

## EDUCATIONAL ADVISORY

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### PRIMER: How to Avoid Having a Simple E-mail from USAC Spiral into an Audit Nightmare

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*Through the years, our law firm and its affiliated consulting arm, [The Compliance Group](#), have represented hundreds of telecommunications and VoIP service providers with an assortment of legal and regulatory compliance matters on a nationwide basis. More than any other area of communications regulation, the complexities of the Federal Communications Commission's ("FCC" or "Commission") Universal Service Fund ("USF" or "Fund") and the administration/enforcement of the program by the Universal Service Administrative Company ("USAC") continue to cause confusion and uncertainty among our clients and the industry at large.*

*Our firm's experience representing clients BEFORE, DURING and AFTER USAC audits has shed a tremendous amount of light onto what was, heretofore, a rather opaque, fluid, and uncertain process. Like USF filing itself, USAC's audit process and procedures can easily trip-up providers who do not deal with USAC on a regular basis, and one seemingly innocuous tool USAC uses presents a special concern for our clients and any USF contributor. In our experience, USAC's use of informal requests for information, often in the form of an email, can be the first step toward a formal audit or desk review of a provider by USAC.*

*In the interest of continuing to educate our clients about the USAC audit process, we have prepared the following "Primer." However, if you take only one piece of information away from this article, remember that we advise our clients to refrain from responding directly to USAC communications asking questions about how a provider reports revenue without first consulting counsel.*

#### USAC Audit Process: Informal Requests for Information from Contributors

##### A. USAC's Role in Administering the USF

The Universal Service Fund is a product of the Telecommunications Act of 1996,<sup>1</sup> and USAC is tasked with administering the Fund.<sup>2</sup> In theory, the FCC limited USAC's authority to addressing

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<sup>1</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended at 47 U.S.C. § 254).

<sup>2</sup> *In re Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service*, Report and Order and Second Order on Reconsideration, 12 FCC Rcd. 18400, 18407-08 (1997). The FCC designated USAC as the interim USF Administrator in 1997. USAC became the permanent Fund Administrator in 1998. See *In re Changes to the Board of Directors of the National Exchange Carrier Association*, Third Report and Order, CC Docket No. 97-21, Fourth Order on Reconsideration in CC

administrative matters regarding the USF.<sup>3</sup> In practice, however, it is our firm's experience that USAC has used its authority to conduct audits to take aggressive positions regarding the FCC's USF rules and regulations,<sup>4</sup> and, either out of inattention or acquiescence, the FCC has permitted USAC to expand the scope of its authority and expand the USF contribution base through the "audit" and "appeal" process.

This expansion of USAC's role in driving USF rules and policy allows USAC to maintain a stable funding base for the USF through technological changes that might otherwise erode the contribution base. It also allows the FCC to dodge difficult issues related to what providers should contribute to the USF and how those providers should contribute. However, the current situation is an abdication of the Commission's responsibility to oversee the USF and provide guidance to USAC.<sup>5</sup> It also has the side-effect of letting numerous appeals of USAC audits languish at the FCC lest contributors challenge USAC's de facto rulemaking in the courts after getting a final decision from the Commission.

## **B. Informal Information Collection Process: USAC's Three Tiered Approach**

It is through our firm's experience dealing with aggressive USAC auditing and representing clients through lengthy (seemingly endless) FCC appeals of adverse audit findings that we now seek to educate clients about the tools USAC uses to collect information regarding USF contributors – and through that information collection, identify non-compliance with USAC's understanding of the FCC's rules. While USAC does not make its internal processes public, and many of the tools USAC uses are not explicitly addressed by FCC regulations, through our experience representing clients, we have witnessed how USAC uses the many tools at its disposal to build its audit decisions. We have also witnessed the mistakes clients sometimes make in responding to USAC requests for information quickly and without consulting counsel.

### **i. STEP ONE: Use of Technology to Detect Material Changes in USF Filings**

USAC constantly monitors the information it receives in 499-A and 499-Q reports, and through our experience, we know that any material changes in a contributor's quarter-over-quarter filings or year-over-year filings is likely to be spotted by USAC through database analytics. Whether USAC's data mining technology generates automated request for information when it detects material changes in a contributor's filings or if a member of USAC's staff reviews the changes detected first, a USF contributor that makes a material change to its Form 499 filing from one period to the next is likely to receive a request for explanatory information from USAC.

A contributor should not take this information to mean it should not change its 499 filings if its circumstances change. Indeed, contributors are obligated to report on the facts, as all Form 499s are signed by an officer under penalty of perjury. A company can make any number of legitimate

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Docket No. 97-21 and Eighth Order on Reconsideration in CC Docket No. 96-45, 13 FCC Rcd. 25058, 25069-70 (1998).

<sup>3</sup> 47 C.F.R. § 54.702(c).

<sup>4</sup> 47 C.F.R. § 54.707.

<sup>5</sup> 47 C.F.R. § 54.702(c).

changes to its product offerings, billing practices, or corporate structure that may justify the changes to its 499 filings. However, it is essential that a company's management understand the potential for material changes in the company's 499 filings to generate a request for information regarding that change from USAC. Legitimate, fact-based changes can and should be made, but companies making such changes must be prepared to respond to USAC questioning in ways that quell the natural curiosity and suspicion of an "auditor." Failure to quell suspicion can and does exacerbate the situation and can lead to increased scrutiny of a company's overall reporting practices.

