

**Universal Service Administrative Company
Audit Committee Quarterly Meeting
Agenda**

**Monday, October 23, 2017
8:00 a.m. – 9:30 a.m. Eastern Time
USAC Offices
700 12th Street, N.W., Suite 900
Washington, D.C. 20005**

OPEN SESSION

- a1.** Consent Items (each available for discussion upon request):
- A.** Approval of Audit Committee Meeting Minutes of July 24, 2017, September 6, 2017 and September 22, 2017.
 - B.** Approval of moving all *Executive Session* items into *Executive Session*.
 - C.** Acceptance of the Annual Assessment by the USAC Internal Audit Division of the Independence and Financial Literacy of USAC Audit Committee Members.
 - D.** Annual Review of the Effectiveness of the Company’s Process for Assessing Significant Risks and Exposures and the Steps Management Has Taken to Minimize Such Risks and Exposures.
 - E.** Annual Review of the Adequacy of USAC’s System of Internal Controls by the USAC Internal Audit Division.

EXECUTIVE SESSION

- i1.** USAC Internal Audit Division Business Update – **Confidential** – *Executive Session Recommended*
- General Business Update.
 - Review of Improper Payment Rates.
 - Update on Procurement Process and Compensation Audits.
- a2.** Annual Review of the Internal Audit Charter; the Organizational Structure, Budget, and Activities of the Internal Audit Division; and Significant Changes to the Internal Audit Plan – **Confidential** – *Executive Session Recommended*.
- a3.** Action on Two USAC Internal Audit Division Operational Audit Reports - **Confidential** – *Executive Session Recommended*.
- i2.** Executive Session with USAC’s Vice President of Internal Audit – **Confidential** – *Executive Session Recommended*.

Next Scheduled USAC Audit Committee Meeting

**Monday, January 29, 2018
8:00 a.m. – 9:30 a.m.
USAC Offices, Washington, D.C.**

Universal Service Administrative Company Audit Committee Meeting

ACTION ITEM

Consent Items

Action Requested

The Audit Committee (Committee) is requested to approve the consent items listed below.

Discussion

The Committee is requested to approve the following items using the consent resolutions below:

- A. Approval of Committee meeting minutes of July 24, 2017, September 6, 2017 and September 22, 2017 (*see Attachments A-1 through A-3*).
- B. Approval for discussing in *Executive Session* agenda items:
 - (1) **i1** – USAC Internal Audit Division Business Update. USAC management recommends that this item be discussed in *Executive Session* because this matter relates to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.
 - (2) **a2** – Annual Review of the Internal Audit Charter, the Organizational Structure, Budget, and Activities of the Internal Audit Division; and Significant Changes to the Internal Audit Plan. USAC management recommends that this matter be discussed in *Executive Session* because the basis to support the changes relate to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.
 - (3) **a3** – Action on Two USAC Internal Audit Division Operational Audit Reports. USAC management recommends that this matter be discussed in *Executive Session* because these reports relate to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.
 - (4) **i2** – Executive Session with USAC’s Vice President of Internal Audit. USAC management recommends that this matter be discussed in *Executive Session* pursuant to the guidelines in the approved Audit Committee Charter.
- C. Acceptance of the Annual Assessment by the USAC Internal Audit Division of the Independence and Financial Literacy of USAC Audit Committee Members.

In accordance with USAC's Audit Committee (Committee) Charter (Charter), the Committee is required to assess the independence and financial literacy of its members to ensure the Committee can adequately fulfill its roles and responsibilities. **Attachment C** to this briefing paper documents the assessment of the Committee made by the USAC Internal Audit Division (IAD). The Committee is requested to review and approve the assessment performed by IAD as set forth in the recommended resolution below.

D. Annual Review of the Effectiveness of the Company's Process for Assessing Significant Risks and Exposures and the Steps Management Has Taken to Minimize Such Risks and Exposures.

In accordance with the Charter, the Committee is required to annually review the effectiveness of USAC's process for assessing significant risks and exposures (collectively, risks), and the steps management has taken to minimize such risks. This issue paper documents the review performed by IAD and discusses the process by which risks are assessed and managed.

A description of USAC's process for assessing significant risks and the steps management has taken to minimize such risks is included in **Attachment D** to this briefing paper. This brief summary of management's efforts to manage risk is not intended to be a comprehensive recitation of the steps taken by USAC relating to risk management. The risk management process outlined in the attachment indicates that there are systems in place for adequate identification and analysis of risks that may affect the achievement of company objectives. The processes followed by USAC are designed to provide a framework by which risks are continually identified, evaluated and managed. Additionally, through the efforts of IAD's risk assessment process, further identification of significant risks, which are brought to the attention of USAC management, ensures that the system of risk assessment and management is effective. The process has been strengthened with the addition of the Enterprise Risk Management (ERM) team, which will further leverage USAC's ability to effectively manage risks.

Accordingly, IAD has concluded that management has established and maintains an effective process for assessing significant risks and taking steps to minimize such risks. IAD recommends that the Committee accept its review and associated conclusion.

E. Annual Review of the Adequacy of USAC's System of Internal Controls.

In accordance with the Charter, the Committee is required to annually review the adequacy of USAC's system of internal controls. The attached briefing paper documents the assessment made by IAD and discusses the standards that comprise

USAC's internal control structure. A narrative description of the adequacy of USAC's system of internal controls is included in **Attachment E** to this briefing paper. The process indicates that there are systems in place to ensure compliance with policies, procedures and FCC regulations.

