



## OFFICE OF INSPECTOR GENERAL

### MEMORANDUM

**DATE:** March 31, 2008

**TO:** Chief, Consumer and Governmental Affairs Bureau

**FROM:** Inspector General

**SUBJECT:** Audit of HOVRS, Inc., Reported Costs and Billings for TRS

Hands On Video Relay Services, Inc., (HOVRS) is a provider of video relay services (VRS). Headquartered in Rocklin, California, HOVRS is the third largest provider of VRS.

We engaged KPMG, LLP, to conduct a performance audit to determine whether the Relay Service Data Requests (RSDR) and the Monthly Reports of Relay Service Minutes submitted by HOVRS from January 2004 through December 2006 were (i) in compliance with applicable laws and regulations and (ii) supported by sufficient documentation to warrant reimbursement with TRS funds. In the attachment, KPMG reports that:

- HOVRS could not substantiate the expenses it reported on its 2003 and 2004 RSDR.
- HOVRS reported expenses that exceeded actual costs in its RSDR for 2004 (i.e., six line items tested by KPMG exceeded actual costs by \$850,000, which was 25% of total actual costs).
- HOVRS also reported expenses that exceeded actual costs in its RSDR for 2005 (i.e., seven line items tested exceeded actual costs by \$475,000, which was 10% of total actual costs).

HOVRS disagreed with KPMG's findings.

KPMG is wholly responsible for its report and the conclusions expressed therein. We express no assurance on the report or its conclusions.

If you have any questions, please contact me at (202) 418-0845.

A handwritten signature in blue ink that reads "Kent R. Nilsson".

Kent R. Nilsson

Attachment: KPMG report dated 3-11-08

cc: Chairman; Chief of Staff  
Deputy Bureau Chief, Policy; Chief, Disability Rights Office  
Managing Director, Associate Managing Director-PERM



Hands On Video Relay  
Services, Inc. TRS  
Performance Audit

Federal Communications  
Commission

Office of the Inspector  
General

March 11, 2008

KPMG LLP



**KPMG LLP**  
2001 M Street, NW  
Washington, DC 20036

Dr. Kent R. Nilsson, Inspector General  
Federal Communications Commission  
Office of Inspector General  
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The FCC Office of the Inspector General (OIG) engaged KPMG LLP (KPMG) to conduct a performance audit to determine whether the Relay Service Data Requests and the Monthly Reports of Relay Service Minutes for the funding years 2004, 2005 and 2006 that were certified and submitted by Hands On Video Relay Services, Inc. (HOVRS), are (i) in compliance with applicable laws and regulations and (ii) supported by sufficient documentation to warrant reimbursement with Telecommunications Relay Service (TRS) funds.

KPMG conducted the performance audit in accordance with Government Auditing Standards issued by the Comptroller General of the U.S. Those standards require that KPMG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives.

In conducting this audit, KPMG reviewed processes for preparation of the Monthly Report of Relay Service Minutes and the Relay Service Data Request and related internal controls for the funding years 2004, 2005 and 2006. This review was designed to identify gaps in the control environment and processes for better maintaining and reporting data. KPMG is not providing an opinion on the adequacy of these controls.

**KPMG LLP**

March 11, 2008

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## 1. Executive Summary

HOVRS is a privately owned provider of Video Relay Services (VRS). Founded in 1990 and headquartered in Rocklin, California, HOVRS is the third largest provider of VRS.

The Monthly Report of Relay Service Minutes is a form submitted by Telecommunication Relay Service (TRS) providers each month to the National Exchange Carrier Association (NECA) TRS Fund Administration to document the minutes of TRS services provided in each month. The providers receive payment from the TRS fund based on the minutes of service reported on this form.

The Relay Service Data Request (RSDR) is a form completed by the TRS providers each year outlining actual costs for the past two years, as well as projected costs for the next two years, for providing TRS services. The providers also report on the RSDR the total actual minutes of services provided for the previous two years and projected demand for the next two years. The RSDR provides the basis for the TRS rate setting process at FCC and NECA.

These forms have a direct effect on the amount of TRS funds disbursed to HOVRS each month for TRS services provided.

The Monthly Reports of Relay Service Minutes and the Relay Service Data Requests for the months of January 2004 through December 2006 submitted to NECA were the focus of this audit. The review of the Monthly Reports of Relay Service did not identify any differences between the Monthly Reports provided by HOVRS and the Monthly Reports of Relay Service Minutes obtained from NECA, and subsequent reimbursements. The Monthly Reports of Relay Service Minutes provided by NECA agreed with the actual reimbursed minutes total for HOVRS. We reviewed the HOVRS Call Detail Records to validate the conversation minutes reported on the Monthly Reports of Relay Service.

However, we identified several issues in connection with the RSDR. We found inaccuracies with the actual data (both expenses and minutes) for periods as they were reported in subsequent years. We also found that HOVRS' documentation and financial records for the actual data did not agree with the amounts submitted on the RSDR.

We selected a limited number of actual expenses, and compared them to their corresponding invoices and receipts. This comparison disclosed the following:

Summary of Findings
Validation of 2005 HOVRS Salaries and Expenses identified a \$240 invoice for monthly gym memberships and day spa massages. <i>(Finding 3.1.A)</i>
For the seven line items tested in the 2005 RSDR, expenses were overstated by approximately \$475,000 or 10% of Total Actual Costs. <i>(Finding 3.1.A)</i>
For the six line items tested in the 2004 RSDR, expenses were overstated by nearly \$850,000 or 25% of Total Actual Costs. <i>(Finding 3.1.A)</i>

KPMG conducted this performance audit based on the information provided to us by HOVRS as of May 3, 2007.

## **2. Background**

### ***Hands On Video Relay Service, Inc. (HOVRS) History & Structure***

HOVRS is a Telecommunications Relay Service provider, with headquarters in Rocklin, California, which currently only offers the Video Relay Service (VRS) form of TRS. Founded in 1990, HOVRS was built from an American Sign Language interpreting service to begin offering VRS services under the auspices of the Federal Communications Commission's (FCC) TRS program in 2003. Organized as a subchapter S corporation under the laws of the State of California, HOVRS was founded by Ron and Denise Obray, with Mr. Obray serving as Chief Executive Officer and President until December of 2006. At that time, Ed Routhier, operator of a private equity fund, succeeded Mr. Obray, as President and CEO, which coincided with an investment in HOVRS by Mr. Routhier's firm, providing HOVRS with additional working capital.

HOVRS has become the third largest provider of VRS, and is close to the second largest in terms of minutes reimbursed. Management stated that HOVRS achieved profitability in 2005, and will remain profitable going forward, assuming that market conditions remain stable and the current VRS rate continues or increases. HOVRS currently operates five call centers throughout the United States with an additional center planned to be added in Phoenix in 2007.

## **2. Objective**

The purpose of the audit is to determine whether the Relay Service Data Requests (RSDR) and the Monthly Reports of Relay Service Minutes that were certified and submitted by HOVRS, are (i) in compliance with applicable laws and regulations and (ii) supported by sufficient documentation to warrant reimbursement with TRS funds. The scope of audit covers calendar year 2004, 2005 and 2006.

KPMG reviewed TRS provider's processes for preparation of the Monthly Report of Relay Service Minutes and the RSDR forms and related internal controls. This review was designed to identify gaps in the control environment and processes for maintaining and reporting data. KPMG is not offering an opinion on the adequacy of these controls. KPMG concluded fieldwork for HOVRS on May 3, 2007. Information received after that date was not considered in the performance audit.

## **3. Findings and Recommendations**

### ***3.1. Data for 2003, 2004, and 2005 HOVRS' Relay Service Data Requests Are Not Reliable***

HOVRS could not substantiate expenses reflected on their 2003 and 2004 RSDR reports. Each year, the FCC uses the reported expenses, both actual and projected, to compute the following year's reimbursement rates. Inaccurate data results in incorrect rates and subsequent payments to the providers. HOVRS reported inconsistent actual cost data for 2004 and 2005 on subsequent RSDR's filed with the FCC and NECA. (*Finding 3.1.B*). HOVRS also could not substantiate actual expenses reported on the RSDR (*Finding 3.1.A*)

We reviewed the actual expenses reported for 23 line items and found the following:

- For 2003 and 2004, 22 of the 23 line items selected for audit from the RSDR could not be fully reconciled to HOVRS' financial records.
- Eleven of those line items had at least \$100,000 or more of difference.
- By year, the following are the net expenses that could not be substantiated:

<i>Year</i>	<i>Total Unsubstantiated Expenses</i>
<b>2003</b>	<b>\$850,000</b>
<b>2004</b>	<b>\$475,000</b>

- HOVRS underreported its expenses by \$73,000 for 2005 on its RSDR.

