Performance Audit of the Federal Communications Commission's Universal Service Fund, High Cost Program, Connect America Fund, Phase I Incremental Support

Audit Report No. 15-AUD-09-11

FINAL REPORT

CONDUCTED FOR:
FEDERAL COMMUNICATIONS COMMISSION,
OFFICE OF INSPECTOR GENERAL

REGIS & ASSOCIATES, PC
MANAGEMENT CONSULTANTS &
CERTIFIED PUBLIC ACCOUNTANTS
1420 K Street, NW
Suite 910
Washington, DC 20005
Tel: 202-296-7101
Fax: 202-296-7284
www.regiscpa.com

Performance Audit of the Federal Communications Commission's
Universal Service Fund, High Cost Program,
Connect America Fund Phase I, Incremental Support
Final Report

Table of Contents

Performance Audit of the Federal Communications Commission's
Universal Service Fund, High Cost Program,
Connect America Fund Phase I, Incremental Support
Final Report

Executive Summary

In 2011, the Federal Communications Commission's (FCC) Transformation Order (FCC 11-161) established the Connect America Fund (CAF). The CAF is part of the High Cost Program, funded through the FCC's Universal Service Fund. The CAF transitions the focus of the High Cost Program from supporting voice only networks, to multiple purpose networks capable of voice and broadband service. The objective of the CAF Phase I, Incremental Support Program (the Program) was to accelerate broadband deployment in un-served areas. The FCC disbursed $438.29 million of Program funds to selected beneficiary companies. This funding was incremental (in addition) to their existing High Cost Program support.

The objectives of our audit of the Program were to: (1) determine the effectiveness of the controls established by the FCC and Universal Service Administrative Company (USAC), to ensure that disbursements of Program funds were for eligible purposes, and in the correct amounts; (2) test a sample of Program disbursements to Eligible Telecommunications Carriers (ETCs) that received funding, to provide reasonable assurance that the ETCs provided the broadband services, as committed; and (3) identify any improvements to the controls that may be needed to protect the fund from fraud, waste, and abuse.

The FCC's Office of the Inspector General (OIG) engaged Regis & Associates, PC, a Certified Public Accounting Firm, to conduct a performance audit of the Program. The period covered by this engagement was April 25, 2012 through November 11, 2015. We performed our audit fieldwork work from November 11, 2015 through June 30, 2017. This performance audit was conducted in accordance with Generally Accepted Government Auditing Standards, issued by the Government Accountability Office.

We reported two findings, which represent significant deficiencies[1] in the FCC and USAC's internal controls over the Program, and offered recommendations to address the significant deficiencies. First, USAC did not monitor the ETCs to ensure that Program funds paid to the ETCs would not replace or duplicate other funding sources. Second, USAC did not monitor the ETCs' progress on a timely basis, to ensure that broadband build-out milestones were being met. We made three recommendations to address USAC's monitoring of ETCs to ensure they were in compliance with Program eligibility requirements. Additionally, we made two recommendations to address deficiencies noted in USAC's build-out monitoring.

The FCC generally agreed with the conclusions discussed in this audit report and explained that the FCC could not have started testing the ETCs' compliance with program eligibility and build-out milestones until after the ETCs filed their FCC Form 481 in November 2015. The FCC also described improvements it made to its monitoring processes for the CAF Phase II build-out

[1] A significant deficiency occurs when the design or operation of internal control could fail to prevent, or detect and correct, fraud, noncompliance with provisions of laws, regulations, or abuse.

program, based on lessons learned from the Phase I program. The FCC's Management response is summarized after each finding in the report, and included in its entirety in Appendix B.

Background

In 2011, the Federal Communications Commission's (FCC) Transformation Order (FCC 11-161) established the Connect America Fund (CAF). The CAF is part of the High Cost Program and is funded through the FCC's Universal Service Fund. The CAF transitions the focus of the High Cost Program, from supporting voice only networks, to multiple purpose networks capable of providing voice and broadband service. The objective of the CAF Phase I, Incremental Support Program (the Program) was to accelerate broadband deployment in un-served areas. In accordance with the Transformation Order, the FCC allocated up to $600 million for the Program, which was offered to beneficiary companies that agreed to participate in the Program. The beneficiary companies are a category of Eligible Telecommunications Carriers (ETCs), known as Price Cap Carriers[2]. This funding was incremental (in addition) to the ETC's existing support. This support was also contingent on the ETCs fulfilling Program obligations for providing broadband-capable networks in un-served areas, within a certain time frame, that meet certain performance metrics. The ETCs that accepted Program funding were required to:

- deploy (build-out) broadband to two-thirds of the eligible locations in the areas that they serve, within two years after accepting Program funds;
- complete the build-out to specific, FCC-designated, eligible locations, within three years of accepting Program funds; and
- meet the Program's performance metrics for delivering broadband service of at least 4 million bits per second (Mbps) download speeds, and 1 Mbps upload speeds.

The FCC disbursed $438.29 million of Program funding to ETCs that accepted the funding. The funding was disbursed in two rounds, hereinafter referred to as Rounds 1 and 2. In 2012, the FCC disbursed $114.34 million in Program support for Round 1, to six holding[3] companies. Those 6 holding companies represented 72 ETCs. In 2013 and 2014, the FCC disbursed $323.95 million in Program support for Round 2, to eight holding companies. Those 8 holding companies represented 112 ETCs. The ETCs were to be paid up to $775 for each new location[4] to which they provided broadband infrastructure. The balance of the $600 million of Program funds allocated, but not disbursed in Rounds 1 and 2, remained in the High Cost Program fund for other purposes. The FCC disbursements and deployments for Rounds 1 and 2, are summarized below.

---

[2] Eligible Telecommunication Carriers are companies that meet specific FCC requirements to receive federal universal service fund support. Price Cap Carriers are large ETCs whose rates are capped for all interstate and intrastate services provided.

[3] A holding company is one that exists solely to hold a percent of the total stock of another company, or multiple companies, in an attempt to diversify or expand by acquisition.

[4] New broadband locations include residences, businesses and community anchor institutions (FCC 11-161 par. 51).

Connect America Fund – Phase 1 Funding Round	Funds Disbursed (in millions)	Locations Served	States Served	ETCs Receiving Funding
Round 1 (2012)	$114.34	147,542	37	72
Round 2 (2013-2014)	323.95	489,743	38*	112
Total	**$438.29**	**637,285**	**45***	**151****

* Amounts include Puerto Rico. Some states received funding in both Rounds 1 and 2.
** Some ETCs received funding in both Rounds 1 and 2.

The FCC directed its Wireline Competition Bureau (WCB) to implement the Program, as mandated in the Transformation Order. WCB delegated Program monitoring responsibilities to USAC. The FCC required the ETCs participating in Round 1 and Round 2 to complete the build-out to two-thirds of their un-served locations within two years, and 100 percent of those locations within three years. The deadline for the two-thirds build-out milestone for Round 1 was July 24, 2014; and the deadline for the 100 percent build-out milestone was July 24, 2015. The deadline for the two-thirds build-out milestone for Round 2 was August 5, 2015. The deadlines for completing the deployment for Phase I, Round 2 were between October 31, 2016 and March 14, 2017 (depending on the date of authorization).

Objectives, Scope, and Methodology

The objectives of this audit were to: (1) determine the effectiveness of the controls established by the FCC and USAC to ensure that disbursements of Program funds were for eligible purposes, and in the correct amounts; (2) test a sample of Program disbursements to the ETCs that received funding, to provide reasonable assurance that the ETCs provided the broadband services, as committed; and (3) identify any improvements to the controls that may be needed to protect the fund from fraud, waste, and abuse.

