FEDERAL COMMUNICATIONS COMMISSION

Fiscal Year 2011
Agency Financial Report

(October 1, 2010 – September 30, 2011)

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Message from the Chairman

I am pleased to present the Federal Communications Commission's (FCC or Commission) Financial Report for Fiscal Year (FY) 2011. The Financial Report provides key financial and performance information to Congress and the American people. As continuing evidence of the FCC's strong commitment to maintaining a culture of accountability for the funds it manages, I am pleased to report that for the sixth consecutive year, the FCC has obtained an unqualified or "clean" audit opinion on its financial statements. In addition, the FCC's independent auditors, KPMG, did not identify any material weaknesses in the FCC's operations. The independent auditors' opinion addresses more than $450 million in FCC operating expenses and over $8 billion in outlays for the Universal Service Fund and Telecommunications Relay Service Fund. Despite the positive audit opinion, the independent auditors' report shows that work remains at the FCC to continue to improve the agency's operations so it can deliver on its mission for the American people.

The FCC's mission centers on communications networks and technology, which have the potential to unleash new waves of innovation, thereby increasing opportunity and prosperity, driving American competitiveness and leadership, connecting our country, strengthening our democracy – and transforming lives for the better. I welcome the opportunity to highlight how the FCC has fulfilled its important role in pursuing these goals on behalf of all Americans throughout FY 2011.

In the American Recovery and Reinvestment Act of 2009, Congress directed the FCC to develop a National Broadband Plan (Plan) to ensure every American has "access to broadband capability." Congress also required that the Plan include a detailed strategy for achieving affordability and maximizing use of broadband to advance "consumer welfare, civic participation, public safety and homeland security, community development, health care delivery, energy independence and efficiency, education, employee training, private sector investment, entrepreneurial activity, job creation and economic growth, and other national purposes."

At the FCC we continue to work hard to implement the Plan, unleashing world-leading innovation, and – critically – bringing the benefits of high-speed Internet to all Americans. Some of the Commission's key accomplishments over the past year include:

- Reform and modernization of the Universal Service Fund and the intercarrier compensation (ICC) system. The Commission took action to bring the high-cost program and ICC in to the 21st century, transitioning legacy programs to the Connect America Fund, which will make affordable broadband available to all Americans while eliminating waste and inefficiency. The Commission also reformed and modernized the E-rate program, giving schools the flexibility to provide Internet access to their communities and to explore the benefits of wireless broadband and e-textbooks. Further, the Commission proposed a comprehensive set of reforms to improve the Lifeline program, including to create pilot programs to increase broadband adoption among low-income Americans.
- Adoption of rules to lower the costs of infrastructure deployment, through reform of tower-siting, pole-attachment, and wireless-backhaul rules.

- Release of the most significant amount of unlicensed spectrum in 25 years, robust spectrum that will enable innovations like super Wi-Fi and increased broadband access in both urban and rural communities.
- Continued movement toward the Plan's goal of unleashing 500 megahertz of spectrum for mobile broadband, by repurposing 25 megahertz previously used only for fixed services and revisiting restrictions on 90 megahertz of mobile satellite spectrum so it can be used for terrestrial broadband.

We will continue to highlight broadband's job-creating power. As an example of this potential, during this past year I had the privilege of joining business leaders from Jobs4America – a coalition of call center companies – in Jefferson, Indiana, to announce the creation of 100,000 new broadband-enabled call center jobs over the next two years in the U.S., helping to revive some of the communities hardest hit by the economic downturn. Many of these call center jobs will be brought on-shore from foreign countries and can be performed at a new call center or through connectivity at home.

We have also continued to empower Native Nations to access and use the latest technologies to grow their businesses, increase their access to quality health care and education, reach 911 during emergencies, and receive public alerts and warnings. In particular, the Commission initiated a proceeding to address a number of issues related to improving communications services for Native Nations, including greater broadband deployment, the need for a uniform definition of Tribal lands to be used agency-wide in rulemakings, and strengthening the FCC's nation-to-nation consultation process with Native Nations. The Commission also initiated a proceeding to expand the efficient use of spectrum over Tribal lands so as to improve access to mobile wireless communications.

In addition to these accomplishments, I have worked with the committed and talented staff of the FCC to build upon prior efforts in making the agency a "model of excellence" in government. Some key highlights include my announcement in July of this year, along with industry and public interest leaders, of the new FCC Technology Experience Center (TEC). The TEC is an innovative on-site resource for FCC employees to experience the latest in communications technology, including technology related to key broadband-enabled applications such as education, telemedicine, small business productivity, public safety, and more. Each month, a section of the TEC features a specific type of communications innovation. We are living in a broadband revolution with massive investment and innovation in the communications and technology space. The TEC serves as a window into that world, enabling the FCC staff to stay on the cutting edge and help drive innovation in the broadband ecosystem.

The FCC also launched a complete overhaul of the agency's web site - FCC.gov. Now architected with a more intuitive user experience and the addition of Web 2.0 technologies, the new site improves and simplifies the FCC.gov experience for consumers, government, public safety agencies, and the business community. The launch of the new site marks a significant step in my initiatives to continuously improve and modernize the way the public interacts with the Commission. The FCC's new media team will continue updating the FCC.gov site with the help of public engagement, including through feedback from the agency's social media outlets.

Other important initiatives from FY 2011 include ways to better serve the public through reducing unnecessary administrative burdens. For instance, we adopted rules enabling all tariff filers to file electronically, which creates a more open, paperless, transparent, and efficient flow of information to the public, and will benefit the public, carriers, and the Commission by creating a uniform system providing online access to all carrier tariffs filed with the Commission. The Commission also continued executing on its regulatory reform goal of removing unnecessary burdens on businesses, by systematically eliminating outdated and obsolete rules.

In closing, please note that a more comprehensive report about the FCC's FY 2011 accomplishments will be included in the FCC's FY 2011 Annual Performance Report, which will be released in February 2012 with the FCC's annual budget submission. The Agency Financial Report that follows contains the FCC's FY 2011 financial statements and other management highlights; the information contained therein is reliable and complete.

Julius Genachowski
Chairman
November 14, 2011

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1. Management's Discussion and Analysis

Overview of the FCC

INTRODUCTION

The revised OMB Circular A-136, released on October 27, 2011, states that agencies may choose to either produce a consolidated Performance and Accountability Report, or a separate Agency Financial Report (AFR) and an Annual Performance Report (APR). The Federal Communications Commission (Commission or FCC) has chosen to produce the AFR as an alternative to the consolidated Performance and Accountability Report. The Commission will include its FY 2011 APR with its Congressional Budget Justification and will post it on the Commission website at http://transition.fcc.gov/omd/strategicplan/ by February 6, 2012.

The AFR includes three sections. AFR Section 1 contains Management's Discussion and Analysis (MD&A) which presents an overview of the Commission, including the agency's organizational chart, map of the field offices, strategic goals and objectives, strategies and resources to achieve goals, components of the Commission for financial statement purposes, work on eliminating and recovering improper payments, performance highlights, management assurances, and a financial discussion and analysis.

AFR Section 2 contains the agency's financial information. This section contains the letter from the chief financial officer (CFO) summarizing planned timeframes for correcting audit weaknesses and non-compliances, major impediments to correcting audit weaknesses and non-compliances, and progress made in correcting previously reported problems. Additionally, this section contains the independent auditors' report, the Commission's response to the independent auditors' report, the financial statements, the notes to the financial statements and required supplementary information.

AFR Section 3 presents other accompanying information such as a summary of financial statement audit results, a summary of management assurances, details on reporting improper payments pursuant to the Improper Payments Information Act (as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA)), management and performance challenges from the Office of Inspector General, and management's response to such challenges.

ABOUT THE FCC

The FCC is an independent regulatory agency of the United States (U.S.) Government. The Commission was established by the Communications Act of 1934 and is charged with regulating interstate and international communications by radio, television, wire, satellite, and cable. The Commission also regulates telecommunications services for hearing-impaired and speech-impaired individuals, as set forth in Title IV of the Americans with Disabilities Act (ADA). The Commission's headquarters is located in Washington, D.C., with three regional offices, sixteen district offices, and eight resident agent offices throughout the nation.

Five Commissioners direct the work of the FCC. All five Commissioners are appointed by the President and confirmed by the Senate for five-year terms, except when filling the unexpired term of a previous Commissioner. Only three Commissioners can be of the same political party at any given time and none can have a financial interest in any company or entity that has a significant interest in activities regulated by the Commission. The President designates one of the Commissioners to serve as Chairman.

The Chairman and the Commissioners at the end of FY 2011 were:

- Chairman Julius Genachowski
- Commissioner Michael J. Copps
- Commissioner Robert M. McDowell
- Commissioner Mignon Clyburn
- Vacant Commissioner

Pictured from left to right are Commissioner Clyburn, Commissioner Copps, Chairman Genachowski, and Commissioner McDowell.

MISSION AND ORGANIZATIONAL STRUCTURE

As specified in section 1 of the Communications Act, the Commission's mission is to "…make available, so far as possible, to all the people of the United States, without discrimination on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." [1] In addition, section one provides that the Commission was created "for the purpose of the national defense" and "for the purpose of promoting safety of life and property through the use of wire and radio communication."[2]

[1] 47 U.S.C. § 151.
[2] *Id.*

The FCC Chairman leads the Commission as head of the agency. In order to accomplish its strategic plan, the FCC is organized by function. There are seven Bureaus and ten Offices. The seven Bureaus and the Office of Engineering and Technology process applications for licenses to operate facilities and provide communication services (in specific locations and on specific radio frequencies), analyze complaints from citizens and other licensees, conduct investigations, develop and implement regulatory programs, and participate in hearings. Generally, the nine other Offices provide specialized support services. Bureaus and Offices regularly join forces and share expertise in addressing FCC-related issues.

There are seven Bureaus and ten Offices. These are:

The Bureaus

- The Consumer and Governmental Affairs Bureau develops and implements the FCC's consumer policies, including disability access. The Bureau serves as the public face of the Commission through outreach and education, as well as through the Consumer Center, which is responsible for responding to consumer inquiries and complaints. The Bureau also maintains collaborative partnerships with state, local, and tribal governments in such critical areas as emergency preparedness and implementation of new technologies.

- The Enforcement Bureau enforces the Communications Act and the FCC's rules. The Bureau protects consumers, fosters efficient use of the spectrum, furthers public safety, and promotes competition.

- The International Bureau administers the FCC's international telecommunications and satellite programs and policies, including licensing and regulatory functions. The Bureau also has a unique role in promoting pro-competitive policies abroad, coordinating the Commission's global spectrum activities, and advocating U.S. interests in international communications and competition. The Bureau works to promote a high quality, reliable, globally interconnected, and interoperable communications infrastructure.

- The Media Bureau recommends, develops, and administers the policy and licensing programs relating to electronic media, including radio and broadcast, cable, and satellite television in the United States and its territories.

- The Public Safety and Homeland Security Bureau supports initiatives that strengthen public safety and emergency response capabilities to better enable the FCC to assist the public, law enforcement, hospitals, communications industry, and all levels of government in the event of a natural disaster, pandemic, or terrorist attack.

- The Wireless Telecommunications Bureau is responsible for wireless telecommunications programs and policies in the United States, including licensing of wireless communications providers. Wireless communications services include cellular, paging, personal communications, and other radio services used by businesses and private citizens. The Bureau also conducts auctions of licenses for the communications spectrum.

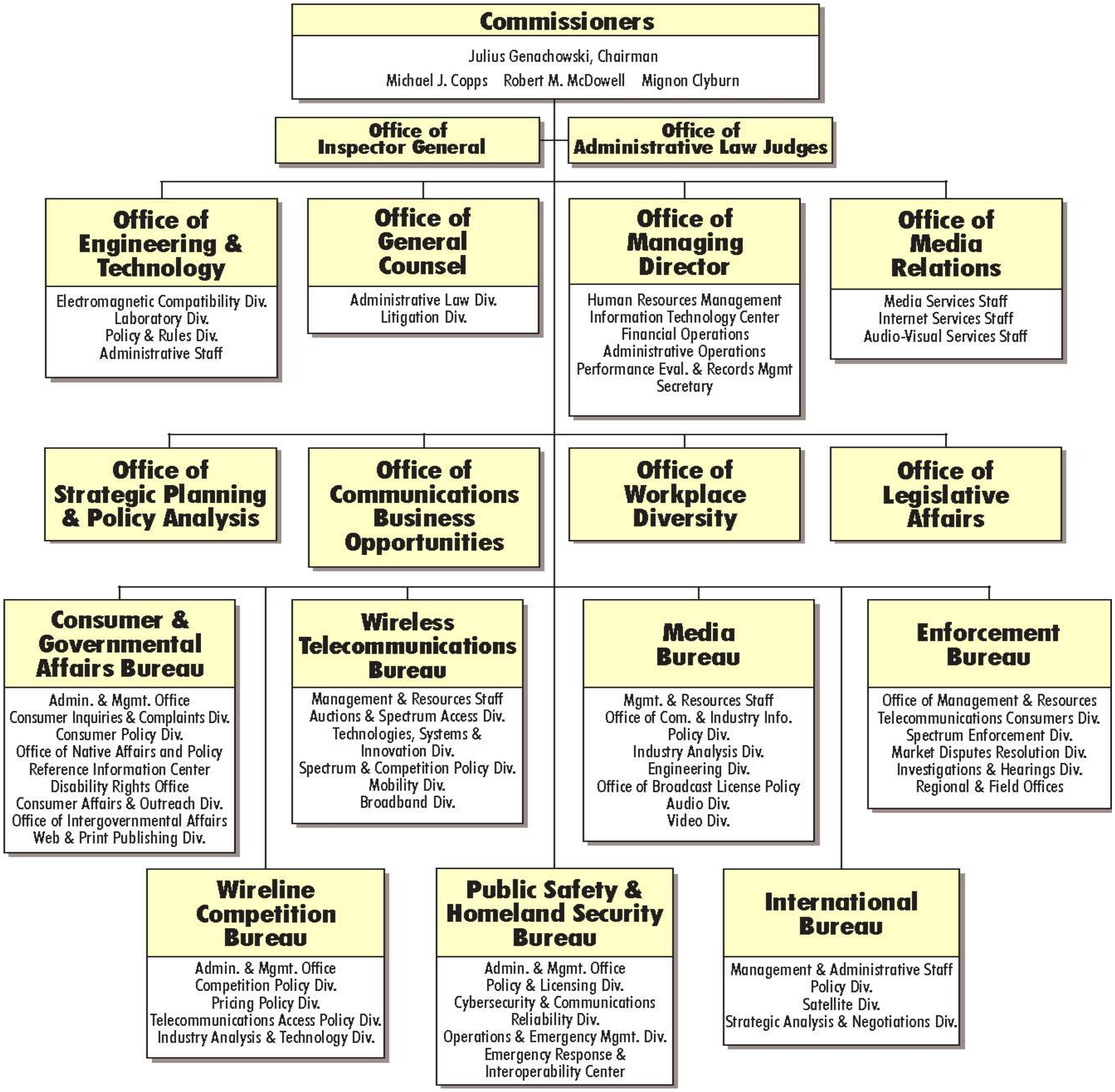
- The Wireline Competition Bureau develops and recommends policy goals, objectives, programs, and plans on matters concerning wireline telecommunications. It strives to ensure choice, opportunity, and fairness in promoting the development and widespread availability of wireline telecommunications services.

The Offices

- The Office of Administrative Law Judges is composed of judges who preside over hearings and issue decisions on matters referred to them by the Commission.
- The Office of Communications Business Opportunities promotes competition and innovation in the provision and ownership of telecommunication services by supporting opportunities for small businesses as well as women- and minority-owned communications businesses.
- The Office of Engineering and Technology advises the Commission on technical and engineering matters. The Office develops and administers FCC decisions regarding spectrum allocations, and grants equipment authorizations and experimental licenses.
- The Office of General Counsel serves as the Commission's chief legal advisor.
- The Office of Inspector General conducts and supervises audits and investigations relating to FCC programs and operations.
- The Office of Legislative Affairs serves as the liaison between the FCC and Congress, as well as other federal agencies.
- The Office of Managing Director administers and manages the FCC.
- The Office of Media Relations informs the media of FCC decisions and serves as the FCC's main point of contact with the media.
- The Office of Strategic Planning and Policy Analysis works with the Chairman, Commissioners, Bureaus, and Offices in strategic planning and policy development for the agency. It also provides research, advice, and analysis of complex, novel, and non-traditional economic and technological communications issues.
- The Office of Workplace Diversity ensures that the FCC provides employment opportunities for all persons regardless of race, color, sex national origin, religion, age, disability, or sexual preference.

Detailed information on specific bureau and office responsibilities can be found in Title 47 of the Code of Federal Regulations and on the Commission's web site at: http://www.fcc.gov.

FCC ORGANIZATIONAL CHART



MAP OF FIELD OFFICES

The Commission's headquarters is located in Washington, D.C., with three regional offices, sixteen district offices, and eight resident agent offices throughout the Nation. The regional and district offices and resident agents are responsible for carrying out on-scene investigations, inspections, audits, and other matters, including matters that are the subject of field complaints and that are referred to them from within the Enforcement Bureau or by other bureaus and offices. These functions include immediate response to safety of life issues, interference resolution, investigation of violations in all communication services, surveys for compliance or feedback to the rulemaking process, local assistance to other agencies or countries in communications matters, representation of the Commission to groups, organizations, and international contacts at a local level, and other matters as may be assigned by the Enforcement Bureau Chief. As appropriate, the field offices refer matters to or coordinate with other divisions within the Enforcement Bureau. Below is a map of all Commission district offices and resident agent locations, including the Equipment Development Group (EDG) which designs, develops, and constructs radio direction-finders and other specialized equipment for use in spectrum enforcement, interference resolution, and other technical activities of the Enforcement Bureau.

STRATEGIC GOALS AND OBJECTIVES

In FY2011, the Commission adopted revised strategic goals for FYs 2011-2016. (The Strategic Goals can be found on the Commission's website at: http://www.fcc.gov/encyclopedia/financial-information). The strategic goals and performance goals shown below reflect those revisions.

BROADBAND	Work to ensure that all Americans have access to reliable and affordable high-speed fixed and mobile broadband capability.
COMPETITION AND INNOVATION	Promote a competitive dynamic for communications and media services that fosters research, innovation and job creation, and presents consumers with reliable, meaningful choice in affordable services.
INTERNATIONAL	Commit to greater international engagement and cooperation.
CONSUMERS	Empower consumers by ensuring that they have the tools and information needed to make the market work and challenge unfair business practices.
PUBLIC SAFETY AND HOMELAND SECURITY	Promote the availability of reliable, interoperable, redundant, rapidly restorable critical communications infrastructures that are supportive of all required services.
CONTINUAL IMPROVEMENT	Make the FCC a model for excellence in government by being data-driven in our decision making and committing to a transparent and participatory process that encourages public involvement and feedback.

STRATEGIES & RESOURCES TO ACHIEVE GOALS

The Commission has identified strategies and resources to achieve its performance goals for each strategic goal. Details on the Commission's strategies and resources for achieving its strategic goals are included in the Commission's strategic plan at: http://www.fcc.gov/omd/strategicplan.

COMPONENTS OF THE FCC FOR FINANCIAL STATEMENT PURPOSES

In addition to the activities directly undertaken by the above bureaus and offices, the Commission components for financial statement purposes include:

Universal Service Fund (USF) - The Telecommunications Act of 1996 further amended the Communications Act of 1934 to codify and modify the Commission's longstanding policy of promoting universal telecommunications service throughout the nation. Pursuant to section 254, the Commission established rules and regulations governing how certain telecommunications service providers contribute to the USF and how those monies are disbursed.[3]

[3] 47 U.S.C. § 254.

