



OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: November 14, 2011
TO: Chairman
FROM: Inspector General
SUBJECT: Audit of the Federal Communications Commission's Financial Statements for Fiscal Year 2011

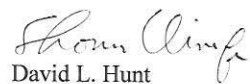
In accordance with the Accountability of Tax Dollars Act of 2002 (Pub. L. 107-289), the Office of Inspector General (OIG) engaged the independent certified public accounting firm of KPMG LLP to audit the fiscal year 2011 financial statements of the Federal Communications Commission (FCC) in accordance with generally accepted government auditing standards.

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

- The financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles.
- There were no material weaknesses in internal control.
- There were two significant deficiencies the first was related to FCC's financial system functionality and integration and the second was related to FCC's information technology controls.
- There were two instances of noncompliance with laws and regulations, the first related to requirements of the Federal Managers' Financial Integrity Act and the second is a noncompliance with the requirements of the Debt Collection Improvement Act.

The OIG reviewed KPMG LLP's reports and related documentation and made necessary inquires of KPMG's representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards was not intended to enable us to express an opinion and we do not express an opinion on the FCC's financial statements, conclusions about the effectiveness of internal controls, or conclusions on compliance with laws and regulations. KPMG LLP is wholly responsible for the attached report dated November 10, 2011 and the conclusions expressed therein.

However, our review, while still ongoing, disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.


David L. Hunt

cc: Managing Director
Chief of Staff
Chief Financial Officer



KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report

Managing Director
Federal Communications Commission

Inspector General
Federal Communications Commission

We have audited the accompanying consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2011 and 2010, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended. These consolidated financial statements are the responsibility of the FCC's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the FCC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Federal Communications Commission as of September 30, 2011 and 2010, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in footnote 21, the FCC updated its strategic plan in fiscal year 2011. As a result, the strategic goals reported for fiscal year 2011 are not comparative to the strategic goals reported for fiscal year 2010 in the consolidated statements of net cost.

The information in the Management's Discussion and Analysis and Required Supplementary Information is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.



Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The information in the Other Accompanying Information section is presented for purposes of additional analysis and is not required as part of the consolidated financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 10, 2011, on our consideration of the FCC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

November 10, 2011



KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report on Internal Control Over Financial Reporting

Managing Director
Federal Communications Commission

Inspector General
Federal Communications Commission

We have audited the consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2011 and 2010, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended, and have issued our report thereon dated November 10, 2011.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

The management of the FCC is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2011 audit, we considered the FCC's internal control over financial reporting by obtaining an understanding of the FCC's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the FCC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FCC's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2011 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting described in Exhibit I that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.



The FCC's response to the findings identified in our audit is presented in the Agency Financial Report. We did not audit the FCC's response and, accordingly, we express no opinion on it.

Exhibit II presents the status of prior year's significant deficiencies.

We noted certain additional matters that we have reported to management of the FCC in a separate letter dated November 10, 2011.

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

KPMG LLP

November 10, 2011

SIGNIFICANT DEFICIENCIES**Financial System Functionality and Integration**

The FCC consolidated financial statements present the financial results of the Commission (FCC) and three components: the Universal Service Fund (USF), the Telecommunications Relay Services Fund (TRS), and the North American Numbering Plan (NANP). The FCC has oversight responsibilities over the three components which are administered by other organizations independent of the FCC. 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 components' trial balances before including that financial data in the FCC consolidated financial statements.

In October of fiscal year 2011, the FCC implemented a new financial system. Throughout fiscal year 2011, FCC management encountered challenges with the new system's functionality. Various transactions were processed through journal voucher instead of the intended system's processing. In addition, adjustments had to be made as a result of several inappropriate transaction posting models and management could not produce a listing of active posting models during the fiscal year. Lastly, certain external reporting functions were not available throughout fiscal year 2011. Significant examples of these issues include (amounts in thousands as of September 30, 2011):

Transactions processed through journal voucher:

- Intra-governmental Disbursements amounting to \$33,700.
- International Telecommunication Settlement (ITS) Collections and Disbursements amounting to \$72,900.
- Obligation increases amounting to \$82,500.

Posting model corrections:

- Apportionments of \$193,500.
- Intra-governmental collections and disbursements of \$82,000.
- Cash disbursements of \$61,400.
- Auction related deferred revenue of \$47,300.
- Regulatory Fee revenue of \$134,600.

Reporting functionality:

- For the entire fiscal year ended September 30, 2011, the FCC was unable to properly age receivables and generate dunning letters in order to transfer overdue receivables to the U.S. Department of Treasury.
- For the total Accounts Receivable balance of \$223,800 as of June 30, 2011, the FCC had a processing lag with collections through May 2011 and was not able to generate bills until June 23, 2011.

- Throughout the fiscal year ended September 30, 2011, the FCC was unable to generate a system allocation of costs for the Statement of Net Cost.
- The USF, TRS, and NANP fiscal year 2011 financial systems and processes were not integrated with the new financial system.

Certain of the components' significant transactions are tracked on Excel spreadsheets and recorded into the general ledger at a summary level. Significant examples of this include (amounts in thousands as of September 30, 2011):

- Investment Transactions for USF and TRS – \$5,822,843.
- Accounts Receivable Subledgers for USF – \$487,359.
- Total Budgetary Resources for USF and TRS – \$12,341,767.

As outlined in the GAO Standards for Internal Control in the Federal Government and the FSIO Core Financial System Requirements, "OMB Circular A-127, *Financial Management Systems*, sets forth general policies for Federal financial management systems. Each agency is required to establish and maintain a single integrated financial management system ... All financial management systems must deliver the following:

- Demonstrate compliance with accounting standards and requirements
- Provide timely, reliable, and complete financial management information for decision making at all levels of government
- Meet downstream information and reporting requirements with transaction processing data linked to transaction engines
- Accept standard information integration and electronic data to and from other internal, governmentwide, or private-sector processing environments
- Provide for "one-time" data entry and reuse of transaction data to support downstream integration, interfacing, or business and reporting requirements
- Build security, internal controls, and accountability into processes and provide an audit trail
- Be modular in design and built with reusability as an objective
- Meet the needs for greater transparency and ready sharing of information
- Scale to meet internal and external operational, reporting, and information requirements for both small and large entities."

The financial system's lack of integration continued to require manual processes and other intervention to ensure the general ledger was materially correct. Additional resources were required to maintain the accuracy of the financial system data as a result of additional reconciliations resulting from non-integrated processes.

Recommendations

1. Implement the planned stabilization efforts on the new financial system so that it 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 the GAO Standards for Internal Control in the Federal Government. **(Updated)**

2. Develop a standard set of transaction codes to process all routine transactions and to allow automated, timely, and accurate recording for all recurring entries that are currently entered manually. **(Re-Issued)**
3. Implement an electronic integration with FCC systems and component financial systems, enabling FCC entities to report financial data efficiently and effectively with the requirements set forth in the GAO Standards for Internal Control in the Federal Government. **(Updated)**

Information Technology Controls

As we reported in fiscal year 2010, the FCC needs to improve its entity-wide security program. An effective security program embodies the organization's internal control responsibilities with respect to securing its IT infrastructure and services. OMB has defined standards within OMB Circular No. A-123, *Management's Responsibility for Internal Control*, related to control environment, risk assessment, control activities, monitoring, and information and communication. For purposes of financial reporting, management is responsible for developing and maintaining internal control activities that comply with OMB standards to ensure the reliability of financial reporting.

We identified deficiencies in the FCC's control environment, risk assessment, control activities, and monitoring as it relates to securing FCC's information technology infrastructure. The application of IT is pervasive throughout the FCC and as a result these deficiencies may impact the FCC's ability to comply with OMB's internal control objectives for financial reporting. We have previously reported these deficiencies to FCC management in more detail. Each of the sections below summarizes the reported control deficiencies.

Control Environment Findings

OMB requires management to clearly identify areas of authority and responsibility and appropriately delegate the authority and responsibility throughout the agency. We noted that the FCC had commenced, but not completed, development of an oversight plan for USAC's IT security program. For other (i.e., not operated by USAC) contractor-operated systems that collect and maintain FCC data, the FCC has not documented or implemented plans for directing and overseeing the contractors' information security programs. The FCC has not documented policies and procedures to define the scope, frequency, methodology, and documentation requirements for the FCC's assessment activities related to the oversight of information systems that collect and maintain FCC data but are not operated by the FCC.

Control Environment Recommendation

Strengthen the control environment by:

4. Completing the development of and implementing policies and procedures for overseeing the information security programs for all information systems that collect and maintain FCC data, but are not operated by the FCC, to ensure that they are administered consistently with all relevant FCC, NIST and OMB requirements and instructions. Policies and procedures should define the scope, frequency, methodology, and documentation requirements for the FCC's assessment activities for contractors' information security programs. **(Updated)**

Risk Assessment Findings

OMB requires management to identify internal and external risks that may prevent the organization from meeting its objectives. We noted that the FCC had performed procedures to assess the effectiveness of its IT security controls and to assess related risks. However, the FCC's assessment procedures were incomplete, falling short of relevant requirements from NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, and NIST SP 800-37 Revision 1, *Guide for Applying the Risk Management Framework to Federal Information Systems*. System-specific controls and the related risks were assessed for the FCC's network. However, for

four other major FCC systems that we tested, risk assessment reports were incomplete and did not identify threats. In addition, the vulnerabilities identified were largely limited to technical vulnerabilities of the type detected by a vulnerability scan and did not encompass management and operational vulnerabilities. We further noted that system security plans for the four major systems were not used to plan controls to mitigate risks identified in the risk assessments.

