

January 11, 2007

Turning a Pig's Ear into a Silk Purse: Successful FCC/USAC Audits

Section 254 of the Communications Act requires the Federal Communications Commission (FCC) to ensure that Americans in rural, high cost, and insular areas receive the same basic telecommunications services as those in urban areas of the country. That same section also requires the FCC to provide support to schools, libraries, and rural health care providers to purchase telecommunications and advanced services. These universal service support payments are funded through contributions from interstate telecommunications providers. Universal service law and regulation have been evolving since the passage of the 1996 Telecommunications Act, resulting in confusing regulations, forms and FCC orders. The private, FCC-chartered corporation called the Universal Service Administrative Corporation (USAC) administers the program. USAC also publishes rules and regulations on its web site, but only some of these are public; others are available only to program participants.

Controversy has grown up around the universal service program because the amount of the fund has risen from \$ 4.7 billion in 2000 to a projected amount of over \$7.4 billion today, not considering the effect of past true ups. Contributions have risen from as low as a 5.7% levy on interstate and international telecommunications service end user revenues to 9.7% in the first quarter of 2007, but the levy has been over 11% during recent past quarters. Waste, fraud and abuse, particularly with respect to the schools and libraries portion of the program, have been alleged in well-publicized detail in three General Accounting Office reports and an investigative report from the House Energy and Commerce Committee. USAC has conducted a large number of audits of schools and libraries and high cost fund beneficiaries. The Inspector General of the FCC continues to conduct an ongoing, aggressive enforcement program. The FCC instituted a rulemaking proceeding when Chairman Kevin Martin took the helm, asking for public comment on ways to improve the administration of all of the universal service programs, including periodic audits of program beneficiaries and contributors.

There is no doubt that the FCC will continue to meet its program responsibilities through increasing numbers of audits of beneficiaries and contributor compliance with program rules. These enforcement actions can lead to hefty fines, require prompt payment of unpaid contribution amounts, and/or require erroneously provided moneys to be repaid to the fund. Certain serious violations can also create potential criminal liability. Failure to make required contributions can embroil the company in the FCC's "red-light" designation. This prevents a company from receiving any disbursements until the lack of payment is rectified. All of these situations can produce serious adverse financial consequences to companies, ruin good reputations of companies that have ongoing business before USAC and the FCC, and produce

sticky adverse impacts in other regulatory areas, and ultimately could lead to debarment from eligibility for receipt of future disbursements from the universal service fund.

Government Inquiries. The FCC often begins an investigation by issuing a letter of inquiry. Although the end consequences to the company can be serious, many actions can be taken to head off an FCC enforcement proceeding. Although these letters are more informal than an audit, they should be taken seriously by the recipient. The following is a checklist of those steps that can keep your company on the up-and-up.

1. *Implement a well-focused FCC compliance manual.* The FCC lives by the old adage that ignorance of the law is no excuse. The FCC rules are complex and ever-changing. It is essential, therefore, that a company has a clearly written, accurate, and up-to-date manual that details how and when to comply with FCC requirements.
2. *Train employees on the manual.* A manual is good as far as it goes, but if employees don't know what is in it, the company still runs a great risk that it will find itself behind the FCC's eight ball.
3. *Keep records.* If something does go awry, it is quite likely that the FCC or USAC will ask the company to prove that it complied with the rules. The only way of doing that is to be able to provide the regulator with documentation that the company had procedures in place to provide accurate information in universal service forms. The FCC now has requirements that some information has to be kept for a period of years, sometimes as long as five years.
4. *Respond to the regulator promptly.* If the company receives a letter of inquiry from the FCC or USAC, a prompt response is essential. Many companies have been fined heavily, solely because they ignored a government letter. Business executives are rightfully resentful of government intruding into their business affairs, but this is not the time to take a stand. The regulator will punish your company for an ill-timed stand on principle. Regulators often view a delayed response as an indication that the company has something to hide. If the compliance deadline is impossible to meet, negotiate a time extension with the regulator: the government may be demanding but it is staffed by people who will accept a reasonable request for additional time.
5. *Be sure any information is accurate.* Busy and understaffed companies often do the least amount of work possible to respond to an inquiry. This is a well-known trap that should be avoided at all costs. The FCC depends on the accuracy of the information provided and reacts very badly if it discovers the information is false, even if the false information was provided through accident or sloppiness. Sloppiness in one area also makes the regulator believe that the company is sloppy in all areas and may lead to further unwanted inquiries. Furthermore, it is always wise to have a lawyer familiar with FCC rules review the response

to ensure there are not any compliance problems revealed by the data that the company may not know about.