There is sufficient separation of duties among the individuals responsible for initiating, preparing, approving and processing data. In addition, management's philosophy and operating style, as well as staff training and education, all encourage the utmost integrity and ethical conduct. Accordingly, management has established and is maintaining an adequate system of internal controls that allows for the successful achievement of objectives without compromising standards. IAD recommends the Committee accept the review of the adequacy of USAC's system of internal controls.

Upon request of a Committee member any one or more of the above items are available for discussion by the Committee.

Recommended USAC Audit Committee Action

APPROVAL OF THE FOLLOWING RESOLUTIONS:

RESOLVED, that the USAC Audit Committee hereby approves the Committee meeting minutes of July 24, 2017, September 6, 2017 and September 22, 2017 and discussion in *Executive Session* of the items noted above; and

RESOLVED FURTHER, that the USAC Audit Committee accepts the assessment made by the USAC Internal Audit Division and agrees that the Audit Committee is adequately staffed with independent members and has a sufficient level of financial expertise; and

RESOLVED FURTHER, that the USAC Audit Committee accepts the USAC Internal Audit Division's review of the effectiveness of the Company's process for assessing significant risks and exposures, and the steps management has taken to minimize such risks and exposures; and

RESOLVED FURTHER, that the USAC Audit Committee accepts the review of the adequacy of USAC's system of internal controls performed by the USAC Internal Audit Division.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY
700 12th Street, N.W., Suite 900
Washington, D.C. 20005

AUDIT COMMITTEE MEETING
Monday, July 24, 2017

(DRAFT) MINUTES¹

The quarterly meeting of the USAC Board of Directors (Board) Audit Committee (Committee) was held at USAC’s offices in Washington, D.C. on Monday, July 24, 2017. Mr. Gillan, Committee Chair, called the meeting to order at 8:03 a.m. Eastern Time, with all five of the Committee members present:

- Feiss, Geoff
- Gillan, Joe – Chair
- Talbott, Dr. Brian
- Tinic, Atilla
- Wibberly, Dr. Kathy

Other Board members and officers of the corporation present:

- Bocher, Bob – Member of the Board
- Davis, Craig – Vice President of Schools & Libraries
- Kinser, Cynthia – Member of the Board
- Lee, Karen – Vice President of Rural Health Care
- Poulin, Chera – Vice President and Chief Human Resources Officer
- Robinson, Vickie – Acting Chief Executive Officer, General Counsel and Assistant Secretary
- Salvator, Charles – Vice President of Finance, Chief Financial Officer and Assistant Treasurer
- Scott, Wayne – Vice President of Internal Audit
- Shah, Hemang – Vice President of Enterprise Portfolio Management
- Sweeney, Mark – Chief Operating Officer

Others present:

| <u>NAME</u> | <u>COMPANY</u> |
|-------------------------|----------------|
| Anderson, Jarnice | USAC |
| Braxton-Johnson, Kianna | USAC |
| Carpenter, Nikki-Blair | USAC |
| Crowe, Jen | USAC |

¹ Draft resolutions were presented to the Committee prior to the Committee meeting. Where appropriate, non-substantive changes have been made to the resolutions set forth herein to clarify language where necessary or to correct grammatical or spelling errors.

| <u>NAME</u> | <u>COMPANY</u> |
|--------------------|------------------------|
| Delmar, Teleshia | USAC |
| Doane, Nathan | PricewaterhouseCoopers |
| Fischer, Dennis | USAC |
| Francisco, Dale | USAC |
| Goode, Vernell | USAC |
| Hughet, Pamela | USAC |
| King, Lauren | USAC |
| Leonard, Tom | PricewaterhouseCoopers |
| Litman, Travis | FCC |
| Lutz, Corey | USAC |
| Lutz, Kevin | USAC |
| Mitchell, Steve | USAC |
| Murray, Sheila | USAC |
| Nuzzo, Patsy | USAC |
| Smith, Chris | USAC |
| Tuinstra, Jason | PricewaterhouseCoopers |

OPEN SESSION

a1. Consent Items. Mr. Gillan presented these items to the Committee.

A. Approval of Committee meeting minutes of April 24, 2017, May 2, 2017, June 9, 2017, June 23, 2017, and June 30, 2017.

B. Approval for discussing in *Executive Session* agenda item:

- (1) **a2** – Acceptance of USAC’s 2016 Annual Financial Audit and Agreed-Upon Procedures Review. USAC management recommends that this matter be discussed in *Executive Session* because this report includes *confidential company data*. *47 C.F.R. § 54.711(b) requires USAC to keep all data obtained from contributors confidential.*
- (2) **a3** – Action on Four USAC Internal Audit Division Operational Audit Reports. USAC management recommends that this matter be discussed in *Executive Session* because these reports relate to *specific internal controls, and/or confidential company data* that would constitute a discussion of internal rules and procedures.
- (3) **i2** – Audit Committee Executive Session with USAC’s Independent Audit Firm. USAC management recommends that this matter be discussed in *Executive Session* pursuant to the guidelines in the approved Audit Committee Charter.
- (4) **i3** – Annual Executive Session with USAC’s Vice President of Internal Audit. USAC management recommends that this matter be discussed in Executive Session consistent with the requirements of the Audit

Committee Charter that the Committee meet annually with the Vice President of Internal Audit in *Executive Session*.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

RESOLVED, that the USAC Audit Committee hereby approves the Committee meeting minutes of April 24, 2017, May 2, 2017, June 9, 2017, June 23, 2017, and June 30, 2017, and discussion in *Executive Session* of the Audit Committee Executive Session with USAC's Independent Audit Firm, and the Annual Executive Session with USAC's Vice President of Internal Audit.

