Common Audit Findings and Recommendations

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Assessment of Control Risk

- Auditors are most concerned with control weaknesses which could lead to material fraud or misstatement of financial statements.
- However, auditors should consider management’s expectations.
- Thus, auditors may want to look at the Company’s controls with regards to areas which are of concern to management even though they may not be material to the financial statements.
- Examples:
  1. Petty cash
  2. Travel advances
  3. Adjustments to customer accounts receivable
AUDIT FINDINGS POINT SHEET

Account Number ________________________
Account Title _________________________

Client

Work Paper Reference __________________

Audit Date (Year End)

Finding, or Problem, Cause and Effect:

Recommendation: ____________________________

Benefits: ____________________________

Implementation Considerations:

Disposition and/or Comments:
(Discussed with: [ ] General Manager [ ] Office Manager [ ] Accountant [ ] Owner [ ] Other)

In charge ________ Date ________ Partner/Manager ________ Date ________
Common Control Weaknesses

- **Cash Controls**

  **Findings:**

  1. Customer payment stubs not stamped with date received.
  2. Checks not stamped “For Deposit Only” when received.
  3. Service order payments and deposits held until service order is closed.

  **Recommendations:**

  1. Are obvious.
Common Control Weaknesses

• Company Credit Cards and Charge Accounts

Findings:

1. Company credit cards and charge accounts used by employees for purchases of personal use items such as fuel, auto parts, etc.
2. Lack of documentation to support credit card charges.

Recommendations:

1. Receipts and other documentation for credit charges should be reviewed by appropriate personnel.
2. Company should monitor trends in expenditures for items such as fuel to help detect theft.
Common Control Weaknesses

- Travel Advances

Findings:

1. Lack of a subsidiary ledger to reconcile to the general ledger.
2. Failure of employees to provide adequate documentation for expenditure of travel advances.
3. Lack of sufficient review of travel expense reports and documentation.

Recommendations:

1. Are obvious.
Common Control Weaknesses

• Adjustments to Customer Accounts

Findings:

1. Adjustments to customer accounts are not reviewed by supervisory personnel.

Effects:
• Control weakness could allow employees to make favorable adjustments to their/others accounts
• Excessive DAK or other adjustments could go undetected

Recommendations:
• Increase controls by requiring supervisory personnel to approve all adjustments in excess of a specified amount
• Limit the number of personnel authorized to make adjustments
• Require periodic review by supervisory personnel of a sample of all adjustments including those that did not require approval
• Reconcile the sum of the individual adjustments support (presented to the supervisor for review) to the total adjustments per the billing register
Common Control Weaknesses

• Inspection of Construction Jobs and Construction Invoices

Findings:

1. Lack of inspection of contract construction work or inspection performed by non-independent personnel.

2. Inadequate review of construction invoices prior to payment - possible “kickbacks”.

Recommendations:

1. Company personnel or outside engineer, independent of the hiring of the contractor, should inspect construction and verify the “as built” documents.

2. Invoices should be compared to the “as built” staking sheets prior to payment.
Continuing Property Records (CPRs)

• Findings:

1. CPRs were incomplete.
   ✓ New general ledger accounts were not included in CPRs
   ✓ Existing CPRs were not up to date
   ✓ Software must be included in the CPRs

Per FCC Part 32 -
“Companies shall establish and maintain basic property records for each class of property recorded in the several plant accounts which comprise the balance sheet Account 2001, Telecommunications Plant In Service, Account 2002, Property Held for Future Telecommunications Use, and Account 2006, Nonoperating Plant”
Continuing Property Records (CPRs)

• Findings:

2. CPRs were adjusted to the prior year audited balance using an incorrect method of spreading the differential.

✓ Differential should be spread to only those units that have had additions during the year
## Continuing Property Records (CPRs)

### Sample OSP CPR

**Sample Telephone Company**  
**Continuing Property Records**  
**Account 2423.20 Buried Cable - Fiber**  
**Period Ending March 31, 2006**