### **Criteria**

According to the FCC regulations governing the TRS program, TRS providers shall provide the administrator with true and accurate data, both historical and projected, including total TRS operating expenses and total TRS minutes of use data, necessary to determine TRS fund revenue requirements and payments as part of the mandatory minimum standards for providing TRS services.<sup>1</sup>

TRS providers are to issue a Cost Allocation Manual or equivalent guidance that describes the underlying basis for all cost allocations.<sup>2</sup> Costs must be allocated between TRS and Non-TRS services<sup>3</sup> and the allocation must be described.

TRS Providers are to submit the original signed Relay Service Data Request form on the standard format provided on the NECA TRS website.<sup>4</sup>

### **3.1.A. HOVRS Could not Substantiate Actual RSDR Expenses.**

#### **Condition**

KPMG compared three years of RSDR filings to the HOVRS financial records. The following table is the sample we selected to include 23 line items of actual expenses reported by HOVRS on their 2004, 2005, and 2006 RSDR:

<i><b>RSDR Reporting Year</b></i>	<i><b>Actual Expense Year</b></i>	<i><b>Number of Tested Line Items</b></i>	<i><b>Percent of Total Expenses for Year Tested</b></i>
2004	2003	6	71%
2005	2004	7	55%
2006	2005	10	70%

We then requested that HOVRS provide us with the general ledger detail that supported the balances reported on those line items.

The documentation, invoices, and receipts provided for the 23 line items did not agree with the amounts reported on the RSDR. Table 1 below details the size of these 23 variances:

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<sup>1</sup> 47 C.F.R. Section 64.604 (c)(6)(iii)(C)

<sup>2</sup> NECA Relay Service Data Request Instructions

<sup>3</sup> FCC Rcd 04-137, paragraph 182 footnote 520

<sup>4</sup> NECA Relay Service Data Request Instructions



*Table 1: Summary of General Ledger vs. RSDR Variances*

<b>Variance</b>	<b>Number of lines</b>
Zero	0
Less than \$1,000	1
Between \$1,000 and \$10,000	1
Between \$10,000 and \$100,000	10
Over \$100,000	11
Total lines with Variance	23

For the 2005 actual data, all ten line items selected had variances in the general ledger balances versus the data reported in the RSDR. The sum of the balances on the RSDR was lower than those in the HOVRS general ledger. The variances are detailed in Table 4 in Appendix 5.

All seven line items selected from the 2004 actual expense data on the RSDR had variances compared to the general ledger data provided by HOVRS.<sup>5</sup> See Table 5 in Appendix 5 for the detailed results of this testing.

The 2003 actual data selection consisted of six line items totaling just over \$3.4 million in the RSDR. All six line items had variances when compared to the supporting general ledger detail between the actual costs reported on the RSDR, and the general ledger. Three of the four had more costs than the general ledger and one has less costs. A fifth item had no costs reported on the RSDR but the general ledger had \$172,397 recorded. A sixth line item had over \$346,000 in costs reported on the RSDR while the general ledger had nothing recorded. The net result of the comparison with the general ledger was that the RSDR expense data for this period was approximately \$850,000, or approximately 33%, higher than the expense recorded in the general ledger. The details are provided in Table 6 in Appendix 5.

In addition to tracing RSDR reports to accounting records, we attempted to trace selected line items to their source documents. We found that for the transactions occurring in 2003, HOVRS staff was unable to provide supporting documentation. Given the significant issues pertaining to these data reported in the findings, we determined that the time and effort required in obtaining the missing documentation would not result in any increased assurance over the reliability of the data.

We requested supporting documentation from the general ledger detail provided by HOVRS to validate operating expenses for their VRS programs. Invoices sampled did not adequately support the costs recorded by HOVRS. For example, HOVRS corporate credit card payments were sampled, and allocations of the payments were provided, but no credit card statements were provided. Also, invoices could not be tracked in the accounting software by correct invoice number, and allocation totals did not agree to the total invoice amount. One invoice sampled from employee expenses included monthly gym memberships and massages at a day spa for \$240.

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<sup>5</sup> Note: the RSDR requests Telecommunications Equipment Depreciation and Furniture & Fixture Depreciation as 2 separate expense items. HOVRS general ledger only reports total depreciation expense. KPMG attempted to reconcile the reported Depreciation line items from the RSDR to the general ledger.

A trial balance summarizing data from HOVRS financial system was purportedly the basis for the costs reported on the RSDR.

***Cause***

Based on inquiry of the consultant serving in the CFO function for HOVRS, our testing of HOVRS financial records, and processes regarding minutes collection and invoicing to NECA, we determined that the cause of the discrepancy between the data in the RSDR and the general ledger was due to HOVRS not successfully closing the financial records prior to submission of the RSDR to NECA.

Additionally, HOVRS personnel did not maintain records of the changes made to the general ledger subsequent to the submission of the RSDR. Furthermore, HOVRS personnel stated that the changes to the general ledger during this period were not limited to adjusting journal entries but rather also included entry of invoices in the accounts payable records. There are certain weaknesses in controls in place to report accurate information on the annual RSDR sent to NECA and the FCC by HOVRS.

***Effect***

The three years of RSDR data could not be relied upon as accurate. Since this data was used by NECA and the FCC in determining the rates for VRS since July of 2004, the appropriateness of those rates is now called into question. To the extent that it was based on data from HOVRS, the VRS rates that took effect in July 2004 and July 2005 may have been established too high, as the HOVRS cost data was overstated by approximately \$850 thousand and \$475 thousand, respectively for those two periods.

***KPMG Recommendations***

FCC and NECA TRS Fund Administration management should develop and institute written policies and procedures for documenting all TRS program expenses incurred by providers which are able to be recovered via the TRS fund. This would help ensure proper handling of TRS funds. Also, policies and procedures would give providers the opportunity to have consistent documented procedures for reporting all allowable TRS related expenses, and present additional direction for those expenses which are not allowable.

HOVRS and outside legal counsel should document the steps taken when reporting actual and projected cost data via the Relay Service Data Requests to NECA. HOVRS should document the complete process used by their legal counsel for preparing all reports for NECA. HOVRS management should document all actual total costs sent to NECA, and also document the process by which projections are developed. Along with the NECA Relay Service Data Request form, a supporting document should be prepared by HOVRS, which should detail the source for all costs and all allocations including a cross reference from line items on the NECA reports to the general ledger, which should, in turn agree with HOVRS' audited financial statements. This would facilitate HOVRS Management's ability to support all expenses submitted to NECA and FCC via their annual RSDR, and also that HOVRS submitted true and accurate data to NECA and the FCC.

HOVRS should reconcile the costs for 2004 and 2005 reported in the RSDR to the general ledger in order to explain all reporting inconsistencies. The adjustments made to the actual data should be noted along with all supporting documents such as invoices and re-allocations with explanations regarding how the costs are associated with TRS services. HOVRS management should develop and implement written procedures for providing cost and minutes demand data

reported on the RSDR. HOVRS should also institute controls in order to ensure that all information provided to NECA via the RSDR is accurate.

We recommend that HOVRS adopt and follow a policy to perform a final reconciliation of the audited financial statements with the trial balance, used to report cost data on the RSDR, once the audit is complete each year and make any necessary adjusting entries to their general ledger. This would help ensure that all actual costs submitted to NECA and the FCC are accurate according to HOVRS' internal financial records.

### ***3.1.B. HOVRS Reported Inconsistent Actual Costs***

#### ***Condition***

The RSDR, which is filed with NECA in February, contains actual and projected data for both cost and minutes of use data for all forms of TRS provided by the providers. Two years of the most recent actual data are presented (minutes and costs), as well as two years of projected data for the coming years. For example, the RSDR filed in February of 2006 contained actual cost and minutes data for 2005 and 2004 and projected data for 2006 and 2007.

The data HOVRS reported on the RSDR did not agree with the actual cost information included in the HOVRS accounting system. Also, in one case, the actual demand minutes data reported in HOVRS' RSDR was not in agreement with information for the same period maintained by NECA, the fund administrator. Actual minutes reported by HOVRS via their 2005 Relay Service Data Request was greater than the number of minutes documented by NECA for 2005. NECA documented a total of 1,350,246 VRS minutes for HOVRS on their summary of relay minutes reimbursed for 2005 while HOVRS reported their actual minutes as 1,489,005 for the same period. This is a difference of 138,749 minutes of use.

Since this information serves as the basis for developing the cost reimbursement rates, the rates developed by NECA for July 2004 going forward were not based on correct information and therefore, may have been set too high since that time.

