

GAO

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

February 2005

TELECOMMUNICATIONS

Greater Involvement
Needed by FCC in the
Management and
Oversight of the
E-Rate Program



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-05-151](#), a report to the Chairman, Committee on Energy and Commerce, House of Representatives

Why GAO Did This Study

Since 1998, the Federal Communications Commission's (FCC) E-rate program has committed more than \$13 billion to help schools and libraries acquire Internet and telecommunications services. Recently, however, allegations of fraud, waste, and abuse by some E-rate program participants have come to light. As steward of the program, FCC must ensure that participants use E-rate funds appropriately and that there is managerial and financial accountability surrounding the funds. GAO reviewed (1) the effect of the current structure of the E-rate program on FCC's management of the program, (2) FCC's development and use of E-rate performance goals and measures, and (3) the effectiveness of FCC's oversight mechanisms in managing the program.

What GAO Recommends

To strengthen FCC's management and oversight of the E-rate program, we are recommending that FCC (1) determine comprehensively which federal accountability requirements apply to E-rate; (2) establish E-rate performance goals and measures; and (3) take steps to reduce the backlog of beneficiary appeals. In response, FCC stated that it does not concur with (1) because it maintains it has done this on a case-by-case basis. We continue to believe that major issues remain unresolved. FCC concurs with (2) and (3), noting that it is already taking steps on these issues.

www.gao.gov/cgi-bin/getrpt?GAO-05-151.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Mark L. Goldstein at (202) 512-2834 or goldsteinm@gao.gov.

TELECOMMUNICATIONS

Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program

What GAO Found

FCC established the E-rate program using an organizational structure unusual to the government without conducting a comprehensive assessment to determine which federal requirements, policies, and practices apply to it. The E-rate program is administered by a private, not-for-profit corporation with no contract or memorandum of understanding with FCC, and program funds are maintained outside of the U.S. Treasury, raising issues related to the collection, deposit, obligation, and disbursement of the funding. While FCC recently concluded that the Universal Service Fund constitutes an appropriation and is subject to the Antideficiency Act, this raises further issues concerning the applicability of other fiscal control and accountability statutes. These issues need to be explored and resolved comprehensively to ensure that appropriate governmental accountability standards are fully in place to help protect the program and the fund from fraud, waste, and abuse.

FCC has not developed useful performance goals and measures for assessing and managing the E-rate program. The goals established for fiscal years 2000 through 2002 focused on the percentage of public schools connected to the Internet, but the data used to measure performance did not isolate the impact of E-rate funding from other sources of funding, such as state and local government. A key unanswered question, therefore, is the extent to which increases in connectivity can be attributed to E-rate. In addition, goals for improving E-rate program management have not been a feature of FCC's performance plans. In its 2003 assessment of the program, OMB noted that FCC discontinued E-rate performance measures after fiscal year 2002 and concluded that there was no way to tell whether the program has resulted in the cost-effective deployment and use of advanced telecommunications services for schools and libraries. In response to OMB's concerns, FCC is currently working on developing new E-rate goals.

FCC's oversight mechanisms contain weaknesses that limit FCC's management of the program and its ability to understand the scope of any waste, fraud, and abuse within the program. According to FCC officials, oversight of the program is primarily handled through agency rulemaking procedures, beneficiary audits, and appeals decisions. FCC's rulemakings have often lacked specificity and led to a distinction between FCC's rules and the procedures put in place by the program administrator—a distinction that has affected the recovery of funds for program violations. While audits of E-rate beneficiaries have been conducted, FCC has been slow to respond to audit findings and make full use of them to strengthen the program. In addition, the small number of audits completed to date do not provide a basis for accurately assessing the level of fraud, waste, and abuse occurring in the program, although the program administrator is working to address this issue. According to FCC officials, there is also a substantial backlog of E-rate appeals due in part to a shortage of staff and staff turnover. Because appeal decisions establish precedent, this slowness adds uncertainty to the program.

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Abbreviations

CBO	Congressional Budget Office
FCC	Federal Communications Commission
FTE	full-time equivalent
GovGAAP	generally accepted accounting principles for federal agencies
IG	inspector general
IPIA	Improper Payments Information Act of 2002
NCES	National Center for Education Statistics
NECA	National Exchange Carrier Association
OMB	Office of Management and Budget
PART	Program Assessment Rating Tool
SLD	Schools and Libraries Division
USAC	Universal Service Administrative Company
USF	Universal Service Fund

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United States Government Accountability Office
Washington, D.C. 20548

February 9, 2005

The Honorable Joe Barton
Chairman
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

Since 1998, the Federal Communications Commission's (FCC) universal service "E-rate" program has committed more than \$13 billion in funding to help schools and libraries across the nation acquire telecommunications and Internet services. Eligible schools and libraries can apply annually to receive support and can spend the funding on specific eligible services and equipment, including telephone services, Internet access services, and the installation of internal wiring and other related items. For example, with the help of E-rate funding, a school district in Alaska that lacked certified math teachers was able to provide students with math, algebra, and geometry lessons through distance learning. Similarly, the State Library of Louisiana has used E-rate funding to help provide Internet connections for use by patrons in all of Louisiana's public libraries. The E-rate program processes around 40,000 applications from schools and libraries each year, and many of these applicants rely heavily on E-rate support for their telecommunications needs.

Recently, allegations have been made that some E-rate beneficiaries (schools and libraries) and service providers (e.g., telecommunications and network equipment companies) have fraudulently obtained, wasted, or abused E-rate funding. In May 2004, for example, one service provider involved in E-rate projects in several states pleaded guilty to bid rigging and wire fraud and agreed to pay more than \$20 million in criminal fines, civil payments, and restitution. In December 2004, another service provider agreed to pay almost \$9 million and plead guilty to charges related to a scheme to defraud the E-rate program by inflating bids, agreeing to submit false and fraudulent documents to hide the planned installation of ineligible items, and submitting false and fraudulent documents to defeat inquiry into the legitimacy of the funding request. Suspected instances of program beneficiaries not paying their portion of service costs and of service provider procurement irregularities are being investigated. In fact, FCC's Inspector General (IG) has devoted special attention to the E-rate program in his most recent reports to Congress. In his May 2004 report, the FCC IG stated that he continues to have numerous concerns about the program and

believes that the program may be subject to a high risk of fraud, waste, and abuse through noncompliance and program weakness.¹

“Universal service” traditionally has meant providing residential customers with affordable nationwide access to basic telephone service. The Telecommunications Act of 1996 expanded the concept of universal service to include assistance to schools and libraries in acquiring telecommunications and Internet services; the act charged FCC with establishing a universal service discount mechanism for schools and libraries. The commission, in turn, created a large and ambitious program that became commonly known as the E-rate program² and gave the program a \$2.25 billion annual funding cap.³ The commission designated a not-for-profit corporation, the Universal Service Administrative Company (USAC), to carry out the day-to-day operations of the program, although FCC retains responsibility for overseeing the program’s operations and ensuring compliance with the commission’s rules.

The public has a vested interest in the proper management of the E-rate program. The program is funded through statutorily mandated payments into the Universal Service Fund⁴ by companies that provide interstate

¹See FCC, *Office of the Inspector General Semiannual Report to Congress, October 1, 2003—March 31, 2004* (Washington, D.C.; May 3, 2004).

²The term “E-rate” evolved from some individuals referring to the program as the “Education” rate.

³Because there was no historical record of what it would cost to provide support to schools and libraries, FCC based the funding cap on data from McKinsey and Company, the U.S. National Committee on Libraries and Information Services, and others that sought to estimate the cost of deploying and supporting the ongoing costs of a communications network for public schools and libraries. The cap has remained the same since it was established in May 1997.

⁴Contributions from companies providing interstate telecommunications services are deposited into the federal Universal Service Fund, from which disbursements are made for the various federal universal service programs, including E-rate. Other universal service programs under the Universal Service Fund are the High Cost program, the Low Income program, and the Rural Health Care program. The High Cost program assists customers living in high-cost, rural, or remote areas through financial support to telephone companies, thereby lowering rates for local and long distance service. The Low Income program assists qualifying low-income consumers through discounted installation and monthly telephone services and free toll limitation service. The Rural Health Care program assists health care providers located in rural areas through discounts for telecommunications services. For more information on the various universal service programs see GAO, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding*, GAO-02-187 (Washington, D.C.: Feb. 4, 2002).

telecommunications services. The companies' "contribution factor" of how much they must pay into the Universal Service Fund is established quarterly by FCC. In practice, however, many of these companies pass this contribution factor along to consumers through fees placed on their phone bills. Also, during most of the program's history, the requests from schools and libraries for E-rate funding have greatly exceeded the annual amounts available from the program. Thus, any misuse of E-rate funding wastes consumers' money and deprives those schools and libraries whose requests for support were denied due to funding limitations. As the steward of this program, FCC must ensure that beneficiaries use the funds appropriately and that there is financial and managerial accountability surrounding the fund.

Since 1998, we have issued eight reports and testimonies discussing various aspects of the E-rate program.⁵ In light of ongoing concerns about the E-rate program, you asked us in December 2003 to review the program. We evaluated (1) the effect of the current structure of the E-rate program on FCC's management of the program, (2) FCC's development and use of performance goals and measures in managing the program, and (3) the effectiveness of FCC's oversight mechanisms—rulemaking proceedings, beneficiary audits, and reviews of USAC decisions (appeals)—in managing the program. To address these issues, we interviewed officials from FCC's Wireline Competition Bureau, Enforcement Bureau, Office of General Counsel, Office of Managing Director, Office of Strategic Planning and Policy Analysis, and Office of Inspector General. We also interviewed officials from USAC. In addition, we interviewed officials from the Office of

⁵See GAO, *Telecommunications: FCC Lacked Authority to Create Corporations to Administer Universal Service Programs*, [GAO/T-RCED/OGC-98-84](#) (Washington, D.C.: 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](#) (Washington, D.C.: May 7, 1998); *Schools and Libraries Corporation: Actions Needed to Strengthen Program Integrity Operations before Committing Funds*, [GAO/T-RCED-98-243](#) (Washington, D.C.: July 16, 1998); *Telecommunications and Information Technology: Federal Programs That Can Be Used to Fund Technology for Schools and Libraries*, [GAO/T-HEHS-98-246](#) (Washington, D.C.: Sept. 16, 1998); *Schools and Libraries Program: Actions Taken to Improve Operational Procedures Prior to Committing Funds*, [GAO/RCED-99-51](#) (Washington, D.C.: Mar. 5, 1999); *Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening*, [GAO-01-105](#) (Washington, D.C.: Dec. 15, 2000); *Schools and Libraries Program: Update on E-rate Funding*, [GAO-01-672](#) (Washington, D.C.: May 11, 2001); and *Schools and Libraries Program: Update on State-Level Funding by Category of Service*, [GAO-01-673](#) (Washington, D.C.: May 11, 2001). In addition, we touched upon the E-rate program in *Telecommunications Technology: Federal Funding for Schools and Libraries*, [GAO/HEHS-99-133](#) (Washington, D.C.: Aug. 20, 1999).

Management and Budget (OMB) and the Department of Education regarding performance goals and measures. OMB had conducted its own assessment of the E-rate program in 2003, which we also discussed with OMB officials. We reviewed and analyzed FCC, USAC, and OMB documents related to the management and oversight of the E-rate program. The information we gathered was sufficiently reliable for the purposes of our review. We conducted our work from December 2003 through December 2004 in accordance with generally accepted government auditing standards. See appendix I for a more detailed explanation of our scope and methodology.

Results in Brief

FCC established E-rate as a multibillion-dollar program operating under an organizational structure unusual to the federal government, and then never conducted a comprehensive assessment to determine which federal requirements, policies, and practices apply to the program, to USAC, and to the Universal Service Fund itself. The E-rate program's structure is unusual in a couple of ways: (1) It is administered by a private, not-for-profit corporation that has no contract or memorandum of understanding with FCC and (2) although the Universal Service Fund is included in the federal budget, program funds are maintained outside of the U.S. Treasury, raising issues related to the collection, deposit, obligation, and disbursement of the funding. Because of this unusual framework, FCC has struggled with determining which fiscal and accountability requirements apply to the E-rate program. FCC has internally considered the applicability of a number of statutes on a case-by-case basis and has concluded that the Universal Service Fund constitutes an appropriation and that the fund is subject to the Antideficiency Act. However, the laws encompassing fiscal and accountability controls are not applied in isolation; rather, they are part of a framework that addresses issues of financial and general management of federal agencies and programs. FCC's conclusions concerning the status of the Universal Service Fund raise further issues concerning the applicability of other fiscal control and accountability statutes (e.g., the Miscellaneous Receipts Statute, the Single Audit Act, and the Cash Management Improvement Act) and the extent to which FCC has delegated certain functions for the E-rate program to USAC—issues that FCC needs to explore and resolve. Timely resolution of these issues in a comprehensive fashion is necessary to ensure that the appropriate governmental accountability safeguards are fully in place to help protect the E-rate program and the Universal Service Fund from fraud, waste, and abuse.

Although \$13 billion in E-rate funding has been committed during the past 7 years, FCC did not develop performance goals and measures that could be used to assess the specific impact of these funds and improve the management of the program. For fiscal years 2000 through 2002, FCC's goals focused on achieving certain percentage levels of Internet access for schools, public school instructional classrooms, and libraries. However, the data that FCC used to report on its progress was limited to public schools (rather than including private schools and libraries) and did not isolate the impact of E-rate funding from other sources of funding, such as state and local government. This is a significant measurement problem because, over the years, the demand for internal connections funding by applicants has exceeded the E-rate funds available for this purpose by billions of dollars. Unsuccessful applicants had to rely on other sources of support to meet their internal connection needs. Consequently, a fundamental performance question that remains unanswered is how much of the increase in public schools' access to the Internet can be attributed to the E-rate program. This, in turn, makes it difficult to address other questions about the program, such as its efficiency and cost-effectiveness in supporting the telecommunications needs of schools and libraries. In addition, goals for improving E-rate program management have not been a feature of FCC's performance plans. For example, two such goals—related to assessing competitive bidding requirements for vendor services and improving participation by eligible schools and libraries in the program—were planned but not carried forward. FCC did not include any E-rate goals for fiscal years 2003 and 2004 in its recent annual performance reports. OMB's own review of the program in 2003 concluded that there was no way to tell whether the program has resulted in the cost-effective deployment and use of advanced telecommunications services for schools and libraries.⁶ In response, FCC staff have been working on developing new performance measures for the E-rate program and plan to finalize them and seek OMB approval in fiscal year 2005.

FCC's three key oversight mechanisms for the E-rate program—rulemaking procedures, beneficiary audits, and reviews of USAC decisions (appeals decisions)—are not fully effective in managing the program. FCC's rulemakings have often lacked specificity and led to situations where USAC, in crafting the details needed to operate the program, has

⁶OMB reviewed E-rate using its Program Assessment Rating Tool (PART), which is a diagnostic tool intended to provide a consistent approach to evaluating federal programs as part of the executive budget formulation process.

established administrative procedures that arguably rise to the level of policy decisions, even though USAC is prohibited from making program policies. This creates a situation where important USAC administrative procedures have been deemed unenforceable by FCC with regard to the recovery of funds for violations of those procedures. While audits have been conducted on E-rate beneficiaries, FCC has been slow to respond to audit findings in the past. Also, neither FCC nor USAC have conducted a large enough number of beneficiary audits to be able to statistically support an accurate assessment of the level of waste, fraud, and abuse in the program. FCC is examining a proposal by USAC for resolving audit findings, and the FCC IG and USAC are planning to conduct a larger number of audits that will allow for an estimation of the annual amount of improper payments by the E-rate program. According to FCC officials, FCC's oversight through appeals decisions suffers from a significant appeals backlog due in part to a shortage of FCC staff and staff turnover. Thus, issues raised on appeal may not be addressed in a timely manner. Because appeals decisions are used as precedent, this slowness adds uncertainty to the program and impacts beneficiaries.

To address the management and oversight problems we have identified, we recommend that the Chairman of FCC: (1) conduct and document a comprehensive assessment to determine whether all necessary government accountability requirements, policies, and practices have been applied and are fully in place to protect the E-rate program and universal service funding; (2) establish meaningful performance goals and measures for the E-rate program; and (3) develop a strategy for reducing the E-rate program's appeals backlog, including ensuring that adequate staffing resources are devoted to E-rate appeals.

We provided a draft of this report to FCC for comment. FCC said that it took a number of steps in 2004 to improve its management and oversight of the program, and anticipates taking additional steps during the coming year. FCC concurred with our recommendations on establishing performance goals and measures and developing a strategy for reducing the backlog of appeals. FCC did not concur with our recommendation that it conduct a comprehensive assessment concerning the applicability of government accountability requirements, policies, and practices. FCC maintains that it has already done so on a case-by-case basis. As noted in our report, however, we believe that major issues remain unresolved, such as the implications of FCC's determination that the Universal Service Fund constitutes an appropriation under the current structure of the E-rate

program and the extent to which FCC has delegated some program functions to USAC.

