High Cost & Low Income Committee

Briefing Book

Monday, July 24, 2017

2:00 p.m. - 4:30 p.m. Eastern Time

Universal Service Administrative Co.

700 12th Street, N.W., Suite 900

Washington, D.C. 20005

Universal Service Administrative Company
High Cost & Low Income Committee Quarterly Meeting
Agenda

Monday, July 24, 2017
2:00 p.m. - 4:30 p.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 High Cost & Low Income Committee Meeting Minutes of April 24, 2017. **B.** Approval of moving all ***Executive Session*** items into ***Executive Session***.

High Cost Agenda

OPEN SESSION	
a2.	Approval of High Cost Support Mechanism 4th Quarter 2017 Budget and Demand Projections for the August 2, 2017 FCC Filing.
i1.	Information on 19 USAC Internal Audit Division High Cost Support Mechanism Beneficiary Audit Reports – ***Executive Session Option***.
i2.	High Cost Support Mechanism Business Update.

EXECUTIVE SESSION	
a3.	Approval of Revised 2017 Annual High Cost Support Mechanism Budget – **Confidential** – ***Executive Session Recommended***.

Low Income Agenda

OPEN SESSION	
a4.	Approval of Low Income Support Mechanism 4th Quarter 2017 Budget and Demand Projections for the August 2, 2017 FCC Filing.
i3.	Information on Three USAC Internal Audit Division Low Income Support Mechanism Beneficiary Audit Reports – ***Executive Session Option***.
i4.	Low Income Support Mechanism (Lifeline) Business Update.

EXECUTIVE SESSION	
i5.	Low Income Support Mechanism (Lifeline) Business Update Continued: • Project Risks and Mitigation • Forecast of National Verifier Multi-Year Expenses – **Confidential** – ***Executive Session Recommended***.
a5.	Approval of Revised 2017 Annual Low Income Support Mechanism Budget – **Confidential** – ***Executive Session Recommended***.

Next Scheduled USAC High Cost & Low Income Committee Meeting

Monday, October 23, 2017 **2:00 - 4:00 p.m. Eastern Time** **USAC Offices, Washington, D.C.**

Universal Service Administrative Company
High Cost & Low Income Committee Meeting

ACTION ITEM

Consent Items

Action Requested

The High Cost & Low Income 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. Committee meeting minutes of April 24, 2017 (*see* **Attachment A-1**).

B. Approval for discussing in ***Executive Session*** agenda items:
   (1) **a3 –** Approval of Revised 2017 Annual High Cost Support Mechanism Programmatic Budget. USAC management recommends that discussion of this item be conducted in ***Executive Session*** because the item relates to USAC's ***procurement strategy and contract administration.***
   (2) **i5 –** Low Income Support Mechanism (Lifeline) Business Update (continued). USAC management recommends that discussion of this item be conducted in ***Executive Session*** because the item relates to USAC's ***procurement strategy and contract administration.***
   (3) **a5** – Approval of Revised 2017 Annual Low Income Support Mechanism Programmatic Budget. USAC management recommends that discussion of this item be conducted in ***Executive Session*** because the item relates to USAC's ***procurement strategy and contract administration.***

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

Recommended USAC High Cost & Low Income Committee Action

APPROVAL OF THE FOLLOWING RESOLUTION:

RESOLVED, that the USAC High Cost & Low Income Committee hereby approves the Committee meeting minutes of April 24, 2017 and discussion in ***Executive Session*** of the items noted above.

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

HIGH COST & LOW INCOME COMMITTEE MEETING
Monday, April 24, 2017

(DRAFT) MINUTES

The quarterly meeting of the USAC Board of Directors (Board) High Cost & Low Income Committee (Committee) was held at USAC's offices in Washington, D.C. on Monday, April 24, 2017. Mr. Joel Lubin, Committee Chair, called the meeting to order at 2:33 p.m. Eastern Time, with all 11 Committee members present:

Brisé, Ronald
Feiss, Geoff
Gerst, Matthew
Gillan, Joe – Vice Chair – *by telephone*
Henderson, Chris – CEO
Jacobs, Ellis
Kinser, Cynthia
Lubin, Joel – Chair
Mason, Ken
Tinic, Atilla
Wein, Olivia

Other Board members and officers of the corporation present:

Bocher, Bob – Member of the Board
Buzacott, Alan – Member of the Board
Gaither, Victor – Vice President of High Cost
Garber, Michelle – Vice President of Lifeline
Hays, Kate – Vice President of Stakeholder Engagement
Lee, Karen – Vice President of Rural Health Care
Poulin, Chera – Vice President of People, Culture and Change
Robinson, Vickie – Vice President, 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 Strategy and Change Management
Sweeney, Mark – Chief Operating Officer
Talbott, Dr. Brian – Member of the Board
Taylor, Peter – Vice President of Information Technology and Chief Information Officer

Others present:

NAME	**COMPANY**
Ahmed, Sharmarke	USAC
Bilodeau, Amanda	USAC
Braxton-Johnson, Kianna	USAC
Butler, Stephen	USAC
Carpenter, Nikki-Blair	USAC
Conradt, Phil	USAC
Cunningham, Christina	USAC
Delmar, Teleshia	USAC
Eltgroth, Deborah	USAC
Gonzales, Veronica	USAC
Griffith, Jodi	FCC
Hampton, Marcus	USAC
Hughet, Pam	USAC
Johnson, William	USAC
Khan, Sammy	USAC
Kim, Joanne	USAC
King, Lauren	USAC
Kusow, Karima	USAC
Lear, Kathleen	Maximus
Litman, Travis	FCC
Mattey, Carol	Mattey Consulting
Miller, Jack	Solix
Numa, Marcel	USAC
Nuzzo, Patsy	USAC
Rasamalle, Sharon	USAC
Roberts, Richard	BCG
Schecker, Laurence	USAC
Sequin, Eric	Solix
Shaffer, Dana – *by telephone*	FCC
Simab, Habib	USAC
Subramariam, Nathan	USAC
Tessler, Joelle	USAC
Veith, Lisa	Maximus
Wieth, Tim	USAC
Wynter, Sherika	USAC

OPEN SESSION

a1. **Consent Items.** Mr. Lubin presented this item to the Committee

A. Committee meeting minutes of January 30, 2017.

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

(1) **a2 –** Consideration of Contract Modification for National Verifier Strategic Consultation. USAC management recommends this item be discussed in ***Executive Session*** because this matter relates to USAC's ***procurement strategy and contract administration***.

(2) **a3 –** Consideration of Contract Modification for Consumer Call Center. USAC management recommends this item be discussed in ***Executive Session*** because this matter relates to USAC's ***procurement strategy and contract administration***.

(3) **i5 –** Discussion of forthcoming Consideration of Contract Award for National Verifier Business Process Outsource Vendor. USAC management recommends this item be discussed in ***Executive Session*** because this matter relates to USAC's ***procurement strategy and contract administration***.

C. Routine procurements, deemed consideration and approval of in ***Executive Session***: None.

D. Approval of High Cost Support Mechanism 3rd Quarter 2017 Budget and Demand Projections for the May 2, 2017 FCC Filing.

The Committee is requested to approve the 3rd Quarter 2017 (3Q2017) programmatic budget and demand projection for the High Cost Support Mechanism for submission to the FCC in USAC's May 2, 2017 quarterly filing.

E. Approval of Low Income Support Mechanism 3rd Quarter 2017 Budget and Demand Projections for the May 2, 2017 FCC Filing.

The Committee is requested to approve the 3rd Quarter 2017 (3Q2017) programmatic budget and demand projection for the Low Income Support Mechanism for submission to the FCC in USAC's May 2, 2017 quarterly filing.

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

RESOLVED, that the USAC High Cost & Low Income Committee hereby approves the Committee meeting minutes of January 30, 2017; and discussion in ***Executive Session*** of the items noted above; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee approves a 3rd Quarter 2017 programmatic operating budget for the High Cost Support Mechanism of $2.52 million; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee directs USAC staff to submit a collection requirement of $2.52 million for High Cost Support Mechanism administrative costs in the required May 2, 2017 filing to the FCC on behalf of the Committee; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee, having reviewed at its meeting on April 24, 2017, a summary of the 3rd Quarter 2017 High Cost Support Mechanism demand estimate, hereby directs USAC staff to proceed with the required May 2, 2017 filing to the FCC on behalf of the Committee. Staff may make adjustments if the total variance for the High Cost Support Mechanism is equal to or less than $10 million and, with approval of the Committee Chair, may make adjustments if the total variance is equal to or less than $15 million; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee approves a 3rd Quarter 2017 programmatic operating budget for the Low Income Support Mechanism of $5.29 million; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee directs USAC staff to submit a collection requirement of $5.29 million for Low Income Support Mechanism administrative costs in the required May 2, 2017 filing to the FCC on behalf of the Committee; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee, having reviewed at its meeting on April 24, 2017 a summary of the 3rd Quarter 2017 Low Income Support Mechanism demand estimate, hereby directs USAC staff to proceed with the required May 2, 2017 filing to the FCC on behalf of the Committee. Staff may make adjustments if the total variance for the Low Income Support Mechanism is equal to or less than $10 million and, with approval of the Committee Chair, may make adjustments if the total variance is equal to or less than $15 million.

i1. **Information on 13 USAC Internal Audit Division High Cost Support Mechanism Beneficiary Audit Reports.** Ms. Pamela Hughet, Senior Manager of Internal Audit, presented this item for discussion.

i2. **High Cost Support Mechanism Business Update.** Mr. Gaither presented this item for discussion:

- Business Review.
- Operational Metrics.
- Update on Key Initiatives.

i3. **Information on Nine USAC Internal Audit Division Low Income Support Mechanism Beneficiary Audit Reports.** Ms. Pamela Hughet, Senior Manager of Internal Audit, presented this item for discussion.

At 3:50 p.m. Eastern Time the Committee recessed and reconvened at 3:56 p.m. Eastern Time.

i4. **Low Income Support Mechanism (Lifeline) Business Update**. Ms. Garber presented this item for discussion:

- Business Review.
- Operational Metrics.
- Update on Key Initiatives.

At 4:26 p.m. Eastern Time, on a motion duly made and seconded, the Committee moved into ***Executive Session*** for the purpose of discussing the confidential items listed above.

EXECUTIVE SESSION

a2. **Consideration of Contract Modification for National Verifier Strategic Consultation.** Ms. Garber presented this item for consideration.

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

RESOLVED, that the High Cost and Low Income Committee, having reviewed USAC management's recommendation, hereby authorizes management to increase the existing value of a contract with BCG at a firm-fixed price of $2,000,000 (plus applicable taxes), which will bring the total contract value for BCG to $6,495,300 (plus applicable taxes), subject to required FCC approvals.

a3. **Consideration of Contract Modification for Consumer Call Center.** Ms. Garber presented this time for consideration.

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

RESOLVED, that the High Cost and Low Income Committee, having reviewed the recommendation of USAC management, hereby authorizes USAC management to increase the existing value of the contract awarded to Group O in the additional amount of $600,000, with a total amended contract value not to exceed $950,042, plus applicable sales taxes, through January 26, 2018, and subject to required FCC approvals.

i5. **Discussion of forthcoming Consideration of Contract Award for National Verifier Business Process Outsource Vendor.** Ms. Garber presented this time for discussion.

At 5:37 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. Lubin reported that in ***Executive Session***, the Committee took action on items a2 and a3, and discussed i5. On a motion duly made and seconded, the Committee adjourned at 5:38 p.m. Eastern Time.

/s/ Vickie Robinson
Assistant Secretary

Universal Service Administrative Company

High Cost & Low Income Committee Meeting

ACTION ITEM

Approval of High Cost Support Mechanism 4th Quarter 2017 Programmatic Budget and Demand Projection for the August 2, 2017 FCC Filing

Action Requested

The USAC Board of Directors High Cost and Low Income Committee (Committee) is requested to approve the 4th Quarter 2017 (4Q2017) programmatic budget and demand projection for the High Cost (HC) Support Mechanism for submission to the FCC in USAC's August 2, 2017 quarterly filing.

Discussion

4Q2017 Operating Budget

The budget before the Committee includes the costs of administering the High Cost (HC) Support Mechanism and an allocation of USAC common costs. As set forth in FCC rules and USAC's By-laws, each programmatic committee has authority over its programmatic budget.[1] The USAC Board of Directors has responsibility for the USAC common budget and for the overall consolidated budget.

The Committee is requested to approve $3.42 million for High Cost Support Mechanism programmatic activities in 4Q2017, which includes:

- $1.59 million for compensation and benefits for 45 full time equivalents (FTEs).
- $0.96 million for professional fees and contract labor.
- $0.57 million for the beneficiary compliance audits under the Beneficiary and Contributor Audit Program (BCAP).
- $0.30 million for data collection, travel and miscellaneous administrative and outreach activities.

Attachment A to this issue paper provides details and compares the 4Q2017 HC Support Mechanism budget to 4th Quarter 2016 (4Q2016) actual expenditures.

The details to support the 4Q2017 allocation of USAC common costs to the HC Support Mechanism are included with the Board budget materials under item aBOD03 072517.

Attachment B to this briefing paper provides a comparison of the HC Support Mechanism budget to actual expenditures for the 6 months ending June 30, 2017. Explanations will be provided for significant variances.

[1] 47 C.F.R. § 54.705(c); By-Laws of Universal Service Administrative Company, Article II, § 8.

4Q2017 Capital Budget

USAC management estimates direct capital expenditures of $0.11 million in 4Q2017 for High Cost Universal Broadband (HUBB) portal software development. Information on allocated capital expenditures, which are not attributable to a specific division, is provided under item aBOD03 072517.

Collection Requirement

Based on the proposed revised annual budget, additional dollars are required to fund programmatic activities in 2017. The resulting collection requirement for 4Q2017 combined administrative expenses and capital costs is $4.59 million ($3.53 million budget plus $1.06 million to fund 2017 activities) as set forth below.

4th Quarter 2017 Administrative Expenses – Collection Requirement (in millions)

	Direct Operating Costs	**Direct Capital Costs**	**Total**
4Q2017 Administrative Expenses	$3.42	$0.11	$3.53
Additional Dollars Required to Fund 2017 Activities	0.45	0.61	1.06
Collection Requirement	**$3.87**	**$0.72**	**$4.59**

Summary of Demand

On a quarterly basis, USAC is required to submit to the FCC the projected demand for the upcoming quarter.[2] This report provides information on the HC Support Mechanism for the period ending June 30, 2017; provides updated projections for the current quarter ending September 30, 2017; and seeks approval of funding requirements for 4Q2017.

[2] 47 C.F.R. § 54.709(a).

USAC estimates the 4Q2017 funding requirement for the HC Support Mechanism as follows:

$ 125.65 million for High Cost Loop Support,[3]
$ 186.12 million for Connect America Broadband Loop Support,[4]
$ 36.73 million for Frozen Price Cap Carrier Support,[5]
$ 394.56 million for Connect America Fund Phase II[6],
$ 0.83 million for Rural Broadband Experiments[7],
$ 124.60 million for Frozen Competitive ETC Support,[8]
$ 106.84 million for Connect America Fund ICC,[9]
$ 32.08 million for Alaska Plan Support,[10]
$ 138.95 million for Alternative Connect America Cost Model[11]
$ (21.36) million for the High Cost Account,[12]
For a total of: **$ 1,125 million**

Prior Period Adjustments

Sixty days prior to the start of each quarter, USAC provides projected support mechanism demand and administrative expense data to the FCC. Thirty days prior to the start of the quarter, USAC submits projected Universal Service contributor revenue data to the FCC. The FCC uses these projections to establish the Universal Service Fund contribution factor for the upcoming quarter, and USAC uses the resulting contribution factor to invoice universal service contributors once the quarter begins.

Results for 2nd Quarter 2017 (2Q2017) contribute to an under-funded condition. The total prior period adjustment to the 4Q2017 funding requirement based on 2Q2017 actual

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[3] High Cost Loop (HCL) support is provided pursuant to 47 C.F.R. §§ 54.1301-.1304 and includes Safety Net Additive Support (SNA) and Safety Valve Support (SVS).
[4] *See Connect America Fund et al.*, WC Docket No. 10-90 et al., CC Docket No. 01-92, Report and Order, Order and Order on Reconsideration and Further Notice of Proposed Rulemaking, 31 FCC Rcd 3087 (2016) (*Rate-of-Return Reform Order*).
[5] *See Connect America Fund et al.*, WC Docket No. 10-92 et al., GN Docket No. 09-51, CC Docket No. 01-92 et al., WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17715, 17725-26, paras. 133, 159 (2011) (*USF/ICC Transformation Order).*
[6] *See Connect America Fund et al.*, WC-Docket Nos. 10-90 et al., Report and Order, 29 FCC Rcd 15644 (2014).
[7] *See Connect America Fund et al.*, WC Docket Nos. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, 29 FCC Rcd 8769 (2014).
[8] *See USF/ICC Transformation Order*, 26 FCC Rcd at 17715, para. 133.
[9] *Id.* at 17956, para. 847.
[10] *See Wireless Telecommunications Bureau Approves Performance Plans of the Eight Wireless Providers that Elected to Participate in the Alaska Plan*, WC Docket No. 16-271, Public Notice, 2016 WL 7410748 (2016).
[11] *See Connect America Fund et al.*, WC Docket Nos. 10-90 et al., CC Docket No. 01-92, Report and Order, Order and Order on Reconsideration and Further Notice of Proposed Rulemaking, 31 FCC Rcd 3087 (2016) (*Rate-of-Return Reform Order*).
[12] *See Rate-of-Return Reform Order*, 31 FCC Rcd at 3111-12, para. 60.

results will increase the funding requirement by $15.67 million. The explanation for the adjustment is provided below:

Reason for the Prior Period Adjustment	**Adjustment in Millions**
The 2Q2017 billings were lower than projected	26.84
Interest income was higher than projected for 2Q2017	(0.32)
Bad debt expense was lower than projected	(10.85)
Total Prior Period Adjustment	**$15.67**

The total fund requirement of $1,125.00 million is adjusted as follows: increased by the prior period adjustments of $15.67 million, increased by administrative costs of $10.14 million (including $5.53 million for USAC's common costs allocated to the HC Support Mechanism[13]), and reduced by projected interest income of $4.74 million; resulting in a total projected 4Q2017 funding requirement for the HC Support Mechanism of $1,146.07 million.

High Cost Support Mechanism
Fund Size Projections for 4th Quarter 2017

	(millions)
High Cost Support	$1,125.00
Prior Period Adjustment	15.67
USAC Admin Expenses	10.14
Interest Income	(4.74)
Total 4Q2017 Demand	**$1,146.07**

Quarter-Over-Quarter Projections

	4Q2017	**3Q2017**	**2Q2017**	**1Q2017**
High Cost Support	$1,125.00	$1,125.00	$1,125.00	$1,125.00
Prior Period Adjustment	15.67	(15.07)	(3.86)	(9.85)
USAC Admin Expenses	10.14	9.58	13.36	11.61
Interest Income	(4.74)	(4.26)	(4.39)	(4.14)
Total Demand	**$1,146.07**	**$1,115.25**	**$1,130.11**	**$1,122.62**

Funds Reserved Pursuant to the USF/ICC Transformation Order

The *USF/ICC Transformation Order* sets a target for High Cost Program support disbursements of $4.50 billion over the next six years. The Order directed USAC to project High Cost Program demand at no less than $1.125 billion per quarter starting in 1st Quarter 2012. The Order required that if actual contributions exceed demand, excess contributions are to be credited to a new Connect America Fund (CAF) reserve account,

[13] This amount includes 4th Quarter allocated common costs of $7.72 million, reduced by allocated common costs of $2.17 million collected but unused in prior quarters.

and if actual High Cost Program demand exceeds the quarterly target of $1.125 billion, the reserve account will fund the additional demand in that quarter. On March 30, 2016, the *Rate-of-Return Reform Order* directed USAC to eliminate the CAF reserve account and transfer the funds to the high-cost account. USAC will credit excess contributions to support the high-cost mechanism to the high-cost account. Funds from the high-cost account will be used to reduce the high-cost demand to $1.125 billion in any quarter that would exceed $1.125 billion. The table below reflects the Connect America Fund activity as of June 30, 2017.

Connect America Fund Activity by Quarter as of June 30, 2017 *(in millions)*				
	Beginning Balance	**Additions**	**Disbursements**	**Ending Balance**
Calendar Year 2012[14]	524.32	$467.70	($105.20)	886.82
Calendar Year 2013	886.82	680.56	(365.06)	1,202.32
Calendar Year 2014	1,202.32	780.90	(34.80)	1,948.42
Calendar Year 2015	1,948.42	657.02	(593.67)	2,011.77
Calendar Year 2016	2,011.77	489.54	(477.83)	2,023.48
1st Q2017	2,023.48	85.47	(103.36)	2,005.59
2nd Q2017	2,005.59	72.37	(105.6)	1,972.36
Projected 3rd Q2017	1,972.36	71.11	(96.02)	1,947.45
Projected 4th Q2017	1,947.45	71.11	(88.24)	1,930.32
Net Activity		$3,375.78	(1,969.78)	

[14] Additions include $27.96 million collected in 3Q2012 via a prior period adjustment for 1Q2012 demand.

The following table provides the status of the Connect America Fund activity by support component:

Connect America Fund Activity by Support Component *(in millions)*				
Support Component	**Allocated**	**Accepted**	**Disbursed**	**Remaining Disbursements**
Incremental Support Round 1	$300.00	$114.34	($114.34)	$0.00
Incremental Support Round 2*	386.00	323.95	(323.95)	0.00
Mobility Fund Phase I	300.00	300.00	(145.62)	154.38
Mobility Fund Phase I – Tribal	50.00	50.00	(21.24)	28.76
Rural Broadband Experiment[15]	100.00	37.80	(13.76)	24.04
CAF Phase II Transition	1,089.60	1,089.60	(711.39)	378.21
CAF Phase II Lump Sum[16]	434.18	434.18	(434.18)	0.00
A-CAM[17]	1,500.00	1,500.00	(21.04)	1,478.96
Total	**$4,159.78**	**$3,849.87**	**($1,785.52)**	**$2,064.35**

*Total demand from all carriers exceeded the allotted $300 million. As directed in FCC 13-73, the additional $86 million is taken out of the remainder of Round 1 support and added to the Incremental Support Round 2 allocation of $300 million.[18]

Alternative Connect America Model (A-CAM)

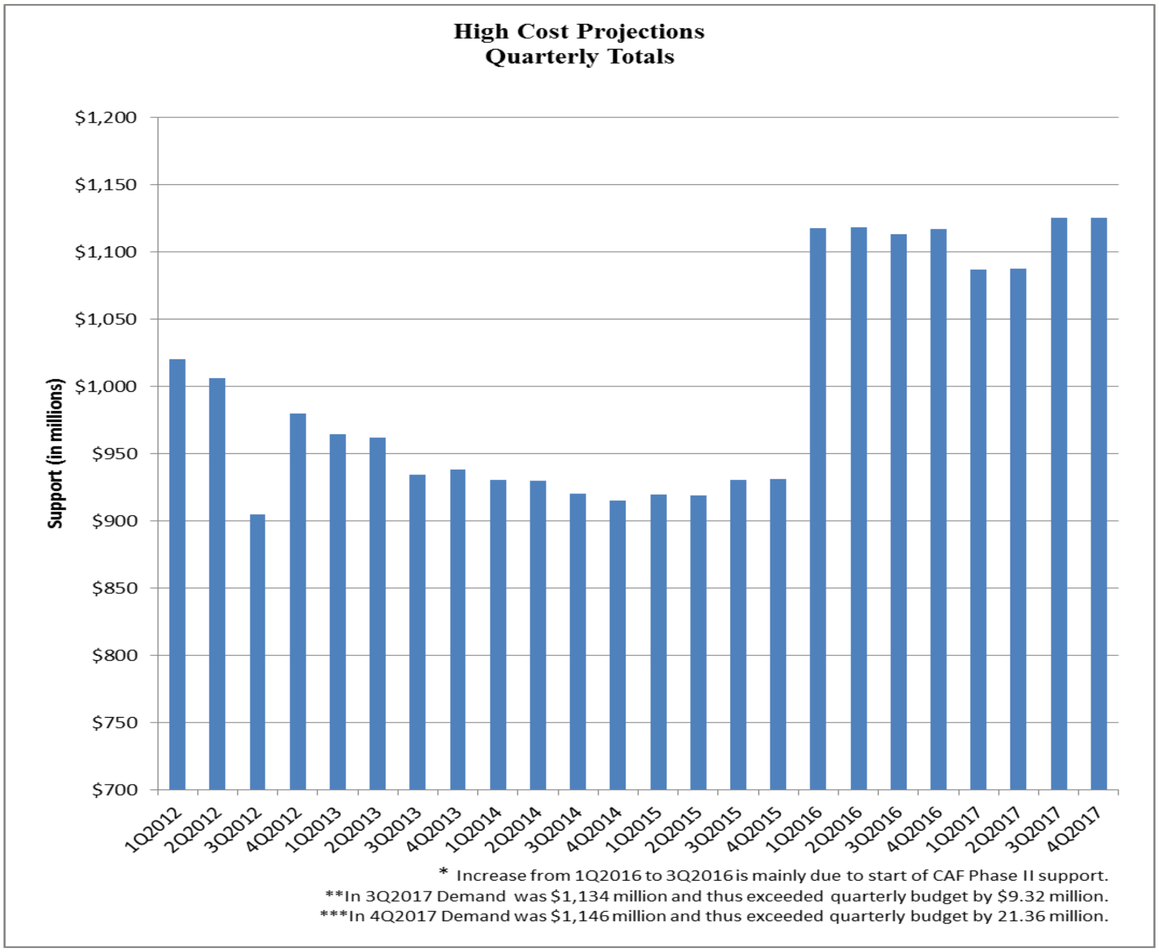
Alternative Connect America Model (A-CAM) allows carriers the option of electing a set amount of monthly support over 10 years, or remaining with a reformed version of legacy support mechanisms with Connect America Fund Broadband Loop Support (CAF-BLS) and High Cost Loop Support (HCL). The initial November 1, 2016 carrier election lead to a high demand for A-CAM support. Thus, additional steps were taken by FCC to address the increased demand.

Those steps included allocating an additional $50 million annually to the A-CAM budget, and making revised offers to 191 carriers that previously elected A-CAM. The methodology used to calculate the revised offers reduces support by varying percentages based on how many locations in a carrier's eligible service territory still lack access to broadband speeds of 10 megabits per second downstream and 1 megabit per second upstream. Carriers that accept the revised offer of support must agree to meet the terms of the original A-CAM offer if additional support becomes available in 2017 to fund the

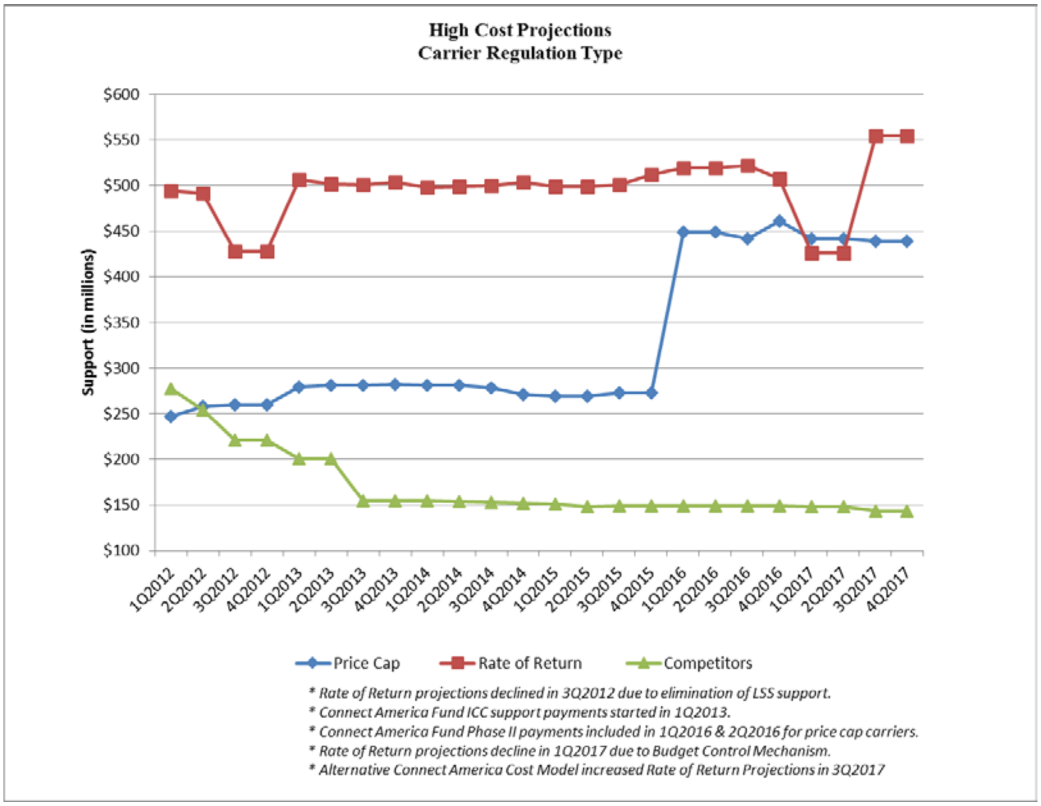
[15] *See Connect America Fund et al.*, 29 FCC Rcd 8769.
[16] *See Connect America Fund et al.*, 29 FCC Rcd 15644.
[17] *See Rate-of-Return Reform Order*, 31 FCC Rcd 3087, para. 60.
[18] *See Connect America Fund*, WC Docket No. 10-90, 28 FCC Rcd 7766, 7770, para. 11 (2013).

original offers. Carriers had until January 19, 2017, to notify the FCC, on a state-by-state basis, whether they elect to receive the revised amount of model-based support.[19]

High Cost Support Mechanism Summary



[19] *See Wireline Competition Bureau Authorizes 35 Rate-of-Return Companies to Receive More than $51 Million Annually in Alternative Connect America Cost Model Support and Announces Offers of Revised A-Cam Support Amounts to 191 Rate-of-Return Companies to Expand Rural Broadband*, WC Docket No. 10-90, Public Notice, 2016 WL 7411674 (2016).



