

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services**

AUDIT REPORT

Report No. 15-AUD-02-01

August 21, 2018



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Table of Contents

EXECUTIVE SUMMARY	1
BACKGROUND	3
OBJECTIVES, SCOPE, AND METHODOLOGY	4
AUDIT RESULTS.....	6
AEE REIMBURSED FOR UNNECESSARY EXPENSES	6
OTHER MATTER.....	9
APPENDIX A - ADDITIONAL DETAILS ON AUDIT METHODOLOGY.....	13
APPENDIX B - AUDITEE’S RESPONSE TO DRAFT AUDIT REPORT.....	15
APPENDIX C - AEE WAIVER PETITIONS.....	26
APPENDIX D - ACRONYMS AND ABBREVIATIONS	27
APPENDIX E - GLOSSARY.....	28



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

EXECUTIVE SUMMARY

The Federal Communications Commission (FCC or Commission), Office of Inspector General (OIG) conducted a performance audit of Adak Eagle Enterprises (AEE), LLC; a beneficiary of the Universal Service Fund (USF) High Cost Program. AEE is a holding company in Anchorage, Alaska and, through an affiliate company, Adak Telephone Utility, provides FCC regulated telecommunication services in remote locations in Adak Island, Alaska. AEE's affiliate companies also provide services that are not regulated by the FCC, including wireless telephone, cable television, and broadband internet.

We conducted the audit in accordance with Generally Accepted Government Auditing Standards - except for internal control testing, as explained below - contained in *Government Auditing Standards* (Yellow Book) issued by the Comptroller General of the United States, December 2011 revision. 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.

We determined that AEE's internal control policies and procedures for accounting for its corporate operations and common costs were not reliable, and thus we did not test or rely on those internal controls. In 2015, the FCC issued a final denial order in response to AEE's 2012 Waiver Requests because AEE submitted unsubstantiated, questionable, or unreasonable corporate related expenses in its regulatory rate filings with the Commission. Therefore, we focused on testing AEE's corporate expenses and related transactions, without regard to AEE's internal controls that may be in place and relied upon by other parties.

The objectives of the audit were to determine (1) the appropriateness of AEE's past and projected allocations of corporate expenses among its regulated¹ and non-regulated entities, (2) whether AEE's related party transactions were in compliance with FCC regulations, and resulted in appropriate cost reimbursements from the USF, and (3) whether AEE's representations made to the FCC during the course of its waiver petition process were materially accurate. Because we did not test AEE's controls over financial reporting, we did not make any conclusions and are not reporting on those controls. We did not obtain sufficient audit evidence to make any conclusions or report on objectives two and three. Additional details explaining our curtailment of our audit work on those objectives are discussed in Appendix A.

Our audit found that AEE claimed [REDACTED] of expenses that, according to FCC rules, were ineligible for reimbursement from the USF. Additional details are provided in the Audit Results Section of this report. We also found that AEE may not have followed FCC cost allocation rules

¹ Regulated telecommunications products and services are fully subject to the accounting and rate of return ratemaking requirements specified in Title II (common carrier regulation) of the Communications Act of 1934.



USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01

when allocating common costs. Our observations and conclusions regarding AEE's allocation of common costs are discussed in the Other Matter section of this report.

The FCC and USAC management did not comment on the finding and Other Matter discussed in this audit report. AEE responded to the findings through their attorney, stating that they generally did not agree with the results of the audit. AEE's attorney stated that AEE's response to the audit report findings is confidential and not for public inspection.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

BACKGROUND

AEE is a holding company² headquartered in Anchorage, Alaska, and provides telecommunication services on Adak Island, Alaska. The island is located approximately 1,200 miles southwest of Anchorage in the Aleutian Islands. AEE’s Chief Executive Officer (CEO) and founder is the sole member of the holding company. AEE’s affiliate companies include Adak Telephone Utility (ATU), Windy City Cellular (WCC), Windy City Broadband (WiCB) and Adak Cablevision (ACV). See Table 1 below for information on AEE’s affiliate companies, including services provided, and whether the company is regulated³ or non-regulated.

Table 1. AEE’s Regulated and Non-Regulated Companies

Company Name	Service Provided	Company Type
Adak Telephone Utility (ATU)	Wireline voice	Regulated
Windy City Cellular (WCC)	Mobile voice and data	Non-regulated
Windy City Broadband (WiCB)	Internet	Non-regulated
Adak Cablevision (ACV)	Television	Non-regulated

Because AEE is geographically located in a remote study area⁴ - study area code 610989 - it received high cost subsidies from the USF. AEE’s non-regulated companies provide competitive services that are not tariffed⁵, and are not eligible for USF High Cost Program support. ATU, which is wholly owned by AEE, is a regulated company, or tariffed, and subject to FCC rate making requirements. AEE (on behalf of its regulated entity, ATU) is, thus, eligible for Universal Service Fund (USF) High Cost Program support.

In 2011, the FCC issued a reform order that established a cap of \$250 monthly, per line, for High Cost Program universal service support (or high cost subsidy). Every year since the 2012 implementation of Connect America Fund, AEE has received high cost subsidy exceeding the \$250 per month (or \$3,000 annual) cap⁶ set by the FCC for each land-based telephone line. In 2012, AEE

² A holding company is one that exists solely to hold a percent of the total stock of another company, or multiple companies, in an attempt to diversify or expand by acquisition. Holding companies reduce the risk of owners and allow the ownership of multiple companies.

³ Regulated telecommunications products and services are fully subject to the accounting and rate of return ratemaking requirements specified in Title II (common carrier regulation) of the Communications Act of 1934.

⁴ A study area is, typically, a telephone company’s service area within a particular State. Study areas and service areas, as defined by regulation, are relevant to FCC subsidy programs for telephone companies.

⁵ Documents filed by a regulated telephone company with a state public utility or the Federal Communications Commission. The tariff, a public document, details services, equipment and pricing offered by the telephone company (a common carrier) to all potential customers.

⁶ Beginning July 1, 2012, the monthly per line limit on High Cost Program universal service support was \$250 monthly or \$3,000 annually.



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

filed a petition with the FCC requesting a waiver of the high cost subsidy cap, stating that a higher amount of subsidy was required for ATU and WCC to maintain their operations. The High Cost Program identical support rule allows AEE's non-regulated wireless carrier, WCC, to receive the same per-line support as its rural carrier, ATU, based on ATU's costs. FCC granted both entities interim support at amounts above the cap, but lower than the amounts requested by AEE, pending the FCC's further review of AEE's petition. FCC granted ATU and WCC additional monthly support of \$33,276 and \$40,104 (above and beyond the \$250 monthly support cap per land line), respectively.

