

**PROBLEMS WITH THE E-RATE PROGRAM: GAO
REVIEW OF FCC MANAGEMENT AND OVERSIGHT**

HEARING
BEFORE THE
SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON ENERGY AND
COMMERCE
HOUSE OF REPRESENTATIVES
ONE HUNDRED NINTH CONGRESS

FIRST SESSION

MARCH 16, 2005

Serial No. 109-7

Printed for the use of the Committee on Energy and Commerce



Available via the World Wide Web: <http://www.access.gpo.gov/congress/house>

U.S. GOVERNMENT PRINTING OFFICE

99-904PDF

WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
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PROBLEMS WITH THE E-RATE PROGRAM: GAO REVIEW OF FCC MANAGEMENT AND OVERSIGHT

WEDNESDAY, MARCH 16, 2005

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:03 p.m., in room 2123 of the Rayburn House Office Building, Hon. Ed Whitfield (chairman) presiding.

Members present: Representatives Whitfield, Burgess, Blackburn, Stupak, Inslee, and Baldwin.

Also present: Representative Engel.

Staff present: Mark Paoletta, chief counsel; Tom Feddo, majority counsel; Peter Spencer, majority professional staff; Jaylyn Jensen, senior legislative analyst; David Nelson, minority investigator and economist; Edith Hollman, minority counsel; Jessica McNeice, research assistant; and David Vogel, staff assistant.

Mr. WHITFIELD. I would like to call this hearing to order and welcome all of you to the Oversight and Investigations Subcommittee hearing on problems with the E-Rate program, the GAC review of FCC management and oversight. Today's hearing will examine the Federal Communications Commission's management and oversight of the E-Rate program. This subcommittee has done much to expose for Congress a range of problems in the E-Rate program management—problems that raise questions about the program's effectiveness and whether the Nation's taxpayers can be assured their tax dollar has been used efficiently.

During the past session of Congress, this subcommittee conducted an extensive investigation of the E-Rate program. Through this work, which was highlighted in three informative hearings last summer and fall, the subcommittee identified a number of expensive failures in the program. The subcommittee spotlight exposed tens of millions of dollars in wasted E-Rate spending. We saw ceiling-high pallets of useless wireless equipment, sitting shrink-wrapped in a warehouse, and we learned that the beneficiaries of that equipment, Puerto Rican schoolchildren, had been deprived of any real benefit of E-Rate, despite the program sending more than \$100 million to Puerto Rico's schools.

We learned of wasted opportunities in Texas where, for instance, the El Paso Independent School District was convinced by an E-Rate vendor—IBM in that situation—that it could use \$60 million

in E-Rate funds for a single school year for about 50 schools. Twenty-four million dollars of this was spent on an operation meant just to maintain the network. That district soon found itself over its head in technology as it watched millions of dollars of planning and preparation, including the entire maintenance operation, simply disappear when funds dried up after authorities discovered it had participated in an anti-competitive process. The district struggles to this day to get its E-Rate program back in order.

We saw the deceit spread by true—for lack of a better term—E-Rate crooks, who sought to line their pockets in a national scheme to funnel tens of millions of E-Rate funds to particular companies, including NEC BNS, and Intertel, both of which pleaded guilty last year to Federal fraud and conspiracy charges. Examples like these were amplified by national news stories of additional waste in Atlanta, Chicago, Houston, and elsewhere that served to highlight what we learned were fundamental weaknesses in the program—that is in the application process, the technology planning, and the oversight by the FCC. Some of these topics we will revisit today.

Against this backdrop, we turn, today, to the FCC, which has been ultimately responsible for this \$2 billion a year program with both its successes and failures these past 7 years. In December 2003, as part of its E-Rate investigation, the committee requested the GAO, the investigative arm of Congress, to look at FCC management and oversight of the program. GAO's findings and recommendations form the centerpiece of today's hearing.

[The report is available at <http://www.gao.gov/new.items/d05151.pdf>]

This will be a straightforward hearing with one panel of witnesses. We will hear from Mark Goldstein, Director of Physical Infrastructure Issues for GAO. We will hear from Jeffrey Carlisle, who is Chief of the FCC's Wireline Competition Bureau, which oversees the E-Rate program. And we will hear from Tom Bennett, FCC's Assistant Inspector General for Universal Service Fund Oversight. He will speak to the IG's perspective on program weaknesses and also to efforts to identify waste, fraud, and abuse in the program. At this time, I would like to welcome the witnesses and say that I am hopeful that we will be able to obtain some clear answers about the state of FCC management today.

The GAO report raises troubling questions about FCC's track record over the 7 years of E-Rate operations, a time period over which more than \$9 billion were expended on E-Rate goods and services, supposedly under FCC's watchful eyes; yet after all of this money has been spent, and several billion more promised or committed, we still have no real firm measure of how effective this spending has been. I would like to understand why the FCC has failed to, until recently, begin addressing programmatic weaknesses long-identified by GAO and the FCC/IG. Why hasn't the FCC taken a comprehensive look at the program, its funding structure, and identify clearly the rules necessary for ensuring sound financial and program management. And what do these current findings say about FCC's management of the billions of dollars of other universal service funding mechanisms? If the patterns of problems we see in E-Rate extend to other portions of universal service, I would be interested in conducting additional investigatory work in

those areas to assist the full committee as it works to make sure these programs work as Congress intended.

In the meantime, while the subcommittee's work is complete, we are preparing a bipartisan staff report that I am confident will assist the telecommunications subcommittee in its efforts to overhaul the E-Rate program. Chairman Upton, I wish you well in preparing such legislation—it will be his subcommittee—and hope that you will find our work helpful in that regard. In my view, the subcommittee's work demonstrates that legislation should not be limited to changes that merely tinker around the edges. E-Rate requires serious reforms, and the FCC may very well turn out to be the wrong steward of this program.

Now, let me, again, welcome the witnesses. And I would now like to recognize the Ranking Member Mr. Stupak of Michigan for the purposes of making an opening statement.

Mr. STUPAK. Well, thank you Mr. Chairman, and thank you for holding this hearing and continuing this bipartisan examination of the E-Rate program, the program set up to wire schools and libraries across the country to the Internet. This program is crucial to fulfill the promise of equal opportunity in America. Without equal access to knowledge, the children of low-income, underserved, and rural America will certainly never be able to flourish in the 21st century economy.

You need only look at my Congressional district to see the power of the E-Rate program. Last month, my constituent Mary Crawford, representing a consortium of 64 libraries in the Upper Peninsula, testified before a Congressional forum about the importance of E-Rate. Through careful planning and prudent use of E-Rate funds, libraries were among the first to bring broadband to my district. Libraries in my district have seen Internet usage increase more than 200 percent in the last 4. More importantly, libraries have been revitalized, becoming hubs of activity for teenagers, children, business owners, and seniors.

Educators tell a similar story. Thanks to E-Rate funds, the world is literally at the fingertips of children in my district who live in some of the most rural areas of the United States. Unfortunately, the power of the E-Rate program has not been fully realized because of greed and incompetence—the greed of a few bad vendors and the complete incompetence of the FCC. As this investigation has demonstrated, large vendors have all too often viewed the \$2.2 billion set aside from the universal service fund for the E-Rate program as a cookie jar to be tapped at will. Some of the biggest names in corporate America have been caught with their hands in the cookie jar. The U.S. subsidiary of the Japanese giant Nippon Electric has pleaded guilty to bid rigging in connection with E-Rate procurement. These vendors have bilked the American public for uncounted millions of dollars, while the schoolchildren in the defrauded districts must do without the bridge across the digital divide that Congress intended.

The FCC has permitted such abuses to flourish. The Commission has ignored repeated warnings and recommendations from the GAO and its own inspector general to reform the program. Most importantly, the FCC has failed to implement—or come to the Congress for the authority to implement remedies that punish the bad

actors. Instead, the FCC's actions to date only punish the innocent victims of these scams.

The chairman brought up, but let me reiterate, the example in Puerto Rico. One hundred million dollars was wasted over a 3-year period from 1998 to 2000 by greedy vendors. Do you know what \$100 million bought? Two lousy computer connections. Yet the sum total of FCC action to date has been to refuse any further funding to the Puerto Rico school district. Thus, we are now approaching the 8 years in which the children of Puerto Rico will have completed their primary or secondary education without the meaningful Internet access that was promised by Congress in 1996, and not a penny has been recovered from the vendors that received the E-Rate dollars that went into the waste.

In Puerto Rico, rural America, and elsewhere, the digital gap is widening, and the opportunity is evaporating. The FCC merely fiddles with ill-conceived reform plans, such as the sudden application of Gov GAAP accounting methods last year. Without the intervention of Congress, that brainstorm would have resulted in hundreds of millions of E-Rate dollars tied up in bureaucracy instead of going to our communities. The Commission cannot or will not use its authority to find these greedy vendors. It will impose debarment sanctions only after the justice department has obtained criminal convictions. In all, too few cases have the FCC or the USAC been able to even recover the funds that they know have been dispersed improperly.

The FCC must find ways to deter waste and abuse from occurring in the first place. The recommendations from the GAO and the FCC inspector general's office that we will hear today are minimal, first steps, steps that should have been taken years ago.

This committee will have its own bipartisan recommendations to offer shortly. I expect the changes that the Commission is urged to make will be made and made promptly. I also anticipate that we will have recommendation regarding statutory changes that this committee and that the Congress should consider. As a member of the telecommunications subcommittee, as well as being the ranking Democratic member on this subcommittee, I look forward to working with Chairman Barton, Chairman Upton, and yourself, Mr. Chairman, as well as Ranking Members Dingell and Markey to enact these reforms. Both the Congress and the FCC have much to do to do a better job than what we have done to date for the children that we promised to elevate out of the digital divide that marks the difference between opportunity and despair in the 21st century.

With that, Mr. Chairman, I yield back the balance of my time, and I will ask unanimous consent the statement of the Honorable John Dingell be made part of the record.

Thank you, Mr. Stupak, and at this time, I would like to welcome the witnesses—oh, Ms. Baldwin, would like an opening statement?

Ms. BALDWIN. Thank you, Mr. Chairman.

As a new member of this subcommittee, I want to acknowledge and commend the subcommittee for its work in prior sessions in examining this issue and abuse in the E-Rate program in general. I would like to begin by noting that the E-Rate program can boast many, many success stories. Millions of children in thousands of

school districts across the country have benefited from improved Internet access due to E-Rate funding. I have heard about the way the E-Rate has been used in school and libraries in my own district, and there should be no doubt about the value of this program.

It is unfortunate that the actions of a few bad actors tarnishes an otherwise worthy program. When a school district fails to properly use E-Rate funds, not only do its students suffer, others that could have benefited also lose. When companies collude with school districts to rig bids, all kids lose.

Reviewing the previous work of this subcommittee and the GAO report released today raises very disturbing questions about the management and oversight of this program. With so much money at stake in so many different school districts, it is, unfortunately, not surprising that some unscrupulous people would attempt to abuse the system. These people should be prosecuted to the full extent of the law.

What is of greater concern are the failures of the Federal Communications Commission to properly safeguard public funds, to provide adequate program goals, and guidelines, and conduct sufficient auditing and oversight of E-Rate awards.

I am pleased that the subcommittee has examined this issue so carefully, and I look forward to working with the chairman and ranking member to make this program a success.

Mr. WHITFIELD. Thank you, Ms. Baldwin. Mr. Burgess, you are recognized for an opening statement.

Mr. BURGESS. I will submit mine for the record in the interest of time, since we vote on.

Mr. WHITFIELD. Without objection.

[Additional statement submitted for the record follows:]

PREPARED STATEMENT OF HON. CLIFF STEARNS, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF FLORIDA

Thank you Mr. Chairman, for holding this important hearing.

I share the concerns of all parties regarding abuse, waste and fraud in the E-Rate program. We are talking about billions of dollars here, money that should be going to help young children learn how to bridge the digital divide.

Obviously, the GAO report is disturbing, and it doesn't pull any punches in laying blame with the FCC, which has oversight over the program.

But we in Congress have oversight over the FCC, so we are also responsible for this debacle. That's why we had GAO conduct this study, and why we are having this hearing. I commend the Chairman for holding this hearing, as well as the other E-Rate related hearings that have been held by this committee the last couple of years.

I would be remiss if during this hearing on abuse of the E-Rate program that I did not bring up the report from Miami-Dade Public Schools in my home state of Florida about the legal quagmire that they appear to be in as a result of a Universal Service Administrative Company (USAC) recovery process.

While I won't discuss the merits or specifics of this particular case, the situation in Florida certainly raises general concerns that can and should be addressed by this committee, the FCC and the USAC. This is especially in regard to the procedural process used by the USDAC and the FCC, which in this case seems to be hurting the local school board.

Mr. Chairman, there are many questions that need to be answered at this hearing by all parties involved. It is the intent of Congress that schools and libraries have access to these funds to help underprivileged children learn using 21st century technology. However, the problems detailed in the GAO report and in other accounts defeat the very goal of the E-Rate program. We must fix this problem before an entire generation of children gets left behind.

Mr. WHITFIELD. As you can hear, it looks like we have a vote on the floor, but before we do that, I would like to, at this time—and by the way, the Chairman of the full committee may come in. If he comes in, he will certainly be allowed to give an opening statement as well, but in the meantime, I would like to introduce the witnesses and welcome you to this panel. First, we have Mr. Mark Goldstein, who is the Director of Physical Infrastructure Issues at the Government Accountability Office, and he will be giving the testimony related to the GAO report, which was embargoed until today. We also have with us Mr. Jeffrey Carlisle, who is the Wireline Competition Bureau at the Federal Communications Commission; he is the Chief. We understand that his mother is in the audience today, and we welcome her as well to watch him testify. Also, Mr. Thomas Bennett, who is the Assistant Inspector General for the Universal Service Fund Oversight at the Federal Communications Commission. And I might add, as you know, we are holding an investigatory hearing, and it is the practice of this committee that we take testimony under oath. And each of you certainly has a right to an attorney being present, and I know that—it is my understanding that Mrs. Emmanuelli-Perez is an attorney that is accompanying you, Mr. Goldstein. Is that correct?

Mr. GOLDSTEIN. That is correct, Mr. Chairman.

Mr. WHITFIELD. Okay. Well, at this time—and Mr. Carlisle, do you want an attorney to be present with you?

Mr. CARLISLE. No, I will be fine.

Mr. WHITFIELD. Mr. Bennett?

Mr. BENNETT. No.

Mr. WHITFIELD. Okay. Well, then, at this time, if you would stand up with me, I would like to swear you in.

[Witnesses sworn.]

Mr. WHITFIELD. Thank you. You are now under oath, and you may now give a 5-minute summary of your written statement.

And Mr. Goldstein, we will start with you.

TESTIMONY OF MARK L. GOLDSTEIN, PHYSICAL INFRASTRUCTURE ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE; JEFFREY CARLISLE, CHIEF, WIRELINE COMPETITION BUREAU, FEDERAL COMMUNICATIONS COMMISSION; AND THOMAS D. BENNETT, ASSISTANT INSPECTOR GENERAL FOR USF OVERSIGHT, FEDERAL COMMUNICATIONS COMMISSION

Mr. GOLDSTEIN. Good afternoon, Mr. Chairman and members of the subcommittee. I am Mark Goldstein, a director with GAO's Physical Infrastructure team. Joining me today at the table is Edda Emmanuelli-Perez, an Assistant General Counsel at GAO. We appreciate the opportunity to come before you today to discuss management and oversight of the Federal E-Rate program, which provides schools and libraries across the country with funding for telecommunications and Internet services.

We are releasing, today, our latest report concerning the E-Rate program. Including today's hearing, GAO, since 1998, has issued 12 reports and testimonies examining or relating to the E-Rate program. Recently, this program has received considerable scrutiny from your subcommittee due to multiple cases of fraud, waste, and abuse that have come to light. The FCC's Inspector General has

testified before Congress concerning a few particularly egregious cases.

Our work related to the E-Rate program has focused more on internal controls and other management-related issues the program faces. For the report being released today, we evaluated: No. 1, the effect of the current structure of the E-Rate program on the FCC's management of the program, No. 2, FCC's development and use of performance goals and measures in managing the program, and No. 3, the effectiveness of FCC's oversight mechanisms.

These oversight mechanisms include FCC rulemaking proceedings, audits of E-Rate beneficiaries, and the appeals process within the E-Rate program. This afternoon I will briefly summarize our findings, which are more fully detailed in our report.

First, FCC established E-Rate as a multi-billion dollar program, operating under an organizational structure unusual to the Federal Government, and then never conducted a comprehensive assessment to determine which Federal requirements, policies, and practices apply to the program, to USAC, and to the Universal Service Fund itself. FCC believes that it has addressed, on a case-by-case basis, the applicability of various Federal requirements. We believe that addressing the applicability of statutes on a case-by-case basis as issues have arisen has put FCC and the E-Rate program in the position of reacting to problems as they occur, rather than setting up an organization of internal controls designed to ensure compliance with applicable laws. The laws encompassing fiscal and accountability rules are not applied in isolation, rather they are part of a framework that addresses issues of financial and general management of Federal agencies and programs. The E-Rate program was established over 7 years ago, yet as illustrated by the recent problems related to the applicability of the Antideficiency Act and its effect on funding commitments, FCC is still analyzing whether certain statutes and requirements apply to this program.

We believe it also remains to be resolved the extent to which FCC has delegated some functions for the E-Rate program to USAC. Because of the unusual program structure, USAC operates and disburses funds under less explicit Federal ties than many other Federal programs. We believe that FCC needs to explore whether the disbursement policies and practices for the E-Rate program are consistent with statutory and regulatory requirements for the disbursement of public funds and whether some of the functions carried out by USAC are inherently governmental activities that should be performed by government personnel.

We are encouraged that FCC just announced that it has contracted with the National Academy of Public Administration for NAPA to study and explore alternative models to the current organizational and governance structure of the Universal Service program. We believe this study will go a long way toward addressing the concerns outlined in our report, and we look forward to seeing the results of NAPA's efforts.

The second issue we examined was FCC's development and use of performance goals and measures. GAO has made past recommendations that FCC develop meaningful performance goals and measures to assess the specific impact of E-Rate funds on schools' and libraries' Internet access and to improve the manage-

ment of the program. When FCC did develop goals for the program, they were related to levels of Internet connectivity in schools; however, FCC failed to use measurements that isolated the effects of E-Rate funding. The FCC has also failed to put in place management-oriented goals and measures, despite longstanding concerns about the program's effectiveness in key areas. OMB, in its own assessment of the program, concluded that there is no way to tell whether the program has resulted in cost-effective deployment and use of advanced telecommunications services to schools and libraries. FCC told us they are currently working on new performance goals and measures and that they plan to seek OMB approval of those goals and measures by the end of the fiscal year.

Third, we examined FCC's oversight mechanisms for the E-Rate program. We found that FCC's rulemakings have often lacked specificity and led to situations where USAC, in crafting the detail needed to operate the program, has established administrative procedures that arguably rise to the level of policy decisions, even though USAC is prohibited by FCC rules from making program policy. This has led to enforcement problems. We found that the Commission has been slow to respond to the findings coming out of beneficiary audits.

Last, we found that the E-Rate program has a significant appeals backlog at FCC, due in part to a shortage of staff and staff turnover. In commenting on our report, the Commission stated that it has begun to redirect staff and hire additional attorneys to Universal Service Fund oversight and program management, including the resolution of E-Rate appeals. We are particularly encouraged that FCC established a measurable goal of resolving all backlogged E-Rate appeals by the end of this year.

