High Cost & Low Income Committee

Audit Reports Briefing Book

Monday, January 27, 2020

2:00 p.m - 5:00 p.m. ET

Universal Service Administrative Company

700 12th Street, NW, Suite 900

Washington, DC, 20005

Summary of High Cost Support Mechanism Beneficiary Audit Report Released: November 6, 2019

Entity Name	Number of Findings	Significant Findings	Amount of Support	Monetary Effect	USAC Management Recovery Action	Entity Disagreement
FairPoint Communications, Inc. **Attachment A**	2	• Inaccurate True-Up Adjustment: Exogenous Cost. The calculations for the reported exogenous costs were calculated using the incorrect base period.	$4,361,088	$19,434	$19,998*	N
Total	**2**		**$4,361,088**	**$19,434**	**$19,998**	

* The USAC Management Recovery Action does not match the Monetary Effect because the audit findings included a monetary effect for several of the carrier's study areas, and USAC does not net audit findings across study areas or disburse additional High Cost support in the event there is an audit finding of an underpayment.

Attachment A

HC2016BE010

Universal Service
Administrative Co.

FairPoint Communications, Inc.

Performance Audit on Compliance with the Federal Universal Service Fund High Cost Support Mechanism Rules

USAC Audit No. HC2016BE010

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Universal Service
Administrative Co.

EXECUTIVE SUMMARY

September 11, 2019

Barbara Galardo, Senior Director
FairPoint Communications, Inc.
One Davis Farm Rd.
Portland, ME 04103

Dear Ms. Galardo:

The Universal Service Administrative Company (USAC) Audit and Assurance Division (AAD) audited the compliance of FairPoint Communications, Inc.[1] (Beneficiary), Connect America Fund Intercarrier Compensation (CAF ICC) disbursements for the year ended December 31, 2015, using the regulations and orders governing the federal universal service high cost support mechanism (High Cost Program), set forth in 47 C.F.R. Parts 32, 36, 51, 54, 64, and 69, as well as other program requirements (collectively, the Rules). Compliance with the Rules is the responsibility of the Beneficiary's management. AAD's responsibility is to make a determination regarding the Beneficiary's compliance with the Rules based on our performance audit.

AAD conducted the audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States (2011 Revision, as amended). Those standards require that AAD plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for its findings and conclusions based on the audit objectives. The 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. The evidence obtained provides a reasonable basis for AAD's findings and conclusions based on the audit objectives.

Based on the test work performed, our examination disclosed two detailed audit findings (Findings), as discussed in the Audit Results and Recovery Action section. For the purpose of this report, a Finding is a condition that shows evidence of non-compliance with the Rules that were in effect during the audit period.

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 Beneficiary, and the Federal Communication Commission (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. This report is not confidential and may be released to a requesting third party.

[1] The Beneficiary, FairPoint Communications, Inc., was acquired by Consolidated Communications.

We appreciate the cooperation and assistance extended by your staff during the audit.

Sincerely,

Teleshia Delmar
USAC Vice President, Audit and Assurance Division

cc: Radha Sekar, USAC Chief Executive Officer
Vic Gaither, USAC Vice President, High Cost Division

AUDIT RESULTS AND RECOVERY ACTION

Audit Results	Monetary Effect & Recommended Recovery[2]
Finding #1: 47 C.F.R. § 51.917(d)(1)(iii) (2015) – Inaccurate True-Up Adjustment: Exogenous Cost. AAD noted that the calculations for the reported exogenous costs were calculated using the incorrect base period.	$17,916
Finding #2: 47 C.F.R. § 51.917(d)(1)(v) (2015) – Inaccurate Intrastate Terminating Switched Access Service Revenues. AAD noted differences between the reported Intrastate Terminating Switched Access Service Revenues and the amounts used in the supporting documentation.	$1,518
Total	**$19,434**

USAC MANAGEMENT RESPONSE

USAC Management concurs with the audit results and will seek recovery from the Beneficiary for the High Cost Program support amount noted in the chart below. Note: USAC's High Cost Program Management does not net findings across SACs and High Cost does not pay additional support in the event of a finding of underpayment.

