

Federal Communications



Commission

Office of the Inspector General
Semiannual Report to Congress
October 1, 2003 - March 31, 2004

H. Walker Feaster III
Inspector General



Federal Communications Commission
Washington

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: May 3, 2004

REPLY TO
ATTN OF: Inspector General

SUBJECT: Semiannual Report

TO: Chairman

In compliance with Section 5 of the Inspector General Act, as amended, 5 U.S.C. App. 3, § 5, I respectfully submit the Office of Inspector General (OIG) Semiannual Report summarizing the activities and accomplishments of the OIG during the six-month period ending March 31, 2004. In accordance with Section 5 (b) of the Act, this Semiannual Report along with the report that you as head of the agency prepares, should be forwarded to the appropriate Congressional oversight committees within 30 days of your receipt of this report.

During this reporting period, as in the previous one, OIG activity continued to focus on the Universal Service Fund activities because of continuing allegations of waste and fraud, and the results of beneficiary audits performed by contract auditors and Commission staff. Our efforts in this area have been summarized in a special section of this report entitled "Universal Service Fund."

The report details a number of audits underway and completed at the Commission during the preceding six months including the annual financial statement audit, the Federal Information Security Management Act (FISMA) evaluation and risk assessment, and an audit of the Commission's Revenue Accounting and Management Information System.

Investigative personnel continued to address investigative issues referred to and developed by this office. Where appropriate, investigative reports have been

forwarded to management for action.

This office remains focused upon providing our customers with the highest possible level of professionalism and quality through our audits, investigations and consultations.

H. Walker Feaster, III
Inspector General

Enclosure

cc: Chief of Staff
Managing Director

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Introduction

The Federal Communications Commission (FCC) is an independent regulatory agency, which was delegated authority by Congress under the Communications Act of 1934, as amended by the Telecommunications Act of 1996. The FCC is charged with the regulation of interstate and international communication by radio, television, wire, satellite and cable. The FCC's jurisdiction covers the fifty states, the District of Columbia and all the U.S. possessions. Under the Communications Act, the FCC is mandated to make rapid, efficient, nationwide and worldwide wire and radio communication service available to all people in its jurisdiction. The FCC performs four major functions to fulfill this charge:

- Spectrum allocation
- Creating rules to promote fair competition and protect consumers where required by market conditions
- Authorization of service
- Enforcement

The Chairman and four Commissioners are appointed by the President and confirmed by the Senate.

Michael K. Powell was designated Chairman on January 22, 2001. Kathleen Q. Abernathy, Jonathan S. Adelstein, Michael J. Copps and Kevin J. Martin serve as Commissioners. The majority of FCC employees are located in Washington, D.C. FCC field offices and resident agents are located throughout the United States. FCC headquarters staff are located in the Portals II building located at 445 12th St., S.W., Washington, D.C. 20554.

The Office of Inspector General (OIG) dedicates itself to assisting the Commission as it continues to improve its effectiveness and efficiency. The Inspector General (IG), H. Walker Feaster III, reports directly to the Chairman. The OIG staff consists of eleven professionals and a student intern. Principal assistants to the IG are: Thomas Cline, Assistant Inspector General (AIG) for Audits; Thomas Bennett, AIG for Universal Service Fund Oversight; Charles J. Willoughby, AIG for Investigations; and Thomas M. Holleran, AIG for Policy and Planning. Mr. Willoughby also serves as counsel.

Universal Service Fund

Independent Oversight of the Universal Service Fund (USF)

Beginning with our semi-annual report for the period ending March 31, 2002, we have included a section highlighting our efforts to implement effective, independent oversight of the Universal Service Fund (USF). We decided that it was necessary to highlight our efforts to provide independent oversight of the USF to ensure that Congress and other recipients of our semi-annual report clearly understood our concerns about this program. We have also used this section of the semi-annual report to identify obstacles to the effective implementation of our oversight program.

In this semi-annual report, we provide a brief background on our efforts to implement independent oversight of USF, an update on our oversight activity during the reporting period, and comments on those areas of the program where we have concerns as a result of our involvement in audits and investigations.

History of USF Oversight

The FCC Office of Inspector General (OIG) first looked at the USF in 1999 as part of our audit of the Commission's FY 1999 financial statement when the USF was determined to be part of the FCC's reporting entity for financial statement reporting. During that audit, we questioned Commission staff regarding the nature of the USF and, specifically, whether it was subject to the statutory and regulatory requirements for federal funds. Starting with that inquiry, the Office of Inspector General has continued to devote considerable resources to independent oversight of the USF.

Due to materiality and our assessment of audit risk, we have focused much of our attention on the USF mechanism for funding telecommunications and information services for schools and libraries, also known as the "Schools and Libraries Program" or the "E-rate" program. Applications for program funding have increased from 30,675 in the first year of the program (funding year 1998) to 43,050 for the current funding year and have included 15,255 different service providers. Applications have been received from schools and libraries in each of

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the 50 states, the District of Columbia, and most territories. Requested funding has increased from \$2,402,291,079 in funding year 1998 to \$4,538,275,093 for the current funding year.

Unfortunately, several obstacles have impeded our ability to implement effective, independent oversight of the program. The primary obstacle has been a lack of adequate resources to conduct audits and provide audit support to investigations. Since our initial involvement in independent oversight of the USF as part of our conduct of the FY 1999 financial statement audit, we have demonstrated our commitment to independent oversight of the USF by adding two (2) staff auditor positions and by organizing USF oversight activities under an Assistant Inspector General for USF Oversight. This represents dedication of three (3) of the eight (8) auditors on the staff of the FCC OIG to USF oversight. In addition to the OIG staff dedicated to USF oversight, two (2) audit staff members responsible for financial audit are also involved in USF oversight as part of the financial statement audit process. In addition to assigning audit staff to USF oversight, we have requested appropriated funding to obtain contract support for our USF oversight activities. In our FY 2004 budget submission, we requested \$2 million for USF oversight. That request was increased to \$3 million in the President's budget submission for FY 2004. Unfortunately, this funding was not included in the Commission's final budget for FY 2004. We are currently considering alternatives for obtaining access to contract audit support to implement the USF oversight portions of our FY 2004 audit plan.

Despite limited resources, my office has implemented an aggressive program for independent oversight of the USF. The oversight program includes: (1) audits conducted using internal resources; (2) audits conducted by other federal Offices of Inspector General under reimbursable agreements; (3) review of audit work conducted by USAC; and (4) active participation in federal investigations of E-rate fraud.

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OIG Audits Using Internal Resources

In October 2001, we obtained four (4) auditors from the Commission's Common Carrier Bureau (since reorganized as the Wireline Competition Bureau) on a temporary detail. We have completed eight (8) of the audits that we initiated using detailed auditors, including four (4) during the reporting period. For the eight (8) audits that have been completed, we concluded that applicants were compliant with program rules in four (4) of the audits, that applicants were generally compliant in two (2) of the audits, and that the applicants were not compliant with program rules in two (2) of the audits. For the four (4) audits where we determined that applicants were generally compliant or not compliant, we have recommended recovery of \$218,447. We have been advised that the Commission's Office of Managing Director (OMD) has directed USAC to initiate recovery proceedings for the recommended recovery amount of \$218,447. Please refer to the audit report section of the semi-annual report for detailed information regarding E-rate audits completed during the reporting period.

Audits Conducted by Other Federal Offices of Inspector General

On January 29, 2003, we executed a Memorandum of Understanding (MOU) with the Department of the Interior (DOI) OIG. This MOU is a three-way agreement among the Commission, DOI OIG, and USAC for audits of schools and libraries funded by the Bureau of Indian Affairs and other universal service support beneficiaries under the audit cognizance of DOI OIG. Under the agreement, auditors from DOI OIG perform audits for USAC and the FCC OIG. In addition to audits of schools and libraries, the agreement allows for the DOI OIG to consider requests for investigative support on a case-by-case basis. During the reporting period, we issued two (2) reports under this MOU and completed fieldwork on three (3) additional audits. For the two (2) audits that were completed, we concluded that the applicant was compliant with program rules in one (1) of the audits and that the applicant was not compliant with program rules in one (1) of the audits. For the audit where we determined that the applicant was not compliant, we have recommended recovery of \$2,084,399. We have been advised that the Commission's Office of Managing Director (OMD) has directed USAC to initiate recovery proceedings for the recommended recovery amount of \$2,084,399. Please refer to the audit report section of the semi-

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annual report for detailed information regarding E-rate audit completed during the reporting period.

We have also established a working relationship with the Office of Inspector General at the Education Department (Education OIG). In April 2003, Education OIG initiated an audit of the use of federal education funding to purchase equipment to make effective use of internal connections and internet connectivity funding by E-rate at a large recipient. The FCC OIG provided support to this audit. In January 2004, Education OIG presented a plan for an audit of telecommunication services at a large E-rate recipient. We are continuing to discuss initiation of this audit with Education OIG, USAC, and Commission management.

