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OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: December 13, 2013

TO: Chairman

FROM: DAR for Inspector General

SUBJECT: Audit of the Federal Communications Commission's Financial Statements for Fiscal Year 2013

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 2013 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 repeat instances of noncompliance with laws and regulations, the first related to requirements of the Federal Managers' Financial Integrity Act and the second is a noncompliance with the requirements of the Debt Collection Improvement Act.

While management has made improvements as it relates to both of the repeated internal control significant deficiencies noted above, these issues have been reported by financial statement auditors since FY 2005.

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 13, 2013 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.

The Office of Inspector General appreciates the cooperation and courtesies to our staff and the staff of KPMG, LLP during audit.

cc: Managing Director
Chief of Staff
Chief Financial Officer

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

Independent Auditors' Report

Managing Director
Federal Communications Commission

Inspector General
Federal Communications Commission

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Federal Communications Commission (FCC), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

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, 2013 and 2012, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

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 consolidated financial statements. Such information, although not a part of the basic consolidated 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 consolidated 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 consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated 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.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The *Message from the Chairman* and the *Other Information* section is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

KPMG

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2013, on our consideration of the FCC's internal control over financial reporting and our report dated December 13, 2013, on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements 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* in considering FCC's internal control over financial reporting and compliance.

KPMG LLP

December 13, 2013

KPMG LLP
Suite 12000
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Washington, DC 20006

Independent Auditors' Report on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Managing Director
Federal Communications Commission

Inspector General
Federal Communications Commission

We have audited, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of the Federal Communications Commission (FCC), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 13, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2013, we considered the FCC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the FCC's internal control. 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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we did identify certain deficiencies in internal control, described in Exhibit I that we consider to be significant deficiencies.

KPMG

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FCC's Response to Findings

The FCC's response to the significant deficiencies identified in our audit is included in the memorandum from management titled, "Management's Response to Independent Auditors' Reports on Internal Control Over Financial Reporting and Compliance and Other Matters for Fiscal Year 2013." The FCC's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the FCC's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FCC's internal control. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 13, 2013

EXHIBIT I

SIGNIFICANT DEFICIENCIES

Financial System Functionality and Integration

The Federal Communication Commission (FCC or Commission) consolidated financial statements present the financial results of its three reporting components. The components include the Commission headquarters and field offices, the Universal Service Fund (USF) and the North American Numbering Plan (NANP), hereafter referred to as the components. The FCC has oversight responsibilities over the USF and NANP funds, which are administered by other organizations independent of the FCC. The USF reports the results of the four Universal Service support mechanisms and the results of the Telecommunications Relay Service (TRS) Fund. 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.

Since FY 2009 we have reported that FCC needs to implement an integrated system that complies with the requirements set forth in OMB Circular No. A-127, *Financial Management Systems*. In October of fiscal year 2011, the FCC implemented a new financial system. As reported in FY 2012 and noted during the FY 2013 audit the following issues still existed as they related to reporting functionality and integration:

- FCC continued to manually consolidate the financial information from the components and generate the FCC consolidated financial statements and related financial information using Microsoft Excel.

- FCC does not fully utilize system functionality to age receivables or remit debt to the Department of Treasury. During FY 2013 FCC utilized a manual process to identify and transfer the eligible delinquent debt to Treasury (or write it off, as appropriate); however, as of September 30, 2013 this had not yet been fully completed.

- Significant transactions were tracked in Microsoft Excel spreadsheets and then recorded in the general ledger at a summary level via journal entry. Significant examples of this include (amounts in thousands as of September 30, 2013):

  - Investment Transactions for USF and TRS – $7,200,600

  - Accounts Receivable Subledgers for USF – $749,633

  - Total Budgetary Resources for USF and TRS – $13,910,643

As outlined in the FSIO Core Financial System Requirements, OMB Circular No. A-127 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 lack of automated integration between the component's financial systems caused the FCC to continue using manual processes to ensure the general ledger was materially correct. Additional resources were required to maintain the accuracy of the financial system data as a result of additional reconciliations resulting from non-integrated processes, and to perform reviews over the manually generated financial statements.

Recommendations

1. Identify and implement an automated integration of the component financial information to generate consolidated financial statements and related financial information efficiently and effectively.**(Reissued)**
2. Utilize an automated process to assist with remittance of debts to Treasury to eliminate excess manual processing. **(New)**
3. Record and track significant transactions within financial systems. **(Reissued)**

Information Technology (IT) Controls

Since fiscal year (FY) 2009, we have reported that the FCC needed 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. Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, defines the standards 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.

In FY 2013, FCC continued to progress in maintaining an entity-wide security program that provided for an internal control environment that included the components of continuous monitoring, risk assessment, control activities, and information and communication in order to prevent and detect unauthorized access to agency information resources. Although FCC performed certain ongoing monitoring activities and initiatives, we noted moderate improvements from the prior year, the FCC IT infrastructure still did not fully comply with certain OMB standards. We continued to identify deficiencies in the FCC's control environment, risk assessment, control activities, and monitoring related to securing FCC's IT infrastructure. The application of IT was pervasive throughout the FCC and, as a result, these deficiencies prevented the FCC from complying with OMB's internal control objectives for financial reporting. FCC's consolidated financial statements are comprised of three reporting components; FCC headquarters and field offices, the Universal Service Fund (USF), and the North American Numbering Plan (NANP). However, the noted IT deficiencies described below relate primarily to the FCC, which represents approximately $457.9 million of $9.4 billion of consolidated net cost of operations. We have previously reported these deficiencies to FCC management in more detail. Each of the sections below provides additional detail on 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 and completed development of an oversight plan for its contractor-operated information systems, which includes the Universal Service Administrative Company's (USAC) IT security program. However, the FCC had not reviewed or approved the procedures for maintaining the FCC IT system inventory.

By not maintaining a detailed inventory of systems operated on behalf of the FCC by contractors, the FCC's system inventory was incomplete. An incomplete system inventory may result in FCC management not being aware when significant changes occur that could impact the effectiveness of contractors' security controls or that require a re-assessment and re-authorization of a relevant contractor's system.

Control Environment Recommendation

Strengthen the control environment by:

4. Completing the development of the Procedure for Maintaining FCC IT System Inventory and implementing it. The approved procedure should also be distributed to contractor management including CGI Federal, USAC, Rolka Loube Saltzer Associates, and Welch LLP. **(Updated)**

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 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 in the National Institute of Standards and Technology (NIST) Special Publication (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*. The following paragraphs provide more details regarding the deficiencies noted.