In a July 2013 Order, FCC's Wireline Competition Bureau (WCB) and Wireless Telecommunications Bureau (WTB) denied AEE's request for continued support above the High Cost support cap of \$250 per line, per month. However, AEE petitioned the FCC for reconsideration, and on February 28, 2014, FCC reinstated the higher support amounts (discussed above) for an additional eight months. In its petition for reconsideration, AEE stated it had implemented significant cost reduction measures to address FCC's concerns regarding excessive corporate expenses.

In May 2015, FCC ultimately denied AEE's petition of reconsideration and request for continued interim support above the High Cost monthly \$250 per line cap for both ATU and WCC. See Appendix C for a timeline detailing AEE's waiver petitions and FCC's rulings on AEE's requests for additional support.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine (1) the appropriateness of AEE's past and projected allocations of corporate expenses among its regulated and non-regulated entities, (2) whether AEE's related party transactions were in compliance with FCC regulations, and resulted in appropriate cost reimbursements from the USF, and (3) whether AEE's representations made to the FCC during the course of its waiver petition process were materially accurate. We did not obtain sufficient audit evidence to make conclusions for objectives two and three. Therefore, we are not reporting on those objectives. Additional details explaining the rationale for our curtailment of the audit work for objectives two and three are discussed in Appendix A.

We conducted the audit in accordance with Generally Accepted Government Auditing Standards - except for our limited internal control testing, as explained below - contained in *Government Auditing Standards* (Yellow Book) issued by the Comptroller General of the United States, December 2011 revision. 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.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

In May of 2015 WCB denied AEE's Waiver Request because of the high amounts of corporate related expenditures that were unsubstantiated and, therefore, questionable. WCB's determination that AEE's costs appeared to be excessive, and not consistent with FCC regulations and orders, contributed to our decision not to test or rely on AEE's internal controls. Therefore, we focused our testing on AEE's corporate expense transactions, without regard to AEE's internal controls that may be in place and relied upon by other parties.

We audited AEE's compliance with the FCC regulations and orders governing High Cost Program support, set forth in 47 C.F.R., Part 32, Part 36, Part 5, and Part 64; collectively referred to as the FCC rules. The audit period covered AEE's financial activity from January 2012 through June 2015. We did not make a site visit to perform physical observations or on-site testing at AEE's offices or other facilities located in Anchorage or Adak Island, Alaska. Further, our audit did not include an examination of AEE's wired and wireless telecommunications, internet, cable television or other non-regulated operations.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

AUDIT RESULTS

Our audit identified [REDACTED] of unnecessary expenses⁷. Our observations and conclusions regarding AEE's allocation of common costs are discussed in the Other Matter section of this report.

The FCC and USAC's management declined to comment on the finding and Other Matter. AEE responded to the findings through their attorney, stating that they generally did not agree with the results of the audit. AEE's attorney stated that AEE's response to the findings in the audit report is confidential and not for public inspection.

AEE REIMBURSED FOR UNNECESSARY EXPENSES

CONDITION

Our audit found that AEE reported [REDACTED] of expenses to the Universal Service Administrative Company (USAC) for USF reimbursement, even though the expenses were defined as unnecessary and, thus, prohibited by FCC rules and Public Notices. Those expenses included family travel, gifts, donations, tuition reimbursement, and special events; costs which were not necessary for maintaining and extending telecommunications services. AEE disagreed with our audit finding and asserted that Public Notice FCC 15-133, which was released in October 2015, should not be applied retroactively to expenses AEE claimed prior to that date. However, the Public Notice serves only as a reminder to High Cost Program beneficiaries, and further clarified FCC High Cost Program rules - provided in 47 C.F.R., Section 254 (e) - that were already in existence when AEE claimed the unnecessary costs.

We reviewed AEE's corporate operations expenses (COE) and other common expense items⁸ claimed during the audit period, January 2012 through June 2015, to identify any questionable or unallowable items or costs. We selected 65 sample items from that period, totaling [REDACTED], to test for AEE's compliance with FCC rules and the adequacy of AEE's supporting documentation. We judgmentally selected a sample of large expenditures that appeared to be unrelated to the purposes of maintaining or extending communications service to rural, high-cost areas, and thus deemed unnecessary. From the 65 sample items selected, we found [REDACTED] of expenses that we determined to be unnecessary. Those unnecessary items included [REDACTED] of travel and training expenses and [REDACTED] of miscellaneous expenses.

⁷ Per FCC 15-133, USF High Cost recipients are obligated to use support only for its intended purposes of maintaining and extending communications service to rural, high-cost areas of the nation.

⁸ AEE's COE consisted of executive compensation, accounting and finance, external relations, human resources, and general and administration expenses. AEE's other common costs consisted of land and buildings expense, general purposes computers, and office equipment.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Unnecessary Travel and Training Expenses

In its waiver petitions filed with the FCC, AEE claimed that it had largely eliminated travel and training expenses. However, from our sample of 65 items, we identified 25 items relating to travel and training costs, totaling [REDACTED], that warranted further examination. We found that 15 of those 25 items, totaling [REDACTED], were unnecessary expenses. [REDACTED]

[REDACTED]

[REDACTED] We determined that those travel expenses were also unnecessary and, thus, not appropriate for reimbursement through high cost support.

Unnecessary Miscellaneous Expenses

We found that 24 of the 65 sample items we tested, totaling [REDACTED], were unnecessary miscellaneous expenses. Those expenses were not for the purpose of maintaining and extending telecommunications services, and, thus, are prohibited by FCC High Cost Program rules. Details on the expenses are provided in Table 2, below.

Table 2. Unnecessary Miscellaneous Expenses

Description of Expense	Amount
[REDACTED]	[REDACTED]
Total	[REDACTED]

CRITERIA

According to 47 C.F.R. Part 54.7, carriers that receive support from the USF High Cost Program must use it only for its intended purpose of maintaining and extending telecommunications services. In October 2015, the FCC issued a Public Notice (FCC 15-133) reminding High Cost beneficiaries of this requirement and listed examples of prohibited expenses.

[REDACTED]

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

CAUSE

AEE management did not ensure that its policies and procedures for accounting and reporting COE expenses were implemented in a manner to ensure compliance with FCC High Cost Program rules provided in 47 C.F.R. Part 54.7. Therefore, AEE submitted expenses that were not necessary for maintaining and extending universal telecommunications service.

EFFECT

AEE received High Cost Program support for ineligible expenses because it submitted expenses in its regulatory filings to USAC⁹ that were not related to the provision or extension of supported telecommunication services.

RECOMMENDATIONS

We recommend that WCB direct USAC to:

- 1) Require AEE to implement accounting procedures and internal controls that ensure only expenses that are necessary for purpose of maintaining and extending telecommunications services are submitted to USAC for universal service support.
- 2) Examine AEE's expenses, totaling [REDACTED], that we found to be unnecessary and prohibited, and recover any USF overpayments related to those expenses. Review a sample of other expenses that are outside of the scope of our audit and recover any USF reimbursements related to ineligible expenses.

