Universal Service Administrative Company
Analysis of the
Federal Communications Commission
Office of Inspector General
2008 Reports on the
Universal Service Fund

February 12, 2009

Executive Summary

- Audits play a fundamental role in the Universal Service Administrative Company's (USAC) administration of the Universal Service Fund (USF). USAC has developed a comprehensive set of measures to promote program compliance and reduce improper payments based on lessons learned from audits, including enhanced outreach regarding best practices and improved information technology tools for USAC and program participants.

- USAC is subject to Federal Communications Commission (FCC) Office of Inspector General (OIG) direction regarding audit matters. Beginning in 2006, the FCC OIG directed USAC to perform three rounds of random "compliance attestation" audits of USF beneficiaries and contributors. The cost to the USF of the first two rounds of the audits mandated by the FCC OIG exceeds $145 million. Round Three is currently underway and is expected to cost over $100 million.

- The FCC OIG appears to be unique among federal entities regarding its approach to compliance with the Improper Payments Information Act of 2002 (IPIA). The FCC OIG USF audit program is not required by the IPIA. Other agencies comply with the IPIA through tools such as data mining rather than engaging firms to perform "compliance attestation" audits of fund recipients. USAC's experience suggests that alternate approaches – such as a combination of random and targeted agreed-upon-procedures or performance audits – would enable the FCC to achieve IPIA compliance and improve USF administration.

- The FCC OIG reported that Round Two (conducted in 2007-08) of the FCC OIG USF audit program generated estimated improper payment rates of 23.3% in the High Cost Program and 13.8% in the Schools and Libraries Program. FCC OIG considered payments to entities where the audit firm could not reach an opinion on compliance with FCC rules as 100% improper, which significantly inflated the estimated error rates, particularly in the High Cost Program. When an audit firm cannot reach an opinion as the result of a "compliance attestation" audit, USAC performs follow-up activity to determine whether there has in fact been an improper payment.

- The Round Two results are statistically indistinguishable from the first round of audits conducted in 2006-07. This is not surprising given that the OIG directed USAC to begin Round Two before the results of Round One had been analyzed and corrective measures implemented. Thus, the Round Two High Cost and Schools and Libraries audits essentially repeated Round One at an additional direct cost to the USF of more than $85 million.

- Recoveries of estimated amounts deemed "improper" for IPIA purposes have been and will continue to be minimal in relation to the dollars audited and the cost of the FCC OIG USF audit program. USAC cannot recover funds based on statistical estimates of "improper" payments reported by the FCC OIG.

- 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.

- The FCC OIG USF audit program reports show USAC's administration of the USF to be virtually free of errors as reported by the auditors.

- Round One of the FCC OIG USF audit program provided useful data to help improve USAC's administration of the program so that future improper payments can be reduced and prevented. However, information gathered in Round Two essentially duplicated the results of Round One, and USAC expects Round Three to largely duplicate the results of Round Two. In light of these results, the amount of money USAC has been directed to spend on this effort, and the fact that IPIA compliance can be achieved in a variety of ways, USAC suggests that more cost-effective approaches be considered.

- The FCC OIG conclusion that *all* Low Income Program payments made by USAC during 2006-2007 were "improper" is based on a highly restrictive definition of improper payments and a flawed understanding of USAC's disbursement process, which has been reviewed and deemed appropriate by independent auditors every year since 2000.

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I. Background

Properly administering and protecting the integrity of the Universal Service Fund (USF) are core responsibilities entrusted to the Universal Service Administrative Company (USAC) by Congress and the Federal Communications Commission (FCC or Commission). Accurately and reliably collecting and disbursing USF money, ensuring program compliance, reducing improper payments, and preventing waste, fraud, and abuse shape all aspects of USAC's operations. Effective outreach and education, robust internal controls, rigorous review procedures, and an effective audit program are key facets of USAC's stewardship of the USF.

Audits of beneficiaries and contributors play a fundamental role in USAC's administration. Audits are an essential tool for assessing participants' conformance with program requirements and providing insight into overall program compliance rates; they detect instances of potential waste, fraud and abuse; and they bring best practices to light that can be communicated to all participants to deter future non-compliance. Where audits reveal instances of mishandling of USF monies, USAC seeks to recover funds consistent with Commission rules.

This analysis reviews reports issued by the Commission's Office of Inspector General (OIG) in late 2008 concerning the results of audits and other activities conducted by or at the direction of the FCC OIG in connection with the Commission's obligations under the Improper Payments Information Act of 2002 (IPIA).[1] This analysis provides background information on the extensive USF audit program conducted by USAC at the direction of the FCC OIG, including its scope, cost, and results; it provides USAC's analysis of the reports issued by the FCC OIG; and for comparison purposes it describes approaches to IPIA compliance adopted by other federal entities.

A. FCC OIG USF Audit Program – Round One

In 2006-07, under the direction of the FCC OIG, USAC conducted a wide-ranging audit program covering all areas of the USF – contributions to the USF, and the High Cost, Low Income, Rural Health Care, and Schools and Libraries Programs.[2] In accordance with FCC OIG direction, Round One[3] of the FCC OIG USF audit program was designed

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[1] Improper Payments Information Act of 2002, 31 U.S.C. § 3321 (2002).

[2] USAC's audit activities are subject to the oversight and direction of the Commission's Inspector General. *See* Memorandum of Understanding between the Federal Communications Commission and the Universal Service Administrative Company (Sept. 9, 2008) (MOU) (http://www.fcc.gov/omd/usac-mou.pdf).

[3] As part of its own audit program, USAC had conducted 588 beneficiary and contributor audits prior to the initiation of the FCC OIG USF audit program in 2006. During Round One of the FCC OIG USF audit program, USAC focused its efforts on completing Round One within the FCC OIG-mandated times frame. During Round Two in 2007-08, however, USAC resumed its audit program and performed 32 audits using internal resources. USAC audited contributors, Low Income Program beneficiaries and Rural Health Care
*No programs were found to be at high risk of improper payments. OMB guidelines state that if an agency program has documented a minimum of two consecutive years of improper payments that are less than $10 million annually and less than 2.5 percent of program disbursements, this agency may request relief from the annual reporting requirements for this program.

to assess levels of compliance with Commission regulations and estimate rates of erroneous payments pursuant to the IPIA. At OIG direction and with Commission staff approval, USAC employed 13 audit firms to conduct 460 "compliance attestation" beneficiary and contributor audits.[4] The cost to date of Round One is $28.3 million.[5] In the fall of 2007, the FCC OIG issued a series of reports analyzing the results.[6] USAC reviewed the audits and the FCC OIG reports and submitted a comprehensive assessment of Round One to the Commission on December 31, 2007.[7] In February 2008, USAC provided the Commission with additional information regarding measures it had taken or intended to take to reduce or prevent improper payments.[8]

Program beneficiaries as those were not included in Round Two. USAC also conducted targeted audits of High Cost and Schools and Libraries Program beneficiaries at the request of USAC management.

[4] Although there are several types of approaches to audits, the FCC OIG directed that the audits performed for the FCC OIG USF audit program be "compliance attestation" audits. Such audits start with a set of assertions by the management of the auditee asserting compliance with program rules and procedures. Auditors then test the validity of the assertions of compliance and provide a cause for the failure of any assertion by management. Audit opinions can take any of the following forms: (1) Unqualified, with no material findings; (2) Qualified, with a limited number of findings associated with certain assertions; (3) Adverse, or material noncompliance with program rules or requirements; (4) Disclaimer, or inability of the auditor to validate or invalidate compliance assertions; or (5) Withdrawal, or inability of the auditor to complete an audit typically because of concerns about the integrity of records or because of a non-cooperative auditee.

