

DOCUMENT RESUME

00647 - [A0590772]

Actions Needed to Improve the Federal Communications Commission's Financial Disclosure System. FPCD-76-51; B-103987; B-180226. December 21, 1976. 29 pp.

Report to the Congress; by Elmer B. Staats, Comptroller General.

Issue Area: Personnel Management and Compensation: Employee Conflicts of Interest (301).

Contact: Federal Personnel and Compensation Div.

Budget Function: Miscellaneous: Financial Management and Information Systems (1002); General Government: Central Personnel Management (805).

Organization Concerned: Federal Communications Commission.

Congressional Relevance: House Committee on Interstate and Foreign Commerce; Senate Committee on Commerce; Congress.

Authority: Federal Communications Act of 1934, sec. 4 (b) (47 U.S.C. 154(b); 18 U.S.C. 208). Executive Order 11222; 47 C.F.R. 19.

Improvements that are needed in FCC's financial disclosure system were discussed in accordance with standards of ethical conduct for Government officials. Findings/Conclusions: Several weaknesses were found in the present system. Criteria for identifying positions requiring disclosure were too general. Procedures for collection, processing, and followup of statements were inadequate. The FCC interpretation of regulations allowed family members to have holdings that would be prohibited if held directly. GAO felt that this practice could result in conflicts of interest. Recommendations: The Chairman of the Federal Communications Commission should develop adequate criteria and procedures for identifying positions requiring disclosure, for prompt collection of statements, and adequate followup. The chairman should develop procedures to enable supervisors to verify employee actions in disqualifying themselves from matters related to their holdings. Congress should enact amendments to apply prohibition only to companies significantly regulated by FCC and to include constructive as well as direct interests of employees. (HTW)

00647

REPORT TO THE CONGRESS

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

Actions Needed To Improve The Federal Communications Commission's Financial Disclosure System

The effectiveness of the Commission in serving the public interest depends on the extent to which it holds the confidence and esteem of the Nation's citizens. Therefore, an effective financial disclosure system must be maintained.

This report discusses several problems with the Commission's financial disclosure system and the actions needed to improve the system.





COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-103987
B-180228

To the President of the Senate and the
Speaker of the House of Representatives

Executive Order No. 11222 prescribes standards of ethical conduct for Government officials and directed the Civil Service Commission to establish guidelines for agency financial disclosure systems. This report discusses improvements that are needed in the Federal Communications Commission's financial disclosure system.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67). Several Members of Congress requested that we review the effectiveness of Federal agencies' financial disclosure systems.

We did not obtain formal comments from Commission officials; however, we discussed the report informally with officials in its Offices of the General Counsel and Executive Director who are responsible for the financial disclosure system. Their comments are included in the report.

We are sending copies of this report to the Director, Office of Management and Budget; the Chairman, Federal Communications Commission; and other interested parties.

A handwritten signature in black ink, appearing to read "James G. Atchafalua".

Comptroller General
of the United States

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ABBREVIATIONS

| | |
|-----|-----------------------------------|
| CSC | Civil Service Commission |
| FCC | Federal Communications Commission |
| GAO | General Accounting Office |

D I G E S T

The Federal Communications Commission has responsibility for regulating the communications industry. To fulfill its responsibilities, Commission employees must maintain impartiality in performing their duties. A sound financial disclosure system can help to achieve this impartiality.

GAO, however, found weaknesses in the Commission's overall financial disclosure system.

--The Commission's criteria for identifying positions whose incumbents should file financial disclosure statements was too general and limited resulting in employees who held positions that greatly affected the communications industry not being required to file financial disclosure statements.

--The Commission did not have adequate procedures to insure that the financial disclosure statements were collected and processed as required and in a timely manner.

--The Commission did not have followup procedures to insure that employees who had been required to disqualify themselves on matters affecting their financial holdings had in fact done so. Although there was no indication that the disqualification requirement had been abused, GAO believes the procedures are needed for the Commission to effectively carry out its responsibilities.

The financial holdings of Commission employees are affected by section 4(b) of the Federal Communications Act, Title 18 U.S.C. 208, and Executive Order No. 11222. Its financial disclosure system has been developed to incorporate the requirements of the above. In applying section 4(b) requirements, the Commission has interpreted the section as prohibiting financial interests in only significantly

regulated firms and of only the employee. Section 4(b)'s prohibitions exclude the financial interests of the employee's spouse, minor child, or immediate household member (constructive interests).

Therefore, under section 4(b) an employee's spouse, minor child, or immediate household member is allowed to retain a financial interest in a company the Commission has determined would be prohibited under that section if directly held, but the employee must obtain a waiver of the prohibitions of 18 U.S.C. 208 and Executive Order No. 11222, which allow for such waivers after a substantiality test of the holdings is made.

The implementation of section 4(b)'s prohibitions allows employees to simply transfer their prohibited holdings to spouses, minor children, or immediate household members and thereby be in compliance.

During GAO's review of 333 employees' financial disclosure statements, it found that 34 employees were granted waivers for 57 constructive interests in companies the Commission defined as prohibited by section 4(b). The fact that employees had requested waivers (10 percent of those required to file) indicates that employees retain the benefit of constructive interests even though the requirements of section 4(b) have been complied with. GAO's position is that constructive financial interests present as great a potential for conflicts of interest or the appearance of conflicts of interest as do those interests directly held by the employee. GAO feels that if an absolute prohibition in addition to existing Government-wide conflict-of-interest restrictions is necessary for Commission employees, it should apply to constructive interests as well as direct interests. (See pp. 8 and 16.)

GAO does not propose to take legal objection to the Commission's interpretation of section 4(b) as prohibiting financial interests in only significantly regulated enterprises, taking into consideration the harsh results which would flow from a literal interpretation of the section, the Department of Justice's similar

interpretation of section 4(b), and in general the considerable deference given to an agency's construction of a statute where the statutory language is reasonably susceptible to more than one interpretation. While GAO agrees in principle with the Commission on this issue, clarifying legislation appears desirable.