MANAGEMENT'S RESPONSE:

The FCC and USAC management did not comment on the finding.

BENEFICIARY'S RESPONSE:

AEE's response, submitted through their attorney, provided a number of reasons for not concurring with the existence of, or the amount of, unnecessary costs found in the audit. AEE disputed whether the criteria is applicable and whether all of the unnecessary expenses found by the audit were allocated to the regulated entity. Nonetheless, AEE offered to reimburse the USF and requested the "opportunity to repay under terms of a mutually agreed-upon installment plan the High Cost Support it received from the USF based on the portion of the costs reported by the regulated entity and

⁹ **Universal Service Administrative Company (USAC)** – administers the four Universal Service Fund (USF) programs and collects monies for the fund under the direction of the FCC. Carriers submit cost data to USAC, which is used to determine the amount of High Cost support.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

determined by the OIG or USAC to have been unallowable”. AEE concurred with Recommendation no. 1, and stated that AEE will continue to work with its auditing firm and cost consultant to ensure that its accounting procedures and internal controls comply with USF program rules. AEE’s complete response is included in Appendix B.

AUDITOR’S RESPONSE:

We reviewed AEE’s response but did not find any cause to revise our finding. We continue to hold that the criteria is valid, as noted in the report. Also for our review we only selected costs that were fully allocated to the regulated entity. AEE did not provide any additional information in its management response to justify any of the costs found to be unnecessary costs in the audit.

OTHER MATTER

Our audit determined that AEE’s methodology for allocating COE and other common costs was not consistent with FCC’s cost allocation rules. AEE’s COE consisted of executive compensation, accounting and finance, external relations, human resources, and general and administration expenses. AEE’s other common costs consisted of land and buildings expense, general purpose computers, and office equipment. The FCC rules require telecommunication providers receiving High Cost Program support to allocate their COE and other common costs among regulated and non-regulated activities using one of three alternatives, in the following hierarchal order: directly, indirectly with a causative link, or indirectly using a general allocator¹⁰.

AEE stated that they used the general allocator for allocating its COE and other common costs. However, our audit concluded that AEE did not comply with FCC rules when computing its general allocator. Our audit testing showed that AEE departed from the FCC rule because AEE computed its general allocator based on the ratio of **all common costs assigned** to regulated and non-regulated activities. The FCC rules require that the general allocator be computed using the ratio of **all costs directly assigned** to regulated and non-regulated activities.

Table 3, below, describes the components of the general allocator ratio, and compares the results of the allocations using the FCC’s rule, to the results using AEE’s allocation methodology, which departs from the FCC rule.

¹⁰ 47 C.F.R. § 64.901 (b)

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Table 3. Comparison of General Allocator Ratios (per FCC rules versus AEE’s methodology)

Components of General Allocator Ratio				Results of Common Cost Allocations	
Allocation Method	Column A	Column B	Column C	To Regulated Activities	To Non-regulated Activities
Per FCC Rule	Direct Costs of Regulated Activities	Direct Costs of Non-regulated Activities	Total Direct Costs	Columns A/C x Common Costs to be Allocated	Columns B/C x Common Costs to be Allocated
Per AEE's Methodology	Common Costs Assigned to Regulated Activities in Prior Year	Common Costs Assigned to Non-regulated Activities in Prior Year	Total Common Costs Allocated in Prior Year	Columns A/C x Total Common Costs to be Allocated	Columns B/C x Total Common Costs to be Allocated

In accordance with FCC rules the beneficiary must allocate expenses based on the allocation hierarchy identified in the Rules as follows:

47 C.F.R. § 64.901(b) (2) “Costs shall be directly assigned to either regulated or non-regulated activities whenever possible”.

47 C.F.R. § 64.901(b) (3) “Costs which cannot be directly assigned to either regulated or non-regulated activities will be described as common costs. Common costs shall be grouped into homogeneous cost categories designed to facilitate the proper allocation of costs among a carrier’s regulated and non-regulated activities. Each cost category shall be allocated between regulated and non-regulated 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 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 non-regulated activities.

In its October 26, 2016 response to OIG’s inquiries about AEE’s COE cost allocation methodology, AEE stated that it used a modified cost allocation methodology because the FCC rule is confusing and susceptible to multiple interpretations. AEE’s comments are excerpted below:



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

“AEE believes the rule could be read a number of ways. For example, the rule could be interpreted to mean that the general allocator should take into account the costs *directly* assigned or attributed under Section 64.901(b) (2). Alternatively, one could determine that because subsection (3) is focused in its entirety on calculating the allocation of common costs, the general allocator should be computed using the ratio of total *common* expenses previously directly assigned or attributed to regulated and nonregulated entities under Section 64.901(b)(3)(i). AEE adopted the latter interpretation. AEE does not have common costs that can be directly assigned under 64.901(b) (3) (i). Instead, the Company modified its calculation, basing the computation of its general allocator on its total common expenses, composed of labor costs, benefits, and overhead declared in the previous year. AEE understands based on NFR-2 that OIG has adopted the former interpretation of the rule, and the Company agrees at this time that OIG’s interpretation may be more reasonable.”¹¹

AEE’s cost allocation methodology did not comply with FCC rules. The methodology overstated COE and other common costs allocated to AEE’s regulated company. As a result, AEE received more High Cost support than allowable per FCC rules. Table 4, below, compares the COE allocations using AEE’s versus the OIG’s interpretation of the general allocator rule, and shows the amounts that the OIG determined to be over-allocated to AEE’s regulated entity, ATU. We did not have enough information to perform the similar comparisons of AEE’s allocations for any common costs other than COE. Therefore, we could not accurately compute the total amount of the overpayments.

Table 4. COE Allocation Calculated using FCC Rules versus AEE Methodology

Calendar Year	Activity	Amount Allocated Per AEE's Interpretation	Ratio Per AEE Method	Amount Allocated Per OIG's Interpretation	Ratio Per OIG Method	Amount Over-Allocated to AEE's Regulated Entities
2013	Regulated	████████	████████	\$569,828	59.0%	████████
	Non-regulated	████████	████████	\$395,981	41.0%	
	Total 2013	████████	████████	\$965,809	100.0%	
2014	Regulated	████████	████████	\$709,492	65.0%	████████
	Non-regulated	████████	████████	\$382,034	35.0%	
	Total 2014	████████	████████	\$1,091,526	100.0%	

¹¹ NFR-2 refers to FCC OIG’s Notice of Finding and Recommendation, or draft audit finding, no. 2.



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

OIG's computations are based on the expenses summarized in AEE's annual audited financial statements. We did not have enough information to perform this analysis for calendar year 2012. Also, because our audit period ended in June 2015, we did not have enough information to analyze costs for the calendar year 2015.

