INSPECTOR GENERAL STATEMENT ON THE FEDERAL COMMUNICATIONS COMMISSION'S MAJOR MANAGEMENT CHALLENGES FISCAL YEAR 2005

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Office of Inspector General

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Federal Communications Commission

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: November 10, 2005

TO: Chairman
Managing Director

FROM: Inspector General

SUBJECT: Inspector General Statement on the Federal Communications Commission's (FCC) Major Management Challenges

In November 2000, the President signed the Reports Consolidation Act of 2000 (Public Law No. 106-531), which requires Inspectors General to provide a summary and assessment of the most serious management and performance challenges facing Federal agencies and the agencies' progress in addressing them. This document responds to the requirements and provides the fiscal year 2005 submission to include in the Fiscal Year 2005 FCC Performance and Accountability Report.

We identified six significant management issues facing FCC for fiscal year 2005.

- Reporting Component Investigations and Fraud
- Financial Reporting
- Financial Reporting Components
- Information Technology and Information Systems Security
- Revenue Gap
- Physical Security and Protection of Personnel

The FCC continues to address these issues, many of which are of a long term nature and do not lend to themselves to quick fixes. Our assessment of the status of these challenges is enclosed.

The Reports Consolidation Act of 2000 permits agency comment to the Inspector General statements. To this effect, we request all comments or responses be received by my office by November 14, 2005.

H Walker Feaster III

H. Walker Feaster, III
Inspector General

Attachment

Cc: Mark Reger, Chief Financial Officer

Reporting Component Investigations and Fraud

Universal Service Fund

The Telecommunications Act of 1996 codified and modified the Federal Communications Commission's (FCC) longstanding policy of promoting universal telecommunications service throughout the nation. Per FCC direction, the Universal Service Administrative Company administers the four universal service support mechanisms of the Universal Service Fund (USF). The four universal service support mechanisms include: high cost, low income, rural health care, and schools and libraries. These support mechanisms are funded through mandatory payments from U.S. telecommunications providers, including local and long distance phone companies, wireless and paging companies, and payphone providers. USAC provides money directly to service providers to defray the cost of serving customers who use the telecommunications services.

Fraud is an inherent risk in the USF core business process: collection, certification, and disbursement of funds for telecommunications services. As of fiscal year-end 2005, 71 investigations have been initiated. This represents a six percent increase to initiated investigations since the previous reporting period. Of those investigations, 39 are on-going and 32 are closed. Investigations have led to indictments as well as subsequent sentencing relating to fraudulent actions. To date, nine individuals and three corporations have been indicted and accepted plea agreements in four separate investigations. Additionally, six corporations and five individuals have been indicted in another case that is currently scheduled for trial. FCC has taken action to address fraud in the USF business process; however, additional efforts are needed.

In addition to law enforcement activities, audits conducted of the schools and libraries support mechanism, commonly referred to as E-rate, disclosed significant potential recoveries. Currently, these recoveries are in excess of $40 million. Although lesser in amounts, additional auditor recommended recoveries exist for funds disbursed in the high cost and low income support mechanisms. FCC has taken action to improve oversight of the USF program; however, additional efforts are needed. Generally, controls over management oversight and accountability for receipt of USF funds by beneficiaries have been materially weak because of inadequate management controls, lack of a sufficient independent audit program to deter future fraudulent activity, and weaknesses in the structure of the program.

Furthermore, the Office of Inspector General is aware of enforcement and audit activities pertaining to the revenue contributed to the USF from the telecommunications industry. Although FCC's focus has been to address the disbursement and use of received funds, it has not fully considered or developed an approach to ensure compliance with contributor revenue requirements.

