

**PENNSYLVANIA UNIVERSAL
SERVICE FUND**

FINANCIAL STATEMENTS

DECEMBER 31, 2003

**PENNSYLVANIA UNIVERSAL SERVICE FUND
CONTENTS TO FINANCIAL STATEMENTS
DECEMBER 31, 2003**

| | <u>Page</u> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| Independent Auditors' Report | 1 |
| Management's Discussion and Analysis For the Year Ended December 31, 2003 | 2 |
| Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards | 3 |
| Balance Sheet December 31, 2003 | 4 |
| Statement of Revenues, Expenses and Changes in Fund Net Assets For the Year Ended December 31, 2003 | 5 |
| Statement of Cash Flows For the Year Ended December 31, 2003 | 6 |
| Notes to Financial Statements | 7-8 |



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INDEPENDENT AUDITORS' REPORT

To the Pennsylvania Public Utility Commission and the Board of Directors of the National Exchange Carrier Association, Inc.:

We have audited the accompanying balance sheet as of December 31, 2003, of the Pennsylvania Universal Service Fund (PUSF), a special revenue unit of the Commonwealth of Pennsylvania administered by the National Exchange Carrier Association, Inc. (NECA), and the related statements of revenues, expenses and changes in fund net assets and cash flows for the year ended December 31, 2003. 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 standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the PUSF administered by NECA as of December 31, 2003, and the changes in fund net assets and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 29, 2004 on our consideration of NECA as administrator for the PUSF's internal control structure over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

June 29, 2004

PENNSYLVANIA UNIVERSAL SERVICE FUND

MANAGEMENTS DISCUSSION AND ANALYSIS

PERIOD ENDING DECEMBER 31, 2003

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

FINANCIAL HIGHLIGHTS

- The PUSF's unrestricted fund balance as of December 31, 2003 was \$2.7 million
- The PUSF's unrestricted net assets increased by approximately \$1.134 million during the period January 1, 2003 through December 31, 2003

OVERVIEW OF THE FINANCIAL STATEMENTS

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.

As of December 31, 2003, the PUSF had net receivables of \$70 thousand comprised of accounts receivables – assessments of \$110 thousand, accounts payable – assessments of \$2 thousand, deferred revenue of \$15 thousand, and accounts payable and accrued expenses of \$23 thousand.

The PUSF maintained an adequate cash flow and balance of funds to satisfy all obligations during 2003.



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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

National Exchange Carrier Association, Inc.
as administrator for the Pennsylvania Universal Service Fund:

We have audited the financial statements of the Pennsylvania Universal Service Fund as of December 31, 2003, and have issued our report thereon dated June 29, 2004. 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.

Compliance

As part of obtaining reasonable assurance whether the Pennsylvania Universal Service Fund's financial statements are free of material misstatement, we performed tests of compliance of the National Exchange Carrier Association, Inc. (NECA) as administrator for the Pennsylvania Universal Service Fund (PUSF) with certain provisions of laws, regulations and contracts, 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered NECA's internal control, in its role as administrator for the PUSF over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Administrator, Contract Administrator, the Pennsylvania Public Utility Commission and State Auditor's Office of the State of Pennsylvania and is not intended to be and should not be used by anyone other than these specified parties.

June 29, 2004

**PENNSYLVANIA UNIVERSAL SERVICE FUND
BALANCE SHEET
DECEMBER 31, 2003
(IN THOUSANDS)**

| ASSETS | |
|-------------------------------------------|---------------------|
| Current Assets: | |
| Cash and cash equivalents | \$ 2,619 |
| Accounts receivable - assessments | <u>110</u> |
| TOTAL ASSETS | <u>\$ 2,729</u> |
| LIABILITIES AND FUND NET ASSETS | |
| Current Liabilities: | |
| Accounts payable - assessments | 2 |
| Deferred revenue | 15 |
| Accounts payable and accrued expenses | <u>23</u> |
| Total Current Liabilities | 40 |
| Fund Net Assets – Unrestricted | <u>2,689</u> |
| TOTAL LIABILITIES AND FUND NET ASSETS | <u>\$ 2,729</u> |

The Notes to Financial Statements are an integral part of this statement.

**PENNSYLVANIA UNIVERSAL SERVICE FUND
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2003
(IN THOUSANDS)**

| | |
|-----------------------------------------------------|------------------------|
| Operating Revenue: | |
| Assessments | \$ 34,818 |
| Operating Expenses: | |
| Amounts paid and due to service providers | 33,515 |
| Bad debt expense | 25 |
| Administrative costs | 182 |
| Total Operating Expenses | <u>33,722</u> |
| Operating Income | 1,096 |
| Non-Operating Income: | |
| Interest income | <u>38</u> |
| Net Increase in Unrestricted Fund Net Assets | 1,134 |
| Fund Net Assets – Unrestricted, Beginning of Period | <u>1,555</u> |
| Fund Net Assets – Unrestricted, End of Period | <u><u>\$ 2,689</u></u> |

The Notes to Financial Statements are an integral part of this statement.

**PENNSYLVANIA UNIVERSAL SERVICE FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2003
(IN THOUSANDS)**

| | |
|--------------------------------------------------------------|-----------------|
| Cash Flows from Operating Activities: | |
| Receipts from assessments and service providers | \$ 34,909 |
| Cash paid to service providers | (33,530) |
| Cash paid for administrative costs | (193) |
| Net Cash Provided by Operating Activities | <u>1,186</u> |
| | |
| Cash Flows from Investing Activities | |
| Interest income | <u>38</u> |
| | |
| Net Increase in Cash and Cash Equivalents | 1,224 |
| | |
| Cash and Cash Equivalents, Beginning of Period | <u>1,395</u> |
| | |
| Cash and Cash Equivalents, End of Period | <u>\$ 2,619</u> |
| | |
| Reconciliation of Net Cash Provided by Operating Activities: | |
| Operating income | \$ 1,096 |
| Changes in assets and liabilities: | |
| Decrease in accounts receivable - assessments | 101 |
| Decrease in accounts payable - assessments | (15) |
| Increase in deferred revenue | 15 |
| Decrease in accounts payable and accrued expenses | <u>(11)</u> |
| Net Cash Provided by Operating Activities | <u>\$ 1,186</u> |

The Notes to Financial Statements are an integral part of this statement.

