USAC
Universal Service Administrative Company

CONFIDENTIAL – USAC PROPRIETARY

To: Karen Majcher, Vice President, High Cost and Low Income Division

From: Wayne Scott, Vice President, Internal Audit Division

Date: September 12, 2011

Re: **Independent Auditor's Report on Nemont Telephone Cooperative, Inc. and Project Telephone Company's Compliance with High Cost Support Mechanism Rules (USAC Audit No. HC2009BE001)**

Introduction

The Universal Service Administrative Company (USAC) Internal Audit Division (IAD) performed an audit of Nemont Telephone Cooperative, Inc. and Project Telephone Company (Beneficiary or Beneficiaries), study area codes 482247 and 482250, respectively, for compliance with the regulations and orders governing the High Cost Support Mechanism, set forth in 47 C.F.R. Parts 32, 36 and 54, as well as other program requirements (collectively, the Rules). Compliance with the Rules is the responsibility of the Beneficiaries' management. USAC IAD's responsibility is to express a conclusion on the Beneficiaries' compliance with the Rules based on our audit.

The Beneficiaries are affiliated incumbent wireline carriers that operate in Montana.

Purpose and Scope

The purpose of our audit was to determine whether the Beneficiaries complied with the Rules and submitted accurate underlying data for the calculation of High Cost Program support. We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States (2007 Revision, as amended), with the exception of the scope limitation identified in Audit Finding #8. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. Our audit included examining, on a test basis, evidence supporting the data used to calculate support as well as performing other procedures we considered necessary to form a conclusion. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following chart summarizes the High Cost Program support the Beneficiaries received for the 2008 program year (audit period).

Nemont Telephone Cooperative, Inc.

High Cost Support	Amount of Support
High Cost Loop (HCL)	$2,119,520
Local Switching Support (LSS)	$ 934,717
Interstate Common Line Support (ICLS)	$1,744,253
Total	**$4,798,490**

Project Telephone Company

High Cost Support	Amount of Support
High Cost Loop (HCL)	$1,434,496
Local Switching Support (LSS)	$ 786,524
Interstate Common Line Support (ICLS)	$1,150,564
Total	**$3,371,584**

For HCL, LSS and ICLS, we obtained and examined certain 2006 financial and cost study records to support the expense and investment amounts reported to the National Exchange Carrier Association (NECA) or USAC. We also examined the Beneficiaries' HCL, LSS and ICLS line counts reported as of December 2006. The 2006 information was factored into the calculation of HCL payments made in 2008, LSS projection payments made in 2007 and true-up payments made in 2008, and ICLS projection payments made in 2006 and 2007 and true-up payments made in 2008.

Our procedures were performed to determine whether the Beneficiaries complied with the Rules. For the purposes of this report, a finding is a condition that shows evidence of noncompliance with the Rules.

Conclusion

USAC IAD concludes that the Beneficiaries were not compliant with the Rules. Our examination disclosed eight audit findings. A summary of the results and procedures are included below.

This audit was announced in October 2009. At the same time, we also announced a High Cost Program audit of Sagebrush Cellular and three Low Income Program audits (Nemont Telephone Cooperative, Inc., Project Telephone Company, and Sagebrush Cellular). After announcing the audits, the Beneficiaries informed us only one contact person who would be responsible for providing the documentation needed to complete the audits. The Beneficiaries requested numerous extensions to provide its supporting documentation; as discussed below we granted all but the final extension request. The numerous extensions requested by Beneficiaries contributed to the extensive length of time required to complete the audits.

Upon fieldwork completion, we provided the audit findings to the Beneficiaries to review and scheduled an exit conference to discuss the audit findings in further detail. We provided the Beneficiaries with a final deadline of August 24, 2011 to provide written responses to the audit findings and to provide any additional documentation to support its responses to the audit findings. The Beneficiaries provided written responses along with additional documentation on August 25, 2011, which we accepted. We examined the additional documentation, adjusted the audit findings where appropriate, and incorporated the Beneficiaries' responses to the audit findings into this report.

On September 12, 2011, after we had finalized our report and after many months of dialogue with the Beneficiaries, the Beneficiaries submitted unsolicited revised responses to audit findings #1 and #4 and provided unsolicited additional documentation to supplement its revised response to audit finding #1. In its initial responses provided on August 25, 2011, the Beneficiaries agreed with the audit findings, but in the revised responses, the Beneficiaries changed to disagreeing with the findings.

