

2016

Audit of the Oklahoma Universal Service Fund

Submitted to the
Public Utility Division
of the
Corporation Commission of the State of Oklahoma

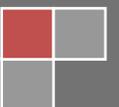
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November 4, 2016



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Introduction

The Ostrander Group conducted an operational audit of the Oklahoma Universal Service Fund, and this Report focuses on recommendations and points for future consideration related to the audit of the Fund Administrator, Schools and Carriers, and Fund Manager Graeper, VanNoy and Wagner (“GVNW”). These value-added recommendations will improve efficiency, controls, and accountability of the administrative and operational functions of the Oklahoma Universal Service Fund (“OUSF”), and also serve to individually benefit the Public Utility Division (“PUD”) and entities receiving funding from the OUSF. These recommendations should be considered in concert with certain financial audit and management letter recommendations of Arledge & Associates, P.C. (“A&A”).

Purpose of Audit

The PUD’s Telecom department administers the Oklahoma Telecommunications Act, which established the Oklahoma Universal Service Fund (“OUSF”). The primary purpose of the OUSF is to ensure reasonable and affordable internet access is available to schools and libraries, and that telemedicine services are available to eligible healthcare entities. The carriers providing these services seek reimbursement from the OUSF. The OUSF supports three primary programs: special universal services, primary universal services; and Oklahoma lifeline (legally, the Oklahoma Lifeline Fund is a separate fund, but due to its comparatively small size it is maintained within the OUSF).

The Ostrander Group¹ was contracted to conduct an independent operational audit of the OUSF to evaluate those three primary entities (also referred to as the three “focus areas”) that substantially influence and impact the operations and outcome of the OUSF as set forth below:

- 1) Audit of Fund Administrator - PUD.
- 2) Audit of Schools and Carriers.
- 3) Audit of Fund Manager - GVNW.

The overall objective was to evaluate procedures, policy, and actions of the three primary entities to identify significant and relevant concerns in order to help ensure the OUSF is operating efficiently, reasonably, and in the public interest.

The audit scope of all three focus areas overlap to some degree and matters regarding the Fund Administrator are also addressed in the Audit of Schools and Carriers and the Audit of the Fund Manager.² The audit scope was developed with input from the PUD, although discretion was

¹ The Ostrander Group is independent, does not have any conflicts of interest regarding this engagement, and does not perform work for the: a) utility industry or the carriers providing services to the schools; b) schools and their related associations and boards, or c) the Fund Manager.

² In addition, Mr. Ostrander acted as an independent agent in hiring and administering the engagement letter (the contractual obligations) related to the independent certified public accounting (“CPA”) firm Arledge & Associates, P.C. to perform audits of the financial statements of the OUSF for fiscal years ending June 30, 2013, 2014, and

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reserved for the Ostrander Group to perform specific audit steps and procedures as they deemed fit to meet the overall objectives of the audit of the three focus areas. It is very important to emphasize that an over-riding and consistent principle throughout this entire audit process has been the PUD giving the Ostrander Group independent and objective discretion to perform necessary audit procedures to meet the overall objectives, such that the PUD does not unduly influence or interject themselves into the audit process or materially impact final recommendations.

Carriers and Schools Subject to Audit

The scope of this audit included four (4) carriers and three (3) schools. The specific carriers and schools were selected at the discretion of the Ostrander Group, although the PUD recommended that we select three to four carriers and schools for review. The Ostrander Group selected the various carriers and schools based on varying factors to get a broad representation of entities, including small and larger entities, entities drawing various levels of funding from the OUSF (and from various funds of the OUSF), various regions of the state, different types of carriers (incumbent rural local exchange carrier, cable company, and others), and carriers which our research showed may have been subject to historical concerns or had recent or pending issues of interest addressed in Commission Orders. Our selection of carriers and schools changed over time as additional or new information and concerns came to our attention as part of our audit process.

All audits of carriers and schools were conducted on-site at the entities business premise, and we interviewed key management and representatives capable of answering our questions at that time without delay (although sometimes follow-up questions were necessary). Most of the audits involved requesting and collecting various documentation from the carriers and schools as issues arose during the discussions, and voluminous data was subsequently provided electronically. The goal was to perform “surprise” audits, such that minimal advance notice was given to carriers and schools before the Ostrander Group arrived on premise for the audit interview. This approach helps ensure more credible, spontaneous and unrehearsed responses. The carriers and schools were given some general idea of what audit discussions would entail, although detailed questions were reserved for the on-site discussion.

