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Report to the Subcommittee on Commerce, Justice, State, the Judiciary, and Related Agencies, Committee on Appropriations, U.S. Senate

December 2000

SCHOOLS AND LIBRARIES PROGRAM

Application and Invoice Review Procedures Need Strengthening

G A O

Accountability * Integrity * Reliability

GAO-01-105

Contents

Figures

Abbreviations

FCC	Federal Communications Commission
MSA	Metropolitan Statistical Area
NECA	National Exchange Carrier Association
PCS	personal communications service
SLD	Schools and Libraries Division
USAC	Universal Service Administrative Company
WAN	Wide Area Network

United States General Accounting Office
Washington, D.C. 20548

December 15, 2000

The Honorable Judd Gregg
Chairman
The Honorable Ernest F. Hollings
Ranking Minority Member
Subcommittee on Commerce, Justice,
State, the Judiciary and Related Agencies
Committee on Appropriations
United States Senate

The Telecommunications Act of 1996 expanded the traditional concept of universal service—affordable, nationwide telephone service. Among other things, the act extended universal service support to eligible schools and libraries and authorized the Federal Communications Commission (FCC) to implement a program to assist these institutions in acquiring advanced telecommunications and information services. Under FCC's program (often referred to as the "e-rate program"), eligible schools and libraries can apply individually or as part of district wide or even state wide consortia for discounts from vendors on the cost of eligible telecommunications services, Internet access, and internal connections (the equipment needed to deliver these services). The e-rate program committed over $3.7 billion to schools and libraries that requested e-rate support during its first 2 years, 1998 and 1999.

We issued several reports in 1998 and 1999 dealing with the program's start-up activities.[1] Among other things, we reviewed key aspects of the program's administrative structure, the design of its procedures, and its internal controls for reviewing applications. We made recommendations to FCC to improve the program's operations, which program officials implemented before making their first-year funding commitments to applicants in late 1998.

[1]See Letter to the Honorable Ted Stevens, B-278820, Feb. 10, 1998; *Telecommunications: FCC Lacked Authority to Create Corporations to Administer Universal Service Programs* (GAO/T-RCED/OGC-98-84, Mar. 31, 1998); *Telecommunications: Court Challenges to FCC's Universal Service Order and Federal Support for Telecommunications for Schools and Libraries* (GAO/RCED/OGC-98-172R, May 7, 1998); *Schools and Libraries Corporation: Actions Needed to Strengthen Program Integrity Operations Before Committing Funds* (GAO/T-RCED-98-243, July 16, 1998); and *Schools and Libraries Program: Actions Taken to Improve Operational Procedures Prior to Committing Funds* (GAO/RCED-99-51, Mar. 5, 1999).

In June 1999, you directed us to review several additional aspects of the program as it neared the beginning of its third year.[2] Specifically, this report discusses four issues:

- the amount of e-rate funding requested by applicants, the amount of funds committed to them, and the amount of committed funds they have actually used;
- whether e-rate funds have been committed to products and services that are ineligible for support under the program's rules;
- whether the administrative costs of the program are increasing and how they compare with those of other federal support programs; and
- FCC's progress in establishing performance goals and measures for the program.

In addition, you asked us to provide information on two related issues. Appendix I describes FCC's authority to increase the program's annual funding level, currently capped at $2.25 billion. Appendix II compares the program's competitive bidding procedures to federal procurement law and includes information on other e-rate competitive bidding issues.

To evaluate these issues, we reviewed relevant laws and regulations, FCC orders, and program procedures; analyzed program data on the demand for funding and funding commitments; obtained the program's administrative expenses from audited financial statements; and compared the program's competitive bidding procedures to federal government practice. We also interviewed officials at FCC's Common Carrier Bureau, as well as at the Universal Service Administrative Company (USAC) and its Schools and Libraries Division (SLD), which is responsible for the program's day-to-day operations. In addition, we reviewed a sample of 44 out of 9,770 applications that requested and received funding commitments for internal connections from June through November 1999 to see if ineligible products and services had received funding commitments. The 44 applications contained over 2,300 separate requests for internal connections and accounted for $285 million of the $1.2 billion in second-year funding commitments for internal connections through November 1999. The results of these 44 applications are not representative of all 9,770 applications, since our sampling procedures gave applications for a large amount of funding a greater chance of being included in our sample. We found that our sample of 44 applications could not be used to provide reliable

[2] S. Rep. No. 106-76 (June 14, 1999).

estimates for all 9,770 applications because there was great variation in the amounts of the errors we observed from one application to the next in our sample. As a result, we do not present the results of this analysis in the body of our report. When using computer-generated data provided by SLD, we tested their reliability against the actual applications or complementary data sets. We performed our review from September 1999 through October 2000 in accordance with generally accepted government auditing standards.

Results in Brief

The amount of annual e-rate funding requested by schools and libraries almost doubled from $2.4 billion in 1998 to an estimated $4.7 billion in 2000. For the first 2 program years (1998 and 1999), SLD committed a total of $3.7 billion in e-rate funding to applicants. However, at least $1.3 billion (35 percent) of the funds committed in these 2 years had not been paid out as of the end of August 2000, even though FCC extended its deadlines for applicants to use their funds. Although funding commitments for the third program year were not complete at the end of August 2000, about $1.5 billion had already been committed, and SLD estimated that it would be committing an additional $600 million.

Weaknesses in SLD's e-rate application review process resulted in commitments of funds for ineligible products and services. We reviewed 44 second-year applications that received funding commitments for internal connections—the type of service most likely to include ineligible items. After screening out $20 million from requests that included ineligible items, SLD committed $285 million in e-rate funds to these applications for internal connections. However, we found that SLD reviewers failed to identify other ineligible items, resulting in at least $6 million in funding errors. This amount understates the extent of the problem because it does not include cases in which we found funds mistakenly committed for ineligible items whose costs could not be determined from the application materials. Also, it does not include the costs of other items whose eligibility was questionable but could not be resolved using the application materials and current review criteria. We traced these funding commitment mistakes and problems to procedural errors, unclear review criteria, and a lack of sufficient information in some applications for reviewers to determine the eligibility of questionable items. In addition, we found that SLD's process for reviewing invoice forms prior to disbursing committed funds provides another opportunity to identify ineligible items. However, the invoice review process requires applicants to submit much less information than found on their applications and involves less comprehensive reviews. An independent auditor hired by SLD has uncovered preliminary evidence that some program funds were spent on ineligible services after clearing SLD's application and invoice reviews. We are making recommendations to further improve SLD's ability to identify and deny funding for ineligible products and services. After reviewing a draft of this report, FCC and USAC said they had begun to implement the recommendations and had already completed action on some of them.

Although the e-rate program's administrative costs grew slightly from 1998 to 2000, they still remain small in relation to the program's overall funding. Program officials recently took actions designed to reduce contractors' costs—the program's biggest expense. We compared the e-rate program's administrative expenses with those of 34 other federal technology support programs by calculating the administrative expenses for each program as a percentage of the total funding provided. The e-rate program's percentage of 2.4 fell in the middle of the range of the other programs' percentages.

Until recently, the e-rate program lacked meaningful performance goals and measures as defined by the Government Performance and Results Act of 1993. FCC's initial goals focused on increasing the percentage of school buildings connected to the Internet, but these connectivity goals were much lower than the percentage of schools already connected. In September 2000, FCC finalized new goals and measures that focus on Internet connections to classrooms. Unlike the old goals, these properly reflect the percentage of classrooms already connected. The new goals include having 100 percent of public school instructional classrooms connected to the Internet by 2002 and 95 percent of private school instructional classrooms connected by 2003. The plan also seeks to improve participation in the e-rate program by urban low-income school districts and rural school districts located outside of towns, as well as rural libraries and libraries serving small populations. According to FCC data, the participation rates for these groups currently fall below the average rates of participation for all groups of applicants.

Background

Universal service traditionally has meant providing residential customers with nationwide access to basic telephone service at reasonable rates. The Telecommunications Act of 1996, however, broadened the scope of universal service, in part by extending universal service support to include eligible schools and libraries. The new program (often referred to as the "e-rate" program) is designed to improve schools' and libraries' access to advanced telecommunications and information services.

The Telecommunications Act of 1996 did not prescribe to FCC a structure for administering the program. In 1997, FCC directed the establishment of the Schools and Libraries Corporation as a not-for-profit organization working within the framework of FCC orders and rules to carry out the program's day-to-day operations, such as processing and reviewing e-rate applications. In November 1998, FCC changed the program's administrative structure in response to legal concerns about FCC's authority to create a corporation and the Congress's directive that a single entity should administer the e-rate program and a related program that provides telecommunications support to rural health care providers.[3] FCC appointed an existing body, the Universal Service Administrative Company (USAC), as the permanent administrator of the program and directed the Schools and Libraries Corporation to merge with USAC by January 1, 1999.[4] Under this merger, the Corporation's staff became part of a new USAC unit called the Schools and Libraries Division (SLD), carrying out essentially the same functions as before. In this report, we will refer to SLD when discussing operational issues associated with the program. FCC retains responsibility for overseeing the program's operations and ensuring compliance with its orders. Among other things, FCC reviews USAC's budget, makes e-rate policy decisions as needed, and handles appeals about funding decisions that are not resolved by SLD in favor of the applicant.

[3]See Senate Bill 1768 and the Conference Report on H.R. 3579 (H. Rept. No. 105-504). Section 2004(b) of the Senate bill provided, in part, that the Commission should propose a structure for the administration of its universal service programs that would consist of one entity.

[4]USAC was originally established as a subsidiary of the National Exchange Carrier Association (NECA) to administer the high-cost and low-income universal service support mechanisms. USAC currently performs billing, collection, and disbursement functions for all the universal support mechanisms. See Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Board on Universal Service, Third Report and Order and Fourth Order on Reconsideration, and Eighth Order on Reconsideration, CC Docket Nos. 96-45, 97-21, FCC 98-306 (rel. Nov. 20, 1998).

Eligibility Defined by Federal and State Law

Generally, educational institutions that meet the definition of “schools” in the Elementary and Secondary Education Act of 1965[5] are eligible to participate, as are libraries that are eligible to receive assistance from a state’s library administrative agency under the Library Services and Technology Act.[6] Prekindergarten education programs, adult secondary education programs, and juvenile justice facilities (e.g., classes leading to the General Educational Development High School Equivalency Test or other education that does not go beyond grade 12) may also be eligible for program funding depending on how state law defines elementary and secondary schools in the state where the program or facility is located. Appendix III identifies the states where this broader eligibility applies.

Eligible schools and libraries may apply annually for e-rate support. Over 30,000 applications were submitted during each of the program’s first 3 program years (1998-2000) from schools and libraries in each of the 50 states, the District of Columbia, and Puerto Rico.[7] Individual applications can cover single schools, whole school districts, consortia, or even schools in entire cities and states. Applicants can also submit multiple applications each year for different services. The amount of support sought in an individual application can range from hundreds of dollars to tens of millions of dollars, depending on the number of schools or libraries covered by the application and the extent of the services for which funding is sought.

[5]20 U.S.C. 8801(14) and (25).

[6]20 U.S.C. 9122. Examples of entities not eligible for support are home school programs, private vocational programs, and institutions of higher education. In addition, private schools with endowments of more than $50 million are not eligible to participate. Libraries whose budgets are part of a school’s budget are not eligible to receive universal service support.

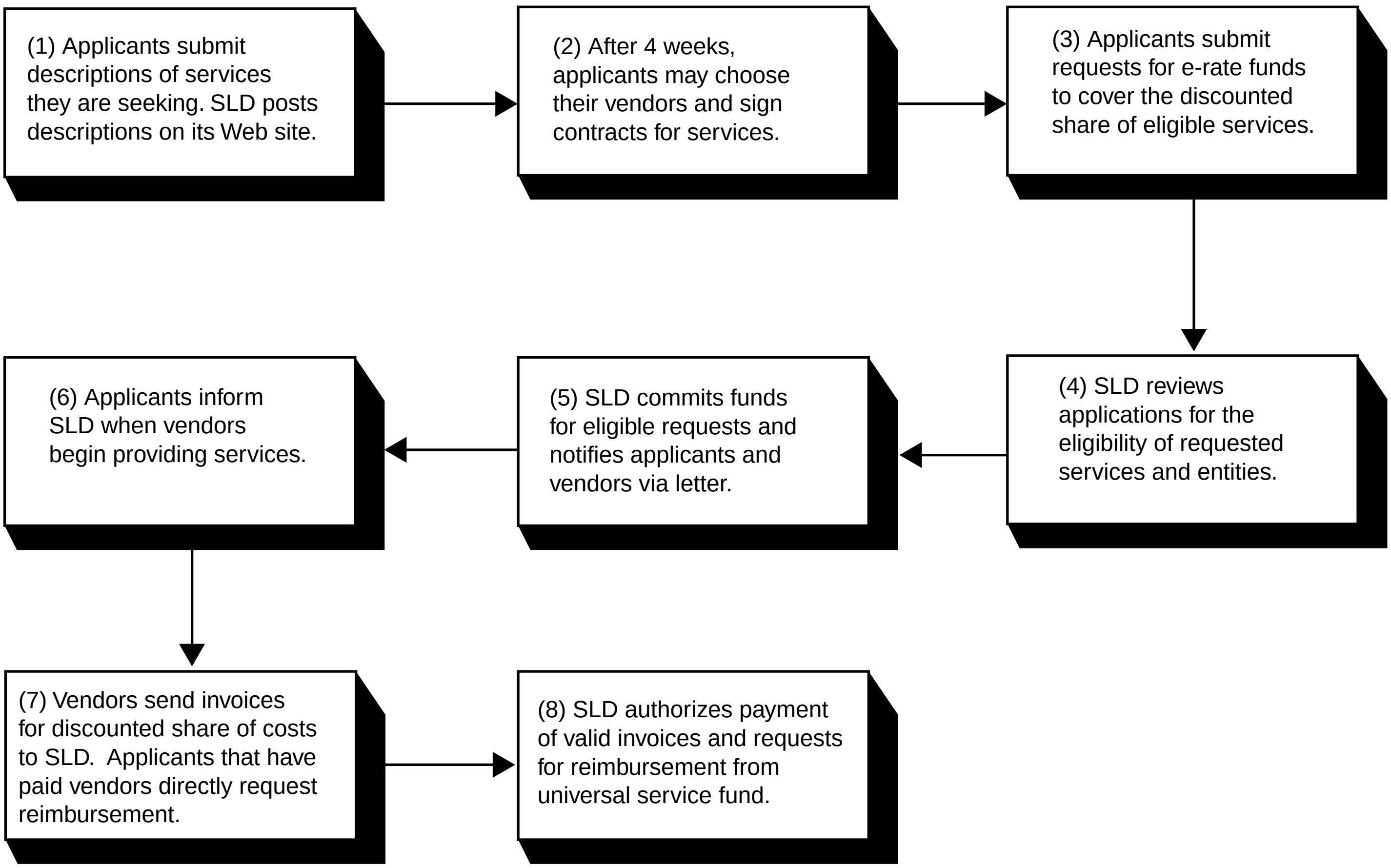
[7]Schools and libraries located in American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands have also requested funds in one or all of the program years.

