

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the matter of:)	
)	
Schools and Libraries Universal Service)	
Support Mechanism)	CC Docket No. 02-6
)	
Ex Parte Comments on the Use of)	
Independent Audits by State Authorities)	

The following comments are submitted in response to the Commission’s Fifth Report and Order (FCC 04-190) in Docket No. 02-6, noting that the FCC is “...continuing to work on various proposals for improving our oversight of the universal service program...” Specifically, E-rate Central is responding to an earlier Commission request for comment in 2002 concerning “...the use of independent audits as an oversight tool to provide assurance of program integrity.”¹

E-Rate Central is an independent firm providing E-rate application services to public and private schools. E-Rate Central is an active member of the State E-Rate Coordinators’ Alliance (“SECA”) and was also represented on the SLD’s 2003 Task Force for the Prevention of Waste, Fraud and Abuse.

COMMENTS

1. Increasing concerns with E-rate waste, fraud, and abuse have focused attention on the need for additional program audits.

Reports, hearings, and other disclosures in recent months have highlighted real and/or potential waste, fraud, and abuse issues connected with the E-rate program. Of particular note were:

- Beginning in May with an investigatory series in the *Atlanta Journal-Constitution*, the press has been reporting instances of real or apparent abuses of E-rate funding by certain vendors and/or large applicants — albeit many problems that had already been identified and addressed by the SLD.

¹ See *Schools and Libraries Notice*, 17 FCC Rcd at 1937, para. 59.

- The semiannual report of the FCC’s own Office of Inspector General (“OIG”), released in June, reported that OIG was supporting or monitoring 42 investigations dealing with procurement irregularities, false claims, ineligible funding, and non-payment of applicant shares. The report was critical of both USAC and the FCC itself with regard to the assessment and implementation of retroactive commitment adjustments (“COMADs”) when audits uncover violations of E-rate program rules.
- Hearings held by the House Energy and Commerce Committee in June and July, entitled “Problems with the E-rate Program: Waste, Fraud, and Abuse Concerns in the Wiring of Our Nation's Schools to the Internet,” set forth a view that the current program structure provides an “invitation” for abuse, and that many more audits are necessary.
- Specific testimony by the FCC’s Inspector General at the first House E-rate hearing noted that there had been audits of only about 0.1% of the number of awards issued, and indicated a budgetary need for about \$11 million to conduct an additional 300 audits nationwide.

2. A significant increase in on-site E-rate audits would be expensive and unnecessarily disruptive.

In the extreme, and as suggested by at least one Congressman in the June hearings, consideration could be given to auditing every E-rate applicant (and vendor) every year or every few years. The cost of such an audit program would be staggering.

Using the Inspector General’s estimate of approximately \$37,000 per audit, and assuming roughly 30,000 E-rate applicants, the cost of auditing all applicants would be on the order of \$1 billion, almost half the program’s annual funding. Assuming that the “80:20” rule holds for E-rate (i.e., 80% of the funding is used by 20% of the applicants), this would mean that 80% or more of the audits would cost more than those individual applicants receive each year — a highly cost ineffective outcome.

When considering cost-effectiveness, the Commission must also recognize that audits involve substantial internal costs to the schools and libraries themselves. For on-site audits, the disruptive costs incurred by entities being audited, simply in terms of personnel time requirements, are extensive. Periodic on-site audits of smaller applicants, in particular, would undoubtedly push many of them from the program.

3. E-rate audits should not be considered in a void. Schools and libraries operate within a broader audit environment already addressing other aspects of Federal, state, and local funding.

E-rate is not the only Federal program affecting schools and libraries, nor is it the only one with auditing requirements. More broadly, according to the U.S. Department of

Labor OIG:² “Over \$300 billion of Federal awards, representing one-sixth of the annual Federal budget, are expended by non-Federal entities (NFEs).” This includes several education-related programs that are even larger than E-rate, including Title I, NSLP, Head Start, and Special Education. This means that many NFEs, and schools in particular, receive awards from more than one Federal agency.