For budgetary purposes, the USF comprises five elements that consist of four universal service support mechanisms and the Telecommunications Relay Service (TRS) Fund. The TRS Fund represents a program established under section 225 of the Act. This statute provides for a mechanism to support relay services necessary for telecommunications access by speech or hearing impaired populations.[4]

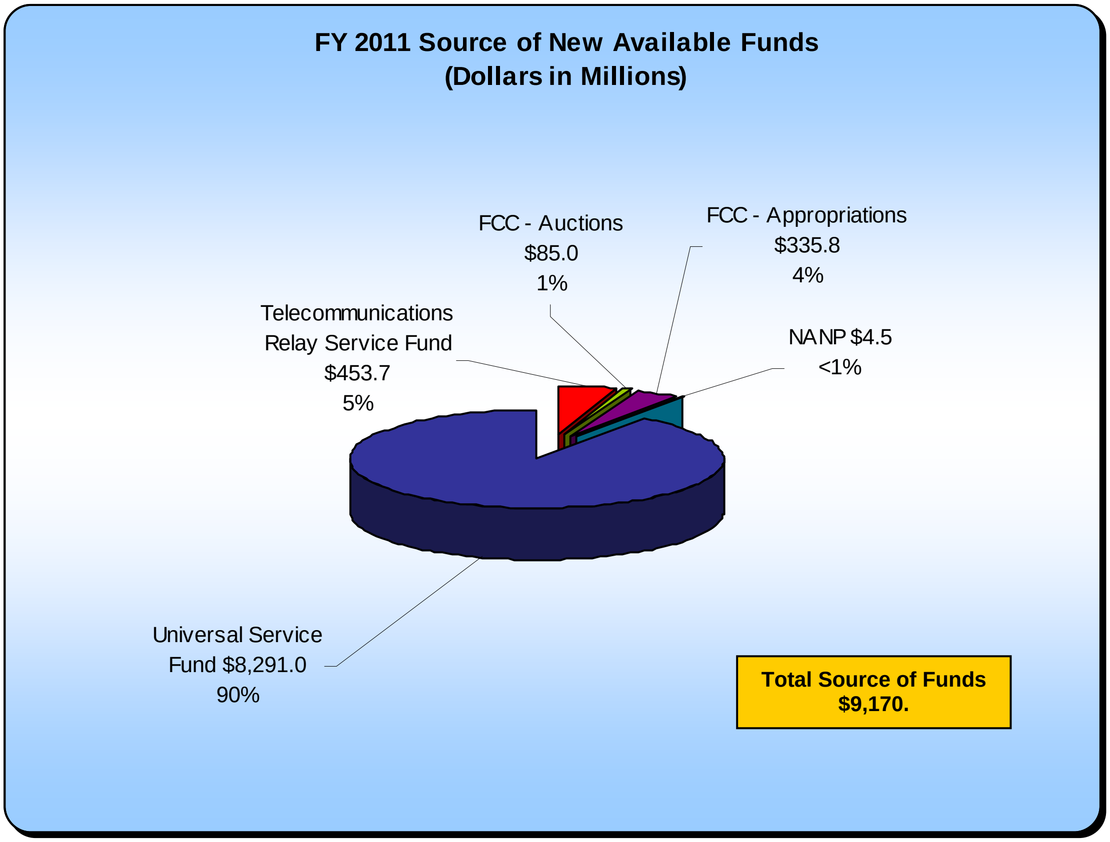
The Universal Service Administrative Company (USAC) administers the four universal service support mechanisms of the USF under the Commission's direction. These support mechanisms are funded through mandatory contributions from U.S. telecommunications service providers, including local and long distance phone companies, wireless and paging companies, payphone providers, and providers of interconnected Voice over Internet Protocol (VoIP) services. The four universal service support mechanisms are: High Cost, Low Income, Rural Health Care, and Schools and Libraries. These support mechanisms provide money directly to service providers to defray the cost of serving customers in high cost and rural areas, and to defray the costs of serving low income consumers as well. In addition, these mechanisms provide support for discounts to schools and libraries and rural health care providers. In FY 2011, the USF accounted for approximately $8.3 billion in new available funds on the Commission's Combined Statement of Budgetary Resources. Additional information on USAC and the USF, respectively, can be found at http://www.usac.org and http://www.fcc.gov/wcb/tapd/universal_service/welcome.html.

During FY 2011, the Commission awarded a firm fixed price contract to administer the TRS Fund to Rolka Loube Saltzer Associates, LLC (RLSA). Prior to this award, the administrator was the National Exchange Carrier Association (NECA). The TRS Fund compensates TRS providers for the reasonable costs of providing interstate telephone transmission services that enable a person with a hearing or speech disability to communicate with a person without hearing or speech disabilities. The costs of providing interstate TRS are recovered from subscribers of interstate telecommunications services. In FY 2011, TRS accounted for approximately $453.7 million in new available funds on the Commission's Combined Statement of Budgetary Resources. Additional information on RLSA and TRS can be found at http://www.rlsa.com/ and http://www.fcc.gov/cgb/dro/trs.html.

North American Numbering Plan (NANP) - The NANP is the basic numbering scheme permitting interoperable telecommunications service within the U.S., Canada, Bermuda, and most of the Caribbean. Section 251(e)(1) of the Act requires the Commission to create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis. Section 251(e)(2) of the Act requires that the costs of number administration and number portability be borne by all telecommunications carriers on a competitively neutral basis, as determined by the Commission. In implementing section 251, the Commission appointed a NANP Administrator (NANPA), a national Pooling Administrator (PA) to administer thousands block number pooling, and a Billing and Collection Agent. The Commission selected Welch LLP to be the Billing and Collection Agent for the NANP effective October 1, 2004. In FY 2011, the NANP accounted for approximately $4.5 million on the Commission's Consolidated Statement of Net Cost. Additional information on the NANPA and the Billing and Collection Agent can be found at http://www.fcc.gov/wcb/cpd/numbering/ and http://www.nanpa.com.

[4] 47 U.S.C. § 225.

For further clarification on the financial relationships between the Commission and these components, see Note 1 of the financial statements in section 2. Also, see the chart below which shows the relative size of the component funds in comparison to the major sources of funds for the Commission.



The Appropriations figure of $335.8 million in the chart above reflects the authority for the Commission to collect regulatory fees. (For additional information, see Note 1 of the financial statements in section 2.)

ELIMINATING AND RECOVERING IMPROPER PAYMENTS

In response to the Improper Payments Elimination and Recovery Act of 2010 (IPERA), the Commission has performed risk assessments of its programs, formulated corrective action plans, and made significant efforts to reduce improper payments. In addition, the Commission initiated a payment recapture program, completing 37 audits involving overpayments. Section 3 provides further details on these efforts.

Performance Highlights

Consistent with the objectives of the Communications Act as amended, as well as the Government Performance and Results Act, the Federal Communications Commission (FCC) identified six strategic goals. The strategic goals serve as guidance directing the actions and performance of the FCC. The Commission assesses the achievement of its performance through the accomplishment of its performance goals. Progress toward accomplishing these goals is measured by the progress and completion of various programs and initiatives during the fiscal year. There are external influences, including economic, legal, and organizational factors beyond the Commission's programs and initiatives that may influence whether the Commission fully meets every performance goal.

During the past fiscal year, the Commission made significant progress toward accomplishing its performance goals. Greater detail on these accomplishments will be discussed in the FCC Annual Performance Report (APR) for FY 2011. The Commission will include the FY 2011 APR with its Congressional Budget Justification and will post it on the Commission web site at http://transition.fcc.gov/omd/strategicplan/ in February 2012. In the discussion below, we identify achievements in the Commission's major initiatives during the past fiscal year, organized by Strategic Goal.

BROADBAND

Work to ensure that all Americans have increased access to robust, reliable, and affordable broadband with universal broadband as our ultimate goal.

Broadband has become the engine driving economic opportunity for individuals, small businesses, and communities. It enables existing businesses to boost productivity and efficiency, reach customers in new markets, and develop new products and services, thus expanding markets to reach customers across the U.S. Broadband expansion lowers costs for businesses, thanks to new services like cloud computing, which in turn increases revenue and creates new jobs. Broadband invites investment, which also leads to jobs. Companies like Groupon and Living Social have created nearly 10,000 jobs over the last few years and spurred millions of dollars in new investment. In order to continue this trend and further spur the economy, broadband deployment and adoption has been a central focus of the FCC.

Those without access to broadband are becoming more isolated from the modern American economy. The latest *Broadband Progress Report* issued by the FCC in May found that approximately 26 million Americans, mostly in rural communities located in every region of the country, are denied access to the jobs and economic opportunity made possible by broadband. While the infrastructure of high-speed Internet is unavailable to those Americans, the FCC report also found that approximately one-third of Americans do not subscribe to broadband, even when it's available. This suggests that barriers to adoption, such as cost, low digital literacy, and concerns about privacy, remain too high. Notwithstanding these continuing challenges, significant progress has been made over the past few years. Despite the difficult economy, the private sector continues to invest tens of billions of dollars in broadband infrastructure each year ($65 billion in capital expenditures in 2010 alone), expanding capacity, increasing speeds, and rolling out next-generation mobile services like 4G.

In 2009, the FCC launched a public process to determine what actions might be necessary to preserve the characteristics that have allowed the Internet to grow into an indispensable platform supporting our nation's economy and civic life, and to foster continued investment in the physical networks that enable the Internet. Through a public rulemaking process that included input from more than 100,000 individuals and organizations and several public workshops, the Commission adopted rules to preserve and protect the Internet as an open network enabling consumer choice, freedom of expression, user control, competition, and the freedom to innovate. The new rules require all broadband providers to publicly disclose network management practices, restrict broadband providers from blocking lawful Internet content and applications, and bar fixed broadband providers from engaging in unreasonable discrimination in transmitting lawful network traffic. The rules ensure much-needed transparency and continued Internet openness, while making clear that broadband providers can effectively manage their networks and respond to market demands. The rules also ensure that consumers are able to file complaints, and that formal complaint and mediation procedures are available for complex disputes in this area.

The Commission addressed the affordability and availability of broadband services by adopting rules to streamline access and reduce costs for attaching broadband lines and wireless antennas to utility poles across America, a key component of broadband infrastructure. The FCC found that the lack of timelines for access to poles, the resulting potential for delay in attaching broadband equipment to poles, and the absence of adequate mechanisms to resolve disputes create uncertainty that deters investment in broadband networks. In addition, widely varying and inefficiently high pole rental rates, from an average of $7 per foot per year for cable companies to $20 or more for some telephone companies, further discourages broadband deployment. To address these concerns, the FCC comprehensively reformed its pole attachment rules for the first time since the 1990s. The rules fairly compensate utility pole owners for use of their poles and toughen penalties which will deter potentially dangerous unauthorized attachments on poles.

The explosive growth in mobile communications threatens to outpace the infrastructure on which it relies. Specifics of this situation were detailed in an FCC white paper entitled, "Mobile Broadband: The Benefits of Additional Spectrum." This technical and economic forecast of mobile broadband market trends detailed the looming spectrum crunch in a concrete, data-driven fashion. Key findings of the paper were that mobile broadband growth is likely to outpace the ability of technology and network improvements to keep up by an estimated factor of three, and within the next five years the spectrum deficit is likely to approach 300 megahertz.

An important step was taken by the Commission to meet the nation's demand for innovative wireless broadband services by adopting a Notice of Proposed Rulemaking (NPRM) proposing that wireless broadband providers have equal access to television broadcast frequencies that could become available in spectrum auctions. The proposed rules would enable television broadcasters to opt to share channels by further tapping the technical capabilities that became available following the nation's historic transition to digital television in 2009.

In September, the FCC announced a 45-day public trial of a database system to identify unused television band channels that are available for unlicensed TV band devices. Unused spectrum between TV stations, called white spaces, represents a valuable opportunity for the wireless mobile landscape. This block of spectrum is a powerful platform for innovation and experimental use, holding rich potential for research and commercial purposes. The result of white spaces innovation has already led to a wave of new consumer technologies, including Wi-Fi and other innovations like baby monitors and cordless phones, that have generated billions in economic growth.

The FCC released a report during FY 2011 on the state of broadband connectivity at schools and libraries receiving funds from the federal E-rate program, which provides support to help connect schools and libraries to the Internet. The report is based on data from a survey conducted in 2010 that examined the success and challenges related to broadband use faced by schools and libraries. The survey found that while almost all survey respondents have some broadband capabilities, nearly 80% of all survey respondents say their broadband connections do not fully meet their current needs. Slow connection speed was the primary reason current Internet connectivity does not meet the needs for 55% of these respondents. This is a growing concern for schools, as 56% of the survey respondents expect to implement or expand the use of digital textbooks in the next two to three years, and 45% expect to implement or expand the use of handheld devices for educational purposes.

The agency launched an innovative program during FY 2011 for schools and libraries in 14 states, aimed at giving participating students in grades K through 12 off-premises connections to the Internet to increase access to digital textbooks, cutting-edge interactive learning tools, and other innovative wireless technologies. The new FCC wireless pilot project, "Learning On-The-Go," will provide up to $9 million for schools and libraries selected for the 2011-2012 funding year. The selected projects include initiatives to improve off-campus access to e-textbooks for students; connectivity for netbooks for students living in remote, isolated areas; and access to flexible, online education programs for home-bound students unable to attend classes. Mobile learning devices enable educators to tailor school curriculum and interactive learning to students' skill sets. Digital textbooks never go out of date and students will have greater opportunities to access the latest educational curriculum available. Digital tools also help parents, allowing them to better monitor and evaluate how their children are doing and where they need more help. Learning-On-The-Go is one of a series of initiatives in the FCC Education Agenda to modernize the E-rate program to help bring fast, affordable Internet access to schools and libraries across the country. The FCC also opened the door to "School Spots" where schools have the option to provide Internet access to the local community after students go home, which can bring the benefits of super-fast broadband to people who otherwise lack access to the Internet.

In a March 2011 NPRM, the Commission proposed to create a Low Income Broadband Pilot program to evaluate whether and how the Universal Service Fund's Lifeline program could effectively support broadband adoption by low-income households. The pilot program would gather statistically significant data to allow the Commission, broadband providers, and the public to identify the most cost effective way to use Lifeline funds to increase broadband adoption and retention among low-income Americans.

A recent FCC survey found that 80 percent of consumers did not know the speed of the broadband service they purchased from their Internet Service Provider. Even if consumers examine their bills, details about broadband speed often remain unclear. As a result, in conjunction with the release of an FCC report titled "Measuring Broadband America," the agency initiated new consumer resources, including an online "Broadband Speed Guide" and a consumer's guide on "Broadband Service for the Home," to help Americans better understand broadband speeds, assess their home needs, choose the right package, and continuously evaluate broadband performance. The report found that, for most major wireline broadband providers, actual speeds are generally 80%-90% of advertised speeds or better, although performance varies by technology and service provider. By shining a spotlight on actual versus advertised speeds, the FCC is ensuring accountability, increasing transparency and enhancing competition in the marketplace. If consumers make informed choices, companies will likely invest in new products, services, and business models to compete more aggressively and offer greater value.

The FCC continued its efforts to increase broadband deployment and adoption on Tribal lands by creating the Native Nations Broadband Task Force with representatives from 19 tribes with unique knowledge about telecommunications challenges on Tribal lands. The Task Force will be responsible for assisting in developing and executing a Commission consultation policy, eliciting input to ensure that Native concerns are considered in all Commission proceedings related to broadband, developing additional recommendations for promoting broadband deployment and adoption on Tribal lands, and coordinating with external entities, including other federal departments and agencies. Commission staff met with representatives of Alaska Native Telephone Cooperatives and Hawaiian homeland telecommunication officials to learn more about the unique issues facing broadband deployment on the Hawaiian Islands and in the State of Alaska.

COMPETITION AND INNOVATION

Promote a competitive dynamic for communications and media services that fosters research, innovation, and job creation, and presents consumers with reliable, meaningful choice in affordable services.

Ubiquitous broadband infrastructure has become crucial to our nation's economic development and civic life. Businesses need broadband to start and grow, adults need broadband to find jobs, and children need broadband to learn. But the FCC's primary tools for meeting the great infrastructure challenge of our time, bringing robust affordable broadband to all Americans, are locked in the last century. The Universal Service Fund (USF), which helped connect rural America to telephone service, fails to effectively and efficiently target support for broadband in rural areas. USF has also become wasteful and inefficient in some situations, paying over $20,000 a year – nearly $2,000 per month – in support per line for some households, while providing little or no support in other communities that lack broadband. USF is intertwined with the complex system of payments between carriers called intercarrier compensation (ICC). The system is rooted in outdated distinctions between local and long-distance telephone service, and inefficient per-minute charges. The ICC system also suffers from loopholes that can distort markets and may derail investment in advanced Internet Protocol (IP) networks.

Building on recommendations contained in the National Broadband Plan and extensive input from a wide array of stakeholders, the Commission adopted a NPRM proposing four key principles to guide reform. First, modernize and refocus USF and ICC to make affordable broadband available to all Americans and accelerate the transition from circuit-switched to IP networks, with voice ultimately one of many applications running over fixed and mobile broadband networks. Second, control the size of USF as it transitions to support broadband by combating waste and inefficiency. American consumers and businesses ultimately pay for USF. Third, require accountability from companies receiving support to ensure that public investments are used wisely to deliver intended results. Government must also be accountable for the administration of USF, including through clear goals and performance metrics for the program. Fourth, transition to market-driven and incentive-based policies that encourage companies to maximize the impact of scarce program resources and benefits to all consumers.

On February 8, 2011, the Commission proposed to modernize and streamline its USF and ICC policies to bring affordable wired and wireless broadband to all Americans while combating waste and inefficiency. Under the proposal, the FCC would create a Connect America Fund (CAF) to quickly and efficiently deliver support to unserved areas. Using market-based policies to support providers in a technology-neutral manner, the CAF would embody areas where broadband funding will have the biggest impact. The CAF would adopt clear performance goals and metrics, require increased disclosures about the operating performance and financial condition of companies that receive support, and increase transparency, oversight, and accountability. Intercarrier compensation would also be reformed to close loopholes to prevent exploitation of existing rules by carriers to earn unjust and unreasonable compensation. The proposal would gradually reduce per-minute intercarrier compensation charges that create incentives for carriers to maintain legacy networks that maximize intercarrier revenues rather than investing in advanced, efficient IP-based infrastructure.

Consistent with a key recommendation of the FCC's National Broadband Plan, the CAF would also include a new Mobility Fund to provide support to accelerate our nation's ongoing efforts to close gaps in mobile wireless service. Despite wireless providers' efforts, millions of Americans still live, work, and travel in areas where these advanced services are unavailable. The proposed Mobility Fund will help improve coverage for current-generation mobile wireless service.

Another USF program under reform in FY 2011 is the Lifeline/Link Up program. This program has provided low-income households with discounts on monthly phone bills and initial installation charges since 1985. But program rules and administration have not kept pace with significant changes in technology, markets, and regulations. A NPRM adopted in March took steps to comprehensively reform and modernize the program for 21st century communications needs, including strengthening protections against waste, fraud and abuse. Then in June, the Commission imposed changes in the program to ensure that multiple carriers do not get support for serving the same consumer. After determining through enhanced oversight that some subscribers have Lifeline-subsidized phone service from multiple carriers, the FCC clarified that its rules expressly bar more than one benefit per subscriber. The action will save potentially millions of dollars per year, helping ensure that Lifeline can reach as many low-income consumers as possible.

Vigilant management and oversight of the E-rate program led to a civil settlement with Hewlett Packard (HP) for alleged E-rate fraud. This followed an extensive investigation by the FCC and the Department of Justice (DOJ). Acting on tips from whistleblowers, the FCC and the DOJ investigated allegations that contractors working with HP and other companies lavished gifts on personnel from two Texas school districts in order to get contracts that included some $17 million in HP equipment. Contractors provided meals and entertainment, including trips on a yacht and Super Bowl tickets, to school personnel to get inside information and win contracts that were supposed to be awarded through a competitive bidding process. As part of the settlement, HP agreed to pay the government $16.25 million, most of which will be returned to the E-rate program. In addition, the FCC has negotiated and will oversee a compliance agreement with HP that will ensure that the company plays by the rules in the future.

