



OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: January 25, 2013

TO: Chairman Julius Genachowski
Commissioner Robert McDowell
Commissioner Mignon Clyburn
Commissioner Jessica Rosenworcel
Commissioner Ajit Pai

CC: General Counsel Sean Lev
Kris Monteith, Acting Bureau Chief, CGB

FROM: David Hunt, Inspector General *H. J. for David Hunt*

SUBJECT: Report on the Audit of the Use of Funds Disbursed to and Received by Telecommunications Relay Service Providers – Snap Telecommunications Inc.

The Office of Inspector General is providing the reissued audit report for Snap Telecommunications Inc.'s (Snap) use of Telecommunications Relay Service (TRS) funds. This audit report is for one in a series of audits to determine if TRS funds were used in accordance with TRS program requirements.

We engaged Clifton Larson Allen LLP to conduct the audit. The scope of the audit was limited to the use of TRS funds received by five TRS providers offering Video Relay Service (VRS) in calendar year 2011. The audit objectives were to:

1. Determine if federal funds disbursed to and received by Telecommunications Relay Service (TRS) providers were applied in accordance with TRS program requirements and supported by adequate documentation.
2. Follow-up on the audit findings of prior year audits of Relay Service Data Requests (RSDR) (TRS provider annual cost data submissions to the FCC).

The audit concluded that:

1. TRS funds received by Snap for VRS compensated the provider for only the reasonable costs of providing access to VRS.

2. Snap's costs that were, as well as those that were not included in the RSDR for the year ending December 31, 2011 were supported by adequate documentation.
3. Snap implemented corrective actions to address the prior year audit findings.

Snap did not provide management comments on the conclusions discussed in the audit report.

Clifton Larson Allen LLP is wholly responsible for the audit, the attached report and the conclusions expressed therein. The FCC-OIG's extent of reliance on this report is "No association with report" as described in the FCC-OIG Audit Manual.

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If you have any questions, please contact Thomas Cline at (202) 418-7890.

Attachment

PERFORMANCE AUDIT REPORT

EXECUTIVE SUMMARY

CliftonLarsonAllen LLP (formerly Clifton Gunderson, LLP) was engaged by the Federal Communications Commission (FCC or the Commission) Office of Inspector General (OIG) to conduct a performance audit of the application of funds received from the Telecommunications Relay Service (TRS) Fund by Snap Telecommunications, Inc. (Snap). Snap is a service provider for the Video Relay Service (VRS) program.

VRS is a form of TRS provided to persons with hearing and speech disabilities in the United States. The TRS Fund is financed by interstate telecommunications providers on the basis of their interstate end-user telecommunication revenues. TRS providers are compensated by the TRS Fund at a rate determined by the FCC. Commission rules provide that rates for the provision of TRS should reflect the "reasonable costs of providing interstate" VRS service, including a reasonable rate of return for capital investment. See 47 C.F.R. §§ 64.604(c) (5)(iii) (C), (E). In recent rate orders, the FCC has found "a 'substantial disparity' between the providers' actual cost of providing VRS and the projected costs which had been used to calculate compensation rates." See Telecommunications Relay Services & Speech-to-Speech Services for individuals with Hearing & Speech Disabilities, 25 FCC Rcd. 8689 at 8694 (2010). The Commission also determined that there exists "substantial evidence that [VRS] providers are receiving far more in compensation than it costs them to provide service." *Id.* ¶12 at 8695.

The objectives of this performance audit were:

1. To determine if VRS-related federal funds disbursed to, and received by, Snap in calendar year 2011, were applied in accordance with TRS program requirements and supported by adequate documentation. The specific TRS program requirements we audited relate to FCC rules and orders, and other policies that require that:
 - a. TRS payments be designed to compensate TRS providers for the reasonable costs of providing VRS. The Commission defines "reasonable costs" to be those direct and indirect costs necessary to provide the service consistent with TRS mandatory minimum standards.
 - b. Costs on the Relay Services Data Request (RSDR) data collection report, submitted to the TRS Fund Administrator are supported by adequate documentation. Other costs not reported on the RSDR but deemed by the service provider to be incurred in providing VRS were also supported by adequate documentation.
2. To follow up on the audit findings of the recent FCC OIG audit of Snap's costs on the RSDR Schedule I forms submitted to the TRS Fund Administrator.

