Federal Communications Commission

Fiscal Year 2002
Annual Financial Report

(October 1, 2001 – September 30, 2002)

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FEDERAL COMMUNICATIONS COMMISSION FISCAL YEAR 2002 ANNUAL FINANCIAL REPORT

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AUDIT OF THE FEDERALCOMMUNICATIONS COMMISSION FISCAL YEAR 2002 ANNUAL FINANCIAL REPORT

MANAGEMENT'S DISCUSSION & ANALYSIS

Overview of the FCC

The Federal Communications Commission (FCC, Commission, or agency) is an independent United States Government regulatory agency, directly responsible to Congress. The FCC was established by the Communications Act of 1934 (the Act) and is charged with regulating interstate and international communications by radio, television, wire, satellite, and cable. The FCC also regulates intrastate telecommunications services for hearing-impaired and speech-impaired individuals as set forth in Title IV of the Americans With Disabilities Act (ADA). The FCC's Headquarters is located in Washington, DC, and it has field 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. Commissioners may not hold a financial interest in any company or entity that has a significant interest in activities regulated by the Commission. The Chairman and other Commissioners supervise FCC activities, delegating responsibilities to the bureaus and staff offices.

This document contains information about the FCC's principal financial statements for fiscal year (FY) 2002, including a Consolidated Balance Sheet, Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, Consolidated Statement of Financing, Consolidated Statement of Custodial Activity, Notes to the Financial Statements, and Required Supplementary Information. Additionally, it presents the FCC's mission and organizational structure, performance information, details on its systems, controls and legal compliance, and possible future issues that may impact the Commission. It is a guide to the key FCC initiatives and activities during FY 2002, or planned for future years, that demonstrate the breadth of the Commission's work.

FCC Mission

> ***"...the Commission continues to build upon the cornerstone principles of the public interest and general consumer welfare to promote access to communications services for all Americans..."***
>
> *Chairman Michael K. Powell*
> *Congressional Testimony, April 17, 2002*[1]

The fundamental mission of the FCC is to implement the Communications Act of 1934, as amended, and the Telecommunications Act of 1996 (the 1996 Act) in a manner that promotes competition, innovation, and deregulation in the communications industry and the availability of high quality communications services for all Americans.

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[1] Testimony before the Subcommittee on Commerce, Justice, State and the Judiciary of the Senate Committee on Appropriations by FCC Chairman Michael K. Powell on April 17, 2002.

FCC Vision and Business Plan

The FCC promotes competition in communications, protects consumers, and supports access for every American to existing and advanced communications services. To better do this, the FCC is executing a new business plan built along the following four dimensions:

- ✓ a clear substantive policy vision, consistent with the various communications statutes and rules, that guides FCC deliberations;
- ✓ a pointed emphasis on management that builds on a strong team, produces a cohesive and efficient operation, and leads to clear and timely decisions;
- ✓ an extensive training and development program to ensure that the FCC possesses independent technical and economic expertise; and
- ✓ an organizational restructuring to align the FCC with the realities of a dynamic and converging marketplace.[2]

The FCC will strive to use taxpayers' funds constructively to improve the Commission's services through a comprehensive retooling of the mission in concert with the FCC's current legislative mandate.[3] The United States has a proud legacy of facilitating and encouraging communication services. This nation has the finest voice communication system in the world, as well as top-notch mass media delivery systems in the form of radio, television, and cable. With advancements in the communications industry, the FCC has begun encouraging deployment of advanced architectures and technologies of services like broadband. Government policy will need to foster the migration towards the digital broadband future. The Commission's policy direction will focus on this migration with several directional guideposts, including efforts to:

- ✓ facilitate the timely and efficient deployment of broadband infrastructure;
- ✓ creatively pursue universal service goals of ubiquity and affordability in deployment;
- ✓ redirect focus onto innovation and investment;
- ✓ harness competition and market forces;
- ✓ rationalize and harmonize regulations across industry segments, where appropriate; and
- ✓ shift from expanding permissive regulations to effective enforcement of necessary ones.[4]

FCC Organizational Structure

The FCC Chairman leads the Commission as head of the agency. The Commissioners supervise all FCC activities, delegating responsibilities to the ten staff offices and six bureaus. The Commission and the Chairman have delegated management and administrative responsibility to the Managing Director. The Commission staff is organized by function into bureaus and staff offices. In March 2002, the FCC undertook a major reorganization to ensure the FCC, as an institution, remains efficient, effective, and responsive. In determining what restructuring was necessary, the FCC was guided by the following principles:

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[2] Testimony before the Subcommittee on Commerce, Justice, State and the Judiciary of the House Committee on Appropriations by FCC Chairman Michael K. Powell on June 28, 2001.
[3] The initial stages of the organizational restructuring, implemented on March 25, 2002, focused on the bureaus.
[4] Testimony before the Subcommittee on Appropriations by Chairman Powell on June 28, 2001.

- ✓ develop a standardized organizational structure across the bureaus;
- ✓ identify a principal deputy in each bureau;
- ✓ move toward a functional alignment;
- ✓ reflect changes in regulation and workload;
- ✓ recognize that in a dynamic communications industry, change will continue;
- ✓ be able to adapt quickly to future changes;
- ✓ minimize disruptions to the agency's work; and
- ✓ use the reorganization to improve technical and economic analysis in decision-making.

Recent changes in organizational structure focused on the bureaus. Under the reorganization, the FCC consolidated functions in order to better address changes in workload and to achieve greater efficiencies. The goal of the reorganization is to ensure enhanced policy, licensing, and economic and technical analysis in each of the bureaus. There are now six, rather than seven, operating bureaus: Consumer and Governmental Affairs, Enforcement, International, Media, Wireless Telecommunications, and Wireline Competition. These bureaus are responsible for developing and implementing regulatory programs, processing applications for licenses or other filings, analyzing complaints, conducting investigations, and taking part in FCC hearings. A more detailed description of the roles of each individual bureau follows below.

In addition, there are ten staff offices: Administrative Law Judges, Communications Business Opportunities, Engineering and Technology, General Counsel, Inspector General, Legislative Affairs, Managing Director, Media Relations, Plans and Policy, and Workplace Diversity. A more detailed description of each office follows. Even though the bureaus and offices have individual functions, they regularly join forces and share expertise in addressing Commission issues.

FCC Bureaus

Consumer and Governmental Affairs Bureau (CGB) – Formerly the Consumer Information Bureau, the CIB was restructured to align the functions more closely, enhance the bureau's policy role in decision-making, and increase the bureau's intergovernmental partnership role with regard to Federal agencies, state, local, and Tribal government. The CGB communicates information to the public regarding Commission policies, programs, and activities; handles public inquiries and informal consumer complaints; and oversees disability mandates. The CGB has the following units: Policy Division, Disability Rights Office, Reference Information Center, Consumer Affairs and Outreach Division, Administration and Management Office, Systems Support Office, Information Access and Privacy Office, and Consumer Inquiries and Complaints Division.

Enforcement Bureau (EB) – The EB serves as the primary Commission entity responsible for the enforcement of the Act, the 1996 Act, and other communications statutes, as well as the Commission's rules, authorizations and orders (except for certain matters). With the reorganization, some enforcement-related functions previously in the Cable Services Bureau were transferred to the EB. The EB consists of: Office of Management and Resources, Telecommunications Consumer Division, Market Disputes Resolution Division, Technical and Public Safety Division, Investigations and Hearings Division, and Regional and Field Offices.

International Bureau (IB) – The IB develops, recommends and administers policies, standards, procedures and programs for the regulation of international telecommunications facilities and services and the licensing of satellite facilities under its jurisdiction. The IB assumes the principal representational role for Commission activities in international organizations and represents the Commission in satellite and international matters (such as rates, standards, and development issues). Under the reorganization, the IB consolidates all intergovernmental and regional leadership and planning functions; leverages policy-making and engineering resources to more efficiently handle policy and rulemaking activities; and improves the focus on satellite licensing and policy issues. The IB has the following units: Administrative and Management Office, Policy Division, Satellite Division, and Strategic Analysis and Negotiations Division.

Media Bureau (MB) – This new bureau, which combines the former Mass Media Bureau and the former Cable Services Bureau, develops, recommends and administers the policy and licensing programs for the regulation of multichannel video programming distribution (i.e., cable and satellite), broadcast radio and television, direct broadcast satellite service, video news, and entertainment. Within the MB, the Office of Broadcast License Policy is responsible for the licensing function of the bureau. The MB consists of the: Management and Resources Staff, Office of Communications and Industry Information, Policy Division, Engineering Division, Industry Analysis Division, Office of Broadcast License Policy, Audio Division, and Video Division.

Wireless Telecommunications Bureau (WTB) – The WTB has the organizational responsibility to develop, recommend, and administer the Commission's policies, programs and rules governing domestic wireless telecommunications including cellular and PCS phones, pagers and two-way radios, but does not oversee satellite communications. The bureau also regulates the use of radio spectrum to fulfill the communications needs of businesses, local and state governments, public safety service providers, aircraft and ship operators, and individuals. Some licensing functions formerly in the Mass Media Bureau were transferred to WTB. Units within WTB include: Management and Planning Staff, Auctions and Industry Analysis Division (including the Auctions Automations Branch, Auctions Expenditures Management Branch, Legal Branch, Auctions Finance and Market Analysis Branch, and the Auctions Operations Branch), Commercial Wireless Division, Data Management Division, Policy Division, and Public Safety and Private Wireless Division.

Wireline Competition Bureau (WCB) – The new WCB, formerly the Common Carrier Bureau, is responsible for matters pertaining to the regulation and licensing of communications common carriers and ancillary operations (except for wireless telecommunications services and facilities). The bureau develops, recommends and administers policies related to competition, pricing, telecommunications access, industry analysis, and technology. The bureau's activities include: policy development and coordination; adjudicatory and rulemaking proceedings; action on requests for interpretation or waivers of rules; determinations regarding lawfulness of carrier tariffs; action on applications for service and facility authorizations; review of carrier performance; administration of accounting requirements for incumbent local exchange carriers; administration of FCC reporting requirements affecting telecommunications carriers; economic research and analysis; and interaction with the public, local, state, and other government agencies and industry groups on wireline telecommunications regulation and related matters. The WCB consists of: Administrative and Management Office, Competition Policy Division, Pricing Policy Division, Telecommunications Access Policy Division, and Industry Analysis and Technology Division.

FCC Staff Offices

Office of Administrative Law Judges (OALJ) – The OALJ presides over hearings and issues Initial Decisions.

Office of Communications Business Opportunities (OCBO) – The OCBO provides advice to the Commission on issues and policies concerning opportunities for ownership and contracting by small, minority, and women-owned communications businesses.

Office of Engineering and Technology (OET) – The OET allocates spectrum for non-governmental use and provides expert advice on technical issues before the Commission. The OET also establishes technical standards for spectrum users.

Office of the General Counsel (OGC) – The General Counsel serves as chief legal advisor to the Commission and its various bureaus and offices. The OGC advises the Commission on fostering competition and promoting deregulation in a competitive environment.

Office of Inspector General (OIG) – The OIG, established in compliance with the Inspector General Act Amendments of 1988, provides the FCC with independent audit and investigative services relating to the operations of the Commission. This office recommends policies for activities designed to promote economy, efficiency, and effectiveness, as well as to prevent and detect fraud, waste, and abuse.

Office of Legislative Affairs (OLA) – The OLA informs Congress of the Commission's regulatory decisions, facilitates responses to Congressional inquiries, prepares Commission responses to legislative proposals, and serves as the Commission's main point of contact with Congress and other governmental entities.

Office of the Managing Director (OMD) – The Managing Director is appointed by the Chairman with approval of the Commission, and functions as a chief operating official, serving at the direction and supervision of the FCC Chairman. The Office of the Secretary is located within the OMD. The OMD provides direction to the bureaus and staff offices in management and administrative matters.

Office of Media Relations (OMR) – The OMR informs the news media of FCC decisions and serves as the Commission's main point of contact with the media. This office also manages the FCC's website.

Office of Plans and Policy (OPP) – The OPP serves as the Commission's chief economic policy advisor, analyzing issues and developing long-term policy planning with respect to the development and implementation of communications policies in all areas of Commission authority and responsibility.

Office of Workplace Diversity (OWD) – The OWD advises the Commission on all issues related to workforce diversity, affirmative recruitment, and equal employment opportunity. A principal function of this office is to lead, advise, and assist the Commission, including all of its component bureau/office managers, supervisors, and staff, on ways to promote inclusion and full participation of all employees in pursuit of the Commission's mission.

The organizational chart for the FCC bureaus and offices appears on page 8.

Components of the FCC for Financial Statement Purposes

The Universal Service Fund

Universal Service Fund (USF) – The USF is a significant program of the FCC. As designated in the U.S. Budget each year, the USF consists of five elements, four of which are the universal service support mechanisms and the fifth being the Telecommunications Relay Service (TRS) Fund. The universal service support mechanisms were established pursuant to Section 254 of the Act, as amended. The TRS Fund was established pursuant to Section 225 of the Act, as amended.

The universal service support mechanisms are funded through mandatory contributions from U.S. telecommunications providers, including local and long distance phone companies, wireless and paging companies, and payphone providers. There are four universal service support mechanisms: high cost, low income, rural health care, and schools and libraries. The High Cost Support Mechanisms, including High Cost Loop Support, Long Term Support, Local Switching Support, Interstate Access Support, and Interstate Common Line Support, provide support to telephone companies that serve high cost areas. The Low Income Support Mechanism assists low-income consumers by supporting service connection charges as well as monthly charges. The Rural Health Care Support Mechanism allows rural health care providers to pay the same for telecommunications services as their urban counterparts. The Schools and Libraries Support Mechanism provides schools and libraries discounts on telecommunications services, Internet access, and internal connections. Consumers benefit from the support mechanisms which provide money directly to service providers to defray the cost of delivering services to customers who use the telecommunications services supported by these mechanisms. The universal service support mechanisms operate on a different fiscal year from other FCC programs; the USF fiscal year commences January 1 and ends December 31.

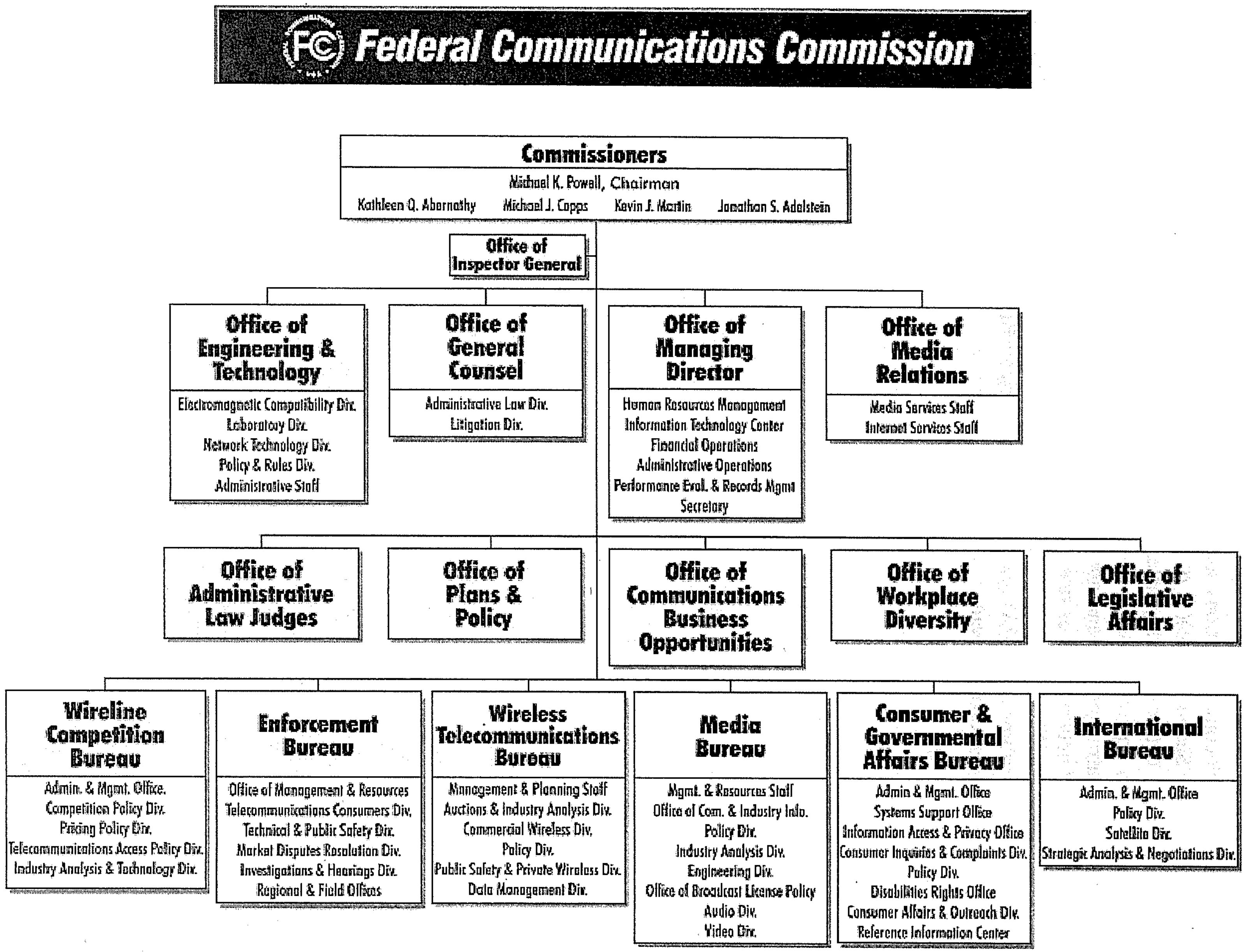
The TRS Fund compensates TRS providers for the reasonable costs of providing interstate telephone transmission services that enable a person with a hearing or speech disability to use such services to communicate with a person without hearing or speech disabilities in a manner that is functionally equivalent to the ability of individuals without hearing or speech disabilities. The costs of providing interstate TRS are recovered from subscribers of interstate telecommunications services through shared-funding cost recovery mechanisms. The TRS program also operates on a different fiscal year from other FCC programs; the TRS fiscal year commences July 1 and ends June 30.

Universal Service Administrative Company (USAC) – USAC administers the four universal service support mechanisms of the USF under the direction of the FCC.

National Exchange Carriers Association (NECA) – NECA administers the TRS Fund under the direction of the FCC.

Other FCC Components

North American Numbering Plan (NANP) – The NANP is the basic numbering scheme permitting interoperable telecommunications service within the United States, Canada, Bermuda, and most of the Caribbean. Section 251(e)(1) of the Act requires the Commission to create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis. Section 251(e)(2) of the Act requires that the costs of number administration arrangements and number portability be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission. In implementing Section 251, the FCC appointed a NANP Administrator and a Billing and Collection Agent. NeuStar, Inc. is the NANP Administrator (NANPA) and the North American Billing and Collection, Inc. (NBANC) is the Billing and Collection Agent.


Federal Communications Commission
Commissioners
Michael K. Powell, Chairman
Kathleen Q. Abernathy
Michael J. Copps
Kevin J. Martin
Jonathan S. Adelstein
Office of Inspector General
Office of Engineering & Technology
Electromagnetic Compatibility Div.
Laboratory Div.
Network Technology Div.
Policy & Rules Div.
Administrative Staff
Office of General Counsel
Administrative Law Div.
Litigation Div.
Office of Managing Director
Human Resources Management
Information Technology Center
Financial Operations
Administrative Operations
Performance Eval. & Records Mgmt
Secretary
Office of Media Relations
Media Services Staff
Internet Services Staff
Office of Administrative Law Judges
Office of Plans & Policy
Office of Communications Business Opportunities
Office of Workplace Diversity
Office of Legislative Affairs
Wireline Competition Bureau
Admin. & Mgmt. Office
Competition Policy Div.
Pricing Policy Div.
Telecommunications Access Policy Div.
Industry Analysis & Technology Div.
Enforcement Bureau
Office of Management & Resources
Telecommunications Consumers Div.
Technical & Public Safety Div.
Market Disputes Resolution Div.
Investigations & Hearings Div.
Regional & Field Offices
Wireless Telecommunications Bureau
Management & Planning Staff
Auctions & Industry Analysis Div.
Commercial Wireless Div.
Policy Div.
Public Safety & Private Wireless Div.
Data Management Div.
Media Bureau
Mgmt. & Resources Staff
Office of Com. & Industry Info.
Policy Div.
Industry Analysis Div.
Engineering Div.
Office of Broadcast License Policy
Audio Div.
Video Div.
Consumer & Governmental Affairs Bureau
Admin & Mgmt. Office
Systems Support Office
Information Access & Privacy Office
Consumer Inquiries & Complaints Div.
Policy Div.
Disabilities Rights Office
Consumer Affairs & Outreach Div.
Reference Information Center
International Bureau
Admin. & Mgmt. Office
Policy Div.
Satellite Div.
Strategic Analysis & Negotiations Div.

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

> ***"The ...FCC continues its efforts to implement a long-term business plan designed to make it a more responsive, efficient and effective agency, capable of facing the technological and economic opportunities and challenges of the new millennium...."***
>
> *Chairman Michael K. Powell*
> *Congressional Testimony, April 17, 2002*[5]

I. **Overview**: Responsive to the rapid changes in technology sectors, the FCC's strategic planning process is continually evolving. However, the fundamental mission of the FCC remains to implement the Act, as amended, in a manner that promotes competition, innovation and deregulation in the communications industry and to make available high-quality communications services for all Americans. In order to achieve these objectives in this time of great innovation in the communications industry, the FCC must strive to remain on the cutting edge of technology, economics, and the law.

To ensure the FCC is making strides in fulfilling its mission and, in accordance with the Government Performance and Results Act of 1993 (GPRA), the Commission developed strategic goals and objectives and related performance measures. The FCC recently posted the revised Strategic Plan for FYs 2003 through 2008 on the FCC website at: http://www.fcc.gov/omd/strategicplan/strategicplan2003-2008.pdf. The Plan reflects the refocusing of the FCC's mission, strategic objective, and reallocation of resources as well as the implementation of the recent organizational restructuring. The consolidation of bureaus and activities allows the FCC to emphasize core performance measures in greater detail. Since passage of the GPRA, the role of, and the environment surrounding the FCC has changed significantly. The revised Strategic Plan reflects the direction in which the FCC should proceed if the American people and economy are to continue to benefit from ongoing developments in global communications.

Because the revised Strategic Plan will not be implemented until FY 2003, this overview focuses on performance measures drawn from the FCC's Annual Performance Plan as submitted to Congress with the Commission's FY 2003 budget estimates as well as the FY 2001 Annual Program Performance Report (March 2002), which assesses FY 2001 performance and highlights the goals for FYs 2002 and 2003. These measures are consistent with the FCC's FY 1999-2002 Strategic Plan,[6] and will be updated in future years as the new Strategic Plan takes effect. The performance measures selected for this Annual Financial Report were based on links to the Commission's most significant activities.

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[5] Testimony before the Subcommittee on Commerce, Justice, State and the Judiciary of the Senate Committee on Appropriations by FCC Chairman Michael K. Powell on April 17, 2002.

[6] Unless otherwise noted, the FCC Strategic Plan referenced is for FY 1999-2002, and not the FY 2003-2008 Strategic Plan.

II. General Goals and Objectives: Consistent with the objectives of the Act, the Commission has sought to rely increasingly on market forces to promote competition to foster the availability of high quality communications services to consumers at reasonable prices. The FCC is challenged to continue to find ways to foster competitive entry into established markets, while encouraging the development of open, competitive markets for new and innovative technological services. The FCC must strive, through the enforcement of policies aimed at encouraging competition, to ensure that rules are adhered to fully, and to continue to monitor business practices and their impact on consumers. The FCC must also keep focused on the global communications marketplace, and the challenges that globalization poses to the sharing of spectrum and the maintenance of open international markets.

The advent of Internet-based and other new, technology-driven, communications services will continue to erode traditional regulatory distinctions between the various sectors of the communications industry. The FCC's most immediate challenge is to integrate the changing character of the industry into its core functions: 1) licensing; 2) competition; 3) enforcement; 4) consumer information services; and 5) spectrum management.[7]

The FCC's goals and objectives, listed in Figure 1, are aligned with the five core functions as well as the FCC's current Strategic Plan and Annual Performance Plan. Eight performance measures (numbered and italicized in parentheses) related to the performance objectives are detailed further in Part VI of this report, starting on page 16. Not all of the FCC's performance measures are addressed in this report. The eight measures included reflect the Commission's mission and goals; the FCC's most significant programs; and are consistent with the Commission's implementation of the GPRA. Since the FY 2002 Annual Program Performance Report is not available until the end of February 2003, a complete assessment of all of the FCC's FY 2002 performance measure results is not incorporated in this document. Additional administrative financial measures are discussed in the "Other Accompanying Information" section on page 107 of this report.

[7] FCC's FY 2003 Budget Estimates to Congress, Annual Performance Plan, page 18.

Figure 1:
Performance Objectives and Measures from Annual Program Performance Report[8]

1. **Licensing: Create A More Efficient, Effective and Responsive Agency**
   - ✔ *Automate agency processes. (1)*
   - ✔ *Streamline agency's processes and procedures. (2 and 3)*
2. **Competition:**
   - A. **Promote Competition In All Communications Markets**
     - ✔ *Eliminate barriers to entry in domestic markets. (4)*
     - ✔ *Deregulate where appropriate to promote competition. (5)*
     - ✔ Promote competition in international communications markets.
   - B. **Promote Opportunities For All Americans To Benefit From The Communications Revolution**
     - ✔ *Promote access for all Americans to communications services. (6)*
     - ✔ Promote consumer education and information.
3. **Enforcement: Promote Competition In All Communications Markets**
   - ✔ *Enforce the rules so businesses compete fairly. (7)*
4. **Consumer Information Services:**
   - A. **Create A More Efficient, Effective and Responsive Agency**
     - ✔ Provide improved access to all agency information.
   - B. **Promote Opportunities For All Americans To Benefit From The Communications Revolution**
     - ✔ Promote access for all Americans to communications services.
5. **Spectrum Management: Manage The Electromagnetic Spectrum In The Public Interest**
   - ✔ Promote more efficient use of spectrum.
   - ✔ *Foster the increased availability of spectrum. (8)*

The FCC is continuing its efforts to integrate the Annual Performance Plan with budget development and execution. Figure 2 shows the crosswalk between the FCC's budget activities and the number of related performance goals.

Figure 2:
Number of Performance Measures by Resource Category/Performance Goals

Performance Goals ↓	Resource Categories →	**Licensing**	**Competition**	**Enforcement**	**Consumer Information**	**Spectrum Management**
Efficient, effective, responsive agency		4			2	
Promote competition			13	4		
Promote opportunities for all Americans			5		2	
Manage electromagnetic spectrum						4

[8] FCC's FY 2001 Annual Program Performance Report, March 2002, page 3.

III. Resources and Strategies to Achieve Performance Goals: The FCC has identified strategies and resources to achieve the performance goals for each of the five core functions. In FYs 2001 and 2002, the FCC increased the number of its program activities from the four included in the FY 2000 Budget to five in order to account for spectrum management program activities. Initially there was no corresponding change in the FCC accounting processes to separately track certain costs associated with spectrum management. As a result, in connection with preparing its FY 2001 financial statements, the FCC needed to re-allocate certain costs after its FY 2001 year-end closing from the four activities for which costs were tracked to the five activities for its Statement of Net Cost using budget and other sources.

To address this reallocation of cost issue in FY 2002, the FCC initiated a project aimed at enhancing its ability to more accurately capture and report costs associated with all five activities using its current cost accounting system. This included implementation of additional project codes within the FCC's accounting system to better capture costs associated with the five activities, as well as for those activities related to the USF. The new project codes allow FCC employees to more easily and accurately report time associated with spectrum management and new program activities. In addition, the FCC developed supplementary time reporting policies and procedures for its cost accounting system to aid FCC employees in more accurately reporting time and expenses for each pay period.

The FCC intends to implement a Managerial Cost Accounting System (MCAS), using in-house software. The FCC is planning a three-phase approach to implementation. The first phase is to implement a cost accounting system, followed by a budget formulation/execution system, and in the third phase, the FTE tracking and reporting system. The cost accounting system transition should begin with initial system testing in late FY 2003. When fully implemented in FY 2004, it will provide a robust and integrated financial management system supporting the partnership between program and financial managers, assuring the integrity of information for decision making, and measuring the full cost of the FCC's programs and their various elements, activities, and outputs.

Figure 3 reflects the estimated appropriated budgetary resources dedicated to achieving the performance goals within the five core functions. The data is based on the FCC's FY 2003 Congressional Budget submission, and does not reflect actual amounts as included in the Statement of Net Cost. Additionally, the data includes both direct organizational full-time equivalent personnel (FTE) and operating cost, as well as other staff office support (FTE and operating cost) necessary to provide policy direction, program development, legal services, executive direction and other services associated with each of the individual functions. The FCC Budget Office developed the cost-by-activity and FTE estimates for spectrum management activities by using similar percentages for allocation of funds as used in the FY 2002 Congressional Budget submission. Changes in FTE allocations by activity reflect management decisions, and impact the resource levels allocated to each activity.

In addition to the appropriated funds of $245.071 million in FY 2002, the FCC utilized an additional $77.918 million in auction recovery funds, and an apportionment of $12.066 million for administrative costs of the credit program to achieve the performance goals of the FCC.

Figure 3:
Appropriated Budgetary Resources for the FCC Programs by the Five Core Functions[9]
(Dollar amounts in thousands)

	FY 2001 Estimate				FY 2002 Estimate[10]			
Core Functions	Cost-by-Activity	%	FTEs	%	Cost-by-Activity	%	FTEs	%
1. Licensing	$44,253	19.2%	392	20.3%	$46,073	18.8%	390	19.7%
2. Competition	$70,177	30.5%	502	26.0%	$73,031	29.8%	496	25.1%
3. Enforcement	$68,083	29.6%	593	30.7%	$72,296	29.5%	603	30.5%
4. Consumer Information Services	$23,918	10.4%	269	13.9%	$25,242	10.3%	271	13.7%
5. Spectrum Management	$23,503	10.2%	175	9.1%	$28,428	11.6%	215	10.9%
TOTAL:	$229,933	100%	1,931	100%	$245,071	100%	1,975	100%

A summary of the strategies to achieve each of the five core FCC functions follows.

A. *Licensing* – The FCC has sought to improve its licensing activities through a multi-year plan to reengineer and integrate its licensing databases, and through implementation of interactive electronic filing systems. Initiatives have included universal licensing, streamlined application processes, revised and simplified licensing forms, blanket authorizations, authorizations for unlicensed services, and electronic filing of license applications and certifications. The benefits derived from these efforts are manifold and include a more economical use of FCC personnel resources, improvement in processing times, the ability of customers to file via the Internet or through other electronic filing mechanisms, and the ability to provide customers with immediate status reports on their applications. These all have resulted in improved service to the public.

B. *Competition* – As the FCC's role changes from market regulator to market facilitator, the Commission will rely less on traditional rulemaking procedures where possible, and will rely more on interagency task forces, advisory committees, and state, local, and regional consortia. The FCC will endeavor to assist the rapid expansion of innovative new technologies. In addition, the Commission will continue to promote the development of competition in the local exchange market through expeditious review of applications to increase the range of choices in local telephone service providers, multipoint video programming market services, and mobile wireless providers. At the same time, the Commission will vigorously review rules and spectrum allocation policies to ensure that FCC rules, regulations, and activities do not deter development of emerging technologies.

[9] Data sources: Annual Performance Plan as included in the FY 2003 Budget Estimates to Congress and supporting documentation from the FCC Budget Office.
[10] At the time the budget was published, the FCC was involved in the restructuring and reorganization of activities, and the FTE allocations were not finalized.

C. ***Enforcement*** – An important element for competitive markets is the full and fair enforcement of FCC's rules and regulations. Effective use of the FCC's resources is critical to ensuring full implementation of the Act, as amended, the 1996 Act, and the Commission's rules specifically designed to open communications markets to competition and enhancing choices for consumers. An essential step in achieving these objectives was the creation of the EB in November 1999, which consolidated functions formerly dispersed throughout the FCC. The EB was created to respond quickly and efficiently to the demands of a competitive environment. It allows for a streamlined, centralized enforcement program, capable of identifying problems as they emerge, thus better equipping the Commission to provide a wide range of enforcement initiatives. The EB and CGB work together to track trends and share information. The end result is improved performance through an expanded outreach program, a better-educated telecommunications consumer, and a more law-abiding industry.

D. ***Consumer Information Services*** – In FY 2000, the FCC consolidated its consumer information activities within one organization to provide "one-stop shopping" to the telecommunications consumer. Consolidation of consumer information services under a single structure yields significant benefits to consumers and stakeholders – providing timely, accurate, and consistent information; tracking trends and mapping "hot" consumer issues nationwide, by region or by state; achieving economies of scale; and developing a useful Consumer Information Strategic Plan for FCC-wide applications without duplication in coverage. Progress in the FCC's consumer information services includes: a thorough evaluation of the web site services, including a survey of users; development of a redesigned homepage with a wealth of information on all telecommunications topics; an electronic comment filing system that allows stakeholders throughout the country to file their rulemaking comments electronically; and Consumer Information Centers that provide consumers with detailed information on all telecommunications-related topics. In September 2002, the FCC was ranked first in the Federal Government for its support of online services and features such as searchable databases, a comprehensive privacy and security policy, language translation availability, publication access, and live audio/video events. The website was also commended for being logical and presented in a clear, concise format.

E. ***Spectrum Management*** – The successful deployment of many new communications technologies depends on the availability of electromagnetic spectrum. To ensure that the FCC does not hinder the growth of new services, the Commission issued guidelines for future spectrum management policies designed to maximize the efficient use of spectrum and make more spectrum available while ensuring the public interest.

   In June 2002, the Commission established the Spectrum Policy Task Force to conduct a systematic evaluation of existing spectrum policies and to provide recommendations on improving spectrum management. The Task Force issued a Public Notice requesting comments on issues related to: market-oriented allocation and assignment polices; interference protection; efficient use of spectrum; public safety communications; and international issues.[11] On October 30, 2002, the FCC Chairman, in a speech on new

[11] Public Notice DA 02-1311, "Spectrum Policy Task Force Seeks Public Comments on Issues Related to Commission's Spectrum Policies," ET Docket No. 02-135, July 8, 2002.

directions in wireless policy, noted that a key objective of the Commission is spectrum policy reform, and that reform should be based on the most updated technologies.[12]

On November 7, 2002, the Task Force presented its findings and recommendations to modernize the rules that guide spectrum management to develop a more flexible, consumer-oriented approach. According to the Task Force, "increasing demand for spectrum-based services and devices are straining longstanding, and outmoded, spectrum polices." Additional and new uses of electromagnetic spectrum hold great promise to the telecommunications industry and the American consumer. Key recommendations of the Task Force include efforts to:

- Migrate toward more flexible, consumer-oriented policies;
- Adopt quantitative standards to provide interference protection;
- Improve access through the time dimension; and
- Shift from a "command and control" model to exclusive and commons models (increasing flexibility).[13]

On November 15, 2002, the Task Force issued its formal report with their recommendations. The report can be found on the FCC website at: http://www.fcc.gov/.

IV. Verification, Validation, and Program Evaluation. The FCC is dedicated to ensuring that both the mission and resources entrusted to it are properly and effectively managed. The FCC uses numerous methods and techniques to verify and validate data underlying its performance indicators. Methods include: certifications of reliability from data providers, a general program of review and evaluation carried out by the Performance Evaluation and Records Management (PERM) staff in the OMD, and audits, reports, and reviews performed by other groups such as the IG and General Accounting Office (GAO). The performance of the FCC is also evaluated through the Annual Program Performance Report.

The data included for each of the performance measures in this report includes baseline and trend data back to FY 1999, as applicable, or as far back as baseline data is available. In general, the expected data sources are internal reports generated by various FCC bureaus and offices,[14] which are often combinations of internally-generated data and externally provided data from government surveys such as the Current Population Survey and industry data. In other cases it is provided by outside sources (and is so noted where external data is used – e.g., Competition Reports).

Since FCC staff and automated processing systems are the source for much of the data on the FCC's performance, an acceptance of the professionalism, expertise, and ethical behavior of the FCC's line staff is fundamental to validating FCC performance data. This trust is further validated by certifications (A-130 and others) done by FCC IT staff on the secure and reliable operations of the FCC's information technology hardware and software. Finally, assistant bureau and office chiefs must sign a statement certifying the accuracy of the performance data they transmit, along with a brief methodology statement identifying the original source of the data (internal or external) and the systems used to gather, process, and analyze the data.

[12] Remarks, Chairman, Michael K. Powell, "Broadband Migration III: New Directions in Wireless Policy," October 30, 2002.
[13] ET Docket 02-135, "Spectrum Policy Task Force Recommendations for Spectrum Policy Reform," November 7, 2002.
[14] Data from FCC programmatic reports and application processing systems, inquiry and complaint tracking systems, enforcement reporting systems, and hiring and training systems.

PERM does a second-level review, cross-checking the basic validation provided by the FCC's Bureaus and Offices as part of its on-going program of internal controls. PERM focuses its program of internal controls on (in priority order): prevention, detection, and, where necessary, correction. Prevention controls are those designed to prevent or discourage errors or irregularities. Detection controls are designed to identify errors or irregularities after they have occurred. PERM methods include random internal reviews, formal program evaluations, and vulnerability assessments. Finally, if conditions are identified in a FCC bureau or office that show a program/project/activity is not operating effectively, efficiently, reliably, or in compliance with applicable laws, regulations, and priorities, PERM works with the affected bureau or office to remedy these conditions in a timely manner.

The final verification and validation process include the audits and studies conducted by the FCC's IG or the GAO. The IG conducts an average of nine audits of FCC activities every year while the GAO has been averaging several studies of FCC activities or issues per year, one or two of which may include recommendations to the Commission. All of these independent reviewers have access to FCC staff and records and point out areas of concern or in need of improvement when they are uncovered.

V. **Performance Measures Highlighted in the Financial Statements**: The process for determining the appropriate performance measures for integration into the financial statements starts with initial discussions between PERM, the Financial Operations Center, the Budget Office, and program staff, as appropriate. In those discussions, participants review the GPRA performance measures, identify measures for sizeable FCC activities, determine data sources, and select measures that have significant programmatic, financial, and/or managerial impacts. The performance measures highlighted in the Annual Financial Report in future years will be updated to reflect changes in the Strategic Plan for FY 2003-2008. Additionally, once the MCAS is implemented, linkages between performance measures, the budget, and the Statement of Net Cost will be more easily achieved.

Based on guidance from the Office of Management and Budget (OMB) and the Financial Accounting Standards Advisory Board (FASAB), performance measures for the FY 2002 Annual Financial Report, highlighted below, have been selected because they are:

- ✓ aligned with the Commission's mission and goals;
- ✓ limited to the FCC's most significant programs; and
- ✓ consistent with the Commission's implementation of the GPRA as reflected in budget documents and other related materials.

VI. **FCC Performance Measures**: This section discusses eight performance measures related to the FCC's strategic goals and objectives (detailed in Figure 1 on page 11) as well as the FCC's success in achieving its FY 2002 targets. All of the measures have been updated to reflect the performance results included in the FCC's FY 2001 Annual Program Performance Report. Each section below includes a table that identifies the FCC's FY 2002 accomplishments. Where data from prior years is available, they are also highlighted to provide trend information. Due to the recent FCC reorganization, performance information has been modified to reflect the creation or elimination of bureaus. The performance measures were selected by FCC management as significant for inclusion in this FY 2002 Annual Financial Report for reasons noted previously.

1. ***LICENSING:***

Strategic Goal – Create a More Efficient, Effective and Responsive Agency

Performance Objective – Automate Agency Processes

Performance Measure – Create a paperless FCC by automating functions and fully implementing automated licensing and electronic filing systems to promote one-stop shopping; consolidate individual systems and adopt one standard user interface where possible to simplify public use of our systems

This performance measure encourages efficient and innovative licensing and authorization of filing services by automating or streamlining several critical FCC functions and business processes. The goal is to implement automated licensing and electronic filing systems across the Commission, creating a more efficient, effective and responsive FCC in a paperless environment. As the FCC works to improve and implement new business processes and practices, coupled with advances in information technology, it moves toward being a leader in implementing Federal e-government initiatives.

Policy Initiative -- Measurement	**FY99**		**FY00**		**FY01**		**FY02**	
	Goal	*Actual*	*Goal*	*Actual*	*Goal*	*Actual*	*Goal*	*Actual*
Electronic Filing – Percentage of electronic applications filed via licensing/filing systems	Provide electronic filing capabilities	Provided electronic filing capabilities	60%	60%	70%	77%	80%	92%

The FCC continues to seek improvements to its licensing activities through a multi-year Chairman-sponsored initiative to design and develop a common repository of information that can be shared by various Commission systems. The objective of this effort is to develop data and business process models for its major licensing systems and help create a vision for licensing systems for the future. This effort's ultimate goal: longer-term process and data improvements that will help the FCC better meet its regulatory and customer service goals.

Specific FCC initiatives to promote improved business processes in licensing/filing activities include providing universal licensing capability, streamlining the application process, revising and simplifying licensing forms, providing blanket authorizations, and enhancing electronic licensing/filing systems functionality.[15] This measure compares the number of applications submitted using electronic licensing/filing systems with the total number of applications processed. In FY 2002, the percentage of licensing applications received electronically by the FCC was 92% of the total processed (572,531 of 621,227 total filings), exceeding the Commission's 80% goal, and representing a 15% increase over FY 2001. Figure 4 provides details for FY 2002 by bureau and office.