Our report details three recommendations for FCC action on the E-Rate program. First, that they conduct a comprehensive assessment to determine whether all necessary government accountability requirements, policies, and practices have been applied and are fully in place to protect the program and its funding. Second, that they establish performance goals and measures for the E-Rate program that are consistent with the Government Performance and Results Act. And third, that they develop a strategy for reducing the E-Rate appeals backlog.

Thank you, Mr. Chairman, this concludes my opening statement. I will be happy to respond to any questions that you or members of the subcommittee may have.

[The prepared statement of Mark Goldstein follows:]

PREPARED STATEMENT OF MARK L. GOLDSTEIN, DIRECTOR, PHYSICAL
INFRASTRUCTURE ISSUES, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Mr. Chairman and Members of the Subcommittee: We are pleased to be here to discuss the results of our recently completed review of the Federal Communications Commission's (FCC) universal service program for schools and libraries. As you know, the Telecommunications Act of 1996 expanded the concept of universal service to include assistance to schools and libraries in acquiring telecommunications and Internet services; the act charged FCC with establishing the universal service discount mechanism for eligible schools and libraries. The commission, in turn, created a large and ambitious program that became commonly known as the "E-rate" program, and set the annual funding cap for the program at \$2.25 billion. FCC designated the Universal Service Administrative Company (USAC), a private, not-for-profit corporation established under FCC's rules, to carry out the day-to-day oper-

ations of the E-rate program. FCC retains responsibility for overseeing the program's operations and ensuring compliance with the commission's rules.

Since 1998, the E-rate program has committed more than \$13 billion in funding to help schools and libraries across the nation acquire telecommunications and Internet services. Eligible schools and libraries can apply annually to receive support, which can be used for specific eligible services and equipment such as telephone services, Internet access services, and the installation of internal wiring and other related items. Recently, however, allegations have been made that some E-rate beneficiaries (schools and libraries) and service providers (e.g., telecommunications and network equipment companies) have fraudulently obtained, wasted, or abused E-rate funding. In May 2004, for example, one service provider involved in E-rate projects in several states pleaded guilty to bid rigging and wire fraud and agreed to pay more than \$20 million in criminal fines, civil payments, and restitution.

In light of ongoing concerns about the E-rate program, we were asked to review various aspects of the program. Specifically, we evaluated (1) the effect of the current structure of the E-rate program on FCC's management of the program, (2) FCC's development and use of performance goals and measures in managing the program, and (3) the effectiveness of FCC's oversight mechanisms—rulemaking proceedings, beneficiary audits, and reviews of USAC decisions (appeals)—in managing the program.

Our testimony is based on a report, being released today, containing the results of our review and recommendations for improving FCC's management and oversight of the E-rate program.¹ In summary, we found the following:

- FCC established E-rate as a multibillion-dollar program operating under an organizational structure unusual to the federal government, but never conducted a comprehensive assessment to determine which federal requirements, policies, and practices apply to the program, to USAC, and to the Universal Service Fund itself. As a result, FCC has struggled with determining which fiscal and accountability requirements apply to the E-rate program. We believe that issues exist concerning the applicability of certain statutes and the extent to which FCC has delegated certain functions for the E-rate program to USAC—issues that FCC needs to explore and resolve.
- FCC has not developed meaningful performance goals and measures for assessing and managing the program. As a result, there is no way to tell whether the program has resulted in the cost-effective deployment and use of advanced telecommunications services for schools and libraries.
- FCC's program oversight mechanisms contain weaknesses that limit FCC's management of the program and its ability to understand the scope of waste, fraud, and abuse within the program. For example, FCC's rulemakings have often lacked specificity and have led to situations where important USAC administrative procedures have been deemed unenforceable by FCC. There is also a significant backlog of E-rate appeals that adds uncertainty to the program and impacts beneficiaries.

FCC has taken some important steps, particularly in recent months, to address some of the areas of concern discussed in our report. Nevertheless, we believe that FCC has not done enough to proactively manage and provide a framework of government accountability for the multibillion-dollar E-rate program.

BACKGROUND

The concept of “universal service” has traditionally meant providing residential telephone subscribers with nationwide access to basic telephone services at reasonable rates. The Telecommunications Act of 1996 broadened the scope of universal service to include, among other things, support for schools and libraries. The act instructed the commission to establish a universal service support mechanism to ensure that eligible schools and libraries have affordable access to and use of certain telecommunications services for educational purposes.² In addition, Congress authorized FCC to “establish competitively neutral rules to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and nonprofit elementary and secondary school classrooms . . . and libraries . . .”³ Based on this direction, and following

¹ *Telecommunications: Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program*, GAO05151 (Washington, D.C.: Feb. 9, 2005). The report is available on GAO's Web site at www.gao.gov.

² 47 U.S.C. § 254(h)(1)(B).

³ 47 U.S.C. § 254(h)(2).

the recommendations of a Federal-State Joint Board on Universal Service,⁴ FCC established the schools and libraries universal service mechanism that is commonly referred to as the E-rate program. The program is funded through statutorily mandated payments by companies that provide interstate telecommunications services.⁵ Many of these companies, in turn, pass their contribution costs on to their subscribers through a line item on subscribers' phone bills.⁶ FCC capped funding for the E-rate program at \$2.25 billion per year, although funding requests by schools and libraries can greatly exceed the cap. For example, schools and libraries requested more than \$4.2 billion in E-rate funding for the 2004 funding year.

In 1998, FCC appointed USAC as the program's permanent administrator, although FCC retains responsibility for overseeing the program's operations and ensuring compliance with the commission's rules.⁷ In response to congressional conference committee direction,⁸ FCC has specified that USAC "may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Congress."⁹ USAC is responsible for carrying out the program's day-to-day operations, such as maintaining a Web site that contains program information and application procedures; answering inquiries from schools and libraries; processing and reviewing applications; making funding commitment decisions and issuing funding commitment letters; and collecting, managing, investing, and disbursing E-rate funds. FCC permits—and in fact relies on—USAC to establish administrative procedures that program participants are required to follow as they work through the application and funding process.

Under the E-rate program, eligible schools, libraries, and consortia that include eligible schools and libraries¹⁰ may receive discounts for eligible services. Eligible schools and libraries may apply annually to receive E-rate support. The program places schools and libraries into various discount categories, based on indicators of need, so that the school or library pays a percentage of the cost for the service and the E-rate program funds the remainder. E-rate discounts range from 20 percent to 90 percent. USAC reviews all of the applications and related forms and issues funding commitment decision letters. Generally, it is the service provider that seeks reimbursement from USAC for the discounted portion of the service rather than the school or library.¹¹

FCC ESTABLISHED AN UNUSUAL PROGRAM STRUCTURE WITHOUT COMPREHENSIVELY ADDRESSING THE APPLICABILITY OF GOVERNMENTAL STANDARDS AND FISCAL CONTROLS

FCC established an unusual structure for the E-rate program but has never conducted a comprehensive assessment of which federal requirements, policies, and practices apply to the program, to USAC, or to the Universal Service Fund itself. FCC recently began to address a few of these issues, concluding that as a permanent indefinite appropriation, the Universal Service Fund is subject to the Antideficiency Act and that USAC's issuance of commitment letters constitutes obligations for purposes of the act. However, FCC's conclusions concerning the status of the Universal Service Fund raise further issues relating to the collection, deposit, obligation, and disbursement of those funds—issues that FCC needs to explore and resolve comprehensively rather than in an ad hoc fashion as problems arise.

⁴The Federal-State Joint Board on Universal Service was established in March 1996 to make recommendations to implement the universal service provisions of the Telecommunications Act of 1996. The board is composed of FCC commissioners, state utility commissioners, and a consumer advocate representative.

⁵These companies include providers of local and long distance telephone services, wireless telephone services, paging services, and pay phone services. 47 C.F.R. § 54.706.

⁶The line item is called various things by various companies, such as the "federal universal service fee" or the "universal connectivity fee." Some companies do not separate out universal service costs as a line item, but instead just build it into their overall costs. Either way, consumers ultimately pay for the various universal service programs, including E-rate.

⁷USAC was established at the direction of FCC and operates under FCC's rules and policies.

⁸See S.1768, 105th Cong., § 2004(b)(2)(A) (1998).

⁹47 C.F.R. § 54.702(c).

¹⁰Eligibility of schools and libraries is defined at 47 U.S.C. § 254. Generally, educational institutions that meet the definition of "schools" in the Elementary and Secondary Education Act of 1965 are eligible to participate, as are libraries that are eligible to receive assistance from a state's library administrative agency under the Library Services and Technology Act. Examples of entities not eligible for support are home school programs, private vocational programs, and institutions of higher education. In addition, neither private schools with endowments of more than \$50 million nor libraries whose budgets are part of a school's budget are eligible to participate. 20 U.S.C. § 9122.

¹¹The school or library could also pay the service provider in full and then seek reimbursement from USAC for the discount portion.

The Telecommunications Act of 1996 neither specified how FCC was to administer universal service to schools and libraries nor prescribed the structure and legal parameters of the universal service mechanisms to be created. To carry out the day-to-day activities of the E-rate program, FCC relied on a structure it had used for other universal service programs in the past—a not-for-profit corporation established at FCC's direction that would operate under FCC oversight. However, the structure of the E-rate program is unusual in several respects compared with other federal programs:

- FCC appointed USAC as the permanent administrator of the Universal Service Fund,¹² and FCC's Chairman has final approval over USAC's Board of Directors. USAC is responsible for administering the program under FCC orders, rules, and directives. However, USAC is not part of FCC or any other government entity; it is not a government corporation established by Congress; and no contract or memorandum of understanding exists between FCC and USAC for the administration of the E-rate program. Thus, USAC operates and disburses funds under less explicit federal ties than many other federal programs.
- Questions as to whether the monies in the Universal Service Fund should be treated as federal funds have troubled the program from the start. Even though the fund has been listed in the budget of the United States and, since fiscal year 2004, has been subject to an annual apportionment from the Office of Management and Budget (OMB), the monies are maintained outside of Treasury accounts by USAC and some of the monies have been invested.¹³ The United States Treasury implements the statutory controls and restrictions involving the proper collection and deposit of appropriated funds, including the financial accounting and reporting of all receipts and disbursements, the security of appropriated funds, and agencies' responsibilities for those funds.¹⁴

Since the inception of the E-rate program, FCC has struggled with identifying the nature of the Universal Service Fund and the managerial, fiscal, and accountability requirements that apply to the fund. In the past, FCC's Inspector General (IG) has noted that the commission could not ensure that Universal Service Fund activities were in compliance with all laws and regulations because the issue of which laws and regulations were applicable to the fund was unresolved. During our review, FCC officials told us that the commission has substantially resolved the IG's concerns through recent orders, including FCC's 2003 order that USAC begin preparing Universal Service Fund financial statements consistent with generally accepted accounting principles for federal agencies (GovGAAP) and keep the fund in accordance with the United States Government Standard General Ledger.¹⁵ While it is true that these steps and other FCC determinations should provide greater protections for universal service funding, FCC has addressed only a few of the issues that need to be resolved. In fact, staff from the FCC's IG's office told us that they do not believe the commission's GovGAAP order adequately addressed their concerns because the order did not comprehensively detail which fiscal requirements apply to the Universal Service Fund and which do not.

FCC maintains that it has undertaken a timely and extensive analysis of the significant legal issues associated with the status of the Universal Service Fund and has generally done so on a case-by-case basis. We recognize that FCC has engaged in internal deliberations and external consultations and analysis of a number of statutes. However, we do not believe that this was done in a timely manner or that it is appropriate to do this on a case-by-case basis, which puts FCC and the program in the position of reacting to problems as they occur rather than setting up an organization and internal controls designed to ensure compliance with applicable laws.

¹²USAC was appointed the permanent administrator subject to a review after one year by FCC to determine that the universal service programs were being administered in an efficient, effective, and competitively neutral manner. 47 C.F.R. § 54.701(a). This review was never conducted.

¹³The Universal Service Fund is included in the federal budget as a special fund. OMB concluded that the fund does not constitute public money subject to the Miscellaneous Receipts Statute, 31 U.S.C. § 3302, and therefore can be maintained outside the Treasury by a non-governmental manager. Letter from Mr. Robert G. Damus, OMB General Counsel to Mr. Christopher Wright, FCC General Counsel, dated April 28, 2000.

¹⁴See 31 U.S.C. §§331, 3301-3305 and the Treasury Financial Manual, vol. I, which instructs federal agencies in areas of central accounting and reporting, disbursing, deposit regulations, and other fiscal matters necessary for the financial accounting and reporting of all receipts and disbursements of the federal government.

¹⁵See FCC, *Order, In the Matter of Application of Generally Accepted Accounting Principles for Federal Agencies and Generally Accepted Government Auditing Standards to the Universal Service Fund*, FCC 03-232 (Washington, D.C.; Oct. 3, 2003).

As you know, Mr. Chairman, a problem with this ad hoc approach was dramatically illustrated with regard to the applicability of the Antideficiency Act to the Universal Service Fund. In October 2003, FCC ordered USAC to prepare financial statements for the Universal Service Fund, as a component of FCC, consistent with GovGAAP, which FCC and USAC had not previously applied to the fund. In February 2004, staff from USAC realized during contractor-provided training on GovGAAP procedures that the commitment letters sent to beneficiaries (notifying them whether their funding is approved and in what amount) might be viewed as “obligations” of appropriated funds.¹⁶ If so viewed, and if FCC also found the Antideficiency Act—which does not allow an agency or program to make obligations in excess of available budgetary resources—to be applicable to the E-rate program, then USAC would need to dramatically increase the program’s cash-on-hand and lessen the program’s investments¹⁷ to provide budgetary authority sufficient to satisfy the Antideficiency Act. As a result, USAC suspended funding commitments in August 2004 while waiting for a commission decision on how to proceed. At the end of September 2004—facing the end of the fiscal year—FCC decided that commitment letters were obligations; that the Antideficiency Act did apply to the program; and that USAC would need to immediately liquidate some of its investments to come into compliance with the Antideficiency Act. According to USAC officials, the liquidations cost the fund approximately \$4.6 million in immediate losses and could potentially result in millions in foregone annual interest income. In response to these events, in December 2004, Congress passed a bill granting the Universal Service Fund a one-year exemption from the Antideficiency Act.¹⁸

As we explain more fully in our report, Mr. Chairman, we agree with FCC’s determinations that the Universal Service Fund is a permanent appropriation subject to the Antideficiency Act and that its funding commitment decision letters constitute recordable obligations of the Universal Service Fund. However, there are several significant fiscal law issues that remain unresolved. We believe that where FCC has determined that fiscal controls and policies do not apply, the commission should reconsider these determinations in light of the status of universal service monies as federal funds. For example, in view of its determination that the fund constitutes an appropriation, FCC needs to reconsider the applicability of the Miscellaneous Receipts Statute, 31 U.S.C. § 3302, which requires that money received for the use of the United States be deposited in the Treasury unless otherwise authorized by law.¹⁹ FCC also needs to assess the applicability of other fiscal control and accountability statutes (e.g., the Single Audit Act and the Cash Management Improvement Act).²⁰

Another major issue that remains to be resolved involves the extent to which FCC has delegated some functions for the E-rate program to USAC. For example, are the disbursement policies and practices for the E-rate program consistent with statutory and regulatory requirements for the disbursement of public funds?²¹ Are some of the functions carried out by USAC, even though they have been characterized as administrative or ministerial, arguably inherently governmental activities²² that must be performed by government personnel? Resolving these issues in a com-

¹⁶An “obligation” is an action that creates a legal liability or definite commitment on the part of the government to make a disbursement at some later date.

¹⁷According to USAC, the Universal Service Fund was invested in a variety of securities, including cash and cash equivalents, government and government-backed securities, and high-grade commercial paper. USAC generally did not seek the approval of the commission on particular investments, although investments were made with FCC knowledge and oversight through formal audits and informal meetings and review.

¹⁸Universal Service Antideficiency Temporary Suspension Act, Pub. L. No. 108-494, § 302, 118 Stat. 3986 (2004). The law exempts universal service monies from the Antideficiency Act until December 31, 2005.

¹⁹Because OMB and FCC had believed the funds were not public monies “for the use of the United States” under the Miscellaneous Receipts Statute, neither OMB nor FCC viewed the Universal Service Fund as subject to that statute.

²⁰For example, in October 2003, when FCC ordered USAC to comply with GovGAAP, it noted that the Universal Service Fund was subject to the Debt Collection Improvement Act of 1996. In that same order, FCC stated that “the funds *may* be subject to a number of federal financial and reporting statutes” (emphasis added) and “relevant portions of the Federal Financial Management Improvement Act of 1996,” but did not specify which specific statutes or the relevant portions or further analyze their applicability. FCC officials also told us that they were uncertain whether procurement requirements such as the Federal Acquisition Regulation (FAR) applied to arrangements between FCC and USAC, but they recommended that those requirements be followed as a matter of policy.

²¹See 31 U.S.C. §§ 3321, 3322, 3325, and the Treasury Financial Manual.

²²See OMB Circular A-76, May 29, 2003, which defines an inherently governmental activity as requiring “the exercise of substantial discretion in applying government authority and/or in making decisions for the government.”

prehensive fashion, rather than continuing to rely on reactive, case-by-case determinations, is key to ensuring that FCC establishes the proper foundation of government accountability standards and safeguards for the E-rate program and the Universal Service Fund. We are encouraged that FCC just announced that it has contracted with the National Academy of Public Administration (NAPA) for NAPA to study and explore alternative models to the current organizational and governance structure of the Universal Service Fund program. We believe this study will go a long way toward addressing the concerns outlined in our report and we look forward to seeing the results of NAPA's efforts.

FCC DID NOT DEVELOP USEFUL PERFORMANCE GOALS AND MEASURES FOR ASSESSING AND MANAGING THE E-RATE PROGRAM

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

One of the management tasks facing FCC is to establish strategic goals for the E-rate program, as well as annual goals linked to them. The Telecommunications Act of 1996 did not include specific goals for supporting schools and libraries, but instead used general language directing FCC to establish competitively neutral rules for enhancing access to advanced telecommunications and information services for all public and nonprofit private elementary and secondary school classrooms and libraries.²³ As the agency accountable for the E-rate program, FCC is responsible under the Government Performance and Results Act of 1993 (Results Act) for establishing the program's long-term strategic goals and annual goals, measuring its own performance in meeting these goals, and reporting publicly on how well it is doing.²⁴

For fiscal years 2000 through 2002, FCC's goals focused on achieving certain percentage levels of Internet connectivity during a given fiscal year for schools, public school instructional classrooms, and libraries. However, the data that FCC used to report on its progress was limited to public schools (thereby excluding two other major groups of beneficiaries—private schools and libraries) and did not isolate the impact of E-rate funding from other sources of funding, such as state and local government. This is a significant measurement problem because, over the years, the demand for internal connections funding by applicants has exceeded the E-rate funds available for this purpose by billions of dollars. Unsuccessful applicants had to rely on other sources of support to meet their internal connection needs. Even with these E-rate funding limitations, there has been significant growth in Internet access for public schools since the program issued its first funding commitments in late 1998. At the time, according to data from the Department of Education's National Center for Educational Statistics (NCES), 89 percent of all public schools and 51 percent of public school instructional classrooms already had Internet access. By 2002, 99 percent of public schools and 92 percent of public school instructional classrooms had Internet access.²⁵ Yet although billions of dollars in E-rate funds have been committed since 1998, adequate program data was not developed to answer a fundamental performance question: How much of the increase since 1998 in public schools' Internet access has been a result of the E-rate program, as opposed to other sources of federal, state, local, and private funding?

Performance goals and measures are used not only to assess a program's impact but also to develop strategies for resolving mission-critical management problems. However, management-oriented goals have not been a feature of FCC's performance plans, despite long-standing concerns about the program's effectiveness in key areas. For example, two such goals—related to assessing how well the program's competitive bidding process was working and increasing program participation by low-in-

²³ 47 U.S.C. § 254(h)(2)(A).

