OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: November 14, 2012

TO: Chairman

FROM: Inspector General for

SUBJECT: Audit of the Federal Communications Commission's Financial Statements for Fiscal Year 2012

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 2012 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 repeat significant deficiencies related to FCC's financial system functionality and integration and 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 IntegrityAct 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 14, 2012 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.

cc: Managing Director
Chief of Staff
Chief Financial Officer

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KPMG LLP
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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, 2012 and 2011, 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" or "basic 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, 2012 and 2011, 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 Note 20 to the consolidated financial statements, the FCC changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012 based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting*

Requirements. As a result, the FCC's combined statement of budgetary resources for fiscal year 2011 has been adjusted to conform to the current year presentation.

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary Information sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic 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 basic financial statements. Such information has not been subjected to the auditing procedures applied during our audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 14, 2012, 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 14, 2012

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

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, 2012 and 2011, 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 14, 2012. As discussed in Note 20 to the consolidated financial statements, the FCC changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012 based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*.

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 over financial reporting. In planning and performing our fiscal year 2012 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 2012 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 written response to the significant deficiencies identified in our audit and presented in the Agency Financial Report was not subjected to the auditing procedures applied in the audit of the FCC's consolidated financial statements 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 14, 2012.

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 14, 2012

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. During the FY 2012 audit, we noted the following issues still existed as they relate to reporting functionality:

- 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 until June 2012. FCC is still unable to properly refer debt to Treasury for servicing.

- Throughout the fiscal year ended September 30, 2012, the FCC was unable to generate a system allocation of costs for the Statement of Net Cost, and continued to manually generate the FCC consolidated financial statements using Microsoft Excel.

Certain of the components' significant transactions are tracked on Microsoft Excel spreadsheets and recorded into the general ledger at a summary level. Significant examples of this include (amounts in thousands as of September 30, 2012):

- Investment Transactions for USF and TRS – $6,548,090

- Accounts Receivable Subledgers for USF – $791,882

- Total Budgetary Resources for USF and TRS – $13,799,794

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 due to the need for additional reconciliations resulting from non-integrated processes.

Recommendations

1. Record and track significant component level proprietary and budgetary transactions within the component financial systems in accordance with the requirements set forth in the GAO Standards for Internal Control in the Federal Government. (**Updated**)
2. Utilize the electronic integration of the component financial information to generate consolidated financial statements efficiently and effectively with the requirements set forth in the GAO Standards for Internal Control in the Federal Government. (**Updated**)

Information Technology (IT) Controls

As we reported in fiscal year 2011, 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. FCC consolidated financial statements are comprised of three reporting components; Commission headquarters and field offices, the Universal Service Fund (USF), and the North American Numbering Plan (NANP). However, the noted IT deficiencies described below relate to the Commission, which represents approximately $339.8 million of $9.9 billion of consolidated Statement of Net Cost. 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 Circular A-123 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 Universal Service Administrative Company's (USAC) 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:

3. Completing the development of and implementing policies and procedures for overseeing the information security programs for contractor 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, National Institute of Standards and Technology (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. (**Re-issued**)

Risk Assessment Findings

OMB Circular A-123 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 one other major FCC system that we tested, the security assessment report was incomplete, as 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 the system security plan for one major system was not used to plan controls to mitigate risks identified in the security assessment report.

Furthermore, we noted that the FCC's risk management activities were behind schedule. Specifically, the authorization to operate was expired for ten of the twelve FCC information systems that the FCC defines as major applications. Re-assessment activities were in progress for four of the ten systems, but for the other six unauthorized systems no progress had been made. Not reassessing risks and control effectiveness and then reauthorizing an information system at a minimum of every three years, increases the risk that since the previous security authorization, the current state of a system, its controls or the environment it operates in will have changed to the point that the system security plan no longer describes the system's current controls and the security assessment report no longer considers the full range of significant risks to which the system is subject.

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:

4. 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). **(Re-issued)**
5. After planning and successfully testing the necessary IT security controls and assessing the residual risks, the FCC makes authorization decisions for its currently ten unauthorized information systems. (**New**)
6. 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)**
7. 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)**

Control Activities Findings

OMB Circular A-123 requires internal control to be in place over information systems in the form of general and application controls. General controls 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*, which are 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. One major application lacked documented guidance on the assignment of access privileges. 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 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*. **(Re-issued)**

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. **(Re-issued)**

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,* which are 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. (**Re-issued**)

14. Reviewing and updating procedures to ensure that access badges are collected and physical access is disabled when individuals leave the FCC. (**Re-issued)**

15. Granting individuals computer room access only after management approval. (**Re-issued**)

16. Revising current vulnerability assessment procedures to be more broadly applied and to have more consistent reporting requirements. (**Re-issued**)

17. Documenting and implementing procedures for security audit logging and review. (**Re-issued**)

18. Documenting policy to define requirements for password strength and account lockout, including the scope and applicability of password policies. (**Re-issued**)

Change Control

Strengthen change and configuration management controls by:

19. Restricting developer access to the production environment. (**Re-issued**)

20. 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. **(Re-issued)**

21. Documenting and implementing configuration management procedures for maintaining securely configured applications, databases, and infrastructure components. **(Re-issued)**

Monitoring Findings

OMB Circular A-123 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:

22. 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. **(Re-issued)**

23. 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 10, 2011. The following table provides our assessment of the progress the FCC has made through September 30, 2012, in correcting the significant deficiencies identified in the fiscal year 2011 Independent Auditors' Report.

