Clifton Gunderson LLP
Certified Public Accountants & Consultants

November 13, 2008

Subject: Audited Financial Statements for Fiscal Years 2008 and 2007, Federal Communications Commission

To: Dr. Kent Nilsson, Inspector General of the Federal Communications Commission

Dear Dr. Nilsson:

We are pleased to present the attached Independent Auditor's Report for the audits of the Federal Communications Commission (FCC) Financial Statements as of and for the years ending September 30, 2008 and 2007.

The auditor's report contains an unqualified opinion on the financial statements, one material weakness in internal control, three significant deficiencies, and two instances of noncompliance with laws and regulations.

Material Weakness
1. USF Budgetary Accounts

Other Significant Deficiencies
1. Financial Reporting Process;
2. Allowance for Loss on Accounts Receivable Methodology; and
3. Information Technology Control Deficiencies.

Noncompliance with Laws and Regulations
1. Federal Managers Financial Integrity Act of 1982 (FMFIA)
2. Debt Collection Improvement Act of 1996 (DCIA)

We appreciate the cooperation and assistance of the FCC management and the OIG representatives. If we can answer any questions, please call me at (571)227-9607 or Denise Wu at (301)902-8586.

Sincerely,

CLIFTON GUNDERSON LLP

Mia Leswing

Mia Leswing, CPA, CGFM, CISA
Partner

Attachment

11710 Beltsville Drive, Suite 300
Calverton, MD 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

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INDEPENDENT AUDITOR'S REPORT

Managing Director of the Federal Communications Commission
Chief Financial Officer of the Federal Communications Commission

In our audit of the Federal Communications Commission (FCC) for fiscal year (FY) 2008, we found:

- The FCC financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- One material weakness in internal control and three significant deficiencies; and
- Two instances of noncompliance with laws and regulations.

The following sections discuss in more detail: (1) these conclusions, (2) our conclusions on Management's Discussion and Analysis (MD&A) and other supplementary information, (3) our audit objectives, scope and methodology, and (4) agency comments and evaluation.

OPINION ON FINANCIAL STATEMENTS

The accompanying financial statements including the accompanying notes present fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America, FCC's assets, liabilities, and net position as of September 30, 2008 and 2007; and net costs; changes in net position; budgetary resources; and custodial activity for the years then ended.

CONSIDERATION OF INTERNAL CONTROL

In planning and performing our audit, we considered FCC's internal control over financial reporting as a basis for designing our auditing procedures and to comply with the Office of Management and Budget (OMB) audit guidance for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on internal control and compliance or on management's assertion on internal control included in MD&A. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses.

We identified certain deficiencies, as described in Exhibits I and II, involving internal control over financial reporting and its operation that we consider to be a material weakness or significant deficiencies. The deficiencies are summarized as follows:

Material Weakness – Exhibit I

- USF Budgetary Accounts

Other Significant Deficiencies – Exhibit II

- Financial Reporting Process;
- Allowance for Loss on Accounts Receivable Methodology; and
- Information Technology Control Deficiencies.

These deficiencies in internal control may adversely affect any decision by management that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Unaudited financial information reported by FCC, including budget information, also may contain misstatements not prevented or detected because of these deficiencies.

In addition, we noted other matters involving internal control and its operation that are not considered significant deficiencies that we will communicate in a separate management letter.

COMPLIANCE WITH LAWS AND REGULATIONS

Except as noted below and described in Exhibit III, our tests of FCC's compliance with selected provisions of laws and regulations for fiscal 2008 disclosed no instances of noncompliance that would be reportable under United States Government Auditing Standards or OMB audit guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

The continuing instances of noncompliance are summarized as follows:

- Federal Managers Financial Integrity Act of 1982 (FMFIA)
- Debt Collection Improvement Act of 1996 (DCIA)

STATUS OF PRIOR YEAR'S CONTROL DEFICIENCIES AND NONCOMPLIANCE ISSUES

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have reviewed the status of FCC's corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditor's Report dated November 13, 2007. Exhibit IV provides a discussion on the status of prior year findings and recommendations.

CONSISTENCY OF OTHER INFORMATION

FCC MD&A included as Section I is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The introductory information, performance information and other accompanying information listed in the table of contents are presented for additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

OBJECTIVES, SCOPE AND METHODOLOGY

FCC management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the United States, (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of FMFIA are met, and (3) complying with other applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States. We are also responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing, and (3) performing limited procedures with respect to certain other information appearing in the Annual Financial Report.

In order to fulfill these responsibilities, we (1) examined on a test basis, evidence supporting the amounts and disclosures in the financial statements, (2) assessed the accounting principles used and significant estimates made by management, (3) evaluated the overall presentation of the financial statements, (4) obtained an understanding of FCC and its operations, (including safeguarding of assets), compliance with laws and regulations (including execution of transactions in accordance with budget authority), (5) tested relevant internal controls over financial reporting, and compliance, and evaluated the design and operating effectiveness of internal control, (6) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA, and (7) tested compliance with selected provisions of certain laws and regulations.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to FCC. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB audit guidance that we deemed applicable to FCC's financial statements for the fiscal year ended September 30, 2008. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to the financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB guidance.

<u>AGENCY COMMENTS AND OUR EVALUATION</u>

In commenting on a draft of this report (Exhibits I, II & III), FCC concurred with the facts and conclusions in our report.

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This report is intended solely for the information and use of FCC's management, FCC's Office of Inspector General, OMB, the Government Accountability Office, and the U.S. 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 13, 2008

MATERIAL WEAKNESS

1. USF Budgetary Accounts

USF management does not have formal policies and procedures that provide detailed guidance or instructions on the accounting for recoveries of prior year obligations although these recoveries constitute a significant balance on the FCC's consolidated financial statements. During our interim testing, we inquired about the accounting treatment for the recoveries reported in the FCC Statement of Budgetary Resources. FCC researched the issue and determined that USF management did not record the downward and upward adjustments during fiscal year 2007 and for the eight months ended May 31, 2008, as verbally instructed by FCC management.

The Universal Service Administrative Company (USAC) failed to properly implement FCC's verbal instruction to record all expirations at the Funding Request Number (FRN) level as downward adjustments and all re-instatements as upward adjustments. It continued to record the net change in recoveries by program funding year in FY 2007.

During FY 2008, the FCC followed up on its original instruction to USAC and directed USAC again to book the recovery events at the FRN level as discreet upward and downward adjustments for all of fiscal year 2008; the change was implemented and retroactive adjustments made back to October 1, 2007, as of June 30, 2008.

During September 2008, FCC management obtained guidance from the Office of Management and Budget (OMB) on the preferable accounting treatment for USF's expired commitments. OMB concurred with FCC's proposed methodology of accounting for the upward and downward activity for Funding Request Numbers (FRNs) as two separate and distinct accounting events. This methodology is different from USF's practice in FY 2007 and prior years of recording downward and upward adjustments for obligations based on net expirations by program funding year. Consequently, this procedure change resulted in an understatement of approximately $437 million related to expired activity recorded in the recoveries of prior year obligations and obligated incurred balances at September 30, 2007.

In addition, during the audit process, a second matter surfaced concerning the SBR. This issue was due to a misinterpretation of instructions provided by the FCC to USAC concerning how to account for posting activity on expired commitment letters. The result of this error was that the reversal of the FY 2007 upward adjustment accrual (reported on line 8 of the SBR) in the amount of $548 million was incorrectly recorded as a downward adjustment or recovery of prior year obligations (on line 2 of the SBR). The initial accrual entries and the reversal of those entries should have been netted in the same account and cross-walked to the obligation incurred balance reported on line 8 of the SBR. The recording of these transactions overstated the upward and downward adjustments by $548 million.

Although the net effect of these two matters of approximately $111 million or 0.96% of the Total Budgetary Resources reported on the SBR did not result in prior period adjustments to either the "Total Budgetary Resources" or the "Total Status of Budgetary Resources", the above scenarios illustrate the USF and FCC's lack of an adequate and/or detailed review over the journal entries to identify the error and ensure accurate reporting. This condition is driven in part by USF financial management staff not being fully familiar with federal financial accounting standards and reporting requirements. USF, as a FCC component entity, should fully understand and take responsibility for its financial results. The FCC's review should serve as an additional layer of review control for financial reporting.