²⁴ For additional details on the Results Act and its requirements, see GAO, *Executive Guide: Effectively Implementing the Government Performance and Results Act*, GAO/GGD-96-118 (Washington, D.C.: June 1996). GAO first noted the lack of clear and specific E-rate performance goals and measures in its July 1998 testimony before the Senate Committee on Commerce, Science, and Transportation. See GAO, *Schools and Libraries Corporation: Actions Needed to Strengthen Program Integrity Operations before Committing Funds*, GAO/TRCED98243 (Washington, D.C.: July 16, 1998), pp. 15-16.

²⁵ See NCES, *Internet Access in U.S. Public Schools and Classrooms: 1994-2002*, NCES-2004-011 (Washington, D.C.; October 2003). This was the most recent update available at the time of our review.

come and rural school districts and rural libraries—were planned but not carried forward.

FCC did not include any E-rate goals for fiscal years 2003 and 2004 in its recent annual performance reports. The failure to measure effectively the program's impact on public and private schools and libraries over the past 7 years undercuts one of the fundamental purposes of the Results Act: to have federal agencies adopt a fact-based, businesslike framework for program management and accountability. The problem is not just a lack of data for accurately characterizing program results in terms of increasing Internet access. Other basic questions about the E-rate program also become more difficult to address, such as the program's efficiency and cost-effectiveness in supporting the telecommunications needs of schools and libraries. For example, a review of the program by OMB in 2003 concluded that there was no way to tell whether the program has resulted in the cost-effective deployment and use of advanced telecommunications services for schools and libraries.²⁶ OMB also noted that there was little oversight to ensure that the program beneficiaries were using the funding appropriately and effectively. In response to these concerns, FCC staff have been working on developing new performance goals and measures for the E-rate program and plan to finalize them and seek OMB approval in fiscal year 2005.

FCC'S OVERSIGHT MECHANISMS ARE NOT FULLY EFFECTIVE IN MANAGING THE E-RATE PROGRAM

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

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

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

First, although USAC is prohibited under FCC rules from making policy, some USAC procedures deal with more than just ministerial details and arguably rise to the level of policy decisions. For example, in June 2004, USAC was able to identify at least a dozen administrative procedures that, if violated by the applicant, would lead to complete or partial denial of the funding request even though there was no precisely corresponding FCC rule. The critical nature of USAC's administrative procedures is further illustrated by FCC's repeated codification of them throughout the history of the program. FCC's codification of USAC procedures—after those procedures have been put in place and applied to program participants—raises concerns about whether these procedures are more than ministerial and are, in fact, policy changes that should be coming from FCC in the first place. Moreover, in its August 2004 order (in a section dealing with the resolution of audit findings), the commission directs USAC to annually "identify any USAC administrative procedures that should be codified in our rules to facilitate program oversight." This process begs the question of which entity is really establishing the rules of the E-rate program and raises concerns about the depth of involvement by FCC staff with the management of the program.

²⁶ OMB reviewed E-rate using its Program Assessment Rating Tool (PART), which is a diagnostic tool intended to provide a consistent approach to evaluating federal programs as part of the executive budget formulation process.

Second, even though USAC procedures are issued with some degree of FCC approval, enforcement problems could arise when audits uncover violations of USAC procedures by beneficiaries or service providers. The FCC IG has expressed concern over situations where USAC administrative procedures have not been formally codified because commission staff have stated that, in such situations, there is generally no legal basis to recover funds from applicants that failed to comply with the USAC procedures. In its August 2004 order, the commission attempted to clarify the rules of the program with relation to recovery of funds. However, even under the August 2004 order, the commission did not clearly address the treatment of beneficiaries who violate a USAC administrative procedure that has not been codified.

FCC Has Been Slow to Address Problems Raised by Audit Findings

FCC's use of beneficiary audits as an oversight mechanism has also had weaknesses, although FCC and USAC are now working to address some of these weaknesses. Since 2000, there have been 122 beneficiary audits conducted by outside firms, 57 by USAC staff, and 14 by the FCC IG (2 of which were performed under agreement with the Inspector General of the Department of the Interior). Beneficiary audits are the most robust mechanism available to the commission in the oversight of the E-rate program, yet FCC generally has been slow to respond to audit findings and has not made full use of the audit findings as a means to understand and resolve problems within the program.

First, audit findings can indicate that a beneficiary or service provider has violated existing E-rate program rules. In these cases, USAC or FCC can seek recovery of E-rate funds, if justified.²⁷ In the FCC IG's May 2004 Semiannual Report, however, the IG observes that audit findings are not being addressed in a timely manner and that, as a result, timely action is not being taken to recover inappropriately disbursed funds.²⁸ The IG notes that in some cases the delay is caused by USAC and, in other cases, the delay is caused because USAC is not receiving timely guidance from the commission (USAC must seek guidance from the commission when an audit finding is not a clear violation of an FCC rule or when policy questions are raised). Regardless, the recovery of inappropriately disbursed funds is important to the integrity of the program and needs to occur in a timely fashion.

Second, under GAO's Standards for Internal Controls in the Federal Government,²⁹ agencies are responsible for promptly reviewing and evaluating findings from audits, including taking action to correct a deficiency or taking advantage of the opportunity for improvement. Thus, if an audit shows a problem but no actual rule violation, FCC should be examining why the problem arose and determining if a rule change is needed to address the problem (or perhaps simply addressing the problem through a clarification to applicant instructions or forms). FCC has been slow, however, to use audit findings to make programmatic changes. For example, several important audit findings from the 1998 program year were only recently resolved by an FCC rulemaking in August 2004.

In its August 2004 order, the commission concluded that a standardized, uniform process for resolving audit findings was necessary, and directed USAC to submit to FCC a proposal for resolving audit findings. FCC also instructed USAC to specify deadlines in its proposal "to ensure audit findings are resolved in a timely manner."³⁰ USAC submitted its Proposed Audit Resolution Plan to FCC on October 28, 2004. The plan memorializes much of the current audit process and provides deadlines for the various stages of the audit process. FCC released the proposed audit plan for public comment in December 2004.³¹

In addition to the Proposed Audit Resolution Plan, the commission instructed USAC to submit a report to FCC on a semiannual basis summarizing the status of all outstanding audit findings. The commission also stated that it expects USAC to identify for commission consideration on at least an annual basis all audit findings raising management concerns that are not addressed by existing FCC rules. Lastly, the commission took the unusual step of providing a limited delegation to

²⁷ USAC, through its duties as administrator of the fund, initially seeks recovery of erroneously disbursed funds. In addition, the commission adopted rules in April 2003 to provide for suspension and debarment from the program for persons convicted of criminal violations or held civilly liable for certain acts arising from their E-rate participation. Debarments would be for a period of three years unless circumstances warrant a longer debarment period in order to protect the public interest.

²⁸ See FCC, *Office of the Inspector General Semiannual Report to Congress*, October 1, 2003-March 31, 2004 (Washington, D.C.; May 3, 2004).

²⁹ GAO/aimd-00-21.3.1.

³⁰ FCC, *Fifth Report and Order, In the Matter of Schools and Libraries Universal Service Support Mechanism*, FCC-04-190 (Washington, D.C.; Aug. 13, 2004), para. 74.

³¹ Comments were due January 5, 2005; reply comments were due January 20, 2005.

the Wireline Competition Bureau (the bureau within FCC with the greatest share of the responsibility for managing the E-rate program) to address audit findings and to act on requests for waiver of rules warranting recovery of funds.³² These actions could help ensure, on a prospective basis, that audit findings are more thoroughly and quickly addressed. However, much still depends on timely action being taken by FCC, particularly if audit findings suggest the need for a rulemaking.

In addition to problems with responding to audit findings, the audits conducted to date have been of limited use because neither FCC nor USAC have conducted an audit effort using a statistical approach that would allow them to project the audit results to all E-rate beneficiaries. Thus, at present, no one involved with the E-rate program has a basis for making a definitive statement about the amount of waste, fraud, and abuse in the program.³³ Of the various groups of beneficiary audits conducted to date, all were of insufficient size and design to analyze the amount of fraud or waste in the program or the number of times that any particular problem might be occurring programwide. At the time we concluded our review, FCC and USAC were in the process of soliciting and reviewing responses to a Request for Proposal for audit services to conduct additional beneficiary audits.

FCC HAS BEEN SLOW TO ACT ON SOME E-RATE APPEALS

Under FCC's rules, program participants can seek review of USAC's decisions,³⁴ although FCC's appeals process for the E-rate program has been slow in some cases. Because appeals decisions are used as precedent, this slowness adds uncertainty to the program and impacts beneficiaries. FCC rules state that FCC is to decide appeals within 90 days, although FCC can extend this period. At the time of our review there was a substantial appeals backlog at FCC (i.e., appeals pending for longer than 90 days). Out of 1,865 appeals to FCC from 1998 through the end of 2004, approximately 527 appeals remain undecided, of which 458 (25 percent) are backlog appeals.³⁵

We were told by FCC officials that some of the backlog is due to staffing issues. FCC officials said they do not have enough staff to handle appeals in a timely manner. FCC officials also noted that there has been frequent staff turnover within the E-rate program, which adds some delay to appeals decisions because new staff necessarily take time to learn about the program and the issues. Additionally, we were told that another factor contributing to the backlog is that the appeals have become more complicated as the program has matured. Lastly, some appeals may be tied up if the issue is currently in the rulemaking process.

The appeals backlog is of particular concern given that the E-rate program is a technology program. An applicant who appeals a funding denial and works through the process to achieve a reversal and funding two years later might have ultimately won funding for outdated technology. FCC officials told us that they are working to resolve all backlogged E-rate appeals by the end of calendar year 2005.

In summary, Mr. Chairman, we remain concerned that FCC has not done enough to proactively manage and provide a framework of government accountability for the multibillion-dollar E-rate program. Lack of clarity about what accountability standards apply to the program causes confusion among program participants and can lead to situations where funding commitments are interrupted pending decisions about applicable law, such as happened with the Antideficiency Act in the fall of 2004. Ineffective performance goals and measures make it difficult to assess the program's effectiveness and chart its future course. Weaknesses in oversight and enforcement can lead to misuse of E-rate funding by program participants that, in turn, deprives other schools and libraries whose requests for support were denied due to funding limitations.

³²FCC 04-190, para. 75.

³³In testimony before the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce in June 2004, FCC's Inspector General submitted a prepared statement that said the "results of audits that have been performed and the allegations under investigation lead us to believe the program may be subject to unacceptably high risk of fraud, waste and abuse." At the same hearing, the Chief of FCC's Office of Strategic Planning and Policy Analysis and the Deputy Chief of FCC's Wireline Competition Bureau submitted a prepared statement that said that FCC had "enabled implementation of the [E-rate] statutory goals with a minimum of fraud, waste, and abuse."

³⁴Virtually all of the decisions made by FCC and USAC in their management and administration of the E-rate program may be subject to petition for reconsideration or appeal by beneficiaries. Moreover, schools and libraries have the option of multiple appeal levels, including USAC, the Wireline Competition Bureau, and the commission.

³⁵The bulk of the appeals are to USAC, which received a total of 16,782 appeals from the beginning of the program through 2003. Of these, 646—roughly 4 percent—remained undecided as of September 20, 2004.

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

SCOPE AND METHODOLOGY

We conducted our work from December 2003 through December 2004 in accordance with generally accepted government auditing standards. We interviewed officials from FCC's Wireline Competition Bureau, Enforcement Bureau, Office of General Counsel, Office of Managing Director, Office of Strategic Planning and Policy Analysis, and Office of Inspector General. We also interviewed officials from USAC. In addition, we interviewed officials from OMB and the Department of Education regarding performance goals and measures. OMB had conducted its own assessment of the E-rate program in 2003, which we also discussed with OMB officials. We reviewed and analyzed FCC, USAC, and OMB documents related to the management and oversight of the E-rate program. The information we gathered was sufficiently reliable for the purposes of our review. See our full report for a more detailed explanation of our scope and methodology.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other Members of the Subcommittee may have.

Mr. WHITFIELD. Mr. Goldstein, thank you, and we have about 6 minutes remaining on a vote on the floor. We are going to have a series of votes, so we are going to suspend this hearing. And Mr. Carlisle, when we come back, we will pick up with your testimony, and then yours, Mr. Bennett. So we will be recessed for a period of time for us to make these votes.

[Brief recess.]

Mr. WHITFIELD. We will reconvene this hearing, and I apologize to the witness for the interruption for votes. I would also note that the chairman of the full committee, the Energy and Commerce Committee, Joe Barton, will not be able to be here, but we are going to submit his opening statement for the record.

And with that, Mr. Carlisle, I will call on you for your opening statement.

TESTIMONY OF JEFFREY CARLISLE

Mr. CARLISLE. Good morning, Mr. Chairman, and distinguished members of the subcommittee. Thank you for giving me the opportunity to discuss with you the GAO report regarding FCC management and oversight of the E-Rate program. We believe that the GAO report provides us a good opportunity to focus on areas in the E-Rate program and our management of it that need attention in order to ensure that oversight of the Universal Service Fund meets the highest standards of government accountability. We look forward to continuing to work with GAO to improve our process. And indeed, as our response GAO details, and as I will summarize here, we are continuing existing and have initiated new measures to address issues identified by the GAO. In doing so, we are doing nothing more than acknowledging the need to undertake a serious review of the FCC's management and oversight of Universal Service. Indeed, doing so is the only way to ensure that we are doing our jobs to act as safeguards of the public's interest and its money.

The GAO report made three recommendations that have been summarized in the statement of Mr. Goldstein; I will not repeat them here. On January 14, we provided a response to the GAO report. In the first area, in the first recommendation, of assessing government accountability requirements, our response details analyses that have been performed by the FCC of 15 separate statutes and the regulations thereunder, including the Antideficiency Act, the Miscellaneous Receipts Act, The Improper Payments Information Act, the Single Audit Act, and the Cash Management Improvement Act. We have shared these analyses with GAO and specifically asked GAO to if it disagrees with them and welcome its expert guidance and expect fully to continue to work with them.

In the second area, establishing government accountability requirements, we are in full agreement with this recommendation and are already working to address it. We are working with OMB and its program-assessment rating tool process to establish better and more comprehensive ways for measuring E-Rate performance. We anticipate including revised performance measures for the High-Cost Fund and the E-Rate Program in the FCC's fiscal year 2007 budget submission.

In the third area, developing a strategy to reduce our backlog of E-Rate appeals, we have taken several steps outlined in the response and are already seeing process. We have prioritized pending cases and reassigned agency resources in order to bring more attorneys and other professionals to bear on outstanding cases. On January 1, our backlog—defined as cases pending for longer than 90 days—stood at 458 cases. Since then, we have resolved 100 cases. These results are due in large part to the addition of four new staff members of the E-Rate team during the first quarter of this year. With this increased staff level, we are now resolving between 60 and 70 cases a month, with a goal of increasing that rate to 80 to 90 cases a month. In all, we are on track to reduce our backlog to zero by the end of this year.

I will also take this opportunity to emphasize some of the additional steps the agency is taking to improve oversight. Last year, we adopted rules codifying certain USAC procedures regarding technology plans and document retention, and we will soon recommend that the Commission adopt a notice of proposed rulemaking to codify a substantial number of additional procedures. Following on an initiative by our Office of the Managing Director, begun in Fall of last year, we have recently retained the National Academy of Public Administration to evaluate the management structure of the program. On a separate track, the bureau is considering making a recommendation to the Commission to adopt a notice of proposed rulemaking that would solicit public comment on this issue and also present specific questions as to current structure and management of each of the funds. We are also considering making a recommendation to the Commission to adopt an order that would expand audit coverage of the entities receiving the largest financial benefits from the E-Rate program. As is reflected in the President's budget for the next fiscal year, we are also seeking additional resources so that we can hire the staff necessary to improve oversight of the program and review of beneficiary audits.

Thank you, Mr. Chairman, for the opportunity to speak with you today. I look forward to your questions.

[The prepared statement of Jeffrey Carlisle follows:]

FCC Response to Draft GAO Report

Submitted by

Jeffrey Carlisle

**Federal Communications Commission
Chief, Wireline Competition Bureau**

In connection with:

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

Before the

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

March 16, 2005



Federal Communications Commission
Washington, D.C. 20554

January 14, 2005

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

Dear Mr. Goldstein:

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

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

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

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

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

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

FCC Management of the E-Rate Program

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Establishing Goals and Performance Measures

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

Reducing Backlog of E-Rate Appeals

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

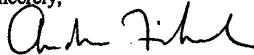
⁷ As the GAO Draft Report notes, the FCC used to measure the number of public schools connected to the Internet, but stopped doing so because, among other reasons, the measure was no longer a useful indicator of the impact of E-rate funds. (Draft Report at 24-25).

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

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

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

Sincerely,



Andrew S. Fishel
Managing Director

Enclosures

Mr. WHITFIELD. Thank you, Mr. Carlisle. And at this time, Mr. Bennett, if you would, give your opening statement.

TESTIMONY OF THOMAS D. BENNETT

Mr. BENNETT. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to come before you today to discuss oversight of the Universal Service Fund program, and more specifically the E-Rate program. This is the third time the FCC/OIG has testified before this subcommittee on oversight of the Universal Service Fund program. In my testimony, I will briefly summarize OIG involvement in the USF oversight, discuss concerns that the OIG has regarding the program, and provide an update on OIG oversight activities.

The FCC/OIG first looked at the USF in 1999 as part of our audit of the Commission's fiscal year 1999 financial statement. Starting with that audit, the Office of Inspector General has continued to devote considerable resources to 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—the schools and libraries program also known as the E-Rate program.

Despite limited resources, the OIG has implemented an aggressive, independent oversight program. Our oversight program includes audits conducted using internal resources, audits conducted by other Federal Offices of Inspector General under reimbursable agreement, review of audit work conducted by auditors with the Universal Service Administrative Company, and active participation in Federal investigations of E-Rate fraud. In addition to conducting audits, 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 anti-trust division of the Department of Justice. We are also supporting several investigations being con-

ducted by Assistant United States attorneys. We are currently supporting 17 investigations and monitoring an additional 15 investigations.

Allegations being investigated in these cases include: 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; and beneficiaries not paying the local portion of the costs, resulting in inflated costs for goods and services to the program and potential kickback issues.

In the past year, there have been a number of significant law enforcement actions involving the E-Rate program. In May 2004, NEC Business Network Solutions, Inc. plead guilty and agreed to pay a total \$20.6 million criminal fine, civil settlement, and restitution related to charges of collusion and wire fraud involving the E-Rate program. In December 2004, Inter-Tel technologies, Inc. plead guilty and agreed to pay a total \$8.71 million criminal fine, civil settlement, and restitution related to charges of bid rigging and wire fraud in connection with the E-Rate program. The NEC and Inter-Tel cases are part of a large, ongoing investigation. In October 2004, Qasim Bokhari and Haider Bokhari plead guilty to charges of conspiracy, fraud, and money laundering involving the E-Rate program. This past January Qasim Bokhari and Haider Bokhari were each sentenced to 6-year prison terms.

Our involvement in E-Rate audits and investigations has highlighted numerous concerns with the program. General concerns include lack of clarity regarding program rules and lack of timely and effective resolution of audit findings. Specific concerns regarding program design include weaknesses in program competitive procurement requirements, ineffective use of purchased goods and services, over-reliance on applicant certifications, weaknesses in technology planning, and issues relating to discount calculation and payment.

I am pleased to report that concerns that we have raised about the E-Rate program have received considerable attention at the Commission. Most notably, on August 4, 2004, the Commission adopted the fifth report and order on the school and libraries universal service support mechanism. In the Fifth Report and Order, the Commission resolved a number of issues arising from audits of the E-rate program and programmatic concerns, including concerns about E-Rate certifications raised by the OIG.

