Audit of the Federal Communications Commission Improper Payments Elimination and Recovery Improvement Act FY 2018

(Report No. 19-AUD-02-01)

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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.*

We determined that FCC was noncompliant with IPERIA criteria defined in OMB Memorandum M-18-20. According to OMB Memorandum M-18-20, Inspectors General are required to determine compliance based on an assessment of (a) the accuracy and completeness of agency reporting, (b) the agencies 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	Compliant	Compliant
USF – Lifeline	Noncompliant	NA	Compliant	Noncompliant[4]	Compliant	Noncompliant
USF – Rural Health Care	Compliant	Compliant	NA	NA	NA	NA
USF – Administrative Costs	Compliant	Compliant	NA	NA	NA	NA
Interstate Telecommunications Relay Services	Compliant	NA	Compliant	NA	Compliant	Compliant
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 AFRs or 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-High Cost Program due to deficiencies identified in Finding No. 2 of this report.

[4] Agencies should ensure that each corrective action is specifically aimed toward the true root cause and specifically focused on preventing improper payments. OMB Memorandum, M-18-20, Part IV.B.2 (d).

We found noncompliance with IPERIA in two FCC programs, which accounted for $5.8 billion of the FCC's FY 2018 total Outlays of $9.7 billion (or 60 percent of total Outlays). Specifically, the audit found that:

- FCC did not report an improper payment rate of less than 10 percent of outlays for the Universal Service Fund (USF)-Lifeline Program.
- FCC's estimated improper payment rate for the USF-High Cost (HC) Program did not adequately reflect the significant risks of improper payments that exist in the USF-HC Program.
- FCC did not report improper payments of $12.5 million and recoveries of $1.1 million for the USF-Lifeline (LL) Program that were identified through sources outside of Universal Service Administrative Company's payment recapture audits, including $14,176 related to the USF-Schools & Libraries (S&L) Program; and
- FCC did not identify and assess fraud risk and report the true root causes for improper payments in the USF-LL Program.

Also, because the reported improper payment rate for the USF-HC Program is not reflective of significant risks of improper payment in the program, we were unable to conclude on the accuracy of certain other USF-HC Program improper payment data and information reported on the FCC's FY 2018 AFR. Specifically, we were unable to conclude whether (a) the improper payment rate was less than 10 percent of program outlays, (b) management should have been required to publish a USF-HC Program corrective action plan, or (c) FCC met the improper payment reduction target for USF-HC Program.

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, 2017, through September 30, 2018.

We identified four findings and made 11 recommendations to FCC's management that we deemed sufficient to address the deficiencies noted. FCC management partially concurred with three of the four audit findings and did not concur with one finding. The Results of Audit section of this report provides detailed audit findings, recommendations, excerpts from the summary section for each finding from USAC's management response (referenced as Attachment 1 in Appendix B), and the auditor's response. FCC's management response is provided in Appendix B and definitions for technical terms are provided in Appendix C.

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 (USF), Telecommunications Relay Service (TRS) Fund, and North American Numbering Plan (NANP). Universal Service Administrative Company (USAC) serves as the Administrator and Billing & Collections (B&C) agent for the USF; RolkaLoube serves as the Administrator and B&C agent for the TRS Fund; and Neustar and Welch LLP serves as the Administrator and B&C agent, respectively, for the NANP. 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 manage.

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 Service 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 Memorandum 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 as being susceptible to the risk of significant improper payments: USF-HC, 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 operating expenses, and NANP programs. Based on the risk assessment, FCC determined USF-RHC should be added to the list of programs that are susceptible to significant improper payments. In the FY 2018 AFR, FCC states that the TVF is a new program and will be assessed for improper payment risk in FY 2019. FCC utilized an OMB-approved alternative sampling methodology[2] to develop a statistically valid estimate of the improper payments for TRS. FCC reported its efforts in reducing and recapturing improper payments for all USF and TRS programs, including payment recapture audits for all nine FCC programs, and improper payment corrective actions for USF-LL and USF-S&L.

[2] OMB Memorandum, M-18-20 Part I.D.1.

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-Lifeline Program Gross Improper Payment Rate Noncompliant Under Requirements of IPERIA

CONDITION:

FCC was noncompliant with IPERIA requirements. Our audit found that the estimated gross improper payment rate for Universal Service Fund – Lifeline (USF-LL), one of FCC's four programs that were susceptible to the risk of significant improper payments, exceeded the threshold permitted for compliance with IPERIA. Specifically, we noted that the estimated gross improper payment rate for the USF-LL Program exceeded the IPERIA threshold of less than 10 percent of the gross USF-LL Program outlays. The estimated gross improper payment rate decreased from 21.93 percent in FY 2017 to 18.47 percent in FY 2018.

FCC reported USF-LL Program Outlays of $1.2 billion and $1.5 billion, for FY 2018 and FY 2017, respectively.

Table 2. Estimated Gross Improper Payment Rate for USF Programs As Reported in FCC's FY 2017 and FY 2018 AFR.

