United States General Accounting Office

GAO

Report to the Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate

March 1999

SCHOOLS AND LIBRARIES PROGRAM

Actions Taken to Improve Operational Procedures Prior to Committing Funds

GAO/RCED-99-51

GAO

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

Resources, Community, and
Economic Development Division

B-281644

March 5, 1999

The Honorable John McCain
Chairman, Committee on Commerce
Science, and Transportation
United States Senate

Dear Mr. Chairman:

As you know, the Telecommunications Act of 1996 expanded universal service—affordable, nationwide telephone service—to eligible schools and libraries and authorized the Federal Communications Commission (FCC) to implement a program to assist these institutions in acquiring modern telecommunications services. As implemented by FCC, schools and libraries eligible for this program could receive discounts from vendors on the cost of approved telecommunications services, Internet access, and internal connections. To administer the program, FCC directed the creation of the Schools and Libraries Corporation (the Corporation), which was established in late 1997.

Concerned about the Corporation's start-up activities, you asked us to review its procedures and internal controls. In our testimony before your Committee on July 16, 1998, we noted that the Corporation had made progress in establishing an operational framework for the program that was consistent with relevant FCC Orders.[1] However, we also found several areas of concern and recommended that the FCC Chairman direct the Corporation to take the following actions to strengthen its operations before issuing any funding commitment letters to applicants:

- analyze a random sample of processed applications to determine if there are any systemic weaknesses in the application review procedures;
- complete the design of the program's operational procedures, automated systems, and internal controls; and
- obtain a report from its independent accountants that finds that the Corporation has developed an appropriate set of internal controls to mitigate against waste, fraud, and abuse.

In addition, we recommended that the Corporation conduct in-depth reviews of applications designated as "high risk" before, rather than after, issuing commitment letters to these applicants. We also recommended

[1]Schools and Libraries Corporation: Actions Needed to Strengthen Program Integrity Operations Before Committing Funds (GAO/T-RCED-98-243, July 16, 1998).

that FCC develop goals, measures, and performance targets for the program that are consistent with the requirements of the Government Performance and Results Act of 1993.

Following our July testimony, both the FCC Chairman and the Corporation agreed to implement these recommendations to strengthen program operations. This report responds to your subsequent request that we assess the Corporation's progress in implementing our recommendations. You also asked us to highlight any additional issues that need to be monitored as the program moves forward.

Results in Brief

The Corporation has taken actions to implement the key recommendations that we believed needed to be completed prior to issuing any funding commitment letters to applicants. These included (1) sampling processed applications to identify and correct any systemic weaknesses in program integrity review procedures; (2) finalizing the program's procedures, automated systems, and internal controls; and (3) obtaining a report from its independent accountants on the suitability of the Corporation's internal controls to prevent or detect material departures from its Program Objectives. In addition, the Corporation is taking action on our recommendation to complete special reviews of "high-risk" applicants before issuing commitment letters to these applicants. FCC, however, has not yet implemented our recommendation to develop adequate goals, performance targets, and measures for the program.

With our key operational recommendations implemented, the Corporation began issuing its funding commitments for the first year to applicants in late November 1998. The program, however, still faces major challenges as it moves into new operational areas, such as reviewing and authorizing reimbursements to vendors. Given the fact that the program is still essentially in a start-up mode, close oversight by FCC will be especially important in helping to identify and resolve operational problems.

Background

Universal service traditionally has meant providing residential customers with affordable, nationwide access to basic telephone service. The Telecommunications Act of 1996, however, extended universal service support to eligible schools and libraries. The new program (often referred to as the "e-rate" program) is designed to improve schools' and libraries' access to modern telecommunications services. Generally, educational institutions that meet the definition of “schools” laid out in the Elementary and Secondary Education Act of 1965 are eligible to participate,[2] as are libraries that can receive assistance from a state’s library administrative agency under the Library Services and Technology Act.[3]

Schools and libraries do not receive direct funding from the program. Instead, support comes in the form of discounts on the costs of telecommunications services. FCC’s orders provided for discounts ranging from 20 to 90 percent on all commercially available telecommunications services, Internet access, and internal connections.[4] The act specifies that every telecommunications carrier providing interstate telecommunications services must contribute to a universal service fund, unless exempted by FCC.[5] This fund is used to reimburse vendors for the discounted services that they provide to program participants.