The primary obstacle to implementation of effective OIG oversight has been a lack of adequate resources to conduct audits and provide audit support to investigation. This lack of resources has prevented us from conducting an audit using a statistical approach that would allow us to project the audit results to all E-Rate beneficiaries. Today, I am happy to report that we have made significant progress in addressing our resource concerns. In January, we added two new staff to the USF team and the OIG has been advised that we will be receiving two additional staff. Last summer, we began working with USAC to establish a three-way contract, under which the OIG and USAC can obtain access to audit resources to conduct USF audits. We released a request for proposal in November 2004 and expect to complete the contractor selection process very soon.

We are also currently working with USAC and a public accounting firm to conduct the fourth large-scale audit of E-Rate beneficiaries. One hundred beneficiaries are being audited as part of this project. The project was initiated in August 2004 and is expected to be completed next summer. The Office of Inspector General remains committed to meeting our responsibility for providing effective, independent oversight of the Universal Service Fund, and we believe we have made significant progress.

While the Commission has taken steps to address programmatic weaknesses, more work remains to be done. Through our participation in the fourth large-scale round of E-Rate beneficiary audits with USAC and through audits that we anticipate conducting under our three-way agreement with USAC, we are moving forward to evaluate the state of the program and identify opportunities for programmatic improvements.

Thank you. I will be happy to answer any of your questions.
[The prepared statement of Thomas D. Bennett follows:]

PREPARED STATEMENT OF THOMAS D. BENNETT, ASSISTANT INSPECTOR GENERAL FOR
USF OVERSIGHT, FEDERAL COMMUNICATIONS COMMISSION

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to come before you today to discuss oversight of the Universal Service Fund (USF) program and more specifically the E-rate program. My name is Tom Bennett and I am the Assistant Inspector General for USF Oversight with the FCC Office of Inspector General (OIG). This is the third time that the FCC OIG has testified before the subcommittee on oversight of the Universal Service Fund (USF) program. In my testimony, I will briefly summarize OIG involvement in USF oversight, discuss concerns that the OIG has regarding the program, and provide an update on OIG oversight activities.

OIG OVERSIGHT OF THE UNIVERSAL SERVICE FUND (USF)

The FCC OIG first looked at the USF in 1999 as part of our audit of the Commission's FY 1999 financial statement. During that audit, we questioned the Commission 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 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 E-rate funding have increased from 30,675 in funding year 1998 to 43,050 for the current funding year. Applications have been received from schools and libraries in each of the 50 states, the District of Columbia, and most territories and included 15,255 different service providers. Requested funding has increased from \$2,402,291,079 in funding year 1998 to \$4,538,275,093 for the current funding year.

OIG Oversight

During FY 2001, we worked with Commission staff as well as with the Defense Contract Audit Agency (DCAA) and the Universal Service Administrative Company (USAC), to design an audit program that would provide the Commission with programmatic insight into compliance with rules and requirements on the part of E-rate program beneficiaries and service providers. Our program was designed around two corollary and complementary efforts. First, we would conduct reviews on a statistical sample of beneficiaries large enough to allow us to derive inferences regarding beneficiary compliance at the program level. Second, we would establish a process for vigorously investigating allegations of fraud, waste, and abuse in the program.

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. Despite limited resources, the OIG has implemented an aggressive independent oversight program. My 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.

One-hundred and thirty five (135) audits have been completed by the OIG, USAC internal auditors, or USAC contract auditors in which the auditors have reached a conclusion about beneficiary compliance. Of the 135 audits, auditors determined that beneficiary were not compliance in 48 audits (36%) and generally compliant in an additional 22 audits (16%). Beneficiaries were determined to be compliant in 65 audits (48%). Recommended fund recoveries for those audits where problems were identified total over \$17 million.

OIG Audits Using Internal Resources

The FCC OIG has completed thirteen (13) audits that we initiated during fiscal year 2002 using auditors detailed from the Commission's Common Carrier Bureau (since reorganized as the Wireline Competition Bureau). For these thirteen (13) audits, we concluded that applicants were compliant with program rules in five (5) 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 six (6) of the audits. We have recommended recovery of \$1,794,792 as shown below:

| Report Date | Applicant | Conclusion | Potential Fund Recovery |
|-------------|----------------------------------|---------------------|-------------------------|
| 09/11/0 | Enoch Pratt Free Library | Compliant | \$0 |
| 02/03/03 | Robeson County Public Schools | Compliant | 0 |
| 02/05/03 | Wake County Public Schools | Compliant | 0 |
| 08/27/03 | Albemarle Regional Library | Compliant | 0 |
| 12/22/03 | St. Matthews Lutheran School | Not Compliant | 136,593 |
| 12/22/03 | Prince William County Schools | Generally Compliant | 5,452 |
| 12/22/03 | Arlington Public School District | Generally Compliant | 7,556 |
| 03/24/04 | Immaculate Conception School | Not Compliant | 68,846 |
| 04/06/04 | Children's Store Front School | Not Compliant | 491,447 |
| 05/19/04 | St. Augustine School | Not Compliant | 21,600 |
| 05/25/04 | Southern Westchester BOCES | Compliant | 0 |
| 06/07/04 | United Talmudical Academy | Not Compliant | 934,300 |
| 08/12/04 | Annunciation Elementary School | Not Compliant | 129,003 |
| | | | \$1,794,797 |

Audits Conducted by Other Federal Offices of Inspector General

On January 29, 2003, the FCC OIG and USAC executed a Memorandum of Understanding (MOU) with the Department of the Interior (DOI) OIG. The MOU is a three-way agreement among the Commission, DOI OIG, and USAC for reviews 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 the Department of the Interior 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. We have issued two (2) final audit reports under this MOU, three (3) draft audit reports, and have completed fieldwork on two (2) additional audits. For the audit where we determined that the applicant was not compliant, we have recommended recovery of \$2,084,399. A summary of completed audits is as follows:

| Report Date | Applicant | Conclusion | Potential Fund Recovery |
|-------------|----------------------------|---------------|-------------------------|
| 11/06/03 | Santa Fe Indian School | Compliant | \$0 |
| 01/07/04 | Navajo Preparatory Academy | Not Compliant | 2,084,399 |

We have also established a working relationship with the Office of Inspector General at the Education Department (Education OIG). In January 2004, Education OIG presented a plan for an audit of telecommunication services at the New York City Department of Education (NYCDOE). Because of the significant amount of E-rate funding for telecommunication services at NYCDOE, Education OIG has proposed that they be reimbursed for this audit under a three-way MOU similar to the existing MOU with DOI OIG. In April 2004, the Universal Service Board of Direc-

tors approved the MOU. In June 2004, the MOU was signed and the audit was initiated.

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 sample of beneficiaries was selected by the OIG. In a departure from the two previous large-scale rounds of E-rate beneficiary audits conducted by USAC contractors, 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 (GAGAS or "Yellow Book" standards). 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 under "Yellow Book" standards 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). Many of the audit findings raised by this body of work are reflected in the section addressing concerns with the E-rate program.

Support to Investigations

In addition to conducting audits, 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. We are also supporting several investigations being conducted by Assistant United States Attorneys.

We are currently supporting seventeen (17) investigations and monitoring an additional fifteen (15) investigations. 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; and
- Beneficiaries not paying the local portion of the costs resulting in inflated costs for goods and services to the program and potential kickback issues.

In the past year, there have been a number of significant law enforcement actions involving the E-rate program:

- In May 2004, NEC-Business Network Solutions Inc. (NEC/BNS) pled guilty and agreed to pay a total \$20.6 million criminal fine, civil settlement and restitution relating to charges of collusion and wire fraud involving the E-rate program. NEC/BNS was charged with allocating contracts and rigging bids for E-Rate projects at five different school districts in Michigan, Wisconsin, Arkansas, and South Carolina, in violation of the Sherman Antitrust Act. NEC/BNS was also charged with wire fraud by entering into a scheme to defraud the E-Rate program and the San Francisco Unified School District by inflating bids, agreeing to submit false and fraudulent documents to hide the fact that it planned on installing ineligible items, agreeing to donate "free" items that it planned to bill E-rate for, and submitting false and fraudulent documents to defeat inquiry into the legitimacy of the funding request. In May 2004, NEC/BNS filed a petition for waiver of program suspension and debarment rules. In July 2004, the Commission sought comment on NEC/BNS's petition for waiver. The Commission has not taken action on NEC/BNS's petition.
- In December 2004, Inter-Tel Technologies Inc. pled guilty and agreed to pay a total of \$8.71 million in criminal fines, civil settlement, and restitution relating to charges of bid rigging and wire fraud in connection with the E-Rate program. Inter-Tel was charged with one count of allocating contracts and submitting rigged bids for E-Rate projects at two different school districts in Michigan and California. Inter-Tel also was charged with one count of wire fraud and aiding and abetting by willfully entering into a scheme to defraud the E-Rate program in San Francisco by inflating bids, agreeing to submit false and fraudulent documents to hide the planned installation of ineligible items, and submitting false and fraudulent documents to defeat inquiry into the legitimacy of the funding

request. In January 2005, Inter-Tel received a notice of suspension and of proposed debarment from the E-rate program. The NEC/BNS and Inter-Tel cases are part of a large, on-going investigation.

- In October 2004, Qasim Bokhari and Haider Bokhari pled guilty to charges of conspiracy, fraud, and money laundering involving the E-rate program. According to court papers, in 2001, Qasim Bokhari and his company submitted applications for E-Rate Program funding on behalf of 21 schools in the Milwaukee and Chicago areas totaling more than \$16 million. Qasim Bokhari and his company eventually received more than \$1.2 million for goods and services that were not provided to three of these schools. Additionally, according to the charges, Qasim Bokhari, Haider Bokhari, and Raza Bokhari conspired to conduct numerous financial transactions involving the proceeds of the fraud to conceal and disguise the source of the proceeds. These alleged financial transactions include wiring more than \$600,000 to Pakistan, purchasing a residence, and acquiring several automobiles. In January 2005, Qasim Bokhari and Haider Bokhari were each sentenced to six-year prison terms. In February 2005, Qasim Bokhari and Haider Bokhari received notices of suspension and proposed debarment from the E-rate program.

CONCERNS WITH THE E-RATE PROGRAM

OIG involvement in E-rate audits and investigations has highlighted numerous concerns with this program. These include general programmatic and management concerns as well as specific concerns related to program design. General concerns include:

- lack of clarity regarding program rules, and;
 - lack of timely and effective resolution of audit findings.
- Specific concerns regarding program design include;
- weaknesses in program competitive procurement requirements;
 - ineffective use of purchased goods and services;
 - over-reliance on certifications;
 - weaknesses in technology planning; and
 - issues relating to discount calculation and payment.

Lack of Clarity Regarding Program Rules

Under Commission staff oversight, USAC has implemented numerous policies and procedures to administer the E-rate program. In some cases, the Commission has adopted these USAC operating procedures, 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, it is the position of Commission staff that there is no legal basis for recovery of funds when applicants fail to comply with these procedures. To further complicate matters, we have been advised that, in some cases, USAC may have exceeded their authority in establishing program 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. Within their authority under program rules, USAC has established implementing procedures to ensure 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 no mechanism for enforcing beneficiary compliance.
- 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 the consequences that exist if they fail to comply with those rules. We do not believe that it is possible under the current structure for applicants to have a clear understanding of program 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 the Commission has addressed the issue of consequences for non-compliance, the consequences associated with clear violations of program rules do not appear to be consistent.
- 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 implementation of corrective action resulting from audits. This matter is further complicated by the Commission's position that USAC may have exceeded their authority in establishing some of the

implementing procedures. As a result, we have determined that it is necessary, as part of the E-rate beneficiary audit process, to examine USAC authority for establishing procedures for which we are evaluating beneficiary compliance.

Lack of Timely and Effective Resolution of Audit Findings from E-rate Beneficiary Audits

Since our involvement in this program, I have become increasingly concerned about efforts to resolve audit findings and to recover funds resulting from E-rate beneficiary audits. It has been our observation that audit findings are not being resolved in a timely manner and that, as a result, actions to recover inappropriately disbursed funds are not being taken in a timely manner. In some cases, it appears that audit findings are not being resolved because USAC is not taking action in a timely manner. In other cases, findings are not being resolved because USAC is not receiving guidance from the Commission that is necessary to resolve findings. USAC is prohibited under program rules from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. As a result of this prohibition, USAC must seek guidance from the Commission when audit findings are not clearly violations of Commission rules.

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. E-rate disbursements to these beneficiaries 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.

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 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.

Weaknesses in Program Competitive Procurement Requirements

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 wait at least 28 days after the form 470 is post-

ed 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. Further, although no program rule establishes this requirement, applicants are encouraged by USAC 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.

Although the programs 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. We question whether the rules are adequate to ensure a competitive process is followed. In addition, weak record-keeping requirements to support the procurement process, as well as other aspects of the E-rate application, offer little protection to the program. We believe that the competitive procurement requirements are based on some faulty assumptions. For example,

- Form 470s will have enough information for meaningful proposals from prospective service providers.
- Service providers are reviewing and considering posted form 470s (particularly for smaller schools).
- “Applicable” state and local procurement regulations exist and those regulations are consistent with program rules.

Ineffective Use of Purchased 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.
- 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 non-recurring 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.

Over-reliance on Certifications

The E-rate program is heavily reliant on applicant and service provider certifications. For example, on the form 470, applicants certify that the support received is conditional upon the ability of an applicant to secure access to all of the resources, including computers, training, software, maintenance, and electrical connections, necessary to use effectively the services that will be purchased under this mechanism. On the form 471, applicants make several important certifications. Applicants certify that they have “complied with all applicable state and local laws regarding procurement of services for which support is being sought” and that “the services that the applicant purchases—will not be sold, resold, or transferred in consideration for money or any other thing of value.” Other certifications are required on various program forms.

My office started to raise concerns about perceived weaknesses in the competitive procurement process and over reliance on certifications shortly after we became involved in program oversight. We first became concerned about the competitive procurement process as a result of our involvement in the Metropolitan Regional Education Service Agency (MRESA) investigation. During that investigation we observed how weaknesses in competitive bidding requirements and reliance on self certification were exploited resulting in, at a minimum, a significant amount of wasteful spending. We continued to express our concerns as we designed our oversight program, developed a program for auditing beneficiaries, and supported E-rate

fraud investigations. In fact, we established a working relationship with the Antitrust Division of the Department of Justice in a large part because of the number of investigations that we were supporting that involved allegations regarding the competitive procurement process.

Our level of concern regarding both the competitive procurement process and reliance on self-certification was heightened as we started to work with the Antitrust Division. During our discussions with Antitrust, they expressed a general concern with the lack of information regarding the competitive process and specific concerns regarding applicant and service provider certifications. We started to pursue issues raised by the Antitrust Division with Commission staff in the fall of 2002. I am pleased to report today that the Commission has addressed many of the recommendations from Antitrust and is considering action on other recommendations.

Weaknesses in Technology Planning

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.
- Technology plans do not address 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. As part of the current round of beneficiary audits, we are attempting to determine if USAC had the authority to establish these requirements.
- 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. 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.

Discount Calculation and Payment of the Non-Discount Portion

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.

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. The discount rate calculation and program requirement for payment of the non-discount portion are intended to ensure that recipients avoid unnecessary and wasteful expenditures and encourage schools to seek the best pre-discount rate. Examples of concerns identified during audits and investigations are as follows:

- Applicant not paying the non-discount portion;
- Applicant not paying the non-discount portion in a timely manner; and
- Service providers not billing recipients for the non-discount portion.

I am pleased to report that concerns that we have raised about the E-rate program have received considerable attention at the Commission. Most notably, on August 4, 2004, the Commission adopted the Fifth Report and Order on the Schools and Libraries Universal Service Support Mechanism. In the Fifth Report and Order,

the Commission resolved a number of issues arising from audits of the E-rate program and programmatic concerns raised by my office. In the introduction to the Fifth Report and Order, the Commission included the following statement regarding actions taken in the order:

First, we set forth a framework regarding what amounts should be recovered by the Universal Service Administrative Company (USAC or Administrator) and the Commission when funds have been disbursed in violation of specific statutory provisions and Commission rules. Second, we announce our policy regarding the timeframe in which USAC and the Commission will conduct audits or other investigations relating to use of E-rate funds. Third, we eliminate the current option to offset amounts disbursed in violation of the statute or a rule against other funding commitments. Fourth, we extend our red light rule previously adopted pursuant to the Debt Collection Improvement Act (DCIA) to bar beneficiaries or service providers from receiving additional benefits under the schools and libraries program if they have failed to satisfy any outstanding obligation to repay monies into the fund. Fifth, we adopt a strengthened document retention requirement to enhance our ability to conduct all necessary oversight and provide a stronger enforcement tool for detecting statutory and rule violations. Sixth, we modify our current requirements regarding the timing, content and approval of technology plans. Seventh, we amend our beneficiary certification requirements to enhance our oversight and enforcement activities. Eighth, we direct USAC to submit a plan for timely audit resolution, and we delegate authority to the Chief of the Wireline Competition Bureau to resolve audit findings. Finally, we direct USAC to submit on an annual basis a list of all USAC administrative procedures to the Wireline Competition Bureau (Bureau) for review and further action, if necessary, to ensure that such procedures effectively serve our objective of preventing waste, fraud and abuse.

UPDATE ON OIG OVERSIGHT ACTIVITIES

As I discussed earlier in this testimony, the primary obstacle to implementation of effective, independent oversight has been a lack of adequate resources to conduct audits and provide audit support to investigations. This lack of resources has prevented us from completing the body of work necessary to assess fraud, waste, and abuse at the program level.

Since our initial involvement in independent oversight of the USF as part of our conduct of the FY 1999 financial statement audit, we have added four (4) staff auditor positions and organized USF oversight activities under an Assistant Inspector General for USF Oversight. This represents dedication of five (5) of the ten (10) 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 January 2005, we were advised that the OIG would receive two (2) additional staff for USF oversight. We are in the process of hiring these additional staff.

We have also 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. This funding was not included in the Commission's final budget for FY 2004 and report language indicated that monies for USF audits should come from the fund itself.

Based largely on that report language, we began to explore alternatives for obtaining access to contract audit support to implement the USF oversight portions of our audit plan. We have been working with USAC since last summer to establish a three-way contract under which the OIG and USAC can obtain audit resources to conduct USF audits. Under this contract, we intend to conduct the body of audits necessary to assess fraud, waste, and abuse at the program level by conducting a statistically valid sample of audits for each of the four USF funding mechanisms. The objectives of the audits are to: (1) detect waste, fraud, and abuse by beneficiaries of the universal service support mechanisms, (2) deter waste, fraud, and abuse by beneficiaries of the universal service support mechanisms, (3) generate insights about the compliance of beneficiaries with applicable law and the quality of administration of the universal service support mechanisms and (4) identify areas for improvement in the compliance of beneficiaries with applicable law and in the administration of the universal service mechanisms. An additional objective is to identify improper payments as defined by the Office of Management and Budget to estimate error rates for the Improper Payments Improvement Act of 2002 (IPIA). I am pleased today to report that we are close to selecting a public accounting firm, or firms, to provide support for our USF oversight activities, including E-rate audits

and support to E-rate investigations. We released a Request for Proposal in November 2004 and expect to complete the selection process very soon.

We are also working with USAC and a public accounting firm under contract to USAC to conduct the fourth large-scale audit of E-rate beneficiaries. One-hundred beneficiaries are being audited as part of this project. The project was initiated in August 2004 and is expected to be completed next summer.

