Audit of the
Federal Communications Commission
Improper Payments Elimination and Recovery Improvement Act
FY 2019

(Report No. 20-AUD-01-01)
June 15, 2020

FINAL REPORT

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EXECUTIVE SUMMARY

The objective of our performance audit of the Federal Communications Commission (FCC) was to evaluate FCC's compliance with the Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010 and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012, in accordance with the Office of Management and Budget (OMB) Memorandum M-18-20, Appendix C to OMB Circular A-123, *Requirements for Payment Integrity Improvement* (OMB M-18-20).

We determined that FCC was noncompliant with IPERIA criteria defined in OMB M-18-20. According to OMB M-18-20, Inspectors General are required to determine agency compliance with IPERIA criteria based on an assessment of (a) the accuracy and completeness of agency reporting, (b) the agency's performance in reducing and recapturing improper payments, and (c) whether the agency has accurately classified the true root cause of improper payments. The table below identifies FCC's nine programs with funding disbursements that are under the direction of FCC, and the status of FCC's compliance with each of the six IPERIA criteria.

Table 1. FCC IPERIA Compliance Table

Program Name	Published an AFR[1]	Conducted a Risk Assessment	Published an Improper Payment Estimate	Published Corrective Action Plan	Published and is Meeting Reduction Targets	Reported an Improper Payment Rate of Less than 10 Percent
USF – High Cost	Noncompliant	NA	Noncompliant[2]	[3]	[3]	[3]
USF – Schools and Libraries	Compliant	NA	Compliant	Compliant	Noncompliant	Compliant
USF – Lifeline	Noncompliant	NA	Noncompliant[2]	[3]	[3]	[3]
USF – Rural Health Care	Compliant	NA	Compliant	Compliant	N/A[4]	Noncompliant
USF – Administrative Costs	Compliant	Compliant	NA	NA	NA	NA
Interstate Telecommunications Relay Services	Noncompliant	NA	Noncompliant[2]	NA	[3]	[3]
North American Numbering Plan	Compliant	Compliant	NA	NA	NA	NA
FCC Operating Expenses	Compliant	Compliant	NA	NA	NA	NA
TV Broadcasting Relocation Fund	Compliant	Compliant	NA	NA	NA	NA

[1] Agencies should ensure that their Agency Financial Reports (AFRs) or Performance and Accountability Reports (PARs) are complete and accurate. For example, if an agency completes the root cause category matrix, the agency should ensure that the root cause category classification accurately classifies the true root causes of improper payments. OMB Memorandum M-18-20, Part IV.B.2 (a).
[2] When determining compliance, the agency Inspector General should evaluate whether the program improper payment rate estimates are accurate and whether the sampling and estimation plan used is appropriate given program characteristics. OMB Memorandum M-18-20, Part IV.B.2 (c).
[3] Auditors were unable to rely on the improper payment rate reported for the USF-Lifeline Program, Interstate Telecommunications Relay Services Fund, and USF-High Cost Program due to deficiencies identified in Finding No. 2, Finding No. 3, and Finding No. 4 of this report.
[4] FY 2019 is the first fiscal year that FCC is reporting an error rate for USF-Rural Health Care.

We found noncompliance with IPERIA in four Universal Service Fund (USF) programs and the Interstate Telecommunications Relay Services (TRS) Fund. The four USF programs and the TRS Fund reported total Outlays of $9.9 billion for fiscal year (FY) 2019. Specifically, the audit found that:

- The USF-Rural Health Care (RHC) Program estimated an improper rate of 11.46 percent of total USF-RHC Program outlays exceed the OMB IPERIA limit of less than 10 percent of outlays.
- The USF-Lifeline (USF-LL) Program estimated improper payments identified through sources outside of Universal Service Administrative Company's (USAC) payment recapture audits were understated by $205 million or 17.55 percent of total USF-LL Program outlays. FCC and USAC have not adequately assessed the improper payment risk associated with FCC USF-LL rules.
- The TRS Fund's improper payment rate may be underestimated because the FCC and TRS Administrator's test plan used to estimate the improper payment rate did not sufficiently address significant risks of improper payments in the TRS Fund.
- The USF-High Cost (USF-HC) Program improper payment rates of 0.01 percent and 0.03 percent for FY 2019 and FY 2018, respectively, did not adequately reflect the significant risks of improper payments that exist in the USF-HC Programs.
- The USF-Schools and Libraries (USF-S&L) Program did not meet its improper payment reduction target. Also, the statistical sampling plan was not consistent with the sampling plan certified by FCC management and submitted to the Office of Management and Budget (OMB).

Because the reported improper payment rates were not reflective of significant risks of improper payment in their respective programs and the fund, we were unable to reach a conclusion regarding the accuracy of the improper payment data and information reported on the FCC's FY 2019 AFR. Specifically, for the USF-HC Program, USF-LL Program and TRS Fund we were unable to conclude whether (a) the improper payment rate was less than 10 percent of program outlays, (b) FCC management should publish corrective action plans, or (c) the programs and the fund met their IPERIA improper payment reduction target.

We identified five findings and made 19 recommendations to FCC's management that we deemed sufficient to address the deficiencies noted. The Results of Audit section of this report provides detailed audit findings and recommendations.

We provided a draft copy of this report to FCC management for its review and comments. FCC and administrators of the USF programs and the TRS Fund provided separate written comments on the draft audit report. We reviewed the responses from FCC management and each administrator (USAC and RolkaLoube) and considered the responses in finalizing the report. FCC management is responsible for the representations made in the FY 2019 AFR. Therefore, we present FCC's written comments in full in Appendix B. FCC management comments adequately summarize the matters raised in the written comments of USAC and RolkaLoube. A summary of FCC management comments and the auditor's responses are provided for each finding.

FCC management concurs that the USF-RHC Program and the USF-LL Program are not compliant with IPERIA. FCC management did not agree with our findings for the USF-HC Program and the USF-S&L Program, and the two audit recommendations for the TRS Fund.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence gathered provides a reasonable basis for our findings and conclusions. Our audit covered the period October 1, 2018, through September 30, 2019.

BACKGROUND

The Federal Communications Commission (FCC) is an independent United States government agency, directly responsible to Congress. FCC was established by the Communications Act of 1934 and is charged with regulating interstate and international communications by radio, television, wire, satellite, and cable. FCC has seven operating Bureaus and ten Staff Offices. The Bureaus' responsibilities include processing applications for licenses and other filings, analyzing complaints, conducting investigations, developing and implementing regulatory programs, and taking part in hearings.

FCC's component entities are the Universal Service Fund, Interstate Telecommunications Relay Services Fund, and North American Numbering Plan. Universal Service Administrative Company serves as the Administrator and Billing & Collections (B&C) agent for the Universal Service Fund; RolkaLoube serves as the Administrator and B&C agent for the Interstate Telecommunications Relay Services Fund, and Welch LLP serves as the Administrator and B&C agent for the North American Numbering Plan. FCC's Office of the Managing Director provides direction to the administrators and B&C agents and approves the administrative costs paid to these entities from the respective funds they administer.

The FCC and its Administrators make disbursements for the following nine programs:

- Universal Service Fund High-Cost Program (USF-HC),
- Universal Service Fund Lifeline Program (USF-LL),
- Universal Service Fund Rural Health Care Program (USF-RHC),
- Universal Service Fund Schools and Libraries Program (USF-S&L),
- Universal Service Fund Administrative Costs (USF-Admin),
- Interstate Telecommunications Relay Services Fund (TRS),
- North American Numbering Plan (NANP),
- FCC Operating Expenses (FCC-OE), and
- TV Broadcasting Relocation Fund (TVF).

In 2018, the Office of Management and Budget (OMB) issued Memorandum M-18-20, Appendix C to Circular No. A-123, *Requirements for Payment Integrity Improvement*. The goal of this revised version of OMB Circular A-123, Appendix C, is to transform the improper payment compliance framework to a more unified, comprehensive, and less burdensome set of requirements. OMB Memorandum M-18-20 provides government-wide guidance regarding implementation of the

Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010, and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012. The Recovery Auditing Act of 2002 was, generally, repealed by these amendments to OMB Circular A-123.

OMB M-18-20 requires federal agencies to conduct risk assessments to identify programs that are susceptible to significant improper payments, report improper payment estimates for programs that are determined to be susceptible to significant improper payments, and report their efforts in reducing improper payments and recapturing overpayments.

FCC identified the following four programs and a fund as being susceptible to the risk of significant improper payments: USF-HC, USF-RHC, USF-S&L, USF-LL, and TRS. Under OMB Memorandum M-18-20, which requires a risk assessment once every three years for programs not susceptible to significant improper payments (or periodically if significant changes occur), FCC conducted risk assessments of the USF-RHC, USAC-Admin, FCC incentive auction reimbursements, FCC operating expenses, and NANP. FCC utilized an OMB-approved alternative sampling methodology[2] to develop a statistically valid estimate of the improper payments for the TRS Fund. FCC reported its efforts in reducing and recapturing improper payments for all the USF programs and the TRS Fund, including payment recapture audits for all FCC programs and funds, and improper payment corrective actions for the USF-LL, USF-RHC and USF-S&L.

During the audit FCC management shared with OIG its request to OMB for relief from the annual reporting requirements of OMB Memorandum M-18-20 for the USF-HC Program and the TRS Fund. A federal agency may seek such relief for an agency's activity that has a minimum of two consecutive years of improper payments below the statutory thresholds, or if the activity is no longer susceptible to significant improper payments.[3] OIG did not concur with FCC management's request for relief for the USF-HC Program and the TRS Fund.

OMB approved FCC management request for relief for the TRS Fund from the improper payment reporting requirements. With regards to the USF-HC Program, OMB recognized that this program was identified as non-compliant in the Audit of the Federal Communication Commission Improper Payments Elimination and Recovery Improvement Act in FY 2018. OMB recommended that FCC management resolve outstanding issues of non-compliance with the FCC's Office of the Inspector General.

[2] OMB Memorandum M-18-20, Part I.D.1.
[3] https://www.fcc.gov/sites/default/files/19-aud-02-01_fy18_iperia_rpt_05302019.pdf (See Table -2).

RESULTS OF AUDIT

Based on our audit, we determined that Federal Communications Commission (FCC) is noncompliant with the requirements of IPERIA.

FINDING No. 1 – USF-Rural Health Care Program Gross Improper Payment Rate Noncompliant Under Requirements of IPERIA

CONDITION:

The Universal Service Fund (USF)-Rural Health Care (RHC) did not comply with the IPERIA requirement that a federal program reports a gross improper payment rate of less than 10 percent[4] of the program outlays. Our audit found that the USF-RHC Program estimated gross improper payment rate of 11.46 percent of the USF-RHC Program outlays exceeded the statutory threshold of less than 10 percent of the gross program outlays. The USF-RHC Program is one of the FCC's four USF programs, which, along with the Telecommunications Relay Service (TRS) Fund, management reported as being susceptible to the risk of significant improper payments in fiscal year (FY) 2019.

The table below details the FCC's estimated gross improper payment rates for the USF programs and the TRS Fund.

