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# TELECOMMUNICATIONS

## Application of the Antideficiency Act and Other Fiscal Controls to FCC's E-Rate Program

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Physical Infrastructure Issues





Highlights of [GAO-05-546T](#), a testimony before the Committee on Commerce, Science, and Transportation, U.S. Senate

## Why GAO Did This Study

Since 1998, the Federal Communications Commission's (FCC) E-rate program has committed more than \$13 billion to help schools and libraries acquire Internet and telecommunications services. As steward of the program, FCC must ensure that participants use E-rate funds appropriately and that there is managerial and financial accountability surrounding the funds. This testimony is based on GAO's February 2005 report GAO-05-151, which reviewed (1) the effect of the current structure of the E-rate program on FCC's management of the program, including the applicability of the Antideficiency Act, (2) FCC's development and use of E-rate performance goals and measures, and (3) the effectiveness of FCC's program oversight mechanisms.

## What GAO Recommends

In its report, GAO recommends that FCC (1) comprehensively determine which federal accountability requirements apply to E-rate; (2) establish meaningful E-rate performance goals and measures; and (3) take steps to reduce its backlog of appeals. In response, FCC stated that it does not concur with (1) because it maintains it has done this on a case-by-case basis. GAO continues to believe that major issues remain unresolved. FCC concurs with (2) and (3), noting that it is already taking steps on these issues.

[www.gao.gov/cgi-bin/getrpt?GAO-05-546T](http://www.gao.gov/cgi-bin/getrpt?GAO-05-546T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Patricia A. Dalton at (202) 512-2834 or [daltonp@gao.gov](mailto:daltonp@gao.gov).

# TELECOMMUNICATIONS

## Application of the Antideficiency Act and Other Fiscal Controls to FCC's E-Rate Program

### What GAO Found

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 the Universal Service Administrative Company, and to the Universal Service Fund itself. FCC has addressed these issues on a case-by-case basis, but this has put FCC and the E-rate 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.

With regard to the Antideficiency Act, we agree with FCC's conclusions that the Universal Service Fund is a permanent indefinite appropriation, is subject to that act, and that the issuance of E-rate funding commitment letters constitutes obligations for purposes of the act. We believe that Congress should consider either granting the Universal Service Fund a two- or three-year exemption from the Antideficiency Act or crafting a limited exemption that would provide management flexibility. For example, Congress could specify that FCC could use certain receivables or assets as budgetary resources. These more limited solutions would allow time for the National Academy of Public Administration to complete its study of the Universal Service Fund program and report its findings to FCC. Congress and FCC could then comprehensively assess, based on decisions concerning the structure of the program, which federal requirements, policies, and practices should apply to the fund and to any entities administering the program. It could then be determined whether a permanent and complete exemption from the Antideficiency Act is warranted.

FCC has not developed useful performance goals and measures for assessing and managing the E-rate program. The goals established for fiscal years 2000 through 2002 focused on the percentage of public schools connected to the Internet, but the data used to measure performance did not isolate the impact of E-rate funding from other sources of funding, such as state and local government. In its 2003 assessment of the program, OMB concluded that there was no way to tell whether the program has resulted in the cost-effective deployment and use of advanced telecommunications services. In response, FCC is working with OMB on developing new E-rate measures.

According to FCC officials, oversight of the program is primarily handled through agency rulemaking procedures, beneficiary audits, and appeals decisions. FCC's rulemakings, however, have often lacked specificity, which has affected the recovery of funds for program violations. FCC has also been slow to respond to beneficiary audit findings and make full use of them to strengthen the program. In addition, the small number of these audits completed to date do not provide a basis for accurately assessing the level of fraud, waste, and abuse occurring in the program. According to FCC officials, there is also a substantial backlog of E-rate appeals.

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Mr. Chairman, Mr. Co-Chairman, and Members of the Committee:

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 and to discuss specifically the applicability of the Antideficiency Act to the program. 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 operations 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 February 2005, we issued a report on 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 today is based on this report, which contains a fuller discussion of the results of our review and recommendations for

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improving FCC's management and oversight of the E-rate program.<sup>1</sup> 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 the Universal Service Administrative Company, and to the Universal Service Fund itself. FCC has addressed these issues on a case-by-case basis, but this has put FCC and the E-rate 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.
- With regard to the Antideficiency Act, we agree with FCC's conclusions that the Universal Service Fund is a permanent indefinite appropriation, is subject to that act, and that the issuance of E-rate funding commitment letters constitutes obligations for purposes of the act. We believe that Congress should consider either granting the Universal Service Fund a two- or three-year exemption from the Antideficiency Act or crafting a limited exemption that would provide management flexibility. For example, Congress could specify that FCC could use certain receivables or assets as budgetary resources. These more limited solutions would allow time for the National Academy of Public Administration to complete its study of the Universal Service Fund program and report its findings to FCC. Congress and FCC could then comprehensively assess, based on decisions concerning the structure of the program, which federal requirements, policies, and practices should apply to the fund and to any entities administering the program. It could then be determined whether a permanent and complete exemption from the Antideficiency Act is warranted.
- 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

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<sup>1</sup>*Telecommunications: Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program*, [GAO-05-151](#) (Washington, D.C.: Feb. 9, 2005). The report is available on GAO's Web site at [www.gao.gov](http://www.gao.gov).