Although agency officials did not have an opportunity to review a draft of this report and submit formal comments, GAO discussed its findings with officials responsible for the financial disclosure system in the Commission's Offices of the General Counsel and Executive Director. They stated that basically their system was sound, but there were areas where improvements can be made. They felt as GAO does that the Commission's interpretation of section 4(b) was correct. These officials also stated that the restrictiveness of section 4(b)'s prohibitions, if literally interpreted, would have an adverse impact on the Commission's ability to hire qualified personnel and on the administration of its financial disclosure system. (See p. 15.)

GAO recommends that the Chairman, Federal Communications Commission, develop:

- Adequate criteria for identifying positions whose incumbents should file statements and apply that criteria to all agency positions.
- Procedures to insure that statements are promptly collected.
- Procedures to inform supervisors of their subordinates' financial holdings which they have been permitted to retain if they disqualify themselves from participating in Commission matters affecting those interests. This would help to insure, to the extent possible, that such disqualifications take place.
- Followup procedures to insure that no employees own financial interests prohibited by section 4(b) of the Federal Communications Act, particularly those employees who are not required to file financial disclosure statements.

If the Congress continues to deem it necessary to keep the prohibitions of section 4(b) of the 1934 Communications Act, GAO believes that the act should be amended as follows. First, in view of the uncertainty as to the companies which can fall under section 4(b), and the interpretations of that section by the Commission and the Department of Justice, the legislation should be clarified to apply the prohibition only to companies the Commission significantly regulates. Second, the section should be amended to also apply to the constructive interests of employees. The constructive interests could affect an employee as much as those interests directly held, but the section as currently written and interpreted by the Commission, Justice, and GAO applies only to the employees' direct interests.

CHAPTER 1

INTRODUCTION

The Federal Communications Act of 1934 established the Federal Communications Commission (FCC) as an independent agency. FCC regulates interstate and foreign communication to make available a rapid, efficient, nationwide and worldwide wire and radio communications service. FCC regulates all U.S. radio and television broadcasting stations, telephone, telegraph, and cable television service; two-way radio and radio operators; and communication by satellite. FCC is comprised of seven commissioners, one of which serves as Chairman, who are appointed by the President and confirmed by the U.S. Senate for 7-year terms. At the time of our audit, FCC had about 2,000 employees.

FCC activities are divided into four major fields:

1. Broadcast: television, standard radio broadcast frequency modulation broadcast, and related auxiliary services.
2. Common carrier: telephone, telegraph, and submarine cable--both wire and radio and interstate and foreign.
3. Safety and special services: marine, aeronautical, public safety, amateur, disaster, industrial, and land transportation.
4. Cable television.

As part of its activities in these fields FCC

- allocates bands of frequencies to non-Government communication services and assigns frequencies to individual stations;
- licenses and regulates stations and operators;
- regulates common carriers engaged in interstate and foreign communication by telegraph, telephone, and satellite;
- promotes safety through the use of radio on land, water, and in the air; and
- utilizes wire and radio communication services in national defense.

Due to FCC's responsibilities, it is important that a sound financial disclosure system be maintained.

SCOPE OF REVIEW

Our review, conducted at FCC headquarters, Washington, D.C. was made pursuant to requests from several Members of Congress. The primary concerns in these requests were whether:

- Federal agencies had effective financial disclosure systems for revealing conflicts of interest.
- All required financial disclosure statements were filed promptly and properly.
- The financial disclosure statements were adequately reviewed and analyzed.

We reviewed all financial interests employees listed on their 1974 financial disclosure statements and on previous statements. The statements listed only the companies' names and not the dollar value of the investment or number of shares held. Confidentiality was maintained at all times. Our working papers do not contain employee names but only codes which are traceable to the names of employees and their questionable holdings. Lists of the employees, our code, and their questionable holdings were given to FCC at the completion of our audit. We also reviewed position descriptions of employees required to file statements. The responsibilities of certain employees not currently required to file financial disclosure statements were also reviewed to determine whether they should be filing. We did not determine whether the employees that filed statements were on FCC's employment roles during our review nor did we talk with specific individuals regarding their actual duties or their financial holdings.

Our review did not focus on existing statutory criminal provisions concerning the activities of Federal employees affecting their personal financial interests (18 U.S.C. 208 (1974)). However, we noted that the disclosure requirements of the statute were no more stringent than the requirements of the regulations we reviewed.

The Chairman of the FCC during the period covered by our audit was Dean Burch from October 1969 to March 1974 and Richard E. Wiley from March 1974 to the present.

CHAPTER 2

FINANCIAL DISCLOSURE REQUIREMENTS

AND AGENCY PROHIBITIONS

In 1965 the President issued Executive Order No. 11222 which prescribed standards of ethical conduct for Government officers and employees and directed the Civil Service Commission (CSC) to establish regulations implementing the order. Subsequently, in November 1965, CSC issued instructions requiring each agency to prepare standards of employee conduct and establish a system for reviewing employee financial disclosure statements. CSC must approve regulations established by each agency.

In February 1966 the Federal Communications Commission issued regulations, 47 CFR 19, governing employees' responsibilities and conduct. These regulations established the financial disclosure system for all FCC employees.

The General Counsel was designated the agency's ethics counselor. He is responsible for providing guidance and interpretative rulings, upon request, to employees on all matters relating to standards of conduct and for serving as FCC's designee with CSC on such matters.

The FCC Chairman is responsible for reviewing financial disclosure statements of officials in charge of offices and bureaus. Each individual Commissioner is responsible for reviewing the statements of employees in his or her immediate offices. The Executive Director is responsible for reviewing the statements of all other employees. All statements are maintained in the Office of the Executive Director. The seven Commissioners' statements are filed at and reviewed by CSC.

Occupants of designated positions in FCC must file financial disclosure statements within 30 days after entrance on duty and update them annually as of June 30. FCC's regulations require employees having a conflict to divest themselves of the interest, disqualify themselves from particular assignments, or have assigned duties changed. Serious offenses could result in suspension or separation.

