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Telecommunications Discounts for Schools and Libraries: The "E-Rate" Program and Controversies

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Telecommunications Discounts for Schools and Libraries: The "E-Rate" Program and Controversies

SUMMARY

Passage of the Telecommunications Act of 1996 (P.L. 104-104) codified the long standing policy commitment to ensure universal service in the provision of telecommunications services. The 1996 Act also expanded the concept to include, among other principles, that elementary schools and classrooms, and libraries should have access to telecommunications services for educational purposes at discounted rates. The Federal Communications Commission (FCC) was tasked with implementing the universal provisions of the act and on May 7, 1997, adopted its order detailing its guidelines.

Included within that order was the establishment of the schools and libraries, or E-rate, program. Under this program telecommunications services, Internet access, and internal connections will be provided at discounts ranging from 20% to 90 % to eligible schools and libraries. The FCC established the Schools and Libraries Corporation (SLC), an independent, not-for-profit corporation to administer the program. As the result of a January 1, 1999 reorganization, however, the SLC became the Schools and Libraries Division of the Universal Service Administrative Company (USAC) and ceased to exist as a separate corporate entity. The program receives no federal funds but is funded by mandatory contributions from interstate telecommunications service providers. Many of these providers have chosen to pass through universal service charges directly to consumers and earmark a universal service charge on subscribers' bills.

Although most support the concept, the FCC's implementation of the schools and libraries provisions of the 1996 Act generated significant and diverse controversy. The decision by various telecommunications service providers to pass through and itemize universal service contributions on subscribers' bills focused further attention on this issue. Concerns focus on : the administrative structure designed to implement the program; the scope and funding level of the program; and the potential for application fraud, waste and abuse.

Since its implementation the E-rate program has been the subject of Congressional scrutiny, and while legislative measures to modify the program have been introduced, since the 105th Congress, none have been enacted. A series of reports, issued by the FCC's Office of Inspector General, raising concerns about the financial oversight of the program has, once again, prompted scrutiny on a number of fronts. In the 108th Congress the House Energy and Commerce Committee and the Senate Commerce Committee held hearings on the oversight and compliance of the program. The FCC as well as the USAC have also initiated actions to examine and strengthen the program and the Department of Justice has taken action to investigate and prosecute E-rate fraud.

The yearly program funding level, which was established by the FCC in May 1999, remains at $2.25 billion. For the first six years of the program $12.9 billion in funds have been committed.

MOST RECENT DEVELOPMENTS

Continued Congressional concern over oversight of the E-rate program coupled with the expiration, at the end of 2005, of the exemption of the USF from the Anti-Deficiency Act has made the management and operation of the E-rate program an issue in the 109th Congress. The FCC as well as the USAC have also initiated actions to examine and strengthen the program and the Department of Justice has convened a task force and grand jury to investigate and prosecute E-rate fraud.

Over the first six years of the E- rate program, $12.9 billion in funds have been committed. Funding commitments for Year 2004, the seventh and current year of the program, totaled $1.8 billion as of March 1, 2005.

BACKGROUND AND ANALYSIS

Passage of the Telecommunications Act of 1996 (P.L.104-104) codified the long-standing commitment by U.S. policymakers to ensure universal service in the provision of telecommunications services. The universal service concept, as originally designed, called for the establishment of policies to ensure that local telephone service is available to all Americans by ensuring that rates for residential consumers as well as consumers in high cost areas were kept reasonable. Congress, through the 1996 Act, not only codified this concept, but also expanded the concept of universal service to include, among other principles, that elementary and secondary schools and classrooms, and libraries should have access to telecommunications services for educational purposes at discounted rates. (See Sections 254(b)(6) and 254(h)of the 1996 Telecommunications Act.)

Consistent with provisions contained in the 1996 Act the FCC, guided by the recommendations of a federal-state joint board, was assigned the responsibility for implementing these universal service guidelines. On May 7,1997, the FCC adopted its order implementing the universal service provisions and principles set forth in the act. Included within that order was the establishment of the schools and libraries, or E(education) - rate, program. Under this program telecommunications services, Internet access, and internal connections are to be provided at discounts ranging from 20% to 90 % to eligible schools and libraries. Therefore schools and libraries do not receive direct funding from the program but monies from the fund are used to reimburse the vendors who supply the services to the program's participants.

This issue brief does not attempt to explain the specifics of the E-rate program. It solely addresses the controversial issues surrounding the program's implementation and subsequent legislative measures introduced to address these issues. An additional issue, concern that minors may gain access to "inappropriate" material through the Internet has also had an impact on the E-rate program. This issue goes beyond the scope of this issue brief, but is addressed in CRS Report RS21328, *Internet: Status Report on Legislative Attempts To Protect Children from Unsuitable Material on the Web,* by Marcia Smith and Amanda Jacobs.

Although most policymakers support the universal service concept, the FCC's implementation of the schools and libraries provisions of the 1996 Act has generated significant controversy. The decision by various telecommunications service providers to pass through and itemize universal service contributions on subscribers' bills has focused further attention on this issue. Oversight of the schools and libraries program by the 105th Congress became intense with congressional comments ranging from those who called for the abolishment of the program, to those who supported of the program but felt it needed major revisions, to those who continued to support the program as funded and designed. Concerns regarding the schools and libraries program focus on: the administrative structure designed to implement the program; the scope and funding level of the program; and the potential for fraud, waste, and abuse.

