

CALIFORNIA PUBLIC UTILITIES COMMISSION

Audit Report

California Advanced Services Fund Second Interim Financial Audit

July 1, 2010, through December 31, 2015



BETTY T. YEE
California State Controller

March 2017



BETTY T. YEE
California State Controller

March 30, 2017

Daniel Alvarez, Secretary of the Senate
State Capitol, Room 3044
Sacramento, CA 95814

Dear Mr. Alvarez:

The State Controller's Office conducted a second interim special purposes financial audit of the California Advanced Services Fund (CASF) results for the period of July 1, 2010, through December 31, 2015. The CASF was adopted in Decision 07-12-054 by the five-member commission (Commission), the members of which sit on the California Public Utilities Commission (CPUC), pursuant to Senate Bill 1193, and Public Utilities Code sections 281 (a), 701 and 912.2 (a).

Our audit determined that: 1) CASF program expenditures are in compliance with Public Utilities Code sections 281 and 282, other state laws, and Commission directives; 2) records are reliable; 3) revenue is properly managed and correctly recorded per our audit schedule; and 4) the CASF program has proper oversight. Audit adjustments are the result of timing difference, methodologies of reporting, and surcharges applied incorrectly. Specifically our audit determined that:

- Surcharge revenue and investment income was understated by \$2,977,155 and \$149,296, respectively, because the CPUC did not have a policy for revenue recognition;
- Surcharge revenue were understated by \$761,590, as they were misapplied to the wrong surcharge program;
- Surcharge revenue totaling \$1,012,770 was past due and not collected from telecommunication carriers;
- Expenditures were understated by \$806,013 due to unreconciled differences between the California State Accounting and Reporting System (CALSTARS) and the CPUC Communications Division's payment and report tracking logs; and
- Administrative, pro rata, and loan accounting services costs were classified to the incorrect CASF account.

Our audit also identified processes and procedures that should be implemented to improve CPUC oversight of the CASF. Details can be found in the Additional Information section of this report. In brief, we recommend that the CPUC:

- For revenue reporting, run the CALSTARS for the calendar year-end report at least 60 days past December 31;
- Confirm prior-year revenue when calculating the cumulative total revenue;
- Develop correlation analysis between the Telecommunications and User Fee Filing System (TUFFS) and CALSTARS;
- Track CALSTARS payments by matching them to the corresponding entry in TUFFS and reconciling any difference;
- Use TUFFS to record and track any outstanding payments due to the CASF;
- Consider using TUFFS reporting, not CALSTARS, for future reporting of CASF revenue;
- Reconcile payment logs to CALSTARS and reconcile any difference;
- Properly report allocated amounts of administrative and pro rata expenses in the annual report going forward; and
- Develop and adopt a formal allocation methodology for pro rata expenses.

If you have any questions, please contact Andrew Finlayson, Bureau Chief, State Controller's Office, by telephone at (916) 324-6310 or by email at afinlayson@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/rg

cc: Diane F. Boyer-Vine, Legislative Counsel
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Attachment 1—California Public Utilities Commission’s Response to Draft Audit Report

Attachment 2—2015 California Advanced Services Fund Annual Report, Prepared by the California Public Utilities Commission



BETTY T. YEE
California State Controller

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying Schedule of Revenue and Expenditures (Schedule) of the California Advanced Services Fund (CASF), a fund of the California Public Utilities Commission (CPUC) for the period of July 1, 2010, through December 31, 2015, contained in the 2015 CASF Annual Report issued by the CPUC and concluded on conditions stated in the Additional Information section of this report.

Management's Responsibility for Financial Results

Management of CPUC is responsible for the preparation and presentation of these financial results in the attached 2015 CASF Annual Report; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and presentation of financial results that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the accompanying Schedule. We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial results are adequately reported.

We are not expressing an opinion or responsible for the information contained in the CPUC's 2015 CASF Annual Report, Issued April 2016. CPUC's management is responsible for this report. Our responsibility is limited to the accompanying Schedule.

An audit involves performing procedures to obtain audit evidence about the amounts reported in the accompanying Schedule. The procedures selected depend on the auditor's judgement, including the assessment of risk of inaccuracies in the Schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation of the Schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall presentation of the Schedule.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, revenue and expenditures were understated by \$3,888,041 and \$806,013 respectively, the accompanying Schedule reflects the financial results of the CASF for the period of July 1, 2010, through December 31, 2015.