While proposed mergers of media or communications firms are becoming commonplace, the FCC conducts thorough reviews of each transaction to ensure that the public interest is protected. In January, the Commission granted approval, with conditions and enforceable commitments, to assignments and transfers of control of broadcast, satellite, and other radio licenses from General Electric (GE) to Comcast. The approval allowed GE and Comcast to create a joint venture involving NBC Universal (NBCU) and Comcast. As part of the merger, Comcast-NBCU is required to take affirmative steps to foster competition in the video marketplace. In addition, Comcast-NBCU will increase local news coverage to viewers; expand children's programming; enhance the diversity of programming available to Spanish-speaking viewers; offer broadband services to low-income Americans at reduced monthly prices; and provide high-speed broadband to schools, libraries and underserved communities, among other public benefits.

Other measures that the Commission took to promote competition in the video distribution marketplace included the issuance of three Report and Orders, and a Public Notice to implement the new statutory requirements of the Satellite Television Extension and Localism Act (STELA). STELA provides the framework for satellite carriage of local television stations. The Commission’s actions provided satellite subscribers with greater programming choices and improved parity and competition between satellite and cable carriage of broadcast stations. The Commission also proposed rules to improve the procedures for the filing and resolution of carriage complaints filed by video programming vendors.

In March, the Commission approved the merger of CenturyLink and Qwest Communications International. In doing so, the Commission imposed protections against the risk of harm to competition, and ensured the merged entity will live up to its commitments to significantly expand its network and launch a major broadband adoption program for low-income consumers. These commitments include significantly increasing the capacity of the Qwest network, bringing broadband with actual download speeds of at least 4 Megabits per second to at least four million more homes and businesses, and at least 20,000 more anchor institutions, such as schools, libraries, and community centers. The merged entity also agreed to significantly increase the availability of higher-speed broadband by more than doubling the number of homes and businesses that can get 12 Megabits per second broadband, and more than tripling the number that can get 40 Megabits per second broadband.

The Commission launched two proceedings during the fiscal year that will help to promote investment and create jobs in developing innovative spectrum-efficient technologies and services to help meet the growing demand for wireless broadband services. The first action is a NPRM that seeks to expand the FCC's existing Experimental Radio Service rules to promote cutting-edge research and foster development of new wireless technologies, devices, and applications. Specifically, the Commission proposed a new type of license, called a "program license," which would give qualified entities broad authority to conduct research without the need to seek new approval for each individual experiment. The second action is a NOI to promote wireless innovation by examining how dynamic access radios and techniques, which use technology to squeeze the most use out of available spectrum, can provide more intensive and efficient use of spectrum. The Commission sought comment on how to advance these technologies, whether by creating test-beds or modifying spectrum management practices and policies for future uses of both licensed and unlicensed devices and services.

To comply with its obligations under the National Environmental Policy Act, the FCC commenced a Programmatic Environmental Assessment (PEA) of its Antenna Structure Registration (ASR) program. The purpose of the PEA is to evaluate the potential environmental effects of the ASR program. Under the program, owners of antenna structures that are taller than 200 feet above ground level or that may interfere with the flight path of a nearby airport must register those structures with the FCC. The antenna structure owner must obtain painting and lighting specifications from the Federal Aviation Administration and include those specifications in its registration prior to construction. The Commission is undertaking the PEA in response to the determination of the Court of Appeals for the District of Columbia Circuit in *American Bird Conservancy v. FCC* that registered towers may have a significant environmental effect on migratory birds.

In March, the FCC released reports on Internet access service connections and telephone subscribership in the U.S. Titled *Internet Access Services* and *Local Telephone Competition*, the two reports are based on data submitted by carriers every six months. The reports track changes at the state and national level in the number of subscribers to Internet access service in 72 different combinations of speed tiers, and the number of wireline, mobile, and interconnected VoIP telephone subscribers.

INTERNATIONAL

Commit to greater international engagement and cooperation.

The Commission adopted a NPRM to eliminate outdated regulations governing agreements between U.S. and foreign carriers for delivering international phone traffic, and to seek comment on other ways to protect against anticompetitive conduct by monopolistic foreign carriers. Established over eighty years ago, the International Settlements Policy (ISP) ensured fair treatment for U.S. carriers negotiating agreements with foreign carriers with market power. However, over the past fifteen years, global competition has significantly increased, new alternative traffic routing possibilities have emerged, and the average U.S. calling price for international phone calls has fallen from $0.74 per minute to $0.08 per minute. These changes have made the ISP less relevant and necessary to ensure fair competition. In some cases, the ISP may now be hindering attempts by U.S. carriers to negotiate agreements that reduce international telephone rates for American customers. This proposal would give U.S. carriers greater flexibility to negotiate agreements with foreign counterparts that reflect modern routing arrangements, resulting in lower rates for international calls.

As part of its Data Innovation Initiative, the Commission eliminated more than 25 outdated and unnecessary reporting requirements related to international telephone traffic and revenue, and sought comment on additional reforms to streamline and modernize remaining international data collections. In particular, the Commission eliminated the quarterly international traffic and revenue reporting requirements for large carriers and foreign-affiliated carriers, the annual circuit-addition report, and the telegraph toll division report. The Commission also eliminated the need to file separate international traffic and revenue reports for U.S. offshore points. The Commission concluded that the burdens to U.S. carriers of providing those reports now outweigh the benefits of this data.

During the fiscal year, the FCC reached arrangements with Industry Canada and Mexico's Secretariat of Communications and Transportation for sharing commercial wireless broadband spectrum in the 700 MHz band along the U.S.-Canadian and U.S.-Mexican border areas. This will facilitate the deployment of mobile wireless broadband systems near the U.S.-Canadian and U.S.-Mexican borders, and will provide consumers in these areas with advanced opportunities for 4G high-speed mobile broadband access. The FCC also reached an arrangement with Industry Canada for sharing spectrum in the 800 MHz band, which will pave the way for completion of 800 MHz rebanding by U.S. public safety and commercial licensees operating along the U.S.-Canadian border.

The FCC's International Bureau released the *International Broadband Data Report* in May, presenting comparative data on international broadband capability. The report provided data on broadband service plans and pricing in 38 countries (including the United States) representing a broad range of broadband markets, including countries of various sizes and population densities. The report results suggest a correlation between broadband adoption and (1) communities with larger populations, (2) communities with higher population density, and (3) communities with higher income. The data on average actual download speeds reported by consumers in U.S. and foreign cities show that some large European and Asian cities exhibit a significant edge over comparable U.S. cities in reported download speeds. Reported speeds for some other international cities, however, are roughly comparable to speeds in many U.S. cities.

CONSUMERS

Empower consumers by ensuring that they have the tools to make informed decisions and challenge unfair business practices.

The mobile broadband revolution is well under way. New mobile technologies are changing the way people live, driving our economy and creating jobs. Making sure consumers have the tools and information they need to navigate this changing landscape has been one of FCC Chairman Julius Genachowski's top priorities. During FY 2011, the FCC proposed new rules to help consumers by addressing wireless "bill shock," which an estimated 30 million Americans have experienced according to an FCC study. Wireless bill shock often results from international roaming charges that consumers run up without realizing they are doing so, or charges that accrue when consumers exceed the limits on their voice, text, or data plans. The FCC proposed rules that would require customer notification, such as voice or text alerts, when the customer approaches and reaches monthly limits that will result in overage charges; require mobile providers to notify customers when they are about to incur international roaming charges, and require mobile providers to clearly disclose any tools they offer to let customers set usage limits or review their usage balances. Toward the end of FY 2011, the FCC worked with industry leaders and CTIA – The Wireless Association to craft modifications to the wireless industry's Code of Conduct as an alternative to these proposed regulations. The result is a voluntary agreement, announced in the first few weeks of FY 2012, that ensures the same kinds of consumer protections that the FCC's proposed rules would have ensured. To help ensure compliance, Consumers Union and the FCC will work together to launch a new web portal on the FCC website that will allow the public to see what types of alerts are provided by each CTIA member.

Enforcement of the FCC's rules provides consumers with confidence that they are being protected from fraudulent and misleading practices. The FCC's Enforcement Bureau announced a historic consent decree with Verizon Wireless, including a record $25 million payment to the U.S. Treasury, regarding "mystery fees" the company charged its customers over the last several years. The payment was the largest in FCC history and the settlement concluded the agency's ten-month investigation into these overcharges. In addition to Verizon Wireless's payment to the Treasury, the company made refunds to approximately 15 million customers and ensured that consumers are no longer charged the mystery fees.

Similarly, the agency proposed a total of $11.7 million in penalties against four companies that appear to have unlawfully billed tens of thousands of consumers for unauthorized charges, a practice known as "cramming." Cramming occurs when a company places charges on a consumer's phone bill without authorization. These mystery fees typically range from $1.99 to as much as $19.99 per month. They are often buried in multi-page phone bills and have misleading labels that make it difficult for a consumer to detect them. The proposed penalties were issued against Main Street Telephone ($4,200,000); VoiceNet Telephone, LLC ($3,000,000); Cheap2Dial Telephone, LLC ($3,000,000); and Norristown Telephone, LLC ($1,500,000).

The Commission took action to protect Americans from "mystery fees" and "cramming" by proposing rules that would require landline telephone companies to notify subscribers clearly and conspicuously, at the point of sale, on each bill, and on their websites, of the option to block third-party charges from their telephone bills if the carrier offers that option. The proposed rules also strengthen the Commission's requirement that third-party charges be separated on bills from the telephone company's charges. In addition, both landline and wireless telephone companies would have to include a notice that consumers may file complaints with the FCC and provide the Commission's contact information for the submission of complaints.

The Commission works diligently to assist individual consumers. During this fiscal year, the Commission processed over 290,000 "informal" consumer complaints and responded to over 370,000 consumer inquiries. In addition, the Commission does educational outreach at major consumer and educational conventions such as AARP and the American Library Association.

In 2010, the FCC initiated a staff-level working group to identify trends and make recommendations on how the information needs of communities can be met in a broadband world. The working group included journalists, entrepreneurs, scholars, and government officials. The group interviewed more than 600 individuals and organizations, collected over 1,000 public comments, reviewed existing research, held multiple hearings and made site visits to newsrooms across the country. On June 9, 2011, the group issued an in-depth analysis of the current state of the media landscape along with a broad range of recommendations. The staff-level report, titled *Information Needs of Communities: The Changing Media Landscape in a Broadband Age*, found that the Internet has enabled an unprecedented free exchange of ideas and information, empowering individuals with a wealth of new information to better inform decision-making and engender more accountable government. Local news continues to play a vital role, with some stations seizing multiplatform opportunities. Newspapers and television stations have emerged as the largest providers of local news online. However, an abundance of media outlets does not necessarily translate into an abundance of reporting**.** In many communities there are now more outlets, but less local accountability reporting. Key recommendations in the report included eliminating burdensome rules and streamlining disclosures about local programming by moving FCC files online, and discouraging "pay-for-play" arrangements in which TV stations allow advertisers to dictate on-air content without disclosing it to viewers by requiring online disclosure of such arrangements.

The overwhelming majority of digital cable subscribers currently lease set-top boxes from their cable providers. As video drives additional broadband usage, it becomes increasingly important to stimulate competition and innovation in set-top boxes. Further innovation will lead to greater choice, lower prices, and more capability in the boxes. In October 2010, the Commission adopted rules to remedy current issues with set-top boxes using CableCARDs by ensuring that retail devices have access to all video programming that is prescheduled by the programming provider; making CableCARD pricing and billing more transparent; and streamlining CableCARD installations. These actions were intended to unleash video innovation and consumer choice in equipment. The Commission took this step as an interim measure while it considers new rules that would allow consumers to buy smart video devices that can access all multichannel video programming services. The Commission also issued an Enforcement Advisory that underscored a commitment to strictly enforce the CableCARD rules.

The FCC adopted a NPRM to consider possible amendments to rules concerning retransmission consent negotiations. The Communications Act requires cable systems and other pay television services to obtain a television station's permission before carrying the station's signal. The Act also requires broadcasters and pay television service providers to negotiate retransmission consent agreements in good faith. The NPRM sought comment on proposals that would provide more guidance to the negotiating parties on good-faith negotiation requirements; improve notice to consumers in advance of possible service disruptions caused by impasses in retransmission consent negotiations; and eliminate the Commission's network non-duplication and syndicated exclusivity rules, which provide a means for parties to enforce certain exclusive contractual rights to network or syndicated programming through the Commission rather than through the courts.

The FCC has taken several actions as part of its ongoing efforts to implement the Twenty-First Century Communications and Video Accessibility Act of 2010 (CVAA). The CVAA is considered the most significant piece of accessibility legislation since the passage of the Americans with Disabilities Act in 1990, modernizing existing communications laws to ensure that people with disabilities are able to share fully in the economic, social, and civic benefits of broadband and other 21st century communication technologies. In accordance with the CVAA, the Commission established two advisory committees. The first was the Video Programming Accessibility Advisory Committee, created to address the Act's directives on Internet-based captioning, video description, accessible video equipment, and emergency access by people who are blind and visually impaired. The second was the Emergency Access Advisory Committee, created to recommend measures to ensure that people with disabilities have access to next generation 9-1-1 technologies and services.

With respect to the CVAA's mandates, the Commission adopted rules to ensure that the 54 million individuals with disabilities living in the United States are able to fully use advanced communications services, equipment, and networks through telecommunications and interconnected Voice over Internet Protocol (VoIP) manufacturers providing such access. Also pursuant to the CVAA, the Commission reinstated the video description rules originally adopted by the Commission in 2000. Video description is the insertion of audio-narrated descriptions of a television program's key visual elements into natural pauses in the program's dialogue, makes video programming more accessible to individuals who are blind or visually impaired. The enactment of the CVAA provided the Commission with authority to reinstate rules overturned by the U.S. Court of Appeals.

The FCC adopted a third set of rules to extend participation in and contributions to the Telecommunications Relay Service (TRS) Fund to interconnected and non-interconnected VoIP service providers. Next, the agency established a National Deaf-Blind Equipment Distribution Program (NDBEDP) to enable low-income individuals who are deaf-blind to receive equipment to access 21st Century communications services. The pilot program will help ensure that qualified individuals have access to the Internet, as well as telecommunications, advanced communications, and information services. The CVAA directs that funding for equipment distributed under the NDBEDP will come from the Interstate TRS Fund.

Finally, the Commission issued an NPRM seeking comment on proposed rules to enable the provision of closed captions on video programming delivered over the Internet. This CVAA requirement will apply to any video programming delivered via the Internet that had previously been shown on television with captions after the effective date of the rules. Also contained in this NPRM are proposals to ensure that, with limited exceptions, modern video programming devices of any size that are used to receive or play back video programming are equipped to decode and display closed captioning. This includes devices that record video and the interconnection mechanisms that carry signals from these source devices to consumer equipment.

As part of its ongoing efforts to ensure that the Video Relay Service (VRS) continues to provide a crucial telecommunications link for people who are deaf and hard-of-hearing, the Commission adopted rules designed to eliminate the waste, fraud, and abuse in the VRS program that threatened its ability to continue serving Americans who use it. The Commission also adopted new rules modifying its criteria for granting certification to companies seeking to provide and get reimbursed for any form of Internet-based TRS, including VRS. VRS enables persons who use American Sign Language to communicate with other individuals who do not know ASL through a broadband connection using a video link. A communications assistant interprets the conversation back and forth between the parties in sign language and voice. The FCC's actions are intended to eliminate illegitimate payments from the TRS Fund to providers, ensure that only qualified providers of service are permitted to receive compensation from the TRS Fund, and enable the Commission to improve its oversight of provider operations to achieve better compliance with the TRS rules.

The FCC acted on several items to strengthen and expand communications services to Native nations and their communities. The FCC conducted "Native Nations Day" on March 3, 2011, as part of its open meeting, with a renewed focus on initiatives that will help expand access to vital communications, including broadband, wireless, and radio services in Native communities across the United States. The meeting included public presentations from several Native nation leaders, and nation-to-nation consultation sessions. The items adopted by the Commission include a Notice of Inquiry (NOI) on improving communications services for Native nations that seeks comment on a number of issues, including greater broadband deployment, the need for a uniform definition of Tribal lands to be used in rulemakings, and the importance of strengthening the FCC's nation-to-nation consultation process with Native nations. The Commission approved a NPRM on ways to expand the efficient use of spectrum over Tribal lands so as to improve access to mobile wireless communications, providing consumers with more choices on how they communicate, share information, and get their news. Finally, the Commission adopted an Order that will help expand opportunities for Tribal entities to provide broadcast radio services to Native communities.

Over the last year, the FCC began utilizing prizes and challenges as tools for advancing open government, innovation, and to promote broadband deployment and adoption by launching and conducting three challenges using Challenge.gov as its platform. Challenge.gov is a GSA-run crowd sourcing platform to help increase innovation in federal government processes and serve as a place where the public and government can solve problems together. The "Apps for Communities Challenge" was a joint initiative of the FCC and Knight Foundation to foster digital inclusion and promote broadband adoption by bringing together providers of public data and developers through a national contest to make local public information more personalized, usable, and accessible for all Americans, particularly traditionally underserved populations. "Lifted by the Cloud: Visions of Cloud-Enhanced Accessibility Challenge" was a national contest co-sponsored by the FCC, the Coleman Institute for Cognitive Disabilities, and Raising the Floor that challenged the public to submit short multimedia presentations on their visions of how cloud computing can create new opportunities for people with disabilities. The "Open Internet Challenge" was a prize competition for innovative research and useful applications that further the understanding of Internet connectivity and network science.

Consumers gained new protections against fraudulent and deceptive use of caller ID services under new rules adopted by the FCC. Increasingly, bad actors are altering or manipulating caller ID information (known as caller ID spoofing) to further a wide variety of malicious schemes from identity theft to placing false emergency calls to SWAT teams. Using spoofing services accessible through the web or prepaid cards, anyone can inexpensively mask the origin of a call with fake caller identification information. Last year, in response to malicious caller ID spoofing, Congress passed and President Obama signed into law the *Truth in Caller ID Act*, which prohibited caller ID spoofing with harmful or fraudulent intent, and directed the FCC to adopt rules implementing the Act. Under the FCC's new rules, violators are subject to up to $10,000 for each violation, or three times that amount for each day of continuing violation, to a maximum of $1 million for any continuing violation. The FCC may assess fines against entities it does not traditionally regulate without first issuing a citation, and can impose penalties more readily than it can under other provisions of the Communications Act.

The FCC conducted outreach and education to increase consumer awareness about on-line privacy issues. Efforts included a public education forum featuring representatives of telecommunications carriers, technology companies, consumer advocacy groups, and academia that explored how consumers can be both smart and secure when realizing the benefits of Location Based Services (LBS), and a roundtable with leaders from across the public and private sectors on cyber security strategies for small business owners across the country.

The FCC announced the creation of the Rural Call Completion Task Force to investigate and address the growing problem of calls to rural customers that are being delayed or that fail to connect. Rural telephone companies have reported a 2000% increase in complaints between April 2010 and March 2011 regarding incoming calls that are delayed, never completed, of poor quality, or lack accurate caller ID information. Failed or degraded calls not only undermine the integrity of the nation's telephone networks and frustrate consumers, but they also pose a serious risk to public safety and harm the rural economy. The problem appears to be occurring in rural areas where long-distance carriers pay high access charges to complete calls to the local telephone company, calls which may be delivered using specialized call routing providers.

The Commission proposed rules to implement the Commercial Advertisement Loudness Mitigation (CALM) Act. Loud commercials on television are a leading source of consumer complaints to the FCC. The Commission proposed a solution that relieves consumers of this problem while limiting costs to TV broadcasters, cable operators, and other multichannel video programming distributors.