The FCC's risk management activities were behind schedule. Specifically, we noted that the authorizations to operate 18 of the 23 FCC systems, including 11 of 14 major applications that expired on October 31, 2012. Without an updated Authorization To Operate (ATO), the system security plan may no longer describe the system's current controls, and the security assessment report may no longer consider the full range of significant risks to which the system is subject. This may result in security control gaps remaining undetected.

Furthermore, we noted the security assessment testing and the assessment of risks for two major applications were incomplete and did not include a full range of technical, operational and management controls and the related vulnerabilities. More specifically, we noted the security assessment testing was incomplete and did not include management and operational controls, as required by NIST 800-53 rev 3. Additionally, testing did not include all technical controls because security assessment testing was limited to technical vulnerability scans of relevant servers. The security assessment and authorization process as required by NIST 800-53, rev 3 is intended to drive the adoption of necessary IT security controls designed to achieve more secure information systems at federal agencies. However, for two out of the four major FCC systems that we tested, the security assessment report was incomplete as the vulnerabilities identified were largely limited to technical vulnerabilities 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.

The FCC had not performed a system security planning and assessment consistent with NIST 800-53, rev 3 requirements and did not reassess and reauthorize its information systems every three years, at a minimum, because of competing operational priorities. However, the FCC did make certain progress during FY 2013. For example, FCC implemented a tool called Xacta, which provides guidance and templates to assist in security authorization efforts. FCC also selected a new Chief Information Security Officer (CISO), Security Architect, and a team of contractors (C-CAP) that were dedicated to planning, implementing and monitoring the FCC's Security Program. Due to the majority of FCC systems having expired Authorizations to Operate, the CISO believes that updating each Certification & Accreditation package will be a long-term process due to operational priorities and limited resources.

We also noted that risk assessments for two 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*.

If all necessary, IT security controls are not planned and complete security assessment testing is not performed, there is an increased risk that control gaps or weaknesses will not be detected and corrected, or mitigated with compensating controls. Additionally, incomplete security assessment testing limits the FCC's ability to perform risk assessments that consider a full range of relevant vulnerabilities and risks.

Risk Assessment Recommendations

Strengthen the approach to performing risk assessments by:

5. Ensuring when security assessment testing identifies vulnerabilities, the FCC assesses the risks (by considering both vulnerabilities and related threats), and adds mitigating controls to the system security plans. These recommendations should be applied to upcoming system security assessment and authorization projects. **(Re-issued)**

6. Planning and successfully testing the necessary IT security controls, and then authorizing for operation its currently 18 unauthorized information systems, prioritizing the 11 systems that are considered major applications. **(Updated)**

7. Performing e-authentication risk assessments and updating system security plans for the remaining two major applications to define for each e-government application the relevant authentication level and the required level of e-authentication controls to implement. **(Updated)**

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. For instance, 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. Two major applications lacked documented guidance on the assignment of access privileges. In addition, FCC did not consistently document and implement procedures for user account management functions for major applications. Furthermore, inconsistent implementation of the procedures that were documented led to instances where access was granted without documented authorization.

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. FCC also did not perform periodic reviews and recertification of network and infrastructure users.

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. Documenting system security plans in detail sufficient to plan system security controls for information systems that are equivalent to the NIST SP 800-53 Revision 3 minimum baseline controls (including required enhancements), that categorize controls as common, hybrid or system-specific, and that describe controls in sufficient detail to identify the system components to which they are applicable. **(Updated)**

9. Performing security assessment testing for applicable management, operational and technical controls in accordance with evaluation criteria from NIST SP 800-53a Revision 1, *Guide for Assessing the Security Controls in Federal Information Systems,* at least once every three years for FCC information systems. **(Re-issued)**

Access Controls

Strengthen access controls by:

10. Consolidating its numerous procedures for adding users to information systems into a comprehensive document with a standardized process that specifies the correct access request form to be used for each system. Systems for which approval for access should be documented include the FCC network, remote access systems (i.e., VPN, and dial-up), FCC applications, and backend infrastructure including servers and databases. **(Updated)**

11. Establishing a process for retaining access authorization forms for new users granted access to the FCC network domain, remote access and FCC applications. **(New)**

12. Documenting a process that informs supervisors how to approve their supervisees' user roles on the new recertification SharePoint site for applications including Commissions Registration System

(CORES) and Genesis. In addition, access should be disabled for application users lacking a supervisor recertification approval after a set timeframe. **(New)**

13. Reviewing, finalizing, and implementing its Application User Account Management Procedures, and ensuring that user's access to the FCC Network and major applications is reviewed and recertified by management. Access should be promptly revoked for users found to no longer need access or whose access is not recertified. **(Updated)**

14. Ensuring individuals are not granted computer room access without prior management approval. **(Re-issued)**

15. Documenting and approving the Chief of Systems', and any other users, access to the WebTA "Admin" account, and setting up mitigating controls to include the monitoring and review of this account's activity. **(New)**

16. Documenting policies and procedures that only allow access to root passwords in emergency situations. **(New)**

17. Revising current vulnerability assessment program to include information and/or procedures, which at a minimum contains the following: the tools currently utilized for configuration and licensing specifications, a list of all FCC devices and assets subject to periodic vulnerability scanning, reporting requirements for vulnerabilities that are identified, and how to document exceptions and establish mitigating security controls when vulnerabilities cannot be remediated.. (**Updated**)

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

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

20. Performing E-File user access reviews every 30 days and ensuring prompt action is taken on results of the reviews. **(New)**

21. Documenting in greater detail the E-File policies and procedures for access recertification. **(New)**

22. Documenting an E-File process to perform periodic reviews of the database audit log activity and implementing the documented process to periodically perform reviews on E-File audit logs database as defined by NIST 800-53 criteria. **(New)**

23. Purchasing an E-File audit log reporting tool to formalize the access review process for the current USAC resources. **(New)**

Change Control

Strengthen change and configuration management controls by:

24. Enforcing policy and procedures to restrict developers' access to the production environment and to ensure that where such access is deemed necessary, any developer actions within production are logged and reviewed in a timely manner. (**Updated**)

25. 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)**

26. Documenting and implementing configuration management procedures for server operating systems, server software, network devices and database management systems. **(Updated)**

27. Ensuring and Infrastructure Change Control Board (ICCB) E-File approval is sought before changes to application code or after every urgent change to the application code to comply with NIST 800-53 and USAC Infrastructure Change Control Board Processes. **(New)**

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 finalized and implemented its IT Continuous Monitoring and Enforcement Plan, and did not include certain items referenced in NIST SP 800-37. NIST 800-37 states an effective organization-wide continuous monitoring program includes: "Configuration management and control processes for organizational information systems; Security impact analyses on…changes to organizational information systems and environments of operation; Security status reporting to appropriate organizational officials; and an assessment of selected security controls (including system-specific, hybrid, and common controls) based on the organization-defined continuous monitoring strategy."