USAC is required to conduct audits in accordance with GAGAS, which specifies that auditors obtain sufficient, appropriate evidence to substantiate audit findings and conclusions.[1] Because the Beneficiaries did not provide adequate documentation in a timely manner, we were unable to conclude with reasonable confidence that the additional documentation provided after fieldwork was complete is accurate, relevant and reliable.

GAGAS also requires auditors to exercise professional judgment, which includes exercising reasonable care and professional skepticism. Reasonable care concerns acting diligently in accordance with applicable professional standards and ethical principles.[2] Further, GAGAS requires auditors to consider the risk level of each assignment, including the risk that auditors may arrive at an improper conclusion.[3]

We informed the Beneficiaries that the documentation submitted after fieldwork completion would not be audited. The submission of additional documentation at such a late stage in the process, as well as the nature of the documentation itself, increased our professional skepticism. Specifically, the Beneficiaries provided new reports for audit finding #1 with a system-generated date of September 8, 2011, almost three years after the audit period in question. As auditors, our ability to rely on the accuracy and sufficiency of audit evidence is reduced when documentation is received after audit completion. Therefore, we concluded the audit based on the documentation provided as of the final deadline. We have exercised professional judgment and considered the risk that we may come to an improper conclusion by considering the documentation that was submitted after fieldwork completion. For the reasons discussed herein, our conclusion that the Beneficiaries failed to timely provide sufficient, appropriate evidence to demonstrate compliance with the Rules remains unchanged.

[1] *Government Auditing Standards*, GAO-07-162G, ¶ 7.55 (2007 revision, as amended).
[2] *Government Auditing Standards,* GAO-07-162G, ¶ 3.32 (2007 revision, as amended).
[3] *Government Auditing Standards,* GAO-07-162G, ¶ 3.37 (2007 revision, as amended).

Findings

- Lack of Documentation - Cost Study Adjustments.
- Improper Charges to Telecommunications Plant in Service.
- Improper Amounts Reported – HCL, LSS.
- Improper Expense Amounts – HCL, LSS.
- Improper Number of Line Counts – HCL, LSS.
- Inadequate Documentation - Affiliate Transactions.
- Improper Line Count and ICLS Revenue Cut-off Date.
- Scope Limitation – Unsupported Variance Analysis.

Exceptions Taken and Recovery Action

Findings	Monetary Effect of Finding	USAC Recovery Action[4]
#1 – Lack of Documentation - Cost Study Adjustments.	$155,707	$155,707
#2 – Improper Charges to Telecommunications Plant in Service.	$61,601	$61,601
#3 – Improper Amounts Reported – HCL, LSS.	$29,112	$29,112
#4 – Improper Expense Amounts – HCL, LSS.	$8,897	$8,897
#5 Improper Number of Line Counts – HCL, LSS.	$1,535	$1,535
#6 – Inadequate Documentation - Affiliate Transactions.	$0	$0
#7 – Improper Line Count and ICLS Revenue Cut-off Date.	$0	$0
#8 – Scope Limitation – Unsupported Variance Analysis.	$0	$0
Total Net Monetary Effect	**$256,852**	**$256,852**

Audit Procedures, Findings, and Responses

A. General Procedures

We obtained and reviewed the Eligible Telecommunication Carriers (ETC) designation order to ensure the Beneficiaries were designated prior to receiving support. We also obtained and reviewed the Beneficiaries' state and self-certification letters for timeliness and with the notation that the Beneficiaries will only use support for the provision, maintenance, and upgrading of facilities and services for which the support was intended.

[4] USAC management notes that any recoveries or disbursements resulting from this audit are contingent upon the carrier submitting certified data for review and correcting any clerical or ministerial errors that may be found in data submitted by the carrier to NECA under Part 36 of the FCC's rules.

B. Understanding the Business

We met with the Beneficiaries' Controller and Cost Consultant to gain a detailed understanding of its processes related to the High Cost Program. We performed a walkthrough of the Beneficiaries' internal control environment, inquired about the companies' process to review documentation prior to its submission to USAC/NECA, and inquired about the companies' accounting system used and the types of documentation generated for HCL, LSS and ICLS purposes.

C. Line Counts

We met with the Beneficiaries' Controller to obtain a detailed understanding of its process for compiling and reporting line counts. We inquired about the Beneficiaries' internal control environment and the system used to compile the line counts. We also obtained an understanding of how the Beneficiaries classified lines as residential/single-line business or multi-line business for ICLS purposes.

D. Fixed Assets

We attempted to obtain and review the Beneficiaries' continuing property records (CPRs) and related documentation to verify the accuracy and existence of the circuit and central office transmission equipment balances as well as outside cable and wire facility equipment balances. We also examined documentation and conducted a physical inventory to ensure the proper categorization of fixed assets.

