



**PENNSYLVANIA UNIVERSAL  
SERVICE FUND**

**FINANCIAL STATEMENTS**

**DECEMBER 31, 2004**

**PENNSYLVANIA UNIVERSAL SERVICE FUND  
CONTENTS TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004**

	<u>Page</u>
Independent Auditors' Report	1
Management's Discussion and Analysis For the Years Ended December 31, 2004 and 2003	2
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	3
Balance Sheets December 31, 2004 and 2003	4
Statements of Revenues, Expenses and Changes in Fund Net Assets For the Years Ended December 31, 2004 and 2003	5
Statements of Cash Flows For the Years Ended December 31, 2004 and 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 sheets as of December 31, 2004 and 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 years then ended. 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, 2004 and 2003, and the changes in fund net assets and cash flows for the years 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 13, 2005 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, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control of 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 read in conjunction with this report in considering the results of our audits.

June 13, 2005

## **PENNSYLVANIA UNIVERSAL SERVICE FUND**

### **MANAGEMENTS DISCUSSION AND ANALYSIS**

#### **PERIOD ENDING DECEMBER 31, 2004 AND 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, 2004 and December 31, 2003 was \$2.3 million and \$2.7 million, respectively
- The PUSF's unrestricted net assets decreased by approximately \$.365 million during the period January 1, 2004 through December 31, 2004
- 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, 2004, the PUSF had net payables of \$55 thousand comprised of accounts receivables – assessments of \$114 thousand, accounts payable – assessments of \$4 thousand, deferred revenue of \$14 thousand, and accounts payable and accrued expenses of \$151 thousand.

As of December 31, 2003, the PUSF had net receivables of \$45 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 \$48 thousand.

The PUSF maintained an adequate cash flow and balance of funds to satisfy all obligations during 2004 and 2003.



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**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**

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, 2004 and 2003, and have issued our report thereon dated June 13, 2005. 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 National Exchange Carrier Association, Inc.'s (NECA) internal control, in its role as administrator for the Pennsylvania Universal Service Fund (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 reportable 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 caused by error or fraud 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.

Compliance and Other Matters

As part of obtaining reasonable assurance whether the PUSF's financial statements are free of material misstatement, we performed tests of compliance of NECA as administrator for the 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 or other matters that are required to be reported under *Government Auditing Standards*.

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 13, 2005

**PENNSYLVANIA UNIVERSAL SERVICE FUND**  
**BALANCE SHEETS**  
**DECEMBER 31, 2004 AND 2003**  
**(IN THOUSANDS)**

ASSETS	<u>2004</u>	<u>2003</u>
Current Assets:		
Short-term investments	\$ 2,379	\$ 2,644
Accounts receivable - assessments	<u>114</u>	<u>110</u>
 TOTAL ASSETS	 <u>\$ 2,493</u>	 <u>\$ 2,754</u>
 LIABILITIES AND FUND NET ASSETS		
Current Liabilities:		
Accounts payable - assessments	\$ 4	\$ 2
Deferred revenue	14	15
Accounts payable and accrued expenses	<u>151</u>	<u>48</u>
Total Current Liabilities	169	65
 Fund Net Assets – Unrestricted	 <u>2,324</u>	 <u>2,689</u>
 TOTAL LIABILITIES AND FUND NET ASSETS	 <u>\$ 2,493</u>	 <u>\$ 2,754</u>

The Notes to Financial Statements are an integral part of these statements.

**PENNSYLVANIA UNIVERSAL SERVICE FUND**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS**  
**FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003**  
**(IN THOUSANDS)**

	<u>2004</u>	<u>2003</u>
Operating Revenue:		
Assessments	\$ 33,289	\$ 34,818
Operating Expenses:		
Amounts paid and due to service providers	33,524	33,515
Bad debt expense	2	25
Administrative costs	<u>176</u>	<u>182</u>
Total Operating Expenses	<u>33,702</u>	<u>33,722</u>
Operating Income (Loss)	(413)	1,096
Non-Operating Income:		
Interest income	<u>48</u>	<u>38</u>
Net Increase (Decrease) in Unrestricted Fund Net Assets	(365)	1,134
Fund Net Assets – Unrestricted, Beginning of Period	<u>2,689</u>	<u>1,555</u>
Fund Net Assets – Unrestricted, End of Period	<u>\$ 2,324</u>	<u>\$ 2,689</u>

