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WASTE, FRAUD, AND ABUSE CON-
CERNS WITH THE E-RATE PROGRAM

A STAFF REPORT

ADOPTED BY THE

SUBCOMMITTEE ON OVERSIGHT AND
INVESTIGATIONS

OF THE

COMMITTEE ON ENERGY AND
COMMERCE

U.S. HOUSE OF REPRESENTATIVES
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U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

November 2, 2005

To the Members of the Committee on Energy and Commerce:

It is our pleasure to forward to you for your information the bipartisan report entitled “Waste, Fraud, and Abuse Concerns in the E-rate Program,” unanimously adopted by the Subcommittee on Oversight and Investigations on October 18, 2005. This report details the Subcommittee’s two-year investigation of the E-rate program, which is the Universal Service funding mechanism that subsidizes the provision of advanced telecommunications services for schools and libraries.

The Subcommittee’s investigation revealed a well-intentioned program that nevertheless has suffered from poor implementation from the very start. These structural weaknesses made it particularly susceptible to waste, fraud, and abuse—specific cases of which were examined during four Subcommittee hearings on the E-rate program. To be sure, Congress shares some responsibility for the program’s flaws because the program is founded on a very general statutory basis. Looking forward, more time should be devoted to crafting the legislative framework of this program to ensure it achieves the goals that we want it to achieve.

It is clear to us, as we consider the work laid out in this report, that many E-rate program weaknesses must be addressed legislatively to avoid waste and misuse. In light of this, we are transmitting this report to the full Energy and Commerce Committee, and commend it particularly to our colleagues on the Telecommunications and Internet Subcommittee, so that our work can assist the Committee in crafting the appropriate legislative proposals. The report provides a bipartisan list of findings, and a set of eleven principles that should help guide our deliberations over program reform. We appreciate your giving it your careful consideration.

Sincerely,

ED WHITFIELD, *Chairman*
BART STUPAK, *Ranking Member*
Subcommittee on Oversight and Investigations

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WASTE, FRAUD, AND ABUSE CONCERNS WITH THE E-RATE PROGRAM

BIPARTISAN STAFF REPORT FOR THE USE OF
THE COMMITTEE ON ENERGY AND COMMERCE

October 18, 2005

I. INTRODUCTION AND OVERVIEW

In 1996, Congress mandated that schools and libraries receive discounted telecommunications services through the newly codified Universal Service Fund. In turn, the Federal Communications Commission (FCC) proceeded to implement that mandate, commonly known today as the E-rate program, through a private non-profit corporation known as the Universal Service Administrative Company (USAC). Within USAC, the Schools and Libraries Division (SLD) is responsible for the daily administration of the E-rate program. Between 1998 and the present time, USAC has “committed” over \$15 billion and disbursed over \$10 billion, to discount the costs of eligible telecommunications projects for schools and libraries throughout the country.

While E-rate has arguably benefited the nation’s children, the program falls far short as an example of efficiency, effectiveness, or integrity. In fact, the Subcommittee on Oversight and Investigations’ in-depth examination of the E-rate program uncovered serious instances of waste, fraud, and abuse. This work highlighted instances in which all program participants—the FCC, USAC, schools, and vendors—have neglected their respective obligations and responsibilities under the program’s rules.

Key Findings

The Subcommittee’s investigation developed along several directions, culminating in three public “case study” style hearings and the compilation of significant additional information regarding the E-rate programs at Chicago Public Schools and Atlanta Public Schools. Further information was developed, at the direction of the Subcommittee, through a comprehensive review by the Government Accountability Office (GAO), which was reviewed in a fourth public hearing on the E-rate program. Key findings from the Subcommittee investigation include:

- The FCC crafted an ambitious multi-billion-dollar funding program, utilizing an “unusual” organizational structure, and then never conducted a comprehensive assessment to determine which federal requirements, policies, and practices apply to the E-rate program, to USAC, or to the Universal Service Fund itself.
- Although more than \$15 billion has been “committed” by the E-rate program during the past 8 years, the FCC did not develop performance goals and measures that could be utilized to as-

sess the specific impact of the funds and to improve the management of the program.

- The FCC's three key oversight mechanisms for the E-rate program—rulemaking procedures, beneficiary audits, and reviews of USAC decisions (i.e., appeals decisions)—are not sufficient to manage the program.
- Over the course of three program years, more than \$100 million in E-rate funds were provided to one large school district after it certified that its E-rate funded network would be operational and put to educational use, when, in fact, it was never made operational or put to any significant educational use.
- The FCC's failure to help resolve the above school district's enormous mismanagement and planning problems contributed to the waste of E-rate funds, and reflects the underlying deficiencies of the FCC's program management and oversight.
- Currently, the E-rate program does not require beneficiaries of large sums of E-rate funds to comply with standard federal oversight and accounting requirements, such as the Single Audit Act.
- Some school districts have acquired goods and services through the E-rate program without using a formal bidding process, contrary to both the program's rules and local regulations, even though those districts might have otherwise followed the E-rate Form 470 application process.
- A fundamental weakness in the program involves technology planning. Some school districts have received E-rate related goods and services without an adequate technology plan. More broadly, E-rate's current technology plan requirements provide no meaningful protection from "gold-plating" (procurement of technology goods and services far beyond reasonable school district needs and resources).
- The FCC Inspector General (IG) cannot provide adequate assurance that the program is sufficiently protected against waste, fraud, and abuse. Furthermore, the FCC Wireline Competition Bureau (WCB) does not know the magnitude of potential fraud.
- The FCC IG faces several obstacles in implementing effective independent oversight of the program, including insufficient resources to conduct audits and provide audit support to law enforcement investigations.
- The certifications contained on E-rate program application documents apparently have little effect in deterring some school officials and some vendors from taking advantage of the program's weaknesses. In one case examined by the Subcommittee, school officials and several employees of service providers forged documents and signatures as part of a conspiracy to defraud the E-rate program.
- Weak E-rate program competition requirements and inadequate oversight allowed a group of vendors to completely manipulate the competitive process for E-rate program goods and services, without USAC detecting the fraud.
- Weaknesses in the E-rate program application process and related certifications permitted non-competitive procurement of E-rate program goods and services around the country in Funding Years 2001 and 2002. The flawed application process

resulted in the waste of millions of dollars in one school district in Funding Year 2001, and almost led to the waste of tens of millions more among 21 other large school districts in Funding Year 2002. Today, the FCC continues to allow anti-competitive or insufficiently competitive procurement practices, due to remaining weaknesses in the application process.

- The FCC only recently established guidelines for debarment of vendors and applicants, but set standards of program abuse too high, requiring first a civil judgment or criminal conviction against the participant before a suspension may occur and debarment can be considered.
- The E-rate program's ambiguous rules and procedures, and extensive delay in the distribution of funding, create significant confusion among applicants and vendors. This confusion and delay tends to increase program waste.
- E-rate program fund disbursements generally go directly to vendors, rather than being disbursed through the program applicants (the schools and libraries), which lessens applicants' control over work performed and diffuses responsibility and accountability for program integrity; although this structure stems from the FCC's interpretation of the underlying statutory language, it nevertheless makes oversight and enforcement more difficult.

In sum, the Subcommittee's investigative work reveals a well-intentioned program that nonetheless is extremely vulnerable to waste, fraud, and abuse, is poorly managed by the FCC, and completely lacks tangible measures of either effectiveness or impact. This bipartisan staff report recommends certain principles that should guide any effort to improve the E-rate program. These principles are substantially based upon the results of the Subcommittee's investigation and staff opinion that effective improvements may likely require significant legislative reform.

Recommendations:

Based upon the results of the E-rate program investigation, staff identified several overarching principles that should guide program reform:

- 1) The FCC and USAC must conduct more rigorous oversight. To accomplish the necessary rigorous oversight and strong program auditing, the FCC and USAC require adequate personnel resources.
- 2) The E-rate program must have concrete and achievable goals and measures of effectiveness, so that Congress can assess the specific impact and value of program spending. Among a number of key issues, Congress should consider: (a) whether the FCC is the proper agency to manage and oversee the E-rate program; (b) whether the largely arbitrary \$2.25 billion annual price tag is appropriately set; (c) whether control and management of this large sum is appropriately delegated to a non-governmental entity; and, (d) the extent to which E-rate program discounts should cover technological infrastructure and related services, i.e., whether the program covers too much, or should expand to subsidize key technology components that are not

currently eligible, such as computers, software, and teacher training.

- 3) In the interest of ensuring the maximum return on E-rate program funds, the E-rate program must have a mechanism to ensure that “gold-plating” is minimized. That is, schools should request and receive only what they genuinely will put to effective use, and technology plans should not be an empty exercise. The FCC and USAC should develop a mechanism to verify that applicants’ requests match legitimate education-technology needs; this will require revising the technology planning process and requirements.

Among other things, complete and approved E-rate program technology planning documents should be *the required first step* before posting a Form 470. These planning documents cannot be broad-brush, but rather need to: (a) account for the current state of the supporting physical infrastructure at each school for which funding is requested; (b) specify exactly how the technology will be implemented in support of the curriculum, including details of the necessary level of teacher training and the school district’s plan for providing such training; and (c) include the district’s specific budget commitments for infrastructure, training, and maintenance, as well as the computers and other complementary equipment required to make use of the E-rate program funded internal connections being requested.

- 4) Reform should incorporate the GAO’s recent recommendations for the FCC, including that the FCC: (a) comprehensively determine which federal accountability requirements apply to E-rate; (b) establish meaningful E-rate program performance goals and measures; and (c) take steps to reduce its backlog of appeals. The FCC must take these necessary and reasonable actions in order to begin to address the problems identified by this Subcommittee, the FCC IG, and the GAO. In addition, Congress should consider directing the GAO to continue its examination of the E-rate program, focusing on the issues relating to the complexities posed by the FCC’s organizational relationship with USAC and provide guidance to Congress and the FCC on the questions that flow from this organizational structure.
- 5) The E-rate program requires an organizational structure that encourages greater accountability of all program participants—including vendors, consultants, schools, USAC, and the FCC Wireline Competition Bureau.
- 6) The FCC must acquire, and promptly provide to Congress, some tangible measure of the extent and scope of program waste, fraud, and abuse, i.e., statistically significant auditing must be undertaken immediately and accomplished before the end of this Congress. The necessary resources should be made available to ensure an appropriate number of beneficiary audits can be performed to make an accurate assessment of program waste, fraud, and abuse.
- 7) School districts should hold a greater “stake” in their applications for E-rate program discounts. This may be accomplished in a number of ways, including several possibilities that were

suggested during the Subcommittee’s hearings, such as: (a) requiring higher co-payments by the school districts; (b) drafting certifications for vendors and school officials that include tougher criminal penalties; (c) restructuring the program into a reimbursement paradigm (i.e., direct reimbursement to schools and libraries); or (d) conducting verification and inspection of E-rate program related work before discounts are paid out. There are likely other creative options to achieve this goal, as well.

- 8) The E-rate program requires stronger “built-in” disincentives to waste, fraud, and abuse (as opposed to the external disincentives of FCC IG auditing or Justice Department criminal prosecution), including such options as mandatory audits, civil penalties for rule violations, and more flexible provisions for program debarment.
- 9) The program needs a much more robust competitive bidding structure than it currently possesses, in order to ensure that E-rate program funds support the highest per-dollar value possible. Achieving this goal is not simply a matter of mandating that price should be considered the primary factor. Congress should consider whether an adequate competitive bidding environment could be better assured by incorporating relevant portions of the Federal Acquisition Regulations (FAR) to the E-rate program’s rules and regulations.
- 10) The FCC and USAC should act immediately to specify that, for all “Priority II” (internal connections) applications exceeding a reasonable threshold, a portion of the district’s approved funding must be set aside for an independent audit of the total funds committed. Further, USAC must be provided with a copy of all audit results within 30 days of audit completion and within one year of the expenditure.
- 11) The GAO should examine the potential for (and scope of any) waste, fraud, and abuse in the E-rate program’s funding of “Priority I” services (telecommunications and Internet access fees).

II. BACKGROUND

The E-rate Program. Under the Telecommunications Act of 1996 (P.L. 104-104) (the Act), Congress codified a longstanding policy commitment to ensure “universal service” in the provision of telecommunications services, and expanded that policy to cover schools and libraries. Specifically, to “assure that no one is barred from benefiting from the power of the information age,”¹ Congress mandated that elementary and secondary schools, and libraries, be offered discounted access to telecommunications services for educational purposes, including “advanced” telecommunications services.

Consequently, the FCC, which is responsible for implementing universal service policy, established the Schools and Libraries Universal Support Mechanism—more popularly known as the E-rate program. In late 1997, the program began preparations for pro-

¹ See Telecommunications Act of 1996, Conference Report, U.S. House of Representatives (Report 104-458) at 132-33.

viding discounts to eligible schools and libraries for fiscal year² 1998. The E-rate program is funded through the Universal Service Fund (USF, or, the Fund), which is supported by a “Universal Service Fee” charged to telecommunications providers—and which is usually passed on to consumers’ phone bills.³ USAC administers the Fund under the direction of the FCC. USAC is a non-profit corporation and wholly-owned subsidiary of the National Exchange Carrier Association (NECA), whose members are comprised of about 900 “local” telephone companies.⁴ In 2004, USAC disbursed approximately \$5.7 billion in support of four “universal support mechanisms”: \$3.5 billion for the “high cost” program, \$760 million for the “low-income” program, \$21.7 million for the “rural health care” program, and \$1.4 billion for the E-rate program.

The E-rate program provides funding to service providers (telecommunications vendors) to support discounts for schools and libraries in three service categories: telecommunications, Internet access, and “internal connections” (i.e., the cabling and network infrastructure necessary for multiple users within schools to access the Internet). The discounts range from 20% to 90% of the costs of eligible products and services, depending on both the rate of participation in the National School Lunch Program and the urban/rural status of the school or school district. USAC publishes a comprehensive and annually updated list of goods and services that are eligible for E-rate program discounts.

As of October 2005, USAC collected and approved for disbursement roughly \$15 billion since the program’s start. Approximately \$10 billion of that amount has actually been disbursed to E-rate program service providers. The amount of funding available each year for the E-rate program is capped at \$2.25 billion. However, current rules permit unused fund balances to be rolled over to following years. Thus, \$2.4 billion was available for funding commitments in 2004. Each year, requests from nearly 40,000 applicants for E-rate program funds far exceed the available funding. (Approximately \$4.3 billion in requests were submitted in 2004.) Because of the limited funds, program rules prioritize discount commitments first by type of service and then by discount level of the applicant. Under program rules, all eligible applicants receive support for so-called “Priority I” services—that is, telecommunications and Internet access fees. Only applicants qualifying for very high discounts (typically at 80% and higher) receive the remaining support for internal connections, or “Priority II” services, which account for the largest amount of applicant funding requests.

USAC develops and implements procedures, under the supervision of the FCC, to administer the E-rate program in accordance with the program rules.⁵ Essentially, for an eligible applicant to receive funding it must choose services that it intends to use effectively for educational purposes, and must do so through a competi-

²An E-rate program fiscal year is referred to herein as a “Funding Year.” Generally, a given E-rate Funding Year runs from July 1st of one calendar year to June 30th or September 30th of the next calendar year, depending on the category of goods or services funded.

³At the time of this report, the fee assessed on rate-payers’ phone bill amounts to 10% of the total long distance calling costs.

⁴The genesis of the organizational structure and relationship of USAC, NECA, and the FCC, and the resulting concerns, are explained in more detail *infra*, pages 46-47, and also in the GAO Report prepared for the Committee.