Recommendations: We recommend that FCC management:

1. Focus management's efforts on performing periodic in-depth financial analysis, including fluctuation and trend analysis, at a minimum, on a quarterly basis. Enhancement to the fluctuation analysis should include developing expectations that are directly attributed to financial trends, operational trends or both. In addition, the trends should be based on dollar value, percentage changes or both over a period of time. Each expectation that is not met should be researched and results collaborated by data. Analytical tools that could be used are ratio analysis and trend analysis as well as predictive techniques such as calculation of an expected balance. (New)

2. Assess the need for more human capital resources assigned to the financial statement preparation and analysis process. The assessment should be conducted as soon as practical. In addition, a cross-training program should be implemented by providing key financial management personnel training related to federal government accounting standards and reporting requirements. Such training should be continuous to ensure financial management staff understands the current requirements. (New)

SIGNIFICANT DEFICIENCIES

1. *Financial Reporting Process*

The FCC financial statements comprise the financial results of the following reporting components (Entity): The Commission (FCC), the Universal Service Fund (USF), The Telecommunications Relay Services Fund (TRS) and the North American Numbering Plan (NANP). The FCC has the oversight responsibilities over the other component entities. USF, TRS and NANP are administered by other organizations independent of FCC. The FCC and its component entities must have financial systems in place to meet the stringent reporting requirements mandated by OMB. Each component entity is responsible for preparing its trial balance. The FCC's Office of the Managing Director, Division of Financial Operations, is responsible for reviewing the component entities' trial balances before including their financial data in the FCC consolidated financial statements.

We noted that deficiencies continue to exist in the FCC entities' internal controls relating to the financial reporting process as outlined below:

a) Financial Systems do not fully support financial management or facilitate the automated preparation of accurate Financial Statements;
b) Lack of automated integration of component entities' Trial Balances.

The following provides a status of several of the deficiencies noted in our prior year report along with examples of the effect that inadequate financial management systems and continued internal control deficiencies had on the financial statements provided for audit throughout FY 2008.

a) Financial Systems do not fully support financial management or facilitate the timely preparation of accurate Financial Statements

Financial statements should be prepared from an accounting system that is an integral part of a financial management system containing sufficient structure, effective internal controls, and reliable data. Once implemented, this financial management system should allow an entity to prepare reliable financial statements in a timely and efficient manner. The FCC reporting component entities' current financial systems and processes are not capable of achieving this goal. Many of the entities' significant transactions are tracked on Excel spreadsheets and recorded into the general ledger at the summary level. Examples include:

- Spectrum Auction Activities for FCC
- Investment Transactions for USF and TRS
- Deferred Revenues for FCC
- Accounts Payable Transactions for USF
- Loans Transactions for FCC
- Budgetary Transactions/Entries for USF and TRS
- Property Transactions for FCC
- On-top Financial Statement Adjustments
- Accounts Receivable maintained outside of the AR Subsidiary Ledger for USF

Due to the lack of system interface or integration capabilities between the subsidiary systems and the general ledger systems, many routine transactions were periodically recorded into the general ledger at the summary level. Such manual processes are time consuming and increase the risk of potential errors in the financial statements.

Significant manual effort was needed to post transactions before the data was good enough to conclude that there is relatively low risk that further misstatements would be material in relation to the financial statements. Prior to preparing the consolidated financial statements at September 30, 2008, over 2,200 adjustments with an absolute value of approximately $148 billion were made by FCC entities. The volume and amount of these adjustments show that the current financial systems are not working properly to accurately record routine transactions. Also, the frequent use of nonstandard entries inherently increases the potential for errors, as nonstandard accounting entries increase the risk of bypassing accounting and system controls

b) Lack of automated integration of component entities' Trial Balances

Each FCC component entity is responsible for preparing a complete trial balance from its own financial management system(s). Certain aspects of those systems are not compliant with the OMB Circular A-127 requirements as they are not fully integrated with the subsidiary systems and do not record financial activities at the transaction level compliant with the U.S. Government Standard General Ledger (SGL). In order to prepare its consolidated financial statements and related footnotes, the FCC's Office of the Managing Director, Division of Financial Operations, uses a manually intensive process of compiling the component entities' trial balance and financial data in numerous spreadsheets that are subsequently "cross-walked" to the financial statements and footnote balances. This process is extremely time-consuming and could result in errors that are difficult to identify and track. It also could hinder management from adequately reviewing the statements in a timely manner.

<u>Recommendations</u>: Certain FCC component entities are in the process of implementing new systems that are intended to replace their current systems. In order to implement OMB reporting requirements, we recommend that FCC:

3. Implement a financial system that is fully integrated and has the ability to record proprietary and budgetary transactions on a transactional basis and complies with the requirements set forth in regulations such as OMB Circular A-127. Management should set up standard transaction codes to the greatest extent possible in the new financial management system to process all routine transactions and to allow automated, timely, and accurate recording for all recurring entries that are currently entered manually. In addition, electronic integration with the subsidiary systems and with FCC financial management system will enable FCC entities to process accounting transactions or report financial data efficiently and effectively. Subsidiary details should be available at the transaction level so amounts reported in the financial statements are adequately supported and can be easily validated. The system software should be flexible to accommodate new accounting requirements issued by FASAB, OMB, and Treasury. (Updated)

4. Formalize and periodically update policies and procedures to a) provide guidance to management and staff in recording both recurring and unique transactions, including budgetary accounts, and b) strengthen internal controls for financial reporting to enhance the timeliness of financial statement preparation and to minimize the risk of preparing inaccurate financials. (New)

2. Allowance for Loss on Accounts Receivable Methodology

In FY 2008, USF developed a historical trend analysis in accordance with its methodology to estimate the allowance for loss on accounts receivable (ALAR) related to the accounts receivable reported for FCC. Throughout FY 2008, USF management did not follow a consistent methodology or trend when recording the ALAR and management's expectation for what was considered a normal collection pattern was not established prior to applying the calculation. For example, the ALAR calculation and trend analysis at June 30 2008 was not consistent with the methodology at September 30, 2007. Also, the ALAR calculation and trend analysis at September 30, 2008 was not consistent with the methodology at June 30, 2008.

USF reported approximately $278 million as ALAR on approximately $1.1 billion of accounts receivable (AR) as of September 30, 2008, which approximates 25% of the accounts receivable balance and is material to the FCC financial statements. USF management performed collections analysis on all types of receivables in calculating the ALAR except for contributor invoiced receivables of approximately $708 million. At June 30, 2008, USF management selected a December 31st 3-year annual collection average rate by type for the previous three fiscal years (FY 05-07) in accordance with its then existing procedure. Management then used the average collection rate multiplied by the outstanding receivable balances to arrive at the amounts to be reported as the ALAR. At September 30, 2008, management revised the ALAR methodology to calculate ALAR rates that are applied to outstanding AR balances by type based on a 12 quarter weighted average percentage. Based on the aforementioned methodology, the percentage used to calculate the ALAR will continuously be a moving average, which could fluctuate greatly if there is an abnormal quarter. As a result, a change in estimate to the ALAR may occur and not be supported due to the fact that the abnormality was not appropriately evaluated by management.

In accordance with the Statement of Federal Financial Accounting Standard #1, "Accounting for Selected Assets and Liabilities", an entity should recognize and report on its financial statements losses due to uncollectible amounts measured through a systematic methodology. The systematic methodology should be based on analysis of both individual accounts and a group of accounts as a whole. Within a group, receivables are further stratified by risk characteristics. Examples of risk factors are economic stability, payment history, alternative repayment sources, and aging of the receivables. Statistical estimation should take into consideration factors that are essential for estimating the level of losses, including historical loss experience, recent economic events, current and forecast economic conditions, and inherent risks. Accounts that represent significant amounts should be individually analyzed to determine the allowance reserve.

USF management revised its ALAR policies and procedures. However, USF management did not finalize policies and procedures for the ALAR methodology throughout FY 2008.

Therefore, the calculation for ALAR was not performed consistently from year to year or from FY 2008 quarter to quarter. Management provided a version of the ALAR policies and procedures used to calculate and perform the historical trend analysis in August, 2008. We noted that the policy section of the aforementioned document did not contain the following:

- A historical trend analysis that considers age of the receivables to validate the ALAR reserve.
- Information on how the fluctuation analysis expectation should be developed, and the data that will be used to corroborate explanation as well as the overall conclusion on the methodology. The current policy supported a moving ALAR percentage based on a 12-quarter average.
- A requirement for reviewing the ALAR on an item by item basis when the amounts owed by individual carriers are material and for considering the impact of the materiality on the overall ALAR separately rather than treating them as part of the group.
- A requirement for performing fluctuation analyses of amounts reported by types of receivable and age after the calculation is completed.
- Criteria as to which circumstances or factors may render the methodology invalid and thus require further refinement or reinvention.

Recommendations: We recommend that USF management:

5. Develop, formalize and implement the ALAR policies and procedures to reflect an ALAR methodology that includes the following elements:
    - Performance of a historical trend analysis based on both type and age of the receivables to validate the ALAR reserve. If aging trend analysis is not appropriate, management should include the rationale for excluding the aging analysis as supported by historical data in its policy.
    - Consideration and documentation of other factors that could affect the historical trend in the future and how that assessment affects the ALAR methodology. Such factors include the overall economy of the communications industry, and the credit quality of carriers. Once these factors are considered, management should establish a set of rates for the ALAR reserve by type and age, including consideration for anticipated recoveries.
    - Development of management's expectations for the trend analysis which includes setting the criteria for variances that are considered significant. Each significant variance should be researched and resolved. The resolution should be supported by collaborating data and maintained by management for review.
    - Review of the ALAR on an item by item basis when the amounts owed by individual carriers are material and consider their impact on the overall ALAR separately.
    - Performance of fluctuation analyses of amounts reported by types and ages of the receivables after the calculation is completed. If an aging fluctuation analysis is not appropriate, management should include an explanation of the rationale for excluding aging analysis in its policy.

