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# USAC

UNIVERSAL SERVICE  
ADMINISTRATIVE CO.

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## 1999 Annual Report to Congress and the FCC: **Reaching and Connecting Americans**

March 31, 2000

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# The Universal Service Administrative Company

## Bringing Worlds Together Through Communications Technology

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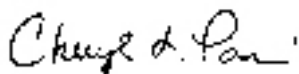
*Who can ignore the power and importance of communication? Communication is the basis for commerce, friendship, learning, and understanding. It is the link between cultures and nations. The USAC Board of Directors and staff are proud to play a part in providing everyone in the United States with access to the modern tools of communication at reasonable rates, regardless of geographic location or economic status. As the administrator of the federal universal service support mechanisms, our mission is to help connect Americans to each other and to the world through the use of the Internet and telecommunications services that now span the globe.*

*Since we began operations in September 1997, USAC has achieved many goals, including: implementing significant improvements in the High Cost and Low Income Programs, establishing and improving a program to promote and advance telehealth services to rural areas, establishing a program to connect schools and libraries to the wealth of knowledge on the Internet and intranets, and completing a merger with the Rural Health Care and Schools and Libraries Corporations. In achieving these objectives, USAC has kept administrative costs low as compared to other nonprofit organizations and government programs (less than 1.2% of the Universal Service Fund), while ensuring that all program rules are rigorously enforced. In these two short years, rates for services in rural areas have remained comparable to the rates charged in urban areas; all fifty states have programs that provide assistance to low-income customers; more rural health care providers are using telemedicine to serve rural customers; and half of the nation's classrooms and libraries have access to modern telecommunications networks. Working with the FCC and our stakeholders, we have helped take universal service from a vision to reality.*

*We have accomplished much in the last two years and we have ambitious goals for the future. We will work to continue to reach every citizen, rural health care provider, school, and library. We will implement major changes in the High Cost and Rural Health Care Programs in 2000. We will also review the other programs and identify opportunities to improve internal controls, streamline processes, and implement operational efficiencies. As a means to ensure that we provide the best quality service at the lowest cost, we will subject all of our contracts to a competitive bidding process. We will continue to adhere to the mission and scope of the universal service support mechanisms as defined by the FCC and Congress by complying with FCC rules, preventing waste, fraud and abuse, streamlining operations wherever possible, and limiting our role to administrative issues.*

*Without question, the new millennium will be an era of ever-increasing opportunities to use technology in every aspect of our lives. We are pleased to help provide access to telecommunications services so that all citizens can have an opportunity to benefit from those technologies. We would like to thank the FCC and Congress for supporting this valuable investment in our nation's future, and for providing USAC with the opportunity to help accomplish the universal service mission.*

Sincerely,



Cheryl L. Parrino  
Chief Executive Officer, USAC

## USAC: An Overview

In the Communications Act of 1934, Congress proclaimed that “all people of the United States” shall have access to a “rapid, efficient, nationwide...communications service with adequate facilities at reasonable charges.” In the Telecommunications Act of 1996, Congress further codified and expanded this concept of “universal service.” January 1999 brought the consolidation of the universal service support mechanisms under the umbrella of the Universal Service Administrative Company (USAC). USAC, and the programs it administers at the direction of Congress and the Federal Communications Commission (FCC), has allowed millions of Americans to realize just how “universal” universal service can be.

USAC administers the Universal Service Fund (USF), which provides communities across the country with access to affordable telecommunications services. USAC is a private, not-for-profit organization directed by the FCC to administer the USF. **USAC’s mission is to deliver the benefits of universal service to all consumers.** All of the country’s communities—remote or rural areas, low-income neighborhoods, rural health care providers, and public and private schools and public libraries—are eligible to seek support from the USF for communications services.

### USAC’s USF PROGRAMS

#### **\* High Cost**

*Provides support to telephone companies that serve high cost areas*

#### **\* Low Income**

*Assists low-income consumers by helping to pay for service connection charges as well as monthly charges*

#### **\* Rural Health Care**

*Allows rural health care providers to pay the same for telecommunications services as their urban counterparts*

#### **\* Schools & Libraries (E-rate)**

*Provides discounted Internet access and telecommunications service to schools and libraries*

Since its incorporation in September 1997, USAC has gone from the drawing board to a full-scale operation. In addition, USAC successfully incorporated the Schools and Libraries Corporation and the Rural Health Care Corporation into USAC in a merger completed December 31, 1998.

USAC collects funds from contributing telecommunications service providers in accordance with FCC regulations. Under rules adopted by the FCC pursuant to the Telecommunications Act of 1996, over 5,000 telecommunications service providers report information to USAC, and more than 2,000 companies contribute to the USF based on their share of interstate and international end-user revenue.

In 1998, USAC distributed \$2,291,933,000 in support to eligible entities participating in the four programs administered by USAC. More than \$3.6 billion was distributed in 1999.

In the pages that follow, USAC provides highlights of changes and improvements, and the successes of the universal service support mechanisms. USAC submits this annual report to Congress and the FCC pursuant to 47 CFR § 54.702 (h). By law, USAC’s annual report must detail USAC’s “operations, activities, and accomplishments for the prior year, including information about participation in each of the universal service support mechanisms and administrative action intended to prevent waste, fraud, and abuse,” as well as an assessment of contractor performance. This annual report covers the period from USAC’s inception through December 31, 1999. As required by regulation, USAC has consulted with FCC staff concerning the scope and content of this annual report.

## The High Cost Program...Connecting All Americans

The High Cost Program provides support to eligible telecommunications service providers to help ensure that the rates paid by Americans living in rural or remote areas for telecommunications services are comparable to the prices charged to those living in more densely populated areas. As the administrator of the High Cost Program, USAC must collect contributions, determine the amount of support that can be made available to eligible service providers, and distribute funds, all in accordance with FCC regulations. In 1998 and again in 1999, USAC distributed more than \$1.7 billion of the USF to companies who serve customers in these high cost areas.

There are three components to the High Cost Program:

- \* *High Cost Loop* support covers the cost for the “last mile” of connection in service areas where the cost to provide this service exceeds 115 percent of the national average.
- \* *Local Switching* support provides interstate assistance which covers switching costs for companies that serve fewer than 50,000 customers.
- \* *Long Term* support helps offset interstate “access charges” for companies that participate in the interstate Common Line Access Charge pooling arrangement managed by the National Exchange Carrier Association, Inc. (NECA).

Each of these components plays an important role in advancing the objectives of Congress and the FCC to keep the cost of telecommunications services reasonable for subscribers living in high cost, rural or remote areas of the United States, while at the same time maintaining the high quality of service required by law. The result is that recipients of telecommunications services near communities such as Brainerd, Minnesota or Anchorage, Alaska pay rates comparable to their more urban neighbors.

## The Low Income Program...Assisting Low Income Customers

The Low Income Program assists eligible low-income consumers in establishing and maintaining telephone service by discounting services provided by local telephone companies. In 1998, the Low Income Program was expanded to make available a baseline amount of support to companies in all states. Since that time, more than 1,500 telephone companies in all 50 states, United States territories, and the District of Columbia, have provided assistance to more than 5 million customers. In 1998, nearly \$470 million in support was extended to low-income consumers, and in 1999 nearly \$480 million.

