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Federal Communications Commission
Office of the Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	
Comprehensive Review of Universal Service Fund Management, Administration, and Oversight	WC Docket No. 05-195
Federal-State Joint Board on Universal Service	CC Docket No. 96-45
Schools and Libraries Universal Service Support Mechanism	CC Docket No. 02-6
Rural Health Care Support Mechanism	WC Docket No. 02-60
Lifeline and Link-Up	WC Docket No. 03-109
Changes to the Board of Directors for the National Exchange Carrier Association, Inc.	CC Docket No. 97-21

Comments of the Federal Communications Commission (FCC)
Office of Inspector General (OIG)

The following comments are submitted in response to the Commission's request for comments on the management, administration and oversight of the Universal Service Fund.

1. Introduction

The Federal Communications Commission (FCC) Office of Inspector General (OIG) has the statutorily mandated responsibility to: (1) conduct and supervise audits and investigations relating to the programs and operations of the FCC; (2) provide leadership and coordination and recommend policies for activities designed to promote economy, efficiency, and effectiveness in the administration of, and (3) to prevent and detect fraud and abuse in, such programs and operations. Consistent with this responsibility, the FCC OIG has been actively involved in oversight of the Universal Service Fund (USF) for almost six years beginning with the audit of the Commission's FY 1999 financial statement when the USF was determined to be part of the FCC's reporting entity for financial statement reporting. Starting with that audit, the Office of Inspector General

has devoted considerable resources to oversight of the USF. Based on our assessment of risk, we have devoted most of our limited resources to oversight of the schools and libraries funding mechanism of the USF, also known as the "E-rate program." Accordingly, most of our comments related to program design are limited to the E-rate program. However, we have also provided comments on more general issues related to program management and administration.

Consistent with our statutorily mandated responsibilities, the Office of Inspector General has routinely provided comments on draft Commission rulemaking products, including the Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking ("NPRM") to which we are now responding. Typically, our input is considered prior to public release. Although we have not chosen to do so in the past, we believe that it is necessary to formally respond in this case for two reasons. First, we have several concerns with the scope of the comments requested by the Commission in this matter. Second, we believe that, as a result of our involvement in USF oversight, we have a unique perspective on many of the areas in which the Commission has requested comments. We have organized our comments as follows: (1) management and administration of the USF; and (2) oversight of the USF.

2. Management and Administration of the USF

In this NPRM, the Commission has requested comments on measures that can be taken to improve management and administration of the program. We are pleased to see that the Commission has recognized the impact of the organizational structure on program management and administration and is taking steps with this NPRM to examine the effectiveness of the existing organizational structure. It has been our experience that weaknesses in the existing structure have complicated efforts to address fraud, waste, and abuse in the program. We have addressed many of these concerns in our semi-annual reports to Congress and in testimony before Congressional committees. The Government Accountability Office (GAO) has also recognized weaknesses with the existing organization structure in their February 9, 2005 report entitled "Telecommunications: Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program."

We believe it would benefit the program if the relationship between USAC and the Commission were better defined, perhaps in the form of a contractual arrangement. However, the need for an effective working relationship is contingent upon both parties. As the Commission has noted in the NPRM, the Universal Service Administrative Company (USAC) is prohibited from making policy, interpreting unclear provisions of the statute or the Commission's rules, or interpreting the intent of Congress, and may only advocate positions before the Commission and its staff on administrative matters. The efficiency and effectiveness of this structure is dependent upon timely Commission action on policy matters and timely guidance from the Commission regarding unclear provisions of the statute and Commission rules. In our opinion, and based on our experience in the conduct of audits and involvement in investigations, the Commission has frequently not taken timely action on policy matters or provided timely guidance

regarding unclear provisions of the statute and Commission rules. With respect to Commission action on policy matters, the Commission has taken some steps to address concerns that we have raised such as record retention, technology planning, and certifications. However other areas of concern, most notably the competitive procurement process, have not been addressed. We first raised concerns about rules governing the competitive procurement of goods and services in our semi-annual report to Congress for the period ending September 30, 2002 and have continued to discuss this concern since that report. With respect to Commission guidance regarding unclear provisions of the statute and rules, it has been our experience that obtaining necessary policy guidance as part of the audit process is more complicated and time-consuming now than it was two years ago.

