

An Audit

# **Universal Service Fund**

*Public Service Commission*

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State Auditor – Janice Mueller

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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

**Appendix**

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Current and Former Universal Service Fund Programs



**STATE OF WISCONSIN**  
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Janice Mueller  
State Auditor

September 18, 2008

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 \$30.0 million in fiscal year (FY) 2006-07. Our audit report contains our unqualified opinion on the Universal Service Fund's financial statements for the fiscal years ending June 30, 2007, and June 30, 2006.

Eight of 13 programs currently supported by the Universal Service Fund are operated by the PSC. The programs provide low-income or disabled individuals affordable access to basic telephone and information services, lessen the financial effect of high rate increases, and assist in the purchase of medical telecommunications equipment.

The largest program supported by the Universal Service Fund is the Educational Telecommunications Access Program, which is administered by the Department of Administration (DOA). This program subsidizes data lines and video links for eligible educational institutions. In FY 2006-07, expenditures for the program totaled \$17.4 million.

The Universal Service Fund also supported two programs administered by the Department of Public Instruction (DPI) during FY 2006-07, including state aid to public library systems. Since FY 2004-05, the Universal Service Fund has been used increasingly for library system aid.

In our Report on Internal Control and Compliance, we reported on three fiscal management issues that require attention by the PSC and DOA. We found errors in the financial statements, inaccurate copayment billings for educational institutions participating in the Educational Telecommunications Access Program, and an incorrect treatment of a prior-year refund.

We appreciate the courtesy and cooperation extended to us by staff at the PSC, DOA, DPI, 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 \$2.0 million during FY 2006-07.***

***2007 Wisconsin Act 20 repealed the limitation on assessments to support PSC-operated programs.***

***Conversion to a new statewide data and video network was completed in September 2006.***

***The Universal Service Fund provided increased funding for library system aid during the 2007-09 biennium.***

***Three fiscal management issues require attention by the PSC and DOA.***

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 (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, 2007 and 2006.

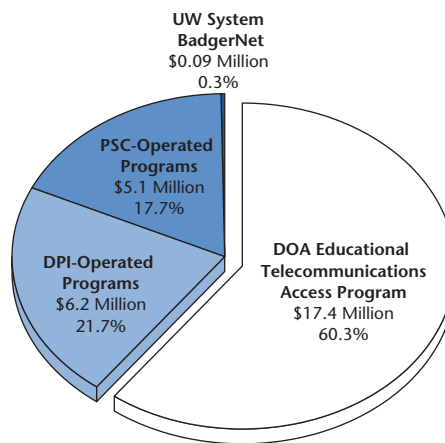
### Fund Finances

The Universal Service Fund is funded primarily through assessments paid by telecommunications providers, which totaled \$30.0 million in FY 2006-07. Interest income totaled \$944,000. Almost \$28.9 million was expended during FY 2006-07 for 13 programs currently supported by the Universal Service Fund. Eight of these programs are operated by the PSC, with expenditures totaling \$5.1 million in FY 2006-07.

The largest program supported by the Universal Service Fund, the Educational Telecommunications Access Program, is operated by DOA. This program subsidizes data lines and video links for eligible educational institutions. As shown in Figure 1, its expenditures of \$17.4 million represented 60.3 percent of the Universal Service Fund’s total expenditures in FY 2006-07.

Figure 1

**Universal Service Fund Expenditures<sup>1</sup>**  
FY 2006-07



<sup>1</sup> Expenditures totaled \$28.9 million in FY 2006-07.

During FY 2006-07, the Universal Service Fund also provided over \$6.2 million for two programs administered by DPI. In addition, it paid almost \$90,000 to UW System to help provide four UW campuses access to voice, data, and video services through the BadgerNet Converged Network, the State’s voice, data, and video telecommunications infrastructure.

We have noted in past audits that the fund balance has steadily increased over the last several years because more assessments were collected than expended. During FY 2006-07, revenues exceeded expenditures by \$2.0 million, and the fund balance totaled \$17.8 million as of June 30, 2007.

The \$2.0 million increase is, in part, attributable to lower than anticipated expenditures for the UW BadgerNet Access Program. Because of billing changes and UW System’s questions about statutory restrictions, expenditures for the program were not funded



through the Universal Service Fund for several months in FY 2006-07. Working with DOA, UW System has subsequently decided that the expenditures can appropriately be funded through the Universal Service Fund, and annual expenditures in this category are expected to increase to over \$1.0 million.

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. In response to a recommendation in our 2007 audit (report 07-11), the PSC has begun to work more closely with other agencies that have programs funded through the Universal Service Fund to determine appropriate assessment levels and prevent similar increases in future fund balances.