There are four components to the Low Income Program:

- \* *Lifeline* support reimburses local service providers for providing discounted telephone charges to eligible subscribers. Lifeline support enables low-income customers to save at least \$5.25 per month and up to \$7 per month on their telephone bills. Consumers may also qualify for an additional \$3.50 per month in matching support from their state.
- \* *Link-Up* support reimburses local service providers for providing discounted connection charges to eligible low-income consumers. Customers qualifying for Link-Up support are eligible to save up to 50 percent on installation fees (not exceeding \$30).

- \* *Toll Limitation Service* support compensates local service providers for costs incurred in establishing the toll limitation service for the low-income subscriber. Service providers are required to offer toll limitation service at no cost to the low income consumer.
- \* *PICC* support reimburses interstate Presubscribed Interexchange Carrier Charges to local service providers in instances where the low-income subscriber has selected toll limitation service.

By identifying and reaching out to potential recipients, service providers are able to extend valuable services to members of the community who would not otherwise have access to basic telephone services. This advances the federal policy of equal access to telecommunications services for all Americans.

## The Rural Health Care Program...Bringing Affordable Telehealth Services to Rural America

Health care providers located in rural areas throughout the United States are increasingly turning to advanced communications technologies to provide telehealth services to patients. The Rural Health Care Program was designed to ensure that these health care providers pay no more than their urban counterparts to use these and other advanced technologies in providing health care services to their patients.

The Rural Health Care Division (RHCD) of USAC administers the program, which supports monthly telecommunications charges, installation charges, and long-distance Internet connection charges. Participating rural health care providers must be either public or not-for-profit to obtain support from the program. Eligible entities include the following:

- \* Post-secondary educational institutions offering health care instruction, teaching hospitals, and medical schools.
- \* Community health centers or health centers providing care to migrants.
- \* Local health departments or agencies.
- \* Community mental health centers.
- \* Not-for-profit hospitals.
- \* Rural health clinics.
- \* Consortia of health care providers consisting of one or more entities described above.

The burgeoning communications and information technologies now available to health care providers are streamlining the process of information sharing among health care practitioners. By making telehealth available to even the smallest and most remote health care providers, universal service support helps to make health care efficient, regardless of where the health care is administered.

# The Schools and Libraries Program...Connecting America's Classrooms and Libraries

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The Schools and Libraries Program—often called the “E-rate”—provides support for eligible schools and libraries to help offset the cost of advanced telecommunications services. USAC’s Schools and Libraries Division (SLD) administers the program. Eligible schools and libraries receive discounts ranging from 20 to 90 percent on the following services:

- \* Telecommunications services, including local and long-distance service.
- \* Internet access.
- \* “Internal connection” projects such as wiring and networking schools and libraries to facilitate the use of advanced telecommunications technology.

The range of discounts available to schools and libraries corresponds to the income level of students in their community and whether their location is urban or rural. Income for a school or district is measured by the percentage of students eligible for the National School Lunch Program (NSLP) administered by the United States Department of Agriculture:

<b>INCOME</b>	<b>URBAN</b>	<b>RURAL</b>
If the percentage of students that qualify for the NSLP is...	...and the school or library is in an urban area, the E-rate discount will be...	...and the school or library is in a rural area, the E-rate discount will be...
Less than 1%	20%	25%
1% to 19%	40%	50%
20% to 34%	50%	60%
35% to 49%	60%	70%
50% to 74%	80%	80%
75% to 100%	90%	90%

Applicants must develop an approved “technology plan” outlining how advanced technologies or discounts on existing technologies will help them in their day-to-day operations or in fulfilling the goals of their organizations. Providing these connections affords students and library patrons the same access to high technology and near-instant information and resources that once could only be found at the university level.

## Milestones for 1997 - 1999

USAC, the Rural Health Care Corporation (RHCC) and the Schools and Libraries Corporation (SLC) were formed in September 1997. In order to reduce administrative costs and streamline the operations of the universal service support mechanisms, a reorganization plan was filed with the FCC and approved in November 1998. The reorganization brought each of the four universal service support mechanisms—the Schools and Libraries Program, the Rural Health Care Program, the High Cost Program, and the Low Income Program—fully within the aegis of USAC. The merger was completed on December 31, 1998, and today each of the programs is administered by USAC.

The High Cost and Low Income Programs were seamlessly transitioned to the new administrator. Over 1,300 carriers have received support from one or more of the components of the High Cost Program since January 1, 1998 (see the chapter on benefits for a breakdown of support by state).

The funds distributed through the Low Income Program have more than doubled as a result of the changes that were instituted on January 1, 1998, requiring both participation of all eligible telecommunications service providers and an increased level of federal support. As of December 31, 1999, the program is providing benefits to over 5 million low-income consumers in all 50 states, United States territories and the District of Columbia.

The Rural Health Care Program accepted its first program applications in May 1998. The FCC approved the audit of the Rural Health Care Program operations and internal controls, and authorized the administrator to begin issuing funding commitment letters beginning June 4, 1999. Additional highlights to date include:

- \* Competitive bidding for program support services work in 1997, and consolidated competitive bidding process for program operations with the Schools and Libraries Program was initiated in late 1999.
- \* Funding commitments to rural health care providers reached one million dollar mark in October 1999.
- \* The FCC modified and improved the program, adopting most of USAC's recommendations, in November 1999.

Prior to SLC's merger with USAC in 1998, the Schools and Libraries Program received a clean opinion from its independent auditor and a "green light" from the United States General Accounting Office. Schools and Libraries Program milestones include:

- \* \$1.75 billion of funding committed in Year One (January 1, 1998 - June 30, 1999), reaching nearly 80 percent of public schools, nearly 50 percent of libraries, and thousands of private schools.
- \* \$1.96 billion of funding committed in Year Two (July 1, 1999 - June 30, 2000), increasing public school participation by 15 percent, providing stable support to libraries, and increasing private school participation by one third, as compared to Year One.
- \* Opening of Year Three filing window on November 10, 1999.



## Summary of Operational Activities

**U**SAC is responsible for collecting and distributing the funds for each of the four universal service support mechanisms. USAC bills and collects approximately \$370 million from over 2,000 telecommunications providers each month. Funds are distributed to entities in accordance with FCC rules and directives. USAC works with the FCC to resolve any issues regarding uncollectibles. Uncollectible accounts are under 1 percent of total funds.

**D**uring its first two years of operation, USAC has focused on reducing administrative expenses. USAC has strived to keep its administrative expenses low compared to both the overall size of the USF and to comparable public and private programs. Pursuant to FCC regulation, USAC submits its projected administrative expenses to the FCC on a quarterly basis. USAC's financial position as of December 31, 1998, including its administrative expenses, are detailed in the audited financial statements attached to this report. Audited financial statements for 1999 are not yet available. In 1998, USAC's administrative costs averaged \$2,590,000 per month. In 1998, USAC's administrative costs constituted only 1.12 percent of the USF. For 1999, we estimate this figure to be approximately 1.07 percent of the USF. USAC will continue to streamline the process and consolidate operations where appropriate as part of its ongoing effort to reduce administrative expenses.

