REPORT ON THE
FEDERAL COMMUNICATIONS COMMISSION
FISCAL YEAR 2006
FINANCIAL STATEMENTS

06-AUD-06-03 November 15, 2006

Office of Inspector General

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Federal Communications Commission

OIG TRANSMITTAL MEMORANDUM

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: November 15, 2006

TO: Chairman

FROM: Inspector General

SUBJECT: Report on Audits of the Federal Communications Commission's Financial Statements for Fiscal Years 2005 and 2006

In accordance with the Accountability of Tax Dollars Act of 2002 (Pub. L. 107-289), the Office of Inspector General engaged the independent certified public accounting firm of Clifton Gunderson, L.L.P. (Clifton Gunderson) to audit the fiscal year 2006 and 2005 financial statements of the Federal Communications Commission (FCC). The fiscal year 2005 financial statements were audited by Clifton Gunderson whose report, dated November 1, 2005, contained a disclaimer of opinion on the financial statements. The contract required that the audit be performed according to generally accepted government auditing standards.

Appended to this report are: the Independent Auditors' Report (opinion on FCC's financial statements, report on internal controls, and report on compliance laws and regulations) and the FCC's financial 2006 statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report must include, a supplementary information section devoted to management's discussion and analysis (MD&A) of the financial statements and information related thereto. The FCC's Chief Financial Officer plans to publish a separate annual report for fiscal year 2006 that conforms to FASAB standards. The MD&A is not included in this report because of its length.

In its Fiscal Year 2006 audit of the FCC, Clifton Gunderson found that:

- the FCC's fiscal year 2006 financial statements were fairly presented, in all material respects, and were in conformity with United States generally accepted accounting principles;
- there are no material weaknesses in the FCC's internal control; and
- there were three (3) reportable instances of noncompliance with laws and regulations were identified on the basis of Clifton Gunderson's auditing tests

Clifton Gunderson is wholly responsible for the attached auditors' report dated November 14, 2006 and the conclusions expressed therein. We do not express an opinion on the FCC's financial statements, or Clifton Gunderson's conclusions on the FCC's internal controls or on the extent to which the FCC is in compliance with applicable laws and regulations.

We very much appreciate the courtesies and cooperation extended to the Clifton Gunderson and my staff by the Office of Managing Director during the conduct of this audit.

Sincerely,

Kent R. Nilsson

Kent R. Nilsson

cc: Chief of Staff
Managing Director
Chief Financial Officer

TABLE OF CONTENTS

Independent Auditor's Report

To the Inspector General of the
Federal Communications Commission

We have audited the accompanying consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2006 (fiscal year 2006) and 2005 (fiscal year 2005), and the related consolidated statements of net cost, changes in net position, financing, and combined statements of budgetary resources, and custodial activity for the years then ended (hereinafter collectively referred to as the "consolidated financial statements"). These consolidated financial statements are the responsibility of the FCC's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

Except as explained in the following paragraph, 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. 06-03, *Audit Requirements for Federal Financial Statements.* Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements' presentation. We believe our audits provide a reasonable basis for our opinion.

The scope of our examination in fiscal year 2005 was limited because the FCC could not provide a representation letter signed by management who, in the auditor's view, is responsible for and knowledgeable, directly or through others, about the matters in the representation letter. As a result, we did not obtain sufficient, competent, evidential matter for applying audit procedures necessary to conduct an audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 06-03.

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the FCC's consolidated financial statements for the fiscal year ended September 30, 2005.

In our opinion, the consolidated financial statements for fiscal year 2006 present fairly, in all material respects, the financial position of the FCC as of September 30, 2006, and the related statements of net costs, changes in net position, budgetary resources, custodial activity, and reconciliation of net costs to budgetary obligations, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 1, 2006 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 and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be considered in assessing 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 required supplementary information and other accompanying information contain a wide range of data, some of which is not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with the FCC officials. Based on this limited work, we found no material inconsistencies with the financial statements or nonconformance with OMB guidance.

Clifton Gunderson LLP

Calverton, Maryland
November 1, 2006

Independent Auditor's Report on Compliance and Other Matters

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, 2006, and have issued our report thereon dated November 1, 2006. We conducted our audit in accordance with the 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 06-03, *Audit Requirements for Federal Financial Statements.*

The management of the FCC is responsible for complying with laws and regulations applicable to the FCC. As part of obtaining reasonable assurance about whether the FCC's financial statements are free of material misstatements, we performed tests of the FCC's compliance with certain provisions of laws and regulations, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the FCC.

The results of our tests of compliance with laws and regulations described in the preceding paragraph, disclosed instances of non-compliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements,* which are described below.

OMB Circular No. A-127, *Financial Management Systems*

OMB Circular No. A-127 prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The policies and standards include the following areas:

- Integrated Financial Management System.
- Application of the Standard General Ledger at the Transaction Level.
- Federal Accounting Standards.
- Financial Reporting.

- Budget Reporting.
- Functional Requirements.
- Computer Security Requirements.
- Documentation, Internal controls, training and user support and maintenance.

In fiscal 2006, as in prior years, the FCC did not fully meet the above criteria as explained in more detail in our Independent Auditor's Report on Internal Control (IC Report). The key items we identified include:

- The FCC reporting components' financial management systems do not fully comply with the requirement of the standard general ledger to record activity at the transaction level.
- The 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.
- The reviews of financial management systems conducted by the FCC did not fully comply with the requirements of Section 7 of the OMB Circular No. A-127, Financial Management Systems Requirements, to determine whether they meet the functional requirements established by OMB's Office of Federal Financial Management (OFFM).

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

Between 1993 and 1995, the FCC offered special financing arrangements to assist small entrepreneurs to obtain licenses. The Narrowband Personal Communication Services licensees were allowed to make installment payments on the remaining balance of their licenses over a 10-year period after an initial 20% down-payment. These installment payments were not reported under the Federal Credit Reform Act until Fiscal Year 1997 when OMB advised FCC to report these installments payments as "direct loans." A direct loan is defined in Sec. 502 of the Federal Credit Reform Act 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. These Narrowband licenses did not have installment payment plan notes stating the loan amounts and terms at origination. In addition, security agreements were not issued by the FCC for this block of loans. The total outstanding balance for these loans was $78 million as of June 30, 2006. There have been no new Narrowband loans issued since at least fiscal year 1997.

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 (DCIA)

In accordance with the *Debt Collection Improvement Act of 1996*, the FCC is required to refer eligible receivables that are delinquent to Treasury for collection or offset. Eligible receivables include those that are not the subject of litigation, related to foreclosure proceedings, or from organizations in bankruptcy. The FCC's Treasury Report on Receivables ,for administrative receivables, submitted to the Department of the Treasury as of June 30, 2006, disclosed that no amounts have been referred for off-set and only $9.8 million of the $92.9 million of receivables was referred to the Department of the Treasury for cross-servicing. Further, the FCC did not perform an annual computer match of their delinquent debts with records of Federal employees as required by the DCIA. See IC Report, Section VI, for a more detailed explanation.

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We also noted certain immaterial instances of noncompliance that we have reported to management of FCC in a separate letter dated November 1, 2006.

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, GAO, 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
November 1, 2006

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, 2006 and have issued our report thereon dated November 1, 2006. We conducted our audit in accordance with the 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 06-03, *Audit Requirements for Federal Financial Statements.*

In planning and performing our audit, we considered the FCC's internal control over financial reporting by obtaining an understanding of the FCC's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing 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. 06-03, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act* (FMFIA) (31 U.S.C. 3512), such as those controls relevant to ensuring efficient operations. The objective of our engagement 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 caused by error or fraud 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. However, none of the reportable conditions are believed to be material weaknesses.

Finally, with respect to internal control related to performance measures reported in the FCC's Performance and Accountability Report, as of September 30, 2006, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 06-03. 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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REPORTABLE CONDITIONS

I. Financial Reporting

During the fiscal year 2006, the FCC management made substantial progress in strengthening controls over financial reporting and the information technology processes. Some of the key initiatives include detailing a number of management personnel to address various personnel shortages in key operations within the Office of the Managing Director, and the establishment of a taskforce to address prior audit findings. However, a number of conditions continue to exist:

A. Integrated Financial Management Systems

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.

The OMB, Office of Federal Financial Management's (OFFM), formerly the Joint Financial Management Improvement Program (JFMIP), publication on "Core

Financial System Requirements", lists the following integrated financial management system attributes:

- Standard data classifications (definition and formats) established and used for recording financial events.

- Common processes used for processing similar kinds of transactions.
- Internal controls over data entry, transaction processing, and reporting applied consistently.
- A system design that eliminates unnecessary duplication of transaction entry.

We identified the following:

The FCC's Core Financial System

The FCC utilizes Federal Financial System (FFS) as its general ledger and core financial management system. This system is not an integrated financial management system as defined by OMB Circular A-127. Software applications such as Revenue Accounting and Management Information System (RAMIS), the property management system, license databases, and various spreadsheets (for International Telecommunication Services (ITS) transactions and auction transactions) were independent systems, not integrated with the FFS.

In addition, the FCC's consolidated financial statements were compiled and prepared from four separate core financial systems administered by four separate reporting components. At financial statement preparation time, FCC goes through the process 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.

Recommendation:

1. Ensure the integration of the overall financial management systems.

Contractor Loan Servicing Database

The design of the FCC's contractor loan servicing database is based on functional requirements established in the contract with the FCC. However, the contract, and consequently the system, did not include certain functional requirements for direct loan systems as required by the OFFM. Therefore, the loan-servicing database is not fully compliant with OFFM requirements.

Recommendation:

2. Assess the need to modify the existing contract to authorize the loan service provider to implement the necessary functional requirements to meet OFFM requirements for a direct loan system.

USF Standard General Ledger

On October 3, 2003, the FCC released an order that requires the administrators of the USF and TRS funds to prepare financial statements for the funds that are consistent with generally accepted accounting principles for Federal entities (Federal GAAP) and to keep accounts for the funds in accordance with the United States Standard General Ledger (USSGL).

In fiscal year 2006, the administrator of the Universal Service Fund (USF) continued to account for the USF with a non-government general ledger system. Our audit disclosed that the account numbers did not fully comply with the United States Standard General Ledger (USSGL) accounts structure. During the compilation of the interim financial statements as of June 30, 2006, the FCC had to map USF account numbers to specified USSGL accounts. Further, the investment activities were not integrated into the general ledger system. Entries are posted manually every month at the summary level. The USF administrator indicated that plans are in place to replace the existing system in 2008 because it lacks the functionality required to comply with the USSGL.

USF Subsidiary Systems

In the prior year, the Commitment Adjustment (COMAD) transactions were tracked in a separate sub-ledger due to the inability of the USF general ledger system to handle multiple sub-ledgers. On a monthly basis, the outstanding COMAD balances were input into the system via a top-sided entry (a summary general ledger entry entered manually into the general ledger system). In fiscal year 2006, the USF administrator continues to track COMAD and accounts payable transactions on a separate spreadsheet (sub-ledger); not interfaced with the general ledger system.

Recommendation:

3. Ensure that the USF general ledger system is in full compliance with the Financial Management System requirements and the USSGL.

B. Federal Financial System Setup and Posting Model

In fiscal year 2006, the FCC continued to use FFS system setup and posting model definitions that were not completely updated. Our audit identified instances in which the approved USSGL account definitions did not agree with the accounts used on the FCC trial balance. Also, the FCC continued to use outdated posting models for the auction and ITS transactions. For instance, the related incorrect postings aggregated for the auction transaction was $172 million. The outdated definitions continued to require corrections to the transaction postings through monthly journal vouchers. The incorrect posting model definitions resulted in non-compliance with Treasury's USSGL Accounting Transactions when recording and classifying some transactions. This system deficiency may continue to impair the quality and reliability of the ITS and the auction financial management information.

Recommendation:

4. Perform a periodic or quarterly update of and correct the FFS system setup and posting model definitions to ensure that transactions are posted to the general ledger properly to eliminate or minimize the risk of errors and the time consuming efforts of identifying and preparing monthly adjustments**.**

C. Financial Statement and Federal Agencies' Centralized Trial-Balance System II (FACTS II) Differences

The FACTS II is a computer program for agencies to submit mostly budgetary information required for the *Report on Budget Execution and Budgetary Resources*, the *Year-end Closing Statement*, and much of the data that will appear in the prior year column of the *Program and Financing Schedule* of the President's budget.

In Fiscal Year 2006, as in prior years, our audit identified significant differences between third quarter FACTS II account balances and the balances reported on the FCC's third quarter financial statements. The differences occurred because the incorrect version of the financial statement was used for the FACTS II submission.

GAO's *Standards for Internal Control in the Federal Government* states that, "Internal control should provide reasonable assurance that the objectives of the agency are being achieved in the reliability of financial reporting, including reports on budget execution, financial statements and other reports for internal or external use."

