



# Audit Committee

## Briefing Book

April 23, 2018

8:00 a.m. - 9:30 a.m. Eastern Time

Universal Service Administrative Company Offices

700 12th Street NW, Suite 900

Washington, DC, 20005

**Universal Service Administrative Company  
Audit Committee Quarterly Meeting  
Agenda**

**Monday, April 23, 2018  
8:00 a.m. – 9:30 a.m. Eastern Time  
USAC Offices  
700 12th Street, N.W., Suite 900  
Washington, D.C. 20005**

<u><b>OPEN SESSION</b></u>		<i>Estimated Duration in Minutes</i>
Chair	<b>a1.</b> Consent Items (each available for discussion upon request): <b>A.</b> Approval of Audit Committee Meeting Minutes of January 29, 2018 <b>B.</b> Approval of Moving all <i>Executive Session</i> Items into <i>Executive Session</i> . <b>C.</b> Review of USAC’s Processes to Assess Compliance with Applicable Laws and Regulations.	5
Wayne	<b>i1.</b> USAC Internal Audit Division Business Update <ul style="list-style-type: none"> <li>• Beneficiary and Contributor Audit Plans.</li> <li>• Payment Quality Assurance.</li> <li>• Corporate Assurance.</li> </ul>	10

<u><b>EXECUTIVE SESSION</b></u>		<i>Estimated Duration in Minutes</i>
Wayne	<b>i1</b> USAC Internal Audit Division Business Update ( <i>Continued</i> ) – <b>Confidential –Executive Session Recommended.</b> <ul style="list-style-type: none"> <li>• Program Risk Analysis.</li> </ul>	10
Wayne	<b>a2.</b> Consideration of the 2018 USAC Internal Audit Plan – <b>Confidential –Executive Session Recommended.</b>	20
Jarnice	<b>a3.</b> Action on Three USAC Internal Audit Division Operational Audit Report – <b>Confidential – Executive Session Recommended.</b>	15
Chair	<b>i2.</b> Executive Session with USAC’s Vice President of Internal Audit – <b>Confidential – Executive Session Recommended.</b>	20

**Next Scheduled USAC Audit Committee Meeting**

**Monday, July 23, 2018  
8:00 a.m. – 9:30 a.m.  
USAC Offices, Washington, D.C.**

## Universal Service Administrative Company Audit Committee Meeting

### ACTION ITEM

#### Consent Items

#### Action Requested

The Audit Committee (Committee) is requested to approve the consent items listed below.

#### Discussion

The Committee is requested to approve the following items using the consent resolutions below:

- A. Approval of Committee meeting minutes of January 29, 2018 (*see Attachment A-1*).
- B. Approval for discussing in *Executive Session* agenda items:
  - (1) i1B. – USAC Internal Audit Division Business Update. USAC management recommends that this matter be discussed in *Executive Session* because the basis to support the changes relate to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.
  - (2) a2 – Approval of the 2018 Internal Audit Plan. USAC management recommends that this matter be discussed in *Executive Session* because the basis to support the changes relate to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.
  - (3) a3 – Action on Three USAC Internal Audit Division Operational Audit Reports. USAC management recommends that this matter be discussed in *Executive Session* because these reports relate to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.
  - (4) i2 – Executive Session with USAC’s Vice President of Internal Audit. USAC management recommends that this matter be discussed in *Executive Session* pursuant to the guidelines in the approved Audit Committee Charter.
- C. Review of USAC’s Processes to Assess Compliance with Applicable Laws and Regulations.

In accordance with USAC's Audit Committee Charter (Charter), Section III.G, the Committee, in consultation with USAC's General Counsel, is required to review annually the processes used by USAC to assess compliance with applicable laws and regulations. **Attachment C** documents the assessment made by the USAC Internal Audit Division (IAD) in this matter and briefly discusses the controls in place to assure compliance. As we have done in prior reports, IAD did not list every step or procedure, nor did we provide more detailed information as we do not want to compromise the integrity of USAC's operating procedures or disclose confidential information.

Compliance processes for administration of the Universal Service Fund (USF) and the Universal Service Support Mechanisms by each programmatic division and USAC's financial operations are based on Section 254 of the Communications Act of 1934, as amended,<sup>1</sup> Part 54 of the Commission's rules,<sup>2</sup> Commission orders, and FCC staff directives. Each division is expected to execute its daily, monthly and quarterly tasks in administering the USF and the support mechanisms in accordance with applicable law, FCC orders and directives, and USAC policies and procedures. Since 1998, USAC has consistently received "clean" financial audit opinions, and the results of operational reviews to test compliance with program rules have not revealed any violations of applicable law. Additionally, through the combined efforts of USAC management, the Office of General Counsel, IAD and USAC Human Resources, ongoing compliance with laws and regulations is monitored and assessed.

IAD has determined that the USAC's processes are in compliance with applicable laws and regulations. Any changes made to this process over the next year will be documented and reported to the Committee at the April 2019 quarterly meeting.

Upon request of a Committee member any one or more of the above items are available for discussion by the Committee.

### **Recommended USAC Audit Committee Action**

APPROVAL OF THE FOLLOWING RESOLUTIONS:

**RESOLVED**, that the USAC Audit Committee hereby approves: (1) the Committee meeting minutes of January 29, 2018; and (2) discussion in *Executive Session* of the items noted above; and

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<sup>1</sup> 47 U.S.C. § 254.

<sup>2</sup> See generally 47 C.F.R. pt. 54.

**RESOLVED FURTHER**, that the USAC Audit Committee accepts the USAC Internal Audit Division's assessment that USAC's processes are in compliance with applicable laws and regulations.

