Assessment of Payments Made Under The Universal Service Fund's Low Income Program

By
Office of Inspector General
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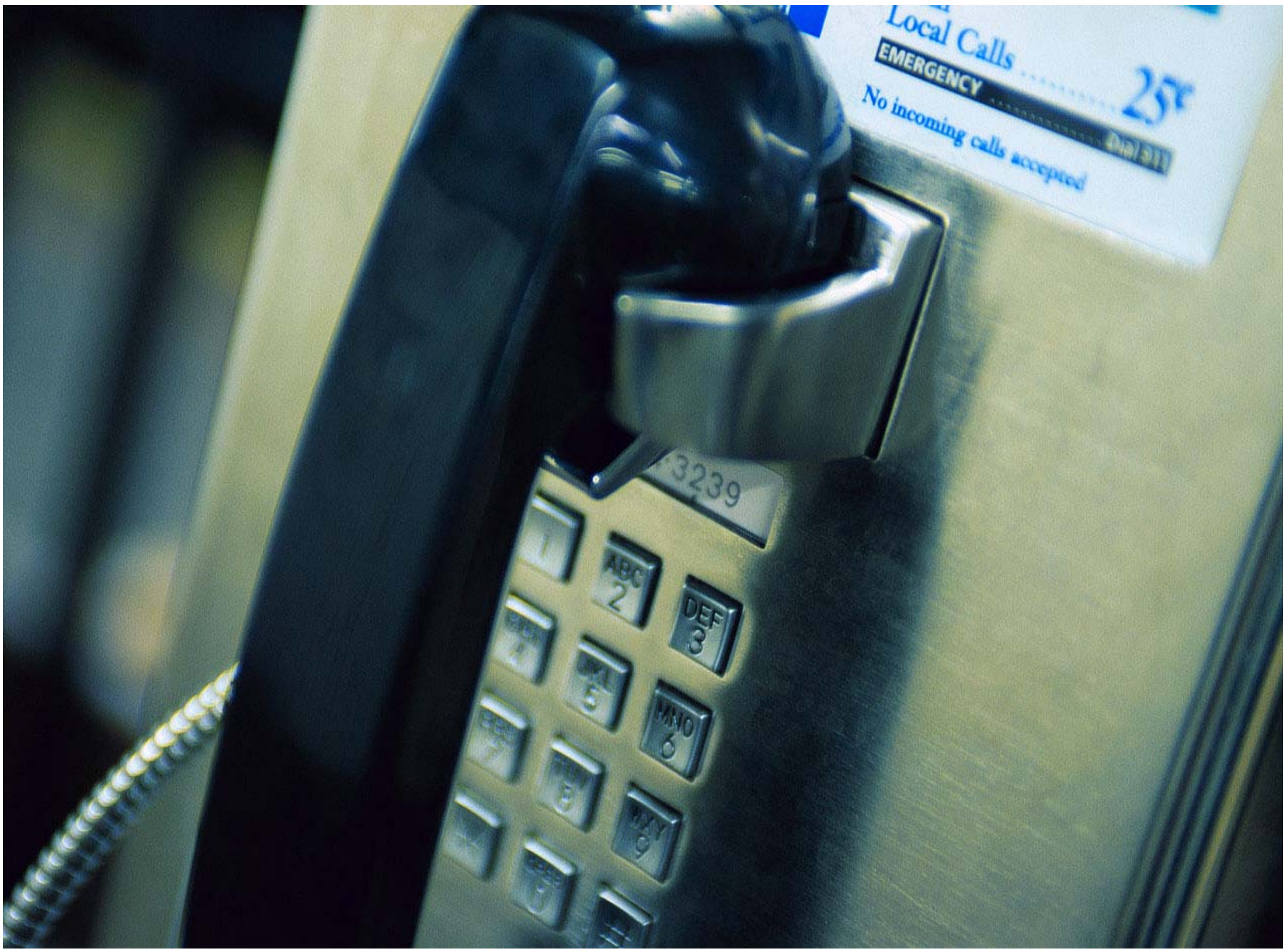

Low Income Program Overview

The Low Income ("LI") Program of the Universal Service Fund ("USF"), which is administered by the Universal Service Administration Company ("USAC"), is designed to ensure that quality telecommunications services are available to low-income customers at just, reasonable, and affordable rates.[1] Similar programs have existed since at least 1985.[2] The Telecommunications Act of 1996 reiterated the importance of those objectives by including the principle that "consumers in all regions of the nation, including low income consumers . . . should have access to telecommunications and information services."[3]

In its May 8, 1997 First Report and Order in the USF proceeding,[4] the Commission established rules to govern Lifeline, Link Up, and Toll Limitation Service program ("TLS") support - the three components of the LI Program.[5] Lifeline support lowers eligible consumers' monthly charges for basic telephone service. Link Up support reduces the cost of initiating new telephone service. TLS support allows eligible consumers to subscribe to toll blocking or toll control at no cost.