The Beneficiary must implement policies and procedures necessary to comply with the Rules. USAC recommends that the Beneficiary implement internal controls to ensure correct application of its procedures to ensure compliance with FCC Rules and Orders.

	CAF ICC (A)	USAC Recovery Action (A)[3]
Finding #1	$18,480	$18,480
Finding #2	$1,518	$1,518
Mechanism Total	**$19,998**	**$19,998**

[2] In the table, the recovery amount does not reflect prior period or cap adjustments. The actual recovery amount for this final audit report will not exceed the proposed recovery amount.
[3] *Id.*

PURPOSE, SCOPE AND PROCEDURES

PURPOSE

The purpose of our audit was to determine whether the Beneficiary complied with the Rules.

SCOPE

In the following chart, AAD summarizes the High Cost Program support included in the scope of this audit:

High Cost Support	Data Period	Disbursement Period	Disbursements Audited
Connect America Fund (CAF) Intercarrier Compensation (ICC)	2011-2014	2015	$4,361,088
Total			**$4,361,088**

BACKGROUND

The Beneficiary is a holding company that operates as an eligible telecommunications carrier (ETC) in various states.

PROCEDURES

AAD performed the following procedures:

A. High Cost Program Support Amount

AAD recalculated the support that the Beneficiary received for each High Cost component and determined that there were no more than nominal differences between the amounts received and those recorded in the High Cost system.

B. High Cost Program Process

AAD obtained an understanding of the Beneficiary's processes related to the High Cost Program to determine whether the Beneficiary complied with the Rules. AAD also obtained and examined documentation to determine whether the Beneficiary reported the information in its High Cost data filings consistent with the dates established by the Rules (*i.e.,* month or year-end, as appropriate).

C. Revenues

AAD obtained and examined the general ledger, invoices, and other related documentation to determine whether the Beneficiary reported accurate common line and other revenue balances.

D. Form 481

AAD obtained and examined the Beneficiary's FCC Forms 481 for accuracy by comparing select reported data against the Beneficiary's data files.

DETAILED AUDIT FINDINGS

Finding #1: 47 C.F.R. § 51.917(d)(1)(iii) (2015) - Inaccurate True-Up Adjustment: Exogenous Cost

CONDITION

AAD obtained and examined the Beneficiary's CAF ICC true-up documentation to determine whether the Beneficiary reported accurate exogenous cost amounts for High Cost Program purposes. Because the Beneficiary is a Rate of Return Price Cap affiliate[4] and its Subscriber Line Charge is at the maximum rate, the Beneficiary may report that portion of increases in mandatory Telecommunication Relay Service (TRS), regulatory, and North American Number Plan Association (NANPA) fees in its Eligible Recovery above its 2012 annual access charge tariff filing.[5] In calculating its incremental exogenous cost, the Beneficiary used data from an incorrect base year. Specifically, instead of using data as of 2011 (reported in its 2012 tariff filing), the beneficiary used data as of 2012 (as reported in its 2013 tariff filing). As a result of using data from the 2012 base year, the Beneficiary reported inaccurate exogenous cost amounts in its CAF ICC true-up adjustments for each study area code (SAC in which the Beneficiary reported an exogenous cost amount.

AAD calculated the exogenous cost by determining the incremental increase in the TRS, NANPA, and FCC regulatory fees attributable to switch access and common line rates that were higher than the reported amounts in the Beneficiary's 2012 base year tariff filing and reports the variances in the following table:

SAC	Exogenous Cost Reported to USAC	Exogenous Cost Calculated by AAD	Variance
150078	$4,308	$2,376	$1,932
150084	$16,874	$9,883	$6,991
170185	$1,109	$518	$591
190244	$4,723	$3,305	$1,418
210339	$20,423	$11,873	$8,550

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[4] *See Connect America Fund et al.*, WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17712-13, para. 128, 129 (2011), *aff'd sub nom. In re FCC 11-161*, 753 F.3d 1015 (10th Cir. 2014) (*USF/ICC Transformation Order*) (*stating*, "[i]n CAF Phase I, we freeze support under our existing high-cost support mechanisms— HCLS, SNA, safety valve support (SVS), high-cost model support (HCMS), LSS, interstate access support...for price cap carriers and their rate-of-return affiliates . . . we will for the purposes of CAF Phase I, treat as price cap carriers the rate-of-return operating companies that are affiliated with holding companies for which the majority of access lines are regulated under price caps . . . we will freeze their universal service support and consider them as price cap areas for the purposes of our new CAF Phase I distribution mechanism."); *Id.* at n.203 (*stating*,"[t]his action does not require mandatory price cap conversion for those operating companies, but rather establishes the principle that such companies in the future will receive support based on a forward looking cost model rather than their embedded costs.").