E. Operating Expenses

We obtained and reviewed tax returns, accrual schedules and related documentation to verify the accuracy and existence of tax expenses and deferred tax liabilities. We obtained and reviewed monthly depreciation and plant accumulated depreciation schedules to verify the accuracy of depreciation expenses and accumulated depreciation. We obtained and reviewed the allocation method and summary schedules to verify the accuracy and existence of benefit and rent expenses. We attempted to obtain and review general ledger details for select expenses and examined invoices to support the existence of the general support, corporate operations, and asset related expenses.

F. Financial Records

We obtained and reviewed the general ledger, invoices, and other related documentation to verify the accuracy and existence of the revenues reported to USAC/NECA. In addition, we obtained the Beneficiaries' financial statements to verify the Telephone Plant in service amounts reported to USAC.

Our audit findings as well as the responses to the findings are provided below. We have evaluated the validity of the Beneficiaries' responses to our findings and our position on these issues remains unchanged.

Finding #1
Lack of Documentation - Cost Study Adjustments
Nemont, Project

Criteria

> "The company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission." 47 C.F.R. § 32.12(b).
>
> "The Commission shall require a company to maintain financial and other subsidiary records in such a manner that specific information, of a type not warranting disclosure as an account or subaccount, will be readily available. When this occurs, or where the full information is not otherwise recorded in the general books, the subsidiary records shall be maintained in sufficient detail to facilitate the reporting of the required specific information. The subsidiary records, in which the full details are shown, shall be sufficiently referenced to permit ready identification and examination by representatives of this Commission." 47 C.F.R. § 32.12(c).
>
> "Auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions." *Government Auditing Standards*, GAO-07-162G, ¶ 7.55 (2007 Revision, as amended).

Condition

We examined the Beneficiaries' cost study to support the amounts reported on the USF Data Collection (HCL) and LSS Forms. The Beneficiaries recorded a cost study adjustment to account 1220 (material and supplies) to reflect their portion of material and supplies allocated from an affiliated entitity's financial records. However, the Beneficiaries provided only a brief email as documentation to substantiate its allocation methodology. The email listed the amounts that were allocated to the Beneficiaries; however, the manner in which those amounts were calculated could not be determined based on the email or on any other documentation provided by the Beneficiaries.

We are required to conduct our audits in accordance with GAGAS, which require auditors to obtain sufficient, appropriate evidence to substantiate audit findings and conclusions. Because the Beneficiaries did not provide adequate documentation as noted in the conclusion section above to substantiate their allocation methodology, we were unable to conclude with reasonable confidence that the Beneficiaries' material and supplies amounts were accurate.

Cause

The Beneficiaries did not have adequate documentation or data retention procedures to ensure the allocation methodology was properly retained.

Effect
Nemont:
The monetary effect for this finding is a $97,322 overpayment of HCL support and a $6,282 overpayment of LSS.

Project:
The monetary effect for this finding is a $44,553 overpayment of HCL support, and a $7,550 overpayment of LSS support.

Recommendation
We recommend USAC management seek recovery of $155,707. We also recommend the Beneficiaries implement policies and procedures to ensure that it maintains adequate records to document compliance with the requirement of the rules cited above to keep records with sufficient particularity to show the facts pertaining to all entries in its accounts.

Beneficiary Response

> Nemont and Project have implemented more automated processes since the audit period thus improving reporting capabilities and the accuracy of our records.

USAC Management Response
USAC management concurs with the auditor. The Beneficiaries do not have documentation consistent with Part 32 rules necessary to support account data reported in its filings with NECA and USAC. As directed by the FCC, USAC management is obligated to implement all recommendations arising from the audits including recovery of funds that may have been improperly disbursed to beneficiaries. Therefore, USAC management will recover High Cost support in the amount of $155,707.

USAC management notes that the Beneficiaries believe it has implemented sufficient internal controls related to this finding, and requests that the Beneficiaries provide a detailed update of specific controls no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

Finding #2
Improper Charges to Telecommunications Plant in Service
Nemont

Criteria

> "(a) This account shall include the original cost of construction projects (note also § 32.2000(c)) of this part and the cost of software development projects that are not yet ready for their intended use.
>
> (b) There may be charged directly to the appropriate plant accounts the cost of any construction project which is estimated to be completed and ready for service within two months from the date on which the project was begun. There may also be charged directly to the plant accounts the cost of any construction project for which the gross additions to plant are estimated to amount to less than $100,000.
>
> (c) If a construction project has been suspended for six months or more, the cost of the project included in this account may remain in this account so long as the carrier excludes the original cost and associated depreciation from its ratebase and ratemaking considerations and reports those amounts in reports filed with the Commission pursuant to §§43.21(e)(1) and 43.21(e)(2) of this chapter. If a project is abandoned, the cost included in this account shall be charged to Account 7300, Nonoperating income and expense.
>
> (d) When any telecommunications plant, the cost of which has been included in this account, is completed ready for service, the cost thereof shall be credited to this account and charged to the appropriate telecommunications plant or other accounts."

