to show that application fees were paid. GAO Standards for Internal Control states that all transactions and significant events are to be clearly documented, and the documentation is to be readily available for examination.

In both the regulatory fee and the application-processing fee, there is a higher risk that fees required by legislation are not recorded and collected. Therefore, the conditions for a potential revenue gap exist.

Management Comments

FCC noted deficiencies in the fee collection programs in 1998 and initiated comprehensive steps to fundamentally reengineer the automated systems. FCC initiated steps to resolve issues originally identified in the U.S General Accounting Office's report. One major initiative is the implementation of two new systems, the Revenue Accounting and Management Information System (RAMIS), and the Commission Registration System (CORES) during FY 2000. The CORES system will assign a specific FCC Registration Number (FRN) to a licensee that will be used to track all transactions related to that licensee. The FRN will be populated in RAMIS, and eventually linked to all the licensee databases in each bureau or office within FCC. Once RAMIS is operational, each phase of collections, whether it is the application fees or the yearly regulatory fees, will be processed through RAMIS. This will be extremely beneficial for the yearly regulatory fees because it will allow management to generate a record of each collection to be used as a basis for bill generation in following years.

During FY 2000, additional resources will be used to ensure that all receipts for the FY 2000 regulatory fees are processed and recorded expeditiously. A project to create policy and procedures has been started and will include these areas.

Recommendations:

We believe FCC is aware of all the weaknesses noted above and has started the process of consolidating databases by creating one database and assigning a unique identifier to each customer. FCC believes that its initiatives aimed at improving the fee collection systems and processes will alleviate the difficult task of monitoring rapid changes in the makeup of the telecommunication industry.

We recommend the following:

- a) Ensure that the new systems [Revenue Accounting and Management Information System (RAMIS) and Commission Registration System (COREs)] address and provide solutions to weaknesses noted in our findings.
- b) Implement alternative procedures to ensure that all regulatory fees are collected, late fees are assessed, and receivables are accrued while the new systems are not operational. Obtain cooperation and assistance from the bureaus in determining the licensees in their databases and compare licensee payment information to the licensee on the databases.
- c) Increase communication and coordination between Financial Operations and the bureaus. Ensure that authorized bureau staff have at least read only access to financial information relevant to their operations.
- d) Document and implement procedures for bureaus to review payment of fees prior to processing an application.
- e) Implement procedures to ensure that collections processed by third party bank are processed and analyzed by FCC timely. To facilitate FCC review and analysis, consider modifying the bank's report to include other relevant information such as date collection is received and date collection is deposited with the Department of the Treasury.
- f) Ensure that appropriate and valid data are used in calculating late fee assessments.

IX. Accounts Payable, Undelivered Orders And Net Position

Although we were able to satisfy ourselves analytically with the accounts payable and undelivered orders balance, we noted several issues that need to be addressed. Accounts Payable and Undelivered Orders (UDO) are not being liquidated after all goods and services have been received and final payments have been made. FCC was only able to provide 29 of the 50 sample items we requested. Of the 29 items, only 26 matched our request. We found problems in 17 of the 26 sample items. To illustrate:

- UDO that are old and without activity remain open. Six sample items with purchase orders obligating funds prior to fiscal year 1999 had no disbursements in fiscal year 1999, with the oldest item having no activity since 1995. At least three of the six sample items had expired purchase order dates. While we were told that FCC Fund

- Managers receive monthly reports of their accounts and are asked to review and certify the validity and correctness of the undelivered orders, we question the effectiveness of this control.
- Supporting documentation kept in files is disorganized and incomplete. Nine sample items have missing invoices and payment authorizations, line items entered into FFS were inconsistent with the purchase order line item, payment sheets were not completed and a date was missing on a travel order. We also noted disorganized files that did not allow verification of amounts obligated and payments made.
- For two sample items, informal notes/memos were used to support requests for changes in the obligations, and there was no explanation for the reason for the changes and no evidence of any review or approval of the changes.
- Two sample items did not have completed payment sheets on file and initials of the entering/approving official were not present.
- Although there is a field for the name of “responsible person” in the electronic purchase order, we found no entry in this field in all sample items except one.
- Expenditure amounts that were reported in the accounting records for three sample items were different from the amounts on the supporting documentation. In addition, the obligation reported on the accounting records for one sample item did not agree to the supporting obligation.

