

**Report 05-14
September 2005**

An Audit

Universal Service Fund

Public Service Commission

2005-2006 Joint Legislative Audit Committee Members

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CONTENTS

| | |
|--|-----------|
| Letter of Transmittal | 1 |
| Report Highlights | 3 |
| Universal Service Fund Programs | 9 |
| Public Service Commission Programs | 9 |
| Department of Public Instruction Programs | 14 |
| Educational Telecommunications Access Program | 16 |
| Audit Opinion | 21 |
| Independent Auditor's Report on the Financial Statements of the State of Wisconsin Universal Service Fund | |
| Management's Discussion and Analysis | 23 |
| Financial Statements | |
| Balance Sheet as of June 30, 2004 and 2003 | 30 |
| Statement of Revenues, Expenditures, and Changes in Fund Balance for the Years Ended June 30, 2004 and 2003 | 31 |
| Notes to the Financial Statements | 33 |
| Supplementary Information | |
| Schedule 1 - Budgetary Comparison Schedule for the Years Ended June 30, 2004 and 2003 | 42 |
| Schedule 2 - Budgetary-GAAP Reporting Reconciliation as of June 30, 2004 and 2003 | 43 |
| Report on Internal Control and Compliance | 45 |
| Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards | |
| Appendix | |
| Universal Service Fund Programs | |



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September 22, 2005

Janice Mueller
State Auditor

Senator Carol A. Roessler and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Roessler and Representative Jeskewitz:

As requested by the Public Service Commission (PSC), we have completed a financial audit of the Universal Service Fund, which was established to ensure that all state residents receive essential telecommunications services and have access to advanced telecommunications capabilities. It is funded primarily through assessments on telecommunications providers, which totaled \$25.5 million in fiscal year (FY) 2003-04. Our audit report contains our unqualified opinion on the Universal Service Fund's financial statements for the fiscal years ending June 30, 2003 and 2004.

The largest program supported by the Universal Service Fund is the Educational Telecommunications Access Program, which is administered by the Department of Administration. This program subsidizes new and existing data lines and video links to eligible educational institutions. In FY 2003-04, expenditures for these activities totaled \$12.7 million, or 54.2 percent of the Universal Service Fund's total expenditures and transfers. In January 2006, a new statewide data and video network is expected to be available to program participants, as well as to the State and other public-sector users.

Eight of the 13 programs supported by the Universal Service Fund are operated by the PSC. As we reported in past audits, expenditures for PSC-operated programs were significantly less than budgeted for several years. The Legislature subsequently limited the amount of assessments to support the PSC-operated programs to \$5.0 million in FY 2003-04 and \$6.0 million in FY 2004-05 and thereafter. However, increasing expenditures are now presenting budgetary challenges for these programs. In response, the PSC reduced benefits and deferred certain payment requests to subsequent fiscal years. If the growth in program demand and expenditures continues, the Legislature may be asked to reconsider the statutory limits on the PSC's annual assessment levels.

Funds are transferred annually to the Department of Public Instruction for the Newslines program, which provides sight-impaired individuals access to newspapers read over the telephone. We found that a balance of almost \$165,000 has accumulated for the program. The PSC does not plan to provide additional funds to the program until the balance has been substantially reduced.

We appreciate the courtesy and cooperation extended to us by staff at the PSC, the departments of Administration and Public Instruction, and the Universal Service Fund's administrator, Wipfli LLP.

Respectfully submitted,

Janice Mueller
State Auditor

JM/DA/ss

Report Highlights ■

The Fund reported a balance of \$6.4 million as of June 30, 2004.

Recent growth in program expenditures is resulting in budgetary challenges for the PSC-operated programs.

The Fund began providing a portion of aid to the State's public library systems in FY 2003-04.

A balance of almost \$165,000 has accumulated in the Newline Program.

A new statewide data and video network will provide higher-capacity data capabilities beginning in January 2006.

The Universal Service Fund was established under 1993 Wisconsin Act 496 to ensure that all state residents receive essential telecommunications services and have access to advanced telecommunications capabilities. It supports telecommunications services and access programs that are provided by several state agencies, including the Public Service Commission (PSC), the Department of Administration (DOA), the University of Wisconsin System, and the Department of Public Instruction (DPI).

The PSC is responsible for developing the overall policies and procedures related to the Universal Service Fund but is directed by statute to contract with a private firm to administer the Fund. At the request of the PSC, we completed a financial audit of the Universal Service Fund to fulfill audit requirements under s. 196.218(2)(d), Wis. Stats. Our audit report contains our unqualified opinion on the Fund's financial statements and related notes for the fiscal years ending June 30, 2003 and 2004.

As part of our financial audit, we also reviewed different aspects of the Universal Service Fund's programs, including growth in expenditures in PSC-operated programs, accumulation of a balance in the Newline program, and planned implementation of a statewide data and video network that will affect the Educational Telecommunications Access Program.

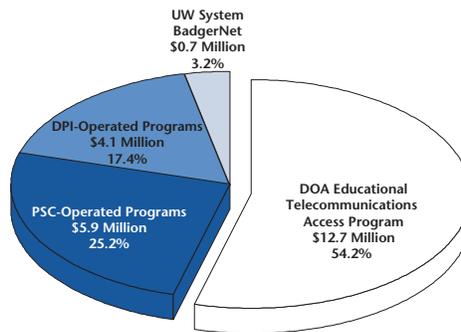
Fund Finances

The Universal Service Fund is funded primarily through assessments paid by telecommunications providers, which totaled \$25.5 million in fiscal year (FY) 2003-04. It also received \$106,000 in interest income and other revenues. Almost \$23.4 million was expended during FY 2003-04 on 13 programs supported by the Fund. The \$2.2 million by which revenues exceeded expenditures increased the Fund's balance at June 30, 2004, to \$6.4 million.

Eight of the 13 programs currently supported by the Universal Service Fund are operated by the PSC, with expenditures totaling \$5.9 million in FY 2003-04. However the largest program, the Educational Telecommunications Access Program, is operated by DOA. This program subsidizes data lines and video links to eligible educational institutions. As shown in Figure 1, its expenditures of \$12.7 million represented 54.2 percent of the Fund's total expenditures and transfers in FY 2003-04.

Figure 1

Universal Service Fund Expenditures and Transfers¹
FY 2003-04



¹ Expenditures and transfers totaled \$23.4 million in FY 2003-04.

During FY 2003-04, the Universal Service Fund also provided \$4.1 million for three programs administered by DPI, and it paid more than \$700,000 to the University of Wisconsin System to provide four campuses access to voice, data, and video services through BadgerNet, the State's current voice, data, and video telecommunications infrastructure.

PSC-Operated Programs

The eight programs operated by the PSC include programs that:

- provide low-income or disabled individuals affordable access to basic telephone and information services;
- lessen the financial effect of high rate increases on users in some parts of the state; and
- assist nonprofit medical clinics or public health agencies in the purchase of medical telecommunications equipment.

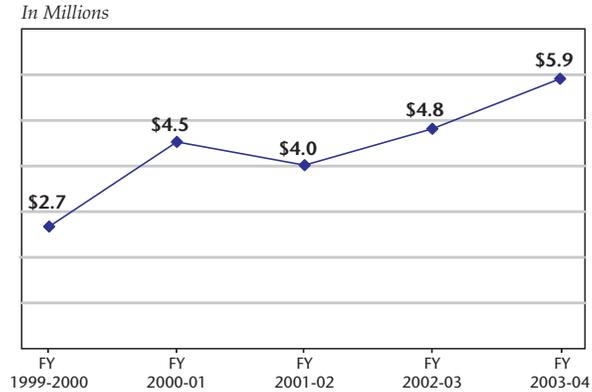
For several years after the first PSC-operated programs were established in 1996, expenditures were significantly less than budgeted. In 2001, the Legislature limited the amount that telecommunications providers could be assessed to support the PSC-operated programs to \$5.0 million in FY 2003-04 and \$6.0 million in FY 2004-05 and thereafter.

However, with the addition, expansion, and promotion of the PSC-operated programs, expenditures for operations and administration have increased significantly since FY 1999-2000, as shown in Figure 2. Increasing expenditures have resulted in budgetary challenges. Because the PSC did not have sufficient spending authority, it deferred decisions to pay on more than \$544,000 in FY 2003-04 payment requests until FY 2004-05, and more than \$740,000 in FY 2004-05 payment requests until FY 2005-06.