Other Information

We have applied additional procedures as required by Interagency Agreement No. 15IA5002, dated May 20, 2016, between the State Controller's Office and CPUC. These procedures were applied in accordance with generally accepted government auditing standards accepted in the United States of America. The procedures included inquiries of management about the methods of preparing the additional information and comparing the additional information for consistency with management's responses to our inquiries, the financial results, and other knowledge we obtained during our audit of the Schedule. Results of the additional procedures are included in the Additional Information attached to this report.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

March 30, 2017

Schedule—Revenue and Expenditures July 1, 2010, through December 31, 2015

	(A)	(B)	(A) - (B)			
	(Unaudited by SCO)	1st Interim Period (Unaudited by SCO)	2nd Interim Period			
	Total Reported in 2015 CASF Annual Report	January 1, 2008 through June 30, 2010	July 1, 2010 through December 31, 2015			
			Amount Reported	Audited Totals	Understated/ (Overstated)	
Revenue						
CASF Surcharges Collected	\$ 255,548,625	\$ 115,140,932	\$ 140,407,693	\$ 144,146,438	\$ 3,738,745	Findings 1 & 2
Delinquent Fees	290,456	161,024	129,432	129,432	-	
Loan Repayments & Interest	15,595	-	15,595	15,595	-	
Investment Income	2,716,543	1,008,965	1,707,578	1,856,874	149,296	Finding 1
Total Revenue	\$ 258,571,219	\$ 116,310,921	\$ 142,260,298	\$ 146,148,339	\$ 3,888,041	
Expenditures						
CASF Projects (Infrastructure Grant)	\$ 59,209,551	\$ 78,007	\$ 59,131,544	\$ 65,858,794	\$ 6,727,250	Finding 4
Infrastructure Loan	40,977	-	40,977	931,567	890,590	Findings 3 & 4
Consortia	7,907,376	-	7,907,376	8,890,241	982,865	Findings 3 & 4
Public Housing	290,081	-	290,081	489,528	199,447	Findings 3 & 4
Administrative Costs	5,714,657	274,432	5,440,225	(274,432)	(5,714,657)	Finding 4
Pro-rata Costs	1,989,507	228,658	1,760,849	(228,658)	(1,989,507)	Finding 4
Loan Account Service	289,975	-	289,975	-	(289,975)	Finding 3
Total Expenditures	\$ 75,442,124	\$ 581,097	\$ 74,861,027	\$ 75,667,040	\$ 806,013	

^(A)2015 CASF Annual Report January 2015 - December 2015, prepared by the CPUC, issued April 1, 2016

^(B)Audited by the CPUC's Utility Audit, Finance and Compliance Branch, issued March 30, 2011

Additional Information

Summary

Pursuant to Public Utilities Code section 912.2(a), the State Controller's Office (SCO) conducted the second independent interim financial audit of the California Advanced Services Fund (CASF) results for the period of July 1, 2010, through December 31, 2015.

The financial audit was performed by the SCO on behalf of the California Public Utilities Commission (CPUC). The authority to conduct this audit given by Interagency Agreement No. 15IA5002, dated May 20, 2016, between the SCO and the CPUC, which provides that the SCO will conduct the second interim financial audit and second interim performance audits of the CASF.

Our audit determined that:

- Surcharge revenue and investment income was understated by \$2,977,155 and \$149,296, respectively, because the CPUC did not have a policy for revenue recognition;
- Surcharge revenue were understated by \$761,590, as they were misapplied to the wrong surcharge program;
- Surcharge revenue totaling \$1,012,770 was not collected and was past due from telecommunication carriers;
- Expenditures were understated by \$806,013 due to unreconciled differences between the California State Accounting and Reporting System (CALSTARS) and the CPUC Communications Division's payment and report tracking logs; and
- Administrative, pro rata, and loan accounting services costs were classified to the incorrect CASF account.

Background

The five-member commission (Commission), the members of which sit on the California Public Utilities Commission (CPUC) authorized the CASF on December 20, 2007, when it adopted Decision 07-12-054, in accordance with Public Utilities Code section 701. The CASF provides grants to bridge the "digital divide" in unserved and underserved areas in the state. The Commission adopted the CASF application requirements, timelines, and scoring criteria for parties to qualify for broadband project funding in Resolution T-17143, issued on June 12, 2008. The State reaffirmed the Commission's creation of the CASF program in Senate Bill 1193, on September 27, 2008, and codified the program in Public Utilities Code section 281. Subsequently, the Legislature passed, and the Governor signed into law, several bills to expand the program and authorize the CPUC to collect surcharges and award grants and loans of the following CASF accounts:

- Infrastructure Grant, which assists in financing the building and/or upgrading of broadband infrastructure in areas that are unserved or underserved by existing broadband providers;

- Infrastructure Loan, authorized by SB 1040 and created by the Commission in February 2012, which finances capital costs of broadband facilities not funded by a grant from the Infrastructure Grant Account.
- Consortia, which provides grants to eligible consortia to fund “the cost of broadband deployment activities other than the capital cost of facilities, as specified by the commission.”
- Public Housing, which provides grants and loans to support deployment of broadband network and adoption programs in eligible publicly supported communities.