We acknowledge that analyzing transactions in accounts payable (Standard General Ledger account 2110) during fiscal year 1999, was complicated by the fact that this account was also used for credit reform transactions.

In addition to weaknesses noted above, FCC does not reconcile its undelivered order subsidiary records with the general ledger control account. Documentation provided to us related to UDO does not agree and FCC could not reconcile the balances. The general ledger balance does not agree to the subsidiary records and to the financial statements. At September 30, 1999, UDO general ledger balance was \$23.2 million, subsidiary record balance was \$19.8 million, and the financial statement balance was \$22.8 million. Although the differences are not material, the risk that errors are not detected is high because of the weaknesses discussed above.

Management Comments

Management agrees there are issues relative to the Accounts Payable, Undelivered Orders and Net Position results identified by the auditors during the audit. During FY 1999,

reconciliations between subsidiary and summary level ledgers were not being conducted, and a formal policy or procedure on liquidating accounts payable and undelivered orders was ineffective. These issues have been addressed during FY 2000 and are corrected. Monthly reports are being distributed to the Bureaus/Offices for their review, verification and reconciliation. Any adjustments needed are annotated on the report, returned to Financial Operations for adjusting entries, and upon completion filed as a formal record. Additionally, an intense review of all open accounts payable or undelivered orders balances is being performed with corrective action to be completed prior to year-end.

Management realizes the importance of the accuracy of these accounts. Neither individually, nor as a whole, did any of these items reflect a material impact on the consolidated balance sheet.

Recommendations:

We recommend that FCC:

- a) Reconcile accounts payable and UDO general ledger control with their subsidiary records monthly.
- b) Ensure that electronic purchase order is complete, including completing the "responsible person" prior to its processing.
- c) Ensure payment sheets are completed and updated timely and perform periodic review and reconciliation of purchase orders and contracts.
- d) Enforce the obligation certification process and work with Fund Managers to ensure year-end review of contracts and purchases occurs. FCC may consider requiring Fund Managers to provide justification for keeping old undelivered orders open.
- e) Ensure that supervisors review supporting documentation for completeness, accuracy, and appropriateness before transactions are entered into FFS.

X. Treasury Fund Suspense Account Activity

The Treasury Financial Manual, Bulletin 97-06, requires agencies to verify their records each month against the transactions recorded by Treasury as shown on Treasury's monthly reports. FCC uses "SUSP Unidentified Suspense" Funds for Clearing/Suspense account for funds received without complete identification. Although these funds amounting to \$6.7 million at September 30, 1999 are not material, they are comprised of

items that have been in suspense since at least fiscal year 1996. Although FCC could identify the age of the suspense items, it does not know the nature of these items. FCC could not provide a schedule of the items in the suspense account.

Recommendation:

We recommend that the suspense balance be researched and appropriate correcting entries be made.

Management Comments

The Accounts Processing Group within Financial Operations has been specifically assigned to identify all the entries in the suspense account and clear them by year-end FY 2000. In coordination with staff within several offices, the items have been identified and will be transferred out of the suspense account by September 30, 2000.

XI. Performance Measurement

The Government Performance and Results Act (GPRA) places new management expectations and requirements on federal agencies by creating a framework for more effective planning, budgeting, program evaluation and fiscal accountability for federal programs. The intent of the GPRA is to improve public confidence in federal agency performance, by holding agencies accountable for achieving program results and to improve congressional decision making by clarifying and stating program performance goals, measures, and costs “up front.” The annual financial statements is one medium for reporting performance measures. OMB Bulletin 97-01, as amended, states that the Overview of Reporting Entity should contain performance goals and results, among other things. FCC’s Overview does not discuss performance goals and results and therefore, does not discuss program and financial results expressed in terms of objective and relevant measures that disclose the extent to which its programs are achieving their intended objectives.