[15] There are twelve electronic filing/licensing systems: Universal Licensing System, Broadband Licensing System, Consolidated Database System, International Bureau Filing System, Management Database System, Electronic Comment Filing System, Operations Support for Complaint Analysis and Resolution, Cable Operations and Licensing System, Electronic Tariff Filing System, Access, Equipment Authorization System, and the Experimental Licensing System.

Figure 4: FY 2002 Electronic Filing/Licensing by Bureau and Office

Bureau/Office	Number of Electronic Filings/Applications	Total Number of Filings/Applications	Percent Achieved
Office of Engineering and Technology	1,943	2,018	96.2%
Wireless Telecommunications Bureau	551,560	595,639	92.6%
Media Bureau*	16,289	18,452	88.3%
International Bureau	1,901	3,323	57.2%
Wireline Competition Bureau	838	1,795	46.6%
Total Agency	**572,531**	**621,227**	**92.1%**

* Represents data from former Mass Media Bureau (1st two quarters) and new MB data (last 2 quarters).

By comparison, in FY 2001, the number of applications received electronically by the FCC was 77% of the total filings processed (475,871 out of 617,259), exceeding the Commission's 70% projected goal, and representing a 17% increase over FY 2000.

In FY 2002 a total of 110 application and licensing services[16] were available to the public, of which 74 (67%) had automated licensing/filing capability, utilizing 20 electronic filing, licensing, and public access systems.[17]

In late FY 2000, the FCC entered into a consolidated Programming Services Contract (PSC), providing technical support for numerous information technology systems throughout various FCC bureaus and offices. Four groups of contractor staff, each supporting application systems by a "system group" – Administrative, Financial, Licensing, or Tracking – provide system technical and enhancement support. Key agency-wide licensing/filing systems, such as the Electronic Comment Filing System, Electronic Tariff Filing System, Operations Support for Complaint Analysis and Resolution, are interspersed among the administrative and tracking contract tasks. This approach was adopted to promote efficient use of contract staff and funding economies, and provide technical resource skills and knowledge sharing among the various applications in (and among) system groups. This concept also provides the added benefit of reducing time spent waiting for availability of the right technician by allowing them to "task share" among various technical support activities.

For FY 2002, PSC technical support is funded and managed by each system group, such as the Licensing Group, and not by individual system applications. Commencing in FY 2004, the implementation of the new cost accounting system will provide the FCC with the means to track contractor costs to the individual application level.

The FCC expended $22.0 million of total appropriated funds in FY 2002 toward the Commission's information technology (IT) program, including base-level funds for day-to-day IT operations, bureau and office application systems maintenance, and limited life-cycle replacement. Of the expended amount, approximately, $2.9 million (13%) was used for

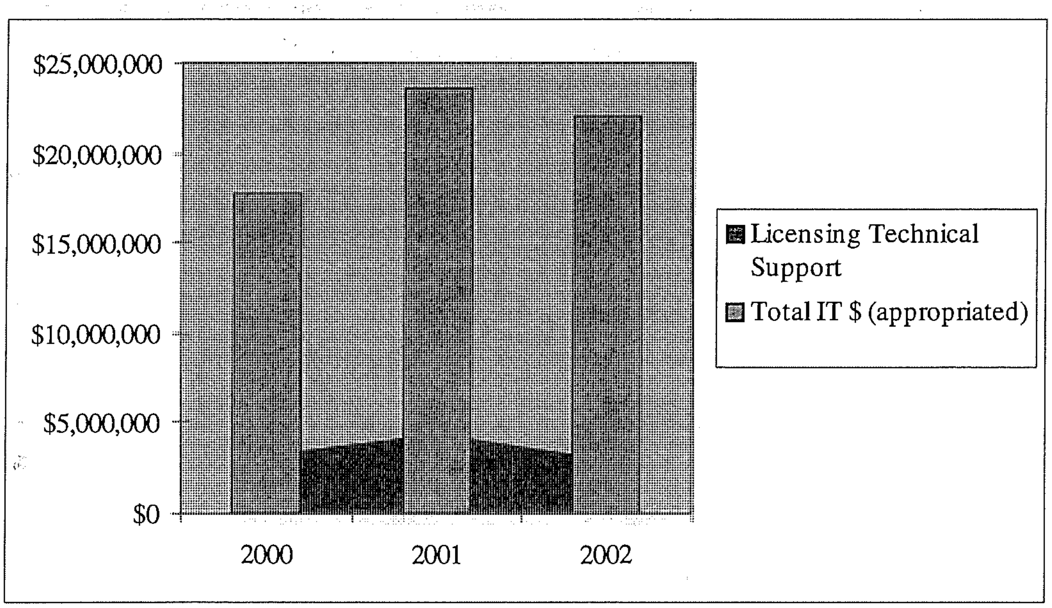
[16] A "service" refers to a discrete application or license.
[17] The FCC recently reviewed application, licensing and public access services to update related information on the FCC's automated capabilities.

electronic filing and licensing system enhancements, technical support, enhanced security, and development.

In FY 2001, the FCC expended $23.6 million of total appropriated funds toward the Commission's IT program. Nearly $4.4 million (19%) of these expenditures were obligated for electronic filing and licensing systems enhancements, technical support, and development.

Figure 5 details actual expenditures for technical support of electronic licensing/filing systems and total IT spending for FYs 2000 - 2002. To more accurately reflect overall costs related to IT, in FY 2002 the expenditures reflect consolidated balances, rather than individual bureau/office expenditures.

Figure 5: Comparison of Licensing/Filing Systems Technical Support and Total IT Dollars – FYs 2000-2002



FY	Licensing Technical Support	Total IT $ (appropriated)	%
2000	$3.2 million	$17.7 million	18%
2001	$4.4 million	$23.6 million	19%
2002	$2.9 million	$22.0 million	13%

The Consumer Information Management System (CIMS) is a strategic initiative being undertaken by the CGB to reengineer its consumer center business processes and to modernize the associated technology infrastructure. While not an electronic licensing/filing system per se, CIMS will remove obsolete and unsupported information tracking technologies, reduce the existing multiple-database environment, and simplify workflows. The overriding goal of CIMS is to create a FCC consumer center that emulates industry best practices and deploys the best available commercial software. In FY 2002, CGB completed CIMS Phase II, which focused on validating requirements and identifying the recommended solution set. This solution set includes products to address electronic case management and workflow, telephony, and database technology. In FY 2003, the CGB will build and deploy CIMS resulting in a quantum leap in the FCC's ability to provide service to the public and meet its e-government goals. Security features will be stringently administered and the ability to capture documents and attachments, such as electronic images, will reduce workflow time and eliminate paper-tracking processes. Once implemented, CIMS will simplify public use of FCC systems and provide the FCC with a single, integrated ("unified messaging" concept), resource to quickly obtain accurate and up-to-date information.

2. *LICENSING:*

Strategic Goal – Create a More Efficient, Effective and Responsive Agency

Performance Objective – Streamline Agency's Processes & Procedures

Performance Measure – Improve speed of disposal for processing license applications

This performance measure promotes efficient and innovative licensing and authorization of services by creating a faster, flatter, more functional FCC. Across the Commission, the FCC must invest in new technologies that will improve processes and allow the Commission to be as responsive to customers as possible. The FCC must be structured to react quickly to market developments, to work more efficiently with a competitive industry, and to focus on bottom line results for consumers. Ultimately, the Commission must be able to render decisions quickly, predictably, and without imposing needless costs on industry or consumers through unnecessary delays.

Policy Initiative – Measurement	**FY99**		**FY00**		**FY01**		**FY02**	
	Goal	*Actual*	*Goal*	*Actual*	*Goal*	*Actual*	*Goal*	*Actual*
Speed of Disposal (SOD) – Percentage of applications disposed within SOD goal	90%	88%	90%	89%	90%	94%	95%	96%

Each of the bureaus and affected offices sets customer service speed of disposal goals for the processing and disposing of license applications, tariff filings, formal complaints, and cable service activities. Internal and external factors, including resources for staffing and estimates of workload, play a role in the FCC's ability to meet goals for processing license applications. In some cases, conflicting applications, complex legal and engineering questions, and other issues impact the measurement of speed of disposal. During FY 2002, the MB transferred all Multichannel Multipoint Distribution Service, and Instructional Television Fixed Service licensing activities to the WTB as a part of the reorganization. In a separate effort, as part of the Chairman's initiative to streamline our processing goals, MB no longer distinguishes between routine and non-routine and has reduced processing goals to 12 months or less (except for Low Power TV). The FCC is continuing its reviews in an effort to improve consistency in measuring the speed of disposal.

Tracking of the speed of disposal goals is based on "non-routine," "routine," and "blocked" categories, defined generally as follows:

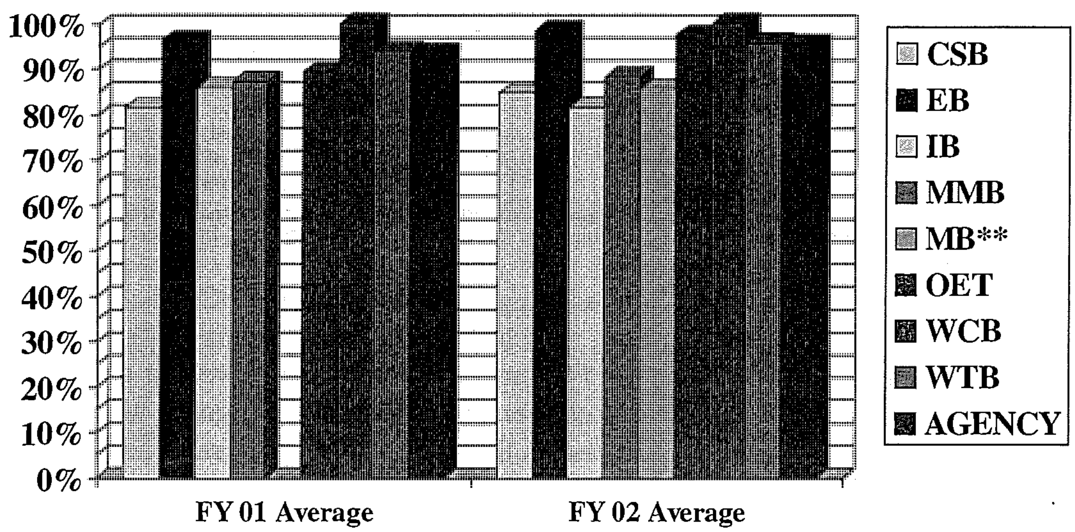
- ✓ **Routine:** applications/cases/proceedings that are uncontested, non-blocked, and do not involve waivers or any complex matters or circumstances.

- ✓ **Non-routine:** applications/cases/proceedings that are contested or involve rule waivers, conflicting proposals or other issues within the bureau's purview.
- ✓ **Blocked:** applications/cases/proceedings that involve issues or processing outside of the Commission's control.

In FY 2002, a total of 635,967 actions were disposed of; 608,701 of which were disposed within the Commission's speed of disposal goals. Agency-wide, the percentage of actions disposed of within these goals was 95.7%, exceeding the 95% target.

Of the 603,417 actions disposed of in FY 2001, 565,830 were disposed of within the goals. Agency-wide, the percentage of actions disposed of within the goals was 93.7%.

Figure 6:
Percentage of Actions Disposed Within Speed of Disposal Goals
FY 2002 Goal: 95%



Source of Data: SOD Reports from bureaus/offices.
**Reflects combined data of Mass Media Bureau & Cable Services Bureau, merged in the MB. Prior data for Mass Media Bureau and Cable Services Bureau is included to reflect activity prior to the March 2002 merger.

3. ***LICENSING:***

Strategic Goal – Create a More Efficient, Effective and Responsive Agency

Performance Objective – Streamline Agency's Processes & Procedures

Performance Measure – Substantially reduce our backlog, including licensing applications, petitions for reconsideration, and other proceedings

This performance measure promotes efficient and innovative licensing and authorization of services by creating a faster, flatter, more functional FCC with substantially reduced backlogs in licensing applications, petitions for reconsideration, and other proceedings. The FCC must be structured to react quickly to market developments, to work more efficiently with a competitive industry, and to protect consumers.

Policy Initiative – Measurement*	FY99		FY00		FY01		FY02	
	Goal	*Actual*	*Goal*	*Actual*	*Goal*	*Actual*	*Goal*	*Actual*
Backlog Reduction – Number of applications backlogged vs. number of applications received. (Backlog is 1.5 times the speed of disposal goal.)	No FY99 goal.	--	60% (not to exceed 40% of receipts)	96% (4% of receipts by end of 4th qtr.)	90% (not to exceed 10% of receipts)	98.5% (1.5% of receipts on average)	95% (not to exceed 5% of receipts)	98.3% (1.7% of receipts on average)

* In some cases the FCC may not meet timelines due to external requirements (e.g., involvement of outside entities).

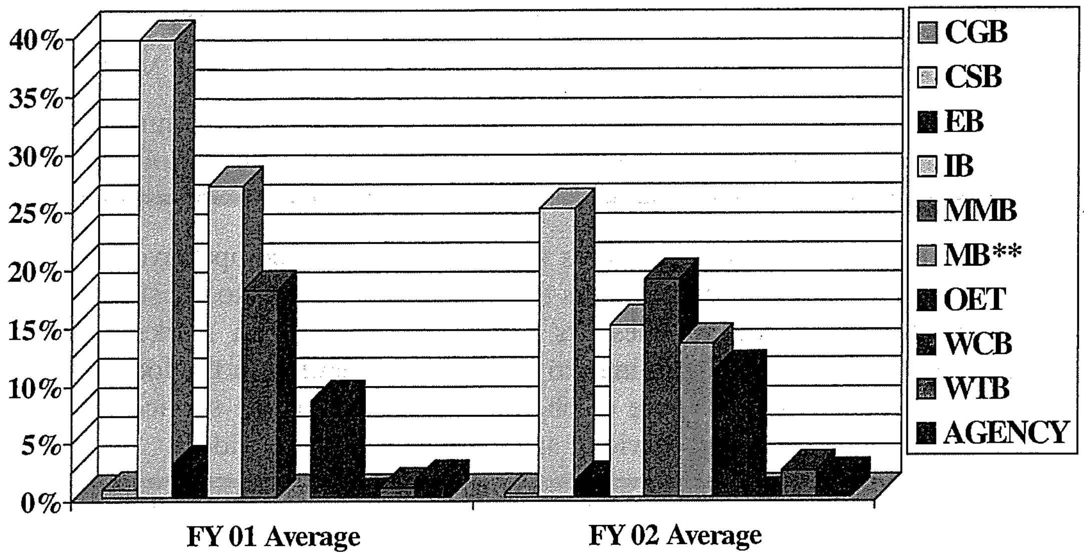
In calculating the percentage of backlogged applications, the FCC incorporates the workload for processing new applications, which impacts the Commission's ability to respond to overage cases. In FY 2002, the FCC maintained backlog levels at approximately 1.7% of receipts on average over the four quarters (exceeding the 5% goal), with a minor drop in the second quarter and a minor increase in the third quarter. Overall, the FCC reduced backlog by 98% FCC-wide.

In FY 2001, the FCC reduced backlogs from 3.1% in the first quarter to 0.82% in the fourth quarter. Overall, by the end of FY 2001, the FCC reduced its backlog by 99% FCC-wide. On average, backlogs were 1.5% of receipts, thus exceeding the goal of 10%. In some cases, these backlogs existed due to technical issues unresolved within the industry, processing procedures in the satellite space program, and broadcast auction procedures.

By reducing the number of forms required, and enabling the public to file applications electronically, the FCC will be in a better position to respond to backlogged applications, thereby providing better customer service.

Figure 7: Backlog Reduction Efforts

(Percentage of Total Workload Identified as Backlogged – i.e., 1.5 times the SOD Goal)



Source of Data: SOD Reports from bureaus/offices.
**Reflects combined data of Mass Media Bureau & Cable Services Bureau, merged in the MB. Prior data for Mass Media Bureau and Cable Services Bureau is included to reflect activity prior to the March 2002 merger.

4. *COMPETITION*:

Strategic Goal – Promote Competition in All Telecommunications Markets

Performance Objective – Eliminate Barriers to Entry in Domestic Markets

Performance Measure – Complete the opening of local telecommunications markets through pro-competitive unbundling, interconnections & co-location policies

This performance measure promotes the development of competitive, innovative, and high quality communications systems. As the Commission strives to assist in the rapid expansion of innovative new technologies, its role will change from market regulator to market facilitator. The FCC will continue to promote competition in the local exchange market to dramatically increase the range of choices in local telephone service providers, multipoint video programming market services, and mobile wireless providers.

Policy Initiatives – Measurement	***Goal***	***Actual Performance***
Competition – Percent growth in competition and consumer options – "State of Competition Reports"	**FY99:** ➢ Implement local competition provisions of the Telecommunications Act of 1996.	**FY99:** ➢ Implemented a variety of rulemakings designed to provide guidance in the areas of unbundling, co-location, line-sharing, and pricing in order to facilitate local competition.
(A) Competitive Local Exchange Carriers (CLECs)	**FY00:** ➢ 15% of households with 1 CLEC; ➢ 10% have 2 new CLECs.	**FY00:** ➢ 88% of households within zip code with 1 new CLEC; ➢ 78%[18] of households with 2 new CLECs.
	FY01: ➢ 30% of households live in zip codes with 1 CLEC; ➢ 10% with 2 CLECs.	**FY01:** ➢ 91% of households resided in zip codes with at least 1 CLEC; ➢ 83% with 2 CLECs.
	FY02: ➢ 90% of households live in zip codes with 1 CLEC; ➢ 80% with 2 CLECs; ➢ 10% with 3 CLECs.	**FY02:** ➢ Results will not be available until the summer of 2003.

[18] Represents a revised estimate from 77% as included in the FY 2001 Annual Financial Report to 78% due to a rounding error.

Policy Initiatives – Measurement	*Goal*	*Actual Performance*
(B) Advanced Technologies: Advanced Cable Services and Multichannel Video Programming Distributors (MVPDs)	**FY99:** ➢ No FY99 goal **FY00:** ➢ 15% of households with access to advanced cable; ➢ 10% of households with access to 3 or more MVPDs. **FY01:** ➢ 15% of households with access to advanced cable; ➢ 10% of households with access to 3 or more MVPDs. **FY02:** ➢ 10% of households with access to 3 or more MVPDs.[19]	 **FY00:** ➢ Goals exceeded by end of calendar year 2000. Approximately 58% of TV households have access to advanced cable (cable modem) service. ➢ 91% have access to 3 or more MVPDs; 5%[20] have access to 4 or more; 5% have access to 5 or more. **FY01:** ➢ Goals exceeded by end of calendar year 2001. Approximately 66%[21] of TV households have access to advanced cable (cable modem) service. ➢ 91% have access to 3 or more MVPDs; 6% have access to 4 or more. **FY02:** ➢ Goals exceeded by the end of calendar year 2002. ➢ 91% have access to 3 or more MVPDs; 6% have access to 4 or more.
(C) Mobile Wireless Providers	**FY99:** ➢ No FY99 goal. **FY00:** ➢ 73% of households with access to 5 or more mobile wireless providers. **FY01:** ➢ 78% of households with access to 5 or more mobile wireless providers. **FY02:** ➢ 80% of households with access to 5 or more mobile wireless providers.	 **FY00:** ➢ 75% of households with access to 5 or more providers. **FY01:** ➢ 80% of households with access to 5 or more mobile wireless providers. **FY02:** ➢ Results will not be available until the summer of 2003.

In FY 1999, the FCC implemented a variety of rulemaking decisions designed to provide guidance in the areas of unbundling, co-location, line-sharing, and pricing in order to facilitate local competition. These decisions prescribe certain minimum points of interconnection necessary to permit competing carriers to choose the most efficient points at which to interconnect with the incumbent local exchange carrier's (ILEC) network. While the actual pricing regulation is left to the states, the FCC provides a methodology for establishing the rates for interconnection and the purchase of unbundled elements. The

[19] In FY 2002, the FCC did not include penetration of advanced cable services as a goal in the Annual Performance Plan. While data is still tracked for advanced communications systems (of which cable is one option) a goal was not set in the APP.
[20] Amount varies slightly from the FY 2001 Annual Financial Report due to revised estimates from the bureau (to 5%).
[21] Figure varies slightly from the FY 2001 Annual Financial Report due to revised estimates from the bureau.

FCC's cost-based pricing methodology is based on forward-looking economic costs, and is at the core of bringing competition to the communications market.

In March 2000, the Commission established a local competition and broadband data-gathering program to assist the Commission in its efforts to monitor and further implement the pro-competitive, deregulatory provisions of the 1996 Act. Under this program, service providers file reports with the WCB (formerly the Common Carrier Bureau) twice a year, providing data that allows the FCC to examine competition and barriers to entry. The MB collects similar industry information once each year (this was formerly done by the Cable Services Bureau). The data is used to develop competition reports on the communications industry. In some cases, these reports are based on the calendar year ending December 31 or based on a July 1 to June 30 year. In no cases, however, do they follow the FCC's Federal fiscal year.

Competitive Local Exchange Carriers

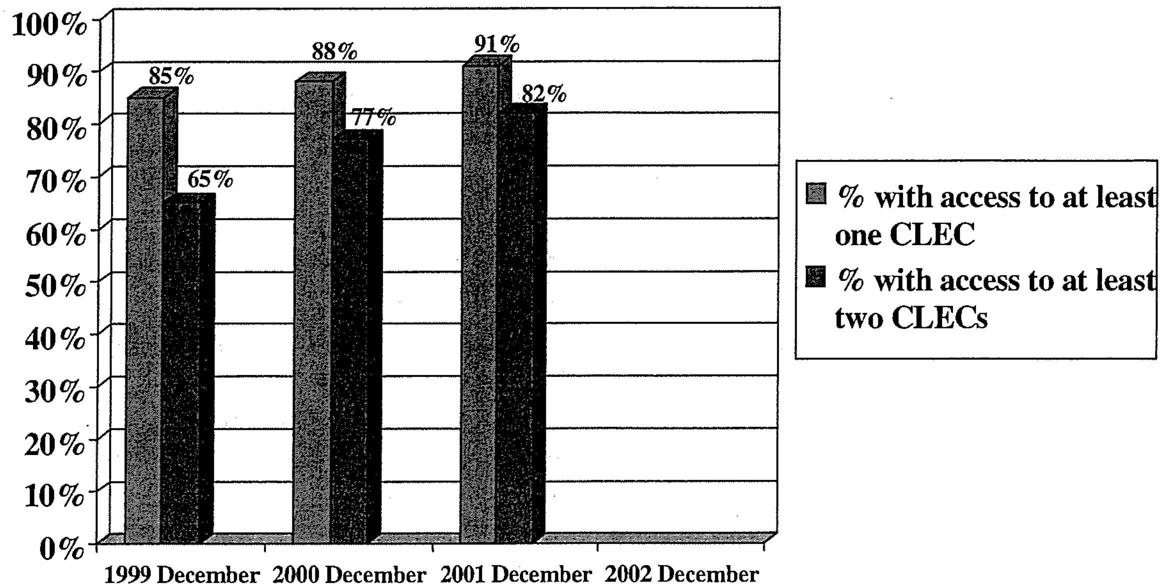
During FY 2001, the Chairman met with several competitive local exchange telephone carriers (CLECs) to discuss and assess what is working in the industry, technological obstacles, and best practices to bring effective competition to local phone markets. These meetings are examples of FCC outreach to better understand the industry.

As shown in Figure 8, at the end of calendar year 2001, approximately 91% of U.S. households resided in zip codes in which at least one CLEC was present, and 83% resided in zip codes in which at least two CLECs were present, exceeding FCC's goals of 30% and 10%, respectively. CLECs served local telephone service end-user customers in 62% of the nation's zip codes, up from 56% in calendar year 2000. CLECs reported 19.7 million (or 10.2%) of the approximately 192 million switched access lines that were in service nationwide at the end of December 2001, compared to 17.3 million (or 9% of nationwide lines) six months earlier. This represents a 14% growth in CLEC market size during the second half of 2001.[22] Calendar year 2002 data will be available in Summer 2003.

At the end of calendar year 2000, 88% of U.S. households resided in zip codes with access to at least one new local exchange carrier and 78% had access to two, exceeding the FCC's goals of 15% and 10%, respectively. By comparison, at the end of calendar year 1999, 85% had access to at least one CLEC.[23] By the end of calendar year 2000, CLECs reported that 14.9 million (or 7.7%) of the approximately 193 million nationwide local telephone lines that were in service to end-user customers, compared to 11.6 million (or 6.0%) six months earlier. This represented a 29% increase in the CLEC market size during the second half of calendar year 2000.[24]

[22] "Local Telephone Competition: Status as of December 31, 2001," Industry Analysis and Technology Division of the Wireline Competition Bureau, Federal Communications Commission, July 2002. Statistics can be found in Table 1 and Table 13.
[23] This percentage is obtained externally from industry reports based on calendar year ending December 31, 1999.
[24] "Local Telephone Competition: Status as of December 31, 2000," Industry Analysis Division of the former Common Carrier Bureau, Federal Communications Commission, May 2001.

Figure 8: Local Exchange Carrier Competition
(FY 2002 Goal: 90% of Households with Access to 1 CLEC
80% with access to 2; 10% with access to 3)



Source of Data: "Local Telephone Competition: Status as of December 31, 2001" except that December 31, 1999 data is obtained externally from industry reports based on the calendar year ending December 31. Results indicate availability within zip code only; the percentage of residential customers currently is lower than the access rate. December 2002 statistics will not be available until Summer 2003.

Advanced Cable Services and Mutichannel Video Program Distribution

Advanced telecommunications capability refers to the availability of high-speed, switched, broadband telecommunications that enables users to "originate and receive high-quality voice, data, graphics, and video using any technology." "Advanced telecommunications capability" and "advanced services" can support two-way (provider-to-customer/downstream and customer-to-provider/upstream) communications with a broadband width in excess of 200 kilobits per second (kbps). "High-speed" services are those with over 200 kbps in at least one direction.[25]

External factors impact the FCC's ability to meet this goal: With many of the new technologies in their infancies, uncertainty remains as to the final capability of some services. In addition, the degree of consumer demand for these new communications services remains unknown, and in these initial stages, prices may outstrip demand. The FCC continues to take steps to remove barriers to deployment, to encourage investment in technologies that deliver advanced services, and vigorously promote competition in the marketplace. The FCC has encouraged initiatives that facilitate the increased speed of deployment of advanced services, by participating in a Joint Federal-State Conference on Advanced Services ("Joint Conference"), promoting competition-friendly laws, encouraging strategic planning and investment by state and local governments, and helping foster

[25] "High-Speed Services for Internet Access: Subscribership as of December 31, 2001," Industry Analysis Division of the Wireline Competition Bureau, Federal Communications Commission, July 2002.

activism among local business and consumer groups. The FCC continues to work with stakeholders on how the FCC or state commissions can better encourage deployment of advanced telecommunications services generally by utilizing "price cap regulations, regulatory forbearance, measures that can promote competition in the local telecommunications market, or other regulatory methods that remove barriers to infrastructure investment."[26]

On December 31 2002, the FCC released the "Ninth Annual Report on Competition in the Market for the Delivery of Video Programming." The report found that competitive alternatives and consumer choices continue to develop. Cable television remained the dominant technology for the delivery of video programming to consumers, although its market share continues to decline. Unlike other competition reports, the data provided in this report is based on the year ending June 30.[27]

The total number of subscribers to both cable and noncable multichannel video program distributors (MVPDs) increased to 89.9 million TV households as of June 30, 2002, an increase of 1.8% over the 88.3 million households subscribing to MPVDs in June 2001. The number of cable subscribers reached nearly 68.8 million as of June 2002, an increase of about 0.4% from the 68.6 million cable subscribers in June 2001. The total number of noncable MVPD subscribers grew to 21.1 million as of June 2002, an increase of more than 9% over the 19.3 million subscribers in June 2001. The growth of noncable MVPD subscribers continues to be primarily attributable to the growth of direct broadcast satellite (DBS) service, which now represents 20.3% of all MVPD subscribers. Some of this increase is attributable to the authority granted to DBS operators to distribute local broadcast television stations in their local markets, which makes DBS service more comparable to cable service and a better competitive alternative for consumers.

As of June 2001, the total number of subscribers to both cable and noncable MVPDs had increased to 88.3 million TV households, an increase of 4.6% over the 84.4 million households subscribing to MPVDs in June 2000. Specifically, the number of cable subscribers reached nearly 69 million in June 2001, an increase of about 1.9% from the 67.7 million cable subscribers in June 2000. The total number of noncable MVPD subscribers grew from 16.7 million in June 2000 to 19.3 million in June 2001, an increase of more than 15%.

The market for the delivery of video programming to households continues to be highly concentrated and characterized by substantial barriers to entry. These barriers may include: (a) predatory conduct including "predatory pricing;" (b) strategic behavior by an incumbent to raise its rival's costs by limiting the availability to rivals of certain popular programming as well as equipment; and (c) local and state level regulations, including delay in gaining access to local public rights-of-way facilities as well as delay in getting cable franchises.[28]

As shown in Figure 9, by the end of calendar year 2002, 91% of households had access to at least three or more MVPD providers far exceeding the 10% goal. In addition, 6% of

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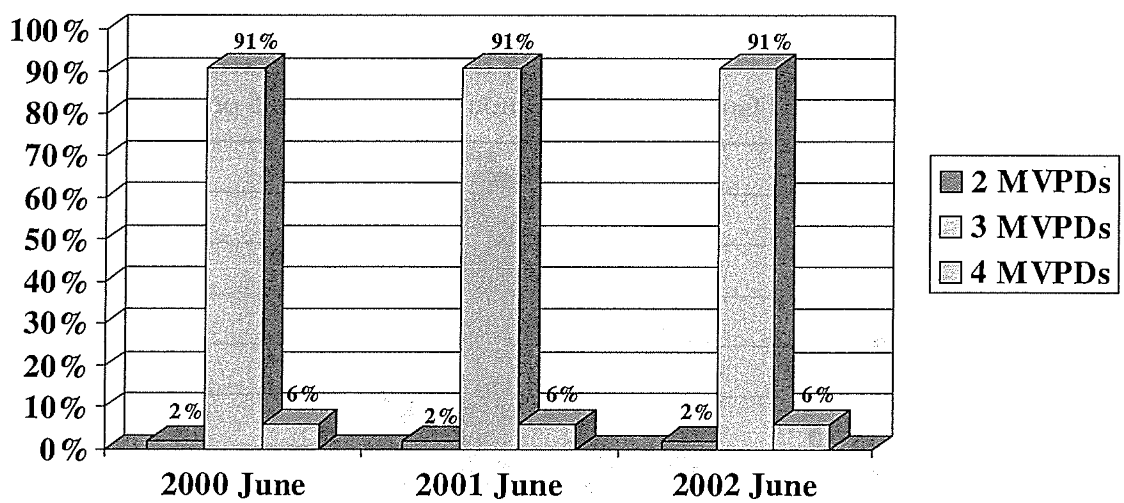
[26] FCC's "Third Notice of Inquiry" released August 10, 2001 (CC Docket No. 98-146).
[27] Note: the FY 2000 Annual Financial Report mistakenly reported data as calendar year end data, rather than June 30 data.
[28] FCC 02-338, "Ninth Annual Report: Annual Status Competition in the Market for Delivery of Video Programming," Media Bureau, December 31, 2002, page 52.

households had access to four or more MVPD providers. These figures were unchanged from the previous two years.

By the end of calendar year 2001, 91% of households had access to at least three or more MVPD providers far exceeding the 10% goal. In addition, 6% of households had access to four or more MVPD providers. These figures were unchanged from calendar year 2000.

By the end of calendar year 2000, 5% of households had access to at least five or more MVPD providers, falling short of the 10% goal.[29] To better reflect ongoing consolidation in the MVPD industry, the FCC changed the annual goal to track households with access to 2, 3, or 4 or more distributors.

Figure 9: Multichannel Video/Broadcasting Penetration
(FY 2002 Goal: 10% of Households with Access to 3 or More Multichannel Video Programming Distributors)



Source of Data: "Ninth Annual Report on Competition in the Market for the Delivery of Video Programming." The data is obtained externally from industry reports based on the calendar year ending June 30.

Access to Wireless Providers

According to the FCC's "Seventh Annual Report on the State of Competition in the Commercial Mobile Radio Service," adopted by the FCC in June 2002, by the end of December 2001, there was continued strong growth in the mobile telephony sector. Subscribership increased from 109.5 million to 128.5 million and produced a nationwide penetration rate of roughly 45%. As shown in Figure 10, at the end of calendar year 2001, 268 million people, or 94% of the total U.S. population, lived in counties with access to three or more different operators (cellular, broadband PCS, and/or digital specialized mobile radio providers). Over 229 million people, or 80% of the U.S. population, lived in counties with five or more mobile telephone operators, exceeding FCC's goal of 78%. And, 151

[29] In order to reflect the ongoing consolidation in the MVPD industry, the FCC no longer tracks the number of households with access to 5 or more distributors.

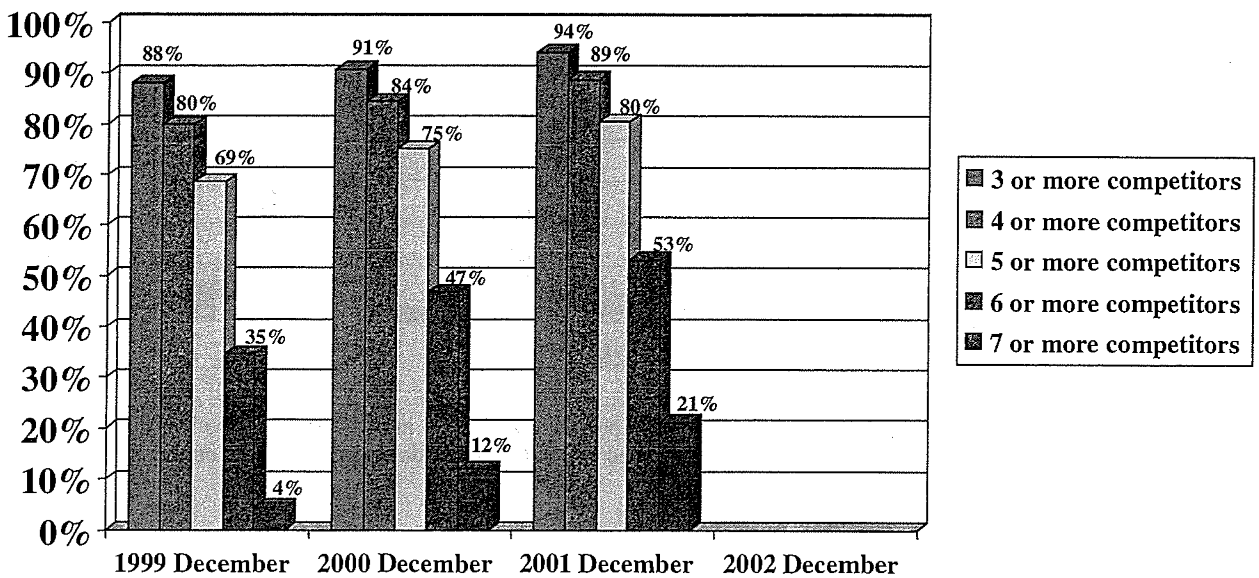
million, or 53% of the population, lived in counties with six different mobile telephone operators.[30]

By comparison, according to the FCC's "Sixth Annual Report on the State of Competition in the Commercial Mobile Radio Service" at the end of calendar year 2000, 259 million people, or almost 91%, had access to three or more different operators offering mobile telephone services in the counties in which they lived. Over 214 million people, or 75% of the U.S. population, lived in areas with five or more mobile telephone operators competing to offer service. And 133 million people, or 47% of the population, could choose from at least six different mobile telephone operators.[31]

Data in Figure 10 below is based on coverage by county. A carrier need only cover a small portion of the geographic area in order to be considered providing service, so coverage is overstated. Digital technology is now dominant, with digital subscribers now comprising approximately 80% of all wireless subscribers (up from 72% in calendar year 2000). Additionally, the average price of mobile telephone service declined, continuing the previous year's trend.

Figure 10: Wireless Competition

(FY 2002 Goal: 80% Population with Access to 5 or More Providers)



Source of Data: "Seventh Annual Report on the State of Competition in the Commercial Mobile Radio Service," June 2002. The data is obtained externally from industry reports based on the calendar year ending December 31. December 2002 statistics will not be available until Summer 2003.

[30] "Seventh Annual Report on the State of Competition in the Commercial Mobile Radio Service," FCC's Seventh Annual Report (FCC 02-179) adopted June 13, 2002.

[31] "Sixth Annual Report on the State of Competition in the Commercial Mobile Radio Service," FCC's Sixth Annual Report (FCC 01-192) released July 17, 2001.

5. ***COMPETITION***:

Strategic Goal – Promote Competition in All Telecommunications Markets

Performance Objective – Deregulate where Appropriate to Promote Competition

Performance Measure – Reduce the burden of filing, reporting, record keeping and accounting requirements across all communications industries

This performance measure encourages the development of competitive, innovative, high quality communications systems, with a minimum of regulation, or with an absence of regulation where appropriate in a competitive market. The FCC is eliminating barriers to competition by deregulating where appropriate, and eliminating outdated rules to reduce the burden on participants in FCC programs.

Policy Initiative – Measurement	***Goal***	***Actual Performance***
Forms Reduction – Percent reduction in the number of forms / information collections required by the FCC	**FY99:** ➢ Continue to evaluate whether certain regulations are no longer necessary in the public interest and should be repealed or modified.	**FY99:** ➢ Initiated a number of rulemakings to eliminate obsolete or overlapping regulations and/or reporting requirements identified in the FY98 Biennial Review of agency's rules and regulations.
	FY00: ➢ Complete an aggressive 2000 Biennial Review aimed at eliminating unnecessary rules and regulations. ➢ 10% reduction in the number of forms required by the FCC, using FY99 as a baseline.	**FY00:** ➢ Biennial Review completed on schedule. The FCC issued a Memorandum Opinion and Order relaxing a number of mass media procedures. ➢ 14 forms eliminated, and 12 added for an annual reduction of 1.4%.[32]
	FY01: ➢ 20% reduction in the number of forms required by the FCC, using FY99 as a baseline.	**FY01:** ➢ Goal partially met. ➢ During FY01, eliminated 20 forms / established 9 new forms with a year-end total of 130, representing a 9.1% reduction from FY99 (143 forms), and a 7.8% reduction from FY00 (141 forms).[33] Due to increases in number of forms, the result of data collection requirements imposed by Congress, failed to meet this goal.
	FY02: ➢ 30% reduction in the number of forms required by the FCC, using FY99 as a baseline.	**FY02:** ➢ During FY 2002, the FCC eliminated 12 forms and added 1 new form, representing a 16.8% reduction over FY99. Due to the reorganization, 11 forms were transferred from MB to WTB.

[32] During FY 2000, the agency did not have a mechanism in place to efficiently track the total number of FCC forms, and numerous forms identified by the OMB were counted twice. The correct number of forms at the end of FY 2000 was 141, thus changing the percentage in forms reduction from 7% to 1.4%.

[33] As noted above, the change in the number of forms impacted the calculation of the percent change in the FY 2001 Annual Financial Report – rather than 7.9%, the total reduction from FY 2000 was 7.8%.

According to performance data collected from the various bureaus and affected offices, the total number of FCC forms at the start of FY 2002 was 130 Commission-wide. During FY 2002, the FCC eliminated 12 forms and added 1 new form. Due to the reorganization, 11 forms were transferred from MB to WTB. The total number of forms at the end of FY 2002 was 119, representing an 8.4% reduction from FY 2001 and a 16.8% reduction over baseline (FY 1999), falling short of the 30% goal. The FCC has determined that a preferred way to measure the Commission's progress in reducing reporting requirements would be a review of half of the FCC's forms annually, to streamline and modernize forms, where appropriate. This performance measurement will be implemented in FY 2003.

The total number of forms at the start of FY 2001 was 141 Commission-wide. During FY 2001, 20 forms were combined or eliminated, and 9 new forms were approved. The total number of forms at the end of FY 2001 was 130, representing a 7.8% reduction over FY 2000.

6. ***COMPETITION***:

Strategic Goal – Promote Opportunities for All Americans to Benefit from the Communications Revolution

Performance Objective – Promote Access For All Americans to Communications Services

Performance Measure – Continue oversight of the universal service discount mechanism for schools; fully implement the Schools and Libraries Program

This performance measure encourages the development of competitive and innovative communications systems, by promoting opportunities for all Americans to access existing and future communications services. As the FCC strives to promote competition, it will continue to monitor the marketplace to ensure that the benefits of advanced telecommunications services and the new information economy is available to everyone, able-bodied or disabled, in every school, instructional classroom, and library as well as in high-cost, low-income, and rural communities throughout the United States.