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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. To address the management and oversight problems we have identified, we recommended in our report that the Chairman of FCC: (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 that adequate staffing resources are devoted to E-rate appeals.

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## 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.<sup>2</sup> 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. . . .”<sup>3</sup> Based on this direction, and following the recommendations of a Federal-State Joint Board on Universal Service,<sup>4</sup>

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<sup>2</sup>47 U.S.C. § 254(h)(1)(B).

<sup>3</sup>47 U.S.C. § 254(h)(2).

<sup>4</sup>The 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.

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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.<sup>5</sup> Many of these companies, in turn, pass their contribution costs on to their subscribers through a line item on subscribers' phone bills.<sup>6</sup> 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.<sup>7</sup> In response to congressional conference committee direction,<sup>8</sup> FCC has specified that USAC "may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Congress."<sup>9</sup> 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

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<sup>5</sup>These 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. Along with the E-rate program, other universal service programs under the Universal Service Fund are the High Cost program, the Low Income program, and the Rural Health Care program. The High Cost program assists customers living in high-cost, rural, or remote areas through financial support to telephone companies, thereby lowering rates for local and long distance service. The Low Income program assists qualifying low-income consumers through discounted installation and monthly telephone services and free toll limitation service. The Rural Health Care program assists health care providers located in rural areas through discounts for telecommunications services. These four programs are sometimes collectively referred to as the Universal Service Fund program. For more information on the various universal service programs, see GAO, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding*, GAO-02-187 (Washington, D.C.: Feb. 4, 2002).

<sup>6</sup>The 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.

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

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

<sup>9</sup>47 C.F.R. § 54.702(c).

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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 libraries<sup>10</sup> 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.<sup>11</sup>

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## 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 only recently began to address a few of these issues.

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. The Telecommunications Act required FCC to consider the recommendations of the Federal-State Joint Board on Universal Service and then to develop specific, predictable, and equitable support mechanisms. Using the broad language of the act, FCC crafted an

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<sup>10</sup>Eligibility 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.

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

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ambitious program for schools and libraries—roughly analogous to a grant program—and gave the program a \$2.25 billion annual funding cap. 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,<sup>12</sup> 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 OMB, the monies are maintained outside of Treasury accounts by USAC and some of the monies have been invested.<sup>13</sup> 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

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<sup>12</sup>USAC 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.

<sup>13</sup>The 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 nongovernmental manager. Letter from Mr. Robert G. Damus, OMB General Counsel to Mr. Christopher Wright, FCC General Counsel, dated April 28, 2000.



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security of appropriated funds, and agencies' responsibilities for those funds.<sup>14</sup>

As explained below, appropriated funds are subject, unless specifically exempted by law, to a variety of statutory controls and restrictions. These controls and restrictions, among other things, limit the purposes for which federal funds can be used and provide a scheme of accountability for federal monies. Key requirements are in Title 31 of the United States Code and the appropriate Treasury regulations,<sup>15</sup> which govern fiscal activities relating to the management, collection, and distribution of public money.

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. FCC's Office of Inspector General first looked at the Universal Service Fund in 1999 as part of its audit of the commission's fiscal year 1999 financial statement because FCC had determined that the Universal Service Fund was a component of FCC for financial reporting purposes. During that audit, the FCC IG questioned commission staff regarding the nature of the fund and, specifically, whether it was subject to the statutory and regulatory requirements for federal funds. In the next year's audit, the FCC IG 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 still unresolved at the end of the audit.

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. While it is true that these steps and other FCC determinations discussed below should provide greater protections for universal service funding, FCC has addressed only

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<sup>14</sup>See 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.

<sup>15</sup>As set forth in part 31 of the Code of Federal Regulations or the Treasury Financial Manual.

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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.

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## FCC's Decision on the Antideficiency Act Should Be Addressed in a Broader Context

FCC has made some determinations concerning the status of the Universal Service Fund and the fiscal controls that apply. For example, FCC has concluded that the Universal Service Fund is a permanent indefinite appropriation subject to the Antideficiency Act and that its issuance of funding commitment letters constitutes recordable obligations for purposes of the act. We agree with FCC's determinations on these issues, as explained in detail in appendix I. 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.

*Status of funds as appropriated funds.* In assessing the financial statement reporting requirements for FCC components in 2000, FCC concluded that the Universal Service Fund constitutes a permanent indefinite appropriation (i.e., funding appropriated or authorized by law to be collected and available for specified purposes without further congressional action). We agree with FCC's conclusion. Typically, Congress will use language of appropriation, such as that found in annual appropriations acts, to identify a fund or account as an appropriation and to authorize an agency to enter into obligations and make disbursements out of available funds. Congress, however, appropriates funds in a variety of ways other than in regular appropriations acts. Thus, a statute that contains a specific direction to pay and a designation of funds to be used constitutes an appropriation.<sup>16</sup> In these statutes, Congress (1) authorizes the collection of fees and their deposit into a particular fund, and (2) makes the fund available for expenditure for a specified purpose without further action by Congress. This authority to obligate or expend collections without further congressional action constitutes a continuing appropriation or a permanent appropriation of the collections.<sup>17</sup> Because

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<sup>16</sup>63 Comp. Gen. 331 (1984); 13 Comp. Gen. 77 (1933).

