

Report 17-11
June 2017

Universal Service Fund

FY 2015-16 and FY 2014-15

Public Service Commission

STATE OF WISCONSIN



Legislative Audit Bureau ■

Universal Service Fund FY 2015-16 and FY 2014-15

Public Service Commission

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STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman
State Auditor

June 28, 2017

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 unmodified opinion on the USF's financial statements for the fiscal years ended June 30, 2016, and June 30, 2015.


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) 2015-16, revenues from providers' assessments totaled \$41.3 million. USF expenditures of \$39.6 million supported 14 programs managed by four state agencies.

The PSC annually determines the monthly rates to assess telecommunications providers based on the funding needed to support the USF programs. In our last audit (report 15-5), we reported that the PSC did not consistently consider unspent revenue from prior years when establishing the assessment rates, and a balance accumulated in the USF. During our current audit, we again found that the PSC did not consider the balance in the USF when determining the rates, and the balance continued to increase. We recommend the PSC establish a policy related to the minimum fund balance, consider the balance for the USF when setting rates, and report by November 1, 2017, on its efforts to implement these recommendations to the Joint Legislative Audit Committee.

In report 15-5, we noted several material or significant errors that required adjustments to the USF's financial statements and notes. During our current audit, we again identified several errors in the preparation of the FY 2015-16 and FY 2014-15 financial statements and notes for the USF, and again report a material weakness in the PSC's internal control over financial reporting for the USF. We recommend the PSC report to the Joint Legislative Audit Committee by February 1, 2018, on its efforts to implement improvements. We also identified a significant deficiency in the Department of Administration's centralized cash reconciliations, which are relied upon by the PSC for the USF. Both issues are included in our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is on page 39.

A response from the PSC follows the report.

Respectfully submitted,


Joe Chrisman
State Auditor

JC/KE/ss

Introduction ■

The Universal Service Fund (USF) was originally established in 1993 to ensure that all residents of Wisconsin receive essential telecommunications services and have access to advanced telecommunications service capabilities. Since then, statutes have also authorized the use of USF funds for other purposes. Providing access to advanced telecommunications service capabilities was eliminated as a purpose of the USF by 2011 Wisconsin Act 22.

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

In fiscal year (FY) 2015-16 and FY 2014-15, the USF-funded programs were managed by four state agencies: the Department of Administration (DOA), the Department of Public Instruction (DPI), the University of Wisconsin (UW) System, and the Public Service Commission (PSC). The PSC also establishes policies and procedures for the USF and is responsible for levying assessments on telecommunications providers to fund the USF. Statutes permit providers to recover from consumers the amounts providers are assessed. The PSC contracts with a private third-party administrator to perform administrative services for the USF, as required by statute.

At the request of the PSC, we completed an independent financial audit to fulfill the requirements of s. 196.218 (2) (d), Wis. Stats. We have provided an unmodified opinion on the financial statements and related notes prepared by the PSC for the fiscal years ended June 30, 2016, and June 30, 2015.

USF Programs

In FY 2015-16, the USF expended \$39.6 million in funding for 14 programs operated by four state agencies.

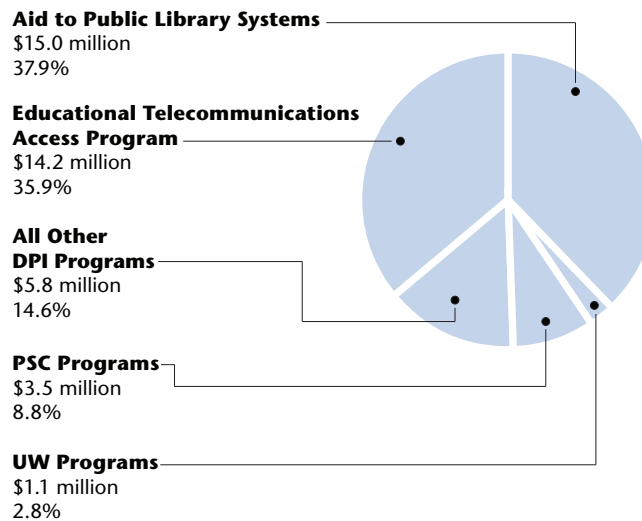
In FY 2015-16, total USF expenditures were \$40.2 million. Of this amount, \$39.6 million, or 98.5 percent, supported 14 programs managed by DOA, DPI, UW System, and the PSC. The remaining \$592,000 was for PSC administrative expenditures, which consisted largely of payments to the private third-party administrator that administered the USF and payments the PSC made to the Department of Health Services related to enhancements to the Lifeline program eligibility verification system. In FY 2014-15, total expenditures were \$39.7 million, including \$39.4 million in program expenditures.

The USF has been the sole funding source for Aid to Public Library Systems since FY 2008-09.

As shown in Figure 1, Aid to Public Library Systems, which is managed by DPI, totaled \$15.0 million and was 37.9 percent of the USF's FY 2015-16 program expenditures. The USF has been the sole funding source for Aid to Public Library Systems since FY 2008-09. Prior to FY 2008-09, the State used general purpose revenue (GPR) to fund a portion of that aid and, prior to FY 2003-04, GPR was the sole funding source for Aid to Public Library Systems.

Figure 1

USF Program Expenditures FY 2015-16



Expenditures for the Educational Telecommunications Access Program, which is managed by DOA, totaled \$14.2 million and were 35.9 percent of the USF's FY 2015-16 program expenditures. The Educational Telecommunications Access Program subsidizes the cost of access to the BadgerNet Converged Network for approximately 800 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 is a state-supported broadband network operated by a consortium of private telecommunications companies.

Beginning in FY 2015-16, the Educational Telecommunications Access Program funded two new grant programs in addition to subsidizing the cost of access to the BadgerNet Converged Network.