On October 3, 2013, Governor Brown approved SB 740 and Assembly Bill 1299. Specifically, SB 740 authorized the collection of an additional \$90 million to be deposited in the CASF Infrastructure Grant Account, extended the surcharge collection through the 2020 calendar year, established the goal of the CASF program to approve funding for infrastructure projects that will provide broadband access to no less than 98% of California households by no later than December 31, 2015, and allowed any entity that is not a telephone corporation to be eligible to apply for a CASF grant and loan if that entity otherwise satisfies the CASF’s eligibility requirements and any other requirements as defined by the Commission, amongst other requirements identified in the bill. AB 1299 created an additional account under the CASF called the Public Housing Account.

The CPUC Communications Division performs ministerial duties on behalf of the CPUC regarding the CASF program, including, among other tasks, reviewing CASF grant applications and recommending CPUC approval, reviewing grantee progress reports and approving grantee payment requests. The CPUC has contracted with an external agency, the State Assistance Fund for Enterprise, Business and Industrial Development Corporation (SAFE-BIDCO), to perform the financial eligibility review of loan applications, processing, and servicing of loans.

The CPUC Fiscal Office is responsible for receiving and accounting for surcharges that telecommunications entities remit. These surcharge revenues are booked to the respective universal service funds accounts according to Program Cost Account (PCA) codes pursuant to the CALSTARS. The Fiscal Office is also responsible for processing CASF payment requests after CASF staff review, encumbering CASF awards, submitting claims to the SCO, maintaining the financial records, and presenting CASF program financial data.

Objectives, Scope, and Methodology

We conducted this financial 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted the financial audit of the CASF to determine whether the CPUC's:

- CASF program expenditures are in compliance with Public Utilities Code sections 281 and 282, other state laws, and Commission directives;
- Records are reliable;
- Revenue is properly managed and correctly recorded; and
- CASF program has proper oversight.

The scope of this audit is from July 1, 2010 through December 31, 2015. The CPUC prepares agency-wide financial statements on a fiscal year basis; however, the CASF is reported to the Legislature on a calendar basis.

The State of California uses the modified accrual accounting methodology. The Government Accounting Standards Board, which is recognized as the official source of generally accepted accounting principles for state and local governments, establishes modified accrual accounting standards. The annual report was not required to be prepared using an accounting methodology; however, this audit was performed using those methodologies as a means for meeting the audit objectives.

The financial results of the CASF program are presented in an annual report. The last report was issued on April 1, 2016, and covered the period of January 1, 2015, through December 31, 2015. The report provides cumulative totals incurred since the inception of the CASF program—January 1, 2008, through December 31, 2015.

On March 30, 2011, the CPUC Utility Audit, Finance, and Compliance Branch issued the first independent interim financial audit of the CASF for the period of January 1, 2008, through June 30, 2010. The report concluded that the CASF was expended in compliance with Public Utilities Code sections 281 and 282, other state laws and Commission directives.

We are responsible for auditing the period of July 1, 2010, through December 31, 2015, and do not present an opinion regarding prior-period balances. The cumulative totals, presented for informational purposes only, are as follows:

	1st Interim Period (Unaudited by SCO)		2nd Interim Period (Unaudited by SCO)		
	January 1, 2008 through June 30, 2010		July 1, 2010 through December 31, 2015		
				Cumulative Total Reported in 2015 CASF Annual Report	
Revenue					
CASF Surcharges Collected	\$	115,140,932	\$	140,407,693	\$ 255,548,625
Delinquent Fees		161,024		129,432	290,456
Loan Repayments & Interest		-		15,595	15,595
Investment Income		1,008,965		1,707,578	2,716,543
Total Revenue	\$	116,310,921	\$	142,260,298	\$ 258,571,219
Expenditures					
CASF Projects (Infrastructure Grant)	\$	78,007	\$	59,131,544	\$ 59,209,551
Infrastructure Loan				40,977	40,977
Consortia				7,907,376	7,907,376
Public Housing				290,081	290,081
Administrative Costs		274,432		5,440,225	5,714,657
Pro-rata Costs		228,658		1,760,849	1,989,507
Loan Account Service				289,975	289,975
Total Expenditures	\$	581,097	\$	74,861,027	\$ 75,442,124

