

July 2012

# TELECOMMUNICATIONS

## FCC Has Reformed the High-Cost Program, but Oversight and Management Could be Improved



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## Why GAO Did This Study

The high-cost program within the Universal Service Fund (USF) provides subsidies to telecommunications carriers that serve rural and other remote areas with high costs of providing telephone service. The annual program cost has grown from \$2.6 billion in 2001 to over \$4 billion in 2011, primarily funded through fees added to consumers' phone bills. The program is managed by the Federal Communications Commission (FCC), which noted that providing universal access to broadband is "the universal service challenge of our time."

Accordingly, FCC made changes to the program to make funds available to support both telephone and broadband. GAO previously reported that using USF monies for broadband could cause the size of the fund to greatly expand unless FCC improved its management and oversight to ensure the program's cost-effectiveness. This requested report examines FCC's (1) plans for repurposing the high-cost program for broadband, and (2) plans to address previously identified management challenges as it broadens the program's scope. GAO reviewed and analyzed pertinent FCC orders, associated stakeholder comments, and reports related to USF and interviewed federal and industry stakeholders, as well as economists and experts.

## What GAO Recommends

FCC should (1) establish a specific data-analysis plan for carrier data to determine program effectiveness, and (2) consult with the Joint Board as it examines the factors for calculating carrier support payments. FCC concurred with the recommendations and provided technical comments.

View [GAO-12-738](#). For more information, contact Mark Goldstein at (202) 512-2834 or [goldsteinm@gao.gov](mailto:goldsteinm@gao.gov).

## TELECOMMUNICATIONS

### FCC Has Reformed the High-Cost Program, but Oversight and Management Could be Improved

## What GAO Found

Under the USF Transformation Order, FCC adopted new rules to fundamentally change the high-cost program by extending the program to support broadband capable networks. For example, FCC established a \$4.5-billion annual program budget for the next 6 years, created new funds—called the Connect America Fund and the Mobility Fund—that will support broadband deployment, and established public interest obligations for the carriers as a condition of receiving funds. Specifically, FCC will require carriers to offer broadband services in their supported service areas, meet certain broadband performance requirements, and report regularly on associated broadband performance measures. FCC also changed its method for distributing funds to carriers to address some of the recognized inefficiencies with the program. According to FCC, these changes will allow it to reduce high-cost support for carriers providing only voice services and make funds available to carriers to offer both voice and broadband services.

FCC has taken several steps to address previously identified oversight and management challenges that GAO and the Office of Management and Budget (OMB) have raised in the last 7 years, but issues remain. Management challenges identified by GAO included a lack of performance goals and measures for the program and weak internal controls, while OMB criticized FCC's inability to base funding decisions on measurable benefits. In response, FCC established performance goals and measures for the high-cost program and improved internal control mechanisms over the fund. While these are noteworthy actions, GAO identified gaps in FCC's plans to better oversee the program and make it more effective and efficient. In particular, FCC has not addressed its inability to determine the effect of the fund and lacks a specific data-analysis plan for carrier data it will collect. Such analysis would enable FCC to adjust the size of the Connect America Fund based on data-driven evaluation and would allow Congress and FCC to make better informed decisions about the program's future and how program efficiency could be improved.

GAO also found that FCC lacks a mechanism to link carrier rates and revenues with support payments. A requirement in statute is for rates for telecommunications services to be reasonably comparable in rural and urban areas, but FCC has noted that some rural carriers are offering basic local rates for telephone services that are lower than the average basic rate paid by urban consumers. FCC has stated that it is not equitable for all consumers to subsidize the cost of service for some consumers who pay local service rates that are significantly lower than the national average and has therefore instituted an incentive mechanism for carriers to increase artificially low consumer rates. Although FCC would like to prevent consumers from subsidizing carriers that offer service at artificially low rates, its incentive mechanism to raise rural rates will not reduce the financial burden placed on all consumers as there is currently no connection between the support payments a carrier receives and the carrier's rates and revenues. The Federal-State Joint Board on Universal Service recommended that FCC consider a carrier's revenues when calculating its need for support payments, but in the past, FCC declined to implement this recommendation. FCC is developing a new model to calculate carrier support, but has not stated what factors will be included.

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**Abbreviations**

FCC	Federal Communications Commission
Joint Board	Federal-State Joint Board on Universal Service
OMB	Office of Management and Budget
NASUCA	National Association of State Utility Consumer Advocates
NECA	National Exchange Carrier Association
USAC	Universal Service Administrative Company
USF	Universal Service Fund

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United States Government Accountability Office  
Washington, DC 20548

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July 25, 2012

The Honorable Henry A. Waxman  
Ranking Member  
Committee on Energy and Commerce  
House of Representatives

The Honorable Anna G. Eshoo  
Ranking Member  
Subcommittee on Communications and Technology  
Committee on Energy and Commerce  
House of Representatives

The Honorable Edward J. Markey  
House of Representatives

Federal policy has long called for making affordable residential telephone service available to the greatest possible number of Americans—a policy known as “universal service.” The nation’s Universal Service Fund (USF), managed by the Federal Communications Commission (FCC), includes four programs that subsidize telecommunications carriers that provide telephone and other communications services. Since 1998, USF has distributed about \$81.7 billion to carriers in all 50 states, the District of Columbia, and all U.S. territories. The USF programs are funded through mandatory payments from companies providing telecommunications services—payments usually passed along to consumers as a line item fee on their telephone bill. The USF program with the largest amount of annual expenditures, the high-cost program, provides subsidies to telecommunications carriers that serve rural, remote, and other areas where the costs of providing telephone service are high.<sup>1</sup> 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 those areas. In the past few years, significant growth of the fund has raised concerns about what the program is accomplishing, whether the fund can be sustained over the long term, and the cost burden it imposes

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<sup>1</sup>The high-cost program is the subject of this report. The other three USF programs subsidize telecommunication carriers that serve low-income consumers, schools and libraries, and rural health care providers. For more information on the USF programs, see the “related products” page at the end of this report.

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on consumers. Much of the increase in USF has been the result of growth in the high-cost program. In particular, the annual amount of money disbursed by the high-cost program has increased 54 percent in the last decade, growing from \$2.6 billion in 2001 to over \$4 billion in 2011.

While the high-cost program has traditionally supported telephone service, FCC adopted new program rules to enable program funds to support both telephone and broadband deployment. Broadband service is increasingly viewed as a critical component of the nation's physical infrastructure and a key driver of economic growth. Both the current and former Presidents and Congress have recognized that important policy goals are to ensure the universal availability of infrastructure necessary to provide broadband service and the ability of all citizens to subscribe to it. In early 2009, Congress directed FCC to develop a broadband plan to ensure that every American has access to broadband capability.<sup>2</sup> Congress required that this plan include a detailed strategy for achieving affordability and maximizing use of broadband. In March 2010, an FCC task force issued the *National Broadband Plan*, which recommended reforming USF so that it could support both telephone and broadband service.<sup>3</sup> The *National Broadband Plan* noted that 14 million Americans either have inadequate or no access to residential fixed broadband, and FCC characterized providing universal access to broadband as "the universal service challenge of our time." As such, FCC has made changes in the distribution and use of the high-cost program funds to make them available to support both telephone service and broadband deployment. These changes are outlined in an order released in November 2011, in which FCC said it "comprehensively reforms and modernizes" the universal service system to ensure that affordable voice and broadband service are available throughout the nation.<sup>4</sup> However, there are several legal challenges to FCC's authority to use USF monies for deploying broadband-capable networks.

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<sup>2</sup>Congress required FCC to develop a broadband plan and to report annually on the state of broadband availability. American Recovery and Reinvestment Act, Pub. L. No. 111-5, §6001(k)(1), 123 Stat. 115, 515 (2009).

<sup>3</sup>Federal Communications Commission, *Connecting America: The National Broadband Plan* (Mar. 16, 2010).

<sup>4</sup>We refer to this order as the USF Transformation Order. *Connect America Fund et al., WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking*, 26 FCC Rcd 17663 (2011).

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We previously reported that using USF monies for broadband deployment could cause the size of the fund to greatly expand unless policymakers reexamined its purpose, design, and management, and unless FCC improved its management and oversight processes to ensure the program's cost-effectiveness. In prior reports on FCC's management of USF, we noted long-standing weaknesses, including that FCC had neither undertaken a data-driven approach to overseeing USF nor established performance goals and measures for its programs. Specifically related to the high-cost program, we reported in 2008 that the significant program growth had raised concerns about what the program was accomplishing, whether it had clear objectives, and whether it had effective controls over expenditures.<sup>5</sup>

In response to your request to assess FCC's efforts to repurpose USF for broadband deployment, we examined (1) FCC's plans for repurposing the USF high-cost program for broadband services and (2) how FCC is planning to address previously identified oversight and management challenges as it broadens the program's scope.

To address these objectives, we reviewed and analyzed FCC's 2011 USF Transformation Order and associated stakeholder comments and reviewed our past reports and academic literature related to USF. We also interviewed officials from FCC, the Universal Service Administrative Company (USAC),<sup>6</sup> the National Exchange Carrier Association (NECA),<sup>7</sup> and the National Association of State Utility Consumer Advocates (NASUCA).<sup>8</sup> We met with associations representing the telecommunications industry and state regulatory commissions, and economists from academia and the telecommunications industry

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<sup>5</sup>GAO, *Telecommunications: FCC Needs to Improve Performance Management and Strengthen Oversight of the High-Cost Program*, [GAO-08-633](#) (Washington, D.C.: June 13, 2008).

<sup>6</sup>USAC is the not-for-profit corporation that administers USF programs under FCC's direction.

<sup>7</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. NECA collects cost and line count data from its members and validates this information.

<sup>8</sup>NASUCA is an association of 44 consumer advocates in 40 states and the District of Columbia. NASUCA's members are designated by the laws of their respective jurisdictions to represent the interests of utility consumers before state and federal regulators and in the courts.

