# Office of Inspector General

September 29, 2000
Evaluation Report No. 00-005

## MCI Voice and Video Contract – Intrastate Surcharge and Other Compliance Issues

Office of Congressional Relations and Evaluations

**DATE:** September 29, 2000

**MEMORANDUM TO:** Arleas Upton Kea
Director, Division of Administration

**FROM:** Stephen M. Beard
Assistant Inspector General

**SUBJECT:** *MCI Voice and Video Contract—Intrastate Surcharge and Other Compliance Issues* (EVAL-00-005)

The Office of Congressional Relations and Evaluations has completed a review of FDIC's Voice and Video Long Distance Services Contract (Contract) with MCI WorldCom, Inc. (MCI). The objective of our review was to determine whether MCI billed FDIC according to the terms of the Contract. In December 1999, we reported on MCI's compliance with a Contract price warranty associated with the remaining 2 years of the Contract.[1] This report addresses whether MCI properly billed FDIC for long distance voice services during the first 3 years of the Contract.

Overall, we identified almost $1.26 million in charges that were not supported. We questioned $1.169 million of $1.2 million that MCI billed for a surcharge it applied to most of FDIC's intrastate calls that was not included in the original Contract or in MCI's tariff. We also identified $55,254 in unsupported directory assistance service costs and projected unsupported costs for that service of $18,345 for the remaining 21 months of the Contract. Further, we identified minor differences associated with calling card billings totaling $15,672. Otherwise, MCI generally charged FDIC appropriately for outbound and inbound long distance calls, audio conferencing calls, and fax broadcast calls.

We also concluded that MCI did not comply with what we understood to be the intent of the Contract price warranty clause--to keep the Corporation's long distance rates competitive for the duration of the Contract. Had MCI matched rates available to other government agencies through Federal Technology Service (FTS) contracts, we estimate that FDIC's long distance charges would have been $326,863 to $465,750 less during Contract option years one and two. Several factors limited FDIC's ability to legally enforce the price warranty. Accordingly, we did not recommend that FDIC pursue recovery of those charges. However, we concluded that FDIC might have been able to obtain such pricing through option year negotiations. We plan to issue a separate report shortly on FDIC's oversight of this Contract that will include recommendations to assist the Corporation in this regard for the future.

The Acquisition and Corporate Services Branch (ACSB) discussed our preliminary findings with MCI in June 2000. In late August 2000, MCI proposed a two-part settlement valued at almost $1.7 million.

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[1] *MCI Voice and Video Contract--Price Warranty,* (EVAL-99-009), dated December 20, 1999.

We provided DOA a draft of this report on September 7, 2000. DOA provided a written response to the draft report on September 26, 2000. Management agreed with both of our recommendations. DOA's written response is included in its entirety as Appendix III of this report. Appendix IV presents our assessment of management's response and shows that we have a management decision for each recommendation.

DOA's response indicated that ACSB expects to sign a settlement and release agreement with MCI by October 31, 2000 with a total value approximating $1.68 to $1.78 million. Specifically, MCI agreed to refund to FDIC $882,640 related to intrastate surcharges. MCI also agreed to provide FTS2001 rates during the final year of MCI's separate Wide Area Network (WAN) contract with FDIC. ACSB estimated the revised WAN rates should result in savings of $800,000 to $900,000.

DOA also indicated that ACSB would negotiate a revision to the Contract price schedule to correct the directory assistance rate under the Voice and Video Contract. We estimated this revision would reduce directory assistance charges by $18,345 over the remaining term of the Contract.

Accordingly, we will report questioned costs of $882,640 and funds put to better use of $818,345 in our next *Semiannual Report to the Congress*. The funds put to better use represents $800,000 as a conservative estimate of savings on the new WAN rates plus $18,345 in cost reductions for directory assistance.

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## INTRODUCTION

This report presents the results of our review of FDIC's Voice and Video Long Distance Services Contract (Contract). The objective of our review was to determine whether MCI WorldCom, Inc. (MCI) billed FDIC according to the terms of the Contract. In December 1999, we reported on MCI's compliance with a price warranty clause associated with the remaining 2 years of the Contract. This report addresses whether MCI properly billed FDIC for long distance services during the first 39 months of the Contract.

The scope of our review included charges billed from Contract inception through February 2000. To accomplish our objective we:

- Reviewed the Contract and modifications to understand terms, conditions and price structure.

- Interviewed Federal Communications Commission (FCC) representatives to understand tariff applicability.

- Reviewed the applicable tariff document to understand relevant terms and conditions.

- Interviewed representatives from the Acquisition and Corporate Services Branch (ACSB), Legal Division, and the Division of Information Resources Management (DIRM).

- Reconciled MCI invoice charges against the tariff, the Contract price schedule, and MCI electronic call detail records (CDR).

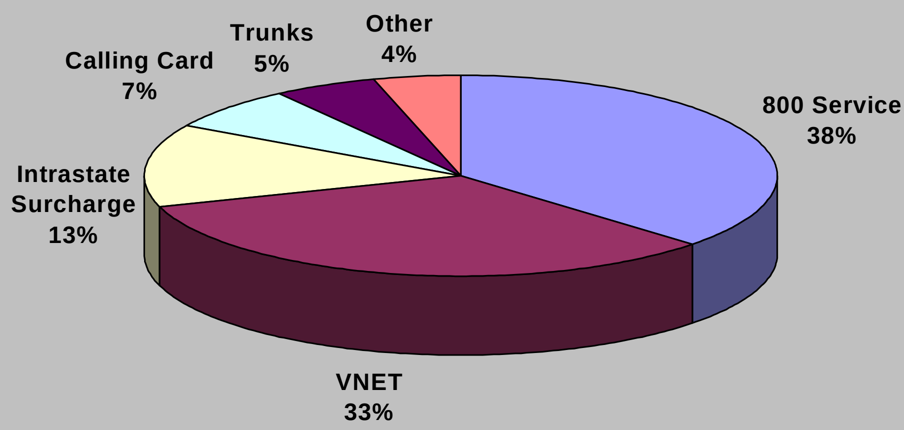
- Reviewed selected invoices over the term of the Contract. A more detailed discussion of our evaluation methodology is included as Appendix II.