<u>Management Recommendation</u>

USAC management recommends the Committee approve the budget and collection requirement as proposed.

<u>Recommended High Cost & Low Income Committee Action</u>

APPROVAL OF THE FOLLOWING RESOLUTIONS:

RESOLVED, that the USAC High Cost & Low Income Committee approves a 4th Quarter 2017 programmatic operating budget for the High Cost Support Mechanism of $3.42 million; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee approves a 4th Quarter 2017 programmatic capital budget for the High Cost Support Mechanism of $0.11 million; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee directs USAC staff to submit a collection requirement of $4.59 million for High Cost Support Mechanism administrative costs in the required August 2, 2017 filing to the FCC on behalf of the Committee; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee, having reviewed at its meeting on July 24, 2017 a summary of the 4th Quarter 2017 High Cost Support Mechanism demand estimate, hereby directs USAC staff to proceed with the required August 2, 2017 filing to the FCC on behalf of the Committee. Staff may make adjustments if the total variance for the High Cost Support Mechanism is equal to or less than $10 million and, with approval of the Committee Chair, may make adjustments if the total variance is equal to or less than $15 million.

High Cost Program

4Q2017 Budget
(in thousands)

Expense Category	4Q2017 Budget	4Q2016 Actuals	Increase/ (Decrease)	Explanations
Compensation & Benefits	$1,588.37	$1,138.53	$449.84	Wages, employment benefits, and payroll taxes for 45 FTEs (vs 31 FTEs in 4Q2016)
External BCAP Costs	569.13	1,356.04	(786.91)	Beneficiary compliance audits (fewer task orders and lower costs due to co-sourcing in 4Q2017)
Professional Fees & Contract Labor	957.28	1,862.97	(905.69)	Lower spending for operations & maintenance and less dedicated IT contract labor
Telephone & Computer Support	0.00	1.19	(1.19)	
Travel, Meetings and Conferences	34.78	13.08	21.70	Additional travel planned for 4Q2017
High Cost Data Collection	206.22	195.66	10.56	
Other Expenses	57.81	25.65	32.16	Printing, personnel training, education and other expenses, dues & subscriptions, and certifications/licensing
Total Programmatic Operating Costs	**$3,413.59**	**$4,593.12**	**$ (1,179.53)**	
Direct Capital Costs	**111.00**	**-**	**111.00**	HUBB Software Development contract labor in 4Q2017
Total Direct Costs - High Cost Program	**$ 3,524.59**	**$4,593.12**	**$ (1,068.52)**	
Common Operating Costs Assigned to High Cost Program	7,425.77	7,168.41	257.36	Allocation of indirect operating costs based on the CAM
Common Capital Costs Assigned to High Cost Program	298.04	376.13	(78.09)	Allocation of indirect common capital budget based on the CAM
Total Common Costs Assigned to High Cost Program	**$ 7,723.81**	**$ 7,544.54**	**$ 179.27**	
Total High Cost Program with Allocations	**$ 11,248.40**	**$ 12,137.66**	**$ (889.25)**	

High Cost Program

For the Six Months Ending June 30, 2017
(in thousands)

Direct Operating Expenses	**Actual**	**Budget**	**Variance**	**%**	**Explanation of Variance**
Compensation & Benefits	$ 2,810.3	$ 2,275.5	$ (534.8)	-24%	38 FTEs vs 31 funded FTEs due to dedicated Data team originally in common budget and lower vacancy rate than anticipated in program and dedicated IT team.
External BCAP Costs	1,194.9	1,180.9	(14.0)	-1%	
Professional Fees & Contract Labor	1,736.0	2,196.9	460.9	21%	Less spend for Mobility Fund Verification
Telephone & Computer Support	79.9	2.4	(77.5)	-3228%	Software licenes for broadband portal
Travel, Meetings and Conferences	5.0	68.3	63.3	93%	No spending for internal audit travel year to date and lower spending for user experience and support related to meetings and conferences.
High Cost Data Collection	181.6	178.2	(3.4)	-2%	
Other Expenses	23.9	18.4	(5.5)	-30%	More training than anticipated
Total Direct Operating Expenses	**$ 6,031.6**	**$ 5,920.6**	**$ (111.0)**	**-2%**	
Indirect Expense / Allocations					
USAC Administration	14,675.4	14,501.3	(174.1)	-1%	
Total Expense	**$ 20,707.0**	**$ 20,421.9**	**$ (285.0)**	**-1%**	

Universal Service Administrative Company
High Cost & Low Income Committee Meeting

ACTION ITEM

Approval Low Income Support Mechanism 4th Quarter 2017 Programmatic Budget and Demand Projection for the August 2, 2017 FCC Filing

Action Requested

The USAC Board of Directors High Cost and Low Income Committee (Committee) is requested to approve the 4th Quarter 2017 (4Q2017) programmatic budget and demand projection for the Low Income (LI) Support Mechanism for submission to the FCC in USAC's August 2, 2017 quarterly filing.

Discussion

4Q2017 Operating Budget

The budget before the Committee includes the costs of administering the Low Income Support Mechanism and an allocation of USAC common costs. As set forth in FCC rules and USAC's By-laws, each programmatic committee has authority over its programmatic budget.[1] The USAC Board of Directors has responsibility for the USAC common budget and for the overall consolidated budget.

The Committee is requested to approve $5.11 million for Low Income Support Mechanism programmatic activities in 4Q2017, which includes:

- $1.98 million for compensation and benefits for 52 full-time equivalents (FTEs) (includes the dedicated information technology and data support teams).
- $2.65 million in professional fees, including $1.14 million for National Verifier outsourced application processing and strategic consulting, $0.44 million for Third Party Identity Verification (TPIV), $0.39 million for contract labor, $0.30 for the call center support, $0.20 million for recertification services, and $0.18 million for a Lifeline risk assessment.
- $0.16 million for the external beneficiary compliance audits under the Beneficiary and Contributor Audit Program (BCAP).
- $0.20 million for printing and postage costs, including costs associated annual Lifeline beneficiary recertification activities.
- $0.12 million for software license agreements, travel, and miscellaneous administrative and outreach activities.

Attachment A to this issue paper provides the details and compares the 4Q2017 budget to 4th Quarter 2016 (4Q2016) actual expenditures.

[1] 47 C.F.R. § 54.705(c); By-Laws of Universal Service Administrative Company, Article II, § 8.

The details to support the 4Q2017 allocation of USAC common costs to the Low Income Support Mechanism are included with the Board budget materials under item aBOD03 072517.

Attachment B to this briefing paper provides a comparison of the Low Income Support Mechanism budget to actual expenditures for the 6 months ending June 30, 2017. Explanations will be provided for significant variances.

Capital Budget

USAC management estimates direct capital expenditures of $2.85 million in 4Q2017 for National Verifier software development. Information on allocated capital expenditures, which are not attributable to a specific division, is provided under item aBOD03 072517.

Collection Requirement

Based on the proposed revised annual budget, additional dollars are required to fund programmatic activities in 2017. The resulting collection requirement for 4Q2017 combined administrative expenses and capital costs is $11.95 million ($7.96 million budget plus $3.99 million to fund 3Q2017 activities) as set forth below.

4th Quarter 2017 Administrative Expenses – Collection Requirement (in millions)

	Direct Operating Costs	Direct Capital Costs	Total
4Q2017 Administrative Expenses	$5.11	$2.85	$7.96
Additional Dollars Required to Fund Activities in 2017	1.31	2.68	3.99
Collection Requirement	**$6.42**	**$5.53**	**$11.95**

Summary of Demand

On a quarterly basis, USAC is required to submit to the FCC the projected demand for the upcoming quarter.[2] This report provides information on the Low Income Support Mechanism for the period ending June 30, 2017; provides updated projections for the current quarter ending September 30, 2017; and seeks approval of funding requirements for 4Q2017.

[2] 47 C.F.R. § 54.709(a).

USAC estimates the 4Q2017 funding requirement for the LI Support Mechanism as follows:

$ 319.85 million for Lifeline,[3]
$ 0.04 million for Link Up[4]
For a total of: $ **319.89 million**.

Prior Period Adjustments

Sixty days prior to the start of each quarter, USAC provides projected support mechanism demand and administrative expense data to the FCC. Thirty days prior to the start of the quarter, USAC submits projected universal service contributor revenue data to the FCC. The FCC uses these projections to establish the Universal Service Fund contribution factor for the upcoming quarter, and USAC uses the resulting contribution factor to invoice universal service contributors once the quarter begins.

Results for 2nd Quarter 2017 (2Q2017) contribute to an over-funded condition. The total prior period adjustment to the 4Q2017 funding requirement based on 2Q2017 actual results will decrease the funding requirement by $44.46 million. The explanation for the adjustment is provided below:

Reason for the Prior Period Adjustment	Adjustment in Millions
The 2Q2017 actual billings were lower than projected	$9.34
Low Income Support Mechanism distributions were lower than projected in 2Q2017	(50.02)
Bad debt expense was lower than anticipated	(3.44)
Interest income was higher than anticipated	(0.34)
Total Prior Period Adjustment	**$(44.46)**

The total fund requirement of $319.89 million is adjusted as follows: decreased by the prior-period adjustments of $44.46 million, increased by administrative costs of $14.69 million (including $2.74 million for USAC's common costs allocated to the LI Support Mechanism[5]), and decreased by allocated projected interest income of $0.28 million; resulting in a total projected 4Q2017 funding requirement for the LI Support Mechanism of $289.84 million.

[3] Lifeline Support is provided pursuant to 47 C.F.R. §§ 54.401-54.411.
[4] Link Up Support is provided pursuant to 47 C.F.R. §§ 54.412-54-415.
[5] This amount includes 4th Quarter allocated common costs of $3.50 million, reduced by allocated common costs of $0.76 million collected but unused in prior quarters.

Low Income Support Mechanism
Fund Size Projections for 4th Quarter 2017

	(millions)
Low Income Support	$319.89
Prior Period Adjustment	(44.46)
USAC Admin Expenses	14.69
Interest Income	(0.28)
Total 4Q2017 Demand	**$289.84**

Quarter-Over-Quarter Projections

	4Q2017	3Q2017	2Q2017	1Q2017
Low Income Support	$319.89	$330.35	$373.90	$381.23
Prior Period Adjustment	(44.46)	(54.67)	(27.03)	(26.13)
USAC Admin Expenses	14.69	8.49	11.40	7.36
Interest Income	(0.28)	(0.17)	(0.14)	(0.15)
Total Demand	**$289.84**	**$284.00**	**$358.13**	**$362.31**

<u>Management Recommendation</u>

USAC management recommends the Committee approve the budget and demand projection as proposed.

<u>Recommended USAC High Cost & Low Income Committee Action</u>

APPROVAL OF THE FOLLOWING RESOLUTIONS:

RESOLVED, that the USAC High Cost & Low Income Committee approves a 4th Quarter 2017 programmatic operating budget for the Low Income Support Mechanism of $5.11 million; and

RESOLVED FURTHER, that the USAC High Cost and Low Income Committee approves a 4th Quarter 2017 programmatic capital budget of $2.85 million; and

RESOLVED FURTHER, that the USAC High Cost & Low Income Committee directs USAC staff to submit a collection requirement of $11.95 million for Low Income Support Mechanism administrative costs in the required August 2, 2017 filing to the FCC on behalf of the Committee; and

RESOLVED, that the USAC High Cost & Low Income Committee, having reviewed at its meeting on July 24, 2017 a summary of the 4th

Quarter 2017 Low Income Support Mechanism demand estimate, hereby directs USAC staff to proceed with the required August 2, 2017 filing to the FCC on behalf of the Committee. Staff may make adjustments if the total variance for the Low Income Support Mechanism is equal to or less than $10 million and, with approval of the Committee Chair, may make adjustments if the total variance is equal to or less than $15 million.

ACTION Item #aHCLI04
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Low Income Program

4Q2017 Budget
(in thousands)

Expense Category	4Q2017 Budget	4Q2016 Actuals	Increase/ (Decrease)	Explanations
Compensation & Benefits	$ 1,981.22	$ 1,417.65	$ 563.57	Wages, employment benefits, and payroll taxes for 52 FTEs (vs an average of 29 in 4Q2016)
External BCAP Costs	155.87	211.46	(55.59)	Beneficiary compliance audits
Professional Fees & Contract Labor	2,650.68	2,424.63	226.05	National Verifier business process outsourcing and Lifeline risk assessment planned in 4Q2017
Telephone & Computer Support	110.69	0.83	109.86	Computer support maintenance agreements and licensing associated with National Verifier
Travel, Meetings and Conferences	6.68	24.28	(17.60)	Lodging, transportation, and meals associated with administrative, outreach, and training travel
Other Expenses	208.69	77.56	131.13	Higher volume of recertifications in 2017
Total Programmatic Operating Costs	**$ 5,113.83**	**$ 4,156.41**	**$ 957.42**	
Direct Capital Costs	**2,847.32**	**-**	**2,847.32**	National Verifier software development
Total Direct Costs - Low Income Program	**$ 7,961.15**	**$ 4,156.41**	**$ 3,804.74**	
Common Operating Costs Assigned to Low Income Program	3,365.80	3,277.18	88.62	Allocation of indirect operating costs based on the CAM
Common Capital Costs Assigned to Low Income Program	135.09	171.95	(36.86)	Allocation of indirect capital costs based on the CAM
Total Common Costs Assigned to Low Income Program	**$ 3,500.89**	**$ 3,449.13**	**$ 51.76**	
Total Low Income Program with Allocations	**$ 11,462.04**	**$ 7,605.54**	**$ 3,856.50**	

Low Income Program
For the Six Months Ending June 30, 2017
(in thousands)

ACTION Item #aHCLI04
Attachment B
07/24/17
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Direct Operating Expenses	Actual	Budget	Variance	%	Explanation of Variance
Compensation & Benefits	$ 3,042.1	$ 2,830.1	$ (212.0)	-7%	
Professional Fees & Contract Labor	5,587.8	4,305.2	(1,282.6)	-30%	Higher operating expense for National Verifier strategic consulting; offset by lower spending on program risk assessment
External BCAP Costs	434.1	485.0	50.9	10%	Lower costs for outsourced audits
Telephone & Computer Support	168.9	14.8	(154.1)	-1041%	Higher operating expense for National Verifier software licensing
Travel, Meetings and Conferences	26.5	32.8	6.3	19%	Lower spending on user experience trainings and conferences
Other Expenses	162.0	262.7	100.7	38%	Lower spending on postage, printing, and graphics year to date
Total Direct Operating Expenses	**$ 9,421.4**	**$ 7,930.6**	**$ (1,490.8)**	-19%	
Indirect Expense / Allocations					
USAC Administration	6,983.9	6,572.8	(411.1)	-6%	
Total Expense	**$ 16,405.3**	**$ 14,503.4**	**$ (1,901.9)**	-13%	

Universal Service Administrative Company
High Cost & Low Income Committee Meeting

INFORMATION ITEM – ***Executive Session Option***

Information on 19 USAC Internal Audit Division High Cost Support Mechanism Beneficiary Audit Reports

Information Presented

This information item provides a summary of the results for 19 High Cost Support Mechanism Beneficiary Audit Reports listed in **Exhibit I** to this briefing paper.

Discussion

A general discussion of the findings contained in the draft audit reports is appropriately held in open session. To the extent that Committee members wish to discuss specific details of the audit findings, USAC staff recommends that, in accordance with the approved criteria and procedures for conducting USAC Board of Directors (Board) and committee business in ***Executive Session*****,** this matter should be considered in ***Executive Session*** because discussion of specific audit plans, targets and/or techniques would constitute a ***discussion of internal rules and procedures***.

Audits were performed on 19 High Cost Support Mechanism beneficiaries. The purpose of the audits was to determine whether the beneficiaries complied with Federal Communications Commission (FCC) rules and program requirements. **Exhibit I** to this briefing paper highlights the results of the audits. The audit reports where the entity disagreed with one or more audit findings can be found in **Attachments A – D.**

Summary of High Cost Support Mechanism Beneficiary Audit Reports

Entity Name, State	**Number of Findings**	**Material Findings**	**Amount of Support**	**Monetary Effect of Findings**	**USAC Management Recovery Action**	**Entity Disagreement**
Pine Telephone System, Inc., Oregon	7	• **Inadequate Documentation: Assets and Expenses.** The Beneficiary did not provide adequate documentation to demonstrate certain assets and expenses were recorded in compliance with High Cost Program rules. • **Improper Inclusion of Non-Regulated Amounts.** The Beneficiary miscalculated its general allocator, which resulted in the improper inclusion of non-regulated amounts in High Cost Program filings. • **Inaccurate Loop Counts.** The Beneficiary reported inaccurate loop counts. • **Improper Power and Common Cost Allocation.** The Beneficiary miscalculated its allocation of power and common costs to central office equipment categories.	$15,988,728	($85,869)	$0	N
Frontier North, Inc., Michigan	1	• No Material Findings.	$291,006	$0	$0	N
Glenwood	5	• **Improper Affiliate Transactions.**	$3,333,480	($31,544)	$0	N

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
Telephone Membership Corporation, Nebraska		One of the 17 affiliate transactions selected for testing had a mathematical error in the amount calculated as due from the Beneficiary. The transaction was related to the shared use of the Accounting Operating System owned by Glenwood Telecommunications (“GT”) and shared with GTMC. The affiliate made a mathematical error in calculating the amount allocated to the regulated entity for shared use of the Accounting Operating System. As a result, GTMC paid a lower monthly cost than they would have, had the amount been calculated accurately. This resulted in High Cost Program (HCP) disbursements being $35,671 lower than they would have been had GTMC paid and recorded the correct expense amount.				
Yukon-Waltz Telephone Company, Pennsylvania	5	• **Incorrect classification of labor and benefits expense**. An employee whose functions included customer service as well as regulatory reporting charged all of their time to customer operations expense rather than	$342,084	($17,601)	$0	N

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		allocating a portion to corporate operations expense in accordance with Part 32. • **Depreciation expense calculation.** The Beneficiary calculated depreciation expense on an individual asset basis rather than under the group plan of accounting for depreciation, In addition, the Beneficiary utilized differing lives within the same asset accounts in its computation of depreciation expense.				
Roanoke Telephone Company, Alabama	4	• **Affiliate Transactions Charged to Beneficiary at Budgeted Rates.** Expenses were not allocated appropriately between regulated and nonregulated activities and between the Beneficiary and its affiliates. Budgeted amounts for certain affiliate expenses used initially to determine the Beneficiary's proportionate share of regulated expenses were not updated for actual amounts incurred in 2011. This resulted in an overstatement of $19,456 in the regulated portion of Circuit Equipment, Access, Accounting and	$584,424	$3,333	$3,333	N

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		Finance, and External Relations expenses.				
Blossom Telephone Company, Inc., Texas **(Attachment A)**	4	• **Inaccurate Depreciation Calculation.** The Beneficiary recorded manual entries to depreciate Cable & Wire Facilities (C&WF) (Account 2410) assets based upon Texas Public Utility Commission (PUC) approved accelerated depreciation rates. However, the Beneficiary continued to depreciate existing individual assets beyond their net book value, which resulted in overstating accumulated depreciation and depreciation expense. • **Improper Affiliate Transactions.** The Beneficiary overstated C&WF Expense (Account 6410) and Motor Vehicle Expense (Account 6112) due to the non-regulated affiliate assessing the Beneficiary tower and vehicle lease charges in excess of fully distributed cost.	$1,518,579	$27,893	$27,893	Y
ENMR-NM Telephone Cooperative Inc., New Mexico	5	• **Improper Distribution of Overhead Amounts.** The Beneficiary utilized total project cost to allocate Plant	$12,638,127	($8,114)	$0	N

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		Operations Administrative Expense and Engineering Expense versus direct labor hours.				
Peñasco Valley Telephone Cooperative, Inc., New Mexico **(Attachment B)**	4	• **Improper Affiliate Transactions.** The Beneficiary overstated Motor Vehicle Expense (Account 6112) due to the nonregulated affiliate assessing the Beneficiary vehicle lease charges in excess of fully distributed cost ("FDC").	$6,203,447	$21,473	$21,473	Y
Sacred Wind Communications, Inc., New Mexico	3	• **Inaccurate Depreciation Calculation**. The Beneficiary did not utilize monthly average asset balances to calculate depreciation. • **Improper Reporting of Non-Regulated Amounts.** The Beneficiary inappropriately allocated C&WF leases (towers) between regulated and non-regulated activities.	$9,240,130	($28,601)	$0	N
Shawnee Telephone Company, Illinois	3	• **Intended Use of Federal Universal Service Support.** The Beneficiary was unable to provide adequate documentation to support the inclusion of various expenditures sampled for testing on the HCP forms as necessary to the provision of HCP	$11,229,746	$37,719	$37,719	N

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		supported services. • **Improper Distribution of Overhead Amounts**. The Beneficiary did not appropriately allocate workers compensation expense to the various regulated Part 32 accounts. • **Miscategorized Cable & Wire Facilities**. The Beneficiary mistakenly duplicated a C&WF route on the C&WF categorization study resulting in an understatement of the C&WF Category 1 amount.				
United Utilities, Inc., Alaska	2	• **Inaccurate Taxes.** The Beneficiary incorrectly calculated the regulated portion of the Deferred Tax Liability included on the HCP Forms. • **Inaccurate Depreciation Calculation**. The Beneficiary utilized ending monthly asset balances to compute depreciation expense versus average monthly asset balances as prescribed by FCC Rules.	$7,550,202	($162,520)	$0	N
Arkwest Communications, Inc., Arkansas	2	• **Misclassified Assets and Expenses.** The Beneficiary improperly coded $80,068 of plant costs and $15,714 of expenses in its general ledger based	$8,074,740	$22,114	$22,114	N

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		on the functionality of the assets and expenses.				
Brazoria Telephone Company, Texas **(Attachment C)**	3	• **Inaccurate Taxes.** The 2013 cost study improperly excluded $1,300,534 from the total net noncurrent deferred operating income tax liability balance as of December 31, 2012, resulting in an understatement of the average cost study balance of $650,267. However, the High Cost Loop (HCL) filing was not impacted as it reports only 2013 balances and not an average of 2012 and 2013. • **Intended Use of Federal Universal Service Support.** The 2013 balance in account 7370, special charges expense, included $26,789 related to donations and sponsorships that are not allowed for recovery according to the Commission's rules as they are not considered necessary for the provisioning of interstate telecommunications service. • **Improper Allocation Methodology.** The Beneficiary's indirect cost allocations between regulated and nonregulated activities were	$2,917,233	$13,886	$13,886	Y

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		calculated using inaccurate factors. As a result regulated expenses were understated by $18,422.				
Dell Telephone Cooperative, Inc., Texas	4	• No Material Findings.	$2,405,564	$0	$0	N
Dumont Telephone Company, Iowa	5	• **Improper Inclusion of Non-Regulated Amounts.** The Beneficiary reported $5,264 of nonregulated lease expense in the rents portion of all operating expenses on its USF data collection form and in the cost study. • **Improper Power & Common Cost Allocation.** The Beneficiary incorrectly calculated the power and common central office equipment rate base asset balance in the cost study.	$731,318	$1,823	$1,823	N
Elkhart Telephone Company, Inc., Kansas **(Attachment D)**	7	• **Improper Data Period: HCL.** The number of Category 1.3 loops reported on the Beneficiary's 2014-1 HCL Form did not reconcile to the source documentation and were over reported by 14 loops. • **Miscategorized Central Office Equipment.** The Beneficiary	$4,021,636	$178,983	$178,983	Y

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		improperly categorized one Central Office Equipment (COE) asset for $1,560 as 4.2 wideband equipment and four COE assets totaling $8,646 as 4.23 interexchange equipment, all of which should have been have been categorized as 4.13 subscriber loop equipment. • **Misclassified Expenses.** The Beneficiary improperly coded labor costs for 3 employees to plant specific (accounts 6212, 6232, 6423) and plant nonspecific expense (account 6532) for tasks that were executive and general and administrative (accounts 6711 and 6721) in nature. • **Improper Allocation Methodology.** The Beneficiary did not reduce general support expense and customer operations expense for computer billing software that was used for both regulated and nonregulated operations, which resulted in an overstatement of regulated expenses. In addition, the Beneficiary used 2012 balances in other nonregulated adjustment calculations, which				

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		resulted in an understatement of net regulated rate base, property tax expense, cable and wire expense, depreciation expense, and corporate operations expense. • **Improper Operating Federal and State Incomes Taxes.** The Beneficiary reported operating tax expense in its HCP filings that exceeded actual operating taxes by $140,720. • **Improper Affiliate Transactions.** The Beneficiary included lease expense charges for the use of fiber cable plant, vehicles, and other network and general support assets owned by affiliates in its 2013 cost study and HCP filings. The lease charges exceeded the lower of fully distributed cost or fair market value by $185,009.				
Leaf River Telephone Company, Illinois	5	• No Material Findings.	$1,126,597	$0	$0	N
Rice Belt Telephone, Inc., Arkansas	3	• **Inaccurate Assets.** The plant assets recognized in the 2013 cost study	$2,033,154	$225,321	$225,321	N

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
		were recorded at fair value rather than historical cost and were overstated by $816,039.				
Summit Telephone Company, Alaska	2	• No Material Findings.	$843,940	$0	$0	N
Total	**74**		**$91,074,135**	**$198,296**	**$532,545**	

Attachment A

HC2016BE013

KPMG

Blossom Telephone Company, Inc.
Audit ID: HC2016BE013
(SAC No.: 442038)

Performance audit for the Universal Service High Cost Program Disbursements made during the twelve-month period ended December 31, 2015

Prepared for: Universal Service Administrative Company

As of Date: April 26, 2017

KPMG LLP
1225 17th Street
Suite 800
Denver, CO 80202

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KPMG

KPMG LLP
Suite 800
1225 17th Street
Denver, CO 80202-5598

EXECUTIVE SUMMARY

April 26, 2017

Mr. Wayne Scott, Vice President – Internal Audit Division
Universal Service Administrative Company
700 12th Street, NW, Suite 900
Washington, DC 20005

Dear Mr. Scott:

This report presents the results of our work conducted to address the performance audit objectives relative to Blossom Telephone Company, Inc. ("Beneficiary"), Study Area Code No. 442038, for disbursements, of $1,518,579, made from the federal Universal Service High Cost Program ("HCP") during the twelve-month period ended December 31, 2015. Our work was performed during the period from June 10, 2016 to April 26, 2017, and our results are as of April 26, 2017.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards issued by the Comptroller General of the United States (2011 Revision, as amended) and *American Institute of Certified Public Accountants Consulting 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.

The objective of this performance audit was to evaluate the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 of the Federal Communications Commission's ("FCC") Rules as well as FCC Orders governing federal Universal Service Support for the HCP (collectively, the "Rules") relative to disbursements, of $1,518,579, made from the HCP during the twelve-month period ended December 31, 2015. Compliance with the Rules is the responsibility of the Beneficiary's management. Our responsibility is to evaluate the Beneficiary's compliance with the Rules based on our audit.

As our report further describes, KPMG identified four findings as discussed in the Audit Results and Recovery Action section as a result of the work performed. Based on these results, we estimate that disbursements made to the Beneficiary from the HCP for the twelve-month period ended December 31, 2015 were $27,893 higher than they would have been had the amounts been reported properly.

In addition, we also noted other matters that we have reported to the management of the Beneficiary in a separate letter dated April 26, 2017.

This report is intended solely for the use of the Universal Service Administrative Company, the Beneficiary, and the FCC and is not intended to be and should not be relied upon by anyone other than these specified parties.