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recognized for their thorough knowledge of universal service. We identified experts and industry stakeholders based on prior published literature and other stakeholders' recommendations. We limited the scope of our review to the USF high-cost program because in the USF Transformation Order, FCC focused on repurposing the high-cost program to support broadband.<sup>9</sup> We did not review FCC's reform efforts related to intercarrier compensation.<sup>10</sup> Further details of our scope and methodology are provided in appendix I.

We conducted this performance audit from September 2011 to July 2012 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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## Background

The Communications Act of 1934 first established the nation's telecommunications policy, including making communications services available "so far as possible, to all the people of the United States." Since the cost of providing telephone service in rural areas is generally higher than the cost of providing service in central cities of metropolitan areas, universal service policy has traditionally targeted financial support to rural and other high-cost areas. In the Telecommunications Act of 1996 (the 1996 Act), Congress specified that consumers in "rural, insular, and high-cost areas" should have access to telecommunication rates and services that are "reasonably comparable" to consumers in urban areas.<sup>11</sup> The 1996 Act established a Federal-State Joint Board on Universal Service (Joint Board), which is composed of three FCC commissioners, four state regulatory commissioners, and a consumer advocate. The Joint Board

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<sup>9</sup>In February 2012, FCC adopted new rules for another USF program that includes developing a pilot to determine how USF monies could be used to increase broadband adoption among low-income consumers. *Lifeline and Link Up Reform and Modernization et al.*, Report and Order and Further Notice of Proposed Rulemaking, WC Dkt. Nos. 11-42 et al., CC Dkt No. 96-45, FCC 12-11, para. 515 (rel. Feb. 6, 2012).

<sup>10</sup>In the USF Transformation Order, FCC also reformed the intercarrier compensation system. Intercarrier compensation refers to a system of payments between carriers for the origination, transportation, and termination of telecommunications traffic.

<sup>11</sup>47 U.S.C. § 254(b)(3).

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makes recommendations to FCC on implementing the universal service related provisions of the 1996 Act.<sup>12</sup> The 1996 Act also altered the federal mechanism for funding universal service by requiring telecommunications carriers and other entities providing interstate telecommunications service to contribute to USF, unless exempted by FCC.<sup>13</sup> The carriers generally pass these costs on to customers, sometimes in the form of a line item on customer's telephone bills. According to FCC, the average cost to each household in America is about \$2.73 per month.<sup>14</sup> The contributions are deposited into the USF and distributed to the telecommunications carriers that provide service.

USF provides financial support (i.e., subsidies) through four different programs, each targeting a particular group of telecommunications users (see table 1). In 2011, support for the four programs totaled \$8 billion, and the high-cost program accounted for the largest amount of support—\$4 billion, or 50 percent of USF support. The high-cost program directly and indirectly supports basic telephone (i.e., fixed wireline), broadband, and wireless telephone (i.e., mobile) services. To make these services universally available, the high-cost program offers support to both wireline and wireless carriers operating in high-cost areas—generally rural—to offset costs, thereby allowing these carriers to provide rates and services that are comparable to the rates and services that consumers in low cost areas—generally urban—receive.<sup>15</sup> Consequently, while urban consumers pay the full cost of their service, many rural consumers receive services that are subsidized by the high-cost fund.

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<sup>12</sup>FCC does not have to implement the recommendations made to it by the Joint Board but it is required to consider them.

<sup>13</sup>47 U.S.C. § 254(d).

<sup>14</sup>This calculation is based on the total size of the USF divided by the number of households, but since USF contributions are also assessed to businesses, FCC believes the average cost to each household is likely to be less than \$2.73 per month.

<sup>15</sup>Wireline carriers are providers of traditional landline telecommunications services involving connections to the public switched telephone network by wire (or fiber) local loops that terminate in fixed locations at customer premises, such as residences. Wireless carriers are providers of wireless telecommunications services, operating with electromagnetic waves, such as providing cellular phone service.

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

Program	Description	Calendar year 2011 disbursements (in millions)
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.	\$4,031
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.	2,232
Low income	Assists qualifying low-income customers through discounted installation and monthly telephone services and free toll limitation service.	1,750
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.	82

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

The USF support a carrier can receive depends on various factors, including its status as either the incumbent or a competitor, and the number of lines it claims in its service territory. Incumbent carriers are telephone carriers for a given service area that were in existence when Congress passed the 1996 Act and were members of NECA. These incumbent carriers are further classified as either “rural”—generally small carriers serving primarily rural areas—or “nonrural”—generally large carriers serving both rural and urban areas. Many small rural carriers are subject to rate-of-return regulation, while nonrural carriers are usually larger and subject to price-cap regulations and provide service to approximately 95 percent of U.S. households, according to FCC officials.<sup>16</sup>

Federal and state governments play a role in implementing the federal high-cost program, as do not-for-profit corporations and associations. FCC has overall responsibility for the federal high-cost program, including making and interpreting policy, overseeing program operations, and ensuring compliance with its rules. However, FCC delegated to USAC

<sup>16</sup>Rate-of-return regulation is a form of rate regulation wherein the carrier is allowed to recover its costs and earn a predetermined rate (or profit). Price-cap regulation is a form of rate regulation wherein the carrier may charge rates for regulated services up to an allowable cap, which is adjusted based on factors beyond the carrier’s control, such as inflation.

responsibility to administer the day-to-day operations of the high-cost program. State regulatory commissions hold the primary responsibility to determine carrier eligibility for program participation (i.e., states designate eligibility status of carriers) and to annually certify that carriers will appropriately use high-cost program support.<sup>17</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 USF</li> <li>• Oversees program administration and finances</li> <li>• Designates eligibility status of some carriers to receive universal service support, including some carriers serving Tribal lands</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>• Collects and validates line count data from carriers</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>• Designate eligibility status of most carriers to receive universal service support</li> <li>• Annually certify that beneficiaries in their jurisdictions will use high-cost program support appropriately</li> <li>• Some states may designate and certify wireless carriers</li> <li>• Some states audit carriers</li> </ul>

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

The 2010 *National Broadband Plan* provided a road map for FCC to reform the high-cost program, among other USF programs, to ensure that all Americans have access to broadband-capable networks. The *National*

<sup>17</sup>FCC also designates eligibility status of some carriers to receive high-cost program funds.

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*Broadband Plan* concluded that millions of Americans do not have access to broadband infrastructure at the target of 4 megabits per second (Mbps) download and 1 Mbps upload.<sup>18</sup> The plan recommended, among other things, creating a Connect America Fund to address broadband availability gaps in unserved areas. The plan also recommended creating a Mobility Fund to provide support for deployment of a wireless network. As we previously reported, implementing the plan's recommendations and ensuring universal broadband availability will be challenging, and it remains to be seen whether and how effectively FCC will be able to address these challenges and implement the plan's recommendations.<sup>19</sup>

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## FCC Aims to Improve Efficiency and Provide Support for Broadband through Changes to the High-Cost Program

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### FCC Adopted New Rules to Support Broadband

FCC adopted new rules to fundamentally change the high-cost program by extending the program to support broadband capable networks. According to FCC, the new rules will not adversely affect traditional voice services; rather the changes will ensure that affordable voice and broadband services are available to all Americans by 2017. The new rules also addressed multiple recommendations from the *National Broadband Plan*. See appendix III for the status of FCC's efforts related to those recommendations and a timeline for implementing the new rules. In adopting the USF Transformation Order, FCC said it would control the size of the fund as it transitions to support broadband and require

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<sup>18</sup>Broadband connections in the U.S. can provide speeds exceeding 1 Mbps both upstream (data transferred from the consumer to the Internet service provider, also known as upload) and downstream (data transferred from the Internet service provider to the consumer, also known as download).

<sup>19</sup>GAO, *Telecommunications: National Broadband Plan Reflects the Experiences of Leading Countries, but Implementation Will Be Challenging*, [GAO-10-825](#) (Washington, D.C.: Sept. 14, 2010).

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accountability from carriers receiving support to ensure that public investments are used wisely to deliver intended results. The order outlines the following rules intended to improve the high-cost program and enable it to support broadband capable networks:

**Establishing a program budget for the first time.** FCC set a budget of \$4.5 billion annually over the next 6 years by taking a number of actions, including placing a cap on total per-line support, freezing certain support for service providers at current levels, eliminating or phasing down certain types of support, and setting caps for rate-of-return carriers' capital and operating expenses. FCC also established an automatic review trigger if the program budget is threatened to be exceeded. Specifically, the USF Transformation Order states that if program demand exceeds the annualized \$4.5 billion budget over any consecutive 4 quarters once fund reserves are exhausted, FCC will initiate a process to bring demand back under budget.<sup>20</sup> According to FCC, the \$4.5 billion, which was set at the 2011 estimated level of support, will provide a predictable funding level for carriers and protect consumers and businesses that ultimately pay for the fund as FCC expands the program to support broadband.<sup>21</sup> In the past, the high-cost program was not constrained by a specified level of funding and we and other stakeholders have previously raised concerns about the growing size of the program. The *National Broadband Plan* recommended that FCC try to keep the overall size of the fund close to its current size (in 2010 dollars) and FCC stated that the budget will help to ensure that consumers will not pay more in contributions given the new program rules.

**Creating the Connect America Fund.** FCC created the Connect America Fund, which will ultimately replace the high-cost fund, to make both wireline and wireless broadband available in unserved areas. Within the Connect America Fund, FCC established support for mobile voice and broadband services, recognizing that promoting universal availability of mobile services is a vital component of universal service. Specifically, FCC established the Mobility Fund, which is the first universal service

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<sup>20</sup>For the years 2012-2017, USAC will forecast total high-cost universal service demand as no less than \$1.125 billion. When the demand for high-cost funds is less than \$1.125 billion, the excess funds will become the fund's reserves and will be used to make up the difference when demand exceeds \$1.125 billion in a quarter.

