

Supplementary Information to the California Teleconnect Fund Compliance Examination of XO Communications, dated July 9, 2013

For the Years Ended June 30, 2011 and June 30, 2012



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Transmittal Letter

California Public Utilities Commission
San Francisco, California

Please find attached Crowe Horwath LLP's (Crowe) consulting report on the potential subsequent impact of certain findings reported in an examination report, dated July 9, 2013, on XO Communications' (XO's) compliance with the rules, regulations, and requirements of the California Teleconnect Fund (CTF) program solely related to program costs and cost related activities for the program year ended June 30, 2010. This consulting report addresses the potential impact of these findings on the CTF program for the program years ended June 30, 2011 and June 30, 2012.

Based on Crowe's analysis:

1. XO failed to demonstrate compliance with Section 884.5 of the Public Utilities Code. Specifically, XO failed to apply the E-rate discount prior to calculating the CTF discount for schools claimed as CTF customers;
2. XO failed to demonstrate compliance with Decision 08-06-020. Specifically, XO claimed the CTF discount on the Auto Attendant service which is an ineligible service;
3. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO provided customer credits to some customers after applying the CTF discount;
4. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO claimed CTF discounts for some customers that were not supported by the billing records;
5. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO provided customer discounts to some customers after applying the CTF discount.

Due to the non-compliance noted above, in total, \$97,425 of over payments were made by the CTF program for the program year ended June 30, 2011, and \$105,363 of over payments were made for the program year ended June 30, 2012. A summary of the over payments is provided in **Attachment A** of this report. Crowe recommends that XO refund a total of \$202,788 (\$97,425 + \$105,363) to the CTF program.

This analysis was conducted in accordance with the Standards for Consulting Services established by the American Institute of Certified Public Accountants (AICPA). Because the assessment did not constitute an audit, review, or examination in accordance with standards established by the AICPA, Crowe does not express an opinion on the supplementary information contained in this report or on the compliance of XO with the rules, regulations, and requirements of the CTF Program solely related to program costs and cost related activities for the program years ended June 30, 2011 and June 30, 2012.

Should you have any questions regarding this report, please contact Bert Nuehring, Partner, at (bert.nuehring@crowehorwath.com).


Crowe Horwath LLP

Executive Summary

As a result of the following non-compliance, XO Communications (XO) was reimbursed for over-claimed California Teleconnect Fund (CTF) program costs by \$97,425 for the program year ended June 30, 2011 and by \$105,363 for the program year ended June 30, 2012.

1. XO failed to demonstrate compliance with Section 884.5 of the Public Utilities Code. Specifically, XO failed to apply the E-rate discount prior to calculating the CTF discount for schools claimed as CTF customers;
2. XO failed to demonstrate compliance with Decision 08-06-020. Specifically, XO claimed the CTF discount on the Auto Attendant service which is an ineligible service;
3. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO provided customer credits to some customers after applying the CTF discount;
4. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO claimed CTF discounts for some customers that were not supported by the billing records;
5. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO provided customer discounts to some customers after applying the CTF discount.

Accordingly, XO should refund to the CTF program a total of \$202,788 for the over claimed amounts.

Brief Background

The California Public Utilities Commission (CPUC) contracted with Crowe Horwath LLP (Crowe) to conduct an examination on XO's compliance with the rules, regulations, and requirements of the CTF Program solely related to program costs and cost related activities related to services provided (herein referred to as the examination report) for the program year ended June 30, 2010 (herein referred to as the examination period). Crowe examined XO's compliance with the applicable requirements of the CTF program solely related to program costs and cost related activities associated to services provided during the program year ended June 30, 2010. On July 9, 2013, Crowe issued its examination report regarding XO's compliance. This report contains the results of consulting services performed by Crowe to determine the monetary impact of the findings noted in the examination report to the program years ended June 30, 2011 and June 30, 2012.