The deferred payment requests were related to two programs for which administrative code permits, but does not require, the PSC to reimburse telecommunications providers for waiving telephone connection charges or reducing monthly telephone rates to lower-income individuals. The PSC believes it has the authority to not pay or to defer consideration of payment requests for these two programs if constrained by budgetary limits.

Figure 2

Expenditures¹ for PSC-Operated Programs



¹ Expenditures reported in the financial statements.

Based on expenditure trends in FY 2003-04, the PSC anticipated early in FY 2004-05 that spending authority would be insufficient to cover expected requests for payments during that year. In response, the PSC reduced benefits in the program that helps people with disabilities acquire special telecommunications equipment and did not provide any medical telecommunications grants during FY 2004-05.

2005 Wisconsin Act 25 establishes annual appropriations of \$6.0 million for the PSC-operated programs in the 2005-07 biennium. The PSC believes it can limit FY 2005-06 expenditures to the \$6.0 million level. However, its ability to quickly respond to future cost increases without significantly affecting its programs may be limited. Consequently, regular monitoring of future expenditure trends for the PSC-operated programs will be important. Furthermore, if growth in program demand and expenditures continues, the Legislature may be asked to reconsider statutory limits on the PSC's annual assessment levels.

Library Aids

For several years, the Universal Service Fund supported two programs administered by DPI: the BadgerLink program, which provides statewide on-line access to reference databases of magazines and newspapers, and the Newline program, which is an electronic information program that allows sight-impaired

individuals to listen to newspapers read over the telephone. Beginning in FY 2003-04, the Fund also helps to support the State's public library systems.

Until FY 2003-04, general purpose revenue (GPR) funded state aid to the public library systems. 2003 Wisconsin Act 33 shifted \$2.1 million in funding for public library aid payments from GPR to the Universal Service Fund for each year of the 2003-05 biennium. 2005 Wisconsin Act 25 further reduces GPR for library systems aid by \$2.2 million and increases funding from the Universal Service Fund by another \$4.2 million over the 2005-07 biennium. Under Act 25, the Fund will pay 28.3 percent of library systems state aid in FY 2005-06.

Newsline Program

The PSC annually transfers funds from the Universal Service Fund to DPI for the Newsline program, which is operated by the National Federation of the Blind. Transfers in each of the last three years have been \$67,500. However, we found that in seven of eight years since the program's inception in FY 1997-98, the funds made available to DPI have exceeded the Newsline program expenditures. As a result, a balance of almost \$165,000 has accumulated for the program.

DPI did not inform the PSC that these funds were not being fully spent, and the PSC did not monitor or require any reporting of program expenditure levels. In light of the accumulated balance we identified, the PSC has not budgeted any funding for the Newsline program in FY 2005-06, and it does not plan to provide any additional funds to DPI for the program until the balance has been substantially reduced.

Educational Telecommunications Access Program

The Educational Telecommunications Access Program, which is administered by DOA, pays for the equipment and installation costs of data lines and video links, and for ongoing service costs in excess of monthly charges paid by eligible institutions. Data line or video link services are provided by a consortium of telecommunications providers under contract with DOA. Almost \$91.0 million has been expended for the program through FY 2004-05.

After completion of an assessment of the State's future educational technology needs and a competitive procurement process, the State entered into a five-year contract with the same consortium for a new

statewide network, which will be known as the BadgerNet Converged Network. The new network is designed to provide higher data capability and video access on the same network to the State of Wisconsin and other public-sector users. It is expected to be available beginning January 1, 2006.

Monthly charges to participants in the Educational Telecommunications Access Program will remain the same: \$100 or \$250 per month, depending on the speed of their Internet data line or video link. Monthly costs to the Universal Service Fund will be \$2,769 per video link and will range from \$500 to \$1,190 per data line.

Recommendations

We include recommendations for the Public Service Commission to:

- ☑ change administrative code to require that telecommunications providers submit requests for payments for their services under the Lifeline, Link-Up America, and High Rate Assistance Credit programs by April 1 of the next fiscal year (*p. 13*);
- ☑ report to the Joint Legislative Audit Committee by March 31, 2006, on expenditure trends, cost projections, and its plans to address any projected payment requests that exceed spending authority in PSC-operated Universal Service Fund programs (*p. 13*); and
- ☑ work with DPI to establish formal procedures for transferring funds for the Newline program based on actual program expenditures (*p. 16*).



Universal Service Fund Programs ■

Most of the programs supported by the Universal Service Fund are operated by the PSC. Over the years, the Legislature has made the Fund available to support programs operated by other state agencies, with the most recent addition being aid to public library systems. The largest program supported by the Universal Service Fund is the Educational Telecommunications Access Program, which subsidizes data lines and video links for eligible educational institutions. Descriptions, expenditures, and budget information for each of the 13 programs currently supported by the Fund are provided in the appendix.

Public Service Commission Programs

The PSC was authorized by 1993 Wisconsin Act 496 to promulgate, by administrative rule, universal telecommunications service programs to be funded from the Universal Service Fund. The PSC was also authorized to appoint a Universal Service Fund Council to advise it on the creation and implementation of these PSC programs. The Council consists of representatives of telecommunications providers and consumers. Statutes require that a majority of its members be representatives of telecommunications consumers.

The amount of assessments that can be collected to support PSC-operated programs was capped beginning in FY 2003-04.

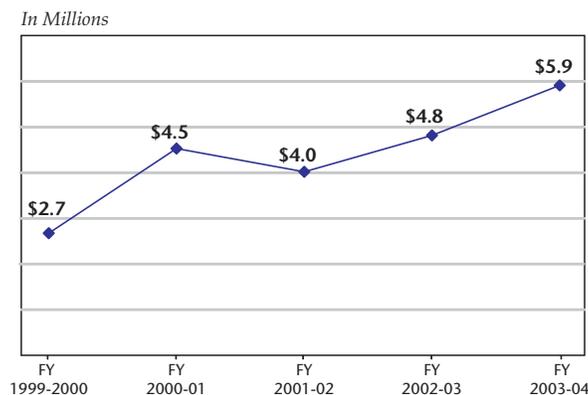
In May 1996, the PSC first promulgated rules that formally established the programs it operates. As we reported in prior audit reports, the PSC-operated programs were not fully developed, and expenditures were significantly less than amounts budgeted for the first several years. In 2001 Wisconsin Act 16, the Legislature limited the amount that telecommunications providers could be assessed to support the PSC-operated programs to \$5.0 million in FY 2003-04 and \$6.0 million in FY 2004-05 and thereafter. In addition, corresponding appropriation expenditure levels were established for the 2003-05 biennium.

The assessment caps did not significantly lower the assessments for PSC-operated programs in FY 2003-04 because a fund balance had accumulated in prior years, when assessments had exceeded expenditure levels. Because the PSC applied \$4.9 million of the available fund balance to limit assessment levels for its programs during FYs 2001-02, 2002-03, and 2003-04, it needed to assess only \$4.0 million for FY 2003-04. However in FY 2004-05, the PSC assessed the full \$6.0 million authorized by statute.

Shortly before the assessment caps were established, programs were added and expanded. At the same time, the PSC also began increasing the promotion of its programs, and expenditures began to increase. As shown in Figure 3, FY 2003-04 expenditures for PSC-operated programs and administration were \$5.9 million, or more than double the expenditure level in FY 1999-2000.

Figure 3

Expenditures¹ for PSC-Operated Programs



¹ Expenditures reported in the financial statements.

During FY 2003-04, expenditures and transfers for PSC-operated programs included:

- \$2.4 million for the Lifeline and Link-Up America programs, which provide support for low-income individuals to establish and receive basic telephone services;
- \$1.9 million for the Telecommunications Equipment Purchase Program, which provides financial assistance to help persons with disabilities in acquiring special telecommunications equipment;
- \$537,000 for the Access Program or Project by Nonprofit Groups Program, which provides grants to nonprofit groups for programs or projects that facilitate affordable access to telecommunications and information services;
- \$425,000 for the High Rate Assistance Credit program, which lessens the financial effects of high rate increases on users;
- \$196,000 for the Medical Telecommunications Equipment Program, which awards grants on a competitive basis to nonprofit medical clinics or public health agencies for the purchase of medical telecommunications equipment;
- \$143,000 for the Public Interest Pay Telephone Program, which ensures that pay telephones remain or are installed at locations where there is a public need;
- \$1,500 for the Two-Line Voice Carryover Program, which provides a second telephone line for certain hearing- or speech-impaired customers who use teletype service; and
- \$304,000 for administrative and other expenditures incurred by the PSC to manage the Fund.

Expenditures for the PSC-operated programs increased by \$1.1 million, or 22.9 percent, in FY 2003-04.