[5] Other costs related to Round One include an estimated $1.8 million in USAC staff costs and $0.4 million in USAC vendor costs to provide documentation necessary for the audits. Based on a survey of Round One beneficiaries, USAC estimates the cost per audit to a beneficiary to be $20,000. Including these costs bring the total cost of Round One to approximately $39.7 million.

[6] *See* Federal Communications Commission Office of Inspector General, High Cost Program, Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits (Oct. 3, 2007) (Round One OIG High Cost Report); Federal Communications Commission Office of Inspector General, Low Income Program, Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits (Oct. 3, 2007) (Round One OIG Low Income Report); Federal Communications Commission Office of Inspector General, Rural Health Care Program, Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits (Oct. 3, 2007) (Round One OIG Rural Health Care Report); Federal Communications Commission Office of Inspector General, Schools and Libraries Program, Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits (Oct. 3, 2007) (Round One OIG Schools and Libraries Report); Federal Communications Commission Office of Inspector General, Contributors to the Universal Service Support Mechanism, Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits (October 3, 2007) (Round One OIG Contributors Report).

[7] *See* Universal Service Administrative Company Report on the Federal Communications Commission Office of Inspector General 2006-07 Universal Service Fund Audit Program (Dec. 31, 2007) (USAC Round One Audit Program Report); *see also* Comments of Universal Service Administrative Company at 17-25 (filed Nov. 13, 2008) (USAC NOI Comments); Reply Comments of the Universal Service Administrative Company at 3-15 (filed Dec. 15, 2008) (USAC NOI Reply Comments) in Comprehensive Review of Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service, WC Docket No. 05-195, Notice of Inquiry, FCC 08-189, (rel. Sep. 12, 2008) (NOI) ¶¶ 12-18 (discussing FCC OIG USF audit program in detail).

[8] *See* Letter from D. Scott Barash, Acting Chief Executive Officer, USAC, to Anthony Dale, Managing Director, FCC (Feb. 28, 2008) (USAC Feb. 28 Letter).

B. FCC OIG USF Audit Program – Round Two

In the fall of 2007, before USAC, the FCC OIG, or other Commission offices had the opportunity to analyze the results of Round One, the FCC OIG directed USAC to begin a second round of audits (Round Two). Round Two continued throughout 2008. Although as directed by the FCC OIG, Round Two covered only the High Cost Program and the Schools and Libraries Program, the 650 audits performed (390 beneficiary audits in the High Cost Program and 260 entity-level beneficiary audits in the Schools and Libraries Program) were significantly greater in number and substantially broader in scale, complexity, and cost than the Round One audit program. At FCC OIG direction and with Commission approval, USAC contracted with 11 firms at a cost to date of $89.7 million to execute the program.[9]

In late 2008, the FCC OIG released reports analyzing the initial results of the Round Two audits of the High Cost Program and the Schools and Libraries Program.[10] The FCC OIG also released a report presenting the results of an FCC OIG staff review of USAC payments to beneficiaries in the Low Income Program between 2006 and 2008.[11] Round Two of the FCC OIG USF audit program did not include Low Income Program beneficiaries, and therefore this assessment did not contain audit results. Based on FCC OIG direction, Round Two also did not include audits of Rural Health Care Program beneficiaries or USF contributors.

The following is a summary of the High Cost and Schools and Libraries audit results as reported by the FCC OIG:

High Cost Program

	ROUND TWO	ROUND ONE
Estimated improper payment rate	23.3%	15.9%
Margin of error	±2.3% at 90% confidence level[12]	±9.7% at 90% confidence level

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[9] Other costs related to Round Two include an estimated $1.8 million in USAC staff costs and $1.5 million in USAC vendor costs to provide documentation necessary for the audits. Based on a survey of Round One beneficiaries, USAC estimates the cost per audit to a beneficiary to be $20,000. Including these costs brings the total cost of Round Two to approximately $106.0 million.

[10] *See* Federal Communications Commission Office of Inspector General, High Cost Program Initial Statistical Analysis of Data from the 2007/2008 Compliances [sic] Attestation Examinations (Nov. 26, 2008) (Round Two OIG High Cost Report); Federal Communications Commission Office of Inspector General, Schools and Libraries Program Initial Statistical Analysis of Data from the 2007/2008 Compliances [sic] Attestation Examinations (Dec.12, 2008) (Round Two OIG Schools and Libraries Report).

[11] *See* Federal Communications Commission, Office of Inspector General, Assessment of Payments Made Under The Universal Service Fund's Low Income Program, Dec. 12, 2008 (FCC OIG Low Income Report).

[12] *See* Round Two OIG High Cost Report at 2.

Schools and Libraries Program

	ROUND TWO	ROUND ONE
Estimated improper payment rate	13.8%	12.9%
Margin of error	±3.1% at 90% confidence level[13]	±4.5% at 90% confidence level

As in Round One, the FCC OIG Round Two reports noted no instances of program fraud and showed USAC's administration of the High Cost and Schools and Libraries Programs to be virtually free of errors. In both programs, a nationally recognized independent statistician engaged by USAC at the direction of the FCC OIG found that the difference in the estimated rates of improper payments in the two rounds was statistically insignificant.[14] The FCC OIG Low Income Report asserts that 100% of program payments made between 2006 and 2008 were improper.[15]

C. FCC OIG USF Audit Program – Round Three

As reporting on and analysis of Round Two began in the fall of 2008, the FCC OIG directed USAC to commence a third round of audits. The OIG informed USAC that Round Three would be larger than Round Two. As of the date of this report, the FCC OIG has directed USAC to conduct 681 audits: 346 Schools and Libraries Program entity-level beneficiary audits and 335 High Cost Program beneficiary audits. The FCC OIG informed USAC in the fall of 2008, however, that there would likely be 90 Low Income Program beneficiary audits, 135 contributor revenue audits, and up to 269 Rural Health Care Program beneficiary audits. As of the date of this report, no direction has been provided as to other beneficiary or contributor audits, but the High Cost Program and Schools and Libraries Program beneficiary audits directed by the FCC OIG are underway.

As in Round Two, the FCC OIG provided USAC with the list of beneficiaries to be audited in Round Three. Of the High Cost Program audits, 147 or 44% are of companies that were also audited in Round Two. Seven of those 147 are being audited for the third consecutive year. Of the Schools and Libraries Program audits, 56 or 16% are of entities that were audited in either Round One or Round Two, with 10 of those 56 being audited for the third consecutive year. The FCC 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.[16]

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[13] *See* Round Two OIG Schools and Libraries Report at 2.

[14] A. Richard Bolstein, LLC, Preliminary Analysis of 2006-07 High Cost & Schools Audit Data (Aug. 18, 2008) (Bolstein Analysis).

[15] *See* FCC OIG Low Income Report at 7.

[16] Analysis performed by the independent statistician retained by USAC suggests that different sampling methods could reduce the high proportion of repeat audits. *See* Bolstein Analysis at 2 ("it is not necessary

D. FCC OIG USF Audit Program – Impact on Beneficiaries

USAC's survey of Round One auditees has led USAC to estimate the cost of an audit to be approximately $20,000 per beneficiary. Moreover, commenters to the Commission's September 2008 Notice of Inquiry informed the Commission of the high costs to beneficiaries of undergoing an audit pursuant to the FCC OIG USF audit program as well as implementing any post-audit compliance measures.[17] Commenters noted that the cost impact of an audit was exacerbated by the prospect of undergoing an audit in consecutive years,[18] and pointed out the frequent disparity between the amount under audit and the costs of performing and undergoing the audit.[19] These commenters urged the Commission and USAC to establish appropriate materiality thresholds and other measures to create a more cost-effective audit program.[20] USAC has attempted to address concerns expressed by auditees to the fullest extent possible while remaining in compliance with FCC OIG directives and deferring to auditor professional standards, both of which USAC is required to do.