PROHIBITIONS AFFECTING FCC EMPLOYEES

Prohibitions affecting FCC employees' financial interests and outside employment are included in FCC's regulations governing employees responsibilities and conduct (47 CFR 19); implementing Executive Order No. 11222; certain sections of Title 18, U.S.C. and section 4(b) of the Federal Communications Act of 1934 (47 U.S.C. 154(b)).

Consistent with Executive Order No. 11222, FCC's regulations state:

"An employee of the Commission shall not have a direct or indirect financial interest that conflicts substantially, or appears to conflict substantially, with his Government duties and responsibilities.

"An employee of the Commission shall not engage in, directly or indirectly, a financial transaction as a result of, or primarily relying on, information obtained through his Government employment."

The regulations further state that the interest of a spouse, minor child, or other member of an employee's immediate household is considered to be an interest of the employee.

Prohibitions in 18 U.S.C. 208(a) and (b) are incorporated in FCC's regulations, and read as follows:

- (a) "An employee may not participate in his governmental capacity in any matter in which he, his spouse, minor child, outside business associate or person with whom he is negotiating for employment has a financial interest. * * *
- (b) "This prohibition shall not apply if the employee advises the Government official responsible for his appointment of the nature of the matter, makes full disclosure of the financial interest, and receives in advance a written determination that the interest is not so substantial as to be deemed likely to affect the integrity of the employee's services."

In addition to the above restrictions, section 4(b) of the Federal Communications Act of 1934 states, in part:

"* * * No member of the Commission or person in its employ shall be financially interested in the manufacture or sale of radio apparatus or of apparatus for wire or radio communication; in communication by wire or radio or in radio transmission of energy; in any company furnishing services or such apparatus to any company engaged in communication by wire or radio or to any company manufacturing or selling apparatus used for communication by wire or radio; or in any company owning stocks, bonds, or other securities of any such company; nor be in the

employ of or hold any official relation to any person subject to any of the provisions of the Act, nor own stocks, bonds, or other securities of any corporation subject to any of the provisions of this Act * * *."

FCC regulations state that an employee is expected to comply with section 4(b) and to support its underlying principles. However, the regulations further state:

"Section 4(b) has been construed in the past not to prohibit financial interests in enterprises whose activities are not subject, in any significant sense, to regulation by the Commission. However, any employee would be disqualified from acting in any matter involving his investments and would be required to seek a waiver under the provisions of 18 U.S.C. 208(b)."

CHAPTER 3

FCC'S INTERPRETATION OF PROHIBITIONS AFFECTING EMPLOYEES FINANCIAL INTERESTS

Part of our study focused on the Federal Communications Commission's interpretation and application of the administrative and statutory prohibitions outlined in chapter 2, specifically section 4(b) of the Federal Communications Act of 1934. Section 4(b), at face value, flatly prohibits FCC employees from having financial interests in communication firms and companies. (See p. 4.)

According to FCC officials, a literal interpretation of section 4(b) would lead to harsh and probably unnecessary results due to later developments in the communications, financial, and business fields. This is because the incidental operations of many business organizations may be subject to FCC regulations even though the primary business of such organizations is unrelated to the field of radio or wire communications. Further, FCC officials told us that such a literal interpretation would impede FCC in employing experienced and qualified personnel. For these reasons FCC has attempted to have section 4(b) amended in recent years to remove its apparently broad, absolute prohibitions and replace them with a substantiality test, as presently contained in 18 U.S.C. 208 and Executive Order No. 11222. Despite FCC's efforts, only once has a cognizant committee prepared a report recommending that the proposed legislation be passed. (See S. Rept. 527, 89th Cong., 1st Sess. (1965).) Neither the House nor the Senate took action on the bill. No action has been taken on comparable bills submitted in this Congress or in prior Congresses. (See app. II.)

APPLICATION OF SECTION 4(b)

In dealing with the above, FCC has applied section 4(b) in the following manner. First, FCC has construed this section as not prohibiting "financial interests in enterprises whose activities are not subject, in any significant sense, to regulation by the Commission." (See 47 CFR 19.735-204(c)(2).) These enterprises, and others that FCC determines to be prohibited although not necessarily significantly regulated, are placed on a prohibited companies list. This list is used when reviewing employees' statements to determine whether the employee has a prohibited interest. Second, FCC and GAO consider section 4(b) as extending only to the financial interests of the employee and not to constructive interests (those of the employee's spouse, minor child, or

immediate household member 1/). (See 47 CFR 19.735-204(e), (2)(ii).) The Department of Justice in a letter to the Chairman, Senate Committee on Commerce, recently supported the FCC interpretation of section 4(b)'s terms and conditions.

COMPARISON WITH EXECUTIVE ORDER NO. 11222
AND 18 U.S.C. 208

Based upon FCC's interpretation of section 4(b), the prohibitions of Executive Order No. 11222 and 18 U.S.C. 208, generally applicable to Government employees, overlap section 4(b)'s prohibitions. (See 47 CFR 19.735-204(e)(2)(ii).) While FCC interprets section 4(b) as prohibiting only the financial interests of an employee in significantly regulated companies, the latter authorities establish, in effect, a substantiality test which is applicable to both an employee's financial interests and his constructive interests. More specifically, Executive Order No. 11222 prohibits an employee from having any financial interest that conflicts substantially, or appears to conflict substantially, with his Government duties and responsibilities. For this purpose, the interest of a spouse, minor child, or other member of an employee's immediate household is considered to be an interest of the employee.

18 U.S.C. 208, a criminal statute, requires an employee to refrain from participating in his governmental capacity in any matter in which he, his spouse, minor child, or outside business associate has a financial interest. A waiver may be granted from the prohibitions in 18 U.S.C. 208 when the financial interest is judged "not so substantial as to be deemed likely to affect the integrity of the employee's services." (See 47 CFR 19.735-204(e)(2)(ii).)