Our audit concluded that:

1. TRS funds received by Snap for VRS were for the reasonable costs of providing VRS.
2. Snap costs that were and were not included in the RSDR data collection report for the year ending December 31, 2011 were supported by adequate documentation.
3. Snap has instituted measures to address the prior year FCC audit findings.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives. Because of inherent limitations, a study and evaluation made for the limited purposes of our review would not necessarily disclose all weaknesses related to the application of VRS program funds received by SNAP.

BACKGROUND

FCC and the TRS Program

Section 225 of the Communications Act, 47 U.S.C. Section 225, requires the FCC to ensure that interstate and intrastate TRS is available, to the extent possible and in the most efficient manner, to persons with hearing and speech disabilities in the United States.

VRS is a form of TRS that allows a person with a hearing or speech disability to communicate with voice telephone users through video equipment. The person with a hearing or speech disability communicates with a communications assistant (CA) using American Sign Language. The CA then conveys that communication to the voice telephone user, thereby serving as an interpreter.

The TRS program is implemented through Title 47, Code of Federal Regulations (C.F.R.), Part 64, Subpart F – Telecommunications Relay Services and Related Customer Premises Equipment for Persons with Disabilities and through orders adopted by the Commission. Specifically, 47 C.F.R. Section 64.604 addresses Mandatory Minimum Standards for TRS providers, including their processes for collecting and reporting minutes of service to the TRS Fund Administrator. The Mandatory Minimum Standards specifies three standards – operational standard, technical standard and functional standard.

Through its rules and orders, the Commission established a shared-funding mechanism that compensates TRS providers for their reasonable costs of providing interstate TRS. The TRS Fund Administrator receives TRS fund contributions from providers of interstate telecommunications services and makes disbursements to TRS providers from the fund. Over the last two funding years approved by FCC, the funding (revenue) requirements specific for VRS program contributed by about 2,800 telecommunication providers were \$523 million for funding year 2010-2011, and \$563 million for funding year 2011-2012. The TRS funding year is from July through June.

TRS providers receive compensation for providing interstate TRS based on FCC established formulas that are designed to ensure that TRS is provided “in the most efficient manner, which ... necessitates adopting reasonable compensation rates that do not overcompensate entities that provide TRS.” See Telecommunications Relay Services & Speech-to-Speech Services for Individuals with Hearing & Speech Disabilities, 25 FCC Rcd. 8689 at 8698 (2010).

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The Commission has defined “reasonable costs” to mean “those direct and indirect costs necessary to provide the service consistent with all applicable regulations governing the provision of the service, *i.e.*, the TRS mandatory minimum standards.” See *Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities, Report and Order, Order on Reconsideration, and Further Notice of Proposed Rulemaking*, 19 FCC Rcd 12475, 12543-544 at para. 181.

By Commission rule, TRS providers seeking compensation from the TRS fund must provide the Fund Administrator with true and adequate data, and other historical, projected and state related information reasonably requested to determine the TRS Fund revenue requirements and payments. See 47 C.F.R. § 64.604(c)(5)(iii)(C). In a series of prior FCC orders, the FCC designated which categories of costs incurred by VRS providers are allowed and which categories of costs are disallowed from compensation. The cost data collected by the Fund Administrator are reported by TRS providers in the RSDR.

The RSDR form, submitted annually, is designed to ensure that TRS providers comply with the TRS rules requiring providers to “provide the administrator with true and adequate data, and other historical, projected and state rate related information reasonably requested by the administrator, necessary to determine TRS Fund revenue requirements and payments.” See 47 C.F.R. § 64.604(c)(5)(iii)(C). The Commission noted in FCC 07-186, paragraph 13, that the data collection form (RSDR) sets forth the categories of costs related to the provision of TRS for which providers may seek compensation, and the United States Court of Appeals for the 10th Circuit acknowledged this in its opinion denying Sorenson’s challenge to the FCC’s 2010 interim TRS rates. See *Sorenson v. FCC*, 659 F.3d 1035, 1040 (10th Cir. 2011).

Under 47 C.F.R §§ 64.604,(c)(5)(iii)(D)(6), the FCC OIG has the authority to examine and verify TRS provider data as necessary to assure the accuracy and integrity of TRS Fund payments.

