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June 12, 2013

FILED VIA ECFS

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W., Room TW-B204
Washington, D.C. 20554

Re: *Ex Parte* Notification
Lifeline Reform: Independent Audit Requirement
WCB Docket No. 11-42

Dear Ms. Dortch:

On behalf of Smith Bagley, Inc. ("SBI"), we write concerning the scope of the biennial independent audit requirement ("Independent Audit") for Lifeline carriers that receive $5 million or more annually in Lifeline reimbursements. SBI shares the Commission's goal of eliminating waste in the Lifeline program. Reaching this goal, however, will require the most efficient possible use of limited administrative resources at USAC and at affected carriers.

Accordingly, SBI respectfully submits that the scope of the Independent Audit should be carefully tailored to: (1) comport with the objectives of the *Lifeline Reform Order*;[1] (2) avoid unnecessary duplication of existing Lifeline oversight mechanisms; and (3) comply with the parameters of the Paperwork Reduction Act ("PRA") approval issued by the Office of Management and Budget ("OMB").

SBI also requests that interested parties be given the opportunity to comment on the proposed scope and procedures of the Independent Audit prior to final adoption by the Commission. Finally, SBI responds to inquiries posed by Commission staff during a May 1, 2013 meeting regarding the scope and specifics of the Independent Audit process.

Background

In the *Lifeline Reform Order*, the Commission adopted "a requirement that every ETC providing Lifeline services and drawing $5 million or more in the aggregate on an annual basis … hire an independent audit firm to assess the ETC's overall compliance with the program's requirements."[2] The FCC specified that such audits will be performed once every two years,[3]

[1] *In the Matter of Lifeline and Link Up Reform and Modernization*, WC Docket No. 11-42, Report and Order and Further Notice of Proposed Rulemaking, FCC 12-11 (rel. Feb. 6, 2012), 77 FR 12952 *("Lifeline Reform Order")*.

[2] *Lifeline Reform Order* at ¶291.

and later clarified that "[i]f there are no material findings in a carrier's first independent audit, the Wireline Competition Bureau has the authority to relieve the ETC of its obligation to perform the biennial audits going forward."[4]

The *Lifeline Reform Order* defines the scope of the Independent Audit, as follows:

- The purpose of the audit is "to develop an understanding of the areas of biggest risk once the new [Lifeline] rules have been implemented."[5]

- The audit should be designed "to assess the ETC's *overall compliance* with the [Lifeline] program's requirements."[6]

- Instead of assessing compliance "at the individual study area level," the audit should "focus on the company's *overall compliance program and internal controls* regarding Commission requirements *as implemented on a nationwide basis.*"[7]

- "[W]hen an ETC has an automated system to verify initial and ongoing eligibility, the biennial independent audit should focus on whether *the methods and procedures* of such automated systems are appropriately structured to ensure compliance with program rules."[8]

- "Independent audits shall be an agreed upon procedures attestation."[9]

Importantly, the Commission explained that the new audit requirements would not replace existing USAC oversight activities.[10] Carriers that receive Lifeline support are already subject to comprehensive audit and oversight procedures undertaken by USAC and the Commission's Office of Inspector General, including the Beneficiary and Contributor Audit

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[3] *Id.*

[4] *Information Collection Being Submitted to Office of Management and Budget ("OMB") for Emergency Review and Approval*, Notice and Request for Comments, 77 Fed. Reg. 52,718 (Aug. 30, 2012) and *FCC Supporting Statement* (Sep. 2012) at 6, OMB Control Number 3060-00819.

[5] *Lifeline Reform Order* at ¶ 295.

[6] *Id.* at ¶291 (emphasis added).

[7] *Id.* at ¶292 (emphasis added).

[8] *Id.* (emphasis added).

[9] *Id. See also* 47 C.F.R. § 54.420(a) ("such [audit] engagements shall be agreed upon attestations to assess the company's *overall compliance with rules* and the company's *internal control* regarding these regulatory requirements." (emphasis added).

[10] *Id.* at ¶295.