Background

The concept of “universal service” has traditionally meant providing residential telephone subscribers with nationwide access to basic telephone services at reasonable rates. Universal service programs traditionally targeted support to low-income customers and customers in rural and other areas where the costs of providing basic telephone service were high. The Telecommunications Act of 1996 broadened the scope of universal service to include, among other things, support for schools and libraries. The act instructed FCC to establish a universal service support mechanism to ensure that eligible schools and libraries have affordable access to and use of certain telecommunications services for educational purposes.⁷ In addition, Congress authorized FCC to “establish competitively neutral rules to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and nonprofit elementary and secondary school classrooms . . . and libraries. . . .”⁸ Based on this direction, and following the recommendations of the Federal-State Joint Board on Universal Service,⁹ FCC established the schools and libraries universal service mechanism that is commonly referred to as the E-rate program. The program is funded through statutorily mandated payments by companies that provide interstate telecommunications services.¹⁰ Many of these companies, in turn, pass their contribution costs on to their subscribers through a line item on subscribers’ phone bills.¹¹ FCC capped funding for the E-rate program at \$2.25 billion per year, although funding requests by

⁷47 U.S.C. § 254(h)(1)(B).

⁸47 U.S.C. § 254(h)(2).

⁹The Federal-State Joint Board on Universal Service was established in March 1996 to make recommendations to implement the universal service provisions of the Telecommunications Act of 1996. The board is composed of FCC commissioners, state utility commissioners, and a consumer advocate representative.

¹⁰These companies include providers of local and long distance telephone services, wireless telephone services, paging services, and pay phone services. 47 C.F.R. § 54.706.

¹¹The line item is called various things by various companies, such as the “federal universal service fee” or the “universal connectivity fee.” Some companies do not separate out universal service costs as a line item, but instead just build it into their overall costs. Either way, consumers ultimately pay for the various universal service programs, including E-rate.

schools and libraries can greatly exceed the cap. For example, schools and libraries requested more than \$4.2 billion in E-rate funding for the 2004 funding year.

In 1998, FCC appointed USAC as the program's permanent administrator,¹² although FCC retains responsibility for overseeing the program's operations and ensuring compliance with the commission's rules. In response to congressional conference committee direction,¹³ FCC has specified that USAC "may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Congress."¹⁴ USAC is responsible for carrying out the program's day-to-day operations, such as maintaining a Web site that contains program information and application procedures; answering inquiries from schools and libraries; processing and reviewing applications; making funding commitment decisions and issuing funding commitment letters; and collecting, managing, investing, and disbursing E-rate funds. FCC permits—and in fact relies on—USAC to establish administrative procedures that program participants are required to follow as they work through the application and funding process. The FCC IG has noted that program participants generally consider USAC the primary source for guidance on the rules governing the E-rate program. See appendix III for a more detailed explanation of the structure of USAC.

¹²In 1998, we issued a legal opinion on the then-current structure of the E-rate program where FCC directed the creation of the Schools and Libraries Corporation to administer the program. Under the Government Corporation Control Act, an agency must have specific statutory authority to establish a corporation. 31 U.S.C. § 9102. We concluded that FCC did not have authority to create a separate independent corporation to administer the E-rate program. B-278820, Feb. 10, 1998. Subsequently, FCC eliminated the Schools and Libraries Corporation as a separate entity and restructured the universal service program to its present form. We have not addressed FCC's authority to establish the current organizational structure. In 1998, in view of the questions surrounding the establishment of USAC itself, the commission requested statutory authorization from Congress. No legislation was enacted. FCC has not sought any further congressional authorization or direction on the nature of the Universal Service Fund or the establishment of USAC.

¹³See S.1768, 105th Cong., § 2004(b)(2)(A) (1998).

¹⁴47 C.F.R. § 54.702(c).

Under the E-rate program, eligible schools, libraries, and consortia that include eligible schools and libraries¹⁵ may receive discounts for eligible services. Eligible schools and libraries may apply annually to receive E-rate support. The program places schools and libraries into various discount categories, based on indicators of need, so that the school or library pays a percentage of the cost for the service and the E-rate program funds the remainder. E-rate discounts range from 20 percent to 90 percent. Schools and libraries in areas with higher percentages of students eligible for free or reduced-price lunches through the National School Lunch Program (or a federally approved alternative mechanism) qualify for higher discounts on eligible services. Schools and libraries located in rural areas¹⁶ also receive greater discounts in most cases, as shown in table 1.

Table 1: E-Rate Program Discount Matrix

Percent		
Students eligible for school lunch program	Urban discount	Rural discount
less than 1	20	25
1–19	40	50
20–34	50	60
35–49	60	70
50–74	80	80
75–100	90	90

Source: 47 C.F.R. § 54.505(c).

¹⁵Eligibility of schools and libraries is defined at 47 U.S.C. § 254. Generally, educational institutions that meet the definition of “schools” in the Elementary and Secondary Education Act of 1965 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. Examples of entities *not* eligible for support are home school programs, private vocational programs, and institutions of higher education. In addition, neither private schools with endowments of more than \$50 million nor libraries whose budgets are part of a school’s budget are eligible to participate. 20 U.S.C. § 9122.

¹⁶An applicant is classified as rural based on the definition adopted by the U.S. Department of Health and Human Services’ Office of Rural Health Policy.

FCC has defined four classes of services 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 (e.g., T-1 lines);
- *Internet access services*, such as broadband Internet access and e-mail services;
- *internal connections*, such as telecommunications wiring, routers, switches, and network servers that are necessary to transport information to individual classrooms; and
- *basic maintenance* on internal connections.

The list of specific eligible services within each class is updated annually and posted on USAC's Web site. FCC's rules provide that requests for telecommunications services and Internet access for all discount categories shall receive first priority for the available funding (Priority One services). The remaining funds are allocated to requests for support for internal connections and basic maintenance (Priority Two services), beginning with the most economically disadvantaged schools and libraries, as determined by the discount matrix. Because of this prioritization, not all requests for internal connections necessarily receive funding.¹⁷

¹⁷Starting in funding year 2005, eligible entities will only be able to receive support for internal connections in two out of every five funding years. All requests for Priority One services that have been found consistent with FCC rules through the Program Integrity Assurance review process have been funded since the beginning of the program.

Prior to applying for discounted services, an applicant must conduct a technology assessment and develop a technology plan to ensure that any services it purchases will be used effectively.¹⁸ The applicant submits a form to USAC setting forth its technological needs. Once the school or library has complied with the commission's competitive bidding requirements and entered into agreements with service providers for eligible services, it must file a second form with USAC that details the types and costs of the services being contracted for, the vendors providing the services, and the amount of discount being requested. USAC reviews the forms and issues funding commitment decision letters (USAC could reduce the amount requested if the school or library has included ineligible services in its application or has calculated its discount category incorrectly¹⁹). Generally, it is the service provider that seeks reimbursement from USAC for the discounted portion of the service.²⁰

FCC Established an Unusual Program Structure without Comprehensively Addressing the Applicability of Governmental Standards and Fiscal Controls

FCC established an unusual structure for the E-rate program but has never conducted a comprehensive assessment of which federal requirements, policies, and practices apply to the program, to USAC, or to the Universal Service Fund itself. FCC recently began to address a few of these issues, concluding that as a permanent indefinite appropriation, the Universal Service Fund is subject to the Antideficiency Act and its issuance of commitment letters constitutes obligations for purposes of the act. We agree with FCC's determinations on these issues, as explained in detail in appendix II. However, FCC's conclusions concerning the status of the Universal Service Fund raise further issues relating to the collection, deposit, obligation, and disbursement of those funds—issues that FCC

¹⁸Applicants do not actually have to submit any proof of having an approved technology plan until much later in the process. Applicants that seek discounts only for basic, long distance, or cellular telephone services are not required to prepare a technology plan.

¹⁹The program relies on applicants to self-certify important information. For example, in addition to calculating their own discount categories based on USAC's formula, applicants must certify that they: (1) based their requests on approved technology plans (if it was required); (2) have sufficient funding to pay for the nondiscounted portion of eligible costs and for ineligible resources, such as computers and software, that are necessary to use the requested services; and (3) complied with all applicable state and local laws or rules regarding procurement.

²⁰The school or library could also pay the service provider in full and then seek reimbursement from USAC for the discount portion.

needs to explore and resolve comprehensively rather than in an ad hoc fashion as problems arise.

The Telecommunications Act of 1996 neither specified how FCC was to administer universal service to schools and libraries nor prescribed the structure and legal parameters of the universal service mechanisms to be created. The Telecommunications Act required FCC to consider the recommendations of the Federal-State Joint Board on Universal Service and then to develop specific, predictable, and equitable support mechanisms. Using the broad language of the act, FCC crafted an ambitious program for schools and libraries—roughly analogous to a grant program—and gave the program a \$2.25 billion annual funding cap. To carry out the day-to-day activities of the E-rate program, FCC relied on a structure it had used for other universal service programs in the past—a not-for-profit corporation established at FCC’s direction that would operate under FCC oversight. However, the structure of the E-rate program is unusual in several respects compared with other federal programs:

- FCC appointed USAC as the permanent administrator of the Universal Service Fund,²¹ and FCC’s Chairman has final approval over USAC’s Board of Directors. USAC is responsible for administering the program under FCC orders, rules, and directives. However, USAC is not part of FCC or any other government entity; it is not a government corporation established by Congress; and no contract or memorandum of understanding exists between FCC and USAC for the administration of the E-rate program. Thus, USAC operates and disburses funds under less explicit federal ties than many other federal programs.

²¹USAC was appointed the permanent administrator subject to a review after one year by FCC to determine that the universal service programs were being administered in an efficient, effective, and competitively neutral manner. 47 C.F.R. § 54.701(a). This review was never conducted.

-
- Questions as to whether the monies in the Universal Service Fund should be treated as federal funds have troubled the program from the start. Even though the fund has been listed in the budget of the United States and, since fiscal year 2004, has been subject to an annual apportionment from OMB, the monies are maintained outside of Treasury accounts by USAC and some of the monies have been invested.²² The United States Treasury implements the statutory controls and restrictions involving the proper collection and deposit of appropriated funds, including the financial accounting and reporting of all receipts and disbursements, the security of appropriated funds, and agencies' responsibilities for those funds.²³

As explained below, appropriated funds are subject, unless specifically exempted by law, to a variety of statutory controls and restrictions. These controls and restrictions, among other things, limit the purposes for which federal funds can be used and provide a scheme of accountability for federal monies. Key requirements are in Title 31 of the United States Code and the appropriate Treasury regulations,²⁴ which govern fiscal activities relating to the management, collection, and distribution of public money.

Since the inception of the E-rate program, FCC has struggled with identifying the nature of the Universal Service Fund and the managerial, fiscal, and accountability requirements that apply to the fund. FCC's Office of Inspector General first looked at the Universal Service Fund in 1999 as part of its audit of the commission's fiscal year 1999 financial statement because FCC had determined that the Universal Service Fund was a component of FCC for financial reporting purposes. During that audit, the FCC IG questioned commission staff regarding the nature of the fund and, specifically, whether it was subject to the statutory and regulatory requirements for federal funds. In the next year's audit, the FCC IG noted

²²The Universal Service Fund is included in the federal budget as a special fund. OMB concluded that the fund does not constitute public money subject to the Miscellaneous Receipts Statute, 31 U.S.C. § 3302, and therefore can be maintained outside the Treasury by a nongovernmental manager. Letter from Mr. Robert G. Damus, OMB General Counsel to Mr. Christopher Wright, FCC General Counsel, dated April 28, 2000.

²³See 31 U.S.C. §§ 331, 3301-3305 and the Treasury Financial Manual, vol. I, which instructs federal agencies in areas of central accounting and reporting, disbursing, deposit regulations, and other fiscal matters necessary for the financial accounting and reporting of all receipts and disbursements of the federal government.

²⁴As set forth in part 31 of the Code of Federal Regulations or the Treasury Financial Manual.

that the commission could not ensure that Universal Service Fund activities were in compliance with all laws and regulations because the issue of which laws and regulations were applicable to the fund was still unresolved at the end of the audit.

FCC officials told us that the commission has substantially resolved the IG's concerns through recent orders, including FCC's 2003 order that USAC begin preparing Universal Service Fund financial statements consistent with generally accepted accounting principles for federal agencies (GovGAAP) and keep the fund in accordance with the United States Government Standard General Ledger. While it is true that these steps and other FCC determinations discussed below should provide greater protections for universal service funding, FCC has addressed only a few of the issues that need to be resolved. In fact, staff from the FCC's IG's office told us that they do not believe the commission's GovGAAP order adequately addressed their concerns because the order did not comprehensively detail which fiscal requirements apply to the Universal Service Fund and which do not.

FCC has, however, made some determinations concerning the status of the Universal Service Fund and the fiscal controls that apply. FCC's determinations, and our analysis, in brief, are discussed below. (See app. II for our more thorough legal analysis of fiscal law issues involving the Universal Service Fund.)

Status of funds as appropriated funds. In assessing the financial statement reporting requirements for FCC components in 2000, FCC concluded that the Universal Service Fund constitutes a permanent indefinite appropriation (i.e., funding appropriated or authorized by law to be collected and available for specified purposes without further congressional action). We agree with FCC's conclusion. Typically, Congress will use language of appropriation, such as that found in annual appropriations acts, to identify a fund or account as an appropriation and to authorize an agency to enter into obligations and make disbursements out of available funds. Congress, however, appropriates funds in a variety of ways other than in regular appropriations acts. Thus, a statute that contains a specific direction to pay and a designation of funds to be used constitutes an appropriation.²⁵ In these statutes, Congress (1) authorizes the collection of fees and their deposit into a particular fund, and (2) makes

²⁵63 Comp. Gen. 331 (1984); 13 Comp. Gen. 77 (1933).

the fund available for expenditure for a specified purpose without further action by Congress. This authority to obligate or expend collections without further congressional action constitutes a continuing appropriation or a permanent appropriation of the collections.²⁶ Because the Universal Service Fund's current authority stems from a statutorily authorized collection of fees from telecommunications carriers and the expenditure of those fees for a specified purpose (that is, the various types of universal service), it meets both elements of the definition of a permanent appropriation.

Decision regarding the Antideficiency Act. As noted above, in October 2003, FCC ordered USAC to prepare financial statements for the Universal Service Fund, as a component of FCC, consistent with GovGAAP, which FCC and USAC had not previously applied to the fund. In February 2004, staff from USAC realized during contractor-provided training on GovGAAP procedures that the commitment letters sent to beneficiaries (notifying them whether or not their funding is approved and in what amount) might be viewed as "obligations" of appropriated funds.²⁷ If so, and if FCC also found the Antideficiency Act—which does not allow an agency or program to make obligations in excess of available budgetary resources—to be applicable to the E-rate program, then USAC would need to dramatically increase the program's cash-on-hand and lessen the program's investments²⁸ to provide budgetary authority sufficient to satisfy the Antideficiency Act. As a result, USAC suspended funding commitments in August 2004 while waiting for a commission decision on how to proceed. At the end of September 2004—facing the end of the fiscal year—FCC decided that commitment letters were obligations, that the Antideficiency Act did apply to the program, and that USAC would need to immediately liquidate some of its investments to come into compliance with the Antideficiency Act. According to USAC officials, the liquidations cost the

²⁶*E.g., United Biscuit Co. v. Wirtz*, 359 F.2d 206, 212 (D.C. Cir. 1965), cert. denied, 384 U.S. 971 (1966); 69 Comp. Gen. 260, 262 (1990); 73 Comp. Gen. 321 (1994).

²⁷An "obligation" is an action that creates a legal liability or definite commitment on the part of the government to make a disbursement at some later date.

²⁸According to USAC, the Universal Service Fund was invested in a variety of securities, including cash and cash equivalents, government and government-backed securities, and high-grade commercial paper. USAC generally did not seek the approval of the commission on particular investments, although investments were made with FCC knowledge and oversight through formal audits and informal meetings and review.

fund approximately \$4.6 million in immediate losses and could potentially result in millions in foregone annual interest income.

FCC was slow to recognize and address the issue of the applicability of the Antideficiency Act, resulting in the abrupt decision to suspend funding commitment decision letters and liquidate investments. In response to these events, in December 2004, Congress passed a bill granting the Universal Service Fund a one-year exemption from the Antideficiency Act.²⁹ Nevertheless, FCC's conclusion on this issue was correct: Absent a statutory exemption, the Universal Service Fund is subject to the Antideficiency Act, and its funding commitment decision letters constitute obligations for purposes of the act.

The Antideficiency Act applies to “official[s] or employee[s] of the United States Government . . . mak[ing] or authorizing an expenditure or obligation . . . from an appropriation or fund.” 31 U.S.C. § 1341(a). As discussed above, the Universal Service Fund is an “appropriation or fund.” Even though USAC—a private entity whose employees are not federal officers or employees—is the administrator of the program and the entity that obligates and disburses money from the fund, application of the act is not negated. This is because, as recognized by FCC, it, and not USAC, is the entity that is legally responsible for the management and oversight of the E-rate program and because FCC's employees are federal officers and employees of the United States subject to the Antideficiency Act. Thus, the Universal Service Fund will again be subject to the Antideficiency Act when the one-year statutory exemption expires, unless action is taken to extend or make permanent the exemption.