FairPoint is a price cap carrier, but in this instance, is filing for its rate-of-return affiliate(s); the rules applicable to a rate-of-return carrier are slightly different than those relevant to a price cap carrier. *See* 47 C.F.R. § 51.903(g) (defining rate-of-return) and § 51.917(a) (setting forth the revenue recovery rate-of-returns carriers).

[5] *Material to be Filed in Support of 2012 Annual Access Tariff Filings,* WCB/Pricing File No. 12-08, DA 12-575, Order (Wir. Comp. Bur. 2012).

210329	$6,512	$3,285	$3,227
210291	$2,664	$1,565	$1,099
300649	$2,476	$2,058	$418
341004	$670	$373	$297
341009	$547	$265	$282
341065	$1,180	$451	$729
421472	$6,557	$3,630	$2,927
431981	$2,933	$1,961	$972
461835	$510	$1,645	($1,135)
462192	$694	$396	$298
462204	$950	$629	$321
522412	$12,261	$8,714	$3,547
522453	$8,571	$5,178	$3,393
Total	**$93,962**	**$58,105**	**$35,857**

Because the Beneficiary did not use data from the correct base year to calculate its exogenous cost, AAD concludes that the Beneficiary did not correctly report its exogenous cost. The Beneficiary must report accurate exogenous costs for High Cost Program purposes.

CAUSE

The Beneficiary did not have an adequate system in place for collecting, reporting, or monitoring data to report accurate Intrastate Revenues for High Cost Program purposes. The Beneficiary informed AAD that errors were made in transferring data from billing to spreadsheets for reporting.[6]

EFFECT

AAD calculated the monetary effect for this finding by deducting the variance noted above from the exogenous cost amounts reported for each respective SAC for the July to December 2015 disbursement period. The results are summarized below:

Support Type	Monetary Effect & Recommended Recovery[7]
CAF ICC	$17,916[8]

RECOMMENDATION

AAD recommends that USAC Management seek recovery of the recommended recovery amount identified in the Effect section above. The Beneficiary must ensure that it has an adequate system to accurately report data for CAF ICC purposes. Specifically, the Beneficiary must use data from the correct base

[6] *See* Beneficiary Responses to the Exception Summary, dated December 5, 2018.

[7] Under the CAF ICC program rules, USAC disburses funds on a July to June basis, with true-up payments disbursed two years after the program year. [C.F.R. 47 § 51.917(d)(1)(iii)] Thus, USAC disbursed the true-up payment for the 2012–2013 CAF ICC program year from July 2014 to June 2015 (based on data submitted in June 2014) and disbursed the true-up payment for the 2013–2014 CAF ICC program year from July 2015 to July 2016 (based on data submitted in June 2015). In the audit, AAD examined disbursements paid in 2015; therefore, the monetary effect for this Finding accounts for the last six months of the 2012-2013 program year when the true-up payment occurred, from January to June 2015.

[8] Under existing policies, High Cost Program Management rounds down CAF ICC Support to the nearest dollar throughout the calculation. Thus, the monetary effect does not exactly equal half of the variance. *See* Appendix A for the monetary effect by SAC.

year when calculating its exogenous costs to ensure accurate reporting. In addition, the Beneficiary may learn more about documentation and reporting requirements on USAC's website at http://www.usac.org/about/about/program-integrity/findings/common-audit-hc.aspx.

BENEFICIARY RESPONSE

FairPoint (Consolidated Communications) agrees with the finding.