Program Administration

The act did not prescribe a structure for administering the program. However, in 1997, FCC directed the establishment of the Schools and Libraries Corporation to carry out this function. The Corporation works within the framework of the FCC’s orders and rules to administer certain program functions.

The Corporation, with a 14-member staff based in Washington, D.C., contracted out most of its application-processing, client support, and review functions to the National Exchange Carrier Association (NECA), located in New Jersey.[6] NECA’s key responsibilities include reviewing applications to ensure compliance with the program’s requirements and processing invoices from telecommunications vendors to reimburse them for the cost of discounts they provide. NECA, in turn, has subcontracted

[2]Most public and private schools teaching kindergarten to grade 12 are eligible for support. Examples of entities not eligible for support are home school programs, private vocational programs, and institutions of higher education. In addition, private schools with endowments of more than $50 million are not eligible to participate.

[3]Libraries whose budgets are part of a school’s budget are not eligible to receive universal service support.

[4]Eligible telecommunications and Internet services include basic phone service, T-1 lines, dial-up Internet access, and direct Internet connections. Eligible internal connections include telecommunications wiring, routers, switches, and network servers that are necessary to transport information to individual classrooms.

[5]The Commission also required certain other providers of telecommunications services to contribute to the universal service fund.

[6]NECA was established at FCC’s direction in 1983 to administer interstate access tariffs and the revenue distribution process for local telephone companies.

with two other organizations to help answer applicants' questions, process and enter applications into the Corporation's database, and establish and maintain the Corporation's public web site, which contains important information about program operations and application procedures.[7]

FCC changed this administrative structure in November 1998 in response to the Congress's directive that a single entity administer universal service support for schools and libraries and rural health care providers. FCC appointed the Universal Service Administrative Company (USAC) as the permanent administrator of the universal service fund and directed the Corporation to merge with USAC by January 1, 1999.[8] Under this merger, the Corporation's staff will become part of USAC's Schools and Libraries Division, carrying out essentially the same functions as before. Since our review ended prior to the reorganization, we continue to refer to "the Corporation" in this report.

Application Process

In order to receive universal service support, each applicant completes a two-stage application process. During the first stage, the applicant submits a form that lists the services for which discounts are being requested. These forms are posted on the Corporation's web site so that vendors can provide applicants with competitive bids on requested services. The second stage begins after the applicant accepts a bid and enters into a contract with a vendor. The applicant submits a second form that details the types and costs of the services being contracted for and the amount of the discount being requested. The Corporation checks these forms using its application review procedures, which are designed to ensure that support goes only to eligible entities, for eligible services, at appropriate discount levels. It then issues commitment letters to successful applicants informing them of the amount of discount they can expect to receive.

[7]The Corporation's Internet web site is at (http://www.slcfund.org).

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

Actions Taken to Implement Key Operational Recommendations

We found that the Corporation has taken actions to implement the key recommendations we believed should be completed before issuing any funding commitment letters to applicants. Specifically, the Corporation has

- sampled applications that were already processed to identify and correct any systemic weaknesses in its program integrity review procedures;
- finalized the program's procedures, automated systems, and internal controls; and
- obtained a report from its independent accountants that the Corporation had suitably designed its internal controls to prevent or detect material departures from program objectives, as of November 4, 1998, in conformity with criteria set forth by the Corporation in its "Management's Statement of Universal Service Discount Mechanism Program Objectives and Internal Control Objectives."

In addition, the Corporation is following our recommendation to complete its special reviews of high-risk applications before issuing funding commitment letters to these applicants. One recommendation, however, still needs to be implemented: FCC needs to develop adequate goals, performance targets, and measures for the program.

Procedures Revised for Review of Services, but Review of Discounts Remains an Issue

One of the Corporation's primary responsibilities is to ensure that funding goes only to eligible applicants, for eligible services, at the appropriate levels of discount—as specified by FCC orders. During our initial review in June and July 1998, we found several areas of potential weakness in the Corporation's program integrity procedures that could result in funding being directed to applicants for ineligible services or at inappropriately high levels of discount. FCC's Chairman accepted our recommendation to delay issuing funding commitment letters until the Corporation randomly selected applications to assess how well its review procedures were actually working.