FY 2018 versus FY 2019 **Source: Agency Financial Report Table 1 (FY 2018 & 2019)** ($ in millions)							
	FY 2018 (estimated)		**FY 2019 (estimated)**			**Increase /Decrease in Improper Payment Rate**	**Increase/ Decrease in Improper Payment Amount**
FCC Program	**Improper Payment Rate**	**Improper Payment Amount**	**Improper Payment rate**	**Improper Payment Amount**	**Percent above OMB Threshold**		
USF – LL	18.47%	$227.02	9.32%[5]	$108.92	0.00%	(9.15%)	($118.10)
USF – HC	0.03%	$1.20	0.01%[6]	$0.65	0.00%	(0.02%)	($0.55)
USF – RHC	N/A	N/A	11.46%[7]	$34.19	1.46%	N/A	N/A
USF – S&L[8]	2.59%	$67.99	6.33%	$139.67	0.00%	3.74%	$71.68
TRS	0.03%	$0.34	0.15%[9]	$2.00	0.00%	0.12%	$1.66

[4] OMB Memorandum M-18-20, Part IV (B)(2)(f)
[5] See Finding No. 2.
[6] See Finding No. 4.
[7] See Finding No. 1.
[8] See Finding No. 5.

In FY 2018, FCC determined that the annual improper payments in the USF-RHC Program may exceed both the congressionally mandated thresholds of 1.5 percent of program outlays and $10 million of all program payments made in a fiscal year. As a result, in FY 2018, USAC conducted an improper payments risk assessment under the requirements of OMB Memorandum M-18-20, Appendix C to OMB Circular A-123, *Requirements for Payment Integrity Improvement* (OMB M-18-20). The purpose of the risk assessment was to determine whether the USF-RHC program is susceptible to significant improper payments.

The risk assessment considered seven factors[10] likely to contribute to improper payments. FCC and Universal Service Administrative Company (USAC) determined that one of the seven factors, regarding significant deficiencies identified through audit reports or other relevant management findings, represents a high-risk of improper payments in the USF-RHC Program. The risk assessment also identified significant non-compliance with the USF-RHC Program rules, and improper payments to the USF-RHC Program service providers and beneficiaries. As a result, FCC management concluded that the USF-RHC Program is susceptible to significant improper payments and should be subject to the annual improper payment estimation process starting in FY 2019.

In FY 2019, FCC obtained a statistically valid sample of invoices that represented 16.38 percent of the total $298.5 million disbursed in FY 2018 by the USF-RHC Program. USAC performed Payment Quality Assurance (PQA) tests on 410 invoices to determine the estimated rate for improper payments in the USF-RHC Program. Based on the results of PQA tests, USAC determined that the improper payment rate for the USF-RHC Program was 11.46 percent (or $34.19 million), and, thus the program was not compliant with IPERIA requirements.

CRITERIA:

OMB Memorandum M-18-20, Part IV.A(3) (f), states that compliance under IPERA means that the agency has, among other things, "Reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the AFR".

CAUSE:

USAC's internal control procedures were not effective to ensure:

a. The USF-RHC Program payments were calculated based on substantiated and documented rates (i.e., urban and rural rates) that were compliant with FCC rules.

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[9] See Finding No. 3.

[10] OMB Circular A-123, Appendix C (M-18-20), "Requirements for Payment Integrity Improvement", Part I (C)(2)(b).

b. The USF-RHC Program payments were invoiced to USAC for services delivered, and the amounts billed to the Rural Healthcare Providers (HCP) matched the dates of service.

c. The Competitive bidding procedures for providing telecommunication services to the HCP were fair and open to all the prospective bidders, and telecommunication service agreements were not initiated with HCP during the 28-day competitive bidding period.

Also, FCC rules for determining the urban and rural rates used to calculate RHC Program telecommunications support in the USF-RHC Program years 2018 and 2019 are complex and susceptible to misinterpretation by program beneficiaries.

EFFECT:

Improper payments may undermine public confidence in USAC's stewardship of taxpayers' dollars and increase the risk that taxpayers and Congress will lose confidence in the integrity and effectiveness of the USF-RHC Program.

RECOMMENDATIONS:

We recommend the FCC Management:

1. Direct USAC to implement policies and procedures to improve internal controls, improve the USF-RHC Program outcomes, and respond to risks of improper payments. (NEW)

2. Continue to enhance USAC's outreach program to help improve HCPs and service providers' understanding of the USF-RHC Program rules, particularly those rules governing the calculation of urban and rural rates and the program's competitive bidding requirements. (NEW)

3. Submit a plan describing how the USF-RHC Program will become compliant with OMB Circular A-123, Appendix C, to the Senate Committee on Homeland Security and Governmental Affairs, the House Committee on Oversight and Government Reform, and the OMB. (NEW)

MANAGEMENT RESPONSE:

FCC and USAC management agree with the auditor's finding that USF-RHC Program was not compliant with IPERIA because the USF-RHC Program's improper payments rate of 11.46 percent exceeded the IPERIA statutory improper payment rate threshold of less than 10 percent.

However, FCC and USAC management disagree with the auditor's assertion in the Cause[11] section that there were weaknesses in USAC's internal control procedures that were designed to ensure a) fairness and openness in the USF-RHC Program competitive bidding process, and b) that service agreements were not initiated with the service provider during the 28-day competitive bidding period.

FCC management noted that out of the USF-RHC Program's improper payments of $32.69 million, the improper payments associated with competitive bidding were $180,000 (or 0.55 percent). Also, FCC informed the auditor that USAC a) has adopted testing procedures for the USF-RHC competitive bidding requirements, and b) is conducting additional outreach seminars to USF-RHC Program participants regarding the competitive bidding requirements.

AUDITOR'S RESPONSE:

FCC and USAC management acknowledged that the USF-RHC Program was non-compliant with IPERIA.

We agree with FCC and USAC management that the improper payments attributed to weaknesses in internal control over the competitive bidding process were not significant quantitatively. However, the relative significance of the risks of improper payments should include considerations of both quantitative and qualitative factors. The lack of a fair and open competitive bidding process exposes federal funds to risks of fraudulent activities (e.g., kickbacks), and raises questions regarding the integrity of the FCC's administration of the USF-RHC Program. Also, health care providers (HCPs) may not receive telecommunication services in the most cost-effective method. In addition to weaknesses in internal control over competitive bidding and service agreements, we reported other weaknesses in internal control over USF-RHC program payments, including procedures for processing invoices and calculating payments due to HCPs.

It is our position that effective internal control[12] is a crucial factor in improving FCC management's accountability for federal funds and the achievement of the USF program's missions. Effective internal control policies and procedures will enable FCC and USAC management to respond appropriately to the risks of improper payments in the USF-RHC Program.

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[11] **GAO's Government Auditing Standards, Section 8.126, "**Cause: The cause is the factor or factors responsible for the difference between the condition and the criteria…"

[12] **GAO's Government Auditing Standards, Section 8.117,** *Auditors should consider internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings when internal control is significant to the audit objectives.*

FINDING No. 2 – USF Lifeline Program Gross Improper Payment Rate Reported Is Understated and Noncompliant Under IPERIA

CONDITION:

The USF-Lifeline (USF-LL) Program did not comply with the IPERIA requirement that the federal program reports a gross improper payment rate of less than 10 percent[13] of the program outlays. We noted that FCC management understated the FY 2019 USF-LL Program gross improper payment amount and rate by $205 million and 17.55 percent of outlays, respectively. FCC reported in its FY 2019 Annual Financial Report (AFR), USF-LL Program outlays of $1.16 billion, and an estimated improper payment amount of $109 million, 9.32 percent of outlays. The unreported improper payments of $205 million, in addition to FCC's reported estimated improper payments of $109 million, total $314 million, or approximately 26.88 percent of the total USF-LL Program outlays.

The unreported USF-LL Program improper payments of $205 million (and 17.55 percent of outlays) are attributable to the USF-LL Program service providers' non-compliance with the USF-LL Program rules. These additional improper payments included:

a. reimbursements to service providers for subscribers who did not use the USF-LL Program supported services,
b. erroneous subscriber claims, and
c. reimbursements to a service provider for subscribers outside its designated service areas.

FCC became aware of each of the improper payments during FY 2019. However, they were not disclosed in the AFR because, according to FCC and USAC management, their investigations of the matters were ongoing as of the end of the audit fieldwork, March 13, 2020. We determined that FCC and USAC management had sufficient evidence available prior to the release of the FCC FY 2019 AFR to report, at a minimum, an estimated range of improper payments.

We were unable to assess FCC's compliance with the reduction target based on the criteria established in IPERIA because the USF-LL Program's improper payments rate reported by FCC management is significantly understated.

CRITERIA:

OMB Memorandum M-18-20,

> Part III.B.2, states, "…Management is required to manage their payment integrity risk to an agency achieving its strategic, operations, reporting, or compliance objectives…ensuring the

[13] OMB M-18-20, Part IV (B)(2)(f)

integrity of federal payments is fundamental to the core mission for agencies..."

> Part III.B.2, states, "…The Extended Enterprise consists of interdependent relationships, parent-child relationships, and relationships external to an agency. It recognizes that no Agency is self-contained, and risk drivers can arise out of organizations that extend beyond the enterprise. These relationships give risk to a need for assurance that risk is being managed in that relationship both appropriately and as planned. In the context of Enterprise Risk Management and the management of payment integrity risk, the extended enterprise includes state, local governments, other departments and agencies, or third-party service providers. Although agencies have less control, they still maintain responsibility for managing risk to payment integrity that comes from the extended enterprise..."
>
> Part IV.(A)(3)(f), states that compliance under IPERA means that the agency has among other things, "(f) Reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the AFR".
>
> Part IV.A.4, states, "…In determining compliance, the agency Inspector General should evaluate the accuracy and completeness of agency reporting, …For example, when determining compliance, the agency Inspector General should evaluate whether the program improper payment rate estimates are accurate..."

GAO's Standards for Internal Control in the Federal Government, Section 4.01, states "Management may engage external parties to perform certain operational processes for the entity... Management, however, retains responsibility for the performance of processes assigned to service organizations..."

CAUSE:

FCC and USAC lacked effective procedures to ensure compliance with OMB M-18-20, which requires complete and accurate reporting of payment integrity information.

FCC management erroneously believes it does not have to report "potential" improper payments in the AFR until it completes its investigation, even in instances where a service provider admitted to the improper payments, the improper payments are material to complete and accurate reporting of payment information in AFR, or the improper payments information was available to FCC management before the AFR was issued.

FCC and USAC management have not developed sufficient, appropriate procedures to determine the full extent to which improper payments occurred within the USF-LL Program.

The risks associated with noncompliance with FCC rules that are likely to result in material, improper payments were not adequately assessed.

FCC and USAC did not have adequate procedures to identify and manage the payment integrity risks associated with their relationships with the USF-LL Program's service providers.

The USF-LL Program corrective action plans were not effective for identifying the true root causes of improper payments and preventing and detecting improper payments.

