April 24, 2009

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Portals II, Room TW-A325
Washington, DC 20554

RE: ***Comprehensive Review of the Universal Service Fund Management Administration and Oversight*, WC Docket No. 05-195**

Dear Ms. Dortch:

CTIA – The Wireless Association and The United States Telecom Association electronically filed the attached letter to the FCC Commissioners and their legal advisors today. In accordance with FCC Rule 1.206(b)(1),[1] please include this notice and the attached letter for inclusion in the public record. Please feel free to contact the undersigned with any questions.

Sincerely,

Jonathan Banks

[1] 47 C.F.R. § 1.1206(b)(1)

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April 24, 2009

Commissioner Michael J. Copps
Acting Chairman
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

Commissioner Robert M. McDowell
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

Commissioner Jonathan S. Adelstein
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

Dear Mr. Chairman and Members of the Commission:

The existing audit program under the Improper Payments and Information Act (IPIA) for carriers that receive high cost universal service support is not working and should be changed. USTelecom and CTIA – The Wireless Association appreciate the Commission's increased efforts to ensure that universal service high cost support is properly distributed for the benefit of consumers. Our members make substantial contributions to the fund and understand the importance of effective oversight and efficient administration of the universal service fund (USF). But the current audit process is not aligned with what the IPIA requires and is not a good use of scarce universal service resources.

Under the IPIA the Commission Office of Inspector General (OIG) is now conducting a huge number – 1,000 or more – of annual audits of support recipients. The objectives of these IPIA audits are not always well-defined, and they often yield meaningless results. Consumers pay for these audits through USF charges on their bills. And the program is enormously expensive – costing more than $100 million per year, all of which is drawn out of the fund. Moreover, only a tiny fraction of these costs are recovered through refunds to the USF of improper payments identified during the audits. At a minimum, the audit program should be scaled back and the process of selecting carriers for audit should be based, at least in part, on an actual assessment of likely risk. The program should also be modified to include uniform standards taking the size of the auditee as well as the number of operating companies being audited into consideration, timely final audit reports, improved auditor training including an understanding of document retention rules, clarification that improper payments do not necessarily represent over-recovery of support, and use of more streamlined and less costly auditing methods.

We are particularly concerned that the Report issued by the OIG entitled "The High Cost Program, Initial Statistical Analysis of Data from the 2007/2008 Compliance Attestation

Examinations" ("Report")[2] vastly overstates the number and amount of "improper" payments pursuant to the IPIA and is not helpful to the Commission in reforming agency rules and procedures under which the high cost fund operates.

Our analysis of the Report indicates a number of substantial problems with the methodology underlying the Report and the Report's conclusion as well as with the conduct of the audits themselves. The Report significantly relies on ambiguous high cost audit standards, non-uniform procedures, as well as findings based on application of rules not in effect during the time period being audited.

Moreover, the OIG report ignores the fundamental discrepancy between the purpose of the IPIA[3] and the OIG's audit program. The IPIA requires federal agencies to "identify systematically areas in which *they* are vulnerable to making erroneous payments and to report on the steps they are taking to reduce these vulnerabilities."[4] (emphasis added). USAC notes that "The breadth of the concept of improper payments illustrates that the IPIA is a management tool designed to identify weakness in the design or administration of a program."[5] Yet, the Inspector General's report does not list this as an objective, stating that the two objectives of each audit were to determine the extent of compliance with FCC rules, orders and interpretive opinions, and to provide a statistical measure of the erroneous payment rate.[6] Neither of these objectives reflects the requirements of the IPIA under which the vast majority of USF audits are conducted. In essence, the Report's statistical analysis extrapolating questionable data generates results that are of little use to the Commission and other policy-makers seeking to improve the integrity and efficiency of the high cost universal service program.

The experience of our members with the auditors raises significant concerns about the quality and reliability of the audit process. Auditees have reported wide variations in the audit plans of various private auditors employed by USAC. The lack of any meaningful consistency among audits resulted in auditors requesting different data for the same type of audits, reviewing and basing their opinions on different data, applying different interpretations of the Commission's rules, evaluating the same factual situations differently, and making different recommendations in response to the same factual situations. A number of auditor requests for documentation were also extremely broad, in some cases calling for production of millions of records, or reflected a lack of understanding of how telecommunications companies operate. Equally problematic is the reverse, one size-fits-all approach. In the same, limited amount of time allocated for the audits, for example, it is simply not realistic to expect that large and mid-sized carriers serving multiple states could produce – and that their auditors could review – data

[2] Released November 26, 2008.

[3] P.L. 107-300, 116 Stat. 2350, *codified at* 31 U.S.C. § 3321. Further citations are to the IPIA as enacted rather than as codified.

[4] H.R. Rep. No. 107-765 at 4 (2002).

[5] See page 6 of USAC Analysis.