- i1. USAC Internal Audit Division Business Update.** Mr. Scott introduced this item to the Committee. He provided an update on the status of audit activities performed under the Beneficiary and Contributor Audit Program (BCAP), the Payment Quality Assurance (PQA) Program, and USAC Corporate Assurance audits. This update also included the Internal Audit Division's (IAD) observations after comparing random audit plans with risk-based audit plans.

At 8:19 a.m. Eastern Time, on a motion duly made and seconded, the Committee moved into *Executive Session* for the purpose of discussing the confidential items noted above.

EXECUTIVE SESSION

In the interest of meeting flow, the Committee modified the order of items to be discussed. The Committee discussed items in the following order: Item a3, a2, i2, then i3.

- a3. Action on Five USAC Internal Audit Division Operational Audit Reports.** Mr. Scott presented this time for consideration.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

RESOLVED, that the USAC Audit Committee, having reviewed the USAC Internal Audit Division (IAD) operational audit reports as listed in Exhibit I to this briefing paper, accepts the recommendations of the USAC Executive Committee and USAC management and hereby deems the reports final.

- a2. Acceptance of USAC's 2016 Annual Financial Audit and Agreed-Upon Procedures Review.** Mr. Scott introduced PricewaterhouseCoopers LLP (PwC) to present this item for consideration.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolutions:

RESOLVED, that the USAC Audit Committee, having reviewed the USAC 2016 Financial Audit Report as submitted by PricewaterhouseCoopers LLP, hereby deems the report final; and

RESOLVED FURTHER, that the USAC Audit Committee, having reviewed the USAC 2016 Agreed-Upon Procedures Review Report as submitted by PricewaterhouseCoopers LLP, hereby deems such report final.

At 8:37 a.m. Eastern Time, the meeting continued in *Executive Session* with only PwC, members of the Board, Ms. Robinson, Mr. Salvator, and Mr. Scott present for the purpose of discussing item i2.

i2. Audit Committee Executive Session with USAC's Independent Audit Firm – PricewaterhouseCoopers LLP. Mr. Scott and representatives of PwC discussed this item with the Committee.

The meeting continued in *Executive Session* with only members of the Board and Mr. Scott present for the purpose of discussing item i3.

i3. Annual Executive Session with USAC's Vice President of Internal Audit. Mr. Scott and the Audit Committee discussed this item.

At 9:52 a.m. Eastern Time, on a motion duly made and seconded, the Committee moved out of *Executive Session* and immediately reconvened in *Open Session*, at which time Mr. Gillan reported that in *Executive Session*, the Committee took action on items a2 and a3 and discussed items i2 and i3.

On a motion duly made and seconded, the Committee adjourned at 9:52 a.m. Eastern Time.

/s/ Vickie Robinson
Assistant Secretary

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY
700 12th Street, N.W., Suite 900
Washington, D.C. 20005

AUDIT COMMITTEE MEETING
Wednesday, September 6, 2017

(DRAFT) MINUTES¹

A meeting of the USAC Board of Directors (Board) Audit Committee (Committee) was held at USAC's offices in Washington, D.C. on Wednesday, September 6, 2017. Mr. Joe Gillan, Committee Chair, called the meeting to order at 4:32 p.m. Eastern Time, with three of the five Committee members present:

Gillan, Joe – Chair – *by telephone*
Tinic, Atilla – *by telephone*

Wibberly, Dr. Kathy – *by telephone*

Members of the Committee not present:

Feiss, Geoff – Vice Chair
Talbott, Dr. Brian

Other Board members and officers of the corporation present:

Kinser, Cynthia – Member of the Board – *by telephone*
Poulin, Chera – Vice President and Chief Human Resources Officer
Robinson, Vickie – Acting Chief Executive Officer, General Counsel and Assistant Secretary
Salvator, Charles – Vice President of Finance, Chief Financial Officer and Assistant Treasurer
Scott, Wayne – Vice President of Internal Audit
Sweeney, Mark – Chief Operating Officer
Wein, Olivia – Member of the Board – *by telephone*

Others present:

| <u>NAME</u> | <u>COMPANY</u> |
|-------------------|----------------|
| Anderson, Jarnice | USAC |
| King, Lauren | USAC |

¹ Draft resolutions were presented to the Committee prior to the Committee meeting. Where appropriate, non-substantive changes have been made to the resolutions set forth herein to clarify language where necessary or to correct grammatical or spelling errors.

NAME

Nuzzo, Patsy

COMPANY

USAC

OPEN SESSION

- a1. **Consideration of a Contract Award for Procurement Process Audit and Compensation Audit.** Ms. Robinson recommended that discussion of this item be conducted *Executive Session* because this matter relates to USAC's *procurement strategy and contract administration*.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

RESOLVED, that the USAC Audit Committee hereby approves the Committee discussing this item in *Executive Session*.