<sup>21</sup>It should be noted that FCC's budget for the high-cost program is not the same as a firm cap, since unlike a firm cap, the \$4.5 billion budget can be exceeded.

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mechanism dedicated to ensuring availability of mobile voice and broadband services in areas where service is currently not available. In 2012, FCC dedicated \$300 million (one-time) for extending wireless coverage in unserved areas and \$500 million annually for ongoing support for mobile voice and broadband service.

**Establishing public interest obligations for all eligible carriers.**

Previously, carriers were required to meet state public interest obligations and limited federal duties as eligible telecommunications carriers to receive USF support payments; however, carriers were not required to meet any specific performance standards in exchange for receiving the funds.<sup>22</sup> Under the USF Transformation Order, FCC requires all carriers to offer broadband services in their supported service areas, meet certain broadband performance requirements, and report regularly on associated broadband performance measures. For instance, one of the broadband performance requirements is for carriers providing service to fixed locations to offer actual download speeds of at least 4 Mbps and upload speeds of at least 1 Mbps to broadband subscribers.

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**FCC Is Implementing Changes to Its Funding Distribution to Improve Program Efficiency**

In the USF Transformation Order, FCC changed its method for distributing funds to carriers to address some of the recognized program inefficiencies. According to FCC, these changes will allow it to reduce high-cost support for carriers providing only voice services and make funds available to carriers for the deployment of both voice and broadband-capable networks. Since many of these changes have yet to be implemented, it is too early to assess their effectiveness. In the order, FCC took the following actions:

**Eliminated the identical support rule.** To encourage competition among carriers in rural areas, in 1997 FCC enacted the identical support rule. At that time, FCC concluded that it would be inconsistent with the statute and the competitive goals of the 1996 Act to exclude any providers (regardless of the technology used for providing voice service) from receiving universal service support and therefore determined that universal service support should be available to all carriers that met the

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<sup>22</sup>Some carriers were required to meet state-defined obligations for carriers of last resort, which include among other things, providing reliable service on nondiscriminatory terms at rates set by the state commission. Although there were no federal carriers of last resort obligations, carriers receiving USF support payments were conditioned to meet limited requirements, such as providing single phone line service and touch-tone dialing.

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eligibility requirements, including competitive carriers that offered service via satellite or other wireless technology. Under this model, incumbent carriers received support based on their costs of providing service in an area or from FCC's cost model and competitive carriers received the same amount of support per line served as the incumbent, regardless of whether the competitor needed that same amount of support to provide service. FCC assumed that high-cost support would be given to the most efficient and competitive carriers providing fixed, wireline telephone service (not mobile wireless providers), as they attracted customers from the incumbent carriers in a competitive marketplace. FCC anticipated that as the number of subscribers taking service from a more efficient competitor increased, the number of subscribers taking service from the incumbent would decrease, thereby decreasing the amount of support FCC paid to the incumbent providers. However, the vast majority of support payments for competitors went to wireless carriers and rather than providing a complete substitute for traditional wireline service, wireless competitors largely provided mobile voice service to customers who also had wireline service. Thus, FCC ended up paying support for both incumbents and competitors serving the same area, which caused disbursements from the fund to increase dramatically.

In the USF Transformation Order, FCC acknowledged that the existing system of providing high-cost support to competitive carriers that were serving the same customers as the incumbent providers was inefficient and the identical support rule failed to efficiently target support payments to where they were most needed. By eliminating the identical support rule, FCC can stop paying competitive carriers providing voice services and make those funds available for fixed and mobile voice and broadband services in targeted areas, including areas unserved by broadband. Several of the stakeholders and economists we contacted supported FCC's decision to eliminate the identical support rule, noting that it was inefficient and ineffective. Starting January 1, 2012, FCC froze support for each competitive carrier at the 2011 monthly baseline amount. Beginning July 1, 2012, FCC stated it would reduce support for each competitive carrier by 20 percent annually for the next 5 years, with the aim of fully eliminating support by July 1, 2016.

**Eliminated support in areas with 100 percent overlap.** FCC also eliminated high-cost support for incumbent carriers in areas where an unsubsidized competitor—or a combination of unsubsidized competitors—also provides voice and broadband in the same service area, known as 100 percent overlap. During the course of its proceedings, FCC found that in many areas of the country, the high-cost

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program provided more support than necessary to achieve its goals by “subsidizing a competitor to a voice and broadband provider that was offering service without government assistance.” Significant improvements in technology have made it possible for some cable operators to offer many services, including both voice and broadband. As such, cable operators have become unsubsidized competitors, offering both voice and broadband services in the same service areas as incumbent carriers. A report commissioned by the National Cable and Telecommunications Association found that \$504 million of high-cost support went to 277 rural incumbent carriers’ service area in which unsubsidized cable voice service was available to more than half of all households. The report also found that in many areas, cable operators offer voice service to more than 75 percent of the households, and in some cases they offer service to 90-100 percent of households in an incumbent carriers’ study area.<sup>23</sup> Documents FCC made available to a congressional committee also showed evidence that other carriers, both wireless and wireline, provide service in high-cost areas but do not receive high-cost support.<sup>24</sup> For example, in an area in which the incumbent carrier received \$1.7 million (almost \$13,000 per line) annually in 2009, four wireless carriers provided voice service to more than 90 percent of that carrier’s service area without receiving USF support.

FCC acknowledged that providing high-cost support in areas of the country where another voice and broadband provider offers high-quality service without government assistance is an inefficient use of high-cost support, and therefore plans to eliminate support in areas with 100 percent overlap service. An economist we contacted raised concerns on how FCC will identify and eliminate support for incumbent carriers in areas where unsubsidized competitors provide coverage. Details on the methodology and data to be used for determining overlap areas are currently unknown, but FCC plans to phase out, over a 3 year period, all support for incumbent carriers in those areas where unsubsidized

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<sup>23</sup>Jeffrey A. Eisenach, *Universal Service Subsidies to Areas Served by Cable Telephony*, (November 2009).

<sup>24</sup>In June 2010, the Committee on Energy and Commerce, U.S. House of Representatives, requested that FCC provide a list of the top 10 recipients of high-cost support and the amount of support received, in total and by subscriber line, and the list of competitors providing service in that area that did not receive high-cost support for years 2007-2009.

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competitors offer voice and broadband services for 100 percent of the residential and business locations in the incumbent's service area.<sup>25</sup>

**Price-Cap and Rate-of-Return Regulation**

Carriers have traditionally been regulated by state commissions to ensure that prices charged to consumers were fair and reasonable. Today, carriers are regulated either on the price they charge customers for regulated services, referred to as "price-cap carriers," or on the rate of return they are allowed to earn from their investments, referred to as "rate-of-return carriers." Price-cap carriers serve about 95 percent of telephone subscribers, serving primarily urban and some rural areas. Rate-of-return carriers serve smaller, rural areas.

**Established a new method to distribute funds to price-cap carriers.**

Prior to the USF Transformation Order, FCC distributed high-cost support to price-cap carriers through multiple mechanisms: for example, in some areas FCC used a cost model to determine the costs of providing service in a specific area, while in other areas, support was based on actual cost of service. FCC recognized that this method of distributing high-cost funds needed to be changed to accelerate broadband deployment in unserved areas. Therefore, FCC changed the rules to (1) freeze the amount of high-cost support distributed to the price-cap carriers at the 2011 support level, and (2) starting when there are model-set support amounts and auction rules in place (which FCC anticipated would be in January 2013) and for the next 5 years, employ a new model and competitive bidding to support networks that can provide both voice and broadband services.<sup>26</sup> Specifically, FCC plans to develop a model that can be used for each census block in high-cost areas to determine the amount of support required to extend and sustain a broadband-capable network. Each incumbent price-cap carrier will have the opportunity to accept the annual support derived from the model in each state in which it operates. In exchange for accepting the support, a carrier must continue providing voice service, commit to deploying broadband service, and meet public interest obligations associated with all the eligible census blocks in its territory. If an incumbent price-cap carrier declines, then FCC will put the service area up for competitive bid. The winning bidder will be required to provide voice and broadband services, and will receive the amount of support the carrier bid to provide service.<sup>27</sup>

Stakeholders we contacted had mixed views on FCC's plans for using both a model and competitive bidding. Several economists we

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<sup>25</sup>This phase down period will start once FCC establishes a methodology for determining areas of overlap and publishes a list of companies for which there is 100 percent overlap. These issues are part of a pending Further Notice.

<sup>26</sup>FCC also made an additional \$300 million in incremental support available to incumbent price-cap carriers to encourage immediate broadband build-out.

<sup>27</sup>The carrier who proposes the lowest bid will be able to deploy the broadband-capable network in that area and receive high-cost support payments. FCC sometimes refers to this competitive bidding process as a "reverse auction" since the lowest bid wins.

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interviewed commented that while FCC's planned model may be an improvement over the previous distribution mechanism, it may not be the most effective way for distributing support because using a model is data intensive and requires accurate and reliable data from carriers. On the other hand, telecommunications stakeholders commented that if the variables used in the model are relatively accurate, the model may ensure that support is properly targeted to the areas most in need.

