

An Audit

# **Universal Service Fund**

*Public Service Commission*

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Universal Service Fund Programs



STATE OF WISCONSIN

## Legislative Audit Bureau

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Janice Mueller  
State Auditor

August 29, 2007

Senator Jim Sullivan and  
Representative Suzanne Jeskewitz, Co-chairpersons  
Joint Legislative Audit Committee  
State Capitol  
Madison, Wisconsin 53702

Dear Senator Sullivan 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 \$30.2 million in fiscal year (FY) 2005-06. Our audit report contains our unqualified opinion on the Universal Service Fund's financial statements for the fiscal years ending June 30, 2006 and 2005.

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 data lines and video links for eligible educational institutions. In FY 2005-06, expenditures for these activities totaled \$11.6 million, or 50.4 percent of the Universal Service Fund's total expenditures. In September 2006, the State completed the conversion to a new statewide data and video network for program participants, as well as for state government and other public sector users.

Eight of the 13 programs supported by the Universal Service Fund are operated by the PSC. The Legislature limits the amount the PSC can annually assess telecommunications providers for the PSC-operated programs to \$6.0 million. The limit and growth in expenditures from FY 2001-02 through FY 2004-05 have presented budgetary challenges for these programs. In response, the PSC has reduced benefits and limited expenditures to better match its spending authority.

During FY 2005-06, revenues exceeded expenditures by \$8.8 million for several of the programs funded through the Universal Service Fund, which increased the fund balance to \$15.8 million as of June 30, 2006. Most significantly, funding received for the Educational Telecommunications Access Program exceeded expenditures by \$6.6 million. We include a recommendation that the PSC work more closely with the Department of Administration and the University of Wisconsin System in establishing annual assessment levels.

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

Respectfully submitted,

Janice Mueller  
State Auditor

JM/DA/ss



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## Report Highlights ■

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***The fund balance increased by \$8.8 million during FY 2005-06.***

***The PSC has reduced benefits and limited expenditures to meet its spending authority.***

***Conversion to a new statewide data and video network that provides higher-capacity data capabilities was completed in September 2006.***

***The Fund provided increased funding for library system aid during the 2005-07 biennium.***

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. The Fund 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 (UW) 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, 2006 and 2005.

As part of our financial audit, we also reviewed various aspects of the Universal Service Fund's programs, including:

- budgetary issues for the PSC-operated programs;
- implementation of a statewide data and video network that affects the Educational Telecommunications Access Program; and
- a large increase in the fund balance.

## Fund Finances

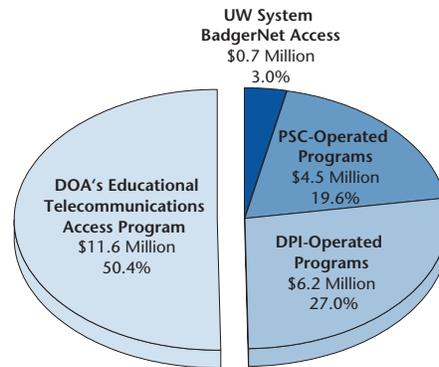
The Universal Service Fund is funded primarily through assessments paid by telecommunications providers, which totaled \$30.2 million in FY 2005-06. It also received \$1.1 million in capital lease financing through the State’s master lease program and \$535,000 in interest income.

More than \$23.0 million was expended during FY 2005-06 for 13 programs supported by the Fund. Eight of these programs are operated by the PSC, with expenditures totaling \$4.5 million in FY 2005-06. However the largest program, the Educational Telecommunications Access Program, is operated by DOA.

The Educational Telecommunications Access Program subsidizes data lines and video links for eligible educational institutions. As shown in Figure 1, its expenditures of \$11.6 million represented 50.4 percent of the Fund’s total expenditures in FY 2005-06.

Figure 1

### Universal Service Fund Expenditures<sup>1</sup> FY 2005-06



<sup>1</sup> Expenditures totaled \$23.0 million in FY 2005-06.

During FY 2005-06, the Universal Service Fund also provided \$6.2 million for three programs administered by DPI. In addition, it paid more than \$700,000 to UW System. That funding helped provide four campuses—River Falls, Stout, Superior, and Whitewater—access to voice, data, and video services through the BadgerNet Converged Network, the State’s voice, data, and video telecommunications infrastructure.

During FY 2005-06, revenue and other financing sources exceeded expenditures by \$8.8 million for several of the programs funded through the Universal Service Fund. As a result, the fund balance increased to \$15.8 million as of June 30, 2006. Most significantly, assessments and other financing resources received for the Educational Telecommunications Access Program exceeded expenditures by \$6.6 million.

Because of billing changes and statutory restrictions, UW System currently is not able to fund expenditures for its BadgerNet Access program through the Universal Service Fund. It is pursuing a statutory change to remove the restricting language and allow funding from the Universal Service Fund to be used for any telecommunications services across UW System. The Legislature is considering the proposed change as part of 2007-09 budget deliberations. The PSC is responsible for determining the assessment rates that apply to telecommunications providers for all Universal Service Fund programs, based on the need for funds and appropriation amounts.

### **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 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 each year thereafter. Corresponding appropriation expenditure levels were also established in the 2003-05 and 2005-07 biennia.