Additionally, the actual cost data reported for 2004 and 2005 on the RSDR sent to NECA for 2006 and 2007 reported inconsistent actual costs. There are significant changes in the line items, which were not explained by HOVRS Management within the data request. Table 2 below outlines the variances between the 2004 actual costs reported by HOVRS in certain lettered sections and numbered line items on the RSDRs in 2006 and 2007. Table 3 below outlines the variances between the 2005 actual costs reported by HOVRS in certain lettered sections and numbered line items on the 2006 and 2007 RSDRs.

Table 2 – Summary of 2004 Actual Cost Variances reported by HOVRS on the 2006 and 2007 RSDRs<sup>6</sup>.

<b>Total Video Relay Services Expense Data</b>	<b>2004</b>	<b>2004</b>	
	<b>Actual Costs – 2006 RSDR</b>	<b>Actual Costs - 2007 RSDR</b>	<b>Variance</b>
<b>A. Annual Recurring Fixed Expenses</b>			
5. Furniture (if leased)	\$51,196	\$0	(\$51,196)
<b>B. Annual Recurring Variable Expenses</b>			
2. Salaries & Benefits (Relay Center: Management)	\$183,094	\$183,089	(\$5)
3. Salaries & Benefits (Relay Center Staff)	\$259,499	\$238,018	(\$21,481)
7. Relay Center Expenses	\$527,841	\$599,352	\$71,511
<b>C. Annual Administrative Expenses</b>			
1. Finance/Accounting	\$504,249	\$499,470	(\$4,779)
10. Other Corporate Overheads	\$545,638	\$970,098	\$424,460
<b>E. Other TRS Expenses</b>			
1. Marketing/Advertising Expenses	\$360,633	\$417,808	\$57,175
2. Outreach Expenses	\$70,365	\$75,177	\$4,812

Table 3 – Summary of 2005 Actual Cost Variances reported by HOVRS on 2006 and 2007 RSDRs.

<b>Total Video Relay Services Expense Data</b>	<b>2005</b>	<b>2005</b>		
	<b>Actual Costs – 2006 RSDR</b>	<b>Actual Costs - 2007 RSDR</b>		<b>Variance</b>
<b>B. Annual Recurring Variable Expenses</b>				
1. Salaries & Benefits (Relay Center: Non - Management)	\$3,779,353	\$3,969,353		\$190,000
<b>C. Annual Administrative Expenses</b>				
1. Finance/Accounting	\$691,967	\$694,464		\$2,497
3. Engineering	\$1,181,147	\$1,201,714		\$20,567
5. Operations Support	\$607,206	\$621,505		\$14,299
6. Human Resources	\$468,651	\$633,239		\$164,588
10. Other Corporate Overheads	\$479,849	\$565,295		\$85,446
1. Marketing/Advertising Expenses	\$396,117	\$366,117		(\$30,000)

HOVRS informed us that the projected costs reported on the RSDR were estimated. They could not substantiate the process for developing the projections on the RSDR, which are used to generate the VRS reimbursement rate. Furthermore, when comparing the actual cost data to the projected cost data, there were significant differences. For example, on HOVRS' 2005 Relay Service Data Request, total projected costs for 2005 were \$21,720,423, while actual costs for 2005 reported on the 2006 Relay Service Data Request were \$11,533,745. This is a difference of \$10,186,678, which is directly associated with the development of the rates for VRS service. See Appendix 3: Projection Analysis Charts.

Finally, the RSDR submitted to FCC OIG during the audit was not in the prescribed NECA format and was not certified by HOVRS' Management.

<sup>6</sup> 2004 and 2005 Actual Cost information in Tables 2 and 3 provided to KPMG by HOVRS via the 2006 and 2007 RSDR's submitted to NECA and the FCC.

***Cause***

The changes made to the actual expenses incurred by HOVRS, subsequent to the submission of the RSDRs to NECA and the FCC, were not documented within the HOVRS accounting system.

HOVRS management had limited working knowledge of the NECA Relay Service Data Request process and rate setting procedures. HOVRS management was unable to explain in detail the forecasting methods for preparing and reporting the projected cost data included in the Relay Service Data Request each year.

HOVRS did not have a documented cost methodology to report cost data used to develop a rate for VRS services. HOVRS management instituted the use of Erlang C<sup>7</sup> in order to project required staffing levels at the call centers. This projection tool does not account for all the projected costs reported on the RSDR by HOVRS, only for those costs associated with staffing video interpreters to meet the projected minute demand.

HOVRS' annual RSDR packets were not submitted in the proper NECA format. As a result, information provided to NECA was not properly certified and signed off according to NECA policies. HOVRS Management did not follow the NECA RSDR instructions, and it is not familiar with the TRS program expense submission policies.

***KPMG Recommendations***

HOVRS should submit accurate, consistent and supportable actual VRS cost data for 2004 and 2005 to NECA and the FCC. HOVRS should also explain the differences between these revised actual costs for 2004 and 2005, and the actual costs previously submitted.

FCC and NECA management should draft and implement a policy for developing projected costs, and also compare all projections for VRS costs and minutes to actual VRS costs. This could help evaluate the effectiveness of the projections. All projections should be explained by indicators such as previous year actual cost increases, industry growth trends, and actual minute demand increases. This would maintain the validity of the TRS rates, as they related to both actual and projected costs submitted by the providers each year via the RSDR.

HOVRS should document the cost methodology use to prepare the RSDR, as per NECA RSDR Instructions.

HOVRS should use the spreadsheet template provided by NECA in order to submit all cost and demand data associated with providing VRS. This would help ensure that the information in the RSDR is reported consistently with that of the other providers, and the NECA and FCC can evaluate fairly the cost data incurred by HOVRS.

## **5. Summary of HOVRS Management Comments**

KPMG provided HOVRS management with the opportunity to comment on the draft performance audit report. The comments we received through their legal counsel are reprinted in their entirety in Appendix 3. Generally, HOVRS management disagreed with our findings. HOVRS questioned the accuracy of KPMG's testing of actual costs, and also that portions of the findings are out of the scope of the performance audit. KPMG revised the draft report as appropriate,

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<sup>7</sup> Erlang C is a software package that allows HOVRS to project relay center costs associated with staffing for the projected minutes demand and the answer performance and utilization rates required by NECA and FCC.

therefore certain HOVRS responses and references in HOVRS responses to the KPMG draft report may not longer be applicable. It is also noted that HOVRS Management declined to sign a representation letter as requested by the FCC OIG.

## 6. Summary of KPMG's Evaluation of HOVRS Comments

The comments provided by HOVRS were evaluated by KPMG and our responses are included in Appendix 4 of this report. Generally, KPMG does not agree with HOVRS' comments in response to the findings. HOVRS included multiple exhibits along with their comments. KPMG gave HOVRS a reasonable amount of time, over sixty days, to send the related exhibits before they received KPMG's draft report for comments. KPMG did not evaluate these exhibits for accuracy, or use the information provided by HOVRS to change the general conclusions expressed in the report. These exhibits were not included in the final report, because they contained confidential and proprietary information.

## **Appendix 1: Approach and Workplan**

### **Approach and Workplan**

The purpose of the audit is to determine whether the Relay Service Data Requests (RSDR) and the Monthly Reports of Relay Service Minutes that were certified and submitted by HOVRS, are (i) in compliance with applicable laws and regulations and (ii) supported by sufficient documentation to warrant reimbursement with TRS funds. The scope of audit covers calendar year 2004, 2005 and 2006.

KPMG employed a combination of performance audit methodologies to meet the objectives of this project. In assessing HOVRS's processes, KPMG considered guidance from the following:

- Part 64 of the FCC's Rules and Regulations
- TRS Fund Instructions for reporting completion of the Monthly Report of Relay Service Minutes.
- NECA Instructions for completion of the Relay Service Data Request.
- FCC Orders pertaining to the preparation of the Relay Service Data Request.

The work plan consisted of three phases:

#### **Phase 1: Planning**

The FCC sent an announcement letter to HOVRS dated March 5, 2007 with an accompanying document request list. KPMG reviewed these documents as they were received.

This phase was also devoted to gathering information relating to the relevant TRS processes at NECA. This information was gathered through the following:

- Review of existing documentation
- Review of records from previous interviews with selected NECA personnel.

#### **Phase 2: Site Visit**

KPMG conducted a site visit to the HOVRS headquarters in Rocklin, California. During this visit, we conducted interviews with key personnel involved in the preparation of the reports under audit. In addition, we collected the information from HOVRS and conducted testing of the back up documentation on a limited basis. After obtaining an understanding of the processes for preparing the reports under audit, we documented those processes and conducted walkthroughs to validate our understanding of those processes and related controls.