On June 30, 2000, the FCC amended its rules to "increase access to telecommunications services and subscribership among low-income individuals living on American Indian and Alaska Native lands."[6] As a result of this order, residents of federal tribal lands receive up to an additional $25 in Lifeline support and an additional $70 in Link Up support to cover 100 percent of all charges between $60 and $130. These provisions bring the cost of basic local telephone service for most tribal residents to $1.00, the minimum charge for tribal Lifeline service. The order also expanded the federal default eligibility criteria to include low-income programs for residents of tribal lands.

On April 29, 2004, the FCC released the *Lifeline and Link Up Order*[7] further modifying the LI Program. That order expanded the eligibility criteria for qualifying consumers to include an income-based criterion and participation in National School Lunch Program and Temporary

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[1] *See MTS and WATS Market Structure, and Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Recommended Decision, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (rel. Nov. 23, 1984) (recommending the adoption of federal lifeline assistance measures); *MTS and WATS Market Structure, and Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Decision and Order, CC Docket Nos. 78-72 and 80-286, FCC 84-637, 50 Fed. Reg. 939 (rel. Dec. 28, 1984) (adopting the Joint Board's recommendation).

[2] *MTS and WATS Market Structure, and Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Decision and Order, CC Docket Nos. 78-72 and 80-286, FCC 85-643, 51 Fed. Reg. 1371 (rel. Dec. 27, 1985).

[3] 47 U.S.C. § 254(b) (3).

[4] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776 (FCC 97-157) (1977).

[5] The Commission's LI rules are codified at 47 C.F.R. § 54.400-417.

[6] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Twelfth Report and Order, Memorandum Opinion and Order, 15 FCC Rcd. 12208 (FCC 00-208) (2000).

[7] Interstate Common Line Support for Lifeline and Link-Up, WC Docket No. 03-109, Report and Order,

Assistance for Needy Families as additional criteria. By expanding the eligibility criteria to include an income-based criterion, the Commission estimated that 1.17 million to 1.29 million additional households that do not participate in the program-based criteria would enroll in Lifeline based on the new criteria.

In addition, the *Lifeline and Link Up Order* adopted certification and validation procedures that are designed to minimize potential abuse of the LI Program. The FCC required carriers that serve in federal default states to complete a verification of a statistically valid sample of their Lifeline customers and submit the results to USAC by June 22, 2005 and annually thereafter on the anniversary of that date. The *Lifeline and Link Up Order* also clarified record keeping requirements and adopted outreach guidelines for carriers.

Assessment of LI Program Payments: Introduction

For all programs and activities where the risk of erroneous payments is significant, agencies are required to estimate the annual percentage of erroneous payments and report this information in their annual Performance and Accountability Reports to the Office of Management and Budget ("OMB").[8] Significant erroneous payments are defined in the Improper Payment Information Act of 2002[9] ("IPIA") as annual erroneous payments that exceed both 2.5% of program payments and $10 million.[10] The term "erroneous payment" and "improper payment" have the same meaning in the OMB Guidance.[11] OMB's Guidance states that "an improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments and underpayments, including inappropriate denial of payment or service. … *In addition, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an error*."[12]

Within that framework, the Universal Service Administrative Company ("USAC"), at the direction of the Office of Inspector General ("OIG"), conducted audits of the Low Income ("LI") program in 2006-2007 ("Round 1").[13] The initial statistical analysis estimated the erroneous payment rate for Round 1 at 9.5% with a margin of error ± 2.1% at the 90% confidence level.[14]

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[8] Office of Management and Budget, Memorandum for Heads of Executive Departments and Agencies (Aug. 10, 2006), Appendix C to OMB Circular A-123 (June 21, 2005) ("OMB Guidance").
[9] Pub. L. 107-300, 116 Stat. 2350.
[10] OMB *supra*.
[11] *Ibid*.
[12] *Id.* at 2.
13 Details on the LI program are provided *infra* at 3-4
[14] The Low Income Program: Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits, Office of Inspector General, October 3, 2007. During the period audited, nearly $795.8 million were disbursed to recipients under the LI program.