Funding Is Provided Through Discounts on Contracted Services

Schools and libraries do not receive funding directly from the program. Instead, the program requires applicants to seek competitive bids from technology vendors for telecommunications services, Internet access, and internal connections that are eligible for e-rate support. The program reimburses the applicants' vendors for discounts the vendors provide on the costs of services, as approved by SLD during the application process. Alternatively, if the applicant has already paid in full for the service, it may seek reimbursement from SLD. Approved reimbursements are paid to the service provider, which passes them on to the applicant. The discount levels range from 20 to 90 percent, with schools and libraries located in rural and low-income areas receiving the highest discounts.[8] See figure 1 for an overview of the e-rate application and funding cycle.

[8]The program measures how economically disadvantaged the schools and libraries are by the number of students eligible to participate in the national school lunch program. Urban and rural designations are based on the Metropolitan Statistical Area (MSA) listing.

Figure 1: Overview of E-Rate Application and Funding Cycle



The discounts are funded by the universal service fund, which is one of the financial support mechanisms used to compensate telephone companies and other communications entities for providing access to telecommunications services at reasonable and affordable prices to high-cost areas, low-income households, and rural health care providers in addition to schools and libraries. The Telecommunications Act specifies that every telecommunications carrier providing interstate telecommunications services must contribute to this fund, unless exempted by FCC.[9] A portion of this fund is used to compensate vendors for the discounts they provide to e-rate program participants. Unless the Commission takes action, $2.25 billion is available for e-rate discounts each year.

Not All Telecommunications Products and Services Are Eligible for Support

The e-rate program does not provide support for all the telecommunications services that schools and libraries may need or desire. The Telecommunications Act directed FCC to convene a Federal-State Joint Board on universal service. Based on the board's recommendations, FCC's May 1997 Universal Service Order, along with several subsequent orders, defines three classes of service that are eligible for e-rate support:

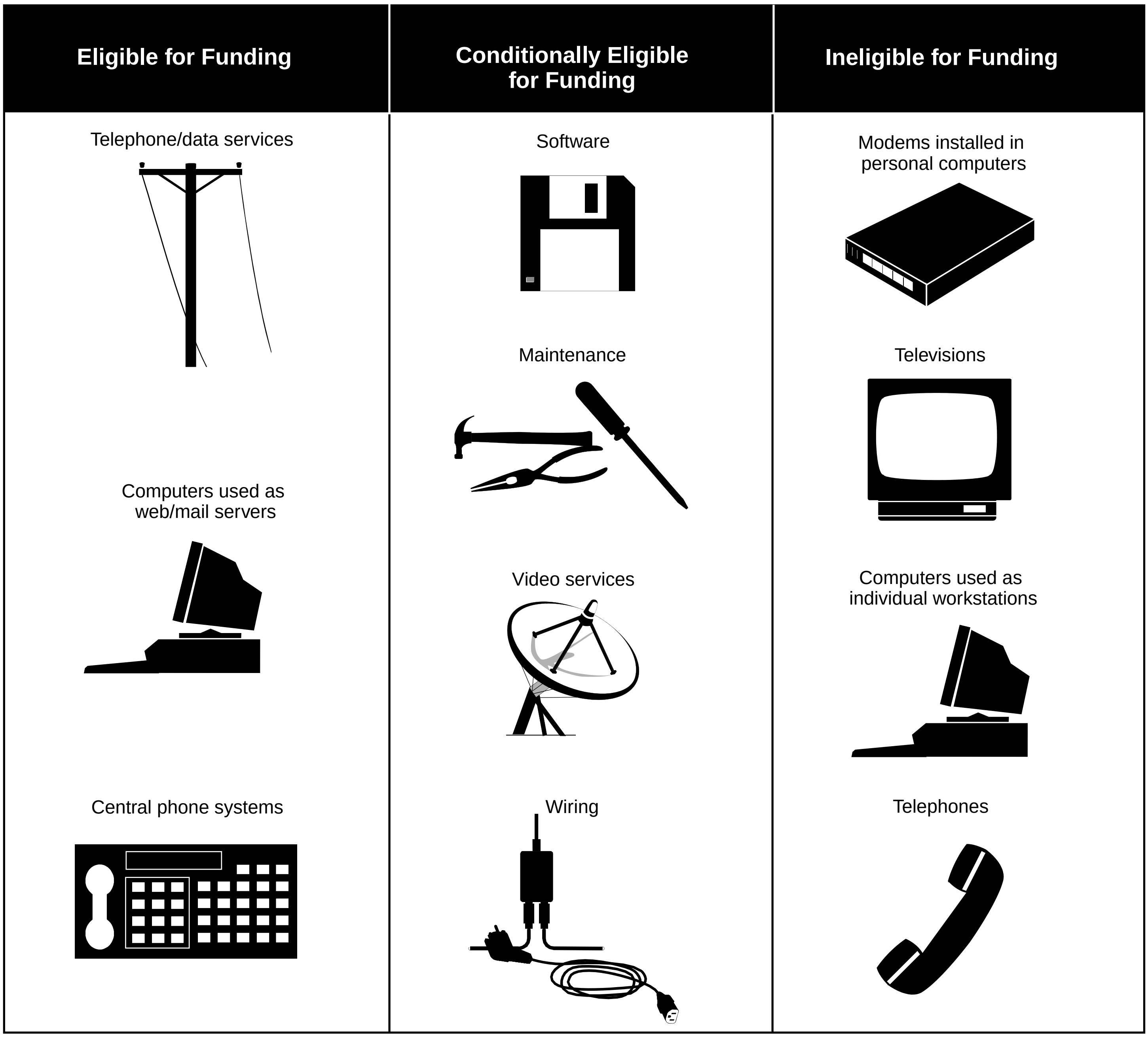
- *telecommunications services*, such as local, long-distance, and international telephone service; as well as high-speed data links (such as T-1 lines);
- *Internet access services*, such as dial-up Internet access, and e-mail services; and
- *internal connections*, such as telecommunications wiring, routers, switches, and network servers that are necessary to transport information to individual classrooms.

Charges for telecommunications and Internet access services can include both recurring costs, such as monthly service, and one-time installation costs. Internal connections are generally one-time costs to purchase and install eligible equipment and software. Some items within these categories are eligible only if certain conditions are met. For example, personal communications service (PCS) and cellular telephone service are conditionally eligible if used at a place of instruction for educational purposes. Other items are always ineligible for e-rate support, even though

[9] The Commission also required certain other providers of telecommunications services, such as payphone service providers, to contribute to the universal service fund.

they may be necessary or desirable for providing students or library patrons with access to advanced telecommunications services, such as the Internet. Ineligible items include personal computers, modems in personal computers, virus protection software, and content-filtering software designed to block access to objectionable Web sites. Figure 2 illustrates some of the common eligible and ineligible products and services. FCC's Schools and Libraries Eligibility List provides additional information on the items that can be funded under each of these categories.

Figure 2: Examples of Eligible, Conditionally Eligible, and Ineligible Products and Services



Schools and libraries are allowed to contract with the same vendor for both eligible and ineligible services. However, in preparing their e-rate applications, applicants are required to exclude the cost of all ineligible items from their funding requests.

Although E-Rate Funding Requests Have Increased, a Significant Amount of Committed Funds Has Not Been Used

The annual amount of e-rate funds requested by applicants has grown sharply, from $2.4 billion for the first program year (1998) to an estimated $4.7 billion for the third program year (2000). This latter amount greatly surpasses the annual e-rate funding cap of $2.25 billion, which FCC established at the outset of the program. For the first 2 program years (1998 and 1999), SLD committed a combined total of $3.7 billion in e-rate support in response to applicants' requests. However, as of August 31, 2000, at least $1.3 billion of this $3.7 billion in committed funds was still unused. Because FCC extended its deadlines, some applicants receiving funds for the second program year will have until September 30, 2001, to receive one-time services. As of August 31, 2000, SLD had committed $1.5 billion for the third program year and expected to commit another $600 million.

Amount of Requested Funding Has Increased Sharply

Section 254 of the Communications Act of 1934, as amended, provided FCC with the authority to set the funding level for the e-rate program. Acting on the recommendations of the Federal-State Joint Board, which estimated the demand for e-rate support, FCC established a $2.25 billion annual funding cap for the program. Each year, FCC determines the funding level for the program, based on projected demand, subject to the cap. Appendix I provides additional details on FCC's authority to set and modify this cap.

Table 1 shows the amounts of e-rate funds requested by applicants and committed to them by SLD for the first 2 program years. (Funding commitments for the third program year were not complete at the time our review ended.) For the first program year, FCC set the funding level at $1.925 billion.[10] This was enough to fund all the applicants' requests for eligible telecommunications services and Internet access support, but not enough to cover all requests for eligible internal connections support. The program's funding priorities call for telecommunications services and Internet access requests to be funded first, with any remaining funding going to internal connections for the most disadvantaged applicants. As a result, only those applicants with discount rates of 70 percent or higher received e-rate funding for their internal connections.[11] For the second program year, FCC raised the funding level to the full $2.25 billion allowed under the cap. SLD received about $2.7 billion in requests but found, after reviewing them against various eligibility criteria, that all eligible requests could be funded for only $1.99 billion. According to SLD officials, FCC directed them to reopen the second-year application period so that they could use the remainder of the funds.[12] These additional applications, requesting an estimated $370 million, had not been processed at the time our review ended and are not included in table 1.

[10] FCC also extended the first program year from 12 to 18 months.

[11] As table 1 shows, the total amount of first year funds committed was $1.731 billion. This amount does not equal the total amount of authorized funding available that year ($1.925 billion). SLD held some funds in reserve to cover appeals by applicants that were denied funding. Program funds are also used to cover the program's administrative costs.

[12] SLD is reviewing applications received between Apr. 7, 1999, and Mar. 31, 2000, for the remaining second-year program funding.

Table 1: Amounts of Funds Requested and Committed for the First 2 Program Years, as of August 31, 2000

	First program year (1998)		Second program year (1999)[a]	
Service type	Amount requested by applicants	Amount committed by SLD	Amount requested by applicants	Amount committed by SLD
Telecommunications	$725,533,870	$679,158,138	$770,554,717	$579,455,836
Internet access	138,977,710	135,647,152	185,823,153	148,408,155
Internal connections	1,536,573,944	917,092,722	1,754,481,404	1,242,965,575
Total	**$2,401,085,524**	**$1,731,898,012**	**$2,710,859,274**	**$1,988,829,566**

[a]Does not include requested and committed amounts for additional applications accepted after April 7, 1999.

Source: SLD's database.

The funding commitment process for the third year was still under way when we ended our audit. SLD estimated, however, that the total amount of third-year funding requested by applicants is about $4.7 billion, almost double the request level for the program's first year. Since this amount is well above the funding level of $2.25 billion that FCC set for this year, many requests will not be met. As noted above, the program's funding priorities call for telecommunications services and Internet access requests to be funded first, with any remaining funding going to internal connections. SLD officials estimated that they would be able to fund eligible internal connection service requests only for applicants that have a discount rate of 82 percent or higher. As of August 31, 2000, SLD had committed $1.5 billion for the third year and estimated that it would be committing an additional $600 million once all the third-year applications were processed.

A Significant Amount of Funds Committed to Applicants Has Not Been Used

Although SLD commits program funds to applicants on the basis of their application requests, it does not authorize payouts of committed funds until it receives valid invoices showing that the applicants have obtained the requested products and services. In accordance with its internal control procedures, SLD will not approve payments of committed funds until (1) applicants certify that they have begun to receive e-rate-supported services from their vendors and (2) vendors file invoice forms requesting reimbursement for the e-rate-supported services that they have provided to the applicants. In many cases, applicants and their vendors have not yet submitted this material. As of August 31, 2000, at least 35 percent ($1.3 billion) of the $3.7 billion in program funds committed to applicants during the first and second program years had not yet been paid out. Table 2 summarizes the amounts of first- and second-year funding that were committed to applicants and the amounts that SLD authorized to be paid out as of August 31, 2000. Appendix IV contains the same data broken out by each state, the District of Columbia, and the Commonwealth of Puerto Rico.

Table 2: Amounts of Funds Committed and Authorized for Payment by SLD for the First 2 Program Years, as of August 31, 2000

	First program year (1998)		Second program year (1999)	
Service type	**Program funds committed**	**Program funds authorized for payment**	**Program funds committed**	**Program funds authorized for payment**
Telecommunications	$679,158,138	$507,321,407	$579,455,836	$233,465,766
Internet access	135,647,152	95,165,521	148,408,155	68,118,565
Internal connections	917,092,722	792,059,949	1,242,965,575	707,530,523
Total	**$1,731,898,012**	**$1,394,546,877**	**$1,988,829,566**	**$1,009,114,854**

Source: SLD's database.