Expenditures for the PSC-operated programs increased by \$1.1 million, or 22.9 percent, in FY 2003-04. A number of factors contributed to the increase. First, Telecommunications Equipment Purchase Program expenditures increased by almost \$500,000, or 34.4 percent, from the prior year. PSC staff attribute this program's growth to implementation of an on-line application process, vendor outreach, and program outreach by independent living centers. Second, a telecommunications company requested payments totaling almost \$402,000 from the Lifeline and High Rate Assistance Credit programs for services provided in the two preceding fiscal years. The PSC concluded it was appropriate to make the payments for the prior years because Wisconsin Statutes and the PSC's administrative code do not establish a time limit for submission of payment requests related to the programs it operates. Finally, PSC staff note that growth and changes in the telecommunications industry, as well as expanded publicity of PSC-operated programs, likely contributed to increased participation.

The growth in expenditures has resulted in budgetary problems for the PSC-operated programs, beginning in FY 2003-04. Because it did not have sufficient spending authority to cover all requests for payment, the PSC deferred decisions to pay on more than \$544,000 in FY 2003-04 payment requests until FY 2004-05, and more than \$740,000 in FY 2004-05 payment requests until FY 2005-06. The deferred payment requests were related to the Link-Up America and Lifeline programs. Because administrative code permits, but does not require, the PSC to reimburse telecommunications providers for waiving telephone connection charges or reducing monthly telephone rates to lower-income individuals, the PSC believes it has authority to not pay or to defer consideration of payment requests for these two programs if constrained by budgetary limits.

The PSC postponed payment of certain payment requests and reduced benefits in response to its funding shortfall.

Based on expenditure trends in FY 2003-04, the PSC anticipated early in FY 2004-05 that spending authority would be insufficient to cover expected requests for payments during that year. Working with the Universal Service Council, the PSC took several steps to reduce costs, including limiting the equipment authorized for purchase by participants in the Telecommunications Equipment Purchase Program and reducing hard-of-hearing benefits in that program from \$200 to \$125 per participant as of September 1, 2004. These changes contributed to a 57.5 percent decrease in program costs, which averaged \$351,000 per month during the first three months of FY 2004-05, compared to \$149,000 for the last nine months of that fiscal year.

The PSC also took steps to reduce costs in the Medical Telecommunications Equipment Program. Initially, \$500,000 was budgeted for medical telecommunications grants during FY 2004-05, with the provision that awards would be made in January based on the

availability of funding. Ultimately, no grants were awarded and the funds were used to cover costs in other PSC-operated programs.

2005 Wisconsin Act 25 establishes annual appropriations of \$6.0 million for PSC-operated programs during the 2005-07 biennium, which, as noted, is the same amount budgeted for FY 2004-05. The PSC believes it can limit FY 2005-06 expenditures to its spending authority, barring unexpected changes in demand for the programs. The limits established in the Telecommunications Equipment Purchase Program will continue in FY 2005-06, and the PSC plans to maintain flexibility in the funding levels for its Medical Telecommunications Equipment and nonprofit access grant programs. The PSC also plans to propose changes to its administrative rules that would require telecommunications providers to submit payment requests by April 1 for services provided in the prior fiscal year under the Lifeline, Link-Up America, and High Rate Assistance Credit programs. Such a change would help to limit unexpected costs when providers submit billings for prior years, such as occurred in FY 2003-04.

The PSC's ability to respond quickly to future cost increases without significantly affecting programs may be limited.

Beyond the steps it is already taking, the PSC's ability to respond quickly to future cost increases without significantly affecting its Universal Service Fund programs may be limited. For example, costs in the Telecommunications Equipment Purchase Program cannot be quickly reduced because applicants have 120 days to redeem vouchers for the established value. Furthermore, reductions in the Lifeline program could potentially result in the loss of federal funds to participating telecommunications providers. Consequently, regular monitoring of future expenditure trends for the PSC-operated programs will be important. Furthermore, if growth in program demand and expenditures continues, the Legislature may be asked to reconsider the statutory limits on the PSC's annual assessment levels.

Recommendation

We recommend the Public Service Commission:

- *change administrative code to require that telecommunications providers submit payment requests for their services under the Lifeline, Link-Up America, and High Rate Assistance Credit programs by April 1 of the next fiscal year; and*
- *report to the Joint Legislative Audit Committee by March 31, 2006, on expenditure trends, cost projections, and its plans to address any projected payment requests that exceed spending authority in PSC-operated Universal Service Fund programs.*

Department of Public Instruction Programs

During FY 2003-04, the Universal Service Fund funded three programs administered by DPI, providing:

- \$2.1 million in aids to the State's public library systems;
- \$1.9 million for the BadgerLink program, which provides statewide on-line access to reference databases of magazines and newspapers; and
- \$67,500 for a contract with the National Federation of the Blind for Newsline, an electronic information program that allows sight-impaired individuals to listen to newspapers read over the telephone.

Expenditures for these three programs totaled \$4.1 million and accounted for 17.4 percent of Universal Service Fund's FY 2003-04 program expenditures.

The Universal Service Fund began providing aid to public library systems in FY 2003-04.

Until FY 2003-04, GPR funded state aids to public library systems. 2003 Wisconsin Act 33 shifted \$2.1 million of the public library aid payments to the Universal Service Fund for each year of the 2003-05 biennium. These payments represented 14.8 percent of the \$14.2 million in state aid payments to public library systems in FY 2003-04. 2005 Wisconsin Act 25 further reduces GPR funding for library systems by \$2.2 million and increases funding from the Universal Service Fund by another \$4.2 million over the 2005-07 biennium. Under Act 25, the Universal Service Fund will fund 28.3 percent of library systems state aid in FY 2005-06, and 27.2 percent in FY 2006-07.

A balance of almost \$165,000 has accumulated for the Newsline program.

During our review of expenditures in the DPI programs, we found that funding provided for the Newsline program exceeded expenditures in seven of the eight years since the program's inception in FY 1997-98. During the eight-year period, the PSC has transferred \$506,000 to DPI to cover Newsline costs, which consist primarily of payments to the National Federation of the Blind. However, as shown in Table 1, DPI spent only \$341,062 during that period, resulting in a cumulative unspent balance of \$164,938. DPI staff indicated they were unable to spend all the funding because demand for the program was less than originally anticipated and annual federal funding to the National Federation of the Blind can fluctuate, making it more challenging to anticipate the amount that DPI will be billed for the program. DPI did not inform the PSC that Newsline funds were not being fully spent, and the PSC did not

monitor or require any reporting of expenditure levels for the program.

Table 1

Newsline Transfers and Expenditures

| Fiscal Year | Universal Service Fund Transfer to DPI | Expenditures | Balance Not Spent |
|----------------------|--|------------------|-------------------|
| 1997-98 | \$111,000 | \$ 85,207 | \$ 25,793 |
| 1998-99 | 35,000 | 29,055 | 5,945 |
| 1999-2000 | 43,500 | 30,680 | 12,820 |
| 2000-01 | 45,500 | 47,318 | (1,818) |
| 2001-02 | 68,500 | 53,727 | 14,773 |
| 2002-03 | 67,500 | 20,558 | 46,942 |
| 2003-04 | 67,500 | 60,850 | 6,650 |
| 2004-05 ¹ | 67,500 | 13,667 | 53,833 |
| Total | \$506,000 | \$341,062 | \$164,938 |

¹ Estimated

Changes in the statutory budget provisions for Newsline may have contributed to confusion regarding the program’s funding requirements. Initially, statutes directed that specific amounts be transferred from the Universal Service Fund to DPI for Newsline. However, beginning in FY 2001-02, they instead enumerate the Newsline program as an allowable purpose for which the Universal Service Fund can be used and establish an appropriation level that DPI can expend for the program.

Despite statutory changes, the PSC believed it still was required to transfer the full amount of DPI’s appropriation for the program. However, administrative code provides that the PSC can establish an annual budget for the Newsline program, as it does for PSC-operated programs. It would, therefore, appear that the PSC now has authority to fund Newsline at a level consistent with the program’s costs.

The PSC does not plan to transfer any additional funds for the Newsline program until the balance has been substantially reduced.

In light of the accumulated balance in the Newsline program, the PSC has not budgeted any funding for the program in FY 2005-06 and does not plan to transfer funds to DPI for the program until the balance has been substantially reduced. Based on average annual expenditures since the program's inception, DPI appears to have adequate funding for three to four fiscal years for the Newsline program.

