



**PENNSYLVANIA UNIVERSAL  
SERVICE FUND**

**Financial Statements**

**December 31, 2005 and 2004**

**With Independent Auditors' Report**

**Pennsylvania Universal Service Fund**  
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**December 31, 2005 and 2004**

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## INDEPENDENT AUDITORS' REPORT

To the Pennsylvania Public Utility Commission and the Board of Directors of  
Solix, Inc.

We have audited the accompanying balance sheets as of December 31, 2005 and 2004, of the Pennsylvania Universal Service Fund (PUSF), a special revenue unit of the Commonwealth of Pennsylvania administered by Solix, Inc. (Solix), 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 Solix as of December 31, 2005 and 2004, 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.

The accompanying required supplementary information such as Management's Discussions and Analysis on page 2 is not a required part of the basic financial statements but is supplementary information required by the Government Accounting Standards Board. 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2006 on our consideration of Solix 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.

*Withum Smith + Brown P.C.*

May 23, 2006

## **PENNSYLVANIA UNIVERSAL SERVICE FUND**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

#### **PERIODS ENDED DECEMBER 31, 2005 AND 2004**

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, 2005 and December 31, 2004 was \$1.9 million and \$2.3 million, respectively.
- The PUSF's unrestricted net assets decreased by approximately \$.448 million during the period January 1, 2005 through December 31, 2005.
- The PUSF's unrestricted net assets decreased by approximately \$.365 million during the period January 1, 2004 through December 31, 2004.

#### 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, 2005, the PUSF had net payables of \$18 thousand comprised of accounts receivables – assessments of \$49 thousand, interest receivable of \$1 thousand, accounts payable – assessments of \$21 thousand, deferred revenue of \$24 thousand, and accounts payable and accrued expenses of \$23 thousand.

As of December 31, 2004, the PUSF had net receivables of \$72 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 \$24 thousand.

The PUSF maintained an adequate cash flow and balance of funds to satisfy all obligations during 2005 and 2004.



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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**

Solix, 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, 2005 and 2004, and have issued our report thereon dated May 23, 2006. 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 Solix, Inc.'s (Solix) 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 Solix 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.

*Withum Smith + Brown P.C.*

May 23, 2006

**Pennsylvania Universal Service Fund**  
**Balance Sheets**  
**December 31, 2005 and 2004**  
**(in Thousands)**

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	2005	2004
<b>Assets</b>		
Cash and cash equivalents	1,894	2,252
Accounts receivable - assessments	49	114
Interest receivable	<u>1</u>	<u>--</u>
	<u>\$ 1,944</u>	<u>\$ 2,366</u>
<b>Liabilities and Fund Net Assets</b>		
Accounts payable - assessments	\$ 21	\$ 4
Deferred revenue	24	14
Accounts payable and accrued expenses	<u>23</u>	<u>24</u>
	68	42
Fund net assets – unrestricted	<u>1,876</u>	<u>2,324</u>
	<u>\$ 1,944</u>	<u>\$ 2,366</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, 2005 and 2004**  
**(in Thousands)**

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	2005	2004
Operating revenue		
Assessments	\$ 33,207	\$ 33,289
Operating expenses		
Amounts paid and due to service providers	33,565	33,524
Bad debt expense	44	2
Administrative costs	144	176
	<u>33,753</u>	<u>33,702</u>
Operating loss	(546)	(413)
Non-operating income		
Interest income	<u>98</u>	<u>48</u>
Net decrease in unrestricted fund net assets	(448)	(365)
<b>Fund net assets - unrestricted</b>		
Beginning of period	<u>2,324</u>	<u>2,689</u>
End of period	<u>\$ 1,876</u>	<u>\$ 2,324</u>

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

**Pennsylvania Universal Service Fund**  
**Statements of Cash Flows**  
**For the Years Ended December 31, 2005 and 2004**  
**(in Thousands)**

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	2005	2004
<b>Cash flows from Operating activities</b>		
Receipts from assessments and service providers	\$ 33,238	\$ 33,282
Cash paid to service providers	(33,548)	(33,522)
Cash paid for administrative costs	<u>(145)</u>	<u>(175)</u>
Net cash used in operating activities	(455)	(415)
<b>Cash flows from investing activities</b>		
Interest income	<u>97</u>	<u>48</u>
<b>Decrease in cash and cash equivalents</b>	(358)	(367)
<b>Cash and cash equivalents</b>		
Beginning of period	<u>2,252</u>	<u>2,619</u>
End of period	<u>\$ 1,894</u>	<u>\$ 2,252</u>
<b>Reconciliation of net cash used in operating activities</b>		
Operating loss	\$ (546)	\$ (413)
Changes in assets and liabilities		
(Increase) decrease in accounts receivable - assessments	65	(4)
Increase in interest receivable	(1)	--
Increase in accounts payable - assessments	18	2
Increase (decrease) in deferred revenue	10	(1)
Increase (decrease) in accounts payable and accrued expenses	<u>(1)</u>	<u>1</u>
Net cash used in operating activities	<u>\$ (455)</u>	<u>\$ (415)</u>

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

**Pennsylvania Universal Service Fund**  
**Notes to Financial Statements**  
**(in Thousands)**  
**December 31 2005 and 2004**

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**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 Solix, Inc. (Solix), which was selected by the PPUC to act as Administrator of the Fund through December 31, 2006. 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.

**2. Summary of Significant Accounting Policies**

**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, 2005 and 2004 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.

**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.

**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.

**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.

**Reclassification**

Certain amounts contained in the 2004 financial statements have been reclassified to conform to the 2005 presentation.

**Pennsylvania Universal Service Fund**  
**Notes to Financial Statements**  
**(in Thousands)**  
**December 31, 2005 and 2004**

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**3. Cash and Cash Equivalents**

As part of its cash management program, Solix 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 Merrill Lynch and Mellon Bank. Interest is credited to the PUSF when earned and the interest rate for the years ended December 31, 2005 and 2004 averaged 3.07% and 1.27%, respectively.

**4. Allowance for Doubtful Accounts**

Allowance for doubtful accounts amounted to \$44,000 at December 31, 2005 to provide for anticipated uncollectible amounts from certain carriers. No uncollectible contributions were written off during the year-end December 31, 2005.

**5. Assessments**

Identified carriers that are operating in the Commonwealth of Pennsylvania, excluding wireless service providers, provide assessments to the Fund. The PPUC notifies Solix 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, 2005 and 2004 was .99 and .93 percent, respectively. The gross assessment totaled \$33,207 and \$33,289 for the years ending December 31, 2005 and 2004, respectively.

**6. Amounts Paid and Due to Service Providers**

Universal Service Support Payments to the qualified recipients are made by Solix 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, 2005 and 2004 the PUSF determined that approximately \$33,565 and \$33,524, respectively, in support payments were due to service providers.

**7. Administrative Costs**

As stated in the Contract, Solix 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 Solix 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, 2005 and 2004 was approximately \$121 and \$154, 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 Solix through December 31, 2006. For the year ended December 31, 2006 the PUSF will pay administrative fees of approximately \$121 to Solix.

The administrative costs were approximately as follows:

	<b>2005</b>	<b>2004</b>
Administrative fees	\$ 121	\$ 154
External audit fees	<u>23</u>	<u>22</u>
	<u>\$ 144</u>	<u>\$ 176</u>

**Pennsylvania Universal Service Fund**  
**Notes to Financial Statements**  
**(in Thousands)**  
**December 31, 2005 and 2004**

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**8. 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.

**9. Concentration of Credit Risk**

The Fund maintains its cash and cash equivalents 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 cash equivalent balances.