RECOMMENDATIONS

We recommend that WCB:

1. Determine whether AEE's modified cost allocation methodology materially departs from FCC rules, and require AEE to revise its methodology, if appropriate.
2. Direct USAC to recover any USF monies that AEE received as a result of any misallocation of costs among its regulated and non-regulated affiliate companies.

MANAGEMENT'S RESPONSE:

The FCC and USAC management did not comment on the Other Matter.

BENEFICIARY'S RESPONSE:

AEE's response, submitted through their attorney, provided several reasons for disagreeing with the Other Matter. AEE asserts that the FCC rule is confusing and susceptible to multiple interpretations. AEE further asserts that even if its cost allocation methodology is found to be incorrect, the amount of USF overpayment would be negligible. AEE's complete response is included in Appendix B.

AUDITOR'S RESPONSE:

We reviewed AEE's response but did not find any cause to revise our reported conclusions. AEE did not submit any information to show that their modified cost allocation methodology complied with the FCC rule, or support their estimated overpayment. Accordingly, FCC OIG reiterates its recommendations that WCB examine AEE's modified cost allocation methodology and USAC recover any USF monies paid as a result of AEE's misallocations.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

APPENDIX A - ADDITIONAL DETAILS ON AUDIT METHODOLOGY

Objectives, Scope and Methodology

We initiated the performance audit in December 2014 to address questions and concerns raised by the Bureaus (WCB and WTB) regarding AEE's waiver petitions. The audit objectives were to determine (1) the appropriateness of AEE's past and projected allocations of corporate expenses among its regulated and non-regulated entities, (2) whether AEE's related party transactions were in compliance with FCC regulations and resulted in appropriate cost reimbursements by the USF, and (3) whether AEE's representations made to the FCC during the course of its waiver petition process were materially accurate. We did not obtain sufficient audit evidence to make conclusions and report on objectives two and three. We did not perform any audit work on-site or visit AEE's facilities because they are located in remote areas in Alaska and not easily assessable. Performing our audit testing off-site contributed to our inability to obtain sufficient audit evidence to conclude and report on objectives two and three. We included results of our limited audit testing for objectives two and three below. However, we did not make or report any conclusions for those objectives.

We selected a sample of 65 Corporate Operations Expense (COE) and other common expense items from AEE's general ledger for the period January 2012 through June 2015 and tested for compliance with FCC rules for High Cost Program support, provided in 47 C.F.R. § 64.901. The COE samples included various salary and bonus payments made to AEE's executives. Supporting documents for these payments included payroll records and timesheets. Payroll records reflected the number of hours worked; labor accounts charged; and pay for vacation, holiday, and other paid time off. Other sample items reviewed include travel and fringe benefit expenses, such as medical, life insurance, disability insurance, and annual bonus awards.

We selected COE samples from AEE's general ledger accounts to test the accuracy of the AEE's accounting treatment, as well as the allowability of those expenses. We also reviewed COE balances recorded on the AEE's general ledger and reported on its financial statements, to ensure that AEE's COE did not exceed the annual caps established by FCC High Cost Program rules.

We reviewed a sample of AEE's invoices and supporting documentation and tested for completeness. We also selected a sample of National Exchange Carrier (NECA) High Cost mechanism disbursements made to ATU and WCC. We compared those disbursements to WCB and WTB interim support calculations to test the disbursements for accuracy. We reviewed AEE's Cost Allocation Manual and Apportionment Table, and other supporting documentation related to its cost allocation computations. This included a review of AEE's general allocator and its methodology for applying the general allocator to COE and other common costs.

Our analysis included a comparison of ATU's corporate operations expenses reported to NECA from 2010 through 2014, to expenses reported by other similar sized carriers, to determine if ATU's expenses were similar to comparable companies in the industry. We also reviewed and analyzed

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

documentation that AEE provided to FCC during the waiver petition process, detailing the cost reduction measures AEE stated it had implemented and planned to implement to reduce its COE. Those COE reduction measures included staff reductions, as well as reductions in executive pay, general and administrative expenses, and travel and training expenses. AEE’s stated cost reduction efforts also included selling its headquarters building in Anchorage, Alaska, and a boat used on Adak Island, in addition to other initiatives to reduce COE and common costs. Based on our audit tests, we noted that AEE reduced its staff headcount during the period under audit.

We reviewed AEE’s office space costs and its lease agreement with L&A Property, LLC, which is jointly owned by AEE’s CEO and COO. L& A Property, LLC was established in 2007 for the purpose of leasing an office building in Anchorage, Alaska. We reviewed the lease costs to identify any potential violation of FCC’s affiliate transaction rules and conflicts of interest. We also reviewed the lease transactions to determine if they met FCC affiliate transaction rules. We were unable to confirm AEE’s assertions that lease payments and other financial obligations were consistent with market rates. Accordingly, we could not determine whether AEE’s lease services and facility costs (i.e. maintenance, repairs, property taxes, etc.) met requirements established by FCC Rules.

While we did not test intercompany balances, we noted that intercompany receivables due to AEE from its affiliate companies [REDACTED]. We did not test and do not express any conclusions on AEE’s intercompany receivables. See **Table 5** for a summary of receivables due to AEE from its affiliate companies.

Table 5. AEE’s Receivables Due from its Affiliate Companies

Year	Cable TV	Broadband	Cellular	Total
2012	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
2013	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
2014	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
2015	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

APPENDIX B - AUDITEE'S RESPONSE TO DRAFT AUDIT REPORT



April 13, 2018

David L. Hunt
Inspector General
Federal Communications Commission 445
12th Street, S.W.
Washington, DC 20554

Re: Adak Eagle Enterprises, LLC Comments on Draft Audit Report, dated March 23, 2018, Audit Assignment No. 15-AUD-02-01

Dear General Hunt:

On behalf and at the express direction of Adak Eagle Enterprises, LLC (AEE or Company)¹, I the undersigned counsel hereby respectfully submit the Company's comments on the draft Office of Inspector General (OIG) audit report, dated March 23, 2018, in the matter of Federal Communications Commission Limited Scope Performance Audit of Adak Eagle Enterprises USF High Cost Beneficiary -Assignment Number 15-AUD-02-01 (Draft).²

The Draft addresses a single "objective:" to determine "the appropriateness of AEE's past and projected allocations of corporate expenses between its regulated and non-regulated entities."³ In that regard, the Draft makes a single audit finding regarding certain AEE expenses, discussed in the Audit Results section. The Draft also includes "observations and conclusions" regarding AEE's allocation of common costs in the Other Matter section. According to the Draft,

¹ Attached is the Declaration of Andilea Weaver, Chief Operating Officer of AEE. This response was prepared pursuant to her direction, control, and approval.