We also noted that risk assessments for three applications that authenticate users outside of the FCC did not map to the required assurance levels in OMB Memorandum 04-04, *E-Authentication Guidance for Federal Agencies*, and the required e-authentication controls in NIST SP 800-63, *Electronic Authentication Guideline*.

Risk Assessment Recommendations

Strengthen the approach to performing risk assessments by:

5. Ensuring that when vulnerabilities are identified through security assessment testing, the FCC evaluates the risks and related threats and adds necessary mitigating controls to the System Security Plans (SSP). **(Updated)**
6. Documenting e-authentication policies and procedures for ensuring the FCC's compliance with OMB Memorandum 04-04, *E-Authentication Guidance for Federal Agencies*. **(Re-Issued)**
7. Performing e-authentication risk assessments and updating system security plans to define for each e-government application the relevant authentication level and the required level of e-authentication controls to implement. **(Re-Issued)**

Control Activities Findings

OMB requires internal control to be in place over information systems in the form of general and application controls. General control applies to all information systems such as servers, the network and end-user environments, and includes agency-wide security program planning, management, control over data center operations, and system software acquisition and maintenance. Due to the rapid changes in information technology, controls must also adjust to remain effective. Required control activities include policies, procedures and mechanisms in place to help ensure that agency objectives are met. Several examples of such mechanisms include: proper segregation of duties (separate personnel with authority to authorize a transaction, process the transaction, and review the transaction); physical controls over assets; proper authorization; and appropriate documentation and access to that documentation. Based on our procedures performed, we noted the following deficiencies in FCC's general control activities related to the FCC security program, access controls, and change controls:

Security Program

The FCC's controls to monitor and assess systems' security had a number of deficiencies. System security plans for several systems did not document controls that mapped to NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, recommended minimum baseline controls. Additionally, security assessments of controls to support the security authorization of the FCC's information systems were incomplete.

Access Controls

The FCC's controls to restrict physical and logical access to FCC systems had a number of deficiencies. Three major applications lacked documented guidance on the assignment of access privileges, including segregation of duties. Controls for limiting physical access to computer rooms were not sufficiently formalized. The FCC's user account management controls were not operating effectively to prevent logical or physical access from being granted to users who should not have access and to remove access from users who no longer needed it. Controls to enforce segregation of duties and to limit privileged access were not operating effectively. The resolution of identified vulnerabilities was not consistently documented and the FCC did not consistently use audit logs to monitor user actions. Finally, the FCC's password policies were not clearly defined.

Change Control

Access of developers to production was not properly restricted and changes were not consistently tested and approved before their migration to production. Additionally, the FCC could not provide documentation to evidence that system configurations were monitored for unauthorized changes.

Control Activities Recommendations

Security Program

Strengthen security program oversight and planning by:

8. Implementing tools to provide structure for security assessment and authorization projects and to help ensure that the tasks included in these projects are performed consistent with requirements from NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, and NIST SP 800-53a Revision 1, *Guide for Assessing the Security Controls in Federal Information Systems*. **(Updated)**
9. Performing security assessment testing for applicable management, operational and technical controls in accordance with evaluation criteria from NIST SP 800-53a Revision 1, *Guide for Assessing the Security Controls in Federal Information Systems*, at least once every three years for FCC information system. **(Updated)**
10. Documenting system security plans in detail sufficient to plan system security controls for FCC information systems that are equivalent to the NIST SP 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems*, minimum baseline controls. **(Re-issued)**

Access Controls

Strengthen access controls by:

11. For newly hired employees and contractors, limiting logical access to FCC systems pending a favorable result from a preliminary background check. **(Re-issued)**
12. Implementing procedures to help ensure that users are not granted access to FCC information systems without documented approval. **(Re-issued)**
13. Requiring that user's system access be reviewed and recertified by management and promptly revoking access for those users who are found to no longer need access or whose access is not recertified. **(Updated)**
14. Reviewing and updating procedures to ensure that access badges are collected and physical access is disabled when individuals leave the FCC. **(New)**
15. Granting individuals computer room access only after management approval. **(Re-issued)**

16. Documenting the roles and permissions used within major applications. **(Re-issued)**
17. Identifying and documenting conflicting privileges within major applications and documenting procedures to help ensure separation of duties and to address developer access. **(Re-Issued)**
18. Revising current vulnerability assessment procedures to be more broadly applied and to have more consistent reporting requirements. **(Updated)**
19. Documenting and implementing procedures for security audit logging and review. **(New)**
20. Documenting policy to define requirements for password strength and account lockout, including the scope and applicability of password policies. **(Updated)**

Change Control

Strengthen change and configuration management controls by:

21. Restricting developer access to the production environment. **(Re-issued)**
22. Documenting and implementing change control procedures for testing and approving changes prior to changes being moved into production and for maintaining records of changes to facilitate management's review of changes made to FCC systems. **(Updated)**
23. Documenting and implementing configuration management procedures for maintaining securely configured applications, databases, and infrastructure components. **(Updated)**

Monitoring Findings

OMB requires that monitoring of the effectiveness of internal control should occur in the normal course of business. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations. We noted that FCC management had not implemented procedures to create a continuous monitoring program. Consequently, for systems that were not being re-authorized in the current year, the FCC did not perform annual security assessment testing of a representative subset of technical, operational and management controls to support its annual Federal Information Security Management Act of 2002 (FISMA) report to OMB and to satisfy FISMA's ongoing monitoring requirements.

OMB also requires that deficiencies found in internal control be reported to the appropriate personnel and management responsible for that area. Deficiencies identified, whether through internal review or by an external audit, should be evaluated and corrected. A systematic process should be in place for addressing deficiencies. The FCC did not provide evidence of tracking and planning for the remediation of IT Security weaknesses. Specifically, the FCC documented neither agency-wide Plans of Action and Milestones (POA&Ms) nor system-level POA&Ms.

Monitoring Recommendations

Strengthen monitoring controls by:

24. Revising as necessary and implementing its Cyber Security Policy to create a continuous monitoring program and ensure that, at least annually, the FCC performs security assessment testing of a subset of controls to monitor the controls' effectiveness. This testing should use the assessment cases provided by NIST SP 800-53a Revision 1, *Guide for Assessing the Security Controls in Federal Information Systems*. All controls should be assessed at least once during the three-year authorization cycle. **(Updated)**

25. Documenting and implementing procedures for the creation, maintenance, and review of both agency and system-level POA&Ms. The FCC should document, prioritize, track and review, at least quarterly, all security weaknesses identified by external and internal reviews at the FCC and at outside organizations which meet the FISMA reporting requirement definition of a contractor. Quarterly reviews should include reporting to the CIO. POA&Ms should include resources required to accomplish elements of the plan, any milestones in meeting the tasks, scheduled completion dates for milestones and a current status. When milestones are adjusted, the rationale for adjusting milestones should be documented. **(Re-issued)**

EXHIBIT II

STATUS OF PRIOR YEAR'S SIGNIFICANT DEFICIENCIES

As required by *Government Auditing Standards* issued by the Comptroller General of the United States, and by OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, 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 report on FCC's internal control over financial reporting dated November 12, 2010. The following table provides our assessment of the progress the FCC has made through September 30, 2011, in correcting the significant deficiencies identified in the fiscal year 2010 Independent Auditors' Report.