E. The IPIA

The IPIA is part of a series of laws "aimed at improving the integrity of the government's payments and the efficiency of its programs and activities."[21] Implementation guidance issued by the Office of Management and Budget (OMB) counsels federal agencies to cast a wide net in gathering information about and identifying "erroneous payments" which are defined as:

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to audit all the large [High Cost] firms (>10m) since they appear generally more organized and have the lowest erroneous payment rate").

[17] *See* e.g. Comments of Alexicon Telecommunications Consulting at 3 (filed Nov. 13, 2008) (stating that "when all relative costs are considered (i.e. consultants; independent CPA firms; attorneys; company personnel; etc.) the actual expenditures may more likely approach $200,000 or more per company); Comments of The National Exchange Carrier Association at 5 (filed Nov. 13, 2008) (NECA Comments); Comments of the National Telecommunications Cooperative Association at 3-4 (filed Nov. 13, 2008) (NTCA Comments) (estimate that audits and attendant compliance measures have "resulted in substantial audit expenses, often ranging between $30,000 and $50,000 per audit"); Comments of Qwest Communications International Inc. at 6 (filed Nov. 13, 2008) (Qwest Comments); Comments of TCA at 3 (filed Nov. 13, 2008) (TCA Comments); Comments of Texas Statewide Telephone Cooperative, Inc. at 2-3 (filed Nov. 13, 2008).

[18] *See* Qwest Comments at 8; *see also* TCA Comments at 3-4; Comments of US Telecom at 3 (filed Nov. 13, 2008).

[19] *See* NECA Comments at 5.

[20] *See* NTCA Comments at 8; Comments of Verizon and Verizon Wireless at 3; Qwest Comments at 6-7; *see also* Comments of E-Rate Management Professionals Association, Inc. on Notice of Inquiry at 7 (filed Nov. 13, 2008).

[21] Office of Management and Budget, Memorandum for Heads of Executive Departments and Agencies: Issuance of Appendix C to OMB Circular A-123, Requirements for Effective Measurement and Remediation of Improper Payments (Aug. 10, 2006) (OMB IPIA Memorandum).

> [A]ny payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments and underpayments…. In addition, 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 be considered an error.[22]

In other words, a payment can be "erroneous" (or "improper") if a program participant fails to comply with a rule that is part of the overall regulatory scheme of the program, even if noncompliance does not directly influence the size, timing, or nature of a specific payment. Moreover, this standard casts as "improper" any payment where it cannot be determined with sufficient certainty whether the recipient complied fully with applicable administrative processes, even if the process in question might be unrelated to the amount or fact of the payment itself. 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.

In the USF context, a payment may be categorized as "improper" under IPIA standards even if the payment is not linked to an audit finding, nor ultimately recoverable under FCC rules. For example, the Round Two results indicate that insufficient documentation prevented audit firms from forming an opinion consistent with the "compliance attestation" methodology directed by the FCC OIG on many payments made in the High Cost and Schools and Libraries Programs. In such instances, the audit firm might decline to provide an opinion on the audit as a whole, resulting in 100% of the payments to a beneficiary being classified as "improper" under the IPIA. However, such a classification constitutes neither an audit finding nor an FCC rule violation, and it does not in itself trigger recovery of the disbursed funds. Rather, to determine whether there is a rule violation or an audit finding and whether or how much recovery is in order, USAC must perform follow-up activity.

[22] *See* OMB IPIA Memorandum at 2.

II. Analysis of FCC OIG Report on High Cost Program Audits

On November 26, 2008, the FCC OIG released the Round Two OIG High Cost Report. Summaries of the scope of activity and results from Round Two appear below, with adjacent comparisons to Round One.

A. FCC OIG USF Audit Program – High Cost Program Overview

PROGRAM ELEMENT	ROUND TWO	ROUND ONE
Number of audits	390	65
Estimated improper payment rate	23.3%	15.9%
Statistical margin of error	2.3%	9.7%
Total payments audited	$2,399,000,000	$140,869,183
Total amount of payments estimated to be "improper"*	$445,000,000	$21,229,500
Total amount of payments estimated to be "improper" extrapolated to program as a whole	$970,000,000	$618,000,000
Contracting costs[23]	$42.1 million	$5.6 million
Amount recovered to date	$0	$171,924

* FCC rules authorize USAC to recover funds based on specific rule violations only. USAC cannot recover funds based on reported estimates of payments deemed "improper" under IPIA standards. USAC therefore must conduct follow-up activity to determine whether estimated improper payments are based on actual rule violations for which USAC is authorized to seek recovery. When they are, USAC seeks recovery of funds subject to appeal by the beneficiary to USAC and/or the FCC. USAC seeks guidance from the Commission when USAC becomes aware of an audit finding based upon a rule violation for which USAC is not authorized to recover funds. Thus, estimates of improper payments – especially in the case of audits in which 100% of payments are deemed "improper" because auditors could not issue an opinion on compliance – do not provide an accurate reflection of levels of program compliance. Indeed, as the Round One OIG High Cost Report stated, there was "general compliance with FCC rules and regulations by beneficiaries."[24]

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[23] These costs are USAC's direct payments to independent audit firms to date. They do not include USAC staff costs, USAC program support vendor expenses related to compiling documents, or costs to beneficiaries.

[24] Round One OIG High Cost Report at 27.

B. Comparison of High Cost Program Rounds One and Two

The Round Two results demonstrate that despite the substantial expansion of the scope of the FCC OIG USF audit program, little new insight was provided into areas of High Cost Program design and administration related to improper payments. Although the Round Two estimated improper payment rate reported by the FCC OIG is higher than Round One, the margins of error led USAC's independent statistician to conclude that there is no statistical significance to the difference in the estimated rates of improper payments between Round One and Round Two.[25] The overall assessment of improper payments, along with the more specific data referenced below, largely replicates the findings of Round One of the FCC OIG USF audit program and adds little new information to help identify weakness in program design and administration so that future improper payments may be prevented and/or reduced.

Round One yielded lessons for USAC, the Commission, and program beneficiaries which USAC has discussed in detail elsewhere.[26] However, because Round Two immediately followed Round One as directed by the FCC OIG, neither the Commission, USAC, nor program beneficiaries had an opportunity either to implement steps to reduce and avoid improper payments or assess the effectiveness of measures initiated by USAC and the Commission to address the causes of the Round One findings.[27] As a result, Round Two reached statistically indistinguishable outcomes from Round One, though at a significantly higher cost in time, money, effort, and impact on beneficiaries.

In the fall of 2008, the FCC OIG directed USAC to proceed with a third round of High Cost Program beneficiary audits. As was the case with the transition from Round One to Round Two, Round Three began well before the reporting and analysis of Round Two could be completed. As stated above, USAC and the Commission have taken a number of steps to reduce the amount of improper payments, as have beneficiaries. Until these measures have been allowed to take full effect, conducting another round of audits on the heels of the previous round will likely yield substantially similar results. The comparison between Rounds One and Two amply demonstrates this.[28]

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[25] *See* Bolstein Analysis at 2.