Recommendation:

5. Implement effective quality control procedures to ensure that external reports are reviewed prior to submission.

D. Auction Transactions

Although the flow of communication and auction documentation between the Wireless Telecommunications Bureau (WTB) and the Auction Accounting Group (AAG), an office within the Financial Operations Center (FOC), has improved significantly in FY 2006, the FCC has not formalized the communication, coordination and reporting practices into written policies and procedures. The WTB is the primary source of substantial activities on auctions and licensing that trigger accounting transactions to be acted upon by the FOC. The Lack of formal policies and procedures on a significant FCC operation increases the risk of noncompliance, misunderstanding, or confusion, ultimately impacting the financial statements.
Also, management did not establish a database for the WTB that is capable of being linked or interfaced with the core financial system to create an audit trail and record of delinquent winning bidders whose licenses were cancelled and then re-auctioned, including the amounts collected or received from the re-auction. Because auctioning licenses is a significant FCC operation, it is essential that information about the current status of a license and its history be easily accessible, providing bureaus and offices with the ability to update and share both financial and non-financial information.

Recommendations:

6. Issue written policies and procedures within the WTB outlining responsible offices, authority, responsibilities, timelines, and others to ensure that all auction and licensing activities with financial impact are reported to FOC for timely and proper recording.
7. Establish a database for the WTB that is capable of being linked or interfaced with the core financial system to create an audit trail and record of delinquent winning bidders whose licenses were cancelled and then re-auctioned, including the amounts collected or received from the re-auction. The comprehensive schedule should be periodically reviewed and reconciled.

E. Spreadsheet Subsidiary Ledger System

As noted above, the FCC and USF use a number of spreadsheet based systems for its accounting applications. For example, the FCC's management decided not to implement the RAMIS Auction Accounting and the ITS modules in FY 2005 because the modules were deemed unusable and unreliable. A spreadsheet subsidiary ledger system therefore continued to support auctions activity in Fiscal Year 2006 and will remain in place until a new core financial system is selected and implemented. These spreadsheets support the flow of transactions throughout the year. In FY 2006, the

FCC implemented controls over the spreadsheet applications to ensure that changes are reviewed and authorized, and that formula cells are protected.

Although the controls that were instituted improved the controls over the use of the spreadsheets, the inherent risks and limitations noted below associated with a spreadsheet-based application in a complex accounting operation remain.

- Substantial manual intervention, thereby increasing the risks of human errors.
- 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 change controls and that error correction changes were made.
- Unique transactions are difficult to incorporate.
- Difficulty in performing automatic checks and balances on the transactions in the spreadsheets.
- Delay in recording transactions in the general ledger.
- Increase in the use of journal vouchers as a means of posting transactions to the general ledger.

Recommendation:

8. Evaluate existing spreadsheet applications and determine ways to reduce the number of spreadsheets involved in the financial reporting process.

II. Component Entities' Financial Reporting Controls

GAO's *Standards for Internal Control in the Federal Government* states, "Internal controls activities help ensure that management's directives are carried out. The control activities should be effective and efficient in accomplishing the agency's control objectives." Examples of control activities include proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control. In addition, "Internal controls 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, comparison, reconciliation, and other actions people take in performing their duties."

OMB Circular No. A-136, *Financial Reporting Requirements*, states "When the reporting entities of which these components are a part, issue consolidated or consolidating statements that include such components, generally accepted accounting principles (GAAP) for Federal entities shall be applied to these components." Also, FCC Order 03-232 required the administrators of USF and TRS to prepare financial statements consistent with generally accepted accounting principles for Federal entities and to account for the funds in accordance with USSGL.

We identified the following two areas needing improvement:

A. Policies and Procedures:

Policies and procedures supporting key activities either did not exist for most or part of the year and are still in draft. Those identified include:

- Policies and procedures for following up on weaknesses noted in other reports, such as the SAS No. 70, *Reports on the Processing of Transactions by Service Organizations*.
- Policies and procedures to support the establishment of accounts payable when Service Provider (SP) invoices are reviewed and approved by USAC.
- Policies and procedures established for recording budgetary transaction for TRS activities.

Lack of policies and procedures for key activities could create confusion and misunderstanding, thus increasing the risk that transactions are not recorded promptly and properly, and subsequently affecting the reliability of financial information.

Recommendation:

9. Finalize all financial policies and procedures still in draft starting with those listed above.

B. Recording and Reconciling Activity:

- USF's chart of accounts is not consistent with the USSGL. The accounting structure used for recording USF transactions are not in a manner consistent with the USSGL. For example, USAC uses Account #113000-20 for Cash invest-SLD-SLD while the corresponding USSGL account that should have been used is 1130: Funds Held by the Public. The accounts are subsequently cross-walked to USSGL accounts at the time the financial statements are prepared.
- Budgetary transactions are not recorded to the appropriate general ledger accounts on a timely basis. Instead, transactions are captured on subsidiary ledger

spreadsheets and, on a monthly basis; the appropriate adjustments are made to the general ledger.

Not recording or a delay in recording of transactions diminishes the value of financial management reports for decision-making purposes. GAO's *Standards for Internal Control in the Federal Government* states "Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions."

Recommendation:

10. Ensure implementation of the USSGL posting model and recording at the transaction level.

III. Tighten FCC Oversight of the Components Entities' Activities

The FCC has the ultimate oversight of the reporting components' financial accounting activities. In many instances, the reporting components consult with the FCC or obtain the FCC's written approval, concurrence, or direction before implementing critical accounting issues; wherein some of these issues may impact on program policies. In Fiscal Year 2006, we noted certain significant accounting transactions issues mentioned below, affecting the reporting components that have not been acted upon by the FCC.

A. Title to Monetary Assets and Investments

Title to USF cash and other monetary assets, and investment accounts maintained at three different banks are held directly in the name of the USF administrator without identifying the fiduciary relationship of the administrator, and not showing any indication that the accounts are the property of the USF. Also, North American Numbering Plan (NANP)'s cash and other monetary assets maintained at the billing and collection fund administrator's bank lock box were held in the administrator's name, without reference to the custodial relationship of the administrator.

Recommendation:

11. Direct the USF and NANP administrators to require the banks to clearly identify the accounts as assets owned by USF or NANP, and that the administrators be limited to a fiduciary role.

B. Controls Over Compliance with Laws and Regulations

The report titled *Evaluation of Federal Financial Requirement* prepared by an independent accountant dated July 15, 2005 confirmed the applicability of certain federal laws and regulations to USF relating to financial management and identified several non-compliances with these laws and regulations. The laws and regulations include OMB Circular A-127 *Federal Managers Financial Integrity Act (FMFIA)*, OMB Circular A-123 and the Prompt Payment Act (PPA). The USF administrators have indicated that non compliance with the OMB Circulars are mainly due to a system limitation that will be addressed when a new financial system is implemented in 2008. On the applicability of the PPA to USF, the FCC guidance was not received by USAC until October 2nd 2006. In that guidance, the FCC concluded that the PPA does not apply to USF.

Recommendation:

12. The FCC's management should provide timely guidance to the USF administrators when consulted on matters to enhance fund management controls and compliance capability.

C. Collateral for TRS Cash

The TRS fund administrator did not have a collateral agreement with the FCC's lock box bank on behalf of USF to provide coverage for deposits in excess of Federal Deposit Insurance Corporation (FDIC) insured amount of $100,000. The Treasury Financial Manual 2-3400, *Accounting for and Reporting on Cash and Investments Held Outside of the U.S. Treasury,* states that "the Federal Government's interest in cash and investments held outside of Treasury accounts further extends to requiring that the deposits be made by Federal agencies in non-Treasury bank accounts be secured by collateral to the extent that the deposits exceed the protection covered by the FDIC." We were informed during the audit that TRS management is in the process of obtaining a collateral agreement with the lock box bank.

The Federal Government's interest in cash and investments held outside of Treasury accounts may be at risk since the excess deposits exceed the protection covered by the FDIC.

Recommendation:

13. Direct the TRS fund administrator to finalize a binding collateral agreement that is sufficient indemnification for all funds deposited, ensuring that it is effective immediately.

D. Accounts Receivable Reconciliation

The FCC does not perform a reconciliation of the accounts receivable (AR) balances transferred from USF to the FCC for purposes of referring accounts to Treasury covered by the Debt Collections Improvement Act (DCIA).

The AR balance transferred to the FCC as of June 30, 2006 per the FCC AR sub-ledger was $84,923,693 while the corresponding amount per USF AR Sub-ledger amounted to $87,707,965. Based on the reconciliation provided by the component entity, we noted that the FCC did not record material transactions communicated to them as of June 30, 2006. These include:

• Unrecorded balance transferred to the FCC	$ (7,146,113)
• Unrecorded balance transfer reversal	$ 11,502,429
• COMMAD Transferred not recorded by the FCC	$ (1,060,461)
• The FCC duplicated balance transferred by USAC	$ 285,294
• RAMIS balance includes lawsuit balances not on USF report	$ 3,316,005

Lack of prompt and periodic reconciliation may result in misstatement of the account balance on the quarterly financial statements.

GAO's *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, reconciliations, and other actions people take in performing their duties."

Recommendation:

14. Perform periodic reconciliation (preferably monthly but at least quarterly) of the accounts receivable transferred from the USF to the FCC.

IV. Cost Accounting

A. Minimum Level of Cost Accounting

FCC has defined its responsibility segments for financial reporting purposes. However, for the consolidated financial statements, which include the component entities, the defined responsibility segment is not adequate to cover the component entities, individually regarded as responsibility segments. Also, documentation provided does not indicate that the FCC has determined the output relating to the responsibility segments, nor has it calculated the related output costs for those responsibility segments as part of its cost allocation methodology.

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards* requires a minimum level for cost accounting to provide basic information to accomplish the many objectives associated with planning, decision-making, and reporting. This minimum level includes, among others, measuring full cost of outputs, providing information for performance measurement, and providing useful information, and accommodating any of management's special cost information needs that may arise due to unusual or special situations or circumstances.

Recommendations:

15. Enhance Budget Execution and Management System (BEAMS) functionality to satisfy the minimum level of cost accounting required in a managerial cost accounting system as required by SFFAS No. 4.
16. Define outputs produced by the responsibility segments and incorporate the definition into the Statement of Net Costs allocation methodology.

B. Matching Revenue to Cost

The FCC's cost allocation system, BEAMS, is configured to allocate 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."

Recommendation:

17. Review the propriety of the costing methodology and the matching of earned revenue against costs. Include a review of different program activities that generate revenue and apply the revenue to those activities that produce the earned revenue.

V. Payroll and Personnel Activities

GAO's *Standards for Internal Control* states "transactions should be accurately recorded in a timely manner". One of the control activities used to accomplish this goal requires the performance of reconciliations and having controls in place to detect errors.

Weaknesses identified in the prior year audits on payroll activities have not been corrected.

- Leave error reports received from the National Finance Center (NFC), showing differences between NFC's leave record for each employee and the FCC's leave and earnings (LES) statements were not reconciled. Although management performed several audits reconciling the LES reports and NFC system, our audit continues to identify multiple instances where significant differences were not reconciled for all categories of leave balances such as, annual leave, sick leave, compensatory time, and credit hour categories.

  Management explained that the NFC System has a cumbersome duplicative process that allows for two sets of leave balances. This is an inherent problem with the NFC system. Hence, until NFC modifies their system (which is not in the foreseeable future) or unless the FCC spends considerable funds to migrate to a different payroll/personnel provider, the problem of leave discrepancies will not be resolved.

- Invalid project codes identified in FFS remain uncorrected for a long period of time. The existing procedures are to facilitate payment of salaries and wages rather than correct invalid project codes. Financial Systems Operation Group (FSOG) generates an invalid project code report from FFS and posts corrections to a single project code, E0200, regardless of what the employee should have charged time against.

  The FCC's new time and attendance system, STARweb is not configured to reject invalid project codes; therefore, an incorrect project code is accepted into the NFC payroll system.

  Recommendations:

  18. Increase the NFC and the FCC system reconciliation procedures to include all leave categories.
  19. Ensure that timekeepers perform monthly reconciliation of time and attendance report errors generated from the FCC's desktop payroll reconciliation system.
  20. Enhance the LES system capabilities to reject incorrect project codes from being entered in the system in the first place.
  21. Issue guidance to establish timeframes for employees to correct invalid project code errors.
  22. Provide the FCC contact person at NFC a listing of uncorrected project codes monthly.

VI. Debt Collection Improvement Act

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

Our review of the Treasury Report on Receivables (TROR) as of June 30, 2006, disclosed that no amounts of administrative receivables had been referred to Treasury for offset, and only $ 9.8 million of eligible administrative receivables out of a total of $ 92.9 million had been referred for cross-servicing. This issue has been reported in prior years.