6. Periodically assess the adequacy of the ALAR by comparing the recorded amounts to the estimated amounts. Any adjustments to the current methodology should be

documented and supported by data or analysis. The estimated collection and recovery amounts are subject to risk that actual amounts collected may be different than management's estimates. When this occurs, management should further analyze the drivers or factors for such an unexpected occurrence to ensure the validity and reasonableness of the current methodology. (New)

3. INFORMATION TECHNOLOGY CONTROL DEFICIENCIES

FCC needs to improve its entity-wide security program plan. For example, FCC has not certified and accredited all its major applications and general support systems, risk assessments were not conducted to identify risks to which the Commission's information technology resources might be exposed and security policies and directives were either expired or not developed. FCC's strategy for addressing controls will not be effective without strong management oversight to ensure policies and procedures are consistently applied and execution meets acceptable standards.

We have identified issues that reflect a combination of these deficiencies that were previously communicated to FCC management. These issues are discussed below:

a) Entity-wide Security Program Planning and Management

During FY 2008, FCC changed its Information Technology Management Team (Chief Information Officer, Deputy Chief Information Officer and Computer Security Officer). The new team commenced improving its entity-wide security program. However, continued efforts are required especially in the areas of security administration and oversight. Specifically, we noted that risk assessments for several FCC major applications were not performed; certification and accreditation was not conducted for 50% of FCC's major applications; some security plans were not updated regularly; the Commission's plan of action and milestones process was deficient; employee new hire and termination processes were not operating effectively; and documentation was not properly maintained for terminated employees in our sample.

Office of Management and Budget (OMB) Circular No. A-130, Appendix III *Security of Federal Automated Information Resources*, requires agencies to implement and maintain a program to assure that adequate security is provided for all agency information collected processed, transmitted, and stored in general support systems and major applications.

Without an effective entity-wide security plan, FCC has an increased risk that security controls are inadequate and inconsistently applied. Such conditions may lead to insufficient protection of sensitive data and high expenditures for controls over low risk resources.

b) Access Controls

During our FY 2008 review, we noted that management and technical controls were not in place to limit, detect, or monitor access to FCC networks. These controls are necessary to protect the networks from unauthorized modification, disclosure, loss or impairment. Not all Government-owned laptop computers and other portable devices had been encrypted and/or password protected, password controls were weak and user access re-certification was not consistently performed. Additionally, there was no evidence of management's review and approval of remote privileged access to FCC resources for a sample of FCC users tested.

NIST Special Publication 800-42, *Guideline on Network Security Testing,* requires agencies to make network security testing a routine and integral part of the system and network operations and administration. OMB Memorandum M-07-16, *Safeguarding against and Responding to the Breach of Personally Identifiable Information,* identifies a number of steps to greatly reduce the risks related to a data breach of personally identifiable information, while the Federal Information Processing Standards Publication (FIPS PUB) 200, *Minimum Security Requirements for Federal Information and Information Systems,* specifies minimum access controls for federal systems.

Access controls should be in place to consistently limit, detect, or monitor access to computer programs, data, equipment, and facilities thereby protecting against unauthorized modification, disclosure, loss, or impairment. Such controls include both logical and physical security controls to ensure that federal employees, contractors, and staff are only granted access privileges necessary to perform business functions.

c) Service Continuity

FCC's Continuity of Operation Plan (COOP) did not include components recommended by NIST SP 800-34 such as backup requirements, preventive controls and associated personnel and recovery strategies. There was no approved IT Disaster Recovery plan and some terminated employees still had access to FCC's backup media stored offsite. Additionally, FCC's service provider did not perform disaster recovery tests of its major applications.

NIST 800-34, Contingency Planning Guide for Information Technology Systems, defines a seven-step contingency process that an agency may develop to maintain a viable contingency planning program for their IT systems.

Service continuity controls ensure that when unexpected events occur, critical operations continue without interruption and critical and sensitive data are protected from destruction.

d) Change Control

During our review of FCC's Application Development and Change Controls, we noted that a uniform configuration management plan had not been developed for the consistent testing, approval and implementation of configuration changes across all FCC applications, and responsibilities of database administrators and application developers for two major applications were not appropriately separated between development and production.

Furthermore, infrastructure changes were not approved by the Change Advisory Board (CAB) for almost fifty percent of sampled changes.

OMB Circular A-130 Appendix III, Security of Federal Automated Information Resources, defines separation of duties as the practice of dividing the steps in a critical function among different individuals. For example, one system programmer can create a critical piece of operating system code, while another authorizes its implementation. Such a control keeps a single individual from subverting a critical process.

Failure to implement a uniform configuration management plan for all FCC applications increases the risk that the approval, testing and implementation of application changes might not be consistently applied.

Recommendations: We recommend that FCC management:

7. Strengthen its security administration; develop new policies when necessary; renew security policies and procedures before they expire; recertify and accredit systems before the accreditation expires and address security vulnerabilities noted in FCC's technology infrastructure (updated).

8. Strengthen system controls and user account management, notably FCC should:

    - provide more oversight and develop its process to effectively provide standard system configuration, patch management and network vulnerability controls;
    - encrypt and password-protect data on government-issued laptops and removable devices;
    - perform periodic review and validation of users to ensure that only authorized users have access to these systems;
    - document the authorization and justification for all users requesting remote access to system resources; and
    - enforce password complexity authentication to FCC IT resources. (updated)

9. Strengthen FCC's application change controls, notably:

    - Develop and implement a uniform configuration management plan for the consistent testing, approval and implementation of changes across all FCC applications. In addition, FCC should actively involve ITC staff in the testing and implementation decision process.
    - Enforce separation of duties to ensure that access of developers to the production environments is restricted or supervised.
    - Update the Support Services Change Management Policy and ensure that post deployment reviews are performed and documented for all changes migrated into production. (updated)

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COMPLIANCE WITH LAWS AND REGULATIONS

Except as noted below, our tests for compliance with selected provisions of laws and regulations disclosed no other instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. The objective of our audit was not to provide an opinion on the Agency's overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

1. **The Federal Managers' Financial Integrity Act (FMFIA) (Repeat Condition)** - The FMFIA requires agencies to establish management controls over their programs and financial systems as stated in the following sections of the Act:

   - Section 2 seeks to assess internal controls necessary to ensure obligations and costs are in compliance with applicable law; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports.

   - Section 4 seeks to assess nonconformance with governmentwide financial systems requirements.

   OMB Circular A-127 offers guidance in implementing FMFIA. OMB Circular A-127 requires that "Financial management systems shall be designed to provide for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems." Furthermore, in doing so, "Financial systems design shall eliminate unnecessary duplication of transaction entry. Whenever appropriate, data needed by the systems to support financial functions shall be entered only once and other parts of the system shall be updated through electronic means consistent with the timing requirements of normal business/transaction cycles."

   Moreover, OMB Circular A-127 requires that agency financial management systems be reviewed for compliance with specified minimum requirements. These include: Agency-wide Financial Information Classification Structure; Integrated Financial Management Systems; Application of the U.S. Government Standard General Ledger at the Transaction Level; Federal Accounting Standards; Financial Reporting; Budget Reporting; Functional Requirements; Computer Security Act Requirements; Documentation; and Internal Controls.

   In fiscal year 2008, as in prior years, the FCC has not fully complied with certain requirements of the FMFIA. See details in our Independent Auditor's Report on Internal Control Section Significant Deficiency No. 1. FCC management should address and resolve the deficiencies noted in the Internal Control Section Significant Deficiency No. 1 of the audit report. The key items we identified include:

   - FCC's current financial management system does not provide for effective and efficient interrelationships between the FCC and its *component* entities' financial information systems. Many of FCC's and its *component* entities' significant types of transactions are tracked on Excel spreadsheets and are recorded at a later time into the general ledger at a summary level. In order to prepare the consolidated financial statements and notes, FCC must compile the component entities' financial data in numerous spreadsheets that are then cross-walked to the financial statements and footnote balances. This process does not facilitate the timely preparation of accurate financial statements, is extremely time consuming, and increases the risk that errors may be present and not detected.

- OMB Circular No. A-127 prescribes policies and standards for executive departments and agencies to follow in developing, operating and reporting on financial management systems. During our review in Fiscal Year 2008, we noted that FCC has started but not completed OMB Circular A-127 reviews of its financial management system.