**Changed the method for determining support levels for rate-of-return carriers.** Prior to the USF Transformation Order, rate-of-return carriers received funding from the high-cost fund based on their actual costs. Under the old rules, some carriers were reimbursed for up to 100 percent of their eligible expenditures, faced no FCC imposed limits, and had no incentive to be more efficient.<sup>28</sup> Under the new rules, FCC is taking multiple actions to target support for investments in broadband, increase accountability, and increase incentives for efficient use of public resources. The reform measures include limiting reimbursements for capital and operating expenses, and establishing an overall cap on the amount of support, totaling \$250 per line per month, or \$3,000 annually. The cap will be phased in over a 3-year period. Some economists we spoke with commented that it does not go far enough to make the mechanism more efficient. Two economists told us that if the reform were to have any impact, the cap needed to be further reduced to \$100 per line per month.<sup>29</sup>

FCC has also adopted a rule to limit support to carriers whose end-user rates (i.e., basic telephone rates that carriers charge their customers) do not meet a local rate floor. During the course of its proceedings, FCC found that some carriers receiving high-cost support were offering basic voice plans as low as \$5 per month, in comparison to the 2008 national average local rate of \$15.62. The law requires that urban and rural rates be reasonably comparable, which FCC has implemented by requiring that rural consumers pay no more than two standard deviations<sup>30</sup> above the

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<sup>28</sup>*Connect America Fund; High-Cost Universal Service Support*, WC Docket Nos. 10-90, 05-337, Order, DA 12-646 (Wireline Comp. Bur. rel. Apr. 25, 2012), para. 1 and 2

<sup>29</sup>According to FCC, some 13,500 lines will be affected with the \$250 per line per month cap. If the cap had been set at \$100 per line per month, then about 185,000 lines in 108 service areas would have been affected in 2010.

<sup>30</sup>The term standard deviation refers to how spread out or widely dispersed the values in the sample are from the mean of the sample.

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average of what urban consumers pay for the same level of voice service.<sup>31</sup> To address this inefficiency, FCC has adopted a rule to reduce high-cost support for carriers whose end-user rates for voice service do not meet the local rate floor.

Furthermore, to help ensure that the reform efforts do not adversely affect traditional voice service, FCC developed a waiver process for carriers that contend the reforms will affect their ability to provide reasonably comparable service at reasonably comparable rates if FCC reduces their current support levels. In petitioning FCC for a waiver, a carrier must clearly demonstrate that good cause exists for exempting it from some or all of the reforms, and that the waiver is necessary and in the public interest to ensure that consumers in the area continue to receive voice service. FCC cautioned that those seeking a waiver would be subject to a rigorous review, including an accounting of all revenues that the carrier receives. However, for those carriers receiving a waiver, FCC has not yet determined if it would impose a ceiling on the amount of support a carrier could receive per line.

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## FCC Has Taken Steps to Address Previously Identified Oversight and Management Challenges, but Issues Remain

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### FCC Steps to Address Management Challenges

We and OMB have each issued a report in the last 7 years critical of FCC's management of the high-cost fund and in the USF Transformation Order, FCC has taken several steps to address these challenges. The management challenges we identified included a lack of performance goals and measures for the program and weak internal controls, resulting in FCC's limited ability to oversee the actions of carriers or the data they provide. In 2005, OMB criticized FCC's inability to measure the effect of

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<sup>31</sup>47 U.S.C. § 254 (b)(3).

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the fund on subscribership in rural areas or to base funding decisions on any indication of measurable benefits.<sup>32</sup> To address these challenges, FCC has (1) established performance goals and measures for the high-cost program, (2) improved its internal control mechanisms over the fund, and (3) directed USAC to undertake additional oversight and management actions.

#### Established Performance Goals and Measures

In 2008, we reported that FCC lacked specific performance goals or measures for the high-cost program. OMB reported that the high-cost program neither measures the impact of funds on telephone subscribership in rural areas nor bases funding decisions on measurable benefits. As a result, after spending more than \$41.1 billion in high-cost funds since 2001, we reported that it was still unclear what FCC had achieved through the program. In our report in 2008, we recommended that FCC establish short- and long-term performance goals and measures to make clear the program's intentions and accomplishments.<sup>33</sup>

As shown in table 3, FCC developed five performance goals and three performance measures for the high-cost program in the USF Transformation Order. As of July 2012, FCC was still formulating measures for the remaining two goals.

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<sup>32</sup>OMB. Program Assessment – Universal Service Fund High-Cost <http://georgewbush-whitehouse.archives.gov/omb/expectmore/detail/10004451.2005.html>, (accessed July 3, 2012).

<sup>33</sup>[GAO-08-633](#).

**Table 3: FCC’s Performance Goals and Measures for the High-Cost Program**

<b>Goals</b>	<b>Measures</b>
Preserve and advance universal availability of voice service.	FCC will use the telephone penetration rate, which measures subscription to telephone service.
Ensure universal availability of voice and broadband to homes, businesses, and community anchor institutions.	FCC will collect the number of residential, business, and community anchor institution locations that newly gain access to broadband services. As an efficiency measure, FCC will use the change in the number of homes, businesses, and community anchor institutions passed or covered per million USF dollars spent.
Minimize the universal service contribution burden on consumers and businesses.	FCC will divide the amount of the total inflation-adjusted expenditures of the high-cost program and Connect America Fund each year by the number of American households and measure it as a monthly dollar figure.
Ensure universal availability of mobile voice and broadband where Americans live, work, and travel.	FCC has not yet developed measures for this goal.
Ensure reasonably comparable rates for voice and broadband services in all regions of the nation.	FCC has not yet developed measures for this goal.

Source: GAO based on FCC information.

### Improved Internal Control Mechanisms

In 2008, we also reported weaknesses in FCC’s internal control mechanisms, including the carrier certification process, carrier audits, and carrier data validation. State officials’ annual certification of carriers is the primary tool used to determine if carriers are operating according to the high-cost fund’s guidelines. However, because the certification requirements were not standardized across states, carriers have been subject to varying levels of oversight. Audits of carriers are the primary tool used to oversee carrier activities, and audits may be conducted by USAC, state regulatory commissions, or FCC’s Office of Inspector General. In 2008, we reported that from 2002 to 2008, USAC had conducted about 17 audits, from more than 1,400 carriers participating annually in the high-cost program. We also found in a survey that 7 out of 50 state regulatory commissions reported auditing incumbent carriers. Based on these findings, among others, we determined that FCC’s internal controls were weak and that its ability to adequately oversee the high-cost program was hindered. In addition, neither FCC nor USAC had audited the carrier-reported data for accuracy, and they did not follow up to assess whether the actions carriers claimed they were taking with regard to using high-cost support were consistent with the actions they actually were taking. We recommended that FCC identify areas of risk in

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its internal control environment and implement mechanisms to help ensure carriers' compliance with program rules.<sup>34</sup>

In the USF Transformation Order, FCC addressed all three of the areas we discussed in our 2008 report. To standardize the certification requirements and bring more scrutiny to the data reported by carriers, FCC established a national oversight framework that will be implemented as a partnership between FCC and the states, U.S. territories, and tribal governments. This framework will include annual reporting and certification requirements for all carriers receiving universal service funds and is designed to provide federal and state regulators with the information needed to determine whether recipients are using support for the intended purposes. Under the new standards, all carriers must include in their annual reports to FCC and their respective state commissions a progress report on their 5-year build-out plans, data, and explanatory text concerning outages, unfulfilled requests for service, and complaints received. They must also certify compliance with applicable service quality and consumer protection standards and further certify their ability to function in emergency situations.

#### Directed USAC to Undertake Additional Oversight

To address the lack of audits on the part of FCC and USAC, FCC directed USAC to review and enhance two programs that are intended to oversee and safeguard USF.<sup>35</sup> FCC developed these programs in coordination with OMB in 2010 to ensure that recipients of USF support comply with FCC rules, and to prevent and detect waste, fraud, and abuse. FCC expects that these audits will verify the accuracy of the underlying data and address our previously reported concern that FCC does not validate the accuracy of data reported by carriers.<sup>36</sup> Additionally, FCC directed USAC to annually assess compliance with the new requirements established for Connect America Fund recipients and test

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<sup>34</sup>[GAO-08-633](#).

<sup>35</sup> These two programs are called the Beneficiary/Contributor Compliance Audit Program and the Payment Quality Assurance Program.

<sup>36</sup>[GAO-08-633](#).

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the accuracy of carriers' certifications.<sup>37</sup> While these activities may improve FCC's oversight of program funds, it is too soon to assess their effectiveness.

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### Gaps in FCC's Oversight and Management of the High-Cost Program

While FCC has taken steps to address several shortcomings of the high-cost program, our review of the order has identified gaps in FCC's plans to better oversee the program and make it more effective and efficient. Specifically, we determined that FCC lacks (1) a data-analysis plan for carrier data it will collect, and (2) a mechanism to link carrier rates and revenues with USF support payments.

#### Lack of a Data-Analysis Plan for Carrier Data

In the past, FCC had no way to measure the effectiveness of the high-cost program because it did not collect adequate data at the service area level, i.e., a geographic area served by a specific carrier that would allow FCC to measure the effect of the funds by carrier on subscribership levels.<sup>38</sup> As a result, FCC did not know if high-cost funds were achieving their intended purpose. Economists have pointed out that to determine if high-cost funds were achieving their intended purpose, FCC would need to determine whether the provision of funds had caused an increase in the level of subscribership that would not have occurred in the absence of the funds. To assess program effectiveness, FCC would need to collect data showing the outcomes (i.e., the change in the level of telephone subscriptions) in study areas that used these funds as well as the outcomes in study areas where these funds were not used.

Under the USF Transformation Order, FCC will start collecting data from carriers that receive Connect America Fund monies on (1) the amount of funding the carriers received, (2) their build-out of infrastructure for broadband capable networks, and (3) service quality and speed in the

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<sup>37</sup>For the first phase of the Connect America Fund, FCC established a requirement that carriers must have completed build-out to two-thirds of the requisite number of locations within 2 years. FCC also directed USAC to assess compliance with this requirement for each holding company that receives funds during the first phase. According to FCC, any oversight program to assess compliance will be designed to ensure that carriers are reporting accurately and will be designed to test some of the underlying data that forms the basis for a carrier's certification of compliance with various requirements.

<sup>38</sup>Service area is usually the service territory where a telecommunications carrier operates and provides services in one state. Holding companies may own multiple operating companies and thus have multiple service areas in a state.