FCC Program	FY 2017 (estimated)		FY 2018 (estimated)		
	Improper Payment Percentage	**Improper Payment Amount**	**Improper Payment Percentage**	**Improper Payment Amount**	**Percent above OMB Threshold**
USF-LL	21.93%	$336.39	18.47%	$227.02	**8.47%**
USF-HC	0.05%	$2.50	0.03%	$1.20	0%
USF-S&L	4.34%	$103.51	2.59%	$67.99	0%
TRS	0.00%	$0.00	0.03%	$0.34	0%

Universal Service Administrative Company (USAC) implemented the Lifeline National Eligibility Verifier (National Verifier) as an integral tool for reducing the USF-LL improper payment rate. The National Verifier is a centralized system that verifies consumers' eligibility before Eligible Telecommunications Carriers (ETCs) enroll consumers for the USF-LL Program service. The National Verifier, which became effective on July 1, 2018, is being rolled out in phases. FCC anticipates the National Verifier will be fully implemented in all participating states/territories by the end of 2019. Effective July 1, 2018, all ETCs are required to use the universal forms[3] or state

[3] In the 2016 Lifeline Order, FCC delegated to the FCC – Wireless Communication Bureau the objective of creating uniform, standardized Lifeline forms for all subscribers receiving Lifeline benefits. ETCs in all states and territories must begin using FCC Forms 5629, 5630 and 5631 for initial eligibility verification by July 1, 2018.

specific forms for new USF-LL Program enrollments and recertifications. Also, the National Lifeline Accountability Database is operational and allows ETCs to check on a real-time, nationwide basis whether a consumer is already receiving a Lifeline Program-supported service.

CRITERIA:

OMB Memorandum M-18-20[4], Part IV.A(3) (f), states that to be compliant under IPERIA, agencies must have "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 procedures for monitoring the telecommunication service providers' compliance with the USF-LL Program rules were not adequate to ensure only eligible consumers received USF-LL benefits, or to ensure eligible consumers did not receive multiple USF-LL benefits. Also, the root cause analysis for the USF-LL Program was not adequate to enable USAC to develop effective corrective actions that address persistent improper payments, fraud, waste, and abuse in the USF-LL Program.

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-LL Program.

RECOMMENDATION:

We recommend that FCC management:

1. Perform an assessment of the USF-LL Program to determine whether additional regulatory changes are necessary to reduce the gross improper payment rate to or below the IPERIA threshold of less than 10 percent of outlays. (REPEAT)

2. 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. (NEW)

3. Submit proposals to OMB during FCC's next budget submission that will bring the USF-LL Program into compliance with IPERIA[5]. (NEW)

[4] Effective starting FY 2018
[5] OMB Memorandum, M-18-20, Part IV.B.1(b)

MANAGEMENT RESPONSE:

FCC and USAC management partially concur with this finding.

USAC clarifies that the period covered by the error rate in excess of 10% is calendar year 2017, which is prior to the calendar year 2018 implementation of (1) the National Lifeline Eligibility Verifier (National Verifier), (2) Universal Lifeline Consumer Forms, and (3) the Lifeline Claims System. In addition, USAC began implementing the Lifeline Implementation Safeguards Plan in August 2017 to address the concerns raised in the U.S. Government Accountability Office (GAO's) May 2017 report on the Lifeline Program. The Universal Service Administrative Company (USAC) provides quarterly updates on the Safeguards Plan to the Federal Communications Commission (FCC or Commission).

USAC believes these corrective actions will be effective in reducing the Lifeline improper payment rate. In addition, USAC conducts an annual root cause analysis of common audit findings called the "Circle of Life." This analysis is designed to reduce future instances of these common audit findings, and thus, reduce the improper payment rate. The most recent "Circle of Life" analysis was provided to the Commission on February 14, 2019.

Thus, USAC does not concur with Lani Eko & Company (LEC)'s statement that "the root- cause analysis for the USF-LL Program was not adequate to enable USAC to develop effective corrective actions that address persistent improper payments, fraud, waste, and abuse in the USF- LL Program." USAC management believes that its root cause analysis was effective in identifying corrective actions to address the concerns identified in this finding.

AUDITOR'S RESPONSE:

The FCC and USAC management have made progress in their efforts to reduce improper payments in the USF-LL Program and we acknowledge that corrective actions implemented by the FCC and USAC beginning in 2016 are a multi-year process. However, the USF – LL Program did not meet the threshold for Estimated Gross Improper Payment Rate of less than 10 percent of gross program outlays, as required by OMB Memorandum M-18-20.

FINDING No. 2 – USF High Cost Program Estimated Improper Payments Noncompliant Under Requirements of IPERIA

CONDITION:

USAC established its Payment Quality Assurance (PQA) program to determine if payments made to 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[6]. We also found that the 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. In FY 2018, FCC reported USF-HC Program outlays of $4.6 billion, an estimated improper amount of $1.2 million, and an estimated improper rate of 0.026 percent. The USF-HC Program improper payments are comprised of improper underpayments of $1.13 million (or 95.6 percent), and overpayments of $53,357 (or 4.4 percent). To gain an understanding of the process USAC used to develop the 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 USF-HC Program audit reports issued by USAC's Independent Public Accountants and FCC-OIG. Table 3 below presents 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	$ 96,826
Incremental Support	$ (10,807,250)
Total	**$ 4,669,515,898**

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

FCC and USAC management stated they do not believe the auditor properly considered the constraints imposed on them because of the complexity of 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 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 USF beneficiaries to determine if the payments were consistent with FCC rules. USAC conducted PQA assessments of the Connect America Fund (CAF)[7] 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.