[26] *See* USAC Round One Audit Program Report; USAC Feb. 28 Letter; USAC NOI Comments; USAC NOI Reply Comments.

[27] For example, the document retention requirements the Commission announced in August 2007 could not have an impact on Round Two of the FCC OIG USF audit program because payments audited were made long before the effective date of the Commission's order. *See Comprehensive Review of Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-Up, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, WC Docket No. 05-195, CC Docket No. 96-45, CC Docket 02-6, WC Docket No. 02-60, WC Docket No. 03-109, CC Docket No. 97-21, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, 22 FCC Rcd 16372 (2007) (Comprehensive Review Order).

[28] Conducting subsequent audits before assessing the results of prior audits may be at odds with Government Auditing Standards. Section 6.09 of the Government Auditing Standards (July 2007 Revision) states as follows:

C. Causes of High Cost Program Estimated Improper Payments

The Round Two High Cost Program beneficiary audits used a set of 21 causes for categorizing the underlying reasons a payment might be classified as improper.[29] In Round One, a similar set of 21 causes was used to classify reasons for non-compliance with program rules. For both rounds, three of the causes address areas associated with USAC, three with the FCC, 13 with beneficiaries, and two are outside any association.

In both rounds, the vast preponderance of improper payment causes lay in areas associated with program beneficiaries. In Round One, zero instances of non-compliance with program rules were found with causes associated with USAC, while in Round Two, the FCC OIG reported that USAC-associated causes for improper payments were at the bottom of the scale of frequency, as discussed in more detail below. The table below presents the top 10 causes in Round Two, along with the rank number of the cause in Round One.

ROUND TWO TOP 10 REPORTED CAUSES OF IMPROPER PAYMENTS	ROUND ONE RANK
1. Inadequate documentation	1
2. Inadequate auditee processes and/or policies and procedures	2
3. Applicant/auditee weak internal controls	4
4. Disregarded FCC rules	8
5. Failure to review/monitor work submitted by consultant/agent	N/A*
6. Inadequate systems for collecting, reporting, and/or monitoring data	2
7. Applicant/auditee data entry error	5
8. Other	N/A
9. Imprecise FCC rule(s)	8
10. NECA error	N/A

*N/A indicates that no causes were placed in this category in Round One.

FCC rules governing the period under audit did not require beneficiaries to retain documentation sufficient to support an audit opinion based on a "compliance attestation" audit. For this reason, the "inadequate documentation" category, which is used to indicate that the auditors were unable to determine whether a payment is proper, does not necessarily reflect a violation of program rules or procedures. Rather, it could mean that beneficiaries did not retain documentation the FCC rules did not unambiguously require them to retain at the time USAC made the payment. In some instances, beneficiaries

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> 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 engagement objectives.

[29] If there were multiple causes, a single instance of an improper payment would be attributed to each relevant cause. *See* Round Two OIG High Cost Report at 17.

declined to provide certain documentation out of concern that to do so would violate requirements regarding protecting Customer Proprietary Network Information.[30] Nearly half – 47.1% – of all payments estimated as improper in Round Two were categorized as resulting from "inadequate documentation."[31] Another 21.9% of estimated improper payments were categorized as "Audit firm withdrew from audit without rendering an opinion." These two causes are associated with 69% of all payments estimated as improper, meaning that for over two-thirds of all estimated "improper payments," auditors simply could not determine one way or the other if the payment was proper or not. However, because of the definition of "improper payments" set forth by OMB and referenced above, these payments were categorized as 100% improper in the FCC OIG reports on Rounds One and Two.

D. Causes of High Cost Program Round Two Improper Payments Associated with USAC

The FCC OIG reported the following causes of High Cost Program improper payments associated with USAC:

- USAC error was cited as the cause of improper payments in 0.9% of the population of beneficiaries audited.
- USAC errors were associated with 0.4% of actual improper payments disbursed.
- USAC errors were generally due to underpayments based on eligibility, misinterpretation of service areas, or data entry errors.

USAC errors identified in audit reports have been corrected and recovery sought where appropriate. Three issues remain unresolved to date as USAC has not yet received draft audit reports. Since the time period under audit, USAC has put extensive systems and internal control enhancements in place that USAC anticipates will address the small number of improper payments associated with USAC.

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[30] *See* 47 U.S.C § 222(a); In the Matter of Implementation of the Telecommunications Act of 1996: Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information and Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, CC Docket Nos. 96-115 and 96-149, FCC 98-27, Order and Further Notice of Proposed Rulemaking, 13 FCC Rcd 8061 (1998) (CPNI Order); *see also*, In the Matter of Implementation of The Telecommunications Act of 1996 Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934,as amended, Order on Reconsideration and Petitions for Forbearance, 14 FCC Rcd 14409 (1999); In The Matter of Implementation of the Telecommunications Act of 1996:Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, Biennial Regulatory Review -- Review of Policies and Rules Concerning Unauthorized Changes of Consumers' Long Distance Carriers, Third Report and Order and Third Further Notice of Proposed Rulemaking, 17 FCC Rcd 14860 (2002).

[31] *See* Round Two OIG High Cost Report at 20 for percentages of improper payments by cause.

E. High Cost Program Recoveries

The Round Two OIG High Cost Report recognizes that the definition of "improper" payment:

> does ***not*** (emphasis added) mean that erroneous payments were the result of fraudulent representations, or a corrupt administrative process, or that the erroneous payments are necessarily recoverable from recipients by process of law.[32]

Accordingly, the actual amount that may be recovered from beneficiaries will be substantially less than the estimates reported by the FCC OIG as "improper" payments. For example, in the High Cost Program, although the Commission established document retention requirements in August 2007, these rules post-date the first two rounds of the FCC OIG USF audit program. Additionally, these rules do not specify whether USAC can seek recovery of funds on the basis of inadequate document retention findings. Accordingly, in Round One of the FCC OIG USF audit program, out of a total of $618 million in payments estimated as improper for IPIA purposes, USAC has sought recovery of $217,924, or approximately 0.13% of the amount audited. Of this amount, $46,000 is currently under appeal to USAC or the FCC and $171,924 has been recovered. In addition, another $21.18 million in potential recoveries is on hold pending follow-up activity related to the disclaimer, withdrawal and adverse opinion audits. At an early stage in the assessment of results from Round Two, audit firms have identified $2,413,007 in potentially recoverable funds.

F. High Cost Program Conclusion

The Round Two OIG High Cost Report indicates that USAC's administration of the High Cost Program is sound because of the low incidence of, and the specific reasons for, the few improper payments associated with USAC error. Additionally, because the improper payments were largely attributed to beneficiary document retention, internal processes and internal control issues, expanding USAC's outreach and training activities based on USAC's analysis of the details underlying each cause appears to have the most potential to directly address the causes of improper payments. USAC has provided to the Commission and has publicly reported detailed information about its efforts in these areas and will not repeat that information here.[33]

USAC anticipates that continuing the current audit program will yield little new information. Round One of the program provided useful data to help identify weakness in the design and administration of the program so that future improper payments can be reduced and prevented. However, Round Two essentially duplicated the results of Round One at a direct cost to the USF of $42.1 million to date for the High Cost Program

[32] *See* Round Two OIG High Cost Report at 2.

[33] *See* USAC Round One Audit Program Report; USAC Feb. 28 Letter; USAC NOI Comments; USAC NOI Reply Comments.

beneficiary audits. Given the consistency of the results between Round One and Round Two, it is reasonable to expect that Round Three will largely duplicate the results of Round Two, again at great cost to the USF and program beneficiaries. The FCC OIG reported no instances of fraud in any of the programs as a result of either Round One or Two, and in fact the results revealed a generally high level of program compliance by beneficiaries, and showed USAC's administration of the program to be virtually free of errors.