47 C.F.R. § 32.2003.

> "This account shall include the original cost of buried cable as well as the cost of other material used in the construction of such plant. This account shall also include the cost of trenching for and burying cable run in conduit not classifiable to Account 2441, Conduit Systems. Subsidiary record categories, as defined below, are to be maintained for nonmetallic buried cable and metallic buried cable." 47 C.F.R. § 32.2423.

Condition

We examined the Beneficiary's documentation to support the amounts reported on the High Cost Program Data Collection HCL and LSS Forms. We also selected individual transactions from specific fixed asset accounts for testing to ensure the amounts were properly recorded in accounts. The Beneficiary charged $388,503 in engineering costs to account 2423 (buried cable) that should been recorded to account 2003 (telecommunications plant under contruction) until the plant was ready for service. As noted in 47 C.F.R. § 32.2003, because the project lasted more than one year and its cost exceeded $100,000, the cost should not have been charged to account 2423.

Cause
The Beneficiary did not demonstrate sufficient knowledge of the Rules governing the proper treatment of account 2003 plant under construction transactions.

Effect
The monetary effect for this finding is a $65,068 overpayment of HCL support and a $3,467 underpayment of LSS.

Recommendation
We recommend USAC management seek recovery of $61,601. We also recommend the Beneficiary implement policies and procedures to ensure that it records the proper amount from telecommunications plant under construction to plant in service as appropriate.

Beneficiary Response

> Nemont agrees that they incurred approximately $387,962 in engineering service charges that may have been incorrectly capitalized via a spread to 2423.01 on existing work orders booked and closed prior to 2006.
>
> Nemont obtained the services of the engineering firm Heberly and Associates to evaluate Nemont's existing network for possible, future fiber upgrades to its network, including ranking or prioritizing the exchanges for FTTP build-outs, and evaluating and staking the cable & wire plant currently in service. The engineers were engaged independent of any future loans, projects, and engineering designs.
>
> Due to the extent that expensing these engineering costs would have adversely impacted Nemont's 2006 financial statements, Nemont sought advice regarding the financial treatment of this charge. Based on the feedback obtained, Nemont was under the impression that they had the option to capitalize such a significant expense, since the alternative had a detrimental effect on their financial statements. Nemont believes in retrospect that the expense associated with the engineering services should have been normalized by booking the charges into a prepaid expense account (does not impact rate base) and then amortizing them over a three year period to expense account 6535, with the first third booked in account 6535 in calendar year 2006.
>
> Nemont respectfully submits that regardless of the accounting method utilized, the settlements received in conjunction with the engineering services received would be approximately the same over the life of the asset.

USAC Management Response
USAC management concurs with the auditor. Failure to submit accurate financial data may result in incorrect payments from the High Cost Program. It is the obligation of the

Beneficiary to ensure that it is providing accurate data consistent with FCC rules. As directed by the FCC, USAC management is obligated to implement all recommendations arising from the audits including recovery of funds that may have been improperly disbursed to the beneficiary. Therefore, USAC management will recover High Cost support in the amount of $61,601.

USAC management directs the Beneficiary to implement internal controls necessary to review and reconcile source documentation and reported High Cost Program data prior to submittal, and requests that the Beneficiary provide a detailed update of specific corrective actions no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

Finding #3
Improper Amounts Reported – HCL, LSS
Project

Criteria

> "The company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission." 47 C.F.R. § 32.12(b).
>
> "The Commission shall require a company to maintain financial and other subsidiary records in such a manner that specific information, of a type not warranting disclosure as an account or subaccount, will be readily available. When this occurs, or where the full information is not otherwise recorded in the general books, the subsidiary records shall be maintained in sufficient detail to facilitate the reporting of the required specific information. The subsidiary records, in which the full details are shown, shall be sufficiently referenced to permit ready identification and examination by representatives of this Commission." 47 C.F.R. § 32.12(c).

