

AT-A-GLANCE | JUNE 2018

USAC AUDIT DEFENSE

**You've been audited.
Now what?**

What The Audit Letter Does Not Tell You – ADVICE FROM OUR EXPERTS

At The *CommLaw* Group, we represent communications companies facing a federal or state-level regulatory compliance audit. If your company is audited, or if you are looking to prepare for the inevitable audit letter, you have come to the right place.

Our experts have defended countless clients facing regulatory audits. Here's their advice about the audit defense process.

WHAT IS A "SUCCESSFUL" AUDIT?

- **FIRST AND FOREMOST**, "success" is always measured from your perspective. A successful audit recognizes your past compliance efforts, and ensures your business goals and operations are not at risk based on the audit decision.
- **SECOND**, a successful audit proceeds smoothly. We work with you and with the auditors to facilitate required exchanges of information in a professional manner.
- **THIRD**, we believe that a successful audit should advance your interests. At the end of the audit, our clients tell us they are even better equipped to manage their compliance programs.

We look forward to working with you toward a successful audit outcome.

This is *Not* a Routine Financial Audit

If you have never faced a regulatory audit, you might be surprised to learn that regulatory audits proceed differently from financial or tax audits.

Of course regulatory auditors delve into financial statements. But they also analyze a company's compliance with pertinent regulations. Auditors put compliance practices under the microscope, searching for mistakes that even the most compliance-conscious companies make. As a result, few businesses leave an audit unscathed.

Here are some of the issues that regulatory auditors analyze:

- **Regulatory Classifications.** Have you classified your services appropriately?
- **Claimed Exemptions.** Have you claimed regulatory exemptions in a correct and well-documented manner?
- **Geography of Service Offerings.** Have you appropriately separated your revenues based on the location of where your service is provided?
- **Corporate Structure.** Auditors will analyze the corporate structure of the company and its affiliates to confirm appropriate compliance of regulated entities.
- **Service Descriptions.** Auditors will evaluate service descriptions to determine whether services are regulated.
- **Invoices.** Auditors will examine customer invoices.
- **Wholesale/Resale Agreements.** Auditors will analyze the regulatory implications of wholesale/resale agreements.

For each of these topics, companies will be asked to provide documentation demonstrating compliance with regulatory requirements.



“Auditors are going to notice when companies have not checked the right box, filed the right paperwork, dotted their i’s or crossed their t’s.”

LINDA MCREYNOLDS | Of Counsel, The CommLaw Group

Audits are Consequential

Audits are consequential. An adverse audit outcome can have severe financial consequences for your business:

- **Retroactive Consequences.** This means that you will be required to compensate the government for fees from prior years. Usually, you will not be able to pass these charges on to your customers.
- **Lasting Effects.** You will be required to comply with the audit decision going forward, which may entail higher regulatory payments in the future.
- **Appeals Languish for Years.** You have the right to appeal an audit outcome, but you may not receive a final decision on your appeal for years. You must pay the invoice while the audit appeal process is underway.



“The biggest mistake you can make when you receive an audit letter is to underestimate it.”

JONATHAN MARASHLIAN | Managing Partner,
The CommLaw Group

Instead, companies should review the materials carefully, respond in a timely manner, provide complete responses without volunteering information that is not requested, and ideally retain counsel for purposes of audit defense.

The On-Site Visit Requires Preparation

The On-Site Visit entails an auditor visiting your offices to review your records. This is often a key part of the audit, but also involves risk.

Auditors will ask questions, request access to records, and have in the past even asked to use company equipment. Companies and their employees should be careful to provide only relevant and accurate information to auditors.



“When no lawyer is present, an auditor can request information that is beyond the scope of the audit process. It is necessary to have an attorney present at the on-site visit.”

ALLISON RULE | Partner, The CommLaw Group

FEDERAL & STATE REGULATORY CONTRIBUTION OBLIGATIONS

In the U.S., regulatory burdens fall on companies that operate in regulated areas of the marketplace. **Communications companies are among the most heavily regulated.**

The Federal Communications Commission (FCC) regulates communications companies at the federal level, enforcing federal laws and imposing federal regulations. For example, many communications companies are required to pay regulatory fees, which are used to support federal universal service programs, such as support for low-income consumers, schools, rural healthcare, and libraries.

The Universal Service Administrative Company (USAC) oversees and manages universal service programs and contributions.

Among its functions, USAC audits communications companies to determine if they have complied with universal service regulatory obligations. USAC may audit a company directly, or contract with third-party auditors.

States also impose regulatory compliance requirements, usually enforced by state Public Utility Commissions or Public Service Commissions. These Commissions either audit companies directly, or contract with third-party auditors.

In-Depth: How Auditors Scrutinize Exemptions

The FCC and state governments make exemptions available to regulated businesses. These exemptions reduce a company’s federal regulatory liability by excluding revenues related to specific kinds of service offerings or business relationships.