2015 Wisconsin Act 55, the 2015-17 Biennial Budget Act, established two new grant programs that began in FY 2015-16 under the Educational Telecommunications Access Program. Act 55 established the Educational Technology Teacher Training Grants program to fund training for teachers on the use of educational technology. Act 55 also established the Information Technology Block Grants program to fund technology infrastructure for school districts in order to better use technology for instruction. Grants under the Information Technology Block Grants program may be awarded only in FY 2015-16 and FY 2016-17.

Expenditures for the four other USF programs managed by DPI totaled \$5.8 million and were 14.6 percent of program expenditures in FY 2015-16:

- BadgerLink 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 funds a contract with the National Federation of the Blind to provide telephone and online access to audio versions of certain national and local newspapers for sight-impaired individuals.
- Digital Learning Collaborative, a new program in FY 2015-16, funds access to online courses for CESAs and students of public school districts, private schools, and charter schools.
- Library Service Contracts 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. Prior to FY 2009-10, the contracts were funded by GPR.

The PSC managed seven USF programs that expended \$3.5 million, or 8.8 percent, of program expenditures in FY 2015-16. The Telecommunications Equipment Purchase Program (TEPP), Lifeline, Two-Line Voice Carryover, High Rate Assistance Credit, Medical Telecommunications Equipment, Broadband Expansion Grant Program, and the Nonprofit Access Program 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, provide reimbursement for expenses incurred to expand broadband telecommunications infrastructure, or assist nonprofit medical clinics and public health agencies in purchasing medical telecommunications equipment. Link-Up, a program that provided basic telephone services for individuals living on tribal lands, was discontinued as of February 1, 2016.

Expenditures for UW System BadgerNet Access, which is managed by the UW System, totaled \$1.1 million and were 2.8 percent of the USF's program expenditures in FY 2015-16. UW System BadgerNet Access helps to fund access to the BadgerNet Converged Network for UW campuses.

Program Funding and Fund Balance

Statutes require most telecommunications providers in Wisconsin to contribute to the USF through monthly assessments. In June 2016, the PSC levied assessments on 173 telecommunications providers. Section 196.218 (3) (e) and (f), Wis. Stats., permits telecommunications providers to recover from consumers the amount providers are assessed. With the exception of information obtained to investigate a formal complaint, PSC staff indicated that information on consumers charged by telecommunications providers is not maintained by PSC.

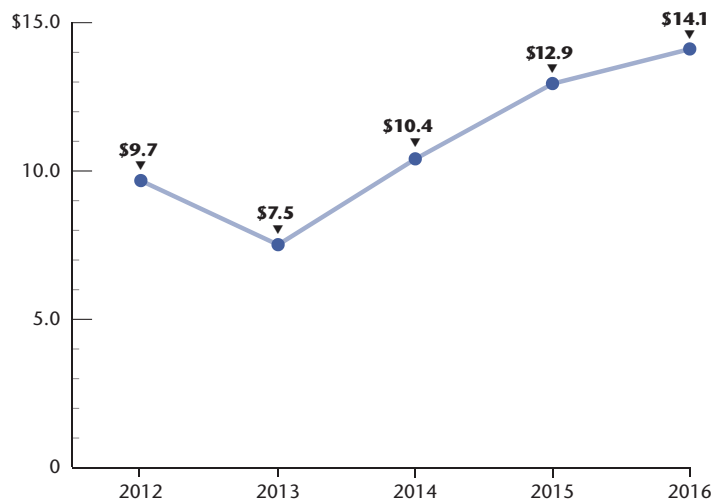
Annually in October, the PSC determines the monthly rates to assess telecommunications providers based on the funding needed to support USF programs. Based on statutes, the determination of the rates must include funding needs for all the USF programs except the Broadband Expansion Grant Program. Therefore, when setting the assessment rates, the PSC should ensure that contribution revenue collected in the current year and any unspent revenues collected in the prior years are sufficient to cover current year funding needs for those programs.

Because the PSC did not consider the balance in the USF when determining provider assessment rates, the fund balance has continued to increase.

In our last audit (report 15-5), we reported that the PSC did not consistently consider unspent revenue when establishing the assessment rates, and a balance accumulated in the USF. Although the PSC applied some available cash when determining the assessment rates in FY 2012-13, the PSC did not consider the balance when establishing the assessment rates in FY 2013-14. During our current audit, we again found that the PSC did not consider the balance in the USF when determining the assessment rates in FY 2014-15 or FY 2015-16. As a result, the fund balance has continued to increase. As shown in Figure 2, the fund balance increased each year since FY 2012-13, when PSC last applied available cash in determining the assessment rates.

Figure 2

USF Fund Balance¹
As of June 30
(in millions)



¹ On the basis of generally accepted accounting principles.

Although it is prudent to maintain a minimum balance in the USF in case of unexpected events, PSC has not developed a policy on what that minimum balance should be. Prior to setting rates in October 2017, PSC should establish a policy related to the minimum fund balance for the USF. It would be appropriate for that policy to consider the balance when setting provider assessment rates.

☑ Recommendation

We recommend the Public Service Commission:

- *establish a policy for a minimum fund balance for the Universal Service Fund prior to setting provider assessment rates in October 2017;*
- *consider the Universal Service Fund's balance when setting rates; and*
- *report to the Joint Legislative Audit Committee by November 1, 2017, on its efforts to implement these recommendations.*

Broadband Expansion

In recent years, several actions have been taken to expand broadband access in rural areas. 2013 Wisconsin Act 20, the 2013-15 Biennial Budget Act, appropriated \$500,000 of non-USF funding in FY 2013-14 and FY 2014-15 for the PSC to provide broadband expansion grants to improve broadband infrastructure in underserved areas. 2015 Wisconsin Act 55, the 2015-17 Biennial Budget Act, directed \$6.0 million of USF funding be used for the Broadband Expansion Grant Program. Act 55 also increased the total amount of grants that could be awarded annually from \$500,000 to \$1.5 million. 2015 Wisconsin Act 278 created the "Broadband Forward!" certification, which the PSC awards to cities, towns, villages, or counties after it is satisfied that obstacles to expanding broadband infrastructure have been reduced.