Sincerely,

KPMG LLP

List of Acronyms

Acronym	Definition
Blossom	Blossom Telephone Company, Inc.
C.F.R.	Code of Federal Regulations
C&WF	Cable and Wire Facilities
CAF	Connect America Fund
COE	Central Office Equipment
CPRs	Continuing Property Records
ETC	Eligible Telecommunications Carrier
FCC	Federal Communications Commission
Form 509	Interstate Common Line Support Mechanism Annual Common Line Actual Cost Data Collection Form
G/L	General Ledger
GAAP	U.S. Generally Accepted Accounting Principles
HCL	High Cost Loop
HCL Form	National Exchange Carrier Association Universal Service Fund Data Collection Form
HCM	High Cost Model
HCP	High Cost Program
ICC	Intercarrier Compensation
ICLS	Interstate Common Line Support
ILEC	Incumbent Local Exchange Carrier
Lamar	Lamar County Cellular
MLB	Multi-Line Business
NECA	National Exchange Carrier Association
PBO	Payroll, Benefits and Overhead
SAC	Study Area Code
SLB	Single-Line Business
SLC	Subscriber Line Charge
SNA	Safety Net Additive
SVS	Safety Valve Support
TB	Trial Balance
Texas PUC	Texas Public Utilities Commission
TPIS	Telecommunications Plant In Service
TPUC	Telecommunications Plant Under Construction
USAC	Universal Service Administrative Company
USF	Universal Service Fund

AUDIT RESULTS AND RECOVERY ACTION

Audit Results	Monetary Effect	Recommended Recovery[1]
HC2016BE013-F01: Inaccurate Depreciation Calculation – The Beneficiary recorded manual entries to depreciate C&WF (Account 2410) assets based upon Texas PUC approved accelerated depreciation rates. However, the Beneficiary continued to depreciate existing individual assets beyond their net book value, which resulted in overstating accumulated depreciation and depreciation expense.	$14,366	$14,366
HC2016BE013-F02: Improper Affiliate Transactions – The Beneficiary overstated C&WF Expense (Account 6410) and Motor Vehicle Expense (Account 6112) due to the non-regulated affiliate assessing the Beneficiary tower and vehicle lease charges in excess of fully distributed cost.	$13,401	$13,401
HC2016BE013-F03: Improper Distribution of Overhead Amounts – The Beneficiary utilized direct labor dollars to clear Motor Vehicle Expense (Account 6112) versus direct labor hours.	$ 384	$ 384
HC2016BE013-F04: Inaccurate Revenues – The Beneficiary overstated 2013 SLC Revenue by $258 on the 2013 FCC Form 509.	($ 258)	($ 258)
Total Net Monetary Effect	**$27,893**	**$27,893**

[1] The recovery amount noted in the table is not reflective of prior period or cap adjustments. The actual recovery amount will not exceed the proposed recovery amount.

USAC MANAGEMENT RESPONSE

USAC management concurs with the findings identified by the auditors. The Beneficiary must implement policies and procedures necessary to comply with FCC rules. USAC requests that the Beneficiary provide a detailed description of the policies and procedures implemented to address all findings no later than sixty (60) days after receipt of this audit report. Please submit the requested information to hcaudits@usac.org. The Beneficiary may be subject to further review if the Beneficiary does not provide the requested information to USAC.

	ICLS	CAF ICC	HCL	Finding Total
Finding #1	($1,508)	$0	$15,874	$14,366
Finding #2	$ 4,625	$0	$ 8,776	$13,401
Finding #3	$ 63	$0	$ 321	$ 384
Finding #4	($ 258)	$0	$ 0	($ 258)
Mechanism Total	**$ 2,922**	**$0**	**$24,971**	**$27,893**

As a result of the audit, USAC management will recover $27,893 of High Cost Program support from SAC# 442038.

BACKGROUND, OBJECTIVES, SCOPE AND PROCEDURES

Background

Program Overview

USAC is an independent not-for-profit corporation that operates under the direction of the FCC pursuant to 47 C.F.R. Part 54. The purpose of USAC is to administer the USF through four support mechanisms: High Cost; Low Income; Rural Health Care; and Schools and Libraries. These four support mechanisms ensure that all people regardless of location or income level have affordable access to telecommunications and information services. USAC is the neutral administrator of the USF and may not make policy, interpret regulations or advocate regarding any matter of universal service policy.

The High Cost Support Mechanism, also known as the HCP, ensures that consumers in all regions of the nation have access to and pay rates for telecommunications services that are reasonably comparable to those services provided and rates paid in urban areas, regardless of location or economic strata. Thus, the HCP provides support for telecommunications companies (Beneficiaries) that offer services to consumers in less-populated areas. The HCP consists of the following support mechanisms:

1. HCL: HCL support is available for rural companies operating in service areas where the cost to provide service exceeds 115% of the national average cost per line. HCL support includes the following two sub-components:
    a. SNA: SNA support is available for carriers that make significant investment in rural infrastructure in years when HCL support is capped and is intended to provide carriers with additional incentives to invest in their networks.
    b. SVS: SVS support is available to rural carriers that acquire high cost exchanges and make substantial post-transaction investments to enhance network infrastructure.
2. HCM: HCM support is available to carriers serving wire centers in certain states where the forward-looking costs to provide service exceed the national benchmark.
3. CAF ICC: CAF ICC support is available to ILECs to recover revenue that is not covered by Access Recovery Charges (ARC) to the end user.
4. ICLS: ICLS is available to rate-of-return incumbent carriers and competitive carriers, and is designed to help carriers offset interstate access charges and to permit each rate-of-return carrier to recover its common line revenue requirement, while ensuring that its SLCs remain affordable to its customers.
5. IAS: IAS is available to price-cap incumbent carriers and competitive carriers, and is designed to offset interstate access charges for price cap carriers.

USAC engaged KPMG to conduct a performance audit relating to the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 of the FCC's Rules as well as FCC Orders governing federal Universal Service Support for the HCP relative to disbursements, of $1,518,579, made from the HCP during the twelve-month period ended December 31, 2015.

Beneficiary Overview

Blossom Telephone Company, Inc. (SAC No. 442038), the subject of this performance audit, is a rural ILEC located in Blossom, Texas which provides regulated landline telecommunications services in North East Texas within and around Blossom, Texas. Blossom has one wholly owned subsidiary, Lamar, whose principal activity is the leasing of support assets to Blossom. Additionally, the Beneficiary's Vice President fully owns Blossom Hardware and leases office space to Blossom. The Beneficiary is a C-

Corporation, and provides non-regulated fixed wireless internet service as Blossom Communications offering internet broadband services in the state of Texas within Lamar and Red River counties.

The following table illustrates the High Cost support disbursed by USAC to the Beneficiary during the twelve-month period ended December 31, 2015 by fund type:

High Cost Support	Data Period	Disbursement Period	Disbursement Amount
Connect America Fund (CAF) Intercarrier Compensation (ICC)	July 1, 2013 - June 30, 2014	January 1 to December 31, 2015	$ 139,734
High Cost Loop (HCL)	January 1, 2013 to December 31, 2013	January 1 to December 31, 2015	$ 762,399
Interstate Common Line Support (ICLS)	January 1, 2013 to December 31, 2013	January 1 to December 31, 2015	$ 616,446
Total			**$1,518,579**

Source: USAC

The High Cost support received by the Beneficiary during the twelve-month period ended December 31, 2015, was based on the following annual financial and operational data submitted by the Beneficiary to NECA and USAC:

- 2014-1 HCL Form, based on the twelve-month period ended December 31, 2013,
- 2013 FCC Form 509, based on calendar year 2013 data, and
- 2013 CAF ICC Form, based on program year 2013 data

The above Forms capture the totals of certain pre-designated G/L Accounts including all asset accounts that roll into the TPIS account as well as certain deferred liabilities and operating expenses, subject to the allocation between regulated and non-regulated activities (Part 64 Cost Allocations), the separation between interstate and intrastate operations (Part 36 Separations) and the separation between access and non-access elements (Part 69 Separations). In addition, the Beneficiary is required to submit certain annual investment data, including the categorization of COE and C&WF on the HCP Forms.

Objectives

The objective of this performance audit was to evaluate the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 of the FCC's Rules as well as FCC Orders governing federal Universal Service Support for the HCP relative to disbursements, of $1,518,579, made from the HCP during the twelve-month period ended December 31, 2015.

Scope

The scope of this performance audit includes, but is not limited to, reviewing HCP Forms or other correspondence and supporting documentation provided by the Beneficiary, assessing the methodology used to prepare or support the HCP Forms or other correspondence, and evaluating disbursement amounts made or potentially due based on filing of HCP Forms or other correspondence relative to disbursements made from the HCP during the twelve-month period ended December 31, 2015, as well as performing other procedures we considered necessary to form a conclusion relative to disbursements made from the HCP during the twelve-month period ended December 31, 2015.

KPMG identified the following areas of focus for this performance audit:[2]

1. General Procedures
2. Materiality Analysis
3. Reconciliation
4. Assets
5. Expenses
6. HCP Eligibility Forms
7. COE Categorization
8. C&WF Categorization
9. Payroll, Benefits and Overhead
10. Taxes
11. Part 64 Cost Allocations
12. Affiliate Transactions
13. Revenues, Subscriber Listings and Billing Records
14. Revenue Requirement

Procedures

1. General Procedures

KPMG obtained and examined the ETC designation order to determine whether the Beneficiary was designated as an ETC in the study area prior to receiving HCP support. We obtained and examined the Beneficiary's state and/or self-certification letters for timeliness and the notation that all federal HCP support provided was used in the preceding calendar year and will be used in the coming calendar year only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. We also obtained the Form 481 filed by the Beneficiary to determine whether the Beneficiary made the required certifications and whether the Beneficiary's supporting documentation agrees to the data reported for the certifications made.

2. Materiality Analysis

For the applicable HCP Forms, we obtained the forms submitted for the twelve-month period ended December 31, 2013, input the information into KPMG's HCP model, and ran an automated materiality analysis that increased and decreased the account balances by +/- 50%, if the impact generated a +/- 5% or $100,000 change to overall disbursements, the individual line item/account was considered material for purposes of our performance audit.

[2] If exceptions were noted in areas other than the aforementioned in-scope areas as a result of our testing procedures and the execution of our performance audit, we identified those findings in the 'Results' section of the report.

3. **Reconciliation**

KPMG obtained the audited 2013 financial statements and reconciled to the G/L, from the G/L we reconciled to the Part 64 cost allocation inputs and then to the applicable HCP Forms. We also reconciled the December 31, 2013 trial balances to the respective Part 64 cost allocation study inputs and then to the 2014-1 HCL Form, respectively. We obtained explanations for any reconciling differences.

4. **Assets**

KPMG utilized a monetary unit sampling methodology to select asset samples from material accounts identified in the relevant HCP Forms. Asset selections were made from CPR details, and material accounts included COE, C&WF and certain general support asset accounts. We determined that asset balances were properly supported by underlying documentation such as work orders, third-party vendor invoices, and time and payroll documentation for labor-related costs; agreed dollar amounts charged to the work orders and verified proper Part 32 categorization; and validated the physical existence of selected assets. Prior to 2008, the Beneficiary filed its HCP Forms as an average schedule company. During that time period, Blossom was not U.S. GAAP or Part 32 compliant as labor costs associated with assets placed into service were expensed instead of capitalized. In 2008, the Beneficiary began filing its HCP Forms as a cost company, and processed adjustments to estimation the amount of previously expensed labor and related benefits that should be allocated to C&WF assets. However, no documentation was retained surrounding the adjustment amounts and allocation basis to specific work orders and Part 32 plant accounts. KPMG performed alternative procedures to test the reasonableness of these capitalized labor adjustments by obtaining W-2 Forms and accompanying benefits information for employees associated with each asset sample selected, and collected the reported C&WF cost and network footage data for like-kind beneficiaries' (based on size and proximity to Texas) spanning the 2010, 2011, 2012, and 2013 reporting periods to assess the reasonableness of total cost per foot reported by the Beneficiary. Additionally, KPMG identified lack of documentation with six of the thirteen initially selected sample assets and therefore obtained supporting documentation for three additional samples to gain further comfort over the asset balances reported.

5. **Expenses**

KPMG utilized a monetary unit sampling methodology to select expense samples from material accounts identified in the relevant HCP Forms. Expense selections were selected via monetary unit sampling from material operating expense accounts identified in the relevant HCP Forms (HCL and ICLS). Expense amounts were agreed to the supporting documentation such as invoices and were reviewed for proper Part 32 account coding and categorization by expense type and nature of the costs incurred (regulated versus non-regulated activities). We also obtained and examined monthly depreciation expense and accumulated depreciation schedules to determine whether the Beneficiary reported accurate depreciation expenses and accumulated depreciation.

6. **HCP Eligibility Forms**

For the relevant HCP Forms (HCL, ICLS and CAF ICC) completeness of reported accounts was determined via reconciliations to the audited financial statements via the 'Reconciliation' process described above. Reconciling items were discussed with the Beneficiary.

7. **COE Categorization**

KPMG reviewed the methodology established by the Beneficiary for COE categorization including the process for updating the network map and COE cost studies as well as performing a physical inspection. We validated that COE amounts reconciled to studies including reviewing power and common, Part 36 inputs and that amounts agreed to the HCL Form data.

8. C&WF Categorization

KPMG reviewed the methodology established by the Beneficiary for C&WF categorization including the process for updating the network map and C&WF cost studies. We validated that C&WF amounts reconciled to studies and that amounts agreed to the HCL Form data and also performed a route distance inspection.

9. Payroll, Benefits and Overhead

KPMG performed a walkthrough of the PBO process and selected a work order from the CPR sample selected for asset testing to perform flow-through payroll testing, tracing the transaction from the work order to the individual timesheet through the payroll process to the G/L. Additionally, we reviewed overhead clearing reports for a selected month and reviewed the overhead clearance process for compliance with Part 32 requirements.

10. Taxes

KPMG determined the tax filing status for the Beneficiary and obtained and reviewed the federal and state tax filings for 2013. KPMG noted that the Beneficiary operates as a C-Corporation incorporated in the state of Texas. The Beneficiary is included in the consolidated tax returns filed by Blossom at the parent company level. KPMG reviewed the tax provision and deferred income tax provision calculations, including supporting documentation, for reasonableness and developed an expectation of the effective tax rate. Additionally, we reviewed the Part 64 apportionment of operating tax account balances and evaluated the reasonableness of cost allocation methods.

11. Part 64 Cost Allocations

KPMG reviewed the Beneficiary's cost apportionment methodology and performed procedures to evaluate the apportionment factors which included performing a walkthrough with the Beneficiary and evaluating the reasonableness of the cost pool and regulated/non-regulated apportionment factors as compared to regulated and non-regulated activities performed by the Beneficiary, assessing the reasonableness of the allocation methods and corresponding data inputs used to calculate the material factors and recalculating each of the material factors.

12. Affiliate Transactions

KPMG performed procedures to assess the reasonableness of affiliate transactions, including tower, vehicle and building leases that occurred during 2013. These procedures included determining the population of affiliate transactions by reviewing the audited financial statements, trial balance, and intercompany accounts, and through inquiry, and utilizing attribute sampling to select a sample of the different types of affiliate transactions for testing. For the sample selected, we reviewed the business purpose of each transaction and determined if the transactions were recorded in accordance with 47 C.F.R. Section 32.27 and categorized in the appropriate Part 32 accounts.

13. Revenues, Subscriber Listings and Billing Records

KPMG examined revenue G/L accounts, invoices and other related documentation to verify the accuracy and existence of revenue account balances. KPMG analyzed subscriber listings and billing records to determine that the number and type of lines reported in the HCP filings agreed to underlying support documentation that subscriber listings did not include duplicate lines, invalid data, or non-revenue producing or non-working loops, and that lines were properly classified as residential/single-line business or multi-line business.

14. Revenue Requirement

KPMG reviewed the calculation of the Beneficiary's revenue requirement, including assessing the reasonableness and application of Part 64 cost allocation, Part 36 and Part 69 separations and other cost study adjustments utilized in the calculation of the common line revenue requirement.

RESULTS

KPMG's performance audit results include a listing of findings, recommendations and Beneficiary responses, with respect to the Beneficiary's compliance with FCC requirements, and an estimate of the monetary impact of such findings relative to 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69, applicable to the disbursements made from the HCP during the twelve-month period ended December 31, 2015.

Findings, Recommendations and Beneficiary Responses

KPMG's performance audit procedures identified four findings. These findings, including the condition, cause, effect, recommendation and Beneficiary response are as follows:

Finding No. **HC2016BE013-F01: Inaccurate Depreciation Calculation**

Condition

In May of 2009, the Beneficiary filed an application with the Texas PUC to increase the depreciation rate for Buried Metallic Cable (Account 2423) from 5% to 12.6%, based on a remaining life of four years. Upon approval of the Texas PUC, the Beneficiary recorded manual journal entries to recognize this additional depreciation of buried cable assets placed into service prior to January 1, 2009. However, the Beneficiary continued to depreciate existing individual buried cable assets at the historical rate of 5%, resulting in an overstatement of depreciation during 2013 on buried cable assets that would have been fully depreciated prior to December 31, 2013. This caused an overstatement of Depreciation Expense – C&WF (Account 6560-2410) of $87,366 and Accumulated Depreciation – C&WF (Account 3100-2410) of $580,856 for the twelve-month period ended December 31, 2013.

Cause

The Beneficiary did not have adequate controls and processes in place governing the proper calculation of manual adjustments to depreciation and the identification of fully depreciated assets in accordance with U.S. GAAP and Part 32 Rules.

Effect

The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an over-disbursement of $14,366 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
HCL	$15,874	$15,874
ICLS	($ 1,508)	($ 1,508)
Total	**$14,366**	**$14,366**

Recommendation

The Beneficiary should enhance the preparation, review and approval processes governing the calculation of manual adjustments to accumulated depreciation and depreciation expense, specifically identifying fully depreciated assets and ensuring that assets are not depreciated beyond their book value to ensure compliance with FCC Rules and Orders.

Beneficiary Response Blossom has no comments related to this finding.

Finding No. **HC2016BE013-F02: Improper Affiliate Transactions**

Condition The Beneficiary overstated Poles Expense-Tower (Account 6411) by $10,040, due to the non-regulated affiliate, Lamar, charging Blossom a lease charge greater than the total fully distributed cost ("FDC") of the towers. Lamar charged Blossom $72,000 in 2013 for the towers, but Blossom was able to support a FDC of $64,640, which included $2,680 in expenses for postage, office, office supplies, repairs, software and donations unrelated to tower operations. Additionally, the Beneficiary overstated Motor Vehicle Expense (Account 6112) by $10,392, due to Lamar assessing a leasing charge to Blossom for two fully depreciated vehicles.

Cause The Beneficiary did not have processes in place to review and determine if assets leased from Lamar to Blossom were charged at the lower of fair market value and FDC. Lamar did not update the tower or vehicle lease contracts to account for the actual cost of the tower or fully depreciated vehicles, thus assessing lease charges that were higher than FDC.

Effect The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an over-disbursement of $13,401 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
HCL	$ 8,776	$ 8,776
ICLS	$ 4,625	$ 4,625
Total	**$13,401**	**$13,401**

Recommendation The Beneficiary should ensure that the FDC analysis established to determine the lease charges for the various assets leased from its affiliate is appropriately computed and updated periodically (at least annually) to ensure compliance with FCC Rules and Orders.

Beneficiary Response Blossom takes minor exception to a portion of this finding associated with the overstatement of Poles Expense – Tower. The Auditors assert that Account 6411 was overstated by $10,040. A portion of this exclusion represented cost recovery that the auditors found to not appear to be related to tower expense. The auditors excluded costs for postage, office, office supplies, and repairs. While not directly associated with the towers, these expenses are indirect or overhead costs incurred to operate the business. The expenses omitted are part of the affiliate's fully distributed costs.

The disputed expense amounts are immaterial and consequently, Blossom doesn't take exception to the amount of the auditor's adjustment. However, Blossom asserts that in the event such expenses are material, that they are appropriately recognized as a portion of the tower costs.

KPMG Response KPMG reiterates that while the aforementioned expenses of $2,680 may be considered legitimate business expenses, they were not related to tower operations and thus should not be included in the tower lease charges and should not be charged to the Beneficiary.

Finding No. **HC2016BE013-F03: Improper Distribution of Overhead Amounts**

Condition The Beneficiary utilized direct labor dollars to clear Motor Vehicle Expense (Account 6112) instead of direct labor hours. Motor Vehicle expense should have been cleared to Plant Specific Expense accounts and TPUC (Account 2003), along with asset and depreciation accounts once work orders closed, on the basis of direct labor hours.

Motor Vehicle Expense (Account 6112) was cleared based on direct labor dollars for the one month tested (October 2013), as follows:

Account	Description	Original Allocation
2003	TPUC	$ 42
2410	C&WF	$ 619
6112	Vehicle Expense	$4,037
6210	COE – Switching Expense	$ 11
6230	COE – Transmission Expense	$1,955
6410	C&WF Expense	$ 409
	Total Motor Vehicle Expense Clearing	**$7,073**

Motor Vehicle Expense (Account 6112) should have been cleared to TPUC, asset accounts (as work orders closed) and Plant Specific Expense accounts based on direct labor hours, for the one month tested (October 2013), as follows :

Account	Description	Recalculated Allocation
2003	TPUC	$ 60
2410	C&WF	$ 893
6112	Vehicle Expense	$2,697
6210	COE – Switching Expense	$ 16
6230	COE – Transmission Expense	$2,818
6410	C&WF Expense	$ 589
	Total Motor Vehicle Expense Clearing	**$7,073**

Cause The Beneficiary did not have processes and controls in place for the preparation, review and approval of the clearing of overhead expenses and did not detect that the basis for allocation used was direct labor dollars rather than direct labor hours as required under Part 32.

Effect

The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an over-disbursement of $384 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
HCL	$321	$321
ICLS	$ 63	$ 63
Total	**$384**	**$384**

Recommendation

The Beneficiary should revise the overhead expense clearing process to be based on direct labor hours rather than direct labor dollars pursuant to the Part 32 Rules.

Beneficiary Response

Blossom has no comments related to this finding.

Finding No.

HC2016BE013-F04: Inaccurate Revenues

Condition

The Beneficiary overstated 2013 SLC Revenue by $258 on the 2013 FCC Form 509 as compared to the G/L account balance for End User SLC Revenue (Account 5081).

Cause

The Beneficiary's policies and procedures governing the preparation and review of the Form 509 did not identify the submission of inaccurate information. The revenue report utilized for the completion of the Form 509 included additional credits for Lifeline customers in End User SLC Revenue (Account 5081), and excluded uncollectibles and partial month SLC revenues that should have been reported on the 2013 FCC Form 509, thus creating inaccuracies in the Form 509.

Effect

The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an under-disbursement of $258 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
ICLS	($258)	($258)
Total	**($258)**	**($258)**

Recommendation

The Beneficiary should enhance policies and procedures governing the accurate reporting of revenue on the FCC Form 509.

Beneficiary Response Blossom has no comments related to this finding.

Criteria

Finding	Criteria	Descriptions
#1	47 C.F.R. Section 32.2000(g)(i) (2013)	"Unless otherwise provided by the Commission, either through prior approval or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation, may be distributed under the straight-line method during the service life of the property."
#1, #2	47 C.F.R. Section 32.12(b) (2013)	"The company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission."
#2	47 C.F.R. Section 32.27(c)(2) (2013)	"*Ceiling*. When services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive."
#3	47 C.F.R. Section 32.6112(b) (2013)	"Credits shall be made to this account for amounts transferred to Construction and/or to other Plant Specific Operations Expense accounts. These amounts shall be computed on the basis of direct labor hours."
#4	47 C.F.R. Section 54.903(a)(4) (2013)	"Each rate-of-return carrier shall submit to the Administrator on December 31st of each year the data necessary to calculate a carrier's Interstate Common Line Support, including common line cost and revenue data, for the prior calendar year. Such data shall be used by the Administrator to make adjustments to monthly per-line Interstate Common Line Support amounts in the final two quarters of the following calendar year to the extent of any differences between the carrier's ICLS received based on projected common line cost and revenue data and the ICLS for which the carrier is ultimately eligible based on its actual common line cost and revenue data during the relevant period."

Conclusion

KPMG's evaluation of the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 applicable to the disbursements made from the HCP during the twelve-month period ended December 31, 2015 identified Inaccurate Depreciation Calculation, Improper Affiliate Transactions, Improper Distribution of Overhead Amounts and Inaccurate Revenues findings. Detailed information relative to the findings is described in the Findings, Recommendations and Beneficiary Responses section above.

The combined estimated monetary impact of these findings is as follows:

Fund Type	Monetary Impact Overpayment (Underpayment)
HCL	$24,971
ICLS	$ 2,922
Total Impact	**$27,893**

KPMG recommends that the Beneficiary enhance the preparation, review and approval processes governing the calculation of manual adjustments to accumulated depreciation and depreciation expense, establish adequate controls to ensure that the lower of fair market value and FDC is assessed by their non-regulated affiliates for assets leased to Blossom, revise the overhead expense clearing process for Motor Vehicle Expense to be based on direct labor hours rather than direct labor dollars, and enhance policies and procedures governing the accurate reporting of revenue on the Form 509 and NECA 24 Month View Report to ensure compliance with FCC Rules and Orders.

Attachment B

HC2016BE020

KPMG

Peñasco Valley Telephone Cooperative, Inc.
Audit ID: HC2016BE020
(SAC No.: 492270)

Performance audit for the Universal Service High Cost Program Disbursements made during the twelve-month period ended December 31, 2015

Prepared for: Universal Service Administrative Company

As of Date: March 22, 2017

KPMG LLP
1225 17th Street
Suite 800
Denver, CO 80202

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KPMG

KPMG LLP
Suite 800
1225 17th Street
Denver, CO 80202-5598

EXECUTIVE SUMMARY

March 22, 2017

Mr. Wayne Scott, Vice President – Internal Audit Division
Universal Service Administrative Company
700 12th Street, NW, Suite 900
Washington, DC 20005

Dear Mr. Scott:

This report presents the results of our work conducted to address the performance audit objectives relative to Peñasco Valley Telephone Cooperative, Inc. ("Beneficiary"), Study Area Code No. 492270, for disbursements, of $6,203,447, made from the Universal Service High Cost Program ("HCP") during the twelve-month period ended December 31, 2015. Our work was performed during the period from September 20, 2016 to March 22, 2017, and our results are as of March 22, 2017.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards issued by the Comptroller General of the United States (2011 Revision, as amended) and *American Institute of Certified Public Accountants Consulting 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.

The objective of this performance audit was to evaluate the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 of the Federal Communications Commission's ("FCC") Rules as well as FCC Orders governing federal Universal Service Support for the HCP (collectively, the "Rules") relative to disbursements, of $6,203,447, made from the HCP during the twelve-month period ended December 31, 2015. Compliance with the Rules is the responsibility of the Beneficiary's management. Our responsibility is to evaluate the Beneficiary's compliance with the Rules based on our audit.

As our report further describes, KPMG identified four findings as discussed in the Audit Results and Recovery Action section as a result of the work performed. Based on these results, we estimate that disbursements made to the Beneficiary from the HCP for the twelve-month period ended December 31, 2015 were $21,473 higher than they would have been had the amounts been reported properly.

In addition, we also noted other matters that we have reported to the management of the Beneficiary in a separate letter dated March 22, 2017.

This report is intended solely for the use of the Universal Service Administrative Company, the Beneficiary, and the FCC and is not intended to be and should not be relied upon by anyone other than these specified parties.

Very truly yours,

KPMG LLP

List of Acronyms

Acronym	Definition
AD	Accumulated Depreciation
ARC	Access Recovery Charge
C.F.R.	Code of Federal Regulations
C&WF	Cable and Wire Facilities
CAF	Connect America Fund
COE	Central Office Equipment
CPRs	Continuing Property Records
DE	Depreciation Expense
ETC	Eligible Telecommunications Carrier
FCC	Federal Communications Commission
FDC	Fully Distributed Cost
Form 509	Interstate Common Line Support Mechanism Annual Common Line Actual Cost Data Collection Form
Fuego	Fuego Wireless, L.L.C.
G/L	General Ledger
HCL	High Cost Loop
HCL Form	National Exchange Carrier Association Universal Service Fund Data Collection Form
HCM	High Cost Model
HCP	High Cost Program
ICC	Intercarrier Compensation
ICLS	Interstate Common Line Support
ILEC	Incumbent Local Exchange Carrier
MLB	Multi-Line Business
NECA	National Exchange Carrier Association
PBO	Payroll, Benefits and Overhead
PVT	Peñasco Valley Telephone Cooperative, Inc.
PVTN	Peñasco Valley Telephone NetWorks, Inc.
PVTW	Peñasco Valley Telephone Wireless Limited Partnership
RSA	Rural Serving Area
SAC	Study Area Code
SLB	Single-Line Business
SLC	Subscriber Line Charge
SNA	Safety Net Additive
SVS	Safety Valve Support
USAC	Universal Service Administrative Company
USF	Universal Service Fund

AUDIT RESULTS AND RECOVERY ACTION

Audit Results	Monetary Effect	Recommended Recovery[1]
HC2016BE020-F01: Improper Affiliate Transactions – The Beneficiary overstated Motor Vehicle Expense (Account 6112) due to the non-regulated affiliate assessing the Beneficiary vehicle lease charges in excess of fully distributed cost ("FDC").	$19,912	$19,912
HC2016BE020-F02: Inaccurate Depreciation Calculation – The Beneficiary utilized beginning of month asset balances to compute depreciation versus average monthly asset balances.	$ 771	$ 771
HC2016BE020-F03: Misclassified Expenses – The Beneficiary inappropriately expensed a flight for $1,539 to regulated Plant Operations Administration Expense (Account 6534) for a meeting regarding wireless spectrum (a non-regulated intangible asset). Additionally, the Beneficiary inappropriately included expenses not necessary to the provision of HCP supported services in regulated General Administrative Expenses (Account 6720) and on the HCP Forms: Tuition Reimbursements of $22,825 and Employee Christmas Gifts of $11,091.	$ 588	$ 588
HC2016BE020-F04: Misclassified Assets – The Beneficiary inappropriately categorized three Parabolic Task Lights (Desk Lamps) as Circuit Equipment - Category 4.13 versus General Support Assets (Account 2110).	$ 202	$ 202
Total Net Monetary Effect	**$21,473**	**$21,473**

[1] The recovery amount noted in the table is not reflective of prior period or cap adjustments. The actual recovery amount will not exceed the proposed recovery amount.