Finding #2: 47 C.F.R. § 51.917(d)(1)(v) (2015) – Inaccurate Intrastate Terminating Switched Access Service Revenues

CONDITION

AAD obtained and examined the Beneficiary's billing reports, general ledger, and Tariff Review Plan data to determine whether the Beneficiary accurately reported the actual payments it received for providing Intrastate Terminating Switched Access Services (Intrastate Revenues).[9] AAD inquired whether the Beneficiary had any bad debts expense that could account for the variance.[10] The Beneficiary was able to reconcile the Intrastate Revenues from its billing reports and general ledger to the Intrastate Revenues it reported for CAF ICC purposes for each SAC except for one, SAC 150084, for which the Intrastate Revenues identified on the Beneficiary's billing reports and general ledger did not agree to what the Beneficiary reported for CAF ICC purposes. AAD summarizes the differences are summarized below:

SAC	Intrastate Revenues	Program Year July 2012 - June 2013
150084	As Reported to USAC for CAF ICC Purposes	$536,272
	Per the Billing Reports	$539,310
	Per the General Ledger (Intrastate Terminating Portion)	$539,313

Because the Beneficiary's supporting documentation (the billing report or the general ledger) did not agree to what the Beneficiary reported to USAC for SAC 150084, AAD concludes that the Beneficiary did not report accurate Intrastate Revenues. Thus, AAD concludes that the CAF ICC true-up amount paid to the Beneficiary was not accurate. The Beneficiary must report accurate Intrastate Revenues for CAF ICC purposes.

CAUSE

The Beneficiary did not have an adequate system in place for collecting, reporting, or monitoring data to report accurate Intrastate Revenues for High Cost Program purposes. The Beneficiary informed AAD that it

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[9] *See* 47 C.F.R. 51.917(d)(1)(v) (explaining the eligible recovery for rate-of-return carriers).

[10] The Beneficiary responded that the variance was not material enough to require further research. *See* email from Barbara Garlardo, Senior Director, FairPoint, to AAD, Cost and Access Tariffs, dated June 26, 2019.

agrees with the finding because it overstated the discounts that it had provided to its customers, thus reducing the amount reported to USAC for CAF ICC purposes.[11]

EFFECT

AAD relied on the Interstate Revenues identified on the Beneficiary's general ledger to perform a reconciliation for SAC 150084 in which the amounts did not agree to what was reported.[12] The difference between the Intrastate Revenues recorded in the general ledger to the Intrastate Revenues reported for SAC 150084 is $3,041 ($539,313 - $536,272).

Support Type	Monetary Effect & Recommended Recovery[13]
CAF ICC	$1,518[14]

RECOMMENDATION

AAD recommends that USAC management seek recovery of the recommended recovery amount identified in the Effect section above. The Beneficiary must ensure that it has an adequate system to report accurate data for High Cost Program purposes and maintain documentation to demonstrate compliance with the Rules. In addition, the Beneficiary may learn more about documentation and reporting requirements on USAC's website at http://www.usac.org/about/about/program-integrity/findings/common-audit-hc.aspx.

BENEFICIARY RESPONSE

FairPoint, now Consolidated Communications, agrees with the finding.

[11] *See* Beneficiary Responses to the Audit Inquiries Record, dated March 16, 2018.

[12] AAD relied on the general ledger because the Beneficiary's billing reports included the original charges, whereas, its general ledger included the original charges, as well as, other charges and credits.

[13] *See supra* n.6.

[14] *See supra* n.7.