Condition

We examined the Beneficiary's cost study to support the amounts reported on the USF Data Collection (HCL) and LSS Forms. We noted that the account 6410 (DL 430) cable and wire facilities expense amount reported on the HCL form was understated by $9,920 and the total benefits (DL600) amount reported on the HCL form was overstated by $83,228. In addition, we noted that the account 4310 (DL550) other long-term liabilities amount reported on the LSS form was understated by $16,225. During the audit, the Beneficiary informed USAC that the LSS form was incorrect.

Cause

The Beneficiary did not have an adequate system in place for collecting, reporting, or monitoring data. In addition, the Beneficiary did not have an adequate process in place to ensure data is reviewed for accuracy prior to its submission to NECA.

Effect

The monetary effect for this finding is a $28,727 overpayment of HCL support. There is a $385 overpayment of LSS support.

Recommendation

We recommend USAC management seek recovery of $29,112. We also recommend the Beneficiary implement a review process to ensure that accurate amounts are reported for High Cost purposes.

Beneficiary Response

> Project will work to ensure that accurate data is being reported prior to submission to NECA.

USAC Management Response

USAC management concurs with the auditor. Failure to submit accurate financial data may result in incorrect payments from the High Cost Progeram. It is the obligation of the Beneficiary to ensure that it is providing accurate data consistent with FCC rules. As directed by the FCC, USAC management is obligated to implement all recommendations arising from the audits including recovery of funds that may have been improperly disbursed to the Beneficiary. Therefore, USAC management will recover High Cost support in the amount of $29,112.

USAC management recognizes that the Beneficiary committed to addressing its internal controls related to this finding, and requests that the Beneficiary provide a detailed update of specific corrective actions no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

Finding #4
Improper Expense Amounts – HCL, LSS
Nemont

Criteria

"The company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission." 47 C.F.R. § 32.12(b).

"Each incumbent local exchange carrier that has been designated an eligible telecommunications carrier and that serves a study area with 50,000 or fewer access lines shall, for each study area, provide the Administrator with the projected total unseparated dollar amount assigned to each account listed below for the calendar year following each filing….The Administrator shall use this information to calculate the projected annual unseparated local switching revenue requirement pursuant to paragraph (d) of this section." 47 C.F.R. § 54.301(b).

Condition

We examined the Beneficiary's documentation to support the amounts reported on the HCL and LSS forms. We also selected individual transactions from specific expense accounts for testing to ensure the amounts were properly recorded. We noted the following:

1. The Beneficiary included $12,432 in account 6410 (cable and wire facilities expense) in 2006 that pertained to 2005. (HCL, LSS)

2. The Beneficiary included $93,958 in account 6620 customer service expense in its entirety although the invoice pertained to multiple related entities. (LSS)

Cause

The Beneficiary did not have an adequate system in place for collecting, reporting or monitoring data.

Effect

The monetary effect for the cable and wire facilities finding is an $8,430 overpayment of HCL support and a $251 underpayment of LSS. The monetary effect for the customer service finding is a $3,606 overpayment of LSS.

Recommendation

We recommend USAC management seek recovery of $11,785. We also recommend the Beneficiary implement a review process to ensure that accurate amounts are reported for High Cost Program purposes.

Beneficiary Response

> While Nemont agrees that the expense in account 6410 was inadvertently recorded in the incorrect period, Nemont did not receive any funding for which the company was not eligible, albeit in the wrong funding year. Nemont will implement procedures to review disbursements before closing its books for the prior year to ensure that expenses are assigned (accrued) in the proper accounting period.
>
> Nemont is awaiting further consideration from USAC [IAD] on the finding for account 6620. Nemont agrees that the entire expense was not properly spread among related entities. However, since Project is also undergoing a High Cost audit, Nemont has asked if the expense can be reduced in Nemont to its proper amount and at the same time increase the expense to its proper amount in Project. Had the accounting entry been discovered in time, it could have been done as a cost study adjustment.

USAC IAD Response

Nemont's monetary effect amount noted above for the customer service finding was calculated with consideration given to the proper amount that should have been expensed. Specifically, we removed the entire expense amount and added back the Beneficiary's correct portion. Therefore, our position on this matter, including the monetary effect amount noted above, remains unchanged.

We considered Project's monetary effect amount for the customer service finding and note a $2,888 underpayment of LSS.

USAC Management Response

USAC management concurs with the auditor. Failure to submit accurate financial data may result in incorrect payments from the High Cost Program. It is the obligation of the Beneficiary to ensure that it is providing accurate data consistent with FCC rules. As directed by the FCC, USAC management is obligated to implement all recommendations arising from the audits including recovery of funds that may have been improperly disbursed to beneficiaries. Therefore, USAC management will recover High Cost Program support in the amount of $8,897.