Each round of the FCC OIG USF audit program has required a larger number of "compliance attestation" audits and has been conducted without consideration of, or provision of the opportunity for, beneficiaries to take corrective action. Moreover, the program has not allowed for the results of thoughtful Commission rule changes and USAC education and outreach activities to have an effect. For these reasons, USAC believes alternate approaches both to assessing levels of program compliance as well as estimating rates of improper payments pursuant to IPIA should be considered. A review of other federal agency approaches to IPIA compliance, as well as USAC's experience in administering its audit program, suggests that a combination of random and targeted agreed-upon-procedures or performance audits would enable the Commission and USAC to fulfill their statutory and regulatory duties. Indeed, USAC understands IPIA requirements to allow an approach that would consist of randomly sampling USAC collections and disbursements and assessing to what extent these activities were in compliance with FCC rules in place at the time of their execution. Many other federal agencies take such an approach, as discussed in the final section of this report.

III. Analysis of FCC OIG Report on Schools and Libraries Program Audits

On December 12, 2008, the FCC OIG released the Round Two OIG Schools and Libraries Report. Summaries of the scope of activity and results from Round Two appear below, with adjacent comparisons to Round One.

A. FCC OIG USF Audit Program – Schools and Libraries Program Overview

PROGRAM ELEMENT	ROUND TWO	ROUND ONE
Number of audits*	260 entities	155 funding requests
Estimated improper payment rate	13.8%	12.9%
Statistical margin of error	3.3%	4.5%
Total payments audited	$450,900,000	$264,431,312
Total amount of payments estimated to be "improper"**	$49,700,000	$34,111,639
Total amount of payments estimated to be "improper" extrapolated to program as a whole	$232,700,000	$210,000,000
Contracting costs[34]	$44.4 million	$12.5 million
Amount recovered to date	$0	$354,000

* An audit of an entire entity expands the scope of the audit to all funding requests submitted by that entity during the relevant time period. For Round Two, the OIG's directive to audit 260 funded entities meant that auditors were required to examine a total universe of over 4,000 individual funding requests, compared to the 155 individual funding requests that were reviewed in total for Round One.

** FCC rules authorize USAC to recover funds based on specific rule violations only. USAC cannot recover funds based on reported estimates of payments deemed "improper" under IPIA standards. USAC therefore must conduct follow-up activity to determine whether estimated improper payments are based on actual rule violations for which USAC is authorized to seek recovery. When they are, USAC seeks recovery of funds subject to appeal by the beneficiary to USAC and/or the FCC. USAC seeks guidance from the Commission when USAC becomes aware of an audit finding based upon a rule

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[34] These costs are USAC's direct payments to independent audit firms to date. They do not include USAC staff expenses, USAC program support vendor expenses related to compiling documents, or costs to beneficiaries.

violation for which USAC is not authorized to recover funds. Thus, estimates of improper payments – especially in the case of audits in which 100% of payments are deemed "improper" because auditors could not issue an opinion on compliance – do not provide an accurate reflection of levels of program compliance. Indeed, as the Round One OIG Schools and Libraries Report stated, "[c]ompliance with rules and regulations was generally high (90 percent or more)."[35]

B. Comparison of Schools and Libraries Program Rounds One and Two

The Round Two results demonstrate that despite the substantial expansion of the scope of the FCC OIG USF audit program, little new insight was provided into areas of Schools and Libraries Program design and administration related to improper payments. The margins of error in Rounds One and Two led USAC's independent statistician to conclude that there is no statistical significance to the difference in these estimated rates of improper payments.[36] The overall assessment of improper payments, along with the more specific data referenced below, largely replicates the findings of Round One of the FCC OIG USF audit program and adds little new information to help identify weakness in program design and administration so that future improper payments can be prevented and/or reduced.

Round One yielded lessons for USAC, the Commission, and program beneficiaries that USAC has discussed in detail elsewhere.[37] However, because Round Two immediately followed Round One, as directed by the FCC OIG, neither the Commission, USAC, nor program beneficiaries had an opportunity to implement steps to reduce and avoid improper payments or to assess the effectiveness of measures initiated by USAC and the Commission to address the causes of the Round One findings. As a result, Round Two reached a statistically indistinguishable outcome from Round One, though at a significantly higher cost in time, money, effort, and impact on beneficiaries.

In the fall of 2008, the FCC OIG directed USAC to proceed with a third round of Schools and Libraries Program beneficiary audits. As was the case with the transition from Round One to Round Two, Round Three began well before the reporting and analysis of Round Two could be completed. As stated above, USAC and the Commission have taken a number of steps to reduce the amount of improper payments, as have beneficiaries. Until these measures have been allowed to take full effect, conducting another round of audits on the heels of the previous round will likely yield substantially similar results. The comparison between Rounds One and Two amply demonstrates this.[38]

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[35] Round One OIG Schools and Libraries Report at 2.

[36] *See* Bolstein Analysis at 2.

[37] *See* USAC Round One Audit Program Report; USAC Feb. 28 Letter; USAC NOI Comments; USAC NOI Reply Comments.

[38] Initiating subsequent audits before assessing the results of prior audits may be at odds with Government Auditing Standards. *See* note 28 above.

C. *Causes of Schools and Libraries Program Estimated Improper Payments*

The Round Two Schools and Libraries Program beneficiary audits used a set of 21 causes for categorizing the underlying reasons a payment might be classified as improper.[39] In Round One, a similar set of 21 causes was used to classify reasons for non-compliance with program rules. For both rounds, three of the causes address areas associated with USAC, three with the FCC, 13 with beneficiaries, and two are outside any association.

For both rounds, the vast preponderance of causes lay in areas associated with program beneficiaries. In Round One, one instance of non-compliance with program rules was found with a cause associated with USAC,[40] while in Round Two, the FCC OIG reported that auditors found no instances of any causes for improper payments associated with USAC. The table below presents the top 10 causes in Round Two, along with the rank number of the cause in Round One.

ROUND TWO TOP 10 REPORTED CAUSES OF IMPROPER PAYMENTS	ROUND ONE RANK
1. Inadequate auditee processes and/or policies and procedures	5
2. Inadequate documentation	2
3. Disregarded FCC rules	6
4. Applicant/auditee weak internal controls	1
5. Inadequate systems for collecting, reporting, and/or monitoring data	3
6. Service Provider Error	2
7. Failure to review/monitor work submitted by consultant/agent	N/A*
8. Service Provider Data Error	N/A*
9. Service Provider Weak Internal Controls	7
10. Applicant/auditee data entry error	4

*N/A indicates that no causes were placed in this category in Round One.

Proportions of total improper payments by cause as identified in the OIG Round Two Schools and Libraries Report are as follows:

CAUSE OF IMPROPER PAYMENT	PROPORTION OF IMPROPER PAYMENTS
Disregarded FCC rule/s	41.1%
Inadequate documentation	23.2%
Applicant / Auditee weak internal controls	15.1%
Inadequate auditee processes and/or policies and procedures	10.8%

[39] If there were multiple causes, a single instance of an improper payment would be attributed to each relevant cause. *See* Round Two OIG Schools and Libraries Report at 16.

[40] The one error associated with USAC in Round One was a single $490 underpayment.