Recommendation:

10. We recommend that management complete OMB Circular A-127 reviews for its financial management system.

2. Debt Collection Improvement Act (DCIA) of 1996 (Repeat Condition) - In accordance with DCIA, 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. In addition, CFR 31 Part 901 requires agencies to charge interest, penalties, and administrative costs on delinquent debt and, unless otherwise established in a contract, repayment agreement, or by statute, the rate of interest charged should be at the rate established annually by the Secretary of the Treasury.

- In the third quarter, the FCC did not transfer approximately $15 million in delinquent receivables over 180 days to Department of Treasury as required by the Debt Collection Improvement Act. In addition, FCC submitted its 3rd quarter Treasury Report on Receivables (TROR) for Administrative Loans that contained an error in the amount of approximately $237 million to be transferred to Treasury.

Recommendations: We recommend that FCC management:

11. Establish and implement guidance in its policies and procedures manual to ensure that delinquent debt 180 days or older is referred to Treasury as required by the Debt Collection Improvement Act and that the TROR is properly reviewed to ensure its reasonableness prior to transmitting to Treasury.

STATUS OF PRIOR YEAR'S FINDINGS AND RECOMMENDATIONS

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, we have reviewed the status of the FCC component entities' corrective actions with respect to the findings and recommendations included in the prior year's report on FCC component entities' internal control dated November 13, 2007. The following analysis provides our assessment of the progress the FCC component entities have made through September 30, 2008 in correcting the noted deficiencies identified in the FY 2007 Internal Control report.

I. Financial Reporting			
Recommendation No.	Condition Audit Area	Recommendation	Current Status
1	A. FCC Entity	Evaluate the need to link or interface the auction spreadsheets/database with the FFS and/or the correction of the RAMIS auction module programming with the objective of having an integrated system that will generate correct data without manual intervention.	Updated – reported in current year recommendation #3
2	A. FCC Entity	Ensure that ITS and PPE transactions are integrated/interfaced with FFS.	Updated – reported in current year recommendation #3
3	A. FCC Entity	Consider using an automated compilation system that will allow component entity trial balances to be interfaced/loaded electronically and that will establish a greater level of control over the conversion of trial balances into financial statement and footnote balances.	Updated – reported in current year recommendation #3
4	B. Component Entities	Either interface various spreadsheets to the core financial system or re-assess the functional requirements of the existing financial system (such as the need for sufficient details for the accounts receivable and accounts payable subsidiary ledgers) to achieve an integrated financial management system.	Updated – reported in current year recommendation #3
5	B. Component Entities	Record USF and TRS budgetary entries at the transaction level and to the appropriate standard general ledger budgetary accounts timely.	Updated – reported in current year recommendation #3
6	B. Component Entities	Perform periodic reconciliation (preferably monthly but at least quarterly) of the accounts receivable transferred from USF to FCC and ensure that reconciling items are promptly followed up and resolved. Clearly define responsibilities for monitoring and reviewing the reconciliation process.	Closed
II. Debt Collection Improvement Act			
7	Debt Collection	Refer all delinquent debt more than 180 days old to the Treasury for offset or for cross servicing in a timely manner.	Repeat – reported in current year recommendation #12

III. Compliance with OMB Circular No. A-130, *Requirement for a Comprehensive Security Plan*			
Recommendation No.	Condition Audit Area	Recommendation	Current Status
8	Compliance A-130	Ensure that transmission of all sensitive date to and from the FCC's contractors and business partners is protected and encrypted.	Closed
9	Compliance A-130	Ensure that MOUs and/or ISAs are signed with all major external entities that the FCC shares data with, or whose systems are interconnected with the FCC systems.	Closed
10	Compliance A-130	Ensure that FCC Computer Incident Response Team conducts meetings in accordance with the FCC Computer Incident Response Team Desk Reference Guide.	Closed
11	Compliance A-130	Consistently implement the certification and accreditation process for all of the FCC's major applications and general support systems. a. Recertify and accredit major applications that have had significant changes to their operating environment in accordance with NIST Special Publication 800-37 and FCC Directive 1479.3 . b. Ensure that all new major applications are certified and accredited before being placed into production. c. Ensure that the six major applications and one general support system are recertified and accredited.	Updated – reported in current year recommendation #8
12	Compliance A-130	Implement procedures to ensure the prompt revocation of access to the FCC resources at the effective date of termination of employees and contractors.	Updated – reported in current year recommendation #8
13	Compliance A-130	Document the policies and procedures for granting access to FCC's networks and systems.	Repeat – reported in current year recommendation #8
14	Compliance A-130	Develop and implement procedures and processes for the consistent implementation of common configuration management controls to minimize security deficiencies in general support systems.	Updated – reported in current year recommendation #10
15	Compliance A-130	Improve and enhance control procedures for the handling and maintenance of sensitive information at the FCC.	Closed
16.	Compliance A-130	Complete the OMB A-127 reviews in fiscal year 2008.	Updated – reported in current year recommendation #11

PRINCIPAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED BALANCE SHEET
As of September 30, 2008 and 2007
(Dollars in thousands)

	FY 2008	FY 2007
ASSETS (Note 2)		
Intragovernmental		
Fund balance with Treasury (Note 3)	$ 444,293	$ 459,523
Investments (Note 5)	5,721,609	5,012,017
Accounts receivable (Note 6)	2,731	4,711
Other (Note 8)	17,177,707	-
Total intragovernmental	23,346,340	5,476,251
Cash and other monetary assets (Note 4)	51,942	100,200
Accounts receivable, net (Note 6)	891,106	750,762
Loans receivable, net (Note 7)	187,340	216,845
General property, plant, and equipment, net	36,082	31,619
Other	15,031	8,674
Total assets	$ 24,527,841	$ 6,584,351
LIABILITIES (Note 9)		
Intragovernmental		
Debt (Note 10)	$ 112,711	$ 105,914
Other (Note 11)		
Custodial	193,854	256,223
Other	2,346	1,840
Total other	196,200	258,063
Total intragovernmental	308,911	363,977
Accounts payable	79,569	94,505
Other (Note 11)		
Deferred revenue (Note 8)	17,302,548	91,619
Prepaid contributions	73,179	45,417
Accrued liabilities for Universal Service	521,319	481,603
Other	46,471	43,327
Total other	17,943,517	661,966
Total liabilities	$ 18,331,997	$ 1,120,448
Commitments and Contingencies (Note 13)		
NET POSITION		
Unexpended appropriations - other funds	$ 11,273	$ 17,544
Cumulative results of operations - earmarked funds (Note 19)	5,927,074	5,193,576
Cumulative results of operations - other funds	257,497	252,783
Total net position	$ 6,195,844	$ 5,463,903
Total liabilities and net position	$ 24,527,841	$ 6,584,351

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2008 and 2007
(Dollars in thousands)

	FY 2008	FY 2007
Program costs:		
Broadband:		
Gross costs (Note 14)	$ 21,787	$ 22,142
Less: earned revenue (Note 14)	(25,109)	(23,989)
Net program costs	(3,322)	(1,847)
Competition:		
Gross costs (Note 14)	7,918,069	7,597,748
Less: earned revenue (Note 14)	(119,669)	(113,911)
Net program costs	7,798,400	7,483,837
Spectrum:		
Gross costs (Note 14)	198,845	28,179
Less: earned revenue (Note 14)	(154,572)	(167,793)
Net program costs	44,273	(139,614)
Media:		
Gross costs (Note 14)	53,368	37,805
Less: earned revenue (Note 14)	(59,717)	(39,805)
Net program costs	(6,349)	(2,000)
Public Safety and Homeland Security:		
Gross costs (Note 14)	32,985	33,664
Less: earned revenue (Note 14)	(37,104)	(34,446)
Net program costs	(4,119)	(782)
Modernize the FCC:		
Gross costs (Note 14)	50,784	50,441
Less: earned revenue (Note 14)	(55,920)	(50,939)
Net program costs	(5,136)	(498)
Total Net Program Costs	7,823,747	7,339,096
Cost not assigned to programs:		
Telecommunications Development Fund	8,960	11,836
Other expenses	(1,311)	(1,386)
Less: earned revenues not attributed to programs:		
Telecommunications Development Fund	(8,960)	(11,836)
Net cost of operations	$ 7,822,436	$ 7,337,710

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, 2008 and 2007
(Dollars in thousands)