EFFECT:

Improper payments undermine public confidence in FCC and USAC's stewardship of taxpayers' dollars and increase the risks of waste or abuse of program funds. Also, the taxpayers and Congress may lose confidence in the integrity and effectiveness of the USF-LL Program.

U.S. Congress and OMB may lack complete, accurate, and timely payment integrity data to perform their oversight functions.

FCC and USAC management may continue to face the challenges of developing and implementing appropriate actions to address the root causes and reduce improper payments.

The methodologies designed by FCC and USAC management to respond to the USF-LL Program payment integrity risks and monitor progress toward mitigating improper payments may be ineffective.

RECOMMENDATIONS:

We recommend the FCC Management:

4. Direct USAC and FCC Wireline Competition Bureau to determine the full monetary impact of the overpayments for a) reimbursements to service providers for subscribers who did not use USF-LL Program services, b) erroneous subscribers claimed by service providers, and c) a service provider operating outside its designated service areas. (NEW)

5. Reissue the AFR and disclose complete and accurate USF-LL Program payment information available and known to management as of the AFR reissue date, or provide notification to the appropriate oversight entities that the payment data in the AFR did not disclose, at a minimum, the actual USF-LL improper payment amount of $205 million and improper payment rate of 26.88 percent. (NEW)

6. Submit to the Senate Committee on Homeland Security and Governmental Affairs, the House Committee on Oversight and Government Reform, and OMB the following by June 15, 2020, to bring the USF-LL Program into compliance with IPERIA:

    a. Reauthorization proposals for the USF-LL Program; or

b. Proposed USF-LL Program rule changes necessary to bring the program into compliance.

If applicable, provide a statement on what FCC is doing to achieve compliance with IPERIA. (UPDATE)

7. Enhance root cause analysis by using the findings and recommendations identified in the most recent USF-LL Program reports issued by Government Accountability Office (GAO), FCC Office of the Inspector General (FCC-OIG), and FCC Enforcement Bureau (FCC-EB) to identify additional relevant factors that underlie improper payments, fraud, waste, and abuse in the USF-LL Program (REPEAT).

8. Work with USAC to refine the process for developing corrective actions to ensure they address the root causes of improper payments and include measurements to assess whether actions taken were successful. (NEW)

9. Enhance the existing quality control over AFR reporting processes to ensure that IPERA data are complete, accurate and timely. (NEW)

10. Work with USAC to develop procedures (e.g., robust risk assessment, internal control and monitoring activity) to identify and manage the risk of improper payments in the USF-LL Program's service providers operations. (NEW)

MANAGEMENT RESPONSE:

FCC management agrees with the auditor's finding that the USF-LL Program was not compliant with IPERIA.

However, FCC and USAC management do not agree with the auditor's recommendation that they should reissue the FY 2019 AFR. FCC and USAC management stated that they disclosed in the AFR that additional potential improper payments had been identified and were under investigation at the time the AFR was issued. According to FCC and USAC management, their interpretation of OMB M-18-20 allows management to classify potential improper payments that are under investigation as questioned costs, which are not reported as improper payments in the AFR until the transactions have been completely reviewed and are confirmed to be improper.

AUDITOR'S RESPONSE:

The improper payments reported in the AFR were significantly understated (by $205 million), and the total improper payments represent over 26.88 percent of USF-LL Program outlays of $1.16 billion. Therefore, we recommended that FCC management reissue the AFR to disclose to the appropriate oversight bodies (including U.S. Congress, OMB and USAC Board of Directors) complete and accurate USF-LL Program payment information available and known to management as of the reissue date. We reiterate that, as an alternative to reissuing the AFR, we recommended that FCC provide notification to the appropriate oversight bodies that the payment data in the AFR are incomplete and inaccurate**.**

We disagree with FCC and USAC management's interpretation of OMB M-18-20, as it relates to questioned costs. Questioned cost, as represented in OMB M-18-20, is defined under the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). FCC and USAC are not among the federal entities identified in the Uniform Guidance. Neither the USF programs nor the TRS Fund is subject to the requirements of the Uniform Guidance.

FCC and USAC management consistently use the arguments of on-going investigations and misinterpretation of OMB M-18-20 to delay the complete and accurate reporting of payment integrity information in the AFR to oversight bodies and decision-makers. It continues to be the auditor's position that FCC management and the decision-makers' efforts to safeguard federal funds from fraud, waste, and abuse could benefit from increased transparency in the reporting of improper payments.

FINDING No. 3 – Telecommunications Relay Services Test Plan Did Not Include Significant Risk Factors

CONDITION:

FCC reported an improper payment amount and rate of $2 million and 0.15 percent, respectively, for the Telecommunications Relay Services (TRS) Fund in FY 2019. The reported improper payment amount and rate may be understated. We found that the FCC and TRS Fund Administrator's risk assessment and testing procedures (the test plan) were not comprehensive because they did not address the risks of improper payments associated with FCC rules related to TRS Fund eligibility and the National Deaf-Blind Equipment Distribution Program (NDBEDP). Specifically, the test plan did not extrapolate an improper payment error rate that is reflective of the actual risks of improper payments in the TRS Fund. We based our conclusion on risk factors we identified in the FCC rules and TRS operations likely to contribute to improper payments. These risk factors were not addressed in the TRS test plan. FCC and the TRS Fund Administrator did not appropriately consider the following risk factors associated with the service providers, NDBEDP, and TRS Fund Administrator in their estimation of the TRS Fund's improper payment amount and rate for FY 2019:

Service Providers

- Compensating service providers for consumers who were not registered users of TRS services;
- Compensating service providers for TRS users who did not select the service provider as a

default provider, and

- Compensating a service provider who did not maintain a current certification with the state or FCC.

National Deaf-Blind Equipment Distribution Program (NDBEDP) Administrator

- Reimbursing the state programs for ineligible equipment or unauthorized services,
- Reimbursing the state programs for equipment furnished to ineligible NDBEDP beneficiaries, and
- Reimbursing the state programs for an amount not authorized, or that exceeded state funding limit.

TRS Fund Administrator

- Disbursing NDBEDP funds before the review of cost submission.

The TRS Fund Administrator informed the auditors that it did not perform tests to obtain the improper payments associated with the eligibility of TRS users and providers. FCC must ensure compliance with its rules so that payments are made to eligible service providers for services performed for eligible users. In their response to the draft audit findings, the TRS Fund Administrator informed the auditors that all of the TRS providers are conditionally certified. The TRS Fund Administrator provided the auditors a 2012 email from an FCC official stating that conditional certifications of TRS providers are of indefinite duration. It appears the TRS Fund Administrator relied on the FCC official's assertion on the conditional certification of providers. However, the FCC rule states that certifications should remain in effect for five years and be renewed 90 days before their expiration. The TRS Fund Administrator also stated that it does not have a method to verify that NDBEDP payments were made for equipment delivered only to eligible individuals and for authorized services.

We determined that the FCC and TRS Fund Administrator's FY 2019 test plan was not sufficient to ensure that the reported estimated improper payment amount and rate reflect the actual risk of improper payments in the TRS Fund. However, we noted that the test plan did address certain risks of improper payment in the TRS Fund. For example, the tests plan included procedures to verify the providers' conditional eligibility for reimbursements. Also, the TRS Fund Administrator confirmed that the payments to TRS providers were:

- supported by complete and complaint Call Detail Records,[14]
- authorized by the TRS Administrator and compliant with FCC approved TRS Fund reimbursement rate, and
- supported by complete Speed of Answer Report[15] and TRS provider compliant performance

[14] Call Detail Record or "CDR" is the monthly data submissions the TRS provider submits to the TRS Fund Administrator to seek reimbursement from the TRS Fund.

[15] Speed of Answer is the time it takes to connect a call to communication assistance.

standards.

CRITERIA:

OMB Memorandum M-18-20,

Part I.C.2.b, states, “Risk Factors: In accordance with IPERA, when conducting improper payment risk assessments, agencies should take into account those risk factors that are likely to contribute to a susceptibility of significant improper payments, …”

Part III.B.2, states, “…Management is required to manage their payment integrity risk to an agency achieving its strategic, operations, reporting, or compliance objectives... ensuring the integrity of federal payments is fundamental to the core mission for agencies...”

Part IV.A.4, states, “…In determining compliance, the agency Inspector General should evaluate the accuracy and completeness of agency reporting, …For example, when determining compliance, the agency Inspector General should evaluate whether the program improper payment rate estimates are accurate...”

Footnote 9, the risk factors likely to contribute to improper payments should be taken into account when designing a systematic method for evaluating improper payment risk.

GAO’s Standards for Internal Control in the Federal Government, Section 4.01, states “Management may engage external parties to perform certain operational processes for the entity, Management, however, retains responsibility for the performance of processes assigned to service organizations...”

IPERIA Planning Document, April 2019,

Page 7, states “…The testing only includes those processes performed by RL [RL – is the administrator of TRS Fund]. This testing does not extend to TRS providers, contributors, equipment distributors, the Perkins School for the Blind, or the FCC. The scope of disbursements and processes may be expanded in subsequent years. Discussions will occur with the FCC OMO [OMD], as needed, relative to any changes in scope prior to the implementation of these changes...”

Page 8, states “…This plan does not include substantive testing of NDBEDP disbursements for improper payments since payment determination is made by the FCC COB. The NDBEDP disbursements are not included in the statistical plan prepared by Dr. --- [Name redacted]…

Title 47, Part 64; Miscellaneous Rules Relating to Common Carriers,

§64.606 (c)(2), states, ***Internet-based TRS Provider FCC certification period.*** Certification granted under this section shall remain in effect for five years. An Internet-based TRS provider applying for renewal of its certification must file documentation with the Commission containing the information described in paragraph (a)(2) of this section at least 90 days prior to expiration of its certification.

§64.610 (f), states, ***Payments to NDBEDP certified programs***. (1) Programs certified under the NDBEDP shall be reimbursed for the cost of equipment that has been distributed to **eligible individuals and authorized related services**, up to the state's funding allotment under this program as determined by the Commission or any entity authorized to act for the Commission on delegated authority.

§64.610 (h), states, ***Administration of the program***. The Consumer and Governmental Affairs Bureau shall designate a Commission official as the NDBEDP Administrator. (1) The NDBEDP Administrator will work in collaboration with the TRS Fund Administrator, and be responsible for…(iii) Reviewing certified program submissions for reimbursement of costs under the NDBEDP, in consultation with the TRS Fund Administrator…(2) The TRS Fund Administrator, as directed by the NDBEDP Administrator, shall have responsibility for (i) Reviewing cost submissions and releasing funds for equipment that has been distributed and authorized related services, including outreach efforts…"

§64.611 (a), states, ***Default provider registration***. Every provider of VRS or IP Relay must, no later than December 31, 2008, provide users with the capability to register with that VRS or IP Relay provider as a "default provider." Upon a user's registration, the VRS or IP Relay provider shall:

§64.611 (a)(3), states, ***Certification of eligibility of VRS users***. (i) A VRS provider seeking compensation from the TRS Fund for providing VRS to a particular user registered with that provider must first obtain a written certification from the user, attesting that the user is eligible to use VRS.