Significant Deficiencies			
Recommendation Number	**Condition Audit Area**	**Recommendation**	**Current Status**
I. Financial Systems Functionality & Integration			
1	FCC Entity	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 Finding #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.	Closed
3	FCC Entity	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 Finding #2
II. Information Technology Controls			
4	FCC Entity	The FCC strengthens its control environment by: 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.	Reissued Finding # 3
5	FCC Entity	The FCC strengthens its approach to performing risk	Reissued

Significant Deficiencies			
Recommendation Number	**Condition Audit Area**	**Recommendation**	**Current Status**
		assessments by: 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).	Finding # 4
6	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.	Reissued Finding # 7
7	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.	Reissued Finding # 6
8	FCC Entity	The FCC strengthens its security program oversight and planning by: 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.	Reissued Finding # 8
9	FCC Entity	The FCC strengthens its security program oversight and planning by: 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.	Reissued Finding # 9
10	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 equivalent to the NIST SP 800-53 Revision 3, Recommended Security Controls for Federal Information Systems, minimum baseline controls.	Reissued Finding # 10

Significant Deficiencies			
Recommendation Number	**Condition Audit Area**	**Recommendation**	**Current Status**
11	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.	Reissued Finding # 11
12	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.	Reissued Finding # 12
13	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.	Reissued Finding # 13
14	FCC Entity	The FCC strengthens its access controls by: Reviewing and updating procedures to ensure that access badges are collected and physical access is disabled when individuals leave the FCC.	Reissued Finding # 14
15	FCC Entity	The FCC strengthens its access controls by: Granting individuals computer room access only after management approval	Reissued Finding # 15
16	FCC Entity	The FCC strengthens its access controls by: Documenting the roles and permissions used within major applications.	Closed
17	FCC Entity	The FCC strengthens its access controls by: Identifying and documenting conflicting privileges within major applications and documenting procedures to help ensure separation of duties and to address developer access.	Closed
18	FCC Entity	The FCC strengthens its access controls by: Revising current vulnerability assessment procedures to be more broadly applied and to have more consistent reporting requirements.	Reissued Finding # 16
19	FCC Entity	The FCC strengthens its access controls by: Documenting and implementing procedures for security audit logging and review.	Reissued Finding # 17
20	FCC Entity	The FCC strengthens its access controls by: Documenting policy to define requirements for password strength and account lockout, including the scope and	Reissued Finding # 18

Significant Deficiencies			
Recommendation Number	**Condition Audit Area**	**Recommendation**	**Current Status**
		applicability of password policies.	
21	FCC Entity	The FCC strengthens its change and configuration management controls by: Restricting developer access to the production environment.	Reissued Finding # 19
22	FCC Entity	The FCC strengthens its change and configuration management controls by: 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.	Reissued Finding # 20
23	FCC Entity	The FCC strengthens its change and configuration management controls by: Documenting and implementing configuration management procedures for maintaining securely configured applications, databases, and infrastructure components.	Reissued Finding # 21
24	FCC Entity	The FCC strengthens its monitoring controls by: 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..	Reissued Finding # 22
25	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.	Reissued Finding # 23

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Independent Auditors' Report on Compliance and Other Matters

Managing Director
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We have audited the consolidated balance sheets of the Federal Communications Commission (FCC) as of September 30, 2012 and 2011, 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 14, 2012. As discussed in Note 20 to the consolidated financial statements, the FCC changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012 based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*.

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 written response to the instances of noncompliance and other matter identified in our audit and presented in Exhibit I and the preceding paragraph was not subjected to the auditing procedures applied in the audit of the FCC's consolidated financial statements and, accordingly, we express no opinion on it.

We noted certain additional matters that we have reported to management of the FCC in a separate letter dated November 14, 2012.

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 14, 2012

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 14, 2012.

Debt Collection Improvement Act of 1996 (DCIA)

In fiscal year 2011, the 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 fiscal year 2012 control walkthrough procedures, we were informed that the FCC had not yet transferred to the Department of Treasury any fiscal year 2011 or 2012 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 because the automated aging capability in the GL System was not functioning until June 2012. However, FCC is still unable to properly refer debt to treasury for servicing.

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 14, 2012.

Office of the Managing Director

M E M O R A N D U M

DATE: November 15, 2012

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 2012

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) 2012 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 2012 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 seventh straight year, the independent auditor provided an unqualified opinion and found that the Commission's consolidated financial statements for FY 2012 present fairly, in all material respects, the financial position of the Commission as of September 30, 2012. Seven 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 2012 audit reports point out two significant deficiencies related to internal controls, note two instances of non-compliance that still need to be resolved, and mention 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 reports.