We conducted our review from March 2000 through June 2000 in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

## BACKGROUND

FDIC awarded the Contract to MCI effective November 1, 1996 for a total amount of $16.4 million over 5 years. Under the terms of the Contract, MCI provided nationwide voice and video long distance services including: outbound, inbound (800), trunks, calling cards, video teleconferencing, fax and dial-up data services. Program responsibility for the Contract rests with DIRM's Telecommunications Section. From Contract inception through January 2000, MCI billed almost $9 million under the Contract. Figure 1 presents the composition of MCI Contract charges through January 2000.

**Figure 1: Composition of Contract Charges**




Source: MCI Invoices

## Tariffs and the Filed Rate Doctrine

Historically, common carriers, such as MCI, were required to file tariffs with state public utility commissions or the FCC.[2] Tariffs are public documents detailing the services, equipment and pricing offered by the common carrier to all potential customers. Non-dominant carriers, such as MCI, are required to file tariffs no later than one day before the subject change goes into effect. The "filed-rate doctrine" is a well-established legal principle that gives precedence to tariffs in common carrier relationships with customers. In short, when discrepancies exist between a tariff, contract, or any other statement or promise made by the carrier, the tariff prevails.

The Contract was supported by MCI Telecommunications Corporation Tariff FCC No. 7, *Government Telecommunications Services* (Tariff No. 7), originally effective February 22, 1991. It appears that Option No. 388 of the Tariff provided for most of the domestic rates and charges paid by FDIC under the Contract.

**Detariffing**

Following the Telecommunications Act of 1996, the FCC ordered detariffing for all interstate long distance carriers. A number of carriers, including MCI, challenged the FCC decision in part on the basis that detariffing eliminated a favorable rule of common carrier law—the filed rate doctrine. In February 1997, the United States Court of Appeals stayed the detariffing order pending judicial review. The Court recently upheld FCC's decision and lifted the stay. In May 2000, the FCC implemented a 9-month transition period requiring non-dominant carriers to cancel their domestic, interstate tariffs by January 31, 2001.

[2] Common carriers are telecommunications companies that offer services to the public. Local exchange carriers are considered "dominant" carriers. Interexchange carriers, such as MCI, are considered "non-dominant."

## RESULTS IN BRIEF

From Contract inception, MCI applied an intrastate surcharge (surcharge) to most of FDIC's intrastate calls that was not included in the original Contract price schedule or in Tariff No. 7. In early 1997, MCI informed FDIC that it was allowed, by tariff, to bill the surcharge. In August 1997, MCI modified the Contract, and later the tariff, to include the surcharge. However, we found inconsistencies between the tariff and the Contract regarding how the surcharge should have been calculated. Until recently, common carriers were required to file tariffs in support of contract prices. These tariffs consistently prevailed over contracts and other carrier promises when discrepancies existed. MCI did not add the surcharge to its tariff until November 1997, thus, we questioned 100 percent of the $281,131 charged before the November 21, 1997 effective date. In addition, we concluded that $887,979 of the $920,464 that MCI billed for the surcharge after it was added to the tariff was calculated incorrectly and therefore not supported.

We also identified a discrepancy between Tariff No. 7 and the Contract price schedule for directory assistance. We recalculated directory assistance charges using the tariff rate and identified unsupported costs of $55,254 from Contract inception through January 2000. Further, we projected unsupported costs of $18,345 for the remaining 21 months of the Contract.

In addition, we concluded that MCI did not comply with what we understood to be the intent of the Contract price warranty clause--to keep the Corporation's long distance rates competitive for the duration of the Contract. FDIC accepted MCI's annual certification that it was offering pricing consistent with the terms of the price warranty without determining MCI's basis for the certification. Assuming the price warranty applied to Federal Technology Service (FTS) contracts, we estimated that FDIC's long distance charges should have been $326,863 to $465,750 less during option years one and two. Several factors limited FDIC's ability to pursue FTS pricing through legal action. That being said, FDIC may have been able to obtain such pricing through option year negotiations.

Otherwise, MCI generally charged FDIC appropriately for outbound and inbound long distance calls, audio conferencing calls, and fax broadcast calls. We identified minor differences between MCI invoices and supporting CDRs associated with calling card billings totaling $15,672. Table 1 summarizes our findings discussed in the body of this report.

**Table 1: Summary Schedule of Evaluation Findings**

| Finding Category | Contract Charges | Questioned Cost | Funds Put to Better Use | Total |
|---|---|---|---|---|
| **Intrastate Surcharge** | $1,201,596 | $1,169,111 | | $1,169,111 |
| **Directory Assistance** | $116,564 | $55,254 | $18,345 | $73,599 |
| **Calling Cards** | $544,090 | $15,672 | | $15,672 |
| **Total** | $1,862,250 | $1,240,037 | $18,345 | $1,258,382 |

## INTRASTATE SURCHARGE

MCI billed a per-minute surcharge for most of FDIC's intrastate calls. This surcharge was not included in the original Contract price schedule. MCI informed FDIC in 1997 that its tariff allowed MCI to bill the surcharge. However, it does not appear that MCI modified its tariff to include the surcharge until more than a year after MCI began billing the charge. Moreover, we identified inconsistencies between the Contract and Tariff No. 7 regarding how MCI should have calculated the surcharge. We concluded that, of the $1.2 million that MCI billed for the surcharge, almost $1.17 million was not supported by the tariff. We also identified surcharges totaling $188,084 that were not supported by the tariff, Contract, or CDRs.

