



Report to the Chairman, Committee on
Energy and Commerce, House of
Representatives

October 2019

TELECOMMUNICATIONS

FCC Should Take Additional Action to Manage Fraud Risks in Its Program to Support Broadband Service in High-Cost Areas

GAO Highlights

Highlights of [GAO-20-27](#), a report to the Chairman, Committee on Energy and Commerce, House of Representatives

Why GAO Did This Study

The Universal Service Fund's high-cost program provides financial support to telecommunications carriers in areas where the cost to provide broadband is high. Through this program, FCC provides about \$2.5 billion in annual support payments to rate-of-return carriers. The manner in which FCC currently provides the support payments to some of these carriers is prone to fraud risks. A prior case involved a rate-of-return carrier that received at least \$27 million in improper payments from the program.

GAO was asked to review funding reforms and fraud controls FCC has implemented for rate-of-return carriers. This report examines the extent to which FCC: (1) has implemented funding reforms specific to rate-of-return carriers, and (2) is managing fraud risks for the high-cost program in accordance with leading practices. GAO reviewed FCC's and USAC's procedures, relevant regulations, and guidance, and assessed these documents against applicable criteria, including federal internal-control standards, FCC's strategic plan, and GAO's fraud risk framework. GAO interviewed FCC and USAC officials, in addition to industry and other stakeholders representing a variety of non-generalizable viewpoints.

What GAO Recommends

GAO is making five recommendations, including that FCC should assess the model-based support mechanism and consider making its use mandatory, and implement an antifraud strategy for the high-cost program. FCC stated it would take steps to implement these recommendations.

View [GAO-20-27](#). For more information, contact Andrew Von Ah at (202) 512-2834 or vonaha@gao.gov.

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FCC Should Take Additional Action to Manage Fraud Risks in Its Program to Support Broadband Service in High-Cost Areas

What GAO Found

The Federal Communications Commission (FCC) has implemented several funding reforms for small, rural telecommunications carriers—referred to as “rate-of-return carriers”—receiving high-cost program support. These reforms are aimed at controlling the program's expenditures and incentivizing efficient broadband deployment. According to FCC's strategic plan, FCC must ensure the high-cost program is well managed, efficient, and fiscally responsible. One of the reforms that GAO reviewed established a funding mechanism for the carriers whereby FCC determines the level of financial support to provide the carriers based on cost and revenue estimates produced by a model. Stakeholders told GAO that this model-based funding mechanism is less prone to fraud risks than the traditional cost-accounting funding mechanism, which reimburses carriers for their reported costs. However, FCC did not make use of this reform mandatory and a substantial number of rate-of-return carriers continue to receive support from the traditional funding mechanism. FCC officials said they developed the model-based funding mechanism in consultation with industry stakeholders. However, FCC officials said they did not have plans to assess the accuracy of cost estimates from the model, which has been in use for several years, or require carriers to receive model-based support as a way to reduce fraud risks. By assessing the model, FCC would have greater assurance that it is producing reliable cost estimates and be better positioned to determine whether to make its use mandatory.

FCC has some policies and processes in place to manage fraud risks for the high-cost program. For example, the Universal Service Administrative Company (USAC)—the not-for-profit corporation that administers the program—reviews and audits rate-of-return support payments and forwards potential fraud cases to FCC's Office of Inspector General and Enforcement Bureau for further investigation. FCC is also developing a data-analytics tool to help detect fraud, and in August 2019 launched a new Fraud Division to focus on investigating fraud in the Universal Service Fund's programs. However, FCC's efforts do not fully align with some elements of GAO's fraud risk framework, including:

- planning regular fraud-risk assessments tailored to the high-cost program, and
- designing and implementing an antifraud strategy for the program.

Without regular fraud-risk assessments of the high-cost program, FCC has no assurance that it has fully considered important fraud risks, determined its tolerance for risks that could be lower priorities, or made sound decisions on how to allocate resources to respond to fraud risks. Not doing so could result in FCC compensating carriers for improper, ineligible, or inflated costs. Furthermore, in the absence of an antifraud strategy, FCC has little assurance that it can prevent or detect the types of documented rate-of-return carrier misconduct that have previously occurred. Designing and implementing an antifraud strategy that conforms to leading practices would help FCC effectively manage and respond to the fraud risks identified during the fraud-risk assessments.

Contents

| | | |
|--------------|--|----|
| Letter | | 1 |
| | Background | 5 |
| | FCC Adopted Several Funding Reforms to Enhance Carriers' Accountability, but Not All Reforms Are Mandatory | 12 |
| | FCC Has Taken Steps to Manage Fraud Risks, but Its Efforts Do Not Fully Align with Leading Practices | 18 |
| | Conclusions | 24 |
| | Recommendations for Executive Action | 24 |
| | Agency Comments | 25 |
| Appendix I | Key Elements of the Fraud-Risk Assessment Process for Creating a Fraud Risk Profile | 26 |
| Appendix II | Assessment of the Federal Communications Commission's Antifraud Efforts for the Universal Service Fund High-Cost Program | 28 |
| Appendix III | Comments from the Federal Communications Commission | 31 |
| Appendix IV | GAO Contact and Staff Acknowledgments | 34 |
| Tables | | |
| | Table 1: Responsibilities for the Universal Service Fund (USF) High-Cost Program | 8 |
| | Table 2: Extent That FCC Has Implemented Leading Practices from GAO's Fraud Risk Framework for the High-Cost Program | 28 |
| Figures | | |
| | Figure 1: The Fraud-Risk Management Framework and Selected Leading Practices | 11 |
| | Figure 2: The Federal Communications Commission's (FCC) Reforms Aimed at Controlling High-Cost Program Expenditures | 13 |

| | |
|---|----|
| Figure 3: The Federal Communications Commission's (FCC) Reforms Aimed at Incentivizing Efficient Broadband Deployment | 15 |
| Figure 4: The Federal Communications Commission's (FCC) Reforms Aimed at Ensuring Carrier Compliance with the High-Cost Program | 16 |
| Figure 5: Key Elements of the Fraud-Risk Assessment Process | 27 |

Abbreviations

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| FCC | Federal Communications Commission |
| NECA | National Exchange Carrier Association |
| OIG | Office of Inspector General |
| the 1996 Act | Telecommunications Act of 1996 |
| USAC | Universal Service Administrative Company |
| USF | Universal Service Fund |

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October 23, 2019

The Honorable Frank Pallone
Chairman
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

Broadband service is a critical component of the nation’s infrastructure and a key driver of economic growth, yet not all areas of the country have service. To help ensure that consumers in rural, insular, and high-cost areas have access to modern communications networks capable of providing broadband service, the Federal Communications Commission (FCC) has a program that provides approximately \$4.5 billion annually to eligible telecommunications carriers that offer services in these areas. This program is referred to as the Universal Service Fund (USF) high-cost program, and the program funding that the carriers receive is referred to as “support.”

One type of carrier that receives support for providing broadband in high-cost areas is a “rate-of-return carrier”—small, rural carriers that serve 5 percent or less of U.S. households.¹ There have been cases involving rate-of-return carriers receiving millions of dollars in improper payments from the high-cost program. For example, from 2002 to 2015, one such carrier received reimbursement for deploying infrastructure to areas where no consumers existed and, at the same time, received at least \$27 million in reimbursement for ineligible costs, including a \$1.3 million personal residence and a \$43,000 sport utility vehicle.² Additionally, in August 2018, FCC’s Office of Inspector General (OIG) reported that a rate-of-return carrier had reported approximately \$80,000 in ineligible expenses from 2012 to 2015 for reimbursement, even though according to FCC, the expenses were defined as unnecessary and, thus,

¹These carriers are called “rate-of-return carriers” because they are subject to rate regulation that allows them to recover eligible costs of service and earn a predetermined rate of return on regulated investments.

²According to FCC, this carrier ceased receiving support from the USF high-cost program to provide telecommunications services in 2015; FCC recovered the improper payments through offsets to the support the carrier otherwise may receive.

prohibited.³ Those expenses included family travel, gifts, donations, tuition reimbursement, and special events; costs that were not necessary for maintaining and extending telecommunications services. These cases came to FCC's attention only after the carriers had already been improperly receiving high-cost support for years, and FCC's OIG staff said that skilled bad actors may remain undetected. FCC has adopted reforms in recent years intended to improve the accountability of rate-of-return carriers' funding.

You asked us to review FCC's oversight of rate-of-return carriers participating in the high-cost program. This report examines the extent to which FCC

- has implemented reforms intended to improve the accountability of rate-of-return carriers' funding, and
- is managing fraud risks for the USF high-cost program in accordance with leading practices.

To evaluate the extent to which FCC has implemented reforms intended to improve the accountability of rate-of-return carriers' funding, we reviewed FCC orders and policies, prior GAO and FCC OIG reports, and other relevant documents related to high-cost support reforms. We reviewed four FCC orders that FCC confirmed contained the significant rate-of-return reforms related to funding accountability and compliance.⁴ We categorized the reforms based on their purpose and determined whether the reforms had been implemented. As appropriate, we assessed FCC's efforts implementing the reforms against federal internal-control standards⁵ and FCC's strategic plan.⁶ In addition, we interviewed

³Federal Communications Commission, Office of Inspector General, *USF High Cost Program Beneficiary Audit Found Costs That Were Not Necessary for Providing or Improving Telecommunications Services*, Report No. 15-AUD-02-01 (Washington, D.C.: Aug. 21, 2018).

⁴For the four orders, see *Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, 26 *FCC Rcd* 17663 (2011); *Connect America Fund et al.*, Report and Order, Order and Order on Reconsideration, and Further Notice of Proposed Rulemaking, 31 *FCC Rcd* 3087 (2016); *Connect America Fund et al.*, Report and Order, Third Order on Reconsideration, and Notice of Proposed Rulemaking, 2018 WL 1452720 (2018); *Connect America Fund et al.*, Report and Order, Further Notice of Proposed Rulemaking, and Order on Reconsideration, 33 *FCC Rcd* 11893 (2018).

⁵GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

⁶FCC, *Strategic Plan 2018–2022* (Washington, D.C.).