§64.611 (j)(1)(i), states, ***IP CTS Registration and Certification Requirements***. IP CTS providers must first obtain the following registration information from each consumer prior to requesting compensation from the TRS Fund for service provided to the consumer: The consumer's full name, date of birth, last four digits of the consumer's social security number, full residential address, and telephone number.

CAUSE:

FCC and TRS Fund Administrator's risk assessment did not sufficiently link the FCC rules for the TRS Fund with their efforts to obtain a complete and accurate improper payment rate and reduce improper payments.

FCC did not have effective procedures to manage the risks to TRS Fund disbursements arising from FCC's relationships with external entities, such as the TRS Fund Administrator and TRS providers.

EFFECT:

FCC did not provide Congress and OMB with a complete and accurate payment integrity report to assess the effectiveness and efficiencies of the TRS Fund operations. Also, OMB lacked accurate payment integrity information to support its review of FCC's request for:

(a) approval of some improper payment requirements (such as the reduction target, and sampling and estimation plan), or

(b) relief from the annual improper payment reporting requirements for the TRS Fund.

The deficiencies in the TRS Fund risk management practices may impair FCC management's ability to:

(a) concentrate its efforts toward key controls in the TRS Fund payment process that represent likely risks of improper payments, and reduce improper payments due to error, fraud or abuse, and

(b) develop robust strategies that address challenges and threats to achieving the FCC's goal of protecting consumers and ensuring public safety (such as improving the quality of communications services available to those with disabilities)

RECOMMENDATIONS:

We recommend the FCC Management:

11. Modify the risk assessment to focus on FCC rules for the TRS Fund that are susceptible to a significant risk of improper payments, such as certification of eligible users, certification of TRS providers, and NDBEDP reimbursements for eligible individuals and authorized services. (NEW)

12. Develop policies and procedures that (a) acknowledge the interdependent relationships between FCC, the TRS Fund Administrator, and TRS providers; (b) address the responsibilities of each party to manage risks of improper payments; and (c) describe methodologies used to obtain assurance that each party manages its risks of improper payments appropriately and as intended. (NEW)

MANAGEMENT RESPONSE:

FCC management did not concur with this finding.

TRS Fund Administrator stated that OMB approved the testing plan executed to identify improper payments in the TRS Fund and that the TRS rules relating to user registration and selecting default service providers were outside the scope of the testing plan. According to the TRS Fund Administrator, the service providers have the sole responsibility to register users. The TRS Fund Administrator stated that all current service providers are certified, and several operate under conditional certifications that do not expire.

TRS Fund Administrator provided a synopsis of the processes for the administration of NDBEDP, which requires all TRS users to submit completed applications and certify their completeness and accuracy. Also, the technology specialist, state program, and NDBEDP participated in assessing the eligibility of equipment provided to NDBEDP beneficiaries. The TRS Fund Administrator and the NDBEDP Administrator review reimbursement claims from the state programs for the unauthorized amount and overfunding. Therefore, FCC management and the TRS Fund Administrator believe the process for the administration of NDBEDP is sufficient to address the auditor's recommendations.

FCC management and TRS Fund Administrator disagree with the auditor's assertions that compensations were made to TRS providers a) when the TRS providers did not maintain current certifications, b) for TRS users who did not select the service provider as their default provider; or c) when consumers were not eligible and registered users of the TRS services.

Also, FCC management stated in its response to the draft report that OMB granted the agency's request for relief from the improper payment reporting requirements.

AUDITOR'S RESPONSE:

In our opinion, the TRS Fund was not compliant with IPERIA. As a result of deficiencies we identified in the test plan (as described in the Condition Section of this finding), we were unable to conclude that the TRS Fund's improper payment rate of 0.15 percent was accurate. According to OMB M-18-20, in determining compliance, the agency Inspector General should evaluate the accuracy and completeness of agency reporting.

In the FY 2019 AFR, FCC management stated, "… the goal was to estimate an improper payment error rate for non-compliance with the Commission (i.e., FCC) rules." The auditor found that the test plan did not address key FCC rules that represent risks of significant improper payments in the TRS Fund. These FCC rules include those pertaining to TRS providers' eligibility and certification, TRS users' eligibility and registration, and NDBEDP administration.

FCC management and the TRS Fund Administrator did not disagree with the primary focus of this finding that these FCC rules represent a significant risk of improper payments. The TRS Fund Administrator's statement that OMB approved its test plan is misleading. While OMB does approve the sampling and estimation plan, it does not approve the audit scope or the test procedures. Also, the TRS Fund Administrator's argument that certain risk factors are not within its audit scope is not a reasonable argument. FCC management has the responsibility to consider all risk factors that are likely to result in significant improper payments as part of FCC's IPERIA activity. It is the auditor's position that FCC management and the TRS Fund Administrator should support their position that NDBEDP represents a low risk of improper payments with findings from a risk assessment or similar analysis of risks in the TRS Fund.

FCC and the TRS Fund Administrator mischaracterized our statement in this finding. We did not assert that the TRS Fund Administrator compensated service providers who did not comply with specific FCC rules. Our position was those FCC rules represent the risks of improper payments to the service providers.

Because the TRS Fund has been granted relief from the improper payment reporting requirements, a comprehensive risk assessment for the TRS Fund is increasingly important. We believe FCC management should implement the recommendations to improve the risk assessment process for the TRS Fund.

FINDING No. 4 – USF High Cost Program Estimated Improper Payments Noncompliant Under Requirements of IPERIA

BACKGROUND:

The auditors updated and reissued the FY 2018 USF High Cost Program improper payment reporting finding, *USF-High Cost Program Estimated Improper Payment Rate May Not Be Accurate* because FCC management did not implement the FY 2018 audit recommendations. According to FCC and USAC management, the FY 2019 Payment Quality Assurance (PQA) tests were completed before the FY 2018 finding was finalized. Also, we reviewed the management's Corrective Actions Plan (CAP) and concluded that it did not properly address concerns we raised in our audit report.

CONDITION:

FY 2018 High Cost Condition:
USAC established its Payment Quality Assurance (PQA) program to determine if payments made to the USF beneficiaries were consistent with FCC rules and estimate the program's rate of improper payments. We found that USAC's PQA program and the sampling and estimation methodology did not adequately reflect the changing characteristics of the USF-HC Program resulting from the implementation of the FCC Transformation Order[16]. We also found that the

[16] Order to reform and modernize the High Cost Program and the intercarrier compensation system.

USF-HC Program estimated improper payment rate published in FCC's FY 2018 AFR did not adequately reflect significant risks of improper payments in the USF-HC Program.[17]

In FY 2018, FCC reported the USF-HC Program outlays of $4.6 billion[18], an estimated improper amount of $1.2 million, and an estimated improper rate of 0.026 percent. The USF-HC Program improper payments reported in FY 2018 are comprised of improper underpayments of $1.13 million (or 95.6 percent of the improper payments), and overpayments of $53,357 (or 4.4 percent of the improper payments)

To gain an understanding of the process USAC used to develop the FY 2018 USF-HC Program estimated improper payments, we reviewed USAC's PQA assessment procedures, and sampling and estimation methodology; and made inquiries of USAC regarding an anomaly in the reported estimated improper payments. Also, we reviewed the USF-HC Program audit reports issued by USAC's Independent Public Accountants and FCC-OIG. Table 3 below presents the USF-HC Program outlays by components according to USAC.

Table 3 - FY 2018 USF-HC Program Outlays by Components

High Cost Components	Outlays
CAF Phase II	$ 1,593,407,789
Frozen High Cost Support	$ 709,537,621
CAF-Broadband Loop Support	$ 653,584,083
High Cost Loop	$ 532,795,124
Alternate Connect America Cost Model	$ 509,485,241
CAF-Intercarrier Compensation	$ 422,291,642
Alaska Plan	$ 117,620,921
Interstate Common Line Support	$ 98,857,346
Mobility Fund Phase I	$ 29,834,272
Safety Net Additive	$ 4,331,776
Safety Valve Support	$ 4,151,986
Rural Broadband Experiment	$ 3,327,858
Local Switching Support	$ 1,000,663
High Cost Model	$ 98,826
Incremental Support	$ (10,807,250)
Total	**$ 4,669,515,898**

In response to our FY 2018 audit findings, FCC and USAC management stated they do not believe the auditor properly considered the constraints imposed on them because of the complexity of the USF-HC Program, challenges in meeting OMB IPERIA reporting deadline, and USAC's limited resources. We share most of those concerns expressed by FCC and USAC management, yet we

[17] GAO report on fraud risk of improper payments in USF-HC Program is presented in: https://www.gao.gov/assets/710/702691.pdf

believe they could either develop an efficient and cost-effective approach, or improve their current approach by working with OMB, FCC-OIG, GAO, and using best practices from other federal agencies.

Payment Quality Assurance (PQA). At the direction of FCC, USAC created its PQA to comply with IPERIA. PQA is used to assess a sample of payments made to the USF beneficiaries to determine if the payments were consistent with FCC rules. USAC conducted PQA assessments of the Connect America Fund (CAF)[19] and the legacy USF-HC Program (e.g., High Cost Loop) disbursements. CAF disbursements accounted for approximately 70 percent of the calendar year 2017 USF-HC Program disbursements.

Our FY 2018 audit noted deficiencies in USAC's PQA procedures for CAF Broadband Loop Support, Intercarrier Compensation, Interstate Common Line Support, Mobility Fund Phase I, and High Cost Loop. The PQA procedures focus primarily on verifying that disbursements to ETCs agree to published auction awards; verifying ETCs' eligibility; confirming that ETCs submitted the required USF-HC Program documents (e.g., Data Validation Report and Letter of Credit); and inspecting ETCs' official certification of compliance with the USF-HC Program rules. While these PQA procedures may be beneficial management initiatives, they did not adequately address the material risks of improper payments or the changing characteristics of the USF-HC Program resulting from the implementation of the FCC *Transformation Order*. The primary objective of CAF is to incentivize ETCs to increase the availability of broadband in rural areas. We believe the risks of improper payments in HC-CAF would be addressed better by verifying the accuracy and completeness of the auction documents and data submitted by the selected ETCs to ensure they comply with FCC auction rules, deployment milestones, and program deployment obligations[20].

We noted the following deficiencies in USAC's PQA procedures:

- CAF Broadband Loop Support (CAF-BLS) enables ETCs to recover their common line revenue requirements[21]. The PQA procedures for CAF-BLS disbursements were not effective because they focus on whether USAC accurately disbursed the CAF-BLS to ETCs. PQA procedures that verify the completeness, validity, and accuracy of supporting documents that underlie the CAF-BLS disbursements would better address the risk of improper payments in CAF-BLS. The 2017 CAF-BLS disbursements were $653.5 million out of the total USF-HC Program outlays of $4.6 billion (or 14 percent). In response to this audit finding, USAC management informed us that it did not test 2017 CAF-BLS disbursements because the calendar years 2017 disbursements were based on a projection and not actual costs.