FCC required that applicants use all funds committed to them in the first program year no later than June 30, 1999. In March 1999, FCC granted a partial extension of this deadline, allowing the payment of funds committed for one-time services provided through September 30, 1999. FCC permitted this extension because a number of schools and libraries received late notice of funding commitment decisions, making it difficult for them to initiate the installation of internal connection services.[13] In December 1999, FCC waived the new deadline for those applicants that had received late funding commitments following appeal decisions, requested a change in vendors, or for some reason had their payments delayed. The waiver generally gives an applicant an additional 180 days from the time of receiving the late commitment letter or changing the vendor to use its funds committed for one-time services.[14] Despite these extensions, about $337 million of the total funds committed during the first program year had not been authorized for payment as of August 31, 2000.

[13]In addition, FCC noted the extension would allow schools to use internal connection funding over the summer months when schools were in recess.

[14]Because of these extensions and pending appeals, SLD estimates that it is possible that as much as $44 million committed in the first year could still be paid out.

For the second program year, FCC originally established a deadline of June 30, 2000, for receiving services supported by committed funds. FCC subsequently extended this deadline for one-time services to September 30, 2000, largely because SLD again notified applicants of their funding commitments later than anticipated. As of August 31, 2000 (30 days before the deadline), about $980 million of these committed funds, or nearly 50 percent, had not been authorized for payment. On October 31, 2000, FCC again extended this deadline. Applicants meeting certain criteria now have until September 30, 2001, to use second-year funds committed for one-time services.

It is currently unclear what percentage of committed funds will ultimately be used. Given the deadline extensions and waivers, SLD officials expect that additional applicants and vendors will eventually file the required forms and receive some of the committed funding, while others may never claim all of the funds committed to them because they did not obtain all of the items included in their request. FCC has already used $447 million of first-year program funds to reduce the amount that telecommunications carriers paid into the universal service fund in the second and third program years. Both FCC and SLD officials stated that a comprehensive analysis has not been conducted to determine why some committed funds have not been claimed or whether changes in program procedures could reduce the amount of unused funds.

Weaknesses Found in Application and Invoice Review Procedures

Weaknesses in SLD's application review process caused some funds to be committed for ineligible products and services. We reviewed 44 second-year applications that received funding commitments for internal connections—the type of service most likely to include ineligible items. After screening out $20 million from requests that included ineligible items, SLD committed $285 million in e-rate funds to these applications. However, we found that SLD reviewers had failed to identify other ineligible items that resulted in at least $6 million in funding errors. This amount understates the extent of the problem because it does not include cases we found in which funds were mistakenly committed for ineligible items whose costs could not be determined from the application materials. Furthermore, it does not include the costs of other items whose eligibility was questionable but could not be resolved using the application materials and current review criteria. We traced these funding commitment mistakes and problems to procedural errors, unclear review criteria, and a lack of sufficient information in some applications that prevented reviewers from determining the eligibility of questionable items. In addition, we found that

SLD's process for reviewing invoice forms prior to disbursing committed funds provides another opportunity to identify ineligible items. However, the invoice review process requires applicants to submit much less information than is found on their applications and involves less comprehensive reviews. An independent auditor hired by SLD has uncovered preliminary evidence that some program funds were spent on ineligible services after the requests for these funds cleared SLD's application and invoice reviews. SLD officials have begun efforts to address some of these weaknesses.

Application Review Includes Procedures to Prevent Funding of Ineligible Items

One of SLD's key management objectives is to ensure that e-rate funds are provided only to eligible entities for eligible products and services. Not only is it inequitable for some applicants to receive funding for ineligible products while others do not, but such errors deplete the funds available to other applicants. This latter point is particularly important because, as we noted earlier, there was not enough funding available during the first and third program years (1998 and 2000) to meet all the applicants' requests.

SLD's primary internal control for ensuring that program funds are not directed to ineligible products and services is the application review process. This process calls for more than one reviewer to examine virtually all applications, identify all ineligible items that an applicant may have included, and exclude these items from the funding commitment made to the applicant. One key aspect of this process calls for reviewers to compare the services described in each application to a database listing more than 750 telecommunications services, Internet access services, and internal connection items.[15] For each item, the database identifies the type of service, provides a definition, and specifies whether it is eligible, ineligible, or eligible only if certain conditions are met. Any funding request that includes an ineligible entity or an ineligible product or service must be reduced by the cost of the ineligible item. If the cost of ineligible items totals more than 30 percent of the funding request, then the whole request is denied.[16]

[15]This aspect of the review process was implemented as a result of our testimony *Schools and Libraries Corporation: Actions Needed to Strengthen Program Integrity Operations Before Committing Funds* (GAO/T-RCED-98-243, July 16, 1998), which found that the same review criteria were not being applied to all applications.

[16]This procedure was put in place to prompt applicants to prepare their applications carefully and make a conscientious effort to exclude ineligible items.

While the process used to review the eligibility of services is the same for all applications, the amount of effort needed to review an application varies. Some applications are quite large, covering many schools and containing hundreds of separate requests for products and services, each of which needs to be reviewed, whereas other applications include only a few products or services. Applications also vary in the amount of information provided. Some applications we reviewed included detailed descriptions of every product or service for which support was requested. In other cases, reviewers had to ask applicants for more information to understand what services they had included.

The importance of the application review process is underscored by the fact that applicants can request substantial funding for ineligible items. For example, for the 1999 program year, SLD officials said that they had identified and denied nearly $400 million in internal connection funding requests for ineligible items or requests that did not meet other eligibility rules.[17] Once SLD reviews the applications and adjusts the requested amounts to remove the cost of ineligible items, it makes its funding determinations. Each applicant receives a letter detailing the amount of funding committed for each funding request and noting any funding that was denied.

Some Ineligible Internal Connection Items Were Included in Second-Year Funding Commitments

To test the effectiveness of SLD's application review process, we examined a sample of applications that received funding commitments for internal connections during the second program year (1999), the one most recently completed at the time of our review. Our objective was to determine how effective the process was in funding only eligible items. We focused on internal connections because many ineligible products and services fall into this category. All of the applications in our sample had gone through SLD's review process and had received funding commitments. Our sample universe was the 9,770 applications that had received funding for internal connections for the 1999 program year. We selected applications for review with a probability proportionate to their size, as measured by the number of dollars committed for internal connections. Our sample included 44 applications that accounted for more than $285 million of the $1.2 billion in

[17]SLD officials stated that, during the 1999 program year, they denied a total of $700 million in funding requests for ineligible items or requests that did not meet other eligibility rules. These denials included requests for telecommunications, Internet, and internal connection services.

second-year funds committed for internal connections through November 1999. These applications contained over 2,300 separate funding requests for internal connections, many of which contained dozens of internal connection items. Because of the great variation in the amounts of the errors we observed from one application to the next in our sample, we were unable to reliably estimate the total amount of funding for ineligible or potentially ineligible services committed by SLD in the second program year. Additional information on our sampling methodology appears in appendix V.

We found that SLD reviewers correctly identified and screened out $20 million from requests that included ineligible items before committing $285 million in internal connections funding to the 44 applications. This $20 million includes both ineligible items and requests in which more than 30 percent of the cost was for ineligible items (a condition that results in a denial of funding for the entire request). The following examples illustrate some of the ineligible items that SLD caught during the application review process:

- $6.8 million was correctly denied to an applicant requesting ineligible multimedia equipment.
- $4.2 million was correctly denied to an applicant requesting ineligible satellite and computer services, Wide Area Network (WAN) equipment, software, and maintenance.
- $3.7 million was correctly denied to an applicant requesting equipment identified as part of an ineligible WAN.
- About $336,000 was correctly denied to an applicant requesting wiring at ineligible locations, including a stadium and housing, as well as ineligible software, modems, and telephones.

Overall, we believe that about $193 million of the $285 million in commitments was correctly reviewed and processed. We found, however, that SLD reviewers missed other ineligible items in these 44 applications and incorrectly included them in funding commitments made to applicants. Specifically, we found that SLD improperly committed at least $6 million for ineligible items or for requests in which more than 30 percent of the funding was for ineligible items and should have been denied entirely. Some of the ineligible items missed by reviewers involved relatively small amounts. For example, $6,000 was incorrectly committed to one applicant for ineligible WAN equipment. Other missed items involved larger amounts of funding, as the following cases show:

- About $1.8 million was incorrectly committed to an applicant for ineligible videoconference capabilities.
- About $2 million was incorrectly committed to an applicant for ineligible maintenance services that were intended to be delivered outside the program year.
- About $306,000 was incorrectly committed to an applicant for ineligible interface cards, video cameras, and maintenance.
- About $50,000 was incorrectly committed to an applicant for services to ineligible locations and for ineligible telephone maintenance.

In addition, we found that SLD committed funds to requests when (1) an applicant included an ineligible item whose cost was not identified or (2) the eligibility of the requested services could not be determined because descriptive information in the application material was not sufficiently clear. These problems occurred in requests that totaled $86 million, but we did not have enough information to determine what proportion of this amount might involve ineligible items. Specific examples include the following:

- One application submitted by a city school district included more than 600 requests. The attachment to the application listed a number of eligible services and items, including servers, switches, and hubs, as well as an ineligible software product. Since the application did not specify the amount of funding related to the ineligible software, or even which of the 600 requests included the ineligible item, neither we nor SLD could determine how much of the $21 million requested in this application and committed to the applicant was committed in error.
- Another applicant (a school system) requested about $1.2 million for approximately 93 file servers. The application, however, suggests that an ineligible service center could be one of the locations scheduled to receive a server. Neither we nor SLD could determine whether and to what extent the applicant was going to use program funding for this ineligible location.
- Still another applicant asked for $2.7 million to support the installation of voice, data, and video cabling. SLD approved this request because the list of eligible services it maintains indicates that each of the requested services is eligible. However, the list also includes a description noting that video services are eligible only under certain circumstances. Neither we nor SLD could determine if the applicant intended to use the television cabling to provide ineligible video services (which would make the cabling itself ineligible). SLD stated that reviewers should

have sought additional information from the applicant to resolve this matter.

Inadequate Information and Unclear Guidance Weaken the Review Process

As shown by the proceeding examples, weaknesses exist in the application review process. Some mistakes appear to be the result of human error, since the information needed to make a correct determination was available in the application materials. For example, one application clearly indicated that the applicant intended to use $1.7 million in program funds to upgrade its telephone systems to include videoconferencing capabilities—an ineligible service. However, other errors appear to be the result of problems in the application and review process. First, applicants did not always describe the services for which they requested funding in enough detail to enable the reviewers to determine whether any of the requested services were ineligible. For their part, SLD reviewers did not always contact applicants for additional information needed to make informed decisions about the eligibility of requested services. Second, the program's policies and guidance do not always effectively define which services are eligible for funding support.

Inadequate Information in Applications

E-rate applications do not always include detailed information on the services for which funding is requested. This is the result of FCC's policy to allow the applicants flexibility in how they document their funding requests. The e-rate application requires one line of basic information for each funding request, including such information as the vendor, the general type of service requested, the total monthly and annual costs, and the discount rate requested. In addition, applicants are required to provide an attachment for each request that includes "a concise but specific itemization of services provided." In the applications we reviewed, some applicants listed every item for which they were requesting support, while others included only a general description of the requested services, making it difficult to readily determine if these requests included ineligible items.

Procedures direct SLD reviewers to contact applicants for additional information if the application is unclear. Moreover, for conditionally eligible services, reviewers are required to determine whether the requested service will be used according to the program's rules. If the reviewers cannot make that determination from the information provided in the application, they are required to ask the applicant for clarification. However, we found that this procedure was not being consistently followed for the applications that we reviewed. We identified several instances when reviewers approved requests for conditionally eligible services without having documentation showing how the services would be used. For example, two applicants requested program funds for network equipment maintenance, which is eligible for program support if the equipment being maintained is eligible. However, the applicant did not identify the equipment to be maintained, and SLD approved the request without seeking additional information.

Similarly, service to administrative buildings is conditionally eligible. Such a building is eligible only if needed to provide service to instructional buildings. However, we found instances when SLD approved requests for services to buildings despite evidence that they could be ineligible administrative sites. For example, an applicant included in its list of sites to be funded one site that had no students. SLD fully funded this request, even though the application did not specify whether the site with no students was an instructional or an administrative building. SLD stated that while additional information should have been requested, reviewers did not ask for additional information on this conditionally eligible item because they assumed the request was eligible.

Lack of Clarity as to the Eligibility of Some Items

FCC's rules do not always clearly define which services and entities are ineligible for program funding. For example, FCC's rules state that WANs are not eligible for funding but do not provide clear guidance on what should be considered a WAN.[18] As a result, SLD reviewed 1999 applications under a policy that rejected any item specifically identified as part of a WAN, such as components with the acronym "WAN" in their description. However, similar items that did not include the acronym "WAN" in their description were approved. For example, SLD denied one applicant's request for radios used to cross a public right-of-way. However, SLD approved a request by another applicant because the acronym "WAN" was not used in the application's description of wireless transmitters capable of transmitting data up to 600 feet from the school. When we pointed out this inconsistency, SLD (with FCC's concurrence) changed its procedures for dealing with WANs. Under the new procedures, all types of networking equipment located within school and library facilities are considered eligible, regardless of how they are labeled. Only the actual wires that carry data across public rights-of-way are considered ineligible WAN components.

[18]See 47 C.F.R. 54.500 and 54.518.

FCC has also identified teacher training as an ineligible service but does not specifically define the type of training that is ineligible or discuss the training of other personnel. As a result, SLD approved several requests for what it assumed was initial training provided by vendors on the use of eligible items. For example, one applicant submitted a request stating that over $4,500 in program funds would be spent for “on-premises training” and “on-site translation.” SLD approved the request, considering it a reasonable cost of installing eligible equipment. FCC staff stated that this policy is consistent with the intent of the original order, which identified training as an ineligible item and FCC subsequently specified as teacher training. FCC staff concluded that basic instruction in using eligible equipment is eligible, provided it is “reasonable.” However, they have not defined any criteria to determine when these training costs should be considered reasonable or provided guidance to SLD on how training costs should be reviewed.

