

Report 13-6
April 2013

Universal Service Fund

Public Service Commission

STATE OF WISCONSIN



Legislative Audit Bureau ■

Universal Service Fund

Public Service Commission

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State Auditor – Joe Chrisman

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Joe Chrisman
State Auditor

April 4, 2013

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

As requested by the Public Service Commission (PSC), we have completed a financial audit of the Universal Service Fund (USF). We have provided an unqualified opinion on the financial statements prepared by USF management for the fiscal years ended June 30, 2012, and June 30, 2011.

The USF funds a variety of telecommunications and other programs. It is funded by assessments on telecommunications providers that are typically recovered from consumers. In fiscal year (FY) 2011-12, provider assessments totaled \$42.3 million and the USF provided \$40.5 million in funding for 13 programs operated by four state agencies.

Two programs—the Educational Telecommunications Access Program and Aid to Public Library Systems—represented 78.5 percent of the USF's FY 2011-12 program expenditures. The USF has been the sole funding source for Aid to Public Library Systems since FY 2008-09. The Educational Telecommunications Access Program is managed by the Department of Administration (DOA) and subsidizes access for approximately 1,000 pre-K-12 public, private, and charter schools; technical colleges; public libraries; and other educational institutions to a state-supported broadband network known as the BadgerNet Converged Network. Our report includes a recommendation for DOA to ensure that an administrative fee it charges the USF for services related to use of the BadgerNet Converged Network reflects only the actual costs of providing those services. We estimate that at least \$4.3 million of the \$5.4 million that has accumulated in a DOA appropriation represents excess administrative services fees paid by the USF.

We appreciate the courtesy and cooperation extended to us by staff of the PSC and three other agencies that manage USF programs—DOA, the Department of Public Instruction, and the University of Wisconsin System—as well as by the USF's administrator, Wipfli LLP.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/BN/ss

Introduction ■

Telecommunications providers fund the USF through assessments that they are permitted to recover from consumers.

The Universal Service Fund (USF) was established in 1993 to ensure that all residents of Wisconsin receive essential telecommunications services and have access to advanced telecommunications service capabilities. In FY 2011-12 and FY 2010-11, it funded programs that were managed by four state agencies: the Department of Administration (DOA), the Department of Public Instruction (DPI), University of Wisconsin (UW) System, and the Public Service Commission (PSC), which also establishes policies and procedures for the USF and is responsible for levying the assessments paid by telecommunications providers to fund USF programs. In 2011 Wisconsin Act 22, providing access to advanced telecommunications service capabilities was eliminated as a purpose of PSC-operated programs. Statutes permit providers to recover the amounts they are assessed from consumers. PSC contracts with a private contractor to perform administrative services for the USF, as required by statute.

At the request of the PSC, we completed an independent audit to fulfill the requirements of s. 196.218(2)(d), Wis. Stats. We have provided an unqualified opinion on the financial statements and related notes prepared by USF management for the fiscal years ended June 30, 2012, and June 30, 2011. In addition, we identified a fiscal management issue related to an administrative services fee that DOA charges the USF.

USF Programs

In FY 2011-12, the USF provided \$40.5 million in funding for 13 programs operated by four state agencies.

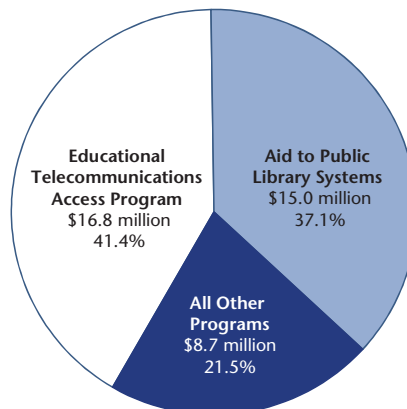
In fiscal year (FY) 2011-12, total USF expenditures were \$40.9 million. Of this amount, \$40.5 million, or 99.1 percent, supported 13 programs managed by DOA, DPI, UW System, and the PSC. The remaining \$370,000 was for administrative expenditures and consisted largely of payments to the private contractor that administers the USF. In FY 2010-11, total expenditures were \$44.5 million, including \$44.2 million in program expenditures. In addition to these expenditures, DOA transferred \$1.2 million from the USF to the State’s General Fund during FY 2010-11 as part of DOA’s efforts to meet the lapse requirements for the 2009-11 biennium. No such transfer was made during FY 2011-12.

Most program expenditures funded the Educational Telecommunications Access Program and Aid to Public Library Systems.