Cause of Improper Payment	Proportion of Improper Payments
Followed State rules	2.8%
Inadequate systems for collecting, reporting and/or monitoring data	1.8%

In the category identified as the largest cause of improper payments – "disregarded FCC rules" at 41.1% of total improper payments – there is no single predominant factor. Rather, there are numerous issues, each of which occurred infrequently, including: Children's Internet Protection Act non-compliance, funding of ineligible services, technology plan issues, competitive bidding issues, ineligible entities, discount rate calculation errors, and using services for ineligible purposes.

OMB guidance requires that when an agency is "unable to discern whether a payment was proper" the entire payment must be deemed improper. Here, lack of documentation resulting in the auditors being "unable to discern" whether the payments in question were proper is the basis for 23% of the estimated improper payments identified in the FCC OIG Round Two Schools and Libraries report.

No improper payments reported by auditors were associated with USAC error.[41]

D. Schools and Libraries Program Recoveries

The Round Two OIG Schools and Libraries Report recognizes that the definition of "improper" payment:

> does ***not*** (emphasis added) mean that erroneous payments were the result of fraudulent representations, or a corrupt administrative process, or that the erroneous payments are necessarily recoverable from recipients by process of law.[42]

Accordingly, the actual amount that may be recovered from beneficiaries will be substantially less than the estimates reported by the FCC OIG as "improper" payments. For example, in Round One of the FCC OIG USF audit program, out of a total of $210 million in payments estimated as improper for IPIA purposes, USAC has sought recovery of $6.2 million, or approximately 3% of the amount audited. Of this amount, $3.4 million is currently under appeal to USAC or the FCC, $2.3 million was appealed to the FCC and remanded to USAC for further review, $100,000 was reversed on appeal, and $354,000 has been recovered. In addition, another $3.5 million in potential recoveries is

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[41] One improper payment identified as "Followed USAC Procedures (in apparent conflict with FCC Rules)" was misclassified by the auditors. The actual violation was that the applicant did not follow its state procurement rules as required by their County Office of Education (COE). The beneficiary posted an FCC Form 470 and had a Request for Proposal (RFP) available for bidders, but did not post advertisements in the local newspaper, in violation of the COE requirement.

[42] *See* Round Two OIG Schools and Libraries Report at 2.

on hold pending policy guidance from the FCC. It is too early in the process to assess how much money might be recoverable as a result of findings from Round Two audits.

E. Schools and Libraries Program Conclusion

The Round Two OIG Schools and Libraries Report indicates that USAC's administration of the Schools and Libraries Program is sound. No improper payments reported by auditors were associated with USAC error. Additionally, because the improper payments were largely attributed to beneficiary compliance with a variety of FCC rules and with document retention issues, expanding USAC's outreach and training activities based on USAC's analysis of the details underlying each cause appears to have the most potential to directly address the causes of improper payments. USAC has provided to the Commission and has publicly reported detailed information about its efforts in these areas and will not repeat that information here.[43]

USAC anticipates that continuing the current audit program will yield little new information. Round One of the program provided useful data to help identify weakness in the design and administration of the program so that future improper payments can be reduced and prevented. However, Round Two essentially duplicated the results of Round One at a direct cost to the USF of $44.4 million to date for the Schools and Libraries Program beneficiary audits. Given the consistency of the results between Round One and Round Two, it is reasonable to expect that Round Three will largely duplicate the results of Round Two, again at great cost to the USF and program beneficiaries. The FCC OIG reported no instances of fraud in any of the programs as a result of either Round One or Two, and in fact the results revealed a generally high level of program compliance by beneficiaries, and showed USAC's administration of the program to be virtually free of errors.

Each round of the FCC OIG USF audit program has required a larger number of compliance attestation audits and has been conducted without consideration of, or provision of the opportunity for, beneficiaries to take corrective action. Moreover, the program has not allowed for the results of thoughtful Commission rule changes and USAC education and outreach activities to have an effect. For these reasons, USAC believes alternate approaches both to assessing levels of program compliance as well as estimating rates of improper payments pursuant to IPIA should be considered. A review of other federal agency approaches to IPIA compliance, as well as USAC's experience in administering its audit program, suggests that a combination of random and targeted agreed-upon-procedures or performance audits would enable the Commission and USAC to fulfill their statutory and regulatory duties. Indeed, USAC understands IPIA requirements to allow an approach that would consist of randomly sampling USAC collections and disbursements and assessing to what extent these activities were in compliance with FCC rules in place at the time of their execution. Many other federal agencies take such an approach, as discussed in the final section of this report.

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[43] *See* USAC Round One Audit Program Report; USAC Feb. 28 Letter; USAC NOI Comments; USAC NOI Reply Comments.

IV. FCC OIG USF Audit Program Cost Summary

The table below presents an overview of the costs to date for the first two rounds of the FCC OIG USF audit program and an estimate for Round Three. All cost figures are in millions.

PROGRAM ELEMENT	ROUND ONE	ROUND TWO	ROUND THREE (ESTIMATED)
Number of audits	460	650	1175
Total direct audit and quality assurance costs	$28.3	$89.7	$127.7
High Cost Program audit cost	$5.6	$42.1	$40.4
Schools and Libraries Program audit cost	$12.5	$44.4	$60.2
Low Income Program audit cost	$1.6	n/a	$4.8
Rural Health Care Program audit cost	$1.2	n/a	$7.0
USF Contributors audit cost	$4.9	n/a	$12.8
Project management cost	$1.7	$1.7	$2.5
Audit follow-up activity cost	$0.8	$1.5	TBD
(OTHER AUDIT RELATED COSTS)			
USAC staff costs[44]	$1.8	$1.8	$2.4
USAC vendor costs[45]	$0.4	$1.5	$2.0
Cost to beneficiaries[46]	$9.2	$13.0	$23.5
Total Cost of FCC OIG USF Audit Program[47]	$39.7	$106.0	$155.6

[44] Estimated for 12, 12, and 16 person years of effort.

[45] Costs for document compilation required by audit firms before field visits.

[46] Assumed estimate of $20,000 per audit for beneficiaries – based on survey of Round One beneficiaries.

[47] In addition to the USAC expenditures directed by the FCC OIG, the Consolidated Appropriations Act of 2008, HR 2764, provides that "$21,480,000 may be transferred from the Universal Service Fund in fiscal year 2008 to remain available until expended, to monitor the Universal Service Fund program to prevent and remedy waste, fraud and abuse and to conduct audits and investigations by the Office of Inspector General."

V. Analysis of FCC OIG Report on the Low Income Program

On December 12, 2008, the FCC OIG released its FCC OIG Low Income Report. The report represented the results of FCC OIG staff review of USAC's administration of the program, rather than audits of beneficiaries. The FCC OIG determined that "all Low Income Program payments that were made by USAC during 2007-2008 ($810.6 millions [sic]) and during 2006-2007 ($795.8 millions [sic]) must be considered erroneous payments." The basis for the FCC OIG's finding is a conclusion that "USAC does not have the source documentation that would permit verification of the calculations of the amounts disbursed."[48]

USAC retains all relevant data and can recreate any calculation that formed the basis for any payment. The very calculation process identified in the FCC OIG Low Income Report has been tested and found accurate by independent auditors working under the direction of the FCC OIG hundreds of times over a several-year period. Those auditors have raised no concerns regarding USAC's administration of the Low Income Program, retention of data, or accuracy of payments.