Our audit also noted that management had not implemented controls to ensure that debts that were delinquent were assessed interest, penalties, or administrative fees as allowed by the DCIA and the FCC's rules, 47 CFR Part 1.1940 *Interest, Penalties, Administrative Costs and Other Sanctions Assessment*.

The lack of referral of all delinquent debt to Treasury or the non-assessment of interest, penalties, or administrative fees on delinquent debts results in noncompliance with the DCIA.

Recommendations:

23. Refer all eligible delinquent debt more than 180 days old to the Treasury for offset or timely cross servicing.
24. Perform a review of the delinquency debt letter procedures to ensure that all delinquent debtors receive dunning letters and interest, penalties, and administrative fees are assessed in conjunction with the submission of the letters to the debtors.

VII. Compliance with OMB Circular No. A-130, *Requirement for a Comprehensive Security Plan*

Effective information security management is critical to the FCC's ability to ensure the reliability, availability, and confidentiality of its information assets, and thus its ability to perform its mission. If effective information security practices are not in place, the FCC's data and systems are at risk of inadvertent or deliberate misuse, fraud, improper disclosure, or destruction—possibly without detection.

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.

Although the FCC has made progress in implementing important elements of its information security program, including establishing its *Computer Security Program* – the FCC Directive 1479.2, a computer security program group and appointing a senior information security officer to manage the program, it has not fully implemented other essential elements. The FCC has not consistently implemented important information security practices and controls, including fully implementing its certification and accreditation program, ensuring that sensitive data transmissions are encrypted, and ensuring a memorandum of understanding and/or interconnection security agreements are in place. These deficiencies in security controls decrease the FCC's ability to protect its sensitive or critical resources. Specifically, deficiencies include the following:

- One of FCC's security manuals has expired. The FCC has not issued a new directive to replace the expired security directive 1131.1.
- The FCC has not established policies and procedures to ensure that all sensitive data to and from its contractors are protected, remain private and that critical business transactions remain trusted and secure.
- We noted that one of the FCC's major financial applications had control weaknesses associated with the enforcement of the "principle of least privilege", which allowed some users inappropriate access to "override" privileges.
- The FCC has not enforced a program for the periodic recertification of users' access to its major applications.
- The FCC's re-certification of the contractor loan servicing system was incomplete and did not uncover certain weaknesses that the contractor knew about.
- One of the FCC's major financial system applications has had significant changes to its operating environment. Both the operating system and the database system have been changed. The financial application was put into production before the certification and accreditation was completed as required by FCC Directive 1479.2.
- Logical access is not always promptly revoked after the separation of employees and contractors.
- The FCC does not have signed Memorandum of Understanding and/or Interconnection Security Agreements (ISA) for all major external entities that the FCC shares data with, or whose systems are interconnected with the FCC systems.
- The FCC did not certify and accredit a major application before authorizing it to operate.
- Security weaknesses were noted in an operating system that supports some of the FCC's major applications.

- The FCC does not require and/or maintain access authorization forms for its major applications to ensure that appropriate level of access is granted based on job function.

  Recommendations:

25. Issue a new directive to replace the expired security directive 1131.1.
26. Ensure that transmission of all sensitive data to and from the FCC's contractors and business partners is protected and encrypted.
27. Ensure that the "principle of least privilege" is adequately enforced across all major applications and general support systems.
28. Ensure that periodic recertification of users' access to its major applications is adequately enforced and operating effectively to ensure the "principle of least privilege" is in place and that incompatible duties are properly segregated.
29. Ensure that the recertification process for all systems (including contractors) is thorough and complete.
30. Recertify and accredit major applications that have had significant changes to their operating environment before being placed into production in accordance with NIST Special Publication 800-37 and FCC Directive 1479.2.
31. Implement procedures to ensure the prompt revocation of access to the FCC resources at the effective date of termination of employees and contractors.
32. Ensure that Memorandum of Understanding and/or Interconnection Security Agreements (ISA) are signed with all major external entities that the FCC shares data with, or whose systems are interconnected with the FCC systems.
33. Ensure that all new major applications are certified and accredited before being placed in to production.
34. Ensure that security weaknesses noted in a major operating system is addressed and that a comprehensive security review is conducted.
35. Maintain access authorization forms for all major applications to ensure that appropriate level of access is granted based on job function.

STATUS OF PRIOR YEAR COMMENTS

As required by *Government Auditing Standards* and OMB Bulletin No. 06-03, 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. Details of the status of the recommendations are reported as Appendix A to this report.

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In addition to the 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 November 1, 2006.

This report is intended solely for the information and use of the management of FCC, FCC Office of Inspector General, OMB, the Government Accountability Office 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
November 1, 2006

LIMITATIONS OF THE FINANCIAL STATEMENTS

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

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

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PRINCIPAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED BALANCE SHEET
As of September 30, 2006 and 2005
(Dollars in thousands)

	FY 2006	Unaudited FY 2005
ASSETS (Note 2)		
Intragovernmental		
Fund Balance with Treasury (Note 3)	$ 606,696	$ 1,522,785
Investments (Note 5)	4,723,516	4,139,945
Accounts Receivable (Note 6)	229,322	4,996
Total Intragovernmental	5,559,534	5,667,726
Cash and Other Monetary Assets (Note 4)	3,152,377	57,114
Accounts Receivable, net (Note 6)	933,943	673,493
Loans Receivable, net (Note 7)	149,421	1,257,265
General Property, Plant, and Equipment, net (Note 9)	38,156	51,198
Other	10,013	10,447
Total Assets	$ 9,843,444	$ 7,717,243
LIABILITIES (Note 10)		
Intragovernmental		
Debt (Note 11)	$ 448,997	$ 1,273,798
Other (Note 12)		
Custodial	152,036	222,350
Other	1,810	1,826
Total Other	153,846	224,176
Total Intragovernmental	602,843	1,497,974
Accounts Payable	300,925	74,451
Other (Note 12)		
Deferred Revenue	3,100,144	1,185,774
Prepaid Contributions	63,461	57,360
Deposit/Unapplied Liability	41,737	5,232
Accrued Liabilities for Universal Service	451,860	418,826
Telecommunications Development Account (TDA) Interest	28,623	1
Other	42,130	43,399
Total Other	3,727,955	1,710,592
Total Liabilities	$ 4,631,723	$ 3,283,017
Commitments and Contingencies (Note 14)		
NET POSITION		
Unexpended Appropriations	$ -	$ 24,617
Unexpended Appropriations - Earmarked Funds (Note 23)	-	-
Unexpended Appropriations - Other Funds	17,843	-
Cumulative Results of Operations	-	4,409,609
Cumulative Results of Operations - Earmarked Funds (Note 23)	5,112,001	-
Cumulative Results of Operations - Other Funds	81,877	-
Total Net Position	$ 5,211,721	$ 4,434,226
Total Liabilities and Net Position	$ 9,843,444	$ 7,717,243

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST
For the Years Ended September 30, 2006 and 2005
(Dollars in thousands)

	FY 2006	Unaudited FY 2005
PROGRAM COSTS:		
Broadband:		
Gross costs (Note 15)	$ 26,795	$ 24,692
Less: Earned Revenue (Note 15)	(30,374)	(26,995)
Net Program Costs	(3,579)	(2,303)
Competition:		
Gross costs (Note 15)	7,259,004	6,679,252
Less: Earned Revenue (Note 15)	(117,840)	(118,231)
Net Program Costs	7,141,164	6,561,021
Spectrum:		
Gross costs (Note 15)	446,348	503,517
Less: Earned Revenue (Note 15)	(248,297)	(489,887)
Net Program Costs	198,051	13,630
Media:		
Gross costs (Note 15)	30,887	30,433
Less: Earned Revenue (Note 15)	(33,584)	(31,887)
Net Program Costs	(2,697)	(1,454)
Homeland Security:		
Gross costs (Note 15)	37,851	35,445
Less: Earned Revenue (Note 15)	(41,196)	(36,953)
Net Program Costs	(3,345)	(1,508)
Modernize the FCC:		
Gross costs (Note 15)	50,228	53,334
Less: Earned Revenue (Note 15)	(54,573)	(54,280)
Net Program Costs	(4,345)	(946)
Total Net Program Costs	7,325,249	6,568,440
Cost not Assigned to Programs:		
Telecommunications Development Fund	28,885	1,314
Other Expenses	4,954	(759)
Less: Earned Revenues not Attributed to Programs:		
Telecommunications Development Fund	(28,885)	(1,314)
Net Cost of Operations	$ 7,330,203	$ 6,567,681

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Years Ended September 30, 2006 and 2005
(Dollars in thousands)

	FY 2006 Consolidated Earmarked Funds	FY 2006 Consolidated All Other Funds	FY 2006 Consolidated Total	Unaudited FY 2005 Consolidated Total
Cumulative Results of Operations:				
Beginning Balances	$ 4,276,827	$ 132,782	$ 4,409,609	$ 2,267,478
Adjustments:				
Changes in accounting principles (Note 24)	-	9,886	9,886	-
Beginning Balance, as adjusted	4,276,827	142,668	4,419,495	2,267,478
Budgetary Financing Sources:				
Other Adjustments (rescissions, etc.)	-	(2,463)	(2,463)	(1,095)
Appropriations Used	-	142,847	142,847	1,272,637
Non-exchange Revenue	7,982,384	-	7,982,384	7,449,284
Other Financing Sources (Non Exchange):				
Transfers in/ out reimbursement	-	(32,233)	(32,233)	(25,463)
Imputed financing	-	14,068	14,068	14,449
Other	-	(17)	(17)	-
Total Financing Sources	7,982,384	122,202	8,104,586	8,709,812
Net Cost of Operations	7,147,210	182,993	7,330,203	6,567,681
Net Change	835,174	(60,791)	774,383	2,142,131
Cumulative Results of Operations	5,112,001	81,877	5,193,878	4,409,609
Unexpended Appropriations:				
Beginning Balances	-	24,617	24,617	38,155
Adjustments:				
Changes in accounting principles (Note 24)	-	(9,886)	(9,886)	-
Beginning Balance, as adjusted	-	14,731	14,731	38,155
Budgetary Financing Sources:				
Appropriations Received	-	146,168	146,168	1,260,763
Other Adjustments	-	(209)	(209)	(1,664)
Appropriations Used	-	(142,847)	(142,847)	(1,272,637)
Total Budgetary Financing Sources	-	3,112	3,112	(13,538)
Total Unexpended Appropriations	-	17,843	17,843	24,617
Net Position	5,112,001	99,720	5,211,721	4,434,226

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
(Dollars in thousands)

	FY 2006		Unaudited FY 2005	
	Budgetary	Non Budgetary Credit Program Financing Acct	Budgetary	Non Budgetary Credit Program Financing Acct
Budgetary Resources:				
Unobligated balance, brought forward, October 1:	$ 1,006,367	$ 67,196	$ 272,571	$ 59,507
Recoveries of prior year unpaid obligations	954,957	-	664,116	-
Budget authority:				
Appropriations received	8,306,644	-	9,899,436	-
Borrowing authority	-	183,059	-	38,124
Spending authority from offsetting collections				
Earned:				
Collected	384,148	1,320,704	416,792	2,981,006
Change in receivables from Federal sources	31	-	(342)	-
Change in unfilled customer orders:				
Without advance from Federal sources	-	-	13	-
Previously unavailable	12,000	-	-	-
Budget authority subtotal	8,702,823	1,503,763	10,315,899	3,019,130
Temporarily not available pursuant to Public Law	(25,300)	-	(12,000)	-
Permanently not available	(2,686)	(1,007,860)	(2,742)	(2,705,090)
Total Budgetary Resources	$ 10,636,161	$ 563,099	$ 11,237,844	$ 373,547
Status of Budgetary Resources:				
Obligations incurred: (Note 16)				
Direct	$ 8,653,372	$ 278,958	$ 10,230,118	$ 306,351
Reimbursable	1,778	-	1,359	-
Subtotal	8,655,150	278,958	10,231,477	306,351
Unobligated balance:				
Apportioned	155,098	187	217,449	382
Unobligated balance not available	1,825,913	283,954	788,918	66,814
Total, Status of Budgetary Resources	$ 10,636,161	$ 563,099	$ 11,237,844	$ 373,547
Change in Obligated Balance:				
Obligated balance, net				
Unpaid Obligations, brought forward, October 1	$ 3,265,134	$ -	$ 3,085,539	$ -
Less: Uncollected customer payments from Federal sources, brought forward, October 1	15	-	344	-
Total unpaid obligated balance, net	3,265,119	-	3,085,195	-
Obligations incurred net (+/-)	8,655,150	278,958	10,231,477	306,351
Less: Gross outlays	8,066,684	278,958	9,387,765	306,351
Less: Recoveries of prior year unpaid obligations, actual	954,957	-	664,116	-
Change in uncollected customer payments from Federal sources	(31)	-	343	-
Obligated balance, net, end of period				
Unpaid obligations	2,898,642	-	3,265,134	-
Less: Uncollected customer payments from Federal sources	46	-	15	-
Total, unpaid obligated balance, net, end of period	2,898,596	-	3,265,119	-
Net Outlays				
Net Outlays:				
Gross outlays	$ 8,066,684	$ 278,958	$ 9,387,765	$ 306,351
Less: Offsetting collections	384,148	1,320,704	416,792	2,981,006
Less: Distributed Offsetting receipts (Note 22)	32,233	-	25,463	-
Net Outlays	$ 7,650,303	$ (1,041,746)	$ 8,945,510	$ (2,674,655)