Corporation's Test for Applicants' Eligibility Was Effective

One of the Corporation's automated tests is designed to determine whether an applicant is eligible for support under the program. A computer program compares the name of the applying school or library against a database of eligible schools and libraries. Although we did not identify a weakness with this test approach during our initial review, we recommended that the Corporation verify the approach's effectiveness as part of its review of a random sample of processed applications.

The verification showed that only one application in a sample of 100 was from an ineligible applicant. This application, however, had already been flagged by the Corporation's automated test for eligible applicants. This result indicates that the Corporation's procedures for preventing ineligible schools and libraries from participating in the program appear to be working effectively.

Corporation Has Strengthened Its Test for Eligible Services

As noted earlier, FCC provides discounts for telecommunications services, Internet access, and internal connections. Checking on the eligibility of requested services is not easy, however, because of the variety and technical nature of many of these services—especially those related to internal connections.[9]

The Corporation's review procedures for eligible services use both manual inspections and an automated system for flagging problem applications. An important internal control document in this review process is a checklist of ineligible items, which is used during the initial screening of applications. If a clerical staff member using this checklist finds an ineligible item on an application, the application is flagged in the application processing system for a second, more detailed review by a professional staff member who checks the eligibility of each requested service. We found, however, that as the Corporation processed applications and gained experience in the types of services being requested, it added items to its checklist of ineligible services. As a result, different criteria were applied to applications, depending on when they were first screened. In our early discussions with Corporation officials, we learned that they did not intend to recheck applications that had been processed before the checklist was updated. This raised our concern that some early applications may have cleared the screening process that should have been flagged for detailed review.

The results of the Corporation's review of a random sample showed that weaknesses indeed existed in its procedures for ensuring that only eligible services receive funding. At least 19 of the 100 applications in the sample contained requests for ineligible items as defined by FCC orders, totaling approximately $106,000 in inappropriately requested funding. Of these 19 applications, 7 had been classified as "clean" (that is, containing no ineligible items) by the Corporation's earlier review and contained approximately $6,000 in inappropriately requested funding. The

[9]For example, the installation of power poles (metal or plastic pipes used to carry wiring from the ceiling to the floor) may or may not be eligible for support. Under the program rules, power poles used for the distribution of telecommunications wiring are considered an eligible internal connection service. Power poles used for the distribution of electrical wiring are not eligible.

Corporation's independent accountants, PricewaterhouseCoopers, subsequently requested the Corporation to conduct a further sample of 300 applications that had been classified as "clean." This review found that 4.6 percent, or approximately $314,000, of the discount funding requested in these applications would have gone to ineligible items.

Given the error level revealed by these two samples, Corporation officials concluded that their test had to be strengthened. Accordingly, they changed their review procedures to require staff to perform a complete manual review of every requested service item in all 32,000 applications, regardless of whether these applications had been flagged during the initial screening. To implement these new procedures in a timely manner, the Corporation's contractor augmented its permanent staff with temporary staff to perform the reviews. Training and supervising new staff is, of course, important in ensuring that the new review procedures are carried out effectively.

Discount Issue Needs Further Scrutiny

FCC orders state that the level of discount that each school or library can receive should be determined by the applicant's economic need and location. Discounts range from 20 to 90 percent of the costs of the services to the applicants, with higher discounts going to those in low-income and rural areas.[10] Applicants calculate the discount level to which they are entitled by following instructions and criteria on the application form and certify that their discount calculations are correct.[11] When the Corporation processes an application, it uses an automated test to check the requested discount level. This test compares the applicant's requested discount with a discount level calculated from data on schools in the Corporation's database. If the applicant is requesting a higher discount than indicated by the Corporation's database, the test can flag the application for special review. As part of this review, a program official contacts the applicant and gathers information to determine whether the requested discount level is in fact correct.

It is possible for the automated system to flag every application that shows a variance from the Corporation's own calculation. However, the Corporation decided that such a stringent approach was not warranted

[10]The program measures how economically disadvantaged the schools and libraries are by the number of students eligible to participate in the National School Lunch Program. Rural designations are based on the Metropolitan Statistical Area listing and the Goldsmith modification covering rural pockets located within these areas.