Review of USAC Audits

We have reviewed work performed by USAC's Internal Audit Division and performed the procedures necessary under our audit standards to rely on that work. In December 2002, USAC established a contract with a public accounting firm to perform agreed-upon procedures at a sample of seventy-nine (79) beneficiaries from funding year 2000. The audit program for this review was created with input from the OIG and the sample of beneficiaries was selected by the OIG. In a departure from the two previous large-scale E-rate beneficiary audits conducted by USAC, the agreed-upon procedures being performed under this contract would be performed in accordance with both the Attestation Standards established by the American Institute of Certified Public Accountants (AICPA) Standards and Generally Accepted Government Auditing Standards, issued by the Comptroller General (GAS 1994 revision, as amended) (GAGAS). In March 2003, we signed a contract with a public accounting firm to provide audit support services for USF oversight to the OIG. The first task order that we established under this contract was for the performance of those procedures necessary to determine the degree to which we can rely on the results of that work (i.e., to verify that the work was performed in accordance with the AICPA and GAGAS standards). The OIG review team is currently completing this work. Many of the audit findings raised by this body of work are reflected in the section addressing concerns with the E-rate program.

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Support to Investigations

In addition to the audit component of our independent oversight program, we are providing audit support to a number of investigations of E-rate recipients and service providers. To implement the investigative component of our plan, we established a working relationship with the Antitrust Division of the Department of Justice (DOJ). The Antitrust Division has established a task force to conduct USF investigations comprised of attorneys in each of the Antitrust Division's seven (7) field offices and the National Criminal Office.

As of the end of the reporting period, we were supporting twenty-six (26) investigations and monitoring an additional sixteen (16) investigations. Unfortunately, the increased interest in these cases has resulted in an increased demand for OIG audit support. In fact, the amount of audit support has exacerbated our previously stated concern about the availability of resources and our ability to implement other components of our USF oversight plan. Allegations being investigated in these cases include the following:

- Procurement irregularities – including lack of a competitive process and bid rigging.
- False Claims – Service Providers billing for goods and services not provided.
- Ineligible items being funded.
- Beneficiaries are not paying the local portion of the costs resulting in inflated costs for goods and services to the program and potential kickback issues.

Significant accomplishments in investigative support during the reporting period are as follows:

- We issued one (1) report summarizing the results of audit procedures performed at the request of federal law enforcement in support of an on-going investigation. In our report, we identified monetary findings in the amount of \$766,062 related to goods and services that were missing or were not provided and for which the service provider was paid. We also identified several apparent instances of noncompliance with program rules. Issues of noncom-

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pliance included schools not budgeting for, or paying, the non-discounted portion of the cost of goods and services provided and schools not preparing technology plans in accordance with program implementing procedures or submitting technology plans for review and approval in accordance with program rules.

- OIG staff testified before three (3) federal Grand Juries investigating E-rate fraud.
- We received allegations and opened six (6) new E-rate fraud cases. We are providing support to federal law enforcement in the conduct of these cases.
- We were advised of four (4) new E-rate fraud cases that we are monitoring.
- We completed fieldwork on two (2) E-rate fraud cases for which federal law enforcement requested that we conduct audit procedures. We provided the results of those audit procedures to federal law enforcement.

Concerns with the E-rate Program

Since we became involved in USF oversight, we have devoted a considerable portion of available resources to USF oversight, focusing primarily on the E-rate program. We have conducted audits and evaluated the results of audits conducted by others, supported numerous federal, state, and local investigations, and examined the program for purposes of planning effective, independent oversight. We believe that the work that we have performed provides us with a unique perspective on the program in general and specifically on fraud, waste, and abuse in the program. In this section of the semi-annual report, we address aspects of the program where we have concerns as a result of our involvement in audits and investigations. These concerns include macro level issues related to audit resolution and fund recoveries and specific concerns related to program design and beneficiary compliance.

Resolution of Audit Findings and Fund Recoveries

During this semi-annual reporting period, we have become increasingly concerned about efforts to resolve audit findings and to recover funds resulting from E-rate beneficiary audits. We have observed that findings from audits conducted by USAC are not being resolved in a timely

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manner and that, as a result, timely action is not being taken to recover inappropriately disbursed funds. In some cases, it appears that the delay is caused by USAC. In other cases, findings are not being resolved because USAC is not receiving necessary guidance from the Commission in a timely manner. Under program rules, USAC is prohibited from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. As a result this prohibition, USAC must seek guidance from the Commission when audit findings are not clearly violations of Commission rules or when other policy questions are raised.

The second large-scale audit of E-rate beneficiaries was conducted by the public accounting firm of Arthur Andersen under contract to USAC. In 2001, USAC contracted with Arthur Andersen to conduct audits at twenty-five (25) beneficiaries from funding years 1999 and 2000. Audited disbursements to these beneficiaries at the same time these audits were completed totaled \$322 million. Arthur Andersen provided a draft audit report summarizing the results of these audits on May 31, 2002. The final report, including responses from the USAC Schools and Libraries Division, was released by the Schools and Libraries Committee of the USAC Board of Directors on April 23, 2003, eleven months after the draft report was provided by Arthur Andersen. The audit report disclosed monetary findings at fourteen (14) of the twenty-five (25) beneficiaries including \$11.4 million dollars in inappropriate disbursements and unsupported costs. As of September 30, 2003, USAC had recovered \$1,927,579 in inappropriate disbursements and unsupported costs and initiated recovery actions for another \$1,353,741, of which \$709,013 is under appeal. We have been advised that USAC initiated recovery actions for the remaining \$8,059,141 during the reporting period. In addition, the report identified findings at many of the beneficiaries where there are no monetary findings.

The final report adopted by the Universal Service Board also identified eleven (11) policy issues, relating to thirty-three (33) separate findings, for which USAC determined that FCC policy guidance was required. The dollar value of potential fund recoveries associated with these thirty-three (33) findings was not available because, in most cases, the final report indicated that those amounts had not been

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determined. Policy issues identified included the lack of fixed asset and associated records, maintenance of connectivity once it is established, technology plan approver control and requirements, insufficient documentation including lack of invoice detail and vendor payment information, incomplete or insufficient competitive bidding documentation, monitoring of technology plan goals and objectives, and physical security of equipment. Although the final report was released on April 23, 2003, USAC did not request policy guidance from Commission staff until October 2003. In January 2004, Commission staff provided "informal" guidance to USAC related to E-rate beneficiary audits being conducted by KPMG. These informal comments included reference to four (4) of the eleven (11) Arthur Anderson round 2 policy questions raised by USAC in their October 2003 request. On March 4, 2004, Commission staff provided guidance to USAC on the eleven (11) policy issues, almost two years after the draft report was submitted by Arthur Andersen. Many of the policy questions raised in USAC's request for guidance address issues identified in other audits including other E-rate beneficiary audits conducted by USAC's Internal Audit Division and those conducted by the FCC OIG. Where appropriate, we have incorporated Commission staff policy guidance under the next section of the semi-annual report addressing our concerns regarding program design and beneficiary compliance.

Program Design and Beneficiary Compliance

The rules governing USAC's administration of all universal service programs are found in Part 54 of the Commission's rules. As previously discussed, USAC is prohibited under program rules from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. However, under Commission staff oversight, USAC has implemented numerous policies and procedures to administer the E-rate program. In some cases, the Commission has expressly endorsed specific USAC operating procedures in Commission orders; in other cases, the Commission has formally codified USAC procedures into its rules. In other cases, however, USAC procedures have not been formally adopted by the FCC. In those cases where USAC implementing procedures have not been formally adopted by the Commission, Commission staff has stated that there is no legal basis for recovery of funds when applicants fail to comply with these procedures.

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During this reporting period, we began a discussion with Commission staff regarding the adoption of USAC implementing procedures as program rules. Initially, Commission staff reported that USAC procedures have also been memorialized in FCC Forms that receive approval from the Office of Management and Budget. In March 2004, we received updated guidance from Commission staff stating that they now believe that they cannot use beneficiary failure to comply with the record retention requirements listed in FCC forms as the sole basis for recovery of funds until the Commission adopts a rule that requires them to keep the documents, without regard to individual record retention requirements.

We are concerned about the distinction that Commission staff makes between program rules and USAC implementing procedures for a number of reasons. First, we believe that this distinction represents a weakness in program design. As stated previously, USAC has established implementing procedures presumably for the purpose of ensuring that program beneficiaries comply with program rules and that the objectives of the program are met. In those cases where USAC has established implementing procedures that are not supported by program rules, USAC and the Commission have limited ability to enforce beneficiary compliance with these implementing procedures. We are concerned with the number of audits that have been completed that include findings of non-compliance with USAC implementing procedures for which no recovery actions are intended. For example, the Commission has established a rule requiring that applicants keep the kinds of procurement records that they keep for other purchases and USAC has established procedures to require numerous program-related documents. However, Commission staff have not defined what they mean by a procurement record and have provided guidance to indicate that it can be interpreted narrowly or broadly. Numerous audits have included audit findings citing beneficiaries for lack of documentation. In fact, lack of documentation was cited as finding by KPMG in fourteen (14) of the sixty-two (62) audits they recently completed under contract to USAC. Commission staff have taken the position that these findings do not represent rule violations and do not serve as a basis for recovery of funds.