As shown in Figure 1, two programs—the Educational Telecommunications Access Program and Aid to Public Library Systems—represented 78.5 percent of the USF’s FY 2011-12 program expenditures. The Educational Telecommunications Access Program subsidizes the cost of equipment, installation, and a portion of the monthly service fees for access to the BadgerNet Converged Network for approximately 1,000 pre-K-12 public, private, and charter schools; technical colleges; public libraries; Cooperative Educational Service Agencies (CESAs); and other educational institutions statewide. The BadgerNet Converged Network, which we describe in greater detail in report 12-18, is a state-supported broadband network operated by a consortium of private telecommunications companies.

Figure 1

USF Program Expenditures FY 2011-12



The USF has replaced GPR as the sole funding source for Aid to Public Library Systems.

The State used general purpose revenue (GPR) as the sole funding source for the Aid to Public Library Systems program, which is managed by DPI, until 2003 Wisconsin Act 33 first required the USF to fund a portion of that aid in FY 2003-04. As part of the State's efforts to address budget shortfalls, additional USF resources were used for public library aids. The USF has been the sole funding source for the Aid to Public Library Systems program since FY 2008-09.

Eleven other USF programs managed by DPI, UW System, or the PSC accounted for the remaining 21.5 percent of program expenditures in FY 2011-12:

- BadgerLink is a DPI program that funds statewide public access to information resources available in Wisconsin's public, school, academic, and special libraries. These resources include online access to the full text of numerous magazines, journals, newspapers, reference publications, and other licensed material. BadgerLink also connects users to WISCAT, the online catalog of Wisconsin library holdings, and to other information resources.
- Newslines for the Blind is a DPI program that funds a contract with the National Federation of the Blind to provide telephone and online access to audio versions of national and some local newspapers for sight-impaired individuals.
- Library Service Contracts is a DPI program that funds contracts for specialized library materials and information provided by the Milwaukee Public Library, Wisconsin Library Services, the Wisconsin Regional Library for the Blind and Physically Handicapped, and the Cooperative Children's Book Center. Before FY 2009-10, the contracts had been funded with GPR.
- UW System BadgerNet Access helps to fund access to the BadgerNet Converged Network for certain UW campuses.
- The Telecommunications Equipment Purchase Program (TEPP), Lifeline, High Rate Assistance Credit, Medical Telecommunications Equipment, the Nonprofit Access Program, and Two-Line Voice Carryover are six programs currently

operated by the PSC to either provide access to basic telephone and information services for individuals with low incomes or disabilities, lessen the financial impacts of service rate increases on individuals with low incomes, or assist nonprofit medical clinics and public health agencies in purchasing medical telecommunications equipment. A seventh program operated by the PSC during our audit period, Link-Up, was suspended in April 2012, except for individuals living on tribal lands. This suspension was implemented to allow time for the PSC to reconsider the program, particularly with respect to prepaid wireless providers.

Program Funding and Fund Balance

The PSC applied \$4.3 million of USF cash to offset provider assessments for FY 2012-13.

Statutes require most telecommunications providers in Wisconsin to contribute to the USF. The PSC is responsible for designating the method by which contributions are calculated and collected. Each October, the PSC determines the rates that will be used to assess each telecommunications provider for its share of contributions. The assessment rates should ensure that revenues collected in the current year and any unspent revenues collected in the prior year are sufficient to cover current year appropriations. However, the PSC has not always considered unspent revenues when establishing annual assessment rates for programs operated by other agencies. As a result, a cash balance accumulated in the USF. In response to our audit inquiries concerning the cash balance, the PSC applied \$4.3 million in available cash to offset provider assessments during FY 2012-13. The PSC has indicated that it will evaluate the overall fund balance at the end of FY 2012-13 to determine if an additional offset of provider assessments is appropriate when setting the rates for FY 2013-14. We note that 2013 Assembly Bill 40, the Governor's 2013-15 biennial budget proposal, creates a broadband grant program funded by \$4.7 million in USF funds. This program would be administered by DOA, in consultation with PSC, to expand broadband access in underserved areas.

As noted in report 11-10, 2009 Wisconsin Act 28 required Commercial Mobile Radio Service (CMRS) providers, including cell phone providers, to be assessed for USF program and administrative costs beginning in September 2009. However, the PSC was not able to begin making assessments until the following month. The PSC ultimately determined that retroactively calculating and collecting assessments from CMRS providers for the month of September 2009 would impose "excessive administrative burdens" on the PSC and

on CMRS providers. Therefore, based on its authority under s. 196.218(3)(d), Wis. Stats., the PSC determined that the public interest was better served by not retroactively assessing CMRS providers for USF contributions for September 2009.

Follow-Up to Fiscal Management Issue

DOA charges the USF an administrative fee for services, such as help desk assistance, provided to users of the BadgerNet Converged Network that participate in the Educational Telecommunications Access Program. Tribes, counties, and certain other entities that also use the BadgerNet Converged Network but do not participate in the Educational Telecommunications Access Program also pay DOA an administrative services fee.