### Surcharge Billed Since Contract Inception

Although the surcharge was not included in the original price schedule, MCI began billing the surcharge at Contract inception. FDIC paid several invoices that included the surcharge before rejecting invoices and questioning MCI about the charge. MCI stated that its tariff allowed MCI to bill the surcharge and that the price schedule was not detailed enough to include all standard MCI charges.[3] Table 2 presents amounts that FDIC paid related to the intrastate surcharge.

In August 1997, FDIC and MCI modified the Contract to include the surcharge. MCI and FDIC signed a payment agreement for intrastate surcharges billed, but not paid, during 1997. During our initial review of the Contract, we noted that MCI was not billing the intrastate surcharge under the FTS2001 contract.[4] Thus, we questioned whether the surcharge was allowable under the terms of the Contract price warranty. FDIC's Contracting Officer requested that MCI discontinue the surcharge, to which MCI agreed effective February 2000. In total, FDIC paid $1.2 million related to the intrastate surcharge.

**Table 2: Intrastate Surcharge Amounts**

| Calendar Year | Amount |
|---|---|
| 1996 Payments | $66,420 |
| 1997 Payments | $235,431 |
| 1998 Payments | $359,310 |
| 1999 Payments | $494,288 |
| 2000 Payments | $46,147 |
| Total Payments | $1,201,596 |

Source: MCI Invoices and file documents

### Initial Charges May Not Have Been Supported by Tariff

We found no evidence to support MCI's statement that the tariff allowed MCI to bill the surcharge, or that the tariff supported the surcharge during the first year of the Contract. MCI issued Option No. 388, effective November 21, 1997, which added the intrastate surcharge to Tariff No. 7. Figure 2 presents a timeline of events related to the intrastate surcharge.

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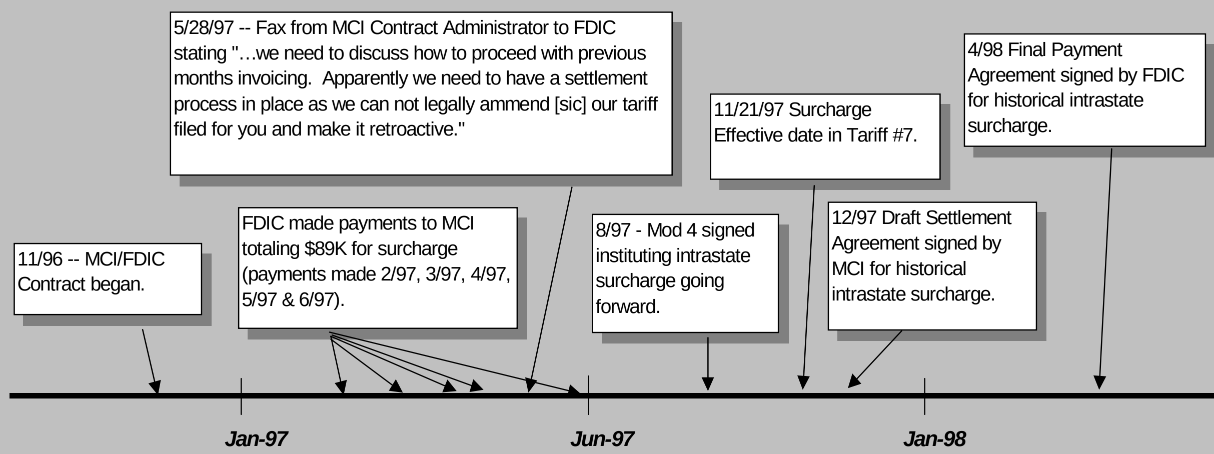
[3] MCI was also FDIC's prior national long distance carrier. DIRM informed us that MCI did not charge FDIC the intrastate surcharge under the prior long distance contract.

[4] *MCI Voice and Video Contract--Price Warranty*, (EVAL-99-009), dated December 20, 1999. MCI and Sprint were vendors under FTS2001.

**Figure 2: Timeline of Events Related to the Intrastate Surcharge**




Source: ACSB and DIRM contract files.

As shown, Option No. 388 was not effective until 11 months after MCI began charging the surcharge and 3 months after MCI and FDIC modified the Contract to add the surcharge to the price schedule. A FCC representative confirmed that the “Original Page” terminology documented on Option No. 388 indicated that November 21, 1997 was the first time the option was included in the tariff. We reviewed the tariff and found no other citations or options resembling the intrastate surcharge.

47 CFR 61.23 required non-dominant carriers, such as MCI, to file tariffs no later than one day before the effective date of the change. A FCC representative opined that MCI would have a "hard time" collecting a charge that was not included in the tariff. During the intrastate surcharge negotiations, MCI informed the Contracting Officer and oversight manager that the tariff allowed MCI to bill the surcharge. We questioned whether MCI acted in good faith by stating that the tariff “allowed” MCI to bill the intrastate surcharge. Accordingly, we questioned 100 percent of the $281,131 in intrastate charges billed prior to the November 21, 1997 effective date of Option No. 388.

### Surcharge Billed Inconsistently with Tariff

We reviewed Option No. 388 and identified inconsistencies between the tariff and the MCI Contract regarding how the intrastate surcharge should have been calculated. Figure 3 presents a comparison of the Contract and tariff.

**Figure 3: Comparison of Intrastate Surcharge Between the MCI Contract and Tariff No. 7**

**MCI/Contract Calculation of Intrastate Surcharge:**
If, on a monthly basis, intrastate calls accounted for 15% or more of total calls, MCI applied the following surcharge to the total of all intrastate minutes.

- 800 Calls -- $.08 per minute
- VNET Calls -- $.04 per minute

**OIG/Tariff-Based Calculation of Intrastate Surcharge:**
If, on a monthly basis, intrastate minutes accounted for 15% of total minutes, the following surcharge should have been applied to those calls exceeding the 15% threshold.

