

June 2008

TELECOMMUNICATIONS

FCC Needs to Improve  
Performance  
Management and  
Strengthen Oversight  
of the High-Cost  
Program





Highlights of [GAO-08-633](#), a report to congressional committees

## Why GAO Did This Study

In the Telecommunications Act of 1996 (1996 Act), the Congress said that consumers in “rural, insular, and high-cost areas” should have access to services and rates that are “reasonably comparable” to those in urban areas. To implement the 1996 Act, the Federal Communications Commission (FCC) modified and expanded the high-cost program. The program provides funding to some telecommunications carriers, facilitating lower telephone rates in rural areas. GAO was asked to review (1) the effect that the program structure has on the level of support and types of services in rural areas, (2) the extent to which FCC has developed performance goals and measures for the program, and (3) the extent to which FCC has implemented internal control mechanisms.

GAO reviewed relevant documents; interviewed federal and state officials, industry participants, and experts; conducted 11 state site visits; and conducted a survey of state regulators, available online at [GAO-08-662SP](#).

## What GAO Recommends

To strengthen management and oversight of the program, FCC should (1) establish short- and long-term performance goals and measures for the program and (2) identify areas of risk and implement mechanisms to help produce cost-effective expenditures. FCC intends to issue a Notice of Inquiry to address GAO’s recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-633](#). For more information, contact Mark Goldstein, (202) 512-2834, [goldsteinm@gao.gov](mailto:goldsteinm@gao.gov).

## TELECOMMUNICATIONS

### FCC Needs to Improve Performance Management and Strengthen Oversight of the High-Cost Program

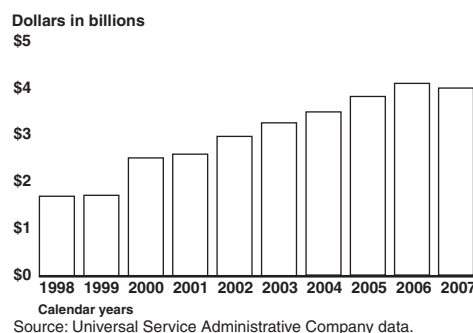
#### What GAO Found

The high-cost program’s structure has resulted in the inconsistent distribution of support and availability of services across rural America. The program provides support to carriers in all states. However, small carriers receive more support than large carriers. As a result, carriers serving similar rural areas can receive different levels of support. Currently, the high-cost program provides support for the provision of basic telephone service, which is widely available and subscribed to in the nation. But, the program also indirectly supports broadband service, including high-speed Internet, in some rural areas, particularly those areas served by small carriers. The program provides support to both incumbents and competitors; as a result, it creates an incentive for competition to exist where it might not otherwise occur.

There is a clearly established purpose for the high-cost program, but FCC has not established performance goals or measures. GAO was unable to identify performance goals or measures for the program. While FCC has begun preliminary efforts to address these shortcomings, the efforts do not align with practices that GAO has identified as useful for developing successful performance goals and measures. For example, FCC has not created performance goals and measures for intermediate and multiyear periods. In the absence of performance goals and measures, the Congress and FCC are limited in their ability to make informed decisions about the future of the high-cost program.

While some internal control mechanisms exist for the high-cost program, these mechanisms are limited and exhibit weaknesses that hinder FCC’s ability to assess the risk of noncompliance with program rules and ensure cost-effective use of program funds. Internal control mechanisms for the program consist of (1) carrier certification that funds will be used consistent with program rules, (2) carrier audits, and (3) carrier data validation. Yet, each mechanism has weaknesses. The carrier certification process exhibits inconsistency across the states that certify carriers, carrier audits have been limited in number and reported findings, and carrier data validation focuses primarily on completeness and not accuracy. These weaknesses could contribute to excessive program expenditures.

#### High-Cost Program Expenditures



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## Abbreviations

AT&T	American Telephone and Telegraph Company
CETC	competitive eligible telecommunications carrier
ETC	eligible telecommunications carrier
FCC	Federal Communications Commission
IPIA	Improper Payments and Information Act of 2002
Joint Board	Federal-State Joint Board on Universal Service
MOU	Memorandum of Understanding
NECA	National Exchange Carrier Association
NPRM	Notice of Proposed Rulemaking
OIG	Office of Inspector General
OMB	Office of Management and Budget
USAC	Universal Service Administrative Company
USF	Universal Service Fund
1996 Act	Telecommunications Act of 1996

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United States Government Accountability Office  
Washington, DC 20548

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June 13, 2008

The Honorable John D. Dingell  
Chairman  
The Honorable Joe Barton  
Ranking Member  
Committee on Energy and Commerce  
House of Representatives

The Honorable Bart Stupak  
Chairman  
The Honorable John Shimkus  
Ranking Member  
Subcommittee on Oversight and Investigations  
Committee on Energy and Commerce  
House of Representatives

For many decades, federal policy has called for making affordable residential telephone service available to the greatest possible number of Americans—a policy known as “universal service.” Provision of this service is often a concern in rural areas, where the cost of providing telephone service can be particularly high. For example, in 2002, we reported that the cost of providing telephone service in rural areas was nearly three times the cost of providing service in central cities of metropolitan areas.<sup>1</sup> As a result, universal service policy traditionally targeted financial support to rural areas where the costs of providing telephone service are high. In the Telecommunications Act of 1996 (1996 Act), the Congress codified universal service which, among other things, specified that consumers in “rural, insular, and high-cost areas” should have access to services and rates that are “reasonably comparable” to consumers in urban areas, and required that all companies providing interstate telecommunications service contribute to a mechanism that would fund universal service.<sup>2</sup>

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<sup>1</sup>GAO, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding*, GAO-02-187 (Washington, D.C.: Feb. 4, 2002).

<sup>2</sup>Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (Feb. 8, 1996).

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To implement the 1996 Act, the Federal Communications Commission (FCC) modified and expanded the high-cost program.<sup>3</sup> This program provides support to companies designated as eligible telecommunications carriers (ETC). There are two types of ETCs that receive support from the program: incumbents and competitors. The incumbents were already providing service when the Congress passed the 1996 Act. These incumbents are further classified as either “rural”—generally small carriers serving primarily rural areas—or “nonrural”—generally large carriers serving both rural and urban areas. To a large extent, these carriers receive support based on their size (as recognized by their classification as rural or nonrural) and their cost characteristics. The competitors—known as competitive eligible telecommunications carriers (CETC)—receive support based on the level of support the incumbent receives where the service is provided. By providing support to carriers, the high-cost program allows the carriers to charge lower telephone rates than otherwise would be available to customers in high-cost, rural, and remote areas.

To implement the high-cost program, FCC relies on the Universal Service Administrative Company (USAC) and state regulatory commissions. FCC has overall responsibility for the high-cost program, including making and interpreting policy, overseeing the operations of the program, and ensuring compliance with its rules. However, FCC delegated to USAC responsibility to administer the day-to-day operations of the program. At the state level, state regulatory commissions (that is, the state agencies responsible for regulating telephone service within the states) hold the primary responsibility to determine carrier eligibility for participation in the program and to annually certify that carriers will appropriately use high-cost program support.

While considering legislation codifying universal service, the Senate Committee on Commerce, Science, and Transportation anticipated that competition and new technologies would reduce or eliminate the need for universal service support mechanisms.<sup>4</sup> However, rather than decreasing, the cost of the high-cost program has grown substantially to \$4.3 billion in

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<sup>3</sup>The 1996 Act also specified universal service support for other entities, including schools, libraries, and rural health care facilities. As such, FCC established the schools and libraries (E-Rate) and rural health care programs. The 1996 Act also codified an existing program for low-income consumers.

<sup>4</sup>S. Rep. No. 104-23 (1995).

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2007, increasing nearly 153 percent between calendar years 1998 and 2007. This significant growth has raised concerns about what the program is accomplishing, whether it has clear objectives, and whether it has effective controls over expenditures. In response to your request that we examine the federal high-cost program's operation, this report addresses three main questions:

1. What effect has the structure of the program had on levels of support received and types of services available in rural areas?
2. To what extent does the program have performance goals and measures?
3. To what extent does the program have mechanisms in place to prevent and detect fraud, waste, and abuse?<sup>5</sup>

To respond to the objectives of this report, we reviewed documents and interviewed officials from FCC and USAC. We also interviewed officials from industry associations, national wireline and wireless carriers, the National Exchange Carrier Association (NECA),<sup>6</sup> and other individuals with knowledge of the high-cost program. To develop an understanding of how the program works in specific locations, we conducted site visits in six states: Alabama, Iowa, Montana, Oklahoma, Oregon, and Wisconsin. We chose these six states on the basis of such criteria as the extent of rural population, geographic diversity, and the number of wireline and wireless carriers present in the state. Within each state, we interviewed the state regulatory commission, rural and nonrural incumbent carriers, and competitive carriers. To test our structured interview and site selection methodology, we also conducted site visits in the following states: Arizona, Maine, Massachusetts, New Hampshire, and New Mexico. For additional information about the types of mechanisms in place for preventing waste, fraud, and abuse, we conducted a survey of state regulatory commissions. The survey sought information pertaining to the state's regulation of telephone service and the state's internal control procedures for incumbent and competitive carriers receiving high-cost program support in the state. The survey was available online to officials

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<sup>5</sup>We also are reviewing the schools and libraries (E-Rate) program and will issue a separate report on it.

<sup>6</sup>NECA is a not-for-profit association of local telephone carriers established by FCC in 1983 to perform telephone industry tariff filings and revenue distributions.

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in the 50 states and the District of Columbia on a secure Web site. We received complete responses from 50 of the 51 commissions surveyed, for an overall response rate of 98 percent. This report does not contain all the results from the survey. The survey and a more complete tabulation of the results can be viewed at [GAO-08-662SP](#). See appendix I for a more detailed discussion of our overall scope and methodology.

We conducted this performance audit from July 2007 through June 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Results in Brief

The high-cost program's structure has contributed to inconsistent distribution of support and availability of services across rural America. In 2007, eligible carriers in every state received support, with state-by-state distributions ranging from \$31,000 for carriers in Rhode Island to \$283 million for carriers in Mississippi. In general, the program provides greater levels of financial support in more rural states, such as Mississippi and Alaska. However, the program does not distribute support consistently to carriers operating in rural areas. Because of the program's structure—which consists of five components, each with different eligibility criteria and thresholds for distributing support—rural carriers generally receive more support than nonrural carriers, even though both types of carriers serve rural areas. Thus, two carriers serving similar customers in similar environs can receive different levels of support, which can lead to different levels of telecommunications service across rural areas. The program supports basic telephone service, which to a great extent is available and widely subscribed to throughout much of the country. But, the program also indirectly supports broadband service in some rural areas, particularly those areas served by rural carriers. Since rural carriers receive high levels of support, these carriers can upgrade their networks with new technologies, which often facilitate broadband service, in addition to basic telephone service. Conversely, since nonrural carriers do not receive as much funding, it is not always cost-effective for them to make similar upgrades in rural areas, which can limit their ability to provide broadband service in the rural areas where they provide service. Additionally, the program provides support to both incumbent and competitive carriers; as a result, it creates an incentive for competition to exist in areas where it might not occur otherwise. For the most part,



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wireless carriers have used this incentive, which has contributed to recent growth in the program.

While there is a clearly established purpose for the high-cost program, FCC has not established performance goals or measures. In the 1996 Act, the Congress clearly established the principles underlying universal service policy, including that consumers in “rural, insular, and high-cost areas” should have access to telecommunications and information services that are “reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.” These guiding principles provide a clear purpose for the high-cost program. However, 12 years after the passage of the 1996 Act and after distributing over \$30 billion in high-cost program support, FCC has yet to develop specific performance goals and measures for the program. In response to our 2005 report on the federal E-Rate program,<sup>7</sup> which found similar problems in that program, in August 2007, FCC initiated preliminary efforts to collect data on the high-cost program in order to develop program goals. However, these efforts do not align with practices GAO and the Office of Management and Budget (OMB) have identified as useful for developing successful performance goals and measures. In particular, prior GAO reports indicate that best practices include developing goals and measures that address important dimensions of program performance, developing intermediate goals and measures, and developing goals to address mission-critical management problems. Yet, FCC has not established long-term or intermediate performance goals and measures. Additionally, OMB noted that performance measures should reflect desired outcomes, which describe the intended results of the program. Yet, FCC data collection efforts focus on program outputs, such as the number of requests for support payments, which describe the level of activity. In the absence of program goals, measures, and data about the program’s performance, the Congress and FCC may be limited in their ability to make informed decisions about the program’s future.

While some internal control mechanisms for the high-cost program exist, these mechanisms are limited and exhibit weaknesses that, collectively, hinder FCC’s ability to assess the risk of noncompliance with program rules and ensure cost-effective use of program funds. Essentially, internal

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<sup>7</sup>GAO, *Telecommunications: Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program*, [GAO-05-151](#) (Washington, D.C.: Feb. 9, 2005).

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control mechanisms for the high-cost program focus on three areas: (1) carrier self-certification, (2) carrier audits, and (3) carrier data validation processes. Each of these processes has limitations. Carrier self-certification is the primary tool used to ensure that carriers use high-cost program support consistent with program rules. Yet, the process does not have standardized requirements for achieving this objective since FCC and the states each impose different requirements. Additionally, carrier audits are the primary tool used in monitoring and overseeing carrier activities, yet these audits have been limited in number and the type of reported findings. FCC's Office of Inspector General, USAC, and state regulatory commissions conduct carrier audits. But, since 2002, USAC has conducted audits of 17 carriers, from a population of over 1,400 carriers. The carrier audits have yielded limited findings; according to USAC, it has been difficult to determine whether carriers are in compliance with FCC rules largely due to a lack of documentation available to substantiate the carriers' information. Lastly, the carrier data validation processes, which USAC and NECA conduct, are used to ensure the reliability of financial data underlying the program. However, these validation processes focus on the completeness of data reported by carriers and do not include processes for ensuring the accuracy of these data. These weaknesses limit FCC's ability to assess the risk of noncompliance with program rules. Further, these weaknesses could contribute to excessive program expenditures. For example, these mechanisms are limited in assessing the cost-effectiveness of carriers, the accuracy of carriers' cost and line count data, and the appropriate use of high-cost program support, each of which could contribute to excessive program expenditures.

To strengthen management and oversight of the high-cost program, we recommend that the Chairman, FCC, take the following two actions. To better ensure that its efforts are on target and that the high-cost program supports the mission of universal service, FCC should first clearly define the goals of the high-cost program and subsequently develop quantifiable performance measures. To ensure a robust internal control environment that supports performance-based management, FCC should identify areas of risk in its internal control environment and implement mechanisms that will help ensure compliance with program rules and produce cost-effective use of program funds.

We provided a draft of this report to FCC and USAC for their review and comment. FCC noted that it was aware of, and had addressed or planned to address, the shortcomings we identified in the report. However, FCC noted that it would issue a Notice of Inquiry to seek information on ways to further strengthen its management and oversight of the high-cost

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program. FCC and USAC both provided information to further clarify the actions that are currently underway and provided technical comments that we incorporated where appropriate.

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## Background

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### The Nation's Universal Service Policy Has Changed Over Time

The Communications Act of 1934 sets forth the nation's telecommunications policy, including making communication services available "so far as possible, to all the people of the United States." Early efforts by FCC, state regulators, and industry to promote universal service generally began in the 1950s. At that time, increasing amounts of the costs associated with providing local telephone service were recovered from rates for long-distance services. This had the effect of lowering local telephone rates and raising long-distance rates, which was intended to make local telephone service more affordable. Because American Telephone and Telegraph Company (AT&T) provided both nationwide long-distance service and local telephone service to approximately 80 percent of the nation's telephone subscribers, universal service was largely promoted by shifting costs between different customers and services.