The Office of Inspector General has been unable to implement effective independent audit oversight of the USF program because of inadequate resources. In the summer of 2004, the Office of Inspector General and the USF administrator worked to establish a contract under which these organizations could obtain resources to conduct USF audits and support USF investigations. As part of this process, a request for proposal was released in November 2004 and contractor selection was finalized in March 2005. In April 2005, the USF administrator board of directors approved the selection of contractors presented by the review team and the USF administrator referred the matter to the FCC for approval. Subsequent to fiscal year-end, FCC communicated to the USF administrator that the procurement would need to be re-competed per Federal Acquisition Regulations. As a result of the subsequent decision by the Commission, the Office of Inspector General has reinstated planning for USF audits. However, the lack of access to resources anticipated under the agreement have impeded the ability of the Office of Inspector General to provide support to Federal investigations.

Telecommunications Relay Service Fund

Similar to the USF, fraud is an inherent risk in the Telecommunications Relay Service (TRS) fund. The TRS fund compensates providers for the reasonable cost of providing interstate telephone transmission services that enable a person with a hearing or speech disability to use such services to communicate with a person without disabilities.

To date, one corporation and one individual have been indicted and accepted settlement agreements. The agreement includes the return of $2 million disbursed funds and the forfeiture of related financial assets.

Financial Reporting

Financial Management Weaknesses

FCC does not maintain current and accurate financial data during the course of the year. As a result, FCC undertakes a massive, manually intensive effort to compile, analyze, and correct its financial data to prepare accurate financial statements quarterly and at fiscal year-end. FCC can enhance both its processes and timing of financial reporting practices, improve its policies and procedures to ensure consistent accounting practices, and continue its endeavor for an updated, integrated financial management system entity-wide.

FCC has made progress in correcting financial management weaknesses given the resources available. However, requests by financial managers for additional resources to address expanding financial requirements, oversight functions, and Office of Inspector General recommendations remain outstanding and resources are still required.

Recent improvements include the implementation and enhancement of FCC's cost accounting system and certain modules of its revenue management system. To address this challenge, currently FCC is reviewing potential replacements for its core accounting and general ledger system. Despite these actions, FCC needs to take additional steps to ensure proper financial management reporting. Specifically, it has not made the major changes needed to address a long-standing condition in financial reporting. Significant elements of this condition include the need for:

- integrated financial management system(s) within FCC as well as its reporting components;
- a cost accounting system that accounts for unit costs per generally accepted accounting principles, provides information for performance measurement, and routinely provides this information to program managers;
- complete budgetary accounting for consolidating reporting components;
- timely recording and analysis of financial activities for certain accounts;
- a complete and thorough process for compiling the entity consolidated statements with minimum errors; and
- expanded oversight of component accounting activities.

Financial Management Relationships with Consolidating Component Entities

FCC lacks clear, comprehensive, and accountable relationships with its financial reporting consolidating component entities, which include the administrators of the Universal Service Fund, the Telecommunications Relay Services fund, and the North American Numbering Plan (NANP), as well as their respective service organizations. As a result, FCC's consolidated financial reporting process experiences delays, errors, and recently, attestation impacts.

Primarily, FCC relies on periodic financial and data reporting to compile its consolidated financial reporting products. To date, FCC accountants and financial managers are not involved in the financial operations of these entities nor do they possess a comprehensive understanding of component entity financial or business processes. Specifically, FCC staff lack complete understanding of each component entity's: functions, internal control, information technology aspects, contracted service vendor operations, and other business applications that derive the component's periodic reporting. FCC has not invested resources to obtain this understanding. For many of the component entities and contracted service organizations, FCC staff only make on-site visits at component locations if a decision if made to accompany the financial auditors.

FCC's financial compilation process requires FCC accountants and staff to prepare most component entity submissions for Federal financial reporting requirements. This is in direct contrast to a process where the component entity is responsible for the preparation of its financial reporting and FCC accountants act as reviewers and consolidators, a relationship expected for an organization of FCC's size and financial balance. The current FCC relationship is weakened and inefficient, by not placing accountability on the component entities, thereby diverting needed resources from consolidating reporting efforts.