[6] See page 13 of the report of the Inspector General titled "The High Cost Program Initial Statistical Analysis of Data from the 2007/2008 Compliances Attestation Examinations", November 26, 2008

proportional to that requested from the smallest providers And the burden on small carriers is extraordinary, given their limited personnel and financial resources. Again, these competing concerns result from the strictures of a compliance attestation procedure.

Furthermore, the cost of the current audit process must be measured against its results. The cost to the USF of the first two rounds of the audits mandated by the FCC OIG exceeds $145 million, and Round Three expected to cost at least another $100 million.[7] This quarter of a billion dollars should be compared with the glaring lack of any solid recommendations for improving the administration of the program, which is the purpose of the IPIA.

The Improper Payments Information Act

Enacted in 2002, the IPIA [8] requires federal agencies identify areas of vulnerability in federal payment programs as well as corrective measures.[9] The term "improper payment" is defined to include "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments)."[10] The IPIA contemplates that the Office of Management and Budget (OMB) would elaborate on its requirements, and OMB guidance states that in addition to the circumstances in the statute itself that are described as improper payments, "when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an error."[11] Of course, a lack of "sufficient" documentation does not mean that a beneficiary was overpaid, underpaid, or that any program rule was violated.[12]

To comply with the IPIA, OMB does not require formal audits, let alone the use of a particular audit standard such as a "compliance attestation," which involves validating company representations. The *OMB Guidance* requires that agencies "obtain a statistically valid estimate of the annual amount of improper payments in programs and activities."[13] Agencies are directed to base estimates on a random sample of payments of "sufficient size to yield an estimate with a 90 percent confidence interval of plus or minus 2.5 percentage points." However, the guidance does not specify the manner in which estimates are to be gathered. Rather, the *OMB Guidance* recommends to the agency administering a program the most basic of program integrity activities – prevention. It states that "Prevention activities are by definition proactive. These are actions

[7] See Universal Service Administrative Company Analysis of the Federal Communications Commission Office of Inspector General 2008 Reports on the Universal Service Fund ("Analysis"), Executive Summary, Page I

[8] P.L. 107-300, 116 Stat. 2350, *codified at* 31 U.S.C. § 3321.

[9] H.R. Rep. No. 107-765 at 4 (2002).

[10] IPIA § 2 (d)(2).

[11] *See* Robert Portman, *Memorandum For Heads of Executive Departments and Agencies*, M-06-23 (Aug. 10, 2006)(also known as OMB Circular A-123 Appendix C)("*OMB Guidance*") at 2.

[12] This is particularly true in the current situation where there was no program-specific document retention guidance, as explained below.

[13] *OMB Guidance* at 10-11.

performed prior to payment issuance to assure that the payment is accurate when made. Examples of this type of activity include pre-payment audits, due diligence based on risk prioritization, and predictive modeling."[14]

Instead of utilizing efficient preventative techniques, the OIG has embarked upon a massive and expensive post-payment auditing program. The results of this program have been that "The FCC OIG has reported no instances of fraud in any of the programs as a result of either Round One or Two audits and has recognized a generally high level of program compliance."[15] The OIG's audit program has added considerable costs to the USF, and has required companies themselves to expend significant resources to respond to audit requests. Over the past few years, the OIG received more than $20 million per year in direct appropriations out of the USF to conduct universal service audits.[16] This was in addition to the OIG's existing operating budget. Further, at the OIG's request, USAC itself is now spending roughly $100 million annually on USF auditing.

The omnibus spending bill just passed by the House of Representatives allocates another $25.48 million in USF receipts for even more USF audits, despite the fact that the results of the second round of audits yielded statistically indistinguishable outcomes from Round One.[17] According to USAC, "Given the consistency of the results between Round One and Round Two, it is reasonable to expect that Round Three will largely duplicate the result of Round Two, again at great cost to the USF and program beneficiaries."[18] USAC also estimates that the cost per audit to a beneficiary to be $20,000.[19] For the average small rural LEC that serves less than

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[14] *OMB Guidance* at 11. According to OMB, on pages 11 and 12 of the *OMB Guidance,* current effective monitoring practices in certain federal agencies include:

- Predictive modeling – an automated process whereby transactions that have pre-established criteria or characteristics are automatically deemed high risk and therefore receive increased focus both pre- and post-payment. For State-administered programs, in which States are utilizing unique predictive models, Federal agencies should evaluate which States have the most effective methods and ensure that best practices in this area are disseminated to other States.
- Data mining – an automated process used to scan data bases to detect patterns, trends, and/or anomalies for use in risk management or other areas of analysis. This technique can be used to build more effective predictive modeling criteria, identify control weaknesses that are leading to improper payments, and/or inform on the most effective oversight and due diligence activities.
- Alignment of due diligence and risk oversight – Federal agencies should structure due diligence and oversight activities so that higher risk transactions generate additional due diligence/review and lower risk transactions generate limited or no due diligence/review.
- Prioritization of verification activities based on effectiveness – Federal agencies should evaluate the return on investment of various outreach efforts (e.g., in-person audits, written notices, phone calls) and utilize those efforts with the greatest return on investment.
- Data matches – Federal agencies should be evaluating Federal, State, local, and private databases to assess whether data matches can help strengthen pre- and post-payment reviews.