A. USAC's Administration of the Low Income Program

USAC makes monthly Low Income Program payments to eligible telecommunications carriers (ETCs) based on projections generated by an algorithm embedded in USAC's computer system. This algorithm uses the prior 13 months of ETC projections and/or actual data to establish a growth factor (positive or negative) and then utilizes this growth factor to project the next month's payment to the ETC. An ETC's projection for a particular month is then "trued-up" once the ETC files its actual support claims on FCC Form 497 for that month.

USAC has administered the Low Income Program in the same manner since 2000. Under USAC's longstanding administrative practice, ETCs receive monthly payments for Lifeline, Link Up, and Toll Limitation Service discounts that were already provided to eligible customers based on these projections rather than ETCs needing to submit data by a specific date each month in order to receive the support. This approach is in place because, unlike the High Cost Program, the Low Income Program support reimburses companies for discounts that have already been provided to customers. Commission rules authorize USAC to determine the frequency with which ETCs must file support claims,[49] but neither require nor prohibit USAC's practice of paying ETCs based on projections and then truing-up payments once ETCs file actual support claims.

USAC maintains all relevant data and can recreate any projection or payment calculation at any time. The USAC system used to store data, calculate projections and perform true-

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[48] FCC OIG Low Income Report at 7.

[49] 47 C.F.R. § 54.407(c) (Records of revenues companies forgo "shall be kept in the form directed by the Administrator and provided to the Administrator at intervals as directed by the Administrator, or as provided in this subpart.").

ups does not destroy or over-write any data. USAC can demonstrate the manner in which any projection was calculated. All relevant data regarding how a projection was calculated is retained, but the projection information must be retrieved from the system manually. The USAC system does not produce an automated report that shows how the projection was calculated, but rather, data must be pulled from the system and the algorithm applied manually through the use of a spreadsheet to demonstrate how a particular projection was calculated. This appears to be the basis for the FCC OIG's conclusion that all payments must be deemed "improper."

USAC has administered the Low Income Program in this way because it makes sense for program beneficiaries and results in accurate payments. As the FCC OIG itself acknowledged, there is almost no variation between USAC's projections and actual support claims by ETCs: "the projected and actual amounts were identical, or nearly so."[50] Thus, there is no basis for concluding that USAC's projection process distorts support amounts paid to ETCs carriers or that the projections are arbitrary or improper in any way.

Independent auditors have examined and approved this very aspect of USAC's Low Income Program payment process for many years. FCC rules require the FCC OIG to oversee an annual independent audit of USAC operations "to determine, among other things, whether [USAC] is properly administering the universal service support mechanisms to prevent fraud, waste, and abuse."[51] Pursuant to this requirement, annual agreed-upon procedures audits and financial audits are performed, and there have been no material findings as a result of these audits since they began in 1998.[52] Thus, the very

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[50] FCC OIG Low Income Report at 7.

[51] 47 C.F.R. § 54.717.

[52] *See* Arthur Andersen, LLP, Agreed-Upon Procedures Report of Independent Public Accountants, Universal Service Administrative Company Schools and Libraries Division, Year Ended December 31, 1999 (February 28, 2000); Arthur Andersen, LLP, Agreed-Upon Procedures Report of Independent Public Accountants, Universal Service Administrative Company, Year Ended December 31, 1999 (April 12, 2000); Arthur Andersen, LLP, Agreed-Upon Procedures Report of Independent Public Accountants, Universal Service Administrative Company, Rural Health Care Division Beneficiaries (July 31, 2000); Arthur Andersen, LLP, Agreed-Upon Procedures Report of Independent Public Accountants, Universal Service Administrative Company, Year Ended December 31, 2000 (April 13, 2001); Arthur Andersen, LLP, Agreed Upon Procedure Report, Year Ended of December 31, 2001 (April 15, 2002); Deloitte & Touche LLP, Independent Accountant's Report on Applying Agreed-Upon Procedures, Universal Service Administrative Company, Agreed-Upon Procedures Report, Year Ended December 31, 2002 (February 28, 2003); Deloitte & Touche LLP, Independent Accountant's Report on Applying Agreed-Upon Procedures, Universal Service Administrative Company, Agreed-Upon Procedures Report, Year Ended December 31, 2003 (June 23, 2004); Deloitte & Touche LLP, Independent Accountant's Report on Applying Agreed-Upon Procedures, Universal Service Administrative Company, Agreed-Upon Procedures Report, Year Ended December 31, 2004 (September 21, 2005); Deloitte & Touche LLP, Independent Accountant's Report on Applying Agreed-Upon Procedures, Universal Service Administrative Company, Agreed-Upon Procedures Report, Year Ended December 1, 2005 (June 30, 2006); Deloitte & Touche LLP, Independent Accountant's Report on Applying Agreed-Upon Procedures, Universal Service Administrative Company, Agreed-Upon Procedures Report, Year Ended December 31, 2006 (June 25, 2007).

process questioned by the FCC OIG has been reviewed by independent auditors and found to be appropriate on multiple occasions.[53]

B. The FCC OIG Low Income Report

The FCC OIG Low Income Report concluded that a total of $1.606 billion in Low Income Program payments were "erroneous" because "USAC does not have the source documentation that would permit verification of the calculations of the amounts disbursed."[54] The explanation above demonstrates that this conclusion is based on a lack of understanding of a process used by USAC since 2000 that has been reviewed and deemed appropriate by other independent auditors retained at the direction of the Inspector General. Thus, the FCC OIG's conclusion that all Low Income Program payments made by USAC in 2007-2008 must be considered "erroneous" does not withstand scrutiny. As every independent audit of USAC's administration of the program has shown, USAC's processes are sound, payments to carriers are accurate, and all relevant data is preserved.

[53] The independent audit firm retained at the direction of the FCC OIG reviews the projection calculation for a sample of carriers each year. Each year, the audit firm randomly selects 45 carriers and performs 13 different tests to ensure the payments are accurate. Over the past three years, this amounted to more than 1,750 individual tests with a total of one exception noted. This analysis, along with the multitude of other procedures conducted, has resulted in USAC receiving an unqualified opinion on this issue from the independent audit firm every year that this audit has been conducted.

[54] FCC OIG Low Income Report at 7.

VI. Alternative Federal Agency Approaches to IPIA Compliance

USAC strongly supports extensive, robust scrutiny and assessment of the USF and its administration. USAC recognizes and appreciates the importance of a comprehensive audit program that identifies areas of program vulnerability, enhances program integrity, and promotes compliance with program rules and procedures. USAC will continue to embrace actions to reduce improper payments, strengthen USF oversight, improve USF administrative operations, and implement performance measures designed to ensure that the USF operates as Congress and the Commission intend.

USAC recognizes that the Commission must adhere to the IPIA. The IPIA does not require formal audits, nor does OMB require the use of a particular audit standard such as the "compliance attestation" methodology mandated by the FCC OIG. OMB requires that agencies "obtain a statistically valid estimate of the annual amount of improper payments in programs and activities."[55] 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." OMB does not dictate the manner in which estimates are to be gathered and outlines a range of "current practices that are yielding positive results in certain Federal agencies,"[56] such as predictive modeling, data mining, alignment of due diligence and risk oversight, and data matches. Federal agencies have, accordingly, adopted numerous approaches to IPIA compliance.