[19] CAF was implemented as part of FCC's *Transformation Order*. The objective was to increase the availability of broadband in rural areas.
[20] Broadband obligation is the number of locations an ETC is required to deploy broadband over the course of the given HC fund.
[21] Common Line Revenue Requirements (CLRR) is the minimum revenue required by a rate of return telecommunications carrier to ensure that its SLC charges are affordable to its customers.

- The Interstate Common Line Support (ICLS) True-up is a process that reconciles the projected ICLS disbursements to the actual ICLS costs to determine the amount due to ETCs from the USF (or reimbursements due from the ETCs to the USF). The PQA procedures focused primarily on the Common Line Revenues components reported on FCC Form 509, and not the cost components that represent the primary risk of improper overpayments. The PQA procedures did not include tests to determine whether ICLS costs were supported and allocated in a manner consistent with FCC rules. USAC management stated that it is not cost effective to test cost components reported on FCC Form 509 because of the large number disbursements selected in their PQA statistical sample (i.e., 509 disbursements), time constraints in meeting the OMB IPERIA deadline, and USAC's limited resources.

- CAF Intercarrier Compensation (CAF-ICC) allows incumbent local exchange carriers to charge residential customers an Access Recovery Charge, and to recover access charges from certain multiline business customers. To determine whether CAF-ICC disbursements were supported and calculated accurately, USAC compared the data obtained directly from the ETC to the information in the USF-HC Access Database, which was inputted by the same ETCs, and recalculated the CAF-ICC support. This PQA procedure was not adequate for identifying material risks of improper payments in the CAF-ICC. The data on the annual Tariff Plan submitted by ETCs were the basis of CAF-ICC support payments to the ETCs. Therefore, PQA procedures that verify the accuracy and completeness of the annual Tariff Plan would better address the risk of improper CAF-ICC payments to ETCs. FCC and USAC management stated they would modify the PQA procedures in FY 2019 to address the additional risks of improper payments in CAF-ICC.

- Mobility Fund (MF) Phase I, a wireless component of the CAF, provides one-time support payments to ETCs to accelerate the deployment of mobile broadband and voice service to unserved areas. We identified a deficiency in the PQA procedures for testing MF Phase I disbursements for the improper payments. The PQA did not include procedures to validate the data and management assertions on FCC Form 690, *Mobility Fund Phase I*, and related attachments, to determine whether ETCs were meeting their deployment obligations and project milestones. USAC informed us it contracted with a third-party firm to verify ETCs compliance with deployment obligations and project milestones. USAC management stated, "While the PQA procedures do not include the validation of the data submitted with the FCC Form 690 or management assertions, USAC management believes the alternative procedures address the risk of ETCs meeting deployment obligations and project milestones." Also, USAC management did not provide, and thus, we were unable to examine, evidence that these alternative procedures were applied to the MF Phase I payments included in the sample of payments tested by USAC.

- High Cost Loop (HCL) provides support for the "last mile" of connection for rural telecommunications companies in service areas where the cost to provide service exceeds 115 percent of the national average cost per line. USAC's PQA procedures for identifying improper HCL support were not effective. USAC did not assess ETCs' eligibility for HCL support, the reasonableness of their investment expenses, and adequacy of the documents supporting their Part 36 expenses. USAC agreed, in part, that its PQA procedures may not be effective. USAC management further stated, "While verifying the reasonableness of ETCs' investment expenses, and adequacy of the documents supporting their Part 36 expenses could address the risk of improper payments to ETCs, these procedures would not be feasible due to the complexity of such testing, the number of samples required by the statistical sample, the OMB IPERIA reporting deadline, and USAC's limited resources." The concerns raised by USAC management require consideration by FCC management. We believe that FCC management has the primary responsibility for developing a sampling plan that complies with IPERIA, and PQA procedures that are efficient and cost-effective.

Sampling and Estimation Plan. USAC's FY 2018 sampling and estimation plan did not reflect the risk factors for each component of the USF-HC Program and the regulatory and funding changes in the USF-HC Program. Also, the sampling plan was not adequate to ensure the selection of a representative sample from all the USF-HC Program components that have a material risk of improper payments. These deficiencies in USAC's sampling and estimation plan may be the reason that Rate-of-Return[22] carriers and the legacy USF-HC Program accounted for all the FY 2018 USF-HC Program estimated improper payments, and none were identified in other program components.

We noted that the disbursement population from which the sample was drawn might not be valid and complete. The population for the USF-HC Program disbursements in 2017 was the total outlays of $4.6 billion. The 2017 ICLS true-up adjustment disbursements[23] of $98.8 million included in the population may have been misstated, as the true-up disbursements represent only the excess of the actual costs and revenue (reported on FCC Form 509) over the projected costs and revenues (reported on FCC Form 508). USAC's sample should be drawn from the population of total disbursements reported in FCC Form 509. That amount was $941.31[24] in 2017. We were unable to determine how USAC accounted for the total outlays in instances where there were no disbursements to ETCs because the projected ICLS disbursements to ETCs exceeded the actual ICLS reported on FCC Form 509. Also, USAC's inclusion of CAF-BLS disbursements of $653.58 million in the population was not appropriate because those disbursements were not tested for improper payments.

USAC selected a sample for the USF-HC Program based on the 2017 disbursement size. Because of deficiencies in USAC's sampling methodology, the sample selected was not representative of the 15 USF-HC Program components that made up the population. There is no evidence the sampling plan adequately accounted for HC-ICLS projected support disbursed in 2015, for which the ETCs were required to report their actual costs to USAC in 2017. We requested a schedule that categorizes the sample by the USF-HC Program components, but USAC did not provide the schedule for our examination.

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[22] Traditional small rural eligible telecommunication carriers.
[23] https://www.usac.org/wp-content/uploads/about/documents/annual-reports/2018/USAC-2018-Annual-Report.pdf (page 5, footnote 2).
[24] https://www.usac.org/about/reports-orders/fcc-filings/#results (HC-16)

The FCC's USF-HC Program transformation order established the HC-CAF and transformed the program from a legacy service-based approach to a deployment obligation and milestones-based approach. Approximately 70 percent of the USF-HC Program disbursements in 2017 were HC-CAF. The most significant risks in the HC-CAF were ETCs (a) not meeting eligibility requirements for auction awards, and (b) not meeting their telecommunications deployment obligations and milestones. The most significant risks for the legacy USF-HC Program were unsupported, unallowable and misclassified costs; and unreported revenues.

Because of the deficiencies in the sampling plan, there is an increased probability that the sample did not include disbursements from every component of the USF-HC Program and, as a result, the most significant risks of improper payments were not tested. A sample drawn from each USF-HC Program component would be more effective and efficient, and would better approximate disbursements for each component in the population and the related risks.

We questioned USAC regarding its interpretation of the results of the PQA procedures it applied to the sample and how the sample results were projected to the population. According to USAC, if an ETC was unable to provide support for the Subscriber Line Charge (SLC) revenue it previously reported to USAC, USAC reported the exceptions as improper underpayments. These unsupported SLC revenues and depreciation/amortization expenses accounted for $1,009.84 thousand of the $1,202.19 thousand (84 percent) USAC reported as FY 2018 USF-HC improper payments. OMB guidance (OMB Memorandum M-18-20, Part II.C.1, *Table 1 – Matrix of Improper Payment Categories*) does not permit agencies to report transactions that lack supporting documentation as an improper underpayment.

Also, USAC did not take into consideration that SLC revenues represent recoveries of other program costs (Part 36 costs[25]) when computing the subsidy due to ETCs. A decrease in an ETC's SLC revenues would increase the USF-HC Program subsidy due to the ETC. USAC extrapolated the improper payment error rate in the sample across the population of total disbursements of $4.6 billion to compute the improper payments in the population. Because the exceptions related to the ICLS (SLC revenue) were extrapolated to the disbursements' population, the impact of the exceptions was overstated, and not reflective of the risk of improper payments related to SLC revenue in the population. ICLS disbursements of $98.85 million accounted for only two percent of the total USF-HC Program outlays of $4.6 billion. USAC reported ICLS (SLC revenue) improper payments of $1.02 million out of the total FY 2018 USF-HC Program estimated improper payments of $1.20 million (or 85 percent of the USF-HC Program FY 2018 improper payments). A more accurate methodology for estimating improper payments and assessing the risk of improper payments in the USF-HC Program could be derived by projecting the exceptions in the sample to the related USF-HC Program component's total disbursements.

[25] Allocation and classification of telecommunication costs outlined in Part 36 of the FCC rule (47 C.F.R. Section 36).

FY 2019 High-Cost Condition Update:
During the FY 2019 IPERIA audit, we examined FCC's reported USF HC program outlays by component and noted there were no significant changes from the prior year and that, in most cases, the amounts were consistent with FY 2018 Program outlays. In FY 2019, FCC reported the USF-HC Program outlays of $4.88 billion[26], an estimated improper payment amount of $650 thousand, and an estimated improper payment rate of 0.01 percent. The FY 2019 USF-HC Program improper payments were comprised of improper underpayments of $550 thousand (or 84.6 percent of the improper payments), and overpayments of $100 thousand (or 15.4 percent of the improper payments). CAF disbursements of $3.54 billion, accounted for approximately 73 percent of the USF-HC Program disbursements.

Table 3 - FY 2019 USF-HC Program Outlays by Components

High Cost Components	Outlays
CAF Phase II	$ 1,547,963,037
Frozen High Cost Support	$ 699,220,509
CAF-Broadband Loop Support	$ 823,955,143
High Cost Loop	$ 573,659,778
Alternate Connect America Cost Model	$ 616,783,605
CAF-Intercarrier Compensation	$ 426,392,217
Alaska Plan	$ 128,313,732
Interstate Common Line Support	$ 57,608,680
Mobility Fund Phase I	$ 101,600
Safety Net Additive	$ 575,993
Safety Valve Support	$ 4,645,019
Rural Broadband Experiment	$ 3,323,259
Local Switching Support	$ 161,441
High Cost Model	$ 174,164
Incremental Support	$ 18,375
Total	**$ 4,882,896,552**

CRITERIA:

OMB Memorandum M-18-20:

> Part IV.A.4, states, "All programs and activities susceptible to significant improper payments should design and implement appropriate statistical sampling and estimation methods to produce statistically valid improper payment estimates."

[26] The amount reported is calendar year 2018 outlays. USF-HC Program runs on a calendar year basis.

Part I.D.1, states, “Programs should consider updating their plan if the program undergoes any significant changes such as legislative, funding, structural.…”

Part IV.A.4, states, “…. In determining compliance, the agency Inspector General should evaluate the accuracy and completeness of agency reporting and evaluate agency performance in reducing and recapturing improper payments. For example, when determining compliance, the agency Inspector General should evaluate whether the program improper payment rate estimates are accurate and whether the sampling and estimation plan used is appropriate given program characteristics."

GAO’s *Standards for Internal Control in the Federal Government* states:

Principle 6, “Management should define objectives clearly to enable the identification of risks and define risk tolerances.”

Principle 7, “Management should identify, analyze, and respond to risks related to achieving the defined objectives.”

CAUSE:

FCC and USAC management have not adequately assessed the risks of improper payments in the USF-HC Program and evaluated whether the PQA assessment procedures effectively address those risks.