Recommendation

We recommend the Public Service Commission work with the Department of Public Instruction to establish formal procedures for transferring funds for the Newsline program based on actual program expenditures.

Educational Telecommunications Access Program

The Educational Telecommunications Access Program provides subsidized access to new data lines for direct Internet access, as well as two-way interactive video links that also allow participants to view and respond to instructional presentations from off-site locations. Eligible entities, which include public and private K-12 schools; private, tribal, and state technical colleges; public libraries; correctional facilities; the Wisconsin School for the Deaf and the Wisconsin Center for the Blind and Visually Impaired; and public museums, are charged a maximum of either \$100 or \$250 per month, depending on the speed of their Internet data line or video link.

The program pays for equipment, for installation costs of the data lines and video links, and for ongoing service costs in excess of the monthly charges paid by the eligible institutions. The data line and video link services are provided by telecommunications providers in the Wisconsin BadgerNet Access Alliance, which is a consortium of telecommunications companies under contract with DOA. In 1998, DOA signed three contracts with the BadgerNet Access Alliance, one each for voice, data, and video services, all of which are part of the statewide network known as BadgerNet. The Educational Telecommunications Access Program's video link and data line costs were financed through the State's master lease program, with semiannual payments due through 2006.

Almost \$91.0 million has been expended for the Educational Telecommunications Access Program through FY 2004-05.

As shown in Table 2, \$12.7 million in Universal Service Fund funds were spent on the Educational Telecommunications Access Program in FY 2003-04, which is a decrease of \$5.3 million, or approximately 29.6 percent, from FY 2002-03. The decrease in expenditures is largely related to \$5.0 million in prepayments made in FY 2002-03 to reduce the program's master lease obligation, and \$1.0 million paid for the design and construction of three gateways.

Table 2

Educational Telecommunications Access Program Expenditures
FY 1998-99 through FY 2004-05

| Period | Expenditures |
|-------------------------|---------------------|
| FY 1998-99 | \$12,232,143 |
| FY 1999-2000 | 8,750,186 |
| FY 2000-01 | 10,480,498 |
| FY 2001-02 | 11,704,793 |
| FY 2002-03 | 18,014,975 |
| FY 2003-04 | 12,686,709 |
| FY 2004-05 ¹ | 16,846,105 |
| Total | \$90,715,409 |

¹ Estimated

In addition to subsidizing new data lines and video links, the Educational Telecommunications Access Program also provides grants for data lines and video links that were in existence on or before October 14, 1997. Entities that receive funding for existing contracts may not also receive support for new data lines or video links. The program's existing contract grants component was originally scheduled to sunset June 30, 2002, but it was extended through December 31, 2005, in 2001 Wisconsin Act 16. As the existing contract grant component is phased out at the end of 2005, participating entities will be eligible to receive data or video services through the State at a cost of \$100 or \$250 per month.

As of June 30, 2004, the Educational Telecommunications Access Program has provided subsidies for 227 new video links and 561 new data lines, as well as grants for 87 video links and 1 data line that were in existence as of October 14, 1997.

A Wisconsin Education Network Collaboration Committee was formed to address the expiration of the BadgerNet contracts for video and data services in 2005. This committee assessed current and future educational technology needs and evaluated the State's options. It concluded that extending the current contract would not meet Wisconsin's educational and training needs and recommended procuring a network that would better meet the needs of educational, governmental, and business entities. The Wisconsin Collaborative Network Initiative Committee, which consisted of representatives of state agencies, educational institutions, libraries, and local governments, led the development of specifications for a new distance education network to meet the needs identified by the Collaboration Committee.

The State entered into a new five-year contract for video and data services beginning in January 2006.

After completing a competitive procurement process, DOA selected the same Wisconsin BadgerNet Access Alliance as its vendor for the new network. In March 2005, DOA entered into a \$116 million five-year agreement for data and video services for the State of Wisconsin and other public-sector users beginning January 1, 2006. The new statewide network, which will be known as the BadgerNet Converged Network, is designed to provide higher data capability and video access on the same network. Voice services for state government may also be added in the future.

Under the new contract, video links will cost \$3,019 per month, which is slightly more than the \$3,000 paid under the old contract. However, DOA expects to save approximately \$1.5 million annually on video gateways and intercluster links, which allow for connection to other sites. Participants in the Educational Telecommunications Access Program will continue to pay \$250 per month for a video link, with the remaining cost of \$2,769 per month paid by the Universal Service Fund.

Data line rates will be more complex, as eligible organizations will have a wider array of data capacities than currently available on BadgerNet. Participants in the Educational Telecommunications Access program will continue to pay \$100 per month for lines with basic capacity, or \$250 per month for lines with higher capacity. Monthly costs to the Universal Service Fund will range from \$500 to \$1,190 per data line, depending on the line's data capacity.

2005 Wisconsin Act 25 establishes spending authority of \$17.3 million for the Educational Telecommunication Access Program for each year of the 2005-07 biennium. Although DOA expended only \$12.7 million in FY 2003-04, spending increased to an estimated \$16.8 million in FY 2004-05. DOA staff expect that all of the proposed spending authority for FY 2005-06 and FY 2006-07 will be used to cover the expanded capacity costs of the BadgerNet Converged Network.

In addition to funding from the Universal Service Fund, federal funding is also available for telecommunications access services through the federal E-rate program. The E-rate program consists of discounts applied to telecommunications services such as basic and long-distance telephone services, Internet access, and equipment to provide internal telecommunications connections. As a purchaser of telecommunications services, DOA applies for and receives federal E-rate funds on behalf of school districts and libraries with video links and data lines provided through the Educational Telecommunications Access Program.

As directed by the Legislature, the E-rate funding received by the State was used during the 2003-05 biennium to offset the GPR-funded debt service costs associated with the Infrastructure Financial Assistance Program. That program provided grants and loans to school districts and libraries to upgrade data and electrical wiring needed for high-speed data transmission through FY 2002-03. DOA received \$5.8 million in E-rate funds during 2003-04 and \$5.7 million in FY 2004-05, which were used for the GPR-funded wiring loan costs in those years.

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Audit Opinion ■

Independent Auditor's Report on the Financial Statements of the State of Wisconsin Universal Service Fund

We have audited the accompanying financial statements of the Universal Service Fund of the State of Wisconsin as of and for the years ended June 30, 2004 and 2003. These financial statements are the responsibility of the management of the Universal Service Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2A, the financial statements referred to in the first paragraph present only the Universal Service Fund and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Universal Service Fund as of June 30, 2004 and 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Universal Service Fund. The supplementary information included as Management's Discussion and Analysis on pages 23 through 27 and as Schedules 1 and 2 on pages 42 and 43 is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 11, 2005, on our consideration of the Universal Service Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

August 11, 2005

LEGISLATIVE AUDIT BUREAU
by 
Diann Allsen
Audit Director

Management's Discussion and Analysis ■

Prepared by Public Service Commission Management

Management's Discussion and Analysis (MD&A) is prepared by the Public Service Commission management to provide general information on the financial activities of the Universal Service Fund. The MD&A should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of PSC management.

The PSC is an independent regulatory agency of the State of Wisconsin that is responsible for the regulation of public utilities, including electric, natural gas, telephone, water, and combined water and sewer facilities. The PSC receives its authority and responsibilities from the State Legislature. One of the PSC's responsibilities is to administer the Fund. The Fund was established to further the goal of providing both basic essential telecommunications services and access to advanced service capabilities to utility customers in Wisconsin.

Overview of the Financial Statements

The Universal Service Fund is accounted for as a special revenue fund, which is a governmental fund that uses the flow of current financial resources and the modified accrual basis of accounting. The financial statements provide a detailed short-term view of the Fund's finances that assists in determining whether there will be adequate resources available to meet the current needs of the Fund. The Fund financial statements include two statements:

- The Balance Sheet presents only assets expected to be used and liabilities that come due during the year or soon thereafter. The difference between assets and liabilities is reported as fund balance.

- The Statement of Revenues, Expenditures, and Changes in Fund Balance presents a comparison of revenues for which cash is received during or soon after the end of the year; expenditures for which payment is due during the year or soon thereafter; and other financing sources and uses, such as transfers to the General Fund. The net of these categories increases or decreases the fund balance.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

Noteworthy Financial Activity

Condensed financial statements for the fiscal years ended June 30, 2004 and 2003, are shown in the following table.