At 4:33 p.m. Eastern Time, on a motion duly made and seconded, the Committee moved into *Executive Session* for the purpose of discussing the confidential item listed above.

EXECUTIVE SESSION

- a1. **Consideration of a Contract Award for Procurement Process Audit and Compensation Audit.** Mr. Scott presented this item for consideration, noting that the procurement process audit will include a review of documentation and evaluation of all processes and internal controls related to procurement activities. The compensation audit will cover compensation policies, procedures and practices for officers and employees of the company, including traditional and non-traditional employees.

On a motion duly made and seconded and after discussion, the Committee adopted the following resolution:

RESOLVED, that the USAC Audit Committee, having reviewed the recommendation of USAC management, hereby authorizes management to award a contract to Crowe Horwath LLP for a not-to-exceed total cost of \$175,000 plus applicable sales taxes.

At 4:49 p.m. Eastern Time, on a motion duly made and seconded, the Committee moved out of *Executive Session* and immediately reconvened in *Open Session*, at which time Mr. Gillan reported that in *Executive Session*, the Committee took action on item a1. On a motion duly made and seconded, the Committee adjourned at 4:49 p.m. Eastern Time.

/s/ Vickie Robinson
Assistant Secretary

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY
700 12th Street, N.W., Suite 900
Washington, D.C. 20005

AUDIT COMMITTEE MEETING
Friday, September 22, 2017

(DRAFT) MINUTES¹

A meeting of the USAC Board of Directors (Board) Audit Committee (Committee) was held at USAC's offices in Washington, D.C. on Friday, September 22, 2017. Mr. Joe Gillan, Committee Chair, called the meeting to order at 11:08 a.m. Eastern Time, with three of the five Committee members present:

Feiss, Geoff – Vice Chair – *by telephone*
Gillan, Joe – Chair – *by telephone*
Talbott, Dr. Brian – *by telephone*

Members of the Committee not present:

Tinic, Atilla
Wibberly, Dr. Kathy

Other Board members and officers of the corporation present:

Robinson, Vickie – Acting Chief Executive Officer, General Counsel and Assistant Secretary
Scott, Wayne – Vice President of Internal Audit

Others present:

| <u>NAME</u> | <u>COMPANY</u> |
|------------------|----------------|
| Jarnice Anderson | USAC |
| Mark Maraccini | Crowe Horwath |

OPEN SESSION

- i1. Update Regarding Procurement and Compensation Audits.** Ms. Robinson recommended that discussion of this item be conducted in *Executive Session*

¹ Draft resolutions were presented to the Committee prior to the Committee meeting. Where appropriate, non-substantive changes have been made to the resolutions set forth herein to clarify language where necessary or to correct grammatical or spelling errors.

because this matter relates to USAC's *procurement strategy and contract administration, internal controls, and/or confidential company data, and may also include pre-decisional matters pending before the FCC.*

On a motion duly made and seconded and after discussion, the Board adopted the following resolution:

RESOLVED, that the USAC Audit Committee hereby approves the Committee discussing this item in *Executive Session*.

At 11:10 a.m. Eastern Time, the Committee moved into *Executive Session* for the purpose of discussing the confidential item listed above.

EXECUTIVE SESSION

- i1. Update Regarding Procurement and Compensation Audit.** Mr. Scott introduced the item to the Committee for discussion by introducing Mr. Mark Maraccini from the audit firm of Crowe Horwath, who led the discussion regarding the audits. Mr. Maraccini discussed the audit objectives and the proposed audit scope. He then began asking questions of the various Committee members and Ms. Robinson to obtain feedback to plan for the audits.

At 12:00 p.m. Eastern Time, the Committee moved out of *Executive Session* and immediately reconvened in *Open Session*, at which time Mr. Gillan reported that in *Executive Session*, the Committee discussed item i1. On a motion duly made and seconded, the Committee adjourned at 12:01 p.m. Eastern Time.

/s/ Vickie Robinson
Assistant Secretary

Attachment C
Acceptance of the Annual Assessment by
the USAC Internal Audit Division of the Independence and Financial Literacy
of USAC Audit Committee Members

Action Requested

In accordance with USAC’s Audit Committee (Committee) Charter (Charter), the Committee is required to assess the independence and financial literacy of its members to ensure the Committee can adequately fulfill its roles and responsibilities. This issue paper documents the assessment of the Committee made by the USAC Internal Audit Division (IAD).

Discussion

The Charter requires that the Committee assess the independence and financial literacy of its members at least annually to verify that the Committee is independent and has a sufficient level of financial expertise to perform its duties.