An important issue that arises from the application of the Antideficiency Act to the Universal Service Fund is what actions constitute obligations chargeable against the fund. Under the Antideficiency Act, an agency may not incur an obligation in excess of the amount available to it in an appropriation or fund. Thus, proper recording of obligations with respect to the timing and amount of such obligations permits compliance with the Antideficiency Act by ensuring that agencies have adequate budget authority to cover all of their obligations. Our decisions have defined an “obligation” as a commitment creating a legal liability of the government,

²⁹Universal Service Antideficiency Temporary Suspension Act, Pub. L. No. 108-494, § 302, 118 Stat. 3986 (2004). The law exempts universal service monies from the Antideficiency Act until December 31, 2005.

including a “legal duty . . . which could mature into a liability by virtue of actions on the part of the other party beyond the control of the United States. . . .”³⁰

With respect to the Universal Service Fund, the funding commitment decision letter provides the school or library with the authority to obtain services from a provider with the commitment that the school or library will receive a discount and the service provider will be paid for the discounted portion with E-rate funding. Although the school or library could decide not to seek the services or the discount, so long as the funding commitment decision letter remains valid and outstanding, USAC and FCC no longer control the Universal Service Fund’s liability; it is dependent on the actions taken by the school or library. Consequently, we agree with FCC that a recordable obligation is incurred at the time of issuance of the funding commitment decision letter indicating approval of the applicant’s discount.

While we agree with FCC’s determinations that the Universal Service Fund is a permanent appropriation subject to the Antideficiency Act and that its funding commitment decision letters constitute recordable obligations of the Universal Service Fund, there are several significant fiscal law issues that remain unresolved. We believe that where FCC has determined that fiscal controls and policies do not apply, the commission should reconsider these determinations in light of the status of universal service monies as federal funds. For example, in view of its determination that the fund constitutes an appropriation, FCC needs to reconsider the applicability of the Miscellaneous Receipts Statute, 31 U.S.C. § 3302, which requires that money received for the use of the United States be deposited in the Treasury unless otherwise authorized by law.³¹ FCC also needs to assess

³⁰See B-300480, April 9, 2003.

³¹Because OMB and FCC had believed the funds were not public monies “for the use of the United States” under the Miscellaneous Receipts Statute, neither OMB nor FCC viewed the Universal Service Fund as subject to that statute.

the applicability of other fiscal control and accountability statutes (e.g., the Single Audit Act and the Cash Management Improvement Act).³²

Another major issue that remains to be resolved involves the extent to which FCC has delegated some functions for the E-rate program to USAC. For example, are the disbursement policies and practices for the E-rate program consistent with statutory and regulatory requirements for the disbursement of public funds?³³ Are some of the functions carried out by USAC, even though they have been characterized as administrative or ministerial, arguably inherently governmental activities³⁴ that must be performed by government personnel? Resolving these issues in a comprehensive fashion, rather than continuing to rely on reactive, case-by-case determinations, is key to ensuring that FCC establishes the proper foundation of government accountability standards and safeguards for the E-rate program and the Universal Service Fund.

³²For example, in October 2003, when the FCC ordered USAC to comply with GovGAAP, it noted that the Universal Service Fund was subject to the Debt Collection Improvement Act of 1996. In that same order, FCC stated that “the funds *may* be subject to a number of federal financial and reporting statutes” (emphasis added) and “relevant portions of the Federal Financial Management Improvement Act of 1996,” but did not specify which specific statutes or the relevant portions or further analyze their applicability. FCC officials also told us that they were uncertain whether procurement requirements such as the Federal Acquisition Regulation (FAR) applied to arrangements between FCC and USAC, but they recommended that those requirements be followed as a matter of policy.

³³See 31 U.S.C. §§ 3321, 3322, 3325, and the Treasury Financial Manual.

³⁴See OMB Circular A-76, May 29, 2003, which defines an inherently governmental activity as requiring “the exercise of substantial discretion in applying government authority and/or in making decisions for the government.” OMB Cir. A-76, Attachment A. Inherently governmental activities include the establishment of procedures and processes related to the oversight of monetary transactions or entitlements. OMB Circular A-76 further states that “[e]xerting ultimate control over the acquisition, use or disposition of United States government property . . . including establishing policies or procedures for the collection, control, or disbursement of appropriated and other federal funds” involves an inherently governmental activity.

FCC Did Not Develop Useful Performance Goals and Measures for Assessing and Managing the E-Rate Program

Although \$13 billion in E-rate funding has been committed to beneficiaries during the past 7 years, FCC did not develop useful performance goals and measures to assess the specific impact of these funds on schools' and libraries' Internet access and to improve the management of the program, despite a recommendation by us in 1998 to do so. At the time of our current review, FCC staff was considering, but had not yet finalized, new E-rate goals and measures in response to OMB's concerns about this deficiency in a 2003 OMB assessment of the program.

FCC's Performance Goals and Measures Were Not Useful in Assessing the Impact of E-Rate Funds

One of the management tasks facing FCC is to establish strategic goals for the E-rate program, as well as annual goals linked to them. The Telecommunications Act of 1996 did not include specific goals for supporting schools and libraries, but instead used general language directing FCC to establish competitively neutral rules for enhancing access to advanced telecommunications and information services for all public and nonprofit private elementary and secondary school classrooms and libraries.³⁵ As the agency accountable for the E-rate program, FCC is responsible under the Government Performance and Results Act of 1993 (Results Act) for establishing the program's long-term strategic goals and annual goals, measuring its own performance in meeting these goals, and reporting publicly on how well it is doing.³⁶

³⁵47 U.S.C. § 254(h)(2)(A).

³⁶For additional details on the Results Act and its requirements, see GAO, *Executive Guide: Effectively Implementing the Government Performance and Results Act*, GAO/GGD-96-118 (Washington, D.C.: June 1996).

In testimony before the Senate Committee on Commerce, Science, and Transportation in July 1998, we stated that the E-rate program was beginning its first funding year without clear and specific goals and measures. FCC simply noted in its 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.” This type of general statement, with no specific goals and measures for agency accountability, is not in accord with the Results Act. We recommended in our testimony that FCC develop specific E-rate goals and measures before the end of fiscal year 1998, in time to gauge the effect of the program’s first year of operations.³⁷ As we stated at that time, performance measurement is critical to determining a program’s progress in meeting its intended outcomes. Without clearly articulated goals and reliable performance data, Congress, FCC, and USAC would have a difficult time assessing the effectiveness of the program and determining whether operational changes were needed. Although FCC responded that our recommendation was “reasonable,” we noted in our subsequent March 1999 report on the program that FCC had not acted on our recommendation and again stressed the importance of implementing it.³⁸ FCC began including specific E-rate goals and measures in its fiscal year 2000 budget estimate submission to Congress and continued to set annual E-rate goals for fiscal years 2001 and 2002. No annual goals for fiscal years 2003 or 2004 were included in FCC’s performance reports, however.³⁹

The goals and measures that FCC set for fiscal years 2000 through 2002 were not useful in assessing the impact of E-rate program funding. The goals focused on achieving certain percentage levels of Internet connectivity during a given fiscal year for schools, public school

³⁷See GAO, *Schools and Libraries Corporation: Actions Needed to Strengthen Program Integrity Operations before Committing Funds*, [GAO/T-RCED-98-243](#) (Washington, D.C.: July 16, 1998).

³⁸See GAO, *Schools and Libraries Program: Actions Taken to Improve Operational Procedures Prior to Committing Funds*, [GAO/RCED-99-51](#) (Washington, D.C.: Mar. 5, 1999).

³⁹FCC’s fiscal year 2003 budget estimate to Congress (dated February 2002) and its 2001 annual performance report (dated March 2002) included E-rate goals for fiscal year 2003 of connecting 100 percent of public school instructional classrooms and 85 percent of private school instructional classrooms to the Internet. However, these goals for fiscal year 2003 were dropped from subsequent budget submissions and annual performance reports. FCC’s last connectivity goal to be carried forward into subsequent budget submissions and annual performance reports—that 93 percent of public school instructional classrooms have Internet access—was for fiscal year 2002.

instructional classrooms, and libraries. For example, FCC set a fiscal year 2001 goal of having 90 percent of public school instructional classrooms connected to the Internet. FCC measured its performance in meeting these goals using nationwide survey data from the Department of Education's National Center for Education Statistics (NCES) on the percentages of public schools and public school instructional classrooms that are connected to the Internet. The percentages are based on a nationally representative sample of approximately 1,000 public schools that are surveyed about Internet access and Internet-related topics. A fundamental problem with using these NCES percentages is that a nationally representative sample covers both public schools that received E-rate funding for internal connections and those that did not. The percentages, therefore, do not directly measure the impact of E-rate funds, as opposed to other sources of funding, on increases in the percentage of schools connected to the Internet. This is a significant problem because the applicants' requests for E-rate funds for internal connections have exceeded the amounts available for that purpose by billions of dollars. As a result, while E-rate funds for internal connections have been provided on a priority basis to applicants eligible for very high discounts (generally 70 percent to 80 percent or higher), funding has typically not been available to meet the internal connections requests of the other applicants. Only in the second funding year (1999) were funds sufficient to cover eligible internal connections requests for applicants in all of the discount bands. The applicants who were denied E-rate support for internal connections have had to rely on other funding sources for their internal connections needs, such as state and local government.

Even with these E-rate funding limitations, there has been significant growth in Internet access for public schools since the program issued its first funding commitments in late 1998. At the time, according to NCES data, 89 percent of all public schools and 51 percent of public school instructional classrooms already had Internet access. By 2002, 99 percent of public schools and 92 percent of public school instructional classrooms had Internet access.⁴⁰ Yet although billions of dollars in E-rate funds have been committed since 1998, adequate program data was not developed to answer a fundamental performance question: How much of the increase since 1998 in public schools' Internet access has been a result of the E-rate

⁴⁰See NCES, *Internet Access in U.S. Public Schools and Classrooms: 1994-2002*, NCES-2004-011 (Washington, D.C.; October 2003). This was the most recent update available at the time of our review.

program, as opposed to other sources of federal, state, local, and private funding?

Another problem is that FCC did not consistently set annual goals for the two other major groups of E-rate beneficiaries—libraries and private schools. For example, FCC’s budget submission to Congress in February 2000 included a fiscal year 2001 goal of having 90 percent of libraries connected to the Internet. But this goal was dropped from FCC’s subsequent performance reports and budget estimate submissions, and no other library connectivity goal was set. As for private schools, no specific Internet connectivity goal was set for them until early 2002, when FCC included a fiscal year 2003 goal of having 85 percent of private school instructional classrooms connected to the Internet in both its fiscal year 2003 budget estimate to Congress (dated February 2002) and its 2001 annual performance report (dated March 2002). But these were the only instances where this goal appeared. It was dropped from FCC’s subsequent budget estimate submissions and annual performance reports. In addition to these goal-setting shortcomings, no performance measurement data for either libraries’ or private schools’ Internet connectivity levels have been included in any of FCC’s annual budget estimate submissions or performance reports.

The failure to measure the program’s impact on public and private schools and libraries over the past 7 years undercuts one of the fundamental purposes the Results Act: to have federal agencies adopt a fact-based, businesslike framework for program management and accountability. The problem is not just a lack of data for accurately characterizing program results in terms of increasing Internet access. Other basic questions about the E-rate program also become more difficult to address, such as the program’s efficiency and cost-effectiveness in supporting the telecommunications needs of schools and libraries.

E-Rate Management Improvement Goals Not Featured in FCC Performance Plans

Performance goals and measures are used not only to assess a program’s impact, but also to develop strategies for resolving mission-critical management problems.⁴¹ Under the Results Act, managers should use performance data to identify performance gaps and determine where to target their resources to improve overall mission accomplishment.

⁴¹See, GAO, *Agency Performance Plans: Examples of Practices That Can Improve Usefulness to Decisionmakers*, GAO/GGD/AIMD-99-69 (Washington, D.C.: Feb. 26, 1999).

However, management-oriented goals have not been a feature of FCC's performance plans, despite long-standing concerns about the program's effectiveness in key areas. For example, E-rate applicants' technology needs are posted on USAC's Web site to allow service providers an opportunity to bid on them. FCC has maintained that absent competitive bidding, the prices charged by service providers could be needlessly high, unnecessarily depleting the program's funds and limiting its ability to support other applicants. In the commission's fiscal year 2000 budget estimate submission, FCC included a goal for ensuring that the program's competitive bidding process led to bids by two or more service providers for the majority of applicants. However, this goal was dropped from FCC's subsequent budget submissions and annual performance reports. No other goal was developed in its place to assess how well the competitive bidding process is working.

In another example, FCC found that the E-rate participation rates for urban low-income school districts and rural school districts fell below the average participation rate for all eligible schools. In preparing our December 2000 report on the E-rate program, FCC officials told us they had finalized a new performance plan for the E-rate program that included tactical goals targeted at increasing participation by both of these groups, as well as rural libraries and libraries serving small areas.⁴² During our current review, when we asked FCC officials about the plan, we were told that it had not been implemented and that none of the FCC staff currently working on E-rate was familiar with the plan.

⁴²See GAO, *Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening*, [GAO-01-105](#) (Washington, D.C.: Dec. 15, 2000).

Another ongoing program management issue is that a significant amount of funds committed annually go unused by the applicants that requested them. This is troubling because, as noted earlier, the demand for funding is high and there is typically not enough money each year to meet all funding requests for internal connections. In December 2000, we recommended that FCC ascertain and address the difficulties that applicants may be having in this regard. FCC responded that it would undertake an analysis, with USAC, of the factors leading to funds being committed to applicants but not used; and USAC responded that it would develop and pursue options for narrowing the gap between commitments and disbursements, and discuss the options with FCC. Here again was an opportunity to develop a performance goal and measure to address this program management problem, but none was developed.⁴³ Similarly, no performance goals and measures have been included in FCC's performance reports related to the management responsibility of identifying and mitigating fraud, waste, and abuse of program funds.

FCC Is Currently Considering E-Rate Goals in Response to OMB's Concerns

OMB also has raised concerns about FCC's lack of E-rate performance goals and measures. In its 2003 assessment of the E-rate program, OMB, using its Program Assessment Rating Tool (PART), noted that FCC discontinued specific E-rate program measures after fiscal year 2002.⁴⁴ OMB's overall PART rating for the E-rate program was "results not demonstrated." This does not necessarily mean that the program is ineffective, but rather that its effectiveness is unknown.⁴⁵ OMB observed

⁴³See GAO, *Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening*, GAO-01-105 (Washington, D.C.: Dec. 15, 2000). FCC now allows unused E-rate funds to be carried over into a subsequent funding year. For example, in June 2004, FCC announced that \$150 million in unused funds would be carried forward from funding year 2001 to increase funds for funding year 2004 in excess of the annual cap. However, neither FCC nor USAC have dealt with identifying the underlying causes of why millions of dollars in committed funds go unused and determining whether changes in program rules and procedures are needed to address difficulties that applicants may be having in using the funds committed to them.

⁴⁴OMB developed PART as a diagnostic tool to provide a consistent approach to evaluating federal programs as part of the executive budget formulation process. The goal of PART is to evaluate program performance, determine the causes for strong or weak performance, and take action to remedy deficiencies and achieve better results. OMB chose to review the E-rate program because of the large amount of dollars involved.

⁴⁵For a discussion of the PART assessment process, see GAO, *Performance Budgeting: Observations on the Use of OMB's Program Assessment Rating Tool for Fiscal Year 2004 Budget*, GAO-04-174 (Washington, D.C.: Jan. 30, 2004).

that the program lacked long-term, outcome-oriented performance goals and efficiency measures against which to measure the program's success in promoting connectivity and to improve and refine the program going forward. Because of this, OMB stated that it is not clear what the end goal of the E-rate program is or how to measure its effectiveness other than incremental increases in the number of classrooms and libraries connected to the Internet. While recognizing that E-rate funding is generally going to the intended beneficiaries of the program, OMB concluded that there was no way to tell whether the program has resulted in cost-effective deployment and use of advanced telecommunications services for schools and libraries. OMB also noted that there was little oversight to ensure that the program beneficiaries were using the funding appropriately and effectively. Among other things, OMB's report recommended that for fiscal year 2005, FCC should develop a long-term outcome goal for the program, and consider reinstating a connectivity measure and developing an efficiency measure.

FCC officials told us they have been working with OMB to respond to the concerns raised in its PART assessment and that several FCC staff have recently received training in the development of performance measures. At the time of our review, FCC was considering goals that involve classroom connectivity and program efficiency. As we discussed earlier, any meaningful goals on connectivity would need to have associated measurement data that could isolate the impact of E-rate funding on changes in connectivity in order to assess the program's impact. It should be noted that with 99 percent of public schools and 92 percent of public school instructional classrooms connected to the Internet in 2002 (according to the most current NCEs report on public school connectivity at the time of our review), applicants are moving past achieving initial connectivity to maintaining and upgrading existing connections over the long term. As a result, simple measures of Internet connectivity will be much less useful indicators of the program's performance than in past years.

As for the program's efficiency in providing support for telecommunications services, FCC staff told us they are considering a measure that would calculate and track the E-rate disbursements for each school (or school system) divided by the number of students, further broken down by the eligible services categories. An efficiency measure would be valuable, as there has been a long-standing concern about some applicants requesting funding for technology that greatly exceeds their needs (sometimes referred to as "goldplating"). While "E-rate dollars-per-student" ratios might be interesting data to assess in this regard, a performance measure needs to have a goal associated with it in order to be a meaningful tool for performance management. Currently, the program rules do not expressly establish a clear test for cost-effectiveness that could be used as a measurable goal, although in late 2003, FCC asked for comment on whether it would be beneficial or administratively feasible to develop such a test.⁴⁶ At the time we concluded our review, FCC planned to finalize performance measures for the E-rate program and seek OMB approval in fiscal year 2005.