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Second, we believe that it is critical that participants in the E-rate program have a clear understanding of the rules governing the program and of the consequences that exist if they fail to comply with those rules. We are concerned that the Commission has not determined the consequences of beneficiary non-compliance in many cases and that, in those instances where Commission staff have addressed the issue of consequences for non-compliance, the consequences associated with clear violations of program rules do not appear to be consistent. For example, program rules require that applicants prepare a technology plan and that the plan be reviewed and approved by an approved technology plan approver. Commission staff have consistently stated that the failure to have an authorized technology plan is a basis for the full recovery of those disbursed funds for which the technology plan was required. However, in the case of a violation of program rules governing the discount rate calculation, Commission staff has stated that it is appropriate to base recovery on the recalculation of the discount rate using National School Lunch Program (NSLP) numbers. The financial effect of beneficiary non-compliance with program rules in these two examples is vastly different and, we believe, represents inconsistent treatment of program rule violations and the consequences of those violations. In the case of beneficiary non-compliance with discount calculation rules, it is our opinion that the position taken by Commission staff on the appropriate basis for recovery provides little deterrence to non-compliance with those rules governing discount calculation especially when compared to the consequences for failure to comply with technology planning rules.

Third, a clear understanding of the distinction between program rules and USAC implementing procedures is necessary for the design and implementation of effective oversight. It is necessary for the timely completion of audits and the timely resolution of audit findings, and the implementation of corrective action resulting from audits. Based on our involvement in audits and investigations, it has been our observation that program participants generally consider USAC as the source for definitive guidance on the rules governing the E-rate program. However, as we have discussed, USAC must rely on Commission staff guidance to determine whether an audit finding represents a violation of program rules for which a funding recovery or other action can be

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taken or not. It is also important to note that this distinction between program rules and USAC implementing procedures is seldom made in guidance provided by USAC to E-rate beneficiaries. For example, in the area of technology planning, Commission staff has provided guidance stating that FCC rules require only that applicants have a technology plan and that the plan be approved by the state or an alternative tech plan approver in a timely fashion. USAC guidance on technology planning identifies these requirements and states that to qualify as an approved technology plan for a Universal Service discount, the plan **must** (emphasis added) contain specific elements to address school and library technology initiatives. Numerous audits have identified beneficiary non-compliance with USAC implementing procedures governing technology planning. In fact, failure to address required technology plan elements was cited as findings by KPMG in nine (9) of the sixty-seven (62) audits they recently completed under contract to USAC. Commission staff has taken the position that these findings do not represent rule violations and do not serve as a basis for recovery of funds.

Applicant Technology Planning – As we have stated previously, program rules require that applicants prepare a technology plan and that the technology plan be approved. The approved technology plan is supposed to include a sufficient level of information to justify and validate the purpose of a request for E-rate funding. USAC implementing procedures state that approved technology plans must establish the connections between the information technology and the professional development strategies, curriculum initiatives, and library objectives that will lead to improved education and library services. Although the technology plan is intended to serve as the basis for an application, we have observed many instances of non-compliance with program rules and USAC procedures related to the technology planning process. Examples of technology planning concerns identified during audits and investigations are as follows:

- Technology plans are not being reviewed and approved in accordance with program rules. Commission staff has provided guidance failure to prepare a technology plan and have that plan approved in a timely manner is basis for full recovery of disburse-

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ments.

- Technology plans not addressing all required plan elements in accordance with USAC implementing procedures for technology planning. Commission staff has provided guidance that failure to comply with USAC implementing procedures for technology plans is not a rule violation and does not warrant recovery of funds.
- Applicants not being able to provide documentation to support the review and approval of technology plan. USAC guidance on technology planning states that "(i)n the event of an audit, you may be required to produce a certification similar to the SLD sample "Technology Plan Certification Form," in order to document approval of your technology plan." Numerous audits have included findings beneficiaries were unable to provide documentation to demonstrate the review and approval of technology plans. Commission staff have stated that, although program rules require that applicants have a technology plan and that the plan be approved, the rules do not require that the applicant maintain specific documentation regarding the approval process. Given that Commission staff have not defined "procurement records" that are required by program rules, we are unsure how Commission staff could have determined that documents demonstrating technology plan approval are not required.

Competitive Procurement - Program rules require that applicants use a competitive procurement process to select vendors. In establishing this requirement, the Commission recognized that "(c)ompetitive bidding is the most efficient means for ensuring that eligible schools and libraries are informed about all of the choices available to them" and that "(a)bsent competitive bidding, prices charged to schools and libraries may be needlessly high, with the result that fewer eligible schools and libraries would be able to participate in the program or the demand on universal service support mechanisms would be needlessly great."

Applicants are required to submit a form 470 identifying the products and services needed to implement the technology plan. The form 470 is posted to the USAC web page to notify service providers that the applicant is seeking the products and services identified. Applicants must

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wait at least 28 days after the form 470 is posted to the web site and consider all bids they receive before selecting the service provider to provide the services desired. In addition, applicants must comply with all applicable state and local procurement rules and regulations and competitive bidding requirements. The form 470 cannot be completed by a service provider who will participate in the competitive process as a bidder and the applicant is responsible for ensuring an open, fair competitive process and selecting the most cost-effective provider of the desired services. In their guidance, USAC encourages applicants to save all competing bids for services to be able to demonstrate that the bid chosen is the most cost-effective, with price being the primary consideration. Commission staff have stated that "(t)here is no FCC requirement that an applicant keep all competing bids for services." Given that the Commission has not defined "procurement records" that are required by program rules, we are unsure how Commission staff could have determined that these documents, that are clearly part of the procurement process, are not required.

Although the program's competitive bidding requirements were intended to ensure that schools and libraries are informed about all of the choices available to them, we have observed numerous instances in which beneficiaries are not following the program's competitive bidding requirements or are not able to demonstrate that competitive bidding requirements are being followed. Examples of competitive procurement concerns identified during audits and investigations are as follows:

- Applicant did not follow program rules for a competitive process with price as the primary determining factor.
- Applicant did not follow state and local procurement regulations.
- Applicant did not maintain documentation to demonstrate compliance with the programs competitive procurement requirement.

Program rules require that applicants follow a competitive process and that applicants keep the kinds of procurement records that they keep for other purchases. However, Commission staff have provided guidance stating that "the mere failure of the beneficiary to produce documentation relating to the competitive bidding process cannot form

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the basis for finding a rule violation or seeking recovery of funds. A rule violation could be established if the audit process secured the beneficiary's record retention plan and determined that the beneficiary had failed to comply with that policy." In that guidance, Commission staff goes on to state that a rule violation "could be established if the audit process secured the beneficiary's record retention plan and determined that the beneficiary had failed to comply with that policy." In effect, Commission staff has taken the position that if no record retention plan exists, there is no requirement for the applicant to maintain records.

Discount Calculation - The E-rate program allows eligible schools and libraries to receive telecommunications services, Internet access, and internal connections at discounted rates. Discounts range from 20% to 90% of the costs of eligible services, depending on the level of poverty and the urban/rural status of the population served, and are based on the percentage of students eligible for free and reduced lunches under the National School Lunch Program (NSLP) and other approved alternative methods. A number of audits have identified audit findings that applicants have not followed program requirements for discount rate calculation or were unable to support the discount rate calculated. As discussed above, we are concerned with guidance that Commission staff have provided on the consequences of failure to comply with program rules governing discount calculation.

Payment of the Non-Discount Portion - Applicants are required to pay the non-discount portion of the cost of the goods and services to their service providers and service providers are required to bill applicants for the non-discount portion. In establishing this requirement, the Commission recognized that "(r)equiring schools and libraries to pay a share of the cost should encourage them to avoid unnecessary and wasteful expenditures because they will be unlikely to commit their own funds for purchases that they cannot use effectively." Further, the Commission recognized that "(a) percentage discount also encourages schools and libraries to seek the best pre-discount price and to make informed, knowledgeable choices among their options, thereby building in effective fiscal constraints on the discount fund."

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As a result of our involvement in audits and investigations, we have the following concerns regarding payment of the non-discount portion:

- Applicant not paying the non-discount portion. Commission staff have provided guidance stating that if the non-discount portion was not budgeted for and was not paid, this is always a rule violation authorizing full recovery. If the non-discount portion was budgeted and not paid, Commission staff have provided guidance that this is technically a rule violation authorizing full recovery but that mitigating factors can be considered. Mitigating factors can include bona fide disputes with service providers over delivery of service, claims of fraud, or violations of procurement practices.
- Applicant not paying the non-discount portion in a timely manner. Commission staff have provided guidance stating that, although program rules require that applicants pay the non-discount portion, the rules do not establish a time frame in which the applicant must make payment.
- Service providers not billing recipients for the non-discount portion.

Delivery of Goods and Services - Site visits are conducted during most E-rate beneficiary audits. Site visits are conducted for several reasons including to evaluate the eligibility of facilities where equipment is installed, verify that equipment is installed and operational, and to verify that equipment is being used for its intended purpose. Examples of concerns identified during audits and investigations are as follows:

- Goods and services not being provided.
- Unauthorized substitution of goods and services. Some question remains about the consequences associated with this audit finding. In response to a request for informal comments on a recent draft audit report, Commission staff provided informal guidance on this issue stating that "(i)f a service substitution is unauthorized it is a rule violation authorizing full recovery." As we were finalizing the audit report to issue in draft for formal comment, Commission staff withdrew this guidance and provided revised guidance stating that they believe that "ultimately the question about the appropriate penalties and remedies in this situation ...