The scope of this audit included Program activities for the period April 25, 2012 (the date of the Round 1 Public Notice) through November 11, 2015 (the date of the audit entrance conference). We did not audit the ETCs' compliance with the Round 1 requirement for a 100 percent build-out because it was outside our audit scope. Further, we did not audit the ETCs' compliance with the build-out milestones for Round 2 because the ETCs' reporting data was not available during the period of our audit testing. We interviewed WCB, USAC, and the ETCs' management, and performed additional audit procedures, as necessary, to meet the overall objectives of this audit.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS), issued by the Government Accountability Office, December 2011 revision. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions, based on our audit objectives. We conducted the audit from November 11, 2015 through June 30, 2017.

See Appendix A for a detailed discussion of the audit objectives, scope, and methodology.

Audit Results

We found significant deficiencies in the internal controls for the Program. We identified two findings that discuss areas in which the FCC and USAC should improve the internal controls for the Program. Specifically, we found that USAC did not: (1) effectively monitor the ETCs' compliance with program eligibility requirements, and (2) adequately monitor the ETCs' build-out progress. Additional details are discussed in the Findings and Recommendations section of this report.

The FCC generally agreed with the conclusions discussed in this audit report and explained that they have could not have started testing the ETCs' compliance with program eligibility and build-out milestones until after the ETCs filed their FCC Form 481 in November 2015. The FCC's Management response is summarized after each finding in the report, and included in its entirety in Appendix B.

Findings and Recommendations

Finding 1. USAC Did Not Monitor the ETCs' Compliance with Program Eligibility Requirements

<u>Condition:</u>

USAC did not monitor the ETCs' compliance with the FCC's eligibility requirements for receiving Program funding. In particular, USAC did not monitor the ETCs to ensure the ETCs had not previously planned to expand broadband services to any of the locations for which they accepted Program funds. Also, USAC did not monitor whether Program funding duplicated other Federal program funding, such as the Broadband Initiatives Program (BIP), or the Broadband Technology Opportunities Program (BTOP). In other words, USAC did not ensure that ETCs would not have expanded broadband services to locations selected for build-out, even if Program funding had not been provided.

In Round 1, the ETCs certified[5] that their Study Area[6] locations funded by the Program were included in the June 2011 National Broadband Map of un-served locations, and were not duplicated by their Capital Improvement Plans (CIPs) for the years 2011 through 2013. Similarly, for Round 2, the ETCs certified[7] that their locations funded by the Program were included in the June 2012 National Broadband Map of un-served locations, and were not duplicated by their (CIPs) for years 2012 through 2015. However, USAC had not tested the accuracy of the ETCs' self-certifications, as of November 11, 2015, in accordance with their monitoring requirements[8] established by FCC's rules and orders.

USAC informed us that they planned to begin monitoring the ETCs' compliance with eligibility requirements after they submitted their FCC Forms 481, *Carrier Annual Reporting Data Collection Form*[9]. USAC further stated that the Form 481 reports were due November 9, 2015; more than three months after the completion deadline for the Round 1 build-out. As such, USAC did not perform any testing in 2012, 2013, and 2014; despite the FCC requirement that USAC,

[5] Holding Companies certified on behalf of their ETCs.
[6] A study area is a specific geographical location based on the National Broadband Map. Each study area boundary must be approved by the state commission. FCC DA 13-282, Order on Reconsideration, concludes that it is more appropriate for state commissions to certify to the accuracy of the study area boundary data.
[7] Holding Companies certified on behalf of their ETCs
[8] Transformation Order, par. 628 states: "We direct USAC to annually assess compliance with the new requirements established for recipients, including for recipients of CAF Phase I and Phase II."
[9] All ETCs receiving High Cost Support and/or Lifeline Program Support were required to submit the FCC Form 481, which the ETCs use to provide data collection information to USAC.

annually, assess the ETCs' compliance with Program rules and test the accuracy of the ETC's certifications[10].

We tested a sample of ETCs participating in the Program, and found that they did not comply with the requirement to provide CIPs upon request. Our sample consisted of 33 Study Areas, served by 33 ETCs[11]. Those 33 ETCs were controlled by 9 holding companies. We requested the CIPs and other documentation from the ETCs that supported the ETCs' certifications for Round 1 and Round 2. However, none of the 33 ETCs provided us with adequate documentation to demonstrate their compliance with the non-replacement requirement established by FCC rules and orders. One holding company stated that its nine ETC affiliates selected for testing did not have formal CIPs detailing specific build-out plans. Another holding company provided us with a capital budget and a risk assessment analysis in lieu of a CIP, but those documents did not demonstrate that their 13 ETC affiliates did not already plan to serve the same broadband locations within the next three years. Another 20 ETCs did not agree that they were required to, and did not provide us copies of their CIPs, as required by FCC Public Notice, DA 16-618. This notice states that ETCs "… should be prepared to produce their CIP from the time period immediately pre-dating the acceptance of the program funding for either round."

USAC's management stated that USAC did not test ETCs' certifications during the three-year build-out period because the FCC gave the ETCs the flexibility to decide to which un-served locations they would provide service[12]. According to USAC, it would have been premature for USAC to obtain the ETCs' CIPs prior to the ETCs filing their FCC Form 481 for Round 1 in November 2015. USAC further stated that they could not obtain evidence from the ETCs that corroborated the ETCs' eligibility certifications, until after November 9, 2015, the due date of the ETCs' certifications. However, we found that the ETCs began providing USAC their Program acceptance letters and certifications as early as July 2012. Therefore, USAC could have begun monitoring the ETCs' compliance with the eligibility requirements upon receipt of those certifications.

CRITERIA:

The USF High Cost Program Transformation Order, paragraph 628, states:

> "We direct USAC to annually assess compliance with the new requirements established for recipients, including for recipients of CAF Phase I and Phase II."

---

[10] The Transformation Order paragraph 628 states "…. We also direct USAC to test the accuracy of certifications made pursuant to our new reporting requirements…." Also see Public Notice DA 16-618;

[11] In our sample of 33 study areas, each of the 9 holding companies controlled between 1 and 12 ETCs. The holding companies accepted the Program funding on behalf of the ETCs. ETCs provide certifications and information to their holding company. The holding company compile the information and submit reports and certifications to FCC and USAC on behalf of the ETCs.

[12] We address USAC's position on the location flexibility issue in the finding no. 2 section entitled, "USAC Did Not Monitor the ETCs' Reallocations Among Study Areas."

> "We also direct USAC to test the accuracy of certifications made pursuant to our new reporting requirements. Any oversight program to assess compliance should be designed to ensure that management is reporting accurately to the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate, and should be designed to test some of the underlying data that forms the basis for management's certification of compliance with various requirements."

47 CFR § 54.313(b) (1) states:

> Annual reporting requirements for high-cost recipients, requires carriers to certify, in their annual reporting requirements for high-cost recipients, that subsequent to filing a notice of acceptance of funding pursuant to § 54.312(c), recipients of the incremental CAF Phase I support should provide the following in their annual reports that are due after one, two, and three years:
>
> i. A certification that, to the best of the recipient's knowledge, the locations in question are not receiving support under the Broadband Initiatives Program, or the Broadband Technology Opportunities Program, for specific projects.
>
> ii. A statement of the total amount of capital funding expended in the previous year, in meeting Connect America Fund, Phase I deployment obligations; accompanied by a list of census blocks indicating where funding was spent.