Following the divestiture of AT&T's local telephone companies in 1984,<sup>8</sup> FCC made several changes to universal service policy. First, the costs associated with local telephone service could no longer be shifted internally within AT&T. FCC therefore implemented access charges—fees that long-distance companies pay to originate and terminate long-distance telephone calls over the local telephone network. Access charges were intended to not only recover the cost of originating and terminating long-distance telephone calls over the local telephone networks, but also to subsidize local telephone service. Second, FCC initiated several federal efforts that targeted support to low-income customers to bring the rates for basic telephone service within their reach. At this time, federal universal service was for the most part funded through charges imposed on long-distance companies.

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<sup>8</sup>In 1974, the Department of Justice brought an antitrust suit against AT&T, alleging that the company was engaging in anticompetitive behavior. The Department of Justice and AT&T entered into a consent decree that required AT&T to divest its local telephone companies.

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The Congress made significant changes to universal service policy through the 1996 Act. First, the 1996 Act provided explicit statutory support for federal universal service policy. Second, the 1996 Act extended the scope of federal universal service—beyond the traditional focus on low-income consumers and consumers in rural and high-cost areas—to include eligible schools, libraries, and rural health care providers. Third, the 1996 Act altered the federal mechanism for funding universal service. Every telecommunications carrier, and other entities, providing interstate telecommunications services were required to contribute to federal universal service, unless exempted by FCC; and their contributions were to be equitable, nondiscriminatory, and explicit.<sup>9</sup> Contributions are deposited into the federal Universal Service Fund (USF), from which disbursements are made for the various federal universal service programs. Fourth, the 1996 Act established a Federal-State Joint Board on Universal Service (Joint Board). This Joint Board, which is composed of three FCC commissioners, four state regulatory commissioners, and a consumer advocate, makes recommendations to FCC on implementing the universal service-related provisions of the 1996 Act.

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### The High-Cost Program Is One of Four Universal Service Programs

The USF provides support through four different programs, each targeting a particular group of telecommunications users (see table 1). In 2007, support for the four USF programs totaled \$7 billion. Among the four programs, the high-cost program accounted for the largest amount of support—\$4.3 billion or 62 percent of USF support. The high-cost program provides financial support to carriers operating in high-cost—generally rural—areas in order to offset their costs, thereby allowing these carriers to provide rates and services that are comparable to the rates and services that customers in low-cost—generally urban—areas receive.

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<sup>9</sup>See, 47 U.S.C. Section 254(b)(4). Companies generally pass these contributions on to customers, sometimes in the form of a line item on customers' monthly telephone bills.

**Table 1: Summary of Universal Service Fund Programs**

<b>Program</b>	<b>Description</b>	<b>Calendar year 2007 disbursements (in millions)</b>
High-cost	Assists customers living in high-cost, rural, or insular areas through financial support to telephone carriers, thereby lowering rates for local and long-distance service.	\$4,287
Schools and libraries (federal E-Rate program)	Assists eligible schools and libraries through discounted telecommunications and information services. Discounts available for local and long-distance telephone service, Internet access, and internal connection projects.	1,808
Low-income	Assists qualifying low-income customers through discounted installation and monthly telephone services and free toll limitation service.	823
Rural health care	Assists health care providers located in rural areas through discounts for telecommunications and Internet access services. Discounts are provided to make rates for facilities in rural areas reasonably comparable to those in nearby urban areas.	37

Source: GAO presentation of FCC, NECA, and USAC data.

## High-Cost Program Administration

Both federal and state governments play a role in implementing the federal high-cost program. FCC has overall responsibility for the federal high-cost program, including making and interpreting policy, overseeing the operations of the program, and ensuring compliance with its rules. However, FCC delegated to USAC responsibility to administer the day-to-day operations of the high-cost program. USAC is a not-for-profit corporation and a subsidiary of NECA, although NECA does not participate in the management of USAC.<sup>10</sup> NECA, a not-for-profit association of local telephone carriers and the primary administrator of FCC's access charge plan,<sup>11</sup> collects cost and line count data from its

<sup>10</sup>FCC rules require that USAC maintain its books separately from NECA and have a Board of Directors separate from the NECA Board, with the NECA Board prohibited from participating in USAC. In addition, the FCC Chairman selects the members of USAC's Board of Directors, with nominations from constituent groups represented by each Board seat, and must approve the appointment of USAC's Chief Executive Officer. See, 47 C.F.R. Sections 54.702(e), 54.703(a), 54.703, and 54.704(b).

<sup>11</sup>NECA files a tariff with FCC specifying the level of access charges (the fees paid by long-distance companies to use local telephone networks). Participating local telephone carriers bill long-distance companies at the tariff rate and submit the revenues to NECA. NECA subsequently distributes these revenues to the participating carriers based either on the carrier's cost (known as cost companies) or a formula (known as average schedule companies).

members and validates this information. At the state level, state regulatory commissions hold the primary responsibility to determine carrier eligibility for participation in the program and to annually certify that carriers will appropriately use high-cost program support.<sup>12</sup> Table 2 summarizes the general roles and responsibilities of the agencies and organizations involved in high-cost program administration.

**Table 2: General Roles of Agencies and Organizations Involved in High-Cost Program Administration**

Agency/Organization	Description
FCC	<ul style="list-style-type: none"> <li>• Makes all policy decisions pertaining to the Universal Service Fund</li> <li>• Oversees program administration and finances</li> <li>• Designates eligibility status of some carriers to receive universal service support</li> <li>• Conducts oversight of some carriers' use of funds</li> </ul>
USAC	<ul style="list-style-type: none"> <li>• Primary administrator of the high-cost program</li> <li>• Bills contributors, collects contributions, and disburses universal service support</li> <li>• Recovers improperly disbursed funds</li> <li>• Maintains accounting records</li> <li>• Processes appeals of funding decisions</li> <li>• Submits periodic reports to FCC</li> <li>• Conducts carrier oversight</li> </ul>
NECA	<ul style="list-style-type: none"> <li>• Collects and validates cost and revenue data from carriers</li> <li>• Collects and validates line count data from carriers</li> <li>• Calculates the national average cost per loop</li> <li>• Administers the interstate access charge revenue pools</li> </ul>
State regulatory commissions	<ul style="list-style-type: none"> <li>• Designates eligibility status to receive universal service support</li> <li>• Annually certifies that beneficiaries will use high-cost program support appropriately</li> <li>• Some states may designate and certify wireless carriers</li> <li>• Some states may audit carriers</li> </ul>

Source: GAO presentation of FCC, NECA, and USAC data.

## High-Cost Program Beneficiaries

To be eligible to receive high-cost program support, a carrier must be designated as an eligible telecommunications carrier (ETC). Section 214(e)(1) of the 1996 Act requires that to be designated an ETC, the carrier must (1) offer the services that FCC identified as eligible for universal service support throughout the service area for which the designation is received, (2) advertise the availability of those services, and (3) use at

<sup>12</sup>If the state does not have jurisdiction over carrier eligibility, the carrier may seek designation from FCC. See, 47 U.S.C. Section 214(e)(6).

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least some of its own facilities to deliver those services.<sup>13</sup> There are two types of carriers.

- *Incumbents.* When the Congress passed the 1996 Act, existing telephone carriers that were members of NECA were designated as incumbent carriers for their service areas. These incumbents subsequently received ETC status. These incumbents are further classified as either “rural”—generally small carriers serving primarily rural areas—or “nonrural”—generally large carriers serving both rural and urban areas.<sup>14</sup>
- *Competitors.* Carriers competing against incumbents—both wireline and wireless—also are eligible to receive high-cost program support. Just like incumbents, these companies must apply for eligibility and receive ETC status before they can receive support; these carriers are referred to as competitive eligible telecommunications carriers (CETC). Competitors can provide service without receiving CETC status or high-cost program support.

Carriers that receive high-cost program support may use this support only for the “provision, maintenance, and upgrading of facilities and services for which the support is intended.”<sup>15</sup>

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## High-Cost Program Support Components

The high-cost program consists of five components, each with different eligibility criteria and different methods to determine the level of support. Four of the components provide support to carriers to offset the costs of the network, including local loops (primarily, the equipment that runs from the carrier’s facilities to the customer’s premises). The four

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<sup>13</sup>See, 47 U.S.C. Section 214 and 47 C.F.R. Section 54.201. In 2005, FCC adopted additional requirements that carriers must meet to be designated as an ETC by the FCC. See, 47 C.F.R. Section 54.202.

<sup>14</sup>To be a “rural telephone company,” the carrier must (1) provide service to any area that does not include either (a) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census, or (b) any territory incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993; (2) provide telephone service, including exchange access, to fewer than 50,000 access lines; (3) provide telephone service to any study area with fewer than 100,000 access lines; or (4) have less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the 1996 Act. Any carrier that does not meet this definition is considered a nonrural carrier. See, 47 U.S.C. Section 153(37).

<sup>15</sup>See, 47 U.S.C. Section 254(e).

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components are high-cost loop, high-cost model, interstate access, and interstate common line.<sup>16</sup> The fifth component, local switching support, provides support for very small carriers to offset the cost of their switching equipment.<sup>17</sup> For incumbent carriers, eligibility for the components depends on the carrier's size (as recognized by their classification as rural or nonrural) and the type of regulation the carrier is subject to—either rate-of-return<sup>18</sup> or price-cap<sup>19</sup> regulation. In 2007, USAC reported that there were 1,250 rural carriers subject to rate-of-return regulation, 105 rural carriers subject to price-cap regulation, 5 nonrural carriers subject to rate-of-return regulation, and 81 nonrural carriers subject to price-cap regulation. Based on the components for which they qualify, rural carriers receive support based on the costs they incurred, whereas based on the components for which they qualify, nonrural carriers receive part of their support based on projected costs using an FCC model. Table 3 summarizes each of the five high-cost program components, which carriers are eligible for each, the qualification criteria for each component, and the amount of support provided in 2007. For example, a rural carrier with less than 50,000 customers and subject to rate-of-return regulation could receive support through the high-cost loop, local switching, and interstate common line components.

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<sup>16</sup>High-cost loop support includes disbursement for two subcomponents: safety net additive support and safety valve support.

<sup>17</sup>A switch is equipment that routes a customer's call to its destination. High-cost model support also provides funding for a carrier's switching and interoffice costs.

<sup>18</sup>Rate-of-return regulation is a form of rate regulation wherein the carrier is allowed to recover its costs and earn a predetermined return (or profit).

<sup>19</sup>Price-cap regulation is a form of rate regulation wherein a carrier may charge rates up to an allowable cap, which is adjusted based on factors beyond the carrier's control, such as inflation.



**Table 3: High-Cost Program Components, Eligibility, and Funding Levels**

High-cost component	Description	Participant eligibility	Calendar year 2007 support (in millions)
High-cost loop support	Assists local telephone carriers with high loop costs. <sup>a</sup>	Rural carriers with local costs exceeding 115 percent of the national average.	\$1,444
High-cost model support	Assists local telephone carriers with high costs, based on FCC's Hybrid Cost Proxy Model of forward-looking costs. <sup>b</sup>	Nonrural carriers in states with a statewide average cost per line for nonrural carriers that exceeds 2 standard deviations of the national average (approximately 131 percent of the national average).	346
Local switching support	Assists local telephone carriers serving 50,000 or fewer access lines.	Rural carriers serving 50,000 or fewer access lines.	460
Interstate access support	Assists local telephone carriers subject to price-cap regulation <sup>c</sup> with high costs.	Price-cap regulated carriers with high costs.	645
Interstate common line support	Assists local telephone carriers subject to rate-of-return regulation <sup>d</sup> with high costs.	Rate-of-return regulated carriers with high costs.	1,392
<b>Total</b>			<b>\$4,287</b>

Source: GAO presentation of FCC, NECA, and USAC data.

<sup>a</sup>Loop costs are the costs to run a wired connection from a telephone company's facility to the customer's premises.

<sup>b</sup>The FCC's Hybrid Cost Proxy Model assumes an efficient carrier constructs the most efficient network to serve existing customers.

<sup>c</sup>Price-cap regulation is a form of rate regulation wherein the carrier may charge rates up to an allowable cap, which is based on factors beyond the carrier's control, such as inflation.

<sup>d</sup>Rate-of-return regulation is a form of rate regulation wherein the carrier is allowed to recover its costs and earn a predetermined return (or profit).

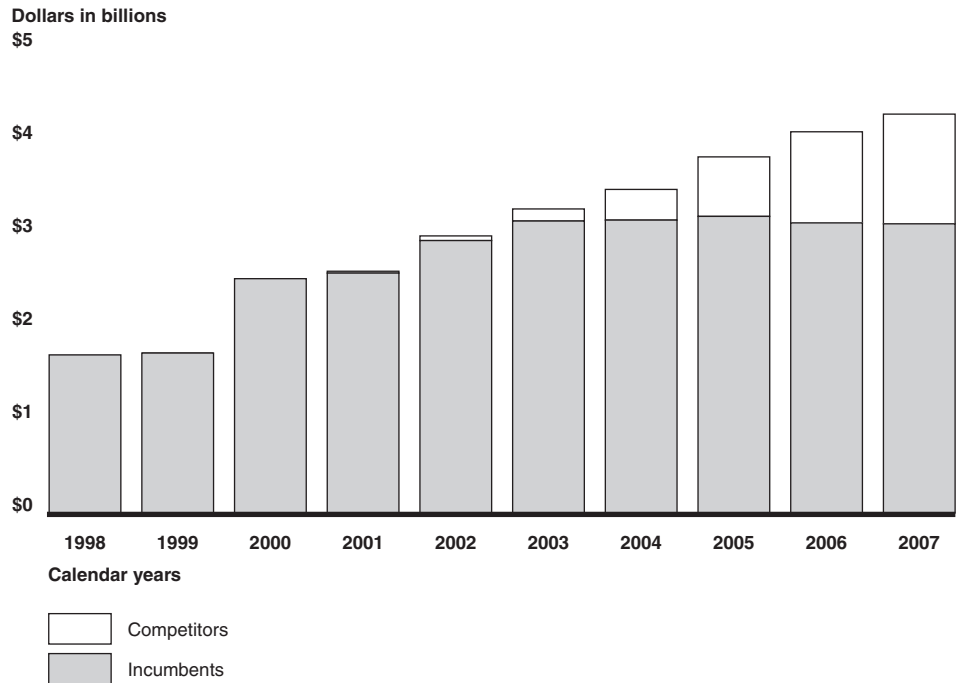
Unlike incumbents, competitors do not directly receive funds based on their costs or FCC's model. Rather, once a competitor receives CETC status, it qualifies for the identical per-line level of support that the incumbent receives for the area it serves; this is known as the identical support rule.<sup>20</sup>

<sup>20</sup>See, 47 C.F.R. Section 54.307.

## Current Status of the High-Cost Program

Since its inception in 1998, the high-cost program has increased nearly 153 percent, from \$1.7 billion in 1998 to about \$4.3 billion in 2007. This significant growth has raised concerns about the program's long-term sustainability, efficiency, and effectiveness, as well as the adequacy of the oversight of carriers' need for and use of support. Figure 1 illustrates the growth in the high-cost program, including both incumbents and competitors. Several factors have contributed to the growth in the high-cost program. In the early years of the program, support grew as FCC reduced access charges (a form of implicit support for carriers) to incumbents and offset those reductions with greater high-cost program support (a form of explicit subsidy). However, in recent years, the high-cost program has grown because of support provided to competitors, especially wireless companies.