	FY 2008 Consolidated Earmarked Funds	FY 2008 Consolidated All Other Funds	FY 2008 Consolidated Total	FY 2007 Consolidated Earmarked Funds	FY 2007 Consolidated All Other Funds	FY 2007 Consolidated Total
Cumulative Results of Operations:						
Beginning Balances	$ 5,193,576	$ 252,783	$ 5,446,359	$ 5,112,001	$ 81,877	$ 5,193,878
Budgetary Financing Sources:						
Other adjustments (rescissions, etc.)	-	(2,781)	(2,781)	-	(1,619)	(1,619)
Appropriations used	-	7,495	7,495	-	32,518	32,518
Non-exchange revenue	8,566,063	-	8,566,063	7,570,445	-	7,570,445
Transfers in/ out without reimbursement	(21,480)	21,480	-	-	-	-
Other Financing Sources (Non Exchange):						
Transfers in/ out without reimbursement	-	(22,115)	(22,115)	-	(25,163)	(25,163)
Imputed financing	-	13,568	13,568	-	14,585	14,585
Other	-	(1,582)	(1,582)	-	(575)	(575)
Total Financing Sources	8,544,583	16,065	8,560,648	7,570,445	19,746	7,590,191
Net Cost of Operations	7,811,085	11,351	7,822,436	7,488,870	(151,160)	7,337,710
Net Change	733,498	4,714	738,212	81,575	170,906	252,481
Cumulative Results of Operations	5,927,074	257,497	6,184,571	5,193,576	252,783	5,446,359
Unexpended Appropriations:						
Beginning Balances	-	17,544	17,544	-	17,843	17,843
Budgetary Financing Sources:						
Appropriations received	-	1,000	1,000	-	32,219	32,219
Other adjustments	-	224	224	-	-	-
Appropriations used	-	(7,495)	(7,495)	-	(32,518)	(32,518)
Total Budgetary Financing Sources	-	(6,271)	(6,271)	-	(299)	(299)
Total Unexpended Appropriations	-	11,273	11,273	-	17,544	17,544
Net Position	$ 5,927,074	$ 268,770	$ 6,195,844	$ 5,193,576	$ 270,327	$ 5,463,903

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2008 and 2007

(Dollars in thousands)

	FY 2008 Budgetary	FY 2008 Non Budgetary Credit Program Financing Acct	FY 2007 Budgetary	FY 2007 Non Budgetary Credit Program Financing Acct
Budgetary Resources:				
Unobligated balance, brought forward, October 1:	$ 1,702,164	$ 45,527	$ 1,981,011	$ 284,141
Recoveries of prior year unpaid obligations (Note 22)	1,036,931	-	1,405,407	-
Budget authority:				
Appropriations received	8,598,479	-	7,793,793	-
Borrowing authority (Note 16)	-	6,797	-	3,274
Spending authority from offsetting collections				
Earned:				
Collected	411,862	15,258	383,376	137,328
Change in receivables from Federal sources	7	-	(37)	-
Previously unavailable	31,702	-	25,300	-
Budget authority subtotal	9,042,050	22,055	8,202,432	140,602
Temporarily not available pursuant to Public Law	(54,130)	-	(31,702)	-
Permanently not available	(4,139)	-	(1,813)	(346,356)
Total budgetary resources	$ 11,722,876	$ 67,582	$ 11,555,335	$ 78,387
Status of Budgetary Resources:				
Obligations incurred: (Note 15)				
Direct	$ 9,438,478	$ 13,678	$ 9,851,168	$ 32,860
Reimbursable	2,361	-	2,003	-
Subtotal	9,440,839	13,678	9,853,171	32,860
Unobligated balance - available:				
Apportioned	113,905	-	126,021	343
Exempt from apportionment	2,061,178	-	1,564,395	-
Unobligated balance not available	106,954	53,904	11,748	45,184
Total status of budgetary resources	$ 11,722,876	$ 67,582	$ 11,555,335	$ 78,387
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 3,464,773	$ -	$ 2,898,642	$ -
Uncollected customer payments from Federal sources, brought forward, October 1	(9)	-	(46)	-
Total unpaid obligated balance, brought forward, net	3,464,764	-	2,898,596	-
Obligations incurred net (+/-)	9,440,839	13,678	9,853,171	32,860
Gross outlays	(8,279,906)	(13,678)	(7,881,633)	(32,860)
Recoveries of prior year unpaid obligations, actual	(1,036,931)	-	(1,405,407)	-
Change in uncollected customer payments from Federal sources	(7)	-	37	-
Total, unpaid obligated balance, net, end of period	3,588,759	-	3,464,764	-
Obligated balance, net, end of period				
Unpaid obligations	3,588,774	-	3,464,773	-
Uncollected customer payments from Federal sources	(15)	-	(9)	-
Total, unpaid obligated balance, net, end of period	3,588,759	-	3,464,764	-
Net Outlays				
Net Outlays:				
Gross outlays	$ 8,279,906	$ 13,678	$ 7,881,633	$ 32,860
Offsetting collections	(411,862)	(15,258)	(383,376)	(137,328)
Distributed offsetting receipts	(216,686)	-	(275,777)	-
Net outlays	$ 7,651,358	$ (1,580)	$ 7,222,480	$ (104,468)

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2008 and 2007
(Dollars in thousands)

	FY 2008	FY 2007
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	$ 1,793,794	$ 13,912,025
Fines and Penalties	35,172	54,122
Credit Reform	13,678	32,860
TDA Interest	8,960	11,836
Total Cash Collections	1,851,604	14,010,843
Accrual Adjustments		
Spectrum Auctions	(444)	(7,363)
Fines and Penalties	8,515	(15,776)
Total Accrual Adjustments	8,071	(23,139)
Total Custodial Revenue	1,859,675	13,987,704
Disposition of Collections:		
Transferred to Others:		
Recipient A: U.S. Treasury	(49,010)	(6,936,797)
Recipient B: Spectrum Relocation Fund	(92)	(6,849,884)
Recipient C: National Telecommunications & Information Admin.	(1,778,983)	-
(Increase)/Decrease in Amounts Yet to be Transferred	62,369	(104,187)
Retained by the Reporting Entity	(93,959)	(96,836)
Net Custodial Activity	$ -	$ -

The accompanying notes are an integral part of these statements.

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NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007
(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 or serving in holdover status.

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

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 (GAAP) and the form and content for entity financial statements specified by OMB Circular No. A-136 "Financial Reporting Requirements."

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

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 in accounts maintained by USAC, NECA, and Welch, which contain the names of those entities and also refer to the Commission or the fund for which they serve as administrator or billing and collection agent. Cash on deposit is collateralized by the Federal Reserve.

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 the public and other federal entities. Gross receivables are reduced to net realizable value by an allowance for doubtful accounts.

Loans Receivable, Net

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 thousand or more and all internally developed software with a development cost of $50 thousand 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 thousand but collectively worth more than $250 thousand, 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)

Other Assets

Other Assets represents the balance of transfers less expenses made by the USF to the Universal Service Administration Company (USAC) to fund administrative costs in advance. Advances are drawn down as expenses are incurred. Other Assets – Intragovernmental are discussed in Note 8.

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.

The NANP and USF collect contributions from U.S., Canadian, and Caribbean carriers to cover the costs of the programs. Some carriers have the option of paying monthly or annually. The unearned portion of annual contributions is recognized as deferred revenue.

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 payments on debt are 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, plus a component for incurred but not reported claims. 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, public safety and 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 $312,000 for FY 2008 and $290,295 for FY 2007 were achieved.

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 $1,793,350 in FY 2008 and $13,904,662 in FY 2007.

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 were capped at $85,000 in FY 2008 and FY 2007.

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 $22,175 in FY 2008 and $22,535 in FY 2007.

Reimbursable Work Agreements (Exchange) – The Commission recognizes reimbursable work agreement revenue when earned, *i.e.*, goods that have been delivered or services rendered. The Commission executed agreements totaling $2,052 in FY 2008 and $1,686 in FY 2007.

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 2008 is $313,000 with regulatory fee collections of $312,000 resulting in a net appropriation of $1,000. The annual appropriation for FY 2007 was $291,282 with regulatory fee collections of $290,295 resulting in a net appropriation of $987. The Commission funds expenditures first from appropriations and then from offsetting collections.

Note 1 - Summary of Significant Accounting Policies (continued)

Revenues and Other Financing Sources (continued)

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 no appropriations in FY 2008 and $31,232 in FY 2007 for these purposes. These appropriations are available until used.

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 $8,566,063 in FY 2008 and $7,570,445 in FY 2007.

Allocation of Exchange Revenues

The FCC directly assigns exchange revenue from reimbursable work agreements to specific programs on the statement of net cost. Exchange revenue from regulatory fees, offsetting collections, and application fees is assigned to programs in direct proportion to the level of direct and indirect costs recognized for each program. Radio Spectrum Auction proceeds are exchange revenue but are recorded on the statement of custodial activity because there is no relationship between the cost of the spectrum and the revenue it generates.

Reclassifications

Statement of Budgetary Resources

Congress provided an exemption to the USF (excluding TRS) from the Anti-Deficiency Act in both FY 2008 and FY 2007. In FY 2008 OMB provided new guidance to the Commission indicating that USF unobligated balances should be reflected as exempt from apportionment, because of the ADA exemption. For comparative purposes, the Commission has reclassified the FY 2007 USF unobligated balances from the unobligated balances not available line to the exempt from apportionment line.