Similarly, we identified several requests to fund project design costs and contingency fees. Guidance provided by FCC describes “room design consulting and system integration” as ineligible services. However, FCC staff responsible for e-rate oversight told us that design costs and contingency fees are eligible for program funds if they are related to eligible services and are “reasonable.” Again, FCC has not defined what is reasonable. In one case involving these services, SLD approved a $3 million request from one applicant that included over $621,000 in design costs and almost $200,000 in contingency fees. Because this request also included some ineligible services, program officials have yet to determine how much of the requested design and contingency fees should have been denied. Although they stated that the applicant’s contingency fee was not unreasonable because it represented only 6 percent of the contract’s total cost, they did not define the precise threshold that SLD could use to determine whether similar requests are reasonable.

In addition, FCC staff stated in June 1998 that no universal service support will be provided for the costs of tearing down walls to install wiring, repairing carpets, or repainting. The applications we reviewed, however, included funding SLD had approved for an indeterminate amount of repainting and construction of walls and doors. For example, SLD approved a request by one applicant for over $18 million in program funds for a vendor to install new central telephone systems in 133 schools. At the request of an SLD reviewer, the applicant later provided a comprehensive list of the equipment and cabling to be included in 1 of the 133 schools. Although this list included the costs of constructing a wall and door, SLD stated that these costs might be allowable if they resulted from and were required for the installation of the equipment. As of September 2000, FCC staff had not determined if these items were eligible to receive funding, although they said that nominal repair and painting may sometimes be linked to installation. FCC staff had not provided this additional guidance to SLD.

We also found that SLD sometimes failed to inform applicants that they had requested funds for ineligible services, even though its internal procedures require such notification. For example, one applicant requested more than $7.7 million for a districtwide cabling project, including approximately $183,000 in equipment and maintenance that were not eligible for e-rate support. While SLD denied the funds requested for the ineligible items, its letter to the applicant did not explain the basis for the reduction or caution the applicant not to spend any e-rate funds on the ineligible equipment and maintenance. Without such explicit notification, an applicant could mistakenly apply funds to ineligible items.

Most Invoices Paid Without Detailed Review

SLD's invoice review procedures provide another opportunity to prevent funding from going to ineligible products and services. Both the applicant and its vendor must file additional forms before committed e-rate funds are paid. However, these forms contain less information and are reviewed in a less comprehensive manner than e-rate applications.

One way in which the invoice review process differs from the application review process is that neither the applicant nor the vendor is required to provide a descriptive listing of the products and services for which the invoice seeks payment. The form submitted by the applicant simply states that it has begun receiving services under an approved request. The invoice form submitted by vendors also includes few details. It essentially requires the vendor to identify itself, the application and request number for which it is seeking reimbursement, and the total amount of reimbursement requested. Both the applicant and the vendor must certify on their forms that the information they are providing is accurate.[19]

[19]When an applicant has paid a vendor the entire cost of an approved service, the applicant may apply for reimbursement through its service provider to SLD of the approved, discounted cost. As when vendors submit invoices, the forms do not require detailed information on the services provided.

In contrast to the application review process, when every application is checked for ineligible services, the invoice review process scrutinizes only a limited number of invoices to determine what services are being funded. SLD's invoice reviews begin with an automated validation process that determines if all the required information is included on an invoice form.[20] Once this validation is complete, the invoice is approved for payment, denied for payment, put on hold, or assigned to a reviewer for a special review. Invoices are generally chosen for a special review because they are considered to be "high risk." For example, invoices from an applicant or vendor that has previously violated program rules generally receive special reviews. In some cases, SLD requires the applicant or vendor to submit detailed billing statements as part of a special review.

Prior to January 2000, reviewers were not required to verify that only eligible products and services were included in any billing information submitted by applicants or vendors during the invoice review process. Because of ongoing concerns about vulnerabilities in this review process, SLD clarified its procedures in early 2000 to require reviewers to examine all submitted billing information for evidence of ineligible services. However, these new procedures are still more limited than those applied to applications because SLD does not require additional billing information for all special reviews. Even for cases that require additional information, SLD did not specify what level of detail should be provided. Since they began, SLD's special reviews have identified a limited number of invoices that requested payment for ineligible services, resulting in a denial of payment. For example, one applicant's vendor requested payment of about $535,000 in program funding for an ineligible service. As a result, SLD withheld some of the funds related to the invoice. In addition, SLD plans to modify the applicant's funding commitment to deny the amount associated with the ineligible service.

SLD officials also told us in September 2000 that they were taking further steps to improve their invoice review process. Another detailed review will be added to identify invoices associated with funding commitments that were modified by SLD from the original requests because they included ineligible items. According to SLD officials, procedures for this additional detailed invoice review are being developed. Also, on October 12, 2000, SLD released a request for proposals for the evaluation and improvement

[20]These checks include determining if the invoice is missing information about the contact, vendor, or service delivery dates.

of its invoice authorization and payment procedures.

As part of its ongoing quality control efforts, SLD has a contract with an outside auditor (Arthur Andersen LLP) to conduct site visits to a number of applicants that received funding during the first program year after clearing SLD's application and invoice reviews.[21] At the time we completed our review, SLD had received information from the auditor that some funds approved for payment had not been used in accordance with the program's rules. In October 2000, SLD officials told us that over half of the auditor's reviews had been completed or virtually completed with no major reportable findings. However, the remaining reviews have disclosed some violations, including cases in which program funds were used to pay for ineligible services and services delivered outside the program year. At one location, there are preliminary indications that program funds could have been intentionally misused. USAC forwarded this information to FCC, and as a result, this case is under investigation by FCC's Office of Inspector General.

Administrative Costs Remain a Small Percentage of Overall Funding

The e-rate program's administrative costs for 1997 through 1999, together with the projected costs for 2000, show some overall growth despite earlier expectations that they would decline following the program's start-up phase. Program officials recently took action to reduce contract costs—the source of most of the increase—but it is too early to determine the success of their effort. Even with this growth, however, administrative costs remain a small percentage of the program's total costs. We compared the e-rate program with 34 other federal programs that can provide technology funding to schools and libraries by calculating each program's administrative costs as a percentage of its total program costs. The e-rate program's administrative costs were 2.4 percent of its total program costs, while the others ranged from less than 1 percent to 15 percent. Overall, the percentage of administrative costs was higher for 12 of the 34 programs than for the e-rate program, lower for 21, and the same for 1. However, it is difficult to draw conclusions from this comparison, given the many differences in these programs' characteristics and operations.

[21]SLD selected a diverse sample of applications based on a variety of factors, including high-risk designations.

Operating Expenses of the E-Rate Program Administrator

Most of the administrative cost of the e-rate program stems from the operations of the program administrator. Table 3 provides a breakdown of the operating expenses for the Schools and Libraries Corporation (which operated from the inception of the program in September 1997 through 1998), and the current administrator, the Schools and Libraries Division of USAC (which has operated since January 1, 1999). The data, based on independently audited financial statements, cover two time frames: the 16 months of the Corporation's operational lifetime and the first 12 months of the current administrator's operations.

Table 3: E-Rate Program's Operating Expenses, 1997-99

Dollars in thousands

Expense category	Schools and Libraries Corporation (Sept. 1997 to Dec. 1998)	Schools and Libraries Division, USAC (Jan. 1999 to Dec. 1999)
Compensation and related expenses (includes program's staff salaries and benefits)	$1,269	$881
Professional fees (includes legal, audit, bookkeeping expenses)	1,574	510
Other operating expense (includes rent, taxes, office supplies, postage and freight, travel, telephone, computer support, dues, and subscriptions)	1,140	899
Depreciation and amortization (includes furniture and computer software)	—	89
Contractual expenses (includes salaries and expenses of NECA and its subcontractors for day-to-day e-rate program support operations)	23,341	26,555
Total	**$27,324**	**$28,934**

Source: Report by Arthur Andersen LLP to USAC's Board of Directors, dated Apr. 12, 2000.

Audited financial statements for 2000 are not yet available. However, USAC submits projections of its operating expenses to FCC in advance of each quarter of the calendar year. The projected expenses for the four quarters of 2000 total somewhat over $34 million. According to USAC, the actual expenses should come close to these projections.

Together, the audited financial statements and the projections for 2000 indicate a small, but steady, growth in administrative expenses. In testimony before the Senate Committee on Commerce, Science, and

Transportation on July 16, 1998, the head of the Schools and Libraries Corporation at that time stated that “[i]n future years, with start-up costs behind us, we anticipate administrative costs will decline accordingly.” As table 3 indicates, there were decreases in several expense categories in 1999. These decreases are attributable to the change in program administrators. According to USAC’s Chief Executive Officer, consolidating e-rate program operations with USAC’s existing universal service operations and rebidding contacts produced savings in compensation and benefits, insurance, rent, independent audits, and general accounting.

However, contract costs for the day-to-day operational support performed by NECA increased, rather than decreased. The former administrator of the Schools and Libraries Corporation awarded a support services contract to NECA without using a competitive bidding process involving formal requests for proposals. NECA’s contract was a “time and materials” contract under which the Corporation agreed to pay “all reasonable, actual costs” incurred by NECA in carrying out the agreed upon work. The heavy workload for 1999 contributed to the increase in contract costs.

The policy of USAC, the current program administrator, requires that all contracts over $100,000 be put out for competitive bid unless an exception is approved by its Board. Accordingly, in December 1999, USAC issued a request for proposals for programmatic support services for the e-rate program and a related telecommunications program covering rural health care providers.[22] Unlike the previous contract, whose price was based on actual costs, the new solicitation was for a firm fixed-price contract. At the conclusion of the competitive bidding process, USAC announced in May 2000 that it had awarded this new contract to the incumbent, NECA. The 3-year contract, running from July 2000 through June 2003, is valued at $61.6 million and covers both the schools and libraries and rural health support mechanisms. USAC estimates that the new contract will result in a 25-percent savings over the old contract. However, the actual savings depend on the accuracy of the workload assumptions included in the contract’s statement of work. Although a lower-than-expected workload could result in reduced contract costs, a higher-than-expected workload could result in additional costs.

[22]The Rural Health Care Program is a universal service support program authorized by the Congress to provide reduced rates to rural health care providers for telecommunications services related to the use of telemedicine and telehealth. It can provide up to $400 million in support annually.

USAC also plans to solicit competitive bids for its billing and collections services, which could result in additional savings in administrative costs. The request for proposals for this service is expected to be issued this fall, with the aim of having a new contract in place by July 2001. In addition, USAC plans to seek competitive bids on its employee benefits package, which could further reduce some administrative costs.

FCC's E-Rate Administrative Costs

The salaries of the FCC staff working on the program are another component of the e-rate program's administrative costs. At the time of our review, four managers and nine staff in FCC's Common Carrier Bureau were spending some portion of their time on e-rate activities, such as reviewing USAC documents, forms, and audit plans; dealing with policy questions; responding to inquiries from the public and the Congress; performing outreach to the applicant and vendor communities; reviewing and providing feedback on USAC's operational and financial audits; and resolving appeals from schools and libraries.

The portion of FCC staff salaries that can be allocated to e-rate administrative activities cannot be precisely determined because the Common Carrier Bureau's procedures do not call for the staff to track the amount of time they spend working on e-rate activities. However, Common Carrier Bureau officials estimate their staff cost for administering the program during fiscal year 2000 to be roughly $420,000 (the equivalent of about 5 full-time staff years). This is an increase from the fiscal year 1998 workload, which FCC estimated to be the equivalent of 2 full-time staff years. Common Carrier Bureau officials attributed the increased staff workload to several factors related to the e-rate program: the need for FCC to respond to numerous appeals (as of July 2000, it had resolved 185 appeals and had 253 pending); a steadily growing number of administrative and policy issues; and audits and inquiries from the executive and legislative branches.

Comparison of Administrative Costs for E-Rate and Related Federal Programs

In August 1999, we reported on 35 federal programs (including the e-rate program) that could be used as a source of federal funding for schools and libraries.[23] Using fiscal year 1998 data, we found that the annual administrative costs of the programs varied widely, with the National Science Foundation's Connections to the Internet Program having the lowest costs at $4,000 and FCC's e-rate program having the highest costs at $26,909,000.[24] However, to compare the programs, we calculated the administrative costs as a percentage of the total program costs.[25] For example, the program costs for Connections to the Internet for fiscal year 1998 were only $147,000, making the administrative costs 2.6 percent of the program costs. For the e-rate program with its much higher funding level, the administrative costs were 2.4 percent of the program costs, somewhat lower than for the Connections to the Internet program.[26]

Our analysis showed that the administrative costs of the 35 programs, expressed as a percentage of the programs' total fiscal year 1998 costs, ranged from less than 0.02 percent for the Department of Education's Emergency Immigrant Education Assistance Program to 15 percent for the Department of Commerce's Telecommunications and Information Infrastructure Assistance Program. Twelve of the programs had higher percentages of administrative costs to total program costs than the e-rate program; the e-rate program and another program had the same percentage; and 21 others had lower percentages. This analysis can be

[23] *Telecommunications Technology: Federal Funding for Schools and Libraries* (GAO/HEHS-99-133, Aug. 20, 1999).

[24] The e-rate administrative costs used in our analysis of the 35 programs cover the 12-month period from Jan. 1, 1998, through Dec. 31, 1998. This total includes both FCC and SLD e-rate administrative costs for this period.

[25] Administrative costs as a percentage of total program costs are calculated by dividing the 1998 administrative costs by the sum of the 1998 program funding and the 1998 administrative costs, except for programs (like the e-rate program) that pay administrative costs out of program funds. For those programs, administrative costs as a percentage of total program costs are calculated by dividing the 1998 administrative costs by the 1998 program funding.

[26] The e-rate program was funded at $1.66 billion for the 18-month period from Jan. 1, 1998, through June 30, 1999. In order to calculate administrative costs as a percentage of total program costs on an annual basis, the 18-month figure of $1.66 billion was reduced by one-third to $1.1 billion. Even though funding commitments were not made until late 1998 and early 1999, the applicants were being reimbursed the discounted portion of bills they paid in full as early as Jan. 1998. Therefore, the one-third reduction is a reasonably accurate estimate.

further refined by focusing on the 10 programs out of the 35 that specifically target their funds to technology initiatives, rather than simply including technology among the items they can fund. Of these 10 technology-targeted programs (which include the e-rate program), 6 had higher percentages of administrative costs to total program costs than the e-rate program and 3 had lower percentages. See appendix VI for details on these 10 programs.