We estimate \$4.3 million of the surplus balance in a DOA appropriation is attributable to fees paid by the USF.

We found that the amount charged for administrative services was greater than the cost of providing the services and, in report 11-10, we recommended DOA review the fee to ensure it reflects only the actual costs of providing those services. In response, in November 2011, DOA reduced the administrative services fee charged the USF from 15 percent to 10 percent. Despite this reduction, the ending cash balance in the appropriation used to account for these fees under s. 20.505(1)(is), Wis. Stats., increased by \$1.7 million during FY 2011-12 and totaled \$5.4 million as of June 30, 2012. We estimate that at least \$4.3 million, or 80 percent, of the surplus balance can be attributed to the administrative services fee paid by the USF.

Recommendation

We again recommend that the Department of Administration ensure that the fee it charges the Universal Service Fund for administrative services related to the BadgerNet Converged Network reflects only the actual costs of providing those services.

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Audit Opinion ■

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

We have audited the accompanying financial statements of the Universal Service Fund of the State of Wisconsin as of and for the years ended June 30, 2012, and June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the Universal Service Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 audit provides 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 as of June 30, 2012, or June 30, 2011, the changes in its financial position, or where applicable, its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.


In our opinion, based on our audit, 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, 2012, and June 30, 2011, 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.

As discussed in Note 2E, beginning with FY 2010-11, the Universal Service Fund implemented Governmental Accounting Standards Board Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Statement Number 54 established a hierarchy of five new fund balance reporting classifications for financial statement purposes.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 27, 2013, on our consideration of the Universal Service Fund's internal control over financial reporting; 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.

Our audit was 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 11 through 17 is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures to the information, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

March 27, 2013

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Deputy State Auditor for Financial Audit

Management's Discussion and Analysis ■

Prepared by Public Service Commission Management

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

The PSC is an independent regulatory agency of the State of Wisconsin that is responsible for the regulation of public utilities, including electric, natural gas, telephone, water, and combined water and sewer facilities. One of the PSC's responsibilities is to administer the USF. The USF was originally established to further the goal of providing both basic essential telecommunications services and access to advanced service capabilities to telecommunications service customers in Wisconsin. 2011 Wisconsin Act 22 eliminated providing access to advanced telecommunications services as a purpose of PSC-operated programs.

Overview of the Financial Statements

The USF 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 USF's finances that assists in determining whether there will be adequate resources available to meet the current needs of the USF. The financial statements include:

- the Balance Sheet, which presents only assets expected to be used and liabilities that come due during the next fiscal year and reports the difference between assets and liabilities as the Fund Balance; and
- the Statement of Revenues, Expenditures, and Changes in Fund Balance, which 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, 2012, 2011, and 2010 are shown in the following tables.

Table A

A Comparison of Condensed Financial Information for FY 2011-12 and FY 2010-11

	June 30, 2012	June 30, 2011	Change	
			Amount	Percentage
Total Assets	\$12,953,386	\$10,095,345	\$2,858,041	28.3%
Total Liabilities	3,279,004	1,922,825	1,356,179	70.5
Fund Balance	\$ 9,674,382	\$ 8,172,520	\$1,501,862	

	FY 2011-12	FY 2010-11	Change	
			Amount	Percentage
Total Revenues	\$42,354,387	\$45,475,210	\$(3,120,823)	(6.9)%
Total Expenditures	40,852,525	44,501,923	(3,649,398)	(8.2)
Total Other Financing Uses	0	1,236,700 ¹	(1,236,700)	(100.0)
Excess of Revenues over Expenditures and Other Uses	\$ 1,501,862	\$ (263,413)	\$ 1,765,275	

¹ Represents transfers from the USF to the General Fund. These transfers were directed by DOA to meet lapse requirements for the 2009-11 biennium.

Table B

A Comparison of Condensed Financial Information for FY 2010-11 and FY 2009-10

	June 30, 2011	June 30, 2010	Change	
			Amount	Percentage
Total Assets	\$10,095,345	\$10,198,913	\$(103,568)	(1.0)%
Total Liabilities	1,922,825	1,762,980	159,845	9.1
Fund Balance	\$ 8,172,520	\$ 8,435,933	\$(263,413)	

	FY 2010-11	FY 2009-10	Change	
			Amount	Percentage
Total Revenues	\$45,475,210	\$51,711,536	\$(6,236,326)	(12.1)%
Total Expenditures	44,501,923	42,507,727	1,994,196	4.7
Total Other Financing Uses	1,236,700 ¹	1,236,700 ¹	0	0.0
Excess of Revenues over Expenditures and Other Uses	\$ (263,413)	\$ 7,967,109	\$(8,230,522)	

¹ Represents transfers from the USF to the General Fund. These transfers were directed by DOA to meet lapse requirements for the 2009-11 biennium.