FCC officials responsible for setting overall policy and the regulations that govern the USF program. Because of their high-cost program roles and responsibilities, we interviewed officials from the Universal Service Administrative Company (USAC)⁷ and a representative from the National Exchange Carrier Association (NECA).⁸

We also interviewed officials from FCC's OIG who had conducted previous audit work related to rate-of-return carriers. We interviewed 19 other stakeholders representing a variety of perspectives. We judgmentally selected officials from five industry associations and four accounting firms that assist rate-of-return carriers in their filings based on their involvement with these issues, which we determined through such factors as their level of activity in commenting on relevant FCC orders and recommendations by others we interviewed. To obtain a variety of carrier perspectives, we used carrier telecommunications data across the four U.S. Census Bureau's regions provided by NECA to judgmentally select six rate-of-return carriers of different sizes and from different regions of the country, including those that had either accepted traditional cost-accounting support or support based on an FCC cost-estimating model. Because states administer state-level programs similar to the USF, we selected four state utility commissions from across each of the four U.S. Census Bureau regions to provide us with a variety of state perspectives.⁹ These interviews represent a variety of non-generalizable viewpoints.

To evaluate the extent to which FCC is managing fraud risks for the USF high-cost program in accordance with leading practices, we reviewed FCC, USAC, and NECA orders, policies, and procedures related to the processes each entity had in place to manage fraud risks associated with support disbursements to rate-of-return carriers. These included two USAC risk assessment documents FCC uses to collect information on

⁷USAC is the not-for-profit corporation that manages the day-to-day administration of the high-cost program and that disburses high-cost support to carriers.

⁸NECA is a membership association of typically smaller telecommunications carriers.

⁹In addition to the federal program, 42 states and the District of Columbia provide state universal-service support and 22 of those states have state-level equivalents of FCC's high-cost program. In 2017, states provided more than \$1.7 billion of state USF funding, the largest portion of which they directed to carriers to provide service in high-cost or remote areas. The ways states compensate carriers varies by state. For more, see National Regulatory Research Institute, *State Universal Service Funds 2018: Updating the Numbers* (April 2019).

risks, including fraud risks, to meet federal improper-payment requirements.¹⁰ In addition, we interviewed FCC officials responsible for setting policy for fraud risk management for rate-of-return carriers as well as those responsible for working with USAC to develop audit plans. We also interviewed high-cost program and audit officials, FCC's OIG officials, a NECA representative, and the same 19 stakeholders noted above from the industry, rate-of-return carriers, state utility commissions, and accounting firms to gain their perspectives on rate-of-return carrier fraud risks and FCC's approaches for managing fraud risk in the high-cost program. We assessed the information gathered to determine the extent to which FCC had implemented leading practices contained in GAO's fraud risk framework.¹¹ The framework contains four components: (1) commit, (2) assess, (3) design and implement, and (4) evaluate and adapt. Within the four components, there are overarching concepts and leading practices. Our assessment focused on the overarching concepts and leading practices contained in the first three components. We did not review the fourth component of the framework, which focuses on evaluating outcomes using a risk-based approach and then adapting activities to improve fraud risk management. Because we determined that FCC had not fully adopted fraud risk management activities from the first three components, it was premature for us to assess whether or not FCC was evaluating and adapting its use of leading fraud-risk-management practices.

We conducted this performance audit from September 2018 to October 2019 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

¹⁰To address the problem of improper payments, since 2002 federal agencies have been required, among other things, to review their programs and identify those that are susceptible to significant improper payments—a process known as risk assessment. The Improper Payments Information Act of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010 and the Improper Payments Elimination and Recovery Improvement Act of 2012, also requires federal executive-branch agencies to estimate the annual amount of improper payments for those programs and activities and report on actions taken to reduce improper payments. Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002), as amended by the Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, 124 Stat. 2224 (2010), and the Improper Payments Elimination and Recovery Improvement Act of 2012, Pub. L. No. 112-248, 126 Stat. 2390 (2013) (codified as amended at 31 U.S.C. § 3321).

¹¹GAO, *A Framework for Managing Fraud Risks in Federal Programs*, [GAO-15-593SP](#) (Washington, D.C.: July 28, 2015).

that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

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.¹² The 1996 Act altered the federal mechanism for funding universal service by requiring telecommunications carriers and other entities providing interstate telecommunications service to contribute to the USF, unless exempted by FCC.¹³ The carriers generally pass these costs on to customers, sometimes in the form of a line item on customers’ telephone bills.

USF provides financial support to carriers through four different programs, each targeting a particular group of telecommunications carriers or consumers. The high-cost program provides support to both wireline and wireless carriers that provide telecommunications services in areas that carriers would otherwise not serve and where there is no competition from other providers. These are typically rural or remote areas where the customer base is relatively small and the cost of installing infrastructure is high. The high-cost program has been the largest USF program based on disbursements and has been particularly important to rural areas. High-cost support is intended to offset the carriers’ higher costs, thereby allowing them to provide services and rates that are reasonably comparable to those that consumers in lower-cost—generally urban—areas receive.

In 2009, Congress required FCC to develop a broadband plan to ensure that every American has access to broadband capability, including a detailed plan for providing this service at affordable rates.¹⁴ In response, an FCC task force issued the *National Broadband Plan* in 2010, which recommended reforming USF so it could support both telephone and broadband service.¹⁵ FCC’s USF Transformation Order of 2011 emerged

¹²Pub. L. No. 104-104, § 101(a), 110 Stat. 71 (1996).

¹³47 U.S.C. § 254(d).

¹⁴American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 6001(k)(1), 123 Stat. 115, 515 (2009).

¹⁵FCC, *Connecting America: The National Broadband Plan* (Washington, D.C.: Mar. 16, 2010).

in response to this recommendation and provided USF support to carriers for broadband capable networks.¹⁶ The order required carriers that receive support to meet broadband-speed and quality-deployment requirements.

Through the USF Transformation Order, FCC adopted a framework to transition high-cost carriers from traditional cost-accounting support to incentive-based support mechanisms, using forward-looking broadband cost models and competitive bidding.¹⁷ FCC's forward-looking cost models use historical data to project the future financial needs of carriers providing telecommunications services. According to FCC, rate-of-return carriers receive about \$2.5 billion in annual support from the high-cost program to support service deployments in these carriers' 1,078 rate-of-return service areas, which FCC refers to as "study areas."¹⁸ FCC has allowed rate-of-return carriers to choose, on a voluntarily basis, one the following mechanisms to receive USF support:

- **Traditional cost-accounting support mechanism.** This method retroactively provides support to carriers for costs already incurred, based on cost studies, including financial statements these companies provide each year. At the time of our review, according to FCC officials, FCC guaranteed these companies recovery of eligible deployment costs, plus a return of 10.25 percent on regulated investment costs.¹⁹ According to FCC's OIG officials we interviewed, many carriers contract with telecommunications accountants to navigate the complicated process of determining which costs are

¹⁶*Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, 26 *FCC Rcd* 17663 (2011).

¹⁷Incentive-based regulation refers to a variety of regulatory approaches that generally use rewards and penalties to encourage desired behavior on the part of a regulated entity. For example, cost models may limit the amount of support to a regulated entity to encourage them to reduce costs. Regarding competitive bidding, FCC puts unserved areas up for competitive bid. The winning bidders are required to provide voice and broadband services, and will receive the amount of support that the carrier bid to provide the service. 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.

¹⁸FCC defines a "study area" as the defined geographic area served by a telecommunications carrier. A company that has more than one study area within a state was required to elect model-based support for either all or none of its study areas in that state.

¹⁹FCC intends the return on eligible costs to be 9.75 percent by July 2021. See 2016 *Rate-of-Return Reform Order*, 31 *FCC Rcd* at 2312, para. 326.

reimbursable by the high-cost program and file the associated documentation with USAC.²⁰ According to FCC, as of September 2019, there were approximately 437 study areas served by rate-of-return carriers receiving support through this mechanism.

- **Model-based support mechanism.** This method is aimed at providing a level of support to carriers based on modeled forward-looking costs and revenues of an efficient carrier to serve an area with voice and broadband Internet. According to FCC officials, in developing the model, FCC:
 - had experts peer-review the model's methodology;
 - demonstrated how different inputs affect model support and sought stakeholder feedback on the reasonableness of how these inputs affected support levels;
 - publicly released the model's methodology; and
 - used historical deployment cost and revenue data to develop the model's inputs and assumptions.
- As of September 2019, FCC officials told us that rate-of-return companies serving 641 study areas were receiving support through this mechanism (or almost 60 percent of all 1,078 rate-of-return carriers' study areas).²¹

FCC determines overall policy and issues the regulations that govern the high-cost program, while FCC's Wireline Competition Bureau in particular implements FCC's policies and programs regarding rate-of-return

²⁰47 C.F.R. Parts 32, 36, 64, and 69 contain various aspects relating to the process by which carriers determine which costs qualify for reimbursement. Rate-of-return carrier companies are to record costs, including investments and expenses, into various accounts in accordance with the Uniform System of Accounts, a system prescribed by FCC. Also, these companies are to allocate investments, expenses, and revenues between regulated (reimbursable) and non-regulated (non-reimbursable) activities using FCC rules and cost allocation principles. FCC's rules are designed to protect consumers by separating regulated and non-regulated activities, ensure fair competition in non-regulated markets, and protect consumers from the costs of non-regulated activities.

²¹See Wireline Competition Bureau Authorizes 171 Rate-of-Return Companies to Receive \$491 Million Annually in Alternative Connect America Cost Model II Support to Expand Rural Broadband, Public Notice, 2019 WL 3996343 (2019); Wireline Competition Bureau Authorizes 186 Rate-of-Return Companies to Receive an Additional \$65.7 Million Annually in Alternative Connect America Cost Model Support to Expand Rural Broadband, Public Notice, 2019 WL 1915589 (2019) (announcing all carriers that have been authorized to receive ACAM I support).

carriers.²² State governments play a role in implementing the federal high-cost program, as do a not-for-profit corporation (USAC) and an association (NECA).²³ As shown in table 1, FCC, USAC, and NECA have responsibilities for the high-cost program to ensure payments to rate-of-return carriers are made properly.

