



CHAIRMAN

Federal Communications Commission

Washington, D.C.

October 5, 2004

The Honorable Olympia J. Snowe  
The Honorable John D. Rockefeller, IV  
United States Senate  
508 Dirksen Senate Office Building  
Washington, DC 20510-6125

Dear Senators Snowe and Rockefeller:

Thank you for your letter of October 1, 2004, regarding the federal Universal Service Fund (USF) and issues that have arisen during the transition of the USF from generally accepted accounting principles (GAAP) to Government GAAP accounting standards.

Providing high-quality telecommunications services to all Americans at affordable rates was a cornerstone of the Communications Act of 1934, and Congress reinforced this principle in the Telecommunications Act of 1996. Universal service has been an unqualified success in bringing telephone service to Americans. The Commission is committed to ensuring that the USF will continue to support ubiquitous and affordable telecommunications service for all Americans. I also share your commitment to the provisions of the law that created the schools and libraries and rural healthcare funds. These programs are vital to America but we must insist that they comply with the highest government accounting standards. Working in partnership with USAC, our permanent fund administrator, the Commission can ensure the program is placed on solid financial footing.

To that end, in October 2003, the Commission adopted a rule requiring the Universal Service Administrative Company (USAC) to account for the financial transactions of the USF in accordance with GAAP for federal agencies and to maintain the accounts of the USF in accordance with the U.S. Government Standard General Ledger. We view the transition to Government GAAP standards as an additional measure for strengthening the financial foundation of the USF, particularly as we are confronted with the potential for waste, fraud, and abuse in the program. We recognize, nevertheless, that the process of implementing the necessary changes to convert to Government GAAP standards has not been easy for USAC or the Commission. The Commission is therefore working in close consultation with USAC during this transition to advance the goals of the universal service program, while ensuring that the program operates on the soundest of economic footings free of waste, fraud, and abuse. The Commission is also continuing to work closely with the Department of Justice to protect

the assets of the USF. In this way, we further our commitment to ensure the integrity of the USF and to protect it from waste, fraud, and abuse.

We also recognize that the transition to Government GAAP standards has created unique challenges in the schools and libraries (E-rate program) and rural health care mechanisms, particularly with regard to the question of whether Funding Commitment Decision Letters ("Commitment Letters") constitute "obligations" for federal budgetary accounting purposes and the concomitant impact on the issuance of the Commitment Letters in this environment. As noted in your letter, one issue in particular that we are grappling with at the Commission involves questions relating to the application of the Antideficiency Act to the universal service programs. The Commission is committed to minimizing the impact of these changes on the programmatic decisions related to these funds and resuming new funding decisions as soon as practicable. However, we can only do so within the confines of the legal and accounting requirements that apply to the USF. In furtherance of this goal, the Commission yesterday directed USAC to liquidate an additional \$210 million in funds designed to expedite release of new commitments to meet the pending needs of universal service beneficiaries including schools, libraries, and rural health care providers.

First, in this regard, let me assure you that I appreciate and share your concern that the Antideficiency Act may affect the operation of the universal service program. To address this concern, one option would be legislation that would exempt the fund from the requirements of the Antideficiency Act. Among other things, remedial legislation would permit the fund to incur obligations prior to the receipt of cash intended to cover those obligations. Such an exemption would also permit the fund to invest in securities backed by the federal government, which otherwise would be treated as obligations. I would welcome an opportunity to work with your staff to craft such legislation.

As you note in your letter, Commission personnel could be subject to criminal sanctions for intentional violations of the Antideficiency Act. The serious nature of these provisions requires the Commission to take every possible step to comply with the law. Because it was necessary to completion of work on the Commission's annual financial statement, the FCC Inspector General's auditors required that the General Counsel explain -- on an expedited basis -- whether the Antideficiency Act ("ADA") applies to the fund and whether funding commitment decision letters (FCDLs) in the e-rate program are obligations for purposes of the Antideficiency Act. Based on our review of the relevant law and in consultation with the Office of Management and Budget and Government Accountability Office (GAO), the Commission has taken action to preclude intentional violations of the Act. To the extent that any unintentional violations may have already occurred, the Commission is taking steps to comply fully with all reporting requirements in the Antideficiency Act.

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Question

Is it the Commission's legal opinion that the Universal Service Fund is subject to the provisions of the federal Anti-Deficiency Act?

Question

If so, on what basis? What written or unwritten guidance has the Commission received from the Office of Management and Budget?

Answer: For the following reasons, and after extensive consultation with OMB, we have concluded that the fund is subject to the Antideficiency Act. OMB determined in 1996 that the USF should be included in the Budget of the United States and classified as a "special fund." See "Significant Presentation and Technical Changes in the Budget of the United States Government, Fiscal Year 1997," at p. 7, submitted to the Congress by OMB Director Alice M. Rivlin, March 19, 1996. Under appropriations law, because the collection and expenditures with respect to the fund are authorized by permanent law (i.e., section 254 of the Communications Act), and there is no statutory limit on the fund, the fund is considered appropriated funds, and specifically, a "permanent, indefinite appropriation." See, e.g., 59 Comp. Gen. 215 (1980). This characterization is also reflected in the federal budget, where the fund has been listed as a "mandatory appropriation" and as an "appropriation, permanent." See, e.g. Budget of the United States Government, Fiscal Year 1997, Analytical Perspectives at 486; Budget of the United States Government, Fiscal Year 2001, Federal Programs by Agency and Account at 645. The Congressional Budget Office (CBO) has also noted that "CBO and the Office of Management and Budget (OMB) count payments into the Universal Service Fund as federal revenues and payments from the fund as federal outlays." CBO, Federal Subsidies of Advanced Telecommunications for Schools, Libraries, and Health Care Providers, January 1998 at 5. CBO explains that "Both agencies have interpreted the Telecommunications Act of 1996 to mean that the fund's expenditures should be part of the federal budget, because the transfers of income between various classes of telephone users would not occur but for the exercise of the sovereign power of the federal government." Id. Further, consistent with Universal Service Fund's budgetary status, OMB issued an apportionment for the USF for FY 2004, in accordance with the Antideficiency Act provision at 31 U.S.C. 1512(a), which requires apportionments of appropriations. Accordingly, we believe that the fund is covered by the Antideficiency Act.