<sup>17</sup>*E.g., United Biscuit Co. v. Wirtz*, 359 F.2d 206, 212 (D.C. Cir. 1965), cert. denied, 384 U.S. 971 (1966); 69 Comp. Gen. 260, 262 (1990); 73 Comp. Gen. 321 (1994).

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the Universal Service Fund's current authority stems from a statutorily authorized collection of fees from telecommunications carriers and the expenditure of those fees for a specified purpose (that is, the various types of universal service), it meets both elements of the definition of a permanent appropriation.

*Decision regarding the Antideficiency Act.* As noted above, 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 or not their funding is approved and in what amount) might be viewed as "obligations" of appropriated funds.<sup>18</sup> If so, 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 investments<sup>19</sup> 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.

FCC was slow to recognize and address the issue of the applicability of the Antideficiency Act, resulting in the abrupt decision to suspend funding commitment decision letters and liquidate investments. In response to these events, in December 2004, Congress passed a bill granting the Universal Service Fund a one-year exemption from the Antideficiency

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<sup>18</sup>An "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.

<sup>19</sup>According 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.

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Act.<sup>20</sup> Nevertheless, FCC's conclusion on this issue was correct: Absent a statutory exemption, the Universal Service Fund is subject to the Antideficiency Act, and its funding commitment decision letters constitute obligations for purposes of the act.

The Antideficiency Act applies to “official[s] or employee[s] of the United States Government . . . mak[ing] or authorizing an expenditure or obligation . . . from an appropriation or fund.” 31 U.S.C. § 1341(a). As discussed above, the Universal Service Fund is an “appropriation or fund.” Even though USAC—a private entity whose employees are not federal officers or employees—is the administrator of the program and the entity that obligates and disburses money from the fund, application of the act is not negated. This is because, as recognized by FCC, it, and not USAC, is the entity that is legally responsible for the management and oversight of the E-rate program and because FCC's employees are federal officers and employees of the United States subject to the Antideficiency Act. Thus, the Universal Service Fund will again be subject to the Antideficiency Act when the one-year statutory exemption expires, unless action is taken to extend or make permanent the exemption.

An important issue that arises from the application of the Antideficiency Act to the Universal Service Fund is what actions constitute obligations chargeable against the fund. Under the Antideficiency Act, an agency may not incur an obligation in excess of the amount available to it in an appropriation or fund. Thus, proper recording of obligations with respect to the timing and amount of such obligations permits compliance with the Antideficiency Act by ensuring that agencies have adequate budget authority to cover all of their obligations. Our decisions have defined an “obligation” as a commitment creating a legal liability of the government, including a “legal duty . . . which could mature into a liability by virtue of actions on the part of the other party beyond the control of the United States. . . .”<sup>21</sup>

With respect to the Universal Service Fund, the funding commitment decision letter provides the school or library with the authority to obtain services from a provider with the commitment that the school or library

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<sup>20</sup>Universal 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.

<sup>21</sup>See B-300480, April 9, 2003.

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will receive a discount and the service provider will be paid for the discounted portion with E-rate funding. Although the school or library could decide not to seek the services or the discount, so long as the funding commitment decision letter remains valid and outstanding, USAC and FCC no longer control the Universal Service Fund's liability; it is dependent on the actions taken by the school or library. Consequently, we agree with FCC that a recordable obligation is incurred at the time of issuance of the funding commitment decision letter indicating approval of the applicant's discount.

Additional issues that remain to be resolved by FCC include whether other actions taken in the Universal Service Fund program constitute obligations and the timing and amounts of obligations that must be recorded. For example, this includes the projections and data submissions by USAC to FCC and by participants in the High Cost and Low Income support mechanisms to USAC. FCC has indicated that it is considering this issue and consulting with the Office of Management and Budget. FCC should also identify any other actions that may constitute recordable obligations and ensure that those are properly recorded.

While 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 (see app. I), 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.<sup>22</sup> 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).<sup>23</sup>

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<sup>22</sup>Because 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.

<sup>23</sup>For example, in October 2003, when the 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

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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?<sup>24</sup> Are some of the functions carried out by USAC, even though they have been characterized as administrative or ministerial, arguably inherently governmental activities<sup>25</sup> that must be performed by government personnel? Resolving these issues in a comprehensive 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 recently announced that it has contracted with the National Academy of Public Administration (NAPA) for NAPA to study the administration of the Universal Service Fund. NAPA will review the current status of the Universal Service Fund program as well as other similar governmental and quasi-governmental programs. Among other things, NAPA is to examine the pros and cons of continuing with the program's current structure or switching to an alternative model. NAPA is also to identify specific ways to improve the oversight and operation of the program, as well as any legislative or rule changes that would be needed to implement its recommendations. In addition, the review will identify internal controls in typical federal grant or subsidy programs that are not present in the Universal Service Fund program and determine whether the manner in which other analogous programs handle the holding,

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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 it was 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.