[11]The Corporation provides additional information and tools on its web site, and encourages applicants to call, e-mail, or send a fax to get additional information and help on filling out their application forms.

because of limitations in the database it uses to make its calculations. For example, the database contains the number of students actually participating in the National School Lunch Program, rather than the number eligible to participate, which is the measure adopted by FCC. Moreover, the data are about a year old. Mindful of these limitations, the Corporation decided to establish some latitude in its review procedures for eligible discounts. Thus, the Corporation allows applications to pass unchallenged through its automated discount review if the requested discount level does not exceed a certain threshold of variance from the Corporation's own calculation. Applications that cross this threshold are flagged for manual review by a program official. Corporation officials stated that adopting this procedure was a reasonable business decision because the cost of manually reviewing all applications that showed any variance from the Corporation's own calculations would exceed the benefits gained.

We found in our initial review, however, that the Corporation had not performed a sound benefit-cost analysis to justify this business decision. We were concerned about this situation not only because of the need to enforce program rules for the sake of equity but also because the total amount of funding available during the program's first year was not enough to cover all of the applicants' requests for support. Providing funding for ineligible services or allowing inappropriate discount levels could result in some applicants' proper requests for support being denied.

The Corporation's review of a sample of 100 processed applications showed that 57 of them requested discount levels that varied from the Corporation's own calculation. After obtaining additional information for these 57 applications, the Corporation determined that at least 9 could not support their requested level of discounts. The dollar amount of these inappropriate discount requests totaled about $14,000 out of the approximately $4.5 million in requested funding.

At the request of its independent accountants, the Corporation conducted a review of an additional sample. The Corporation selected 50 applications that requested $100,000 or more in support. In this second sample, 39 of the 50 processed applications contained discount levels that varied from the Corporation's own calculation. The Corporation found that 6 of the 39 applications requested discounts that could not be validated. The funding that would have been awarded for these inappropriate discount levels totaled about $35,000 out of approximately $28.5 million in requested funding.

Having considered these results, Corporation officials decided that they did not need to change their procedures for reviewing requested discount rates for the first funding year. As before, they maintained that the amount of inappropriate funding in question was not large enough to warrant the time and cost of performing follow-ups on every application that showed any variation from the discount level calculated by the Corporation's automated check.

We remain concerned, however, that the amount of inappropriate discounts passing unchallenged through the review process, though relatively low now, could grow larger in subsequent funding years. We therefore believe that the Corporation needs to explore methods for mitigating this risk in a cost-beneficial manner. Aware of our continuing concern, the FCC Chairman directed the Corporation in November 1998 to work with FCC staff "to establish a method for improving the procedures for ensuring that discounts are provided in accordance with the discount levels set forth in the Commission's rules."

Final Operating Procedures Have Been Established

At the time of our initial review in June and July 1998, the Corporation had not yet finalized all the procedures, automated systems, and internal controls needed to make funding commitments and approve vendors' compensation for the discounted services provided to applicants. Nevertheless, the Corporation was planning to issue funding commitment letters before the remaining procedures were finalized. We maintained, however, that this approach would have put the Corporation at risk of being unable to process nearly $2 billion in vendors' invoices in a timely manner. Corporation officials themselves estimated that in cases where services were already being provided to applicants, invoices for payment could be sent in by vendors as soon as 15 days after commitment letters were sent out, thereby triggering the reimbursement process. Therefore, we recommended in our July 1998 testimony that the Corporation make no funding commitments until it had finalized all of its operating procedures and automated systems. FCC and the Corporation accepted this recommendation.

The Corporation needed until early November 1998 to finalize its operating procedures, complete the testing of the automated systems supporting these procedures, and secure the Office of Management and Budget's approval of the applicant and vendor forms needed for the reimbursement process. This delay occurred in part because on June 22, 1998, FCC released a reconsideration order that significantly altered the program.

Specifically, the program's funding year was changed from a calendar year cycle to a fiscal year cycle, and the period for the first round of funding was changed from 12 months to 18 months. The order also adjusted the maximum amounts that could be collected and spent during 1998 and the first 6 months of 1999, directing the Corporation to commit no more than $1.925 billion for the schools and libraries program during this time frame. Because this amount was not expected to cover all of the applicants' requests, FCC directed the Corporation to give funding priority to applicants' requests for telecommunications services and Internet access. Once these requests are satisfied, the remaining funds are to be used for internal connections, with priority given to applicants eligible for higher discounts. To implement these new priority rules, the Corporation had to significantly revise its funding award process and automated support systems.