⁵See Code of Federal Regulations (CFR), Title 47, Part 54, §§1 *et. seq.*

tive bidding process (to ensure cost effectiveness). Applicants must also certify that they have the resources—including a budget, computers, teacher training, and infrastructure—necessary to make effective use of the products and services for which they request discounts. Put another way, applicants are required to “do their homework” before applying for funds. Schools accomplish this by developing technology plans, which are meant to set forth in detail how the applicant intends to use the technologies and how it plans to integrate technology into its curriculum.— Applicants also must bear the costs for any necessary initial planning for the implementation of E-rate program products and services, such as design of technology architecture, determination of project scope, and evaluation of the products and services needed.

After determining the products and services for which they will seek E-rate program discounts, the applicants file—for posting on USAC’s Web site—an FCC “Form 470.” Applicants must supply information on this basic form with sufficient specificity for potential bidders to formulate bids for eligible E-rate program products and services. According to the statute, E-rate program discounts must be provided to eligible applicants who make a “bona fide request” for products and services for educational purposes. Through its May 8, 1997 Universal Service Order, the FCC attempted to implement this requirement by mandating that applicants (*i.e.*, the school or school district):⁶ “(1) conduct internal assessments of the components necessary to use effectively the discounted services they order, (2) submit a complete description of the services they seek so that it may be posted for competing service providers to evaluate, and (3) certify to [sic] certain criteria under penalty of perjury.”⁷

Since the program’s inception, the integrity of this E-rate program application process has relied (almost exclusively) upon applicants to (1) certify that they possess the necessary resources and plans to use the products and services for which they request E-rate program subsidies, and (2) choose the most cost-effective products and services through a competitive bidding process for those products and services. When applicants subsequently select the most cost-effective bid or bids, price must be the primary factor considered. After winning vendors are chosen from the pool of bidders, the—applicant requests funding from USAC for specific products and services on an FCC “Form 471.”

After the applicant files a Form 471, having its own set of mandatory certifications, USAC evaluates the request and then makes a funding commitment to the applicant, adjusting the request if necessary or rejecting the request outright if it fails to conform to the program’s rules. E-rate program funds are disbursed by USAC’s Schools and Libraries Division (SLD) directly to service providers, based upon invoices submitted by the service provider and a certification submitted by the applicant that installation of the products and services has or is about to commence, or has been completed. Applicants submit their “co-payment” for the E-rate program goods and services directly to the service providers.

⁶This report’s references to schools and school systems apply to libraries as well.

⁷See Federal-State Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157, ¶ 570.

While disbursing funds, USAC also conducts invoice review, special investigations, and site visits when circumstances warrant. Finally, USAC draws on both its internal audit staff and independent auditors (in consultation with the FCC and the FCC IG) to gather further information regarding program integrity and to identify waste, fraud, or abuse of the disbursed funds.

Since the program's inception, however, serious questions concerning the ability of these administrative processes to effectively tackle the risks of waste, fraud, and abuse have been repeatedly raised—despite some continuing efforts to improve program oversight and management by both the FCC and USAC. These questions highlight fundamental weaknesses in the program's application and review processes, as well as in the overall structure and direction of the program.

The Subcommittee Investigation. In January 2003, the Subcommittee on Oversight and Investigations initiated its investigation of the E-rate program to examine the potential for waste, fraud, and abuse in the program. The investigation was in part prompted by news reports of incidents in December 2002 that suggested serious problems of program waste, fraud, and abuse. In particular, a New York City E-rate program vendor was indicted on federal charges for defrauding the E-rate program. Additionally, the FCC IG's October 31, 2002, semi-annual report to Congress described a number of concerns with the program, as well as the rise in law enforcement activity, including the creation of a special Department of Justice (DOJ) E-rate program task force. Further, the FCC IG criticized the insufficient funding devoted to oversight and concluded that, "until such time as resources and funding are available to provide adequate oversight for the USF program, we are unable to give the Chairman, Congress and the public an appropriate level of assurance that the program is protected from fraud, waste and abuse."

At the outset, Committee staff interviewed FCC and USAC officials, GAO staff, as well as some E-rate program vendors, to identify the scope and nature of the issues affecting the E-rate program. That initial work revealed that problems of waste, fraud, and abuse have followed the E-rate program from the beginning. For example, Committee staff learned that the relatively small number of targeted audits of funding beneficiaries over the first two years identified more than \$10 million in inappropriate funding disbursements.

Also at this time, there were approximately 30 active Federal and state investigations of either vendors or recipients of E-rate program funds around the United States—involving, in aggregate, more than \$200 million of questionable funding. Moreover, ongoing and ensuing work by the FCC IG, and concerns raised by both the IG and the GAO, revealed an inadequate system of E-rate program oversight. The IG had estimated that the E-rate program, given the magnitude of its yearly funding, may face up to \$180 million in improper and fraudulent disbursements annually, based upon a GAO analysis of similar-sized programs. This also suggested that the emerging evidence of fraud and abuse around the country might just be the tip of an iceberg. Committee concerns on this front were underscored by the absence of a statistically representative audit

of the full program. As a result, the Committee had little reassurance that the efforts made by the FCC and USAC to administer the E-rate program and to improve program oversight and auditing were actually addressing the full extent of the problems.

In light of this information, then-Chairman Tauzin and then-Subcommittee Chairman Greenwood wrote the FCC and USAC on March 13, 2003, requesting records relating to implementation, oversight, and management of the E-rate program.⁸ Further review of preliminary information from vendors and applicants participating in the program prompted the Committee to seek information on the implementation of E-rate program products and services at the school level. Data showed that the largest potential for waste, fraud, and abuse resided with the provision of “internal connections” (Priority II) products and services. Accordingly, staff identified several internal connections service providers whose participation in the program was particularly large and active.⁹ On July 14, 2003, then-Chairman Tauzin and then-Subcommittee Chairman Greenwood wrote to the five largest internal connections vendors over the duration of the E-rate program (by funding receipts), including the companies SBC Telecommunications and IBM. Additionally, the Committee wrote to seven other vendors that ranked among those with the largest rate of increase in internal connections funding requests (over \$30 million for any given year), which included the company NEC Business Network Solutions, among others.

Subsequent document productions and related interviews focused the inquiry on certain topics that illuminated some of the main problems plaguing the E-rate program. The staff pursued several case studies that resulted in four public hearings by the Oversight and Investigations Subcommittee, as well as additional work that, while not directly addressed during the hearings, provided further information that has proven helpful in identifying major program issues.

In the course of this work, it is important to note, the Committee staff observed instances of the E-rate program working effectively. Such cases helped to underscore the importance of identifying E-rate program weaknesses and vulnerabilities, and of developing meaningful fixes to the program.

An example of the E-rate program’s potential can be found on the southwest side of the City of Chicago, at the Nathaniel Greene Elementary School (Greene School). Of the 803 students in kindergarten through fifth grade at Greene, 88% are Hispanic. For many, if not most, English is a second language. Roughly 94% of the students are enrolled in the free or reduced lunch program. Nonetheless, the combination of technology, determined administrators, and a well-trained and dedicated faculty is transforming the educational experience to a level comparable with the best that subur-

⁸The requests to USAC, which fully cooperated in the document production, were augmented by a subpoena on April 29, 2003 for certain records that USAC could not initially provide due to confidentiality concerns.

⁹The investigation focused on waste, fraud, and abuse in provision of Priority II funding; it did not examine the provision of Priority I services to determine the extent, if any, of problems under that category of funding. The FCC IG testified that his office has not conducted enough work to draw a conclusion about problems in that funding category, and acknowledged that waste, fraud, and abuse may exist there as well.

ban schools have to offer. Not only are computers used effectively in the lab and the library, but in each classroom as well. Even a brief visit found kindergarten students spelling out words on their computers, third grade students preparing PowerPoint® presentations, fifth grade students forecasting the weather, and a science fair that would impress any elementary school teacher. Most important, the children were truly engaged in the learning process and appeared to delight in their assignments. The E-rate program has played a big role in providing the opportunity for learning in this inner-city community.¹⁰

The School District of Philadelphia presents another positive example of the E-rate program's impact. When that district began to participate in the E-rate program, much of the school district's physical infrastructure was obsolete and it had already completed a five-year plan to modernize education-related technology. Instead of falling for vendor temptation to "gold-plate" problem schools, Philadelphia chose a slower and economically reasonable path to maximize the efficient use of technology. The school district applied for E-rate program funds only as the technology plan dictated, and it never requested more than could be effectively integrated in any given year.

School district officials used the E-rate program as a complement, not as a crutch. Local funding sources were used to upgrade the schools' electrical systems, buy computers, develop software, and, in part, to install wireless networks and construct a fiber-optic network. Philadelphia's plan emphasized and funded training for teachers and students. School district officials tied the installation of technology in each of the schools to both professional development and specific curriculum needs—hence, assuring productive and efficient use. The school district refrained from installing expensive technology simply because E-rate program funds were available.

Philadelphia's completion of an integrated and comprehensive technology plan, effective teacher training, and resistance to overstating its needs or procuring unnecessary goods and services, all demonstrate the proper use of the E-rate program.

III. CASE STUDIES AND OTHER WORK OF THE INVESTIGATION

The following section details the key facts of specific case studies and their related hearings, followed by additional information relating to those parts of the investigation concerning E-rate program participation by Chicago Public Schools and Atlanta Public Schools, and finally, a discussion regarding the GAO's recent E-rate program report that was requested by the Subcommittee.

A. E-rate and the Puerto Rico Department of Education (PRDOE)

In the case of Puerto Rico's experience with seeking E-rate program discounts for its public schools, the situation involved: (1) questionable planning and a clear failure by administrators of the school district to make any use of E-rate program funded infrastructure and ensure the integrity of the investment of E-rate pro-

¹⁰The Greene School's Web site can be found at <http://www.greene.cps.k12.il.us/>

gram funds; (2) questionable implementation of and billing for E-rate program products and services by the vendors, Puerto Rico Telephone Company (PRTC) and Data Research Corporation (DRC); and, (3) a critical failure on the part of USAC and especially the FCC to respond effectively to the severity of a situation in which more than \$100 million of E-rate program funds had been spent, with nothing significant to show for it. Thus, 50,000 students have been graduating each year from the largest school system in the country without having any of the broadband Internet access (IA) that the program is intended to support.

PRDOE operates the entire public school system for the Commonwealth of Puerto Rico, overseeing approximately 610,000 students and 1,540 schools. By number of school facilities, the system is the largest in the United States (by comparison, the New York City Board of Education administers 1,200 schools but one million students, and ranks second). Additionally, Puerto Rico is among the poorest school districts in the United States, eligible for 90% E-rate program discounts district-wide.

PRDOE applied for funding in each of the first six years of the E-rate program—from 1998 to 2003—and has not applied for funding since. In the first three years of the program—1998, 1999, and 2000—USAC committed and disbursed funds on behalf of PRDOE to two service providers, PRTC and DRC. All told, USAC disbursed \$101.2 million during this period—with PRTC receiving a total of \$31.6 million for the supply of Internet access and broadband (T1) service, and DRC receiving a total of \$69.6 million for a combination of internal connections (totaling \$58.6 million), Internet access, and T1 service fees. PRDOE's E-rate program applications stated that the funding was intended to support broadband service and the underlying infrastructure to enable Internet access for all 1,540 schools.

A new governor of Puerto Rico, elected in November 2000, appointed a new Secretary of Education, who assumed leadership of PRDOE in January 2001. After assuming office, the new administration continued the Funding Year's E-rate program application process started by the departing administration. Over the course of 2001, the new PRDOE administration progressively learned through vendors, school personnel, and site visits of chronic problems within the schools—in terms of electrical infrastructure, security, inadequate teacher training, and other facility problems. Most important, the fact emerged that very few schools—and virtually no students—actually had access to computers connected to the Internet.

In the spring of 2001 the Office of the Comptroller of Puerto Rico reported its preliminary findings of an audit of PRDOE's E-rate program to the FCC IG, noting concerns about competitive bidding irregularities. The IG collected information on PRDOE from USAC and proceeded to make a referral to the U.S. Department of Justice (DOJ). (At the same time, the DOJ was investigating broader corruption by the former Secretary of Education, who later was indicted and convicted, and is serving 12 years in federal prison.) In October 2001, an Arthur Andersen audit conducted during the summer of 2000 was released. The audit showed that PRDOE had failed to acquire some 100,000 computers to be used by students

to connect to the E-rate program funded infrastructure. On December 5, 2001, USAC wrote PRDOE requesting a report on questions generated by the audit, stating that PRDOE's outstanding E-rate program applications would not be processed or any more funds disbursed until USAC received and evaluated the information. To date, \$102 million in requests (for Funding Years 2001, 2002, and 2003) still await USAC decisions.

PRDOE responded to USAC's inquiries on January 15, 2002, with additional information about problems it had identified in the management and planning of E-rate program related work done by the previous administration, and also identified steps it was taking to rectify the situation. Over the course of the next year, PRDOE made presentations to USAC and FCC staff, describing efforts to ensure resources were available and to rectify problems identified in the workings of the network. By January 30, 2003, PRDOE had petitioned the FCC to direct USAC to process its applications.

In May 2003, the FCC issued a request for public comment on PRDOE's petition for the continued processing of the outstanding E-rate program funding requests. On November 14, 2003—two years after E-rate program funding was halted—the FCC issued an order directing USAC to (1) process applications for 2001 and 2002, except for DRC-related funding, but only subsequent to an audit; and (2) investigate the use of E-rate program funds during Funding Years 1998, 1999, and 2000, after which the FCC would evaluate the results and determine appropriate action. DRC-related funding was held due to allegations of on-going investigations of DRC by authorities in Puerto Rico and the United States.

In February 2003, following interviews with relevant parties at PRDOE, PRTC, DRC, USAC, and the FCC, Committee staff visited Puerto Rico to examine the infrastructure and high-speed network that the E-rate program had funded, and to determine the extent of the efforts by the current PRDOE administration to put the system to effective use. During the visit, Committee staff discovered nearly \$23.5 million in E-rate program funded equipment in a PRDOE warehouse, in violation of program rules. The gear included about 73,000 “wireless cards” that were to be used in PRDOE computers for the wireless portion of PRDOE's network. The Committee staff found the equipment shrink-wrapped and sitting on storage pallets. Committee staff also observed that, in the schools that they visited, there were very few, if any, computers dedicated to utilizing the E-rate program funded network, and especially the wireless half of the network. Staff also observed substandard equipment installation, placement of servers and switches near open windows, and little security for protecting equipment from vandalism. Due in part to a grossly inadequate number of computers available for utilization of the system, a roughly \$58 million high-speed computer network remained virtually unused.

Further, USAC paid \$43 million for T1 service and Internet access fees, but because of the very small number of computers and the inadequate training of teachers very few school children ever benefited educationally from the learning resources broadband Internet access made available by paying these fees. At the time of the staff visit, Puerto Rico's school children who could access the Internet did so via 56K dial-up modems—staff learned that

broadband service had been terminated after July 2003 because, according to school district officials, USAC had not yet released more funding or processed outstanding E-rate program applications for such services.

On June 17, 2004, the Subcommittee on Oversight and Investigations held the first of three hearings entitled: “Problems with the E-rate Program: Waste, Fraud, and Abuse Concerns in the Wiring of Our Nation’s Schools to the Internet.” The hearing examined: (1) the factors surrounding the evident failure of PRDOE to make effective use of more than \$100 million of E-rate program funding from 1998 through 2001; (2) the role played by the school district’s two principal E-rate program service providers, PRTC and DRC; and (3) the actions taken by USAC and the FCC to identify and resolve the school district’s problems, and what such actions demonstrated regarding oversight of the E-rate program generally.