Note 1 - Summary of Significant Accounting Policies (continued)

Transactions with Related Parties

The Commission has a direct oversight relationship with the administrators and billing and collection agents (B&C agents) of funds that are components under the overall Commission entity. These organizations are the Universal Service Administrative Company (USAC), which is both the administrator and B&C agent for the four USF support mechanisms, the National Exchange Carrier Association (NECA) which is both the administrator and B&C agent for the TRS Fund, and Neustar which is the administrator for the NANP fund and Welch LLP which is the B&C agent for the NANP fund. The Commission approves the administrative costs paid to these entities from the respective funds that they manage. The administrative costs cover expenses such as the salaries and benefits for the employees dedicated to managing the funds; rent and utilities for office space used; accounting and other financial reporting related services; and other management activities. All related party balances as of and for FY 2008 and FY 2007 are listed below:

	USF	TRS	NANP	Total
FY 2008:				
Administrative Fees	$ 156,120	$ 1,097	$ 3,875	$ 161,092
Due To	-	93	265	358
Due From	15,031	-	-	15,031
Total	$ 171,151	$ 1,190	$ 4,140	$ 176,481
FY 2007:				
Administrative Fees	$ 77,778	$ 1,046	$ 5,140	$ 83,964
Due To	-	69	720	789
Due From	8,674	-	-	8,674
Total	$ 86,452	$ 1,115	$ 5,860	$ 93,427

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, 2008 and 2007:

	FY 2008	FY 2007
Intragovernmental:		
Fund Balance with Treasury (FBWT)	$ 212,116	$ 268,434
Accounts Receivable, Net	2,716	4,703
Other (Note 8)	17,177,707	-
Total Intragovernmental	17,392,539	273,137
Cash and Other Monetary Assets	1	-
Accounts Receivable, Net	30,259	16,593
Total Non-entity Assets	17,422,799	289,730
Total Entity Assets	7,105,042	6,294,621
Total Assets	$ 24,527,841	$ 6,584,351

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for $208,390 in FY 2008 and $267,178 in FY 2007. 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, 2008 and 2007:

FY 2008

	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	$ 39,246	$ 53,904	$ -	$ 93,150
Unavailable	56,966	-	-	56,966
Obligated Balance not yet Disbursed	82,061	-	-	82,061
Non-Budgetary FBWT	-	-	212,116	212,116
Total	$ 178,273	$ 53,904	$ 212,116	$ 444,293

FY 2007

	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	$ 27,051	$ 45,527	$ -	$ 72,578
Unavailable	36,768	-	-	36,768
Obligated Balance not yet Disbursed	81,743	-	-	81,743
Non-Budgetary FBWT	-	-	268,434	268,434
Total	$ 145,562	$ 45,527	$ 268,434	$ 459,523

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, 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, 2008 and 2007:

	FY 2008	FY 2007
Cash and Cash Equivalents	$ 51,942	$ 100,200

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 2008 Cash and Other Monetary Assets included $1 in deposits or related accrued interest being held for spectrum auctions, $46,864 in USF contributions and related accrued interest being held for distribution, and $5,077 in NANP deposits and related accrued interest.

In FY 2007 Cash and Other Monetary Assets included no deposits and related accrued interest being held for spectrum auctions, $95,241 in USF contributions and related accrued interest being held for distribution, and $4,959 in NANP deposits and related accrued interest.

Note 5 - Investments

The following summarizes Investments as of September 30, 2008 and 2007:

	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
FY 2008						
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	$ 5,211,180	EI	$ 20,246	$ -	$ 5,231,426	$ 5,241,995
Treasury Notes	488,609	EI	(4,045)	5,619	490,183	491,554
Total	$ 5,699,789		$ 16,201	$ 5,619	$ 5,721,609	$ 5,733,549
FY 2007						
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	$ 3,445,376	EI	$ 28,263	$ -	$ 3,473,639	$ 3,478,422
Treasury Notes	1,512,455	EI	3,034	22,889	1,538,378	1,517,768
Total	$ 4,957,831		$ 31,297	$ 22,889	$ 5,012,017	$ 4,996,190

EI - Effective Interest Method

All Treasury securities, regardless of the maturity date, are reported as investments. The Commission expects to hold all investments to maturity; therefore, no adjustments have been made to present market values. All investments are held by USF and are also recognized as part of earmarked funds in Note 19.

The cash receipts collected from the public for the Universal Service Fund are used to purchase federal securities. Treasury securities are an asset to the Universal Service Fund and a liability to the U.S. Treasury. Because the Universal Service Fund and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the Universal Service Fund with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Universal Service Fund requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

The format for the Investments note has been updated to agree with the revised OMB Circular A-136. For comparability purposes, the FY 2007 format has been adjusted to agree with this update.

Note 6 - Accounts Receivable, Net

The following summarizes Accounts Receivable, Net as of September 30, 2008 and 2007:

	Intragovernmental	Public	Total
FY 2008			
Gross Accounts Receivable	$ 2,731	$ 1,297,076	$ 1,299,807
Allowance for Doubtful Accounts	(-)	(405,970)	(405,970)
Net Accounts Receivable	$ 2,731	$ 891,106	$ 893,837
FY 2007			
Gross Accounts Receivable	$ 4,711	$ 1,533,201	$ 1,537,912
Allowance for Doubtful Accounts	(-)	(782,439)	(782,439)
Net Accounts Receivable	$ 4,711	$ 750,762	$ 755,473
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. The general allowance is calculated by multiplying the receivable amounts by the percentage of the estimated uncollectible amount as determined by a review of historical collection rates by type of receivable.

The Notice of Apparent Liabilities (NAL) receivables represent notifications of a forfeiture, subject to final determination. The NAL receivables are included under the Forfeitures category in the table below. 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. A 100% allowance is made for all NAL receivables. Similarly, the Commitment Adjustment (COMAD) audit receivables are subject to appeal and are not considered final until the appeals period has lapsed or a final determination has been issued. The COMAD audit receivables for Schools and Libraries have an 86% allowance in FY 2008 and a 90% allowance in FY 2007.

In FY 2008 the FCC completed the write-off process for two large Spectrum Auction receivables totaling $386,810. These write-offs are responsible for the large decrease in the Spectrum Auction Accounts receivable and Allowance balances for uncollectibles between FY 2007 and FY 2008.

Note 6 - Accounts Receivable, Net (continued)

	FY 2008			FY 2007		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	$ 1,043,273	$ (198,862)	$ 844,411	$ 932,030	$ (208,793)	$ 723,237
COMAD	115,016	(98,914)	16,102	110,981	(99,883)	11,098
Regulatory Fees	29,498	(15,684)	13,814	24,737	(16,958)	7,779
Spectrum Auction	26,089	(23,596)	2,493	415,147	(412,211)	2,936
Forfeitures	72,410	(60,767)	11,643	39,804	(37,156)	2,648
Other	13,521	(8,147)	5,374	15,213	(7,438)	7,775
Total	$ 1,299,807	$ (405,970)	$ 893,837	$ 1,537,912	$ (782,439)	$ 755,473

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 Commission's installment loan portfolio is tracked under ten cohorts. The last active loan matured in April 2007.

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 September 2008 for actual performance data through August 31, 2008. The reestimate resulted in a net upward adjustment, including interest on the reestimate, of $27,627 reported in the FY 2008 financial statements.

Note 7 – Loans Receivable, Net (continued)

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 2008 Bal.	$ 210,275	$ 16,511	$ 1,480	$ (40,926)	$ 187,340
FY 2007 Bal.	$ 377,368	$ 28,444	$ 1,849	$ (190,816)	$ 216,845

Interest accrued on bankrupt and defaulted loans totaled $16,511 in FY 2008 and $28,444 in FY 2007.

Total Amount of Direct Loans Disbursed

No new loans were issued in FY 2008 and 2007.

Subsidy Expense for Direct Loans by Program and Component

Direct Loan Modifications and Reestimates:

Loan Program	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Spectrum Auctions:				
FY 2008 (Net)	$ -	$ -	$ 27,627	$ 27,627
FY 2007 (Net)	$ -	$ -	$ (29,099)	$ (29,099)

Schedule for Reconciling Subsidy Cost Allowance Balances

	FY 2008	FY 2007
Beginning Balance of the Subsidy Cost Allowance	$ 190,816	$ 313,486
Adjustments:		
Recoveries	85	21,942
Loans written off	(193,048)	(15,663)
Subsidy allowance amortization	15,446	21,253
Other	-	(121,103)
Ending balance before reestimates	13,299	219,915
Subsidy reestimates:		
Technical/default reestimate	27,627	(29,099)
Ending balance of the subsidy cost allowance	$ 40,926	$ 190,816

Note 7 – Loans Receivable, Net (continued)

Administrative Expense	FY 2008	FY 2007
Spectrum Auctions	$ 6,426	$ 6,622

Note 8 – Other Assets

The FCC was required by the Digital Television Transition and Public Safety Act of 2005 to transfer the proceeds received from its competitive bidding system for recovered analog spectrum into the Digital Television Transition and Public Safety Fund (the Fund) by June 30, 2008. At the time of transfer and through September 30, 2008, there were $17,177,707 in proceeds that had not been earned by the Federal government because the licenses related to these proceeds had not been granted. As the custodian for this spectrum, the FCC has retained a deferred revenue liability to the public for this amount in the event that any of these proceeds is required to be refunded. As an offset to the liability, the FCC has recognized an Intragovernmental Other Asset from the National Telecommunications and Information Administration (NTIA) who holds the related Fund Balance. The NTIA has recorded a corresponding Other Liability that will eliminate with the FCC Other Asset for Governmentwide Financial Reporting purposes.