Following is a summary of the Charter’s independence and financial literacy requirements and an assessment of committee member compliance with specific sections below:

| Audit Committee Charter (Section II, A1c, 2a-c) | Joseph Gillan | Geoff Feiss | Brian Talbott | Atila Tinic | Kathy Wibberly |
|---|----------------------|--------------------|----------------------|--------------------|-----------------------|
| [The member] is not and has not been employed in an executive capacity by the Company for at least five years prior to appointment to the Audit Committee. | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> |
| [The member] is not an advisor or consultant to the Company, and does not have a personal services contract or other business relationship with the Company.* | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> |

| Audit Committee Charter (Section II, A1c, 2a-c) | Joseph Gillan | Geoff Feiss | Brian Talbott | Atilla Tinic | Kathy Wibberly |
|---|----------------------|--------------------|----------------------|---------------------|-----------------------|
| [The member] is not a spouse, parent, sibling, child, or in-law of any person described in the preceding two clauses of this paragraph or of any member of the management of the Company. | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> | <i>Yes</i> |
| At least one member shall have a background in financial reporting, accounting, or auditing, or other financial expertise. | <i>Yes</i> | <i>No</i> | <i>Yes</i> | <i>Yes</i> | <i>No</i> |
| <i>*NOTE: None of the members of the Audit Committee have a consulting arrangement or contractual business relationship with USAC. Members may be employees of companies or entities that contribute to and/or receive funds from the Universal Service Fund (USF).</i> | | | | | |

The financial proficiency shown by Mr. Joseph Gillan, Dr. Brian Talbott, and Mr. Atilla Tinic is experience acquired during their professional careers.

As previously reported to the Committee, Dr. Talbott was an adjunct professor at Gonzaga University, Central Washington University, and Eastern Washington University where he taught public finance, law and school administration. All of which were graduate level courses, and Dr. Talbott was the expert for doctoral dissertations at Gonzaga in the area of school finance. In addition, Dr. Talbott has served on the USAC Board of Directors (Board) and one of its predecessor entities, the Schools and Libraries Corporation, since 1998. During this time, Dr. Talbott served on various committees, including the Schools & Libraries Committee and the Executive Committee. Among other things, the Executive Committee was responsible for overseeing USAC’s annual financial audits and operational reviews until the Audit Committee was formed in 2003.

Mr. Gillan is an economist with extensive experience evaluating financial implications of technological change and regulatory policy in the telecommunications industry. Mr. Gillan has provided expert testimony in over 300 proceedings. Mr. Gillan was previously employed on the staff of the Illinois Commerce Commission as the Director of Market Structure, where he oversaw Commission policies that encouraged competition in the electric, gas and telecommunications industries.

Mr. Tinic is Vice President of Information Technology (IT) for Level 3 Communications, Inc., where he is responsible for Business and Customer Support Systems (BCIlaSS). Mr. Tinic has been in information and communication technology for over 20 years,

where he has a long track record of deploying new and innovative solutions. Before assuming his current role, Mr. Tinic was Vice President of IT for tw telecom, inc. (tw telecom) leading all functions around business support systems. Mr. Tinic was also responsible for revenue assurance and billing operations for 10 years while at tw telecom. In this role, he worked closely with the Controller and Chief Accounting Officer by managing internal controls that were subject to Sarbanes-Oxley (SOX) testing and reporting in conjunction with internal and external auditors. His significant experience in billing and financial systems provides a solid basis for understanding financial reporting and accounting controls.

The professional backgrounds noted above provide the Committee with adequate financial, telecommunications, and regulatory experience to sufficiently fulfill Committee roles and responsibilities. IAD has concluded that the members of the Committee as a whole fulfill the requirements for independence and financial literacy required by the Charter and recommends that the Committee accept this assessment.

Attachment D
USAC Internal Audit Division Annual Review of the
Effectiveness of the Company’s Process for Assessing Significant Risks
and Exposures and the Steps Management Has Taken
to Minimize Such Risks and Exposures

Background

Risk management is the process of identifying and analyzing risks and exposures (collectively, risks) that affect the achievement of company objectives while having controls in place to mitigate these risks. Risk can be divided into three primary categories: environment, process (operational or compliance), and information for decision-making risk. Depending on the business or organization, one or more of these risk categories may be applicable.

Risk Management Process

USAC has two main vehicles to manage risk within the organization — the internal audit risk assessment process and the USAC management team risk process. Risk management, however, is a top-down mindset that has been embraced by each member of the Leadership team and within each of the USAC business units. In addition, USAC has adopted an “enterprise view” of risk management, and is formalizing its enterprise risk management (ERM) strategy to the benefit of key operational imperatives. Further discussion regarding the ERM strategy is provided in the USAC Management Team section below.

Executive Summary: Internal Audit Division -Risk Assessment Process

USAC’s Internal Audit Division (IAD) conducts various risk assessment activities of USAC operations and within the Universal Service Fund (USF) to identify processes where the operational or process risk of loss is significant with consideration given to mitigating controls. Risk assessment activities are performed at the USF program level, at the beneficiary and contributor audit level, and within USAC corporate functions. The results of program level risk assessments are used to develop internal audit plans or to advise USAC senior management of areas needing additional mitigating controls. IAD also focuses on identifying corporate activities or functions where controls may exist to mitigate such risks, and performs audits to verify that the established controls are working as designed. IAD also performs detailed risk assessment activities during the audit planning process to identify more specific risks which may adversely impact a particular audit entity. Outlined below is a summary of IAD’s risk assessment process.

1. *Define Risk Categories – Meetings with USAC Management and the Audit Committee*

IAD has identified various categories by which risks applicable to USAC are known and then shared with USAC senior management and USAC process owners. In consultation with process owners, weights are assigned as a percentage to each risk type category, as some risk types are more significant to the organization than others. Risk categories are determined by considering what events/scenarios, if realized, could hinder USAC from meeting its business objectives. Audit Committee members may use this meeting to discuss risk factors and organizational risks for inclusion in the risk assessment process.

