

FCC Response to Draft GAO Report

Submitted by

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Chief, Wireline Competition Bureau**

In connection with:

**Problems with the E-rate Program:
GAO Review of FCC Management and Oversight**

Before the

**Subcommittee on Oversight and Investigations
of the Committee on Energy and Commerce
United States House of Representatives**

March 16, 2005



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

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).

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).

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

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:

- 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 (USGGSL). *See GovGAAP Order*, 18 FCC Rcd 19911.

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.

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

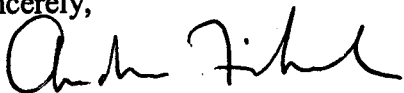
⁷ As the GAO Draft Report notes, the FCC used to measure the number of public schools connected to the Internet, but stopped doing so because, among other reasons, the measure was no longer a useful indicator of the impact of E-rate funds. (Draft Report at 24-25).

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