As noted above, OMB's PART assessment recommended that FCC develop a long-term outcome goal for the program. "Outcomes" are the results or benefits of the products or services provided by the program. A basic policy issue associated with the E-rate program involves assessing the extent to which the billions of dollars of support for telecommunications services are providing the sought-after return on investment: improvement in the quality of education. As we noted in our 2000 report on the program, the complex issue of measuring educational outcomes lies outside FCC's expertise and comes under the purview of the Department of Education.⁴⁷ FCC officials told us they have made initial contact with staff at the Department of Education to discuss the development of a long-term E-rate outcome measure. According to FCC's current timetable, the collection and analysis of data for outcome measures would start with funding year 2006.

⁴⁶See FCC, *Third Report and Order and Second Further Notice of Proposed Rulemaking*, FCC 03-323 (Washington, D.C.; Dec. 23, 2003), paragraph 87.

⁴⁷See GAO, *Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening*, [GAO-01-105](#) (Washington, D.C.: Dec. 15, 2000).

FCC's Oversight Mechanisms Are Not Fully Effective in Managing the E-Rate Program

FCC testified before Congress in June 2004 that it relies on three chief components in overseeing the E-rate program: rulemaking proceedings, beneficiary audits, and fact-specific adjudicatory decisions (i.e., appeals decisions). We found weaknesses with FCC's implementation of each of these mechanisms, limiting the effectiveness of FCC's oversight of the program and the enforcement of program procedures to guard against waste, fraud, and abuse of E-rate funding.

FCC's Rulemakings Have Led to Problems with USAC's Procedures and Enforcement of Those Procedures

As part of its oversight of the E-rate program, FCC is responsible for establishing new rules and policies for the program and making changes to existing rules, as well as for providing the detailed guidance that USAC requires to effectively administer the program. FCC carries out this responsibility through its rulemaking process. FCC's E-rate rulemakings, however, have often been broadly worded and lacking specificity. Thus, USAC has needed to craft the more detailed administrative procedures necessary to implement the rules. However, in crafting administrative procedures, USAC is strictly prohibited under FCC rules from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. We were told by FCC and USAC officials that USAC does not put procedures in place without some level of FCC approval. We were told that this approval is sometimes informal, such as e-mail exchanges or telephone conversations between FCC and USAC staff. This approval can come in more formal ways as well, such as when the commission expressly endorses USAC operating procedures in commission orders or codifies USAC procedures into FCC's rules.

However, two problems have arisen with USAC administrative procedures. First, although USAC is prohibited from making policy, some USAC procedures arguably rise to the level of policy decisions. Second, even though USAC procedures are issued with some degree of FCC approval, enforcement problems could arise when audits uncover violations of USAC procedures by beneficiaries or service providers. The FCC IG has expressed concern over situations where USAC administrative procedures have not been formally codified because commission staff have stated that, in such situations, there is generally no legal basis to recover funds from applicants that failed to comply with the USAC administrative procedures.

Throughout the history of the program, USAC has found it necessary to create additional procedures to effectively and efficiently process more than 40,000 applications annually. However, these procedures sometimes

deal with more than just ministerial details. For example, procedures that affect funding decisions arguably rise to the level of policy decisions. In June 2004, USAC was able to identify at least a dozen administrative procedures that, if violated by the applicant, would lead to complete or partial denial of the funding request even though there was no precisely corresponding FCC rule. The FCC IG stated in May 2004 in his Semiannual Report to Congress that he believes the distinction between FCC rules and USAC administrative procedures represents a weakness in program design, fails to give program participants a clear understanding of the rules and the consequences associated with rule violations, and complicates the design and implementation of effective program oversight.

The critical nature of USAC's administrative procedures is further illustrated by FCC's repeated codification of them throughout the history of the program. For example, in 1999, USAC implemented a procedure known as "the 30-percent policy."⁴⁸ This procedure sought to avoid blanket denials of funding requests because of minor errors in the eligibility of the services requested, while at the same time prompting applicants to prepare their applications carefully and make a conscientious effort to exclude ineligible items. If more than 30 percent of the services for which discounts were requested were ineligible, USAC denied the funding request rather than undertake the administratively burdensome task of correcting the request and refiguring the amount based only on the eligible services requested. In April 2003, in the commission's Second Report and Order in its E-rate docket, FCC codified USAC's 30-percent policy, stating that the commission found the procedure "improves program operation and is important in reducing the administrative costs of the program."⁴⁹ In fact, the procedures put in place by USAC generally appear to be sensible and represent thoughtful administration of the E-rate program. Nonetheless, USAC is prohibited from making program rules. FCC's codification of USAC procedures—after those procedures have been put in place and applied to program participants—raises concerns about whether these

⁴⁸Although FCC rules prohibit USAC from making policy, even the commission referred to USAC's procedure as the 30-percent "policy." According to a USAC official, USAC originally thought that it had to deny any application that contained a request for an ineligible service or item. To avoid this, USAC suggested a 10-percent threshold. During 1998, FCC staff suggested that the threshold be set at 50 percent. In 1999, the threshold was changed to 30 percent and later codified at that level.

⁴⁹FCC, *Second Report and Order and Further Notice of Proposed Rulemaking, In the Matter of Schools and Libraries Universal Service Support Mechanism*, FCC 03-101 (Washington, D.C.; Apr. 30, 2003), paragraph 40.

procedures are more than ministerial and are, in fact, policy changes that should be coming from FCC in the first place. Moreover, in its August 2004 order (in a section dealing with the resolution of audit findings), the commission directs USAC to annually “identify any USAC administrative procedures that should be codified in our rules to facilitate program oversight.”⁵⁰ This process begs the question of which entity is really establishing the rules of the E-rate program and raises concerns about the depth of involvement by FCC staff with the management of the program.

The other problem with USAC administrative procedures is the question of enforcement of those procedures through recovery of funds for procedural violations. FCC has generally held that funds can be recovered from a beneficiary or service provider only if an FCC rule was violated. In its August 2004 order, after several years of E-rate audits by USAC and the FCC IG, the commission attempted to clarify the rules of the program with relation to recovery of funds. In the order, the commission describes nine overall categories of statutory violations or FCC rule violations that would result in fund recovery being sought, in whole or in part, from beneficiaries or service providers. With respect to violations of USAC operating procedures, FCC said in its August 2004 order that it intends to evaluate whether there are USAC procedures that should be codified into the commission’s rules and whether violation of any of these codified procedures should also be a basis for recovery of funding.⁵¹ The commission noted that recovery of funds may not be appropriate for violations of procedural rules codified to enhance operations. Nevertheless, the commission stated that applicants will be required to comply with procedural rules and that applications that do not comply will be rejected. The commission noted, however, that if the codified procedural rule violation “is inadvertently overlooked during the application phase and funds are disbursed, the commission will not require that they be recovered, except to the extent that such rules are essential to

⁵⁰FCC, *Fifth Report and Order, In the Matter of Schools and Libraries Universal Service Support Mechanism*, FCC-04-190 (Washington, D.C.; Aug. 13, 2004), paragraph 78.

⁵¹In its August 2004 E-rate order, FCC directed USAC to submit to the commission a list summarizing all current USAC administrative procedures identifying, where appropriate, the specific rules or statutory requirements that such procedures further, and those procedures that serve to protect against waste, fraud, and abuse (FCC 04-190 at paragraph 80). On October 29, 2004, USAC submitted to FCC a 52-page document listing the USAC procedures that were currently used in making E-rate funding decisions, but that were not explicitly stated in a commission rule. Under the August 2004 FCC order, USAC is to produce such a document annually.

the financial integrity of the program, as designated by the agency, or that circumstances suggest the possibility of waste, fraud, or abuse, which will be evaluated on a case-by-case basis.”⁵²

Thus, even under the August 2004 FCC order, the commission did not clearly address the treatment of beneficiaries who violate a USAC administrative procedure that has not been codified. This creates a potentially unfair situation when the procedure is one that can lead to denial of an application. That is, if violation of the procedure is caught in the application process, funding will be denied. However, if the violation slips by in the application process, funding is granted, and the violation is later caught during a beneficiary audit, no recovery of funding can be attempted since there was no actual rule violation by the beneficiary. Also, as noted earlier, the FCC order also leaves to USAC the initial determination of which procedures should be codified rather than having FCC make that determination. Lastly, FCC did not establish a time frame for its review of USAC procedures.

FCC Has Been Slow to Address Problems Raised by Audit Findings

FCC’s use of beneficiary audits as an oversight mechanism has also had weaknesses, although FCC and USAC are now working to address some of these weaknesses. In December 2000, we recommended that USAC establish a quality assurance function responsible for ensuring that its funding decisions adhere to FCC’s program eligibility rules.⁵³ In response to our recommendation, USAC increased both its in-house audit staff and the number of beneficiary audits conducted by outside accounting firms.⁵⁴ Since 2000, there have been 122 beneficiary audits conducted by outside

⁵²FCC 04-190, paragraph 19. The commission’s actual sentence only referred to “the procedural violation,” but read in the context of the entire paragraph, the commission appears to be discussing procedures that have been codified into its rules.

⁵³See [GAO-01-105](#), 37.

⁵⁴USAC also maintains a whistleblower hotline to provide the public with a means of reporting activities that may violate E-rate program rules. USAC’s Special Investigations Team investigates every call to determine if further action is required. Since 2001, USAC has received and followed up on over 100 calls per year. In addition to the whistleblower hotline, USAC, with support from FCC, created in May 2003 a 14-member Task Force on the Prevention of Waste, Fraud and Abuse to share their perspectives on where the program could be susceptible to waste, fraud, and abuse and what specific steps could be taken to address those areas. The task force released its report on September 22, 2003. Most of the task force’s recommendations have been implemented or are under consideration by USAC or FCC.

firms, 57 by USAC staff, and 14 by the FCC IG (2 of which were performed under agreement with the Inspector General of the Department of the Interior).

Beneficiary audits are the most robust mechanism available to the commission in the oversight of the E-rate program, yet FCC generally has been slow to respond to audit findings and has not made full use of the audit findings as a means to understand and resolve problems within the program. First, audit findings can indicate that a beneficiary or service provider has violated existing E-rate program rules. In these cases, USAC or FCC can seek recovery of E-rate funds, if justified.⁵⁵ In the FCC IG's May 2004 Semiannual Report, however, the IG observes that audit findings are not being addressed in a timely manner and that, as a result, timely action is not being taken to recover inappropriately disbursed funds. The IG notes that in some cases the delay is caused by USAC and, in other cases, the delay is caused because USAC is not receiving timely guidance from the commission (USAC must seek guidance from the commission when an audit finding is not a clear violation of an FCC rule or when policy questions are raised). Regardless, the recovery of inappropriately disbursed funds is important to the integrity of the program and needs to occur in a timely fashion.

Second, under GAO's *Standards for Internal Controls in the Federal Government*,⁵⁶ agencies are responsible for promptly reviewing and evaluating findings from audits, including taking action to correct a deficiency or taking advantage of the opportunity for improvement. Thus, if an audit shows a problem but no actual rule violation, FCC should be examining why the problem arose and determining if a rule change is needed to address the problem (or perhaps simply addressing the problem through a clarification to applicant instructions or forms). FCC has been slow, however, to use audit findings to make programmatic changes. For example, table 2 below shows audit findings from the 1998 program year that were only recently resolved by FCC's August 2004 rulemaking.

⁵⁵USAC, through its duties as administrator of the fund, initially seeks recovery of erroneously disbursed funds. In addition, the commission adopted rules in April 2003 to provide for suspension and debarment from the program for persons convicted of criminal violations or held civilly liable for certain acts arising from their E-rate participation. Debarments would be for a period of three years unless circumstances warrant a longer debarment period in order to protect the public interest.

⁵⁶[GAO/AIMD-00-21.3.1](#)

Table 2: Examples of E-Rate Beneficiary Audit Findings from Program Year 1998, Resolved in 2004

Issue	Types of audit findings included in beneficiary audits
Record retention—competitive bidding	Copies of contracts could not be provided upon request. In addition, evidence could not be provided of compliance with competitive bidding requirements.
Services provided within funding year	Services delivered after the last date to receive services.
Record retention—equipment and services	E-rate equipment could not be identified because fixed asset details were insufficient to identify specific equipment.
Technology plans	Beneficiary was not monitoring its technology plan implementation.

Source: GAO analysis of USAC audit reports.

As table 2 illustrates, audit findings related to the lack of record retention by beneficiaries were a problem. Given that the E-rate program operates similarly in some ways to a grant program, FCC should have had in place a record retention policy at the start of the program as a basic accountability measure since record retention is fundamental to an audit trail. In fact, early in the program, FCC did create rules on beneficiary and service provider document retention, but the rules contained a potentially enormous loophole. Under FCC’s rules, program participants were required only to maintain “the kind of procurement records that they maintain for other purchases.”⁵⁷ Thus, if a school or library had no record retention policy for other purchases, they did not need to retain records related to E-rate purchases. FCC proposed a more comprehensive record retention policy in December 2003 and released it for comment. In August 2004—7 years into the existence of the E-rate program—FCC adopted record retention rules that call for beneficiaries and service providers to retain E-rate program-related records for at least five years.

⁵⁷At the same time, however, applicants had to certify on FCC Form 471 that they would retain for 5 years any and all worksheets and other records that they relied upon to fill out their applications and, if audited, would make such records available to USAC. We were told by FCC that the form does not carry the force of a rule.

In its August 2004 order, the commission concluded that a standardized, uniform process for resolving audit findings was necessary, and directed USAC to submit to FCC a proposal for resolving audit findings. FCC also instructed USAC to specify deadlines in its proposal “to ensure audit findings are resolved in a timely manner.”⁵⁸ USAC submitted its Proposed Audit Resolution Plan to FCC on October 28, 2004. The plan memorializes much of the current audit process and provides deadlines for the various stages of the audit process. FCC released the proposed audit plan for public comment in December 2004.⁵⁹

In addition to the Proposed Audit Resolution Plan, the commission instructed USAC to submit a report to FCC on a semiannual basis summarizing the status of all outstanding audit findings. The commission also stated that it expects USAC to identify for commission consideration on at least an annual basis all audit findings raising management concerns that are not addressed by existing FCC rules. Lastly, the commission took the unusual step of providing a limited delegation to the Wireline Competition Bureau (the bureau within FCC with the greatest share of the responsibility for managing the E-rate program) to address audit findings and to act on requests for waivers of rules warranting recovery of funds.⁶⁰ These actions could help ensure, on a prospective basis, that audit findings are more thoroughly and quickly addressed. However, much still depends on timely action being taken by FCC, particularly if audit findings suggest the need for a rulemaking.

⁵⁸FCC 04-190, paragraph 74.

⁵⁹Comments were due January 5, 2005; reply comments were due January 20, 2005.

⁶⁰FCC 04-190, paragraph 75.

In addition to problems with responding to audit findings, the audits conducted to date have been of limited use because neither FCC nor USAC have conducted an audit using a statistical approach that would allow them to project the audit results to all E-rate beneficiaries. Thus, at present, no one involved with the E-rate program has a basis for making a definitive statement about the amount of waste, fraud, and abuse in the program.⁶¹ Of the various groups of beneficiary audits conducted to date, all were of insufficient size and design to analyze the amount of fraud or waste in the program or the number of times that any particular problem might be occurring programwide. FCC's IG and USAC are currently working to address this problem by following OMB's guidance on the Improper Payments Information Act of 2002 (IPIA). IPIA requires that agencies annually estimate the amount of improper payments for programs and activities susceptible to significant improper payments. In response to IPIA, FCC and USAC are currently in the process of soliciting and evaluating responses to a Request for Proposals issued to procure the services of an independent auditor to conduct approximately 250 beneficiary audits in the E-rate program.

We examined the methodology used by FCC's IG and USAC for arriving at a sample size of 250, and it appears that they properly used OMB guidance under IPIA in determining the sample size. However, because the effort is still in the beginning stages, they were not able to provide additional information on the sample design, such as the method of sample selection, stratification criteria, and estimation methods. Sample design will be critical in determining the value of the information gained from the audits. In addition, FCC IG officials estimated the cost at approximately \$50,000 per audit. With an anticipated total cost of \$12.5 million (250 audits at \$50,000 per audit), this is an expensive effort. If the cost of the 250 audits varies by the size of the grant, the sample design could be optimized based on variable cost, which may either yield a tighter precision of the estimate of the amount of improper payments or reduce the total cost of the audit. It should also be noted that because this represents a sizable increase from

⁶¹In testimony before the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce in June 2004, FCC's Inspector General submitted a prepared statement that said the "results of audits that have been performed and the allegations under investigation lead us to believe the program may be subject to unacceptably high risk of fraud, waste and abuse. . . ." At the same hearing, the Chief of FCC's Office of Strategic Planning and Policy Analysis and the Deputy Chief of FCC's Wireline Competition Bureau submitted a prepared statement saying that FCC had "enabled implementation of the [E-rate] statutory goals with a minimum of fraud, waste, and abuse."

prior audits, FCC may face an even greater challenge in resolving the audit findings in a timely manner.