**Figure 1: Growth in High-Cost Program Support Payments to Incumbent and Competitive Carriers**



Source: Universal Service Administrative Company data.

In response to concerns about the long-term sustainability of the high-cost program, FCC issued several Notices of Proposed Rulemaking (NPRM) in January 2008, seeking comment on proposals for comprehensive reform of the program. These NPRMs represent the culmination of efforts by FCC

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and the Joint Board to reform the program. FCC released an NPRM seeking comment on a Joint Board recommendation that the high-cost program be divided into three separate funds: broadband service, mobility (or wireless) service, and traditional provider of last resort service.<sup>21,22</sup> FCC also released an NPRM seeking comment on changing the current funding mechanism for CETCs, namely eliminating the identical support rule and requiring CETCs to submit cost data.<sup>23</sup> Finally, FCC released an NPRM that sought comment on implementing reverse auctions to determine the amount of high-cost program support to be given to an ETC;<sup>24</sup> with reverse auctions, support generally would be determined by the lowest bid to serve the auctioned area. In this report, however, we will not assess or discuss the merits of the reform proposals; instead, we will review the high-cost program in its current state and discuss best practices that are critical for the future of the fund, regardless of which reform efforts are adopted, if any.

In addition to these three proposals, on May 1, 2008, FCC released an order adopting an interim cap on high-cost program support for CETCs. FCC adopted the interim cap to stem the growth of the program while it considers these comprehensive reform proposals. Under this order, total annual support for CETCs will be capped at the level of support that they were eligible to receive in each state during March 2008.<sup>25</sup>

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<sup>21</sup>*In the Matter of Federal-State Joint Board on Universal Service*, Recommended Decision, 22 FCC Rcd. 20477 (2007).

<sup>22</sup>*In the Matter of Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-22 (rel. Jan. 29, 2008).

<sup>23</sup>*In the Matter of Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-4 (rel. Jan. 29, 2008) (*Identical Support Rule NPRM*).

<sup>24</sup>*In the Matter of Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-5 (rel. Jan. 29, 2008) (*Reverse Auctions NPRM*).

<sup>25</sup>*In the Matter of High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, Order, FCC 08-122 (rel. May 1, 2008).

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## The High-Cost Program's Structure Has Contributed to Inconsistent Distribution of Support and Availability of Services across Rural America

The high-cost program provides support to eligible carriers in all states, with higher levels of support going to more rural states. However, the high-cost program does not provide support consistently to carriers operating in similar locations, which can lead to different levels of telecommunications service across rural areas. In general, rural carriers receive more support than nonrural carriers. The high-cost program provides support for the provision of basic telephone service and, to a great extent, access to this service is available and widely subscribed to throughout much of the country. But the high-cost program also indirectly supports broadband service in some rural areas, particularly those areas served by rural carriers. Finally, the high-cost program supports competitive carriers, and support for these carriers has increased greatly in recent years.

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## The High-Cost Program Provides Support to Carriers in All States, but Support Is Dispersed Inconsistently across Rural Areas

In 2007, carriers in all states received some form of high-cost program support, with higher levels of support going to more rural states.<sup>26</sup> Generally, carriers operating in states with below-average population densities received more support than those in more densely populated states. For example, the five states in which carriers received the greatest amount of support in 2007 include Mississippi (\$283 million), Texas (\$246 million), Kansas (\$222 million), Louisiana (\$163 million), and Alaska (\$161 million). While the average national population density is 190.1 people per square mile,<sup>27</sup> these states have lower-than-average population densities, ranging from 1.2 people per square mile in Alaska to 98.4 people per square mile in Louisiana. Alternatively, the five states that receive the least support tend to have higher-than-average population densities, including Rhode Island (\$31,000), Delaware (\$245,000), Connecticut (\$1.3 million), New Jersey (\$1.7 million), and Massachusetts (\$2.3 million); these states have population densities ranging from 436.9 people per square mile in Delaware to 1,176.2 people per square mile in New Jersey. Thus, at a broad, national level, high-cost program support flows to more rural states.

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<sup>26</sup> Carriers in the U.S. territories also receive high-cost support, including American Samoa, Guam, Puerto Rico, Northern Mariana Islands, and the Virgin Islands. The District of Columbia is the only jurisdiction that does not receive high-cost support.

<sup>27</sup> This national average does not include the District of Columbia, which has a population density of 9,471.2 people per square mile.

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However, the high-cost program does not provide support consistently to carriers operating in similar rural locations. To a large extent, this situation arises because of the program's structure: the five different high-cost program components, each with different eligibility and methods to determine support. As mentioned earlier, rural carriers typically receive high-cost program support through components that base support on the carrier's incurred costs. Thus, in the case of a rural carrier, the higher its actual costs, the more funding it receives. Because of this, the funding that a rural carrier receives depends on how much money it chooses to spend on its network. Additionally, the disparity between rural and nonrural carrier is even greater, as support to one carrier can be significantly more generous than support provided to another carrier for serving comparable areas. As mentioned earlier, nonrural carriers typically receive part of their high-cost program support (high-cost model) through a component that utilizes an FCC cost model; this model assumes the most efficient carrier providing service to existing customers. Since this model is not based on an individual carrier's actual costs, investment in new network infrastructure will not lead to greater high-cost program support. Further, the threshold to receive support is greater for nonrural carriers; a rural carrier's costs must exceed 115 percent of the national average whereas the statewide average cost must exceed approximately 131 percent of the national average for nonrural carriers. As such, nonrural carriers in 10 states currently are eligible for this funding, yet nonrural carriers in other states serve high-cost locations as well.<sup>28</sup> Overall, rural carriers receive more funding than nonrural carriers and in 2007, rural carriers received \$1.7 billion more in high-cost program support than nonrural carriers.<sup>29</sup> In November 2007, the Joint Board recognized this situation itself, noting that "support for customers served by one kind of carrier can be significantly more generous than for comparably situated customers served by the other kind of carrier."<sup>30</sup>

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<sup>28</sup>Nonrural carriers in these 10 states, as well as other states, can receive other high-cost program support, such as interstate access support.

<sup>29</sup>As mentioned earlier, there are more incumbent rural carriers (1,355) than nonrural carriers (86). Yet, nonrural carriers serve many customers in rural areas. For example, one nonrural carrier—AT&T—serves over 7 million rural lines, or nearly one-third of the rural lines in the nation. Thus, on a per-rural-customer basis, rural carriers generally receive more support than nonrural carriers.

<sup>30</sup>See, 22 FCC Rcd. 20477, para. 20 (2007).

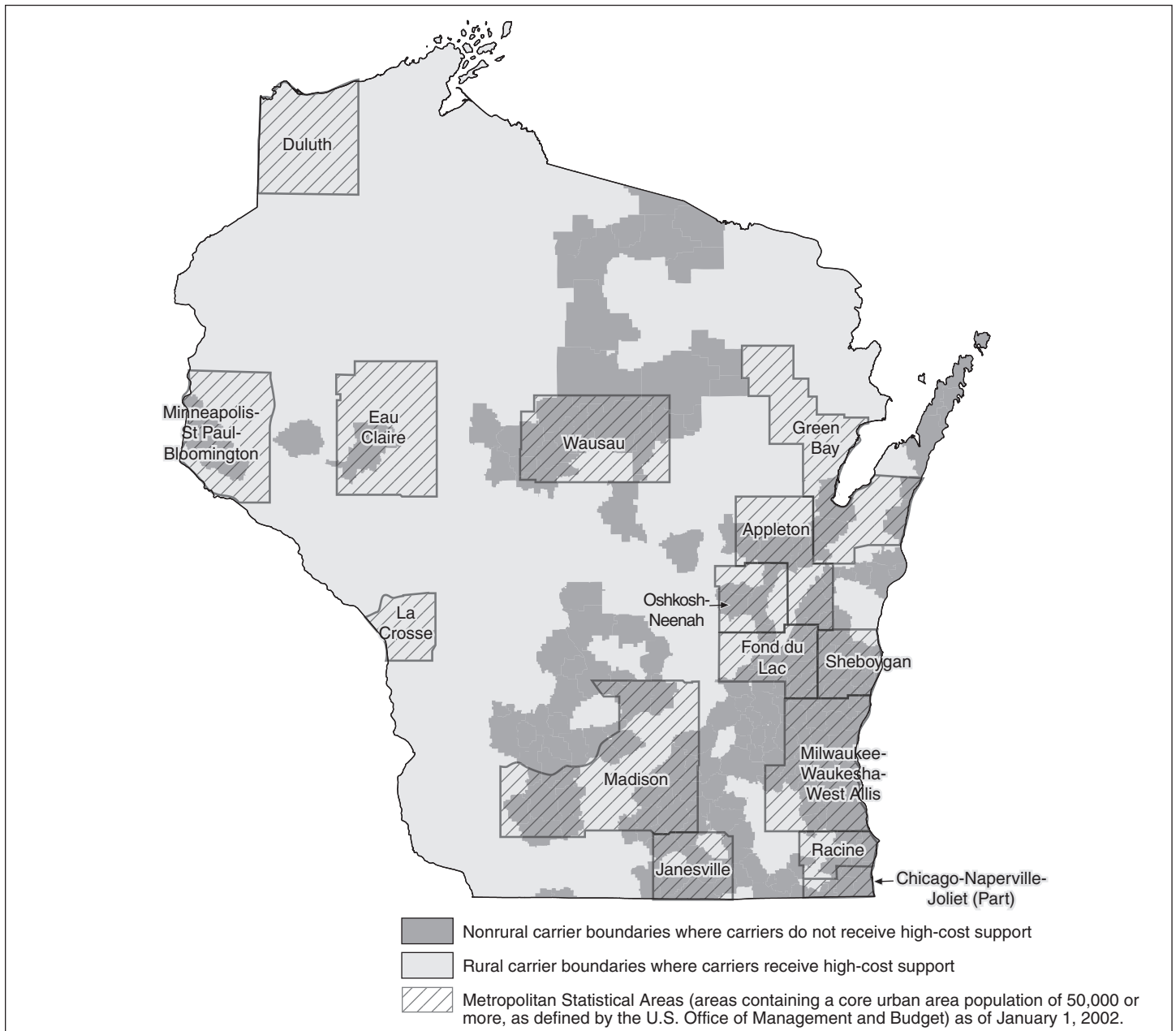
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We found similar results in our site-visit states. In the 11 states we visited, 9 states had rural carriers receiving more funding than nonrural carriers.<sup>31</sup> While rural carriers generally serve only rural areas, nonrural carriers also can serve large swaths of rural areas. In fact, carriers providing service in similar, even adjacent, areas can receive vastly different levels of high-cost program support. For example, as shown in figure 2, in Wisconsin, there are two nonrural carriers (areas in dark shading) that provide service to rural areas, yet these carriers do not qualify to receive the same types of support as rural carriers serving comparable adjacent areas. Similarly, in Oregon, 25 percent of the lines served by a large, national carrier are located in rural areas of the state; this carrier does not qualify to receive the same type of support for these lines that rural carriers in the same area do.

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<sup>31</sup>Alabama and Massachusetts are the two states where nonrural carriers receive more funding than rural carriers.

**Figure 2: Areas in Wisconsin Served by Rural and Nonrural Carriers**



Sources: Wisconsin Public Service Commission (exchange boundaries); U.S. Department of Commerce (MSA boundaries); and GAO (composite map).

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## The High-Cost Program Supports Basic Telephone and Wireless Service, and Indirectly Supports Broadband Service

The high-cost program directly and indirectly supports several types of service including (1) basic telephone service, (2) broadband service, and (3) wireless telephone service.

### Basic Telephone Service

Currently, the high-cost program provides support for the provision of basic telephone service. In the 1996 Act, the Congress stated as one of the principles underlying universal service that people in rural, insular, and high-cost areas should have access to telecommunications and information services that are reasonably comparable to those provided in urban areas and at comparable rates. However, the Congress did not define universal service or specify a list of services to be supported by the program. Instead, the 1996 Act recognized universal service as an evolving level of telecommunications services and directed FCC, after recommendations from the Joint Board, to establish a definition of the services to be supported by the program.<sup>32</sup> In 1997, FCC adopted a set of communications services and “functionalities” for rural, insular, and high-cost areas that were to be supported by the high-cost program.<sup>33</sup>

To a great extent, access to basic telephone service is available and widely subscribed to throughout much of the country. One widely used measure of telephone subscribership is the penetration rate, which is based on survey data collected by the U.S. Census Bureau to estimate the percentage of U.S. households with telephone service. In 2007, the overall penetration rate in the United States was 95 percent, representing an increase of 0.9 percent since the inception of the high-cost program in 1998. While the penetration rate has increased marginally, there are several factors that could contribute to this result in addition to the high-

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<sup>32</sup>In the 1996 Act, the Congress included a broad set of criteria for FCC to consider as it identifies the supported services. These criteria include the extent to which the services (1) are essential to education, public health, or public safety; (2) have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers; (3) are being deployed in public communications networks by telecommunications carriers; and (4) are consistent with the public interest, convenience, and necessity. 47 U.S.C. Section 254(c)(1).

<sup>33</sup>These services and functionalities include single-party service; voice grade access to the telephone network; Touch-Tone service or its equivalent; access to emergency services, operator services, long-distance service, and directory assistance; and toll limitation service. See, 47 C.F.R. Section 54.101. We refer to these services and functionalities as basic telephone service.



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cost program, including changes in income levels, greater diffusion of communications technology, or state-level programs. Appendix II shows penetration rates by state and changes in the percentage of households with telephone service from November 1983 through July 2007.

Most of the rural carriers with whom we spoke agreed that support from the high-cost program has been an important source of their operating revenue. One recent study estimated that 30 percent of rural carriers' annual operating revenues are derived from federal and state universal service programs, including the high-cost program.<sup>34</sup> Our site visit interviews similarly suggest that rural carriers depend on high-cost program support to provide customers with access to affordable telephone rates. For example, one carrier with whom we spoke received nearly 80 percent of its annual operating revenues from the high-cost program. Moreover, many of the rural carriers we met with told us that they would be unable to provide the same range or quality of service to their customers without support from the high-cost program. Most of these carriers, who serve very remote and sparsely populated rural areas where it is very costly to provide telecommunications services, stated that without the support, they would likely need to increase the rates they charge their customers for basic services.

## Broadband Service

Although there have been a number of proposals to revise the list of services supported by the high-cost program over the past decade, FCC has not taken action to change the original definition.<sup>35</sup> To be eligible to receive high-cost program support, a carrier must offer each of the services and functionalities supported by the program. Additionally, carriers that receive high-cost program support may only use this support for the "provision, maintenance, and upgrading of facilities and services for which the support is intended."<sup>36</sup> While one of the universal service

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<sup>34</sup>Congressional Budget Office, *Factors That May Increase Future Spending from the Universal Service Fund* (Washington, D.C., June 2006), page 19, table 4-2.

<sup>35</sup>In the 1996 Act, the Congress defined universal service as an evolving level of telecommunication services and directed FCC to periodically review advancements in information technologies and services to determine whether additional services should be added to the definition of supported services. 47 U.S.C. Section 254(c). In 2002, the Joint Board considered whether to modify the list of supported services and ultimately issued a recommendation to FCC that no changes were necessary at that time. See, *In the Matter of Federal-State Joint Board on Universal Service*, Recommended Decision, 17 FCC Rcd. 14095 (2002). FCC accepted the recommendation, in effect leaving the definition of supported service unchanged since originally established in 1997.

<sup>36</sup>See, 47 U.S.C. Section 254(e).

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principles adopted in the 1996 Act is that all regions of the country should have access to advanced telecommunication and information services, the high-cost program does not explicitly support access to broadband services.