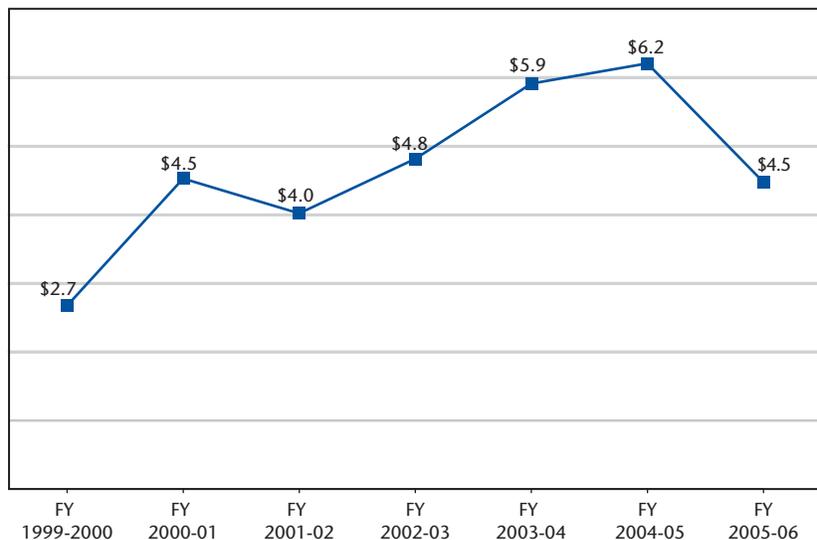
However, with the addition, expansion, and promotion of PSC-operated programs, expenditures for operations and administration increased to \$6.2 million in FY 2004-05. As shown in Figure 2, expenditures decreased to \$4.5 million in FY 2005-06, as the PSC reduced costs to meet the appropriation limits. As part of these efforts, the PSC reduced benefits in the program that helps people

with disabilities acquire special telecommunications equipment and reduced its promotion efforts.

The Governor’s 2007-09 biennial budget proposal would repeal the limitation on assessments to support the PSC-operated programs. Currently, the Legislature is also considering an Assembly proposal to limit overall Universal Service Fund assessments paid by telecommunications providers to \$32.0 million annually.

Figure 2

**Expenditures<sup>1</sup> for PSC-Operated Programs  
(in Millions)**



<sup>1</sup> Expenditures reported in the financial statements.

**Educational Telecommunications  
Access Program**

The Educational Telecommunications Access Program, which is administered by DOA, pays for equipment, installation costs for data lines and video links, and a portion of monthly service costs for eligible educational institutions. Over \$102.3 million has been expended for the program through FY 2005-06.

The data line and video link services are provided by a consortium of telecommunications providers. In March 2005, DOA entered into a new \$116.7 million, five-year agreement with the consortium for a

new converged statewide data and video network that provides higher-capacity data capabilities and video access to the State of Wisconsin and other public users. Conversion to the new network was completed on September 1, 2006.

The amount expended for the Educational Telecommunications Access Program decreased by \$5.2 million, or 31 percent, during FY 2005-06. In addition, the program's expenditures were \$5.7 million less than its spending authority of \$17.3 million for the year. DOA attributes the underspending in FY 2005-06 to slower than anticipated conversion to the new network. It expects ongoing annual costs will be close to the current appropriation level.

## Library Aid

Until FY 2003-04, general purpose revenue (GPR) funded state aid to public library systems. 2003 Wisconsin Act 23 shifted \$4.2 million in funding for public library system aid payments from GPR to the Universal Service Fund for the 2003-05 biennium.

2005 Wisconsin Act 25 further reduced GPR funding for library systems by \$2.2 million and increased funding from the Universal Service Fund by another \$4.2 million over the 2005-07 biennium. Under Act 25, the Fund paid 28.3 percent of the library systems' state aid in FY 2005-06, and 27.2 percent in FY 2006-07.

The Governor's 2007-09 biennial budget proposal includes a provision to increase funding from the Universal Service Fund for public library systems by \$1.9 million over the 2007-09 biennium. In addition, the Legislature is currently considering a proposal by the Joint Committee on Finance that would direct the PSC to use \$9.2 million of the Fund's available balance to replace a similar amount of GPR funding for public library systems during FY 2007-08.

## Recommendation

We include a recommendation for the Public Service Commission to:

- ☑ work with agency staff in DOA and UW System to consider available fund balances when establishing assessment levels for all programs funded by the Universal Service Fund (*p. 16*).

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## Universal Service Fund Programs ■

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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 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.

***Annual assessments to support PSC-operated programs are currently capped at \$6.0 million.***

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 2000, several new programs were added or expanded, and the PSC began increasing the promotion of its programs. As was shown in Figure 2, expenditures for the PSC-operated programs increased from \$2.7 million in FY 1999-2000 to \$6.2 million in FY 2004-05. Expenditures decreased to \$4.5 million in FY 2005-06 as the PSC reduced costs to better match its appropriation expenditure level and an annual assessment limit of \$6.0 million that was established in 2001 Wisconsin Act 16 for PSC-operated programs.

The growth in expenditures from FY 2001-02 through FY 2004-05 and the limit on assessments resulted in budgetary challenges for the PSC-operated programs. Because it did not have sufficient spending authority to cover all requests for payment in FY 2003-04, the PSC deferred decisions to pay on more than \$544,000 in payment requests until FY 2004-05. In FY 2004-05, it deferred decisions to pay on more than \$740,000 in payment requests until FY 2005-06. While these deferred payment requests did not affect budgetary balances, they were reflected as expenditures in the Fund's financial statements prepared in accordance with generally accepted accounting principles for those years, because the underlying events supporting the payment requests had occurred.

During FY 2005-06, the PSC was able to limit expenditures to its spending authority without deferring any decisions to pay on the FY 2005-06 payment requests. Because the deferred payment requests from FY 2004-05 were paid in FY 2005-06, it was also required to reduce other expenditures to stay within its budgetary authority.

***The PSC reduced benefit levels for the Telecommunications Equipment Purchase Program.***

Beginning in FY 2004-05, the PSC consulted with the Universal Service Fund Council to identify areas in which costs could be reduced. As part of these efforts, the PSC limited the equipment authorized for purchase by participants in the Telecommunications Equipment Purchase Program, reduced that program's hard-of-hearing benefits from \$200 to \$125 per participant, and reduced promotion efforts to address an increasing number of participants in many of the PSC-operated programs.

The PSC has also funded, in alternate years, the Medical Telecommunications Equipment program and the Access Program or Project by Nonprofit Groups. The PSC did not fund the Medical Telecommunications Equipment program in FY 2004-05, and it did not fund the Access Program or Project by Nonprofit Groups in FY 2005-06. The PSC determined it had sufficient funding to fully fund both grant programs in FY 2006-07.

