

SUMMARY

A Review of the South Carolina Universal Service Fund

INTRODUCTION

Members of the General Assembly requested the LAC to conduct an audit of the South Carolina universal service fund (USF) administered by the Public Service Commission (PSC). We reviewed the need for the USF and the PSC's administration of the fund. Because the state's interim LEC fund is closely connected to the universal service fund, we also assessed the need for this fund.

BACKGROUND

The goal of universal service is to ensure the widespread availability of affordable local telephone service. The S.C. universal service fund establishes a complex system by which consumers pay a 2.9% surcharge on their telephone bills to support local telephone companies. The fund amounts to more than \$51 million in 2004-2005 and is projected to be \$340 million annually when fully implemented. South Carolina also has an Interim LEC fund to replace certain revenues for participating local exchange carriers (LECs). The contributors to this fund are long distance companies. The size of this fund for 2004 was \$31 million.

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NO LONG-TERM NEED FOR CURRENT STATE USF

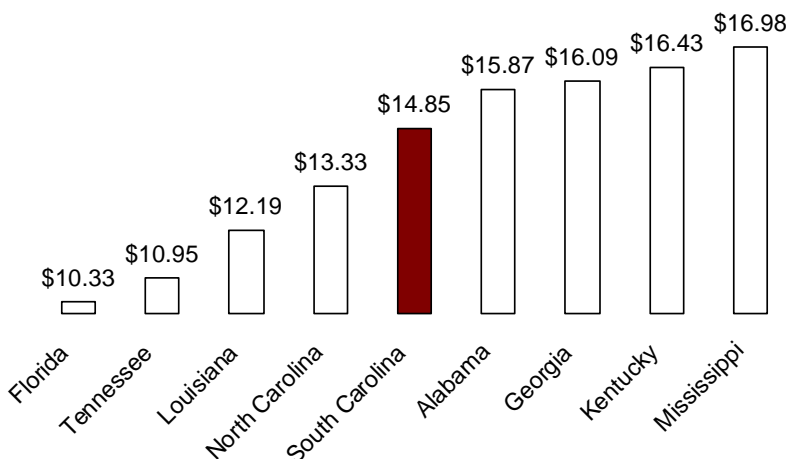
We found that the state USF does not need to be continued in its present form and should be scaled down. This conclusion is based on several factors.

- Telephone companies receive support from the federal universal service fund with South Carolina companies receiving \$126 million in 2003.
- The goals of universal service have largely been met.
- None of the eight other states in BellSouth's service area has a USF comparable to South Carolina's, and their basic telephone rates are equivalent to South Carolina's rates (see chart).
- The telecommunications market is rapidly changing. The number of wireless subscribers has increased dramatically. It is not an appropriate long-term policy to intensely regulate and subsidize one segment of the market (landline providers of basic service) when an increasing part of the market (cellular and Internet-based providers) is not regulated or subsidized by the state.
- The state USF focuses on replacing companies' revenue rather than providing support to areas with high costs for local phone service. The companies do not have to provide evidence of revenue losses or use the funds provided to support basic local service.

The state USF should be scaled back to include only supplements for low-income subscribers and support for those lines for which companies can provide evidence that costs are excessive. By changing the state USF, the goals of universal service could be advanced more directly, and the funds would be used to reach the neediest customers.

Consumers would benefit from reduced charges on their telephone bills. Some customers could experience increases in their bills due to redistribution of costs for service. However, customers would be paying directly for services they receive instead of subsidizing companies' overall revenues.

Average BellSouth Residential Rates



INTERIM LEC FUND SHOULD BE PHASED OUT

AUDITS BY THE LEGISLATIVE AUDIT COUNCIL CONFORM TO GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS AS SET FORTH BY THE COMPTROLLER GENERAL OF THE UNITED STATES.

FOR MORE INFORMATION

Our full report, including comments from the PSC and the ORS, and this document are published on the Internet at

www.state.sc.us/sclac

Copies can also be obtained by calling

(803) 253-7612

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The state's interim LEC fund provides subsidies that should be eliminated or transitioned into the universal service fund for those companies that could demonstrate need. The fund was established in 1996 to replace revenues lost when participating local exchange carriers (LECs) reduced the access charges paid by long distance companies. The statutory purpose of the fund has been accomplished. Other issues relating to the interim LEC fund include the following:

- The companies receive payments based on the number of minutes that long distance companies used their networks in 1996, with increases for growth. However, if they have fewer customers and fewer minutes of use, their payments from the fund have not been decreased.
- Although the law requires the interim LEC fund to transition into the state USF, further statutory change is necessary to accomplish this transition.

In many cases, the per line revenue loss to companies from the elimination of the interim LEC fund would not be significant, and revenue losses could be recovered by increasing rates.

ADMINISTRATION OF THE STATE USF

The Public Service Commission has not implemented adequate controls over the management of the state USF. As shown in the table, in FY 03-04, the USF processed more than \$48 million that is ultimately paid by South Carolina's consumers.

YEAR	CONTRIBUTIONS TO STATE USF	DISTRIBUTIONS FROM STATE USF
FY 01-02	\$29,720,989	\$27,270,133
FY 02-03	\$41,074,180	\$40,895,116
FY 03-04	\$48,089,178	\$48,268,797

See full report for table note.

We found the following deficiencies in the PSC's administration of the fund:

- Lack of proper follow-up to determine whether companies comply with requirements or have a need for the subsidies.
- Failure to provide an independent third-party audit.
- Inadequate internal policies and procedures.
- No established system to audit participant information.
- Inadequate computer system and lack of appropriate data entry controls.
- A conflict of interest with the administration and auditing of fund participants.

Beginning in January 2005, the administration of the state USF is the responsibility of the newly-created state agency, Office of Regulatory Staff (ORS). The administrative procedures adopted by the PSC allow for administrative costs to be recovered from the state USF, but the PSC has not recovered those costs. ORS should use the resources of the USF to cover the costs of administering the fund. ORS should also investigate the costs and benefits of hiring an experienced fund administrator to properly administer the fund. Fifteen of twenty-five states with a state USF reported that they use a private contractor to administer their funds.