DOA Administrative Services Fee

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. An administrative services fee is also paid to DOA by tribes, counties, and certain other entities that also use the BadgerNet Converged Network but do not participate in the Educational Telecommunications Access Program.

DOA reviewed and reduced the administrative services fee charged to the USF from 10 percent to 3 percent, retroactive to the beginning of FY 2014-15.

In prior audits, we found that the amount charged for administrative services was greater than the cost of providing the services. After our inquiries in early 2015, DOA reviewed and reduced the administrative services fee charged to the USF from 10 percent to 3 percent, retroactive to the beginning of FY 2014-15. As of June 30, 2014, the ending cash balance in the appropriation used to account for these fees totaled \$3.7 million. The cash balance decreased to \$3.6 million as of June 30, 2016.

Internal Control Concerns

Our Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 39, includes two concerns. First, we report a material weakness related to the PSC’s internal controls over financial reporting for the USF. In report 15-5, we noted several material or significant errors that required adjustments to the USF’s financial statements and notes. During our current audit, we again identified several errors in the preparation of the FY 2015-16 and FY 2014-15 financial statements and notes for the USF. The errors occurred because the PSC did not have detailed written procedures for the preparation of the financial statements, the PSC’s understanding of the relevant information was not sufficient, and the PSC did not seek sufficient assistance from other agencies. We make recommendations for improvement in the financial reporting process for USF. We also recommend that the PSC report to the Joint Legislative Audit Committee by February 1, 2018, on its efforts to implement our recommendations. Overall, the PSC agrees with our recommendations.

Second, we report a significant deficiency in internal controls over cash reconciliations at the Department of Administration (DOA). This concern was described in greater detail in report 17-4. The PSC relies on these controls at DOA related to its administration of the USF. Due to the pervasiveness of this deficiency and its effects on state agencies and programs, this deficiency is reported to users of the USF’s financial statements. We did not request a response from the management of the PSC since DOA is responsible for corrective action.

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Audit Opinion ■



Independent Auditor's Report on the Financial Statements and Other Reporting Required by *Government Auditing Standards*

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Ms. Ellen Nowak, Chairperson
Public Service Commission

Report on the Financial Statements

We have audited the accompanying financial statements and the related notes of the Universal Service Fund (USF) of the State of Wisconsin as of and for the years ended June 30, 2016, and June 30, 2015, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management of the USF is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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*, which is 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes

evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on these financial statements.

Opinion

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the USF as of June 30, 2016, and June 30, 2015, and the respective changes in its financial position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphases of Matter

As discussed in Note 2A to the financial statements, the financial statements referred to in the first paragraph present only the USF and do not purport to, and do not, present fairly the financial position of the State of Wisconsin as of June 30, 2016, and June 30, 2015, the changes in its financial position, or where applicable, its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

As discussed in Note 2F to the financial statements, the USF implemented Governmental Accounting Standards Board Statement Number 72, *Fair Value Measurement and Application*, which addresses accounting and reporting issues related to fair value measurements.

Our opinion is not modified with respect to these matters.

Other Matter

Required Supplementary Information—Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis on pages 17 through 23 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, which considers it to be essential for placing the financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information that included inquiries of management about the methods of preparing the information. We further compared 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 do so.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated June 21, 2017, on our consideration of the USF'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 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 used when considering the USF's internal control over financial reporting and compliance.

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A handwritten signature in black ink, appearing to read "Joe Chrisman". The signature is fluid and cursive, with a long horizontal stroke at the end.

Joe Chrisman
State Auditor

June 21, 2017

Management's Discussion and Analysis ■

Prepared by Public Service Commission Management

Management's Discussion and Analysis (MD&A) is prepared by Public Service Commission (PSC) management to provide general information on the financial activities of the Universal Service Fund (USF). 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; and expenditures for which payment is due during the year or soon thereafter. 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 information as of and for the fiscal years (FYs) ended June 30, 2016; June 30, 2015; and June 30, 2014, is shown in Tables A and B.

Table A

A Comparison of Condensed Financial Information for FY 2015-16 and FY 2014-15

	June 30, 2016	June 30, 2015	Change	
			Amount	Percentage
Total Assets	\$17,725,706	\$15,078,082	\$2,647,624	17.6%
Total Liabilities	3,615,524	2,133,258	1,482,266	69.5
Fund Balance	\$14,110,182	\$12,944,824	\$1,165,358	9.0

	FY 2015-16	FY 2014-15	Change	
			Amount	Percentage
Total Revenues	\$41,353,697	\$42,239,858	\$ (886,161)	(2.1)%
Total Expenditures	40,188,339	39,702,111	486,228	1.2
Excess of Revenues over Expenditures and Other Uses	\$ 1,165,358	\$ 2,537,747	\$(1,372,389)	(54.1)

Table B

A Comparison of Condensed Financial Information for FY 2014-15 and FY 2013-14

	June 30, 2015	June 30, 2014	Change	
			Amount	Percentage
Total Assets	\$15,078,082	\$14,271,837	\$ 806,245	5.6%
Total Liabilities	2,133,258	3,864,760	(1,731,502)	(44.8)
Fund Balance	\$12,944,824	\$10,407,077	\$2,537,747	24.4

	FY 2014-15	FY 2013-14	Change	
			Amount	Percentage
Total Revenues	\$42,239,858	\$42,745,385	\$(505,527)	(1.2)%
Total Expenditures	39,702,111	39,852,451	(150,340)	(0.4)
Excess of Revenues over Expenditures and Other Uses	\$ 2,537,747	\$ 2,892,934	\$(355,187)	(12.3)

The USF's total assets increased by 5.6 percent in FY 2014-15 and then increased by 17.6 percent in FY 2015-16. The fluctuations were largely related to the fluctuations in revenues, which are discussed below. The USF's total liabilities decreased by 44.8 percent in FY 2014-15 and then increased by 69.5 percent in FY 2015-16. The fluctuations generally occurred because of the timing of typical operating activities of the Educational Telecommunications Access Program.