***Changes to the assessment limits are being deliberated as part of the 2007-09 biennial budget process.***

The Governor's 2007-09 biennial budget proposal would repeal the limitation on assessments of telecommunications providers to support the PSC-operated programs, although it would maintain the \$6.0 million appropriation level for each year of the 2007-09 biennium. Currently, the Legislature is also considering an Assembly proposal to limit overall Universal Service Fund assessments for all programs to \$32.0 million annually.

## **Educational Telecommunications Access Program**

The Educational Telecommunications Access Program provides subsidized access to new data lines for direct Internet or Intranet access, as well as two-way interactive video links that 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 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, that were part of the statewide network known as BadgerNet. The Educational Telecommunications Access Program's video link and data line costs through these contracts were financed through the State's master lease program.

***The State entered into a new \$116.7 million five-year contract for video and data services that began in January 2006.***

In March 2005, DOA entered into a new \$116.7 million, five-year agreement with the same Wisconsin BadgerNet Access Alliance. This contract was for data and video services for the State of Wisconsin and other public sector users that began January 1, 2006. The new statewide network, which is known as the BadgerNet Converged Network, is designed to provide higher data capability and video access on the same network. Conversion to the new network began in September 2005 and was completed on September 1, 2006. Current ongoing costs are paid directly to the telecommunications providers on a monthly basis, rather than financed through the State's master lease program as was done under the old contract.

**Over \$102.3 million has been expended for the Educational Telecommunications Access Program through FY 2005-06.**

As shown in Table 1, Universal Service Fund expenditures for the Educational Telecommunications Access Program were \$11.6 million in FY 2005-06, which is a decrease of \$5.2 million, or 31 percent, from FY 2004-05. The decrease in expenditures is partially related to \$2.9 million in prepayments made in FY 2004-05 against the remaining balance of the program’s master lease obligation. A similar prepayment was not made in FY 2005-06. In addition, the Educational Telecommunications Access Program did not incur costs related to the old network in FY 2005-06 because the master lease obligations were fully prepaid in FY 2004-05, and costs related to the new network were only incurred for the last half of FY 2005-06 because the new contract did not begin until January 1, 2006.

Table 1

**Educational Telecommunications Access Program Expenditures**  
FY 1998-99 through FY 2005-06

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	16,846,105
FY 2005-06	11,613,304
<b>Total</b>	<b>\$102,328,713</b>

**The Educational Telecommunications Access Program significantly underspent its appropriation in FY 2005-06.**

2005 Wisconsin Act 25 established spending authority of \$17.3 million for the Educational Telecommunication Access Program for each year of the 2005-07 biennium. DOA attributes the underspending in FY 2005-06 to slower than anticipated conversion to the new network. The program will expend all of its \$17.3 million appropriation for FY 2006-07, and DOA anticipates that annual costs will remain close to this level in future years. Any future cost fluctuations will likely be related to the addition or removal of data lines and video links from the 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 \$5.9 million in E-rate funding received by the State for FY 2005-06 was used to offset GPR-funded debt service costs associated with the Infrastructure Financial Assistance Program. That program, which was funded through the issuance of general obligation debt, 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. The Governor's 2007-09 biennial budget proposal would allow E-rate funds not needed for the debt service costs of wiring loans to be used for educational agencies' telecommunications costs that are not subsidized by the Educational Telecommunications Access Program. This proposal is currently being considered by the Legislature as part of budget deliberations.

## Department of Public Instruction Programs

During FY 2005-06, the Universal Service Fund funded two programs administered by DPI, providing:

- \$4.2 million in aid to the State's public library systems; and
- \$2.0 million for the BadgerLink program, which provides statewide on-line access to reference databases of magazines and newspapers.

Expenditures for these two programs totaled \$6.2 million and accounted for 27.0 percent of the Universal Service Fund's FY 2005-06 program expenditures.

***The Universal Service Fund funded 28.3 percent of state aid to public library systems in FY 2005-06.***

Until FY 2003-04, GPR funded state aid to public library systems. 2003 Wisconsin Act 33 shifted \$4.2 million of the public library aid payments to the Universal Service Fund for the 2003-05 biennium. 2005 Wisconsin Act 25 further reduced GPR funding for library systems by \$2.2 million but increased funding from the Universal Service Fund by \$4.2 million over the 2005-07 biennium. Under

Act 25, the Universal Service Fund funded 28.3 percent of the \$14.9 million in state aid to public library systems in FY 2005-06, and 27.2 percent of the \$15.5 million in state aid in FY 2006-07.

The Governor's 2007-09 biennial budget proposal includes a provision to increase funding from the Universal Service Fund for public library systems by another \$1.9 million over the 2007-09 biennium. In addition, the Legislature is considering a proposal by the Joint Committee on Finance that would direct the PSC to use \$9.2 million of the Fund's available balance to replace a similar amount of GPR funding for public library systems during FY 2007-08. If both proposals are enacted, the Universal Service Fund would provide a total of \$19.5 million in funding for public library systems during the 2007-09 biennium.

A third DPI program regularly funded by the Universal Service Fund is 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. Prior to FY 2005-06, the PSC transferred \$67,500 annually from its appropriation for the cost of the contract. However in 2005 (report 05-14), we noted that funding provided for the Newsline program exceeded expenditures in seven of the eight years since the program's inception in FY 1997-98, which resulted in a cumulative unspent balance of \$164,938 as of June 30, 2005.

***No funds were transferred to the Newsline program during the 2005-07 biennium.***

In light of the accumulated balance related to the Newsline program, the PSC did not transfer any funding for the program in FY 2005-06 or FY 2006-07. However, DPI anticipates that funding will again be needed for the program beginning in FY 2007-08. Further, the Governor's 2007-09 biennial budget proposal would modify budgetary provisions so that funding from the Universal Service Fund for the Newsline program would be directly appropriated through DPI's BadgerLink appropriation, and the PSC would no longer be required to transfer funding from its appropriation for the program.