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
(Dollars in thousands)

Resources Used to Finance Activities:	**FY 2006**	**Unaudited FY 2005**
Budgetary Resources Obligated		
Obligations incurred	$ 8,934,108	$ 10,537,828
Less: Spending authority from offsetting collections and recoveries	2,659,840	4,061,585
Obligations net of offsetting collections and recoveries	6,274,268	6,476,243
Less: Offsetting receipts (Note 22)	32,233	25,463
Net obligations	6,242,035	6,450,780
Other Resources		
Transfers in/out without reimbursement (+/-) (Note 22)	32,233	25,463
Imputed financing from costs absorbed by others	14,068	14,449
Other (+/-)	17	-
Net other resources used to finance activities	46,318	39,912
Total resources used to finance activities	6,288,353	6,490,692
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 (+/-)	(374,883)	168,435
Resources that fund expenses recognized in prior periods	316,972	1,269,099
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	(1,320,706)	(3,016,923)
Other	98,409	350,860
Resources that finance the acquisition of assets	404,819	1,137,808
Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	23,192	57,786
Total resources used to finance items not part of the net cost of operations	(852,197)	(32,935)
Total resources used to finance the net cost of operations	7,140,550	6,523,627
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	(111)	-
Upward/Downward reestimates of credit subsidy (+/-)	22,444	(44,224)
Increase in exchange revenue receivable from the public	(8,370)	2,957
Other (+/-)	32,542	32,205
Total components of Net Cost of Operations that will require or generate resources in future periods	46,505	(9,062)
Components not Requiring or Generating Resources:		
Depreciation and Amortization	21,712	16,922
Other (+/-)	121,436	36,194
Total components of Net Cost of Operations that will not require or generate resources	143,148	53,116
Total components of Net Cost of Operations that will not require or generate resources in the current period	189,653	44,054
Net Cost of Operations	$ 7,330,203	$ 6,567,681

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2006 and 2005
(Dollars in thousands)

	FY 2006	Unaudited FY 2005
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	$ 104,471	$ 152,355
Fines and Penalties (Note 25)	100,133	12,435
Credit Reform	276,311	269,233
TDA Interest	28,885	1,314
Total Cash Collections	509,800	435,337
Accrual Adjustments		
Spectrum Auctions	4,121	6,132
Fines and Penalties	20,119	(1,472)
Total Accrual Adjustments	24,240	4,660
Total Custodial Revenue	534,040	439,997
Disposition of Collections:		
Transferred to Others:		
Recipient A: U.S. Treasury	(490,469)	(441,448)
(Increase)/Decrease in Amounts Yet to be Transferred	70,314	87,780
Retained by the Reporting Entity	(113,885)	(86,329)
Net Custodial Activity	$ -	$ -

The accompanying notes are an integral part of these statements.

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005 (UNAUDITED AS TO FY 2005)
(DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED)

Note 1 - Summary of Significant Accounting Policies

Reporting Entity

The Commission is an independent United States Government agency, established by the Communications Act (Act) of 1934, as amended. The Commission is charged with regulating interstate and international communications by radio, television, wire, satellite, and cable. The Commission's jurisdiction spans the 50 states, the District of Columbia, and the U.S. possessions. Five commissioners direct the Commission; they are appointed by the President of the United States and confirmed by the Senate for five-year terms, except when filling an unexpired term.

The Commission comprises three reporting components. The primary component consists of Commission headquarters and field offices. The two additional components are the Universal Service Fund (USF) and the North American Numbering Plan (NANP). The USF reports the results of the four Universal Service support mechanisms (established pursuant to section 254 of the Act, as amended) and the results of the Telecommunications Relay Service (TRS) Fund (established by the Americans with Disabilities Act of 1990, Title IV). The NANP reports the results of billing and collection activities conducted to support the NANP (47 U.S.C. § 251(e); 47 C.F.R. § 52.16, 52.17, 52.32, and 52.33).

Basis of Accounting and Presentation

The consolidated financial statements (financial statements) have been prepared from the accounting records of the Commission in conformity with U.S. Federal Generally Accepted Accounting Principles and the form and content for entity financial statements specified by OMB Circular A -136 "Financial Reporting Requirements."

The preparation of financial statements in conformity with GAAP 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.

Fund Balance with Treasury

Funds with the Department of the Treasury (Treasury) primarily represent appropriated, revolving, and deposit funds. The Commission may use the appropriated and revolving funds to finance expenditures, depending on budgetary availability. The deposit accounts are used to hold funds temporarily until they can be properly disbursed or distributed.

Note 1 - Summary of Significant Accounting Policies (continued)

Cash and Other Monetary Assets

Cash and Other Monetary Assets represent cash on deposit and money market funds at several commercial banks. Cash on deposit is collateralized by the Federal Reserve and typically exceeds federally insured limits.

Investments

Investments are reported net of the unamortized premium or discount. All investments are in Treasury securities.

Accounts Receivable, Net

Accounts Receivable consists of claims made for payment from other entities. Gross receivables are reduced to net realizable value by an allowance for doubtful accounts.

Loans

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

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. All PP&E with an initial acquisition cost of $25 or more and all internally developed software with a development cost of $50 or more, and with an estimated useful life of two years or greater, are capitalized. Bulk purchases of similar items, individually worth less than $25 but collectively worth more than $250, 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 lives of the items. The useful lives used are: forty years for buildings, seven years for non-computer equipment, five years for computers and vehicles, and three years for software. Neither land, including permanent improvements, nor software in development is depreciated. Normal maintenance and repair costs are expensed as incurred.

Leasehold improvements include all costs incurred during the design and construction phase of the improvement. These costs are amortized over the remaining life of the lease, or the useful life of the improvements, whichever is shorter.

Note 1 - Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

The Commission's authority relative to seized and forfeited property is cited in 47 U.S.C. § 510. Seized property consists of personal property and equipment seized from illegal telecommunication operations. The property is considered prohibited and is held pending an outcome of court proceedings. Forfeited property consists of seized property turned over to the Commission to be destroyed or disposed of through a surplus process. The values assigned to the seized and forfeited property are determined by Commission engineers and are based on current market values for comparable property.

Other Assets

Other Assets represents the balance of transfers less expenses made by the USF to Universal Service Administration Company (USAC) to fund administrative costs in advance. Advances are drawn down as expenses are incurred.

Accounts Payable and Accrued Liabilities

Accounts Payable and Accrued Liabilities represent a probable future outflow or other sacrifice of resources as a result of past transactions or events. Liabilities are recognized when they are incurred, regardless of whether they are covered by available budgetary resources. Liabilities cannot be liquidated without legislation that provides resources to do so. As a component of the U.S. Government, a sovereign entity, payments of all liabilities other than contracts can be abrogated by the sovereign entity.

Deferred Revenue

The Commission collects proceeds from the sale of communications spectrum on behalf of the U.S. Government. All proceeds collected up to the amount of the net winning bid are recognized as deferred revenue until a "prepared to grant" or "grant" public notice is issued. In addition, the Commission collects multi-year regulatory fees for five- and ten-year periods that are recorded as deferred revenue and amortized over the period of the fee.

Debt

This account represents amounts due to the U.S. Treasury's Bureau of Public Debt (BPD) to support the spectrum auction loans program. Borrowings from BPD are determined based on subsidy estimates and re-estimates in accordance with the FCRA of 1990, as amended, and OMB guidance. Interest payment on debt is calculated annually and remitted to BPD at the end of the fiscal year. These payments are recorded in a receipt account maintained by the Commission.

Retirement Plans and Other Benefits

Federal employee benefits consist of the actuarial portions of future benefits earned by Federal employees, including pensions, other retirement benefits, and other post-employment benefits. The Office of Personnel Management (OPM) administers these benefits. The Commission does not recognize any liability on the Balance Sheet for pensions, other retirement benefits, and other post-employment benefits. The Commission recognizes and allocates the imputed costs on the Statement of Net Cost and recognizes imputed financing related to these costs on the Statement of Changes in Net Position.

Note 1 - Summary of Significant Accounting Policies (continued)

Retirement Plans and Other Benefits (continued)

Pensions provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. Most Commission employees participate in the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). Under CSRS, the Commission makes matching contributions equal to seven percent of basic pay. For FERS employees, the Commission contributes the employer's matching share for Social Security, 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 approved compensation cases. The liability is determined by using historical benefit payment patterns related to a specific incurred period to predict the ultimate payment related to that period. The Department of Labor determines no actuarial liability for the Commission, due to the immateriality to the Federal Government as a whole.

Leave

Annual leave is accrued as earned, and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current leave balances and pay rates. Annual leave is reflected as a liability not covered by current budgetary resources. Sick leave and other types of non-vested leave are expensed as taken.

Revenue and Other Financing Sources

<u>Regulatory Fee Collections (Exchange)</u> - The Omnibus Budget Reconciliation Act of 1993 directed the Commission to assess and collect regulatory fees to recover the costs incurred in carrying out certain provisions of its mission. Section 9(a) of the Act, as amended, authorizes the Commission to assess and collect annual regulatory fees to recover the costs, as determined annually by Congress, incurred in carrying out its strategic goals of broadband, competition, spectrum, media, homeland security and modernizing the Commission. These fees were established by congressional authority, and, consistent with OMB Circular No. A-25 revised, *User Charges*, the Commission did not determine the full costs associated with its regulatory activity in establishing regulatory fees. Since 1993, Congress has annually reviewed the regulatory fee collection requirements of the Commission and established the total fee levels to be collected. Fees collected up to the level established by Congress are applied against the Commission's annual appropriation at the close of each fiscal year. The regulatory fee levels of $298,771 for FY 2006 and $280,098 for FY 2005 were achieved. The Congress has designated $10,000 of the FY 2006 fees for deposit into Treasury.

Note 1 - Summary of Significant Accounting Policies (continued)

Revenues and Other Financing Sources (continued)

Radio Spectrum Auction Proceeds (Exchange) – In accordance with the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources*, the Commission accounts for this exchange revenue as a custodial activity. Revenue from spectrum auctions is recognized when a "prepared to grant" or "grant" public notice is issued. The value of available spectrum is determined by the market place at the time of auction. The Commission recognized custodial revenue of $108,592 in FY 2006 and $158,487 in FY 2005.

Offsetting Collections (Exchange) – One of the Commission's primary functions is managing the spectrum auction program. Proceeds from the auctions are initially remitted to the Commission and are later transferred to the U.S. Treasury, net of anticipated auction related costs (under 47 U.S.C. § 309, the Commission may retain a portion of the spectrum auction proceeds to offset the cost of performing the auction function). Collections used to offset the cost of performing auctions-related activity totaled $85,000 in FY 2006 and $85,000 in FY 2005.

Application Fees (Exchange) – Congress authorized the Commission (47 U.S.C. § 8) to impose and collect application processing fees and directed the Commission to prescribe charges for certain types of application processing or authorization services it provides to communications entities over which the Commission has jurisdiction. The Commission amends its Schedule of Application Fees (47 C.F.R. § 1.1102 *et seq*.) to adjust the fees for processing applications and other filings. Section 8(b) of the Act, as amended, requires the Commission to review and adjust its application fees every two years. The adjusted or increased fees reflect the net change in the Consumer Price Index for all Urban Consumers (CPI-U), calculated over a specific period of time**.** Application fees are deposited in the Treasury and are not available for the Commission's use. Application fees collected totaled $22,233 in FY 2006 and $25,463 in FY 2005.

Reimbursable Work Agreements (Exchange) – The Commission recognizes reimbursable work agreement revenue when earned, *i.e.*, goods that have been delivered or services rendered. The Commission executed agreements totaling $1,426 in FY 2006 and $1,372 in FY 2005.

Annual Appropriations (Financing Source) – The Commission receives an annual Salaries and Expenses appropriation from Congress. These funds are used to pay for operations during the fiscal year and are repaid to the Treasury once regulatory fees are collected. The annual appropriation for FY 2006 is $289,758 with regulatory fee collections of $288,771 resulting in a net appropriation of $987. The annual appropriation for FY 2005 was $281,085 with regulatory fee collections of $280,098 resulting in a net appropriation of $987.