With one exception, FCC determines whether financial interests are substantial or insubstantial on a case-by-case basis. In those cases where the financial interests are determined to be substantial, the employee must either divest of the interests or disqualify himself from participating in his governmental capacity in any matter which may affect such interests. Where the financial interests are considered insubstantial, the employee is permitted to participate in matters which may affect the interests only after concurrence of responsible FCC officials.

1/FCC regulations define immediate household member as those blood relations who are residents of the employee's household.

The one exception mentioned above refers to an employee's financial interests in a significantly regulated company according to FCC's interpretation of section 4(b). Under section 4(b) the prohibition is considered to be absolute, requiring an employee's termination of employment if he should have any financial interest falling thereunder unless he removes himself of such interests. In such a case, waivers from 18 U.S.C. 208 are not available. (See 47 CFR 19.735-204(e)(2)(ii).) This exception does not extend to an employee's constructive financial interests, since FCC does not consider such interests as coming within section 4(b)'s prohibitions.

SUMMARY

FCC employees are subject not only to the Government-wide standards set forth in Executive Order No. 11222 and 18 U.S.C. 208, but also to the prohibitions of section 4(b) of the Federal Communications Act of 1934. FCC considers section 4(b) as extending only to (1) significantly regulated enterprises and (2) the financial interests of the employee himself--not to constructive interests.

We do not propose to take legal objection to FCC's interpretation of section 4(b) as prohibiting financial interests in only significantly regulated enterprises, taking into consideration the harsh results which would flow from a literal interpretation of the section, the Department of Justice's similar interpretation of section 4(b), and in general the considerable deference given to an agency's construction of a statute where the statutory language is reasonably susceptible to more than one interpretation. While we agree in principle with FCC on this issue, clarifying legislation appears desirable. If the absolute prohibitions, such as section 4(b), are necessary in the case of direct interests held by employees of agencies, such as FCC, they should apply to constructive interests as well.

CHAPTER 4

WEAKNESSES IN FCC'S FINANCIAL DISCLOSURE SYSTEM

We found weaknesses in the design and operation of the Federal Communications Commission's financial disclosure system that need to be corrected if the system is to be effective in protecting the Government, employee, and public from potential or apparent conflicts of interest at FCC.

The areas where the system should be changed include:

- Requiring additional FCC employees to file financial disclosure statements who are currently not required to file and revising the criteria for such a filing requirement in the regulations.
- Insuring that reviews of statements by FCC officials have taken place on a timely basis.
- Insuring that those employees who are not required to file financial statements do not have interests that violate statutory and/or administrative prohibitions.
- Insuring that persons permitted to retain their holdings disqualify themselves from duties and responsibilities associated with their financial holdings.

MORE EMPLOYEES SHOULD FILE THAN CURRENTLY REQUIRED

Currently, FCC requires 333 employees in the following designated positions to file financial disclosure statements.

- Hearing Examiners;
- Members of the review board;
- GS-13's or above who are Heads or Assistant Heads of Offices, Bureaus, Divisions, or Branches, or comparable units;
- GS-13's or above who are legal, engineering, or other professional assistants to the Commissioners; and
- GS-11's or above who are Heads or Supervisors of field offices.

We examined the duties and responsibilities of 52 employees at GS-13, 14, and 15 levels that do not file

statements. In our opinion, 44 of the 52 employees exercised regulatory responsibilities which affect the communications industry and, accordingly, should be required to file statements.

Each of the employees occupied positions that according to their job descriptions could provide access to privileged information and most worked independently with a limited amount of supervision. The job descriptions indicated that several of the employees recommended or developed FCC policy, assumed various roles in hearings, conducted meetings with industry officials, or were involved directly with regulatory activities. Others had duties in approving or disapproving various industry actions. Seven were involved with enforcing agency policy through inspections or investigations. Two of the employees' duties included awarding FCC contracts, and five assumed, in an acting capacity, the duties of employees required to file financial disclosure statements.

On the basis of the duties and responsibilities in the position descriptions of the 44 employees, we believe FCC needs more specific criteria for identifying employees required to file statements and needs to require financial disclosures from incumbents of additional positions.

COLLECTING AND PROCESSING PROCEDURES

FCC's regulations require employees first entering positions meeting the financial disclosure requirement to submit statements within 30 days. In addition, all of these employees are required to submit annual supplemental statements as of June 30. An FCC reviewing official stated that the as of June 30 date had been interpreted to include holdings held on such a date, and the employees are given 30 days from June 30 to submit their statements.

We found that FCC had not collected June 30, 1974, statements according to the above procedure and the regulations. FCC did not notify employees of their requirement to file a 1974 statement until August 2, 1974. The notice for filing 1975 and 1976 statements was sent to employees on June 9, 1975 and June 18, 1976, respectively, which is a substantial improvement over 1974. Until the statements are received, reviewing officials cannot promptly determine whether employees own questionable interests. As a result, employees could have such a financial interest for some time and not be promptly informed on the need to change the situation.

In addition, FCC needs to employ better techniques to insure proper processing of the financial disclosure statements. The following weaknesses were noted during our review.

- Nineteen statements had review dates at least 6 months later than when they were required to be submitted to review officials, and other statements had no dates on them to indicate that they had been reviewed by FCC officials. Employees whose statements are included above, ranged from GS-13 to GS-17 and had such positions as electronics engineers, attorneys, hearing examiners, and a top level regional official.
- FCC took an extended amount of time to process waiver submissions. For example, we noted 13 cases in which employees were awaiting rulings on their waiver requests some 7 to 8 months after the statements were reviewed. From the data reviewed we were unable to determine whether these employees participated in FCC matters regarding these interests while awaiting the rulings.

WHAT CONTROLS EXIST ON FINANCIAL HOLDINGS OF FCC EMPLOYEES NOT REQUIRED TO FILE?

The prohibition of section 4(b) of the Federal Communication's Act applies to all FCC employees; however, only 333 out of about 2,000 employees are required to file financial disclosure statements. FCC does require all employees at the time of appointment to state that they have no employment by or financial interest in any entity covered by its regulations. Subsequently, each employee is reminded annually to avoid, at all times, acquiring a financial interest that could result, or take an action that could result, in a violation of conflict-of-interest provisions.