### **Fund Balance**

***Funding for the Educational Telecommunications Access Program exceeded expenditures by \$6.6 million during FY 2005-06.***

The large increase in the fund balance during FY 2005-06 occurred because more assessments were collected than were expended for several programs. Most significantly, assessments and other financing sources received for the Educational Telecommunications Access Program exceeded expenditures by \$6.6 million, as shown in Table 2.

Table 2

**Excess Assessments and Other Financing Resources over Expenditures**

Program	Excess Assessments and Other Financing Resources over Expenditures
Educational Telecommunications Access Program	\$6,590,668
Public Service Commission-Operated Programs	1,454,047
UW BadgerNet Access	303,437
<b>Total</b>	<b>\$8,348,152</b>

Expenditure levels for the PSC-related programs also resulted in an increase of \$1.5 million in the fund balance during FY 2005-06. As noted, during FY 2005-06 the PSC paid deferred payment requests from the prior year and reduced expenditures to remain within its budgetary authority. These efforts were successful and, in some cases, resulted in expenditures falling below expectations for FY 2005-06. Among the more significant decreases in expenditures for the PSC-related programs was a decrease from \$2.4 million in FY 2004-05 to \$1.3 million in FY 2005-06 for the Telecommunications Equipment Purchase Program and a decrease from \$370,249 in FY 2004-05 to \$404 in FY 2005-06 for the Medical Telecommunications Equipment program.

Finally, the UW BadgerNet Access program has regularly underspent its appropriation and the assessments collected for it since FY 2002-03. During FY 2005-06, assessments exceeded program expenditures by \$303,000. Further, because of billing changes and current statutory restrictions, UW System currently is not able to fund program expenditures through the Universal Service Fund. Statutes require that Universal Service Fund payments for the UW BadgerNet Access program be made directly to DOA. However, under billing procedures for the new converged network, payments are now made directly to the telecommunications provider. Therefore, most of the \$1.0 million in assessments collected for the UW BadgerNet Access program during FY 2006-07 has not been used. Instead, UW System has funded costs for the four campuses covered under the program from other sources.

As part of 2007-09 budget deliberations, the Legislature is considering a statutory change proposed by UW System to remove the restricting language. In addition, the proposed change would allow funding from the Universal Service Fund to be used for any

telecommunications services across UW System, rather than only telecommunications services provided by DOA to the campuses at River Falls, Stout, Superior, and Whitewater.

The PSC is responsible for determining the assessment rates to apply to telecommunications providers for all Universal Service Fund programs based on the need for funds and appropriation amounts. When establishing the annual assessment levels for PSC-operated programs, the PSC considers any excess balances that accumulated when revenues have exceeded expenditures. However, the PSC has not considered prior balances when establishing annual assessment needs for programs operated by other agencies. For example, it maintained a similar assessment level for the Educational Telecommunications Access Program during FY 2006-07, even though the program had not spent over \$6.6 million in assessments during FY 2005-06.

#### Recommendation

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*We recommend the Public Service Commission work with agency staff in the Department of Administration and the University of Wisconsin System to consider available fund balances when establishing assessment levels for all programs funded by the Universal Service Fund.*

## Wireless and Cellular Providers

The assessment of wireless and cellular providers has also been an area of continuing legislative interest. The Universal Service Fund is currently funded through assessments paid by telecommunications providers that are wireline telephone companies. After promulgating administrative rules, the PSC also had begun assessing wireless and cellular providers in August 2000.

***Wireless and cellular providers are currently not subject to the Universal Service Fund assessments.***

However, wireless and cellular providers objected to participating in the Universal Service Fund. After a public hearing in October 2000, the Legislature's Joint Committee for Review of Administrative Rules voted to suspend the portion of the administrative rule establishing the effective date for the wireless and cellular provider assessments, reasoning that the assessments imposed an undue hardship on an industry that is sensitive to rate increases and they could negatively affect the development of competition, consumer choice, and infrastructure development. In November 2000, the PSC issued an order temporarily suspending the assessment of wireless and cellular providers.

In 2001 Wisconsin Act 16, the Legislature enacted a provision that wireless and cellular providers would be subject to assessments for the Universal Service Fund only if the PSC promulgated rules designating such providers as eligible to receive funding under both federal and state Universal Service Fund programs. At the time, the PSC decided to extend the suspension of assessments on wireless and cellular providers until it could give further consideration to the issue. The PSC has recently been in the process of promulgating rules that would allow it to assess wireless and cellular providers. However, as part of 2007-09 budget deliberations, the Legislature is considering whether the PSC should be allowed to promulgate such rules.

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## Audit Opinion ■

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### *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, 2006 and 2005. 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 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, 2006 and 2005, 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 21 through 26 and as Schedules 1 and 2 on pages 40 and 41 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 17, 2007, 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 17, 2007

LEGISLATIVE AUDIT BUREAU  
by   
Diann Allsen  
Audit Director

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# Management's Discussion and Analysis ■

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## *Prepared by Public Service Commission Management*

Management's discussion and analysis (MD&A) is prepared by PSC management, with assistance from staff at DOA and UW System, 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 Universal Service Fund. The Fund was established to further the goal of providing both basic essential telecommunications services and access to advanced service capabilities to telecommunications service 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 the 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 for the Newline program. 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 as of and for the fiscal years ended June 30, 2006 and 2005, are shown in the following tables.