The multimillion-dollar cost of the FCC OIG USF audit program is the result of the approach to IPIA compliance required by the FCC OIG. Using "compliance attestation" examinations by independent audit firms to estimate rates of improper payments is, as far as USAC can determine, a practice used by only one other federal agency on a much smaller scale than the FCC OIG USF audit program. In its Farm Security and Rural Investment Program, the Department of Agriculture uses a compliance attestation methodology on a small sample of payments made in the program.[57] As befits the nature of the IPIA as a tool to assess program management and government efficiency, the vast majority of federal programs assemble statistically valid samples of payments for inspection, performing a combination of data matching or mining operations and risk management operations to estimate rates of improper payments. As stated above, regardless of the methodology used by the Commission to achieve IPIA compliance, USAC would continue to conduct an appropriate audit program as a core component of USAC's responsible stewardship of the USF.

The table starting on the next page provides an overview of the variety of approaches that other federal agencies have taken to achieve IPIA compliance.

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[55] *See* OMB IPIA Memorandum at 5.

[56] *Se*e *id*. at 5, 11.

[57] *See* Department of Agriculture 2008 Performance and Accountability Report at 287.

Federal Agency Approaches to Estimating Rates of Improper Payments

	METHODOLOGY						
FEDERAL AGENCY	Compliance Attestation Audits	Data Matches	Data Mining	Due Diligence & Risk Oversight	Predictive Modeling	Statistical Sampling	Additional Methods (Type)
Department of Agriculture[58]	☑		☑		☑	☑	☑ (Observations & Surveys)
Department of Commerce*[59]				☑		☑	
Department of Defense*[60]		☑		☑		☑	☑ (Audit Reviews)
Department of Education[61]				☑		☑	
Department of Energy*[62]						☑	
Department of Health and Human Services[63]		☑	☑	☑		☑	☑ (Surveys & Site Visits)
Department of Homeland Security[64]						☑	
Department of Housing and Urban Development[65]				☑		☑	☑ (Surveys)
Department of Justice*[66]				☑			
Department of Labor[67]		☑				☑	☑ (Single Audit Act Reports)
Department of State*[68]				☑			☑ (Single Audit Act Reports, CFO Act & GAO reviews)
Department of the Interior*[69]				☑			☑ (Single Audit Act Reports)

58 Department of Agriculture, PAR 2008: http://www.ocfo.usda.gov/usdarpt/pdf/par2008.pdf
59 Department of Commerce, PAR 2008: http://www.osec.doc.gov/bmi/budget/FY08PAR.htm
60 Department of Defense, PAR 2008: http://www.defenselink.mil/comptroller/afr/index.html
61 Department of Education, PAR 2008: http://www.ed.gov/about/reports/annual/2008report/index.html
62 Department of Energy, PAR 2008: http://www.cfo.doe.gov/cf1-2/2008parpilot.htm
63 Department of Health and Human Services, PAR 2008: http://www.hhs.gov/afr/2008sectiii.pdf
64 Department of Homeland Security, PAR 2008: http://www.dhs.gov/xabout/budget/editorial_0430.shtm
65 Department of Housing and Urban Development, PAR 2008: http://www.hud.gov/offices/cfo/reports/2008par.cfm
66 Department of Justice, PAR 2008: http://www.usdoj.gov/ag/annualreports/pr2008/TableofContents.htm
67 Department of Labor, PAR 2008: http://www.dol.gov/_sec/media/reports/annual2008/
68 Department of State, PAR 2008: http://www.state.gov/s/d/rm/rls/perfrpt/
69 Department of the Interior, PAR 2008: http://www.doi.gov/pfm/par/par2008/par08_final.pdf

*No programs were found to be at high risk of improper payments. OMB guidelines state that if an agency program has documented a minimum of two consecutive years of improper payments that are less than $10 million annually and less than 2.5 percent of program disbursements, this agency may request relief from the annual reporting requirements for this program.

FEDERAL AGENCY	Compliance Attestation Audits	Data Matches	Data Mining	Due Diligence & Risk Oversight	Predictive Modeling	Statistical Sampling	Additional Methods (Type)
Department of the Treasury[70]		☑				☑	
Department of Transportation[71]						☑	☑ (Tests of Administrative Procedures & Contractual Elements)
Department of Veterans Affairs[72]		☑				☑	☑(Quality Assurance Program, Statistical Quality Control, & Reviews)
Environmental Protection Agency*[73]				☑			
General Services Administration*[74]				☑			
National Aeronautics and Space Administration[75]						☑	
National Science Foundation*[76]				☑		☑	
Nuclear Regulatory Commission*[77]				☑			
Office of Personnel Management[78]		☑		☑		☑	☑(Historical Audits of Premiums Paid)
Small Business Administration[79]						☑	☑ (Disaster Quality Assurance Program & Loan Guaranty Purchase and Approval Review)
Social Security Administration[80]		☑				☑	☑ (National database)
United States Agency for International Development[81]				☑		☑	

Source: Information gathered from federal agencies' 2008 Performance and Accountability Report (PAR

[70] Department of the Treasury, PAR 2008: http://www.ustreas.gov/offices/management/dcfo/accountability-reports/2008-par.shtml\
[71] Department of Transportation, PAR 2008: http://www.dot.gov/par/2008/index.htm
[72] Department of Veterans Affairs, PAR 2008: http://www.va.gov/budget/report/2008/index.htm
[73] Environmental Protection Agency, PAR 2008: http://www.epa.gov/ocfo/par/2008par/index.htm
[74] General Services Administration, PAR 2008: http://www.gsa.gov/graphics/staffoffices/GSAFY2008PAR.pdf
[75] National Aeronautics and Space Administration, PAR 2008: http://www.nasa.gov/news/budget/index.html
[76] National Science Foundation, PAR 2008: http://www.nsf.gov/about/performance/index.jsp
[77] Nuclear Regulatory Commission, PAR 2008: http://www.nrc.gov/reading-rm/doc-collections/nuregs/staff/sr1542/v14/
[78] Office of Personnel Management, PAR 2008: http://www.opm.gov/gpra/opmgpra/
[79] Small Business Administration, PAR 2008: http://www.sba.gov/aboutsba/budgetsplans/BUD_PERF_ACCT_REPORT.html
[80] Social Security Administration, PAR 2008: http://www.ssa.gov/finance/
[81] United States Agency for International Development, PAR 2008: http://www.usaid.gov/policy/budget/

*No programs were found to be at high risk of improper payments. OMB guidelines state that if an agency program has documented a minimum of two consecutive years of improper payments that are less than $10 million annually and less than 2.5 percent of program disbursements, this agency may request relief from the annual reporting requirements for this program.

Methodology Definitions[82]

Additional Methods – Agencies may utilize an alternative sampling approach provided they obtain OMB approval prior to implementation.

Compliance Attestation Audit – A set of assertions by the management of the auditee, set forth in a letter, regarding operations and practices that would represent an auditee's full compliance with program rules. The auditee is required to sign the assertion letter acknowledging responsibility for compliance with program rules and procedures. Auditors then validate or invalidate the assertions of compliance, providing a cause for the failure of any assertion by management.

Data Matches – Evaluation of Federal, State, local, and private databases to assess whether data matches can help strengthen pre-and post-payment reviews.

Data Mining – An automated process used to scan databases to detect patterns, trends, and/or anomalies for use in risk management or other areas of analysis.

Due Diligence and Risk Oversight – Activities to generate additional due diligence/review of higher risk transactions and limited or no due diligence/review of lower risk transactions.

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.

Statistical Sampling – Estimates shall be based on the equivalent of a statistically random sample of sufficient size to yield an estimate with a 90 percent confidence interval of plus or minus 2.5 percentage points around the estimate of the percentage of erroneous payments.

[82] OMB Circular A-123: Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments (08/10/2006), http://www.whitehouse.gov/omb/circulars/a123/a123_appx-c.pdf, (p8-12).