Enforcement has been at the core of the Commission's agenda to protect consumers. In addition to the specific examples noted above, the Commission has focused considerable resources on enforcing those rules that directly impact consumers. Areas of activity concerning consumers include, among others, closed captioning, telecommunications relay service, privacy/customer proprietary network information, junk faxes, do-not call violations, and prepaid calling cards.

PUBLIC SAFETY AND HOMELAND SECURITY

Promote the availability of reliable, interoperable, redundant, and rapidly restorable critical communications infrastructures that are supportive of all required services.

Access to critical emergency communications is a vital need for all Americans. The FCC is taking steps to revolutionize America's 911 system by harnessing the life-saving potential of broadband communications, including text, photo, and video in emergencies. Seventy percent of 911 calls come from mobile phones. But increasingly, consumers are using their mobile phones less to make calls and more for texting and sending pictures and videos. These new technologies have the potential to revolutionize emergency response by providing public safety officials with critical real-time, on-the-ground information. In some emergency situations, especially in circumstances where a call could further jeopardize someone's life and safety, texting may be the only way to reach out for help. In addition, many Americans, particularly those with disabilities, rely on text messaging as their primary means of communication.

Today's 911 system is not equipped to take advantage of new technologies. 911 call centers lack the technical capability to receive texts, photos, videos, and other data. Many 911 call centers do not have access to broadband, which makes it difficult to receive incoming data, particularly in large volume. In December 2010, the Commission adopted a NOI seeking public comment on how Next Generation 911 (NG911) can enable the public to obtain emergency assistance by means of advanced communications technologies beyond traditional voice. The NOI asked a comprehensive set of questions that address a number of issues related to the deployment of NG911 services, including the technical feasibility and limitations of text messaging, video streaming, and photos, consumer privacy issues related to the sharing of personal electronic medical data, and the development of technical and policy standards.

Near the end of FY 2011, the Commission adopted a NPRM examining options for enabling consumers to send texts to 911, and to seek comment on long-term development of multimedia NG911 technology that would support delivery of photos, videos, and data in addition to texting. The Commission will consider the appropriate role for the agency in facilitating, and if necessary accelerating, the rollout of these capabilities. FCC staff also presented a Cost Study which provided cost models for the capital and operating expenses for network connectivity of America's public safety answering points in order to support NG911.

Continuing its efforts to improve the public's ability to contact emergency services and to enable public safety personnel to obtain accurate information regarding the location of a 911 caller, the Commission strengthened its Enhanced 911 (E911) location accuracy rules for wireless carriers by adopting an Order to phase out the less stringent network-based location accuracy standard. In this Order, the Commission also required new Commercial Mobile Radio Service (CMRS) providers to comply with the Commission's more stringent handset-based location accuracy standard, regardless of the location technology they use. In addition, the Order required wireless carriers to periodically test their outdoor E911 location accuracy results and to share the results with Public Safety Answering Points (PSAPs), state 911 offices, and the Commission, subject to confidentiality safeguards.

In a companion Further Notice of Proposed Rulemaking (FNPRM) to the Order, the Commission sought comment on improving both 911 availability and E911 location determination for VoIP services. The Commission wants to ensure that all interconnected VoIP providers can provide automatic location information for VoIP 911 calls, rather than relying on the subscriber to register his or her location with the VoIP provider. The Commission is also seeking ways that location technologies that are already being developed for commercial broadband applications might be leveraged to support 911 location determination. Finally, the Commission sought comment on how to improve location accuracy for 911 calls made from indoors, including large office buildings where it may be difficult to locate an individual in trouble based only on a street address.

Network outage reports enable the FCC to track and analyze information on outages affecting 911 service and determine if action is needed to prevent future outages from occurring. Analysis of data collected pursuant to the FCC's current outage reporting requirements have led to a reduction in the number of communications outages and improved the pace of recovery. For instance, within hours of Hurricane Katrina hitting land in 2005, the Commission's outage reporting data quickly became the Federal government's best source of information about the conditions of critical communications infrastructure in the disaster area. In a more recent example, the Commission worked with individual carriers and industry groups to identify and remediate the cause of wireless 911 failures in the Washington, DC area during a severe snowstorm. This work led to equipment and process adjustments in several carrier networks nationwide.

Currently, the FCC's outage reporting rules apply only to legacy communications services. This year, the Commission adopted a NPRM proposing that interconnected VoIP service and broadband Internet service providers report significant outages. Under this proposal, providers of these services would report outages of at least thirty minutes that meet certain thresholds, helping fulfill the FCC's mission to ensure that our country's critical communications infrastructure remains operating in times of crisis. In addition, the Commission continued its enforcement of the network outage reporting rules, which allow the government to identify widespread problems that could be indicative of terrorist activity, and to generally monitor the reliability of communications networks. During FY2011, the Commission released six Consent Decrees, totaling $2,087,000, including a $1,800,000 Consent Decree with AT&T.

Vital communications can be disrupted not only by outages, but by harmful interference as well. Throughout the year, the Commission's Enforcement Bureau worked tirelessly to track down sources of interference to the military, first responders, other federal agencies, and consumers. For example, the Enforcement Bureau acted against the use and sale of cell and GPS "jammers" which intentionally block, jam, or interfere with authorized radio communications, and therefore pose significant risks to public safety and other emergency communications. In February, the Bureau launched an education and outreach campaign emphasizing that the operation and marketing of jamming devices is illegal, and recently cited 20 online retailers for illegally marketing these devices. Similarly, the Enforcement Bureau issued six Notices of Apparent Liability for Forfeiture against companies operating devices causing interference to Terminal Doppler Weather Radars (TDWRs) maintained by the Federal Aviation Administration (FAA). TDWR systems serve the critical function of providing the FAA with quantitative measurements for gust fronts, windshear, microbursts, and other weather hazards.

Disaster preparedness and response continues to be a priority for the FCC. Following the devastating earthquakes in Japan, the Commission's Public Safety and Homeland Security Bureau conducted a public forum in May exploring earthquake-related emergency preparedness and response issues. In response to Hurricane Irene's arrival in August, the Public Safety and Homeland Security Bureau, in conjunction with the National Communications System, activated the agency's Disaster Information Reporting System (DIRS). DIRS is a voluntary web-based system that communications providers can use to report communications infrastructure status and situational awareness information during times of crisis. Service providers in areas affected by a disaster are able to report the status of their communications equipment, restoration efforts, power (*i.e.*, whether they are using commercial power, generator or battery), and access to fuel. The FCC also deployed several teams with mobile spectrum occupancy scanning equipment to survey critical spectrum for steady-state users before Hurricane Irene struck land, and then, in Hurricane Irene's aftermath, cross-checked the spectrum to determine whether any of those users had lost their ability to communicate. The FCC, working with FEMA and other agencies, stood ready to provide aid to public safety licensees and others responsible for the safety of life and property, the health and welfare of the population, and utility services.

As part of National Preparedness Month in September, the FCC and the Federal Emergency Management Agency (FEMA) released tips for consumers aimed at preparing them for major disasters when communications networks are more likely to be compromised, damaged, or congested. When disaster strikes, persons may need to call 911 for assistance, locate friends or family, or let loved ones know that they are okay. A fact sheet was developed providing two important sets of tips. The first will help the public prepare home and mobile devices for a disaster. The second will assist Americans to communicate more effectively during and immediately after a disaster.

Not only must consumers be prepared if disaster strikes, but the communications industry has a responsibility to prepare as well. The Commission adopted a NOI seeking comment on ways to further strengthen the reliability and resiliency of America's communications networks. As the communications infrastructure migrates to broadband technology, critical communications services will travel over a network infrastructure that may or may not be built to the high standards of legacy systems. The potential for differences in service reliability may be a major source of concern for consumers, government, and businesses across America. This action is part of the FCC's ongoing efforts to help ensure the reliability and resiliency of communications for the public, emergency responders, healthcare providers, and providers of other critical services such as electric power during natural or man-made disasters.

The Public Safety and Homeland Security Bureau released a comprehensive white paper outlining a vision for how deployable aerial communications architecture (DACA) can be used to provide communications following a catastrophic event when the terrestrial communications infrastructure is severely damaged or unavailable. The paper offers an analysis of how DACA could fit into the restoration of communications services in the early hours immediately after a catastrophic event. DACA is deployable 12 to 18 hours after a catastrophic event to restore critical communications temporarily for a period of 72 hours or more. This capability would be useful in situations where the power grid may be inoperable for several days, depleting back-up power supplies and resulting in an almost complete failure of landline, cellular, public safety radio, broadcast, and cable transmissions, as well as Wi-Fi and Internet services.

Along with ensuring that consumers can complete critical communications during and after disasters, actions are being taken to facilitate and expand emergency alert capabilities. The Commission adopted a Report and Order to allow for the first-ever nationwide test of the Emergency Alert System (EAS) to be conducted by FEMA and the FCC along with television and radio broadcasters, cable systems, satellite service and wireline video service providers who deliver EAS alerts to the American public. This test took place on November 9, 2011. The national test helps determine the reliability of the EAS system and its effectiveness in notifying the public of emergencies and potential danger nationwide and regionally.

EAS capabilities will be significantly expanded as a result of the introduction of the Common Alerting Protocol (CAP) which the Commission mandated must be introduced by EAS participants no later than June 30, 2012. In connection with that mandate, the Commission issued a NPRM exploring necessary changes to its Part 11 rules governing the EAS. Working with wireless communications service providers, the Commission continued its efforts to implement the Commercial Mobile Alert System mandated by statute. Nationwide introduction of commercial wireless alerting is scheduled to begin in April of 2012, but a number of large wireless service providers agreed to early implementation of the system in New York City in December of 2011. The Commission also adopted an Order and NPRM seeking public comment on whether the role of travelers information stations should be expanded to include broadcasting of Amber alerts, public health warnings, terror threat levels, weather reports, and other public safety information.

The Commission's Public Safety and Homeland Security Bureau continued to encourage licensees to make the system and licensing modifications necessary to meet the 2013 deadline for 12.5 kHz operations in the bands below 512 MHz. In 2010, the Bureau determined that only 28 percent of the 109,000 public safety pool call signs had converted to narrowband operation and initiated an aggressive outreach campaign, incorporating narrowbanding into the Bureau's core message. In December 2010, the Bureau hosted a workshop on the topic, and launched a webpage (which by August had received 32,000 hits), and a dedicated email box. In April the Bureau sent over 32,000 letters to public safety licensees whose authorizations indicated that they had not yet narrowbanded. As a result, as of October 21, 47 percent of the 109,000 public safety pool call signs are ready for 2013, a significant increase.

The Commission's 800 MHz "rebanding" initiative was initiated to resolve interference that public safety licensees were encountering from commercial licensees in the band. Sprint Nextel Corp. is paying public safety and other 800 MHz licensees to relocate within the 800 MHz band. To date, 99 percent of the non-border Public Safety 800 MHz licensees have executed rebanding contracts with Sprint Nextel. Under these contracts, licensees retuned or replaced approximately 73,000 radios in the second quarter, raising the total number of retuned or replaced radios to approximately 1.3 million. Approximately 3,000 infrastructure units (base stations) were retuned or replaced in the same period.

The rapid expansion and adoption of broadband services has created new reliability and security challenges. The Commission has identified key cyber security threats to our nation's communications infrastructure and critical sectors, and is working in partnership with industry and all levels of government to address these new threats through the newly rechartered Communications Security, Reliability and Interoperability Council, a federal advisory committee.

CONTINUAL IMPROVEMENT

Make the FCC a model for excellence in government by being data-driven in our decision making and committing to a transparent and participatory process that encourages public involvement and feedback.

Continuing to deliver on its promise of bringing Web 2.0 to government, the FCC launched a complete overhaul of the agency's web site, FCC.gov. Providing a more intuitive user experience and adding Web 2.0 technologies, the new site improves and simplifies FCC.gov for consumers, government, public safety agencies and the business community. The new FCC.gov is built using web services, a series of standards employed across many of the Web's most popular sites, which empowers citizen developers to build off the new FCC.gov in innovative ways. By building the new site using an open source, cloud-hosted, and scalable architecture, the FCC has leveraged modern tools as a long-term cost-saving strategy and lowered the barriers to future development and innovation among other public and private sector web sites. The Commission's new web site was shaped by public feedback and sharpened through an ongoing conversation with users over several months. It represents the Commission's first overhaul of its main web site in more than a decade.

On August 22, 2011, FCC Chairman Julius Genachowski announced the elimination of 83 outdated and obsolete media-related rules, including Fairness Doctrine regulations which have not been applied for more than 20 years. In addition, the FCC eliminated obsolete rules concerning cable programming service tier rates, and broadcast applications and proceedings. The elimination of these rules adds to the more than 50 outdated regulations that were already deleted as part of the Commission's robust regulatory review process. Going forward, Chairman Genachowski directed each FCC bureau to conduct a review of rules within their areas with the goal of eliminating or revising rules that are outdated or place needless burdens on businesses.

In a February Report and Order, the Commission revised portions of the Commission's Part 1 procedural rules and Part 0 organizational rules. These revisions will increase the efficiency of Commission decision-making, modernize Commission procedures for the digital age, and enhance the openness and transparency of Commission proceedings for practitioners and the public. The rule revisions fall into three general categories. First, the agency increased the efficiency of docket management and enhanced public participation by broadening the use of docketed proceedings; expanding the requirement for electronic filing (and reducing the scope of the obligation to file paper copies); and permitting staff in certain circumstances to notify parties electronically of docket filings and to close inactive dockets. Second, the Commission delegated authority to the staff to dismiss or deny defective or repetitive petitions for reconsideration of Commission decisions, and amended the rule that authorizes the Commission to reconsider a decision on its own motion within 30 days to make clear that the Commission may modify a decision and not merely set it aside or vacate it. Finally, the FCC implemented changes to miscellaneous Part 1 and Part 0 rules. In accordance with the rule changes, the Commission issued a public notice announcing 1,000 dormant proceedings that would be terminated if there were no objections within 45 days after the list had been published in the Federal Register.

As part of its Data Innovation Initiative, the FCC launched two proceedings to ensure that it collects the data it needs to make sensible policy, streamlines its data collection program, and eliminates unneeded data collections that impose unnecessary burdens on filers. The Commission approved a NPRM to eliminate 20-year-old requirements for certain telephone companies to submit data which may no longer be necessary due to subsequent policy decisions. The Commission also approved a second NPRM that seeks comment on whether and how to reform collection of data regarding broadband and local telephone service to better serve the agency, consumers, and other stakeholders after more than a decade of rapid innovation in the marketplace for these services. The FCC requires broadband service providers to report the number of subscribers they have in each census tract they serve, and local and mobile telephone service providers to report subscribers at the state level.

The Commission also adopted a NPRM proposing to reduce regulatory burdens and streamline the foreign ownership review process for U.S. companies with common carrier radio licenses (*e.g.*, wireless phone companies) and certain aeronautical radio licenses. The proposals would ensure that the Commission continues to receive the information it needs to serve the public interest while reducing the number of required filings by more than 70%.

The FCC took steps to expand its Electronic Comment Filing System to include non-docketed proceedings. These electronic filings will provide the public with more information about the workings of the FCC, and save industry and the agency staff time and money. The FCC also expanded electronic filing of information about rates, terms, and conditions of telecommunications services by having competitive local providers and other nondominant carriers use the FCC's existing Electronic Tariff Filing System for all tariff filings. This creates a uniform system of online access that not only increases transparency for consumers and reduces burdens on industry, but also eases tariff enforcement and facilitates tracking of industry trends.

This past year, the Commission implemented the Plain Writing Act of 2010. The Commission named a senior plain writing official, created a plain writing website, and issued a new guide called "Plain Language Workbook: Five Steps to Clear, Effective Communications." In addition, approximately 880 staff members were trained in plain writing.

Management Assurances

In accordance with Office of Management and Budget (OMB) Circular A-123, the Commission maintains internal control for financial and management reporting that provides reasonable assurance that the financial statements fairly present information related to assets, liabilities, and net position and do not contain material misstatements. Transactions are executed in accordance with budgetary and financial laws, consistent with the Commission's statutory requirements, and are recorded in accordance with Federal accounting standards.

Additionally, assets are properly acquired, used, and safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud. Further, the Commission's internal controls provide for the existence and completeness of its performance measures, as required by OMB Circular A-136.

The Commission received an unqualified opinion on its financial statements in FY 2009 and FY 2010. In conjunction with both of these opinions, the independent auditors provided the Commission with reports on internal control and compliance with laws and regulations. The independent auditors' report identified no material weakness in internal controls in FY 2009 and FY 2010.

The FY 2010 report identified no material weaknesses in internal controls but included significant deficiencies in the following areas: 1) the financial reporting process, and 2) some information technology control areas. During FY 2011, the FCC worked to remediate any risk associated with these findings and to take corrective action to close them. First, with regard to addressing the significant deficiency for the financial reporting process related to the Commission and its reporting components, the Commission took significant steps in 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 in FY 2011 worked to efficiently deploy the 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 has been working to fully assess the auditors' recommendations, develop corrective action plans, and remediate these findings. Some findings are already in the process of being addressed, and the Commission will make every effort in FY 2012 to complete corrective action for each of the recommendations associated with these findings so as to avoid any repeat findings in this area.

In both fiscal years the Commission also received findings of non-compliance with the Federal Managers' Financial Integrity Act (FMFIA). With respect to the instances of non-compliance with FMFIA, 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. As noted above, the Commission's new core financial system was launched in October 2010 and the Commission in FY 2011 worked to efficiently deploy the 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. The Commission continues to work diligently on closing all findings from prior year audits and has made significant progress on resolving most recommendations presented.

During FY 2011, the Commission has continued its efforts to develop a baseline on internal control as it works within the requirements of OMB Circular A-123. The Commission's Senior Management Council continues to meet regularly to strengthen its efforts and efficiencies over Commission operations. During the current fiscal year, the Commission also continued to work with two of its reporting components, USAC and NECA/RLSA, to implement an OMB Circular A-123 framework and take the appropriate steps to strengthen their internal control frameworks. The Commission continues to receive unqualified opinions over its financial statements; however, the Commission will continue to focus its efforts to make its internal controls over operations more effective and efficient as it moves forward.

MANAGEMENT ASSURANCES – FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT OF 1982 (FMFIA)

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) establishes overall requirements with regard to internal control. FMFIA requires agencies to establish controls that reasonably ensure that: (i) obligations and costs are in compliance with applicable laws; (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 assets. Pursuant to FMFIA's requirements, agencies must annually evaluate their system of internal controls and report on the results of those evaluations through management assurance statements.

Statement of Assurance

The Commission's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of FMFIA. The Commission conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control.* Based on the results of this evaluation, the Commission can provide reasonable assurance that its internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2011 were operating effectively, and no material weaknesses were found in the design or operation of internal controls. In addition, with the exception of the instances of non-conformances with government-wide financial systems requirements discussed below, the Commission can provide reasonable assurance that its financial management systems meet the objectives of FMFIA.

Julius Genachowski
Chairman
November 14, 2011

Status of Internal Controls – Section 2 of FMFIA

During FY 2011, the Commission continued its efforts to improve and strengthen its internal controls over operations and financial reporting. In addition to its own risk assessments over its operations, the Commission worked with USAC, NECA, and RLSA to strengthen their frameworks on internal controls to comply with OMB Circular A-123. Throughout FY 2011, the Commission continued to work diligently to close out audit findings from previous audits. The Commission was able to close out 84 audit findings in FY 2011. The Commission continues to tighten its controls over operations and improve its policies and procedures where necessary.

Despite recent success, the Commission needs to finish the work at hand. The FY 2011 audit report identified significant deficiencies that still need to be resolved. The primary areas of concern relate to the financial reporting process at the Commission and its reporting components, and information technology controls.