FCC, as the steward of the TRS Fund, has a fiduciary duty to ensure that the TRS Fund operates efficiently and to guard against waste, fraud, and abuse.

Snap

Snap is a wholly-owned subsidiary of Aequus Technologies Corporation (“Aequus”). Snap began providing VRS in January 2007 and up until 2011, subcontracted out part of its VRS technology platform and support services to “white label” VRS provider customers, namely Interpretel, Convo and American Network. The term “white label” refers to entities who, prior to the effective date of the FCC’s 2011 *Anti-Fraud Order*, held themselves out as VRS providers, who were not themselves eligible to receive payments from the TRS Fund, and who made arrangements with eligible providers to submit payment claims to the TRS Fund on their behalf (or to receive a share of the TRS Fund payments to the eligible provider). *Id.* at 5571, ¶ 52 n.147. See also *id.* at 5570, ¶¶ 48-49.

Aequus and Viable Communications, Inc. (Viable) entered into an agreement dated August 13, 2009 that provided for the terms and conditions under which Viable engaged Snap to manage, for and on behalf of Viable and as its agent, substantially all of the business affairs of Viable with respect to the operation and management of Viable’s VRS and Video Remote Interpreting (VRI) services, including serving as the exclusive provider of those services to Viable’s customers and handling of all filings for and receipt of all related reimbursements. As a bridge to consummation of the transaction, Aequus provided [REDACTED] of short-term financing to Viable to cover certain expenses critical to the continued operation of Viable during the pre-closing period. Given the

multitude of issues surrounding Viable and FCC orders specific to white-label providers, Aequus terminated its agreement with Viable and all white label providers (except Convo) effective May 2011, and with Convo effective November 2011.

AUDIT OBJECTIVES

The objectives of this performance audit were:

1. To determine if VRS-related federal funds disbursed to, and received by, Snap in calendar year 2011, were applied in accordance with TRS program requirements and supported by adequate documentation. The specific TRS program requirements we audited relate to FCC rules and orders, and other policies that require that:
 - a. TRS payments are designed to compensate TRS providers for the reasonable costs of providing VRS. The Commission defines “reasonable costs” to be those direct and indirect costs necessary to provide the service consistent with... TRS mandatory minimum standards.
 - b. Costs on the RSDR, submitted to the TRS Fund Administrator are supported by adequate documentation. Other costs not reported on the RSDR but deemed by the service provider to be incurred in providing VRS are also supported by adequate documentation.

2. To follow up on the audit findings of the recent FCC OIG audit of Snap’s costs on the RSDR Schedule I forms submitted to the TRS Fund Administrator.

SCOPE AND METHODOLOGY

We audited the VRS funds earned (used interchangeably with received) by Snap from January 1, 2011 through December 31, 2011 (calendar year 2011) in relation to the cost incurred for VRS.

Table A below shows an analysis of the total VRS funds received by Snap and costs related to VRS that were reported in the RSDR forms.

Table A – Analysis of VRS Funds Received and Cost Reported by Snap in Calendar Year 2011

| VRS Funds | Amount | Percentage |
|--|------------|------------|
| VRS funds received (based on FCC approved minutes-of-use rates) – specific to Snap | ██████████ | ██████████ |
| Costs reported on the RSDR form specific to Snap and are related to VRS funds received | ██████████ | ██████████ |
| Excess of total cost over cost reported on the RSDR form to VRS funds received | ██████████ | ██████████ |

In addition to the funds discussed in the table above, Snap received about [REDACTED] for providing VRS services on behalf of Viable; [REDACTED] for providing services on behalf of Convo and [REDACTED] for providing services on behalf of Interpretel. Although the cost reported by Snap in its 2011 RSDR forms was [REDACTED] it included about [REDACTED] chargeback cost to Viable, which we deducted to arrive at the [REDACTED] presented in Table A . We excluded from the Table A above, any revenues received and costs incurred by Snap on behalf of Viable, Convo or Interpretel.

A high level summary of our audit methodology is set forth in Appendix A.