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 2012 to resolve the auditors' findings and improve the performance of its financial reporting process. The Commission's new core financial system was launched in October 2010, and during FY 2012 the Commission worked to further deploy all the functionality of that system. Also in FY

2012, 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 2013, 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 2013.

Fifth, the Other Matters reported under review as a possible violation of the Anti-Deficiency Act will be fully investigated in FY 2013. 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 2013 to resolve the FY 2012 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, 2012 and 2011
(Dollars in thousands)

	FY 2012	FY 2011
ASSETS (Note 2):		
Intragovernmental:		
Fund balance with Treasury (Note 3)	$ 361,739	$ 494,340
Investments (Note 5)	6,548,090	5,822,843
Accounts receivable (Note 6)	1,574	1,097
Other	-	2,436
Total intragovernmental	6,911,403	6,320,716
Cash and other monetary assets (Note 4)	139,322	213,944
Accounts receivable, net (Note 6)	875,088	831,072
Loans receivable, net (Note 7)	335	4
General property, plant, and equipment, net	56,832	60,461
Other	13,024	13,053
Total assets	$ 7,996,004	$ 7,439,250
LIABILITIES (Note 8):		
Intragovernmental:		
Debt (Note 9)	$ -	$ 50,300
Other (Note 10)		
Custodial	162,657	206,524
Other	6,240	13,725
Total other	168,897	220,249
Total intragovernmental	168,897	270,549
Accounts payable	110,523	92,976
Other (Note 10)		
Deferred revenue	62,971	93,053
Prepaid contributions	85,849	77,362
Accrued liabilities for Universal Service	752,423	633,967
Other	39,578	35,804
Total other	940,821	840,186
Total liabilities	$ 1,220,241	$ 1,203,711
Commitments and Contingencies (Note 11)		
NET POSITION		
Unexpended appropriations - other funds	$ 4,251	$ 15,105
Cumulative results of operations - earmarked funds (Note 17)	6,622,985	6,089,350
Cumulative results of operations - other funds	148,527	131,084
Total net position	$ 6,775,763	$ 6,235,539
Total liabilities and net position	$ 7,996,004	$ 7,439,250

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST

For the Periods Ended September 30, 2012 and 2011
(Dollars in thousands)

	FY 2012	FY 2011
Program costs (Note 12)**:**		
Broadband:		
Total Gross Cost	$ 48,428	$ 54,536
Competition and Innovation:		
Total Gross Cost	9,739,491	9,099,922
International:		
Total Gross Cost	10,126	6,753
Consumers:		
Total Gross Cost	52,200	46,156
Public Safety and Homeland Security:		
Total Gross Cost	48,123	35,576
Continual Improvement:		
Total Gross Cost	98,582	50,626
Total Program Costs	$ 9,996,950	$ 9,293,569
Cost not assigned to programs:		
Other expenses	(5)	25
Less: earned revenues not attributed to programs	(460,246)	(472,830)
Net cost of operations	$ 9,536,699	$ 8,820,764

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Periods Ended September 30, 2012 and 2011
(Dollars in thousands)

	FY 2012			FY 2011		
	Earmarked Funds	All Other Funds	Total	Earmarked Funds	All Other Funds	Total
Cumulative Results of Operations:						
Beginning Balances	$ 6,089,350	$ 131,084	$ 6,220,434	$ 6,135,941	$ 93,773	$ 6,229,714
Budgetary Financing Sources:						
Other adjustments	-	-	-	-	1,041	1,041
Appropriations used	-	20,301	20,301	-	45,266	45,266
Non-exchange revenue (Note 17)	10,078,791	-	10,078,791	8,771,949	-	8,771,949
Other Financing Sources (Non Exchange):						
Imputed financing	-	15,487	15,487	-	17,457	17,457
Other	-	(26,802)	(26,802)	-	(24,229)	(24,229)
Total Financing Sources	10,078,791	8,986	10,087,777	8,771,949	39,535	8,811,484
Net Cost of Operations	9,545,156	(8,457)	9,536,699	8,818,540	2,224	8,820,764
Net Change	533,635	17,443	551,078	(46,591)	37,311	(9,280)
Cumulative Results of Operations	6,622,985	148,527	6,771,512	6,089,350	131,084	6,220,434
Unexpended Appropriations:						
Beginning Balances	-	15,105	15,105	-	21,183	21,183
Budgetary Financing Sources:						
Appropriations received	-	18,432	18,432	-	40,267	40,267
Other adjustments	-	(8,985)	(8,985)	-	(1,079)	(1,079)
Appropriations used	-	(20,301)	(20,301)	-	(45,266)	(45,266)
Total Budgetary Financing Sources	-	(10,854)	(10,854)	-	(6,078)	(6,078)
Total Unexpended Appropriations	-	4,251	4,251	-	15,105	15,105
Net Position	$ 6,622,985	$ 152,778	$ 6,775,763	$ 6,089,350	$ 146,189	$ 6,235,539

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Periods Ended September 30, 2012 and 2011
(Dollars in thousands)