### **PSC-Operated Programs**

The eight programs currently operated by the PSC include programs that:

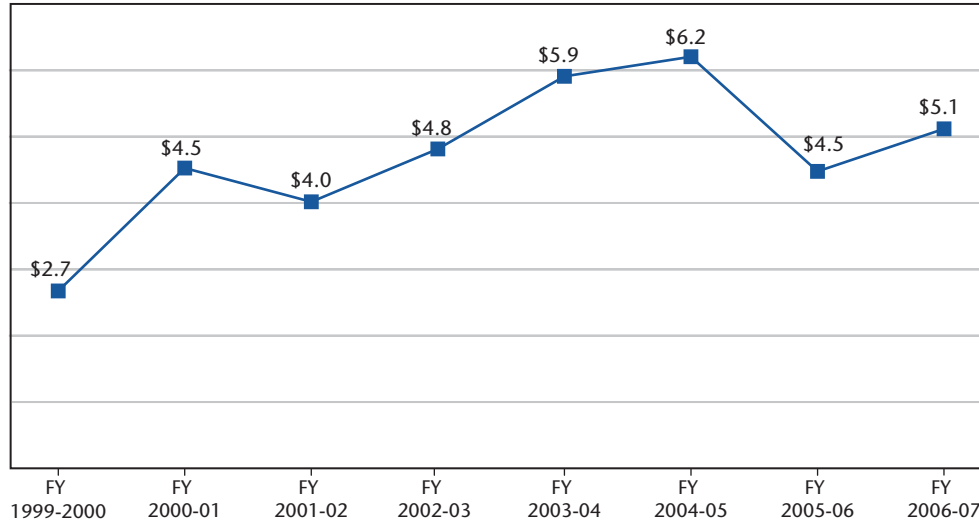
- provide low-income or disabled individuals affordable access to basic telephone and information services;
- lessen the financial effect of rate increases on users in the state; and
- assist nonprofit medical clinics or public health agencies in the purchase of medical telecommunications equipment.

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 beginning in FY 2004-05. Corresponding appropriation expenditure levels were also established for the 2003-05 and 2005-07 biennia.

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 the PSC has made efforts to reduce costs to match appropriation limits, expenditures for operations and administration of PSC-operated programs have decreased from FY 2004-05 levels, as shown in Figure 2.

Figure 2

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



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

2007 Wisconsin Act 20, the 2007-09 Biennial Budget Act, repealed the limitation on assessments to support the PSC-operated programs but maintained the \$6.0 million appropriation level for each year of the biennium.

**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 more than 900 participating educational institutions. Over \$119.7 million has been expended for the program from July 1, 1998, through June 30, 2007.

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 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.

## Library System Aid

Until FY 2003-04, general purpose revenue (GPR) funded state aid to public library systems. 2003 Wisconsin Act 33 shifted \$4.2 million in funding for public library system aid payments from GPR to the Universal Service Fund for the 2003-05 biennium. The next two biennial budgets increased the amount of funding from the Universal Service Fund for state aid to public library systems. 2005 Wisconsin Act 25 increased funding from the Universal Service Fund by another \$4.2 million over the 2005-07 biennium, for a total of \$8.4 million.

2007 Wisconsin Act 20 again increased funding from the Universal Service Fund by \$11.1 million over the 2007-09 biennium. As part of the \$11.1 million funding increase from the Universal Service Fund, the Legislature directed the PSC to use \$9.2 million of the Fund's balance. In total, the Universal Service Fund is providing \$19.5 million in funding for public library systems for the 2007-09 biennium.

## Fiscal Management Issues

Our Report on Internal Control and Compliance includes three fiscal management issues. First, we recommend the PSC more thoroughly review the Universal Service Fund's financial statements to ensure they are reasonable and materially accurate. We found a material misclassification of expenditures that could easily have been identified by the PSC if such a review had been completed.

Second, DOA does not have adequate procedures in place to ensure the accuracy of the copayment billings to educational institutions participating in the Educational Telecommunications Access Program. During our testing of the copayment billings, we identified 45 educational institutions that were not billed according to the services they were receiving.

Finally, DOA incorrectly accounted for a prior-year's refund of \$196,701 for the Educational Telecommunications Access Program. We recommend improvements to address these errors.

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## Universal Service Fund Programs ■

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Most 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 and, more recently, 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 programs currently or formerly 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 the 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.

In May 1996, the PSC first promulgated rules that formally established the programs it operates. As we noted 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 limit of \$6.0 million on provider assessments for PSC-operated programs, which was established in 2001 Wisconsin Act 16. Expenditures increased to \$5.1 million in FY 2006-07 as the PSC budgeted and managed program expenditures to continue to match the \$6.0 million appropriation level.

The growth in expenditures from FY 2001-02 through FY 2004-05, together with the assessment cap, 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 and FY 2004-05, the PSC deferred decisions on payment requests for various programs until the subsequent year. 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.

Beginning in FY 2004-05, the PSC consulted with the Universal Service Fund Council to identify areas in which costs could be reduced, including reducing benefit levels for the Telecommunications Equipment Purchase Program, reducing promotion efforts, and varying the amount and timing of grant funds available for the Medical Telecommunications Equipment program and the Access Program or Project by Nonprofit Groups. As a result, the PSC has been able to limit expenditures to its spending authority without deferring any decisions on payment requests.