In March 1999, FCC OIG issued a *Final Report on the Audit of FCC’s Implementation of the Government Performance and Results Act (GPRA)*. The report states that although FCC has made significant strides in meeting GPRA requirements, a major weakness of the plan is its lack of outcome-oriented annual performance goals.

FCC has established the framework for compliance with GPRA by assigning compliance oversight to the Program Evaluation and Records Management (PERM), an office within OMD. PERM worked with bureaus and offices in obtaining program goals and indicators for submission of FCC’s Annual Performance Plan to Congress and OMB. However,

FCC does not have a mechanism for identifying, assembling and analyzing performance data for financial reporting. Moreover, it has not established a framework and mechanism for the verification and validation of its performance indicators and presentation of the data in the financial statements.

We believe that one reason for this weakness was the limited communication and coordination related to performance goals and results between PERM and the Office of the CFO.

Recommendations:

- a) Define the process and implement a mechanism for identifying, assembling, and analyzing, and reporting performance data. The documented process should include, at a minimum, the staff responsible for preparation and review, formats, due dates, sources of data, review and analysis methodology, and supervisory verification and report retention.

Management Comments

Management concurs. While management is in overall agreement with the recommendation contained above, management believes the findings more accurately reflect the current problem of incorporating the provisions of GPRA into FCC's Annual Federal Financial Accountability Report and not the need to establish a process or mechanism in place for implementing GPRA as a whole.

- b) Reevaluate performance goals and indicators reported in the strategic plan and ensure that the performance goals are outcome oriented.

Management Comment

Management concurs.

- c) Establish a formal commission-wide system for tracking the indicators such as integrated system databases.

Management Comment

Management concurs.

- d) Enhance the communication and coordination among key offices (PERM, CFO, Budget) responsible for the successful implementation of the GPRA.

Management Comments

Adequate coordination exists currently among all offices of FCC in preparing and coordinating FCC's Strategic Plan, Annual Performance Plan, and Annual Performance Report. Specifically, adequate coordination does exist between PERM and the Budget Office for the purposes of successfully implementing GPRA. Coordination between these two offices plays an integral role in the preparation of the agency's Annual Performance Plans and our annual budget submission. Additionally, during FY 2000, we are extending and strengthening our coordination of mission-critical performance goals as they pertain to annual reporting on financial statements.

XII. OMB Circulars A-127 and A-130 Reviews

FCC has only recently identified its major financial applications and general support systems, and has not established a timetable for conducting OMB Circular A-127 and A-130 reviews of these applications. FCC cannot determine compliance with these Circulars to include in its annual FMFIA report and ensure substantial compliance with Federal Financial Management Improvement Act (FFMIA) without performing such reviews.

Recommendations:

- a) Institute a program for conducting periodic reviews in accordance with OMB Circulars A-127 and A-130.
- b) Include the results of OMB Circulars A-127 and A-130 reviews as part of Section 4 reporting in FCC's annual FMFIA report.

XIII. FMFIA

As required under OMB Bulletin 98-08, as amended, we compared the material weaknesses identified during the audit to those included in FCC's FMFIA report. The fiscal year 1999 FMFIA report did not identify most of the weaknesses discussed in this report affecting internal controls in its management of financial resources. In addition, FCC has not considered USF in its FMFIA process nor has it performed vulnerability assessments for USF operations.

Recommendation:

We recommend that FCC review its procedures in developing its FMFIA report to ensure all material weaknesses for all entities and operations are reported.

Management Comments

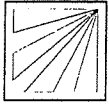
Management concurs. As part of the project to revise or write new policies and procedures, the FMFIA process will be updated. Coordination between all Bureaus/Offices will be implemented to ensure all weaknesses, not just ones from this audit, will be incorporated in the final report.

In addition to the reportable conditions described above, we noted certain matters involving internal control and its operations that we reported to management of FCC in a separate letter dated January 18, 2000.

This report is intended solely for the information and use of the management of FCC, FCC OIG, OMB, and Congress, and is not intended to be, and should not be, used by anyone other than these specified parties. We caution that misstatements, losses, and noncompliance may occur and not be detected by the testing performed and that such testing may not be sufficient for other purposes.