While access to advanced services, such as broadband, is not included among the designated list of services supported by the high-cost program, the program has indirectly facilitated broadband deployment in many rural areas. In recent years, some carriers have been using high-cost program support to upgrade their telephone networks, including upgrading to fiber optic cable and extending it closer to their customers.<sup>37</sup> Because of advances in telecommunications technology, these upgrades increase the capacity of the network, thereby facilitating the provision of advanced services, such as broadband. For example, many rural carriers with whom we spoke have or are replacing their copper wire with fiber optic cable. One carrier was in the early phases of a 7-year, \$1.8 million expansion to install fiber-to-the-home for each customer in one of its exchanges that served about 700 lines. In addition to transitioning from copper to fiber, carriers are investing in modern switching equipment and remote terminals to improve the connection speeds available to their customers.<sup>38</sup> For example, one carrier told us that it is currently installing more remote terminals to provide higher-speed broadband service, and that it currently has 96 remote terminals to serve customers spread out across a 1,300 square mile area.

The availability of high-cost program support can, in part, determine whether deployment of broadband service is feasible in a rural area. In rural areas served by rural carriers, the high-cost program allows the carrier to recoup a large portion of the investment that facilitates broadband service since, as we mentioned earlier, these carriers receive high-cost program support based on their costs. Alternatively, in rural areas served by nonrural carriers, which generally do not receive as much funding as rural carriers and do not receive funding based on their costs, the network upgrades necessary for broadband service are less likely. As a result, the availability of broadband services to rural customers is largely

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<sup>37</sup>When deploying fiber, the carrier can install fiber to a remote terminal (essentially a box or small shelter with communications equipment) and leave copper to the customer's premises or install fiber entirely to the customer's premises (known as fiber-to-the-home).

<sup>38</sup>Generally, to receive DSL service (a form of high-speed Internet access), a customer must be within 18,000 feet of the carrier's facility, either a central office or remote terminal.

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determined by the type of carrier they are served by, and not where they are located.

- *Rural carriers.* Most rural carriers with whom we spoke had or were deploying advanced network features, such as fiber optic cable. For example, of the rural carriers we spoke with during our site visits, many stated they were able to provide broadband Internet service to 100 percent of their customers or service areas. In addition, FCC estimates that in 2007, 82 percent of households served by rural incumbent carriers had access to high-speed broadband connections.
- *Nonrural carriers.* Nonrural carriers with whom we spoke reported that they have broadband-enabled equipment in most or all facilities, but these carriers are generally unable to provide all rural customers with broadband service. Rather, only those customers residing relatively close to the carrier's facility can receive broadband service.<sup>39</sup> These carriers indicated that deploying broadband service to a wider service territory was not economical given the diffuse population in rural areas.

## Competition and Wireless Service

Another impact of the high-cost program has been the increase in competitive carriers, especially wireless carriers, in rural areas. Beginning in 1997, FCC adopted a series of measures intended to encourage competition between carriers in rural areas to promote the principles of universal service.<sup>40</sup> Among the actions taken by FCC was adopting the principle of "competitive neutrality" as part of the high-cost program. Under this principle, one carrier should not be favored over another carrier, and support should be available to any carrier that meets the requirements for operating as an ETC, regardless of the type of technology the carrier employs (such as wireline, wireless, or satellite). This principle was supported by granting high-cost program support to CETCs. While incumbents—both rural and nonrural—receive support based on their costs of providing service in an area or FCC's cost model, CETCs receive support based on the number of lines they serve through a mechanism known as the identical support rule. Under this rule, CETCs in an area receive the same level of high-cost program support, on a per-line basis, as

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<sup>39</sup>In some cases where broadband service is not generally available to customers, the carrier can make special arrangements with a customer to provide broadband service. However, in these instances, the customer could incur substantial charges for adding the service.

<sup>40</sup>*In the Matter Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd. 8776 (1997).

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the incumbent carrier in that area.<sup>41</sup> For example, if the incumbent carrier receives support that, based on the number of lines it serves, results in \$20 of support per line, every competitor designated as an ETC in that area also will receive \$20 in support for each line it serves in the same area regardless of its costs.<sup>42</sup>

ETC status is not required for a competitive carrier to operate in an area, but it is required if the carrier wants to receive high-cost program funding. As a result, the number of carriers seeking CETC status has increased dramatically, and the majority of newly designated carriers are wireless. Since 1998, the number of CETCs receiving support through the high-cost program has risen from a total of 2 carriers in 1998, to 362 competitive carriers in 2007. Of these 362 CETCs, 260 carriers—over 70 percent—are wireless carriers. Along with an increase in the number of carriers, the amount of funding provided to CETCs has increased over this time period, growing from \$535,104 in 1999, with 100 percent going to wireless carriers, to \$1.2 billion by 2007, with 98 percent of all CETC funding going to wireless carriers.<sup>43</sup>

A recent report by FCC estimated that at the end of 2006, wireless carriers had achieved an 80 percent penetration rate across the country,<sup>44</sup> and according to the wireless carriers with whom we spoke, high-cost program support has allowed them to invest in improving and expanding their networks in rural areas where they would otherwise be unable to economically justify the investment. For example, one carrier told us that it can cost from \$350,000 to \$500,000 to install a cell tower in rugged or

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<sup>41</sup>See, 47 C.F.R. Section 54.307(a).

<sup>42</sup>FCC has tentatively concluded that the identical support rule should be eliminated and replaced with support based on CETCs' own costs of providing the supported services. See, FCC 08-4.

<sup>43</sup>In 2004, the Joint Board recommended that high-cost support be limited to one connection per household, thereby capping the number of supported lines. See, *In the Matter of Federal-State Joint Board on Universal Service*, Recommended Decision, 19 FCC Rcd. 4257 (2004). However, the Congress inserted language into FCC's 2005 appropriations that restricted FCC from spending appropriated funds to carry out the Joint Board's recommendation. See, Consolidated Appropriations Act, 2005, Pub. L. 108-447, 118 Stat. 2809 (Dec. 8, 2004). The Congress continued this restriction. See, Consolidated Appropriations Act, 2008, Pub. L. 110-161, 121 Stat. 1844 (Dec. 26, 2007).

<sup>44</sup>*Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, WC Docket No. 07-71 (Terminated), Twelfth Report, FCC 08-28 (rel. Feb. 4, 2008).

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mountainous terrain, in addition to other installation expenses such as land rent and maintenance costs, but that in most cases, low population density in the area would not yield enough customers to recover the investment. Additionally, wireless companies and regulators with whom we spoke stated that the availability of wireless communication is a public safety concern; travelers along rural highways expect to be able to use cell phones in the event of an emergency. However, wireless carriers often lack the economic incentive to install cell phone towers in rural areas where they are unlikely to recover the installation and maintenance costs, but high-cost program support allows them to make these investments.

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### **While There Is a Clearly Established Purpose for the High-Cost Program, FCC Has Not Established Performance Goals and Measures**

In the 1996 Act, the Congress established the principles underlying universal service, which provide a clear purpose for the high-cost program. However, since 1998, FCC has distributed over \$30 billion in high-cost funding without developing specific performance goals for the program. Additionally, FCC has not developed outcome-based performance measures for the program. While FCC has begun preliminary efforts to address these shortcomings, its efforts do not align with practices GAO and OMB have identified as useful in developing successful performance goals and measures. In the absence of program goals and data pertaining to the program's performance, the Congress and FCC may be limited in their ability to make informed decisions about the future of the program.

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### **The High-Cost Program Has a Clear Purpose, but Lacks Explicit Performance Goals and Measures**

In the 1996 Act, the Congress clearly established the principles underlying universal service. In particular, the Congress said that "quality services should be available at just, reasonable, and affordable rates." Additionally, the Congress said that consumers in all regions of the country, including "those in rural, insular, and high-cost areas" should have access to telecommunications and information services that are "reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas." These guiding principles provide a clear purpose for the high-cost program.

However, 12 years after the passage of the 1996 Act and after distributing over \$30 billion in high-cost program support, FCC has yet to develop specific performance goals and measures for the program. We were unable

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to identify any performance goals or measures for the high-cost program. In its 2005 program assessment of the high-cost program, OMB also concluded that the program did not have performance goals or measures.<sup>45</sup> OMB reported that the program neither measures the impact of funds on telephone subscribership in rural areas or other potential measures of program success, nor bases funding decisions on measurable benefits. OMB also reported that the high-cost program does not have specific, long-term performance measures that focus on outcomes and meaningfully reflect the purpose of the program. Additionally, in February 2005, we reported that FCC had not established performance goals and measures for the E-Rate program, the second-largest universal service program.<sup>46</sup> At that time, we observed that under the Government Performance and Results Act, FCC was responsible for establishing goals for the universal service programs, despite the fact that the 1996 Act did not specifically require them.

Further, FCC has not adequately defined the key terms of the high-cost program's purpose. For example, the Congress directed FCC to ensure consumers in rural areas received access to "reasonably comparable" services at "reasonably comparable" rates to those in urban America. To address this, in a report and order issued in 1999, FCC defined "reasonably comparable" as "a fair range of urban/rural rates both within a state's borders, and among states nationwide."<sup>47</sup> This definition only focused on rates and did not address what FCC considered "reasonably comparable" services; 2 years after FCC issued this definition, its adequacy was challenged in federal court. In July 2001, the Tenth Circuit Court rejected FCC's use of this definition, and required that FCC more precisely define "reasonably comparable" in reference to rates charged in rural and urban areas.<sup>48</sup> Subsequently, in October 2003, FCC attempted to again define "reasonably comparable," this time stating that rates are considered

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<sup>45</sup>OMB, Program Assessment – Universal Service Fund High Cost <http://www.whitehouse.gov/omb/expectmore/summary/10004451.2005.html> (accessed Apr. 2, 2008).

<sup>46</sup>GAO, *Telecommunications: Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program*, [GAO-05-151](#) (Washington, D.C.: Feb. 9, 2005).

<sup>47</sup>*In the Matter of Federal-State Joint Board on Universal Service*, Seventh Report and Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report and Order in CC Docket No. 96-262, and Further Notice of Proposed Rulemaking, 14 FCC Rcd. 8078 (1999).

<sup>48</sup>*Qwest Corporation v. Federal Communications Commission*, 258 F.3d 1191 (10th Cir. 2001) (*Qwest I*).

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reasonably comparable if they fall within two standard deviations of the national urban average.<sup>49</sup> Again, this definition did not address what services should be supported by the high-cost program, and again in February 2005, the Tenth Circuit Court rejected the adequacy of this definition, stating that it was not clear how this new definition preserved and advanced universal service.<sup>50</sup> To date, FCC has not adopted any other definitions for “reasonably comparable” rates or services.<sup>51</sup>

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### FCC’s Efforts Do Not Align with Successful Practices for Developing Performance Goals and Will Provide Limited Insight to the High-Cost Program’s Performance

In June 2005, FCC issued a Notice of Proposed Rulemaking, in which it sought comment on establishing useful outcome, output, and efficiency measures for each of the universal service programs, including the high-cost program.<sup>52</sup> In this notice, FCC recognized that clearly articulated goals and reliable performance data would allow for assessment of the effectiveness of the high-cost program and would allow FCC to determine whether changes to the program are needed. As of August 2007, FCC had not established performance goals and measures for the high-cost program, and FCC stated it did not have sufficient data available to establish high-cost program performance goals.<sup>53</sup> To begin addressing this shortcoming, FCC started collecting performance data from USAC on a quarterly basis, including:<sup>54</sup>

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<sup>49</sup>*In the Matter of Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd. 22559 (2003), remanded by *Qwest Corporation v. Federal Communications Commission*, 398 F.3d 1222 (10th Cir. 2005) (*Qwest II*).

<sup>50</sup>*Qwest II*, 398 F.3d 1222 (2005).

<sup>51</sup>FCC issued a Notice of Proposed Rulemaking seeking comment on how to define “sufficient” and “reasonably comparable” in light of the ruling of the Tenth Circuit. See, *In the Matter of Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking, 20 FCC Rcd. 19731 (2005).

<sup>52</sup>See, *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, 20 FCC Rcd. 11308 (2005).

<sup>53</sup>See, *In the Matter of Federal-State Joint Board on Universal Service, Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, Report and Order, 22 FCC Rcd. 16372 (2007).

<sup>54</sup>Certain data USAC is to provide to FCC are presently not collected by USAC because FCC rules do not require carriers to provide these data; these data include the number of program beneficiaries per wire center, the number of lines per wire center (except for the high-cost model component), and the rate of telephone subscribership in urban vs. rural areas.

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- number of program beneficiaries (i.e. ETCs) per study area and per wire center;
  - number of lines, per study area and per wire center, for each ETC;
  - number of requests for support payments;
  - average (mean) dollar amount of support and median dollar amount of support for each line for high-cost ETCs;
  - total amount disbursed—aggregate and for each ETC;
  - time to process 50 percent, 75 percent, and 100 percent of the high-cost support requests and authorize disbursements; and
  - rate of telephone subscribership in urban vs. rural areas.

However, these efforts generally do not align with known practices for developing performance goals. We have reported that in developing performance goals, an agency's efforts should focus on the results it expects its programs to achieve, that is, the differences the program will make in people's lives. In doing this, an agency's efforts should work to strike difficult balances among program priorities that reflect competing demands and provide congressional and other decision makers with an indication of the incremental progress the agency expects to make in achieving results. Additionally, we have identified many useful practices for developing program goals and measures; these practices include developing goals and measures that address important dimensions of program performance, developing intermediate goals and measures, and developing goals to address mission-critical management problems.<sup>55</sup> As seen in table 4, we found that FCC's efforts do not align with useful practices we have identified for developing successful goals.

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<sup>55</sup>GAO, *Agency Performance Plans: Examples of Practices That Can Improve Usefulness to Decisionmakers*, GAO/GGD/AIMD-99-69 (Washington, D.C.: Feb. 26, 1999).



**Table 4: Alignment of FCC Efforts with Useful Practices for Developing Successful Performance Goals**

Practice to enhance performance goals	Reason for practice	How FCC's efforts align with practice
Create a set of performance goals and measures that address important dimensions of a program's performance and balance competing priorities.	Programs often are forced to strike difficult balances among priorities that reflect competing demands. Sets of performance goals and measures could provide a balanced perspective of the intended performance of a program's multiple priorities.	FCC's efforts <u>do not</u> align with this practice. A general purpose for the high-cost program exists—to promote nationwide rate and service comparability for people in high-cost areas—but explicit performance goals and measures for how this is to be achieved and measured have not been established.
Use intermediate goals and measures to show progress or contribution to intended results.	Intermediate goals and measures, such as outputs or intermediate outcomes, can be used to show progress or contribution to intended results.	FCC's efforts <u>do not</u> align with this practice. While FCC has begun to collect output data in order to develop performance measures for the high-cost program, it has not yet determined the goals of the program. Therefore, it is unclear how these output data will illustrate progress in meeting performance goals.
Include explanatory information on the goals and measures.	Explanatory information in a performance plan can help to show the relationship between results-oriented goals, measures, and program outputs and services.	FCC's efforts <u>do not</u> align with this practice.
Develop performance goals to address mission-critical management problems.	Weaknesses in internal management processes and systems undermine the achievement of program results; therefore, performance goals to address mission-critical management problems are valuable in program management.	FCC's efforts <u>somewhat</u> align with this practice. FCC issued a Report and Order in August 2007 which adopted measures to improve the management, administration, and oversight of the USF. This includes actions specific to the high-cost program.
Show baseline and trend data for past performance.	Baseline and trend data provide a context for drawing conclusions about whether performance goals are reasonable and appropriate.	FCC's efforts <u>somewhat</u> align with this practice. While FCC began collecting quarterly data in April 2007, to establish a baseline for performance measures, because the high-cost program is in its 10th year, it is unclear if this data collection effort will adequately demonstrate past performance trends.
Identify projected target levels of performance for multiyear goals.	Multiyear performance goals can provide congressional and other decision makers with an indication of the incremental progress the agency expects to make in achieving results.	FCC's efforts <u>do not</u> align with this practice.
Link the goals of component organizations to departmental strategic goals.	Linking component performance to departmental goals can provide a clear, direct understanding of how the achievement of the components' annual goals will lead to the achievement of the agency's strategic goals.	FCC's efforts <u>somewhat</u> align with this practice. FCC's performance and accountability report includes accomplishments related to enhancing universal service, but does not specifically address the high-cost program, or how it has impacted the provision of universal service.