The hearing provided a case study of the E-rate program and the substantial waste of more than \$100 million in one large school district, and highlighted programmatic weaknesses—in the application process, the certification process, technology planning, auditing, implementation of goods and services, resolution of problems by USAC and the FCC, and overall program guidance by the FCC.

Findings from the PRDOE-focused hearing and related investigation:

- Over the course of three years, more than \$100 million in funds were provided after PRDOE certified that its E-rate program funded network would be operational and put to educational use, when, in fact, it was never made operational or put to any significant educational use.

In the most egregious sign of this waste, funds were paid to vendors when the school district certified that key wireless components of the network infrastructure were installed and operational, when installation of those components had actually never occurred.

The Committee staff discovery of \$23.5 million of unused and unopened wireless cards in a PRDOE warehouse, which had been invoiced as delivered and installed, represents one of the most flagrant examples of the failure to deliver or make use of goods and services purchased through the E-rate program. (The investigation identified similar patterns of failure in other school districts as well, some of which are discussed below.) This failure signals an underlying weakness of the E-rate program; that is, the difficulty to ensure that E-rate program funded goods and services are put to effective educational use. It also underscores a weakness in USAC’s reliance on certifications in lieu of independent verification. Until staff made the discovery, neither the FCC nor USAC knew of the warehoused equipment, although school district officials were fully aware of the circumstances. Moreover, these officials seemed unaware that the situation amounted to a major program rule violation.

Puerto Rico’s Comptroller testified that insufficient planning and oversight by PRDOE contributed to the nonfunctional network. Limited inspections by both the Comptroller and an outside consultant for the school district revealed inadequate facilities and security for equipment. Documents also revealed extensive problems,

either due to equipment malfunctions or the lack of technical training, for the school district to maintain consistent connectivity to the Internet. The District neglected to provide training resources for teachers during the time of funding, further limiting the ability to make effective educational use of the E-rate program funds.

Puerto Rico's deficiencies in resources, training, infrastructure maintenance, and equipment installation also underscore the weakness in applicant certifications. Puerto Rico had certified, as required by the E-rate program on every application, that it possessed the resources necessary to make effective use of the goods and services it was seeking. Yet this was clearly not the case, and the program's money was wasted. Given the annual number of E-rate program applications, independent verification of all requests may be prohibitively expensive; however, the situation in Puerto Rico underscores the critical need to ensure the penalties behind false certifications are sufficiently strong to effectively deter wasteful or fraudulent requests.

- Over two years, and for more than 700 schools, a monthly fee of up to \$1,500 per school was charged for T1 lines that were essentially not being utilized.

The failure to provide adequate internal connections infrastructure, sufficient computers for student access, and teacher training did not stop the E-rate program from paying for broadband service and Internet access. Hearing testimony and documents indicate that approximately \$43 million was disbursed for either T1 lines or Internet access fees before the district's follow-on applications were placed on hold in December 2001. PRTC continued to provide broadband service for the portion of the district's schools under its contract (760 schools at a monthly rate of \$1,500 per school), irrespective of whether any schools were actively using the lines or had fully functioning internal networks. In the vast majority of cases, according to documents, testimony, and staff interviews, the networks were not utilized, but PRTC maintained that it was contractually obligated to provide the service. In the meantime, PRDOE neglected to alert USAC that E-rate program funds were supporting unused services. The E-rate program cannot mandate how often or how much a beneficiary actually uses the delivered goods and services; but the circumstances in Puerto Rico nonetheless reveal a weakness with regard to ensuring that the delivered goods and services are in fact used by students.

- The FCC did not help resolve PRDOE's enormous funding management and planning problems, and therefore contributed to both the waste of E-rate program funds and the failure of the program there. This shows one symptom of the underlying problem of the FCC's poor program management and oversight.

The FCC and USAC squandered valuable time by delaying any intervention in Puerto Rico, thus effectively prolonging the school district's E-rate program problems. Throughout 2002, according to documents in the record, PRDOE continued infrastructure upgrades and informed the FCC and USAC regarding its progress, to ensure that resources would be available to put the E-rate funded internal connections to effective use. PRDOE reported spending approximately \$136 million in facility upgrades, computer and infrastructure purchases, and training. In the course of meetings with

USAC, the district stressed the urgent need for releasing the E-rate program funds in order to continue development of the network. During its October 1, 2002 presentation, Puerto Rico requested that USAC act upon its Funding Year 2001 and 2002 requests—again citing its work to ensure resources would be available, and the urgency of making the E-rate program funded internal connections available to the school system.

At the same time, according to the record and staff interviews, USAC and the FCC's Office of General Counsel, in coordination with staff at the FCC's Wireline Competition Bureau (WCB), prepared a plan to allow USAC to resume processing Puerto Rico's 2001 and 2002 applications, provided that the district made certain certifications. The FCC examined the U.S. Department of Education's prior work in Puerto Rico when developing the plan. The FCC's General Counsel outlined to the DOJ its intentions to process Puerto Rico's funding requests, and asked the DOJ to respond with objections within fourteen days. The FCC letter explained that absent any objections, it would "go forward with the process of reviewing and granting, subject to conditions, PRDOE's application for funding years 3 and 4 [sic, years 4 and 5 were at issue]." The FCC's self-described "work-out" conditions required PRDOE to enter a binding agreement to take various steps to establish compliance and demonstrate the ability to use the funds, including hiring an independent auditor at PRDOE's expense. The DOJ did not respond to the FCC. Subsequently, however, the FCC requested on January 30, 2003, that Puerto Rico submit a petition for the release of the funds. Initially, the FCC planned to process the district's petition as a unique case, without public notice. Puerto Rico's attorney told Committee staff that the FCC made no indication that the petition would be posted for public comment.

In May 2003, however, the FCC decided that Puerto Rico's request should obtain public comment. According to Committee staff interviews with the FCC, the WCB decided that the district's funding request provided an opportunity for the agency to develop a broader policy concerning waste, fraud, and abuse in the E-rate program. Thus, the FCC abandoned its "work-out plan," and instead noticed the Puerto Rico petition on May 16, 2003 for public comment. On November 25, 2003—two years after USAC initially postponed further funding for Puerto Rico—the FCC issued an order instructing USAC to: (1) process funds for 2001 and 2002 (excluding any funding related to the vendor DRC), but only after USAC conducted an audit; and (2) investigate Puerto Rico's use of E-rate funds during Funding Years 1998, 1999, and 2000, following which the FCC would evaluate the results and determine any appropriate action.

Notably, the FCC order did not contain the procedures detailed in the fall 2002 "work-out plan." Much of the lengthy consultation and negotiation between the FCC and the district was abandoned in favor of a more arms-length approach. By contrast, with regard to Puerto Rico's use of fiscally unrelated federal education funds, the U.S. Department of Education (USDOE) has worked actively and closely with the district to resolve major financial control issues that arose under the Single Audit Act. The FCC's decision

regarding Puerto Rico will likely delay resolution until well into 2005.

- The E-rate program does not presently require compliance with standard federal oversight requirements, such as the Single Audit Act.

Important information regarding a given school district's management and use of federal funds is not collected as a matter of practice. From the program's inception, there has been much confusion surrounding the legal status of E-rate program funds, and the consequent statutory financial oversight and accounting activities that should result from that legal status. One example of this is the Single Audit Act of 1984, 31 U.S.C. §§7501 *et. seq.*, which sets forth certain auditing requirements for "non-Federal entities" that "expend" federal funds exceeding a specified amount¹¹ in a given fiscal year. The single audit of all federal funds received by a non-Federal entity must be conducted by an independent auditor, in accordance with generally accepted government auditing standards. The single audit is then submitted to the OMB's Federal Audit Clearinghouse, from which the OMB prepares and submits an annual report to Congress regarding all such audits.

In Puerto Rico, the Arthur Anderson "beneficiary" audit of the school district's E-rate program projects—commissioned by USAC—did not identify the fiscal situation described by USDOE documents contained in the record. The documents, not directly related to the E-rate program, noted that "large scale fiscal and accountability problems" in the district had existed for a number of years "and appear to be continuing."¹²

- The Puerto Rico Department of Education acquired goods and services through the E-rate program without using a formal bidding process, contrary to both the program's rules and the Commonwealth's regulations, and even though the district otherwise followed the E-rate program's Form 470 application process.

According to Puerto Rico's Comptroller, the district did not adhere to formal bid procurement procedures in awarding E-rate program contracts during Funding Years 1998 and 1999. Further, the Commonwealth's Office of Management and Budget failed to approve the E-rate program contracts in accordance with established rules. E-rate program rules require applicants to follow state and local bidding requirements, as well as the E-rate program's competitive bidding requirements. The Comptroller's audit findings showed that Puerto Rico had not done so. In contrast, USAC's outside auditor, Arthur Andersen, did not identify the irregular proce-

¹¹ Currently, the threshold is set at \$500,000, as determined biannually by the Office of Management and Budget. This sum is the aggregate of all Federal awards in a given fiscal year.

¹² See E-rate Hearing, June 17, 2004, Committee on Energy and Commerce, Serial No. 108-92 (hereinafter referred to as Hearing, Part 1) at 160. According to the FCC IG and USAC, current E-rate beneficiary audits require that auditors examine Single Audit findings, if they exist, to see if the findings affect E-rate program funding management; this requirement was not instituted until 2002. In May 2002, the USDOE had designated Puerto Rico a "high risk grantee." The USDOE made this determination based upon information gathered through the Single Audit Act—the USDOE tabulated literally 300 findings that were unresolved and extended as far back as the mid-1990s. (The USDOE disburses roughly \$1 billion annually to Puerto Rico through various programs.) As a result, the USDOE requested periodic progress reports from Puerto Rico as a precondition to receiving further education funding. While the findings did not directly address the E-rate program, they questioned financial controls and oversight by the school district that clearly might also impact the management and use of E-rate program resources. Based upon continued accountability concerns, the USDOE established "special conditions" in August 2002, and began its own "work-out" plan with PRDOE.

dures. For example, Arthur Andersen reported that the Form 470 was filed properly and noted “we ascertained through discussion with PRDOE management that they had established appropriate procedures to evaluate and select the most cost-effective bidder based on the responses to their 470 posting. PRDOE management also indicated that all bids received were appropriately evaluated in accordance with state and local requirements.”¹³ Arthur Anderson evidently did not verify the district’s assertions. Puerto Rico’s broader problems, as identified by the Comptroller and the USDOE, show the limited utility of the Form 470 and Form 471 as the basis for competitive procurement and obtaining E-rate program funds.¹⁴

- PRDOE acquired E-rate program related goods and services without an adequate technology plan. More broadly, the E-rate program’s current technology plan requirements provide no meaningful protection from gold-plating (over-procurement of goods and services, beyond the needs and resources of the school district).

Under E-rate program rules, an applicant must certify that it has a technology plan that has been endorsed by its state, USAC, or an “independent entity” approved by the FCC.¹⁵ According to the FCC, this requirement ensures: (1) that schools and libraries prepare “specific plans for using [E-rate program funded] technologies, both over the near term and into the future, and how they plan to integrate the use of these technologies into their curriculum” and (2) that the technology plans “are based on the reasonable needs and resources of the applicant and are consistent with the goals of the program.”¹⁶

Puerto Rico’s then-Secretary of Education testified that no E-rate program related documentation, including the required technology plan, was located when his administration assumed office, suggesting that the prior administration, which was largely responsible for ordering the E-rate program goods and services, did not have an approved plan. USAC relied on Puerto Rico’s certifications on the program’s forms and did not review a technology plan, according to testimony.¹⁷ Moreover, whether or not a technology plan existed and was approved, testimony, documents, and staff interviews all indicate that the E-rate program’s technology-plan requirements have no real effect on what applicants actually request from the program. In short, the technology planning requirements, as shown by the excessive purchases in Puerto Rico and in other districts, are not effective and do not serve the intended purpose.

Although USAC implementing procedures specify criteria that applicants must include in their technology plans, these criteria are not enforceable or necessarily effective in guarding against gold-plating. As the hearing showed, plan “approvers” have no incentive to carefully monitor the substance and specificity of a technology plan, and USAC does not regularly refer to the plans when assess-

¹³ See Hearing, Part 1 at 233.

¹⁴ Arthur Andersen’s failure on this front raises questions of the quality of the auditors’ work. The FCC IG expressed such concerns in a memo to the FCC Chairman, criticizing both Andersen’s work and USAC’s acceptance of this work. See Hearing, Part 1 at 184 *et. seq.*

¹⁵ See 47 CFR 54.508(d).

¹⁶ See FCC Order 97-157, ¶573-74.

¹⁷ See Hearing, Part 1 at 108-09. However, the Arthur Andersen audit reported reviewing a technology plan.

ing applications. Moreover, the FCC did not codify the criteria that technology plans should cover until its August 2004 Fifth Report and Order, and even so, other weaknesses in technology planning still remain (*infra*, pages 31-32).

- The FCC IG cannot provide adequate assurance that the program is sufficiently protected against waste, fraud, and abuse. Furthermore, the FCC's Wireline Competition Bureau does not know the magnitude of potential fraud.

According to hearing testimony and staff interviews, to date no statistically representative audit of the E-rate program has been completed to determine the extent of waste, fraud, and abuse. Without this critical information, the IG testified that he could not assure that the program could be protected against waste, fraud, and abuse. The deputy chief of the WCB also testified that the magnitude of potential fraud was unknown. (See GAO discussion below.)

Further, the FCC IG testified that those audits that have been conducted and reviewed by his office raise several questions about the program's weaknesses. For example, according to an IG review of 135 E-rate program "beneficiary audits," only 65 beneficiaries (schools and school districts) were determined to be compliant with program rules, 22 were determined to be "generally" compliant but with some problems identified, and 48 were not compliant and evidenced significant problems.¹⁸ Moreover, compliance with the rules does not necessarily mean the absence of audit "findings" questioning the integrity of the application process. In short, the type and magnitude of the problems found by this small number of audits suggests the need for a more thorough and systemic review of the universe of applicants.

- The FCC IG faces several obstacles in implementing effective independent oversight of the program. The IG testified that he lacks sufficient resources to conduct audits and provide audit support to law enforcement investigations.

The FCC IG testified that his office would need approximately \$12 million to hire the contractors to conduct approximately 240 audits, as well as to hire additional FCC staff to review the work. This would provide, according to the testimony, a statistically valid sample to enable the FCC IG to draw conclusions concerning the scope and nature of problems in the program.

Under the program's current structure, the FCC cannot use funds from the USF to accomplish this oversight work. Congress would need to provide express statutory language authorizing the FCC or FCC IG to use E-rate program funds for audits and oversight of the E-rate program, or otherwise appropriate money for this purpose.

It should be noted that at the time of this report's completion, the FCC IG and USAC are in the final stages of signing three-way contracts with outside audit firms to conduct statistically valid audits of all USF funding mechanisms. This would amount to an estimated 700 audits across the funding mechanisms and would likely provide sufficient statistical confidence to make determinations

¹⁸ See "Hearing on Problems with the E-rate Program: GAO Review of FCC Management and Oversight," March 16, 2005, Committee on Energy and Commerce, Serial No. 109-7, at 30.

about the scope of waste, fraud, and abuse both in the E-rate program and Universal Service funding in general.¹⁹

B. San Francisco Unified School District's E-rate Experience, and NEC BNS

On July 22, 2004, the Subcommittee held the second of three hearings entitled "Problems with the E-rate Program: Waste, Fraud, and Abuse Concerns in the Wiring of Our Nation's Schools to the Internet." The Subcommittee considered the circumstances surrounding bid-rigging, inflated pricing, and the filing of false statements during the application process for E-rate program funding by San Francisco Unified School District (SFUSD). During Funding Year 2000, the competitive bidding process for SFUSD's E-rate program projects was completely corrupted, and the self-certification process failed. The Subcommittee also examined why USAC approved more than \$48 million for a plainly fraudulent application, and how the school district superintendent, Dr. Arlene Ackerman, and others thwarted the scheme.