To meet these objectives, we:

- Analyzed internal controls;
- Determined whether the Financial Office, Communications Division, and CASF recipients' internal controls were adequate to ensure the reliability of recorded and reported information;
- Determined whether the Financial Office properly records and reports CASF program revenue;
- Determined the adequacy of Communications Division and Financial Office oversight over CASF remittances;
- Determined whether the Financial Office properly recorded and reported CASF program expenditures;
- Determined the adequacy of Communications Division management and oversight over CASF expenditures;
- Determined the adequacy of CASF recipients' management and oversight over CASF project/consortium expenditures;
- Determined whether disbursements from the CASF were in compliance with Public Utilities Code sections 281 and 282, other state laws, and Commission directives, including payment requests to grantees receiving funding from each account;
- Determined total CASF program expenditures as of December 31, 2015, including disbursements to contractors, internal administrative expenses and inter-departmental charges;

See Independent Auditor's Report

- Performed specific project reviews for the following:
 - Central Valley Independent Network, LLC (CVIN)
 - Race Telecom
 - San Joaquin Valley Consortium
 - Los Angeles County South Bay Bus Regional
 - Additional Rural and Regional Urban Consortia; and
- Reviewed the processes and procedures for at least one unsuccessful application in each of the CASF accounts to confirm that the CPUC staff recommendation or other action was in accordance with Public Utilities Code section 281, other state laws, and Commission directives.

Conclusion

Our audit determined the following as of December 31, 2015:

- CASF program expenditures are in compliance with Public Utilities Code sections 281 and 282, other state laws, and Commission directives;
- Records are reliable;
- Revenue is properly managed and correctly recorded per our audit schedule (see page 9); and
- The CASF program has proper oversight.

Audit adjustments are the result of timing differences, methodologies of reporting, and surcharges applied incorrectly (see the Findings and Recommendations section).

Audit adjustments are summarized as follows:

(A)	(B)	(C) = (A) - (B)					(D)	(E) = (C) + (D)	(B) + (E)		
(Unaudited by SCO)	1st Interim Financial Audit (Unaudited by SCO)	2nd Interim Financial Audit							(Unaudited by SCO)		
July 1, 2010 through December 31, 2015											
Total Reported in 2015 CASF Annual Report	January 1, 2008, through June 30, 2010	Amount Reported	Finding #1	Finding #2	Finding #3	Finding #4	Finding #5	Total Understated/ (Overstated)	Audited Totals	Totals Adjusted as of December 31, 2015*	
Revenue											
CASF Surcharges Collected	\$ 255,548,625	\$ 115,140,932	\$ 140,407,693	\$ 2,977,155	\$ 761,590	\$ -	\$ -	\$ -	\$ 3,738,745	\$ 144,146,438	\$ 259,287,370
Delinquent Fees	290,456	161,024	129,432	-	-	-	-	-	-	129,432	290,456
Loan Repayments & Interest	15,595	-	15,595	-	-	-	-	-	-	15,595	15,595
Investment Income	2,716,543	1,008,965	1,707,578	149,296	-	-	-	-	149,296	1,856,874	2,865,839
Total Revenue	\$ 258,571,219	\$ 116,310,921	\$ 142,260,298	\$ 3,126,451	\$ 761,590	\$ -	\$ -	\$ -	\$ 3,888,041	\$ 146,148,339	\$ 262,459,260
Expenditures											
CASF Projects (Infrastructure Grant)	\$ 59,209,551	\$ 78,007	\$ 59,131,544	\$ -	\$ -	\$ -	\$ 4,830,570	\$ 1,896,680	\$ 6,727,250	\$ 65,858,794	\$ 65,936,801
Infrastructure Loan	40,977	-	40,977	-	-	289,975	431,278	169,337	890,590	931,567	931,567
Consortia	7,907,376	-	7,907,376	-	-	(1,057)	706,515	277,407	982,865	8,890,241	8,890,241
Public Housing	290,081	-	290,081	-	-	-	143,215	56,232	199,447	489,528	489,528
Administrative Costs	5,714,657	274,432	5,440,225	-	-	396,921	(6,111,578)	-	(5,714,657)	(274,432)	-
Pro-rata Costs	1,989,507	228,658	1,760,849	-	-	410,149	-	(2,399,656)	(1,989,507)	(228,658)	-
Loan Account Service	289,975	-	289,975	-	-	(289,975)	-	-	(289,975)	-	-
Total Expenditures	\$ 75,442,124	\$ 581,097	\$ 74,861,027	\$ -	\$ -	\$ 806,013	\$ -	\$ -	\$ 806,013	\$ 75,667,040	\$ 76,248,137