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
I. Financial Reporting Process			
1	FCC Entity	Complete implementation of 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 the GAO Standards for Internal Control in the Federal Government. The system should be flexible to accommodate new accounting requirements issued by FASAB, OMB and Treasury.	Updated, recommendation # 1
2	FCC Entity	Develop a standard set of transaction codes to process all routine transactions and to allow automated, timely, and accurate recording for all recurring entries that are currently entered manually.	Re-issued, recommendation #2
3	FCC Entity	Develop an electronic integration between the subsidiary systems and the FCC financial management system to enable FCC component entities to process accounting transactions or report financial data efficiently and effectively.	Updated, recommendation #3
II. Information Technology Controls			
4	FCC Entity	The FCC strengthens its control environment by: <ul style="list-style-type: none"> • Documenting and implementing policies and procedures for actively directing and overseeing the information security programs for information systems that collect and maintain FCC data, but are not operated by the FCC, to ensure that they are administered consistent with all relevant FCC, NIST and OMB requirements 	Updated, recommendation # 4

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
		and instructions.	
5	FCC Entity	The FCC strengthens its approach to performing risk assessments by: <ul style="list-style-type: none"> Updating risk assessments at least every three years. 	Closed
6	FCC Entity	The FCC strengthens its approach to performing risk assessments by: <ul style="list-style-type: none"> Considering a full range of significant risks and ensuring that control recommendations from risk assessments are used to create or update system security plans. 	Updated, recommendation # 5
7	FCC Entity	The FCC strengthens its approach to performing risk assessments by: <ul style="list-style-type: none"> Documenting e-authentication policies and procedures for ensuring the FCC's compliance with OMB Memorandum 04-04, <i>E-Authentication Guidance for Federal Agencies</i>. 	Re-issued, recommendation # 6
8	FCC Entity	The FCC strengthens its approach to performing risk assessments by: <ul style="list-style-type: none"> Performing e-authentication risk assessments and updating system security plans to define for each e-government application the relevant authentication level and the required level of e-authentication controls to implement. 	Re-issued, recommendation # 7
9	FCC Entity	The FCC strengthens its security program oversight and planning by: <ul style="list-style-type: none"> Documenting system security plans in detail sufficient to plan system security controls for FCC information systems that are identical or equivalent to the NIST SP 800-53 minimum baseline controls. 	Re-issued, recommendation # 10
10	FCC Entity	The FCC strengthens its security program oversight and planning by: <ul style="list-style-type: none"> Updating security authorization packages for FCC information systems and, after planning and successfully testing the necessary IT 	Updated, recommendation # 8

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
		security controls, re-authorizing information systems for operation.	
11	FCC Entity	<p>The FCC strengthens its security program oversight and planning by:</p> <ul style="list-style-type: none"> Revising, finalizing, and implementing procedures for completing a security authorization package, including planning and scoping guidance, and procedures for creating a security authorization package in accordance with NIST guidance and for administering the security authorization program across the Commission. Policies and procedures should require that security assessment testing cover all management, operational and technical controls in accordance with evaluation criteria from NIST SP 800-53a. 	Updated, recommendation # 9
12	FCC Entity	<p>The FCC strengthens its access controls by:</p> <ul style="list-style-type: none"> For newly hired employees and contractors, limiting logical access to FCC systems pending a favorable result from a preliminary background check. 	Re-issued, recommendation # 11
13	FCC Entity	<p>The FCC strengthens its access controls by:</p> <ul style="list-style-type: none"> Implementing procedures to help ensure that users are not granted access to FCC information systems without documented approval. 	Re-issued, recommendation # 12
14	FCC Entity	<p>The FCC strengthens its access controls by:</p> <ul style="list-style-type: none"> Requiring that all user access be reviewed and recertified by management and promptly revoking access for those users who are found to no longer need access or whose access is not recertified. 	Updated, recommendation # 13
15	FCC Entity	<p>The FCC strengthens its access controls by:</p> <ul style="list-style-type: none"> Documenting the roles and permissions used within major applications. 	Re-issued, recommendation # 16
16	FCC Entity	<p>The FCC strengthens its access controls by:</p> <ul style="list-style-type: none"> Identifying and documenting conflicting privileges within major applications and documenting procedures to help ensure 	Re-issued, recommendation # 17

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
		separation of duties and to address developer access.	
17	FCC Entity	The FCC strengthens its access controls by: <ul style="list-style-type: none"> Granting individuals computer room access only after management approval. 	Re-issued, recommendation # 15
18	FCC Entity	The FCC strengthens its access controls by: <ul style="list-style-type: none"> Documenting and implementing procedures for documenting and tracking vulnerability remediation. 	Updated, recommendation # 18
19	FCC Entity	The FCC strengthens its access controls by: <ul style="list-style-type: none"> Reviewing the scope and applicability of the FCC's password policies, documenting any exceptions to FCC password policies, and wherever applicable, ensuring that password settings are consistent with the FCC's policies. 	Updated, recommendation # 20
20	FCC Entity	The FCC strengthens its change and configuration management controls by: <ul style="list-style-type: none"> Restricting developer access to the production environment. 	Re-issued, recommendation # 21
21	FCC Entity	The FCC strengthens its change and configuration management controls by: <ul style="list-style-type: none"> Documenting a change and configuration management policy to require that changes be tested and approved prior to being moved into production. 	Updated, recommendation # 22
22	FCC Entity	The FCC strengthens its change and configuration management controls by: <ul style="list-style-type: none"> Implementing a change and configuration management policy by documenting and implementing change control and configuration management procedures for major applications, databases, and infrastructure components. 	Updated, recommendation # 23
23	FCC Entity	The FCC strengthens its monitoring controls by: <ul style="list-style-type: none"> Documenting and implementing procedures that ensure that at least annually, the FCC performs security assessment testing, using the assessment cases provided by NIST SP 800-53a, 	Updated, recommendation # 24

Significant Deficiencies			
Recommendation Number	Condition Audit Area	Recommendation	Current Status
		of a subset of controls to monitor the controls' effectiveness, with all controls being assessed at least once during the three-year authorization cycle.	
24	FCC Entity	<p>The FCC strengthens its monitoring controls by:</p> <ul style="list-style-type: none"> Documenting and implementing procedures for the creation, maintenance, and review of both agency and system-level POA&Ms. The FCC should document, prioritize, track and review, at least quarterly, all security weaknesses identified by external and internal reviews at the FCC and at outside organizations (e.g., USAC) which meet the FISMA reporting requirement definition of a contractor. Quarterly reviews should include reporting to the CIO. POA&Ms should include resources required to accomplish elements of the plan, any milestones in meeting the tasks, scheduled completion dates for milestones and a current status. When milestones are adjusted, the rationale for adjusting milestones should be documented. 	Re-issued, recommendation # 25



KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report on Compliance and Other Matters

Managing Director
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Inspector General
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We have audited the consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2011 and 2010, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended, and have issued our report thereon dated November 10, 2011.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

The management of the FCC is responsible for complying with laws, regulations, and contracts applicable to the FCC. As part of obtaining reasonable assurance about whether the FCC's consolidated financial statements are free of material misstatement, we performed tests of the FCC's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in OMB Circular A-127, *Financial Management Systems*. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the FCC. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of certain of our tests of compliance described in the preceding paragraph disclosed two instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit I.

The results of our other tests of compliance discussed in the third paragraph of this report, disclosed no instances of noncompliance and one other matter that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and is described in the following paragraph.

Management has identified a matter that may be reported as a violation of the Anti-Deficiency Act. The outcome of this matter, and any resulting ramifications, is not presently known.

The FCC's response to the instances of noncompliance and other matter identified in our audit is presented in the Agency Financial Report. We did not audit the FCC's response and, accordingly, we express no opinion on it.



We noted certain additional matters that we have reported to management of the FCC in a separate letter dated November 10, 2011.

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

KPMG LLP

November 10, 2011

EXHIBIT I

The Federal Managers' Financial Integrity Act (FMFIA)

The FMFIA establishes overall requirements with regard to internal control. The agency head must establish controls that reasonably ensure that: "(i) obligations and costs are in compliance with applicable law; (ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and (iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets."

In addition, the agency head annually must evaluate and report on the control and financial systems that protect the integrity of Federal programs (Section 2 and Section 4 of FMFIA, respectively).

- Section 2 seeks to assess internal controls necessary to ensure that 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, and to maintain accountability of assets.
- Section 4 seeks to assess nonconformance of the agency's accounting system with the principles, standards, and related requirements prescribed by the Comptroller General.

As outlined in the GAO Standards for Internal Control in the Federal Government and the FSIO Core Financial System Requirements, "OMB Circular A-127, *Financial Management Systems*, sets forth general policies for Federal financial management systems. Each agency is required to establish and maintain a single integrated financial management system... All financial management systems must deliver the following:

- Demonstrate compliance with accounting standards and requirements
- Provide timely, reliable, and complete financial management information for decision making at all levels of government
- Meet downstream information and reporting requirements with transaction processing data linked to transaction engines
- Accept standard information integration and electronic data to and from other internal, governmentwide, or private-sector processing environments
- Provide for "one-time" data entry and reuse of transaction data to support downstream integration, interfacing, or business and reporting requirements
- Build security, internal controls, and accountability into processes and provide an audit trail
- Be modular in design and built with reusability as an objective
- Meet the needs for greater transparency and ready sharing of information
- Scale to meet internal and external operational, reporting, and information requirements for both small and large entities."

The FCC reporting component entities' current financial systems and processes are not capable of achieving the financial system integration standards set within GAO Standards for Internal Control in the Federal Government.

Findings and recommendations were issued under the Financial System Functionality and Integration Significant Deficiency noted in the *Independent Auditors' Report on Internal Control Over Financial Reporting* dated November 10, 2011.

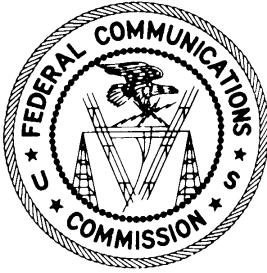
Debt Collection Improvement Act of 1996 (DCIA)

In fiscal year 2011, FCC implemented a new financial system. As a result of the implementation, FCC management encountered challenges with processing transactions and creating reports from the system. During our control walkthrough procedures, we were informed that the FCC had not transferred to the Department of Treasury any fiscal year 2011 FCC or component debt outstanding for more than 90 days per FCC policy, or 180 days in accordance with the Debt Collection Improvement Act. The new financial system was unable to facilitate timely identification of delinquent accounts and produce the required dunning letters during FY 2011 because the automated aging capability in the GL System was not functioning.