#### **Phase 3: Reporting**

This phase was the culmination of all prior phases of the engagement and consisted of the following steps:

- **Prepared a written draft report of our findings and recommendations.** This document served as the output of our review and included all of our findings and recommendations.
- **Issued Final Report.** After review of the draft report by FCC OIG personnel, we incorporated their comments, as appropriate, and distributed a revised draft to

HOVRS Management. HOVRS Management's comments are provided in Appendix 3 of the final report.



## **Appendix 2: List of Acronyms**

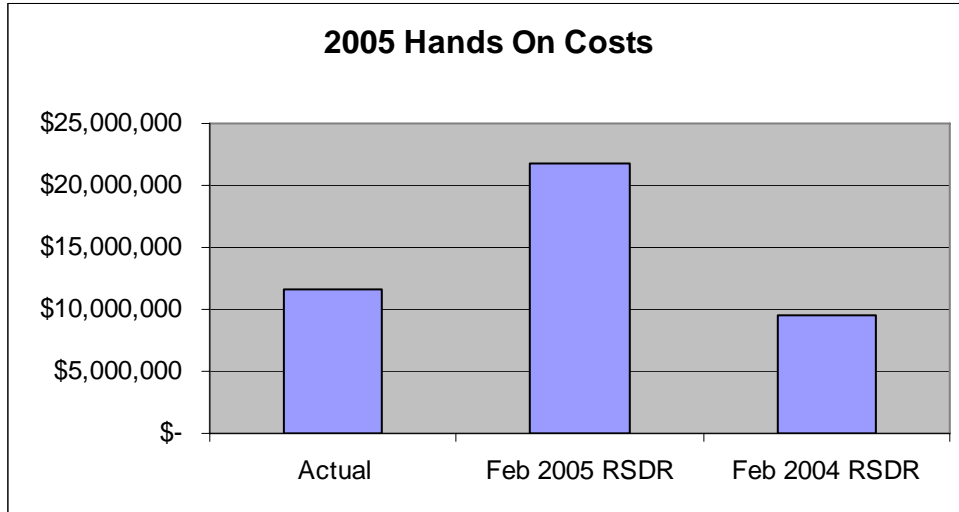
### **List of Acronyms**

ASL	American Sign Language
DRO	Disability Rights Office
FCC	Federal Communications Commission
HOVRS	Hands On Video Relay Service, Inc.
IP Relay	Internet Protocol Relay
NECA	National Exchange Carrier Association
RSDR	Relay Service Data Request
TRS	Telecommunications Relay Service
VCO	Voice Carry Over
VI	Video Interpreter
VRS	Video Relay Service

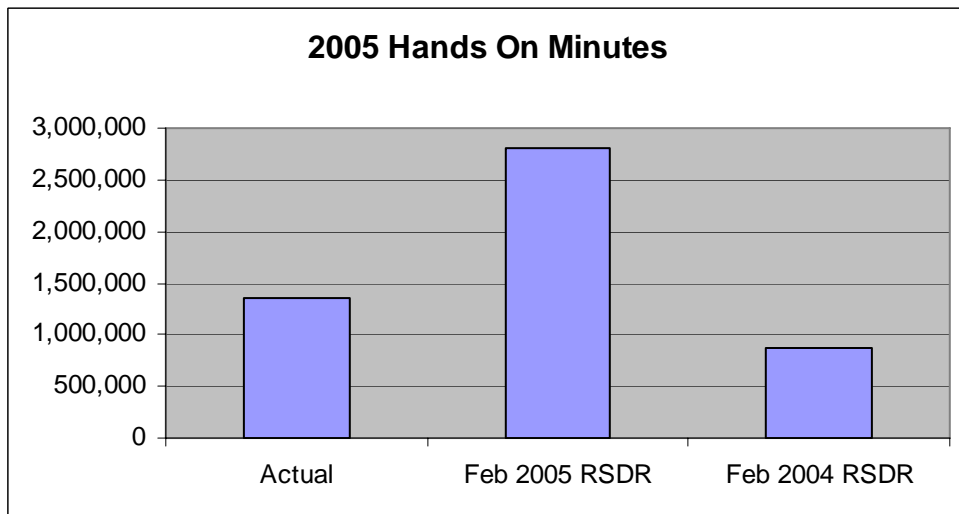
### Appendix 3: Projection Analysis Charts

#### Projection Analysis Chart 1 – HOVRS Cost Analysis –

*The following charts contain comparison of the actual vs. projected cost and minute data submitted by HOVRS to the FCC-OIG on 2006, 2005, and 2004 RSDRs.*



#### Projection Analysis Chart 2 – HOVRS Minutes Analysis



## **Appendix 4: HOVRS Management Comments<sup>8</sup>**

**Email of Management Comments**  
**Hands On Video Relay Services, Inc.**  
**October 26, 2007**

**Attachments:** finalauditresponse.pdf

Sir:

Attached is HOVRS's response to KPMG's draft audit report.

Since we were unable to agree on a form of the representation letter, since I have my doubts as to the appropriateness of a representation letter when KPMG was not engaged by my client, and since Mr. Garay advised that HOVRS is under no FCC obligation to execute any such letter, I believe it is inappropriate for HOVRS to do so.

Please address any questions to this office.

George L. Lyon, Jr.  
Counsel to Hands On Video Relay Services, Inc.

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<sup>8</sup> Auditor's Note: This Appendix presents management's comments on KPMG's original draft report. Some revisions were made based upon managements comments and certain HOVRS comments and references may no longer be applicable.

## **HOVRS'S RESPONSE TO DRAFT PERFORMANCE AUDIT**

This constitutes Hands On Video Relay Services, Inc.'s ("HOVRS") response to the October 10, 2007 draft Performance Audit ("Draft Audit") undertaken by KPMG on behalf of the FCC's Office of Inspector General ("OIG"). As shown below, the Draft Audit appears to be based upon certain misunderstandings of HOVRS's accounting system, the process for the preparation of the annual report to NECA, and the NECA rate calculation methodology. HOVRS is prepared to provide any additional assistance to KPMG necessary to clarify such matters.

More importantly and of primary concern to HOVRS is KPMG's preliminary conclusion that the actual minutes reported by HOVRS to NECA for 2005 is greater than the number of documented minutes. As discussed below, that is incorrect. KPMG's preliminary finding on this matter fails to account for the VRS minutes that HOVRS provided to AT&T as a subcontractor to AT&T. When those minutes are accounted for there is no discrepancy.

### **I. Summary.**

#### **A. Risk of Overpayment to HOVRS.**

KPMG was engaged to conduct the audit and to "assess the risk of improper payments from the Telecommunications Relay Fund" ("Fund") to HOVRS. Draft Audit at § 1.

Central to this is the question whether HOVRS accurately invoiced the Fund for VRS conversation minutes completed by HOVRS's Communications Assistants ("CAs"). With regard to this question, the audit states only that "review of the Monthly Report of Relay Service Minutes did not result in any findings." *Id.* In light of the discussion below showing that HOVRS's 2005 minutes are accurate, that finding should be revised to explicitly state that the audit uncovered no problems with the conversation minutes reported by HOVRS and paid by the Fund; and, therefore, the audit finds that there is no known risk of improper payment from the Fund to HOVRS.

#### **B. KPMG's Recommendations to NECA and the FCC.**

In several instances, the Draft Audit makes recommendations to the FCC and NECA about procedures the FCC and NECA should adopt. For instance, KPMG recommends that the FCC and NECA "develop and institute written policies and procedures for documenting all TRS program expenses incurred by providers." Draft Audit at Section 3.1 (under KPMG Recommendations). These recommendations have nothing to do with HOVRS, and therefore should be presented elsewhere other than in an audit of HOVRS.

#### **C. HOVRS's Controls.**

The Draft Audit also reviews various of the HOVRS's internal controls. KPMG states that it "is not offering an opinion on the adequacy of these controls." Draft Audit at § 1. In fact, substantial amounts of the Draft Audit consist of a review of HOVRS's internal controls and reporting standards vis-à-vis the NECA and FCC standards, which standards NECA criticizes for the lack of their

specificity.

Much of the audit is concerned with the information HOVRS provided on the Relay Service Data Request ("RSDR") form that HOVRS files each year with NECA. On the RSDR, TRS providers such as HOVRS provide data about (1) their actual costs of providing TRS service for each of the last two years, and (2) their estimated cost of providing service over the next two years. The Draft Audit finds "inaccuracies with the actual data (both expenses and minutes) for periods as they were reported in subsequent years" and that "HOVRS documentation and financial record [sic] for the actual data failed to agree with the amounts submitted on the RSDR." Draft Audit at 1 (under Summary of Findings).