Table 1: Responsibilities for the Universal Service Fund (USF) High-Cost Program

| Agency/Organization | Responsibilities |
|---|--|
| Federal Communications Commission (FCC) | <ul style="list-style-type: none"> Oversees program administration and finances and promulgates regulations Directs USAC and NECA regarding policies and procedures Conducts oversight of some carriers' use of funds Enforcement Bureau enforces FCC rules and orders, and investigates potentially unlawful conduct Office of Inspector General conducts audits and investigations |
| Universal Service Administrative Company (USAC) | <ul style="list-style-type: none"> Collects rate-of-return carriers' data, some of which are forwarded from NECA, and uses these data to determine support amounts Collects, validates, and verifies carriers' broadband deployment data Disburses USF support to carriers after they file paperwork that shows, among other information, their corporate revenue, costs, numbers of lines, and customers served Audits USF payments Refers cases of suspected fraud, waste, or abuse to FCC for potential enforcement action |
| National Exchange Carrier Association (NECA) | <ul style="list-style-type: none"> Manages process for its member rate-of-return carriers to submit their cost data to USAC Collects and initially validates rate-of-return carriers' cost data for its members Calculates the amount of support its members are eligible to receive based on cost data; submits the results of its calculations to USAC along with the cost data |

Source: GAO analysis of FCC, USAC, and NECA information. | GAO-20-27

FCC has the following audit and oversight procedures for the high-cost program:

²²Wireline 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. Among other duties, FCC's Wireline Competition Bureau reviews communications industry transactions and conducts rulemakings and proceedings to ensure the availability of important components for communications providers, such as access to utility poles and rights-of-way.

²³For example, state regulatory commissions are primarily responsible for determining carriers' eligibility to participate in the high-cost program by certifying them as eligible telecommunications carriers.

-
- **Carrier self-certification.** Carriers submit cost and line count data directly to NECA. Carrier self-certification is the primary tool for ensuring that carriers use high-cost program support consistent with program rules. USAC uses these data to qualify carriers for the program and also to calculate the amount of support carriers are eligible to receive.
 - **Carrier audits.** Audits of carriers receiving high-cost program support are the primary tool used to oversee carrier activities, and audits may be conducted by USAC, state regulators, or FCC's OIG. USAC primarily relies on assessments from the Payment Quality Assurance Program²⁴ and Beneficiary and Contributor Audit Program²⁵ that occur after disbursements have been made to detect improper payments, which may include fraud.
 - **Carrier data validation process.** All cost data that the carriers submit to NECA for purposes of high-cost support are subject to several electronic validations, which focus on ensuring that all required data are reported and that the data ranges are consistent with information reported in previous years.²⁶ In addition, NECA compares the reported cost data with financial records supporting carriers' audited financial statements to identify any discrepancies and to require corrections when discrepancies are discovered.²⁷
 - **Carriers' broadband deployment verification.** Since 2018, USAC has performed carrier broadband deployment verifications by obtaining broadband location data to monitor whether a carrier's broadband deployment meets FCC requirements. Carriers receive verification reports from USAC that reflect the results of the verification process.

²⁴USAC conducts improper payment testing via its Payment Quality Assurance Program, which is designed to assess the accuracy of USF disbursements and determine whether improper payments exist. USAC performs payment verification on a statistically valid sample of annual disbursements, which also helps FCC meet its reporting obligations under the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA).

²⁵For the Beneficiary and Contributor Audit Program, USAC conducts in-depth assessments of program compliance among individual USF beneficiaries and contributors.

²⁶For FCC's high-cost program, NECA is responsible only for collecting carrier cost and line count data for support funding the "last mile" of connection, as specified in Part 54, Subpart M of FCC's rules.

²⁷According to NECA documents provided by FCC, NECA submits annual Cost Study Review Process reports to FCC and NECA's Internal Audit department audits NECA's process annually, and NECA has an independent auditor review the process as well.

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- **Whistleblower process.** USAC maintains a whistleblower log that is shared with FCC. Through whistleblower complaints, USAC may identify instances of potentially fraudulent activity.

FCC has identified three rate-of-return carriers that received at least \$34 million in improper payments from the high-cost program in prior years. Two such cases were described above. In the third case, a rate-of-return carrier self-reported to NECA and USAC what it represented to be the costs and revenues of providing its telecommunications service; as discussed previously, NECA and USAC rely upon the accuracy and completeness of the carrier's reporting to calculate the carrier's support. An FCC OIG investigation later revealed that the carrier had manipulated FCC's accounting rules by including the costs of a nonregulated, commercial mobile radio service in the information it submitted to NECA, thus inflating the amount of high-cost program support the carrier received. FCC eventually determined that the carrier owed the federal government almost \$7 million in support overpayments received between 2005 and 2010. A petition for reconsideration is pending. As there is a finite amount of funding for the high-cost program, compensating carriers for improper, ineligible, and inflated costs they claim means less program funds are available for deploying service to the areas the program was designed to serve.

Federal internal control standards,²⁸ along with GAO's fraud risk framework,²⁹ OMB guidance,³⁰ and the Fraud Reduction and Data Analytics Act of 2015³¹ have placed an increased focus on the need for federal program managers to take a strategic approach to managing

²⁸[GAO-14-704G](#).

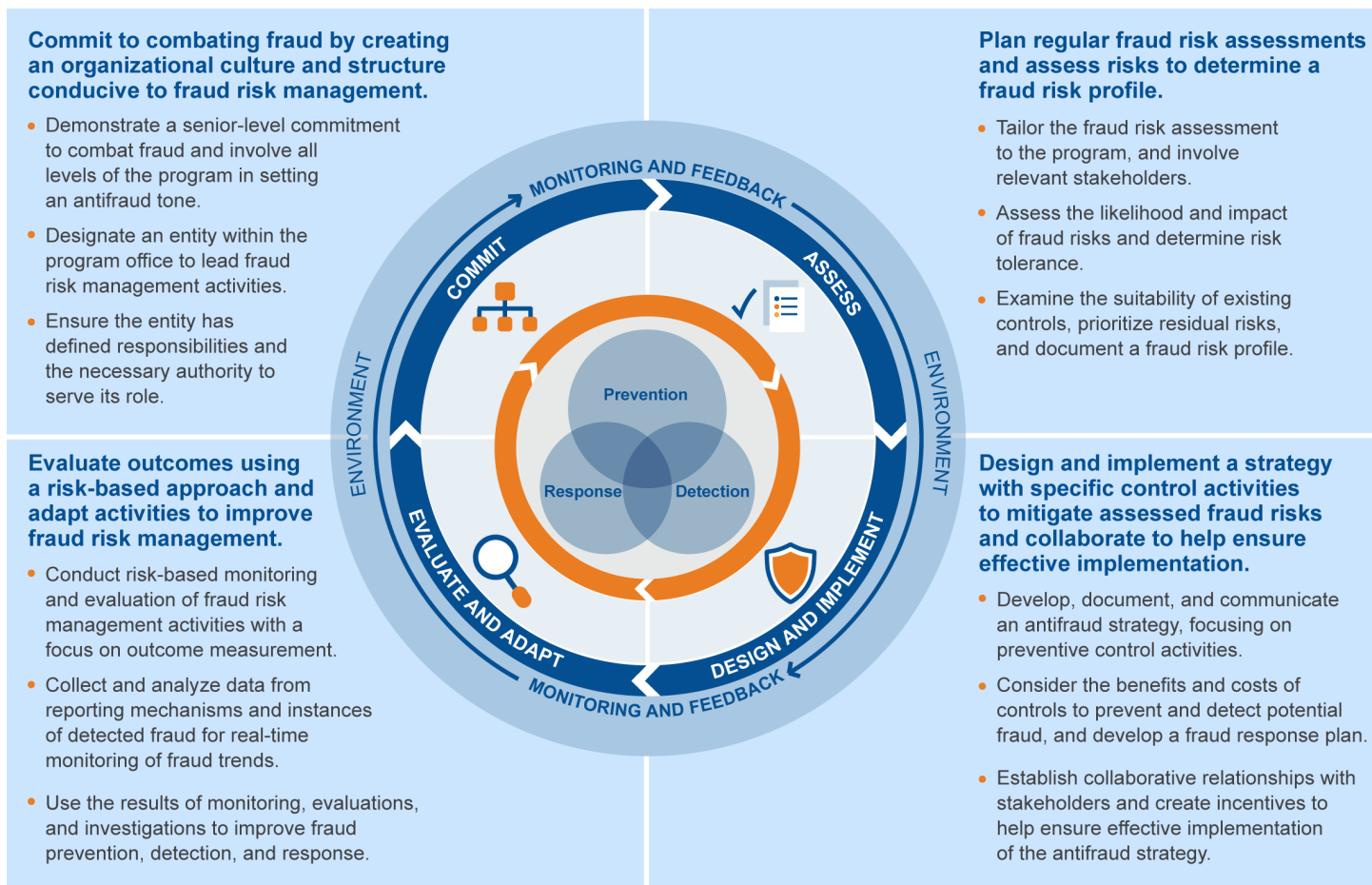
²⁹[GAO-15-593SP](#).

³⁰OMB issues guidance in the form of OMB circulars. OMB Circular No. A-123 defines management's responsibility for internal control in federal agencies, and affirms that managers should adhere to the leading practices identified in GAO's fraud risk framework. Office of Management and Budget, *Management's Responsibility for Enterprise Risk Management and Internal Control*, OMB Circular No. A-123 (Washington, D.C.: July 15, 2016).

³¹The act requires agencies to conduct an evaluation of fraud risks and, using a risk-based approach, to design and implement financial and administrative control activities to mitigate identified fraud risks; collect and analyze data from reporting mechanisms on detected fraud to monitor fraud trends and use those data and information to continuously improve fraud prevention controls; and use the results of monitoring, evaluation, audits, and investigations to improve fraud prevention, detection, and response. See Fraud Reduction and Data Analytics Act of 2015, Pub. L. No. 114-186, 130 Stat. 546 (2016).

improper payments and risks, including the risk of fraud. GAO’s fraud risk framework provides comprehensive guidance for conducting fraud-risk assessments and using the results to develop a robust fraud risk management strategy. This framework also describes overarching concepts and leading practices for establishing an organizational structure and culture that are conducive to fraud risk management, designing and implementing controls to prevent and detect potential fraud, and monitoring and evaluating fraud risk management activities. The leading practices in the fraud risk framework are organized into four components—commit, assess, design and implement, and evaluate and adapt—as depicted in figure 1.