CONCLUSION

The Office of Inspector General remains committed to meeting our responsibility for providing effective independent oversight of the USF and we believe we have made significant progress. While the Commission has taken steps to address programmatic weaknesses, more work remains to be done. Through our participation in the fourth large-scale round of E-rate beneficiary audits with USAC and through audits that we anticipate conducting under our three-way agreement with USAC, we are moving forward to evaluate the state of the program and identify opportunities for programmatic improvements.

Mr. WHITFIELD. Thank you, Mr. Bennett, and we appreciate the testimony of all of you.

Listening to the testimony this afternoon emphasizes, once again, what I consider to be some significant problems with this program. We have heard mentioned today procurement irregularities, false claims, purchase of ineligible items of the E-Rate program, local match not being made, civil fines and criminal fines totaling \$20 million, totaling \$8 million in another instance, people going to prison. And yet this was a program, I think, that started with great promise, certainly sufficient funding to make a significant difference in the lives of a lot of young people; and yet report after report after report points out serious shortcomings in the oversight of this program.

One issue that I would like to discuss—and there will be many more, of course—but the National Exchange Carrier Association is a body of about 900 companies that provide Internet services, phone services, whatever. And a subsidiary of that is the Universal Service Administrative Company. And the carriers, themselves, that go to the local school boards or libraries and talk to them about the various equipment that is available to them, they do certification themselves; the schools do certification themselves; the libraries certify themselves. Do you not see an inherent conflict of interest with this Universal Service Corporation that is administering this program being a subsidiary of the companies that benefit by selling the equipment? I would just ask all three of you that question to start off with. Do you see an inherent conflict in that setup?

Mr. GOLDSTEIN. Mr. Chairman, we didn't really look at that, per se, but I think what is important is that structural clarity is obviously required in this program at a lot of levels. We think it is clear, particularly between the FCC and USAC, that while they have tried to make a number of changes in the last couple years to improve the program—and the August order that the other gentleman at the table had mentioned has helped to improve some of the structural issues—there are many issues that still remain. I am sure that the issue that you referred to may partly be suffering from the same kind of question. But we did not specifically look at that, and so it is difficult for me to comment.

Mr. WHITFIELD. Well, what is your impression, Mr. Carlisle, of that issue?

Mr. CARLISLE. NECA is an entity that predated the 1996 act that was established not to represent rural carriers so much as it was established to coordinate pooling of payments, of costs among them, so that they could recover their costs through common tariff filings.

So NECA is an independent entity. I do not see that there is specifically a conflict of interest. Now, there may be other reasons to change the structure of USAC and how it manages the fund, but I don't see that, specifically, as being an issue. I could certainly talk about it in further detail with your staff if you would like.

Mr. WHITFIELD. But from your perspective, you don't see any conflict at all?

Mr. CARLISLE. I don't know that that has been—I don't see a conflict, given how NECA was set up and what its intent is. Is there a possibility that you have carriers—you do have carriers on the USAC board, for example, but you also have representatives from State consumer groups, and you have other entities on the board as well—representatives from the schools and library community. So it certainly bears looking into, and we can talk about the issues relating to NECA specifically, in detail with your—

Mr. WHITFIELD. Do you have any thoughts on this, Mr. Bennett?

Mr. BENNETT. This was actually an area that, when we first got involved in oversight of USF, it was certainly something that we had questions about. As we got more involved, our focus began to shift toward, how the funds were being used; so it is not something we have really explored in some time.

Mr. WHITFIELD. Well, Mr. Goldstein, and you, Mr. Bennett, you all are involved in a lot of studies and oversight investigations in a lot of different programs. When you read these GAO reports, and when you go back and you look at the hearings from last year, you see these criminal convictions and these civil convictions. It appears that—and not being able to determine how much this program specifically contributed to connecting these schools and libraries, it seems pretty frustrating to me. In comparing this to other investigations, do you find this to be a blatantly badly administered program compared to other investigations you have done?

Mr. GOLDSTEIN. I would say, Mr. Chairman, that I think there are a number of issues which are outlined in the report that are problems that have been surfaced now for a number of years. At the same time, I think that FCC and USAC have tried to make progress, particularly in the last couple of years. I think they have gotten a better handle on how portions of this, being Federal funds, are going to be connected to various laws. As they have tried to work out procedures that ought to be codified, they have dealt with other issues.

But I think, really, at the bottom of it, though, is an issue with respect to what is trying to be achieved. The goals and the performance measures for this program have never really been developed, frankly, and until or unless that is done, it is difficult to know what the program is achieving and what its connection to connectivity in the schools really is, so I think that is—

Mr. WHITFIELD. Mr. Carlisle, do you agree that the goals have never really been clearly articulated?

Mr. CARLISLE. Of the program?

Mr. WHITFIELD. Yes.

Mr. CARLISLE. I believe the goals of the program—what we were told by the statute to do was to facilitate the funding of telecommunications services in schools; that was the goal that we were given.

In terms of the FCC having effective metrics to ensure that that goal was being met, I would absolutely agree that effective metrics for that were never adopted by the Commission. We adopted a metric that basically looked at gross Internet connections; but as GAO points out, it doesn't really break out what effect the fund, itself, had on that and what would have been the effect if the fund had never been in place. So I agree. We need to get those metrics in place.

Mr. WHITFIELD. Well, you know, you hear, repeatedly, that one of the primary obstacles for the FCC is lack of resources; and yet you look at the money that is available in this fund—over \$14 billion, \$9 billion committed—why hasn't the FCC every come forward and asked for additional resources, even from the fund, to help provide adequate oversight and to remove some of these errors?

Mr. CARLISLE. I think I should give you my answer in two parts.

First of all, we have come to Congress, repeatedly, to ask for additional resources in order to improve our oversight, and we have another request in 2006 submission. In terms of use of the fund—this is the second part of the answer. In terms of use of the fund, my understanding from our general counsel's office is that 31-USC-1351 prohibits an agency from transferring funds between accounts in the budget.

Mr. WHITFIELD. Well, why don't we change that?

Mr. CARLISLE. That would allow us to do so, and I think that has been discussed before.

Mr. WHITFIELD. Yes, but we have lost millions of dollars in this program, and it seems to me that changing a law to allow you to use those funds would not be something that would be all that difficult.

Mr. CARLISLE. If Congress would like to do that, I would be absolutely thrilled.

Mr. WHITFIELD. Mr. Goldstein and Mr. Bennett, I noticed that in the letter that was submitted as the testimony for the FCC that they mentioned—in the GAO report it said that the FCC has not done a comprehensive assessment of what Federal requirements, policies, and practices apply to the E-Rate program. The FCC responded to your report by stating that it has undertaken timely and extensive analysis of the significant legal issues related to the status of the Universal Service Fund on a case-by-case basis. Mr. Goldstein, what is your concern with the FCC's case-by-case approach?

Mr. GOLDSTEIN. We have a couple of concerns, Mr. Chairman. We recognize that the Commission has, indeed, gone through a process on an ad hoc basis where they have tried to determine which laws applied to the Universal Service Fund. The problem is, from our perspective, twofold. One is that they didn't do it comprehensively. They haven't taken a look at the entire financial management structure that would accrue to funds that are considered to be Federal funds, and when this became a permanent and definite appropriation, it seems to us that they had to take a look

at that from the perspective of how these various laws would apply and to do so, not in isolation, but together, because some of them have impacts on other laws. There is a framework, frankly, we believe, of how the laws are applied to be able to protect the program and the funds themselves.

Second of all, over time, this program has obviously changed considerably I think it is important to note that back 1998, the Commission did what I would call a kind of cursory look at the Anti-deficiency Act—and whether it applied to the fund. That was before there was a determination that these were Federal funds. And they really, as far as we can tell, never went back, until last year, to look again. In other words, the passage of time, in addition to the framework, need to be looked at together, over time, vigilantly, to make sure that these kinds of things are dealt with forthrightly and that the funds are protected in the way that the government expects Federal funds to be protected.

Mr. WHITFIELD. Thank you, my time has expired. Mr. Stupak?

Mr. STUPAK. Thank you, Mr. Chairman. Mr. Carlisle, I would like to follow up a couple of questions that the Chairman had asked.

You indicated that you have come to Congress to ask for more people, correct? To do your work? I need yes or no.

Mr. CARLISLE. Yes.

Mr. STUPAK. Okay. But yet, you pay for USAC out of this fund, don't you?

Mr. CARLISLE. Yes.

Mr. STUPAK. You don't have to come to Congress to get authorization to pay USAC.

Mr. CARLISLE. That is correct.

Mr. STUPAK. So you could put more auditors in USAC to help find these deficiencies or problems within this program, could you not?

Mr. CARLISLE. I believe USAC has hired additional personnel in order to deal with this, and that is being reflected in their increased administrative costs over the last year.

Mr. STUPAK. Yes. Right. But the point is, if you were aggressive, you don't really need to come to Congress. If you can hire USAC, you certainly can hire auditors for USAC to make sure that these discrepancies were not there.

Mr. CARLISLE. But even if USAC does have a full team of auditors and goes out and finds problems with the program, at some point, we bear operational or we bear programmatic responsibility to review those findings.

Mr. STUPAK. Sure.

Mr. CARLISLE. And at the same time as handing the policy on the program, how funds are distributed, who receives the funds, how we get the funds in—

Mr. STUPAK. Sure.

Mr. CARLISLE. [continuing] that is a lot of responsibility. And so getting additional resources into USAC helps, but it doesn't solve the problem for us. We need additional resources in the FCC to deal to with it.

Mr. STUPAK. Hindsight is always 20/20, but if USAC would have been set up differently, maybe you wouldn't have had all problems

if you had ongoing audits because I mean it seems like, you know, when no one is watching the store, that is when it gets robbed. Right?

Mr. CARLISLE. I think the—well, I have to agree with you that if USAC had been set up differently from the beginning, we may very well have avoided some of these problems.

Mr. STUPAK. Well, how about the FCC? Does that come underneath the Single Audit Act?

Mr. CARLISLE. Pardon me?

Mr. STUPAK. Is FCC subject to the Single Audit Act?

Mr. CARLISLE. Yes, I believe so.

Mr. STUPAK. Okay. Well, then, why wouldn't you use that Act because any expenditure over \$300,000 is required to be audited, and that Act expressly allows you to pay for auditors from the funds from which the money came from.

Mr. CARLISLE. Well, I believe we are going through processes where we are using funds from the USF to pay for audits. For example, the audits under the Improper Payment Improve Act—later on this year, we are going to be conducting hundreds of those audits. Those audits are being conducted under a 3-way agreement between our inspector general—

Mr. STUPAK. Sure.

Mr. CARLISLE. —USAC, and the auditors.

Mr. STUPAK. Right.

Mr. CARLISLE. [continuing] and those auditors are being paid for out of the fund.

Mr. STUPAK. Right. Well, my question was in the past 8 or 9 years that the fund has been there, why wasn't that Single Audit Act looked at because, again, any expenditure over \$300,000 has to be audited; and if the FCC is subject to it, that would give you more personnel because you can take the money out of that fund. Again, hindsight is always 20/20, but I can just point to two examples where I think the FCC could have done a better job, and the existing law is there where the funds would have been made available.

Mr. CARLISLE. Well, with regard to the use of the Single Audit Act historically, I will be happy to talk to our Office of the General Counsel and get back to your staff about that.

Mr. STUPAK. Mr. Goldstein, is that a fair assessment of the Single Audit Act that they could have done that?

Mr. GOLDSTEIN. The Single Audit Act could be used, sir, and my understanding of it—and counsel can certainly help me—is that it involves anything related to law, to grants, to loans, cooperative agreements, and “other assistance.”

Mr. STUPAK. Sure.

Mr. GOLDSTEIN. And this would certainly fall into that category, as it seems to us.

Mr. STUPAK. Well, Mr. Carlisle, let me ask you this: you know the chairman and I and others have brought up the \$100 million of Puerto Rico, \$67 million from the El Paso, and the FCC has been aware of these cases for some time. Yet from everything we can gather, the FCC has only recovered—\$36 million in overcharges have been identified—not recovered, but at least identified. And if you have been aware of these cases for some time, why has no de-

termination been made, then, regarding the refunds due to the E-Rate program, much less any steps for recovery on these two cases?

Mr. CARLISLE. You are talking about El Paso, specifically?

Mr. STUPAK. Well, sure. El Paso and Puerto Rico, I mean. I know you tried to do some stuff on Puerto Rico, but if you take these two cases, there is \$167 million that has sort of been wasted, and only \$36 million in overcharges have been identified. I would think we would find a lot more, so I guess I am asking you why has no determination been made regarding recovery of funds? And let us start with El Paso because I don't think anything has been done on that case, \$67 million.

Mr. CARLISLE. I am actually more familiar with the facts of the Puerto Rico case.

Mr. STUPAK. Okay.

Mr. CARLISLE. On El Paso, I will not be able to provide any details at this time. On Puerto Rico, however, I believe KPMG is going to be finishing its final audit report within the next month or so, and it is going to be submitted for consideration at the USAC board meeting.

Mr. STUPAK. Will they identify that could possibly be recovered?

Mr. CARLISLE. I believe so. We will see when we see their actual final audit report. I have not seen a draft of it.

Mr. STUPAK. Okay. I spoke of the \$36 million that has been identified. Of that \$36 million, only \$3.2 million has actually been recovered; \$14.4 million is tied up in appeals. This is money that could have gone back into the E-Rate. Why have we only been able to recover \$3.2 million? I mean how long has this program been going on now? Eight years at \$2 billion a year, that is about \$16 billion; and of all the money spent and problems we have, we only got about \$3 million ever recovered—\$3.2 million.

Mr. CARLISLE. I would have to actually check on the \$3.2 million number. However, in terms of the process for recovery, like any other audit and recovery process, there is a process to it to ensure that the beneficiaries actually have a fair opportunity to take a look at the audit reports. They have the ability to challenge the audit findings. If USAC comes out with an audit finding that warrants recovery, they can appeal that to the Commission.

Mr. STUPAK. Sure.

Mr. CARLISLE. And Commission review of that can take some time.

Mr. STUPAK. Take some time.

Mr. CARLISLE. And so I think that is probably the primary reason why you haven't seen recovery tracking the total amount that has been identified. However, I am hopeful that we will move forward very quickly over the next year to increase that that.

Mr. STUPAK. In the responder saying the FCC Wireline Competition Bureau cannot provide Congress or the public with any indication as to the magnitude of the potential of waste, fraud, and abuse within the E-Rate program? Is that correct?

Mr. CARLISLE. Where do you get that understanding? I don't—was that something that we said, if I may ask?

Mr. STUPAK. It was in one of the report we read that the FCC Wireline Competition Bureau cannot provide Congress or the public with any indication as to the magnitude of a potential waste,

fraud, and abuse within the E-Rate program. So if that is correct, how do you propose to provide us with a meaningful counting of the FCC's stewardship of the E-Rate program?

Mr. CARLISLE. Well, first, as to a concept as to the amount of waste, fraud, and abuse in the program: I believe we are getting a sense of that as a result of the audits that have been conducted so far.

Mr. STUPAK. What is that sense? What do you think? 10 percent? 20 percent?

Mr. CARLISLE. Well, if we look at the audits that have been conducted so far—

Mr. STUPAK. Sure.

Mr. CARLISLE. [continuing] as the IG stated in their testimony, they found that there were compliance issues with about 36 percent of the audits that they have conducted. If you look at the total amount of dollars disbursed that would be recoverable because of those compliance issues, it comes out to somewhere, I believe, between 3 and 5 percent of the dollars disbursed, and I believe that is actually confirmed by the results of our most recent round of—I believe it was the KPMG audits, which saw that out of the total numbers of dollars disbursed that were audited, about 3-percent recovery was warranted.

Mr. STUPAK. So that is about, if my math is correct, about \$500 million; yet nationwide, we have identified about \$36 million.

Mr. CARLISLE. As a result of the audits that we conducted—and some of those were audits—I believe some of the audits that were conducted were as a result of specific issues that were identified, so it was not a random sampling. The KPMG audit was a random sampling. So in terms of how that lines up, I would have to look at the details myself and get back to you.

Mr. STUPAK. Okay. If I can go back to El Paso for a minute—and maybe Mr. Bennett will want to help you on that one. Over the course of the subcommittee's investigation into the El Paso School System, we learned that El Paso persuaded USAC to fund a \$27 million, state-of-the-art, network-maintenance-system support center for 53 of the districts' school that keep the networks so-called up and running. And you know, I think the Chairman brought it up—it was switches and routers and cables; all should have been conveyed by vendor warranties—or at least the first year after installation should have been warranted. They spend the \$27 million, and it only operates for about 3 months, and the system sort of crashes.

And in order to ensure that this type of deceit does not happen again, what mechanisms can the FCC put in to make sure that—first of all, \$27 million, there is a Cadillac plan was way too much for the school, and that is why the whole system crashed. What do you have in there to make sure that you don't have that kind of rip off again by vendors? And I will use El Paso as an example.

Mr. CARLISLE. Well, I believe there are several steps that the Commission has taken and will continue to take in order to protect against that. First of all, in the Fifth Report and Order that was released last year, the Commission codified rules regarding technology plans that the schools are supposed to have in order to determine the equipment that is appropriate for them. These plans

have to be consistent with Department of Education guidelines. That is in place now. And they are also required to retain documents related to the development of the technology plan.

Separately, when USAC goes through the 35,000—actually it is approaching 40,000, now—applications a year for E-Rate funding, they actually have a system very similar to, for example, the system that the SEC uses to identify possible insider trading transactions. Flags will go up if certain parameters are not met when a bid is submitted. So we actually have the ability to take a look at that and prevent the actual application from being approved. So there are steps that are taken before the funding every goes out; and then there are steps that can be taking after the funding goes out through the auditing of the program.

Mr. STUPAK. Well, I know my time is up. Can I just ask one more question? Okay.

The El Paso system—just a little more on El Paso here. On El Paso School System, if it had a 1-year warranty, it crashes after 3 months, have you done anything to try and go after this \$27 million? It seems like you have a warranty, you have a great legal to ground to go after it. Has anything been sought to recover any of that money?

Mr. CARLISLE. I am sorry. I am going to have to get back to you on details about that. I am just not familiar enough with the details of the case. I am sorry about that.

Mr. STUPAK. Thank you, Mister—

Mr. WHITFIELD. The gentleman's time is expired. The gentlelady from Tennessee, Ms. Blackburn.

Ms. BLACKBURN. Thank you, Mr. Chairman, and thank you to each of you for being here today. We have been interested to read your testimony and interested to have you here with us. And Director Goldstein, I think I will begin with you, if you don't mind.

From my time I served on government reform, I have come to really appreciate you guys—

Mr. GOLDSTEIN. Thank you very much.

Ms. BLACKBURN. [continuing] and the work that you. You all have indicated that there may be 35 programs—or at least 35 other programs that provide funding for technology in schools and that this funding could move as high as \$12 billion. Is that correct?

Mr. GOLDSTEIN. Are you referring to an older report of ours? Are you—

Ms. BLACKBURN. Yes.

Mr. GOLDSTEIN. Yes. This is—

Mr. BLACKBURN. Okay.

Mr. GOLDSTEIN. In a report that we issued a number of years ago, that is correct.

Ms. BLACKBURN. Okay. Great. Have any of these other programs had the financial problems that E-Rate has?

Mr. GOLDSTEIN. I am not sure that we have tracked them since then, so I think it is pretty difficult for us to tell. This is a report that was issued some time ago about other kinds of programs. And obviously, they have, no doubt, changed over the years, so I would hesitate to characterize what kinds of problems they may have today. Whether they had problems at that time, obviously, is an-

other issue; but we haven't tracked them in a way that would help us to answer that question.