***The annual \$6.0 million cap on provider assessments was repealed in 2007.***

2007 Wisconsin Act 20, the 2007-09 Biennial Budget Act, repealed the \$6.0 million cap on provider assessments for support of PSC-operated programs, although it maintained the \$6.0 million appropriation level for each year of the 2007-09 biennium.

## **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 include public and private K-12 schools; private, tribal, and state technical colleges; public libraries; juvenile correctional facilities; cooperative educational service agencies; the Wisconsin School for the Deaf and the Wisconsin Center for the Blind and Visually Impaired; and public museums. Participating entities are charged a monthly service rate 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 State's master lease program financed the Educational Telecommunications Access Program's video link and data line costs under these contracts.

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

In March 2005, DOA entered into a new \$116.7 million, five-year agreement with the same Wisconsin BadgerNet Access Alliance for data and video services provided to the State of Wisconsin and other public-sector users beginning 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. Under the new contract, ongoing costs that previously had been financed through the State's master lease program are paid directly on a monthly basis.

***Over \$119.7 million has been expended for the Educational Telecommunications Access Program through FY 2006-07.***

As shown in Table 1, Universal Service Fund expenditures for the Educational Telecommunications Access Program were \$17.4 million in FY 2006-07, which is an increase of \$5.8 million, or 49.8 percent, from FY 2005-06 expenditures. The increase reflects a full year of costs under the BadgerNet Converged Network. 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. Costs related to the new network were incurred only 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 2006-07

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
FY 2006-07	17,395,356
<b>Total</b>	<b>\$119,724,069</b>

***Federal funding is also available for telecommunications access services through the federal E-rate program.***

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 \$5.0 million in E-rate funding received by the State for FY 2006-07 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. With the enactment of 2007 Wisconsin Act 20, E-rate funds not needed for the debt service costs of wiring loans can be used for educational institutions' telecommunications costs that are not subsidized by the Educational Telecommunications Access Program.



## Department of Public Instruction Programs

During FY 2006-07, 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 online access to reference databases of magazines and newspapers.

Expenditures for these two programs totaled over \$6.2 million and accounted for 21.7 percent of the Universal Service Fund's FY 2006-07 program expenditures.

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 increased funding from the Universal Service Fund by \$4.2 million over the 2005-07 biennium, for a total of \$8.4 million.

***The Legislature directed that \$9.2 million of the Fund's balance be used for state aid to public library systems in FY 2007-08.***

2007 Wisconsin Act 20 again increased funding from the Universal Service Fund by \$11.1 million over the 2007-09 biennium. As part of the \$11.1 million funding increase from the Universal Service Fund, the Legislature directed the PSC to use \$9.2 million of the Fund's balance. In total, the Universal Service Fund is providing \$19.5 million in funding for the public library systems for the 2007-09 biennium.

***No funds were transferred to the Newsline program during the 2005-07 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. Because a balance had accumulated for the Newsline program, the PSC did not transfer any funding for the program in FY 2005-06 or FY 2006-07.

2007 Wisconsin Act 20 modified budgetary provisions so that funding from the Universal Service Fund for the Newsline program is appropriated directly to DPI, and the PSC is no longer required to transfer funding from its appropriation for the program.

## Fund Balance

***The fund balance increased by \$13.6 million from June 30, 2003, to reach \$17.8 million at June 30, 2007.***

The fund balance for the Universal Service Fund has steadily increased over the last several years because more assessments were collected than expended. As shown in Table 2, the balance increased from \$4.2 million as of June 30, 2003, to \$17.8 million as of June 30, 2007. The increase of almost \$8.9 million in FY 2005-06 was in large part attributable to expenditures being significantly less than funding for the Educational Telecommunications Access Program during conversion to the new BadgerNet Converged Network.

Table 2

### Fund Balance (in millions)

Date	Fund Balance
June 30, 2003	\$ 4.2
June 30, 2004	6.4
June 30, 2005	6.9
June 30, 2006	15.8
June 30, 2007	17.8

***UW System did not use the Universal Service Fund for the BadgerNet Access Program for several months in FY 2006-07.***

The \$2.0 million increase in the fund balance during FY 2006-07 is in part attributable to lower than anticipated expenditures for the UW BadgerNet Access program. Because of billing changes and UW System’s interpretation of related statutory restrictions, expenditures for the BadgerNet Access Program were not funded through the Universal Service Fund for several months in FY 2006-07. Instead, UW System funded costs for the four campuses covered under the program from other UW sources.

Statutes require that UW System pay DOA for telecommunications services provided through the UW BadgerNet Access Program. However, with the conversion to the new BadgerNet Converged Network, billings for the network services began to be sent by the service provider, a private company. Because it was not paying DOA for the services, UW System questioned whether it could legally participate.