* Cumulative Totals are provided for informational purposes only

(A) 2015 CASF Annual Report January 2015 - December 2015, Prepared by the California Public Utilities Commission, Issued April 1, 2016

(B) Audited by the California Public Utility Commission's Utility Audit, Finance and Compliance Branch, Report Issued March 30, 2011

Views of Responsible Officials

We discussed our results with representatives from CPUC at an exit conference held on March 7, 2017, at CPUC headquarters. At the exit conference, we stated that the final report will include their views. On March 14, 2017, we issued a draft report. We received a management response to the draft report on March 24, 2017. CPUC agreed with Findings 1, 3, and 4 and did not agree or disagree with Finding 2. CPUC's response for Finding 2 has been incorporated within the report and the response has been included in its entirety as an attachment.

Restricted Use

This report is intended for the information and use of the CPUC and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Findings and Recommendations

**FINDING 1—
Surcharge
revenue and
investment
income was
understated**

The audit determined that surcharge revenue was understated by \$2,977,155 as of December 31, 2015. The understatement was due to the methodology used by the CPUC to record the amount of revenue received.

Depending on how certain reports were generated, the CPUC's reporting methodology switched between the cash method of accounting and the accrual method of accounting, resulting in the discrepancy. The 2015 CASF Annual Report was not required to use a specific method of accounting principles; therefore, the finding is not the result of any error or irregularities. The understatement resulted because the CPUC did not adopt an accounting principle or standard method of reporting. There is no consistency or reconciliation between the two approaches.

The CPUC's TUFFS determines surcharge amounts (program revenues) payable to the CPUC based on the intrastate revenue earned and reported by utilities in a given monthly period. The purpose of TUFFS is to ensure regulatory compliance with surcharge remittance for the period in which utility revenues were earned. TUFFS will permit transaction adjustments to monthly periods back to May 2010.

In contrast, CALSTARS reports revenue in the monthly period it is received. Since 2012, at the end of each fiscal year, an adjustment is made to reflect reported revenue accruals. Additional payments received for any reporting period (including multiple years) prior to the current year are applied to the prior year as an adjustment to the prior year's last quarter cash revenue. CALSTARS reflects cash transactions received in a given period, while TUFFS reflects transactions earned but not necessarily received in that period. Therefore, respective TUFFS and CALSTARS revenue reports for a given period do not agree.

For 2011 and 2012, it appears that a CALSTARS report that was run after March of the subsequent year, inclusive of the cumulative months, overstated CASF end-of-year program revenues. Further, for reporting years 2013 and 2014, it appears that the CALSTARS report may have been generated prior to March of the subsequent year. Revenue is often received 45 to 60 days after the reporting period; therefore, the November and December revenue might not have been received by the CPUC at the time the report was generated. As a result, CASF program revenue was not reflected in CALSTARS. The total revenue for the reporting period was then added to the cumulative total of the prior year. Thus, the total became understated going forward under the modified accrual accounting principle, the recommended accounting methodology.

We discovered the discrepancy when we attempted to recreate the CALSTARS reports and could not generate the original revenue figures reported in the 2015 CASF Annual Report prepared by CPUC, Table 16, page 41. The discrepancy was determined to be in FY 2012-13 and FY 2013-14; however, any understatement in one fiscal year would result in an overstatement revenue in the subsequent fiscal year, so the discrepancy would not compound each year. As the 2015 CASF Annual

Report reported cumulative revenue since inception, both the CPUC and SCO audit staff reviewed the totals instead of auditing each calendar year and determined that the cumulative effect was revenue understated by \$2,977,155 as of December 31, 2015 and could result in the CASF over-collecting beyond its \$315 million program authority.

Using the same audit methodology for investment income, we determined that the amounts reported were understated by \$149,296 as of December 31, 2015.

Recommendations

The SCO recommends that CPUC staff continue to use CALSTARS as the primary determinant of annual revenue. However, the CPUC should:

- For revenue reporting, run the CALSTARS for the calendar year end report at least 60 days past December 31;
- Confirm prior revenue amounts when calculating the cumulative total revenue; and
- Develop correlation analysis between TUFFS and CALSTARS.