**U**SAC determines the amount of High Cost Program support based on cost data submitted by the contributing companies. The FCC's forward-looking cost model will be the basis for determining high cost loop support for non-rural carriers beginning in 2000. USAC also utilizes data provided by NECA to determine the high cost loop support for rural carriers. Carriers also provide USAC with information regarding their projected Local Switching Support requirements. Long Term Support is calculated by USAC based on historical requirements adjusted for changes in economic indicators. Demand for the High Cost Program is then estimated based on all of the data provided. Included in the collection of data for these programs is information from competitive providers that are certified by a state commission to be eligible for support.

**F**or the Low Income Program, each participant was required to submit monthly data in order to receive reimbursement for discounts provided to low-income consumers. This monthly data submission would result in a payment to the carrier months later. USAC has taken steps to revise the process to require data submissions on a less frequent basis. Beginning in 2000, USAC will estimate the projected funding requirements of the participating carriers based on historical performance. Actual amounts of low-income support provided to consumers are then reported to USAC by the carriers. Discounts will then used to adjust payments made based on the projections and to update the model for use in determining future projections. This change will decrease administrative costs and provide that payments are distributed more evenly.

**O**n March 5, 1999, at the FCC's request, USAC submitted a report evaluating the Rural Health Care Program. Based on USAC's recommendations, as well as those submitted during the public comment period, the FCC released two orders in early November 1999 that serve to expand rural health care provider participation in the program and increase the amount of support available to participants. As of December 31, 1999, over \$1.6 million has been committed to more than 295 rural health care providers for Year One. Based on the program changes adopted by the FCC, USAC expects that nearly \$3 million in support will be provided for Year One.

USAC's March 1999 report to the FCC recommended changes intended to increase participation in the program and simplify the application process. Among other things, USAC recommended that the FCC:

- \* Streamline the application process.
- \* Simplify the rate calculations used to determine the level of support.
- \* Change the distance calculation to reduce complexity for applicants seeking support.

In November 1999, the FCC adopted many of the changes recommended by USAC, as well as other recommendations made by service providers and the rural health care community. In the first of two orders concerning the Rural Health Care Program, the FCC made the following modifications:

- \* Eliminated the limit on the amount of funding any one telemedicine location can receive.
- \* Authorized support for any commercially available telecommunications service, regardless of the bandwidth. Under previous rules, only telecommunications services employing a transmission speed up to 1.54 Mbps (T-1) were eligible.
- \* Simplified the application process by eliminating the requirement that discounts be based on the tariffed or publicly-available rates for the telecommunications service. Instead, discounts will be based on actual distance-based charges paid by the health care providers.
- \* Affirmed the ability of rural health care providers to join consortia with other subscribers of telecommunications services and continue to be eligible for program discounts, even if the consortium is receiving volume discounts.

In the second order, the FCC dealt specifically with carriers eligible for the program. Previously, service providers had to be designated as "eligible telecommunications carriers" (ETCs) to receive support. Because many service providers do not provide all the services necessary to receive this designation (non-ETCs), some rural health care facilities that used those services were excluded. Under the new provision, rural health care providers that were otherwise eligible will be able to participate if their service is provided by any common carrier, not just an ETC.

The Schools and Libraries Program continues to be a focal point of interest in the education/technology field for its mission to wire the nation's schools and libraries. For Year Three, demand has grown (including most long-distance carriers) to \$4.72 billion, as compared to \$2.3 billion in Year Two, with a 12 percent increase in the number of applications. Year Three has also seen an expansion of service providers registered to participate in the program. While this achievement reflects a growing familiarity with the program, operational improvements also contributed to this growth. Operational improvements implemented in 1999 included:

- \* A streamlined application process.
- \* Customer-focused forms.
- \* Enhancements to the electronic filing systems which tripled the number of electronically filed funding requests.
- \* Expanding the availability of electronic filing of invoices.

## Report on Benefits to Americans

The greatest benefits to Americans from the universal service support mechanisms will be realized in the years to come, as citizens in every corner of this country and every income level gain affordable access to information in all of its forms, medical professionals find innovative ways to use and manage vital data, and high school graduates go to college or enter the workforce. In the meantime, it is important to consider the quantitative impact of the USF as millions of people are affected every year. The charts and tables in this section of the report are indicators of USAC's success in its ongoing efforts to reach and connect Americans.

Conversely, though it is important to understand the quantitative impact of the universal service programs, the qualitative impact is perhaps the most impressive. Far more than a matter of funds committed or dollars distributed is the reality that individual communities, organizations, and citizens are affected in direct and positive ways. Consider the effect of the universal service support mechanisms on real individuals while reviewing the quantitative data and reading the quotations included in this section of the report.

### HIGH COST AND LOW INCOME PROGRAMS - INDICATORS OF SUCCESS:

#### 1998 HIGH COST SUPPORT BY STATE

State	Total	State	Total
AL	\$38,999,825	MT	\$42,183,725
AK	61,281,953	NE	19,979,797
AZ	32,951,372	NV	10,265,552
AR	68,740,007	NH	8,476,715
CNMI	4,238,232	NJ	2,842,242
CA	53,158,775	NM	33,536,118
CO	43,457,581	NY	35,274,368
CT	1,197,790	NC	39,121,395
DE	-	ND	21,420,549
DC	-	OH	13,989,063
FL	19,023,095	OK	59,803,663
GA	74,962,701	OR	34,553,028
GU	1,941,468	PA	22,329,343
HI	1,235,468	PR	137,238,900
ID	29,582,492	RI	-
IL	23,541,317	SC	43,979,346
IN	16,334,453	SD	17,566,415
IA	25,782,801	TN	27,168,006
KS	61,125,752	TX	121,444,027
KY	24,093,554	UT	9,830,519
LA	65,249,845	VT	11,571,451
ME	18,555,473	VI	18,407,328
MD	564,500	VA	12,518,215
MA	490,768	WA	42,114,505
MI	32,231,154	WV	24,333,543
MN	38,099,416	WI	49,314,982
MS	26,914,902	WY	21,633,497
MO	47,768,150		
		<b>Grand Total</b>	<b>\$1,692,419,136</b>

“Without the public policy assistance provided through the High Cost Program, it would be very difficult, if not impossible, to provide the affordable high quality telecommunications service Scio Mutual Telephone Association offers its customers in rural Oregon.”