**Actual Cost Issues.** With regard to HOVRS's actual cost data on the RSDRs, the Draft Audit focuses on alleged discrepancies between the most recent operational year and subsequent audited general ledger data. The Draft Audit fails to contemplate the significance (1) that the NECA form calls for annualized data from part year data; (2) that the data are compiled well before completion of the company's annual audit; and (3) that NECA's rate recommendations are based on projected future costs not historical actual costs. Moreover, the Draft Audit's findings of discrepancies in the reported annualized data appear largely based on the inability of the Draft Audit to correctly map HOVRS's general ledger accounts to the RSDR line items examined. When correctly mapped, any discrepancies are minor.

**Estimated Cost Issues.** With regard to HOVRS's estimated costs, the Draft Audit notes substantial differences between HOVRS's predicted cost and VRS demand and ultimate results. The Draft Audit fails to note, however, that the effect of HOVRS's overestimation of demand was to lower the VRS rate due to the inability to achieve contemplated economies of scale such as trunking efficiencies in CA usage.

**D. HOVRS As a Going Concern.**

The Draft Audit contains a brief discussion about a going concern comment in HOVRS's 2005 financial statements. As KPMG identifies, it was engaged to conduct a performance audit of HOVRS to assess the risk of improper payments to HOVRS from the Fund. This going concern comment from two year old financials has nothing whatsoever to do with the purpose of the audit and should be stricken.

**II. Certain Factual Errors.**

**A. HOVRS's 2005 Minutes Were Not Misreported and Are Accurate.**

The Draft Audit states (at pages 6-7) that HOVRS misreported the number of minutes processed for 2005 by 138,749 on the 2005 RSDR. That is incorrect. Actual 2005 minutes were not reported on the 2005 RSDR, but were instead reported on the 2006 RSDR. The 2006 RSDR was accurate. HOVRS processed 1,489,005 minutes of VRS in 2005. 1,350,246 minutes were processed

for HOVRS's own account and 138,749 minutes were processed for the account of AT&T. *See* Exhibit 1, hereto, copies of the invoices to AT&T. In preparation for the 2003 RSDR, the FCC and NECA instructed HOVRS that the RSDR should include costs and minutes not only as a direct provider but as a contractor. As a result, HOVRS's practice (which neither NECA nor the FCC has ever questioned) has been to combine its cost and minute reports on the RSDR, both estimated and actual minutes for its own account, and for any other provider for whom HOVRS provides contract VRS. Addition of the minutes HOVRS processed for AT&T shows no discrepancy in the 2005 minute report. Therefore, the minutes that were reported to NECA were accurate.

**B. Miscellaneous Points.**

1. The Draft Audit states (at page 1) that NECA payments to TRS providers are federal funds. This is technically inaccurate. The funds are collected from interexchange carriers by NECA, a private corporation, and are disbursed by NECA. Thus, they are private funds collected by and disbursed according to regulatory mandate.

2. The Draft Audit (at page 3) describes as a "notable finding" that an invoice was uncovered for monthly gym memberships and day spa massages. There is nothing notable about such a finding. Gym memberships and massages are a benefit provided to HOVRS employees. That is a particularly important benefit for sign language interpreters who are particularly susceptible to repetitive stress injuries. *See* Sanderson, *Overuse Syndrome Among Sign Language Interpreters* available at [www.theinterpretersfriend.com/tersnet/2.html](http://www.theinterpretersfriend.com/tersnet/2.html); *See also* [www.deservingbodymassage.com/interpreters-asl-massage.html](http://www.deservingbodymassage.com/interpreters-asl-massage.html).

3. The Draft Audit states (at page 6) that corporate credit card statements were not provided. Such statements were available. They will be provided upon request.

4. The Draft Audit states (at page 6) that HOVRS was unable to provide a trial balance that could be used to arrive at the amounts in the audited financial statements. Such trial balances were in fact available for the OIG auditors, were provided in advance, and HOVRS would be pleased to provide them again upon request.

5. The Draft Audit states (at page 6) that actual cost data for 2004 and 2005 on the RSDR data requests for 2004, 2005 and 2006 were inconsistent and that such inconsistencies were not explained by HOVRS within the RSDR submissions. This is true, but not meaningful, because no such explanation is required on the RSDR.

The differences in amounts reported on the 2004, 2005 and 2006 RSDRs for 2004 costs are explained by the fact that 2004 cost data set forth in the 2004 RSDR was estimated cost data, was annualized cost data in the 2005 RSDR, and was actual data in the 2006 RSDR, having been subject to validation by the company's audit. Likewise 2005 cost data in the 2005 RSDR was estimated cost data and in the 2006 RSDR it was annualized cost data. Differences are natural and to be expected in such circumstances.

6. The Draft Audit states (at page 7) that HOVRS's annual RSDR submissions were not submitted to NECA in the proper format.<sup>1</sup> This is incorrect. The RSDRs were submitted in accordance with the instructions from NECA and included such supplemental data as NECA instructed. NECA has never advised HOVRS that its annual RSDRs lacked proper formatting. Moreover, the related suggestion (Draft Audit at page 7) that the RSDRs lacked proper certification is incorrect. NECA can confirm receipt of such certifications.

7. The Draft Audit claims (at page 7) that the effect of errors in reported annualized costs call into question the appropriateness of the VRS rates and that such rates may have been too high.<sup>2</sup> However, as explained below, historical costs, whether annualized or actual, have not been used by NECA to recommend VRS rates; rather, NECA uses estimated costs for the upcoming two years to recommend such rates. It is not appropriate to raise concerns about the FCC's ratemaking procedures in an audit of HOVRS, and such comments should be stricken from the audit.

**C. Misunderstanding of FCC Ratemaking Process (and Use of Estimated Expense Data).**

The Draft Audit states (at page 1) that it "found inaccuracies with the actual data (both expenses and minutes) for periods as they were reported in subsequent years." This refers to the fact that there were discrepancies between the costs estimated by HOVRS on its RSDRs for the forthcoming year and the costs actually incurred by HOVRS in that year. The Draft Audit concludes (at page 7) that the effect of these discrepancies is that the "three years of RSDR data could not be relied upon as accurate" and that "[s]ince this data was used by NECA and the FCC in determining the rates for VRS... the appropriateness of those rates is now called into question." Legally this is inaccurate. NECA and the FCC have established a ratemaking process based upon estimated costs, which does not contain a process for truing those estimated costs up with actual costs. The FCC is currently engaged in a rulemaking in which it is examining the continued viability of that ratemaking scheme. HOVRS has participated in that rulemaking and has argued that the scheme should be discontinued in favor of a "rate cap" formula which is no longer tied to the reporting of estimated costs. HOVRS's comments can be found in FCC Docket 03-123.

Thus, the suggestion that the calculated rate may have been higher than appropriate is based on a false premise, and all references to this point should be stricken from the audit.

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<sup>1</sup> At page 8 the Draft Audit suggests HOVRS should use NECA's spreadsheet template for its RSDR. HOVRS does use the NECA template. *See, e.g.*, HOVRS 2006 RSDR at 4; HOVRS 2005 RSDR at 4; HOVRS 2004 RSDR at 5 (Copies attached as Exhibit 2.)

<sup>2</sup> *See also* Draft Audit at 5 ("in one case the actual demand data reported in HOVRS' RSDR was not in agreement with information for the same period maintained by NECA.... Since this information serves as the basis for developing the cost reimbursement rates, the rates ... may have been set too high...").

**D. Misunderstanding of HOVRS's Accounting System in Relation to FCC Rules.**

The Draft Report makes several assertions that there are inaccuracies in HOVRS's reporting of expense data. These assertions are based upon a lack of understanding of the HOVRS accounting system and the basis for calculation of the reported figures, explained below.

First, it needs to be understood that neither FCC nor NECA rules specify how relay providers are to maintain their accounting systems. Although Section 64.604(c)(5)(iii)(C) of the FCC's rules provides that information is to be provided to NECA in general accordance with Part 32 of the FCC's rules ("Uniform System of Accounts"), the expense categories in the RSDR bear no resemblance to Part 32's accounting structure. Nor do the RSDR expense categories comport with normal financial statements and general ledger expense categories. Moreover, as a matter of general accounting principles, there is considerable discretion in allocating expenses to various general ledger categories. Finally, allocations are expected to and do change from the initial in-house categorization to the final certified audit.