We 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 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[8].

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[9]. 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 year 2017 disbursements were based on a projection and not actual costs.

- 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

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

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., 309 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 input 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 sampling and estimation plan did not reflect the risk factors for each component of 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[10] 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 USF-HC Program disbursements in 2017 was the total outlays of $4.6 billion. The 2017 ICLS true-up adjustment disbursements[11] 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 million[12] 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 USF-HC Program components, but USAC did not provide the schedule for our examination.

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, unallowed and misclassified costs; and unreported revenues.

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[10] Traditional small rural eligible telecommunication carriers.
[11] https://www.usac.org/_res/documents/about/pdf/annual-reports/usac-annual-report-2017.pdf (page 10, footnote 2).
[12] https://www.usac.org/about/tools/fcc/filings/2017/q4.aspx (HC-17)

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 accounted for $1,009.84 of the $1,202.19 million (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 underpayments 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[13]) 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 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 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.

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."
>
> 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

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

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 USF-HC Program services to eligible consumers.

RECOMMENDATIONS:

We recommend that FCC management:

4. Modify the PQA assessment procedures to target USF-HC program rules and significant risks of improper payments. (New)

5. Direct USAC management to leverage its Beneficiary and Contributor Audit Program (BCAP)[14] (or a modified version) for the assessment of improper payments to USF-HC Program beneficiaries. (New)

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

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

7. 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. (New)

MANAGEMENT RESPONSE:

The FCC and USAC management do not concur with this finding.

USAC management concentrated its resources into testing the higher risk areas, which have a greater potential for exceptions. In concentrating Payment Quality Assurance (PQA) testing to those areas with a greater probability for errors, USAC management was able to better substantiate errors for a given amount of PQA resources. Statistically valid sampling was performed to estimate the probability for payment errors.

USAC believes that the PQA testing for High Cost Program disbursements is sufficient to identify improper payments with the legacy, cost-based rate-of-return program, as well as the modernized programs, which provide fixed monthly support amounts with commensurate build-out obligations. The PQA plan reflects the unique characteristics, risk factors, and the regulatory and funding changes for each component of the High Cost Program. In addition, the sampling and estimation plan that was developed by an independent statistician is in compliance with OMB A-123 guidelines.

The PQA's assessment plan was developed jointly by USAC and the FCC's Office of Managing Director (OMD) and Wireline Competition Bureau (WCB) to comply with the IPERIA requirements to measure the rate of improper payments disbursed by USAC. The PQA plan is centered on the following key principles:

- Establishing a statistically valid sample size that meets OMB requirements;
- Evaluating the accuracy of payments made to entities;
- Assessing a statistically valid number of high-risk disbursements through a series of procedures; and
- Complying with OMB requirements to determine a statistically valid error rate.

Further, USAC adheres to a sampling plan that follows the Office of Management and Budget (OMB) A-123 checklist and is approved by OMB) to determine the improper payment rate for the High Cost Program.

The PQA assessment selection process utilizes an independent statistician for sampling, modeling, and analyzing carrier data. In estimating improper payment rates, the independent statistician selected a statistically valid sample of study area codes (SACs) to estimate improper payments (95% confidence and 3% margin-of-error). The 309 randomly selected SACs comprised about $3.2 billion of the $4.6 billion in total High Cost Program disbursements for the total population of 1,696 SACs. These 309 SACs made up 18% of the population (0.182 = 309/1,696) but comprised 70% (0.696 = 3.2/4.6) of total disbursements. The sampling plan excluded 12 SACs with less than $900 in disbursements for the year. In order to obtain a representative sample of SACs and to reduce the burden on ETCs of being assessed multiple times per SAC, AAD randomly selected 1 of the 12 monthly disbursements for each SAC selected by the statistician. This has no bearing on the possibility of a support mechanism being excluded from the sample. The total disbursements for the year subject to sampling represents all disbursements across all support mechanisms (subject to the removal of $4,111 due to immaterial disbursements for 12 SACs). By sampling one month of disbursements from any one SAC, the disbursements sampled amounted to a substantial 6% of total population of disbursements ($3.2 billion divided by 12 is about $270 million which is 5.8% of $4.6 billion).

In addition, USAC management does not believe that LEC has taken into consideration the significant time (and ultimately cost) constraints in examining each High Cost Program component. A PQA assessment for the High Cost Program currently takes about 10 hours per case. A full-scope Beneficiary and Contribution Audit Program (BCAP) audit that examines every consideration and aspect of the High Cost Program requires upwards of 135 hours to 1,200 hours per case. The purpose of BCAP audits is to determine whether the audited carriers complied with FCC rules and orders, which requires much more detailed testing. Conducting a full-scope audit for IPERIA is not feasible when considering the OMB IPERIA reporting deadline (July 31st) and that the sampling and estimation plan requires an examination of 309 SACs. BCAP audits typically take over one year to complete, and it is not reasonable to design PQA procedures in the same manner as the BCAP procedures because it would duplicate efforts and it would not be cost-effective to cover the same level of testing that is already covered in BCAP audits. As stated above, USAC management concentrated its PQA testing resources into testing the higher risk areas, which have a greater potential for exceptions. In concentrating PQA testing to those areas with a greater probability for errors, USAC management was able to better substantiate errors for a given amount of PQA resources.