The USF revenues decreased by 1.2 percent from FY 2013-14 to FY 2014-15 and again decreased by 2.1 percent from FY 2014-15 to FY 2015-16 due to decreases in overall revenue needs for all programs in FY 2014-15 and TEACH and the PSC USF programs in FY 2015-16. At the same time a greater decrease in total liabilities caused the fund balance to increase by 24.4 percent in FY 2014-15 and increase by 9.0 percent in FY 2015-16.

The USF's total revenues of \$41.4 million in FY 2015-16, \$42.2 million in FY 2014-15, and \$42.7 million in FY 2013-14 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 89 percent of total assessed revenues for FY 2015-16, as well as 86 percent of total assessed revenues for FY 2014-15 and 86 percent of total assessed revenues for FY 2013-14, were intended for six programs the PSC does not manage: the Educational Telecommunications Access Program, which is managed by Department of Administration; Aid to Public Library Systems, BadgerLink, Newslines for the Blind, Library Service Contracts, and the Digital Learning Collaborative, which are managed by Department of Public Instruction (DPI); and University of Wisconsin (UW) System BadgerNet Access for UW 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.

Appropriations for the DPI programs created under 2009 Wisconsin Act 28 continued the trend of using the USF for funding Aid to Public Library Systems in place of general purpose revenue. The 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 and FY 2012-13. Aid to Public Library Systems remained at \$15.0 million for FY 2015-16. Funding for the Digital Learning Collaborative was added in 2015 Wisconsin Act 55 under DPI programs in FY 2015-16 in the amount of \$2.0 million.

Total expenditures for the Educational Telecommunications Access Program have steadily increased over the years to peak 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. These factors caused minor fluctuations in expenditures for this program. In FY 2014-15 expenditures decreased to \$16.3 million and in FY 2015-16 expenditures decreased to \$14.2 million. With 2015 Wisconsin Act 55, two TEACH grant programs were created: Information Technology Block Grants and Educational Technology Teacher Training Grants.

The Information Technology Block Grants program provides up to \$7,500,000 in funding to provide technology infrastructure to improve the capacity of school districts to utilize technology for instruction. The funding for these grants is contingent upon available funds with the TEACH program.

The Educational Technology Teacher Training Grants program provides \$1,500,000 in funding for FY 2015-16 and FY 2016-17. These grants shall be made available to consortia of three or more school districts for the purpose of training teachers on the use of educational technology. The following funding will be available: \$7,500 for districts with fewer than 750 students; \$10 per student for districts with between 750 and 1,500 students; \$15,000 for districts with more than 1,500 students. These are not additional funds to the TEACH program. They are a

reallocation of existing funds within TEACH. These TEACH grants would only be available for districts that have 13 or fewer students per square mile.

Actual expenditure levels for PSC-operated programs, including administrative costs, increased by \$183,579, or 5.2 percent, from FY 2013-14 to FY 2014-15 to a total of \$3.7 million. The actual expenditures for PSC-operated programs, including administrative costs, increased by \$355,434, or 9.5 percent, from FY 2014-15 to FY 2015-16 to a total of \$4.1 million. Funding for the Broadband Expansion Grant Program was added in FY 2015-16, which accounts for \$346,061, or 8.3 percent, of expenditures. Section 196.504, Wis. Stats., gives the PSC authority to establish criteria for evaluating grant applications. The statute requires that the criteria adopted by the PSC give priority to applications that include any of seven priority factors listed in the statute. Tables C and D show the year-over-year changes in expenditures for PSC-operated programs, including administrative expenditures, for FY 2014-15 and FY 2015-16.

Table C

PSC USF Program Expenditure Changes for FY 2014-15

	FY 2014-15	FY 2013-14	Dollar Change	Percentage Change
TEPP	\$1,365,516	\$1,446,773	\$ (81,257)	(5.6)%
High Rate Assistance Credit	726	1,005	(279)	(27.8)
Lifeline	1,031,977	1,362,384	(330,407)	(24.3)
Link-Up	0	0	0	-
Medical Telecommunications Equipment	632,727	183,174	449,553	245.4
Nonprofit Access Program	435,016	305,318	129,698	42.5
Two-Line Voice Carryover	10,470	16,245	(5,775)	(35.5)
Administrative Expenditures	264,646	242,600	22,046	9.1
Total	\$3,741,078	\$3,557,499	\$183,579	5.2

Table D
PSC USF Program Expenditure Changes for FY 2015-16

	FY 2015-16	FY 2014-15	Dollar Change	Percentage Change
TEPP	\$1,328,263	\$1,365,516	\$ (37,253)	(2.7)%
High Rate Assistance Credit	52	726	(674)	(92.8)
Lifeline	899,599	1,031,977	(132,378)	(12.8)
Link-Up	0	0	0	-
Medical Telecommunications Equipment	412,636	632,727	(220,091)	(34.8)
Nonprofit Access Program	512,285	435,016	77,269	17.8
Two-Line Voice Carryover	5,830	10,470	(4,640)	(44.3)
Broadband Expansion Grant Program	346,061	0	346,061	-
Administrative Expenditures	591,786	264,646	327,140	123.6
Total	\$4,096,512	\$3,741,078	\$355,434	9.5

