



CHAIRMAN

Federal Communications Commission

Washington, D.C.

Senator John McCain
Chairman
Committee on Commerce, Science and Transportation
241 Russell State Office Building
Washington, D.C. 20510

Dear Senator McCain:

In accordance with the Inspector General Act, the FCC Office of Inspector General (OIG) recently issued the attached semi-annual report. This report reflects the activities and accomplishments of the OIG for the six-month period ending March 31, 2004.

The Federal Communications Commission (Commission) continues its efforts to implement and oversee the schools and libraries program and dedicates significant resources to the improvement of the program. During the reporting period, the Commission took several steps in furtherance of the program.

In December 2003, the Commission adopted rules prohibiting equipment and service duplication; limiting the transfer of E-rate funded equipment; and limiting repeated requests for internal connections. The Commission also clarified the types of maintenance services that are eligible for support, and adopted a more transparent process for updating the list of eligible services in future years. Finally, the Commission directed USAC to develop a pilot program to test a computerized online list of eligible internal connections equipment, a measure expected to enable better tracking of the types of equipment the program is supporting.

In a companion Further Notice of Proposed Rulemaking (FNPRM), the Commission sought comment on additional proposals designed to curb waste, fraud, and abuse. A paramount goal of the FNPRM is to incorporate the most useful of USAC's operating procedures into the Commission's rules. Specifically, the Commission sought public comment on adopting bright line rules for determining "cost effective" funding requests; codifying additional requirements for technology plans; amending record retention rules; and reducing the highest discount rates, in response to suggestions that the current discount levels may not provide sufficient incentives to make prudent funding requests. Adoption of some or all of these measures will enhance USAC's ability to process applications and improve the Commission's capacity to monitor program compliance and its ability to take enforcement actions when necessary.

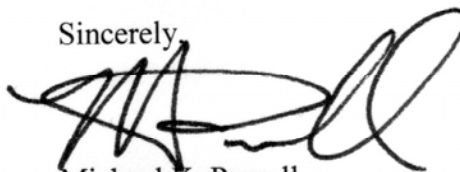
In addition, through the issuance of a Report and Order in April 2003, procedures now exist to debar from the program *anyone* (i.e., not only bad actors) convicted of a criminal violation or found civilly liable for actions relating to the schools and libraries program. In fact, several companies were debarred during the reporting period, and the Commission has sought comment on what other situations may warrant such debarment.

Outside of the rulemaking context, the Commission addressed three significant E-rate issues during the reporting period. In November 2003, the Commission enunciated a framework for the E-rate program's treatment of program participants subject to law enforcement investigations in the *Puerto Rico Department of Education Order*. The Commission held that USAC generally should defer action on any application upon receiving evidence, including evidence from an active law enforcement investigation, of potential program violations, until such time as questions raised by the evidence can be resolved, or until there is sufficient reason to believe that potential program violations are no longer implicated. The Commission also clarified the requirements of the competitive bidding rules that govern the program during the reporting period. The December 2003 *Ysleta Order* clarified that price must be the primary factor for applicants when selecting service providers. These guideposts provide greater transparency to program participants with regard to the E-rate rules and allow USAC to review applications more efficiently. In addition, the Commission has increased its oversight over USAC's recovery of improperly disbursed funds. For example, on March 29, 2004, the Commission's Office of Managing Director (OMD) issued a letter to USAC that directed USAC to recover amounts identified by the Commission's Office of Inspector General (OIG) in its E-rate audits during the reporting period. Subsequent to the reporting period, USAC issued letters requesting recovery of the amounts identified by the Commission's OIG audit efforts.

Finally, the Commission increased its oversight over the beneficiary audits that USAC conducts pursuant to the Commission's rules. An independent auditor engaged by USAC completed 62 audits of E-rate beneficiaries that received a total of \$258,995,667 in discounts. From these audits, USAC determined that it should recover \$1,719,853 from the beneficiaries. Commission staff worked closely with USAC to develop a more intensive beneficiary audit plan that contemplates procedures narrowly tailored to reveal rule violations and systemic program abuses and that uses statistical sampling techniques, so that audit results can provide a basis for forming conclusions about overall program compliance. The Commission is also working to develop a process that will expedite the resolution of audit findings in situations where the Commission has not yet addressed the consequences of a particular rule violation.

If you wish to obtain further information regarding the Universal Service Fund Program, please contact H. Walker Feaster, Inspector General, at (202) 418-0476.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Powell', with a large, stylized flourish at the end.

Michael K. Powell

Enclosure