In addition, 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. During FY 2013, the FCC did not finalize its process for tracking and remediating identified vulnerabilities into a Plan Of Action & Milestone (POA&M). When security weaknesses are not centrally tracked and prioritized, appropriate resources may not be assigned, and remediation of security weaknesses may not be accomplished in a timely manner, if at all.

Monitoring Recommendations

Strengthen monitoring controls by:

28. Documenting and implementing procedures for the creation, maintenance, and review of POA&Ms for every program and system for which weaknesses were discovered during reviews, including Government Accountability Office audits, financial system audits, and critical infrastructure vulnerability assessments. **(Updated)**

29. Updating and finalizing its IT Continuous Monitoring and Enforcement Plan based on the guidance provided in NIST Special Publication 800-37, and enforcing the plan though the FCC Cyber Security Policy. **(New)**

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30. Ensuring 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. All controls should be assessed at least once during the three-year authorization cycle. **(Updated)**

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Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Managing Director
Federal Communications Commission

Inspector General
Federal Communications Commission

We have audited, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of Federal Communications Commission (FCC), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 13, 2013.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FCC's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. 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 our tests disclosed two instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02, and which are described in Exhibit I.

Management is currently reviewing a matter regarding a potential violation of the Anti-Deficiency Act. As of the date of this report, the outcome of this matter, and any resulting ramifications, is not known.

FCC's Response to Findings

The FCC's response to the findings identified in our audit is included in the memorandum from management titled "Management's Response to Independent Auditors' Reports on Internal Control Over Financial Reporting and Compliance and Other Matters for Fiscal Year 2013". The FCC's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the responses.

Federal Communications Commission
December 13, 2013
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Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the FCC's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FCC's compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 13, 2013

EXHIBIT I

The Federal Managers' Financial Integrity Act (FMFIA) – Office of Management and Budget (OMB) Circular No. A-127

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.

The FMFIA requires Federal agencies to establish controls in accordance with standards prescribed by the Comptroller General and evaluate such controls using guidelines established by the Office of Management and Budget (OMB). As outlined in 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."

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The FCC reporting component entities' current financial systems and processes were not capable of achieving the financial system integration requirements.

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 Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards* dated December 13, 2013.

Debt Collection Improvement Act of 1996 (DCIA)

FCC had not transferred all eligible debt outstanding for more than 180 days to the Department of Treasury in accordance with the DCIA during fiscal year 2013. FCC was in the process of transferring the eligible delinquent debt to Treasury or writing it off; however, as of September 30, 2013 this had not yet been completed.

The DCIA, 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;"

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 Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards* dated December 13, 2013.

Office of the Managing Director

M E M O R A N D U M

DATE: December 13, 2013

TO: David L. Hunt, Inspector General

FROM: 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 2013

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) 2013 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 2013 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 eighth straight year, the independent auditor provided an unmodified opinion and found that the Commission's consolidated financial statements for FY 2013 present fairly, in all material respects, the financial position of the Commission as of September 30, 2013. Eight 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 2013 audit reports point out two significant deficiencies related to internal controls, and notes two instances of non-compliance that still need to be resolved. The primary areas of concern relate to financial system functionality and integration, information technology 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 2013 to resolve the auditors' findings and improve the performance of its financial reporting process. The Commission's core financial system was launched in October 2010, and during

FY 2013 the Commission worked to further deploy all the functionality of that system. In December, 2013, the Commission will upgrade its core financial system, and this system upgrade will address even more of the auditors' concerns. Also in FY 2013, 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 2014, 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 committed to resolving this issue in FY 2013. By the end of FY 2013, the Commission was close to being current on its referrals to Treasury of all overdue outstanding debt. The Commission plans to be completely current with referrals in FY 2014.

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 2014 to resolve the FY 2013 audit findings and to enhance the culture of integrity, accountability, and excellence that exists here at the Commission.

Mark Stephens, Chief Financial Officer
Office of Managing Director

PRINCIPAL STATEMENTS

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED BALANCE SHEET
As of September 30, 2013 and 2012
(Dollars in thousands)

	FY 2013	FY 2012
Assets (Note 2):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 279,163	$ 361,739
Investments (Note 5)	7,200,600	6,548,090
Accounts receivable (Note 6)	1,235	1,574
Total intragovernmental	7,480,998	6,911,403
Cash and other monetary assets (Note 4)	173,084	139,322
Accounts receivable, net (Note 6)	852,026	875,088
Direct loans receivable, net (Note 7)	3,502	335
General property, plant, and equipment, net	47,590	56,832
Other	13,024	13,024
Total assets	$ 8,570,224	$ 7,996,004
Liabilities (Note 8):		
Intragovernmental:		
Accounts payable	$ 2,522	$ -
Debt (Note 9)	353	-
Other (Note 10)		
Custodial	81,444	162,657
Other	8,114	6,240
Total other	89,558	168,897
Total intragovernmental	92,433	168,897
Accounts payable	134,727	110,523
Other (Note 10)		
Deferred revenue	59,920	62,971
Prepaid contributions	110,057	85,849
Accrued liabilities for Universal Service	1,088,415	752,423
Other	35,036	39,578
Total other	1,293,428	940,821
Total liabilities	$ 1,520,588	$ 1,220,241
Commitments and Contingencies (Note 11)		
Net position		
Unexpended appropriations - All Other Funds	$ 3,394	$ 4,251
Cumulative results of operations - Funds from Dedicated Collections (Note 12)	6,884,853	6,622,985
Cumulative results of operations - All Other Funds	161,389	148,527
Total net position	$ 7,049,636	$ 6,775,763
Total liabilities and net position	$ 8,570,224	$ 7,996,004

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF NET COST
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	FY 2013	FY 2012
Program costs (Note 13):		
Connect America:		
Total Gross Cost	$ 47,037	$ -
Maximize Benefits of Spectrum:		
Total Gross Cost	79,655	-
Broadband:		
Total Gross Cost	-	48,428
Promote Innovation, Investment, and America's Global Competitiveness:		
Total Gross Cost	9,697	-
Promote Competition:		
Total Gross Cost	9,580,394	-
Competition and Innovation:		
Total Gross Cost	-	9,739,491
International:		
Total Gross Cost	-	10,126
Protect and Empower Consumers:		
Total Gross Cost	52,155	-
Consumers:		
Total Gross Cost	-	52,200
Public Safety and Homeland Security:		
Total Gross Cost	47,359	48,123
Advance Key National Purposes:		
Total Gross Cost	10,000	-
Operational Exellence:		
Total Gross Cost	92,807	-
Continual Improvement:		
Total Gross Cost	-	98,582
Total Program Costs	$ 9,919,104	$ 9,996,950
Cost not assigned to programs:		
Other expenses	-	(5)
Less: earned revenues not attributed to programs	(486,596)	(460,246)
Net cost of operations	$ 9,432,508	$ 9,536,699