Figure 1: The Fraud-Risk Management Framework and Selected Leading Practices



Source: GAO. | GAO-20-27

FCC Adopted Several Funding Reforms to Enhance Carriers' Accountability, but Not All Reforms Are Mandatory

FCC Reforms Are Intended to Improve the Accountability of Rate-of-Return Funding


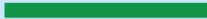
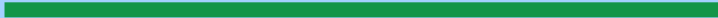
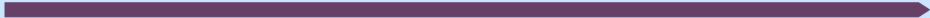

FCC, in various orders, has adopted several funding and other reforms specific to rate-of-return carriers. As described below, the reforms we reviewed were designed to (1) control the carrier and high-cost program expenditures, (2) incentivize efficient broadband deployment, and (3) ensure carriers' compliance with the high-cost program.

Control Carrier and High-Cost Program Expenditures

Prior to the 2011 USF Transformation Order, rate-of-return carriers primarily received high-cost support based on their actual costs. Under the old rules, carriers faced no FCC-imposed limits and, according to FCC, had no incentive to be more efficient.³² FCC adopted the reforms described in figure 2 to control the program's expenditures.

³²Connect America Fund; High-Cost Universal Service Support, Order, 27 FCC Rcd 4235 (2012).

Figure 2: The Federal Communications Commission’s (FCC) Reforms Aimed at Controlling High-Cost Program Expenditures

| Reform | Implementation status | | | | | | | | | | | |
|---|---|--------|------|------|------|------|------|------|------|------|------|------|
| <p>Establishing a \$225 per-month-per-line support cap FCC capped high-cost support³ for rate-of-return carriers at \$225 per-line-per-month.</p> | <p>✔ Complete: FCC phased in a \$250 per-month-per-line support cap on July 1, 2012 and reduced the cap to \$225 on July 1, 2019. This support will be further reduced to \$200 in 2021. Carriers that receive support amounts over the cap will have their support reduced over 3 years.</p>  <table border="1"> <tr> <th>Year ▶</th> <td>2010</td> <td>2011</td> <td>2012</td> <td>2013</td> <td>2014</td> <td>2015</td> <td>2016</td> <td>2017</td> <td>2018</td> <td>2019</td> </tr> </table> | Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | | |
| <p>Rate floor FCC limited support to carriers whose rates charged to customers do not meet a local rate floor.</p> | <p>✔ Complete: Beginning July 1, 2012, FCC adopted a rule to limit support to carriers whose end-user rates (the rates charged to consumers) do not meet a local rate floor. According to FCC officials, FCC voted to eliminate the rate floor in April 2019 because FCC determined that the practical effect of this rule had been to increase the rates of rural customers, who are often older Americans on fixed incomes, lower-income Americans, and individuals living on tribal lands.</p>  <table border="1"> <tr> <th>Year ▶</th> <td>2010</td> <td>2011</td> <td>2012</td> <td>2013</td> <td>2014</td> <td>2015</td> <td>2016</td> <td>2017</td> <td>2018</td> <td>2019</td> </tr> </table> | Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | | |
| <p>Limits on reimbursable capital and operating costs FCC limits the amount of high-cost support carriers receive from capital and operating expenses in order to stay within FCC’s total budget of \$2 billion per year for rate-of-return carriers.</p> | <p>✔ Complete: In 2012, FCC initially adopted two cost estimating mechanisms—one for determining capital and one for operating expense limits. However, by December 2013, capital and operating expense limits had only decreased support in 107 service areas, while support had in fact increased in 769 service areas. Subsequently, FCC ended the cost estimating approach and stated that it would evaluate alternative methods to determine capital and operating expense limits in 2014. In 2016, FCC adopted an alternative operating expense limit and capital investment allowance methodology. In 2018, FCC ended the capital investment allowance limit altogether.</p>  <table border="1"> <tr> <th>Year ▶</th> <td>2010</td> <td>2011</td> <td>2012</td> <td>2013</td> <td>2014</td> <td>2015</td> <td>2016</td> <td>2017</td> <td>2018</td> <td>2019</td> </tr> </table> | Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | | |
| <p>Eliminate support to areas with fully overlapping competition FCC sought to end high-cost support for incumbent carriers in areas where an unsubsidized competitor—or a combination of unsubsidized competitors—also provided voice and broadband in the same service area.</p> | <p>➔ On-going: In 2011, FCC sought comment on a process to reduce support to carriers in areas where another existing and unsubsidized carrier offers service to a substantial majority, but not 100 percent, of the service area. FCC used deployment data it collects to make a preliminary determination of which census blocks are serviced by providers offering broadband service. In July 2015, FCC published its list of competitors serving specific census blocks and sought comment on the preliminary determination of areas subject to overlapping competition. In the 2016 Rate-of-Return Reform Order, FCC adopted a challenge process that carriers could initiate to dispute these determinations. In the 2018 Rate-of-Return Reform Order, however, FCC ended its process for determining areas with overlapping competition due to low carrier participation in the challenge process. Instead, FCC proposed and sought comment on a new process to allow competitors in the same service area to bid for the lowest dollar amount of FCC support in exchange for meeting minimum broadband service level requirements.</p>  <table border="1"> <tr> <th>Year ▶</th> <td>2010</td> <td>2011</td> <td>2012</td> <td>2013</td> <td>2014</td> <td>2015</td> <td>2016</td> <td>2017</td> <td>2018</td> <td>2019</td> </tr> </table> | Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | | |
| <p>Budgetary controls FCC limits support paid to traditional cost-based carriers.</p> | <p>✔ Complete: Beginning July 1, 2016, USAC applied budgetary limits to carriers that receive traditional cost-based support to remain within the annual high-cost budget. In the 2018 Rate of Return Reform Order, FCC reformed the methodology for applying the budgetary control mechanism to simplify the application of the limits and make the application more transparent.</p>  <table border="1"> <tr> <th>Year ▶</th> <td>2010</td> <td>2011</td> <td>2012</td> <td>2013</td> <td>2014</td> <td>2015</td> <td>2016</td> <td>2017</td> <td>2018</td> <td>2019</td> </tr> </table> | Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Year ▶ | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | | |

Source: GAO analysis of FCC information. | GAO-20-27

³High-cost support provides financial support to telecommunications carriers in areas where the cost to provide broadband is high.

As shown in figure 2 above, FCC’s reform effort related to eliminating support to areas with competition has been ongoing since 2011.

Incentivize Efficient Broadband Deployment

According to FCC officials, FCC relied on its broadband deployment data to identify competitively served areas, but we have previously reported that FCC's broadband deployment data are not always accurate.³³ In August 2017, FCC initiated a proceeding to review the Form 477—the principal tool FCC uses to gather data on communications services, including broadband services—to help inform its policy making.³⁴ According to FCC, a goal of this proceeding was to enable FCC to collect better and more accurate information on the Form 477. In August 2019, FCC adopted an order based on the proceeding that, among other things, established requirements for collecting geospatial broadband-coverage maps from internet service providers. According to the order, FCC will require the service providers to submit granular maps of the areas where they have broadband-capable networks; FCC intends that these broadband-deployment maps will enable FCC to precisely target scarce universal service dollars to where broadband service is lacking.³⁵

According to FCC, one of the USF's core principles since 2011 has been to ensure that support is provided in the most efficient manner possible, recognizing that ultimately American consumers contribute to programs like the high-cost program.³⁶ FCC adopted the reforms described in figure 3 to advance its long-standing objective of adopting incentive-based

³³GAO, *Broadband Internet: FCC's Data Overstate Access on Tribal Lands*, [GAO-18-630](#) (Washington, D.C.: Sept. 7, 2018). We made three recommendations to FCC to improve the accuracy of its broadband data. FCC concurred with these recommendations and said it would take steps to implement them.

³⁴*In the Matter of Modernizing the FCC Form 477 Data Program*, Further Notice of Proposed Rulemaking, 32 FCC Rcd. 6329 (2017).

³⁵An Order and Further Notice of Proposed Rulemaking addressing these issues was approved at FCC's August 1, 2019 Open Meeting. In the Order, FCC established a new broadband-deployment data collection to help target USF support to areas where it is needed most. According to FCC officials, the coverage maps resulting from the broadband coverage data collected from providers will provide a more precise and accurate depiction of coverage than is available through the Form 477 census-block-based data collection method. According to the officials, FCC will continue to maintain the Form 477 data collection method while the new process is established. FCC has requested comment on discontinuing the deployment aspect of Form 477 once the new method is fully in place. *Establishing the Digital Opportunity Data Collection and Modernizing the FCC Form 477 Data Program*, Report and Order and Second Further Notice of Proposed Rulemaking, WC Docket No. 11-10, 11-10 (2019).

³⁶*USF/ICC Transformation Order*, 26 FCC Rcd 17663, 17670-71, paras. 1, 11 (2011). See also 26 FCC Rcd 17663 at 17682-83, para. 57 (adopting performance goal of minimizing universal service contribution's burden on consumers and businesses).

policies to spur additional broadband deployment, while preserving additional funding in the high-cost program for other reforms.