**UNIVERSAL SERVICE ADMINISTRATIVE COMPANY**  
**700 12th Street, N.W., Suite 900**  
**Washington, D.C. 20005**

**AUDIT COMMITTEE MEETING**  
**Monday, January 29, 2018**

**(DRAFT) MINUTES<sup>1</sup>**

The quarterly meeting of the USAC Board of Directors (Board) Audit Committee (Committee) was held at USAC's offices in Washington, D.C. on Monday, January 29, 2018. Mr. Gillan, Committee Chair, called the meeting to order at 8:00 a.m. Eastern Time, with all four Committee members present. (There is one vacancy on the Committee):

Feiss, Geoff – Vice Chair  
Gillan, Joe – Chair

Tinic, Atilla  
Wibberly, Dr. Kathy

Other Board members and officers of the corporation present:

Bocher, Bob – Member of the Board  
Choroser, Beth – Member of the Board  
Davis, Craig – Vice President of Procurement and Strategic Sourcing  
Fontana, Brent – Member of the Board – *by telephone*  
Lubin, Joel – Member of the Board  
Mason, Ken – Member of the Board  
Salvator, Charles – Vice President of Finance, Chief Financial Officer and Assistant Treasurer  
Scott, Wayne – Vice President of Internal Audit  
Sekar, Radha – Chief Executive Officer  
Sweeney, Mark – Chief Operating Officer

Others present:

<u>NAME</u>	<u>COMPANY</u>
Anderson, Jarnice	USAC
Anderson, Latoya	USAC
Beckford, Ernesto	USAC
Braxton-Johnson, Kianna	USAC
Carpenter, Nikki-Blair	USAC
Crowe, Jennifer	USAC
Daniels, Joel	USAC

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<sup>1</sup> Draft resolutions were presented to the Committee prior to the Committee meeting. Where appropriate, non-substantive changes have been made to the resolutions set forth herein to clarify language where necessary or to correct grammatical or spelling errors.

<u>NAME</u>	<u>COMPANY</u>
Delmar, Teleshia	USAC
Goode, Vernell	USAC
Guinan, Gabriela Gross	USAC
Hughet, Pamela	USAC
Hutchinson, Kyle	USAC
Lutz, Corey	USAC
Nuzzo, Patsy	USAC
Santana-Gonzalez, Jeanette	USAC
Schell, Julie	Pennsylvania Department of Education
Smith, Chris	USAC
Talbott, Dr. Brian	Dimensional Learning Solutions, LLC
Tawes, Pauline	USAC

### OPEN SESSION

- a1. Consent Items.** Mr. Gillan presented these items to the Committee requesting that item i1 be discussed in Open Session and item a5 be discussed in *Executive Session*.
- A. Approval of Committee meeting minutes of October 23, 2017.
- B. Approval for discussing in *Executive Session* agenda items:
- (1) **a4** – Annual Review of the Adequacy of USAC’s System of Internal Controls by the USAC Internal Audit Division. USAC management recommends that this item be discussed in *Executive Session* because this matter relates to *specific internal controls, and /or confidential company data* that would constitute a discussion of internal rules and procedures. In addition, the attachment to this issue paper involves a personnel matter; and, therefore, USAC management recommends that this item be discussed in *Executive Session* for this reason as well consistent with USAC’s long-standing practice and to preserve privacy.
  - (2) **a5** – Approval of the 2018 Internal Audit Plan. USAC management recommends that discussion of the Audit Plan contained in the attachments to this issue paper be conducted in *Executive Session* because discussion of *specific audit plans, internal controls, and/or confidential company data* constitutes a discussion of *internal rules and procedures*.
  - (3) **a6** – Action on One USAC Internal Audit Division Operational Audit Report. USAC management recommends that this matter be discussed in *Executive Session* because the report relates to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.

- (4) **i2** – Executive Session with USAC’s Vice President of Internal Audit. USAC management recommends that this matter be discussed in *Executive Session* pursuant to the guidelines in the approved Audit Committee Charter.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

**RESOLVED**, that the USAC Audit Committee hereby approves: (1) the Committee meeting minutes of October 23, 2017, and (2) discussion in *Executive Session* of the agenda items noted above.

- a2. Recommendation for Election of Committee Chair and Vice Chair.** Mr. Mason, Chair of the Nominating Committee, provide the Nominating Committee’s recommendations for Chair and Vice Chair of the Audit Committee.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

**RESOLVED**, that the USAC Audit Committee recommends that the USAC Board of Directors elects **Geoff Feiss** as Chair and **Atila Tinic** as Vice Chair of the Committee. The term for each position begins immediately upon the election to such position by the Board and ends at such time as the Chair or Vice Chair (as the case may be): (i) is replaced by a successor selected by the Board, (ii) resigns from the Committee or the Board, (iii) is removed by resolution of the Board, or (iv) is no longer a member of the Board (whichever comes first).

- a3. Approval of 2018 Audit Committee Charter.** Mr. Scott presented this item to the Committee, noting that changes to the Audit Committee Charter included additions to the Committee’s responsibilities (incorporating risk management and receiving whistleblower complaints) and alignment of the Committee’s responsibilities around financial internal control reporting with the Chief Financial Officer.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

**RESOLVED**, that the USAC Audit Committee, having reviewed the current Audit Committee Charter and the proposed changes presented by the USAC Internal Audit Division, hereby accepts the recommendation of the Audit Committee and approves the revised Audit Committee Charter.

- i1. USAC Internal Audit Division Business Update.** Mr. Scott presented an update on the status of audit activities performed under the Beneficiary and Contributor

Audit Program (BCAP), the Payment Quality Assurance (PQA) Program's improper payment results, and USAC Corporate Assurance audits. In addition, Mr. Scott discussed the comparison of various data points between random audit plans to risk-based audit plans

At 8:34 a.m. Eastern Time, on a motion duly made and seconded, the Committee moved into *Executive Session* for the purpose of discussing the confidential items noted above.

### **EXECUTIVE SESSION**

- a4. Annual Review of the Adequacy of USAC's System of Internal Controls by the USAC Internal Audit Division.** Mr. Scott presented this item for consideration, noting that there are systems in place to ensure compliance with policies, procedures and Federal Communications Commission (FCC) regulations.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

**RESOLVED**, that the USAC Audit Committee accepts the review of the adequacy of USAC's system of internal controls performed by the USAC Internal Audit Division.

- a6. Action on One USAC Internal Audit Division Operational Audit Reports.** Ms. Anderson presented this item for consideration. The operational audit report pertained to vendor management practices and involved review of the policies, procedures and related controls associated with USAC's vendor management process. The report also identified areas of internal control weaknesses and made recommendations for improvement.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

**RESOLVED**, that the USAC Audit Committee, having reviewed the USAC Internal Audit Division Vendor Management Report, accepts the recommendations of USAC management and hereby deems the report final.