² See Letter, dated March 27, 2018, from David L. Hunt, Inspector General, Federal Communications Commission, to Adak Eagle Enterprises, LLC, Attn: Larry Mayes, President and CEO (Hunt Letter). Sharon Spencer, Deputy Assistant Inspector General for Audit, by electronic message dated March 30, 2018, extended the time for submitting these comments until April 13, 2018.

³ Hunt Letter, p. 1. "the audit period covered AEE's financial activity from January 2012 through June 2015," a substantially shorter period than the period for which data was provided.⁴

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Squire Patton Boggs (US) LLP

rules -provided in 47 C.F.R., Section 254(e) -that were already in existence when AEE claimed the unnecessary costs."¹¹

Thus, the Draft implicitly acknowledges that the general statutory and regulatory requirement (i.e., that universal service support be used only "for the provision, maintenance and upgrading of facilities for which the support was intended"¹² did not provide clear guidance to AEE and other High Cost recipients on allowable expenses. AEE respectfully submits that the 2015 Public Notice did not provide "further" clarification, but rather *initial* clarification, and that it is unnecessary to clarify things that are clear.¹³ As AEE previously noted – and the Draft does not contest - AEE was unable to find any prior interpretation of this very broad standard and OIG staff confirmed during the August 3, 2016 teleconference with the audit staff that there likely was not one issued by the Commission prior to the release of the 2015 Public Notice.¹⁴

Number 15-AUD-02-01 Notification of Findings and Recommendations, Federal Communications Commission (Office of Inspector Gen. Aug. 26, 2016) (NFR-1), p. 1. The Draft does not explain the reason for these admittedly minor differences in amounts.

¹⁰ Draft, p. 3; *see All Universal Service High-Cost Support Recipients Are Reminded That Support Must Be Used For Its Intended Purpose*, Public Notice, WC Docket Nos. 10-90, 14-58, 30 FCC Red 11821 (2015) (2015 Public Notice).

¹¹ Draft, p. 3 (emphasis supplied). At the time, Commissioners Clyburn and O'Rielly noted that certain expenses not related to the provision of services could still "be permitted under certain readings of our rules." 2015 Public Notice, p.4 (Joint Statement of Commissioners Mignon Clyburn and Michael O'Rielly). In their view, an FCC rulemaking to address these issues was necessary. *Id.* The Commission initiated such a proceeding in March of 2016. *See* footnote 13, *infra*.

¹² 47 United States Code § 254(e); 47 C.F.R. § 54.7(a).

¹³ *See In the Matter of Connect America Fund, ETC Annual Reports and Certifications, Developing a Unified Intercarrier Compensation Regime*, WC Docket Nos. 10-90 and 14-58, CC Docket No. 01-92, Report and Order, Order and Order On Reconsideration, and Further Notice of Proposed Rulemaking, 31 FCC Red, 3087, 3216, 340 (2016) (Rate of Return Reform Order or Rate of Return Reform Further Notice) ("The Commission *recently indicated* that ETCs may not recover certain types of expenses through high-cost support." - referring to the 2015 Public Notice) (emphasis supplied); *see also In the Matter of Connect America Fund, ETC Reports and Certifications, Establishing Just and Reasonable Rates for Local Exchange Carriers, Developing a Unified Intercarrier Compensation Regime*, WC Docket Nos. 10-90, 14-58, 07-135, CC Docket No. 01-92, Report and Order, Third Order on Reconsideration, and Notice of Proposed Rulemaking, FCC 18-29, 17 (2018) (Commission codifies a "simple, clear and carefully defined, non-exclusive list of expenses categories....").

¹⁴ *See* Letter, dated September 2, 2016, from Koyulyn Miller, Counsel for AEE, to Paul Stone, Auditor – USF Program Audits, Office of the Inspector General Federal Communications Commission, Re: NFR

As a result, the 2015 Public Notice, which came out, perhaps not coincidentally, at the end of the audit period, at most could only have been a *reminder* of the general standard, not a reminder that there

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Squire Patton Boggs (US) LLP

were specific categories of expenses -such as those deemed unallowable by the Draft - previously proscribed.¹⁵ Under such circumstances, AEE cannot fairly be held to retroactively applied, clarifying guidance.

Eligible telecommunications carriers may recover costs relating to corporate expenses so long as "those expenses fall within the scope of the statutory requirement that support be used" according to Section 254(e).¹⁶ Based on the information available to the Company at the time, AEE made certain discretionary decisions regarding its expenditures. Given the lack of clarity as to which expenses the Commission would consider reimbursable, the Company respectfully disagrees that it should have known that the Commission would later determine, in October of 2015, these expenses would be unallowable.

Buttressing AEE's position on the purported import of the 2015 Public Notice, we cite to an internal memorandum issued by Attorney General Sessions to all Justice Department (DOJ) components on November 16, 2017 titled, "Prohibition on Improper Guidance Documents," https://www.justice.gov/opa/pres_s-release/file/1012271/download (the Sessions Memo). The Sessions Memo prohibits DOJ components from issuing guidance that purports to bind persons or entities outside the Executive Branch and, in so doing, circumvents the formal rulemaking process. The key language from the Memo is as follows, "...agencies may use guidance and similar documents to educate regulated parties *through plain-language restatements of existing legal requirements* or provide *non-binding* advice on technical issues through examples or practices to guide the application or interpretation of statutes and regulations. But guidance may not be used as a substitute for rulemaking and may not be used to impose new requirements on entities outside the Executive Branch. *Nor should guidance create binding standards by which the Department will determine compliance with existing regulatory or statutory requirements.*" Emphasis added. The Sessions Memo defines "guidance" documents as "instruments of *future* effect," indicating that not only may guidance documents not go beyond the four corners of a rule to create new obligations or additional prohibitions, they also may not be applied retroactively because to do so is effectively to circumvent the rulemaking process. In light of the Session Memo pronouncements, footnote 11, *supra*, bears repeating here. In their statement accompanying the issuance of the Public Notice, even two Commissioners acknowledged that the general rule on permissible expenses as written was open to varying interpretations and that, accordingly, a formal rulemaking was called for. The Sessions Memo was followed on January

Number 1-Unallowable Expenses; Audit Assignment No. 15-AUD-02-01 (NFR-1 Response). We again note that the audit period captures financials as far back as 2012, three years prior to the release of the 2015 Public Notice.

¹⁵ 2015 Public Notice, p.1 ("The Commission reminds all eligible telecommunications carrier (ETCs) that receive support from the Universal Service Fund's high cost mechanisms ...of their obligation to use such support only for ...maintaining and extending service to rural, high-cost areas of the nation.").