Universal Service Fund Condensed Financial Information

| | FY 2003-04 | FY 2002-03 | Dollar Change | Percentage Change |
|---|--------------------|----------------------|--------------------|-------------------|
| Total Assets | \$8,674,031 | \$6,063,015 | \$2,611,016 | 43% |
| Total Liabilities | 2,262,169 | 1,867,735 | 394,434 | 21 |
| Fund Balance | 6,411,862 | 4,195,280 | 2,216,582 | 53 |
| Total Revenues | 25,638,450 | 23,354,958 | 2,283,492 | 10 |
| Total Expenditures | 23,354,368 | 25,613,254 | (2,258,886) | -9 |
| Excess of Revenues over Expenditures¹ | 2,284,082 | (2,258,296) | 4,542,378 | N/A |
| Transfers to State of Wisconsin General Fund ² | 67,500 | 3,706,500 | (3,639,000) | -98 |
| Excess of Revenues over Expenditures and Transfers to the General Fund¹ | \$2,216,582 | \$(5,964,796) | \$8,181,378 | N/A |

¹ Percentage change is not calculated for amounts that changed from negative to positive.

² FY 2002-03 includes cash lapses of \$3,639,000 to the General Fund. No funds were lapsed in FY 2003-04.

The Fund's total revenue of \$25.6 million consists primarily of billed revenue plus interest income. Billed revenue is what the PSC assesses telecommunications providers as required by statute and administrative rule. Providers are assessed over a 12-month period based on budget appropriations. Almost 84 percent of total revenue is intended for four programs the PSC does not manage: the Educational Telecommunications Access Program, which is managed by the Department of Administration; library aids and BadgerLink, which are managed by the

Department of Public Instruction; and the University of Wisconsin BadgerNet. The remaining 16 percent of revenue is used to support PSC-operated programs, which include the Telecommunications Equipment Purchase Program (TEPP), Lifeline, Link-Up America, the High Rate Assistance Credit program, the Medical Telecommunications Equipment program, the Access Program or Project by Nonprofit Groups, and the Public Interest Pay Telephone program.

DPI assessments increased by \$2.1 million to cover payments for library aids, which were first funded in FY 2003-04. In addition, DOA assessments for the Educational Telecommunications Access Program increased by almost \$600,000, or 4 percent. Assessments for PSC-operated programs totaled \$4.0 million and were 7 percent less than in FY 2002-03, and \$1.0 million less than appropriation spending authority. The PSC was able to assess a lower amount because the available fund balance had accumulated from prior years. 2001 Wisconsin Act 16 limited assessments for PSC-operated programs to \$5.0 million for FY 2003-04. Beginning in FY 2004-05, assessments for these programs are limited to \$6.0 million.

The amount reported as excess of revenues over expenditures increased by \$4.6 million from -\$2.3 million to \$2.3 million because of the increase in revenues and a decrease in expenditures. As a result, the fund balance increased \$2.2 million, or 53 percent, from \$4.2 million in FY 2002-03 to \$6.4 million in FY 2003-04.

The decrease in expenditures can be attributed to the Educational Telecommunications Access Program, which reported \$12.7 million in expenditures in FY 2003-04, compared to \$18.0 million in FY 2002-03. The \$5.3 million decrease occurred primarily because \$5.0 million was prepaid to the State's master lease program in FY 2002-03, which had helped finance the costs of video and data links provided under the program. Similar prepayments were not made in FY 2003-04.

Offsetting the decrease in expenditures in the Educational Telecommunications Access Program was a \$2.1 million increase in expenditures for DPI programs. 2003 Wisconsin Act 33 created a second DPI appropriation to fund a portion of state aid payments to 17 state public library systems. As a result, the Universal Service Fund for the first time paid \$2.1 million for library aids in FY 2003-04.

While the PSC did not fully spend its appropriations for its programs prior to FY 2001-02, that trend began to change in FY 2002-03 when expenditures grew to \$4.8 million. Considerable time was needed to develop and market a number of the PSC programs, which resulted in program growth. At the same time participation rates and costs were increasing, 2001 Wisconsin Act 16 was enacted, which capped assessments for FY 2003-04 to \$5.0 million, or slightly more than FY 2002-03 expenditures. Although assessments were capped, participation rates and expenditure increases continued into FY 2003-04.

TEPP expenditures increased by 35 percent, from \$1.4 million in FY 2002-03 to \$1.9 million in FY 2003-04. Implementation of an electronic application process in October 2003, vendor outreach, and involvement of independent living centers in program outreach contributed to a significant increase in the number of program participants receiving benefits. TEPP applications nearly doubled from 5,885 applications in FY 2002-03 to 10,630 applications in FY 2003-04. To limit

growth of the program, as of September 1, 2004, the PSC limited the equipment approved for purchase by TEPP program participants. In addition, as of October 1, 2004, TEPP hard-of-hearing voucher benefits were reduced from \$200 to \$125 per person.

Lifeline expenditures increased by almost \$600,000, to \$1.6 million in FY 2003-04. The 57 percent increase is partially attributed to increased program participation resulting from additional outreach efforts. In addition, payments totaling more than \$250,000 were made to a telecommunications company for services provided in two prior fiscal years but not billed until FY 2003-04. The prior-year payments were 25 percent of the established Lifeline budget of \$1.0 million and contributed significantly to expenditures exceeding the budget by nearly \$600,000.

Expenditures for the High Rate Assistance Credit program also increased significantly, from \$4,700 in FY 2002-03 to \$425,000 in FY 2003-04. The cost increases of \$420,000 are partially attributed to increased program participation. In addition, payments of \$151,000 were made to a telecommunications company for services provided in two prior fiscal years but not billed until FY 2003-04. The prior-year payments were 46 percent of the established High Rate Assistance Credit program budget of \$330,000 and contributed significantly to expenditures exceeding the budget by \$95,000.

Link-Up expenditures increased by almost \$148,000, to \$809,000 in FY 2003-04. The 22 percent increase is attributed to increased participation in the program. As a result, expenditures exceeded the \$677,000 program budget by over \$130,000.

Expenditures for the Medical Telecommunications Equipment program decreased by \$558,000, to \$196,000 in FY 2003-04. At the same time, expenditures for the Access Program or Project by Nonprofit Groups increased by \$67,000, or 14 percent, from the prior year. Expenditures may vary significantly between years for both programs, based on the timing of grantee reimbursement requests. The PSC awarded grants of \$500,000 in each program in FY 2003-04.

Public Interest Pay Telephone program expenditures decreased from \$191,000 in FY 2002-03 to \$143,000 in FY 2003-04. In anticipation of spending limitations, applications for additional public interest pay phones have not been accepted since early 2003.

Demand for PSC programs exceeded the funding available in FY 2003-04, and expenditures would have exceeded the \$5.0 million spending cap. As a result, payment decisions about requests totaling more than \$544,000 were not made until FY 2004-05, when additional spending authority became available. The invoices were primarily for the Lifeline and Link-Up America programs. Contributing to the spending authority shortfall were payments made to a telecommunications company for Lifeline and High Rate Assistance Credit program services provided in two prior fiscal years but not billed until FY 2003-04. These payments totaled \$401,000 and represent 74 percent of the \$544,000 shortfall in appropriation spending authority.

This financial report is designed to provide an overview of the Universal Service Fund's finances. Questions concerning any of the information it provides, or requests for additional information, should be addressed to the Public Service Commission of Wisconsin, in care of the Universal Service Fund Manager, P.O. Box 7854, Madison, WI 53707-7854.

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Financial Statements ■

Universal Service Fund

Balance Sheet
June 30, 2004 and 2003

| | <u>June 30, 2004</u> | <u>June 30, 2003</u> |
|---|----------------------------|----------------------------|
| ASSETS | | |
| Cash and Cash Equivalents (Note 3) | \$ 6,919,225 | \$ 4,487,516 |
| Assessments Receivable (Note 2D) | 1,562,904 | 1,575,499 |
| Other Receivables | 191,902 | 0 |
| Total Assets | <u>\$ 8,674,031</u> | <u>\$ 6,063,015</u> |
| LIABILITIES AND FUND BALANCE | | |
| Liabilities: | | |
| Program liabilities: | | |
| Lifeline Program | \$ 725,124 | \$ 235,154 |
| Educational Telecommunications Access Program | 488,107 | 476,623 |
| Link-Up America Program | 370,428 | 188,608 |
| Telecommunications Equipment Purchase Program | 275,068 | 0 |
| Access Program or Project by Nonprofit Groups | 190,502 | 83,997 |
| High Rate Assistance Credit Program | 187,057 | 33 |
| Public Interest Pay Telephone Program | 11,079 | 13,651 |
| Two-Line Voice Carryover Program | 408 | 253 |
| BadgerLink Program | 0 | 539,700 |
| Medical Telecommunications Equipment Program | 0 | 291,542 |
| Accounts payable | 14,396 | 38,174 |
| Total Liabilities | <u>2,262,169</u> | <u>1,867,735</u> |
| Fund Balance: | | |
| Reserved for encumbrances (Note 6) | 2,433,736 | 1,124,891 |
| Unreserved | 3,978,126 | 3,070,389 |
| Total Fund Balance | <u>6,411,862</u> | <u>4,195,280</u> |
| TOTAL LIABILITIES AND FUND BALANCE | <u>\$ 8,674,031</u> | <u>\$ 6,063,015</u> |

The accompanying notes are an integral part of this statement.