Ms. BLACKBURN. Okay. So you have not tracked the effectiveness of those programs?

Mr. GOLDSTEIN. No, ma'am.

Ms. BLACKBURN. Okay. Is it too much for me to ask if you would respond to me on those programs and the financial management of those programs so that we will know what is still in effect? I see the individuals who are with you and seated behind you kind of nodding their heads—

Mr. GOLDSTEIN. I hope they are nodding their heads, yes.

Ms. BLACKBURN. [continuing] making some comments, and I think that would be helpful to us.

Mr. GOLDSTEIN. We will be happy to get back to you and to figure out how we can—

Ms. BLACKBURN. That would be great.

Mr. GOLDSTEIN. [continuing] help you with that.

Ms. BLACKBURN. That would be great. I think as we look at E-Rate that that would be helpful to have that information because if there is a way to begin to measure some effectiveness moving forward, I think it would serve us well.

Another thing on E-Rate, funded, primarily, through the Universal Service Fee, and that is capped at \$2.25 billion per year. And the tax started out at 3 percent in 1998 and is now at 9 percent. Is that correct?

Mr. CARLISLE. May I?

Ms. BLACKBURN. Yes. Go ahead, please, Mr. Carlisle.

Mr. CARLISLE. It is actually, for the first quarter of the year, it is at 10.7 percent.

Ms. BLACKBURN. 10.7? Thank you for that. That is important. I have just left a telecommunications subcommittee hearing, and you know, as we look at the Telecom Act, I think that applies to us.

Okay. Mr. Goldstein, to you again: does the FCC's administration of the E-Rate program comply with the FFMIA?

Mr. GOLDSTEIN. One of the things we are trying to ask FCC to do is to go back and look at the various financial laws and make that determination. We are not in a position to specifically determine—

Ms. BLACKBURN. You are not? Mr. Carlisle, I saw your interest peaked a bit by that question. Do you have an answer for that one?

Mr. CARLISLE. I believe the Office of the General Counsel made a determination and communicated in a letter—and I am going to forget exactly to whom it was sent—but it made a determination in 2000 the FFMIA did apply to the fund.

Ms. BLACKBURN. And do they comply?

Mr. CARLISLE. We have no reason to believe they are not in compliance.

Ms. BLACKBURN. Okay. Great. Wonderful. And Mr. Goldstein, another one for you.

Going back to all of the programs—let me loop this back into my first question, going back into the technology funding. With the 35 programs that have been in existence—as you respond to me on that, I would like to know—we are looking at waste, fraud, and abuse, and we are looking at where our opportunities for savings

exist. I would like to know how much efficiency could be gained if you were take all 35 of these various and sundry programs with the different—probably different levels of effectiveness, and if they were rolled and consolidated into one program—more or less what our administrative savings would be and what we could gain from that oversight, what we could address through rules, what we would need to address through legislation. So that would be helpful.

Mr. GOLDSTEIN. We would be happy to take a preliminary look, come talk to you and your staff, and see what we can do from there.

Ms. BLACKBURN. Okay. That will be great.

Mr. Carlisle, has the FCC consulted with school and libraries on the programs' goals and measures of those goals? And what ought to be done next with the program, now that 90 percent of the schools are—they have connectivity.

Mr. CARLISLE. Usually the way that we interface with the schools and libraries is through the notice and comment process, when we are adopting rules related to the program, and so we do always have the opportunity to get input from them. We also have regular calls—my staff has regular calls with the national coordinating bodies for schools and libraries participating in the program. So we do have the opportunity to talk to them about the goals of the program and how they change, and we are looking forward to receiving further comment from them as we continue to modify the program.

Ms. BLACKBURN. Will E-rate have outlived its usefulness when we see most of the service going wireless?

Mr. CARLISLE. Well, certainly, that may be, in some cases, a more cost-effective way of providing broadband to schools, as opposed to running actual wires out to schools located at a distance. Now, it may be that even it is more cost effective, it may be very expensive for some schools to actually buy that equipment; there may still be a gap between what the schools are able to pay and what the technology costs. So I would hope, that as technology becomes more ubiquitous and cheaper over time, you would see less of a need for extremely high funding requests for equipment, over time. But is a valid question; as we do reach a level of—for example, 94-percent penetration of broadband services to schools—how should the funding program change? Should it become more targeted? Should we be looking at more cost-effective technologies? And we have solicited comment on some of those issues; we hope to solicit comment on more of them very soon.

Ms. BLACKBURN. Do you feel that, even with these other 35 funding programs that have been there over the past decade, do you think that the E-rate Program is the main reason or the primary cause of most of the schools in underserved areas being connected to the Internet?

Mr. CARLISLE. Well, I think if you look at where the U.S. was in—say for 1999—or 1998, I believe, the numbers stood at something like somewhere under 60 percent of the schools were connected to the Internet. Now, it is 94 percent. Do I believe that the program had a—that amount would have gone up over time. There is no question. I believe the program, however, did certainly—it

must have had an impact in term of accelerating the deployment of broadband to these schools. Now, GAO has appropriately raised the issue that our performance metrics didn't serve to measure that difference, and we are trying to come up with that.

Ms. BLACKBURN. Mr. Goldstein, would you like to comment on that?

Mr. GOLDSTEIN. Thank you. I think Mr. Carlisle has said it fairly succinctly. While it is certainly true that the number of schools that have been hooked up to the Internet and received other services has obviously increased by various measures, the FCC is unable to tell us how much of those increases are due to the E-rate Program. They were unable to isolate the effect of E-rate funding on connectivity in their performance measures because they did not have those measures in place or any ways to validate them. So that is the case today.

Ms. BLACKBURN. All right. Thank you.

Mr. Carlisle, has OMB done a PART analysis on the E-rate Program?

Mr. CARLISLE. Well, we have gone through the process with them, I believe, last year, and I believe last year they said that, as part of their PART analysis, that we did not have—they could not make a judgment that the program was effective because we didn't have performance measurements. After that, we started working with them very closely and have been working with them in order to develop new management and also program-performance metrics.

Ms. BLACKBURN. So they rendered it ineffective, and you all are taking steps in what timeline? What is your timeline for bringing it into a compliance or up to a certain level of effectiveness?

Mr. CARLISLE. I believe we will have a set of metrics within the next few months brought together, certainly by the end of this fiscal year. Because of the way the PART process operates, I believe they will actually be used by the agency in fiscal year 2007, which is in our response to the GAO report.

Ms. BLACKBURN. So your timeline, then, would bear out that you would have a compliance by 2007.

Mr. CARLISLE. We would hope so, yes.

Ms. BLACKBURN. Thank you. My time has expired. Thank you, Mr. Chairman.

Mr. WHITFIELD. Mr. Inslee, would you like time for questions?

Mr. INSLEE. I would. Thank you—and answers, too.

I am sorry. I haven't been able to join you for this whole hearing, so my apologies if my questions are redundant. This has been a pretty startling report to read, in some of these revelations, to see—and I have looked at a lot of GAO reports, and perfection is never attained and always sought for, and we never get there, and so we recognize criticisms for every potential project; but this one is really disturbing to me. And I will just be very candid with the FCC on this. Looking at these multiple sort of structural failures, I am very glad that we are raising these funds for this incredible need that we need in our schools, but I am honestly questioning whether this is the right agency to be responsible for the distribution of these funds. I think it is incredibly important program, and it has an incredible demand in our schools. I think the fund is ap-

appropriate and want to see it remain. But I really wonder if having a regulatory agency responsible for distributing funds to other local agencies is really the right mix for the talents of the FCC and whether there is another agency in the Federal Government that is more adept at that type of procedure, of establishing audit trails, criteria for funding, a good, competitive bidding process, matrixes for determining performance—that is a skill set, you know, that I just really wonder whether this agency has, given its sort of historic regulatory function. Now, that is a broad question. You know, what assurance do we have that it wouldn't be better for us to go to an agency who really has one its principal focuses the distribution of funds to other agencies? Is there some inherent difficulty for a regulatory agency to be given that type of responsibility? Anyone can answer that. The FCC might go first, but—

Mr. CARLISLE. I think you are actually asking exactly the right question. When this program was established in 1996, it was given to an independent regulatory agency that has an annual budget of about \$250 million. Alright? Nothing near the size of—for example, the Department of Education, the Department of Agriculture—any executive branch Agency. Moreover, it is a regulatory agency which is largely populated with regulatory attorneys and economists, not people who have had extensive experience with grant-making programs. So as a result, the FCC did the best it could in setting up the program. Now, I think it is a valid criticism that should it have asked for more help early on, should have gotten outside help, should have gotten outside consultants, talked with NAPA, the National Academy of Public Administration, earlier? Absolutely. At this point and I believe for the last couple of years, we have focused on trying to undo some of the effect of that process we started out with. But to a certain extent, I think you are raising a very valid question about whether or not the FCC is the appropriate holder for this responsibility.

Mr. GOLDSTEIN. I would add a couple of points. First, I think the GAO has long been concerned, since we have done quite a few reports over the years, that there are a lot of structural issues, a lot of administrative issues, surrounding USAC and FCC and the E-rate Program, that things have never worked, nearly, in the way they could have, particularly early on.

We are not in a position to say whether or not this is something that ought to be sent to another agency. We are very happy to see that FCC is going to have NAPA take a look at this because it is certainly time that an outside entity helped them determine what are some of the other ways that these kinds of programs could be delivered, how these funds could be managed, and how could this program be more effective. I think it is important that there be a number of attributes to this program, wherever it ends up and however it's finally managed. I think it has to have structural clarity between any of the entities that are involved in it; it has to have financial management and internal controls that apply to Federal funds and that work effectively; it has to have clear program goals and performance measures; it should continue to have minimal burdens for the beneficiaries, as minimal as possible; and it ought to have extremely effective oversight through rulemaking, through the audit process, through appeals processes, through an

effective Inspector General that has enough funds to do the job, if indeed the program continues to reside at the FCC.

Mr. INSLEE. If another agency was going to take over responsibility for distribution—and I am not proposing that at the minute. It is just an honest, open-minded questions. Would that in some way damage the ability to collect the funds from the payers? There is no difficulty there we would encounter, is there?

Mr. CARLISLE. No, at the present time, we collect the funds through the 499 form, which is filed by telecommunications carriers every year on, I believe, a semi-annual basis. There is no reason why that form and its return couldn't be lodged somewhere else.

Mr. INSLEE. I noted a newspaper article that suggested that of the \$14.6 billion that had been collected or awarded, only \$9.2 billion has been spent. Is that a correct characterization? Are those real terms? And if so, you know, what are we to make of that, and what is the principal reason for that?

Mr. CARLISLE. I believe those numbers are approximately correct. Historically, we have known that every year the amount of funds disbursed does not match the amount of funds committed, and lags it every year; and there are a number of reasons for this.

Quite frequently, when funds are actually committed to the schools through a final commitment decision letter, usually the school does not come back with an invoice to claim the funds for a number of months. In some cases, it could be 1 or 2 months, but in many cases, it might be 12 months or 18 months, once the actual work—and usually on priority 2, wiring work, it usually takes about that long.

Now, there is certainly an issue that we need to consider as to whether that indicates that our processes aren't efficient enough, but I think there is also an issue that is just inevitable: that equipment prices go down; schools decide that they don't want to do certain work; contractors aren't available; and the funds don't get used. So there is always going to be a situation, no matter how efficient our processes are, where your disbursements in a program of this type may lag commitments. However, programmatically, we have handled this. And in order to make sure we continue to be able to make funds available to schools, if we have unused funds from year to year, they roll over to the next year and increase the cap. So the cap for this year is not \$2.25 billion; it is \$2.4 billion. And that additional money, we believe, will actually allow us to provide more funding to schools that otherwise wouldn't have received it.

Mr. INSLEE. Mr. Bennett, did you have response to that kind of issue?

Mr. BENNETT. No; no response at all.

Mr. INSLEE. Got you. Thank you, gentleman and lady. Thank you.

Mr. WHITFIELD. Thank you, Mr. Inslee, and I am delighted that the chairman of the full committee, Mr. Barton of Texas, was able to join us, and I will call on him now for an opening statement or any comments he might want to make.

Chairman BARTON. Well, thank you, Mr. Chairman, and thank you for continuing the series of hearings that we have held on this

program. We would also like to thank our GAO witnesses for the report that they are releasing today.

I don't really have an opening statement, other than what we are going to submit for the record. I will say I think the E-Rate program is broken; I am not sure it can be fixed. I think we ought to seriously look at significantly restructuring the program. We are going to have a Telecommunications Act this summer that we are going to put before the committee, and there will certainly be a component of it that deals with the E-Rate program.

[The prepared statement of Hon. Joe Barton follows:]

PREPARED STATEMENT OF HON. JOE BARTON, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

Thank you Chairman Whitfield. This afternoon we consider the results of a study by the Government Accountability Office of the E-rate program. I appreciate the GAO's hard work in building this report, as it will help lay the groundwork for repairing the flawed E-rate program.

Last year, in the three hearings held during the 108th Congress, we examined specific examples of E-rate waste, fraud, and abuse. I have said from the beginning of my chairmanship of this committee that we would not shy from conducting an aggressive and bipartisan investigation of E-rate—whether it be the FCC's poor management and oversight of E-rate, or program abuse by schools or vendors. I am pleased to say that we have done exactly that.

The 1996 Telecommunications Act Conference Report explained that the overarching reason for providing schools and libraries with a telecommunications discount was to "assure that no one is barred from benefiting from the power of the information age." In the abstract, everyone can appreciate a program intended to give schools and libraries financial assistance so they can afford Internet access and other telecom services necessary for improving the educational environment of our children.

However, if this is our goal, we also have to ensure that the program is cost-effective, efficient, and—most importantly—actually reaching that goal. But the Subcommittee's work has revealed a program containing powerful incentives for waste, fraud, and abuse. And, as we'll hear today, there are also very serious issues regarding the structure and management of the E-rate program. While every player—schools, equipment vendors, telephone companies, and consultants—has an obligation to responsibly participate in E-rate, the FCC and USAC have obligations as well. Unfortunately, they have been lackluster stewards of the program, to say the least.

Today's GAO report and testimony describe how the FCC mismanaged the E-rate program. The report explains that the FCC *never* conducted a comprehensive review to determine which federal financial and accounting statutes, as well as other laws and policies, apply to E-rate. As we have said before, E-rate is not a small-money program—it is funded at \$2.25 billion per year. So, given the size of this multi-billion dollar program and its significant burden on telephone rate-payers, I am bewildered that the FCC would respond to the GAO by maintaining that the FCC *has* conducted a comprehensive evaluation of the program—"on a case by case basis." I hope the FCC will be able to answer why E-rate has never received the sort of review that the GAO clearly thinks is required.

The GAO also reports that the FCC has never implemented useful performance goals and measures for E-rate. In fact, according to the GAO, "a key unanswered question is the extent to which increases in connectivity can be attributed to E-rate." After committing over \$14 billion, and actually disbursing nearly \$9 billion, the fact that nobody has any idea about how helpful this money has been in getting schools and libraries connected to the Internet is simply stunning. What's more, I am told that recent statistics show that as of 2003, nearly 100% of public schools and 93% of public school instructional classrooms have Internet access. Given this rate of connectivity, the FCC's poor oversight, and the fact that—after seven years—the agency has *no idea* to what extent E-rate has had an impact in our schools, the FCC will be hard pressed to convince me that the E-rate program belongs in its hands. These statistics also bring to the forefront the question of what is E-rate's mission going forward?

Finally, the GAO report confirms the Subcommittee's concerns regarding the weaknesses in the FCC's oversight mechanisms—pointing out that the FCC has been slow to respond to audit findings, has a massive backlog of beneficiary funding

appeals, and promulgates rules that are often unclear or unspecific, leading to serious problems in enforcing the program's rules.

In sum, the GAO's testimony and report reinforce the Subcommittee's work during its E-rate oversight of the last two years. E-rate seems to be rudderless, and I fear that the waste, fraud, and abuse we have seen so far may be just the tip of the iceberg. No one responsible for the program knows how deep the problems run. I look forward to hearing the FCC's response to the GAO's report today. Clearly, based upon the work of our investigation, and the GAO's report, the Congress needs to move expeditiously on legislation to reform the E-rate program. I look forward to Telecommunications Subcommittee Chairman Upton's work in this regard. We must ensure that this money is spent wisely, and for its intended purpose.

I'm pleased to see that the FCC's Assistant Inspector General for Universal Service Fund Oversight will testify today, and describe both his continuing concerns and the latest developments in rooting out program waste, fraud and abuse.

Thank you, Mr. Chairman. I yield back the remainder of my time. ###

Chairman BARTON. I guess my question to this panel—I have 2 or 3 general questions. In hindsight, was it an appropriate role of the Congress to expand the concept of universal service to require that we connect our schools and libraries to the Internet? Is that a reasonable expansion of the definition of universal service?

Mr. GOLDSTEIN. Mr. Barton, I think it was, in that you have seen—again notwithstanding the issue that it is difficult to determine whether E-Rate, specifically, or how much of it, specifically, aided the connectivity of schools—we have seen the growth of technology in schools, and we have seen poorer schools become more adept using technologies, and we have seen a lot of really good benefits in terms of schools in rural areas being able to have different kinds of benefits that they might not have otherwise had and the educational benefits that accrue to them.

Chairman BARTON. Wouldn't a lot of that have happened anyway?

Mr. GOLDSTEIN. Yes, sir, but I do think that there is a lot of money that has come through this program. Some of it has, as Mr. Carlisle has said, undoubtedly had a benefit. It is just difficult to determine how much.

Chairman BARTON. Okay. Anybody else want to make a comment on that?

The second general question: now that we have had this program in operation for a number of years, what data is there and how many schools and libraries are now up and running, actually have Internet connections, and they are working? Are we at 100 percent, 90 percent, 80 percent? Where are we?

Mr. CARLISLE. I believe our most recent data from the 706 Report to Congress indicates that 94 percent of schools, and approximately the same number of libraries—I believe it might be even 95 percent of libraries have high-speed connections to the Internet.

Chairman BARTON. Okay. Well, so I think the universal service requirement for telephone—and correct me if I am wrong. But I think telephone service, where we have had universal service requirement for, I guess, 60 years, is a little bit less than that. I think it is around 92, 93 percent. Is that right?

Mr. CARLISLE. I believe we just published in our Telephone Penetration Report that it is somewhere between 93 and 94 percent—

Chairman BARTON. Okay.

Mr. CARLISLE. [continuing] at this time. Yes.

Chairman BARTON. On the other hand, television sets in home, which has no universal service requirement, is about 99 percent.

And cell phones, which are certainly no requirement, are probably close to 100 percent, especially if you have a teenager who just has to have one so that she can talk to his or her boyfriend or girlfriend. Is there any reason to continue this program past where it is? If we have basically penetrated the market, what public good is to be served by continuing the program? We have done what we set out to accomplish, even though we did it very inefficiently and messily.

Mr. CARLISLE. When you say "this program" do you mean only E-Rate or do you mean E-Rate and High Cost?

Chairman BARTON. You can define it either way.

Mr. CARLISLE. Okay. Since the hearing is focusing on E-Rate, I will focus on E-Rate; and if you would like me to address High Cost, I can do that as well.

From a point of view of program management, once you achieve an extremely high penetration level, you can go two ways. You can either say, alright. We have done our job. Everybody is on their own from now on. If you do that, though, you have to acknowledge that there will be recurring costs of continuing to receive the service from the service providers, but there will also be costs in terms of continuing to keep the network maintained and upgraded, at some point replaced. So you can either say, look. Everybody is on their own. Or you can say there will continue to be a certain amount of targeted funding in order to maintain the networks. I think it is a valid question to say is our priority to funding appropriately targeted to do that, and we will be soliciting comment on that.

