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# Surviving a USAC Audit: Tips for Facing an Audit with Confidence

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# Introduction

- **Audit Experience:**

- *Represented nearly 20% of all contributors audited since 2012*
- *Advise clients on audit preparation and mitigation*
- *Provide full coverage of USAC audits and FCC appeals, start to finish, including appellate work*

- **Breadth of Experience:**

- *Represent both contributors and clients on the distribution side (focus of today's presentation is on contributor audits)*
- *Cover informal USAC reviews, as well as full audits*
- *Counsel clients on a variety of mitigation strategies designed to minimize exposure without creating competitive disadvantages*



# Presentation Outline

- I. General Overview of USAC/ USF Contributor Audits
- II. Can You Avoid an Audit?
- III. How to Face an Audit with Confidence
- IV. Steps to Take NOW to Prepare for a Potential Audit
- V. Expectations During an Audit
- VI. Common Audit Issues
- VII. Audit Results
- VIII. Summary of Audit Guidance



# USAC's Role as USF Administrator

- As USF Administrator, USAC:
  - Is authorized to audit USF contributors' FCC Forms 499 (47 C.F.R. § 54.707)
  - Conducts about 25 audits per year
    - In 2013 alone, our firm was retained to represent nine companies under audit, including complex affiliate group audit
- Audits are *not* rulemakings, but the findings have industry-wide impact because the decisions are often later embodied in the Forms 499-A/Q Instructions (which USAC treats as “rules” in practice)

2010 FCC Form 499-A Telecommunications Reporting Worksheet (Reporting Calendar 2009 Revenues) Approval by OMB 3000-0855  
Annual Filing - due April 1, 2010

Block 1: Contributor identification information

101. File one ID (If you don't know your number, contact the administrator at (888) 641-6722. If you are a new filer, write "new" in this block and a File# 499 ID will be assigned to you.)

102. Legal name of reporting entity

103. IRS employer identification number [Enter 9-digit number]

104. Name telecommunications provider is doing business as

105. Telecommunications activities of filer (Select up to 5 boxes that best describe the reporting entity. Enter numbers starting with "1" to show the order of importance -- see directions.)

106. 1. Holding company name (or affiliated corporation name for non-SEC entities) [Enter 9-digit number]

107. FCC Registration Number (FRN) [https://frn.fcc.gov/frn/Web/publicHome.do] [For assistance, contact the COPES help desk at 877-465-3001 or COPES@fcc.gov] [Enter 10 digit number]

108. Management company (If filer is managed by another entity) [Select] [Yes] [No] [Domestic] [Country/USA]

109. Complete mailing address of reporting entity [Select] [Yes] [No] [Domestic] [Country/USA]

110. Complete business address for customer inquiries and complaints [Select] [Yes] [No] [Domestic] [Country/USA]

111. Telephone number for customer complaints and inquiries (Include number if available)

112. List all trade names used in the past 3 years in providing telecommunications. Include all names by which you are known by customers.

Use an additional sheet if necessary. Each reporting entity must provide all names used for telecommunications activities.

FORGING FIDELITY: FALSE STATEMENTS IN THE WORKSHEET CAN BE PUNISHED BY FINE OR IMPRISONMENT UNDER TITLE 18 OF THE UNITED STATES CODE, 18 U.S.C. § 1001

Save time, avoid problems - file electronically at <http://forms.universal-service.gov> FCC Form 499-A February 2010

FCC Form 499-Q, February 2008  
Approval by OMB 3000-0855  
Estimated Average Burden Hours Per Response: 10 Hours

## Telecommunications Reporting Worksheet, FCC Form 499-Q

Instructions for Completing the Quarterly  
Worksheet for Filing Contributions  
to Universal Service Support Mechanisms

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NOTICE: Sections 54.706, 54.711, and 54.713 of the Federal Communications Commission's rules require all telecommunications carriers providing interstate telecommunications services, interconnected voice-over-Internet-protocol (VoIP) providers that provide interstate telecommunications, providers of interstate telecommunications that offer interstate telecommunications for a fee on a non-common carrier basis, and nonwired providers that are interconnected to contribute to universal service and file this Telecommunications

# FCC's General Approach toward Appeals of USAC Decisions

## USAC Audit Findings and Appeals:

- Audit appeals have generally languished for years before the Commission (roughly rules on only 1 in 20 appeals)
  - *AT&T (pending since October 2006)*
  - *IDT Corporation (pending since April 2008)*
- FCC has historically upheld USAC audit decisions, but the tide may be turning
  - *RICA/ Blackfoot (November 2013)*



# Can you Avoid an Audit?

How Does USAC Select its Targets?