SFUSD has about 60,000 students enrolled in approximately 116 schools. During the first two years of the E-rate program, Funding Years 1998 and 1999, SFUSD applied for \$3.5 million and \$6.8 million respectively. By contrast, in Funding Year 2000, SFUSD submitted several E-rate program applications totaling \$112 million. Of that total amount, two of the applications sought \$106 million in internal connections discounts through two vendors—InterTel, Inc. (\$23 million) and NEC BNS (\$83 million).

During the applications' processing, USAC conducted its routine program integrity assurance (PIA) review. USAC also performed a "selective review" of the applications because of the magnitude of funds being requested. Subsequently, in September 2000, USAC committed \$48.68 million to SFUSD for the products and services to be provided by NEC BNS and InterTel. While USAC approved this funding commitment, it neglected to perform the requisite due diligence despite finding certain irregularities in the SFUSD application, such as altered district budget documents.

Shortly after Dr. Ackerman assumed leadership of SFUSD in August of 2000, she determined that there was something unusual about the school district's pending E-rate program applications, turned down the funding, and alerted the FBI. In April, 2001 Ms. Ackerman also requested that the San Francisco City Attorney investigate certain SFUSD employees, including Mr. Desmond McQuoid, who were involved with the suspect E-rate program applications. The City Attorney ultimately uncovered a nation-wide scheme to defraud the E-rate program, and filed a lawsuit under the False Claims Act against NEC BNS, VNCI, InterTel, and other parties involved with SFUSD's E-rate program application.

On May 27, 2004, NEC BNS pleaded guilty to federal antitrust violations under Section 1 of the Sherman Act, and to wire fraud. As part of the plea agreement, NEC BNS agreed to pay \$20.7 million in fines and restitution. According to both the plea agreement and the testimony provided by San Francisco officials before the

¹⁹ See Request for Proposals for Audit Services in Support of Oversight Program for the Universal Service Fund, USAC.

Subcommittee, NEC BNS, VNCI, and InterTel established an agreement to circumvent competition for E-rate program projects by rigging the bidding process, submitting fraudulent bids, and pre-determining who would win. Afterwards, the co-conspirators would submit Form 471s that grossly inflated the cost of the work (for example, SFUSD's Form 471 was inflated by roughly \$26 million), forging signatures and falsifying documents when necessary. Between December 1999 and March 2001, the co-conspirators used the bid-rigging scheme at several schools across the country. On December 8, 2004, the Justice Department announced that InterTel also pleaded guilty to similar federal antitrust violations under Section 1 of the Sherman Act, and to wire fraud. InterTel's agreement included fines and restitution totaling \$8.7 million.²⁰

For the July 22nd hearing, the Subcommittee subpoenaed four witnesses who had been invited but declined to voluntarily attend and testify. The individuals included: Mr. Thomas J. Burger, the President and CEO of NEC BNS; Mr. William Holman, the former Senior Vice President of Sales for NEC BNS; Mr. George Marchelos, a former E-rate consultant and VNCI employee; and Ms. Judy Green, also a former E-rate consultant and VNCI employee. While Ms. Green successfully evaded service by U.S. Marshals, the other subpoenaed witnesses appeared at the hearing and all of them invoked their Fifth Amendment rights against self-incrimination.

On September 22, 2004, the first part of the Subcommittee's third E-rate hearing continued the examination of the NEC BNS-related bid-rigging conspiracy. Testimony focused on other school districts that, unlike San Francisco, actually received E-rate program funded products and services through the conspiracy. The Subcommittee considered issues including: E-rate program funding of ineligible goods and services; vendors' inappropriate use of "in-kind" donations to schools; school districts' obligations and responsibilities under program rules, including the mandatory requirement that schools contribute a co-payment to the cost of E-rate program projects; and, the role played by certain consultants in the conspiracy, as well as the role played by consultants in the E-rate program more broadly.

Again, four witnesses who were invited to the hearing declined to attend and testify voluntarily, and the Subcommittee subsequently compelled their appearance through subpoenas. The individuals included: Ms. Judy Green, former E-rate consultant and VNCI employee; Dr. Emma Epps, Superintendent of Ecorse Public School District; Dr. Douglas Benit, the former facilities director for Ecorse Public School District; and Mr. Quentin Lawson, the Executive Director of the National Alliance of Black School Educators (NABSE). At the hearing, Ms. Green and Mr. Lawson invoked their Fifth Amendment rights and declined to testify. Additionally, Mr. Carl Muscari, the President and CEO of VNCI, appeared voluntarily, but also chose to invoke the Fifth Amendment at the hearing.

²⁰ On April 7, 2005, VNCI, Judy Green, Allan Green, George Marchelos, and others were charged in a 22-count indictment with wire fraud, conspiracy, and various federal antitrust violations related to E-rate programs in more than 20 schools or school districts throughout the country. See *United States v. Video Network Communications, Inc.* (N.D. Cal.).

Testimony at the September 22nd hearing showed that both the Ecorse Public School District, in Michigan, and the Jasper County School District, in South Carolina, failed to pay their required co-payment to NEC BNS for the cost of their respective projects. NEC BNS and VNCI “waived” the school districts’ co-payments, despite clear FCC and USAC guidance that this was prohibited. Instead, the inflated funding requests on the Form 471s were used to cover the schools’ obligations. Additionally, both school districts’ superintendents admitted that their schools received substantial in-kind donations of clearly ineligible goods and services. In the case of Ecorse, the Subcommittee examined documents and received testimony from an NEC BNS project manager that revealed that E-rate program funds paid for the construction of an \$800,000 “TV production studio” at the district’s high school. Testimony provided by USAC’s Schools and Libraries Division Vice President, George McDonald, made clear that the TV studio and other in-kind donations were ineligible for E-rate program discounts and violated program rules. Neither the Ecorse nor Jasper County school officials were able to explain or justify the violation of the program’s rules. Furthermore, in Ecorse, neither Dr. Epps nor Dr. Benit provided credible testimony about the funding of the TV studio or the school’s failure to pay its co-payment. Specifically, under questioning, neither school official could credibly explain several documents that showed Dr. Benit directing NEC BNS to allocate E-rate program funds to pay for the studio, other ineligible goods and services, and, implicitly, the school’s mandatory co-payment.²¹

Finally, the September 22nd hearing examined the involvement of NABSE in the E-rate program, and its association with NEC BNS, VNCI, and other parties. For example, testimony showed that NABSE had an apparent contractual arrangement to provide potential E-rate program project leads to NEC BNS and VNCI through its large membership of school superintendents. Further, for every funded E-rate program project resulting from a NABSE lead, NABSE was slated to receive what amounted to a 1.5% revenue return on all business related to the E-rate program. Despite Mr. Lawson’s refusal to testify, a ten-minute NABSE E-rate program marketing video and documents entered into the record showed very active participation by NABSE officials in attempting to steer E-rate program related business to NEC BNS and VNCI.²² In fact, statements in the video and documents claim that NABSE’s E-rate “team” had helped nine school districts receive a total of roughly \$81 million in program discounts. The hearing showed that while NABSE held itself out to its members as simply being interested in ensuring that poor school districts were able to take full advantage of E-rate program funding, the organization actually held a financial stake in the process. USAC’s George McDonald testified that any E-rate program funds that USAC determines actu-

²¹ For a complete accounting of Ecorse’s allocation of E-rate funds, see E-rate Hearing, September 22, 2004, Committee on Energy and Commerce, Serial No. 108-124 (hereinafter referred to as Hearing, Part 3) at 54-77. See also *id.* at 67 (Dr. Benit was not able to locate documents that supported his assertion that Ecorse School District paid NEC BNS its co-payment for the E-rate project).

²² The NABSE video also refers to IBM as a member of the NABSE E-rate “team,” but the investigation did not find evidence of IBM actually receiving business from NABSE efforts, and IBM officials testified that they had no knowledge of any such relationship.

ally went to NABSE inappropriately are subject to recovery actions. (To date, no attempts at recovery have been undertaken.)

Findings from the NEC-focused hearings and related investigation:

- USAC failed to reject the fraudulent SFUSD E-rate program applications, despite the fact that its employees identified several red flags and discrepancies, perhaps most notably among them an altered school district budget document.

During the hearing, USAC Vice President George McDonald could not adequately explain why the forged budget document did not halt the program's application approval process for San Francisco. Mr. McDonald did note that the application reviewer's notes were not placed into a computer system, and that, at the time, "novel" issues were passed on to supervisors orally. Mr. McDonald did say that USAC has improved its review process since that time, compiling reviewers' observations in a database, and conducting quality assurance reviews of the reviewers. Mr. McDonald stated that he believed that today's reviewers would have been more diligent in investigating the budget forgery and notifying supervisors, and that USAC's approval would have been withheld. However, the hearing showed that Members remain concerned about "rubber-stamping" of applications and inadequate scrutiny of the details and reasonableness of very large funding requests.

- The certifications contained on E-rate program application documents had little effect in deterring certain San Francisco school officials or the employees of NEC BNS, InterTel, or VNCI from forging documents and signatures and attempting to defraud the E-rate program.

The certifications contained in E-rate program forms have failed to deter abuse by predatory vendors or irresponsible school officials. In December 2002, the FCC IG, in consultation with the Justice Department, provided the WCB with a series of recommendations to strengthen certifications, but, according to testimony and staff interviews with the Inspector General, the recommendations were largely ignored for more than 18 months. Only in 2004—six years into the program—did the FCC begin to propose changes in the certifications. Further, the FCC has not been comprehensive in its approach to strengthening the certifications. For example, the FCC's Chief of the WCB, Mr. William Maher, testified that the FCC was not considering requiring "certificates of independent pricing," even though the Justice Department had suggested it, and Mr. Maher testified that he thought such a certificate would be a "great idea." In the end, the hearing illustrated the weakness of certifications, to date, and the reticence of the FCC to promulgate certifications containing stronger criminal sanctions for acts of fraud and abuse, and greater deterrents to program predators—despite the sound advice provided by the Justice Department and endorsed by the FCC's IG.²³

- Employees of NEC BNS and VNCI completely manipulated the competitive process for E-rate program goods and services, and USAC did not discover the fraud.

²³ See Hearing, Part 2, Tab 130.

The hearing also illustrated some of the weaknesses contained in the E-rate program's competitive bidding requirements. The program's competitive bidding requirements should ensure the maximum value received by the applicant for the price paid, and reduce the risk of fraud and abuse. The Justice Department's certification memorandum also made suggestions regarding improving the competitive bidding environment.²⁴ In answering questions at the hearing regarding those suggestions, Mr. Maher testified that establishing competitive bidding standards to ensure reasonable pricing, such as requiring a minimum number of bidders, posed "a difficult policy issue" with which the FCC was "grappling." However, the WCB Chief could not answer how he thought an adequate competitive bidding process could be assured. Currently, one of the primary rules regarding competition simply requires a waiting period of 28 days between posting a Form 470 and entering into a contract. Program rules provide little guidance regarding exactly how E-rate program applicants should ensure competition, except to the extent that state and local procurement standards must be followed.

- The E-rate program recently gained the option of debarbing abusive vendors and applicants, but the rule established by the FCC is very limited in scope.

Only since April 2003 has the program had access to the tool of debarment for purposes of deterring waste, fraud, and abuse, but the thresholds of conduct that trigger the "suspension and debarment" process are set too high. According to the E-rate program's rules, an E-rate program participant may be barred from participating in the program for three years, but only upon a finding of criminal or civil liability. Debarment could be an effective tool for both holding program abusers accountable, and for deterring future abuse. However, the current rule does not address abusive or wasteful behavior that falls short of criminal or civil liability. For debarment to have a legitimate deterrent effect, and given that criminal or civil litigation may take several years to reach a judgment, the FCC's debarment standards should be more flexible, so that when an E-rate program participant considers abusing the program or intentionally exploiting program loopholes, it must also consider that the FCC has the power to address the participant's abusive actions.

- According to testimony, staff interviews, and criminal plea agreements to date, USAC and the FCC have dedicated insufficient attention and oversight to the activities of program consultants such as Judy Green, George Marchelos, VNCI, and NABSE.

USAC and the FCC have not done enough to ensure that consultants play a fair and independent role in school districts' E-rate programs, that they have no financial stake in the outcome of the competitive bidding process, and that the E-rate program is not billed for those consulting services that are ineligible for E-rate funding. Testimony and documents from the NEC BNS-related hearings demonstrate how these "consultants" either worked with willing and cooperative school officials to defraud the program, or used their greater knowledge of the program (or, in the case of NABSE,

²⁴ *Id.*

used its position of trust) to take advantage of overly-reliant school district personnel. According to testimony, documents, and the NABSE marketing video, employees of NEC BNS and VNCI in many cases had broad authority over decisions that should have been made by school officials. In other instances, such as in San Francisco, school district officials were extensively involved in the fraudulent procurements; in Ecorse, Michigan, school district officials were directly involved in highly questionable procurements. Further, the hearings examined documents showing a financial arrangement that NABSE had established with preferred vendors, such as NEC BNS and VNCI.²⁵ However, staff found no information indicating that either the vendors or NABSE ever disclosed these contractual arrangements to NABSE's member school districts.

C. The Denial of \$500 million in applicant requests associated with IBM

During E-rate program Funding Year 2002, USAC rejected program funding requests from 21 school districts totaling approximately \$517 million, due to a distinct pattern of program rule violations. In particular, USAC identified a pattern of procurement that violated the program's competitive bidding requirements. With minor variations, each school district engaged in a type of procurement that, according to the FCC, in affirming USAC's decision, "effectively eliminates competitive bidding for the products and services eligible for discounts under the [E-rate] support mechanism." Notwithstanding the FCC's decision that the school districts violated E-rate program rules, the FCC permitted the rejected applicants who submitted appeals to resubmit their E-rate program applications for 2002 in accordance with proper procedures. The FCC reasoned that allowing reapplications would be in "the public interest."²⁶

Although the Funding Year 2002 "boilerplate" applications were noticed and denied by USAC, the identical bidding procedure had actually succeeded during the prior E-rate program Funding Year 2001, in El Paso Independent School District (EPISD), Texas. This urban school district—the 7th largest district in Texas, with 86 schools and approximately 62,000 students—had participated in every year of the E-rate program. During the first three years, USAC approved \$2.6 million, \$6.4 million, and \$1.4 million, respectively, in program funding for El Paso. However, in Funding Year 2001, after EPISD selected IBM as a "Strategic Technology Solutions Provider" to integrate technology (including E-rate program funded technology) throughout the District, El Paso's E-rate program funding request swelled to more than \$65 million.

²⁵ Documents in the record only show payments made by VNCI to NABSE. While the letter purporting to establish an E-rate program partnership agreement was also signed by an IBM employee—Mr. Don Parker, a Customer Services Executive for IBM Global Services—who also appears in the NABSE E-rate program marketing video, the Subcommittee has no other evidence showing IBM's actual involvement with NABSE's E-rate "Team." IBM representatives testified, and a subsequent IBM letter submitted for the record declares (Hearing, Part 3, at 761-62), that Mr. Parker was not authorized to enter into any E-rate program teaming agreement with NABSE, and that IBM was not aware of the NABSE E-rate program video that suggests IBM's partnership with NABSE. Further, IBM's letter states that it has never made payments to NABSE in exchange for E-rate business referrals.

²⁶ See the FCC "Ysleta" Order, FCC Order 03-313, December 8, 2003.

