

Independent Auditor's Report on Audits of
Financial Statements of the

South Carolina Universal Service Fund

for the years ended December 31, 2012 and 2011

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Independent Auditor's Report

South Carolina Office of Regulatory Staff
Columbia, South Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of the South Carolina Universal Service Fund (the "Fund") as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Fund's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management 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*, 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 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 audit opinion.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the South Carolina Universal Service Fund, as of December 31, 2012 and 2011, and the changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 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, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, 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 audits 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 opinions or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated August 26, 2013, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

Scott and Company LLC

Columbia, South Carolina
August 26, 2013

Required Supplementary Information

South Carolina Universal Service Fund Management's Discussion and Analysis

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

The ORS is an independent regulatory agency of the State of South Carolina that is responsible for representing the public interest in the regulation of public utilities, including electric, natural gas and telephone. The ORS receives its authority and responsibilities from the State Legislature. One of the ORS's responsibilities is to administer the Fund. The Fund was established to ensure the widespread availability of affordable local exchange telephone service.

This section of the Fund's financial report represents our discussion and analysis of the financial performance during the period presented. It should be read in conjunction with the Fund's financial statements, which follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

The Balance Sheet/Statement of Net Position presents only assets expected to be used and liabilities that come due during the year or soon thereafter. The difference between assets and liabilities is reported as fund balance/net position.

The Statement of Revenues, Expenditures, and Changes in Fund Balance/Statement of Activities 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 the categories increases or decreases the fund balance/net position.

This annual report consists of two parts – management's discussion and analysis and the financial statements. The financial statements also include notes that explain key information contained in the financial statements and provide further details on select data.

FINANCIAL HIGHLIGHTS

The Fund is resized each November based on Public Service Commission of South Carolina ("PSC") orders and information reported by the telecommunication companies. The Fund has a \$2,114 fund balance/ net position at December 31, 2012.

CURRENTLY KNOWN FACTS

- Assessable revenues reported during Fund Year 2012 were down. Several factors contribute to this decline including:
 - 1) Continued South Carolina consumer migration to alternative communication services including wireless and voice over internet protocol; and
 - 2) Nationwide flat-rate calling plans and other pricing changes instituted by telecommunications carriers.
- There is "churn" in the telecommunications industry with various companies entering and exiting the market. Several companies that were contributing to the Fund have effectively removed themselves from the market.
- The current process of resizing the Fund results in using revenue data that is more than 18 months old by the time the Fund is resized. In a turbulent sector such as telecommunications, 18 months is excessive and does not allow the Fund to respond rapidly to changes in the telecommunications industry. A request to shorten the time period for resizing the Fund is pending before the PSC.
- The SC General Assembly passed the *Consumer Choice and Technology Act (Act 7)* in May 2009. This legislation allows electing telecommunications carriers to opt out of PSC regulation (S.C. Code Ann. § 58-9-576(C)). Telecommunications carriers who elect this de-regulation receive reduced distributions from the South Carolina Universal Service Fund. AT&T South Carolina elected to operate under Act 7 in October 2009 and there has been a significant reduction in the amounts disbursed to AT&T. Since 2009, AT&T's distribution from the State USF has been reduced by approximately \$24 million.
- On February 6, 2012, the FCC released an order reforming the Lifeline program. Lifeline is a government benefit program that offers a discount to eligible consumers on their telephone service. This order mandates changes to the qualification requirements and the amount of support for the Federal Lifeline and Linkup programs. The SC Lifeline program has made certain changes in order to remain in alignment with the Federal programs. To date, the FCC's changes to the Lifeline program have had no significant impact on Fund revenues or expenses.
- On June 14, 2013, the South Carolina Cable Television Association filed a motion with the PSC to require reductions in amounts drawn from the Fund. To date, the PSC has not issued a decision on this motion.

**Balances Sheets/Statements of Fund Balance (Deficit)/Net Position
as of December 31,**

	2012	2011
Assets		
Cash and cash equivalents	\$ 2,554,318	\$ 1,950,020
Accounts receivable, less allowance for doubtful accounts in 2012 and 2011 of \$14,621 and \$11,326, respectively	224,820	771,857
Prepaid expenses	762	733
Total assets	\$ 2,779,900	\$ 2,722,610
 Liabilities and Fund Balance (Deficit)/Net Position		
Distributions payable	\$ 2,664,612	\$ 2,611,595
Accounts payable	8,803	51,893
Overpayments/credits payable	104,371	80,305
Total liabilities	2,777,786	2,743,793
 Fund Balance (Deficit)/Net Position		
Non-spendable – prepaid expenses	762	733
Unassigned fund balance (deficit)/unrestricted net position	1,352	(21,916)
Total fund balance (deficit)/net position	2,114	(21,183)
Total liabilities and fund balance (deficit)/net position	\$ 2,779,900	\$ 2,722,610