Program ("BCAP"), Payment Quality Assurance ("PQA") reviews, and In-depth Data Validations ("IDV").[11]

Proper Scope and Methodology of Independent Audit Requirement

The plan for the Independent Audits should reflect the narrowly tailored scope previously articulated by the Commission and summarized above. Consistent with the *Lifeline Reform Order*, the Independent Audits should be conducted as a high-level review of a company's internal controls[12] so that USAC and the Commission can identify the greatest risk areas and thereby efficiently target USAC's oversight mechanisms. The Independent Audits should be complementary, not duplicative, of existing audit and review procedures, including BCAP, PQAs and IDVs.[13]

The Commission must remain within the scope of the audit authority it sought, and obtained, from OMB pursuant to the PRA in connection with the data collection. The Commission estimated that the Independent Audit would require 250 hours of work by auditors on average per carrier.[14] In order to remain in compliance with the approved data collection, the Commission must now ensure that the actual Independent Audits, as implemented, do not require a significantly greater level of work. Further, in order to remain in compliance with the PRA, the Commission must ensure that the information collection has "practical utility" and "is not unnecessarily duplicative of information otherwise reasonably accessible to the [Commission]."[15]

What the Commission's Independent Audits Should Do

The Commission's Independent Audits should focus on a high-level review of internal company procedures and controls regarding the aspects of the Lifeline program that present the greatest risk to the program. This limited risk assessment will allow the Commission and USAC to effectively allocate administrative resources required to provide program oversight.

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[11] *Id.* at ¶283 n. 787 and n. 788.

[12] An "internal control" is "an accounting procedure or system designed to promote efficiency or assure the implementation of a policy or safeguard assets or avoid fraud and error etc." PRINCETON UNIVERSITY WORDNET (Princeton University. 2010) http://wordnet.princeton.edu.

[13] *See* Exhibit 1, schematic diagram showing appropriate scope of Independent Audit process.

[14] Supporting Statement at p. 14. It appears that the 250 hour estimate did not include internal employee time required to complete the Independent Audit because the Commission referred only to the estimated $200 per hour cost of outside auditors, and then multiplied that cost by 250 hours. In SBI's experience, audits impose significant costs on companies in terms of employee time, as well as the opportunity cost of diverting employees from profitable work.

[15] Small Business Paperwork Relief Act of 2002, § 2(c)(3), Pub. L. No. 107-198 ("Paperwork Reduction Act"), 44 U.S.C. § 3506 (c)(3)(A) and (B).

Specifically, SBI submits that the Independent Audits should review the following, and only the following, areas of carrier processes and procedures:

- Initial determination of program- or income-based eligibility
- Annual re-certification of subscriber eligibility
- Duplicate Lifeline discounts provided to the same subscriber
- Duplicate Lifeline discounts provided to the same household
- Usage monitoring, and de-enrollment for non-usage, for subscribers not paying a fee for service

The Independent Audits presumably will include a limited sampling of actual customer data sufficient to test that these internal controls are functioning and effective.[16] Further sampling would occur only as needed to validate a negative result from the initial sample.

What the Commission's Independent Audits Should Not Do

The Commission's Independent Audits should not, except for the sample discussed above, review specific compliance with Lifeline requirements on a customer-by-customer basis. Specifically, the Independent Audits should not:

- Conduct a detailed review of all filings, certifications, and billing records supporting a carrier's Lifeline disbursements;
- Match the totals reported on Form 497 with the carrier's billing and subscriber records;
- Identify all apparent individual and household duplicates in the carrier's records, and verify resolution of each;
- Estimate or determine specific overpayment amounts for recovery; or
- Evaluate internal control procedures for aspects of compliance beyond the areas delineated above.

SBI submits that to the extent that the Independent Audits undertake any of the above steps, they will duplicate rather than complement existing USAC audit and oversight procedures. Independent Audits that undertake these steps would also impose burdens on carriers substantially in excess of the Commission's estimates to OMB.