Financial Management Systems – Section 4 of FMFIA

Section 4 of FMFIA requires agencies to annually evaluate whether the agency's financial management systems conform to government-wide requirements. These financial systems requirements are included in OMB Circular A-127, *Financial Management Systems.* If the agency's systems do not substantially conform to financial systems requirements, agencies must report the non-conformances and discuss the agency's plan to bring the systems into substantial compliance.

As previously noted by the Commission's auditors, the Commission's financial systems did not substantially conform to government-wide requirements. Specifically, the Commission lacked a fully integrated financial system. In October, 2010, the Commission launched a new core financial system and in FY 2011 the Commission worked through the process to fully launch all functionality of its new system. The Commission continues to work with its reporting components to launch their new financial systems and to improve the Commission's financial systems.

Financial Discussion and Analysis

UNDERSTANDING THE FINANCIAL STATEMENTS

The Commission is committed to excellence and accuracy in financial reporting, transparency, and financial management. Preparing the Commission financial statements is part of the goal to improve financial management and provide accurate and reliable financial information that is useful for assessing performance and allocating resources. The Commission's management is responsible for the integrity and objectivity of the information presented in the financial statements. For six consecutive years, the financial statements have received an unqualified audit opinion from the external auditors.

The principal financial statements have been prepared to report the financial position and results of operations of the Commission. The statements have been prepared from the books and records of the Commission, in accordance with U.S. generally accepted accounting principles (GAAP) for Federal entities. The financial statements and notes are presented in accordance with OMB Circular No. A-136, *Financial Reporting Requirements,* dated October 27, 2011.

This section presents a summary analysis of key financial statement core business activities. The principal financial statements include the Consolidated Balance Sheet, Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources and Consolidated Statement of Custodial Activity. This section also summarizes the financial activity and net position of the Commission. The complete set of principal financial statements is included in section 2 of this report.

A summary of the Commission's major financial activities in FY 2011 and FY 2010 is presented in the table on the next page. This table represents the resources available for use (assets) against the amount owed (liabilities) and the amount that comprises the difference (net position). The net cost represents the gross cost of operating the Commission's lines of business less earned revenue. Budgetary resources represent funds made available to the Commission.

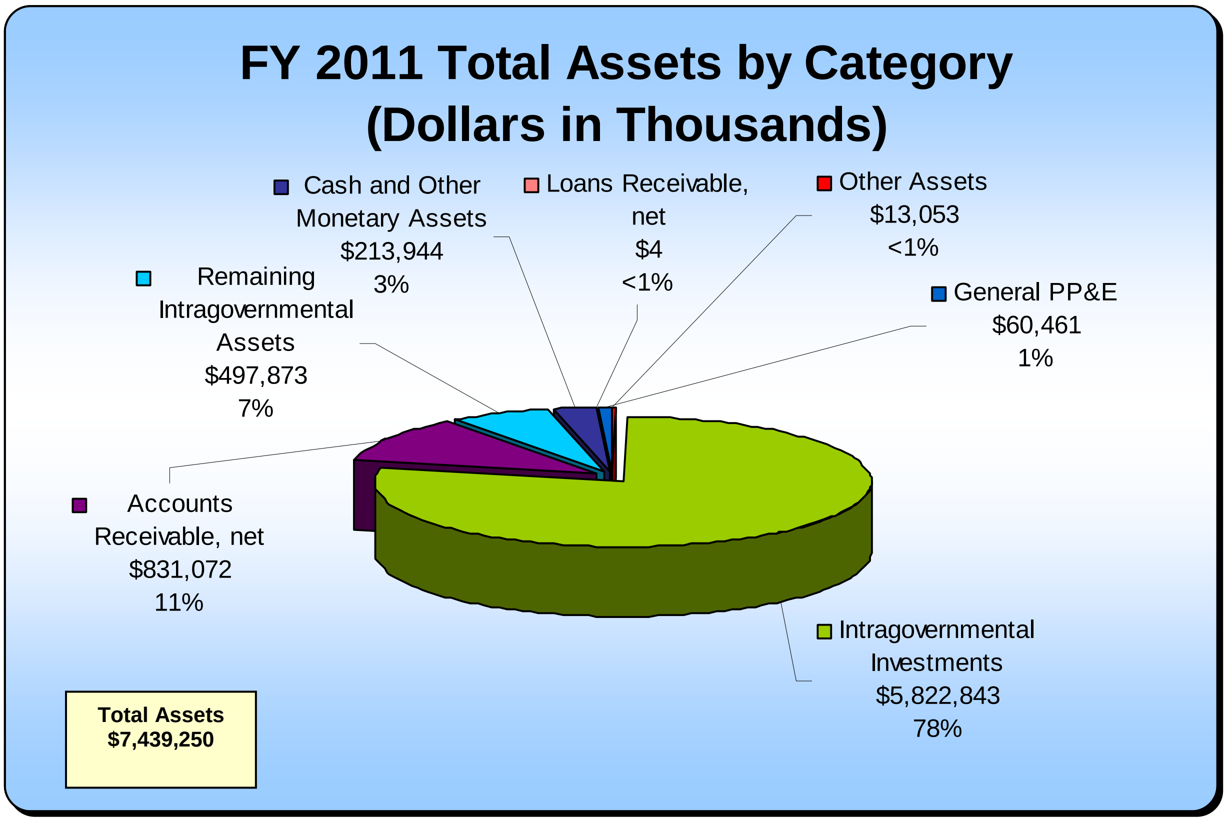
CHANGES IN FINANCIAL POSITION IN FY 2011 Consolidated					
(Dollars in Thousands)					
Net Financial Condition		**2011**		**2010**	**Percentage Change in Financial Position**
Intragovernmental					
Fund Balance with Treasury	$	494,340	$	457,368	8%
Investments		5,822,843		6,087,715	-4%
Accounts Receivable		1,097		571	92%
Other		2,436		33,838	-93%
Total Intragovernmental	$	6,320,716	$	6,579,492	-4%
Cash and Other Monetary Assets		213,944		100,344	113%
Accounts Receivable, net		831,072		783,620	6%
Loans Receivable, net		4		48,470	-99%
General Property & Equipment, net		60,461		65,167	-7%
Other		13,053		13,088	<1%
Total Assets	**$**	**7,439,250**	**$**	**7,590,181**	-2%
Intragovernmental					
Debt	$	50,300	$	87,726	-43%
Other		220,249		251,972	-13%
Total Intragovernmental	$	270,549	$	339,698	-20%
Accounts Payable		92,976		120,477	-23%
Deferred Revenue		93,053		132,386	-30%
Prepaid Contributions		77,362		74,915	3%
Accrued Liabilities for Universal Service		633,967		622,400	2%
Other		35,804		49,408	-28%
Total Liabilities	**$**	**1,203,711**	**$**	**1,339,284**	-10%
Unexpended Appropriations	$	15,105	$	21,183	-29%
Cumulative Results of Operations		6,220,434		6,229,714	<1%
Total Net Position	**$**	**6,235,539**	**$**	**6,250,897**	<1%
Net Cost of Operations	**$**	**8,820,764**	**$**	**8,961,165**	-2%
Total Budgetary Resources	**$**	**12,904,395**	**$**	**13,612,371**	-5%

The following is a brief description of the nature of each required financial statement and its relevance, including a description of certain significant balances on Commission operations.

*Consolidated Balance Sheet***:** The Consolidated Balance Sheet presents the total amounts available for use by the Commission (total assets) and the amounts owed by the Commission (total liabilities). Investments and Accounts Receivable represent over 89% of total assets as of September 30, 2011.

The graph below presents the total assets of the Commission as of September 30, 2011. The large Investments balance of $5,822.8 million results from carryover in the USF Schools and Libraries and Rural Healthcare programs that has grown since the programs' inception as a result of annual contributions that have exceeded annual distributions.

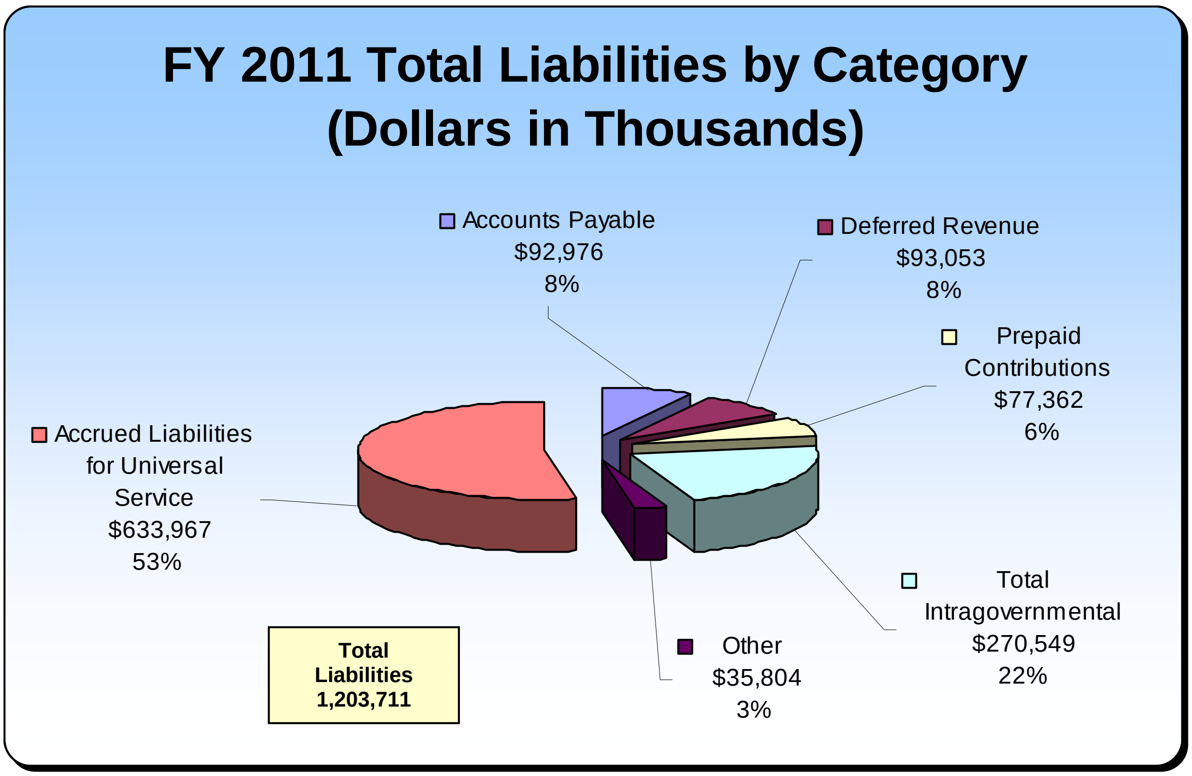
The Accounts Receivable balance of $831.1 million is primarily composed of USF receivables totaling $780.5 million.



The graph below presents the total liabilities of the Commission as of September 30, 2011. The Commission's most significant liabilities are Deferred Revenue of $93 million and Accrued Liabilities for Universal Service of $634.0 million, which accounted for over 60% of total liabilities as of September 30, 2011.

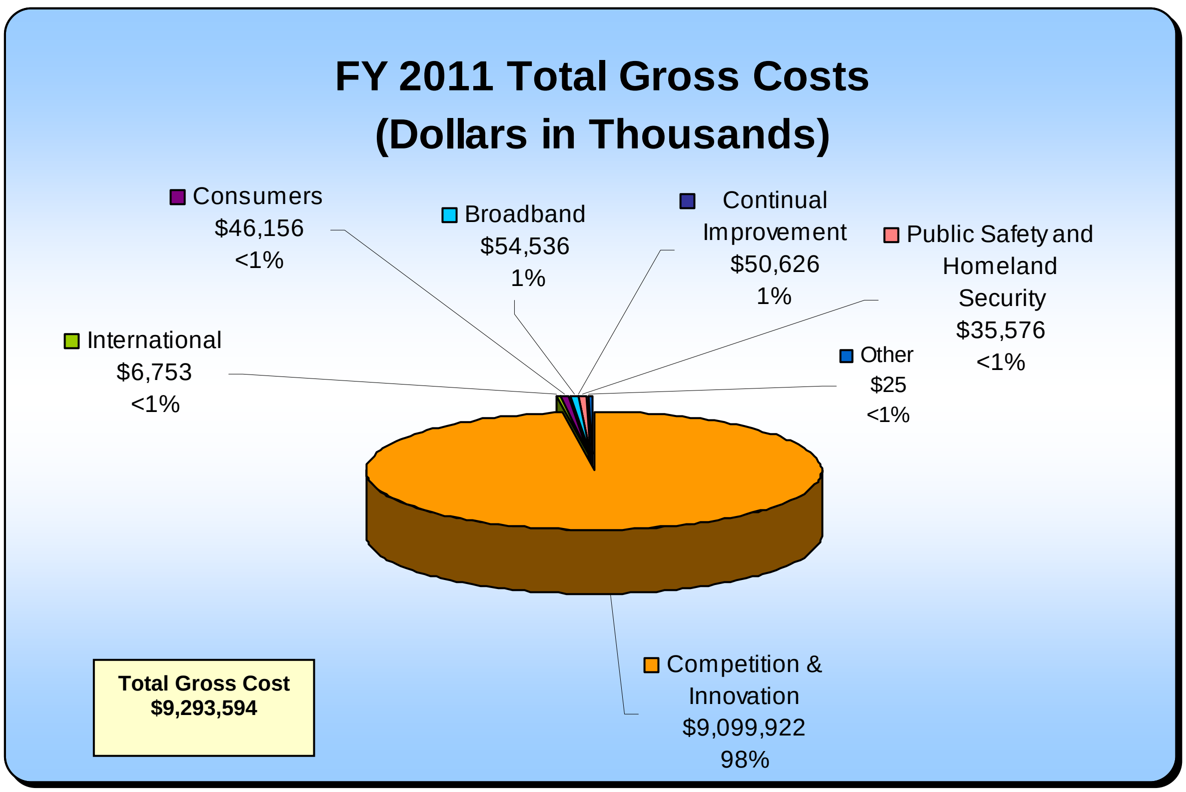
The Deferred Revenue balance includes $19.8 million in winning bids for auction #92 and $21.6 million for other auctions where the corresponding licenses have not been granted. As these licenses are granted, the revenue will be recognized on the Statement of Custodial Activity by the Commission.

The Accrued Liabilities for Universal Service represent the expected October (FY 2012) payments for the Telecommunications Relay Service Program and the Universal Service Fund High Cost and Low Income Programs.



*Consolidated Statement of Net Cost***:** This statement presents the annual cost of operating Commission programs. The Consolidated Statement of Net Cost is aligned with the six strategic goals of the Commission which changed effective FY 2011: Broadband, Competition & Innovation, International, Consumers, Public Safety and Homeland Security and Continual Improvement. Prior to FY 2011, this statement was aligned with the following strategic goals: Broadband, Competition, Spectrum, Media, Public Safety and Homeland Security, and Modernize the FCC. Gross costs for each goal are presented individually while revenue is presented in total rather than by goal. The program costs for the USF, TRS and NANP are included within the Competition and Innovation strategic goal. The Commission's subsidy costs for the Spectrum Auction Loan Program are included with the Competition and Innovation strategic goal. As a result of the accounting for these activities, the cost for these goals may be significantly higher than the cost of the five other goals. Contributions received for the USF and TRS programs are shown on the Statement of Changes in Net Position and do not directly offset the costs of these programs on the Statement of Net Cost.

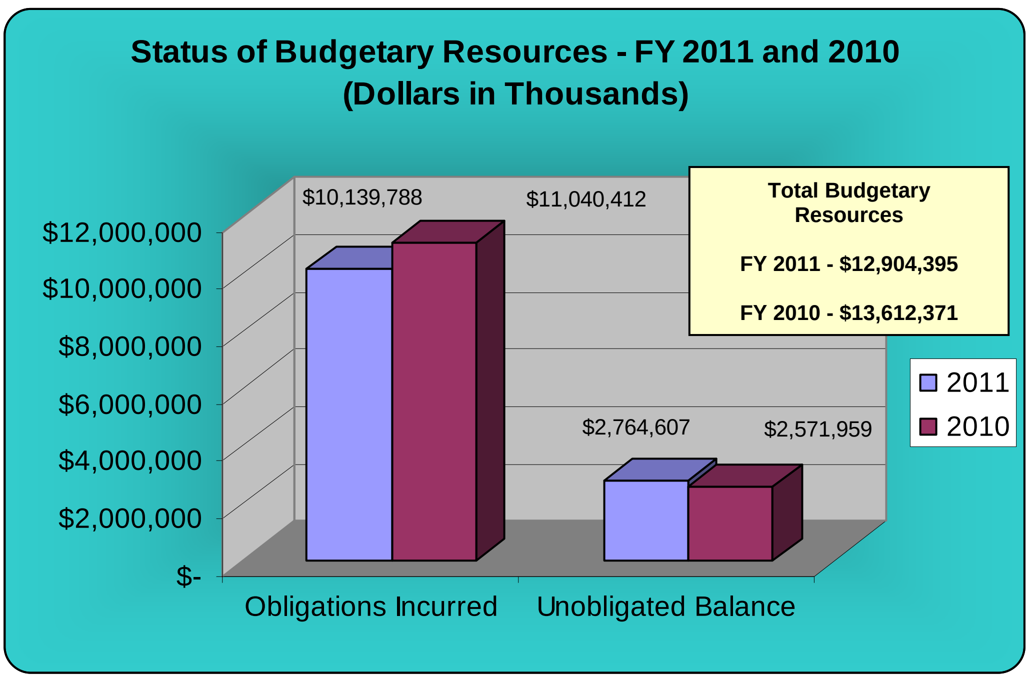
The graph below presents the total gross costs of each Commission program.



Consolidated Statement of Changes in Net Position: This statement presents the cumulative net results of operations and total unexpended appropriations in order to understand the nature of changes to the net position as a whole. The Commission's Net Position decreased to $6,236 million or a net decrease of $15.4 million or less than 1% in FY 2011.

Combined Statement of Budgetary Resources: This statement provides information on how budgetary resources were made available to the Commission for the year and the status of those budgetary resources at the end of the year. The Commission receives most of its budgetary authority from appropriations. Budgetary resources consist of the resources available to the Commission at the beginning of the year, plus appropriations, spending authority from offsetting collections, and other budgetary resources received during the year. The Commission had $12.9 billion in budgetary resources of which $10.1 billion was obligations incurred and $2.8 billion remained unobligated.

The chart below presents the status of budgetary resources comparatively between FY 2011 and FY 2010.



Consolidated Statement of Custodial Activity: The Commission recognized $116 million of custodial revenue during FY 2011. From this balance, $50.9 million was transferred to Treasury. The $19.9 decrease in amounts yet to be transferred is a result of the FCC not holding as much in Auction Custodial Collections for future years at September 30, 2011. The remaining Auctions revenues were retained by the Commission.

OTHER KEY FINANCIAL STATEMENT HIGHLIGHTS

The Commission must annually adjust its allowance for losses on the credit portfolio. In accordance with OMB guidance, the Commission calculates its subsidy reestimate based on the most recent economic and technical assumptions of current portfolio performance.

The Commission's FY 2011 subsidy reestimate was completed to reflect the actual loan performance through September 30, 2011. The reestimate resulted in a net upward adjustment (increase in the subsidy cost), including interest on the reestimate, totaling $17.6 million in the Spectrum Auction program.

This reestimate is reported in the Commission's FY 2011 financial statements, but will not be reported in the budget until FY 2012. For more details, see financial statement Footnote 7.

Regulatory Fee Collections

Section 6003(a) of the Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, added a new section 9 to the Communications Act. The law requires that the Commission annually collect fees and retain them to offset certain costs incurred by the Commission. The fees collected are intended to recover the non-licensing costs attributable to the Commission's competition, enforcement, consumer information, and spectrum management activities. The amount the Commission is required to recover is included in the Commission's annual appropriations.

Regulatory fees are collected and warranted back to the Treasury to offset the Commission's appropriations for the current fiscal year. In FY 2011, the Commission was required to collect $335.8 million in regulatory fees. Actual collections were slightly over $342.0 million.