Administrative Structure

The FCC established the Schools and Libraries Corporation (SLC), an independent not-for- profit corporation, to administer the universal service program for schools and libraries. Since its inception, however, the SLC became the focus of a wide range of concerns which eventually led to the reorganization of the administrative structure of the E-rate program. (See Restructuring — from SLC to SLD, below.) Some questioned the need for the SLC and expressed concern that it only adds "new levels of bureaucracy" and siphons away money that could be used to fund universal service objectives. Concerns have also been expressed over the size of the SLC's first year operating budget ($18.8 million) as well as employee compensation levels. Of greater significance was the debate over whether the FCC had exceeded its authority when it directed the establishment of the corporation.

The General Accounting Office (GAO) in response to a November 1997 request from Senator Stevens, reviewed the FCC's action establishing the SLC. The GAO concluded, in its February 10, 1998 response, that the FCC had exceeded its authority when it directed the creation of the SLC, in violation of the Government Corporation Control Act (P.L. 97-258). FCC Chairman Kennard disagreed with the GAO's conclusion and stated that the FCC was within its authority, based on its general authority under Section 4(i) of the Communications Act, to establish this corporation. However, continued controversy over the legality of and the need for the SLC led to congressional action to modify the administrative structure of the E-rate program.

An amendment added to the Senate's 1998 supplemental appropriations bill (S. 1768), by Senator Stevens, addressed the administration of the schools and libraries and rural health care portion of the universal service fund. This amendment, which was approved by the Senate by voice vote on March 24, 1998, would have required the FCC to abolish the SLC and its rural health care counterpart, consolidate them into a single entity, and cap the compensation given to its officers and employees. The FCC was required to submit to Congress by May 8, 1998, a report detailing the revised structure for this entity, and additional information on the contributions to, and requests for funding from the schools and libraries program. These provisions were not included in the text of the final bill (H.R. 3579), which was signed into law on May 1, 1998 (P.L. 105-174). However, the conference committee's "joint explanatory statement" did make mention of these provisions and stated that "while the conference agreement does not include" the provisions relating to universal service contained in S. 1768 the conferees "expect that the FCC will comply with the

reporting requirements in the Senate bill, respond to inquiries regarding the universal service contribution mechanisms, access charges, and cost data, and propose a new structure for the implementation of the universal service programs." The joint statement also concurs with the provisions relating to a compensation cap for employees administering the program. The FCC complied with the provisions contained in S. 1768 and submitted its report to Congress on May 8, 1998.

Restructuring — from SLC to SLD. In its May 8 Report to Congress (FCC 98-85), and a subsequent action of June 12, 1998 (CC Docket No. 96-45), the FCC: proposed the elimination of the SLC as a separate entity; lowered the compensation level of officers and employees of the SLC; and requested that Congress grant specific statutory authority for the newly proposed restructuring. The FCC requested that the administrative entities affected by this proposal submit a reorganization plan to implement these changes for FCC approval.

The restructuring plan was submitted to the FCC on July 1, 1998 and after receiving public comment was approved, with modifications, by the FCC on November 19, 1998. The approved plan, which went into effect on January 1, 1999, calls for the administration of all forms of federal universal service support to be consolidated in a single entity, the Universal Service Administrative Company (USAC). The USAC, the entity that among other duties currently administers the high cost and low income portions of the universal service program, was to become the permanent, sole administrator of all universal service programs, subject to FCC determination, after one year, that the USAC is administering support in an "efficient, effective, and competitively neutral manner." The SLC would become the Schools and Libraries Division (SLD), one of three divisions within the USAC. The USAC CEO would manage all three divisions. The USAC will continue to function as a subsidiary of the National Exchange Carrier Association (NECA), and the FCC will review, after one year, whether the USAC should be divested from the NECA. This reorganization plan, became effective as of January 1, 1999 and the independent SLC ceased to exist. (A copy of the approved reorganization plan can be found on the FCC's web page at [http://www.fcc.gov/wcb/universal_service/usacjuly.pdf].)

As a result of the reorganization a single entity, the USAC, is now responsible for administering all the telecommunications universal service programs for the FCC, including the schools and libraries or E-rate program. The USAC, a not-for-profit subsidiary of the National Exchange Carrier Association, is governed by a Board of Directors composed of a broad range of industry and non-industry interests. Committees of the USAC Board govern each division and each committee of the USAC Board oversees the budget of its respective Division and reports to the overall USAC Board. The USAC Board has the authority to review any action taken by a committee. The SLC no longer exists and has become one of three divisions of the USAC known as the Schools and Libraries Division (SLD). Although no longer a separate entity , the SLD essentially carries out the same functions as the former SLC.

While continuing to uphold its legal right to create a separate entity to administer the schools and libraries fund, a position contrary to a February 10, 1998 GAO opinion, the FCC has requested that the Congress provide specific statutory authority for the restructuring to eliminate any question concerning the USAC's legal status and authority.

The FCC also directed that effective July 1, 1998, the level of compensation be lowered for the officers and employees of the SLC. Compensation cannot exceed the rate of basic pay for level I of the Federal Executive schedule, which is currently $151, 800 a year. (The May 8, 1998 Report to Congress, and the subsequent June 12, 1998 order are available at the FCC's website at [http://www.fcc.gov].

