Report on Audits of Financial Statements of the

South Carolina Universal Service Fund

for the years ended December 31, 2009 and 2008

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SCOTT McELVEEN L.L.P.

Independent Auditors' Report

South Carolina Office of Regulatory Staff
Columbia, South Carolina

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, 2009 and 2008, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Fund are intended to present the financial position and results of operations of the Fund and do not purport to and do not present fairly the financial position of the State of South Carolina and the changes in its financial position or cash flows for the periods then ended in conformity with accounting principles generally accepted in the United States of America, and do not include any other agencies, divisions or component units of the State of South Carolina.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Fund. In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the Fund as of December 31, 2009, and the respective change in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 27, 2010, on our consideration of the Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 3 thru 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Scott McElveen, L.L.P.

Columbia, South Carolina
May 27, 2010

Required Supplementary Information

South Carolina Universal Service Fund
Management's Discussion and Analysis

Management's Discussion and Analysis ("MD&A") is prepared by the Office of Regulatory Staff (the "ORS") management to provide general information on the financial activities of the 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 South Carolina Office of Regulatory Staff 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 Assets 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.

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.

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

FINANCIAL HIGHLIGHTS

In November 2008, the Fund was resized based on the South Carolina Public Service Commission orders and information reported by the telecommunication companies. Overpayments/credits payable were reduced during 2009 due to continued refinement of the revenue forecasting process. In addition, many outstanding accounts receivable issues from prior years were resolved in 2009. Gross Accounts Receivable decreased from $473,052 to $217,977.

CURRENTLY KNOWN FACTS

- Assessable revenues reported during Fund Year 2009 were down. Several factors contribute to this decline including:
  1) The South Carolina Public Service Commission decision to exclude international revenues for assessment purposes;
  2) South Carolina consumer migration to alternative communication services including wireless and voIP; and/or
  3) 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. This churn, along with various mergers and acquisitions, poses challenges for the administrators of the fund. 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 telephone carriers. A request to shorten the time period for resizing the fund is now pending before the South Carolina Public Service Commission.
- The SC General Assembly passed the *Consumer Choice and Technology Act* in May 2009. This legislation allows electing telecommunications carriers to opt out of South Carolina Public Service Commission regulation (S.C. Code Ann. § 58-9-576(C)). Telecommunications carriers who elect this de-regulation receive reduced withdrawals from the South Carolina Universal Service Fund. AT&T South Carolina elected to operate under the *Consumer Choice and Technology Act* in October 2009.

Balances Sheets/Statements of Net Assets as of December 31,

	2009	2008
Assets		
Cash and cash equivalents	**$ 6,277,994**	$ 5,310,261
Accounts receivable, less allowance for doubtful accounts in 2009 and 2008 of $42,693 and $263,958, respectively	**175,284**	209,094
Total assets	**$ 6,453,278**	$ 5,519,355
Liabilities and Fund Balance/Net Assets		
Distributions payable	**$ 5,657,394**	$ 4,269,448
Accounts payable	**2,157**	2,745
Overpayments/credits payable	**392,904**	820,086
Due to South Carolina Office of Regulatory Staff	**94,993**	—
Other liabilities	**—**	11,095
Total liabilities	**6,147,448**	5,103,374
Fund Balance/Net Assets		
Reserved fund balance/restricted net assets	**305,830**	415,981
Total fund balance/net assets	**305,830**	415,981
Total liabilities and fund balance/net assets	**$ 6,453,278**	$ 5,519,355

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

	2009	2008
Revenues		
Contributions	**$ 52,459,474**	$ 53,954,766
Late payment assessments	**7,587**	10,706
Total revenues	**52,467,061**	53,965,472
Expenditures/Expenses		
Telecommunication service providers	**52,286,642**	53,224,278
General and administrative expenditures/expenses	**290,570**	535,091
Total expenditures/expenses	**52,577,212**	53,759,369
(Deficiency) excess of revenues (under) over expenditures/changes in net assets	**(110,151)**	206,103
Fund balance/net assets, at beginning of year	**415,981**	209,878
Fund balance/net assets, at end of year	**$ 305,830**	$ 415,981

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 Assets
as of December 31,

	2009	2008
Assets		
Cash and cash equivalents	**$ 6,277,994**	$ 5,310,261
Accounts receivable, less allowance for doubtful accounts in 2009 and 2008 of $42,693 and $263,958, respectively	**175,284**	209,094
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Total liabilities and fund balance/net assets	**$ 6,453,278**	$ 5,519,355

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/
Statements of Activities
for the years ended December 31,

	2009	2008
Revenues		
Contributions	**$ 52,459,474**	$ 53,954,766
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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 SCORS. 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.

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.

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, 2009 and 2008, were $7,587 and $10,706, respectively.

Note 1. Summary of Significant Accounting Policies (continued)

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, 2009 and 2008 was $36,540 and $237,460, 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.

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 $6,277,994 and $5,310,261, at December 31, 2009 and 2008, 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 SCORS 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, 2009 and 2008 were $52,459,474 and $53,954,766, 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 SCORS. 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, 2009 and 2008, the Fund determined that $52,286,642 and $53,224,278, respectively in support payments were due to service providers.

Note 6. Related Parties

The Fund is administered by the SCORS as set forth by the State of South Carolina Act 175 of 2004. For the years ended December 31, 2009 and 2008, the SCORS incurred general and administration expenditures/expenses related to administration of the Fund and Lifeline/Linkup outreach in the amounts of $235,530 and $279,731, respectively. A payable of $94,993 and $0 was recorded to the SCORS related to these expenditures/expenses as of December 31, 2009 and 2008, respectively.

Note 7. Commitments and Contingencies

In 2001 and 2002, the SCPSC Orders that established and sized the Fund were appealed by two separate parties. Following a decision in favor of the Fund at the Circuit Court level, the cases were then appealed to the South Carolina Supreme Court. The cases were briefed and argued before the South Carolina Supreme Court in October 2003. On June 25, 2007, the Supreme Court issued an opinion in which they affirmed the decisions of the SCPSC. The case has ended, and there are no refunds due or changes to the Fund related to that case.

Subsequent appeals have also 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 in the initial cases discussed above. 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. Judgment against the Fund in these cases could result in an inability to collect assessed revenues of approximately $60,000.

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*

SCOTT McELVEEN L.L.P.

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 the financial statements of the South Carolina Universal Service Fund (the "Fund") as of and for the years ended December 31, 2009 and 2008, and have issued our report thereon dated May 27, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

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

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

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*.

This report is intended solely for the information and use of management of the South Carolina Office of Regulatory Staff, the South Carolina Public Service Commission, and other agencies of the State of South Carolina, and is not intended to be and should not be used by anyone other than these specified parties.

Scott McElveen, L.L.P.

Columbia, South Carolina
May 27, 2010