AUDIT RESULTS

Our audit concluded that:

1. TRS funds received by Snap for VRS were for the reasonable costs of providing VRS.
2. Snap costs that were included in the RSDR, as well as those not included in the RSDR, for the year ending December 31, 2011 were supported by adequate documentation.
3. Snap has instituted measures to address the prior year audit findings.

Conclusion 1: TRS Funds Received by Snap were for the Reasonable Costs of Providing VRS

VRS payments are based on FCC approved rates per minute of service provided. FCC established these rates per minute of service provided based on a variety of, largely unaudited, information, including the consideration of costs identified by service providers. Accordingly, FCC rules require service providers to submit annual cost data to assist the FCC in the rate setting process. The RSDR requests cost data by categories that the FCC determines to be reasonable, and allowable or "compensable" costs. The RSDR instructions include descriptions of allowable costs and unallowable costs as explained in the FCC rules and orders. FCC rules and orders also consider an 11.25 percent rate of return on capital investments as "reasonable" compensation for providing VRS.

Our audit found that TRS payments to Snap for providing VRS were for the reasonable costs of providing VRS in calendar year 2011. The VRS payments to Snap were [REDACTED] less than the costs it reported on the RSDR, representing [REDACTED] of the total amount spent by Snap for the provision of VRS in 2011 as shown in Table A above.

Conclusion 2: Snap costs that were and were not included in the RSDR for the year ending December 31, 2011 were supported by adequate documentation.

We tested samples of all costs incurred by Snap for CY 2011 – both those included and not included in the data collection report (the RSDR) – to determine if the costs were supported by adequate documentation. We found no exception in the results of our tests.

Conclusion 3: Snap has instituted measures to address prior year audit findings.

Snap had instituted measures to address prior year RSDR findings and recommendations as shown in Table B below.

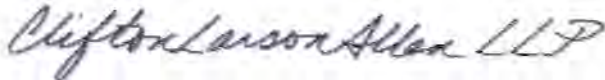
Table B - Prior Year Audit of RSDR Findings

| PY Finding No. | Topic | Years Reported | Finding | Corrected Measures Implemented by Snap |
|-----------------------|-----------------------------------|-----------------------|---|---|
| Finding 1 | Fixed Asset Detail | 2008 to 2010 | Fixed asset records lacked sufficient detail to track assets. | Snap is now utilizing asset tags on all assets and tracking those assets in an excel spreadsheet. |
| Finding 2 | Non-Payroll support documentation | 2008 to 2010 | Lack of supporting documentation for non-payroll expenses | The sample of non-payroll expenses that we tested had adequate supporting documentation. |
| Finding 3 | Payroll Supporting documentation | 2008 to 2010 | Lack of supporting documentation for payroll expense testing. | The sample of payroll expenses that we tested had adequate supporting documentation. |

We provided a draft of our report to the FCC OIG and Snap. We considered comments received from FCC OIG prior to finalizing this report. No comments were provided by Snap.

CLA performed its work between January 11, 2012 and March 31, 2012.

CLIFTONLARSONALLEN LLP



Arlington, Virginia
May 1, 2012

Appendix A
High Level Summary of the Audit Methodology

Our audit methodology included the following:

- Assessing audit risk and significance within the context of the audit objectives.
- Obtaining an understanding of internal control that is significant to the administration of the TRS/VRS funds through review of prior year's audit reports and management inquiries.
- Understanding relevant information systems controls as applicable.
- Identifying sources of evidence and the amount and type of evidence required.

To implement our audit methodology, below are some of the audit procedures we performed:

- Inquired from Snap's management, through the use of a management questionnaire and interviews, about the organization and operations of the TRS/VRS program.
- Reviewed policies, procedures and regulations for the Snap's management and accounting systems as they relate to the administration of TRS/VRS programs.
- Reviewed the operations of Snap in relation to the corporate structure and governance.
- Reviewed the TRS/VRS funds received in 2011 and related supporting documentation.
- Tested randomly selected expense items such as payroll, interest expenses and other expenses and related supporting documentation.
- Evaluated expenses against FCC rules for allowable and unallowable costs.
- Reviewed relevant contracts and agreements.
- Reviewed fixed assets schedule.
- Performed analytical reviews such as financial ratios analyses relevant to the audit objectives.
- Inquired with Snap concerning the status of the findings reported in the latest FCC audit of costs reported in RSDR.