Possible Future Effects of Existing Events and Conditions

The last active loans in the Commission's spectrum auction loan program were repaid during FY 2007. In conjunction with this event, the Commission generated the FY 2011 and FY 2012 subsidy reestimates. The generation of the remaining cash flows is dependent upon the outcome of bankruptcy proceedings, settlement efforts, and Treasury collection efforts on remaining loans, which are all either in a bankruptcy or default status.

In addition to the discussion of the loan program above, the Commission addresses the possible future effects of existing claims, commitments, and major unfunded liabilities in the notes to the financial statements as well as required supplementary information.

Limitations on the Financial Statements

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

The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity.

2. Financial Statements and Auditors' Reports

Message from the Chief Financial Officer

I am pleased to present the Commission's financial statements for fiscal year (FY) 2011 and to report that the Commission's auditors issued an unqualified opinion on each of the Commission's financial statements for FY 2011. Furthermore, I am proud to say that this is the sixth straight fiscal year the Commission has received an unqualified opinion. Six straight years of unqualified opinions is the longest consecutive period of "clean" audit opinions that the Commission has received in the thirteen fiscal years that its financial statements have been audited, dating back to FY 1999. The Commission is proud of the work of its staff over the past six fiscal years to obtain and maintain an unqualified opinion.

Throughout FY 2011, the Commission worked diligently on closing audit findings from previous audits. The Commission as a whole closed 84 audit findings during FY 2011. As a part of this effort, the Commission made progress on resolving matters raised by its auditors in their FY 2010 audit report. The Commission closed findings relating to its information technology control deficiencies and made progress in resolving findings related to its financial management systems by launching its new core financial system effective October 1, 2010, and reviewing its feeder systems as required by Office of Management and Budget Circular A-127.

Significantly, for FY 2011 the Commission's independent auditor did not report any material weaknesses for the Commission or its reporting components. Despite these successes, work remains here at the Commission. The FY 2011 audit report points out two significant deficiencies related to internal controls and notes two instances of non-compliance that still need to be resolved. The primary areas of concern relate to financial system functionality and integration, information technology controls, and compliance with the Federal Managers' Financial Integrity Act and the Debt Collection Improvement Act.

The Commission is committed to improving its financial processes, fiscal integrity, minimizing the risk of improper payments, and to reducing improper payments to the customers and beneficiaries of its reporting components. The Commission continues to make improvements to the fiscal management, administration, and oversight of funds reported by the Commission.

I look forward to FY 2012 and making every effort to continue to strengthen the internal control environment of the Commission and its reporting components, and to improve the effectiveness of the financial operations at the Commission and its reporting components.

Mark Stephens
Chief Financial Officer
November 14, 2011

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.

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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.

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

EXHIBIT I

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: • 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: • Updating risk assessments at least every three years.	Closed
6	FCC Entity	The FCC strengthens its approach to performing risk assessments by: • 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: • 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, recommendation # 6
8	FCC Entity	The FCC strengthens its approach to performing risk assessments by: • 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: • 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: • 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	The FCC strengthens its security program oversight and planning by: • 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	The FCC strengthens its access controls by: • 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	The FCC strengthens its access controls by: • 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	The FCC strengthens its access controls by: • 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	The FCC strengthens its access controls by: • Documenting the roles and permissions used within major applications.	Re-issued, recommendation # 16
16	FCC Entity	The FCC strengthens its access controls by: • 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: • Granting individuals computer room access only after management approval.	Re-issued, recommendation # 15
18	FCC Entity	The FCC strengthens its access controls by: • Documenting and implementing procedures for documenting and tracking vulnerability remediation.	Updated, recommendation # 18
19	FCC Entity	The FCC strengthens its access controls by: • 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: • Restricting developer access to the production environment.	Re-issued, recommendation # 21
21	FCC Entity	The FCC strengthens its change and configuration management controls by: • 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: • 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: • 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	The FCC strengthens its monitoring controls by: • 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

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2001 M Street, NW
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Independent Auditors' Report on Compliance and Other Matters

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 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.

KPMG

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

M E M O R A N D U M

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.

David B. Robbins, Managing Director
Office of Managing Director

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	6,320,716	6,579,492
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	**$ 7,439,250**	**$ 7,590,181**
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	220,249	251,972
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	840,186	879,109
Total liabilities	**$ 1,203,711**	**$ 1,339,284**
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	**$ 6,235,539**	**$ 6,250,897**
Total liabilities and net position	**$ 7,439,250**	**$ 7,590,181**

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	$ 9,293,569	$ 9,421,788
Cost not assigned to programs:		
Telecommunications Development Fund	-	7
Other expenses	25	3,415
Less: earned revenues not attributed to programs	(472,830)	(464,045)
Net cost of operations	$ 8,820,764	$ 8,961,165

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 Earmarked Funds	FY 2011 All Other Funds	FY 2011 Total	FY 2010 Earmarked Funds	FY 2010 All Other Funds	FY 2010 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	9,235,875	128,560	9,471,281	71,605
Temporarily not available pursuant to Public Law	(6,247)	-	(5,739)	-
Permanently not available	(38)	(87,874)	(75)	(15,490)
Total budgetary resources	$ 12,859,322	$ 45,073	$ 13,543,912	$ 68,459
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	10,131,723	8,065	10,976,340	64,072
Unobligated balance:				
Apportioned	21,134	1	244,720	-
Exempt from apportionment	2,550,957	-	2,164,357	-
Unobligated balance not available	155,508	37,007	158,495	4,387
Total status of budgetary resources	$ 12,859,322	$ 45,073	$ 13,543,912	$ 68,459
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	3,736,251	-	3,157,411	-
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	3,416,407	-	3,736,251	-
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	3,416,407	-	3,736,251	-
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	$ 8,879,517	$ (70,046)	$ 8,777,946	$ 49,199

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	117,763	408,550
Accrual Adjustments		
Spectrum Auctions	4	-
Fines and Penalties	(1,751)	6,061
Total Accrual Adjustments	(1,747)	6,061
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	(85,000)	(85,007)
Net Custodial Activity	$ -	$ -

The accompanying notes are an integral part of these statements.

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 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 Loube 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:

	USF	TRS	NANP	Total
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:

	FY 2011	FY 2010
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	270,498	296,216
Accounts Receivable, Net	19,304	21,598
Total Non-entity Assets	289,802	317,814
Total Entity Assets	7,149,448	7,272,367
Total Assets	$ 7,439,250	$ 7,590,181

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	$ 190,351	$ 37,008	$ 266,981	$ 494,340

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	$ 191,159	$ 4,387	$ 261,822	$ 457,368

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:

	FY 2011	FY 2010
Cash and Other Monetary Assets	$ 213,944	$ 100,344

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
FY 2011						
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	$ 5,820,942		$ (4,699)	$ 6,600	$ 5,822,843	$ 5,834,322
FY 2010						
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	$ 6,086,451		$ (3,400)	$ 4,664	$ 6,087,715	$ 6,088,952

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	$	1,097	$	831,072	$ 832,169

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	$	571	$	783,620	$ 784,191

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	$ 1,432,596	$ (600,427)	$ 832,169	$ 1,237,530	$ (453,339)	$ 784,191

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

Loan Program	Loans Receivable, Gross	Interest Receivable	Other Receivables	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Spectrum Auctions:					
FY 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

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

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:

	FY 2011	FY 2010
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	633,967	622,400
Total liabilities not covered by budgetary resources	656,914	649,016
Total liabilities covered by budgetary resources	546,797	690,268
Total Liabilities	$ 1,203,711	$ 1,339,284

Note 10 - Debt

	FY 2010 Beginning Balance	Net Borrowing	FY 2010 Ending Balance	Net Borrowing	FY 2011 Ending Balance
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:

FY 2011	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 206,524	$ 206,524
Other	-	13,725	13,725
Total Intragovernmental	$ -	$ 220,249	$ 220,249
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	$ 30,144	$ 810,042	$ 840,186

FY 2010	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 226,400	$ 226,400
Other	-	25,572	25,572
Total Intragovernmental	$ -	$ 251,972	$ 251,972
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	$ 26,637	$ 852,472	$ 879,109

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	$ 10,127,517	$ 8,065	$ 10,958,600	$64,072
Reimbursable				
Category A	$ 4,206	$ -	$ 17,740	$ -

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

Note 15 - Terms of Borrowing Authority Used

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

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)

	FY 2011	FY 2010
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	$ 6,895,913	$ 6,984,521
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	$ 806,563	$ 848,580
Cumulative results of operations	$ 6,089,350	$ 6,135,941
Total liabilities and net position	$ 6,895,913	$ 6,984,521
Statement of Net Cost		
Net cost of operations	$ 8,818,540	$ 8,906,162
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	(46,591)	84,764
Net position end of period	$ 6,089,350	$ 6,135,941

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	$ 8,820,764	$ 8,961,165

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	**S&E**	**Credit**	**Auctions**	**USF**	**Total**
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	$ 384,568	$ 92,090	$ 85,970	$ 12,341,767	$ 12,904,395
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	$ 384,568	$ 92,090	$ 85,970	$ 12,341,767	$ 12,904,395
Change in Obligated Balance:					
Total unpaid obligated balance, net brought Forward	$ 59,979	$ 4,444	$ 21,138	$ 3,650,690	$ 3,736,251
Obligations incurrred, 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	$ 55,211	$ 1,572	$ 24,255	$ 3,335,369	$ 3,416,407
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	$ (36,092)	$ (24,654)	$ (4,680)	$ 8,874,897	$ 8,809,471

3. Other Accompanying Information

Summary of Financial Statement Audit

Audit Opinion	Unqualified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
	0	0	0	0	0
Total Material Weaknesses	0	0	0	0	0

Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Unqualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
	0	0	0	0	0	0
Total Material Weaknesses	0	0	0	0	0	0

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Unqualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
	0	0	0	0	0	0
Total Material Weaknesses	0	0	0	0	0	0

Conformance with financial management system requirements (FMFIA § 4)						
Statement of Assurance	Systems do not conform to financial management system requirements					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
System is not fully integrated	✓					✓
Perform functional requirement reviews						
Total Non-Conformances	1	0	0	0	0	1

Improper Payments Elimination and Recovery Act Reporting Details

As required by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and the Improper Payments Information Act ((IPIA) (henceforth referred to collectively as IPERA), the Commission reports the following information.

I. RISK ASSESSMENTS

The Commission has eight programs that make disbursements under the direction of the Commission and its Administrators. Of these programs listed below, the two programs highlighted in bold were previously identified as susceptible to significant improper payments.

- **Universal Service Fund High Cost Program (USF-HC)**
- **Universal Service Fund Schools and Libraries Program (USF-S&L)**
- Universal Service Fund Low Income Program (USF-LI)
- Universal Service Fund Rural Health Care Program (USF-RHC)
- Universal Service Fund Administrative Costs (USF-Admin)
- Interstate Telecommunications Relay Services Fund (TRS)
- North American Numbering Plan (NANP)
- FCC Operating Funds (FCC)

In FY 2011, the Commission reviewed the six programs above that were not previously identified as susceptible to significant improper payments. The risk assessment process considered the following risk factors: (1) whether the program was new to the Commission; (2) complexity of the program; (3) volume of payments made annually; (4) whether payment decisions were made outside the Commission; (5) whether any major changes were made to the program; (6) level of experience and quality of training provided to personnel responsible for making programmatic decisions regarding eligibility and payments; (7) significant deficiencies identified in audit reports performed by the Commission, external auditors, the Office of Inspector General, the Government Accountability Office, and other relevant management reports; and (8) results from other improper payment work.

After completion of the risk assessment review process for FY 2011, the Commission added one program to the list of programs susceptible to significant improper payments: the Interstate Telecommunications Relay Service Fund (TRS). As a result, the Commission's updated list of programs that are susceptible to significant improper payments contains the following programs:

- Universal Service Fund High Cost Program (USF-HC)
- Universal Service Fund Schools and Libraries Program (USF-S&L)
- Interstate Telecommunications Relay Services Fund (TRS)

II. STATISTICAL SAMPLING PROCESS

In FY 2011, the Commission used a different statistical sampling process to obtain a statistically valid estimate of the annual amount of improper payments in the USF-HC fund and the USF-S&L fund than it had used previously. The prior FCC USF audit program followed a dual-objective audit approach that simultaneously used audit procedures to test beneficiary compliance with FCC rules and addressed the requirements of the IPERA. The results obtained from this prior process did not satisfy the Office of Management and Budget's (OMB) requirement that agencies assert the improper payment error rate with precision. As a result, in consultation with OMB, the FCC directed the Universal Service Administrative Company (USAC) in 2010 to separate the two objectives into distinct programs – one focused on improper payment assessment and the second on auditing compliance with all four USF programs. The new IPERA assessment plan is consistent with the 2009 IPIA Executive Order and applicable OMB circulars, and is overseen by the Commission's Office of the Managing Director. In FY 2011, the Commission used the improved methodology to test a statistically valid number of disbursement transactions in the USF-HC and USF-S&L programs to obtain a statistically valid estimate of the improper payment error rate. In accordance with OMB guidance, a brief description of these processes follows below, including additional details about prior year results.

USF-HC The Commission worked closely with OMB in FY 2010 and FY 2011 to improve the process that the Commission uses to identify improper payments. This effort resulted in the Commission adopting a payment quality assurance (PQA) assessment process to identify improper payments and an audit process to evaluate compliance with Commission rules. The Commission used stratified simple random sampling in FY 2011 based on calendar year 2010 disbursements. Samples from USF-HC disbursements were randomly selected simultaneously from all twelve months to ensure that no study area would be assessed more than once during the year. Assessments of calendar year 2010 transactions were conducted monthly and included: 1) steps to measure the accuracy of payments; 2) evaluation of program applicants' eligibility; 3) testing of high level information obtained from program participants; and, 4) testing for line count duplicates and summary schedule variances. The sampling units for USF-HC were study area codes that were divided into three strata according to disbursement amounts. The strata were defined based on total disbursement amount to the beneficiary for all of calendar year 2010. The disbursement strata based on annual disbursements were: less than $1.0 million; $1.0 million to $4.99 million; and $5 million or more. Using stratified simple random sampling the Commission determined the total number of study area codes to be tested each month was 20 and the total number for calendar year 2010 was 240, or $76.2 million in disbursements. Improper payments of $65 thousand were identified in the sample. Weights were used to extrapolate estimates of total improper payments and total disbursements from the sample to the population, commonly referred to as simple expansion estimators. The combined ratio estimator was used to estimate the improper payment rate by dividing the extrapolated total improper payments by the total extrapolated disbursements. Using this methodology, the estimated improper payment rate for USF-HC is .11% for calendar year 2010. The total extrapolated amount of improper payments for calendar year 2010 is $5.1 million out of disbursements of $4.5 billion.

For FY 2010, the Commission reported in its Agency Financial Report (AFR) that the results of the FY 2007 audits, previously overseen by the Office of Inspector General (OIG), identified an improper payment error rate of 16.6% (initial results). These results were later revised by the Commission to 2.7% based upon additional audit work performed by external auditors and the Commission. The FY 2008 audit effort, also previously overseen by OIG, reported an improper payment error rate for FY 2008 of 23.3% (initial results). For FY 2011, external auditors and the Commission completed additional audit work on the FY 2008 audits and revised the error rate to 2.7%. The FY 2009 audit effort, which was previously overseen by the OIG until oversight was transferred to the Office of Managing Director, was completed this year by external auditors and the Commission. The error rate was calculated to be 2.4% for the FY 2009 audit effort.

USF-S&L The Commission worked closely with OMB in FY 2010 and FY 2011 to improve the process that the Commission uses to identify improper payments. This effort resulted in the Commission adopting a PQA assessment process to identify improper payments and an audit process to evaluate compliance with Commission rules. The Commission used stratified simple random sampling in FY 2011 based on calendar year 2010 disbursements. Samples from USF-S&L disbursements were randomly selected on a monthly basis. Assessments of calendar year 2010 transactions were conducted monthly and included: 1) steps to measure the accuracy of payments; 2) evaluation of program applicants' eligibility; 3) testing of high level information obtained from program participants; 4) review of technology plans for certified approval and timing of approval; and 5) verification of service eligibility. The sampling units for USF-S&L were invoice lines that were divided into four strata according to disbursement amounts. The strata were defined based on the total amount disbursed to the beneficiary for all of calendar year 2010. The disbursement strata based on annual disbursements were: less than $1,000; $1,000 to $9,999; $10,000 to $99,999; and, $100,000 or more. Using stratified simple random sampling, the Commission determined the total number of invoice lines to be tested each month averaged 60 and the total number for calendar year 2010 was 724, or $55.9 million in disbursements. Improper payments of $549 thousand were identified in the sample. Weights were used to extrapolate estimates of total improper payments and total disbursements from the sample to the population, commonly referred to as simple expansion estimators. The combined ratio estimator was used to estimate the improper payment rate by dividing the extrapolated total improper payments by the total extrapolated disbursements. Using this methodology, the estimated improper payment rate for USF-S&L is .94% for calendar year 2010. The total extrapolated amount of improper payments for calendar year 2010 is $21.9 million out of disbursements of $2.3 billion.

For FY 2010, the Commission reported in its AFR the results of the FY 2007 audits, previously overseen by the OIG, and identified an improper payment error rate of 12.9% (initial results). As with USF-HC, these results were later revised by the Commission to 8.6% based on additional audit work performed by external auditors and the Commission. The FY 2008 audit effort, also previously overseen by the OIG, reported an improper payment error rate for FY 2008 of 13.8%**.** For FY 2011, external auditors and the Commission completed additional audit work on the FY 2008 audits, which were previously overseen by the OIG until oversight was transferred to OMD, and revised the error rate to 10.4%. The FY 2009 audit effort, which was initiated under the oversight of the OIG until transferred to OMD, has not been completed.

III. CORRECTIVE ACTION PLANS

The following discussion describes the corrective action plans for USF-HC and USF-S&L, and includes, where available, root cause information (error amount) and ongoing corrective actions to reduce improper payments. Also included below is an update on the implementation of the TRS corrective action plan.

<u>USF-HC</u> From 2007 to 2009, USAC conducted 786 audits of USF-HC Program beneficiaries, in three rounds, under the oversight of the OIG. One of the main objectives of the audits was to determine an estimated improper payment error rate under IPERA. Based upon follow-up audit work from rounds 2 and 3[5], the following root causes were identified as resulting in improper payments:

High-Cost Audit Issues by Number of Audits	Number of Audits
Inadequate/missing documentation	94
Line count/loop inaccurate	160
Accounting error	152
Subscriber list error	28
Revenue reporting error	13
Other Reasons	31

High-Cost Audit Issues by Improper Payment Amount	Improper Payment Amount Totals
Line count/loop inaccurate	$53,139,271
Inadequate/missing documentation	$15,208,866
Accounting error	$23,263,505
Eligibility error	$2,534,262
Subscriber list error	$313,712
Other findings	$973,367

In FY 2011, the PQA process identified the following improper payment issues and amounts. The Commission is currently working with USAC to recover these funds and to make additional improvements to the USF-HC program.

High-Cost PQA issues by Improper Payment Amount	Improper Payment Amount Totals	Number of Instances
Inadequate documentation	$19,857	39
Line count inaccurate	$33,214	19
Other findings	$12,104	1

[5] The error rate for the program is discussed above. In addition, although Round 1 results were similar, they were not reported in the above format and are not included in this table.

USF S&L From 2007 to 2009, USAC conducted 760 audits of USF-S&L Program beneficiaries, in three rounds, under the oversight of the OIG. One of the main objectives of these audits was to determine an estimated improper payment rate under IPERA. Based upon follow-up audit work from round 2[6], the following root causes were identified as resulting in improper payments:

E-rate Audit Issues by Number of Audits	Number of Audits
Missing documentation	19
Bidding Violation	19
Invoicing Error	18
Ineligible entity or participants	12
Improper discount rate	11
Other Reasons	27

E-rate Audit Issues by Improper Payment Amount	Improper Payment Amount Totals
Bidding Violation	$11,711,547
Ineligible services or equipment	$2,388,347
Ineligible entity or participants	$1,925,480
Inadequate or missing technology plan	$903,975
Invoicing error	$877,676
Improper discount rate	$873,814

In FY 2011, the PQA process identified the following improper payment issues and amounts. The Commission is currently working with USAC to recover these funds and to make improvements to the USF-S&L program.