Scope and Funding

Although federally mandated, the E-rate program, as designed by Congress, is funded by telecommunications service providers. All interstate telecommunications providers, as defined by the FCC, are required to contribute to the program. Contributions are based on a percentage of both interstate and international revenues. This percentage or "contribution factor" is calculated by the FCC's Common Carrier Bureau on a quarterly basis and varies depending on the anticipated funding needs for the program. Many telecommunications service providers have chosen to pass through these costs directly to their subscribers ultimately making consumers of telecommunications services bare the costs of the program.

Congressional concerns regarding funding rest on both the scope of the services included in the program and the funding level established to meet the program's needs. The $2.25 billion per year funding ceiling established by the FCC to implement the schools and libraries discount and the range of services included in the program have generated significant concern.

While most support the basic concept of the program, many have questioned the need for a multi-billion dollar funding level and have expressed concern that the range of services included in the program goes beyond congressional intent. Critics feel that the program, as implemented by the FCC, is too extensive and will result in the funding of "gold plated" systems. Coverage of sophisticated equipment such as routers, hubs, and network file servers, as well as the inclusion of internal connections (i.e., wiring to connect classrooms within a school), has been criticized. Opponents claim that the extensive scope of the program goes beyond the program's intent and has resulted in an unnecessarily high funding level. Those critical of the program as implemented support a more modest approach. Opinions have also been expressed that the FCC's time frame for accomplishing the program is too short and overly ambitious and should be lengthened, thereby reducing the amount of funding needed yearly.

On the other hand, many supporters of the E-rate program feel that the range of services covered and the funding level should remain or, if anything, be expanded. A decrease in funding levels or scope is viewed as a retreat to the commitment Congress made to schools and children. Furthermore, the $2.25 billion funding ceiling is not considered unreasonable, they state, given the revenue stream of the industry. The inclusion of internal wiring they note is consistent with the intent of Congress and critical to the program's success. They cite specific reference in the universal service provisions to access by "school classrooms" to advanced telecommunications services to bolster their claim. Some also support expansion of the program to include funding for time of use on the Internet. This they feel is particularly critical for economically disadvantaged schools since connection is of little

value, they claim, if there is no funding for usage time. Proposals to expand the organizations covered by the program have also been discussed.

Concern has also been expressed that the FCC has given priority to the schools and libraries facet of the program at the expense of other, more primary aspects of the universal service mandate, such as the "high cost" fund. The primary cornerstone of universal service has been to ensure that telephone rates remain reasonable by assisting telephone providers in high cost, typically rural, areas. The emphasis on the schools and libraries some claim, has skewed the intent of Congress and diverted attention away from high cost concerns. The "high cost" program could suffer, they state, if contributors are forced to shift resources to the E-rate program. Some favor suspending the E-rate program and addressing all aspects of universal service simultaneously in an integrated proceeding.

FCC Funding Modifications. Concerns over the direction the FCC is taking in implementing and funding the universal service provisions of the 1996 Act in general, and the schools and libraries program in particular, prompted the FCC to reconsider its actions regarding universal service support for schools and libraries. The FCC released a public notice (CC Docket No. 96-45) on May 13, 1998, seeking comment on a proposal to phase-in funding for the schools and libraries portion of the Universal Service Fund. After examination of the comments, the FCC adopted an order on June 12, 1998, that modified funding aspects of the E- rate program. Among other actions the FCC adjusted downward the amounts that would be collected to fund the E-rate program through June 30, 1999.

More specifically the FCC, in its June 12, 1998 order (CC docket No. 96-45), made the following modifications to the funding level and disbursement rules of the E- rate program:

- revised the funding year from a calendar year (January 1 - December 31) to a fiscal year (July 1 - June 30) cycle. This is accomplished by extending the first year funding cycle by six months through June 30, 1999. This modification, according to the FCC, will synchronize the program with the budgetary and planning cycles of most schools and libraries as well as align changes in universal service contribution levels with local exchange carrier annual access tariff filing schedules.
- froze the amount of funding at current rates. Program administrators were directed to collect and disperse no more than $325 million per quarter for the third and fourth quarters of 1998 and the first and second quarters of 1999. Although the cap for the program remains unchanged, at $2.25 billion, when added to the $625 million collected in the first half of 1998, the available funding for the first 18 months of the program will total no more than $1.925 billion.
- revised disbursement rules to insure that the most disadvantaged schools and libraries get priority for support. Based on a preliminary review of pending applications demand for discounts is estimated at $2.02 billion, an amount exceeding the ceiling of $1.925 billion for disbursements. Since funding will be less than demand, the FCC has adopted rules to prioritize distributions. When demand exceeds the level of funding all eligible schools and libraries will receive support for recurring services such as telecommunications services and Internet access, but only the most

economically disadvantaged applicants will receive support for internal connections.
- changed the second year application cycle to begin no later than October 1, 1998, rather than July 1, 1998. Note, the application window for the second funding year (July 1, 1999 - June 30, 2000) was delayed. It opened on December 1, 1998 and closed on April 6, 1999.

The FCC's May 27, 1999 decision to fully fund the second year of program at the $2.25 billion cap generated significant controversy. In a 3-2 split decision the FCC Commissioners decided that, given the level of demand as determined by a review of pending applications, the second year of the program should be funded at its maximum level. This is in contrast to the annual funding level of $1.3 billion for the first year of the program. This significant increase reignited the debate which occurred in the 105th Congress regarding the need for, the administration of, and the funding source and level of, the program. The FCC, in May 1999, established and continues to maintain, a yearly funding level cap of $2.25 billion.