Working with DOA, UW System subsequently decided that because DOA's contract with the service provider includes a provision that requires all revenues collected to be remitted to DOA, UW System could resume using the Universal Service Fund in FY 2007-08. Further, 2007 Wisconsin Act 20 expanded use of the Universal Service Fund for telecommunications costs of any UW System campus beginning in FY 2007-08. Consequently, expenditures for the UW BadgerNet Access program will be closer to assessment amounts for this program, which are over \$1.0 million annually.

The PSC is responsible for determining the annual assessment levels applied 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 have accumulated when revenues exceed expenditures. In response to a recommendation in our 2007 audit (report 07-11), the PSC has begun to work more closely with other agencies whose programs are funded through the Universal Service Fund to determine appropriate assessment levels and prevent a similar increase in the fund balance in the future.

Working with DOA, the PSC had intended to apply part of the fund balance for the Educational Telecommunications Access Program and, correspondingly, reduce the assessment level for the program for FY 2007-08. However, as noted, \$9.2 million of the fund balance was used to replace GPR funding for state aid to public library systems during FY 2007-08. Consequently, the amount assessed for the Educational Telecommunications Access Program was kept at the projected expenditure level.

## **Wireless and Cellular Providers**

The assessment of wireless and cellular providers, which provide telephone service through the airwaves, has been an area of longstanding debate. The Universal Service Fund is currently funded only through assessments paid by telecommunications providers that provide services through land lines.

The PSC had begun assessing wireless and cellular providers in August 2000. It suspended the assessments in November 2000, after the Legislature's Joint Committee for Review of Administrative Rules concluded that the assessments imposed an undue hardship on an emerging and developing industry and suspended that portion of the administrative code establishing the effective date.

***The PSC is in the process of considering reversing an order that exempts wireless providers from the fund assessment.***

Since 2000, the wireless and cellular industry has grown significantly. The Federal Communications Commission's annual report on local telephone competition issues indicates that as of June 30, 2007, Wisconsin had 3.1 million access lines served by local exchange land line carriers, and 3.6 million wireless telephone subscribers. In response to maturing of the industry, the PSC is currently in the process of considering reversing an order that exempts wireless providers from the Universal Service Fund assessment. The PSC also anticipates submitting revised administrative rules for legislative review.

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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, 2007 and 2006. 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, 2007 and 2006, 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 19 through 24 and as Schedules 1 and 2 on pages 38 and 39 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 September 4, 2008, 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.

September 4, 2008

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. They 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. 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, 2007 and 2006, are shown in the following tables.

Table A

#### A Comparison of Condensed Financial Information for FY 2006-07 and FY 2005-06

	June 30, 2007	June 30, 2006	Dollar Change	Percentage Change
Total Assets	\$20,202,166	\$17,343,309	\$2,858,857	16%
Total Liabilities	2,370,658	1,563,810	806,848	52
<b>Fund Balance</b>	<b>\$17,831,508</b>	<b>\$15,779,499</b>	<b>\$2,052,009</b>	13

	FY 2006-07	FY 2005-06	Dollar Change	Percentage Change
Total Revenues	\$30,908,883	\$30,771,234	\$137,649	<1%
Total Expenditures	28,856,874	23,045,538	5,811,336	25
Excess of Revenues over Expenditures	2,052,009	7,725,696	(5,673,687)	(73)
Capital Lease Acquisitions	0	1,116,000	(1,116,000)	(100)
<b>Excess of Revenues and Other Sources over Expenditures and Other Uses</b>	<b>\$ 2,052,009</b>	<b>\$ 8,841,696</b>	<b>\$(6,789,687)</b>	(77)



Table B

## 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 Newsline 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

The Fund's total revenues of \$30.9 million in FY 2006-07 and \$30.8 million in FY 2005-06 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 78 percent of total revenues in FY 2006-07 and almost 79 percent in FY 2005-06 were intended for four programs the PSC does not manage: the Educational Telecommunications Access Program, which is managed by DOA; library system aid 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.

Assessments increased by almost 7 percent from FY 2004-05 to FY 2005-06 but remained relatively constant from FY 2005-06 to FY 2006-07. Assessments for the Educational Telecommunications Access Program, the UW BadgerNet Access

program, and the PSC-operated programs for FY 2006-07 totaled \$23.8 million and were largely unchanged from FY 2005-06 and FY 2004-05. Assessments for the DPI programs increased by \$2.1 million, or 52 percent, during FY 2005-06 but remained constant during FY 2006-07. 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 system aid program.

Annual assessments for the PSC-operated programs were statutorily limited to \$6.0 million for FY 2004-05 through FY 2006-07. Subsequently, 2007 Wisconsin Act 20 removed the annual \$6.0 million cap, effective for FY 2007-08 and each year thereafter. However, the PSC is still required to stay within the limits of the budget appropriation for PSC-operated programs.