Of the larger PSC-operated programs, Lifeline has had a significant change in expenditures from FY 2013-14 to FY 2015-16. Lifeline expenditures decreased by \$330,407 from FY 2013-14 to FY 2014-15, and then further decreased in the following year by \$132,378 to \$0.9 million in FY 2015-16. The decrease for FY 2014-15 was largely due to several changes made by the Federal Communications Commission (FCC) to limit fraud and abuse in prepaid wireless services. The PSC closely monitored the rapid increases in payments to these providers in prior years and reported several potential fraud concerns to the 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 reduced reimbursement requests in FY 2014-15. In FY 2015-16, the amount decreased by 12.8 percent due to state-required adjustments to telecommunications providers' annual recertification under federal procedures that had resulted in disenrollment of large numbers of qualified households.

Expenditures for Link-Up remained at zero in FY 2015-16. In FY 2013-14, 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. There were no requests for reimbursement for the state Link-Up program in FY 2015-16, and Link-Up was removed from state USF support in rule revisions to ch. PSC 160, Wis. Admin. Code, that went into effect February 1, 2016.

Expenditures for TEPP decreased by 5.6 percent in FY 2014-15 and decreased by 2.7 percent in FY 2015-16. 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. There have been no changes in the limits on equipment purchases or in the voucher amounts; however, overall, prices have been declining for the specialized equipment purchased with TEPP vouchers. In addition, smart phones and the Internet now offer more features and services that meet the needs of individuals with disabilities without the use of a TEPP voucher.

Expenditures for the Medical Telecommunications Equipment program increased 245.4 percent in FY 2014-15 but decreased 34.8 percent in FY 2015-16. Expenditures for the Nonprofit Access Program increased 42.5 percent in FY 2014-15 and increased 17.8 percent in FY 2015-16. 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 the Medical Telecommunications Equipment program were awarded \$500,000 in both FY 2014-15 and FY 2015-16. Grant recipients tend to make use of the majority of their grant funds in the first year of the two-year grant cycle, causing the large shifts in year-over-year expenses. Grants for the Nonprofit Access Program were awarded totaling \$498,985 in FY 2014-15 and \$500,000 in FY 2015-16. The lower-than-budgeted grant awards in prior fiscal years were due to provisions of 2011 Wisconsin Act 22 that changed what projects could be funded by the Nonprofit Access Program. For example, in FY 2013-14, grants awarded totaled \$341,000. With aggressive information and education efforts regarding what projects are still eligible, and broader distribution of the request for grant proposals, the requests for Nonprofit Access Program grants are now on target with budgeted amounts.

PSC administrative costs for the USF increased by \$22,046, or 9.1 percent, in FY 2014-15 due to higher third-party web-hosting fees and other administrative fees that can fluctuate from year to year. Administrative costs in FY 2015-16 increased by \$327,140, or 123.6 percent, from FY 2014-15 due to the first two invoices for work performed to upgrade the CALER Lifeline eligibility verification system, which resulted in payments of \$328,484 to Wisconsin Department of Health Services for costs related to this upgrade.

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



Financial Statements ■

Balance Sheet
June 30, 2016, and June 30, 2015

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
ASSETS		
Cash and Cash Equivalents (Notes 2C and 3)	\$ 15,620,582	\$ 12,545,372
Assessments Receivable (Note 2D)	2,098,024	2,522,910
Due from Other Funds	<u>7,100</u>	<u>9,800</u>
TOTAL ASSETS	<u>\$ 17,725,706</u>	<u>\$ 15,078,082</u>
LIABILITIES AND FUND BALANCE		
Liabilities:		
Program Liabilities:		
Educational Telecommunications Access Program	\$ 1,542,919	\$ 1,039,260
BadgerLink and Newslite for the Blind	21,933	24,169
Telecommunications Equipment Purchase Program (TEPP)	165,185	226,117
Lifeline	196,021	156,027
Library Service Contracts	480,178	452,408
UW System BadgerNet Access	0	0
Nonprofit Access Program	115,528	114,939
Medical Telecommunications Equipment	63,716	95,370
Two-Line Voice Carryover	162	689
High Rate Assistance Credit	0	61
Digital Learning Collaborative	496,218	0
Broadband Expansion Grant Program	<u>181,269</u>	<u>0</u>
Total Program Liabilities	<u>3,263,129</u>	<u>2,109,040</u>
Accounts Payable	352,395	24,218
Due to Other Funds	<u>0</u>	<u>0</u>
Total Liabilities	<u>3,615,524</u>	<u>2,133,258</u>
Fund Balance:		
Committed	<u>14,110,182</u>	<u>12,944,824</u>
Total Fund Balance	<u>14,110,182</u>	<u>12,944,824</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 17,725,706</u>	<u>\$ 15,078,082</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, 2016, and June 30, 2015**