Figure 3: The Federal Communications Commission’s (FCC) Reforms Aimed at Incentivizing Efficient Broadband Deployment

| Reform | Implementation status |
|---|---|
| <p>Model-based support FCC established a voluntary path for rate-of-return carriers to elect model-based support—which estimates expected carrier costs for deploying services—for a 10-year term in exchange for extending broadband service to a predetermined number of eligible locations.</p> | <p>✓ Complete: In 2016, FCC first offered model-based support to carriers with a per month funding cap up to \$146.10 per location receiving service. In December 2018, FCC extended a revised offer to carriers that received model-based support to receive up to \$200 per-line-per-month to deploy broadband with speeds of 25 megabits per second (Mbps) download and 3 Mbps upload (25/3 Mbps) to a designated number of locations.</p> <p>Year ▶ 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019</p> |
| <p>Support for broadband-only service FCC introduced a new traditional cost-based funding mechanism—which compensates carriers based on costs they previously incurred to deploy service—to provide support for broadband-only lines.</p> | <p>✓ Complete: Beginning January 2017, FCC offered financial support for broadband-only lines based on carrier costs. FCC offered 5 years of guaranteed support to carriers that deployed broadband with speeds greater than 10/1 Mbps in less than 80 percent of their service areas in exchange for mandatory deployment obligations to build broadband of at least 10/1 Mbps to a portion of the remaining unserved locations. Carriers that already deployed broadband at speeds of 10/1 Mbps to over 80 percent of their service areas do not have mandatory deployment obligations. In 2018, FCC offered a new 5-year deployment term and revised the minimum deployment speed to 25/3 Mbps.</p> <p>Year ▶ 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019</p> |
| <p>New model offer for traditional-cost based carriers FCC offered a second model-based support offer for carriers that remained on traditional cost-based support mechanisms.</p> | <p>✓ Complete: In 2018, FCC offered a new version of model-based support to carriers that did not initially transition to model-based support in 2016. Carriers could elect this support in return for specific deployment obligations and providing broadband speeds of 25/3 Mbps. Carriers were required to elect the offer of model-based support by July 17, 2019. In August 2019, FCC authorized support from the new version of model-based support to 217 service areas.</p> <p>Year ▶ 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019</p> |
| <p>New budget for traditional cost-based carriers FCC separated the traditional cost-based financial support budget from model-based support.</p> | <p>✓ Complete: In 2018, FCC adopted a new budget for traditional cost-based support in exchange for additional buildout requirements and 25/3 Mbps service. The new budget separated the model-based support budget from the traditional cost-based support budget to ensure that traditional cost-based carriers’ total dollar support was not reduced by the amount of support received by carriers accepting model-based support.</p> <p>Year ▶ 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019</p> |

Source: GAO analysis of FCC information. | GAO-20-27

Ensure Carrier Compliance with the High-Cost Program

According to FCC, the prior cases of carriers’ abuses of USF support for unrelated purposes prompted FCC to issue more specific rules for compliance and reporting obligations. Accordingly, FCC adopted reforms described in figure 4 to improve accountability and transparency of the high-cost program.

Figure 4: The Federal Communications Commission’s (FCC) Reforms Aimed at Ensuring That Carriers Comply with the High-Cost Program

| Reform | Implementation status |
|--|--|
| <p>Carrier reporting requirements FCC included broadband deployment information in its carrier reporting requirements. FCC demonstrates how high-cost support^a funds were used to improve broadband availability, service quality, and capacity at the smallest geographic area possible.</p> | <p>✓ Complete: In 2016, FCC reformed its annual reporting requirements for rate-of-return carriers to include broadband deployment information. As recommended by GAO in 2014, FCC began requiring carriers to annually submit geocoded locations where broadband was deployed.^b Since 2018, as part of its High-Cost Universal Broadband carrier broadband deployment verification process, FCC uses location-specific data as a metric to show the extent carriers have deployed broadband service, which is plotted on an interactive map to illustrate this information.</p> |
| <p>Classification of ineligible expenses FCC provided additional clarity on specific prohibited expenses for high-cost funds.</p> | <p>✓ Complete: In 2018, FCC provided guidance that clearly and specifically defined expenses that are ineligible for high-cost support, such as those for expenses that are not used for the provision, maintenance, and upgrading of facilities and services.</p> |

Source: GAO analysis of FCC information. | GAO-20-27

^aHigh-cost support provides financial support to telecommunications carriers in areas where the cost to provide broadband is high.

^bSee GAO, *Telecommunications: FCC Should Improve the Accountability and Transparency of High-Cost Program Funding*, GAO-14-587 (Washington, D.C.: July 22, 2014).

FCC’s Model-Based Support Reform May Reduce Fraud Risks, but It Is Voluntary and Not All Carriers Received Model-Based Support

Of the reforms we reviewed, one reform in particular—the development of a model-based support mechanism—shows promise in reducing fraud risk, according to stakeholders from federal and state government, industry, and accounting firms we contacted. Stakeholders said the model-based support mechanism is less prone to fraud risks and is a more efficient support mechanism than traditional cost-accounting support. In particular, unlike the traditional cost-accounting-support mechanism, model-based support does not rely on carrier-submitted data to determine support amounts. Instead, the model uses, among other things, a combination of historical cost data and other data, such as expected customer revenue, to determine support amounts. Since there are no data provided by carriers in the process of determining support amounts, there is no means by which carriers can provide falsified information to fraudulently receive excess support. The carriers involved in the previously described improper payments cases were receiving support from the traditional cost-accounting support mechanism.

On the other hand, stakeholders told us FCC’s traditional cost-accounting support mechanism is complex and difficult to audit, and that such

weaknesses make it prone to fraud risks. For example, USAC officials told us it is time consuming to detect inflated costs associated with carriers' affiliate company transactions. The traditional cost-accounting support mechanism also requires that carriers separate costs based upon the type of service with which the cost was associated. According to FCC's OIG officials and representatives from accounting firms we contacted, determining whether a carrier has overly attributed costs to eligible services is difficult. For instance, determining if labor costs are properly being allocated between eligible and ineligible services requires looking at each employee's timesheet. According to USAC, it also faces challenges auditing traditional cost-accounting support payments due to limited expertise and capacity to address the complexity of the audits. USAC officials noted that this issue has been exacerbated by audit staff turnover. According to USAC officials and some stakeholders we contacted, auditing carriers receiving traditional cost-accounting support is also difficult due to the extensive documentation requirements for this type of support, requirements that often entails hundreds of pages of financial information per carrier. USAC officials told us that a single audit can take over 1,000 hours to complete, and USAC officials told us they only completed 10 audits of carriers that received support on a traditional cost-accounting basis in fiscal year 2018.

As previously noted, FCC allows carriers to choose which funding mechanism is best suited for their company. FCC officials told us they developed the model-based funding mechanism in consultation with carriers and industry stakeholders. However, according to FCC officials, the model's use is not mandatory because some carriers do not believe that the model would accurately reflect their specific costs.³⁷ FCC officials said the agency does not have plans to assess the accuracy of the model's cost estimates or require carriers to receive model-based support. FCC officials told us they did not have plans to assess the model. FCC officials told us they had not planned to do so because in May 2019 FCC had just made available model-based support to the remaining legacy carriers, and FCC was still in the process of evaluating next steps. Planning for and conducting such an assessment would enable FCC to demonstrate the validity of the model and its reliability in accounting for the costs of broadband deployment. Federal internal-

³⁷ For example, a carrier we contacted said that the model did not account for higher costs this carrier faced. The costs were associated with providing service in a coastal area due to damage to electrical equipment caused by relatively higher levels of salinity in the region.

control standards state that management should use quality information to make informed decisions and evaluate program performance in achieving key objectives.³⁸ Furthermore, according to FCC’s strategic plan, FCC must ensure its USF programs, including those for the high-cost program, are well managed, efficient, and fiscally responsible, and the *National Broadband Plan* says that FCC should move rate-of-return carriers to incentive-based regulation mechanisms, such as model-based support. Yet because a substantial number of rate-of-return study areas—437—continue to receive traditional cost-accounting support, and the carriers that provide service in these areas cannot be effectively audited, significant fraud risks remain for the high-cost program. By assessing the model, FCC would have greater assurance that it is producing reliable cost estimates and be better positioned to determine whether to make its use mandatory.

FCC Has Taken Steps to Manage Fraud Risks, but Its Efforts Do Not Fully Align with Leading Practices

Managers of federal programs are responsible for managing fraud risks.³⁹ Implementing effective fraud risk-management processes is important to help ensure that federal programs fulfill their intended purpose and funds are spent effectively. GAO’s fraud risk framework is aligned with federal internal-control standards related to assessing fraud risk.⁴⁰ It focuses on preventive activities, which generally offer the most cost-efficient use of resources since they enable managers to avoid a costly and inefficient “pay-and-chase” model, which refers to the practice of detecting fraudulent transactions and recovering funds after fraudulent payments have been made. As discussed previously, our fraud risk framework consists of four components—commit, assess, design and implement, and evaluate and adapt—each of which includes overarching concepts and leading practices for carrying them out.

³⁸[GAO-14-704G](#).

³⁹Fraud and fraud risk are distinct concepts. Fraud—obtaining something of value through willful misrepresentation—is a determination to be made through the judicial or other adjudicative system, and that determination is beyond management’s professional responsibility. Fraud risk exists when individuals have an opportunity to engage in fraudulent activity, have an incentive or are under pressure to commit fraud, or are able to rationalize committing fraud. Although the occurrence of fraud indicates there is a fraud risk, a fraud risk can exist even if actual fraud has not yet been identified or occurred. When fraud risks can be identified and mitigated, agencies may be able to improve fraud prevention, detection, and response.

⁴⁰[GAO-14-704G](#).

We found that FCC has implemented some policies and procedures related to managing fraud risk for the high-cost program. For example, according to a memorandum of understanding between FCC and USAC, FCC requires USAC to alert, as appropriate, FCC’s OIG and Enforcement Bureau about potential instances of fraud. However, as detailed in appendix II, FCC’s efforts do not fully align with some elements of the fraud risk framework. In particular, we found deficiencies in FCC’s efforts related to the following three overarching concepts and one high-level component:⁴¹

- creating a structure with a dedicated entity to manage fraud risk activities (overarching concept within the *commit* component);
- planning regular fraud-risk assessments tailored to the program and assessing these risks to determine the program’s fraud risk profile (two overarching concepts within the *assess* component); and
- designing and implementing an antifraud strategy for the program (the *design and implement* component).