The amount reported as excess of revenues over expenditures increased by \$7.1 million in FY 2005-06 but decreased by \$5.7 million in FY 2006-07. 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 decreased by \$5.2 million, or 31 percent, during FY 2005-06, largely because of a 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 conversion to the new BadgerNet Converged Network did not begin until January 2006. As a result, there was a period in FY 2005-06 when the old lines were fully paid but still in use, which significantly reduced costs for FY 2005-06. By FY 2006-07, the conversion was complete and costs increased by \$5.8 million, or 50 percent, and returned to expected levels.

Expenditure levels for the PSC-operated programs decreased by \$1.7 million, or 28 percent, during FY 2005-06 and then increased \$641,000, or 14 percent, during FY 2006-07. The most significant decrease in expenditures during FY 2005-06 was for TEPP, for which expenditures decreased by \$1.1 million, or 45 percent, as the PSC took steps to address budgetary constraints. Expenditures for TEPP increased by \$133,000, or 10 percent, during FY 2006-07. The other PSC-operated programs that had significant changes in expenditures from FY 2005-06 through FY 2006-07 were the Link-Up, Medical Telecommunications Equipment, and Access Program or Project by Nonprofit Groups programs.

Link-Up is one of the two programs provided jointly with the federal government that are focused on bringing affordable telephone services to low-income customers. Link-Up waives connection fees for low-income eligible customers. Lifeline, the other low-income focused program, provides a discount on the monthly telephone bill to eligible customers.

Expenditures for Link-Up increased by \$441,000, or 54 percent, in FY 2006-07 because of the entrance of new competitive local exchange carriers that primarily focus on serving low-income customers. Expenditures and participation rates for Lifeline changed very little from FY 2005-06 to FY 2006-07, suggesting that the number of low-income customers was not necessarily increasing. Instead, low-income participants were switching providers, which contributed to the increase in Link-Up expenditures. In addition, the new providers charge higher connection fees that increased reimbursement amounts and corresponding expenditure levels for Link-Up. The PSC took action in early 2008 to address the increase in Link-Up expenditures.

Expenditures for the Medical Telecommunications Equipment program decreased by \$370,000 in FY 2005-06 but increased by \$351,000 in FY 2006-07. Expenditures may vary significantly between years for this program based on the timing of grant awards and grantee reimbursements. The PSC did not award any grants under the Medical Telecommunications Equipment program during FY 2004-05, which contributed to the decrease in grant expenditures in FY 2005-06. The PSC awarded grants of \$500,000 late in FY 2005-06, which contributed to the increase in expenditures in FY 2006-07.

Similar to the Medical Telecommunications Equipment program, expenditures for the Access Program or Project by Nonprofit Groups program may vary significantly between years based on the timing of grant awards and grantee reimbursements. Further, expenditures for this program tend to extend over several years because of the preparation time needed by nonprofit groups to operate their programs. Expenditures for the program decreased by \$186,000, or 58 percent, during FY 2006-07 because the PSC did not award any grants in FY 2005-06 in response to budgetary constraints. The PSC did award \$467,861 in grants for the Access Program or Project by Nonprofit Groups program in FY 2006-07.

The UW BadgerNet Access expenditures were relatively constant in FY 2004-05 and FY 2005-06 but decreased significantly in FY 2006-07, because of changes in the administration of the new BadgerNet Converged Network and interpretation of related statutory provisions. Statutory language required that UW System pay DOA for telecommunications services provided to the UW campuses at River Falls, Stout, Superior, and Whitewater under s. 16.973(1), Wis. Stats. With the conversion to the new BadgerNet Converged Network, billings for the services are sent out by AT&T, the service provider for the network.

Initially, UW System questioned whether the new billing process limited its ability to use funds from the Universal Service Fund because it was not paying DOA for the services. UW System therefore discontinued using the funds in October 2006. Working with DOA, UW System subsequently determined that DOA's contract with AT&T includes a provision for billing services in which AT&T invoices the users of the network and remits the resulting revenue to DOA. Consequently, UW System concluded that, based on its understanding of the billing arrangement, it ultimately was paying DOA for the telecommunications services.

UW System resumed using the Universal Service Fund to fund telecommunications services in FY 2007-08. Further, 2007 Wisconsin Act 20 expanded use of the Universal Service Fund for telecommunications costs at any UW System campus beginning in FY 2007-08.

Liabilities for the Universal Service Fund decreased by \$3.4 million, or 69 percent, during FY 2005-06 and increased by \$0.8 million, or 52 percent, during FY 2006-07, largely because of the timing of payments for the Educational Telecommunications Access Program. The large decrease in FY 2005-06 was primarily associated with the timing of the actual cash transfer for a \$2.9 million master lease prepayment for the program.