USAC MANAGEMENT RESPONSE

USAC management concurs with the findings identified by the auditors. With respect to findings one, two and four, USAC recognizes that the Beneficiary is undertaking steps to implement the processes and procedures necessary to be in compliance. With respect to finding three, the Beneficiary must implement policies and procedures necessary to comply with FCC rules. USAC requests that the Beneficiary provide a detailed description of the policies and procedures implemented to address all findings no later than sixty (60) days after receipt of this audit report. Please submit the requested information to hcaudits@usac.org. The Beneficiary may be subject to further review if the Beneficiary does not provide the requested information to USAC.

	ICLS	CAF ICC	HCL	Finding Total
Finding #1	$5,700	$0	$14,212	$19,912
Finding #2	$1,173	$0	($ 402)	$ 771
Finding #3	$ 263	$0	$ 325	$ 588
Finding #4	$ 27	$0	$ 175	$ 202
Mechanism Total	**$7,163**	**$0**	**$14,310**	**$21,473**

As a result of the audit, USAC management will recover $21,473 of High Cost Program support from the Beneficiary for SAC# 492270.

BACKGROUND, OBJECTIVES, SCOPE AND PROCEDURES

Background

Program Overview

USAC is an independent not-for-profit corporation that operates under the direction of the FCC pursuant to 47 C.F.R. Part 54. The purpose of USAC is to administer the USF through four support mechanisms: High Cost; Low Income; Rural Health Care; and Schools and Libraries. These four support mechanisms ensure that all people regardless of location or income level have affordable access to telecommunications and information services. USAC is the neutral administrator of the USF and may not make policy, interpret regulations or advocate regarding any matter of universal service policy.

The High Cost Support Mechanism, also known as the HCP, ensures that consumers in all regions of the nation have access to and pay rates for telecommunications services that are reasonably comparable to those services provided and rates paid in urban areas, regardless of location or economic strata. Thus, the HCP provides support for telecommunications companies (Beneficiaries) that offer services to consumers in less-populated areas. The HCP consists of the following support mechanisms:

1. HCL: HCL support is available for rural companies operating in service areas where the cost to provide service exceeds 115% of the national average cost per line. HCL support includes the following two sub-components:
   a. SNA: SNA support is available for carriers that make significant investment in rural infrastructure in years when HCL support is capped and is intended to provide carriers with additional incentives to invest in their networks.
   b. SVS: SVS support is available to rural carriers that acquire high cost exchanges and make substantial post-transaction investments to enhance network infrastructure.
2. HCM: HCM support is available to carriers serving wire centers in certain states where the forward-looking costs to provide service exceed the national benchmark.
3. CAF ICC: CAF ICC support is available to ILECs to recover revenue that is not covered by Access Recovery Charges (ARC) to the end user.
4. ICLS: ICLS is available to rate-of-return incumbent carriers and competitive carriers, and is designed to help carriers offset interstate access charges and to permit each rate-of-return carrier to recover its common line revenue requirement, while ensuring that its SLCs remain affordable to its customers.
5. IAS: IAS is available to price-cap incumbent carriers and competitive carriers, and is designed to offset interstate access charges for price cap carriers.

USAC engaged KPMG to conduct a performance audit relating to the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 of the FCC's Rules as well as FCC Orders governing federal Universal Service Support for the HCP relative to disbursements, of $6,203,447, made from the HCP during the twelve-month period ended December 31, 2015.

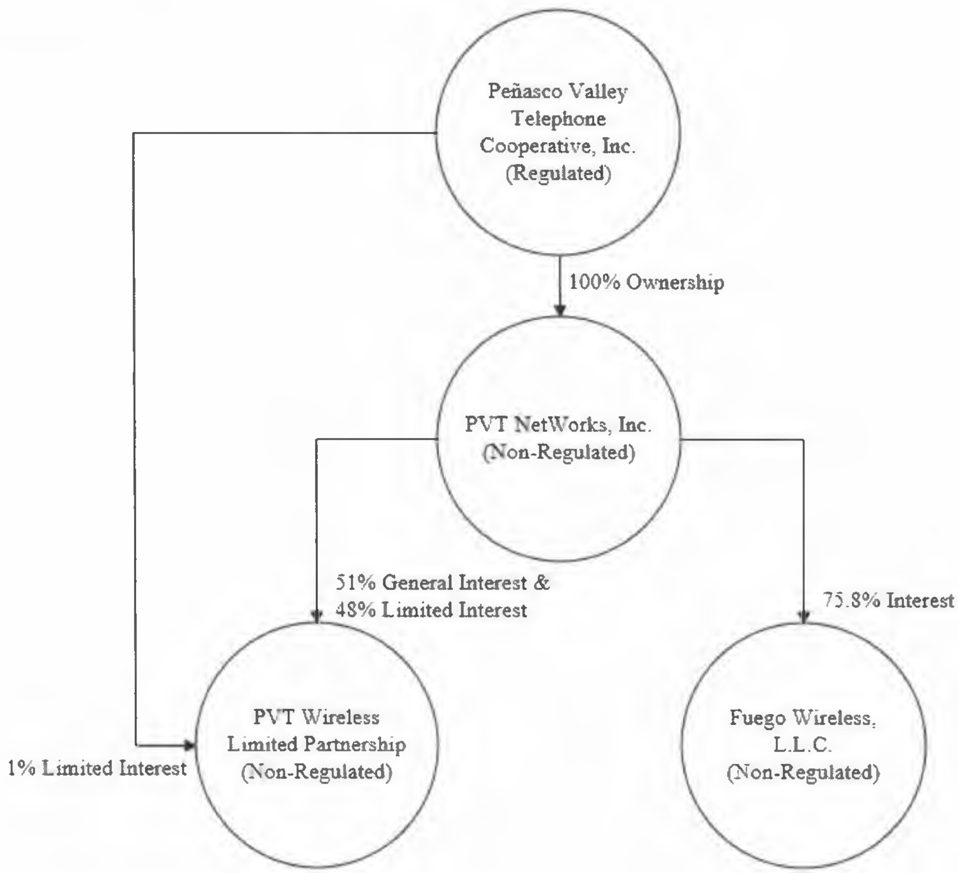
Beneficiary Overview

Peñasco Valley Telephone Cooperative, Inc. (SAC No. 492270), the subject of this performance audit, is a rural ILEC located in Artesia, New Mexico that serves residential and commercial customers in eastern New Mexico.

The Beneficiary is a New Mexico tax-exempt cooperative, and has ownership in three subsidiaries: PVTN, PVTW and Fuego. PVTN provides cable television, data, voice, data services, and wireless throughout

Eastern New Mexico. PVTN also offers cellular telecommunications services to rural areas through its investment in the New Mexico RSA 6-I partnership, and provides long distance telecommunications and paging services. PVTW was formed for the purpose of purchasing personal communication systems (PCS) franchises and to subsequently provide such services in designated geographic areas. Fuego was formed to fund, establish, and provide advanced wireless communication services to portions of the State of New Mexico and surrounding areas.

The following diagram demonstrates the ownership structure of the Beneficiary (parent company) and its non-regulated affiliates:



The following table illustrates the High Cost support disbursed by USAC to the Beneficiary during the twelve-month period ended December 31, 2015 by fund type:

High Cost Support	Data Period	Disbursement Period	Disbursement Amount
High Cost Loop (HCL)	January 1, 2013 to September 30, 2014	January 1 to December 31, 2015	$3,957,959
Interstate Common Line Support (ICLS)	January 1, 2013 to December 31, 2013	January 1 to December 31, 2015	$1,940,064
Connect America Fund (CAF) Intercarrier Compensation (ICC)	July 1, 2013 - June 30, 2014	January 1 to December 31, 2015	$ 305,424
Total			**$6,203,447**

Source: USAC

The High Cost support received by the Beneficiary during the twelve-month period ended December 31, 2015, was based on the following annual financial and operational data submitted by the Beneficiary to NECA and USAC:

- 2014-1, 2014-3 and 2014-4 HCL Forms, based on the twelve-month periods ended December 31, 2013, June 30, 2014 and September 30, 2014, respectively,
- 2013 FCC Form 509, based on calendar year 2013 data, and
- 2013 CAF ICC Form, based on program year 2013 data

The above Forms capture the totals of certain pre-designated G/L Accounts including all asset accounts that roll into the TPIS account as well as certain deferred liabilities and operating expenses, subject to the allocation between regulated and non-regulated activities (Part 64 Cost Allocations), the separation between interstate and intrastate operations (Part 36 Separations) and the separation between access and non-access elements (Part 69 Separations). In addition, the Beneficiary is required to submit certain annual investment data, including the categorization of COE and C&WF on the HCP Forms.

Objectives

The objective of this performance audit was to evaluate the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 of the FCC's Rules as well as FCC Orders governing federal Universal Service Support for the HCP relative to disbursements, of $6,203,447, made from the HCP during the twelve-month period ended December 31, 2015.

Scope

The scope of this performance audit includes, but is not limited to, reviewing HCP Forms or other correspondence and supporting documentation provided by the Beneficiary, assessing the methodology used to prepare or support the HCP Forms or other correspondence, and evaluating disbursement amounts made or potentially due based on filing of HCP Forms or other correspondence relative to disbursements made from the HCP during the twelve-month period ended December 31, 2015, as well as performing other procedures we considered necessary to form a conclusion relative to disbursements made from the HCP during the twelve-month period ended December 31, 2015.

KPMG identified the following areas of focus for this performance audit:[2]

1. General Procedures
2. Materiality Analysis
3. Reconciliation
4. Assets
5. Expenses
6. HCP Eligibility Forms
7. COE Categorization
8. C&WF Categorization
9. Payroll, Benefits and Overhead
10. Taxes
11. Part 64 Cost Allocations
12. Affiliate Transactions
13. Revenues, Subscriber Listings and Billing Records
14. Revenue Requirement

Procedures

1. General Procedures

KPMG obtained and examined the ETC designation order to determine whether the Beneficiary was designated as an ETC in the study area prior to receiving HCP support. We obtained and examined the Beneficiary's state and/or self-certification letters for timeliness and the notation that all federal HCP support provided was used in the preceding calendar year and will be used in the coming calendar year only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. We also obtained the Form 481 filed by the Beneficiary to determine whether the Beneficiary made the required certifications and whether the Beneficiary's supporting documentation agrees to the data reported for the certifications made.

2. Materiality Analysis

For the applicable HCP Forms, we obtained the forms submitted for the twelve-month period ended December 31, 2013, input the information into KPMG's HCP model, and ran an automated materiality analysis that increased and decreased the account balances by +/- 50%, if the impact generated a +/- 5% or $100,000 change to overall disbursements, the individual line item/account was considered material for purposes of our performance audit.

[2] If exceptions were noted in areas other than the aforementioned in-scope areas as a result of our testing procedures and the execution of our performance audit, we identified those findings in the 'Results' section of the report.

3. **Reconciliation**

KPMG obtained the audited 2013 financial statements and reconciled to the G/L, from the G/L we reconciled to the Part 64 cost allocation inputs and then to the applicable HCP Forms. We obtained explanations for any reconciling differences.

4. **Assets**

KPMG utilized a monetary unit sampling methodology to select asset samples from material accounts identified in the relevant HCP Forms. Asset selections were made from CPR details, and material accounts included COE, C&WF and certain general support asset accounts. We determined that asset balances were properly supported by underlying documentation such as work orders, third-party vendor invoices, and time and payroll documentation for labor-related costs; agreed dollar amounts charged to the work orders and verified proper Part 32 categorization; and validated the physical existence of selected assets.

5. **Expenses**

KPMG utilized a monetary unit sampling methodology to select expense samples from material accounts identified in the relevant HCP Forms. Expense selections were selected via monetary unit sampling from material operating expense accounts identified in the relevant HCP Forms (HCL and ICLS). Expense amounts were agreed to the supporting documentation such as invoices and were reviewed for proper Part 32 account coding and categorization by expense type and nature of the costs incurred (regulated versus non-regulated activities). We also obtained and examined monthly depreciation expense and accumulated depreciation schedules to determine whether the Beneficiary reported accurate depreciation expenses and accumulated depreciation.

6. **HCP Eligibility Forms**

For the relevant HCP Forms (HCL, ICLS and CAF ICC) completeness of reported accounts was determined via reconciliations to the audited financial statements via the 'Reconciliation' process described above. Reconciling items were discussed with the Beneficiary.

7. **COE Categorization**

KPMG reviewed the methodology established by the Beneficiary for COE categorization including the process for updating the network map and COE cost studies as well as performing a physical inspection. We validated that COE amounts reconciled to studies including reviewing power and common, Part 36 inputs and that amounts agreed to the HCL Form data.

8. **C&WF Categorization**

KPMG reviewed the methodology established by the Beneficiary for C&WF categorization including the process for updating the network map and C&WF cost studies. We validated that C&WF amounts reconciled to studies and that amounts agreed to the HCL Form data and also performed a route distance inspection.

9. **Payroll, Benefits and Overhead**

KPMG performed a walkthrough of the PBO process and selected a work order from the CPR sample selected for asset testing to perform flow-through payroll testing, tracing the transaction from the work order to the individual timesheet through the payroll process to the G/L. Additionally, we reviewed overhead clearing reports for a selected month and reviewed the overhead clearance process for compliance with Part 32 requirements.

10. Taxes

We determined the tax filing status for the Beneficiary and obtained and reviewed the applicable New Mexico Public Regulation Commissions Certificate of Good Standing and Compliance for 2013. As the Beneficiary is tax exempt as a cooperative, the tax provision and deferred income tax provision calculations are not applicable. KPMG reviewed the Part 64 apportionment of operating tax account balances and evaluated the reasonableness of cost allocation methods.

11. Part 64 Cost Allocations

KPMG reviewed the Beneficiary's cost apportionment methodology and performed procedures to evaluate the apportionment factors which included performing a walkthrough with the Beneficiary and evaluating the reasonableness of the cost pool and regulated/nonregulated apportionment factors as compared to regulated and nonregulated activities performed by the Beneficiary, assessing the reasonableness of the allocation methods and corresponding data inputs used to calculate the material factors and recalculating each of the material factors.

12. Affiliate Transactions

KPMG performed procedures to assess the reasonableness of affiliate transactions, including vehicle and fiber leases, and intercompany transactions that occurred during 2013. These procedures included determining the population of affiliate transactions by reviewing the audited financial statements, trial balance, and intercompany accounts, and through inquiry, and utilizing attribute sampling to select a sample of the different types of affiliate transactions for testing. For the sample selected, we reviewed the business purpose of each transaction and determined if the transactions were recorded in accordance with 47 C.F.R. Section 32.27 and categorized in the appropriate Part 32 accounts.

13. Revenues, Subscriber Listings and Billing Records

KPMG examined revenue G/L accounts, invoices and other related documentation to verify the accuracy and existence of revenue account balances. KPMG analyzed subscriber listings and billing records to determine that the number and type of lines reported in the HCP filings agreed to underlying support documentation, that subscriber listings did not include duplicate lines, invalid data, or non-revenue producing or non-working loops, and that lines were properly classified as residential/single-line business or multi-line business.

14. Revenue Requirement

KPMG reviewed the calculation of the Beneficiary's revenue requirement, including assessing the reasonableness and application of Part 64 cost allocation, Part 36 and Part 69 separations and other cost study adjustments utilized in the calculation of the common line revenue requirement.

RESULTS

KPMG's performance audit results include a listing of findings, recommendations and Beneficiary responses, with respect to the Beneficiary's compliance with FCC requirements, and an estimate of the monetary impact of such findings relative to 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69, applicable to the disbursements made from the HCP during the twelve-month period ended December 31, 2015.

Findings, Recommendations and Beneficiary Responses

KPMG's performance audit procedures identified four findings. These findings, including the condition, cause, effect, recommendation and Beneficiary response are as follows:

Finding No. **HC2016BE020-F01: Improper Affiliate Transactions**

Condition The Beneficiary overstated Motor Vehicle Expense (Account 6112) by $58,343 for three vehicles from January 1, 2013 through September 30, 2014 due to the non-regulated affiliate, PVTN, assessing a leasing charge to PVT for three fully depreciated vehicles.

Cause The Beneficiary did not have processes in place to review and determine if assets leased from PVTN to PVT were charged at the lower of fair market value and FDC. PVTN does not have a control in place to monitor when vehicles leased to PVT are fully depreciated and to cease billing.

Effect The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an over-disbursement of $19,912 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
HCL	$14,212	$14,212
ICLS	$ 5,700	$ 5,700
Total	**$19,912**	**$19,912**

Recommendation The Beneficiary should establish adequate controls to ensure that the lower of fair market value and FDC is assessed by their non-regulated affiliates for assets or services provided to the Beneficiary to ensure compliance with FCC Rules and Orders.

Beneficiary Response PVT has processes in place to review all of our accounting procedures as well as the lease transactions. PVT also leases equipment from third party leasing companies. PVTN had structured the leases the same as PVT's third party leases and were based on market. PVT and PVTN will restructure our leases to fully comply with the lower of fair market value and fully distributed costs as opposed to market.

Finding No. **HC2016BE020-F02: Inaccurate Depreciation Calculation**

Condition The Beneficiary utilized beginning of month asset balances to compute depreciation expense ("DE") and accumulated depreciation ("AD") from January 1, 2013 through September 30, 2014 versus average monthly asset balances as prescribed by FCC Rules and Regulations.

The following differences were noted upon recalculation of depreciation expense and accumulated depreciation of material accounts:

Twelve-month period ended December 31, 2013 impacting the 2014-1 HCL Form and 2013 Form 509:

Account	Reported Amount	Recalculated Amount	Difference
AD – General Support Assets (3100-2110)	$ (8,595,227)	$ (8,597,801)	$ (2,574)
AD – COE Transmission (3100-2230)	$ (6,559,849)	$ (6,512,041)	$ 47,808
AD – C&WF (3100-2410)	$(26,562,334)	$(26,571,048)	$ (8,714)
DE – General Support Assets (6560-2110)	$ 561,006	$ 566,153	$ 5,147
DE – COE Transmission (6560-2230)	$ 666,421	$ 618,613	$(47,808)
DE – C&WF (6560-2410)	$ 2,265,196	$ 2,273,910	$ 8,714

Twelve-month period ended June 30, 2014 impacting the 2014-3 HCL Form:

Account	Reported Amount	Recalculated Amount	Difference
AD – COE Transmission (3100-2230)	$ (6,882,866)	$ (6,873,751)	$ 9,115
AD – C&WF (3100-2410)	$(27,750,191)	$(27,755,461)	$(5,270)
DE – COE Transmission (6560-2230)	$ 618,885	$ 609,770	$(9,115)
DE – C&WF (6560-2410)	$ 2,337,256	$ 2,342,526	$ 5,270

Twelve-month period ended September 30, 2014 impacting the 2014-4 HCL Form:

Account	Reported Amount	Recalculated Amount	Difference
AD – COE Transmission (3100-2230)	$ (7,034,983)	$ (7,038,015)	$(3,032)
AD – C&WF (3100-2410)	$(28,375,478)	$(28,376,113)	$ (635)
DE – COE Transmission (6560-2230)	$ 624,079	$ 627,111	$ 3,032
DE – C&WF (6560-2410)	$ 2,409,413	$ 2,410,048	$ 635

Cause

The Beneficiary did not use the average monthly asset balance method for calculating monthly depreciation expense as using beginning monthly balance to calculate monthly depreciation expense expedited the monthly close process.

Effect

The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an over-disbursement of $771 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
HCL	$(402)	$(402)
ICLS	$1,173	$1,173
Total	**$ 771**	**$ 771**

Recommendation

The Beneficiary should establish adequate controls to review the depreciation calculations prior to posting to the G/L to ensure compliance with FCC Rules and Regulations.

Beneficiary Response

Although long term, there is no impact on calculating depreciation based on the beginning balance versus the average balance, PVT will change our accounting procedure to comply with calculating depreciation based on the average monthly balance. Per KPMG's recommendation, PVT will continue to calculate monthly depreciation based on the beginning month's balance for expedited monthly closing and true up the depreciation at year-end based on average monthly balance.

Finding No. **HC2016BE020-F03: Misclassified Expenses**

Condition

The Beneficiary inappropriately included expenses of $1,539 related to a flight to Alaska to regulated Plant Operations Administration Expense (Account 6534). The purpose of the flight was to meet with an Alaskan Telecommunications specialist regarding the use of spectrum for internet and wireless connectivity in locations where the terrain makes it impractical to bury fiber. As spectrum for internet and wireless is a non-regulated intangible asset, the expense should not have been included on the HCP Forms.

Additionally, two of 32 expense items tested were inappropriately recorded to General and Administrative Expenses (Account 6720). The expenses, totaling $22,825 for tuition reimbursement and $11,091 for employee Christmas gifts, should have been excluded from the HCP Forms as not necessary to the provision of HCP supported services. These expense items did not impact disbursements due to the Beneficiary exceeding the allowable threshold on the HCP Forms for Corporate Operations Expenses.

Cause

The Beneficiary did not have adequate preparation, review and approval processes to evaluate the proper inclusion of only expenses necessary to the provision of HCP supported services in the HCP Forms.

Effect

The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an over-disbursement of $588 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
HCL	$325	$325
ICLS	$263	$263
Total	**$588**	**$588**

Recommendation

The Beneficiary should develop and implement procedures to review transactions and ensure only expenses necessary to the provision of HCP supported services are included in the HCP Forms in accordance with FCC Rules and Orders.

Beneficiary Response

PVT has processes in place to review all of our accounting transactions. PVT believes the above expenses are legitimate business expenses and therefore PVT correctly classified them. The $1,539 related to a flight to Alaska to meet with Alcatel Lucent was to determine how to cost effectively provide fixed wireless services in PVT's regulated service territory. Since PVT has ½ of one customer per square mile in its service territory, fixed wireless would be a very cost effective means of providing service to subscribers. The $22,825 for tuition reimbursement was for training and education. This additional training and education should make PVT's employees more productive as the company is striving to be cost-efficient by doing "more with less". PVT believes the FCC rules want providers to be efficient and provide the best/cost effective service to our rural customers as possible. The $11,091 for "PVT Logo" jackets was for advertising. Although the description on the check was "Christmas Gifts", these jackets are very efficient and effective advertising mechanisms. Again, PVT believes all of these expenses are legitimate business expenses and we are following the FCC Rules and Orders.

KPMG Response

KPMG reiterates that while aforementioned expenses may be considered legitimate business expenses, they are not considered regulated business expenses necessary to the provision of HCP supported services and should not have been included on the HCP Forms. Specifically, the flight to Alaska was related to wireless service and should not have been coded to regulated Plant Operations Administration Expense (Account 6534), and tuition reimbursement and logo jackets should not have been classified to regulated General and Administrative Expenses (Account 6720).

Finding No.

HC2016BE020-F04: Misclassified Assets

Condition

The Beneficiary inappropriately recorded and categorized three Parabolic Task Lights (Desk Lamps) as Circuit Equipment - Category 4.13 (Account 2230) versus expensing such items as Office Equipment Expense (Account 6123). Due to this incorrect categorization, Circuit Equipment - Category 4.13 and COE - Transmission (Account 2230) were overstated by $1,411. The Beneficiary purchased the three Parabolic Task Lights in 2006 and should have expensed such costs in that period.

Cause

The Beneficiary did not have processes in place to accurately review and classify assets, thus incorrectly reporting the Circuit Equipment - Category 4.13 balance.

Effect

The monetary impact of this finding relative to disbursements made from the HCP for the twelve-month period ended December 31, 2015 is estimated as an over-disbursement of $202 and is summarized by support mechanism as follows:

Support Type	Monetary Effect	Recommended Recovery
HCL	$175	$175
ICLS	$ 27	$ 27
Total	**$202**	**$202**

Recommendation

The Beneficiary should enhance its preparation, review and approval processes over the accuracy of documenting and reporting asset categorizations to ensure compliance with FCC Rules and Orders.

Beneficiary Response

PVT has processes in place to review all of our accounting transactions; however, this one transaction slipped through. PVT agrees with this finding.

Criteria

Finding	Criteria	Description
#1	47 C.F.R. Section 32.12(b) (2013)	"The company's financial records should be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission."
#1	47 C.F.R. Section 32.27(c)(2) (2013)	"*Ceiling*. When services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive."
#2	47 C.F.R. Section 32.2000(g)(2)(iii) (2013)	"Charges for currently accruing depreciation shall be made monthly to the appropriate depreciation accounts, and corresponding credits shall be made to the appropriate depreciation reserve accounts. Current monthly charges shall normally be computed by the application of one-twelfth of the annual depreciation rate to the monthly average balance of the associated category of plant. The average monthly balance shall be computed using the balance as of the first and last days of the current month."
#3	47 C.F.R. Section 32.6534(a) (2013)	"This account shall include costs incurred in the general administration of plant operations. This includes supervising plant operations (except as specified in Section 32.5999(a)(3) of this subpart); planning, coordinating and monitoring plant operations; and performing staff work such as developing methods and procedures, preparing and conducting training (except on-the-job training) and coordinating safety programs."
#3	*All Universal Service High-Cost Support Recipients Are Reminded That Support Must Be Used For Its Intended Purpose*, WC Docket No. 10-90, WC Docket No. 14-58, Public Notice, FCC 15-133 at pp.1-2 (October 19, 2015)	"Under federal law, high-cost support provided to an ETC must be used 'only for the provision, maintenance, and upgrading of facilities and services for which the support is intended'.... [T]he following is a *non-exhaustive* list of expenditures that are not necessary for the provision of supported services and therefore may not be recovered through universal service support:...Scholarships;... Gifts to Employees...."

Finding	Criteria	Description
#3	47 C.F.R. Section 32.7300, 32.7300(h)(2) (2013)	"This account shall be used to record the results of transactions, events and circumstances affecting the company during a period and which are not operational in nature....This account shall include the following: ...(h) Costs that are typically given special regulatory scrutiny for ratemaking purposes. Unless specific justification to the contrary is given, such costs are presumed to be excluded from the costs of service in setting rates....(2) Contributions for charitable, social or community welfare purposes."
#4	47 C.F.R. Section 36.126(c)(3) (2013)	"Exchange Line Circuit Equipment Excluding Wideband—Category 4.13—The cost of Circuit Equipment associated with exchange line plant excluding wideband for the study area is assigned to subcategories and is allocated to the appropriate operation in the same manner as the related exchange line cable and wire facilities for nonwideband service as described in Section 36.154."
#4	47 C.F.R. Section 32.2000(a)(4) (2013)	"The cost of the individual items of equipment, classifiable to Accounts 2112, Motor vehicles; 2113, Aircraft; 2114, Tools and other work equipment; 2122, Furniture; 2123, Office equipment; 2124, General purpose computers, costing $2,000 or less or having a life of less than one year shall be charged to the applicable expense accounts, except for personal computers falling within Account 2124."

Conclusion

KPMG's evaluation of the Beneficiary's compliance with the applicable requirements of 47 C.F.R. Parts 32, 36, 51, 54, 64 and 69 applicable to the disbursements made from the HCP during the twelve-month period ended December 31, 2015 identified improper affiliate transactions, inaccurate depreciation calculation, misclassified expenses, and misclassified assets as performance audit findings. Detailed information relative to the findings is described in the Findings, Recommendations and Beneficiary Responses section above.

The combined estimated monetary impact of these findings is as follows:

Fund Type	Monetary Impact Overpayment (Underpayment)
HCL	$14,310
ICLS	$ 7,163
Total Impact	**$21,473**

KPMG recommends that the Beneficiary:

- Establish adequate controls to ensure that the lower of fair market value and FDC is assessed by their non-regulated affiliates for assets or services provided to the Beneficiary.
- Review the depreciation calculations for compliance with appropriate FCC Rules and Regulations prior to posting to the G/L.
- Develop and implement procedures to review transactions and ensure only expenses incurred in the provision of HCP supported services are included in the HCP Forms.
- Enhance processes over the accuracy of reporting asset categorization to ensure compliance with FCC Rules and Orders.