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	FY 2013			FY 2012		
	Funds from Dedicated Collections (Note 12)	All Other Funds	Total	Funds from Dedicated Collections (Note 12)	All Other Funds	Total
Cumulative Results of Operations:						
Beginning Balances	$ 6,622,985	$ 148,527	$ 6,771,512	$ 6,089,350	$ 131,084	$ 6,220,434
Budgetary Financing Sources:						
Other adjustments	-	(1)	(1)	-	-	-
Appropriations used	-	661	661	-	20,301	20,301
Non-exchange revenue (Note 12)	9,722,967	-	9,722,967	10,078,791	-	10,078,791
Other (Note 12)	67	-	67	-	-	-
Other Financing Sources (Non Exchange):						
Imputed financing	-	15,146	15,146	-	15,487	15,487
Other	-	(31,602)	(31,602)	-	(26,802)	(26,802)
Total Financing Sources	9,723,034	(15,796)	9,707,238	10,078,791	8,986	10,087,777
Net Cost of Operations	9,461,166	(28,658)	9,432,508	9,545,156	(8,457)	9,536,699
Net Change	261,868	12,862	274,730	533,635	17,443	551,078
Cumulative Results of Operations	6,884,853	161,389	7,046,242	6,622,985	148,527	6,771,512
Unexpended Appropriations:						
Beginning Balances	-	4,251	4,251	-	15,105	15,105
Budgetary Financing Sources:						
Appropriations received	-	-	-	-	18,432	18,432
Other adjustments	-	(196)	(196)	-	(8,985)	(8,985)
Appropriations used	-	(661)	(661)	-	(20,301)	(20,301)
Total Budgetary Financing Sources	-	(857)	(857)	-	(10,854)	(10,854)
Total Unexpended Appropriations	-	3,394	3,394	-	4,251	4,251
Net Position	$ 6,884,853	$ 164,783	$ 7,049,636	$ 6,622,985	$ 152,778	$ 6,775,763

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	FY 2013		FY 2012	
	Budgetary	Non-Budgetary Credit Reform Financing Account	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 3,202,610	$ 4,357	$ 2,727,599	$ 37,008
Recoveries of prior year unpaid obligations	927,684	-	1,065,292	-
Other changes in unobligated balance (+ or -)	(1)	-	(8,987)	(32,724)
Unobligated balance from prior year budget authority, net	4,130,293	4,357	3,783,904	4,284
Appropriations (discretionary and mandatory)	9,786,362	-	10,060,594	-
Borrowing authority (discretionary and mandatory) (Note 14)	-	1,496	-	856
Spending authority from offsetting collections (discretionary and mandatory)	448,153	2,516	445,864	2,016
Total budgetary resources	$ 14,364,808	$ 8,369	$ 14,290,362	$ 7,156
Status of Budgetary Resources:				
Obligations incurred	$ 11,004,372	$ 1,536	$ 11,087,752	$ 2,799
Unobligated balance, end of year:				
Apportioned	11,041	32	14,537	1,005
Exempt from apportionment	3,173,822	-	3,055,396	-
Unapportioned	175,573	6,801	132,677	3,352
Total unobligated balance, end of year	3,360,436	6,833	3,202,610	4,357
Total status of budgetary resources	$ 14,364,808	$ 8,369	$ 14,290,362	$ 7,156
Change in Obligated Balance:				
Unpaid obligations:				
Unpaid obligations, brought forward, Oct 1	$ 3,581,685	$ -	$ 3,416,789	$ -
Obligations incurred (Note 15)	11,004,372	1,536	11,087,752	2,799
Outlays (gross) (-)	(9,606,177)	(1,536)	(9,857,564)	(2,799)
Recoveries of prior year unpaid obligations (-)	(927,684)	-	(1,065,292)	-
Unpaid obligations, end of year	4,052,196	-	3,581,685	-
Uncollected payments:				
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(5,616)	-	(382)	-
Change in uncollected pymts, Fed sources (+ or -)	1,198	-	(5,234)	-
Uncollected pymts, Fed sources, end of year (-)	(4,418)	-	(5,616)	-
Memorandum (non-add) entries				
Obligated balance, start of year (+ or -)	$ 3,576,069	$ -	$ 3,416,407	$ -
Obligated balance, end of year (net)	$ 4,047,778	$ -	$ 3,576,069	$ -
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	$ 10,234,515	$ 4,012	$ 10,506,458	$ 2,872
Actual offsetting collections (discretionary and mandatory) (-)	(477,380)	(3,658)	(445,504)	(20,448)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)	1,198	-	(5,234)	-
Budget Authority, net (discretionary and mandatory)	$ 9,758,333	$ 354	$ 10,055,720	$ (17,576)
Outlays, gross (discretionary and mandatory)	$ 9,606,177	$ 1,536	$ 9,857,564	$ 2,799
Actual offsetting collections (discretionary and mandatory) (-)	(477,380)	(3,658)	(445,504)	(20,448)
Outlays, net (discretionary and mandatory)	9,128,797	(2,122)	9,412,060	(17,649)
Distributed offsetting receipts (-)	(13,356)	-	(54,772)	-
Agency outlays, net (discretionary and mandatory)	$ 9,115,441	$ (2,122)	$ 9,357,288	$ (17,649)

The accompanying notes are an integral part of these statements.

FEDERAL COMMUNICATIONS COMMISSION
CONSOLIDATED STATEMENT OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2013 and 2012
(Dollars in thousands)

	FY 2013	FY 2012
Revenue Activity:		
Sources of Cash Collections:		
Spectrum Auctions	$ 15,183	$ 38,477
Fines and Penalties	25,287	8,656
Credit Reform	62	1,761
Total Cash Collections	40,532	48,894
Accrual Adjustments (+/-)		
Spectrum Auctions	(1,564)	1,560
Fines and Penalties	3,907	1,096
Total Accrual Adjustments	2,343	2,656
Total Custodial Revenue	42,875	51,550
Disposition of Collections:		
Transferred to Others:		
U.S. Treasury	(25,349)	(10,417)
Decrease in Amounts Yet to be Transferred	81,213	43,867
Retained by the Reporting Entity	(98,739)	(85,000)
Total Disposition of Collections	(42,875)	(51,550)
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, 2013 AND 2012

(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*. Custodial activity reported on the Statement of Custodial Activity is prepared on the modified cash basis.