Restructuring and Funding Alternatives. Changes in the administrative structure of the program, while welcomed by many, have not satisfied a number of critics. An alternative administrative structure was offered in legislative initiatives (H.R. 1746 and S. 1004) introduced in the 106th Congress by Representative Tauzin and Senator Burns. These bills, (which also contain provisions addressing funding) called for the elimination of the E-rate program and the transfer of authority for the program from the FCC. The E-rate program would be replaced by a Telecommunications Technology Trust Fund and would be designed as a state block grant program. The Department of Commerce's National Telecommunications and Information Administration (NTIA) would become its administrative entity.

This approach, according to its supporters, would alleviate the present legal questions regarding FCC authority to establish entities and would give the program to an agency familiar with the process of administrating grant programs. Supporters of the presently designed E-rate program have expressed concerns that this approach would remove the goals of the schools and libraries program from the universal service concept. Furthermore, they claim, it would have a severe disruptive impact on the existing program, would result in a more burdensome application process, and would make the program dependent on appropriated funds.

Debate over funding issues has also focused on what the appropriate funding mechanism for the E-rate program should be. One suggested source for funding for the E-rate program is the revenues collected from the 3% federal telephone excise tax. The federal telephone excise tax, which is currently assessed on consumers' local and long distance telephone service, generates approximately $5 billion in yearly revenues. The revenue, while collected from consumers by telephone companies, is forwarded to the U.S. Treasury and added to general revenues. Three measures, H.R. 727, S. 1004, and H.R. 1746 to use revenues generated from that tax to address the funding issue were introduced in the 106th Congress.

This approach, sponsors claim, would eliminate concerns over the legality of the present funding mechanism and would result in funding for the program without adding new upward pressures on consumers' telephone bills. Furthermore, sponsors state, expenditures for the

program would be made explicit through a capped tax that is currently listed on telephone bills. While interest has been expressed in examining this proposal, a number of questions and concerns regarding the funding aspects of the measures remain. Included among these are: concern that it would, at a minimum, cause disruption of a presently functioning program; concern that the funding source for the program is not permanent; questions whether money generated by taxes can be used to support private or parochial schools; and the potential negative impact of use of general funds on other government outlays.

Need for the Program. Despite the changes made to funding levels and administrative structure a more fundamental question rests with the debate over whether the E-rate program, as implemented, is needed. Those who question the need for such a program claim that voluntary private sector initiatives such as "Net Days" as well as other federal programs alleviate the need for the E-rate program as designed. Some also question whether the alleged benefits that such access to technology has on education can be substantiated. However, supporters of the E-rate program cite its high level of demand (39,785 applications and an estimated funding request of $4.3 billion for program year 2004) as proof that existing federal programs and private sector initiatives are not meeting the needs of schools and libraries. Citing statistics contained in a Commerce Department study, *A Nation on Line: How Americans are Expanding Their Use of the Internet,* that show a decreasing but continuing disparity in access to computers and online services by race and income, supporters also claim that this program is needed to help bridge the divide between information "haves and have nots" and ensure access to communities that may otherwise be left behind. Access to computers and on line services is vital, they claim, to ensure that the upcoming generation is prepared to fill the growing number of computer-related jobs. (For background on technology in education see CRS Report 96-178.)

Some question whether the E-rate program as designed duplicates or overlaps existing federal programs. In an attempt to address this concern then House Commerce Committee Chairman Bliley (106th Congress) and House Education Committee Chairman Goodling(106th Congress) asked the General Accounting Office (GAO) to undertake an examination of federal programs, previously identified by the GAO at the request of Senator Stevens, that may in some way be duplicative. The report was directed to examine a number of areas including the potential for duplication and potential problems associated with fraud, waste, and abuse. The GAO report (*Telecommunications Technology: Federal Funding for Schools and Libraries*), which was released in August 1999, identified 35 federal programs that could be used as a source of support for telecommunications and information technology by libraries or elementary or secondary schools in FY1998; ten programs specifically targeted technology while the remaining 25 included technology as a possible use of funds. Based on the GAO's review it found that there are "similarities" among the programs, but the GAO "... did not identify instances where two programs were designed to provide identical services to identical recipients." Furthermore, the GAO did not "identify information that indicates that fraud, waste, and abuse are systemic or widespread problems" but did find instances of such problems with individual guarantees. The GAO noted that action was taken against these individual guarantees and to prevent reoccurrence of such problems. The GAO did not examine the implementation of each program or conduct its own audits but relied on interviews, agency program documents, and reports to reach its conclusions.

Eligible Services and Application Integrity

Directly related to the funding issue are concerns over the potential for possible fraud, waste, or abuse of the program. The ability to ensure that only eligible services are funded and that funding is dispersed at the proper level of discount has been questioned.