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level of broadband service provided.<sup>39</sup> According to the order, FCC is collecting the information to monitor progress in achieving its broadband goals and to assist FCC in determining whether the funds are being used appropriately. However, FCC's order does not articulate a specific data-analysis plan for the carrier data it will collect and it is unclear if or how FCC plans to use the data. We have previously noted that sound program evaluation should include a detailed data-analysis plan to track the program's performance and evaluate its final results.<sup>40</sup> Lacking such an evaluation, the achievements and overall effectiveness of the Connect America Fund are less likely to be clear and FCC might not have the analysis to determine what changes should be made to improve the program. Analyzing the carrier data could enable FCC to determine the program's effectiveness because the analysis would provide some definitive examples of the connection between the level of subsidy and the specific demographic factors of the service areas that have shown an increase in broadband access.<sup>41</sup> Furthermore, such analysis would enable FCC to adjust the size of the Connect America Fund based on sound evaluation and would allow Congress and FCC to make better informed decisions about the future of the program and how program efficiency could be improved. Although FCC plans to determine the number of residential, business, and community anchor institution locations that have newly gained access to broadband service per \$1 million spent in USF subsidy, such an evaluation does not provide any direct link between an increase in broadband access and funding subsidies provided by the Connect America Fund. In other words, FCC will know the extent to which broadband access has changed over time, but it will not know what factors have influenced the change.

Lack of a Mechanism to Link Carrier Rates and Revenues with Support Payments

One of FCC's performance goals (and a requirement in statute) is to ensure that rates for broadband and voice services are reasonably comparable in all regions of the country. FCC has defined voice rates as being reasonably comparable if the rural rate is equal to or greater than

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<sup>39</sup>USF Transformation Order, Appendix A, ¶54.313.

<sup>40</sup>GAO, *Telecommunications: FCC's Performance Management Weaknesses Could Jeopardize Proposed Reforms of the Rural Health Care*, [GAO-11-27](#) (Washington, D.C.: Nov. 17, 2010).

<sup>41</sup>FCC noted that this data will not allow direct attribution of improvement in the availability of broadband to the amount of money provided as this would assume that there would not be any investment on the part of the carrier.

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the average urban rate but not by more than two standard deviations. However, in the USF Transformation Order, FCC reported that many rural carriers are offering basic local rates for telephone service that are lower than the average basic local rate paid by urban consumers. In fact, FCC cited data submitted by NECA which summarized 2008 residential rates for over 600 companies — a broad cross-section of carriers that typically receive universal service support — showing that approximately 60 percent of those carriers offered pricing plans that were below the 2008 national average local rate of \$15.62. (According to FCC information published in 2008, if the average urban rate plus federal and state charges were \$25.62, rural rates plus federal and state charges could be as high as \$36.52.) Two of the economists we contacted have written on the inequity of this urban-rural rate difference, stressing that an effect of this inequity could be the transfer of wealth from poor urban consumers who pay into the fund but receive no subsidy, to wealthy rural consumers who benefit from subsidized rates.<sup>42</sup>

To address this discrepancy, the USF Transformation Order required carriers to provide price data for both local telephone rates and broadband service. FCC will begin collecting data in July 2012 regarding rates paid by consumers in rural areas that do not meet the local rate floor. FCC officials told us they are developing a survey of urban rates to obtain more current information than the last urban rate survey, which was published in 2008. Once it obtains these data, it can analyze the extent to which rural consumers pay rates lower than urban consumers. FCC also instituted an incentive for carriers to increase artificially low consumer rates by reducing high-cost support for voice services to those carriers whose customers do not pay an amount equal to a specified local rate floor.<sup>43</sup> In other words, FCC plans to limit high-cost support for carriers to the extent they provide service to consumers at rates below the national urban average.<sup>44</sup> In the USF Transformation Order, FCC justified this reduction by stating that “we do not believe it is equitable for

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<sup>42</sup>Gregory Rosston and Bradley Wimmer, “The ‘State’ of Universal Service,” *Information Economics and Policy* 12, no.3 (2000): 261-283.; Scott Wallsten, *The Universal Service Fund: What do High-Cost Subsidies Subsidize?* (Washington, D.C.: Technology Policy Institute, February 2011).

<sup>43</sup>USF Transformation Order, para 235 & 240.

<sup>44</sup>FCC requires carriers to report the number of customer lines that are less than the average urban rate.

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consumers across the country to subsidize the cost of service for some consumers that pay local service rates that are significantly lower than the national urban average.”<sup>45</sup> FCC officials told us they plan to determine how much carrier revenue would increase if the rural rates increased to the urban rate average. However, because FCC does not include carrier revenues in determining USF support payments for the carriers, FCC will allow carriers that subsequently raise their rates to the national urban average to receive the support payments they were initially denied when their rates were below the specified floor. As a result, FCC’s incentive mechanism to raise rural rates will not result in any reduction in the amount consumers are charged for universal service. Members of the National Association of State Utility Consumer Advocates (NASUCA) we contacted expressed concern that the level of USF support payments is not tied to a carrier’s rates and revenues. They explained that carriers’ revenues come from services other than basic local service, but all of those services are carried over the networks to which consumers have contributed for years through the USF. These revenues are not included in the determination of USF payments that the carriers will receive. In addition, of the six economists we interviewed who are knowledgeable about how universal service support payments are determined, four explicitly mentioned revenues as one of the factors that should be taken into account for modeling the level of support that carriers receive.

In 2007, the Joint Board adopted as a basic principle that USF should exist within a limited budget and made several recommendations to help FCC do so, including considering a carrier’s revenues when calculating its need for USF support. Controlling the growth of the high-cost fund could help FCC achieve its goal of minimizing the universal service contribution burden on consumers and businesses. Similar to the points raised by NASUCA and four of the economists we contacted, the Joint Board believed in 2007 that if broadband was to become a funded universal service, then the mechanisms used to calculate support payments should be revised to take into account the carriers’ net profits from selling broadband to wireline customers. The Joint Board noted that such profits should be measured and used to offset some of the carriers’ claims for explicit USF support. However, in 2008, FCC declined to implement the Joint Board’s recommendation related to considering carrier revenues when calculating support payments. According to the Joint Board, FCC

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<sup>45</sup>USF Transformation Order, para 237.

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did not address why the Joint Board's recommendation had not been adopted.

Under the USF Transformation Order, FCC will consider a carrier's revenue when determining support payments under certain circumstances. In particular, for those carriers that petition for a waiver to exempt the carrier from some or all USF reforms, FCC intends to subject such requests to a rigorous, thorough, and searching review comparable to a total company earnings review. In those cases, FCC intends to take into account not only all revenues derived from network facilities that are supported by universal service, but also revenues derived from unregulated and unsupported services as well. As we noted previously, under the USF Transformation Order, FCC is developing a new model to revise its method for calculating carrier support, since FCC recognized that the prior method of distributing high-cost funds needed to be changed to accelerate broadband deployment in unserved areas. However, FCC has not stated what factors, such as carrier revenues, will be included in the model.<sup>46</sup>

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## Conclusions

FCC has undertaken the difficult task of reforming the high-cost program to make it more efficient and thus able to support both voice and broadband services. In the USF Transformation Order, FCC said it would control the size of USF as it transitions to support broadband and adopted new rules to make the fund more efficient as a way to minimize the universal service contribution burden on consumers and businesses. As FCC looks to broaden the scope of the high-cost program by providing support for broadband capable networks, it is therefore important for FCC to ensure that the limited program funds are used as effectively and efficiently as possible to stem further growth in the fund. Historically, FCC has not collected data at the level economists agree is necessary to determine the overall effectiveness of the high-cost program or demonstrate that the program increased telephone subscribership beyond the level that would have been achieved if there were no subsidy. Rather, FCC has assumed that the subsidies going to carriers were

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<sup>46</sup>FCC plans to complete the model by the end of 2012 and has not yet made the proposed model public. FCC officials believe FCC is not prohibited per se from considering revenues. Rather, FCC would consider the statutory directives, relevant legal precedent, and the record in the relevant FCC proceedings in determining whether support is sufficient but not excessive to achieve the goals of universal service.

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positively affecting subscribership even though it collected no empirical data to support that conclusion. In the USF Transformation Order, FCC instituted performance goals and measures with the intention of ensuring that the reforms achieve their intended purpose, and will require those carriers receiving support from the Connect America Fund to submit additional information. However, FCC has no specific data-analysis plan for the carrier data it will collect. Such analysis could enable FCC to correlate the amount of money spent with the increase in broadband access in specific areas and thus help FCC to determine the effectiveness of Connect America Fund expenditures. Lacking such analysis, the program's achievements and overall effectiveness are less likely to be clear and Congress and FCC might not have the information necessary to make informed decisions about the program's future.

According to statute, urban and rural telecommunication rates should be reasonably comparable, but many rural consumers, whose rates are supported through the high-cost fund, pay rates that are lower than many urban consumers. FCC has stated that it is not equitable for all consumers to subsidize the cost of service for some consumers who pay local service rates that are significantly lower than the national average. In addition, given the way the high-cost program is funded, it is possible that poor urban consumers are subsidizing wealthy rural consumers. To provide an incentive for carriers to raise rates in rural areas, FCC plans to penalize carriers with rates that are too low by reducing the amount of high-cost support they can receive. While this action should help rural and urban rates become more comparable, it will not prevent consumers from subsidizing the cost of service for those areas where rates are too low because FCC will continue to allow carriers to receive the same amount of subsidy once their rates are raised to the urban mean. Therefore, although FCC would like to prevent consumers from subsidizing carriers whose rates for basic local service are artificially low, its incentive mechanism to raise rural rates will not reduce the financial burden placed on all consumers as there is currently no connection between the amount of support payments a carrier receives and the revenue a carrier earns, through rates or any other source. In addition to voicing concern for the potential inequity of rural rates that are lower than urban rates, FCC has a stated goal to minimize the universal service contribution burden on consumers and businesses. The *National Broadband Plan* recommended that FCC keep the overall size of the fund close to its 2010 funding level, and the Joint Board has stated its strong commitment to limit the size of the fund. As a way to control the size of the fund, the Joint Board recommended that FCC consider a carrier's revenues when calculating its need for USF support but FCC declined to implement this

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recommendation. Under the USF Transformation Order, FCC has the opportunity to revisit this issue as it develops a new model to determine the amount of support a carrier should receive, however it has not stated what factors will be included in the model.