Policy Initiative – Measurement	*Goal*	*Actual Performance*
Schools and Libraries – Percentage of public school instructional rooms receiving telecommunications services, Internet access, or internal connections at reasonable rates.[34]	**FY99:** ➢ Improve the connections of instructional classrooms, libraries and rural health facilities to the Internet. **FY00:** ➢ 75% of schools and libraries connected to the Internet. **FY01:** ➢ 90% of public school instructional rooms connected to the Internet. **FY02:** ➢ 93% of public school instructional rooms connected to the Internet.	**FY99:** ➢ Released Order extending funding for schools and libraries to get connected to the Internet. **FY00:** ➢ 77% of public school instructional rooms connected to the Internet. **FY01:** ➢ 87% of public school instructional rooms connected. **FY02:** ➢ FY02 statistics will not be available until the summer of 2003.

The Schools and Libraries support mechanism of the USF – often called the Education rate or "E-rate" – provides support for eligible schools and libraries to help offset the cost of telecommunications services, including advanced communication services and equipment. The range of discounts available corresponds to the income level as well as the location of the school or library (e.g., urban or rural). The income level for a school or district is measured by the percentage of students eligible for the National School Lunch Program.

In FY 2002, the USF collected gross receipts of approximately $2.23 billion, with outlays of approximately $1.84 billion for the Schools and Libraries mechanism. In FY 2001, the USF collected gross receipts of approximately $1.98 billion, respectively, with outlays of approximately $1.69 billion, respectively.[35] The EOY balance for the Schools and Libraries mechanism increased from $2.01 billion in FY 2001 to $2.40 billion in FY 2002. Figure 11 provides the end of year (EOY) receipts, outlays and fund balance for the Schools and Libraries support mechanism. Overall, the fund balances for the Schools and Libraries Program have built-up as a result of universal service billings that were assessed based on projections of demand. Distributions of funding, however, may lag due, for example, to the timing of: the receipt of applications, review, approval, and applicant revisions.

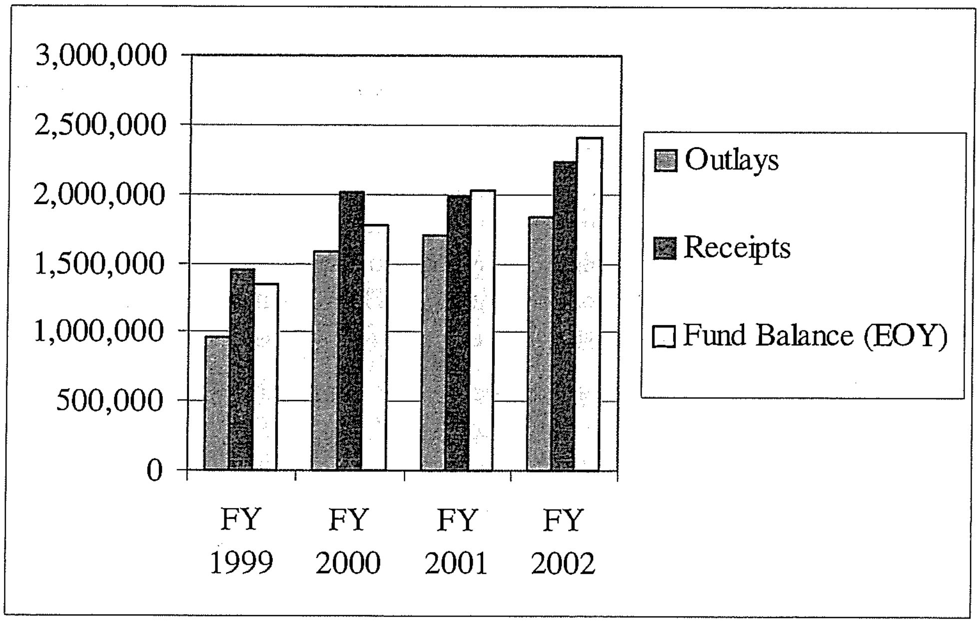
By the fall of 2001, approximately 99% of public schools (as distinct from instructional rooms)[36] were connected to the Internet, an increase of 1% over the previous year's results (98% in the fall of 2000). The percentage of public school instructional rooms connected to the Internet increased dramatically to 87% (a significant increase over the previous year's connection rate of 77%), however, the results were below the FCC's goal of 90%. This goal was not met because the demand for priority one services (telecommunications and Internet access) had increased substantially, leaving less funding for priority two services (internal connections that bring access to individual classrooms. As has been the case in previous

[34] Performance for Universal Service and related goals is derived from data obtained from the Universal Service Administrator and from the National Center for Educational Statistics, and is based on a fiscal year starting July 1st and ending June 30th.
[35] Gross receipts and outlays are based on monthly SF-224 reports, using the FCC's FY October 1 to September 30.
[36] Instructional rooms include classrooms, computer and other labs, library/media centers, and other rooms that are utilized for instructional purposes.

years, instructional room connection rates in schools with the highest minority enrollment (50% or more) and the highest poverty concentration (75% or more of the students eligible for school lunch programs) continued to lag behind other schools. However, despite the differences, Internet connections in these schools continued to increase in 2001 from 64 to 81% in instructional classrooms with high minority enrollment and from 60 to 79% in instructional classrooms with the highest poverty concentration.[37]

Instructional classroom connection rates for 2002 will be available when the National Center for Education Statistics (NCES) publishes their 2003 report in the summer of 2003.

Figure 11:
FYs 1999 – 2002 USF Schools and Libraries Mechanism
(in thousands)



In addition to the Schools and Libraries support mechanism, the USF also comprises the High-Cost, Low-Income, and Rural Health Care Support mechanisms. Figures 12, 13 and 14 provide trend data on the year-end receipts, outlays and fund balance for each of these three support mechanisms, respectively.

In FY 2002, the High Cost Support mechanisms collected gross receipts of approximately \$2.61 billion (an increase from FY 2001 with \$2.60 billion) and outlays of approximately \$2.57 billion (a reduction from FY 2001 with \$2.63 million). The EOY balance increased from \$70.6 million in FY 2001 to \$110.1 million in FY 2002. The High Cost Support mechanism has been impacted by two recent developments: changes adopted by the Commission based on recommendations of the Rural Task Force and the creation of a new High Cost Support mechanism, the Interstate Common Line Support.

[37] National Center for Education Statistics, "Internet Access in U.S. Public Schools and Classrooms: 1994-2001" (September 2002), U.S. Department of Education, Office of Educational Research and Improvement (NCES 2002-018).

In FY 2002, the Low Income mechanism had gross receipts of approximately $607.2 million (a reduction over FY 2001 with $633.2 million), and outlays of approximately $661.6 million (an increase over FY 2001 with $569 million). The EOY balance decreased from $122.8 million in FY 2001 to $68.5 million in FY 2002. Reductions in the EOY balance for this mechanism occurred primarily because of process change improvements that eliminated some of the lag time in the funding process.

The Rural Health Care mechanism had gross receipts of approximately $27.6 million in FY 2002 (an increase over FY 2001 with $9.1 million), and outlays of approximately $33.0 million (an increase over FY 2001 with $5.5 million). The EOY balance decreased from $10.0 million in FY 2001 to $4.7 million in FY 2002. Decreases in the EOY balance occurred due to the increase in popularity of the program evidenced by a significant increase in applications. Despite this increase, efficiency in the release of funds has enabled the EOY fund balance to remain fairly stable.

Figure 12: FYs 1999 – 2002 USF High Cost Mechanism
(in thousands)

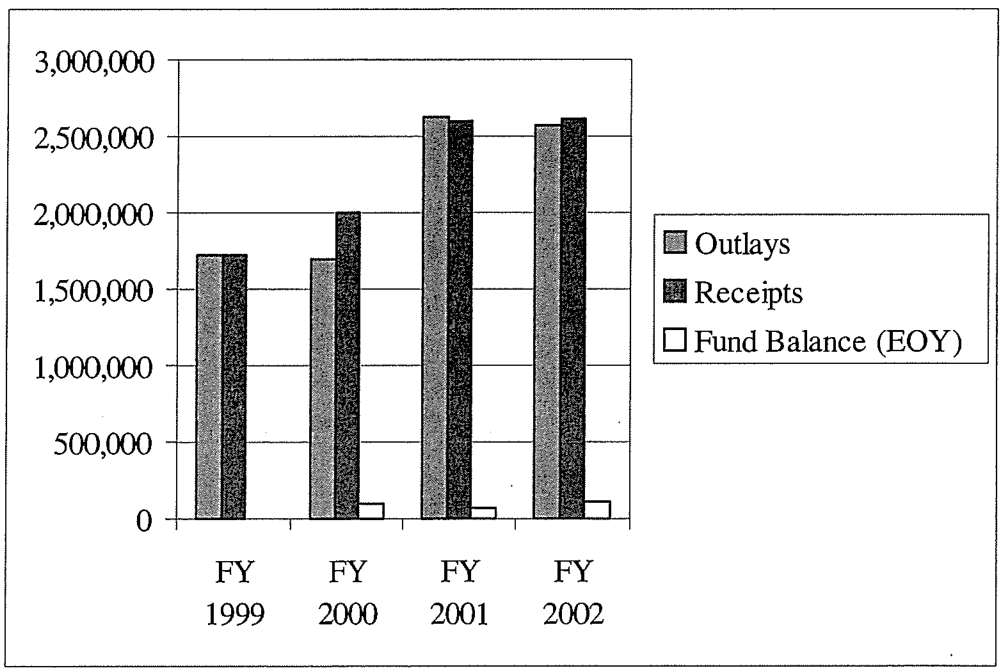


Figure 13: FYs 1999 – 2002 USF Low Income Mechanism

(in thousands)

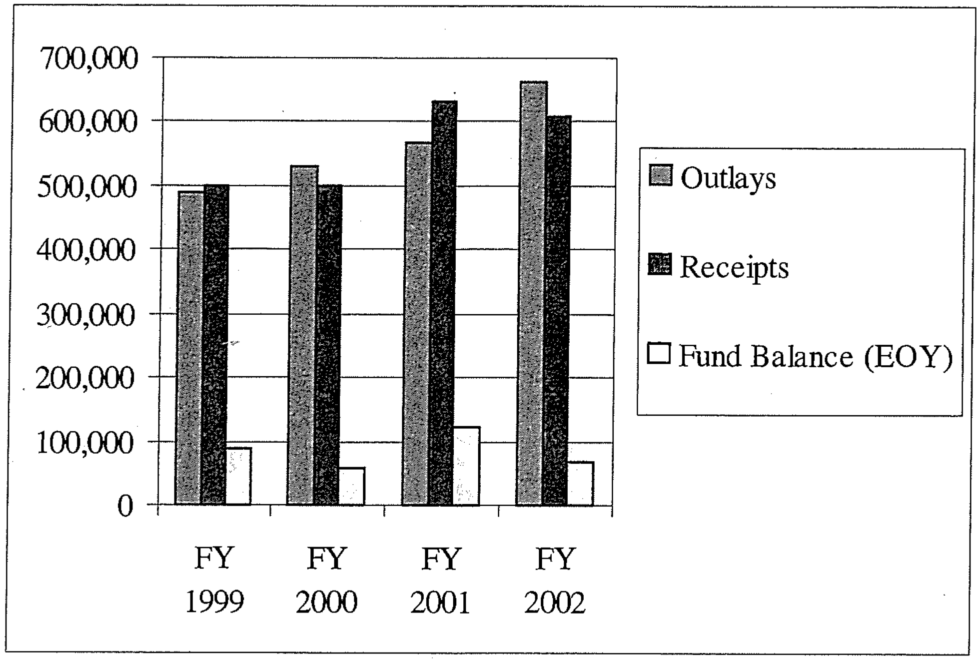
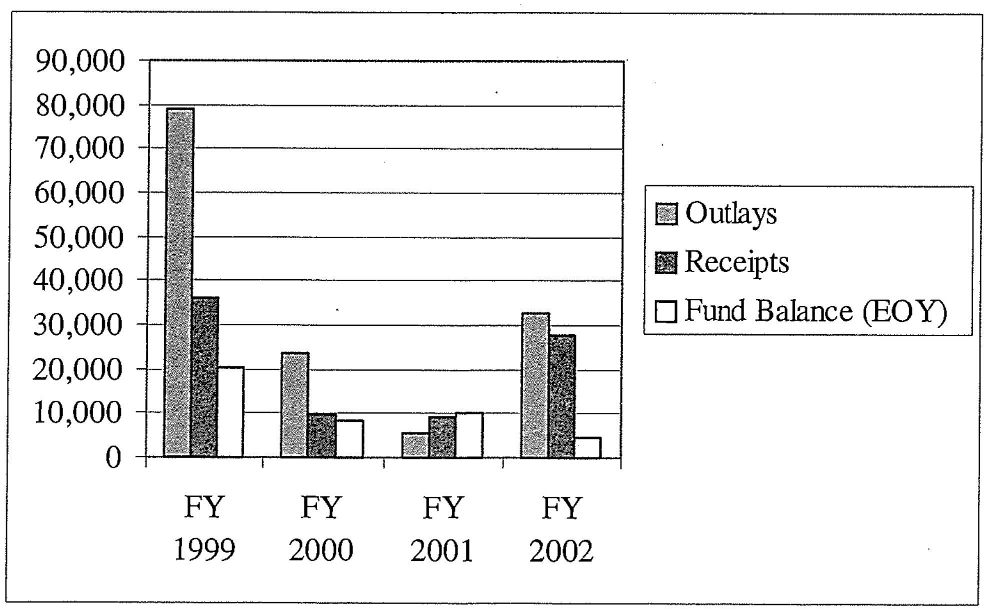


Figure 14: FYs 1999 – 2002 USF Rural Health Care Mechanism

(in thousands)



7. ***ENFORCEMENT*:**

Strategic Goal – Promote Competition in all Communications Markets

Performance Objective – Enforce the Rules so that Businesses Compete Fairly

Performance Measure – Show zero tolerance for perpetrators of consumer fraud such as slamming and cramming; impose substantial monetary forfeitures against the worst offenders

This performance measure is part of the FCC's efforts to enforce the Act, as amended, the 1996 Act, and the Commission's rules, regulations, and authorizations. These enforcement efforts involve investigations, inspections, compliance monitoring, and sanctions, including civil monetary penalties (CMPs). The FCC promotes the public interest and pro-competitive policies by enforcing statutory provisions and rules and regulations that ensure that Americans are afforded efficient use of communications services and technologies. By enforcing the rules, businesses will compete more fairly.

Policy Initiative – Measurement	***Goal***	***Actual Performance***
Zero Tolerance – Percent reduction in the number of informal long distance slamming complaints.	**FY99:** ➢ No FY99 goal.	
	FY00: ➢ 10% reduction in the number of informal long-distance slamming complaints.	**FY00:** ➢ Data collection procedures were under review such that it was not possible to determine if goal was met. However, significant monetary fines were levied on carriers guilty of slamming practices ($5.65 million collected) and 9 major slamming actions were taken.
	FY01: ➢ 20% reduction in the number of informal long-distance slamming complaints.	**FY01:** ➢ The FCC exceeded its goal with a 51% reduction in the number of informal long-distance slamming complaints. This reflects the industry's attempt to be more consumer-oriented, to avoid any illegal action and to provide the consumer with a more reliable, consumer friendly service. Approximately $520,000 was collected and 10 major slamming actions were taken.
	FY02: ➢ 40% reduction in the number of informal long-distance slamming complaints.	**FY02:** ➢ 41% reduction in the number of informal long-distance slamming complaints.

Slamming is the illegal practice of changing a consumer's preferred local or long distance telecommunications provider without permission. The FCC adopted new slamming liability rules (effective November 2000), which allow states to "opt in" to become the primary forums for administering the slamming liability rules and resolving individual slamming complaints. Where states do not opt in, the FCC administers the rules.

The Commission's slamming liability rules provide a remedy to better protect consumers by requiring unauthorized carriers to absolve consumers of unauthorized charges and to reimburse authorized carriers and consumers for charges already paid. These rules help to eliminate profits for telephone companies that slam consumers. Where the consumer has not paid the unauthorized carrier, the consumer will be absolved of the obligation to pay for service for up to 30 days after a slam. Where the consumer has paid the unauthorized carrier, the rules require the unauthorized carrier to pay 150% of the charges it received from the consumer to the authorized carrier, which must, in turn, reimburse the consumer 50% of the charges paid by the consumer.

Consumers file informal slamming complaints (by phone, letter, e-mail), and the FCC or the "opt-in" state serves the carrier with the complaint. Carriers have 30 days to respond. The Commission staff then puts out an order making a determination about the carrier's liability. If consumers are unhappy with the outcome they may file a formal complaint with the FCC. Complaints by carriers against other carriers are generally formal complaints (adjudications governed by formal procedural rules). In addition to enforcing the slamming complaint rules, the FCC regularly tracks informal slamming complaints filed with both the FCC and the states, and where the trend shows repeat slamming cases, the FCC serves a "Notice of Apparent Liability" (i.e., a notice of proposed forfeiture). The carrier has 30 days to file a response to the Notice of Apparent Liability or pay the proposed forfeiture amount. In some cases, the FCC concurs with the carrier's response and lowers the proposed fine in the resulting Forfeiture Order. These forfeiture proceedings have resulted in millions of dollars in fines levied against unauthorized carriers.

In FY 2002, a total of 4,179 informal long-distance slamming complaints were filed with the FCC, representing a 41.2% reduction over FY 2000 (baseline). Approximately, 1,986 additional complaints were forwarded to "opt-in" states to resolve (under the provisions noted above), and therefore were not included in the FCC's FY 2002 results. While the FCC met the FY 2002 goal with over 40% fewer slamming complaints in FY 2000, the number of slamming complaints filed with the FCC increased between FYs 2001 and 2002. One possible reason for the increase in complaints may be due to the fact that the FCC has successfully educated consumers, through fact sheets, brochures and direct outreach, about their right to seek refunds due to the new slamming liability rules. To manage the increase in pending slamming complaints, the FCC has detailed six staff within the CGB to process cases more quickly. Additionally, in order to deter slamming, the FCC continues to fine violators. During FY 2002, the FCC issued one Forfeiture Order in the amount of $1,020,000 and one Notice of Apparent Liability for $1,200,000. The FCC is working with the Department of Justice (DOJ) to collect the $1,020,000 forfeiture, and the FCC is evaluating the carrier's response in the $1,200,000 proceeding.

In FY 2001, 3,493 informal long-distance slamming complaints were filed with the FCC for resolution, representing a reduction of 50.8% over FY 2000. Approximately 2,300 additional slamming complaints received by the FCC in FY 2001 were forwarded to the "opt-in" states to resolve, and therefore were not included in the FCC's FY 2001 results. The FCC also completed ten major actions (i.e., issued a Forfeiture Order, Consent Decree, and/or Petition for Reconsideration) against six carriers, and $520,000 was collected for slamming offenses against one carrier. Where the FCC is unable to collect fines, or negotiate an appropriate settlement, the cases are referred to the DOJ for collection. The FY

2000 performance plan did not include quantitative goals for reducing the number of slamming complaints. However, in FY 2000, the FCC received a total of 7,104 slamming complaints filed with the Commission by members of the public. During FY 2000, the FCC completed nine major actions against eight carriers guilty of slamming practices. The FCC collected $5.65 million for violations from three of the carriers.

8. ***SPECTRUM MANAGEMENT*:**

Strategic Goal – Manage the Electromagnetic Spectrum in the Public Interest

Performance Objective – Foster the Increased Availability of Spectrum

Performance Measure – Increase the availability of flexibly allocated spectrum for new services by 20% (over FY 2000); initiate third generation (3G) spectrum allocations

This performance measure promotes efficient and effective management of the Nation's airwaves for all non-Federal Government users, including commercial, international business, and public safety users. Spectrum management includes the structures and processes for allocating and assigning this scarce resource in a way that promotes competition while ensuring the public interest is served. The Commission employs market-based solutions to maximize use of spectrum in an efficient and equitable manner.

Policy Initiative – Measurement	***Goal***	***Actual Performance***
New Services – The number of new mobile, fixed, and broadcast services.	**FY00:** ➢ Initiate actions to promote the development of new services. ➢ Allocate 4 GHz of spectrum for unlicensed services. **FY01:** ➢ Increase the availability of flexibly allocated spectrum by 20% (baseline: FY00). ➢ Initiate 3G spectrum allocations. **FY02:** ➢ Increase availability of flexibly allocated spectrum by 20% (baseline: FY00). ➢ Implement 3G spectrum allocation and service rules.	**FY00:** ➢ Received a total of 100 applications to support the development of new technology applications in 7 services. ➢ Completed a Report and Order allocating 2 GHz of spectrum for unlicensed services. **FY01:**[38] ➢ Completed a proceeding to add flexibility to 190 MHz of spectrum at 2.5 GHz. ➢ Initiated Advanced Wireless Services (includes 3G) spectrum allocations by issuing a *Notice of Proposed Rulemaking*. **FY02:** ➢ Completed spectrum allocations in two separate proceedings for 77 MHz of spectrum transferred from Federal government use and 48 MHz of spectrum reallocated from TV broadcast use. ➢ Completed flexible spectrum allocations for 125 MHz, an increase of 47.6% (baseline: FY 00 of 262.5 MHz). ➢ Advanced Wireless Services (3G) spectrum allocations were delayed until after FY 2002 assessment completed.

[38] Note that information provided in the FY 2002 Annual Financial Report differs from the previous year's results as the OET provided updates reflecting corrected FY 2001 performance data.

In June 2002, the FCC created a Spectrum Policy Task Force to improve spectrum management by identifying and evaluating changes in spectrum policy that will increase the public benefits derived from the use of the radio spectrum. The Task Force was directed to:

- Recommend ways to evolve the current "command and control" approach to spectrum policy into a more integrated, market-oriented approach that provides greater regulatory certainty, while minimizing regulatory intervention.
- Assist the Commission in addressing ubiquitous spectrum issues, including interference protection, spectral efficiency, effective public safety communications, and implications of international spectrum policies.

Spectrum is divided into bands of frequencies. Each band is associated with one or more allocations, which determine the type of use allowed (*e.g.*, fixed, mobile, broadcast, etc.). Some of the considerations in determining allocations include: public need and benefits; amount required to provide a particular service or services by one or more licensees; technical considerations, including interference control with other services; and economic viability of services. Finding spectrum for new services includes efforts to increase sharing (different services using the same spectrum) or reallocating spectrum for different uses (and relocating incumbent users to other spectrum).

Advanced wireless service systems – including those employing "3G" services - will provide access, by means of one or more radio links, to a wide range of telecommunication services supported by fixed networks and to other services specific to mobile users. These services are likely to employ a range of mobile terminal types (for mobile or fixed use) that link to terrestrial and/or satellite-based networks. Key features of 3G systems include: a high degree of commonality of design worldwide, compatibility of services, use of small pocket terminals with worldwide roaming capability, and Internet and other multimedia applications. It is likely that many of the applications developed for the advanced wireless services will include one or more of these attributes.

Because of the critical nature of Federal Government-use spectrum, the transfer of spectrum to non-Federal Government use has been a complex and time-consuming process. For example, in July 2001, the Department of Commerce (DOC) and the FCC agreed to postpone the FY 2001 deadline for the Commission to identify spectrum allocations for 3G systems until FY 2002. The National Telecommunications and Information Administration (NTIA), the Department of Defense (DOD), the Commission and other government stakeholders worked together to identify spectrum for advanced wireless services. The interagency effort included the examination of existing Federal operations in spectrum already earmarked for transfer to non-Federal use – specifically, the 1710-1755 MHz band. The terms of the transfer would have allowed certain Federal operations – both military and non-military to continue indefinitely. Permissible, grandfathered, operations at 16 military facilities would have particularly impeded the development of new nationwide services. An interagency working group developed a creative plan that can be used to relocate the majority of these operations to other bands no later than 2008, thus substantially clearing the band for commercial use.

In July 2002, NTIA announced that 90 MHz of spectrum could be made available for advanced wireless services in the United States. However, the spectrum was not allocated until early FY 2003. On November 7, 2002, the FCC issued a *Second Report and Order* that allocated two contiguous 45 MHz frequency bands for fixed and mobile services. Additionally, the FCC issued a companion *Notice of Proposed Rulemaking* that proposed licensing and servicing rules to permit these bands to be used for any service consistent with the bands' fixed and mobile allocations, including provision of advanced wireless services. This spectrum is intended to provide capacity for new wireless carriers and additional capacity for existing wireless carriers to keep pace with consumer demand for new and innovative services. The Commission will also continue to evaluate whether additional spectrum can be made available for wireless services, as future events warrant.

In FY 2002, seven auctions of spectrum were held, and the FCC recorded $133.5 million in net winning bids. This amount represents the net winning bids excluding possible defaults as well as the costs to the FCC of $77.9 million. Auction of the Upper 700 MHz band (Auction No. 31) and portions of the Lower 700 MHz band (Auction No. 44) were postponed from FY 2002 to FY 2003. Additional information on these delays is discussed in the "Highlights to the Financial Statements" section of this MD&A. The FY 2003 President's Budget submitted in FY 2001 estimated that a total of $530 million in auction receipts would be generated from the anticipated auctions in FY 2002.

In FY 2001, four auctions of spectrum were held, and the FCC recorded $16.9 billion in net winning bids. This amount represents the net winning bids excluding possible defaults and the costs to the FCC of $67.5 million. This amount is recognized as revenue when a final payment date is established by a Public "prepared to grant" Notice rather than when the auction is held or cash is received.

There were several reasons for the increase in costs to support the spectrum auction program activities from $67.5 million in FY 2001 to $77.9 million in FY 2002. The increases reflect: annualized pay increases to provide personnel compensation and benefits as well as increases resulting from enhanced accuracy in cost reporting for commission-wide on-board staff and the addition of direct staff increases to support the program; overhead costs in previously underreported areas such as information technology; increases in building rent, telephone service, utilities, etc. associated with the increase in FTE support; supplies, equipment and security costs to house and support the Revenue Accounting and Management Information System, the Commission Registration System (CORES); as well as the costs of security enhancements to respond to concerns raised as a result of "9-11" to ensure employee safety and implement previous OIG security audit recommendations; increased costs for loan maintenance, storage and support as well as contract costs for full loan servicing by a major financial services firm; licensing litigation costs, physical and computer security, additional audit related costs, including enhanced inventory control support, audit travel, auctions program services contract increases; and upgrades to auctions infrastructure including IT equipment and software and physical plant upgrades in the Gettysburg facility. In FY 2002, the FCC was apportioned $12.066 million to support the administrative costs related to the spectrum auction Credit Programs.

Financial Management – Legal Compliance, Systems, and Controls

Legal Compliance

The FCC, like other Federal agencies, is required to comply with statutes and regulations related to appropriations, safety and health, and employment. Compliance with such requirements is the responsibility of FCC management. The OMD has responsibility for implementing accounting and financial policies, systems, and reports; improving the reliability of financial information; implementing debt collection; and implementing financial management legislation including the following:

- ✓ Prompt Payment Act of 1982
- ✓ Federal Managers' Financial Integrity Act of 1982
- ✓ Cash Management Improvement Act of 1990
- ✓ Federal Credit Reform Act of 1990, as amended
- ✓ Chief Financial Officer's Act of 1990
- ✓ Government Performance and Results Act of 1993
- ✓ Government Management Reform Act of 1994
- ✓ Federal Financial Management Improvement Act of 1996
- ✓ Debt Collection Improvement Act of 1996
- ✓ Reports Consolidation Act of 2000
- ✓ Accountability for Tax Dollars Act of 2002

In the FCC's efforts to achieve compliance with applicable legislation, it is necessary to have effective management and system controls in place. The FCC has established formal policies and procedures regarding the processing, maintaining, and reporting of financial information. The FCC has updated its policies and procedures for financial-related sections (e.g., Accounts Receivable, Budget, Revenue, Administrative Expenses). Revisions to remaining sections, including policies and procedures for the preparation of the financial statements and performance measures, are currently in progress. Although the FCC has made significant improvement with regards to its management controls, additional improvement is needed as indicated by the results of the FY 2001 financial statement audit. These improvement efforts are described below.

Systems

The Financial Systems Operations Group, within the OMD, oversees maintenance support for the system controls of the financial systems. The following summarizes several significant financial systems:

- ✓ Federal Financial System
- ✓ Revenue & Accounting Management Information System
- ✓ Collections System
- ✓ Management Cost Accounting System

The Federal Financial System (FFS) is a commercial off-the-shelf (COTS) software package, which serves as the FCC's central accounting system. FFS runs on a mainframe located at the Department of the Interior's (DOI) National Business Center (NBC) in Denver, Colorado. The DOI NBC provides system maintenance support through a cross-servicing agreement. FCC staff within the office of the Associate Managing Director – Financial Operations (AMD-FO), performs system operations, maintenance of system tables, and security administration for the

FFS application. The system is supplemented by a data warehouse, which provides ad hoc reporting capabilities.

The Revenue Accounting and Management Information System (RAMIS) is a COTS software package modified to handle all of the collections, accounts receivables, and loan management specific to the FCC. It is designed to interface with the FCC's central accounting system, FFS, and licensing systems throughout the Commission. Once all reporting modules are complete, all collection activity of the FCC will be recorded and tracked in RAMIS. RAMIS will also record the collection of receipts, produce dunning letters for past due accounts, and track account forfeitures submitted to the OGC for referral to the DOJ for collection. Implementation of RAMIS is intended to assist the FCC in achieving better system integration, as well as to meet system requirements established by the Joint Financial Management Improvement Program (JFMIP). As of the date of the FY 2002 audit, the RAMIS system is serving as the system of record for all fines and forfeitures activities. It also records collections received from Mellon Bank in parallel with the Collections System.

The Collections System is a custom-built database application designed to store and display all collections accounting information for the FCC. It is designed to interface with licensing and other systems throughout the Commission. In FY 2002, the FCC began phasing out the processing of application and regulatory fees in the Collections System in conjunction with the implementation of RAMIS.

Also as part of the RAMIS implementation, use of the Nortridge Loan System (NLS), the COTS software package formerly used to track the Spectrum Auction Direct Loan Portfolio program, was discontinued. The information from the Nortridge database, at the time of retirement, is still available for historical records through a data warehouse, which provides the FCC with the capability to retrieve and print payment histories.

The AMD-FO is in the process of developing requirements for a streamlined automated management cost accounting system that will be in compliance with high-level core financial system requirements for cost and budget management as prescribed by the JFMIP. The AMD-FO is planning to link the MCAS to in-house software, and is planning a three-phase approach. The first phase is to implement a cost accounting system, followed by a budget formulation/execution system, and finally, in the third phase, the FTE tracking and reporting system. The cost accounting system transition should begin with system testing in late FY 2003. Once implemented in FY 2004, the MCAS will provide a financial management system that offers FCC management an increased level of detail concerning the cost of doing business. Financial management data and information, which is accurate, timely, and consistent across FCC bureaus and offices, will be available simultaneously to program managers, financial managers and budget officials. The MCAS will support budget and cost control, performance measurement, fee and price determinations for reimbursements, program evaluations, and economic decisions. The MCAS will use JFMIP-certified COTS managerial cost accounting and budget formulation and execution applications and related implementation support services.

Not included as part of its financial systems, but still an important financial management tool for FCC management in FY 2002, are the Loan Model Spreadsheets used to calculate loan balances on the FCC's credit reform loans. On a monthly basis, the spreadsheets are updated with the monthly collections from RAMIS. This process was previously done through the NLS, but after several months of parallel downloading of collections information during FY 2002, the FCC now receives the collections information directly from RAMIS. The Loan Model Spreadsheets have been maintained by an outside contractor throughout the course of the year and have served as the basis for numbers used in the calculation of FCC's subsidy reestimate and loan subsidiary records. Ultimately, these spreadsheets will be replaced by an outside loan servicing system.

The FCC has contracted with a major financial services firm to provide loan servicing for the portfolio, document management, and Uniform Commercial Code (UCC) review and filing services. The FCC will complete the transfer of loan data to its new loan service provider in December 2002, with the full loan servicing implementation scheduled for January 2003. The FCC also tasked the service provider with producing a document management, imaging and retrieval system. A secure password-protected system, it can be accessed via the Internet. The system further allows users to electronically store, retrieve, copy and correlate data and images directly from their desktop. The FCC currently has the ability to search and retrieve loan documents from desktops, thereby eliminating the need to manually store and research files.

Internal Controls

The FCC has in place numerous internal controls over financial reporting that provide reasonable assurance the financial statements do not contain material misstatement, and fairly present information related to assets, liabilities and net position. As noted in the preceding section, transactions are executed in accordance with budgetary and financial laws, consistent with the FCC statutory requirements, and are recorded in accordance with Federal accounting standards. Additionally, assets are properly acquired and used, safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud. Further, the FCC internal controls exist to assure the existence and completeness of the performance measures, as required by OMB Bulletin 01-09 (*Form and Content of Agency Financial Statements*).

The FCC received a qualified opinion in FY 2001 due to scope limitation in the areas of cost allocation, the USF and other entities. Auditors found material weaknesses for the following:

1. Financial Reporting
   a. controlling quality in the preparation of financial statements
   b. supervising the USF and TRS Fund financial reporting process
   c. addressing changes in accounting for program costs
   d. obtaining auditable financial data from Local Number Portability Administration
   e. integrating financial management systems
   f. correcting and updating financial system setup and posting model definitions
   g. recording activities in a timely manner and preparing and analyzing financial activity
   h. improving Federal Agencies' Centralized Trial Balance (FACTS) reporting process
   i. resolving a combination of reportable conditions, including recovering USF disbursements
2. Cost Accounting System
3. USF and TRS Fund Financial Reporting
4. Loans Receivable and Related Accounts
   a. improving loan subsidiary ledger system
   b. reconciling general ledger to the subsidiary ledger balances

5. Information Technology
    a. creating a comprehensive security plan in compliance with OMB Circular A-130
    b. improving controls to protect FCC information
    c. accelerating efforts to develop and test contingency plans

Additionally, the auditors identified the following reportable conditions for the FCC to:

1. Improve Controls Surrounding Data used in the Preparation of the Management's Discussion and Analysis (MD&A)
2. Improve Internal Controls over Certain Accounts Receivable
3. Improve Supporting Documentation and Controls on Property and Equipment
4. Improve Controls over Accounts Receivable and Accounts Payable Subsidiary Records
5. Ensure Compliance with Clinger-Cohen Act of 1996
6. Conduct OMB Circular A-127 and A-130 Reviews

In accordance with the Federal Managers' Financial Integrity Act (FMFIA), the FCC has identified corrective actions to be taken during FY 2002 for the purpose of addressing material weaknesses and reportable conditions related to internal controls. The FCC has created a team to address all findings in the internal control report. The team has identified items that can be resolved in the short- (this fiscal year), medium- (next fiscal year), and long-term. Issues being addressed related to FY 2002 financial reporting include: continued efforts to develop policies and procedures for improved quality control over preparation of financial statements; increased oversight of USF and TRS reporting through development of new procedures; improvements in the cost accounting system through training employees on the proper use of the revised activity codes and emphasizing the importance of properly coding their time; continued efforts to address certain FCC fund specific issues to improve the financial reporting process; timely recording activities are anticipated as management becomes more familiar with processes; and improved FACTS reporting will be addressed through planned staff training. As noted earlier in this report, the cost accounting system is being addressed in the short term, and the FCC hopes to begin testing the cost accounting system by the end of FY 2003, with implementation in FY 2004. Increased controls over the financial reporting of the USF and TRS Fund have been put in place. For example, a new procedure for USF and NANP was established to include both a low level and senior management review of information submitted prior to inclusion in the financial statements. In FY 2002, the FCC established a monthly cash reconciliation process to improve control over the application of cash in the loan model for loan receivables and related accounts. Once the RAMIS and loan servicing systems are fully implemented and integrated with FFS, the FCC will establish a monthly loan balance reconciliation.

The FCC also identified corrective action plans for non-conformances including: developing, documenting and implementing policies and procedures and program evaluations to address several noted deficiencies, continuing implementation of new financial systems for increased level of controls and elimination of manual processes, resolving several property, plant and equipment items such as capitalized versus non-capitalized costs, increasing controls over accounts receivable and payable, and reducing the use of journal vouchers by implementing additional compliant standard journal entries.

As in the past, the OGC determined that NANP is an entity of the FCC and therefore should, if deemed material by management, be included in the FCC's FY 2002 financial statements. The determination for it as an entity is primarily based on the level of FCC oversight of the program and the program's close connection to the FCC's core mission. Administratively, the NANP program is subject to controls including the ability to: select or remove administrators; review or change carrier contribution factors; veto or modify management decisions; and require audits.

Possible Future Effects on the FCC – Looking Ahead

The Commission has identified certain demands, risks, uncertainties, events, conditions, and trends that may impact the FCC's ability to achieve its goals and objectives in the future. A range of external factors may affect the continued development of competition in telecommunications markets. An overview of nine potential factors follows.

First, convergence-driven competition depends heavily on *market and economic uncertainties*. To date, traditional wireline telephone service providers, cable operators, wireless firms, and satellite companies have made massive investments in new networks that do, or will, allow:

- ✓ telephone companies to offer high-speed Internet and possibly video service,
- ✓ cable operators to offer phone service and high-speed Internet,
- ✓ wireless companies to offer phone service reliable and inexpensive enough to compete for basic local voice telephony, and
- ✓ satellite companies to offer television, radio and high-speed Internet.

With the current economic situation in the telecommunications industry, including high-profile bankruptcies, restructuring and putative mergers, the pace of investment in these networks may be impacted, and competition may be slower to develop.

Second, significant *technological uncertainty* remains for many new converged technologies. For example, although the carriage of voice traffic over packet-based, Internet Protocol (IP) networks promises significant new competitive entry into the local and long distance voice markets, "IP telephony" technology is still developing. Also, the use of shared "tree-and-branch" networks, such as hybrid fiber-coax cable networks for voice or data service, similarly poses technical obstacles at moderate to high penetration levels. Until the full reliability of cable networks can be demonstrated, the competitive impact of cable entry into telephone and data markets may be delayed. As a third example, a significant factor in the development of robust competition in the broadband access market is the slow rate of technological development of various "xDSL" (digital subscriber lines which provide high-speed data transmission) technologies that will be used to offer high-speed service over copper telephone loops. Each of these, as well as many other technological factors, could affect the rate at which competition develops across communications markets.

A third category of uncertainty is the degree of *consumer demand for new communications services*. Many new services, such as high-speed Internet access, digital television (DTV), wireless data service, and satellite-delivered services will continue to be deployed by service providers, and many market analysts forecast strong consumer adoption rates. However, the breadth and depth of long-term consumer demand for these new services remain unknown. The business models of many new competitors hinge on combining multiple existing and new services on a single service delivery platform. The profitability of companies that are "overbuilding" new hybrid fiber-coax networks to compete with cable and telephone incumbents depends on selling customers bundles of service including multichannel digital video, high-speed Internet access, and telephony. Only by combining revenue streams can new entrants, saddled with heavy network construction costs, compete with incumbents operating existing networks. If consumer adoption of new services fails to meet expectations, competition could be slower to develop.

The fourth factor, combining *both consumer demand and impacts on equipment manufacturers*, involves the recent plan to give consumers access to digital programming over television by requiring off-air DTV tuners on nearly all new TV sets by 2007. The FCC's five-year rollout plan starts with larger, more expensive TV sets to minimize the costs for both equipment manufacturers and consumers. The FCC estimates that approximately 81 million television sets in the U.S. (over 30% of the total) rely solely on free, over-the-air broadcasting (i.e., via antennae vs. cable or satellite). About 46.5 million of these sets that rely on over-the-air service are in broadcast-only homes (i.e., where cable and/or satellite are not available). While the DTV tuner will initially add costs, economies of scale will drive costs down for manufacturers and consumers.

Fifth, the prospects for competitive communications markets are significantly affected not only by national developments, but also by *developments in world markets*. The opportunities for increased competition in the United States can be more fully realized if other countries join us in fostering competition in their communications marketplaces. Market access restrictions in foreign countries significantly impede U.S. companies' ability to compete on a global scale. Specifically, the FCC's vision of fully competitive communications markets in the U.S. is contingent, to some degree, on whether other nations also establish the necessary conditions for deregulation, competition, and increased private investment in their communications infrastructure. The FCC's success will depend on vigorous enforcement of the market access commitments set forth in the 1997 World Trade Organization (WTO) Agreement on Basic Telecommunications Services.

The Commission's ability to carry out its vision also is largely dependent on a sixth category of uncertainty—*adequate resources to carry out critical activities*. In many cases, the FCC will need to redeploy existing budget and staff resources to address changing priorities. The FCC is planning a three-phase approach for implementation of new systems for cost accounting, budget formulation and execution, and FTE tracking and reporting. The cost accounting system transition should begin by the end of FY 2004. These systems will improve the Commission's ability to appropriately allocate resources and to more accurately link resources to performance. The FCC's success is tied directly to its ability to maintain critical staffing levels and adequate funding. Moreover, for the FCC to fulfill its congressional charge, it will write and execute a new strategic plan built along the following dimensions: (1) a clear policy vision for broadband, spectrum, media, competition, and homeland security and (2) a pointed emphasis on management that builds a strong team, produces a cohesive and efficient operation, and leads to timely decisions.

Seventh, the *recent financial upheavals* in the telecommunications industry and the resulting impact on the stock market caused by questionable business practices have led to a reexamination of enforcement activities, including auditing and accounting reviews of common carriers. In July 2002, the FCC asked Congress to extend the Commission's ability to prevent service disruptions, to increase the maximum fines the FCC can impose in enforcement actions, and to provide the right regulatory environment for the provision of broadband services. Specifically, the request asked for an increase in the maximum fine allowable under the Act from $120,000 to $1 million for a single violation and from $1.2 million to $10 million for a continuing violation and to lengthen the statue of limitation for common carrier enforcement.[39] While the FCC has taken measures to ensure that the American public continues to have uninterrupted access to essential communications services, the current instability in the telecommunications industry will continue to affect the economic viability of both conventional and technologically innovative new communications services.