Table A

#### A Comparison of Condensed Financial Information for FY 2005-06 and FY 2004-05

	June 30, 2006	June 30, 2005	Dollar Change	Percentage Change
Total Assets	\$17,343,309	\$11,926,142	\$5,417,167	45%
Total Liabilities	1,563,810	4,988,339	(3,424,529)	-69
<b>Fund Balance</b>	<b>\$15,779,499</b>	<b>\$ 6,937,803</b>	<b>\$8,841,696</b>	127

	FY 2005-06	FY 2004-05	Dollar Change	Percentage Change
Total Revenues	\$30,771,234	\$28,463,276	\$ 2,307,958	8%
Total Expenditures	23,045,538	27,869,835	(4,824,297)	-17
Excess of Revenues over Expenditures	7,725,696	593,441	7,132,255	1,202
Capital Lease Acquisitions	1,116,000	0	1,116,000	NA
Transfers for the Newline Program	0	(67,500)	67,500	100
<b>Excess of Revenues and Other Sources over Expenditures and Other Uses</b>	<b>\$ 8,841,696</b>	<b>\$ 525,941</b>	<b>\$8,315,755</b>	1,581

Table B

**A Comparison of Condensed Financial Information for FY 2004-05 and FY 2003-04**

	June 30, 2005	June 30, 2004	Dollar Change	Percentage Change
Total Assets	\$11,926,142	\$8,674,031	\$3,252,111	37%
Total Liabilities	4,988,339	2,262,169	2,726,170	121
<b>Fund Balance</b>	<b>\$ 6,937,803</b>	<b>\$6,411,862</b>	<b>\$ 525,941</b>	<b>8</b>

	FY 2004-05	FY 2003-04	Dollar Change	Percentage Change
Total Revenues	\$28,463,276	\$25,638,450	\$ 2,824,826	11%
Total Expenditures	27,869,835	23,354,368	4,515,467	19
Excess of Revenues over Expenditures	593,441	2,284,082	(1,690,641)	-74
Transfers for the Newslines Program	(67,500)	(67,500)	0	0
<b>Excess of Revenues over Expenditures and Other Uses</b>	<b>\$ 525,941</b>	<b>\$ 2,216,582</b>	<b>\$(1,690,641)</b>	<b>-76</b>

The Fund's total revenues of \$30.8 million in FY 2005-06 and \$28.5 million in FY 2004-05 consisted 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 79 percent of total revenues in FY 2005-06 and over 78 percent in FY 2004-05 were intended for four programs the PSC does not manage: the Educational Telecommunications Access Program, which is managed by DOA; library aids and BadgerLink, which are managed by DPI; and the UW BadgerNet Access program for four UW campuses. The remaining revenues were 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, the Public Interest Pay Telephone program, and the Two-Line Voice Carryover program.

Overall, assessments have increased \$4.7 million, or 18 percent, from FY 2003-04 to FY 2005-06. Assessments for the UW BadgerNet Access program remained relatively constant during this period. The Educational Telecommunications Access Program increased by 4 percent during FY 2004-05 but remained relatively constant during FY 2005-06.

Assessments for the PSC-operated programs increased by \$2.0 million, or 50 percent, for FY 2004-05 but remained relatively constant for FY 2005-06. The increase in FY 2004-05 was largely attributable to two factors. First, 2001 Wisconsin Act 16 limited assessments for PSC-operated programs to \$5.0 million for FY 2003-04, whereas assessments for these programs were limited to \$6.0 million for FY 2004-05 and each year thereafter. Second, the PSC was able to assess \$1.0 million less than appropriation spending authority in FY 2003-04 because of the available fund balance that had accumulated in prior years.

Assessments for the DPI programs were relatively constant during FY 2004-05 but increased by \$2.1 million, or 52 percent, during FY 2005-06. The significant increase in FY 2005-06 was largely in response to the enactment of 2005 Wisconsin Act 25, which doubled funding from the Universal Service Fund for the library aid program. Expenditures for the library aid program increased correspondingly in FY 2005-06.

The amount reported as excess of revenues over expenditures decreased by \$1.7 million during FY 2004-05 but increased by \$7.1 million in FY 2005-06. These changes are largely related to changes in expenditure levels for the Educational Telecommunications Access Program and several of the PSC-operated programs.

Expenditures for the Educational Telecommunications Access Program increased by \$4.2 million, or 33 percent, during FY 2004-05, in part because of a prepayment of \$2.9 million to the State's master lease program, which had helped finance the costs of the video and data links provided under the Educational Telecommunications Access Program. In addition, \$1.5 million was paid in FY 2004-05 as initial steps were taken for the conversion to the new BadgerNet Converged Network.

Expenditures for the Educational Telecommunications Access Program decreased by \$5.2 million, or 31 percent, during FY 2005-06, largely because of the master lease prepayment in FY 2004-05 and slower than anticipated conversion to the new BadgerNet Converged Network. Under the old BadgerNet network, costs were financed through the State's master lease program. Because the master lease commitments were prepaid in FY 2004-05, the Educational Telecommunications Access Program did not incur costs related to the old network in FY 2005-06. In addition, the new BadgerNet Converged Network contract did not begin until January 2006. Therefore, the Educational Telecommunications Access Program only incurred costs related to the new network contract for one-half of FY 2005-06.

In addition, grant payments provided for data lines and video links in existence on or before October 14, 1997, through the Existing Contract Grant program decreased by almost \$470,000 during FY 2005-06. When that program ended with the end of the old BadgerNet network in December 2005, the number of recipients had decreased from 51 in FY 2004-05 to 39 in FY 2005-06. Further, because the program ended in December, the grant payments made to the remaining recipients were for only one-half of the calculated grant amounts.

The Educational Telecommunications Access Program did incur some additional costs in FY 2005-06 for the purchase and transfer of ownership of \$1.1 million in equipment to institutions using video link services prior to the conversion to the

BadgerNet Converged Network. The equipment was financed through the State's master lease program because of an understanding that institutions already in the program would not incur any additional costs to convert to the new network. The funds provided for the equipment through the master lease program are reported as capital lease acquisitions in the other financing sources and uses section of the Statement of Revenues, Expenditures, and Changes in Fund Balance.

Expenditure levels for the PSC-operated programs increased by \$295,000, or 5 percent, during FY 2004-05 and then decreased by \$1.7 million, or 28 percent, during FY 2005-06. The most significant decreases in expenditures during FY 2005-06 were in TEPP, in which expenditures decreased by 45 percent, from \$2.4 million in FY 2004-05 to \$1.3 million in FY 2005-06. Because of the assessment limits and resulting budgetary constraints, the PSC has limited outreach efforts to the involvement of the independent living centers. TEPP applications received decreased from 10,111 in FY 2004-05 to 7,394 in FY 2005-06.

