

This report first addresses implementation of recommendations the Staff made in the Staff's Initial Report Regarding the Impact of the Allegations of Criminal Activities by Kenneth Matzdorff on Missouri Utility Consumers, then addresses the implementation of directives of the Commission in the Commission's Order that established this Case No. TO-2005-0237.

**The Staff's Initial Report Regarding the Impact of the Allegations of Criminal Activities by Kenneth Matzdorff on Missouri Utility Consumers - Recommendations**

*Kenneth M. Matzdorff relinquish all managerial and financial authority for Cass County Telephone Company L.P.*

The Staff is informed that on January 13, Mr. Matzdorff ceded all financial authority for Cass County Telephone Company Limited Partnership ("CassTel"). By agreement dated March 4, 2005 Local Exchange Company, LLC ("LEC, LLC") entered into a Management Agreement with GVNW Consulting Inc. (GVNW). The Management Agreement (Attachment A) calls for LEC, LLC to relinquish all of its operational, functional, regulatory and other control of CassTel and delegates to GVNW all of LEC's operational authority for CassTel and LEC Long Distance. Messrs. Bob Schoonmaker and Scott Smith of GVNW are currently the acting General Managers of CassTel. Staff met with Messrs. Schoonmaker and Smith on March 23, 2005 to discuss in detail the management contract and the operations of CassTel.

*Rebecca Matzdorff be suspended by the Company from all managerial and financial authority for Cass County Telephone Company LP pending the completion of the Staff's investigation as directed by the Commission in Case No. TO-2005-0237.*

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*The Staff explore all options to eliminate the role of LEC LLC regarding the ownership, financing, operation and financial affairs of Cass County Telephone Company LP and New Florence Telephone Company.*

The Staff has prepared a complaint to seek authorization from the Commission to pursue penalties against CassTel in Circuit Court. Additionally, the Commission's General Counsel has been in contact with the Office of the Missouri Attorney General regarding CassTel and is presently waiting on a response from the Missouri Attorney General.

*The Staff initiate management audits of both Cass County Telephone Company and New Florence Telephone Company, to include but not be limited to: 1) quality of service, 2) the operations of the business office, and 3) related party transactions safeguards and controls.*

This recommendation was incorporated into Case No. TO-2005-0237.

Update of the Engineering and Management Services Department:

- Developed Workplan.
- Submitted 35 Data Requests February 22 and 23, 2005.
- Responses to 35 Data Requests (9 notebooks) were delivered to the Commission staff March 14, 2005.
- Currently reviewing the Data Requests, making notations and compiling a list of questions/concerns that will be provided to Sondra Morgan, Cass County Attorney, for clarification from the Company.
- Reviewed filings and motions.
- Read legal documents, newspaper articles, etc.
- Preparing interview questions for an interview to be conducted with Scott Smith and Bob Schoonmaker. This interview will be conducted within the next two weeks.

*The Staff ensure that Century Tel and Spectra have in place an audit program and overall internal controls sufficient to detect possible wrongdoing and report the results of these efforts.*

Staff has been working with CenturyTel and Spectra to ensure the above programs and overall internal controls are in place and functioning.

*The Staff explore Joint Audit option(s) with NECA, Federal Communications Commission, Universal Service Administrator Company, and other interested*

*entities to minimize duplication of effort and improve overall knowledge of the audits and investigations of these matters.*

The Staff is actively working with the Kansas Corporation Commission (KCC) Staff and is in the process of finalizing a non-disclosure agreement with the KCC. On March 23, 2005 the Staff and representatives of the Universal Service Administrator Company ("USAC") meet via conference call in order to explore ways to exchange information and work together as a joint venture. A number of issues were discussed and future meetings will be held.

*The Staff depose Kenneth Matzdorff, Rebecca Matzdorff and Controller Debi Long regarding the scope of their non-Missouri regulated telephone company activities, current Cass County operations, relationship and operation of LEC LLC, relationship and operation of Haug Construction, relationship and operation of Local Exchange Carriers, LLC, relationship and operation of the other firms identified in Section 5, and identification of other firms related to Mr. Matzdorff that have not yet been identified.*

The taking of sworn testimony taken pursuant to *subpoenas* are currently being planned for not only Kenneth Matzdorff, Rebecca Matzdorff and Controller Debi Long, but a number of other LEC, LLC employees. The lack of access to LEC, LLC employees due to restrictions dictated by LEC, LLC's will require far more instances of obtaining sworn testimony pursuant to *subpoenas* than originally planned.