That is why we believe it is important for contributors to use the expertise of its regulatory counsel or consultants to help justify material changes in advance of one's receipt of a USAC request for information (or immediately upon receipt of such a request). In our experience, a request for information is often the first step toward a formal audit, and a company that responds too quickly and too carelessly to a USAC request for information without consulting its counsel or consultants risks providing misguided information to USAC that cannot be easily pulled back or explained away.

Several types of changes to a contributor's 499 filings have a high likelihood of being flagged as material. For example, a contributor that starts reporting revenue where there was no revenue in previous quarters or years risks being flagged by USAC. The inverse is also likely a material change if a contributor stops reporting revenue where previously it had reported revenue. Contributors that shift major revenue amounts from one box to another (for example, from interstate to international revenue) also may be flagged as material changes by USAC's database analysis. And changing the company's designation of service types in Line 105 can also trigger a USAC reaction.

In general, if a contributor makes a material change to any part of its 499 filing from one period to the next, the contributor will likely receive a request for information from USAC regarding the nature, purpose and background supporting the change.

## **ii. STEP TWO: Follow-Up Requests for Information by USAC Staff**

After a contributor responds to USAC's initial request for information, USAC's staff will review the response and can request additional information if the staff feels the initial response was unsatisfactory. In addition to the initial response, USAC may use a contributor's responses to the staff's follow-up questions against the contributor in a subsequent audit. USAC takes the responses a contributor gives to its questions seriously and often relies on the responses in making its audit decision even if the actual evidence produced in the audit shows the contributor complied fully with the rules.

As with the first step in the information request process, it is critical for a company to use the expertise of a firm with significant experience in dealing with USAC to respond to additional requests for information. While it might be easy to respond quickly to a seemingly simple question sent by USAC in a "canned" email, USF rules and filings are highly complex, and USAC may be seeking information as part of a larger review to build its case for an audit. Engaging with counsel early in the process can help minimize the risk of an audit or help prepare for and mitigate an adverse audit finding.

### iii. STEP THREE: The Audit Process

USAC typically uses two types of audits to review a contributor's filings and require changes to the filing. The first option is a desk audit. A desk audit is a less formal process in which a member of USAC's staff will review the information provided by a contributor. The information the staff reviews will consist of 499 filings, information provided to USAC in response to requests for information, and other information, both publicly available and data that is only visible to USAC (through its database, which contains data from all registered service providers). USAC's use of private data is particularly a concern for wholesalers seeking to exempt revenue sold to resellers by reporting revenue in Block 300 of the Form 499-A. Based on this information, the staff may order a contributor to make changes to its filing to bring the filing into compliance with the rules.

The second option is a formal audit by USAC. Formal audits can last up to a year or more and involve significantly more investigation by USAC's staff into a contributor's business operations and filings, including extensive site visits and follow-ups. Formal audits often involve multiple requests for information by USAC. USAC might also request that a contributor produce documents for USAC's review during a formal audit. A contributor also can provide a response to USAC's draft findings before USAC issues a final audit decision that is appealable to the FCC.

While a formal audit decision by USAC is appealable, the appeals process is uncertain, lengthy, and complex. The FCC's rules require the Wireline Bureau to take action on a USAC appeal within 90 days.<sup>6</sup> If the Bureau does not overturn USAC's decision, a contributor would have to seek reconsideration by the Commission before it could challenge the FCC's decision in the court. However, the Commission has allowed some USAC audit appeals to languish for years, some date back to 2005. The endless appeal process effectively robs contributors of the opportunity to challenge USAC's expansion of its authority in court and can ensnarl companies in a state of perpetual limbo and financial risk.

Moreover, USAC's "pay and dispute" policy requires a contributor to pay all outstanding invoices prior to disputing an order to avoid continued accrual of interest and penalties (which can be substantial).<sup>7</sup> The pay and dispute policy means a contributor must contribute to the USF on revenue potentially not subject to contribution obligations during the pendency of its appeal, or it risks liability for interest and penalties accrued during its appeal if it loses.

### C. Conclusion

USF compliance is among the most complex areas of regulation in the highly regulated communications industry. Therefore, our firm routinely advises clients not to answer questions from USAC without consulting counsel with significant experience in advising clients on matters involving USF contributions and USAC audits. A question in a USAC request for information may appear simple, and USAC often includes a deadline (1 week for example) for response in its request. However, an attorney who deals with USAC regularly will often be able to advise a client on why

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<sup>6</sup> 47 C.F.R. § 54.724.

<sup>7</sup> *In re Universal Serv. Contribution Methodology*, 23 FCC Rcd. 17903, 17907 (2008).

USAC is interested in the information it is requesting and provide a response to USAC prior to the deadline that allows a contributor to more thoroughly consider USAC's request and prepare an appropriate response.

If you are concerned about your company's FCC Form 499 / USF compliance profile and want to achieve greater peace of mind, contact [The CommLaw Group](#) today and inquire about our [USAC Compliance, Audit Preparation and Defense Practice](#).

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