It is difficult to draw precise comparisons among these programs because the nature of their administrative costs can vary. For example, some of the programs distribute funding through a formula grant process, while others use a competitive grant process that includes reviewing and scoring applications as part of a selection process. And while most competitive grant programs hired outside experts to review applications, one program used volunteers and another used only agency staff. Moreover, the Department of Education considers the cost of reviewers a "program expense," whereas other agencies consider this cost an "administrative expense." Other key variables include the number of applications reviewed and the amount of funding distributed.

FCC Has Recently Established New Performance Goals and Measures for the Program

After some false starts, FCC recently developed meaningful performance goals and measures for the e-rate program. Performance measurement is critical to managing a program and determining its progress in meeting intended outcomes. In our July 1998 testimony before the Senate Committee on Commerce, Science, and Transportation, we noted that FCC's e-rate program lacked the kinds of specific goals and measures called for under the Government Performance and Results Act of 1993 (the Results Act).[27] At that time, we noted that FCC had simply informed the Congress in its annual performance plan for fiscal year 1999 that it would "work to improve the connections of classrooms, libraries, and rural health care facilities to the Internet by the end of [fiscal year] 1999." We recommended that FCC develop specific goals and measures for the program before the end of fiscal year 1998, in time to gauge the effect of the first year's funding. We reiterated this recommendation in our March 1999 report on the program, just after the first e-rate funding commitments had been made to applicants.

[27]The Results Act defines a performance goal as a target level of performance expressed as a tangible, measurable objective against which actual achievement is to be compared.

The program participation goals and measures that FCC set during the two budget cycles following our July 1998 recommendation did not resolve our initial concern. In February 1999, as part of its fiscal year 2000 budget submission to the Congress, FCC listed a goal of ensuring that 30 percent of eligible schools and libraries would have Internet access by the end of fiscal year 2000. This goal was not meaningful because it was well under the prevailing conditions. According to survey data from Department of Education's National Center for Education Statistics, 89 percent of public schools and 67 percent of private schools were already connected to the Internet in 1998. For the fiscal year 2001 budget submission (dated Feb. 2000), FCC raised the goal to having 90 percent of schools and libraries connected to the Internet by fiscal year 2001. But even this much higher goal still fell short of actual conditions at public schools and libraries. The National Center for Education Statistics reported that in 1999, over 95 percent of all public schools had Internet access. Even those public schools serving the most economically disadvantaged or rural areas were reported to be at least 90 percent connected in 1999. As for libraries, the American Library Association reported in April 2000 that more than 90 percent of them were connected to the Internet. The one area where the fiscal year 2001 goal had potential relevance was private schools, since only 67 percent of them were connected in 1998 (the most recent data available).[28]

During our review, we spoke with FCC staff about the need for effective performance goals and measures. On September 29, 2000, FCC finalized a new performance plan for the e-rate program that has two key features: (1) it recognizes that nearly all school buildings are already connected to the Internet, and (2) it targets populations that are underserved by the e-rate program. Instead of focusing on connections to school buildings, the plan focuses on improving Internet connections to "instructional classrooms." The new goal is to have 100 percent of public school instructional classrooms connected to the Internet by 2002 and 95 percent of private school instructional classrooms connected by 2003. To help accomplish this strategic goal, the plan includes tactical goals targeted at increasing participation in the e-rate program by urban low-income school districts and rural school districts located outside of towns. According to FCC's data, the participation rates for both of these groups currently fall below

[28]The results of several years of surveys on Internet access by the National Center for Education Statistics are summarized in *Internet Access in U.S. Public Schools and Classrooms*: *1994-99* (NCES 2000-086, Feb. 2000) and *Computer and Internet Access in Private Schools and Classrooms*: *1995 and 1998* (NCES 2000-044, Feb. 2000).

the average participation rate for all eligible schools. Similarly, the plan seeks to increase the e-rate program participation rates for rural libraries and libraries serving small areas, which currently lag behind the participation rates for libraries serving larger areas. These new goals, benchmarked to current Internet connectivity rates and program participation rates, should help FCC to assess whether the program is reaching the full spectrum of eligible applicants.

It should be noted that FCC's participation goals do not attempt to measure the impact of advanced telecommunications on improving educational outcomes. This complex issue lies outside the range of FCC's expertise and comes under the purview of the Department of Education, which has developed related performance goals and measures.

Conclusions

In our July 1998 testimony, we recognized that the e-rate program faced many challenges and difficulties during its first year of operation. These challenges continue as the program enters its fourth year. SLD succeeded in committing over $3.7 billion to applicants during the 1998 and 1999 program years. However, a significant amount of these funds has not yet been paid out, even though the deadlines for applicants and vendors to use the funds have been extended more than once. Identifying and addressing the causes of this problem could help increase the amount of funding that is actually used to bring telecommunications services to schools and libraries. In addition, it would be undesirable to have a significant percentage of committed funds go unused at a time when the level of requests for funding greatly exceeds the annual amount available.

In addition, more funding would be available for eligible requests if SLD's review procedures were more effective at identifying and denying ineligible requests. Despite procedures requiring reviewers to deny funding for ineligible items and to confirm that conditionally eligible services are being used according to program rules, we identified millions of dollars in funds incorrectly committed to ineligible products and services. In some cases, reviewers simply overlooked ineligible items that were clearly identified by applicants. In other cases, the lack of clear, consistent rules likely contributed to mistakes made by both applicants and reviewers. Furthermore, the reviewers' ability to identify ineligible requests is limited when applications include vague or broad terms to describe the services for which funding is requested. The frequency of such cases could be reduced if the review procedures and criteria were clarified and if the applicants submitted more details about the items for which they intend to use program funds.

Finally, SLD's practice of approving most vendors' invoices without reviewing how and where the committed funds are actually being spent leaves the program vulnerable to further funding errors and potential abuse. In particular, the larger applications involving dozens of sites and millions of dollars need a higher level of quality assurance to determine that funds are being spent as approved.

SLD has already taken some steps to address the issues we identified, such as contracting with an outside auditor to review a limited number of applicants, and is considering others. However, given the large amount of funds involved in the e-rate program, cost-effective quality assurance procedures that result in more consistent and reliable application and invoice reviews are warranted. Because the next program year is not scheduled to begin until July 2001, we believe that SLD and FCC have adequate time to implement our recommendations.

Recommendations for Executive Action

In order to (1) improve the application review and invoicing process to prevent funds from being used for ineligible services and (2) maximize the funding available to applicants to support eligible services, we recommend that the Chairman, FCC, direct responsible FCC staff to complete the following four actions before funding commitments are made for the fourth program year:

- Finalize all outstanding program rules and review procedures, including determining the extent to which training, design, contingency, and repair fees are eligible for program support.
- Implement procedures for promptly clarifying additional eligibility issues that arise during the application review process and publicizing such clarifications to the applicant community in a timely manner.
- Revise the list of eligible services available to applicants so that it clearly identifies which services are eligible and ineligible for program support. Additionally, the list should clearly identify as "conditionally eligible" all products and services whose eligibility is subject to conditions included in their descriptions, such as cellular telephone service and video services.
- Revise the e-rate program's application to require more detailed information from applicants on the services they intend to purchase with program funds.

In addition, the Chairman, FCC, should direct responsible staff to develop a strategy for reducing the percentages of committed funds that go unused by applicants. This effort should include (1) contacting applicants to ascertain their reasons for not fully using their committed funds and (2) determining whether changes to program rules and procedures are needed to address the difficulties that applicants may be having in this regard.

Finally, the Chairman, FCC, should direct the Chief Executive Officer of USAC to establish a quality assurance function in USAC responsible for (1) ensuring that SLD's funding decisions follow FCC's program eligibility rules, as well as SLD's management goals and procedures; and (2) developing effective internal control procedures over the disbursement of funds to ensure that they have been used as approved.

Agency Comments

We provided a draft of this report to FCC and USAC for comments. In general, they agreed with our findings and recommendations. They stated that they had begun to implement the recommendations and completed some actions, which have already led to significant improvements in the program. However, USAC provided details on some points in our report that USAC believed could be misinterpreted. The full text of FCC's and USAC's comments appears with our responses in appendix VII. FCC and USAC also provided us with technical clarifications, which we included in the report where appropriate.

We are sending copies of this report to interested congressional committees; the Chairman, Commissioners, and Managing Director of FCC; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others upon request.

If you or your staff have any questions about this report, please call me on (202) 512-7631. Key contributors to this report are listed in appendix VII.

Stanley J. Czerwinski
Director, Physical Infrastructure Issues

FCC's Authority to Set and Modify E-Rate's Annual Funding Level

Section 254 of the Communications Act of 1934, as amended, provides the Federal Communications Commission with the authority to set the level of funding for the e-rate program.[1] Among other things, this provision required the Commission, acting on the recommendations of a Federal-State Joint Board, to establish predictable and sufficient mechanisms to preserve and advance universal service. 47 U.S.C. 254(a)(d). The Joint Board recommended a $2.25 billion annual cap on support for schools and libraries. The Board based its estimate on cost data extrapolated from a 1995 McKinsey and Company report entitled *Connecting K-12 Schools to the Information Superhighway* adjusted to reflect the Board's modeling assumptions.[2] On the basis of this and a few other sources, the Joint Board estimated "that the total cost of the [eligible] communications services [sought by schools and libraries] . . . would be approximately $3.1 to $3.4 billion annually during an initial four year deployment period, and approximately $2.4 to $2.7 billion annually during subsequent years."[3] The Commission has not revisited this issue to obtain more current cost data.

According to FCC officials, the Commission adopted the $2.25 billion annual cap recommended by the Joint Board in accordance with section 254.[4] Each year, the Commission bases the funding level for the schools and libraries program on demand and on the expense of administering the program, subject to the cap. FCC officials stated that as long as the Commission adopts a funding level that is less than or equal to the cap, no formal proceeding is generally necessary. They noted that the funding levels for the first and second year were promulgated through formal FCC orders because of extenuating circumstances. However, the funding level for the third year was simply announced by the Chairman through a public statement.[5]

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[1]Section 254 was added by the Telecommunications Act of 1996.

[2]For example, the Board adjusted the McKinsey base cost estimates for the full classroom model. This model assumes one computer for every five students in all classrooms, with a T-1 connection.

[3]*Federal-State Joint Board on Universal Service Recommended Decision*, 12 FCC Rcd. 87, 369-70, para. 554 (1996).

[4]Letter from Federal Communications Commission Chairman, William E. Kennard to U.S. General Accounting Office Assistant General Counsel Michael R. Volpe, dated Apr. 28, 2000.

[5]*Statement of FCC Chairman William E. Kennard and Commissioner Gloria Tristani*, 2000 FCC LEXIS 1906, Apr. 13, 2000.

Although the demand for program funds increased sharply in the third year (to $4.7 billion, according to program officials' estimates), the Commission maintained the funding level for the schools and libraries program at the $2.25 billion annual cap. FCC officials stated that a readjustment of the cap would require an amendment of FCC's rules. As of September 2000, no rulemaking proceeding was under way to consider readjusting the cap.

Questions have been raised as to whether e-rate funds are federal funds. The Congressional Budget Office and the Office of Management and Budget count payments into the universal service fund as federal revenues and payments from the fund (including payments for e-rate support) as federal outlays. Both agencies have interpreted the act to mean that the expenditures from the fund should be part of the federal budget because the transfer of income between various classes of telephone users would not occur but for the exercise of the sovereign power of the United States.[6] Nevertheless, both the Commission and the Office of Management and Budget have determined that these funds are appropriately maintained outside the Treasury by a nongovernmental manager. Action by the U.S. Senate appears to concur with this assessment. In 1997, the Senate passed a "sense of the Senate" provision that stated, "Federal and State universal service contributions are administered by an independent, non-Federal entity and are not deposited into the Federal Treasury and therefore are not available for Federal appropriations."[7]

[6]Congressional Budget Office, *Federal Subsidies of Advanced Telecommunications for Schools, Libraries, and Health Care Providers*, Jan. 1998, p. 5.

[7]See section 614, H.R. 2267, as passed by the Senate (Oct. 1, 1997).

Competitive Bidding Requirements

FCC's rules generally require applicants to seek competitive bids for all services eligible for e-rate support.[1] The Commission found competitive bidding to be the most efficient means of ensuring that applicants were informed about all of the choices available to them. It also found that without competitive bidding, an applicant may not receive the most cost-effective services available, resulting in a higher-than-necessary demand for e-rate support and, consequently, less support available for other applicants.[2]

Applicants May Consider Factors Other Than Price in Selecting a Bid

FCC's competitive bidding rules require applicants, as an initial step, to provide the Schools and Libraries Division (SLD) with a description of the services for which e-rate support is sought. SLD then posts this description on its public Web site for all potential competing vendors to review. An applicant must wait at least 4 weeks from the time the description is posted on the Web site before entering into an agreement with a vendor in order to give vendors an opportunity to evaluate and respond to the applicant's stated needs. SLD will deny (and has denied) funding for services based on contracts that were signed fewer than 28 days after the related service descriptions were posted.

FCC concluded that applicants should consider price to be the primary factor in selecting a bid. However, FCC does not require applicants to select the lowest bid offered, even among bids for comparable services. In its *Universal Service Order*, FCC concurred with the Joint Board's recommendation that applicants should be given "maximum flexibility" to take service quality into account and choose the offering that meets their needs "most effectively and efficiently," where this is consistent with other procurement rules under which they must operate. The Commission noted several other factors that applicants could also consider in determining which vendor meets their needs "most effectively and efficiently." These additional factors—when permitted by state and local procurement rules—include "prior experience, including past performance; personnel qualifications, including technical excellence; management capability, including schedule compliance; and environmental objectives."[3] FCC

[1]Pre-existing contracts, as defined by FCC's rules, are exempt from competitive bidding requirements. 47 C.F.R. sec. 54.511(c).

[2]*Universal Service Order*, 12 FCC Rcd. at 9029, para. 480.

[3]*Universal Service Order*, at 9028, para. 481.

cautioned, however, that when comparable services are being offered, price needs to be carefully considered "to ensure that any considerations between price and technical excellence (or other factors) are reasonable."