Subsidy Estimates and Reestimates (Financing Source) – The Commission receives permanent-indefinite authority for its credit reform program account in accordance with the FCRA of 1990, as amended, to fund its subsidy estimates and reestimates, unless otherwise prescribed by OMB. This account records the subsidy costs associated with the direct loans after FY 1991, as well as administrative expenses of the loan program. The Commission received appropriations of $145,181 in FY 2006 and $1,259,776 in FY 2005 for these purposes. These appropriations are available until used.

Note 1 - Summary of Significant Accounting Policies (continued)

Revenues and Other Financing Sources (continued)

USF (Nonexchange) – Carriers conducting interstate telecommunications are required to contribute a portion of their revenues to fund the cost of providing universal service. These contributions represent appropriated dedicated and earmarked receipts and are accounted for as a budgetary financing source. Contributions and related interest totaled $7,982,384 in FY 2006 and $7,449,284 in FY 2005.

Receipts and Outlays

In reporting the receipts and gross outlays of the TRS, the multiplying effect of processing the redemption and repurchase of Federal securities through the TRS money market account is reduced. Since money market funds are classified as non-Federal securities, the receipts are obligated and outlaid at the time of initial non-Federal investment. When receipts (including interest, dividends, realized gains and proceeds not immediately reinvested but reported as new receipts) are subsequently re-invested, an obligation and outlay would be recorded. The Commission has reviewed this practice with the OMB and they are in agreement that recording each transaction would distort the receipts and gross outlays of the program. This treatment is also used in the Appropriations Received and Obligations Incurred lines on the SBR and the Resources that Finance the Acquisition of Assets line on the SOF.

Transactions with Related Parties

The Commission has relationships and conducts financial transactions with numerous Federal agencies, most prominently the Treasury. In addition to its Federal relationships, the Commission has a direct relationship with the administrators of those funds that are components under the overall Commission entity. These organizations are USAC, which administers the four USF support mechanisms, National Exchange Carrier Association (NECA) which administers the TRS Fund, and Neustar which administers the NANP. Welch and Company, LLC serves as the Billing and Collection agent for the NANP.

Net Position

Net Position is the residual difference between assets and liabilities and comprises Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations represents the amount of unobligated and unexpended budget authority. Unobligated Balance is the amount of appropriations or other authority remaining after deducting the cumulative obligations from the amount available for obligation. Cumulative Results of Operations is the net result of the Commission's operations since inception.

Note 2 - Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2006 and 2005:

	FY 2006	FY 2005
Intragovernmental:		
Fund Balance with Treasury	$ 187,221	$ 1,342,976
Accounts Receivable, Net	4,322	4,996
Total Intragovernmental	191,543	1,347,972
Cash and Other Monetary Assets	3,050,763	749
Accounts Receivable, Net	46,291	20,892
Total Non-entity Assets	3,288,597	1,369,613
Total Entity Assets	6,554,847	6,347,630
Total Assets	$ 9,843,444	$ 7,717,243

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for $175,948 in FY 2006 and $1,337,550 in FY 2005. Non-entity Cash and Other Monetary Assets also consist of deposits made by spectrum auction bidders that are held outside of Treasury. Receivables considered non-entity are for regulatory fees, application fees, fines and forfeitures, spectrum auction receivables, and International Telecommunications Settlement (ITS) charges.

Note 3 - Fund Balance with Treasury

The following summarizes Fund Balance with Treasury as of September 30, 2006 and 2005:

September 30, 2006

	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Budgetary Resources				
Available	$ 27,928	$ 284,142	$ -	$ 312,070
Unavailable	27,684	-	187,221	214,905
Obligated Balance not yet Disbursed	79,721	-	-	79,721
Total	$ 135,333	$ 284,142	$ 187,221	$ 606,696

September 30, 2005

	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Budgetary Resources				
Available	$ 31,234	$ 67,196	$ -	$ 98,430
Unavailable	8,331	-	1,342,976	1,351,307
Obligated Balance not yet Disbursed	73,048	-	-	73,048
Total	$ 112,613	$ 67,196	$ 1,342,976	$ 1,522,785

Note 3 - Fund Balance with Treasury (continued)

Appropriated Funds – Includes the salaries and expense appropriation used to fund agency operations, the auction and reimbursable accounts, the no-year accounts used to carry over spectrum auction and regulatory fee funds, and the credit reform program account.

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

Deposit Funds – Includes monies being held for spectrum auctions, International Telecommunications Settlement (ITS), and regulatory fees. Deposit funds are not available for use by the Commission unless they are properly identified or reclassified as Commission funds. Otherwise, these funds are returned to the depositor or transferred to the Treasury.

Note 4 – Cash and Other Monetary Assets

The following summarizes Cash and Other Monetary Assets as of September 30, 2006 and 2005:

	FY 2006	FY 2005
Cash and Cash Equivalents	$ 3,152,377	$ 57,114

USF and NANP contributions and third party deposits made pursuant to spectrum auction activities are the source of funds for these balances. Third-party deposits, unless refunded, are held until 45 days after the close of a given auction and then transferred to the Commission's Treasury account. Interest earned on cash

and other monetary assets is reinvested, with the exception of interest earned on third-party deposits, which is transferred to the Telecommunications Development Fund (TDF).

In FY 2006 Cash and Other Monetary Assets included $3,050,763 in deposits or related accrued interest being held for spectrum auctions, $96,203 in USF contributions and related accrued interest being held for distribution, and $5,411 in NANP deposits and related accrued interest.

In FY 2005 Cash and Other Monetary Assets included $749 in deposits and related accrued interest being held for spectrum auctions, $48,150 in USF contributions and related accrued interest being held for distribution, and $8,215 in NANP deposits and related accrued interest.

Note 5 - Investments

The following summarizes Investments as of September 30, 2006 and 2005:

FY 2006	Cost	Amortization Method	Unamortized (Premium) Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities:					
Marketable Securities:					
Treasury Bills	$3,285,930	EI	$ 46,197	$ 3,332,127	$3,287,848
Treasury Notes	1,422,545	EI	7,506	1,430,051	1,422,752
Accrued Interest	15,041	NA		15,041	15,041
Total	$4,723,516			$ 4,777,219	$4,725,641

FY 2005	Cost	Amortization Method	Unamortized (Premium) Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities:					
Marketable Securities:					
Treasury Bills	$4,119,760	EI	$ 17,094	$ 4,136,854	$ 4,121,516
Treasury Notes	19,996	EI	4	20,000	19,803
Accrued Interest	189	NA		189	189
Total	$4,139,945			$ 4,157,043	$ 4,141,508

EI – Effective Interest Method
NA – Not Applicable

All Treasury securities, regardless of the maturity date, are reported as investments. The Commission expects to hold all investments to maturity; therefore, no adjustments have been made to present market values. All investments are held by USF and are also recognized as part of earmarked funds in Note 23.

The USF had two Treasury Bills for $225,000 that matured on September 30, 2006, but did not settle until October 2, 2006. These securities were reclassified out of investments and into intragovernmental accounts receivable at September 30, 2006. In addition, two new Treasury Bills for $225,000 were purchased on September 29, 2006, but did not settle until October 2, 2006. These transactions were recorded as intragovernmental investments with corresponding accounts payable at September 30, 2006.

Note 6 - Accounts Receivable, Net

The following summarizes Accounts Receivable, Net as of September 30, 2006 and 2005:

	Intragovernmental	Public	Total
FY 2006			
Gross Accounts Receivable	$ 229,322	$ 1,630,380	$ 1,859,702
Allowance for Doubtful Accounts	(-)	(696,437)	(696,437)
Net Accounts Receivable	$ 229,322	$ 933,943	$ 1,163,265
Interest on Delinquent AR	$ -	$ 45,856	$ 45,856
FY 2005			
Gross Accounts Receivable	$ 4,996	$ 1,369,248	$ 1,374,244
Allowance for Doubtful Accounts	(-)	(695,755)	(695,755)
Net Accounts Receivable	$ 4,996	$ 673,493	$ 678,489
Interest on Delinquent AR	$ -	$ 45,856	$ 45,856

Accounts receivable are recorded net of any related allowance for doubtful accounts. The Commission's portion is determined by applying predetermined percentages against the respective date the receivable was established. The current formula for the Commission's allowance is 25% for receivables 91-180 days outstanding, 75% for those 181-365 days outstanding, and 100% for anything greater than 365 days outstanding. An additional analysis of higher dollar value receivables is also performed on individual account balances. The USF portion 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.

A 100% allowance is also made for all Notice of Apparent Liabilities (NAL) receivables and 75% allowance is made for all Commitment Adjustment (COMAD) audit receivables. The NAL receivables represent notifications of a forfeiture, subject to final determination. While these receivables are included on the Treasury Report on Receivables at the request of Treasury, the ability to collect these receivables is not determined until a final judgment is issued. Similarly, the COMAD audit receivables represent preliminary audit findings that are subject to appeal by the auditee and are not considered final until the appeals period has lapsed or a final determination has been issued.

	FY 2006			FY 2005		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	$ 1,289,171	$ (191,279)	$ 1,097,892	$ 843,931	$ (191,390)	$ 652,541
COMAD	58,612	(43,959)	14,653	59,981	(59,981)	-
Regulatory Fees	32,866	(18,325)	14,541	24,207	(13,423)	10,784
Spectrum Auction	416,624	(406,325)	10,299	408,969	(402,791)	6,178
Forfeitures	48,692	(29,873)	18,819	24,798	(23,661)	1,137
Other	13,737	(6,676)	7,061	12,358	(4,509)	7,849
Total	$ 1,859,702	$ (696,437)	$ 1,163,265	$ 1,374,244	$ (695,755)	$ 678,489

Note 7 – Loans Receivable, Net

Under section 309(j)(3) of the Act, as amended, Congress directed the Commission to implement a competitive bidding (auctions) system for licensing spectrum to expand economic opportunity, promote competition, and facilitate the development and delivery of new and improved telecommunications services to the public. Section 309(j)(4) of the Act gave the Commission certain instructions for implementing regulations for this system, including a directive to ensure that small businesses, rural telephone companies, and women and minority-owned businesses have an opportunity to participate in providing spectrum-based services. The Commission can use various means to facilitate expanded participation, including alternative payment schedules, tax certificates, bidding preferences, and other procedures.

To address the mandate, the Commission provided installment financing in connection with its spectrum auction events, including the C Block Broadband Personal Communications Services (PCS), F Block PCS, Narrowband PCS, Interactive Video and Data Service (IVDS), Multichannel Distribution Service (MDS), and 900MHz Specialized Mobile Radio (SMR). Under the installment financing program, winning bidders were generally given five or ten years to repay their net winning bid amount (less the down payment), with up to five-year, interest-only initial payment periods. Interest rates varied by the type of borrower. Retention of licenses granted at auction was strictly conditioned on making full and timely payment of amounts as they 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 a separate process.

The Commission's first auction was conducted in 1994, and starting in 1995 installment payment mechanisms were used to finance portions of some winning bids. The last active loan will mature in FY 2009. The Commission's installment loan portfolio is tracked under ten cohorts.

As required under the FCRA of 1990, as amended, the Commission coordinates with the OMB in developing estimation guidelines, regulations, and the criteria used in calculating the subsidy estimates and reestimates.

The most recent subsidy reestimate was completed in August 2006 for actual performance data through May 31, 2006 and estimated data from June through September, 2006. The reestimate resulted in a net upward adjustment, including interest on the reestimate, of $22,444 reported in the FY 2006 financial statements.

Direct Loans

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 2006 Bal.	$ 427,581	$ 33,400	$ 1,926	$ (313,486)	$ 149,421
FY 2005 Bal.	$ 471,917	$ 33,989	$ 1,987	$ 749,372	$ 1,257,265

Interest accrued on bankrupt and defaulted loans totaled $33,230 in FY 2006 and $33,281 in FY 2005.

Note 7 – Loans Receivable, Net (continued)

Total Amount of Direct Loans Disbursed

No new loans were issued in FY 2006 and 2005.