2. *Identify Risks – Specific Situations Hindering USAC from Meeting Objectives*

IAD obtains pertinent information about various business units or functions via a Risk Assessment Questionnaire (RAQ). The RAQ considers both gross and residual risks. The difference between the two are that the latter takes into consideration mitigating controls in place (preventative, detective, directive or corrective controls), which reduces the gross risk.

3. *Analyze Risks*

IAD identifies appropriate key personnel to complete the RAQ as part of the audit planning process. The survey assists users in identifying potential risks within the processes they manage. IAD meets with these individuals to gain an understanding of each process, identify the cause and effect of each risk, and define its impact and likelihood of occurrence.

4. *Prioritize Risks*

IAD compiles the results of the entire risk assessment process into a matrix (risk register) by applicable division/business unit, and ranks the residual risks listing those risks with the highest potential to adversely impact USAC's operations first. IAD also leverages the prior year USAC risk assessments to assist in audit plan development.

5. *Annual Audit Plan Development*

The risk assessment process is used to assist in the design of audit plans, and the procedures used for operational, beneficiary, and contributor audits. The plans incorporate functions and entities where we determine the risk for noncompliance to Federal Communications Commission (FCC) rules or risk to the USAC internal control environment to be significant. These areas/entities of significance are then incorporated into audit plans, and consideration is given to areas or entities that have not been subject to recent audit activity either by USAC, the FCC Office

of Inspector General, FCC Enforcement Bureau, or the Government Accountability Office.

Executive Summary: USAC Management Team - Risk Assessment Process

ERM is a discipline performed by the organization that identifies risks from a broad scope and as an interrelated portfolio. To adopt this new approach to risk management, in 2016, USAC created a cross-divisional ERM team. The ERM team is organized with members from the Office of General Counsel, Information Technology, Enterprise Project Management, and Internal Audit Divisions. A primary focus of the ERM team will be to focus on the higher level risks that impact USAC's key objectives/initiatives; what is being done to mitigate those risks; and whether we are pursuing the most effective risk mitigation strategy or if it should be changed. The ERM team reports risk incidents on a monthly basis as part of the USAC 360 Snapshot Report and on a quarterly basis to the newly formed Risk Management Council (Council). Risk discussions and related efforts are ongoing, and USAC will continue to engage this Committee and the Board, as appropriate.

In 2017, the Compliance and Risk Team (C&R Team) has made significant progress with standing up the ERM program by implementing several enterprise-wide practices including the following: (1) chartering the Risk Management Council; (2) drafting and adopting risk profiles that align with the corporate goals; (3) drafting risk registers for all divisions for monthly reporting and monitoring of risk within USAC; (4) monitoring of medium to high risks, and (5) commencing an enterprise-wide review of process narratives, policies, and procedures.

- The Council was established in compliance with the Office of Management and Budget's (OMB) Circular A-123 requirements to provide an oversight body to discuss and review enterprise risk management practices and internal controls testing and monitoring. The Council is comprised of all USAC Vice Presidents, and is chaired by the Chief Financial Officer. The Council meets on a quarterly basis to review and discuss risk incidents, risk mitigation, internal controls testing and other relevant issues.
- The C&R Team drafted and presented risk profiles to the Risk Management Council. These fifteen (15) profiles map to the company's eight (8) corporate goals. The profiles were organized in conjunction with the four OMB categories of risk: Operations, Compliance, Reporting and Strategic risk. The Council reviewed and adopted these profiles. In August, we submitted the risk profiles to the FCC for review and submission to the OMB.
- The C&R Team drafted risk registers that categorized risk based on the risk profiles and corporate strategic initiatives. The risk registers include general risks that are realized throughout USAC and provide a section where the divisions may

identify other unique risks specific to their division. In August, the C&R Team provided small group training with each division to review the risk registers and the ongoing monthly monitoring process. The ERM group attended these meetings and was charged in assisting the divisions in developing the risk mitigation strategy for the various risks.

- Divisions will update the risk registers on a monthly basis, and the C&R Team will meet with divisions bi-monthly to ensure that risks identified as medium to high risks have robust risk mitigation plans.
- The C&R Team is also spearheading the task of reviewing and updating all USAC process narratives, policies and procedures. OGC will assist in reviewing these documents to ensure they accurately reflect actual divisional practices.

Compliance risk (i.e., compliance with applicable laws and regulations) is consistently identified as the most significant potential risk to USAC by, and continues to be an area of significant focus for USAC management, IAD and the Audit Committee. Below is an overview of the key processes USAC uses to assure compliance with applicable laws and regulations, which are also examples of how risks are minimized. Every step and procedure is not listed nor is detailed information provided on steps and procedures because disclosure of this information could compromise the integrity of our operating procedures or disclose proprietary information.

- USAC performs daily, monthly, and quarterly procedures in compliance with FCC regulations set forth in 47 C.F.R. Part 54 and FCC orders and FCC staff directives (collectively, FCC Directives).
- Members of USAC's management team, including staff from the Office of General Counsel, Finance, Information Technology, the programmatic groups and IAD, periodically meet with FCC staff to discuss FCC Directives and Orders.
- USAC's external auditors test compliance with FCC Directives and, to date, has noted where USAC was not in full compliance. Management has taken these findings seriously and has taken steps to immediately correct the deficiencies noted or develop a plan that will get USAC in full compliance.
- The USAC leadership team meets regularly to discuss company operations. This forum is also used to recognize and weigh the positive and negative consequences if potential events were to occur in the organization and to assess how risks can be mitigated.
- USAC management also has an internal control review function to evaluate and regularly test internal controls. This function serves as an important management tool to measure control effectiveness and assist in mitigating organizational risk.