The USF's total revenues of \$42.4 million in FY 2011-12, \$45.5 million in FY 2010-11, and \$51.7 million in FY 2009-10 consisted of assessed revenue and interest income. The PSC assesses telecommunications providers, as required by statute and administrative rule, over a 12-month period to fund amounts appropriated from the USF.

Approximately 86 percent of total assessed revenues for FY 2011-12, as well as 88 percent of total assessed revenues for FY 2010-11 and 89 percent of total assessed revenues for FY 2009-10, were intended for six programs the PSC does not manage: the Educational Telecommunications Access Program, which is managed by DOA; Aid to Public Library Systems, BadgerLink, Newslines for the Blind, and Library Service Contracts, which are managed by DPI; and UW System BadgerNet Access for University of Wisconsin campuses. The remaining revenues were used to support seven PSC-operated programs: the Telecommunications Equipment Purchase Program (TEPP), Lifeline, Link-Up, High Rate Assistance Credit, Medical Telecommunications Equipment, the Nonprofit Access Program, and Two-Line Voice Carryover.

USF revenues decreased by 12.1 percent from FY 2009-10 to FY 2010-11. This decrease was primarily the result of a one-time increase in revenues in FY 2009-10 that was not repeated in FY 2010-11. 2009 Wisconsin Act 28, the 2009-11 Biennial Budget Act, made the USF the sole source of funding for the Aid to Public Library Systems and required the PSC to assess telecommunications providers for both FY 2008-09 and FY 2009-10 programs costs in FY 2009-10. The overall decrease was mitigated slightly by a \$766,000, or 3.9 percent, increase in assessments for DPI's USF appropriations between FY 2009-10 and FY 2010-11. USF revenues decreased again from FY 2010-11 to FY 2011-12 due to a \$1.7 million, or 10 percent, decrease in the assessments for Aid to Public Libraries, and lesser reductions to assessments for Library Service Contracts and the Educational Telecommunications Access Program for school districts. There was no change in assessments for UW System BadgerNet Access in FY 2009-10, FY 2010-11, or FY 2011-12.

Appropriations for the DPI programs under 2009 Wisconsin Act 28 continued the trend of using the USF for funding the Aid to Public Library Systems in place of GPR. USF appropriations for Aid to Public Library Systems began in FY 2003-04 at \$2.1 million and have increased in the intervening years to \$16.7 million in FY 2010-11. That trend changed under 2011 Wisconsin Act 32, the 2011-13 Biennial Budget Act, when Aid to Public Library Systems was reduced to \$15.0 million for FY 2011-12.

Total expenditures for the Educational Telecommunications Access Program have steadily increased over the years to reach \$16.8 million in FY 2009-10, and peaking at \$17.0 million in FY 2010-11. This program grows in two ways: 1) the customer base expands to include additional schools and libraries; and 2) the current customers have a justified need to increase their existing bandwidth. This growth results in an increase in annual expenditures under this program. Expenditures can also be reduced due to a decrease in the cost of services or program participation. This was the case in FY 2011-12 when the expenditures declined to \$16.8 million.

Actual expenditure levels for the PSC-operated programs, including administrative costs, increased by \$1.0 million, or 20.8 percent, from FY 2009-10 to FY 2010-11 to a total of \$6.1 million. The actual expenditures for the PSC-operated programs, including administrative costs, declined by \$1.4 million from FY 2010-11 to FY 2011-12 to a total of \$4.7 million. The following tables show the year-over-year changes in expenditures for the PSC-operated programs, including administrative expenditures, for FY 2010-11 and FY 2011-12.

Table C

PSC USF Program Expenditure Changes for FY 2010-11

	FY 2010-11	FY 2009-10	Dollar Change	Percentage Change
TEPP	\$1,636,955	\$1,903,538	\$ (266,583)	(14.0)%
High Rate Assistance Credit	11,414	11,420	(6)	(0.1)
Lifeline	2,879,719	1,864,758	1,014,961	54.4
Link-Up	290,531	394,175	(103,644)	(26.3)
Medical Telecommunications Equipment	682,839	295,758	387,081	130.9
Nonprofit Access Program	301,934	249,006	52,928	21.3
Two-Line Voice Carryover	8,979	5,895	3,084	52.3
Administrative Expenditures	285,065	323,938	(38,873)	(12.0)
Total	\$6,097,436	\$5,048,488	\$1,048,949	

Table D

PSC USF Program Expenditure Changes for FY 2011-12

	FY 2011-12	FY 2010-11	Dollar Change	Percentage Change
TEPP	\$1,404,083	\$1,636,955	\$ (232,872)	(14.2)%
High Rate Assistance Credit	4,890	11,414	(6,524)	(57.2)
Lifeline	2,076,446	2,879,719	(803,273)	(27.9)
Link-Up	139,163	290,531	(151,368)	(52.1)
Medical Telecommunications Equipment	216,286	682,839	(466,553)	(68.3)
Nonprofit Access Program	430,311	301,934	128,377	42.5
Two-Line Voice Carryover	9,821	8,979	842	9.4
Administrative Expenditures	369,666	285,065	84,601	29.7
Total	\$4,650,666	\$6,097,436	\$(1,446,770)	