One concern has focused on possible confusion by applicants over the range of services considered eligible for the program and the fear expressed by some that pending applications contain requests for ineligible services. Confusion over what services and related expenses are covered by the program prompted the FCC to issue a public notice clarifying this issue. The FCC, in a June 11, 1998 order (CC Docket No. 96-45), stated that services eligible for discounts include "...All telecommunications services, Internet access, and internal connections provided by telecommunications carriers, as well as Internet access and internal connects provided by non-telecommunications carriers." The FCC also clarified what services *are not* eligible for discounts. Services not eligible for discounts include purchases of personal computers, fax machines, modems, telephone handsets, as well as teacher training, and expenses related to the installation of wiring (such as removing asbestos, tearing down walls, repairing carpets, or repainting). The FCC reiterated that schools and libraries are required to select "the most cost effective bid" when examining competing bids and that "price should be the primary factor." However other relevant factors that can be considered include "prior experience; personnel qualifications, including technical excellence; management capability, including schedule compliance; and environmental objectives."

Concern that only eligible services be funded also brought up issues relating to application integrity. Critics of the program, as well as some supporters, questioned whether the necessary mechanisms are in place to ensure that only eligible services receive funding and that such funding is given at the proper level of discount. Although the FCC's clarification order has helped to resolve confusion over eligibility criteria, critics said it had come too late for the 30,000 application that had already been filed. Concern was also expressed that the FCC's decision to allow other "relevant factors" to be considered in the selection process, not solely cost, could result in inflated costs for the program as the lowest bidder may not necessarily be chosen. These other factors are ambiguous at best, critics claim, and could be used to manipulate the selection process.

Concerns about fraud and abuse are shared by both critics and supporters of the program. Some critics of the program claim that the program as devised is fraught with problems and at a minimum should be suspended until additional safeguards are in place. Supporters also want to ensure integrity of the program since the funding of ineligible services or unreasonable administrative costs will only decrease available funding to meet the program's goals. Many supporters, however, do not view this as a major problem and feel that the program as devised is basically sound. They point to the willingness of the SLD and the FCC to take further steps to ensure program integrity such as the establishment of a program integrity hotline (888-203-8100) to report potential instances of waste, fraud, or abuse of program rules as well as the creation of a Year 3 Task Force to evaluate and make recommendations to improve the program. (See [http://www.ala.org/cfapps /archive.cfm?path=oitp/year3.html] for an executive summary of the task force's recommendations.)

In an attempt to ensure the integrity of the E-rate program and assess the ability to properly audit applications Senator McCain, requested that the GAO initiate a formal investigation and audit of the Schools and Libraries program. Results of the GAO assessment were released at a Senate Commerce Committee hearing held on July 16, 1998. Based on its review the GAO recommended that prior to making any funding commitments, the SLC should: conduct a statistically valid random sample of applications to assess the effectiveness of its procedures, and if needed take corrective action; finalize procedures, automated systems, and internal controls for the post-commitment phase of the program's funding cycle; obtain a report from its independent auditor verifying that the SLC has developed an appropriate set of internal controls to mitigate against waste, fraud, and abuse; and conduct a review of the technology plans of applications identified as "high risk" to determine whether applicants have the resources to effectively use the services requested and are in compliance with eligibility criteria.

The E-rate program administrator announced that it would comply with all of the GAO's recommendations prior to the commitment of any funds and incorporate other recommendations based on an FCC-required independent audit of its procedures conducted by an independent accounting firm. A follow-up report, conducted by the GAO at the request of Senator McCain, assessing the program's progress in implementing the GAO's recommendations was released in March 1999 (*Schools and Libraries Program: Actions Taken to Improve Operational Procedures Prior to Committing Funds).* According to the GAO assessment the SLD "...has taken actions to implement the key recommendations that we believe are needed to be completed prior to issuing any funding commitment letters to applicants." However, the GAO did express concern over the adequacy of the procedures used to ensure applicants' self certified discount levels are accurate. It also noted that "... the program still faces major challenges as it moves into new operational areas" and recommended that "... close oversight by the FCC will be especially important..." In addition the GAO noted that the FCC has yet to implement the earlier GAO recommendation "... to develop adequate goals, performance targets, and measures for the program." The president of the SLD stated that based on the experienced gained after the first year of the program and in response to the FCC Chairman's direction the SLD " ...will implement new, tighter procedures for evaluating discounts." Furthermore, the FCC, according to the GAO report, acknowledged the importance of and intent to address the recommendation to establish adequate performance goals and measures for the program, but did not indicate a time frame for such action.

The GAO continued to express concerns regarding the administration of the program in its report, *Schools and Libraries Program: Application and Invoice Review Procedures Need Strengthening,* issued in December 2000. According to the GAO their audit (which covered the first two years of the program) identified "millions of dollars of funds incorrectly committed to ineligible products and services" and despite the extension of deadlines for eligible applicants and vendors "a significant amount" of eligible committed funds have yet to be paid out. The GAO report cited a total of $1.3 billion (35 percent) of funds that while committed, were not dispersed as of the end of August 2000. The GAO also cited "weaknesses in the SLD's e-rate application review process [which] resulted in commitments of funds for ineligible products and services." According to the FCC/USAC only 10 percent of the commitments for GAO-identified ineligible services have been dispersed and that any that have been dispersed will be recovered. While the reasons why committed funds remain unused are likely to vary with each applicant the FCC/USAC "will