Chairman BARTON. Well, I mean I don't know where the votes are. I was a part of the debate in 1996 and the Telco Act, and my recollection was that Congressman Field and Congressman Synar were the proponents of this, but I could be corrected. Mr. Markey and some others are not here, but they were part of that debate, too. So we didn't put a lot of thought into it. And it is obvious that the program had done good because we have a lot of schools and libraries that are now connected, and the majority of them have operated within the system; but there has been so much fraud and corruption and waste and gold-plating. And I mean I don't need to repeat all of our other hearings, but now that we are 94 percent, I really question whether we should do anything, other than maybe have some subsidy for low-income schools and libraries to help them, you know, pay the ongoing costs; but above and beyond that, turn it over to the local and State communities and let them do the upgrades and the things that need to be done. We have done the major job, which was to get the connection. You know, I am only one vote, so I don't know where the votes are.

But I guess my last question to the GAO: if you had to make a decision to where to put this if we decide to continue the program, is there a better place to have it than the FCC?

Mr. GOLDSTEIN. Congressman, I am not really sure where you would put it. I indicated, earlier, that we are really pleased that NAPA is going to study this issue for the FCC and that hopefully they will come to some conclusions that the FCC can use and that Congress can use in understanding the future of the program. I think that is about as much as I would want to say at this point.

We haven't studied, specifically, options like NAPA is going to do. As I had mentioned earlier, there are certain attributes that any program, regardless of where it is going to be placed, ought to have, including better structural clarity, financial-management controls, better oversight, and the ability to have more of an auditing capability—things like that, regardless of where it goes, that it needs to have, whether that is within FCC or some other part of the government or some other structure.

Chairman BARTON. Well, I will ask Mr. Carlisle. Do you want to keep it?

Mr. CARLISLE. I would only want to keep it if we can continue the progress that we have made within the last couple of years to improve oversight over the program, oversight and management of the program. If we can continue that pace of improvement, then I think we should keep it.

The only other logical place for it to go—and I won't make any friends over there by saying this—would be the Department of Education.

Chairman BARTON. Okay. Mr. Bennett, you are the assistant inspector general for the FCC. Should the FCC be allowed to keep it, given their absolutely dismal records, until very recently, in even caring about the program in terms of its management?

Mr. BENNETT. I think from our perspective we have been looking at the program within the context of it being at the FCC and focusing on the weaknesses in the design of the program and trying to make recommendations. Certainly, we have been frustrated with the time it has taken to address some of the weakness that we have talked about. However, as I indicated in my testimony, the Commission has started to give consideration to these matters. At the same time, we have worked very closely with USAC.

We are very close to having in place a contract, under which we are going to be able to do the number of audits that we believe needs to be done to get a handle on the level of waste, fraud, and abuse in the program. So I feel like we have made important progress. We are now poised to do this large body of work. We want to do that work and basically design oversight based on the results of that work.

Chairman BARTON. Well, my time is about to expire. I will say, on the record, before I turn it back to Chairman Whitfield, again, because of, in my opinion, the lack of direction that we gave to this program in the implementing legislation in the 1996 Telecommunications Act, the Congress and the House and this committee bear some responsibility for what has happened. I can't put all of the responsibility on the executive branch. So that when we get to the Telecommunications Restructuring Act of 2005 later this summer, we are going to put more thought into this and almost certainly give more direction, if the collective decision of the committee is to maintain the program.

With that, Mr. Chairman, I yield back.

Mr. WHITFIELD. Thank you, Mr. Chairman, and at this time, I will recognize Mr. Engle for 10 minutes.

Mr. ENGEL. Well, thank you Mr. Chairman. I appreciate the opportunity to participate, and I will be brief.

I really just have one question that I would like to ask Mr. Carlisle. It is about the schools in my hometown in New York City. E-Rate, obviously, has helped wire all of our schools in over 80 percent of the classrooms. I, obviously, like everybody else, want to make sure that E-Rate is free of fraud and abuse, and I want to ensure that the program continues to provide service to needy kids. But why has—I am told of a problem that USAC has chosen to suspend payments for several months now to New York City schools while conducting a routine audit. I am told—and you can correct me if that is not the case, that previous audits have shown no abuse of the E-Rate program. So I don't disagree with conducting audits, but I want to know why it is taking so long and why payments are being held off while this happening. It is really to a point of crisis, where the schools are worried because the payments have been withheld; they cannot pay their bills; and they are very much afraid that they are going to be shut down.

Mr. CARLISLE. I recently had a meeting with the New York City Department of Education on exactly this issue, and we have, my staff, has discussed the issue with USAC. My understanding is that the New York City Department of Education has had a call with USAC to discuss moving forward on processing their funds. Now, I cannot here say exactly when that is going to happen, but my understanding is that the process is moving forward as a result of those discussions that we have had.

Mr. ENGEL. Well, I would like to continue to work on this with you, and after the hearing, I am wondering if we can be in touch—

Mr. CARLISLE. Absolutely.

Mr. ENGEL. [continuing] because I am told that things really are at a breaking point, and I haven't been told that things are moving along and that they have, you know, been in touch and that things are proceeding. I am told just the opposite, so perhaps I have gotten some miscommunication, but I have had a lot of people feel strongly, and they are very frighten about the prospect of this dragging on any further, so I would welcome the opportunity to dialog with you.

Mr. CARLISLE. These are all very recent developments, and I will be happy to follow up with you on this.

Mr. ENGEL. All right. Thank you very much. And I thank you, Mr. Chairman. That is all I have.

Mr. CARLISLE. Yes, sir.

Mr. WHITFIELD. Dr. Burgess, you are recognized for 10 minutes.

Mr. BURGESS. Thank you, Mr. Chairman. I apologize to the panel for being out of the room for part of this.

Mr. Goldstein, the FCC recently contracted with the National Academy of Public Administration to examine a structure of the current Universal Service program and its alternatives. Would you characterize this as a positive development?

Mr. GOLDSTEIN. Yes, sir. It is a very positive development. We think it will help the FCC and potentially the Congress to determine what kind of a structure would most be appropriate to a program that has not always worked very well, and that, while it has improved over the last couple of years, still has a considerable way to go to do better in providing timely funds to beneficiaries, making

sure they can determine how the program is measured in terms of the delivery of its services, and how it is effectively structured to ensure that it is working well from both a financial and a legal perspective.

Mr. BURGESS. Well, in regards to measuring, what will be the metrics to ensure that this has been an effective movement?

Mr. GOLDSTEIN. I think that it is really up for FCC to decide that, working with the various stakeholders in the program. There are various ways, hopefully, that they can determine how to measure it. The problem has been, in the past, for some of the reasons we have discussed here, that these measures haven't really been adopted. And GAO has looked at this a number of times over the years, and it has been, frankly, kind of either a nonexistent or a relatively haphazard approach to performance. To developing metrics, they have, at times, had some metrics, but they haven't been metrics that would be useful in isolating E-Rate funding. At other times, there have been metrics that would be put into, say, budget submissions, but then they were never in the performance plans and then would disappear all together. We are pleased the FCC is working, at this point with OMB to try to develop more effective metrics that are supposed to be completed by the end of this year.

Mr. BURGESS. Mr. Bennett, would you care to comment on the use of those metrics?

Mr. BENNETT. Only to concur with what Mr. Goldstein has indicated.

Mr. BURGESS. Do you think we will be able to tell that we are doing an effective job at the end of this?

Mr. BENNETT. I think if we design the metrics correctly, we will be able to tell.

Mr. BURGESS. Will we be able to tell from here, in Congress, that it has been effective? Well, Mr. Bennett, does the USAC have sufficient authority to operate the program effectively?

Mr. BENNETT. I think that is an area that has been of some concern to us. Talking from the audit perspective, one of the things that we learned in the conduct of audits and our involvement in investigations has been the difference that exists between the program rules, as they are contained in Part 54 of Title 47 of the Code of Federal Regulations and the rules that USAC has created under their authority. And this disconnect that exists between the rules contained in Part 54 of Title 47 and USAC implementing procedures has created a situation where if an applicant doesn't comply with an implementing procedure, there may be no way to enforce compliance; there may be no legal basis for recovering funds related to those issues. And that has been an area of concern for us. As we indicated in my testimony last August, the Commission adopted the Fifth Report and Order and has started to adopt and recognize some of the USAC implementing procedures, and we think that is an important step.

Mr. BURGESS. Thank you, Mr. Chairman. I will yield back.

Mr. WHITFIELD. We are going to do another round here for those interested. And I would just make the comment that the very first sentence in the GAO report says, "the FCC established the E-Rate program using an organizational structure unusual to the govern-

ment, without conducting a comprehensive assessment to determine which Federal requirements, policies, and practices apply to it." And since the inception of the program, all of the reports, all of the oversight reports, the Congressional reports—there has been a disagreement and differences of opinions about which policies apply and which policies do not apply.

Then, as Mr. Carlisle made the statement, "the FCC is a regulatory body with a regulatory expertise. They do not really have the expertise to process applications." In addition to that, we have had all of these various criminal activities going on with entities being convicted, and then we have got NEC BNS that was convicted of wire-fraud and bid-rigging, as an example; and they, after being convicted last May, asked the FCC to waive its pending debarment from the program, and since then, the FCC has not yet issued a decision on their debarment, as an example, which it seems to me should be pretty clear, but there may be some factors there that I do not know about. But Mr. Carlisle, why would it take the FCC so long to make a decision about that issue?

Mr. CARLISLE. My understanding is that waiver proceeding is being handled by the Enforcement Bureau right now, and they have been considering that waiver petition in the context of the DOJ's investigation of NEC, so they have spoken with DOJ about their concerns about the information that they have received from NEC over time in their investigation, and they are taking those considerations into account.

I would point out, however, that during the pendency of the waiver, and in fact, predating the filing of their waiver, NEC has not participated in the program. They have voluntarily said, we are not going to participate in the program until this is resolved. So they actually have not been involved in E-Rate or in any bids on E-Rate for over a year now.

Mr. WHITFIELD. Well, I am glad to hear that because I don't think they should be—

Mr. CARLISLE. Right.

Mr. WHITFIELD. [continuing] participating in program. I might, also, just make the comment that basically, the priority-1 needs, I think, have been met through this program, and so we are moving into new areas, and I think the questions raised by Mr. Inslee and the chairman of the committee and Mr. Stupak—all of those comments are warranted because as we move forward, I think we have to reevaluate this program. Do we continue this program? Do we keep it at the FCC? Do we move it to the Department of Education? What do we need to make it more effective and less fraud and abuse?

And this committee, after this hearing, is going to submit a report, a bipartisan report, to the chairman of the Telecommunications Committee as they prepare to revisit the entire telecommunications issues later this year. And so I think this has been a helpful, constructive hearing going over the GAO report, and I think we are back to the very starting point, from my perspective, of where do we go with this E-Rate program? It is a useful program, an important program, and there is a lot of money; and so we want to be sure that we move forward in the most constructive, effective, efficient way that we can.

And with that, I will turn it over to Mr. Stupak.

Mr. STUPAK. Well, thank you, Mr. Chairman. And if I can pick on your first question there, when you said that on the GAO report that was released today, the first sentence, "FCC established the E-Rate program using an organizational structure unusual to the government, without conducting a comprehensive assessment to determine which Federal requirements, policies, and practices apply to it." In fact, that is the first GAO recommendation. Isn't that, Mr. Goldstein, your first recommendations to the FCC to actually use Federal requirements, policies, and practices?

Mr. GOLDSTEIN. Yes, sir. We would like them to do a comprehensive assessment—that is correct—along the lines that we have been talking about—

Mr. STUPAK. Right.

Mr. GOLDSTEIN. [continuing] so that they can determine how best to structure the program and to apply to the program those laws and policies and procedures that should have been applied long ago and to do so—even in instances where they did apply them—in a more comprehensive manner that has a framework surrounding it and so that all of the various laws that apply are applied in tandem.

Mr. STUPAK. But in reading the GAO, Mr. Carlisle, it says the FCC doesn't accept that recommendation; you would rather do it on a case-by-case basis. Is that correct?

Mr. CARLISLE. Well, I think we don't accept the recommendation that we have never done the assessment. We have done assessments of whether various statutes apply to the program, and we may not have done them in the way that GAO is recommending that we have done them, but we have done them. And so the question, now that we have the GAO recommendation, is what exactly does it mean to do a comprehensive assessment. Is it merely a re-tread of the analyses that we have already done, or is it something that is potentially more useful? And I have already spoken with Mr. Goldstein about following up with him and GAO to get more detail as to the sort of process they would like us to engage in, so I can make sure it is an appropriate process.

Mr. STUPAK. Well, yes. I think if you do that comprehensive study, then some of the laws we spoke about—the Single Audit Act, some of the others that we spoke of here today—would apply to everybody, and I think if it is applied on everybody, you could move these applications faster, get through these appeals quick, and actually, everyone knows the rules we are all playing by, as opposed to a case-by-case review. Because you know—and let me ask this one. Maybe it would be fair to ask Mr. Bennett. In order to do competitive bidding here—it is my understanding that the current E-Rate competitive bidding process consists of or is based upon the assumption that you post a form on the Internet. It says 470, Form 470, on USAC's website for 28 days. And do you believe that promotes, you know, a competitive bidding process? Posting a forum for 28 days?

Mr. BENNETT. Well, we have been concerned about the competitive bidding process almost as long as we have been looking at this program. Actually, there are a couple things that happen. The Form 470 is posted for 28 days. The program rules require that the

applicant comply with State and local procurement regulations, and that has given us some concern as well. In some cases, there may not be any applicable State and local procurement regulations. In other cases, we may have concerns about the State and local procurement regulations that exist. So we have been concerned about competitive procurement and talking about our concerns regarding competitive procurement for some time.

Mr. STUPAK. I guess it goes back to our first statement. Maybe if we had a comprehensive assessment to determine what do we do on other Federal programs—I am sure we don't use Form 470—we will probably get better compliance and less waste. Because this is a great program, I don't want to see it go anywhere. I think the FCC is capable of handling it. I just would hope that the rules that the rest of the government lives by, FCC would live by, especially with this program, because as I said, I believe in this program; it is a great program, and it has really helped in my district.

Mr. Carlisle, it is my understanding—and I know the chairman had a lot of good questions, and I was dying to interrupt him to try to point out a couple of things. So let me ask you these questions, because I do believe in this program. It is a great program.

The needs of the E-Rate and the need for money for this program doesn't go away, even if 100 percent of every school and every library in the United State is wired. Correct?

Mr. CARLISLE. I believe that is correct.

Mr. STUPAK. I mean besides upgrades—I am on telecommunications, a number of others were talking about VOIP, and we have got wireless and tomorrow there will be some new technology, and all parts of America should have access to it, and one way of doing it is the Universal Service Fund, through the E-Rate, through our libraries and that—but is it correct that two-thirds of the money, though, that is spent in this program really goes to pay the telephone bill for libraries, pay the service provider, the Internet provider? Isn't that where two-thirds of the money goes?

Mr. CARLISLE. There are two separate types of funding. There is priority-1 funding, which is exactly the kind of recurring charges that you just mentioned. And then there is priority-2 funding, which is wiring.

Mr. STUPAK. Okay.

Mr. CARLISLE. Under the statute—the statute makes clear that the priority-1 types of funding are to be supported through the program.

Mr. STUPAK. Correct.

Mr. CARLISLE. It provides the FCC discretion about priority-2 funding, and we exercised that discretion and said, okay. It should be funded.

Mr. STUPAK. Sure.

Mr. CARLISLE. But yes, that is approximately the break out, two-thirds to one-third, and historically that has been the case. That has been a consistent point over time.

Mr. STUPAK. So to all due respect to Chairman, if he would like to see the upgrades paid by State and local governments, that may be one thing; but the biggest cost here to a lot of these taxpayers is just the access cost of the program through the platform that

they are using at the time. Is that basically correct? Two-thirds of the money goes that way? To there?

Mr. CARLISLE. I am sorry. I have actually been told that the numbers are actually closer to 50/50, as—

Mr. STUPAK. 50/50, though?

Mr. CARLISLE. [continuing] as opposed to one-third. However, you know, 50 percent is still a lot.

Mr. STUPAK. It is still a lot of money—

Mr. CARLISLE. And I think if that is the case, however, the statute would actually have to be changed in order for us to make a significant shift in priority there.

Mr. STUPAK. Well, I don't want to make that significant shift because I like it at two-thirds—

Mr. CARLISLE. Well, okay.

Mr. STUPAK. [continuing] but if it is 50—my small district—I mean I don't have a city over 20,000 people. I mean most of mine are 2,000 or 3,000, and they now have access to the Internet because of this program. And now, if you suddenly say, well, your monthly support bill, or your bill to the telephone company or the service provider, Internet provider—you have to pay, they are not going to have money for the upgrades. They are probably going to lose the process. In Michigan, we are cutting school aid; we are not expanding it, unfortunately. Unfortunately.

Mr. Bennett, one more question, if I may. And I don't mean to end on a negative note here, because I do believe in this program. But it is painfully obvious that certification contained in the E-Rate forms have failed to deter abuse by predatory vendors and irresponsible school officials. On September 22, the inspector general testified before this subcommittee oversight and investigation that reliance on beneficiary self-certification is a serious vulnerability. Why do you believe that self-certification is a serious weakness in the program, and then what can we do to improve upon that?

Mr. BENNETT. We had a couple of concerns with certification. One was what we viewed as an over-reliance on certifications—that is relying on certification without following up and reviewing documents. Excuse me.

The other issue we had with certifications was the design of the certifications themselves. When we got involved with the Antitrust Division of Department of Justice, primarily because of concerns related to the competitive process, we sat down with their attorneys; their attorneys looked at these various forms and raised concerns to us about the way the certifications were written, their concern being can they indict people for making false statements based on the certifications, and they had concerns about the way things were structured. They brought those concerns to us. We brought those concerns to the Commission, and the Commission has—actually, starting with the Fifth Report and Order last August and moving forward—begun to address modifying the certifications in those forms.

So it was really two things. It was the design of the forms, which is being addressed. There are still some open issues that the Wireline Competition Bureau is looking at, but it is also the process itself, that is relying on certifications while doing no follow up and looking at no additional documentation.

USAC has done a great deal to address their application-review process. In the earliest days, there was very little documentation provided or reviewed. That has changed significantly, so I mean we have seen improvement on both fronts.

Mr. STUPAK. Well, let me ask you this: it is my understanding USAC might do one set of procedures, but those procedures may not have been approved by FCC. And if USAC says do this, and FCC says, well, we haven't certified that procedure; we haven't done that, then, doesn't that really allow the discrepancy here, really allowing schools and vendors to really get around this whole process, and there is no enforcement then?

Mr. BENNETT. It creates a problem when we are trying to enforce—

Mr. STUPAK. Sure.

Mr. BENNETT. [continuing] compliance with the rules. If there are no financial consequences for beneficiary noncompliance, then it is very difficult for us to send a message that applicants need to comply with the rules.

Mr. STUPAK. And if FCC doesn't bless those rules, certify them, then there is really no need to comply because they can say, hey, FCC hasn't even approved this, so you can't enforce this upon us. Right?

Mr. BENNETT. That is correct, and it has been—this is really a concern that we identified through our involvement in audits. And you know, in the Fifth Report and Order last August the Commission did adopt a number of the USAC implementing procedures where we had been identifying concerns.

Mr. STUPAK. Well, it looks like we are moving in the right direction, and it looks like with USAC—and I do believe that more money can put into USCA to put auditors in—and also with the Single Audit Act. Hopefully, we have identified some ways we can keep this viable program going. I salute the GAO for their report. It has been a good report—OIG—and let us work together and get this thing going. This is a great program.