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 third party deposits and demand deposits at several commercial banks which are maintained by Universal Service Administrative Company (USAC), Rolka Loube Saltzer Associates, LLC (RLSA), and Welch LLP, serving as administrators and/or billing and

Note 1 - Summary of Significant Accounting Policies (continued)

D. Cash and Other Monetary Assets (continued)

collection agents. Demand deposits 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.

E. Investments

Investments are reported at their acquisition cost, adjusted for amortization of 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. In FY 2012 and prior years, 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, were capitalized. Bulk purchases of similar items, individually worth less than $25 but collectively worth more than $250, were also capitalized using the same equipment categories and useful lives as capital acquisitions. Beginning in FY 2013, the FCC increased its capitalization threshold to $100 for all PP&E and $200 for all internally developed software. The FCC also no longer capitalizes bulk purchases of similar items. The impact of these changes has no material effect on the Commission's financial position or results of operations. The capitalized PP&E and software have an estimated useful life of two years or greater. PP&E are depreciated on a straight-line basis over the estimated useful lives of the items. The useful lives used are: forty years for buildings; seven years for non-computer equipment; five years for computers and vehicles; and three years for software. Neither land, including permanent improvements, nor software in development is depreciated. Normal maintenance and repair costs are expensed as incurred.

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

Note 1 - Summary of Significant Accounting Policies (continued)

I. Other Assets

Other Assets with the public represent the balance of transfers less expenses made by the USF to 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

Debt represents amounts due to the U.S. Treasury’s Bureau of the Fiscal Service (BFS) to support the spectrum auction loan program. Borrowings from BFS 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 BFS 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 portion 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), the Federal Employee Retirement

Note 1 - Summary of Significant Accounting Policies (continued)

M. Retirement Plans and Other Benefits (continued)

System (FERS), or the FERS-Revised Annuity Employee (RAE). Under CSRS, the Commission makes matching contributions equal to seven percent of basic pay. Under both FERS plans, the Commission contributes the employer's matching share for Social Security. All employees are eligible to contribute to the Thrift Saving Plan (TSP) which is a defined contribution retirement savings and investment plan. For those employees covered by the FERS plans, a TSP account is automatically established to which the commission is required to contribute 1% of gross pay and match dollar-for-dollar on the first 3% of pay contributed each pay period and 50 cents on the dollar for the next 2% of pay contributed. No government contributions are made to the TSP accounts established by CSRS employees. Most employees hired after December 31, 1983, are covered by the FERS plans.

The OPM reports on CSRS, FERS, and FERS-RAE assets, accumulated plan benefits, and unfunded liabilities, if any, applicable to Federal employees.

The actuarial liability for future workers' compensation benefits payable includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, as well as a component for incurred but not reported claims. The liability is determined using historical benefit payment patterns related to injury years to predict the ultimate payment. 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

<u>Regulatory Fee Offsetting Collections (Exchange)</u> – The Omnibus Budget Reconciliation Act of 1993 directed the Commission to assess and collect regulatory fees to recover the costs incurred in carrying out certain provisions of its mission. Section 9(a) of the Act, as amended, authorizes the Commission to assess and collect annual regulatory fees to recover the costs, as determined annually by Congress, incurred in carrying out its strategic goals: Connect America; Maximize Benefits of Spectrum; Promote Innovation, Investment, and America's Global Competitiveness; Promote Competition; Protect and Empower Consumers; Public Safety and Homeland Security; Advance Key National Purposes; and Operational Excellence. These are different from the strategic goals in FY 2012: 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

Note 1 - Summary of Significant Accounting Policies (continued)

O. Revenues and Other Financing Sources (continued)

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 2013 and $339,844 for FY 2012 were achieved. The Commission collected $10,933 above the required regulatory level in FY 2013 and $4,874 in FY 2012. The cumulative amount collected above the required annual regulatory level is $81,977 at September 30, 2013. In addition, the cumulative amount collected above the required annual regulatory level has been temporarily precluded from obligation since FY 2008.

<u>Competitive Bidding System Offsetting Collections (Exchange)</u> – One of the Commission's primary functions is managing the spectrum auction program. Proceeds from the auctions are initially remitted to the Commission and are later transferred to the U.S. Treasury, net of anticipated auction related costs (under 47 U.S.C. § 309, the Commission may retain a portion of the spectrum auction proceeds to offset the cost of performing the auction function). Collections used to offset the cost of performing auctions-related activity were capped at $98,739 in FY 2013 and $85,000 in FY 2012.

<u>Radio Spectrum Auction Proceeds (Exchange)</u> – 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 $13,619 in FY 2013 and $40,036 in FY 2012.

<u>Application Fees (Exchange)</u> – Congress authorized the Commission (47 U.S.C. § 8) to collect application processing fees and directed the Commission to prescribe charges for certain types of application processing or authorization services over which the Commission has jurisdiction. Section 8(b) of the Act, as amended, requires the Commission to review and amend its application fees every two years. The amended fees (Schedule of Application Fees 14 U.S.C. § 1.1102 *et seq*.) reflect the net change in the Consumer Price Index for all Urban Consumers calculated over a specific period of time, and the Commission's cost of processing applications and associated filings. Application fees are deposited in the Treasury and are not available for the Commission's use. Application fee revenue totaled $27,985 in FY 2013 and $24,804 in FY 2012.

<u>Reimbursable Work Agreements (Exchange)</u> – The Commission recognizes reimbursable work agreement revenue when earned, i.e., goods that have been delivered or services rendered. In FY 2013, the Commission executed agreements totaling $4,168. In FY 2012, the Commission executed agreements totaling $661, and 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.

Note 1 – Summary of Significant Accounting Policies (continued)

O. Revenues and Other Financing Sources (continued)

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.

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 dedicated collections and are accounted for as a budgetary financing source.

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 for FY 2013 is $339,844, which includes a temporary reduction of $17,096 due to the FY 2013 sequestration order implemented on March 1, 2013 and required by the Budget Control Act of 2011. The annual appropriation for FY 2012 was $339,844. Regulatory fee collections fully fund the annual appropriation for FY 2013 and FY 2012.

Subsidy Estimates and Reestimates (Financing Source) – In accordance with the FCRA of 1990 and as amended, the Commission receives permanent-indefinite authority for its credit reform program account, unless otherwise prescribed by OMB, to fund its subsidy estimates and reestimates. This account records the subsidy costs associated with the direct loans after FY 1991, as well as administrative expenses of the loan program. In FY 2013, the Commission did not receive an appropriation since there was no upward reestimate component. In FY 2012, the Commission received an appropriation of $18,432. The appropriation is available until used.

P. Reprogramming

In FY 2013, the Commission received approval to reprogram $8,433 of prior year de-obligations to fund a number of projects. The projects include settling legal claims, compensation and benefits, and capital improvements and information technology investments. In FY 2012, the Commission received approval to reprogram $12,100 of prior year de-obligations to implement certain initiatives. The initiatives included cyber security and incentive spectrum auctions.