At 8:41 a.m. Eastern Time, the meeting continued in *Executive Session* with only members of the Board, Ms. Sekar, and Mr. Scott present for the purpose of discussing item a5.

- a5. Approval of the 2018 Internal Audit Plan.** This item was tabled for further review and will be added to the April 23, 2018 agenda for consideration.

At 9:10 a.m. Eastern Time, the meeting continued in *Executive Session* with only members of the Committee and Mr. Scott.

- i2. Executive Session with USAC’s Vice President of Internal Audit.** Mr. Scott and the Audit Committee discussed this item.

At 9:30 a.m. Eastern Time, on a motion duly made and seconded, the Committee moved out of *Executive Session* and immediately reconvened in *Open Session*, at which time Mr. Gillan reported that in *Executive Session*, the Committee took action on items a4, a5 and a6 and discussed item i2.

On a motion duly made and seconded, the Committee adjourned at 9:31 a.m. Eastern Time.

/s/ Ellis Jacobs  
Secretary

**ATTACHMENT C**  
**USAC INTERNAL AUDIT DIVISION ASSESSMENT**  
**OF USAC'S PROCESSES FOR COMPLIANCE**  
**WITH APPLICABLE LAWS AND REGULATIONS**

Overview

The Universal Service Administrative Company (USAC) is a private, not-for-profit corporation, organized under the laws of Delaware. In 1998, pursuant to federal regulation, the Federal Communications Commission (FCC or Commission) designated USAC as the permanent Administrator of the federal Universal Service Fund (USF) and the four federal Universal Service Support Mechanisms the USF supports, including the High Cost, Low Income (Lifeline), Schools and Libraries (E-Rate), and Rural Health Care programs.<sup>1</sup> Pursuant to Section 254 of the Communications Act of 1934, as amended,<sup>2</sup> and Part 54 of the Commission's rules,<sup>3</sup> USAC administers the USF and the Universal Service Support Mechanisms, including performing the billing, collection, and disbursement (BC&D) functions. The policies and procedures followed by USAC are documented and executed in accordance with these rules, Commission orders, FCC staff directives, and other applicable law.

Following is an overview of the methods employed by USAC to verify compliance with applicable laws and regulations. This document does not list every step or procedure or provide detailed information, as we do not want to compromise the integrity of our operating procedures or disclose proprietary information.

Universal Service Support Mechanisms and the Universal Service Fund

The processes established for management of the USF and each of the support mechanisms are designed to comply with Part 54 of the Commission's rules, and, in particular, 47 C.F.R. §§ 54.700-717. Section 54.717 provides that USAC shall obtain and pay for an annual audit conducted by an independent auditor to examine its operations and books of account to determine whether USAC is properly administering the Universal Service Support Mechanisms.<sup>4</sup> The annual audit encompasses: (i) an audit of the financial statements of USAC; and (ii) an agreed-upon procedures (AUP) review of operations for compliance with the FCC's rules, including a review of internal controls for accounting and administration. The AUP review covers the USF, the support mechanisms and related BC&D functions, and other administrative areas of USAC, corporate governance, anti-fraud measures, audit follow-up and disbursements to name a

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<sup>1</sup> See 47 C.F.R. § 54.701(a); *Changes to the Board of Directors of the National Exchange Carrier Association, Inc. et al.*, CC Docket Nos. 97-21 *et al.*, Third Report and Order, Fourth Order on Reconsideration, and Eight Order on Reconsideration, 13 FCC Rcd 25058, 25069-70, para. 20 (1998).

<sup>2</sup> 47 U.S.C. § 254.

<sup>3</sup> See generally 47 C.F.R. pt. 54.

<sup>4</sup> See 47 C.F.R. § 54.717.

few. A section of the AUP verifies compliance with USAC policies and procedures and FCC rules and directives.

FCC rules provide that in choosing an auditing firm to conduct the annual audit, USAC shall not “engage an independent auditor that has been involved in designing the accounting or reporting systems under review in the audit.”<sup>5</sup> The independent audit provides an outside review as to whether the procedures used by USAC in administering the USF, the support mechanisms and related BC&D functions are in compliance with FCC rules. This is a major component of USAC’s program to determine compliance with FCC rules. The AUP document is revised annually by USAC and FCC staff to include testing compliance with new applicable rules and directives implemented over the past year.

All of the FCC-mandated financial audits of USAC conducted to date have resulted in “clean” financial audit opinions, and the agreed-upon procedure reviews have not resulted in findings that USAC failed to comply with applicable FCC directives with the exception of the AUP completed for 2016. The AUP operational review disclosed one item of significance under the audit procedures related to Corporate Governance. USAC management has completed or initiated action to address and comply with all recommendations in PwC’s reports concerning that finding.<sup>6</sup>

USAC staff for each of these areas is knowledgeable in applicable FCC rules, and staff reviews the rules to verify operating processes are compliant. In addition, the management of each area regularly communicates with FCC staff to seek guidance and discuss implementation issues to determine whether USAC is implementing the rules as intended by the Commission.

#### Universal Service Administrative Company

##### *A. Office of the General Counsel*

USAC’s Office of the General Counsel (OGC) advises the company concerning compliance with applicable laws and regulations. The OGC regularly consults with USAC management concerning compliance with local, state and federal laws applicable to USAC’s operations. The USAC General Counsel is a member of the company’s senior leadership group. USAC attorneys assist USAC programmatic and administrative groups (including Internal Audit) when requested on matters dealing with FCC rules and directives as well as on issues not addressed in the rules or directives. The OGC utilizes outside counsel and other information resources as needed. USAC attorneys also attend continuing education and other professional development programs throughout the year.

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<sup>5</sup> 47 C.F.R. § 54.717(c).

<sup>6</sup> See aAC02cf 072417 Acceptance of 2016 Annual Audit.