In its annual reminder to employees, FCC advises the employees that a prohibited companies list, although not all inclusive, is available to them. We feel it would be beneficial if this list was furnished to all employees with an annual update on additions to and deletions from the list. We also believe that employees who do not file financial statements should be required to state that they do not have financial interests which violate either statutory provisions or administration regulations. Using the list and the certification in the manner discussed would (1) help FCC employees identify interests that they should not acquire and (2) provide greater assurance to FCC that statutory provisions and regulations were being followed.

FCC'S SYSTEM ON DISQUALIFICATION OF EMPLOYEES NEEDS TIGHTENING

As stated previously, FCC regulations permit employees to disqualify themselves from participating in FCC matters

which may concern the employee's financial holdings. (See p. 7.) We noted that FCC does permit employees to disqualify themselves. This procedure is permitted by 18 U.S.C. 208 and by Executive Order No. 11222.

We did not determine the number of disqualifications which FCC had permitted since these were not compiled or analyzed on this basis. During our systems review we did not audit individual transactions to insure that employees required to disqualify themselves had in fact done so. Although there was no indication of FCC employees failing to disqualify themselves, we believe FCC's system should inform supervisors of their subordinates' financial holdings which they have been permitted to retain if they disqualify themselves from participating in FCC matters affecting those interests. We believe this procedure is needed to prevent or minimize the possibility of employees failing to disqualify themselves.

CHAPTER 5

REVIEW OF EMPLOYEES' FINANCIAL

DISCLOSURE STATEMENTS

We reviewed the financial disclosure statements of the 333 employees the Federal Communications Commission requires to file. Employees must list any financial interests they may have with creditors, real property, or business entities. We compared each employee's job description with their financial holdings listed. However, as stated previously, they do not list either the dollar amount of the holdings, or the number of shares held. We also examined their financial holdings to determine whether the companies were involved in or had other affiliations with communications industries which possibly would be prohibited by section 4(b) of the Federal Communications Act. We also used FCC's prohibited companies list to determine whether employees reported financial holdings in companies that appeared on the list.

We found that employees reported interests which included firms on FCC's prohibited companies list and firms which, in our opinion, after researching the firms activities, should have been on the list. We also noted that employees reported interests which may have conflicted with their duties and responsibilities.

Thirty-four employees, or more than 10 percent of those required to file statements, reported 57 constructive interests in companies on FCC's prohibited companies list. (See p. 6 for a discussion of prohibited companies list.) Divestiture of these constructive interests would be required if the interests were in the employee's name. However, divestiture is not required since the statute at face value refers only to employees. Some of these interests were originally in the employees' names and to meet FCC's regulations were transferred creating constructive interests. Consequently, the interests of a spouse, minor child, or immediate household member may be retained once a waiver is granted.

Seven of the above 34 employees reported 11 constructive interests that appeared questionable in light of the employee's duties and responsibilities as spelled out in their position descriptions. Although these employees had been granted waivers under 18 U.S.C. 208, we questioned the interests from the standpoint of the appearance of a conflict of interest under Executive Order No. 11222. FCC officials believed that none of the cases represented a violation of any legal prohibition. The employees had been granted waivers because FCC felt the interests were not substantial and as

such would not affect the employees' integrity in performing his services. They also said that the employees' family member owned the interests and were entitled to them under the provisions of 18 U.S.C. 208.

Seven employees reported seven interests in four companies that appeared to be involved in communications activities. Because of the nature of the firm's products or services, these companies were of the type that could have been included on FCC's prohibited companies list. FCC's General Counsel reviewed these firms and ruled that one of the four should be on FCC's prohibited companies list. The employee that had this interest transferred ownership to his spouse and was granted a waiver under 18 U.S.C. 208.

One employee reported an interest in his own right which was in a company on the prohibited companies list. The FCC review official overlooked this financial interest in reviewing the employee's statements. Upon FCC's request, the employee fully divested of this interest.

SUMMARY

The constructive holdings of FCC employees would be a clear violation to section 4(b) of the 1934 Communications Act if the holdings were in the name of FCC employees.

Since section 4(b) does not apply to constructive holdings, the propriety of holdings by the employees' families must be evaluated under the provisions of 18 U.S.C. 208 and Executive Order No. 11222. These provisions allow for waivers on financial interests that meet the substantiality tests as explained on page 7. We noted many cases where employees were granted waivers for constructive financial holdings that were in companies on FCC's prohibited companies list.

CHAPTER 6

AGENCY COMMENTS

We discussed our findings with Federal Communications Commission officials in the Offices of General Counsel and Executive Director who are responsible for the financial disclosure system. FCC was not given the opportunity to formally comment on this report but the Executive Director furnished us with informal written comments in December 1975. (See app. I.) We also obtained oral comments in several meetings with FCC officials responsible for implementing FCC's financial disclosure system. As a result, we reevaluated our position and revised our report where warranted to more accurately reflect the facts.

FCC officials agreed that there is a need for a sound financial disclosure system. They stated that FCC's system was basically good though certain aspects of it needed improvement. The Executive Director stated that our audit reaffirmed the importance of the system and that FCC has made and will continue to make improvements to its system. He said that they needed to followup on employees that must disqualify themselves from participation to insure that they are not involved in matters related to prohibited companies. FCC officials cited staff resources as an important consideration regarding the attention provided to the financial disclosure system. They also said the changing nature of the companies operations causes problems in determining when a company becomes or ceases to be a section 4(b) company.

The Executive Director, in his December 1, 1975, letter, pointed out that we had assisted FCC in effecting an organizational change that would insure internal audit coverage of its system. In addition, he provided evidence that FCC had taken steps to better inform all FCC employees about companies FCC's General Counsel determined to be within the scope of section 4(b). Additional information FCC provided had, in substance, been considered during our review or had no bearing on the conclusions and recommendations of this report.