USAC management recognizes that the Beneficiary committed to addressing its internal controls related to this finding, and requests that the Beneficiary provide a detailed update of specific corrective actions no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

Finding #5
Improper Number of Line Counts – HCL, LSS
Nemont

Criteria

> "[E]ach incumbent local exchange carrier (LEC) must provide the National Exchange Carrier Association (NECA) with….(h) For rural telephone companies, as that term is defined in Sec. 51.5 of this chapter, the number of working loops for each study area….These figures shall be calculated as of December 31st of the calendar year preceding each July 31st filing." 47 C.F.R. § 36.611.

Condition

We examined the Beneficiary's documentation to support the line counts it reported to NECA. The line counts reported on the HCL and LSS forms were not accurate. The Beneficiary understated its line counts by five lines.

Cause

The Beneficiary did not have an adequate system in place for collecting, reporting, or monitoring data.

Effect

The monetary effect for this finding is a $1,535 overpayment of HCL support. There is no monetary effect on LSS.

Recommendation

We recommend USAC management seek recovery of $1,535. We also recommend the Beneficiary implement policies and procedures to ensure that it reports the proper number of line counts.

Beneficiary Response

> Nemont will promptly implement internal controls so that line count data is properly counted and reported.

USAC Management Response

USAC management concurs with the auditor. Failure to submit accurate line count data may result in incorrect payments from the High Cost Program. It is the obligation of the Beneficiary to ensure that it is providing accurate data consistent with FCC rules. As directed by the FCC, USAC management is obligated to implement all recommendations arising from the audits including recovery of funds that may have been improperly disbursed to the Beneficiary. Therefore, USAC management will recover High Cost support in the amount of $1,535.

USAC management recognizes that the Beneficiary committed to addressing its internal controls related to this finding, and requests that the Beneficiary provide a detailed update of specific corrective actions no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

Finding #6
Inadequate Documentation - Affiliate Transactions
Nemont, Project

Criteria

"Services provided between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Non-tariffed services provided between a carrier and its affiliate pursuant to publicly-filed agreements submitted to a state commission pursuant to section 252(e) of the Communications Act of 1934 or statements of generally available terms pursuant to section 252(f) shall be recorded using the charges appearing in such publicly filed agreements or statements. Nontariffed services provided between a carrier and its affiliate that qualify for prevailing price valuation, as defined in paragraph (d) of this section, shall be recorded at the prevailing price. For all other services sold by or transferred from a carrier to its affiliate, the services shall be recorded at no less than the higher of fair market value and fully distributed cost. For all other services sold by or transferred to a carrier from its affiliate, the services shall be recorded at no more than the lower of fair market value and fully distributed cost." 47 C.F.R. § 32.27(c).

Condition

We examined the Beneficiaries' documentation to support the amounts reported on the USF Data Collection (HCL) and LSS Forms. We also selected individual transactions from expense accounts for testing to ensure the amounts were properly recorded. We noted the Beneficiaries did not use the lower of cost or market methodology to value the services that Nemont Communications Inc. (NCI), an affiliated entity, allocated to other affiliates. The Beneficiaries incurred rental expenses for vehicles, equipment (tools & construction), buildings (headquarters and warehouse), furniture, computers, a fiber network, with all rental expenses based on NCI's cost. We noted the following:

1. For the vehicles, equipment (tools & construction), furniture, and computers, a fair market analysis was not performed to confirm that the cost was not in excess of the fair market value or vice versa.

2. For the buildings (headquarters and warehouse), a fair market analysis was performed; however, the lower of cost or market value was not used.

3. For the rental expense related to fiber optic cable, the cost was detailed in a formal agreement; however, the recorded amount was based on NCI's cost and no consideration was given to fair market value.

Cause

The Beneficiaries did not demonstrate sufficient knowledge of the Rules governing the proper treament of affiliate transactions.

Effect
We are unable to determine the monetary effect for this finding, as the proper amounts to be reported for High Cost Program purposes could not be established.

Recommendation
We recommend the Beneficiaries implement policies and procedures to ensure that it record transactions between affiliates in a proper manner.

Beneficiary Response

> Nemont and Project will promptly work on bringing affiliate transactions into compliance with the applicable rules.

USAC Management Response
USAC management concurs with the auditor. Failure to submit accurate financial data may result in incorrect payments from the High Cost Program. It is the obligation of the Beneficiaries to ensure that it is providing accurate data consistent with FCC rules.