FCC and USAC’s sampling and estimation approach did not adequately address risks associated with each of the USF-HC Program components.

FCC and USAC’s analysis of the results of the PQA was not consistent with OMB guidance.

According to USAC and FCC management, the USF-HC Program is complex and significant time and cost would be required to examine each of the USF-HC Program components.

EFFECT:

Because the reported improper payments may not be accurate and not reflective of the risk of improper payments in the USF-HC Program, the root causes may not have been accurately identified and management’s corrective actions for addressing improper payments may not be effective. Also, Congress may not be fully informed of the impact of improper payments on the delivery of the USF-HC Program services to eligible consumers.

RECOMMENDATIONS:

We recommend that FCC management:

13. Modify the PQA assessment procedures to target the USF-HC Program rules and significant risks of improper payments. (REPEAT)

14. Direct USAC management to use the Beneficiary and Contributor Audit Program (BCAP)[27] results or a modified version of BCAP to project the estimated improper payments rate in the USF-HC Program. (UPDATED)

15. Direct USAC management to develop guidance, consistent with OMB Memorandum M-18-20, for analyzing the results of PQA procedures. (REPEAT)

16. Direct USAC to work with its statisticians to develop a sampling and estimation plan that is reflective of the risks of improper payments of each component of the USF-HC Program. (REPEAT)

MANAGEMENT RESPONSE:

FCC management does not concur with the auditor's finding that the USF-HC Program is not compliant with IPERIA for a second consecutive fiscal year.

FCC management disagrees that the reported estimated improper payment rate: a) did not adequately reflect the significant risks of improper payments, and b) the testing procedures, and the sampling and the estimation plan did not adequately reflect the changing characteristics of the USF-HC Program.

Also, USAC management disagrees with the auditor's position that IPERIA does not permit reporting of the USF-HC Program underpayments. According to USAC management, the classification of the root cause of the USF-HC Program underpayments as "Other Reasons " (instead of "Insufficient Documentation to Determine") is consistent with the instructions of "OMB Memorandum M-18-20, Part II.C.1, Table 1 – Matrix of Improper Payment Categories, and supports reporting of the USF-HC Program underpayments.

However, FCC management has directed USAC to implement several of the recommendations from the FY 2018 IPERIA audit. FCC management considers other FY 2018 IPERIA audit recommendations as not cost-effective or challenging to implement because of the complexity of the USF-HC Program. USAC believes that leveraging BCAP to determine the improper payment rate and to comply with OMB requirements would not be cost-effective.

[27] BCAP is designed to measure rates of program compliance among universal service beneficiaries and contributors.

AUDITOR'S RESPONSE:

We present below a five-year summary of USF-HC Program payment data[28] to show that PQA was not useful in identifying the true risks of improper payments in the USF-HC Program. The BCAP audits identified unprojected overpayments of $16.01 million[29] and during the same five-year period, the PQA results reported in the AFRs, projected overpayments of only $1.18 million.

		/--------------------BCAP Audits-----------------/			/--------------------PQA------------------- -/		
Fiscal Year	**USF-HC Outlays**	**No. of Audits**	**Audits with Overpayment**	**Overpayments**	**Estimated Overpayment**	**Estimated Under Payment**	**Total Improper Payment**
2019	$ 4,882 90	13	9	$ 8 89	$ 0 01	$ 0 55	$ 0 65
2018	4603 94	10	7	$ 2 71	$ 0 05	$ 1 15	$ 1 20
2017	4652 00	43	22	$ 2 64	$ 0 43	$ 2 07	$ 2 50
2016	3744 68	46	29	$ 1 46	$ 0 30	$ 0 80	$ 1 10
2015	4164 04	20	6	$ 0 31	$ 0 39	$ 2 41	$ 2 80
Total	**$ 22,047.56**	**132**	**73**	**$ 16.01**	**$ 1.18**	**$ 6.98**	**$ 8.25**

As we stated in the finding, the method used by FCC and USAC's management to report the USF-HC Program underpayments was not consistent with the guidance contained in OMB M-18-20. USAC management erroneously believes that by reclassifying the root cause of the USF-HC Program underpayments as "Other Reason", it met the condition for reporting the underpayments under IPERIA. However, the underlying event, the lack of supporting documentation, does not support the reporting of USF-HC Program underpayments under IPERIA.

In our recommendation that USAC leverage BCAP for assessment of improper payments, we are not suggesting that USAC incur additional costs. We believe that USAC can use the BCAP results that is available to comply with the requirements of OMB M-18-20.

FCC management's implementation of several of the recommendations from the FY 2018 audit will strengthen FCC's focus on preventing improper payments and ensuring that the USF-HC Program funds are serving their intended purposes.

[28] Source: FCC Annual Financial Reports for FY 2015 through FY 2019 ($ in millions)

[29] Of samples of 132 Study Area Codes (SAC) selected for BCAP audits, from a population of about 55,000 SACs, 73 SACs (or 55 percent) reported overpayments.

FINDING No. 5 – USF Schools & Libraries Program Statistical Sampling Plan Not Compliant with Requirements of IPERIA OMB “*Statistically Valid and Rigorous Plan*” and Reduction Target Noncompliant Under IPERIA

CONDITION:

USAC did not use the statistical sampling plan that was certified by FCC management and submitted to OMB to estimate improper payments in the USF-Schools and Libraries (USF-S&L) Program. The USF-S&L Program sampling plan submitted to OMB by FCC was supposed to meet the requirements of a statistically valid and rigorous plan. Moreover, FCC did not meet its improper payment reduction target for the USF-S&L Program.

OMB classified IPERIA sampling plans into three categories: (a) a statistically valid and rigorous plan, (b) a statistically valid plan, and (c) a non-statistically valid plan. Both the statistically valid and rigorous plan and the statistically valid plan, are statistically valid (i.e., are based on unbiased random sampling and produce valid point estimates and confidence intervals around those estimates). Federal agencies self-certify that their sampling plan will produce a statistically valid estimate and submit the sampling plan to OMB for review. The statistically valid and rigorous plan and the statistically valid plan have different IPERIA requirements for the estimation of error rate and improper payment reduction target. A federal agency that cannot meet the requirements of a statistically valid sampling plan must obtain OMB approval for a non-statistically valid sampling plan.

According to OMB requirements, a statistically valid and rigorous plan must have a margin of error of plus or minus 3 percent (or better). USAC implemented a sampling plan with a margin of error of plus or minus 3.85 percent, which meets the IPERIA requirements for a statistically valid plan, but not a statistically valid and rigorous plan.

We reviewed the FCC-certified USF-S&L sampling plan submitted to OMB, which presented a margin of error for the estimated total dollar amount of improper payments not to exceed plus or minus 3 percent (or better) of the total program outlays. The FCC-certified USF-S&L sampling plan is statistically valid and rigorous, according to OMB IPERIA guidance. However, FCC reported a USF-S&L FY 2019 improper payment rate of 6.33 percent with a margin of error of plus or minus 3.85 percent. This reported margin of error exceeds the error rate of plus or minus 3 percent (or better), which is OMB’s criteria for a statistically valid and rigorous plan.

The USF-S&L sampling plan used by USAC, with a margin of error of plus or minus 3.85 percent, is not consistent with OMB requirements for a statistically valid and rigorous plan. While the sampling plan used by USAC is statistically valid, according to OMB IPERIA guidance, federal agencies should work towards improving their sampling plans to meet the criteria for a statistically valid and rigorous plan.

Additionally, FCC did not meet the IPERIA reduction target for the USF-S&L Program based on the sampling plan requirements of a statistically valid and rigorous plan or a statistically valid plan.

Specifically, we noted that the lower end of the range of the actual improper rate in the FY 2019 USF-S&L Program, 2.48[30] percent, is higher than the reduction target of 2.20 percent for a statistically valid and rigorous plan. Also, the USF-S&L Program estimated improper payment rate of 6.33 percent is higher than the reduction target of 2.20 percent for a statistically valid plan. OMB requirements for compliance with the IPERIA reduction targets for statistically valid and non-statistically valid plans are more stringent than for a statistically valid and rigorous plan.

Finally, FCC disclosed in its FY 2019 AFR that the margin of error for the USF-S&L Program improper rate was 3.85 percent but did not disclose that the margin of error was wider than the plus or minus 3 percent submitted to OMB and that the USF-S&L Program did not meet the IPERIA reduction target.

CRITERIA:

OMB M-18-20,

Part I.D.1 (Step 2.d), states “Precision. …OMB categorizes sampling plans into three groups:

1. **Statistically Valid and Rigorous Plans**…
    b. These plans obtain a +/- 3% or better margin of error at the 95% confidence level for the improper payment percentage estimate…
    c. Agencies should see these types of plans as the target for improper payment plans.
    d. These plans are self-certified by each agency and do not require OMB approval, although they must still be submitted to OMB by June 30th.
    e. These plans should count reduction targets as being met if the 95% confidence interval includes the reduction target…

2. **Statistically Valid**…
    b. These plans obtain a wider than +/-3% margin of error at the 95% confidence level for the improper payment percentage estimate.
    c. Agencies should work towards improving these plans to meet the requirements for statistically valid and rigorous plans outlined above. [Emphasis added]
    d. These plans are self-certified by each agency and do not require OMB approval, although they must still be submitted to OMB by June 30th.
    e. These plans should count reduction targets as being met only if their estimated improper payment rate is lower than or equal to the reduction target……”

3. Non-Statistically Valid…
    b. These plans must be approved by the Director of OMB. The agency must clearly state

[30] The margin of error of plus or minus 3.85% and an improper payment rate of 6.33%, resulting in a range of 2.48% to 10.18%. The reduction target of 2.2% is not within the range, and the lower end of the range is higher than the reduction target.

the reasons why it cannot obtain a statistically valid estimate when asking for approval.

c. These plans should count reduction targets as being met only if their estimated improper payment rate is lower than or equal to the reduction target (See Part IV.A.5).
d. For more information on non-statistically valid plans, see Question 2, below.
e. These plans are constructed in consultation with a statistician.
f. These plans should be submitted by January 30th on the FY being sampled…"

Part I.D.1 (Step 2): Content of Statistical Sampling and Estimation Plans states, "Agency sampling and estimation plans must be complete and internally consistent"

Part I.D.1 (Step 2.g) states, "…A plan that is being updated or changed should include some language explaining why the plan is changing and how the plan is difference for the one previously submitted. Agencies should err on the side of caution and resubmit their plans if they are in doubt as to whether or not they need to…"

Part IV.A.4, states, "…In determining compliance, the agency Inspector General should evaluate the accuracy and completeness of agency reporting …"

Part IV.B.2.e (i) states,"…An agency should ensure that their improper payment reduction targets are the appropriate balance of aggressive and realistic given the program characteristics."

FY 2019 IPERIA PQA Assessment Sampling Plan for USF – Schools and Libraries Program, states, "…This report describes the sample design for the *Schools &* Libraries (*E-rate*) program proposed by USAC for the FY 2019 PQA assessment process testing disbursements made in calendar year 2018. The sample design was constructed so that the margin of error of the estimated total dollar amount of improper payments will not exceed plus or minus 3% of the total of absolute dollars disbursed for the full year at the (*two-sided*) 95-percent confidence level..."