“Auditors carefully scrutinize exemptions that companies claim. Companies have to be able to support the exemptions that they claim, and explain the exemptions to the auditors.”

JACKIE NEFF | Senior Managing Attorney, The CommLaw Group

Here are examples of popular exemptions available to telecommunications companies that contribute to the federal Universal Service Fund (USF):

EXEMPTION	DETAILS	WHAT AUDITORS ARE LOOKING FOR
RESELLER CERTIFICATES	FCC rules provide that contributions to the USF are only made on retail, end-user services. Wholesale carriers providing services to other carriers for resale to end users may be exempt from contribution. The FCC has set up a system of exemption certificates that allow resellers to provide reliable proof to wholesale providers that purchased services will be resold.	Auditors will ask to see exemption certificates. Companies should make an effort to collect annual exemption certificates that are accurate and complete. Certificates with errors raise red flags. Auditors also scrutinize reseller records to confirm proper treatment of pass-through charges (USF charges added to end-user customer invoices).
DE MINIMIS	A carrier is considered <i>de minimis</i> when annual USF contribution obligations are less than \$10,000.	Auditors will confirm that companies have properly reported revenues related to telecommunications, so that the company can take advantage of the <i>de minimis</i> status in good faith.
INTERNATIONAL	Companies with quarterly interstate revenue that is less than 12 percent of combined quarterly interstate and international revenue are exempt from contribution on international revenue. This exemption is called the Limited International Revenue Exemption (LIRE).	Auditors will review and confirm exemptions of international revenues. Companies need to establish to auditors that they are separating revenues by jurisdiction properly.
PRIVATE CARRIAGE	Private carriage status is available to companies that provide services to a select number of customers on individually negotiated terms. In contrast, common carriers provide standard services that they offer to the public indiscriminately. Private carriers are not exempt from USF contributions, but they are exempt from other regulatory fees. States may exempt private carriers from certain obligations, as well.	Auditors will analyze the company’s service offerings to re-confirm eligibility for private carriage treatment. Private carriage status is fact specific, meaning auditors will ask for facts about the kinds of services offered and how they are offered.

Our Approach to Audit Defense

The Audit Defense Team at The *CommLaw* Group is experienced in defending clients in the regulatory audit context. We understand the nuances of regulatory audits, and we are experienced in working with our clients and with auditors toward a positive audit result.

Guided by our experience, we have developed a tested, client-centric approach to regulatory audit defense based on the following principles:

- **Client Focused.** We manage all aspects of the audit defense process for our clients. We work with our clients to identify their goals for the audit process, and work to meet those goals.
- **Detail Oriented.** We work closely with our clients and with the auditors throughout the audit process, always with attention to detail. We work with our clients to meet key deadlines and accurately respond to auditor questions. We also perform careful regulatory analyses to anticipate audit issues, and remedy any compliance concerns.
- **Compliance as Opportunity.** We know that there are only two categories of communications companies – those who have been audited, and those who will be audited. We work with companies who have been audited to exit the audit with a strong compliance framework that the company can use to its advantage. Once a company has been audited, it can take advantage of regulatory certainty to build a robust compliance program. We work with companies to use compliance as a competitive advantage in the marketplace, helping companies achieve their business goals.

We know that no company wants to face a time-consuming, costly regulatory audit. But when the inevitable audit letter arrives in the mail, know that you can turn to The *CommLaw* Group for zealous representation, backed by our Audit Defense Team's experience.



THE FINAL OUTCOME

< \$100

Auditors often determine that the audited company underpaid regulatory fees. The final balance owed to the government can be steep. Of course, the final amount owed varies from case to case, and past experience does not represent guaranteed future outcomes. But we are proud to report that some of our clients audited by USAC have not had to pay more than \$100 at the end of the audits.

> 1 YEAR

USAC audits are lengthy processes that involve numerous formal communications between the auditors and the company's representatives. The timelines vary considerably based on the scope of the audit, the approach of the specific auditor, and the company's cooperation. But in our experience, regardless of what you might expect, audits take longer than one year, and often last around 18 months.

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About The *CommLaw* Group

The *CommLaw* Group is unique among its peers, offering clients a scope of capabilities rarely found in boutique law firms. With a headcount rivaling the Telecom Practice Groups of most major law firms, we boast

a team of attorneys, paraprofessionals and consultants possessing the skills, focus, and resources necessary to serve the communications law needs of Fortune 100 companies, all without sacrificing the range of services and affordability which makes us the “go-to” firm for new entrants and service providers of all sizes.

In association with [The Compliance Group](#), which specializes in fixed-fee licensing and compliance services tailored to the communications industry, The *CommLaw* Group offers businesses the “Full Spectrum” of legal, regulatory, administrative, and consultative services.

The *CommLaw* Group was recently profiled in *The Wall Street Journal* as one of the Capital Region’s Premier Law Firms.

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