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about the appropriate penalties and remedies in this situation ... may require official Commission action.”

- Goods and services being provided to ineligible facilities (e.g., non-instructional building including dormitories, cafeterias, and administrative facilities).
- Equipment not being installed or not operational. Program rules require that nonrecurring services be installed by a specified date. However, there is no specific FCC rule requiring beneficiaries to use equipment in a particular way, or for a specified period of time, or to full efficiency. Commission staff have provided guidance stating that if the equipment was uninstalled (i.e., still in a box) that would represent a rule violation. However, Commission staff have also provided guidance stating that the rules do not require that beneficiaries effectively utilize the services provided or that the beneficiaries maintain continuous network or Internet connectivity once internal connections are installed.

It appears the Commission has taken steps during the reporting period to assess some of the areas where we have expressed concern. On December 23, 2003, the Commission released the Second Further Notice of Proposed Rulemaking (CC Docket No. 02-6) related to the Schools and Libraries Universal Service Support Mechanism. In the Second Further Notice, the Commission has requested comment on several of the areas where we have expressed concern regarding program design including competitive bidding requirements, recovery of funds, recordkeeping requirements, and technology planning.

Conclusion

The Office of Inspector General remains committed to meeting our responsibility for providing effective independent oversight of the Universal Service Fund program. As we have described in this semi-annual report, we continue to have numerous concerns about this program. The results of audits that have been performed and the allegations under investigation lead us to believe the program may be subject to a high risk of fraud, waste, and abuse through noncompliance and program weakness. We are concerned with efforts to resolve audit findings and to recover funds resulting from E-rate beneficiary audits and we are concerned with aspects of program design and beneficiary

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compliance with program rules.

We believe we have made significant progress toward our goal of designing and implementing an effective, independent oversight program. However, primarily because of a lack of adequate resources, we have been unable to implement our oversight program. As I have stated previously in my semi-annual reports to the Congress, until resources and funding are available to provide adequate independent oversight for the USF program, we are unable to give the Chairman, Congress and the public an appropriate level of assurance that the program is protected from fraud, waste and abuse.

Audits

I. Financial statement audits provide practical assurance about whether the financial statement of an audited agency presents the financial position, results of operations, and costs in the standards of generally accepted accounting principles. These audits are used to decipher whether or not financial information is presented according to established or stated criteria. These audits also reveal if the firm's internal control over financial reporting and/or safeguarding assets is designed to adequately fit the firm and if it is fully implemented to achieve the control objectives.

Audit of the Commission's FY 2003 Financial Statement (Report No. 03-AUD-05-07 Issued on December 19, 2003)

The Federal Communications Commission (FCC) is a covered agency under the Accountability of Tax Dollars Act of 2002. As a covered agency, FCC prepares financial statements in accordance with generally accepted accounting principles per the Government Management Reform Act (GMRA) of 1994, which amended the Chief Financial Officers Act (CFO Act) of 1990, to require annual preparation and audit of organization wide financial statements of the United States.

In accordance with the Accountability of Tax Dollars Act of 2002, FCC prepared consolidated financial statements in accordance with Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and subjected them to audit. The Chief Financial Officers Act of 1990 (Public Law 101-576 referred to as the "CFO Act"), amended, requires the FCC OIG, or an independent external auditor as determined by the Inspector General, to audit agency financial statements in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Under a contract monitored by the OIG, Clifton Gunderson, LLP (CG-LLP), an independent public accounting firm, performed the audit of FCC's FY 2003 financial statements.

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To fulfill our audit responsibilities under the CFO Act for ensuring the quality of the audit work performed, we conducted a review of CG-LLP's audit of FCC's FY 2003 financial statements in accordance with *Government Auditing Standards* and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

Specifically, we:

- ◆ Reviewed CG-LLP's approach and planning of the audit
- ◆ Evaluated the qualifications and independence of its auditors
- ◆ Monitored the progress of the audit at key points
- ◆ Examined working papers and audit documents to evaluate compliance with *Government Auditing Standards*
- ◆ Reviewed CG-LLP's audit reports to ensure compliance with *Government Auditing Standards* and OMB Bulletin No. 01-02
- ◆ Performed other procedures deemed necessary



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Based on the results of our review, we determined CG-LLP planned, executed and reported the results of its audit of FCC's FY 2003 financial statements in accordance with applicable auditing standards. Therefore, in our opinion, CG-LLP's work provides a reliable basis for the firm's opinion on FCC's FY 2003 financial statements. Based on our review of the audit, we concur with CG-LLP's findings of reportable conditions related to internal control and instances of noncompliance with applicable laws and regulations. Accordingly, we concur with its reports thereon.

◆ **Opinion on the Financial Statements**

CG-LLP issued an unqualified opinion on FCC's consolidated balance sheets as of September 30, 2003 and 2002, the related consolidated statements of net cost, changes in net position, financing, combined statement of budgetary resources, and statement of custodial activity. CG-LLP opined the financial statements referred to above present fairly, in all material respects, the financial position of the FCC as of September 30, 2003 and 2002, its net cost, changes in net position, budgetary resources, custodial activity, and reconciliation of net cost to budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America. In performing its internal control testing of controls necessary to achieve the objectives in OMB Bulletin No. 01-02, CG-LLP identified matters relating to significant deficiencies in the design or operation of FCC's internal control.

In performing its internal control testing of controls necessary to achieve the objectives in OMB Bulletin No. 01-02, CG-LLP identified matters relating to significant deficiencies in the design or operation of FCC's internal control that, in its judgment, could adversely affect FCC's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Specifically, these matters were categorized as material weaknesses and reportable conditions per definitions of the American Institute of Certified Public Accountants.

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CG-LLP identified material weaknesses in the areas of:

- ◆ Financial Reporting
- ◆ Auction Transactions
- ◆ Cost Accounting
- ◆ Universal Service Fund Financial Reporting: Accounting and Reporting Controls
- ◆ Information Technology

CG-LLP identified additional reportable conditions not considered to be material weaknesses, which include:

- ◆ Revenue Recognition
- ◆ RAMIS Application and Processes
- ◆ Payroll Activities
- ◆ Debt Collection Improvement Act Reporting
- ◆ OMB Circular Nos. A-127 and A-130 Reviews
- ◆ Federal Managers' Financial Integrity Act of 1982 Compliance and Reporting

FCC management is responsible for complying with laws and regulations applicable to the agency. To obtain reasonable assurance about whether FCC's financial statements are free of material misstatements, CG-LLP performed tests of compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act of 1996. As appropriate, CG-LLP limited its tests of compliance to these provisions and it did not test compliance with all laws and regulations applicable to FCC.

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Tests disclosed instances of noncompliance with specific laws and regulations required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02 as follows:

- ◆ Chief Financial Officer's Act of 1990
- ◆ OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*
- ◆ Debt Collection Improvement Act of 1996
- ◆ Federal Financial Management Improvement Act of 1996

In accordance with generally accepted government auditing standards the Independent Auditor's Report prepared by CG-LLP is dated December 8, 2003, the last day of audit fieldwork.

II. Performance audits are systematic examinations of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity or function, in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

The OIG began contract auditing for the purposes of establishing contract audit oversight and providing accounting and financial advisory services in connection with the negotiation, administration and settlement of contracts and subcontracts to FCC procurement and contract administrators. In that capacity the Defense Contract Audit Agency (DCAA) performs audits, reviews and agreed-upon procedures reviews of contractors providing goods and services to the FCC. These projects include labor timekeeping reviews, billing system reviews, forward pricing audits, incurred cost audits, equitable adjustment proposal audits, etc. throughout the fiscal year.

In addition, OIG staff performs contract audits upon request from FCC's Contract and Purchasing Center.

Audits

1. Report on Pre-award Accounting System Survey and Billing System Review of Leads Corporation (Audit Report No. 03-AUD-10-22 issued on October 14, 2003)

The Leads Corporation (Leads) is a contractor with the FCC specializing in management and technical consulting. The objective of the audit was to determine whether Leads accounting and billing systems are adequate for accumulating costs under prospective Government contracts.

The audit determined that Leads accounting and billing systems were adequate for accumulating costs under prospective Government contracts.

2. Report on Computech, Inc. FY 2003 Labor Timekeeping Review (Issued on December 15, 2003)

Computech, Inc., a professional consulting firm specializing in information management, provides information management support for the Commission' electronic auction system for commercial communications licensing.

The objective of the audit was to determine if the contractor consistently complies with established timekeeping system policies and procedures for recording labor charges.

The audit disclosed no significant deficiencies in the contractor's time-keeping or labor system.

III. Program audits assess whether the objectives of both new and ongoing programs are proper, suitable or relevant, and also assess compliance with laws and regulations applicable to the program. This particular type of audit also serves to determine whether management has reported measures of program effectiveness that are valid and reliable.