Source: GAO, *Agency Performance Plans: Examples of Practices That Can Improve Usefulness to Decisionmakers*, GAO/GGD/AIMD-99-69 (Washington, D.C.: Feb. 26, 1999).

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Additionally, FCC's efforts do not align with guidance set forth by OMB. According to OMB, output measures describe the level of a program's activity, whereas outcome measures describe the intended result from carrying out a program or activity and efficiency measures capture a program's ability to perform its function and achieve its intended results. In its Program Assessment Rating Tool Guidance, OMB noted that measures should reflect desired outcomes.<sup>56</sup> Yet, FCC's data collection efforts focus on program outputs, and not program outcome or efficiency. Therefore, FCC's efforts will be of limited use in illustrating the impacts of the high-cost program or how efficiently the program is operating.

Clearly articulated performance goals and measures are important to help ensure the high-cost program meets the guiding principles set forth by the Congress. These guiding principles include comparable rates and services for consumers in all regions of the country. Yet, as mentioned earlier, the program's structure has contributed to inconsistent distribution of support and availability of telecommunications services across rural America, which is not consistent with these guiding principles. Outcome-based performance goals and measures will help illustrate to what extent, if any, the program's structure is fulfilling the guiding principles set forth by the Congress. Finally, FCC is reviewing several recommendations and proposals to restructure the high-cost program. Yet, because there is limited information available on what the program in its current form is intended to accomplish, what it is accomplishing, and how well it is doing so, it remains unclear how FCC will be able to make informed decisions about which option is best for the future.

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<sup>56</sup>See, Program Assessment Rating Tool Guidance No. 2008-01. According to OMB, it is acceptable to use output measures when outcome measures are not available, comprehensive, or of sufficient quality. However, OMB noted that in these cases, the agency must provide clear justification and rationales for why the measures chosen are appropriate.

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## Internal Control Mechanisms for the High-Cost Program Are Limited and Hinder FCC's Ability to Assess the Risk of Noncompliance with Program Rules and Ensure Cost-Effective Use of Program Funds

Internal controls mechanisms for the high-cost program focus on three areas. Yet, each area has weaknesses. The carrier certification process exhibits inconsistency across states and carriers, the carrier audits have been limited in number and types of reported findings, and carrier data validation focuses primarily on completeness and not accuracy. Collectively, these weaknesses hinder FCC's ability to understand the risks associated with noncompliance with program rules. Further, these weaknesses could contribute to excessive program expenditures. In particular, the high-cost program could incur excessive expenditures because of carrier inefficiencies, excessive payments to carriers, and provision of funding for nonsupported services.

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## Internal Control Mechanisms for the High-Cost Program Exhibit Weaknesses

Internal control mechanisms for the high-cost program focus on three areas: (1) carrier certification, (2) carrier audits, and (3) carrier data validation processes. In each of these three areas, we found weaknesses in the internal control mechanisms.

### Carrier Certification

Annual certification is the primary tool used to enforce carrier accountability for use of high-cost program support, yet the certification process does not have standardized requirements. FCC requires that all states annually certify that all federal high-cost program support provided to eligible carriers in their state will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.<sup>57</sup> It is up to the states to determine if carriers are operating in accordance with these guidelines. Generally, states do so by collecting information from carriers regarding their use of high-cost program funds. However, states have different requirements for what information carriers must submit. Additionally, if a state does not have jurisdiction over a carrier, then the carrier provides annual certification

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<sup>57</sup>In 2004, the Joint Board reported that the state certification process provides the most reliable means of determining whether carriers are using support in a manner consistent with the 1996 Act. See, 19 FCC Rcd. 4257, para. 46 (2004).

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data directly to FCC.<sup>58</sup> As a result, carriers are subject to different levels of oversight and documentation requirements to demonstrate that high-cost program support was used appropriately.

FCC established requirements for information that must be submitted by the carriers it designates as ETCs. Incumbent carriers designated as ETCs by FCC must provide a sworn affidavit stating they are using high-cost program funding only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Additionally, all carriers—incumbent and competitive—designated as ETCs by FCC must provide:<sup>59</sup>

- progress reports on the ETC's 5-year service quality improvement plan;
- detailed outage information;
- the number of unfulfilled service requests from potential customers;
- the number of complaints per 1,000 handsets or lines;
- certification that the ETC is complying with applicable service quality standards and consumer protection rules;
- certification that the ETC is able to function in emergency situations;
- certification that the ETC is offering a local usage plan comparable to that offered by the incumbent in the relevant service areas; and
- certification that the carrier acknowledges that FCC may require it to provide equal access to long-distance carriers in the event that no other eligible telecommunications carrier is providing equal access within the service area.

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<sup>58</sup>Under the 1996 Act, states have primary oversight of carriers, but some states lack jurisdiction to regulate certain types of carriers—generally wireless and tribal carriers. In these cases, FCC assumes jurisdiction over the carriers. Currently, FCC has oversight of 46 carriers.

<sup>59</sup>See, *In the Matter of Federal-State Joint Board on Universal Service*, Report and Order, 20 FCC Rcd. 6371 (2005).

While FCC encourages state regulatory commissions to adopt these requirements, it is not mandatory.<sup>60</sup> Nevertheless, in our survey of state regulatory commissions, we found that many states require carriers to provide information similar to some of the information collected by FCC, particularly with respect to quality-of-service data. For example, FCC requires carriers to submit annual information on the number of unfulfilled service requests from potential customers, the number of complaints per 1,000 handsets or lines, as well as detailed information on outages the carrier experienced. According to our survey, we found that many states require similar information from carriers. Additionally, in our survey, we asked the state regulatory commissions to specify the types of quality-of-service measures they require for incumbent, competitive wireline, and wireless carriers. We found that state requirements are somewhat varied across the three different types of carriers. For example, of the 45 states that indicated they measure consumer complaints, 22 states indicated they require this information for at least one type of carrier but not all types of carriers. (See table 5.)

**Table 5: Number of States Collecting Selected Quality-of-Service Data**

Quality-of-service measure	Number of states that have measurement for any type of carrier	Number of states that apply same requirements across all types of carriers	Number of states that apply different requirements based on the type of carrier
Number of consumer complaints	45	23	22
Unfulfilled service requests	43	18	25
Number of outages	43	19	24

Source: GAO survey of state regulatory commissions.

In addition to the quality-of-service information, we found that state regulatory commissions collect a variety of information pertaining directly to the annual certification process. States most frequently require carriers to submit affidavits that future support will be used for its intended purpose; plans for quality, coverage, or capacity improvements; and evidence that past support was used for its intended purposes. However, according to our survey, 10 state regulatory commissions require

<sup>60</sup>According to FCC, the setting of voluntary standards is consistent with its statutory authority and the holding of the United States Court of Appeals for the Fifth Circuit, *Texas Off. of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 418 (5th Cir. 1999).

incumbent carriers to submit only an affidavit, with no additional information. Additionally, in some instances, these requirements vary based on the type of carrier. (See table 6.)

**Table 6: Information Collected by States as Part of the Annual Certification Process**

Requirements for annual certification	Number of states that have requirement for any type of carrier	Number of states that apply same requirements across all types of carriers	Number of states that apply different requirements based on the type of carrier
Affidavit indicating that high-cost program funding will be used for its intended purposes	44	32	12
Carriers' plans for quality, coverage, or capacity improvements	33	19	14
Evidence that previously received high-cost program funding was used for its intended purposes	31	22	9
Consultation between state commission and carrier	27	16	11
Evidence that the carrier has complied with state requirements for use of funds	26	17	9
Review of carriers' annual or other periodic reports	24	18	6
Other requirements	14	9	5
New application	7	4	3

Source: GAO survey of state regulatory commissions.

## Carrier Audits

Carrier audits are the primary tool used in monitoring and overseeing carrier activities, but these audits have been limited in number and types of reported findings. While the 1996 Act does not require audits, FCC has

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authorized USAC to conduct audits.<sup>61</sup> FCC, USAC, and some state regulatory commissions conduct carrier audits for the high-cost program.

*USAC audits.* USAC operates an audit program to determine if carriers are complying with the program's rules. This audit program has been limited; according to USAC officials, since 2002, USAC has conducted about 17 audits, from more than 1,400 carriers participating in the high-cost program (approximately 1.2 percent coverage). USAC officials told us these audits are time-consuming, and have yielded limited findings because participants did not maintain adequate documentation to validate their information. This occurred for two reasons: (1) the high-cost program had no requirement that carriers retain documents and (2) rural carriers receive funding as a reimbursement for costs incurred 2 years prior to the receipt of support and therefore carriers did not keep records going back a sufficient period of time for the audit. To address these problems, in August 2007, FCC imposed and USAC implemented document retention rules for high-cost program participants; participants are now required to maintain records that can be used to demonstrate to auditors that support received was used consistent with the 1996 Act and FCC's rules for 5 years.<sup>62</sup>

*FCC audits.* In 2006 and 2007, FCC's Office of Inspector General (OIG) instructed USAC to begin conducting audits and assessments to determine the extent to which high-cost program beneficiaries were in compliance with program rules. These audits and assessments have two objectives: (1) validate the accuracy of carrier self-certifications—audits—and (2) provide a basis for identifying and estimating improper payments under the Improper Payments and Information Act of 2002 (IPIA)—assessments.<sup>63</sup> To conduct these audits and assessments, a random sample of 65 out of about 1,400 carriers was selected by OIG. In meeting its first objective, findings were similar to USAC's audit findings, in that it could

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<sup>61</sup>Section 152(b) of the 1996 Act precludes FCC from imposing audit requirements on state regulatory commissions.

<sup>62</sup>*In the Matter of Federal-State Joint Board on Universal Service, Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, Report and Order, 22 FCC Rcd. 16372 (2007).

<sup>63</sup>Pub. L. No. 107-300. IPIA requires federal agencies to annually (1) review all programs and activities to identify those that may be susceptible to significant improper payments, (2) estimate the amount of improper payments in those programs and activities, (3) report these estimates, and (4) implement a plan to reduce improper payments for estimates exceeding \$10 million.

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not be determined if the information that carriers attested to in their annual certifications was accurate because carriers did not have proper documentation to validate their information. For the second objective, OIG reported that the high-cost program had an estimated 16.6 percent rate of improper payments.<sup>64</sup> In response to these findings, USAC maintained that this error rate was primarily indicative of carrier noncompliance with program rules, and not a result of payments made to carriers for inaccurate amounts. For example, USAC stated that these payments were categorized as erroneous because the carrier failed to comply with high-cost program rules such as meeting filing deadlines or completing required documentation.<sup>65,66</sup> In November 2007, a second round of beneficiary audits and assessments was begun to further review program compliance and should be completed by the end of calendar year 2008.

*State audits.* In addition to the USAC and FCC OIG audits, 7 of the 50 state regulatory commissions that responded to our survey reported that they audit incumbent carriers.<sup>67</sup> These audits focus on the appropriate use of high-cost program funding, the accuracy of carrier-reported costs, and the compliance with quality-of-service standards. Two of the 7 states reported that they audit all incumbent carriers, while the remaining 5 states reported that audits are based on a risk assessment of the carrier, or triggered by unusual behavior on the part of the carrier. While these 7 states conduct audits, states generally do not revoke carrier's ETC status. According to our survey, since 2002, one state reported it had revoked a carrier's ETC status (for a competitive carrier). Additionally, during our site visits, several state officials told us they did not conduct audits because they did not feel it was the state's jurisdiction or they lack the

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<sup>64</sup>According to FCC's OIG, the high-cost program was determined to be at risk. Under IPIA standards, a program is at risk if the erroneous payment rate equals or exceeds both 2.5 percent of program payments and \$10 million annually.

<sup>65</sup>IPIA defines improper payments as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. We did not assess whether these payments were improper as defined by IPIA.

<sup>66</sup>In response to these findings, FCC imposed and USAC implemented document retention rules for high-cost program participants.

<sup>67</sup>Fewer state regulatory commissions audit competitive wireline and competitive wireless carriers, four and two states, respectively.



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resources to perform in-depth reviews of carriers' use of high-cost program funds.

## Carrier Data Validation

Data validation processes to ensure the reliability of financial data primarily focus on the completeness of the data provided by carriers, but not the accuracy of the data. Incumbents submit cost and line count data directly to NECA and USAC; these cost and line count data are used to qualify carriers for and to calculate the amount of carriers' high-cost program support. NECA is responsible only for collecting carrier cost and line count data for the high-cost loop support component of the high-cost program. All cost data NECA collects for this component are subject to several electronic validations which primarily focus on ensuring that all required data are reported and that the data ranges are consistent with information reported in previous years. In addition, NECA compares reported cost data with information provided in carriers' audited financial statements to identify any discrepancies. According to NECA officials, these statements are available for about 90 percent of its member carriers. If inaccuracies are found, member carriers are required to provide NECA with an explanation to resolve the situation, but no action is taken against the carrier. NECA officials do not conduct any additional oversight of the line count data they receive. USAC collects cost and line count data for the remaining components of the high-cost program, and similarly to NECA, these data are subject to several electronic data validations for completeness. While these validations and reviews provide NECA and USAC with opportunities to identify input errors, they do not address whether or not the data provided by participants are accurate or if the money spent addresses the intended purposes of the high-cost program.

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## Internal Control Weaknesses Could Lead to Excessive Program Expenditures

While some internal control mechanisms are in place, the weaknesses we identified hinder FCC's ability to assess the risk of noncompliance with program rules. In particular, the internal control mechanisms may not fully address the following concerns, which could contribute to excessive program expenditures.

- *Cost-effectiveness.* In some instances, carriers receive high-cost program support based on their costs. Historically, carriers often were subject to rate-of-return regulation, wherein a state regulatory commission would assess the carrier's costs and investments to ensure these were appropriate and necessary. Of the 50 respondents to our survey of state regulatory commissions, 33 apply rate-of-return regulation to rural

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incumbent carriers, 13 apply it to nonrural incumbent carriers, and 4 apply it to competitive wireline carriers.<sup>68</sup> Further, during our site visits, several state commissions told us that rate cases in which a state regulatory commission evaluates a carrier's costs and investments are very infrequent, if they take place at all. As such, there is limited assessment of the cost-effectiveness of carriers and their investments. Further, as OMB noted, there is no evidence that the program explicitly encourages carriers to achieve efficient and cost-effective delivery of service; rather, the program simply makes rural incumbent carriers whole, regardless of their investment decisions or business model, or the presence of competition in the market by guaranteeing "reasonable" rates of return.<sup>69</sup> The combination of a funding mechanism that does not encourage cost-effectiveness, combined with a lack of detailed oversight, may not yield the most cost-effective program expenditures.