6. *Ask the regulator whether they are satisfied with the information.* It is only a common courtesy to ask the government investigator whether he or she is satisfied with the information provided and to ask whether there are any further questions. It proves to the government that you have nothing to hide and are fully cooperating with the investigation.
7. *If there is a compliance problem, negotiate a resolution.* If the company's lawyer determines that there is a reasonable risk that the company may be fined for rule violations, the government usually will be willing to negotiate a resolution of the problem informally. The FCC makes no secret that it is willing to "settle" an anticipated fine at a huge discount if the company voluntarily pays the equivalent of a fine and demonstrates that it has a compliance plan for the future. The result would be a "consent decree," which sounds intimidating, but usually allows the company to avoid admission of any wrongdoing. This is very useful to avoid any third-part lawsuits because of the incident. And remember, government staffers may decide to drop enforcement action if the attorney is able to convince them that the conduct does not clearly violate a rule and therefore future compliance is sufficient. It may also be time to involve other government staffers who may bring about a successful resolution of the issues.

Government Audits. USAC has also begun to perform a number of routine audits of beneficiary compliance with program rules, and the FCC's Inspector General has announced that it will perform audits itself. These procedures were first introduced to the schools and libraries program, but then high cost fund beneficiaries were added to the audit schedule. USAC can perform these audits with its own staff, but it also hires private auditing firms to conduct these audits for it, subject to USAC oversight and ultimate adoption of the audit findings. These audits resemble to some extent the type of audit that is performed for a company by its outside auditors. These auditors typically have a number of questions where they are seeking answers. In particular, when a private auditor performs audits on behalf of USAC, the agency provides it with specific inquiries and "findings" that it is seeking the auditor to make, somewhat along the line of an agreed-to procedures audit that is typical in private audits.

The audit is typically begun by USAC issuing a letter to the company requesting production of specific documents by a specified date. These requests can ask for extensive information and the return dates for a response can be quite short. The auditors typically request that the information be copied and sent to the auditors' offices, although sometimes the auditors will conduct a portion of the audit by examining documents at the beneficiary's site. These auditors will often ask for clarifying information about the documents either orally, or through written requests such as e-mails. Companies can ask that the auditors keep the information confidential. Companies

should expect that these auditors can be quite aggressive, sometimes even belligerent, when confronting issues about limiting the scope of the request or delaying a response. USAC has been known to make direct threats of enforcement action for noncompliance with its requests.

Once the audit is complete, it is the practice of the auditors to provide the audited party with its written findings and to obtain the company's response to those audit findings. The auditing staff will then insert its reply to the company's response. The auditor's report, plus its findings, will then be presented to USAC. USAC's division responsible for a particular universal service program will then typically make a recommendation to the USAC Board on whether to approve particular audit findings and whether further action should be taken. These Board approvals are then provided to the FCC. None of these procedures is clearly outlined in any public document; it is unknown whether the procedures are consistently followed; and any discussions between the auditors, USAC and the FCC are not transparent to the public. If USAC or the FCC decide to take some action based on the audit, the beneficiary will often only discover that fact when a letter is issued specifying the enforcement action to be taken. If no action is to be taken, the beneficiary will often never know the eventual resolution of the audit.

Audit Checklist. Responding to a routine audit is somewhat different from responding to a general government inquiry. The following are some steps to keep in mind in responding to a FCC/USAC audit of universal service programs.