Of the larger PSC-operated programs, Lifeline and Link-Up had the most significant changes in expenditures. Lifeline expenditures increased by \$1.0 million from FY 2009-10 to FY 2010-11, but in the following year they decreased by \$0.8 million to \$2.1 million in FY 2011-12. The FY 2010-11 increase was largely due to several new providers of prepaid wireless service aggressively marketing their Lifeline services in Wisconsin. The PSC closely monitored the rapid increases in payments to these providers and reported several potential fraud concerns to the Federal Communications Commission (FCC) and the Universal Service Administrative Company (USAC). The PSC, the FCC, and the USAC dealt with the apparent fraudulent actions in marketing and management of prepaid wireless Lifeline programs, and this significantly reduced reimbursement requests in FY 2011-12.

Expenditures for Link-Up have continued the decline that commenced in FY 2008-09. The expenditures declined \$104,000, or 26 percent, in FY 2010-11 from the FY 2009-10 levels and declined another \$151,000, or 52 percent, again in FY 2011-12. Earlier declines were in response to the PSC's actions to address growth of the Link-Up program. These more recent declines are more likely a reflection of the decline in new wireline subscriptions to Lifeline service as wireless Lifeline services were aggressively being marketed. The state USF does not generally pay a Link-Up component for wireless services. Further, several of the wireless providers that were eligible for state USF Link-Up reimbursements did not file requests for such reimbursements. Lastly, in FY 2011-12 the FCC issued an order to end the federal Link-Up program on all but services to individuals living on tribal lands. The PSC suspended its state Link-Up program, other than for services to individuals living on tribal lands, in April 2012 pending further analysis regarding the need for a state-only Link-Up program and what limits, if any, to benefits would be appropriate for such a program.

Expenditures for TEPP decreased by 14.0 percent in FY 2010-11 and then decreased by another 14.2 percent in FY 2011-12. In general, TEPP expenditures vary from year to year due to the variation in outreach done by equipment vendors as part of their marketing plans and equipment choices of the voucher recipients. The recent declines in TEPP expenditures are due to two other factors: (1) the limits on equipment purchases; and (2) a reduction in the amount for the hard-of-hearing vouchers. These changes were put in place three years ago to stem the growth of TEPP expenditures. The effects in FY 2010-11 were to significantly reduce the expenditures for the hard-of-hearing category, but were countered by a significant increase in demand in other voucher categories.

Expenditures for the Medical Telecommunications Equipment program increased 130.9 percent in FY 2010-11 but decreased 68.3 percent in FY 2011-12, while expenditures for the Nonprofit Access Program increased 21.3 percent in FY 2010-11 and increased another 42.5 percent in FY 2011-12. Fluctuations in expenditures for the Medical Telecommunications Equipment program and the Nonprofit Access Program occurred largely because of the timing of grant awards and grantee reimbursements. Grants for \$500,000 were awarded in both FY 2010-11 and FY 2011-12 for the Medical Telecommunications Equipment program. Grants

for the Nonprofit Access Program were awarded totaling \$500,000 in FY 2010-11 and \$322,000 FY 2011-12. The lower-than-budgeted grant awards in FY 2011-12 were due to provisions of 2011 Wisconsin Act 22 that changed what projects could be funded by the Nonprofit Access Program.

PSC administrative costs for the USF decreased by \$39,000, or 12.0 percent, in FY 2010-11 because some of the costs of prior improvements made to the TEPP website, the development of a telecommunications provider reimbursement website, and improved financial tracking and reporting of the USF program carried over into FY 2009-10 and there were no comparable costs in FY 2010-11. Administrative costs in FY 2011-12 increased by \$85,000, or 29.7 percent, from FY 2010-11 due to costs incurred to upgrade telecommunications providers' access to a database maintained by the Department of Health Services that is used to verify Lifeline eligibility.