Lastly, we were told by USAC officials that they have recently contracted with a consulting firm to conduct approximately 1,000 site visits a year to program beneficiaries beginning in mid-January 2005. Although these are not audits, USAC testified in June 2004 that the site visits will allow USAC to assess more fully, in real time, how E-rate funds are being used, to learn about and publicize best practices in education technology and program compliance, and to help ensure that products and services have in fact been delivered and are being used effectively. For each visit, the selected vendor will, among other things, conduct a physical inspection of equipment and services purchased with E-rate funds. A checklist, outlining the steps for review, is to be followed for each visit to ensure consistency. The deliverables will include a formal report on each beneficiary visited, a monthly report on best practices observed and outreach suggestions, and immediate notification to USAC in instances where significant noncompliance is discovered.

FCC Has Been Slow to Act on Some E-Rate Appeals

Under FCC's rules, program participants can seek review of USAC's decisions,⁶² although FCC's appeals process for the E-rate program has been slow in some cases. Because appeals decisions are used as precedent, this slowness adds uncertainty to the program and impacts beneficiaries. FCC rules state that FCC is to decide appeals within 90 days, although FCC can extend this period. There is currently a substantial appeals backlog at FCC (i.e., appeals pending for longer than 90 days). Out of 1,865 appeals to FCC from 1998 through the end of 2004, approximately 527 appeals remain undecided, of which approximately 458 (25 percent) are backlog appeals.⁶³

⁶²Virtually all of the decisions made by FCC and USAC in their management and administration of the E-rate program may be subject to petition for reconsideration or appeal by beneficiaries. Moreover, schools and libraries have the option of multiple appeal levels, including USAC, the Wireline Competition Bureau, and the commission.

⁶³The bulk of the appeals are to USAC, which received a total of 16,782 appeals from the beginning of the program through 2003. Of these, 646—roughly 4 percent—remained undecided as of September 20, 2004.

Perhaps of most concern are the subset of appeals dealing with recovery of funding erroneously committed to schools and libraries.⁶⁴ According to USAC, recovery has been slowed, in part, because FCC has not been timely in resolving these types of appeals from beneficiaries. In fact, through October 2004, of the approximately \$36 million in E-rate funding for which USAC has brought recovery actions since the beginning of the program, only \$3.2 million has been recovered and approximately \$14.4 million is tied up in appeals with FCC.⁶⁵ This is money that might be placed back into the E-rate program for disbursement to applicants.

We were told by FCC officials that some of the backlog is due to staffing issues. FCC officials said they do not have enough staff to handle appeals in a timely manner. FCC officials also noted that there has been frequent staff turnover within the E-rate program, adding some delay to appeals decisions because new staff necessarily take time to learn about the program and the issues. (See app. IV for additional information on FCC staffing levels in support of the E-rate program.) Additionally, we were told that another factor contributing to the backlog is that the appeals have become more complicated as the program has matured. For example, applicants are increasingly appealing decisions concerning eligible services. These appeals can be difficult to resolve because the technology needs of participants in the program can be complex. Lastly, some appeals may be tied up if the issue is currently in the rulemaking process.

The appeals backlog is of particular concern given that the E-rate program is a technology program. An applicant who appeals a funding denial and works through the process to achieve a reversal and funding two years later might have ultimately won funding for outdated technology.

Conclusions

FCC has not done enough to proactively manage and provide a framework of government accountability for the multibillion-dollar E-rate program. FCC established an unusual structure for the E-rate program but has never conducted a comprehensive assessment of which federal requirements,

⁶⁴When USAC finds that funds were disbursed to a beneficiary or service provider in error or that fraud, waste, or abuse has taken place, USAC must seek to recover the funds through cash payments.

⁶⁵Approximately \$8.9 million in recoveries is tied up in appeals with USAC, \$8.7 million is in various stages of the improperly dispersed funds recovery process, and \$800,000 has been referred to FCC.

policies, and practices apply to the program, to USAC, or to the Universal Service Fund. FCC has recently begun to address a few of these issues, concluding that the Universal Service Fund constitutes an appropriation and that the Fund is subject to the Antideficiency Act. Nevertheless, fundamental issues affecting the E-rate program remain to be resolved. Resolving these issues in a comprehensive fashion is key to ensuring that FCC applies the appropriate government accountability standards and safeguards to the E-rate program and to the Universal Service Fund.

In managing the program, FCC has not developed specific and meaningful goals and measures to assess the impact of E-rate funding, address mission critical management problems, and establish the direction of the program as schools and libraries move beyond initial Internet connectivity to long-term maintenance concerns. Moreover, FCC has consistently shifted many important responsibilities onto USAC, such as identifying which administrative procedures should be adopted as commission rules and handling resolutions of audit findings. Combined with the weaknesses in FCC's oversight mechanisms, these problems create barriers to enforcement, uncertainty about what the program's requirements really are, and questions about the soundness of the program's structure and accountability amid recent cases of fraud, waste, and abuse. This mixture of E-rate problems—related both to the structure of the program and to FCC's shortcomings in carrying out key E-rate management responsibilities—indicates the need for corrective actions by FCC.

Finally, regardless of the problems with the E-rate program, schools and libraries across the country use E-rate funds for their purchases of telecommunications services. Any reassessment of the program must take the needs of the beneficiaries into account. It is particularly important that efforts to protect the program from fraud, waste, and abuse do not result in a program that is excessively burdensome on program participants.

Recommendations for Executive Action

Given the critical importance of telecommunications technologies to schools and libraries, we recommend that the Chairman of the Federal Communications Commission direct FCC staff to take the following three actions:

1. Conduct and document a comprehensive assessment to determine whether all necessary government accountability requirements, policies, and practices have been applied and are fully in place to

protect the program and the funding. The assessment should include, but not be limited to

- the implications of FCC's determination that the Universal Service Fund constitutes an appropriation by identifying the fiscal controls that apply and do not apply to the Universal Service Fund, including the collection, deposit, obligation, and disbursement of funds; and
- an evaluation of the legal authority for the organizational structure for carrying out the E-rate program, including the relationship between FCC and USAC and their respective authorities and roles in implementing the E-rate program.

Because of the complexities posed by FCC's arrangements with USAC and the questions that flow from these arrangements, FCC may want to request an advance decision from the Comptroller General under 31 U.S.C. § 3529. Section 3529 provides the heads of agencies and certifying and disbursing officers of the government an opportunity to request decisions from the Comptroller General on matters of appropriations law in order to ensure compliance with fiscal law.

2. Establish performance goals and measures for the E-rate program that are consistent with the Government Performance and Results Act. FCC should use the resulting performance data to develop analyses of the actual impact of E-rate funding and to determine areas for improved program operations.
3. Develop a strategy for reducing the E-rate program's appeals backlog, including ensuring that adequate staffing resources are devoted to E-rate appeals resolution.

Agency Comments and Our Evaluation

We provided a draft of this report to FCC for review and comment. In its comments, which are reprinted in appendix V, FCC noted that it took a number of steps during 2004 to improve its management and oversight of the E-rate program. These included the adoption of new rules regarding the recovery of improperly disbursed funds; the implementation of new accounting requirements related to the Universal Service Fund; new efforts to deter waste, fraud, and abuse; and work with the FCC IG to develop a plan for conducting hundreds of additional beneficiary audits. FCC commented that it has strengthened its oversight and management of USAC through the establishment of a high-level working group to

coordinate oversight and has adopted rules codifying certain USAC procedures. FCC also noted that it is currently evaluating USAC's existing operations and administrative procedures to determine which should be codified into FCC rules.

FCC reaffirmed its belief that the current structure of USAC is consistent with congressional intent and guidance, adding that it nevertheless intends to consider whether to modify the manner in which the Universal Service Fund is administered. During the coming year, FCC anticipates examining whether and how to modify its existing administrative structure and processes as they apply to the E-rate program. FCC intends to consider other administrative structures and their implications, including those relying on contractual arrangements. Other actions under consideration include initiating a notice-and-comment rulemaking proceeding to assess the management of the E-rate program and the Universal Service Fund; retaining an outside contractor to evaluate the program and make recommendations for improving its administration; and requiring certain beneficiaries to obtain an independent audit of their compliance with FCC rules.

Regarding our recommendations, FCC officials told us they did not concur with our recommendation to conduct a comprehensive assessment concerning the applicability of government accountability requirements, policies, and practices. FCC maintains that it has conducted timely and extensive analysis of significant legal issues related to the status of the fund on a case-by-case basis, and provided examples. Although we recognize that FCC has engaged in internal deliberations and external consultations and analyses of a number of statutes, we do not believe this has been done in a timely manner or that it is appropriate to do so on a case-by-case basis. A definitive determination on the entire framework of laws that apply or do not apply to this program and to the Universal Service Fund itself would enable FCC to make proactive operational decisions on what steps it should take and what internal controls it should have in place. As noted in our report, we continue to believe that major issues remain unresolved such as defining the relationship between FCC and USAC and their respective authorities and roles in implementing the E-rate program and identifying whether other actions taken in the universal service programs constitute obligations and ensuring that those are properly recorded. FCC officials told us that they concurred with our recommendations for establishing performance goals and measures and developing a strategy for reducing the backlog of appeals, noting that the commission is already taking steps to address these recommendations.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to interested congressional committees; the Chairman, FCC; the Chief Executive Officer, USAC; and other interested parties. We also will make copies available to others upon request. In addition, this report will be available at no cost on the GAO Web site at <http://www.gao.gov>. If you have any questions about this report, please contact me at (202) 512-2834 or goldsteinm@gao.gov. Key contributors to this report are listed in appendix VI.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Mark L. Goldstein', with a long, sweeping horizontal line extending to the right.

Mark L. Goldstein
Director, Physical Infrastructure Issues

Scope and Methodology

Our objectives were to review and evaluate: (1) the effect of the current structure of the E-rate program on the Federal Communications Commission's (FCC) management of the program, (2) FCC's establishment of and use of goals and performance measures in managing the program, and (3) the effectiveness of FCC's oversight mechanisms—rulemaking proceedings, beneficiary audits, and reviews of the Universal Service Administrative Company's (USAC) decisions (appeals)—in managing the program.

To provide information on the effect of the current structure of the E-rate program, we reviewed provisions of the Telecommunications Act, as well as documents and records used by FCC to implement and administer the E-rate program. We also assessed the extent to which FCC had established managerial and financial government accountability standards, safeguards, and legal relationships for the E-rate program and the Universal Service Fund. Additionally, we interviewed officials from FCC's Wireline Competition Bureau, Office of General Counsel, Office of Managing Director, and Office of Inspector General. We also interviewed officials from the Office of Management and Budget (OMB) and USAC, the not-for-profit corporation that administers the E-rate program under FCC oversight.

To respond to the second objective on FCC's use of goals and performance measures in managing the program, we reviewed provisions of the Government Performance and Results Act of 1993, as well as documents and records used by FCC to establish goals and performance measures—budget justifications, performance plans, and strategic plans. We also reviewed OMB's Program Assessment Rating Tool that assessed FCC's performance goals and related measures for the E-rate program. In addition, we discussed this issue with officials from FCC's Wireline Competition Bureau, Office of Managing Director, Office of Strategic Planning and Policy Analysis, and Office of Inspector General. We also interviewed officials from the Office of Management and Budget and Department of Education.

Finally, to evaluate FCC's oversight mechanisms for managing the program, we reviewed relevant documents relating to all three oversight mechanisms: (1) rulemaking proceedings, (2) beneficiary audits, and (3) fact-specific adjudicatory decisions (i.e., appeals decisions). Specifically, we reviewed FCC orders and provisions of the Code of Federal Regulations, which sets forth FCC's rulemaking process. In addition, we reviewed relevant USAC documents and policies, including its procedures

that are in place to aid in the administration of the program. To assess FCC's oversight mechanism of auditing, we reviewed the FCC Inspector General's (IG) Semi-Annual Reports to Congress, GAO's *Standards for Internal Controls in the Federal Government*, recent FCC orders, and beneficiary audits used to assess program compliance. Our statistician also examined the methodology (based on interviews with and documentation provided by FCC and USAC) that the FCC IG and USAC have proposed for the next round of beneficiary audits. To gain an understanding of how FCC manages appeals, we reviewed relevant documents and gathered data from FCC and USAC regarding the number of outstanding appeals and USAC recovery actions tied up in FCC appeals.

To assess the reliability of the FCC appeals data and USAC recovery actions tied up in FCC appeals, we (1) reviewed related documentation, (2) conducted electronic testing of the source databases, and (3) interviewed knowledgeable agency officials about the quality of the data.¹ We found that one database was limited in producing reports that track historical trends. However, this limitation was minor in the context of our engagement. As a result, we determined that the data were sufficiently reliable for the purposes of this report. Finally, we discussed this issue with officials from FCC's Wireline Competition Bureau, Office of General Counsel, Office of Managing Director, Office of Inspector General, and USAC.

We also reviewed internal memorandums provided by FCC's Office of General Counsel to determine how FCC has applied federal requirements, policies, and practices to the E-rate program and to the Universal Service Fund. We interviewed FCC officials to obtain their views concerning whether monies in the Universal Service Fund should be treated as federal funds and the effect of using government accounting standards on the fund.

Funding commitments since the inception of the program, the number of USAC appeals, and USAC recoveries tied up in appeals to USAC were used only as background information in the report to provide context for our findings; therefore, the data were not verified for data reliability purposes. However, to assess the reliability of funding for which USAC has brought recovery actions, we (1) reviewed related documentation, (2) conducted electronic testing of the source databases, and (3) interviewed

¹We also cross-walked the number of FCC appeals and FCC commitment adjustment appeals back to the respective source databases.

knowledgeable agency officials about the quality of the data. As a result, we determined that the data were sufficiently reliable for the purposes of this report. We also determined that other relevant documents and records that we gathered were sufficiently reliable for the purposes of our review.

Our review was performed from December 2003 through December 2004 in accordance with generally accepted government auditing standards.

Fiscal Law Issues Involving the Universal Service Fund

There have been questions from the start of the E-rate program regarding the nature of the Universal Service Fund (USF) and the applicability of managerial, fiscal, and financial accountability requirements to USF. FCC has never clearly determined the nature of USF, and the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and GAO have at various times noted that USF has not been recognized or treated as federal funds for several purposes.¹ However, FCC has never confronted or assessed these issues in a comprehensive fashion and has only recently begun to address a few of these issues. In particular, FCC has recently concluded that as a permanent indefinite appropriation, USF is subject to the Antideficiency Act and its funding commitment decision letters constitute obligations for purposes of the Antideficiency Act. As explained below, we agree with FCC's determination. However, FCC's conclusions concerning the status of USF raise further issues related to the collection, deposit, obligation, and disbursement of those funds—issues that FCC needs to explore and resolve.

Background

Universal service has been a basic goal of telecommunications regulation since the 1950s, when FCC focused on increasing the availability of reasonably priced, basic telephone service. *See Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 405-406 (5th Cir., 1999), cert. denied sub nom; *Celpage Inc. v. FCC*, 530 U.S. 1210 (2000). FCC has not relied solely on market forces, but has used a combination of explicit and implicit subsidies to achieve this goal. *Id.* Prior to 1983, FCC used the regulation of AT&T's internal rate structure to garner funds to support universal service. With the breakup of AT&T in 1983, FCC established a Universal Service Fund administered by the National Exchange Carrier Association (NECA). NECA is an association of incumbent local telephone companies, also established at the direction of FCC. Among other things, NECA was to

¹See GAO, *Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening*, GAO-01-105, 41. FCC's IG has also raised questions regarding the nature of USF. FCC's IG first looked at USF in 1999 as part of its audit of the commission's fiscal year 1999 financial statement. During that audit, the FCC IG questioned commission staff regarding the nature of the fund and, specifically, whether USF was subject to the statutory and regulatory requirements for federal funds. In the next year's audit, the FCC IG noted that the commission could not ensure that USF activities were in compliance with all laws and regulations because the issue of which laws and regulations were applicable to USF was still unresolved at the end of the audit. In the FCC IG's reports on FCC's financial statements from fiscal years 1999 to 2003, the IG consistently recommended that FCC management formally define in writing the financial management roles and responsibilities of FCC and USAC to avoid confusion and misunderstanding.

administer universal service through interstate access tariffs and the revenue distribution process for the nation's local telephone companies. At that time, NECA, a nongovernmental entity, privately maintained the Universal Service Fund outside the U.S. Treasury.

Section 254 of the Telecommunications Act of 1996 codified the concept of universal service and expanded it to include support for acquisition by schools and libraries of telecommunications and Internet services. Pub. L. No. 104-104, § 254, 110 Stat. 56 (1996) (classified at 47 U.S.C. § 254). The act defines universal service, generally, as a level of telecommunications services that FCC establishes periodically after taking into account various considerations, including the extent to which telecommunications services are essential to education, public health, and public safety. 47 U.S.C. § 254 (c)(1). The act also requires that “every telecommunications carrier that provides interstate telecommunications services shall contribute . . . to the specific, predictable, and sufficient mechanisms” established by FCC “to preserve and advance universal service.” *Id.*, §254 (d). The act did not specify how FCC was to administer the E-rate program, but required FCC, acting on the recommendations of the Federal-State Joint Board, to define universal service and develop specific, predictable, and equitable support mechanisms.