undertake an analysis of the factors leading to funds being committed to applicants, but not ultimately disbursed." While acknowledging that the SLD has taken steps to alleviate some of these problems the GAO has made a number of suggestions for corrective procedures and recommended that they be enacted prior to the award and distribution of funds for Year 4 of the program. According to the GAO report the FCC and the USAC, after reviewing the draft of the report, have begun to implement, and in some cases have already completed action on, the recommendations. The GAO's most recent follow-up report, *Schools and Libraries Program: Update on E-Rate Funding*, issued in May 2001, shows that the amount of undistributed funds is declining. According to data from January 2001 the amount of uncommitted funds for the first two years of the program has decreased to $880 million (24 percent) of the $3.7 billion committed to applicants compared to the earlier $1.3 million (35 percent) in unused funds. Furthermore the FCC stated that more recent data, as of April 2001, showed that the amount of unused funds decreased further to $774 million. (See Program Status, below, regarding the FCC's June 13, 2002 decision on what to do with undistributed funds.) Representatives Tauzin and Greenwood requested on December 2, 2003 that the GAO initiate another review of the E-rate program to examine the program's current status.

Despite these favorable trends, an audit report issued by the FCC's Office of Inspector General (OIG) stating that the E-rate and other universal service programs were lacking adequate financial oversight has focused attention on the program. (OIG Semiannual Report issued October 31, 2002. According to the report the OIG cited three concerns regarding the program: lack of resources for adequate oversight; inadequate competitive bidding requirements; and no suspension or debarment process. The OIG is seeking additional resources to focus more attention on the E-rate and other universal service programs and announced creation of a new position, assistant inspector general for USF oversight. That position was filled by Thomas D.Bennett on March 10,2003. The OIG's follow-up semi-annual report released June 3, 2003, covering the period October 1, 2002-March 31, 2003, while citing some progress, continued to express concerns that "...the [E-rate] program may be subject to an unacceptably high risk of fraud, waste, and abuse through noncompliance and program weaknesses." The December 2003 OIG report, covering April 1 through September 30, 2003, continued to express concern that additional resources and funding are needed to provide the assurance that the program is protected from fraud, waste and abuse. The OIG report, released on June 8, 2004, which covers the period from October 1, 2003 through March 31, 2004, continued to express "... numerous concerns" about the E-Rate program. The most recent semi-annual OIG report, released in January 2005, still expressed concerns about the level of "... waste, fraud and abuse in Universal Service Fund Programs." and noted that of the 135 audits conducted to date of E-rate program beneficiaries 36 percent (48 beneficiaries) were found to not be in compliance with program requirements. While the report noted significant progress in developing and implementing an effective oversight program and noted FCC support in its efforts, the OIG stated that more resources and funding were needed. Copies of audit reports are available at the OIG web page at [http://www.fcc.gov/oig/].)

The OIG reports have prompted scrutiny of the E-rate program on a number of fronts including the USAC , the FCC, the Department of Justice, and the Congress.[1] The USAC's School and Libraries Division established a Task Force on the Prevention of Waste, Fraud, and Abuse to identify areas where improvements can be made in the administration of the program. The Task Force, composed of 14 members of the applicant and service provider communities, issued a final report, in September 2003, containing its recommendations and forwarded them to the FCC for consideration.

The FCC in a April 23, 2003 action (CC Docket 02-6) adopted new rules to improve the E-rate program. These rules seek to improve program administration and oversight and create a more efficient application process. The measures adopted include barring, for three years or if warranted for a longer period, persons convicted of criminal violations or held civilly liable for misconduct in conjunction with the program; clarified that requests for duplicative services will not be funded; adding voice mail as an eligible service; making wireless services eligible for support in the same manner as wireline services; developing a pilot program to create an online list of eligible equipment to wire schools; and allowing applicants the option of either paying their service provider the full discounted cost of services received or pay the full price and then receive reimbursements. (See *Federal Register*, vol 68, no.119 (June 20, 2003), p.36931.) In its first action related to these rules the FCC, in a December 2003, debarred three individuals from participating in the E-rate program for three years. The FCC also adopted a further notice of proposed rulemaking (FCC 03-101) seeking comment on measures to further strength and improve the operation of the program. Issues to be examined include procedures to carry forward unused program funds to subsequent funding years; the feasability of establishing an online computerized eligible services list for telecommunications services and Internet access; rules pertaining to when applicants file a technology plan; and whether to further expand upon the circumstances under which persons may be barred from the program. (See *Federal Register*, vol 68, no. 119 (June 20, 2003), p. 36961.)

Further action was taken by the FCC in December 2003 when it adopted additional steps to improve the administration of the E-rate fund. Steps taken include prohibits, with limited exceptions, the transfer of equipment purchased with E-rate funds to other locations for three years after purchase; formalizes and clarifies the process for the annual update of the list of services eligible for support; and limits the support for upgrading or replacing internal connections to no more than twice every five years, but exempts basic maintenance services. The FCC also released approximately $420 million in unused funds from prior years for disbursement in funding year 2003. (See *Federal Register*, vol 69, no. 27 (February 10, 2004), p. 6181.) In a further order released in August 2004, which takes effect October 13, 2004, the FCC, among other actions: set a five-year deadline to complete FCC investigations into alleged violations; directs the USAC to fully recover funds disbursed to beneficiaries that do not comply with program rules, unless the administrative costs outweigh the cost of recovery; bars beneficiaries or service providers from receiving additional benefits if they have outstanding obligations to repay monies into the fund; eliminates the current rule that permits the offset of amounts disbursed in violation of the program against other funding commitments; modifies current requirements regarding the timing, content and approval of

[1] See Activities in the 108th Congress, below, for a review of Congressional action.

technology plans; and amends beneficiary certification requirements. (See *Federal Register*, vol. 69, no. 176 [September 13, 2004], p.55097.).