Although federal procurement regulations are not applicable to the contracts between e-rate applicants and their vendors, FCC's e-rate competitive bidding rules are similar to the rules and factors used in federal procurements. In federal procurements, price must always be considered—but is not necessarily the primary factor—in determining which bid is most advantageous to the government. Federal contract officials may also address the quality of the product or service by considering, along with price, evaluation factors such as prior experience, personnel qualifications, and technical excellence to form a reasonable basis for selecting an offer. With negotiated procurements, federal acquisition regulations state that "the objective of source selection is to select the proposal that represents the best value." And with invitations for bid, the regulations state that the award is made to the "responsible bidder whose bids, conforming to the invitation, will be most advantageous to the Government, considering only the price and price-related factors . . . included in the invitation."

FCC has noted that its competitive bidding requirements are not intended to preempt state and local bidding requirements. In fact, in addition to complying with FCC's rules, applicants are required to certify on their applications that they have complied with all applicable state and local laws regarding procurements of services for which e-rate support is sought. One of the reasons that FCC maintains it is sensible to rely on state and local procurement practices for determining compliance with its own competitive bidding requirements is "because such rules and practices will generally consider price to be a 'primary factor' . . . and select the most cost-effective bid."

No Performance Data Related to Vendor Competition

Neither FCC nor SLD has data on the extent to which applicants did not choose the lowest bidders. Although applicants must maintain records of their bidding process, they were not required to report the number of bids they received or the number of times they did not choose vendors offering the lowest-priced bids. Given the large number of applicants that have received funding so far, it is likely that there are many thousands of vendor contracts associated with the e-rate funding. Tracking this issue in detail, therefore, would be a time-consuming undertaking for both applicants and program officials. In 1999, FCC did establish a performance goal related to vendor competition, which was to ensure that a majority of the requests for services posted on SLD's Web site received two or more bids. However, FCC did not gather any data to measure its performance in meeting this goal and decided to drop the goal from its subsequent performance plans.

E-Rate Appeals Have Focused on Funding Decisions, Not Competition Issues

Vendors that have concerns about the competitive bidding process can raise them through an appeal to SLD or FCC. Both applicants and vendors can appeal to SLD regarding decisions it makes about e-rate applications and funding. If not satisfied with SLD's determination, they can appeal to FCC. According to SLD and FCC officials, as of the end of September 2000, there were only four appeals related to vendor competition issues.

SLD received two appeals from a vendor in Alaska that was not awarded contracts with two school districts, even though it had submitted the lowest-price estimates. In one of the cases, SLD's general counsel determined that the school district had considered price as the primary factor when reviewing bids from different vendors and denied the appeal. In the other case, SLD determined that price had not been considered the primary factor and informed the school district that its application would not be considered for e-rate funding.

FCC dealt with two other vendor appeals. One vendor appealed the outcome of a competitive bidding process, complaining that the Department of Education of the State of Tennessee (the applicant) awarded more bid points to a rival vendor's bid, even though the rival's initial bid was greater. The rival was ultimately awarded the contract. SLD's position on the vendor's complaint was that it would "defer to the state and local competitive bidding procurement review and procedures and findings." In reviewing the appeal, FCC determined that the applicant adequately considered price, as well as other factors, in determining the most cost-effective bid. FCC therefore denied the vendor's appeal.[4] In another case, the applicant had the vendor prepare the applicant's description of requested services, and the vendor was listed as the point of contact. The vendor was ultimately awarded the contract for the requested services. SLD denied funding because of the vendor's inappropriate involvement. The vendor appealed to FCC, but FCC upheld in part SLD's decision to deny funding to the applicant on the ground that having a

[4] FCC 99-216, (Order) rel. Aug. 11, 1999. Other issues were also considered in this case.

vendor involved in the competitive bidding process in this way was contrary to the principle of fair and open competition.[5]

SLD's Reviews Disclosed Some Cases Involving Unfair Competition

SLD has identified other cases through its own review procedures when a vendor's actions have led SLD to conclude that the vendor engaged in unfair competition. For example, in the third program year, SLD found that about 160 of more than 200 applications prepared by the same consultant indicated that a particular vendor had been selected to deliver the requested services. In addition, regardless of the school size or number of students, every sample contract with the vendor provided for the same number of servers at each location. SLD conducted a more thorough review and discovered, among other things, that the consultant was listed as a beneficiary in each of a sample of contracts that it reviewed and there was evidence that prices had been inflated. On the basis of this information, SLD, with FCC's knowledge, concluded there was evidence that prices had been inflated, and SLD denied every application associated with this consultant and vendor. The total amount of third-year program funding denied for these applications was approximately $26 million.

[5] FCC 00-167, (Order) rel. May 23, 2000.

Additional Eligible Students and Facilities

The e-rate program is directed at providing support to public and private elementary and secondary schools and libraries. Prekindergarten education programs, adult secondary education programs, and juvenile justice facilities (e.g., classes leading to the General Educational Development High School Equivalency Test, or other education that does not go beyond grade 12) may be eligible for program funding depending on how state law defines elementary and secondary schools in the state where the program or facility is located. Table 4 provides the results of USAC's analysis of each state's definition of elementary and secondary schools for the second and third program year funding decisions. (“Yes” indicates that the category of facility or student is eligible for e-rate funding.)

Table 4: Additional Facilities and Students Eligible for E-Rate Funding

	Prekindergarten		Adult secondary education		Juvenile justice	
State[a]	Facilities	Students	Facilities	Students	Facilities	Students
Alabama	No	No	No	No	Yes	Yes
Alaska	Yes	Yes	No	Yes	No	Yes
American Samoa	No	No	No	No	Yes	Yes
Arizona	No	No	No	No	No	Yes
Arkansas	No	No	No	No	No	Yes
California	Yes	Yes	Yes	Yes	Yes	Yes
Colorado	No	No	No	No	No	No
Connecticut	No	Yes	No	Yes	Yes[b]	Yes[b]
Delaware	No	No	No	No	Yes	Yes
District of Columbia	No	No	No	No	Yes	Yes
Florida	Yes	Yes	Yes	Yes	Yes	Yes
Georgia	No	Yes	No	Yes	Yes	Yes
Guam	No	No	No	No	No	No
Hawaii	Yes	Yes	Yes	Yes	Yes	Yes
Idaho	No	No	No	No	No	Yes
Illinois	No	Yes	No	Yes	No	Yes
Indiana	No	No	No	Yes	Yes	Yes
Iowa	Yes	Yes	Yes	Yes	Yes	Yes
Kansas	No	Yes	No	No	Yes	Yes
Kentucky	No	No	No	No	No	No
Louisiana	Yes	Yes	Yes	Yes	Yes	Yes
Maine	No	No	No	Yes	Yes	Yes

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	Prekindergarten		Adult secondary education		Juvenile justice	
State[a]	Facilities	Students	Facilities	Students	Facilities	Students
Maryland	Yes	Yes	No	Yes[c]	No	No
Massachusetts	No	No	No	No	No	No
Michigan	No	No	No	No	Yes	Yes
Minnesota	No	No	No	No	No	Yes
Mississippi	No	Yes	No	Yes	Yes	Yes
Missouri	No	Yes	No	Yes	No	Yes
Montana	No	No	No	No	No	No
Nebraska	No	No	No	No	No	No
Nevada	No	No	No	No	No	No
New Hampshire	No	No	No	Yes	No	No
New Jersey	No	Yes	No	No	Yes[d]	Yes
New Mexico	No	No	No	No	No	Yes[d]
New York	No	Yes	No	Yes	Yes	Yes
North Carolina	No	Yes	No	No	Yes	Yes
North Dakota	No	No	Yes	Yes	Yes	Yes
Ohio	No	No	No	No	No	No
Oklahoma	Yes	Yes	No	Yes	Yes	Yes
Oregon	No	No	No	No	No	Yes
Pennsylvania	No	No	No	No	Yes	Yes
Puerto Rico	No	No	Yes	Yes	Yes	Yes
Rhode Island	Yes	Yes	Yes	Yes	Yes	Yes
South Carolina	No	No	No	No	Yes[d]	Yes
South Dakota	No	Yes	No	No	Yes[d]	Yes
Tennessee	No	No	No	No	Yes	Yes
Texas	No	Yes	No	Yes	Yes	Yes
U.S. Virgin Islands	No	No	Yes	Yes	Yes	Yes
Utah	No	No	No	No	No	No
Vermont	No	No	No	No	Yes	Yes
Virginia	No	No	No	Yes	Yes	Yes
Washington	Yes	Yes	Yes	Yes	Yes[d]	Yes
West Virginia	No	No	No	Yes	Yes	Yes
Wisconsin	No	Yes	No	No	Yes	Yes
Wyoming	No	No	No	No	No	No

[a]USAC's legal counsel has not reviewed the eligibility of additional programs or facilities in the Northern Mariana Islands.
[b]Only juvenile justice schools in District 1 are eligible.

[c] For General Educational Development (High School Equivalency).
[d] Only juvenile justice schools listed in statutes are eligible.

Source: SLD.

Funding Commitments and Authorized Payments, 1998-99

SLD provided us with a copy of its database for the first 3 program years. This database included all commitments and authorized payments of committed funds as of August 31, 2000. Since SLD's database is constantly changing as funding decisions and appeal decisions are reached, the data included in this report constitute a snapshot in time. In addition, we were unable to report the actual amount of discount funding requested by applicants, since SLD has modified the requests. For example, some entries in the database include the original amounts requested minus funding for ineligible services removed by SLD. Other entries were adjusted to correct mathematical errors made by the applicants.[1] In addition, we found that discount funding restored through the appeal process was not reflected consistently in the database—the committed amounts but not the requested amounts were adjusted to reflect the appeal decisions. As a result, some applicants appeared to receive more discount funds than the database showed them requesting. SLD officials stated, however, that no applicant received more discount funding than requested.[2]

Table 5 shows the amounts of discount funding requested by applicants, as well as the amounts of discount funding committed to applicants by SLD in the first 2 program years. Table 6 presents the amounts of these committed funds that SLD authorized to be paid out to vendors participating in the program.[3]

[1]SLD officials said they could examine the record for each application in the database to determine the original amount of discount funding requested but doing so would be costly and time-consuming.

[2]In the first program year, the data show that the schools and libraries that applied for discount funding from Tennessee received more funding than requested. According to SLD officials, this discrepancy reflects FCC's reversal of an SLD decision to deny funds to the Tennessee Department of Education. While SLD updated its data to reflect the funds committed, it did not update the amount requested, which had been reduced to reflect the original denial. We could not verify the accuracy of this statement.

[3]According to SLD's database, American Samoa, the Northern Mariana Islands, and the U.S. Virgin Islands were committed $10.9 million in discount funds during the first 2 program years. As of Aug. 31, 2000, SLD had authorized payment of about $8.8 million (81 percent) of these funds. Guam did not request any program funding during the first 2 program years.

Table 5: Amounts of Funds Requested and Committed for the First 2 Program Years, as of August 31, 2000

	First program year (1998)		Second program year (1999)	
State	Amount requested by applicants	Amount committed by SLD	Amount requested by applicants	Amount committed by SLD
Alabama	$56,882,765	$46,885,216	$35,038,876	$26,652,386
Alaska	15,276,225	13,577,806	16,521,143	12,189,113
Arizona	51,191,444	35,640,711	55,670,736	38,716,994
Arkansas	15,831,916	13,408,504	13,263,241	10,497,241
California	288,618,184	212,079,600	396,351,207	256,663,058
Colorado	25,608,514	14,316,805	14,703,097	11,786,626
Connecticut	33,548,696	24,192,938	46,207,112	32,133,484
Delaware	4,062,132	1,017,272	1,435,969	1,393,689
District of Columbia	17,575,100	4,866,571	21,822,021	9,348,789
Florida	76,942,833	49,676,963	109,560,958	73,022,870
Georgia	90,932,457	78,357,505	104,153,221	91,565,615
Hawaii	7,307,019	5,891,308	6,277,569	5,301,184
Idaho	6,220,849	4,620,940	6,096,407	5,124,101
Illinois	113,401,873	81,032,031	199,076,472	162,605,582
Indiana	33,757,611	21,906,914	27,661,323	22,876,019
Iowa	26,214,828	7,343,810	12,612,038	8,140,673
Kansas	15,550,865	10,462,313	19,364,587	14,990,120
Kentucky	57,099,768	50,354,985	75,868,966	57,599,372
Louisiana	45,321,832	40,153,955	46,941,793	37,725,411
Maine	3,963,159	3,014,559	6,025,067	3,649,468
Maryland	23,002,868	15,026,602	28,263,284	22,062,531
Massachusetts	43,592,441	30,264,968	42,756,850	33,836,941
Michigan	94,992,053	58,533,358	111,139,905	78,997,144
Minnesota	33,976,833	24,757,330	41,242,594	29,290,076
Mississippi	26,675,416	24,373,162	34,968,751	30,240,179
Missouri	35,363,557	24,916,281	33,732,699	28,776,550
Montana	4,736,337	3,674,052	4,468,041	3,776,331
Nebraska	6,384,251	4,926,858	8,175,526	6,811,847
Nevada	9,840,915	5,380,808	5,219,146	3,147,926
New Hampshire	3,151,087	1,619,847	1,801,528	1,269,103
New Jersey	82,341,010	62,698,153	69,456,029	42,938,426
New Mexico	35,762,517	19,308,898	32,967,739	29,168,906
New York	215,937,895	172,068,433	266,812,092	195,037,891

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	First program year (1998)		Second program year (1999)	
State	**Amount requested by applicants**	**Amount committed by SLD**	**Amount requested by applicants**	**Amount committed by SLD**
North Carolina	36,970,225	26,908,604	44,328,601	37,790,543
North Dakota	4,528,745	2,585,531	2,690,849	2,212,311
Ohio	74,650,282	58,136,696	52,361,094	42,615,140
Oklahoma	41,015,572	33,696,296	70,186,268	34,114,998
Oregon	14,086,139	9,596,037	14,489,153	11,101,943
Pennsylvania	83,437,796	52,219,303	95,013,595	56,633,437
Puerto Rico	47,692,072	47,646,855	68,570,966	67,842,733
Rhode Island	7,044,468	6,010,398	10,356,442	7,831,110
South Carolina	30,540,070	26,365,435	46,266,917	32,368,742
South Dakota	4,487,782	2,965,172	3,046,233	2,150,742
Tennessee	49,092,319	51,665,111	69,320,100	61,632,448
Texas	198,643,013	129,802,466	189,290,644	135,891,161
Utah	7,522,346	6,386,095	6,537,625	5,430,865
Vermont	3,503,543	2,073,329	2,060,499	1,604,751
Virginia	39,762,879	25,494,960	37,450,614	25,284,943
Washington	51,234,165	29,442,396	47,515,398	31,341,756
West Virginia	10,543,250	9,350,687	9,421,348	9,375,906
Wisconsin	87,400,413	38,244,130	34,933,585	26,134,345
Wyoming	2,125,917	1,221,264	5,391,091	4,989,311
American Samoa, Northern Mariana Islands, U.S. Virgin Islands[a]	5,739,277[b]	5,737,792	5,972,267	5,146,738
Total	**$2,401,085,524**	**$1,731,898,012**	**$2,710,859,274**	**$1,988,829,566**

[a]Guam did not request any program funds in the first and second program years.