	For the Year Ended June 30, 2016	For the Year Ended June 30, 2015
REVENUES		
Telecommunications Providers' Assessments (Note 2D) for:		
Department of Public Instruction Programs	\$ 20,908,291	\$ 18,546,562
Educational Telecommunications Access Program	14,871,453	16,781,596
Public Service Commission Programs	4,492,555	5,859,983
UW System BadgerNet Access	1,046,632	1,042,217
Total Telecommunications Providers' Assessments	<u>41,318,931</u>	<u>42,230,358</u>
Interest Income	34,766	9,500
Other Revenue	0	0
Total Revenues	<u>41,353,697</u>	<u>42,239,858</u>
EXPENDITURES		
Program Expenditures:		
Educational Telecommunications Access Program	14,202,784	16,267,600
Aid to Public Library Systems	15,013,100	15,013,100
BadgerLink and Newsline for the Blind	2,766,059	2,678,973
Telecommunications Equipment Purchase Program (TEPP)	1,328,263	1,365,516
Digital Learning Collaborative	1,999,944	0
Lifeline	899,599	1,031,977
Library Service Contracts	1,055,140	946,560
UW System BadgerNet Access	1,054,800	1,054,800
Nonprofit Access Program	512,285	435,016
Medical Telecommunications Equipment	412,636	632,727
Broadband Expansion Grant Program	346,061	0
Two-Line Voice Carryover	5,830	10,470
High Rate Assistance Credit	52	726
Total Program Expenditures	<u>39,596,553</u>	<u>39,437,465</u>
PSC Administrative Expenditures	591,786	264,646
Total Expenditures	<u>40,188,339</u>	<u>39,702,111</u>
EXCESS OF REVENUES OVER EXPENDITURES	1,165,358	2,537,747
FUND BALANCE		
Fund Balance—Beginning of the Year	12,944,824	10,407,077
Fund Balance—End of the Year	<u><u>\$ 14,110,182</u></u>	<u><u>\$ 12,944,824</u></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 (PSC) established the State of Wisconsin Universal Service Fund (USF), 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 (UW) System, the Department of Public Instruction (DPI), and the Department of Administration (DOA).

A description of each of the programs under which the USF incurred expenditures during fiscal year (FY) 2015-16 and FY 2014-15 follows.

A. Educational Telecommunications Access Program

The BadgerNet Converged Network is a state-supported broadband voice, data, and video network. The Educational Telecommunications Access Program, which is managed by DOA and was implemented in February 1998, provides 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.

i) Information Technology Block Grants

This grant program is administered by DOA and is authorized by ss. 16.994 and 196.218 (5) (a) 12., Wis. Stats. Grant awards under this program were limited to \$7,500,000 in FY 2015-16 to provide technology infrastructure to improve the capacity of school districts to utilize technology for instruction.

ii) Educational Technology Teacher Training Grants

This grant program is administered by DOA and is authorized by ss. 16.996 and 196.218 (5) (a) 12., Wis. Stats. Grant awards under this program were limited to \$1,500,000 in FY 2015-16 for the purpose of training teachers on the use of educational technology.

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. General purpose revenue (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 Newsline 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. 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.

E. 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. As of April 2012, the federal and state Link-Up programs only provide waivers to individuals living on tribal lands. 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.

F. 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, the USF funds DPI's contract with the Milwaukee Public Library to process, maintain, and circulate full-length books and magazines in braille.

G. UW 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.

H. 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 for individuals with disabilities, low-income households, and those affected by the high costs of telecommunications services.

I. 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.

J. 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.

K. High Rate Assistance Credit

This program, which was implemented in May 1996, lessens 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.

L. Digital Learning Collaborative

In FY 2015-16, the Legislature added an appropriation under DPI for the Digital Learning Collaborative to fund the Digital Learning Academy, collaborative content, and online courses and instruction.

M. Broadband Expansion Grant Program

The Broadband Expansion Grant Program is funded from the balance in the USF. This grant program is not supported by the USF assessment on telecommunications providers, but instead is paid for with unobligated funds in the USF account. This grant program is administered by the PSC and is authorized by ss. 20.155 (3) (r), 196.218 (5) (a) 10., and 196.504, Wis. Stats. Grant awards under this program were limited to \$1,500,000 in FY 2015-16.

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 shares in the State Investment Fund, a short-term investment pool of state and local funds, and cash deposited in the State of Wisconsin's bank awaiting transfer to the State Investment Fund.

D. Telecommunications Providers' Assessments

Annually, the PSC estimates the revenues needed to pay for the fiscal 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 the USF assessments. Commercial Mobile Radio Service (CMRS) providers, which include cell phone providers, were assessed beginning in FY 2009-10. Telecommunications providers generally 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 USF's assets and liabilities. GASB Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, establishes a hierarchy of five fund balance reporting classifications including non-spendable, 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 USF is reported as committed rather than restricted.

F. Fair Value Measurement and Application

GASB issued Statement Number 72, *Fair Value Measurement and Application*, effective beginning FY 2015-16. This statement was issued to address accounting and financial reporting issues related to fair value measurements. The effect of this change is detailed in Note 3.

3. DEPOSITS

The USF's cash and cash equivalents balance consists of shares in the State Investment Fund and amounts deposited in the State of Wisconsin's bank awaiting transfer to 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, 2016, and June 30, 2015, none of the USF's deposits were uninsured by the FDIC. A state appropriation for losses on public deposits (s. 34.08, Wis. Stats.) insures up to \$400,000 over the amount of federal insurance.

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 \$15,713,000 as of June 30, 2016, and \$12,545,000 as of June 30, 2015.

The fair value of the investment in the State Investment Fund, a pooled short-term investment fund managed by the State of Wisconsin Investment Board, is based on net asset value (NAV) per share (or its equivalent), as of June 30, 2016. This is a commingled fund with the investment objective of safety of principal and liquidity while earning a competitive money market rate of return. The valuation of the underlying investments of the State Investment Fund depends on asset class and maturity date. Repurchase agreements and non-negotiable certificates of deposit are valued at cost. All other short-term debt investments with remaining maturities of up to ninety days are valued at amortized cost. Finally, all other short-term investments with remaining maturities of over ninety days are valued at fair value by third-party pricing services using a matrix-pricing technique. There are no unfunded commitments relating to the State Investment Fund, and shares of the State Investment Fund can be fully redeemed at any time with no notice or other restrictions. Further information about the investments in the State Investment Fund can be obtained from the separately issued *State Investment Fund Annual Financial Report* for the fiscal year ended June 30, 2016.