- *Accuracy of cost and line count data.* ETCs and CETCs receive high-cost program support based on their costs and line counts. However, as mentioned above, FCC, USAC, and NECA data collection efforts generally focus on completeness and consistency of carriers' data submissions, but not the accuracy of the data. Further, USAC, FCC, and state regulatory commissions audit a small fraction of program participants, and in the case of FCC's IPIA audits, these audits do not assess the accuracy of cost and line count data which are used to form the basis for carrier support. Inaccuracies in cost and line count data, which are not uncovered through review, could facilitate excessive program expenditures.
- *Appropriate use of high-cost program support.* The high-cost program rules delineate the appropriate uses of the program's support. As we discussed, carriers must annually certify that their use of high-cost program support complies with the program rules. However, the self-certification process varies based on who oversees the carrier; further, there is little follow-up to assess whether carriers' actions are consistent with the certifications. As such, program administrators cannot fully assess whether carriers are appropriately using high-cost program support. Thus, program expenditures could prove excessive if high-cost

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<sup>68</sup>These state regulatory commissions do not necessarily apply rate-of-return regulation to all rural incumbent carriers, nonrural incumbent carriers, or competitive wireline carriers in their states.

<sup>69</sup>OMB, Program Assessment – Universal Service Fund High Cost <http://www.whitehouse.gov/omb/expectmore/summary/10004451.2005.html> (accessed Apr. 2, 2008).

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program funding is used to support services not covered by the program (such as broadband).

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## Conclusion

In the 1996 Act, the Congress said that consumers in “rural, insular, and high-cost areas” should have access to services and rates that are “reasonably comparable” to consumers in urban areas. To respond to this task, FCC modified and expanded the high-cost program. In the intervening 10 years, FCC has distributed over \$30 billion to carriers, with much of this support coming from fees charged to consumers. Yet, FCC has not established performance goals or measures for the program. Thus, it is neither clear what outcomes the program is intended to produce nor what outcomes the program has achieved. What we and the Joint Board found were differences in telecommunications services in rural areas across the country. For example, in some rural areas, carriers receive generous support and provide advanced services, such as fiber-to-the-home, while in other rural areas, carriers receive little or no support and provide basic services. In addition to the lack of performance goals and measures, the internal control mechanisms in place have weaknesses, which hinder FCC’s ability to assess the risk of noncompliance with program rules and ensure cost-effective use of program funds. The internal control mechanisms are inconsistent, limited in number, and appear more concerned with data completeness than accuracy. Thus, for example, it is not clear that the program ensures the most cost-effective delivery of services to rural areas. Therefore, program expenditures may be higher than necessary. These problems raise concerns about past and current program expenditures. But, they also raise concerns about the future of the program. In January 2008, FCC issued several notices proposing fundamental, policy-oriented reform of the program. For example, FCC proposed reverse auctions for the program, but it is not clear how FCC can assess this proposal when it does not know what goals the program should achieve or how it will measure program outcomes. Additionally, the Joint Board proposed separate funds for broadband, mobility, and provider-of-last resort services, with a \$4 billion funding level that was based on the current level of program expenditures. But, it is not clear that the \$4 billion is the correct funding level. Without performance goals, measures, and adequate internal controls, it will be difficult for FCC to assess these proposals. Finally, failure to address these problems may undermine support for the program over time, as program expenditures continue to increase.

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## Recommendations for Executive Action

To strengthen management and oversight of the high-cost program, we recommend that the Chairman, FCC take the following two actions:

1. To better ensure that the high-cost program supports the purpose it is intended to fill, FCC should first clearly define the specific long-term and short-term goals of the high-cost program and subsequently develop quantifiable measures that can be used by the Congress and FCC in determining the program's success in meeting its goals.
2. To ensure a robust internal control environment that supports performance-based management, FCC should identify areas of risk in its internal control environment and implement mechanisms that will help ensure compliance with program rules and produce cost-effective use of program funds.

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## Agency Comments and Our Evaluation

We provided a draft of this report to FCC and USAC for their review and comment. FCC noted that it was aware of, and had addressed or planned to address, the shortcomings we identified in the report. However, FCC noted that it would issue a Notice of Inquiry to seek information on ways to further strengthen its management and oversight of the high-cost program. FCC and USAC both provided information to further clarify the actions that are currently underway and provided technical comments that we incorporated where appropriate. The written comments of FCC and USAC appear in appendices III and IV, respectively.

In its comments, FCC reiterated the status of its existing efforts to strengthen the management and oversight of the high-cost program, as well as to restrain the growth in program expenditures. In particular, FCC cited the OIG audits, the new document retention requirements, and the Memorandum of Understanding (MOU) between FCC and USAC. We agree that these are important efforts, but they do not resolve the shortcomings we identified in the report. FCC also noted that we did not mention the MOU in the report; while we did not cite the MOU, we did incorporate elements of the MOU in the report, including, for example, the requirement that USAC collect and report performance data on a quarterly basis. In addition, FCC noted that it issued several NPRMs seeking comments on proposals to restrain the growth in program expenditures, including removal of the identical support rule and adoption of reverse auctions, and noted that we did not consider these reform proposals in our report. We did provide background information on these proposals; however, we did not provide an assessment of these proposals since FCC was actively seeking comments on the proposals and the outcome of the proposals was

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speculative; further, our findings and recommendations regarding management and oversight are applicable to the program in general, regardless of the specific reform proposal adopted.

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As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. At that time, we will send copies of this report to the appropriate congressional committees, the Chairman of the Federal Communications Commission, and the Chairman of the Universal Service Administrative Company. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have any questions about this report, please contact me at (202) 512-2834 or [goldsteinm@gao.gov](mailto:goldsteinm@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Contact information and major contributors to this report are listed in appendix V.



Mark L. Goldstein  
Director, Physical Infrastructure Issues

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# Appendix I: Objectives, Scope, and Methodology

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This report examines the operation of the high-cost program of the Universal Service Fund. In particular, the report provides information on (1) the effect that the structure of the program has on the levels of support and types of services available in high-cost areas; (2) the extent that the program has performance goals and measures; and (3) the extent that the program has mechanisms in place to prevent and detect fraud, waste, and abuse.

To respond to the overall objectives of this report, we interviewed officials from the Federal Communications Commission (FCC) and the Universal Service Administrative Company (USAC). In addition, we reviewed FCC and USAC documents, as well as relevant legislation and federal regulations. We also interviewed industry associations, national wireline and wireless companies, the National Exchange Carrier Association (NECA), and other individuals with knowledge of the high-cost program. We reviewed USAC data on the distribution of high-cost funds across states and companies. Finally, we compared FCC, USAC, and state policies to GAO and Office of Management and Budget (OMB) guidance. Table 7 lists the individuals and organizations with whom we spoke.

For the first and third objectives, we conducted site visits in six states: Alabama, Iowa, Montana, Oklahoma, Oregon, and Wisconsin. We used a multistep process to select these six states. First, we divided states into Census Bureau regions, excluding states where (1) no competitive eligible telecommunications carriers (CETC) received support in 2006 and (2) the urban population was equal to or above average, since the high-cost program provides support for rural areas. Second, we selected states within each region based on the number of eligible telecommunications carriers (ETC) and CETCs present in the state. Within each state, we interviewed the state regulatory commission (that is, the state agency responsible for regulating telephone service within the state), “rural” and “nonrural” ETCs, and CETCs. In some states, we also interviewed cost consultants, state industry associations, and wireless carriers. To test our structured interview and site selection methodology, we also conducted site visits in the following states: Arizona, Maine, Massachusetts, New Hampshire, and New Mexico. We interviewed similar state and industry officials in these five states.

For the third objective, we conducted a survey of state regulatory commissions. The survey field period was from December 12, 2007, to February 8, 2008, and sought information pertaining to the state’s regulation of telephone service; the state’s internal control procedures for incumbent, competitive wireline, and competitive wireless carriers

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receiving high-cost support in the state; and the state's high-cost program, if any. To help ensure that the survey questions were clear and understandable to respondents, and that we gathered the information we desired, we conducted pretests with relevant officials in Mississippi, North Carolina, Pennsylvania, Virginia, and Washington. The survey was available online to officials in the 50 states and the District of Columbia on a secure Web site. We received complete responses from 50 of the 51 commissions we surveyed, for an overall response rate of 98 percent. This report does not contain all the results from the survey. The survey and a more complete tabulation of the results can be viewed at [GAO-08-662SP](#).

We conducted this performance audit from July 2007 through June 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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**Table 7: Individuals and Organizations Interviewed**

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Alabama-Mississippi Telecommunications Association
Alabama Public Service Commission
Alltel
Arizona Corporation Commission
AT&T
Balhoff, Rowe & Williams, LLC (Robert C. Rowe, Esq.)
Beaver Creek Cooperative Telephone Company
Blackfoot Telephone Cooperative, Inc.
BTC Broadband
Carnegie Telephone Company
Cascade Utilities, Inc.
CenturyTel
Chibardun Telephone Cooperative, Inc.
Chickasaw Telecom, Inc.
Clear Creek Telephone & TeleVision
CLTel
Comptel
Consumer Advocate Division, Public Service Commission of West Virginia
Corr Wireless

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**Appendix I: Objectives, Scope, and Methodology**

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CTIA
Davis Brown Law Firm (Robert F. Holz, Jr.)
Department of Telecommunications and Cable, The Commonwealth of Massachusetts
Dobson Telephone Company
Dumont Telephone Company
Farmers Mutual Cooperative Telephone Company
Federal Communications Commission
Granite State Telephone
Harris, Wiltshire & Grannis LLP (John T. Nakahata, Attorney at Law)
Hayneville Telephone Company, Inc.
Heart of Iowa Communications Cooperative
Hot Springs Telephone Company
Huxley Communications
Iowa Telecom
Iowa Telecommunications Association
Iowa Utilities Board
Jackson Thorton (Rob Ballard, CPA)
Kiesling (Burnie Snoddy, Consultant)
La Jicarita Rural Telephone Cooperative
Maine Public Utilities Commission
Martin Group (Darrell Bolen, CPA)
Massachusetts Office of Consumer Affairs and Business Regulation
McCloud Telephone Company
Medicine Park Telephone Company
MHTC
MonCre Telephone Cooperative
Montana Public Service Commission
Montana Telecommunications Association
National Association of Regulatory Utility Commissioners
National Exchange Carrier Association
National Regulatory Research Institute
National Telecommunications Cooperative Association
New Hampshire Public Utilities Commission
New Mexico Consumer Advocate, Office of the Attorney General
Oklahoma Corporation Commission, Public Utility Division
Oklahoma Telephone Association
Oregon Public Utility Commission

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**Appendix I: Objectives, Scope, and Methodology**

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Organization for the Promotion and Advancement of Small Telecommunications Companies
Partner Communications Cooperative
Panhandle Telecommunication Systems, Inc.
Pioneer Telephone Cooperative
Public Advocate Office, State of Maine
Public Regulation Commission of New Mexico
Public Service Commission of Wisconsin
Qwest
Ron Comingdeer & Assoc.
Sacred Wind Communications
Southern Montana Telephone Company
Totah Communications, Inc
Trans-Cascade Telephone Company
Union Springs Telephone Company
United States Telecom Association
Unitel Incorporated
Universal Service Administrative Company
U.S. Cellular
Verizon
West Wisconsin Telcom Cooperative, Inc.
Wisconsin State Telecommunications Association
Zona Communications
3 Rivers Communications

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Source: GAO.

# Appendix II: Telephone Penetration Rate by State (Percentage of Households with Telephone Service)

State	November 1983 (%)	July 2007 (%)	Change (%)
Alabama	87.9	92.6	4.7
Alaska	83.8	96.7	12.9
Arizona	88.8	93.1	4.3
Arkansas	88.2	93.0	4.9
California	91.7	96.7	5.0
Colorado	94.4	97.4	3.0
Connecticut	95.5	96.7	1.1
Delaware	95.0	95.0	0.0
District of Columbia	94.7	90.5	-4.3
Florida	85.5	93.3	7.8
Georgia	88.9	92.2	3.3
Hawaii	94.6	96.9	2.3
Idaho	89.5	96.8	7.3
Illinois	95.0	94.1	-0.9
Indiana	90.3	91.0	0.7
Iowa	95.4	97.7	2.3
Kansas	94.9	97.0	2.1
Kentucky	86.9	94.4	7.5
Louisiana	88.9	93.9	5.0
Maine	90.7	97.0	6.3
Maryland	96.3	96.3	0.0
Massachusetts	94.3	95.9	1.6
Michigan	93.8	95.6	1.9
Minnesota	96.4	97.8	1.5
Mississippi	82.4	89.8	7.5
Missouri	92.1	96.1	4.1
Montana	92.8	94.7	1.9
Nebraska	94.0	92.8	-1.2
Nevada	89.4	95.5	6.1
New Hampshire	95.0	96.6	1.6
New Jersey	94.1	94.9	0.7
New Mexico	85.3	91.1	5.7
New York	90.8	93.0	2.1
North Carolina	89.3	94.8	5.5
North Dakota	95.1	97.6	2.5

**Appendix II: Telephone Penetration Rate by State (Percentage of Households with Telephone Service)**

<b>State</b>	<b>November 1983 (%)</b>	<b>July 2007 (%)</b>	<b>Change (%)</b>
Ohio	92.2	96.6	4.4
Oklahoma	91.5	95.3	3.8
Oregon	91.2	97.7	6.5
Pennsylvania	95.1	97.3	2.2
Rhode Island	93.3	95.4	2.1
South Carolina	81.8	91.6	9.8
South Dakota	92.7	96.4	3.7
Tennessee	87.6	93.2	5.6
Texas	89.0	94.1	5.1
Utah	90.3	96.6	6.3
Vermont	92.7	98.0	5.3
Virginia	93.1	95.6	2.5
Washington	92.5	95.8	3.4
West Virginia	88.1	94.3	6.2
Wisconsin	94.8	97.7	2.9
Wyoming	89.7	95.3	5.6
<b>Total United States</b>	<b>91.4</b>	<b>95.0</b>	<b>3.6</b>

Source: FCC, *Telephone Subscribership in the United States* (Washington, D.C., February 2008).

Note: The Census Bureau collects these data. Through November 2004, the Census Bureau asked "Is there a telephone in this house/apartment?" Subsequently, the Census Bureau has asked "Does this house, apartment, or mobile home have telephone service from which you can both make and receive calls? Please include cell phones, regular phones, and any other type of telephone."

# Appendix III: Comments from the Federal Communications Commission

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Federal Communications Commission  
Washington, D.C. 20554

May 16, 2008

Mr. Mark Goldstein  
Director, Physical Infrastructure  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, D.C. 20548

Dear Mr. Goldstein:

Thank you for the opportunity to respond to the draft Government Accountability Office (GAO) report concerning program management and oversight of the universal service fund (USF or the fund) high-cost program.

During Chairman Martin's tenure, the Commission has been a proponent of strong action to strengthen the management, oversight, and policies of the USF high-cost fund, enabling it to fulfill its statutory goals under section 254 of the Communications Act of 1934, as amended (the Act) so that consumers throughout rural and insular areas of the nation have access to affordable, quality telecommunications services.<sup>1</sup> Among other things, these actions have resulted in the initiation or completion of over 450 audits of high-cost program beneficiaries since August 2006. The Commission also has taken actions to rein in the explosive growth in high-cost universal service support disbursements caused primarily by disbursements to competitive eligible telecommunications carriers (ETCs), which have grown from approximately \$1.5 million in 2000 to well over \$1 billion in 2007. The Commission also has acted to establish performance measures for the universal service programs and the fund administrator, the Universal Service Administrative Company (USAC). In addition, the Commission has devoted significant resources to establish a Memorandum of Understanding (MOU) with USAC to ensure its performance measures are met and ensure greater clarity in USAC's administrative and management functions.