The Debt Collection Improvement Act of 1996, as cited at 31 U.S.C. 3711(g)(1), states that: “If a nontax debt or claim owed to the United States has been delinquent for a period of 180 days – (A) the head of the executive, judicial, or legislative agency that administers the program that gave rise to the debt or claim shall transfer the debt or claim to the Secretary of the Treasury;”

In addition to the DCIA requirements, FCC policy states that: “If a debt is more than 90 days past due, and it is a legally enforceable non-tax debt, the debt will be referred to the Treasury for either administrative offset and/or cross servicing.”

Findings and recommendations were issued under the Financial System Functionality and Integration Significant Deficiency noted in the *Independent Auditors' Report on Internal Control Over Financial Reporting* dated November 10, 2011.



Office of the Managing Director

MEMORANDUM

DATE: November 14, 2011

TO: David L. Hunt, Inspector General

FROM: David B. Robbins, Managing Director and Mark Stephens, Chief Financial Officer

SUBJECT: Management's Response to Independent Auditors' Reports on Internal Control Over Financial Reporting and Compliance and Other Matters for Fiscal Year 2011

Thank you for the opportunity to review and comment on the draft reports entitled *Independent Auditors' Report on Internal Control Over Financial Reporting* and *Independent Auditors' Report on Compliance and Other Matters*. We appreciate the efforts of your team and the independent auditor, KPMG LLP, to work with the Federal Communications Commission (Commission) throughout the fiscal year (FY) 2011 audit process. This year's audit opinion was the result of the commitment and professionalism that both of our offices as well as the independent auditors demonstrated during the FY 2011 audit process. During the entire audit process, the Commission worked closely with your office and the independent auditors' team to provide necessary and timely information to facilitate an efficient audit process.

We are pleased that, for the sixth straight year, the independent auditor provided an unqualified opinion and found that the Commission's consolidated financial statements for FY 2011 present fairly, in all material respects, the financial position of the Commission as of September 30, 2011. Six straight years of clean audit opinions is an unprecedented accomplishment for the Commission. We are also pleased that the independent auditor did not identify any material weaknesses in the Commission's financial reporting. 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 2011 audit report points out two significant deficiencies related to internal controls, notes two instances of non-compliance that still need to be resolved, and mentions one matter that is currently under review. The primary areas of concern relate to financial system functionality and integration, information technology control weaknesses, and noncompliance with the Federal Managers' Financial Integrity Act and the Debt Collection Improvement Act. We concur with the recommendations made by the independent auditors in their report.

First, with regard to addressing the significant deficiency for financial system functionality and integration related to the Commission and its reporting components, the Commission has taken significant steps throughout FY 2011 to resolve the auditors' findings and improve the performance of its financial reporting process through the implementation of a new core financial management system. The Commission's new core financial system was launched in October 2010, and the Commission is currently

working to efficiently deploy all functionality of that system. Also in FY 2011, the Commission continued to work closely with its reporting components in their efforts to modernize their financial systems.

Second, with respect to the significant deficiency related to information technology control weaknesses, the Commission is already working to fully assess the auditors' recommendations and to develop corrective action plans. Some findings are already in the process of being addressed. During FY 2012, the Commission will make every effort to complete corrective action for each of the recommendations associated with these findings to avoid any repeat findings in this area.

Third, with respect to the instance of noncompliance with the Federal Managers' Financial Integrity Act, the Commission and its reporting components are committed to implementing financial systems that are fully integrated, and that provide efficient and effective processing and reporting of accounting transactions and financial information.

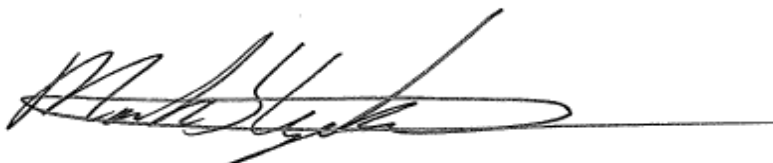
Fourth, with respect to the instance of noncompliance with the Debt Collection and Improvement Act, the Commission is committed to resolving this issue in FY 2012.

Fifth, the Other Matters reported under review as a possible violation of the Anti-Deficiency Act will be fully investigated in FY 2012. If any violations of the Anti-Deficiency Act are identified after the investigation, they will be reported to the President and Congress as required by statute and implementing guidance.

Finally, 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 2012 to resolve the FY 2011 audit findings and to enhance the culture of integrity, accountability, and excellence that exists here at the Commission.

A large, stylized handwritten signature in blue ink, likely belonging to David B. Robbins, the Managing Director.

David B. Robbins, Managing Director
Office of Managing Director

A handwritten signature in black ink, likely belonging to Mark Stephens, the Chief Financial Officer.

Mark Stephens, Chief Financial Officer
Office of Managing Director

PRINCIPAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION CONSOLIDATED BALANCE SHEET

As of September 30, 2011 and 2010
(Dollars in thousands)

	FY 2011	FY 2010
ASSETS (Note 2)		
Intragovernmental		
Fund balance with Treasury (Note 3)	\$ 494,340	\$ 457,368
Investments (Note 5)	5,822,843	6,087,715
Accounts receivable (Note 6)	1,097	571
Other (Note 8)	2,436	33,838
Total intragovernmental	<u>6,320,716</u>	<u>6,579,492</u>
Cash and other monetary assets (Note 4)	213,944	100,344
Accounts receivable, net (Note 6)	831,072	783,620
Loans receivable, net (Note 7)	4	48,470
General property, plant, and equipment, net	60,461	65,167
Other	13,053	13,088
Total assets	<u>\$ 7,439,250</u>	<u>\$ 7,590,181</u>
LIABILITIES (Note 9)		
Intragovernmental		
Debt (Note 10)	\$ 50,300	\$ 87,726
Other (Note 11)		
Custodial	206,524	226,400
Other	13,725	25,572
Total other	<u>220,249</u>	<u>251,972</u>
Total intragovernmental	270,549	339,698
Accounts payable	92,976	120,477
Other (Note 11)		
Deferred revenue	93,053	132,386
Prepaid contributions	77,362	74,915
Accrued liabilities for Universal Service	633,967	622,400
Other	35,804	49,408
Total other	<u>840,186</u>	<u>879,109</u>
Total liabilities	<u>\$ 1,203,711</u>	<u>\$ 1,339,284</u>
Commitments and Contingencies (Note 12)		
NET POSITION		
Unexpended appropriations - other funds	\$ 15,105	\$ 21,183
Cumulative results of operations - earmarked funds (Note 18)	6,089,350	6,135,941
Cumulative results of operations - other funds	131,084	93,773
Total net position	<u>\$ 6,235,539</u>	<u>\$ 6,250,897</u>
Total liabilities and net position	<u>\$ 7,439,250</u>	<u>\$ 7,590,181</u>

The accompanying notes are an integral part of these statements.

**FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST**

For the Years Ended September 30, 2011 and 2010

(Dollars in thousands)

	FY 2011	FY 2010
Program costs (Note 13):		
Broadband:		
Total Gross Cost	\$ 54,536	\$ 80,775
Competition & Innovation:		
Total Gross Cost	9,099,922	-
Competition:		
Total Gross Cost	-	9,023,883
Spectrum:		
Total Gross Cost	-	154,485
Media:		
Total Gross Cost	-	50,180
International:		
Total Gross Cost	6,753	-
Consumers:		
Total Gross Cost	46,156	-
Public Safety & Homeland Security:		
Total Gross Cost	35,576	42,320
Continual Improvement:		
Total Gross Cost	50,626	-
Modernize the FCC:		
Total Gross Cost	-	70,145
Total Program Costs	<u>\$ 9,293,569</u>	<u>\$ 9,421,788</u>
Cost not assigned to programs:		
Telecommunications Development Fund	-	7
Other expenses	25	3,415
Less: earned revenues not attributed to programs	<u>(472,830)</u>	<u>(464,045)</u>
Net cost of operations	<u><u>\$ 8,820,764</u></u>	<u><u>\$ 8,961,165</u></u>

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, 2011 and 2010

(Dollars in thousands)