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## Recommendations for Executive Action

FCC should take the following two actions:

- To determine the overall effectiveness of the Connect America Fund as well as improve the oversight and transparency of the high-cost program, establish a specific data-analysis plan for the carrier data and make the information publicly available.
- To help minimize the universal service contribution burden on consumers and businesses, as FCC examines and revises the manner in which carrier support payments are calculated, consult with the Joint Board and/or make appropriate referrals to determine what factors, such as carrier revenues, should be considered in the calculation.

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## Agency Comments

We provided a draft of this report to FCC for its review and comment. In response, FCC stated that our recommendations were valuable and noted that it has taken steps to address the oversight and management challenges we previously identified. Specifically, FCC noted that in the USF Transformation Order, FCC has adopted performance goals, set forth requirements to provide voice and broadband service to all Americans, and established a national framework to ensure that recipients who benefit from public investment in their networks have clearly defined public interest obligations and reporting requirements. FCC's written response also included information to further clarify the actions that are currently under way related to the USF Transformation Order. With respect to our first recommendation, FCC agreed that it should establish a specific plan to analyze the data reported by the carriers as a way to improve oversight of the program, and noted it is planning to build on measures adopted in the USF Transformation Order to improve the effectiveness of the new program. Related to our second recommendation, FCC agreed that revenues derived from infrastructure supported by universal service are an important consideration when determining support provided to carriers, and FCC appreciated our suggestion that it work with the Joint Board to implement the reforms in the USF Transformation Order. FCC's written comments are reprinted in appendix II.

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FCC provided technical comments on the draft report that we incorporated as appropriate.

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We are sending copies of this report to the Chairman of FCC and appropriate congressional committees. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff 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 on appendix IV.

A handwritten signature in black ink, appearing to read 'M. Goldstein', with a long horizontal flourish extending to the right.

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 Federal Communications Commission's (FCC) plans to refocus and expand the high-cost program of the Universal Service Fund (USF) to provide support for broadband-capable networks. In particular, the report provides information on (1) FCC's plans for repurposing the USF high-cost program for broadband services and (2) how FCC is planning to address previously identified oversight and management challenges as it broadens the scope of the program.

To understand FCC's plans for repurposing the high-cost program for broadband service, we reviewed and analyzed FCC's USF Transformation Order and associated stakeholder comments. We interviewed officials from FCC, the Universal Service Administrative Company (USAC),<sup>1</sup> and the National Exchange Carrier Association (NECA)<sup>2</sup> on the rule changes outlined in the order and other actions that FCC has taken to repurpose USF to support broadband services in addition to voice services. We analyzed and assessed the previous and planned high-cost program structure and method of distributing funds. We also reviewed and analyzed telecommunications stakeholders' filings and studies on the potential impact of FCC's planned changes to the existing high-cost program. We limited the scope of our review to the USF high-cost program because in the USF Transformation Order, FCC focused on repurposing the high-cost program to support broadband. Although FCC made changes to intercarrier compensation in the USF Transformation Order, we did not review FCC's reform efforts related to intercarrier compensation. Intercarrier compensation refers to the charges that one carrier pays to another carrier to originate, transport, and/or terminate telecommunications traffic. The intercarrier compensation regimes are governed by a complex and different system of federal and state rules than those of universal services; therefore, we decided not to review intercarrier compensation.

To determine how FCC is planning to address previously identified oversight and management challenges as it broadens the scope of the program, we reviewed our past reports, documents from the Office of Management and Budget and FCC's Office of Inspector General, and academic literature related to the high-cost program of USF. We met with

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<sup>1</sup>USAC is the not-for-profit corporation that administers the USF programs.

<sup>2</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.

telecommunications stakeholders, including associations representing consumers, small and large telecommunications carriers, and state regulatory commissions, to obtain their views on FCC’s management of and the changes made to the high-cost program. We identified industry stakeholders based on prior published literature, including filings with FCC, and other stakeholders’ recommendations. We also conducted semi-structured interviews with economists from academia and the telecommunications industry, recognized for their thorough knowledge of universal service. The economists we spoke with were selected based on studies focused on the high-cost program of USF, published within the last 5 years, and recommendations from telecommunications industry stakeholders, including associations representing telecommunications carriers, consumers, and state regulatory commissions. See table 4 for the stakeholders and economists we contacted.

**Table 4: List of Telecommunications Industry Stakeholders and Economists Contacted**

Stakeholder Groups	Stakeholders
Associations representing telecommunications carriers	CTIA -The Wireless Association
	National Telecommunications Cooperative Association (NTCA)
	Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO)
	RCA – The Competitive Carriers Association
	USTelecom Association
Associations representing state regulatory commissions	National Association of Regulatory Utility Commissioners (NARUC)
Consumer advocates	National Association of State Utility Consumer Advocates (NASUCA)
	Public Knowledge
Economists	Michelle Connolly, Duke University
	Bob Loube, Rolka Loube Saltzer Associates
	John Mayo, Georgetown University
	Douglas Meredith, John Staurulakis, Inc.
	Greg Rosston, Stanford University
	Scott Wallsten, Technology Policy Institute

Source: GAO.

We conducted this performance audit from September 2011 to July 2012 in accordance with generally accepted government auditing standards.

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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.

# Appendix II: Comments from the Federal Communications Commission



Federal Communications Commission  
Washington, D.C. 20554

July 12, 2012

Mark Goldstein  
Director, Physical Infrastructure Issues  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Goldstein:

Thank you for the opportunity to review the draft Government Accountability Office (GAO) Report regarding the reforms to and management of the universal service high-cost program. The high-cost program is designed to promote the goal of section 254 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 (the Act), that consumers in rural and other high-cost areas of the country have access to services that are reasonably comparable to those in urban areas, at reasonably comparable rates. The Commission is dedicated to achieving the universal service goals of section 254 of the Act, and therefore welcomes suggestions on making additional improvements to the high-cost program.

GAO's draft report includes two primary recommendations for the Commission to consider as we continue forward with our implementation of universal service reform and our modernization of the program to ensure that voice and broadband service are available throughout the nation. GAO first recommends that we establish a specific plan to analyze the data carriers will be reporting in order to determine the effectiveness of the new programs as well as improve oversight. GAO also recommends that we consult with the Federal-State Joint Board on Universal Service ("Joint Board") to determine what factors, such as carrier revenues, should be considered in support calculations in order to minimize contribution burdens as we proceed with the reform. As discussed in more detail below, we find both GAO recommendations valuable. The Commission's Connect America Fund reforms will directly link universal service funding to broadband expansion for the first time, allowing the Commission to directly determine the effect of the funding. In addition, the Commission's existing regular programs to assess broadband deployment and adoption will provide opportunities to review the impact of the reforms. Nevertheless, we agree with GAO that as carrier data are submitted, it will be valuable for the Commission to review how it will use these reports, and any other necessary reviews, to regularly assess progress. We also agree that carrier revenues are a relevant consideration in determining appropriate support levels that are sufficient but not excessive. Our reforms include a number of measures to take these revenues into account, particularly for price-cap carriers, and we will continue to examine additional reforms to better account for revenues for rate-of-return carriers.

As the draft report recognizes, in the *USF/ICC Transformation Order*, the Commission comprehensively reformed and modernized the high-cost program to ensure that voice and broadband service, both fixed and mobile, are available to Americans throughout the nation. The Commission adopted fiscally responsible, accountable, incentive-based policies to transition the outdated high-cost program to the Connect America Fund, ensuring fairness for consumers and addressing the communications infrastructure challenges of today and tomorrow. The Connect America Fund, which will ultimately replace all existing high-cost support mechanisms, will help make broadband available to homes, businesses, and community anchor institutions in areas that do not, or would not otherwise, have broadband, while preserving voice service. In addition, the Mobility Fund, an essential part of the Connect America Fund, will promote access to mobile voice and broadband service. The Commission

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

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also established a budget of \$4.5 billion for the Connect America Fund, with an automatic review trigger if it appears the budget will be exceeded.

The draft report also acknowledges that the Commission has taken steps to address oversight and management challenges previously identified by GAO and the Office of Management and Budget (OMB). In the *USF/ICC Transformation Order*, the Commission adopted specific performance goals to enable the Commission to determine not just whether the federal funding is used for the intended purposes, but also whether that funding is accomplishing the intended results – including the Commission’s objectives of preserving and advancing voice, broadband, and advanced mobility for all Americans. In addition, the Commission set forth robust and meaningful requirements to provide voice and broadband service to ensure that recipients that benefit from public investment in their networks have clearly defined public interest obligations associated with the use of such funding. The Commission also established a national framework for certifications and reporting requirements for all high-cost recipients to ensure that they are satisfying their public interest obligations, that state and federal regulators have the tools needed to conduct meaningful oversight, and that public funds are expended in an efficient and effective manner.

We appreciate GAO’s recognition of the Commission’s efforts to date to reform the high-cost program, and we agree that the Commission should strive to continue to improve the effectiveness of the high-cost program and improve program oversight. The Commission and its staff are in the midst of implementing the framework established in the *USF/ICC Transformation Order*, and this draft report is timely and helpful in assisting our efforts.

In the draft report, GAO first recommends the Commission establish a specific plan to analyze the data reported by the carriers as a way to improve oversight of the program. We agree with this assessment and are planning to build on measures adopted by the Commission in the *USF/ICC Transformation Order* to improve the effectiveness of the new program.