- 800 Calls -- $.08 per call
- VNET Calls -- $.04 per call

We recalculated the intrastate surcharge based on Tariff No. 7 and concluded that MCI overcharged FDIC by $887,979 for the intrastate surcharge from December 1997 through January 2000. Table 3 presents our summary analysis of the intrastate surcharge.

**Table 3: Summary Analysis of Intrastate Surcharge: December 1997 through January 2000**

| Intrastate Surcharge | MCI Charges | OIG Estimate Per Tariff No.7 | Difference |
|---|---|---|---|
| **800** | $755,783 | $ 31,911 | $723,872 |
| **VNET** | $164,680 | $573 | $164,107 |
| **Total** | $920,463 | $ 32,484 | $887,979 |

Source: MCI Invoices and Tariff No.7

The Contracting Officer asked MCI for the tariff citation supporting the surcharge in early May 2000 and specifically discussed Option No. 388 with MCI in early June 2000. On July 14, 2000, MCI acknowledged to the Contracting Officer that it had not charged FDIC for the surcharge in accordance with Tariff No. 7. MCI indicated that it should have charged FDIC the surcharge per call instead of per minute.

**Surcharge Not Billed in Compliance with the Terms of the Contract**

Notwithstanding the tariff discrepancies discussed above, we also identified surcharge amounts that were not supported by the Contract or CDRs. We recalculated the intrastate surcharge based on the methodology in the Contract and concluded that over the first 3 years of the Contract, MCI overcharged FDIC by $188,084.

Specifically, we recalculated the intrastate surcharge using MCI invoices and CDRs from Contract inception through January 2000 for VNET and 800 service. MCI billed FDIC $19,633 in intrastate surcharges for October 1996 service, one month before the Contract began. In addition, we were unable to find call detail support for 4.7 million minutes of usage for which

MCI billed $168,451 in intrastate surcharges. We concluded that FDIC should have been able to recover the $188,084 regardless of its success in recovering charges not supported by the tariff.

**DIRECTORY ASSISTANCE**

MCI also overcharged FDIC for directory assistance service under the Contract. We identified a discrepancy between Tariff No. 7 and the Contract price schedule for directory assistance. We estimated that $55,254 of the $116,564 in directory assistance charges that FDIC paid through January 2000 was unsupported by the tariff. We projected that FDIC would pay an additional $18,345 in unsupported directory assistance charges over the remaining term of the Contract if MCI continued to bill FDIC the Contract rate instead of the Tariff No. 7 rate, as shown in Table 4.

**Table 4: Directory Assistance Analysis**

**Questioned Cost (Historical)**

| Period | MCI Charges | Tariff-Based Calculation | Difference |
|---|---|---|---|
| **1997** | $39,428 | $22,632 | $16,796 |
| **1998** | $44,630 | $22,755 | $21,875 |
| **1999** | $30,553 | $14,973 | $15,580 |
| **1/00** | $1,953 | $950 | $1,003 |
| **Total** | $116,564 | $61,310 | $55,254 |

**Funds Put to Better Use (Projected)**

| Period | MCI Charges | Tariff-Based Calculation | Difference |
|---|---|---|---|
| **2000** | $24,582 | $14,973 | $9,609 |
| **2001** | $22,347 | $13,611 | $8,736 |
| **Total** | $46,929 | $28,584 | $18,345 |

Source: MCI Invoices

MCI billed directory assistance on a per call basis. VNET and calling card directory assistance averaged $1.25 and $1.27 per call, respectively, through January 2000. The original Contract price schedule did not include a line item amount for directory assistance. Modification No. 4, dated August 7, 1997, added a directory assistance per call usage charge of $1.10 to the Contract price schedule.

However, MCI's Tariff No. 7 required MCI to bill a lower per-minute rate. At the beginning of the Voice Contract, MCI's tariff rate for directory assistance was $.64 per call. In 1998, MCI amended Tariff No. 7 and increased the tariff rate to $.67 per call. Based on our calculation of directory assistance using the tariff rate, we identified unsupported costs of $55,254 through January 2000 of the Contract.

As of the date of this report, MCI was still charging FDIC the incorrect rate. Accordingly, we projected that FDIC would lower its costs by $18,345 for the remaining 21 months of the Contract if MCI corrected the rate charged for directory assistance.

## PRICE WARRANTY CLAUSE

MCI did not comply with what we understood to be the intent of the Contract price warranty clause--to keep FDIC's long distance rates competitive for the duration of the Contract. The clause required MCI to adjust pricing each year to match pricing offered to other MCI customers, or otherwise available under FTS contracts. FDIC relied on MCI's self-certification that it was offering pricing consistent with the terms of the price warranty. We found that FTS2000 rates were lower than MCI rates charged to FDIC during option years one and two of the Contract. Had MCI matched pricing available under FTS contracts, we estimated that FDIC's long distance charges would have been about $326,863 to $465,750 less during option years one and two. Several factors limited FDIC's ability to legally enforce the price warranty clause. However, we concluded that FDIC might have been able to obtain such pricing through option year negotiations.

During the original solicitation for the Contract, MCI was effectively the only offeror. AT&T declined to bid on the solicitation and requested that FDIC procure telecommunication services from the FTS2000 contract. AT&T and Sprint were vendors under the FTS2000 program.

The Acquisition Services Branch (ASB) conducted a price comparison between MCI's proposal and AT&T prices available under the FTS2000 contract.[3] ASB concluded the MCI Contract would be substantially less expensive than FTS2000. However, ASB recognized that FTS2000 included several price control mechanisms that could erode MCI's cost advantage over the 5-year term of the Contract. Accordingly, ASB recommended, in an internal memorandum, that MCI and FTS2000 prices be compared annually prior to Contract renewal to ensure that FDIC continued to receive competitive rates for long distance service.

To accomplish this price confirmation, ASB included a price warranty clause in the MCI Contract that required MCI to adjust Contract pricing each option year to match pricing offered to other MCI customers or otherwise available under General Services Administration (GSA) contracts. However, during the best and final offer stage of the solicitation, MCI added language limiting the clause to sales by MCI Government Markets.