In addition, the Corporation found that some established procedures needed to be modified as it learned lessons from reviewing the first round of applications. For example, the Corporation initially cautioned schools and libraries that they would not receive discounts on any items in their funding requests that had included ineligible services mixed with eligible services. However, when the Corporation began reviewing applications, it found some cases in which applicants included an ineligible service that accounted for only a small percentage of the total cost of the service item being requested.[12] As a result, the Corporation, with FCC's concurrence, modified its procedures so as to provide funding for items that were substantially correct even though they contained some ineligible services. Specifically, if the ineligible services accounted for less than 50 percent of the total dollar amount of the item requested, the Corporation would separate out the cost of the ineligible services and provide discount funding for the remaining eligible services.

Independent Accountants' Report on the Corporation's Internal Controls Has Been Completed

In December 1997, FCC's Chairman directed the Corporation to contract with an independent accounting firm to assess—before any program disbursements were made—whether the program's processes and procedures provided the controls needed to mitigate against fraud, waste, and abuse. In December 1997, with the approval of the Corporation's Board of Directors, the Corporation engaged the services of Coopers & Lybrand, LLP (which became PricewaterhouseCoopers, LLP, on July 1,

[12]A sample showed that 6 out of 100 applications had funding requests that contained ineligible items. Under the Corporation's old procedures, approximately $482,000 of a total of $2.7 million in requested discount funding for the 100 applications would have been denied. Under the new procedures, the Corporation approved approximately $388,000 (80 percent) of this $482,000.

1998). The independent accountants were to examine the Corporation's assertions that internal controls over the processing of funding requests from applicants were suitably designed to detect material departures from the Program Objectives set forth in the Corporation's document, "Management's Statement of Universal Service Discount Mechanism Program Objectives and Internal Control Objectives."

At the time of our initial review during June and July 1998, the Corporation planned to issue funding commitment letters to applicants before the independent accountants had completed their review but not disburse any funds until the review was complete. We were concerned, however, that setting the funding commitment process in motion before the underlying control design has been fully reviewed would undercut the purpose and value of the independent review. Therefore, we recommended that the Corporation refrain from making funding commitments until it had obtained a report from its independent accountants stating that an appropriate set of internal controls was in place. Both FCC and the Corporation accepted this recommendation. On November 4, 1998, the independent accountants' report was issued stating that the Corporation had suitably designed internal controls to prevent or detect material departures from its Program Objectives as of November 4, 1998.

Scope of the Independent Review

The Corporation engaged the independent accountants to determine whether the internal controls over its processing of funding requests from applicants were in accordance with these six Program Objectives:

- All applications are processed in accordance with FCC's priority rules.
- Only eligible schools and libraries receive discounts.
- Only eligible services as defined by FCC's orders are funded.
- Discount percentages are approved in accordance with the criteria specified under FCC's orders and rules.
- Payments to vendors are authorized in a timely manner.
- Funding commitments do not exceed the program's funding limits.

The independent accountants' work included reviewing the Corporation's procedures and documentation related to its control environment, application controls, computer controls, and monitoring controls. In addition, the independent accountants discussed control issues with the Corporation's management and closed them out, as appropriate, when satisfied with the documentation and the suitability of the design. Before issuing a final report, the independent accountants briefed the Corporation's Board of Directors, the FCC's Common Carrier Bureau, and the FCC Chairman. Because the Corporation was in a start-up phase during 1998, the independent accountants were not engaged to examine and report on the actual operating effectiveness of these internal controls.

During the course of its review, the independent accountants became concerned, as we were, about the efficacy of the Corporation's review procedures for ensuring that only eligible services receive support at the appropriate level of discount. The weakness in the service review procedures, discussed earlier, was addressed to the independent accountants' satisfaction when the Corporation changed them to require a complete review of all requested services on all applications before committing funds. The independent accountants' concern with the discount review focused on the Corporation's decision to allow some applications to go through the review process unchallenged even though they were requesting a higher discount than calculated by the Corporation in its review process. Near the end of the independent accountants' review in November 1998, the Corporation modified its written program objective for discounts to reflect its practice of accepting and approving discounts that are higher than its own discount calculation, provided that they are within a certain threshold of variance. The Corporation cited limitations in its verification sources, discussed earlier, as the reason for adopting this procedure. With this modification, the independent accountants concluded that the Corporation's internal controls were suitably designed to prevent or detect material departures from the Program Objectives, as amended by management.