1. *Promptly comply with the request for materials.* There is no doubt that the request will come at the worst possible time for the company: it will be an annoyance that busy executives and staff do not have time to address. Notwithstanding, refusals to comply with the request or failing to respond at all will be treated harshly by the regulators and will be viewed as the company's effort to hide something. Bite the bullet and comply. If you need more time to respond, the auditors will often be willing to renegotiate the response date, and will often accept part of the information requested while the company is gathering the rest of the information.
2. *Ensure that there are no outstanding compliance issues.* It is important for the company to seek the advice of a knowledgeable FCC attorney or other FCC compliance expert during the course of an audit to determine whether the company has any potential exposure for enforcement action. Discovering any problems early, hopefully before documents are provided to the auditor, will give the company a chance to minimize any damage that could occur from a disclosure. It also allows the company to present the issue to the auditor in the most favorable light to the company, particularly when an incomplete response could lead to a misunderstanding of the facts.

3. *Don't be defensive.* It is sometimes impossible to hide one's hostility to questions from outside government auditors, particularly if the auditor is rude and aggressive. Don't fall into the trap of being unnecessarily hostile or confrontational with the auditor. Such behavior often tends to provoke even more aggressive behavior on the part of the auditor, can make him or her suspicious, and really does not advance the company's interests. Such behavior will not deter the auditor from asking questions or obtaining information. At base, the government has a right to audit the company if the company is receiving government funds from the universal service program. If the company complied with the rules, the audit will end successfully with no action taken and government payments will continue in the future. So take a deep breath and pretend the auditor is reasonable.
4. *Ensure that the company understands what the auditor is requesting.* If the request is ambiguous or you are not sure what company records would respond to the particular request, ask the auditor for a clarification. The last thing the company needs is to spend hours responding to a request that the auditor didn't make in the first place. A lawyer or other FCC compliance expert can also help interpret a request. Remember that it is easy to misunderstand a question, and time spent analyzing what the question means (even putting two head together) can often help in focusing the request to exactly what the auditor states in writing.
5. *Provide an accurate and complete response to the request.* This is the same point as number 5 made above: sloppiness can lead to charges of lying to the government and discredits the company's integrity and honesty. If your company has a good reputation to preserve, spending time on the request is essential.
6. *Keep a record of the information provided and conversations had with the auditors.* In case any question comes up later in the process as to what facts were provided, when, and what was said to whom, it is always a good idea to keep good records of the exchange of information between the parties. The company should keep a complete set of the information it provided to the auditors. Any person who speaks to the auditors should make notes of the substance of the conversations, particularly as to what information is provided by the company and what the auditor says.
7. *Ask the auditor what he or she expects to happen during the process.* It is always a good idea to ask what the next steps in the audit process are and what the auditor expects to happen and when the auditor expects it to happen. This will let you know what schedule the auditor is trying to meet and what are the next steps in the process. If the auditor won't answer these questions, ask someone on the USAC auditing staff what the process will entail.
8. *If a compliance problem becomes apparent, be honest with the auditor.* It is generally unwise to be silent and expect that the auditor will miss a problem. If the company, at the appropriate time, informs the auditor of the problem, the company has the opportunity to

present the problem in the most favorable light and its credibility will be improved. Of course, if there is a good faith argument that the company is in compliance with program rules, then there is no reason to identify the issue to the auditor.

9. *Negotiate with the auditor.* If the auditor identifies a problem, the company is entitled to present its position to the auditor and approving agencies. If the auditor is unconvinced, at the appropriate time, the company has the opportunity to argue its case to USAC. The timing is one of strategy best made by the attorney and the company in the context of the specific facts discovered during the audit.
10. *Take the opportunity to work the process.* There are a number of opportunities for the company to terminate any further enforcement activity once a perceived or alleged problems is discovered by an auditor. Given that an audit is reviewed at different times by USAC audit staff, USAC Board and the FCC, contacts with the appropriate reviewers at the correct time can be effective in convincing the regulators to take no action. Deciding who to talk to and when is again a matter of strategy between the attorney and the company in the context of the specific facts. Remember, the process is far from transparent so it pays to ask questions about what the next steps of the audit are and when they will occur so that the company does not lose an opportunity to plead its case.

Hopefully this information will prove useful if your company is ever audited by the FCC or USAC in the universal service context. Although universal service funds have involved very few government audits in the past, that history is being rewritten daily. The universal service program will continue to be attacked by opponents in both the private sector and in Congress. As a recipient of universal service funds or payer of universal service contributions, it is in your company's interest to maintain the integrity of the program. Handling audits prudently, with the right advice, can go far to avoid unnecessary attacks on such a vital national program.

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