### Memorandum of Understanding (MOU)

An MOU was executed on September 9, 2008 between USAC and the FCC and was amended on November 4, 2014. The FCC and USAC began initial negotiations for a new MOU in summer 2015, with more formal negotiations occurring in fall 2015 and were finalized in May 2016. The new MOU is a streamlined framework memorializing the FCC's and USAC's partnership to achieve success in the federal Universal Service Fund (USF) and its programs.

The MOU recognizes USAC as responsible for the efficient, effective, and competitively neutral management of the USF including:

- Providing a consistently positive stakeholder experience.
- Producing timely and relevant data and analysis to inform the Commission's policy-making and oversight of the USF.
- Educating stakeholders to promote successful participation in the USF programs.

Also, it provides greater flexibility to FCC and USAC management of the USF programs in alignment with the success model. The revised MOU was signed on May 2, 2016.

#### B. Human Resources (HR)

USAC's Chief Human Resources Officer is responsible for administering USAC's Human Resources (HR) policies and procedures in accordance with applicable employment laws and practices. To accomplish this task, HR is a member of various professional associations that monitor and provide nationwide employment law references and best practices. USAC's OGC has access to expertise in labor and employment law matters and has arranged with outside counsel for assistance when needed. To promote compliance with applicable employment laws and regulations, USAC managers who supervise staff are required to attend management training seminars. In addition, all USAC employees are required to attend an annual ethics training provided by HR and the OGC.

#### C. Internal Audit Division

USAC's Internal Audit Division (IAD) provides objective and independent testing for the support mechanism administrative groups, Information Technology and the Finance Division. As IAD conducts various operational, beneficiary and contributor revenue audits and Payment Quality Assurance (PQA) reviews, one of the primary purposes of each audit and PQA review is to test compliance with FCC rules and directives and other applicable law. The division works closely with USAC's OGC, the FCC Office of Inspector General (OIG), and the FCC Office of Managing Director (OMD) on many of the audits.

Summary

USAC policies and procedures for administering the USF and the support mechanisms are designed to comply with applicable Commission rules and orders and FCC staff directives. Since 1998, USAC has consistently received “clean” financial audit opinions and the results of our operational reviews to test compliance with program rules have not identified any violations of applicable law.<sup>7</sup> In addition, through the efforts of USAC’s OGC, IAD, and HR divisions, ongoing compliance with applicable laws and rules is monitored and assessed.

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<sup>7</sup> We note that USAC management is aware of one area in which it is not in full compliance with applicable law. USF accounting is not fully compliant with Generally Accepted Auditing Principles applicable to government entities (GovGAAP) as required by 47 C.F.R. § 54.702(n). USAC is working with the FCC to implement the necessary system changes to achieve full GovGAAP compliance. The processes and procedures used by USAC to assess compliance with applicable laws and regulations appropriately identified this issue, and it has been fully disclosed and discussed.

**ATTACHMENT C**  
**USAC INTERNAL AUDIT DIVISION ASSESSMENT**  
**OF USAC'S PROCESSES FOR COMPLIANCE**  
**WITH APPLICABLE LAWS AND REGULATIONS**

Overview

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Following is an overview of the methods employed by USAC to verify compliance with applicable laws and regulations. This document does not list every step or procedure or provide detailed information, as we do not want to compromise the integrity of our operating procedures or disclose proprietary information.

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<sup>3</sup> See generally 47 C.F.R. pt. 54.

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few. A section of the AUP verifies compliance with USAC policies and procedures and FCC rules and directives.

FCC rules provide that in choosing an auditing firm to conduct the annual audit, USAC shall not “engage an independent auditor that has been involved in designing the accounting or reporting systems under review in the audit.”<sup>5</sup> The independent audit provides an outside review as to whether the procedures used by USAC in administering the USF, the support mechanisms and related BC&D functions are in compliance with FCC rules. This is a major component of USAC’s program to determine compliance with FCC rules. The AUP document is revised annually by USAC and FCC staff to include testing compliance with new applicable rules and directives implemented over the past year.

All of the FCC-mandated financial audits of USAC conducted to date have resulted in “clean” financial audit opinions, and the agreed-upon procedure reviews have not resulted in findings that USAC failed to comply with applicable FCC directives with the exception of the AUP completed for 2016. The AUP operational review disclosed one item of significance under the audit procedures related to Corporate Governance. USAC management has completed or initiated action to address and comply with all recommendations in PwC’s reports concerning that finding.<sup>6</sup>

USAC staff for each of these areas is knowledgeable in applicable FCC rules, and staff reviews the rules to verify operating processes are compliant. In addition, the management of each area regularly communicates with FCC staff to seek guidance and discuss implementation issues to determine whether USAC is implementing the rules as intended by the Commission.

### Universal Service Administrative Company

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USAC’s Office of the General Counsel (OGC) advises the company concerning compliance with applicable laws and regulations. The OGC regularly consults with USAC management concerning compliance with local, state and federal laws applicable to USAC’s operations. The USAC General Counsel is a member of the company’s senior leadership group. USAC attorneys assist USAC programmatic and administrative groups (including Internal Audit) when requested on matters dealing with FCC rules and directives as well as on issues not addressed in the rules or directives. The OGC utilizes outside counsel and other information resources as needed. USAC attorneys also attend continuing education and other professional development programs throughout the year.

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<sup>5</sup> 47 C.F.R. § 54.717(c).

<sup>6</sup> See aAC02cf 072417 Acceptance of 2016 Annual Audit.

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The MOU recognizes USAC as responsible for the efficient, effective, and competitively neutral management of the USF including:

- Providing a consistently positive stakeholder experience.
- Producing timely and relevant data and analysis to inform the Commission's policy-making and oversight of the USF.
- Educating stakeholders to promote successful participation in the USF programs.

Also, it provides greater flexibility to FCC and USAC management of the USF programs in alignment with the success model. The revised MOU was signed on May 2, 2016.

### B. Human Resources (HR)

USAC's Chief Human Resources Officer is responsible for administering USAC's Human Resources (HR) policies and procedures in accordance with applicable employment laws and practices. To accomplish this task, HR is a member of various professional associations that monitor and provide nationwide employment law references and best practices. USAC's OGC has access to expertise in labor and employment law matters and has arranged with outside counsel for assistance when needed. To promote compliance with applicable employment laws and regulations, USAC managers who supervise staff are required to attend management training seminars. In addition, all USAC employees are required to attend an annual ethics training provided by HR and the OGC.