CRITERIA

Finding	Criteria	Description
#1	47 C.F.R. § 51.917(d)(1)(iii) (2015)	Beginning July 1, 2014, a Rate-of-Return Carrier's eligible recovery will be equal to the 2011 Rate-of-Return Carrier Base Period Revenue multiplied by the Rate-of-Return Carrier Baseline Adjustment Factor…
#1	*USF/ICC Transformation Order*	In CAF Phase I, we freeze support under our existing high-cost support mechanisms— HCLS, SNA, safety valve support (SVS), high-cost model support (HCMS), LSS, interstate access support…for price cap carriers and their rate-of-return affiliates" and "…we will for the purposes of CAF Phase I, treat as price cap carriers the rate-of-return operating companies that are affiliated with holding companies for which the majority of access lines are regulated under price caps. That is, we will freeze their universal service support and consider them as price cap areas for the purposes of our new CAF Phase I distribution mechanism."). The FCC stated, "this action does not require mandatory price cap conversion for those operating companies, but rather establishes the principle that such companies in the future will receive support based on a forward looking cost model rather than their embedded costs.
#1	47 C.F.R. § 51.903(g) (2015)	*Rate-of-Return Carrier* is any incumbent local exchange carrier not subject to price cap regulation as that term is defined in § 61.3(bb) of this chapter, but only with respect to the territory in which it operates as an incumbent local exchange carrier.
#1	47 C.F.R. § 51.917(a)(2015)	*Scope.* This section sets forth the extent to which Rate-of-Return Carriers may recover, through the recovery mechanism outlined in paragraphs (d) through (f) of this section, a portion of revenues lost due to rate reductions required by § 20.11(b) of this chapter, and §§ 51.705, 51.909.
#1	*In the Matter of Material to be Filed in Support of 2012 Annual Access Tariff Filings,* WCB/Pricing File No. 12-08, DA 12-575, Order, (Wir. Comp. Bur. 2012)	For the purposes of including an increase in a mandatory fee in the SLC, price cap carriers will be permitted to raise the SLC to the maximum level permitted pursuant to sections 69.152(d)(1)(ii), 69.152(e)(1)(i), and 69.152(k)(1)(i) of the Commission's rules, and rate-of-return carriers will be permitted to raise the SLC to the maximum level permitted pursuant to sections 69.104(n)(1)(ii)(c) and 69.104(o)(1)(i) of the Commission's rules. However, if the carrier is already at the maximum SLC level, the carrier will be permitted to include that portion of increases in mandatory TRS, regulatory, or NANPA fees associated with a rate that is capped in their Eligible Recovery for the 2012 annual access charge tariff filing.
#2	47 C.F.R. § 51.917(d)(1)(v) (2015)	If a Rate-of-Return Carrier receives payments for intrastate or interstate switched access services or for Access Recovery Charges after the period used to measure the adjustments to reflect the differences between estimated and actual revenues, it shall treat such payments as actual revenue in the year the payment is received and shall reflect this as an additional adjustment for that year.

Appendix A

Supplemental Information for Finding #1 – Monetary Effect by SAC

Finding #1: Exogenous Cost					
	SAC	Exogenous Cost Reported to USAC	Exogenous Cost Calculated by AAD	Variance	Audit Period Monetary Effect
Berkshire	150073	$ -	$ -	$ -	$ -
Chautauqua	150078	$ 4,308	$ 2,376	$ 1,932	$ 966
Taconic	150084	$ 16,874	$ 9,883	$ 6,991	$ 3,498
Marianna & Scenery	170185	$ 1,109	$ 518	$ 590	$ 294
People's Mutual	190244	$ 4,723	$ 3,305	$ 1,418	$ 714
St Joe	210339	$ 20,423	$ 11,873	$ 8,550	$ 4,272
Perry	210329	$ 6,512	$ 3,285	$ 3,227	$ 1,614
Florala	210291	$ 2,664	$ 1,565	$ 1,099	$ 552
The Orwell Tel	300649	$ 2,476	$ 2,058	$ 418	$ 204
El Paso	341004	$ 670	$ 373	$ 297	$ 144
C-R	341009	$ 547	$ 265	$ 282	$ 138
Odin	341065	$ 1,180	$ 451	$ 729	$ 360
Sunflower Tel	411835	$ -	$ -	$ -	$ -
FairPoint Missouri	421472	$ 6,557	$ 3,630	$ 2,927	$ 1,464
Chouteau	431981	$ 2,933	$ 1,961	$ 973	$ 486
Sunflower CO	461835	$ 510	$ 1,645	$ (1,135)	$ (564)
Big Sandy	462192	$ 694	$ 396	$ 298	$ 150
Columbine	462204	$ 950	$ 629	$ 321	$ 156
Ellensburg	522412	$ 12,261	$ 8,714	$ 3,547	$ 1,776
YCOM	522453	$ 8,571	$ 5,178	$ 3,393	$ 1,692
Totals		**$ 93,962**	**$ 58,105**	**$ 35,857**	**$ 17,916**