[b]The Northern Mariana Islands did not request any program funds the first program year.

Source: SLD's database.

Table 6: Amounts of Funds Committed and Authorized for Payment by SLD for the First 2 Program Years, as of August 31, 2000

	First program year (1998)		Second program year (1999)	
State	Program funds committed	Program funds authorized for payment	Program funds committed	Program funds authorized for payment
Alabama	$46,885,216	$40,810,055	$26,652,386	$16,211,376
Alaska	13,577,806	8,759,085	12,189,113	6,111,844
Arizona	35,640,711	30,105,673	38,716,994	22,931,162
Arkansas	13,408,504	10,543,027	10,497,241	6,636,497
California	212,079,600	164,843,376	256,663,058	121,723,361
Colorado	14,316,805	11,494,794	11,786,626	5,445,640
Connecticut	24,192,938	21,492,462	32,133,484	25,514,375
Delaware	1,017,272	922,451	1,393,689	536,682
District of Columbia	4,866,571	4,624,354	9,348,789	1,127,049
Florida	49,676,963	41,429,911	73,022,870	35,303,208
Georgia	78,357,505	56,795,293	91,565,615	43,662,006
Hawaii	5,891,308	5,191,882	5,301,184	3,016,966
Idaho	4,620,940	3,508,863	5,124,101	2,650,957
Illinois	81,032,031	63,829,587	162,605,582	56,493,845
Indiana	21,906,914	16,127,441	22,876,019	14,194,016
Iowa	7,343,810	5,578,971	8,140,673	3,554,659
Kansas	10,462,313	7,874,118	14,990,120	7,622,748
Kentucky	50,354,985	38,220,231	57,599,372	22,063,658
Louisiana	40,153,955	33,608,775	37,725,411	26,358,899
Maine	3,014,559	2,243,649	3,649,468	1,863,445
Maryland	15,026,602	13,321,165	22,062,531	11,678,928
Massachusetts	30,264,968	24,954,239	33,836,941	23,638,936
Michigan	58,533,358	49,684,389	78,997,144	38,099,072
Minnesota	24,757,330	20,244,463	29,290,076	16,493,348
Mississippi	24,373,162	19,221,676	30,240,179	19,383,924
Missouri	24,916,281	20,637,661	28,776,550	17,341,361
Montana	3,674,052	2,797,163	3,776,331	2,649,380
Nebraska	4,926,858	4,196,382	6,811,847	3,158,944
Nevada	5,380,808	4,067,259	3,147,926	1,899,684
New Hampshire	1,619,847	1,269,193	1,269,103	617,911
New Jersey	62,698,153	53,437,478	42,938,426	20,413,844
New Mexico	19,308,898	12,660,849	29,168,906	20,499,847
New York	172,068,433	139,049,679	195,037,891	95,404,330

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State	First program year (1998)		Second program year (1999)	
	Program funds committed	Program funds authorized for payment	Program funds committed	Program funds authorized for payment
North Carolina	26,908,604	21,035,624	37,790,543	23,723,984
North Dakota	2,585,531	2,191,752	2,212,311	1,327,158
Ohio	58,136,696	50,030,883	42,615,140	19,290,911
Oklahoma	33,696,296	27,887,035	34,114,998	22,592,264
Oregon	9,596,037	7,558,639	11,101,943	4,133,059
Pennsylvania	52,219,303	45,341,213	56,633,437	23,731,474
Puerto Rico	47,646,855	22,056,308	67,842,733	27,497,004
Rhode Island	6,010,398	5,843,552	7,831,110	3,993,011
South Carolina	26,365,435	23,001,684	32,368,742	19,022,935
South Dakota	2,965,172	2,010,585	2,150,742	976,252
Tennessee	51,665,111	45,767,927	61,632,448	37,864,701
Texas	129,802,466	114,831,265	135,891,161	80,295,742
Utah	6,386,095	5,216,653	5,430,865	2,296,329
Vermont	2,073,329	1,303,886	1,604,751	666,551
Virginia	25,494,960	21,227,017	25,284,943	12,831,582
Washington	29,442,396	22,468,500	31,341,756	13,959,886
West Virginia	9,350,687	5,519,416	9,375,906	2,663,463
Wisconsin	38,244,130	31,935,968	26,134,345	11,898,359
Wyoming	1,221,264	853,053	4,989,311	2,188,798
American Samoa, Northern Mariana Islands, U.S. Virgin Islands[a]	5,737,792[b]	4,920,320	5,146,738	3,889,492
Total	$1,731,898,012	$1,394,546,877	$1,988,829,566	$1,009,114,854

[a]Guam did not request any program funds in the first and second program years.

[b]The Northern Mariana Islands did not request any program funds the first program year.

Source: SLD database.

Application Sampling Methodology and Detailed Results

One of the objectives mandated for inclusion in our review was to determine whether ineligible products and services had received e-rate funding support. From the 9,770 applications for the second program year (1999), we reviewed a sample of 44 that received funding commitments for internal connections. This was the most recent complete funding year at the time of our review, and internal connections was the area most likely to include ineligible products and services. The 44 applications in our sample contained over 2,300 separate requests for internal connections and accounted for $285 million of the $1.2 billion in second-year internal connections funding committed through November 1999. The applications were selected for review with probability proportionate to size, as measured by the number of dollars committed for internal connections. For example, an application with a $2 million commitment for internal connections was twice as likely to be selected for our review as an application with a $1 million internal connections commitment. The applications we reviewed included a geographically dispersed group of 22 states or territories. The amount of program funding committed for internal connections in these applications ranged from $57.3 million to $5,527. The unweighted results of our review are presented in table 7.

Table 7: Unweighted Results of GAO's Review of Internal Connections Funding Denied or Committed From 44 Applications From the Second Program Year, Through November 1999

Dollars in millions

Unweighted results from 44 applications	Dollars denied or committed
Total funding denied by SLD	**$20.2**
Committed Funding	
Funding based on requests with no evidence of ineligible services	$192.5
Funding based on requests with clear evidence of ineligible services	6.3
Funding based on requests with evidence of ineligible or potentially ineligible services[a]	86.4
Total funding committed	**$285.2**

Note: These results exclude applications on which SLD denied all requests for internal connections funding.

[a]Dollars included in this category come from requests containing ineligible services with unknown costs or services whose eligibility could not be determined.

We properly weighted the results from our sample shown in table 7 to represent the population of 9,770 applications containing funds committed to internal connections. These estimates for the 9,770 applications are presented in table 8. However, the estimates contain a substantial margin of error because there was great variation in the amounts of the errors we observed from one application to the next in our sample. As a result, we do not present the results of this analysis in the body of our report.

Table 8: GAO's Estimates of Internal Connections Funding Denied or Committed From the Second Program Year, Through November 1999

Dollars in millions

Dollars SLD denied or committed	Estimate	Margin of error[a]
Total funding denied by SLD[b]	**$135.7**	**$98.2**
Committed Funding		
Funding based on requests with no evidence of ineligible services	$780.5	$138.0
Funding based on requests with clear evidence of ineligible services	87.6	80.5
Funding based on requests with evidence of ineligible or potentially ineligible services	348.1	130.1
Total	**$1,216.3**	[c]

[a]Margin of error is reported at the 95-percent confidence level.

[b]This estimate includes the amount SLD denied on applications when some internal connections funding was committed; it excludes amounts on applications with all requests for internal connections denied.

[c]Not applicable.

Administrative Costs of Selected Technology Support Programs

Table 9 provides information on the fiscal year 1998 administrative costs of 10 federal programs that specifically target funds for technology. The first four technology programs target funds exclusively to schools and libraries. The other six programs have goals and activities that are targeted to technology, but not exclusively to schools and libraries. More detailed information on these and 25 other programs that schools and libraries could use as a source of funding for telecommunications and information technology in fiscal year 1998 is found in our August 1999 report on this subject.[1]

Table 9: Fiscal Year 1998 Administrative Costs for Selected Federal Programs That Target Technology

Dollars in thousands

Program (Agency)	Program goals	1998 estimated administrative costs[a]	1998 program funding[b]	Federal administrative costs as a percentage of total program costs[c]
Star Schools (Dept. of Education)	To use distance learning to (1) improve instruction in mathematics, science, foreign languages, and other subjects, such as literacy skills and vocational education, and (2) serve underserviced populations, including the disadvantaged, illiterate, limited-English proficient, and individuals with disabilities.	$1,175	$34,000	3.3
Technology Innovation Challenge Grants (Dept. of Education)	To implement, evaluate, and document innovative applications of information and computer technologies to support systemic educational reform.	740	106,000	0.7
Technology Literacy Challenge Fund (Dept. of Education)	To implement state strategies designed to enable all schools to integrate technology into the curriculum so that all students become technologically literate in reading, math, science, and other core academic skills essential for their success in the 21st century.	71	425,000	<0.1

[1] *Telecommunications Technology: Federal Funding for Schools and Libraries* (GAO/HEHS-99-133, Aug. 20, 1999).

(Continued From Previous Page)

Dollars in thousands

Program (Agency)	Program goals	1998 estimated administrative costs[a]	1998 program funding[b]	Federal administrative costs as a percentage of total program costs[c]
E-Rate Program for Schools and Libraries (FCC)	To improve schools' and libraries' access to modern telecommunications services.	26,909[d]	1,108,982[e] in discounts for the 12 mos. beginning Jan. 1, 1998.	2.4[e]
Special Education Technology and Media Services for Individuals with Disabilities (Dept. of Education)	To promote the development, demonstration, and utilization of technology and to support educational media activities for children with disabilities.	786	34,023	2.3
Public Telecommunications Facilities Program (Dept. of Commerce)	To extend telecommunications services, including public broadcasting and nonbroadcast technologies; increase public broadcasting services and facilities available to, operated by, and owned by minorities and women; strengthen the capability of existing public television and radio stations; and facilitate the development of a variety of technology-oriented distance learning projects.	1,823 (included in program funding)	21,767	8.4
Telecommunications and Information Infrastructure Assistance Program (Dept. of Commerce)	To promote the development, widespread availability, and use of advanced telecommunications and information technologies to serve the public interest.	3,271 (included in program funding)	21,782	15.0
Distance Learning and Telemedicine Grants (Dept. of Agriculture)	To enhance learning and health care opportunities for rural residents.	2,010	12,500	13.9
Information Systems and Access Grants (National Institutes of Health)	To foster the use of computer and telecommunications technologies to coordinate and disseminate health information.	97	1,550	5.9
Connections to the Internet (National Science Foundation)	Encourage Internet connections for highly innovative strategies with potential for accelerating network development.	4	147	2.6

[a]Administrative costs are in addition to program funding except where noted. In those cases, administrative costs are included in program funding.

[b]Program funding includes all funding available as grants and includes—but may not be limited to—funds spent on technology.

[c]Administrative costs as a percentage of total program costs are calculated by dividing the 1998 administrative costs by the sum of the 1998 program funding and the 1998 administrative costs, except for programs that pay administrative costs out of program funds. In those cases, the administrative cost as a percentage of program funding is calculated by dividing the 1998 administrative cost by the 1998 program funding.

[d]Includes both FCC's and SLD's administrative costs.

[e]The e-rate program was funded for the 18-month period from Jan. 1, 1998, through June 30, 1999, and the administrative costs are for the 12-month period from Jan. 1, 1998, through Dec. 31, 1998. In order to calculate administrative costs as a percentage of total program costs on an annual basis, the 18-month figure of $1.66 billion was reduced by one-third to $1.1 billion. Even though funding commitments were not made until late 1998 and early 1999, the applicants were being reimbursed the discounted portion of the bills they paid in full as early as Jan. 1998. Therefore, the one-third reduction is a reasonably accurate estimate.

Comments From the Federal Communications Commission and Univeral Service Administrative Company

FEDERAL COMMUNICATIONS COMMISSION
Washington, D. C. 20554

OFFICE OF
MANAGING DIRECTOR

November 22, 2000

Mr. Stanley J. Czerwinski
Director, Physical Infrastructure Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Czerwinski:

Thank you for the opportunity to comment on GAO's Draft Report regarding the application and invoice review procedures of the Schools and Libraries Universal Service Program. We appreciate the insights your expertise has given us into how we can further improve this important program. While much of the day-to-day work on the audit took place directly with USAC, the Program Administrator, FCC staff worked with USAC throughout the audit process to address issues as they were identified. In preparing our response to the Report, we asked USAC for its analysis of the Report and an update on the implementation of its recommendations. We concur with their analysis and are enclosing it as part of our response.

The Schools and Libraries Program is concluding its third round of reviewing applications for funding, and is in its second year of invoicing. Working together, USAC and the FCC have made significant improvements to the program in each year to make it easier for participating schools and libraries and to better prevent and detect violations of program rules. This audit, like previous audits conducted by GAO and other independent auditors, has provided valuable input.

The attached response from USAC explains in detail that the implementation of the recommendations in this Report is already completed or under way. Highlights of those actions that directly address the recommendations are listed below.