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary Credit Reform Financing Account	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources:				
Unobligated balance brought forward, Oct 1	$ 2,727,599	$ 37,008	$ 2,567,572	$ 4,387
Recoveries of prior year unpaid obligations	1,065,292	-	1,062,160	-
Other changes in unobligated balance (+ or -)	(8,987)	(32,724)	(38)	-
Unobligated balance from prior year budget authority, net	3,783,904	4,284	3,629,694	4,387
Appropriations (discretionary and mandatory)	10,060,594	-	8,785,026	-
Borrowing authority (discretionary and mandatory) (Note 14)	-	856	-	2,843
Spending authority from offsetting collections (discretionary and mandatory)	445,864	2,016	444,602	37,843
Total budgetary resources	$ 14,290,362	$ 7,156	$ 12,859,322	$ 45,073
Status of Budgetary Resources:				
Obligations incurred (Note 13)	$ 11,087,752	$ 2,799	$ 10,131,723	$ 8,065
Unobligated balance, end of year:				
Apportioned	14,537	1,005	21,134	1
Exempt from apportionment	3,055,396	-	2,550,957	-
Unapportioned	132,677	3,352	155,508	37,007
Total unobligated balance, end of year	3,202,610	4,357	2,727,599	37,008
Total budgetary resources	$ 14,290,362	$ 7,156	$ 12,859,322	$ 45,073
Change in Obligated Balance:				
Unpaid obligations, brought forward, Oct 1	$ 3,416,789	$ -	$ 3,736,251	$ -
Uncollected customer payments from Federal sources, brought forward, Oct 1 (-)	(382)	-	-	-
Obligated balance, start of year (net), as adjusted	3,416,407	-	3,736,251	-
Obligations incurred	11,087,752	2,799	10,131,723	8,065
Outlays (gross) (-)	(9,857,564)	(2,799)	(9,389,025)	(8,065)
Change in uncollected customer payments from Federal sources (+ or -)	(5,234)	-	(382)	-
Recoveries of prior year unpaid obligations (-)	(1,065,292)	-	(1,062,160)	-
Obligated balance, end of year				
Unpaid obligations, end of year (gross)	3,581,685	-	3,416,789	-
Uncollected customer payments from Federal sources, end of year (-)	(5,616)	-	(382)	-
Obligated balance, end of year (net)	$ 3,576,069	$ -	$ 3,416,407	$ -
Budget Authority and Outlays, Net:				
Budgetary authority, gross (discretionary and mandatory)	$ 10,506,458	$ 2,872	$ 9,229,628	$ 40,686
Actual offsetting collections (discretionary and mandatory) (-)	(445,504)	(20,448)	(450,467)	(78,111)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(5,234)	-	(382)	-
Budgetary authority, net (discretionary and mandatory)	$ 10,055,720	$ (17,576)	$ 8,778,779	$ (37,425)
Outlays, gross (discretionary and mandatory)	$ 9,857,564	$ 2,799	$ 9,389,025	$ 8,065
Actual offsetting collections (discretionary and mandatory) (-)	(445,504)	(20,448)	(450,467)	(78,111)
Outlays, net (discretionary and mandatory)	9,412,060	(17,649)	8,938,558	(70,046)
Distributed offsetting receipts (-)	(54,772)	-	(59,041)	-
Agency outlays, net (discretionary and mandatory)	$ 9,357,288	$ (17,649)	$ 8,879,517	$ (70,046)

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY
For the Periods Ended September 30, 2012 and 2011
(Dollars in thousands)

	FY 2012	FY 2011
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	$ 38,477	$ 66,871
Fines and Penalties	8,656	43,061
Credit Reform	1,761	7,831
Total Cash Collections	48,894	117,763
Accrual Adjustments (+/-)		
Spectrum Auctions	1,560	4
Fines and Penalties	1,096	(1,751)
Total Accrual Adjustments	2,656	(1,747)
Total Custodial Revenue	51,550	116,016
Disposition of Collections:		
Transferred to Others:		
U.S. Treasury	(10,417)	(50,892)
(Increase)/Decrease in Amounts Yet to be Transferred (+/-)	43,867	19,876
Retained by the Reporting Entity	(85,000)	(85,000)
Total Disposition of Collections	(51,550)	(116,016)
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, 2012 AND 2011
(DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED)

Note 1 - Summary of Significant Accounting Policies

A. Reporting Entity

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

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

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 U.S. 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.

D. Cash and Other Monetary Assets

Cash and Other Monetary Assets represent cash on deposit and money market funds at several commercial banks. Accounts are maintained by the Universal Service Administrative Company (USAC), Rolka Loube Saltzer Associates, LLC (RLSA), and Welch LLP, serving as administrators and/or billing and collection agents for their respective programs. The accounts bear the names of those entities, as well as the Commission or the fund for which they serve as administrator and/or billing and collection agent. Cash on deposit is collateralized by the Federal Reserve.

Note 1 - Summary of Significant Accounting Policies (continued)

D. Cash and Other Monetary Assets (continued)

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.

I. Other Assets

Other Assets – Intragovernmental represent funds related to Auction #73 licenses that have not been granted. These funds were transferred to the National Telecommunications and Information Administration (NTIA) in FY 2008 as required by the Digital Television Transition and Public Safety Act of 2005.

Note 1 - Summary of Significant Accounting Policies (continued)

I. Other Assets (continued)

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.