[15] See Page II of the Executive Summary of the USAC Analysis.

[16] *See* Federal Communications Commission FY 2007-2009 Budget Estimates; *see also* USAC 2007-2009 Budgets.

[17] See pages 8 and 12 of the USAC Analysis.

[18] USAC Analysis, page 12.

[19] See Footnote 5 on page 2 of the USAC Analysis.

5,000 customers, the USF audit burden per customer exceeds $4. The cost to large and mid-sized carriers is also significant considering that they usually have multiple companies being concurrently audited. Considering that that carriers serving multiple study areas use the same procedures to calculate their support, it is not surprising that the audit findings are almost identical. Audits should be more targeted considering that results are not likely to be different and the cost of complying with the audits are high.

OIG Report Infirmities

The IPIA gives federal agencies the authority to conduct reviews of federal programs involving payments made to eligible entities. Based on audits conducted in 2007 covering the period from July 2006 through June 2007, the Report calculates that the statistical estimate of improper high cost payments during FY 2006 was $970.3 million. There are a number of issues that suggest this is a vast overstatement of "improper" payments and does not provide a reasonable basis to compare improper payments in the high cost program with other federal programs.

First, by far the largest category of "improper" payments that the Report identifies can be attributed to a lack of documentation resulting in the auditor being "unable to discern" whether the payments in question were proper. This single category accounted for 47.1 percent of the payments identified in the Report. During the period covered by these audits, however, FCC program rules did not set out any requirement that companies receiving support from the high cost program maintain specific documentation. This issue had been brought to the FCC's attention by a number of entities, and was identified in the first round of audits as a program deficiency. The FCC remedied this in its 2007 *Program Management Order*,[20] but the order set out program document retention requirements that did not become effective until January 2008.[21] Thus like the first round of audits, the second round of audits described in the Report was also for a period that pre-dated the new recordkeeping requirements and is therefore of little use in assessing program risk. A third round of audits that will again examine documentation issues for another period pre-dating the Commission's 2007 *Program Management Order* is now underway. This practice is at odds with government (and any other) auditing standards and commonsense. Section 6.09 of the Government Auditing Standards (July 2007 Revision) points out that, "*When planning the engagement, auditors should ask entity management to identify previous audits, attestation engagements, and other studies that directly relate to the subject matter of the attestation engagement being undertaken* ***, including whether related recommendations have been implemented. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current work****, including determining the extent to which testing the implementation of the corrective actions is applicable to the current*

[20] *Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight,* Report and Order, 22 FCC Rcd 16372 (2007) ("*Program Management Order*").

[21] As noted by USTelecom in Comments to the Commission in its proceeding on USF administration, auditors have effectively applied the 2007 document retention rule to periods predating its adoption. *See* Comments of the United States Telecom Association, *Comprehensive Review of the Universal Service Fund Management, Administration and Oversight, WC Docket No. 05-195,* submitted November 13, 2008.

engagement objectives." It simply is not possible for carriers to retroactively implement recordkeeping requirements, and auditing against standards that did not exist contemporaneously – now for the third time – is not a good use of resources.

In addition, given the absence of any FCC rules spelling out specific documentation requirements for high cost program participants during the audit period, there has been no formal guidance to auditors as to what constitutes sufficient documentation to meet OMB's requirements. The OIG Report also supplies no informal guidance as to how the sufficiency of documentation was assessed, what efforts an auditor should undertake before concluding that it is "unable to discern" whether a payment was properly made, and how judgments about sufficiency were linked to the amount of a payment deemed to be "improper." This appears to leave these judgments solely to individual auditors and audit firms. Thus because the USF IPIA audits are structured as compliance attestation engagements, there are few applicable standards, and the auditors have considerable discretion in "exercising professional judgment" regarding how they choose to verify compliance.[22] It is, therefore, at best unclear what documentation standards were applied and how those standards were linked to conclusions about high cost payments.

Although there is confusion surrounding audit standards, it is, however, clear that judgments about documentation had a very broad effect. As noted above, 47 percent of "improper" payments resulted from subjective judgments of insufficient documentation. Of that amount, over 83 percent of the dollar amounts of improper payments are identified in the Report as instances in which the *entire* amount of the high cost payments during the audit period to a provider was characterized as improper. It is again unclear as to what standard was applied in judging whether, for instance, to conclude that a $1 million payment was entirely "improper" based on insufficient documentation for a minor supporting item.