The June 30, 2005 interim consolidated financial statements are a current year example of the effects of this challenge. These statements were submitted late to required Federal agencies as well as the FCC's auditors. Additionally, they contained material unsupported adjustments to balances, as well numerous material adjustments to make them consistent with other Federal financial reporting and normal account relationships.

Disclaimers of Opinion on FCC Consolidated Financial Statements

FCC senior management has been slow to address, mitigate, and remedy financial issues which resulted in disclaimers of opinion on FCC's Fiscal Years 2004 and 2003 Combined Statement of Budgetary Resources and Consolidated Statement of Financing. Although FCC responded effectively in fiscal year 2004 when a determination, in concurrence with the Office of Management and Budget, was made regarding material matters to these statements; management made minimal efforts to address its inability to make representations concerning the accuracy or completeness of these matters until mid-August 2005. Additionally, during the interim, between fiscal year opening to August 2005, FCC program and financial management staff were not empowered to address existing conditions. As stated in the fiscal year 2005 management representation letter, unfortunately "[FCC] again this year [makes] no representations concerning the accuracy or completeness of the information…reported as an opening balance on September 30, 2004 or the activity associated with this account[s] during [fiscal year] 2005."

Relatedly, senior agency management responded untimely and incompletely to formal inquiries from the Office of Inspector General regarding fundamental audit and accounting issues pertaining to these material matters. At the close of fieldwork, formal audit requests and further inquiries for these matters await an informative and effective response.

Moreover , senior management's reluctance to sign a management representation letter, which resulted in disclaimers of opinion for all principal financial statements for fiscal year 2005, overshadows the continuing issues related to the fiscal years 2004 and 2003 disclaimers of opinion. The President's Management Agenda (PMA) defines success or "green" for financial performance as:

- an unqualified audit opinion,
- with no auditor reported material weaknesses,
- no material noncompliance with laws and regulations,
- no chronic or significant Antideficiency Act violations,
- which is Federal Financial Management Improvement Act of 1996 compliant,

- no material weaknesses for Federal Managers' Financial Integrity Act of 1982 Section 2 and 4, and
- submitted to meet reporting deadlines.

For the audit period of fiscal years 2004 and 2005, FCC fails all required elements to be categorized as "green" in the PMA.

Financial Reporting Components

Throughout its history, FCC created subsidiary organizations and administrative components, subject to various levels of FCC oversight, to conduct Commission business and meet the agency mission. Presently, there are three financial reporting components of the FCC: the Universal Service Fund, the Telecommunications Relay Services Fund, and the North American Numbering Plan. Fundamentally, these organizations were created without a complete assessment or determination of how component functions or responsibilities would comply with Federal laws and regulations, policies, or concepts. This creates considerable confusion between FCC and its components.

In fiscal year 2003, FCC adopted Commission Order FCC 03-232, the first of what was expected to be a series of orders defining the applicability of certain laws and regulations to these organizations and components. Although the order defined the applicability of certain requirements for two of three current financial reporting components, it did not address the North American Numbering Plan. Additionally, the scope of the new requirements was fairly ambiguous as to which relevant provisions of Federal financial management and reporting statutes and laws it applied. To date, FCC has not issued similar orders to address this issue, nor clarified the relevancy of the other existing provisions. Thus, the applicability of key provisions of Federal financial management and reporting statutes, as well as some in their entirety, remains undecided.

This challenge has existed for multiple reporting periods and continues to exists to date. During fiscal year 2005, the reporting components addressed by Commission Order FCC 03-232 progressed toward meeting requirements, but much remains to be completed. Recently, the depth of this challenge was compounded when original subsidiary organizations contracted with third party service organizations to perform their functions. An understanding of the applicability of certain laws and regulations addressed in FCC Order 03-232 is not shared by the service organizations.