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.

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

Note 1 - Summary of Significant Accounting Policies (continued)

M. Retirement Plans and Other Benefits (continued)

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 fees were established by congressional authority, and consistent with OMB Circular No. A-25 revised, *User Charges*, the Commission did not determine the full costs associated with its regulatory activity in establishing regulatory fees. Since 1993, Congress has annually reviewed the regulatory fee collection requirements of the Commission and established the total fee levels to be collected. Fees collected up to the level established by Congress are applied against the Commission's annual appropriation at the close of each fiscal year. The regulatory fee levels of $339,844 for FY 2012 and $335,794 for FY 2011 were achieved. The Commission collected $4,874 above the required regulatory level in FY 2012 and $6,247 in FY 2011. The total cumulative amount collected above the required regulatory level since 1997 was $71,044 at September 30, 2012, which is temporarily precluded from obligation.

Note 1 - Summary of Significant Accounting Policies (continued)

O. Revenues and Other Financing Sources (continued)

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 2012 and FY 2011.

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 $40,036 in FY 2012 and $66,875 in FY 2011.

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, calculated over a specific period of time. Application fees are deposited in the Treasury and are not available for the Commission's use. Application fee revenue totaled $24,804 in FY 2012 and $23,892 in FY 2011.

Reimbursable Work Agreements (Exchange) – The Commission recognizes reimbursable work agreement revenue when earned, i.e., goods that have been delivered or services rendered. In FY 2012, the Commission executed agreements totaling $661. The Commission also returned $3,621 in unobligated funds from the American Recovery and Reinvestment Act for Broadband Technology Opportunities Program, which ended in FY 2010, to the appropriate Federal agencies. In FY 2011, the Commission executed agreements totaling $3,893 and no unobligated funds were returned in FY 2011.

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 $339,844 for FY 2012 and $335,794 for FY 2011 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 $18,432 in FY 2012 and $40,267 in FY 2011. 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.

Allocation of Exchange Revenues
The Commission reports the entire balance of exchange revenue on line "Less: earned revenues not attributed to programs" since there is no direct relationship between earned revenues and specific programs.

Reprogramming
In FY 2012, the Commission received approval to reprogram $12,100 of prior year obligations that were deobligated to enable the Commission to implement certain initiatives. The initiatives included $10,000 for cyber security and $2,100 to implement the incentive spectrum auctions provisions included in the *Middle Class Tax Relief and Job Creation Act of 2012*. In FY 2011, the Commission did not submit any requests for reprogramming.

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; 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. 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).

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 for the years ended September 30, 2012 and 2011 are listed below:

Administrative Fees:

	USF	TRS	NANP	Total
FY 2012	$ 105,358	$ 1,094	$ 5,409	$ 111,861
FY 2011	$ 102,118	$ 2,082	$ 4,587	$ 108,787

Note 1 - Summary of Significant Accounting Policies (continued)

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.

R. Mobility Fund Phase I Auction

On September 27, 2012, the Commission completed the Mobility Fund Phase I Auction. In this auction, designated as Auction 901, there were a total of 33 winning bidders. The winning bidders have a binding obligation to file a post-auction long-form application by the applicable deadline and consistent with other requirements of the long-form application process. After the deadline, the Commission will issue a public notice identifying the winning bids that are authorized to receive support. The Mobility Fund Phase I Auction did not have any financial impact in FY 2012.

Note 2 - Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2012 and 2011:

	FY 2012	FY 2011
Intragovernmental:		
Fund Balance with Treasury	$ 179,007	$ 266,981
Accounts Receivable, Net	439	1,081
Other	-	2,436
Total Intragovernmental	179,446	270,498
Accounts Receivable, Net	21,565	19,304
Total Non-entity Assets	201,011	289,802
Total Entity Assets	7,794,993	7,149,448
Total Assets	$ 7,996,004	$ 7,439,250

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for $166,489 in FY 2012 and $238,425 in FY 2011. 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 (FBWT) as of September 30, 2012 and 2011:

FY 2012	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	$ 15,814	$ 4,357	$ -	$ 20,171
Unavailable	78,777	-	-	78,777
Obligated Balance not yet Disbursed	83,784	-	-	83,784
Non-Budgetary FBWT	-	-	179,007	179,007
Total	$ 178,375	$ 4,357	$ 179,007	$ 361,739
FY 2011				
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

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 U.S. Treasury.

Note 4 – Cash and Other Monetary Assets

The following summarizes Cash and Other Monetary Assets as of September 30, 2012 and 2011:

	FY 2012	FY 2011
Cash and Other Monetary Assets	$ 139,322	$ 213,944

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.

Effective February 17, 2012, interest earned on third-party deposits is transferred to the Treasury's General Fund. Prior to February 17, 2012, interest earned on third-party deposits was transferred to the Telecommunications Development Fund.

Note 4 – Cash and Other Monetary Assets (continued)

In FY 2012, Cash and Other Monetary Assets included $136,475 in USF contributions and related accrued interest being held for distribution, and $2,847 in NANP deposits and related accrued interest. 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.