Schools and Libraries PQA issues and Improper Payment Amount	Improper Payment Amount Totals	Number of Instances
Incomplete documentation	$33,572	14
Inadequate or missing technology plan	$87,691	11
Ineligible entity or participants	$2,363	2
Failure to utilize services and goods	$425,473	1

Efforts to Reduce Future Improper Payments The Commission has taken several actions to further strengthen oversight of the USF and reduce improper payments. At the direction of the FCC, USAC has developed a comprehensive set of measures to reduce improper payments arising from the errors identified in the tables above which include outreach, oversight and management, audits, and information technology resources. USAC has expanded outreach designed to prevent the errors identified above from reoccurring. enhanced internal controls and data collection to gain greater visibility into payment operations, calibrated audit and audit follow-up activities to gain greater certainty about beneficiary support, and modernized information technology systems to achieve greater efficiencies and improve

[6] The error rate for the program is discussed above. In addition, although Round 1 results were similar, they were not reported in the above format and are not included in this table. Also, because final review of Round 3 results remains underway, those results are not included in this table.

reporting capabilities. Key actions undertaken by the FCC and USAC to correct issues identified in the audits and PQA tests include:

- The FCC directed USAC to separate the USF IPERA efforts into two distinct programs with two objectives – one focused on improper payment assessment and the second on auditing compliance with the rules for all four USF programs. In the previous FCC USF audit program, an audit approach was utilized which tested beneficiary compliance with FCC rules and simultaneously addressed the requirements of IPERA.
- The FCC released an Order adopting rules that addressed issues identified in the IPERA audits, such as: establishing tighter document retention requirements for program participants, providing for a uniform standard for recovering improperly disbursed funds, and creating additional penalties for bad actors, such as debarment.
- The FCC released a Notice of Inquiry seeking recommendations on ways to prevent or reduce improper payments and to further strengthen management and oversight of the USF.
- The FCC implemented a Memorandum of Understanding with USAC to improve the management, administration, and oversight of the USF.
- The USAC internal controls team continued the required internal control related documentation and testing to ensure the company's internal controls program and internal controls framework are in compliance with best practices consistent with the internal controls process defined in OMB Circular A-123. Corrective action plans have been developed by the Commission and USAC, and are currently being implemented to remediate all identified control deficiencies.
- USAC increased the number of employees and resources dedicated to review audit findings and seek recovery of improper payments.
- Under the Commission's oversight and review, USAC has conducted extensive and multiple training sessions and webinars to educate program beneficiaries about program rules and other requirements.

TRS In March 2011, for the first time, the FCC transitioned to a contract arrangement with the TRS Administrator, selecting Rolka Loube Saltzer Associates (RLSA) to serve as the TRS Fund Administrator beginning in July 2011. RLSA is in the process of implementing a payment recapture audit program as part of its overall program of effective internal control over disbursements. The payment recapture audit program includes preventive and detective controls to ensure payments are legal, accurate, and consistent with IPERA. Accordingly, these implementing policies and procedures provide a methodology for identifying improper payments and establishing a system to track improper payments through the collection/recapture process, corrective action implementation, identification of root causes for findings, and plans to learn from findings and change internal controls as appropriate. The implementing policies also include controls and processes for preventing, detecting, and recapturing improper payments. In addition, the Commission continues its efforts in making programmatic changes to protect against improper payments.

Within five months of its selection as the contractual administrator of the TRS fund, the Commission also instructed RLSA to: (1) implement an internal control structure consistent with the standards and guidance contained in OMB Circular A-123 and OMB Circular A-50; (2) perform an annual Fraud Risk Assessment to assess the adequacy of existing controls and to determine whether additional fraud counter-measures require remediation plans; (3) ensure that the audit follow-up, resolution, and corrective action of audit findings are documented and in place, and that recovery actions are instituted in instances where recovery of TRS Funds is warranted; and (4) notify the FCC in writing of potential noncompliance, or any waste, fraud, or abuse, as soon as possible.

IV. IMPROPER PAYMENT REPORTING

Table 1 below reports the initial baseline improper payment rate for USF-HC and USF-S&L programs. Because this is the first year in which the Commission has labeled the TRS program as susceptible to significant improper payments, no error rate is listed below for TRS. In FY 2012 the Commission will identify and report a baseline error rate for the TRS program.

Table 1 Improper Payment Reduction Outlook
(Dollars in thousands)

Program or Activity	USF-HC	USF-S&L	TRS
PY Outlays	n/a	n/a	n/a
PY IP%	n/a	n/a	n/a
PY IPS	n/a	n/a	n/a
CY Outlays	$4,574,000	$2,314,000	n/a
CY IP%	.11%	.94%	n/a
CY IP$	$5,031	$21,752	n/a
CY Overpayment $	$16	$549	n/a
CY Underpayment $	$49	-	n/a
CY+1 Est. Outlays	$4,590,300	$2,244,100	n/a
CY+1 IP%	.11%	.94%	n/a
CY+1 IP$	$5,049	$21,095	n/a
CY+2 Est. Outlays	$4,613,300	$2,265,000	n/a
CY+2 IP%	.11%	.94%	n/a
CY+2 IPS	$5,075	$21,291	n/a
CY+3 Est. Outlays	$4,642,800	$2,235,200	n/a
CY+3 IP%	.11%	.94%	n/a
CY+3 IPS	$5,107	$21,011	n/a

V. RECAPTURE OF IMPROPER PAYMENTS REPORTING

The following discussion is a summary of the Commission's payment recapture audits for FY 2011 for programs with over $1 million in annual outlays.

USF USF outlays for FY 2011 totaled over $8 billion. Although the Commission's payment recapture plan has been initiated, the majority of audits remain underway and most recommendations are expected in Fiscal Year 2012. Below are details concerning: (1) the agency's efforts in implementing the payment recapture audit plan that is underway; (2) information concerning payment recapture audits completed in FY 2011; and (3) other completed audit efforts for FY 2011.

The previous FCC USF audit program followed a dual-objective audit approach, which simultaneously used audit procedures to test beneficiary compliance with FCC rules and addressed the requirements of the IPERA. The FCC has since directed USAC to separate the two objectives into distinct programs – one focused on improper payment assessment and the second on auditing compliance with all four USF programs. The program summarized below outlines the payment recapture audit program designed to evaluate USF beneficiary and contributor compliance with FCC rules. This compliance audit program was developed with the following objectives:

- Covering all four USF programs and contributors;
- Tailoring audit type and scope to program risk elements, size of disbursement, audit timing, and other specific factors (i.e., recognizing that the varying programs and beneficiary types do not warrant a "one size fits all" approach);
- Keeping the costs of the program reasonable relative to overall program disbursements, the amounts disbursed to the beneficiary being audited, and USF administrative costs;
- Spreading audits throughout the year to balance workload, improve efficiencies, control costs, reduce unnecessary burdens on beneficiaries, and maintain a pool of trained auditors; and
- Retaining capability and capacity for targeted and risk-based audits to be conducted as recommended by USAC management, the FCC, and/or law enforcement entities.

The following table summarizes the USF compliance audit program that USAC has been directed to implement:

Program / Area	No. of Audits	Estimated Cost (in millions)
High Cost	100	$ 9.7
Schools and Libraries	100	$ 7.5
Low Income	48	$ 1.2
Rural Health Care	32	$ 0.3
USF Contributors	50	$ 6.7
Targeted / Risk-Based	10	$ 1.0
Total	**343**	**$26.4**

USAC will examine the results of the audit and assessment programs outlined here, and implement a corrective action plan in response to any findings that is consistent with OMB Circular A-123 and OMB Circular A-50 (provides guidance for executive agencies in responding to reports issued by the OIG, other executive branch audit organizations, the Government Accountability Office, and non-Federal auditors where follow up is necessary). In addition, USAC will incorporate the lessons learned from each recommendation into future audit and assessment efforts. USAC also is ensuring that auditors receive adequate training on the telecommunications industry and the USF rules and requirements.

Consistent with reporting requirements of OMB Circular A-123, the payment recapture auditor has conducted audits and provided recommendations on how to mitigate conditions giving rise to overpayments in the USF for FY 2011. Follow-up audits also continue in response to findings from the prior fiscal year FCC audit plan mentioned above and independent performance audits conducted by USAC's auditing group. Specifically, USAC has completed 37 audits in FY 2011 that identified overpayments, and identified $10.2 million to be recovered. USAC has completed recovery of overpayments for more than half of these audits, and the recovery process is ongoing for the remainder.

FY 2011 USF Admin Outlays USAC is an independent, not-for-profit corporation designated as the administrator of the USF by the FCC. Each year, an independent audit of USAC is conducted to determine, among other things, whether USAC is properly administering the Universal Service Fund to prevent waste, fraud, and abuse. Included in this examination is whether any overpayments have been made concerning fund administration. Examination of the 2010 calendar year audit continues to demonstrate that USAC Administrative (Admin) outlays are low-risk and there were no findings of improper payments. In addition, the Commission closely follows the USAC Admin outlays through review of USAC's quarterly program demand filings and monthly administrative expense statements. In response to these findings and other reviews performed by the Commission, the Commission is examining whether it is cost effective pursuant to OMB Circular A-123 to conduct a payment recapture audit of USAC Admin outlays. Finally, all payments related to USAC administrative costs will be reviewed every three calendar years using a statistically valid sample to determine any improper payments, and recapture actions will be taken as necessary. USAC Admin outlays for FY 2011 totaled approximately $101 million.

TRS The TRS Fund compensates telecommunications relay service providers for the reasonable costs of offering services, in compliance with Commission rules, that enable individuals who are deaf-blind or have a hearing or speech disability to communicate in a manner that is functionally equivalent to voice telephone users. The TRS Fund Administrator, appointed by the FCC and under its oversight, is responsible for the collections and disbursements from the TRS Fund. In March 2011, for the first time, the FCC transitioned to a contract arrangement with the TRS Administrator, selecting RLSA to serve as the TRS Fund Administrator beginning in July 2011. As the new administrator of TRS, RLSA is in the process of implementing a payment recapture audit program as part of its overall program of effective internal control over disbursements. The payment recapture audit program includes preventive and detective controls to ensure payments are legal, accurate, and consistent with IPERA. Accordingly, these implementing policies and procedures provide a methodology for identifying improper payments and establishing a system to track improper payments through the collection/recapture process, corrective action implementation, identification of root causes for findings, and plans to learn from findings and change internal controls as appropriate. The policies also include controls and processes for preventing, detecting, and recapturing improper payments. In addition, the Commission is continuing its efforts to make programmatic changes to protect against improper payments.

The Commission has also instructed RLSA to: (1) implement an internal control structure consistent with the standards and guidance contained in OMB Circular A-123 and OMB Circular A-50; (2) perform an annual Fraud Risk Assessment to assess the adequacy of existing controls and to determine whether additional fraud counter-measures require remediation plans; (3) ensure that the audit follow-up, resolution, and corrective action of audit findings are documented and in place, as well as recovery actions in instances where recovery of TRS Funds is warranted; and (4) notify the FCC in writing of potential noncompliance or any waste, fraud, or abuse as soon as possible.

Because TRS providers submit monthly minutes for reimbursement, the submission of fraudulent and/or inflated TRS minutes increases the risk of improper payments. Under the direction of the FCC, the TRS Administrator implemented procedures and controls to identify potential fraud and abuse in its monthly review/analyses of the Video Relay Service (VRS) call data detail records. The TRS Administrator modified its processes and procedures for data reporting and provider payments, increased the amount of information the providers are required to submit, and expanded its review procedures. Consequently, VRS providers are required to submit the call data information along with their monthly minute report. The call data information includes: (1) the call record ID sequence; (2) CA ID number; (3) session start and end times noted at a minimum to the nearest second; (4) conversation start and end times noted at a minimum to the nearest second; (5) incoming telephone number and IP address (if call originates with an IP-based device) at the time of the call; (6) outbound telephone number (if call terminates to a telephone) and IP address (if call terminates to an IP-based device) at the time of call; (7) total conversation minutes; (8) total session minutes; (9) the call center (by assigned center ID number) that handled the call; and (10) the URL address through which the call is handled. In addition, VRS providers are required to employ an automated record keeping system to capture the call data information listed above that must be submitted when seeking compensation from the Fund.

The monthly rate at which the TRS Administrator withheld payment from August 2009 through April 2011 reflected a decline from 6.7% to 0.13% of total VRS minutes submitted for payment. While this decline may be the product of various factors, it may in part indicate that providers are more accurately submitting minutes that are compensable for reimbursement. Moreover, the TRS Fund continues to be audited by both the Commission's independent auditors and the TRS Administrator. In prior fiscal years, the Fund was also audited by the independent auditors of the National Exchange Carrier Association (NECA), the prior TRS Administrator. No major findings were reported, and an unqualified opinion was rendered by NECA's auditor. TRS outlays for FY 2011 totaled approximately $678 million.

NANP NANP is the basic numbering scheme permitting interoperable telecommunications services within the U.S., Canada, Bermuda, and most of the Caribbean. Neustar administers NANP and Welch LLP is the billing and collection agent. For FY 2010, an independent auditor conducted a financial statement audit which examined all transactions over $7,500 incurred by NANP. Specifically, this audit tested 53 percent of the approximately $4.5 million expenditures of NANP. NANP also has an annual Agreed Upon Procedures (AUP) engagement conducted to assess internal control and compliance with the Fund's requirements and FCC rules. NANP's billing and collection agent oversees administration of the program, and submits the annual financial statement audit and AUP. As a further safeguard, as part of its internal control measures, NANP also reviews each transaction by the billing and collection agent for completeness and ensures compliance with FCC requirements and relevant regulations. Based on the above audit, AUP, and additional safeguards, NANP was determined to be a low risk program with no identified overpayments for FY 2010. Based on these findings, the Commission is examining whether it is cost effective pursuant to OMB Circular A-123 to conduct a payment recapture audit. NANP outlays for FY 2011 totaled approximately $4.5 million.

FCC Operating Expenses. Overseen by the Office of Managing Director (OMD), the FCC's operating expenses are separated into two categories, Compensation and Benefits, and Non-salary or Operating Expenses. Each year an independent audit is performed for the FCC's financial statements. For FY 2011, FCC operating expenses were determined to be low risk with no identified overpayments. Based on these findings, the Commission is examining whether it is cost effective pursuant to OMB Circular A-123 to conduct payment recapture audits. In addition, operating expenses will be subject to a risk assessment repeated every 3 years to ensure that the risk of improper payments remains low. FCC Operating Expenses for FY 2011 totaled approximately $111 million.

The Commission reports in Table 2 the results of FY 2011 payment recapture audits, and also reports prior year payment recapture audits for FY 2004 through FY 2010 as prior year results.

Table 2 Payment Recapture Audit Reporting
(Dollars in thousands)

Program or Activity	USF-HC	USF- LI	USF-RHC	USF-S&L	USF-Admin	TRS	NANP	FCC
Type of Payment (contract, grant, benefit, loan, or other)	Benefit	Benefit	Benefit	Benefit	Other	Benefit	Contract	Other
Amount Subject to Review for CY Reporting	$4,049,400	$1,590,900	$126,300	$2,351,900	$101,200	$677,941	$4,516	$111,154
Actual Amount Reviewed and Reported (CY)	$86,408	$20,034	$153	$28,406	-	-	-	-
Amount Identified for Recovery (CY)	$2,256	$125	$17	$7,887	-	-	-	-
Amount Recovered (CY)	$1,163	$118	$15	$160	-	-	-	-
% of Amount Recovered out of Amount Identified (CY)	51.5%	94.4%	89.1%	2.0%	0.0%	0.0%	0.0%	0.0%
Amount Outstanding (CY)	$1,093	$7	$2	$7,727	-	-	-	-
% of Amount Outstanding out of Amount Identified (CY)	48.5%	5.6%	10.9%	98.0%	0.0%	0.0%	0.0%	0.0%
Amount Determined Not to be Collectable (CY)	-	-	-	-	-	-	-	-
% of Amount Determined Not to be Collectable out of Amount Identified (CY)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Amounts Identified for Recovery (PYs)	$108,906	$9,819	$132	$103,256	-	-	-	-
Amounts Recovered (PYs)	$61,399	$799	$132	$19,650	-	-	-	-
Cumulative Amounts Identified for Recovery (CY + PYs)	$111,162	$9,944	$149	$111,143	-	-	-	-
Cumulative Amounts Recovered (CY + PYs)	$62,562	$917	$147	$19,810	-	-	-	-
Cumulative Amounts Outstanding (CY+PYs)	$48,600	$9,027	$2	$91,333	-	-	-	-
Cumulative Amounts Determined Not to be Collectable (CY+PYs)	-	-	-	-	-	-	-	-

The Commission is currently establishing targets for the payment recapture audit program. Listed below in Table 3 are the preliminary targets for the program using the FY 2011 results.

Table 3 Payment Recapture Audit Targets
(Dollars in thousands)

Program or Activity	Type of Payment (contract, grant, benefit, loan, or other)	CY Amount Identified	CY Amount Recovered	CY Recovery Rate (Amount Recovered/ Amount Identified)	CY+1 Recovery Rate Target	CY + 2 Recovery Rate Target	CY + 3 Recovery Rate Target
USF-HC	Benefit	$2,256	$1,163	51.50%	75%	95%	100%
USF-LI	Benefit	$125	$118	94.40%	98%	99%	100%
USF-RHC	Benefit	$17	$15	89.10%	95%	99%	100%
USF-S&L	Benefit	$7,887	$160	2.0%[7]	75%	95%	100%

The Commission reports in Table 4 the aging of its outstanding overpayments from the payment recapture audits performed in FY 2011.

Table 4 Aging of Outstanding Overpayments
(Dollars in thousands)

Program or Activity	Type of Payment (contract, grant, benefit, loan, or other)	CY Amount Outstanding (0-6 months)	CY Amount Outstanding (6 months to 1 year)	CY Amount Outstanding (over 1 year)
USF-HC	Benefit	-	$1,094	-
USF-LI	Benefit	$7	-	-
USF-RHC	Benefit	$2	-	-
USF-S&L	Benefit	$20	$7,707	-

[7] Based on pending audit follow-up work, $6.5 million of the $7.9 million has been reduced to less than $200 thousand. The recovery amount and rate will be revised once the audit follow-up work effort is completed and a final recovery total has been determined.

The Commission reports in Table 5 the disposition of recaptured funds from FY 2011 payment recapture audits.

Table 5 Disposition of Recaptured Funds
(Dollars in thousands)

Program or Activity	Type of Payment (contract, grant, benefit, loan, or other)	Agency Expenses to Administer the Program	Payment Recapture Auditor Fees	Financial Management Improvement Activities	Original Purpose	Office of Inspector General	Returned to Treasury
USF-HC	Benefit	$177	$268	-	$1,163	-	-
USF-LI	Benefit	$826	-	-	$118	-	-
USF-RHC	Benefit	$531	-	-	$160	-	-
USF-S&L	Benefit	$767	-	-	$15	-	-

The Commission reports in Table 6 those improper payments identified through and recovered through sources other than payment recapture audits.