Subsidy Expense for Direct Loans by Program and Component

1. Direct Loan Modifications and Reestimates:

Loan Program	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Spectrum Auctions				
FY 2006 (Net)	$ -	$ -	$ 11,328	$ 11,328
FY 2005 (Net)	$ -	$ -	$ (24,501)	$ (24,501)

Schedule for Reconciling Subsidy Cost Allowance Balances

	FY 2006	FY 2005
Beginning Balance of the Subsidy Cost Allowance	$ (749,372)	$ 3,831,651
Adjustments:		
Recoveries	1,083,346	1,027,251
Loans written off	-	(5,470,721)
Subsidy allowance amortization	(42,932)	(113,078)
Other	11,116	26
Ending balance before reestimates	302,158	(724,871)
Subsidy reestimates:		
Technical/default reestimate	11,328	(24,501)
Ending balance of the subsidy cost allowance	$ 313,486	$ (749,372)

Administrative Expense	FY 2006	FY 2005
Spectrum Auctions	$ 5,212	$ 24,269

Note 8 – Seized and Forfeited Property

The Commission seizes property from illegally operated radio and other communication operations. The property is comprised of radio frequency, audio, and other communications equipment. Forfeited property consists of seized property legally turned over to the Commission. Although seized and forfeited property cannot be sold due to legal restrictions, and is not recognized for financial purposes, the quantity and value of seized and forfeited property is reported below. The property is tracked using the lot number assigned when seized. The following summarizes Seized and Forfeited Property as of September 30, 2006 and 2005:

	FY 2006		FY 2005	
	No. of Lots	Dollar Value	No. of Lots	Dollar Value
Seized Property				
Beginning Balance	38	$ 88	40	$ 92
Seized	-	-	2	12
Forfeited	(12)	(14)	(4)	(16)
Ending Balance	26	$ 74	38	$ 88

	FY 2006		FY 2005	
	No. of Lots	Dollar Value	No. of Lots	Dollar Value
Forfeited Property				
Beginning Balance	11	$ 10	14	$ 10
Forfeited	12	14	4	16
Disposed	(14)	(16)	(7)	(16)
Ending Balance	9	$ 8	11	$ 10

Note 9 - General Property, Plant and Equipment, Net

The following summarizes General PP&E as of September 30, 2006 and 2005:

	FY 2006			FY 2005			
Major Classes	Cost	Accum. Deprec.	Net Book Value	Cost	Accum. Deprec.	Net Book Value	Estimated Useful Life
Land	$ 1,443	$ -	$ 1,443	$ 1,443	$ -	$ 1,443	N/A
Buildings	5,493	3,986	1,507	5,493	3,941	1,552	40
Non-Computer Equipment	36,852	33,288	3,564	37,493	32,356	5,137	7
Computer Equipment	34,042	22,929	11,113	28,613	18,694	9,919	5
Vehicle Systems	5,158	3,458	1,700	4,380	3,306	1,074	5
Leasehold Improvements	3,108	881	2,227	3,108	570	2,538	10
ADP Software	66,322	51,581	14,741	45,919	37,420	8,499	3
Software in Development	1,861	-	1,861	21,036	-	21,036	N/A
Total	$ 154,279	$ 116,123	$ 38,156	$147,485	$ 96,287	$ 51,198	

Equipment being held by Commission component entities totaled $1,560 in FY 2006 and $2,094 in FY 2005. All asset classes are depreciated on a straight-line basis.

Note 10 - Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources September 30, 2006 and 2005:

	FY 2006	FY 2005
Intragovernmental:		
Other:		
FECA Liability	$ 403	$ 457
Other:		
Unfunded Leave	16,941	17,052
Accrued Liabilities for Universal Service	451,860	418,826
Total liabilities not covered by budgetary resources	469,204	436,335
Total liabilities covered by budgetary resources	4,162,519	2,846,682
Total Liabilities	$ 4,631,723	$ 3,283,017

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 the leave is taken, and is therefore not funded with current year budgetary resources.

Note 11 - Debt

	FY 2005 Beginning Balance	Net Borrowing	FY 2005 Ending Balance	Net Borrowing	FY 2006 Ending Balance
Debt to the Treasury	$ 3,940,764	$ (2,666,966)	$ 1,273,798	$ (824,801)	$ 448,997

The Commission borrows from the Treasury for costs associated with its spectrum auction loan program. Borrowings, pertaining to all loan cohorts, are determined by calculating the subsidy estimates and reestimates in accordance with the FCRA of 1990, as amended.

Note 12 - Other Liabilities

The following summarizes Other Liabilities as of September 30, 2006 and 2005:

FY 2006	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 152,036	$ 152,036
Other:			
Accrued Payroll	-	1,378	1,378
FECA Liability	-	403	403
Other	-	29	29
Total Other	-	1,810	1,810
Total Intragovernmental	$ -	$ 153,846	$ 153,846
Deferred Revenue	$ 17,874	$ 3,082,270	$ 3,100,144
Prepaid Contributions	-	63,461	63,461
Deposit/ Unapplied Liability	-	41,737	41,737
Accrued Liabilities for Universal Service	-	451,860	451,860
TDA Interest	-	28,623	28,623
Other:			
Accrued Payroll	-	7,332	7,332
Unfunded Leave	-	16,941	16,941
Other	-	17,857	17,857
Total Other	-	42,130	42,130
Total Other Public	$ 17,874	$ 3,710,081	$ 3,727,955

FY 2005	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 222,350	$ 222,350
Other:			
Accrued Payroll	-	1,339	1,339
FECA Liability	-	457	457
Other	-	30	30
Total Other	-	1,826	1,826
Total Intragovernmental	$ -	$ 224,176	$ 224,176
Deferred Revenue	$ 18,135	$ 1,167,639	$ 1,185,774
Prepaid Contributions	-	57,360	57,360
Deposit/ Unapplied Liability	-	5,232	5,232
Accrued Liabilities for Universal Service	-	418,826	418,826
TDA Interest	-	1	1
Other:			
Accrued Payroll	-	7,009	7,009
Unfunded Leave	-	17,052	17,052
Other	-	19,338	19,338
Total Other	-	43,399	43,399
Total Other Public	$ 18,135	$ 1,692,457	$ 1,710,592

Note 12 - Other Liabilities (continued)

The Custodial Liability includes both cash collected and receivables being held for transfer to the Treasury's General Fund. The Commission collects the following types of custodial revenue: spectrum auction revenue, fines and forfeitures revenue, penalty revenue on regulatory fees, ITS processing fees, and interest revenue on auction deposits (held for TDF). Deferred revenue represents regulatory fees, spectrum auction revenue, or contributor payments that have been received but not earned by the Commission.

Deposit/Unapplied Liability represents upfront deposits made by auction bidders as well as funds received that are being held until proper application is determined. Prepaid Contributions include contribution overpayments that may be refunded and USF contributions paid in advance that will be drawn down during the year. Accrued Liabilities for Universal Service represent liabilities recorded by the USF for anticipated subsidies in the High Cost, Low Income, and TRS programs. The obligation for these subsidies is not recognized until payment files are approved in the subsequent month.

Note 13 - Leases

Operating Leases

The Commission 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 Commission is not liable for any lease terms beyond one year. The Commission anticipates that space levels consistent with FY 2006 will be required for the next five years and has estimated space and copier payments consistent with the schedule below. No estimates beyond five years have been provided because of the cancelable nature of the agreements.

Anticipated lease requirements are as follows:

Fiscal Year	Building	Copier	Total
2007	$ 39,898	$ 1,419	$ 41,317
2008	40,780	1,419	42,199
2009	41,684	1,419	43,103
2010	42,608	1,419	44,027
2011	43,348	1,419	44,767
Total Future Lease Payment	$ 208,318	$ 7,095	$215,413

Note 14 - Commitments and Contingencies

The Commission, USAC, and the Department of Justice are investigating several cases and prosecuting others related to disbursements of USF funds from the schools and libraries program, which might result in future proceedings or actions. The complexity of these actions precludes management from estimating the total amount of recovery that may result from these actions.

The Commission is a party in various administrative proceedings, legal actions, and claims brought by or against the agency. In addition, several ongoing bankruptcy proceedings are related to the loan portfolio. In the opinion of Commission management, the ultimate resolution of proceedings, actions and claims will not materially affect the Commission's financial position or results of operations.

The Commission has examined its obligations related to cancelled authority and believes it has no outstanding commitments requiring future resources.

Note 15 – Intragovernmental Costs and Exchange Revenue

Intragovernmental costs primarily represent interest expense paid by the Commission on outstanding credit reform borrowing. Additional amounts are also recognized for goods and services purchased by the Commission from other Federal agencies

Program Costs - FY 2006

Program	Intragovernmental	Public	Total
Broadband	$ 7,179	$ 19,616	$ 26,795
Competition	28,049	7,230,955	7,259,004
Spectrum	128,091	318,257	446,348
Media	7,966	22,921	30,887
Homeland Security	10,197	27,654	37,851
Modernize the FCC	11,973	38,255	50,228
Total	$ 193,455	$ 7,657,658	$ 7,851,113

Program Earned Revenue - FY 2006

Program	Intragovernmental	Public	Total
Broadband	$ -	$ 30,374	$ 30,374
Competition	-	117,840	117,840
Spectrum	53,499	194,798	248,297
Media	-	33,584	33,584
Homeland Security	1,037	40,159	41,196
Modernize the FCC	-	54,573	54,573
Total	$ 54,536	$ 471,328	$ 525,864

Program Costs - FY 2005

Program	Intragovernmental	Public	Total
Broadband	$ 6,792	$ 17,900	$ 24,692
Competition	29,987	6,649,265	6,679,252
Spectrum	316,376	187,141	503,517
Media	8,328	22,105	30,433
Homeland Security	9,765	25,680	35,445
Modernize the FCC	13,023	40,311	53,334
Total	$ 384,271	$ 6,942,402	$ 7,326,673

Program Earned Revenue - FY 2005

Program	Intragovernmental	Public	Total
Broadband	-	$ 26,995	$ 26,995
Competition	-	118,231	118,231
Spectrum	102,729	387,158	489,887
Media	-	31,887	31,887
Homeland Security	990	35,963	36,953
Modernize the FCC	-	54,280	54,280
Total	$ 103,719	$ 654,514	$ 758,233

Note 16 - Apportionment Categories of Obligations Incurred

The following summarizes Apportionment Categories of Obligations Incurred September 30, 2006 and 2005:

	FY 2006		FY 2005	
	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Direct				
Category A	$ 372,116	$ -	$ 365,848	$ -
Category B	142,232	278,958	9,864,270	306,351
Exempt from Apportionment	8,139,024	-	-	-
Total Direct	$ 8,653,372	$ 278,958	$10,230,118	$ 306,351
Reimbursable				
Category A	$ 1,778	$ -	$ 1,359	$ -
Category B	-	-	-	-
Total Reimbursable	$ 1,778	$ -	$ 1,359	$ -

Category A – Apportioned by Quarter
Category B – Apportioned by Purpose

Note 17 - Available Borrowing/Contract Authority, End of Period

The Commission receives borrowing authority consistent with the FCRA of 1990, as amended. The borrowing is authorized through an indefinite permanent authority at interest rates the Treasury sets each year. In addition, the Commission has permanent indefinite authority for subsidizing the spectrum auction direct loan program.

All borrowings are from the BPD. In accordance with applicable standards, all funds are borrowed at the beginning of the period. Therefore, the Commission does not carry over any unused borrowing authority. Repayments of borrowings are made in accordance with the terms of the FCRA of 1990, as amended. Financing sources for repayment are collections from borrowers or subsidy. The Commission had no borrowing authority at September 30, 2006.

Note 18 - Terms of Borrowing Authority Used

The Commission has three types of financing sources: loan payments made by the public, interest from the Treasury, and subsidy expenses received from the Treasury. The FCRA 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 made to the public. The majority of the Commission's direct loans have a maturity of ten years.

Note 19 – Legal Arrangements Affecting Use of Unobligated Balances

The Commission may carry forward regulatory fees received for use in the next fiscal year, subject to notification of the congressional appropriations subcommittees. All other no-year unobligated balances are available at the start of the next fiscal year, following apportionment by the OMB.

Note 20 - Explanation of Differences Between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

The schedule below presents differences for FY 2005. The *Budget of the United States Government* with actual numbers for FY 2006 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.

Budgetary Resources ($ in millions):	Combined Statement of Budgetary Resources 2005	President's Budget 2005	Difference	
Unobligated Balance, Brought Forward, Oct. 1	$ 332	$ 310	$ 22	A
Recoveries of Prior Year Unpaid Obligations	664	662	2	B
Budget Authority:				
Appropriations Received	9,900	9,900	-	
Borrowing Authority	38	38	-	
Spending Authority From Offsetting Collections	3,397	680	2,717	C
Temporarily Not Available Pursuant to Public Law	(12)	-	(12)	D
Permanently Not Available	(2,708)	-	(2,708)	E
Total Budgetary Resources	11,611	11,590	21	
Status of Budgetary Resources ($ in millions):				
Obligations Incurred	$ 10,537	$ 10,537	$ -	
Unobligated Balances – Available	218	1,053	(835)	F
Unobligated Balances – Not Available	856	-	856	F
Total, Status of Budgetary Resources	11,611	11,590	21	
Change in Obligated Balance ($ in millions):				
Obligated balance, net – Beginning of Period	$ 3,085	$ 3,085	$ -	
Obligations, Incurred net (+/-)	10,537	10,537	-	
Less: Gross Outlays	9,695	9,695	-	
Less: Recoveries of PY unpaid obligations, actual	664	662	2	B
Change in Uncollected Customer Payments From				
Obligated Balance, net, End of Period (calculated)	3,263	3,265	(2)	
Net Outlays ($ in millions):				
Gross Outlays	$ 9,695	$ 9,695	-	
Less: Offsetting Collections	3,397	3,397	-	
Less: Distributed Offsetting Receipts	25	25	-	
Net Outlays	$ 6,273	$ 6,273	$ -	

Note 20 - Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the U.S. Government (continued)

A –The President's Budget (the Budget) excludes $22 million in unobligated balances - unavailable because the funds are not available for use.