Q. 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 USAC, which is both the administrator and B&C agent for the four USF support mechanisms, RLSA, which is both the administrator and B&C agent for TRS, Neustar which is the administrator for NANP, and Welch LLP which is the B&C agent for NANP.

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

Note 1 - Summary of Significant Accounting Policies (continued)

Q. Transactions with Related Parties (continued)

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, 2013 and 2012 are listed below:

Administrative Fees:

	USF	TRS	NANP	Total
FY 2013	$ 111,112	$ 1,107	$ 5,762	$ 117,981
FY 2012	$ 105,358	$ 1,094	$ 5,409	$ 111,861

R. 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.

S. Reclassification and Other

The FY 2012 financial statements were reclassified to conform to the FY 2013 OMB financial statement presentation requirements. The changes to the presentation of the Combined Statements of Budgetary Resources were made in accordance with guidance provided in OMB Circular No. A-136, *Financial Reporting Requirements*, and as such, activity and balances reported on the FY 2012 Combined Statement of Budgetary Resources have been reclassified to conform to the presentation in the current year. Certain other prior year amounts have also been reclassified to conform to the presentation in the current year. The reclassifications have no material effect on total assets, liabilities, net position, change in net position, or budgetary resources as previously reported.

Effective for FY 2013, the Commission began accounting for costs under new strategic goals as presented in the FY 2013 Performance Plan. The FY 2012 strategic goals are listed separately from the FY 2013 strategic goals in the Statement of Net Costs since they cannot be easily crosswalked to the new goals.

The Commission implemented in FY 2013 Statement of Federal Financial Accounting Standards 43, *Funds from Dedicated Collections,* amending Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Earmarked Funds*. No restatement was necessary as a result of this change. The only impact on the financial statements and accompanying notes was the term “earmarked funds” was changed to “Funds from Dedicated Collections.”

Note 2 - Non-entity Assets

The following summarizes Non-entity Assets as of September 30, 2013 and 2012:

	FY 2013	FY 2012
Intragovernmental:		
Fund Balance with Treasury	$ 78,415	$ 179,007
Accounts Receivable, Net	433	439
Total Intragovernmental	78,848	179,446
Accounts Receivable, Net	25,620	21,565
Total Non-entity Assets	104,468	201,011
Total Entity Assets	8,465,756	7,794,993
Total Assets	$ 8,570,224	$ 7,996,004

Non-entity Fund Balance with Treasury primarily represents deposits made towards spectrum auction winning bids. These deposits accounted for $76,432 in FY 2013 and $166,489 in FY 2012. 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, 2013 and 2012:

FY 2013	Appropriated Funds	Revolving Funds	Deposit Funds	Total
Unobligated Balance				
Available	$ 19,378	$ 6,833	$ -	$ 26,211
Unavailable	103,329	-	-	103,329
Obligated Balance not yet Disbursed	71,208	-	-	71,208
Non-Budgetary FBWT	-	-	78,415	78,415
Total	$ 193,915	$ 6,833	$ 78,415	$ 279,163
FY 2012				
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

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

Note 3 – Fund Balance with Treasury (continued)

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 non-budgetary and 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, 2013 and 2012:

	FY 2013	FY 2012
Cash and Other Monetary Assets	$ 173,084	$ 139,322

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.

In FY 2013, Cash and Other Monetary Assets included $170,085 in USF contributions and related accrued interest being held for distribution, and $2,999 in NANP deposits and related accrued interest. 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.

Note 5 - Investments

The following summarizes Investments as of September 30, 2013 and 2012:

FY 2013	Purchase Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosures
Intragovernmental Securities:						
Marketable Securities						
Treasury Bills	$ 1,287,513	EI	$ 29	$ -	$ 1,287,542	$ 1,287,533
Treasury Notes	5,913,637	EI	(7,179)	6,600	5,913,058	5,901,937
Total	$ 7,201,150		$ (7,150)	$ 6,600	$ 7,200,600	$ 7,189,470
FY 2012						
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

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 Funds from Dedicated Collections in Note 12.

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, 2013 and 2012:

	Intragovernmental		Public		Total	
FY 2013						
Gross Accounts Receivable	$	1,235	$	1,617,710	$	1,618,945
Allowance for Doubtful Accounts		-		(765,684)		(765,684)
Net Accounts Receivable	$	1,235	$	852,026	$	853,261
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

Accounts receivable are recorded net of any related allowance for doubtful accounts. The Commission's portion of the allowance for doubtful accounts is determined by applying predetermined percentages against the respective date the receivable was established. The 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 of the allowance 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 95% allowance in FY 2013 and 96% allowance in FY 2012.

Note 6 - Accounts Receivable, Net (continued)

The following summarizes accounts receivable by type as of September 30, 2013 and 2012:

	FY 2013			FY 2012		
	Accounts Receivable	Allowance	Net	Accounts Receivable	Allowance	Net
USF	$ 1,303,849	$ (483,749)	$ 820,100	$ 1,289,562	$ (442,926)	$ 846,636
COMAD - Schools and Libraries	123,145	(117,357)	5,788	148,896	(142,345)	6,551
Regulatory Fees	40,708	(28,771)	11,937	38,369	(28,147)	10,222
Spectrum Auction	21,568	(21,568)	-	24,194	(22,630)	1,564
Forfeitures	114,125	(104,776)	9,349	100,549	(97,849)	2,700
Other	15,550	(9,463)	6,087	17,830	(8,841)	8,989
Total	$ 1,618,945	$ (765,684)	$ 853,261	$ 1,619,400	$ (742,738)	$ 876,662

Note 7 – Direct 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. In FY 2013, the Commission wrote off all remaining loan balances.

Note 7 – Direct Loans Receivable, Net (continued)

As required under the FCRA of 1990, as amended, the Commission coordinates with OMB in developing estimation guidelines, regulations, and the criteria used in calculating the subsidy estimates and reestimates. The most recent subsidy reestimate was completed in September, 2013. The reestimate resulted in a net downward adjustment, including interest on the reestimate, of $3,265 reported in FY 2013 financial statements.

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 2013	$ -	$ -	$ -	$ 3,502	$ 3,502
FY 2012	$ 111,074	$ 7,883	$ 857	$ (119,479)	$ 335

Interest accrued on bankrupt and defaulted loans totaled $- in FY 2013 and $7,883 in FY 2012.

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

Total Amount of Direct Loans Disbursed

No new loans were issued in FY 2013 and FY 2012.