IBM has participated as an E-rate program vendor since the very start in 1998, and is the largest single recipient of the program's "internal connections" funding. Over the course of the program, IBM has received more than \$832 million for E-rate related work. In Funding Year 2002, IBM was associated with more than \$1 billion of E-rate program funding requests—almost double the value from the previous year.

In El Paso, after the school district approved IBM as its "technology integrator," IBM provided El Paso with E-rate program "statements of work" for particular products and services, as well as the associated documents for the district's E-rate program application. These materials were prepared through Alpha Telecommunications (Alpha), IBM's E-rate program consultant. Without adequate analysis²⁷ or price competition for the products and services, El Paso submitted the documents provided by IBM as the basis of its E-rate program application. With IBM serving as El Paso's primary program vendor, USAC approved \$65.7 million in E-rate program funds in October 2001 for 52 schools. EPISD eventually spent \$57 million of this amount, and also paid its \$6 million co-payment.

After USAC approved El Paso's E-rate program request, IBM aggressively marketed its "systems integrator" concept and promoted its work in El Paso as an example of how IBM could maximize E-rate program funds for other districts across the country, focusing primarily on IBM's "West" sales region. Documents in the record show that IBM supplied templates for school districts to use in making their requests for proposals, both for a strategic technology partner and for the E-rate program related services. IBM's marketing and the boilerplate E-rate program documents ultimately led to 21 school districts selecting IBM to coordinate their E-rate projects. Those 21 contracts involved the previously mentioned \$517 million in funding requests for Funding Year 2002, which USAC began to review in the spring of 2002.

Meanwhile, in January 2002, USAC received an anonymous whistleblower letter that complained about IBM's role in El Paso and which prompted USAC to scrutinize the procurement process more closely. At that time, there was no indication on EPISD's funding request that it had engaged IBM as a strategic partner. USAC's investigation expanded to several other districts in 2002, and directly led to the denials for funding. USAC's investigation also determined that funds had been disbursed for ineligible services performed by IBM and its subcontractors.

Of the 21 districts that were denied funding by USAC, nine districts (totaling \$268 million in funds), appealed to the FCC. Additionally, IBM submitted its own appeals on behalf of eight of the districts. In December 2003, the FCC upheld USAC's decision regarding eight of the nine districts, but allowed them to re-submit applications for the funding year. The FCC sided with the remaining appellant—Winston-Salem School District, involving \$16.7 million—determining that Winston-Salem did not exhibit the same pattern that had triggered the other rejections.

²⁷ See Hearing, Part 3, at 136.

In light of the numerous applicants and the magnitude of E-rate program funds involved, the Committee staff focused extensively on the facts and circumstances surrounding these IBM-related applications. Staff conducted interviews with school officials at districts that were denied funding, and particularly focused on the circumstances at the El Paso Independent School District. Committee staff conducted a site visit to EPISD in August 2003.

On September 22, 2004, the Subcommittee's third hearing addressed information regarding the roles of the FCC, USAC, IBM, Alpha Telecommunications, and several school districts that worked with IBM in 2001 and 2002. The hearing examined the integrity of the E-rate program application process generally, and in particular, in the context of the IBM-related applications. The hearing also considered the specific circumstances leading up to and surrounding the denial of the Funding Year 2002 applications.

The hearing presented a case study regarding the roles of vendors and of school districts in the E-rate program application process, and the propensity of schools and vendors to "gold-plate" the technology of the schools, far exceeding any reasonable educational technology needs. The hearing considered: 1) how IBM "captured" the E-rate program planning and procurement process at the schools by encouraging school districts to adopt the concept of a "strategic integrator," and how this placed IBM in a conflicted advisor/vendor situation; 2) how vendors can "bundle" millions of dollars of ineligible goods and services, in effect removing them from USAC scrutiny; and 3) how weaknesses in the program were exploited by a large technology industry icon—as well as by school districts that were encouraged by the prospect of essentially paying only ten cents on the dollar for technology goods and services and of avoiding the difficult task of adequately planning for the integration of infrastructure, peripheral equipment, and teacher training with the technology purchased by E-rate program dollars.

Findings from the IBM-focused hearing and related investigation:

- Weaknesses in the E-rate program application process, including applicant certifications, allowed non-competitive procurement of E-rate related goods and services. The flawed application process resulted in the extravagant and wasteful E-rate program funding in EPISD in Funding Year 2001, and nearly resulted in the waste of at least tens of millions of dollars more, among 21 other large school districts in Funding Year 2002. Today, the FCC still allows anti-competitive or insufficiently competitive procurement practices. The program remains plagued with weaknesses in the application process, including vague or ambiguous rules regarding the requirements for competition.

Competitive bidding for particular products and services sought by the applicants is fundamental to cost-effective procurement of goods and services. The program's minimal competition requirements and weak certifications do not ensure such price competition. Consequently, the program is highly susceptible to funding expensive, ineligible, and inappropriate products and services.

The case in point is the El Paso Independent School District (and the attempts to mimic that paradigm around the country). Essentially, El Paso lacked any meaningful price competition for the

goods and services requested by the District through the program. IBM was selected by the applicant in a two-step process that enabled the company to be the only service provider “at the table” when details of the goods and services were placed on the E-rate program application. In this instance, IBM made the most significant decisions regarding what services to request. As school district officials testified, district personnel had little time to review the application before it was submitted to USAC and relied “too heavily” upon IBM.²⁸ In fact, IBM crafted portions of the E-rate project “statements of work” without even consulting with EPISD staff.

Whatever oversight the El Paso school district exerted before the E-rate program forms were signed and certified, the documents and testimony (as well as the templates used by IBM around the country) show that the service provider was guiding decision-making. This raises questions about the integrity of certifications that school officials must make. IBM and its consultant Alpha were able to bundle ineligible goods and services at excessive rates. For example, IBM did not specify in its invoices ineligible consulting services (i.e., Alpha’s assistance in determining school discount eligibility and in preparing application forms and subsequent responses to USAC queries), which cost the E-rate program more than \$4 million for El Paso alone. Alpha charged 7% for each E-rate program funded statement of work that it helped to prepare. This fee was actually rolled into the statements of work’s final price tags.²⁹ USAC explained that these services were ineligible for E-rate program funding. That is, if the school district had sought the services provided by Alpha separately, the E-rate program would not have covered the cost. Had similar IBM-associated applications for Funding Year 2002 been approved, the program would have paid out an even larger sum for these ineligible consulting services. Further, the consulting fees amount to just one part of more than \$20 million in wasteful E-rate program spending in El Paso.

Fortunately, USAC was able to identify the anti-competitive practices and deny the “technology integrator” pattern of applications in 2002. Subsequently, the FCC and USAC did clarify rules and procedures regarding price competition in the aftermath of these denials. However, underlying problems in the process still remain. The FCC IG testified that IBM-related applications highlight the IG’s concern about weaknesses in the rules governing competition for E-rate projects. One fundamental weakness in this regard is the reliance on the Form 470 as the basis of competition. The FCC IG testified that the current E-rate program competitive process is based upon the faulty assumption that by posting a Form 470 on USAC’s Web site for 28 days—as the current rules require—healthy and rigorous competition will occur. The FCC IG further testified that its audits indicate that this “frequently does not happen.” Simply put, the Form 470 is too general for vendors to discern project parameters and build robust, highly competitive bids that meet the schools’ needs, and therefore frequently fails to generate the level of competition envisioned for the program. The hearing testimony demonstrated that school officials often fail to

²⁸ See Hearing, Part 3, at 135.

²⁹ In a truly competitive bidding process, this additional 7% “fee” would have likely made IBM less competitive in each of its bids.

carry out their obligations to the competitive process—for example, neglecting to provide interested vendors with answers to questions about a given RFP.³⁰

Additional testimony illustrated that school districts often already have vendors in mind when they post the Form 470s, or otherwise fail to respond to legitimate vendor inquiries. This weakness provides some vendors with an opportunity to insert themselves, inappropriately, into a school's planning process. As one witness testified, service providers “prey upon applicants that have no knowledge of the program but are told this service provider can get them money for computers.”³¹ Testimony and documents suggest that vendors have improperly sought advance commitments from school officials. For example, documents in the record showed IBM seeking “verbal commits” during the posting of RFPs and the Form 470. USAC testified that if the verbal commit occurred before the posting of the Form 470, that it would violate E-rate program rules.³²

Additionally, certifications made by school officials on applications may not be sufficiently strong to deter false claims and statements, and ultimately prevent waste, fraud, or abuse. The FCC IG testified that reliance on beneficiary “self-certification” is a serious vulnerability because the program uses these signatures as a primary bulwark against improper funding requests. Without an ability to police these certifications and punish false statements, this flaw opens an avenue for waste and abuse. There have been no false statement charges asserted in the criminal indictments, to date, or that are being pursued by ongoing federal investigations, as reported by the FCC IG.³³ The FCC IG testified that the FCC waited until September 2004 to begin to address some of the Justice Department's December 2002 recommendations regarding the certifications.

- El Paso and other school districts involved in the IBM-related “strategic integrator” applications demonstrate that the current E-rate program application approval process cannot either prevent “gold-plating,” which far exceeds the reasonable needs of a school district, or ensure the cost-effective delivery of E-rate program goods and services. In fact, the program's current structure may actually encourage gold-plating.

The Subcommittee's work unearthed a number of vivid examples of wasteful and excessive spending. For example, the El Paso application persuaded USAC to fund a \$27 million, state-of-the-art network maintenance support center for 53 of the district's poorest schools to keep the network “up and running.”³⁴ As troubling, the \$27 million maintenance center only operated for three months before the funding year ended. Even though IBM billed USAC and the district for the full \$27 million, most of the funds were dedicated to the design and set up of the maintenance center. Further, the set-up costs involved included ineligible inventory surveys, high-level design and planning, and leasing and construction of an

³⁰ See Hearing, Part 3, at 155-57.

³¹ *Id.*

³² *Id.* at 46.

³³ *Id.*

³⁴ *Id.* at 246.

off-site call center.³⁵ In the end, the help desk possessed so much capacity that IBM sales staff considered using it to support other school districts.³⁶

At the hearing, EPISD's superintendent testified that the district did not get its money's worth from the partnership with IBM. Moreover, documents show that the maintenance system placed an enormous burden on the district's resources, prompting El Paso to redirect some of its staff to assist with the help desk. For all the 2001 E-rate project's promise, the district technology director became concerned that the district had "bit off more than it could chew," and documents and testimony show that he had difficulty articulating the value of the maintenance center to the school board.³⁷ When USAC rejected the district's E-rate program application for Funding Year 2002, IBM removed the associated-equipment and closed the center—to the surprise of the school district—and left the school to manage on its own, on roughly a \$2 million annual technical maintenance budget—or about 7% of the IBM maintenance support funding.³⁸ It should be noted that no technical assistance relating to the problems with computers, printers, or other non-E-rate program equipment were eligible under this maintenance support. Most technical problems with E-rate program eligible equipment should have been provided for under the standard warranties that IBM and other equipment vendors provide purchasers. It is no exaggeration to claim that virtually the entire \$27 million maintenance operation was ineligible.

Another example of waste may be found in the failure to prevent excessive and redundant acquisition of E-rate program goods and services. In El Paso, the scope of work was drafted by IBM to include all 86 schools in the district, not the 53 that were eligible for funding. Yet the district made no change in the scope of work applied for, and thus received funding for an additional 33 schools. In the Dallas Independent School District (DISD), IBM planned and priced the E-rate program related work for all of the district's 245 schools.³⁹ Documents and testimony indicate that, as a result, the initial request to USAC for \$216 million for the district's 155 eligible schools was excessive. The Dallas School District official responsible for the project testified that when he reviewed the application, he was able to cut about \$86 million in duplicative products, services, and support. Overly duplicative applications were also part of the broader pattern of applications associated with IBM in Funding Year 2002. Documents in the record indicate that IBM recommended (and drafted into its statements of work for each applicant) "stand-alone" E-rate projects that had maintenance and other installation services actually built into the cost, in the event

³⁵ Documents in hearing record reveal funding for maintenance support covered more than "basic maintenance." *See Id.* at 478-79, 556-57, 561-65.

³⁶ Email subject line "TSO Support Multiple ISD," from Milota to Diaz et. al, of IBM, July 18, 2002. (This document is stored at the Committee on Energy and Commerce.)

³⁷ *See* Hearing, Part 3 at 560, 570.

³⁸ IBM testified that its maintenance costs were high because the District was moving from essentially no maintenance infrastructure to the set up of "a large, complex system." Actual maintenance and "help desk" support represented only a portion of the total costs. *See Id.* at 260, 261.

³⁹ *Id.* at 617.

that other maintenance projects were rejected. This approach led to large, redundant requests that inflated the cost.

- E-rate program technology plan requirements and resource requirements for school districts insufficiently guard against waste, fraud, and abuse.

EPISD maintained that the \$27 million maintenance operation and \$30 million worth of other E-rate program related work was consistent with the district's technology plan. However, that technology plan—as is generally the case for E-rate program technology plans—was insufficient to prevent waste, fraud, and abuse. In fact, the initial \$70 million in funding requests was made under the technology plan used by the EPISD the previous three years, when the school district received E-rate program funds averaging \$3.4 million per year. The plan provided no meaningful measures to ensure that the goods and services purchased were reasonably connected to the school district's needs and abilities. Significantly, USAC's guidance on technology plans notes that "it is only necessary that the approved plan include a sufficient level of information to justify and validate the purpose of a Universal Service Program request. However, it does not have to include the specific details and information called for on FCC Forms 470, 471, and 486 [request to commence invoicing]."⁴⁰ Moreover, USAC does not review plans as part of its normal application review process. The FCC in its August 2004 Fifth Report and Order declined recommendations to require such review, "for administrative efficiency." Given weaknesses in content and timing of plan preparation—the FCC only "expects," not requires, that plans are prepared prior to posting a Form 470.⁴¹

- The program does not ensure that schools and teachers have chosen goods and services they actually need.

Despite spending more than \$60 million in E-rate program funds, as well as its own money, for services and upgrades to its telecommunications infrastructure, El Paso was actually reducing its focus on integrating technology into the classroom. In the first three years of the program, the District's head of instructional technology, Ms. Sharon Foster, coordinated E-rate program applications. When Ms. Foster departed, E-rate program management was completely shifted to the technology department, which, by all available information to the Subcommittee, neglected to coordinate with the instructional needs of teachers. Indeed, during an August 2003 site visit, Subcommittee staff learned that in the year leading up to and following installation of the Funding Year 2001 project, El Paso effectively eliminated eight to ten "Campus Technology Coordinators." In short, the district eliminated a key element for coordinating training and curricula needs with the E-rate program application for goods and services. Consequently, high-quality gear and services were not being fully utilized more than a year after the systems were installed.

Hearing testimony by Ms. Foster also provided a broader perspective to the issue. That is, absent a direct link to the instructional needs of the students, school districts that have been driven

⁴⁰ See USAC technology plan guidelines at www.sl.universalservice.org

⁴¹ See FCC Fifth Report and Order and Order, August 2004, ¶¶ 56, 62.

by vendor influence have “asked for too much too quickly and were not in the best position to fully support technology projects for which funding was awarded.”⁴² “In short,” she said, “staff development, like the funding for network and technology projects, must be on a consistent, realistic, multi-year basis.”⁴³ With these weaknesses in technology planning and application certifications the E-rate program lacks an effective and reliable mechanism for ensuring that E-rate program funding requests are driven by instructional need.

- Unclear rules and program procedures and delays in program funding generate confusion among applicants and vendors, and are a source of waste.

