

USAC Audits

What to Expect When You're Expecting

Presented by:

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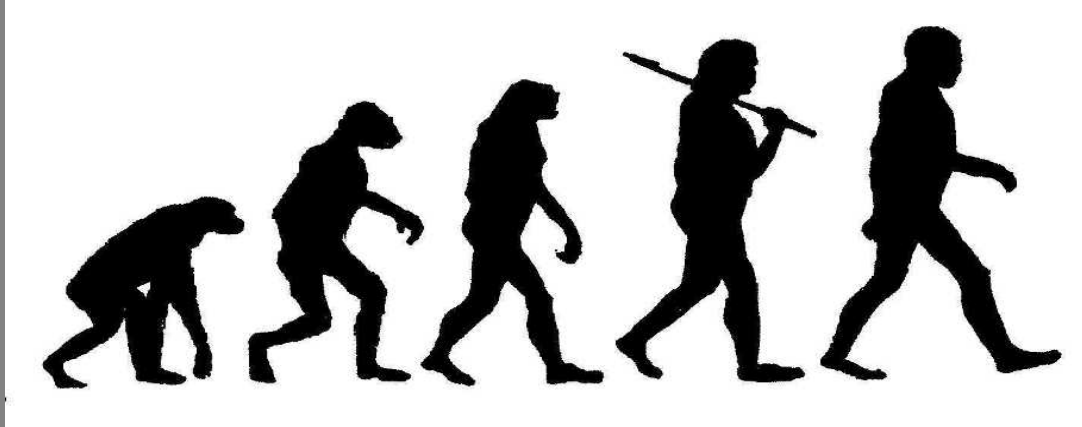


Qualifications?

- CPA with Curtis Blakely and Co, CPAs (1977)
- 21 years with CBCo
- Shareholder since 2000
- Clients - 30+ Telcos in Texas, Oklahoma, New Mexico, Louisiana, Arizona
- Acted as an interim accountant/controller for 4 different Telcos during my career
- Perform monthly compilation for 2 telcos.
- Used MACC on almost a daily basis while assisting these clients
- We have represented many clients during the USAC audits, and are well versed in the auditor's expectations



Origins Of The USAC Audit



- 47 CFR 54.707 USAC has the authority to conduct audits
- Improper Payments Information Act (IPIA) of 2002
 - Gives FCC Office of Inspector General (OIG) authority to conduct audits
 - Applies to any company that receives funds from the Federal Universal Service Fund
- Inspector general act of 1978, as amended



Overall Audit Responsibility

- OIG auditors review your information to determine:
 - Reliability of information
 - Whether assets are safeguarded
 - That amounts have been used in a manner consistent with laws, regulations and policies
 - That resources are used economically and efficiently
 - That desired results are achieved



How Did You Get Selected?

- USAC audited 459 in 2007, 800 in 2008
- Based on sample size driven by certain requirements
- OIG utilizes a statistician to perform steps to identify the Telcos selected for audits
- You could possibly be selected even though you have already been audited previously



Your Company's Responsibility

- You must comply with the request as a recipient of federal funds
- Cooperate with the audit firm, USAC and the FCC-OIG
- Attempt to minimize the financial impact of the audit



Your Company's Responsibility

- Possible Audit Outcomes...
 - Unqualified Opinion – “Clean”
 - Qualified Opinion – “Except for”
 - Adverse Opinion – Negative
 - Disclaimer – Unable to express an opinion
 - Withdrawal



What To Expect

- USAC announcement letter
- Possible phone call close to receipt of letter
- “Initial” request letter (2 week turnaround)
- Internal control questionnaire (2 week turnaround)



Let The Games Begin!!!