	FY 2011			FY 2010		
	Earmarked Funds	All Other Funds	Total	Earmarked Funds	All Other Funds	Total
Cumulative Results of Operations:						
Beginning Balances	\$ 6,135,941	\$ 93,773	\$ 6,229,714	\$ 6,051,177	\$ 171,894	\$ 6,223,071
Budgetary Financing Sources:						
Other adjustments (rescissions, etc)	-	1,041	1,041	-	(77)	(77)
Appropriations used	-	45,266	45,266	-	41,773	41,773
Non-exchange revenue (Note 18)	8,771,949	-	8,771,949	8,990,926	-	8,990,926
Other Financing Sources (Non Exchange):						
Transfers in/out without reimbursement	-	-	-	-	(23,311)	(23,311)
Imputed financing	-	17,457	17,457	-	15,382	15,382
Other	-	(24,229)	(24,229)	-	(56,885)	(56,885)
Total Financing Sources	8,771,949	39,535	8,811,484	8,990,926	(23,118)	8,967,808
Net Cost of Operations	8,818,540	2,224	8,820,764	8,906,162	55,003	8,961,165
Net Change	(46,591)	37,311	(9,280)	84,764	(78,121)	6,643
Cumulative Results of Operations	6,089,350	131,084	6,220,434	6,135,941	93,773	6,229,714
Unexpended Appropriations:						
Beginning Balances	-	21,183	21,183	-	44,000	44,000
Budgetary Financing Sources:						
Appropriations received	-	40,267	40,267	-	18,956	18,956
Other adjustments	-	(1,079)	(1,079)	-	-	-
Appropriations used	-	(45,266)	(45,266)	-	(41,773)	(41,773)
Total Budgetary Financing Sources	-	(6,078)	(6,078)	-	(22,817)	(22,817)
Total Unexpended Appropriations	-	15,105	15,105	-	21,183	21,183
Net Position	\$ 6,089,350	\$ 146,189	\$ 6,235,539	\$ 6,135,941	\$ 114,956	\$ 6,250,897

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2011 and 2010

(Dollars in thousands)

	FY 2011		FY 2010	
	Budgetary	Non Budgetary Credit Program Financing Acct	Budgetary	Non Budgetary Credit Program Financing Acct
Budgetary Resources:				
Unobligated balance, brought forward, October 1:	\$ 2,567,572	\$ 4,387	\$ 3,035,116	\$ 12,344
Recoveries of prior year unpaid obligations	1,062,160	-	1,043,329	-
Budget authority:				
Appropriations received	8,785,026	-	9,005,071	-
Borrowing authority (Note 15)	-	50,449	-	56,732
Spending authority from offsetting collections				
Earned:				
Collected	460,046	78,111	450,207	14,873
Change in receivables from Federal sources	343	-	-	-
Change in unfilled customer orders:				
Advance received	(9,579)	-	16,003	-
Without advance from Federal sources	39	-	-	-
Budget authority subtotal	<u>9,235,875</u>	<u>128,560</u>	<u>9,471,281</u>	<u>71,605</u>
Temporarily not available pursuant to Public Law	(6,247)	-	(5,739)	-
Permanently not available	(38)	(87,874)	(75)	(15,490)
Total budgetary resources	<u>\$ 12,859,322</u>	<u>\$ 45,073</u>	<u>\$ 13,543,912</u>	<u>\$ 68,459</u>
Status of Budgetary Resources:				
Obligations incurred: (Note 14)				
Direct	\$ 10,127,517	\$ 8,065	\$ 10,958,600	\$ 64,072
Reimbursable	4,206	-	17,740	-
Subtotal	<u>10,131,723</u>	<u>8,065</u>	<u>10,976,340</u>	<u>64,072</u>
Unobligated balance:				
Apportioned	21,134	1	244,720	-
Exempt from apportionment	2,550,957	-	2,164,357	-
Unobligated balance not available	<u>155,508</u>	<u>37,007</u>	<u>158,495</u>	<u>4,387</u>
Total status of budgetary resources	<u>\$ 12,859,322</u>	<u>\$ 45,073</u>	<u>\$ 13,543,912</u>	<u>\$ 68,459</u>
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	\$ 3,736,251	\$ -	\$ 3,157,411	\$ -
Total unpaid obligated balance, brought forward, net	<u>3,736,251</u>	<u>-</u>	<u>3,157,411</u>	<u>-</u>
Obligations incurred net (+/-)	10,131,723	8,065	10,976,340	64,072
Gross outlays	(9,389,025)	(8,065)	(9,354,171)	(64,072)
Recoveries of prior year unpaid obligations, actual	(1,062,160)	-	(1,043,329)	-
Change in uncollected customer payments from Federal sources	(382)	-	-	-
Total, unpaid obligated balance, net, end of period	<u>3,416,407</u>	<u>-</u>	<u>3,736,251</u>	<u>-</u>
Obligated balance, net, end of period				
Unpaid obligations	3,416,789	-	3,736,251	-
Uncollected customer payments from				
Federal sources	(382)	-	-	-
Total, unpaid obligated balance, net, end of period	<u>3,416,407</u>	<u>-</u>	<u>3,736,251</u>	<u>-</u>
Net Outlays				
Net Outlays:				
Gross outlays	\$ 9,389,025	\$ 8,065	\$ 9,354,171	\$ 64,072
Offsetting collections	(450,467)	(78,111)	(466,210)	(14,873)
Distributed offsetting receipts	(59,041)	-	(110,015)	-
Net outlays	<u>\$ 8,879,517</u>	<u>\$ (70,046)</u>	<u>\$ 8,777,946</u>	<u>\$ 49,199</u>

The accompanying notes are an integral part of these statements.

**FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY**

For the Years Ended September 30, 2011 and 2010
(Dollars in thousands)

	FY 2011	FY 2010
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	\$ 66,871	\$ 391,144
Fines and Penalties	43,061	10,438
Credit Reform	7,831	6,961
TDA Interest	-	7
Total Cash Collections	<u>117,763</u>	<u>408,550</u>
Accrual Adjustments		
Spectrum Auctions	4	-
Fines and Penalties	(1,751)	6,061
Total Accrual Adjustments	<u>(1,747)</u>	<u>6,061</u>
Total Custodial Revenue	116,016	414,611
Disposition of Collections:		
Transferred to Others:		
Recipient A: U.S. Treasury	(50,892)	(17,399)
Recipient B: National Telecommunications & Information Admin.	-	(196,613)
(Increase)/Decrease in Amounts Yet to be Transferred	19,876	(115,592)
Retained by the Reporting Entity	<u>(85,000)</u>	<u>(85,007)</u>
Net Custodial Activity	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of these statements.

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010
(DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED)

Note 1 - Summary of Significant Accounting Policies

A. Reporting Entity

The Federal Communications Commission (Commission or FCC) 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).

B. 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. generally accepted accounting principles (GAAP) and the form and content for Federal entity financial statements specified by the Office of Management and Budget (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.

C. 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)

D. Cash and Other Monetary Assets

Cash and Other Monetary Assets represent cash on deposit and money market funds at several commercial banks. The accounts are maintained by Universal Service Administrative Company (USAC), Rolka Loube Saltzer Associates, LLC (RLSA), and Welch LLP, serving as administrators and/or billing and collection agents. The accounts bear the names of those entities, as well as 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.

As of July 1, 2011, RLSA became the new administrator for the TRS Fund. Prior to July 1, 2011, the TRS fund was administered by the National Exchange Carrier Association (NECA).

E. Investments

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

F. Accounts Receivable, Net

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

G. 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. The 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.

H. Property, Plant and Equipment

The basis for recording purchased general Property, Plant, and Equipment (PP&E) is full cost, including all costs incurred to bring the PP&E to and from a location suitable for its intended use. All PP&E with an initial acquisition cost of \$25 or more and all internally developed software with a development cost of \$50 or more, and with an estimated useful life of two years or greater, are capitalized. Bulk purchases of similar items, individually worth less than \$25 but collectively worth more than \$250, are also capitalized using the same equipment categories and useful lives as capital acquisitions. PP&E are depreciated on a straight-line basis over the estimated useful lives of the items. The useful lives used are: forty years for buildings, seven years for non-computer equipment, five years for computers and vehicles, and three years for software. Neither land, including permanent improvements, nor software in development is depreciated. Normal maintenance and repair costs are expensed as incurred.

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

Note 1 - Summary of Significant Accounting Policies (continued)

I. Other Assets

Other Assets with the public represent the balance of transfers less expenses made by the USF to the USAC to fund administrative costs in advance. Advances are drawn down as expenses are incurred. Other Assets – Intragovernmental are discussed in Note 8.

J. 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.

K. Deferred Revenue

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

The USF and NANP 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.

L. 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 reestimates 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.

M. 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)

M. 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 (DOL) determines no actuarial liability for the Commission due to the immateriality to the Federal Government as a whole.

The unfunded Federal Employees' Compensation Act (FECA) liability covers unemployment compensation and medical benefits. The calculation takes the amount of benefit payments over the last nine to twelve quarters and then calculates the annual average of payments. The compensation and medical payments can be found in the chargeback reports that are issued by DOL.

N. 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.

O. Revenue and Other Financing Sources

Regulatory Fee Offsetting Collections (Exchange) - 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 and Innovation, International, Consumers, Public Safety and Homeland Security, and Continual Improvement. These are different from the strategic goals in FY 2010 which were Broadband, Competition, Spectrum, Media, Public Safety and Homeland Security, and Modernize 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

Note 1 - Summary of Significant Accounting Policies (continued)

O. Revenues and Other Financing Sources (continued)

levels of \$335,794 for FY 2011 and \$335,794 for FY 2010 were achieved. The Commission collected \$6,247 above the required regulatory level in FY 2011 and \$5,739 in FY 2010, which are reported as temporarily not available pursuant to Public Law. The total cumulative amount collected above the required regulatory level was \$66,170 at September 30, 2011.

Competitive Bidding System 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 are capped at \$85,000 in FY 2011 and FY 2010.