Public Notice DA 16-618 states:

> "In response to informal inquiries from CAF Phase I incremental support recipients, we now provide guidance as to the types of documentation that recipients should be prepared to produce upon request. (See FCC Rule 47 CFR 54.320 (b) below). Examples of potentially relevant documentation would include, but not be limited to, engineering studies, construction schedules, records of plant placed in service, network maps, advertising materials and/or customer subscription records. Carriers should be prepared to produce their capital improvement plan from the time period immediately pre-dating the acceptance of CAF Phase I incremental support for either round. Carriers also should be prepared to produce documentation demonstrating the steps taken to determine an area was not already served according to the then-current National Broadband Map or slated to become served as a BIP or BTOP project, to the best of their knowledge."

CAUSE:

The FCC did not ensure that USAC established policies and procedures for effective monitoring of the ETCs' eligibility to receive Program funding. These policies and procedures should have included: (1) monitoring the ETCs to ensure that Program funds would not replace or duplicate other funding sources, and (2) evaluating the ETCs' self-certifications affirming that they meet the Program's eligibility requirements.

EFFECT:

There is a risk that the ETCs may have received Program funding for locations that ETCs had already designated for build-out using their own capital funding or funding from other programs.

RECOMMENDATIONS:

We recommend that the FCC direct USAC to:

(1) establish detailed policies and procedures for monitoring ETCs' eligibility for Program funding;

(2) promptly begin testing ETCs' compliance with Program requirements not to replace or duplicate the Program funding, and recover any funds disbursed for ineligible build-out projects; and

(3) test the ETCs' self-certifications to ensure the ETCs meet Program eligibility requirements prior to disbursing funds for any future broadband build-out programs.

FCC'S MANAGEMENT RESPONSE (SUMMARY):

USAC monitored the ETCs' compliance with program eligibility requirements after the ETCs filed their final FCC Form 481 in November 2015, rather than at the beginning of the program in 2012. This delay occurred because the participating ETCs had the flexibility to determine where to deploy broadband service within the eligible areas, which was not known until after the final FCC Forms 481 were submitted in November 2015. For subsequent build-out programs, the new High Cost Universal Broadband (HUBB) portal will enable USAC to complete eligibility validations for program compliance at a much-improved rate, and at an earlier stage of program rollout.

AUDITOR'S COMMENTS:

The FCC did not dispute that USAC's monitoring of the ETCs' program eligibility requirements was not timely. The FCC should have directed USAC to test compliance with the ETCs' non-replacement and non-duplication requirements, prior to the disbursement of Program funds, or shortly after the funds were disbursed. We also noted that the FCC's response does not specify details of the program eligibility testing done by USAC after November 2015, or the results of those tests.

Finding 2. USAC Did Not Adequately Monitor the ETCs' Build-out Milestone Progress

CONDITION:

USAC did not monitor ETCs on a timely basis, to ensure that they met the Program's broadband build-out milestones for Round 1. Specifically, (1) USAC's audit program did not include procedures to ensure that ETCs complied with build-out milestones, (2) USAC's monitoring plan did not require ETCs to provide adequate supporting documents, and (3) USAC did not monitor reallocations of Program funding among Study Areas.

USAC's Audit Procedures did not Ensure ETC Compliance with Program Build-out Milestones

FCC directed[13] USAC to update its Beneficiary and Contributor Audit Program (BCAP or audit plan), to add procedures for monitoring and validating ETC compliance with Program requirements. In response to the FCC's direction, USAC drafted a BCAP Compliance Memorandum, which documented their revised audit procedures. This memorandum included procedures for testing ETCs' compliance with Program requirements to meet build-out milestones dates and performance metrics. WCB approved USAC's BCAP Compliance Memorandum on April 28, 2016. However, USAC's updated audit plan did not include a start date or milestones for USAC's monitoring of the ETCs' progress toward build-out milestones.

USAC Did Not Ensure the ETCs Provided Adequate Supporting Documentation

USAC did not ensure that ETCs provided adequate supporting documentation to substantiate that they were in compliance with Program build-out requirements. The FCC required the ETCs to certify, on their FCC Forms 481 submitted to USAC, that they had completed the two-thirds build-out to un-served locations in their respective Study Areas. However, USAC did not ensure that the ETCs provided complete lists of their respective build-out locations in their FCC Form 481 submissions. Without complete and accurate build-out lists, USAC did not have the

[13] Per Transformation Order, Paragraph 628, "We direct USAC to submit a report to WCB, WTB, and OMD within 60 days of release of this Order (November 11, 2011) proposing changes to the BCAP and PQA programs consistent with this Order'.

information necessary to plan and perform effective reviews of the ETCs' submissions and determine whether they complied with the Program's requirements.

USAC Did Not Monitor the ETCs' Reallocation of Funding Among Study Areas

USAC did not monitor the ETCs and their holding companies to ensure that they did not improperly reallocate Program funding to Study Areas other than the FCC approved locations. The FCC provided the ETCs funding to build out to specific, designated locations, which the ETCs agreed to in their acceptance letters. The ETCs had flexibility to reallocate Program funds received within their Study Areas, provided that they followed the FCC's required steps. However, the ETCs' holding companies did not have the authority to reallocate Program funding from one ETC's Study Area to another ETC's Study Area, even if those Study Areas included un-served locations. The FCC established its build-out requirements at the ETC or Study Area level, and not at the holding company level. FCC rules allow ETCs to substitute a designated location for another un-served location, but only within their own Study Areas. Further, the rules require the ETC to notify the FCC, USAC, State Commissions, and Tribal governments, 90 days prior to starting the build-out[14] in the substituted area.

We performed tests to determine whether the ETCs improperly reallocated Program funding to other Study Areas. The test consisted of determining whether the ETCs complied with the Program requirement to complete the build-out to two-thirds of the total number of locations for each of the Study Areas for which they accepted funding[15]. FCC Public Notice DA 12-639 confirmed the amount of funds allocated to each holding company's affiliate ETCs[16]. In Round 1, a total of 9 holding companies, on behalf of 72 ETCs, affirmed in their signed acceptance letters that they would complete the build-out to their specified locations in 72 unique Study Areas. Those 72 Study Areas contained 147,542 un-served locations.

---

[14] 47 CFR 54.312(b)(3), (c)(4) If a carrier intends to deploy to census blocks not initially identified at the time of election, it must inform the Commission, the Administrator, relevant state commissions, and any affected Tribal government of the change at least 90 days prior to commencing deployment in the new census blocks.
No sooner than 46 days after the Wireline Competition Bureau issues a public notice announcing the updated deployment plans but prior to commencing deployment, the carrier must make the certifications described in this paragraph with respect to the new census blocks. If a carrier no longer intends to deploy to a previously identified census block, it must inform the Commission, the Administrator, relevant state commission, and any affected Tribal government prior to filing its certification pursuant to § 54.313(b)(2).

[15] FCC Rule 47 CFR 54.313 (b) states "In addition to the information and certifications in paragraph (a) of this section: (1) Any recipient of incremental Connect America Phase I support pursuant to § 54.312(b) and (c) shall provide: (i) In its next annual report due after two years after filing a notice of acceptance of funding pursuant to § 54.312(b) and (c), a certification that the company has deployed to no fewer than two-thirds of the required number of locations; and…"

[16] According to FCC Public Notice DA 12-639, pg. 4: "No later than 90 days after the release of this Public Notice, ETCs must file notices stating the amount of support each wishes to accept, and the areas by wire line and census block in which the carrier intends to deploy broadband to meet its obligation, or stating that the carrier declines incremental support for 2012."