There are three factors at work here that are responsible for any apparent inconsistencies. *First*, as the Draft Audit admits, the final audited financial statements for HOVRS (prepared several months after the RSDR is submitted) reflect reallocation of certain expenses. *Second*, NECA's instructions for the RSDR are to annualize the data for the most recent historical year's costs in recognition that actual expenses cannot be known for the closing months of the fiscal year, when the RSDR is being prepared. Thus, a certain degree of variance from actual expenses is to be expected. *Third*, the OIG auditors failed to properly map HOVRS's general ledger accounts to the RSDR expense categories. Due to the Draft Audit's failure to consider all general ledger line items which comprised the various RSDR line items, its conclusion that HOVRS overstated or understated expenses for any one year do not follow and cannot be credited.

That being said, it is also important to understand that HOVRS's accounting system has evolved since it began providing VRS, in December of 2002. In 2004, for example, HOVRS adopted a departmental expense structure to more specifically tailor its general ledger entries to individual departments. Even then, given the lack of controlling authority from the FCC, the company struggled with the appropriate ledger classification of various expense items. It should also be noted that due to consistent decreases in VRS payment rates, the company until 2006 ran substantial deficits which have strained, among other departments, the accounting department. Only recently, following the investment by Caymus Partners, did the company hire a full-time CFO and an experienced comptroller.

**III. Analysis of 2003 Expenses.**

The Draft Audit claims HOVRS overstated 2003 expenses on the 2004 RSDR by some \$850,000. The Draft Audit comes to that conclusion, however, only by looking at six line items.



The actual trial balance for 2003 shows HOVRS's audited expenses as \$4,805,802. The RSDR for 2004 shows 2003 annualized expenses as \$4,846,507. This is a difference of less than one percent. Thus, there was no material overstatement of expenses in the 2004 RSDR. The alleged discrepancies, according to the Draft Audit, are presented below:

Item	2004 RSDR	GL According to Report	Alleged Difference
Salaries Benefits Relay Center Non-management	1,807,277	1,626,789	180,488
Legal/Regulatory	309,575	290,941	18,488
Engineering	327,666	418,379	(90,713)
Other Corp. Overhead	627,586	60,271	567,315
Marketing/Advertising	–	172,397	(172,397)
Outreach Expenses	346,186	–	346,186

The Draft Audit's methodology of looking at individual line items in the 2004 RSDR suffers from an apparent misidentification of the various HOVRS accounts which comprised the line items reported to NECA in 2004.<sup>3</sup> This is shown by Exhibit 3, hereto, which is a reconstruction of the individual HOVRS accounts which comprised the six subject 2004 RSDR line items. For example, Exhibit 3 shows that the OIG auditors were unaware of 90 percent of the expense items comprising Other Corporate Overheads. Correction of this error results in reconciling some 70 percent of the alleged overstatement of expenses among the six examined 2003 RSDR line items. As Exhibit 3 also shows, the variance between the 2004 RSDR annualized expenses and the actual 2004 expenses -- once properly reconciled -- was minimal and is fully explained by the difference which would be expected between annualized and actual expenses.<sup>4</sup>

<sup>3</sup> The Draft Audit does not present sufficient detail to know with certainty what HOVRS accounts the OIG auditors assumed comprised the 2004 RSDR line items, and as stated in the Draft Audit, HOVRS did not maintain a record of its actual allocation of these items.

<sup>4</sup> Should the auditors desire, electronic copies of HOVRS's general ledgers for the years discussed in the Draft Audit can be provided, and HOVRS can walk them through the proper allocations for the line items evaluated in the Draft Audit.

Some additional comments are appropriate beyond the showing of Exhibit 3 with respect to the Draft Audit's discussion of 2003 marketing and outreach expenses. The FCC and NECA have admitted that past definitions for marketing and outreach were vague and confusing. Partly because of this and partly as a result of some of the problems discussed above concerning HOVRS's legacy accounting system issues, HOVRS has not in the past consistently treated expense items falling in the marketing and outreach categories. Other VRS providers have reported similar issues. In addition, it should be noted that the Draft Audit concludes that HOVRS's 2003 general ledger showed no outreach expense in 2003 despite a specific GL account referencing outreach, i.e., 2006 ("Employee Wages Outreach"). Furthermore, it appears that the KPMG was unaware of the outreach nature of the various deaf oriented conventions and meetings HOVRS attends.

#### IV. Analysis of 2004 Expenses.

The Draft Audit states that for seven line items tested in the 2005 RSDR, expenses were overstated by approximately \$475,000 or 10 percent. These items are reprinted below.

Item	05 RSDR	GL According to Report	Alleged Difference
Salaries and Benefits Relay Center: Non-management	2,460,534	2,593,656	(133,122)
Salaries and Benefits (Relay Center Management)	526,286	183,094	343,192
Finance/Accounting	391,336	288,043	103,293
Operations Support	515,942	419,323	96,619
Telecommunications Equipment Depreciation	173,484	N/A	
Furniture & Fixture Depreciation	23,755	N/A	
Total Depreciation	197,239	230,873	(33,634)
Marketing/Advertising Expenses	466,844	361,539	105,305
Outreach Expenses	64,000	70,365	(7,365)

Exhibit 4 hereto, is a reconstruction of the accounts comprising the seven line items the Draft Audit examined for the annualized 2004 expenses set forth on the 2005 RSDR. As Exhibit 4 shows, HOVRS actually understated its actual expenses for these seven line items.<sup>5</sup>

**V. Analysis of 2005 expenses.**

The Draft Audit concludes that HOVRS under reported its 2005 expenses on some 10 line items in its 2006 RSDR by some \$73,000. The alleged under reporting is explained largely by consideration of the same factors and errors of methodology discussed with respect to the alleged over reporting of 2003 and 2004 expenses. HOVRS's reconciliation of the Draft Audit and its 2005 General Ledger is attached as Exhibit 5 and shows that HOVRS underreported on the 2006 RSDR its expenses for year 2005 by some 4.9 percent.

**VI. Comments on "Other Items."**

The Draft Audit states (at page 7) that estimated cost data for the upcoming year is budgeted, but there is no explanation for the budgeting process. No such requirement exists, however, beyond the specific RSDR instructions which HOVRS followed.

The Draft Audit states (at page 7) that actual costs varied significantly from previously estimated costs. This is true. Actual costs reflect among other things actual demand for service, which HOVRS has found difficult to predict. HOVRS's overestimation of expected demand has served to understate its cost per minute of VRS since it failed to achieve all the economies of scale it anticipated. This served to cause the VRS rate to be below true cost. Furthermore, HOVRS had to eliminate planned expenditures in every year studied by the OIG auditors due to the VRS rate being set lower than HOVRS's projections.

The Draft Audit (at page 7) misapprehends outside counsel's role concerning the preparation of financial data for the annual NECA submission. Counsel compiles data and submits the final RSDR to NECA, including narrative statements, call center staffing requirements, and job descriptions. However, the presentation format for financial data and the financial data itself are prepared and obtained from HOVRS. Counsel reviews this data looking for anomalies and internal inconsistencies and requests HOVRS to explain and or correct any such matters.

The Draft Audit claims management lacks sufficient working knowledge of the RSDR process and rate setting procedures. However, the Draft Audit fails to acknowledge that existing senior management with the exception of CEO Ronald O'Bray, who was apparently not interviewed by the OIG auditors, had just recently come on board and had not previously participated in the

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<sup>5</sup> Exhibit 4 also shows that in total, HOVRS's reported annualized 2004 costs on its 2005 RSDR were approximately 4.8 percent above its final audited expenses. As discussed above, however, this discrepancy had no affect on the VRS rate since that rate is based on estimated, not historical costs.

RSDR process. Mr. Obray supervised preparation of each of the RSDRs reviewed in the Draft Audit. The failure to interview him was not explained.

**VII. Comments on “KPMG Recommendations.”**

The OIG auditors recommend (at page 8) that NECA and the FCC develop written policies and procedures for documenting TRS program expenses. The auditors are apparently unaware that the FCC and NECA met with providers in September of 2004 -- prior to the submission of the 2005 RSDR -- to standardize the data collection process. HOVRS has consistently called for more transparency in the VRS rate setting process.

The Draft Audit suggests (at page 8) that HOVRS should prepare a supporting document detailing the source of all costs and all allocations, including a cross reference from line items on the NECA reports to the general ledger and in turn with HOVRS's audited financial statements. The problem with that suggestion as the Draft Audit itself recognizes, is that the RSDR is submitted prior to HOVRS closing out its fiscal year and many months prior to completion of its audited financial statement. Therefore, actual audited cost information is not known for the most recently completed fiscal year.