This financial report is designed to provide an overview of the USF'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 Director
P.O. Box 7854
Madison, WI 53707-7854

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Financial Statements ■

Balance Sheet June 30, 2012 and 2011

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
ASSETS		
Cash and Cash Equivalents (Notes 2C and 3)	\$ 9,448,181	\$ 4,248,157
Assessments Receivable (Note 2D)	3,469,928	5,840,725
Other Receivables	6,066	6,463
Due from Other Funds	<u>29,211</u>	<u>0</u>
TOTAL ASSETS	<u>\$ 12,953,386</u>	<u>\$ 10,095,345</u>
LIABILITIES AND FUND BALANCE		
Liabilities:		
Program Liabilities:		
Educational Telecommunications Access Program	\$ 2,009,707	\$ 299,524
Lifeline	83,102	483,964
Telecommunications Equipment Purchase Program (TEPP)	237,580	210,876
Medical Telecommunications Equipment	0	59,975
Link-Up	107	46,810
Nonprofit Access Program	129,586	34,920
Library Service Contracts	383,800	446,331
High Rate Assistance Credit	95	1,892
Two-Line Voice Carryover	477	1,063
BadgerLink and Newline for the Blind	47,415	22,956
UW System BadgerNet Access	14,505	0
Accounts Payable	<u>372,630</u>	<u>314,514</u>
Total Liabilities	<u>3,279,004</u>	<u>1,922,825</u>
Fund Balance:		
Committed	<u>9,674,382</u>	<u>8,172,520</u>
Total Fund Balance	<u>9,674,382</u>	<u>8,172,520</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 12,953,386</u>	<u>\$ 10,095,345</u>

The accompanying notes are an integral part of this statement

**Statement of Revenues, Expenditures, and Changes in Fund Balance
for the Years Ended June 30, 2012 and 2011**

	Year Ended June 30, 2012	Year Ended June 30, 2011
REVENUES		
Telecommunications Providers' Assessments (Note 2D) for:		
Department of Public Instruction Programs	\$ 18,558,483	\$ 21,610,387
Educational Telecommunications Access Program	16,849,038	17,244,275
Public Service Commission Programs	5,890,441	5,518,338
UW System BadgerNet Access	<u>1,045,673</u>	<u>1,086,249</u>
Total Telecommunications Providers' Assessments	\$ 42,343,635	\$ 45,459,249
Interest Income	10,752	15,861
Other Revenue	<u>0</u>	<u>100</u>
Total Revenues	<u>42,354,387</u>	<u>45,475,210</u>
EXPENDITURES		
Program Expenditures:		
Educational Telecommunications Access Program	16,778,783	17,016,123
Aid to Public Library Systems	15,013,100	16,681,200
BadgerLink and Newline for the Blind	2,560,000	2,544,312
Lifeline	2,076,446	2,879,719
Telecommunications Equipment Purchase Program (TEPP)	1,404,083	1,636,955
UW System BadgerNet Access	1,054,800	1,054,800
Library Service Contracts	795,176	1,108,052
Link-Up	139,163	290,531
Medical Telecommunications Equipment	216,286	682,839
Nonprofit Access Program	430,311	301,934
High Rate Assistance Credit	4,890	11,414
Two-Line Voice Carryover	<u>9,821</u>	<u>8,979</u>
Total Program Expenditures	40,482,859	44,216,858
Administrative Expenditures	<u>369,666</u>	<u>285,065</u>
Total Expenditures	<u>40,852,525</u>	<u>44,501,923</u>
EXCESS OF REVENUES OVER EXPENDITURES	1,501,862	973,287
OTHER FINANCING SOURCES (USES)		
Transfer to State of Wisconsin General Fund (Note 4)	<u>0</u>	<u>1,236,700</u>
Excess of Revenues and Other Sources over Expenditures and Other Uses	1,501,862	(263,413)
FUND BALANCE		
Fund Balance—Beginning of the Year (Note 6)	<u>8,172,520</u>	<u>8,435,933</u>
Fund Balance—End of the Year	<u>\$ 9,674,382</u>	<u>\$ 8,172,520</u>

The accompanying notes are an integral part of this statement

Notes to the Financial Statements ■

1. DESCRIPTION OF THE UNIVERSAL SERVICE FUND

The Wisconsin Public Service Commission established the State of Wisconsin Universal Service Fund, as directed by 1993 Wisconsin Act 496, to ensure that all residents of Wisconsin receive essential telecommunications services and have access to advanced telecommunications service capabilities. 2011 Wisconsin Act 22 eliminated providing access to advanced telecommunications service capabilities as a purpose of PSC-operated programs. 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 USF. Act 496 also directed the PSC to contract with a private firm to administer the USF. The PSC has contracted with Wipfli LLP, an accounting firm, for these services.

The USF 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 USF in amounts sufficient to support the USF's programs and operations. The USF supports funding for telecommunications services and access provided through several state agencies, including the PSC, the University of Wisconsin System, the Department of Public Instruction, and the Department of Administration.

A description of each of the programs under which the USF incurred expenditures during FY 2011-12 and FY 2010-11 follows.