We selected a sample of 16 Study Areas from the population of 72, which included 112,132 un-served locations. The 16 Study Areas were served by 16 ETCs, which were represented by 3 holding companies. We compared the number of locations that each ETC agreed to build-out, to the number of locations reported on its Form 481. We found that 6 of the 16 ETCs tested (samples number 1 through 6) reported, on their Forms 481, that they completed a greater number of build-outs than the number listed in their corresponding acceptance letters. Five ETCs (samples number 7 through 11) did not report any locations built-out. Five of the 16 ETCs tested (samples number 12 through 16) reported, on their Forms 481, fewer locations built out than they listed in their corresponding acceptance letters.

In the table below, we summarized the results of our comparison of the build-out locations the ETCs reported they completed, to the locations listed in their corresponding acceptance letters:

Comparison of Accepted to Reported Build-out Locations						
Sample	Study Area Name	SAC	State	Locations Based on Acceptance Letters[17]	Locations Reported on Form 481[18]	Locations Reported Over (Under) Built
1	[redacted]	[redacted]	WV	3,951	43,888	39,937
2	[redacted]	[redacted]	CO	5,282	8,633	3,351
3	[redacted]	[redacted]	WA	4,980	7,332	2,352
4	[redacted]	[redacted]	WA	3,029	4,204	1,175
5	[redacted]	[redacted]	FL	265	1,391	1,126
6	[redacted]	[redacted]	IL	3,188	4,198	1,010
Total Build-out Locations for the 6 ETCs that Reported Over-Built						**48,951**

[17] The total number of locations accepted was multiplied by two-thirds for the comparison.
[18] The number of locations reported on FCC Form 481 was for the two-thirds build-out completion milestone.

Comparison of Accepted to Reported Build-out Locations						
Sample	Study Area Name	SAC	State	Locations Based on Acceptance Letters[19]	Locations Reported on Form 481[20]	Locations Reported Over (Under) Built
7	[redacted]	[redacted]	OR	298	-	(298)
8	[redacted]	[redacted]	TN	174	-	(174)
9	[redacted]	[redacted]	MO	119	-	(119)
10	[redacted]	[redacted]	NM	93	-	(93)
11	[redacted]	[redacted]	WA	77	-	(77)
Total Build-out Locations for the 5 ETCs that Did Not Report Any Build-Out						**(761)**
12	[redacted].	[redacted]	WI	32,962	9,739	(23,223)
13	[redacted]	[redacted]	MN	9,377	3,204	(6,173)
14	[redacted]	[redacted]	ID	4,039	952	(3,087)
15	[redacted]	[redacted]	MI	6,169	5,649	(520)
16	[redacted]	[redacted]	IL	748	689	(59)
Total Build-out Locations for the 5 ETCs that Reported Under-Built						**(33,062)**

USAC's management disagreed with our conclusion that USAC did not timely or adequately monitor the ETCs' build-out progress. USAC stated that the monitoring could not have commenced prior to November 9, 2015, the due date of the ETCs' first submission of their Forms 481 to USAC for Round 1. USAC also stated that upon receipt of the Forms 481, they promptly initiated the review of the forms and started monitoring Program activities. USAC further stated that the FCC did not require ETCs to submit the build-out locations on the Forms 481, and that the FCC could not require ETCs to submit build-out data prior to Office of Management and Budget approval of the revised Form 481 in September 2015. Further, USAC disagreed with our finding that the holding companies inappropriately reallocated funds among ETCs.

We do not agree with USAC's explanations. USAC's monitoring was not timely, because it was not conducted annually, as required by paragraph 628 of the Transformation Order. USAC could have begun monitoring prior to November 2015, because they received the ETCs' acceptance

[19] The total number of locations accepted was multiplied by two-thirds for the comparison.
[20] The number of locations reported on FCC Form 481 was for the two-thirds build-out completion milestone.

letters and certifications in July 2012. We also found that USAC's monitoring, which started after November 2015, was not adequate because it consisted merely of testing whether ETCs filed their Forms 481. Further, we found that USAC's monitoring was not contingent upon Office of Management and Budget approval, because USAC could have monitored the ETCs' buildout progress prior to receiving the ETCs' Forms 481.

CRITERIA:

The Transformation Order delegates authority to WCB; who in turn directs USAC to, annually, assess compliance with CAF requirements. Transformation Order, par. 628 states:

> "We direct USAC to review and revise the Beneficiary Compliance Audit Program (BCAP) and Payment Quality Assurance (PQA) programs to take into account the changes adopted in this Order. We direct USAC to annually assess compliance with the new requirements established for recipients, including for recipients of CAF Phase I and Phase II. For CAF Phase I, we establish above a requirement that companies have completed build-out to two-thirds of the requisite number of locations within two years."
>
> "We also direct USAC to test the accuracy of certifications made pursuant to our new reporting requirements. Any oversight program to assess compliance should be designed to ensure that management is reporting accurately to the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate, and should be designed to test some of the underlying data that forms the basis for management's certification of compliance with various requirements."
>
> "We direct USAC to submit a report to WCB, WTB [Wireless Telecommunications Bureau], and OMD within 60 days of release of this Order proposing changes to the BCAP and PQA programs consistent with this Order."

FCC Rule 47 CFR 54.312 (b) (2) states:

> "An eligible telecommunications carrier accepting incremental support, must deploy broadband to a number of un-served locations, as shown as un-served by fixed broadband on the then current version of the National Broadband Map, equal to the amount of incremental support it accepts divided by $775."

According to FCC Order DA 12-1155, page 2:

> "Each carrier accepting funding must identify the areas, by wire center and census block, in which it intends to deploy broadband to meet its obligation, when it files its notice of acceptance. Carriers are required to complete deployment to no fewer than two-thirds of the required number of locations within two years and all required locations within three

> years, and they must certify that they have done so as part of their annual certifications under section 54.313 of the Commission's rules."
>
> The Commission also provided that "carriers failing to meet a deployment milestone will be required to return the incremental support distributed in connection with that deployment obligation and will be potentially subject to other penalties, including additional forfeitures, as the Commission deems appropriate." The Commission continued, "if a carrier fails to meet the two-thirds deployment milestone within two years and returns the incremental support provided, and then meets its full deployment obligation associated with that support by the third year, it will be eligible to have support it returned restored to it."

FCC Order 13-97, page 7 states:

> "If a carrier intends to deploy to census blocks not initially identified at the time of election, it must inform the Commission, the Administrator, relevant State commissions, and any affected Tribal government of the change at least 90 days prior to commencing deployment in the new census blocks."

According to FCC Public Notice DA 12-639, page 4 states:

> "No later than 90 days after the release of this Public Notice, carriers must file notices stating the amount of support each wishes to accept, and the areas by wire line and census block in which the carrier intends to deploy broadband to meet its obligation, or stating that the carrier declines incremental support for 2012."

FCC Public Notice (PN) DA16-618, page 3 states:

> "For both rounds of Phase I incremental support, if the carrier fails to certify in FCC Form 481 that it is meeting its obligations with respect to the required number of total locations by the three-year deadline, it should provide geo-coded locations for those locations that it seeks to count towards its compliance obligation. USAC then will recover funds from the carrier on a per-location basis for the requisite number of locations in the month immediately following the failure to certify compliance with the requisite deadline. Likewise, for the upcoming certification for the second round of Phase I incremental support, if the carrier fails to certify in FCC Form 481 that it deployed to the requisite number of locations for the two-year milestone, it should submit the geo-coded locations for those locations that it seeks to count towards its compliance obligation. USAC will recover funds from the carrier on a per-location basis in the month immediately following the failure to certify compliance with that deadline."

CAUSE:

The FCC did not ensure that USAC developed procedures for monitoring the ETCs' build-out progress on a timely basis.