-Robert M. Shelton  
Executive Vice President & General Manager  
Scio Mutual Telephone Association  
Scio, Oregon

**1999 HIGH COST SUPPORT BY STATE:**

State	NonRural	Rural	Total
AL	\$ 10,942,680	\$ 26,610,465	\$ 37,553,145
AK	-	68,411,841	68,411,841
AZ	1,619,988	29,831,940	31,451,928
AR	3,708,732	70,825,188	74,533,920
CA	5,548,908	44,840,637	50,389,545
CO	1,927,260	42,100,644	44,027,904
CT	-	924,456	924,456
DE	-	-	-
DC	-	-	-
FL	-	18,759,381	18,759,381
GA	1,809,072	69,099,483	70,908,555
GU	-	2,344,236	2,344,236
HI	-	751,560	751,560
ID	-	29,433,663	29,433,663
IL	14,447,124	23,970,360	38,417,484
IN	-	15,999,405	15,999,405
IA	-	25,225,425	25,225,425
KS	-	64,524,933	64,524,933
KY	1,060,884	18,269,466	19,330,350
LA	-	64,906,518	64,906,518
ME	-	17,878,422	17,878,422
MD	-	535,176	535,176
MA	-	524,976	524,976
MI	573,816	33,967,827	34,541,643
MN	-	41,085,171	41,085,171
MS	6,977,304	19,776,276	26,753,580
MO	5,984,340	44,523,270	50,507,610
MT	1,681,248	42,210,162	43,891,410
NE	-	20,737,128	20,737,128
NV	-	10,845,060	10,845,060
NH	-	8,186,901	8,186,901

(Table continued on next page)

**...1999 HIGH COST SUPPORT BY STATE CONTINUED:**

State	NonRural	Rural	Total
NJ	\$ -	\$ 1,364,556	\$ 1,364,556
NM	4,409,904	31,130,352	35,540,256
NY	-	37,986,228	37,986,228
NC	7,682,520	24,201,189	31,883,709
ND	-	21,502,644	21,502,644
NMI	-	6,824,640	6,824,640
OH	-	15,050,844	15,050,844
OK	-	57,608,348	57,608,348
OR	-	36,712,212	36,712,212
PA	-	21,758,748	21,758,748
PR*	133,184,976	-	133,720,080
RI	-	-	-
SC	5,166,036	37,383,795	42,549,831
SD	-	8,381,936	18,381,936
TN	-	28,995,273	28,995,273
TX	5,202,072	114,278,355	119,480,427
UT	-	11,400,744	11,400,744
VT	1,356,648	10,488,708	11,845,356
VI	-	22,996,128	22,996,128
VA	1,179,504	11,195,475	12,374,979
WA	-	43,277,742	43,277,742
WV	1,438,356	21,673,896	23,112,252
WI	-	50,786,355	50,786,355
WY	4,387,656	20,956,914	25,344,570
<b>Grand Total:</b>	<b>\$220,289,028</b>	<b>\$1,503,055,052</b>	<b>\$1,723,879,184</b>

\*Puerto Rico received an additional \$535,104 in support for competitive local exchange carriers (CLECs) (this amount is included in the total and grand total)

**1998 LOW INCOME SUPPORT BY STATE:**

(Table continued on next page)

STATE	LIFELINE	LINKUP	TLS	PICC	TOTAL
Alabama	\$1,427,833	\$37,868	\$2,119	\$16,305	\$1,484,125
Alaska	191,009	18,665	14,584	60	224,318
American Samoa	8,167	3,660	0	0	11,827
Arizona	1,591,648	12,473	13,621	1,018	1,618,760
Arkansas	579,956	142,382	2,837	3,140	728,315
California	245,308,717	28,645,433	2,077,337	762,996	276,794,483
Colorado	1,830,491	44,545	18,578	8,345	1,901,959
Connecticut	3,611,946	201,089	27,447	21,318	3,861,800
Delaware	23,198	2,376	0	0	25,574
District of Columbia	0	0	0	0	0
Florida	10,035,423	96,450	10,707	70,479	10,313,059
Georgia	6,129,384	204,709	8,052	49,896	6,392,041
Guam	18,303	3,539	0	0	21,842
Hawaii	551,000	145,251	0	150	696,401
Idaho	571,682	11,553	3,877	997	588,109
Illinois	1,834,078	317,932	995	17,291	2,170,296
Indiana	783,774	103,940	1,533	9,888	899,135
Iowa	148,248	29,437	11,232	1,816	190,733
Kansas	337,250	26,737	993	1,984	366,964
Kentucky	305,764	143,905	4,200	5,307	459,176
Louisiana	366,712	74,087	1,433	10,857	453,089
Maine	5,299,276	477,470	19,660	19,402	5,815,808
Maryland	317,814	0	0	0	317,814
Massachusetts	13,572,243	108,720	0	5,882	10,144,397
Michigan	9,678,049	384,073	8,773	73,502	10,144,397
Minnesota	3,526,916	15,793	3,233	932	3,546,874

**...1998 LOW INCOME SUPPORT BY STATE CONTINUED:**

STATE	LIFELINE	LINKUP	TLS	PICC	TOTAL
Mississippi	876,569	38,302	1,362	10,264	926,497
Missouri	545,925	83,766	2,683	2,494	634,868
Montana	665,529	22,356	10,524	1,945	700,354
Nebraska	599,080	8,541	12,640	3,411	623,672
Nevada	214,128	1,902	410	13	216,453
New Hampshire	161,489	26,155	0	873	188,517
New Jersey	317,378	2,356	330	0	340,210
New Mexico	2,511,329	116,307	70,603	31,716	2,729,955
New York	53,790,679	5,479,659	74	969,427	60,239,839
North Carolina	2,427,820	38,589	2,416	13,365	2,482,190
North Dakota	863,031	23,146	10,603	4,525	901,305
Northern Marianas	10,659	5,887	0	0	16,546
Ohio	5,251,690	321,546	21,328	99,255	5,693,819
Oklahoma	104,566	47,878	883	1,077	154,404
Oregon	2,351,144	46,207	19,739	10,280	2,427,370
Pennsylvania	1,741,705	1,469,381	90	800	3,211,976
Puerto Rico	587,167	68,116	0	0	655,283
Rhode Island	3,753,152	29,878	0	0	3,806,876
South Carolina	1,798,292	42,514	6,278	21,106	1,868,190
South Dakota	656,428	29,490	14,889	3,267	704,074
Tennessee	1,862,743	78,217	1,364	10,248	1,952,572
Texas	17,080,005	2,248,046	173,804	368,228	19,870,083
Utah	1,665,232	36,078	24,856	9,186	1,735,352
Vermont	2,211,458	24,174	487	2,958	2,239,077
Virgin Islands	49,229	2,005	0	0	51,234
Virginia	1,772,837	182,449	478	627	1,956,391
Washington	4,059,632	418,244	89,905	33,236	4,601,017
West Virginia	367,899	8,966	0	23	376,888
Wisconsin	2,716,362	378,836	3,037	48,748	3,146,983
Wyoming	92,881	474	456	127	93,938
<b>GRAND TOTAL:</b>	<b>\$419,154,919</b>	<b>\$42,651,698</b>	<b>\$2,700,450</b>	<b>\$2,802,610</b>	<b>\$467,309,677</b>