FCC designated the Universal Service Administrative Company (USAC), a nonprofit corporation that is a wholly owned subsidiary of NECA, as the administrator of the universal service mechanisms.² USAC administers the program pursuant to FCC orders, rules, and directives. As part of its duties, USAC collects the carriers' universal service contributions, which constitute the Universal Service Fund, and deposits them to a private bank account under USAC's control and in USAC's name. FCC has directed the use of USF to, among other things, subsidize advanced telecommunications services for schools and libraries in a program commonly referred to as the

²In 1998, we issued a legal opinion on the then-current structure of the E-rate program where FCC directed the creation of the Schools and Libraries Corporation to administer the universal service program. Under the Government Corporation Control Act, an agency must have specific statutory authority to establish a corporation. 31 U.S.C. § 9102. We concluded that FCC did not have authority to create a separate independent corporation to administer the E-rate program. B-278820, Feb. 10, 1998. Subsequently, FCC eliminated the Schools and Libraries Corporation as a separate entity, and restructured the universal service program to its present form.

E-rate program.³ Pursuant to the E-rate program, eligible schools and libraries can apply annually to receive support and can spend the funding on specific eligible services and equipment, including telephone services, Internet access services, and the installation of internal wiring and other related items. Generally, FCC orders, rules, and directives, as well as procedures developed by USAC, establish the program's criteria. USAC carries out the program's day-to-day operations, such as answering inquiries from schools and libraries; processing and reviewing applications; making funding commitment decisions and issuing funding commitment decision letters; and collecting, managing, investing, and disbursing E-rate funds.

Eligible schools and libraries may apply annually to receive E-rate support. The program places schools and libraries into various discount categories, based on indicators of need. As a result of the application of the discount rate to the cost of the service, the school or library pays a percentage of the cost for the service and the E-rate program covers the remainder. E-rate discounts range from 20 percent to 90 percent.

Once the school or library has complied with the program's requirements and entered into agreements with vendors for eligible services, the school or library must file a form with USAC noting the types and costs of the services being contracted for, the vendors providing the services, and the amount of discount being requested. USAC reviews the forms and issues funding commitment decision letters.⁴ The funding commitment decision letters notify the applicants of the decisions regarding their E-rate discounts. These funding commitment decision letters also notify the applicants that USAC will send the information on the approved E-rate discounts to the providers so that "preparations can be made to begin implementing . . . E-rate discount(s) upon the filing [by the applicant] of . . . Form 486." The applicant files FCC Form 486 to notify USAC that services have started and USAC can pay service provider invoices. Generally, the service provider seeks reimbursement from USAC for the discounted portion of the service, although the school or library also could pay the service provider in full and then seek reimbursement from USAC for the discount portion.

³The term "E-rate" evolved from some individuals referring to the program as the "Education" rate.

⁴USAC could reduce the amount requested if the school or library has included ineligible services in its application or has calculated its discount category incorrectly.

What Is the Universal Service Fund?

The precise phrasing of the questions regarding the nature of USF has varied over the years, including asking whether they are federal funds, appropriated funds, or public funds and, if so, for what purposes? While the various fiscal statutes may use these different terms to describe the status of funds, we think the fundamental issue is what statutory controls involving the collection, deposit, obligation, and disbursement of funds apply to USF. As explained below, funds that are appropriated funds are subject, unless specifically exempted by law, to a variety of statutory provisions providing a scheme of funds controls. *See* B-257525, Nov. 30, 1994; 63 Comp. Gen. 31 (1983); 35 Comp. Gen. 436 (1956); B-204078.2, May 6, 1988. On the other hand, funds that are not appropriated funds are not subject to such controls unless the law specifically applies such controls. Thus, we believe the initial question is whether USF funds are appropriated funds.

FCC has concluded that USF constitutes a permanent indefinite appropriation. We agree with FCC's conclusion. Typical language of appropriation identifies a fund or account as an appropriation and authorizes an agency to enter into obligations and make disbursements out of available funds. For example, Congress utilizes such language in the annual appropriations acts. *See* 1 U.S.C. § 105 (requiring regular annual appropriations acts to bear the title "An Act making appropriations. . ."). Congress, however, appropriates funds in a variety of ways other than in regular annual appropriation acts.⁵ Indeed, our decisions and those of the courts so recognize.

⁵Congress has recognized that an appropriation is a form of budget authority that makes funds available to an agency to incur obligations and make expenditures in a number of different statutes. For example, *see* 2 U.S.C. § 622(2)(A)(i) (budget authority includes "provisions of law that make funds available for obligation and expenditure . . . including the authority to obligate and expend the proceeds of offsetting receipts and collections") and 31 U.S.C. § 701(2)(C) (appropriations include "other authority making amounts available for obligation or expenditure").

Thus, a statute that contains a specific direction to pay, and a designation of funds to be used, constitutes an appropriation. 63 Comp. Gen. 331 (1984); 13 Comp. Gen. 77 (1933). In these statutes, Congress (1) authorizes the collection of fees and their deposit into a particular fund, and (2) makes the fund available for expenditure for a specified purpose without further action by Congress. This authority to obligate or expend collections without further congressional action constitutes a continuing appropriation or a permanent appropriation of the collections. *E.g.*, *United Biscuit Co. v. Wirtz*, 359 F.2d 206, 212 (D.C. Cir. 1965), cert. denied, 384 U.S. 971 (1966); 69 Comp. Gen. 260, 262 (1990); 73 Comp. Gen. 321 (1994). Our decisions are replete with examples of permanent appropriations, such as revolving funds and various special deposit funds, including mobile home inspection fees collected by the Secretary of Housing and Urban Development,⁶ licensing revenues received by the Commission on the Bicentennial,⁷ tolls and other receipts deposited in the Panama Canal Revolving Fund,⁸ user fees collected by the Saint Lawrence Seaway Development Corporation,⁹ user fees collected from tobacco producers to provide tobacco inspection, certification and other services,¹⁰ and user fees collected from firms using the Department of Agriculture's meat grading services.¹¹ It is not essential for Congress to expressly designate a fund as an appropriation or to use literal language of "appropriation," so long as Congress authorizes the expenditure of fees or receipts collected and deposited to a specific account or fund.¹² In cases where Congress does not intend these types of collections or funds to be considered "appropriated funds," it explicitly states that in law. *See e.g.*, 12 U.S.C. § 244 (the Federal Reserve Board levies assessments on its member banks to pay for its expenses and "funds derived from such assessments shall not be construed to be government funds or appropriated moneys"); 12 U.S.C. § 1422b(c) (the Office of Federal Housing Enterprise Oversight levies assessments upon the Federal Home Loan Banks and from other sources to pay its

⁶59 Comp. Gen. 215 (1980).

⁷B-228777, Aug. 26, 1988.

⁸B-204078.2, May 6, 1988 and B-257525, Nov. 30, 1994.

⁹B-193573, Jan. 8, 1979; B-193573, Dec. 19, 1979; B-217578, Oct. 16, 1986.

¹⁰63 Comp. Gen. 285 (1984).

¹¹B-191761, Sept. 22, 1978.

¹²B-193573, Dec. 19, 1979.

expenses, but such funds “shall not be construed to be government funds or appropriated monies, or subject to apportionment for the purposes of chapter 15 of title 31, or any other authority”).

Like the above examples, USF’s current authority stems from a statutorily authorized collection of fees from telecommunications carriers, and expenditures for a specified purpose—that is, the various types of universal service.¹³ Thus, USF meets both elements of the definition of a permanent appropriation.

We recognize that prior to the passage of the Telecommunications Act of 1996, there existed an administratively sanctioned universal service fund. With the Telecommunications Act of 1996, Congress specifically expanded the contribution base of the fund, statutorily mandated contributions into the fund, and designated the purposes for which the monies could be expended. These congressional actions established USF in a manner that meets the elements for a permanent appropriation and Congress did not specify that USF should be considered anything other than an appropriation.¹⁴

Does the Antideficiency Act Apply to USF?

Appropriated funds are subject to a variety of statutory controls and restrictions. These controls and restrictions, among other things, limit the purposes for which they may be used and provide a scheme of funds control. *See e.g.*, 63 Comp. Gen. 110 (1983); B-257525, Nov. 30, 1994; B-

¹³The United States Court of Appeals for the Fifth Circuit has recognized the governmental character of the funds. *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 426-428 (5th Cir., 1999), cert. denied sub nom; *Celpage Inc. v. FCC*, 530 U.S. 1210, 2212 (2000). The Fifth Circuit held that USF funds are statutorily mandated special assessments supporting a federal program mandated by Congress. FCC has also requested that the Department of Justice recognize that USF are federal funds for purposes of representing FCC and the United States in litigation involving USF, such as the False Claims Act.

¹⁴The Senate passed a “sense of the Senate” provision that stated, “Federal and State universal service contributions are administered by an independent nonfederal entity and are not deposited into the federal Treasury and therefore are not available for federal appropriations.” *See* section 614, H.R. 2267, as passed by the Senate (Oct. 1, 1997). However, the purpose of that resolution was to respond to an attempt to withhold USF payments as a means to balance the federal budget or achieve budget savings. We understand section 614, H.R. 2267 intended to insulate USF from budgetary pressures and not to express a view on the proper fiscal treatment of USF. Our interpretation of USF as a permanent appropriation is consistent with the intent that USF is only available for universal service and could only be changed if Congress amended the law to permit USF to be used for other purposes.

228777, Aug. 26, 1988; B-223857, Feb. 27, 1987; 35 Comp. Gen. 436 (1956). A key component of this scheme of funds control is the Antideficiency Act. B-223857, Feb. 27, 1987. The Antideficiency Act¹⁵ has been termed “the cornerstone of congressional efforts to bind the executive branch of government to the limits on expenditure of appropriated funds.”¹⁶ Primarily, the purpose of the Antideficiency Act is to prevent the obligation and expenditure of funds in excess of the amounts available in an appropriation or in advance of the appropriation of funds. 31 U.S.C. § 1341(a)(1). FCC has determined that the Antideficiency Act applies to USF, and as explained below, we agree with FCC’s conclusion.

The Antideficiency Act applies to “officer[s] or employee[s] of the United States Government . . . mak[ing] or authoriz[ing] an expenditure or obligation . . . from an appropriation or fund.” 31 U.S.C. § 1341(a). As established above, USF is an “appropriation or fund.” The fact that USAC, a private entity whose employees are not federal officers or employees, is the administrator of the E-rate program and obligates and disburses funds from USF is not dispositive of the application of the Antideficiency Act. This is because, as the FCC recognizes, it, not USAC, is the entity that is legally responsible for the management and oversight of the E-rate program and FCC’s employees are federal officers and employees of the United States subject to the Antideficiency Act.¹⁷

Where entities operate with funds that are regarded as appropriated funds, such as some government corporations, they, too, are subject to the Antideficiency Act. *See e.g.*, B-223857, Feb. 27, 1987 (funds available to Commodity Credit Corporation pursuant to borrowing authority are subject to Antideficiency Act); B-135075-O.M., Feb. 14, 1975 (Inter-American Foundation). The Antideficiency Act applies to permanent

¹⁵31 U.S.C. §§ 1341, 1342 and 1517.

¹⁶Hopkins & Nutt, *The Anti-Deficiency Act (Revised Statutes 3679) and Funding Federal Contracts: An Analysis*, 80 Mil. L. Rev. 51, 56 (1978).

¹⁷Under FCC’s rules, USAC is prohibited from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. 47 C.F.R. § 54.702(c). As addressed below, one of the issues that remains to be resolved is whether USAC is authorized to take the actions that obligate and disburse USF funds pursuant to FCC orders, rules, and directives or whether FCC must implement additional steps to ensure that obligations and disbursements are specifically authorized by FCC officials and employees.

appropriations such as revolving funds¹⁸ and special funds. 72 Comp. Gen. 59 (1992) (Corps of Engineers Civil Works Revolving Fund subject to Antideficiency Act); B-120480, Sep. 6, 1967, B-247348, June 22, 1992, and B-260606, July 25, 1997 (GPO revolving funds subject to Antideficiency Act); 71 Comp. Gen. 224 (1992) (special fund that receives fees, reimbursements, and advances for services available to finance its operations is subject to Antideficiency Act).

Where Congress intends for appropriated funds to be exempt from the application of statutory controls on the use of appropriations, including the Antideficiency Act, it does so expressly. *See e.g.*, B-193573, Jan. 8, 1979; B-193573, Dec. 19, 1979; B-217578, Oct. 16, 1986 (Saint Lawrence Seaway Development Corporation has express statutory authority to determine the character and necessity of its obligations and is therefore exempt from many of the restrictions on the use of appropriated funds that would otherwise apply); B-197742, Aug. 1, 1986 (Price-Anderson Act expressly exempts the Nuclear Regulatory Commission from Antideficiency Act prohibition against obligations or expenditures in advance or in excess of appropriations). There is no such exemption for FCC or USF from the prohibitions of the Antideficiency Act. Thus, USF is subject to the Antideficiency Act.

Do the Funding
Commitment Decision
Letters Issued to Schools
and Libraries Constitute
Obligations?

An important issue that arises from the application of the Antideficiency Act to USF is what actions constitute obligations chargeable against the fund. Understanding the concept of an obligation and properly recording obligations are important because an obligation serves as the basis for the scheme of funds control that Congress envisioned when it enacted fiscal laws such as the Antideficiency Act. B-300480, Apr. 9, 2003. For USF's schools and libraries program, one of the main questions is whether the funding commitment decision letters issued to schools and libraries are properly regarded as obligations. FCC has determined that funding commitment decision letters constitute obligations. And again, as explained below, we agree with FCC's determination.

Under the Antideficiency Act, an agency may not incur an obligation in excess of the amount available to it in an appropriation or fund. 31 U.S.C.

¹⁸Revolving funds are funds authorized by law to be credited with collections and receipts from various sources that generally remain available for continuing operations of the revolving fund without further congressional action. *See* 72 Comp. Gen. 59 (1992).

§ 1341(a). Thus, proper recording of obligations with respect to the timing and amount of such obligations permits compliance with the Antideficiency Act by ensuring that agencies have adequate budget authority to cover all of their obligations.¹⁹ B-300480, Apr. 9, 2003. We have defined an “obligation” as a “definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received.” *Id.* A legal liability is generally any duty, obligation or responsibility established by a statute, regulation, or court decision, or where the agency has agreed to assume responsibility in an interagency agreement, settlement agreement or similar legally binding document. *Id.* citing to Black’s Law Dictionary 925 (7th ed. 1999). The definition of “obligation” also extends to “[a] legal duty on the part of the United States which constitutes a legal liability or which could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. . . .” *Id.* citing to 42 Comp. Gen. 733 (1963); *see also McDonnell Douglas Corp. v. United States*, 37 Fed. Cl. 295, 301 (1997).

The funding commitment decision letters provided to applicant schools and libraries notify them of the decisions regarding their E-rate discounts. In other words, it notifies them whether their funding is approved and in what amounts. The funding commitment decision letters also notify schools and libraries that the information on the approved E-rate discounts is sent to the providers so that “preparations can be made to begin implementing . . . E-rate discount(s) upon the filing [by applicants] of . . . Form 486.” The applicant files FCC Form 486 to notify USAC that services have started and USAC can pay service provider invoices. At the time a school or library receives a funding commitment decision letter, the FCC has taken an action that accepts a “legal duty . . . which could mature into a legal liability by virtue of actions on the part of the grantee beyond the control of the United States.” *Id.* citing 42 Comp. Gen. 733, 734 (1963). In this instance, the funding commitment decision letter provides the school or library with the authority to obtain services from a provider with the commitment that it will receive a discount and the provider will be reimbursed for the discount provided. While the school or library could decide not to seek the services or the discount, so long as the funding

¹⁹Legal liability for obligational accounting and to comply with the Antideficiency Act and the Recording Statute, 31 U.S.C. § 1501 is distinct from accounting liabilities and projections booked in its proprietary accounting systems for financial statement purposes. For proprietary accounting purposes, a liability is probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. *See* B-300480, Apr. 9, 2003, and FASAB Statement of Federal Financial Accounting Standards Number 1.

commitment decision letter remains valid and outstanding, USAC and FCC no longer control USF's liability; it is dependent on the actions taken by the other party—that is, the school or library. In our view, a recordable USF obligation is incurred at the time of issuance of the funding commitment decision letter indicating approval of the applicant's discount. Thus, these obligations should be recorded in the amounts approved by the funding commitment decision letters. If at a later date, a particular applicant uses an amount less than the maximum or rejects funding, then the obligation amount can be adjusted or deobligated, respectively.

Additional issues that remain to be resolved by FCC include whether other actions taken in the universal service program constitute obligations and the timing of and amounts of obligations that must be recorded. For example, this includes the projections and data submissions by USAC to FCC and by participants in the High Cost and Low Income Support Mechanisms to USAC. FCC has indicated that it is considering this issue and consulting with the Office of Management and Budget. FCC should also identify any other actions that may constitute recordable obligations and ensure those are properly recorded.

Structure of the Universal Service Administrative Company

Various policies to promote universal service—providing residential customers with affordable, nationwide access to basic telephone service—have generally been around since the 1950s. Congress codified and made significant changes to universal service policy in the Telecommunications Act of 1996. However, Congress did not prescribe a structure for administering the universal service programs and instead called for a Federal-State Joint Board on Universal Service (Joint Board) to make recommendations to FCC.¹

At the time of the act, the National Exchange Carrier Association (NECA) was responsible for administering the existing universal service mechanisms providing support for high-cost areas and low-income individuals. NECA is an association of incumbent local telephone companies that was established at FCC's direction in 1983 (in anticipation of the breakup of the Bell System) to administer interstate access tariffs and the revenue distribution process for the nation's nearly 1,000 local telephone companies. In November 1996, the Joint Board recommended that, in the interest of providing services to schools and libraries and health care providers quickly, FCC should appoint NECA as the temporary administrator of universal service to these groups, subject to changes in NECA's governance to make NECA more representative of the telecommunications industry as a whole. Under the Joint Board's recommendation, NECA would continue this role until a permanent administrator was appointed. The Joint Board recommended that FCC establish an advisory board to select and oversee a neutral third-party administrator for all universal service programs and suggested criteria to be used in that selection. The Joint Board further recommended that FCC allow NECA to change its membership and governance in a manner that would allow it to compete for the role of permanent administrator in the advisory board's selection process.