Audits

1. Survey of Mellon Bank Lockbox Operations (Issued on October 10, 2003)

Mellon Bank in Pittsburgh, PA collects, through its lockbox operations, FCC's regulatory and application fees, auction installment loan payments, and international telecommunications settlements. In addition, the bank receives "upfront" auction deposits from potential bidders. During FY 2002, FCC received more than \$200 million of regulatory and application revenue collected through the bank.

The bank's lockbox operations became a concern after IRS tax returns for 2000 were intentionally misplaced by the bank's contractors. The bank has also recently relocated its lockbox operations to a new facility.

The objectives of the survey were to observe the lockbox process and control environment, suggest any enhancements from our review, and identify areas where additional audit work should be performed.

Survey observations disclosed no concerns that the risks of incorrect transactions exceeded acceptable risk levels. Based on the results of the survey, the OIG does not plan to perform additional audit work relating to FCC lockbox processing beyond its annual review as part of the Commission's financial statement audit.

2. Gettysburg Site Interim Physical Security Review (Audit Report No. 02-AUD-03-11 issued on October 28, 2003)

The FCC moved into its 40,000 square facility Gettysburg, PA in May, 1981. Today, it houses approximately 200 employees. Approximately 93% of all FCC licenses granted are issued there. The FCC Consumer Center is located there as well as a number of other functions.

As a result of the events of September 11, 2001 the FCC as well as a number of other Federal agencies refocused their efforts on physical security. Concurrently, the OIG enhanced its physical security review program. As part of its program, it plans to conduct a number

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of physical security reviews at various FCC facilities. The reviews will include physical access testing, analysis of security processes, and other tests of physical security. The overall objective of the program is to identify vulnerabilities and opportunities for improvement in the FCC's physical security posture.

This audit was conducted as part of our physical security review program. To accomplish the audit of the Gettysburg facility the OIG established a contract with Job Performance Systems, Inc. The guideline for performing the report was the Department of Justice's (DOJ's) "Vulnerability Assessment of Federal Facilities." The document describes DOJ building security standards developed after the Oklahoma City Murrah Federal Building disaster.

As a result of the audit, the OIG reported on five security or safety issues. The Office of the Managing Director (OMD) concurred with two of the findings and partially concurred on the other three. For all findings, the OMD outlined the corrective taken and/or a date for implementation of corrective action.

3. Report on Audit of the E-rate Program at Santa Fe Indian School, Inc. (Audit Report No. R-GR-FCC-0006-2003 issued on November 6, 2003)

This E-rate beneficiary audit was conducted as part of our Universal Service Fund (USF) oversight program. The Santa Fe Indian School, Inc. (Santa Fe Indian School), located in Santa Fe, New Mexico, operates an academic program for grades 7 through 12 with a population of over 600 students, of which approximately two-thirds reside in the School's dormitories. The objective of this audit was to determine whether the Santa Fe Indian School complied with the rules and regulations of the E-rate Program and to identify Program areas that may need improvement. This audit was conducted under the terms of a Memorandum of Understanding between the Universal Service Administrative Company (USAC) in conjunction with the FCC OIG and the Department of Interior's OIG.

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We concluded that the Santa Fe Indian School complied with the program rules and requirements of the E-rate Program for funding years 1998 through 2001.

4. Survey of Software Technology Purchases (Audit Report No. 03-AUD-08-11 issued on November 20, 2003)

Under guidelines and policies established by the Chairman and the Managing Director, the Information Technology Center (ITC) is responsible for the overall direction of Commission programs involving the use of computer and telecommunications systems.

The objective of the survey was to identify possible duplicate software purchases between core IT services for the Commission as a whole and services for individual bureaus and offices, then calculate the amount overspent and make the necessary adjustments to curb future duplicate purchases.

To accomplish the objectives of this survey we reviewed IT purchasing information, including documentation on policy, practices, invoices, templates, checklists and General Services Administration (GSA) Advantage schedules. Federal government documents, including OMB circulars, were also reviewed. And interviews were conducted with other Commission staff who have expertise on this subject.

Based on the results of this survey, the OIG will not perform additional audit work on the purchases of IT software within the Commission. There currently is enough information to demonstrate that items are duplicated in the purchase orders between the two offices, yet procedures have recently been developed to prevent future purchases from being duplicated. We will continue to analyze invoices with GSA Advantage schedules for the best method for purchasing software and we will review the new procedures that OMD has implemented.

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5. Report on Audit of the Revenue Accounting and Management Information System (RAMIS), (Audit Report No. 03-AUD-01-01 issued on November 24, 2003)

The Federal Communications Commission's Revenue Accounting and Management Information System (RAMIS) is a mission critical information system responsible for the processing of all FCC receivable transactions. As the Commission's internal revenue management system, RAMIS supports application and regulatory fee accounting, spectrum auction loan portfolio management, accounting for auction proceeds, accounting for enforcement actions, and other accounts receivable. It is imperative that RAMIS be secured against internal and external computer security threats.

The objective of this audit was to determine the extent and effectiveness of application and security controls of RAMIS. KPMG, LLP was engaged to perform an independent audit of the application and security controls over RAMIS. To achieve our objectives, we performed a review of RAMIS and its related network components using the National Institute of Standards and Technology (NIST) 800-26 Self-Assessment Guide, as well as guidance from the Federal Information System Controls Audit Manual (FISCAM). The general controls review was performed to assess controls related to the risk assessment process, access controls, system software, service continuity, security program planning, incident response, and application change controls. During the application controls review component, we evaluated authorization, completeness, and accuracy controls as well as controls over integrity of processing and data files. A review of the RAMIS database was performed to assess the security controls over critical databases, tables, and records, which included such information as payment amounts and RAMIS password controls. The final component of our audit of RAMIS application and security controls was a vulnerability assessment. The vulnerability assessment evaluated whether RAMIS and its related network components are secure from unauthorized intrusion and misuse, vulnerable to attacks, and accessible via unauthorized paths.

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Our audit yielded several positive observations about RAMIS. We also identified areas of improvement for the FCC's security controls over RAMIS. This report details the conditions identified during our audit and communicates findings and recommendations to FCC management. Specifically, we identified twenty-two (22) findings in the areas of management, operational, and technical controls. The recommendations we generated and actions already begun by the FCC should result in the correction of present vulnerabilities and minimization of the risk of occurrence of future security-related events.

6. Report on Supervisor/Manager Telecommuting Survey (Audit Report No. 03-AUD-09-17 issued on November 25, 2003)

The Commission established its Flexible Workplace Program (also known as telecommuting or telework) on June 8, 2000 to increase productivity, improve employee morale and job satisfaction, reduce absenteeism at the Commission, and enhance the Commission's Bureau and Office efforts to accomplish their respective missions.

We designed and conducted this survey to determine whether the Commission was achieving its stated objectives with its Flexible Workplace Program.

We found that the Commission's Flexible Workplace Program Policy complies with Federal Policy. We also discovered that the FCC employee participation rate of 21% and 25% for fiscal years 2001 and 2002 significantly exceed Federal agency telecommuting averages of 4.2% and 5% for those same years.

We learned from the survey responses that Commission supervisors and managers support the Flexible Workplace Program, primarily because their telecommuting employees exhibit improved morale and job satisfaction and tend to use a little less leave than their non-telecommuting counterparts. However, they were neutral about how their employees' participation in the program achieves the FCC's goals

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of increasing employee productivity and reducing supervisor/manager oversight or monitoring in accomplishing their respective mission objectives.

As a result, we recommend that the Commission provide training to supervisors and managers to ensure that they are aware of the Flexible Workplace program's policies and procedures and of their authority and responsibilities for supervising employees who participate in the program.

7. Report on Audit of the E-rate Program at St. Matthew Lutheran School (Audit Report No. 02-AUD-02-04-07 issued on December 22, 2003)

This E-rate beneficiary audit was conducted as part of our Universal Service Fund (USF) oversight program. St. Matthew Lutheran School is a small religious/private school located in the Washington Heights Section of New York City operating an academic program for pre-kindergarten to 8th grade classes. The objective of this audit was to determine whether St. Matthew Lutheran School complied with the rules and regulations of the E-rate Program and to identify Program areas that may need improvement.

We concluded that St. Matthew Lutheran School was not compliant with the requirements of the program for funding years 1999 and 2000. The audit resulted in ten (10) specific findings and \$55,639 in potential fund recoveries as a result of those audit findings. However, in light of the multitude of findings and systemic noncompliance with Commission rules and program requirements, we recommended that the Commission recover the full amount of \$136,593 disbursed on behalf of St. Matthew Lutheran School in funding years 1999 and 2000. Specific findings were as follows:

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1. The Technology plan was not approved in funding years 1999 and 2000.
2. An unacceptable methodology was used to calculate the discount percentage, resulting in an overpayment of \$13,161.
3. St. Matthew Lutheran School did not budget for the non-discounted portion of the costs.
4. St. Matthew Lutheran School did not pay the non-discounted portion of the costs.
5. The service provider billed for T-1 internet access but provided less functional integrated services digital network (ISDN) services, resulting in an overpayment of \$30,642.
6. Other unauthorized changes were made to the approved system, resulting in a system with less functionality and payments of \$8,631 for assets purchased and not installed.
7. The service provider billed for recurring maintenance costs that were not provided resulting in an overpayment of \$3,205.
8. Contracts with the service provider were signed prior to the allowable date.
9. There was no documented competitive bidding process.
10. St. Matthew Lutheran School did not have adequate resources to effectively utilize the services provided.