<table>
<thead>
<tr>
<th>Items</th>
<th>Number of Units Beg. of Period</th>
<th>Beg. Trial Unit Price</th>
<th>Beg. Trial Total Value</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Total Change</th>
<th>Number of Units End of Period</th>
<th>Trial Value Additions</th>
<th>Total Trial Value</th>
<th>Amount To Allocate</th>
<th>Adjustment</th>
<th>Allocated Book Value</th>
<th>Adjusted Unit Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>BF0 (12)</td>
<td>32,000</td>
<td>3.37</td>
<td>107,860.22</td>
<td>IN</td>
<td>1,200</td>
<td>1,200</td>
<td>33,206</td>
<td>4,014.00</td>
<td>111,904.22</td>
<td>5,104.46</td>
<td>117,008.68</td>
<td>3.52</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BF0 (12)</td>
<td>23,266</td>
<td>2.76</td>
<td>64,326.51</td>
<td>OUT</td>
<td>1,800</td>
<td>1,800</td>
<td>25,086</td>
<td>4,977.42</td>
<td>69,298.93</td>
<td>6,278.35</td>
<td>75,577.28</td>
<td>3.01</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BF0 (24)</td>
<td>166</td>
<td>3.01</td>
<td>499.03</td>
<td>IN</td>
<td></td>
<td></td>
<td>166</td>
<td></td>
<td>499.03</td>
<td></td>
<td>499.03</td>
<td>3.01</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BF0 (48)</td>
<td>64,390</td>
<td>3.98</td>
<td>335,972.14</td>
<td>OUT</td>
<td>1,500</td>
<td>1,500</td>
<td>85,680</td>
<td>5,971.73</td>
<td>341,943.82</td>
<td>7,537.77</td>
<td>349,481.69</td>
<td>4.07</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BF0 (72)</td>
<td>7,372</td>
<td>5.08</td>
<td>37,435.32</td>
<td>IN</td>
<td></td>
<td></td>
<td>7,372</td>
<td></td>
<td>37,435.32</td>
<td></td>
<td>37,435.32</td>
<td>5.08</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Totals** | | | 546,093.22 | | | | | $14,988.20 | | $581,081.42 | | $18,918.58 | | $580,000.00 |

- Current GL Balance: $580,000.00
- Total Trial Value: $581,081.42
- Difference: $18,918.58
- Trial Value Additions: $14,988.20

**Factor**: 126.22316%
Continuing Property Records (CPRs)
Sample Support Asset CPR

Sample Telephone Company
Account 2112.000.00 Motor Vehicles
June 30, 2006

<table>
<thead>
<tr>
<th>Purchase Date</th>
<th>Description</th>
<th>Original Cost</th>
<th>Other Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/01/01</td>
<td>1993 CHEVY SILVERADO PU</td>
<td>13,539.30</td>
<td>J. Smith Primary Driver VIN 123456789</td>
</tr>
<tr>
<td>01/01/02</td>
<td>2001 CHEVY TAHOE</td>
<td>35,409.24</td>
<td>J. Doe Primary Driver VIN 123456790</td>
</tr>
<tr>
<td>03/01/02</td>
<td>2002 CHEVY SILVERADO PU</td>
<td>27,353.07</td>
<td>B. Baggins Primary Driver VIN 123456791</td>
</tr>
<tr>
<td>03/01/02</td>
<td>2002 FORD F-150 SUPER CAB</td>
<td>23,812.56</td>
<td>Pool Vehicle VIN 987654321</td>
</tr>
<tr>
<td>06/30/03</td>
<td>2003 CHEVY TRAILBLAZER</td>
<td>28,896.25</td>
<td>Pool Vehicle VIN 987654322</td>
</tr>
<tr>
<td>07/31/03</td>
<td>2000 FORD RANGER 12 PU - COE</td>
<td>6,000.00</td>
<td>Pool Vehicle VIN 987654323</td>
</tr>
<tr>
<td>07/31/04</td>
<td>2001 FORD RANGER 12 PU - CSR</td>
<td>6,000.00</td>
<td>Pool Vehicle VIN 987654324</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>141,010.42</strong></td>
<td></td>
</tr>
</tbody>
</table>

