Federal Communications Commission
Washington, DC

Schools and Libraries Universal Service Support Mechanism	:	
	:	CC Docket No. 02-6
Universal Service Administrative Company's Audit Resolution Plan	:	

COMMENTS OF THE STATE E-RATE COORDINATORS ALLIANCE

I. Introduction and Background

The State E-rate Coordinators Alliance (SECA) submits these Comments in response to the December 7, 2004 Public Notice (corrected on December 9, 2004) issued by the Wireline Competition Bureau at DA 04-3851. The Public Notice invites interested parties to file Comments regarding the Universal Service Administrative Company's (USAC) Proposed Audit Resolution Plan for Schools and Libraries Support Mechanism Auditees (Audit Plan). USAC submitted the Audit Plan in response to the FCC's directive in its Fifth Report and Order.[1]

SECA members comprise the state E-rate coordinators responsible for disseminating programmatic information to E-rate applicants and other stakeholders in their respective states. SECA members are intimately familiar with the operational details of the E-rate program as they are called upon to respond to applicants' questions on a daily basis and to facilitate applicants' participation in the program. By serving in the field, SECA members are very aware of the impact of FCC rules and procedures on E-rate applicants.

We commend the FCC and USAC for expending the resources necessary to develop a comprehensive process for addressing the audit findings contained in audit reports. As the FCC pointed out in the Fifth Report and Order, audits are being conducted by numerous entities – the FCC's Inspector General, USAC's Internal Audit Division or by independent public accounting firms on contract to USAC.

[1] CC Docket No. 02-6, FCC 04-190 (released August 13, 2004)(hereinafter referred to as "Fifth Report and Order").

By establishing a unified audit resolution plan, audited parties should be subject to the same set of resolution procedures regardless of which organization conducted the audit.

We fully support the FCC's and SLD's efforts to assure that applicants and service providers are in compliance with the E-rate program rules. We recognize that audits of beneficiaries and service providers are an important component in assuring that the integrity of the E-rate program is maintained and preserved. We are well aware of the detrimental effect of adverse publicity concerning instances of fraud, waste or abuse of E-rate funds. These non-compliant stakeholders raise concerns that reverberate through the program about the accountability for the program's vital resources. We concur with the FCC's assessment that audits will help to insure that the E-rate resources are monitored sufficiently to thwart fraud, waste or abuse.

At the same time, we implore the Commission to establish fair procedures that concentrates the available audit resources on identifying ambiguities in the program rules that prompt the FCC to issue the appropriate guidance and clarification, and encourages compliance with program rules. Based on our collective experiences of interacting with applicants and other stakeholders on a daily basis, we are firmly of the view that the vast majority of applicants work very hard to comply with the program rules. In most instances where an applicant may be out of compliance, the applicant is guilty of nothing more than a mistake committed in good faith, not an intentional misdeed.

While the USAC Audit Plan is a good first step in developing consistent audit resolution procedures, the Plan is sorely lacking in details and information that is critical to assure that applicants are afforded an appropriate opportunity to provide their views when SLD attempts to resolve a beneficiary audit.

II. Audited Entities Must Have The Right To Submit Comments To The Draft And Final Audit Reports And These Comments Should Be Submitted To The USAC Board.

The Fifth Report and Order specifically directed that USAC's Audit Resolution Plan must encompass all audits conducted by USAC's internal audit department, independent public accounting firms under

contract with USAC, or government audit organizations.[2] Moreover, the FCC prescribed that the audit resolution plan must be consistent with government auditing standards. Specifically, the FCC directed:

> USAC's audit resolution plan should be consistent with government auditing standards by, for example, providing a formal process for informing audited beneficiaries of the audit results (*e.g.*, submitting a draft audit report to the audited beneficiary for comment, affording an opportunity to provide formal written comments to the final audit report, etc).[3]

This critical protection, e.g., the establishment of a formal process to discuss and receive written comments from the audited entity on the final audit report, is not sufficiently detailed in the Audit Plan. The only mention of providing the audited entity with an opportunity to comment on the draft audit report is the following sentence: "The auditors perform the fieldwork, draft audit findings, discuss audit findings with the applicant, and draft the report." USAC Audit Plan at 2. There is absolutely no mention – as the FCC directed – that audited entities be given the opportunity to submit written comments to the draft audit report. This omission should be corrected, and the audit plan should be revised so as to confirm that audited entities must be given a sufficient opportunity to submit written comments to the draft audit report.