Lifeline expenditures decreased by \$205,000, from \$1.7 million in FY 2004-05 to \$1.5 million in FY 2005-06. The majority of this decrease is related to payments totaling more than \$181,000 that were made in FY 2004-05 to a telecommunications company for services provided in prior years.

Expenditures for the Medical Telecommunications Equipment program decreased by \$370,000, to \$400 in FY 2005-06. Expenditures may vary significantly between years for this program based on the timing of grantee reimbursements. However, the PSC did not award any grants under the Medical Telecommunications Equipment program during FY 2004-05 and awarded grants of \$500,000 late in FY 2005-06. Because of this, no grant payments were made for these awards until FY 2006-07.

Spending patterns for the UW BadgerNet Access program contributed slightly to an increased excess of revenues over expenditures. In FY 2005-06, revenues exceeded expenditures by \$303,000, compared to \$289,000 in FY 2004-05. The fund balance, however, has been affected more significantly by the spending patterns for this program because similar levels of excess of revenues over expenditures have occurred since FY 2002-03. This excess has accumulated and comprises over \$987,000 of the fund balance as of June 30, 2006.

Expenditures for UW BadgerNet Access subsequently have decreased significantly in FY 2006-07 because current statutory language does not conform to changes in the administration of the new BadgerNet Converged Network. Current statutory language limits payment to DOA for telecommunications services provided under s. 16.973(1), Wis. Stats., to the UW campuses at River Falls, Stout, Superior, and Whitewater. Under the old statewide network, BadgerNet, only those costs specific to the four institutions and a prorated amount of general costs benefiting all institutions were funded through the Universal Service Fund. The business model for the new network requires that payments be made directly to the service provider rather than through DOA. Moreover, the new network aggregates rates in such a way that it is not necessary to single out specific campuses for special

payments. To allow continued use of the Universal Service Fund to help support this infrastructure, UW System is pursuing a statutory language change that would allow direct payment to the service provider and allow BadgerNet Converged Network costs for any UW campus to be funded through the Universal Service Fund. If that change is approved, expenditures would once again meet the assessments collected for the program.

As a result of changes in revenues and expenditures, the fund balance has increased 146 percent over two years, from \$6.4 million at the end of FY 2003-04 to \$15.8 million at the end of FY 2005-06. Correspondingly, total assets have increased \$8.7 million, or 100 percent, over the two years, with most of the increase in cash and cash equivalents.

Liabilities increased by 121 percent during FY 2004-05 but decreased by 69 percent during FY 2005-06. The majority of the liability changes are attributable to the \$2.9 million master lease prepayment made in FY 2004-05 for the Educational Telecommunications Access Program. The actual cash transfer for the prepayment was not made until FY 2005-06, which significantly increased the liability at the end of FY 2004-05. The decrease in the liability during FY 2005-06 was also attributable to a decrease of almost \$1.0 million for PSC-operated programs. Costs for the PSC-operated programs were within the appropriation spending authority of \$6.0 million, and the PSC did not incur liabilities for deferred payment decisions in FY 2005-06, as it had in the prior two years.

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:

Public Service Commission of Wisconsin  
c/o Universal Service Fund Manager  
P.O. Box 7854  
Madison, WI 53707-7854

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## **Financial Statements ■**

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Universal Service Fund

**Balance Sheet**  
**June 30, 2006 and 2005**

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
<b>ASSETS</b>		
Cash and Cash Equivalents (Notes 2C and 3)	\$ 15,553,127	\$ 10,040,905
Assessments Receivable (Note 2D)	1,632,536	1,879,937
Other Receivables	<u>157,646</u>	<u>5,300</u>
<b>Total Assets</b>	<b><u>\$ 17,343,309</u></b>	<b><u>\$ 11,926,142</u></b>
<b>LIABILITIES AND FUND BALANCE</b>		
Liabilities:		
Program liabilities:		
Educational Telecommunications Access Program	\$ 562,574	\$ 3,326,842
Lifeline Program	336,185	948,700
BadgerLink Program	307,500	0
Link-Up America Program	179,406	412,817
Telecommunications Equipment Purchase Program	96,568	109,085
High Rate Assistance Credit Program	25,535	115,274
Public Interest Pay Telephone Program	4,142	0
Access Program or Project by Nonprofit Groups	2,880	32,546
Two-Line Voice Carryover Program	616	394
Accounts payable	<u>48,404</u>	<u>42,681</u>
<b>Total Liabilities</b>	<b><u>1,563,810</u></b>	<b><u>4,988,339</u></b>
Fund Balance:		
Reserved for encumbrances (Note 6)	1,751,810	1,322,533
Unreserved	<u>14,027,689</u>	<u>5,615,270</u>
<b>Total Fund Balance</b>	<b><u>15,779,499</u></b>	<b><u>6,937,803</u></b>
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<b><u>\$ 17,343,309</u></b>	<b><u>\$ 11,926,142</u></b>