**Statement of Revenues, Expenditures, and Changes in Fund Balance
for the Years Ended June 30, 2004 and 2003**

| | Year Ended June 30, 2004 | Year Ended June 30, 2003 |
|---|----------------------------|----------------------------|
| REVENUES | | |
| Telecommunications Providers Assessments (Note 2D) for: | | |
| Educational Telecommunications Access Program | \$ 16,494,039 | \$ 15,909,308 |
| Public Service Commission Programs (Note 7) | 3,993,343 | 4,301,508 |
| Department of Public Instruction Programs | 3,990,947 | 1,848,656 |
| University of Wisconsin BadgerNet Access | <u>1,053,772</u> | <u>1,052,889</u> |
| Total Telecommunications Providers Assessments | \$ 25,532,101 | \$ 23,112,361 |
| Interest Income | 38,949 | 191,897 |
| Other Revenue | <u>67,400</u> | <u>50,700</u> |
| Total Revenues | <u>25,638,450</u> | <u>23,354,958</u> |
| EXPENDITURES | | |
| Program Expenditures: | | |
| Educational Telecommunications Access Program | 12,686,709 | 18,014,975 |
| Library Aids | 2,111,900 | 0 |
| BadgerLink Program | 1,886,870 | 1,832,862 |
| Telecommunications Equipment Purchase Program | 1,935,188 | 1,439,604 |
| Lifeline Program | 1,559,003 | 989,734 |
| Link-Up America Program | 808,693 | 660,980 |
| University of Wisconsin BadgerNet Access | 759,783 | 951,594 |
| Access Program or Project by Nonprofit Groups | 536,831 | 470,112 |
| High Rate Assistance Credit Program | 424,872 | 4,699 |
| Medical Telecommunications Equipment Program | 195,938 | 754,065 |
| Public Interest Pay Telephone Program | 142,695 | 191,108 |
| Two-Line Voice Carryover Program | <u>1,481</u> | <u>1,137</u> |
| Total Program Expenditures | 23,049,963 | 25,310,870 |
| Administrative Expenditures | 237,063 | 251,627 |
| Other Expenditures and Adjustments | <u>67,342</u> | <u>50,757</u> |
| Total Expenditures | <u>23,354,368</u> | <u>25,613,254</u> |
| EXCESS OF REVENUES OVER EXPENDITURES | 2,284,082 | (2,258,296) |
| OTHER FINANCING USES | | |
| Transfer to the State of Wisconsin General Fund (Note 4) | <u>67,500</u> | <u>3,706,500</u> |
| Excess of Revenues over Expenditures and Other Financing Uses | 2,216,582 | (5,964,796) |
| FUND BALANCE | | |
| Fund Balance—Beginning of the Year | <u>4,195,280</u> | <u>10,160,076</u> |
| Fund Balance—End of the Year | <u>\$ 6,411,862</u> | <u>\$ 4,195,280</u> |

The accompanying notes are an integral part of this statement

Notes to the Financial Statements ■

1. DESCRIPTION OF THE UNIVERSAL SERVICE FUND

The Wisconsin Public Service Commission established the State of Wisconsin Universal Service Fund, as directed by 1993 Wisconsin Act 496, to ensure that all residents of Wisconsin receive essential telecommunications services and have access to advanced telecommunications service capabilities. Act 496 directed the PSC to create and appoint the members of the Universal Service Fund Council, the majority of whom are to be representatives of consumers of telecommunications services, to advise the PSC concerning the administration of the Fund. Act 496 also directed the PSC to contract with a private firm to administer the Fund. The PSC has contracted with Wipfli LLP, an accounting firm, for these services.

The Universal Service Fund is established as a trust fund in s. 25.95, Wis. Stats. As allowed by statute, the PSC requires telecommunications providers to contribute to the Universal Service Fund in amounts sufficient to support the Fund's programs and operations. The Fund supports funding for telecommunications services and access provided through several state agencies, including the PSC, the University of Wisconsin (UW) System, the Department of Public Instruction (DPI), and the Department of Administration (DOA).

A description of each of the programs under which the Universal Service Fund incurred expenditures during FYs 2003-04 and 2002-03 follows:

A. Educational Telecommunications Access Program

This program, which had been administered by the Technology for Educational Achievement (TEACH) Board, was implemented in

February 1998 to provide educational entities with subsidized access to new data lines for direct Internet access and video links, which also provide for two-way interactive video that allows participants to view and respond to instructional presentations from off-site locations. In addition, the program provides grants for data lines and video links in existence before October 14, 1997. Beginning in FY 2003-04, the TEACH Board was disbanded and the Educational Telecommunications Access Program was transferred to DOA.

B. BadgerLink

Beginning in FY 1999-2000, the Universal Service Fund pays for contracts with vendors that provide statewide access to reference databases of magazines and newspapers through BadgerLink, which is a program administered by DPI to provide access to information resources using existing telecommunications networks and Internet connections.

C. Library Aids

2003 Wisconsin Act 33 provided statutory language that included the payment of public library system aid as an authorized use of the Universal Service Fund beginning in FY 2003-04. General purpose revenue is the major source of funding for library aids. DPI is responsible for distributing the aids payments to 17 Wisconsin public library systems according to a statutory formula.

D. Telecommunications Equipment Purchase Program

This program, which was implemented in May 1996, assists persons with disabilities in acquiring special telecommunications equipment. Six categories of disabilities qualify for the program: hard of hearing, deaf, speech impaired, mobility/motion impaired, deaf and low vision, and deaf and blind. For each disability, the PSC has established a maximum dollar amount that the Universal Service Fund will pay toward the purchase of special telecommunications equipment. Participants in this program, except for hard-of-hearing participants, are required to contribute \$100 toward the cost of the special equipment, plus any amount in excess of the maximum amount that the Fund will pay. The Fund issues vouchers to approved eligible disabled persons, who present them to vendors when equipment is purchased. Vendors subsequently submit the vouchers to the Fund administrator for payment.

E. University of Wisconsin BadgerNet Access

BadgerNet is the State's telecommunications infrastructure of voice, data, and video networks and communication services provided by DOA to Wisconsin state agencies, local governments, UW campuses, technical colleges, public and private schools, and other eligible users. Beginning in FY 1997-98, the Legislature appropriated funds from the

Universal Service Fund to provide BadgerNet access for UW-River Falls, UW-Stout, UW-Superior, and UW-Whitewater in a manner equivalent to the access provided through other funding sources for the other nine four-year campuses.

F. Lifeline and Link-Up America

These are separate but complementary programs that were implemented in June 1997, with retroactive assistance to May 1996. Certain low-income individuals are eligible to participate in these programs. The Lifeline program is based on a maximum rate of \$15 per month for certain basic services consisting of single-party residential touch-tone service, including "911" emergency service. When the actual approved rate for these services exceeds \$15 per month, low-income customers may receive support for the difference. The Link-Up America program provides a waiver of certain regulated service charges when low-income residential customers initiate or move telephone service. For both of these programs, telecommunications providers establish eligibility and request reimbursement from the Fund for its share of these costs.

G. High Rate Assistance Credit

This program was implemented in May 1996 to lessen the financial effects of rapid increases in approved telecommunications rates charged to users. Under the program, telecommunications providers issue credits to residential customers when the telecommunications rates approved by the PSC exceed certain levels that are based on the median household income level for which the rates apply. Monthly, the Universal Service Fund reimburses telecommunications providers the value of the credits issued.

H. Medical Telecommunications Equipment

This program, which was implemented in FY 2000-01, provides grants to nonprofit medical clinics and public health agencies to purchase medical telecommunications equipment that will promote technologically advanced medical services or will enhance access to medical care.

I. Access Program or Project by Nonprofit Groups

This program, which was implemented in FY 2000-01, provides grants to nonprofit groups for partial funding of programs or projects that will facilitate affordable access to telecommunications and information services.