General Ledger Balance

| Difference | 141,010.42 |

| Difference | 0.00       |
Work Orders - Common Findings

• Findings:

1. Work orders are not closed in a timely manner.

   Effects:
   • Causes telco to overcapitalize AFUDC, understate interest expense
   • Causes telco to understate depreciation expense
   • CPRs may be incorrect
   • Can affect NECA recovery

   Recommendations:
   • List any work orders with no activity for 30 days and provide list to plant supervisor for resolution
   • Consider a scope. Close work orders automatically each month under that scope
Work Orders - Common Findings

Findings:

2. Materials are not assigned to work orders in a timely manner.

Effects:

- Overstates inventory, understates plant or TPUC
- Inventory adjustments may be spread to incorrect accounts
- Causes AFUDC to be understated, if applicable
- Causes Depreciation to be understated
- Can affect NECA recovery
- Creates unnecessary work for all involved
- Clearing of provisioning expense is not accurate

Recommendations:

- Checklist when plantmen remove inventory from warehouse, requiring work order number
- Establish procedures for timely reporting of material usage; for example, a section of each employee’s daily timecard can be used for material usage reporting
- Accountable employee and training
- Regular physical inventory counts should be taken and reconciled to the perpetual inventory ledger
- Perpetual inventory ledger should be reconciled monthly to the general ledger
Work Orders - Common Findings

• Findings:

3. Retirement work orders do not include value of plant retired.

Effects:
• Overstates Plant In Service
• CPRs are not accurate
• May cause depreciation expense to be overstated
• Can affect NECA recovery
• Creates unnecessary work for all involved

Recommendations:
• Training
• Accountable employee
• Consider revising timesheet
Work Orders - Common Findings

Findings:

4. Subsidiary work order ledger does not agree with general ledger telephone plant under construction account.

Effects:
- Lack of reconciliation may cause errors to be overlooked
- Could indicate a problem with the labor and distribution spreads
- Adjustment necessary to correct may be spread to incorrect account
- Can affect NECA recovery
- Creates unnecessary work for all involved

Recommendations:
- Monthly checklist of reconciliations
- Training on specific software
Aid To Construction - Common Findings

Findings:

1. Telco recorded amounts received for aid to construction as a revenue.

Effects:

- Overstates Income, expense
- Can affect NECA Settlement Revenues
Aid To Construction - Common Findings

A Company Might Receive Aid to Construction For Several Reasons:

- **Relocate Or Move Existing Plant**
  - **If Amount Is Specific To The Cost Of Replacement**
    - Amounts Received Should Offset (Credit) Any Expenses, With Remaining Amount Credited To The Appropriate Plant Account
  - **If Funds Are For The Loss Of The Plant Retired Due To Relocation:**
    - Amounts Received Should Offset (Credit) Any Expenses, With Remaining Amount Credited To The Appropriate Reserve Account As Salvage For The Old Plant Retired Connected With The Relocation
Aid To Construction - Common Findings

- **Joint Projects**
  - Amounts Received Should Offset (Credit) Any Expenses, With Remaining Amount Credited To The Appropriate Plant Account
Accounts Receivable - Findings

• Findings:

1. No allowance was recorded for uncollectibles for Other Accounts Receivable.

   Effects:
   • Overstates receivables and income

   Recommendations:
   • Carrier Access Billing Accounts Receivable should be reviewed to determine if collection is feasible. If not, an allowance should be recorded.
   • Consider setting up an allowance for the following:
     ° KSU Sales
     ° Cable cut (or repairs) billed to others
     ° Terminated Employee Receivables
Accounts Receivable - Findings

• Findings:

2. Employee Telecommunications Accounts Receivable are not monitored for material balances forward, payments, adjustments.