**PENNSYLVANIA UNIVERSAL SERVICE FUND
NOTES TO FINANCIAL STATEMENTS
(IN THOUSANDS)**

Note 1 - General:

On September 30, 1999 the Pennsylvania Public Utility Commission (PPUC) issued an Order at Docket Nos. P-00991648 and P-00991649 (Global Order), as amended by the Order entered November 5, 1999, and as amended by the Proposed Order in Rulemaking Re: Establishing Universal Service Fund Regulations at 52 Pa.Code §§63.141-63.151, Docket No. L-00000148, (1/27/00), to create the Pennsylvania Universal Service Fund (PUSF). The PUSF was established to both reduce and restructure access charges and further the opportunity for development of local competition. The PUSF is a means to reduce access and toll rates for the ultimate benefit of the end-user and to encourage greater toll competition, while enabling carriers to continue to preserve the affordability of local service rates.

The PUSF is funded by an assessment on all Pennsylvania telecommunications service providers that provide intrastate telecommunications services (excluding wireless carriers) and is paid, via a monthly remittance advice, to the National Exchange Carrier Association, Inc. (NECA), which in February 2000, was selected by the PPUC to act as Administrator of the Fund. Carriers contribute a fixed monthly assessment amount based on company-specific revenues. Eligible recipients receive fixed monthly support payments from the PUSF as approved by the PPUC.

Note 2 - Summary of Significant Accounting Policies:

A. Basis of Presentation

These statements have been prepared on the accrual basis in accordance with the Governmental Accounting Standards Board (GASB), for the period presented. For the period ending December 31, 2003 the PUSF had accounting transactions in the unrestricted fund net assets only. The PUSF's financial statement presentation follows the recommendation of GASB No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments" and amendments. GASB No. 34, as amended, establishes standards for financial reporting for state and local governments.

B. Cash and Cash Equivalents

All highly liquid securities, purchased with a maturity of three months or less, are considered cash equivalents. Surplus funds of the PUSF are invested in two money market funds maintained by Fidelity Investment and Mellon Bank. Interest is credited to the PUSF when earned and the interest rate for the period ending December 31, 2003 averaged 1.09%.

C. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

D. Revenue Recognition

Telecommunications companies doing business in the Commonwealth of Pennsylvania are required to pay into the PUSF a fixed monthly amount as determined in accordance with PUC regulations. It is the PUSF's policy to record revenues in the period earned.

E. Receivables and Credit Policies

Accounts receivable – assessments are due under normal terms requiring payment by the 15th of the month. Any accounts not paid by the 15th of the month plus a five day grace period are assessed a late payment charge of 18 percent per annum, adjusted to a daily percent. Late payment charges are recorded as assessments.

PENNSYLVANIA UNIVERSAL SERVICE FUND
NOTES TO FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 3 - Assessments:

Identified carriers that are operating in the Commonwealth of Pennsylvania, excluding wireless service providers, provide assessments to the Fund. NECA searches publicly available resources to identify carriers operating in the Commonwealth of Pennsylvania that are not providing assessments to the Fund. In addition, the PPUC notifies NECA when new carriers are certified to offer service in the Commonwealth of Pennsylvania. The carriers are assessed at a flat rate based on the intrastate revenue of two years prior. The assessment rate for the period ending December 31, 2003 was .96 percent. The gross assessment for the period ending December 31, 2003 was approximately \$34,793.

Note 4 - Amounts Paid and Due to Service Providers:

Universal Service Support Payments to the qualified recipients are made by NECA as directed by the PPUC. The qualified recipients receive payments in order to neutralize the revenue deficits created by mandated decreases in toll and access charges. For the period ending December 31, 2003 the PUSF determined that approximately \$33,515 in support payments were due to service providers.

Note 5 - Administrative Costs:

As stated in the Contract, NECA is reimbursed a fixed amount each fiscal year plus any allowable variable costs, as defined. Such variable costs include customary, reasonable and necessary expenses incurred by NECA in performance of services, including payments to an independent accountant for an annual audit, extraordinary legal work provided by external counsel, taxes, application fees, licensing fees, and similar expenses.

The administrative fee for the period ending December 31, 2003 was approximately \$160 payable in twelve monthly installments of \$13.3. NECA is under contract as the administrator of the PUSF through December 31, 2004.

For the year ended December 31, 2003, the administrative costs were approximately as follows:

| | |
|--------------------------|---------------|
| NECA administrative fees | \$ 160 |
| External audit fees | <u>22</u> |
| | <u>\$ 182</u> |

Note 6 - Income Taxes:

These financial statements present the activities of the PUSF. The activities of the PUSF are tax-exempt since the PUSF is a special revenue unit of the Commonwealth of Pennsylvania, and therefore not subject to federal or state income taxes or sales, use, gross receipts or other taxes. As such, no provision for such taxes has been reflected in the accompanying financial statements.

Note 7 - Concentration of Credit Risk:

The Fund maintains its cash balances at a financial institution, which may at times exceed amounts insured by the Federal Deposit Insurance Corporation. Since this is a high quality financial institution, management does not believe the Fund is exposed to any significant credit risk on its cash balances.