In paragraph 22 of the NPRM, the Commission seeks comment on whether certain USAC administrative procedures should be codified in Commission rules. It has long been our position that clarity is needed regarding the rules governing this program. In our semi-annual report to Congress for the period ending March 31, 2004, we pointed out that Commission staff was making a distinction between program rules and implementing procedures established by USAC in accordance with their authority under program rules. We explained that we were concerned with this distinction for three reasons. First, we believe that this distinction represents a weakness in program design. Second, we believe that it is critical that participants in the E-rate program have a clear understanding of the rules governing the program and of the consequences that exist if they fail to comply with those rules. Third, a clear understanding of the distinction between program rules and USAC implementing procedures is necessary for the design and implementation of effective oversight. To the extent that the rules need to be codified to ensure that a legal basis exists for Commission action in the case of non-compliance, we believe that the rules should be codified.

In paragraph 23, the Commission seeks comment on whether a rule should be adopted to require USAC to develop and maintain continuity of operations ("COOP") plans to ensure that essential services will be available in emergency situations. We question the need for public comment on this point since USAC has a COOP which is currently being audited by OIG.

In paragraph 29, the Commission seeks comment on timing issues that need improvement. The Commission notes that "the timing of the Commission's and USAC's processes may be critical to schools and libraries" and that "(l)engthy intervals for processing or reviewing applications could have a disruptive effect on the budget or procurement schedule for schools or libraries." As we stated earlier in this response, the efficiency and effectiveness of the current program structure is dependent upon timely Commission action on policy matters and timely guidance from the Commission regarding unclear provisions of the statute and Commission rules. In our opinion, and based on our experience in the conduct of audits and involvement in investigations, the Commission has frequently not taken timely action on policy matters or provided timely guidance on unclear provisions of the statute and Commission rules.

In paragraph 40 of the NPRM, the Commission seeks comment on modifying the current rules requiring competitive bidding. The rules regarding competitive procurements under the E-rate program have been a source of great concern for the FCC OIG for several years. We have addressed these concerns in our semiannual reports to Congress and in Congressional testimony. We have provided suggestions to the Commission for improving this area. It has been our position that the 28 day posting to USAC's website and compliance with state and local procurement regulations (when they are applicable) do not provide adequate assurance of a competitive procurement. We believe competitive bids should be required of all E-rate procurements, or at a minimum those awards which exceed a determined dollar amount.

In paragraph 42, the Commission asks if October 1st, or some other date, should be used to determine the number of students eligible for the National School Lunch Program (NSLP). The Commission's E-rate program rules rely on the U. S. Department of Agriculture (USDA) NSLP (in addition to other federally approved alternate mechanisms) to determine the relative economic need of the beneficiary applicant in order to assign an appropriate discount percentage. The Commission chose eligibility for participation in NSLP as a standard to determine poverty level in part because the Commission believed that this standard would not be administratively burdensome to schools.

The FCC OIG is concerned that the date provided in the instructions to the Form 471 is not in conformance with USDA NSLP regulations on which the FCC rules rely to determine eligibility.

USDA NSLP regulations determine a school's eligibility based on the number of approved applications it has on file as of October 31st of each school year. The school is required to report the total number of NSLP eligible students, and must maintain the related supporting documentation for a period of three (3) years.

We have requested clarification from Wireline Competition Bureau (WCB) staff on whether the FCC's rules require compliance with USDA's date specific eligibility requirements for NSLP data, and are working with them to determine a definitive answer to this outstanding issue. Our position is that an applicant's NSLP data used to support eligibility should comply with USDA NSLP rules, since the program relies upon NLSP data to determine E-rate eligibility.