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 2013 (Net)	$ -	$ -	$ (3,265)	$ (3,265)
FY 2012 (Net)	$ -	$ -	$ (1,473)	$ (1,473)

Note 7 – Direct Loans Receivable, Net (continued)

Schedule for Reconciling Subsidy Cost Allowance Balances

	FY 2013	FY 2012
Beginning Balance of the Subsidy Cost Allowance	$ 119,479	$ 140,656
Adjustments:		
Loans written off	(119,810)	(20,599)
Other	-	810
Subsidy allowance amortization	94	85
Ending balance before reestimates	(237)	120,952
Subsidy reestimates:		
Technical/default reestimate	(3,265)	(1,473)
Ending balance of the subsidy cost allowance	$ (3,502)	$ 119,479
Administrative Expense – Spectrum Auctions	$ 555	$ 1,837

Note 8 - Liabilities Not Covered by Budgetary Resources

The following summarizes Liabilities Not Covered by Budgetary Resources as of September 30, 2013 and 2012:

	FY 2013	FY 2012
Intragovernmental:		
FECA Liability	$ 441	$ 342
GSA Real Estate Taxes	2,357	1,922
Other:		
Unfunded Leave	20,734	20,452
Accrued Liabilities for Universal Service	1,088,415	752,423
Total liabilities not covered by budgetary resources	1,111,947	775,139
Total liabilities covered by budgetary resources	408,641	445,102
Total Liabilities	$ 1,520,588	$ 1,220,241

Liabilities not covered by budgetary resources are liabilities incurred that are not covered by realized budgetary resources as of the Balance Sheet date.

Note 9 - Debt

	FY 2012 Beginning Balance	Net Borrowing	FY 2012 Ending Balance	Net Borrowing	FY 2013 Ending Balance
Debt to the Treasury	$ 50,300	$ (50,300)	$ -	$ 353	$ 353

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, 2013 and 2012:

FY 2013	Non-Current	Current	Total
Intragovernmental			
Custodial Liability	$ -	$ 81,444	$ 81,444
Other	-	8,114	8,114
Total Intragovernmental	$ -	$ 89,558	$ 89,558
Deferred Revenue	$ 35,400	$ 24,520	$ 59,920
Prepaid Contributions	-	110,057	110,057
Accrued Liabilities for Universal Service	-	1,088,415	1,088,415
Other	-	35,036	35,036
Total Other	$ 35,400	$ 1,258,028	$ 1,293,428

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	$ 33,392	$ 907,429	$ 940,821

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 the opinion of Commission management, early contract termination will not materially affect the Commission's financial statements.

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. In FY 2013 the Commission entered into an agreement with the National Treasury Employee Union (NTEU) to settle overtime claims. The Commission and its payroll partner, National Finance Center (NFC), are determining the amounts and processes for payment. Since the amount cannot be calculated at this time, it does not materially affect the financial statements.

Note 12 – Funds from Dedicated Collections

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 12 – Funds from Dedicated Collections (continued)

The following summarizes the significant assets, liabilities, and related costs incurred with managing the USF Program as of September 30, 2013 and 2012:

Balance Sheet	**FY 2013**	**FY 2012**
Assets		
Investments	$ 7,200,600	$ 6,548,090
Cash and other monetary assets	170,085	136,475
Accounts receivable, net	827,903	866,813
General property, plant, and equipment, net	3,999	2,678
Other assets	13,024	13,024
Total assets	$ 8,215,611	$ 7,567,080
Liabilities		
Accounts payable	$ 125,046	$ 98,743
Deferred revenue	7,262	7,149
Prepaid contributions	110,035	85,780
Accrued liabilities	1,088,415	752,423
Total liabilities	$ 1,330,758	$ 944,095
Cumulative results of operations	$ 6,884,853	$ 6,622,985
Total liabilities and net position	$ 8,215,611	$ 7,567,080
Statement of Net Cost		
Net cost of operations	$ 9,461,166	$ 9,545,156
Statement of Changes in Net Position		
Net position beginning of period	$ 6,622,985	$ 6,089,350
Non-exchange revenue	9,722,967	10,078,791
Other financing sources	67	-
Net cost of operations	9,461,166	9,545,156
Change in net position	261,868	533,635
Net position end of period	$ 6,884,853	$ 6,622,985

Note 13 – Intragovernmental Costs and Exchange Revenue

Intragovernmental costs primarily represent goods and services purchased by the Commission from other Federal agencies. Effective for FY 2013, the Commission began accounting for costs under new strategic goals as presented in the FY 2013 Performance Plan.

FY 2013

Program Costs	**Intragovernmental**	**Public**	**Total**
Connect America	$ 12,563	$ 34,474	$ 47,037
Maximize Benefits of Spectrum	21,275	58,380	79,655
Promote Innovation, Investment, and America's Global Competitiveness	2,590	7,107	9,697
Promote Competition	30,288	9,550,106	9,580,394
Protect and Empower Consumers	13,930	38,225	52,155
Public Safety and Homeland Security	12,649	34,710	47,359
Advance Key National Purposes	2,671	7,329	10,000
Operational Excellence	24,789	68,018	92,807
Total	$ 120,755	$ 9,798,349	$ 9,919,104
Total Earned Revenue	$ 4,491	$ 482,105	$ 486,596

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

Note 14 - Terms of Borrowing Authority Used

	Borrowing Authority Used	
Maturity Dates:	FY 2013	FY 2012
September 30, 2012	$ -	$ 856
September 30, 2020	1,496	-
Total Borrowing Authority Used	$ 1,496	$ 856

In FY 2013, the Commission used $1,496 in borrowing authority to fund the FY 2012 Credit Reform Downward Subsidy, pay FY 2013 interest expense, and to extend the maturity date of the debt owed to BFS. In FY 2012, the Commission used $856 in borrowing authority to fund the FY 2011 Credit Reform Downward Subsidy. All borrowing authority was from the BFS.

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

The following summarizes Apportionment Categories of Obligations Incurred for the years ended September 30, 2013 and 2012:

	FY 2013		FY 2012	
	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Direct:				
Category A	$ 422,882	$ -	$ 424,746	$ -
Category B	739,994	1,536	757,242	2,799
Exempt from Apportionment	9,838,207	-	9,896,697	-
Total Direct	11,001,083	1,536	11,078,685	2,799
Reimbursable:				
Category A	3,289	-	9,067	-
Total Obligations Incurred	$ 11,004,372	$ 1,536	$ 11,087,752	$ 2,799

Category A - Apportioned by Quarter
Category B - Apportioned by Purpose

Note 16 – Undelivered Orders at the End of the Period

The amount of budgetary resources obligated for undelivered orders totaled $3,917,916 as of September 30, 2013 and $3,463,190 as of September 30, 2012.