### C. Internal Audit Division

USAC's Internal Audit Division (IAD) provides objective and independent testing for the support mechanism administrative groups, Information Technology and the Finance Division. As IAD conducts various operational, beneficiary and contributor revenue audits and Payment Quality Assurance (PQA) reviews, one of the primary purposes of each audit and PQA review is to test compliance with FCC rules and directives and other applicable law. The division works closely with USAC's OGC, the FCC Office of Inspector General (OIG), and the FCC Office of Managing Director (OMD) on many of the audits.

Summary

USAC policies and procedures for administering the USF and the support mechanisms are designed to comply with applicable Commission rules and orders and FCC staff directives. Since 1998, USAC has consistently received “clean” financial audit opinions and the results of our operational reviews to test compliance with program rules have not identified any violations of applicable law.<sup>7</sup> In addition, through the efforts of USAC’s OGC, IAD, and HR divisions, ongoing compliance with applicable laws and rules is monitored and assessed.

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<sup>7</sup> We note that USAC management is aware of one area in which it is not in full compliance with applicable law. USF accounting is not fully compliant with Generally Accepted Auditing Principles applicable to government entities (GovGAAP) as required by 47 C.F.R. § 54.702(n). USAC is working with the FCC to implement the necessary system changes to achieve full GovGAAP compliance. The processes and procedures used by USAC to assess compliance with applicable laws and regulations appropriately identified this issue, and it has been fully disclosed and discussed.

## Universal Service Administrative Company Audit Committee Meeting

### INFORMATION ITEM

#### USAC Internal Audit Division Business Update

##### **Information Presented**

This information paper provides an update on the status of audits conducted by the USAC Internal Audit Division (IAD), and audit activities managed by IAD staff. Audit activities reported in this paper include the Beneficiary and Contributor Audit Program (BCAP), the USAC Payment Quality Assurance (PQA) Program, and USAC audits of company operations referred to as Corporate Assurance.

##### **Beneficiary and Contributor Audit Program (BCAP)**

Audits occurring under BCAP are performed using USAC IAD internal staff and outside audit firms that either: (i) work under USAC IAD supervision in co-source arrangement (staff augmentation) arrangement or (ii) perform audits outside of USAC IAD direct supervision. The audit plans summarized below were developed in coordination with the Federal Communications Commission (FCC) Office of Managing Director (OMD) and, more recently, with the FCC Wireline Competition Bureau (WCB).

##### ***BCAP Audits***

As a reminder, in mid-2013 IAD and FCC OMD staff began discussions on the development of an audit plan that would address fiscal years 2014 and 2015 (audits announced beginning October 1, 2013 through September 30, 2015). This audit plan was developed by selecting entities at random with the goal of concentrating on entities receiving larger federal Universal Service Fund (USF) disbursements.

In early 2015, USAC IAD, in consultation with the FCC OMD and the WCB, jointly developed a new audit program methodology that is designed to focus audit resources on USF participants with the highest risk of noncompliance with FCC rules. Starting with the 2016 audit plan and all subsequent plans, these audit plans are now centered on the following key principles:

- Detect and deter noncompliance;
- Promote and enhance compliance;
- Reduce burden on lower risk carriers; and
- Advance the audit selection process and procedures.

USF participants selected for audit after October 1, 2015, were selected using the risk-based principles noted above. Each year, USAC IAD, OMD, and WCB will meet to discuss updates to the risk methodologies and to make updates to audit procedures and sampling plans.

The combined status of all audits underway from each plan is summarized in the table below.

Audit Plan		Audit Status				Total Audits
Program	Audit Goal	Announced	Fieldwork	Reporting	Final Report Released	
CR	101	1	16	5	62	84
HC	186	0	31	3	117	151
LI	159	0	36	8	108	152
SL	279	9	37	19	198	263
RHC	59	0	1	6	47	54
Total	784	10	121	41	532	704

### ***BCAP Audits – Connect America Fund***

In 1Q2017, USAC IAD began performing audits of the fund components created as a result of various High Cost orders. The objective of these audits is to independently confirm whether High Cost disbursements are accurate and in alignment with the associated FCC requirements. Substantive audit testing for Connect America Fund (CAF) Phase 1 Round 2 and Rural Broadband Experiments are complete and final reports are included under agenda item *aAC03 042318*.

### ***BCAP Audit Plan Business Updates***

An update by audit program area that summarizes key activity is included as **Attachment A and Attachment B** to this briefing paper. These updates provide a summary of the audits in process, an analysis of common audit findings, and the status of corrective action plans. As noted above, the 2016 audit plan marked the beginning of using a risk based approach to audit selection. Included within **Attachment B** is a summary of the key risks identified within completed audits and the associated recommended recovery. Because Attachment B includes specific internal controls, this Attachment is labeled Confidential and Not for Public Disclosure.

## **Payment Quality Assurance (PQA) Program**

The PQA Program collects information from program beneficiaries for the purpose of verifying the accuracy of program disbursements requested and received by beneficiaries. PQA also assists the FCC in meeting its reporting obligations under the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA).<sup>1</sup> The PQA team performs payment verification on randomly selected beneficiaries over a calendar year. Testing calendar year 2017 payments began mid 4Q2017.

The table below provides the number of payments tested for calendar year 2017 (January – December).

### **PQA 2018 Testing (Calendar Disbursements 2017)**

<b>Program</b>	<b>Sample Size</b>	<b>Cases Completed</b>	<b>% Complete</b>	<b>Cases In Progress</b>
High Cost	309	119	39%	190
Lifeline	365	3	<1%	362
Schools & Libraries	443	0	0%	443
<b>Total</b>	<b>1117</b>	<b>122</b>	<b>1%</b>	<b>995</b>

The PQA team is on track to complete all testing by August 31, 2018. Results will be shared with the Committee upon completion of the analysis by the statistician.