> ***"With the events of September 11th, it has become imperative that the communications community come together to determine our role in ensuring homeland security. We must be aggressive in ensuring that our policies maximize the many efforts being made to make our nation safe. We will work with industry to ensure the reliability and security of our nation's communications infrastructure."***
>
> *Chairman Michael K. Powell*
> *Press Conference, October 23, 2001*[40]

Eighth, the Commission's ability to achieve its goals and objectives in the future will be affected by *the unpredictable.* Factors beyond the FCC's control range from possible future actions by Congress, changing Federal laws and potentially affecting FCC's responsibilities and workload, to unexpected international events such as those of September 11, 2001. Events such as "9-11" emphasized the need to ensure the reliability and interoperability of the nation's communications networks.

And finally, relative to the USF, on Feb. 14, 2002, the Commission adopted a Notice of Proposed Rulemaking (NPRM) concerning changes to the *contribution methodology for federal universal service support mechanisms.* On June 13, 2002, the FCC adopted an Order to ensure that unused funds from the USF's schools and libraries program will be applied to stabilize the amount of contributions to USF until March 2003. Following that period, surplus USF funds will be distributed through the Schools and Libraries mechanism, increasing the funds available for participants. The annual funding cap for the Schools and Libraries program is $2.25 billion, and as of May 2002, the program had received over $8.25 billion in funding commitments since its inception in 1998.

Over the last four years, overall demand on the USF has grown considerably, rising from $1.9 billion in 1997 to $5.5 billion in 2002. At the same time, the universal service revenue base has become smaller, causing the contribution factor, and therefore carrier contribution obligations, to increase, and carriers have generally passed through much of these increases to their customer base. The following market trends are impacting the current revenue base supporting USF:

- **New Entrants / Increased Competition** – To date, Regional Bell Operating Companies have authority to provide in-region long distance service in 13 states. Additionally, for the first time, interstate telecommunications revenues declined in 2001.

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[39] Testimony of FCC Chairman, Michael K. Powell before the Senate Commerce Committee on, "Financial Turmoil in the Telecommunications Marketplace: Maintaining the Operations of Essential Communications," July 30, 2002.
[40] Press conference on "Digital Broadband Migration, Part II," October 23, 2001.

- **Wireless Sector Growth / Technology Migration** – Subscribership to mobile services has increased from 55.3 million in 1997 to 109.5 million in 2001, and minutes of use has increased from 117 minutes per month to 255 minutes per month over the same period.
- **Bundled Services** – Bundling, such as local and long distance, and telecommunications and non-telecommunications services, has implications for carriers' ability to distinguish and allocate revenue from these different services.
- **Bankruptcies** – Recent bankruptcies among major interstate service providers will further reduce the revenue base.

Cross-Cutting Functions of the Commission

The Commission routinely interacts with a number of other Federal agencies. For example, the FCC:

- ✓ coordinates radio antenna and tower proposals with the Federal Aviation Administration (FAA) to prevent interference and to ensure the safety of life and property;
- ✓ measures spurious radio signal emissions in cooperation with the Environmental Protection Agency (EPA) to monitor public risks associated with radiation;
- ✓ coordinates with the U.S. Customs Service (USCS) concerning the import of electronic devices;
- ✓ coordinates with the NTIA to ensure the effective management of the public and private spectrum;
- ✓ works closely with the FTC on consumer issues, e.g., unscrupulous practices such as "slamming" and "cramming" practiced by some service providers;
- ✓ coordinates with Federal agencies to ensure public safety, public health, and other emergency and defense personnel have effective communications services in the event of a terrorist attack or other national disaster such as wireless priority access. Agencies sharing responsibility include the Homeland Security Office, Network Reliability and Interoperability Council (NRIC), Media Security and Reliability Council (MSRC), DOD, and the Federal Emergency Management Agency among others; and
- ✓ coordinates with the DOJ on enforcement Section 271 of the Act, which ensures that a Bell Operating Company (BOC) continues to comply with market opening requirements after the Commission has approved its application to provide long distance service in its home region.

In addition to coordination efforts with other Federal agencies, the FCC must also seek the input of state and local governments to achieve a truly national telecommunications policy. The 1996 Act set the groundwork for this goal, and the Commission is fulfilling its role in establishing the rules for opening communications markets across the country, in partnership with state regulators. The Commission will continue to work with state and local agencies, and toward this end the FCC has instituted a Local and State Government Advisory Committee to share information and views on many critical communications issues.

Highlights of the Financial Statements

Future Effects of Current Demands

Since 1994, the FCC has conducted auctions of licenses for spectrum. These auctions are open to any eligible company or individual that submits an application and upfront payment, and is found to be a qualified bidder by the Commission. Qualified bidders are those applicants whose FCC Form 175 applications have been accepted for filing and that have submitted timely upfront payments sufficient to make them eligible to bid on at least one of the licenses for which they applied.

Auction No. 35 – NextWave

In FY 2001, Auction No. 35 offered a total of 422 licenses covering 195 markets for C and F Block Broadband PCS (January 2001). In Auction No. 35, the FCC reauctioned spectrum associated with the licenses won by NextWave and for which the company defaulted on its payments. Under the Commission's rules, NextWave's default resulted in automatic cancellation of its licenses. In June 2001, the U.S. Court of Appeals for the District of Columbia Circuit held that Section 525 of the Bankruptcy Code precluded the FCC from canceling NextWave's licenses.

In October 2001, the Government asked the Supreme Court to review the ruling by the D.C. Circuit. On March 4, 2002, the Supreme Court granted the Government's petition for certiorari from the Court of Appeals decision. The FCC prosecuted its case to the Supreme Court, and oral argument was held in the case on October 8, 2002.

On January 4, 2002, the Auction No. 35 winning bidders for spectrum associated with NextWave's licenses asked the FCC to refund the approximately $3.3 billion in down payments that the agency had been holding since February 2001. On March 26, 2002, the Commission issued an order to return 85% of approximately $3.3 billion in down payments, retaining amounts equal to 3% of each winning bid, the minimum bidder default payment under the Commission's rules. The Commission stated that the FCC will keep the related Auction No. 35 licenses in a pending status until final resolution of the litigation and will require the winning bidders to pay their full bids if the U.S. Supreme Court rules in the FCC's favor. To date, the FCC has refunded 22 bidders a total of $2.8 billion.

On September 12, 2002, the FCC released a public notice seeking views on whether it should allow carriers to opt out of their $16.3 billion in bids for licenses reclaimed from NextWave, and another bankrupt company. Commissioners solicited feedback on two opt-out options: (1) full refund and option to dismiss all pending applications – applicants would lose all claims to the affected Auction No. 35 licenses – or (2) selective opt-out for pending applications – applicants would have the opportunity to pick and choose licenses to keep or dismiss.

On November 14, 2002, the Commission announced their decision in the matter: Eligible Auction No. 35 winning bidders that request dismissal of their pending applications will be relieved of their bid obligations and receive a full refund of their deposits. The Order imposes no restrictions on electing bidders' ability to acquire such spectrum in future auctions. Eligible winning bidders must make an election not later than 45 days from the date of this Order. Noting that the telecommunications industries have been undergoing serious economic difficulties, the Commission said that granting this relief to Auction No. 35 bidders may help consumers by promoting greater stability in the wireless sector and allowing the companies to redirect their capital and focus their resources on providing communications services. During the month of December 2002, the Commission received and processed refunds for 18 of the 22 bidders for a total of $486.3 million. Refunds for the other four bidders, totaling $3.2 million, remain pending final approval.

On January 27, 2003, the Supreme Court of the United States made a favorable ruling for NextWave Personal Communications, Inc. (Nextwave) on the FCC's case against NextWave.

The recovery and timing of recovery on loans in default are key factors in the FCC's calculation of its annual credit reform subsidy. For the FCC's FY 2003 credit subsidy re-estimate, which is reflected in the FY 2002 financial statements, the FCC assumed a 100% recovery rate for the NextWave licenses with receipt in the first quarter of FY 2005. The Supreme Court decision. addresses ownership of the licenses, not the amount of the payments owed by NextWave as a result of its winning bids for the licenses. Any dispute regarding the amounts owed by NextWave for the licenses, and the timing of future recoveries has not changed as a result of the Supreme Court ruling. These issues will be resolved in bankruptcy court. As a result, the FCC has not made additional changes to these financial statements for this event.

Delayed Auctions

In May 2002, the FCC issued a decision postponing the June 2002 auction of licenses in the Upper 700 MHz band (Auction No. 31) until January 2003, in order to provide Congress more time to consider legislation affecting the timing of that auction, and accordingly, bidder preparation and planning.[41] On June 19, 2002, the President signed into law the "Auction Reform Act of 2002," which prohibited the FCC from commencing auction of licenses in the Lower 700 MHz band (Auction No. 44) originally scheduled for that same day. The Auction Reform Act directed the Commission to commence an auction of a portion of the Lower 700 MHz band, the C and D block licenses, no earlier than August 19, 2002 and no later than September 19, 2002. Additionally, it required the FCC, within one month of enactment, to return to bidders for licenses in the A, B, and E blocks in Auction No. 44 the full amount of all upfront payments made by such bidders for such licenses.[42] The auction commenced August 27, 2002. On September 18, 2002, the FCC completed the auction of 740 licenses in the Lower 700 MHz C and D blocks, or the 710-716/740-746 MHz and 716-722 MHz bands ("Auction No. 44"), raising (in net high bids) a total of $88,651,630 for the U.S. Treasury. In this auction, 102 winning bidders won a total of 484 licenses.[43]

Results of Financial Position and Operations

A significant aspect of the FCC's operations is managing its Spectrum Auction Direct Loan portfolio (Spectrum Auction). In FY 2002, the net loans receivable balance, which represents

[41] FCC Public Notice, FCC 02-158, "Report No. AUC-02-31-F (Auction 31) and AUC-02-44-D (Auction No. 44), May 24, 2002.
[42] Memorandum Opinion and Order, "Auction No. 44 Revised Schedule, License, Inventory and Procedures, *Public Notice DA-02-1817*," July 25, 2002.
[43] FCC Public Notice, DA-02-2323, "Lower 700 MHz Band Auction Closes," Report No. AUC 02-44-1 (Auction No. 44), September 20, 2002.

installments due from loans under the Spectrum Auction program, was approximately $5.3 billion, representing more than half of the Commission's total assets of $9.8 billion.

The FCC is required to annually adjust its allowance for losses on the credit portfolio based on the most current portfolio performance information. In accordance with OMB guidance, the FCC calculates its subsidy reestimate based on the most recent economic and technical assumptions.

In FY 2002, at the direction of the OMB, the FCC changed the discount rate methodology it used to calculate subsidy reestimates. In prior years, the discount rate for each cohort was set based on the weighted average comparable Treasury rate at the time of "loan disbursement," or the grant date. The OMB directed the FCC to switch to a simplified actual annual average discount rate approach. This approach is most commonly used by other Federal credit agencies in calculating reestimates. If the FY 2003 reestimate had been done using the old methodology, the FY 2002 subsidy expense recognized in these financial statements would have been higher by $56.3 million.

Also in FY 2002, the FCC made the conversion from the use of the OMB Subsidy Model to the use of the OMB Credit Subsidy Calculator (CSC). Unlike the OMB Subsidy Model, the CSC allows for input of the loan disbursements at the exact month of disbursement. The increased precision in the timing of disbursements resulted in subsidy rate changes from the FY 2002 reestimate. These changes do not reflect a change in the FCC's risk, but rather a change in the tools that OMB issues for agency use.

For the FY 2001 financial statements, the FCC completed one subsidy reestimate in December 2001 to reflect the loan performance through September 30, 2001. The result of this reestimate was an upward adjustment of $91.7 million that was reported in the FY 2001 financial statements, and in the FY 2002 budget.

The FCC's FY 2003 subsidy reestimate resulted in an upward reestimate totaling $500.1 million in the Spectrum Auction program of which, $346.4 million is primarily due to the timing of recoveries on previously defaulted NextWave loans. An additional $153.7 million increase is due to interest on the reestimate, which represents interest lost from the time of origination. This reestimate is reported in the FCC's FY 2002 financial statements, but will not be reported in the budget until FY 2003. The average subsidy rate increased from 44.9% in the FY 2001 financial statements to 48.4% in the FY 2002 financial statements.

The most significant components of the subsidy cost historically have been the FY 1997 C and F Block installment loans. Based on the FY 2003 reestimate, the FY 1997 C and F Block account for 97% of the Spectrum Auction licenses.

The FY 2003 subsidy cost reestimate of the C Block FY 1997-cohort as included in the FY 2002 financial statements was 54.3%, an increase from 50.7% in the FY 2001 financial statements, which equated to a subsidy cost of $4.9 billion, an increase from $4.6 billion the prior year. The F Block FY 1997 cohort subsidy rate for as included in the FY 2002 financial statements was –44.7%, an increase from –52.4% in the FY 2001 financial statements, which equated to a subsidy cost of -$222 million, an increase from -$260 million the prior year.

The subsidy reestimates for the C and F Block 1997-cohorts increased primarily because the expected cash flows from the Auction No. 35 recovery time was extended from mid-2002 to mid-2003 for non-NextWave related licenses, and from the end of FY 2002 to the first quarter of

FY 2005 for NextWave related licenses. The switch from the FCC-specific discount rate to the OMB default discount rate also contributed to the increase in the subsidy rate.

The Narrowband FY 2003 subsidy rate included in the FY 2002 financial statements was 55.0%, a decrease from 56.5% in the FY 2001 financial statements, which equated to a subsidy cost of $66.9 million, a decrease from $68.6 million the prior year. The subsidy cost decreased for Narrowband in the FY 2003 reestimate primarily due to the timing of recoveries being shortened from mid 2005 to the fourth quarter of 2004 and the change to OMB published "Actual average interest rates."

The Interactive Video and Data Service (IVDS) FY 2003 subsidy rate included in the FY 2002 financial statements was 81.1%, a decrease from 90.7% in the FY 2001 financial statements, which equated to a subsidy cost of $71.8 million, a decrease from $80.3 million the prior year. The subsidy cost decreased for IVDS in FY 2003 as a result of an increase in loan payments and thus a lower number of defaults and the change to OMB published "Actual average interest rates."

Borrowers are required to repay loans on a quarterly basis and are allowed to prepay their loans without penalties. In FY 2002, 141 loans were paid off. Collections resulting from these loan payoffs, which include principal, interest, suspension interest, and late fees, totaled $264.5 million. When compared with FCC's total collections of $345.1 million in principal, interest, suspension interest, and late fees, loan payoffs represent approximately 77% of all collections.

The Debt Collection Act of 1996 requires Federal agencies to transfer to the Treasury for debt collection any non-tax debt that is over 180 days delinquent. In cases where delinquency occurs, the full amount of outstanding debt including, but not limited to, outstanding principal, past-due interest, and late fees, will be accelerated and must be paid in full. Failure to pay in full upon demand results in the transfer of the debt to the Treasury FMS for debt collection and the assessment of additional interest, penalties, and other administrative charges. In FY 2002, the FCC transferred 18 loans totaling $3.8 million to Treasury for debt collection.

FCC's assets include its Fund Balance with the Department of the Treasury (Treasury) and Cash and Other Monetary Assets. The approximately $2.8 billion decrease over FY 2001 in Fund Balance with Treasury is primarily the result of $2.8 billion in refunds processed for Auction No. 35. The $741 million increase over FY 2001 in Cash and Other Monetary Assets is attributed to the continued change in USF investments, away from individual securities and into mutual funds and money market funds. USF continues to build a Fund Balance due to the lag in distribution of funds.

The FCC's most significant liability account is Debt of $5.9 billion. Debt includes $5.8 billion owed to Treasury for borrowing related to credit reform installment loans, and $114 million in debt with the public for one voucher issued as a result of litigation. Deferred revenue decreased by $2.8 billion over FY 2001, also as a result of Auction No. 35 refunds.

The net cost of FCC operations for FY 2002 was $5.8 billion, which was allocated to the five programs of the FCC: Consumer Information Service, Enforcement, Competition, Licensing, and Spectrum Management; and to Credit Reform, the USF and NANP. The $2.7 billion decrease can be contributed to the fact that multiple, large subsidy reestimates were not performed in FY 2002 as they were in FY 2001.

The FCC's budget authority in FY 2002 was $173 million, and an additional $5.5 billion for USF, which in total represents a $23.9 billion decrease over FY 2001. The decrease is a result of not having the large upward or downward subsidy reestimates that led to the $23.5 billion in authority in FY 2001. For FY 2002, the FCC received upward reestimate authority of $133 million and borrowing authority of $4.4 million.

Another significant dimension of the financial statements is the USF. The Fund continued to grow over the past year, and collections have outpaced the new support requirements of carriers. The Fund has met all obligations during the year. Management expects the Fund to continue to meet all obligations presented.

The USF had a total cash distribution of $5.1 billion in fiscal year 2002. Net cash collections of $5.5 billion exceeded the total cash distributed by $364 million. Those collections when added to previous collections and receivables constitute the total net assets of the Fund, $3.2 billion. Those assets are sufficient to meet the total liabilities of the Fund and consideration of the best way to reduce the growing fund balance in this program is underway at the FCC.

In FY 2002, FCC management deemed the activity of the NANP as material. As a result, the FCC is incorporating the activity of the NANP into these financial statements for the first time. NANP contributes an additional $12.5 million in total assets to the FCC Balance Sheet, primarily in Cash and Other Monetary Assets where the NANP holds $11.6 million. The net cost added by inclusion of the NANP totals $1.3 million.

Limitations of the Financial Statements

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

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

FINANCIAL STATEMENTS

Federal Communications Commission
Consolidated Balance Sheet
As of September 30, 2002 and 2001
(dollars in thousands)

	2002	2001
ASSETS (Note 2)		
Intragovernmental		
Fund Balance with Treasury (Note 3)	$ 1,285,165	$ 4,058,202
Accounts Receivable (Note 6)	3,041	-
Total Intragovernmental	1,288,206	4,058,202
Cash and Other Monetary Assets (Note 4)	2,347,998	1,606,598
Investments (Note 5)	328,194	656,116
Accounts Receivable, net (Note 6)	515,359	773,078
Loans Receivable, net (Note 7)	5,259,258	5,972,496
General Property, Plant, and Equipment, net (Note 9)	41,813	35,318
Other	2	-
Total Assets	$ 9,780,830	$ 13,101,808
LIABILITIES (Note 10)		
Intragovernmental		
Debt (Note 11)	$ 5,770,915	$ 6,109,604
Other (Note 12)		
Custodial	691,662	848,619
Other	1,074	2,973
Total Other	692,736	851,592
Total Intragovernmental	6,463,651	6,961,196
Accounts Payable	410,171	350,297
Debt Held by the Public (Note 11)	114,425	125,274
Other (Note 12)		
Deferred Revenue	551,450	3,304,671
Other	113,990	95,000
Total Other	665,440	3,399,671
Total Liabilities	$ 7,653,687	$ 10,836,438
Commitments and Contingencies (Note 14)		
NET POSITION		
Unexpended Appropriations	$ 22,158	$ 24,012
Cumulative Results of Operations	2,104,985	2,241,358
Total Net Position	2,127,143	2,265,370
Total Liabilities and Net Position	$ 9,780,830	$ 13,101,808

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidated Statement of Net Cost
For the Years Ended September 30, 2002 and September 30, 2001
(dollars in thousands)

	2002	2001
PROGRAM COSTS:		
Licensing:		
Intragovernmental gross costs	$ 18,805	$ 19,209
Less: Intragovernmental earned revenue	(274)	(313)
Intragovernmental net costs	18,531	18,896
Gross costs with the public	55,448	61,831
Less: Earned revenues from the public	(76,853)	(86,588)
Net costs with the public	(21,405)	(24,757)
Total net cost	(2,874)	(5,861)
Competition:		
Intragovernmental gross costs	$ 27,368	$ 21,146
Less: Intragovernmental earned revenue	(386)	(342)
Intragovernmental net costs	26,982	20,804
Gross costs with the public	80,624	68,093
Less: Earned revenues from the public	(108,113)	(94,534)
Net costs with the public	(27,489)	(26,441)
Total net cost	(507)	(5,637)
Enforcement:		
Intragovernmental gross costs	$ 17,899	$ 18,100
Less: Intragovernmental earned revenue	(247)	(290)
Intragovernmental net costs	17,652	17,810
Gross costs with the public	52,728	58,253
Less: Earned revenues from the public	(69,073)	(80,263)
Net costs with the public	(16,345)	(22,010)
Total net cost	1,307	(4,200)
Consumer Information Services:		
Intragovernmental gross costs	$ 8,994	$ 3,685
Less: Intragovernmental earned revenue	(125)	(59)
Intragovernmental net costs	8,869	3,626
Gross costs with the public	26,495	11,671
Less: Earned revenues from the public	(34,859)	(16,434)
Net costs with the public	(8,364)	(4,763)
Total net cost	505	(1,137)
Spectrum Management:		
Intragovernmental gross costs	$ 10,382	$ 6,598
Less: Intragovernmental earned revenue	(147)	(106)
Intragovernmental net costs	10,235	6,492
Gross costs with the public	30,584	21,036
Less: Earned revenues from the public	(41,139)	(29,403)
Net costs with the public	(10,555)	(8,367)
Total net cost	(320)	(1,875)

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidated Statement of Net Cost
For the Years Ended September 30, 2002 and September 30, 2001
(dollars in thousands)

	2002	2001
Universal Service:		
Intragovernmental gross costs	$ 463	$ -
Less: Intragovernmental earned revenue	(7)	-
Intragovernmental net costs	456	-
Gross costs with the public	5,282,968	4,980,967
Less: Earned revenues from the public	(1,807)	-
Net costs with the public	5,281,161	4,980,967
Total net cost	5,281,617	4,980,967
Numbering:		
Intragovernmental gross costs	$ -	$ -
Less: Intragovernmental earned revenue	-	-
Intragovernmental net costs	-	-
Gross costs with the public	9,685	-
Less: Earned revenues from the public	(11,010)	-
Net costs with the public	(1,325)	-
Total net cost	(1,325)	-
Credit Reform:		
Intragovernmental gross costs	$ 416,251	$ 1,214,175
Less: Intragovernmental earned revenue	(26,000)	(843,627)
Intragovernmental net costs	390,251	370,548
Gross costs with the public	521,095	7,965,866
Less: Earned revenues from the public	(399,705)	(4,760,043)
Net costs with the public	121,390	3,205,823
Total net cost	511,641	3,576,371
Total Net Program Costs	$ 5,790,044	$ 8,538,628
Cost not Assigned to Programs:		
Depreciation	$ 10,716	$ 11,662
Telecommunications Development Fund	262	19,852
Other Expenses	1,313	1,036
Less: Earned Revenues not Attributed to Programs:		
Telecommunications Development Fund	$ (262)	$ (19,852)
Net Cost of Operations (Note 16)	$ 5,802,073	$ 8,551,326

Page 2 of 2

The accompanying notes are an integral part of these statements

Federal Communications Commision
Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 2002

(dollars in thousands)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	$ 2,241,358	$ 24,012
Prior period adjustments (Note 17)	(22,073)	-
New Reporting Entity (Note 29)	10,781	-
Beginning balances, as adjusted	2,230,066	24,012
Budgetary Financing Sources:		
Appropriations received	-	387,428
Other adjustments (recission, etc) (+/-)	-	(220,338)
Appropriations used	168,944	(168,944)
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(21,284)	-
Imputed financing from costs absorbed by others	11,069	-
Universal Service Fund Nonexchange Revenue	5,518,572	-
Other (+/-)	(309)	-
Total Financing Sources	5,676,992	(1,854)
Less: Net Cost of Operations	5,802,073	
Ending Balances	$ 2,104,985	$ 22,158

The accompanying notes are an integral part of these statements

Federal Communications Commission
Combined Statement of Budgetary Resources
For the Year Ended September 30, 2002
(dollars in thousands)

	Budgetary	Non Budgetary Credit Program Financing Account
Budgetary Resources:		
Budget Authority		
Appropriations Received	$ 5,711,907	$ -
Borrowing Authority	-	4,456
Unobligated Balance:		
Beginning of Period (Note 21)	1,917,318	18,175
Spending Authority from Offsetting Collections:		
Earned		
Collected	312,914	762,860
Receivable from Federal Sources	7	-
Changed Unfilled Customer Orders		
Without Advance from Federal Sources	1	-
Subtotal	7,942,147	785,491
Recoveries of Prior Year Obligations	6,958	-
Permanently not available	(15,524)	(343,145)
Total Budgetary Resources	$ 7,933,581	$ 442,346
Status of Budgetary Resources:		
Obligations Incurred (Note 18):		
Direct	$ 5,686,628	$ 420,777
Reimbursable	1,372	-
Subtotal	5,688,000	420,777
Unobligated Balance:		
Apportioned	7,398	21,569
Exempt from Apportionment	2,228,067	-
Unobligated Balance not Available	10,116	-
Total Status of Budgetary Resources	$ 7,933,581	$ 442,346
Relationship of Obligations to Outlays:		
Obligated Balance, net, Beginning of Period (Note 21)	$ 407,397	$ -
Obligated Balance, net, End of Period:		
Accounts Receivable	405	-
Unfilled Customer Orders from Federal Sources	(532)	-
Undelivered Orders	43,592	-
Accounts Payable	409,366	-
Outlays:		
Disbursements	5,635,599	420,777
Collections	(312,914)	(762,860)
Subtotal	5,322,685	(342,083)
Less: Offsetting Receipts	21,284	-
Net Outlays	$ 5,301,401	$ (342,083)

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidated Statement of Financing
For the Year Ended September 30, 2002
(dollars in thousands)

Resources Used to Finance Activities:	
Budgetary Resources Obligated	
Obligations incurred	$ 6,108,777
Less: Spending authority from offsetting collections and recoveries	1,082,739
Obligations net of offsetting collections and recoveries	5,026,038
Less: Offsetting receipts	21,284
Net obligations	5,004,754
Other Resources	
Transfers in/out without reimbursement (+/-)	(21,284)
Imputed financing from costs absorbed by others	11,069
Other (+/-)	309
Net other resources used to finance activities	(9,906)
Total resources used to finance activities	4,994,848
Resources Used to Finance Items not Part of the Net Cost of Operations:	
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided (+/-)	(8,264)
Resources that fund expenses recognized in prior periods	(23,975)
Budgetary offsetting collections and receipts that do not affect net cost of operations	
Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	(739,915)
Other	399,705
Resources that finance the acquisition of assets	15,773
Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	(5,623)
Total resources used to finance items not part of the net cost of operations	(362,299)
Total resources used to finance the net cost of operations	5,357,147
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:	
Components Requiring or Generating Resources in Future Periods:	
Increase in annual leave liability	1,255
Upward/Downward reestimates of credit subsidy (+/-)	366,685
Increase in exchange revenue receivable from the public	(1,893)
Other (+/-)	(22,996)
Total components of Net Cost of Operations that will require or generate resources in future periods	343,051
Components not Requiring or Generating Resources:	
Depreciation and Amortization	10,716
Other (+/-)	91,159
Total components of Net Cost of Operations that will not require or generate resources	101,875
Total components of Net Cost of Operations that will not require or generate resources in the current period	444,926
Net Cost of Operations	$ 5,802,073

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidated Statement of Custodial Activity
For the Years Ended September 30, 2002 and September 30, 2001
(dollars in thousands)

	2002	2001
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	$ 405,321	$ 1,507,584
Fines and Penalties	38,957	52,916
Credit Reform Interest (Note 29)	416,251	-
TDA Interest	258	19,886
Total Cash Collections	860,787	1,580,386
Accrual Adjustments		
Spectrum Auctions	(192,756)	129,848
Fines and Penalties	(4,865)	(315)
TDA Interest	4	(34)
Total Accrual Adjustments	(197,617)	129,499
Total Custodial Revenue	663,170	1,709,885
Disposition of Collections:		
Transferred to Others:		
Recipient A: U.S. Treasury	(456,366)	(1,077,197)
Recipient B: FCC Financing Account - Credit Reform (Recoveries)	(258,163)	-
(Increase)/Decrease in Amounts Yet to be Transferred	156,957	(543,540)
Refunds and Other Payments	(16,552)	(1,771)
Retained by the Reporting Entity	(89,046)	(87,377)
Net Custodial Activity	$ -	$ -

The accompanying notes are an integral part of these statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2002 and 2001
(dollars in thousands unless otherwise stated)

Note 1 - Summary of Significant Accounting Policies:

Reporting Entity

The Federal Communications Commission ("FCC" or "Commission") is an independent United States government agency, directly reporting to Congress. The FCC was established by the Communications Act of 1934, as 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 the U.S. possessions.

The FCC is directed by five Commissioners appointed by the President of the United States 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 Chairman. Only three Commissioners may be members of the same political party. Commissioners may not hold a financial interest in any company or entity that has a significant interest in activities regulated by the Commission.

The FCC's operations are divided among six bureaus that are supported by ten offices. The six bureaus are International, Consumer and Governmental Affairs, Media, Wireline Competition, Wireless Telecommunications, and Enforcement. Two outside entities, the Universal Service Administrative Company (USAC) and the National Exchange Carrier Association (NECA) administer the activities of the Universal Service Fund Program (USF Program). The USF Program includes the Universal Service Fund (USF), administered by USAC, and the Telecommunications Relay Service Fund (TRS), administered by NECA. The USF consists of four universal service support mechanisms that were established pursuant to Section 254 of the Communications Act of 1934, as amended. The USAC was appointed by the FCC to administer the four USF support mechanisms: high cost areas, low-income consumers, schools and libraries, and rural health care providers. It also submits projections of demand and administrative expenses for each of these mechanisms and quarterly USF contribution data to the FCC. The TRS was established by the Americans with Disabilities Act of 1990, Title IV, and provides telephone service to the blind and physically handicapped. The NECA is the appointed administrator for the TRS Fund. For consolidating purposes, we group USF and TRS together as "Universal Service."

An additional component of the FCC, as defined by Statement of Federal Financial Accounting Concepts (SFFAC) No. 2 *Entity and Display*, includes the North American Numbering Plan (NANP) program administered by the North American Numbering Plan Administrator (NANPA). The administrators and billing and collection agent serve an initial period of five years and are required to be independent and impartial non-governmental entities under FCC regulations (47 C.F.R. §52.12, 52.21h). Revenues to support the program are collected by the administrator or the billing and collection agent (47 C.F.R. §52.16, 52.17, 52.32, 52.33). Amounts presented for this component in these statements are referred to under the heading "NANP." The inclusion of the NANP program in FY 2002 represents a change in the reporting entity from FY 2001. The impact of this change on FY 2001 has been disclosed in Note 29.

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

Basis of Accounting

The consolidated financial statements have been prepared from the accounting records of the FCC and its consolidating entities in conformity with accounting principles generally accepted in the United States (GAAP), and standards specified by the Office of Management and Budget (OMB) in OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements* (OMB Form and Content). GAAP for Federal entities are the standards prescribed by FASAB, which was designated the official accounting standards-setting body for the Federal government by the American Institute of Certified Public Accountants. The consolidated financial statements are different from the financial reports, also prepared by FCC pursuant to OMB directives used to monitor and control FCC's use of budgetary resources.

Basis of Presentation

The accompanying consolidated financial statements have been prepared to report the financial position, results of operations, changes in net position, budgetary resources, custodial activity, and financing of the FCC as of and for the year ended September 30, 2002 and the financial position, results of operations, and custodial activity as of and for the year ended September 30, 2001. The consolidated financial statements have been prepared from the books and records of the FCC in accordance with OMB Form and Content and GAAP of the Federal government.

The preparation of financial statements, in accordance with accounting principles generally accepted in the United States, 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.

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."

Presentation changes have been made in FY 2002 as a result of a change in reporting entity, new reporting guidance, and internal policy changes that are not comparable with FY 2001 presentation. Additional disclosures regarding the impact of these changes are included in Note 29.

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

Assets

Assets are tangible or intangible items owned by the FCC that have probable economic benefits that can be obtained or controlled by the FCC. The intragovernmental assets of an agency are separately reported on the face of the balance sheet. The non-entity assets, which are assets the entity holds but does not have the authority to use in its operations, are separately disclosed in Note 2. Entity assets are those assets which the reporting entity holds and has the authority to use in its operations.

Fund Balance with Treasury

The FCC maintains seven types of accounts with the U.S. Treasury: general, revolving, deposit, special, receipt, trust, and clearing. The general and revolving accounts may be used by the FCC to finance expenditures depending on budgetary availability. The deposit accounts are used to hold funds received through spectrum auctions, international telecommunications settlements (ITS), or regulatory fee monies until they can be distributed to the proper account. The special account is used to track USF and TRS funds held outside of the U.S. Treasury. The receipt accounts are used to record collections made by the FCC on behalf of the Department of the Treasury's General fund. The trust account was established in FY 2001 to track funds donated for a special study on noise and interference affecting the performance of current and proposed communications systems, and the clearing account is used to clear unidentified collections and reimbursements throughout the year.

Cash and Other Monetary Assets

Cash and Other Monetary Assets represents cash on deposit at several commercial banks and highly liquid securities with an original maturity of three months or less. The commercial accounts are in the form of mutual funds and money market funds that can easily be drawn against. In the case of USF, TRS and NANP, interest proceeds are reinvested and remain available for use. In the case of the FCC, these funds represent third party deposits 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 the Telecommunications Development Account (TDA), an interest bearing account, for subsequent transfer to the Telecommunications Development Fund (TDF) during and for a 45 day period after the close of a given auction. These funds represent a liability to the FCC until such time as they are applied toward a valid spectrum license, returned to the depositor, or transferred to the TDF.

The 1996 Act established the 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

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

Cash and Other Monetary Assets (continued)

areas. Pursuant 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.

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

Investments

Investments are reported net of any unamortized premium or discount. All of USF's investments are in marketable non-federal debt securities. All investments are considered to be short term with maturity dates that do not exceed one year.

Accounts Receivable, Net

Accounts Receivable consists of claims by the FCC for payment from other entities. Gross receivables shall be reduced to net realizable value by an allowance for doubtful accounts.

Loans

Reporting requirements for direct loan obligations made after fiscal year 1991 are governed by the Federal Credit Reform Act (FCRA) of 1990, as amended. 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 obligated. Direct loans are reported net of an allowance for subsidy at the present value.

Property, Plant and Equipment

The basis for recording purchased general Property, Plant, and Equipment (PP&E) is full cost, including all costs incurred to bring the PP&E to and from a location suitable for its intended use. The 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 recorded by 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 useful lives as capital acquisitions. PP&E are depreciated on a straight-line basis over the estimated useful life of the item. The useful lives used are: forty years

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

Property, Plant and Equipment (continued)

for buildings, seventeen years for patents, seven years for equipment and furniture, five years for computers and vehicles, and three years for software. Land and land rights, including permanent improvements, are not depreciated. Also, software in process is not depreciated. Normal maintenance and repair costs are expensed as incurred.

The FCC's authority relative to seized and forfeited property is cited in 47 U.S.C., Section 510. Seized property consists of personal property and equipment seized from illegal telecommunication operations. The property is considered prohibited and held pending an outcome of court proceedings. Forfeited property consists of seized property turned over to the FCC and disposed of through the General Service Administration's (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.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities represent a probable future outflow or other sacrifice of resources as a result of past transactions or events. 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.

<u>Liabilities Covered by Budgetary Resources</u> – Represent liabilities funded by available budgetary resources including: (1) new budget authority, (2) spending authority from offsetting collections, (3) recoveries of expired 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 Consolidated Balance Sheet date. All liabilities covered by budgetary resources are classified as current, and are expected to be paid within one year following the reporting date.

<u>Liabilities Not Covered by Budgetary Resources</u> – Exist when funding has not yet been made available through Congressional appropriations or current earnings. The 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.

Deferred Revenue

The FCC collects proceeds from the sale of communications spectrum on behalf of the U.S. Government. Spectrum sales transactions typically consist of an initial down payment equal to 20% of the net winning bid and a final down payment at the time the license is granted. All first down payment money is recognized by the FCC as deferred revenue until a final payment date is established by "prepared to grant" public notice.

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

Debt to the U.S. Treasury

This account represents amounts due to the Bureau of Public Debt, 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 of 1990, as amended, and guidance issued by OMB. Interest payments made by the FCC on borrowings from the Bureau of Public Debt are recorded in a receipt account maintained by the FCC. New guidance from Treasury FMS requires the FCC to record the collection of the interest as custodial activity. This represents a change in treatment from FY 2001.

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 administered by Office of Personnel Management (OPM) and not by the FCC. Since the FCC does not administer the benefit plans, the FCC does not recognize any liability on the Consolidated Balance Sheet for pensions, other retirement benefits, and other post-employment benefits. FCC does, however, recognize and allocate the imputed costs on the Statement of Net Costs and recognizes imputed financing related to these costs on the Statement of Changes in Net Position.

Pensions provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. Most 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 OPM reports on CSRS and FERS assets, accumulated plan benefits, and unfunded liabilities, if any, applicable to Federal employees.

The actuarial liability for future workers' compensation benefits includes the expected liability for death, disability, medical and miscellaneous costs for 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 the Department of Labor (DOL) for the FCC, due to the immateriality to the Federal government as a whole.

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

Exchange revenue is the amount of money earned for goods and services provided to other agencies and the public. For example, spectrum auction sales and reimbursable agreements are considered exchange revenue to the Federal government. Exchange revenue, except for radio spectrum auction proceeds, is reported on the SNC where it is allocated based on the ratio of individual program costs to total program costs. Nonexchange revenue is recorded for transactions where revenue is earned at no substantial cost to the provider. For example, collections from fines and forfeitures are considered nonexchange revenue. Nonexchange revenue is reported on either the SCNP or the SCA. Other Financing sources are funding such as appropriations, where resources are received and nothing of value is given in return. Other Financing sources are reported on SCNP.

Regulatory Fee Collections (Exchange) - 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's mission. Regulatory fees are intended to offset costs associated with the FCC competition, enforcement, consumer information, and spectrum management activities. Since 1993, Congress has annually reviewed the regulatory fee collection requirements of the Commission and established the total fee levels to be collected. Fees collected up to the level established by Congress are applied against the FCC's annual appropriation via a negative warrant processed at the close of each fiscal year. Only once, in fiscal year 1998, have fee attainments been less than the established level. The regulatory fee levels of $218,757 and $200,146 established for FY 2002 and FY 2001, respectively, were achieved.

Radio Spectrum Auction Proceeds (Exchange) – The proceeds from auctioning the right to use the radio spectrum are exchange revenues, because each party receives and sacrifices something of value. The amount of revenue is earned by sales in the market at auctions. The proceeds from the auction of the radio spectrum bear little relationship to the costs recognized by the FCC, which collects the revenue, and should not, according to SFFAS No. 7, ***Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,*** as issued by the FASAB, be offset against the costs of the FCC in determining its net cost of operations. Therefore, FCC accounts for this exchange revenue as a custodial activity. Revenue on spectrum auction is recognized when the final payment date is established by the "prepared to grant" public notice.

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

Revenues and Other Financing Sources (continued)

When spectrum licenses are transferred between companies in the market place, additional revenues may be recognized as a result of unjust enrichments. Unjust enrichments occur when the original licensee qualifies to receive a bidding credit at the time of the auction that the new licensee does not qualify to receive. In these cases, the FCC requires that the original credit be paid as a condition to approving the transfer. For recognition purposes, the FCC recognizes unjust enrichment revenue under three different scenarios: 1) at the time of receipt if the original license was paid in full, 2) at the point when both a payoff and unjust enrichment have been received if the license was in the installment loan program and is being paid off, or 3) at the later of the assignment and assumption effective date or the date the executed agreement and funds are received at the Commission if the license is in the installment loan program and the existing loan is being assumed.

Offsetting Collections (Exchange) – One of FCC's primary functions is the management of the Spectrum Auction 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, net of anticipated auction related costs. Under 47 U.S.C. Section 309, a portion of the Spectrum Auction proceeds may be retained by the FCC to offset the cost of performing the auction function. Collections used to offset the cost of performing auctions related activity totaled $77,918 for FY 2002 and $67,526 for FY 2001.

Application Fees (Exchange) - Congress authorized the FCC (Section 8, 47 U.S.C.) to impose and collect application processing fees and directed the FCC to prescribe charges for certain types of application processing or authorization services it provides to communications entities over which the FCC has jurisdiction. Application fees are deposited in the U.S. Treasury and are not available for the FCC to use. Application fees collected in FY 2002 and FY 2001 were $21,284 and $24,053, respectively.

Reimbursable Work Agreements (Exchange) – The FCC recognizes reimbursable work agreement revenue when earned, i.e. goods have been delivered or services rendered. The FCC executed agreements with other agencies totaling approximately $1,233 in FY 2002 and $1,100 in FY 2001.

Annual Appropriations (Financing Source) - 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 repaid to the U.S. Treasury once regulatory fees have been collected. The annual appropriation for fiscal year 2002 was $245,042 less anticipated regulatory fee collections of $218,757 resulting in a net appropriation of $26,285. The annual appropriation for FY 2001 was $230,000 less regulatory fee collections of $200,146 for a net appropriation of $29,854.