<sup>24</sup>See 31 U.S.C. §§ 3321, 3322, 3325, and the Treasury Financial Manual.

<sup>25</sup>See 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." OMB Cir. A-76, Attachment A. Inherently governmental activities include the establishment of procedures and processes related to the oversight of monetary transactions or entitlements. OMB Circular A-76 further states that "[e]xercising ultimate control over the acquisition, use or disposition of United States government property . . . including establishing policies or procedures for the collection, control, or disbursement of appropriated and other federal funds" involves an inherently governmental activity.

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investment, and monitoring of program funds offers models for improving the operation of the Universal Service Fund.

We believe that NAPA's 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. Given this important ongoing study and the unresolved issues mentioned previously, Congress may wish to consider deferring a decision on permanently exempting the Universal Service Fund from the Antideficiency Act at this time and instead consider either granting the fund a two- or three-year exemption from the Antideficiency Act or crafting a limited exemption that would provide management flexibility. For example, Congress could specify that FCC could use certain receivables or assets as budgetary resources. These more limited solutions would allow time for the National Academy of Public Administration to complete its study of the Universal Service Fund program and report its findings to FCC. Congress and FCC could then comprehensively assess, based on decisions concerning the structure of the program, which federal requirements, policies, and practices should apply to the fund and to any entities administering the program. It could then be determined whether a permanent and complete exemption from the Antideficiency Act is warranted.

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## 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

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and libraries.<sup>26</sup> 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.<sup>27</sup>

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.<sup>28</sup> 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

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<sup>26</sup> 47 U.S.C. § 254(h)(2)(A).

<sup>27</sup> 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/T-RCED-98-243](#) (Washington, D.C.: July 16, 1998), pp. 15-16.

<sup>28</sup> 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.



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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-income 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.<sup>29</sup> 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.

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<sup>29</sup>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.

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## 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.

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## 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

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“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.

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.

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### 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.<sup>30</sup> In the FCC IG’s May 2004 Semiannual Report, however, the IG observes that audit findings are not

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<sup>30</sup>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.

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being addressed in a timely manner and that, as a result, timely action is not being taken to recover inappropriately disbursed funds.<sup>31</sup> 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,<sup>32</sup> 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."<sup>33</sup> 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.<sup>34</sup>

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

<sup>32</sup>[GAO/AIMD-00-21.3.1](#).

<sup>33</sup>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.

<sup>34</sup>Comments were due January 5, 2005; reply comments were due January 20, 2005.

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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 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.<sup>35</sup> 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.<sup>36</sup> 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.

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<sup>35</sup>FCC 04-190, para. 75.

<sup>36</sup>In 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."

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## FCC Has Been Slow to Act on Some E-Rate Appeals

Under FCC's rules, program participants can seek review of USAC's decisions,<sup>37</sup> 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.<sup>38</sup>

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.

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## Summary

In summary, 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

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<sup>37</sup>Virtually 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.

<sup>38</sup>The 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.

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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.

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.

We provided a draft of our report to FCC for comment. FCC said that it took a number of steps in 2004 to improve its management and oversight of the program, and anticipates taking additional steps during the coming year. FCC concurred with our recommendations on establishing performance goals and measures and developing a strategy for reducing the backlog of appeals. FCC did not concur with our recommendation that it conduct a comprehensive assessment concerning the applicability of government accountability requirements, policies, and practices. FCC maintains that it has already done so on a case-by-case basis. As noted in our report, however, we believe that major issues remain unresolved, such as the implications of FCC's determination that the Universal Service Fund constitutes an appropriation under the current structure of the E-rate program and the extent to which FCC has delegated some program functions to USAC.

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## 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

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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.

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This concludes my prepared statement. I would be pleased to respond to any questions that you or other Members of the Committee may have.

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**GAO Contact and  
Staff  
Acknowledgments**

For further information about this testimony, please contact me at (202) 512-2834. Edda Emmanuelli-Perez, John Finedore, Faye Morrison, and Mindi Weisenbloom also made key contributions to this statement.



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# Appendix I: Fiscal Law Issues Involving the Universal Service Fund

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There have been questions from the start of the E-rate program regarding the nature of the Universal Service Fund (USF) and the applicability of managerial, fiscal, and financial accountability requirements to USF. FCC has never clearly determined the nature of USF, and the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and GAO have at various times noted that USF has not been recognized or treated as federal funds for several purposes.<sup>1</sup> However, FCC has never confronted or assessed these issues in a comprehensive fashion and has only recently begun to address a few of these issues. In particular, FCC has recently concluded that as a permanent indefinite appropriation, USF is subject to the Antideficiency Act and its funding commitment decision letters constitute obligations for purposes of the Antideficiency Act. As explained below, we agree with FCC's determination. However, FCC's conclusions concerning the status of USF raise further issues related to the collection, deposit, obligation, and disbursement of those funds—issues that FCC needs to explore and resolve.