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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## Balance Sheet June 30, 2007 and 2006

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
<b>ASSETS</b>		
Cash and Cash Equivalents (Notes 2C and 3)	\$ 18,720,875	\$ 15,553,127
Assessments Receivable (Note 2D)	1,471,707	1,632,536
Other Receivables	9,570	157,646
Prepays	14	0
<b>Total Assets</b>	<b><u>\$ 20,202,166</u></b>	<b><u>\$ 17,343,309</u></b>
<b>LIABILITIES AND FUND BALANCE</b>		
Liabilities:		
Program liabilities:		
Educational Telecommunications Access Program	\$ 1,540,806	\$ 562,574
Lifeline Program	336,022	336,185
Link-Up Program	222,522	179,406
Telecommunications Equipment Purchase Program	144,008	96,568
Medical Telecommunications Equipment Program	57,850	0
Public Interest Pay Telephone Program	14,278	4,142
High Rate Assistance Credit Program	12,263	25,535
Access Program or Project by Nonprofit Groups	11,355	2,880
Two-Line Voice Carryover Program	663	616
BadgerLink Program	0	307,500
Accounts payable	30,891	48,404
<b>Total Liabilities</b>	<b><u>2,370,658</u></b>	<b><u>1,563,810</u></b>
Fund Balance:		
Reserved for encumbrances (Note 6)	1,859,102	1,751,810
Reserved for Prepays	14	0
Unreserved	15,972,392	14,027,689
<b>Total Fund Balance</b>	<b><u>17,831,508</u></b>	<b><u>15,779,499</u></b>
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<b><u>\$ 20,202,166</u></b>	<b><u>\$ 17,343,309</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, 2007 and 2006**

	Year Ended June 30, 2007	Year Ended June 30, 2006
<b>REVENUES</b>		
Telecommunications Providers' Assessments (Note 2D) for:		
Educational Telecommunications Access Program	\$ 16,923,900	\$ 17,087,972
Department of Public Instruction Programs	6,142,936	6,174,916
Public Service Commission Programs (Note 7)	5,862,791	5,930,119
University of Wisconsin BadgerNet Access	<u>1,035,083</u>	<u>1,043,336</u>
Total Telecommunications Providers' Assessments	\$ 29,964,710	\$ 30,236,343
Interest Income	<u>944,173</u>	<u>534,891</u>
<b>Total Revenues</b>	<b><u>30,908,883</u></b>	<b><u>30,771,234</u></b>
<b>EXPENDITURES</b>		
Program Expenditures:		
Educational Telecommunications Access Program (Note 5)	17,395,356	11,613,304
Library Aids	4,223,800	4,223,800
BadgerLink Program	2,030,500	1,992,463
Telecommunications Equipment Purchase Program	1,459,668	1,327,136
Lifeline Program	1,457,231	1,450,067
Link-Up Program	1,259,807	818,099
Medical Telecommunications Equipment Program	351,644	404
Access Program or Project by Nonprofit Groups	136,027	321,926
University of Wisconsin BadgerNet Access	89,668	739,899
Public Interest Pay Telephone Program	87,918	88,920
High Rate Assistance Credit Program	74,224	125,931
Two-Line Voice Carryover Program	<u>3,431</u>	<u>3,288</u>
Total Program Expenditures	28,569,274	22,705,237
Administrative Expenditures	<u>287,600</u>	<u>340,301</u>
<b>Total Expenditures</b>	<b><u>28,856,874</u></b>	<b><u>23,045,538</u></b>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	<b>2,052,009</b>	<b>7,725,696</b>
<b>OTHER FINANCING SOURCES (USES)</b>		
Capital Lease Acquisitions (Note 5)	<u>0</u>	<u>1,116,000</u>
Excess of Revenues and Other Sources over Expenditures and Other Uses	2,052,009	8,841,696
<b>FUND BALANCE</b>		
Fund Balance—Beginning of the Year	<u>15,779,499</u>	<u>6,937,803</u>
Fund Balance—End of the Year	<b><u>\$ 17,831,508</u></b>	<b><u>\$ 15,779,499</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 2006-07 and 2005-06 follows.

**A. Educational Telecommunications Access Program**

This program, which is 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 was previously the sole source of funding for state 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. Effective for FY 2007-08, the Legislature expanded the appropriation to all UW campuses.

**F. Lifeline and Link-Up**

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 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 high 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. Newslines**

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 Newslines electronic information service, which provides telephone access for sight-impaired individuals to audio versions of major national newspapers and several local newspapers. Beginning in FY 2007-08, funding for the program will be directly appropriated to DPI.

**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 \$7,486 as of June 30, 2007, and \$117,336 as of June 30, 2006. The amount exposed to custodial credit risk was \$0 as of June 30, 2007, and \$17,336 as of June 30, 2006. As of June 30, 2007, 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 \$18,641,000 as of June 30, 2007, and \$15,486,000 as of June 30, 2006. 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

From FY 1997-98 through FY 2004-05, the Universal Service Fund annually 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 Newsline electronic information service that provides telephone access to audio versions of major national newspapers for blind and visually impaired individuals. Based upon a memorandum of understanding between DPI and the PSC, transfers were not completed in FY 2006-07 or FY 2005-06 because an unspent balance had accumulated in the appropriation.

#### 5. MASTER LEASE COMMITMENTS

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 (Uses)" section of the Statement of Revenues, Expenditures, and Changes in Fund Balance for FY 2005-06.