Recommendations:

• Employee receivables should follow the same disconnect policy as other subscribers
• A supervisor or management should be responsible for monitoring employee accounts receivable
• Some billing systems allow the user to design a custom report that will list specific accounts that you wish to review. Check with your vendor or IT department to see if your system will allow it.
Accounts Receivable - Findings

**Findings:**

3. Payments have been received and deposited but not applied to a customer account.

**Effects:**
- Could be an indication of internal control weakness
- Inflates the aged receivable balance
- Could cause allowance to be overstated
- Could cause duplicate payment by subscriber

**Recommendations:**
- Reconciliation procedures must be modified, as the payment is reflected in the GL, and not the subsidiary (AR) register, such as deposits posted after accounts receivable cut-off date
- Company is susceptible to lapping or other fraudulent activities
Accounts Receivable - Findings

- Findings:

  4. Old customer accounts receivable account balances are growing.

Effects:

- Delay in recovery of bad debts from IXC’s for purchase of accounts receivable
- Financial statements may not properly reflect the financial position of the company, unless an adequate allowance for bad debts is recorded

Recommendations:

- Accounts receivable aging report should be reviewed regularly for possible write-offs
- Disconnects should be done timely in order to decrease bad debt expense
- Inactive customers which have uncollectible balances should be written off timely
- Apply retired capital credits to receivables written off
Clearances and Spreads - Findings

• Findings:

1. Spreads do not include all of the necessary accounts.

Effects:

• Financial statements may include understated expenses and overstated assets

Recommendations:

• Annual review of spreads to ensure new accounts have been added
• Checklist to use when adding a new account, noting that clearances have been addressed
Interstate Uncollectibles - Findings

• Findings:

1. The interstate portion of uncollectibles has not been reported to NECA properly.

Effects:
• Reduced NECA Settlement Revenues

Recommendations:
• NECA has strict requirements for claiming the uncollectibles
• Consider a monthly checklist
NECA - Instructions For Claiming Uncollectibles On EC1050

3.2.2 Access Billing Claim Adjustments
Access billing claim adjustments regulated pursuant to NECA Tariff FCC No. 5, Section 2.4.1 (d), (e) should be reported to the pool. Adjustments are reported as either a reduction or increase in revenue. To make these adjustments, it is necessary to report them on EC1050. Adjustments should be reported to NECA of potential billing adjustments prior to reporting them to the pool.

3.2.3 Net Realized Uncollectible Revenue
Net realized uncollectible revenue is net revenue applicable to the NECA CL/JS pool, which is the exchange carrier's revenue less the cost of goods sold, plus the exchange carrier's share of the pool's net income. The amount reported as net realized uncollectible revenue applicable to the NECA CL/JS pool is the net revenue applicable to the pool, less the exchange carrier's share of the pool's net income.

Exchange carriers should not report revenue as uncollectible until reasonable collection efforts have been exhausted. NECA's Tariff FCC No. 5, Section 2.1.4.6 states: "The Telephone Company may, up to 30 days after they are received by the customer by certified mail, take the following actions:

- refuse additional applications for service or refuse to extend any existing service, and
- discontinue the provision of service to the customer." When reporting uncollectible revenue on the monthly data input form, use the "volumes" section to identify which unit claimers total amount reported. If more than one, identify each separately and the related dollar amount.

Bankruptcy
Exchange carriers are not required to report their NECA uncollectible revenue when they are not in bankruptcy. However, if an exchange carrier determines that it is in bankruptcy, it must report its NECA uncollectible revenue to the bankruptcy court as required by law.

Net Realized Uncollectible Revenue
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## Sample EC1050

<table>
<thead>
<tr>
<th>ECA SETTLEMENTS</th>
<th>EXCHANGE CARRIER INPUT</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPUTED: MMM, YYYY</td>
<td>REG: ___________ SUBSET: ________</td>
</tr>
<tr>
<td>APPLIES TO: MMM, YYYY</td>
<td>AOI/QS: ___________</td>
</tr>
<tr>
<td>DATA TYPE: XXX</td>
<td>MSN: ___________</td>
</tr>
<tr>
<td>STATUS: ___________</td>
<td>CSLT: ___________</td>
</tr>
<tr>
<td>TRANS TYPE: ___________</td>
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<tr>
<td></td>
<td>SA: ___________</td>
</tr>
<tr>
<td></td>
<td>EG: ___________</td>
</tr>
</tbody>
</table>