In the *USF/ICC Transformation Order*, the Commission established a foundation for collecting meaningful data to judge the effectiveness of the support provided and the program as a whole. For example, the Commission adopted threshold reporting and certification requirements that apply to all high-cost recipients, which we intend to use to evaluate the impact of these reforms. The Commission adopted additional, specific reporting requirements for the first phase of the Connect America Fund, for example, requiring both fixed and mobile participants to commit to provide specific levels of service before accepting support, and to satisfy specific build-out requirements. In addition, those recipients will be required to submit reports demonstrating that they are meeting interim benchmarks or “milestones.” Targeting specific levels of support to these services in this way and requiring proof of build-out will allow us to gauge the impact of the program funds throughout the course of these programs. While the contours of the second phase of the Mobility Fund and the Remote Areas Fund are not yet finalized, the Commission contemplated similar commitments from participants in these programs. Finally, outside the universal service context, the Commission also collects data on broadband deployment and adoption which is regularly disseminated through other reports, such as the annual section 706 report that requires the Commission to determine and report annually on whether advanced telecommunications capability is being deployed to all Americans in a reasonable and timely fashion. These other sources of data on deployment will also allow us to evaluate the impact and effectiveness of our universal service reforms. We are committed to analyzing the impact of our reforms on the achievement of our goals for the program as set forth by Congress. Even though we are in the early stages of the reforms, we are cognizant of the importance of reliable and consistent data as a way to measure the success of the reforms and the high-cost program itself. As the Commission and staff develop and refine our data analysis plan

in the months ahead, we will continue to place a premium on collecting and reviewing data submitted by all recipients to improve upon the effectiveness of the program.

GAO also recommends that the Commission consult with the Joint Board as we examine and revise the manner in which high-cost support payments are calculated, including specifically the extent to which carrier revenues should be included in any such calculation. We agree that revenues derived from infrastructure supported by universal service are an important consideration when determining support provided to carriers. The Commission recognized the importance of revenues in the *USF/ICC Transformation Order* when it directed staff to identify areas where the cost of service provided by price cap carriers is greater than can be supported through reasonably comparable end-user rates. The Commission adopted a requirement that no support be provided to such carriers below a cost benchmark; such a benchmark necessarily will require carriers to cover a minimum level of costs with their own revenues from both regulated and unregulated services delivered over the supported network infrastructure. The Commission also anticipated that revenues from services delivered over supported plant for rate-of-return carriers would be a relevant consideration when evaluating carrier requests for waiver of support reductions. Moreover, consistent with the Commission's framework for reform, we will consider other ways to better take into account revenues of rate-of-return carriers as we continue with implementation. In addition, the Order phases in a limit of support to carriers whose end-user rates are below an urban mean.

Likewise, the Commission designed the Mobility Fund in a way that ensures support levels are no greater than necessary. The first phase of the Mobility Fund, for example, will use a reverse auction to set support levels and will incorporate market-based forces to ensure that carriers reveal the lowest amount of support required to provide a service. In developing their bids, carriers will take into account their anticipated revenues and will have strong incentives to bid the lowest amount possible, in order to win such support.

Regardless of the specific ways in which revenues are taken into account, directly or indirectly, in the implementation of the Connect America Fund, the Commission is committed to minimizing the contribution burden on consumers and businesses. The Commission adopted that as an explicit performance goal and took action to ensure that the goal would be achieved by establishing, for the first time, a firm and comprehensive budget for the high-cost program of \$4.5 billion. This budget will provide for more predictable funding for carriers and will protect consumers and businesses that ultimately pay for the fund through fees on their communications bills.

Finally, we appreciate GAO's suggestion that the Commission work with the Joint Board as we implement the reforms in the *USF/ICC Transformation Order*. As the GAO recognizes in the draft report, the Commission followed the Joint Board's recommendation in adopted the principle, pursuant to the Commission's section 254(b)(7) authority, that universal service support should be directed where possible to networks that provide advanced services as well as voice services. Moreover, many of the policy innovations adopted by the Commission in the *USF/ICC Transformation Order* arose from Joint Board discussions and past recommendations, including establishing a budget for the high-cost program of \$4.5 billion, establishing a separate fund dedicated to supporting mobility services, and the gradual elimination of support to competitive carriers under the "identical support rule." In the past, the Joint Board also suggested, and the Commission embraced in the *USF/ICC Transformation Order*, a new rates test as a condition of or an adjustment to cost-based support, providing more limits on support for operating expenses, and targeting support to only one service provider in an area and reducing or eliminating support to areas with multiple providers. The Commission's reforms are significant steps in implementing these past recommendations of the Joint Board, and we will continue our ongoing dialogue with the State Members of the Joint Board.

Thank you again for providing the draft report to us for review and comment. We very much appreciate the recommendations and look forward to working with you in the future.

Sincerely,

A handwritten signature in blue ink that reads "Julie A. Veach". The signature is written in a cursive style with a long, sweeping tail on the letter 'h'.

Julie A. Veach  
Acting Chief, Wireline Competition Bureau

# Appendix III: Federal Communications Commission's Action to Implement *National Broadband Plan* Recommendations Related to the Universal Service Fund and Implement the USF Transformation Order

In early 2009, Congress directed the Federal Communications Commission (FCC) to develop a broadband plan to ensure every American has “access to broadband capability” and to report annually on the state of broadband availability. In March 2010, an FCC task force issued the *National Broadband Plan*, which provided a road map for FCC to reform Universal Service Fund (USF) and the high-cost program, in particular. The *National Broadband Plan* made 11 recommendations as it relates to universal service.<sup>1</sup> FCC has implemented or partially implemented 3 and is planning to implement the remaining 8 recommendations. Table 5 provides information on actions FCC has taken to enact the selected recommendations made in the *National Broadband Plan*.

In the USF Transformation Order, released in November 2011, FCC took action to realize the overarching goal of the *National Broadband Plan* to make affordable broadband service available to all Americans. In particular, FCC adopted a number of actions designed to transition universal service funds from supporting only voice service to supporting networks that can provide both voice and broadband services. Table 6 displays FCC's timeline for making this transition.

**Table 5: Status of FCC Actions to Implement Recommendations from the *National Broadband Plan***

<i>National Broadband Plan</i> Recommendations	FCC Actions
1. FCC should improve USF performance and accountability. As FCC reforms its USF support and disbursement mechanisms, it should also ensure that any future enhancements to the USF program have accountability and oversight provisions built in from the outset. As FCC moves forward on the reforms in the plan, it should enhance its data collection and reporting to ensure that the nation's funds are being used effectively to advance defined programmatic goals.	Planning under way. FCC established public interest obligations, including meeting certain broadband performance requirements, in exchange for receiving support. FCC also developed accountability mechanisms, such as requiring default payments, in case carriers receiving support default from their obligations.
2. FCC should create the Connect America Fund. FCC's long range goal should be to replace all of the legacy high-cost programs with a new program that preserves the connectivity that Americans have today and advances universal broadband in the 21st century.	Implemented. In the USF Transformation Order, FCC created the Connect America Fund, which will ultimately replace the high-cost program.

<sup>1</sup>We are reporting on recommendations specifically directed to FCC related to the high-cost fund.

**Appendix III: Federal Communications  
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<b>National Broadband Plan Recommendations</b>	<b>FCC Actions</b>
<p>3. FCC should create a Mobility Fund. FCC should create a Mobility Fund to provide one-time support for deployment of 3G networks, to bring all states to a minimum level of 3G (or better) mobile service availability. FCC should select an efficient method, such as a market-based mechanism, for supporting mobility in targeted areas.</p>	<p>Implemented. In the USF Transformation Order, FCC created the Mobility Fund. A one-time support of \$300 million will be made available and disbursed through a competitive bidding process. Ongoing support of \$500 million will also be made available for carriers to deploy a minimum level of 3G mobile service availability.</p>
<p>4. FCC should design new USF funds in a tax-efficient manner to minimize the size of the gap. In certain circumstances, the Department of Treasury's Internal Revenue Service treats governmental payments to private parties for the purpose of making capital investments to advance public purposes as contributions to capital under section 118 of the U.S. Internal Revenue Code. Such treatment allows recipients to exclude the payments from income, but reduces depreciation deductions in future years.</p>	<p>Planning under way. According to FCC officials, the first phase of Connect America Fund and Mobility Fund has been designed to enable carriers to seek an advisory ruling from the Internal Revenue Service that the funding represents a contribution to capital under section 118.</p>
<p>5. Throughout the USF reform process, FCC should solicit input from Tribal governments on USF matters that affect Tribal lands. In recognition of Tribal sovereignty, FCC should solicit input from Tribal governments on any proposed changes to USF that would affect Tribal lands. Tribal governments should play an integral role in the process for designating carriers that may receive support to serve Tribal lands. The eligible carrier designation process should require consultation with the relevant Tribal government after a carrier files an application to serve a Tribal land. It should also require that an eligible carrier file a plan with both FCC (or state, in those cases where a carrier is seeking eligible carrier designation from a state) and the Tribe on proposed plans to serve the area.</p>	<p>Planning under way. FCC is requiring eligible carriers serving Tribal lands to demonstrate and report meaningful engagement with Tribal governments in their supported areas. Carriers must document that they had, at the minimum, discussions that included: (1) a needs assessment and deployment planning with a focus on Tribal community anchor institutions; (2) feasibility and sustainability planning; (3) marketing services in a culturally sensitive manner; (4) rights of way processes, land use permitting, facilities siting, environmental and cultural preservation review processes; and (5) compliance with Tribal business and licensing requirements.</p>
<p>6. FCC should take action to shift up to \$15.5 billion over the next decade from the current high-cost program to broadband through commonsense reforms. FCC should issue an order to implement the voluntary commitments of Sprint and Verizon Wireless to reduce the high-cost funding they receive as competitive carriers to zero over a 5-year period as a condition of earlier merger decisions. FCC should require rate-of-return carriers to move to incentive regulation. FCC should phase out the remaining legacy high-cost support for competitive carriers and establish a schedule to reduce support to zero over 5 years. As support levels for competitive carriers are reduced, this funding should be redirected toward broadband. Depending on the details and timing of implementation, these actions collectively will free up to \$15.5 billion (present value in 2010 dollars) in funding from the legacy high-cost program between 2010 and 2020.</p>	<p>Planning under way. Proposals to move rate-of-return carriers to an incentive regulation are out for comment. FCC also froze support for each competitive carrier at the 2011 monthly baseline amount, starting in January 1, 2012. Beginning July 1, 2012, FCC plans to reduce support for each competitive carrier by 20 percent annually for the next 5 years, with the aim of fully eliminating support by July 1, 2012.</p>
<p>7. FCC should examine middle-mile costs and pricing. An examination of middle-mile costs and pricing should occur in concert with the comprehensive USF reform program.</p>	<p>Planning under way. FCC is gathering data, as part of its consideration of special access reform. The FCC Chairman circulated a proposed item to the other commissioners, setting forth a path to reform and modernize FCC's rules for special access services to protect competition and ensure access to robust, affordable broadband for small business, mobile providers, and others.</p>