A. Educational Telecommunications Access Program

The BadgerNet Converged Network is the State's broadband voice, data, and video network provided by DOA to state agencies, local governments, UW campuses, technical colleges, public and private schools, and other eligible users. This program, which is administered by DOA, was implemented in February 1998 to provide educational institutions and other entities with subsidized access to the BadgerNet Converged Network. The educational institutions use the data lines for direct internet or intranet access, and for video links to provide for two-way interactive video that allows participants to view and respond to instructional presentations from off-site locations.

B. Aid to Public Library Systems

2003 Wisconsin Act 33 included statutory language providing that the payment of public library system aid is an authorized use of the USF. GPR provided additional funding for public library aid. Since FY 2008-09, when the GPR appropriation for public library aid was repealed by 2009 Wisconsin Act 28, the USF has provided the entirety of funding for public library aid. DPI is responsible for distributing the aid payments to 17 Wisconsin public library systems according to a statutory formula.

C. BadgerLink and Newline for the Blind

Since FY 1999-2000, the USF 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.

A contract exists between DPI and the National Federation of the Blind to provide Newline for the Blind, which is an electronic information service that provides telephone and online access for sight-impaired individuals to audio versions of major national newspapers and several local newspapers.

D. Lifeline and Link-Up Programs

Lifeline and Link-Up are separate but complementary programs administered by the State of Wisconsin and the federal government. Eligible low-income individuals may receive assistance from both the State of Wisconsin and the federal government. The state and federal Lifeline programs for wireless and wireline customers are based on a standard discount that generally reduces the cost of monthly telephone service by \$10 for certain basic services consisting of single-party residential touch-tone telephone service, including 911 emergency service. However, when the telecommunications provider's actual approved rate for these services exceeds \$25 per month, the difference is waived for eligible low-income customers so that the monthly charge

does not exceed \$15. Prepaid wireless Lifeline customers receive a set number of minutes each month equivalent to the \$10 standard discount. In addition, the state and federal Link-Up programs have provided a waiver of certain regulated service charges when low-income residential customers initiate or move telephone service. For both programs, telecommunications providers establish eligibility and request reimbursement separately from the State of Wisconsin and the federal government for each entity's share of the waived costs. The federal Link-Up program going forward only applies to individuals living on tribal lands. The state Link-Up program was suspended, other than for services to individuals living on tribal lands, in April 2012 to allow the PSC to consider what effect changes in the federal program may have on the state program.

E. Telecommunications Equipment Purchase Program (TEPP)

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 category of disability, the PSC has established a maximum dollar amount that the USF 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 USF will pay. The USF administrator issues vouchers to approved eligible disabled persons, who present them to vendors when equipment is purchased. Vendors subsequently submit the vouchers to the USF administrator for payment.

F. University of Wisconsin System BadgerNet Access

Beginning in FY 1997-98, the Legislature appropriated funds from the USF to provide funding for the BadgerNet Converged Network for four UW campuses. Funds from the USF became available to all UW System campuses beginning in FY 2007-08.

G. Library Service Contracts

2009 Wisconsin Act 28 included statutory language providing that the payment of library service contracts is an authorized use of the USF. DPI enters into annual contracts with the Milwaukee Public Library, Wisconsin Library Services, the Wisconsin Regional Library for the Blind and Physically Handicapped, and the Cooperative Children's Book Center to provide funding for specialized library materials and information. For instance, USF funds DPI's contract with the Milwaukee Public Library to process, maintain, and circulate full-length books and magazines in braille.

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. Nonprofit Access Program

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 services.

J. 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 USF reimburses telecommunications providers the value of the credits issued.

K. Two-Line Voice Carryover

This program, which was implemented in FY 2001-02, provides payment for a second telephone line to certain hearing- or speech-impaired customers who use two lines for the voice and text components of voice or speech carryover service.

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

The USF'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 USF 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 USF and are not intended to present the financial activity for the State of Wisconsin as a whole.

B. Basis of Accounting

The USF 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 USF 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.

C. Cash and Cash Equivalents

Cash and cash equivalents include a demand deposit account at a commercial financial institution and cash deposited in the State Investment Fund, a short-term investment pool of state and local funds.

D. Telecommunications Providers' Assessments

Annually, the PSC estimates the revenues needed to pay for the year's program and administrative costs up to the amounts appropriated by the Legislature. The PSC then assesses certain telecommunications providers their share of these costs based on intrastate revenues.

Telecommunications providers with intrastate gross telecommunications revenues of less than \$200,000 annually are exempt from USF assessments. Commercial Mobile Radio Service (CMRS) providers, which include cell phone providers, were assessed beginning in FY 2009-10. Telecommunications providers pay one-twelfth of the assessed amount each month. The USF recognizes telecommunications providers' assessments when due. Unpaid assessments as of June 30 are reported on the Balance Sheet as assessments receivable.

