

Report on Audits of Financial Statements of the  
South Carolina Universal Service Fund  
*for the years ended December 31, 2011 and 2010*



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## Independent Auditors' Report

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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, 2011 and 2010, 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, 2011 and 2010, and the respective changes in financial position for the years 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 July 25, 2012, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages three through six 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 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 audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Scott and Company LLP*

Columbia, South Carolina  
July 25, 2012

## 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 Deficit 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

The Fund is resized each November based on the Public Service Commission of South Carolina (PSC) orders and information reported by the telecommunication companies. The Fund has a \$21,183 deficit balance at December 31, 2011 primarily due to approximately \$35,000 of additional accounts receivable reserved.

## CURRENTLY KNOWN FACTS

- Assessable revenues reported during Fund Year 2011 were down. Several factors contribute to this decline including:
  - 1) The PSC's decision to exclude international revenues for assessment purposes;
  - 2) South Carolina consumer migration to alternative communication services including wireless and voice over internet protocol; 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 PSC.
- The SC General Assembly passed the *Consumer Choice and Technology Act* 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 deregulation 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.
- On February 6, 2012, the FCC released an order reforming the Lifeline program. This order mandates changes to the qualification requirements and the amount of support for the Federal Lifeline and Linkup programs. These changes are likely to evolve as implementation progresses. The SC Lifeline program will likely change in order to remain in alignment with the Federal programs. It is not yet known what impact the changes will have on future Fund revenues and expense, but it is not expected to be significant.

**Balances Sheets/Statements of Net Deficit as of December 31,**

	<u>2011</u>	<u>2010</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 1,950,020	\$ 3,531,758
Accounts receivable, less allowance for doubtful accounts in 2011 and 2010 of \$11,326 and \$3,951, respectively	771,857	378,424
Prepaid expenses	733	—
Total assets	<u>\$ 2,722,610</u>	<u>\$ 3,910,182</u>
 <b>Liabilities and Fund Balance/Net Assets</b>		
Distributions payable	\$ 2,611,585	\$ 4,006,790
Accounts payable	51,893	8,991
Overpayments/credits payable	80,305	52,796
Due to South Carolina Office of Regulatory Staff	10	—
Total liabilities	<u>2,743,793</u>	<u>4,068,577</u>
 <b>Fund Balance/Net Assets</b>		
Non-spendable – prepaid expenses	733	—
Unassigned fund deficit/unrestricted net deficit	<u>(21,916)</u>	<u>(158,395)</u>
Total fund deficit/net deficit	<u>(21,183)</u>	<u>(158,395)</u>
Total liabilities and fund deficit/net deficit	<u>\$ 2,722,610</u>	<u>\$ 3,910,182</u>

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

	<u>2011</u>	<u>2010</u>
<b>Revenues</b>		
Contributions	\$ 41,337,860	\$ 47,772,364
Late payment assessments	2,735	8,983
Other income	—	42,693
Total revenues	<u>41,340,595</u>	<u>47,824,040</u>
 <b>Expenditures/Expenses</b>		
Telecommunication service providers	40,880,959	47,990,983
General and administrative expenditures/expenses	<u>322,424</u>	<u>297,282</u>
Total expenditures/expenses	<u>41,203,383</u>	<u>48,288,265</u>
 Excess (deficiency) of revenues over (under) expenditures/changes in net assets	<u>137,212</u>	<u>(464,225)</u>
 Fund deficit/net deficit, at beginning of year	<u>(158,395)</u>	305,830
Fund deficit/net deficit, at end of year	<u>\$ (21,183)</u>	<u>\$ (158,395)</u>

## **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 Deficit  
as of December 31,

	2011	2010
<b>Assets</b>		
Cash and cash equivalents	\$ 1,950,020	\$ 3,531,758
Accounts receivable, less allowance for doubtful accounts in 2011 and 2010 of \$11,326 and \$3,951, respectively	771,857	378,424
Prepaid expenses	733	—
Total assets	\$ 2,722,610	\$ 3,910,182
<b>Liabilities and Fund Deficit/Net Deficit</b>		
Distributions payable	\$ 2,611,585	\$ 4,006,790
Accounts payable	51,893	8,991
Overpayments/credits payable	80,305	52,796
Due to South Carolina Office of Regulatory Staff	10	—
Total liabilities	2,743,793	4,068,577
<b>Fund Deficit/Net Deficit</b>		
Non-spendable – prepaid expenses	733	—
Unassigned fund deficit/unrestricted net deficit	(21,916)	(158,395)
Total fund deficit/net deficit	(21,183)	(158,395)
Total liabilities and fund deficit/net deficit	\$ 2,722,610	\$ 3,910,182

*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)/  
 Statements of Activities  
 for the years ended December 31,

	2011	2010
<b>Revenues</b>		
Contributions	\$ 41,337,860	\$ 47,772,364
Late payment assessments	2,735	8,983
Other income	—	42,693
Total revenues	41,340,595	47,824,040
<b>Expenditures/Expenses</b>		
Telecommunication service providers	40,880,959	47,990,983
General and administrative expenditures/expenses	322,424	297,282
Total expenditures/expenses	41,203,383	48,288,265
Excess (deficiency) of revenues over (under) expenditures/changes in net assets	137,212	(464,225)
Fund (deficit) balance/net (deficit) assets, at beginning of year	(158,395)	305,830
Fund deficit/net deficit, at end of year	\$ (21,183)	\$ (158,395)

*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.

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 30<sup>th</sup> of the month. Any accounts not paid by the 30<sup>th</sup> 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, 2011 and 2010, were \$2,735 and \$8,983 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, 2011 and 2010 was \$34,846 and \$3,853, respectively. Recoveries of previous accounts receivable, written off as bad debt expense in prior years, were included as other income in the amount of \$42,693 for the year ended December 31, 2010.

**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 \$1,950,020 and \$3,531,758 at December 31, 2011 and 2010, 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, 2011 and 2010 were \$41,337,860 and \$47,772,364, 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, 2011 and 2010, the Fund determined that \$40,880,959 and \$47,990,983, 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, 2011 and 2010, the ORS incurred general and administration expenditures/expenses related to administration of the Fund and Lifeline/Linkup outreach in the amounts of \$269,578 and \$275,429 respectively. A payable of \$10 and \$0 was recorded to the ORS related to these expenditures/expenses as of December 31, 2011 and 2010, 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.

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*

**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, 2011 and 2010, and have issued our report thereon dated July 25, 2012. 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 *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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. 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 and Company LLP*

Columbia, South Carolina

July 25, 2012