Likewise, in the section explaining how it proposes to resolve audit findings, the SLD indicates that there are three possible final outcomes to each audit finding: (1) audit finding is cleared; (2) finding is determined not to be a rule violation; or (3) finding is determined to be a rule violation. USAC Audit Plan at 3-4. The audit plan does not make clear whether SLD has notified the audited party of the proposed disposition of each finding prior to finalizing the disposition of each finding. In other words, it is not clear whether the draft audit report—which definitely should be shared with the audited party—contains a proposed disposition of each finding. It is imperative, therefore, that the USAC audit plan be revised so as to make clear that in addition to being required to share the draft audit report with the audited party, the SLD is explicitly required to share the proposed disposition of each audit finding with the audited party so that the audited party has an opportunity to comment.

The proposed approach for presenting the audit report to the USAC Board of Directors similarly lacks the specificity required to assure that the audited party's comments are circulated to the Board. The audit plan indicates that the SLD Internal Audit Division will prepare an executive summary of each audit report prepared by outside auditors, and the SLD will prepare a management response to the audit

[2] *Id.* at ¶ 74.
[3] *Id.* at n.133.

report. Importantly, however, there is no mention of the opportunity for the party who was subject to the audit to prepare and submit the party's response to each audit finding. Again, this is patently unfair because it fails to allow the "voice" of the audited party to be heard (or reviewed) by the Board of Directors. At a minimum, USAC should be required to circulate to the Board the audited party's response or comments to the draft and final reports in order for the Board to be informed of *all* relevant information of *all* stakeholders to the audit—and not just the information prepared by USAC and/or the auditor.

III. Audit Findings Of Program Rule Violations Must Be Based On The Rules Then In Effect During The Time Period Under Review In The Audit.

USAC's audit plan indicates the possibility that an audited entity could receive a finding of program non-compliance based on violations of rules that were not in effect during the time period under review in the audit. USAC states, "For example, if an audit report contains a finding based on a rule violation, but the rule was not in effect during the relevant year, that finding will be clarified in the report." SECA strongly urges that the FCC and SLD should take care to inform auditors of the program rules and FCC Orders that were in effect during the time period being audited. These rules and Orders should serve as the basis for conducting an audit. It makes little sense to conduct a compliance audit using rules and orders promulgated *after* the time period covered in the audit. These later materials were not available to inform and guide the audited entity's behavior during the time period being audited. If these later materials are used to evaluate the audited entity's behavior, the auditors are unfairly holding the audited entity to a higher standard of compliance retroactively. Moreover, the rules and orders that the FCC promulgates concerning the E-rate program typically are applied on a prospective basis only. If these later rules and orders are used to gauge whether an audited entity committed a rule infraction during a prior period, the FCC rules and orders will be given retroactive effect in violation of the clear language of those orders.

For example, prior to the close of the Funding Year 2004 application filing window, the FCC clarified that dark fiber no longer was eligible for E-rate discounts. During prior funding years, the FCC and SLD had determined that dark fiber service was eligible for discounts. If an applicant was audited for the Funding Year 2003, according to the USAC audit plan, the applicant could receive an adverse finding

concerning its dark fiber agreement since current program rules do not allow dark fiber service to be eligible for discounts. The USAC audit plan seems to suggest that this finding would be clarified in the audit report and determined not to be a program rule violation. It does not make any sense, however, for this situation to produce *any* finding – even if the finding is cleared – because the program rule was not in effect during the time period being audited.

Not even a clarification or clearance of this finding will dispel the implication that an applicant did something wrong – when in fact the applicant did nothing wrong by virtue of obtaining E-rate discounts on a dark fiber service agreement prior to Funding Year 2004. The Commission should keep in mind that the dark fiber scenario is just one example of the unfair result of the SLD's proposed audit plan. This unjust result will occur any time the auditors make a finding based on rules and orders promulgated after the time period that is being audited, and that are given retroactive application. The scope of the audit is unfairly enlarged, and the auditors' valuable resources are not expended wisely, when an audit is conducted using later issued FCC orders and rules. Applying current rules to a prior period in time penalizes applicants who were not clairvoyant and could not predict and comply with future program rule clarifications. The FCC should correct and clarify that auditors should rely on the program rules and orders that were issued and available during the time period for which an entity is audited.

IV. The SLD Should Be Required To Resolve Audit Findings Using Information That Is Currently Available To The SLD Without Seeking Any Clarification Or Policy Guidance From The FCC.