**VIII. Comments on “Additional Matters.”**

At page 8, the Draft Audit points out that HOVRS's 2005 audit contained a going concern qualification. The 2006 audit, just recently completed, contains no such qualification. Given recent corporate developments, such as the planned merger of HOVRS and GoAmerica, the Draft Audit's concern is no longer operable. In any event, such a matter appears beyond the scope of the audit and should therefore be stricken.

The Draft Audit also mentions that HOVRS had been factoring its receivables. This fact is reflective of the financial strain the company has faced due to severe cuts by the FCC in the VRS payment rate. This practice was recently discontinued. Again, such a comment appears beyond the scope of the audit and should be stricken.

**IX. Conclusion.**

As shown above, the Draft Audit suffers from several factual errors as well as a misunderstanding of HOVRS's accounting system and NECA's process for recommending the VRS rate. The “notable findings” set forth in the Draft Audit have thus been explained as based on errors of fact or misunderstanding of the process for preparation of HOVRS's RSDRs and the NECA VRS rate recommendation process. The Draft Audit should be corrected accordingly. Significantly, the Draft Audit makes no finding concerning the accuracy of HOVRS's monthly minute submissions to NECA for payment. Thus, the audit should conclude that there is no risk of overpayments to HOVRS from the Fund.

## **Appendix 5: KPMG's Analysis of HOVRS Management Comments**

### **KPMG Response to Management Comments – HOVRS**

KPMG provided management of HOVRS with the opportunity to comment on the report. The comments we received through their legal counsel are reprinted in their entirety in the previous appendix. We incorporated technical comments into the report as appropriate.

The comments provided by HOVRS were evaluated and are included in their entirety in Appendix 4, in accordance with paragraph 8.33 of the 2003 Government Auditing Standards. The standard further states that comments such as a promise or plan for corrective action should be noted, but should not be accepted as justification for dropping a finding or related recommendation. In accordance with paragraph 8.34 of the 2003 Government Auditing Standards, KPMG is stating below those incidents in which it disagrees with management's comments or planned corrective actions.

#### **HOVRS Response Reference: Section I. Summary**

##### **Part A—Risk of Overpayment to HOVRS**

KPMG responds with regard to the review of the Monthly Reports of Relay Service Minutes and the report was clarified to explain that KPMG did not review HOVRS documentation supporting the minutes reported to and subsequently paid by NECA. However, KPMG disagrees with HOVRS comment that there is no risk of improper payments to the fund. The results of our procedures with respect to the supporting documentation for the reported expense data supports the stated conclusion in the our report.

##### **Part B—KPMG's Recommendations to NECA and FCC**

The performance audit was focused on the HOVRS to assess the risk of improper payments from the TRS Fund, which would include ensuring that appropriate actions and oversight were performed by the Federal components responsible for managing the program and making the appropriate payments. Accordingly, recommendations are appropriate to any and all components involved with the program to reduce the risk of improper payments from the TRS Fund.

##### **Part C—HOVRS' Controls**

KPMG does not agree with the comments provided by HOVRS with regard to HOVRS' processes for actual expense reporting to NECA. The data collection processes calls for TRS providers to provide NECA with true and accurate data necessary to determine TRS fund revenue requirements and payments. In accordance with part 32 of the Communications Act, other historical and/or projected information reasonably requested by the administrator for purposes of computing payments and revenue requirements. Audits of this data are to assure the accuracy and integrity of fund payments.<sup>9</sup> Furthermore, when the current VRS compensation rate was established, the FCC used actual cost data and projections submitted by the VRS providers, in order to institute a reasonable rate for the service.<sup>10</sup>

HOVRS' comments with regard KPMG's misunderstanding of the FCC rate setting process and FCC's lack of reliance on the actual costs submitted by HOVRS with regard to FCC VRS rate setting process are not correct. We have confirmed with the FCC that actual costs as well as the

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<sup>9</sup> 47 CFR 64.604( c ) (5)(iii)(B)

<sup>10</sup> FCC 04-137 paragraph 174

projected costs submitted by the providers were used to set the VRS compensation rate; therefore, the HOVRS submission of inaccurate data does have an effect on the compensation rate set forth by the FCC for VRS.

HOVRS also seems to misunderstand the test steps associated with auditing their accounting systems and actual expenses reported on the RSDRs. Any variance which was noted comes from data reported by HOVRS to NECA as actual, and all tested line items were sampled from HOVRS accounting system information provided to KPMG auditors at the time of the audit. The tables presented in the report are the discrepancies between the actual expenses and the available documentation. Line items were also tested, and support documentation was requested at the time of the audit. HOVRS did not provide adequate supporting documentation and adequate trial balances matching the audited financial statements at the time of the audit.

The trial balance provided to KPMG was not consistent with the audited financial statements at the time of the audit. KPMG made inquiries about, and attempted to test, the line items within the trial balances and were unable to do so while onsite. HOVRS management and personnel could not provide proper documentation at the time of the audit.

#### **Part D—HOVRS As a Going Concern**

Agree. KPMG has deleted this matter from the report.

### **Section II. Certain Factual Errors – Part A. HOVRS’ 2005 Minutes Were Not Misreported and Are Accurate**

KPMG does not agree with HOVRS management’s statement that 2005 minutes were reported correctly on the RSDR. According to NECA RSDR Instructions, all 2005 actual minutes reported by HOVRS are to be reported in the RSDR, including subcontractor minutes. Subcontractor’s are also required to submit RSDR data, but HOVRS is also required to report all actual minutes paid to HOVRS by the TRS Fund, regardless of subcontractor agreements. HOVRS did not report the 2005 actual VRS minutes appropriately, according to NECA Instructions and FCC Orders.

During the course of our audit, KPMG inquired about the discrepancy in minutes to HOVRS management, and at the time of the audit, HOVRS was unable to provide documentation. The only subcontractor information HOVRS provided to KPMG was in reference to American Sign Language Interpreting Services for 2006. There was no information received about subcontracting work for AT&T. The information provided by HOVRS in the AT&T relationship was not produced in a timely manner and was, therefore, not considered.

### **Section II. Certain Factual Errors – Part B. Miscellaneous Points**

**B 1.** While KPMG understands the concern about the TRS funds being federal funds, there is no question that the TRS program is subject to Federal oversight and management. As a result, the TRS providers must comply with FCC rules and policies related to the program and are subject to audit to ensure compliance. The TRS Fund is governed by the FCC, and those funds are considered to be federal. Additionally, the Telecommunications Access Policy Division (TAPD) is a division within the Federal Communications Commission’s Wireline Competition Bureau.<sup>11</sup> TAPD administers a comprehensive policy for Commission oversight over funds used to support

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<sup>11</sup> <http://www.fcc.gov/web/tapd/welcome.html>

universal service. TAPD is also responsible for the oversight of the interstate TRS Fund<sup>12</sup>, and handles all rulemakings and other matters relating to the funding of interstate TRS. KPMG has, however, changed the reference of “federal funds” to TRS funds” in the final report.

**B 2.** HOVRS commented that gym memberships, and massages are a benefit that is extended to employees, and is necessary to ASL interpreters, and asserts that this finding is not “notable.” In discussions with the FCC OIG, we were informed that these expenses were not considered a “reasonable cost” for reimbursement.

**B 3.** HOVRS also commented that HOVRS credit card statements were available, but were in fact not provided to the KPMG auditors during the audit, despite requests made to HOVRS management and personnel while onsite.

**B 4.** See KPMG response for Section I Part C paragraph 4.

**B 5.** KPMG responds to HOVRS’ Comments with the following RSDR rule, relating to the submission of inconsistent cost data:

KPMG does not agree with management’s statement that inconsistencies in cost data are not meaningful. NECA and the FCC use the actual cost data submitted by providers to ensure that only “reasonable” costs of providing TRS services are reflected in the compensation rates.<sup>13</sup> If a provider’s actual cost data changes from year to year, and a compensation rate has been set on previous data, changes should be documented to ensure that all changes are “reasonable,” and that set compensation rates are accurate. Also, according to Part 64, TRS providers shall provide the administrator with true and accurate data, both historical and projected, including total TRS operating expenses and total TRS minutes of use data, necessary to determine TRS fund revenue requirements and payments as part of the mandatory minimum standards for providing TRS services.<sup>14</sup>

**B 6.** KPMG does not agree that HOVRS’s RSDRs were properly certified. HOVRS was requested by KPMG to provide 2004, 2005 and 2006 RSDRs submitted to the FCC and NECA for the past three years. The RSDRs provided to KPMG did not include a certification page signed by an agent of HOVRS. In addition, the RSDRs submitted to KPMG did not follow the scripted instructions set forth on the NECA website.