¹⁶ *Id.*, p. 2.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Squire Patton Boggs (US) LLP

25, 2018 by one issued by then Associate Attorney General Rachel Brand (the Brand Memo), <https://www.justice.gov/file/1028756/download>. The Brand Memo expands upon the Sessions Memo by prohibiting DOJ's civil litigators from "...treat[ing] a party's noncompliance with an agency guidance document as presumptively or conclusively establishing that the party violated the applicable statute or regulation. That a party fails to comply with agency guidance expanding upon statutory or regulatory requirements does not mean that a party violated those underlying legal requirements; agency guidance documents cannot create any additional legal obligations." Accordingly, DOJ's civil litigators may not use a party's failure to comply with, as here, a guidance document that goes beyond merely paraphrasing an existing rule to essentially re-writing it or creating and retroactively applying a whole new one as the basis for an affirmative civil enforcement action.

In addition, in its NFR-1 Response AEE made several other comments with respect to the finding of unallowable expenses, which the Draft does not in any way address. These comments should be addressed before the conclusions of the Draft regarding unallowable expenses are finalized.

First, the Draft's finding that the expenses are unallowable appears to be based on the assumption that the full amount (i.e., all [REDACTED] dollar-for-dollar) was allocated to the AEE's regulated entity. That is not the case. While some portion of the expenses was allocated to the regulated accounts, certain of those costs were allocated to the non-regulated accounts pursuant to Part 32 of the Commission's rules.¹⁷ As a result, some of the expenses would not have been used to prepare the cost study and thus did not form the basis of a High Cost Support Program cost determination. Moreover, the portion of the expenses the regulated entity reported in the cost study would have been subject to additional reductions based on further allocations performed by the cost study consultant under the Part 64 of the FCC's rules, which governs the allocation of expenses to regulated and non regulated operations.¹⁸ In addition, pursuant to Part 36 of the Commission's rules,¹⁹ the separations factors applied to the regulated costs that allocate specific costs between interstate and intrastate jurisdictions would have been applied, rendering only approximately \$0.40 eligible for inclusion in support calculations for every dollar included in the cost study. Indeed, AEE respectfully submits that the amount of USF support received- based on expenses that could be categorized correctly as unallowable is likely nominal.²⁰

Second, the Draft assumption that the expenses were all paid with monies from High Cost Support is unsubstantiated. AEE receives monies from a number of sources, including state and local billed services. AEE is unaware of a requirement that obligates a carrier receiving

¹⁷ 47 C.F.R. Part 32.

¹⁸ 47 C.F.R. Part 64.

¹⁹ 47 C.F.R. Part 36.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Squire Patton Boggs (US) LLP

²⁰ In its NFR-1 Response AEE requested the opportunity to have its cost consultant reconcile the NFR-1 findings with the consultant's calculations and provide that information to OIG by Friday, September 9, 2016. OIG never responded or agreed to that request.

High Cost Loop Support to segregate its funding into different bank accounts by source; consequently, all of the Company's funds are deposited into the general fund account. As a result, it is impossible for OIG to ascertain with certainty that the funds used to pay for the expenses were all USF funds, and it is conceivable that at least some of the expenses were paid using monies from one of AEE's other sources of funding.

Third, as the OIG knows, AEE was subject to the annual cap on corporate operations expenses established by the FCC High Cost rules and was allowed to claim corporate expenses up to these limits each year, thus reducing the total amount of USF support AEE actually received based on the allocation of these expenses. Thus, in Table 4, the capped amount of corporate operations expenses for 2013 according to AEE's cost consultant was [REDACTED] not the [REDACTED] claimed by the Draft – a difference of [REDACTED] or nearly 2/3 of the alleged over-allocation to regulated entities.²¹

The Draft makes two recommendations to the Wireline Competition Bureau (Bureau) in light of the expense finding.²²

The first recommendation would require implementation of "accounting procedures and internal controls that ensure only expenses that are necessary for the purpose of maintaining and extending telecommunications services that are submitted to USAC for universal service support." The Draft concedes that the OIG concluded that the existing controls were "not reliable" without testing or relying on them at all.²³ The fact is that AEE's accounting procedures and internal controls are reviewed annually by an independent accounting firm, Moss Adams, and no weaknesses or issues with internal control processes have been identified. AEE, working with its auditing firm and cost consultant, will continue to support the objectives of the OIG and FCC to ensure, as the USF and other programs implement new accounting standards, that the Company remains in good standing.

The second recommendation would have USAC "examine" the [REDACTED] in expenses "found to be unnecessary and prohibited, and recover any USF overpayments."²⁴ However, in the event the recommendation is accepted, AEE requests the opportunity to repay under the terms of a mutually agreed-upon installment plan the High Cost Support it received from the

²¹ For 2014, AEE's consultant calculated the capped amount to be [REDACTED], as compared to [REDACTED], a difference of [REDACTED], or approximately 1.20 times the alleged overallocation to regulated entities. The Draft does not explain its calculation of the Table 4 figures.

²² Draft, p. 5

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Squire Patton Boggs (US) LLP

²³ Draft, p. i. The OIG apparently based its conclusion on a 2015 Bureau "determination that AEE's costs *appeared to be* excessive and not consistent with FCC regulations and orders." *Id.*, p. 2 (emphasis supplied).

²⁴ This recommendation in and of itself indicates that OIG has not been able to conclude what, if any, USF overpayments actually occurred. It is asking USAC to "examine" whether that is even the case.

USF based on the portion of the costs reported by the regulated entity and determined by the OIG or USAC to have been unallowable.

The second recommendation also would have USAC "review a sample of other expenses that are outside the scope of [the OIG] audit and recover any USF reimbursements related to ineligible expenses." The Draft does not explain or establish the basis for this recommendation. The OIG initiated this audit in 2014. The OIG chose not to make a site visit or perform onsite- testing at AEE's offices or other facilities.²⁵ OIG also decided not to include an examination of AEE's wired and wireless telecommunications operations.²⁶ There was more than ample time for OIG to consider other expenses if it so desired or had a basis for doing so. Therefore, AEE objects to this recommendation and requests that it be deleted from the final report.

In summary, AEE respectfully disagrees that the FCC rules applicable during the audit period addressed the allowability of the contested expenses. Furthermore, the Draft does not address certain of the challenged assumptions that appear to form the basis of the expense finding. AEE reiterates the request for an opportunity to work with its cost study consultant to determine with specificity the portion of the [REDACTED] that would have formed the basis for High Cost Support the company received, and to provide that information to OIG for its consideration before the Draft is finalized.

2. Other Matter – Methodology for Allocating Corporate Operations Expenses (COE) and Other Common Costs

As previously noted, the Draft also includes "observations and conclusions regarding AEE's allocation of common costs" that are "discussed in the Other Matter section." The substance of the "conclusions" regarding AEE's allocation methodology is at best unclear.