Attachment C

HC2016BE029

Performance Audit on Compliance with the Federal Universal Service Fund High Cost Support Mechanism Rules

Brazoria Telephone Company
USAC Audit ID: HC2016BE029
SAC No.: 442040

Disbursements Made During the Year Ended December 31, 2015

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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EXECUTIVE SUMMARY

February 6, 2017

Universal Service Administrative Company
700 12th Street, N.W., Suite 900
Washington, DC 20005

Attention: Mr. Wayne Scott

This report represents the results of Moss Adams LLP's (we, us, our, and Moss Adams) work conducted to address the performance audit objectives relative to Brazoria Telephone Company, Study Area Code (SAC) No. 442040, (Brazoria or Beneficiary) for disbursements of $2,917,233 made from the Universal Service High Cost Program (HCP) (Disbursements) during the year ended December 31, 2015.

We conducted our performance audit in accordance with the standards applicable to performance audits contained in generally accepted *Government Auditing Standards*, issued by the Comptroller General of the United States (2011 Revision). Those standards require that we plan and perform the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The audit included examining, on a test basis, evidence supporting the data used to calculate support, as well as performing other procedures we considered necessary to form conclusions. We believe the evidence we have obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. However, our performance audit does not provide a legal determination of the Beneficiary's compliance with specified requirements.

The objective of this performance audit was to evaluate the Beneficiary's compliance with the regulations and orders governing the federal Universal Service High Cost Support Mechanism, set forth in of 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support for the HCP relative to the disbursements (collectively, the Rules).

Based on the test work performed, our audit disclosed three detailed audit findings (Finding or Findings) discussed in the Audit Results section. For the purpose of this report, a Finding is a condition that shows evidence of non-compliance with the Rules that were in effect during the audit period.

Certain information may have been omitted from this report concerning communications with Universal Service Administrative Company (USAC) management or other officials and/or details about internal operating processes or investigations.

This report is intended solely for the use of USAC, the Beneficiary, and the FCC and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of those procedures for their purposes. This report is not confidential and may be released to a requesting third party.

Moss Adams LLP

Spokane, Washington
February 6, 2017

Audit Results

Audit Results	Monetary Effect	Recommended Recovery
Finding #1: 47 C.F.R. § 32.12(b) and § 54.320(b) – Inaccurate Taxes: The 2013 cost study improperly excluded $1,300,534 from the total net noncurrent deferred operating income tax liability balance as of December 31, 2012, resulting in an understatement of the average cost study balance of $650,267. However, the HCL filing was not impacted as it reports only 2013 balances and not an average of 2012 and 2013.	$17,461	$17,461
Finding #2: 47 C.F.R. § 54.7, 47 U.S.C. § 254, and 47 C.F.R § 65.450(d) – Intended Use of Federal Universal Service Support: The 2013 balance in account 7370, special charges expense, included $26,789 related to donations and sponsorships that are not allowed for recovery according to the Commission's rules as they are not considered necessary for the provisioning of interstate telecommunications service.	$4,553	$4,553
Finding #3: 47 C.F.R. § 64.901 – Improper Allocation Methodology: The Beneficiary's indirect cost allocations between regulated and nonregulated activities were calculated using inaccurate factors. As a result regulated expenses were understated by $18,422.	$(8,128)	$(8,128)
Total Net Monetary Effect	**$13,886**	**$13,886**

USAC Management Response

USAC management concurs with the findings identified by the auditors. With respect to findings one and three, USAC acknowledges that the Beneficiary has implemented policies and procedures necessary to comply with FCC rules. With respect to finding two, USAC recognizes that the Beneficiary is undertaking steps to implement the processes and procedures necessary to be in compliance. USAC requests that the Beneficiary provide a detailed description of the policies and procedures implemented to address finding two no later than sixty (60) days after receipt of this audit report. Please submit the requested information to hcaudits@usac.org. The Beneficiary may be subject to further review if the Beneficiary does not provide the requested information to USAC.

	ICLS	HCL	Finding Total
Finding #1	$17,461	$0	$17,461
Finding #2	$4,553	$0	$4,553
Finding #3	($2,687)	($5,441)	($8,128)
Mechanism Total	$19,327	($5,441)	$13,886

As a result of the audit, USAC management will recover $13,886 of High Cost Program support from Beneficiary for SAC# 442040.

Background and Program Overview

BACKGROUND

The Beneficiary is a cost-based eligible telecommunications carrier (ETC) that provides telecommunications services, including local service, in areas of southeastern Texas.

PROGRAM OVERVIEW

USAC is an independent not-for-profit corporation that operates under the direction of the Federal Communications Commission (FCC) pursuant to 47 C.F.R. Part 54. The purpose of USAC is to administer the federal Universal Service Fund (USF), which is designed to ensure that all people, regardless of location or income have affordable access to telecommunications and information services. USAC is the neutral administrator of the USF and may not make policy, interpret regulations, or advocate regarding any matter of universal service policy.

The High Cost Program (HCP), a component of the USF, ensures that consumers in all less populated areas of the country have access to and pay rates for telecommunications services that are reasonably comparable to those services provided and rates paid in urban areas. The HCP consists of the following support mechanisms:

- High cost loop support (HCLS): HCLS is available for rural companies operating in service areas where the cost to provide service exceeds 115% of the national average cost per loop.

HCLS includes the following:

- Safety net additive (SNA): SNA support is available for carriers that make significant investment in rural infrastructure in years when HCLS is capped and is intended to provide carriers with additional incentives to invest in their networks.
- Safety valve support (SVS): SVS is available to rural carriers that acquire high cost exchanges and make substantial post-acquisition investments to enhance network infrastructure.

- High cost model (HCM): HCM support is available to carriers serving wire centers in certain states where the forward looking costs to provide service exceed the national benchmark.
- Connect America Fund Intercarrier Compensation support (CAF ICC): CAF ICC support replaced Local Switching Support and is available to ILEC's to assist them in recovering a portion of the revenue requirement related to switching investment that is not covered by the access recovery charge (ARC) billed to the end user or certain other charges billed to other carriers. This revenue requirement was frozen based on forecasted switching investment filed by eligible carriers in 2011 and is being reduced by 5% per year. CAF ICC disbursements began July 1, 2012.
- Interstate common line support (ICLS): ICLS is available to ILECs and is designed to help its recipients recover common line revenue requirement while ensuring the subscriber line charge (SLC) remains affordable to customers. The common line revenue requirement is related to facilities that connect end users to the carrier's switching equipment.
- Interstate access support (IAS): IAS is available to price-cap ILECs and competitive carriers, and is designed to offset interstate access charges.

Objective, Scope, and Audit Methodology

OBJECTIVE

The objective of our performance audit was to evaluate the Beneficiary's compliance with 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's Orders governing Federal Universal Service Support for the HCP relative to the disbursements for the 12-month period ended December 31, 2015.

This performance audit did not constitute an audit of financial statements in accordance with *Government Auditing Standards*. We were not engaged to, and do not render an opinion on the Beneficiary's internal control over financial reporting or internal control over compliance. We caution that projecting the results of our evaluation on future periods is subject to the risks that controls may become inadequate because of changes in conditions that affect compliance.

SCOPE

The following chart summarizes the Universal Service High Cost Program support that was included in the scope of this audit:

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	12/31/2013	12/31/2015	$255,864
High Cost Loop Support (HCLS)	12/31/2013	12/31/2015	$1,431,537
Interstate Common Line Support (ICLS)	12/31/2013	12/31/2015	$1,229,832
Total			**$2,917,233**

AUDIT METHODOLOGY

To accomplish our audit objective, we performed the following procedures:

Reconciliation – We reconciled the December 31, 2013 and 2012, trial balances to the separations and Part 64 study inputs and then to the applicable HCP Forms, obtained explanations for any variances, and evaluated the explanations for reasonableness.

Rate Base and Investment in Network Facilities – We utilized an attribute sampling methodology to select asset samples from central office equipment (COE) and cable and wire facilities (CWF) accounts. Asset selections were made from continuing property record (CPR) detail. We determined that balances for the selected assets were properly supported by underlying documentation such as work order detail, third-party vendor invoices, materials used sheets, and time and payroll documentation for labor and related costs. We agreed the amounts charged to work order detail and verified the proper general ledger coding under Part 32. In addition, we verified the physical existence of selected assets.

Tax Filing Status – We verified the tax filing status for the Beneficiary and obtained and reviewed the tax provision and deferred income tax provision calculations, including supporting documentation, for reasonableness.

Postretirement Benefit Liability Accounting – We tested the accounting for the Beneficiary's postretirement benefit liability and associated other comprehensive income for accuracy and compliance with Part 32.

Expenses – We utilized an attribute sampling methodology to select expense samples from operating expense accounts that impact HCLS, ICLS, and CAF ICC. Payroll selections were made from a listing of employees. We agreed the amounts to supporting documentation such as time sheets, labor distribution reports, and approved pay rates, and verified the costs were coded to the proper Part 32 account. We reviewed benefits and clearings for compliance with Part 32.

We made other disbursement selections from accounts payable transactions and agreed amounts to supporting documentation, reviewing for proper coding under Part 32. We selected a sample of manual journal entries to ensure reclassifications between expense accounts were appropriate and reasonable.

Affiliate Transactions – We performed procedures to assess the reasonableness of affiliate transactions that occurred during the period under audit. These transactions involve the transfer of assets or the provision of service between the Beneficiary and another entity with common ownership. We noted that the Beneficiary wholly owns two entities: BTC Enterprises and Coastal Link Communications, LLC. Additionally, the following are companies that are commonly owned: HFT Communications, LP, HFT Mini Storage, LLC, HFT Tower, LLC, and HFT Realty, LLC. The Beneficiary purchases services from each of these affiliates. We selected a sample of various types of transactions to determine if the transactions were recorded in accordance with 47 C.F.R. Section 32.27 and categorized in the appropriate Part 32 accounts. The following transactions were selected for testing:

- Maintenance and cellular sales – the Beneficiary contracts with HFT Communications, LP for the maintenance of cellular network and cellular sales. Transactions occur at prevailing price.
- Employee labor – HFT Communications, LP utilizes employees from the Beneficiary and is charged for labor provided at actual cost.
- Building lease – the Beneficiary contracts with HFT Mini Storage, LLC to lease building space for the offices of Brazoria. Transactions occur at fully distributed cost.
- Tower lease – the Beneficiary contracts with HFT Tower, LLC for use of tower space. Transactions occur at fair market value.
- Machinery lease – the Beneficiary contracts with HFT Realty, LLC to lease machinery equipment. Transactions occur at fully distributed cost.

For each transaction, we reviewed supporting documentation including lease agreements, continuing property records, work orders, cost analysis files and journal entries to determine if the transaction was priced in accordance with Part 32.27.

Revenues and Subscriber Listings - We tested revenue general ledger accounts, subscriber bills, and other documentation to verify the accuracy and existence of revenues. We utilized an attribute sampling methodology to select revenue samples from subscriber listings. Our testing of subscriber bills consisted of procedures to ensure the lines were properly classified as residential, single-line business, or multi-line business. In addition, we reconciled the revenues reported to National Exchange Carrier Association (NECA) to the general ledger and billing support. We obtained subscriber listings and billing records to determine the lines or loops reported in the HCP filings agreed to supporting documentation. Our analysis included reviewing the listing for duplicate lines, invalid data, and nonrevenue producing lines.

Part 64 Allocations – We reviewed the Beneficiary's cost apportionment methodology and assessed the allocation methods to determine they were either directly allocated, indirectly allocated based on a cost causative factor, or indirectly allocated using a general allocator in accordance with Part 64. We reviewed corresponding data inputs used to calculate the factors, recalculated the material factors, and recalculated the material amounts allocated. We also evaluated the assignment of trial balance accounts between regulated, nonregulated, and common costs and the apportionment factors as compared to our understanding of the regulated and nonregulated activities performed by the Beneficiary.

COE and CWF Categorization – We reviewed the methodology for categorizing assets including a comparison to network diagrams. We reconciled the COE and CWF amounts to the cost studies and agreed them to the applicable HCP Forms. In addition, we reviewed power and common allocation and physically inspected a sample of COE assets and tested route distances of CWF for reasonableness.

Revenue Requirement – We recalculated the Beneficiary's revenue requirement using our cost allocation software program and reviewed the calculation of revenue requirement including the applications of Part 64, 36, and 69 for reasonableness. In addition, we traced cost study adjustments that were not recorded in the general ledger to supporting documentation and reviewed them for reasonableness.

Detailed Audit Findings

Our performance audit resulted in the following detailed audit findings and recommendations with respect to the Beneficiary's compliance with the Rules. The findings also include an estimate of the monetary impact relative to 47 C.F.R. Part 54, Subparts C, D, K, and M, Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B, as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support applicable to the disbursements made from the HCP during the year ended December 31, 2015.

FINDING No.: HC2016BE029-F01: 47 C.F.R. § 32.12(b) and § 54.320(b) – INACCURATE TAXES

Condition –
The 2013 cost study improperly excluded $1,300,534 relating to accelerated depreciation of property, plant and equipment from the total net noncurrent deferred operating income tax liability balance as of December 31, 2012, resulting in an understatement of the average cost study balance of $650,267.

Cause –
The process to review, approve, and prepare the 2013 cost study did not identify and adjust for the excluded net noncurrent deferred operating income tax liability balance.

Effect –
The exception identified above resulted in an understatement of the average balance of the net deferred operating income tax liability balance of $650,267, which impacted ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2013, is estimated to be an overpayment of $17,461 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	$17,461

Recommendation –
The Beneficiary should implement policies and procedures to ensure that all rate base items are properly included in the cost study in accordance with the Commission's rules.

Beneficiary Response –
The beneficiary will take additional steps to reconcile cost study inputs to the audited financial data. These steps will include detailed reviews including comparative variance reports detailing changes in account balances included in cost study and High Cost financial inputs. There will also be increased communications throughout the data gathering and analysis processes, and proactive discussions between the beneficiary and its consulting vendor regarding what is included in Part 32 accounts along with reviews of general ledger activity occurring in the relevant cost period.

FINDING No.: HC2016BE029-F02: 47 C.F.R. § 54.7, 47 U.S.C. § 254, AND 47 C.F.R. § 65.450(d) – INTENDED USE OF FEDERAL UNIVERSAL SERVICE SUPPORT

Condition –
The 2013 balance in account 7370, special charges expense, included $26,789 related to donations and sponsorships that are not allowed for recovery according to the Commission's rules as they are not considered necessary for the provisioning of interstate telecommunications service.

Cause –
The processes to prepare, review and approve the HCP filings did not identify and adjust for expenses that are not considered necessary for the provisioning of interstate telecommunications service.

Effect –
The exception identified above resulted in an overstatement of expenses, which impacted ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2013, is estimated to be an overpayment of $4,553 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	$4,553

Recommendation –
The Beneficiary should implement policies and procedures to ensure that all disallowed expenses are properly excluded from the regulatory filings in accordance with the Commission's rules.

Beneficiary Response –
We do not agree entirely with the "Condition" noted in this finding that all expenses in this account are "not allowed for recovery according to the Commission's rules". We believe that $18,283 of the cost included in this account that is related to charitable donations is eligible for recovery based on 47 C.F.R. § 65.450 (d). The rule, in effect during the review period and currently in effect, states, with emphasis added, "Except for the allowance for funds used during construction, reasonable charitable deductions and interest related to customer deposits, the amounts recorded as non-operating income and expenses and taxes (Accounts 7300 and 7400) and interest and related items (Account 7500) and extraordinary items (Account 7600) shall not be included unless this Commission specifically determines that particular items recorded in those accounts shall be included".

Furthermore, 47 C.F.R § 36.222 states, with emphasis added, "(a) Only allowance for funds used during construction, and charitable, social and community welfare contributions are considered in this account for separations purposes. (b) Subsidiary record categories should be maintained for this account that include identification of amounts made to the account for (1) credits representing allowance for funds used during construction and (2) contributions for charitable, social or community welfare purposes, employee activities, membership dues and fees in service clubs, community welfare association and similar organizations."

Accordingly, we believe that expenses related to charitable contributions in this finding are reasonable, and are allowed per rules and rule interpretations effective during the review period.

The beneficiary will however take corrective actions by conducting a thorough review of its accounting procedures, and will communicate and discuss expenses allowable under FCC rules with its consulting firm to ensure compliance with FCC C.F.R. rules.

Auditor Response –
As the FCC reminded carriers in public notice FCC 15-133, charitable donations and sponsorships are not necessary for the provision of supported services and therefore may not be recovered through universal service support.

FINDING No.: HC2016BE029-F03: 47 C.F.R. § 64.901 – IMPROPER ALLOCATION METHODOLOGY

Condition –
The Beneficiary's indirect cost allocations between regulated and nonregulated activities were based on inaccurate factors. Specifically, certain rate base and expense accounts were allocated based on 2012 labor distributions that did not drive the costs incurred in 2013. We determined that the inputs were not cost causative for the 2013 data period. Additionally, the total plant in service allocator and general allocator were miscalculated due to an input error.

The table below summarizes differences between the Beneficiary's nonregulated allocation factors used in its HCP filings and updated factors after corrections for 2013 data period inputs and calculation errors. The calculations were performed prior to deferred taxes being subtracted from the rate base as the factors are based on labor distributions which are not impacted by deferred taxes:

Account	Description	Beneficiary Factor	Updated Factor Based on 2013 Activity	Increase (Decrease) to Non-regulated Adjustment
2122	Furniture	2.67%	0.91%	$(9,329)
2123	Office Equipment	2.67%	0.91%	$(6,938)
2124	General Purpose Computers	2.67%	0.91%	$(13,312)
3122	Accumulated Depreciation – Furniture	2.67%	0.91%	$9,329
3123	Accumulated Depreciation – Office Equip	2.67%	0.91%	$6,938
3124	Accumulated Depreciation - GPC	2.67%	0.91%	$13,312
6121	Land & Building Expense	2.67%	0.91%	$ (11,752)
6122	Furniture Expense	2.67%	0.91%	$ (177)
6123	Office Equipment Expense	2.67%	0.91%	$ (246)
6124	General Purpose Computers Expense	2.67%	0.91%	$ (4,176)

6561	Depreciation Expense	1.21%	1.25%	$(380)
6711	Executive Expense	3.45%	3.41%	$(495)
6712	Planning Expense	3.45%	3.41%	$(10)
6721	Accounting & Finance Expense	3.45%	3.41%	$(293)
6722	External Relations Expense	3.45%	3.41%	$(79)
6723	Human Resources Expense	3.45%	3.41%	$(1)
6725	Legal Expense	3.45%	3.41%	$(9)
6726	Procurement Expense	3.45%	3.41%	$(24)
6728	Other General & Administrative Expense	2.67%	0.91%	$ (750)
7200	Operating Tax Expense	1.21%	1.20%	$(30)
Total				**$(18,422)**

Cause –
The processes to prepare, review and approve the regulatory filings did not identify and adjust for inaccurate nonregulated allocation factors.

Effect –
The exception identified above resulted in an understatement of regulated operating expenses of $18,422, which impacted ICLS and HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2013, is estimated to be an underpayment of $8,128 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	$(2,687)
HCLS	$(5,441)

Recommendation –
The Beneficiary should implement policies and procedures to ensure that factors used to allocate rate base and expenses between the regulated and nonregulated jurisdictions are based on current period information and accurate calculations.

Beneficiary Response –
We will update and implement additional policies and procedures to achieve a higher level of accuracy in the Part 64 allocation factors development process. These policies will include added focus and attention on reviewing allocation methods to ensure they are current, and cost causative.

Criteria

Finding	Criteria	Description
#1	47 C.F.R. § 32.12(b) (2013) 47 C.F.R. § 54.320(b) (2013)	The Company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission. All eligible telecommunications carriers shall retain all records required to demonstrate to auditors that the support received was consistent with the universal service high-cost program rules. This documentation must be maintained for at least ten years from the receipt of funding. All such documents shall be made available upon request to the Commission and any of its Bureaus or Offices, the Administrator, and their respective auditors.
#2	47 C.F.R. § 54.7 (2013) 47 U.S.C. § 254(e) (2013) 47 C.F.R. § 65.450(d) (2013)	(a) A carrier that receives federal universal service support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. (b) The use of federal universal service support that is authorized by paragraph (a) of this section shall include investments in plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information services. (e) Universal service support After the date on which Commission regulations implementing this section take effect, only an eligible telecommunications carrier designated under section 214(e) of this title shall be eligible to receive specific Federal universal service support. A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Any such support should be explicit and sufficient to achieve the purposes of this section. (d) Except for the allowance for funds used during construction, reasonable charitable deductions and interest related to customer deposits, the amounts recorded as nonoperating income and expenses and taxes (Accounts 7300 and 7400) and interest and related items (Account 7500) and extraordinary items (Account 7600) shall not be included unless this Commission specifically determines that particular items recorded in those accounts shall be included.
#3	47 C.F.R. §	Carriers required to separate their regulated costs from

Finding	Criteria	Description
	64.901(a) and (b), (2013)	nonregulated costs shall use the attributable cost method of cost allocation for such purpose. In assigning or allocating costs to regulated and nonregulated activities, carriers shall follow the principles described herein. (1) Costs shall be directly assigned to either regulated or nonregulated activities whenever possible. (2) Costs that cannot be directly assigned to either regulated or nonregulated activities will be described as common costs. Common costs shall be grouped into homogeneous cost categories designed to facilitate the proper allocation of costs between a carrier's regulated and nonregulated activities. Each cost category shall be allocated between regulated and nonregulated activities in accordance with the following hierarchy: (i) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves. (ii) When direct analysis is not possible, common cost categories shall be allocated based upon an indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available. (iii) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.

Attachment D

HC2016BE034

Performance Audit on Compliance with the Federal Universal
Service Fund High Cost Support Mechanism Rules

Elkhart Telephone Company, Inc.
USAC Audit ID: HC2016BE034
SAC No.: 411764

Disbursements Made During the
Year Ended December 31, 2015

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

CONTENTS

MOSS ADAMS LLP
Certified Public Accountants | Business Consultants

EXECUTIVE SUMMARY

March 9, 2017

Universal Service Administrative Company
2000 L Street, N.W., Suite 200
Washington, DC 20036

Attention: Mr. Wayne Scott

This report represents the results of Moss Adams LLP's (we, us, our, and Moss Adams) work conducted to address the performance audit objectives relative to Elkhart Telephone Company, Inc., Study Area Code (SAC) No. 411764, (Elkhart or Beneficiary) for disbursements of $4,021,636 made from the Universal Service High Cost Program (HCP) (Disbursements) during the year ended December 31, 2015.

We conducted our performance audit in accordance with the standards applicable to performance audits contained in generally accepted *Government Auditing Standards*, issued by the Comptroller General of the United States (2011 Revision). Those standards require that we plan and perform the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The audit included examining, on a test basis, evidence supporting the data used to calculate support, as well as performing other procedures we considered necessary to form conclusions. We believe the evidence we have obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. However, our performance audit does not provide a legal determination of the Beneficiary's compliance with specified requirements.

The objective of this performance audit was to evaluate the Beneficiary's compliance with the regulations and orders governing the federal Universal Service High Cost Support Mechanism, set forth in of 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support for the HCP relative to the disbursements (collectively, the Rules).

Based on the test work performed, our audit disclosed seven detailed audit findings (Finding or Findings) discussed in the Audit Results section. For the purpose of this report, a Finding is a condition that shows evidence of non-compliance with the Rules that were in effect during the audit period.

Certain information may have been omitted from this report concerning communications with Universal Service Administrative Company (USAC) management or other officials and/or details about internal operating processes or investigations.

This report is intended solely for the use of USAC, the Beneficiary, and the FCC and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of those procedures for their purposes. This report is not confidential and may be released to a requesting third party.

Moss Adams LLP

Overland Park, Kansas
March 9, 2017

Audit Results

Audit Results	Monetary Effect	Recommended Recovery
Finding #1: 47 C.F.R. § 36.611(h) – Improper Data Period: HCL: The number of Category 1.3 Loops reported on the Beneficiary's 2014-1 HCL Form did not reconcile to the source documentation and were over reported by 14 loops.	($8,130)	($8,130)
Finding #2: 47 C.F.R. § 36.121(c) & 47 C.F.R. § 36.126(b)(1)(iii)– Miscategorized Central Office Equipment: The Beneficiary improperly categorized one central office equipment (COE) asset for $1,560 as 4.2 wideband equipment and four COE assets totaling $8,646 as 4.23 interexchange equipment, all of which should have been have been categorized as 4.13 subscriber loop equipment.	($4,667)	($4,667)
Finding #3: 47 C.F.R. § 32.5999(a)(2) – Misclassified Expenses: The Beneficiary improperly coded labor costs for 3 employees to plant specific (accounts 6212, 6232, 6423) and plant nonspecific expense (account 6532) for tasks that were executive and general and administrative (accounts 6711 and 6721) in nature.	($4,223)	($4,223)

Finding #4: 47 C.F.R. § 64.901(a) and (b) – Improper Allocation Methodology: The Beneficiary did not reduce general support expense and customer operations expense for computer billing software that was used for both regulated and nonregulated operations, which resulted in an overstatement of regulated expenses. In addition, the Beneficiary used 2012 balances in other nonregulated adjustment calculations, which resulted in an understatement of net regulated rate base, property tax expense, cable and wire expense, depreciation expense, and corporate operations expense.	($6,671)	($6,671)
Finding #5: 47 C.F.R. §54.7(a), and 47 C.F.R §65.450(a)– Intended Use of Federal Universal Service Support: The Beneficiary included $8,611 of expenses related to sponsorships, scholarships, and lobbying expenses in its 2013 cost study that are not considered necessary for the provision, maintenance or upgrade of facilities for which support is intended.	$1,841	$1,841
Finding #6: 47 C.F.R. §32.7220(a) and 47 C.F.R. §32.7230(a) – Improper Operating Federal and State Income Taxes: The Beneficiary reported operating tax expense in its HCP filings that exceeded actual operating taxes by $140,720.	$71,997	$71,997
Finding #7: 47 C.F.R. §32.27(c) – Improper Affiliate Transactions: The Beneficiary included lease expense charges for the use of fiber cable plant, vehicles, and other network and general support assets owned by affiliates in its 2013 cost study and HCP filings. The lease charges exceeded the lower of fully distributed cost or fair market value by $185,009.	$128,836	$128,836
Total Net Monetary Effect	**$178,983**	**$178,983**

USAC Management Response

USAC management concurs with the findings identified by the auditors. With respect to findings one through five, USAC management recognizes the Beneficiary is undertaking steps to implement the processes and procedures necessary to be in compliance. With respect to findings six and seven, the Beneficiary must implement policies and procedures necessary to comply with FCC rules. USAC requests that the Beneficiary provide a detailed description of the policies and procedures implemented to address all findings no later than sixty (60) days after receipt of this audit report. Please submit the requested information to hcaudits@usac.org. The Beneficiary may be subject to further review if the Beneficiary does not provide the requested information to USAC.

	ICLS	CAFICC	HCL	Finding Total
Finding #1	$6	$0	($8,136)	($8,130)
Finding #2	($786)	$0	($3,881)	($4,667)
Finding #3	($3,637)	$0	($586)	($4,223)
Finding #4	($1,207)	$0	($5,464)	($6,671)
Finding #5	$1,841	$0	$0	$1,841
Finding #6	$185	$0	$71,812	$71,997
Finding #7	$30,969	$0	$97,867	$128,836
Mechanism Total	$27,371	$0	$151,612	$178,983

As a result of the audit, USAC management will recover $178,983 of High Cost Program support from the Beneficiary for SAC# 411764.

Background and Program Overview

BACKGROUND

The Beneficiary is a cost-based eligible telecommunications carrier (ETC) that provides telecommunications services, including local service, cable television, and Internet to residential and business customers residing in areas of southwestern Kansas and northwestern Oklahoma.

PROGRAM OVERVIEW

USAC is an independent not-for-profit corporation that operates under the direction of the Federal Communications Commission (FCC) pursuant to 47 C.F.R. Part 54. The purpose of USAC is to administer the federal Universal Service Fund (USF), which is designed to ensure that all people, regardless of location or income have affordable access to telecommunications and information services. USAC is the neutral administrator of the USF and may not make policy, interpret regulations, or advocate regarding any matter of universal service policy.

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OBJECTIVE

The objective of our performance audit was to evaluate the Beneficiary's compliance with 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's Orders governing Federal Universal Service Support for the HCP relative to the disbursements for the 12-month period ended December 31, 2015.

This performance audit did not constitute an audit of financial statements in accordance with *Government Auditing Standards*. We were not engaged to, and do not render an opinion on the Beneficiary's internal control over financial reporting or internal control over compliance. We caution that projecting the results of our evaluation on future periods is subject to the risks that controls may become inadequate because of changes in conditions that affect compliance.