B – The Budget does not include $2 million of recoveries in single year appropriations because the funds are expired and not available for use.

C – The President's Budget recognizes the temporary reduction in authority related to FY 2004 excess regulatory fees of $12 million as a reduction to offsetting collections while the SBR reflects this amount on a separate line. The remaining $2,705 represents the Commission's Debt repayment to Treasury which is also a reduction to offsetting collections in the Budget but shown separately under Permanently Not Available on the SBR.

D – See explanation for excess regulatory fees under C.

E – The Budget does not include cancelled and other returned authority of $3 million and reflects the Debt repayment to Treasury of $2,705 million as part of offsetting collections (see explanation C).

F – The unapportioned balances for the USF and the Financing Account, $768 and $67 respectively, are reflected in the SBR as "not available while the Budget reflects these funds as available." These funds do become available to the Commission at the start of each fiscal year. These funds account for all of the available variance and $835 of the not available variance. The remaining $21 is accounted for by the combination of explanation A through E above.

Note 21 - 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

Two amounts are shown in Note 10 as not covered by budgetary resources: FECA Liability and Unfunded Leave. The changes in both of these balances between FY 2006 and FY 2005 are reflected as part of Components Requiring or Generating Resources in Future Periods on the Statement of Financing. The decrease in unfunded leave of $111 is included in the increase in Annual Leave line on the Statement of Financing, and the decrease in FECA Liability of $54 is included as part of the Resources that fund expenses recognized in prior periods line item.

Note 22 - Description of Transfers that Appear as a Reconciling Item on the Statement of Financing

The Commission collects application fees to cover the cost of processing license applications. The Commission reports the revenue associated with these fees as a revenue source on its Statement of Net Cost, but does not retain the fees. Additionally, the Commission collected $10,000 in off-setting collections in FY 2006 at the request of Congress which has been recorded in the same receipt account with application fees. To reflect the transfer of these fees to the Treasury, the Commission recognizes a transfer out on the Statement of Changes in Net Position. The amount of $32,233 included in the Offsetting Receipts line on the Statement of Financing is the total transferred for FY 2006.

Note 23 – Earmarked Funds

U.S. telecommunications companies are obligated to pay assessments for Universal Service support and for Telecommunications Relay Service, established by the Commission. These assessments are accounted for in the Budget of the U.S. Government as the "Universal Service Fund." The Commission currently recognizes the assessments collected under the USF Program as non-exchange revenue on its Statement of Changes in Net Position, and the related disbursements as program expenses on the Statement of Net Cost.

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program.

	Total Earmarked Funds	
Balance Sheet as of September 30, 2006		
ASSETS		
Investments	$	4,723,516
Cash and Other Monetary Assets		96,203
Acounts Receivable, net		1,120,982
General Property, Plant, and Equipment, net		1,540
Other Assets		10,013
Total Assets	$	5,952,254
Accounts Payable	$	294,116
Deferred Revenue		30,920
Prepaid Contributions		63,357
Accrued Liabilities		451,860
Total Liabilities	$	840,253
Unexpended Appropriations	$	-
Cumulative Results of Operations		5,112,001
Total Liabilities and Net Position	$	5,952,254
Statement of Net Cost For the Period Ended September 30, 2006		
Gross Program Costs	$	7,147,210
Less Earned Revenues		-
Net Cost of Operations	$	7,147,210
Statement of Changes in Net Position For the Period Ended September 30, 2006		
Net Position Beginning of Period	$	4,276,827
Non-Exchange Revenue		7,982,384
Other Financing Sources		-
Net Cost of Operations		7,147,210
Change in Net Position		835,174
Net Position End of Period	$	5,112,001

Note 23 – Earmarked Funds (continued)

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 24 – Change in Accounting Principles

In FY 2006 the Commission adopted a change in the method it uses to account for expenditures against Salaries & Expenses (S&E) funding. The S&E funding represents a combination of offsetting collections and congressional appropriations. In previous years, the Commission has recognized expenses incurred in its S&E fund as coming first from offsetting collections and second from appropriations. This accounting treatment was elected because unexpended S&E funds were recorded under a single year Treasury Account Fund Symbol and were cancelled and returned at the end of the fifth year after availability. To mirror the cancellation process which is generally associated with appropriations, the Commission elected to spend against appropriations last so that the cancellation of funding was against appropriations.

Since the adoption of the initial accounting method, the portion of Commission operations funded by offsetting collections has grown to the point where only a net of $1,000 in appropriations is received by the Commission annually. Additionally, offsetting collections represents funding that remains available to the Commission until expended. Given these factors, it was preferable to the Commission to change its method of accounting to reverse the order in which it applies funding so that funding would come first from appropriations and then from offsetting collections.

The change has a beginning balance impact of $9,886 on the following balances:

Statement of Changes in Net Position:

	Before	After
Unexpended Appropriations	$ 24,617	$ 14,731
Cumulative Results of Operations	$ 4,409,609	$ 4,419,495

Note 25 – Custodial Fines and Penalties Collections

The unusual increase in Fines and Penalties cash collections resulted from the collection of a single settlement payment totaling $94,866.

Note 26 – Comparability of the Statements

Balance Sheet

The Commission listed TDA Interest as a separate line on the face of the Consolidated Balance Sheet, since it was a material balance in FY 2006. For comparability purposes the amount was broken out of Other Liabilities for FY 2005.

Note 26 – Comparability of the Statements (continued)

Statement of Budgetary Resources

The presentation used for the Statement of Budgetary Resources (SBR) prior to FY 2006 has been revised to reflect a new format required pursuant to the OMB Circular A-136, "*Financial Reporting Requirements.*" Circular A-136 requires agencies to present both the FY 2006 and 2005 SBR in the same format. Accordingly, certain reclassifications were made to the previously issued FY 2005 SBR to conform to the new format.

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REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION - DEFERRED MAINTENANCE

As of September 30, 2006
(Dollars in thousands)

To determine the original estimated cost of deferred maintenance in FY 2000, the Commission contracted with professional building inspectors to inspect its real property holdings, including buildings and structures. In most cases the inspection reports were comprehensive reviews of the buildings and ground conditions and included all items that required attention, whether critical to the functionality of the building or a cosmetic feature. Each year, the Commission updates the report from the previous year for items completed and newly identified projects. The estimated deferred maintenance for FY 2006 is $1,413.

REQUIRED SUPPLEMENTARY INFORMATION – STATEMENT OF BUDGETARY RESOURCES

For the Year Ended September 30, 2006
(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 September 30, 2006 Combined Statement of Budgetary Resources.

FY2006	S&E	Credit	Auctions	USF	Total
Budgetary Resources:					
Unobligated balances - brought forward, October 1:	$ 18,805	$ 72,145	$ 3,798	$ 978,815	$ 1,073,563
Recoveries of prior year unpaid obligations	3,595	1	917	$ 950,444	954,957
Budget authority:	312,179	1,648,945	84,999	8,160,463	10,206,586
Temporarily not available pursuant to Public Law	(25,300)	-	-	-	(25,300)
Permanently not available	(258)	(1,007,860)	(2,428)	-	(1,010,546)
Total budgetary resources	$ 309,021	$ 713,231	$ 87,286	$ 10,089,722	$ 11,199,260
Status of Budgetary Resources:					
Obligations incurred	$ 288,838	$ 421,090	$ 85,156	$ 8,139,024	$ 8,934,108
Unobligated balances - available	10,751	8,186	194	136,154	155,285
Unobligated balances - not available	9,432	283,955	1,936	1,814,544	2,109,867
Total, status of budgetary resources	$ 309,021	$ 713,231	$ 87,286	$ 10,089,722	$ 11,199,260
Change in Obligated Balance:					
Obligated balance, net	$ 33,010	$ 10,553	$ 29,484	$ 3,192,072	$ 3,265,119
Obligations incurrred, net	288,837	421,090	85,157	8,139,024	8,934,108
Less: Gross outlays	278,847	421,165	83,856	7,561,774	8,345,642
Less: Recoveries of prior year unpaid obligations, actual	3,595	1	917	950,444	954,957
Change in uncollected customer payments from Federal sources	(31)	-	-	-	(31)
Obligated balance, net, end of period	39,376	10,476	29,868	2,818,876	2,898,596
Net Outlays					
Gross outlays	$ 278,847	$ 421,165	$ 83,856	$ 7,561,774	$ 8,345,642
Less: offsetting collections	299,146	1,320,706	85,000	-	1,704,852
Less: distributed offsetting receipts	32,233	-	-	-	32,233
Net outlays	$ (52,532)	$ (899,541)	$ (1,144)	$ 7,561,774	$ 6,608,557

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	Condition/Audit Area	Recommendation	Current Status
Material Weaknesses			
I. Control Environment Changes			
1	Control Environment Changes	FCC Order 04-163 was intended to publicly clarify the office responsible for all of FCC's financial activities, including those of the component entities. The Chairman, as the Chief Executive Officer of the FCC should assess the need and role of his office to participate in the day-to-day financial activities of the agency rather than the Managing Director, and determine if the order should be rescinded and replaced with one that fits the results of his assessment, clarifying any future confusion and strengthening the control environment by aligning the roles and functions with the appropriate activities.	Closed
2	Control Environment Changes	To clarify and strengthen the Office of the Chairman-delegated roles, the Chairman should issue explicit and agency-wide (or publicly available) delegations of authority for individuals instructed or asked to represent his office, even if that delegation is one of a temporary nature.	Closed
3	Control Environment Changes	Because financial reporting is mandated and must be complete at a time-definite, management should ensure that it meets all delivery timeframes, external and internal, to ensure effective and efficient use of agency resources, and to achieve	Closed

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

		more positive results.	
Recommendation No.	**Condition/Audit Area**	**Recommendation**	**Current Status**
4	Control Environment Changes	To protect the agency from compromising its requirement to support the independence of the Office of Inspector General, senior management, including OCM, should become acquainted with the Inspectors General Act, its purpose, and become more familiar with the Inspector General's role and responsibilities to the agency, that is, if it has not already done so.	Closed
II. Component Entities' Financial Reporting Controls			
5	A. Control Over Budgetary Transactions	Ensure that the financial policies and procedures are finalized and include, among others, monthly reconciliation of budgetary and proprietary accounts, consistent application of budgetary transactions, and follow-up procedures on weaknesses identified in reports issued by its service organizations.	Open: Now a reportable condition
6	A. Control Over Budgetary Transactions	Ensure the component entities' full implementation of the USSGL posting model at the transaction level.	Open: Now a reportable condition
7	A. Control Over Budgetary Transactions	Design the Pre-Petition Bankruptcy accounts receivable sub ledger to report the net receivable amount from each Filer ID.	Closed

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	Condition/Audit Area	Recommendation	Current Status
8	A. Control Over Budgetary Transactions	Finalize and consistently implement the FCC policies and procedures related to the reporting components' financial reporting, compilation, and review process to include review procedures that will assess and assure data integrity, completeness, existence, quality and reliability of the financial data.	Open: Now a reportable condition
9	A. Control Over Budgetary Transactions	Institute a methodology to record the correct receivable amount at the time of recognition instead of recording duplicate receivables and correcting the entry at a later time.	Open: Now a reportable condition
10	A. Control Over Budgetary Transactions	Develop a subsidiary ledger for USF account payable details to support the reported balances.	Open: Now a reportable condition
11	A. Control Over Budgetary Transactions	Require the administrator of TRS to obtain an accountant with related experience to take responsibility for TRS accounts and compile consolidating TRS financial data into GAAP financial statements.	Open: Now a reportable condition
12	B. Universal Service Fund Commitments	The USF administrator should establish written policies and procedures, and implement internal controls to ensure completeness, existence, and proper valuation of the commitment letter amounts.	Closed

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	Condition/Audit Area	Recommendation	Current Status
13	B. Universal Service Fund Commitments	To support future [audit] representations, the FCC in coordination with USF administrator should verify and validate commitment letter balances, activity, and transactions as of September 30, 2005, no later than the second quarter of fiscal year 2006 to determine if the balances are fairly materially stated in accordance with generally accepted accounting principles.	Closed
14	B. Universal Service Fund Commitments	Establish a cross-bureau and cross-entity task force to address the USF commitment and obligations issue. The task force should be similar in scope and approach as the Spectrum Auction Loan Servicing Activity task force that was used to address the material issues related to FCC spectrum auction loans.	Closed
15	C. Timelines of Transactions Entry and Reconciliation	Implement procedures to ensure that the reporting components' unadjusted balances are reconciled and supported with appropriate roll-forward analysis.	Open: Now a reportable condition
16	C. Timelines of Transactions Entry and Reconciliation	Ensure that the reporting components received and understood the year-end adjusting entries which should be promptly recorded on their books.	Open: Now a reportable condition