To help ensure Independent Audits in practice avoid imposing excessive costs, the Commission should cap the cost to affected ETCs with 250 or fewer employees at $25,000 per audit. Any audit costs in excess of $25,000 would represent a severe burden for SBI and other

[16] For example, American Institute of Certified Public Accountants ("AICPA") standards for field work suggest a sample size of 60 may be sufficient in some cases to establish that a control is functioning. See AICPA Statements on Auditing Standards, AU § 350.41 ("For example, if the tolerable [deviation] rate for a population is 5 percent and no deviations are found in a sample of 60 items, the auditor may conclude that there is an acceptably low sampling risk that the true deviation rate in the population exceeds the tolerable rate of 5 percent.").

small entities that are already subject to thousands of dollars in Lifeline compliance costs each year, and should be reimbursed from USAC's budget for universal service fund audits and oversight. For carriers with more than 250 employees, the Commission should impose an overall limit of $60,000 per audit, beyond which USAC's budget would be required to cover costs. This represents 300 hours of auditor work (20% higher than the 250 hour average estimated by the FCC) at $200 per hour.

Follow-Up and Use of the Independent Audit Results

The *Lifeline Reform Order* does not explicitly address what actions, if any, the Commission should take following the completion of an Independent Audit. However, based on the Commission's determination that the audits will be agreed-upon procedures ("AUP" attestations), the follow-up should differ significantly from USAC's existing audit program.

In contrast to the compliance audits performed as part of the BCAP, an auditor conducting an AUP attestation does not issue an opinion or negative assurance; instead, the auditor's report takes the form of "procedures and findings."[17] In other words, the auditor does not issue an opinion that the company does or does not comply with the Lifeline rules; rather, the auditor conducts selected procedures and simply reports what it found. USAC would then use that information to better structure and target its oversight.

Similarly, the Independent Audits should not involve determinations of improper payments to be recovered through offsets or other means. Procedures to determine overpayment amounts are more intensive and are properly part of granular USAC audits to determine if a carrier has failed to provide adequate verification for support for specific customers.[18] Such procedures are not appropriate for a high-level review of internal controls as contemplated by the Independent Audit requirement.

SBI proposes the following use of, and follow-up to, the results of Independent Audits:

If the Independent Audit Indicates Compliance

The Commission has specified that "[i]f there are no material findings in a carrier's first independent audit, the Wireline Competition Bureau has the authority to relieve the ETC of its obligation to perform the biennial audits going forward."[19] If the Independent Audit demonstrates adequate internal controls over compliance and if the sample shows those controls are functioning effectively, carriers should be recognized as presenting a low risk of non-compliance in the targeted areas and be relieved of the Independent Audit requirement on a

[17] AICPA Agreed-Upon Procedures Engagements, AT § 201.14.

[18] *Lifeline Reform Order* at ¶¶298–299.

[19] OMB Control Number 3060-00819, *FCC Supporting Statement* (Sept. 2012) at 6.

going forward basis. SBI notes that such carriers will remain subject to all other audit and review procedures available to USAC and the Commission.

If the Independent Audit Indicates Inadequate Internal Control Systems

In the event an Independent Audit reveals inadequate internal controls in one or more of the targeted areas of carrier compliance, the auditor should report these results to the carrier, the Commission and USAC. The reported results will provide USAC with useful information for determining an appropriate response using existing oversight mechanisms including study-area level BCAP audits to determine compliance.

If the Independent Audit Indicates Adequate Internal Controls But the Subscriber Sample Indicates Non-Compliance

In the event the carrier's internal controls are adequate but the sampled records indicate they are not functioning effectively, SBI proposes that a further sample of similar size to the initial sample be surveyed. The auditor would include the results from both samples in its report to the carrier, to the Commission and USAC. This would again provide USAC with useful information for possible further inquiry.

Comment Period for Proposed Independent Audit Procedures

SBI urges the Commission to issue a Public Notice setting forth the proposed Independent Audit procedures, and to give carriers an opportunity to submit comments prior to final adoption by the Commission.