The proposed Audit Plan indicates that in making a determination of whether an audit finding is a program rule violation, the SLD intends to seek guidance from the FCC's Wireline Competition Bureau (WCB) if the SLD is uncertain whether a particular situation constitutes a rule violation.[4] SECA firmly believes that the SLD should make its resolution based on the same information that was available to E-rate stakeholders during the time period under review in the audit. It is patently unfair for the SLD to confer with the FCC, and to then conclude—based on the additional clarification provided by the FCC, that a program rule was violated. Indeed, this scenario illustrates the potential inequity of the SLD's

[4] USAC Audit Plan at 3.

application of rules or policy clarifications which were provided *after* the time period being audited. Surely if the SLD itself requires policy guidance and clarification of the rules from the FCC, applicants and other entities cannot be held accountable for complying with whatever new policy guidance that the FCC provides to the SLD. Yet this is the precise outcome that is contemplated to occur under the USAC proposed audit plan. Engaging in 20/20 hindsight in determining that a particular action or conduct constitutes a program rule violation does little to encourage program compliance and instead converts the auditing process into a quest to find violations.

V. The FCC And The SLD Should Clarify The *De Minimis* Standard Governing SLD's Actions For Recovery Of Improperly Disbursed Funds.

The Fifth Report and Order recognized that there is some threshold amount of improperly disbursed funds below which it is not economically feasible for USAC to seek recoupment. As the FCC stated:

> We conclude that it does not serve the public interest to seek to recover funds associated with statutory or rule violations when the administrative costs of seeking recovery outweigh the dollars subject to recovery.[5]

Accordingly, the FCC directed USAC to not seek recovery of such "de minimis" amounts.[6] The FCC further directed USAC to "to provide the Wireline Competition Bureau and the Office of Managing Director sufficient information regarding the administrative costs of seeking recovery of improperly disbursed funds so that a *de minimis* amount can be determined."[7]

To SECA's knowledge, there has been no public announcement of the *de minimis* amount and there is no mention of this requirement in the USAC audit plan. So as to conserve and funnel USAC's limited resources, SECA encourages the FCC to resolve this matter promptly as part of the FCC's review of the USAC audit plan. While not privy to USAC's costs of seeking recovery of improperly disbursed funds, SECA members are familiar with the multi-step procedure that is contemplated. SECA suggests that the *de minimis* floor should be set not lower than $2,500. This amount is rather conservative given that the following steps (as well as other work efforts that must be purposefully withheld from public view

[5] *Id.* at ¶37.
[6] *Id.*
[7] *Id.*

such as coordinating communications with law enforcement officials) may be required in seeking recovery of improperly disbursed funds:

- Quantification of the amount of improperly disbursed funds based on final audit report.
- Prepare revised funding commitment decisions letter to implement recovery of improperly disbursed funds.
- Respond to any appeal that a recipient of a recovery of improperly disbursed funds (RIDF) may file.
- Issue demand notification letters.
- Refer matter to FCC for collection and notify FCC that the recipient of the RIDF letter should be put on red light.
- Prepare semiannual report of SLD activities relating to audits including RIDF actions. (A proportionate amount of these costs should be allocated to each separate RIDF action).
- Prepare advisory reports to apprise USAC board of RIDF activities. (A proportionate amount of these costs should be allocated to each separate RIDF action).

Although each of these steps may not be required for each RIDF action, on average, the time required is significant, and the associated work effort would appear to be valued at a minimum, $2,500.

VI. The SLD Should Be Prohibited From Issuing Demand Letters For Recovery Of Improperly Disbursed Funds While An Appeal Is Pending.

One of the issues on which the SLD has requested FCC guidance is whether the SLD should proceed to issue a demand letter if, after the SLD issued a notification letter advising an audited party of the SLD's conclusion that a program rule violation was committed which resulted in the SLD's improperly disbursing funds, an appeal is taken of the SLD's notification letter. USAC Audit Plan at 6. This issue has very significant implications because once a demand letter is issued, an applicant or service provider risks being put on "red light" if the amount demanded is not paid back to SLD promptly. The SLD's proposed audit plan appropriately suggests that it will refrain from issuing a demand letter if an appeal is filed in response to the SLD's notification of improperly disbursed funds letter. Specifically, the audit plan suggests that if no appeal is received to the notification letter, then SLD will issue a demand payment letter. An appeal filed by an audited party should stay the issuance of a demand payment letter until after the appeal is resolved. This protection assures that the SLD's actions will be reviewed by the FCC prior to the audited party being put on red light.

VII. Conclusion

SECA respectfully requests the FCC to modify the USAC proposed Audit Plan consistent with the Comments set forth above.

Respectfully submitted,

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