Mr. WHITFIELD. Thank you, Mr. Stupak. Dr. Burgess, do you have any other questions?

Mr. BURGESS. Thank you, Mr. Chairman. Yes, I would just ask the question, again, that Chairman Barton asked. Is it time to revisit the concept, here, and ask if this would not be better handled at the local level, and perhaps Congress just be involved from a monitoring or oversight standpoint and not involved in a primary way in this program?

Mr. GOLDSTEIN. I can't say one way or the other that it ought to be at a particular level of government or even in a particular agency. As I have indicated, it is important to look at the program and try to understand how we can make it better. The kinds of issues that Mr. Stupak was just referring to with respect to how there are differences in procedures that USAC handles versus rules that the FCC puts in place gets at the heart of the structural issues when you have a nonprofit, private entity essentially all but making policy and then turning around to the agency in charge and saying, these are the things that we think you ought to put into code. It gets at a lot of the issues of structure here.

So I think there is still a lot of work that does need to be done to try and improve the structure. Again, where that structure best ends up—whether it is in a Federal agency, whether it is some kind of contract entity, whether it is with the State and local government—I think that NAPA will help FCC grapple with some of those issues. Then it is a question of trying to implement it in a way that gets to really protect Federal funds and a program that has done some good for the country.

Mr. BURGESS. Well, Mr. Bennett—just going through your testimony. And you seem to detail a lot of areas where someone has fallen down on the job. You discussed the auditing agreement, the 3-way auditing agreement that you are about to implement. Will this address concerns about a statistically representative audit? Is this going to do the job?

Mr. BENNETT. It will. This will finally give us the ability to make statements about programmatic compliance, program-wide. Up to this point, audits have been in some cases random, in some cases targeted; but as GAO pointed out in their report, we have never done the necessary body of audits to make a statement about beneficiary compliance, program-wide, so we are very pleased to report today that we are close to reaching an agreement and moving forward with those audits.

Mr. BURGESS. Mr. Bennett, given the findings of the GAO and the inspector general's work regarding the Universal Service funds, how do the management issues that we are addressing today reflect on management and potential problems for other funding mechanisms?

Mr. BENNETT. Well, as I said in my testimony, the Commission has begun to take the concerns that we have raised very seriously, and we have seen, you know, a lot of movement on addressing some of these concerns. We have been focused on not only working with management to address these concerns, but trying to get the process in place to do the audits that we believe are necessary to not only evaluate beneficiary compliance, but identify additional opportunities for programmatic improvement.

Mr. BURGESS. Thank you. Mr. Chairman, I will yield back the balance of my time.

Mr. WHITFIELD. Thank you, Dr. Burgess, and that will conclude today's hearing. I might add, though, that Mr. Stupak raised this issue of competitive bidding. And another issue that we can consider, of course, is that the Federal acquisition regulations has been a particularly effective method to ensure competitive bidding, and that might be something that we can look at as well. But we have a lot of issues on our plate relating to this great program.

And Mr. Goldstein, we want to thank you—Mr. Carlisle and Mr. Bennett, for your testimony. And Ms. Perez, we want to thank you for keeping Mr. Goldstein out of trouble. And then, I want to thank Mr. Carlisle's mother for being here, and I hope that you found it so stimulating you will come back again. Yes.

And the record will stay open for 30 days, and we will be entering the report into the record. Thank you all very much.

[Whereupon, at 4:42 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554
April 21, 2005

The Honorable ED WHITFIELD
Chairman, Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
United States House of Representatives
Washington, DC 20515

DEAR CHAIRMAN WHITFIELD: Thank you for your concern regarding reports of waste, fraud and abuse in the Schools and Libraries universal service support mechanism of the Universal Service Fund (USF), otherwise known as the E-rate program. I appreciated the opportunity to appear before the Subcommittee on March 16, 2005 to discuss the steps that the FCC Office of Inspector General has taken to establish effective, independent oversight of this program. As I indicated during the hearing, we believe that we have made significant progress in ensuring adequate oversight of the USF, however, we recognize that much additional work remains to be done. I am writing this letter in response to your letter dated April 15, 2005 that included additional questions from the Honorable Marsha Blackburn. My response to each of those questions is as follows:

Question #1—What is your estimate of the number of locations with e-rate contracts that have had questionable financial dealings?

Response—The FCC Office of Inspector General has not completed the body of work necessary to estimate the number of locations with E-rate contracts that have had questionable financial dealings. However, as a result of our involvement in E-rate audits and investigations, we have become concerned about the effectiveness of the program's requirements for competitive procurement. On the audit side, numerous of the audits completed by the FCC OIG, auditors from USAC, and others have identified findings related to competitive procurement. In our role supporting investigations related to the program, we are currently supporting twenty-two (22) investigations and monitoring an additional eight (8) investigations. Many of these investigations involve allegations related to questionable financial dealings including procurement irregularities such as lack of a competitive process and bid rigging; false claims in which service providers are billing the program for goods and services that are not provided; ineligible items being funded; and beneficiaries not paying the local portion of the costs resulting in inflated costs for goods and services to the program and potential kickback issues. In fact, the Antitrust Division of the Department of Justice established an E-rate fraud task force largely because of the number of E-rate cases involving competitive procurement.

Question #2—Mr. Bennett, in your testimony, in agreement with GAO, that FCC fails to timely act on audit findings. What is their current time frame to act on audit findings as compared to other audits for other programs your office performs?

Response—The Commission is required to resolve audit findings within six-months from the date of the final audit report. This requirement applies to all FCC OIG audit reports including E-rate beneficiary audits. The concern that we raised in our testimony, and that GAO referred to in their report, relates to our observation that audit findings are not being resolved in a timely manner and that, as a result, actions to recover inappropriately disbursed funds are not being taken in a timely manner. As we stated in our testimony, we believe that audit findings are not being resolved in a timely manner because, in some cases, USAC is not taking action in a timely and because USAC is not receiving guidance from the Commission that is necessary to resolve findings.

Question #3—Does FCC or USAC have any procedures to enforce beneficiary compliance with rules and regulations.

Response—The Commission and USAC have many procedures to enforce beneficiary compliance with program rules and regulations. The Commission uses the rulemaking process, adjudication of USAC decisions, and audits of E-rate recipients to enforce compliance with program rules. USAC employs a variety of procedures—including the application review process, program integrity assurance process, and site visits—to enforce compliance. However, although there are procedures to enforce compliance to program rules and regulations, we remain concerned about beneficiary compliance because of the lack of clarity regarding the rules and regulations governing the program.

Question #4—In your opinion, do you think e-rate has significant waste, fraud, and abuse within the program?

Response—As I indicated in my response to the first question, the FCC Office of Inspector General has not done the body of work necessary to assess fraud, waste, and abuse at the program level. However, as a result of our involvement in audit

and investigations, we are concerned about the level of fraud, waste, and abuse in this program.

Question #5—How much would it cost to audit every beneficiary every year?

Response—We believe that it would be very expensive to audit every beneficiary every year. We are currently in the process of establishing a three-way agreement with USAC and a public accounting firm to conduct audits of the four USF funding mechanisms, including E-rate. We have conducted a preliminary estimate of the cost to conduct a statistically valid number of audits. Based on our experience and USAC's experience conducting E-rate beneficiary audits, we have used an estimated cost of \$50,000 per audit to estimate the total cost of this project. There have been over 43,000 applications for funding in the current funding year.

Question #6—What would be the most efficient method of overseeing disbursement of e-rate projects?

Response—We believe that effective, independent oversight of this program is the most efficient method of overseeing disbursements. During FY 2001, we worked with Commission staff as well as with the Defense Contract Audit Agency (DCAA) and the Universal Service Administrative Company (USAC), to design an audit program that would provide the Commission with programmatic insight into compliance with rules and requirements on the part of E-rate program beneficiaries and service providers. Our program was designed around two corollary and complementary efforts. First, we would conduct reviews on a statistical sample of beneficiaries large enough to allow us to derive inferences regarding beneficiary compliance at the program level. Second, we would establish a process for vigorously investigating allegations of fraud, waste, and abuse in the program. As we discussed in our testimony, we are very close to establishing a contract under which we will obtain access to the resources necessary to implement the oversight program that we have designed. We believe that this oversight program will allow us to detect and deter waste, fraud, and abuse by beneficiaries of the universal service support mechanisms. In addition, the program will generate insights about the compliance of beneficiaries with applicable law and the quality of administration of the universal service support mechanisms and identify areas for improvement in the compliance of beneficiaries with applicable law and in the administration of the universal service mechanisms.

We look forward to continuing to work with the Committee and Subcommittee on oversight of this program. Please do not hesitate to contact me if you have further questions.

Sincerely,

THOMAS BENNETT
Assistant IG for USF Oversight

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554
May 12, 2005

The Honorable ED WHITFIELD
Chairman
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
U.S. House of Representatives
2125 Rayburn House Office Building
Washington, D.C. 20515

DEAR CHAIRMAN WHITFIELD: Thank you for your April 15, 2005 letter concerning former Wireline Competition Bureau Chief Jeffrey Carlisle's appearance before the Subcommittee on Oversight and Investigations at the March 16, 2005 hearing. Please find attached written responses to post-hearing questions included in your letter posed by the Honorable Cliff Stearns and the Honorable Marsha Blackburn.

Please do not hesitate to contact me if I can be of further assistance concerning this matter.

Sincerely,

THOMAS J. NAVIN
Acting Chief, Wireline Competition Bureau

Enclosures

QUESTIONS FROM THE HONORABLE CLIFF STEARNS

Question 1. Is USAC governed by the FCC rules of procedure and practice?

Response. The Commission's rules of procedure and practice generally apply to parties and participants in Commission proceedings. The Universal Service Administrative Company (USAC) assists the Commission in its administration of the universal service program, but it is not permitted to participate as a party in the Commission's proceedings. 47 C.F.R. § 54.702(d). In the performance of its functions with respect to the universal service program, USAC is therefore not governed by the rules of practice and procedure that apply generally to parties in proceedings before the Commission. The Commission has adopted specific procedural rules that apply to parties in proceedings before USAC. See, e.g., 47 C.F.R. §§ 54.719, 54.720, 54.721.

Question 2. Does the FCC *ex parte* rules apply to USAC recovery processes and suspension determinations and appeals from such USAC actions?

Response. The Commission's *ex parte* rules apply only in proceedings before the Commission. See 47 C.F.R. § 1.1200 (a). Pursuant to section 1.1204(a)(12)(iii) of the Commission rules, presentations between Commission staff and USAC relating to the administration of universal service support mechanisms, including recovery processes and appeals, are exempt from *ex parte* requirements. 47 C.F.R. § 1.1204(a)(12)(iii). The *ex parte* rules do apply to a party if that party appeals a USAC decision to the Commission.

Question 3. Does the FCC staff discuss pending appeals at the FCC from USAC actions with USAC staff? Shouldn't the FCC *ex parte* rules apply to pending USAC appeals at the FCC?

Response. The Commission's *ex parte* rules place restrictions on communications between parties or others and decision-making personnel. 47 C.F.R. §§ 1.1206(a), 1.1208. The rules do not, however, prohibit or place restrictions on discussions among decision-makers. In this respect, USAC is treated in the same manner as Commission staff, who are treated as decision makers and may talk freely to the Commission about administrative appeals from the staff's own decisions. See 47 C.F.R. § 1.1202 (c) (definition of decision-making personnel). The Commission staff is likewise permitted to discuss with USAC pending appeals from USAC decisions. Thus, although the Commission's *ex parte* rules do apply to parties in USAC appeal proceedings at the Commission, those rules do not restrict USAC's discussions with the Commission.

Question 4. As I understand it, the FCC rules and procedures assure parties of due process by providing them with an opportunity to review allegations of violations and having an opportunity to respond prior to the FCC making a determination. Doesn't this same procedure apply to USAC and its consideration of potential program violations and subsequent actions by USAC including recovery actions and suspension of funding requests?

Response. In Commission proceedings in which the Commission seeks to impose monetary sanctions ("forfeitures") for rule violations, the Communications Act sets forth specific statutory procedures that provide for notice and an opportunity to respond and other due process protections. See 47 U.S.C. § 503. In contrast, the Commission's recovery procedures for debts owed to the government, including matters involving payments from the universal service fund, assure parties of due process by following the notification and other administrative appeal procedures mandated by the Debt Collection Act. *Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service*, 15 FCC Rcd 22975 (2000); *recon. granted* 19 FCC Rcd 15252 (2004); *modified in Schools and Libraries Universal Service Support Mechanism, Fifth Report and Order*, 19 FCC Rcd 15808 (2004). In addition, specific Commission rules provide for notice and an opportunity to respond to allegations of "prohibitive conduct" in certain proceedings involving appeals of actions taken by USAC. See 47 C.F.R. § 54.721(d). The Commission's rules also permit, and sometimes require, USAC to withhold disbursements pending the disposition of administrative appeals in recovery proceedings. See 47 C.F.R. § 54.725.

Question 5. The FCC has a long history of handling confidential information from various parties subject to FCC rules and regulations including having a model protective order available to parties. Shouldn't USAC have these same procedures and protective orders available for adverse parties in recovery and/or suspension proceedings?

Response. Protective orders and other procedures may be available, where appropriate, in Commission regulatory proceedings that involve adverse parties and where the materials subject to a protective order are relevant to the Commission's decision. Such procedures are not used for preliminary administrative actions taken by USAC involving debt collection or related matters, nor has the Commission had occasion to routinely use such procedures in appeals from debt collection actions in its own proceedings. Such proceedings to recover money owed to the government by debtors are generally governed by the separate federal laws and procedures for debt

collection and do not normally involve adverse parties or necessitate the disclosure of confidential information to parties using protective orders. The Commission's policies are intended to protect, insofar as possible, the confidentiality of proprietary information submitted by carriers and others.

Question 6. In the Puerto Rico case, it is my understanding that the FCC restricted USAC's authority to suspend pending and future funding applications only when there were allegations of program violations related to the funding requests or the proposed service provider. Has USAC been following the FCC's mandate in tailoring its suspension orders?

Response. In accordance with its standard operating procedures, USAC committed and disbursed funds on behalf of the Puerto Rico Department of Education (PRDOE) for Funding Years (FYs) 1998-2000. On December 5, 2001, USAC suspended payments on behalf of PRDOE for FYs 1998-2000 based on an audit that identified apparent program violations involving PRDOE funding. After consultation with the Wireline Competition Bureau, USAC also suspended consideration of PRDOE's applications for FY 2001 and 2002, and it required PRDOE to respond to the findings of the USAC-initiated audit. Subsequent to that audit, USAC became aware of a number of local and federal law enforcement investigations involving activities of the PRDOE. On January 30, 2003, PRDOE petitioned the Commission to direct USAC to resume processing PRDOE's applications for FY 2001 and 2002.¹

On November 25, 2003, the Commission released the Order addressing PRDOE's request, providing direction for treating applications involving potential program violations. Specifically, the Commission concluded that, "to guard against waste, fraud, and abuse, it is reasonable for USAC to generally defer action on applications upon receiving evidence of potential program violations, including evidence acquired from an active law enforcement investigation related to the E-rate related activities of the applicant or any of the service providers utilized by that applicant, until such time as questions raised by the evidence can be resolved."²

Consistent with the Commission's directive as articulated in various orders,³ USAC has developed principles for treating entities under investigation for program violations.⁴ These principles balance the goal of preventing waste, fraud, and abuse against the need to ensure due process and fundamental fairness, as well as respect for the integrity of law enforcement investigations.

QUESTIONS FROM THE HONORABLE MARSHA BLACKBURN

Question 1. In 2003, IBM had sought to handle almost \$1 billion on E-rate projects, but it was later held until completion of an investigation. What was the outcome of this investigation?

Response. For FY 2002 (July 1, 2002-June 30, 2003), eighteen applicants sought approximately \$500 million for contracts employing IBM as a systems integrator or in other substantial capacities. In response to a tip from a whistleblower in mid-2002, USAC began investigating these applications, and as a result of that and subsequent related investigations, denied the funding requests. Nine of the applicants

¹ See Letter from Dr. César A. Rey Hernández, Secretary, PRDOE, to Jane Mago, General Counsel, Federal Communications Commission, dated January 30, 2003. See also *Wireline Competition Bureau Seeks Comment on a Petition by Puerto Rico Department of Education to Release Funds Associated With Schools and Libraries Universal Service Support Mechanism for Funding Years 2001 and 2002*, CC Docket No. 02-6, Public Notice, 18 FCC Rcd 10467 (Wireline Comp. Bur. 2003). Comments, all in support of PRDOE's Petition, were submitted by the Hon. Anibal Acevedo-Vilá, Resident Commissioner, Commonwealth of Puerto Rico, U.S. House of Representatives; Centennial Communications Corp.; and The Hispanic Information and Telecommunications Network, Inc. PRDOE had selected the Puerto Rico Telephone Company (PRTC) for telecommunications service and Internet access and Data Research Communications Company for Internet access and internal connections for FY 2001. PRDOE selected PRTC for telecommunications service, Internet access, and internal connections and Sprint for telecommunications service for FY 2002.

² *Petition of the Puerto Rico Department of Education to Release Funds Associated with the Schools and Libraries Universal Service Support Mechanisms for Years 2001 and 2002, Federal-State Joint Board on Universal Service*, CC Docket No. 02-6, Order, 18 FCC Rcd 25417, 25422, para. 15 (2003) (Puerto Rico Order).

³ See generally *Schools and Libraries Universal Service Support Mechanism*, CC Docket 02-6, Notice of Proposed Rulemaking, 17 FCC Rcd 1914 (2002); *Request for Immediate Relief filed by the State of Tennessee, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, CC Docket Nos. 96-45 and 97-21, Order, 18 FCC Rcd 13581 (2003); Puerto Rico Order.

⁴ Principles for Treating Entities Under Investigation Relating to Their Participation in the Schools and Libraries Universal Service Support Mechanism <http://www.sl.universalservice.org/reference/investigation.asp>.

representing \$268 million in IBM contracts appealed those USAC decisions to the Commission.

In December 2003, the Commission upheld USAC denial of \$251 million in funding requests to eight of the nine applicants.⁵ Although the Commission concluded that the practices followed in various applications were not consistent with the competitive bidding rules, the Commission found that good cause existed to re-open the filing window for FY 2002 to allow the applicants that appealed SLD's denial of their funding requests to re-bid for services. Four of the applicants sought re-bids for the FY 2002 requests. While the Commission permitted IBM to re-bid on those applications, its single bid was unsuccessful.

Question 2. Some school districts have wired their own schools because the funds they need to match the e-rate program would have cost them more. Does USAC perform any cost-benefit fair market value analysis of wiring an individual school, library or a local district?

Response. USAC does not perform a cost-benefit fair market value analysis of wiring for any individual school, library, or local district. As noted in the Universal Service Order, the Commission's competitive bidding requirements are designed to assist schools and libraries in receiving the best value for their limited funds.⁶ Under the competitive bidding requirements, applicants must select the most cost-effective offerings, and price must be the primary factor in determining whether a particular vendor is the most cost-effective.⁷ In addition to the competitive bidding requirements, program beneficiaries must pay the non-discounted share of the supported services and have resources necessary for sufficient computer equipment, software, staff training, internal connections, maintenance and electrical capacity to make use of the supported services. These safeguards help ensure that participants employ cost-effective services.

⁵*Request for Review of the Universal Service Administrator by Ysleta Independent School District*, CC Docket Nos. 96-45 and 97-21, Order, 18 FCC Rcd 26407 (2003).

⁶*Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9027-29, paras. 475-480 (1997) (*Universal Service Order*).

⁷*Universal Service Order*, 12 FCC Rcd at 9029-30, para. 481; 47 C.F.R. § 54.511(a).