**Price Warranty Clause**
Section C, Article VII, of the Contract:

"...Contractor warrants that the prices offered for the goods and services to be provided under this Contract are no higher than any price charged to any other customer, including any governmental instrumentality, purchasing the same or substantially similar goods and services in like or similar quantities under similar conditions or otherwise available under a General Services Administration (GSA) schedule or contract…

"For this Article VII only, the Contractor's warranty is limited to sales by MCI Government Markets, its successor(s), or assignee(s)."

DOA did not perform a market analysis before exercising option years one and two of the MCI Contract as recommended during the original solicitation. Instead, DOA relied on MCI's self-certification at the outset of each option year that its pricing complied with the terms of the price schedule without determining the basis for the certification. MCI's pricing remained largely unchanged over the first 3 years of the Contract. However, average FTS rates experienced a cumulative decrease of about 30 percent during the

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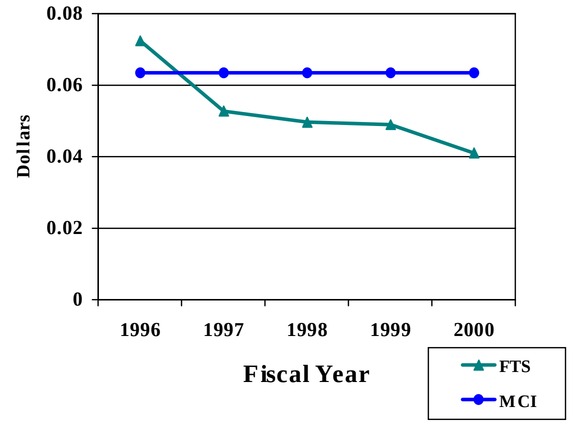
[3] Prior to March 1999, ACSB functions and staff were divided between ASB and the Corporate Services Branch.

same 3-year period. Figure 4 compares average rates for long distance voice service between the MCI Contract and FTS contracts.

Figure 4: Analysis of Average Per-Minute Rates Under FTS and the MCI Contract




We spoke with an AT&T account manager who provided average FTS2000 per minute pricing during 1997 and 1998—when option years one and two of the MCI Contract were exercised. Under FTS2000, pricing varied based on the originating and terminating local access and transport area (LATA) of each call and monthly call volume levels. The account manager provided a per-minute average range for FTS2000 pricing. Table 5 compares MCI pricing to FTS2000 average pricing.

Using FTS2000 historical pricing and FDIC's actual monthly call volume levels, we concluded that FDIC could have saved between $326,863 to $465,750 during option years one and two had MCI offered current market pricing as intended by the price warranty clause.

We did not report these amounts as questioned costs for several reasons. First, MCI added limiting language to the price warranty section of the Contract during the best and final offer phase. FDIC's Legal Division opined that this language effectively limited price warranty comparisons to contracts awarded by MCI's Government Markets. MCI was not a vendor under FTS2000.

Second, the pricing structures between FTS2000 and the MCI Voice and Video Contract were disparate. AT&T's price structure was based on the originating and terminating LATA and monthly call volumes, while MCI's price was a flat, per-minute rate nationwide. The Legal Division advised that pricing structures needed to be largely similar to make price warranty comparisons.

**Table 5: Comparison of Average Per-Minute Pricing**

| Access Category | MCI Contract | FTS2000 AT&T |
|---|---|---|
| **Dedicated to Dedicated** | $.04 | $.03-.04 |
| **Dedicated to Switched** | $.065 | $.06 |
| **Switched to Switched** | $.10 | $.07-.08 |

Source: Discussion with AT&T Representative, MCI Contract

Third, the price warranty clause was not addressed in Tariff No. 7. The Legal Division informed us the filed-rate doctrine would likely prevail and override the Contract price warranty clause.

Nevertheless, from a price competition standpoint, we concluded FDIC could have possibly achieved more competitive rates by testing the market each year prior to exercising the Contract option. While the Corporation may not have legally been able to force a price reduction via the price warranty clause, FDIC could have pursued option year negotiations with MCI based on current market pricing and FDIC's client leverage. Indeed, MCI's rationale for ultimately providing FTS2001 pricing was not because MCI agreed with FDIC's interpretation of the price warranty. Instead, MCI reported that it was providing FDIC FTS2001 pricing because FDIC was a "valued customer." We plan to issue a separate report shortly on FDIC's oversight of this Contract that will include recommendations to assist the Corporation in this regard for the future.

## OTHER USAGE CHARGES

We also recalculated MCI charges from selected invoices for VNET, 800, audio conferencing and teleconferencing. We concluded that MCI generally billed FDIC properly for those services.

In addition, we reviewed all of the invoices for calling card service and found minor inconsistencies between the Contract price schedule and amounts charged for calling card calls. Based on our review of invoices, we calculated $15,672 in unsupported costs from Contract inception through January 2000.

## CONCLUSIONS AND RECOMMENDATIONS

MCI applied an intrastate surcharge that was not included in the original Contract or corresponding tariff. MCI indicated this surcharge was required under the tariff, then later modified the Contract and tariff to include the surcharge. Further, MCI calculated the surcharge incorrectly. We determined that over 97 percent of the $1.2 million that MCI billed for the surcharge was not supported by the tariff.

MCI also charged a rate for directory assistance that was inconsistent with the tariff. We identified unsupported costs of $55,254 and projected unsupported costs of $18,345 over the remainder of the Contract associated with directory assistance.

Moreover, MCI did not comply with what we understood to be the intent of the Contract price warranty clause. FDIC relied on MCI's annual certification of compliance. We estimated FDIC's long distance charges would have been $326,863 to $465,750 less had MCI matched FTS pricing. Several factors impacted FDIC's ability to legally enforce the price warranty as it pertained to entities other than MCI. However, we concluded that the Corporation might have been able to obtain more competitive pricing through Contract option year negotiations.