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

Revenues and Other Financing Sources (continued)

Subsidy Estimates and Reestimates (Financing Source) – The FCC receives permanent-indefinite authority in accordance with the FCRA of 1990, as amended , to fund its subsidy estimates and reestimates, unless otherwise prescribed by OMB. This authority funds repayment to the U.S. Treasury for the portion of Spectrum Auction loans that will not be recovered from the borrower.

USF Program (Nonexchange Revenue) – Carriers conducting interstate telecommunications are required to remit a portion of their revenues to fund the cost of providing universal service. The USF Program consists of five elements, four of which are the USF support mechanisms: (1) schools and libraries; (2) low income consumers; (3) high cost areas; and (4) rural health care. The fifth element is the TRS which provides services to the blind and physically handicapped.

Transactions with Related Parties

In the course of its operations, the FCC has relationships and financial transactions with numerous Federal agencies. The more prominent of those relationships are with the Department of the Treasury (Treasury) and the OMB. FCC also has relationships with agencies such as the GSA, the DOL, the OPM, and the Department of Agriculture (USDA), National Finance Center (NFC), among others.

In addition to its relationships and financial transactions with Federal agencies, the FCC has a direct relationship with organizations that were established to assist the FCC in carrying out its mission. These organizations are USAC, which administers the four USF support mechanisms, NECA which administers the TRS Fund, and the North American Numbering Plan Administration which includes NBANC as the Billing and Collection agent and Neustar as the NANP Administrator and the Thousand Block Pooling administrator.

Other related entities not meeting the inclusion criteria as defined by SFFAC No.2 include the programs administered by the Local Number Portability Administrator (LNPA). LNPA works with carriers to update data tables for required number portability.

Net Position

Net position account balances consist of the following components:

Unexpended Appropriations – Unexpended Appropriations represent amounts of spending authority that are unobligated and available to the FCC, or obligated but not expended. Unexpended appropriations can also result from downward subsidy cost reestimates of mandatory loan programs.

(dollars in thousands unless otherwise stated)

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

Net Position (continued)

Cumulative Results of Operations – Cumulative Results of Operations represent the FCC's net results of operations (expenses less revenues and other financing sources) since inception. As a Federal Entity, the FCC is tasked with operating on a break even basis however, certain timing differences result in the reflection of a balance in cumulative results. The most significant of these is the timing difference between the receipt of USF contributions and the approval and disbursement of those funds to qualified providers. Other differences occur as a result of the accounting for capital equipment purchases and the recognition of certain expenses such as leave that are funded by future authority.

Note 2 - Non-entity Assets:

The following summarizes non-entity assets as of September 30, 2002 and 2001:

	2002	2001
Intragovernmental:		
Fund balance with Treasury	$ 1,190,419	$ 3,954,848
Accounts Receivable, Net	3,041	-
Total Intragovernmental	1,193,460	3,954,848
Cash and other monetary assets	35,402	7,524
Accounts receivable, net	20,330	223,761
Total non-entity assets	1,249,192	4,186,133
Total entity assets	8,531,638	8,915,675
Total assets	$ 9,780,830	$13,101,808

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for $1,185,363 in FY 2002 and $3,948,676 in FY 2001. Non-entity Cash and Other Monetary Assets consist of upfront deposits made by potential spectrum auction bidders. Receivables that are considered non-entity are those for regulatory fees, application fees, fines and forfeitures, spectrum auction receivables, and ITS receivables.

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Note 3 - Fund Balance with Treasury:

The following summarizes Fund Balance with Treasury as of September 30, 2002 and 2001:

Fund Balances:

	2002	2001
Trust Funds	$ -	$ 88
Revolving Funds	21,569	18,175
Appropriated Funds	73,177	85,179
Deposit Funds	1,190,419	3,954,760
Total Fund Balance	$ 1,285,165	$ 4,058,202

Status of Fund Balance with Treasury:

	2002	2001
Unobligated Balance		
Available	$ 30,620	$ 31,760
Unavailable	1,198,764	3,962,612
Obligated Balance not yet Disbursed	55,781	63,830
Total	$ 1,285,165	$ 4,058,202

Trust Funds – The FCC maintains one Gift and Bequest fund, established in FY 2001. The funds were given to perform a study on noise and interference affecting the performance of existing and proposed communication systems. All remaining funds were used during FY 2002.

Revolving Funds – The credit reform financing account is considered to be a revolving fund by the U.S. Treasury. This is the only revolving fund maintained by the FCC. This fund records cash flows associated with the FCC's Auction Spectrum Loan program.

Appropriated Funds - These funds consist of salaries and expense appropriation accounts used to fund agency operations and capital expenditures, no-year accounts used to carryover spectrum auction and regulatory fee funds not obligated in the year received, and the credit reform program account.

Deposit Funds - These funds are maintained to account for receipts awaiting proper classification or receipts being held in escrow until proper distribution can be made. There are three deposit accounts used by FCC to hold spectrum auction receipts, international telecommunications settlements, 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 the Treasury.

(dollars in thousands unless otherwise stated)

Note 4 – Cash and Other Monetary Assets:

The following summarizes Cash and Other Monetary Assets as of September 30, 2002 and 2001:

	2002	2001
Cash	$ 2,344,941	$ 1,602,254
Accrued Interest	3,057	4,344
Total	$ 2,347,998	$ 1,606,598

In FY 2002, Cash and Other Monetary Assets include $35,402 in upfront deposits and related accrued interest being held for various Spectrum Auctions. There is also $2,300,949 in Universal Service contributions and related accrued interest being held for distribution and $11,647 in NANP deposits and related accrued interest.

In FY 2001, Cash and Other Monetary Assets includes $7,524 in upfront deposits and related accrued interest being held for various Auctions and $65 in cash held in the Imprest Fund. There was also $1,599,009 in Universal Service contributions and related accrued interest being held for distribution. NANP was not consolidated in the FY 2001 balance.

Accrued interest is composed of interest income earned by The FCC, Universal Service and NANP, but not received on demand deposits as of September 30.

Note 5 - Investments:

The following summarizes Investments as of September 30, 2002 and 2001:

FY 2002	Cost	Amortization Method	Unamortized (Premium) Discount	Investments, Net	Market Value Disclosure
Intragovernmental					
Marketable Securities	$ -	EI	$ -	$ -	$ -
Other Securites:					
Marketable Securities	326,701	EI	812	327,513	327,111
Repurchase Agreements	-	NA	-	-	-
Total Other Securities	326,701		812	327,513	327,111
Accrued Interest	1,493	NA	-	-	1,493
Total	$ 328,194				$ 328,604

(dollars in thousands unless otherwise stated)

Note 5 - Investments: (continued)

FY 2001	Cost	Amortization Method	Unamortized (Premium) Discount	Investments, Net	Market Value Disclosure
Intragovernmental					
Marketable Securities	$ -	SL	$ -	$ -	$ -
Other Securities:					
Marketable Securities	620,056	SL	3,669	623,725	611,648
Repurchase Agreements	32,515	NA	-	32,515	32,515
Total Other Securities	652,571		3,669	656,240	644,163
Accrued Interest	3,545	NA	-	-	3,545
Total	$ 656,116				$ 647,708

EI – Effective Interest Method
SL – Straight Line Method
NA – Not Applicable

Investment balances represent USF funds that have been invested in low risk marketable securities. All investments are considered to be short term with maturity dates greater than three months but generally not exceeding one year. All investments are held to maturity therefore no adjustments have been made to present market values.

Note 6 - Accounts Receivable, Net:

The following summarizes Accounts Receivable as of September 30, 2002 and 2001:

	2002	2001
Intra-governmental		
Gross Accounts Receivable	$ 3,041	$ -
Allowance for Doubtful Accounts	(-)	(-)
Net Accounts Receivable	$ 3,041	$ -
With the Public		
Gross Accounts Receivable	$ 740,279	$ 880,679
Allowance for Doubtful Accounts	(224,920)	(107,601)
Net Accounts Receivable	$ 515,359	$ 773,078

Accounts receivable are recorded net of any related allowance for doubtful accounts. The FCC's portion is determined by applying predetermined percentages against the respective year the receivable was established. The current formula for FCC accounts receivables is 25% for those 91 -180 days, 75% for those 181-365 days, and 100% for anything greater than 365 days

Note 6 - Accounts Receivable, Net: (continued)

outstanding. All Notice of Apparent Liabilities (NAL) are reserved 100% since the FCC does not have the authority to bill these entities. An additional analysis of higher dollar value receivables is also performed on individual account balances. The USF portion is determined by calculating an estimated general allowance for doubtful accounts receivable, and reserving 100% for known bankruptcy and inactive accounts. The general allowance is calculated by multiplying the aged billing amounts by the percentage of the monthly delinquent accounts receivable over the monthly billing amounts.

FY 2002 accounts receivable balances by type include $656,189 due from Universal Service contributors. The related allowance for Universal Service receivables is $162,000. NANP accounts for an additional $962 with a related allowance of $137. Another $19,987 is specific to 47 U.S.C., Section 9 regulatory fees with a related allowance of $9,134. Spectrum auction receivables total $7,097 with a related allowance of $5,567. Fines and forfeitures receivables are another $47,342 with a related allowance of $46,723. Other accounts receivable total $11,743 with a related allowance of $1,359.

FY 2001 accounts receivable balances by type include $632,622 due from Universal Service contributors. The related allowance for Universal Service receivables was $83,381. Another $18,494 was specific to 47 U.S.C., Section 9 regulatory fees as of September 30, 2001 with a related allowance of $2,902. Spectrum auction receivables totaled $199,317 with a related allowance of $5,031 established for the full amount of one receivable that has been sent to the Department of Justice for settlement. Fines and forfeitures receivables were another $24,179 with a related $16,155 allowance for doubtful accounts. Other accounts receivable total $6,067 with a related allowance of $132.

Note 7 - Direct Loans, Non-Federal Borrowers:

Under Section 309(j)(3) of the Communications Act of 1934, as amended, Congress directed the FCC to implement a competitive bidding (auctions) system for licensing spectrum, in order to expand economic opportunity, promote competition, and facilitate the development and delivery of new and improved telecommunications services to the public. Section 309(j)(4) gave the Commission certain instructions for implementing regulations for this system, including a directive to ensure that small businesses, rural telephone companies, and women and minority-owned businesses were provided 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.

To address the mandate, the FCC provided installment financing in connection with its Spectrum Auction events, including the C Block Broadband Personal Communications Services' (PCS), F Block PCS, Narrowband PCS, Interactive Video and Data Service (IVDS), Multipoint Distribution Service

Note 7 - Direct Loans, Non-Federal Borrowers: (continued)

(MDS), and 900MHz Specialized Mobile Radio (SMR). Under the installment financing program, winning bidders were generally 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. Retention of licenses granted at auction was strictly conditioned on making full and timely payment of amounts as they become due. The return or repossession of auctioned licenses, which may have previously been associated with installment payment plans, does not directly or immediately affect the amount of the outstanding debt recorded in the agency's financial records. Outstanding debt adjustments are subject to the completion of a separate process.

The FCC's first auction was conducted in 1994, and starting in 1995, installment payment mechanisms were used to finance portions of some of the winning bid amounts. Except for the Pioneer Broadband PCS, which was paid off in FY 2001, all of FCC's loan portfolio is accounted for in accordance with the FCRA of 1990. As of FY 2002, the FCC's installment loan portfolio is tracked under ten cohorts. The loans receivable balance and value of the assets related to the direct loans are not the same as the proceeds FCC would expect to receive from selling their loans.

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, Federal agencies are required to reestimate the subsidy estimates and re-estimates annually as of the date of the financial statements. Any increase or decrease in the subsidy cost allowance resulting from the reestimates is recognized as a change in the subsidy expense.

The most recent subsidy reestimate was completed in December 2002 for performance data through September 30, 2002. The result of this reestimate was a net upward adjustment of $346,421 that is reported in the FY 2002 financial statements.

As required under the FCRA of 1990, as amended, the FCC coordinates with the OMB in developing estimation guidelines, regulations, and the criteria to be used in calculating the subsidy estimates and re-estimates. This joint effort is undertaken to facilitate the development and improvement of cost and recovery rate estimates. Therefore, the subsidy cost allowance has been prepared under specific guidance provided by the OMB in an effort to ensure that the objectives of the Federal government, taken as a whole, are being achieved and may not represent the FCC's current policy position on the auction of spectrum held previously by other parties.

In FY 2002, at the request of OMB, the FCC changed the discount rates it used to calculate subsidy reestimates. In prior years, the discount rate for each cohort was set based on the weighted average of comparable Treasury rate at the time of loan disbursement, or the grant date. OMB asked the FCC to switch to the simpler actual annual average discount rate approach for the most recent reestimate. This approach is most commonly used by other Federal credit agencies, and allows the FCC to make better use of the tools created by OMB for

(dollars in thousands unless otherwise stated)

Note 7 - Direct Loans, Non-Federal Borrowers: (continued)

credit agencies. Application of the weighted average discount rates to the most recent subsidy reestimate would have resulted in additional net subsidy cost of $56,328.

Loans Receivable - Loans receivable for post-1995 Spectrum Auctions are recorded at the principal outstanding, net of allowance 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 U.S. Treasury's interest rate for the year that the loans were disbursed. The allowance for subsidy also provides for write-offs on defaults and other costs that may affect cash flows.

Accrued Interest – FCC accrues interest on loans as it is earned. Current FCC policy automatically grants Spectrum Auction loans two sequential three-month grace periods for which borrowers are charged late fees. In accordance with the FCC rules, at the end of the six-month total grace period, loans are considered to be in default and the license is automatically cancelled. For financial reporting purposes, it is the FCC's policy to discontinue accruing interest on loans that are beyond the six-month grace period, since these loans are considered non-performing. Therefore, it is the FCC's policy to accrue and record interest only on the performing loans for financial reporting purposes.

Direct Loans Obligated After FY 1991

Loan Program	Loans Receivable, Gross	Interest Receivable	Other Receivables	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Spectrum Auctions:					
FY 2002 Bal.	$ 5,293,072	$ 292,747	$ 2,506	$ (329,067)	$ 5,259,258
FY 2001 Bal.	$ 5,593,132	$ 291,656	$ 2,935	$ 84,773	$ 5,972,496

Total Amount of Direct Loans Disbursed (Post 1991)

Loan Program	FY 2002	FY 2001
Spectrum Auctions	$ 1,369	$ -

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Note 7 - Direct Loans, Non-Federal Borrowers: (continued)

Subsidy Expense for Direct Loans by Program and Component

1. Subsidy Expense for New Direct Loans Disbursed:

Loan Program	Interest Differential	Defaults	Fees	Other	Total
FY 2002	$ (129)	$ 339	$ -	$ -	$ 210
FY 2001	$ -	$ -	$ -	$ -	$ -

2. Direct Loan Modifications and Reestimates:

Loan Program	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Spectrum Auctions				
FY 2002 (Net)	$ -	$ -	$ 346,421	$ 346,421
FY 2001 (Net)	$ -	$ -	$ 2,668,531	$ 2,668,531

3. Total Direct Loan Subsidy Expense:

FY 2002	$ 346,631
FY 2001	$ 2,668,531

Subsidy Rates for Direct Loans by Program and Component

Loan Program	Interest Differential	Defaults	Fees	Other	Total
FY 2002	(9.40)%	24.77%	0%	0%	15.37%
FY 2001	0%	0%	0%	0%	0%

(dollars in thousands unless otherwise stated)

Note 7 - Direct Loans, Non-Federal Borrowers: (continued)

Schedule for Reconciling Subsidy Cost Allowance Balances

	2002	2001
Beginning Balance of the Subsidy Cost Allowance	$ (84,773)	$ (982,418)
Subsidy expense for direct loans disbursed:		
During the reporting years by component:		
Interest rate differential costs	(129)	-
Default costs (net of recoveries)	339	-
Fees and other collections	-	-
Other subsidy costs	-	-
Adjustments:		
Loan modifications	-	-
Fees received	258,163	-
Loans written off	-	(2,352,755)
Subsidy allowance amortization	(191,170)	591,430
Other	216	(9,561)
Ending balance before reestimates	(17,354)	(2,753,304)
Subsidy reestimates:		
Interest rate reestimate	-	-
Technical/default reestimate	346,421	2,668,531
Ending balance of the subsidy cost allowance	$ 329,067	$ (84,773)

Administrative Expense

Spectrum Auctions Total FY 2002	$ 9,770
Spectrum Auctions Total FY 2001	$ 6,700

Note 8 – Seized and Forfeited Property:

Consistent with OMB Form and Content, seized and forfeited property that cannot be sold due to legal restrictions, but may be either donated or destroyed, is not recognized for financial purposes. However, the number and value of seized and forfeited property is reported below in accordance with OMB Form and Content. The property database accounts for this property using the lot number assigned to it.

(dollars in thousands unless otherwise stated)

Note 8 – Seized and Forfeited Property: (continued)

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 communications equipment.

FY 2002

Seized	No. of Lots	Dollar Value
Beginning Balance	18	$ 37
Seized	11	33
Forfeited	(5)	(17)
Ending Balance	24	53

FY 2001

Seized	No. of Lots	Dollar Value
Beginning Balance	26	$ 55
Seized	10	15
Forfeited	(18)	(33)
Ending Balance	18	37

Forfeited Property

Forfeited property consists of seized property legally turned over to the FCC. The 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 communications equipment.

FY 2002

Forfeited	No. of Lots	Dollar Value
Beginning Balance	18	$ 19
Forfeited	5	17
Disposed	(16)	(30)
Ending Balance	7	6

(dollars in thousands unless otherwise stated)

Note 8 - Seized and Forfeited Property: (continued)

FY 2001

Forfeited	No. of Lots	Dollar Value
Beginning Balance	53	$ 61
Forfeited	18	33
Disposed	(53)	(75)
Ending Balance	18	19

Note 9 - General Property, Plant and Equipment, Net:

The following summarizes General Property, Plant and Equipment (PP&E) as of September 30, 2002 and 2001:

FY 2002 Classes of PP&E	Acquisition Cost	Accumulated Depreciation	Net Book Value	Service Life in Years
Land	$ 1,304	$ -	$ 1,304	N/A
Buildings	4,091	3,867	224	40
Furniture	19,158	10,491	8,667	7
Equipment	9,795	6,375	3,420	7
Computer Equip.	18,019	9,484	8,535	5
Bulk Purchases	4,409	3,548	861	5 - 7
Vehicle Systems	2,913	2,287	626	5
Broadcast Station, Equipment	4,096	4,077	19	7
Patent	800	255	545	17
ADP Software	18,557	15,293	3,264	3
Software In Process	14,348	-	14,348	N/A
Total	$ 97,490	$ 55,677	$ 41,813	

(dollars in thousands unless otherwise stated)

Note 9 - General Property, Plant and Equipment, Net: (continued)

FY 2001 Classes of PP&E	Acquisition Cost	Accumulated Depreciation	Net Book Value	Service Life in Years
Land	$ 1,304	$ -	$ 1,304	N/A
Buildings	4,091	3,858	233	40
Furniture	19,158	7,755	11,403	7
Equipment	7,891	5,497	2,394	7
Computer Equip.	14,214	8,583	5,631	5
Bulk Purchases	4,409	2,753	1,656	5 - 7
Vehicle Systems	2,913	1,901	1,012	5
Broadcast Station Equipment	4,096	4,036	60	7
Patent	800	208	592	17
ADP Software	16,037	11,807	4,230	3
Software In Process	6,803	-	6,803	N/A
Total	$ 81,716	$ 46,398	$ 35,318	

Internally developed software includes the direct costs incurred during the software development stage. All assets classes are depreciated on a straight-line basis.

Note 10 - Liabilities Not Covered by Budgetary Resources:

	2002	2001
Intragovernmental:		
Other:		
FECA Liability	$ 438	$ 313
Other:		
Unfunded Leave	14,612	13,357
Total liabilities not covered by budgetary resources	15,050	13,670
Total liabilities covered by budgetary resources	7,638,637	10,822,768
Total Liabilities	$ 7,653,687	$ 10,836,438

The Federal Employees Compensation Act (FECA) liability represents the amount of bills received by the Department of Labor for worker's compensation. These bills are received one year in advance of when they are due and are not funded until the subsequent Fiscal Year.

Unfunded Leave is funded at the time when it is taken, and is therefore not funded with current year budgetary resources, but with future resources.

(dollars in thousands unless otherwise stated)

Note 11 - Debt:

	2001 Beginning Balance	Net Borrowing	2001 Ending Balance	Net Borrowing	2002 Ending Balance
Agency Debt:					
Intragovernmental	$ -	$ -	$ -	$ -	$ -
Held by the Public	125,274	-	125,274	(10,849)	114,425
Total Agency Debt	125,274	-	125,274	(10,849)	114,425
Other Debt:					
Debt to the Treasury	5,307,271	802,333	6,109,604	(338,689)	5,770,915
Held by the Public	-	-	-	-	-
Total Agency Debt	5,307,271	802,333	6,109,604	(338,689)	5,770,915
Total Debt	5,432,545	802,333	6,234,878	(349,538)	5,885,340

Classification of Debt:

	2002	2001
Debt to the Treasury	$ 5,770,915	$ 6,109,604
Debt held by the Public	114,425	125,274
Total Debt	$ 5,885,340	$ 6,234,878

Agency debt is comprised of a liability of $114,425 resulting from litigation against the FCC. The liability consists of a voucher that can be used as credit for payment against winning bid amounts in future auctions. The voucher is scheduled to expire in FY 2003. The FCC also 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 reestimates in accordance with the FCRA of 1990, as amended. The borrowings pertain to all loan cohorts.

(dollars in thousands unless otherwise stated)

Note 12 - Other Liabilities:

The following summarizes Other Liabilities as of September 30, 2002 and 2001:

	2002 Current	2001 Current
Intra-governmental		
Custodial Liability	$ 691,662	$ 848,619
Other:		
Accrued Payroll	656	1,919
FECA Liability	438	313
Other Liability	(20)	741
Total Other	1,074	2,973
Total Intragovernmental	$ 692,736	$ 851,592
Deferred Revenue	$ 551,450	$ 3,304,671
Other:		
Accrued Payroll	4,223	9,047
Unfunded Leave	14,612	13,357
Deposit/Unapplied Liability	19,987	20,784
Prepaid Contributions	64,870	36,116
Other	10,298	15,696
Total Other	113,990	95,000
Total Other Public	$ 665,440	$ 3,399,671

The Custodial Liability includes both cash collected and receivables being held for transfer to the U.S. Treasury General Fund. The FCC collects the following types of custodial revenue: spectrum auction revenue, fines and forfeitures revenue, penalty revenue on regulatory fees, ITS processing fees, and interest revenue on auction deposits (held for TDF).

Deposit/Unapplied Liabilities represent either upfront deposits made by auction bidders, or funds received that are being held until proper application is determined.

Prepaid Contributions includes USF contributions paid in advance that will be drawn down during the course of the year and contribution overpayments that may be refunded.

(dollars in thousands unless otherwise stated)

Note 13 - Leases:

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. As a Federal Agency, the FCC is not liable for any lease terms beyond one year. The FCC anticipates that space levels consistent with FY 2002 will be required for the next five years and has estimated space and copier payments consistent with that need in the schedule below. No estimates beyond five years have been provided because of the cancelable nature of the agreements.

Future lease obligations under operating leases are as follows:

Fiscal Year	Bldg	Copier	Total
2003	$ 36,404	$ 1,154	$ 37,558
2004	36,630	1,154	37,784
2005	36,867	1,171	38,038
2006	37,101	1,171	38,272
2007	37,232	1,171	38,403
Total Future Lease Payments	$ 184,234	$ 5,821	$190,055

Note 14 - Commitments and Contingencies:

A contingency is an existing condition, situation, or set of circumstances involving uncertainty regarding possible gain or loss to FCC. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. With the exception of pending, threatened, or potential litigation, a contingent liability is recognized when a past transaction or event has occurred, a future outflow or other sacrifice of resources is more likely than not, and the related future outflow or sacrifice is measurable. For pending, threatened, or potential litigation, a liability is recognized when a past transaction or event has occurred, a future outflow or other sacrifice of resources is likely, and the related future outflow or sacrifice of resources is measurable.

The FCC is a party in various administrative proceedings, legal actions, and claims brought by or against the agency. In addition, several bankruptcy proceedings are ongoing related to the loan portfolio. See Note 7 for more information related to the loans. In the opinion of FCC management, the ultimate resolution of proceedings, actions and claims, outside of the loans, will not materially affect the financial position or results of operations of FCC.

The FCC, USAC, and the Department of Justice are investigating a number of cases related to disbursements of funds from the schools and libraries program, which might result in future proceedings or actions. The number of cases under investigation has increased from FY 2001 to FY 2002, but the complexity of these actions continue to preclude management from estimating the total amount of recovery that may result from these actions.

(dollars in thousands unless otherwise stated)

Note 14 - Commitments and Contingencies: (continued)

During FY 2001, the Fund recovered $1.6 million as a result of these investigations. During FY 2002, the Fund received no recoveries. These matters include an investigation of certain contracting provisions of one of the largest service suppliers, who has recently acquired a portion of a major accounting firm which provides significant accounting support to the Fund.

The FCC has examined its obligations related to canceled FY 1997 authority and believes that it has no outstanding commitments that will require future resources.

Note 15 - Exchange Revenues:

Section 9(a) of the Communications Act of 1934, as amended, authorizes the Commission to assess and collect annual regulatory fees to recover the costs, as determined annually by Congress, that it incurs in carrying out competition, enforcement, consumer information, and spectrum management activities. OMB Circular No. A-25 revised, *User Charges*, requires an agency to assess a user charge against each identifiable recipient for special benefits derived from Federal activities beyond those received by the general public. The Circular also requires that user fees be established to recover the full cost to the Federal government of providing the service when the Government is not acting in its capacity as a sovereign entity. Where a statute prohibits certain aspects of the user fee, the statute shall take precedence over the requirements of OMB Circular A-25. These fees were established by Congressional authority, and, consistent with OMB Circular A-25, the FCC did not determine the full costs associated with its regulatory activity in the establishment of regulatory fees.

Note 16 - Gross Costs and Earned Revenue by Budget Functional Classification:

The tables below represent the costs and revenues of the FCC by budget functional classification for FY 2002 and FY 2001.

Budget Functional Classification	Gross Cost	Earned Revenue	Net Cost
2002			
376	$ 6,571,821	$ (737,614)	$ 5,823,359
959	262	(32,396)	(21,286)
Total	$ 6,572,083	$ (770,010)	$ 5,802,073
2001			
376	$ 14,463,326	$ (5,887,946)	$ 8,575,380
959	19,852	(43,906)	(24,054)
Total	$ 14,483,178	$ (5,931,852)	$ 8,551,326

FEDERAL COMMUNICATIONS COMMISSION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2002 and 2001
(dollars in thousands unless otherwise stated)

Note 16 - Gross Costs and Earned Revenue by Budget Functional Classification: (continued)

Intragovernmental:

Budget Functional Classification	Gross Cost	Earned Revenue	Net Cost
2002			
376	$ 500,162	$ 389,065	$ 889,227
959	-	201,716	201,716
Total	$ 500,162	$ 590,781	$ 1,090,943
2001			
376	$ 1,292,464	$ (844,722)	$ 447,742
959	-	1,637,433	1,637,433
Total	$ 1,292,464	$ 792,711	$ 2,085,175

Code 376 – Other advancement of commerce
Code 959 – Other undistributed offsetting receipts

Note 17 - Prior Period Adjustments:

During FY 2002, prior period adjustments were made to the accounting records. These adjustments were identified as part of a continuing effort to establish stronger review and control procedures. The following schedule presents the adjustments by category for September 30, 2002:

	FY 2002
Entries to recognize property and related depreciation for items purchased in prior years but not identified until the current year	$ 859
FY 1997 Cancelled Authority Adjustments	(2,591)
Recognition of PY Revenue	605
Conversion of Multi-Year Regulatory fees to a deferred revenue basis vs year of receipt basis	(20,884)
Other	(62)
Total Prior Period Adjustments	$ (22,073)

(dollars in thousands unless otherwise stated)

Note 18 - Apportionment Categories of Obligations Incurred:

The following summarizes Apportionment Categories of Obligations Incurred as of September 30, 2002:

	Budgetary	Non-Budgetary
Direct		
Category A	$ 476,192	$ 420,777
Category B	-	-
Exempt from Appropriation	5,210,436	-
Total Direct	$ 5,686,628	$ 420,777
Reimbursable		
Category A	$ 1,372	$ -
Category B	-	-
Exempt from Appropriation	-	-
Total Reimbursable	$ 1,372	$ -

Note 19 - Available Borrowing/Contract Authority, End of Period:

FCC receives borrowing authority consistent with the Federal Credit Reform Act of 1990, as amended. The borrowing is authorized through an indefinite permanent authority at interest rates set each year by the Treasury. In addition, the FCC has permanent indefinite authority for subsidizing the Spectrum Auction direct loan program.

With the exception of a monetary credit that resulted as a judgment against the FCC, all borrowings are from the Bureau of Public Debt. In accordance with applicable standards, all funds are borrowed at the beginning of the period. Therefore, the FCC does not carry over any unused borrowing authority. Repayments of borrowings are made in accordance with the terms of the Federal Credit Reform Act of 1990, as amended. Financing sources for repayment are collections from borrowers or subsidy. The FCC had no available borrowing authority at September 30, 2002.

Note 20 - Terms of Borrowing Authority Used:

The FCC has three types of Financing Sources. These are loan payments made by the Public, interest from U.S. Treasury, and subsidy expense received from Treasury. The Federal Credit Reform Act of 1990 stipulates that the rate used for subsidy calculations, borrowings, and interest on uninvested funds must be for a maturity comparable to the maturity of the direct loans being made to the Public. The majority of FCC's direct loans have a maturity of ten years.

Note 21 – Adjustments to Beginning Balance of Budgetary Resources

The Unobligated Balance – Beginning of Period has been decreased by $343,627 and $56,981 to recognize the impact of including Delivered Orders – Unpaid and Outstanding Checks in the prior year. A corresponding increase of $343,627 has also been recognized for the Obligated balance, net, Beginning of Period.

Note 22 – Permanent Indefinite Appropriations:

The FCC receives permanent indefinite appropriations authority as the funding source for its credit reform program account. As required by the Federal Credit Reform Act of 1990, this account records the subsidy costs associated with the direct loans obligated in 1992 and beyond (including modifications of direct loans or loan guarantees that resulted from obligations or commitments in any year), as well as administrative expenses of the loan program. The FCC received $130,348 related to subsidy and $11,828 related to administrative expense. These appropriations are available until used.

Note 23 – Legal Arrangements Affecting Use of Unobligated Balances:

Regulatory Fees received in excess of the legislative level contained in the FCC's annual appropriation language may be carried forward by the FCC for use in the next fiscal year, subject to the notification of the Congressional appropriations subcommittees. All other no year unobligated balances are available without restriction at the start of the next fiscal year following apportionment by the Office of Management and Budget.

Note 24 - Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the U.S. Government:

SFFAS No. 7 calls for explanations of material differences between budgetary resources available, status of those resources, and outlays as presented in the statement of budgetary resources to the related actual balances published in the *Budget of the United States Government.* However, the *Budget of the United States Government* with actual numbers for FY 2002 has not been published. Pursuant to 31 USC 1105, the *Budget of the United States Government* will be released the first Monday in February, and will be available at the following website: http:/www.whitehouse.gov/omb.

Note 25 - Explanation of the Relationship Between Liabilities Not Covered by Budgetary Resources on the Balance Sheet and the Change in Components Requiring or Generating Resources in Future Periods:

There are two amounts shown in Note 10 as not covered by budgetary resources: FECA Liability and Unfunded Leave. The changes in both of these balances between FY 2001 and FY 2002 are reflected as part of Components Requiring or Generating Resources in Future Periods on the Statement of Financing. The change in unfunded leave of $1,255 is shown on the Increase in Unfunded Leave Liability line on the statement of financing, and the change in FECA Liability of $125 is included as part of the other line item.

Note 26 - Description of Transfers that Appear as a Reconciling Item on the Statement of Financing:

The FCC collects applications fees to cover the cost of processing license applications. The FCC reports the revenue associated with these fees as a revenue source on its Statement of Net Cost. However, the fees are not retained by the FCC. To reflect the transfer of these fees back to the Treasury, the FCC recognizes a transfer out on the Statement of Changes in Net Position. The amount of $21,284 on the Statement of Financing is the total transferred for application fees.

Note 27 - Nonexchange Revenue:

The FCC records all nonexchange revenue recognized on the Statement of Custodial Activity using the accrual basis of accounting. Pursuant to direction provided in SFFAS No. 7, the FCC records Auctions exchange revenue on the Statement of Custodial Activity as well. All receivables recognized as custodial revenues are subjected to the same allowance for loss calculations as other FCC receivables with the exception of Notices of Apparent Liability which are reserved at 100%..

Note 28 - Dedicated Collections:

U.S. telecommunication companies are obligated to pay assessments for Universal Service support and for Telecommunications Relay Service, which are established by the FCC. These assessments are accounted for in the Budget of the U.S. Government as the "Universal Service Fund." As defined by the SFFAS No. 7, such monies are not considered exchange revenues because neither the FCC nor the USF Program sacrificed value or received value in return for the collection and disbursement of the contributed funds (e.g., provided goods or services for a price).

The FCC currently recognizes the assessments collected under the USF Program as nonexchange revenue on its Statement of Changes in Net Position, and the related disbursements as program expenses on the Statement of Net Cost.

(dollars in thousands unless otherwise stated)

Note 28 - Dedicated Collections: (continued)

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program. See Required Supplementary Information for complete disclosure of all activity related to the USF Program.

	FY 2002	FY 2001
Assets		
Cash and Other		
Monetary Asset (Note 4)	$ 2,300,949	$ 1,599,009
Investments (Note 5)	328,194	656,116
Accounts Receivable, net (Note 6)	494,189	549,241
Liabilities		
Accounts Payable	$ 397,180	$ 343,627
Other Liabilities	64,561	36,116
Net Position	2,661,591	2,424,623
Nonexchange Revenue		
Contributions	$ 5,466,034	$ 5,263,872
Interest	52,538	88,868
Expenses		
Provider Related	$ 5,238,739	$ 4,940,907
Administrative Costs	42,865	40,060

The administrative costs are expenses related to managing and overseeing the USF Program. The USF Program is charged administrative expenses by the USAC and the NECA for expenses such as salaries and benefits of the employees dedicated to managing the universal service support mechanisms and the telecommunications relay services mechanism, rent and utilities for office space used, providing accounting and other financial reporting related services, and other miscellaneous activities.

Note 29 – Comparability of the Statements:

Two reporting changes were made during FY 2002 that impacted the comparability of the FY 2002 statements with FY 2001. The FY 2001 balances have not been restated for these changes however, the impact of the changes on FY 2001 is disclosed below:

Inclusion of NANP entity in FCC financial Statement - Management determined that the inclusion of the NANP program administered by the NANPA provides a more complete presentation of FCC financial balances (See Note 1). To establish opening entity balances, the beginning net position has been adjusted by $10,781 in the current fiscal year.

Credit Reform Interest - Based on new guidance from Treasury-FMS, the FCC reported the amount collected in the Treasury interest receipt account as a custodial collection and transfer to Treasury (See Note 1). If the same guidance were in effect for FY 2001, the FCC would have recognized credit reform interest and additional transfers to the U.S. Treasury of $1,214,175.

Note 30 – Reclassifications:

The FCC has adopted OMB Form and Content of Agency Financial Statements effective October 1, 2001. Accordingly, certain amounts for FY 2001 were reclassified to conform with this bulletin.

Note 31 – Subsequent Events:

On January 27, 2003, the Supreme Court of the United States made a favorable ruling for NextWave Personal Communications, Inc. (Nextwave) on the FCC's case against NextWave. At issue was the ownership of licenses for spectrum for which NextWave was the winning bidder in FCC spectrum auctions held in 1996 and 1997 (Auctions 5, 10 and 11). At the time of original auctions, the value of the spectrum licenses sold was approximately $4.7 billion. Sometime after obtaining the licenses, NextWave declared bankruptcy, and in the course of the bankruptcy proceeding, NextWave failed to make the required installment payments due under the FCC's installment payment plan authorized by the Commission's rules. Under the Commission's rules, NextWave's payment default resulted in automatic cancellation of its licenses and the FCC took the licenses back for re-auction.

In FY 2001, the FCC auction (Auction 35) of licenses of spectrum associated with previously auctioned spectrum licenses resulted in approximately $16 billion in winning bids. While the revenue from Auction 35 was not recognized as spectrum auction revenue due to its pending status, the winning bids represented recovery on a significant portion of the previously auctioned spectrum licenses for the purpose of subsidy cost estimation as required by the FCRA of 1990.

Note 31 – Subsequent Events: (continued)

In response to a request from the winning bidders of spectrum re-auctioned as discussed above, the Commission issued an order on March 26, 2002, to return $2.8 billion, or 85% of approximately $3.3 billion in down payments relating to Auction 35, retaining amounts equal to 3% of each winning bid, the minimum bidder default payment under the Commission's rules. As a result of further requests from the winning bidders, the Commission issued an order on November 14, 2002, to grant relief to the eligible winning bidders in Auction 35. Most of those requests have been processed as of December 31, 2002.

The recovery and timing of recovery on loans in default are key factors in the FCC's calculation of its annual credit reform subsidy. For the FCC's FY 2003 credit subsidy re-estimate, which is reflected in the FY 2002 financial statements, the FCC assumed a 100% recovery rate for the NextWave licenses with receipt in the first quarter of FY 2005. The Supreme Court decision addresses ownership of the licenses, not the amount of the payments owed by NextWave as a result of its winning bids for the licenses. Any dispute regarding the amounts owed by NextWave for the licenses, and the timing of future recoveries has not changed as a result of the Supreme Court ruling. These issues will be resolved in bankruptcy court. As a result, the FCC has not made additional changes to these financial statements for this event.

FCC does not believe that an adjustment is necessary on the Federal credit reform subsidy calculation for this significant event because the timing of the recovery assumptions made and the recovery assumption of 100 percent recovery are still appropriate. In addition, FCC is not able to determine any potential contingent liability impact of this ruling on other licenses that were cancelled and re-auctioned in the past. Therefore, no adjustment was made to the September 30, 2002, financial statements for the effects of this subsequent event.

REQUIRED SUPPLEMENTARY INFORMATION

FEDERAL COMMUNICATIONS COMMISSION
REQUIRED SUPPLEMENTARY INFORMATION
September 30, 2002
(Dollars in thousands unless otherwise stated)

Intra-Governmental Assets

Partner Code	Trading Partner	Fund Balance	Accounts Receivable	Loans Receivable	Investments	Other	Total
17	Department of Navy	-	2,273	-	-	-	$ 2,273
97	Department of Defense	-	768	-	-	-	768
20	Department of Treasury	1,285,165	-	-	-	-	1,285,165
99	General Fund/Other	-	-	-	-	-	-
	Total	$ 1,285,165	3,041	$ -	$ -	$ -	$ 1,288,206

Intra-Governmental Liabilities

Partner Code	Trading Partner	Accounts Payable	Borrowings From Treasury (BPD)	Other Liabilities	Total
	Funded				
20	Department of Treasury	$ -	$ 5,770,915	$ -	$ 5,770,915
16	Department of Labor				
	Workman's Compensation	-	-	438	438
	Total Department of Labor	-	-	438	438
24	Office of Personnel Management				
	Health	-	-	174	174
	Life	-	-	7	7
	Retirement	-	-	376	376
	Total Office of Personnel Management	-	-	557	557
	Accrued Liabilities				
4	Government Printing Office	-	-	-	-
13	Department of Commerce	-	-	-	-
14	Department of Interior	-	-	(20)	(20)
19	Department of State & ICASS	-	-	-	-
21	Department of Army	-	-	-	-
24	Office of Personal Management	-	-	-	-
47	General Services Administration	-	-	-	-
	Total Accrued Liabilities	-	-	(20)	(20)
20	Department of Treasury	-	-	-	-
99	General Fund/Other	-	-	691,761	691,761
	Total	$ -	$ 5,770,915	$ 692,736	$ 6,463,651

FEDERAL COMMUNICATIONS COMMISSION
REQUIRED SUPPLEMENTARY INFORMATION
September 30, 2002
(Dollars in thousands unless otherwise stated)

Intragovernmental Earned Revenues and Related Costs

Partner Code	Trading Partner	Earned Revenue	Expenses
03	Library of Congress	$ -	$ 19
04	Government Printing Office	-	1,323
12	Department of Agriculture & NFC	-	245
13	Department of Commerce	-	89
14	Department of Interior	-	806
15	Department Of Justice	150	39
16	**Department of Labor**		
	Workman's Compensation		215
	Other		998
17	Department of Navy		78
18	United States Postal Service	-	621
19	U. S. Department of State		6
20	**Department of Treasury**		
	Bureau of Public Debt	26,000	416,251
	Financial Mang. Svc.	195	-
	Imputed Costs	-	-
	Other	-	61
21	Department of Army	-	-
24	**Office of Personnel Management**		
	Health	-	7,225
	Life	-	263
	Retirement	-	15,760
	Other	-	803
	Imputed Costs	-	11,024
45	Equal Employment Opportunity		10
47	General Services Administration	-	36,133
58	Federal Emergency Management Agency	-	50
69	Dept. of Transportation - USCG	150	-
72	Agency for International Aid	101	-
75	Federal Occupation and Health	-	51
95	Board for International Broadcasting	120	-
97	Department of Defense	470	26
99	General Fund/Other	-	8,066
	Total	$ 27,186	$ 500,162

Federal Communications Commission
Required Supplementary Information
September 30, 2002 and 2001

DEFERRED MAINTENANCE

To determine the estimated cost of deferred maintenance in fiscal year 2000, FCC contracted with professional building inspectors to inspect its real property holdings including buildings and structures. The inspection reports were, in most cases, comprehensive reviews of the buildings and ground conditions and included all items that required attention, whether critical to the functionality of the building or more of a cosmetic nature. In assessing deferred maintenance in fiscal year 2002, FCC reviewed the prior year report and updated it for items completed and newly identified projects. The estimated deferred maintenance for FY 2002 and FY 2001 are $1.5 million and $1.6 million, respectively.