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, 2007, and June 30, 2006, the Telecommunications Equipment Purchase Program encumbrances were \$684,700 and \$813,225, respectively.

**B. Other Encumbrances**

As of June 30, 2007, and June 30, 2006, 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, 2007</u>	<u>Encumbrances at June 30, 2006</u>
Medical Telecommunications Equipment	\$659,694	\$500,000
Access Program or Project by Nonprofit Groups	514,708	233,020
Educational Telecommunications Access Program	0	205,565

**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 could not assess more than \$5.0 million in FY 2003-04, \$6.0 million in FY 2004-05, and \$6.0 million in FY 2006-07 for PSC-operated programs. 2007 Wisconsin Act 20 removed the \$6.0 million assessment cap beginning in FY 2007-08 and each year thereafter.

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## **Supplementary Information ■**

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## Budgetary Comparison Schedule for the Years Ended June 30, 2007 and 2006

	Year Ended June 30, 2007		Year Ended June 30, 2006	
	<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>		\$ 14,268,698		\$ 6,341,641
Revenues <sup>2</sup>	\$ 31,066,613	<u>31,066,613</u>	\$ 31,018,836	<u>31,018,836</u>
<b>Amount Available for Appropriation</b>		<b>45,335,311</b>		<b>37,360,477</b>
<b>APPROPRIATIONS AND TRANSFERS (OUTFLOWS)<sup>3</sup></b>				
Educational Telecommunications Access Program <sup>4</sup>	24,153,973	17,514,015	17,267,900	10,378,646
PSC Programs and Transfer for Newslines Program	6,825,697	4,964,038	6,595,776	5,756,971
BadgerLink Program	2,030,500	2,030,500	1,992,500	1,992,463
Aid to Public Library Systems	4,223,800	4,223,800	4,223,800	4,223,800
University of Wisconsin BadgerNet Access	1,054,800	89,668	1,054,800	739,899
<b>Total Appropriations and Transfers</b>	<b>38,288,770</b>	<b>28,822,021</b>	<b>31,134,776</b>	<b>23,091,779</b>
<b>FUND BALANCE</b>				
Unexpended Budgetary Fund Balance—End of the Year		16,513,290		14,268,698
Less Encumbrances Outstanding at End of the Year		<u>(1,859,102)</u>		<u>(1,751,810)</u>
<b>Unencumbered Fund Balance—End of the Year</b>				
<b>Budgetary Basis</b>		<b><u>\$ 14,654,188</u></b>		<b><u>\$ 12,516,888</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 Committee on Finance 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> Appropriation amounts include encumbrances carried forward from the prior year.

<sup>4</sup> Appropriations for the Educational Telecommunications Access Program are biennial appropriations. The unspent balances from FY 2005-06 are forwarded to FY 2006-07, the second year of the biennium.

## Budgetary-GAAP Reporting Reconciliation as of June 30, 2007 and 2006

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, 2007 and 2006.

	June 30, 2007	June 30, 2006
Fund Balance (Budgetary Basis) as Reported on the Budgetary Comparison Schedule	\$ 14,654,188	\$ 12,516,888
Adjustments (Basis Differences):		
To eliminate the effect of encumbrances that reduce the unexpended budgetary fund balance under budgetary reporting <sup>1</sup>	1,859,102	1,751,810
To adjust revenues for cash deposits not recorded until after year-end <sup>2</sup>	57,648	12,511
To accrue assessments and other receivables <sup>3</sup>	1,422,259	1,625,125
To accrue payables <sup>4</sup>	(161,689)	(126,835)
Fund Balance, End of the Year (GAAP Basis) as Reported in the Financial Statements	\$ 17,831,508	\$ 15,779,499

<sup>1</sup> Encumbrances may be carried over to the next fiscal year as a revision to the budgetary appropriation with DOA's approval. 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 reported 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, 2007 and 2006, and have issued our report thereon dated September 4, 2008. 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 Universal Service Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Universal Service Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Universal Service Fund's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies and, accordingly, would not necessarily disclose all significant

deficiencies that are also considered material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

*A control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. *A significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following three deficiencies to be significant deficiencies in internal control over financial reporting.

#### *Misclassification of Expenditure Accounts*

A lack of sufficient review procedures by the PSC to ensure the reasonableness and accuracy of the Universal Service Fund's financial statements resulted in a misclassification of expenditures on the draft financial statements. Most significantly, expenditures of \$1,952,554 for the BadgerLink program and \$4,223,800 for the Library Aids program were reversed in the financial statements. These errors could have been easily identified by the PSC if it had completed a thorough review of the financial statements, including comparing them to the prior year's statements for reasonableness.

PSC staff agreed to the audit adjustments and agreed to implement a more thorough review process over the Universal Service Fund's financial statements. As part of this review, the PSC plans to complete a detailed examination of expenditures for each program, including comparing expenditures to budget authority. It also plans to compare the financial statements to prior-year statements to assess their reasonableness.