Regarding FCC's attempts to have section 4(b) of the Federal Communications Act amended (see pp. 6 and app. II), we were informed on May 5, 1976, by officials in FCC's Office of the General Counsel that the restrictive provisions of section 4(b), if literally interpreted, would have a significant impact on FCC's ability to hire qualified personnel and its implementation of the financial disclosure system.

CHAPTER 7

CONCLUSIONS, RECOMMENDATIONS, AND

MATTERS FOR CONSIDERATION BY THE CONGRESS

CONCLUSIONS

Because of its regulatory responsibilities, the Federal Communications Commission must insure the maintenance of a sound financial disclosure system. However, FCC did not have adequate criteria to determine which employees should file financial disclosure statements. As a result, 44 employees had not been required to file statements, although their duties indicated they should.

FCC's practice of not considering employee's constructive interests as being prohibited by section 4(b) of the Federal Communications Act is in accordance with the terms of the section. The presence of constructive interests in prohibited companies indicates that employees retain the benefit of constructive interests even though the provisions of section 4(b) have been complied with. Our position is that constructive financial interests present as great a potential for conflict of interest or the appearance of conflict of interest as do the interests directly held by the employee. We feel that if an absolute prohibition in addition to existing Government-wide conflict of interest restrictions is necessary for FCC employees, it should apply to constructive interests as well as direct interests.

We do not propose to take legal objection to FCC's interpretation of section 4(b) as prohibiting financial interests in only significantly regulated enterprises, taking into consideration the harsh results which would flow from a literal interpretation of the section, the Department of Justice's similar interpretation of section 4(b), and in general the considerable deference given to an agency's construction of a statute where the statutory language is reasonably susceptible to more than one interpretation. While we agree in principle with FCC on this issue, clarifying legislation appears desirable.

FCC had not developed followup procedures to insure (1) employee nonparticipation with companies in which they have disqualifying interests and (2) nonacquisition of prohibited interests by employees not required to file. In addition, FCC had not collected 1974 statements according to requirements. FCC's reorganization to provide internal audit coverage will improve some of the system weaknesses.

RECOMMENDATIONS

We recommend that the Chairman, Federal Communications Commission, develop

- Adequate criteria for identifying positions whose incumbents should file statements and apply that criteria to all agency positions.
- Procedures to insure that statements are promptly collected.
- Procedures to inform supervisors of their subordinates' financial holdings which they have been permitted to retain if they disqualify themselves from participating in FCC matters affecting those interests. This would help to insure, to the extent possible, that such disqualifications take place.
- Followup procedures to insure that no employees own financial interests prohibited by section 4(b) of the Federal Communications Act, particularly those employees who are not required to file financial disclosure statements.

MATTERS FOR CONSIDERATION BY THE CONGRESS

If the Congress continues to deem it necessary to keep the prohibitions of section 4(b) of the 1934 Communications Act, we believe that the act should be amended as follows. First, in view of the uncertainty as to the companies which can fall under section 4(b) and the interpretations of that section by FCC and the Department of Justice, the legislation should be clarified to apply the prohibitions only to companies FCC significantly regulates. Second, the section should be amended to also apply to the constructive interests of employees. The constructive interests could affect an employee as much as those interests directly held, but the section as currently written and interpreted by FCC, Justice, and GAO applies only to the employees' direct interests.

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20534

December 1, 1975

IN REPLY REFER TO:

2090

Mr. Edward Morahan
General Accounting Office
Penn Park Building
803 West Broad Street
Falls Church, Virginia 22046

Dear Mr. Morahan:

As a follow-up to our meeting of November 6, 1975, and upon your invitation, some further comments are offered on the matters reviewed and considered to have a bearing on the Commission's implementation of Executive Order No. 11222 and Federal Personnel Manual, Chapter 735.

1. The employment of former industry personnel in duties where the agency's actions might be influenced by the employee's judgment of his former employer.

I am attaching informal comments on this point in elaboration of our prior discussion. As you will see, the agency's need for the particular expertise such individuals can provide is real, and it cannot be satisfied by other means.

2. Guidance and support given the FCC program by the Civil Service Commission.

Basically, there is a good working relationship with the Legal Advisory Section. The Office of General Counsel here has had limited contact with the Conflicts Counsel of USCSC, primarily because that office is more involved with the appointed officials of the agency, i.e., commissioners.

3. Use of the 7-point Position Evaluation Criteria.

Upon further examination of this criteria developed by your office and proposed as applicable, at least in part, to this Commission and to more than forty employees, it would appear necessary for your headquarters and the Civil Service Commission to agree on a revision of the criteria

contained in the Federal Personnel Manual, insofar as employees below grade GS-13 are concerned. In the case of GS-13 or above, the present criteria, developed in coordination with, and approved by, the Civil Service Commission are organizationally workable because they were based on readily identifiable positions (Assistant Chief of Branch or comparable unit) at a level where it was reasonable to expect the incumbent to begin to exercise judgment in making a Government decision, or to require the incumbent to report involvement in a possible conflicts-of-interest situation. Separate from our present requirement for filing of statements by the above personnel, is that imposed on all employees to state that they have no employment by or financial interest in any entity covered under our regulations. If to this one adds the annual reminder given each employee, a viable and satisfactory system would appear to exist. Obviously, it would be the ideal and possibly the most desirable situation were all employees covered in one way or another by your criteria and called on to file a statement. But this must be weighed against both the expected gain and the amount of resources needed to manage such an enlarged program. It would seem that our present procedures with some further improvements, present an acceptable system that meets the Government's conduct requirements.

For your use I am enclosing a copy of our reminder to all employees and the internal check form used in our review. It will be of interest to you to know that your recent audit helped to highlight the particular responsibilities performed by the Security Office in support of the Financial Disclosure System, and it thus assisted in bringing to completion a pending re-organization that now has resulted in an Internal Review and Security Division, with an internal audit capability to supplement the duties already being performed.

Should you require any further information or clarification, please contact me.