Testimony by E-rate program vendors and school district officials provided an important perspective regarding the E-rate program’s rules and operation. First, substantial confusion regarding goods and services eligibility and the interpretation of vague rules and procedures contributes to waste and abuse. Notably, the FCC essentially acknowledged this confusion in its “Ysleta” Order regarding Funding Year 2002. Furthermore, the ambiguity of program rules also provides an incentive to vendors and consultants to take advantage of school districts that have either not necessarily planned for the E-rate program adequately, or that are not equipped with “technology-savvy” staff.

Second, the structure of the E-rate program funding cycle, with its very large time span between when an application is submitted and when it is funded, does not efficiently fit into the typical school district’s budget and planning cycles—an issue the Committee staff observed in many school districts. This disconnect between typical school operations and the program’s funding process generates waste, because districts must either scramble to spend the funds before the program’s implementation deadlines, or apply for E-rate program funds before other resources have been budgeted and secured. According to testimony, school districts that are burdened by limited planning in the first place may struggle to manage the overlapping phases of three E-rate program funding years that may be occurring at any one time. This inherent program confusion and delay contributes even more complexity to the effective implementation, management, and oversight of the program, from the perspective of the applicants, USAC or the FCC.

D. E-rate Related Investigation of Chicago Public Schools

The Subcommittee’s E-rate program oversight hearings were largely focused on the programmatic flaws and concerns with the program’s “front end” application process. Significantly, our work has determined that the E-rate program also encountered problems during the “implementation” stage of the funding process—that is, the period of time when E-rate program goods and services are provided, and the funds actually are spent.

Subcommittee oversight of Chicago Public Schools’ (CPS) participation in the E-rate program, and CPS’ relationship with the school district’s program manager, SBC Telecommunications

⁴² See Hearing, Part 3 at 154.

⁴³ *Id.*

(SBC)⁴⁴, helped to illuminate some of the major pitfalls of E-rate program implementation. In Chicago, the school district created an environment that encouraged program fund mismanagement by both the school and the primary E-rate program contractor, SBC, and led to the improper stockpiling of \$8.5 million in internal connections equipment, much of which included expensive electronic switches that never left distribution warehouses.⁴⁵

CPS is one of the largest school districts in the country, with nearly 600 schools and 435,000 students. CPS has received over \$236 million in E-rate program discounts since the program's inception, and according to the district has spent over \$600 million of non-E-rate funds on infrastructure improvements necessary to prepare the schools for the internal connections funded by the E-rate program.⁴⁶ Chicago became one focal point of the investigation as a result of Committee letters sent during July 2003 to 14 E-rate program vendors, including several SBC operating units.

During the course of the Committee's work, staff visited school districts across the country to observe first-hand how the E-rate program was actually being implemented. Among the site visits were two trips to Chicago, one in early December 2003 and the other in late August 2004, during both of which staff conducted interviews of the relevant employees of SBC and CPS. Staff had scheduled a December 11, 2003 site visit to Chicago, and on December 9, 2003, SBC's Washington, D.C. office contacted staff to alert the Committee regarding a then-current stockpile of \$5 million worth of E-rate program related inventory sitting unused in three Chicago warehouses. Committee staff later ascertained that SBC officials in Chicago had knowledge of the stockpiled equipment at least since early 2001, when more than \$8 million sat in inventory. There is no evidence indicating that SBC's knowledge extended beyond the Chicago office. Staff also determined that school district officials were aware of the inventory at least as early as April 2002. Staff further learned that SBC had been reimbursed by USAC for this unused equipment.

Also in December 2003, SBC tasked the law firm Mayer, Brown, Rowe & Maw LLP ("Mayer Brown") to conduct an internal investigation regarding the improper stockpiling and billing of USAC for the equipment. On January 14, 2004, the Committee issued a second letter to SBC requesting further details and documentation of the E-rate program in Chicago, and particularly the circumstances surrounding the equipment stockpiling. In mid-January 2004, Mayer Brown completed its investigation, and SBC provided a copy of the firm's report to the Committee.⁴⁷ The Mayer Brown Report concluded that SBC had violated program rules and that the company was required to return \$8.8 million to the E-rate program. On January 16, 2004, SBC submitted a payment of \$8.8 million to USAC. Subsequently, in late January 2004 the Committee requested further documents and information from the school district regarding its participation in the E-rate program, and specifically

⁴⁴ See Investigation Report by Mayer, Brown, Rowe & Maw LLP, dated January 14, 2004 (Mayer Brown Report) at 21. (The Report is stored at the Committee on Energy and Commerce).

⁴⁵ *Id.* at 2 and 35.

⁴⁶ See Investigation Report by Hogan & Hartson LLP, dated August 16, 2004 (Hogan Report) at 1. (The Report is stored at the Committee on Energy and Commerce.)

⁴⁷ See Mayer Brown Report.

regarding the inappropriate stockpiling. CPS hired outside counsel, the law firm Hogan & Hartson LLP (“Hogan”), which conducted an investigation and prepared a report of its own. CPS provided the Committee a copy of the report on August 16, 2004.⁴⁸

During Funding Year 1999, USAC approved CPS’ request for \$66 million for internal connections projects in July 1999.⁴⁹ CPS awarded a contract for management of the E-rate program project to SBC, which had specifically held itself out to CPS as having an expertise in project management.⁵⁰ Due to a number of issues, including inconsistent decisions by CPS administrators and poor planning, as well as lengthy USAC funding-decision delays, CPS faced a severe time crunch for fully implementing the \$66 million project before the funding year’s deadline of September 2000.⁵¹ Consequently, CPS instituted a “Fast Track” plan between June and September of 2000 to accomplish basic Local Area Network (LAN)⁵² construction in as many schools as possible before the deadline.⁵³ That decision ultimately led SBC and its subcontractors to bulk purchase and stockpile large quantities of internal connections equipment, including several hundred Cisco switches.⁵⁴ SBC submitted invoices and was reimbursed for this equipment, much of which had not been installed, violating E-rate program rules.⁵⁵

In April 2002, SBC and its major equipment supplier, Cisco, prepared an E-rate program related work proposal for marketing to Chicago Public Schools a “refresh” of the uninstalled switches. SBC and Cisco described the warehoused switches to CPS as being “obsolete.”⁵⁶ The SBC/Cisco switch refresh required that the school district return the “old” unused switches for a minimal discount against the cost of the new switches.⁵⁷ Thus, CPS and the E-rate program would essentially pay twice for equipment that had never been installed into the school district’s networks.⁵⁸ Under E-rate program rules and procedures, USAC would have simply approved the funding request for the new switches from CPS—as long as the request form was correctly filled out, submitted, and certified. At the time, USAC had no safeguards to prevent this sort of “refreshing” of otherwise usable equipment, or for detecting duplicative equipment requests.

In sum, the Chicago Public Schools case study highlights management and implementation problems that may be encountered

⁴⁸ See Hogan Report.

⁴⁹ See Mayer Brown Report at 27.

⁵⁰ See Hogan Report at 23. See also Mayer Brown Report at 21.

⁵¹ *Id.* at 27-32. See also Hogan Report at 31-38.

⁵² A LAN is generally defined as: “A system that links together electronic office equipment, such as computers, and forms a network within an office or a building.” (*Webster’s II New College Dictionary*, 3rd Ed., Houghton Mifflin Co., 2005). An “Ethernet” is one example of a LAN.

⁵³ See Mayer Brown Report at 32-33.

⁵⁴ *Id.* at 35-38.

⁵⁵ *Id.* at 39. In general, after a school certifies to USAC on an E-rate Form 486 that the applicant “is receiving, is scheduled to receive, or has received service” from the vendor, USAC will reimburse the vendor upon receipt of the vendor’s invoices. Subsequently, the vendor may submit a Form 474 (“service provider invoice”), informing USAC the amount of E-rate program funds owed to the vendor for the work performed. While the vendor indicates either the date it billed the school district for the work or the date that it completed the E-rate program related work, there is no requirement for the vendor to provide detailed billing information or supporting documentation.

⁵⁶ See Mayer Brown Report at 44. According to staff interviews of Cisco employees, however, the switches were far from obsolete, either in terms of their usefulness or the last date for which service support would be available.

⁵⁷ *Id.* at 45.

⁵⁸ *Id.*

when carrying out a very large and expensive E-rate program internal connections project over multiple years. The extended delay by USAC in making a funding commitment to Chicago Public Schools led the school district to make key project decisions that further compounded implementation issues. Furthermore, the case study highlights the limitations of USAC to effectively oversee the implementation of such complex projects.

Additionally, then-Chairman Tauzin and then-Subcommittee Chairman Greenwood requested further documents and information from SBC regarding its participation in the E-rate program in other regions of the country. SBC responded to the Committee's request, providing information to the Committee regarding: (1) an SBC Connecticut sales employee who discussed with school officials the possibility of inflating SBC's bid costs, so that sufficient margin would be available to cover Bridgeport Public School's co-payment; (2) SBC Ohio personnel who offered to provide Cleveland Municipal Public School District an interest-free loan to cover its co-payment, which the school rejected after its attorneys determined that such a transaction would violate E-rate program rules; and (3) an SBC refund to SLD of \$1.4 million in E-rate program funds from Funding Year 2003 that had been spent on ineligible services in New London, Connecticut.⁵⁹ In the Connecticut instance, SBC later entered into a consent decree with the FCC in which SBC made "a voluntary contribution to the United States Treasury in the amount of five hundred thousand dollars" in addition to the \$1.4 million that it had refunded to the SLD.⁶⁰ SBC also agreed to implement an extensive E-rate training and compliance program for its employees, designate regional E-rate program coordinators throughout the company, and create its own internal E-rate program oversight structure.⁶¹

Findings from the Chicago Public Schools related investigation:

- The timing of the E-rate program application, review, and approval process makes implementation of large internal connections projects, such as at Chicago Public Schools, particularly vulnerable to waste, fraud, and abuse.

Because of the very long delays in funding decisions by USAC, CPS faced the dilemma of spending \$66 million for Funding Year 2000 in only a matter of months. (In fact, during the course of the investigation, the Subcommittee frequently came upon instances in which school officials and their vendors found themselves with large sums of E-rate program funds being approved late in the program funding cycle and very little time to utilize those funds before the deadlines.) In late July 2000, the CPS Board and CEO directed Ms. Elaine Williams (the head of the school district's Office of Technology Services), against her recommendation to return unspent funds to USAC⁶², to spend \$54 million by September 30,

⁵⁹ See Letter from SBC to the Committee on Energy and Commerce, dated August 6, 2004. (The document is stored at the Committee on Energy and Commerce.)

⁶⁰ See FCC/SBC Consent Decree, adopted December 14, 2004.

⁶¹ *Id.*

⁶² It is not necessarily the case that CPS or any other school district that did not spend the entire committed amount in a given Funding Year would lose those funds. In the first instance, applicants have the opportunity to submit a request for an extension of time to complete the E-rate related project. Furthermore, USAC would likely approve a new application, for the following Funding Year, to complete the work that it had previously authorized.

2000.⁶³ This gave rise to the decision to implement the Fast Track program, setting off a chain of events that led to advance purchases of large amounts of equipment by SBC's distributors, and ultimately to the stockpiled surplus. Indeed, the SBC project management team in Chicago believed that the lynch pin to completing the work and utilizing the funds by the program deadline was materials procurement.⁶⁴

SBC and CPS agreed that bulk purchase of key materials, including "long-lead-time" components, was indeed the solution, and on July 20, 2000 CPS authorized SBC to make the bulk purchases.⁶⁵ Among other steps, SBC placed a purchase order with each of its three distributors for a total of \$24.5 million, based upon a generic "template design" for wiring all of the schools.⁶⁶ SBC also placed a \$3 million open purchase order with each distributor "to cover the materials needed for the Fast Track installations for both E-rate Year 2 and Year 3 which... had an identical scope of work and an overlapping three-month period."⁶⁷ According to one SBC program manager, contractors may have deliberately ordered excess materials to prevent any delays.⁶⁸ Ultimately, the Mayer Brown investigation determined that the initial Fast Track invoices were not based on actual shipments to schools, but rather were "pre-bills" for materials that were not yet shipped, but merely ordered or to be ordered by the distributors."⁶⁹

Further procurement confusion grew from a three-month overlap in E-rate program Funding Years 1999 and 2000, as well as from the fact that the "scope of work" for CPS' LAN project was identical for each year.⁷⁰ According to the Mayer Brown Report, this may have fostered "a lack of rigor among project personnel in failing to assure that all work funded with E-rate Year 2 SLD dollars was completed by the Year 2 implementation deadline, rather than being allowed to spill over into E-rate Year 3, and beyond."⁷¹

Building upon the unintended consequences, SBC's three distributors purchased directly from the switch vendor, Cisco, rather than through the program manager, SBC.⁷² Thus, "SBC had to pay the standard, non-discounted prices for the Cisco network equipment that its distributors had purchased, rather than the 35% bulk-rate discounts that would have been available on Cisco equipment had SBC ordered the equipment directly from Cisco."⁷³ Indeed, at a June, 2003 "Inventory Issues Meeting" between CPS and SBC, the meeting minutes state:

when CPS questioned why the amount paid for the original Cisco equipment (switches) was so large (approximately \$4 million), SBC stated that they paid full price for the Cisco materials. SBC could not obtain a discount, as is customary, because they ordered the Cisco Equipment from distributors. The

⁶³ See Mayer Brown Report at 34.

⁶⁴ *Id.* at 35.

⁶⁵ *Id.* at 36.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.* at 37.

⁷⁰ *Id.* at 32.

⁷¹ *Id.*

⁷² SBC is one of Cisco's industry "channel partners," and as such Cisco extends a substantial discount to SBC on its equipment purchases.

⁷³ See Hogan Report at 40.

discount can only be obtained if the order is placed directly through Cisco (material ordered directly from Cisco is discounted at 35%). SBC stated that there was not enough time to place the order directly with Cisco because of the time constraint imposed by the September 30 deadline.⁷⁴

Finally, with regard to the implementation phase of very large E-rate program projects, there is no commensurate oversight by the FCC or USAC after applications for funds are approved for disbursement. As a case in point, USAC's Arthur Anderson beneficiary audit of Funding Years 1999 and 2000 at Chicago Public Schools completely failed to identify the \$8.5 million in uninstalled inventory that USAC had funded. Instead, the audit identified some other billing and invoice discrepancies, which ultimately prompted CPS to hire its own auditor, KPMG. KPMG resolved many of the problems identified by Anderson, but also identified the deeper problems of program management detailed above.

- SBC and CPS failed to effectively plan, manage, and keep accurate records, and failed to resolve problems in a timely manner, which led to considerable waste.

The SBC project management team in Chicago failed to understand the E-rate program's rules. According to the Mayer Brown Report, "[e]mployees involved with the CPS E-rate Program had not received adequate training with respect to contractor obligations in a federally-funded program. This lack of training with respect to the unique obligations imposed under such a program resulted in the employees inappropriately relying on exchanges of e-mails with a federal agency for interpretation of federal regulatory requirements..."⁷⁵

SBC's account team lacked training regarding the issues surrounding the receipt of federal funds.⁷⁶ The SBC "management team received no formal E-rate training, nor training on regulatory compliance..." and the individuals in charge of that team "had no prior experience in managing E-rate projects or contracts involving federal funds."⁷⁷ For example, SBC's "program executive" for the Chicago E-rate project lacked any experience on federal government contracts or E-rate program projects prior to her leadership of the CPS LAN project.⁷⁸

The Mayer Brown investigation found that "at least by the end of 2000, SBC personnel were aware of the general requirement that materials be 'delivered and installed' in the E-rate year in which the materials were purchased."⁷⁹ SBC's subcontractor, TeamWerks, when told in writing by the SLD that it was against the rules to bill for "work" not installed by September 30, 2000, characterized that guidance as "quite ambiguous" because the SLD had made no reference to "materials."⁸⁰ Ultimately, SBC decided to roll forward the Funding Year 2000 inventory to Funding Year 2001—despite its knowledge of the rules requiring delivery and installation—based upon a tenuous distinction between "returned" excess inven-

⁷⁴ See Mayer Brown Report at Tab 30, at 9.