The audits of carriers was performed first, so that certain discussion points with the carriers could be confirmed or evaluated in the context of subsequent discussions with schools (in those cases where the schools used that particular carrier to provide services).

2015. It was the desire of the PUD that the audit engagement be conducted under foremost scrutiny and objectivity without any undue influence of the PUD or OUSF. Therefore, Mr. Ostrander acted as an intermediary to preserve such objectivity and independence, and he selected and hired the CPA firm, provided oversight for audit engagement, administered the engagement letter, and was the primary point of contact for issues during the audit engagement. Mr. Ostrander did not perform any audit functions for A&A, was not an agent or contractor to A&A, and has never had any previous contact or association with A&A.

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Evolution of the Fund Administrator Responsibilities

The procedures and policy impacting the OUSF continues to rapidly evolve over time as changes in legislation, the E-rate program, technology and services, internet capability and demand, and the related significant increase in the size of the OUSF³ (in terms of dollars) all impose increasingly new and challenging responsibilities upon the PUD's⁴ administration of the OUSF. In this constantly evolving environment, the PUD must react swiftly and professionally to efficiently administer millions of dollars of Oklahoma universal service funds to benefit the public in general, the at-risk poverty population, schools, libraries, and telemedicine beneficiaries.

When the Ostrander Group began this audit process the PUD had recently started relying primarily on a policy of "lowest cost reasonable bid" to select the carrier to receive OUSF funding for schools and telemedicine. During our audit interview process, most carriers and schools expressed strong concerns with the "lowest reasonable cost" policy and other PUD and Commission policies and practices. However, near the end of our interview process with carriers and schools, House Bill No. 2616 ("HB 2616") was adopted by the Legislature and signed into law by the Governor on May 9, 2016 (and related emergency rules were adopted by the Commission effective August 12, 2016).⁵

Essentially HB 2616 substantially satisfied the concerns that were expressed to us by carriers and schools, although we make no value judgment on these rules or any related benefits or detriments. The relevant point is, if our report had been issued prior to the May 2016 enactment of HB 2616 (or without considering the related rules adopted by the Commission in August 2016), it would look substantially different because it would have addressed these concerns of carriers and schools in part with balanced consideration of the PUD's obligations and responsibilities. These industry concerns are now moot in regards to our report at this time because of the adoption of HB 2616, and so it is not necessary to address these related matters in this report.

Because the PUD is still in the process of implementing changes to address the requirements of HB 2616, our audit focused primarily on the policies and practices of the Fund Administrator for the period prior to the enactment of HB 2616. However, the adoption of HB 2616 does not impact the recommendations in this report. It is anticipated that the next audit process will address the changes necessitated by the requirements of HB 2616.

³ The significant increase in OUSF support for special universal services in recent years (and the related increase in entities providing the related services) is particularly challenging.

⁴ The terms "PUD" and "Fund Administrator" are used interchangeably, but intended to refer to the same entity.

⁵ HB 2616 provided significant changes to Title 17, Sections 137.3 and 139.101 to 139.109, and adopted Title 17, Section 139.109.1.

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Audit Recommendations and Recommended Points for Future Consideration

There is a distinction between “audit recommendations” and “recommended points for future consideration” in this Report, although in this case neither of these recommendations reflects a violation of any specific statute or internally documented operating practices. In both cases, the recommendations reflects industry best practices that should be adopted and implemented as soon as possible.

The audit recommendations reflect an enhancement to existing internal OUSF procedures which will impact upon reporting by carriers. And although this audit recommendation places an additional reasonable and non-burdensome reporting responsibility upon carriers, the result is an improvement in the OUSF’s operating efficiency and internal control processes.

The recommended points for future consideration reflect new procedures or additional documentation that should be implemented by the OUSF, although these measures have no direct impact on carriers or other beneficiaries of the OUSF. The points for future consideration will also result in an improvement in the OUSF’s operating efficiency and internal control processes, and are also more consistent with industry best practices. Some of these points of consideration may take a longer time period to implement.

Audit of Fund Administrator and Schools/Carriers

There are various recommendations that are in part related to the audit of the processes and policies of the Fund Administrator and which will be addressed in other parts of this report. However, this section of the report will address the global recommendations regarding the joint audit of the Fund Administrator and Schools/Carriers, and which included a primary focus on the OUSF pay-out or distribution process.