E. Fund Balance

Fund balance represents the difference between the Universal Service Fund's assets and liabilities. For FY 2011-12 and FY 2010-11, the PSC implemented GASB Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Statement Number 54 establishes a hierarchy of five new fund balance reporting classifications including nonspendable, restricted, committed, assigned, and unassigned. These classifications are based primarily on constraints placed on the use of the funds. Resources in the USF are restricted in use by s. 196.218(5), Wis. Stats. However, because restricted amounts can be transferred to the General Fund, the entire balance in the Universal Service Fund is reported as committed rather than restricted.

3. DEPOSITS

The USF's cash and cash equivalents balance consists of deposits in a commercial checking account established by the USF's administrator and shares in the State Investment Fund. Deposits in the commercial checking account are used to process payments under the telecommunications programs established by the PSC. Payments from the USF's bank account are funded by periodic transfers from the State Investment Fund. GASB Statement Number 40, *Deposit and Investment Risk Disclosures—an Amendment of GASB Statement No. 3*, requires certain disclosures related to the USF's deposits and shares in the State Investment Fund.

A. Deposits

Custodial Credit Risk for Deposits—Custodial credit risk is the risk that in the event of the failure of a financial institution, deposits may not be returned. The USF does not have a deposit policy relating to custodial credit risk. The Federal Deposit Insurance Corporation (FDIC) insures the USF's deposits for losses up to \$250,000 resulting from the failure of a financial institution. As of June 30, 2012, \$106,157 of the USF's deposits were uninsured. As of June 30, 2011, the USF's deposits were fully insured by the FDIC.

B. State Investment Fund

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 State Investment Fund is not registered with the Securities and Exchange Commission. The carrying amount of shares in the State Investment Fund, which approximates fair market value, was \$9,448,000 as of June 30, 2012, and \$4,248,000 as of June 30, 2011.

The types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17(3)(b), (ba), (bd), and (dg), Wis. Stats., and include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States and solvent financial institutions in Wisconsin, and bankers acceptances. The Investment Board's trustees may specifically approve other prudent investments.

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The State Investment Fund is unrated; however, the State Investment Fund's investment guidelines establish specific maximum exposure limits by security types based on the minimum credit ratings as issued by nationally recognized statistical rating organizations.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The State Investment Fund uses the weighted average maturity method to analyze interest rate risk. Its investment guidelines mandate that the weighted average maturity for the entire portfolio not exceed one year. The weighted average maturity of the State Investment Fund was 75 days as of June 30, 2012, and 73 days as of June 30, 2011.

4. TRANSFERS TO THE GENERAL FUND

DOA directed that \$1.2 million be transferred from the USF to the State of Wisconsin General Fund in FY 2010-11, which allowed DOA to meet lapse requirements during the 2009-11 biennium.

5. COMMITMENTS

The USF is committed to making future payments for vouchers issued but not yet redeemed by TEPP participants and for awards made to participants in the Medical Telecommunications Equipment program and the Nonprofit Access Program. These commitments are included in the amount reported as committed fund balance for financial statement purposes and not as a liability because the required invoices and supporting documentation necessary to accrue a payable had not yet been presented to the PSC. As of June 30, 2012, and June 30, 2011, the following commitments were included in the committed fund balance:

<u>Program</u>	<u>June 30, 2012</u>	<u>June 30, 2011</u>
TEPP	\$ 430,485	\$ 424,959
Medical Telecommunications Equipment	537,867	254,154
Nonprofit Access Program	<u>471,724</u>	<u>579,796</u>
	\$1,440,076	\$1,258,909

6. PRIOR-PERIOD ADJUSTMENT

The fund balance has been restated to correct for an understatement of liabilities as of June 30, 2010, associated with TEPP and Library Service Contracts. This restatement resulted in the beginning of the year fund balance for FY 2010-11 being reduced by \$402,331 from \$8,838,264 to \$8,435,933.



Report on Internal Control and Compliance ■

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

We have audited the financial statements of the State of Wisconsin Universal Service Fund as of and for the years ended June 30, 2012, and June 30, 2011, and have issued our report thereon dated March 27, 2013. We conducted our audit 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

Management of the Universal Service Fund is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the Universal Service Fund's internal control 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. Accordingly, we do not express an opinion on the effectiveness of the Universal Service Fund's internal control.

A *deficiency* in internal control 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 to detect and correct misstatements on a timely

basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or will not be detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined in the preceding paragraph.

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*.

We noted certain additional matters pertaining to an administrative services fee paid by the Universal Service Fund to the Department of Administration, as discussed on page 7. In its written response, the Department of Administration agreed to reevaluate the administrative services fee to ensure that it is reasonable and anticipates that this process will begin prior to June 30, 2013.

We did not audit the Department of Administration's response and, accordingly, express no opinion on it.

This independent auditor's report is intended solely 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 report is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the Universal Service Fund's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

March 27, 2013

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Deputy State Auditor for Financial Audit