--- COMMON LINE ------
1. Interstate Access Minutes
2. Access Lines in Service (A+B)  
   A) Residential & Single-Line Bus  
   B) Multi-Line Business
3. Common Line Earned Revenues:  
   A) Reserved  
   B) Reserved  
   C) Other CL Charges (1+2+3)  
     1) Special Access Surcharge  
     2) Federal Universal Service Charge  
     3) Line Port Charges: ISDN Lines, DS1 Channel Service*
4. Other CL Charges Realized Uncollectibles
5. Other CL Net Earned Revenue (3C-4)
6. EU Earned Revenue (A+B)  
   A) Residential & Single-Line Bus  
   B) Multi-Line Business
7. EU Net Realized Uncollectibles
8. EU Net Earned Revenue (6-7)
9. CL Expenses & Other Taxes (A+B)
   A) CL FOT Amount  
   B) Universal Service Contribution Reimbursement
10. CL Average Net Investment
11. CL Income from AFUDC
12. CL Income Adjustment for FIT
13. CL FIT Tax Credit
14. SW Earned Revenue
15. SW Net Earned Uncollectibles
16. SW Net Earned Revenue (14-15)
17. SW Expenses & Other Taxes
18. SW Average Net Investment
19. SW Income from AFUDC
20. SW Income Adjustment for FIT
21. SW FIT Tax Credit
22. SP Earned Revenue
23. SP Net Realized Uncollectibles
24. SP Net Earned Revenue (22-23)
25. SP Expenses & Other Taxes
26. SP Average Net Investment
27. SP Income from AFUDC
28. SP Income Adjustment for FIT
29. SP FIT Tax Credit

--- CONTROL TOTAL: ---

**COMMENT:**

PREPARED BY: ___________  DATE: __/__/____  TEL: ___
CERTIFIED BY: ___________  DATE: __/__/____  TEL: ___

PURSUANT TO FCC RULE, SECTION 69.561, ECS ARE REQUIRED TO CERTIFY EC1050 DATA.
Inventory - Findings

Findings:

1. Inventory that is obsolete is included in the materials and supplies inventory.

Effects:

• Overstate inventory
• Possible overstatement of Net Income

Recommendations:

• If inventory was salvaged from a previous retirement
  1. Reverse entry that previously recorded the inventory
  2. Consider reviewing depreciation rates to ensure that they are reasonable
  3. In rare cases, this could indicate an extraordinary retirement
• Physically segregate and label obsolete inventory
• Educate the employees performing the physical count
Inventory - Findings

• Findings:
  2. Poor physical inventory counts including ineffective cut-off procedures and the improper inclusion in inventory count of critical spares previously capitalized.

Recommendations:
• Physically segregate, and maintain a list of, critical spares
• Review accounts payable cut-off procedures
• Educate the employees performing the physical count
Affiliate Transactions - Findings

• Findings:

  1. Affiliate transactions are not recorded properly.

   Effects:
   • Financial statements are misleading
   • NECA settlements may be misstated
Affiliate Transactions - Findings


  1. If a tariff exists, company should use the tariffed rate.
  2. If no tariff exists, company should use prevailing rates as long as 25% or more of the service is provided to non-affiliates.
  3. If neither of the above applies and the total amount is less than $500,000, the company should use fully distributed cost (FDC). Therefore the Fair Market Value (FMV) comparison is not applicable for transfers when the total annual value of the asset or services is less than $500,000.
  4. Carriers can use the higher or lower of cost or market valuation to operate as a floor or ceiling, depending on the direction of the transaction. The change allows carriers to assign whatever value they deem appropriate for a transaction, as long as the value falls within the parameters of the adopted floor or ceiling.
Affiliate Transactions - Findings

- Proper Treatment of Related Party Transactions Per FCC Docket FCC 04-149; Released June 24, 2004, Effective January 1, 2005 (continued).