OIG twice states, "AEE *may* not have followed cost allocation rules."²⁷ Further, the Draft recommends that the Bureau "[d]etermine whether AEE's modified cost allocation methodology *materially* departs from FCC rules, and require AEE to revise its methodology, *if appropriate*."²⁸ In effect, the Draft is recommending that the Bureau determine whether there has been any violation at all. AEE respectfully submits that this level of uncertainty and equivocation raises genuine questions as to whether the OIG has any firm basis for including conclusions or

²⁵ Draft, p. 3.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Squire Patton Boggs (US) LLP

²⁶ *Id.* The General Accountability Office has noted that evidence obtained through the auditor's direct physical examination, observation, computation and inspection is generally more reliable than evidence obtained indirectly. Further examination of original documents is generally more reliable than examination of copies. GAO 12-331G, Government Auditing Standards, p. 152.

²⁷ Hunt Letter, p. 1; Draft, p. ii (emphasis supplied).

²⁸ Draft, p. 8.

recommendations regarding alleged cost allocation violations in the Draft, and, ultimately the final audit report. Further, the fact that they are called "observations and conclusions" rather than the more substantive, "findings," likewise suggests uncertainty and equivocation on OIG's part.

The Draft does assert, "AEE did not comply with FCC rules when computing its general allocator" because the computation was "based on the ratio of all common costs assigned to regulated and non-regulated activities." The Draft contends that FCC rules required the computation to use the "ratio of all costs directly assigned to regulated and non-regulated activities."²⁹ As a result the Draft claims that the AEE "methodology overstated corporate operating expenses and other common costs allocated to AEE's regulated company." Consequently, AEE allegedly "received more High Cost support than allowable per FCC rules."³⁰

Even the Commission has agreed that the Part 64 rules involved "broad principles" that "lack ...specificity" and give carriers "a degree of discretion in making these allocation decisions."³¹ In fact, in March of 2016, the Commission recognized that it needed to "provide greater clarity to rate-of-return carriers regarding how to determine the relative allocation of costs between regulated and non-regulated activities...."³²

AEE's response to NFR-2 regarding the computation of the general allocator stated that the "rule is confusing and susceptible to multiple interpretations,"³³ along with Company's belief that the rule "could be read a number of ways."³⁴ Although AEE acknowledged the reasonableness of the OIG reading, the Draft does not include AEE's complete response, deleting the following significant language that immediately follows that acknowledgement:

"AEE notes, however, the practical difficulty inherent in OIG's reading of the rule. Because substantial resources are devoted to work for the regulated entity, basing the computation of the general allocator on activities directly assigned under subsection

²⁹ *Id.*, p. 5.

³⁰ *Id.*, p. 7.

³¹ Rate-of Return Reform Order, 353

³² *Id.*

³³ The Draft eliminated this language from the quote on p. 4.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

Squire Patton Boggs (US) LLP

³⁴ *Federal Communications Commission Limited Scope Performance Audit of Adak Eagle Enterprises USF High Cost Beneficiary- Assignment Number 15-AUD-02-01 Notification of Findings and Recommendations*, Federal Communications Commission (Office of Inspector Gen. October 12, 2016) (NFR-2) and Letter, dated October 26, 2016, from Koyulyn Miller, Counsel for AEE, to Paul Stone, Auditor -USF Program Audits, Office of the Inspector General Federal Communications Commission, Re: NFR Number 2 – Common Costs Need to be Allocated to Non-regulated Companies; Audit Assignment No. 15-AUD-02-01 (NFR-2 Response), p. 4.

(b)(2) may result in the regulated entity taking on substantially higher cost than if the determination is made based on the shared costs alone."³⁵

By deleting it, the Draft avoids answering or countering this point.

Further, the Draft again ignores additional points made by AEE in its NFR-2 Response.

For example, AEE's methodology was developed, at considerable time and expense, in consultation with an outside consultant-upon whom the Company believes it reasonably relied-to develop its Cost Allocation Manual in concert with AEE's executives. In its NFR-2 Response, AEE indicated that AEE would be receptive to having an opportunity to evaluate its accounting methods with assistance from OIG staff or other designee to ensure the Company is operating consistently with the Commission's requirements. OIG never responded to that suggestion. Rather, as the Draft recites, it summarily determined that AEE's internal control policies and procedures for accounting for its corporate operations and common costs were not reliable, and thus did not test or rely on those controls.³⁶

The Draft includes two new tables 3 and 4.³⁷ These were not included in the NFR-2 in 2016 and AEE has not previously had any opportunity to respond to this information. Collectively, the two tables purport to show the amounts of corporate operations expenses that OIG determined were overallocated to AEE's regulated entity for calendar years 2013 and 2014. The Draft provides no explanation of the source of these figures, how they were developed, and ultimately the calculation of the alleged over allocation. Further, the Draft makes no finding as to the amount of excess High Cost support, if any, that AEE received because of the alleged over- allocation. Indeed, the Draft's second recommendation apparently leaves that further investigation to USAC.³⁸

Thus, the Draft does not address AEE's point that to the extent that any violation – material or not material - of the FCC rules may have occurred, any such violation likely had little to no impact on the amount of Federal High Cost support AEE received because majority of the Company's time is spent on matters that significantly impact the regulated entity, even if they are not directly attributable to it.

³⁵ *Id.*, p. 4.

³⁶ Draft, p. i.

³⁷ *Id.*, pp. 5, 6.

³⁸ The Draft's second recommendation under this Other Matter leaves to USAC the determination of whether there are any USF monies at all to be recovered. Draft, p. 8.

Applying the cost study separations process, corporate cap³⁹ and interstate common line support mechanisms that scrub out costs not permitted under the High Cost program would impact the amount of potential "overpayment" of High Cost. Indeed, AEE estimates that taking the OIG's alleged overallocation for 2013 of [REDACTED] and applying such processes would yield an approximate "overpayment" of [REDACTED]. Of course, any overpayment is not acceptable, but the impression created by the Draft that for each dollar of overallocation a dollar of overpayment of High Cost support is received is incorrect.

In summary, the Draft found only that AEE "*may not have followed*" FCC rules when allocating common costs. It leaves to the Bureau to determine whether AEE's cost allocation methodology "*departs*" from FCC rules. AEE acted in good faith based on expert consulting advice. The OIG, as reflected in the Draft, was unable to determine that the allocation methodology resulted in any High Cost support that the Company was not entitled to receive.

AEE is prepared to respond to any further questions that the OIG might have on this matter and as noted above respectfully renews certain requests that it made in its NFR Responses 1 and 2.

Respectfully submitted,

cc:

Robert McGriff

Sharon Spencer

Paul Stone

³⁹ Again, AEE maintains that the Draft figures for corporate operations expenses for 2013 and 2014 as reflected in Table 4 appear to ignore the impact of the corporate cap. *See* discussion of corporate cap, *supra*.