**B 7.** See KPMG response for Section II Part B 5.

## **Section II. Certain Factual Errors – Part C. Misunderstanding of FCC Ratemaking Process (and Use of Estimated Expense Data)**

KPMG does not agree with HOVRS’ comments with regard KPMG’s misunderstanding of the FCC rate setting process, and FCC’s lack of reliance on the actual costs submitted by HOVRS with regard to FCC VRS rate setting process. The actual costs as well as the projected costs submitted by the providers were used to set the VRS compensation rate; therefore, the HOVRS submission of inaccurate data does have an effect on the compensation rate set forth by the FCC for VRS. As previously noted, KPMG has confirmed this understanding with the FCC.

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<sup>12</sup> <http://www.fcc.gov/web/tapd/trs/>

<sup>13</sup> FCC Order DA 06-1345 Section II. A (1)

<sup>14</sup> 47 C.F.R. Section 64.604 (c)(6)(iii)(C)

## **Section II. Certain Factual Errors – Part D. Misunderstanding of HOVRS’ Accounting System in Relation to FCC Rules**

KPMG disagrees with HOVRS’s claim that the OIG auditors failed to map HOVRS’ general ledger accounts properly. HOVRS should be able to support all actual costs reported on the RSDRs. HOVRS management was unable to provide this detail, as per NECA instructions, to the OIG auditors. KPMG’s response to Section I Part C addresses the primary concerns with the data reported by HOVRS from their accounting system.

It is further important to note that the auditors do not have the responsibility to “map the HOVRS general ledger accounts to the RSDR expense categories”, but rather that is management’s responsibility. HOVRS is also to provide NECA and the FCC a cost methodology which describes all allocations made between TRS and non-TRS services within the company, as part of the RSDR submission process. HOVRS is responsible for providing supporting documentation to justify the amounts reported and claimed on its reports to the FCC and its agents for the TRS program. At the time of our audit, the supporting documentation did not support the information reported on the RSDR as discussed in our report.

The differences noted by KPMG in this report are not differences relating to annualizing expenses for the purposes of submission to NECA. KPMG tested the actual costs. For example, in the 2006 and 2007 RSDR, HOVRS did not report the same 2004 actual costs, and they were not annualized actual costs.

## **Section III. Analysis of 2003 Expenses (See results in Appendix 5 in Table 6 and Table 7)**

KPMG does not agree with HOVRS’ management analysis primarily because management discusses annualized expenses versus the actual expenses. As we previously discussed, we analyzed actual expenses reported on the RSDR, not annualized expenses. The results identified a net difference of \$850 thousand in expenses tested according to line items on the RSDR, and general ledger account detail. This testing yielded an exception rate of 18% from our sample of tested line items, therefore, of the support documentation requested, HOVRS was not able to support \$850 thousand dollars of reported actual costs.

## **Section IV. Analysis of 2004 Expenses (See results in Appendix 5 in Table 5 and Table 7)**

KPMG disagrees with HOVRS comment that the draft audit methodology suffers from an apparent misidentification of HOVRS accounts. Instead, KPMG agrees with the result that the RSDR expenses are overstated by 10% and we reiterate that we reviewed actual expenses, not annualized expenses. This review included the testing of actual line items and general ledger detail testing.

## **Section V. Analysis of 2005 Expenses (See results in Appendix 5 in Table 4)**

KPMG has revised the report to identify more clearly the underreported actual expenses.

## **Section VI. Comments on “Other Items”**

KPMG addressed other items in previous comments as described below:

Paragraph 1—See comment in Section II Part B, B6 above.



Paragraph 2 – KPMG disagrees with HOVRS’ assumption that VRS rates are set lower than they should be. The audit only assesses HOVRS’ compliance with NECA instructions and FCC rules. These rules state that providers are to submit true and accurate data, for both historical and projected costs, in order to set the rates for VRS accordingly.

Paragraphs 3 and 4. KPMG disagrees with HOVRS’ comment which claims a failure to interview CEO Ron O Bray. KPMG auditors did speak with Ron O Bray, CEO of HOVRS, on May 3, 2007 at 2 pm EST. Both Mr. O Bray and Mr. Routhier informed KPMG that the information provided by the counsel and by the CFO on the RSDR was accurate.

#### **Section VII. Comments on KPMG Recommendations**

Notwithstanding NECA’s and FCC’s responsibility for the monitoring and rate setting processes, we reiterate that HOVRS management has a responsibility to document the costs reported for the TRS program. We suggest that a cross walk between HOVRS’ general ledger and the RSDR form will provide accurate identification of the appropriate costs.

#### **Section VIII. Comments on “Additional Matters”**

KPMG agrees and has made the appropriate changes in the final report.

#### **IX. Conclusion**

KPMG has made changes deemed appropriate based upon Management’s comments. However, the evidence developed during the audit does not support a change in the overall conclusions and the recommendations proposed to address the reported issues. KPMG did not consider the appendices sent with HOVRS management response, which was provided 7 months after our audit fieldwork.

## Appendix 5: Additional Tables

(Tables 1-3 appear in the body of the report)

Table 4: 2005 Comparison of General Ledger vs. RSDR

Line Item Description	Balance per '06 RSDR	Balance per G/L	Diff. vs. G/L	% of Diff. vs. RSDR
Salaries & Benefits (Relay Center: Non-Management)	\$3,779,353	\$3,970,179	-\$190,826	(5%)
Marketing/Advertising Expenses	\$396,117	\$359,986	\$36,131	9.1%
Outreach Expenses	\$367,927	\$382,085	-\$14,158	(3.8%)
Rent	\$452,893	\$430,379	\$22,514	5%
Utilities	\$610,372	\$701,815	-\$91,443	(15%)
Property Tax	\$41,784	\$41,450	\$334	0.8%
Engineering	\$1,181,147	\$1,087,014	\$94,133	8%
Human Resources	\$468,651	\$310,523	\$158,128	33.7%
Other Corporate Overhead	\$479,849	\$466,262	\$13,587	2.8%
Telecommunications Equipment Depreciation	\$232,646	\$334,789	-\$102,143	(43.9%)
Totals	\$8,010,739	\$8,084,482	-\$73,743	(0.9%)

Table 5: 2004 Comparison of General Ledger vs. RSDR

Line Item Description	Balance per '05 RSDR	Balance per G/L	Diff. vs. G/L	% of Diff. vs. RSDR
Salaries & Benefits (Relay Center: Non-Management)	\$2,460,534	\$2,593,656	-\$133,122	(5.4%)
Salaries & Benefits (Relay Center: Management)	\$526,286	\$183,094	\$343,192	65.2%
Finance/Accounting	\$391,336	\$288,043	\$103,293	26.4%
Operations Support	\$515,942	\$419,323	\$96,619	18.7%
Total depreciation	\$197,239	\$230,873	-\$33,634	(17.1%)
Marketing/Advertising Expenses	\$466,844	\$361,539	\$105,305	22.6%
Outreach Expenses	\$63,000	\$70,365	-\$7,365	(11.7%)
Totals	\$4,621,181	\$4,146,893	\$474,288	10.3%

Table 6: 2003 Comparison of General Ledger vs. RSDR

Line Item Description	Balance per '04 RSDR	Balance per G/L	Diff. vs. G/L	% of Diff. vs. RSDR
Salaries & Benefits (Relay Center: Non-Management)	\$1,807,277	\$1,626,789	\$180,488	10%
Legal/Regulatory	\$309,575	\$290,941	\$18,634	6%
Engineering	\$327,666	\$418,379	-\$90,713	(27.7%)
Other Corporate Overheads	\$627,586	\$60,271	\$567,315	90.4%
Marketing/Advertising Expenses	-	\$172,397	\$172,397	(100%)
Outreach Expenses	\$346,186	-	\$346,186	100%
Totals	\$3,418,290	\$2,568,777	\$849,513	24.9%

Table 7: 2003, 2004, and 2005 Percentage of VRS Expenses tested by KPMG

Total Dollars of the tested line items vs. Total Expense for VRS			
Year	Total of the tested line items	Total VRS Expenses	Percentage
2003	\$ 3,418,290	\$ 4,846,507	70.53%
2004	\$ 4,621,181	\$ 8,384,603	55.11%
2005	\$ 8,010,739	\$ 11,533,747	69.45%

**Purpose:** The chart above explains the percentage of VRS expenses reviewed by KPMG with the testing of the RSDR line items for the years of 2003, 2004, and 2005. Through the review of KPMG, an average of 65% of the Total VRS Expenses was tested.