CAUSE:

FCC proposed a sampling plan margin of error of plus or minus 3 percent, which, according to OMB guidance, would be a statistically valid and rigorous plan for IPERIA reporting purposes. FCC acknowledged to the auditors that its USF-S&L Program estimated improper payment rate is less precise than that requested from OMB. Nevertheless, FCC still, erroneously, considers its sampling plan to meet OMB requirements for statistically valid and rigorous plans. OMB guidance requires that a sampling plan have a margin of error no wider than plus or minus 3 percent to fall within the category of statistically valid and rigorous plans, and no exceptions are provided in the guidance.

FCC and USAC did not consult with OMB when the USF-S&L Program margin of error exceeded the estimated margin of error of plus or minus 3 percent that was reported in the sampling plan.

EFFECT:

Because FCC and USAC departure from their sampling plan and did not consult with OMB regarding impact of the departure, there is a lack of certainty that the USAC's estimated improper payment rate for the FY 2019 USF-S&L Program reflects the actual rate of improper payments in the USF-S&L Program.

RECOMMENDATIONS:

We recommend the FCC Management:

17. Work with USAC to refine the process for implementing the USF-S&L sampling plan to ensure it is consistent with the sampling plan FCC submitted to OMB. In accordance with OMB M-18-20, Part I.D.1 1 develop a process to consult with OMB when a departure from the sampling plan submitted to OMB arises. The process should either reflect the effect of unanticipated significant errors in the sample, refine the sampling plan for adjustments made to sample size because of costs, or for other changes made to the sampling plan or the USF-S&L Program. (NEW)

18. Enhance AFR transparency by disclosing whether FCC met OMB IPERIA guidance pertaining to margins of error for the category of sampling plan selected, and reduction targets for each USF program and TRS Fund deemed susceptible to significant improper payments. (NEW)

19. Work with USAC to develop the procedures for setting a USF-S&L Program improper payment reduction target that is both aggressive and realistic. The procedures should include an action plan on how to meet the reduction target, recognize the challenges in the USF-S&L Program, and define the roles and responsibilities of FCC, USAC, and external parties, such as beneficiaries and service providers. Also, the procedures should include a method for monitoring progress toward achieving the USF-S&L Program's improper payment reduction target. (NEW)

MANAGEMENT RESPONSE:

USAC management concurs that USF-S&L Program did not meet its reduction target and is non-compliant with IPERIA.

However, FCC management disagrees with the auditor's finding that the USF-SL Program was non-compliant with IPERIA on the basis that the sampling and estimation plan was not statistically valid and rigorous. According to FCC management, the FY 2019 USF-S&L Program sampling plan is statistically valid and compliant under the requirements of M-18-20. USAC management acknowledges that the USF-S&L improper payments sampling plan previously submitted by the FCC to OMB was for a statistically valid and rigorous plan.

AUDITOR RESPONSE:

USAC management agrees that the USF-S&L Program was not compliant with IPERIA because the reported improper payment rate of 6.33 percent exceeded the reduction target of 2.20 percent.

However, FCC management mischaracterized this finding in their response to the draft audit report. As we stated in the condition section of this finding, the USF-S&L FY 2019 sampling plan is statistically valid, as defined in OMB M-18-20. The auditors concluded that the USF-S&L Program was non-compliant with IPERIA because it did not meet its annual reduction target for FY 2019, not because of deficiencies noted in the sampling plan.

We addressed the USF-S&L Program sampling plan in this finding to show FCC's lack of full disclosures in the reporting of payment integrity information in the FY 2019 AFR. FCC management did not disclose in the FY 2019 AFR that the USF-S&L sampling plan did not meet the requirements for a statistically valid and rigorous plan, as previously certified and reported to OMB. Also, FCC management did not address in the AFR how it will improve the sampling plan to meet the requirement for a statistically valid and rigorous sampling plan. OMB’s intention is that all federal agencies would strive for a statistically valid and rigorous sampling plan.

FCC management did not disclose to OMB that the USF-S&L Sampling Plan’s sample size was decreased from 443 invoice lines in FY 2018 to 360 invoice lines in FY 2019 (a decrease of 18.7 percent), or report the impact of the reduced sample size on the margin of error and the reported improper payment rate in the AFR. OMB requires federal agencies to submit an updated sampling and estimation plan when a program has an increase or decrease in a sample size of 5 percent or more of the previous sample size.[31] FCC management exceeded this threshold but did not notify OMB.

[31] OMB M-18-20, Part I.D.1 (Step 2.1g).

APPENDIX A – OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether FCC has complied with the six IPERIA criteria defined in the OMB Memorandum M-18-20, Appendix C to OMB Circular A-123, *Requirements for Payment Integrity Improvement*. These criteria are whether FCC:

1. Published a Performance and Accountability Report (PAR) or Agency Financial Report (AFR) for the most recent fiscal year and posted that report and any accompanying materials required by OMB on the agency website;
2. Conducted a program-specific risk assessment for each program or activity that conforms with IPERIA, Section 3321 of Title 31 U.S.C. (if required);
3. Published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment (if required);
4. Published programmatic corrective action plans in the PAR or AFR (if required);
5. Published, and has met, annual reduction targets for each program assessed to be at risk and measured for improper payments; and
6. Reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the PAR or AFR.

Also, we evaluated the accuracy and completeness of FCC's IPERIA reporting and performance in reducing and recapturing improper payments.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit covered the period October 1, 2018, through September 30, 2019.

To achieve the objectives, we performed audit procedures as deemed appropriate, including:

- Obtained and reviewed significant provisions of laws and regulations applicable to IPERIA.
- Reviewed GAO reports on IPERIA and related challenges faced by federal agencies in implementing IPERIA, to update our understanding and awareness of compliance issues with IPERIA.
- Made inquiries with appropriate FCC officials and obtained documentation to understand the following: how FCC implemented the provisions of IPERIA; significant programs/activities; guidance provided in FCC's directives and policies and procedures manuals; documentation maintained to support IPERIA data; information reported on the AFR; and FCC's oversight over the calculation of improper payments.
- Reviewed previous years' IPERIA audit reports to understand the FCC's IPERIA program and processes, challenges, and focus areas for process improvement and reporting.

- Reviewed FCC's effort in improving the IPERIA process by following up on FCC's implementation of prior year audit recommendations.
- Reviewed FCC's FY 2019 AFR, *Payment Integrity* to assess compliance with revised requirements for reporting IPERIA, outlined in OMB Circular No. A-136, *Financial Reporting Requirements*.
- Reviewed the latest program risk assessments to assess FCC's compliance with OMB Memorandum M-18-20 risk assessment requirements.
- Reviewed USAC's sampling and estimation plan, sampling results and FCC's correspondence with OMB.
- Reviewed PQA objectives and the procedures applied to the samples selected.
- Validated the improper payment rate calculation methodology and the amounts reported for the TRS Fund.
- Reviewed the AFR, *IPERIA Payment Integrity*, and obtained additional supporting documentation to evaluate FCC's effort in preventing, reducing, and recovering improper payments.
- Reviewed FCC's processes for identifying and reporting of recaptures of improper payments.
- Reviewed, recalculated and agreed key information in the AFR, *IPERIA Payment Integrity* to supporting program documentation, including USF-HC, USF-RHC, USF-S&L, and USF-LL.
- Reviewed FCC's IPERIA reporting quality control procedures and supporting documentation.

UNITED STATES GOVERNMENT
FEDERAL COMMUNICATIONS COMMISSION

Office of Managing Director

MEMORANDUM

DATE: May 26, 2020

TO: David L. Hunt, Inspector General

FROM: Mark Stephens, Managing Director

SUBJECT: Management's Response to Independent Auditor's Report on the Federal Communications Commission's Improper Payments Elimination and Recovery Improvement Act (IPERIA) Reporting for Fiscal Year (FY) 2019

Thank you for the opportunity to respond to the draft report from the Office of Inspector General (OIG) to the Managing Director, regarding the Federal Communications Commission's (FCC or Commission) compliance with the requirements described in the Office of Management and Budget (OMB) *Memorandum M-18-20, Appendix C to OMB Circular No. A-123, Requirements for Payment Integrity Improvement*, for the year ending September 30, 2019. We appreciate the efforts of your team to work with the Commission on this audit and share your interest in reducing waste, fraud, and abuse in the Universal Service Fund (USF) and Telecommunications Relay Service (TRS) programs. This audit was conducted by the independent auditors, Lani Eko & Company, CPAs, PLLC.

We have reviewed the findings and recommendations in the draft report and either partially concur or do not concur with the findings and recommendations. The FCC's response includes two attachments that are an integral part of the FCC's analysis of its concerns with the auditor's findings and recommendations. Attachment 1 is a memorandum prepared by the Universal Service Administrative Company (USAC), the administrator of the USF and the four USF programs (*i.e.*, High Cost, Lifeline, Schools and Libraries, and Rural Health Care), and Attachment 2 is a memorandum prepared by Rolka Loube, the administrator of TRS. These two attachments provide in-depth comments on the specific findings and recommendations in the draft report. We incorporate these two memoranda into our response in their entirety and ask that the two memoranda be included with our response in the final report.

We recognize that the auditors identified all four of the USF programs and the TRS program as not being compliant this year for various reasons. As described by the auditors in the draft report: (1) the Rural Health Care program was not compliant because the gross improper payment rate exceeded the statutory threshold of 10% or less of gross program outlay; (2) the Lifeline program reported a gross improper payment rate of 9.32%; however, the auditor believed that the gross improper payment rate was understated; (3) the TRS program did not consider all the risk factors when performing its sampling and estimation plan; (4) the High Cost program was a repeat finding from the prior year; and (5) the Schools and Libraries program was not compliant because the sampling and estimation plan did not meet the +/-3% threshold for being rigorous and valid and the reduction target was not met.

The Commission has worked extremely hard to comply with all of the reporting requirements under OMB's M-18-20 guidance. We continue to make strides to improve all of our programs that are subject to significant risk and to prevent, detect, and respond to improper payments. Furthermore, the Wireline Competition Bureau, the Office of the Managing Director, USAC, and Rolka Loube worked closely with your office and the auditor over the past year and a half during the FY 2018 and FY 2019 IPERIA audits to furnish a wealth of information to provide an in-depth understanding of the complexities of the various USF programs and facilitate an efficient audit process. Despite the collective efforts of the FCC and its reporting components, the draft audit report's analysis of the FCC's programs does not accurately reflect the FCC's explanations and responses to the auditors. The FCC requests that the auditors and Office of Inspector General consider all of the information provided by the FCC prior to issuing the final report on this audit.