## Background

Universal service has been a basic goal of telecommunications regulation since the 1950s, when FCC focused on increasing the availability of reasonably priced, basic telephone service. *See Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 405-406 (5<sup>th</sup> Cir., 1999), cert. denied sub nom; *Celpage Inc. v. FCC*, 530 U.S. 1210 (2000). FCC has not relied solely on market forces, but has used a combination of explicit and implicit subsidies to achieve this goal. *Id.* Prior to 1983, FCC used the regulation of AT&T's internal rate structure to garner funds to support universal service. With the breakup of AT&T in 1983, FCC established a Universal Service Fund administered by the National Exchange Carrier

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<sup>1</sup>See GAO, *Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening*, GAO-01-105, 41. FCC's IG has also raised questions regarding the nature of USF. FCC's IG first looked at USF in 1999 as part of its audit of the commission's fiscal year 1999 financial statement. During that audit, the FCC IG questioned commission staff regarding the nature of the fund and, specifically, whether USF was subject to the statutory and regulatory requirements for federal funds. In the next year's audit, the FCC IG noted that the commission could not ensure that USF activities were in compliance with all laws and regulations because the issue of which laws and regulations were applicable to USF was still unresolved at the end of the audit. In the FCC IG's reports on FCC's financial statements from fiscal years 1999 to 2003, the IG consistently recommended that FCC management formally define in writing the financial management roles and responsibilities of FCC and USAC to avoid confusion and misunderstanding.

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Association (NECA). NECA is an association of incumbent local telephone companies, also established at the direction of the FCC. Among other things, NECA was to administer universal service through interstate access tariffs and the revenue distribution process for the nation's local telephone companies. At that time, NECA, a nongovernmental entity, privately maintained the Universal Service Fund outside the U.S. Treasury.

Section 254 of the Telecommunications Act of 1996 codified the concept of universal service and expanded it to include support for acquisition by schools and libraries of telecommunications and Internet services. Pub. L. No. 104-104, § 254, 110 Stat. 56 (1996) (classified at 47 U.S.C. § 254). The act defines universal service, generally, as a level of telecommunications services that FCC establishes periodically after taking into account various considerations, including the extent to which telecommunications services are essential to education, public health, and public safety. 47 U.S.C. § 254 (c)(1). The act also requires that “every telecommunications carrier that provides interstate telecommunications services shall contribute . . . to the specific, predictable, and sufficient mechanisms” established by FCC “to preserve and advance universal service.” *Id.*, §254 (d). The act did not specify how FCC was to administer the E-rate program, but required FCC, acting on the recommendations of the Federal-State Joint Board, to define universal service and develop specific, predictable, and equitable support mechanisms.

FCC designated the Universal Services Administrative Company (USAC), a nonprofit corporation that is a wholly owned subsidiary of NECA, as the administrator of the universal service mechanisms.<sup>2</sup> USAC administers the program pursuant to FCC orders, rules, and directives. As part of its duties, USAC collects the carriers' universal service contributions, which constitute the Universal Service Fund, and deposits them to a private bank account under USAC's control and in USAC's name. FCC has directed the use of USF to, among other things, subsidize advanced telecommunications services for schools and libraries in a program

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<sup>2</sup>In 1998, we issued a legal opinion on the then-current structure of the E-rate program where FCC directed the creation of the Schools and Libraries Corporation to administer the universal service program. Under the Government Corporation Control Act, an agency must have specific statutory authority to establish a corporation. 31 U.S.C. § 9102. We concluded that FCC did not have authority to create a separate independent corporation to administer the E-rate program. B-278820, Feb. 10, 1998. Subsequently, FCC eliminated the Schools and Libraries Corporation as a separate entity, and restructured the universal service program to its present form.

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commonly referred to as the E-rate program.<sup>3</sup> Pursuant to the E-rate program, eligible schools and libraries can apply annually to receive support and can spend the funding on specific eligible services and equipment, including telephone services, Internet access services, and the installation of internal wiring and other related items. Generally, FCC orders, rules, and directives, as well as procedures developed by USAC, establish the program's criteria. USAC carries out the program's day-to-day operations, such as answering inquiries from schools and libraries; processing and reviewing applications; making funding commitment decisions and issuing funding commitment decision letters; and collecting, managing, investing, and disbursing E-rate funds.

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. As a result of the application of the discount rate to the cost of the service, the school or library pays a percentage of the cost for the service and the E-rate program covers the remainder. E-rate discounts range from 20 percent to 90 percent.

Once the school or library has complied with the program's requirements and entered into agreements with vendors for eligible services, the school or library must file a form with USAC noting the types and costs of the services being contracted for, the vendors providing the services, and the amount of discount being requested. USAC reviews the forms and issues funding commitment decision letters.<sup>4</sup> The funding commitment decision letters notify the applicants of the decisions regarding their E-rate discounts. These funding commitment decision letters also notify the applicants that USAC will send the information on the approved E-rate discounts to the providers so that "preparations can be made to begin implementing . . . E-rate discount(s) upon the filing [by the applicant] of . . . Form 486." The applicant files FCC Form 486 to notify USAC that services have started and USAC can pay service provider invoices. Generally, the service provider seeks reimbursement from USAC for the discounted portion of the service, although the school or library also could pay the service provider in full and then seek reimbursement from USAC for the discount portion.