Table 6 Overpayments Recaptured Outside of Payment Recapture Audits
(Dollars in thousands)

Source of Recovery	Amount Identified (CY)	Amount Recovered (CY)	Amount Identified (PY)	Amount Recovered (PY)	Cumulative Amount Identified (CY+PYs)	Cumulative Amount Recovered (CY+PYs)
USF-HC PQA	$10	$7.70	-	-	$10	$7.70
USF-LI IDV	$2,676	$111	-	-	$2,676	$111
USF-LI PQA	$44	$15	-	-	$44	$15
USF-RHC PQA	$147	-	-	-	$147	-
USF-RHC Non-Audits	$221	$227	$1,319	$734	$1,540	$961
USF-S&L PQA	$448	$0.80	-	-	$448	$0.80
USF-S&L Non-Audits	$50,135	$1,181	$96,446	$8,720	$146,581	$9,901

VI. ACCOUNTABILITY

In prior years, the Commission directed USAC to implement a performance-based compensation program that links executive compensation and bonuses to efforts to reduce and prevent improper payments. Although no longer in effect, the Commission is actively working with USAC's management to implement new performance measurements for program management that will help ensure accountability over USAC's operations and senior leadership.

VII. AGENCY INFORMATION SYSTEMS AND INFRASTRUCTURE

USF Under the Commission's oversight, USAC has expanded outreach designed to prevent the errors identified in the PQA process from reoccurring, enhanced internal controls and data collection to gain greater visibility into payment operations, calibrated audit and audit follow-up activities to gain greater certainty about beneficiary support, and modernized information technology systems to achieve greater efficiencies and improve reporting capabilities. As discussed above, USAC has also increased the number of employees and resources to perform reviews of audit findings and recovery of funds.

TRS As the new TRS administrator, RLSA is in the process of implementing a payment recapture audit program as part of its overall program of effective internal control over disbursements. The payment recapture audit program includes preventive and detective controls to ensure payments are legal, accurate, and consistent with IPERA. The Commission is working with the TRS administrator to ensure sufficient information systems and infrastructure is in place to effectively carry out the program.

VIII. BARRIERS

No barriers to be reported at this time.

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: October 14, 2011

TO: Julius Genachowski, Chairman

FROM: David L. Hunt, Inspector General

SUBJECT: Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000, the Office of Inspector General ("OIG") is submitting its annual statement summarizing our assessment of the most serious management challenges facing the Federal Communications Commission ("FCC') in Fiscal Year ("FY") 2011 and beyond.

During our audits and investigations we have worked with managers in the FCC in recommending actions that best address these challenges. More information on this can be found in our last Semiannual Report to Congress.

Universal Service Fund ("USF") Program

The Telecommunications Act of 1996 created the framework for the Universal Service Fund, ("Fund") which consists of support mechanisms for: (1) providing financial support to eligible telecommunications carriers that serve high-cost areas; (2) assisting schools and libraries with telecommunications and internet services; (3) assisting low-income consumers with being able to afford telephone service; and (4) assisting rural health care providers with access to telecommunications and internet services. The Fund is administered by the Universal Service Administrative Company. The Office of Inspector General has ongoing audits and is supporting investigations addressing allegations of fraudulent activity involving the Fund.

Reform of the USF programs – Lifeline, High Cost, Schools and Libraries, and Rural Health Care – may represent the FCC's most serious management challenge. The goals of the National Broadband Plan and the impact on the transition of the current High Cost Program to a Connect America Fund are significant. In his October 6, 2011 address regarding High Cost, the Chairman stated the following:

- USF worked in the 20th century. But the program isn't working for the 21st.
- USF is outdated.
- USF is wasteful and inefficient.
- USF is unfair.
- USF is not sufficiently accountable.

Changes to the Schools & Libraries, Low Income, and Rural Health Care programs also present significant challenges as the FCC transitions the existing programs. We believe planning and implementating changes in USF presents a significant management challenge.

Telecommunications Relay Service ("TRS") Fund

The TRS Fund, which encompasses video relay services ("VRS") was established to compensate service providers for their estimated costs of providing interstate telephone transmission services that enable a person with a hearing or speech disability to communicate with a person who does not have a hearing or speech disability. Distributions from the TRS Fund have grown substantially over the years, with especially significant increases in more recent years.

The OIG continues to receive allegations of fraud and is supporting investigations and audits to address these allegations. The OIG has also provided input to the Commission as they continue to address fraudulent activity and programmatic shortcomings. We recognize that the Commission has taken many positive remedial steps thus far. As the program remedies are on-going, however, fraud prevention remedies are the subject of petitions for reconsideration and waivers. As we continue to receive new allegations of fraudulent TRS activity, we believe much remains to be done. Accordingly, we believe that improving the oversight of the TRS program remains a significant management and performance challenge.

Innovation at the FCC

One of the FCC's new strategic goals for FY 2011 is Continual Improvement. Specifically, the Commission states that "The FCC is striving to become a model for excellence in government. The FCC will be data-driven in our decision making and is committed to transparent and participatory processes that encourage public involvement and feedback. We will maintain an organizational culture that promotes innovation and accountability." The FCC depends upon its information systems and the information within them to effectively and efficiently accomplish its mission. Additionally, The FCC, along with the rest of the federal government, is being asked to use technology to a greater extent in order to reduce costs and, at the same time, achieve greater productivity, for example, moving to cloud computing. Expectations are high that the use of Web 2.0 technologies will increase citizen participation in government through better communication, along with providing greater government transparency. This all reflects rapid technological change, which introduces both risks and rewards. One of the major challenges with this rapid change is the proper implementation, management, and oversight of these new technologies, which have inherent, and constantly evolving, information security risks.

One of the Commission's information technology projects over the past several years has been to implement an integrated financial management system. At the beginning of FY 2011, the FCC began implementation of its new core financial management system, GENISIS, to remedy longstanding weaknesses with regard to the lack of data integration capabilities of the former financial management system. The former system did not integrate with key FCC systems or the FCC reporting components (i.e., the Universal Service Fund, the Telecommunications Relay Service Fund, and the North American Numbering Plan) and as a result financial data for FCC's consolidated financial statements was compiled manually in a complex and time-consuming process.

During the first year of GENESIS operation, however, we note that management was faced with challenges with day-to-day financial transaction processing, budget execution, and reporting due to initial integration and data migration issues that require manual workarounds. The functionality has improved substantially over the last few months, however some transactions continue to be processed via workarounds. As of the end of FY 2011, the component financial information is not fully integrated with GENESIS and certain elements of the revenue and disbursements modules are not fully operational. With the increasing demand for accountability and transparency throughout the federal government completing the remaining financial system integration projects so that the FCC is able to operate a fully functioning and integrated financial information system is critical remains a management challenge.

Sincerely,

David L. Hunt

cc: Edward Lazarus, Chief of Staff
David B. Robbins, Managing Director
Mark Stephens, Chief Financial Officer

Office of the Managing Director

M E M O R A N D U M

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 Inspector General's Management and Performance Challenges

Management appreciates the Office of the Inspector General's (OIG) assessment of the most serious management challenges facing the Federal Communications Commission (Commission or FCC) for fiscal year (FY) 2011 and beyond. In its October 14, 2011 memorandum, the OIG identifies several management challenges facing the Commission. First, OIG states that reform to the Universal Service Fund (USF) programs, which include high cost, schools and libraries, low income, and rural health care, may represent the FCC's most serious management challenge. Second, OIG states that improving the oversight of the Telecommunications Relay Services (TRS) program remains a significant management challenge. Third, OIG states that proper implementation, management, and oversight of new technologies are major challenges at the Commission. Finally, OIG states that with the increasing demand for accountability and transparency throughout the federal government, completing the remaining financial system integration projects so that the FCC is able to operate a fully functioning and integrated financial information system is critical and remains a management challenge.

Management concurs with the challenges identified by the OIG. In the upcoming year, management will continue its efforts to address and resolve these challenges.

First, OIG correctly notes the significant challenges before the FCC under the various proposals to reform the Universal Service Programs. For example, the Commission has taken action to reform the high cost program into a streamlined efficient Connect America Fund designed to help make 21^{st} century broadband available and affordable to rural communities. Concerning the E-rate (schools and libraries) program, the Commission has taken action so that schools are provided the flexibility to open their Internet connections to their communities and to explore the benefits of wireless for education. Further, the Commission staff is actively engaged in the proceeding examining the question of whether to explicitly allow Lifeline support for broadband. Finally, the Commission continues its efforts to reform the rural health care program to expand the reach and use of broadband connectivity by health care providers throughout the nation.

The Commission has worked diligently and will continue to do so by implementing changes to these programs so that American consumers receive the benefits of broadband. For example, as part of recent USF proceedings, Commission staff has sought extensive public input, through written comment submissions, public workshops, ex parte meetings, and presentations. These efforts have provided valuable input in refining proposals as the Commission adopted or moved towards adoption on these proposals. In addition, the Commission will work closely in its role as overseer of the Universal Service Administrative Company (USAC) to monitor its implementation of any orders. The Commission will also work closely with state commissions, consumers, tribal governments, and telecommunications providers to provide feedback and directives. Through these efforts, the Commission will try to ensure that all of the benefits of moving USF into the 21st century are achieved.

Management would also like to update OIG on its efforts to resolve identified control weaknesses and provide updates on efforts to improve oversight of the USF. During FY 2011 alone, the Commission closed 84 various audit recommendations, which is indicative of the heavy emphasis that is placed on resolving management and performance challenges. In addition, during FY 2011, management took numerous measures to improve the controls surrounding the USF. The actions listed below provide a summary of the Commission's concerted efforts to improve both USF and USAC's operations throughout FY 2011.

- Issued two suspension orders against individuals regarding the E-rate program after they were convicted of engaging in fraud or similar criminal acts related to the schools and libraries support mechanism.
- Released two enforcement actions against companies that failed to comply with universal service filing and payment rules. These actions include the issuance of a Forfeiture Order imposing a monetary forfeiture in excess of $660,000 against ADMA Telecom, Inc. The Commission also entered into a consent decree with Allegiance Communications, Inc., which included a $20,000 voluntary contribution to the U.S. Treasury.
- Worked with USAC and the Department of Justice (DOJ) in successfully pursuing wrongdoers who sought to defraud the USF. In FY 2011, these efforts yielded cash recoveries of approximately $17.8 million. The Commission continues to support DOJ in seeking criminal convictions and civil judgments against defendants charged with E-rate and other USF fraud. The FY 2011 caseload consisted of 6 active cases that cumulatively involved more than $4.9 million in claims for which the amount of the alleged fraud has been calculated and additional claims for which the dollar amount cannot yet be determined.
- Expanded and intensified efforts to recapture improper payments. Specifically, the FCC has embarked on a plan which separates improper payment assessment from the USF compliance audit program, and which both improves and streamlines the audit review process. The revised recapture plan is consistent with the Improper Payments Elimination and Recovery Act, the Improper Payments Information Act, and Office of Management and Budget (OMB) guidance. The Commission's Office of the Managing Director (OMD) oversees these efforts.
- Provided detailed steps that USAC should follow when performing audits, overseeing audits, and resolving audit findings and recommendations concerning USF. In particular, the Commission directed USAC to develop a systematic process for assessing internal controls that considers audit findings and is supported by documented procedures and policies.
- Directed USAC to improve existing internal controls for protecting against improper payments when distributing support under all four universal service programs.
- Directed USAC, in response to a recommendation from the Government Accountability Office (GAO), to conduct a robust risk assessment of the E-rate program. The assessment must consider, among other things, the top five findings from the last five rounds of E-rate audits and their impact on meeting program objectives. In addition, the FCC directed USAC to implement a series of measures to strengthen internal controls.

- Directed USAC, in response to a recommendation from GAO, to conduct a robust risk assessment of the Low Income Program and implement a series of measures to strengthen internal controls.
- In response to the December 2010 report *USAC Final Report and Statistical Analysis of the 2007-08 High Cost Program Beneficiary Audits*, and to further identify and reduce improper payments, the FCC instructed USAC, for each of finding concerning improper payments, to examine, identify, explain, and categorize the cause(s) of each error and to make recommendations to prevent these errors from re-occurring.
- Provided additional instruction to USAC concerning compliance with the Federal Information Security Management Act of 2002.
- Resolved several contributor appeals clarifying contribution requirements, including issues involving revenue reporting for universal service assessment purposes and wholesale and resale provider obligations.
- Directed USAC to develop a plan to reimburse Eligible Telecommunications Carriers (ETCs) for Lifeline support based on actual claims as opposed to projected claims, which is how USAC currently reimburses carriers. USAC developed a plan and the Wireline Competition Bureau put it out for public comment in October of 2011.
- The *Sixth Report and Order*, adopted in September 2010, established rules regarding gifts between applicants and service providers in the E-rate program. In December 2010, the Wireline Competition Bureau released an order providing further guidance on the gift rules adopted by the Commission.
- Adopted an order in January 2011 clarifying that applicants must submit detailed documentation supporting their requests for funding at the same time they submit their applications for E-rate funding. This change was made because applicants who do not submit that information when they file often overestimate their funding requests, which has the effect of reducing the funds available for other applicants and potentially increasing the amount of E-rate funds left unused each year. Furthermore, when USAC must seek submission of the information, the efficiency of USAC's review process suffers and administrative costs increase.
- Released a Report and Order clarifying the current Children's Internet Protection Act rules and requiring E-rate recipient schools, per the Protecting Children in the 21st Century Act, to certify that they have updated their Internet safety policy to include provisions for educating minors about interacting on social networking websites and cyberbullying awareness.
- Adopted an order accelerating disbursements of E-rate funding reserves so that more schools and libraries can upgrade their access to broadband services this year. The Wireline Competition Bureau also directed USAC to make funding commitments for priority two services at all discount levels for FY 2010.
- Commission staff attended all eight of the USAC E-rate trainings for applicants and service providers to ensure that guidance given during the training sessions was consistent with Commission rules and orders.
- In November 2010, the Federal-State Board on Universal Service issued a Recommended Decision on consumer eligibility, verification, and outreach for the Low Income program. The Commission incorporated the Joint Board's recommendations into a Notice of Proposed Rulemaking, released in March 2011, and expects to issue an Order to reform and modernize the Low Income program by the end of the year.
- Adopted a Notice of Proposed Rulemaking that proposed to adopt performance goals and measures for the High Cost program and improve accountability from companies receiving High Cost support to ensure that public investments are used wisely to deliver intended results. The Commission expects to issue an Order shortly.

We also agree with OIG's assessment that improving the oversight of the TRS program remains a significant management challenge. During the past fiscal year, the Commission has worked hard to improve the TRS program and has taken the following steps to strengthen the TRS program administration:

- Issued 23 citations to "white-label" Video Relay Services (VRS) providers who continued to offer and provide VRS to the public after the Commission established new rules to ensure that only entities which receive reimbursements directly from the TRS Fund, e.g., eligible providers, offered and provided VRS to the public. Should subsequent violations occur, these entities would be subject to a Notice of Apparent Liability (NAL).
- Initiated investigations to determine if eligible providers submitted minutes for reimbursement that were generated through use of telephone numbers associated with their business operations. Through these investigations, more than $3 million in potential overpayments has been identified. Once verification of the overpayments has been completed, the Commission will work with the providers and the TRS Fund administrator to recover the funds. Subsequent enforcement may be taken against the providers for the inaccurate submittals.
- Released a Report and Order and Further Notice of Proposed Rulemaking adopting reforms to address fraud in the VRS industry, and seeking comment on further reform proposals.
- Released an Order freezing the VRS rates to facilitate further reforms of the VRS program.
- Released a Second Report and Order strengthening the eligibility criteria for certification to receive compensation from the Interstate TRS Fund to provide VRS.
- Released a Memorandum Opinion and Order, Order, and Further Notice of Proposed Rulemaking clarifying and further strengthening the certification process for VRS provider applicants.
- Performed monthly reviews of the administrative expenses of NECA.
- Conducted a fraud risk assessment of TRS and identified weaknesses to be strengthened.
- Finalized a competitive procurement, effective July 1, 2011, selecting Rolka Loube Saltzer Associates, LLC (RLSA) as the new TRS Fund Administrator. The Commission is working closely with RLSA concerning steps to strengthen oversight of the program. Steps taken by the Commission include:
    - Requiring the TRS Administrator to implement an internal control structure consistent with the standards and guidance contained in OMB Circular A-123, which includes risk assessments performed in critical areas of greatest risk and remedial action plans for control issues identified by the assessments.
    - Directing the TRS Administrator to perform a Fraud Risk Assessment as in past years to assess the adequacy of existing controls and to determine whether additional fraud counter-measures require remediation plans.
    - Ensuring that the audit follow-up, resolution, and corrective action of audit findings are documented and in place, as well as recovery actions in instances where recovery of TRS Funds is warranted.
    - Directing the TRS Administrator to notify the FCC in writing of potential noncompliance or any waste, fraud, or abuse as soon as possible.
    - Directing whistle blowers to report waste, fraud, and abuse to the FCC's OIG hot line.

- Directing the TRS Administrator to develop an audit program to evaluate the compliance of TRS providers with FCC rules.

Management further agrees with OIG that a proper implementation, management, and oversight of new technologies, such as transition to Web 2.0, at the Commission is a major challenge. The Commission continues its efforts to transition to new technologies with proper implementation, management, and oversight. For example, to effectively and efficiently transition to Web 2.0, the Commission has, among other things, formed a multi-bureau team to review and assess the new and developing Web 2.0 technologies, implemented Web 2.0 tools such as blogs, Facebook, Twitter, and Uservoice to encourage public involvement and feedback, and implemented the use of cloud computing to help manage costs.

Management also agrees with OIG that new technologies are not without information security risks. The FCC's Cyber Security program must, therefore, keep pace with the adversary's technological advances or face egregious harm to its network and reputation. To keep pace, the FCC has developed a comprehensive, risk-based approach to protect and support our missions. Over the past six months, the Chief Information Officer and Chief Information Security Officer have collaborated with the U.S. Congress, the Department of Homeland Security, National Security Agency, Department of Veterans Affairs, Department of State, and the Federal Bureau of Investigation to develop best practices in order to implement a best of breed and integrated approach that will transform the FCC into a Cyber Security Center of Excellence in government. To safeguard against information security risks, the CIO has also implemented an audit tracking and accountability system to assist in the overall IT audit and operational management.

Finally, management agrees with OIG's finding that completing the remaining financial system integration projects, so that the FCC is able to operate a fully functioning and integrated financial information system, remains a management challenge. The Commission has made substantial progress in response to this challenge. The FCC "went live" with the Core Financial System Replacement (Genesis) project on October 14, 2010. As a modern, integrated core financial system, Genesis allows the FCC to manage its finance, accounting, and budget activities in a more efficient and effective manner. The newly implemented financial system reduces and/or eliminates instances of duplicate transaction entry and reduces preparation of manually intensive reconciliations. Financial business processes were reengineered to leverage best practices and improved functionality provided by the new system. Genesis provides a web-enabled self service capacity for the Bureaus and Offices to execute accounting functions using business analytics for decision making and supports the reduction of the paper chain associated with the approval and manual distribution of documents.

During the second quarter of FY 2011, the FCC along with the system integrator, CGI, performed a joint assessment to evaluate the operational state of the Genesis financial system after "go-live" and its ability to meet the Commission's needs. Based on this assessment and supplemental discussions, the FCC worked jointly with the CGI integration team to identify outstanding FCC system issues and to establish a "Get Well Plan" for resolving remaining system functionality problems and defects. The Commission made substantial progress in closing and resolving the remaining implementation issues in FY 2011 resulting in an 83% closure rate for the year.

In August 2011, the FCC also initiated implementation of the Genesis Acquisitions module to replace an antiquated procurement system which interfaced with the financial system. The new Acquisitions module is fully integrated within the Genesis application and is consistent with OIG's recommendation. During FY 2012, the Commission plans to continue working closely with its reporting components to fully integrate financial information into the Genesis application. In addition, the Commission will continue to examine additional integration functionality which can be leveraged.

We look forward to continuing to work with the Commission's OIG to identify and address challenges to the Commission's operations and to strengthen the culture of integrity, accountability, and excellence that exists at the Commission.

David B. Robbins, Managing Director
Office of Managing Director

Mark Stephens, Chief Financial Officer
Office of Managing Director