Note 5 - Investments

The following summarizes Investments as of September 30, 2012 and 2011:

FY 2012	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	$ 2,269,876	EI	$ 233	$ -	$ 2,270,109	$ 2,270,170
Treasury Notes	4,274,042	EI	(4,086)	8,025	4,277,981	4,277,414
Total	$ 6,543,918		$ (3,853)	$ 8,025	$ 6,548,090	$ 6,547,584
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

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 17.

The cash receipts collected from the public for the USF are used to purchase federal securities. U.S. 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, 2012 and 2011:

	Intragovernmental		Public		Total	
FY 2012						
Gross Accounts Receivable	$	1,574	$	1,617,826	$	1,619,400
Allowance for Doubtful Accounts		-		(742,738)		(742,738)
Net Accounts Receivable	$	1,574	$	875,088	$	876,662
FY 2011						
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

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 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 96% allowance in FY 2012 and 93% allowance in FY 2011.

	FY 2012			FY 2011		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	$ 1,289,562	$ (442,926)	$ 846,636	$ 1,065,218	$ (268,724)	$ 796,494
COMAD - Schools and Libraries	148,896	(142,345)	6,551	200,342	(185,717)	14,625
Regulatory Fees	38,369	(28,147)	10,222	35,740	(24,194)	11,546
Spectrum Auction	24,194	(22,630)	1,564	21,258	(21,254)	4
Forfeitures	100,549	(97,849)	2,700	95,102	(88,399)	6,703
Other	17,830	(8,841)	8,989	14,936	(12,139)	2,797
Total	$ 1,619,400	$ (742,738)	$ 876,662	$ 1,432,596	$ (600,427)	$ 832,169

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 as of September 30, 2012. The reestimate resulted in a net downward adjustment, including interest on the reestimate, of $1,473.

Direct Loans

Loan Program	Loans Receivable Gross	Interest Receivable	Other Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Spectrum Auctions:					
FY 2012	$ 111,074	$ 7,883	$ 857	$ (119,479)	$ 335
FY 2011	$ 130,533	$ 8,932	$ 1,195	$ (140,656)	$ 4

Interest accrued on bankrupt and defaulted loans totaled $7,883 in FY 2012 and $8,932 in FY 2011.

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

Total Amount of Direct Loans Disbursed

No new loans were issued in FY 2012 and FY 2011.

Note 7 – Loans Receivable, Net (continued)

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 2012 (Net)	$ -	$ -	$ (1,473)	$ (1,473)
FY 2011 (Net)	$ -	$ -	$ 17,629	$ 17,629

Schedule for Reconciling Subsidy Cost Allowance Balances

	FY 2012	FY 2011
Beginning Balance of the Subsidy Cost Allowance	$ 140,656	$ 166,260
Adjustments:		
Loans written off	(20,599)	(42,711)
Other	810	-
Subsidy allowance amortization	85	(522)
Ending balance before reestimates	120,952	123,027
Subsidy reestimates:		
Technical/default reestimate	(1,473)	17,629
Ending balance of the subsidy cost allowance	$ 119,479	$ 140,656
Administrative Expense – Spectrum Auctions	$ 1,837	$ 4,884

Note 8 - Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2012 and 2011:

Intragovernmental:	FY 2012	FY 2011
Other:		
FECA Liability	$ 342	$ 482
GSA Real Estate Taxes	1,922	2,357
Other:		
Unfunded Leave	20,452	20,108
Accrued Liabilities for Universal Service	752,423	633,967
Total liabilities not covered by budgetary resources	775,139	656,914
Total liabilities covered by budgetary resources	445,102	546,797
Total Liabilities	$ 1,220,241	$ 1,203,711

Note 9 - Debt

	FY 2011 Beginning Balance	Net Borrowing	FY 2011 Ending Balance	Net Borrowing	FY 2012 Ending Balance
Debt to the Treasury	$ 87,726	$ (37,426)	$ 50,300	$ (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 10 - Other Liabilities

The following summarizes Other Liabilities as of September 30, 2012 and 2011:

FY 2012	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 162,657	$ 162,657
Other	-	6,240	6,240
Total Intragovernmental	$ -	$ 168,897	$ 168,897
Deferred Revenue	$ 33,392	$ 29,579	$ 62,971
Prepaid Contributions	-	85,849	85,849
Accrued Liabilities for Universal Service	-	752,423	752,423
Other	-	39,578	39,578
Total Other Public	$ 33,392	$ 907,429	$ 940,821

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

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. Deferred revenue represents regulatory fees, spectrum auction revenue, or contributor payments that have been received but not earned by the Commission.

Note 10 - Other Liabilities (continued)

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 11 - 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 8. In addition, there are certain operating leases that may contain provisions regarding contract termination costs upon early contract termination.

In September 2007, a grievance was filed with the Commission under the Federal Labor Standards Act alleging that certain Commission bargaining unit employees were not sufficiently compensated for overtime work. Management in consultation with legal counsel has determined that it is "probable" that some issues presented by this pending grievance will result in payments to some employees, but an estimate of the range of the payments cannot be reasonably measured at this time.