Clifton Sunderson L.L.C.

Greenbelt, Maryland
January 18, 2000



**Independent Auditor's Report On
Compliance With Laws and Regulations**

To the Inspector General of the
Federal Communications Commission

We have audited the consolidating balance sheet (hereinafter referred to as financial statement) of the Federal Communications Commission (FCC) as of September 30, 1999, and have issued our report thereon dated January 18, 2000. We conducted our audit in accordance with generally accepted auditing standards, 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. 98-08, *Audits of Federal Financial Statements*, as amended (OMB Bulletin 98-08, as amended).

The management of FCC is responsible for complying with laws and regulations applicable to FCC. As part of obtaining reasonable assurance about whether the FCC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 98-08, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to FCC.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin 98-08, as amended, which are described below.

Chief Financial Officers Act of 1990 (CFO Act)

The Government Management Reform Act of 1994 (GMRA) amended the requirements of the CFO Act by requiring, among other things, the annual preparation and audit of organization-wide financial statements of twenty-four executive departments and

agencies. Although FCC is not listed in OMB Bulletin 98-08, as amended, as one of the agencies required to comply with these requirements, management has elected compliance beginning with the fiscal year ended September 30, 1999 and as such is being evaluated accordingly.

FCC had not effectively established and implemented general and financial management practices and systems of accounting, financial management, and internal controls to ensure the issuance of reliable financial information and to provide for the production of complete, reliable, timely, and consistent financial information. As such, FCC was not in compliance with these requirements of the CFO Act.

The government has a responsibility to use timely, reliable, and comprehensive financial information when making decisions, which have an impact on citizens' lives and livelihood. To meet this responsibility, the CFO Act of 1990 establishes a leadership structure, provides for long-range planning, requires audited financial statements, and strengthens accountability reporting. Specifically, the CFO Act establishes the authority, functions and responsibilities of a CFO. These include, among others, that a CFO:

- develops and maintains an integrated accounting and financial management system including financial reporting and internal control standards;
- directs, manages, and provides policy guidance and oversight of all agency financial management personnel, activities, and operations;
- implements agency asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and control; and
- oversees the training of personnel to carry out agency financial management functions.

The FCC does not meet the above criteria as explained in more detail in our Report on Internal Control, items I and II. The key items we identified include:

- FCC management has not incorporated financial management activities of the Universal Service Fund (USF) into FCC's financial reporting process.
- Policy guidance for financial management personnel, activities and operations are not formalized in writing, not updated, and not enforced effectively.

- The financial statement preparation process is manually intensive.
- FCC's financial information system is not fully integrated and it relies on data from various subsystems and spreadsheet programs for the accounting, preparing and reporting of financial statements.

Federal Managers' Financial Integrity Act of 1982 (FMFIA)

Compliance with FMFIA requires two reports to be prepared by an agency head for review by the President and the Congress. The two reports are:

- "Section 2" reports on whether or not the agency's system of internal accounting and administrative controls complies with this law's requirements. This report should identify material weaknesses and provide related corrective actions; and
- "Section 4" reports on whether the agency's accounting system conforms to the principles, standards, and related requirements prescribed by the Comptroller General under section 112 of this law.

These two reports are to be based on evaluations conducted under the OMB Circulars A-123 *Management Accountability and Control* (as revised), A-127 *Financial Management Systems*, and A-130 *Management of Federal Information Resources*. OMB Circular A-123 provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls. OMB Circular A-127 prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. OMB Circular A-130 provides government-wide information resources management policies as required by the Paperwork Reduction Act of 1980, as amended by the Paperwork Reduction Act of 1995, 44 U.S.C. Chapter 35.

As explained in more detail in our Report on Internal Control, item XIII, FCC's report did not identify most of the material weaknesses discussed in our report on internal controls. In addition, FCC has not considered USF in its FMFIA reports. FCC also did not review its systems for conformance with the requirements of OMB Circulars A-127 and A-130. See related finding on FMFIA discussed later in this report.