EFFECT:

USAC's lack of an adequate monitoring process exposed the Program to the risk that ETCs may not have completed the build-out timely, within the proper locations, and met performance requirements. We found that the ETCs included in our testing sample did not complete a total of 33,823 of the accepted build-out locations in a timely manner[21]. This represents, approximately, 23 percent of the total locations accepted in Round 1. The Program funds associated with the 33,823 fewer build-out locations completed, at $775 per location, totals $26,212,825. There is also the risk that these funds may have been used for unintended purposes.

RECOMMENDATIONS:

We recommend that WCB direct USAC to:

(1) perform a review to determine whether the ETCs completed the Round 1 and 2 build out in the proper un-served locations, and by the interim and final milestone dates; and

(2) develop detailed monitoring procedures to ensure that ETCs adhere to the performance and reporting requirements of any future broadband build-out support programs.

FCC'S MANAGEMENT RESPONSE (SUMMARY):

The FCC and USAC could not initiate monitoring of the ETCs' build-out while the program was underway because (1) this was the first time USAC was receiving and reviewing geocoded location data; and (2) the FCC gave ETCs the flexibility to determine which un-served locations to serve. Instead, USAC developed and documented testing procedures between November 2015 and April 2016. USAC also stated it has completed its verification of the Phase I build-out, and identified less than $20,000 of support for locations reported by ETCs' that it was not able to verify.

[21] See table, Comparison of Accepted to Reported Build-out Locations, sample numbers 7-11 (761 locations) plus sample numbers 12-16 (33,062 locations) equals 33,823 locations.

AUDITOR'S COMMENTS:

The FCC did not dispute the audit conclusion that USAC's monitoring of the build-out milestones was not timely. Monitoring at the end, rather than the beginning of the Program, could have allowed fraud, waste, or abuse to occur and not be detected timely. We commend the FCC and USAC for implementing more timely build-out reporting requirements and monitoring procedures for its subsequent broadband build-out programs. The FCC's response did not include details of USAC's tests that identified $20,000 of support for unverified locations. Therefore, we could not evaluate the accuracy of this amount. We also noted that the response did not address the requirement that ETCs notify the FCC, USAC, State Commissions, and Tribal governments, 90 days prior to starting the build-out in the substituted areas. Therefore, additional amounts of unverified support could be attributable to ETCs that may not have complied with the requirements for substituted build-out areas.

Appendix A – Detailed Objectives, Scope and Methodology

To accomplish objective 1 (determine the effectiveness of the controls established by the FCC and USAC to ensure that disbursements of Program funds were for eligible purposes, and in the correct amounts), we performed audit procedures to determine whether USAC's disbursements to the ETCs were in the correct amounts, and whether USAC monitored the ETCs' compliance with eligibility requirements. We completed this audit objective for both Program Rounds 1 and 2. To accomplish objective 2 (test a sample of Program disbursements to the ETCs that received funding, to provide reasonable assurance that the ETCs provided the broadband services, as committed), we performed audit procedures to determine whether USAC monitored the ETCs' compliance with their two-thirds build-out requirement in Round 1. To accomplish objective 3 (identify any improvements to the controls that may be needed to protect the fund from fraud, waste, and abuse), we developed findings and made recommendations based on the audit procedures performed.

The performance audit consisted of three significant areas of testing: eligibility for disbursement; cash disbursement; and build-out monitoring. We examined the Transformation Order relating to Program funding; orders related to Program support; and other related FCC rules and regulations. We obtained Form 481 certifications that ETCs made to the Commission, and submitted to USAC. We then evaluated the quality of those certifications, using the Government Accountability Office's Standards for Internal Control in the Federal Government. The population of Round 1 consisted of $114,343,753 in Program funding; disbursed to 72 ETCs. We applied Monetary Unit Sampling (MUS) to this population, to arrive at a sample of transactions to be tested. The sample size derived from this process represented, approximately, 76 percent of the population. Similarly, we applied MUS to the Round 2 population of transactions. That population consisted of, approximately, $323,948,322 of Program funding that was disbursed to 112 ETCs. The sample derived from the application of MUS, represented approximately, 77 percent of the population. We then interviewed WCB, USAC, and the ETCs' management, to assess whether they met the Program objectives. These test procedures were designed to identify deficiencies and recommend improvements to the controls to prevent fraud, waste, and abuse. We performed other test procedures, as deemed necessary, to meet the overall objectives of this audit.

The objective of eligibility for disbursement testing was to determine whether USAC was monitoring ETCs' compliance with eligibility requirements for Program disbursements. To accomplish this objective, we examined USAC's policies and procedures for monitoring ETC compliance. We examined ETCs' eligibility to accept Program funds, prior to, and subsequent to, accepting those funds. We also determined, from our sample of ETCs, whether their Capital Improvement Plans (CIP) supported non-replacement certifications. We then assessed USAC's controls over eligibility monitoring, and the ETCs' compliance with document retention regulations.

The objective of cash disbursement testing of Program funding was to determine whether USAC made Program disbursements to the correct ETCs and in the correct amounts. To accomplish this objective, we requested confirmation from the ETCs as to the validity of the disbursements they received from USAC. In addition, we examined authorized supporting documents for disbursements of Program funds. We also assessed whether bank reconciliations and cash disbursements posted to USAC's general ledger were reasonable. We then assessed the controls over cash disbursements for Round 1 and Round 2 to determine whether improvements were needed to protect the fund from fraud, waste, and abuse. We selected 33 ETCs for testing of USAC's internal controls over cash disbursements. We found no material variances between the amounts that USAC disbursed and the amounts that the ETCs confirmed receiving. We also determined that USAC recorded the disbursements accurately in its general ledger, and disbursed the correct amounts to the ETCs.

The objective of our testing of build-out monitoring was to determine whether USAC had controls over the build-out oversight reporting and monitoring processes. To accomplish this objective, we assessed USAC's monitoring procedures for the two-thirds build out milestone. We then determined whether USAC required ETCs to provide adequate supporting documents to facilitate monitoring of their performance. Additionally, we assessed USAC's policies and procedures for ETC Program submissions. We conducted an analysis to determine whether ETCs met the two-thirds build-out milestone, by reviewing their Forms 481 and the accompanying location schedules for Program build-out. We also performed testing and analysis to determine whether ETCs reallocated funds in accordance with FCC regulations. We accomplished this by performing re-calculations of the build-out by Study Areas.

We were unable to select and test a sample of USAC's eligibility reviews, because these reviews were not performed. Our testing of ETCs' eligibility for disbursements revealed that the ETCs did not maintain evidence to support their non-replacement certifications. We found that ETCs did not have formal CIPs that detailed specific build-out plans. ETCs' lack of maintenance of supporting documentation for CAF certifications impairs their ability to support their compliance with the Program's non-replacement requirements. Since USAC did not perform monitoring procedures, we selected 33 ETCs to test their CIPs for compliance with the non-replacement of un-served locations. Program policies require ETCs to maintain CIPs that support their certifications. In accordance with Public Notice DA 16-618, ETCs were required to produce their CIPs, if requested, to satisfy the non-replacement requirement. Specifically, they were required to produce CIPs for the period prior to the acceptance of Program funding for Round 1 and Round 2. The ETCs in our sample did not provide adequate documentation to demonstrate compliance with the non-replacement requirement. Also, the ETCs did not retain supporting documentation for their CIP certifications, in accordance with the Program's document retention policies.