Sincerely yours,


L.D. Lichowarot
Executive Director

Enclosures

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum

TO : All Employees

DATE: June 4, 1975

FROM : Executive Director

SUBJECT: Financial Interests of FCC Employees

As was done in past years, the Commission has included in its legislative program (94th Congress) a proposal to amend Section 4 of the Communications Act of 1934 in order to remove inequities imposed by the conflict-of-interest provisions. This action was taken because the existing provisions were considered unnecessarily harsh, particularly in view of the changed conditions over the past 30 years in the field of communications.

Until and unless such relief is provided, all employees, whether required to submit annual reports of their financial holdings or not, are cautioned to avoid at all times acquiring a financial interest that could result, or take an action that would result, in a violation of the conflict-of-interest provisions of Section 208, Title 18, U.S. Code, or subpart B of Part 19, FCC Rules and Regulations.

To assist in this, the General Counsel has prepared a list of companies which have been reviewed in the past and concerning which the General Counsel has issued specific rulings to the effect that a financial interest by FCC employees in such companies is contrary to Section 4(b) of the Communications Act. This list may be reviewed at my office. What must be remembered is that the list is merely a consolidation of past rulings, and therefore it does not mean a company not listed is not subject to the 4(b) prohibition, but only that some corporations were reviewed because of disclosed or proposed ownership of securities. A further complicating factor is the constant change in the corporate structure through acquisitions or sale, causing a 4(b) conflict to appear or dissolve at any point in time. In most instances, the employee should be able through personal research, or through a broker, to identify a corporation whose products or services bring it within the present 4(b) criteria. Where interpretation or advisory service is needed, it should be obtained from the Office of General Counsel under his counseling service on questions of conflict of interests.

The matter of mutual funds has been the subject of extensive discussion. Investments in funds whose holdings include companies engaged in communications by wire or radio, or in the manufacture or sale of communications apparatus, or in furnishing services to



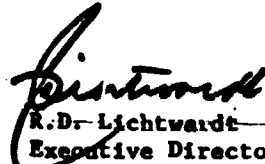
Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

SUBJECT: Financial Interests of FCC Employees

such companies are barred under a literal reading of the language contained in Section 4(b). However, the General Counsel has advised that the intent of this section would not be transgressed if an employee were to hold small investments in the ordinary variety of mutual funds so long as such interests were not so substantial as to be likely to affect the integrity of the employee's services.

An ordinary type of mutual fund is considered to be one having a diversified portfolio with no concentration in the regulated companies and where the fund's holding in any such company is not substantial in nature. On the other hand, it should be understood that a mutual fund whose holdings are concentrated substantially in broadcasting, communications by wire or in any of the other stock described in 4(b), or a mutual fund owned by a corporation itself subject to 4(b), would be outside the permissible ownership.

Once the employee has determined to his own satisfaction that the fund's holdings are sufficiently diversified, but that there are some communications securities in the portfolio, a waiver should be requested under Section 19.735-412, since the employees would be barred from participating in any matters affecting the companies held by the fund, unless, after disclosure, it was determined that the holdings were regarded as too insubstantial to be deemed likely to affect the integrity of the employee's services within the meaning of 18 U.S.C. 208(b).


R. Dr. Lichtwardt
Executive Director

REVIEW OF FINANCIAL DISCLOSURES FY 1975

Name of Employee: _____

Title: _____

Date of Review: _____

| HOLDINGS | PRICR 4(b) Det. | CC DET. REQUIRED | MAIIVER REQUIRED | OTHER ACTIONS |
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STATEMENT OF RICHARD E. WILEY, CHAIRMAN
FEDERAL COMMUNICATIONS COMMISSION
Before the
SUBCOMMITTEE ON COMMUNICATIONS
of the
SENATE COMMITTEE ON COMMERCE

60053

on S. 2343, S. 2846, and S. 2847,
bills to amend the Communications Act of 1934

January 21, 1976

Mr. Chairman and Members of the Subcommittee:

I very much appreciate your holding these hearings on three bills introduced at the request of the Commission. Since each bill concerns a separate and distinct subject, I would like to comment briefly on what each would do and why the Commission proposed them.

S. 2846 would amend the conflict of interest provisions of subsection 4(b) of the Communications Act to remove certain inequities.

Quite simply, while FCC Commissioners and employees would continue to be prohibited from investing in broadcasting companies, CATV systems, and communications common carriers, such prohibition would not apply to those thousands of companies which use radio merely as an incident of their business or to the purchase of an ordinary mutual fund.

I do not believe this bill should engender any controversy. It is somewhat more restrictive than a similar bill enacted by the Senate in 1965 after hearings and a favorable report by this Committee. That bill, which unfortunately did not receive consideration by the House of Representatives, provided exemptions from the conflict of interest provisions of subsection 4(b) for executive reservists and special government employees. Those exemptions, which were viewed by one

member of the House Committee on Interstate & Foreign Commerce as a possible loophole, are not contained in S. 2846. I am hopeful that this bill--which I believe to be a modest and reasonable proposal--will be enacted by both houses in this Congress.

So that your hearing record may be complete, I have included in my statement another four pages explaining the bill. I will be pleased at this point to read it, summarize it or respond to questions as the Chairman may desire.

Subsection 4(b) was enacted to ensure that the decisions reached by Commissioners and Commission employees are shaped by public interest considerations, and not the prospect of personal economic gain. To achieve this objective, Congress saw fit to bar members of the Commission and its employees from having a financial interest in:

1. The manufacture or sale of radio apparatus or apparatus for wire or radio communication;
2. Communication by wire or radio;
3. Companies furnishing services or such apparatus to any company engaged in communication by wire or radio or to any company manufacturing or selling apparatus used for communication by wire or radio;
4. Any company owning stocks, bonds, or other securities of any such company.

Moreover, Congress barred such persons from owning stocks, bonds or other securities of any corporation subject to any of the provisions of the Communications Act. The various provisions of subsection 4(b) were

warranted and also her appropriate at the time they were enacted. However, in view of subsequent developments, they now sweep with much too broad a brush.