*The Staff initiate discussions with Missouri LECs and Missouri Telephone Industry Association (MTIA) regarding development of a whistleblower program for Missouri telecommunications activities.*

Staff has contacted the MTIA and plans are being developed to meet with the Telecommunications industry regarding the development of a whistleblower program.

*The Staff initiate discussions with interested parties to develop an affiliate transaction rule for small Missouri telephone companies.*

The Staff has contacted representatives of the Telecommunications industry in order to start the exchange of ideas. The initial meeting should be held sometime in late May – early June time frame.

*The Staff modify the Missouri telephone company annual report format to include identification of related party transactions above a specified threshold and the amount of the transaction.*

The Staff has contacted representatives of the Telecommunications industry regarding this recommendation. An initial meeting to should be held sometime in late May – early June time frame.

*The Staff continue to work with federal agencies involved in the investigation of these matters.*

The Staff will be meeting the U.S. Attorney's Office for the Western District of Missouri in the near future to review the forensic audit information gathered during the recently completed investigations.

**Case No. TO-2005-0237 – An Investigation of the Fiscal and Operational Reliability of Cass County Telephone Company and New Florence Telephone Company, and Related Matters of Illegal Activity**

*Network/Provisioning Quality*

The Telecommunication's Staff has formulated a 5-step process to verify the operational reliability, safety and quality of service provided the consumers of CassTel and New Florence Telephone Company.

The process consists of the following:

1. Fact Finding: Obtain information thru data requests necessary to conduct portions of the reviews and analyses listed below. These requests seek information on the following topics: Basic Service Orders Installed with in 5 days; Installation Commitments; Operator Assisted Calls; Customer Assisted Calls; Originated Switch Calls; Local Exchanged Switched Calls; InterExchange Switched Calls; Customer Trouble Report Rate; Clearing Time Out of Service Trouble in < 24 hours; Repair Commitments; Held Service Order Logs; Directory Publication requirements and Consumer Bill Requirements. The information received will be used to perform the reviews in step 2 and 3. **Information Requested 02/25/2005. Information will be provided onsite at the time of the Administrative Review per Scott Smith of GVNW.**

2. Review Compliance with Commission Rules: Staff will review how the company tracks and tabulates its quarterly quality of service report. This review will reveal if the company's quality of service results are accurate and a true reflection of compliance with the Commission's service objectives for quality of service. In addition Staff will review compliance with other Commission rules. **Scheduled initial on-site visit: 03/29/2005**

3. Analyze Outside Plant: Staff will analyze the condition of the company's outside plant facilities. This analysis will consist of field investigations of various components of the company's outside plant facilities. Compliance with requirements contained in 4 CSR 240.32.60 and 4 CSR 240.18 will be specifically investigated. Staff will attempt to rate or score the overall condition of the company's outside plant facilities based on set criteria.

4. Analyze Central Office Facilities: Staff will analyze the condition of the company's Central Office and Remote facilities, including digital line carriers located in the field. Compliance with requirements contained in 4 CSR 240.32.60 and 4CSR 240.18 will be specifically investigated. Staff will attempt to rate or score the overall condition of the company's switching facilities based on set criteria.

5. Contractor Administrative Review: The Telecommunications Department will provide assistance to analyze capital improvement expenditures of Cass County and New Florence Telephone Companies.

#### *Receipt and Disbursement of Universal Service Funds*

Data requests (21) have been issued in accordance the work plan.

Work has started to recreate the plant investment of CassTel and New Florence Telephone Company from the time the change in ownership took place from GTE to present. This will include but not be limited to validating and verifying the approvals, authorizations and payment process of plant investment, retirements and operation and maintenance of utility property.

Staff has had conversations with the Federal Communications Commission (FCC), USAC and the National Exchange Carriers Association (NECA) as to the scope of any pending investigations by these agencies.

The FCC is completing an audit of the CassTel high cost loop support for 2004. The FCC's authority is limited to any forfeiture that occurs in the previous year only. The FCC indicated it is not likely that it will seek any enforcement action because of the timing of the activity and its limitations to review only one year. The FCC's report should be available by the end of April. While the full report cannot be released, the FCC indicated its willingness to share the findings and conclusions with Staff upon the receipt of the proper confidentiality agreement. Staff submitted a request for the findings and conclusions and the confidentiality agreement.