Appendix B – FCC's Management Response

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

April 27, 2018

Transmitted via E-mail

David L. Hunt, J.D.
Inspector General
Office of Inspector General
Federal Communications Commission

Dear Mr. Hunt:

Thank you for the opportunity to review and comment on the draft report from the Office of Inspector General (OIG) entitled *Performance Audit of the Federal Communication Commission's Universal Service Fund, High Cost Program, Connect America Fund, Phase I Incremental Support*. The Commission takes seriously its role as stewards of public funds that contribute to the Universal Service Fund (USF or Fund), as well as its duty to exercise responsible programmatic oversight of the Fund. In the draft report, OIG makes two findings. We address each of the OIG's findings below.

Background

In the 2011 *USF/ICC Transformation Order*, the Commission decided to offer additional, incremental support to price cap carriers – Connect America Fund (CAF) Phase I – to spur the deployment of voice and broadband-capable infrastructure to unserved locations on an interim basis while the Wireline Competition Bureau (Bureau) developed a forward-looking cost model to calculate the offer of ongoing Phase II support.[1]

In July 2012, price cap carriers elected nearly $115 million in Phase I incremental support, committing to bring broadband-capable infrastructure to nearly 150,000 previously unserved locations by 2015.[2] Within two years of accepting Phase I support, carriers were required to deploy to two-thirds of the required number of Phase I locations, which they reported to the Commission, state public utility commissions, and the Administrator of the Universal Service Administrative Company (USAC) in November 2015.[3] The deadline for completion of deployment for the first round of Phase I incremental support was July 2015, which carriers reported in their July 2016 FCC Form 481.[4]

---

[1] *Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17712, para. 128, 17715-17, paras. 133-38 (2011) (*USF/ICC Transformation Order*); *see also* 47 CFR §§ 54.312(b), (c), 54.313(b).

[2] Press Release, FCC, FCC Kicks-Off 'Connect America Fund' with Major Announcement: Nearly 400,000 Unserved Americans in Rural Communities in 37 States Will Gain Access to High-Speed Internet within Three Years (July 25, 2012), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-315413A1.pdf.

[3] Notice of Office and Management and Budget Action, Sept. 2, 2015 (approving without change OMB Control No. 3060-0986).

[4] *See* IATD, Wir. Comp. Bur., Universal Service Monitoring Report, Appx. (Fig. 1) (Dec. 2016).

In May 2013, the Commission adopted rules for a second round of Connect America Phase I incremental support.[5] By March 2014, the Bureau had authorized nearly $324 million in Phase I Round 2 support for deployment of broadband-capable infrastructure to almost 500,000 previously unserved locations.[6] Within two years of accepting Phase I Round 2 support, carriers were required to deploy to two-thirds of the required number of Phase I locations, which they reported in July 2016.[7] The deadlines for completion of deployment for Phase I Round 2 were between October 31, 2016 and March 14, 2017 (depending on the date of authorization), and was reported July 2017.[8] For Phase I Round 2, carriers could, and did, modify their planned deployment, with an opportunity for other providers to indicate they already serve the proposed blocks.[9]

Ultimately, CAF Phase I Rounds 1 and 2 disbursed $438.29 million to deploy service to more than 500,000 previously unserved locations.

OIG Findings

The OIG found that USAC did not adequately monitor eligible telecommunications carriers' (ETCs') compliance with either (1) program eligibility requirements; or (2) build-out milestones. We respectfully disagree. As a matter of process, we note at the outset that OIG's findings likely stem, in large measure, from the time frame selected for the audit period.[10] Given programmatic requirements, most of the validation and verification work that USAC completed necessarily took place outside of the OIG audit period.[11] As a result, the significant effort undertaken by USAC was not reflected in OIG's

[5] *Connect America Fund,* Report and Order, 28 FCC Rcd 7766 (2013) (*Phase I Round 2 Order*). The Commission expanded the eligible locations to include areas lacking Internet access with 3 Mbps downstream and 768 kbps upstream, *id.* at 7771-72, paras. 15-16, and concluded that parties could challenge whether a location was in fact served by an existing provider and thus ineligible for support. *Id.* at 7776-79, paras. 28-33. On January 10, 2014, the Bureau issued an Order adjudicating challenges filed by over 80 interested parties. *Connect America Fund,* Order, 29 FCC Rcd 181 (WCB 2014).

[6] *Phase I Round 2 Order,* 28 FCC Rcd at 7776-79, paras. 28-33; *see also Over $32 Million of Connect America Funding Authorized to Connect Unserved Homes and Businesses in Alaska, Hawaii, and Puerto Rico,* Public Notice, 28 FCC Rcd 14896 (WCB 2013); *Over $255 Million of Connect America Funding Authorized to Connect Unserved Homes and Businesses in 41 States,* Public Notice, 28 FCC Rcd 16450 (WCB 2013); *Additional $16.7 Million in Connect America Phase I Support Authorized,* Public Notice, 29 FCC Rcd 2824 (WCB 2014).

[7] *Wireline Competition Bureau Announces Deadlines for Connect America Phase I Round Two,* Public Notice, 29 FCC Rcd 11445 (WCB 2014).

[8] *See Wireline Competition Bureau Reminds Connect America Phase I Round Two Recipients of Deployment and Certification Deadlines,* Public Notice, 31 FCC Rcd 13298 (WCB 2016). Please note that this date range differs from the deadline identified by the OIG as August 5, 2016.

[9] *See, e.g., Wireline Competition Bureau Announces Deadline for Existing Providers to Notify Puerto Rico Telephone Company That They Serve Census Blocks That Puerto Rico Telephone Company Proposes to Serve with Connect America Phase I Incremental Support,* WC Docket No. 10-90, Public Notice, 31 FCC Rcd 1893 (WCB 2016); *Wireline Competition Bureau Announces Deadline for Existing Providers to Notify Alaska Communications Systems That They Serve Census Blocks That Alaska Communications Systems Proposes to Serve with Connect America Phase I Incremental Support,* WC Docket No. 10-90, Public Notice, 30 FCC Rcd 2791 (WCB 2015); *Wireline Competition Bureau Announces Deadline for Existing Providers to Notify Puerto Rico Telephone Company or Hawaiian Telcom, Inc. That They Serve Census Blocks That the Price Cap Carriers Propose to Serve with Connect America Phase I Incremental Support,* WC Docket No. 10-90, Public Notice, 30 FCC Rcd 1862 (WCB 2015); *Wireline Competition Bureau Announces Deadline for Existing Providers to Notify AT&T That They Serve Census Blocks That AT&T Proposes to Serve with Connect America Phase I Incremental Support,* WC Docket No. 10-90, Public Notice, 30 FCC Rcd 412 (WCB 2015).

[10] The time frame covered by the OIG engagement was April 25, 2012 through November 11, 2015.

[11] The time frames for the various workstreams is discussed below. Although compliance planning began months earlier, the actual validation and verification work took place after the November 2015 deadline for CAF Phase I

findings, but nonetheless serves to protect the integrity of the CAF Phase I program. Our more substantive responses to the audit report are set forth below.

First, the OIG finds that "USAC did not monitor the [eligible telecommunications carriers] ETCs' compliance with program eligibility." USAC did monitor the ETCs' compliance with program eligibility, but given the time frames selected by OIG for this audit, USAC conducted its validation and verification process outside of the audit period. Consistent with Phase I rules and programmatic timing, USAC has now completed its verification work for locations submitted for both Rounds 1 and 2. During the course of its testing and review, USAC validated 524,789 locations and verified 1,547 locations.[12] As a result of its verification work and pursuant to Commission rule, USAC has identified less than $20,000 of support for reported locations that it was unable to verify.