MCI generally charged FDIC appropriately for other usage services that we reviewed with the exception of calling card service for which we identified minor unsupported charges totaling $15,672.

We recommended the Director, DOA:

1. Coordinate with the Legal Division to review Tariff No. 7, the Contract, and the results of our analysis, and:

    a. Recover $1,169,110 in intrastate surcharges that were not supported by Tariff No. 7, Option No. 388.

    b. In the event that FDIC determined that recovery of the tariff-based overcharges was not possible, recover $188,084 in intrastate surcharges that were not supported by the Contract.

    c. Recover $55,254 in directory assistance charges that were not supported by Tariff No. 7.

    d. Recover $15,672 in calling card charges that were not supported by the Contract.

2. Work with MCI to revise the Contract price schedule to reflect the tariff-based directory assistance rate.

## CORPORATION COMMENTS AND OIG EVALUATION

The Director, DOA, provided the Corporation's written response to a draft of this report on September 26, 2000. The response is presented as Appendix III to this report. DOA agreed with, and provided the requisites of a management decision for, both of our recommendations.

DOA's response indicated that ACSB was in the final stages of negotiating a settlement with MCI that should result in refunds and savings exceeding those discussed in our report. Specifically, MCI agreed to refund to FDIC $882,640 related specifically to intrastate surcharges. MCI also agreed to provide FTS2001 rates to FDIC during the final year of the WAN contract which ACSB estimates should result in savings of $800,000 to $900,000.

DOA also indicated that ACSB would negotiate a revision to the Contract price schedule to correct the directory assistance rate. We estimated that revising the directory assistance rate would reduce costs by $18,345 over the remaining term of the Contract.

Accordingly, we will report questioned costs of $882,640 and funds put to better use of $818,345 in our next *Semiannual Report to the Congress*. The funds put to better use represents $800,000 as a conservative estimate of savings on the new WAN rates plus $18,345 in cost reductions for directory assistance.

## APPENDIX I: GLOSSARY AND ACRONYMS

| Term | Definition |
|---|---|
| ACSB | Acquisition and Corporate Services Branch. Division of Administration branch with contract authority for the MCI Contract. In March 1999, functions and staff from the Acquisition Services Branch and Corporate Services Branch were combined to form ACSB. |
| Calling Card | Essentially a credit card used to bill long distance calls. Calling card calls originate from non-FDIC facilities and terminate at locations not serviced by a FDIC 800 number. |
| CDR | Call Detail Record. An accounting record, produced by telephone switches, that tracks call type, time, duration, facilities used, originator, destination, and so forth. CDRs are used for customer billing, rate determination, network monitoring, and facility capacity planning. |
| Common carrier | Telecommunications companies that offer services to the public. Local exchange carriers (LECs), such as Verizon, are considered "dominant" carriers. Interexchange carriers, such as MCI, are considered "non-dominant." |
| DA | Directory Assistance. An information service in which operators assist customers in obtaining telephone numbers. Under the Contract, DA charges appeared on VNET and calling card invoices. |
| DIRM | Division of Information Resources Management. Program office for the Contract. Specifically, the Telecommunications Section within DIRM had program responsibility for the MCI Contract. |
| DOA | Division of Administration. FDIC division providing human resource, organizational, procurement, and administrative support services to the Corporation. |
| FCC | Federal Communications Commission. The U.S. Government board of five presidential appointees vested with the authority to regulate all non-Federal Government interstate telecommunications as well as all international communications that originate or terminate in the United States. |
| Filed-rate doctrine | Well-established legal principle that gave precedence to tariffs in common carrier relationships with customers. |
| FTS | Federal Technology Service. An organization within the General Services Administration that provided information technology and network services solutions to government agencies. FTS provided long distance telecommunications service to agencies via the FTS contracts. FTS2000 was awarded to AT&T and Sprint in 1988. In late 1998 and early 1999, FTS awarded the FTS2001 contract to Sprint and MCI, respectively. |
| IEC | Interexchange Carrier. A company providing long distance telephone service between LECs and local access and transport areas (LATAs). |
| Inbound | 800 Toll Free calls. Calls for which the party being called, in this case FDIC, were billed. Under the MCI Contract, inbound calls were known as 800 service. |
| Interlata | Telecommunications services originating in one LATA and terminating in another LATA or outside of a LATA. |
| Interstate | Any telecommunications channel, facility, or network that provides transmission between locations in two or more states. Interstate operation is regulated by the FCC. |