  5. If the telco purchases services from a related party, and the related party is organized solely for the provision of services to the telco, then the service should be recorded at its FDC, without determining that the FDC is below market value.

  6. The affiliate transaction rules apply to all transactions between the carrier and its nonregulated affiliates, including transactions between a carrier’s nonregulated operations and its nonregulated affiliates.

  7. Affiliate transactions rules do not apply to transactions between an ILEC and its regulated affiliates, even if they are within the same holding company.

For additional information, see www.cbandco.com’s website speech titled “USOA Part 32 and RUS Accounting Update”
Affiliate Transactions - Findings

• Proper Treatment of Related Party Transactions - **RUS Did Not Adopt the FCC Affiliate Transaction Changes in FCC 04-149.**

1. If a tariff exists, company should use the tariffed rate.
2. If no tariff exists, company should use prevailing rates as long as **50%** or more of the service is provided to non-affiliates.
3. If neither of the above applies and the total amount is less than **$500,000**, the company should use fully distributed cost (FDC). Therefore the Fair Market Value (FMV) comparison is **not applicable** when the total annual value of the services is less than **$500,000** - **not assets**.
4. [Sales of assets] or [services over $500K] **BY a regulated entity TO an affiliate** are recorded at the greater of cost or FMV.
5. [Purchases of assets] or [services over $500K] **BY a regulated entity FROM an affiliate** are recorded at lesser of cost or FMV.
Affiliate Transactions - Findings

• **Proper Treatment of Related Party Transactions - RUS Did Not Adopt the FCC Affiliate Transaction Changes in FCC 04-149.**

  6. If the telco purchases services from a related party, and the related party is organized solely for the provision of services to the telco, then the service should be recorded at its FDC, without determining that the FDC is below market value.

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*For additional information, see [www.cbandco.com’s website](http://www.cbandco.com)’s website speech titled “USOA Part 32 and RUS Accounting Update”*
Cost of Goods Sold - Findings

• Findings:

  1. Cost of Goods Sold (COGS) was understated due to untimely work order closings and expenses coded incorrectly to accounts other than COGS.

Effects:

  • Expense and Revenues may not be matched
  • Services may be under priced
  • Expenses that should be billed to customers could be missed
Cost of Goods Sold - Findings

- Recommendation:
  1. Match billed invoices to related COGS for each invoice using an excel spreadsheet.
  2. This comparison should be prepared by accounting, but shared with other departments if they are responsible for determining pricing, etc for the goods or services.
  3. Compare this spreadsheet to any other internally prepared documentation used in determining the sales price of the goods or service.

Examples of this include sales of KSU’s and other custom work performed on behalf of others.
Sales Tax DSL Equipment CPE - Findings

• Findings:

1. Sales tax was remitted by a telco when purchasing DSL modems that were given or leased to subscribers. These modems are at the customer’s location. Assuming, the customer has care, custody and control of the modem at their location, they may be purchased tax free in Texas. This is so because they are being provided in conjunction with a taxable service. It is probable that the same reasoning applies to other states as well.

Effects:

• Reduces cash and overstates inventory and expense
Sales Tax - Cooperatives - Findings

- Findings:
  1. A cooperative purchased heavy work equipment and was erroneously charged sales tax. Cooperatives are exempt from paying state taxes in many states.

  Effects:
  - Reduces cash, increased cost of equipment

  Recommendations:
  - When coding invoices, especially those from nonrecurring vendors, accountant should review invoice to ensure sales tax was not charged on equipment, when applicable
Sales Tax - Cooperatives - Findings

Findings:


Effects:

- Potential liability if audited by the Comptroller’s office
- Appearance of avoidance of tax can increase review by Comptroller’s office, possible fines and penalties

Recommendations:

- Review invoices to ensure that either sales tax is remitted to the vendor, or subsidiary can pay use tax on their sales tax forms
Netting Revenues and Expenses - Findings

• Findings:

1. Amounts billed to customers to pass through the cost of federal or state USF and other assessments are improperly netted against the related expense account.