**Statements of Revenues, Expenditures and Changes in Fund Deficit/Statements of Activities
for the years ended December 31,**

	2012	2011
Revenues		
Contributions	\$ 30,872,663	\$ 41,337,860
Late payment assessments	3,717	2,735
Total revenues	30,876,380	41,340,595
 Expenditures/Expenses		
Telecommunication service providers	30,539,563	40,880,959
General and administrative expenditures/expenses	313,520	322,424
Total expenditures/expenses	30,853,083	41,203,383
 Excess of revenues over expenditures/changes in net position	23,297	137,212
 Fund deficit/net position, at beginning of year	(21,183)	(158,395)
Fund balance (deficit)/net position, at end of year	\$ 2,114	\$ (21,183)

REQUEST FOR INFORMATION

The primary purpose of this financial report is to provide a general overview of the Fund's finances and to demonstrate the Fund's accountability for the money it receives and spends. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

South Carolina Office of Regulatory Staff
Attn: Finance Director
1401 Main Street, Suite 900
Columbia, SC 29201

Financial Statements

South Carolina Universal Service Fund
Balance Sheets/Statements of Net Position
as of December 31,

	2012	2011
Assets		
Cash and cash equivalents	\$ 2,554,318	\$ 1,950,020
Accounts receivable, less allowance for doubtful accounts in 2012 and 2011 of \$14,621 and \$11,326, respectively	224,820	771,857
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Total fund balance (deficit)/net position	2,114	(21,183)
Total liabilities and fund balance (deficit)/net position	\$ 2,779,900	\$ 2,722,610

The accompanying notes are an integral part of these financial statements.

South Carolina Universal Service Fund
 Statements of Revenues, Expenditures and Changes in Fund Balance (Deficit)/Net Position
 for the years ended December 31,

	2012	2011
Revenues		
Contributions	\$ 30,872,663	\$ 41,337,860
Late payment assessments	3,717	2,735
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Fund deficit /net position, at beginning of year	(21,183)	(158,395)
Fund balance (deficit)/net position, at end of year	\$ 2,114	\$ (21,183)

The accompanying notes are an integral part of these financial statements.

South Carolina Universal Service Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

General and Basis of Accounting – On October 10, 2001, the SCPSC issued Order No. 2001-996 at Docket No. 97-239-C which approved the final guidelines for the establishment of the Fund. The Fund was established to provide both universally available basic local exchange telephone service at affordable rates and to assist with the alignment of prices and/or cost recovery.

The Fund is funded by an assessment on all telecommunications service providers, with the exception of wireless providers, that provide intrastate and interstate telecommunications services in the State and is paid, via a monthly remittance advice, to the ORS. Support disbursements from the Fund are made monthly to eligible telecommunication service providers.

The Fund's financial statements have been prepared in conformity with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board ("GASB"), for the period presented. The Fund's financial statement presentation follows the guidelines of GASB No. 34, as amended, which establishes standards for financial reporting for state and local governments. The Fund is a special revenue fund of the State. These statements present the financial position and results of operations of only the activity of the Fund, and are not intended to present the financial activity for the State.

The Fund is accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheets. The statements of revenues present revenues and expenditures that result in changes in fund balance/net position.

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

For the purposes of the Fund, there are no reconciling items between the fund financial statements and the presentation on an entity-wide basis. Accordingly, the financial statements have been presented in a combined format as permitted under GASB No. 34.

The Fund has adopted GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (required implementation date of June 2011). This Statement establishes criteria for classifying governmental fund balances into specifically defined classifications. Classifications are hierarchical and are based primarily on the extent to which the Fund is bound to honor constraints on the specific purposes for which amounts in the funds may be spent. Application of the Statement requires the Fund to classify and report amounts in the appropriate fund balance classifications. The Fund's accounting and finance policies are used to interpret the nature and/or requirements of the funds and their corresponding assignment of restricted, committed, assigned, or unassigned. Fund balances are classified as follows:

Non-spendable – amounts that cannot be spent either because they are not in a spendable form, such as inventory or prepaid insurance, or because they are legally or contractually required to be maintained intact – such as a trust.

Restricted – amounts that can be spent only for specific purposes because of ordinances, state or federal laws, or externally imposed conditions by grantors or creditors.

South Carolina Universal Service Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Committed – amounts constrained to specific purposes by the Fund itself, using the highest level of decision-making authority. To be reported as committed, amounts cannot be used for any other purpose unless the Fund takes the same highest level action to remove or change the constraint.

Assigned – amounts the Fund intends to use for a specific purpose. Intent can be expressed by an official or body to which the Fund delegates the authority.

Unassigned – all amounts not included in other spendable classifications.

The Agency permits funds to be expended in the following order: restricted, committed, assigned, and unassigned.

Cash and Cash Equivalents – Cash and cash equivalents represent cash on deposit and invested in various instruments by the State Treasurer as part of the South Carolina Local Government Investment Pool (the “Pool”). Because the Pool operates as a demand deposit account, amounts invested in the Pool are classified as cash and cash equivalents.