In conclusion, OMB's requirements and guidance define how agencies should determine an improper payment error rate for programs that are labeled as "subject to significant risk." The FCC and USAC firmly believe that its systematic PQA process is compliant with the requirements and adequately demonstrates whether the High Cost Program is subject to significant risk for making improper payments. USAC purposely chose to institute a systematic PQA methodology that is stringent and complies with OMB requirements and is part of USAC's ongoing commitment to strong financial management controls.

AUDITOR’S RESPONSE:

We evaluated FCC and USAC management comments, and determined that the management comments were not substantially valid. We based our audit conclusion on the results of our review of the PQA procedures and the Sampling and Estimation plan utilized to derive the USF-HC estimated improper payment rate and amount. While FCC and USAC management believe that the PQA testing for USF-HC Program is sufficient to identify improper payments, they also acknowledged that the PQA testing did not adequately address the risks of improper payments in specific USF-HC Program components - such as the Part 36 cost element for CAF-BLS, ICLS True-Up, and USF-HCL; and ETC’s representations and certifications on the annual Tariff Plan. According to USAC management, the sampling plan follows the OMB A-123 checklist and was approved by OMB to determine the improper payment rate for the USF-HC Program. During our audit, we were unable to determine (a) completeness and accuracy of the population of disbursements, and (b) whether the disbursements sample is reflective of the risk in each component of the USF-HC Program. We also questioned FCC and USAC’s interpretation of the test results and the projection of the test results to the underlying population.

Contrary to what was stated by USAC management, OMB does not approve sampling plans. OMB Memorandum M-18-20, Part 1.D.1 Step 1(e) states, *It is important to note that OMB will not be issuing a formal approval to the agency for the statistically valid sampling plan— rather, it is the agency’s responsibility to produce a statistically valid methodology.* We reiterate that the PQA procedures and the sampling and estimation plan are not adequate to identify improper payments in the USF-HC Program.

FINDING No. 3 – Improvement Is Needed In FCC’s Payment Integrity Reporting

CONDITION:

FCC did not completely and accurately report improper payments in its FY 2018 AFR, issued on November 15, 2018. Specifically, the FCC’s FY 2018 AFR did not report improper payments of approximately $12.50 million, and recovery of improper payments of $1.1 million identified through sources outside of payment recapture audits.

USF-LL Program:
In FY 2017, an ETC admitted to FCC and USAC that it received overpayments of approximately $12.48 million from the USF-LL Program. In a letter dated December 21, 2016, USAC demanded repayment of the improperly disbursed USF-LL Program support. FCC and USAC management stated it was appropriate to exclude the $12.48 million improper payments from the FY 2018 AFR because they are related to FY 2017. We noted that these improper payments were also not reported in the FY 2017 AFR. Furthermore, FCC and USAC management did not disclose the improper payments to the auditors during the FY 2017 or FY 2018 IPERIA audits. We found the improper payments during our FY 2018 audit fieldwork. In its response to our audit finding, USAC disclosed that additional recoveries of $1.1 million related to these improper payments were not reported in the FY 2018 AFR.

Also, FCC OIG's Office of Investigations identified approximately 44,500 USF-LL Program subscribers listed in Social Security Administration (SSA) Master Death File as being deceased. According to USAC, improper payments of $2,601 were reported in the FY 2018 AFR for those subscribers. USAC did not disclose to the auditor the total dollar value of the improper payments associated with these subscribers. However, USF reimburses ETCs $9.25 monthly, per subscriber, for providing USF-LL Program-supported service. Therefore, FCC may have understated USF-LL Program improper payments associated with the in the FY 2018 AFR, Table 3, *Improper Payment Recaptures with or without Audit Programs*.

USF-S&L Program:
The $14,176 of USF-S&L improper payments USAC identified outside the payment recapture audits was not reported in FY 2018 AFR, Table 3, *Improper Payment Recaptures with or without Audit Programs*

CRITERIA:

31 U.S.C. § 3321 defines the term, "improper payment"

> "(A) means any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements; and
>
> "(B) includes any payment to an ineligible recipient, any payment for an ineligible good or service, any duplicate payment, any payment for a good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts.

GAO's *Standards for Internal Control in the Federal Government*, Principle No. 11, states, "Management should design the entity's information system and related control activities to achieve objectives and respond to risks."

CAUSE:

FCC and USAC lack uniform and systematic procedures for identifying and reporting improper payments in the AFR.

According to FCC and USAC management, the improper payments of $12.48 million admitted to by the ETC are "potential" improper payments and not confirmed ones. Therefore, those payments were not reported in the FCC's FY 2018 AFR. We believe these improper payments should have been reported in the FY 2018 AFR, consistent with provisions of OMB Memorandum M-18-20. The federal programs susceptible to significant improper payments must report payments that should not have been made, were made in incorrect amounts, or were not sufficiently supported.

Additionally, USAC had not implemented a check of the SSA Death Master File at the time the improper payments occurred.