Federal Communications Commission
Consolidating Balance Sheet
As of September 30, 2002
(dollars in thousands)

	FCC	USF	NANP	Consolidated
ASSETS				
Intragovernmental				
Fund Balance with Treasury (Note 3)	$ 1,285,165	$ -	$ -	$ 1,285,165
Accounts Receivable (Note 6)	$ 3,041	-	-	$ 3,041
Total Intragovernmental	1,288,206	-	-	1,288,206
Cash and Other Monetary Assets (Note 4)	35,402	2,300,949	11,647	2,347,998
Investments (Note 5)	-	328,194	-	328,194
Accounts Receivable, net (Note 6)	20,345	494,189	825	515,359
Loans Receivable, net (Note 7)	5,259,258	-	-	5,259,258
General Property, Plant, and Equipment, net (Note 9)	41,813	-	-	41,813
Other	2	-	-	2
Total Assets	6,645,026	3,123,332	12,472	9,780,830
LIABILITIES				
Intragovernmental				
Debt (Note 11)	$ 5,770,915	$ -	$ -	$ 5,770,915
Other (Note 12)				
Custodial	691,662	-	-	691,662
Other	1,074	-	-	1,074
Total Other	692,736	-	-	692,736
Total Intragovernmental	6,463,651	-	-	6,463,651
Accounts Payable	12,935	397,180	56	410,171
Debt Held by the Public (Note 11)	114,425	-	-	114,425
Other (Note 12)				
Deferred Revenue	551,450	-	-	551,450
Other	49,119	64,561	310	113,990
Total Other	600,569	64,561	310	665,440
Total Liabilities	$ 7,191,580	$ 461,741	$ 366	$ 7,653,687
Commitments and Contingencies (Note 14)				
NET POSITION				
Unexpended Appropriations	$ 22,158	$ -	$ -	$ 22,158
Cumulative Results of Operations	(568,712)	2,661,591	12,106	2,104,985
Total Net Position	(546,554)	2,661,591	12,106	2,127,143
Total Liabilities and Net Position	$ 6,645,026	$ 3,123,332	$ 12,472	$ 9,780,830

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidating Statement of Net Cost
For the Year Ended September 30, 2002
(dollars in thousands)

		FCC		USF		NANP		Consolidated
PROGRAM COSTS:								
Licensing:								
Intragovernmental gross costs	$	18,805	$	-	$	-	$	18,805
Less: Intragovernmental earned revenue		(274)		-		-		(274)
Intragovernmental net costs		18,531		-		-		18,531
Gross costs with the public		55,448		-		-		55,448
Less: Earned revenues from the public		(76,853)		-		-		(76,853)
Net costs with the public		(21,405)		-		-		(21,405)
Total net cost		(2,874)		-		-		(2,874)
Competition:								
Intragovernmental gross costs	$	27,368	$	-	$	-	$	27,368
Less: Intragovernmental earned revenue		(386)		-		-		(386)
Intragovernmental net costs		26,982		-		-		26,982
Gross costs with the public		80,624		-		-		80,624
Less: Earned revenues from the public		(108,113)		-		-		(108,113)
Net costs with the public		(27,489)		-		-		(27,489)
Total net cost		(507)		-		-		(507)
Enforcement:								
Intragovernmental gross costs	$	17,899	$	-	$	-	$	17,899
Less: Intragovernmental earned revenue		(247)		-		-		(247)
Intragovernmental net costs		17,652		-		-		17,652
Gross costs with the public		52,728		-		-		52,728
Less: Earned revenues from the public		(69,073)		-		-		(69,073)
Net costs with the public		(16,345)		-		-		(16,345)
Total net cost		1,307		-		-		1,307
Consumer Information Services:								
Intragovernmental gross costs	$	8,994	$	-	$	-	$	8,994
Less: Intragovernmental earned revenue		(125)		-		-		(125)
Intragovernmental net costs		8,869		-		-		8,869
Gross costs with the public		26,495		-		-		26,495
Less: Earned revenues from the public		(34,859)		-		-		(34,859)
Net costs with the public		(8,364)		-		-		(8,364)
Total net cost		505		-		-		505
Spectrum Management:								
Intragovernmental gross costs	$	10,382	$	-	$	-	$	10,382
Less: Intragovernmental earned revenue		(147)		-		-		(147)
Intragovernmental net costs		10,235		-		-		10,235
Gross costs with the public		30,584		-		-		30,584
Less: Earned revenues from the public		(41,139)		-		-		(41,139)
Net costs with the public		(10,555)		-		-		(10,555)
Total net cost		(320)		-		-		(320)

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidating Statement of Net Cost
For the Year Ended September 30, 2002
(dollars in thousands)

	FCC	USF	NANP	Consolidated
Universal Service:				
Intragovernmental gross costs	$ 463	$ -	$ -	$ 463
Less: Intragovernmental earned revenue	(7)	-	-	(7)
Intragovernmental net costs	456	-	-	456
Gross costs with the public	1,364	5,281,604	-	5,282,968
Less: Earned revenues from the public	(1,807)	-	-	(1,807)
Net costs with the public	(443)	5,281,604	-	5,281,161
Total net cost	13	5,281,604	-	5,281,617
Numbering:				
Intragovernmental gross costs	$ -	$ -	$ -	$ -
Less: Intragovernmental earned revenue	-	-	-	-
Intragovernmental net costs	-	-	-	-
Gross costs with the public	-	-	9,685	9,685
Less: Earned revenues from the public	-	-	(11,010)	(11,010)
Net costs with the public	-	-	(1,325)	(1,325)
Total net cost	-	-	(1,325)	(1,325)
Credit Reform:				
Intragovernmental gross costs	$ 416,251	$ -	$ -	$ 416,251
Less: Intragovernmental earned revenue	(26,000)	-	-	(26,000)
Intragovernmental net costs	390,251	-	-	390,251
Gross costs with the public	521,095	-	-	521,095
Less: Earned revenues from the public	(399,705)	-	-	(399,705)
Net costs with the public	121,390	-	-	121,390
Total net cost	511,641	-	-	511,641
Total Net Program Costs	$ 509,765	$ 5,281,604	$ (1,325)	$ 5,790,044
Cost not Assigned to Programs:				
Depreciation	$ 10,716	$ -	$ -	$ 10,716
Telecommunications Development Fund	262	-	-	262
Other Expenses	1,313	-	-	1,313
				-
Less: Earned Revenues not Attributed to Programs:				
Telecommunications Development Fund	$ (262)	$ -	$ -	$ (262)
Net Cost of Operations (Note 16)	$ 521,794	$ 5,281,604	$ (1,325)	$ 5,802,073

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidating Statement of Changes in Net Position
For the Year Ended September 30, 2002
(dollars in thousands)

	FCC		USF		NANP		Consolidated	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	$ (183,265)	$ 24,012	$ 2,424,623	$ -	$ -	$ -	$ 2,241,358	$ 24,012
Prior period adjustments (Note 17)	(22,073)	-	-	-	-	-	(22,073)	-
New Reporting Entity (Note 29)					10,781		10,781	-
Beginning balances, as adjusted	(205,338)	24,012	2,424,623	-	10,781	-	2,230,066	24,012
Budgetary Financing Sources:								
Appropriations received	-	387,428	-	-	-	-	-	387,428
Appropriations transferred in/out (+/-)	-	-	-	-	-	-	-	-
Other adjustments (recission, etc) (+/-)	-	(220,338)	-	-	-	-	-	(220,338)
Appropriations used	168,944	(168,944)	-	-	-	-	168,944	(168,944)
Other Financing Sources:								
Transfers-in/out without reimbursement (+/-)	(21,284)	-	-	-	-	-	(21,284)	-
Imputed financing from costs absorbed by others	11,069	-	-	-	-	-	11,069	-
Universal Service Fund Nonexchange Revenue	-	-	5,518,572	-	-	-	5,518,572	-
Other (+/-)	(309)	-	-	-	-	-	(309)	-
Total Financing Sources	158,420	(1,854)	5,518,572	-	-	-	5,676,992	(1,854)
Less: Net Cost of Operations	521,794		5,281,604		(1,325)		5,802,073	
Ending Balances	$ (568,712)	$ 22,158	$ 2,661,591	$ -	$ 12,106	$ -	$ 2,104,985	$ 22,158

The accompanying notes are an integral part of these statements

Federal Communications Commission
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2002
(dollars in thousands)

	FCC		USF		Consolidated	
	Budgetary	Non Budgetary Credit Program Financing Account	Budgetary	Non Budgetary Credit Program Financing Account	Budgetary	Non Budgetary Credit Program Financing Account
Budgetary Resources:						
Budget Authority						
Appropriations Received	$ 168,671	$ -	$ 5,543,236	$ -	$ 5,711,907	$ -
Borrowing Authority	-	4,456	-	-	-	4,456
Unobligated Balance:						
Beginning of Period (Note 21)	22,051	18,175	1,895,267	-	1,917,318	18,175
Spending Authority from Offsetting Collections:						
Earned						
Collected	312,914	762,860	-	-	312,914	762,860
Receivable from Federal Sources	7	-	-	-	7	-
Changed Unfilled Customer Orders						
Without Advance from Federal Sources	1	-	-	-	1	-
Subtotal	503,644	785,491	7,438,503	-	7,942,147	785,491
Recoveries of Prior Year Obligations	6,958	-	-	-	6,958	-
Permanently not available	(15,524)	(343,145)	-	-	(15,524)	(343,145)
Total Budgetary Resources	$ 495,078	$ 442,346	$ 7,438,503	$ -	$ 7,933,581	$ 442,346
Status of Budgetary Resources:						
Obligations Incurred (Note 18):						
Direct	$ 476,192	$ 420,777	$ 5,210,436	$ -	$ 5,686,628	$ 420,777
Reimbursable	1,372	-	-	-	1,372	-
Subtotal	477,564	420,777	5,210,436	-	5,688,000	420,777
Unobligated Balance:						
Apportioned	7,398	21,569	-	-	7,398	21,569
Other Available	-	-	2,228,067	-	2,228,067	-
Unobligated Balance not Available	10,116	-	-	-	10,116	-
Total Status of Budgetary Resources	$ 495,078	$ 442,346	$ 7,438,503	$ -	$ 7,933,581	$ 442,346
Relationship of Obligations to Outlays:						
Obligated Balance, net, Beginning of Period (Note 21)	$ 63,770	$ -	$ 343,627	$ -	$ 407,397	$ -
Obligated Balance, net, End of Period:						
Accounts Receivable	405	-	-	-	405	-
Unfilled Customer Orders from Federal Sources	(532)	-	-	-	(532)	-
Undelivered Orders	43,592	-	-	-	43,592	-
Accounts Payable	12,186	-	397,180	-	409,366	-
Outlays:						
Disbursements	478,716	420,777	5,156,883	-	5,635,599	420,777
Collections	(312,914)	(762,860)	-	-	(312,914)	(762,860)
Subtotal	165,802	(342,083)	5,156,883	-	5,322,685	(342,083)
Less: Offsetting Receipts	21,284	-	-	-	21,284	-
Net Outlays	144,518	(342,083)	5,156,883	-	5,301,401	(342,083)

The accompanying notes are an integral part of these statements

Federal Communications Commission
Consolidating Statement of Financing
For the Year Ended September 30, 2002
(dollars in thousands)

	FCC	USF	NANP	Consolidated
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
Obligations incurred	$ 898,341	$ 5,210,436	$ -	$ 6,108,777
Less: Spending authority from offsetting collections and recoveries	1,082,739	-	-	1,082,739
Obligations net of offsetting collections and recoveries	(184,398)	5,210,436	-	5,026,038
Less: Offsetting receipts	21,284	-	-	21,284
Net obligations	(205,682)	5,210,436	-	5,004,754
Other Resources				
Transfers in/out without reimbursement (+/-)	(21,284)	-	-	(21,284)
Imputed financing from costs absorbed by others	11,069	-	-	11,069
Other (+/-)	309	-	-	309
Net other resources used to finance activities	(9,906)	-	-	(9,906)
Total resources used to finance activities	(215,588)	5,210,436	-	4,994,848
Resources Used to Finance Items not Part of the Net Cost of Operations				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided (+/-)	(8,264)	-	-	(8,264)
Resources that fund expenses recognized in prior periods	(23,975)	-	-	(23,975)
Budgetary offsetting collections and receipts that do not affect net cost of operations				
Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	(739,915)	-	-	(739,915)
Other	399,705	-	-	399,705
Resources that finance the acquisition of assets	15,773	-	-	15,773
Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	(5,623)	-	-	(5,623)
Total resources used to finance items not part of the net cost of operations	(362,299)	-	-	(362,299)
Total resources used to finance the net cost of operations	146,711	5,210,436	-	5,357,147
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Periods:				
Increase in annual leave liability	1,255	-	-	1,255
Upward/Downward reestimates of credit subsidy (+/-)	366,685	-	-	366,685
Increase in exchange revenue receivable from the public	(1,893)	-	-	(1,893)
Other (+/-)	(22,996)	-	-	(22,996)
Total components of Net Cost of Operations that will require or generate resources in future periods	343,051	-	-	343,051
Components not Requiring or Generating Resources:				
Depreciation and Amortization	10,716	-	-	10,716
Other (+/-)	21,316	71,168	(1,325)	91,159
Total components of Net Cost of Operations that will not require or generate resources	32,032	71,168	(1,325)	101,875
Total components of Net Cost of Operations that will not require or generate resources in the current period	375,083	71,168	(1,325)	444,926
Net Cost of Operations	$ 521,794	$ 5,281,604	$ (1,325)	$ 5,802,073

The accompanying notes are an integral part of these statements

Federal Communications Commission
Required Supplementary Information
For the Year ended September 30, 2002
(dollars in thousands)

STATEMENT OF BUDGETARY RESOURCES

The Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Federal Agency Financial Statements* requires additional disclosure of an entity's budgetary information by major budgetary account if the information was aggregated for presentation purposes on the Statement of Budgetary Resources. The major budget accounts include the FCC and the Universal Service Fund. Reflected in the chart below are the major accounts of the FCC that are aggregated and presented in the FY 2002 Combined Statement of Budgetary Resources.

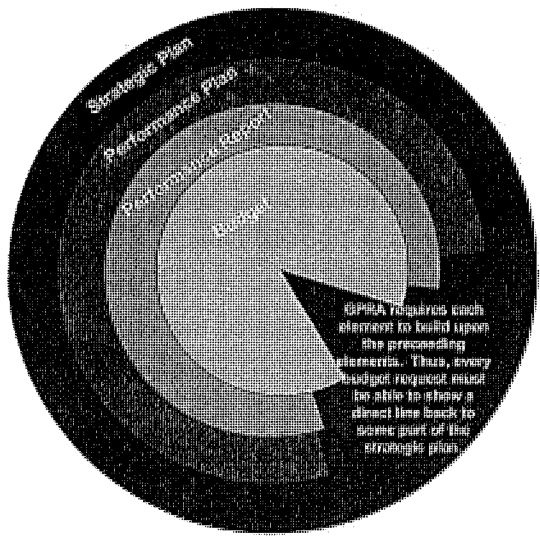
FY 2002	**S&E**	**Credit Reform**	**Auctions**	**USF**	**Total**
Budgetary Resources:					
Budget authority	$ 26,285	$ 146,842	$ -	$ 5,543,236	$ 5,716,363
Unobligated balances - beginning of period	12,452	18,413	9,361	1,895,267	1,935,493
Spending authority from offsetting collections	231,948	765,916	77,918	-	1,075,782
Adjustments	(12,616)	(343,131)	4,036		(351,711)
Total budgetary resources	$ 258,069	$ 588,040	$ 91,315	$ 7,438,503	$ 8,375,927
Status of Budgetary Resources:					
Obligations incurred	$ 249,720	$ 563,578	$ 85,043	$ 5,210,436	$ 6,108,777
Unobligated balances - available	4,500	24,462	5	2,228,067	2,257,034
Unobligated balances - not available	3,849	-	6,267	-	10,116
Total, status of budgetary resources	$ 258,069	$ 588,040	$ 91,315	$ 7,438,503	$ 8,375,927
Relationship of Obligations to Outlays:					
Obligated balance, net, beginning of period	$ 41,719	$ 2,700	$ 19,351	$ 343,627	$ 407,397
Obligated balance transferred, net	-	-	-	-	-
Obligated balance, net, end of period	31,487	2,919	21,245	397,180	452,831
Outlays:					
Disbursements	257,035	563,345	79,113	5,156,883	6,056,376
Collections	(231,941)	(765,916)	(77,917)	-	(1,075,774)
Subtotal	25,094	(202,571)	1,196	5,156,883	4,980,602
Less: Offsetting Receipts	21,284	-	-	-	21,284
Net Outlays	$ 3,810	$ (202,571)	$ 1,196	$ 5,156,883	$ 4,959,318

OTHER ACCOMPANYING INFORMATION

Incorporating Performance Measurement in Management Activities

The GPRA requires that Federal agencies establish standards to measure effectiveness and performance in achieving their goals and objectives. The GPRA requires Federal agencies to: develop a Strategic Plan covering the current and subsequent five fiscal years (revised every three years); prepare an Annual Performance Plan setting out performance goals for one fiscal year; and submit an Annual Program Performance Report comparing actual performance results with performance goals as detailed in Figure 15.

Figure 15: Interdependence of Elements Required by GPRA



The FCC has taken numerous steps to ensure that performance measures are integrated into the day-to-day activities of the Commission and used by FCC staff to manage results. Recently, the FCC established a working group comprised of all the chiefs of staff from the bureaus and offices and in some cases, the assistant bureau chiefs for management. The working group meets during the planning cycle to discuss the Strategic Plan, the Annual Performance Plan, and performance measures that accurately reflect the Commission's strategic goals and objectives. Additionally, the working group was created to help the Commission move towards performance budgeting. Accordingly, budget obligations-by-program-activity will eventually be aligned with an output, or a cluster of related outputs, intended to influence a single outcome. In this way, program costs can be matched with the outputs produced. The FCC recognizes that the GPRA is a valuable tool for achieving these ends, and has integrated performance measures into budget and management activities. In general, the following steps are taken:

A. ***Coordination***. PERM staff coordinates with the FCC Budget Office, the Chief Financial Officer (CFO), and the bureaus and offices to discuss the various performance reports including the Commission's Strategic Plan, the development of performance measures for the Annual Performance Plan, evaluation processes, and the Annual Program Performance Report. Additionally, PERM coordinates efforts to ensure performance measures are incorporated into FCC operations.

B. ***Review of Performance Measures***. In response to requests from the Managing Director and PERM staff, bureaus and offices are asked to review performance measures and provide feedback on the previous year's Annual Performance Plan – which measures are still useful, which should be modified, and whether there are additional measures that would be useful from a management perspective.

C. ***Develop Outcome Measures***. Bureau and office chiefs are encouraged to develop outcome measures, which reflect the intended result, effect, or consequence (e.g., impact) of carrying out a program or activity. Output goals, on the other hand, result from process-related measures, and reflect the level of activity or effort over a period of time (or by a specified date), including characteristics and attributes (e.g., timeliness) set as standards for conducting the activity or effort.[44] As a regulatory agency, however, it is difficult to measure with certainty the market impact of many of the FCC's measures. In addition, there are other limitations to performance measurement: performance cannot be fully described by a single indicator; indicators do not by themselves say why performance is at the level reported; focusing on quantifiable indicators can sometimes have unintended consequences; and, where performance measurement is feasible, the impacts will likely occur over a period of time, not in a single fiscal year.

D. ***Documentation***. Once the results of the efforts to develop performance measures are completed and analyzed, the new and revised measures are incorporated into financial and budget documents and the Annual Performance Plan. PERM maintains records of data collections from the bureaus/offices through a quarterly report, described in E. below.

E. ***Data Collection, Verification and Validation, and Creation of Quarterly Reports***. PERM collects relevant quarterly data on performance measures from the bureaus and staff offices. The data is analyzed and summarized for the Quarterly Performance & Results Review (QPRR). The FCC uses numerous methods and techniques to verify and validate data as described in Section IV of the MD&A (pp. 15-16).

F. ***Information Sharing***. The QPRR is distributed to management in all FCC bureaus and staff offices as a management tool for assessing performance to date. In addition, the QPRR is provided to, and used as a benchmark by, the Chief of Staff and the Chairman.

G. ***Management Tool***. FCC management uses the QPRR information as a tool to identify areas where goals are not being met, which enables PERM staff to work with bureaus and offices to make adjustments as necessary throughout the year. With the FCC's new pass/fail employee appraisal process, it is at the discretion of each bureau and office manager to identify the key performance measures that will be used for staff appraisals.

The FCC strives to ensure that staff regularly assesses efforts to meet the FCC's performance goals so that appropriate progress is made throughout the year. As noted previously, the FCC is currently refining its methods of tracking FTE time and expenses by activity starting in FY

[44] OMB Circular A-11, Section 200, page 200-3, June 2002.

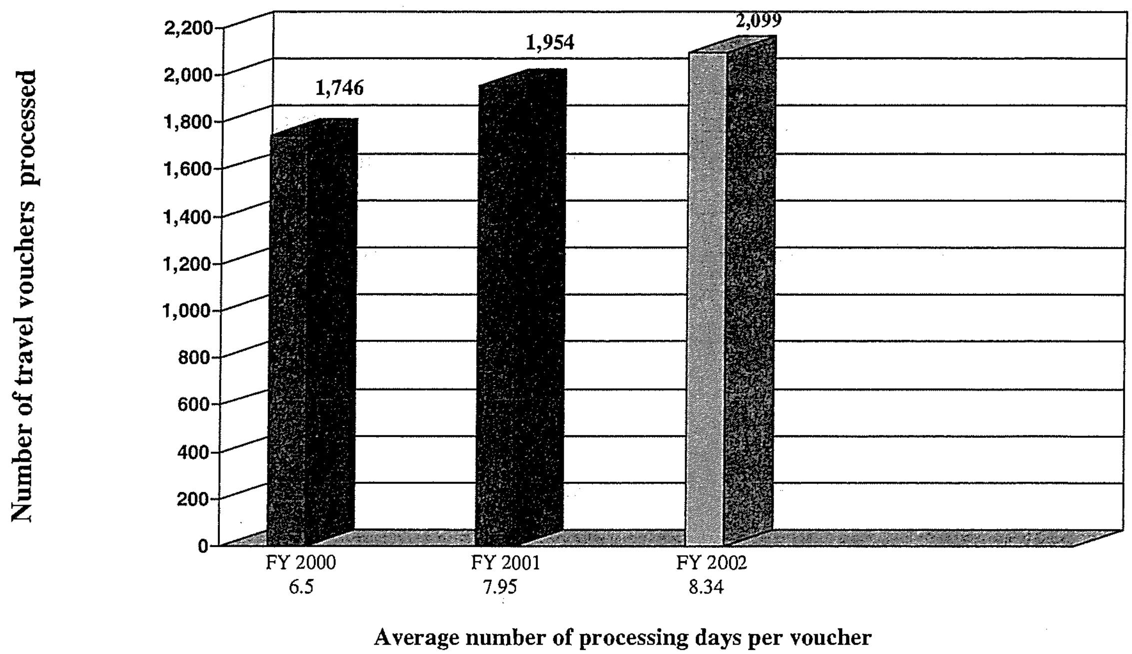
2003. Before the end of FY 2003, the FCC intends to begin testing the system with full implementation of the MCAS by FY 2004. Once implemented the MCAS will provide a robust and integrated financial management system supporting the partnership between program and financial managers, assuring the integrity of information for decision making, and measuring the full cost of the FCC's programs and their various elements, activities, and outputs. By using such a cost accounting system, FCC management will have an increased level of detail concerning the cost of doing business. Accurate, timely, and consistent financial management data and information across FCC bureaus and offices, will then be available simultaneously to program managers, financial managers, and budget officials.

A complete list of the FCC's performance measures and the results of the FCC's FY 2002 performance will be published in the FY 2002 Annual Program Performance Report when it is published in early calendar year 2003. The report will be located on the FCC webpage at http://www.fcc.gov/annual_reports.html.

Financial Performance Measures

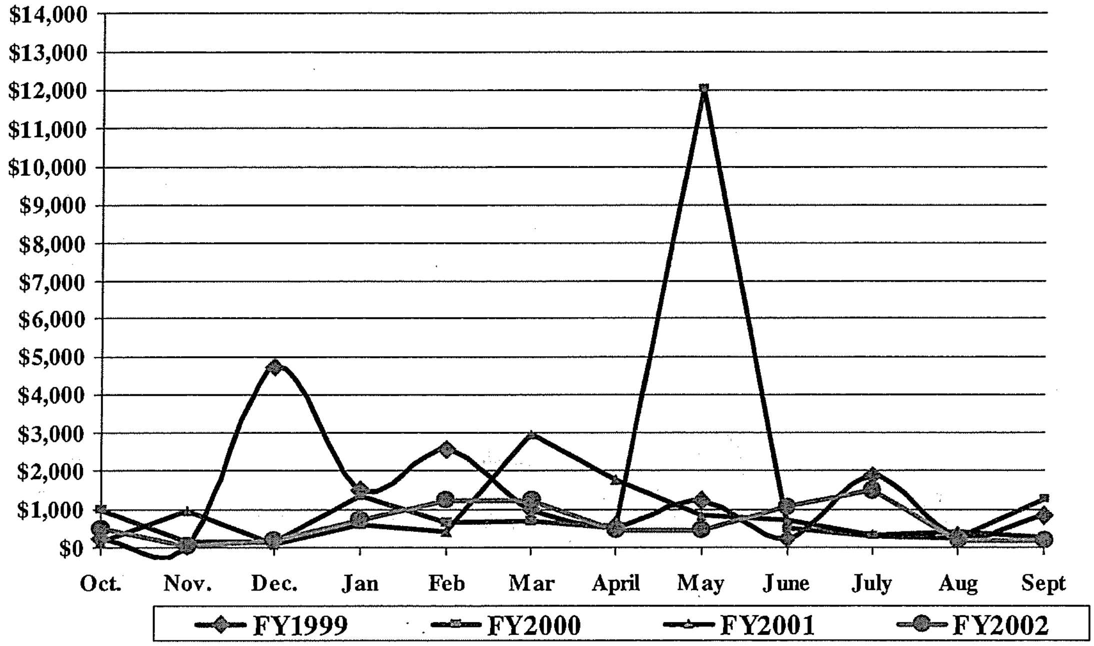
The following additional administrative financial measures are included to highlight the FCC's performance in the areas of travel voucher processing, prompt payment interest, remittance over secure Internet (e-commerce/ROSIE), electronic fund transfers (EFT), application and licensing fees, fines and forfeitures, spectrum auctions, and budget figures. These measures are separate from the Strategic Planning process and are not tracked in the budget tables above. The AMD-FO monitors these financial measures.

Figure 16: Travel Voucher Processing FY 2002



The FCC's travel voucher processing goal of ten working days begins with the receipt of a correct voucher with all proper backup documentation. The Federal Travel Regulations allow 30 days. During FY 2002, 2,099 travel vouchers were processed with an average processing time of 8.34 working days. During FY 2001, a total of 1,954 travel vouchers were processed with an average processing time of 7.95 working days. In FY 2000, fewer travel vouchers were processed, a total of 1,746, with an average processing time of 6.5 working days.

Figure 17: Prompt Payment Interest

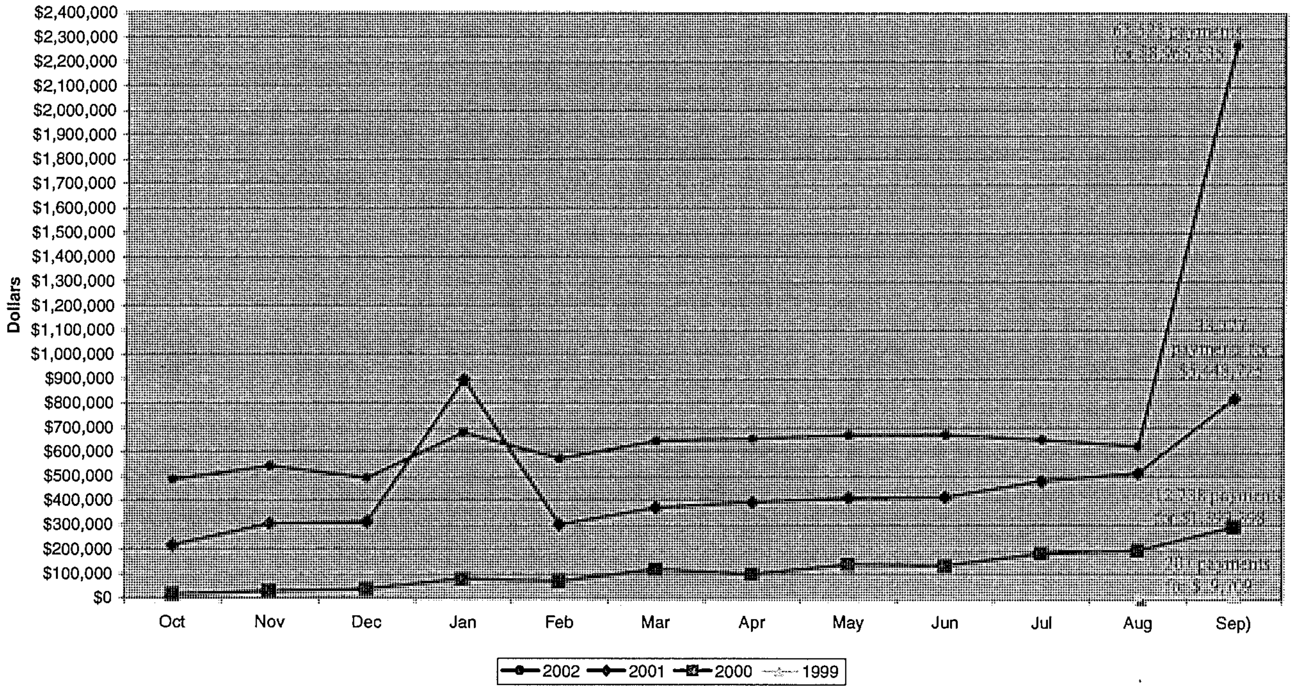


Total prompt payment interest incurred during FY 2002 was $7,840. The FCC processed 5,021 invoices totaling $91,653,172 during FY 2002 of which 890 invoices, totaling $7,406,472, were subject to prompt payment interest.The total prompt payment interest incurred during FY 2001 was $9,603. The FCC processed 4,802 invoices totaling $64,565,269 during FY 2001 of which 912 invoices, totaling $6,333,546, were subject to the late payment provisions of the Prompt Payment Act. During FY 2001, there was an increase in purchases being processed by credit cards, therefore resulting in fewer invoices.

In FY 2000, total prompt payment interest incurred was $20,123. Included in this total was $12,051 paid on travel from the central billing account in May due to a contract dispute between the General Services Administrator (GSA) and the card processor. The total number of invoices processed in FY 2000 was 6,421, totaling $59,420,521, of which 1,453 invoices, totaling $5,285,128, were subject to the late payment provisions of the Prompt Payment Act.

Figure 18: Remittance Over Secure Internet (ROSIE)

(ROSIE Monthly Totals by Fiscal Year)



ROSIE, Remittance Over Secure Internet (E-Commerce), is a payment system, which allows license applicants to pay their application fees electronically via credit card. The system, built to Department of Treasury security specifications, employs the latest encryption technology and architecture to safeguard data. ROSIE is accessed via links in the licensing systems, which offer the electronic credit card payment option.

ROSIE was implemented in August 1999, processing a total of 207 payments for $19,709 in FY 1999. In FY 2000, 12,738 payments for $1,393,398 were processed. In FY 2001, 33,777 payments for a total of $5,448,725 were processed.

ROSIE's impressive record of steady growth continued, and even accelerated, during FY 2002, in which 63,523 payments for a total of $8,965,535 were processed. As can be seen from the accompanying graph, ROSIE enjoyed its most successful month ever in September 2002, in which $2,271,465 was collected, more than double our previous monthly high.

The FCC has made enhancements to strengthen security and make ROSIE more customer-friendly. The FCC regards this venture into electronic commerce as a great success and may possibly expand the on-line payment option to include all payments made to the agency.

Figure 19: Electronic Funds Transfer (EFT)
(Percent of Payments via EFT for FY 2002)

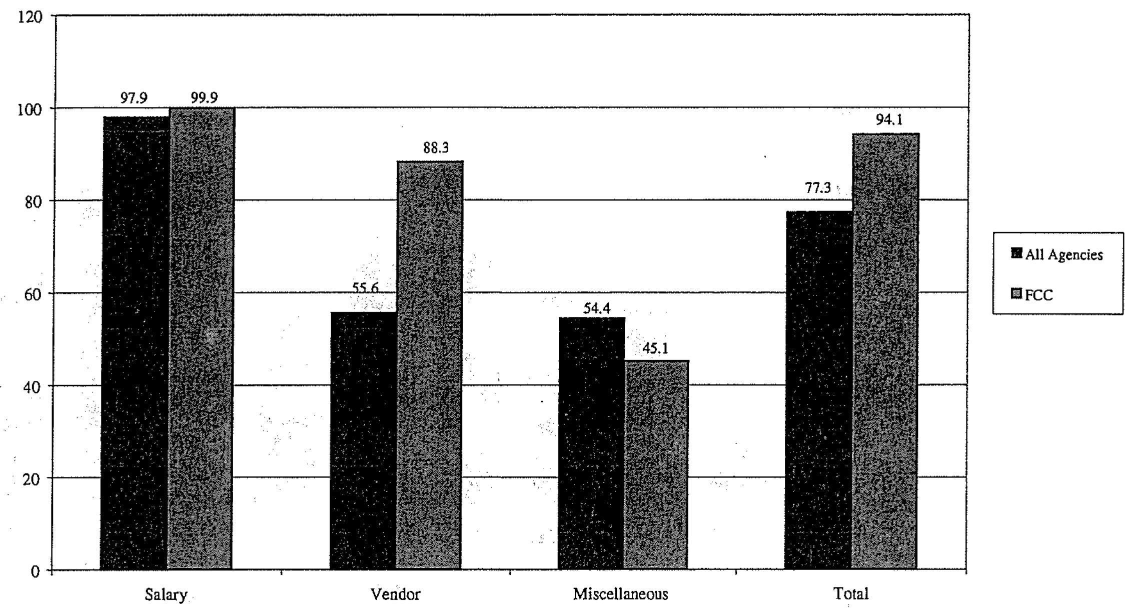
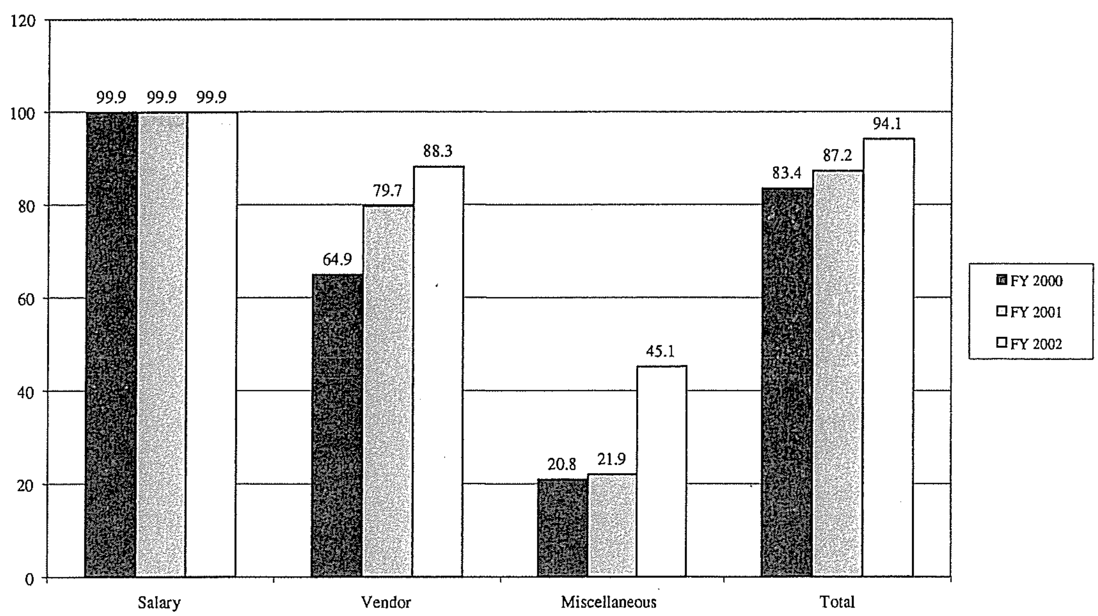
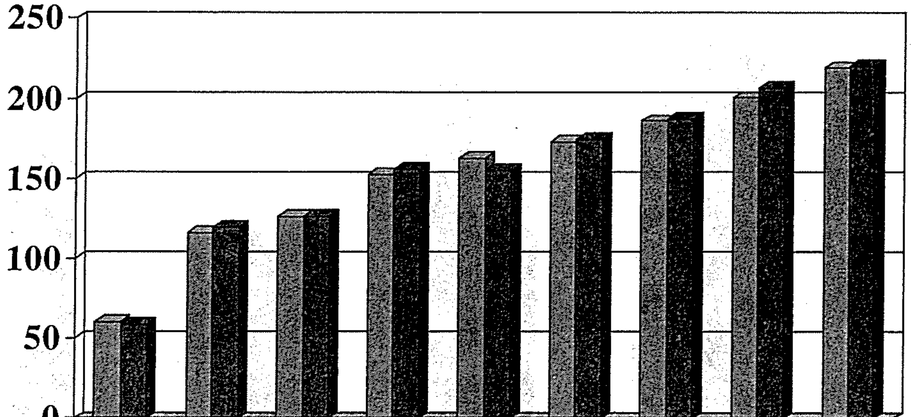


Figure 20: Percent of Payments via EFT
(Comparison of FYs 2000, 2001 and 2002)



The FCC has worked to increase its level of payments via EFT/direct deposit. Through various outreach programs, such as including letters to vendors with contract and purchase order mailings, offering e-mail notifications of EFT payments, and telephoning vendors, the percentage of vendor payments via EFT has increased from 79.7% in FY 2001 to 88.3% in FY 2002. In FY 2000, that figure was 64.9%. There is also an initiative in progress to increase the percentage of fee refunds via EFT. Currently, all refunds are paid by check and comprise 98% of the FCC's manual miscellaneous payments. The Commission is endeavoring to convert these check payments to EFT by capturing bank information from the applicant's remittance. The FCC hopes to implement this capability during FY 2003.