The Commission designed CAF Phase I incremental support "to provide an immediate boost to broadband deployment" during the transition from the old high-cost support mechanisms for price cap carriers while the Commission established and implemented the new modernized CAF Phase II support mechanism.[13] As such, the Commission specifically contemplated that participating carriers should have flexibility to determine where to deploy complying networks within the eligible areas and confirmed compliance should be assessed on the final certifications.[14]

We agree that testing for ETC compliance with the non-replacement and non-duplication requirements is critical. The Bureau ensured that USAC established policies and procedures to effectively monitor carriers' eligibility for Phase I funding, by specifically including measures to (1) monitor the ETCs to ensure that Phase I funds did not replace or duplicate other funding sources, and (2) evaluate the ETCs' self-certifications affirming they met the eligibility requirements. USAC began testing and review work promptly after the November 2015 reporting deadline. Between November 2015 and April 2016, USAC and Bureau staff worked closely through an iterative process to develop and document robust and thorough testing procedures. The procedures did not include milestone dates because this was the first time USAC was receiving and reviewing geocoded location data. That is, because the Bureau and USAC did not yet have a clear understanding of what was feasible or reasonable, they used this first instance to gather information to help inform such decisions and avoid setting arbitrary milestones going forward.

USAC monitored ETCs on a timely basis to ensure that the ETCs met the Phase I build-out milestones. Specifically, USAC's verification policies and procedures (1) ensured that ETCs were in compliance with build-out milestones; (2) required ETCs to provide adequate supporting documents to

support recipients to report that they completed deployment to two-thirds of the required locations. That work continued until USAC completed its review of recipient compliance with the final (100 percent) deployment milestone.

[12] The Bureau has recently resolved two petitions related to CAF Phase I Round 2. *See Connect America Fund*, Order, DA 18-337 (WCB rel. Apr. 4, 2018) (denying a petition for clarification or waiver filed by Alaska Communications Services Group, Inc. (ACS) of the geocoded location identification requirements of the CAF Phase I Round 2); *Connect America Fund*, Declaratory Ruling and Order, DA 18-242 (WCB rel. Mar. 13, 2018) (denying a petition for waiver filed by Puerto Rico Telephone Company, Inc. (PRTC) of the final deadline for CAF Phase I Round 2). One petition remains pending. *See Petition for Limited Waiver to Identify,* Nunc Pro Tunc, *the Census Blocks and Locations in Virginia in which FairPoint Deployed Broadband to Meet the Requirements of CAF Phase I, Round 2*, FairPoint Communications, Inc, WC Docket No. 10-90 (filed Mar. 30, 2017).

[13] *USF/ICC Transformation Order*, 26 FCC Rcd at 17717, para. 137.

[14] *Phase I Round 2 Order*, 28 FCC Rcd at 7780, para. 36 (2013) ("Compliance with the deployment requirements will be determined based on the recipient's final deployment certification."); *see also Connect America Fund*, Further Notice of Proposed Rulemaking, 27 FCC Rcd 14566, 14578 para. 47 (2012) (*Phase I Round 2 FNPRM*) ("Compliance with our rules will be determined based on the carrier's final deployment certification, which would identify where the carrier did, in fact, deploy.").

substantiate compliance; and (3) monitored modification to deployment plans. Pursuant to Commission Order, USAC's compliance test work is performed after a participating carrier submits data identifying the locations where the carrier deployed broadband using CAF Phase I incremental support.[15] Compliance was evaluated at the end, rather than at the beginning, of the support term for CAF Phase I incremental support because the Commission gave carriers the flexibility to determine which unserved locations they ultimately would provide service to within the eligible census blocks.[16] As a result, until the end of the support term, the compliance obligations were not location-specific, and deployment data could not be evaluated for compliance purposes until the final certifications were filed. Therefore, while USAC conducted limited reviews for the location data received for the Year 2 milestone, it only performed a comprehensive test work for the Year 3 (100 percent completion) milestone.

Second, the OIG finds that "USAC did not adequately monitor the ETCs' build-out progress." Specifically, the OIG alleges that "(1) USAC's audit program did not include procedures to ensure that ETCs were in compliance with build-out milestones, (2) USAC's monitoring plan did not require ETCs to provide adequate supporting documents, and (3) USAC did not monitor reallocations of Program funding among Study Areas."

As explained above, once USAC received geocoded location data related to the two-thirds completion requirement for CAF Phase I Round 1 in November 2015, it began testing and review work. During the weeks immediately following the certification due date, USAC compiled location data for participating carriers to confirm that the numbers of locations were sufficient to achieve the milestones for which carriers had certified completion. USAC initiated its formal verification process of the final reported locations beginning December 2016, after the close of OIG's selected audit period, by requesting additional documentation to substantiate the carriers' certifications. The Commission directed USAC "to assess compliance with [the two-thirds build-out] requirement for each holding company that receives CAF Phase I funds"[17] because, "historically, carriers have always been able to use support in wire centers other than the ones for which support is paid, and nothing in the Act constrains that flexibility such that it applies only within state boundaries. Accordingly, in the context of this interim mechanism, we will permit carriers to continue to have such flexibility."[18] The Commission's Phase I rules explicitly did not require USAC to monitor the allocation by a carrier of funding among its own study areas. Nor did the Commission require carriers to spend precisely $775 per location, but rather used that number to calculate an average support amount that would determine the deployment obligation for a given holding company

[15] *Id.*.

[16] *USF/ICC Transformation Order*, 26 FCC Rcd at 17719-21, paras. 144-47; *Phase I Round 2 Order*, 28 FCC Rcd at 7777, para. 31 n.60; *Connect America Fund*, Order, 29 FCC Rcd 181, 237, para. 298 (WCB 2014); *see also Phase I Round 2 FNPRM*, 27 FCC Rcd at 14577 para. 46 (2012) ("Those initial [acceptance letter] filings, however, do not bind the carriers to deploy only in those areas, or to every location in those areas. Rather, the initial filings are only good faith statements of the carriers' initial intentions — carriers may deploy broadband to other eligible locations instead, though, if they do so, they are required to identify where they in fact deployed."). FCC rules require a separate letter to notify location changes from those included in the initial acceptance letters. *See* 47 CFR § 54.312(b)(3), (c)(4). However, this requirement was not effective until June 18, 2014. *See Connect America Fund*, 79 Fed. Reg. 34639 (June 18, 2014). Thus, this requirement did not apply to any locations where the new construction had commenced prior to that effective date. *See Connect America Fund*, Order on Reconsideration, 28 FCC Rcd 10488, 10489-91, paras. 5-7 n.13 (2013).

[17] *USF/ICC Transformation Order*, 26 FCC Rcd at 17866, para. 628; *see also Wireline Competition Bureau Provides Guidance to Connect America Fund Phase I Incremental Support Recipients Regarding Validation of Compliance*, WC Docket No. 10-90, Public Notice, 31 FCC Rcd 5728 (WCB 2016) ("In the *USF/ICC Transformation Order*, the Commission directed USAC to assess compliance for each holding company that receives CAF Phase I funds.").

[18] *USF/ICC Transformation Order*, 26 FCC Rcd at 17720, para. 145.

in areas where it would require universal service support to serve.[19] Therefore, the Commission's objective for Phase I did not require USAC to confirm that a specific amount of support was spent only within specific study areas, but only required that USAC verify locations were deployed within identified census blocks throughout the holding company's territory. USAC's verification work confirmed that carriers overwhelmingly complied with the Phase I deployment rules.