Fraud Risk Framework Component:

Commit to combating fraud by creating an organizational culture and structure conducive to fraud risk management



Source: GAO. | GAO-20-27

Creating a structure with a dedicated entity to lead fraud risk-management activities. Leading practices for managing fraud risk include demonstrating management’s commitment to combating fraud and designating an entity to design and oversee fraud risk-management activities. According to GAO’s fraud risk framework, an entity should lead these activities by serving as the repository of knowledge on fraud risks and controls, managing the fraud-risk assessment process, leading fraud-awareness activities, and coordinating antifraud initiatives. According to FCC officials, FCC has steering committees for each of the four USF programs, including the high-cost program. According to FCC officials, the steering committees allow in-depth discussions about each program, including on operational issues such as current spending levels and information technology systems, as well as improper payments and other issues. However, fraud risk is but one of many responsibilities of these steering committees, and they do not fill the role of a dedicated fraud risk-management entity, as called for by the fraud risk framework. In August 2019, FCC officially launched a Fraud Division—comprising existing FCC staff who investigate and prosecute fraud—within its Enforcement Bureau. However, FCC told us the scope of the new division’s operations

⁴¹The deficiencies we describe in this section have “Partially” or “No” responses in the “Implemented” column of table 2, located in appendix II.

is limited to investigations, so the Fraud Division does not fill the role of a dedicated fraud risk-management entity.⁴²

Fraud Risk Framework Component:

Plan regular fraud-risk assessments and assess risks to determine a fraud risk profile



Planning regular fraud-risk assessments tailored to the program and determining the fraud risk profile. An effective antifraud entity tailors the approach for carrying out regular fraud-risk assessments of its programs. According to GAO’s fraud risk framework, the approach should, among other things:

- fully consider the specific fraud risks the agency or program faces,
- analyze the potential likelihood and effects of fraud schemes, and
- document prioritized fraud risks.⁴³

According to FCC officials, FCC has annually worked with USAC high-cost program staff to identify and assess some risks facing the high-cost program, some of which are fraud risks, but has not planned regular fraud-risk assessments that are tailored to the high-cost program in accordance with GAO’s fraud risk framework.⁴⁴ FCC officials also told us that they adopted a tool originally developed by another agency that was used to evaluate risks facing that agency’s loan and grant programs, not just fraud risks. Using that tool as a model, FCC created a risk assessment document that included fraud risk as one of nine categories of risks across the high-cost program. Based on our discussions with FCC officials, however, the document does not constitute a fraud-risk assessment that takes into account changes to the program or operating environment. Furthermore, the risk assessment document does not constitute a fully tailored risk assessment because it does not identify and assess the fraud risks stakeholders we interviewed described as inherent to the high-cost program, detailed below.

⁴²See *Establishment of the Fraud Division of the Enforcement Bureau*, Order, 2019 WL 458078 (2019).

⁴³Appendix I contains a more detailed visual depiction of the key elements of the fraud-risk assessment process that leads to the creation of a program’s fraud risk profile.

⁴⁴We previously made a recommendation to FCC on a risk assessment for another USF program (Lifeline); as of September 2019, FCC was in the process of implementing this recommendation. See GAO, *Telecommunications: Improved Management Can Enhance FCC Decision Making for the Universal Service Fund Low-Income Program*, [GAO-11-11](#) (Washington, D.C.: Oct. 28, 2010).

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- **Risk caused by the complexity of the high-cost program's cost-allocation rules.** Officials from three out of four accounting firms, FCC's OIG, and a state utility commission we contacted singled out the specific fraud risk caused by what they described as confusing and subjective rules governing the process carriers use to separate eligible and ineligible costs.
 - **Risks related to oversight challenges.** Stakeholders identified several oversight challenges as significant in that they could contribute to fraud risks for the program, such as:
 - financial mismanagement within carriers that allowed companies to submit potentially fraudulent information to USAC and NECA, and that a telecommunications accountant told us contributed to previous instances of alleged fraud;
 - USAC's audit personnel challenges that were due to attrition and limited resources and expertise and that were identified by officials from FCC, USAC, FCC's OIG, and an accounting firm; and
 - deficiencies identified by FCC's OIG in NECA's internal controls over payments to carriers, data validation, and the appropriateness of NECA's role validating carriers' cost information.⁴⁵ In addition, FCC's OIG officials told us of oversight challenges related to carriers' reporting, including that it is difficult for USAC to detect when carriers improperly report rates billed for services provided by an affiliate of the company or report incorrect labor rates.

Furthermore, we found FCC had not identified and assessed risks to determine the fraud risk profile for the high-cost program, as called for in the fraud risk framework. A fraud risk profile is the summation of key findings and conclusions from a fraud-risk assessment, including the analysis of the types of internal and external fraud risks, their perceived likelihood and effects, managers' risk tolerance, and the prioritization of risks. FCC officials said they consider the risk of fraud to be low in the high-cost program, and FCC includes fraud risk in its current risk assessment process. Since FCC believes the fraud risk is low for the high-cost program, FCC has not deemed it necessary to conduct a separate fraud-risk assessment of the program. For example, FCC provided us with documentation related to its Enterprise Risk Management activities that identifies risks USAC faces to achieving its

⁴⁵See, Federal Communications Commission, Office of Inspector General, *Performance Audit of Universal Service Fund High Cost Program—Interstate Common Line Support*.

corporate objectives. However, while FCC considers fraud risks as part of these activities, the document does not specify the fraud risk tolerance for the program or constitute a fraud risk profile.

Without conducting regular fraud-risk assessments to gauge the likelihood and effects of the inherent fraud risks described above, and potentially others, FCC cannot determine or document the program's fraud risk profile. Furthermore, FCC has no assurance that it has fully considered important fraud risks, determined its tolerance for risks that could be lower priorities, or made sound decisions on how to allocate resources to respond to fraud risks. Not doing so could result in FCC compensating carriers for improper, ineligible, and inflated costs, such as in the previously discussed cases of identified fraud. By regularly assessing fraud risks to determine a fraud risk profile, FCC could better determine the extent to which it has designed and implemented adequate fraud-prevention controls.

Fraud Risk Framework Component:

Design and implement a strategy with specific control activities to mitigate assessed fraud risks and collaborate to help ensure effective implementation



Designing and implementing an antifraud strategy for the program.

Managers who effectively manage fraud risk develop and document an antifraud strategy that describes the program's activities for preventing, detecting, and responding to the fraud risks identified during the fraud-risk assessment. FCC and USAC have established mechanisms to enhance the oversight of USF programs, mechanisms that can also help mitigate fraud risks for the high-cost program, including:

- In fiscal year 2016, USAC implemented a risk-based selection method for conducting audits to identify the entities with the greatest risk.⁴⁶
- USAC forwards potential fraud, waste, and abuse cases to FCC.
- FCC's OIG established a hotline that can be used to report potential fraud, and USAC established a Whistleblower Alert mechanism to inform USAC of possible instances of universal service support being misapplied or mismanaged, or when carriers are potentially violating laws, rules, or regulations. USAC shares this information with FCC.
- FCC and USAC formed a working group tasked with developing a data-analytics tool designed to share USAC high-cost program data

⁴⁶The primary purpose of the audits is to ensure compliance with FCC rules and program requirements, and to assist in program compliance. USAC officials told us that before fiscal year 2016, many of the audited entities were randomly selected, and the selection process was designed to include a wide variety of entities with regard to size and geographic location.

with FCC. FCC's documentation of the tool states that once developed, the tool will help FCC's Enforcement Bureau in its fraud detection activities across all USF programs. FCC officials described the development of the tool as technically challenging and said there is no established timeline for implementing the tool.⁴⁷

- FCC officials said that FCC has regular, informal interactions concerning fraud risk with USAC and, to a lesser degree, with NECA and that FCC has confidence that USAC's improved audit processes are identifying issues appropriately.

However, FCC has not specifically designed or implemented an overall strategy to mitigate fraud risks across the high-cost program. An FCC official said FCC believes its existing antifraud activities are adequate. The FCC official said FCC considers the risk of fraud in the high-cost program to be low because USAC audits have revealed that carriers' financial reporting errors occur at a low rate and therefore do not indicate that a large amount of fraud is occurring. The official said FCC's fraud risk-management practices are based on federal internal-control standards and are woven into existing FCC mechanisms.

Given that FCC has not conducted a fraud-risk assessment that is tailored to the high-cost program and that the deceptive nature of fraud makes it difficult to measure in a reliable way, it is unclear how FCC officials reached the conclusion that the program's risk of fraud is low. Also, in the absence of an antifraud strategy, FCC has little assurance that it has the specific control activities to prevent and detect high-cost program fraud and that the types of misconduct that previously occurred are not widespread. The improper payment activity discussed previously was caught after USAC provided support to these carriers, and it was not prevented or detected through any strategic fraud risk-management effort on FCC's part. Furthermore, the FCC's OIG has expressed significant concerns about such abuses by rate-of-return carriers and about the effectiveness of USAC's auditing processes in helping prevent improper payments to these carriers. As noted above, USAC's high-cost program audits can take over 1,000 hours and USAC faces human capital challenges that have diminished its audit capacity. In addition, while NECA's data validations and reviews of high-cost support provide opportunities to identify input and data-reporting errors, they do not specifically address whether or not the data provided by carriers are

⁴⁷Because FCC has not yet determined the specifics of which data the tool will use and how it will evaluate such data, we did not assess the tool.

reasonable or if the money carriers spent addresses the intended purposes of the high-cost program. Designing and implementing an antifraud strategy that conforms to leading practices would help FCC effectively manage and respond to the fraud risks identified during the fraud-risk assessments.

Conclusions

Given the continuing importance of deploying telecommunications services in difficult-to-serve areas, effective oversight for rate-of-return carriers is an important component for helping ensure that the high-cost program's finite funds are used properly to meet the intent of the program. Overall, the traditional cost-accounting mechanism that FCC uses to provide support to a substantial number of rate-of-return carriers is complex, prone to fraud risks, and presents auditing challenges that FCC has not fully addressed. By following leading practices from GAO's fraud risk framework, FCC could better ensure that it is addressing and strategically targeting the most significant fraud risks facing the high-cost program. Furthermore, FCC's model-based support mechanism has now been in use by some rate-of-return carriers for several years and stakeholders agree that it is less prone to fraud risks. However, FCC has not assessed the extent to which the model is producing reliable cost estimates. By conducting such an assessment, FCC would have greater assurance that it is producing reliable cost estimates and be better positioned to determine whether to make its use mandatory.