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<b>National Broadband Plan Recommendations</b>	<b>FCC Actions</b>
8. FCC should begin making disbursements from the Connect America Fund. Once FCC completes rulemakings to establish the parameters of the new Connect America Fund, it should begin to distribute funds to discrete geographic areas that contain unserved households.	Planning under way. As part of the first phase of implementing the Connect America Fund, FCC froze support for price cap carriers and announced incremental support amounts under the Connect America Fund.
9. FCC should broaden the universal service contribution base. As FCC establishes the Connect America Fund, it should also adopt revised contribution methodology rules to ensure that USF remains sustainable over time.	Planning under way. FCC developed proposals to reform and modernize how USF contributions are assessed and recovered. A Notice for Proposed Rulemaking is out for public comment.
10. FCC should manage the total size of USF to remain close to its current size (in 2010 dollars) in order to minimize the burden of increasing universal service contributions on consumers. Unrestrained growth of the USF, regardless of reason, could jeopardize public support for the goals of universal service. FCC should aim to keep the overall size of the fund close to its current size (in 2010 dollars), while recognizing that the uncapped parts of USF may continue to grow due to factors outside the scope of the <i>National Broadband Plan</i> . As FCC implements the recommendations of the plan, it should evaluate innovative strategies to leverage the reach of existing governmental support programs and evaluate whether to adjust the relative proportion of supply-side versus demand-side subsidies over time.	Partially implemented. In the USF Transformation Order, FCC established a budget of \$4.5 billion annually over the next 6 years.
11. FCC should eliminate the legacy high-cost program, with all federal government funding to support broadband availability provided through the Connect America Fund. By 2020, the "old" high-cost program will cease operations, and service providers will only receive support for deployment and provision of supported services (i.e., broadband that offers high-quality voice) through the Connect America Fund. FCC should set a deadline for recipients of USF to offer supported services. FCC should consider alternative approaches, such as satellite broadband, for addressing the most costly areas of the country to minimize the contribution burden on consumers across America.	Planning under way. In the USF Transformation Order, FCC created the Connect America Fund to ultimately replace the high-cost program. FCC has established deadlines to offer supported services. For instance, carriers receiving incremental support from the Connect America Fund in 2012 are required to complete broadband deployment to all required locations within 3 years. FCC is considering alternative approaches, such as satellite broadband, for addressing the most costly areas.

Source: GAO analysis of the *National Broadband Plan* and USF Transformation Order.

Note: The *National Broadband Plan* made 15 recommendations under the universal service category, which included recommendations for reforming intercarrier compensation. Because we did not review intercarrier compensation, those recommendations were not included in our analysis and the table above. One recommendation that was not directed to FCC was also excluded from our analysis.

**Table 6: Key Actions and Timeline for Implementing the USF Transformation Order**

<b>Time frame</b>	<b>Key Actions and Requirements</b>
Nov. 18, 2011	USF Transformation Order released.
Jan. 1, 2012	<ul style="list-style-type: none"> <li>FCC froze high-cost support to carriers, equal to the amount of support the carriers received in 2011 in a given study area.</li> <li>FCC eliminated the identical support rule and began phasing down the support provided to carriers under that rule.</li> </ul>
Feb. 15, 2012	The Universal Service Administrative Company (USAC) published each carrier's frozen high-cost support amount.

**Appendix III: Federal Communications  
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<b>Time frame</b>	<b>Key Actions and Requirements</b>
April 25, 2012	FCC announced the \$300-million incremental support amounts for carriers (this occurred about a month later than the originally planned March 31, 2012, date in the USF Transformation Order).
June 1, 2012	As directed in the USF Transformation Order, FCC issued a progress report on the status of developing a cost model for price-cap carriers, in preparation for implementing the revised disbursement mechanisms (i.e., the cost model and competitive bidding mechanisms) under the Connect America Fund.
July 25, 2012	Each carrier must notify FCC within 90 days of being informed of the incremental support amount (i.e., April 25, 2012), identifying the amount of support it wishes to accept and the areas by wire centers and census blocks in which the carrier intends to deploy broadband to meet its obligation. Carriers can also decline the incremental support.
September 27, 2012	Competitive bidding for the one-time, \$300-million disbursement of the Mobility Fund is scheduled to begin.
December 31, 2012	<ul style="list-style-type: none"> <li>• FCC plans to have adopted a forward-looking cost model for the purpose of implementing the second phase of the Connect America Fund.</li> <li>• FCC will begin disbursing \$300 million from the Mobility Fund no later than 2013.</li> </ul>
January 1, 2013	<ul style="list-style-type: none"> <li>• FCC will begin implementing the second phase of Connect America Fund, which consists of generating a support amount from a cost-model and/or conducting competitive bidding.</li> <li>• Contingency plan will take effect if second phase of Connect America Fund (i.e., the cost model and competitive bidding mechanism) is not ready for implementation. <ul style="list-style-type: none"> <li>○ FCC will phase in a requirement that carriers use the incremental support amount for building and operating broadband-capable networks and offering broadband services in substantially unserved areas.</li> </ul> </li> </ul>
2013	<ul style="list-style-type: none"> <li>• All carriers receiving frozen high-cost support will be required to use at least one-third of the support to build and operate broadband-capable networks used to offer broadband services in substantially unserved areas.</li> <li>• Carriers accepting support that was generated from the cost-model will receive half of the full amount the carrier was designed to receive and half the amount the carrier received under the first phase of the Connect America Fund (which would be the frozen 2011 support amount or the frozen amount plus the incremental support amount the carrier may have accepted from the first phase of implementing the Connect America Fund).</li> </ul>
July –September 2013	FCC plans to hold a reverse auction (i.e., competitive bidding) in the third quarter of 2013, with an annual budget of \$500 million from the Mobility Fund.
2014	<ul style="list-style-type: none"> <li>• At least two-thirds of the frozen high-cost support from Connect America Fund must be used as required.</li> <li>• Carriers declining the support amount generated from the cost-model of the Connect America Fund will continue to receive support in an amount equal to its 2011 support amount until the first month that the winner of any competitive process receives support under the second phase of implementing the Connect America Fund; at that time, the carrier declining support in the second phase will stop receiving high-cost universal service support.</li> <li>• If carriers accepted incremental support in 2012, then they are required by this time to complete broadband deployment to no less than two-thirds of the required number of locations within 2 years.</li> <li>• FCC will begin disbursing \$500 million from the Mobility Fund.</li> </ul>
2015	<ul style="list-style-type: none"> <li>• All frozen high-cost support disbursed under the Connect America Fund must be spent as required. Carriers will be required to certify that they have spent high-cost support consistent with FCC requirements in their annual filings.</li> <li>• Carriers receiving incremental support from the Connect America Fund in 2012 are required to complete broadband deployment to all required locations.</li> </ul>

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<b>Time frame</b>	<b>Key Actions and Requirements</b>
2016	Carriers receiving support under the cost-model must offer at least 4 Megabits per second (Mbps) download and 1 Mbps upload broadband service level to at least 85 percent of their high-cost locations, including those on Tribal lands.
2017	FCC plans to evaluate the need for ongoing support at the set budget levels and determine how best to drive support to efficient levels, given consumer demand and technological developments at that time.
2018	<ul style="list-style-type: none"> <li>• By the end of the fifth year, price-cap carriers must offer at least 4 Mbps download and 1 Mbps upload broadband service level to all supported locations, and at least 6 Mbps download and 1.5 Mbps upload speed to a number of supported locations to be specified.</li> <li>• After the end of the 5-year planned term, FCC plans to distribute all support for price-cap areas, using a market-based mechanism (i.e., competitive bidding) from the Connect America Fund.</li> </ul>

Source: GAO analysis of FCC information.

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# Appendix IV: 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

In addition to the contact named above, Sally Moino, Assistant Director; Pedro Almoguera; Colin Fallon; David Hooper; Jennifer Kim; Andrew Stavisky; and Nancy Zearfoss made key contributions to this report.

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*Telecommunications: FCC's Performance Management Weaknesses Could Jeopardize Proposed Reforms of the Rural Health Care Program.* [GAO-11-27](#). Washington, D.C.: November 17, 2010.

*Telecommunications: Improved Management Can Enhance FCC Decision Making for the Universal Service Fund Low-Income Program.* [GAO-11-11](#). Washington, D.C.: October 28, 2010.

*Telecommunications: FCC Should Assess the Design of the E-rate Program's Internal Control Structure.* [GAO-10-908](#). Washington, D.C.: September 29, 2010.

*Telecommunications: Long-Term Strategic Vision Would Help Ensure Targeting of E-rate Funds to Highest-Priority Uses.* [GAO-09-253](#). Washington, D.C.: March 27, 2009.

*Telecommunications: FCC Needs to Improve Performance Management and Strengthen Oversight of the High-Cost Program.* [GAO-08-633](#). Washington, D.C.: June 13, 2008.

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