8. Report on Audit of the E-rate Program at Prince William County Schools (Audit Report No. 02-AUD-02-04-11 issued on December 22, 2003)

This E-rate beneficiary audit was conducted as part of our Universal Service Fund (USF) oversight program. Prince William County Schools is a public school system located in Prince William County, Virginia. The objective of this audit was to determine whether Prince William County Schools complied with the rules and regulations of the E-rate Program and to identify Program areas that may need improvement.

We concluded that Prince William County Schools was compliant in most respects with the requirements of the program for funding year 1999. However, the audit identified one area of noncompliance.

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Eighty-five (85) cellular phones associated with a cellular service contract were identified as paid for by SLD but not compliant with the educational purpose requirements of e-rate funding. We recommended that the Commission recover \$5,452 for the ineligible cellular phones.

9. Report on Audit of the E-rate Program at Arlington Public Schools (Audit Report No. 02-AUD-02-04-12 issued on December 22, 2003)

This E-rate beneficiary audit was conducted as part of our Universal Service Fund (USF) oversight program. Arlington Public Schools is a public school system located in Arlington County, Virginia. The objective of this audit was to determine whether Arlington Public Schools complied with the rules and regulations of the E-rate Program and to identify Program areas that may need improvement.

We concluded that Arlington Public Schools was compliant in most respects with the requirements of the program for funding year 1999. However, the audit identified one area of noncompliance. One hundred and ninety-five (195) pagers associated with a paging services contract were identified as funded and paid for by SLD but were not compliant with the educational purpose requirement of e-rate. We recommended that the Commission recover \$7,556 for the ineligible paging services.

10. Report on Audit of the E-rate Program at Navajo Preparatory School, Inc. (Audit Report No. R-GR-FCC-0005-2003 issued on January 7, 2004)

This E-rate beneficiary audit was conducted as part of our Universal Service Fund (USF) oversight program. The Navajo Preparatory School, Inc. (Navajo Preparatory School) is located in Farmington, New Mexico on the 82.45 acre site of the former campus of the Navajo Methodist Mission School. The objective of this audit was to determine whether the Navajo Preparatory School complied with the rules and regulations of the E-rate Program and to identify Program areas that may need improvement. This audit was conducted by the Department of Interior OIG under the terms of a Memorandum of Understanding with the Universal Service Administrative Company (USAC) and the FCC OIG to

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conduct audits of E-rate beneficiaries.

We concluded that the Navajo Preparatory School did not comply with the requirements of the E-rate program for funding year 2001. The audit resulted in eight (8) specific findings and \$1,000,592 in potential fund recoveries as a result of those audit findings. In light of the multitude and severity of findings and systemic noncompliance with Commission rules and program requirements, we recommended that the Commission recover the full amount of \$2,084,399.45 disbursed on behalf of Navajo Preparatory School in funding year 2001. Specific findings were as follows:

1. The technology plan was not properly approved or adequately prepared.
2. The discount rate was not supported.
3. The service contract was not competitively awarded.
4. Services were put in ineligible buildings.
5. Buildings were not wired.
6. Equipment was not installed as approved.
7. The school's program support funding appears insufficient.
8. Applications for services were inflated and services installed were underutilized.

11. Report on Fiscal Year 2003 Federal Information Security Management Act (FISMA) Evaluation and Risk Assessment

(Audit Report No. 03-AUD-06-09 issued on February 6, 2004)

The Federal Information Security Management Act (FISMA) focuses on the program management, implementation, and evaluation aspects of agency security systems. FISMA requires that Inspectors General, or the independent evaluators they choose, perform an annual evaluation of each agency's information security program and practices. We contracted with KPMG, LLP to perform the independent evaluation.

On September 22, 2003, we issued a report, entitled "FY 2003 Federal Information Security Management Act (FISMA) Independent Evaluation," summarizing the results of our independent evaluation.

Audits

As a result of the independent evaluation, we have concluded that the Commission has a generally effective information security program with acceptable practices for managing and safeguarding the Federal Communications Commission's (FCC's) information technology assets. Our report, comprised of an executive summary and an independent evaluation, was included in a package of information provided by the Commission to the Office of Management and Budget (OMB) on September 22, 2003.

However, during the independent evaluation, we identified areas for improvement in the FCC's information security management, operational and technical controls. The evaluation identified seven (7) new findings in the areas of management, operational, and technical controls. Additionally, we determined that eight (8) of the conditions identified during the FY 2002 and FY 2001 Government Information Security Reform Act (GISRA) evaluations had not been fully corrected at the time of audit fieldwork. Implementation of our recommendations and correction of the prior year conditions will strengthen the security of the Commission's information security program.

12. Payroll Fraud Detection Survey (Issued on March 17, 2004)

Increasing security issues facing other federal agencies in the past several years have justified a concern for fraudulent activity in payroll systems within the Office of Inspector General (OIG) of the FCC. No inquiry of this nature has been initiated by the Commission or the OIG in recent years. This survey was performed to determine if an audit of personal security of FCC employees was warranted.

The objectives of this survey were to indicate if any FCC employee was utilizing an invalid Social Security Number (SSN), document any anomaly that arose while comparing SSNs to various databases, and identify areas where more audit work should be performed.

Our survey disclosed no discrepancies with employee social security numbers. Based on these results, an audit is not warranted relating to payroll fraud detection.

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13. Report on Audit of the E-Rate Program at Immaculate Conception School (Audit Report No. 02-AUD-02-04-20 issued on March 24, 2004)

This E-rate beneficiary audit was conducted as part of our Universal Service Fund (USF) oversight program. Immaculate Conception School is a Catholic school located in the south Bronx section of New York City and teaches pre-kindergarten to 8th grade classes. The objective of this audit was to determine whether Immaculate Conception School complied with the rules and regulations of the E-rate Program and to identify Program areas that may need improvement.

We concluded that Immaculate Conception School was not compliant with the requirements of the program for funding years 1998 through 2000. The audit resulted in seven (7) specific findings and \$68,846 identified as potential fund recoveries as a result of those audit findings. Based on the results of the audit, we recommended that the Commission recover \$68,846 disbursed on behalf of Immaculate Conception School. Specific findings were as follows:

1. Immaculate Conception School did not pay the entire nondiscounted portion of the costs.
2. Internal connections equipment purchased with E-rate funds was missing, resulting in overpayments of \$33,060.
3. The service provider billed for T-1 internet access but provided less functional integrated services digital network (ISDN) service, resulting in overpayments of \$16,065.
4. Wiring and installation costs were determined to be unreasonable for funding year 1999, resulting in \$19,440 in inappropriate funding disbursements.
5. Ineligible telecommunications services were claimed on FCC Form 472 Billed Entity Reimbursement Application (BEAR) Forms for funding year 2001, resulting in over-reimbursements of \$281.
6. There was no documented competitive bidding process.
7. Support was lacking for the calculation of the E-Rate discount percentage for funding years 1998 and 1999.

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14. Telephone System Survey (Issued on March 25, 2004)

This survey was conducted as a follow-up to a similar survey conducted in 1999. The Office of the Inspector General wanted to identify what, if any, changes had taken place since the conclusion of the first survey. The objective of this survey was to assess the availability of telephones in the FCC that would accept long-distance and international numbers. If any telephone open to all employees would accept a long-distance or international call, phone records would be obtained from the Commission and examined.

Our survey disclosed no risk of inappropriate telephone usage. Based on these results an audit is not recommended of the telephone system.

IV. Work-In-Process Reports on the following audits were not completed as of the date of the publication of this report.

1. Risk Assessment of the FCC's Human Capital Management Framework

The objective of this risk assessment is to evaluate the FCC's implementation of the Human Capital Framework issued by the Office of Personnel Management (OPM). We will also determine the status of the FCC's human capital management to determine if additional audit work in the area is needed. This review was initiated in July 2003 and we anticipate issuing our report in the 3rd Quarter of FY 2004.

2. FY 2004 FISMA Evaluation

The Federal Information System Management Act (FISMA) focuses on the program management, implementation, and evaluation aspects of agency security systems. FISMA replaced the Government Information Security Reform Act (GISRA) which expired in November 2002. A key provision of the FISMA requires that Inspectors General perform an annual independent evaluation of Agency information security programs. The objective of this independent evaluation is to examine the

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Commission's security program and practices for major applications. We anticipate issuing an audit report with findings and recommendations in the 4th quarter of 2004.

3. Web Presence Audit Follow-up

This objective of this audit is to determine the status of findings identified in OIG's prior audit of this area. Additionally, we will perform tests of the security posture of the FCC's web presence. This audit was initiated in September 2003 and we anticipate issuing an audit report during the 3rd quarter of FY 2004.