- Final review procedures for Program Year 4, which address the areas identified in the Report, are in place.
- We have developed procedures with USAC for clarifying future eligibility issues that arise.
- The Eligible Services list for Year 4 has been revised to identify more clearly eligible and ineligible items, and now includes further explanation of all conditionally eligible items.
- The Year 4 application has been revised to require more detailed information from applicants regarding the services they intend to purchase.

- The staff dedicated to the quality assurance function in USAC will be increased from one full-time employee to three.

In addition, the Common Carrier Bureau and USAC will undertake an analysis of the factors leading to funds being committed to applicants, but not ultimately disbursed.

We recognize the errors in funding your auditors discovered and have taken action to correct them. It is worth noting that only 10.3% of the commitments for ineligible services identified in your review has actually been disbursed. In accordance with FCC Orders, USAC will reduce funding commitments and recover any disbursed funds associated with these ineligible items. To prevent any additional disbursement, holds have been placed on the undisbursed funding requests which contain ineligible items.

Since the program's inception, USAC has had an extensive process in place to weed out requests for ineligible services during the application process. USAC has a systematic approach to evaluating the eligibility of each of the over 30,000 requests for funding received each year. As you note in your Report, those procedures resulted in rejection of $700 million of funding requests in Year 2. In addition, USAC regularly does an empirical analysis of program procedures to determine which reviews are the most cost effective in identifying ineligible items and what indicators suggest most strongly that an application may be in violation of program rules and should undergo further review. The work done to develop this Report is being incorporated into these on-going efforts and will further improve our ability to ensure that only eligible items are funded and that program rule compliance is improved.

We also agree with the assessment in the Report that the invoicing process is an opportunity for further quality control. In fact, prior to this audit, USAC had budgeted for a thorough review of the invoice review process for the fourth quarter of this year for just this purpose. Selection of a contractor for that effort is underway.

Because none of the applications reviewed by your Report have reached the appropriate point in the program cycle, your audit was not able to capture the effect of our Beneficiary Audit program. These audits, part of the on-going quality control effort, are on-site examinations of program beneficiaries to determine if program rules are being followed. These audits represent an additional opportunity to ensure only eligible items have been funded. This year, USAC has had its first opportunity to conduct these audits for Year 1 participants. The FCC has worked closely with USAC throughout the course of these audits. Once they are completed we will assess their effectiveness and direct USAC to modify the audit plan as necessary.

Finally, it deserves noting that this program is unique. It serves over two-thirds of the nation's public schools and half the nation's public libraries. It requires up-to-date knowledge of the rapidly and ever changing field of information technology, by both program staff and applicants. Equipment that did not exist in 1996 is now eligible for support, and each year new, better and cheaper equipment and services are available to

2

schools to meet their communications needs. We are committed to keeping administrative costs low, and, in fact, as the Report demonstrates have clearly been successful.

Sincerely,

Andrew S. Fishel
Managing Director

Enclosure

3

USAC

Universal Service Administrative Company

Cheryl L. Parrino
Chief Executive Officer

2000 NOV 22 P 12: 02

OFFICE OF THE CHAIRMAN

November 22, 2000

The Honorable William E. Kennard
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

RE: Response to Draft Report Concerning the <u>Schools and Libraries Support Mechanism</u>

Dear Chairman Kennard:

This letter comments on the draft report entitled "Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening" from the U.S. General Accounting Office (GAO). We have worked very closely with GAO staff during the course of their review and very much appreciate their comprehensive, and fair, review of the Schools and Libraries Support Mechanism. We have also worked very closely with the staff of the Common Carrier Bureau of the FCC, which has been very responsive to issues raised during the GAO's review.

The findings and recommendations included in the report, as well as the issues that were brought to our attention over the course of the review, have already led to significant improvements to the Schools and Libraries Support Mechanism. We are committed to implementing the remainder of GAO's recommendations that have not already been put in place. We will specifically address the report's findings and recommendations below. Under separate cover, we have provided to the GAO some minor comments on the draft report for purposes of clarification.

See comment 1.

GAO has acknowledged that the administration of the Schools and Libraries Support Mechanism is a challenging and complex task. While the draft report is careful to include numerous caveats about its conclusions, we are concerned that a casual reader might be left with a misimpression of some of the conclusions in the draft report. As the report points out, there are reasons why the errors discovered in the course of GAO's review may understate the actual number of erroneous funding commitments made to schools and libraries. We believe, however, that it is just as important to recognize that the report's conclusions concerning the applications GAO staff reviewed cannot be extrapolated to the entire population of Schools and Libraries Support Mechanism applications because GAO purposely selected for review requests for "internal connections" discounts, with an emphasis on complex, high-dollar requests. We all recognize these requests are the most likely to include ineligible services. In addition, a significant portion (15%) of the funds GAO identifies as having been committed in

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Chairman William E. Kennard
November 22, 2000
Page 2

See comment 2.

error were not committed for ineligible services. Rather, this portion was committed for eligible services mixed in with ineligible services – a departure from Schools and Libraries Division (SLD) administrative procedures, but not a violation of the Telecommunications Act or FCC rules. As we indicated to GAO staff during the course of the audit, SLD would reduce a funding commitment upon discovery that a portion of the commitment is for ineligible services but would not reduce the portion of the commitment associated with eligible services, even if our procedures would have led to denial of the entire request on original review. Our estimate is that exclusion of these commitments for eligible services mixed with ineligible services would reduce the level of "error" from $6 million to approximately $5 million.

See comment 3.

Further, a casual reader might infer that the amount of ineligible services that SLD did identify and disapprove was small since the report indicates that SLD denied $20 million on the 44 applications reviewed. However, as the report also points out, GAO's sample did not include applications on which *all* requests for internal connections were denied. As the report indicates, SLD denied nearly $700 million in Year 2 funding requests – largely for ineligible items or items that did not meet other eligibility rules but also including some portion (not easily calculated) of funds for eligible services mixed with funding for ineligible services in the same funding request.

While we are concerned that the report's findings be properly interpreted, we are fully committed to effective stewardship of the Schools and Libraries Support Mechanism. Our goal is to ensure that discounts are received only by eligible entities for eligible services. GAO's suggestions in the draft report, as well as the many issues we discussed with GAO staff during the course of the review, will help us achieve our mutual objective of eliminating as many errors as possible while ensuring cost-effective and efficient administration of the Schools and Libraries Support Mechanism.

The draft GAO report includes six specific "Recommendations for Executive Action." FCC staff and USAC/SLD have already implemented improvements to address the first four recommendations. USAC/SLD staff members are already working with FCC's Common Carrier Bureau staff to address the remaining GAO recommendations.

USAC/SLD, Working with FCC, Has Already Implemented Significant Improvements

USAC/SLD has already implemented improvements to address the following four recommendations in the draft report:

- Finalize all outstanding program rule and review procedures.
- Implement procedures for promptly clarifying eligibility issues and publicizing such clarifications to the applicant community in a timely manner.
- Revise the Eligible Services List available to applicants to clarify conditions of eligibility.

Chairman William E. Kennard
November 22, 2000
Page 3

- Revise Schools and Libraries Support Mechanism application materials to require more detail on the services applicants seek to purchase with support mechanism funds.

In the course of the GAO review, USAC and SLD, in consultation with FCC staff, responded to the findings-in-progress and have already implemented seven new improvements to address these recommendations:

Eligible Services

1. GAO's reviews and observations have led us to analyze carefully the procedures and determinations of service eligibility. As highlighted in the report, the determinations on the eligibility of internal connections connected to wide area networks have been revised in consultation with the FCC. The new approach is more logical in the context of the FCC rules and is much more easily understood by applicants and service providers.

2. Many of the other ineligible items that are identified in the GAO report are video equipment items. The Eligible Services List posted on the USAC/SLD web site identified video equipment as ineligible. The FCC's determination of the eligibility of video equipment, however, has been revised. The Eligible Services List, revised as of November 17, 2000, and now posted on the USAC/SLD web site indicates that video equipment and cabling (other than end-user equipment) are eligible. Because video service is eligible if provided by a telecommunications provider, FCC staff determined that it is logical that equipment that carries the services to the classroom be eligible as well.

3. As part of our preparation for the opening of the Year 4 application filing window, we have worked closely with FCC staff to clarify open eligibility issues and posted these new determinations for use by the applicant community on October 12, 2000. We are confident that we have an effective arrangement with staff in the Common Carrier Bureau to raise any new issues that arise during application review and to get prompt decisions. We will add any significant new decisions to the Eligible Services List on our web site and alert applicants to such additions through notice in the "What's New" section of the web site.

4. Also, as recommended in the report, the Eligible Services List has been enhanced to identify explicitly the services that are conditionally eligible and to state explicitly the conditions for eligibility.

5. The draft report also raises concerns about other services, such as training, design costs, and contingency fees, and the lack of objective criteria to determine when such costs should be considered reasonable. We have consulted with FCC staff, which has provided more explicit guidance in these areas. We have provided that guidance to our staff for use

Chairman William E. Kennard
November 22, 2000
Page 4

in reviewing Funding Year 4 applications, for which the filing window has recently opened.

Clarity of Procedures

6. As the draft report notes, some errors were the result of human mistakes. Our program integrity assurance procedures have been reviewed and clarified wherever necessary. We continuously review those procedures and make refinements when appropriate. We have provided the revised procedures to our staff and will continue to train our staff members concerning the revised procedures as well as any additional improvements as we move forward.

Information Provided by Applicants

7. Working with FCC and Office of Management and Budget staff, we have revised the instructions for the FCC Form 471 (the primary application form that describes the services for which discounts are being sought) for Funding Year 4 to require more detailed information on the services for which discounts are being requested. This will provide additional certainty about the services for which discounts are requested. The revised instructions require applicants to attach "a specific itemization of products and/or services to be provided and the associated costs adding up to the prediscount costs shown in Item (23) of Block 5." A list of suggestions for the information to be provided in the attachments is also provided in the revised instructions for FCC Form 471. We believe that this modification will facilitate a more detailed and thorough review by our staff of the requests for discounts.

USAC Will Work with FCC to Implement the Remaining Recommendations in the Report

USAC/SLD is addressing the two remaining recommendations in the draft report as follows:

- Develop a strategy for reducing the percentage of committed funds that go unused by applicants.

USAC/SLD will support FCC staff in developing this strategy. The Schools and Libraries Committee of the USAC Board of Directors, as well as the staff, share GAO's concern that Schools and Libraries Support Mechanism funds are going unused. At its October 2000 meeting, the Committee directed staff to pursue and develop options for narrowing the gap between commitments and disbursements and to discuss those options with the FCC. This will be a priority for us in the months ahead.

- Establish a quality assurance function in USAC responsible for ensuring that SLD's funding decisions follow FCC rules and developing effective internal control procedures over disbursement of funds.

Chairman William E. Kennard
November 22, 2000
Page 5

USAC currently has one internal auditor on staff. Based in part on the GAO recommendation, the USAC Board of Directors has approved two additional internal auditor positions in the 2001 USAC budget, a doubling of the increase that we had previously planned. We have advised the FCC Common Carrier Bureau of our plans and appreciate their support for this initiative.

Finally, the draft report expresses concern about the thoroughness of the review of invoices, but acknowledges specific steps we are taking to improve our invoice processes. Please be advised that we will go beyond the steps listed in the draft report in our effort to improve the invoice review process. We are implementing additional reviews to increase the level of confidence that funds are not disbursed for ineligible services. In addition, as mentioned in the report, we will be hiring a consultant to review the invoice process and procedures and provide recommendations for further strengthening the procedures.

Conclusion

The thorough work of GAO staff in this review has helped us to identify areas of improvement, which we very much appreciate. USAC has implemented improvements immediately whenever possible with FCC's support and guidance. We commit to implement additional improvements as soon as possible. We believe that the GAO review has contributed to a real strengthening of the Schools and Libraries Support Mechanism, and we sincerely appreciate GAO's contribution.

Sincerely,

Cheryl L. Parrino
Chief Executive Officer, USAC

Kate L. Moore
President, Schools and Libraries Division of USAC

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cc: Commissioner Ness
Commissioner Furchtgott-Roth
Commissioner Powell
Commissioner Tristani
Dorothy Attwood, Chief, Common Carrier Bureau
Andy Fishel, FCC Managing Director
Anna Gomez, Legal Advisor to Chairman Kennard
Jordan Goldstein, Legal Advisor to Commissioner Ness
Rebecca Beynon, Legal Advisor to Commissioner Furchtgott-Roth
Kyle Dixon, Legal Advisor to Commissioner Powell
Deena Shetler, Legal Advisor to Commissioner Tristani

The following are GAO's comments on the Universal Service Administrative Company's letter dated November 22, 2000.

GAO's Comments

1. While our methodology was designed to select more high-dollar applications than would be expected under a random sample, a significant number of the applications we reviewed were for less than $500,000. Twelve of the 44 were for amounts under $250,000, and another 7 were for amounts between $250,000 and $500,000. We found errors in these applications as well. Also, we did not attempt to measure the complexity of any application.

2. While we agree that some of the funding we classify as "committed in error" was for services that are themselves eligible, we disagree that such funding should be excluded from the level of error. Our methodology followed SLD's quality assurance procedures, which require the complete denial of any request in which at least 30 percent of the amount requested is ineligible. In addition, the $20 million SLD denied to the applications in our sample includes funding that SLD denied under this procedure. Therefore, when comparing the $20 million SLD denied with the $6 million it should have denied but did not deny, it is appropriate to include all reasons for denial.

3. We excluded from our sample any applications that were denied in full because there was no chance that funds would have been committed in error. This exclusion is consistent with SLD's internal goals, which measure improper funding as a percentage of funds committed. USAC's response states that SLD denied $700 million for the second program year. This amount represents the total amount denied for all reasons and all categories of service. The portion of this total that relates to denials for internal connections is $400 million.

GAO Contacts and Staff Acknowledgments

GAO Contacts

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Acknowledgments

Other key contributors to this report were Karen Bracey, Krista Ely, D. Allan Rogers, Teresa Russell, James R. Sweetman, Jr., Michael R. Volpe, Edward Warner, and Mindi Weisenbloom.

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