3. Oversight of the USF

In paragraph 70, the NPRM discusses several statistics relative to funding recoveries based on audits and rules violations. It notes that the recommended recovery amounts from audits has been small and concludes that this demonstrates that "the great majority of (USF) recipients have not engaged in fraud." Our position is that, given that the audits performed to date have been ad hoc and nonstatistical, it is premature to reach any conclusions regarding overall program compliance. We note that in audits performed to date in which an opinion was expressed regarding compliance, the auditors found the

funding recipient to be noncompliant with program rules in over a third of the audits. Further, we believe that the low amount of recommended recoveries may be due to weaknesses in program rules. For example, many audits have noted that installed systems do not work or provide capacities far beyond the needs of the funded entity. However, since program rules do not preclude these situations, the Commission has informed us that there is no legal basis for recovering funds based on these circumstances.

Paragraph 71 discusses an annual audit requirement for high dollar fund recipient and mentions that many schools and libraries obtain annual audits to comply with the Single Audit Act. We will discuss the Single Audit Act in some detail later in these comments. First, we will comment on several observations in the NPRM that begin at this point and address many topics related to audits of the USF.

Paragraph 71 also asks if post-disbursement audits are inappropriate when the cost of the audit exceeds the amount of funding provided. Paragraphs 74 and 76 both request comments on whether there should be regulatory limits on the number of times an entity gets audited. Paragraph 73 and 74 also discuss the auditing standards and types of audits that should be performed. Paragraph 78 extends this discussion to the other USF funding mechanisms.

While OIG appreciates the Commission's interests in these matters and we look forward to reviewing the comments that are generated by these questions, we take this opportunity to remind the Commission and the public that the FCC OIG is the audit organization that is statutorily required to conduct independent audits of the FCC's programs and operations. These responsibilities include conducting and supervising audits and investigations, providing leadership and coordination and recommend policies for activities designed to promote economy, efficiency, and effectiveness in the administration of, and to prevent and detect fraud and abuse in, such programs and operations. Limitations on audits, whether based on the size of the auditee or an arbitrary length of time between audits or since the receipt of the funding, serves to imply the existence of limitations upon the OIG and our ability to independently plan and conduct audits.

An additional concern the NPRM raises along these lines is contained in Sections 2 and 3 of the NPRM (paragraphs 83, 84, 87 and 88). These paragraphs note that the *Schools and Libraries Fifth report and Order* adopted a five year records retention requirement and establishes a five-year period in which "inquiries" to determine rules violations will be initiated and completed. The Commission seeks comments on whether this record retention requirement should be applied to all USF programs. We informed Commission management at the time the Fifth Report and Order was being drafted that such arbitrary limits on auditing are poor policy and do not apply to OIG audits. Our position on that matter is unchanged and will be the same if these limits on record retention are expanded to the other USF programs.

Additionally, good stewardship of federal funds and the requirements for agency reporting under the Improper Payments Improvement Act (IPIA) should serve as ample notice that limitations on the planning and conduct of audits based on arbitrary values represent unnecessary risk. This is not to say that audit planning should not consider such factors as funds expended, size of auditee and prior audit results. Rather we are saying that these factors do not indicate the need or lack of need for audit coverage in and of themselves and should not be used to do so.

Paragraph 73 discusses requirements with generally accepted government auditing standards (GAGAS) and use of internal auditors. The IG Act of 1978, as amended, places the responsibility upon the Inspector General to establish guidelines for determining when it is appropriate to use non-Federal auditors and to ensure that any such work performed complies with GAGAS.

All of the above referenced paragraphs of the NPRM imply a lack of recognition for the role of the Inspector General in conducting and supervising audits of the FCC's operations and programs. The content and tone of these paragraphs give us great concern that our ability to fulfill our responsibilities under the IG Act may be impeded or preempted.

Paragraph 81 of the NPRM seeks comments on modeling audit requirements on the requirements contained in the Single Audit Act and Office of Management and Budget (OMB) implementing guidance contained in Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. OMB Circular A-133 requires that non-federal entities that expend $300,000 or more of Federal awards in a year are required to obtain a single or program-specific audit. OIG has advocated adopting these guidelines several times in the past several years.