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<sup>3</sup>The term "E-rate" evolved from some individuals referring to the program as the "Education" rate.

<sup>4</sup>USAC could reduce the amount requested if the school or library has included ineligible services in its application or has calculated its discount category incorrectly.

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## What Is the Universal Service Fund?

The precise phrasing of the questions regarding the nature of USF has varied over the years, including asking whether they are federal funds, appropriated funds, or public funds and, if so, for what purposes? While the various fiscal statutes may use these different terms to describe the status of funds, we think the fundamental issue is what statutory controls involving the collection, deposit, obligation, and disbursement of funds apply to USF. As explained below, funds that are appropriated funds are subject, unless specifically exempted by law, to a variety of statutory provisions providing a scheme of funds controls. *See* B-257525, Nov. 30, 1994; 63 Comp. Gen. 31 (1983); 35 Comp. Gen. 436 (1956); B-204078.2, May 6, 1988. On the other hand, funds that are not appropriated funds are not subject to such controls unless the law specifically applies such controls. Thus, we believe the initial question is whether USF funds are appropriated funds.

FCC has concluded that USF constitutes a permanent indefinite appropriation. We agree with FCC's conclusion. Typical language of appropriation identifies a fund or account as an appropriation and authorizes an agency to enter into obligations and make disbursements out of available funds. For example, Congress utilizes such language in the annual appropriations acts. *See* 1 U.S.C. § 105 (requiring regular annual appropriations acts to bear the title "An Act making appropriations. . ."). Congress, however, appropriates funds in a variety of ways other than in regular annual appropriation acts.<sup>5</sup> Indeed, our decisions and those of the courts so recognize.

Thus, a statute that contains a specific direction to pay, and a designation of funds to be used, constitutes an appropriation. 63 Comp. Gen. 331 (1984); 13 Comp. Gen. 77 (1933). In these statutes, Congress (1) authorizes the collection of fees and their deposit into a particular fund, and (2) makes the fund available for expenditure for a specified purpose without further action by Congress. This authority to obligate or expend

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<sup>5</sup>Congress has recognized that an appropriation is a form of budget authority that makes funds available to an agency to incur obligations and make expenditures in a number of different statutes. For example, *see* 2 U.S.C. § 622(2)(A)(i) (budget authority includes "provisions of law that make funds available for obligation and expenditure . . . including the authority to obligate and expend the proceeds of offsetting receipts and collections") and 31 U.S.C. § 701(2)(C) (appropriations include "other authority making amounts available for obligation or expenditure").

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collections without further congressional action constitutes a continuing appropriation or a permanent appropriation of the collections. E.g., *United Biscuit Co. v. Wirtz*, 359 F.2d 206, 212 (D.C. Cir. 1965), cert. denied, 384 U.S. 971 (1966); 69 Comp. Gen. 260, 262 (1990); 73 Comp. Gen. 321 (1994). Our decisions are replete with examples of permanent appropriations, such as revolving funds and various special deposit funds, including mobile home inspection fees collected by the Secretary of Housing and Urban Development,<sup>6</sup> licensing revenues received by the Commission on the Bicentennial,<sup>7</sup> tolls and other receipts deposited in the Panama Canal Revolving Fund,<sup>8</sup> user fees collected by the Saint Lawrence Seaway Development Corporation,<sup>9</sup> user fees collected from tobacco producers to provide tobacco inspection, certification and other services,<sup>10</sup> and user fees collected from firms using the Department of Agriculture’s meat grading services.<sup>11</sup> It is not essential for Congress to expressly designate a fund as an appropriation or to use literal language of “appropriation,” so long as Congress authorizes the expenditure of fees or receipts collected and deposited to a specific account or fund.<sup>12</sup> In cases where Congress does not intend these types of collections or funds to be considered “appropriated funds,” it explicitly states that in law. *See e.g.*, 12 U.S.C. § 244 (the Federal Reserve Board levies assessments on its member banks to pay for its expenses and “funds derived from such assessments shall not be construed to be government funds or appropriated moneys”); 12 U.S.C. § 1422b(c) (the Office of Federal Housing Enterprise Oversight levies assessments upon the Federal Home Loan Banks and from other sources to pay its expenses, but such funds “shall not be construed to be government funds or appropriated monies, or subject to apportionment for the purposes of chapter 15 of title 31, or any other authority”).

Like the above examples, USF’s current authority stems from a statutorily authorized collection of fees from telecommunication carriers, and

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<sup>6</sup>59 Comp. Gen. 215 (1980).

<sup>7</sup>B-228777, Aug. 26, 1988.

<sup>8</sup>B-204078.2, May 6, 1988 and B-257525, Nov. 30, 1994.

<sup>9</sup>B-193573, Jan. 8, 1979; B-193573, Dec. 19, 1979; B-217578, Oct. 16, 1986.

<sup>10</sup>63 Comp. Gen. 285 (1984).

<sup>11</sup>B-191761, Sept. 22, 1978.