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**PENNSYLVANIA UNIVERSAL SERVICE FUND**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003**  
**(IN THOUSANDS)**

	<u>2004</u>	<u>2003</u>
<b>Cash Flows from Operating Activities:</b>		
Receipts from assessments and service providers	\$ 33,282	\$ 34,909
Cash paid to service providers	(33,419)	(33,546)
Cash paid for administrative costs	<u>(176)</u>	<u>(193)</u>
Net Cash Provided by (Used in) Operating Activities	(313)	1,170
<b>Cash Flows from Investing Activities:</b>		
Change in short-term investments	265	(1,208)
Interest income	<u>48</u>	<u>38</u>
Net Cash Provided by (Used in) Investing Activities	<u>313</u>	<u>(1,170)</u>
<b>Net Change in Cash and Cash Equivalents</b>	--	--
<b>Cash and Cash Equivalents, Beginning of Period</b>	<u>--</u>	<u>--</u>
<b>Cash and Cash Equivalents, End of Period</b>	<u>\$ --</u>	<u>\$ --</u>
<b>Reconciliation of Net Cash Provided by (Used in) Operating Activities:</b>		
Operating income (loss)	\$ (413)	\$ 1,096
Changes in assets and liabilities:		
Increase (decrease) in accounts receivable - assessments	(4)	101
Increase (decrease) in accounts payable - assessments	2	(15)
Increase (decrease) in deferred revenue	(1)	15
Increase (decrease) in accounts payable and accrued expenses	<u>103</u>	<u>(27)</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ (313)</u>	<u>\$ 1,170</u>

The Notes to Financial Statements are an integral part of these statements.

**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 was selected by the PPUC to act as Administrator of the Fund through December 31, 2004. 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 years ended December 31, 2004 and 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. 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.

**C. 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 PPUC regulations. It is the PUSF's policy to record revenues in the period earned.

**D. Receivables and Credit Policies**

Accounts receivable – assessments are due under normal terms requiring payment by the 15<sup>th</sup> of the month. Any accounts not paid by the 15<sup>th</sup> 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.

**E. Reclassification**

Certain amounts contained in the 2003 financial statements have been reclassified to conform to the 2004 presentation.

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

**Note 3 - Short-term Investments:**

As part of its cash management program, NECA maintains a portfolio of daily valued mutual funds. The carrying value of such funds approximates market due to their short-term nature. 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 years ended December 31, 2004 and 2003 averaged 1.27% and 1.09%, respectively.

**Note 4 - Assessments:**

Identified carriers that are operating in the Commonwealth of Pennsylvania, excluding wireless service providers, provide assessments to the Fund. 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 years ending December 31, 2004 and 2003 was .93 and .96 percent, respectively. The gross assessment totaled \$33,290 and \$34,818 for the years ending December 31, 2004 and 2003, respectively.

**Note 5 - 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 years ended December 31, 2004 and 2003 the PUSF determined that approximately \$33,524 and \$33,515, respectively, in support payments were due to service providers.

**Note 6 - 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 year ended December 31, 2004 and 2003 was approximately \$154 and \$160, respectively. NECA was under contract as the administrator of the PUSF through December 31, 2004. Effective January 1, 2005 the PPUC awarded the administrative duties to NECA Services, Inc (NSI) through December 31, 2006. For the years ended December 31, 2005 and 2006 the PUSF will pay administrative fees of approximately \$121 to NSI.

The administrative costs were approximately as follows:

	<u>2004</u>	<u>2003</u>
NECA administrative fees	\$ 154	\$ 160
External audit fees	<u>22</u>	<u>22</u>
	<u>\$ 176</u>	<u>\$ 182</u>

**Note 7 - 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 8 - Concentration of Credit Risk:**

The Fund maintains its cash and short-term investment balances with financial institutions, which may at times exceed amounts insured by the Federal Deposit Insurance Corporation. Since these are high quality financial institutions, management does not believe the Fund is exposed to any significant credit risk on its cash and short-term investment balances.