- USAC’s contributor audits are occasionally random, but frequently targeted
- Because audits can be random, selection for audit does *not* suggest that the filer engaged in any wrongdoing or violations
- But, audits are frequently targeted, and can arise as a result of sloppy/inconsistent/materially divergent reporting practices quarter to quarter, year to year
  - *USAC also appears to occasionally target particular “areas of interest,” e.g.,*
    - Carrier’s Carrier Rule (to ensure all providers in service delivery chain contribute, as appropriate)
    - LIRE Affiliate Rule (to circumscribe International Revenue Exemption)
    - Call Bridging & Separable Voice Element (to extend awareness and effectiveness of *InterCall* and *MeetingOne* rulings and further limit reliance on “Contamination Doctrine”)
    - Successor Liability Rule

# Can You Avoid an Audit? (Cont.)

- While not every contributor will be audited, once a contributor is selected for an audit, the audit is unavoidable and requires active/sustained participation by the filer from beginning (*announcement letter*) to the end of the audit (*final report*)
  - *There are no shortcuts: you should expect that once you're in, you're in*
  - *Audit process typically takes at least a year, if not longer*
    - Expect first 3-5 months to be intense, requiring significant investment of both personnel and financial resources
    - Upon completion of USAC on-site visits and subsequent follow-up requests, the process tapers until issuance of preliminary audit findings
    - Ill-prepared companies will find the process considerably more grueling and painful
- However, there are ways to mitigate the pain/ stress of the audit process

# How to Face an Audit with Confidence

Prepare and Follow the Form Instructions



- Prepare, Prepare, Prepare
- **When you report revenues, rely on the Form 499 – A/Q Instructions as if they are FCC Rules**
  - *That’s what the auditors do (Instructions = binding rules)*
  - *FCC Orders/ Rules trump Form 499 – A/Q Instructions*
  - *But, if you depart from the Instructions:*
    - Do so under careful consideration
    - Be prepared to provide the auditors with your rationale based on FCC precedent and rules
- Undergo a pre-USAC audit, internal review to:
  - *Identify and rectify gaps in data and process flaws*
  - *Determine and resolve regulatory classification ambiguities and uncertainties*

# How to Face an Audit with Confidence

Keep Accurate and Complete Records

Documentation/ Recordkeeping is CRITICAL:

- Key to getting through a USAC audit efficiently/ effectively
- Be sure to document:
  - *Form 499 reporting process*
  - *Revenue classification claims*
  - *Jurisdictional allocation methodology*
  - *Verification of Reseller Exemption Claims*
  - *USF pass-through practices/ procedures*



# How to Face an Audit with Confidence

## Keep Accurate and Complete Records (Cont.)

Be Prepared to Produce Certain Documents/Records Quickly if Selected for an Audit:

- The initial document request will pertain to documents verifying *revenue reports/ processes*
- If you are unable to produce such documents quickly, that alone is a **red flag** that internal controls/ procedures are potentially lacking



# Steps to Take NOW to Prepare for a Potential Audit

## Adopt good recordkeeping practices:

- Maintain Form 499 related documents for 5 years
- Organize/ keep specific documents on hand that USAC may request:
  - *Trial balance*
  - *Financial statements*
  - *Reseller certification/ reseller verification process (including: list of resellers, Filer IDs, contact info, and contributor status)*
    - USE SAFE HARBOR process and language in reseller certifications
  - *Compliance manuals*
  - *Internal control manuals*
  - *Product listing*
  - *Documents used to prepare the Form 499-A*
- Discuss Form 499 processes with key personnel to ensure a uniform approach
- Document reporting processes/ procedures
- Be prepared to explain current reporting practices/ procedures
- Consult with counsel early and regularly!