The FCC also adopted a further rulemaking seeking comment on additional measures including changing the current discount matrix; placing a ceiling on the total funding an applicant can request on an annual basis; strengthening requirements for technology plans; and additional record keeping requirements. (See *Federal Register*, vol 69, no.27 (February 10, 2004), p. 6229.).

The antitrust Division of the Department of Justice (DOJ) has established a task force and grand jury to investigate E-rate program fraud and has indicted a former contractor for bid-rigging; in an earlier separate incident a contractor was convicted of program fraud. In further action, in March 2004, the DOJ indicted five people on charges of fraud alleging that they falsely claimed to have provided E-rate services to schools in Milwaukee and Chicago collecting $1.2 million from the program. The Justice Department announced on May 27,2004 that a subsidiary of NEC pleaded guilty to defrauding the program and agreed to pay a $20.6 million fine. Most recently, in a December 2004 action, Inter-Tel, an Arizona corporation that sells and installs telecommunications equipment, offered to pay $1.71 million in fines and $7 million in restitution to settle DOJ allegations that a subsidiary engaged in bid-rigging and wire fraud in a scheme to defraud the E-rate program in Michigan and California.

Program Status

During the first six years of the program(covering funding years from January 1998 through June 30, 2004), $12.9 billion of funds have been committed. (For more detailed statistics on the breakdown of funding, including data by state, see the program's website [http://www.sl.universalservice.org].)

The filing window for Year 2004, covering July 1, 2004 through June 30, 2005, closed on February 4, 2004. Demand, based on 39,785 requests received in the filing window, is estimated at $4.3 billion. According to the FCC an estimated $150 million of unused funds from Program Year 2001 will be added to the yearly $2.25 billion funding cap, making the maximum funding for the year$2.4 billion. Funding commitments for Year 2004, the seventh year of the program, totaled $ 1.76 billion to 30,983 applicants, as of March 1, 2005. FCC-required program compliance with a new accounting standard resulted in the temporary suspension of funding commitment letters from August through November. (See Activities in the 108th Congress for further information on this issue.)

The filing window for Year 2005, covering July 1, 2005 through June 30, 2006, the eight and current year of the program, closed on February 18, 2005. All applications received during the open window period which commenced on December 14, 2004, will be considered simultaneously filed for funding purposes.

The FCC initiated a proposed rulemaking to seek comments on a proposal to revise its method of distributing e-rate funds under certain circumstances. Under the proposal, when there is insufficient funding to fulfill all requests for internal connections, those entities who did not receive funding commitments for internal connections for the previous year would

be given priority, in order of discount level. Funding for telecommunications services and Internet access would not be affected by this proposal. The FCC also sought comment on proposed administrative rules to provide additional time for recipients to implement contracts or agreements with service providers for non-recurring services. (See *Federal Register*, vol.66, no.89 (May 8, 2001), pp. 23204-232048.) The FCC concluded, in a June 27, 2001 decision, that it would not change funding priority rules for Year 4, but will continue to reserve the right to make modifications for future years of the program. The FCC, however, did modify the rules to extend the deadline for the receipt of non-recurring services from June 30 to September 30 following the close of a funding year.

In a further action the FCC, on January 25, 2002, released a notice of proposed rulemaking (NPRM) (CC Docket 02-6) to review certain rules relating to the schools and libraries program. (See *Federal Register*, vol.67, no.33 (February 19, 2002), pp.7327-7341.) According to the FCC the goals of this proceeding are to: consider changes to fine-tune the rules to improve program operation; ensure that the benefits of the program are distributed in a manner that is fair and equitable; and improve FCC oversight to ensure that the goals are met without waste, fraud, or abuse. Among the issues considered was what to do with schools and libraries program funds that were committed but never used. The FCC, in a June 13, 2002 order, addressed this issue. The Commission concluded that unused funds, that is funds awarded to applicants through the schools and libraries program but unclaimed, will be applied to the general universal service fund, to help stabilize the amount of contributions, for no more than the next 3 quarters, ending March 2003. After that date all schools and libraries program funds unclaimed by approved applicants will be solely distributed to the schools and libraries program for disbursement in subsequent years, thereby increasing the amount of available funds for the program. Other issues, including those relating to the strengthening of financial oversight measures, were also considered. (See Eligible Services and Application Integrity, above, for a discussion of FCC action related to those issues.)

Activities in the 109th Congress

Continued Congressional concern over oversight of the E-rate program coupled with the expiration, at the end of 2005, of the exemption of the USF from the Anti-Deficiency Act has made the management and operation of the E-rate program an issue in the 109th Congress.

In the 109th Congress two bills, S. 241 and H.R. 102, relating to the E-rate program have been introduced. S. 241 would permanently exempt funds received as universal service contributions and the universal service support programs, of which the E-rate is one, from the Anti-deficiency Act. This would make permanent the one-year exemption enacted in P.L. 108-494. (See Activities in the 108th Congress, below, for a detailed discussion of the issues surrounding the application of the Anti-deficiency Act to the E-rate program.) H.R. 102 provides for the distribution of unexpended E-rate funds to low- income schools, subject to an overall limit of $100 million and an individual school yearly limit of $25,000. The bill would also expand the services eligible for the use of these funds to include information services and the devices required to access and use them. Unexpended funds will be awarded based on a lottery system.