Prior to 1979, each Federal agency was responsible for auditing its own awards. “Frequently the grant-by-grant audit processes of the Federal agencies were not coordinated, resulting in audits that overlapped or were conducted at different times. This inflated the audit costs to the Federal Government and placed an undue administrative burden on many NFEs. Additionally, some NFEs may not have been audited at all.”³

In 1979, The Office of Management and Budget (“OMB”) established standards for Federal-wide audit requirements. Five years later, Congress enacted the Single Audit Act of 1984 that extended the organization-wide audit process to state and local governments. The Act was subsequently amended and strengthened in 1996. Again, as noted by the Department of Labor:⁴

- “The single audit is intended to provide a cost-effective audit of NFEs. Efficiencies can be considerable when an organization-wide audit, or single audit, is conducted in lieu of multiple audits of individual Federal programs. The parties involved in the audit process know beforehand what is expected and what the products of the audit will be. Furthermore, repeated exposures to a structured audit process promote discipline in an auditee’s accounting practices.”
- “The single audit is the primary mechanism used by Federal agencies to ensure accountability of Federal awards.”

4. Although E-rate funds are not considered a form of Federal financial assistance subject to single audit requirements,⁵ this does not mean that single audit principles and practices cannot be applied to cost-effectively strengthen and extend the E-rate audit program.

With limited resources, the SLD and FCC may find it difficult to significantly expand the number of applicants subjected to dedicated on-site E-rate audits. Schools and libraries, on the other hand, are usually audited every year — and at their own expense — by independent auditors. These are broad financial audits which, if appropriate under the Single Audit Act, include Federal program reviews. Indeed, many

² See http://www.oig.dol.gov/public/programs/oa/single_audit/single_audit_process.htm#history.

³ Ibid.

⁴ Ibid.

⁵ See OMB Circular A-133.

Federal programs require copies of these audits to be submitted with additional grant applications.

Many states are also auditing schools on a periodic or random basis. The Office of the New York State Comptroller, for example, has just proposed a program expansion that provides for state-run audits of public school districts every five years. We believe that other states have similar programs requiring periodic state audits.

If the states and/or the independent auditors can be induced to include an E-rate component in their audits, as is already done on behalf of other Federal funding programs through the single audit process, many more E-rate applicants could be efficiently covered. While the level of E-rate detail covered in a broader state or local audit may be less, we note the following:

- Utilization of single audit principles and practices at the state or local level does not preclude more detailed E-rate only audits of a smaller number of applicants on either a targeted or random basis. State and/or independent audits would be designed to supplement, not supplant, program-specific Federal audits.
- One important benefit of including an E-rate component in broader audits is that applicants will know that their E-rate practices are going to be reviewed. This should dramatically elevate applicant awareness of E-rate rules and recordkeeping requirements.

The scope of audits available under this approach may vary by state. At a minimum, a reasonable objective might be to target E-rate auditees under the Federal single audit standards. This would include:

- All large applicants except, under certain conditions, those identified as low-risk. “Large,” in the context of the \$2.25 billion E-rate program, would be applicants with awards of \$6.75 million (0.3% of program size).
- Smaller applicants identified as high risk.

5. Since E-rate auditing issues are not normally addressed by state and/or independent auditors, and are not required by the Single Audit Act, certain resources and other incentives may be required to encourage state and/or local participation.

An agreement with a state to include E-rate components in its own audits, or require independent auditors to do likewise, might reasonably include the following elements.

- The SLD would help design a uniform set of audit procedures to be included as a subset of a full audit. The E-rate audit procedures would necessarily be less inclusive than those used by the SLD’s outside auditors

during the last round of beneficiary audits, but should include a review of the major E-rate concerns and indicators.

- The SLD would provide or sponsor E-rate training and coordination for both state and independent auditors. Compared with the costs to the SLD and FCC of an expanded, standalone, E-rate audit program, the financial resources needed to support state auditing efforts would be modest.⁶
- In return for the state's efforts in broadening E-rate audit coverage, and in recognition of the internal costs that audits impose on schools and libraries, the SLD would agree to reduce the number of standalone E-rate audits to which that state's schools and libraries would be subjected.

SUMMARY

E-Rate Central believes that there are ample incentives at both the Federal and state levels to incorporate a cost-effective E-rate component into the broader audit programs currently existing in many states. While not directly applicable, the Single Audit Act provides ample precedence, principles, and procedures for these types of Federal/state agreements. By redirecting a fraction of the resources required for standalone Federal audits to cooperative state and/or independent audits, the SLD and FCC can significantly expand E-rate audit coverage in a cost-effective, productive, and prudent manner.

Respectfully submitted,



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⁶ Note, for example, that for a total cost of about half the additional auditing budget requested by OIG, the SLD could sponsor one FTE person in each state.