USAC management recognizes that the Beneficiaries committed to addressing its internal controls related to this finding, and requests that the Beneficiaries provide a detailed update of specific corrective actions no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

Finding #7
Improper Line Count and ICLS Revenue Cut-off Date
Nemont, Project

Criteria

"[E]ach incumbent local exchange carrier (LEC) must provide the National Exchange Carrier Association (NECA) with….(h) For rural telephone companies, as that term is defined in Sec. 51.5 of this chapter, the number of working loops for each study area….These figures shall be calculated as of December 31st of the calendar year preceding each July 31st filing." 47 C.F.R. § 36.611.

"Any rural telephone company, as that term is defined in Sec. 51.5 of this chapter, may update the information submitted to the National Exchange Carrier Association (NECA) on July 31st pursuant to Sec. 36.611 (a) through (h) one or more times annually on a rolling year basis according to the schedule, except that rural telephone companies in service areas where an eligible telecommunications carrier has initiated service and has reported line count data pursuant to Sec. 54.307(c) of this chapter must update the information submitted to NECA on July 31st pursuant to Sec. 36.611(h) according to the schedule. Every non-rural telephone company must update the information submitted to NECA on July 31st pursuant to Sec. 36.611 (h) according to the schedule.

(1) Submit data covering the last nine months of the previous calendar year and the first three months of the existing calendar year no later than September 30th of the existing year;

(2) Submit data covering the last six months of the previous calendar year and the first six months of the existing calendar year no later than December 30th of the existing year;

(3) Submit data covering the last three months of the second previous calendar year and the first nine months of the previous calendar year no later than March 30th of the existing year." 47 C.F.R. § 36.612(a).

"Each rate-of-return carrier in service areas where a competitive eligible telecommunications carrier has initiated service and reported line count data pursuant to Sec. 54.307(c) shall submit the information in paragraph (a) of this section in accordance with the schedule in Sec. 36.612 of this chapter. A rate-of-return carrier may submit the information in paragraph (a) of this section in accordance with the schedule in Sec. 36.612 of this chapter, even if it is not required to do so. If a rate-of-return carrier makes a filing under this paragraph, it shall separately indicate any lines that it has acquired from another carrier that it has not previously reported pursuant to paragraph (a) of this section, identified by customer class and the carrier from which the lines were acquired." 47 C.F.R. § 54.903.

Condition
We examined the Beneficiaries' process for compiling their line counts and ICLS revenue amounts. While the Beneficiaries filed their line counts and ICLS revenue amounts in a timely manner, the cut-off date by which they reported this information was as of the billing cycle date, and not as of the end of the month. The billing cycle date for Nemont's 2006 year end was December 16, 2006 and the billing cycle date for Project's year end was December 20, 2006.

Cause
The Beneficiaries did not demonstrate sufficient knowledge of the Rules governing the dates for which the information must be based upon for High Cost Program purposes.

Effect
We are unable to determine the monetary effect for this finding, as we are unable to establish the number of subscribers that were active and the revenues that were earned from the billing cycle date to the end of the month.

Recommendation
We recommend the Beneficiaries implement policies and procedures to ensure that it report its line counts and ICLS revenue amounts as of the end of the month.

Beneficiary Response

> Nemont and Project acknowledges that their reporting of line counts using the billing cycle is inconsistent with the FCC rules regarding these reports. Nemont and Project will take action to set up procedures to correct this inconsistency by completing an access line count reconciliation for each reporting period. This will be completed by taking the billing cycle date line counts and adding or removing lines for connects/disconnects for the interim period (billing cycle date and period ending date) to report the line counts at the proper cut-off date. The end user revenue will be actual end user revenue booked at the billing cycle date, plus the adds/disconnects times $6.50 (single) and $9.20 (multi-line) for the interim period.

USAC Management Response
USAC management concurs with the auditor. Failure to submit accurate line count data may result in incorrect payments from the High Cost Program. It is the obligation of the Beneficiaries to ensure that it is providing accurate data consistent with FCC rules. While USAC management understands that quarterly and annually reported data are often reported consistent with a carrier's billing cycle, and that reporting based on billing cycles is a standard industry practice and typically results in a de minimis variance from data reported as of the month end, the practice is nevertheless contrary to FCC rules. USAC management notes that the auditor did not quantify a monetary effect and did not recommend recovery of funds for this finding.

USAC management recognizes that the Beneficiaries committed to taking the necessary steps to ensure future compliance with loop and revenue reporting requirements. No further internal controls action related to this finding is necessary.