**1999 LOW INCOME SUPPORT BY STATE:  
RURAL HEALTH CARE PROGRAM - INDICATORS OF SUCCESS:**

STATE	LIFELINE	LINKUP	TLS	PICC	TOTAL
Alabama	\$1,557,261	\$28,862	\$2,175	\$24,324	\$1,612,622
Alaska	343,120	24,134	29,075	468	396,797
American Samoa	26,893	20,820	0	0	47,713
Arizona	1,610,400	104,539	69,449	32,668	1,817,056
Arkansas	584,319	101,090	2,315	7,596	695,320
California	247,301,095	24,062,256	2,268,441	1,056,418	274,688,210
Colorado	2,013,724	22,506	37,514	24,531	2,098,275
Connecticut	3,906,470	149,399	20,515	21,397	4,097,781
Delaware	38,185	1,116	0	0	39,301
District of Columbia	876,337	430	0	0	876,767
Florida	10,911,154	188,296	16,581	108,367	11,224,398
Georgia	6,207,788	167,685	10,594	89,634	6,475,701
Guam	68,177	12,304	0	0	80,481
Hawaii	796,373	229,187	3,520	5,033	1,034,113
Idaho	1,261,703	16,003	24,355	17,510	1,319,571
Illinois	3,159,443	332,878	2,085	46,739	3,541,145
Indiana	1,204,107	127,536	2,801	23,700	1,358,144
Iowa	382,918	21,526	15,981	8,880	429,305
Kansas	465,671	28,662	2,279	6,927	503,539
Kentucky	1,981,682	177,483	6,176	22,909	2,188,250
Louisiana	656,464	26,208	1,985	22,518	707,175
Maine	5,638,439	574,671	8,086	56,742	6,277,938
Maryland	326,288	21,760	0	0	348,048
Massachusetts	14,086,751	186,067	0	121,091	14,393,909
Michigan	9,919,343	405,932	9,234	116,681	10,451,190
Minnesota	3,449,555	6,078	10,887	5,864	3,472,384

(Table continued on next page)

**...1999 LOW INCOME SUPPORT BY STATE CONTINUED:**

<b>STATE</b>	<b>LIFELINE</b>	<b>LINKUP</b>	<b>TLS</b>	<b>PICC</b>	<b>TOTAL</b>
Mississippi	1,114,842	24,647	2,003	19,577	1,161,069
Missouri	738,877	18,627	4,310	9,566	771,380
Montana	799,430	20,819	18,141	5,368	843,758
Nebraska	783,481	8,117	15,183	8,670	815,451
Nevada	747,681	55,557	2,562	3,716	809,516
New Hampshire	327,542	26,750	0	4,414	358,706
New Jersey	404,504	10,043	353	0	414,900
New Mexico	2,726,539	114,263	80,826	67,548	2,989,176
New York	50,316,921	1,470,534	3,613	1,151,456	52,942,524
North Carolina	3,722,441	51,344	5,429	29,075	3,808,289
North Dakota	883,972	16,576	15,270	9,695	925,513
Northern Marianas	30,391	11,435	0	0	41,826
Ohio	6,891,158	393,170	22,875	179,122	7,486,325
Oklahoma	164,904	30,265	1,110	2,776	199,055
Oregon	2,436,562	39,955	20,675	26,542	2,523,734
Pennsylvania	3,009,748	1,039,848	28	1,852	4,051,476
Puerto Rico	1,064,389	31,208	0	0	1,095,597
Rhode Island	3,851,306	26,478	0	47,055	3,924,839
South Carolina	1,696,495	39,074	10,849	28,275	1,774,666
South Dakota	712,284	22,401	9,546	9,547	753,778
Tennessee	2,477,646	107,628	7,151	28,748	2,621,173
Texas	19,355,660	2,322,352	203,308	758,432	22,639,752
Utah	1,614,110	25,779	31,234	18,343	1,689,466
Vermont	2,391,146	26,545	2,779	8,533	2,429,003
Virgin Islands	19,472	440	0	0	19,912
Virginia	1,856,220	140,954	751	1,250	1,999,175
Washington	4,779,689	424,636	105,612	74,014	5,383,951
West Virginia	382,514	12,814	871	99	396,298
Wisconsin	3,792,565	449,945	4,985	75,728	4,323,223
Wyoming	111,837	893	794	393	113,917
<b>GRAND TOTAL:</b>	<b>\$439,977,986</b>	<b>\$34,000,498</b>	<b>\$3,114,306</b>	<b>\$4,389,791</b>	<b>\$479,482,581</b>

“As a TDS TELECOM - Riverside customer, I am forever grateful for the Lifeline program which helps to make my phone service more affordable. Recently, I had a liver transplant. As you can imagine, my medical bills have put a tremendous strain on my financial stability. TDS TELECOM - Riverside has always been supportive and understanding of my individual needs.”

-Jeannie Last  
Johnson Creek, WI

During Year One of the Rural Health Care Program, over 2,800 rural health care providers expressed interest in seeking program benefits. As of December 31, 1999, USAC had committed more than \$1.6 million to eligible health care providers in 39 states. More than 800 rural health care providers have already expressed interest in participating in Year Two of the program.

Applications for Year Two were accepted beginning on March 1, 1999. As of December 31, 1999, approximately 300 completed applications have been received. RHCD expects that \$3 million will be provided in Year One and more than \$6 million will be committed to rural health care providers for Year Two.

In an effort to streamline the program and increase participation, the FCC recently eliminated the requirement that only carriers that have been designated as ETCs may receive a credit against their universal service contribution for providing telecommunications services to rural health care providers. Under previous rules, carriers that had not been designated ETCs could not receive support for providing the discounted services to rural health care providers. This change will result in the following benefits:

- \* More support for applicants.
- \* Increased competition.
- \* Better choices for applicants.

The following chart highlights the amount committed in funding per state, as of December 31, 1999, for the first year of the Rural Health Care Program:

### Rural Health Care Program Year One Funding Commitments by State

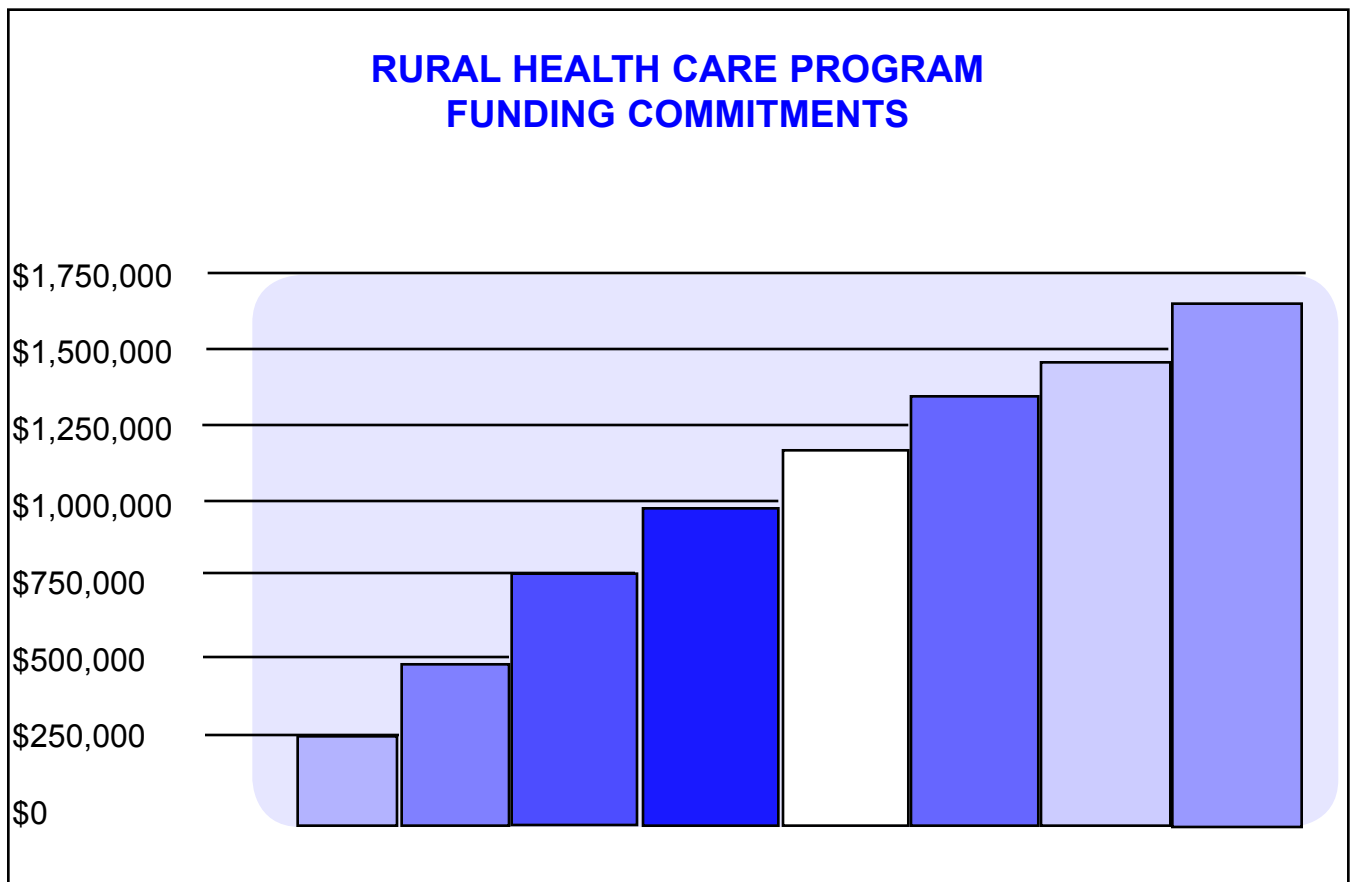
State	Amount
AK	\$205,867.96
AL	\$9,198.81
AR	\$13,353.97
AZ	\$163,826.96
CA	\$9,981.77
CO	\$59,470.77
HI	\$91,612.44
IA	\$27,418.44
ID	\$9,622.77
IL	\$17,309.89
KS	\$39,412.04
ME	\$2,493.92
MI	\$5,015.48
MN	\$126,882.34
MO	\$45,890.30
MS	\$40,200.01
MT	\$119,143.65
NC	\$29,679.49
ND	\$182,245.34
NE	\$11,688.33
NH	\$10,443.97
NM	\$43,033.88
NV	\$58,236.38
NY	\$124,386.36
OH	\$33,466.19
OK	\$20,537.43
OR	\$6,346.38
PA	\$790.00
SD	\$22,214.26
TN	\$9,990.61
TX	\$12,278.68
UT	\$29,534.58
VA	\$44,902.03
VI	\$7,986.60
VT	\$4,612.61
WA	\$21,040.75
WV	\$16,922.24
WY	\$1,022.52
<b>TOTAL:</b>	<b>\$1,678,306.97</b>



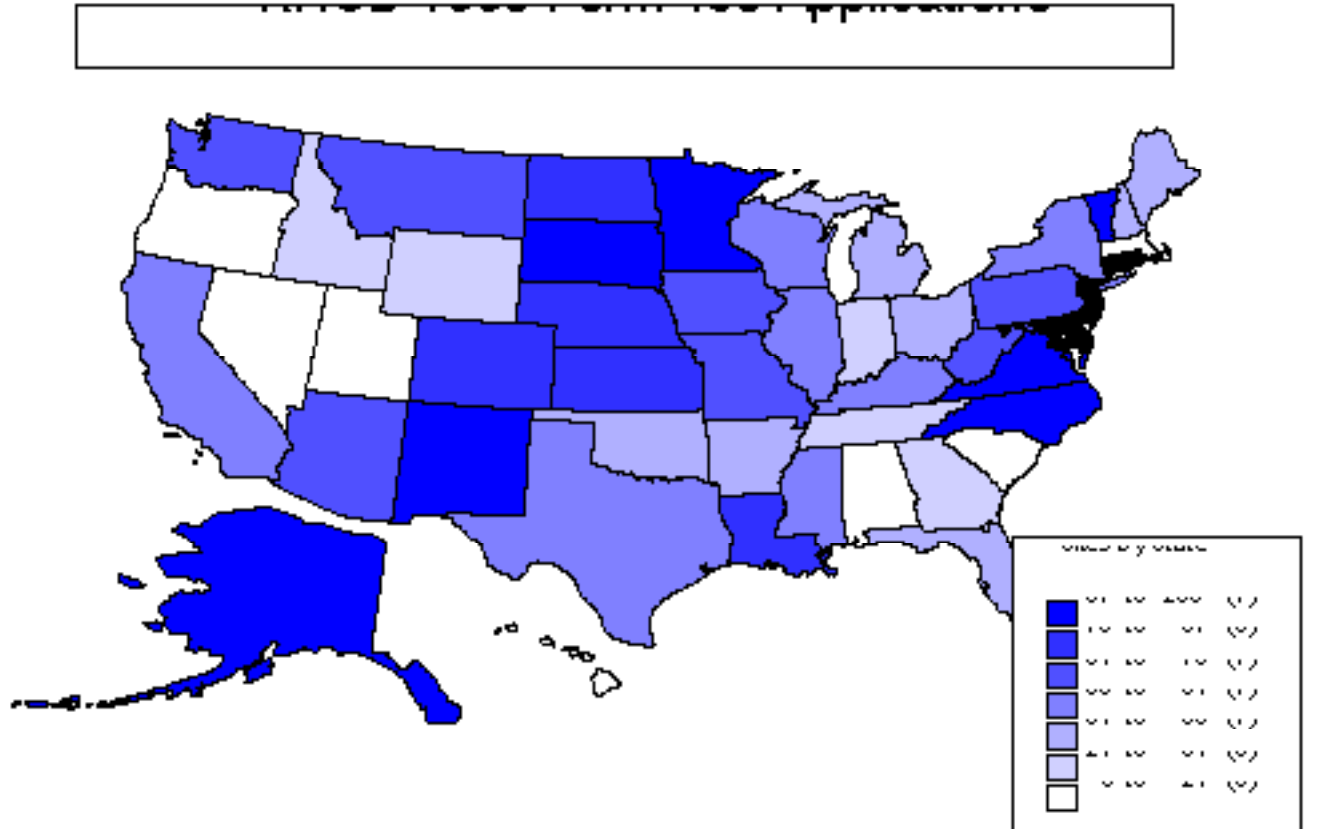
“We are delighted to have received the funding commitment letter for the Universal Service Fund discounts. These discounts will allow our telemedicine efforts to continue, and thus, we will be able to extend health care services to a greater number of people.”