Because the Commission is dedicated to ensuring the statutory principles of section 254 of the Act are met, the Commission welcomes recommendations on making additional improvements. In its draft report, the GAO first recommends that the Commission clearly define the specific long-term and short-term goals of the high-cost program and subsequently develop quantifiable measures that can be used by Congress and the Commission in determining the program's success in meeting its goals.<sup>2</sup> The report concludes that "because there is limited information available on what the program in its current form is intended to accomplish, what it is accomplishing, and how well it is doing, so it remains unclear how Commission will be able to make informed decisions about which option is best for the future."<sup>3</sup> Second, the GAO recommends that the Commission identify areas of risk in its internal control environment and implement mechanisms that will help ensure compliance with program rules and produce cost-effective

<sup>1</sup> 47 U.S.C. § 254. The Telecommunications Act of 1996 (1996 Act) amended the Communications Act of 1934. Pub. L. No. 104-104, 110 Stat. 56 (1996).

<sup>2</sup> GAO Draft Report at 40.

<sup>3</sup> *Id.* at 31.

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**Appendix III: Comments from the Federal Communications Commission**

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use of program funds.<sup>4</sup> GAO states that the high-cost program's internal control measures contain weaknesses which could contribute to excessive program expenditures.<sup>5</sup>

We are pleased to report that the Commission has already implemented measures that address both GAO recommendations. As the Commission staff indicated to GAO during the course of its examination (beginning in June 2007), we were already aware of the issues GAO raised throughout the investigation and had either addressed, or had plans in place to improve, both the Commission's performance measures and internal controls for the USF high-cost program.

First, the Inspector General (IG) has initiated and completed 459 audits of USF program beneficiaries and contributors since August of 2006, and the IG has an additional 650 audits of the USF program beneficiaries and contributors currently underway. For the high-cost program alone, the IG has initiated and completed 65 audits of program beneficiaries since August of 2006, and the IG has an additional 390 high-cost audits currently underway. As part of these audits, for the first time, the high-cost program is subject to statistical sampling and attest audits to determine compliance with the Act and the Commission rules.<sup>6</sup>

Second, in June 2007, the Commission established an MOU with USAC to ensure greater clarity in administrative and management functions. In particular, the MOU established reporting requirements of key performance measurement data to the Commission, instructed USAC to take corrective action on all audit findings including recovery of any funds identified as improperly disbursed, and directed USAC to maintain effective internal controls over its operations.

Third, in August of 2007, the Commission adopted rules that address many of the problems previously identified with the USF program.<sup>7</sup> The Commission's new rules establish rigorous document retention requirements for program participants and establish performance measurements to better manage USAC and the high-cost program. These measurements, among other things, require USAC to provide specific performance measurements for the high-cost program, such as, the number of program beneficiaries, rates of telephone subscribership in urban versus rural areas, and the average median dollar amount of support.<sup>8</sup> The Commission's new rules also create additional penalties for bad actors – specifically, the Commission can now debar from continued participation in the program, any party that defrauds any of the programs, including the high-cost program. The Commission is revising the MOU to reflect these new rules, and to further bolster its oversight of USAC, the Commission will require additional data from USAC so the Commission can better determine whether the adopted performance measure requirements are being met.

The GAO's assessments of the high-cost mechanism, unfortunately, do not mention key Commission actions, such as the MOU, and contain inaccuracies, which detract from the report's utility. Specifically:

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<sup>4</sup> *Id.* at 40.

<sup>5</sup> *Id.* at 31.

<sup>6</sup> See Office of the Inspector General, Semiannual Report to Congress, April 1, 2007 to September 30, 2007 (dated Oct. 31, 2007), available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-278589A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-278589A1.pdf).

<sup>7</sup> *Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, WC Docket Nos. 05-195, 02-60, 03-109, CC Docket Nos. 96-45, 02-6, 97-21, Report and Order, 22 FCC Rcd 16372 (2007) (*Comprehensive Review Order*).

<sup>8</sup> *Id.* at 16397-98, para. 55.

**Appendix III: Comments from the Federal Communications Commission**

See comment 1.

See comment 2.

See comment 3.

See comment 4.

- As discussed above, the GAO draft report does not mention the MOU in the sections of the report on internal controls. The Commission included provisions concerning internal controls in the MOU to strengthen the controls over the USF program in general. As part of the MOU, the Commission directs USAC to implement an internal control structure consistent with the requirements of Office of Management and Budget Circular A-123. In compliance with this instruction, USAC is in the process of re-assessing its internal controls framework. The results of this effort will enable USAC to develop and implement corrective action plans for any identified internal control weaknesses, which will help to prevent and reduce improper payments across all of the USF programs, including the high-cost program.
- At pages 2 and 39, the GAO draft report incorrectly states the USF high-cost program was established in response to the 1996 Act. The high-cost program predates the 1996 Act, and included the high-cost loop support, dial equipment minutes (DEM) weighting, and long term support programs. To implement the 1996 Act, these programs were modified and additional mechanisms were adopted to make support explicit and funded by all providers of interstate telecommunications.<sup>9</sup>
- At pages 27-28, the GAO's draft report acknowledges that the Commission has made preliminary efforts to collect high-cost data to develop program goals and adopted performance measures in August of 2007 as a result of the June 2005 notice of proposed rulemaking.<sup>10</sup> It should also be noted that the Commission's efforts in this regard under Chairman Martin represent the most comprehensive efforts to date to seek input from the public, USAC, the National Exchange Carrier Association (NECA), and program participants to determine appropriate performance measures for the USF programs. In addition, this section of the report does not mention the MOU between the Commission and USAC, which formalized the reporting of the performance measurement data to the Commission on a quarterly basis and stated that the Commission anticipated adopting goals for the programs as the Commission and USAC gain experience with the data.
- At page 32, the GAO draft report contains inaccuracies concerning the ETC USF high-cost certification process. In particular, the GAO draft report states that "all carriers – incumbents and competitive – under the FCC's jurisdiction" are required to submit certifications and the associated reporting data.<sup>11</sup> However, only carriers who seek ETC status under section 241(e)(6) of the Act – not all carriers under the FCC's jurisdiction -- are subject to the certification and data reporting requirements set forth in the Commission's *2005 ETC Designation Order*.<sup>12</sup>

<sup>9</sup> 47 U.S.C. § 254.

<sup>10</sup> *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, WC Docket Nos. 05-195, 02-60, 03-109, CC Docket Nos. 96-45, 02-6, 97-21, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, 20 FCC Rcd 11308 (2005).

<sup>11</sup> GAO Draft Report at p. 32 (emphasis added); *see also* n. 56 (incorrectly stating that the Commission assumes jurisdiction over carriers that are not designated by state commissions).

<sup>12</sup> *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 20 FCC Rcd 6371 (2005) (*2005 ETC Designation Order*).

See comment 5.

- At pages 31-32, the GAO draft report states the USF high-cost certification process lacks standardized requirements because carriers throughout the nation may be subject to different levels of oversight and documentation requirements concerning certification and data reporting. The draft report, however, lacks any recognition of Congress' intent in providing state commissions with the primary responsibility to perform ETC designations under section 214(e)(2) of the Act.<sup>13</sup> More importantly, the draft report fails to acknowledge that the Commission's action adopting federal permissive guidelines for ETC designations, as opposed to mandatorily-imposed nationwide requirements, was consistent not only with statutory directive, but also with the holding of the United States Court of Appeals for the Fifth Circuit that the Act does not preclude states from imposing their own eligibility requirements on ETCs.<sup>14</sup>

See comment 6.

- At page 35, note 58, the GAO draft report states that, concerning audits of incumbent local exchange carriers (LECs), the "FCC imposes no audit requirements on state regulatory commissions." Section 152(b) of the Act, however, expressly precludes the Commission from jurisdiction over intrastate services, limiting the Commission's ability to direct state regulatory commissions to conduct audits concerning costs and rates for intrastate services.<sup>15</sup>

See comment 7.

- At page 38, in the paragraph on the Accuracy of Cost and Line-Count Data, the GAO draft report states that: "... FCC, USAC, and NECA data collection efforts generally focus on completeness and consistency of carriers' data submissions, but not the accuracy of the data." In fact, NECA does have controls in place to look for deviations of information reported by carriers from year to year in support of their claims for USF support. For example, as the report states, NECA compares reported cost data with information provided in carriers' audited financial statements to identify any discrepancies. If significant deviations in cost or line count data are discovered through NECA's checks, NECA will seek to validate that information and can ask the carrier to revise the data if it is found to be inaccurate. Further, NECA cost and line-count data study results are provided to USAC and made available on the Commission's website for any interested party to review and analyze.<sup>16</sup> The underlying data used to compile the NECA study has also been made available to USAC for its review and analysis.

See comment 8.

- Further, in the same paragraph on the Accuracy of Cost and Line-Count Data, GAO states that: "... in the case of the FCC's IPIA audits, these audits do not assess the accuracy of cost and line-count data which are used to form the basis for carrier support." Contrary to GAO's observations, the IG's audits were in fact designed to render an independent auditor's opinion on the accuracy of carriers' cost and line counts. Some audits specifically found instances where the carrier could provide no supporting data and other instances in which the data did not support carriers' reported costs or line counts.

<sup>13</sup> 2005 ETC Designation Order, 20 FCC Rcd at 6397-98, para. 61.

<sup>14</sup> *Id.*; *Texas Off. of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 418 (5<sup>th</sup> Cir. 1999) (*TOPUC v. FCC*).

<sup>15</sup> 47 U.S.C. § 152(b).

<sup>16</sup> See NECA Overview of Universal Service Fund, available at <http://www.fcc.gov/wcb/iatd/neca.html> (last visited May 14, 2008). (NECA Cost Study Results). The 2007 Submission of the NECA Cost Study Results is attached.

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**Appendix III: Comments from the Federal Communications Commission**

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The GAO draft report also determines, that, without performance goals, measures, and adequate internal controls, it will be difficult for the Commission to assess proceedings contemplating reform of the high-cost program and GAO expressly refused to consider these Commission efforts as part of its analysis.<sup>17</sup>

First, as discussed above, the GAO report neglected to reference or adequately describe certain Commission actions strengthening performance measures and internal controls. The Commission, however, is open to GAO's recommendations on making additional improvements. To that end, the Commission intends to issue a Notice of Inquiry (NOI) seeking information on ways to further strengthen management and oversight of the high-cost program, how to more clearly define the goals of the high-cost program, and what additional quantifiable performance measures are needed. In addition, the NOI will seek information on whether and to what extent the Commission's internal controls and compliance oversight can be improved. We commit to issuing this NOI promptly, and to act within one year.

Second, as the draft report acknowledges, GAO refused to "assess or discuss the merits of the [Commission's] reform proposals."<sup>18</sup> Given the significant and increasing pressure on the stability of the high-cost fund, which grew from approximately \$2.6 billion in 2001 to approximately \$4.3 billion in 2007, it is imperative that the Commission consider proposals to address its current policies and rules concerning support distribution; the utility of the draft report is undermined by its failure to consider the need for fundamental reform of the program.

For example, the draft report fails to properly recognize that the most rapidly growing portion of the high-cost support program is now devoted to supporting multiple competitors who are not required to file cost information at all, and, therefore, are not subject to the types of cost oversight discussed in the GAO investigation. These competitive ETCs, primarily wireless carriers, do not receive support based on their own costs, but rather on the costs of the incumbent provider, even if their costs of providing service are lower.<sup>19</sup>

Indeed, growth in required contributions to the fund is largely attributable to these competitive ETCs. High-cost support to competitive ETCs has grown from approximately \$1.5 million in 2000 to well over \$1 billion in 2007. The Commission recently took action to rein in the explosive growth in high-cost universal service support disbursements by adopting an interim, emergency cap on the amount of high-cost support that competitive ETCs may receive.<sup>20</sup>

The Commission plans to move forward on adopting comprehensive reform measures in an expeditious manner. Specifically, the Commission is considering all the principles in section 254(b) of the Act, including reasonable comparability, in the *Tenth Circuit Remand* proceeding.<sup>21</sup>

In addition, on November 19, 2007, the Joint Board submitted to the Commission recommendations for comprehensive reform of high-cost universal service support,<sup>22</sup> and on January 29, 2008, the Commission

<sup>17</sup> GAO Draft Report at pp. 16, 40.

<sup>18</sup> GAO Draft Report at p. 16.

<sup>19</sup> See 47 C.F.R. §54.307(a).

<sup>20</sup> See *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, FCC 08-122 (rel. May 1, 2008).

<sup>21</sup> See *Federal-State Joint Board on Universal Service, High-Cost Service Support*, CC Docket No. 96-45, WC Docket No. 05-337, Notice of Proposed Rulemaking, 20 FCC Rcd 19731 (2005).

See comment 9.

See comment 10.



See comment 9.

released three notices of proposed rulemaking addressing proposals for comprehensive reform of the high-cost universal service support program.<sup>23</sup> In the *Identical Support Rule NPRM*, the Commission tentatively concludes that it should eliminate the Commission's current "identical support" rule, which provides competitive ETCs with the same per-line high-cost support amounts that incumbent LECs receive. In the *Reverse Auctions NPRM*, the Commission tentatively concludes that reverse auctions offer several potential advantages over the current high-cost support distribution mechanisms. Auctions would allow direct market signals to be used as a supplement to, and possible replacement of, cost estimates made from either historical cost accounting data or forward-looking cost models, and thereby minimize the level of subsidy required to achieve universal service goals. An auction could also provide a fair and efficient means of eliminating the subsidization of multiple ETCs in a given area. In the *Joint Board Comprehensive Reform NPRM*, the Commission is considering the recommendations of the Joint Board to establish three separate funds with distinct budgets and purposes: a broadband fund; a mobility fund; and a provider of last resort fund, and to adopt an overall cap on high-cost funding. Comments on the *Reform Notices* were due by April 17, 2008, and reply comments are due by June 2, 2008.<sup>24</sup>

Finally, GAO's refusal to consider these reform proposals and its recommendation that the Commission focus its reform efforts elsewhere ignores the Commission's clear statutory obligation to act. Specifically, section 254(a)(2) of the Act requires the Commission to act on the Joint Board's recommended decision within one year.<sup>25</sup>

<sup>22</sup> *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 20477 (Fed.-State Jt. Bd. 2007).

<sup>23</sup> *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1467 (2008) (*Identical Support Rule NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008) (*Reverse Auctions NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1531 (2008) (*Joint Board Comprehensive Reform NPRM*) (collectively *Reform Notices*).

<sup>24</sup> *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; WC Docket No. 05-337, Order, DA 08-674 (rel. Mar. 24, 2008); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, DA No. 08-1168 (rel. May 15, 2008) (extending comment and reply comment dates).

<sup>25</sup> 47 U.S.C. § 254(a)(2).

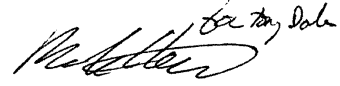
**Appendix III: Comments from the Federal  
Communications Commission**

Although we are concerned about the flaws in the GAO's examination noted above, we appreciate GAO's recommendations on making additional improvements. We agree that the Commission should continue to strengthen the USF high-cost program's performance measures and internal controls. At the same time, however, we remain committed to meeting the Commission's statutory obligations and to preserve and advance universal service, and to ensure the sufficiency of the fund so that people throughout rural areas of the nation have access to telecommunications services.<sup>26</sup> We look forward to working with the GAO on this and other matters in the future.

Sincerely,



Dana R. Shaffer  
Chief, Wireline Competition Bureau



Anthony J. Dale  
Managing Director

Attachment

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<sup>26</sup> 47 U.S.C. § 254(b).

The following are GAO's comments on the Federal Communications Commission's letter dated May 16, 2008.