The CPUC has stopped CASF program surcharge revenue collections as of December 1, 2016, in anticipation that all funds will have been collected by that date. (CPUC Resolution T-17536)

FINDING 2— Surcharge revenue was credited to the wrong account, and carriers are past due

During the course of the audit, the SCO requested that the CPUC staff test the revenue calculated by TUFFS to provide better assurance of its accuracy. CPUC staff reported that they initially identified unpaid amounts to the CASF totaling \$1,774,360 from nine carriers, but later determined that \$761,590 had been paid but had been misapplied to the wrong surcharge program. Therefore, revenue reporting in the annual report is understated by \$761,590 as follows:

Carrier	Unpaid	Misapplied	Total Due per TUFFS
Granite Telecommunications	\$ 27,537	\$ 11,679	\$ 39,216
TWC Digital Phone LLC	-	-	-
AT&T Mobility Wireless	21,074	11,506	32,580
Cox California	-	84,017	84,017
8 & 8	2,349	20,113	22,462
New Cingular Wireless	949,752	540,951	1,490,703
AT&T Corp	-	40,735	40,735
Global Crossing	1,903	45,644	47,547
Santa Barbara Cellular	10,155	6,945	17,100
Total Revenue	<u>\$1,012,770</u>	<u>\$ 761,590</u>	<u>\$1,774,360</u>

During our review of the CPUC's internal control processes, the SCO attempted to reconcile the revenue reported in TUFFS to the amounts reported in CALSTARS. We found it difficult to correlate the two reports due to differences in reporting methodology. TUFFS provides accrual-based reporting, whereas CALSTARS uses cash-based reporting.

See Independent Auditor's Report

The CPUC does not reconcile differences between TUFFS and CALSTARS, so we did not perform additional testing to determine the reliance of TUFFS. Instead, we elected to test revenue using the modified accrual accounting methodology, which recognizes revenue only when received. Therefore, amounts reported by TUFFS as owed to the CASF but not received do not have any impact on the financial audit, as only revenue received is relevant under Government Accounting Standards.

Although the financial reporting is correct, proper management of the CASF should account for unpaid surcharges due, as leaving amounts uncollected could put an unfair burden on carriers that properly submit their surcharges. Additionally, sudden collection of unpaid surcharges could result in the CASF over-collecting beyond its \$315 million program authority.

The SCO recognizes that the CPUC understands the issue regarding the accuracy of surcharges calculated in TUFFS. The CPUC has put processes and procedures in place to audit the submissions by carriers. The results and effect of these audits are limited, as this is a new process; without reconciling the differences between TUFFS and CALSTARS, the CPUC cannot quantify any issues that may currently exist.

As the Communications Division uses the Utility Audit, Finance, and Compliance Branch and other contractors to audit the accuracy of the data entered into TUFFS, we did not test individual transactions entered into the system. We used other audit procedures to analytically validate the difference between TUFFS and CALSTARS and determined that revenue in total had an approximately 60 to 90 days discrepancy; this discrepancy was expected when comparing accrual-based revenue to cash-based revenue. Therefore, we did not perform additional audit procedures on the TUFFS system.

Recommendations

We recommend that the CPUC:

- Track CALSTARS payments by matching them to the corresponding entry in TUFFS and reconcile any difference;
- Use TUFFS to record and track any outstanding payments due to the CASF; and
- Consider using TUFFS reporting, not CALSTARS, for future reporting of CASF revenue.

Management Response

Surcharge payments are occasionally incorrectly applied in TUFFS by the carrier entry to the wrong account or surcharge program category. Carriers are responsible for inputting data correctly, but CD/TUFFS administration staff performs periodic reviews to detect such errors and, upon detection of such errors, contact the carrier to advise them of their need to request payment and surcharge program corrections. Additionally, the CPUC contracts with external auditors to perform surcharge audits on selected carriers.

See Independent Auditor's Report

The Fiscal Office performs daily reconciliation between TUFFS and CAISTARS to ensure that all TUFFS payments are properly recorded in CAISTARS. However, not all CAISTARS payments are recorded in TUFFS. For this reason, surcharge program reviews should continue to rely on CAISTARS for the most accurate and comprehensive revenue tracking.

To track any outstanding payments due to CASF, the Fiscal Office and CD personnel will coordinate to follow up with non-compliant carriers through TUFFS review.

SCO's Comments

The CPUC has indicated that it has instituted corrective action. We will follow up at a later date to ensure such corrective action is adequate and appropriate.