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

by
Cros

Sergio
Muller
LLP

Paul C. Bezzo

Clark K. Ervin

Squire Patton Boggs (US) 2550 M Street, NW Washington, DC 20037

202-457-5292

Counsel to Adak Eagle Enterprises, LLC; Adak Telephone Utility, LLC; and Windy City Cellular, LLC

**DECLARATION OF ANDILEA WEAVER ADAK EAGLE ENTERPRISES, LLC;
ADAK TELEPHONE UTILITY, LLC; AND WINDY CITY CELLULAR, LLC**

I, Andilea Weaver, declare the following is true and correct to the best of my knowledge and belief:

I am the Chief Operations Officer of Adak Eagle Enterprises, LLC; Adak Telephone Utility, LLC; and Windy City Cellular, LLC (collectively, the Companies). I have reviewed the Companies' foregoing comments to the draft Office of Inspector General (OIG) audit report, dated March 23, 2018, in the matter of Federal Communications Commission Limited Scope Performance Audit of Adak Eagle Enterprises USF High Cost Beneficiary – Assignment Number 15-AUD-02-01. I hereby attest – under penalty of perjury – that the comments were prepared pursuant to my direction, control, and approval, and that the facts contained therein are known to me and are accurate.

Executed on this 3 day of April, 2018.



Andilea Weaver

Chief Operations Officer

Adak Eagle Enterprises, LLC; Adak Telephone Utility, LLC; and Windy City Cellular, LLC

USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
 Providing or Improving Telecommunications Services
 FINAL AUDIT REPORT NUMBER 15-AUD-02-01

APPENDIX C - AEE WAIVER PETITIONS

Table 6. Timeline -AEE's Waiver Petitions and FCC's Rulings on Interim Support

Date	Event
November 2011	USF/ICC Transformation Order capped support at \$250 per line per month, effective July 2012
April 2012	AEE filed a petition to the FCC for a waiver of the \$250 per line cap for WCC.
May 2012	AEE filed a petition to the FCC for a waiver of the \$250 per line cap for ATU.
July 2012	FCC granted limited interim support at \$33,276 per month for ATU, and at \$40,104 per month for WCC, pending further review of the petitions.
July 2013	FCC denied AEE's petition due to excessive expenses and availability of alternative wireless voice service. However, FCC approved an additional six months of interim support totaling \$33,276 and \$40,104 per month for ATU and WCC, respectively.
August 2013	AEE filed a petition for reconsideration of the FCC's denial.
January 2014	FCC extended additional support for ATU and WCC for December 2013 and January 2014, pending further review.
February 2014	FCC extended interim support for six additional months pending further review.
May 2015	FCC issued a final denial order for any continued support above the cap for both ATU and WCC.



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

APPENDIX D - ACRONYMS AND ABBREVIATIONS

ACV	Adak Cablevision
AEE	Adak Eagle Enterprises, LLC
ATU	Adak Telephone Utility
CEO	Chief Executive Officer
COO	Chief Operating Officer
FCC	Federal Communications Commission
NECA	National Exchange Carrier Association
OIG	Office of the Inspector General
USAC	Universal Service Administrative Company
USF	Universal Service Fund
WCC	Windy City Cellular
WCB	Wireline Competition Bureau
WiCB	Windy City Broadband
WTB	Wireless Telecommunications Bureau

**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

APPENDIX E - GLOSSARY

<p>Affiliate company - An affiliate is a company that is related to another company, usually by being in the position of a member or a subordinate role. One corporation can be affiliated with another corporation by shareholdings, by holding a minority interest, or one corporation might be a subsidiary of another.</p>
<p>Common cost - The cost of resources employed jointly in the production of two or more outputs and the cost cannot be directly traced to any one of those outputs.</p>
<p>Corporate Operations Expense (COE) - The Corporate Operations Expense accounts includes the costs of performing executive and planning activities, and general and administrative activities described in narratives for individual accounts. These costs also include the costs of supervision, office support and training for these activities.</p>
<p>Cost Allocation Manual (CAM) - Describes the cost allocation procedures used by the telephone company to allocate costs among regulated and non-regulated products and services.</p>
<p>Direct cost - The cost of resources directly consumed by an activity. Direct costs are assigned to activities by direct tracing of units of resources consumed by individual activities. A cost that is specifically identified with a single cost object.</p>
<p>Holding company - A holding company is one that exists solely to hold a percent of the total stock of another company, or multiple companies, in an attempt to diversify or expand by acquisition. Holding companies reduce the risk of owners and allow the ownership of multiple companies.</p>
<p>Indirect cost - A cost that cannot be identified specifically with or traced to a given cost object in an economically feasible way.</p>
<p>National Exchange Carrier Association (NECA) - Is an organization founded by the telecommunications industry representatives. NECA manages the distribution of interstate access revenues through revenue pooling. Over 1,300 local telephone companies, or exchange carriers, are members of NECA.</p>
<p>Non-regulated - Non-regulated companies provide competitive services that are not rate tariffed by the FCC. Deregulated activities and activities (other than incidental activities) never subject to regulation are classified, for accounting purposes, as nonregulated.</p>
<p>Provision of service - Supplying local and long-distance telecommunications service paid for by the business and residential end user, including all associated transmission, wiring, and sufficient quantities of switching equipment to meet established service standards.</p>
<p>Regulated - Regulated telecommunications products and services are fully subject to the accounting requirements and rate of return ratemaking requirements specified in Title II (common carrier regulation) of the Communications Act of 1934.</p>
<p>Study Area - A study area is typically a telephone companies' service area within a particular state. Study areas and service areas, as defined by regulation, are relevant to FCC subsidy programs for telephone companies.</p>



**USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for
Providing or Improving Telecommunications Services
FINAL AUDIT REPORT NUMBER 15-AUD-02-01**

<p>Tariff - Documents filed by a regulated telephone company with a state public utility or the Federal Communications Commission. The tariff, a public document, details services, equipment and pricing offered by the telephone company (a common carrier) to all potential customers. Being a “common carrier” means it (the phone company) must offer its services to everybody at the prices and at the conditions outlined in its public tariffs.</p>
<p>Universal Service Administrative Company (USAC) – USAC administers the four Universal Service Fund (USF) programs and collects monies for the fund under the direction of the FCC. Carriers also recover some of their costs from the fund based on their cost study data filed with USAC.</p>
<p>Uniform System of Accounts - Sets out the detailed accounting practices and financial reporting requirements that document the separation of regulated and non-regulated costs as denoted in Uniform System of Accounts Part 32.</p>
<p>Waiver petition document - A waiver request from a telecommunications company to the FCC pertaining to the provision of the Uniform System of Accounts. The waiver must be in the public interest and each expressly demonstrates that existing peculiarities or unusual circumstances warrant a departure from a prescribed procedure or technique.</p>