-Ryan Wiest  
Telemedicine Coordinator  
St. Charles Medical Center

The following graph depicts the cumulative amount of funding committed from the Rural Health Care Program’s inception through December 31, 1999:



The following map illustrates participation in the Rural Health Care Program based on the number of FCC Form 465 applications submitted by health care providers. Form 465 is the initial application that specifies the services required by the entity and notifies potential vendors of the opportunity to bid on those services:



The following chart depicts committed funds according to the type of health care provider:

<b>RHCD Committed Funds by HCP Type - Funding Year One</b>		
As of December 31, 1999		
<b>HCP Type</b>	<b>HCP Count</b>	<b>Committed Funds</b>
Not-for-profit Hospital	154	\$839,182.67
Rural Health Clinic	46	\$184,068.31
Community Mental Health Center	40	\$210,776.62
Rural Health Care Provider (1)	30	\$339,535.64
Community Health Center or Health Center		
Providing Health Care to Migrants	12	\$42,951.57
Other (2)	6	\$20,073.06
Post-secondary educational Institution	5	\$32,398.72
Local Health Dept. of Agency	2	\$9,320.38
<b>TOTAL</b>	<b>295</b>	<b>\$1,678,306.97</b>

(1) Based on 1998 FORM 465 - HCP sites in this category did not specify their type on FORM 465.

(2) Based on 1998 FORM 465 - "Other" is listed as a choice for HCP type.

The following chart depicts the amount of committed funds according to the type of service:

<b>RHCD Committed Funds by Service Type - Funding Year One</b>		
As of December 31, 1999		
<b><u>Service Type</u></b>	<b><u>HCP Count</u></b>	<b><u>Committed Funds</u></b>
T1 - 1.544 Mbps	172	\$1,254,024.83
ISDN BRI - 128 Kbps	37	\$48,395.21
Frame Relay - 56 Kbps	24	\$33,241.36
NRS - T1	8	\$13,353.97
DDS - 56 Kbps	6	\$9,940.30
Fractional T1 - 384 Kbps	7	\$44,205.58
Frame Relay - 1.544	7	\$33,440.32
Frame Relay - 128 Kbps	16	\$207,062.52
ISDN PRI - 1.544 Mbps	3	\$9,847.88
56k Synchonet	2	\$1,380.41
Dedicated Analog Line - 4 wire (UGPA)	2	\$1,475.38
Switchnet 56K	2	\$1,941.17
ATM - 1.544 Mbps	1	\$1,344.16
DDS - 64 Kbps	1	\$86.09
Dedicated Line - 56 Kbps	1	\$4,419.58
Direct Inward Dial	1	\$531.23
Foreign Exchange	1	\$987.88
Frame Relay - 384 Kbps	1	\$1,167.38
Frame Relay - 64 Kbps	1	\$7,396.41
Off Premise Extension	2	\$9,664.29
T1 Selectdata	1	\$537.78
Internet Toll Charges	1	\$246.82
<b>TOTAL</b>	<b>297(1)</b>	<b>\$1,678,306.97</b>

(1) HCP count totals 297 instead of 295 since two HCPs received support for two different service types each.

## SCHOOLS AND LIBRARIES PROGRAM- INDICATORS OF SUCCESS:

In Year One of the Schools and Libraries Program (the eighteen month period ending on June 30, 1999), over \$1.7 billion in discounts were committed to participating schools and libraries across the nation. Twenty-five thousand recipients received funding commitments and over 640,000 classrooms were connected to modern telecommunications networks. Additionally, over 5,800 library buildings received discounts on their telecommunications and Internet services.

For Year Two (July 1, 1999 – June 30, 2000), 32,000 applications were received during the filing “window,” the period during which all applications are treated as if they were filed simultaneously. The FCC established a funding level of \$2.25 billion, which allowed USAC to fund all approved applications received within the filing window. The following table shows the cumulative totals for Program Years One and Two for each of the 50 States, 4 United States territories, and the District of Columbia as of December 31, 1999:

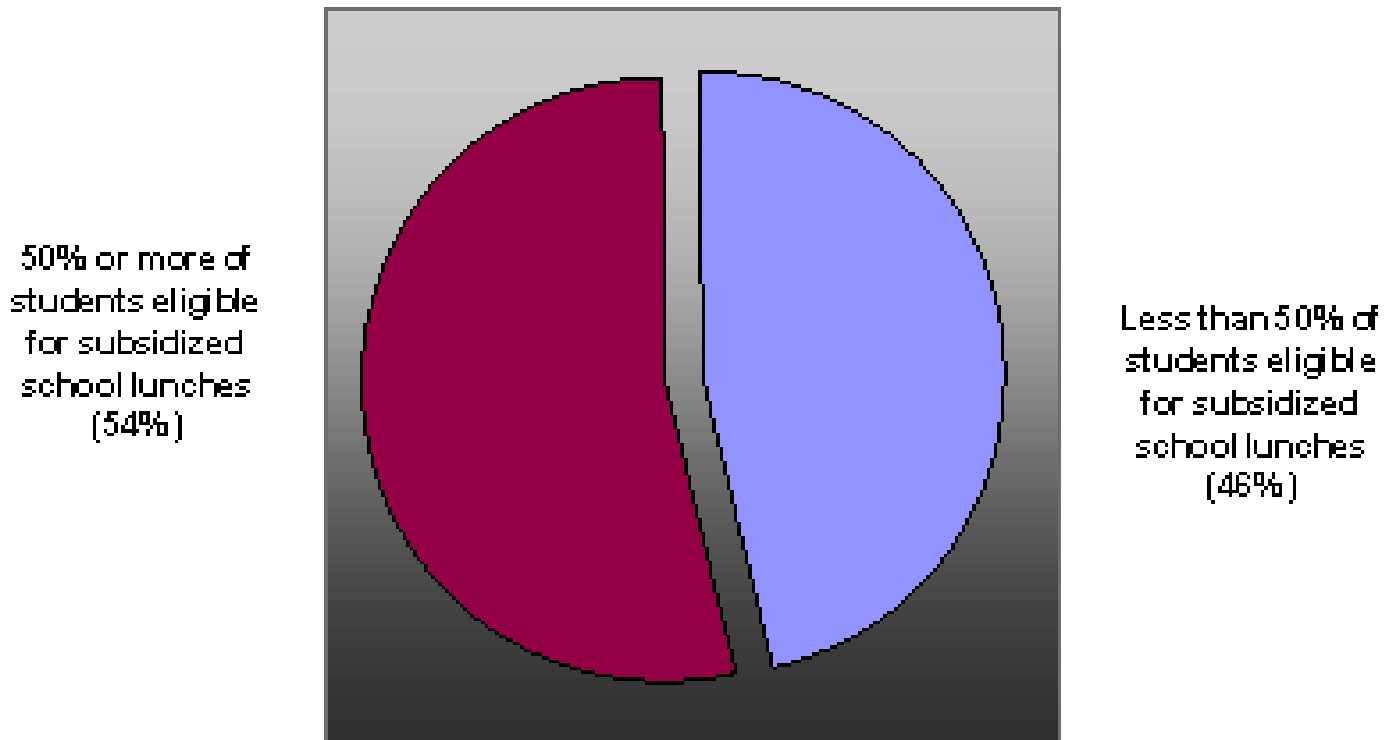
### E-rate Funding for Year One and Year Two (Cumulative Dollars Committed)