The $14,176 USF-S&L Program improper payment was due to an error in the automated data transfer into the USAC's SharePoint, which missed two improper payments identified during PQA.

EFFECT:

There is increased risk that USAC management and oversight bodies (i.e., Congress, OMB, FCC and USAC's Board of Directors) lack complete and accurate payment information needed to fulfill their roles with respect to combating improper payments, fraud, waste, and abuse in the USF Programs.

RECOMMENDATION:

We recommend that FCC management:

8. Coordinate with USAC to conduct periodic training for all appropriate FCC and USF Program personnel, to further clarify and emphasize the requirements of guidance for reporting improper payments. (REPEAT)

9. Require USAC to conduct periodic checks of Information Technology systems that support USF programs, to ensure that their configurations support complete, accurate and valid processing of data and payments. (REPEAT)

MANAGEMENT RESPONSE:

FCC and USAC management partially concur with this finding.

LEC identified four items that it believed USAC should have reported in the FCC's FY 2018 Agency Financial Report (AFR). USAC management concurs that it should have reported two of the four items. USAC management does not concur that it should have reported the remaining two items.

USAC agrees that it should have reported the following two items in the FCC's FY 2018 AFR:

- $14,000 in improper payments due to a system transfer issue (self-identified by USAC and reported to the FCC).

- $1.095 million in recoveries. USAC management notes that these recoveries occurred in FY 2018. Thus, these recoveries should have been reported in the FCC's FY 2018 AFR.

The total amount of these items is $1.109 million.

USAC does not concur that the following two items should have been reported in the FCC's FY 2018 AFR. USAC properly excluded these items from the FCC's FY 2018 AFR in accordance with OMB A-123 requirements:

- $12.48 million related to a FY 2017 improper payment. USAC agrees that it failed to report this improper payment in FY 2017. However, this type of reporting issue was previously identified by LEC as a finding in the FY 2017 IPERIA audit and addressed by USAC at that time.

  Further, improper payments should be reported in the year in which they occur. In this instance, USAC should have reported the $12.48 million item as an improper payment in the FY 2017 AFR. Because this $12.48 million item related to an FY 2017 improper payment, USAC believes it was appropriate to exclude this improper payment from the FCC's FY 2018 AFR.

- Potential improper payments related to possible deceased subscribers. Although preliminary results indicate that ETCs received reimbursement for deceased Lifeline subscribers, the FCC and USAC continue to work together to investigate potential deceased subscribers. As both USAC and the FCC confirm a subscriber is in fact deceased, improper payments are confirmed and reported in the AFR in the fiscal year in which they are confirmed.

  Until these potential issues are confirmed as actual improper payments, they are considered "questioned costs." Per OMB A-123, a "'questioned cost' should not be considered an improper payment until the transaction has been completely reviewed and is confirmed to be improper." [15] Thus, it is appropriate to exclude these items from the AFR until they are confirmed.

  USAC properly reported the confirmed improper payments related to deceased subscribers in the FCC's FY 2018 AFR in accordance with OMB A-123 requirements.

In addition, USAC management does not concur with the statement that "FCC and USAC lack uniform and systematic procedures for identifying and reporting improper payments in the AFR." Of the four items that LEC believes USAC should have reported in the FCC's FY 2018 AFR, USAC management agrees that it did not properly report two of these items in the FCC's FY 2018 AFR. However, USAC management does not believe that two items represent a systematic issue. As described above, USAC management believes that it does have uniform and systematic procedures for identifying and reporting improper payments in the AFR.

AUDITOR'S RESPONSE:

We evaluated FCC and USAC management's responses to this finding and do not agree with their statement that "improper payments should be reported in the year in which they occur". We identified the $12.48 million of USF-LL improper payments during FY 2018 audit fieldwork. FCC and USAC did not disclose to the auditors this oversight during the FY 2017 or FY 2018 IPERIA Audits.

FCC and USAC management's statements regarding deceased subscribers identified by FCC OIG's Office of Investigations does not align with OMB Memorandum M-18-20 requirements to report

[15] *See OMB Circular A-123,* Part I.A.1.

improper payments that should not have been made or that was made in error. The notice from FCC OIG's Office of Investigations was issued to FCC and USAC in October 2017, the beginning of FY 2018, and improper payments related to the deceased subscribers should have been reported in the FY 2018 AFR issued on November 15, 2018. Also, FCC management introduced the concept of "Questioned Costs" as a basis for not reporting improper payments in the AFR. As described in OMB M-18-20, "questioned costs" applies to audits of federal domestic assistance grants under the guidance of *OMB Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (commonly called "Uniform Guidance").*

The items above are examples of FCC management's interpretations of OMB guidance in a manner that raises questions regarding transparency of payment integrity reporting under the requirements of IPERIA. FCC uses terms for reporting that are not consistent with OMB guidance (e.g., "Confirmed improper payments" and "confirmed fraud").

FINDING No. 4 – FCC Did Not Accurately Identify the True Root Causes of Improper Payments in the USF-Lifeline Program

CONDITION:

FCC and USAC did not accurately identify the true root causes of improper payments in the USF-LL Program. Accurately identifying and remediating the true root causes of an improper payment would help to prevent its reoccurrence. We present in Table 4 below, the root causes of estimated improper payments in the USF-LL Program[16] , as reported in FCC's FY 2018 AFR.