INFORMATION REQUESTS



Information Request

- **Initial** request is typically around 40 pieces of information
- Covers several years' worth of information
- Depending on your company, much of the information can be obtained from consultants and your financial statement audit firm



Information Request - Continued

- Examples of items requested:
 - ETC designation letter from state regulatory authority
 - Audited financial statements for several years
 - Information provided previously to NECA with support (LSS data, etc.)
 - Cost allocation manual
 - Part 64 allocation information
 - Documented payroll processes
 - Tax returns
 - CPRs



CPRs

- Contrary to popular belief this does NOT stand for **C**annot **P**roduce **R**ecords.....



Continuing Property Records

- A **CPR** is a complete record of the cost and quantity of each type of property unit in a plant account
- If you are not currently using MACC's CPR module, I suggest you consider implementing it, especially if you have no real CPRs



CPR Verification

- The review will most likely include the following:
 - Verification that the invoice provided ties back to the material cost in the CPR (Problem: average cost!)
 - Examining contractor's invoice for materials costs, labor, etc. (Problem: materials that are not a unit of property)
 - Recompute labor, benefits and other overheads for the retirement costs. (Problem: labor spread methodology!)



CPR Verification

- Check support (i.e., time sheets, time studies, cancelled checks) for accuracy.
- Physical examination of the plant items
- Compare CPR balance to general ledger



CPR Verification

- Support Assets
 - Auditor will review your support asset CPRs (Accts 2114-2121)
 - Auditor will check to ensure that they are updated timely
 - Compare the ending CPR balance to the audited general ledger balance



CPR Verification

- Auditor will compare the balances to the cost studies
- In some cases, the auditor may ask to visually examine some of the support assets
- Auditor may question the support asset's use as a regulated item (i.e., snowmobile, trailer, etc.)



CPR Verification “Discrepancies”

- Many Telcos use average cost for materials
 - Auditor was not satisfied with discrepancy between invoice price for similar cable and amount transferred from materials inventory
 - Requested several years worth of invoices of certain sizes of cable to develop an average cost approximating the amount in the CPR
 - The difference can be explained if the auditor is reasonable



CPR Verification “Discrepancies”

- Work order closing information
 - Telco closed \$1,000,000 in work orders comprised of over 100 invoices
 - The GL account had the total \$1,000,000 closing, and did not provide invoice detail
 - Telco provided auditor with a spreadsheet listing invoices, dates, etc. The spreadsheet covered 3 years worth of invoices, and totaled MORE than the 1,000,000 – as some partial amounts of the invoices were properly expensed



CPR Verification “Discrepancies”

- Auditor contended that Telco would have to provide copy of every invoice that totaled the \$1,000,000, plus provide proof that invoices had not been recorded in previous years. Auditor would have required Telco to provide 3 years of invoices for certain vendors, 3 years worth of cash disbursements journals, and cross reference every invoice to ensure that invoice was booked once only
- Telco requested that auditor sample the 100+ invoices and Telco would provide copies of sampled invoices. Auditor refused



CPR Verification “Discrepancies”

- Telco offered to ship auditor 4 boxes of invoice copies so the auditor could sample any that they wished. Auditor refused, insisting on Telco compiling copies. Essentially the materiality on the invoices was .01
- Telco offered copies of FRS forms completed and RUS loan audits of FRS, all of which were approved by RUS field auditor. RUS field auditor had examined 100% of invoices and agreed to FRS total. Auditor refused to accept the RUS audit as support



CPR Verification “Discrepancies”

- Telco offered as support a confirmation of amounts from the various vendors. Auditor would not accept the list, required actual invoices
- Auditor essentially disallowed the entire amount in its “effect report”. Telco disagreed. So far no response regarding the effect of this finding