Question

If so, is such a conclusion consistent with an August 2000 legal opinion from the Office of Management and Budget concluding that "the Universal Service Fund does not constitute public money. . . and is appropriately maintained outside the Treasury by a non-governmental manager"?

Answer: The August 2000 OMB legal opinion addressed a separate legal issue -- whether the fund is "public money" for purposes of the Miscellaneous Receipts Act, which requires that public money be deposited in the Treasury. The OMB letter did not address whether the fund is subject to the Antideficiency Act, which prohibits "an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation ...." As indicated above the fund is treated and listed as appropriated funds for purposes of the federal budget. Moreover, in FY 2004, OMB subjected the fund to an annual apportionment, a requirement that is grounded in provisions of the Antideficiency Act. These facts indicate that, whatever may be concluded about the August 2000 OMB opinion, OMB has determined that the fund is subject to the apportionment provisions of the Antideficiency Act. We have also asked OMB for a formal written opinion as to whether the funding commitment decision letters in the e-rate program are "obligations" for purposes of the Antideficiency Act and whether the fund is subject to the ADA.

Question

If so, is such a conclusion consistent with Congress' intent in a 1997 amendment to the Commerce, Justice, State appropriations legislation stating that "federal and state universal service contributions are administered by an independent, non-Federal entity and are not deposited into the Federal Treasury and therefore [are] not available for Federal appropriations?"

Answer: It is our understanding that the purpose of the Senate's action was to express the sense of the Senate that receipts in the universal service fund would not be available for federal expenditure other than to fund the universal service program. That expression is consistent with treatment of the fund as a "special fund" in the budget, as explained above, and as a mandatory, permanent appropriation in both the budget and under Comptroller General decisions.

Question

If the Commission concludes that funds held in the Universal Service Fund are "federal funds," can a non-governmental entity such as USAC hold and disburse such funds?

Answer: The Commission's rules for the fund, enacted under general authority of section 254 of the Communications Act, permit USAC to hold and disburse universal service funds. The 2000 OMB opinion, mentioned above, has concluded that the fund may be held outside the Treasury.

Question

How should projected cost estimates used in the administration of the universal service high-cost and low income funds be treated for accounting purposes? If the Commission is unable to decide this question, does such a result create potential liability under the

Anti-Deficiency Act if actual high-cost and low income outlays exceed projected estimates?

Answer: As you may know, this issue has only recently come to our attention. To date, OMB has not given the Commission any indication that operation of the High Cost or Low Income universal service mechanisms creates liability under the Antideficiency Act. At this time, pending further consideration of this issue, the FCC is not treating these projections and submissions as "obligations" for federal budgetary accounting purposes.

Question

Given these accounting changes, what action, if any, does the Commission expect will be necessary to recover the \$550 million that will have failed to collect over the 2nd, 3<sup>rd</sup> and 4<sup>th</sup> Quarters of 2004 to cover E-rate and rural health care obligations?

Answer: We are gathering facts and exploring options available to the Commission to determine whether the existing contribution factor would need to be modified in future periods. As you know, prior contribution factor decisions were based on the then-applicable accounting procedures. Going forward, the Commission must assess any new contribution level on the new accounting rules applicable to the funds.

Question

It is our understanding that these accounting changes will require USAC to make changes in the way that cash balances are invested. What guidelines govern the investment of cash balances in the Universal Service Fund programs? Are those guidelines subject to approval by USAC and/or the Commission? What effect will recent changes ordered by the Commission have on expected interest income?

Answer: USAC has issued written sets of investment guidelines since 1997, which it sends to the Commission for review. On September 8, 2004, representatives of the FCC and USAC, including USAC's CEO and its General Counsel, attended a meeting at OMB to discuss issues that had arisen under the Antideficiency Act. At that meeting, OMB pointed out that, under OMB guidance in OMB Circular A-11 implementing the Antideficiency Act, USAC must have sufficient cash on hand to meet all its outstanding obligations, including obligations in FCDLs. OMB also pointed out that, under OMB Circular A-11, investments other than in Treasury notes, even if backed by the Federal Government, would be treated as obligations for purposes of the Antideficiency Act.

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Page 6 of 6

Subsequently, and based on financial data provided by USAC, the Commission's staff instructed USAC on September 27, 2004 that it should take appropriate action to liquidate investments in any vehicle other than Federal securities (as defined by OMB) to cover obligations of the USF. In general, the accounting changes described above are expected to reduce the USF's interest income.

Sincerely,

A large, stylized handwritten signature in black ink, appearing to read 'M. Powell', with a long horizontal flourish extending to the right.

Michael K. Powell