Table 4. USF Lifeline Program Root Cause for Improper Payments ($ in millions)

Outlays: $ 1,228.90	
Reasons For Improper Payments	
I. Insufficient Documentation:	
(a) Inadequate certifications	$ 214.03
(b) Missing certifications	$ 7.68
(c) One Per Household Rule	$ 0.44
(d) Unsupported subscriber counts	$ 0.05
II. Other Reasons:	
(a) Ineligible subscribers	$ 3.12
(b) Intercarrier duplicates	$ 1.18
(c) Duplicate subscribers	$ 0.52
Total	**$ 227.02**

According to FCC and USAC, inadequate or missing certifications were the primary root causes of improper payments in the USF-LL Program[17]. However, based on our knowledge of the USF-LL

[16] FCC FY 2018 AFR at pages 82-83, available at *https //docs.fcc.gov/public/attachments/DOC-355122A1.pdf*
[17] FCC FY 2018 AFR at page 82, Tables 2 and 2.1, available at *https //docs.fcc.gov/public/attachments/DOC-355122A1.pdf*

Program[18] and FCC's payment integrity reporting process; as well as our review of the results of audits and investigations completed by GAO[19], FCC-EB[20], and FCC-OIG Office of Investigations, we determined the following to be the primary root causes of improper payments in the USF-LL Program:

- Ineligible consumers receiving USF-LL Program supported-service, and
- USF-LL Program payments for fraudulent actions by ETCs and beneficiaries.

Ineligible consumers receiving USF-LL Program supported-service

Under the USF-LL Program rules[21], consumers must certify: (1) their initial income-based or program-based eligibility and recertify each year; (2) their continued eligibility to receive the USF-LL Program-supported service; and (3) that no one else in their household is receiving a USF-LL Program-supported service. At the time of their certification of initial eligibility, a consumer must present certain eligibility documents (e.g., Supplementary Nutritional Assistance Program card, Medicaid card, proof of residency, and proof of age, etc.) to support representations made on the certification forms. However, prior GAO and FCC-OIG audits and investigations demonstrate that FCC and USAC have not implemented effective procedures to authenticate consumers' eligibility for USF-LL Program supported-service.

Regulatory constraints may have prevented FCC and USAC from accessing information in government databases (i.e., Social Security Administration (SSA) Death Master File, and SSA-Supplemental Security Income Database) that would help FCC to identify and prevent improper payments. However, FCC management stated that USAC implemented a check of the SSA Death Master File starting in May 2018.

In addition to regulatory constraints, FCC and USAC lack an effective method for detecting: (a) misuse of eligibility documents used to validate the consumers' representations on the certification forms, (b) bogus consumers created by using identity of other individuals with or without their consent, or (c) inappropriate receipt of multiple USF-LL Program benefits for a single household. FCC and USAC management stated that missing or inadequate certifications and eligibility documentation do not necessarily mean the consumer is not eligible for USF-LL Program-supported services. However, USAC acknowledged that the root cause categories identified in Table 4, above, apply to situations where subscribers were not eligible to receive USF-LL Program support. Therefore, each of the root causes fall under the overall category of "Ineligible consumers receiving USF-LL Program supported-service." USAC further clarified that in a situation where improper payments were made due to an inadequate subscriber certification or inadequate eligibility documentation, USAC categorized the root cause as "Inadequate Certification."

[18] Final Audit Report No. 15-AUD-07-05, *Audit of Nexus Communications, Inc. Compliance with FCC's Lifeline Rules*
Final Audit Report No. 15-AUD- 10-09 on the Universal Service Administrative Company's Implementation of the National Lifeline Accountability Database
[19] GAO Report, *Additional Action Needed to Mitigate Significant Risks in FCC's Lifeline Program*, GAO-17-805T, May 2017
[20] FCC Notice of Apparent Liability For Forfeiture and Order (File No.: EB-IHD-17-00023554), Adopted October 23, 2018
[21] 47 U.S.C. § 54-400 to 54.422

FCC management's response to FCC Inspector General's Management and Performance Challenges, dated November 15, 2018, further demonstrates that insufficient certification documents were not the primary root cause of improper payments in the USF-LL Program. According to FCC management, USAC initiated monthly reviews to test a statistically valid sample of enrolled or recertified subscribers. The sample was selected from the 10 ETCs with the highest number of potentially ineligible subscribers, as identified by GAO. USAC's first monthly review found that ETCs failed to provide adequate eligibility or recertification documentation for approximately 5 percent of the subscribers sampled.

USAC management stated that the results of its monthly review are not comparable to the root cause categories reported in FCC's FY 2018 AFR because the sample was drawn from a targeted risk-based population, the exceptions identified were not projected to the population from which the sample was drawn, and the error rate was determined based on the subscriber population and not by the amount.

We cite the results of USAC's monthly review to further demonstrate that insufficient certifications do not represent a significant root cause of improper payments in the USF-LL Program. The expected error due to insufficient certifications should have been much higher than the five percent exception rate found in the monthly review, given that the sample was drawn from a targeted risk-based population. Finally, whether the error rate is based on the number of subscribers with exceptions or total amount of exceptions in the population does not materially impact our finding since USF reimburses ETC a uniform monthly rate of $9.25 per subscriber.