Effects:
• Financial statement revenues and expenses are understated

Recommendations:
• Amounts billed to customers to pass through these costs should be recorded as revenue in Account 5264 - Other Incidental Regulated Revenue - State and Account 5264 or 5083 - Federal, not netted against the expense account
• This applies only to taxes/fees that are assessed to the service provider as opposed to taxes such as sales or excise tax for which the telephone company merely bills, collects and remits to the taxing agency
Depreciation - Findings

• Findings:
  1. Limiting depreciation on plant accounts that can be over depreciated to allow for cost of removal.
  2. Recording gains/losses on disposal of assets.
  3. Failure to record depreciation on new plant accounts.

Effects:
  • Depreciation expense and accumulated depreciation improperly stated on the financial statements

Recommendations:
  • Check rates periodically
  • Compare each plant and associated reserve balance
  • Compare each plant account in the general ledger to the depreciation calculation schedule to ascertain that each plant account is included
Advances to Employees - Findings

- **Findings:**
  1. RUS prohibits advances to employees under most situations.
  2. Some companies have made advances to employees without RUS approval.

- **Recommendations:**
  1. A company can request approval for an advance to an employee in certain situations.
  2. RUS has given approval to some borrowers to finance personal computers for employees.
Customer Billings

- **Findings:**
  1. Incorrect billing of taxes and assessments.

- **Recommendations:**
  1. Review customer billing for proper billing of taxes and assessments - sales, excise, etc.
  2. Review changes relative to excise tax on long-distance services.
Federal Excise Tax Changes

- IRS Notice 2006-50 Issued May 25, 2006
  1. Redefines nontaxable telephone service.
     ✓ Long-distance telephone service
     ✓ Bundled telephone service
     ✓ Prepaid
     ✓ Voice over Internet Protocol (VoIP)
  2. Excise tax due on local-only telephone service.
  3. Applies to nontaxable services billed after July 31, 2006.
Federal Excise Tax Changes

• Refunds and Credits Allowed
  - Available for excise tax paid on nontaxable service that was billed after February 28, 2003 and before August 1, 2006
    • Individuals
    • Business Entities
  
  - Refund request must be made on 2006 federal income tax return
Specifically SAS 112 does this following:

- Defines the terms *significant deficiency* and *material weakness*.
- Provides guidance on evaluating the severity of control deficiencies identified in an audit of financial statements.
- Requires the auditor to communicate, in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in an audit.
SAS No. 112

SAS 112 includes the following three important definitions:

1. **Control deficiency (CD)** - exists when the design or operation does not allow management or employees, in the normal course of performing their assigned function, to prevent or detect misstatements on a timely basis.

2. **Significant deficiency (SD)** - a CD, or combination of CDs, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such as there is more than a remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected.
3. **Material weakness (MW)** - a SD, or a combination of SDs, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.

- Events are either “probable”, “reasonably possible”, or “remote”.
  - **Probable** - future event is likely to occur
  - **Reasonably possible** - chance of the event occurring is more than remote but less than likely
  - **Remote** - chance of the future event is slight

- More than a remote likelihood means that the event is either reasonably possible or probable.
SAS No. 112

If the following controls are not effective, the auditor should consider them to be at least SDs:

• Controls over accounting principles in conformity with GAAP

• Antifraud programs and controls

• Controls over nonroutine and nonsystematic transactions

• Controls over period-end financial reporting process
SAS No. 112

If the following are **not effective**, the auditor should consider them to be strong indicators of MWs:

- Oversight by governing board
- Internal audit or risk management function
- Compliance function in highly regulated industries
- Control environment
If the following circumstances exist, the auditor should consider them to be strong indicators of MWs:

- Restatement of prior year financial statements to reflect correction of material misstatement

- Auditor’s identification of a material misstatement that was not caught by internal controls

- Identification of fraud

- Failure to handle previously communicated SD
Effective for audits of financial statements for periods ending on or after 12/15/06, there are two unconditional requirements to comply with SAS 112:

1. Auditor must evaluate identified CDs and determine if they are SDs.

2. Auditor must communicate, in writing, SDs and MWs to management and the board, including those identified in prior audits that have not been remediated. These SDs and MWs are reported in the “Independent Auditor’s Report on Internal Controls Over Financial Reporting”.
SAS No. 112

What can your entity do to prepare for SAS 112?