Note 12 – Intragovernmental Costs and Exchange Revenue

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

FY 2012

Program Costs	Intragovernmental	Public	Total
Broadband	$ 12,417	$ 36,011	$ 48,428
Competition and Innovation	48,435	9,691,056	9,739,491
International	2,597	7,529	10,126
Consumers	13,385	38,815	52,200
Public Safety and Homeland Security	12,339	35,784	48,123
Continual Improvement	25,277	73,305	98,582
Total	$ 114,450	$ 9,882,500	$ 9,996,950
Total Earned Revenue	$ 6,065	$ 454,181	$ 460,246

FY 2011

Program Costs	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
Total Earned Revenue	$ 18,624	$ 454,206	$ 472,830

Note 13 - Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations

The following summarizes Apportionment Categories of Obligations Incurred for the years ended September 30, 2012 and 2011:

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Direct:				
Category A	$ 1,148,054	$ -	$ 1,098,682	$ -
Category B	33,934	2,799	49,304	8,065
Exempt from Apportionment	9,896,697	-	8,979,531	-
Total Direct	$11,078,685	$ 2,799	$10,127,517	$ 8,065
Reimbursable:				
Category A	$ 9,067	$ -	$ 4,206	$ -

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

Note 14 - Terms of Borrowing Authority Used

	Borrowing Authority Used	
Maturity Dates:	FY 2012	FY 2011
September 30, 2012	$ 856	$ -
September 30, 2013	-	50,449
Total Borrowing Authority Used	$ 856	$ 50,449

In FY 2012, the Commission used $856 in borrowing authority to fund the FY 2011 Credit Reform Downward Subsidy. The Commission used $50,449 in FY 2011 borrowing authority to extend the maturity dates of the debt owed to BPD. In FY 2012, the entire debt was repaid.

Note 15 – Legal Arrangements Affecting Use of Unobligated Balances

Pursuant to Public Law 111-8, offsetting collections received in excess of $339,844 in FY 2012 shall not be available for obligation. Also, any offsetting collections received in prior years that otherwise become available on or after October 1, 2011, are not available for obligation.

Note 16 - 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 2011 and the amounts presented in the 2013 President's Budget was the presentation of the unapportioned balance of $176,000. OMB Circular No. A-136, *Financial Reporting Requirements*, requires all unapportioned balances to be reflected as "Unobligated balance – Exempt from Apportionment" and "Unapportioned" 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 "Unexpired unobligated balance, end of the year."

The FY 2014 *Budget of the United States Government* (President's Budget) with actual numbers for FY 2012 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 17 – 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.

Note 17 – Earmarked Funds (continued)

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program as of September 30, 2012 and 2011:

Balance Sheet	**FY 2012**	**FY 2011**
ASSETS		
Investments	$ 6,548,090	$ 5,822,843
Cash and other monetary assets	136,475	210,948
Accounts receivable, net	866,813	842,768
General property, plant, and equipment, net	2,678	6,330
Other assets	13,024	13,024
Total assets	$ 7,567,080	$ 6,895,913
LIABILITIES		
Accounts payable	$ 98,743	$ 82,113
Deferred revenue	7,149	13,161
Prepaid contributions	85,780	77,322
Accrued liabilities	752,423	633,967
Total liabilities	$ 944,095	$ 806,563
Cumulative results of operations	$ 6,622,985	$ 6,089,350
Total liabilities and net position	$ 7,567,080	$ 6,895,913
Statement of Net Cost		
Net cost of operations	$ 9,545,156	$ 8,818,540
Statement of Changes in Net Position		
Net position beginning of period	$ 6,089,350	$ 6,135,941
Non-exchange revenue	10,078,791	8,771,949
Net cost of operations	9,545,156	8,818,540
Change in net position	533,635	(46,591)
Net position end of period	$ 6,622,985	$ 6,089,350

Note 18 – Undelivered Orders at the End of the Period

The amount of budgetary resources obligated for undelivered orders totaled $3,463,190 as of September 30, 2012 and $3,314,084 as of September 30, 2011.

Note 19 – Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)

As of September 30, 2012 and 2011:

	FY 2012	FY 2011
Budgetary Resources Obligated:		
Obligations incurred	$ 11,090,551	$ 10,139,788
Less: spending authority from offsetting collections and recoveries	1,536,478	1,591,120
Obligations net of offsetting collections and recoveries	9,554,073	8,548,668
Less: offsetting receipts	54,772	59,041
Net obligations	9,499,301	8,489,627
Other Resources	(11,315)	(6,772)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Undelivered Orders	(149,106)	271,372
Resources that fund expenses recognized in prior periods	-	(691)
Budgetary offsetting collections and receipts that do not affect net cost of operations	75,220	137,152
Resources that finance the acquisition of assets	(16,182)	(13,089)
Other	37,200	145,253
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Increase in annual leave liability	344	(583)
Upward/Downward reestimates of credit subsidy (+/-)	(1,473)	17,629
Increase in exchange revenue receivable from the public	5,277	3,872
Depreciation and amortization	19,810	17,797
Other (+/-)	77,623	(240,803)
Net Cost of Operations	$ 9,536,699	$ 8,820,764

Note 20 – Comparability of the Financial Statements

<u>Statement of Budgetary Resources</u>

The presentation used for the Statement of Budgetary Resources (SBR) prior to FY 2012 has been revised to reflect a new format required pursuant to the OMB Circular No. A-136, *Financial Reporting Requirements*. OMB Circular No. A-136 requires agencies to present both the FY 2012 and 2011 SBR in the same format. Accordingly, certain reclassifications were made to the previously issued FY 2011 SBR to conform to the new format.

REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION – STATEMENT OF BUDGETARY RESOURCES

For the Year Ended September 30, 2012
(Dollars in thousands)

OMB Circular No. A-136, *Financial Reporting Requirements*, requires additional disclosure of an entity's budgetary information by major budgetary accounts if the information was aggregated for presentation purposes on the Statement of Budgetary Resources. Major budgetary accounts of the Commission include Salaries and Expenses (S&E), Credit, Auctions, and USF. S&E represents general salaries and expenses of the Commission. Credit reflects the program and financing accounts related to the direct loan program. Auctions include salaries and expenses of the spectrum auction program. USF includes Universal Service and Telecommunications Relay Service Funds.

Reflected in the chart below are the major budgetary accounts of the Commission that are aggregated and presented in the September 30, 2012 Combined Statement of Budgetary Resources.

STATEMENT OF BUDGETARY RESOURCES

FY 2012	S&E	Credit	Auctions	USF	Total
Budgetary Resources:					
Unobligated balance brought forward, Oct 1	$ 37,051	$ 41,497	$ 1,603	$ 2,684,456	$ 2,764,607
Recoveries of prior year unpaid obligations	5,411	411	979	1,058,491	1,065,292
Other changes in unobligated balance (+ or -)	(6,824)	(32,724)	(2,163)	-	(41,711)
Unobligated balance from prior year budget authority, net	35,638	9,184	419	3,742,947	3,788,188
Appropriations (discretionary and mandatory)	-	18,432	-	10,042,162	10,060,594
Borrowing authority (discretionary and mandatory) (Note 14)	-	856	-	-	856
Spending authority from offsetting collections (discretionary and mandatory)	345,933	2,016	85,246	14,685	447,880
Total budgetary resources	$ 381,571	$ 30,488	$ 85,665	$ 13,799,794	$ 14,297,518
Status of Budgetary Resources:					
Obligations incurred	$ 363,153	$ 22,207	$ 85,186	$ 10,620,005	$ 11,090,551
Unobligated balance, end of year:					
Apportioned	11,039	4,501	2	-	15,542
Exempt from apportionment	-	-	-	3,055,396	3,055,396
Unapportioned	7,379	3,780	477	124,393	136,029
Total unobligated balance, end of year	18,418	8,281	479	3,179,789	3,206,967
Total budgetary resources	$ 381,571	$ 30,488	$ 85,665	$ 13,799,794	$ 14,297,518
Change in Obligated Balance:					
Unpaid obligations, brought forward, Oct 1	$ 55,594	$ 1,572	$ 24,255	$ 3,335,368	$ 3,416,789
Uncollected customer payments from Federal sources, brought forward, Oct 1 (-)	(382)	-	-	-	(382)
Obligated balance, start of year (net), as adjusted	55,212	1,572	24,255	3,335,368	3,416,407
Obligations incurred	363,154	22,206	85,186	10,620,005	11,090,551
Outlays (gross) (-)	(346,753)	(23,099)	(85,188)	(9,405,323)	(9,860,363)
Change in uncollected customer payments from Federal sources (+ or -)	(5,234)	-	-	-	(5,234)
Recoveries of prior year unpaid obligations (-)	(5,411)	(411)	(979)	(1,058,491)	(1,065,292)
Obligated balance, end of year					
Unpaid obligations, end of year (gross)	66,584	268	23,274	3,491,559	3,581,685
Uncollected customer payments from Federal sources, end of year (-)	(5,616)	-	-	-	(5,616)
Obligated balance, end of year (net)	$ 60,968	$ 268	$ 23,274	$ 3,491,559	$ 3,576,069
Budget Authority and Outlays, Net:					
Budgetary authority, gross (discretionary and mandatory)	$ 345,934	$ 21,304	$ 85,245	$ 10,056,847	$ 10,509,330
Actual offsetting collections (discretionary and mandatory) (-)	(345,574)	(20,448)	(85,245)	(14,685)	(465,952)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(5,234)	-	-	-	(5,234)
Budgetary authority, net (discretionary and mandatory)	$ (4,874)	$ 856	$ -	$ 10,042,162	$ 10,038,144
Outlays, gross (discretionary and mandatory)	346,753	23,099	85,188	9,405,323	9,860,363
Actual offsetting collections (discretionary and mandatory) (-)	(345,574)	(20,448)	(85,245)	(14,685)	(465,952)
Outlays, net (discretionary and mandatory)	1,179	2,651	(57)	9,390,638	9,394,411
Distributed offsetting receipts (-)	(26,900)	-	-	(27,872)	(54,772)
Agency outlays, net (discretionary and mandatory)	$ (25,721)	$ 2,651	$ (57)	$ 9,362,766	$ 9,339,639