| Term | Definition |
|---|---|
| Intralata | Telecommunications services originating and terminating within the same LATA. |
| Intrastate | Telecommunications services originating and terminating within the same state. Intrastate connections are regulated by each state's public utility commission. |
| LATA | Local Access and Transport Area. A geographic service area defined in the AT&T Modification of Final Judgement (MFJ). Long-distance service within a LATA is provided by the LEC. Service between LATAs is provided by an IEC. There are approximately 200 LATAs in the U.S. |
| LEC | Local Exchange Carrier. A local telephone company that provides ordinary local voice-grade telecommunications service under regulation within a specified service area. |
| MCI | The FDIC Voice and Video Long Distance Services Contract, effective November 1, 1996, was signed by MCI Telecommunications Corp. (MCIT), a subsidiary of MCI Communications Corporation (MCIC).<br><br>In September 1998, WorldCom, Inc. acquired MCIC and was renamed MCI WorldCom, Inc. In October 1999, MCIT was renamed MCI WorldCom Network Services, Inc.<br><br>MCI’s organization pertaining to the Contract was:<br>• MCI WorldCom, Inc. -- parent company,<br>• MCI WorldCom Network Services, Inc. -- wholly owned subsidiary. |
| Outbound | Outgoing calls. Calls originating from or between FDIC facilities. Under the MCI Contract, outbound service was known as VNET service. |
| Switch | A device that can be controlled to interconnect two circuits that responds to originator signals and dynamically accepts, routes, and places or forwards a call or other transmission; includes LEC central office switches, IEC switches and private branch exchange. |
| Tariff | Published schedule of rates or charges for a specific unit of equipment, facility, or type of service provided by a telecommunications common carrier. |
| Tariff No. 7 | Government Telecommunications Services tariff document filed with the FCC originally effective February 22, 1991, containing rules, regulations and rates applicable to service provided by MCI WorldCom Network Services, Inc. It was the governing document for FDIC’s Voice and Video Long Distance Services Contract. |
| Trunk | A high-capacity connection between switches. From a customer perspective, trunk may refer to an external carrier line connected to customer premises equipment/private branch exchange (CPE/PBX), including local exchange lines, wide area telecommunications service (WATS) lines and dedicated private lines. Customer trunks may be outgoing only, incoming only, or two-way. Trunks perform various control functions associated with call processing. |
| Usage | For the purposes of this report, usage referred to the volume of traffic for specific services. Most charges under the Contract varied with the level of usage. For example, VNET and 800 calls were priced according to the number of long distance minutes. Calling card surcharges and directory assistance were priced according to the number of calls. Some charges, such as monthly recurring charges for trunk lines were fixed and were not affected by volume or usage. |

## APPENDIX II: INVOICE REVIEW METHODOLOGY AND SCOPE OF REVIEW

MCI billed FDIC monthly for Contract services. In some instances, MCI provided CD-ROM-based invoices and electronic CDRs for selected service categories. Billings consisted of seven invoices for the following service types as shown in Table 6.

**Table 6: Contract Invoices and Service Categories**

| Service Category | Call Detail Support | |
|---|---|---|
| | Paper-Based | Electronic |
| Intrastate Surcharge | No | No |
| VNET | Yes | Yes |
| 800 | Yes | Yes |
| Calling Cards | Yes | No |
| Frame Relay (Trunk Lines) | N/A | N/A |
| Bill #6 (Audio Conferencing, Fax Broadcast) | Yes | No |
| Video Teleconferencing | Yes | No |

We analyzed charges for each service type and concentrated our work on those that represented the bulk of the Contract charges. We initially reviewed charges quarterly for each service category to determine if charges were supportable. In instances where we identified discrepancies, we expanded our coverage to review all charges.

When possible, we used Interactive Data Extraction and Analysis (IDEA) audit software to recalculate Contract charges from the electronic CDRs. We were unable to read electronic CDRs prior to November 1998 for 800 service, and May 1998 for VNET service, using IDEA and Microsoft Access.

We also reviewed hardcopy invoices for selected services. In a few cases, invoices were either missing, incomplete, or not available at the time of our review. Table 7 itemizes, by month, the scope of our analysis and the information that we reviewed.

DIRM also maintained an invoice log with summary minute and charge information for each service category. Where noted in Table 7, we used summary information from the invoice log to assess the reasonableness of service charges.

For most of our calculations, we determined per minute or per call usage information from the electronic CDR or from summary invoice pages. We then researched the Contract price schedule or appropriate tariff document to determine the correct price for the service and how the service should have been billed. We recalculated Contract amounts and compared our results to MCI invoice amounts.

We did not review, or performed a limited review, of the following:

- Frame Relay invoices because we found that the Oversight Managers monitored trunk line charges fairly closely. Frame Relay accounted for about 5 percent of the total Contract charges through January 2000,

- Audio Conferencing and Fax Broadcast (Fax B.C.) because those services accounted for less than 2 percent of total Contract charges, and

- International calls, which represented less than 1 percent of total Contract charges, because pricing was disparate and dependent on the terminating location of each call.

Table 7 presents the periods and sources of Contract billing information that we reviewed.

**Table 7: Scope of Contract Review**

| | Intrastate Surcharge | | Directory Assistance | | Contract Compliance | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Usage Month | 800 | VNET | VNET | Calling Cards | 800 | VNET | Calling Cards | Audio Conf. | Fax B.C. | Video TeleConf. |
| Nov-96 | Invoice | Invoice | Missing | Missing | | | Missing | (X) | | Summary Invoice |
| Dec-96 | Invoice | Invoice | Missing | Missing | | | Missing | | | Summary Invoice |
| Jan-97 | Invoice | Invoice | Missing | Missing | | | Missing | | | |
| Feb-97 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | Summary Invoice |
| Mar-97 | Invoice | Invoice | Missing | Missing | Invoice | Invoice | Missing | Invoice | Invoice | Invoice |
| Apr-97 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | Summary Invoice |
| May-97 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | Summary Invoice |
| Jun-97 | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | (X) |
| Jul-97 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | (X) |
| Aug-97 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | (X) | (X) |
| Sep-97 | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | (X) |
| Oct-97 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | (X) | (X) |
| Nov-97 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | (X) |
| Dec-97 | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | (X) |
| Jan-98 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | |
| Feb-98 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | (X) |
| Mar-98 | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | (X) |
| Apr-98 | Invoice | Invoice | Invoice | Invoice | | | Invoice | | | (X) |
| May-98 | Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |

| | Intrastate Surcharge | | Directory Assistance | | Contract Compliance | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Usage Month | 800 | VNET | VNET | Calling Cards | 800 | VNET | Calling Cards | Audio Conf. | Fax B.C. | Video TeleConf. |
| Jun-98 | Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | Invoice | CD-ROM & Invoice | Invoice | Missing | Missing | (X) |
| Jul-98 | Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Aug-98 | Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Sep-98 | Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | Invoice | CD-ROM & Invoice | Invoice | Missing | (X) | (X) |
| Oct-98 | Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Nov-98 | Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Dec-98 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Jan-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | Invoice | CD-ROM & Invoice | Invoice | Missing | Missing | (X) |
| Feb-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Mar-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Apr-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | Invoice | Invoice | Invoice | | | (X) |
| May-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Jun-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Jul-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | Invoice | Invoice | Invoice | | | (X) |
| Aug-99 | CD-ROM & Invoice | Missing | Missing | Missing | | | Missing | | | (X) |
| Sep-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | | | (X) |
| Oct-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | Invoice | Invoice | Invoice | Invoice | | (X) |
| Nov-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | Invoice | | (X) |
| Dec-99 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | Invoice | | (X) |
| Jan-00 | CD-ROM & Invoice | CD-ROM & Invoice | CD-ROM & Invoice | Invoice | | | Invoice | Invoice | | (X) |