<sup>12</sup>B-193573, Dec. 19, 1979.

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expenditures for a specified purpose—that is, the various types of universal service.<sup>13</sup> Thus, USF meets both elements of the definition of a permanent appropriation.

We recognize that prior to the passage of the Telecommunications Act of 1996, there existed an administratively sanctioned universal service fund. With the Telecommunications Act of 1996, Congress specifically expanded the contribution base of the fund, statutorily mandated contributions into the fund, and designated the purposes for which the monies could be expended. These congressional actions established USF in a manner that meets the elements for a permanent appropriation and Congress did not specify that USF should be considered anything other than an appropriation.<sup>14</sup>

### **Does the Antideficiency Act Apply to USF?**

Appropriated funds are subject to a variety of statutory controls and restrictions. These controls and restrictions, among other things, limit the purposes for which they may be used and provide a scheme of funds control. *See e.g.*, 63 Comp. Gen. 110 (1983); B-257525, Nov. 30, 1994; B-228777, Aug. 26, 1988; B-223857, Feb. 27, 1987; 35 Comp. Gen. 436 (1956). A key component of this scheme of funds control is the Antideficiency Act. B-223857, Feb. 27, 1987. The Antideficiency Act<sup>15</sup> has been termed “the cornerstone of congressional efforts to bind the executive branch of

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<sup>13</sup>The United States Court of Appeals for the Fifth Circuit has recognized the governmental character of the funds. *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 426-428 (5<sup>th</sup> Cir., 1999), cert. denied sub nom; *Celpage Inc. v. FCC*, 530 U.S. 1210 2212 (2000). The Fifth Circuit held that USF funds are statutorily mandated special assessments supporting a federal program mandated by Congress. FCC has also requested that the Department of Justice recognize that USF are federal funds for purposes of representing FCC and the United States in litigation involving USF, such as the False Claims Act.

<sup>14</sup>The Senate passed a “sense of the Senate” provision that stated, “Federal and State universal service contributions are administered by an independent nonfederal entity and are not deposited into the federal Treasury and therefore are not available for federal appropriations.” See section 614, H.R. 2267, as passed by the Senate (Oct. 1, 1997). However, the purpose of that resolution was to respond to an attempt to withhold USF payments as a means to balance the federal budget or achieve budget savings. We understand section 614, H.R. 2267 intended to insulate USF from budgetary pressures and not to express a view on the proper fiscal treatment of USF. Our interpretation of USF as a permanent appropriation is consistent with the intent that USF is only available for universal service and could only be changed if Congress amended the law to permit USF to be used for other purposes.

<sup>15</sup>31 U.S.C. §§ 1341, 1342 and 1517.

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government to the limits on expenditure of appropriated funds.”<sup>16</sup>

Primarily, the purpose of the Antideficiency Act is to prevent the obligation and expenditure of funds in excess of the amounts available in an appropriation or in advance of the appropriation of funds. 31 U.S.C. § 1341(a)(1). FCC has determined that the Antideficiency Act applies to USF, and as explained below, we agree with FCC’s conclusion.

The Antideficiency Act applies to “officer[s] or employee[s] of the United States Government . . . mak[ing] or authoriz[ing] an expenditure or obligation . . . from an appropriation or fund.” 31 U.S.C. § 1341(a). As established above, USF is an “appropriation or fund.” The fact that USAC, a private entity whose employees are not federal officers or employees, is the administrator of the E-rate program and obligates and disburses funds from USF is not dispositive of the application of the Antideficiency Act. This is because, as the FCC recognizes, it, not USAC, is the entity that is legally responsible for the management and oversight of the E-rate program and FCC’s employees are federal officers and employees of the United States subject to the Antideficiency Act.<sup>17</sup>

Where entities operate with funds that are regarded as appropriated funds, such as some government corporations, they, too, are subject to the Antideficiency Act. *See e.g.*, B-223857, Feb. 27, 1987 (funds available to Commodity Credit Corporation pursuant to borrowing authority are subject to Antideficiency Act); B-135075-O.M., Feb. 14, 1975 (Inter-American Foundation). The Antideficiency Act applies to permanent appropriations such as revolving funds<sup>18</sup> and special funds. 72 Comp. Gen. 59 (1992) (Corps of Engineers Civil Works Revolving Fund subject to Antideficiency Act); B-120480, Sep. 6, 1967, B-247348, June 22, 1992, and B-260606, July 25, 1997 (GPO revolving funds subject to Antideficiency Act);

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<sup>16</sup>Hopkins & Nutt, *The Anti-Deficiency Act (Revised Statutes 3679) and Funding Federal Contracts: An Analysis*, 80 Mil. L. Rev. 51, 56 (1978).

<sup>17</sup>Under FCC’s rules, USAC is prohibited from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. 47 C.F.R. § 54.702(c). As addressed below, one of the issues that remains to be resolved is whether USAC is authorized to take the actions that obligate and disburse USF funds pursuant to FCC orders, rules, and directives or whether FCC must implement additional steps to ensure that obligations and disbursements are specifically authorized by FCC officials and employees.