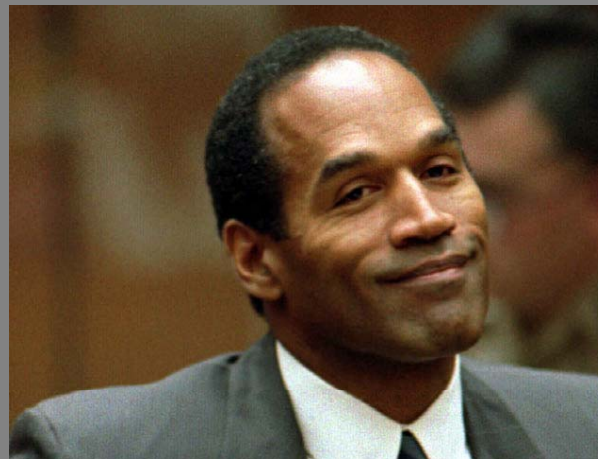
Invoice Sampling

- The auditors will make random selections of invoices based on a review of the general ledger detail and cash disbursements
- Auditor will request copies of the invoice and cancelled check
- For payroll related selections, they will ask for timesheets, time cards, labor distribution summaries, etc. (With MACC, you are in good shape on this.)
- Planning note: Time Studies – retain support, or begin requiring support



Payroll Discrepancies...

- **Labor, benefits and overheads**
 - Auditor felt charging “de minimis” hours for voting, bereavement or jury duty to employee’s most common account was not compliant with FCC Part 32 guidelines
 - We computed the difference between allocating the labor based on total hours and charging the employees’ most common account at \$4.16 in nonreg expense and \$1.11 in Net Investment Base
 - The auditor insisted on having this as a finding...



Telephone Plant Under Construction

- Auditor will request information relative to Telco's procedures for closing work orders to plant in service from your plant under construction accounts
- **Tip – use folders to support the closing of work orders each month. Folder should contain everything necessary to support the work order closing**



OIG Expectations

- OIG estimated audits would uncover 1.293 billion in improper payments in the 2007 audits
- Actual findings for improper payments 6.17 million in “potentially improper” payments in the 2007 audits...
- Less than $\frac{1}{2}$ of 1 percent of their original estimate (.48%)
- There have been some larger amounts in the more recent audits, but nothing as significant as the cost of the audits.



Record Retention Issues

- The Commission established explicit high cost document retention rules requiring carriers to retain records necessary to support expenditures for 5 years from date of funding effective March 2008
- There are approximately 100 audits that have a finding relative to record retention and documentation for periods under audit



Record Retention Issues

- Depending on circumstances you can either stick to your retention policy, request invoice from vendor, or request auditor to allow additional support
- *Suggestion:* Develop a strong record retention policy and adhere to it



Develop A Record Retention And Destruction Policy

SAMPLE TELCO RECORD RETENTION AND DESTRUCTION POLICY

Purpose:

To describe SAMPLE TELCO'S perspective to ensure that necessary records and documents are adequately protected and maintained and to ensure that records that are no longer needed or those of no value are discarded at the proper time. This policy is also for the purpose of aiding employees of SAMPLE TELCO in understanding their obligations in retaining and destroying documents.

Policy:

It is the policy of SAMPLE TELCO that documents are retained and destroyed consistently according to the policy set forth in the record retention and destruction policy of SAMPLE TELCO.

Attached as Appendix A is a Record Retention Schedule that is approved as the initial maintenance, retention, and disposal schedule for company records.

SAMPLE TELCO's Human Resources Department (OR OTHER DESIGNATED DEPARTMENT) is the administrator of this policy and the implementation of processes and procedures to ensure that the Record Retention Schedule is followed. The administrator is also authorized to make modifications to the Record Retention Schedule from time to time to ensure that it is in compliance with local, state, and federal laws and annually review the record retention and disposal program and monitor compliance with this policy.

Documents will be retained for the designated time stated according to Appendix A. Once the document has reached its termed retention date the document will be destroyed by a secure, protective, and safe method, which may include but not limited to shredding of the document.

In the event that SAMPLE TELCO is served with any subpoena or request for documents or any employee becomes aware of an investigation or audit concerning or the commencement of any litigation against or concerning SAMPLE TELCO, such employee shall inform the Administrator and any further disposal of SAMPLE TELCO documents shall be suspended until further notification is received from the Administrator. The Administrator shall take appropriate steps to promptly inform all staff of any suspension in the further disposal of documents.