The erroneous payment amount was estimated at $75.5 million. Given that the Low Income program was ‘at risk,’ a further risk assessment was required by the IPIA which was begun in March of 2008 (“Round 2”) and was based on disbursements for the period July 2006 through June 2007. The OIG also hoped to produce data from those audits that would enable it to determine beneficiaries’ compliance both with FCC rules and opinions interpreting those rules, and gain additional insight into the LI program's erroneous payments.

For Round 1, USAC provided data on disbursements and filed claims for payment for a stratified random sample of LI providers in 60 Study Area Codes (“SACs”).[15] USAC’s methodology posited that claims filed by carriers were accurate. Working with OIG, USAC developed a Request for Proposals for audits that would produce data for statistical estimates of the erroneous payment rate and the amount of erroneous payments for the LI program.[16] It was hoped that this information would assist the Commission in determining how best to administer the LI Program.

In order to determine compliance (as captured within the general administrative process for approval described below), the OIG directed USAC to undertake compliance attestation examinations. A compliance attestation requires the auditee (management of the service provider) to sign an assertion letter acknowledging its responsibility for compliance with applicable requirements of the FCC’s rules (e.g., 47 C.F.R §§ 54.400 - 54.417) and orders and to make specific assertions relative to an applicant’s compliance with those rules. Auditors validate the assertions, and in the event of invalidation, identify the cause(s) for the failure of an assertion. Data generated from the compliance attestation audits were then to be used for statistical analyses.

For Round 2, the OIG developed additional information concerning USAC administrative processes which caused it to significantly modify its methods in conducting the assessment. As a result, the OIG also reviewed the findings on the LI Program for Round 1 and concluded that revisions were necessary. This report details the assessment of the erroneous payment rate and the amount of erroneous payments as well as the OIG’s reassessment of the erroneous payment rate and the amount of erroneous payments for Round 1 on the basis of this new information.

[15] A SAC is assigned to each service provider in each individual market

[16] USAC, Request for Proposals for Audit Services In Support of the Oversight Program for the Universal Service Fund Low Income Support Mechanism, June, 7, 2006.

Overview of Administrative Process and USAC's Disbursement System[17]

Consumers apply for Lifeline, Link Up, and TLS support in the nature of reductions in local rates (either recurring or non-recurring) from their local telephone company or a designated agency.[18] The companies then seek reimbursement from the federal USF LI Program for the revenue they forgo when providing discounted service to eligible low-income consumers. USAC's LI payment calculation system generates a projected support payment for each component of LI support for each SAC on a monthly basis.[19]

USAC's initial disbursement to the LI provider is a projection based on "a company's data for 12 of the past 13 months…to calculate a growth rate"[20] using a model ("Projection Algorithm") that reflects the company's disbursements (projections and true-ups) for the past twelve months plus a projected growth factor.[21] An average of the month-to-month growth rates is used to determine the payment for any given month.[22] Thus, once the average month-to-month growth rate is determined, it is multiplied by the previous month's payment to determine the increase for the current month.[23] The projected payment is allocated across the three LI components (Lifeline, Link Up and TLS).[24] All initial disbursements for companies that have been in the program for 3 months or longer are based upon USAC's Projection Algorithm.[25] New companies are initially paid on the basis of their Form 497 submissions until USAC has three months' of 497 forms to populate the projection algorithm.

USAC then adjusts that initial amount when it receives from eligible telecommunications carriers ("ETCs")[26] their claim for payment on certified Form 497 which serves as a true-up. Carriers must file one Form 497 for each month for which they claim support.[27] Carriers file LI claims for payment on FCC Form 497 monthly, quarterly, semi-annually or sporadically. Carriers may file an original and revised Form 497 for up to 25 months after the 'data month' depending on the time of year. Moreover, once filed, a claim may be revised for 15 or 25

[17] As described in a USAC training presentation (May 8, 2008). (hereinafter "USAC").
[18] Eligibility for Lifeline, Link Up, and TLS varies by state. Individuals who reside in states that have their own discount programs qualify for federal Lifeline, Link Up, and TLS support if they meet the eligibility criteria established by their state. The application process for Lifeline and Link Up varies by state. In some states, consumers apply for Lifeline by contacting their local telephone company directly. In others, consumers must apply through a designated agency.
[19] USAC *supra* at n.17.
[20] USAC, *supra*. If a carrier has not provided 12 months of data, the Projection Algorithm employs prior projections as well as actual data.
[21] *Id*.
[22] USAC *supra.*
[23] USAC does on occasion "override the projection". USAC *supra.*.
[24] USAC *supra*.
[25] USAC *supra*.
[26] ETCs include incumbent local exchange companies, competitive local exchange companies, and wireless carriers so designated.
[27] Additionally, as for all USF programs, ETCs must file: (1) Form 499-Q, Quarterly Telecommunications Reporting Worksheet; (2) Form 499-A, Annual Telecommunications Reporting Worksheet; and (3) Form 498, Service Provider Information Form.

months depending on the time of year. There is no time limitation on downward revisions of claims.[28] Carriers regularly file revisions to update their support claim for reimbursement for foregone revenue in providing discounted low income rates to those eligible.