⁷⁵ *Id.* at 3.

⁷⁶ *Id.* at 26.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.* at 54.

⁸⁰ *Id.* at 55.

tory and excess materials that had never left warehouses.⁸¹ Further, SBC project leaders were willing to rely on an old and vague e-mail message from April 2001 to support their actions.⁸²

The school district also was responsible for the spate of program management problems. In order to ensure sufficient electrical power support for the LAN project, CPS undertook an electrical service upgrade at the same time as the LAN implementation.⁸³ CPS chose to execute both projects simultaneously, through a single contractor leading both efforts—even though the electrical infrastructure upgrades were not E-rate program eligible. As a result, “the LAN installation and power upgrade work contributed to a convoluted organizational structure for the overall project.”⁸⁴ Furthermore, SBC did not report directly to the school district. Instead, a consulting firm named Chicago School Associates (CSA) was hired by the district to manage the LAN installation and power upgrade general contractors, including SBC, so SBC’s project team reported to the Director of Program Management at CSA.⁸⁵

The school district made several other decisions that hampered project planning and efficiency, including, among others: 1) CPS had 250 schools that had separately applied for Funding Year 1999 E-rate funds, and which were outside the scope of the CPS-SBC agreement, but which still required E-rate program work to be accomplished; 2) the LAN project was initially supervised by the district’s Capital Improvements Department, not by the Office of Technology Services where the knowledge of the E-rate program and the LAN project actually resided; 3) the Capital Improvements Department generated its own LAN designs for the schools, despite the lack of necessary technical expertise, resulting in the majority of the designs being rejected by SBC and its network architect; 4) CPS required SBC to seek combined LAN/power upgrade bids from subcontractors⁸⁶; 5) CPS failed to promptly issue SBC a “notice to proceed,” further constraining the time available to fully utilize E-rate program funds before the funding deadline; 6) CPS delayed providing SBC specific school assignments for E-rate program LAN work; and 7) CPS frequently made revisions to the list of schools at which SBC needed to do E-rate program work. These sorts of choices ultimately end up costing a school district countless dollars in E-rate program resources.

- The E-rate program offers vendors a powerful incentive to sell unnecessary or excessive gear, and to upgrade equipment quickly.

According to the Mayer Brown Report, under the SBC-CPS LAN Agreement, SBC agreed to contract directly with contractors to perform the construction, installation and related services and to be responsible for paying such subcontractors on a timely basis. Generally, “SBC would be compensated by adding a 9.5% project man-

⁸¹*Id.* at 56.

⁸²*Id.* at 1-2. When KPMG first learned of the April 2001 e-mail to the SLD, it described the question as “misleading”—“apparently because it used the words ‘some inventory’ instead of disclosing the amount.” *Id.* at 48.

⁸³*Id.* at 28.

⁸⁴*Id.*

⁸⁵*Id.*

⁸⁶The Mayer Brown Report points out that because these combined bids were screened for the lowest *lump* sum price, the district had no guarantee that the E-rate program portion of a particular subcontract was being awarded to the lowest bidder for those services. *Id.* at 29.

agement fee to the amounts it paid out to its contractors.”⁸⁷ Further, explains the Mayer Brown Report, “given the costly infrastructure that SBC had to put in place to manage the project, SBC faced the risk of losing money on the contract if CPS failed to authorize a level of work sufficient to generate project management fees in excess of SBC’s costs. The structure of the contract’s payment terms created an economic incentive for SBC to encourage CPS to spend the full amount of any Universal Service Fund award it received from SLD.”⁸⁸

One additional result of this economic incentive was the problematic “refresh” proposal, described above, involving warehoused, new switches that Cisco and SBC described as “obsolete.” While the switches that CPS had purchased only months before were no longer “top of the line” due to technological advances, they were more than adequate for the district’s governing technology plan at the time. The “obsolescence” to which the vendors referred actually described the fact that the equipment possessed a finite date beyond which it would not be eligible for vendor maintenance. Yet, the switches at issue in Chicago would not reach that service life end date for another five years.

In the end, CPS bought new switches to replace ones that had never been installed and which had only been purchased mere months before vendors were proposing to replace them. This replacement of uninstalled equipment ultimately led to unnecessary costs for both the school district and for the E-rate program. While the proposal included a small trade-in rebate on the old switches, CPS would essentially be wasting nearly \$3.6 million.⁸⁹

E. E-rate Related Investigation of Atlanta Public Schools

In May 2004, a series of investigative reports by the Atlanta Journal-Constitution (AJC) newspaper alleged widespread waste, abuse, and mismanagement of more than \$60 million in E-rate program funds by officials at Atlanta Public Schools (APS). Subsequently, in June 2004, the Committee began an investigation and issued several letters to the district and its primary vendors, requesting documents and information regarding APS’ E-rate program.⁹⁰ The Committee’s letters focused on serious allegations that included the improper stockpiling of more than \$4.5 million in E-rate program funded equipment, non-competitive bidding for E-rate program work, installation of multiple \$100,000 Cisco switches in a single school, and other examples of “gold-plating.”⁹¹

The Committee also sought details regarding BellSouth’s installation of an expensive high-capacity network “backbone” into the district’s elementary schools, despite warnings to the school board by APS’ technology director at the time, that the project expansion

⁸⁷ See Mayer Brown Report at 21-22.

⁸⁸ *Id.* at 22.

⁸⁹ *Id.* at 45. While the full refresh plan was never carried out, a smaller variation of the refresh went forward. Importantly, however, SBC maintains that the SLD had not been billed for the purchase of the new switches because CPS never approved the relevant invoices. *Id.* at 47.

⁹⁰ See Committee Letter to Dr. Beverly L. Hall, Atlanta Public Schools, dated June 8, 2004.

⁹¹ The Subcommittee concluded its investigation without determining who was responsible for the decisions regarding the installation of these expensive Cisco switches or other gold-plating in Atlanta that wasted E-rate program funds. In Chicago, where Staff conducted an extensive investigation of CPS’ participation in the program, Cisco was a prime motivator in the school district’s decision to install unnecessary switches, as explained, *supra*, at 35-36.

was unnecessary and proceeding too rapidly. On December 19, 2004, a follow-on article by the AJC reported that school district officials diverted about \$5 million in E-rate program funds, between 2000 and 2002, to cover the cost of unauthorized or ineligible goods and services, including consulting fees, plasma television monitors, cell phone bills, and wireless Internet access for two of the district's football stadiums.

APS is comprised of 95 schools and approximately 57,000 students, with 80 of those schools at the E-rate program's 90% discount level. During the first four years of the E-rate program, \$81 million was committed to APS, of which approximately \$59 million has been disbursed. Additionally, a state educational consortium (known as the Metropolitan Regional Educational Service Agency, or MRESA) supplied an estimated \$8 million in E-rate program funded equipment to the district during Funding Year 1999. Thus, the district has received roughly \$68 million in E-rate program funded products and services. In Funding Year 2002, APS requested \$71 million from E-rate, but USAC denied that application because APS submitted an E-rate program application that was associated with the anti-competitive "strategic technology partner" application process involving IBM, as described earlier in this report.

A case study of Atlanta Public Schools therefore provided an opportunity to examine various dimensions of the implementation of E-rate program funded goods and services. Subcommittee staff recognized issues relating to competitive bidding procedures and the awarding of E-rate program contracts, "gold plating" schools with unnecessary technology, ordering equipment that might never have been installed, and funding of equipment that was not ordered. In response to the Committee's letter, the school district committed itself to providing answers to all of the Committee's questions by conducting an internal investigation and submitting a comprehensive report on its findings.⁹² As a *preliminary* answer to the requests for documents and information, on September 23, 2004, APS provided an "interim" report⁹³ to the Committee, prepared by its outside counsel, Greenberg Traurig, LLP ("Greenberg").

Greenberg submitted an "interim" report because the school district continued "to review documents including electronic data recovered during the investigation. Also, the information contained in this report was not based upon a complete audit."⁹⁴ Further, the interim report was submitted without the benefit of adequate interviews of several key school officials, and did not answer the Subcommittee's Question No. 6, regarding the school district's competitive bidding procedures, and Question No. 7(a), regarding any circumstances in which "the school did not receive the products and

⁹²As staff commenced work regarding Atlanta, attempts were made to interview several former school officials who were key decision-makers in APS' E-rate program. Two former leaders of the school district's technology department during the relevant time period declined, through their respective attorneys, to be interviewed regarding APS' participation in the E-rate program. Significantly, the respective attorneys for the two technology department officials each stated that, unless granted immunity, his client was likely to invoke his Fifth Amendment rights if invited to testify at a Committee hearing.

⁹³See Atlanta Public Schools E-rate Program Interim Report by Greenberg Traurig, LLP, dated September 23, 2004 (Greenberg Interim Report). (The Report is stored at the Committee on Energy and Commerce.)

⁹⁴*Id.* at 1.

services as specified on E-rate applications or invoices.”⁹⁵ Thus, the interim report failed to answer critical questions about waste, fraud, and abuse in the district’s E-rate program.

In fact, Greenberg informed Subcommittee staff that APS could not produce a complete report without further document retrieval and review and that it would cost approximately \$80,000 to do so. Given the breadth and scope of E-rate program waste, fraud, and abuse that the Subcommittee had already uncovered and examined elsewhere, it was decided that requiring the public school system to incur these additional costs was not essential for the Subcommittee to complete its work. Thus, before APS submitted a final and complete report, the Subcommittee finished its two-year investigation and began the work of assembling its findings to assist in laying the groundwork for legislation to improve the program. In the meantime, APS decided not to proceed with the additional work and expense of its internal investigation in connection with the Subcommittee’s request.

Moreover, because the Subcommittee ended its E-rate program investigation, having accumulated sufficient information regarding the program and its weaknesses, staff did not continue to further develop information regarding the respective roles of the school district and its E-rate program vendors in Atlanta. Because this information was not fully developed, Subcommittee staff has chosen not to include a “findings” section within this report.

In February 2005, however, APS issued a press release on its Internet website entitled “National E-rate Investigations Not Focused on APS,”⁹⁶ in which it misrepresented the outcome of the Subcommittee’s work. The school district declared that it had conducted an “exhaustive probe” and provided the Subcommittee with a report and eight boxes of documents. The document further stated that “after reviewing the files, Congress took no action against the APS,” implying that the Subcommittee gave APS a clean bill of health regarding its participation in the E-rate program.⁹⁷ As previously mentioned, contrary to APS’ representations, the documents and interim report did not answer all the serious questions regarding the school district’s management of its E-rate program. Additionally, the report incorrectly declared that APS had “no documentary evidence” regarding an allegation that vendors had improperly influenced the E-rate program application process during Funding Year 2002. In fact, the school district had e-mail documents that supported the allegation and that at least called for further examination by APS.⁹⁸

⁹⁵*Id.* at 6. *See also id.* at 116-17.

⁹⁶*See* <http://www.atlanta.k12.ga.us/news/goodnews/doc/022505SoutheastInvestigationOver.pdf>

⁹⁷On May 6, 2005, the *Atlanta Journal-Constitution* reported that in late April the Justice Department subpoenaed E-rate related records from Atlanta Public Schools, for delivery to a federal grand jury by May 24, 2005.

⁹⁸The report states that investigators could not locate any documentary evidence supporting an allegation that an IBM representative established a close relationship with Mr. Robert Beman, the school district’s former Chief Information Officer, and that IBM used that relationship to ensure that it had a major role in preparing APS’ Funding Year 2002 E-rate application through its consultant Alpha Telecommunications (“Alpha”). Specifically, an APS employee believed that IBM and Alpha had persuaded Mr. Beman to permit Alpha to prepare the E-rate forms, to “assure that IBM received [follow-on] E-rate funded contracts . . . in direct response to IBM’s alleged dissatisfaction about not being awarded APS E-rate funded contracts during Funding Year [2001].” *See* Greenberg Interim Report at 71-72. According to the employee, Mr. Beman “developed a close relationship with IBM, and in particular with IBM’s Atlanta representative, Portia Lemons.” *Id.* at 72. The employee believed that Mr. Beman was urged to

F. GAO Work Requested by the Committee

The Subcommittee has examined various aspects of the E-rate program and its impact in several school districts. Through this work, a number of troubling failures and weaknesses were identified, as outlined in this report. More broadly, the failures in preventing waste, fraud, and abuse point to problems in the program's structure and the FCC's management of the E-rate program.

In recent years, several initiatives were established to address issues of waste, fraud, and abuse in the E-rate program. For example, USAC, with the support of FCC, convened a 14-member Task Force of program "stakeholders"—comprised of vendors, consultants, and school and library officials—to make recommendations to reduce waste, fraud, and abuse and improve program effectiveness. A number of its recommendations have subsequently been addressed in procedural changes or in FCC rulemaking.⁹⁹ Since January 2002, the FCC has conducted a series of program rulemakings to address a number of issues relating to reducing waste, fraud, and abuse, such as strengthening application certifications or bidding requirements. While the Subcommittee considers these actions to be positive steps, the effectiveness of any given program change cannot be assessed until more information is collected from audits and the FCC IG's investigations. While the E-rate program has evolved, and certainly operates better in some ways today than it did in 2001, that evolution has proceeded much too slowly. Clearly, not all problems have been addressed by these measures. Indeed, the pattern of problems and failures involves more fundamental questions about the FCC's management.

Thus, with an eye toward gathering further information and gaining a better understanding of the FCC's stewardship of the E-rate program, then-Chairman Tauzin and then-Subcommittee Chairman Greenwood requested that the Government Accountability Office (GAO) "review the E-rate program's structure and operations to determine whether federal funds are being used in accordance with program rules, whether the funds are being used effectively to achieve program goals, and whether the program needs fundamental changes to ensure program goals are met."¹⁰⁰ In response to the Committee's request, the GAO set out to "evaluate (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

allow Alpha to prepare the E-rate forms, so that Alpha could "ensure that IBM would be awarded an E-rate funded contract." *Id.* The Greenberg Interim Report stated that there was no evidence of such communications with Alpha before the application's submission in January 2002. However, Alpha produced e-mail documents to the Subcommittee that show IBM's and Alpha's interaction with Mr. Beman regarding the E-rate program and which support the APS employee's account. APS' Funding Year 2002 application was denied because it was part of the "technology integrator" pattern that was identified by USAC as subverting the competitive bid process.

⁹⁹ See USAC Memorandum to FCC, dated November 26, 2003. The recommendations by the Task Force represented a broad consensus; i.e. recommendations were supported by at least 10 Task Force members and opposed by no more than two members. Thus, recommendations that might have been viewed as affecting too much the interests of vendors (with five representatives), would not have been reported.

¹⁰⁰ See <http://energycommerce.house.gov/108/Letters/12022003—1142.htm>

proceedings, beneficiary audits, and reviews of USAC decisions (appeals)—in managing the program.”¹⁰¹

The completed report, released at a Subcommittee E-rate program hearing on March 16, 2005,¹⁰² raises serious questions about the FCC’s management and oversight. The report finds an astounding degree of managerial neglect of the E-rate program. Due to this neglect, Congress cannot confidently assess either: a) the adequacy of the current program structure, or b) whether the program is in fact achieving the goals contemplated by Congress when it “created” the program in 1996.