USF-LL Program Payments for fraudulent actions of ETCs and Beneficiaries

FCC and USAC inappropriately did not report fraud as a root cause of estimated improper payment in instances when USF-LL Program payments were made based on false information provided by ETCs or beneficiaries, and those payments were not referred for a judicial or adjudicative determination. The root cause table in the payment integrity section of FCC's FY 2018 AFR applies to improper payments identified through the estimation process. The root causes of improper payments identified during the estimation process should reflect the characteristics of the underlying improper payments in the population from which the sample was selected. We do not believe that the root causes reported in the FCC's FY 2018 AFR are reflective of the characteristics of the underlying improper payments in the USF-LL Program outlays. The USF-LL Program has a documented history of making improper payments as a result of fraudulent actions by ETCs and beneficiaries. However, FCC management has not reported in its AFR, that fraud was a root cause of estimated improper payments in the USF-LL Program.

We agree with FCC and USAC management's determination that payments indicative of fraud that are referred to agency's Inspector General or the U.S. Department of Justice should not be reported as a fraud until completion of the judicial or adjudicative process – which FCC and USAC refer to as "Confirmed Fraud."

CRITERIA:

OMB Memorandum M-18-20[22], *Appendix C to Circular No. A-123, Requirements for Payment Integrity Improvement*:

> Overview, states, "Programs susceptible to significant improper payments must[23] identify the root causes of the improper payments and implement appropriate corrective actions to prevent and reduce improper payments".
>
> Part II, Section C (1), states, **"What categories should agencies use when reporting improper payment estimates?** Agencies with programs that are reporting an improper payment estimate should report information based on the categories described below…These categories: (1) help agencies present the different categories of improper payments in their programs and the percentage of the total improper payment estimate that each category represents; and (2) provide granularity on improper payment estimates—thus leading to more effective corrective actions at the program level and more focused strategies for preventing improper payments".
>
> Part II, Section C.1 (h), states, "If none of the above categories apply, include any other reasons for the improper payment under this category—and please explain the reasons in more detail either in footnotes or in the narrative below the table. In instances where agencies are able to identify improper payments resulting from **fraud**, they should report those dollar amounts in this row".
>
> Part II, Section C (2), states, **"**When agencies are reviewing the root causes of improper payments, or -in the case of high-priority programs -analyzing areas for semi-annual or quarterly actions, agencies should be mindful of maintaining a focus on fraudulent activity within the program".
>
> Part IV, Section A (4), states, "In determining compliance, the agency Inspector General should evaluate the accuracy and completeness of agency reporting, and …The agency Inspector General should evaluate the root cause category classification and determine whether the agency has accurately classified the true root causes of improper payments..."

CAUSE:

USAC lacks adequate procedures to analyze the root causes of recurring improper payments in the USF-LL Program.

FCC and USAC did not appropriately interpret and apply Part II, Section C (2) of OMB Memorandum M-18-20, to the USF-LL Program estimation process. USAC did not refer the improper payments identified by the USF-LL Program estimation process that were indicative of fraud to the FCC's Inspector General or the U.S. Department of Justice for the judicial or the adjudicative determination.

[22] Effective starting FY 2018
[23] OMB Memorandum (M) 18-20, *Appendix C to Circular No. A-123, Introduction Section,* "Throughout the Appendix, the terms "Must" and "Will" denote a requirement that management will comply in all cases..."

While FCC and USAC management have directives that outline policies, procedures, and responsibilities relating to fraud, none of the documented procedures address analyzing the root causes of improper payments to identify improper payments resulting from fraud and other causes as part of USF-LL Program improper payment estimation process.

The PQA procedures were not designed to detect fraudulent USF payments.

USAC did not categorize the root cause of improper payments in a manner that represents the most significant risk of improper payments to the USF program (i.e., payments to ineligible subscribers represent a more significant risk to the USF-LL Program than payments to subscribers with insufficient certifications).

EFFECT:

USAC and FCC management's corrective actions may be less effective because the root causes reported in FCC's FY 2018 AFR did not address the risks associated with authentication of consumers' eligibility and fraudulent activities in the USF-LL Program. Also, Congress may not be fully informed of the impact of regulatory constraints and fraud.

RECOMMENDATION:

We recommend the FCC management:

10. Implement procedures to examine the root causes of USF-LL estimated improper payments and consider the results of recent audits and investigations to more accurately report information in the AFR and the report to Congress. (UPDATE)

11. Implement procedures to ensure that if multiple root causes are associated with improper payments, the root cause is categorized and reported in a manner that represents the most significant risk to the particular USF Program. (NEW)

MANAGEMENT RESPONSE:

FCC and USAC management partially concur with this finding.

USAC management agrees that the language used for the Lifeline root-cause categories can be modified to more clearly articulate the overall concerns with the Lifeline Program. USAC management will work with the FCC to clarify this language. In addition, USAC management will work with the FCC to determine what information in recent Lifeline audits and investigations is appropriate to include in the FCC's AFR.