On the basis of the Joint Board's recommendations, FCC agreed in a May 1997 order to appoint NECA as the temporary administrator, subject to changes in NECA's governance. It also agreed to create a federal advisory committee, whose sole responsibility would be to recommend an administrator, and directed that the administrator should select a contractor to manage the application process for schools and libraries. NECA later determined that developing a satisfactory board structure to be

¹GAO, *Telecommunications: FCC Lacked Authority to Create Corporations to Administer Universal Service Programs*, [GAO/T-RCED/OGC-98-84](#) (Washington, D.C.: Mar. 31, 1998).

able to bid for the permanent administrator role might not be possible. Thus, NECA proposed to FCC in January 1997 that it be allowed to establish a separate subsidiary to administer universal service.

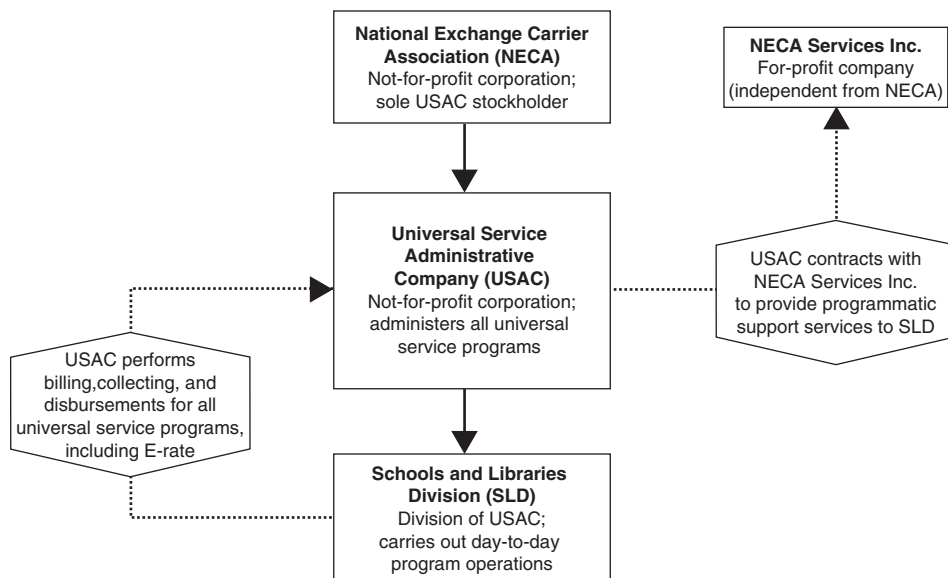
In July 1997, FCC issued an order directing NECA to create two independent nonprofit corporations—one to administer the program for schools and libraries (the Schools and Libraries Corporation) and one to administer the program for rural health care providers (the Rural Health Care Corporation). FCC's order further specified that these corporations would continue to administer the programs even after the appointment of a permanent administrator. To carry out billing, collecting, and disbursement activities for these programs, FCC directed NECA to create a nonprofit subsidiary. FCC further directed that the subsidiary create a special committee of its board of directors to administer the universal service programs for high-cost areas and low-income individuals. NECA created the Universal Service Administrative Company (USAC) as the subsidiary.

In November 1998, FCC changed the universal service structure in response to legal concerns about FCC's authority to create the two independent corporations and Congress's directive that a single entity administer universal service support.² FCC appointed an existing body, USAC, as the permanent administrator of the program and directed the Schools and Libraries Corporation and the Rural Health Care Corporation to merge with USAC by January 1, 1999. Under this merger, the staff of the Schools and Libraries Corporation became part of a new Schools and Libraries Division (SLD) within USAC, carrying out essentially the same functions as before, such as processing and reviewing E-rate applications. However, SLD contracts out most of its billing, collecting, and disbursement activities to USAC. In addition, in 2000 NECA formed an unaffiliated, for-profit corporation, NECA Services Inc., to pursue new business opportunities. USAC later contracted most of its application processing, client support, and review functions to NECA Services Inc. See figure 1.

²GAO, *Schools and Libraries Program: Actions Taken to Improve Operational Procedures Prior to Committing Funds*, [GAO/RCED-99-51](#) (Washington, D.C.: Mar. 5, 1999).

Appendix III
Structure of the Universal Service
Administrative Company

Figure 1: Relationship among Entities Involved in the E-Rate Program



Source: GAO analysis of USAC information.

FCC Staffing Levels in Support of the E-Rate Program

Table 3: Number of FCC Full-Time Equivalent (FTE)^a Positions Supporting E-Rate Program, Fiscal Years 1997-2004

FCC bureau/office	Fiscal years							
	1997	1998	1999	2000	2001	2002	2003	2004
Enforcement Bureau^b								
Professional	N/A	N/A	N/A	N/A	N/A	N/A	0.50	0.75
Managerial	N/A	N/A	N/A	N/A	N/A	N/A	0.20	0.50
Administrative	N/A	N/A	N/A	N/A	N/A	N/A	0.20	0.30
Subtotal							0.90	1.55
Office of General Counsel								
Professional	0.65-0.70	0.30-0.40	0.80-0.90	0.55-0.60	0.30-0.35	0.35-0.40	0.30-0.40	0.30-0.40
Managerial	0.65	0.10-0.15	0.40	0.40	0.20-0.23	0.20-0.25	0.25-0.30	0.10-0.15
Subtotal	1.30-1.35	0.40-0.55	1.20-1.30	0.95-1	0.50-0.58	0.55-0.65	0.55-0.70	0.40-0.55
Office of Managing Director								
Professional	0.00	0.00	0.25	0.50	0.50	1.00	1.00	1.10
Managerial	0.00	0.00	0.25	0.25	0.25	0.30	0.30	0.30
Subtotal	0.00	0.00	0.50	0.75	0.75	1.30	1.30	1.40
Office of Strategic Planning								
Professional	1.50 ^c	0.10	0.10	0.10	0.10	0.10	0.50	0.50
Subtotal	1.50	0.10	0.10	0.10	0.10	0.10	0.50	0.50
Wireline Competition Bureau								
Professional	4.00	6.00	10.00	13.00	10.00	9.00	8.00	5.80
Managerial	0.30	0.30	0.30	1.30	2.00	1.00	1.00	1.00
Administrative	1.20	1.60	2.20	2.50	2.80	2.80	2.20	2.20
Front office managerial	0.50	0.50	0.50	0.50	0.50	1.00	0.83	1.33
Subtotal	6.00	8.40	13.00	17.30	15.30	13.80	12.03	10.33
Total	8.80-8.85	8.90-9.05	14.80-14.90	19.10-19.15	16.65-16.73	15.75-15.85	15.28-15.43	14.18-14.33

Source: FCC.

Notes: N/A = not applicable.

^aFull-time equivalent (FTE) is a measure of federal civilian employment. One FTE is equal to 1 work-year of 2,080 hours.

^bAll E-rate related investigation and audit work performed by FCC's Enforcement Bureau is contained in the figures for 2003 and 2004. The Enforcement Bureau was established in 1999 and first assigned an audit function in the commission's 2002 reorganization.

^cThis estimate is for all universal service programs.

Comments from the Federal Communications Commission

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Federal Communications Commission
Washington, D.C. 20554

January 14, 2005

Mr. Mark Goldstein
Director
Physical Infrastructure Issues
U.S. Government Accountability Office
Washington, DC 20548

Dear Mr. Goldstein:

Thank you for the opportunity to review and comment on the Government Accountability Office's (GAO) Draft Report *Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program* (GAO Draft Report). This letter provides the Federal Communication Commission's (FCC) response to the GAO conclusions and recommendations contained in the Draft Report.

Since its inception, the E-rate program has been a success in connecting schools and libraries to the Internet and promoting the deployment of advanced telecommunications services and broadband capability to program stakeholders. Over the years, approximately 100,000 public schools, private schools, and libraries have participated in the E-rate program. The FCC recognizes that the \$2.25 billion E-rate program continues to experience operational and management challenges, some of which have been addressed in past GAO reports. We continue to strive to improve the management and oversight of the program, and we continue to devote resources to improve all aspects of the program and detect and deter the misconduct of bad actors seeking to gain at the public's expense.

In the Draft Report, the GAO draws several conclusions about the FCC's management and oversight of the E-rate program. In particular, the GAO concludes that the FCC has not done enough to manage the E-rate program proactively; established an unusual structure for the E-rate program without conducting a comprehensive assessment of the applicability of federal requirements, laws, and policies; not developed specific and meaningful goals and measures to assess the impact of E-rate funding; and shifted many important responsibilities onto the Universal Service Administrative Company (USAC). See GAO Draft Report at 46-47. We respond to those conclusions below.

The GAO Draft Report notes that any reassessment of the E-rate program must take the needs of beneficiaries into account, and cautions that any efforts to protect the Universal Service Fund (USF) from waste, fraud, and abuse should not result in excessive burdens on program participants. *Id.* at 47. We agree that the administration of USF must carefully balance the need for accountability and efficiency with the desire not to impose unnecessary burdens on the intended beneficiaries of the programs.

Finally, the GAO makes three recommendations for executive action. First, it recommends that the FCC conduct and document a comprehensive assessment to determine whether all necessary

Now on pp. 36 and 37.

Now on p. 37.

Now on pp. 37 and 38.

Now on p. 38.

government accountability requirements, policies, and practices have been applied and are fully in place to protect the program. The GAO recommends that this assessment include both the implications of the FCC's determination that the USF constitutes an appropriation by identifying the fiscal controls that apply as well as those that do not apply to the USF, including the collection, deposit, obligation, and disbursement of USF monies, and an evaluation of the legal authority for the organizational structure for carrying out the program, including the relationship between the FCC and USAC and their respective authorities and roles in implementing the E-rate program. *Id.* at 47-48. Second, the GAO recommends that the FCC establish performance goals and measures for the E-rate program that are consistent with the Government Performance and Results Act. Third, the GAO recommends that the FCC develop a strategy for reducing the backlog of E-rate appeals, including ensuring that adequate staffing resources are devoted to E-rate appeals. *Id.* at 48. Our responses below first address the management of the program, then the three specific recommendations.

FCC Management of the E-Rate Program

This past year, the FCC took a number of steps to improve its management and oversight of the E-rate program. In particular, the FCC adopted new rules to revise the FCC's recovery of improperly disbursed funds, strengthen audit and investigation processes, and apply federal government accountability requirements to the USF, including compliance with government accounting standards and the Debt Collection Improvement Act (DCIA).¹ The FCC also took steps to ensure that the Universal Service Administrative Company (USAC) improved its efforts to deter waste, fraud, and abuse. For example, the FCC directed USAC to develop a comprehensive plan to promote awareness of program rules in the E-rate community, engage an independent auditor to conduct 100 audits of E-rate program beneficiaries, work with the FCC's Office of Inspector General (OIG) to develop a plan for conducting hundreds more beneficiary audits,² and improve its review and processing of E-rate applications.³ In addition, the FCC

¹ See, e.g., Schools and Libraries Universal Service Support Mechanism, *Fifth Report and Order and Order*, 19 FCC Rcd 15808 (2004) (*Fifth Report and Order*) (strengthening audit and investigation processes applicable to the E-rate program); Federal-State Joint Board on Universal Service, Changes to the Board of Directors for the National Exchange Carriers Association, Inc., Schools and Libraries Universal Service Support Mechanism, *Order on Reconsideration and Fourth Report and Order*, 19 FCC Rcd 15252 (2004) (revising rules for recovery of E-rate funds); Amendment of Parts 0 and 1 of the Commission's Rules; Implementation of the Debt Collection Improvement Act of 1996 and Adoption of Rules Governing Applications or Requests for Benefits by Delinquent Debtors, *Report and Order*, 19 FCC Rcd 6540 (2004); Application of Generally Accepted Accounting Principles For Federal Agencies And Generally Accepted Government Auditing Standards to the Universal Service Fund, Application of Generally Accepted Accounting Principles For Federal Agencies and Generally Accepted Government Auditing Standards to the Telecommunications Relay Services Fund, *Order*, 18 FCC 19911 (2003) (*GovGAAP Order*) (applying government accounting and auditing standards to the USF).

² As of the date of this letter, the FCC and USAC are currently in the process of soliciting and evaluating responses to a Request for Proposal issued to procure the services of an independent auditor. See Universal Service Administrative Company, *Request for Proposals for Audit Services in Support of Oversight Program for the Universal Service Fund* (Nov. 12, 2004) (seeking proposals for audit services to conduct USF beneficiary audits). We expect to complete this process during the first quarter of calendar year 2005.

³ See, e.g., Letter from Richard Lerner, Associate Chief, Wireline Competition Bureau, FCC to George McDonald, Vice President – Schools and Libraries Division, Universal Service Administrative Company (Nov. 10, 2004) (providing instructions to USAC concerning its E-rate outreach and education efforts); Letter from Richard Lerner,

improved oversight efforts by dedicating additional staff to USF audit and oversight issues, providing written instructions to USAC on these issues, and revising the annual independent audit of USAC's operations.⁴ The FCC also strengthened its oversight and management of USAC by establishing a high-level staff working group to coordinate oversight issues affecting USAC and the E-rate program, requiring additional reports from USAC concerning its financial and operating data, directing USAC to enhance its audit and oversight efforts, and providing guidance to USAC's written requests concerning the applicability of Federal budgetary requirements.⁵ With respect to the roles of the FCC and USAC, the FCC adopted rules codifying certain USAC procedures that had formed the basis for audit findings in the past.⁶ The FCC is currently evaluating USAC's existing operations and administrative procedures to determine which additional USAC procedures should be codified in the FCC's rules in order to improve the effectiveness of the program or facilitate the recovery of improperly disbursed funds.

We believe that the current USAC structure is consistent with congressional intent and conforms with congressional guidance. The FCC anticipates taking additional steps to strengthen management and oversight of the E-rate program in the coming year. We are examining whether and how to modify our administrative structure and processes as they apply to the program. For the upcoming year, the FCC is considering, among other things, initiating a notice-and-comment rulemaking proceeding to assess management of the E-rate program and the USF and, contemporaneously, retaining an outside contractor to evaluate the program and make recommendations for revising and improving its administration. In addition, we are currently considering expanding the audit coverage of the USF by requiring certain E-rate beneficiaries – both schools and libraries and service providers – to obtain an independent audit of their compliance with FCC rules. These audits would focus on entities receiving the largest financial benefit from the E-rate program. We are also seeking additional resources to hire more staff to address management and oversight of the E-rate program, and we are redirecting existing staff to these areas.

Associate Chief, Wireline Competition Bureau, FCC to Wayne Scott, Vice President – Internal Audits, Universal Service Administrative Company (Sept. 29, 2004) (providing instructions to USAC concerning its internal audit efforts).

⁴ See, e.g., Letter from Richard Lerner, Associate Chief, Wireline Competition Bureau, FCC to Wayne Scott, Vice President – Internal Audits, Universal Service Administrative Company (Sept. 30, 2004) (providing guidance concerning the planned revisions to the annual independent audit of USAC's operations); Letter from Jeffrey Carlisle, Chief, Wireline Competition Bureau, FCC to Lisa Zaina, Chief Executive Officer, Universal Service Administrative Company (Oct. 13, 2004) (requiring USAC to submit a plan for processing of E-rate funding commitment decision letters); Letter from Jeffrey Carlisle, Chief, Wireline Competition Bureau, FCC to Lisa Zaina, Chief Executive Officer, Universal Service Administrative Company (Oct. 22, 2004) (approving plan for processing of E-rate funding commitment decision letters).

⁵ See, e.g., Letter from Jeffrey Carlisle, Chief, Wireline Competition Bureau, FCC and Andrew S. Fishel, Managing Director, FCC to Frank Gumper, Chairman of the Board, Universal Service Administrative Company (Sept. 27, 2004) (providing guidance concerning Federal budgetary requirements).

⁶ See, e.g., *Fifth Report and Order* at paras. 45-63 (adopting rules pertaining to technology plan requirements and document retention requirements).

Now on p. 12.