SCOPE

The following chart summarizes the Universal Service High Cost Program support that was included in the scope of this audit:

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	12/31/2013	12/31/2015	$259,422
High Cost Loop Support (HCLS)	12/31/2013	12/31/2015	$2,429,354
Interstate Common Line Support (ICLS)	12/31/2013	12/31/2015	$1,226,864
Safety Net Additive (SNA)	12/31/2013	12/31/2015	$105,996
Total			**$4,021,636**

AUDIT METHODOLOGY

To accomplish our audit objective, we performed the following procedures:

Reconciliation – We reconciled the December 31, 2013 and 2012, trial balances to the separations and Part 64 study inputs and then to the applicable HCP Forms, obtained explanations for any variances, and evaluated the explanations for reasonableness.

Rate Base and Investment in Network Facilities – We utilized an attribute sampling methodology to select asset samples from central office equipment (COE) and cable and wire facilities (CWF) accounts. Asset selections were made from continuing property record (CPR) detail. We determined that balances for the selected assets were properly supported by underlying documentation such as work order detail, third-party vendor invoices, materials used sheets, and time and payroll documentation for labor and related costs. We agreed the amounts charged to work order detail and verified the proper general ledger coding under Part 32. In addition, we verified the physical existence of selected assets.

Tax Filing Status – We verified the tax filing status for the Beneficiary and obtained and reviewed the tax provision and deferred income tax provision calculations, including supporting documentation, for reasonableness.

Expenses – We utilized an attribute sampling methodology to select expense samples from operating expense accounts that impact HCLS, ICLS, and CAF ICC. Payroll selections were made from a listing of employees. We agreed the amounts to supporting documentation such as time sheets, labor distribution reports, and approved pay rates, and verified the costs were coded to the proper Part 32 account. We reviewed benefits and clearings for compliance with Part 32.

We made other disbursement selections from accounts payable transactions and agreed amounts to supporting documentation, reviewing for proper coding under Part 32. We selected a sample of manual journal entries to ensure reclassifications between expense accounts were appropriate and reasonable.

Affiliate Transactions – We performed procedures to assess the reasonableness of affiliate transactions that occurred during the period under audit. These transactions involve the transfer of assets or the provision of service between the Beneficiary and another entity with common ownership. We noted the Beneficiary has one wholly owned subsidiary, Epic Touch Company, whose operations primarily consist of retail internet, video, and long distance services. The Beneficiary engages in business transactions with Epic Touch Company, its owners, and with entities under common control. We selected a sample of various types of transactions to determine if the transactions were recorded in accordance with 47 C.F.R. Section 32.27 and categorized in the appropriate Part 32 accounts. The following transactions were selected for testing:

- Tower lease space – the Beneficiary contracts with Epic Touch Company to lease tower space for microwave equipment. The transaction is priced based on the Beneficiary's fully distributed cost analysis.
- Building leases – the Beneficiary contracts with the owners of the Beneficiary and with other entities under common control of the Beneficiary's ownership to lease various building space. Transactions are priced based on the Beneficiary's fully distributed cost analysis.
- Vehicle leases – the Beneficiary contracts with the owners of the Beneficiary for the lease of certain vehicles. The transaction occurs based on a contract price.

- Vehicles and other general support asset leases – the Beneficiary contracts with Epic Touch Company to lease various vehicles and other general support assets, including computer equipment, office equipment, and various other equipment. The transactions are priced based on the Beneficiary's fully distributed cost analysis.
- Fiber lease – the Beneficiary contracts with Epic Touch Company to lease 32 miles of fiber cable. The transaction is priced based on the Beneficiary's fully distributed cost analysis.
- Utilities/employee concession services/office supplies – the Beneficiary allocates various monthly utility costs, employee concession services, and office supplies expense to Epic Touch Company through monthly payroll distributions based on payroll hours.
- DSL service – the Beneficiary contracts with Epic Touch Company to provide DSL through monthly billing of a special access circuit. Transactions occur at NECA tariff rates.
- Local telephone service – the Beneficiary contracts with Epic Touch Company to provide local phone telephone service. Transactions occur at tariff rates.

Revenues and Subscriber Listings - We tested revenue general ledger accounts, subscriber bills, and other documentation to verify the accuracy and existence of revenues. We utilized an attribute sampling methodology to select revenue samples from subscriber listings. Our testing of subscriber bills consisted of procedures to ensure the lines were properly classified as residential, single-line business, or multi-line business. In addition, we reconciled the revenues reported to National Exchange Carrier Association (NECA) to the general ledger and billing support. We obtained subscriber listings and billing records to determine the lines or loops reported in the HCP filings agreed to supporting documentation. Our analysis included reviewing the listing for duplicate lines, invalid data, and nonrevenue producing lines.

Part 64 Allocations – We reviewed the Beneficiary's cost apportionment methodology and assessed the reasonableness of the allocation methods and corresponding data inputs used to calculate the factors, recalculated the material factors, and recalculated the material amounts allocated. We also evaluated the reasonableness of the assignment between regulated, nonregulated, and common costs and the apportionment factors as compared to the regulated and nonregulated activities performed by the Beneficiary.

COE and CWF Categorization – We reviewed the methodology for categorizing assets including a comparison to network diagrams. We reconciled the COE and CWF amounts to the cost studies and agreed them to the applicable HCP Forms. In addition, we reviewed power and common allocation and physically inspected a sample of COE assets and tested route distances of CWF for reasonableness.

Revenue Requirement – We recalculated the Beneficiary's revenue requirement using our cost allocation software program and reviewed the calculation of revenue requirement including the applications of Part 64, 36, and 69 for reasonableness. In addition, we traced cost study adjustments that were not recorded in the general ledger to supporting documentation and reviewed them for reasonableness.

Detailed Audit Findings

Our performance audit resulted in the following detailed audit findings and recommendations with respect to the Beneficiary's compliance with the Rules, and an estimate of the monetary impact of such findings relative to 47 C.F.R. Part 54, Subparts C, D, K ,and M, Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B, as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support applicable to the disbursements made from the HCP during the year ended December 31, 2015.

FINDING No.: HC2016BE034-F01: 47 C.F.R. § 36.611(h) – IMPROPER DATA PERIOD: HCL

Condition –
The number of Category 1.3 Loops reported on the Beneficiary's 2014-1 HCL Form did not reconcile to the source documentation and were over reported by 14 loops.

Cause –
The beneficiary's billing software included internal notations that counted these loops in error.

Effect –
The exception identified above resulted in an overstatement of 14 subscriber loops, which impacted ICLS and HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an underpayment of $8,130 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	$6
HCLS	($8,136)

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for preparing, reviewing, and approving data reported in its HCP filings to ensure compliance with applicable FCC rules.

Beneficiary Response –
The Beneficiary agrees with this finding and will enhance procedures to ensure data reported in its HCP filings complies with FCC rules.

FINDING No.: HC2016BE034-F02: 47 C.F.R. § 36.121(c) & 47 C.F.R. § 36.126(b)(1)(iii)– MISCATEGORIZED CENTRAL OFFICE EQUIPMENT

Condition –
The Beneficiary improperly categorized one central office equipment (COE) asset for $1,560 as 4.2 wideband equipment and four COE assets totaling $8,646 as 4.23 interexchange equipment, all of which should have been have been categorized as 4.13 subscriber loop equipment.

Cause –
The preparation, review, and approval process over the 2013 cost study did not detect the categorization errors during the cost study preparation process.

Effect –
The exceptions identified above resulted in a $10,206 reduction of non-loop COE equipment and an increase of subscriber loop equipment of $10,206, which impacted both ICLS and HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an underpayment of $4,667 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	($786)
HCLS	($3,881)

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for preparing, reviewing, and approving data reported in its HCP filings to ensure compliance with applicable FCC rules.

Beneficiary Response –
The Beneficiary agrees with this finding and will enhance procedures to ensure data reported in its HCP filings complies with FCC rules.

FINDING No.: HC2016BE034-F03: 47 C.F.R. § 32.5999(a)(2) – MISCLASSIFIED EXPENSES

Condition –
The Beneficiary improperly coded labor costs for 3 employees to plant specific expense (accounts 6212, 6232, 6423) and plant nonspecific expense (account 6532) for tasks that were executive and general and administrative (accounts 6711 and 6721) in nature.

Cause –
The preparation, review, and approval process for the classification of payroll data based on the employee functions performed did not detect the incorrect timesheet allocation of payroll for certain employees.

Effect –
The exceptions identified above resulted in reductions of plant specific expenses of $21,954, plant nonspecific expenses of $71,708 and increases in corporate expenses of $93,962, which impacted both ICLS and HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an underpayment of $4,223 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	($3,637)
HCLS	($586)

Recommendation –
The Beneficiary should enhance the preparation and review process over labor expense coding to properly identify and account for allocations of payroll transactions based on the nature of the work performed.

Beneficiary Response –
The Beneficiary agrees with this finding and will enhance procedures to ensure data reported in its HCP filings complies with FCC rules.

FINDING No.: HC2016BE034-F04: 47 C.F.R. § 64.901(a) and (b) – IMPROPER ALLOCATION METHODOLOGY

Condition –
The Beneficiary did not reduce general support expense and customer operations expense for computer billing software that was used for both regulated and nonregulated operations, which resulted in an overstatement of regulated expenses. In addition, the Beneficiary used 2012 balances in other nonregulated adjustment calculations, which resulted in an understatement of net regulated rate base, property tax expense, cable and wire expense, depreciation expense, and corporate operations expense.

Cause –
The preparation, review, and approval process over the 2013 cost study and HCP filings did not detect errors in the Beneficiary's nonregulated cost allocations.

Effect –
The exceptions noted above resulted in an incorrect allocation of nonregulated expenses, which impacted both ICLS and HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an underpayment of $6,671 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	($1,207)
HCLS	($5,464)

Recommendation –
The Beneficiary should enhance the preparation and review process to identify and properly exclude nonregulated costs from its HCP filings.

Beneficiary Response –
The Beneficiary agrees with this finding and will enhance procedures to ensure data reported in its HCP filings complies with FCC rules.

FINDING No.: HC2016BE034-F05: 47 C.F.R. §54.7(a) and 47 C.F.R §65.450(a)– INTENDED USE OF FEDERAL UNIVERSAL SERVICE SUPPORT

Condition –
The Beneficiary included $8,611 of expenses related to sponsorships, scholarships, and lobbying expenses in its 2013 cost study that are not considered necessary for the provision, maintenance or upgrade of facilities for which support is intended.

Cause –
The processes to prepare, review, and approve the 2013 cost study and HCP filings did not identify and adjust for the disallowed expenses.

Effect –
The exceptions noted above resulted in a decrease in special charges expense (account 7370) of $8,611, which impacted ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an overpayment of $1,841 for ICLS disbursements.

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for preparing, reviewing, and approving data reported in its HCP filings to ensure compliance with applicable FCC rules.

Beneficiary Response –
The Beneficiary agrees with this finding and will enhance procedures to ensure data reported in its HCP filings complies with FCC rules.

FINDING No.: HC2016BE034-F06: 47 C.F.R. §32.7220(a) and §32.7230(a) – IMPROPER OPERATING FEDERAL AND STATE INCOME TAXES

Condition –
The Beneficiary reported operating tax expense in its HCP filings that exceeded actual operating taxes by $140,720. Specifically, the Beneficiary made a cost study adjustment to gross up income taxes and did not use actual book income tax expense[1].

Cause –
The preparation, review, and approval process over cost study adjustments used in the Beneficiary's HCP filings did not detect the error in the income tax adjustment.

Effect –
The exceptions noted above resulted in an overstatement of operating federal and state income taxes of $140,720 included in the 2013 HCP filings, which impacted both ICLS and HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an overpayment of $71,997 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	$185
HCLS	$71,812

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for preparing, reviewing, and approving data reported in its HCP filings to ensure compliance with applicable FCC rules.

Beneficiary Response –
The Beneficiary does not agree with this finding. The Beneficiary notes that during the development of its HCLS filing, complying with FCC rules often requires companies who are members of the National Exchange Carrier Association (NECA) to follow NECA policies and procedures. Indeed, NECA has noted its authority in interpreting FCC rules where necessary.[2] Given this, the Beneficiary notes three instances where NECA interpretations, enforcement, and direction gives the Beneficiary reasonable assurance of NECA-allowed procedural compliance, as follows:

1. In many cases, financial information contained in consolidated audit reports will not match one-to-one the underlying trial balance information due to nonregulated activity, subsidiary information, consolidated reporting and similar occurrences. ***It is not expected that the numbers in these audited financials directly reconcile the financial information used in***

[1] Universal Service Fund data collection instructions for HCLF line 650 – Operating Taxes specifies the inclusion of Account 72XX subaccounts [Part 32.7200].

[2] See for example Safeguards to Improve the Interstate Access Tariff and Revenue Distribution Processes, CC Docket 93-6, Report and Order to Show Cause, 10 FCC Rcd. 6243 (1995). Also, for example, NECA reporting guideline 4.19, page 4 of 10

the cost study. However, the financial data used in the study should be based on the financial results of the audit with appropriate adjustments made. [3] (emphasis added)

2. Similarly, it is the Beneficiary's understanding that NECA allows normalized federal income taxes to be computed for regulated operations. [4]
3. Lastly, in NECA's Pool Administration Procedures Cost Company manual, Section 6 Revenue and Cost Analysis, dated July 2016, NECA states, "For reporting of operating/regulated income taxes in Account 7200 for High Cost Loop Support, NECA requires documentation that supports amounts ***representing regulated, operating taxes only***. Reported amounts must reconcile to amounts reported on company books."

The Beneficiary believes the above-noted interpretations and procedures allowed the Beneficiary to compute normalized, regulated, operating-only income taxes in accordance with NECA guidelines.

Auditor Response –
The Beneficiary recorded a cost study adjustment to accounts 7220 and 7230 to increase income taxes reported in its HCP filings by $284,850 based on amounts derived from a return on rate base and tax gross up factor, essentially using income taxes derived from the Beneficiary's Part 36 cost study for its 2014-1 High Cost Loop Support filing. In number 3 above, the Beneficiary references Section 6 of NECA's Pool Administration Procedures which states that reported amounts (for High Cost Loop Support) must reconcile to amounts reported on the company's books. Utilizing an income tax gross up derived from a return on rate base from the Part 36 cost study does not produce regulated income taxes that reconcile to amounts reported on the Company's books in account 7200 and the results are not a representation of actual regulated operating income taxes.

Further, Parts 32.7220 and 32.7230, as referenced in our criteria for this finding, state that amounts included in the accounts should represent the amount of income taxes for the current period. Current period income taxes are not those derived from Part 36, but rather should be derived from regulated pre-tax income. Therefore, our position on this matter is unchanged.

FINDING No.: HC2016BE034-F07: 47 C.F.R. §32.27(c) – IMPROPER AFFILIATE TRANSACTIONS

Condition –
The Beneficiary included lease expense charges for the use of fiber cable plant, vehicles, and other network and general support assets owned by affiliates in its 2013 cost study and HCP filings. The lease charges exceeded the lower of fully distributed cost or fair market value by $185,009.

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[3] NECA Pool Administration Procedures, Section 6, Revenue and Cost Analysis, pg 6-5 (copyright April 2006, July 2008, July 2016)

[4] Ibid, pg 6-5, "Include a worksheet (e.g., Exhibit 5-1B or equivalent) ***which shows the calculation of the effective normalized FIT rate for the regulated operations."***

Cause –
The preparation, review, and approval process over the determination of affiliate transaction pricing used in the 2013 cost study and HCP filings did not detect the excess charges over fully distributed cost.

Effect –
The exceptions noted above resulted in an overstatement of vehicle expense (account 6112) of $79,594, an overstatement of general purpose computer expenses (account 6124) of $30,076, an overstatement office equipment expense (account 6123) of $46,906, and an overstatement of cable and wire expense (account 6410) of $28,433, which impacted both ICLS and HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an overpayment of $128,836 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	$30,969
HCLS	$97,867

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for preparing, reviewing, and approving data reported in its HCP filings to ensure compliance with applicable FCC rules.

Beneficiary Response –
The Beneficiary does not agree with this finding. The Beneficiary adopted Accounting Codification Standard (ASC) Topic 840, "Leases" for both its 2013 cost study and financial statements for the year ended December 31, 2013, in accordance with generally accepted accounting principles (GAAP). For certain assets held by a Lessor for a long period of time, the basis of the assets underlying a lease can be the lower of cost or fair market value, or a reasonable amount determined at the time of the lease. The beneficiary believes the above noted GAAP principles allowed the Beneficiary to determine the value of the assets based on a reasonable amount determined at the time of the lease.

Auditor Response –
Expenses included in the Beneficiary's 2013 cost study and HCP filings related to leases provided by affiliates of the Beneficiary exceeded fully distributed cost. As noted in 47 C.F.R. §32.27(c)(2), when services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded. We believe 47 C.F.R. §32.27(c)(2) takes precedence over ASC Topic 840 as referenced by the Beneficiary. Therefore, our position on this matter is unchanged.

Criteria

Finding	Criteria	Description
#1	47 C.F.R. § 36.611(h) (2013)	For universal support purposes, working loops are defined as the number of working Exchange Line CWF loops used jointly for exchange and message telecommunications service, including CWF subscriber lines associated with pay telephones in CWF Category 1, but excluding Wide Area Telephone Service (WATS) closed end access and Teletypewriter Exchange Service (TWX) service.
#2	47 C.F.R. § 36.121(c) (2013) 47 C.F.R. § 36.126 (b)(1)(iii) (2013)	In the separation of the cost of central office equipment among the operations, the first step is the assignment of the equipment in each study area to categories. The basic method of making this assignment is the identification of the equipment assignable to each category and the determination of the cost of the identified equipment by analysis of accounting, engineering and other records. For apportionment among the operations, the cost of circuit equipment is assigned to the following subsidiary categories: (1)(iii) Exchange Line Circuit Equipment Excluding Wideband – Category 4.13
#3	47 C.F.R. § 32.5999(a)(2) (2013)	The expense section of this system of accounts shall be comprised of four major expense groups—Plant Specific Operations, Plant Nonspecific Operations, Customer Operations and Corporate Operations. Expenses to be recorded in Plant Specific and Plant Nonspecific Operations Expense Groups generally reflect cost associated with the various kinds of equipment identified in the plant asset accounts. Expenses to be recorded in the Customer Operations and Corporate Operations accounts reflect the costs of, or are associated with, functions performed by people, irrespective of the organization in which any particular function is performed.
#4	47 C.F.R. § 64.901(a) and (b) (2013)	Carriers required to separate their regulated costs from nonregulated costs shall use the attributable cost method of cost allocation for such purpose. In assigning or allocating costs to regulated and nonregulated activities, carriers shall follow the principles described herein. . . . (2) Costs shall be directly assigned to either regulated or nonregulated activities whenever possible. (3) Costs which cannot be directly assigned to either regulated or nonregulated activities will be described as common costs. Common costs shall be grouped into

Finding	Criteria	Description
		homogeneous cost categories designed to facilitate the proper allocation of costs between a carrier's regulated and nonregulated activities. Each cost category shall be allocated between regulated and nonregulated activities in accordance with the following hierarchy: (i) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves. (ii) When direct analysis is not possible, common cost categories shall be allocated based upon an indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available. (iii) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.
#5	47 C.F.R. § 54.7(a) (2013) 47 C.F.R. § 65.450(a) (2013)[5]	(a) A carrier that receives federal universal service support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Net income shall consist of all revenues derived from the provision of interstate telecommunications services regulated by this Commission less expenses recognized by the Commission as necessary to the provision of these services. The calculation of expenses entering into the determination of net income shall include the interstate portion of plant specific operations (Accounts 6110-6441), plant nonspecific operations (Accounts 6510-6565), customer operations (Accounts 6610-6623), corporate operations (Accounts 6720-6790), other operating income and expense (Account 7100), and operating taxes (Accounts 7200-7250), except to the extent this Commission specifically provides to the contrary.
#6	47 C.F.R. §32.7220(a) (2013)	(a) This account shall be charged and Account 4070, Income Taxes-Accrued, shall be credited for the amount of Federal Income Taxes for the current period. This account shall also reflect subsequent adjustments to amounts previously charged.

[5] Public Notice FCC 15-133 reiterates the prohibition of rate of return carriers from including expenses that are not necessary for the provision, maintenance, or upgrading of facilities and services for which support is intended.

Finding	Criteria	Description
	47 C.F.R. §32.7230(a) (2013)	(a) This account shall be charged and Account 4070, Income Taxes—Accrued, shall be credited for the amount of state and local income taxes for the current period. This account shall also reflect subsequent adjustments to amounts previously charged.
#7	47 C.F.R. §32.27(c)(2013)	Services provided between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Non-tariffed services provided between a carrier and its affiliate pursuant to publicly-filed agreements submitted to a state commission pursuant to section 252(e) of the Communications Act of 1934 or statements of generally available terms pursuant to section 252(f) shall be recorded using the charges appearing in such publicly-filed agreements or statements. Non-tariffed services provided between a carrier and its affiliate that qualify for prevailing price valuation, as defined in paragraph (d) of this section, shall be recorded at the prevailing price. For all other services sold by or transferred from a carrier to its affiliate, the services shall be recorded at no less than the higher of fair market value and fully distributed cost. For all other services sold by or transferred to a carrier from its affiliate, the services shall be recorded at no more than the lower of fair market value and fully distributed cost. (1) *Floor.* When services are sold by or transferred from a carrier to an affiliate, the higher of fair market value and fully distributed cost establishes a floor, below which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or greater than the floor, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive. (2) *Ceiling.* When services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, an is not otherwise anti-competitive. (3) *Threshold.* For purposes of this section, carriers are required to make a good faith determination of fair market value for a service when the total aggregate annual value of that service reaches or exceeds $500,000, per affiliate. When a carrier reaches or exceeds the $500,000 threshold for a particular service for the first time, the carrier must perform

Finding	Criteria	Description
		the market valuation and value the transaction in accordance with affiliate transactions rules on a going-forward basis. All services received by a carrier from its affiliate(s) that exist solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost.

Universal Service Administrative Company
High Cost & Low Income Committee Meeting

INFORMATION ITEM

High Cost Support Mechanism Business Update

Information Presented:

This information item provides the High Cost & Low Income (HCLI) Committee with a quarterly status report on the operation of the High Cost (HC) Support Mechanism for 2nd Quarter 2017 (2Q2017). The update includes information on ongoing High Cost operations, as well as major High Cost projects.

Discussion:

Program Highlights – 2Q2017

- On May 1, 2017, High Cost implemented and posted to USAC's website the 2017-2018 budget control mechanism for rate of return carriers. The FCC's *Rate-of-Return Reform Order* requires USAC to calculate total support available for distribution to rate of return (RoR) carriers.[1] The Budget Control Mechanism determines whether reductions in support are required for RoR carriers receiving Connect America Fund Broadband Loop Support (CAF-BLS) or High Cost Loop Support (HCLS, including safety net additive support and safety valve support).

- On May 18, 2017, the FCC released a Notice of Proposed Rulemaking and Order seeking comments on whether the FCC should change the current methodology or eliminate the rate floor and it's accompanying reporting obligations.[2] Additionally, the FCC froze the monthly rate floor at $18, and RoR carriers will not be subject to support reductions for any rate that is at least $18. The temporary freeze will remain in effect until the FCC takes further action.

- As of May 2017, High Cost has disbursed $92 million in Mobility Fund Phase I final payment support, representing 82% of total support available to Mobility Fund Phase I recipients and 66% of the total support available to Mobility Fund Phase I Tribal recipients.

[1] *Connect America Fund et al.*, WC Docket No. 10-90 *et al.*, Report and Order, Order and Order on Reconsideration, and Further Notice of Proposed Rulemaking, 31 FCC Rcd 3087, 3144-45, paras. 150-155 (2016) (*Rate-of-Return Reform Order*).

[2] *Connect America Fund*, WC Docket No. 10-90, Further Notice of Proposed Rulemaking and Order, 32 FCC Rcd 4509 (2017). The rate floor requires that any ILEC recipient of HCLS whose rate for local service plus state regulated fees is below the rate floor shall have its support reduced by an amount equal to the extent to which its rates for residential local service plus state regulated fees are below the local urban rate floor, multiplied by the number of lines for which it is receiving support.

- On June 2, 2017, CenturyLink updated its list of locations identifying where it will deploy broadband service using the funding it received during the second round of Connect America Fund Phase I, Incremental Support, further reducing the total number of locations to which it plans to deploy broadband.

- See **Attachment A** for additional operational metrics.

- See **Attachment B** for additional updates on major projects.

High Cost Support Mechanism Operational Update

Disbursements
High Cost disbursed approximately $1.9 billion in support through second quarter 2017 (see details below). This includes, $745 million to 187 price cap study area codes (SACs), $944 million to 1095 rate of return SACs, and $242 million to 340 other SACs.

Carrier Regulation Type	Total Amount	Total SACs
Price Cap	$ 744,710,433.15	187
Rate of Return	$ 944,057,397.40	1095
Competitors	$ 242,031,065.53	340
Total	**$ 1,930,798,896.08**	**1622**

The two-thirds phase down of Intercarrier Compensation (CAF-ICC) support for price cap carriers begins in July 2017 and will be completely phased out in July 2019.

Rate of Return (RoR) carriers electing Alternative Connect America Cost Model (A-CAM), CAF-BLS, or Alaska Plan support began receiving support in January 2017. A total of 207 carriers accepted A-CAM support totaling $556 Million per year across 43 states. A total of 654 carriers elected to receive CAF-BLS, which is subject to pro rata reduction by SAC under the Budget Control Mechanism. While thirteen (13) Alaskan RoR carriers accepted Alaska Plan support for the next ten years, two (2) Alaskan carriers opted instead to transition to A-CAM support. In addition, eight (8) wireless Alaskan carriers will receive $73.9 million per year for the next 10 years in exchange for deploying wireless networks to unserved and underserved areas.

Three SACs associated with the Mobility Fund Phase I (MF I) were determined to be in default of the required performance obligations in 2Q2017; accordingly, USAC recovered $5.1 million in support previously disbursed.

Wireless
On March 7, 2017 the FCC released the *Mobility Fund Phase II Report and Order*. Prior to conducting the reverse auction for Mobility Fund Phase II (MF II) support, the FCC will conduct a challenge process to efficiently resolve disputes about areas eligible for MF II support. The requirements for this project will not be finalized until the FCC releases an order establishing the parameters for the MF-II challenge process. A draft

order is currently on the agenda for the FCC's August 2017 meeting. Once the order is adopted, the requirements will be finalized and a delivery date will be set with the FCC for implementation. The earliest anticipated implementation is January 2018. In order to address the requirements of the *Mobility Fund Phase II Order*, including the challenge process, USAC has allocated internal resources to develop a system to collect and analyze wireless-based geospatial data and provide the FCC with the ability to adjudicate on the challenge data submitted by carriers.

<u>Certification Compliance</u>

FCC Form 481
The FCC Form 481 collects financial and operational data from High Cost recipients in accordance with 47 C.F.R. § 54.313 and from Lifeline recipients in accordance with 47 C.F.R. § 54.422. Eligible telecommunications carriers (ETCs) are required to submit the form by July 1 to USAC, the FCC, state commissions, tribal authorities and other relevant authorities. As of June 2017, we were on track to accept the online certification by both High Cost Program and Lifeline beneficiaries and will continue to work with late-filers to remedy the non-compliance.

FCC Form 690
The FCC Form 690 collects drive test data and certifications from High Cost recipients in accordance with 47 C.F.R. § 54.1009. ETCs receiving Mobility Fund Phase I support are required to submit the form by July 1 to USAC. As of July 2017, High Cost Program is on track to complete the online certifications.[3]

<u>Broadband Deployment Compliance</u>

Wireline
Carriers that elect to participate in the modernized CAF programs are required to report locations where broadband is being deployed.[4] Millions of locations are expected to be submitted to USAC, and the High Cost division is responsible for ensuring carriers build broadband networks in compliance with FCC rules and requirements. As part of our on-going efforts to improve the verification process, in 2017 the team will develop statistical sampling methodologies to test location data.

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[3] Two carriers completed their online certifications after the deadline, and USAC staff is working with the FCC to determine how to address these instances of non-compliance.

[4] USAC performs its compliance test work after a participating carrier submits data identifying the locations where the carrier deployed broadband. USAC's compliance test work involves three distinct stages. First, USAC reviews the certifications and compiles the number of locations to confirm the submitted information substantiates that the entity completed the required deployment. Second, USAC validates the eligibility of the locations reported. Third, USAC selects a sample of locations for additional testing and requests supporting documentation from the carriers to further verify compliance. The first and second stages are completed for all location data as soon as the data is submitted and, in some instances, these stages are performed automatically by USAC's High Cost Universal Broadband (HUBB) portal. The third stage is performed after the first and second stages are complete and only for only a sample of the location data.

Recipients of CAF Phase I Incremental Support (CAF Phase I) and Rural Broadband Experiments (RBE) support report location data via the FCC Form 481. The High Cost team is currently validating and verifying the data submitted for CAF Phase I and RBE locations through a manual review. Additional location reporting for the RBE and second round of CAF Phase I will be submitted via the FCC Form 481 in July 2017. During the remainder of 2017, High Cost staff will complete validation and verification procedures for CAF Phase I and begin verification test work for RBE.