This policy applies to all records generated in the course of SAMPLE TELCO's operation, including both original documents and reproductions.

C:\Documents and Settings\calbert\Local Settings\Temporary Internet Files\Content.Outlook\1SPDE2FL\RECORD RETENTION AND DESTRUCTION POLICY SAMPLE TELCO.doc



Other Information In Audit

- Payroll and clearances
- Time sheets/time studies
- Depreciation rates
- Taxes (ad valorem, income, other)
- Organizational chart
- Cost allocation procedures
- Review of affiliate transactions
- Subscriber line charge review
- Standard internal control questions



Suggestions

- Documentation of entire audit procedure
- Retain emails with supporting attachments
- Retain copies of all electronic files sent
- Mark each document with a confidentiality statement, no exceptions
- Don't make waves. Go with their dates, etc. if at all possible. Reduce conflicts if at all possible
- Supply data in an electronic format, and as quickly and efficiently as possible



Suggestions

- Realize that these auditors think a CAB is a yellow taxi at the airport. They do not typically understand telephony
- Use an FTP site to transfer data and retain copies of all data for future reference
- Develop an index for all information provided to auditors
- “Don’t sweat the small stuff”



What Is An Improper Payment?

- Includes both overpayments and underpayments
- Defined as “any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements
- In many cases, if the USAC contract auditor was unable to discern whether the payment was proper as result of insufficient documentation, the payment was considered erroneous or improper

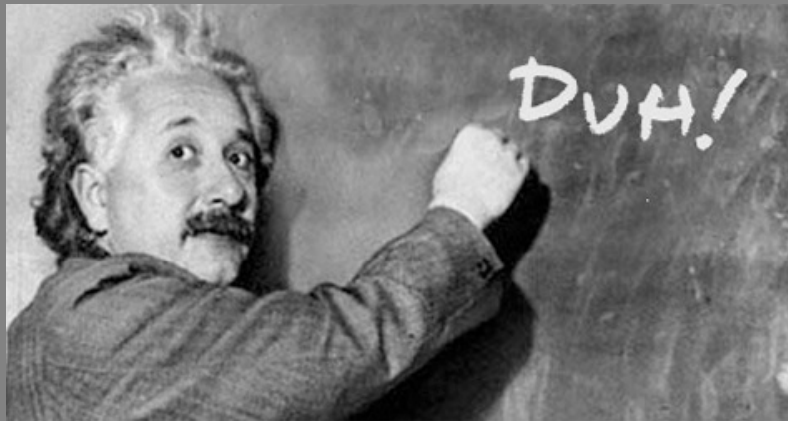


A Better Use For The Dollars Spent...



Wholly Interstate Expense?

- Rural ILECs currently undergoing costly audits - often ranging from \$30,000 - \$50,000 - by the OIG, and have been informed that they must allocate their federal USF audit-related expenses to account 6720 pursuant to the FCC's Part 32 and 36 accounting and separations rules which allocates a portion of these costs to the interstate (federal) jurisdiction and another portion to the intrastate (state) jurisdiction



"Acts 20:35 - It Is Better To Give Than Receive" – USAC Style?

- *"As a matter of administrative practice, USAC does not disburse funds due to audit where the net variances in USF support calculations would otherwise entitle a carrier to recovery of funds"*
- If the net amount is in favor of USAC, the Telco must pay. If it is favor of the Telco, they do not get reimbursed



Oops?

- The OIG has initiated its own audits to address issues of confidentiality, lack of adequate audit coverage, and audit firm and program management missteps
 - Released confidential and competitively sensitive information to other Telcos
 - Stolen PC with sensitive information
 - Missing, lost information
 - Repeated requests for the same information



The End

(or just the beginning?)



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