**Legend**
Invoice -- Reviewed charges using paper invoice and contract price schedule.
CD-ROM -- Electronically recalculated from electronic CDR and price schedule information.
Summary Invoice -- Assessed reasonableness of charge using summary minute and summary charges information from DIRM invoice log.
Missing -- Unable to locate invoice at time of review.
(X) -- DIRM invoice database indicated no charges were incurred or no invoices were received for the period.

# APPENDIX III: CORPORATION COMMENTS

**FDIC**
**Federal Deposit Insurance Corporation**
550 17th Street, NW, Washington, DC 20429

Division of Administration

September 26, 2000

**MEMORANDUM TO:** Stephen M. Beard
Director, Office of Congressional Relations and Evaluations

**FROM:** Arleas Upton Kea Arleas Upton Kea
Director, Division of Administration

**SUBJECT:** Management Response to OIG Draft Report entitled *MCI Voice and Video Contract—Intrastate Surcharge and Other Compliance Issues*

The Division of Administration's (DOA) Acquisition and Corporate Services Branch (ACSB) has completed its evaluation of the Office of Inspector General (OIG) Draft Report entitled *"MCI Voice and Video Contract—Intrastate Surcharge and Other Compliance Issues."*

The OIG found that MCI WorldCom, Inc.(MCI) has not been billing FDIC at rates that conform with terms and conditions of the contract. The OIG made two recommendations. The first involves a maximum recovery of $1,240,036 for amounts over-billed or not supported. The second recommendation calls for a revision of the contract price schedule that will affect future rates.

<u>**Management Decision**</u>:

**OIG Finding #1: MCI Billed At Rates Higher Than Allowed In the Contract or That Could Not Be Supported**

**OIG Recommendation #1:** Coordinate with the Legal Division to review Tariff No. 7, the Contract, and the results of our analysis, and:

a. Recover $1,169,110 in intrastate surcharges that were not supported by Tariff No. 7, Option No. 388.
b. In the event that FDIC determines that recovery of the tariff-based overcharges is not possible, recover $188,084 in intrastate surcharges that were not supported by the Contract.
c. Recover $55,254 in directory assistance charges that were not supported by Tariff No. 7.
d. Recover $15,672 in calling card charges that were not supported by the Contract.

**Management Response:** We agree with the recommendation. ACSB is in the final stages of negotiations that will result in refunds and savings from MCI that we expect will exceed the total amount the OIG has recommended that we recover. Recoveries and savings will be recorded and accrued through another MCI contract--the Wide Area Network (WAN) Contract No. 96-00986. This contract was chosen for the monetary recovery because the amount of unpaid invoices currently being withheld under the WAN contract exceeds the amount to be recovered. It would take several months to recover the full amount through the voice and video contract.

MCI has agreed to refund FDIC $882,640 related specifically to intrastate surcharges. This recovery will be recorded in the form of credits on Wide Area Network (WAN) invoices, another MCI contract (No. 96-00986). Although MCI did not agree with all the amounts questioned in the OIG report, it has agreed to charge FDIC the current FTS rates under the WAN contract for the next option year that will be renewed effective November 1, 2000. When that part of the agreement is finalized, we estimate 12-month savings of $800,000 to $900,000, based on the Corporation's historical telephone usage. A Settlement and Release Agreement and our renewal of the MCI contract for the upcoming option year will confirm our completion of corrective action. We estimate final resolution of this recommendation by October 31, 2000.

**OIG Finding #2: MCI is Currently Charging An Incorrect Rate For Directory Assistance**

**OIG Recommendation #2:** Work with MCI to revise the Contact price schedule to reflect the tariff-based directory assistance rate.

**Management Response:** We agree with the recommendation. ACSB will be exercising an option to extend the MCI Voice and Video contract for twelve months beginning November 1. As part of that process, we will negotiate a revision to the price schedule to correct the tariff-based directory assistance rate. The signed contract and revised price schedule will document completion of corrective action. We estimate final resolution of this recommendation by November 30, 2000.

If you have any questions concerning the management responses, please contact Richard Johnson at (202) 942-3191.

cc: Mike Rubino
Deborah Reilly
Andrew Nickle
Tom Harris
Richard Johnson
E. Marshall Gentry

## APPENDIX IV: MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on DOA management's written response to our draft report.

| Rec. Number | Corrective Action: Taken or Planned / Status | Expected or Actual Completion Date | Documentation that will Confirm Final Action | Monetary Benefits | Management Decision: Yes or No |
|---|---|---|---|---|---|
| 1 | ACSB is in the final stages of negotiations with MCI. MCI has agreed to:<br>• Refund FDIC $882,640 related specifically to intrastate surcharges. Refund will be recorded in the form of credits under MCI's Wide Area Network (WAN) contract with FDIC.<br>• Provide FDIC with FTS2001 pricing during the final option year of the WAN contract. ACSB estimates that FTS2001 pricing will result in cost savings of $800,000 to $900,000. | 10/31/00 | Settlement and Release Agreement | $1,682,640 to $1,782,640 | Yes |
| 2 | ACSB will negotiate a revision to the price schedule during the upcoming option year decision period to correct the tariff-based directory assistance rate. | 11/30/00 | Contract Modification | $18,345 | Yes |