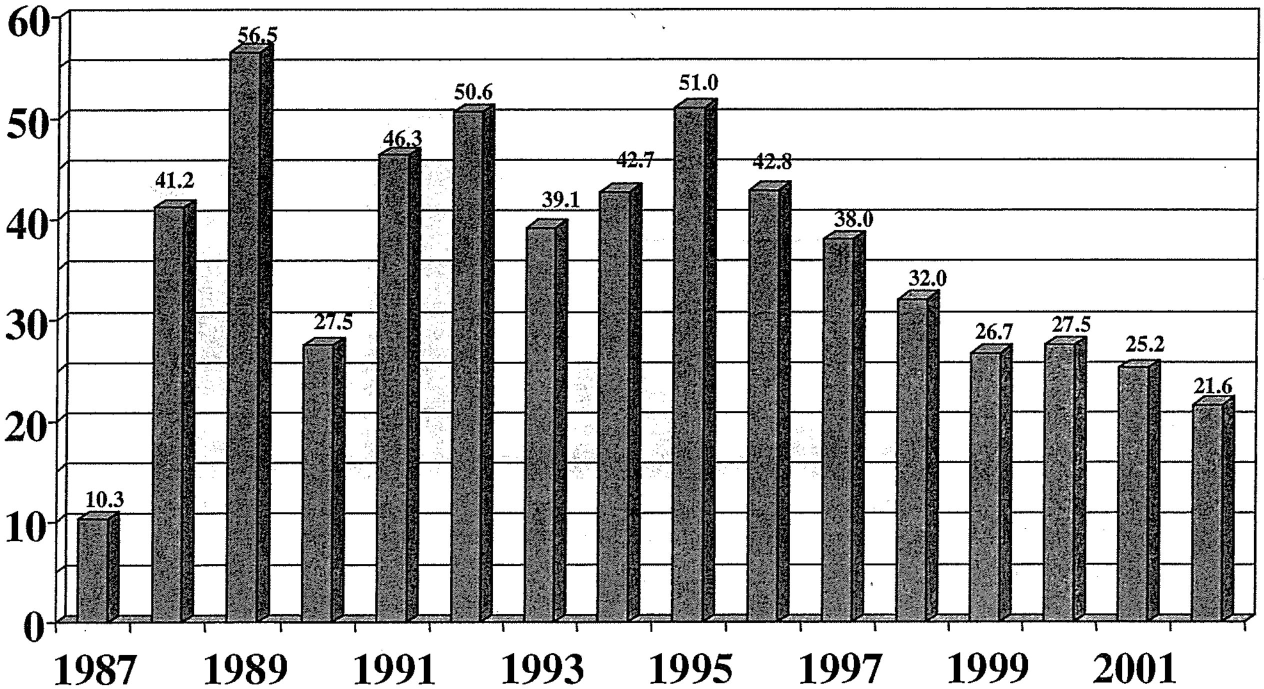
Figure 21: Regulatory Fees
(FY 1994 to Present in $ Millions)



	1994	1995	1996	1997	1998	1999	2000	2001	2002
Expected	**60.4**	**116**	**126**	**153**	**163**	**173**	**186**	**200**	**219**
Collected	**58.7**	**119**	**127**	**156**	**155**	**174**	**187**	**207**	**220**

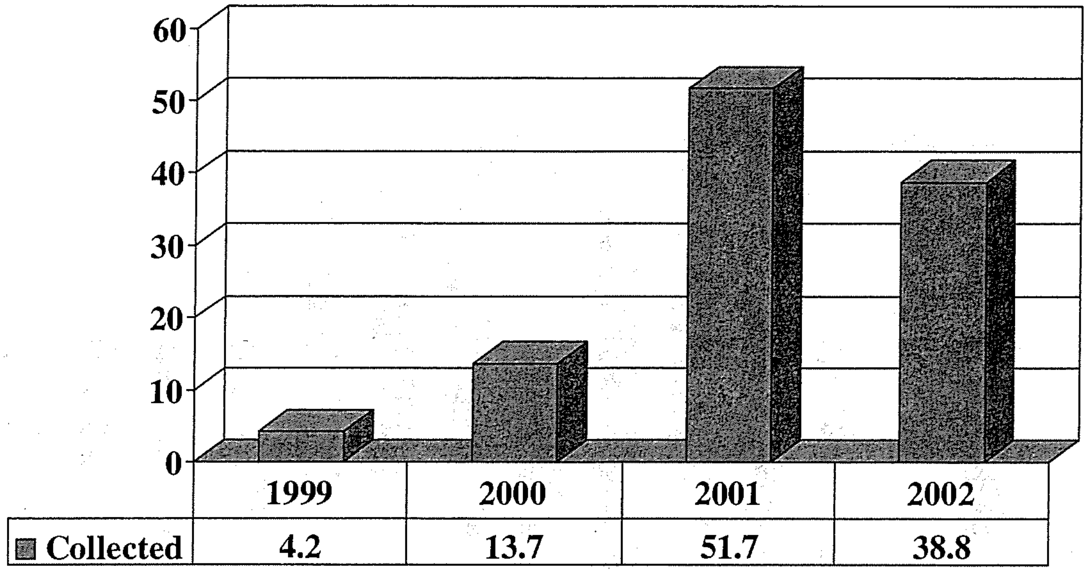
The Fee Collection Program authorizes the Commission to prescribe charges for certain regulatory services it provides to many of the communications entities within its jurisdiction. Figure 21 above shows the Regulatory Fees collected since implementation in 1994.

Figure 22: Authorization of Services
(FY 1987 to Present in $ Millions)



The Congressionally-mandated Fee Collection Program was implemented on April 1, 1987. Figure 22 above shows filing fees collected since the inception of the Fee Collection Program to date.

Figure 23: Fines and Forfeitures
(FY 1999 to Present in $ Millions)

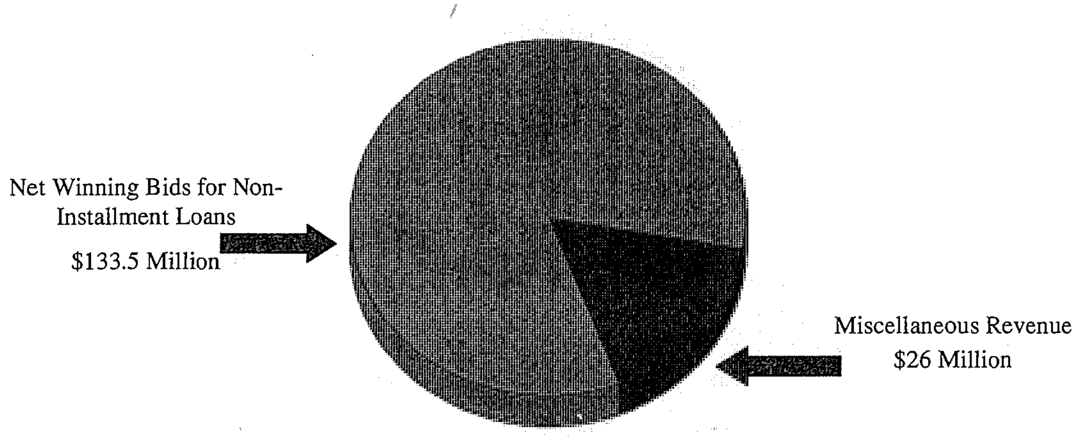


In FY 2002, collections for fines and forfeitures totaled $38,753,010. In FY 2001, collections for fines and forfeitures totaled $51,687,758. In FY 2000, the total amount collected was $13,749,209, and in FY 1999, $4,160,504.

In 1999, the Commission approved a corporate merger. In its order, the Commission adopted a "Performance Assurance Plan" designed to promote the quality of service provided by one company to competitive carriers. The Performance Assurance Plan requires the company to make voluntary payments to the Treasury if its wholesale service quality falls below certain set standards. Because the performance fell below the standards specified in the Commission's order, the company made substantial payments to the Treasury in FY 2001 and continued payments under the consent decree in FY 2002.

Similar requirements were applicable to a second company. In calendar year 2001, their performance also fell below the standards established in the Commission's order and was required to submit payments to the Treasury, which continued in FY 2002.

Figure 24: FY 2002 Collected & Anticipated Cash Flows Generated By Auctions $159.5 Million



Net winning bids represent the total amount expected to be collected from FY 2002 Spectrum Auctions. Miscellaneous revenue includes assessed penalties, late fees and unjust enrichments collected in FY 2002.

Figure 25: FY 2002 Budget Authority (BA) Distribution by Object Class

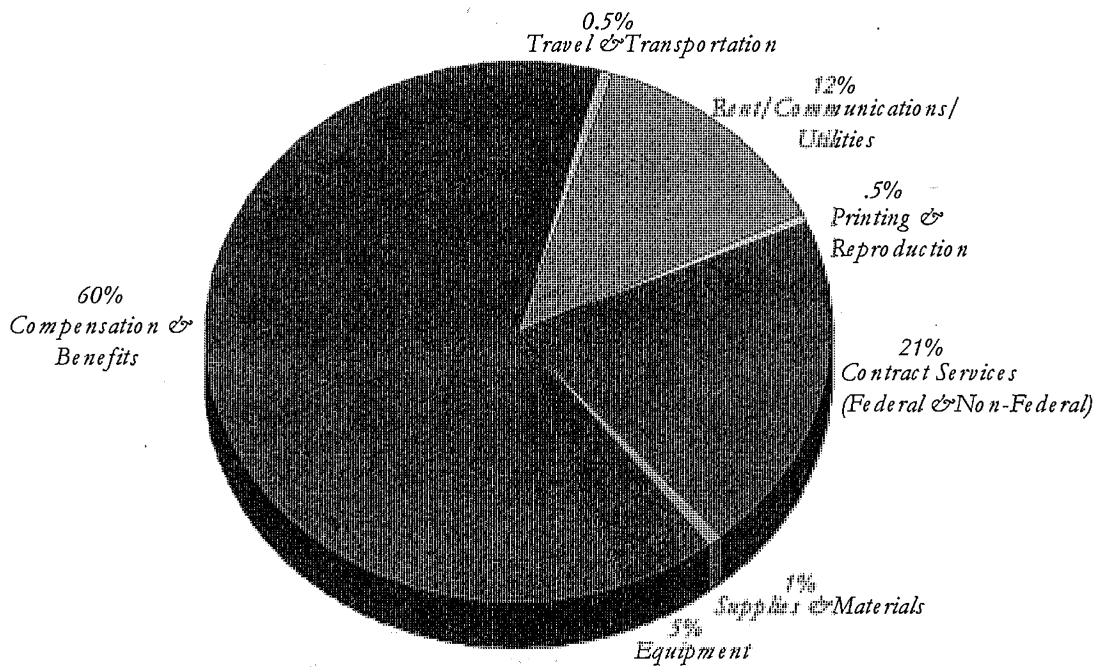


Figure 25 illustrates the distribution of obligations by budget category in FY 2002 (excluding the USF funds and the Auctions Loan Program administrative funds). These obligations are funded from multiple funding sources including annual appropriations, offsetting collections (regulatory fees, interagency and travel reimbursements), and Auctions Loan Program reimbursements. No gift and bequest funding was received in FY 2002.

Figure 26: FY 2002 BA Distribution by Object Class Credit Program Account (0300)

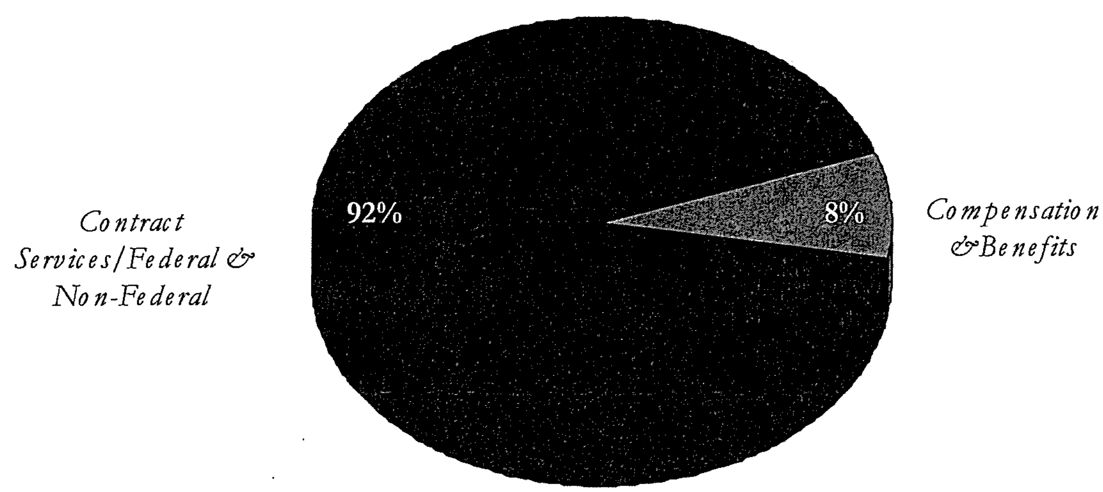


Figure 26 illustrates the distribution of administrative cost by budgetary category required to provide for Auctions Loan Program activities in FY 2002.

GLOSSARY OF ACRONYMS

3G	Third generation (wireless systems)
AMD-FO	Associate Managing Director – Financial Operations
BA	Budget authority
BOC	Bell Operating Company
CFO	Chief Financial Officer
CGB	Consumer and Governmental Affairs Bureau
CIMS	Consumer Information Management System
CLEC	Competitive local exchange carrier
CMP	Civil monetary penalties
CORES	Commission Registration System
COTS	Commercial off-the-shelf
CSB	Cable Services Bureau
DBS	Direct broadcast satellite
DOC	U.S. Department of Commerce
DOD	U.S. Department of Defense
DOI	U.S. Department of the Interior
DOJ	U.S. Department of Justice
DOL	U.S. Department of Labor
DTV	Digital Television
EB	Enforcement Bureau
EFT	Electronic Funds Transfer
EPA	Environmental Protection Agency
FAA	Federal Aviation Administration
FASAB	Financial Accounting Standards Advisory Board
FCRA	Federal Credit Reform Act of 1990
FERS	Federal Employee Retirement System
FFS	Federal Financial System
FMFIA	Federal Managers Financial Integrity Act
FTC	Federal Trade Commission
FTE	Full-time equivalents
FY	Fiscal year

GAAP	Generally accepted accounting principles
GAO	General Accounting Office
GPRA	Government Performance and Results Act of 1993
GSA	General Services Administration
IB	International Bureau
ICASS	International Cooperative Administrative Support Services
ICB	Information Collection Budget
ILEC	Incumbent local exchange carrier
IP	Internet protocol
IT	Information technology
ITS	International Telecommunications Settlement
IVDS	Interactive Video and Data Service
JFMIP	Joint Financial Management Improvement Program
Kbps	Kilobits per second
LNPA	Local Number Portability Administrator(s)
MB	Media Bureau
MCAS	Managerial Cost Accounting System
MDS	Multipoint Distribution Service
MMB	Mass Media Bureau
MSRC	Media Security and Reliability Council
MVPD	Multichannel video program distribution
NAL	Notice of Apparent Liability
NANC	North American Numbering Council
NANP	North American Numbering Plan
NANPA	North American Numbering Plan Administrator
NBANC	North American Billing and Collection, Inc.
NBC	National Business Center
NCES	National Center for Education Statistics
NFC	National Finance Center of the U.S. Department of Agriculture
NLS	Nortridge Loan System
NPRM	Notice of Proposed Rulemaking
NRIC	Network Reliability and Interoperability Council
NTIA	National Telecommunications and Information Administration
OALJ	Office of Administrative Law Judges

OCBO	Office of Communications and Business Opportunities
OET	Office of Engineering and Technology
OGC	Office of the General Counsel
OIG	Office of Inspector General
OLA	Office of Legislative Affairs
OMB	Office of Management and Budget
OMD	Office of the Managing Director
OMR	Office of Media Relations
OPM	Office of Personnel Management
OPP	Office of Plans and Policy
OWD	Office of Workplace Diversity
PCS	Personal Communications Service
PP&E	Property, Plant and Equipment
PY	Prior year
QPRR	Quarterly Performance and Results Review
RSI	Required Supplementary Information
SBR	Statement of Budgetary Resources
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TDA	Telecommunications Development Account
TDF	Telecommunications Development Fund
Treasury	U.S. Department of the Treasury
TRS	Telecommunications Relay Service (Fund)
UCC	Uniform commercial code
U.S.	United States
USAC	Universal Service Administrative Company
USCS	United States Customs Service
USDA	United States Department of Agriculture
USF	Universal Service Fund
USF Program	The four support mechanisms of the USF and the TRS
WCB	Wireline Competition Bureau
WTB	Wireless Telecommunications Bureau
WTO	World Trade Organization
Y2K	Year 2000

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Inspector General of the
Federal Communications Commission

We have audited the accompanying consolidated balance sheet of the Federal Communications Commission (FCC) as of September 30, 2002 (FY 2002) and 2001 (FY 2001), the related consolidated statements of net cost and custodial activity for the years then ended; and the consolidated statement of changes in net position, combined statements of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002 (collectively the financial statements). These financial statements are the responsibility of the FCC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraphs, we conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall principal statements' presentation. We believe our audits provide a reasonable basis for our opinion.

The FCC's Office of the General Counsel (OGC) determined that for FY 2001, Local Number Portability Administration (LNPA) met the indicative criteria to be included as an FCC reporting entity as set forth in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*. LNPA was not included as a reporting entity in the FCC's FY 2001 financial statements. The FCC was not able to provide adequate financial information to enable us to perform adequate audit procedures to determine the materiality of this reporting entity; nor were we able to satisfy ourselves by other auditing procedures. The FCC's OGC reevaluated the status of FCC's reporting entities and concluded that for FY 2002 LNPA did not meet the indicative criteria and therefore, is not included as an FCC reporting entity.

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FCC changed its method of accounting and financial statement presentation of the Universal Service Fund's (USF) collections and disbursements late in the FY 2001 audit process. For FY 2001, we were not able to obtain adequate documentation to support earned revenues of $5,353 million and program costs of $4,981 million; nor were we able to satisfy ourselves as to these amounts by performing other auditing procedures.

Beginning in FY 2001, FCC changed its financial statement presentation of FCC program costs from four programs to five programs. For FY 2001, we were not able to adequately verify the allocation of the program costs, nor were we able to satisfy ourselves by performing other auditing procedures.

In our opinion, except for the effects of such adjustments to the FY 2001 consolidated balance sheet and statement of net cost, if any, as might have been necessary had we been able to perform adequate audit procedures on the LNPA reporting entity, USF's collections and disbursements, and program costs' allocation referred to in the preceding paragraphs, the financial statements and related notes referred to in the first paragraph, present fairly, in all material respects, the financial position of the FCC as of September 30, 2002 and 2001, its net cost and custodial activity for the years then ended; and its changes in net position; budgetary resources; and reconciliation of net cost to budgetary resources for the year ended September 30, 2002 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 7, Direct Loans, Non-Federal Borrowers, FCC changed, at the request of the OMB, the discount rates it used to calculate subsidy re-estimates from the weighted average of comparable Treasury rates at the time of loan disbursement or grant date to the actual annual average discount rate.

Also, as discussed in Note 29, Comparability of the Statements, several reporting changes were made during FY 2002 that impacted the comparability of the FY 2002 and FY 2001 financial statements. FCC included the North American Numbering Plan as a reporting entity in FY 2002. In addition, based on new guidance from the Department of the Treasury, Financial Management Service, the FCC reported the amount collected in the Department of the Treasury interest receipt account as a custodial collection and a transfer in the FY 2002 statement of custodial activity. The FY 2001 balances were not restated for these changes.

In accordance with *Government Auditing Standards*, we have also issued our reports dated January 3, 2003 on our consideration of the FCC's internal control over financial reporting, and on our tests of the FCC's compliance with certain provisions of laws and regulations. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management Discussion and Analysis and Required Supplemental Information are not a required part of the basic financial statements but are supplementary information required by OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements.* The Other Accompanying Information is presented for the purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures to such information, which consisted principally of inquiries of FCC management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Clifton Gunderson LLP

Calverton, Maryland
January 3, 2003, except for Note 31,
as to which the date is January 27, 2003

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control

To the Inspector General of the
Federal Communications Commission

We have audited the financial statements of the Federal Communications Commission (FCC) as of and for the year ended September 30, 2002, and have issued our report thereon dual dated January 3, 2003 and January 27, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

In planning and performing our audit, we considered FCC's internal control over financial reporting by obtaining an understanding of FCC's internal control, determined whether 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 described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA) (31 U.S.C. 3512), 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 agency'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 noncompliance may nevertheless occur and not be detected. However, we noted certain matters discussed in the following paragraphs involving the internal control and its operation that we consider to be reportable conditions and material weaknesses.

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Finally, with respect to internal control related to performance measures reported in FCC's Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. 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.

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MATERIAL WEAKNESSES

I. Financial Reporting (Modified Repeat Condition)

The Chief Financial Officers Act of 1990 (CFO Act) assigned responsibility for developing and maintaining integrated accounting and financial management systems including financial reporting and internal control to each Federal agency. OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, defines the form and content of financial statements to be prepared by each agency. 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 (GAAP). 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 also consists of policies and procedures related to the processing and summarizing of accounting entries and the preparation of financial statements.

FCC's financial reporting process has significantly improved over the last couple years. However, the continued reliance on inadequate financial management systems, as in prior years, results in a material weakness in financial reporting.

A. Integrated Financial Management Systems (Modified Repeat Condition)

OMB Circular No. A-127, *Financial Management Systems,* requires that each agency establish and maintain a single integrated financial management system. Without a single integrated financial management system to ensure timely and accurate financial data, poor policy decisions may occur due to inaccurate or untimely information. Managers are less likely to be able to report accurately to the President, Congress, and the public on Government operations in a timely manner. In addition, scarce resources are more likely to be directed toward the collection of information rather than to delivery of the intended programs.

Having a single, integrated financial management system does not necessarily mean having only one software application covering all financial management systems needs within an agency. Also, it does not mean that all information is physically located in the same database. Rather, a single, integrated financial management system is a unified set of financial systems linked together electronically in an efficient and effective manner to provide agency-wide financial system support. Integration means that the user is able to have one view into systems such that, at whatever level the individual is using the system, he or she can obtain needed information efficiently and effectively through electronic means. Interfaces are acceptable as long as the supporting detail is maintained and accessible to managers. Interface linkages must be electronic unless the number of transactions is so small that it is not cost beneficial to automate the interface. Easy reconciliations between systems, where interface linkages are appropriate, must be maintained to ensure data accuracy.

FCC's consolidated financial statements were compiled and prepared from four separate core financial systems administered by four separate entities. At financial statement preparation time, FCC goes through the exercise of compiling financial data in separate spreadsheets in a complex and time-consuming process. The financial data included in the spreadsheets is consolidated for financial statement preparation.

- <u>FCC's Core Financial System</u>
  FCC utilizes the Federal Financial System (FFS) as its general ledger and core financial management system. FFS is not capable of generating most user reports for data analysis on a real time basis. To compensate for FFS's limitations, FCC uses a software application to download data from FFS for its analysis. Other financial management systems used at FCC include the property management system, loan model spreadsheets, license databases, fee billings and collection systems, cost system, and various spreadsheet applications. None of these financial management systems are integrated. Also, FCC's fee collection system 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.

  FCC has on-going efforts over the last three years to strengthen its financial management systems. FCC management expects to achieve some level of financial management systems' integration by implementing the Revenue Accounting and Management Information System (RAMIS). RAMIS is designed to integrate, among others, the direct loan system, fee billing and collection systems, fines and forfeitures, licensees' databases, and the interface with FFS. RAMIS, however, was still not fully operational at September 30, 2002. As of September 30, 2002, only four of the seven modules were completed and parallel testing of the three modules remained in progress.

- <u>Universal Service Fund (USF), the Telecommunications Relay Services Fund (TRS) and the North America Numbering Plan (NANP) Core Financial Systems</u>
  The USF, TRS, and NANP general ledger systems do not interface with FCC's own accounts receivable sub-ledger, accounts payable sub-ledger, or cash systems. In addition, each of these sub-systems is an independent system or is comprised of spreadsheets. Monthly, accounting transactions from various systems are summarized in spreadsheets for data entry into FCC's general ledger system.

  The USF, TRS, and NANP general ledger systems are also not United States Standard General Ledger (USSGL) compliant. There are no budgetary entries in these general ledgers. FCC prepares a crosswalk of the USF, TRS, and NANP proprietary accounts to USSGL.

  OMB Bulletin No. 01-09 states, "When the reporting entities of which these components are a part, issue consolidated or consolidating statements that include such components, GAAP for Federal entities shall be applied to these components."

Recommendation:

1. Focus on meeting RAMIS milestones and ensure that all target dates are met. Document the plan outlining the steps taken (i.e., processes, data stewardship, management information, systems architecture, and internal control) to meet a unified set of financial systems linked together electronically in an efficient and effective manner to provide agency-wide financial system support.

Management Comment:

Management concurs. The effort to develop an integrated financial system has been ongoing since FY 1998. A major part of that effort is the implementation of RAMIS. In conjunction with RAMIS, FCC selected an outside loan processor whose system will interface directly with FFS and replace the current spreadsheet models used to account for loans. FCC selected a new cost accounting system that will be fully integrated with the existing core financial system. The cost accounting system will be implemented during FY 2003 and is expected to be operational for FY 2004.

Recommendation:

2. Assess the degree of integration needed in the USF, TRS, and NANP financial systems. Develop plans to integrate each of the USF, TRS, and NANP financial systems so that they will meet the requirements of OMB Circular No. A-127 and the Federal Financial Management Improvement Act of 1996 (FFMIA).

Management Comment:

Management concurs. FCC is working with the reporting entities to address the need for systems integrations to meet the requirement of the OMB Circular No. A-127 and the FFMIA.

Recommendation:

3. Implement Federal GAAP accounting, including budgetary accounting, for the USF, TRS, and NANP to facilitate compliance with Federal financial reporting requirements.

Management Comment:

Management concurs. FCC is responsible for incorporating into its consolidated statements the financial information concerning a variety of non-traditional Federal programs, most notably the USF, TRS, and NANP. The administrators of these funds do not currently maintain the funds in accordance with standard accounting guidelines over Federal funds. Thus, forcing the agency to take extraordinary efforts to express the financial activities of these reporting components, which were accounted for under standards for not-for-profits, into standards for Federal funds. The most notable issues being the lack of budgetary accounting and fund obligation policies. FCC concurs with the recommendation that FCC instruct the administrators of these funds to account for the funds under generally accepted accounting principals over Federal government funds as long as these funds are included in the consolidated financial representations of the agency.

B. Federal Financial System Setup and Posting Model Definitions (Modified Repeat Condition)

In fiscal year 2002, FCC continues to have problems with the FFS system setup and posting model definitions. These problems result in non-compliance with the transaction posting models consistent with USSGL guidance and policies when recording and classifying some transactions. Although FCC had already addressed a number of issues related to the transaction-posting model, our audit noted several instances of incorrect transaction posting logic. This system deficiency may continue to impair the quality and reliability of the financial management information even though the incorrect entries identified were corrected at year-end.

Recommendations:

4. Continue to update and correct FFS system setup and posting model definitions to comply with the transaction posting models consistent with USSGL guidance and policies for recording and classifying transactions. Ensure changes made to FFS are tested and accepted before entering production.

5. Continue to review all frequently used transaction types and transaction codes to ensure the accounting entries (budgetary and proprietary) are correct.

Management Comment:

Management concur. FCC maintains copies of the most recent Treasury Financial Manual and receives updates from Financial Management Services (FMS) that it uses to identify USSGL account and posting model changes. Additional posting model changes have been identified. However, the FCC has not had the resources needed to complete required analysis to effect the changes in a timely manner. We plan to prioritize and address these changes in FY 2003.

C. Timely Recording and Analysis of Financial Activities (Modified Repeat Condition)

Transaction level activities are not recorded to the general ledger and/or subsidiary ledger on a timely basis and analysis of several activities is inadequate. Although FCC's interim (June 30, 2002) financial statements were more complete this year when compared to prior year in terms of reported accounting transactions, several significant transactions are recorded through period-end journal voucher entries or through the use of "on-top" financial statement adjustments. For example, loan activities (principal and interest receivable, interest revenue and application of collections) for the whole year were recorded using a journal voucher entry at year-end.

Not recording or delayed recording of transactions diminishes the value of financial management reports for decision-making purposes. *Standards for Internal Control in the Federal Government* issued by the General Accounting Office (GAO) page 15 states that "Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions."

Recommendation:

6. Record and analyze financial transactions at least once a month or more frequently as appropriate.

Management Comment:

Management concurs. The conversions to RAMIS and an outside loan processor in FY 2003 will automate several receipt posting processes that currently are performed manually. The conversion will allow FCC to post transactions more timely and update the core system more frequently.

D. Supervisory Review of the USF, TRS, and NANP Financial Reporting Process (Modified Repeat Condition)

FCC did not apply adequate review procedures to ensure that financial information provided for the USF, TRS, and NANP, collectively mentioned herein as the reporting entities, are accurate, reasonable, and properly supported prior to inclusion in the FCC consolidated financial statements. However, FCC communicated with the reporting entities' management regarding consolidation efforts. Nevertheless, some errors and adjustments relating to the USF were identified only as a result of the audit process.

FCC management is responsible for obtaining reasonable assurance on the completeness and the reliability of the reporting entities' financial reporting and their compliance with laws and regulations before their financial information is consolidated into the FCC consolidated financial statements.

Recommendation:

7. Conduct a comprehensive review of the reporting entities' accounting policies to ensure their policies are acceptable and in compliance with FCC's policies. In addition, FCC should include appropriate accounting guidelines that will ensure that the reporting entities obtain FCC concurrence for any accounting policy changes.

Management Comment:

Management concurs. Communication between reporting components and FCC were enhanced during FY 2002 and will continue for FY 2003. Monthly meetings are held to discuss open issues as they relate to the financial reporting aspects of the consolidated entity, which have been instrumental in structuring the financial reporting process. FCC will complete its policies and procedures and will include review processes performed before the consolidation of the financial data into the financial statements.

Recommendation:

8. Ensure that the reporting entities' financial information provided by the entities' administrators are reviewed for accuracy, reasonableness, and propriety prior to incorporation in the FCC consolidated financial statements. Improve two-way open communications allowing the entities' administrators to review financial information included in the FCC consolidated financial statements.

Management Comment:

Management concurs. The FCC continued to develop stronger communication and reporting lines with all of its reporting components in FY 2002. As a result of adjustments identified from the audit, policies and procedures to address the errors will be reviewed and updated. Currently FCC does not allocate staff to reviewing the financial representation of its reporting components. The need for this level of activity is under review.

Recommendation:

9. Document clearly the legal, financial, and operational boundaries of FCC, USF, TRS, NANP, and the entities' administrators. With the assistance of FCC Office of the General Counsel (OGC) and the entities' administrators, FCC management needs to formally define in writing each entity's financial management role and responsibility to avoid confusion and misunderstanding.

Management Comment:

Management concurs. FCC's OGC provides guidance on the inclusion of reporting components for financial reporting purposes and other legal and operational boundaries. No formal document outlining the roles and responsibilities of all the "involved" staff has been prepared. However, in FY 2003, FCC will prepare formal documentation to be provided to all staff playing a part in the compilation and audit of the financial statements.

Recommendation:

10. Expand and document a formal financial reporting compilation process that adequately addresses the processes and issues for consolidating the USF, TRS, and NANP.

Management Comment:

Management concurs. FCC will complete the policies and procedures manual for Financial Reporting and will incorporate the compilation process requirements of FCC and its reporting components.

II. Cost Accounting (Modified Repeat Condition)

A. Cost Accounting System (Modified Repeat Finding)

In fiscal year 2002, FCC continued to lack a cost accounting system that (1) collects and reports the costs of FCC's activities and programs accurately and timely, and (2) meets the Joint Financial Management Improvement Program's (JFMIP) *System Requirements for Managerial Cost Accounting.*

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, and the lack of review of the proper application of the cost accounting activity codes. Because the

Management Comment:

Management concurs. The current cost accounting system was designed before FCC faced meeting the requirements of SFFAS No. 4 and was designed to meet budgetary requirements and accounting requirements of the original regulatory fee and auctions program. Realizing the need for a more comprehensive and integrated cost accounting system, FCC selected a new cost accounting system in FY 2002. The new system has the capability to meet not only financial and performance requirements, but also bureau specific requirements. The FCC will implement the new system during FY 2003 and is expected to be operational for FY 2004. Until the new system is implemented, FCC will continue to rely on cost finding techniques like those performed in FY 2002.

B. Cost Finding Techniques

In fiscal year 2001, the audit opinion on FCC's SNC was qualified due to the auditor's inability to verify the cost allocation resulting from FCC's change from four reporting entity programs to five entity programs [the addition of Spectrum Management (SM)] and USF. To compensate for the inadequate cost accounting system and to address the qualification on the SNC, FCC instituted cost finding techniques in fiscal year 2002 to collect the costs of the additional programs - SM and USF.

In implementing these cost finding techniques, FCC modified FFS to accumulate cost data forming the basis for program cost allocation. This new approach used several specific processes to establish the actual costs associated with the SM and the USF in the fourth quarter, and used the fourth quarter actual costs to estimate the SM and the USF costs for the first three quarters.

We found that implementation of these cost-finding techniques, simultaneously during the operating fiscal year, required significant resources and extraordinary efforts which may not have been necessary if project planning had commenced earlier. Although FCC was aware of the change in programs before the beginning of the fiscal year, it did not implement its cost finding techniques for SM and USF until the fourth quarter. The timing of this implementation led to management difficulty in monitoring progress and reviewing deliverables.

Monitoring progress

There was little management acknowledgement of the errors associated with the new process, no analysis to assess the severity of the errors or potential impact, and no qualifying statements informing the reader of data limitations attributable to errors when providing information to those who will use the information for decision-making, accounting, or reporting. Additionally, the initial costing methodology for fiscal year 2002 did not address significant issues communicated from the prior fiscal year audit relating to: mitigating the risk of incorrect costing for programs when aspects of program definitions and functions were identical or similar, validating non-personnel costs with the newly created codes and related code changes, and accounting for reporting component costs in the consolidated financial statements.

Additionally, FCC did not provide the Office of Inspector General (OIG) the cost allocation methodology timely to allow requested review and feedback before management's use for analytical review of period data. Management provided the resulting analytical review a day after receipt of the methodology. FCC was also unable to provide a list of supervisors who sign the bi-weekly timecards. Another listing used in the costing methodology for verification purposes was determined, after use in the costing techniques, to be outdated and not relative to the verification step to which it was applied. These lists supported cost-finding techniques.

GAO *Standards for Internal Control in the Federal Government* state, "Internal control monitoring should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

<u>Reviewing deliverables</u>

Documentation of the costing process provided for audit contained discrepancies and errors. FCC's new processes and results were not sufficiently documented, as well as, key management assumptions and decisions contained in the costing methodology were not documented or summarized until late in the process. And, USF costs were never formally defined and documented, leaving it for self interpretation by FCC employees to report.

GAO *Standards for Internal Control in the Federal Government* state, "It [internal control] comprises the plans, methods, and procedures used to meet missions, goals and objectives and, in doing so, supports performance-based management." Internal control should provide reasonable assurance that the objectives of the agency, such as the effectiveness and efficiency of operations including the use of the entity's resources, are being achieved.

Although we were eventually able to satisfy ourselves with the reasonableness of the program allocations, most of the internal control deficiencies relating to the cost finding techniques could have been alleviated had the efforts been undertaken earlier in the fiscal year.

Recommendations:

14. Evaluate the adequacy of the modified cost-finding techniques in accumulating and allocating costs, matching revenue, accounting and generating financial information as they are applied in fiscal year 2003.

15. Ensure that cost finding techniques are sufficiently documented and supported.

16. Provide clear, consistent and uniform terminology and definition of each program, especially the USF. Clearly document and outline direct costs that should be charged to each program.

17. Continue training employees on the proper use of the revised activity codes and emphasize the importance of properly coding their time. Ensure that appropriate employees of bureaus and offices fully understand the importance of properly classifying costs and are trained on the proper application of the activity codes.

Management Comment:

Management concurs. The original cost accounting project was envisioned for implementation for fiscal year 2003. Management accelerated the implementation in an attempt to provide some reasonable form of cost accounting data for fiscal year 2002. We agree the fiscal year 2002 documentation and other considerations needed strengthening. The process will be refined for FY 2003.

The cost finding techniques used to accomplish the cost allocation project were adequate to accomplish the task of accurately reflecting the costs of the five activities of the FCC, the USF/TRS, NANP, and Credit Reform. The FCC will review the processes from fiscal year 2002 and, where necessary, provide updates and reminders to staff on the new cost codes. FCC will use the same cost methodology applied in fiscal year 2002 for fiscal year 2003 as we work to implement the new cost accounting system.

C. Matching Revenues to Costs (Repeat Finding)

FCC allocated earned revenues in the same proportion as allocated costs instead of matching related revenues to costs. SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* states, "related revenue should be matched with the cost." Specific earned revenue should be matched against specific program costs in accordance with the program costs and revenue description in the budget submission to Congress.

Recommendation:

18. Review the propriety of the costing methodology and the matching of earned revenue against costs (costing methodologies).

Management Comment:

Management concurs. FCC will address this issue as part of its approach to establish the new cost accounting system for FY 2004. Until that time, the FCC will review alternative processes for FY 2003.

Recommendation:

20. Update accounting policies and procedures to ensure consistent accounting application and consistent definition of transactions.

Management Comment:

Management concurs. USAC and the USF accountants have procedures and controls in effect that are designed to prevent errors, and they will continue to review their existing policies and procedures and update them as necessary to ensure consistent accounting applications and definition of transactions.

Recommendation:

21. Establish and perform supervisory reviews to ensure that reports and financial data received from USAC contractors are supported, accurate, reasonable and that transactions are properly and consistently classified and recorded.

Management Comment:

Management concurs. Supervisory review is of paramount importance to USAC. Review occurs on several levels. Reviews and approvals are conducted prior to monthly closing and after closing takes place. Periodic variance analysis is considered an important part of the accounting process. All disbursements are approved prior to release of the payment. FCC will work with USAC to review internal controls.

B. Controls Over USF Disbursements to "At Risk" Service Providers

USF maintains a disbursement watch list of service providers under investigation for various reasons. Invoices submitted by these "at risk" service providers are to be placed either in a "hold" status or "do not disburse" status. During our audit, we noted that at least one service provider in the "do not disburse" status received payment.

GAO *Standards for Internal Control in the Federal Government* states, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliation, and other actions people take in performing their duties."

Recommendations:

22. Tighten controls to ensure that immediate communication to appropriate parties is made regarding service providers that are placed in the watch list.

encourage consistent formats for entering data directly into the financial management systems, and ensure that consistent information is readily available and provided to internal managers at all levels within the organization."

Recommendation:

24. While the spreadsheets are used as the detailed records, periodically and haphazardly select detail auction subsidiary records for testing to determine that the formulas are calculating the correct amounts and the calculated amounts can be supported by the underlying transaction and documentation.

Management Comment:

Management concurs. During FY 2003, and until the process is operational in RAMIS, FCC will perform periodic review of the spreadsheet and its data for accuracy.

Recommendations:

25. Develop and implement policies and procedures for the use and review of the auction subsidiary spreadsheets. These policies should include, but not be limited to:

    - Allowing only limited users to make changes to the files,
    - Requiring changes made by authorized users to be verified and authorized by another person, and
    - Periodic reconciliation that verifies auction totals is being accurately captured and reported in the worksheets.

26. Implement control features in the spreadsheet software, such as cell locking, using a data entry form, worksheet and/or password protections, and others.

Management Comment:

Management concurs. FCC generated the spreadsheet in FY 2002 and that file is now located on a shared drive. The file created is a secure file and access is limited to a limited number of authorized users. This process was implemented to minimize errors and limit write access capabilities while working within a manual process. With the implementation of the Auctions module of RAMIS in FY 2003, all the information that is currently being captured in the auction spreadsheets will transition to RAMIS at which time the proper interfaces will be in place to capture the auction activity in an automated environment. In addition, RAMIS will be able to capture the financial history of the license through re-auctions, disaggregations, and partitions when a financial transaction is involved. Policy and procedure manuals will be written and distributed within FCC on the Auctions module of RAMIS.

23. Compare payments to be made against the disbursement watch list prior to releasing the payment, or institute a payment system flagging the service providers in the "do not disburse" list.

Management Comment:

Management concurs. Controls and procedures to monitor "at risk" providers exist and more are to be provided. Authorizations from qualified staff can and do allow for the payment of eligible invoices within the "do not disburse" criteria. These controls have been strengthened by the addition of a step in the process whereby the originator of the indicator receives confirmation that the action has been applied.

IV. Auction Related Subsidiary System

The sale and related activities of spectrum auction licenses are tracked and accounted for in a subsidiary ledger system that is comprised of numerous manually prepared spreadsheets. A detailed summarized spreadsheet contains auction by auction information such as gross winning bids, net winning bids, first down payment from upfront payments, additional first down payment paid, penalties, second down payment paid, outstanding balance, collections, deferred revenue, transferred to revenue, and revenue. These spreadsheets are the basis for recording the auction related transactions at year-end.

During our test work, a formula error was noted in one of the spreadsheets in calculating the collections that should have been transferred from deferred revenue to revenue. With the volume of individual licenses and the complexity of these formula driven spreadsheets, the risk of errors is high. Such risks include:

- Formulas can be changed easily, affecting the flow through the rest of the spreadsheets,
- Difficulty in tracking changes made to spreadsheets, including formula changes,
- Difficulty in verifying that correct changes were made,
- Difficulty in verifying that changes made were authorized,
- Transactions unique to few licenses are difficult to incorporate, and
- Difficulty in performing automatic checks and balances on the transactions in the spreadsheets.

OMB Circular No. A-127 prescribes policies and standards in developing, operating, evaluating and reporting on financial management systems. One of the system requirements specifically identified in Section 7 states that agency financial management systems shall comply with agency-wide financial information classification structure. "The design of financial management systems shall reflect an agency-wide financial information classification structure that is consistent with the USSGL, provides tracking of specific program expenditures, and covers financial and financially related information. This structure will minimize data redundancy, ensure that consistent information is collected for similar transactions throughout the agency, The direct loan system must be able to support managerial cost accounting. These internal management information system requirements establish compliance for credit management and financial reporting systems with standards provided in OMB Circular Nos. A-34, *Instructions on Budget Execution;* A-123, *Management Accountability and Control;* A-127, *Financial Management Systems;* and A-129, *Policies for Federal Credit Programs and Non-Tax Receivables.*

FCC's plan to replace these loan models with RAMIS since fiscal year 2000 has not materialized. As of September 30, 2002, RAMIS was still not a system of record for loans. Consequently, FCC continued to use these spreadsheet-based loan models in fiscal year 2002 as its loan subsidiary system with the assistance of consultants.

FCC had also contracted with a loan servicing firm to service its loan portfolio. While the loan servicing firm had started performing services in fiscal year 2002, FCC had not decided whether RAMIS or the loan servicing systems will be the official system of records.

Recommendation:

27. Continue with thorough and regular reviews and analysis of activities included and excluded in the loan models until RAMIS and/or the loan servicing become operational.

Management Comment:

Management concurs. During FY 2002, FCC continued its extensive work on reviewing the entire loan portfolio to ensure the results of the conversions during transition. We will continue to perform those reviews until the final conversion to the new provider is complete.

Recommendation:

28. Ensure that the loan subsidiary system being tested (RAMIS) and/or the loan servicing system is capable of interfacing with other financial management systems and meets all applicable requirements in the *Direct Loan System Requirements* issued by JFMIP.