The USAC Internal Controls team also performs risk assessment activities around key controls. In addition, a cost benefit analysis is performed, when possible, to determine the costs associated with proposed process changes and the benefits to be gained if the change were implemented. Understanding that all risks cannot be eliminated, for each risk evaluation, USAC management makes a determination as to what level of risk can be minimized versus what will be acceptable.

- Annually, all USAC employees are required to sign the Statement of Ethical Conduct and Disclosure Form, and are provided with ethics training. In addition, any employee who participates on a procurement review team is required to sign an additional conflict of interest statement. These additional directive controls are followed to further mitigate compliance and operational risk, and to specifically cover topics such as related party transactions and illegal acts.

Summary

The operational and risk management processes used by USAC are designed to provide a framework by which risks are continually identified, evaluated, and managed. The addition of the ERM team has further leveraged USAC's ability to effectively manage risks. In addition, through the efforts of IAD's risk assessment process, further identification of significant risks, which are brought to the attention of USAC management, ensures that the system of risk assessment and management is effective. Accordingly, management has established and maintained an effective process for assessing significant risks and taking steps to minimize such risks.

This overview of USAC's efforts to manage risk is not intended to be a comprehensive recitation of all steps taken by USAC to ensure that it has effectively designed such a system.

Attachment E
Annual Review of the Adequacy of the Company's System of Internal Controls
by the USAC Internal Audit Division
October 2017

Background

Internal control processes are designed by management and administered by an organization's personnel. The primary objectives of USAC's system of internal controls are to: (1) verify the reliability and integrity of financial information; (2) determine compliance with USAC policies and procedures and FCC regulations; (3) safeguard assets; and (4) achieve the economical and effective use of resources. Effective internal controls also reduce the possibility of significant errors and irregularities and assist in timely detection and mitigation when such events do occur. Generally, controls are of four types: (a) preventative, (b) detective, (c) corrective, and (d) directive.

Preventative Controls are designed to discourage errors or irregularities from occurring. Example: background checks on new employees.

Detective Controls are designed to find errors or irregularities after they have occurred. Example: investigating variances over pre-established dollar or percentage thresholds.

Corrective Controls are designed to fix errors or irregularities after they are detected. Example: recovery of erroneously disbursed funds.

Directive Controls are actions taken to cause or encourage a desirable event to occur.

USAC has a team within the Internal Audit Division (IAD) focused on internal controls with responsibility for determining whether internal controls are functioning as intended, and assisting management in development of an effective internal controls structure to achieve the control objectives specified above. The IAD team maintains up-to-date documentation of key internal controls, including process narratives and risk and control matrices, and tests the design and operating effectiveness of the controls on a three year cycle (all key internal controls are tested at least once every three years). The IAD team reports testing results to USAC's Office of General Counsel (OGC) Compliance and Risk Team (CRT) who is responsible for reporting testing results, remediation efforts, and program statuses to senior management and the Federal Communications Commission (FCC) on a quarterly basis. IAD and the CRT work in close collaboration to develop and coordinate the testing plans and reporting to the FCC. The CRT is also responsible for monitoring the testing results and providing updates on prior results for accurate reporting to the FCC. USAC has designed its operations to achieve an adequate internal control infrastructure within and around operating processes.

In this paper, we have not provided every control, step or procedure, or detailed information because disclosing this information may compromise the integrity of our

operating procedures or disclose proprietary information. As part of the USAC Internal Audit Plan, operational audits are conducted on USAC's internal operations. On occasion, those audits will identify controls needing improvement or are not working as designed. These internal control weaknesses are discussed with USAC management and corrective action is taken as an ongoing effort to improve controls. Below is a summary of USAC's system of internal controls and examples of controls in place.

Reliability and Integrity of Financial Information

USAC has policies and procedures designed to promote uniformity in timely executing and properly recording transactions. These policies and procedures outline adequate separation of duties among the individuals responsible for initiating, preparing, approving, processing and reconciling data. In addition, controls exist for approval levels and access to the computer systems that generate financial transactions and reporting. Each year, USAC is required to contract with an independent external auditing firm to perform a financial audit of USAC's financial statements. As part of that engagement, the auditors obtain an understanding of USAC's internal controls. Based on the most recent audit performed, USAC's external auditors have concluded there were no material weaknesses involving USAC's internal controls. The USAC annual financial audit also includes an audit of the controls over financial reporting.

To further enhance USAC internal controls, the Payment Quality Assurance (PQA) program provides ongoing monitoring of USAC disbursement process controls. The PQA Program enables USAC to provide the FCC with accurate, timely information about improper payments to support mechanism beneficiaries, as required by the Improper Payments Elimination and Recovery Improvement Act (IPERIA), formerly known as the Improper Payments Elimination and Recovery Act (IPERA). Under this program, USAC assesses specific payments made to beneficiaries in all four support mechanisms to determine if these payments were made in accordance with FCC rules and USAC procedures.