Near fiscal year-end 2004, one component's management informed FCC it would not meet the implementation date for key elements of Commission Order 03-232. At the close of fiscal year 2005, key elements noted in 2004 remain to be implemented. Specifically, the component entity does not satisfy FCC Order 03-232's requirement for Federal budgetary accounting. To the best of our knowledge, no temporary, interim, or corrective actions to mitigate this challenge have been provided to or by FCC management.

Furthermore, bureaus and offices which facilitate reporting component oversight are slow to address known problem areas and fundamental questions. This observation is not limited to those directly responsible for component oversight, but to other relative areas including: legal, planning, financial management, information technology, and senior and general management. Identified issues and problem areas languish for multiple fiscal years with limited or no resolution. This fact was evident during fiscal year 2005 as FCC failed to or significantly delayed responding to inquiries on fundamental matters. Specifically, fundamental questions from component entities and the Office of Inspector General remain unanswered or were responded to ambiguously. During fiscal year 2005, FCC's actions are still categorized as reactive versus proactive oversight, albeit a slower approach.

Information Technology and Information Systems Security

As technology advances and our reliance on technology increases, the need for a strong information technology infrastructure becomes more important. FCC's operations have become increasingly more reliant on automated systems and further integration of FCC data and services with external users via the internet is escalating. Along with explosive growth in computer connectivity comes the ability to disrupt or sabotage critical operations, read or copy sensitive data, and tamper with critical processes.

FCC's information technology control environment and systems security need to be enhanced. FCC is noncompliant with a number of Federal statutes and policies. Commission systems have been susceptible to malicious attacks via viruses and worms, and unauthorized access. Inadequacies and inconsistencies exist in outsourced systems and network access request process and efforts to develop and test FCC's contingency plans have been slow. Additionally, FCC lacks a comprehensive capital asset plan, needs to further enhance its audit trail facility utilization and review, and strengthen its password access controls.

FCC has taken steps to address its information technology and information systems security vulnerabilities. FCC developed an agency-wide security plan and is working toward compliance with required Federal policies and statutes; however, completion dates for key items to address this challenge have repeatedly been revised due to budget constraints. In the area of information system security, FCC successfully tested its continuity of operations plan during the "Pinnacle 2005" interagency test. Furthermore, the Commission has begun implementing its capital investment program. The most visible element of this program is the Information Technology Steering Committee.

Revenue Gap

Although FCC collects approximately $280 million in regulatory fees each year, FCC cannot determine if all required fees are collected. The difference between what is collected, an amount subject to Congressional determination, and what should have been collected if all regulated parties fully paid their fees, is deemed a revenue gap.

FCC's ability to bill regulatory fee payees is significant progress relating to collection of known payees. During fiscal year 2005, FCC expanded on its capability to bill regulatory fee payees. In fiscal year 2005, FCC billed 3,164 payees comprising $145.8 million in regulatory fees. As of fiscal year-end, FCC received $139.6 million of the billed regulatory fees. Furthermore, FCC purports its billing and assessment represents in excess of 94% of all regulatory fees owed. However, since FCC does not have a complete universe of potential regulatory fee payees, it cannot determine the total regulatory fee subject to collection. FCC's inability to determine total fee for collection creates an incomplete universe for facilitating regulatory fee rate assessment in future years.

Physical Security and Protection of Personnel

This challenge is not unique to FCC. Since September 11, 2001, physical security and protection of personnel are critical issues in the Federal Government and the United States in general. As the world experienced the devastating effect of the tsunami, Hurricane Katrina, and Pakistani earthquake, it reminded us that threats are not limited to actions of man.

The FCC has taken steps to identify and implement security measures to protect FCC personnel and its physical infrastructure. Specifically, FCC created a program to inform personnel regarding potential threats and threat management, prepared measures to address potential catastrophic events, and made security enhancements to FCC facilities. In the area of physical security, the Commission significantly upgraded the security of its Gettysburg facility and has enhanced physical access security to the Portals II building by installing concrete street barriers. Despite these efforts, the Commission has personnel and physical infrastructure issues to complete. For example, FCC has not completed its Business Continuity Plans for key bureaus and offices. Additionally, although most were completed, some facility security and protection enhancements have not been completed to date.