Carriers have had no opportunity to review the proposed Independent Audit procedures. Yet, it is the carriers that will have to comply with these procedures and to pay for the independent auditors. The carriers also possess the unique knowledge of whether and how they can comply with any proposed procedures, and the input of the carriers will be invaluable to the Bureau to fine tune these procedures to ensure they are efficiently designed and consistent with the scope the Commission has outlined.[20]

Providing a comment period will not materially delay the Independent Audit process. The *Lifeline Reform Order* directed USAC "to prepare proposed audit guidelines … and submit them to the Bureau and OMD within 60 days of the release of the [*Lifeline Reform Order*].[21]

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[20] Notably the AICPA standards governing Agreed-Upon Procedures audits suggest the entity being audited should work with the auditor and the users of the resulting audit report in agreeing on the procedures to be performed. *See AICPA Standards for Agreed-Upon Procedures Engagements*, AT § 201.03 ("The specified parties and the practitioner agree upon the procedures to be performed by the practitioner that the specified parties believe are appropriate."); AT § 201.04 (defining "specified parties" to include the entity that is the subject of the audit).

[21] *Lifeline Reform Order* at ¶292.

The Lifeline Reform Order was released on February 6, 2012 – more than fifteen months ago. To the best of SBI's knowledge, USAC has not yet submitted the proposed audit guidelines to the Commission. Further, the rules provide that the initial audit must be completed within one year after the Commission issues the audit guidelines.[22] As a result, even if the guidelines were released tomorrow, the audit results would not be due until June 2014.[23] Therefore, a 45 day comment and reply comment period would not materially delay implementation of the Independent Audit process.

Commission Staff Questions and SBI Responses

During SBI's May 1, 2013 *ex parte* meeting, Bureau staff raised several questions.[24] SBI addresses those questions below.

Verification of controls: (1) How can the auditor verify that a company's internal controls produce accurate results; (2) What is the right amount of data to perform the review; and (3) Should a second sample be taken if the first sample shows a material level of non-compliance at the subscriber level?

As set forth above, SBI anticipates that the Independent Audits will include a limited sampling of actual customer data sufficient to test that a carrier's internal controls are functioning and effective.[25] As noted above, if the first sample shows a material level of non-compliance, SBI proposes that a further sample of similar size to the initial sample be taken to determine whether the carrier is in compliance. If the further sample indicates material compliance, the inquiry would be terminated. If the further sample indicates material non-compliance, the matter should be referred to the Commission and USAC for possible further investigation.

Carrier work burdens: How many hours would it take for a carrier to pull subscriber information for a given month, or for a few months?

SBI submits that any subscriber sample should be a small fraction of a carrier's subscribers reviewed for compliance with the five areas of carrier processes and procedures set forth on page 4 above. SBI opposes any requirement for a carrier to pull all subscriber data for a given month, or for a few months. This would create a huge, and unnecessary, work burden because it would duplicate other USAC and FCC review processes, and would be wholly inconsistent with the underlying purpose of, and limitations on, the Independent Audit requirement.

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[22] 47 U.S.C. § 54.420(a)(2).

[23] The actual date will be even later if Federal Register publication is required.

[24] The questions were not presented in writing. SBI has attempted here to accurately represent the substance of the questions.

[25] *See infra* n. 16.

Selection of auditors: How difficult will it be for carriers to select an auditor to undertake an Independent Audit?

Any requirement that audit firms performing the Independent Audits must be certified in government auditing standards would limit the pool of potentially qualified auditors. Also, the pool of auditors with familiarity with the Lifeline program may also be limited. Knowledge and experience with Lifeline would presumably help ensure a more efficient audit process. For that reason, SBI encourages the Commission to require USAC to conduct auditor training sessions and to make training materials available on line. The Commission may also want to consider requiring potential Lifeline auditors to complete and certify their completion of such training.

Conclusion

The scope of the Independent Audit should be carefully tailored to: (1) comport with the objectives of the *Lifeline Reform Order*: (2) avoid unnecessary duplication of existing Lifeline oversight mechanisms; and (3) comply with the parameters of the Paperwork Reduction Act ("PRA") approval issued by the Office of Management and Budget ("OMB"). In addition, interested parties should be given the opportunity to comment on the proposed scope and procedures of the Independent Audit prior to final adoption by the Commission.

Respectfully submitted,

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