Since that time, communications equipment has been used in ways and to a degree not anticipated. At present, radio communication apparatus is employed in virtually every facet of business. It is found in delivery trucks, taxi cabs, aircraft, boats and automobiles, and it is used in such diverse fields as farming, fishing and mining. A literal application of subsection 4(b) would preclude Commissioners and Commission employees from owning stocks, bonds, or other securities of any corporation which holds even a single Commission radio license for perhaps a delivery van or a corporate airplane, or any corporation providing services, such as building maintenance, to such corporations. Given such a broad application, it is difficult to conceive of a security which Commission personnel could purchase. The Commission does not believe that Congress intended this result. Accordingly, the proposed amendment makes clear that subsection 4(b) would not apply to securities of corporations whose use of radio is merely incidental to their primary business.

In addition, advancements in the area of corporate organization and the means by which securities are distributed have caused subsection 4(b) to become outdated. In recent years, we have witnessed the development of many complex corporate interrelationships. As a result, many large corporations now have connections--some quite remote-- with licensees of the Commission. Consequently, it is altogether possible that Commissioners and Commission employees may acquire securities in a corporation having such connections which are not readily apparent, and thus unknowingly violate

the Act. The proposed amendment would make clear that subsection 4(b) does not apply to securities of corporations whose relationship to corporations subject to the Communications Act is remote.

The recent proliferation of mutual funds also raises subsection 4(b) questions. Since almost any mutual fund would hold some communications securities--such as AT&T, GE or RCA--a strict application of the subsection would preclude Commissioners and Commission employees from purchasing shares in such funds. The Commission believes that investment in mutual funds should be permitted where the fund's holdings are not concentrated in broadcasting companies, cable television systems, communications common carriers or companies engaged in the manufacture or sale of apparatus for wire or radio communication. The proposed amendment would implement this belief.

As further justification for the proposed amendments, I note that 18 U.S.C. 208, the general statute addressing conflicts of interest, is far less restrictive than subsection 4(b). Section 208 bars an officer or employee of the executive branch from participating in decisions in an official capacity in which he has a financial interest, absent disclosure of the nature and circumstances of his interest and receipt of a ruling that such interest is so insubstantial as to be unlikely to affect his decision; or exemption of his interest by general rule or regulation.

The Commission recognizes, of course, that where employees of a federal regulatory agency are involved, additional restrictions may be appropriate. For this reason, the proposed subsection 4(b) would continue

to prohibit Commissioners and Commission employees from having a direct financial interest in, employment by or any official relationship to:

1. Any person engaged in radio broadcasting;
2. Any person engaged in the distribution of programs over wire;
3. Communications common carriers;
4. Persons a substantial part of whose activities consist of the manufacture or sale of apparatus for wire or radio communication;
5. Mutual funds, holding companies, or other investment companies whose investments are concentrated substantially in the entities included in paragraphs (1), (2), (3) and (4). As an additional safeguard, the amendment also specifically states that nothing herein shall limit the authority of the Commission under Public Law 87-849 (87th Congress, approved October 23, 1962) or other law or Executive Order to restrict further the financial interests or official relations of its employees.

The proposed amendment also contains a provision modeled after 18 U.S.C. 208(b) which would authorize waiver of the provisions of subsection 4(b) in certain cases.

I wish to stress that the Commission is not seeking special treatment in this area. To the contrary, we seek only to amend current subsection 4(b) to eliminate antiquated provisions which, because of changed circumstances, may cause unnecessarily harsh results. Accordingly, I am confident that the proposed amendments will not affect the impartiality with which Commission decisions are rendered. To the contrary, they will provide a more realistic basis for the protection of the public interest.

GAO Note: The remainder of this testimony is not included because it relates to bills non related to the subject discussed.

REPORTS ISSUED ON AGENCIES'
FINANCIAL DISCLOSURE SYSTEMS

| <u>Agency</u> | <u>Report title, number, and issue date</u> |
|--|---|
| Federal Power Commission | Need for Improving the Regulation of the Natural Gas Industry and Management of Internal Operations, B-180228, 9-13-74. |
| Department of the Interior | Effectiveness of the Financial Disclosure System for Employees of the U.S. Geological Survey, FPCD-75-131, 3-3-75. |
| Civil Aeronautics Board | Effectiveness of the Financial Disclosure System For Civil Aeronautics Board Employees Needs Improvement, FPCD-76-6, 9-16-75. |
| Federal Maritime Commission | Improvements Needed In the Federal Maritime Commission's Financial Disclosure System For Employees, FPCD-76-16, 10-22-75. |
| U.S. Railway Association | Improvements Needed in Procurement and Financial Disclosure Activities of the U.S. Railway Association, RED-76-41, 11-5-75 |
| Department of the Interior | Department of the Interior Improves Its Financial Disclosure System For Employees, FPCD-75-167, 12-2-75. |
| Department of Health, Education, and Welfare | Financial Disclosure System for Employees of the Food and Drug Administration Needs Tightening, FPCD-76-21, 1-19-76. |
| Department of the Interior | Letter report to Congressman John Moss on U.S. Geological Survey employees divestiture, FPCD-76-37, 2-2-76. |
| Inter-American Foundation | Inter-American Foundation's Financial Disclosure System For Employees and Its Procurement Practices, ID-76-69, 6-30-76. |

APPENDIX III

APPENDIX III

| <u>Agency</u> | <u>Report title, number, and issue date</u> |
|-------------------------------|--|
| Department of Transportation | Problems with the Federal Aviation Administration's Financial Disclosure System, FPCD-76-50, 8-4-76. |
| Department of Commerce | Problems Found In the Financial Disclosure System For Department of Commerce Employees, FPCD-76-55, 8-10-76. |
| Small Business Administration | Management Control Functions Of The Small Business Administration--Improvements Are Needed, GGD-76-74, 8-23-76. |
| Export-Import Bank | Export-Import Bank's Financial Disclosure System for Employees and its Procurement Practices, ID-76-81, 10-4-76. |