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, 2006 and 2005**

	<u>Year Ended June 30, 2006</u>	<u>Year Ended June 30, 2005</u>
<b>REVENUES</b>		
Telecommunications Providers' Assessments (Note 2D) for:		
Educational Telecommunications Access Program	\$ 17,087,972	\$ 17,236,229
Department of Public Instruction Programs	6,174,916	4,049,667
Public Service Commission Programs (Note 7)	5,930,119	5,975,269
University of Wisconsin BadgerNet Access	<u>1,043,336</u>	<u>1,052,942</u>
Total Telecommunications Providers' Assessments	\$ 30,236,343	\$ 28,314,107
Interest Income	<u>534,891</u>	<u>149,169</u>
<b>Total Revenues</b>	<b><u>30,771,234</u></b>	<b><u>28,463,276</u></b>
<b>EXPENDITURES</b>		
Program Expenditures:		
Educational Telecommunications Access Program (Note 5)	11,613,304	16,846,105
Library Aids	4,223,800	2,111,900
BadgerLink Program	1,992,463	1,943,499
Lifeline Program	1,450,067	1,655,275
Telecommunications Equipment Purchase Program	1,327,136	2,406,255
Link-Up America Program	818,099	892,067
University of Wisconsin BadgerNet Access	739,899	763,993
Access Program or Project by Nonprofit Groups	321,926	324,001
High Rate Assistance Credit Program	125,931	166,262
Public Interest Pay Telephone Program	88,920	90,365
Two-Line Voice Carryover Program	3,288	1,893
Medical Telecommunications Equipment Program	<u>404</u>	<u>370,249</u>
Total Program Expenditures	22,705,237	27,571,864
Administrative Expenditures	<u>340,301</u>	<u>297,971</u>
<b>Total Expenditures</b>	<b><u>23,045,538</u></b>	<b><u>27,869,835</u></b>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	<b>7,725,696</b>	<b>593,441</b>
<b>OTHER FINANCING SOURCES (USES)</b>		
Capital Lease Acquisitions (Note 5)	1,116,000	0
Transfers for the Newslines Program (Note 4)	<u>0</u>	<u>(67,500)</u>
Excess of Revenues and Other Sources over Expenditures and Other Uses	8,841,696	525,941
<b>FUND BALANCE</b>		
Fund Balance—Beginning of the Year	<u>6,937,803</u>	<u>6,411,862</u>
Fund Balance—End of the Year	<b><u>\$ 15,779,499</u></b>	<b><u>\$ 6,937,803</u></b>

The accompanying notes are an integral part of this statement



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# Notes to the Financial Statements ■

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## 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 2005-06 and 2004-05 follows.

**A. Educational Telecommunications Access Program**

This program, which is currently administered by DOA, was implemented in February 1998 to provide educational entities with subsidized access to new data lines for direct Internet or Intranet 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, through December 2005, the program provided grants for data lines and video links in existence before October 14, 1997.

**B. BadgerLink**

Since FY 1999-2000, the Universal Service Fund has paid 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. Supplemental Aid to Public Library Systems**

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 aid. DPI is responsible for distributing the aid 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. UW System BadgerNet Access**

The BadgerNet Converged Network is the State's telecommunications infrastructure of voice, data, and video networks and communications services provided by DOA to 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 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 telecommunications rates exceed certain levels that are based on the median household income level for which the rates apply. 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 their use 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. Newsline**

Beginning with FY 1997-98, a transfer from the Universal Service Fund is made to the State of Wisconsin General Fund as needed to fund a contract between DPI and the National Federation of the Blind to provide the Newsline electronic information service that provides telephone 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, expenditures, and other financing sources and uses 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 in the State Investment Fund 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 revenues needed to pay for the year's program and administrative costs up to limits established by the Legislature. 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**

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.

Custodial credit risk is the risk that in the event of the failure of a financial institution, deposits may not be returned. The Federal Deposit Insurance Corporation (FDIC) insures the Fund's deposits for losses up to \$100,000 resulting from the failure of a financial institution. The amount of the bank account balance was \$117,336 as of June 30, 2006, and \$7,809 as of June 30, 2005. The amount exposed to custodial credit risk was \$17,336 as of June 30, 2006, and \$0 as of June 30, 2005. As of June 30, 2006, the Fund does not have a deposit policy relating to custodial credit risk.

Cash deposited with the State of Wisconsin is invested in the State Investment Fund, 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 State Investment Fund, which is presented at fair value, was \$15,486,000 as of June 30, 2006, and \$10,019,000 as of June 30, 2005. Holdings 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. The State Investment Fund is not registered with the Securities and Exchange Commission.

#### 4. TRANSFERS FOR NEWSLINE PROGRAM

During FY 2004-05, the Universal Service Fund transferred funds 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 Newslines electronic information service that provides telephone access to audio versions of major national newspapers for blind and visually impaired individuals. \$67,500 was transferred in FY 2004-05. Based upon a memorandum of understanding between DPI and the PSC, a transfer was not completed in FY 2005-06 because an unspent balance had accumulated in the appropriation.

#### 5. MASTER LEASE COMMITMENTS

The subsidized video link and data line costs of the Educational Telecommunications Access Program were financed through the State's master lease program until the conversion to the BadgerNet Converged Network in FY 2005-06. The Universal Service Fund's expenditures for the program include master lease payments of \$9.2 million during FY 2004-05, which included \$0.5 million for interest. Included in the \$9.2 million of payments in FY 2004-05 was a prepayment of \$2.9 million that satisfied remaining master lease commitments. The ongoing costs of the new network are paid directly to the service provider on a monthly basis, rather than financed through the State's master lease program.

In FY 2005-06, equipment was purchased for some of the institutions using video link services under the Educational Telecommunications Access Program prior to the conversion to the BadgerNet Converged Network. This equipment, which was subsequently transferred to the institutions at the time of conversion, was financed through the State's master lease program. The funds provided for the equipment through the master lease program are reported as capital lease acquisitions in the other financing sources and uses section of the Statement of Revenues, Expenditures, and Changes in Fund Balance. The Universal Service Fund's expenditures for the program include \$118,659 in master lease payments payable during FY 2005-06, including \$15,190 for interest. The \$1,062,283 balance of the master lease commitment for this equipment, which included \$49,751 for interest, was subsequently prepaid in FY 2006-07.

**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**

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, 2006, and June 30, 2005, the Telecommunications Equipment Purchase Program encumbrances were \$813,225 and \$714,075, respectively.