4. Physical Review of Enforcement Bureau Facilities and Monitoring Station of Commission Facilities

We have initiated an audit of Commission facilities other than its Gettysburg, PA location and headquarters. We anticipate issuing a report during the 3rd quarter of FY 2004.

5. Continuity of Operations (COOP) and Disaster Recovery Plans (DRP) Audit

In the post 9/11 environment, contingency planning and business continuity are critical. In 2002, the FCC began to develop and business continuity plans. The objective of this audit is to determine the progress of FCC's contingency planning and business continuity program and determine if the FCC has a useable and viable program.

This audit was initiated in September 2003 and we anticipate issuing a report during the 4th quarter of FY 2004.

6. Defense Contract Audit Agency (DCAA) Audit Services

The objectives of these reviews are to task DCCA with performing contract audits of contractors providing goods and services to the

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Commission. Reviews include labor timekeeping reviews, billing system reviews, forward pricing audits, incurred cost audits, equitable adjustment audits, etc.

Contract audit activities are on-going and will continue throughout FY 2004.

7. Survey of Fee Collections

The objective of this survey will be to examine the Commission's fee collection process to determine whether we can reasonably assure that all applicable licensing and regulatory fees are being collected. The OIG will review both manual and automated controls over the fee collection process. We will also attempt to decide if a viable process exists to determine if all licenses have paid their applicable fees.

8. Audit of the Commission's FY 2004 Financial Statement

The FCC is a covered agency under the Accountability of Tax Dollars Act of 2002. As a covered agency, FCC prepares financial statements in accordance with generally accepted accounting principles per the Government Management Reform Act (GMRA) of 1994 which amended the Chief Financial Officers Act (CFO Act) of 1990 to require annual preparation and audit of organization-wide financial statements.

This audit will be performed as part of our commitment to support management's efforts to align the FCC's financial accounting and reporting systems with related accounting principles, federal laws and regulations, and policy guidelines. This is not only important internally to the FCC's operations, but is also necessary to the audit of the Consolidated Financial Statements of the United States. The objective of this audit is to provide an opinion on the FY 2004 financial statements.

In accordance with the Accountability of Tax Dollars Act of 2002, FCC prepares consolidated financial statements in accordance with Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and subjects them to audit. The Chief

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Financial Officers Act of 1990 (Public Law 101-576 referred to as the "CFO Act"), amended, requires the FCC OIG, or an independent external auditor as determined by the Inspector General, to audit agency financial statements in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Under a contract monitored by the OIG, CG-LLP, an independent accounting firm, is performing the audit of FCC's FY 2004 financial statements.

At the close of this semi-annual period, CG-LLP and OIG auditors have substantially completed comprehensive planning and recently initiated interim testing of internal controls. Interim substantive testing is planned for the March 31 and June 30 submissions to OMB. The OIG expects to issue the Independent Auditors' Reports in the first quarter of FY2005 in accordance with the accelerated year-end financial statement submission date of November 15, 2004.

9. NBANC Equitable Adjustment Proposal Audit

The evaluation focuses on determining the reasonableness, the costs allocable and allowable submitted by NBANC related to its proposed increased costs due to the events giving rise to the adjustment. Because NBANC provides billing and collection services for the North American Numbering Plan under 47 CFR Part 52.12, with no express Government contract in place, audit scope will generally depend on individual circumstances. In general this review will evaluate NBANC's compliance with applicable acquisition regulations, report and order, and letter terms as appropriate. We anticipate issuing our report during the third quarter of FY 2004.

Management

◆ External Audit of Quality Control

The OIG of the Equal Employment Opportunity Commission (EEOC) performed a review of our system of quality control to determine if we were in compliance with quality control standards. We received their draft report on our quality system on March 26, 2004. Subsequent to the semiannual reporting period (on April 19, 2004) we received their final report. They determined that our system was compliant and issued an unqualified opinion.

◆ Specialized Training and Activities

In our continuing effort to expand the expertise of our audit staff, two auditors attended the 10 day, non-criminal investigator training at the Federal Law Enforcement Agency in Georgia.

◆ Report Availability

The OIG audit and other types of reports can generally be obtained via the Internet from the OIG web page located on the FCC website at <http://www.fcc.gov/oig>. However, OIG reports containing sensitive or proprietary information will be restricted to specific individuals and organizations with a need to know the detailed information.

◆ Internships

The OIG welcomes college interns during the fall, spring and summer. Most of these students take their internships for credit. Recent interns have come from schools across the country, including Hamilton College UC Berkeley, American University, Georgetown University, DePauw University, and James Madison University.

These internships prove to be a rewarding experience for both parties. Students leave with a good understanding of how a government agency is run, and they have the opportunity to encounter the challenges involved in governance and regulation. In turn, the office benefits from the students' excellent work performance that reflects their youth and exuberance.

Investigations

OVERVIEW

Investigative matters pursued by this office are generally initiated as a result of allegations received through the OIG Hotline or from FCC managers and employees who contact the OIG directly. Investigations may also be predicated upon audit or inspection findings of fraud, waste, abuse, corruption, or mismanagement by FCC employees, contractors, and/or subcontractors. Upon receipt of an allegation of an administrative or criminal violation, the OIG usually conducts a preliminary inquiry to determine if an investigation is warranted. Investigations may involve possible violations of regulations regarding employee responsibilities and conduct, federal criminal law, and other regulations and statutes pertaining to the activities of the Commission. Investigative findings may lead to criminal or civil prosecution, or administrative action.

The OIG also receives complaints from the general public, both private citizens and commercial enterprises, about the manner in which the FCC executes its programs and oversight responsibilities. All complaints are examined to determine whether there is any basis for OIG audit or investigative action. If nothing within the jurisdiction of the OIG is alleged, the complaint is usually referred to the appropriate FCC bureau or office for response directly to the complainant. Over the period of the last several semi-annual periods, the OIG has increasingly served as a facilitator in the Commission responding to those complaints that are outside the jurisdiction of this office. In many instances where the nature of the complaint does not fall within the jurisdiction of the OIG, a copy of the response is also provided to the OIG. Finally, matters may be referred to this office for investigative action from other governmental entities, such as the General Accounting Office, the Office of Special Counsel or congressional offices.

ACTIVITY DURING THIS PERIOD

Twenty-eight cases were pending from the prior period. Twenty-six of those cases involve the Commission's Universal Service Fund

Investigations

(USF) program and have been referred to the Federal Bureau of investigation (FBI) and/or the Department of Justice and the investigations are ongoing. An additional ten non-USF complaints were received during the current reporting period. Also, during this period, for tracking purposes, 17 USF-related cases were received. Over the last six months eight cases have been closed. A total of 47 cases are still pending, 42 of which relate to the USF program. The OIG continues to monitor, coordinate, and/or support activities regarding those 42 investigations. The investigations pertaining to the pending five non-USF cases are ongoing.

STATISTICS

Cases pending as of October 1, 2003.....	28
New cases.....	27
Cases closed.....	8
Cases pending as of March 31, 2004.....	47

SIGNIFICANT INVESTIGATIVE CASE SUMMARIES

The OIG initiated an inquiry into allegations of the misuse of official resources by an employee by allegedly conducting a real estate business during official hours. As part of the investigation, an analysis was performed of a sampling of the employee's work station activities. Based on the analysis, while unofficial documents were found, the OIG was unable to find sufficient evidence from which to conclude that the employee was conducting any type of business let alone a real estate business on official time and/or abusing official resources. Accordingly, the matter has been closed.

The OIG initiated an inquiry into allegations of the possible abuse of authority by a Commission employee with regard to the processing of a consumer request for a declaratory ruling. Specifically, it was alleged that the employee in his or her role deliberately delayed the

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processing of the request. Through investigation, the OIG was unable to find any evidence of employee misconduct with regard to the processing of the request. It was determined that the employee lacked any decisional authority or responsibility and thus did not possess the ability to delay or impede the processing of the complaint. The matter has been closed.

The OIG initiated an inquiry into the alleged release of non-public information involving the Commission's consideration of total-element long-run incremental cost methodology. It was alleged that a copy of a report pertaining to the subject matter had been disclosed to the media. A review by the Computer Security Office of the Commission's computer system indicated that the document was not transmitted electronically. Further, it was determined that the document was accessible throughout the Commission. For this reason and the inability of the OIG to discover any evidence to narrow down the scope of individuals who could have released or disclosed of the document, the matter has been closed.

The OIG has initiated an inquiry into the allegations of misconduct by employees with respect to a contractor's termination of a subcontract concerning document management. Specifically, it was alleged by the subcontractor that Commission employees improperly caused the termination of his services. The Commission had contracted with the contractor for services related to document management and the contractor subcontracted an aspect of the services to be performed to a subcontractor. Subsequently, the Commission decided to delay implementation of that aspect of the services that had been subcontracted by the contractor and the contractor terminated the services of the subcontractor. Through investigation, no evidence of employee misconduct was found. Further, it was determined that the Commission's action complied with its contract with the contractor. For this reason and in light of the fact that there was not any contractual relationship between the Commission and the subcontractor, the matter has been closed.