Memorandum

To: H. Walker Feaster III, Inspector General

From: Andrew S. Fishel, Managing Director

Date: November 15, 2005

Re: Responses to the Inspector General's Statement on the Federal Communications Commission's Major Management Challenges

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Attached please find the official agency responses to the OIG management challenges provided as part of the annual agency financial statement audit.

Attachment

Management appreciates the Office of Inspector General's (OIG's) assessment of the challenges facing management with respect to the risk of waste, fraud, and abuse affecting the Universal Service Fund (USF) and the Telecommunications Relay Service (TRS) fund; the oversight and management of the Universal Service Administrative Company (USAC) for the USF, the National Exchange Carrier Association (NECA) for the TRS fund, and Welch & Company, LLP for the North American Numbering Plan (NANP); financial reporting; information technology and security; and the physical security and protection of the Federal Communications Commission's (Commission's) employees. Management has already started to address many of these challenges and will develop a plan to address these issues during FY 2006. Management is looking forward to working with the OIG in this process.

In June 2005, the Commission launched a comprehensive review of the management, administration, and oversight of the USF. In this proceeding, the Commission is exploring ways to address the management and administration issues raised by the Government Accountability Office (GAO) and others, including whether fundamental structural reform will improve the management and administration of the USF. The Commission is also evaluating ways to ensure USF monies are used properly and to safeguard the USF from waste, fraud, and abuse. The comment cycle for this proceeding closes in December 2005, and management will work to address these issues as quickly as possible.

With respect to the OIG's plans to enhance oversight of the USF through additional audits, management notes that an Office of General Counsel (OGC) review of the procurement conducted by USAC and the OIG revealed fundamental problems with competitive procurement principles contained in the Federal Acquisition Regulation (FAR) and operational guidance provided to USAC during FY 2005. OGC noted these problems in a memorandum submitted to the Chief of Staff that provided a range of options to cure the procurement deficiencies, including modifying the award selection or restarting the procurement process. The Chief of Staff forwarded the OGC memorandum to the OIG and informed the OIG that deciding upon the appropriate course of action was the OIG's decision to make. The OIG decided to restart the procurement process. Although management did not make this decision, management did communicate the results of the OIG's decision to USAC and has been assisting to ensure the process is fully competitive.

With respect to the financial reporting issues and the audit opinion, the outside auditor, Clifton Gunderson, LLP, did not provide an opinion concerning the Commission's financial statements. Management cooperated fully with the audit. In its report, the outside auditor explains that it did not provide an opinion because management did not provide "a management representation letter signed by the chairman of the FCC." During the audit, the OIG and the outside auditor requested that management deviate from the practice followed in every previous financial statements audit by having the Commission's chairman sign the management representation letter. The OIG provided several primary explanations for why the outside auditor and the OIG would not continue to follow the established practice: the appointment of a new chairman midway through the fiscal year and noncompliance with accounting requirements that occurred prior to the appointment of a new chairman. Commission management adhered to established practice – a practice followed and accepted by the Clifton Gunderson, LLP and the OIG in every previous Commission financial statements audit – and submitted a management representation letter signed by the Chief Financial Officer (CFO) and the Managing Director. In addition, management notes that its signatory practices were reviewed by the GAO, which noted no deficiencies or problems in its July 2005 report. The OIG provided a written response to the GAO's report and noted no exceptions or concerns with the GAO's conclusions. Although the outside auditor and the OIG have accepted management's signatory practices in every past financial statements audit, the outside auditor and the OIG determined that this approach would not provide sufficient evidential matter to conduct the audit for FY 2005 and thus did not provide an opinion.