When Congress codified Universal Service in 1996, it effectively changed the nature of the industry-managed universal service support from an administratively sanctioned process, to a statutorily authorized collection of funds for universal service as determined by Congress. The GAO details that this action caused the fund to become, essentially, a permanent congressional appropriation. Consequently, a key series of questions were—or should have been—brought to bear on the structure of the fund, the structure of the various “funding mechanisms,” and the entities established to administer the fund. It was incumbent upon the FCC, as the agency responsible for the fund, to follow the direction of Congress concerning universal service. Implicitly, the FCC had broader obligations to Congress to ensure the fund’s new structure adhered to all the relevant statutes, including any and all requirements concerning the treatment of appropriated funds. This did not happen. As a result, the E-rate program from the start has been hampered by lingering questions concerning its organization and structure, as mentioned in previous GAO reviews of the program.¹⁰³ Furthermore, “new” questions continue to arise, many of which could have been resolved early on in the program.¹⁰⁴ The FCC’s failure to resolve these issues in a comprehensive fashion at the outset has led to a number of problems that Congress must now address. The GAO report’s main findings, with a brief Subcommittee staff commentary, include:

- The FCC crafted an ambitious, multi-billion-dollar funding program, using an “unusual” organizational structure, and then never conducted a comprehensive assessment to determine which federal requirements, policies, and practices apply to the program, to USAC, and to the Universal Service Fund itself.

This circumstance requires the resolution of several structural and fiscal questions to ensure program integrity in the future. The GAO notes that USAC—a non-profit, private entity—operates and disburses funds under a less explicit federal affiliation than many other federal programs. For example, USAC and the FCC share no

¹⁰¹ See “Telecommunications: Greater Involvement Needed by FCC in the Management and Oversight of the E-Rate Program,” GAO-05-151, Feb. 2005 at 3 (hereinafter referred to as the “GAO Report”); Available at <http://www.gao.gov/new.items/d05151.pdf>.

¹⁰² See “Hearing on Problems with the E-rate Program: GAO Review of FCC Management and Oversight,” March 16, 2005, Committee on Energy and Commerce, Serial No. 109-7.

¹⁰³ See, e.g., GAO-02-187, February 2002; GAO-01-673, May 2001; GAO-01-672, May 2001; GAO-01-105, December 2000; GAO/HEHS-99-133, August 1999; RCED-99-51, March 1999; GAO/T-HEHS-98-246, September 1998; T-RCED-98-243, July 1998; GAO/RCED/OGC-98-172R, May 1998; GAO/T-RCED/OGC-98-84, March 1998.

¹⁰⁴ For example, in later September and early October 2004, a last-minute decision by the FCC regarding the Anti-Deficiency Act’s (ADA) effects on the E-rate program temporarily prevented USAC from issuing commitment letters to E-rate program applicants, until Congress passed a temporary exemption of the E-rate program from the ADA.

contract or memorandum of understanding for administering E-rate. Moreover, USAC is a wholly owned subsidiary of another private entity—the National Exchange Carriers Association (NECA). This relationship gives rise to unanswered questions concerning: (a) the fact that a non-governmental entity administers billions of dollars in “federal funds”; and (b) the questionable and, by appearance, potentially conflicted relationship of USAC and NECA—further, while NECA is the sole shareholder of USAC, it is also a major subcontractor for USAC that administers part of the fund.¹⁰⁵ The GAO report provides some details regarding the current structure, established by the FCC in November 1998 when it appointed USAC the “permanent” administrator of the program, in an effort to address legal concerns raised by the GAO and Congress. Because questions remained, the FCC made this appointment subject to a one-year review. Significantly, and to some degree emblematic of other promises made by the FCC regarding the program, that review was never performed. Furthermore, the plan the FCC adopted to make USAC the permanent administrator—drafted by the funding administrators—recommended full divestiture of USAC from NECA. In its 1998 Third Report and Order, the FCC pledged to review the divestiture issue after one year, but, again, that review never happened. At this point, resolution of these structural issues may likely need Congress to provide specific statutory guidance.¹⁰⁶

The nature of the USAC/FCC relationship exacerbates current issues concerning the treatment and handling of E-rate program funds. The GAO explains that questions about whether Universal Service Funds should be treated as “federal funds”—and thus implicating all relevant federal statutes that protect taxpayer interests—have plagued the program from the start. The FCC failed at the start to determine clearly and comprehensively the nature of the funds. Instead, the FCC took a case-by-case approach to questions of fund status, and did so with some delay. As the GAO notes, this “put FCC and the program in the position of reacting to problems as they occur rather setting up an organization and internal controls designed to ensure compliance with applicable laws.” It also raises questions about past FCC determinations. Given the piecemeal decision making, the GAO states that “where FCC has determined that fiscal controls and policy do apply [to the USF], the commission should reconsider these determinations in light of the status of universal service monies as federal funds.”¹⁰⁷ While the FCC recently began to address some of the issues surrounding the funds’ status, it has been slow to tackle the implications of their status.

Indeed, the FCC’s hesitation has caused unnecessary disruptions and waste in E-rate program operations. For example, on September 26, 2003—more than five years into the E-rate program—the FCC mandated that USAC prepare USF financial statements consistent with “generally accepted accounting principles for federal agencies’ (GovGAPP). The FCC expressly noted that this

¹⁰⁵ See GAO Report at 70.

¹⁰⁶ For example, Congressional guidance may be necessary expressly to make USAC the permanent administrator, or to place the E-rate program within the Executive Branch, or elsewhere. See Third Report and Order, FCC 98-306, November 19, 1998.

¹⁰⁷ See GAO Report at 66-68.

change could have broad implications regarding compliance with a myriad of federal accounting statutes, and therefore gave USAC one year to transition to GovGAPP. But the FCC subsequently failed to review in a timely manner the change's implications and provide the necessary guidance to USAC. Ultimately, the FCC's delay led to USAC suspending E-rate program commitments in August 2004 until the FCC responded to USAC's query as to whether the Anti-Deficiency Act applied to E-rate program funds. The FCC did not address the issue until two weeks before the deadline for the GovGAPP standards to take effect. As a result of the FCC's actions, the USF lost approximately \$4.6 million. Additionally, the delay froze hundreds of millions of dollars in E-rate program commitment decisions, thus postponing and disrupting the planning at school districts around the nation. As this report noted earlier, funding delays by the FCC and USAC conflict with school districts' budgeting and planning cycles and thus increase the risk of waste and abuse.

The GAO report confirms that Universal Service Funds should be treated as federal funds, and that all applicable federal statutes and requirements apply to the administration of the USF, unless specifically exempted by Congress. What remains unclear, however, is the extent to which such requirements will affect USAC and the Fund. For example, how do relevant statutes such as the Single Audit Act, the Cash Management Improvement Act, and the Improper Payments Information Act of 2002 impact E-rate program funds? Furthermore, absent a comprehensive review and assessment, poorly founded decisions may be made about Fund treatment, to the detriment of the taxpayers.¹⁰⁸

- Although USAC has committed more than \$15 billion to E-rate program applicants during the past 8 years, the FCC did not develop performance goals and measures that could be used to assess the specific impact of this spending and to improve the management of the program.¹⁰⁹

The FCC, USAC, E-rate program participants, and observers of the E-rate program have frequently noted that, since the program began in 1998, the nation's schools have significantly increased their rates of Internet access and connectivity. The Department of Education's National Center for Education Statistics are frequently cited—which report that, as of 2003, 100% of public schools and 93% of public school instructional classrooms had Internet access, up from 89% and 51%, respectively, in 1998.¹¹⁰ While this information may be valuable to a broader assessment of the nation's telecommunications and education policies, it does not provide or represent a meaningful measure of the E-rate program's impact. The GAO notes that “although billions of dollars of E-rate funds have been committed since 1998, adequate program data was not developed to answer a fundamental performance question: how much of the increase since 1998 in public schools' Internet access has been

¹⁰⁸ A bill has been introduced in the Senate, S. 241, that exempts the Universal Service Fund from the Anti-Deficiency Act. Absent careful study, any exemptions from federal accounting statutes may be premature and may do more harm than good.

¹⁰⁹ According to USAC data, as of October 5, 2005, it has committed over \$15 billion and actually disbursed more than \$10 billion in E-rate program funds.

¹¹⁰ See “Internet Access in U.S. Public Schools and Classrooms: 1994-2003,” National Center for Education Statistics, February 2005 at 3-7, 18-23.

a result of the E-rate program, as opposed to other sources of federal, state, local, and private funding?”¹¹¹

The failure to implement performance measures bears on a number of aspects of the FCC’s E-rate program management, in addition to the fact that it ignores requirements of the Government Performance Results Act of 1993. Perhaps most troubling, Congress has little or no information about the program’s effectiveness; yet, more than \$9 billion has been spent. This does not mean that the program has not been effective—the Subcommittee’s investigation has observed compelling examples of E-rate program funding being used to improve classroom instruction and the coordination of effective instruction. However, the FCC has squandered the opportunity to quantify and assess—and ultimately, to improve—the program’s effectiveness and efficiency in a meaningful way. This is a profound failure in the FCC’s responsibility and accountability to Congress, which in the end must answer to American taxpayers about the value and direction of the E-rate program.

The failure to institute performance measures is symptomatic of the broader management problems at the FCC concerning the E-rate program. In the past, the FCC has informed the GAO that it would implement performance goals and plans for the E-rate program, but then failed to do so. For example, in December 2000 the FCC told the GAO that it had finalized a new performance plan to increase the rate of program participation by low-income, urban schools. Yet, the current GAO report notes that when it inquired in 2004 about the plan, “we were told that it had not been implemented and that none of the FCC staff currently working on E-rate was familiar with the plan.”¹¹² Staff turnover, as well as the size of the staff overseeing the USF,¹¹³ contributes to this lack of institutional follow-through and the general ability to address program issues and policy questions in a timely manner, see below. Instances such as this undercut confidence in the FCC’s promises to address these issues and increase its attention to the program.

- The FCC’s three key oversight mechanisms for the E-rate program—rulemaking procedures, beneficiary audits, and reviews of USAC decisions (appeals decisions)—are not fully effective to manage the program.

This GAO finding highlights a number of observations and problems identified by the Subcommittee during the course of the investigation. However potentially effective these three oversight mechanisms may be for a regulatory agency, the record suggests that they fall short in effectively managing a large, complicated, quasi-grant program like E-rate. These mechanisms are even less effective because of the FCC’s evident inattention to the program.

The management and oversight issues identified by the GAO include:

- (1) The FCC is currently relying on USAC to identify which procedures should be codified into rules, raising the question of which “entity is really establishing the rules of the program and—con-

¹¹¹ See GAO Report at 21-22.

¹¹² *Id.* at 23.

¹¹³ *Id.* at 57.

cerns about the depth of involvement by FCC staff with the management of the program.”¹¹⁴

(2) The FCC has not fully addressed confusion and enforcement issues arising from the distinction between USAC “implementing procedures” and the FCC’s program rules. This causes confusion regarding rule enforcement and the ability to recover funds when USAC procedures are violated. The GAO notes, for example, that, even under the FCC’s August 2004 Fifth Report and Order, which addressed some questions concerning codifying procedures, “the commission did not clearly address the treatment of beneficiaries who violate a USAC administrative procedure that has not been codified.” The GAO explains that this “creates a potentially unfair situation when the procedure is one that can lead to denial of an application.” That is, if a procedure violation is caught in the application process, funding will be denied; if it is caught later, in a beneficiary audit, no action to recover funds can be taken.¹¹⁵

(3) The FCC resolves appeals too slowly, and has a very large backlog of appeals—527 appeals were pending decisions at the time the GAO completed its review. This adds uncertainty to the program and leaves applicants in an E-rate program “limbo,” and raises the risk of both wasted funding opportunities and wasteful spending. All of these examples raise questions about the FCC’s ability to handle the additional burden of audit resolution that is expected to arise from a new set of about 200 beneficiary audits planned for the program. Resource demands are only likely to grow, and it is not clear that the FCC will be able to keep up. In short, the GAO concludes, the FCC simply has not done enough to manage and provide a framework of government accountability for the multi-billion-dollar E-rate program. The prospects for positive progress in the future, given the FCC’s past actions, staff turnover, and neglect, are not encouraging.

GAO Recommendations: The GAO concluded that the problems it identified signal that the FCC must take corrective action. The GAO report recommended that the Chairman of the FCC direct the agency to take the following actions:

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 program and the funding. The assessment should include, but not be limited to: (a) the implications of the FCC’s determination that the Universal Service Fund amounts to an “appropriation” by identifying the fiscal controls that apply to the Universal Service Fund, including the collection, deposit, obligation, and disbursement of funds; and (b) an evaluation of the legal authority for the organizational structure of the E-rate program, including the relationship between the FCC and USAC and their respective authorities and roles in implementing the E-rate program.¹¹⁶

¹¹⁴*Id.* at 29.

¹¹⁵*Id.* at 27-30.

¹¹⁶In connection with the GAO work and Subcommittee inquiry, the FCC announced in March 2005 that it had contracted with the National Academy of Public Administration (NAPA) for NAPA to study and explore alternative models to the current organizational and government structure of the Universal Service program. The GAO testified before the Subcommittee on March 16, 2005 that this study would go “a long way toward addressing the concerns” on this

2. Establish performance goals and measures for the E-rate program that are consistent with the Government Performance and Results Act. The FCC should use the resulting performance data to develop analyses of the actual impact of E-rate program funding and to determine areas for improved program operations.
3. Develop a strategy for reducing the E-rate program's backlog, including ensuring that adequate staffing resources are devoted to E-rate program appeals resolution.

The staff concurs with these recommendations. They are reasonable and necessary steps that the FCC must take to begin resolving the problems identified both by this Subcommittee, the FCC IG, and the GAO. Each of the recommendations addresses the main findings in the GAO report. Further, as the GAO recommends, the FCC should request of the Comptroller General an advance decision, as applicable under 31 U.S.C § 3529, on matters relating to the complexities posed by the FCC's arrangements with USAC and the questions that flow from these arrangements.

Given the FCC's history of E-rate program management, as identified by the GAO and this Subcommittee's investigation, the FCC should produce for the Committee a report with relevant findings and actions, addressing the GAO's recommendations. The FCC's analysis should recognize the dynamic state of technology, and offer an assessment of the extent that, given the data that 100% of schools are reportedly connected to the Internet, the emphasis of the E-rate program's non-Priority I funding may well shift to upgrades and maintenance. Given the current state of Internet connectivity, measurement and goals matrices for assessing program progress that may have been appropriate for 1998 may no longer be valid for 2006 and beyond. The FCC should account for the current state of school technology in its analyses.

The staff agrees with the GAO's view that any reassessment of the program must consider the needs of the beneficiaries—the schools and libraries across the country that use the E-rate program to support their purchase of telecommunications services. Efforts to protect the program from waste, fraud, and abuse do not need to be mutually exclusive of a program that does not excessively burden the participants. This may first require an honest assessment of the program's goals and operations. Additional assistance from the GAO to review and assess crosscutting efforts by other Federal agencies to assist schools and school districts is probably necessary to develop an accurate picture of federal support of telecommunications in education.



issue outlined in its report. However, at an April 26, 2005 House Appropriations Justice State Subcommittee hearing, FCC Chairman Martin testified that the study had been put on hold pending further review. On June 9, 2005 the FCC issued a Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking to initiate "a broad inquiry into the management and administration of the Universal Service Fund." Because of this action, Chairman Martin cancelled the NAPA contract. Staff believes the FCC's decisions on this front will demonstrate the depth of the agency's seriousness in implementing the GAO's recommended reforms.