Recommendations for Executive Action

We are making the following five recommendations to FCC:

- The Chairman of FCC should ensure that FCC's Office of Managing Director follows the leading practices in GAO's fraud risk framework related to a dedicated entity's management of its antifraud activities, such as serving as the repository of knowledge on fraud risks and coordinating antifraud initiatives. (Recommendation 1)
- The Chairman of FCC should plan regular fraud-risk assessments tailored to the high-cost program and assess these risks to determine the program's fraud risk profile, as provided in GAO's fraud risk framework. (Recommendation 2)
- The Chairman of FCC should design and implement an antifraud strategy for the high-cost program with specific control activities, based upon the results of fraud-risk assessments and a corresponding fraud risk profile, as provided in GAO's fraud risk framework. (Recommendation 3)

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- The Chairman of FCC should assess the model-based support mechanism to determine the extent to which it produces reliable cost estimates. (Recommendation 4)
 - The Chairman of FCC should consider whether to make use of the model-based support mechanism mandatory depending on the results of the assessment. (Recommendation 5)

Agency Comments

We provided a draft of this report to FCC for review and comment. In FCC's written comments, reprinted in appendix III, FCC described actions it would take to implement our recommendations. FCC also provided technical comments, which we incorporated as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees, the Chairman of the FCC, and other interested parties. 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 vonaha@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

Sincerely yours,

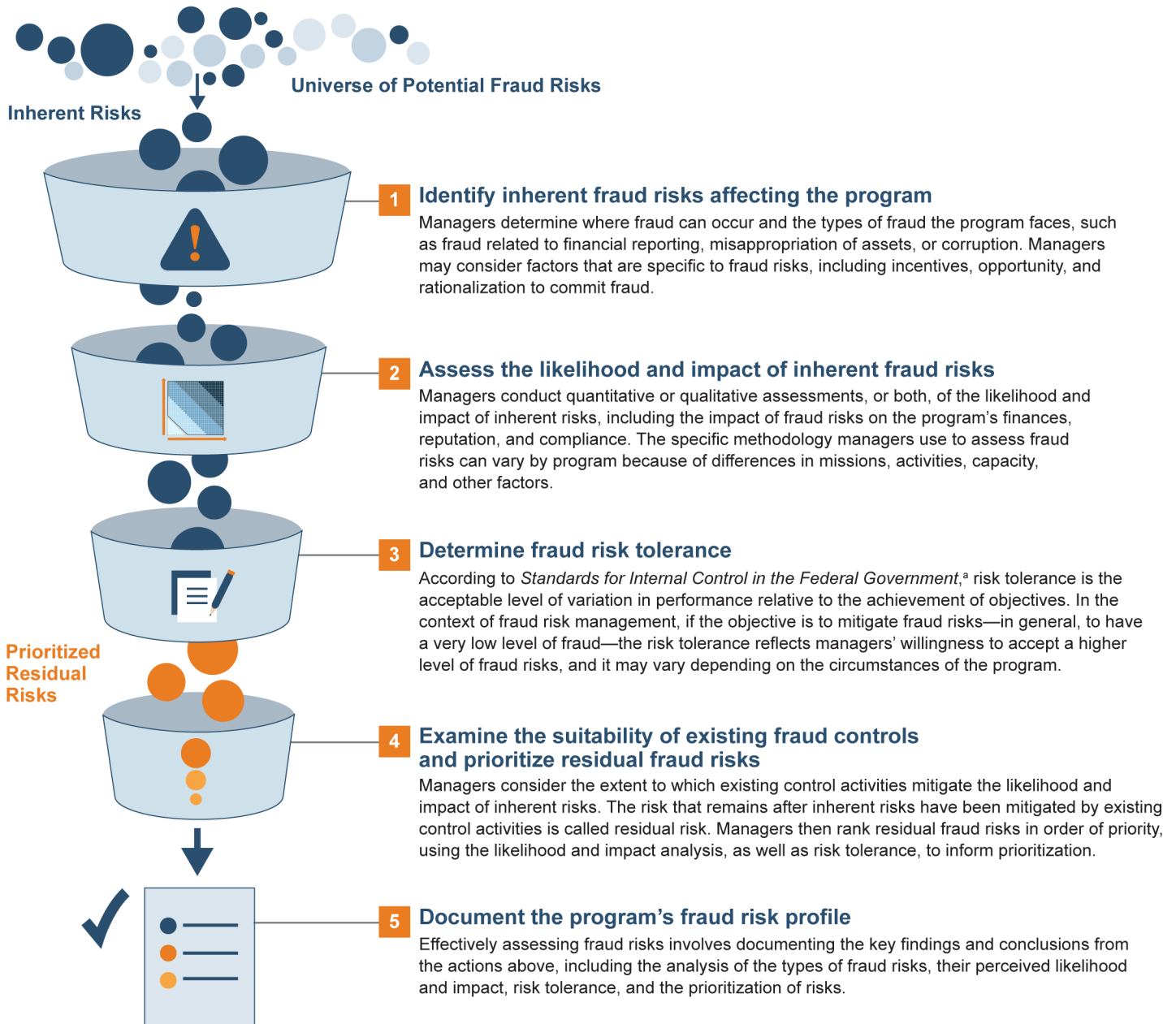


Andrew Von Ah
Director
Physical Infrastructure Issues

Appendix I: Key Elements of the Fraud-Risk Assessment Process for Creating a Fraud Risk Profile

To help managers combat fraud and preserve integrity in government agencies and programs, we identified leading practices for managing fraud risks and organized them into a conceptual framework called the *Fraud Risk Management Framework* (the framework). As described in the background section of this report and depicted visually in figure 1, the framework encompasses control activities to prevent, detect, and respond to fraud, with an emphasis on prevention, to help managers achieve the objective of mitigating fraud risks. The second of four framework components—*Assess*—calls for specific actions managers should take to achieve the objective of mitigating fraud risks. Specifically, managers should plan regular fraud-risk assessments and assess these risks to determine a fraud risk profile. Figure 5 illustrates the key elements of the fraud-risk assessment process that lead to the creation of a program’s fraud risk profile.

Figure 5: Key Elements of the Fraud-Risk Assessment Process



Source: GAO. | GAO-20-27

^aGAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014), 6.08.

Appendix II: Assessment of the Federal Communications Commission’s Antifraud Efforts for the Universal Service Fund High-Cost Program

We developed a data collection instrument to structure our assessment of the Federal Communications Commission’s (FCC) antifraud efforts for the high-cost program related to the commit, assess, and design and implement components of GAO’s fraud risk framework. For our assessment, we determined the extent to which FCC had implemented the leading practices within each component, as summarized in table 2. We did not assess FCC’s approach against leading practices in the “evaluate and adapt” component of the framework because we determined that FCC had not adopted fraud risk management leading practices within the first three components, and therefore it was premature for us to assess whether FCC was evaluating and adapting its use of these practices.

Table 2: Extent That FCC Has Implemented Leading Practices from GAO’s Fraud Risk Framework for the High-Cost Program

| Component | Overarching concept | Leading practice | Implemented |
|-----------|---|--|-------------|
| Commit | 1.1 Create an Organizational Culture to Combat Fraud at All Levels of the Agency | Demonstrate a senior-level commitment to integrity and combating fraud. | Partially |
| | | Involve all levels of the agency in setting an antifraud tone that permeates the organizational culture. | Partially |
| | 1.2 Create a Structure with a Dedicated Entity to Lead Fraud Risk Management Activities | Designate an entity to design and oversee fraud risk management activities, an entity that: <ul style="list-style-type: none"> understands the program and its operations, as well as the fraud risks and controls throughout the program; has defined responsibilities and the necessary authority across the program; has a direct reporting line to senior-level managers within the agency; and is located within the agency and not the Office of Inspector General (OIG), so the latter can retain its independence to serve its oversight role. | Partially |
| | | In carrying out its role, the antifraud entity, among other things <ul style="list-style-type: none"> serves as the repository of knowledge on fraud risks and controls; manages the fraud-risk assessment process; leads or assists with trainings and other fraud-awareness activities; and coordinates antifraud initiatives across the program. | No |
| Assess | 2.1 Plan Regular Fraud-Risk Assessments That Are Tailored to the Program | Tailor the fraud-risk assessment to the program. | Partially |
| | | Plan to conduct fraud-risk assessments at regular intervals and when there are changes to the program or operating environment, as assessing fraud risks is an iterative process. | No |
| | | Identify specific tools, methods, and sources for gathering information about fraud risks, including data on fraud schemes and trends from monitoring and detection activities. | Partially |

Appendix II: Assessment of the Federal Communications Commission’s Antifraud Efforts for the Universal Service Fund High-Cost Program

| Component | Overarching concept | Leading practice | Implemented |
|--|--|---|--------------------|
| | | Involve relevant stakeholders in the assessment process, including individuals responsible for the design and implementation of fraud controls. | Partially |
| | 2.2 Identify and Assess Risks to Determine the Program’s Fraud Risk Profile | Identify inherent fraud risks affecting the program. | No |
| | | Assess the likelihood and potential effects of inherent fraud risks. | Partially |
| | | <ul style="list-style-type: none"> Involve qualified specialists, such as statisticians and subject-matter experts, to contribute expertise and guidance when employing techniques like analyzing statistically valid samples to estimate fraud losses and frequency. Consider the nonfinancial effects of fraud risks, including the effects on reputation and compliance with laws, regulations, and standards. | |
| | | Determine fraud risk tolerance. | No |
| | | Examine the suitability of existing fraud controls and prioritize residual fraud risks. | Partially |
| | | Document the program’s fraud risk profile. | No |
| Design and Implement | 3.1 Determine Risk Responses and Document an Antifraud Strategy Based on the Fraud Risk Profile | Use the fraud risk profile to help decide how to allocate resources to respond to residual fraud risks. | No |
| | | Develop, document, and communicate an antifraud strategy to employees and stakeholders that describes the program’s activities for preventing, detecting, and responding to fraud, as well as monitoring and evaluation. | No |
| | | Establish roles and responsibilities of those involved in fraud risk-management activities, such as the antifraud entity and external parties responsible for fraud controls, and communicate the role of the Office of Inspector General (OIG) to investigate potential fraud. | Partially |
| | | Create timelines for implementing fraud risk-management activities, as appropriate, including monitoring and evaluations. | Partially |
| | | Demonstrate links to the highest internal and external residual fraud risks outlined in the fraud risk profile. | No |
| | | Link antifraud efforts to other risk management activities, if any. | Partially |
| | | | |
| | 3.2 Design and Implement Specific Control Activities to Prevent and Detect Fraud | Focus on fraud prevention over detection and response to avoid a “pay-and-chase” model, to the extent possible. | No |
| | | Consider the benefits and costs of control activities to address identified residual risks. | No |
| | | Design and implement the following control activities to prevent and detect fraud: <ul style="list-style-type: none"> data-analytics activities, fraud-awareness initiatives, reporting mechanisms, and employee-integrity activities. | Partially |
| 3.3 Develop a Plan Outlining How the Program Will Respond to | Develop a plan outlining how the program will respond to identified instances of fraud and ensure the response is prompt and consistently applied. | Partially | |