Concerns Resolved Over the Timing of "High-Risk" Reviews

As an extra quality control step, the Corporation planned to conduct special reviews of applications that it considered to be high risk. The Corporation designates applications as high risk on the basis of several criteria, including the size of the request, evidence from external sources of possible program compliance issues, and indications that a school has an endowment of more than $50 million.

The Corporation estimated that about 1,600 of the approximately 32,600 applications were high risk. These represent about $1.2 billion of the $2 billion requested by all applicants for the program's first year. As part of its high-risk reviews, the Corporation plans to require these applicants to submit additional material to support their funding requests. This material is then to be reviewed by program staff to check for conformity to program rules.

Because these high-risk reviews are an important internal control, we were concerned about their timing. The Corporation originally planned to wait until after the applicants had received their funding commitment letters before doing their high-risk reviews. Under this scenario, if the Corporation found a problem with a high-risk application during its special review, it might have to reduce or withdraw the funding commitment that it had already made. In such cases, applicants who decided to begin receiving contracted services on the basis of their funding commitment letters could find themselves responsible for paying more than they had planned.

Accordingly, in our July 1998 testimony, we recommended that the Corporation complete these special reviews before sending funding commitment letters to high-risk applicants. The Corporation agreed to change its procedures and in October 1998 began conducting its first special reviews of the high-risk applications. In October 1998, Corporation officials stated that none of these approximately 1,600 applications would receive funding commitment letters until their selective reviews were completed.

FCC Still Needs to Develop Goals and Measures for the Program

Performance measurement is critical for determining a program's progress in meeting its intended outcomes. During our initial review, we noted that FCC's combined "Strategic Plan for Fiscal Years 1997-2002 and Annual Performance Plan for Fiscal Year 1999" provided no specific strategic goals, performance measures, or target levels of performance for the program. Without clear goals and measures, the Congress, FCC, and the Corporation would have a difficult time assessing the effectiveness of the program and determining whether operational changes are needed. Accordingly, we recommended that the FCC Chairman direct responsible FCC staff to develop goals and measures for the program before the end of fiscal year 1998 so that the Congress and others would be able to assess the results of the program's first year of operations.

This recommendation still needs to be implemented. FCC's February 1999 "Annual Performance Plan for Fiscal Year 2000" still fails to provide well-defined goals, performance targets, and measures. For example, it is unclear whether FCC intends to use "schools" or "classrooms" as the unit of measurement in tracking access to advanced telecommunications services—a point of major significance. In our subsequent discussions with FCC and Corporation officials, we found that FCC did not coordinate with program officials when developing its revised plan. As we noted in our previous testimony, we have issued guidance on developing effective strategic plans.[13] One of the key practices in developing these plans is to involve stakeholders—such as school and library officials—in the goal-setting process. The involvement of the Congress is also indispensable to defining goals, as are the agency's customers—in this case, the schools and libraries themselves.

Corporation officials have already identified a number of data sources that could be used to develop baseline data and measure trends in areas such as Internet connections. They are also posting the results of their funding decisions on the Corporation's web site, broken down by states, types of services funded, and the percentage of funding going to rural/low-income areas. In addition, Corporation officials are currently exploring ways to measure the efficiency of their work processes. While these efforts are useful, it is important that FCC take the lead as part of its policy-making and oversight responsibilities to define specific goals and measures for the program, particularly as they relate to the outcomes being achieved by the expenditure of funds.

Other Management Challenges Will Need Close Attention

When we completed our audit in early December 1998, the Corporation was finishing its review of applications and starting to make funding decisions, a process that was going much more slowely than expected. As a result, our review did not include certain key activities that the Corporation had not yet completed or begun. These include

- implementing the newly revised review procedures, especially for high-risk applications;
- setting priorities for funding commitments in accordance with FCC's orders and rules;
- dealing with applicants' appeals on commitment decisions, including establishing a funding reserve to cover those that are successful; and
- reviewing and authorizing vendors' requests for reimbursement.

These are challenging activities in themselves and will be even more challenging because they can overlap in time. For example, the reimbursement activity will involve processing tens of thousands of forms submitted by successful applicants and their vendors. While this activity is occurring, applications for the second funding cycle will be coming in. This application period began on December 1, 1998, and was originally

[13]See Executive Guide: Effectively Implementing the Government Performance and Results Act (GAO/GGD-96-118, June 1996) and Agencies' Strategic Plans Under GPRA: Key Questions to Facilitate Congressional Review (Version 1, GAO/GGD-10.1.16, May 1997).

scheduled to close in mid-February. However, the Corporation extended the deadline to mid-March 1999 because of the delay in getting out the first year's commitment letters. The closing date was extended again, to April 6, 1999, because commitment letters were still going out in February 1999. This extension, together with the added workload of vendor reimbursements, raises the question of whether the program staff and contractors will have enough time to carefully review and process all the new applications by July 1999—the start of the next funding period.