The OIG initiated an inquiry into allegations of the improper transfer of a radio license. Specifically, it was alleged that based on

Investigations

improper considerations by the Commission, a radio license transfer was approved. The matter is currently pending.

The OIG has initiated an inquiry into the possible improper destruction and/or removal of information on a Commission computer work station. The matter is currently pending.

The OIG initiated an inquiry into allegations that a Commission employee violated applicable ex parte rules by improperly requesting information from a party in a pending Commission proceeding. Through investigation, it was determined the information sought was clarification of evidence that was already in the record. Further, it was determined that under Commission ex parte rules such requests are permissible. Accordingly, the OIG was unable to find any evidence of employee misconduct and the matter was closed.

The OIG continues to coordinate and provide assistance to law enforcement entities with respect to investigations pertaining to infractions within the Universal Service Fund program of the Commission.

Legislation

Overview

Pursuant to section 4(a)(2) of the Inspector General Act of 1978 (IG Act), as amended, our office monitors and reviews existing and proposed legislative and regulatory items for their impact on the Office of the Inspector General and the Federal Communications Commission programs and operations. Specifically, we perform this activity to evaluate their potential for encouraging economy and efficiency and preventing fraud, waste and mismanagement.

*** Legislative Activity During This Period**

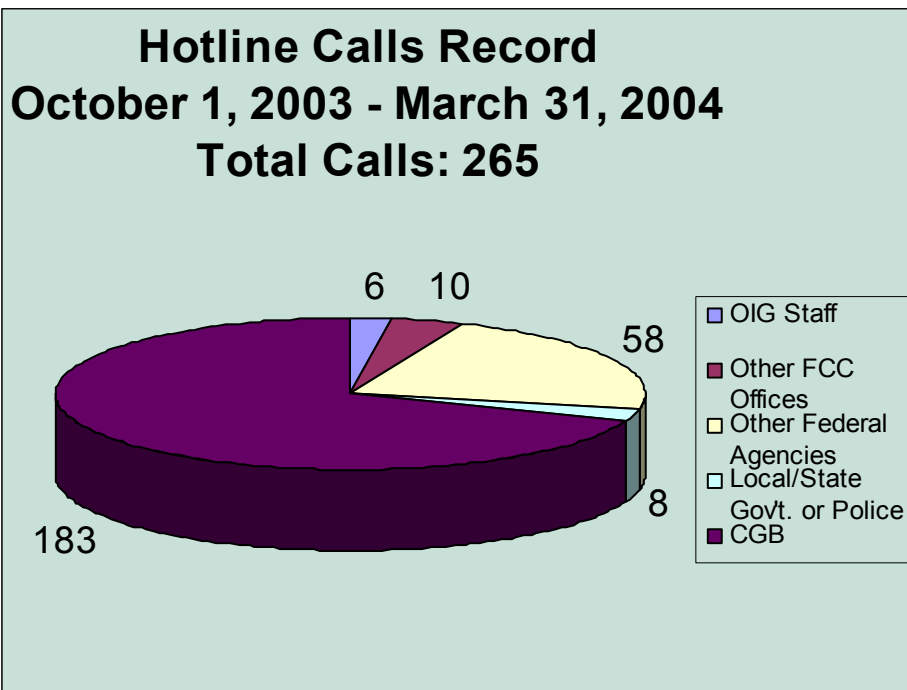
The Counsel to the IG continued to monitor legislative activities affecting the activities of the OIG and the FCC.

During this period, this office continued to monitor legislation and legislatively related proposals, which directly or indirectly impact on the ability of Designated Federal Entity IGs to function independently and objectively. As previously noted, the office monitored the legislation granting statutory law enforcement authority to certain designated OIGs. This office was not among the designated OIGs under the legislation. However, again as previously noted, the legislation was monitored with respect to any possible indirect impact that it may have on this office's operations. Under the legislation, there are peer review requirements for the designated OIGs that may have an impact on the non-designated OIGs. In this vein, this office continues to work with and participate in discussions with other OIGs with respect to, among other things, the development and implementation of a peer review process for non-designated OIGs.

IG Hotline

HOTLINE CALLS

During this reporting period, the OIG Hotline Technician received 265 hotline calls to the published hotline numbers of (202) 418-0473 and 1-888-863-2244(toll free). The OIG Hotline continues to be a vehicle by which Commission employees and parties external to the FCC can contact the OIG to speak with a trained Hotline Technician. Callers who have general questions or concerns not specifically related to the missions or functions of the OIG office are referred to the FCC National Call Center (NCC) at 1-888-225-5322. In addition, the OIG also refers calls that do not fall within its jurisdiction to such other entities as other FCC offices, federal agencies and local or state governments. Examples of calls referred to the NCC or other FCC offices include complaints pertaining to customers' phone service and local cable providers, long-distance carrier slamming, interference, or similar matters within the program responsibility of other FCC bureaus and offices.



IG Hotline

Report Fraud, Waste or Abuse to:

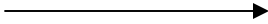
Office of the Inspector General
Federal Communications Commission



CALL
Hotline: (202) 418-0473
or
(888) 863-2244
www.fcc.gov/oig

You are always welcome to write or visit.

ABC 2	OPER 0	ABC 2	
GHI 4	1	TUV 8	
OPER 0	GHI 4	PQRS 7	DEF 3



Federal Communications Commission
Portals II Building
445 12th St., S.W. -Room #2-C762

Specific Reporting Requirements of the Inspector General Act

The following summarizes the Office of Inspector General response to the 12 specific reporting requirements set forth in Section 5(a) of the Inspector General Act of 1978, as amended.

1. A description of significant problems, abuses, and deficiencies relating to the administration of programs and operations of such establishment disclosed by such activities during the reporting period.

Refer to the Section of the semiannual report entitled "Universal Service Fund" on pages 2 through 17.

2. A description of the recommendations for corrective action made by the Office during the reporting period with respect to significant problems, abuses, or deficiencies identified pursuant to paragraph (1).

Refer to the Section of the semiannual report entitled "Universal Service Fund" on pages 2 through 17.

3. An identification of each significant recommendation described in previous semiannual reports on which corrective action has not yet been completed.

No significant recommendations remain outstanding.

4. A summary of matters referred to authorities, and the prosecutions and convictions which have resulted.

Sixteen cases associated with the Commission's Universal Service Program have been referred to the Department of Justice.

5. A summary of each report made to the head of the establishment under section (6)(b)(2) during the reporting period.

No report was made to the Chairman of the FCC under section (6)(b)(2) during the reporting period.

Specific Reporting Requirements of the Inspector General Act

6. A listing, subdivided according to subject matter, of each audit report issued by the office during the reporting period, and for each audit report, where applicable, the total dollar value of questioned costs (including a separate category for the dollar value of unsupported costs) and the dollar value of recommendations that funds be put to better use. *Each audit report issued during the reporting period is listed according to subject matter and described in part II, above.*

7. A summary of each particularly significant report.

Each significant audit and investigative report issued during the reporting period is summarized within the body of this report.

8. Statistical tables showing the total number of audit reports with questioned costs and the total dollar value of questioned costs.

The required statistical table can be found at Table I to this report.

9. Statistical tables showing the total number of audit reports with recommendations that funds be put to better use and the total dollar value of such recommendations.

The required statistical table can be found at Table II to this report.

10. A summary of each audit report issued before the commencement of the reporting period for which no management decision has been made by the end of the reporting period (including the date and title of each such report), an explanation of the reasons why such a management decision has not been made, and a statement concerning the desired timetable for achieving a management decision on each such report.

No audit reports fall within this category.

11. A description and explanation of the reasons for any significant revised management decision made during the reporting period.

No management decisions fall within this category.

Specific Reporting Requirements of the Inspector General Act

12. Information concerning any significant management decision with which the Inspector General is in disagreement.

No management decisions fall within this category.

OIG Reports With Questioned Costs

Table I.

Inspector General Reports With Questioned Costs	Number of Reports	Questioned Costs	Unsupported Costs
A. For which no management decision has been made of the reporting period.	-	-	-
B. Which were issued during the reporting period.	5	2, 302, 846	-
Subtotals (A+B)	5	2, 302, 846	-
C. For which a management decision was made during the reporting period.	-	-	-
(i) Dollar value of disallowed costs	-	-	-
(ii) Dollar value of costs allowed	-	-	-
D. For which no management decision has been made by the end of the reporting period.	5	2, 302, 846	-
Reports for which no management decision was made within six months of issuance.	-	-	-

OIG Reports With Recommendations That Funds Be Put To Better Use

Table II.

Inspector General Reports With Recommendations That Funds Be Put To Better Use	Number of Reports	Dollar Value
A. For which no management decision has been made by the commencement of the reporting period.	-	-
B. Which were issued during the reporting period.	-	-
Subtotals (A+B)	-	-
C. For which a management decision was made during the reporting period.	-	-
(i) Dollar value of recommendations that were agreed to by management.	-	-
-Based on proposed management action.	-	-
-Based on proposed legislative action.	-	-
(ii) Dollar value of recommendations that were not agreed to by management.	-	-
D. For which no management decision has been made by the end of the reporting period.	-	-
For which no management decision was made within six months of issuance.	-	-