The types of securities in which the State Investment Fund may invest are enumerated in s. 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 67 days as of June 30, 2016, and 80 days as of June 30, 2015.

4. 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, 2016, and June 30, 2015, the following commitments were included in the committed fund balance:

<u>Program</u>	<u>June 30, 2016</u>	<u>June 30, 2015</u>
TEPP	\$ 638,420	\$ 573,548
Medical Telecommunications Equipment	511,558	377,641
Nonprofit Access Program	<u>831,378</u>	<u>860,980</u>
	\$1,981,356	\$1,812,169



Auditor's Report ■



Report 17-11

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Ms. Ellen Nowak, Chairperson
Public Service Commission

We have audited the financial statements and the related notes of the Universal Service Fund (USF) as of and for the years ended June 30, 2016, and June 30, 2015, and have issued our report thereon dated June 21, 2017. 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*, which is issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Public Service Commission (PSC) is responsible for establishing and maintaining effective internal control over financial reporting (internal control) for the USF. In planning and performing our audit of the financial statements, we considered the PSC's internal control related to the USF to determine the audit procedures that are appropriate in the circumstances 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 PSC's internal control. Accordingly, we do not express an opinion on the effectiveness of the PSC'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 misstatements, 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 USF's financial statements will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we identified certain deficiencies in internal control that we consider to be a material weakness or significant deficiency. We consider the deficiency related to the financial reporting process, described in Finding 1 in the accompanying schedule of findings and responses, to be a material weakness. Finding 2 in the accompanying schedule of findings and responses reports a significant deficiency for the year ended June 30, 2016, that we identified with controls over the reconciliation of cash at the Department of Administration (DOA). We believe this deficiency should be reported to the users of the financial statements of the USF.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the USF's financial statements are free from material misstatement, we performed tests of 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*.

Wisconsin Public Service Commission's Response to Findings

The PSC's written response to the finding identified in our audit is included in the accompanying schedule of findings and responses. The PSC's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering the USF's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the USF's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

June 21, 2017

SCHEDULE OF FINDINGS AND RESPONSES

Finding 1: Financial Reporting Process

The PSC is responsible for preparing the financial statements, including the related notes, for the USF. In fulfilling that responsibility, the PSC must maintain effective internal controls that ensure the financial statements are fairly presented and that misstatements are prevented, or detected and corrected in a timely manner.

In our last audit (report 15-5), we reported a material weakness because the PSC did not maintain effective internal controls over financial reporting for the USF. We recommended the PSC take steps to prevent or detect errors in the preparation of the USF's financial statements and notes, including implementing a thorough secondary review process. Although the PSC hired an additional accountant who focused on the USF, it did not implement a secondary review process and did not have detailed written procedures documenting the process for preparing the financial statements.

During our current audit, we again found that the PSC did not maintain effective internal controls over financial reporting. We identified several errors in the preparation of the FY 2014-15 and FY 2015-16 financial statements and notes for the USF. For example the PSC:

- did not accurately compute and record adjusting journal entries to accrue program liabilities and expenditures. As a result, Lifeline liabilities and expenditures for FY 2015-16 were overstated by \$198,348, Digital Learning Collaborative liabilities and expenditures for FY 2015-16 were understated by \$149,944, Medical Telecommunications Equipment expenditures for FY 2015-16 were understated by \$67,868, and Library Service Contracts expenditures for FY 2015-16 were understated by \$51,435.
- incorrectly classified certain program liabilities. Most significantly, \$63,716 of Medical Telecommunications Equipment liabilities was incorrectly classified as Lifeline liabilities for FY 2015-16.
- used plug amounts to ensure the financial statements were appropriately stated for FY 2014-15 and FY 2015-16. However, PSC was unable to identify the underlying cause that resulted in the need for these entries.
- did not adequately consider the requirements of Governmental Accounting Standards Board Statement Number 72, *Fair Value Measurement and Application*, which was first effective for the FY 2015-16 financial statements. As a result, fair value measurement information was not initially included in the notes to the USF financial statements.

The errors in preparing the USF financial statements and notes occurred because the PSC did not have detailed written procedures for the preparation of the financial statements that included assessing changes in reporting requirements and a secondary review of the financial statements. In addition, the PSC's understanding of the information relevant to the preparation

of the financial statements, including information received from other agencies or its third-party administrator, was not sufficient to ensure the accurate determination of the necessary adjusting journal entries. Further, the PSC did not seek sufficient assistance from other agencies that administer programs funded by the USF to determine the appropriate adjusting journal entries for those programs.

Recommendation

We recommend that the Public Service Commission:

- *develop detailed written procedures for preparing the financial statements for the Universal Service Fund that include assessing changes in financial reporting requirements and proactively implementing relevant changes;*
- *seek additional assistance from other agencies that operate programs funded by the Universal Service Fund to determine the necessary and appropriate adjusting journal entries for these programs;*
- *implement a thorough secondary review process that includes a review of the adjusting journal entries and the compilation of the financial statements for the Universal Service Fund; and*
- *report to the Joint Legislative Audit Committee by February 1, 2018, on its efforts to implement these recommendations.*

Public Service Commission Response: Thank you for the opportunity to respond. The PSC welcomes the input provided by these audits to better address our financial controls and processes as they relate to financial and programmatic oversight of the Universal Service Fund. As with any small financial unit, establishing strong internal controls can become cumbersome and difficult with so few staff to provide those defined layers of control. The PSC agrees with the recommendations and would like to provide comments and updates related to those recommendations.