Radio Spectrum Auction Proceeds (Exchange) – In accordance with the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources*, the Commission accounts for this exchange revenue as a custodial activity. Revenue from spectrum auctions is recognized when a “prepared to grant” or “grant” public notice is issued. The value of available spectrum is determined in the market place at the time of auction. The Commission recognized total custodial revenue related to spectrum auctions net of accrual adjustments of \$66,875 in FY 2011 and \$391,144 in FY 2010.

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 \$23,892 in FY 2011 and \$23,311 in FY 2010.

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 \$3,893 in FY 2011 and \$21,410 in FY 2010.

Annual Appropriations (Financing Source) – The Commission receives an annual Salaries and Expense appropriation from Congress. These funds are used to pay for operations during the fiscal year and are repaid to the Treasury once regulatory fees are collected. The annual appropriation of \$335,794 for FY 2011 and \$335,794 for FY 2010 is fully funded by regulatory fee collections.

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 an appropriation for an upward subsidy of \$40,267 in FY 2011 and \$18,956 in FY 2010. These appropriations are available until used.

Note 1 - Summary of Significant Accounting Policies (continued)

O. Revenues and Other Financing Sources (continued)

USF (Nonexchange) – Carriers conducting interstate telecommunications are required to contribute a portion of their revenues to fund the cost of providing universal service. These contributions represent appropriated and earmarked receipts and are accounted for as a budgetary financing source.

Digital to Analog Converter Box Program – DTV Outreach Recovery Act Funds (Financing Source) – During FY 2009, the National Telecommunications and Information Administration (NTIA), U.S. Department of Commerce (DOC), transferred \$70,605 in appropriated funds to the Commission for the purposes of consumer education and outreach regarding the digital television transition. These funds were part of the American Recovery and Reinvestment Act (ARRA) of 2009, which were available for use during FY 2009 and FY 2010.

Broadband Technology Opportunities Program (BTOP) – National Broadband Plan Recovery Act Funds (Financing Source) - During FY 2009, the NTIA transferred \$20,055 in appropriated funds to the Commission for the purpose of establishing benchmarks to ensure that all people of the United States have access to broadband capability. These funds are part of the ARRA of 2009. The Commission also entered into additional reimbursable agreements with NTIA and the United States Department of Agriculture (USDA) for the detail of various Commission employees to provide advice and assistance in the implementation and administration of BTOP as well as providing for the use of the Tower Construction Notification System in support of the Broadband Initiatives Program. NTIA and USDA advanced the Commission \$724 in appropriated funds for these efforts. These funds are part of the ARRA of 2009, which were available for use during FY 2009 and FY 2010.

Broadband Technology Opportunities Program – National Broadband Map Recovery Act Funds (Financing Source) – During FY 2010, the NTIA entered into a reimbursable agreement with the Commission to provide technical and other services needed to develop a comprehensive nationwide inventory map of existing broadband service capability and availability in the United States. NTIA advanced the Commission a total of \$18,650 in ARRA funds to support this effort.

Allocation of Exchange Revenues

In FY 2010, the Commission directly assigned exchange revenue from reimbursable work agreements to specific programs on the Statement of Net Cost. Exchange revenue from application fees and offsetting collections related to Regulatory Fees and the Competitive Bidding System were 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 were recorded on the Statement of Custodial Activity because the Commission recognizes virtually no cost in connection with the revenues earned in the spectrum auction. Beginning in FY 2011, the Commission no longer allocates exchange revenue to programs since there is no direct relationship between earned revenues and specific programs. The entire balance is reported on the line "Less: earned revenues not attributed to programs."

Reprogramming

The Commission received approval in FY 2010 to reprogram \$4,500 of prior year obligations that were deobligated to enable the Commission to focus on important media issues and continue to make a critical investment in the people needed to transform the Commission into a twenty-first century agency for the information age. The Commission did not submit a request in FY 2011 to reprogram any of these prior year funds.

Note 1 - Summary of Significant Accounting Policies (continued)

P. 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 Universal Service Fund (USF) support mechanisms, Rolka Loubé Saltzer Associates (RLSA), which is both the administrator and B&C agent for the Telecommunications Relay Service (TRS) Fund (prior to July 1, 2011, the National Exchange Carrier Association (NECA) was the administrator and B&C agent for the TRS Fund), and Neustar which is the administrator for the North American Numbering Plan (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 the years ended September 30, 2011 and 2010 are listed below:

	<u>USF</u>	<u>TRS</u>	<u>NANP</u>	<u>Total</u>
Administrative Fees:				
FY 2011	\$ 102,118	\$ 2,082	\$ 4,587	\$ 108,787
FY 2010	\$ 108,105	\$ 1,521	\$ 3,899	\$ 113,525

Q. Net Position

Net Position is the residual difference between assets and liabilities, and is comprised of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations represents the amount of unobligated and unexpended budget authority. Unobligated Balance is the amount of appropriations or other authority remaining after deducting the cumulative obligations from the amount available for obligation. Cumulative Results of Operations is the net difference since the inception of the Commission of (1) expenses and losses and (2) financing sources including appropriations, revenues, and gains.

Note 2 - Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2011 and 2010:

	<u>FY 2011</u>	<u>FY 2010</u>
Intragovernmental:		
Fund Balance with Treasury (FBWT)	\$ 266,981	\$ 261,822
Accounts Receivable, Net	1,081	556
Other (Note 8)	2,436	33,838
Total Intragovernmental	<u>270,498</u>	<u>296,216</u>
Accounts Receivable, Net	<u>19,304</u>	<u>21,598</u>
Total Non-entity Assets	289,802	317,814
Total Entity Assets	<u>7,149,448</u>	<u>7,272,367</u>
Total Assets	<u>\$ 7,439,250</u>	<u>\$ 7,590,181</u>

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for \$238,425 in FY 2011 and \$250,788 in FY 2010. 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, 2011 and 2010:

FY 2011

	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	\$ 28,782	\$ 37,008	\$ -	\$ 65,790
Unavailable	80,990	-	-	80,990
Obligated Balance not yet Disbursed	80,579	-	-	80,579
Non-Budgetary FBWT	-	-	266,981	266,981
Total	<u>\$ 190,351</u>	<u>\$ 37,008</u>	<u>\$ 266,981</u>	<u>\$ 494,340</u>

FY 2010

	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	\$ 44,972	\$ 4,387	\$ -	\$ 49,359
Unavailable	61,004	-	-	61,004
Obligated Balance not yet Disbursed	85,183	-	-	85,183
Non-Budgetary FBWT	-	-	261,822	261,822
Total	<u>\$ 191,159</u>	<u>\$ 4,387</u>	<u>\$ 261,822</u>	<u>\$ 457,368</u>

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 credit reform program account, and the no-year accounts used to carry over spectrum auction funds, offsetting collections, excess regulatory fees, and the Office of Inspector General USF funds.

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

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, 2011 and 2010:

	<u>FY 2011</u>	<u>FY 2010</u>
Cash and Other Monetary Assets	\$ <u>213,944</u>	\$ <u>100,344</u>

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 2011, Cash and Other Monetary Assets included \$210,948 in USF contributions and related accrued interest being held for distribution, and \$2,996 in NANP deposits and related accrued interest.

In FY 2010, Cash and Other Monetary Assets included \$97,417 in USF contributions and related accrued interest being held for distribution, and \$2,927 in NANP deposits and related accrued interest.

Note 5 - Investments

The following summarizes Investments as of September 30, 2011 and 2010:

	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
<u>FY 2011</u>						
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	\$ 1,462,490	EI	\$ 36	\$ -	\$ 1,462,526	\$ 1,462,532
Treasury Notes	4,358,452	EI	(4,735)	6,600	4,360,317	4,371,790
Total	<u>\$ 5,820,942</u>		<u>\$ (4,699)</u>	<u>\$ 6,600</u>	<u>\$ 5,822,843</u>	<u>\$ 5,834,322</u>
<u>FY 2010</u>						
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	\$ 4,264,815	EI	\$ 2,370	\$ -	\$ 4,267,185	\$ 4,267,642
Treasury Notes	1,821,636	EI	(5,770)	4,664	1,820,530	1,821,310
Total	<u>\$ 6,086,451</u>		<u>\$ (3,400)</u>	<u>\$ 4,664</u>	<u>\$ 6,087,715</u>	<u>\$ 6,088,952</u>

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 18.

The cash receipts collected from the public for the USF are used to purchase federal securities. Treasury securities are an asset to the USF and a liability to the U.S. Treasury. Because the USF 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 USF with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the USF 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.