Note 9 - Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2008 and 2007:

	FY 2008	FY 2007
Intragovernmental:		
Other:		
FECA Liability	$ 480	$ 399
Other:		
Unfunded Leave	18,190	17,186
Accrued Liabilities for Universal Service	521,319	481,603
Total liabilities not covered by budgetary resources	539,989	499,188
Total liabilities covered by budgetary resources	17,792,008	621,260
Total Liabilities	$ 18,331,997	$ 1,120,448

Note 10 - Debt

	FY 2007 Beginning Balance	Net Borrowing	FY 2007 Ending Balance	Net Borrowing	FY 2008 Ending Balance
Debt to the Treasury	$ 448,997	$ (343,083)	$ 105,914	$ 6,797	$ 112,711

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 11 - Other Liabilities

The following summarizes Other Liabilities as of September 30, 2008 and 2007:

FY 2008	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 193,854	$ 193,854
Other	-	2,346	2,346
Total Intragovernmental	$ -	$ 196,200	$ 196,200
Deferred Revenue	$ 30,509	$ 17,272,039	$ 17,302,548
Prepaid Contributions	-	73,179	73,179
Accrued Liabilities for Universal Service	-	521,319	521,319
Other	-	46,471	46,471
Total Other Public	$ 30,509	$ 17,913,008	$ 17,943,517

FY 2007	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 256,223	$ 256,223
Other	-	1,840	1,840
Total Intragovernmental	$ -	$ 258,063	$ 258,063
Deferred Revenue	$ 20,282	$ 71,337	$ 91,619
Prepaid Contributions	-	45,417	45,417
Accrued Liabilities for Universal Service	-	481,603	481,603
Other		43,327	43,327
Total Other Public	$ 20,282	$ 641,684	$ 661,966

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.

Prepaid Contributions include USF and NANP contribution overpayments that may be refunded or used to offset future payments. 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. Remaining Other Liabilities primarily represent anticipated payments for services received, but not billed and Deposit/Unapplied Liability which represents upfront deposits made by auction bidders as well as funds received that are being held until proper application is determined.

Note 12 - 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 2008 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
2009	$ 44,217	$ 1,532	$ 45,749
2010	45,102	1,532	46,634
2011	46,005	1,532	47,537
2012	47,054	1,532	48,586
2013	48,129	1,532	49,661
Total Future Lease Payment	$ 230,507	$ 7,660	$ 238,167

Note 13 - 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 canceled authority and believes it has no outstanding commitments requiring future resources.

Note 14 – 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 2008

Program	Intragovernmental	Public	Total
Broadband	$ 6,069	$ 15,718	$ 21,787
Competition	28,618	7,889,451	7,918,069
Spectrum	47,898	150,947	198,845
Media	14,543	38,825	53,368
Public Safety and Homeland Security	10,110	22,875	32,985
Modernize the FCC	12,638	38,146	50,784
Total	$ 119,876	$ 8,155,962	$ 8,275,838

Program Earned Revenue - FY 2008

Program	Intragovernmental	Public	Total
Broadband	$ -	$ 25,109	$ 25,109
Competition	-	119,669	119,669
Spectrum	10,112	144,460	154,572
Media	593	59,124	59,717
Public Safety and Homeland Security	1,287	35,817	37,104
Modernize the FCC	-	55,920	55,920
Total	$ 11,992	$ 440,099	$ 452,091

Program Costs - FY 2007

Program	Intragovernmental	Public	Total
Broadband	$ 6,266	$ 15,876	$ 22,142
Competition	29,182	7,568,566	7,597,748
Spectrum	63,377	(35,198)	28,179
Media	10,360	27,445	37,805
Public Safety and Homeland Security	9,639	24,025	33,664
Modernize the FCC	12,698	37,743	50,441
Total	$ 131,522	$ 7,638,457	$ 7,769,979

Program Earned Revenue - FY 2007

Program	Intragovernmental	Public	Total
Broadband	$ -	$ 23,989	$ 23,989
Competition	-	113,911	113,911
Spectrum	25,796	141,997	167,793
Media	198	39,607	39,805
Public Safety and Homeland Security	1,161	33,285	34,446
Modernize the FCC	-	50,939	50,939
Total	$ 27,155	$ 403,728	$ 430,883

Note 15 - Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations

The following summarizes Apportionment Categories of Obligations Incurred as of September 30, 2008 and 2007:

	FY 2008		FY 2007	
	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Direct				
Category A	$ 399,995	$ -	$ 377,668	$ -
Category B	654,178	13,678	549,655	32,860
Exempt from Apportionment	8,384,305	-	8,923,845	-
Total Direct	$ 9,438,478	$ 13,678	$ 9,851,168	$ 32,860
Reimbursable				
Category A	$ 2,361	$ -	$ 2,003	$ -

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

Note 16 - Terms of Borrowing Authority Used

Maturity Dates :	FY 2008	FY 2007
September 30, 2007	$ -	$ 38
September 30, 2008	-	166
September 30, 2009	543	3,070
September 30, 2010	1	-
September 30, 2011	6,253	-
Total Borrowing Authority Used	$ 6,797	$ 3,274

In FY 2008 the FCC used borrowing authority of $6,797 to cover interest expense. In FY 2007 the FCC used borrowing authority of $2,628 to cover downward subsidy and $646 to cover interest expense. The FCC anticipates that this borrowing will be repaid from proceeds generated from the recovery of funds related to bankrupt and defaulted loans.

Note 17 – Legal Arrangements Affecting Use of Unobligated Balances

Pursuant to Public Law 110-161, 121 Stat. 1844 (Dec. 26, 2007), offsetting collections received in excess of $312,000 in FY 2008 shall not be available for obligation and any remaining offsetting collections from prior years collected in excess of the amount specified for collection in each such year otherwise becoming available on October 1, 2007, are not available for obligation. All other no-year unobligated balances are available at the start of the next fiscal year, following apportionment by the OMB.

Note 18 - Explanation of Differences Between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

There were no material differences between the Statement of Budgetary Resources for FY 2007 and the amounts presented in the 2009 President's Budget. The FY 2010 *Budget of the United States Government* (President's Budget) with actual numbers for FY 2008 has not been published. Pursuant to 31 USC § 1105, the *Budget of the United States Government* will be released the first Monday in February, and will be available at the following website: http:/www.whitehouse.gov/omb.

Note 19 – Earmarked Funds

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

Note 19 – Earmarked Funds (continued)

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program as of September 30, 2008 and 2007:

	FY 2008		FY 2007	
Balance Sheet				
ASSETS				
Investments	$	5,721,609	$	5,012,017
Cash and other monetary assets		46,864		95,241
Acounts receivable, net		862,058		735,032
General property, plant, and equipment, net		10,723		1,748
Other assets		15,031		8,674
Total assets	$	6,656,285	$	5,852,712
LIABILITIES				
Accounts payable	$	77,125	$	91,512
Deferred revenue		57,622		40,652
Prepaid contributions		73,145		45,369
Accrued liabilities		521,319		481,603
Total liabilities	$	729,211	$	659,136
Cumulative results of operations	$	5,927,074	$	5,193,576
Total liabilities and net position	$	6,656,285	$	5,852,712
Statement of Net Cost				
Gross program costs	$	7,811,085	$	7,488,870
Less earned revenues		-		-
Net cost of operations	$	7,811,085	$	7,488,870
Statement of Changes in Net Position				
Net position beginning of period	$	5,193,576	$	5,112,001
Non-exchange revenue		8,566,063		7,570,445
Transfers in/out without reimbursement		(21,480)		-
Net cost of operations		7,811,085		7,488,870
Change in net position		733,498		81,575
Net position end of period	$	5,927,074	$	5,193,576

Note 20 – Undelivered Orders at the End of the Period

The amount of budgetary resources obligated for undelivered orders totaled $3,501,751 as of September 30, 2008 and $3,359,478 as of September 30, 2007.