## **Corporate Audits**

### ***Financial Audits***

1. *Independent Audit of USAC's 2017 Financial Statements and Agreed-Upon Procedures Review.* As required by 47 C.F.R. § 54.717, a financial statement audit must be conducted by an independent accounting firm to express an opinion on USAC's financial statements as of December 31, 2017. PricewaterhouseCoopers LLP (PwC) has completed testing and timely filed draft audit reports with the FCC as required by the rules.

### ***Operational Audits and Reviews***

1. *USAC Procurement Process Audit.* USAC engaged the audit firm of Crowe Horwath LLP (Crowe Horwath) to perform an audit of USAC's procurement process. The objective of the audit was to audit documentation and evaluate all related processes and internal controls, including all procurement activities from the request for

<sup>1</sup> See The Improper Payments Elimination and Recovery Act of 2012, Pub L. No. 112 -248 (Jan. 10, 2013).

services through payment of invoices for products and services. The objective of this audit is to assess the policies, procedures and related controls associated with the vendor management process. Specifically, our assessment will address:

- Vendor on-boarding / off-boarding;
- Alignment of vendor activity with contract requirements;
- Management oversight of vendor performance / service level agreements;
- Contract change management practices;
- Cost management / resource management practices;
- Vendor access to USAC systems / data; and
- Vendor compliance with applicable USAC policies (including Ethics and Information Security policies).

The audit is in reporting phase, and USAC management is currently drafting responses to the findings.

2. *USAC Compensation Audit.* In addition to the procurement audit, Crowe Horwath has also performed an audit of USAC's compensation policies and procedures. The audit objective was to audit USAC's compensation policies, procedures and practices for officers and employees of the company, including both traditional and non-traditional employees, associated with the activities reflected below.

- The audit was conducted pursuant to the Code of Federal Regulations (CFR) § 54.715 (b), and the Executive Schedule of United States Code (U.S.C.) Title 5, section 5312, as applicable.
- Assessment of the policies, procedures, and practices used to determine the annual rate of pay for officers and employees (traditional and non-traditional), including:
  - Non-regular payments;
  - Bonuses (e.g., cash, stock certificates, or other non-cash negotiable instruments);
  - Severance (final compensation) payments/benefits;
  - Retirement payments; and
  - Other sources of monetary or non-monetary compensation not specifically excluded under the CFR § 54.715 (b).
- Assessment of the policies, procedures and practices used in the hiring, onboarding, promotion, and termination of officers and employees (traditional and non-traditional).

The audit is in the reporting phase, and USAC management is currently drafting responses to the findings.

3. Information Technology Audits/ Reviews. The following limited scope audits were announced in 4Q2017:

- *Business Continuity/ Disaster Recovery* - IAD has completed a limited scope audit of the Business Continuity and Disaster Recovery process and has held closing discussions with management. The purpose of our procedures was to assess the related processes and controls in place to adequately manage an unplanned outage and fully restore essential business operations as required. Management agreed with the findings and is taking corrective action accordingly
- *Configuration and Change Management* - IAD has completed a limited scope audit of Configuration and Change Management (servers). The purpose of our procedures was to assess the related processes and controls in place to adequately manage baseline, approved, and implemented system inventories running the Linux operating system. Management agreed with the findings and is taking corrective action accordingly.
- *Malware and Anti-Virus Protection* - IAD is in the process of performing a limited scope audit of Malware and Anti-Virus Protection processes for USAC's enterprise systems. The purpose of our procedures is to assess the related processes and controls in place to adequately manage the risk posed by malicious programs that could compromise the confidentiality, integrity, or availability of USAC's enterprise systems. Currently, the audit is scheduled for completion by May 2018.

### *Consultative Activities*

1. *A-123 Controls Testing*. IAD is nearing completion of performing independent walk-throughs and detailed testing of the USF Financial Reporting, Fixed Assets, and USAC Financial Reporting processes to assess compliance with A-123 requirements. The purpose of our procedures is to confirm our understanding of the related business processes, assess the design of the associated controls, and to perform testing of key controls as designated by management within the previously-mentioned business areas. Through this process, we are also developing process flow diagrams and advising management and Compliance and Risk staff of suggested modifications to the associated risk assessment, narrative, and/or key control based on the results of our procedures. Additionally, detailed testing efforts are focused on controls classified as Medium to High risk as determined through the risk assessment process. Current A-123 testing is scheduled for completion by April 2018.

# Audit Committee Meeting

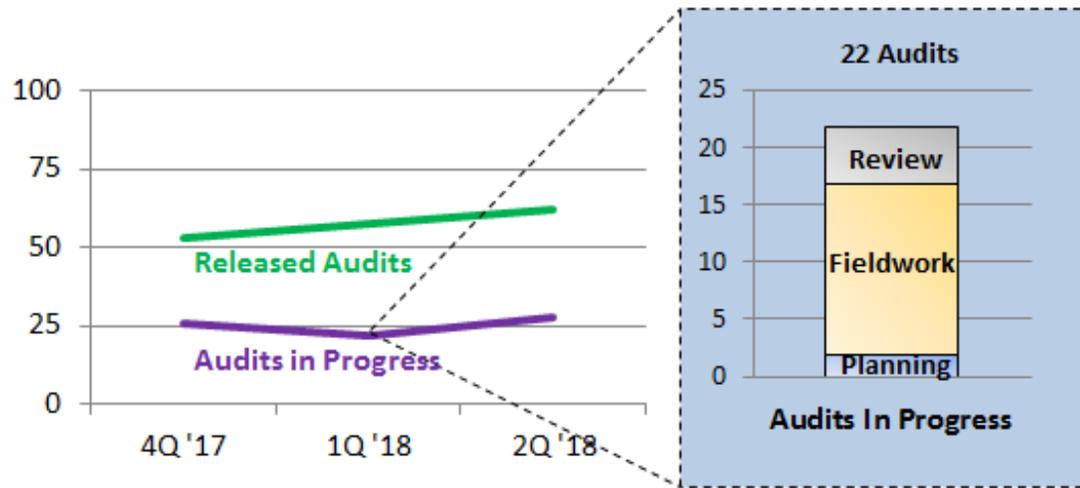
## iAC01 Attachment A

### BCAP Audit Plan Business Update

# Contributor Revenue Business Update

Confidential - All materials discussed in this session

## BCAP Audit Snapshot



## Corrective Action Analysis – 2017 Findings

Top 5 Findings	In Progress Action Plans*	Completed Action Plans*	Target Completion
Non-Telecommunications and Information Service Revenues (CR3)	4	2	12/31/2018
Customer Category – End User vs. Reseller (CR1)	8	6	12/31/2018
Fixed Local Service Revenues (CR2)	6	1	12/31/2018
Toll Service Revenues (CR5)	8	2	12/31/2018
Private Line Revenues (CR4)	6	2	12/31/2018