Management Comment:

Management concurs. Both RAMIS and the new loan service provider systems have the capability of interfacing with FFS. For the past year we have been testing the interface between the new loan service provider and FFS and initiated "live" transactions subsequent to the close of FY 2002.

V. FCC Loan Subsidiary Ledgers (Modified Repeat Finding)

A. Loan Subsidiary System (Modified Repeat Finding)

FCC's loan subsidiary ledger system is comprised of loan models, which are elaborate and complex spreadsheets with configuration settings and information for original and adjusted loan principal, quarterly billed interest, suspension interest, payment data, and application of payments, among other items. These loan models (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) serve as the cash flow model data for the loan subsidy model calculator. These loan models, instituted as a temporary measure, were developed as the loan subsidiary system in fiscal year 1999.

The applications applied in these spreadsheets have been implemented to their maximum potential use, thereby creating some problems in addition to the inherent limitations in a spreadsheet-based application, such as:

- Configuration settings can be changed easily. Alteration of relevant configuration settings used in loan balance calculations 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.
- Separate spreadsheets are generated at year-end to account for the interest receivable earned but not yet billed. Interest receivable earned includes interest receivable on active or defaulted loans after the last billing date, but before the next billing date. The loan models were not developed to calculate the interest earned as of a cut-off date if it differed from the billing date.
- The loan model incorrectly calculated late fee receivable balance for two loans tested due to a spreadsheet formula error.

Generally, the entire loan review process continues to be manually intensive. Interest receivable is recalculated independently each year based on the status of the loans at year-end. Interest revenue is determined at year-end based on an analysis of the prior and current year receivable, collections and adjustments instead of recognizing interest as it is earned. Therefore, the risk of error in this temporary solution (i.e., spreadsheet-based loan models) is higher as a result of the conditions described above.

JFMIP's *Direct Loan System Requirements*, state that a direct loan system 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.

Recommendation:

30. Create a database linked to RAMIS or the future loan subsidiary system to create an audit trail (or record) of licenses with delinquent loans cancelled then re-auctioned, and the proceeds or receivable from the re-auction. While RAMIS is not yet operational, FCC should create and maintain a comprehensive schedule that will provide this information. The comprehensive schedule should be subjected to a quality control review and a reconciliation should be performed on a periodic basis.

Management Comment:

Management concurs. FCC began a project in FY 2002 to inventory outstanding licenses, including those licenses that were taken back from licensees as a result of non-compliance. In instances where a license is recovered and resold, the FCC does not relieve the original debtor of its debt until debt forgiveness is approved.

VI. Information Technology (IT) (Modified Repeat Condition)

A. Compliance with OMB Circular No. A-130 Requirement for a Comprehensive Security Plan (Modified Repeat Condition)

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. Every 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 No. A-130, *Management of Federal Information Resources*, Appendix III, "Security of Federal Automated Information Resources," as revised in November 2000, 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 significantly impact FCC's ability to protect its sensitive or critical resources include:

- FCC has not completed the development and implementation of its entity-wide security program plan. However, FCC plans to complete its entity-wide security program plan by June 2003.
- FCC has not completed nine of its nineteen risk assessments for its major applications and mission-critical general support systems.
- FCC has finalized seventeen security plans for certification and accreditation. Two additional security plans are in development.

- There is no routine review of security controls over FCC's systems. In addition, FCC has not completed any formal certification and accreditation of its systems.
- FCC does not have adequate audit trails facility utilization and review. The Computer Security Officer (CSO) has not developed and distributed a Commission-wide policy to make mandatory the use of audit trails utilization and review.

Recommendation:

31. Develop and implement an FCC-wide security plan as prescribed by OMB Circular No. A-130.

Management Comment:

Management concurs. FCC anticipates an agency-wide security plan will be prepared by June 2003.

Recommendation:

32. Conduct current risk assessments for the two FCC general support systems and seven major applications.

Management Comment:

Management concurs. As part of the Security Test and Evaluation process performed in FY 2002, risk assessments were performed on major applications and are included in the certification and accreditation package for those applications. The risk assessments will be followed by a vulnerability assessment that will include all FCC general support systems and remaining major applications.

Recommendation:

33. Develop and implement security plans for FCC's two newly identified major application systems and mission-critical general support systems.

Management Comment:

Management concurs. Security plans for these systems have been scheduled to be completed or developed. Security plans have been completed on all major applications with the exception of one owned by another Federal agency. That agency has given the FCC assurance statements about the security of the system in lieu of a security plan. FCC, as a customer of the agency, is not authorized to have copies of the plan, as it breeches the agency's security policy.

Recommendation:

34. Certify and accredit FCC's major applications and general support systems based on the security plans developed and implemented.

Management Comment:

Management concurs. FCC's CSO is working to review and to re-write certification packages to bring them into compliance with Federal requirements and best practices. The initial review of the current certification and accreditation packages is to be complete by April 2003.

Recommendation:

35. Establish a system to periodically review security controls over FCC's computer systems in accordance with OMB Circular No. A-130, Appendix III.

Management Comment:

Management concurs. FCC is establishing a tracking system of its computer systems based on their effective last review date and indication of upcoming review dates in order to effectively schedule timely reviews of the security controls over FCC's computer systems in accordance with OMB Circular No. A-130, Appendix III. This tracking system will be completed by February 2003.

Additionally, FCC is continuing to conduct reviews of the security controls for major applications in accordance with the requirements set forth in OMB Circular No. A-130, Appendix III, and FCCINST 1479.2 FCC Directive, *Computer Security Program.*

Recommendation:

36. Enhance audit trail facility utilization and review.

Management Comment:

Management concurs. FCC is creating system-auditing policies and procedures to include the use of an audit log server. FCC will also establish procedures to support the audit review process and ensure that audit logs are reviewed on an as-needed basis. FCC anticipates completion of the auditing policy and procedures by May 2003.

B. Inadequacies and Inconsistencies in the Mainframe and Network Access Request Process (Repeat Condition)

FCC does not consistently apply access request processes stipulated in FCC's policy, FCCINST 1479.2 FCC Directive, *Computer Security Program,* which provides guidelines to grant network access in a consistent fashion. Inadequacies and inconsistencies in the network access request process could have a direct impact (including the granting of inappropriate access rights and privileges granted to incompatible duties and the inability to enforce agency-wide access controls policies) in the overall system-wide security program. FCC has addressed this issue by developing corrective action plans, but has not established procedures to create adequate controls over users' access into FCC's network and major applications.

Recommendation:

37. Address inadequacies and inconsistencies in the mainframe and network access request process.

Management Comment:

Management concurs. FCC's CSO is developing a program, including policies and procedures, to routinely verify that adequate controls are in place and routinely tested as part of the process to grant FCC network and mainframe access with the Commission's Business Partner locations. The FCC CSO has reviewed several of the Commission's Business Partner locations for mainframe and network access request processes. The FCC CSO is planning additional visits in FY 2003 to account for those locations that were not included on the initial review or that were added since the initial review. These reviews should be completed by September 2003.

C. Accelerate Efforts to Develop and Test FCC's Contingency Plans (Repeat Condition)

Losing the capability to process and protect information maintained on FCC's computer systems can significantly impact FCC's ability to accomplish its mission. The purpose of service continuity controls is to ensure that, when unexpected events occur, critical operations continue without interruption or are promptly resumed. FCC does not have (1) procedures in place to protect information resources and minimize the risk of unplanned interruptions; neither does FCC have (2) a plan to recover critical operations should interruptions occur. FCC is not in compliance with OMB Circular No. A-130 Appendix III and Federal Information Processing Standards Publications (FIPS PUBS) 87, *Guidelines for ADP Contingency Planning*.

This weakness was reported in fiscal year 1999, and except for the Auctions network, FCC has not completed the development and documentation of a comprehensive disaster recovery and business continuity plan. FCC has procured contractor assistance in completing this task.

The deficiencies reported in prior years will continue to exist until FCC completes and tests the effectiveness of the security plan being developed. The service continuity control deficiencies, listed below, could affect FCC's ability to respond to a disruption in business operations as a result of a disaster or other long-term emergency.

- 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.

Recommendation:

38. Develop and test contingency plans for FCC's major applications, networks, and telecommunications facilities.

Management Comment:

Management concurs. FCC has taken corrective action by engaging in a major effort to prepare contingency plans for its major applications, networks, and telecommunication facilities. The facility portion of the contingency plan has been completed and is awaiting completion of the contingency plan, which is scheduled for completion in April 2003.

Recommendation:

39. Obtain written documentation from FCC's data centers of developed and tested contingency plans and participate in the scheduled tests of the plans.

Management Comment:

Management concurs. In November 2002, FCC successfully tested and demonstrated the Continuity of Operations Planning Network (COOPNet), phase one of the Information Technology Center (ITC) contingency plan. The COOPNet provides for key personnel desktop resources that are needed for business continuity at the Commission's COOP site. FCC will continue to test portions of the contingency plan as they become available and funding allows. In addition, the CSO will coordinate testing and enhancement of Commission's Business Partner COOPs as they become available and funding allows. Written verification will be requested of test results from both tested FCC and Commission's Business Partner contingency plans.

Recommendation:

40. Develop a comprehensive contingency plan that integrates the individual plans of its data centers, networks, and telecommunications facilities.

Management Comment:

Management concurs. The contingency plan will be integrated with the facility contingency plan and will include major applications to form a comprehensive plan for FCC. Both contingency plans should be completed and ready for review and approval by April 2003. In addition, work will be scheduled to ensure that the FCC is involved in its major business center COOP testing process.

REPORTABLE CONDITIONS

VII. Accounts Receivable and Related Revenues (Modified Repeat Condition)

A. Regulatory Fees (Modified Repeat Condition)

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 establish the regulatory fees to achieve the amount set in the appropriation. In addition, it authorizes FCC to charge a 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.

As noted in prior years, FCC's fee collection database was not linked to its licensing databases, making it difficult for FCC to perform routine automated checks on whether all licensees paid their regulatory fees. FCC initiated corrective actions by implementing the Commission Registration System (CORES), a commercial off-the-shelf software that assigns a specific FCC Registration Number (FRN) to a licensee to track all transactions related to that license. The FRN needs to be populated in RAMIS, and eventually linked to all the databases in each bureau or office within FCC. While RAMIS was used for some financial operations in fiscal year 2002, it was not the system of record for regulatory fees. FCC continues to identify non-payers of regulatory fees through a time-consuming effort comparing payers listed in spreadsheets with the bureaus' databases. The delay in implementing RAMIS continued to delay implementation of a system that will allow FCC to better assess and identify its non-paying licensees and make its process more efficient and effective.

In addition, FCC did not have an agency-wide policy regarding actions that should be taken by the bureaus when a regulatory fee has not been paid. This results in inaction or inconsistent treatment of the regulatory fee non-payers by the bureaus.

Recommendation:

41. Ensure that RAMIS, when fully operational, could generate user reports such as non-payers of regulatory fees.

Management Comment:

Management concurs. During FY 2002, the FRN became mandatory and is now tracked through the licensing systems and RAMIS. The RAMIS database will be used to identify non-payers of regulatory fees through the open accounts receivable which will be cross referenced against the licensing systems for any new or additional non-payers not identified from prior years billings.

Recommendation:

42. Develop and implement an agency-wide policy the bureaus and the Financial Operations Center (FOC) should follow when regulatory fee non-payers are identified.

Management Comment:

Management concurs. On December 12, 2002, the FCC published [in the Federal Register] a Notice of Proposed Rule Making in order to amend Part 1 of the Commission's rules Implementing the Debt Collection Improvement Act of 1996 and adopting rules governing applications or request for benefits by delinquent debtors. Once these rules are adopted, the FCC will modify its processes to ensure that before granting a benefit there will be a check to see if any outstanding debt exists, to include regulatory fees.

VIII. Auction Revenue Recognition Policy

The established accounting policy for the recognition of revenue from auction collections for licenses was not consistently followed. FCC established a policy to recognize auction revenue at the time a Prepared to Grant Public Notice is issued for a specific license. This policy was based on SFFAS No. 1, *Accounting for Selected Assets and Liabilities,* which states, "Federal entities may receive advances and prepayment from other entities for goods to be delivered or services to be performed. Before revenues are earned, the current portion of the advances and prepayment should be recorded as other current liabilities. After the revenue is earned, the entity should record the appropriate amount as revenue or a financing source and should reduce the liability accordingly."

Our audit disclosed several instances where transactions were not accounted for in accordance with the revenue recognition policy. For instance, revenue from two licenses issued under the loan installment program was prematurely recognized. Both licenses were recorded in the loan subsidiary ledgers with principal and interest receivable balances at September 30, 2001; however, the Prepared to Grant Public Notice for these licenses was not issued until June 2002. Under the auction revenue recognition policy, the revenue and loans receivable should not have been recognized until June 2002.

In addition, revenue of $13.5 million was recognized as revenue in fiscal year 2002. This revenue should have been recognized in fiscal year 2001 because the Prepared to Grant Public Notice was issued in fiscal year 2001.

Recommendation:

43. Establish and implement accounting procedures that will track the status (issuance of Prepared to Grant Public Notice) of auction licenses as "not granted," "ready to grant," and "granted." This will include tracking the dates when the status of the license changed and reference to supporting documentation such as the Prepared to Grant Public Notice.

Management Comment:

Management concurs. FCC relies on manually prepared spreadsheets to track and account for the sale of spectrum auction licenses because the core accounting system and previous collections subsidiary system were not designed to post at the license level. RAMIS, which was partially implemented in FY 2002 and will be fully implemented during FY 2003, was designed with this capability and will automate the posting process. Errors do occasionally occur in the manual spreadsheets. The FCC developed reconciliations based on cash receipts to provide control over the spreadsheet process in FY 2002. Additional controls such as inclusion of the prepared to grant date and more frequent postings will be put in place until RAMIS is on-line in FY 2003.

IX. Revenue in Proper Accounting Period

The SFFAS No. 7 paragraph 34 states, "Revenue from exchange transactions should be recognized when goods and services are provided to the public or to another Government entity at a price." Paragraph 5 states that "Non-exchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets." In addition, paragraph 36(d) indicates "Revenue from specific exchange type transactions should be recognized as follows:...(d) when services are rendered continuously over time or the right to use an asset extends continuously over time, such as the use of borrowed money or the rental of space in a building, the revenue should be recognized in proportion to the passage of time or the use of an asset."

Our test disclosed several instances where revenue such as regulatory fee, fines and forfeitures, and auction revenue were not recorded in the proper accounting period or budget year, fees were not amortized over the life of the service, or the revenue recorded in the current period was overstated.

Recommendation:

44. Implement procedures to ensure that revenue transactions are recorded in the proper accounting period. One of these procedures should include the use of the billing

documents on all revenue related transactions and properly and timely applying collections to the billing documents.

Management Comment:

Management concurs. In each fiscal year, multi-year regulatory fees have been collected and were recognized entirely in the year they are collected. However, the new system is not designed to be able to recognize and post for multiple years. Therefore, this process will be entirely manual. A spreadsheet was generated and will be maintained on a regular basis to post any new collections and to recognize the individual year's revenue. To correct issues with billings and collections over several budget years, RAMIS can generate billings for various budget years, collect against those outstanding billings and generate the applicable accounting transactions for all these entries. In addition, the FCC will review its policies and procedures manuals to update them for the new processes.

X. Obligation and Accounts Payable Activities

A. Accounting for Obligation

FCC internal control policy requires a certification from bureau and office managers that obligations have been reviewed and are correct. This policy is part of FCC's monthly and year-end financial and budgetary review process to determine whether an obligation should be deobligated and/or an undelivered order should be reclassified to a delivered order.

Our test of this control questioned the effectiveness of the certification process. We found that two of the three Bureau/Office Reconciliation of Accounts certified reports were not submitted to the FOC within the requested time frame.

In addition, out of the 16 obligations/undelivered orders tested:

- Three obligations dating back to 1998 representing remaining balances of purchase orders were still outstanding even though the purchase orders had expired, goods and services had been received, and payments had been made. The remaining balances should have been de-obligated prior to fiscal year 2002.
- Goods and services for four obligations had been received; these should have been reclassified from undelivered orders to delivered orders at September 30, 2002.

GAO *Standards for Internal Control in the Federal Government* state, "Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities."

Recommendation:

45. Ensure that existing policies and procedures and internal controls outlined in the FCC manual on accounting for obligation are adequate and that these policies and controls are strictly and consistently implemented.

Management Comment:

Management concurs. The total amount of the three obligations dating back to 1998 was approximately $18,000. FCC asks its financial managers to review open obligations on a monthly basis to identify amounts that can be deobligated. In addition, quarterly fund manager's meetings address the responsibility of reviewing the monthly reports, their due dates and certifications, and any other additional information relative to their financial reviews.

B. Accounting for Accounts Payable

During the first half of the year, FCC recognized a liability for goods and services (accounts payable) at the point of disbursement. In the last half of the year, FCC changed its policy to recognize accounts payable when an invoice is received and logged into the FFS. Both of these policies, however, are not in accordance with the GAAP that a liability is to be recognized for the unpaid amounts when goods and services are received, not necessarily at the point of disbursement nor at the point an invoice is received. Although at the end of the fiscal year, FCC accrued accounts payable by reviewing all the invoices received and determined whether goods and services were received, this process will not capture accruals for receipt of goods and services where invoices had not been received. In addition, FCC only accrues accounts payable at year-end and does not accrue for interim periods.

Recommendation:

46. Ensure that a liability is recognized for the unpaid amount when goods and services are received and establish proper cut-off procedures to ensure that all liabilities are recorded as of a reporting period.

Management Comment:

Management concurs. As for the transfer of obligations from undelivered to delivered orders based on the receipt of services, FCC does develop accruals at year end based on receipt of services. These accruals are used to recognize an accrued liability on our balance sheet, however a policy decision was made several years ago not to recognize a budgetary accrual for these items because of system difficulties in reversing budgetary accruals. We believe we have found a means of addressing those difficulties and will re-examine our policy in FY 2003.

XI. Payroll Activities (Modified Repeat Condition)

Weaknesses identified in the past three audits relating to payroll activities had not been corrected.

- Leave error reports received from the National Finance Center (NFC), showing differences between NFC's leave record for each employee and FCC's leave records are not reconciled. Our audit disclosed significant differences for all categories of leave balance such as the annual leave, sick leave, compensatory time, and credit hours categories.
- Other deficiencies include: (1) incorrectly completed timesheets, (2) incorrect accounting codes used on timesheets, and (3) official payroll documents not filed timely.

GAO *Standards for Internal Control in the Federal Government* state that transactions should be accurately recorded in a timely manner. One of the control activities used to accomplish this goal requires the performance of reconciliation and having controls in place to detect errors.

Recommendation:

47. Perform a periodic reconciliation of all the leave categories from the two systems, NFC and FCC records.

Management Comment:

Management concurs. FCC is in the process of securing the services of an outside contractor to conduct audits on all FCC employees identified as having errors. As these audits are conducted and leave balances are entered into the NFC system, FCC will review the bi-weekly culprit report to ensure future leave balance problems are corrected in the following pay period.

Recommendation:

48. Conduct training of employees to re-emphasize the importance of proper coding and to ensure that timesheets are properly completed and certified by supervisors.

Management Comment:

Management concurs. Human Resources Management (HRM), Payroll and Benefits Service Center will send out notices periodically to all FCC employees to re-emphasize the importance of ensuring timecards are properly completed, and reviewed and certified by supervisors.

Recommendation:

49. Ensure that payroll documents are filed timely.

Management Comment:

Management concurs. All payroll and personnel documents are now sent to the HRM Records Center to be filed and/or distributed timely.

XII. Debt Collection Improvement Act Reporting (Modified Repeat Condition)

The Debt Collection Improvement Act of 1996 (DCIA) requires agencies to (1) notify the Department of the Treasury of all debts delinquent by more than 180 days for offset and (2) refer to the Department of the Treasury, with some exclusions, all debts delinquent more than 180 days for cross-servicing debt collection.

Although FCC submits Treasury Report on Receivables (TROR) to the Department of the Treasury, existing policies and procedures are inadequate to ensure that all debts delinquent for more than 180 days are referred to the Department of the Treasury for cross-servicing debt collection. Chapter 4, Accounts Receivable, Section 500 of the FCC policy and procedures manual requires that uncollected receivables (excluding loans) older than 90 days be sent to the Department of the Treasury. Although this current policy is not consistent with the 180 days established by the Department of the Treasury, FCC did not enforce its own policy.

Our review of the TROR as of September 30, 2002, disclosed that only \$4.7 million of eligible administrative receivables of \$77.6 had been referred for cross-servicing.

In addition, our review of the TROR disclosed that USF delinquent accounts receivable details are not provided to FCC for submission to the Department of the Treasury.

Recommendations:

50. Update policies and procedures to incorporate the Department of the Treasury referral requirements for the reporting entities accounts receivables.

51. Refer eligible delinquent debt, more than 180 days old, to the Department of the Treasury for offset or cross-servicing.

52. Ensure that FCC has all the reporting entities' supporting documentation for the TROR.

Management Comment:

Management concurs. Policies and procedures exist but will be updated to incorporate the Department of the Treasury referral requirements. In addition, FCC has been working with its reporting components to establish procedures for referring their delinquent debt to the Department of the Treasury for offset and collection. Those policies and procedures have an implementation date effective July 1, 2003 and will be included in the FCC's policies and procedures manuals in ensuring compliance with the

DCIA. Procedures for the TROR also will be reviewed to guarantee they are all inclusive of the procedures for the FCC and its reporting components.

XIII. Compliance with Certain Aspects of the Clinger-Cohen Act of 1996 (Modified Repeat Condition)

The Clinger-Cohen Act of 1996 requires federal agencies to focus on the results they are achieving through IT investments. Specifically, this act introduces rigor and structure into how agencies approach the selection and management of IT projects. Among other things, the head of each agency is required to implement a process for maximizing the value and assessing and managing the risks of the agency's IT acquisitions.

During our review, we noted that certain aspects of the Clinger-Cohen Act were not followed for fiscal year 2002 in the development and implementation of the RAMIS application. These weaknesses include the following:

- Ineffective hardware planning. FCC did not have a documented plan for the migration strategy in fiscal year 2002 that would include: disaster recovery, proposed data center location changes on strategy, telecommunications, and other logistical support. FCC subsequently completed its migration strategy for RAMIS on October 4, 2002 after the end of the fiscal year 2002.
- Ineffective human resource or staff planning. FCC did not commit adequate resources to manage the implementation of the RAMIS application. FCC still has one position to fill for the management of the RAMIS project.
- Project management tools (i.e., time, function, budget) were not properly utilized. The revised RAMIS implementation plan report provides only additional start and actual dates. There is no way to measure project performance against target dates. No information of delays and slippage has been documented or provided to management.
- Inadequate cost/benefits analysis of the investment.

Furthermore, the FCC's system development life cycle methodology (SDLC) is not being adhered to for all applications. Documentation is not maintained for the CORES, Electronic Management Tracking System (E/MTS), and Cable Operations and Licensing System (COALS); nor are procedures being followed.

Recommendation:

53. Document and implement a migration strategy for the RAMIS application.

Management Comment:

Management concurs. The migration strategy for the RAMIS application has been fully documented and implemented.

Recommendation:

54. Commit adequate resources to the management of the RAMIS project.

Management Comment:

Management concurs. All available resources were devoted to this implementation. The reshuffling of projects to implement RAMIS as a loan system until the portfolio could be transferred to the outside loan service provider was beyond our original project scope. Necessary to RAMIS and also outside the project scope was the design, creation and implementation of CORES.

Recommendation:

55. Document a Capital Asset and Business Case to address summary of spending during project stages.

Management Comment:

Management concurs. FCC has submitted a Capital Asset Plan and Business Case for RAMIS in accordance to OMB Circular No. A-11, *Preparing and Submitting Budget Estimates*, Section 300-17.

Recommendation:

56. Utilize project management tools (i.e., time, function, budget) to determine milestone dates and measure project performance against these target dates.

Management Comment:

Utilize project management tools to determine milestone dates and measure project performance against these target dates.

Recommendation:

57. Ensure that applications in development (i.e., CORES, E/MTS, COALS, and RAMIS) adhere to FCC's SDLC methodology.

Management Comment:

Management concurs. Training in the FCC's SDLC methodology was conducted. This training discusses the importance of, and policies surrounding, the FCC's SDLC methodology. Training included individuals from CORES and COALS. As a result of this training effort, the ITC anticipates that CORES, COALS and RAMIS will comply with the procedures and documentation requirements of the FCC's SDLC methodology as they undergo revision. The E/MTS application did not meet the minimum cost requirements to warrant following the FCC's SDLC methodology.

XIV. OMB Circular Nos. A-127 and A-130 Reviews (Repeat Condition)

FCC has recently identified its major financial applications and general support systems, and established a timetable for meeting the requirements of OMB Circular Nos. A-127 and A-130 review of these applications. FCC had begun conducting some reviews on OMB Circular Nos. A-127 and A-130 reviews in fiscal year 2002. Until these reviews are performed and completed, FCC cannot determine compliance with these circulars to include in its annual FMFIA report and to ensure substantial compliance with FFMIA.

Recommendation:

58. Institute a program for conducting periodic reviews in accordance with OMB Circular Nos. A-127 and A-130.

Management Comment:

Management concurs. FCC is continuing to conduct reviews of the security controls for major applications in accordance with the requirements set forth in OMB Circulars No. A-127 and A-130, Appendix III, and FCCINST 1479.2 FCC Directive, *Computer Security Program.*

Recommendation:

59. Include the results of OMB Circular Nos. A-127 and A-130 reviews as part of the applicable section in FCC's annual FMFIA report.

Management Comment:

Management concurs. The Computer Security Program continues to work with other elements of the Office of the Managing Director to include warranted results of OMB Circulars No. A-127 and A-130 reviews conducted during the fiscal year in the FMFIA report.

XV. Federal Managers' Financial Integrity Act of 1982 Compliance and Reporting

As required by OMB Bulletin No. 01-02, we have compared the material weaknesses and material nonconformances reported by FCC in its FMFIA report dated December 20, 2002 to our report on internal control dated January 3, 2003. We do not believe, however, that failure to report these material weaknesses constitutes a separate reportable condition or material weakness because different criteria are used in determining material weaknesses for both reports, and management has reported some of the material weaknesses. However, FCC did not take timely and effective actions to correct material internal control deficiencies identified. Many of the original target correction dates for the deficiencies reported in the FMFIA report were not met and had to be revised. Section IV of the OMB Circular No. A-123 (Revised June 21, 1995) 5 U.S.C., states, "...management has a responsibility to complete action, in a timely manner, on audit recommendations on which agreement with the IG has been reached."

Following are the elements of material weaknesses identified in this report that were not specifically identified in the FMFIA report:

- Financial Statement Reporting
    - Timely Recording and Analysis of Financial Activities
    - FFS Setup and Posting Model Definitions
- Cost Accounting System
    - Cost Finding Techniques
    - Matching Revenues to Costs
- USF Financial Reporting
    - Controls over USF Disbursements to "At Risk" Service Providers
- Auction Related Subsidiary System
- FCC Loan Subsidiary Ledgers
    - Loans Subsidiary Ledger Non-Financial Information
    - Re-Auctioned Licenses
- In material weakness related to FCC's compliance with OMB Circular No. A-130, FCC reported that Security Tests and Evaluations have been completed for eleven of its major applications. However, support for only ten major applications was made available to us during the audit.
- In material weakness related to inadequacies and inconsistencies in the mainframe and network access request process, FCC reported that it completed many of the recommendations related to this finding in fiscal year 2001. However, this information contradicted current management responses that we received during our follow-up of prior year findings. As noted in our summary of prior year findings matrix, reviews to highlight inconsistencies in the access request process are scheduled for completion in September 2003; and audit log policies and procedures are expected by May 2003.

Management Comment:

Management concurs. Some of those items identified in this audit report were not previously reported as material weaknesses and therefore could not have been reported in the FY 2002 FMFIA report issued in December 2002. However, FCC will review their current policies and procedures on performing the necessary reviews to address more detailed reviews of internal control inadequacies and inconsistencies, and more timely completion of outstanding audit recommendations for input into the yearly FMFIA report.

STATUS OF PRIOR YEAR COMMENTS

As required by *Government Auditing Standards* and OMB Bulletin No. 01-02, we have reviewed the status of FCC's corrective actions with respect to the findings and recommendations from the previous year's report on internal controls. For those items not addressed in various sections of our Independent Auditor's Report on Internal Control, summarized above, the following discusses the current status of resolutions for matters raised:

- **Condition – Internal Controls on the Preparation of the Financial Statements**

  In fiscal year 2001, it was recommended that FCC implement an effective quality control mechanism to ensure that a senior official other than the preparer review the financial statements prior to issuance. In fiscal year 2002, FCC implemented a review process for the preparation of the financial statements, which significantly improved the quality of the financial statements. Although we still have identified minor errors and omissions in the financial statements, this finding is reported in the management letter for fiscal year 2002.

- **Condition – Changes in Accounting for Program Costs**

  In fiscal year 2001, it was noted that FCC had changed its programs from four FCC reporting entity programs in fiscal year 2000 to five programs in fiscal year 2001; however, the change did not result in a corresponding change in the FCC cost accounting processes. In fiscal year 2002, FCC collected costs for five programs and the USF; as a result, this was not included as a material weakness. However, we commented on the internal controls over the cost finding techniques for the five programs and the USF. See IC Report, Section II.B.

- **Condition – Auditable Financial Data for the Local Number Portability Administration (LNPA)**

  In fiscal year 2001, FCC OGC determined that LNPA met the indicative criteria of a reporting entity. FCC OGC further stated that if LNPA met the materiality criterion, it would be considered a component of FCC. FCC provided data that was not supported by adequate documentation for audit purposes. The LNPA financial statements were not included in the FCC consolidated financial statements, and the auditors were not adequately satisfied with the significance or materiality of the LNPA reporting entity. The audit opinion was qualified accordingly. In fiscal year 2002, FCC OGC re-evaluated the status of the reporting entities and determined that LNPA did not meet the indicative criteria of a reporting entity. As a result, this was not a material weakness for fiscal year 2002.

- **Condition – Federal Agencies' Centralized Trial-Balance System (FACTS I) Reporting Process**

  In fiscal year 2001, FCC was requested by the FMS to resubmit the CFO Final Account Groupings Worksheet (AGW) report after the due date submission was made due to errors and failure to incorporate last minute adjustments to the Final AGW report. In addition, the OIG's Agreed-Upon Procedures Report indicated that the CFO procedures, disclosed in the response to one of the three required procedures, were not adequate, resulting in OIG's inability to perform the agreed-upon procedures. In fiscal year 2002, the audited financial statements were issued prior to the submission date of the Final AGW report. Therefore, this finding was not in fiscal year 2002.

- **Condition – Controls Surrounding Data Used in the Preparation of the Management Discussion and Analysis (MD&A)**

  In fiscal year 2001, it was recommended that FCC formalize policies and procedures for the performance measure process and to test the reliability, accuracy, and propriety of the data generated from the systems used in accumulating performance data. In fiscal year 2002, FCC formalized the performance measure process policies and procedures and outlined the procedures to test the reliability, accuracy and propriety of the data used in accumulating performance data. In our limited review of the MD&A performance data, we did not identify errors of similar nature to what was identified in prior year reportable condition. Therefore, we have excluded this reportable condition in fiscal year 2002.

- **Condition – Supporting Documentation and Controls on Property and Equipment**

  In fiscal year 2001, FCC used incorrect budget object codes resulting in capitalized costs not being distinguished from non-capitalized costs. In addition, certification from a software system owner documenting the completion of an in-process software was inadequate. Also, completed software transactions were tracked on spreadsheets and not in the property management system. In fiscal year 2002, although FCC continued to use incorrect budget object codes, it instituted a monthly compensating-control reconciliation of its general ledger balances with the property management system. The property management system automatically capitalized any acquisition in excess of $25,000 and a quality check was performed to ensure that value assigned was correct. Also, the completed software is now recorded in the property management system. The condition related to the use of incorrect budget object codes is reported in the management letter in fiscal year 2002.

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In addition to the material weaknesses and reportable conditions described above, we noted certain matters involving internal control and its operation that we reported to the management of FCC in a separate letter dated January 3, 2003.

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

Clifton Gunderson LLP

Calverton, Maryland
January 3, 2003

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Compliance with Laws and Regulations

To the Inspector General of the
Federal Communications Commission

We have audited the financial statements of the Federal Communications Commission (FCC) as of and for the year ended September 30, 2002, and have issued our report thereon dual dated January 3, 2003 and January 27, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

The management of FCC is responsible for complying with laws and regulations applicable to FCC. As part of obtaining reasonable assurance about whether FCC's financial statements are free of material misstatements, 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 No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). 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 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 No. 01-02, which are described below.

Chief Financial Officers Act of 1990 (CFO Act)

The Accountability Act for Tax Dollars of 2002 (Accountability Act) increased the number of agencies required in the Government Management Reform Act of 1994 (GMRA) to prepare organization-wide financial statements and be audited annually. The FCC was one of the agencies identified in the Accountability Act. Although OMB issued a blanket waiver for fiscal

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year 2002 from the Accountability Act, FCC had voluntarily elected compliance in fiscal year 2002 and as such is being evaluated accordingly.

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 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 Chief Financial Officer (CFO). These include, among others, that the CFO:

- Develop and maintain integrated accounting and financial management systems that comply with applicable accounting principles, standards, and requirements; internal control standards; and requirements of OMB, Department of the Treasury, and others;

- Direct, manage, and provide policy guidance and oversight of all agency financial management personnel, activities, and operations; and

- Implement agency asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and controls.

FCC does not meet the above criteria as explained in more detail in our Independent Auditor's Report on Internal Control (IC Report), Sections I through VI. The key items we identified include:

- FCC's financial management systems do not comply with certain accounting standards and requirements, and internal control standards;

- FCC's financial information system is not fully integrated. Data comes from various subsystems and spreadsheet programs for the accounting, preparing, and reporting of financial statements; and

- Direction, policy guidance memorandum for FCC's financial statement preparation and oversight of the reporting entities' financial operations are inadequate or do not exist.

OMB Circular No. A-129, Policies for Federal Credit Programs and Non-Tax Receivables

FCC's Narrowband licenses with outstanding loan receivables of $113 million did not have Installment Payment Plan Notes stating the amounts and terms of the loans. Additionally, Security Agreements were not issued by FCC for this block of loans. These loans are direct loans accounted for under the Federal Credit Reform Act of 1990. Federal Credit Reform Act, Sec. 502, defines "direct loan" as a disbursement of funds by the Government to a non-Federal borrower under a contract that requires repayment of such funds with or without interest.

In addition, OMB Circular No. A-129, Section III, Loan Documentation states, "Loan origination files should contain loan applications, credit bureau reports, credit analyses, loan contracts, and other documents necessary to conform to private sector standards for that type of loan." Additionally, Section IV, Loan Servicing Requirements states that "Approved loan files (or other systems of records) shall contain adequate up-to-date information reflecting the terms and conditions of the loan, payment history, including occurrences of delinquencies and defaults, and any subsequent loan actions which result in payment deferrals, refinancing or rescheduling."

Debt Collection Improvement Act of 1996

In FCC's Treasury Report on Receivables (TROR) for administrative receivables submitted to Department of the Treasury as of September 30, 2002, it reported $77.6 million as the amount eligible for referral to the Department of the Treasury for offset and cross-servicing. As of September 30, 2002, only $4.7 million of the $77.6 million of eligible receivables was referred to Department of the Treasury for cross-servicing. See IC Report, Section XII for a more detailed explanation.

Prompt Payment Act

Two of the thirty-five invoices examined were not paid within 30 days from the receipt date of a paper invoice and no interest penalty was paid for the late payment. Title 31 of the U. S. Code, Chapter 39, Section 3902 states that "the head of an agency acquiring property or service from a business concern, who does not pay the concern for each complete delivered item of property or service by the required payment date, shall pay an interest penalty to the concern on the amount of the payment due."

Government Performance and Results Act of 1993 (GPRA)

The GPRA requires federal agencies to submit to OMB and Congress the following:

- A strategic plan for program activities, which sets out a course of action and accomplishment over the long term;
- An annual performance plan (APP) that sets annual goals with measurable target levels of performance; and
- An annual program performance report (APPR) that compares actual performance to the annual goals.

FCC did not fully comply with the critical key components of the GPRA as described below:

- The APP for fiscal year 2002 did not clearly describe the means to be used to verify and validate measured values.

- The fiscal year 2002 APP does not clearly address the following:

  - a description of the operational processes,
  - skills and technology, and
  - the human, capital, information, or other resources required to meet the performance.

- The APPR for fiscal year 2001 (latest report available) did not include two significant elements:

  - The APPR did not include a summary of findings for program evaluations completed during the fiscal year covered by the APPR, and
  - The APPR did not describe the use nor assess the effectiveness of achieving the performance goals.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations discussed in the preceding paragraphs, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

Federal Financial Management Improvement Act of 1996

Under FFMIA, we are required to report whether FCC's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed instances, described below, where FCC's financial management systems did not substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level.

Federal Financial Management Systems

- Integrated Financial Management System – The Federal Financial System (FFS) and feeder systems (direct loan systems and spreadsheets, cost systems, auction related systems, property management system, license database systems, collection systems, certain accounts receivable systems, procurement systems and various spreadsheets) are not integrated or electronically interfaced. The reporting entities' core financial systems are also not integrated. A user is not able to have one view into systems such that, at whatever level the individual is using the system, he or she can obtain the information needed efficiently and effectively through electronic means. See our IC Report, Section I.A. for a more detailed explanation.

  FCC has an on-going effort over the last three years to strengthen its financial management systems. FCC management expected to achieve some level of financial management systems' integration by implementing the Revenue Accounting and

Management Information System (RAMIS) by September 30, 2000. RAMIS is designed to integrate, among others, the direct loan system, fee billing and collection systems, fines and forfeitures, licensees' databases, interface with FFS and include a module for cost accounting system. FCC, however, has not met this expectation, as RAMIS was still not fully operational at September 30, 2002. As of September 30, 2002, only four of the seven modules were completed and parallel testing of three modules remained in progress.

The primary reason for noncompliance is FCC's failure to meet its timetable and the length of time needed to implement several financial management systems' enhancements developed over the last three years.

- Agency-wide Financial Information Classification Structure – As explained in detail in the IC Report, Section I.B., FCC's core financial system, FFS, has not been fully consistent with the USSGL. FCC recognized that some posting model changes needed to be made to improve the efficiency and effectiveness of monthly and year-end trial balances. These changes will allow FCC to eliminate manual adjustments currently made to correct for posting model deficiencies. FCC has already identified areas that require changes but has not had the time and resources to complete necessary analysis to effect the changes.

- Security – In fiscal year 2002 as in prior years, we identified several weaknesses, which collectively are considered a material weakness, and are described in more detail in our IC Report, Section VI. The weaknesses include noncompliance with OMB Circular No. A-130's, *Management of Federal Information Resources* requirement for a comprehensive security plan, inadequacies and inconsistencies in the mainframe and network access request process, and lack of a fully developed and tested contingency plan. The FCC has not completed security plans for two of its major applications and does not expect the completion of an entity-wide security plan until June 30, 2003. In addition, none of the major applications and general support systems (GSS) have been certified and accredited. The initial stage of this process, which includes a risk assessment as part of an all-inclusive Security Test and Evaluation, was only completed for ten major applications, and a current risk assessment for the two GSS is in progress. In addition, there was a lack of an agency-wide contingency plan to address continuity of operations in the event of a disaster.

  Information protection-related weaknesses identified in FCC's information systems environment are repeat finding conditions. Impacted areas include FCC's distributed computer system as well as its mainframe computers. 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.

  The weaknesses noted above have been identified since the fiscal year 1999 audit and progress in correcting the deficiencies has been slow. FCC explained that the primary reason for this noncompliance is the length of time needed to implement the corrective actions and the availability of resources.

Federal Accounting Standards

Due to the lack of an adequate cost accounting system, FCC was not able to produce managerial cost information consistent with standards in the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* as described in our IC Report, Section II.

U.S. Standard General Ledger at the Transaction Level

Substantial compliance with the USSGL at the transaction level requires the agency's recording of financial events to be consistent with all applicable account descriptions and posting models/attributes reflected in the USSGL issued by the Department of the Treasury, Financial Management Service, effective for the period covered by the audit. As discussed in our IC Report, Section I.B., the setup and posting model definitions do not fully comply with the transaction posting models consistent with the USSGL guidance and policies, when recording and classifying transactions.

Also, as discussed in Section I.A. of the IC Report, the accounting transactions of the Universal Service Fund, the Telecommunications Relay Services and the North American Numbering Plan, collectively called reporting entities, which were transactions from feeder systems summarized in a trial balance for consolidation into FCC financial statements, were not recorded in a manner consistent with the account definitions and posting models/attributes specified in the USSGL. The feeder systems from the reporting entities also did not record budgetary entries.

FCC Managing Director and the CFO have been assigned the responsibility of ensuring the substantial compliance with the FFMIA. A discussion of the actions taken by FCC and our recommendations to strengthen FCC's financial management systems are outlined in our IC Report. FCC management plans to have some of the corrective actions started or implemented by fiscal year 2003.

Management Comments:

Management concurs. The aforementioned laws and regulations are addressed within the findings on the Independent Auditor's Report on Internal Controls. As FCC corrects and resolves identified issues, the occurrences on non-compliance will diminish.

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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, FCC Office of Inspector General, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
January 3, 2003