We believe applying the federal grant model for the E-rate program would provide many benefits to the program and address many of the areas on which the Commission is seeking comments in this NPRM, and would assist in the detection of waste, fraud, and abuse less difficult.

The primary benefits of using a federal grant model to award, expend and report on E-rate funding is that the system of requirements placed on federal grants ensures accountability and uniform treatment. We have not determined the extent of Single Audit coverage in the E-rate beneficiary community, but, we are comfortable that a significant portion of the applicants are already subject to the Single Audit Act.

The primary benefits to the program of using the federal grant model and bringing in Single Audit coverage are:

- A consistent application of sound business practices that would improve the accountability and effectiveness of the program.
- An increased amount of audit work, much of which is already being conducted, that the FCC may be able to rely upon for oversight.

In addition to audit requirements, the federal grant model incorporates numerous other OMB Circulars regarding requirements for obtaining, expending, managing, and reporting on federal grants. OMB Circular A-133 and these Circulars make requirements out of common business and government aspects of accountability, management and control. There are minor differences between these documents, but generally they all incorporate items such as:

- Equipment and real property management
  - Asset records are maintained
  - Physical inventories periodically taken
  - Policies and procedures for recordkeeping
- Matching funds
  - Required budgeting to ensure matching funds are available and adequate
  - Identification of estimates
  - Review of monthly cost reports
- Federal funds are used only during the authorized period of availability
- Procurements
  - Codes of conduct and other policies are in place
  - A procurement manual that incorporates federal requirements
  - Absence of pressure to meet unrealistic performance targets
  - Procedures to identify risks of vendor inadequacy
- Common cost principles – recording costs to ensure proper identification, allocation, and segregation from non-federal funds. Costs charged to grants must:
  - Be necessary and reasonable
  - Be allocable to the project
  - Meet standard requirements for identifying and valuing contributions used for matching funds
  - Meet required records to maintain, retention periods and access requirements for auditors
  - Require grantees to monitor and report on operations of the grant entity

We believe the consistency and the contents of this framework would bring many advantages to oversight of the E-rate program.

Paragraph 82 asks if audits of USF beneficiaries and contributors should opine on applicable internal controls. We point out that Single Audit Act requirements and GAGAS performance audit standards require that auditors consider internal controls to the extent that the controls are relevant to the program being audited.

Paragraphs 40 and 90 of the NPRM seek comments on modifying the E-rate program's competitive bidding requirements. It also asks if the Commission should adopt rules to ensure applicants are not requesting funding for "gold plated" systems and if maximum prices should be established for particular services or equipment. OIG is supportive of these measures and any standards that contribute a more effective and efficient program.

In particular, numerous audits and investigations have disclosed instances of exorbitant pricing and unnecessary equipment. These instances of abuse are often conducted within the boundaries of the program's rules. The USF must be better protected from waste and abuse, as well as fraud.

OIG first raised this issue of weaknesses in the competitive procurement process in our semi-annual report for the period ending March 31, 2002, and several times since that time. However, little substantive change has taken place in this area. The Antitrust Division of the Department of Justice provided additional comments in December 2002 and recommended that the program implement a requirement for a minimum of three bids for e-rate procurements. The NPRM discusses several of the complications and considerations that might impact this requirement. We understand and agree with the Commission's observations in the NPRM regarding issues with requiring a minimum number of bids. Nonetheless, we believe that a three-bid minimum requirement should be implemented and deviations be allowed when justified.

Paragraph 97 seeks comments on the debarment rule and asks if schools and libraries should be informed when a contractor is under investigation. As a general rule, we believe this would not be advisable as it may have a negative impact on an investigative matter, and we would recommend consultation with the applicable law enforcement agency in advance of sharing any information outside of the investigative/government parties. Additionally, OIG is supportive of applying the debarment process to all USF support mechanisms and expanding the scope of the debarment process to encompass instances of clear and systemic abuse of the program.