Activities in the 108th Congress

An audit report issued in October 2002 by the FCC's Office of Inspector General (OIG) stating that the E-rate and other universal service programs were lacking adequate financial oversight, once again, focused attention on the program. The House Energy and Commerce Committee and Commerce subcommittee on Oversight and Investigations have begun a "preliminary investigation" into these charges. The FCC and USAC has been asked for extensive records relating to the program and 15 companies have received letters from the Committee requesting information regarding their participation in the E-rate program. Specific incidents being examined by the House Commerce Committee include why $5 million worth of equipment, purchased as early as 1999 by the Chicago public school system through the E- rate program, remains uninstalled; waste of more than $100 million of funds in Puerto Rico; as well as attempts by a company to defraud the school district in San Francisco of $50 million in E-rate funds. Representative Barton, the Chairman of the House and Energy and Commerce Committee, specifically mentioned the E-rate program as one of the many programs under his jurisdiction that will be under active review. The Committee's Oversight and Investigation Subcommittee has held three hearings, June 17, July 22, and September 22,2004, examining alleged incidents of fraud, waste, and abuse. The Committee also requested, on December 2, 2003, that the GAO undertake another examination of the program to assess its current status. The Senate Commerce committee held a hearing on October 5, 2004 examining E-rate program fraud, waste and abuse and the August 2004 suspension of funding commitments.

The FCC's decision to require the E-rate program to switch its accounting methodology to comply with a federal government accounting methodology resulted in the temporary four-month suspension of funding commitments from August through November 2004. Under the government accounting methodology funds are subject to the Anti-Deficiency Act thereby precluding the government from incurring obligations prior to the funds being available. As a result of complying with this requirement USAC changed the timing of its funds distribution leading to a temporary disruption in the flow of E-rate funding commitments. The disruption of E-rate funding commitments, coupled with the potential application of this methodology to not only disrupt funding for other USF programs but also to significantly increase needed USF revenues, prompted Congress to enact legislation (H.R. 5419) to provide for a temporary exemption of the USF from this government accounting standard. H.R. 5419 a measure which contained a package of three telecommunications bills, included one which grants the USF a one-year exemption (through December 31, 2005) from the accounting provisions of the Anti-Deficiency Act. The measure passed in the waning days of the 108th Congress and was signed into law (P.L. 108-494) on December 23, 2004.

Two additional bills (H.R. 1252 and S. 1264) specific to the E-rate program were introduced in the 108th Congress. H.R. 1252, introduced by Representative Tancredo, seeks to eliminate the E-rate program. This is accomplished by removing those universal service provisions contained in the 1996 Telecommunications Act, and subsequently incorporated as Section 254 of the Communications Act of 1934, which provide for discounts for schools and libraries for telecommunications services; no action was taken on this measure.

Senate Commerce Committee Chairman McCain introduced S. 1264, an FCC reauthorization measure, which includes provisions specific to the E-rate program. Section 3 of the bill specifically authorizes the FCC to allocate sufficient funds for the FCC to

conduct a yearly review and audit, over the next four years, of the E-rate program to look for possible fraud and abuse. Furthermore, the FCC is required to transmit a yearly report, from fiscal years 2004 through 2007, to the Senate Commerce and House Energy and Commerce Committees detailing the findings of these examinations. The measure passed the Senate Commerce Committee, as amended, on June 26, 2003 and was reported out of Committee (S.Rept. 108-140) on September 3, 2003; no further action was taken on this measure.

Relevant Laws

P.L. 104-104. Provides for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening up all telecommunications markets to competition; the measure also contains provisions for other purposes.

P.L. 105-119. The 1998 appropriations legislation for the Departments of Commerce, Justice, and State. Contains provisions that require the FCC to undertake a review of the implementation of the provisions in the 1996 Telecommunications Act pertaining to universal service and to submit a report to Congress no later than April 10, 1998.

P.L. 105-174. Emergency supplemental appropriations for the fiscal year ending September 30, 1998. Contains within the conference committee's "joint explanatory statement" language that the conferees "expect that the FCC will comply with reporting requirements" contained in S. 1768, regarding universal service.

P.L. 108-199. The 2004 omnibus appropriations legislation includes, by reference, language in the Senate report (108-144) directing the FCC to utilize funds in the USF (not the OIG) to pay for costs associated with the auditing of the USF, including the E-rate program.

P.L. 108-494. A measure containing provisions that grant the USF a one-year exemption (through December 31, 2005) from the accounting provisions of the Anti-Deficiency Act.

LEGISLATION

H.R. 102 (Green, G.)

A bill to amend the 1934 Communications A to provide for the use of unexpended universal service funds in low-income schools, and for other purposes. Introduced January 4, 2005; referred to Subcommittee on Telecommunications and the Internet February 4,2005.

S. 241 (Snowe)

A bill to amend section 254 of the Communications Act to provide the funds received as universal service contributions and the universal service support programs established pursuant to that section are not subject to certain provisions of title 31,United States Code, commonly known as the Anti-Deficiency Act . Introduced February 1,2005; referred to the Committee on Commerce, Science, and Transportation.

FOR ADDITIONAL READING

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