Scope

The examination report noted a total of nine (9) findings related to XO's compliance with the CTF program requirements for the program year ended June 30, 2010. Five (5) of these examination findings had monetary impacts to the CTF program. Per the CPUC's request, Crowe analyzed these five findings (as shown below) for the program years ended June 30, 2011 and June 30, 2012.

1. XO failed to demonstrate compliance with Section 884.5 of the Public Utilities Code. Specifically, XO failed to apply the E-rate discount prior to calculating the CTF discount for schools claimed as CTF customers;

2. XO failed to demonstrate compliance with Decision 08-06-020. Specifically, XO claimed the CTF discount on the Auto Attendant service which is an ineligible service;
3. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO provided customer credits to some customers after applying the CTF discount;
4. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO claimed CTF discounts for some customers that were not supported by the billing records;
5. XO failed to demonstrate compliance with Decision 96-10-066. Specifically, XO provided customer discounts to some customers after applying the CTF discount.

Objectives

Crowe's objectives in analyzing the findings were to:

1. Determine the accuracy of the CTF program discounts that XO provided to its customers and subsequently claimed against the CTF program as reimbursement: and
2. Calculate any over-claimed or under-claimed amounts.

Crowe derived the criteria by which to measure these objectives from the CPUC's CTF program directives including Assembly and Senate Bills, Rulemakings, Decisions, Resolutions and Administrative Letters governing the CTF program.

Methodology

Crowe analyzed the aforementioned monetary findings for the period of July 1, 2010 through June 30, 2011 and the period July 1, 2011 through June 30, 2012. When a finding involved a limited subset of CTF customers, Crowe determined the monetary impact for these specific customers in each program year. When a finding involved an exception that was systemic in nature, Crowe determined the monetary impact for all CTF customers in each program year.

To analyze each finding, Crowe completed an analysis on data provided by XO. For this analysis, Crowe requested that XO provide supporting documentation for its CTF claims made for the periods July 1, 2010 through June 30, 2011 and July 1, 2011 through June 30, 2012. In response, XO provided the following documents:

- 'XO 2010 & 2011 Audit Finding 1 Calculations', 'XO 2010 Audit Findings 5 6 7 9 Calculations' and 'XO 2011 Audit Findings 5 6 7 9 Calculations', which contain CTF customer service quantities and service prices, E-rates, CPUC User Fees, and recalculated CTF discounts for each CTF customer across the respective years;
- '2010-2011 Claim Forms XO' and '2011-2012 Claim Forms XO', which contain the CTF claims submitted by the carrier for both years;
- 'Audit Findings Impact 2010 2011 Funding Years', which compare the recalculated CTF discounts for selected customers against the CTF reimbursements claimed on the CTF monthly claims and then summarize the overclaims.

In addition to the above-mentioned data elements, Crowe requested and obtained the following items:

1. Form 486s for customers that were schools;

2. Additional billing detail for customers where some or all billing detail was omitted from XO's documents;
3. Copies of all XO's CTF monthly claims from the CPUC.

Crowe developed and populated data files that captured information from XO's data submissions, including 2010-2011 and 2011-2012 CTF monthly claim amounts, CTF customer services, service prices, E-rates, and recalculated CTF discounts. Crowe also incorporated into these data files information obtained from the CPUC.

Crowe then tested the information collected in these data files in the following manner:

1. Crowe tested that the billing detail files were complete by comparing the CTF discounts generated from XO's billing systems against the CTF monthly claims.
2. Crowe tested the E-rates used in the datafiles by comparing them to the Form 486s. We checked to see whether the customers had approved E-rates and whether the correct E-rates were used in the recalculation of the CTF discounts.
3. Crowe tested the datafiles for ineligible services.
4. Crowe tested CTF discounts from XO's billing systems to see if they were calculated before or after the application of customer discounts and/or credits.
5. Crowe tested whether the services and service prices provided were mathematically consistent with the CTF discount amounts.
6. Crowe tested that the CTF claim amounts that XO used in calculating the CTF over claims were the same as those in the CTF monthly claims provided by the CPUC.