Recipients of CAF Phase II Model-based Support (a/k/a Connect America Cost Model (CACM)), A-CAM, and CAF-BLS report location data via the HUBB, which automatically performs the validation procedures. RBE location data will be submitted and validated in the HUBB in 2018. Carriers that submitted CAF Phase II locations through the FCC Form 481 last year were requested to refile the location data through the HUBB this year. As of June 2017, approximately 550,000 CAF Phase II locations (deployed in 2015 and 2016) have been certified in the HUBB and all locations deployed in 2016 must be reported by July 3, 2017. Deployment required by the 2017 milestone date (40 percent completion) for price cap carriers will be reported in March 2018.

Wireless
Recipients of the Mobility Fund Phase I program are required to report drive test or scattered site test data for all eligible road miles, including the three required FCC key performance indicators (KPI) of download speed, upload speed, and latency, with coordinates, of where wireless service has been deployed using USF dollars via the FCC Form 690. The High Cost program is responsible for ensuring compliance for the data submitted by the carriers. USAC first performs a desk validation of the data and subsequently has engineer-contractors conduct an on-site drive test (a/k/a site visit verifications). As of June 2017, High Cost has completed site visit verifications for 40,649 road miles of the total 65,603 awarded road miles.

<u>Governance and Cost Controls</u>

In 2Q2017, the High Cost division developed a standardized process for the intake of new FCC orders and projects that will enable the operations to better manage and collaborate with key project stakeholders from the inception of an order to the final implementation. This process will ensure proper and accurate management of scope, time and cost of all HC projects and FCC orders and instructions. The process is currently in use with the recent release of the *Mobility Fund Phase II Order*.

The High Cost division has also implemented an executive steering committee to ensure that all activities supporting operations, systems, processes, and practices are aligned with the USAC's corporate governance structure. Similar meetings are held at a regular cadence to inform our FCC colleagues of progress and is pivotal to ensuring appropriate alignment between USAC and the FCC.

Appeals

In August 2016 the High Cost divisions received two appeals of audits conducted by external auditors as part of the Beneficiary and Contributor Audit Program (BCAP). The High Cost division is reviewing and requesting additional documentation, as necessary, to resolve the appeals. High Cost staff is working closely with the carriers and will continue to engage USAC Office of General Counsel, Internal Audit Division, and external auditors, as needed, to resolve the outstanding issues.

Training & Outreach

In 2Q2017, the High Cost division continued to conduct outreach to carriers and consultants (and industry associations) using the HUBB to file broadband deployment data with USAC. This outreach includes regular updates about the system's features and functionality, filing instructions, reporting deadlines, etc., through email communications, phone conversations and detailed website content available to the HUBB resource page. While we have been in regular contact with carriers of all sizes, the second quarter outreach has focused in particular on the 10 largest price cap carriers that are facing a July 3, 2017 filing deadline. We have reached out to each of these carriers individually to answer questions and provide assistance.

We have ramped up engagement with stakeholders to gather input and feedback to inform design of and improve the CAF compliance process (to verify deployment by carriers that receive High Cost support). These activities have included calls and meetings with many carriers and trade associations (including separate listening sessions with price cap carriers and RoR carriers), engineering consultants, mapping services vendors, billing services providers and USDA Rural Utilities Service. These conversations have focused on what types of documentation carriers could supply to prove deployment and whether there is a role for professional engineers to certify on behalf of carriers, among other questions.

Also in 2Q2017, the High Cost division launched a new customer service center in late April to handle questions and concerns from carriers and other stakeholders. The new customer support center will allow us to better track and report customer service metrics, such as requests for assistance. In the month of May — its first full month of operation — the customer service center handled 345 calls, with 93 percent answered within 30 seconds or less.

Lastly, ETCs are required to submit their annual certifications by July 1 to USAC, the FCC, state commissions, tribal authorities and other relevant authorities. The High Cost division continues to engage with carriers on a weekly basis to ensure carriers timely file their forms and avoid any payment penalties for late filings.

Attachment A

HC Charts — Business Metrics:

Figure 1 — HC Scorecard YTD 2017

High Cost Scorecard – May 2017

Aggregated performance is the composite of multiple metrics | G On-track | Y At-Risk | R Off-track | NA Future Metric

PROGRAM OUTCOMES

Performance Measurement Model

GOAL #1: Expand broadband and maintain voice and broadband coverage by collaborating with users to achieve a shared goal of ensuring universal availability of voice and broadband, both fixed and mobile, that is reasonably comparable to what is available in urban areas.

Measurement Category	Target	Status
Network Build out/Services Offered	Mobility Road Miles Reported: 88% Mobility Population Reported: 69%	G
Validations (CAF Phase I, CAF Phase II)	Location Deployment Obligations: 638,728 (CAF Phase I); 3,515,986 (CAF Phase II) Total Locations Received to Date: 383,327 (CAF Phase I); 519,638 (CAF Phase II) % Initial Validated (of received): 100%	Y
Attest: % Carriers attesting to Urban/Rural Rate Comparability	Voice Rate Certification: 100% Broadband Rate Certification: 100%	G

OPERATIONAL MEASURES

PROGRAM INTEGRITY

Monitor and implement controls to assess and collect contributions

Measurement Category	Target	Status
Improper Payments Rate	< 1%	G
Disbursements	<= 4.5 billion	G
Audits	Completion Time: 10 days	G

USER EXPERIENCE/USER SUPPORT

Strengthen and simplify user experience to enable successful participation

Measurement Category	Target	Status
Form Filing Time	FCC Form 481: 90 day window FCC Form 690: 90 day window	NA
Forms / Certification	Volume: XXXX % certified: 100%	NA
Technology: Severity 1	0 Outages	G

OPERATIONAL EFFECTIVENESS

Improve efficiency and improve business process

Measurement Category	Target	Status
Cycle Time	Mobility Desk Ver.: 30 days Mobility Site Ver.: 45 days	G
	CAF Phase I locations: 60 days CAF Phase II locations : 10 days	Y
Efficiency (minimize expenses)	<1%	G
Customer Service	TBD	NA
Appeals	Completion Time: 90 days	R
Technology	System Uptime: 99%	G
Cycle Time for Form 481	Analysis Phase: 30 days Detail Phase: 90 days	G

Figure 2

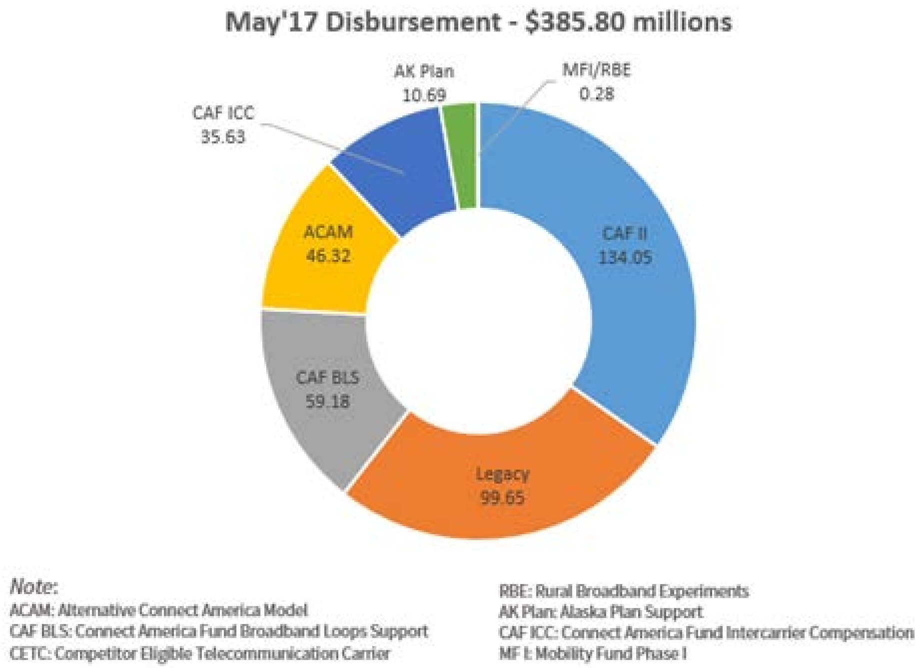
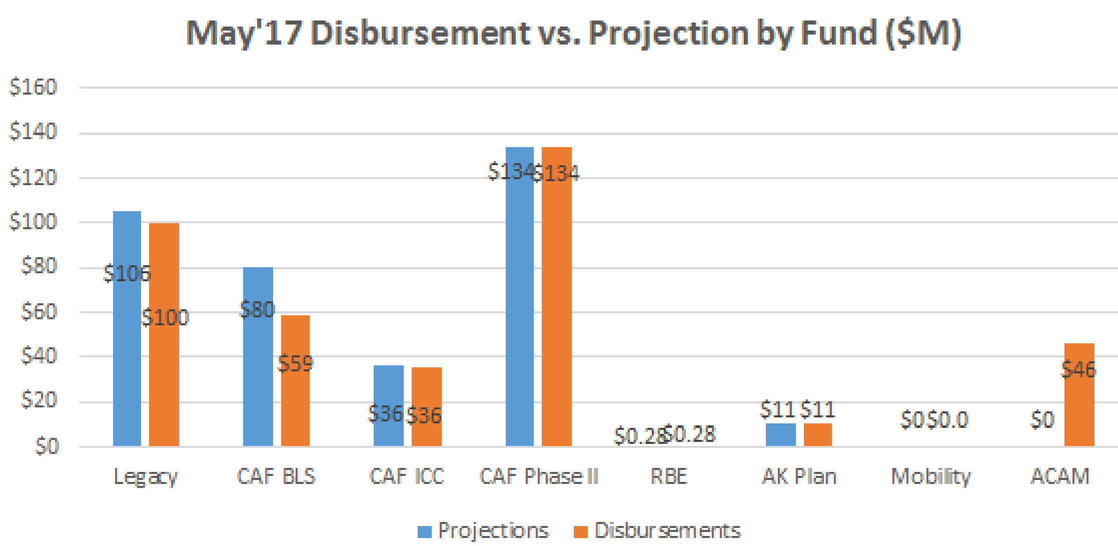


Figure 3



Attachment B

Major HC Project Updates

High Cost Universal Broadband (HUBB) 1.0 — Data Collection
The HUBB launched in March 2017, and carriers are currently entering data in advance of the July filing date. There are several system enhancements in process, including providing State Utility Commissions access to HUBB data, bug fixes, and a more robust Help Center to improve the user experience and reduce customer support issues. A minimum viable product version of the Messaging and Notification function will be developed in 2017. This is an ongoing development project with changes expected throughout 2017 and into 2018.

HUBB 2.0 — Audit & Verification of Data
HUBB 2.0 will provide USAC with the capability to audit and verify data submitted to the HUBB, and includes the addition of a Messaging and Notification function within HUBB to communicate with carriers regarding audits and other issues. A simple workflow management system is needed for accuracy and adherence to sound audit principles. An audit and verification process model will be developed and tested in 2017. As part of that process a review of potential automation systems will be conducted to find an optimal solution. The automation of this function is planned for deployment in 2018. This project may contain private and confidential data and requires review by both the Office of General Counsel and Information Security teams to ensure compliance.

HUBB 3.0 — Mapping of Data
HUBB 3.0 will provide a visual representation of carrier location data submitted to the HUBB in the form of a map that can be viewed by the general public. This allows the public to see where High Cost support is funding broadband deployment and service across the US. This project will only include non-confidential data. The project is estimated to be completed at the end of 2017.

Mobility Fund Phase II Challenge Process
Prior to conducting the reverse auction for Mobility Fund Phase II (MF II) support, the FCC will conduct a challenge process to efficiently resolve disputes about areas eligible for MF II support. The requirements for this project will not be finalized until the FCC releases an order establishing the parameters for the challenge process. Once the order is released, the requirements will be finalized and a delivery date will be set with the FCC for implementation. The earliest anticipated implementation is January 2018.

CAF Broadband Verifications

USAC has commenced verification activities for CAF Phase 1, Round 1 locations. As part of this work, for a sample of locations reported, USAC requests documentation from price cap carriers to support the carrier's certifications that eligible broadband was deployed to the locations reported. Through our compliance efforts, the HC program has recovered approximately $84 million in CAF Phase I Incremental Support due to carriers failing to meet their deployment milestones (see chart below).

	Location Data							
Fund	Total Obligation	Certified to Date	Expected 2017	Projected 2018	Validations Completed	Validations status	Verification status	Recovery to date
CAF 1 Rd 1	147,552	147,552	-	-	104,940	42,612	98**	$ 2,563,700
CAF 1 Rd 2	491,176	234,285	256,891	-	146,539	87,746	TBD**	$ 81,651,800
CAF 2	3,629,996	519,638	TBD*	1,451,998	-	-	TBD**	-
RBE	36,692	9,454	3,495	19,465	-	9,454	TBD**	-

*CAF 2 locations deployed in 2016 will be received by July 2017, however no milestone exist until the end of the year (40 percent completion). The actual location submitted will be available after July 3 filing deadline.
**Currently working with statisticians to develop sampling plans for CAF programs.


High Cost
Program Highlights
Universal Service
Administrative Co.

High Cost Scorecard – Q2 2017

Briefing book excludes all materials discussed in Executive Session

Aggregated performance is the composite of multiple metrics | G On-track | Y At-Risk | R Off-track | NA Future Metric

PROGRAM OUTCOMES

Performance Measurement Model

GOAL #1: Expand broadband and maintain voice and broadband coverage by collaborating with stakeholders to achieve a shared goal of ensuring universal availability of voice and broadband, both fixed and mobile, that is reasonably comparable to what is available in urban areas.

Measurement Category	Target	Status
Network Build out/Services Offered	Mobility Road Miles Reported: 90% Mobility Population Reported: 69%	G
Validations (CAF Phase I, CAF Phase II, RBE)	Location Deployment Obligations: 638,728 (CAF Phase I); 3,627,464 (CAF Phase II); 36,692 (RBE) Total Locations Received to Date: 383,327 (CAF Phase I); 519,638 (CAF Phase II); 9,696 (RBE) % initial Validated (of received): CAF Phase I, CAF Phase II) = 100%; RBE = 35%	Y
Attest: % Carriers attesting to Urban/Rural Rate Comparability	Voice Rate Certification: 100% Broadband Rate Certification: 100%	NA

OPERATIONAL MEASURES

PROGRAM INTEGRITY

Monitor and implement controls to assess and collect contributions

Measurement Category	Target	Status
Improper Payments Rate	< 1%	NA
Disbursements	<= 4.5 billion	G
Audits	Completion Time: 10 days	G

USER EXPERIENCE/USER SUPPORT

Strengthen and simplify stakeholder experience to enable successful participation

Measurement Category	Target	Status
Form Filing Time	FCC Form 481: 90 day window FCC Form 690: 90 day window	NA
Forms / Certification	Volume: XXXX % certified: 100%	NA
Technology: Severity 1	**0 Outages (*as target*)	Y

***There was one outage in April for severity 1*

OPERATIONAL EFFECTIVENESS

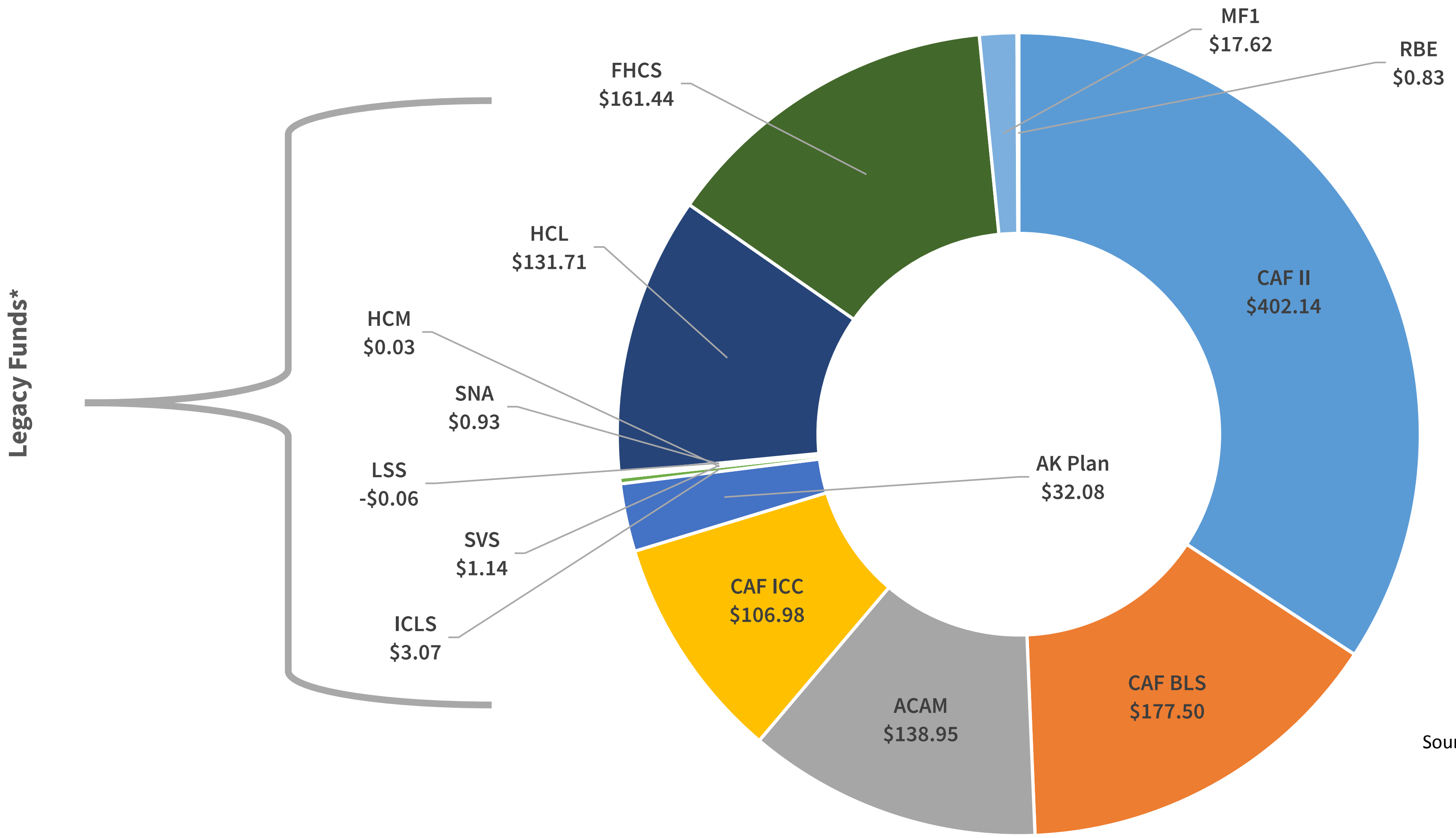
Improve efficiency and improve business process

Measurement Category	Target	Status
Cycle Time	Mobility Desk Ver.: 30 days Mobility Site Ver.: 45 days	G
	CAF Phase I locations: 60 days CAF Phase II locations : 10 days	Y
Efficiency (minimize expenses)	<1%	G
Customer Service	Aggregated Performance	G
Appeals	Completion Time: 90 days	R
Technology	System Uptime: 99%	G
Cycle Time for Form 481	Analysis Phase: 30 days Detail Phase: 90 days	G

Program Integrity: Disbursements

Program Goals: Monitor and implement controls for High Cost funds, audits, improper payments and validate and verify network build-outs.

Q2 2017 Disbursement 1,174.36 Millions



Note:
FHCS: Frozen High Cost Support
HCL: High Cost Loop
HCM: High Cost Model
SNA: Safety Net Additive
SVS: Safety Valve Support
LSS: Local Switching Support
ICLS: Interstate Common Line Support

ACAM: Alternative Connect America Model
CAF BLS: Connect America Fund Broadband Loop Support
RBE: Rural Broadband Experiments
AK Plan: Alaska Plan Support
CAF ICC: Connect America Fund Intercarrier Compensation
MF I: Mobility Fund Phase I
*Legacy Funds includes: FHCS, HCL,HCM,SNA,SVS,LSS,CLS

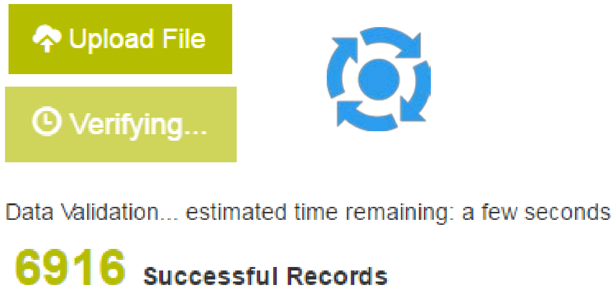
Source: http://www.usac.org/hc/tools/disbursements/default.aspx

Q2 2017 Accomplishments

Briefing book excludes all materials discussed in Executive Session

Annual Carrier Filings

- First HUBB filing closed on July 3
- 1.2 million locations filed YTD
- Form 481
- 1748 carriers (99.66%) filed the timely
- Form 690
- 549 carriers (100%) filed timely
- Other annual filings (CAF ICC and Rate Floor)



Budget Control Mechanism (BCM)

- Implemented and published the results of the BCM on May 1, 2017
- Collaborated with FCC to make necessary changes to process

RoR Budget Control Mechanism

Operational Improvements

- Completed the FCC Order intake process using industry standards
- Currently being used for the MF II Challenge Process
- Enhanced High Cost governance processes and standards

HUBB State Access Tool

- Developed a tool that will enable the FCC and State PUCs to access all location data filed with USAC

MF II Challenge Process

- Resource and budgeting completed
- Collaborated closely with FCC to develop and complete requirements

Mobility Fund Phase ll Challenge Process

User Experience

- Launched a new customer service center to handle high cost inquiries
- Engaged with users to gather input and feedback on the design of the CAF verification process

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High Cost & Low Income Committee Meeting

INFORMATION ITEM – *Executive Session Option*

Information on Three USAC Internal Audit Division Low Income Support Mechanism Beneficiary Audit Reports

Information Presented

This information item provides a summary of the results for three Low Income Support Mechanism Beneficiary Audit Reports listed in **Exhibit I** to this briefing paper.

Discussion

A general discussion of the findings contained in the draft audit reports is appropriately held in open session. To the extent that Committee members wish to discuss specific details of the audit findings, USAC staff recommends that, in accordance with the approved criteria and procedures for conducting USAC Board of Directors (Board) and committee business in ***Executive Session*,** this matter should be considered in ***Executive Session*** because discussion of specific audit plans, targets and/or techniques would constitute a ***discussion of internal rules and procedures***.

Audits were performed on three Low Income Support Mechanism beneficiaries. The purpose of the audits was to determine whether the beneficiaries complied with Federal Communications Commission (FCC) rules and program requirements. **Exhibit I** to this briefing paper highlights the results of the audits.

Summary of Low Income Support Mechanism Beneficiary Audit Reports

Entity Name, State	Number of Findings	Material Findings	Amount of Support	Monetary Effect of Findings	USAC Management Recovery Action	Entity Disagreement
Qwest Corporation – OR, Oregon	0	• No Findings.	$148,363	$0	$0	N/A
NTUA Wireless, LLC, Arizona	1	• No Material Findings.	$352,068	$0	$0	N
Tohono O`odham Utility Authority, Arizona	4	• No Material Findings.	$4,905	$946	$946	N
Total	**5**		**$505,336**	**$946**	**$946**	

Universal Service Administrative Company
High Cost & Low Income Committee Meeting

INFORMATION ITEM

Low Income Support Mechanism Update

<u>Information Presented</u>:

This information item provides the High Cost & Low Income (HCLI) Committee (Committee) with a quarterly status report on the operation of the Low Income (LI) Support Mechanism for 2nd Quarter 2017 (2Q2017). The update includes information on ongoing Lifeline operations, as well as the National Verifier implementation.

Discussion:

<u>Program Highlights – 2Q2017</u>

- 69.7% of the 9 million Lifeline subscribers in the National Lifeline Accountability Database (NLAD) are reported by service providers as having a service that meets the broadband minimum service standards.
- In 2Q2017, there were 1.37 million new enrollments and 1.5 million de-enrollments in NLAD, for a net decrease in subscribership of 130,000.[1]
- USAC conducted rolling recertification for July anniversary dates, the first rolling recertification batch, resulted in a 55% successful recertification rate.
- Lifeline made several enhancements to system validations based on information gained from program integrity projects. They include validations associated with the use of Supplemental Security Income for eligibility, and verification of tribal eligibility.
- The National Verifier (NV) implementation is on track and on budget.
- See **Appendix A** for additional operational metrics.

<u>Low Income Support Mechanism Operational Update</u>

July 2017 USAC Conducted Rolling Recertification

Subscribers with enrollment anniversary dates in July 2017 were the first to be recertified under the new rolling recertification processes implemented as a result of the *2016 Lifeline Modernization Order* (*Order*).[2] Based on service provider elections, USAC conducted recertification for 521 Study Area Codes (SACs) and approximately 30,000 subscribers with July anniversary dates. In this cycle, 55% of subscribers were successfully recertified, as compared to 72% in the annual 2016 process. The key driver for this variance was a 14% increase in the proportion of failed recertifications due to non-responsive subscribers. One-third of those non-responses were the result of subscribers who had de-enrolled during the recertification response window, as compared

[1] Does not include subscribers in opt-out states of CA, TX, OR, VT.

[2] *Lifeline and Link Up Reform and Modernization Order et al.*, Third Report and Order, Further Report and Order, and Order on Reconsideration, 31 FCC Rcd 3962 (2016).

to 10% in 2016. This variance may be due in part to the Commission's change in the response window from 30 to 60 days, giving more time for the subscribers at issue to de-enroll during the recertification period due to normal attrition. If we normalize for this variance in non-responders who were de-enrolled during the response window, the more comparable recertification rate for subscribers with July 2017 anniversary dates would be approximately 62%.

At the normalized rate described above, there is still a 10% variance between the 2016 annual success rate of 72% and the July 2017 success rate of 62%. One possible reason for this variance could be that, given the transition to rolling recertification in 2017, these subscribers may have recertified as recently as four months prior to receiving USAC's recertification letter, and may not have believed the recertification was necessary. The Lifeline team plans to work with service providers to further investigate any challenges or consumer communication strategies that can improve the recertification process going forward. Lifeline will also use data analytics in the coming quarters to determine at what rate the de-enrolled subscribers re-enroll in the program. This will be available on a rolling basis as each recertification cycle closes to determine re-enrollments.

Program Integrity Improvements

During 2Q2017, Lifeline completed several program integrity focused projects that resulted in meaningful improvements to NLAD validations, two of which we will highlight here. First, Lifeline added systematic controls to prevent the use of Supplemental Security Income for eligibility in territories where the program does not exist. Second, Lifeline added systematic controls to prevent the incorrect use of the tribal flag.[3]

In progress now for the Program Integrity Team is a deeper analysis of variances between NLAD and FCC Form 497 filings. This project will both identify any potential service provider reporting errors, as well as identify necessary lessons learned for the transition to payments based on NLAD. To date, the team has performed initial outreach to 35 service providers. At the October meeting, we will report out on themes from this project.

On July 11, 2017, FCC Chairman Pai issued a letter to Acting CEO and General Counsel, Vickie Robinson regarding the Lifeline Program. Following up on the recent report issued by the Government Accountability Office (GAO) and the Chairman's own ongoing investigation into the program, USAC has been directed to implement various safeguards to mitigate the risk of waste, fraud and abuse in the Lifeline program. The letter directs USAC to provide a report on August 8, 2017, detailing our implementation of the specific actions outlined in the letter, and solicits recommendations from the Board to further safeguard the program. The Lifeline Team will work closely with the High Cost & Low Income Committee in the first instance, but we welcome all Board feedback

[3] *Lifeline and Link Up Reform and Modernization Order et al.*, Report and Order and Further Notice of Proposed Rulemaking, 27 FCC Rcd. 6656 (2012).

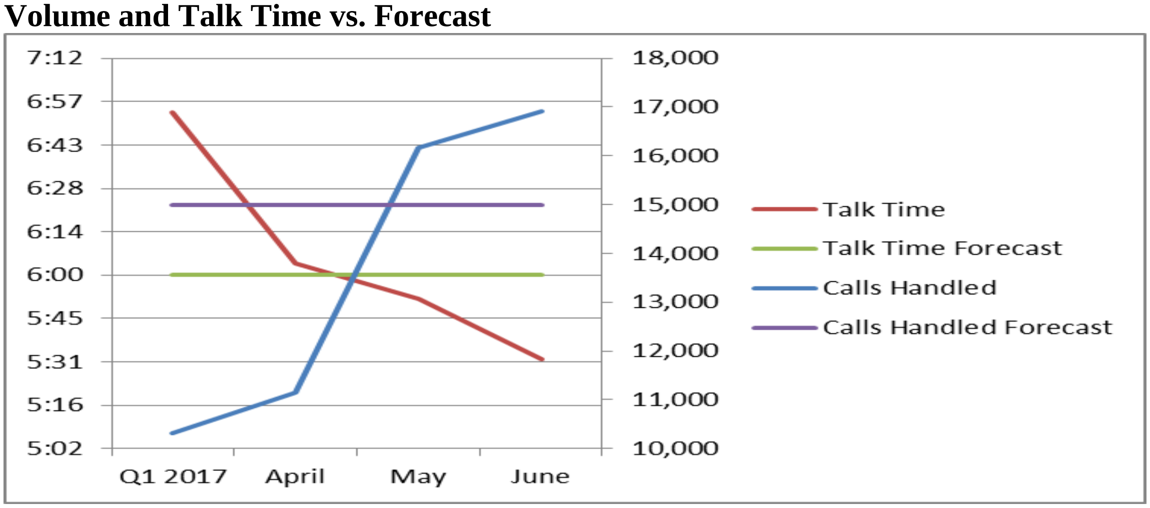
in support of our efforts to faithfully administer the program and take immediate measures to safeguard against waste, fraud and abuse.