## Findings Shift: 2016 – 2017

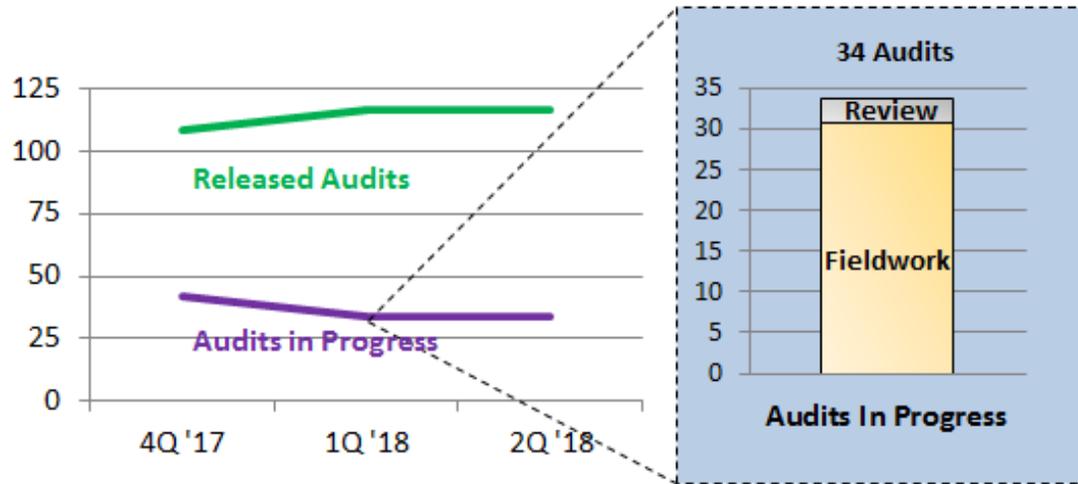
Top 5 Findings [2017 Audits]	2016 Findings	2017 Findings	YoY Shift
Non-Telecommunications and Information Service Revenues	7	26	↑
Customer Category – End User vs. Reseller	3	13	↑
Fixed Local Service Revenues	0	13	↑
Toll Service Revenues	3	12	↑
Private Line Revenues	5	11	↑

\*Action Plan Detail provided in Confidential Appendix

# High Cost Business Update

Bringing back excludes all materials discussed in Executive Session

## BCAP Audit Snapshot



## Findings Shift: 2016 – 2017

Top 5 Findings [2017 Audits]	2016 Findings	2017 Findings	YoY Shift
Lack of / Inadequate Documentation	25	29	↑
Improper Allocation Methodology	13	25	↑
Misclassified Assets, Expenses, and/or Liabilities	15	26	↑
Inaccurate Depreciation Calculation	12	18	↑
Improper / Inaccurate Affiliate Transactions	12	13	↑

## Corrective Action Analysis – 2017 Findings

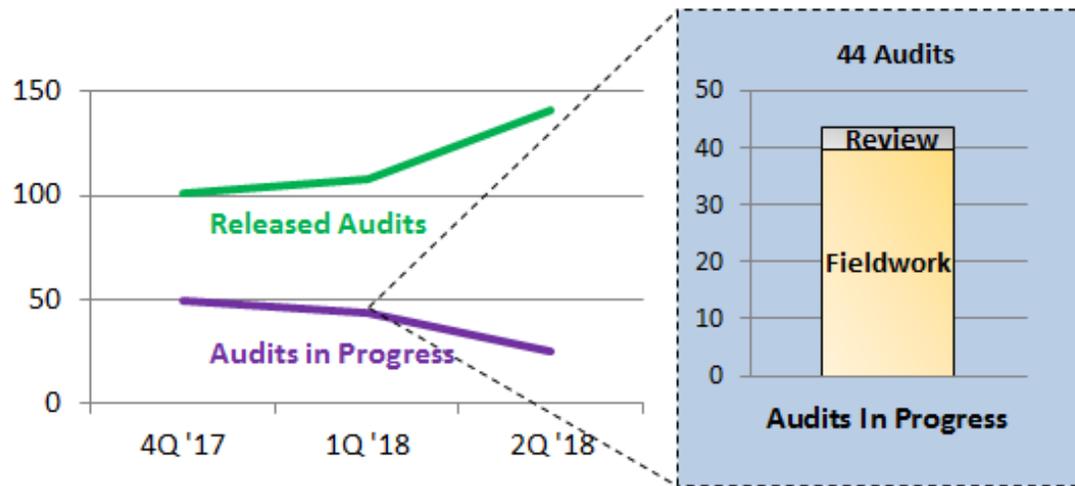
Top 5 Findings	In Progress Action Plans*	Completed Action Plans*	Target Completion
Lack of / Inadequate Documentation (HC5)	0	6	Complete
Improper Allocation Methodology (HC2)	0	6	Complete
Misclassified Assets, Expenses, and/or Liabilities	0	6	Complete
Inaccurate Depreciation Calculation	0	6	Complete
Improper / Inaccurate Affiliate Transactions (HC1)	0	6	Complete

\*Action Plan Detail provided in Confidential Appendix

# Lifeline Business Update

Briefing book excludes all materials discussed in Executive Session

## BCAP Audit Snapshot



## Findings Shift: 2016 – 2017

Top 5 Findings [2017 Audits]	2016 Findings	2017 Findings	YoY Shift
Inaccurate Form 497 Reporting	2	11	↑
Improper Certification and/or Recertification Documentation Disclosures	10	14	↑
Failure to File Form 555	0	2	↑
Improper Recertification Process	5	9	↑
Lack of / Inadequate Documentation	4	13	↑