Note 6 - Accounts Receivable, Net

The following summarizes Accounts Receivable, Net as of September 30, 2011 and 2010:

FY 2011

	Intragovernmental	Public	Total
Gross Accounts Receivable	\$ 1,097	\$ 1,431,499	\$ 1,432,596
Allowance for Doubtful Accounts	(-)	(600,427)	(600,427)
Net Accounts Receivable	<u>\$ 1,097</u>	<u>\$ 831,072</u>	<u>\$ 832,169</u>

FY 2010

	Intragovernmental	Public	Total
Gross Accounts Receivable	\$ 571	\$ 1,236,959	\$ 1,237,530
Allowance for Doubtful Accounts	(-)	(453,339)	(453,339)
Net Accounts Receivable	<u>\$ 571</u>	<u>\$ 783,620</u>	<u>\$ 784,191</u>

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) for Schools and Libraries audit receivables are subject to appeal and are not considered final until the appeals period has lapsed or a final determination has been issued. The COMAD audit receivables for Schools and Libraries have a 93% allowance in FY 2011 and 74% allowance in FY 2010.

	FY 2011			FY 2010		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	\$ 1,065,218	\$ (268,724)	\$ 796,494	\$ 973,987	\$ (245,241)	\$ 728,746
COMAD - Schools and Libraries	200,342	(185,717)	14,625	124,859	(91,896)	32,963
Regulatory Fees	35,740	(24,194)	11,546	29,832	(18,581)	11,251
Spectrum Auction	21,258	(21,254)	4	21,254	(21,254)	-
Forfeitures	95,102	(88,399)	6,703	70,323	(65,393)	4,930
Other	14,936	(12,139)	2,797	17,275	(10,974)	6,301
Total	<u>\$ 1,432,596</u>	<u>\$ (600,427)</u>	<u>\$ 832,169</u>	<u>\$ 1,237,530</u>	<u>\$ (453,339)</u>	<u>\$ 784,191</u>

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 became 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 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 2011 for actual performance data through September 30, 2011. The reestimate resulted in a net upward adjustment, including interest on the reestimate, of \$17,629 reported in FY 2011 financial statements. A net upward adjustment, including interest on the reestimate, of \$40,118 was reported in FY 2010 financial statements.

Direct Loans

<u>Loan Program</u>	<u>Loans Receivable, Gross</u>	<u>Interest Receivable</u>	<u>Other Receivables</u>	<u>Allowance for Subsidy Cost (Present Value)</u>	<u>Value of Assets Related to Direct Loans</u>
Spectrum Auctions:					
FY 2011 Bal.	\$ 130,533	\$ 8,932	\$ 1,195	\$ (140,656)	\$ 4
FY 2010 Bal.	\$ 197,837	\$ 15,410	\$ 1,483	\$ (166,260)	\$ 48,470

Interest accrued on bankrupt and defaulted loans totaled \$8,932 in FY 2011 and \$15,410 in FY 2010.

Other Receivables is composed of outstanding late fees on the loans receivable.

Note 7 – Loans Receivable, Net (continued)

Total Amount of Direct Loans Disbursed

No new loans were issued in FY 2011 and FY 2010.

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 2011 (Net)	\$ -	\$ -	\$ 17,629	\$ 17,629
FY 2010 (Net)	\$ -	\$ -	\$ 40,118	\$ 40,118

Schedule for Reconciling Subsidy Cost Allowance Balances

Beginning Balance of the Subsidy Cost Allowance	FY 2011 \$ 166,260	FY 2010 \$ 135,251
Adjustments:		
Recoveries	-	16
Loans written off	(42,711)	(3,975)
Subsidy allowance amortization	<u>(522)</u>	<u>(5,150)</u>
Ending balance before reestimates	123,027	126,142
Subsidy reestimates:		
Technical/default reestimate	17,629	40,118
Ending balance of the subsidy cost allowance	<u>\$ 140,656</u>	<u>\$ 166,260</u>
Administrative Expense	FY 2011	FY 2010
Spectrum Auctions	\$ 4,884	\$ 3,572

Note 8 – Other Assets

The Commission was required by the Digital Television Transition and Public Safety Act of 2005 to auction recovered analog spectrum licenses; the proceeds received from such auctions were to be transferred in to 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 was \$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 Commission retained a deferred revenue liability to the public for this amount in the event that any of these proceeds were required to be refunded. As an offset to the liability, the Commission recognized an Intragovernmental Other Asset from the National Telecommunications and Information Administration (NTIA) who held the related Fund Balance. The NTIA recorded a corresponding Other Liability that eliminates with the Commission’s Intragovernmental Other Asset for Government-wide Financial Reporting purposes. Since September 30, 2010, the Commission granted additional licenses totaling \$31,402. There remain Intragovernmental Other Asset and Deferred Revenue balances of \$2,436 at September 30, 2011, that relate to Auction #73 licenses that have not yet been granted.

Note 9 - Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2011 and 2010:

	<u>FY 2011</u>	<u>FY 2010</u>
Intragovernmental:		
Other:		
FECA Liability	\$ 482	\$ 590
GSA Real Estate Taxes	2,357	5,335
Other:		
Unfunded Leave	20,108	20,691
Accrued Liabilities for Universal Service	<u>633,967</u>	<u>622,400</u>
Total liabilities not covered by budgetary resources	656,914	649,016
Total liabilities covered by budgetary resources	<u>546,797</u>	<u>690,268</u>
Total Liabilities	<u>\$ 1,203,711</u>	<u>\$ 1,339,284</u>

Note 10 - Debt

	FY 2010		FY 2010		FY 2011
	<u>Beginning</u>	Net	<u>Ending</u>	Net	<u>Ending</u>
	<u>Balance</u>	<u>Borrowing</u>	<u>Balance</u>	<u>Borrowing</u>	<u>Balance</u>
Debt to the Treasury	\$ 46,484	\$ 41,242	\$ 87,726	\$ (37,426)	\$ 50,300

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, 2011 and 2010:

<u>FY 2011</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
Intragovernmental			
Custodial Liability	\$ -	\$ 206,524	\$ 206,524
Other	-	13,725	13,725
Total Intragovernmental	<u>\$ -</u>	<u>\$ 220,249</u>	<u>\$ 220,249</u>
Deferred Revenue	\$ 30,144	\$ 62,909	\$ 93,053
Prepaid Contributions	-	77,362	77,362
Accrued Liabilities for Universal Service	-	633,967	633,967
Other	-	35,804	35,804
Total Other Public	<u>\$ 30,144</u>	<u>\$ 810,042</u>	<u>\$ 840,186</u>
<u>FY 2010</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
Intragovernmental			
Custodial Liability	\$ -	\$ 226,400	\$ 226,400
Other	-	25,572	25,572
Total Intragovernmental	<u>\$ -</u>	<u>\$ 251,972</u>	<u>\$ 251,972</u>
Deferred Revenue	\$ 26,637	\$ 105,749	\$ 132,386
Prepaid Contributions	-	74,915	74,915
Accrued Liabilities for Universal Service	-	622,400	622,400
Other	-	49,408	49,408
Total Other Public	<u>\$ 26,637</u>	<u>\$ 852,472</u>	<u>\$ 879,109</u>

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 - 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, High Cost, and Low Income programs which might result in future proceedings or actions. Similarly the Commission, RLSA, and the Department of Justice are investigating several cases related to the TRS funds. The complexity of these future actions precludes management from estimating the total amount of recovery that may result.

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

The Commission has examined its obligations related to cancelled authority and believes it has no outstanding commitments requiring future resources other than those as disclosed in Note 9. In addition, there are certain operating leases that may contain provisions regarding contract termination costs upon early contract termination.

In September 2007, the National Treasury Employees Union (NTEU) filed a grievance with the Commission under the Federal Labor Standards Act (FLSA) alleging that certain Commission bargaining unit employees were not sufficiently compensated for overtime work. It is reasonable to believe that a Commission loss on some issues is a possible outcome. However, it is impossible to estimate the monetary impact of the grievance at this time.

Note 13 – Intragovernmental Costs and Exchange Revenue

Intragovernmental costs primarily represent goods and services purchased by the Commission from other Federal agencies.

Note 13 – Intragovernmental Costs and Exchange Revenue (continued)

Program Costs - FY 2011

Program	Intragovernmental	Public	Total
Broadband	\$ 14,595	\$ 39,941	\$ 54,536
Competition and Innovation	74,057	9,025,865	9,099,922
International	1,807	4,946	6,753
Consumers	12,353	33,803	46,156
Public Safety and Homeland Security	9,521	26,055	35,576
Continual Improvement	13,549	37,077	50,626
Total	\$ 125,882	\$ 9,167,687	\$ 9,293,569

Earned Revenue - FY 2011

	Intragovernmental	Public	Total
Total Earned Revenue	\$ 18,624	\$ 454,206	\$ 472,830

Program Costs - FY 2010

Program	Intragovernmental	Public	Total
Broadband	\$ 17,197	\$ 63,578	\$ 80,775
Competition	30,157	8,993,726	9,023,883
Spectrum	33,885	120,600	154,485
Media	11,871	38,309	50,180
Public Safety and Homeland Security	12,437	29,883	42,320
Modernize the FCC	14,335	55,810	70,145
Total	\$ 119,882	\$ 9,301,906	\$ 9,421,788

Earned Revenue - FY 2010

	Intragovernmental	Public	Total
Total Earned Revenue	\$ 6,855	\$ 457,190	\$ 464,045

Note 14 - Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations

The following summarizes Apportionment Categories of Obligations Incurred for the years ended September 30, 2011 and 2010:

	FY 2011		FY 2010	
	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Direct				
Category A	\$ 1,098,682	\$ -	\$ 420,586	\$ -
Category B	49,304	8,065	763,872	64,072
Exempt from Apportionment	8,979,531	-	9,774,142	-
Total Direct	<u>\$ 10,127,517</u>	<u>\$ 8,065</u>	<u>\$ 10,958,600</u>	<u>\$64,072</u>
Reimbursable				
Category A	\$ 4,206	\$ -	\$ 17,740	\$ -

Category A – Apportioned by Quarter

Category B – Apportioned by Purpose

Note 15 - Terms of Borrowing Authority Used

	<u>FY 2011</u>	<u>FY 2010</u>
Maturity Dates:		
September 30, 2011	\$ -	\$ 56,732
September 30, 2013	<u>50,449</u>	<u>-</u>
Total Borrowing Authority Used	<u>\$ 50,449</u>	<u>\$ 56,732</u>

The Commission used \$50,449 in borrowing authority for the year ending September 30, 2011, and \$56,732 in borrowing authority for the prior year ending September 30, 2010. This authority was used to extend the maturity dates of the debt owed to BPD. The Commission anticipates that this borrowing will be repaid from proceeds generated from the recovery of funds related to bankrupt and defaulted loans.