Note 17 ï Permanent Indefinite Appropriations

The Commission has permanent indefinite appropriations available to fund its universal service programs and subsidy costs incurred under credit reform programs.

Pursuant to 47 U.S.C §§ 254 and 225, the FCC has a permanent indefinite appropriation to fund its universal service programs (including Telecommunications Relay Service (TRS)). These programs operate by collecting mandatory contributions from telecommunications carriers providing interstate telecommunications services, and from other providers of interstate telecommunications required to contribute if the public interest so requires. These contributions are accounted for federal budgetary purpose as a special fund known as the Universal Service Fund.

The permanent indefinite appropriations for credit reform are mainly available to finance any disbursements incurred under the liquidating accounts. These appropriations become available pursuant to standing provisions of law without further action by Congress after transmittal of the Budget for the year involved. They are treated as permanent the first year they become available, as well as in succeeding years. However, they are not stated as specific amounts but are determined by specified variable factors, such as cash needs for liquidating accounts, and information about the actual performance of a cohort or estimated changes in future cash flows of the cohort in the program accounts.

Note 18 ï Legal Arrangements Affecting Use of Unobligated Balances

Pursuant to Public Law 111-8, offsetting collections received in excess of $339,844 in FY 2013 and $339,844 in FY 2012 are temporarily precluded from obligation. In addition, the cumulative amount collected above the required annual regulatory level has been temporarily precluded from obligation since FY 2008. (Refer to Note 1. O)

Note 19 - Explanation of Differences Between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

There were no material differences between the Combined Statement of Budgetary Resources (SBR) for FY 2012 and the amounts presented in the 2014 President's Budget. The FY 2015 *Budget of the United States Government* (President's Budget) with actual numbers for FY 2013 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 20 – Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)

As of September 30, 2013 and 2012:

	FY 2013	FY 2012
Budgetary Resources Obligated:		
Obligations incurred	$ 11,005,908	$ 11,090,551
Less: spending authority from offsetting collections and recoveries	1,407,524	1,536,478
Obligations net of offsetting collections and recoveries	9,598,384	9,554,073
Less: offsetting receipts	13,356	54,772
Net obligations	9,585,028	9,499,301
Other Resources	(16,389)	(11,315)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Undelivered Orders	(454,726)	(149,106)
Budgetary offsetting collections and receipts that do not affect net cost of operati	17,014	75,220
Resources that finance the acquisition of assets	(9,822)	(16,182)
Other	(30,067)	37,200
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Increase in annual leave liability	282	344
Upward/Downward reestimates of credit subsidy (+/-)	(3,265)	(1,473)
Increase in exchange revenue receivable from the public	758	5,277
Depreciation and amortization	19,064	19,810
Other (+/-)	324,631	77,623
Net Cost of Operations	$ 9,432,508	$ 9,536,699

REQUIRED SUPPLEMENTARY INFORMATION

(Unaudited)

REQUIRED SUPPLEMENTARY INFORMATION ï STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2013 and 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, 2013 and 2012 Combined Statement of Budgetary Resources.

STATEMENT OF BUDGETARY RESOURCES

FY 2013	S&E	Credit	Auctions	USF	Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 18,418	$ 8,281	$ 479	$ 3,179,789	$ 3,206,967
Recoveries of prior year unpaid obligations	3,897	6	710	923,071	927,684
Other changes in unobligated balance (+ or -)	381	-	(382)	-	(1)
Unobligated balance from prior year budget authority, net	22,696	8,287	807	4,102,860	4,134,650
Appropriations (discretionary and mandatory)	-	(196)	-	9,786,558	9,786,362
Borrowing authority (discretionary and mandatory)	-	1,496	-	-	1,496
Spending authority from offsetting collections (discretionary and mandatory)	327,819	2,516	99,109	21,225	450,669
Total budgetary resources	$ 350,515	$ 12,103	$ 99,916	$ 13,910,643	$ 14,373,177
Status of Budgetary Resources:					
Obligations incurred	$ 332,574	$ 2,006	$ 99,179	$ 10,572,149	$ 11,005,908
Unobligated balance, end of year:					
Apportioned	10,644	339	90	-	11,073
Exempt from apportionment	-	-	-	3,173,822	3,173,822
Unapportioned	7,297	9,758	647	164,672	182,374
Total unobligated balance, end of year	17,941	10,097	737	3,338,494	3,367,269
Total status of budgetary resources	$ 350,515	$ 12,103	$ 99,916	$ 13,910,643	$ 14,373,177
Change in Obligated Balance:					
Unpaid obligations:					
Unpaid obligations, brought forward, Oct 1	$ 66,584	$ 268	$ 23,273	$ 3,491,560	$ 3,581,685
Obligations incurred	332,574	2,006	99,179	10,572,149	11,005,908
Outlays (gross) (-)	(351,884)	(2,163)	(87,907)	(9,165,759)	(9,607,713)
Recoveries of prior year unpaid obligations (-)	(3,897)	(6)	(710)	(923,071)	(927,684)
Unpaid obligations, end of year	43,377	105	33,835	3,974,879	4,052,196
Uncollected payments:					
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(5,616)	-	-	-	(5,616)
Change in uncollected pymts, Fed sources (+ or -)	1,198	-	-	-	1,198
Uncollected pymts, Fed sources, end of year (-)	(4,418)	-	-	-	(4,418)
Memorandum (non-add) entries					
Obligated balance, start of year (+ or -)	$ 60,968	$ 268	$ 23,273	$ 3,491,560	$ 3,576,069
Obligated balance, end of year (net)	$ 38,959	$ 105	$ 33,835	$ 3,974,879	$ 4,047,778
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	$ 327,819	$ 3,816	$ 99,109	$ 9,807,783	$ 10,238,527
Actual offsetting collections (discretionary and mandatory) (-)	(357,046)	(3,658)	(99,109)	(21,225)	(481,038)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)	1,198	-	-	-	1,198
Budget Authority, net (discretionary and mandatory)	$ (28,029)	$ 158	$ -	$ 9,786,558	$ 9,758,687
Outlays, gross (discretionary and mandatory)	$ 351,884	$ 2,163	$ 87,907	$ 9,165,759	$ 9,607,713
Actual offsetting collections (discretionary and mandatory) (-)	(357,046)	(3,658)	(99,109)	(21,225)	(481,038)
Outlays, net (discretionary and mandatory)	(5,162)	(1,495)	(11,202)	9,144,534	9,126,675
Distributed offsetting receipts (-)	(35,403)	-	-	22,047	(13,356)
Agency outlays, net (discretionary and mandatory)	$ (40,565)	$ (1,495)	$ (11,202)	$ 9,166,581	$ 9,113,319

See accompanying auditorôs report