**Government Performance and Results Act of 1993 (GPRA)
Information Technology Management Reform Act of 1996 (ITMRA)**

The GPRA requires agencies to set goals, measure performance, and report on their accomplishment. The ITMRA requires, among other things, that agencies, set goals, measure performance, and report on progress in improving the efficiency and effectiveness of operations through the use of information technology.

As explained in more detail in our Report on Internal Control, specifically items I, II and XI, FCC was not able to report performance goals, program and financial results, and financial condition in the Overview of the Reporting Entity section of its financial statement because it has not implemented a mechanism for identifying, assembling, analyzing, and reporting performance data. Moreover, it has not established a mechanism for verifying and validating its performance indicators.

Federal Credit Reform Act of 1990 (FCRA)

The specific purposes of the FCRA are:

- to ensure a timely and accurate measure and presentation in the President's budget of the costs of direct loan and loan guarantee programs;
- to place the cost of credit programs on a budgetary basis equivalent to other federal spending;
- to encourage the delivery of benefits in the form most appropriate to the needs of the beneficiaries; and
- to improve the allocation of resources among credit programs and between credit and other spending programs.

The FCRA, as amended, defines direct loans, among others as the purchase of, or participation in, financing arrangements that defer payment for more than 90 days, including the sale of a government asset on credit terms. FCC provided financing arrangements to winners of some of its electromagnetic spectrum auctions.

FCC is not reporting the financing arrangement with Pioneer licensees under FCRA. The Pioneer preference program, which is no longer in existence, allowed an applicant to receive a preference for a license if the applicant demonstrated that it had developed or advanced a new technology or service. Congress specified that entities awarded licenses

pursuant to this program were required to pay a portion of the license's value as a condition of license grant. Pioneer licensees were allowed to pay for their licenses over a five-year period maturing in fiscal year 2001. FCC management explained that it decided not to report the Pioneer financing arrangement under FCRA because the financial arrangements are maturing in fiscal year 2001 and the Pioneer licensees are currently paying on time. Therefore, these financial arrangements represent no cost to the government.

Federal Financial Management Improvement Act of 1996 (FFMIA)

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin 98-08, as amended.

The results of our tests disclosed instances, where FCC's financial management systems did not substantially comply with certain requirements referenced in the preceding paragraph. The following instances of noncompliance have been identified and such matters are described in more detail in our Report on Internal Control.

Federal Accounting Standards

As indicated in our Report on Internal Controls in items I, III, V, VIII, IX and X, FCC's system is not adequate to prepare timely and reliable financial statements in accordance with Federal Financial Accounting Standards. FCC was not able to complete principal statements other than the consolidating balance sheet and required supplementary information on Intra-governmental assets and liabilities. In addition, its Overview of the Reporting Entity did not include performance measures and results. In accordance with OMB Bulletin No. 97-01, as amended, the other required principal statements and supplementary information are the Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, Statement of Financing, Statement of Custodial Activities and supplementary information on deferred maintenance. These principal statements incorporate the concepts and standards contained in the Statements of Federal Financial Accounting Concepts and Statements of Federal Financial Accounting Standards. In addition, significant financial information, such as the unfunded liability and property, plant and equipment, used in the preparation of the consolidating balance sheet, are not adequately supported by detailed financial records.

Federal Financial Management System Requirements

During our review of Information Technology controls, we identified several weaknesses. These weaknesses are collectively considered a material weakness and are described in more detail in our Report on Internal Control, item IV. The weaknesses include lack of compliance with OMB Circular A-130's requirement for a comprehensive security plan, lack of necessary controls to protect information, and lack of a fully developed and tested contingency plan.

Management Comments Regarding Compliance with Laws and Regulations

The above mentioned laws and regulations are addressed within the findings on the Report on Internal Control. As FCC moves forward in correcting the findings and resolving identified issues, the occurrence of noncompliance will reduce.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of FCC, the FCC Office of the Inspector General, OMB and Congress, and is not intended to be, and should not be, used by anyone other than these specified parties. We caution that noncompliance may occur and not be detected by the tests performed and that such testing may not be sufficient for other purposes.

Clifton Sunderson L.L.C.

Greenbelt, Maryland
January 18, 2000