USAC is completing audits of CassTel and New Florence Telephone Company. USAC plans to off-set any errors, but according to October 2004 federal rule changes, it is only allowed to off-set one month's worth of payments. In other words, if a company receives \$1000 a month and the error is \$2000, USAC could only not pay the company for one month. The balance of any errors has to be collected through an invoice and subsequent debt collection procedures.

Missouri Commission Staff and the staff of the Kansas Corporation Commission, discussed the possibility of coordinating investigative activities with USAC. USAC indicated it was not customary for it to conduct joint audits and indicated confidentiality concerns. Staff explained that it had conducted joint audits with other agencies in the past, employing the appropriate confidentiality measures. Staff also indicated it had talked to the FCC and the FCC was willing to release its findings and conclusions when the proper confidentiality measures were in place. USAC indicated it was held to higher standards for investigative audits and did not want to do anything that would impede its investigation or the state commission's investigation. In short, USAC indicated it did not want to "step on toes" as far as field work.

Since the possibility of collaboration on investigations seemed unlikely, Staff pursued the possibility of sharing data received through data requests. In an effort to avoid an excessive burden on the companies, which would result in delays in the investigations, it was suggested that USAC be copied on all commission discovery requests and the state commissions be copied on all USAC discovery requests. In return, when the companies responded, they would respond to all entities at once. USAC is discussing this option internally and expected to get back with Staff on its determinations.

NECA has indicated it does not have plans to complete an investigation but is monitoring the situation and would like to see the data underlying the fraud allegations before deciding how to proceed. NECA's ability to obtain a settlement is limited to a 24-month window from the date of any suspected violations.

Work is in progress to select a number of CassTel's and New Florence Telephone Company's Continuing Property Records ("CPRs") for testing. Testing will include, but not be limited to tracing entries to the vendor's invoices to determine the reasonableness of amounts, classification, etc. In conjunction with the Telecommunications Department, locate the actual plant item and determine the legitimacy of the expenditures.

#### *Quality of the Books & Records*

The Staff began fieldwork on Tuesday, March 22, 2005 in Peculiar, MO.

The Auditing Department Staff is currently in the process of analyzing the following information in its possession received from prior cases/investigations:

- LEC, LLC invoices to CassTel 2002 general ledger-CassTel and New Florence Telephone Company
- Haug Construction invoices to New Florence Telephone Company
- Audited financial statements from CassTel and New Florence Telephone Company 2002 and 2003

The Staff will continue to review prior case/investigation documents that pertain to its investigation.

PSC annual reports and the external auditor's annual audit reports (including cash flow statements, income statements, balance sheets) from CassTel, New Florence Telephone Company and CassTel Long Distance are being analyzed and compared with the Statement of Revenues for applicable years.

Received copies of CassTel check registers for 2002, 2003 and 2004 (TO-2005-0237, Data Request No. 84) and New Florence Telephone Company check registers for 2002, 2003 and 2004 (TO-2005-0237, Data Request No. 92).

- Selected a sample of checks from each company and each year provided and received copies of invoices that support checks (TO-2005-0237 Data Requests 84.1 and 92.1).
- Reviewed Haug Construction invoices 2002-2004 to CassTel. Received Continuous Property Records on CD. Received some general information related to software accounting process.
- The Staff continues to review this information.

Staff is in the process of developing additional data requests to provide details to support documents currently in its possession:

- Data Requests for determination of plant balances (CPRs, work orders, maps/drawings, Haug invoices)
- Data Requests for determination of accounting process, budgeting, software operating procedures

- Tracking of invoices through general ledger and supporting journals
- Bank statements to support check registers

Staff's work has been significantly hampered by the lack of access to CassTel's and New Florence Telephone Company's external auditor's work papers and LEC, LLC employees. The financial statements of CassTel and New Florence Telephone Company have been significantly changed. The Staff cannot determine the bases of the changes. Further, to determine the quality of the books and records the Staff must have access to the various audit tests conducted by the external auditor.

*Ongoing Fiscal Reliability*

Data requests have been submitted requesting indenture information for any loans outstanding at CassTel or LEC, LLC.

The Financial Analysis Department has performed various ratio analyses of the 2003 CassTel financial statements. The ratio analysis currently shows healthy financial ratios. Various scenarios including the elimination of USF funding are being developed to determine the ongoing fiscal reliability of CassTel and New Florence Telephone Company.