<sup>18</sup>Revolving funds are funds authorized by law to be credited with collections and receipts from various sources that generally remain available for continuing operations of the revolving fund without further congressional action. *See* 72 Comp. Gen. 59 (1992).

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71 Comp. Gen. 224 (1992) (special fund that receives fees, reimbursements, and advances for services available to finance its operations is subject to Antideficiency Act).

Where Congress intends for appropriated funds to be exempt from the application of statutory controls on the use of appropriations, including the Antideficiency Act, it does so expressly. *See e.g.*, B-193573, Jan. 8, 1979; B-193573, Dec. 19, 1979; B-217578, Oct. 16, 1986 (Saint Lawrence Seaway Development Corporation has express statutory authority to determine the character and necessity of its obligations and is therefore exempt from many of the restrictions on the use of appropriated funds that would otherwise apply); B-197742, Aug. 1, 1986 (Price-Anderson Act expressly exempts the Nuclear Regulatory Commission from Antideficiency Act prohibition against obligations or expenditures in advance or in excess of appropriations). There is no such exemption for FCC or USF from the prohibitions of the Antideficiency Act. Thus, USF is subject to the Antideficiency Act.

### **Do the Funding Commitment Decision Letters Issued to Schools and Libraries Constitute Obligations?**

An important issue that arises from the application of the Antideficiency Act to USF is what actions constitute obligations chargeable against the fund. Understanding the concept of an obligation and properly recording obligations are important because an obligation serves as the basis for the scheme of funds control that Congress envisioned when it enacted fiscal laws such as the Antideficiency Act. B-300480, Apr. 9, 2003. For USF's schools and libraries program, one of the main questions is whether the funding commitment decision letters issued to schools and libraries are properly regarded as obligations. FCC has determined that funding commitment decision letters constitute obligations. And again, as explained below, we agree with FCC's determination.

Under the Antideficiency Act, an agency may not incur an obligation in excess of the amount available to it in an appropriation or fund. 31 U.S.C. § 1341(a). Thus, proper recording of obligations with respect to the timing and amount of such obligations permits compliance with the Antideficiency Act by ensuring that agencies have adequate budget



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authority to cover all of their obligations.<sup>19</sup> B-300480, Apr. 9, 2003. We have defined an “obligation” as a “definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received.” *Id.* A legal liability is generally any duty, obligation or responsibility established by a statute, regulation, or court decision, or where the agency has agreed to assume responsibility in an interagency agreement, settlement agreement or similar legally binding document. *Id.* citing to Black’s Law Dictionary 925 (7<sup>th</sup> ed. 1999). The definition of “obligation” also extends to “[a] legal duty on the part of the United States which constitutes a legal liability or which could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. . . .” *Id.* citing to 42 Comp. Gen. 733 (1963); *see also McDonnell Douglas Corp. v. United States*, 37 Fed. Cl. 295, 301 (1997).

The funding commitment decision letters provided to applicant schools and libraries notify them of the decisions regarding their E-rate discounts. In other words, it notifies them whether their funding is approved and in what amounts. The funding commitment decision letters also notify schools and libraries that the information on the approved E-rate discounts is sent to the providers so that “preparations can be made to begin implementing . . . E-rate discount(s) upon the filing [by applicants] of . . . Form 486.” The applicant files FCC Form 486 to notify USAC that services have started and USAC can pay service provider invoices. At the time a school or library receives a funding commitment decision letter, the FCC has taken an action that accepts a “legal duty . . . which could mature into a legal liability by virtue of actions on the part of the grantee beyond the control of the United States.” *Id.* citing 42 Comp. Gen. 733, 734 (1963). In this instance, the funding commitment decision letter provides the school or library with the authority to obtain services from a provider with the commitment that it will receive a discount and the provider will be reimbursed for the discount provided. While the school or library could decide not to seek the services or the discount, so long as the funding commitment decision letter remains valid and outstanding, USAC and FCC no longer control USF’s liability; it is dependent on the actions taken by

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<sup>19</sup>Legal liability for obligational accounting and to comply with the Antideficiency Act and the Recording Statute, 31 U.S.C. § 1501 is distinct from accounting liabilities and projections booked in its proprietary accounting systems for financial statement purposes. For proprietary accounting purposes, a liability is probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. See B-300480, Apr. 9, 2003, and FASAB Statement of Federal Financial Accounting Standards Number 1.

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the other party—that is, the school or library. In our view, a recordable USF obligation is incurred at the time of issuance of the funding commitment decision letter indicating approval of the applicant’s discount. Thus, these obligations should be recorded in the amounts approved by the funding commitment decision letters. If at a later date, a particular applicant uses an amount less than the maximum or rejects funding, then the obligation amount can be adjusted or deobligated, respectively.

Additional issues that remain to be resolved by FCC include whether other actions taken in the universal service program constitute obligations and the timing of and amounts of obligations that must be recorded. For example, this includes the projections and data submissions by USAC to FCC and by participants in the High Cost and Low Income Support Mechanisms to USAC. FCC has indicated that it is considering this issue and consulting with the Office of Management and Budget. FCC should also identify any other actions that may constitute recordable obligations and ensure those are properly recorded.

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