Appendix II: Assessment of the Federal Communications Commission’s Antifraud Efforts for the Universal Service Fund High-Cost Program

| Component | Overarching concept | Leading practice | Implemented |
|------------------|---|---|--------------------|
| | Identified Instances of Fraud | Refer instances of potential fraud to the OIG or other appropriate parties, such as law-enforcement entities or the Department of Justice, for further investigation. | Yes |
| | 3.4 Establish Collaborative Relationships with Stakeholders and Create Incentives to Help Ensure Effective Implementation of the Antifraud Strategy | Establish collaborative relationships with internal and external stakeholders, including other offices within the agency; federal, state, and local agencies; private-sector partners; law-enforcement entities; and entities responsible for control activities to, among other things, <ul style="list-style-type: none"> • share information on fraud risks and emerging fraud schemes, and • share lessons learned related to fraud control activities. | Partially |
| | | Collaborate and communicate with the OIG to improve understanding of fraud risks and align efforts to address fraud. | Partially |
| | | Create incentives for employees to manage risks and report fraud, including <ul style="list-style-type: none"> • creating performance metrics that assess fraud risk-management efforts and employee integrity, particularly for managers; and • balancing fraud-specific performance metrics with other metrics related to employees’ duties. | No |
| | | Provide guidance and other support and create incentives to help external parties, including contractors, effectively carry out fraud risk-management activities. | Partially |

Source: GAO analysis of Federal Communications Commission (FCC) information. | GAO-20-27

Note: Yes indicates that FCC provided evidence that it satisfies all of the leading practice, partially indicates that FCC provided evidence that it satisfies some of the leading practice, and no indicates that FCC provided no evidence that it satisfied the leading practice.

Appendix III: Comments from the Federal Communications Commission



Federal Communications Commission
Washington, D.C. 20554

October 8, 2019

Andrew Von Ah
Director, Physical Infrastructure Issues
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Director Von Ah:

Thank you for the opportunity to review GAO's draft report, "FCC Should Take Additional Action to Manage Fraud Risks in its Program to Support Broadband Service in High-Cost Areas." The Commission is committed to protecting the integrity of the Universal Service Fund (USF or Fund) as we work to close the digital divide and bring digital opportunity to all Americans.

The high-cost program is designed to ensure 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.¹ Over the last decade, the Commission has been comprehensively reforming and modernizing its high-cost program to make it more effective, efficient, and accountable.² Among other things, the Commission provided an opportunity for providers serving some of the smallest and most rural areas—rate-of-return carriers—to elect model-based high-cost support in exchange for robust broadband deployment.³ As noted in your draft report, this shift towards incentive-based regulation has helped to advance the Commission's longstanding objective of administering the Fund in a fiscally responsible manner and to protect it from the risk of waste, fraud, and abuse.

In the draft report, GAO makes five recommendations for Commission action relating to the Commission's fraud risk management program and the use of a model-based mechanism to award high-cost support to rate-of-return carriers. We address each of GAO's recommendations below.

¹ 47 U.S.C. § 254.

² See *Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663 (2011) (*USF/ICC Transformation Order*); *Connect America Fund et al.*, Report and Order et al., 29 FCC Rcd 7051, 7060-66, paras. 29-47 (2014); *Connect America Fund et al.*, Report and Order, 29 FCC Rcd 15644 (2014); *Connect America Fund et al.*, Report and Order, Order on Reconsideration, and Further Notice of Proposed Rulemaking, 31 FCC Rcd 3087 (2016 *Rate-of-Return Reform Order*); *Connect America Fund et al.*, Report and Order, Order on Reconsideration, 31 FCC Rcd 5949 (2016) (*CAF II Auction Order*); *Connect America Fund et al.*, Report and Order, Third Order on Reconsideration, and Notice of Proposed Rulemaking, 33 FCC 2990 (2018) (*March 2018 Rate-of-Return Reform Order and NPRM*); *Connect America Fund et al.*, Report and Order, Further Notice of Proposed Rulemaking and Order on Reconsideration, 33 FCC Rcd 11893 (2018) (*December 2018 Rate-of-Return Reform Order*).

³ See *December 2018 Rate-of-Return Reform Order*; *2016 Rate-of-Return Reform Order*.

Page 2— Director Von Ah

Improving the Commission's Fraud Risk Management Program. GAO recommends three actions regarding the Commission's fraud risk management program to conform with GAO's fraud risk framework. First, GAO recommends that the FCC follow the leading practices in its fraud risk framework related to a dedicated entity's management of its antifraud activities. Second, GAO recommends that the FCC plan regular fraud-risk assessments tailored to the high-cost program and to assess these risks to determine the program's fraud risk profile. Finally, GAO recommends that the FCC design and implement an antifraud strategy for the high-cost program with specific control activities, based upon the results of fraud-risk assessments and a corresponding fraud risk profile, as provided in GAO's fraud risk framework. As discussed below, the Commission has taken a number of steps to implement a robust fraud risk management program, and to prevent waste, fraud, and abuse in the high-cost program. We nonetheless plan to make additional improvements, consistent with GAO's recommendations.

The Commission coordinates all of its fraud risk management activities through the Office of Managing Director. Among other things, the Office of Managing Director conducts an annual risk assessment of the high-cost and other universal service programs, which includes an assessment of fraud risk. It also oversees a number of internal control processes. The Commission also has a variety of audit and oversight procedures for the high-cost program, including carrier self-certification, audits, and data validation processes. Additionally, the Commission implemented deployment verification and performance validation procedures to ensure that carriers meet their defined compliance obligations. Finally, as GAO noted, the Commission has largely transitioned away from its traditional cost-accounting support mechanism, to a model-based approach. Taken together, these efforts have been effective in preventing waste, fraud, and abuse in the Commission's high-cost program. Given that other universal service programs are more susceptible to waste, fraud, and abuse, the Commission has targeted significant focus on anti-fraud efforts in those other programs.⁴

To improve and build upon its existing fraud prevention efforts, the Commission will implement GAO's recommendations. Consistent with GAO's fraud risk framework, the Commission will ensure that its Office of Managing Director follows leading practices related to a dedicated entity's management of its antifraud activities, including: (1) serving as a repository of knowledge on fraud risks and controls; (2) managing the fraud-risk assessment process; (3) leading or assisting with training and other fraud-awareness; and (4) coordinating antifraud initiatives across the Commission's programs. Additionally, the Commission will more closely tailor its annual fraud-risk assessment to the high-cost program and assess those risks to determine the program's fraud risk profile. Finally, the Commission will build upon its existing internal controls to develop an anti-fraud strategy for the high-cost program with specific control activities, based upon the results of its annual fraud-risk assessments and corresponding fraud risk profile.

Use of a Cost Model in the Rate-of-Return Program. GAO also recommends two programmatic changes to the rate-of-return high-cost support mechanisms in order to mitigate fraud risk. One recommendation is that the FCC assess the model-based support mechanism to determine the extent to which it produces reliable cost estimates. GAO also recommends that the

⁴ See FY 2018 FCC Agency Financial Report, page 81, where the improper payment rate is 18.47% for the Lifeline program.

Page 3— Director Von Ah

FCC consider whether to make use of the model-based support mechanism mandatory, depending on the results of any such assessment.

The Commission shares GAO's preference for incentive-based support mechanisms and concurs that the cost model is an important tool in implementing incentive-based programs and policies. The resulting model, the Connect America Cost Model, was used in Phase II of the Connect America Fund to make model-based offers of support to price cap carriers, as well as to set reserve prices for the August 2018 auction of support in areas where the price cap carriers declined support. The model was subsequently modified to reflect the unique characteristics of the smaller, rate-of-return carriers and was used to successfully make offers of Alternative Connect America Cost Model (or A-CAM) support to rate-of-return carriers in exchange for meeting broadband deployment commitments—most recently in May 2019. As GAO noted in its report, these efforts resulted in approximately 60% of all rate-of-return carriers accepting offers of model-based A-CAM support.

Commission staff is evaluating the results of the most recent model election by rate-of-return carriers as it considers whether to make additional recommendations to the Commission, including assessing whether the cost model remains an effective tool to estimate costs. As part of future proceedings, Commission staff will continue to consider how to improve use of model-based support mechanisms, and other incentive regulation, to encourage carriers to transition from legacy programs. We remain committed to our statutory obligation to close the digital divide, while preventing waste, fraud, and abuse of universal service funding.

Thank you for the opportunity to review GAO's recommendations. We look forward to working with GAO in the future.

Sincerely,



Mark Stephens
Managing Director
Office of Managing Director



Kris Anne Monteith
Chief
Wireline Competition Bureau

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact:

Andrew Von Ah, (202) 512-2834 or vonaha@gao.gov

Staff Acknowledgments:

In addition to the individual named above, Sally Moino (Assistant Director); Sean Standley (Analyst in Charge); Philip Farah; Camilo Flores; Mark Goldstein; Gary Guggolz; Hannah Hubbard; Josh Ormond; Ben Licht; Rebecca Shea; Andrew Stavisky; and Michelle Weathers made key contributions to this report.

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