Accounts Receivable – Receivables are payments due under normal terms requiring payment by the 30th of the month. Any accounts not paid by the 30th of the month are assessed a late payment charge of .0493% per day. Late payment charges are recorded as late payment assessments. Late payments assessed for the years ended December 31, 2012 and 2011, were \$3,717 and \$2,735 respectively.

Allowance for Doubtful Accounts – An allowance for doubtful accounts is recorded and reduces the carrying value of accounts receivable to their net realizable value. The amount of the allowance is based upon management’s estimate of currently uncollectible accounts, historical trends, current economic trends, and other factors. Bad debt expense recognized for the years ended December 31, 2012 and 2011 was \$31,885 and \$34,846, respectively.

Accounting Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenditures and affect disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenditures during the reporting period. Accordingly, actual results could differ from those estimates.

Revenue Recognition – Telecommunications companies doing business in the State are required to pay to the Fund a fixed monthly amount as determined in accordance with Fund guidelines. It is the Fund’s policy to record revenue when the revenue is both measurable and available.

South Carolina Universal Service Fund
Notes to Financial Statements

Note 2. Deposits Held by State Treasurer

The deposits of the Fund held by the State Treasurer are under the control of the State Treasurer who, by law, has sole authority for investing State funds. State law requires full collateralization of all State Treasurer balances. The State Treasurer must correct any deficiencies in collateral within seven days.

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are insured or registered or are investments for which the securities are held by the State or its agent in the State's name. Information pertaining to carrying amounts, fair value, credit and other risks as required by GASB No. 40 *Deposits and Investments – Risk Disclosures*, of the State Treasurer's investments are disclosed in the Comprehensive Annual Financial Report of the State.

Deposits held by the State Treasurer are \$2,554,318 and \$1,950,020 at December 31, 2012 and 2011, respectively.

Note 3. Income Taxes

These financial statements present the activities of the Fund. The activities of the Fund are tax-exempt since the Fund is a special revenue fund of the State; therefore, not subject to federal or state income taxes or sales, use, gross receipts or other taxes. As such, no provisions for such taxes have been reflected in the accompanying financial statements.

Note 4. Assessments

Identified carriers that are operating in the State, excluding wireless service providers, provide assessments to the Fund. The ORS searches publicly available resources to identify carriers operating in the State that are not providing assessments to the Fund. The carriers are assessed based upon the weighted average of their total revenues compared to the total revenues of all telecommunication companies operating in the State. The total assessments for the years then ended December 31, 2012 and 2011 were \$30,872,663 and \$41,337,860, respectively.

Note 5. Amounts Paid and Due to Telecommunication Service Providers

Payments to the qualified recipients are made by the State Treasurer's office as directed by the ORS. The qualified recipients receive payments in order to neutralize the revenue deficits created by mandated decreases in access charges in addition to high cost support as determined by the SCPSC. For the years ended December 31, 2012 and 2011, the Fund determined that \$30,539,563 and \$40,880,959, respectively in support payments were due to service providers.

Note 6. Related Parties

The Fund is administered by the ORS as set forth by the State of South Carolina Act 175 of 2004. For the years ended December 31, 2012 and 2011, the ORS incurred general and administration expenditures/expenses related to administration of the Fund and Lifeline/Linkup outreach in the amounts of \$263,635 and \$269,578 respectively.

South Carolina Universal Service Fund
Notes to Financial Statements

Note 7. Commitments and Contingencies

Appeals have been filed concerning either sizing or requests for additional funds by the Fund. Previously, these cases had been stayed pending the decision from the South Carolina Supreme Court. However, the stays will now be lifted and these cases will be placed on the docket of the Circuit Court for hearing.

The Fund has also received notice of claims from telecommunication companies which have filed for bankruptcy protection in various jurisdictions. To date, ORS has not filed proofs of claim in these bankruptcy cases.

Note 8. Change in Accounting Principle for New GASB Statement

During the year ended December 31, 2012, the Fund implemented the requirements of GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position." Statement 63 is effective for the Fund's fiscal year ending December 31, 2012 and provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net positions (which is the net residual amount of the other elements). This Statement requires that deferred outflows of resources and deferred inflows of resources be reported separately from assets and liabilities. This Statement also amends certain provisions of GASB Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, and related pronouncements to reflect the residual measure in the statement of financial position as net position, rather than net assets. As such, the Fund modified its government-wide financial statement presentation to incorporate these requirements.

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

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

South Carolina Office of Regulatory Staff
Columbia, South Carolina

We have audited in accordance with the 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, the financial statements of the South Carolina Universal Service Fund (the "Fund"), and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated August 26, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) 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 Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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 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 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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*.

Purpose of this Report

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

Scott and Company LLC

Columbia, South Carolina
August 26, 2013