**B. Other Encumbrances**

As of June 30, 2006, and June 30, 2005, the following encumbrance balances were outstanding for the various programs in which awards had been made to participants or obligations had been incurred, but the appropriate invoices and supporting documentation had not yet been presented to the Fund for the release of funding to the recipient or vendor:

<u>Program</u>	<u>Encumbrances at June 30, 2006</u>	<u>Encumbrances at June 30, 2005</u>
Medical Telecommunications Equipment	\$500,000	\$ 38,983
Access Program or Project by Nonprofit Groups	233,020	529,053
Educational Telecommunications Access Program	205,565	0
Public Interest Pay Telephone	0	40,422

**7. ASSESSMENT LIMITS**

2001 Wisconsin Act 16 limits the amount of assessments on telecommunications providers to support the PSC-operated programs. Under 2001 Act 16, 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 ■**

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## Budgetary Comparison Schedule for the Years Ended June 30, 2006 and 2005

	Year Ended June 30, 2006		Year Ended June 30, 2005	
	<u>Budget</u>	<u>Actual</u>	<u>Budget</u>	<u>Actual</u>
<b>AVAILABLE FOR APPROPRIATION</b>				
Unexpended Budgetary Fund Balance				
Beginning of the Year <sup>1</sup>		\$ 6,341,641		\$ 5,976,642
Revenues <sup>2</sup>	\$ 31,018,836	<u>31,018,836</u>	\$ 28,153,243	<u>28,153,243</u>
<b>Amount Available for Appropriation</b>		<b>37,360,477</b>		<b>34,129,885</b>
<b>APPROPRIATIONS AND TRANSFERS (OUTFLOWS)</b>				
Educational Telecommunications Access Program	17,267,900	10,378,646	17,262,000	16,846,105
PSC Programs and Transfer for Newslines Program <sup>3</sup>	6,000,000	5,756,971	6,000,000	6,122,747
BadgerLink Program	1,992,500	1,992,463	1,943,500	1,943,499
Aid to Public Library Systems	4,223,800	4,223,800	2,111,900	2,111,900
University of Wisconsin BadgerNet Access	1,054,800	<u>739,899</u>	<u>1,054,800</u>	<u>763,993</u>
<b>Total Appropriations and Transfers</b>	<b>30,539,000</b>	<b>23,091,779</b>	<b>28,372,200</b>	<b>27,788,244</b>
<b>FUND BALANCE</b>				
Unexpended Budgetary Fund Balance—End of the Year		14,268,698		6,341,641
Less Encumbrances Outstanding at End of the Year		<u>(1,751,810)</u>		<u>(1,322,533)</u>
<b>Unencumbered Fund Balance—End of the Year Budgetary Basis</b>		<b><u>\$ 12,516,888</u></b>		<b><u>\$ 5,019,108</u></b>

<sup>1</sup> 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.

<sup>2</sup> Universal Service Fund revenues are not incorporated into the adopted state budget. Telecommunications providers are assessed a fee based on the amount of estimated expenditures as submitted to the Legislature's 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.

<sup>3</sup> An encumbrance balance of \$834,000 from FY 2003-04 carried forward to FY 2004-05 for the PSC programs. Therefore, the programs did not exceed their budget authority in FY 2004-05. In addition, PSC actual expenditures for FY 2004-05 do not include payment requests of \$740,000 that were deferred to the following fiscal year.

## **Budgetary—GAAP Reporting Reconciliation as of June 30, 2006 and 2005**

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, 2006 and 2005.

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Fund Balance (Budgetary Basis) as Reported on the Budgetary Comparison Schedule	\$ 12,516,888	\$ 5,019,108
Adjustments (Basis Differences):		
To eliminate the effect of encumbrances that reduce the unexpended budgetary fund balance under budgetary reporting <sup>1</sup>	1,751,810	1,322,533
To adjust revenues for cash deposits not recorded until after year-end <sup>2</sup>	12,511	8,314
To accrue assessments and other receivables <sup>3</sup>	1,625,125	1,876,923
To accrue payables <sup>4</sup>	<u>(126,835)</u>	<u>(1,289,075)</u>
Fund Balance, End of the Year (GAAP Basis) as Reported in the Financial Statements	<u>\$ 15,779,499</u>	<u>\$ 6,937,803</u>

<sup>1</sup> Encumbrances may be carried over to the next fiscal year as a revision to the budgetary appropriation. Under budgetary reporting, encumbrances 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.

<sup>2</sup> 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.

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

<sup>4</sup> 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.



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# Report on Internal Control and Compliance ■

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## *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, 2006 and 2005, and have issued our report thereon dated August 17, 2007. 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, contracts, and grant agreements, 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 reported to the management of the Universal Service Fund in a separate letter dated June 26, 2007.

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 17, 2007

LEGISLATIVE AUDIT BUREAU  
by   
Diann Allsen  
Audit Director

Appendix

**Universal Service Fund Programs**

Program Name	Description	Year Initiated	Expenditures through 6/30/06	FY 2006-07 Budget
<b>PSC Programs:</b>				
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	\$ 7,601,656	\$ 150,000
Telecommunications Equipment Purchase Program	Provides financial assistance to help persons with disabilities in acquiring special telecommunications equipment.	1996	12,253,487	1,800,000
Lifeline	Provides support to low-income individuals for rates in excess of \$15 per month for basic telephone services.	1997	8,691,257	1,600,000
Link-Up America	Provides a waiver of certain regulated service charges when low-income residential customers establish or move their telephone service.	1997	5,172,382	1,000,000
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 in which 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	1,975,870	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	1,953,434	500,000

Program Name	Description	Year Initiated	Expenditures through 6/30/06	FY 2006-07 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 telephone services.	2000	\$ 674,801	\$ 160,000
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>8,651</u>	<u>2,500</u>
Subtotal of PSC Programs			<u>\$ 39,776,623</u>	<u>\$5,712,500</u>
<b>TEACH/DOA Program:</b>				
Educational Telecommunications Access Program	Provides subsidized access to new data lines for direct Internet or Intranet access and two-way interactive video links, and provided grants through December 2005 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	102,328,713	17,267,900
<b>DPI Programs:</b>				
Newsline	Funds a contract with the National Federation of the Blind to provide Newsline electronic information service that provides telephone access to audio versions of major national newspapers for sight-impaired individuals.	1997	506,000	0
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	11,905,199	2,030,500
Supplemental Aid to Public Library Systems	Funds aid payments to public library systems.	2004	8,447,600	4,223,800
<b>UW System Program:</b>				
UW System BadgerNet Access	Provides support to provide BadgerNet Covered Network access for four UW campuses.	1997	<u>7,870,069</u>	<u>1,054,800</u>
<b>Total of All Programs</b>			<u>\$170,834,204</u>	<u>\$30,289,500</u>