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	**Condition/Audit Area**	**Recommendation**	**Current Status**
17	C. Timelines of Transactions Entry and Reconciliation	Improve quality control reviews of audit schedules to ensure material differences are identified and closed timely.	Open: Now a reportable condition
18	D. Control Over USF Investment Transactions	Review the reasonableness and accuracy of the bank investment reports before recording them in the books and submitting the financial information to FCC.	Closed
19	D. Control Over USF Investment Transactions	Modify the existing template used for calculating unamortized discounts and premiums to ensure correctness of the calculations.	Closed
20	D. Control Over USF Investment Transactions	Ensure all accounts are properly classified in the financial statements.	Closed
21	E. Controls Over Compliance with Laws and Regulations	Implement appropriate corrective action plan to address the recommendations contained in the report.	Open: Now a reportable condition
III. Auction Transactions			
22	A. Auction Revenue and Receivables	Issue a directive for WTB to ensure that all auction and licensing activities with financial impact are reported to FOC for timely and proper recording.	Open: Now a reportable condition

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	Condition/Audit Area	Recommendation	Current Status
23	A. Auction Revenue and Receivables	Establish a database for WTB that is capable of being linked or interfaced with the core financial system to create an audit trail and record of delinquent winning bidders whose licenses were cancelled and then re-auctioned, including the amounts collected or received from the re-auction. Until this database becomes operational, FCC should create and maintain a comprehensive schedule that will provide this information. The comprehensive schedule should be periodically reviewed and reconciled.	Open: Now a reportable condition
24	B. Spreadsheet Subsidiary Ledger System (Modified Repeat Condition)	Implement change control procedures over spreadsheet applications to ensure that changes are reviewed and authorized, and formula cells are protected.	Closed
IV. FCC's Contingency Plans			
25	FCC's Contingency Plans	Complete the development and implementation of a comprehensive contingency plan that integrates the individual plans of FCC’s data centers, networks, and telecommunications facilities.	Closed

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	**Condition/Audit Area**	**Recommendation**	**Current Status**
26	FCC's Contingency Plans	Ensure that the COOP includes the recovery of FCC's major applications in accordance with recovery times deemed critical to mission and operations of the bureaus and offices.	Closed
27	FCC's Contingency Plans	Develop a contingency plan for certain FCC system assets.	Closed
REPORTABLE CONDITIONS			
V. Financial Reporting			
28	A. Integrated Financial Management Systems (Repeat Condition)	Ensure the integration of the overall financial management systems. These integrations should include all receivable transactions to be recorded in RAMIS, the fee billing system, the auction subsidiary systems, and various stand-alone systems such as the property management system, databases, spreadsheets and reporting components' financial reporting.	Open
29	A. Integrated Financial Management Systems (Repeat Condition)	Authorize the loan service provider to implement the necessary functional requirements to meet JFMIP's loan servicing system standards.	Open
30	A. Integrated Financial Management Systems (Repeat Condition)	Ensure that the USF general ledger system is in full compliance with the Financial Management System requirements and the USSGL.	Open

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	Condition/Audit Area	Recommendation	Current Status
31	B. Federal Financial System Setup and Posting Model Definitions (Repeat Condition)	Perform a periodic or quarterly update of FFS system setup and posting model definitions to ensure timely correction of outdated models and compliance with the latest transaction posting models consistent with USSGL guidance and policies for recording and classifying transactions.	Open
32	C. Financial Statement and Federal Agencies' Centralized Trial-Balance System II (FACTS II) Differences (Repeat Condition)	Ensure timely communications of adjusting entries and reconciliations between all groups within FCC with financial reporting responsibilities.	Open
VI. Cost Accounting			
33	A. Minimum Level of Cost Accounting (Modified Repeat Condition)	Enhance BEAMS functionality to satisfy the minimum level of cost accounting required in a managerial cost accounting system by SFFAS No. 4.	Open
34	A. Minimum Level of Cost Accounting (Modified Repeat Condition)	Define outputs produced by the responsibility segments and incorporate the definition into the Statement of Net Costs allocation methodology.	Open
35	B. Matching Revenue to Cost (Repeat Condition)	Review the propriety of the costing methodology and the matching of earned revenue against costs. Include a review of different program activities that generate revenue and apply the revenue to those activities that produce the earned revenue.	Open

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	**Condition/Audit Area**	**Recommendation**	**Current Status**
VII. Reconciliation of Intragovernmental Transaction Balances			
36	Reconciliation of Intragovernmental Transaction Balances	Perform quarterly reconciliation of intragovernmental transactions and balances with other Federal agencies. The reconciliation process should be completed quarterly and include procedures to resolve any differences identified in a timely manner. The procedure should also include confirming amounts with trading partners and meeting with trading partners to resolve differences identified.	Closed
VIII. Payroll and Personnel Activities			
37	A. Payroll Activities	Increase the NFC and FCC system reconciliation procedures to include all leave categories.	Open
38	A. Payroll Activities	Ensure that timekeepers reconcile time and attendance report errors generated from the FCC's desktop payroll reconciliation system.	Open
39	A. Payroll Activities	Enhance the LES system capabilities to reject incorrect project codes from being entered in the system in the first place.	Open
40	A. Payroll Activities	Issue guidance to establish timeframes for employees to correct invalid project code errors.	Open
41	A. Payroll Activities	Provide the FCC contact person at NFC with a listing of uncorrected project codes monthly.	Open

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	**Condition/Audit Area**	**Recommendation**	**Current Status**
42	B. Personnel Activities	Ensure documentation related to personnel actions or employee benefits are promptly updated and filed in the OPF.	Closed
43	B. Personnel Activities	Implement procedures to ensure that the network accounts of separating employees are terminated at the effective date of separation.	Open
IX. Debt Collection Improvement Act			
44	Debt Collection Improvement Act	Refer all eligible delinquent debt more than 180 days old to the Department of the Treasury for offset or timely cross servicing.	Open
45	Debt Collection Improvement Act	Perform a review of the delinquency debt letter procedures to ensure that all delinquent debtors receive dunning letters and interest, penalties, and administrative fees are assessed in conjunction with the submission of the letters to the debtors.	Open
46	Debt Collection Improvement Act	Strengthen quality controls surrounding preparation and submission of reports to external government agencies, including independent review and reconciliation.	Open
X. Electronic Data Processing (EDP) Controls			
47	A. OMB Circular No. A-130 Requirement for a Comprehensive Security Plan (Modified Repeat Condition)	Issue a new directive to replace the expired information security directive 1131.1.	Open

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	Condition/Audit Area	Recommendation	Current Status
48	A. OMB Circular No. A-130 Requirement for a Comprehensive Security Plan (Modified Repeat Condition)	Make a determination on whether the contractor loan servicing system application should be a major application given that FCC identified RAMIS and the loan servicing spread sheets as major applications.	Closed
49	A. OMB Circular No. A-130 Requirement for a Comprehensive Security Plan (Modified Repeat Condition)	Ensure that transmission of all sensitive data to and from FCC's contractors and business partners is protected and encrypted.	Open
50	A. OMB Circular No. A-130 Requirement for a Comprehensive Security Plan (Modified Repeat Condition)	Ensure that the "principle of least privilege" is adequately enforced across all major applications and general support systems.	Open
51	A. OMB Circular No. A-130 Requirement for a Comprehensive Security Plan (Modified Repeat Condition)	Ensure that periodic recertification of users' access to its major applications is adequately enforced and operating effectively to ensure the "principle of least privilege" is in place and that incompatible duties are properly segregated.	Open
52	A. OMB Circular No. A-130 Requirement for a Comprehensive Security Plan (Modified Repeat Condition)	Ensure that the recertification process for all systems (including contractors) is thorough and complete.	Open
53	B. RAMIS Application	Complete the implementation of recommendations made in the report on RAMIS.	Closed
54	C. Security Training and Education (Modified Repeat Condition)	Require that upon an acceptance of an FCC position, the new employee receive a packet with IT security training courses and dates, and a copy of FCC's *Rules of Behavior*.	Closed

APPENDIX A
FEDERAL COMMUNICATIONS COMMISSION
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
September 30, 2006

Recommendation No.	**Condition/Audit Area**	**Recommendation**	**Current Status**
55	C. Security Training and Education (Modified Repeat Condition)	Ensure and require that on the first day of work each employee reads and signs the *Rules of Behavior* as part of the orientation process.	Closed
56	C. Security Training and Education (Modified Repeat Condition)	Require each employee to accomplish a certain amount of security training per year to continue in his or her position.	Closed
57	D. Employee Duties and Position Risk Designation (Modified Repeat Condition)	Review and approve the *Personnel and Security Suitability Manual*.	Closed
58	D. Employee Duties and Position Risk Designation (Modified Repeat Condition)	Prioritize individual position reviews and make the necessary funds available to perform the task.	Closed
59	E. OMB Circular No. A-130 Requirements for USF (Modified Repeat Condition)	USF administrator should complete the certification and accreditation of its major applications and general support systems.	Closed
60	F. USF Password Controls (Modified Repeat Condition)	Strengthen password controls in accordance with USF administrator's password policy.	Closed

APPENDIX B

Federal Communication Commission Management's Response to Independent Auditor's Reports on Internal Controls and Compliance with Laws and Regulations for Fiscal Year 2006

Office of the Managing Director

M E M O R A N D U M

DATE: November 14, 2006

TO: Kent R. Nilsson, Inspector General

FROM: Anthony J. Dale, Managing Director and Mark Stephens, Chief Financial Officer

SUBJECT: Management's Response to Independent Auditor's Reports on Internal Controls and Compliance with Laws and Regulations for Fiscal Year 2006

Thank you for the opportunity to review and comment on the draft reports entitled *Independent Auditor's Report on Internal Control* and *Independent Auditor's Report on Compliance with Laws and Regulations*. We appreciate the efforts of your team and the independent auditor, Clifton Gunderson LLP, to work with the Federal Communications Commission (Commission) throughout the fiscal year (FY) 2006 audit process.

We are pleased that the audit opinion was unqualified and that the independent auditor found that the Commission's consolidated financial statements for FY 2006 present fairly, in all material respects, the financial position of the Commission as of September 30, 2006. We have worked very hard over the past year to strengthen the Commission's internal controls and improve its financial management. We are also pleased that, for the first time, the independent auditor has found that no "material weaknesses" affect the Commission's operations.

Despite these successes and efforts, additional work remains. The FY 2006 *Report on Internal Control* notes seven reportable conditions, and the *Report on Compliance with Laws and Regulations* notes instances on non-compliance with one law and two regulations. We concur with the recommendations made by the independent auditor in its report.

In addressing the reportable conditions, the Commission understands that the greatest opportunity and challenge to improving its financial reporting is to implement an integrated financial management system. The Commission has made the acquisition and implementation of a new core financial management system a top priority and has started an aggressive plan to acquire and deploy a new system. The Commission plans to complete the first phase of this project in FY 2007, and will implement its new core financial management system no later than October 1, 2009. A new core financial system will substantially improve the Commission's financial management by enabling more efficient operations and by addressing several audit recommendations that were raised in the independent auditor's report.

In FY 2007, the Commission also will continue to enhance its oversight and control over the activities of its reporting components in order to improve fiscal management, strengthen accountability, and resolve the independent auditor's longstanding findings on this issue. The Commission will also work with the reporting components to ensure that their financial systems meet the appropriate standards and expectations.

The remaining reportable conditions in the independent auditor's report relate to operational issues at the Commission, including flaws with payroll and personnel reporting processes; lack of timely and comprehensive referral of outstanding debts to the Department of the Treasury for collection activities; and compliance with Office of Management and Budget (OMB) guidance on information security controls for the Commission's information systems. The Commission is already working to assess fully these reportable conditions and to develop corrective action plans. During FY 2007, the Commission will make every effort to implement corrective action plans for each of the recommendations associated with these findings.

Finally, the Commission notes that the findings of non-compliance in the *Report on Compliance with Laws and Regulations* were also generally referenced in the *Report on Internal Controls*. The Commission will take the appropriate steps to ensure future compliance as part of its efforts to remediate the reportable conditions raised by the independent auditor.

We are committed to continually strengthening the internal controls of the Commission and its reporting components. This commitment includes developing timely, accurate, and useful performance and financial information to ensure the most effective stewardship of both the funds that the Commission oversees and the funds that the Commission uses to finance its operations. We look forward to working in FY 2007 to resolve the FY 2006 audit findings and to enhance the culture of integrity, accountability, and excellence that exists here at the Commission.

Anthony J. Dale, Managing Director
Office of Managing Director

Mark Stephens, Chief Financial Officer
Office of Managing Director