This analysis was conducted in accordance with the Standards for Consulting Services established by the American Institute of Certified Public Accountants (AICPA). Because the assessment did not constitute an audit, review, or examination in accordance with standards established by the AICPA, Crowe does not express an opinion on the supplementary information contained in this report or on the compliance of XO with the rules, regulations, and requirements of the CTF Program solely related to program costs and cost related activities for the program years ended June 30, 2011 and June 30, 2012.

Results of Procedures

In analyzing the impact of the findings to the two subsequent program years, Crowe found that:

- 1) XO over claimed \$97,425 in reimbursements from the CTF Program for FY 2010-11; and
- 2) XO over claimed \$105,363 in reimbursements from the CTF Program for FY 2011-12.

Provided below is a summary of each finding included in the scope and Crowe's analysis of each finding that results in a potential CTF over payment for program year 2011 and 2012. **Attachment A** to this report provides a schedule of CTF over payments by program year and by each examination report finding.

Finding 1: E-Rate Discount

Examination Report - XO's detailed billing support for its CTF monthly claims showed that XO did not apply the E-rate discount prior to applying the CTF to any of the 14 schools claimed as CTF customers during the period of July 1, 2009 through June 30, 2010.

2011 and 2012 Analysis – Crowe analyzed the CTF discounts for all XO school customers during program years 2011 and 2012 that were also XO customers during the examination period. Based on Crowe's analysis, XO did not apply the statewide E-rate for these customers before calculating the CTF discount. Additionally, two of these schools (Application #6499 and #6795) obtained approved E-rates during the program years 2011 and 2012, and Crowe found these E-rates were not applied either.

XO agreed in its 'Audit Findings Impact 2010 2011 Funding Years' file that it did not properly calculate CTF discounts for school customers receiving the statewide E-rate. For these customers, Crowe tested the completeness of the 'XO 2010 & 2011 Audit Finding 1 Calculations' file, which contained customer services and CTF discounts provided to schools, against the CTF discounts in the CTF monthly claims. Crowe then recalculated the discounts by using the appropriate statewide E-rates. For Application #6499 and #6795, Crowe tested XO's CTF discount calculations using its billing detail to determine whether E-rates were properly applied.

Overall, this analysis showed an over claim of \$84,931 for program year 2011 and an over claim of \$97,001 for program year 2012.

Finding 2: Ineligible Service Claimed

Examination Report - XO's detailed billing support for its CTF monthly claims showed that it claimed the CTF discount on an ineligible service, Auto Attendant. XO claimed the Auto Attendant service as part of their Internet Access Services. This service and a CTF discount were provided to two CTF customers (Application #1298 and #1424) during the examination period.

2011 and 2012 Analysis - Crowe examined the billing detail (contained in the files 'XO 2010 Audit Findings 5, 6, 7, and 9 Calculations' and 'XO 2011 Audit Findings 5, 6, 7, and 9 Calculations') for Application #1298 and #1424 for the program years ended June 30, 2011 and June 30, 2012 and found instances of the CTF discount being claimed on the Auto Attendant service. This resulted in an over claim of \$861 for program year 2011 and an over claim of \$1,245 for program year 2012.

Finding 3: Customer Credits

Examination Report - XO's detailed billing support for its CTF monthly claims showed that XO provided customer credits to CTF customers after applying the CTF discount. Specifically, Crowe noted that the XO applied credits after applying the CTF discount to 8 customers during the examination period (Application #'s 330, 508, 1524, 1847, 1880, 1931, 4776 and 6795). Thus, these customers paid less than 50 percent of the cost of their CTF-eligible services.

2011 and 2012 Analysis - Crowe examined the billing detail for these 8 customers for the program years ended June 30, 2011 and June 30, 2012 and found instances of customer credits being applied to customer bills after the calculation of the CTF discount. These customer credits specifically involved the use of 5% "Contract Renewal" credits and 10% "Contract Renewal

Promotional Credits.” This resulted in an over claim of \$2,276 for program year 2011 and an over claim of \$2,714 for program year 2012.