After our FY 2011-2013 audit, our Budget Director updated every journal entry with notes that detail procedures for the preparation of the USF's financial statements and notes, including implementing a thorough secondary review process. These procedures footnote where to derive the information for Department of Public Instruction Library Aids, Library Service Contracts and BadgerLink expenditures, and State Investment Fund. The procedures also include details on completing the manual accounting documents required in the preparation of the USF financial statements. For this audit cycle, the PSC will take a further step in creating a written manual that will encompass these notes in detailed document that fiscal staff can easily access from our document management system.

We fully agree with seeking additional assistance from other agencies, and will work with each agency to establish a new process that will allow a timelier review of accruals on a fiscal-year basis.

We hired a dedicated accountant to provide the first-step review, with our Budget Director providing a second set of eyes. While we feel that this was sufficient and that the errors noted in this audit cycle were non-material in nature, we will look to establishing an even more robust review process internally.

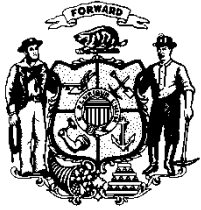
We fully agree with reporting to the Joint Legislative Audit Committee by February 1, 2018, and will work with the Committee to provide an update of our efforts.

Finding 2: Cash Reconciliations at the Department of Administration

DOA is responsible for performing certain centralized internal control functions related to cash. State agencies, including the PSC, rely on these controls. As part of our separate audit of DOA, we identified a significant deficiency in the centralized controls related to cash. This weakness related to the lack of complete and timely reconciliations of cash reported by the bank with cash balances reported in the State's central accounting system. This control is important to ensure cash balances are accurate and to ensure all receipts and disbursements have been properly recorded. Due to the pervasiveness of the deficiency and its effects on state agencies and programs, this deficiency is reported to the users of the financial statements of the USF. We communicated this weakness to DOA, who agreed with the finding. DOA's response is included in our separate report (report 17-4) related to the State's FY 2015-16 Comprehensive Annual Financial Report. We did not request a response from the management of the PSC since DOA is responsible for corrective action.

■ ■ ■ ■

Response ■



Public Service Commission of Wisconsin

Ellen Nowak, Chairperson
Mike Huebsch, Commissioner
Lon Roberts, Commissioner

610 North Whitney Way
P.O. Box 7854
Madison, WI 53707-7854

June 26, 2017

Mr. Joe Chrisman, State Auditor
Legislative Audit Bureau
22 E. Mifflin Street, Suite 500
Madison, WI 53703

Dear Mr. Chrisman:

Thank you for the opportunity to respond to the Legislative Audit Bureau's (LAB) draft Universal Service Fund (USF) Audit Report. The Commission welcomes the input provided by these audits to better address our financial controls and processes as they relate to financial and programmatic oversight of the Universal Service Fund. As with any small financial unit, establishing strong internal controls can become cumbersome and difficult with so few staff to provide those defined layers of control.

The 2014-2016 audit period was a tumultuous one for the Commission and the other USF program agencies given the 18-month transition of the state's financial system to the new STAR PeopleSoft ERP. Financial reporting from other state agencies was delayed due to this transition, and the Commission's small finance team was stretched thin as they took on the lion's share of the work handling the changeover for the Commission. Given that all the agencies involved in this audit were going through this substantial overhaul, resources couldn't allow for such timely review of accruals given the workload. The Commission also transitioned our long-time financial administrator to a new one midstream during this audit, which accounts for some of the non-material weaknesses identified by the LAB.

This audit identified weaknesses that, given their scope, the Commission considers non-material in nature and the LAB noted didn't need to be corrected, but given the Commission's dedication to the accuracy of financial records, it did make these changes during the audit process. There were two weaknesses noted that Commission staff either identified themselves or through the audit process were identified as not being an error.

This audit also recommends that the Commission seek additional assistance from other agencies that operate programs funded by the USF to determine the necessary and appropriate adjusting journal entries for these programs. The Commission fully agrees with this and will work with each agency to establish a new process that will allow a timelier review of accruals on a fiscal-year basis.

Since the last audit, the Commission hired a dedicated accountant to provide the first-step review, with our Budget Director providing a second set of eyes. While we feel that this was sufficient and that the errors noted in this audit cycle were non-material in nature, the

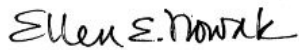
Mr. Joe Chrisman, State Auditor
Legislative Audit Bureau
Page 2

Commission will look to establish an even more robust review process internally to ensure accuracy moving forward.

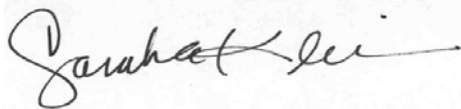
After our FY2011-2013 audit, our Budget Director updated every journal entry with notes that detail procedures for the preparation of the USF's financial statements and notes, including implementing a thorough secondary review process. These procedures footnote where to derive the information for the Department of Public Instruction Library Aids, Library Service Contracts and BadgerLink expenditures, and State Investment Fund within each spreadsheet. The procedures also include details on completing the manual accounting documents required in the preparation of the USF financial statements. While the Commission feels this documentation is sufficient, we will implement this audit's recommendation for a formal, written procedure manual.

Commission staff appreciates the collaborative nature of the audit process and would like to note that working with LAB staff during this process is always a positive experience. Thank you again for the opportunity to respond. The Commission is confident in its proactive corrections of all the issues identified in the audit. Please feel free to contact Commission staff if you require additional information or have any questions.

Sincerely,



Ellen Nowak, Chairperson
Public Service Commission



Sarah Klein, Administrator
Division of Business & Program Management
Public Service Commission

cc: Kendra Eppler; Rachel Inman

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