In regards to the root cause categories reported in the FCC's FY 2018 AFR, USAC management would like to clarify that a subscriber may <u>qualify</u> to receive Lifeline support based on participation in a qualifying program or income level (*e.g.*, Medicaid, Supplemental Security Income, etc.). However, a subscriber is not <u>eligible</u> to receive Lifeline support unless an ETC can demonstrate that a subscriber meets multiple program requirements, including program/income qualification.

USAC's PQA team performs tests to ensure a subscriber is eligible to receive Lifeline support (*e.g.*, program/income qualification, complete certification, etc.). If USAC's PQA team determines a subscriber did not meet a program requirement, that subscriber is considered ineligible for Lifeline support. Thus, each of the Lifeline root causes in the AFR fall under the category of "ineligible consumers."

In addition, USAC management does not concur with LEC's statement that "USAC lacks adequate procedures to analyze the root causes of recurring improper payments in the USF-LL Program." USAC clarifies that the period covered by this finding was calendar year 2017, which is prior to the calendar year 2018 implementation of (1) the National Verifier, (2) Universal Lifeline Consumer Forms, and (3) the Lifeline Claims System. In addition, USAC conducts an annual root cause analysis of common audit findings called the "Circle of Life." This analysis is designed to reduce future instances of these common audit findings, and thus, reduce the improper payment rate. USAC believes these corrective actions will be effective in reducing the Lifeline improper payment rate.

Further, USAC does not concur with LEC's assertions that fraud was not appropriately reported by USAC in the FCC's FY 2018 AFR. USAC management notes that it is not aware of any new improper payments related to FY 2018 improper payment reporting that it believes met the OMB Circular A-123, Part II.C.2 fraud reporting requirements.[24] Thus, USAC's reporting related to this matter was appropriate. USAC management will work with the FCC to determine what additional information can be included in the AFR to discuss potential fraudulent activities in the Lifeline Program.

Lastly, USAC does not concur with LEC's statement that "none of the documented procedures address analyzing the root causes of improper payments to identify improper payments resulting from fraud and other causes as part of USF-LL Program improper payment estimation process." In response to a finding related to the FY 2017 IPERIA audit, USAC implemented additional procedures to identify fraud as a root cause. USAC utilized these procedures when reporting information for the FCC's FY 2018 AFR.

AUDITOR'S RESPONSE:

FCC and USAC management agreed that the language used for the USF-LL Program root because categories should be refined to more clearly identify areas of concern. The USF-LL Program has a history of improper payments and payments for fraudulent activities by ETCs and USF beneficiaries. We believe that one of the primary reasons for the pattern of improper payments is because the corrective actions or solutions implemented by FCC and USAC management were not focused on the true root causes of improper payments in USF-LL Program.

[24] *See OMB Circular A-123*, Part II.C.2.

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*:

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, 2017, through September 30, 2018.

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 2018 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 program.
- 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-S&L, and USF-LL.
- Reviewed FCC's IPERIA reporting quality control procedures and supporting documentation.

APPENDIX B – MANAGEMENT'S RESPONSE

UNITED STATES GOVERNMENT
FEDERAL COMMUNICATIONS COMMISSION

Office of Managing Director

MEMORANDUM

DATE: May 30, 2019

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) 2018

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, 2018 (A-123 Requirements). We appreciate the efforts of your team and the independent auditors, Lani Eko & Company, CPAs, PLLC, to work with the Commission on this audit and share your interest in reducing waste, fraud and abuse in the universal service program.

We have reviewed the draft report findings and recommendations and partially concur with findings 1, 3 and 4 and do not concur with finding 2. Attached to this response as **ATTACHMENT 1** is a memorandum prepared by the Universal Service Administrative Company (USAC), the administrator of the Universal Service Fund (USF), which provides a more in-depth summary and a detailed write up commenting on the specific findings and recommendations in the draft report. We incorporate this memorandum into our response in its entirety and ask that it be included with our response in the final report.

We recognize that the auditors identified the USF Lifeline Program as not being compliant for a second year because the estimated improper payment rate exceeded 10 percent of that program's gross outlay (with estimated improper payments of $227.02 million in 2018, or 18.47% of funds disbursed). The auditors also noted deficiencies in USAC's corrective action plan to reduce improper payments for the Lifeline Program. The period covered by the IPERIA audit for the Lifeline Program included calendar year 2017 outlays. Since 2017, the FCC has made great strides to improve processes that will reduce improper payments. For example, the FCC has worked with USAC to implement: 1) the National Lifeline Eligibility Verifier, 2) Universal Lifeline Consumer Forms, and 3) the Lifeline Claims Systems. We will continue to work with USAC to reduce improper payments and to reduce fraud, waste, and abuse in the Lifeline Program.

The auditors also identified the High Cost Program as not being compliant. The auditors found that the reported estimated improper payment rate did not adequately reflect 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. Rather, 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. The auditor did not raise issues or concerns about the High Cost Program's compliance until the final stages of the audit process. This late notification greatly limited the auditor's time to ask questions and USAC's and the FCC's opportunity to explain the complexities of the High Cost Program and procedures used by USAC to test for improper payments. The attached memorandum provides a more detailed response to the auditor's findings and recommendations. We will continue to work with USAC to review the A-123 Requirements and make any necessary improvements to ensure compliance in the High Cost Program going forward.

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** to this response to provide additional details about why we partially concur with findings 1, 3 and 4 and do not concur with finding 2.

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