**FINDING 3—
Expenditures
reported were
understated due
to unreconciled
differences
between reports**

We determined that CASF expenditures were understated by \$806,013 across all accounts in the fund. We noted the discrepancy when reconciling the Q16 CALSTARS reports that breaks down expenditures by program type using the Program Cost Account (PCA) codes to cost breakdown in the 2015 CASF Annual Report.

Communications Division staff uses monthly H10 CALSTARS reports and multiple Excel spreadsheets to track and report program expenditures, but reconciliation to the Q16 CALSTARS reports does not occur on an annual or semi-annual basis. We were able to reconcile the Communications Division's manually developed payment logs to the 2015 CASF annual report.

We then reconciled the annual report to the Q16 CALSTARS reports and noted the following discrepancies:

- Consortia expenses were correctly paid, but were reported twice in the payment logs for the amount of \$1,057, resulting in an overstatement of expenses in the annual report;
- Pro rata charges were included in PCA 15701 (Infrastructure) in CALSTARS. CALSTARS reports \$80,721 less in expenditures than the annual report;
- Administrative expenses appear understated as CALSTARS (PCA 15700, 15710, 15720, and 15730) are \$396,921 greater than the amounts reported in the annual report;
- Pro rata expenses were understated by \$490,870 due to a fund adjustment that was not included in the Communications Division's manual reports; and
- Loan accounting services of \$289,975 should be reported as Infrastructure loan expenditures.

It appears that when the CASF was established, the Communications Division did not establish the proper detail of PCA codes and combined certain expenses into one or two codes. We tested infrastructure, consortia, and housing expenditures and validated them to the project files; therefore, adjustments appear to be the results of administrative and pro rata administration. We determined that the above discrepancies should be adjusted as follows:

	2015 CASF Annual Report	Audit Adjustment	Adjusted Amount
Expenditures:			
Infrastructure Grant	\$ 59,209,551	\$ -	\$59,209,551
Infrastructure Loan	40,977	289,975	330,952
Consortia	7,907,376	(1,057)	7,906,319
Public Housing	290,081	-	290,081
Administration Costs	5,714,657	396,921	6,111,578
Pro-rata Costs	1,989,507	410,149	2,399,656
Loan Accounting Service	289,975	(289,975)	-
Total Expenditures	<u>\$ 75,442,124</u>	<u>\$ 806,013</u>	<u>\$76,248,137</u>

Recommendations

We recommend that CPUC staff reconcile payment logs to CALSTARS and reconcile any difference.

**FINDING 4—
Administrative
and pro rata
charges were
classified to
incorrect CASF
accounts**

Public Utilities Code section 281 established four CASF accounts: Infrastructure Grant, Infrastructure Loan, Consortia, and Public Housing. The CPUC reports expenditures for each account separately in the annual report; however, administration cost and pro rata costs are reported separately and not correlated in their respective CASF account.

We determined that CPUC staff administering the CASF accounts properly coded the amount of time they worked on each program by coding their timesheets with the appropriate PCA code. Those charges were properly allocated in CALSTARS; however, these amounts were not carried forward to the annual report. The annual report reported administrative and pro rata costs as a lump sum to the CASF.

As mentioned in Finding 3, pro rata charges in CALSTARS were allocated in total to the Infrastructure Grant account; however, pro rata is an overhead charge that should have been equitably allocated over all accounts. We have applied a reasonable method of allocation using the administrative charges as the basis for distribution.

Using the administrative charges coded into CALSTARS and the allocation of pro rata, we have determined the audit adjustments as follows:

	Adjusted Amounts*	Administration Audited Adjustment	Pro rata Audited Adjustment	Total Adjusted Amount
Infrastructure Grant	\$59,209,551	\$ 4,830,570	\$ 1,896,680	\$ 65,936,801
Infrastructure Loan	330,952	431,278	169,337	931,567
Consortia	7,906,319	706,515	277,407	8,890,241
Public Housing	290,081	143,215	56,232	489,528
Administration Costs	6,111,578	(6,111,578)	-	-
Pro-rata Costs	2,399,656	-	(2,399,656)	-
Total Expenditures	<u>\$76,248,137</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$76,248,137</u>

*Adjusted amounts carried forward from Finding 3

If the amounts of administrative and pro rata costs are not allocated to the proper accounts, the CPUC is at risk expending more than the amounts approved for each program.

Recommendations

The SCO recommends that CPUC staff:

- Properly report that allocated amounts of administrative and pro rata expenses in the annual report going forward; and
- Develop and adopt a formal allocation methodology for pro rata expenses.