The Draft Report references the “unusual” administrative structure of the fund. It recommends that we evaluate the legal authority for the organizational structure for carrying out the E-rate program, including the relationships between the FCC and USAC and their respective roles and authority in implementing the E-rate program. We believe that the current structure is consistent with congressional intent, and conforms to guidance that Congress provided in a 1998 conference report. As the Draft Report acknowledges, the Telecommunications Act of 1996 “did not specify how the FCC was to administer” the program, “nor did it prescribe the structure and legal parameters of the universal service mechanisms to be created.” (Draft Report at 14). The administrative structure is consistent with the Commission’s historical practice of using private organizations, such as the National Exchange Carrier Association (NECA), to help administer universal service programs. Congress was well aware of that practice when it enacted the Telecommunications Act of 1996. The Commission’s establishment of the current structure is also consistent with the recommendations of the Federal-State Joint Board, as provided in the statutory provisions authorizing the E-rate program. As noted above, the current structure of the program also follows the specific guidance set out in a 1998 congressional conference report, *Conference Report to Accompany H.R. 3579*, H.R. Rep. No. 504, 105th Cong., 2d Sess. 87 (1998). The Conference Report states that, although the specific provisions of the earlier Senate bill (S. 1768) addressing the structure for the administration of the program were not ultimately incorporated in the conference agreement, “the conferees expect that the FCC will comply with the reporting requirement in the Senate bill . . . and propose a new structure for the implementation of universal service programs.” *Id.* Section 2004(b)(2) of S.1768 required that the Commission’s report “. . . propose a revised structure for the administration of the programs established under section 254(b) . . . The revised structure shall consist of a single entity.” The Commission reported to Congress on its implementation of that guidance. *Report to Congress in Response to Senate Bill 1768 and Conference Report on H.R. 3579*, 13 FCC Rcd 11810 (1998).

See comment 1.

Nevertheless, we intend to consider whether to modify the manner in which the USF is administered, including possible changes to the underlying administrative structure. Among other things, we intend to consider examining other administrative structures, including those relying on contractual arrangements. We also expect to examine the implications of alternative administrative structures, such as any need for increased appropriations to implement a contractual arrangement.

Analysis of the Applicability of Federal Requirements, Laws, and Policies

Now on p. 11.

The draft report indicates that the FCC “has never conducted a comprehensive assessment of which federal requirements, policies, and practices apply to the program, to USAC, or the Universal Service Fund itself.” (Draft Report at 13). To the contrary, the FCC has undertaken timely and extensive analysis of the significant legal issues related to the status of the fund. To determine whether and how statutory provisions should be applied, the specific language of any relevant statutes must be examined to determine whether the provisions apply to the fund, to the fund’s administrator, or to the FCC itself. Thus, the FCC has generally addressed these issues on a case-by-case basis. As set forth below, the FCC has examined the significant, relevant financial management statutes that potentially apply to the fund and has otherwise sought expert advice where appropriate:

See comment 2.

- Nearly five years ago, the FCC confronted the central issue of whether the fund is “public money” subject to the requirements of the Miscellaneous Receipts Act and related laws and regulations that apply to public money. Because of the importance of this question and its implications for the E-rate program, in early 2000 the FCC’s General Counsel, after discussions with the FCC Commissioners on this issue, sought expert guidance from the Office of Management and Budget (OMB). As the Draft Report also notes, OMB’s General Counsel provided advice to the FCC on this issue in April 2000, concluding that the fund was not public money subject to the Miscellaneous Receipts Act. *See* Letter from Robert G. Damus, General Counsel, Office of Management and Budget to Christopher Wright, General Counsel, Federal Communications Commission (Apr. 28, 2000). Moreover, the Commission has long recognized that the fund is a permanent indefinite appropriation, classified as a special fund in the United States budget. *See, e.g.,* Letter from William E. Kennard, Chairman, FCC, to Michael R. Volpe, Assistant General Counsel, GAO, April 28, 2000; Letter from Jane E. Mago, General Counsel, FCC to Robert D. McCallum, Jr. Assistant Attorney General, U.S. Department of Justice, June 3, 2002.
- As the GAO is aware from its investigation, in January 2001, the FCC’s Office of General Counsel (OGC) reviewed relevant statutes and provided specific guidance to the FCC’s Managing Director concerning the applicability to the fund of significant federal financial management statutes, including the Federal Financial Management Improvement Act of 1996, the Federal Managers Financial Integrity Act of 1982, the Government Management Reform Act of 1994, the Information Technology Management Reform Act of 1996, the Federal Credit Reform Act of 1990, the Government Performance and Results Act of 1993, and the Federal Acquisition Regulations.
- After examining the specific language of relevant statutes, the FCC has also assessed the applicability of many other statutes. It has determined that the Freedom of Information Act (FOIA) applies to records of the fund, but that all FOIA requests should be filed with the FCC and not with the fund’s administrator. *Inter-Tel Technologies, Inc.*, 19 FCC Rcd 5204, 5204 n.3 (2004); *also see* the USAC Web site <http://www.universalservice.org/hc/privacypolicy.asp>. The FCC has also determined that the Debt Collection Act applies to the fund, 47 C.F.R. §1.1901(b); *see* Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service, *Order*, FCC 99-291 (rel. Oct. 8, 1999). The FCC also applies relevant provisions of Title 31 of the United States Code, including the Recording Statute, 31 U.S.C. § 501, the Purpose Statute, 31 U.S.C. §1301(a), 31 U.S.C. §3512(c), (d), and the Treasury Financial Manual. Because the FCC is required to prepare audited financial statements under the Accountability for Tax Dollars Act of 2002, P.L. 107-289, the FCC has made clear that the fund’s administrator must maintain the USF’s accounts in accordance with the United States Government Standard General Ledger (USGGS). *See GovGAAP Order*, 18 FCC Rcd 19911.

Now on pp. 17 and 18.
See comment 3.

The Draft Report also suggests that the FCC has not resolved whether certain specific statutes apply to the fund, and mentions in particular the Improper Payments Information Act, the Single Audit Act, the Miscellaneous Receipts Act, and the Cash Management Improvement Act. (Draft Report at 21-22). These conclusions are in error.

- The FCC addressed the applicability of the Improper Payments Information Act to the fund and specifically included the fund in its first report required under that statute. Federal Communications Commission, Report to Congress on Improper Payments, March 31, 2004. As noted above, the FCC will soon initiate several hundred audits intended to assist in identifying potential improper payments of USF monies.
- Because OMB is the expert agency responsible for implementation of the Single Audit Act, 31 U.S.C. §§7504, 7505, the FCC previously sought guidance concerning the applicability of the Single Audit Act to the USF. OMB staff informed FCC staff that they do not believe the Single Audit Act applies to the fund.
- The Secretary of the Treasury is charged with prescribing regulations to implement the Cash Management Improvement Act, and the relevant Treasury regulations state that the rules apply only to programs that are listed in the "Catalogue of Federal Domestic Assistance." 31 C.F.R. §205.1 (c). Because the fund is not listed in the Catalogue, it is not covered by regulations implementing the Cash Management Improvement Act.
- As described above, over five years ago the FCC sought guidance from OMB concerning the applicability of the Miscellaneous Receipts Act, and OMB advised that the fund was not public money subject to the Miscellaneous Receipts Act.
- After consideration of the applicable law by FCC staff, the Commission, in accordance with 31 U.S.C. §1532, has declined to transfer funds from the USF account to the FCC's account for salaries and expenses in the absence of statutory authority, and hence does not use Universal Service funds to cover the expenses of administration by the FCC or an FCC contractor. In contrast, the Commission's rules provide that USAC's expenses of administering the fund may be paid from the appropriation for the fund as an expense reasonably necessary to proper execution of the appropriation and not otherwise precluded.

To the extent that the GAO disagrees with these or any of the prior determinations that have been made, we urge the GAO to make those views known in this report or in a supplemental report. It would also be consistent with the overall scope and purpose of the Report for GAO to provide the legal analysis in its Report, just as the Report provides conclusions concerning the Antideficiency Act. We also welcome the GAO's expert guidance and note that GAO's legal determinations, either in this report or a supplemental report, would also help to resolve any subsidiary issues concerning the applicability of Title 31 of the U.S. Code and relevant Treasury regulations, including those pertaining to disbursements.

See comment 4.

To the extent that the GAO opines on the applicability of any statutory provisions, it would assist legislative and executive policymaking to identify the likely impact of its legal conclusions on the fund. For example, if the GAO were to conclude that the Miscellaneous Receipts Act applies to the USF, it would be useful to include an analysis of the impact that determination, including any lost interest income, would have on the fund, program beneficiaries, and consumers.

Establishing Goals and Performance Measures

As the Draft Report notes, the FCC had established some performance measures, but determined that it needed to establish better and more comprehensive ways of measuring E-rate performance. (Draft Report at 23, 31). We are actively working to reestablish performance goals and measures that are consistent with the Government Performance and Results Act (GPRA).⁷ As noted in the Draft Report, the Telecommunications Act of 1996 did not include specific goals for supporting schools and libraries, but instead used general language directing the FCC to establish the program. (Draft Report at 23). The Draft Report also notes that “the complex issue of measuring educational outcomes lies outside FCC’s expertise and comes under the purview of the Department of Education.” (Draft Report at 32). These factors have contributed to the FCC’s difficulties in establishing final performance measurements for the E-rate program. To address these challenges, we have assigned additional staff to revise the performance measures used for the E-rate program and anticipate including revised performance measures in the FCC’s FY 2007 budget submission as part of the Office of Management and Budget’s (OMB) Program Assessment Rating Tool (PART) process. However, a complete set of performance measures that are consistent with the GPRA may not be implemented until the FCC’s next fiscal year budget submission because of the need to seek comment from program stakeholders, the notice-and-comment requirements of the Administrative Procedure Act, and the need to modify or adopt any necessary information collections.

Reducing Backlog of E-Rate Appeals

We have made progress in reducing the backlog of E-rate appeals (*i.e.*, appeals pending at the FCC for longer than 90 days). Since 1998, approximately 1,865 appeals have been filed with the FCC, and approximately 527 are currently pending, of which approximately 458 are backlog appeals. After devoting the better part of the past year to addressing various issues with the program, such as resolving key rulemakings to address the recovery of improperly disbursed USF monies, we have redirected staffing resources and hired additional attorneys to USF oversight and program management, including the resolution of E-rate appeals. We also are working to resolve all backlogged E-rate appeals by the end of calendar year 2005. To accomplish this, the FCC staff has prioritized the pending cases, assigned attorneys and other professionals to resolving pending appeals, hired new attorneys devoted to resolving E-rate

⁷ As the GAO Draft Report notes, the FCC used to measure the number of public schools connected to the Internet, but stopped doing so because, among other reasons, the measure was no longer a useful indicator of the impact of E-rate funds. (Draft Report at 24-25).

Now on pp. 19 and 25.

See comment 5.

Now on p. 19.

Now on p. 26.

See comment 6.

See comment 7.

Now on pp. 20 and 21.

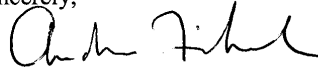
Appendix V
Comments from the Federal Communications
Commission

appeals, and requested and obtained temporary assistance by detailing attorneys from bureaus and offices in the FCC to this effort.

Recognizing, however, that much more could be done with appropriate additional resources, the FCC has requested direct appropriations in prior years to conduct greater oversight of the universal service programs. For example, in both FY 2004 and FY 2005, the FCC requested several million dollars so that the FCC's Office of Inspector General could conduct additional USF program audits. These requests were denied. We expect to continue to request additional resources from Congress to improve USF oversight, resolve E-rate appeals, and handle related matters.

We appreciate the opportunity to review and comment on your draft report. We thank you for your continued contributions to the program's success.

Sincerely,



Andrew S. Fishel
Managing Director

Enclosures

The following are GAO's comments on the Federal Communications Commission's letter dated January 14, 2005.

GAO's Comments

1. As stated in our report, we have not addressed FCC's authority to establish the current organizational structure. We recognize that FCC has reported to Congress on its implementation of the current organizational structure and it believes that structure is consistent with congressional intent and conforms to congressional guidance. However, at the time this structure was established by FCC, numerous issues such as the status of the Universal Service Fund as federal funds—specifically a permanent indefinite appropriation—and the applicability of fiscal statutes such as the Antideficiency Act had not been resolved. It is critical to the management of federal funds that the funds be properly collected, deposited, obligated, and expended by authorized parties in accordance with those determinations regarding the status of the funds. Thus, we believe FCC should consider whether the current organizational structure and roles and responsibilities of FCC and USAC are consistent with law and comply with fiscal and accountability requirements for federal funds. FCC states that it intends to consider whether to modify the manner in which the Universal Service Fund is administered, including possible changes to the underlying administrative structure. We believe this would be a positive step toward carrying out our recommendation.
2. FCC states that it has undertaken a timely and extensive analysis of the significant legal issues related to the status of the Universal Service Fund and has generally done so on a case-by-case basis. We recognize that FCC has engaged in internal deliberations and external consultations and analysis of a number of statutes. However, we do not believe this has been done in a timely manner or that it is appropriate to do so on a case-by-case basis.

Addressing the applicability of the statutes on a case-by-case basis, as issues have arisen, has put FCC and the program in the position of reacting to problems as they occur rather than setting up an organization and internal controls designed to ensure compliance with applicable laws. The laws encompassing fiscal and accountability controls are not applied in isolation; rather, they are part of a framework that addresses issues of financial and general management of federal agencies and programs. The E-rate program was established over seven years ago, yet FCC is still analyzing whether certain statutes

or requirements apply to the program and what actions it must take to implement those statutes and ensure compliance with them. The recent issues involving the Antideficiency Act best illustrate the problem with this case-by-case approach. As explained in our report, it was not until the fall of 2004 that the applicability and consequences of the Antideficiency Act were resolved. Moreover, this was not the first time issues regarding the Antideficiency Act had been raised. In July 1998, a question had been raised regarding USAC's authority to commercially borrow funds. At that time, USAC was instructed to refrain from commercial borrowing while FCC was examining the applicability of the Antideficiency Act to USAC's operations. While FCC determined that USAC should not borrow commercially in 1998, the question of whether there were other consequences for the E-rate program regarding the applicability of the Antideficiency Act was not addressed. Had FCC taken a comprehensive approach to the application of fiscal and accountability statutes such as the Antideficiency Act when the program was created or soon thereafter, FCC would have been in a position to determine what steps they should have taken and what internal controls they should have had in place to ensure compliance with those statutes. For example, with respect to the Antideficiency Act, they could have determined whether actions they were taking were obligations that needed to be recorded and, if so, made any necessary changes to the program to ensure that they had sufficient amounts in the Universal Service Fund to cover those obligations.

Furthermore, while certain determinations may have been made internally, they have neither been analyzed nor definitively determined in FCC's orders on the E-rate program. In addition, USAC has not always received instruction on how to carry out all of these requirements. For example, as noted in our report, in its October 2003 order applying GovGAAP to the Universal Service Fund, FCC stated that "the Funds *may* be subject to a number of federal financial and reporting statutes" (emphasis added) and "relevant portions of the Federal Financial Management Improvement Act of 1996," but did not specify which specific statutes or the relevant portions or further analyze their applicability.

3. In our report, we list several examples of fiscal control and accountability statutes. FCC states in its letter that it has already made a determination of each statute's applicability to the Universal Service Fund. We agree that FCC has made a determination involving the

applicability of the Improper Payments Information Act, and we therefore deleted our references to this act. We recognize that FCC has consulted with other agencies such as OMB and Treasury regarding the applicability of the Miscellaneous Receipts Act, the Single Audit Act, and the Cash Management Improvement Act. However, we believe that where FCC has determined that fiscal controls and policies do not apply, the commission should reconsider these determinations in light of the status of universal service monies as federal funds. Such a reconsideration is particularly important in the case of the Miscellaneous Receipts Act, where OMB and FCC determined in 2000 that the act did not apply because the funds were not public monies for the use of the United States.

Our recommendation focuses on a proactive, comprehensive analysis and determination of legal requirements rather than a continued approach of reactive case-by-case determinations. A definitive determination on the entire framework of laws that apply or do not apply to this program would enable FCC to make operational decisions on what steps they should take and what internal controls they should have in place to ensure compliance with applicable laws.

4. As stated in our report, due to the complexities posed by these issues, GAO remains available to provide an advance decision to FCC under 31 U.S.C. § 3529.
5. Our report does not note that “FCC had established some performance measures, but determined that it needed to establish better and more comprehensive ways of measuring E-rate performance.” It also does not note that the reason FCC stopped using the number of public schools connected to the Internet was that it was no longer a useful measure of the program. Our report states that prior to fiscal year 2000, FCC had no specific goals and measures for the program; that for fiscal years 2000 through 2002, the goals and measures set by FCC were not useful for assessing the impact of E-rate program funding because the measures used did not directly measure the impact of E-rate funding; and that since fiscal year 2002 there have been no E-rate performance goals and measures at all. In its letter, FCC states that it is actively working to *re-establish* performance goals and measures that are consistent with the Government Performance and Results Act. Our finding is that FCC never established E-rate goals and measures that were consistent with the act in the first place, despite our recommendation in 1998 (and reiterated in 1999) to do so. In a

multibillion-dollar program now entering its eighth funding year, this is a serious management deficiency.

In its letter, FCC notes that it needs to seek comment from stakeholders regarding performance measures. GAO's guidance on implementing the Results Act supports this approach: Stakeholder involvement in defining goals is particularly important in a political environment, and the involvement of Congress is indispensable. While we understand the time involved in crafting useful performance goals and measures and complying with the notice-and-comment requirements of the Administrative Procedure Act, we urge FCC to move as quickly as possible in its efforts.

6. Our draft report included appeals numbers that were different from those in FCC's letter. It appears that our numbers included waiver requests as well as appeals. We have changed our report to reflect the numbers included in FCC's letter, which, according to FCC, are current as of January 1, 2005. This numerical difference does not reflect any material change.
7. We are encouraged that FCC has begun redirecting staff and hiring additional attorneys to Universal Service Fund oversight and program management, including the resolution of E-rate appeals. It is a particularly positive step that FCC has established a measurable goal of resolving all backlogged E-rate appeals by the end of calendar year 2005.

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