Control Examples

- Preventative – USAC has established a signature authority policy that outlines the level of authority and scope of responsibility for which certain approvals must be granted before entering into a contract or obligating the company to make expenditures.
- Detective – Universal Service Fund (USF) disbursements are selected each month and various assessment procedures are performed to ensure the payments made are correct.

Compliance with Policies and Procedures, Laws and Regulations

The procedures that guide each programmatic area are based upon FCC regulations as set forth in 47 C.F.R. Part 54, FCC orders, and other FCC guidance (collectively, FCC Directives) issued concerning the administration of the USF and the universal service support mechanisms. As each USAC division executes daily, monthly and quarterly procedures, they are performed in accordance with FCC Directives. USAC's OGC, IAD, and Finance Division, working with the FCC, advise USAC programmatic and USF management groups concerning compliance with FCC directives and other applicable federal, state and local laws and regulations.

USAC and the FCC use a Point-of-Contact (PoC) system to promote greater, efficient coordination and communication. The designated PoCs are responsible for communicating and coordinating with their counterparts and are tasked with making certain the designated PoCs are aware of activities, events, and issues that affect the USF programs, USF contributors and/or USAC. USAC's Compliance and Risk team is responsible for supervising compliance with the USAC-FCC Memorandum of Understanding (MOU), including all FCC filings, MOU and performance measurements reporting, audit finding reporting and follow-up, actions involving complaints and whistleblower alerts, and related variance analyses. The addition of the Compliance and Risk team has improved compliance reporting because this team works closely with divisions to help division staff better understand FCC rules and MOU reporting requirements. This collaboration has increased awareness around MOU requirements.

In addition to USAC's annual financial audit, USAC is required to have an operational audit to test compliance with program rules. Since 1998, the USAC operational audit has revealed one instance of non-compliance with applicable law. The audit finding noted in this audit has been corrected and USAC's controls monitoring has been improved. Also, as we have previously reported, the FCC financial auditors have noted that USF general ledger systems are not in full compliance with Financial Management System requirements and the United States Standard General Ledger as required by Section 54.702(n) of the FCC's rules.¹ In connection with this effort, USAC and the FCC are currently in discussions to determine the degree to which the Digital Accountability and Transparency Act of 2014 will drive modifications to USAC's financial management system processes and supporting technology.

One key element to promote compliance with policy, procedures and laws is the ethical tone of the organization. USAC actively promotes the integrity and ethical values of company personnel through annual training and maintaining policies and procedures to avoid conflicts of interest (e.g., related party transactions) and illegal acts.

¹ See 47 C.F.R. § 54.702(n).

Control Examples

- Directive – USAC provides a mandatory annual ethics refresher to all employees and provides communication channels by which employees can report questionable actions. This training includes discussions on avoiding conflicts of interest and provides examples of inappropriate behavior.
- Preventative – Regular meetings occur with USAC and FCC staff to discuss issues facing USAC and any new FCC directives and orders.
- Detective – Audits of beneficiaries and contributors are performed to determine compliance with FCC rules.

Safeguarding of Assets

USAC takes reasonable steps to safeguard the company's assets by following procedures to maintain assets in a properly controlled and secured environment and limiting access to confidential information contained in USAC computer systems. Functions within the Finance Division are properly separated to hinder assets from being compromised by limiting employee access and responsibility.

Control Examples

- Preventative – USAC has information technology security policy that requires employees to change network passwords periodically and to receive information security training annually.
- Directive – All USAC employees are required to sign a Statement of Ethical Conduct and Disclosure agreement that, among other things, requires employees to safeguard confidential information and report any unauthorized use or disclosure of confidential information.
- Preventative – USAC has begun the activities required to move payroll from the Human Resources division to the Finance division. This environment will ensure that payroll and human resources responsibilities are fully segregated and will enhance the related internal controls environment.

Efficient Use of Resources

In administering the USF, the support mechanisms and the company, USAC has established processes and procedures for complying with FCC directives and applicable federal, state and local laws and regulations. In addition, USAC has policies and procedures in place to facilitate the economical and effective use of company resources. These policies and procedures are designed with various preventative and detective controls to achieve management objectives. Management's philosophy and operating style

demonstrates its conservative manner in analyzing the risks and potential benefits of an action before proceeding.

Control Examples

- Preventative –The IT Change Control Board reviews all proposed changes to the USAC production environment prior to implementation to ensure that all appropriate approvals have been received, that the change will not conflict with other existing deployments or the existing IT infrastructure, and that the change considers the overall priorities of the organization as well.
- Preventative – USAC has a policies and procedures in place for competitive procurement of goods and services.

Summary

The assessment performed by IAD indicates that there are adequate systems in place for compliance with internal policies and procedures, FCC directives and applicable federal, state and local laws and regulations. There is sufficient separation of duties among the individuals responsible for initiating, preparing, approving and processing data. In addition, management’s philosophy and operating style encourages integrity and ethical conduct. Accordingly, management has established and is maintaining an adequate system of internal controls that allows for the successful achievement of objectives without compromising standards.

USAC is proactive in modifying operations in an effort to consistently implement and maintain an effective internal control structure. USAC’s establishment of an internal controls team is a practice used in private industry to improve and regularly monitor the effectiveness of internal controls. The internal control structure is adequate for the continued reliability and integrity of financial information; compliance with internal policies and procedures, FCC directives and applicable federal, state and local laws and regulations; the safeguarding of assets; and the economical and effective use of resources.