Note 16 – Legal Arrangements Affecting Use of Unobligated Balances

Pursuant to Public Law 111-8, offsetting collections received in excess of \$335,794 in FY 2011 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, 2010, are not available for obligation.

Note 17 - Explanation of Differences Between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

The only material difference between the Combined Statement of Budgetary Resources (SBR) for FY 2010 and the amounts presented in the 2012 President's Budget was \$150,000 between the lines titled "Unobligated balance – available" and "Unobligated balance – not available." These two lines net to zero. OMB Circular No. A-136, *Financial Reporting Requirements*, requires all unapportioned balances to be reflected as "Unobligated balance - not available" on the SBR. The President's Budget determines availability based on the fund type and legislation, and places the unapportioned balance for the Commission, including USF, on line "Unobligated balance - available."

The FY 2012 *Budget of the United States Government* (President's Budget) with actual numbers for FY 2011 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 18 – Earmarked Funds

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

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program as of September 30, 2011 and 2010:

Note 18 – Earmarked Funds (continued)

	<u>FY 2011</u>	<u>FY 2010</u>
Balance Sheet		
ASSETS		
Investments	\$ 5,822,843	\$ 6,087,715
Cash and other monetary assets	210,948	97,417
Accounts receivable, net	842,768	775,594
General property, plant, and equipment, net	6,330	10,771
Other assets	13,024	13,024
Total assets	<u>\$ 6,895,913</u>	<u>\$ 6,984,521</u>
LIABILITIES		
Accounts payable	\$ 82,113	\$ 120,149
Deferred revenue	13,161	31,150
Prepaid contributions	77,322	74,881
Accrued liabilities	633,967	622,400
Total liabilities	<u>\$ 806,563</u>	<u>\$ 848,580</u>
Cumulative results of operations	<u>\$ 6,089,350</u>	<u>\$ 6,135,941</u>
Total liabilities and net position	<u>\$ 6,895,913</u>	<u>\$ 6,984,521</u>
Statement of Net Cost		
Net cost of operations	<u>\$ 8,818,540</u>	<u>\$ 8,906,162</u>
Statement of Changes in Net Position		
Net position beginning of period	\$ 6,135,941	\$ 6,051,177
Non-exchange revenue	8,771,949	8,990,926
Net cost of operations	8,818,540	8,906,162
Change in net position	<u>(46,591)</u>	<u>84,764</u>
Net position end of period	<u>\$ 6,089,350</u>	<u>\$ 6,135,941</u>

Note 19 – Undelivered Orders at the End of the Period

The amount of budgetary resources obligated for undelivered orders totaled \$3,314,084 as of September 30, 2011, and \$3,585,456 as of September 30, 2010.

Note 20 – Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)

As of September 30, 2011 and 2010:

	FY 2011	FY 2010
Budgetary Resources Obligated:		
Obligations incurred	\$ 10,139,788	\$ 11,040,412
Less: spending authority from offsetting collections and recoveries	1,591,120	1,524,412
Obligations net of offsetting collections and recoveries	8,548,668	9,516,000
Less: offsetting receipts	59,041	110,015
Net obligations	8,489,627	9,405,985
Other Resources	(6,772)	(64,814)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Undelivered Orders	271,372	(527,248)
Resources that fund expenses recognized in prior periods	(691)	-
Budgetary offsetting collections and receipts that do not affect net cost of operations	137,152	124,888
Resources that finance the acquisition of assets	(13,089)	(32,392)
Other	145,253	21,857
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Increase in annual leave liability	(583)	1,069
Upward/Downward reestimates of credit subsidy (+/-)	17,629	40,118
Increase in exchange revenue receivable from the public	3,872	1,460
Depreciation and amortization	17,797	17,039
Revaluation of assets or liabilities (+/-)	-	(100)
Other (+/-)	(240,803)	(26,697)
Net Cost of Operations	<u>\$ 8,820,764</u>	<u>\$ 8,961,165</u>

Note 21 – Comparability of the Financial Statements

Statement of Net Cost

In FY 2011, the Commission no longer allocated exchange revenues to the programs. Instead the exchange revenue is reported under the line Less: Earned Revenues not Attributed to Programs.

A reporting change was also made for FY 2011 that impacted the programs listed on the Statement of Net Cost. Effective for FY 2011, the Commission began accounting for costs under the new strategic goals presented in the FY 2011-2016 Strategic Plan.

Statement of Changes in Net Position

In FY 2011, the Commission began reporting section 8 fees under Standard General Ledger (SGL) account 5993, *Offsetting Non-entity Collections*, rather than SGL account 5730, *Financing Sources Transferred Out without Reimbursement*, which was used in FY 2010. The effect of this change reports the FY 2011 section 8 fees of \$23,892 on the line Other under Other Financing Sources (Non-exchange) rather than on the line Transfer In/Out without Reimbursement.

REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION – STATEMENT OF BUDGETARY RESOURCES

For the Year Ended September 30, 2011
(Dollars in thousands)

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 Commission and the USF. Reflected in the chart below are the major accounts of the Commission that are aggregated and presented in the September 30, 2011 Combined Statement of Budgetary Resources.

STATEMENT OF BUDGETARY RESOURCES

FY2011	<u>S&E</u>	<u>Credit</u>	<u>Auctions</u>	<u>USF</u>	<u>Total</u>
Budgetary Resources:					
Unobligated balances - brought forward, October 1	\$ 38,735	\$ 11,129	\$ 199	\$ 2,521,896	\$ 2,571,959
Recoveries of prior year unpaid obligations	5,727	8	661	1,055,764	1,062,160
Budget authority	346,232	168,827	85,269	8,764,107	9,364,435
Nonexpenditure transfers, net, anticipated and actual	159	-	(159)	-	-
Temporarily not available pursuant to Public Law	(6,247)	-	-	-	(6,247)
Permanently not available	(38)	(87,874)	-	-	(87,912)
Total budgetary resources	<u>\$ 384,568</u>	<u>\$ 92,090</u>	<u>\$ 85,970</u>	<u>\$ 12,341,767</u>	<u>\$ 12,904,395</u>
Status of Budgetary Resources:					
Obligations incurred	\$ 347,517	\$ 50,593	\$ 84,367	\$ 9,657,311	\$ 10,139,788
Unobligated balances - available	16,067	4,460	608	2,550,957	2,572,092
Unobligated balances - not available	20,984	37,037	995	133,499	192,515
Total, status of budgetary resources	<u>\$ 384,568</u>	<u>\$ 92,090</u>	<u>\$ 85,970</u>	<u>\$ 12,341,767</u>	<u>\$ 12,904,395</u>
Change in Obligated Balance:					
Total unpaid obligated balance, net brought Forward	\$ 59,979	\$ 4,444	\$ 21,138	\$ 3,650,690	\$ 3,736,251
Obligations incurred, net	347,517	50,593	84,367	9,657,311	10,139,788
Gross outlays	(346,175)	(53,457)	(80,589)	(8,916,869)	(9,397,090)
Recoveries of prior year unpaid obligations, actual	(5,728)	(8)	(661)	(1,055,763)	(1,062,160)
Change in uncollected customer payments from Federal sources	(382)	-	-	-	(382)
Total, Unpaid obligated balance, net, end of period	<u>\$ 55,211</u>	<u>\$ 1,572</u>	<u>\$ 24,255</u>	<u>\$ 3,335,369</u>	<u>\$ 3,416,407</u>
Net Outlays					
Gross outlays	\$ 346,175	\$ 53,457	\$ 80,589	\$ 8,916,869	\$ 9,397,090
Offsetting collections	(345,850)	(78,111)	(85,269)	(19,348)	(528,578)
Distributed offsetting receipts	(36,417)	-	-	(22,624)	(59,041)
Net outlays	<u>\$ (36,092)</u>	<u>\$ (24,654)</u>	<u>\$ (4,680)</u>	<u>\$ 8,874,897</u>	<u>\$ 8,809,471</u>