



Federal Communications Commission
Washington, D.C. 20554

November 17, 2008

Mr. Scott Barash
Acting Chief Executive Officer
Universal Service Administrative Company
2000 L Street, NW, Suite 200
Washington, DC 20036

Re: Material Weakness in Financial Statement Audit

Dear Mr. Barash:

This letter addresses a material weakness in the internal controls of the Universal Service Administrative Company (USAC). As explained below, we require USAC to finish implementing corrective action pertaining to this material weakness as soon as possible. In addition, we require USAC to undertake additional steps to strengthen its internal control over the accounting of the Universal Service Fund (USF).

In the course of the Commission's annual financial statements audit, the independent auditor identified a material weakness in USAC's internal control over its budgetary accounting related to the USF. The independent auditor described USAC's material weakness in its audit report and has already provided information to USAC staff concerning the scope of the breakdown. In brief, the independent auditor's conclusion stems from USAC's failure to properly implement a change to an accepted accounting practice concerning the Statement of Budgetary Resources (SBR). USAC staff discussed the accounting change with Commission staff in Fiscal Year (FY) 2007, agreed to implement the change, and later reported to the Commission and its independent auditor that the change had been fully implemented. However, when the independent auditor reviewed the facts during the FY 2008 audit, the independent auditor uncovered the issue and concluded that USAC failed to properly implement the change.

In the independent auditor's judgment, USAC's breakdown resulted in an incorrect accounting entry valued at almost \$550 million. The independent auditor concluded that USAC's breakdown largely stemmed from inadequate accounting policies and procedures governing preparation of the SBR and insufficient personnel with appropriate Federal budgetary accounting expertise. Because USAC is a reporting component reflected on the Commission's financial statements, USAC's breakdown is identified in the Commission's financial statements audit report as a "material weakness" of the Commission's accounting controls. This is the first time the independent auditor has identified a material weakness in the Commission's accounting controls since 2005.

At the outset, we stress that USAC's failure to properly implement the accounting change is a serious matter that should not have occurred. We understand that the independent auditor's conclusion is narrowly tailored and focused on a problem affecting one financial statement and that the breakdown concerns a technical aspect of Federal budgetary accounting. We also understand that USAC's finance and accounting staff has been cooperative, committed to adhering to strong accounting practices, and has worked hard to maintain a constructive working relationship with the Commission's accounting staff. Still, this is a serious matter that requires strong corrective action.

First, USAC should finish implementing corrective action as soon as possible. We understand that, after discussions with Commission staff, USAC has already implemented appropriate action to correct the recording entries and strengthen its procedures. USAC should provide status reports on a monthly basis to the Commission's CFO.

Second, USAC should ensure its accounting staff is appropriately resourced and trained. In particular, USAC should ensure that it has on staff sufficient personnel with knowledge of Federal accounting requirements and procedures, including Federal budgetary accounting procedures. In addition, USAC should ensure that, in FY 2009, it trains its existing finance and accounting staff on Federal budgetary accounting requirements. USAC should submit a training plan to the Commission's Chief Financial Officer (CFO) within 90 days of the date of this letter.

Third, USAC should conduct a comprehensive assessment of its policies and procedures governing preparation of the SBR to ensure that the identified breakdown is not more significant.¹ We recognize that USAC may require the services of an outside consultant to perform this assessment. USAC should submit a report to the Commission's CFO no later than May 1, 2009.

Fourth, USAC should perform periodic in-depth financial analysis, including fluctuation and trend analysis, at a minimum, on a quarterly basis. Enhancement to the fluctuation analysis should include developing expectations that are directly attributed to financial trends, operational trends or both. Analytical tools that could be used are ratio analysis and trend analysis as well as predictive techniques such as calculation of an expected balance.

Fifth, USAC should notify the Commission's CFO of the dates and times scheduled for its Senior Management Council to meet. The Commission's CFO may choose to attend or to have Commission staff attend the meetings of USAC's Senior Management Council.

Finally, USAC should submit the risk assessments conducted by its Senior Management Council to the Commission's CFO and to the Inspector General for review and comment.

We appreciate your prompt attention to implementing these measures. If you have any questions or wish to discuss the issues raised in this letter further, please feel free to contact me. You may also contact Mark Stephens at (202) 418-0817.

Thank you.

Sincerely,



Anthony J. Dale
Managing Director

¹ We note that the independent auditor did not conclude or suggest that USAC's material weakness over internal control extended to any aspect of its accounting operations other than Federal budgetary accounting procedures used to prepare and submit the SBR.

CC: USAC Board of Directors
Dana Shaffer, Chief , Wireline Competition Bureau
Kent Nilsson, Inspector General