USAC stated that it reviews carriers' support claims to determine whether they are consistent with the Commission's rules as required.[29] All ETCs receiving LI support must provide the services or functionalities described in the Commission's rules.[30] In addition, all ETCs providing LI support services must ensure that their subscribers are eligible for the discount based on the applicable state or federal requirements.[31] Thus, in addition to the review of the data submitted on Form 497, USAC's Internal Audit Division states that it conducts LI beneficiary audits to ensure program compliance.

USAC disbursements are not necessarily equal to actual reimbursable claims because of the uncertainty associated with USAC projections. The OIG requested USAC’s documentation regarding its projections to verify the projections and the payment amounts that were based on the projections. The OIG sought to confirm whether the payments were appropriately authorized and whether internal controls were in place to ensure that payments were only made when approved by the appropriate personnel.

In effect, USAC describes its initial LI disbursement for a given month as based on a model that creates an historical projection as described above. USAC, however, could not provide original source documentation that would support the calculations on which USAC disbursements are made. USAC stated that original source data as no longer available because they have been destroyed or written over, a practice described as longstanding. USAC further explained that it retains the services of an IT CPA firm to annually review the inputs and the criteria USAC uses in its model. Consistent with the agreed-upon procedure between USAC and the CPA firm, such examination includes creation of a dummy model on which the USAC model is tested. USAC reports that the most recent such audit resulted in an unqualified (“clean”) opinion letter. That practice, however useful, does not negate the need for the underlying source documentation to be maintained and available for review.

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[28] There is no consideration for the time value of money.
[29] USAC, *supra*.
[30] 47 C.F.R. § 54.101(b).
[31] States have primary responsibility for designating telecommunications providers as ETCs. A carrier seeking ETC designation on non-tribal lands must first consult with its state utility regulator to see if the state utility regulator has ETC jurisdiction and procedures in place for seeking ETC status. If not, the carrier may petition the FCC and must provide an affirmative statement from the state utility regulator to that effect. A carrier seeking ETC designation on tribal lands may directly petition the FCC for designation without first seeking designation from its state utility regulator.

Conclusions and Recommendation

Conclusion #1. The OIG concluded that USAC makes an initial disbursement to carriers on the basis of its estimate of their foregone revenues rather than reimbursing ETCs for actual claims. USAC does not have the source documentation that would permit verification of the calculations of the amounts disbursed.[32] Thus, USAC cannot provide documentation for Rounds 1 and 2 to support the amounts of the payments that it made to the ETCs. Consistent with OMB's guidance as described above, the lack of that documentation necessitates a determination that payment made in reliance on such documentation must be considered an erroneous payment.

Recommendation. In correcting what USAC describes as its longstanding practice of destroying or writing over the source documentation, the OIG recommends that USAC retain complete supporting documentation that can be verified for each disbursement.

Conclusion (2). An informal comparison of a sampling of : (i) the historical projection for a given month that was the basis for the initial disbursement, and (ii) the after-the-fact claim, showed that in some instances there was surprisingly little, if any, variation. In effect, the projected and actual amounts were identical, or nearly so. We intend to examine those patterns more closely.

Conclusion (3). Finally, considerable time has passed since the original Low Income Program was conceived and the implementation procedures described above were devised. The number and nature of providers has changed dramatically since that time. As a consequence, the Commission may want to re-examine the assumptions underlying the LI Program's disbursement structure and disbursements mechanisms.

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[32] Although USAC memoranda describe the process behind the projections, USAC does not maintain a copy of the spreadsheet or actual calculations of the projections for each company. Because monthly disbursements under the LI program to the recipients of funds from that program are based on unsupported projections, USAC was unable to provide documentation that the payments were appropriately authorized or that USAC uses adequate internal controls to ensure that erroneous payments are kept to a minimum. As a result, the OIG is unable to determine that the payments were proper (inter alia, because it is not possible to determine whether the procedures, projections, calculations and disbursements were actually followed and whether disbursements were computed correctly).