# Expectations During an Audit

## What to do if Selected for a USAC Audit



### What If You Receive an Audit Announcement Letter?

- Don't panic!
- Review all of USAC's materials/questions thoroughly and carefully
- Respond in a timely manner to all audit requests (if possible), or notify USAC if issues arise that prevent timely responses
- Be polite, considerate, and patient with the auditors
- Provide complete/ satisfactory responses to the questions asked, and **do not volunteer information that is not requested**
- Consult with counsel especially if questions are confusing, new, or you don't understand how the questions/ information requests relate to the stated scope/ objectives of the audit

# Expectations During an Audit

What to Expect During the Audit:

- Disclosure of financial and other documents
- Interviews with key personnel at your company
- Participation in USAC testing/ verification processes
- Ongoing discussions with USAC re: conclusions/ analysis



# Expectations During an Audit

## Responding to USAC

- Expect significant resource investment by your company into responding to USAC questions / audit defense
  - *Auditors may request add'l documentation from company records/ will test controls described in initial audit responses for accuracy*
  - *Auditors will identify inconsistencies in revenue amounts across systems/ work toward reconciliation during and after site visit*
  - *Auditors will take a “conservative” approach by **leaning in favor of greater contributions into the USF whenever possible***
  - *Auditors are trained to thoroughly review all available information*
- Presenting confusing/ incomplete information will cause the auditors to dig deeper
- Volunteering information *not* called for will *not* help the process / will lead to further delay

# Common Audit Issues for Contributors

- Wholesale revenues – *Were resellers properly validated?*
- International Services
  - *LIRE*
  - *Prepaid Carrier Revenues*
  - *Int'l Private Lines/ Transiting Traffic*
- MPLS “10 % Rule”: *currently awaiting FCC guidance*
- USF Recovery Fees/ Pass-Through Charges

# Common Audit Issues for Contributors (Cont.)

- Type Data Sources/ Reporting Methods
  - *Product listings*
  - *Accuracy of reporting bad debt/ uncertainties*
  - *Correctness of line item classification/ accuracy of reported revenues*
  - *Jurisdictional allocation/ testing of methodology*



# Audit Results – Findings and Other Matters



- Audit report includes:
  - *Findings* – affect USF liability
  - “*Other Matters*” - don’t affect contribution liability
- **Most companies don’t leave an audit unscathed**, and USAC typically issues requirements to:
  - *Reclassify revenues (e.g., from wholesale (non-assessable) to retail (assessable))*
  - *Report unreported revenues/ debts*
  - *Move improperly reported revenues from one line to another for a different reason (e.g., move incorrectly reported transit traffic)*

# Audit Results – Impact on Prior Years

- Although the audit is limited to the year under review, **USAC will instruct the filer to apply the findings reached to prior audit years**
  - *If a filer fails to take the required steps, USAC will prepare revised forms on behalf of the filer, and issue invoices for add'l USF fees if applicable*



# Audit Results – Appeals Process

- *Adverse findings can be appealed to USAC or the FCC (within 60 days)*
- Given the FCC’s “pay and dispute” policy, invoices must be paid even *if under appeal*
  - *Interest will continue to accrue on any unpaid invoice even if under appeal*
  - *However, an invoice subject to appeal will not be referred to the U.S. Treasury for collection under DCIA*



# Summary of Guidance

- Prepare, prepare, prepare: don't be blind-sided
  - *Audits aren't for certain/ are as rare as IRS audits*
  - *But, the best way to survive one is to have your house in order*
- You must **know your business**
  - *Know your product – it is a service falling into multiple grey areas*
  - *Preparation doesn't have to be painful if you take the time to narrow down/ mitigate the problem areas*
- Ignorance is never a defense
  - *Becomes 10 times more costly down the road*
- The cost of pre-audit preparation is a tenth or less of the cost of audit prep commenced during the audit itself
  - *Doing the latter almost ensures negative audit conclusions/ bigger bills/ and more issues to appeal with the FCC*
  - *More than anything, a lack of preparation = UNCERTAINTY and uncertainty is never good for business*

# Questions?



- Contact information:

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