J. Public Interest Pay Telephone

This program, which was implemented in FY 2000-01, provides funding to ensure that pay telephones remain or are installed at locations where there is a public need, even though revenues generated by use of the telephones are not sufficient to have providers willing to maintain or install these telephones.

K. Two-Line Voice Carryover

This program, which was implemented in FY 2001-02, provides a second telephone line to certain hearing- or speech-impaired customers who use teletype service.

L. Newline Electronic Information Service

Beginning with FY 1997-98, an annual transfer from the Universal Service Fund is made to the State of Wisconsin General Fund to fund a contract between DPI and the National Federation of the Blind to provide the Newline electronic information service that provides dial-up access to audio versions of major national newspapers and several local newspapers for sight-impaired individuals.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**A. Basis of Presentation**

The Universal Service Fund's financial statements have been prepared in conformity with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board (GASB). The Universal Service Fund is a special revenue fund of the State of Wisconsin. These statements present the financial position and results of operations of only the activity of the Fund, and are not intended to present the financial activity for the State of Wisconsin as a whole.

B. Basis of Accounting

The Universal Service Fund is accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the Balance Sheet. The operating statement presents revenues and expenditures that result in changes in net available financial resources.

The Fund is accounted for on the modified accrual basis of accounting, which recognizes revenues when they become measurable and available to pay current reporting period liabilities. Revenues are considered to be available if received within one year after the fiscal year-end. Expenditures and related liabilities are recognized when obligations are incurred, with the exception that payments on master lease obligations are recorded as expenditures when due.

C. Cash and Cash Equivalents

Cash and cash equivalents reported on the Balance Sheet include a demand deposit account at a commercial financial institution and cash deposited with the State, where available balances beyond immediate needs are pooled in the State Investment Fund for short-term investment purposes. Balances pooled are restricted to legally

stipulated investments valued consistent with GASB Statement No. 31, *Accounting and Financial Reporting for Investments and for External Investment Pools*.

D. Telecommunications Providers' Assessments

Annually, the PSC estimates the amount of revenues needed to pay for the year's program and administrative costs. The PSC then assesses telecommunications providers their share of these costs based on intrastate revenues. Those telecommunications providers with intrastate gross telecommunications revenues of less than \$200,000 annually are exempt from this assessment. Telecommunications providers pay one-twelfth of the assessed amount each month. The Universal Service Fund recognizes telecommunications providers' assessments when due. Unpaid assessments as of June 30 are reported on the Balance Sheet as assessments receivable.

3. DEPOSITS

GASB Statement 3 requires deposits with financial institutions be categorized to indicate the level of risk assumed by the State. The risk categories for deposits are: 1) insured or collateralized with securities held by the Universal Service Fund or by its agent in the Universal Service Fund's name; 2) uninsured but collateralized by the financial institution; and 3) uninsured and uncollateralized.

The Universal Service Fund's administrator uses a bank account at a commercial financial institution to process payments under the telecommunications programs established by the PSC. Payments from this bank account are funded by periodic transfers from the State's bank account. For the Fund's bank account, the financial statements include cash in the bank, plus cash in transit to or from the bank. The Federal Deposit Insurance Corporation insures the Fund's deposits for losses up to \$100,000. As of June 30, 2004, the amount of the bank account balance was \$2,633. Therefore, the entire balance was insured and categorized as risk category 1. As of June 30, 2003, the amount of the bank account balance was \$143,361. Therefore, \$100,000 was insured and classified in risk category 1; \$43,361 was uninsured and uncollateralized and classified in risk category 3.

Cash deposited with the State of Wisconsin is invested in the State Investment Fund (SIF), which is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees. The carrying amount of shares in the SIF, which is presented at fair value, was \$6,914,000 as of June 30, 2004, and \$3,615,000 as of June 30, 2003. Holdings of the SIF include certificates of deposit and investments consisting primarily of direct obligations of the federal government and the State, and unsecured notes of qualifying financial and industrial issuers. Shares in the SIF are not required to be categorized under GASB Statement No. 3. The SIF is not registered with the Securities and Exchange Commission.

4. TRANSFERS TO THE GENERAL FUND

An annual transfer from the Universal Service Fund is made to the State of Wisconsin General Fund appropriation created under s. 20.255(1)(ke), Wis. Stats., to fund a contract between DPI and the National Federation of the Blind for the Newslite electronic information service that provides dial-up access to audio versions of major national newspapers for blind and visually impaired individuals. \$67,500 was transferred in both FY 2003-04 and FY 2002-03.

In addition, the Universal Service Fund was required to make the following lapses to the State of Wisconsin General Fund in FY 2002-03:

| | <u>FY 2002-03</u> |
|--------------|-------------------|
| 2001 Act 16 | \$ 200,000 |
| 2001 Act 109 | 200,000 |
| 2003 Act 1 | <u>3,239,000</u> |
| Total | \$3,639,000 |

The Universal Service Fund was not required to lapse any funds in FY 2003-04.

5. MASTER LEASE COMMITMENTS

The subsidized video link and data line costs of the Educational Telecommunications Access Program are financed through the State’s master lease program. The Universal Service Fund’s expenditures for the program include master lease payments of \$5.9 million during FY 2003-04 and \$11.3 million during FY 2002-03, which included \$0.7 million and \$1.2 million for interest, respectively. The outstanding balance on the master lease for the Educational Telecommunications Access Program as of June 30, 2004, was \$8.9 million. The following presents the minimum future lease payments as of June 30, 2004:

| Fiscal Year <u>Ended June 30</u> | <u>Total</u> |
|--|------------------|
| 2005 | \$6,324,504 |
| 2006 | <u>3,161,579</u> |
| Total Future Payments | 9,486,083 |
| Less: Interest | <u>(558,675)</u> |
| Present Value of Minimum Lease Payments | \$8,927,408 |

6. ENCUMBRANCE RESERVES

The Universal Service Fund is committed to making future payments related to the Educational Telecommunications Access Program, the Telecommunications Equipment Purchase Program, and various other programs.

A. Telecommunications Equipment Purchase Program

Valid vouchers that have been issued to disabled persons for the purchase of special telecommunications equipment but have yet to be presented to the Fund for payment are reported as reserved for encumbrances. As of June 30, 2004, and June 30, 2003, the amounts reserved for Telecommunications Equipment Purchase Program encumbrances were \$1,635,900 and \$593,400, respectively.

B. Other Encumbrances

As of June 30, 2004, and June 30, 2003, the following encumbrance balances were outstanding for the various programs in which awards had been made to participants, but the appropriate invoices and supporting documentation had not yet been presented to the Fund for the release of funding to the recipient:

| <u>Program</u> | <u>Encumbrances at June 30, 2004</u> | <u>Encumbrances at June 30, 2003</u> |
|--|--|--|
| Access Program or Project by Nonprofit Groups | \$363,115 | \$427,156 |
| Medical Telecommunications Equipment | 434,721 | 104,335 |

7. ASSESSMENT LIMITS

2001 Wisconsin Act 16 limits the amount of assessments on telecommunications providers to support the PSC-operated programs. The PSC may not assess more than \$5.0 million in FY 2003-04, and \$6.0 million in FY 2004-05 and each year thereafter, for PSC-operated programs.

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Supplementary Information ■

Budgetary Comparison Schedule for the Years Ended June 30, 2004 and 2003

| | Year Ended June 30, 2004 | | Year Ended June 30, 2003 | |
|--|--------------------------|---------------------|--------------------------|-------------------|
| | Budget | Actual | Budget | Actual |
| AVAILABLE FOR APPROPRIATION | | | | |
| Unexpended Budgetary Fund Balance | | | | |
| Beginning of the Year ¹ | | \$ 1,767,428 | | \$ 8,461,055 |
| Revenues ² | \$ 26,491,156 | 26,491,156 | \$22,660,119 | 22,660,119 |
| Amount Available for Appropriation | | 28,258,584 | | 31,121,174 |
| APPROPRIATIONS AND TRANSFERS (OUTFLOWS) | | | | |
| Educational Telecommunications Access Program ³ | 16,524,500 | 12,686,709 | 16,102,700 | 18,014,975 |
| PSC Programs ⁴ | 4,932,500 | 4,769,180 | 6,811,500 | 4,847,815 |
| BadgerLink Program | 1,886,900 | 1,886,870 | 1,850,200 | 1,832,862 |
| Aid to Public Library Systems | 2,111,900 | 2,111,900 | 0 | 0 |
| University of Wisconsin BadgerNet Access | 1,054,800 | 759,783 | 1,054,800 | 951,594 |
| Transfer to the General Fund for Newslines Program | 67,500 | 67,500 | 68,500 | 67,500 |
| Transfers to the General Fund for Budget Lapses ⁵ | 0 | 0 | 3,639,000 | 3,639,000 |
| Total Appropriations and Transfers | 26,578,100 | 22,281,942 | 29,526,700 | 29,353,746 |
| FUND BALANCE | | | | |
| Fund Balance—End of the Year | | 5,976,642 | | 1,767,428 |
| Less Encumbrances Outstanding at End of the Year | | (2,433,736) | | (1,124,891) |
| Fund Balance—End of the Year | | \$ 3,542,906 | | \$ 642,537 |
| Budgetary Basis | | \$ 3,542,906 | | \$ 642,537 |

¹ The ending fund balance with encumbrances carries forward because the previous year's encumbrances become expenditures in the next year or continue in the encumbrance line.