Finding 4: Claimed Amounts Not Supported by Billing Records

Examination Report – Crowe found that 8 customers had an amount claimed on the CTF claim form that was different than amounts supported by their detailed billing records (Application #'s 784, 979, 1335, 1524, 1880, 1956, 6697 and 6795).

2011 and 2012 Analysis - Crowe tested the CTF discounts claimed for reimbursement for these 8 customers for the program years ended June 30, 2011 and June 30, 2012 using the billing detail to recalculate their CTF discounts. Crowe found instances of claimed CTF discounts that were not supported by the billing records for four customers (Application #'s 1335, 1880, 1956, and 6795). This resulted in an over claim of \$4,797 for program year 2011 and an over claim of \$577 for program year 2012.

Finding 5: Customer Discounts

Examination Report – XO's detailed billing support for its CTF monthly claims showed that XO provided customer discounts to CTF customers after applying the CTF discount. Specifically, Crowe noted that XO applied XOptions-related discounts after applying the CTF discount for 10 customers (Application #'s 551, 736, 1033, 1145, 1203, 1424, 1734, 1791, 2448 and 2998). Thus, these customers paid less than 50 percent of the cost of their CTF-eligible services.

2011 and 2012 Analysis - Crowe examined the billing detail for these 10 customers for the program years ended June 30, 2011 and June 30, 2012 and found instances of customer discounts being applied to customer bills after the calculation of the CTF discount. This involved “XOptions 2 Year Term Discounts,” “XOptions 3 Year Term Discounts,” “XO Easy Portfolio Discounts,” “3 Year” discounts of 15%, and “Contract Renewal” discounts of 10%. Seven customers received these discounts (Application #'s 551, 736, 1033, 1203, 1734, 1791 and 2448). This resulted in an over claim of \$4,560 for program year 2011 and an over claim of \$3,826 for program year 2012.

California Teleconnect Fund
XO Communications

Attachment A – CTF Over Payments by Program Year

Examination Report Findings			CTF Over Payments		
No.	Title	Description	Examination Period	Fiscal Year Ended June 30, 2011	Fiscal Year Ended June 30, 2012
1	E-Rate Discount	E-Rate discount was not applied prior to calculating the CTF discount for any of the 14 schools	\$ 48,765	\$ 84,931	\$ 97,001
2	CTF Claim Rate Reports*	XO's twelve CTF monthly claim forms for 2009-10 did not include the required Rate Report	\$ -	\$ -	\$ -
3	Customer Reports*	The CTF claim forms were not in the required format because of outdated "Customer Types"	\$ -	\$ -	\$ -
4	CTF Discount on Eligible Services not Provided to Customers*	XO did not provide the customers with the CTF discount for all eligible services	\$ -	\$ -	\$ -
5	Ineligible Service Claimed	XO claimed the CTF discount on the Auto Attendant service which is an ineligible service	\$ 426	\$ 861	\$ 1,245
6	Customer Credits	XO provided credits to 8 customers after applying the CTF discount	\$ 2,558	\$ 2,276	\$ 2,714
7	Claimed Amounts not Supported by Billing Records	Amounts claimed on the CTF claims disagreed with the billing records for 8 customers	\$ 3,783	\$ 4,797	\$ 577
8	Inaccurate Customer Classifications*	4 customers were reported on the CTF claim form with an inaccurate "Customer Type" identification	\$ -	\$ -	\$ -
9	Improper Application of Customer Discounts	XO provided certain customer discounts to customers after applying the CTF discount	\$ 7,518	\$ 4,560	\$ 3,826
Total Over Payments			\$ 63,050	\$ 97,425	\$ 105,363

* - Findings excluded by the CPUC from the scope of this analysis.