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## GAO's Comments

1. While we did not specifically cite the Memorandum of Understanding (MOU), we did discuss elements of this document. With respect to internal controls, the MOU states that USAC "shall implement a comprehensive audit program to ensure that USF monies are used for their intended purpose, to verify that all USF contributors make the appropriate contributions in accordance with the [FCC's] rules, and to detect and deter potential waste, fraud, and abuse. [USAC] shall work under the oversight of the OIG in hiring contractors and auditing contractors . . ." While we acknowledge these recent efforts to conduct audits of USF (Universal Service Fund) program contributors and beneficiaries, as discussed in this report, we found that with respect to the high-cost program, these efforts have been limited and yielded limited results. For example, USAC has conducted about 17 audits, from more than 1,400 participating carriers, and participants did not maintain adequate information for the auditors to validate their information. The MOU also states that USAC "shall implement effective internal control over its operations, including the administration of the USF and compliance with applicable laws and regulations. [USAC] will implement an internal control structure consistent with the standards and guidance contained in OMB Circular A-123, including the methodology for assessing, documenting, and reporting on internal controls. . ." During our review, USAC officials made us aware of the actions they are taking to develop a comprehensive, internal control framework for USAC's internal operations, such as procedures to ensure that cash disbursements are consistent with funds due to participating carriers. While we encourage these efforts, USAC's internal operations were not in the scope of our objectives, and these efforts do not address the issues we raised in the report—weak and limited internal control mechanisms specifically aimed at the high-cost program beneficiaries.
2. We are aware that efforts to promote universal service in rural areas pre-date the 1996 Act, and include background information on these efforts on pages 7-8 of the report. However, to avoid any confusion, we modified the report text to note that FCC modified and expanded the high-cost program after the Telecommunications Act of 1996.
3. Again, while we did not specifically cite the MOU, on page 28 of the report, we did discuss the performance data that FCC requires USAC to collect and report on a quarterly basis. Interestingly, in a previous

meeting with USAC and in USAC's written comments, USAC noted that it is not authorized to collect all the performance data required by FCC. In particular, of the seven categories of performance data, USAC said it was not authorized to collect some portions of three categories, including the number of program beneficiaries per wire center, the number of lines per wire center (except for the high-cost model component), and the rate of telephone subscribership in urban vs. rural areas. Thus, it is unclear how effective this data collection effort will be in developing performance goals and measures.

4. We changed the text to be consistent with the 1996 Act.
5. We did not assert that FCC had the authority to impose mandatory standards on state regulatory commissions, although, since the issue has not been adjudicated, it is unclear whether the statute prohibits FCC from imposing mandatory standards. Irrespective of FCC's authority to impose mandatory standards, the inconsistent requirements imposed by the states represent a weakness in the high-cost program's internal controls. As USAC noted in its written comments, "if states adopted similar requirements there would be more standardized requirements across all ETCs thereby enabling USAC to conduct more comprehensive audits to ensure ETCs are using High Cost funds for the purposes intended."
6. We changed the text to be consistent with the 1996 Act.
7. On page 37 of this report, we discuss the steps NECA takes to verify the accuracy of the data that carriers submit, including analyzing trends and comparing cost data with information in carriers' audited financial statements. Although, as we also discuss, NECA is responsible only for collecting carrier cost and line count data for the high-cost loop support component, representing only one of the five high-cost program components. Further, trend analysis does not necessarily ensure the accuracy of the underlying data. In its comments on this report, USAC, which also performs extensive trending validations, noted that "absent a full-scale audit, it is difficult to determine the level of accuracy of the information provided by the carriers."
8. We acknowledge that FCC's Office of Inspector General (OIG) Improper Payments and Information Act of 2002 (IPIA) audits included a component to determine carrier compliance with high-cost program rules. While FCC's comments state these audits were designed to render an auditor's opinion on the accuracy of carrier data, it was unclear to us that these audits specifically addressed accuracy of

carrier cost and line counts. In the OIG's Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits, the reasons for carrier noncompliance focused on procedural noncompliance. These reports attributed inadequate document retention; inadequate auditee processes or policies and procedures; inadequate systems for collecting, reporting, or monitoring data; auditee weak internal controls; and auditee data entry error. These reports do not discuss the accuracy of carrier's cost or line-count data.

9. We acknowledged the Notice of Proposed Rulemakings that FCC issued to address the growth in the high-cost program's expenditures and provided background information on these proposals. However, we did not provide an assessment of these proposals since FCC was actively seeking comments on the proposals, and the outcome of the proposals was speculative. Further, our findings and recommendations regarding management and oversight of the high-cost program are applicable to the program in general, regardless of the specific reform proposal adopted. In making our recommendations, we are not implying that FCC should discontinue policy-oriented reform of the high-cost program; rather, these efforts are complementary.
10. On page 14 of the report, we provide a discussion of the factors contributing to the growth of high-cost program expenditures, and figure 1 provides a visual illustration of the growth in both incumbent and competitive support. Further, on page 24, we provide detailed information on the growth in the number of CETCs and the overall financial support provided to CETCs.

# Appendix IV: Comments from the Universal Service Administrative Company



*Via Electronic Mail*

May 15, 2008

Michael Clements  
Assistant Director  
United States Government Accountability Office  
441 G Street, Room 2T23  
Washington, D.C. 20548

Re: Response to Draft Report to Congressional Committees on the High Cost Program

Dear Mr. Clements:

This letter responds to the draft Government Accountability Office (GAO) Report to Congressional Committees on the High Cost Program administered by the Universal Service Administrative Company (USAC). USAC is pleased to submit its response and clarify certain report findings as they relate to USAC and its roles and responsibilities regarding the High Cost Program. This response is divided into two sections according to the two main GAO report findings concerning program administration.

#### **Lack of Performance Measures and Goals**

GAO's first recommendation is to clearly define the goals of the High Cost Program and subsequently develop quantifiable performance based measures.<sup>1</sup> While the draft report found that there is a clearly established overall goal for the High Cost Program, it also concluded that current performance measures established by the Federal Communications Commission (FCC or Commission) do not align with GAO and Office of Management and Budget (OMB) standards used in developing successful performance goals and measures.<sup>2</sup> The draft report states that the current measurements established by the FCC focus on program output rather than program outcome and efficiency.<sup>3</sup> USAC looks forward to working with the Commission in developing additional performance measures and goals. Reporting other performance measures identified by GAO may require collection and analysis of additional data that USAC is presently not authorized to collect.

<sup>1</sup> United States Government Accountability Office Report to Congressional Committees, *FCC Needs to Improve Performance Management and Strengthen Oversight of the High Cost Program*, GAO-08-633, Draft Report June 2008, page 7 (*GAO Draft Report*)(draft provided to USAC on April 16, 2008).

<sup>2</sup> *GAO Draft Report*, page 5.

<sup>3</sup> *GAO Draft Report*, pages 27-30.

Michael Clements  
Assistant Director, GAO  
May 15, 2008  
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#### Internal Control Weaknesses

GAO's second recommendation is to implement mechanisms that will help ensure compliance with program rules and produce cost effective use of program funds.<sup>4</sup> While GAO recognizes that internal controls currently exist for the High Cost Program, the draft report states that these mechanisms are limited and exhibit weaknesses that hinder the Commission's ability to assess rules compliance and ensure cost-effective use of program funds.<sup>5</sup> The draft report identified three internal control mechanisms: carrier certifications, carrier audits, and carrier data validation. USAC addresses GAO's concerns regarding each internal control mechanism below.

##### Carrier Certifications

Annual certifications are the primary tool used to ensure that carriers are using High Cost support consistent with program rules. The annual certifications are provided primarily from the state regulatory commissions to USAC and the FCC. GAO found that the certification process lacks standardization because states have different requirements for the type and breadth of information carriers must submit in order to be certified. As a result, GAO concluded that carriers are subject to different levels of oversight and documentation requirements to demonstrate that High Cost support is used appropriately.<sup>6</sup> USAC's authority to review such certifications is limited. USAC must rely on states and territorial certifying authorities having done the due diligence necessary to ensure that carriers use High Cost support consistent with program rules. If a state certifies the carrier, USAC is required to pay support to the carrier consistent with program rules. USAC does not have authority to collect the data necessary to perform due diligence to ensure that carriers are using support consistent with program rules.

In cases where states or territorial authorities do not have jurisdiction over carriers, the FCC is responsible for designating carriers as eligible telecommunications carriers (ETCs). When the FCC designates carriers as ETCs, it requires carriers to provide additional information, such as progress reports on the carrier's five-year service quality improvement plan, detailed outage information, etc.<sup>7</sup> In addition, the carrier must provide an annual self-certification directly to the FCC and USAC that it is using High Cost funds consistent with program rules. More than half of the respondents to the GAO survey indicated that their certifying authorities do not require wireless carriers to fulfill requirements similar to the requirements imposed by the FCC on carriers it designates as ETCs.<sup>8</sup> GAO correctly notes that if states

<sup>4</sup> GAO Draft Report, page 7.

<sup>5</sup> GAO Draft Report, Highlights.

<sup>6</sup> GAO Draft Report, page 32.

<sup>7</sup> GAO Draft Report, pages 32 and 33.

<sup>8</sup> Government Accountability Office Survey of State Regulatory Commissions, GAO-08-622SP, (GAO Survey Results)

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adopted similar requirements there would be more standardized requirements across all ETCs thereby enabling USAC to conduct more comprehensive audits to ensure ETCs are using High Cost funds for the purposes intended.

#### Audits

High Cost Program audits are a key tool used to monitor and oversee carrier activities. In its draft report, GAO noted that "USAC has conducted about 17 audits from over 1,400 carriers participating" in the High Cost Program.<sup>9</sup> While USAC has always considered audits to be an important element of an effective control environment, there are several reasons why USAC conducted only 17 High Cost Program beneficiary audits prior to 2006. In early 2002, USAC began increasing its attention to audit activities by expanding its Internal Audit Division (IAD). In 2002 and 2003, most of USAC's limited audit resources were dedicated to performing audits of Schools and Libraries Program beneficiaries. At the time, the High Cost Program was considered a lower risk program because ETCs have more stringent eligibility requirements for receipt of High Cost support. As USAC's IAD began to expand in late 2002 and 2003, it initiated a limited number of High Cost beneficiary audits.

In mid-2004, USAC was instructed by the FCC Office of Inspector General (OIG) to launch a large scale audit program that included conducting up to 700 audits over a three year period across all support programs. This audit plan included 250 High Cost beneficiary audits. To complete the planned 700 audits, USAC engaged in a procurement process to select outside audit firms to perform the work. Once the procurement process was completed, USAC requested Commission approval of the selected firms in April 2005. In October 2005, the FCC directed USAC to recomplete the procurement. Under the direction of a new FCC Inspector General, the audit program was redesigned, which delayed the recomplete process until July 2006. As such, far fewer High Cost beneficiary audits were performed in 2005 and early 2006 than expected. The audit work began in late 2006 with 65 High Cost Program beneficiary audits. All High Cost FCC OIG audits were completed by mid-2007. Currently, USAC is working with the OIG on a substantially larger sample of High Cost Program beneficiary audits, and USAC IAD is continuing to perform its own audit work with High Cost beneficiaries.

With respect to the 65 OIG High Cost audits performed in 2006-2007, the draft GAO report states that "USAC found that the [H]igh [C]ost Program had an estimated 16.6 percent rate of improper payments."<sup>10</sup> In addition, the draft report states, "USAC maintained this error rate was primarily indicative of carrier non-compliance with program rules and not a result of payments made to carriers for inaccurate amounts."<sup>11</sup> The FCC OIG, not USAC, reported the estimated erroneous payment

<sup>9</sup> GAO Draft Report, page 35.

<sup>10</sup> *Id.*

<sup>11</sup> GAO Draft Report, page 36.



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rate was 16.6 percent. In addition, the FCC OIG reported that there was “general compliance with FCC rules and regulations” in the program.<sup>12</sup> None of the 65 audits indicated fraudulent activity.

Of the 65 High Cost Program audits conducted, 12 were disclaimed by the auditing firm where the firm concluded the carrier lacked sufficient documentation for costs associated with continuing property records.<sup>13</sup> For these disclaimed audits, the OIG considered the entire amounts disbursed as improper payments. USAC is working to determine the true amount of funds that may be subject to recovery or further action. Of the remaining 53 audits performed, 45 received unqualified opinions, five received qualified opinions, and three received adverse opinions. Among the 53 providers for which the auditors did provide opinions, the erroneous payment rate was 6.0%.<sup>14</sup> As stated above, USAC is reviewing the disclaimed audits to determine the actual erroneous payment amount for each audit, which is anticipated to be only a subset of the entire payment amount used by the FCC OIG in its report.

The draft GAO report also states that only seven of the 50 state regulatory commissions that responded to GAO’s survey conduct their own audits of incumbent carriers while even fewer state regulatory commissions conduct audits of competitive carriers.<sup>15</sup> The results of the GAO survey show that only four of 48 state regulatory commissions perform audits of competitive wireline carriers and only two of 48 state regulatory commissions perform audits of competitive wireless carriers.<sup>16</sup> Even in cases where states do perform High Cost audits, USAC is not necessarily aware of such activities. Because there is no requirement that USAC be notified of state audits, USAC is rarely informed of audit results.

#### Carrier Data Validation

Data validation is the primary tool used to ensure the accuracy of the data submitted by carriers that receive High Cost support. The GAO draft report finds that current data validation processes performed by USAC, the National Exchange Carrier Association (NECA), and the FCC are primarily focused on the completeness, not the accuracy, of the data provided by carriers.<sup>17</sup> USAC performs, to the extent possible, extensive trending validations to ensure data accuracy to the extent possible. Absent a full-scale audit, it is difficult to determine the level of accuracy of the information provided by the carriers. In 2005, USAC suggested the Commission authorize USAC

<sup>12</sup> *Federal Communications Commission Office of Inspector General, High Cost Program, Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits*, page 27 (October 3, 2007) (*OIG High Cost Report*).

<sup>13</sup> No High Cost Program record retention rule were promulgated and made effective by the Commission at the time of the FCC OIG audits of 2006-2007.

<sup>14</sup> *Universal Service Report on the Federal Communications Commission Office of Inspector General 2006-07 Universal Support Fund Audit Report*, December 2007, page 13.

<sup>15</sup> *GAO Draft Report*, page 36.

<sup>16</sup> *GAO Survey Results*.

<sup>17</sup> *GAO Draft Report*, page 37.

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**Appendix IV: Comments from the Universal  
Service Administrative Company**

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to receive cost study data and other documentation supporting annual filings and quarterly revisions filed by carriers with NECA pursuant to 47 C.F.R. Part 36.<sup>18</sup> USAC does not seek to assume Part 36 data collection and associated administrative responsibilities, but requested that it be authorized to receive copies of the underlying data submitted by carriers to NECA that is used in the support calculations. USAC's access to this data would enable data reviews and verifications that cannot be performed by USAC today.<sup>19</sup>

USAC appreciates the opportunity to submit its response to the draft report on the High Cost Program. Please contact me if you have questions.

Sincerely,

/s/ Karen Majcher

Vice President  
High Cost and Low Income Division

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<sup>18</sup> See *In the Matter of Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, CC Docket 96-45, *Comments of Universal Service Administrative Company*, filed October 18, 2005, pages 152-53.

<sup>19</sup> USAC's Letter of Additional Steps to Reduce Improper Payments, dated February 28, 2008.

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# Appendix V: GAO Contact and Staff Acknowledgments

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## GAO Contact

Mark L. Goldstein, (202) 512-2834, or [goldsteinm@gao.gov](mailto:goldsteinm@gao.gov)

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## Staff Acknowledgments

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