#### *Errors in Copayment Billings for the Educational Telecommunications Access Program*

DOA did not have adequate procedures in place to ensure the accuracy of the copayment billings to educational institutions participating in the Educational Telecommunications Access Program. The Universal Service Fund subsidizes the cost of data line and video line access for over 900 educational institutions participating in the program. The educational institutions are billed a copayment for the services they receive.

During our testing of the copayment billings, we identified 45 educational institutions that were not billed according to the services they were receiving: 26 were overbilled by a total of \$36,668, and 19 were underbilled by a total of \$36,000. The net effect of these errors was an understatement of \$668 in expenditures, which is immaterial to the Universal Service Fund's financial

statements. However, the billing errors could be more significant at the educational institution level and, therefore, need to be addressed.

Several factors contributed to the billing errors. A significant factor was an increased complexity in the billings because of the conversion to the new BadgerNet Converged Network. At the same time, preparing copayment billings is primarily a manual process and only one person is responsible for the billing process. Further, DOA did not have procedures in place to review and ensure copayment billings were properly calculated.

In response to the errors we found, DOA plans to review all educational agency billings from the initial conversion date to the present to ensure they were billed correctly. It is also changing the current annual billing process to a semi-annual process, which will be based on actual services provided. DOA also indicates that it is working on implementing a more automated application and billing process that will begin with customer inquiries and continue through the application process to billing and reporting functions. Finally, DOA is hiring additional staff to improve controls and provide for increased separation of duties.

#### *Error in Treatment of a Refund of Expenditure*

DOA did not properly account for a refund received in FY 2006-07 for \$196,701 that had been overbilled to the Educational Telecommunications Access Program in FY 2005-06. According to the State Accounting Manual, the refund should have been coded to the “unassigned revenues” class code. Instead, DOA coded it as a refund of expenditure. Coding a prior year’s refund as a refund of expenditure in the current year is not permitted because it could potentially allow an agency to spend more than its appropriation for the fiscal year. We note that this transaction did not result in the Educational Telecommunications Access Program exceeding its biennial appropriation.

DOA staff indicated they coded the refund as a refund of expenditure because they have authority to record only expenditures—not revenues—for the Educational Telecommunications Access Program and did not want to delay the transaction. DOA agrees that accounting transactions should follow accounting policy set by state statute and the State Controller’s Office, and it will ensure that any future return of funds expended from prior periods will be sent to the PSC for redeposit into the Universal Service Fund.

*A material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a likelihood that material misstatement of the financial statements will not be prevented or detected by the entity’s internal control. Of the significant deficiencies described in the preceding paragraphs, we consider the lack of adequate review procedures of the financial statements that resulted in an undetected material misclassification of expenditure accounts to be a material weakness.

## COMPLIANCE AND OTHER MATTERS


As part of obtaining reasonable assurance about whether the 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*.

The written responses that the PSC and DOA provided to our findings are described on the preceding pages. We did not audit the responses and, accordingly, express no opinion on them.

In a separate memorandum dated August 8, 2008, we noted a certain additional matter that we reported to DOA pertaining to its administration of \$25,000 in grants from the Educational Telecommunications Access Program.

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.

September 4, 2008

LEGISLATIVE AUDIT BUREAU  
by   
Diann Allsen  
Audit Director



Appendix

**Current and Former Universal Service Fund Programs**

Program Name	Description	Year Initiated	Expenditures through 6/30/07	FY 2007-08 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	\$ 7,675,880	\$ 70,000
Telecommunications Equipment Purchase Program	Provides financial assistance to help persons with disabilities in acquiring special telecommunications equipment.	1996	13,713,155	1,700,000
Lifeline	Provides support to low-income individuals for rates in excess of \$15 per month for basic telephone services.	1997	10,148,488	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	6,432,189	1,200,000
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	Provided rate credits for customers to temporarily mitigate the effect of large increases in authorized telephone rates. The PSC specified the individual rate cases in which the credits applied.	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	2,111,897	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	2,305,078	500,000

Program Name	Description	Year Initiated	Expenditures through 6/30/07	FY 2007-08 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	\$ 762,719	\$ 135,000
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>12,082</u>	<u>5,000</u>
Subtotal of PSC Programs			<u>\$ 44,606,573</u>	<u>\$5,710,000</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.	1998	119,724,069	17,278,500
<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	106,000
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	13,935,699	2,061,700
Supplemental Aid to Public Library Systems	Funds aid payments to public library systems.	2004	12,671,400	14,040,600 <sup>1</sup>
<b>UW System Program:</b>				
UW System BadgerNet Access	Provides support to provide BadgerNet Converged Network access for UW campuses.	1997	<u>7,959,737</u>	<u>1,054,800</u>
<b>Total, All Programs</b>			<b><u>\$199,403,478</u></b>	<b><u>\$40,251,600</u></b>

<sup>1</sup>Includes a \$9,200,000 transfer from the fund balance.