² Universal Service Fund revenues are not incorporated into the adopted state budget. Revenues are assessed in the amount of estimated expenditures as submitted to the Joint Finance Committee by the Universal Service Fund. As a result, legally budgeted revenues are not available and, consequently, actual amounts are reported in the budget column of the Budgetary Comparison Schedule.

³ The appropriations for the Educational Telecommunication Access Program are biennial, and unused spending authority of \$2,065,607 from FY 2001-02 carried forward to FY 2002-03. Therefore, the program did not exceed its budgetary authority in FY 2003-03.

⁴ PSC actual expenditures for FY 2003-04 do not include payment requests of \$544,000 that were deferred to the following fiscal year.

⁵ Legislation required the Universal Service Fund to lapse \$3,639,000 of the fund balance to the General Fund in FY 2002-03.

Budgetary-GAAP Reporting Reconciliation as of June 30, 2004 and 2003

The following schedule reconciles the budgetary-based fund balance in Schedule 1 with the generally accepted accounting principles (GAAP)-based fund balance in the financial statements as of June 30, 2004 and 2003.

| | <u>June 30, 2004</u> | <u>June 30, 2003</u> |
|--|----------------------|----------------------|
| Fund Balance (Budgetary Basis) as Reported on the Budgetary Comparison Schedule | \$ 3,542,906 | \$ 642,537 |
| Adjustments (Basis Differences): | | |
| To eliminate the effect of encumbrances that were reported as expenditures under budgetary reporting ¹ | 2,433,736 | 1,124,891 |
| To adjust revenues for cash deposits not recorded until after year-end ² | 37,675 | 852,353 |
| To accrue assessments and other receivables ³ | 1,537,528 | 1,575,499 |
| To accrue payables ⁴ | <u>(1,139,983)</u> | <u>0</u> |
| Fund Balance, End of the Year (GAAP basis) as Reported in the Financial Statements | <u>\$ 6,411,862</u> | <u>\$ 4,195,280</u> |

¹ Encumbrances may be carried over to the next fiscal year as a revision to the budgetary appropriation. Under budgetary reporting, encumbrances are treated like expenditures and are shown as a reduction of fund balance. Under GAAP reporting, encumbrances outstanding at year-end for purchase orders and contracts expected to be honored in the following year are reported as reservations of fund balance, since they do not constitute expenditures or liabilities.

² Under budgetary reporting, cash recorded in the State's accounting system is reported. However, under GAAP reporting, cash received by the State's bank by June 30, but not yet recorded on the State's accounting system on June 30 is also reported.

³ Budgetary reporting only recognizes revenue actually received by the State. However, revenue due to the State must also be recorded for GAAP reporting.

⁴ This entry adjusts the GAAP fund balance by additional payables that were not yet recorded on the State's accounting system as of June 30, but were obligations of the State as of June 30.

Report on Internal Control and Compliance ■

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the State of Wisconsin Universal Service Fund as of and for the years ended June 30, 2004, and 2003, and have issued our report thereon dated August 11, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, we considered the State of Wisconsin Universal Service Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees

in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the State of Wisconsin Universal Service Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we communicated to Universal Service Fund management. As discussed in the report section titled "Department of Public Instruction Programs," the Department of Public Instruction had accumulated a balance of \$165,000 in its Newslines program, and formal procedures are needed for transferring funds for the program based on actual expenditures. We also found that liabilities had not been properly accrued for some of the PSC-operated programs. After the errors were communicated, Fund management agreed to correct the financial statements and re-evaluate its procedures to ensure liabilities are accurately reported in future periods.

This independent auditor's report is intended for the information and use of the agencies responsible for management of the Universal Service Fund and the various programs it funds, and the Wisconsin Legislature. This independent auditor's report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on internal control over financial reporting or on compliance, this report is not intended to be used by anyone other than these specified parties.

August 11, 2005

LEGISLATIVE AUDIT BUREAU
by 
Diann Allsen
Audit Director

Appendix

Universal Service Fund Programs

| Program Name | Description | Year Initiated | Expenditures through 6/30/04 | FY 2004-05 Budget |
|---|--|----------------|------------------------------|-------------------|
| PSC Programs: | | | | |
| High Rate Assistance Credit | Provides credits for a portion of local telephone service rates when the rate charged for service exceeds levels set in administrative rule for this program. | 1996 | \$ 7,309,463 | \$ 300,000 |
| Telecommunications Equipment Purchase Program | Provides financial assistance to help persons with disabilities in acquiring special telecommunications equipment. | 1996 | 8,520,096 | 2,350,000 |
| Lifeline | Provides support to low-income individuals for rates in excess of \$15 per month for basic telephone services. | 1997 | 5,585,915 | 1,160,000 |
| Link-Up America | Provides a waiver of certain regulated service charges when low-income residential customers establish or move their telephone service. | 1997 | 3,462,216 | 650,000 |
| Institutional Discount | Provided qualified institutions, such as public libraries, nonprofit schools, and nonprofit hospitals, with discounted rates for new specialized telecommunications services. This program was discontinued in FY 2001-02. | 1996 | 733,897 | 0 |
| Rate-Shock Mitigation | Provides rate credits for customers to temporarily mitigate the effect of large increases in authorized telephone rates. The PSC specifies the individual rate cases where the credits apply. | 1996 | 711,188 | 0 |
| Access Program or Project by Nonprofit Groups | Provides funding for nonprofit groups that will facilitate the provision of affordable access to telecommunications and information services that are consistent with the uses of the Fund. | 2000 | 1,329,943 | 500,000 |
| Medical Telecommunications Equipment | Awards grants on a competitive basis to nonprofit medical clinics and public health agencies for the purchase of telecommunications equipment. | 2000 | 1,582,781 | 500,000 |

| Program Name | Description | Year Initiated | Expenditures through 6/30/04 | FY 2004-05 Budget |
|--|---|----------------|------------------------------|----------------------------|
| Public Interest Pay Telephone | Provides payments from the Fund to pay telephone companies where it is determined that the public health, safety, and welfare will be jeopardized without the availability of public pay phone services. | 2000 | \$ 495,516 | \$210,000 |
| Two-Line Voice Carryover | Waives any intrastate nonrecurring charge or monthly rate for a second telephone line used by hearing-impaired customers for teletype service. | 2000 | <u>3,470</u> | <u>2,500</u> |
| Subtotal of PSC Programs | | | <u>\$29,734,485</u> | <u>\$5,672,500</u> |
| TEACH/DOA Program: | | | | |
| Educational Telecommunications Access | Provides subsidized access to new data lines for direct Internet access and two-way interactive video links, and provides grants for data lines and video link contracts in existence before or on October 14, 1997. This program moved to DOA in FY 2003-04. | 1998 | 73,869,304 | 17,262,000 |
| DPI Programs: | | | | |
| Newsline | Funds a contract with the National Federation of the Blind to provide Newsline electronic information service that provides dial-up access to audio versions of major national newspapers for sight-impaired individuals. | 1997 | 438,500 | 67,500 |
| BadgerLink | Funds a contract with vendors that provide statewide access to reference databases of magazines and newspapers through BadgerLink, which previously had been supported with federal funding. | 1999 | 7,969,237 | 1,943,500 |
| Supplemental Aid to Public Library Systems | Funds aids payments to public library systems. | 2004 | 2,111,900 | 2,111,900 |
| UW System Program: | | | | |
| UW System BadgerNet Access | Provides support to provide BadgerNet access for four UW campuses. | 1997 | <u>6,366,177</u> | <u>1,054,800</u> |
| Total of All Programs | | | <u>\$120,489,603</u> | <u>\$28,112,200</u> |