In general, there have been significant strides of improvement in the PUD’s administration of the OUSF since the problems identified in the Oklahoma State Auditor & Inspector’s (“State Auditor”) Audit Report⁶ for the time period July 1, 2012 through June 30, 2013, and even the State Auditor’s Report acknowledges that the PUD was starting to turn the corner towards improvement at that time. Our audit did not identify any of the same significant underlying fundamental problems regarding documentation and related internal control implications as identified in the State Auditor’s Report. In fact, supporting documentation and related internal controls are now a fundamental underlying strength of the current PUD’s administration processes and policies.

We strongly support the recommendations in this report that will continue to provide for improvement in internal controls, accountability, and efficiencies - - although we are beyond the

⁶ The report is officially titled, “Audit Report of the Oklahoma Corporation Commission Oklahoma Universal Service Fund – Special Universal Services.”

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point of having to address fundamental underlying problems as identified in the prior State Auditor's Report. It is also worth noting that the management letter recommendations of the CPA firm Arledge & Associates, P.C. did not identify any fundamental problems linked to the Fund Administrator's underlying responsibilities or processes.

Our review of Fund Manager GVNW did result in a recommendation to implement a formal written policies and procedures manual, although this primarily relates to documentation of the responsibilities, policies and procedures of GVNW. This is the closest recommendation relating to fundamental underlying documentation, although it primarily relates to the processes of Fund Manager GVNW and not to the fundamental disbursements process and the carrier selection/pricing evaluation process of the Fund Administrator.

In total, our audit of the Fund Administrator did not disclose any material problems or concerns that bear on the day-to-day operations and procedures of the OUSF.

Recommendations – Audit of Fund Administrator and Schools/Carriers (“FASC”)

The recommendations related to the audit of the FASC are set forth in this section.

FASC-R1 - Recommendation 1-2016: The PUD (or GVNW) Should Routinely Monitor and Publicly Disclose Those Carriers/Schools Not Receiving E-Rate Funding

Process: The PUD (or GVNW) does not routinely identify Oklahoma carriers/schools that are not receiving federal E-rate funding for consideration of other potential bidders. This could be an indication of Universal Service Administrative Company (USAC) concerns or problems that might also justify temporary suspension or permanent revocation of OUSF funding for these same carriers/schools. If there are violations by carriers, schools, or related consultants that cause temporary or permanent suspension of federal E-rate funding, then these same issues are likely to be relevant for consideration of OUSF funding, pending resolution of the matters.

Recommendation:

- 1) The PUD should revise Commission rules to require that the OUSF Administrator be notified by carriers of individual incidents within 60 days of a temporary suspension or permanent revocation of their E-rate funding.
- 2) The PUD should post any temporary suspension or permanent revocation of either E-rate funding or OUSF funding resulting from fraud to its public website so this information is available to schools and other parties with a vested interest in being aware of this information, because it could impact the decisions that schools make regarding a selection of a carrier (and impact the PUD's evaluation or approval of these carriers).

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The Administrator monitors activities regarding USAC as it relates to carriers providing internet access and telemedicine facilities to Oklahoma schools, libraries and healthcare providers. The Administrator is aware of a number of USAC investigations currently in progress and in fact the USAC investigation of two Oklahoma companies being investigated is the result of the Administrator advising USAC of various anomalies associated with universal service funding issues associated with these companies. The Administrator has regular direct communications with USAC as part of ongoing investigations but does not make those ongoing investigations public until cleared to do so.

1. The OUSF Administrator supports the suggested revision to Commission rules and is including the suggestion in the current rulemaking process.
2. The OUSF Administrator supports the recommendation to post fraud related suspension to the PUD website for ease of public access.

Recommended Points for Future Consideration – Audit of Fund Administrator

The recommended points for future consideration related to the audit of the FA are set forth in this section.

1. Implement Voluntary Code of Ethics for Marketing and Promotional Practices for Industry Participants.
2. The PUD Should Continue to Offer Training Seminars to Schools and Other Industry Entities.

Audit of Fund Manager GVNW

The Ostrander Group conducted an operational audit of Fund Manager GVNW at their Springfield, Illinois offices during the week of July 11th.

Recommended Points for Future Consideration – Audit of Fund Manager (“FM”)

The recommended points for future consideration related to the audit of the FM are set forth in this section.

1. Implement a Formal Written Policies and Procedures Manual between the OUSF and GVNW.

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2. The future Fund Manager Contract Should Be Specific and Detailed and Reference the Operations Manual.
3. A Formal Uncollected Revenue Policy Should be Implemented.
4. The Fund Administrator Should Provide an Annual Performance Grading of the Fund Manager.

This concludes this Report.