➢ Educate yourself

  • Learn the key components of strong internal controls
  
  • Understand your financial statements and the required disclosures
  
  • Build a resource network to assist you as questions arise
SAS No. 112

- Eliminate all audit adjustments
  - Talk to your auditor about the nature of any prior year audit adjustments
  - Identify and record all potential adjustments prior to the audit
  - Maintain a file of issues and/or transactions occurring during the year that might have GAAP accounting implications
  - Seek advice from your auditor, or others, regarding these items prior to the audit
SAS No. 112

- Educate your management and board of directors (BOD)
  - Don’t let your management and (BOD) be blind-sided
  - Educate them so that they might assist in evaluating and improving controls

- Inventory your system
  - Identify significant accounts, disclosures, processes, and cycles that are used by, or take place in, your organization
SAS No. 112

- Prioritize
  - Do not try to fix or improve everything at once
  - Consider making improvements over multiple years
  - Identify the areas of greatest weakness and improve those first
Findings:

1. Lack of sufficient accounts payable cut-off procedures.

Effects:

- Allows for more than a remote likelihood of a material unrecorded liability
- Unrecorded liability can result in cost for the period to be understated and costs in the following period when the liability is actually recorded to be overstated
- Relying on audit procedures for review of invoices received after the end of the month and recording of appropriate liability is a material weakness, because audit procedures cannot be considered a part of an entity’s internal control

Recommendations:

- Invoices reviewed timely for proper recording of liability and costs
- The actual date when ownership of the purchased asset is transferred to the company or the actual date the service is performed should be used to record the liability, not necessarily the invoice date
SAS No. 112

Findings:

2. Accounts payable subsidiary ledger not properly reconciled to the general ledger.

Effects:

- Lack of reconciliation may cause errors to be overlooked
- Financial statements will not properly reflect the financial position of the company if liabilities and costs are not correctly recorded
- Failure to reconcile subsidiary ledger with general ledger will probably be considered a material weakness

Recommendations:

- Balance sheet accounts should be reconciled monthly
Findings:

3. Outstanding checks over 90 days old left on bank reconciliations.

Effects:
- Financial statements may not properly reflect the financial position of the company
- May be considered a control deficiency

Recommendations:
- Review each bank reconciliation for checks that have not cleared. Investigate any uncleared checks over 90 days old and determine if an adjustment is necessary.
SAS No. 112

Findings:

4. Lack of system in place to report retirement of plant.

Effects:

- Plant and reserve balances are overstated
- Financial statements may not properly reflect the financial position of the company
- May be considered a control deficiency

Recommendations:

- When invoices for new assets are received by Accounting, they should inquire whether the new asset replaces a removed, abandoned or obsolete asset.
- Plant records or CPR’s should be reviewed periodically by appropriate personnel to determine if assets have been retired and not reported to Accounting.
- Procedures should be established for timely reporting of retirements; for example, a section of each employee’s daily timecard can be used for retirement reporting.
SAS No. 112

Findings:

5. Lack of controls—unauthorized use of check signature stamp.

Effects:

- Fraud, resulting in theft of company’s cash
- Probably will be considered a material weakness if no mitigating controls are in place

Recommendations:

- Management should review all bank statements and contents before forwarding on to Accounting
- Proper controls should be established for the use of the check signature stamp
- The stamp should be kept in a secure location
Miscellaneous Information

- Great Internet Links For Telephony Information
  - [FCC Website, Part 32 PDF File]
    http://www.fcc.gov/wcb/CFRparts/PART32.PDF
  - [FCC Website, RAO Letters]
    http://www.fcc.gov/wcb/ppd/RAOLetters.html
  - [Curtis Blakely Website, Part 32 Word Doc]
    http://www.cbandco.com/downloads.html

Copies of our speeches will be available in pdf format on our website
Thank You for Your Attention

The End

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