**Attachment 1—
California Public Utilities Commission’s
Response to Draft Audit Report**

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



March 24, 2017

Andrew Finlayson
Bureau Chief
State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, California 94250-5874

**SUBJECT: COMMUNICATIONS DIVISION COMMENTS ON MARCH 14, 2017
DRAFT CASF FINANCIAL AUDIT REPORT**

Dear Mr. Finlayson,

The Communications Division (CD) appreciates this opportunity to comment on the DRAFT California Advanced Services Fund (CASF) second independent interim financial audit report prepared by the State Controller's Office (SCO) and distributed for comments on March 14, 2017. This audit was initiated pursuant to Public Utilities (PU) Code section 912.2(a) to ensure that program funds have been expended in accordance with the approved terms of the grant awards and loan agreements pursuant to PU Code section 281.

CD is pleased to see SCO's conclusions presented on page 8 of your draft financial audit report that: CASF program expenditures are in compliance with PU Code sections 281 and 282, other state laws, and CPUC directives; records are reliable; revenue is properly managed and correctly recorded per SCO's schedule; and the CASF program has proper oversight. We interpret these audit report findings to confirm that the Commission has been appropriately managing the CASF funds. Further, CD agrees with SCO that audit adjustments are the result of timing differences, methodologies of reporting, and surcharges applied incorrectly. We have already begun implementing several of SCO's recommendations in the upcoming CASF Annual Report, which will be submitted to the Legislature in April 2017.

Finding 1: Surcharge revenue and investment income was understated by \$2,977,155 and \$149,296 respectively. The understatement was due to the methodology used by the CPUC to record the amount of revenue received.

Response: CD agrees with this finding. Revenues were tracked using CalSTARS report Q24. This data was recorded in CD's Surcharge Rate Revenue Tracking workbook (created by CD staff) and totals were transferred to a composite workbook, which showed aggregate revenues and expenses. This information was used for the Estimated Fund Balance - Table 2, the Program Revenues and Expenditures - Table 3, and the Estimated Surcharge Collection - Table 16. CD's Surcharge Rate Revenue Tracking workbook did not record end of year adjustments for surcharge revenue and investment income. The CASF surcharge has reached \$315 million and the collection of surcharges has ceased as of December 1, 2016.

For future years, the Fiscal Office will coordinate with CD to reconcile end of year adjustments as described above, to ensure reconciliation with CalSTARS financial reports. The reconciled surcharge revenue and investment income will be reported in the 2016 CASF Annual Report.

Finding 2: Surcharge revenue was credited to the wrong account. Carriers are past due.

Response: Surcharge payments are occasionally incorrectly applied in TUFFS by carrier entry to the wrong account or surcharge program category. Carriers are responsible for inputting data correctly, but CD/TUFFS administration staff performs periodic reviews to detect such errors and, upon detection of such errors, contact the carrier to advise them of their need to request payment and surcharge program corrections. Additionally, the Commission contracts with external auditors to perform surcharge audits on selected carriers.

The Fiscal Office performs daily reconciliation between TUFFS and CalSTARS to ensure that all TUFFS payments are properly recorded in CalSTARS. However, not all CalSTARS payments are recorded in TUFFS. For this reason, surcharge program reviews should continue to rely on CalSTARS for the most accurate and comprehensive revenue tracking.

To track any outstanding payments due to CASF, the Fiscal Office and CD personnel will coordinate to follow up with non-compliant carriers through TUFFS review.

Finding 3: Expenditures reported were understated by \$806,103 due to unreconciled differences between reports.

Response: CD agrees with this finding. CD staff has been reconciling payment logs to CALSTARS to reconcile any difference.

Finding 4: Administrative and pro rata charges were classified to incorrect CASF accounts.

Response: CD generally agrees with this finding. Pro rata interagency costs represent CASF's contribution to the statewide administrative costs for services rendered by other State agencies. However, this cost element is being discontinued. In allocating future overhead costs, the Fiscal Office will coordinate with the CASF program to arrive at an appropriate allocation of administrative costs.

Again, CD is pleased with the conclusions and appreciates the thoroughness of the Audit and the constructive recommendations for improvements. Should you have any questions, please feel free to contact me or Selena Huang at (415) 703-5247.

Sincerely,

Original signed by

Robert Wullenjohn
Manager
Broadband, Video and Market Branch
Communications Division

cc: Michael Amato, Acting Director, CD
Selena Huang, CASF Section Supervisor, CD
Stacie Castro, CASF Advisory Attorney, Legal Division
Michelle Morales, Fiscal Office