## Corrective Action Analysis – 2017 Findings

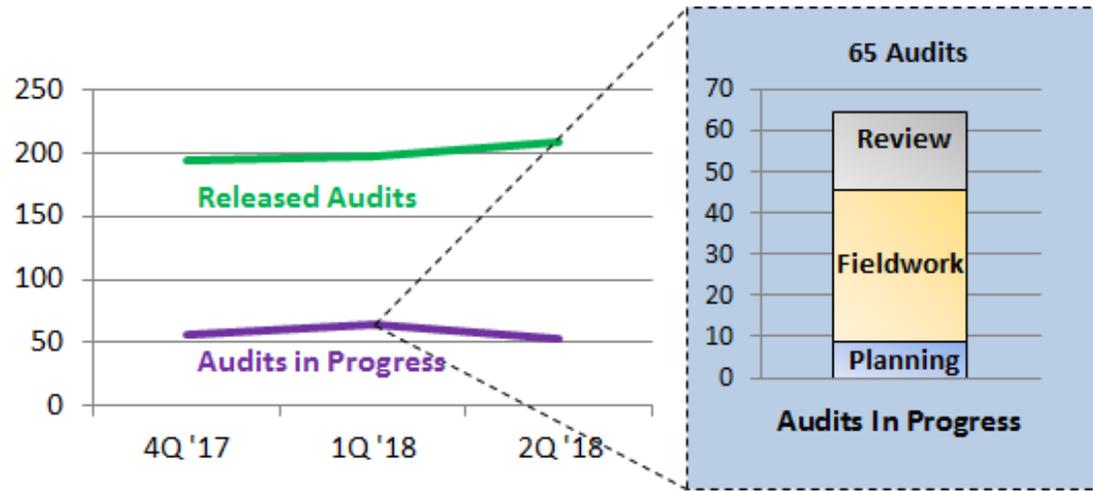
Top 5 Findings	In Progress Action Plans*	Completed Action Plans*	Target Completion
Inaccurate Form 497 Reporting (LL4)	1	3	10/31/2017
Improper Certification and/or Recertification Documentation Disclosures (LL2)	1	4	6/30/2018
Failure to File Form 555	Regulation Change		NA
Improper Recertification Process	Regulation Change		NA
Lack of / Inadequate Documentation	0	3	Complete

\*Action Plan Detail provided in Confidential Appendix

# Schools and Libraries Business Update

Being Booked into the Materials discussed in the session

## BCAP Audit Snapshot



## Corrective Action Analysis – 2017 Findings

Top 5 Findings	In Progress Action Plans*	Completed Action Plans*	Target Completion
Did Not Charge LCP	TBD	TBD	TBD
Competitive Bidding (SL2)	1	7	12/31/2018
Over-Invoicing (SL5)	0	5	Complete
Inaccurate Form 471	TBD	TBD	TBD
Lack of Necessary Resources (SL3)	1	4	5/31/2018

## 2016 – 2017 Findings Shift

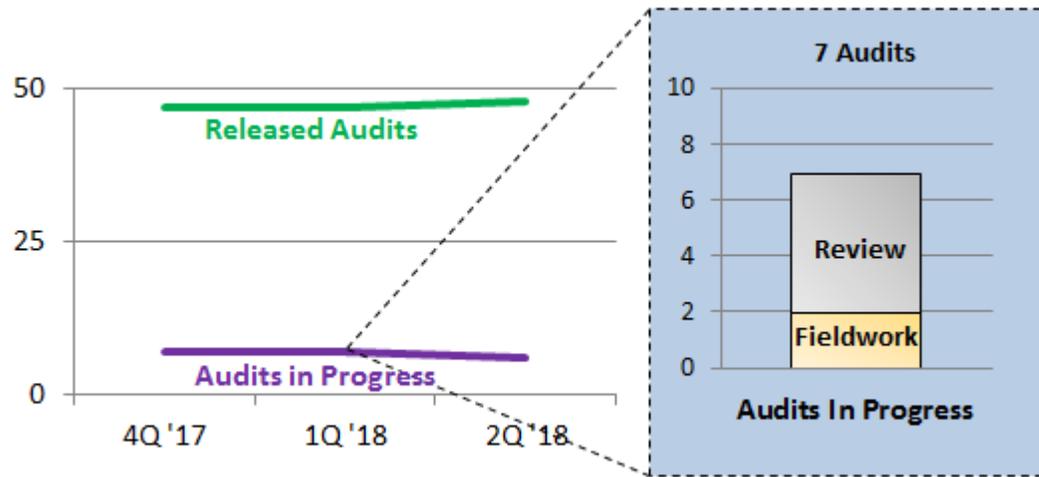
Top 5 Findings [2017 Audits]	2016 Findings	2017 Findings	YoY Shift
Lack of / Inadequate Documentation	11	15	↑
Competitive Bidding	4	6	↑
Over-Invoicing	43	43	↔
Inaccurate Form 471	0	5	↑
Lack of Necessary Resources	1	7	↑

\*Action Plan Detail provided in Confidential Appendix

# Rural Health Care Business Update

Bidding, Procurement, and Materials Issues in Executive Session

## BCAP Audit Snapshot



## Corrective Action Analysis – 2017 Findings

Top 5 Findings	In Progress Action Plans*	Completed Action Plans*	Target Completion
Services and Equipment Not Used for the Provision of Healthcare (RHC5)	3	2	3/31/2018
Untimely Submission of Invoices to RHC	TBD	TBD	TBD
Competitive Bidding (RHC4)	0	3	Complete
Untimely / Lack of notification of service start date	TBD	TBD	TBD
Over-Invoicing	TBD	TBD	TBD

## 2016 – 2017 Findings Shift

Top 5 Findings [2017 Audits]	2016 Findings	2017 Findings	YoY Shift
Services and Equipment Not Used for the Provision of Healthcare	1	1	↔
Untimely Submission of Invoices to RHC	2	1	↓
Competitive Bidding	0	1	↑
Untimely / Lack of notification of service start date	1	0	↓
Over-Invoicing	2	0	↓

\*Action Plan Detail provided in Confidential Appendix