Note 21 – Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)

As of September 30, 2008 and 2007:

	FY 2008	FY 2007
Budgetary Resources Obligated		
Obligations incurred	$ 9,454,517	$ 9,886,031
Less: spending authority from offsetting collections and recoveries	1,464,056	1,926,074
Obligations net of offsetting collections and recoveries	7,990,461	7,959,957
Less: offsetting receipts	216,686	275,777
Net obligations	7,773,775	7,684,180
Other Resources	35,683	37,498
Change in Undelivered Orders	(142,273)	(551,417)
Resources that fund expenses recognized in prior periods	(32,947)	(41,241)
Budgetary offsetting collections and receipts that do not affect net cost of operations	196,091	360,339
Resources that finance the acquisition of assets	(18,373)	(10,837)
Other	(39,425)	(47,283)
Increase in annual leave liability	1,004	245
Upward/Downward reestimates of credit subsidy (+/-)	27,627	(150,202)
Increase in exchange revenue receivable from the public	435	10,517
Other (+/-)	15,230	37,953
Depreciation and amortization	13,911	16,985
Other (+/-)	(8,302)	(9,027)
Net Cost of Operations	$ 7,822,436	$ 7,337,710

Note 22 – Change in Accounting Methods

Pursuant to new guidance obtained from OMB in FY 2008, expirations for obligations recorded for the commitment letters at the time of expiration are recorded as downward adjustments of prior year obligations. Subsequent invoices received beyond the invoice deadline and approved for payments are treated as a second accounting event and an upward adjustment to re-establish prior year obligations.

To ensure that sufficient resources are available to cover obligations, the FCC has incorporated an estimated amount for invoices that will be re-established after the deadline as part of the total obligated balance. The estimate is adjusted each quarter and changes in the estimate are recorded as an upward adjustment to prior year obligations in the same manner that invoices received after the deadline are recorded.

The impact of the finalized accounting practice on the FY 2007 SBR is presented for comparative purposes below:

	Reported	Comparative
Recoveries of prior year unpaid obligations	$1,405,407	$1,294,474
Obligations incurred: Direct	$9,851,168	$9,740,235

REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION – STATEMENT OF BUDGETARY RESOURCES

For the Year Ended September 30, 2008
(Dollars in thousands)

The OMB Circular No. A-136, "Financial Reporting Requirements," 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, 2008 Combined Statement of Budgetary Resources.

FY2008	**S&E**	**Credit**	**Auctions**	**USF**	**Total**
Budgetary Resources:					
Unobligated balances - brought forward, October 1	$ 19,279	$ 54,090	$ 4,273	$ 1,670,049	$ 1,747,691
Recoveries of prior year unpaid obligations	6,221	7,922	2,625	1,020,163	1,036,931
Budget authority	359,570	22,056	85,000	8,597,479	9,064,105
Nonexpenditure transfers, net, anticipated and actual	21,480	-	-	(21,480)	-
Temporarily not available pursuant to Public Law	(54,130)	-	-	-	(54,130)
Permanently not available	(51)	-	(4,088)	-	(4,139)
Total budgetary resources	$ 352,369	$ 84,068	$ 87,810	$ 11,266,211	$ 11,790,458
Status of Budgetary Resources:					
Obligations incurred	$ 321,629	$ 20,586	$ 85,322	$ 9,026,980	$ 9,454,517
Unobligated balances - available	30,355	9,570	-	2,135,158	2,175,083
Unobligated balances - not available	385	53,912	2,488	104,073	160,858
Total, status of budgetary resources	$ 352,369	$ 84,068	$ 87,810	$ 11,266,211	$ 11,790,458
Change in Obligated Balance:					
Total unpaid obligated balance, net brought Forward	$ 43,312	$ 9,606	$ 28,827	$ 3,383,019	$ 3,464,764
Obligations incurrred, net	321,629	20,586	85,322	9,026,980	9,454,517
Gross outlays	(306,107)	(20,116)	(84,946)	(7,882,415)	(8,293,584)
Recoveries of prior year unpaid obligations, actual	(6,221)	(7,922)	(2,625)	(1,020,163)	(1,036,931)
Change in uncollected customer payments from Federal sources	(7)	-	-	-	(7)
Total, Unpaid obligated balance, net, end of period	$ 52,606	$ 2,154	$ 26,578	$ 3,507,421	$ 3,588,759
Net Outlays					
Gross outlays	$ 306,107	$ 20,116	$ 84,946	$ 7,882,415	$ 8,293,584
Offsetting collections	(326,862)	(15,258)	(85,000)	-	(427,120)
Distributed offsetting receipts	(23,888)	-	-	(192,798)	(216,686)
Net outlays	$ (44,643)	$ 4,858	$ (54)	$ 7,689,617	$ 7,649,778

Office of the Managing Director

M E M O R A N D U M

DATE: November 14, 2008

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 2008

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) 2008 audit process.

We are pleased that, for the third straight year, the independent auditor provided an unqualified opinion and found that the Commission's consolidated financial statements for FY 2008 present fairly, in all material respects, the financial position of the Commission as of September 30, 2008. Three straight years of clean audit opinions is an unprecedented accomplishment for the Commission. We have worked very hard to continue strengthening the Commission's internal controls and improving its financial management.

Despite these successes, work remains here at the Commission. The FY 2008 audit report points out one material weakness and three significant deficiencies related to internal controls and notes two instances of non-compliance that still need to be resolved. The primary areas of concern relate to financial reporting, the modernization of the Commission's and its reporting components' financial management systems, information technology control weaknesses, and instances of non-compliance with the Debt Collection Improvement Act. We concur with the recommendations made by the independent auditor in its report.

First, we would like to address the material weakness. For the first time since 2005, the independent auditor identified a material weakness in the Commission's internal controls over its finance and accounting operations. Specifically, the independent auditor concluded that the Universal Service Administrative Company (USAC), which administers the $7.8 billion Universal Service Fund (USF) under Commission oversight, misinterpreted the Commission's instructions and failed to properly implement a change to an accepted accounting method. The independent auditor notes that USAC's internal control breakdown was isolated to only one of the Commission's five financial statements, the Statement of Budgetary Resources (SBR). The Commission and USAC have already started implementing appropriate corrective action to ensure this or similar breakdowns do not occur in the future. The Commission has directed USAC to:

1. Finish implementing corrective action as soon as possible.
2. Ensure its accounting staff is appropriately resourced and trained.
3. Conduct a comprehensive assessment of its policies and procedures governing preparation of the SBR to ensure that the identified breakdown is not more significant.
4. Perform periodic in-depth financial analysis including fluctuation and trend analysis on a quarterly basis
5. Notify the Commission's Chief Financial Officer (CFO) of the dates and times scheduled for its Senior Management Council to meet so that the CFO or his staff may attend.
6. Submit the risk assessments conducted by its Senior Management Council to the Commission's CFO and to the Inspector General for review and comment.
7. Consider adverse findings in internal control assessments in rating, compensating, and awarding USAC executives.

The independent auditor's conclusion underscores the need for strong Commission oversight of USAC. During FY 2008, the Commission revised and strengthened the existing Memorandum of Understanding (MOU) with USAC, required USAC to implement a performance-based executive compensation program, and directed USAC to take strong measures to prevent and deter potential improper payments. Still, USAC's failure to properly implement the Commission's instructions concerning its budgetary accounting procedures highlights the importance of the Commission taking an active role to ensure USAC administers the USF in an efficient, effective manner. During FY 2009, we plan to continue our record of strong oversight of USAC and the USF.

With regard to addressing the significant deficiency and instance of non-compliance related to the Commission's and its reporting components' financial systems, the Commission has taken steps throughout FY 2007 and 2008 to resolve the auditor's findings and improve the performance of its financial reporting through the implementation of a new core financial management system. The Commission is currently relying on a core financial management system that will soon be obsolete and will not be supported by its vendor. The Commission has approached the replacement of its core financial management system as an opportunity to deliver on its strategic goal of modernizing the Commission and to establish a legacy of effectiveness. The Commission released its solicitation for proposals for a new core financial system at the end of FY 2007. During FY 2008, the Commission selected a vendor to supply the new core financial system and provide integration services. The Commission also selected a vendor to assist with change management as it moves to the new core financial system. At this time, the Commission plans to complete the deployment of the new financial system by October 1, 2010. At the same time, the Commission is closely monitoring the progress of its reporting components' efforts to modernize their financial systems.

With regard to addressing the significant deficiency related to USAC's methodology for allowances for losses on accounts receivables for the USF, the Commission will work with USAC to resolve this issue by requiring historical trend analysis that considers the age of the receivables to validate the necessary reserve.

With respect to the significant deficiency related to information technology control weaknesses, the Commission is already working to fully assess the auditor's recommendations and to develop corrective action plans. Some findings are already in the process of being addressed (e.g., the certification and accreditation of key information technology systems). During FY 2009, the Commission will make every effort to complete corrective action for each of the recommendations associated with these findings so as to avoid any repeat findings in this area.

Finally, with respect to the instance of non-compliance concerning timely transfer of delinquent debt to the Department of the Treasury for collection, the Commission has worked throughout the past fiscal year to remedy this issue. During FY 2008, the Commission performed a significant transfer of delinquent debt and reached the 98% percent transfer mark for the fiscal year. The Commission plans to fully address this issue in FY 2009 and ensure that all reporting in this area is accurate.

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 2009 to resolve the FY 2008 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