Second, the Report identifies reasons other than insufficient documentation as causes of some payments being classified as improper. Included in that listing were imprecise FCC rules, contradictory FCC rules, overly complex FCC rules, USAC procedures, and errors by third parties such as USAC and NECA. As with the absence of standards regarding sufficient documentation, there appears to be a substantial lack of clarity regarding just how individual auditors made judgments about how to link a particular FCC rule that was "imprecise" or "overly complex" to a conclusion that a particular payment was "improper." Carriers commonly seek guidance from the FCC and USAC concerning how to apply rules, and auditor judgments should not be allowed to override such guidance. At a minimum, the Commission and the OIG should look to improve the rules or provide guidance or standards to auditors and companies about how these rules will be interpreted before conducting an additional round of audits that will involve these same issues.

Moreover – though not part of the high cost program – as a further example of the problems with the IPIA methodology reflected in the Report, a later OIG report concluded that

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[22] GAGAS at § 3.7.

the entire amount of all payments to carriers out of the low income fund (lifeline and link-up reimbursements) was "improper."[23] This conclusion resulted from a misunderstanding of the manner in which low income program payments are processed. USAC uses an algorithm to project low income payments based on a carrier's prior lifeline and link-up volume. These projected payments are subjected to a true-up process. This algorithm and projection formula ensures that carriers are quickly reimbursed for expenses associated with providing low income telecommunications services to eligible recipients. Apparently USAC has used this process for several years and has had this process audited without incident in the past. But because certain original carrier data used to set the baseline for payments could not be located, all low income payments made last year – approximately $800 million – were deemed improper even though USAC could recreate the payment calculations and actual claim data is filed by carriers during the true-up process.

Going Forward

Implementing the IPIA to properly focus on agency and program administration deficiencies should be the first step in ensuring an efficient USF High Cost program. This could resolve many of the issues identified in the current auditing process. A process by which the Commission and the industry collaborate on reasonable and realistic audit standards and processes would also be beneficial.

Deficiencies in the current auditing process could be resolved by adopting a different approach that would yield a more consistent set of results. Using an approach modeled on the practices of other federal agencies as described in the *OMB Guidance* would prevent payments from being classified as improper, provide more useful results for assessing program risk and would be more efficient. Allowing the OIG and USAC to determine the extent of testing or design of the procedures, potentially through use of a standardized model audit process for similarly situated carriers that takes the size of the auditee into consideration, would also produce better results. In addition, such results would allow for more direct comparisons to other federal programs, and improve efficiency.

USTelecom has previously made suggestions for an improved audit program that would better fulfill the Commission's goals. Those suggestions include:

- Uniform standards across audits, potentially including a model audit plan that takes the size of the auditee into consideration.
- Issuing final audit Reports to individual companies on a timely basis.
- Ceasing to audit for compliance with document retention rules, or other requirements, that were not in effect during the audit year in question.
- Improved training for auditors both to increase their familiarity with the program operation and to promote standardization of the audit process.

[23] Assessment of Payments under the Universal Service Fund's Low Income Program, Office of the Inspector General, Federal Communications Commission, at 6 (Dec. 12, 2008).

- Clarifying that a finding of an improper payment under the IPIA is not necessarily determinative of over-recovery.
- Using performance audits or other proven successful approaches utilized by other federal agencies instead of attestation audits. This would improve the usefulness and efficiency of the assessment program.

In addition, audit scheduling should take into consideration the results of previous audits. If an auditee, for example, has had several audits with minimal or no findings, it is not necessarily productive to conduct multiple additional audits of affiliated companies that use the same accounting and reporting systems. In that respect, selection of auditees based on size may be effective in year one but is of little value thereafter. Furthermore, according to USAC, "The FCC's OIG's direction to re-audit certain beneficiaries appears to be driven by its statistical sampling method, not by findings or concerns discovered in the previous rounds of audits."[24] USTelecom, among others, has noted the exacerbation of the cost impact of undergoing an audit in consecutive years.[25]

There is no question that the integrity of the high cost program is crucial. USTelecom and CTIA – The Wireless Association support an effective and efficient program of audits to guard against fraud and to improve operation of the fund. The current audit program, however, results in misleading statistics generated as improper payments under the IPIA, which undermines the credibility of the audits and the USF. The deficiencies in the audit process and disproportionate cost of the audit program must be resolved.

Sincerely,

Jonathan Banks	Christopher Guttman-McCabe
Senior Vice President, Law and Policy	Vice President, Regulatory Affairs
United States Telecom Association	CTIA – The Wireless Association

cc: Jennifer Schneider, Legal Advisor
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[24] See USAC Analysis, page 4.

[25] See Comments of USTelecom, Quest and TCA filed November 13, 2008.