Finding #8
Scope Limitation – Unsupported Variance Analysis
Nemont, Project

Criteria

"The company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission." 47 C.F.R. § 32.12(b).

"All eligible telecommunications carriers shall retain all records required to demonstrate to auditors that the support received was consistent with the universal service high-cost program rules. These records should include the following: data supporting line count filings; historical customer records; fixed asset property accounting records; general ledgers; invoice copies for the purchase and maintenance of equipment; maintenance contracts for the upgrade or equipment; and any other relevant documentation. This documentation must be maintained for at least five years from the receipt of funding." 47 C.F.R. § 54.202(e).

"Auditors must plan the audit to reduce audit risk to an appropriate level for the auditors to provide reasonable assurance that the evidence is sufficient and appropriate to support the auditors' findings and conclusions. This determination is a matter of professional judgment. In planning the audit, auditors should assess significance and audit risk and apply these assessments in defining the audit objectives and the scope and methodology to address those objectives. Planning is a continuous process throughout the audit. Therefore, auditors may need to adjust the audit objectives, scope, and methodology as work is being completed." *Government Auditing Standards.* GAO-07-l62G, 7.05, 7.07 (2007 revision, as amended).

"Auditors should describe the scope of work performed and any limitations, including issues that would be relevant to likely users, so that they could reasonably interpret the findings, conclusions, and recommendations in the report without being misled. Auditors should also report any significant constraints imposed on the audit approach by information limitations or scope impairments, including denials of access to certain records or individuals." *Government Auditing Standards*, GAO-07-l62G, 8.11 (2007 revision, as amended).

"Auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions." *Government Auditing Standards*, GAO-07-162G, ¶ 7.55 (2007 revision, as amended).

Condition

We examined the Beneficiaries' cost study to support the amounts reported on the HCL and LSS forms. We increased our scope to include a variance analysis of 2004, 2005 and

2006 account balances and noted large variances on 24 account balances. We requested documentation to support the cost study account balances and cost study adjustments with large fluctuations from year-to-year. However, the Beneficiaries did not provide documentation to support the variances.

We are required to conduct our audits in accordance with GAGAS, which specifies that auditors obtain sufficient, appropriate evidence to substantiate audit findings and conclusions. Because the Beneficiaries did not provide adequate documentation to substantiate the variances, we were unable to conclude with reasonable confidence that the fluctuations were appropriate.

Cause
The Beneficiaries did not have an adequate system in place for collecting, reporting, or monitoring data. The Beneficiaries utilized a complex system of accounts, which were restructured during the audit period. Due to the complexity of the system, the Beneficiaries were unable to provide explanations or documentation to substantiate the large fluctutations without extensive research.

Effect
We are unable to calculate a monetary effect for this finding, as we cannot determine if there were reasonable explanations for the large variances noted.

Recommendation
We also recommend the Beneficiaries implement policies and procedures to ensure that it maintains adequate records to document compliance with the requirement to keep records with sufficient detail to show the facts pertaining to all entries in its accounts.

Beneficiary Response

> Nemont and Project will make a variance analysis similar to that performed by USAC or NECA a part of year-end procedures on a go-forward basis.

USAC Management Response
USAC management concurs with the auditor. The Beneficiaries did not have documentation consistent with Part 32 rules necessary to support account data reported in its filings with NECA and USAC.

USAC management recognizes that the Beneficiaries committed to addressing its internal controls related to this finding, and requests that the Beneficiaries provide a detailed update of specific corrective actions no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

USAC Management Audit Recovery Table

Nemont	LSS	HCL	Finding Total
Finding 1	$6,282	$97,322	$103,604
Finding 2	$(3,467)	$65,068	$61,601
Finding 4	$3,355	$8,470	$11,785
Finding 5	$0	$1,535	$1,535
Mechanism Total	$6,170	$172,395	$178,525
Project	**LSS**	**HCL**	**Finding Total**
Finding 1	$7,550	$44,553	$52,103
Finding 3	$385	$28,727	$29,112
Finding 4	($2,888)	$0	($2,888)
Mechanism Total	$5,047	$73,280	$78,327

This concludes the results of our audit. Certain information may have been omitted from this report concerning communications with USAC management or other officials and/or details about internal operating processes or investigations. This report is intended solely for the use of USAC, the Beneficiaries', and the FCC and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of those procedures for their purposes.

cc: Mr. D. Scott Barash, USAC Acting Chief Executive Officer
Mr. David Capozzi, USAC Acting General Counsel