Program Outreach and Customer Service

In early May, Lifeline launched its redesigned consumer facing site, LifelineSupport.org, improving its look, structure, and written information to better serve consumers. The re-design was based on tried and true best practices as well as feedback from stakeholders such as state regulatory commissions and consumer advocates. In 3Q2017 Lifeline will work to enhance the consumer's experience further by providing a more robust report for "Companies Near Me", which allows a consumer to search for companies offering Lifeline service in their area. Today, this search is only available at the state level, but we are working to provide a search at the zip code level.

Last quarter, the Committee and the FCC approved an increase in funding for the Lifeline Consumer Call Center to address higher than anticipated call volumes. At that time, USAC forecasted 15 thousand calls per month with an average talk time of 6 minutes and 45 seconds. In May and June 2017, call volumes spiked above the new projected average per month to approximately 17 thousand calls per month, due in large part to eligible telecommunications carrier (ETC) designation relinquishments that prompted consumers to call Lifeline for assistance in finding a new service provider. This increased call volume created a risk that we would exceed the increased budget amount. Through the recent work with the vendor to improve call handling processes, however, talk time averaged lower than anticipated at 5 minutes and 40 seconds. The result of the increased call volumes was offset by the decreased call duration, allowing USAC to stay within the new budget. USAC will continue to work with the vendor to coach on reducing talktimes to offset potentially growing volumes, and is looking for other opportunities to support consumers outside of the call center. For example, the forthcoming improvements to the "Companies Near Me" page described above will help consumers self-serve, and will also help the call center research and provide helpful information more quickly to reduce call costs.

Volume and Talk Time vs. Forecast



Top Call Drivers

Call Driver (June)	% of Calls	Volume of Calls
Provided Benefit/Carrier info	28%	3,896
Referred to Carrier	15%	2,027
Other	11%	1,554
Program questions	10%	1,428
Opt Out – State	9%	1,279
Total	73%	10,184

Appeals

Lifeline has not met its goal of completing appeals within 90 days so far in 2017. At the start of 2Q2017, Lifeline had 22 workable appeals averaging approximately 300 days in age. In 2Q2017, USAC resolved one of these appeals, and received an additional four appeals, leaving the quarter end with 25 appeals. The 25 appeals can be categorized as follows:

- 17 – dispute audit recovery letters issued related to Payment Quality Assurance (PQA) cases, alleging that FCC Form 497 revisions have already been filed to return the funds related to the audit findings.
- 4 – dispute the merits of PQA, Beneficiary and Contributor Audit Program, or Office of Inspector General audit findings associated with required Lifeline documentation.
- 3 – dispute administrative actions taken by USAC associated with program integrity reviews.
- 1 – disputes USAC's rejection of an untimely downward revision to the FCC Form 497.

The first category is a common appeal type, and is labor intensive to evaluate. At times, service providers will revise an FCC Form 497 during the audit to address findings. It can be challenging to distinguish between revisions made in the normal course from those made specifically to address audit findings. Further, because the FCC Form 497 does not include a detailed subscriber listing, USAC must request and compare subscriber listings collected by the auditor with subscriber listings that support an FCC Form 497 revision alleged to resolve the finding. Decisions on 13 of these 17 appeals have been approved and decision letters are forthcoming to close the appeals.

Going forward, Lifeline is training additional staff to perform review of appeals, so that multiple appeals can be researched in parallel. In addition, peer review of drafted appeal decisions will be used to reduce burden of review currently performed by the Program Integrity Manager.

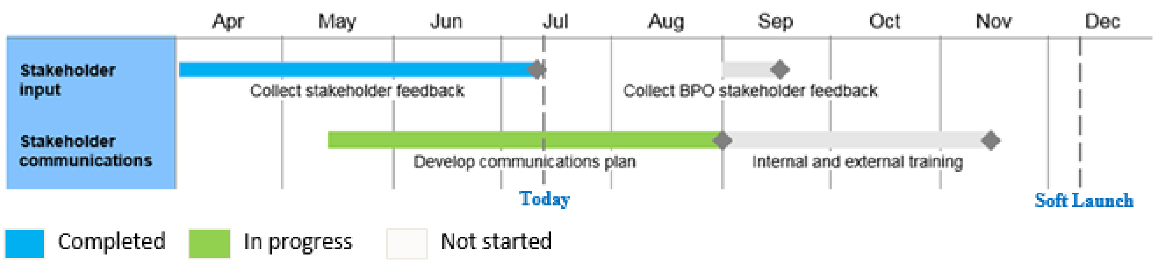
<u>National Verifier (NV) Project Update</u>

Key Milestones

In mid-May, Lifeline released information to stakeholders on the National Verifier Project's key milestones as agreed upon by USAC and the FCC. These milestones include announcement of the first states in August, a "soft launch" of the system in December that provides for optional use of the system, and a "hard launch" with mandatory use of the system the following March. The project is on track against these milestones as described in the work stream breakdowns below. By the end of July, Lifeline will publish an update to the National Verifier Plan.[4]

Program Outreach

Activities associated with the collection of input from stakeholders, and the development of communications and training to push out to stakeholders, are on track as depicted in the timeline below.



The Lifeline team gathered feedback from a diverse group of National Verifier stakeholders during 2Q2017. The feedback discussions included 12 interviews with service providers, seven online focus groups with technical and non-technical groups of service providers, two online feedback sessions with state partners and four in-person conversations with consumer advocates. After collecting feedback in these interviews and small group sessions, we used webinars to validate common themes with a larger stakeholder group.

These feedback sessions delivered a wide range of insights from expectations for the National Verifier's processes and functionality to specific recommendations around how the system can minimize unnecessary manual reviews through intuitive design.

Several common themes emerged from these feedback conversations:

- Stakeholders anticipate at least 30% of customers will require documentation to be verified. There are a variety of legitimate reasons an applicant will require documentation including:
  - Low literacy levels of some applicants;
  - Mismatched names/naming conventions;
  - Address related issues; or
  - Delays in eligibility source database updates.

[4] *See* Lifeline National Verifier Plan (Jan. 2017), available at: http://www.usac.org/_res/documents/li/pdf/nv/Draft-National-Verifier-Plan.pdf.

- Service providers expressed a desire to play an active role supporting customers through the application and recertification processes.

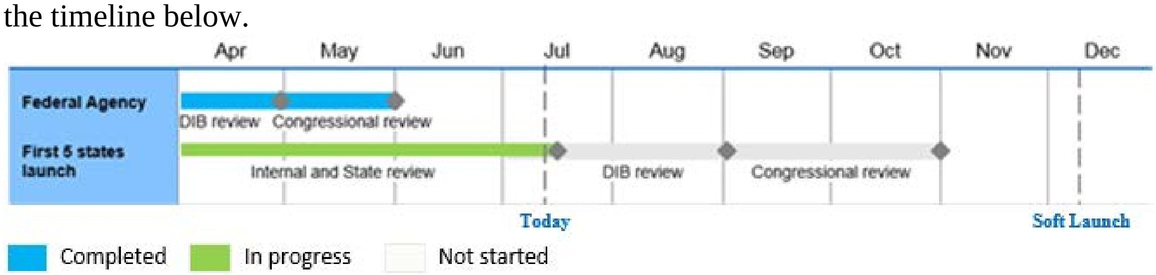
- Maintaining a positive customer experience is critically important for the National Verifier. Specific recommendations to create a positive customer experience include:
  - Delivering real time eligibility results whenever possible;
  - Clearly communicating what is happening throughout the applications process and what the expected wait times will be; and
  - Creating processes that allow customers to complete application and enrollment during their initial transaction.

The Lifeline team will continue to gather feedback from stakeholders next quarter through online focus groups, usability tests for Lifeline forms and systems and technology feedback forums. The insights shared with USAC will continue to be validated across broader audiences through the Lifeline National Verifier blog at www.lifelinenationalverifier.org.

Also in 2Q2017, Accenture worked with Lifeline Stakeholder Engagement and State/Federal Teams to complete the Training and Communication Plan for the roll out of the National Verifier. The plan was also vetted with Lifeline leadership and the FCC. This plan establishes the roadmap for how users of the system will be trained on its features. The training considers the different needs of stakeholders, and uses a blend of delivery methods including in person, webinar, and "learning on the job" tools. Although Accenture is specifically responsible for system training, users will also need training on broader process changes that may fall outside of the system, such as those conducted through the Business Process Outsource vendor (BPO). The training approach combines both system and process information, with Accenture leading the system focused piece and Lifeline leading the process focused piece. Next quarter the training materials themselves will be finalized and approved, so that training and communication can begin in October 2017.

State & Federal Engagement

Activities associated with the development of computer matching agreements (CMA) with any available federal data sources and the first five states are on track as depicted in the timeline below.

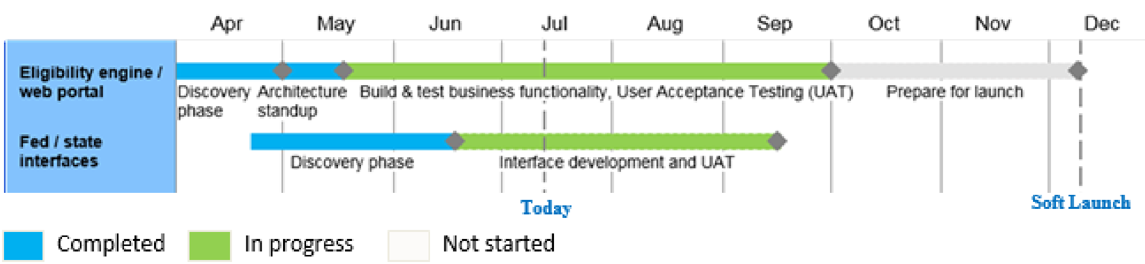


As discussed in previous meetings, we are pursuing CMAs with state and federal agencies that administer the Lifeline qualifying programs to enable automated eligibility checking where possible. We are able to finalize the required federal documentation to substantiate the agreements in parallel to technical development activities. To date, we have reached the following key milestones:

- Federal Agencies - We have completed nearly all activities surrounding the agreement with one Federal Agency. The FCC submitted the matching notice to the Office of Management and Budget (OMB) on June 27th. The remaining step is a 30-day public comment period following publication in the Federal Register, which we expect to be submitted by the end of July. From a technical perspective, we began building the interface with the agency in mid-July.
- State Agencies – By the end of this month, we will have submitted four agreements for the initial launch states to the FCC Data Integrity Board for approval prior to the required Congressional and OMB reviews, and we are on track to announce the initial states in late August. From a technical perspective, we began building interfaces with three states in mid-June, and began building interfaces with two additional states in late-July.

Technical Build

Activities associated with the technical build of the National Verifier System, including the eligibility engine and portal that will be used to interact with users, and the federal and state data interfaces to conduct the verification of eligibility, are on track as depicted in the timeline below.



In addition to the Training and Communications Plan milestone described above, Accenture completed its first three of eight technical milestones on time and with high quality. The completed features include:

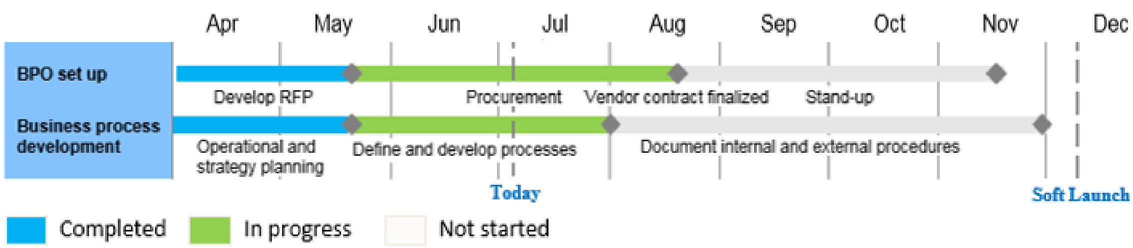
- Stand up of the architecture and environments for Service Now (front end portal) and Eligibility Engine (interfaces to other systems and database for retaining eligibility results)
- Integration with NLAD to leverage existing services such as Third Party Identification Verification, Address Verification, and duplicate checking for inclusion in eligibility responses
- Capability for an initial application, re-certification, and independent economic household (IEH) worksheet to be submitted through the portal (final look and feel of these forms still in progress)

- Ability to upload supporting documents with the forms
- Functionality for validation responses from the system, and a mechanism to submit disputes of the results
- Interface to one federal data source
- Interfaces to three state data sources

In the 3Q2017, the build will focus on completion of all features and interfaces, so that October and November can be used as a hardening phase prior to the December formal launch.

Operations

Activities associated with the procurement of a BPO vendor and development of processes associated with the National Verifier framework are on track as depicted in the timeline below.



The Operations work stream is focused on the people and processes that must wrap around our National Verifier system to bring the framework to life. In 2Q2017, the key focus was the BPO vendor procurement. The BPO will handle two key lines of business: manual eligibility reviews and call center support. Bids were received on June 27, 2017 for evaluation by the committee. The evaluation committee selected a subset of the bidders to come in for oral demonstrations. At the time this paper was written, final proposal revisions are expected to be due by July 20th. We anticipate holding a Committee meeting in August to seek your approval of a final vendor.

In addition to the BPO preparation, the Operations Team is drafting revised and new procedures in support of the framework. The Operations team is partnering with the Sr. Director of Customer Service to develop anticipated call scripts. The Operations Team and Sr. Director of Customer Service are also finalizing the vendor management structure to ensure the BPO vendor is adequately supported and held accountable for the two lines of business in a coordinated manner.

Third quarter will be focused on partnering with the selected BPO vendor around its project plan to integrate with the National Verifier system, conduct training for its staff, and finalize procedures and call scripts.

Key Decisions

Below is a key decision made related to the National Verifier in the past quarter:

- *Migration of Existing Subscribers* – Existing Lifeline subscribers in the initial states will be re-verified at the time of the launch to ensure that all subscribers receiving the Lifeline discount in National Verifier states are eligible for the program. Subscribers will be checked against any available automated eligibility sources first. In the event that they cannot be verified automatically, documentation will be collected from the subscribers or from the service provider's existing retained documents and reviewed to verify eligibility. Service providers will be able to collect this information and transmit it to USAC, or elect USAC to perform the collection of documentation.

Attachment A
Operational Metrics

To be distributed at meeting

Attachment A
Operational Metrics

Overview of Lifeline Metrics:

Lifeline Scorecard – Q2 2017

Aggregated performance is the composite of multiple metrics | G On-track | Y At-Risk | R Off-track | NA Future Metric

PROGRAM OUTCOMES

Performance Measurement Model

GOAL #1: Encourage affordable broadband and broadband bundled services for low-income households to enable essential participation in society.

Measurement Category	Target	Status
% of Lifeline Subscribers receiving Broadband Internet Access Service (BIAS)	33% by 12/31/2017	G

GOAL #2: Continuously improve system and results-oriented business controls for program integrity to minimize fraud, waste, and abuse.

Measurement Category	Target	Status
Refer to Program Integrity metrics below	Aggregated Performance	Y

OPERATIONAL MEASURES

PROGRAM INTEGRITY

Implement division-wide controls and leverage key metrics to mitigate operational risks and proactively address areas of potential waste, fraud and abuse

Measurement Category	Target	Status
% Enrollments w/ Dispute Resolution	< 7.0%	R
Subs with duplicate addresses*	< 19 %	G
Ratio of FCC Form 497 to NLAD Subscribership	93-98%	R
Improper Payment Rate	NA	NA
% Audits with Monetary Findings	< 50%	Y

USER EXPERIENCE/USER SUPPORT

Strengthen and simplify user experience to enable successful participation

Measurement Category	Target	Status
USAC Recertification Rate	> 70%	NA
Number of Complaints	NA	NA
Severity 1 Incidents	0	Y

OPERATIONAL EFFECTIVENESS

Continuously improve the efficiency and effectiveness of business processes

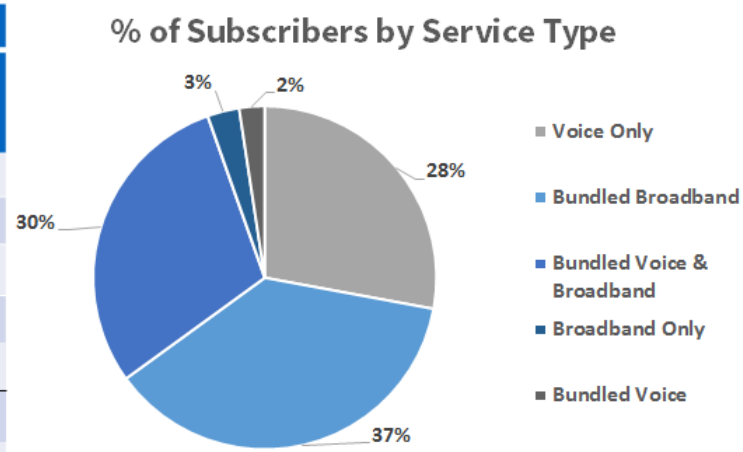
Measurement Category	Target	Status
Customer Service	Aggregated Performance	G
$ Value of Disbursements	< $2.25B	G
Admin Expense as % of Funding	< 2%	NA
Age of Workable Appeals	< 90 days	R
NLAD Uptime %	>99%	Y

Select Metrics:

Lifeline Subscribership by Service Type (Broadband Uptake)

This slide based on subscribers as reported in NLAD.

	April 2017	May 2017	June 2017		
Service Type	% of Subscribers	% of Subscribers	# of Subscribers	% of Subscribers	+/- from Previous Month
Voice Only	52.3%	29.2%	2,516,363	**27.9%**	-1.3%
Bundled Broadband	30.2%	34.1%	3,346,653	**37.1%**	+3.0%
Bundled Voice & Broadband	10.9%	30.9%	2,666,197	**29.6%**	-1.3%
Broadband Only	3.9%	3.3%	266,491	**3.0%**	-0.3%
Bundled Voice	2.7%	2.6%	219,652	**2.4%**	-0.2%
Total Broadband Subscribers	45.03%	68.2%	**69.7%**		
Total			9,015,356		



- Broadband Only – Broadband service meeting minimum service standards
- Bundled Voice – Broadband and voice, only meeting voice minimum service standards
- Bundled Voice & Broadband – Broadband and voice, both meeting minimum service standards
- Bundled Broadband – Broadband and voice, only meeting broadband minimum service standards
- Voice only – Voice service meeting minimum service standards

INFO Item #iHCLI04
Attachment A
7/24/17
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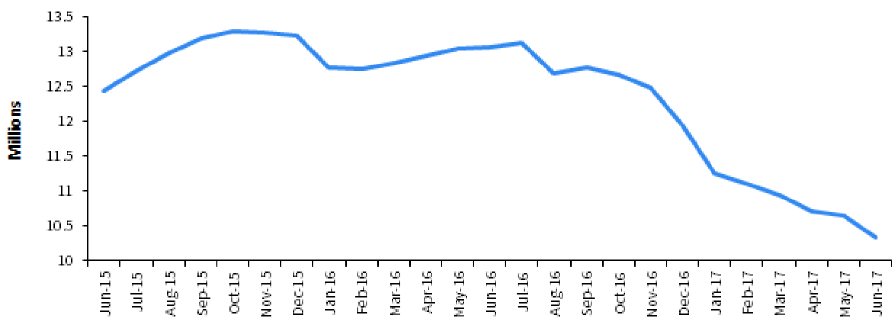
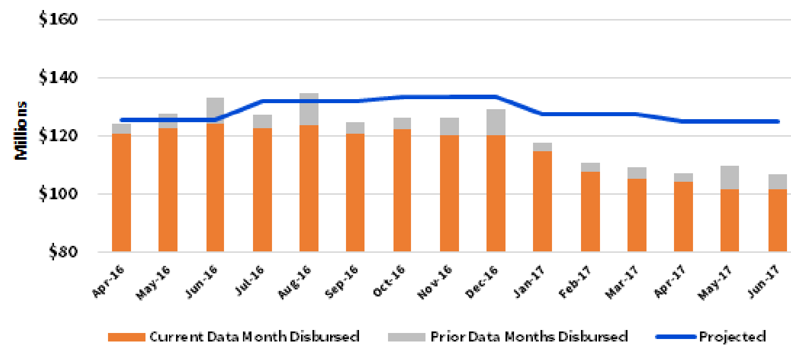
Lifeline Subscribership & Disbursements

This slide based on Form 497 data.

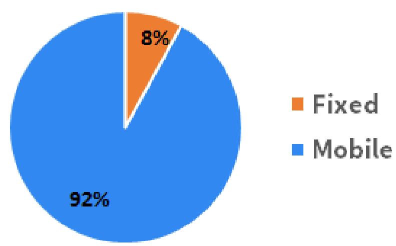
Subscribership



Disbursements



Fixed / Mobile Disbursement Breakdown



Key Takeaways

- Marked drop in enrollment and disbursements most likely due to a combination of factors, including new rules on non-usage, carriers relinquishing their ETC statuses, and USAC program integrity projects.
- Mobile subscribers continue to be the largest of the subscriber base.

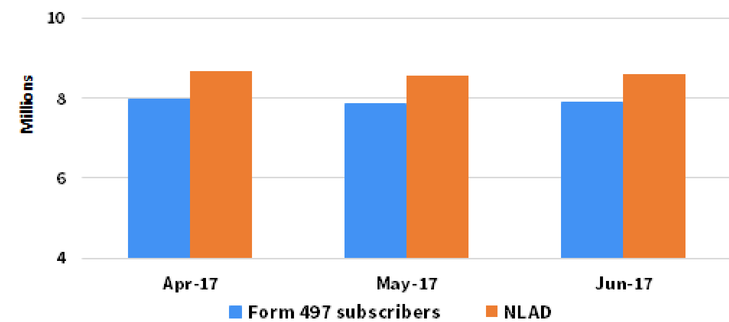
Lifeline NLAD Operations

% Enrollments Subject to Dispute Resolution

	Q4 2016	Q1 2017	Q2 2017
Total Enrollments + Transfers	597,647	553,804	523,484
Total Enroll/Transfer w/Dispute Resolution	48,426	39,671	45,318
% of Total Enrollments + Transfers	**8.1%**	**7.2%**	**8.7%**

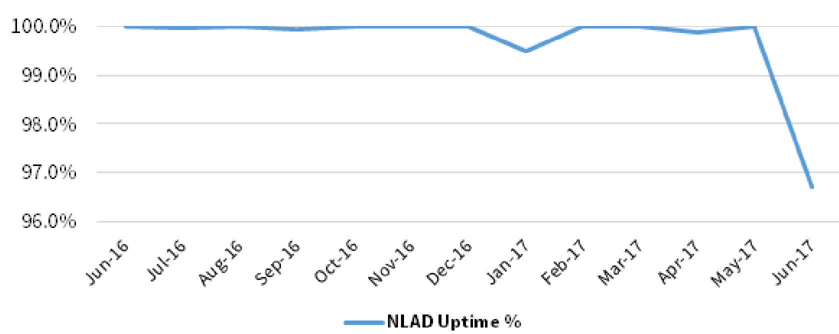
Enrollments subject to dispute resolution are those that required TPIV (Third Party Identification Verification), invalid address, and port freeze exception dispute ticket approval.

NLAD Subscribers vs. Form 497 Claims



Based on Form 497 claims received from carriers for the data month, and corresponding NLAD subscribers on relevant snapshot date (excludes filers who failed to file).

NLAD Uptime %



Key Takeaways

- One carrier submitted a large number of backlogged port freeze disputes in Q2, contributing to the uptick. They should be stable going forward.
- Form 497 claims are less than NLAD subscribers as expected, but the gap is larger than expected. Carrier outreach is ongoing.
- As a result of a mistake during a maintenance weekend, NLAD was down for a period of time that did not meet our SLAs. Lifeline has been briefed by IT on a mitigation strategy going forward.

Lifeline

Program Highlights

Universal Service
Administrative Co.

Lifeline Scorecard – Q2 2017

Briefing book excludes all materials discussed in Executive Session

Aggregated performance is the composite of multiple metrics | G On-track | Y At-Risk | R Off-track | NA Future Metric

PROGRAM OUTCOMES

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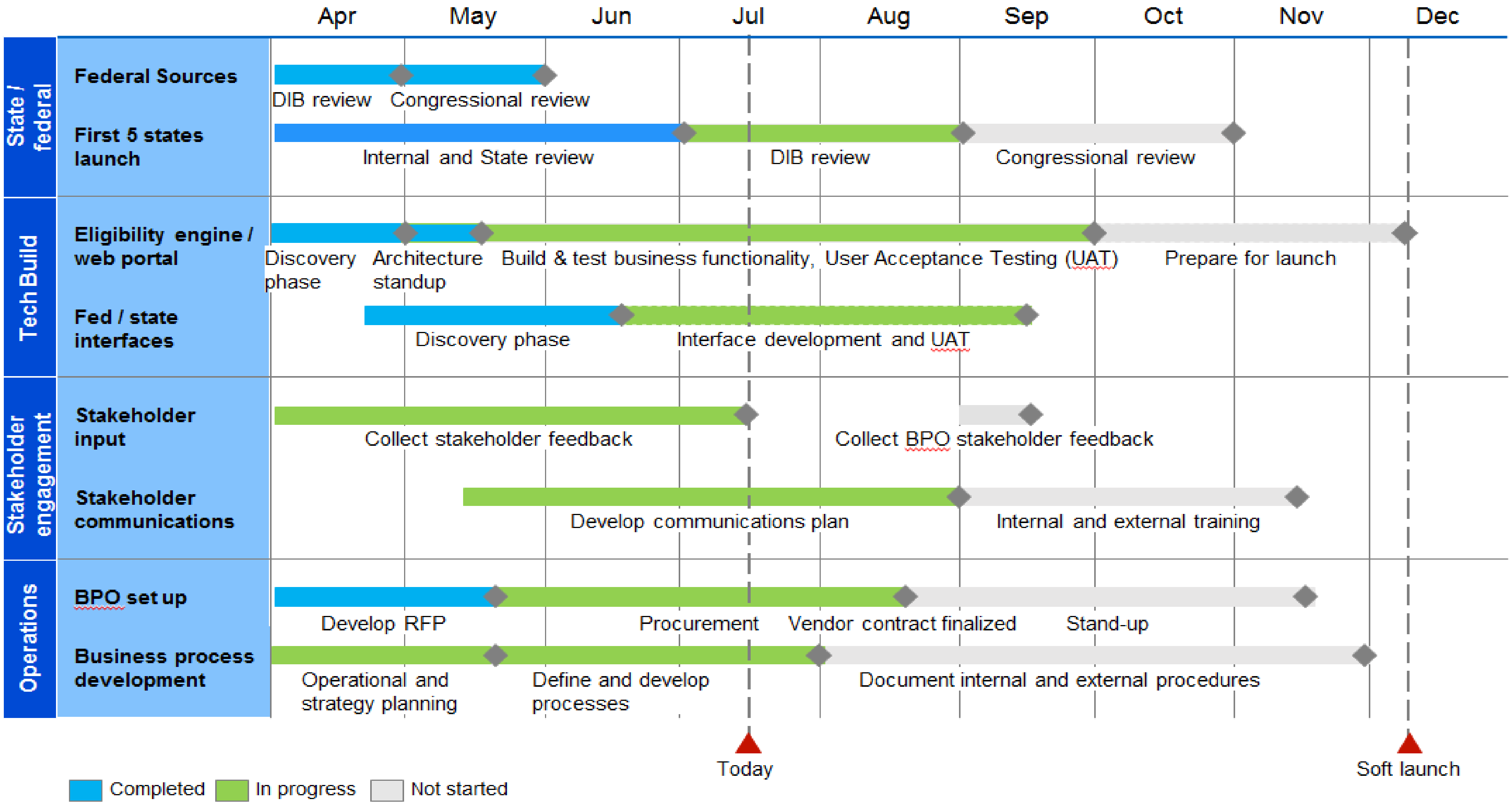
* Change in language, for future approval with FCC

Lifeline Program Highlights

- 69.7% of the 9 million NLAD subscribers receive a service that meets the broadband minimum service standards.
- July rolling recertification batch resulted in a 55% successful recertification rate.
- Implemented validations associated with the use of Supplemental Security Income for eligibility, and verification of tribal eligibility.
- The National Verifier (NV) implementation is on track and on budget.

National Verifier Update



Universal Service
Administrative Co.