USAC Oversight of CAF

With respect to other high-cost funding mechanisms, the Commission has already adopted measures consistent with OIG's recommendations. Based on the experience gained from implementing and administering CAF Phase I incremental support, the Commission and USAC continue to evaluate and improve carriers' compliance requirements and USAC's compliance procedures in order to protect against waste, fraud, and abuse. For example, Commission rules require carriers receiving CAF Phase II model support to both certify and demonstrate compliance with interim build-out milestones; USAC has already begun assessing and verifying compliance throughout the support term.[20] If a carrier fails to meet any interim or final milestones, the Commission's rules require a corresponding reduction in support until the compliance gap is ameliorated.[21] Moreover, to address concerns raised by the long delay between construction and reporting deadlines in the Phase I incremental support rules, the Commission has since modified location reporting requirements for other CAF support mechanisms.[22] ETCs are now encouraged to report location information in real-time as build-out is completed, and must do so within three months of the end of the year.[23] Finally, as an additional administrative improvement, USAC has also automated the early stages of compliance test work completed for all location data when it is submitted through USAC's High Cost Universal Broadband (HUBB) portal. Given its instantaneous results, the HUBB has enabled USAC to complete eligibility validations at a much-improved rate and at an earlier stage of program rollout.

Overall, we are pleased that the OIG did not discover any evidence of actual waste, fraud or abuse within the Phase I incremental support program. The Commission, in coordination with USAC, will continue to ensure the high-cost program is implementing adequate controls to protect the integrity of the USF. Thank you for the opportunity to respond to the findings in this draft report. We appreciate and will take into consideration your recommendations as we continue to develop and improve our oversight and monitoring of other ongoing support programs.

---

[19] *See, e.g., USF/ICC Transformation Order*, 26 FCC Rcd at 17717, n.220, 17718, para. 139, 17719, para. 144.

[20] *See Connect America Fund et al.*, WC Docket No. 10-90 *et al.*, Report and Order, 29 FCC Rcd 15644, 15657, para. 36 (2014) (*December 2014 Connect America Order*) (establishing interim deployment obligations for CAF Phase II support); *id.* at 15689-90, para. 128 & n.284 (directing USAC to monitor CAF Phase II model support recipients' progress in meeting deployment obligations at the state level for a subset of the carriers every year, such that each state for each carrier is evaluated at least once during the support term, except where such review would not be cost-effective due to a small number of reported locations); 47 C.F.R § 54.316(b) (establishing annual deployment reporting and certification requirements for high-cost recipients).

[21] *See id.* at 15693-99, paras. 146-52 (establishing a process for evaluating and reducing support for failing to meet a build-out milestone, including four progressive tiers of non-compliance); *see also* 47 C.F.R § 54.320(d).

[22] *See* 47 CFR § 54.316.

[23] *Connect America Fund et al.*, WC Docket No. 10-90 *et al.*, Report and Order *et al.*, 31 FCC Rcd 3087, 3164, 3167, paras. 211, 218 (2016); *Wireline Competition Bureau Provides Guidance to Carriers Receiving Connect America Fund Support Regarding Their Broadband Location Reporting Obligations*, WC Docket No. 10-90, Public Notice, 31 FCC Rcd 12900, 12907 (WCB 2016) ("[W]e encourage carriers to provide location information in the HUBB within 30 days of service availability but no later than their annual reporting deadlines.").

5

We look forward to working with the OIG in the future.

Sincerely,

Kris Anne Monteith
Chief, Wireline Competition Bureau

Mark Stephens
Managing Director, Office of the Managing Director

6

Appendix C - Acronyms and Glossary

BCAP: The **Beneficiary and Contributor Audit Program** is an audit program designed to measure rates of program compliance among universal service beneficiaries and contributors. USAC utilizes audit approaches tailored to both the distinctive features of the participant's organization and the specific amounts of money being audited.

CAF: The **Connect America Fund** is a High Cost Program fund within the Universal Service Fund. CAF will help make broadband available to homes, businesses, and community anchor institutions in areas that do not, or would not otherwise, have broadband. This fund supports mobile voice and broadband networks in areas that do not, or would not otherwise, have mobile service, and broadband in the most remote areas of the nation.

CIP: A **Capital Improvement Plan** is the ETC's plan for additions and upgrades to its network, and may include broadband build-out to new locations.

CFR: The **Code of Federal Regulations** is the codification of the general and permanent rules published in the Federal Register by the departments and agencies of the Federal Government. It is divided into 50 titles that represent broad areas subject to Federal regulation.

ETC: An **Eligible Telecommunications Carrier** is a telecommunication carrier or an affiliate, which meets specific FCC regulatory requirements. ETC's have obtained a designation which allows a company to receive federal universal service fund support from the High Cost and Lifeline programs.

FCC: The **Federal Communications Commission** is an independent U.S. government agency overseen by Congress, the Commission is the federal agency responsible for implementing and enforcing America's communications law and regulations.

FCC OIG: The **Office of the Inspector General** is the audit and investigative office for FCC. The Inspector General (IG) and his office provide objective and independent investigations, audits, and reviews of the FCC's programs and operations. Incident thereto, the IG provides recommendations to detect and prevent fraud, waste and abuse in FCC programs and operations.

Form 481: The **Form 481** is the Carrier Annual Reporting Data Collection Form required to be completed and submitted to USAC by ETCs receiving support from the USF High Cost and Lifeline programs.

GAGAS: **Generally Accepted Governmental Auditing Standards (Yellow Book)** provides guidance for auditors and audit organizations, outlining the requirements for audit reports, professional qualifications for auditors, and audit organization quality control. Auditors of federal, state, and local government programs use these standards to perform their audits and produce their reports.

High Cost Program: The Program provides USF support to ETCs to provide telecommunications services in areas deemed by the FCC to have high costs.

Holding Company: Holding companies exist solely to hold a percent of the total stock of another company, or multiple companies, in an attempt to diversify or expand by acquisition. Holding companies reduce the risk of owners and allow the ownership of multiple companies.

Incremental Support: The lump sum CAF support to ETCs to provide broadband capabilities to un-served locations in U.S. states and territories.

OMD: The **Office of the Managing Director** is responsible for the administration and management of the Commission. Specifically, OMD manages: the Commission's budget and financial programs; human resources; contracts and purchasing; communications and computer services; physical space; security; the Commission meeting schedule; and distribution of official FCC documents

PN: **Public Notice** in which the FCC announces orders, rules, guidance, results of studies, resolutions issues and other communication to the public and ETCs through official FCC public notices.

PQA: **Payment Quality Assurance** is a payment testing audit program developed by USAC to validate the accuracy of disbursements and identify improper payments.

Price Cap Carrier: A category of ETCs whose rates are capped for all interstate and intrastate services provided.

SA: A **Study Area** is the territory served by an ETC for which High Cost Program support is received from the USF.

SAC: A **Study Area Code** is a unique number that USAC assigns to ETCs that uniquely identifies that company based on its service area. Companies must have at least one SAC per state in which they operate, but can have more than one SAC within a state if they provide service in more than one service area.

Transformation Order: On November 11, 2011, the FCC released the order no. FCC 11-161, also known as the Transformation Order, to comprehensively reform and modernize the Universal Service Fund, High Cost Program.

USAC: **Universal Service Administrative Company** is a non-profit organization that administers the Universal Service Fund. USAC administers almost $10 billion annually to the companies and institutions that make universal service possible.

USF: The **Universal Service Fund** is a system of telecommunications subsidies and fees managed by the FCC intended to promote universal access to telecommunications services in the United States. The FCC established the fund in 1997 in compliance with the Telecommunications Act of 1996.

WCB: The **Wireline Competition Bureau** is a Federal Communications Commission bureau which develops and recommends wireline telecommunications policy goals, objectives, programs and plans. Bureau matters include providing universal service and the deploying advanced telecommunications services such as broadband.