Rural Health Care Program

We recognize that the auditor identified the USF's Rural Health Care (RHC) program (USF-RHC) as non-compliant due to a gross improper payment rate of 11.46%, which exceeds the statutory threshold of 10% or less of the gross program outlay. The auditor found that USAC's internal control procedures were not effective to ensure that USF-RHC program payments are calculated based on substantiated and documented rural and urban rates. The auditor also noted that USAC's internal controls were not effective to ensure the USF-RHC program payments invoiced to USAC were for services delivered and the amounts billed to health care providers matched the dates of service. Finally, the auditor noted that USF-RHC competitive bidding procedures were not effective to ensure health care providers conducted fair and open competitive bidding processes and telecommunications service agreements were not initiated during the 28-day competitive bidding period.

We concur, in part, with these findings. We agree that the 11.46% improper payment rate exceeded the statutory threshold of less than 10%, and we also agree with the auditor's assessment that the Commission's rules for determining the urban and rural rates currently in effect for calculating USF-RHC Telecommunications (Telecom) program support have been complex and difficult to administer. Recognizing that its rules governing the rural and urban rate determinations for the USF-RHC Telecom program are complex, the Commission has recently taken numerous steps to address this issue and to simplify its rules for determining urban and rural rates. On February 15, 2019, the Commission's Wireline Competition Bureau issued a Public Notice (DA 19-92) providing guidance to RHC program participants on calculating these rates and the requirement for supporting documentation. On August 1, 2019, the Commission adopted a Report and Order that streamlines the process to determine urban and rural rates that are used to calculate USF-RHC Telecom program support and strengthens safeguards to protect the USF-RHC program from waste, fraud, and abuse. Specifically, the Commission modified its rules for determining the urban and rural rates and directed USAC to create a publicly available database that will publish the urban rates participants must use to request USF-RHC Telecom support and the maximum rural rate RHC program participants may receive absent a waiver granted by the Commission. As a result of these changes, which will become effective on July 1, 2021, we anticipate these reforms to substantially eliminate improper payments based on the failure of RHC program participants to substantiate and document the urban and rural rates used to determine USF-RHC Telecom program support.

In addition to the Commission's efforts to reform and simplify its rules for calculating urban and rural rates that are used to determine USF-RHC Telecom program support, USAC is also increasing its outreach to remind RHC program participants (both applicants and service providers) that USAC may only be invoiced for services actually delivered, and the amounts on the customer bills must match the dates of service that were submitted and approved on the FCC Form 467 and the amounts that were approved in the funding commitment letter. USAC is also reminding RHC program participants that they must notify USAC of any changes to recurring costs and/or dates of service over the course of the commitment period so that the commitment amount may be properly adjusted.

We disagree with the auditor's finding that USAC's internal control procedures were not effective to ensure that competitive bidding processes for providing services to the health care providers were fair and open to all prospective bidders, and that services agreements were not initiated with the service provider during the 28-day competitive bidding period. We also note that underlying competitive bidding violations only made up a small percentage of the 11.46% improper payment rate. The dollar amount associated with improper competitive bidding was only $180,000 out of $32,690,000 (or 0.55% of the total value of the improper payments for the USF-RHC program for fiscal year 2019). Although we disagree that USAC's competitive bidding procedures were ineffective, USAC has adopted procedures that will further test health care providers' compliance with the competitive bidding requirements as part of its funding application review procedures which will further reduce future improper payments based on any competitive bidding violations. Furthermore, USAC is conducting additional outreach to RHC program participants regarding the competitive bidding requirements.

Lifeline Program

FCC management partially concurs with the auditor's finding that the gross improper payment rate reported for the Lifeline program is understated and noncompliant under IPERIA. FCC management agrees that USAC should establish additional controls and processes to identify and more timely resolve the types of issues identified in this finding. However, FCC management does not agree that the FCC's FY 2019 Agency Financial Report (AFR) should be reissued. As explained in detail in Attachment 1, the FCC's FY 2019 AFR properly communicated the existence of the potential improper payments at issue and per OMB A-123 requirements, those items were "questioned costs" and therefore should not have been reported as improper payments at the time of FY 2019 AFR reporting.

FCC management notes that the Commission continues to make significant improvements to the Lifeline program that will reduce the improper payments in the program. For example, the FCC has worked with USAC to implement: 1) the National Lifeline Eligibility Verifier, 2) Universal Lifeline Consumer Forms, 3) the Lifeline Claims System, and (4) the Representative Accountability Database. The Commission is also implementing new rules adopted in the FCC's 2019 Lifeline Order to strengthen enrollment, recertification, and reimbursement processes to reduce waste, fraud, and abuse in the Lifeline program. In addition, the Commission will work with USAC to improve improper payment testing procedures as necessary, as well as continue to develop and implement proactive controls and processes to timely identify issues that can lead to improper payments. The Commission remains fully committed to minimizing improper payments and reducing fraud, waste, and abuse in the Lifeline program.

TRS

This year the TRS program was considered to be non-compliant with IPERIA requirements even though in past years there were no concerns raised by the auditors. The TRS sampling and estimation plan has not changed and the program continued to show a low rate of improper payments (.015 percent). As such, FCC management does not agree with the two recommendations set forth in the draft report. As the TRS Administrator states at greater length in rebuttal of the draft report's findings that gave rise to the recommendations (see Attachment 2): 1) Although providers were not within the scope of the audit, they alone bear the responsibility for user registrations and attest to their compliance with the rules and, as such, are audited each year by the Administrator; 2) When a user permissibly dials around to use the network of a provider other than the one the user properly selected as their default provider, those calls not carried by the default provider are properly compensable; 3) All providers are properly certified. Some operate under conditional certifications, which do not expire; and, 4) With regard to the NDBEDP, existing processes are thorough and more than sufficient to address the responsibilities of each party to manage the risks of improper payment as well as to serve as methodologies which provide assurance in this area.

As an indicator of the TRS program's continuing compliance with IPERIA requirements, on March 31, 2020, during the course of this audit, the Commission filed a petition seeking relief from IPERIA reporting requirements with OMB. OMB granted this petition. With that grant, the FCC will cease testing the TRS program for improper payments during FY 2020. Going forward, the FCC will perform risk assessments required per IPERIA guidance to monitor whether the TRS program continues to remain low risk. The Commission remains committed to maintaining a compliant TRS program and will work to eliminate any and all improper payments.

High Cost Program

FCC management partially concurs with the auditor's finding that the High Cost program estimated improper payments are noncompliant under the requirements of IPERIA. The Payment Quality Assurance testing procedures have been updated in FY 2019 to address high-risk areas identified by USAC. However, FCC management does not concur with the remainder of the auditor's finding for a second consecutive year that the High Cost program is not compliant. The FY 2019 finding is a repeat from the previous year's finding. The FCC has directed USAC to implement several of the recommendations from the FY 2018 IPERIA audit; USAC further describes its remediation efforts in Attachment 1.

The auditors found that the reported estimated improper payment rate did not adequately reflect the significant risks of improper payments and the testing procedures and the sampling and estimation methodology did not adequately reflect changing characteristics of the High Cost program. We disagree with these findings again. We believe that the testing protocol reflects the unique characteristics, risk factors, and the regulatory and funding changes for the various components of the High Cost program. The High Cost program is a very complex program that undergoes an extensive review each year by the FCC and USAC to determine which areas need to be tested for compliance with OMB requirements. USAC also works with its independent statistician to develop a sampling plan that meets OMB guidance in order to produce an acceptable improper payment estimate. That sampling plan is submitted to and approved by OMB and testing is conducted consistent with that plan. This year a walkthrough of the High Cost program was conducted by the auditor with USAC to gain a better understanding of the complexities of the program. There still remains significant disagreement between the auditor and management regarding the sampling and estimation plan, and it appears the auditor has not considered the complexities of the High Cost program and whether the auditor's proposed recommendations are feasible.

For example, the FCC and USAC explained to the auditors that the auditor's recommended action to leverage the Beneficiary and Contributor Audit Program (BCAP) as the primary source of information for the Payment Quality Assurance (PQA) assessments for the various High Cost programs is implausible and not cost effective. The auditor's concerns focus on USAC not reviewing carrier cost studies for compliance with FCC program rules. The draft report includes this recommendation and disregards the FCC's and USAC's explanations of the complexity of such a proposed review, estimated at 135 to 1200 hours per carrier, and the inability to complete such an undertaking for the required number of carriers (200 Study Area Codes or SACs were examined in FY 2019) to meet the PQA sampling and timing requirements in a cost effective manner. The auditor further asserts that inclusion of underpayments in the improper payment calculation for High Cost is inappropriate and fails to acknowledge the explanation USAC provided on the relevant OMB guidance that provides for the reporting of underpayments.

Schools and Libraries Program

FCC management disagrees with the auditor's finding with respect to the Schools and Libraries program. The Schools and Libraries program was considered by the auditors to be non-compliant this year on the basis that the sampling and estimation plan was not a "statistically valid and rigorous plan." However, under OMB requirements, the FY 2019 Schools and Libraries Program sampling plan is compliant even if it is "statistically valid" (as is the case here) and not "rigorous." While USAC went through an extensive and exhaustive process with its statistician to ensure that the statistician had all of the underlying variables necessary to develop a "rigorous" plan, the 95% confidence level results came back with a margin of error of +/-3.85% instead of the +/-3% required to be deemed "rigorous." And a margin of error that is greater than 3% is still a statistically valid plan and permitted per OMB requirements. In all events, the FCC will work with USAC to strengthen its processes for developing and implementing sampling plans for the Schools and Libraries program.

In conclusion, the Commission continues to work diligently to comply with the requirements of the law, to adhere to OMB's guidance, and to prevent and reduce improper payments in the Commission's programs. We look forward to updating the OIG and its auditor on progress made toward improving our processes going forward. As previously mentioned, we have attached the USAC memorandum as Attachment 1 and the Rolka Loube memorandum as Attachment 2 to this response to provide additional details about where and why we disagree with the findings and recommendations in this report. The Commission requests that the attachments be provided in their entirety in the final report.

Mark Stephens
Managing Director

APPENDIX C – LIST OF ACRONYMS

AFR	Agency Financial Report
B&C	Billing and Collection
CAF	Connect America Fund
CAF BLS	Connect America Fund Broadband Loop Support
EB	Enforcement Bureau
ETC	Eligible Telecommunications Carrier
FCC	Federal Communications Commission
FY	Fiscal Year
GAO	Government Accountability Office
ICLS	Interstate Common Line Support
IS	Incremental Support
IPIA	Improper Payments Information Act
IPERA	Improper Payments Elimination and Recovery Act
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IC–WB	Incentive Auction – Winning Bidders
MF	Mobility Fund
NANP	North American Numbering Plan
NLAD	National Lifeline Accountability Database
OE	Operating Expenses
OIG	Office of Inspector General

OMB	Office of Management and Budget
PAR	Performance and Accountability Report
PQA	Payment Quality Assurance
SLC	Subscriber Line Charge
TRS	Telecommunications Relay Service
TVF	TV Broadcasting Relocation Fund
USAC	Universal Service Administrative Company
USF	Universal Service Fund
USF-HC	Universal Service Fund - High Cost
USF-LL	Universal Service Fund – Lifeline (formerly the USF Low Income Program)
USF-RHC	Universal Service Fund – Rural Health Care
USF- S&L	Universal Service Fund - Schools and Libraries