Given these issues, FCC's role in overseeing the program will be more important than ever. In many ways, the Corporation is still in a start-up mode and continues to need help in resolving operational problems. FCC's oversight will also be important to ensure that the program's transition from the Schools and Libraries Corporation to USAC goes smoothly and that USAC management is appropriately engaged in maintaining and improving the overall integrity of the program's operations.

Scope and Methodology

To track the progress being made in implementing our recommendations, we held ongoing discussions with FCC and Corporation officials. We reviewed draft and final operational procedures, documentation for the automated systems, and other material related to internal controls. We also visited with the Corporation's contractor in New Jersey, which has major responsibilities for developing and implementing program procedures and automated information systems. In addition, we met with PricewaterhouseCoopers to discuss the scope and results of its independent review of the suitability of the design of the Corporation's internal controls. We performed our review from June 1998 through December 1998 in accordance with generally accepted government auditing standards.

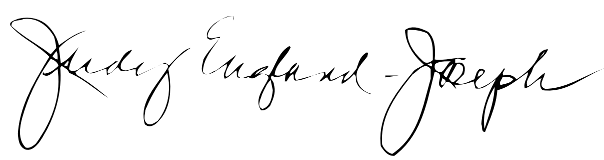
Agency Comments

We provided a draft of this report to the Federal Communications Commission, the Schools and Libraries Corporation (now the Schools and Libraries Division of the Universal Service Administrative Company), and PricewaterhouseCoopers for their review and comment. We subsequently met with officials from the Schools and Libraries Division, the Common Carrier Bureau of the Federal Communications Commission, and PricewaterhouseCoopers. All three concurred with our findings and provided several points of clarification, which we incorporated into our final report. Appendix I contains the Schools and Libraries Division's letter commenting on our draft report. The President of the Division stated that our report captures fairly the work undertaken to provide for effective internal controls. She added that using the experience gained in processing the first year's applications, the Division will implement new and tighter procedures for evaluating discounts in response to direction from the Chairman of the Federal Communications Commission. Regarding the need to establish adequate performance goals and measures for the program, Federal Communications Commission officials told us that they recognize the importance of the recommendation in our July 1998 testimony and intend to address it, but they did not indicate a time frame for doing so.

We are sending copies of this report to interested congressional committees, the Chairman and Commissioners of the Federal Communications Commission, the Chief Executive Officer of the Universal Service Administrative Company, and the President of the Schools and Libraries Division of the Universal Service Administrative Company. Copies of this report will also be made available to others upon request.

If you have any questions about this report, please call me at (202) 512-7631. Major contributors to this report are listed in appendix II.

Sincerely yours,



Judy A. England-Joseph
Director, Housing and Community
Development Issues

Comments From the Schools and Libraries Division, Universal Service Administrative Company

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Kate L. Moore
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February 10, 1999

Ms. Judy England-Joseph
Director, Housing and Community Development Issues
United States General Accounting Office
Washington, D.C. 20548

RE: Response to Draft Report Schools and Libraries Program: Actions Taken to Improve Operational Procedures Prior to Committing Funds

Dear Ms. England-Joseph:

Thank you for the opportunity to comment on GAO's draft report. In my view, the report captures fairly the work undertaken by the Schools and Libraries Corporation in 1998 to provide for effective internal controls. Under separate cover, we have provided minor suggestions for purposes of clarification.

Additionally, I wanted you to know that in response to the FCC Chairman's direction, the Schools and Libraries Division will implement new, tighter procedures for evaluating discounts. Changes will reflect the knowledge gained in our first year and Chairman Kennard's guidance to us in November to "establish a method for improving the procedures."

Thank you for the care you and your staff provided throughout the audit process.

Sincerely,

Kate L. Moore

Kate L. Moore

KLM/tw

cc: Chairman William E. Kennard, Federal Communications Commission
Members, Schools and Libraries Committee, USAC Board of Directors

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