STATE	CUM. TOTAL \$		
	\$23,917,826.21	MT	7,435,701.76
AK	73,035,625.24	NC	64,431,492.16
AL	23,899,752.89	ND	4,632,920.52
AR	6,261,169.01	NE	11,669,861.97
AS	73,380,862.35	NH	2,887,032.37
AZ	458,081,865.08	NJ	103,802,582.00
CA	24,873,554.14	NM	48,338,731.67
CO	56,138,629.73	NV	7,180,030.53
CT	14,114,939.91	NY	349,103,342.28
DC	2,375,463.20	OH	100,537,572.24
DE	119,472,550.20	OK	66,636,284.71
FL	167,899,690.65	OR	20,716,396.75
GA	11,176,282.63	PA	107,108,403.04
HI	15,355,138.04	PR	115,404,642.88
IA	9,683,247.35	RI	13,819,198.46
ID	235,840,344.32	SC	58,459,306.87
IL	41,495,370.26	SD	5,000,156.76
IN	24,106,201.90	TN	113,154,726.13
KS	106,661,234.70	TX	262,936,085.89
KY	77,321,090.34	UT	11,785,643.70
LA	63,975,775.11	VA	51,053,672.10
MA	37,038,635.27	VI	4,391,757.63
MD	6,539,549.75	VT	3,667,931.52
ME	137,119,111.45	WA	61,536,275.62
MI	53,436,161.03	WI	63,165,202.31
MN	51,415,518.62	WV	18,740,614.43
MO	95,400.70	WY	4,858,918.39
MP	54,995,796.83	<b>TOTAL</b>	<b>\$3,652,211,271.60</b>
MS			

Since the first funding commitments were issued in November 1998, the Schools and Libraries Program has enabled thousands of schools and libraries to obtain services that are vital to the education of America's children.

The following chart characterizes E-rate recipients based on the level of economic need. As the chart indicates, those who are neediest received the majority of funds:

**Percent of Total Dollars Committed by Level of Economic Need  
for Years One and Two Combined (\$3.65 billion)**



“Many of our patrons do not have access to the Internet at home. Were it not for the access provided members of our community via the E-rate, literally thousands of people would not be able to use this tool...This has been a tremendous success for the people of Baltimore.”

-Patricia Wallace  
Head of Information Access  
Baltimore Enoch Pratt Free Library

## Beneficiary and Service Provider Participation

Since 1998, over \$6 billion in funding commitments have been issued through the four universal service support mechanisms. This translates into direct benefits from the USF to literally thousands of high cost regions, low-income consumers, health care facilities, as well as schools and libraries throughout the United States. On an individual basis it is difficult to imagine how many people have been and will be affected by this support. Millions of Americans living in rural communities continue to be connected. Five million low-income customers have access to telephone services, many of them for the first time. Countless patients of rural medical facilities will benefit from the advanced technologies of telemedicine afforded health care organizations that previously lacked vital resources. Public libraries, which by definition are open to everyone, are using these funds to expand library holdings to an almost infinite volume without knocking down a wall, or building an addition.

The ongoing task of locating and identifying eligible participants for the Low Income Program remains a high priority. Data characterizing various demographic regions of America is available from a variety of sources, and upon inspection, it does not take long to recognize which areas of the country, whether they be inner-city or rural, should be targeted for outreach. With the help of telecommunications associations and service providers, USAC's outreach team has successfully given multiple seminars to industry participants.

Outreach for the High Cost and the Rural Health Care Programs has included an ongoing campaign of teleconferences and in-person seminars targeted at spreading the message to the more rural and isolated regions of America. Service providers have been, and continue to be, active participants in reaching potential beneficiaries. The development of vital communications tools such as brochures, media kits, and web sites have made this endeavor cost effective and successful for each of the USF programs. For services delivered during Year One of the Rural Health Care Program, nearly 300 health care providers in 39 states will receive supported services. (Please see the section on Benefits to Americans for detailed information on who has been served)

In 1998, the outreach team for the Schools and Libraries Program visited 49 states in order to explain the program and to instruct potential applicants and service providers on how to comply with program rules. The outreach campaign was consolidated in 1999 and the result was tremendous. Via live telecast from nine seminars in regions throughout the United States, the outreach team was able to instruct between 70 and 350 E-rate coordinators per event, representing every state and territory in the nation, and reaching applicants and service providers alike. These efforts were the foundation for a significant increase in program participation.

The impact of the E-rate is becoming evident, both qualitatively and quantitatively. On March 2, 2000, for example, the Benton Foundation released a report evaluating the impact of the first two years of the program in four communities. The report observed that through the E-rate, "Network infrastructure deployment accelerated, and Internet access improved dramatically." It also noted, "E-rate funding has enabled school districts to leverage existing financial resources."

The Department of Education recently released new statistics on the availability of the Internet in public school classrooms. In 1998, just over half of public school classrooms had Internet access; in 1999, the percentage had increased to 63. Data supplied to USAC from Schools and Libraries Program applicants

makes evident that libraries and schools are indeed expanding connectivity in their facilities in large part due to the E-rate.

A technology coordinator for a rural county in a southern state has reported that the E-rate helped the county upgrade slow 56K connections to high-speed T-1 lines. As a result, students in a high school in the county are completing a study of the stock market. The students selected their stock, pretended to buy and sell, watched the daily reports using the Internet and kept a computerized journal of their earnings. With the T-1 lines, all the students could check at any given time without waiting. The "ticker tape" ran all the time on every computer in the buildings. T-1 access at the county library means students no longer have to be transported to colleges to conduct research. None of this would have been possible without E-rate, reports the technology coordinator.

That is just one local story, but it is being repeated around the country. E-rate funds will mean an estimated 50 percent increase in classrooms connected in Catholic schools and an estimated 31 percent increase in other private schools. The number of direct connections in libraries will increase 48 percent after two years of E-rate funding.

Service provider participation continues to be positive and competitive. Currently, there are over twenty-one thousand service provider identification numbers (SPINs - the nine digit number assigned to service providers participating in the Universal Service Program), equating to more than sixty-five hundred service providers that actively participate in the universal service support mechanisms. These service providers include local and interstate telecommunications companies, Internet service providers (ISPs) and various internal connections contractors.

## Actions to Prevent Waste, Fraud and Abuse

The most significant administrative change that has occurred since the creation of USAC has been the consolidation and streamlining of the administrative process resulting from giving USAC responsibility for managing all the universal service support mechanisms. After approval by the FCC, in order to foster greater accountability, control administrative costs, and establish a more efficient environment for the administration of the four programs, the Schools and Libraries Corporation and the Rural Health Care Corporation merged into USAC effective December 31, 1998.

The internal controls of the universal service support mechanisms have been examined and independent firms have attested that no material issues have been identified. The financial statements have been audited and all records have been found to accurately state the financial position of the company. USAC and the programs it administers have received a clean bill of health from independent auditors and the United States General Accounting Office (GAO).

Program integrity is critically important to USAC, and we strive to fully comply with all applicable laws and to ensure that only eligible entities receive support for eligible services. In order to provide that the programs administered by USAC minimize waste, fraud, and abuse, USAC has instituted and enforced stringent internal controls that have been scrutinized by independent auditors and the GAO. In May 1998, USAC submitted audit reports to the Common Carrier Bureau of the FCC in compliance with the Commission's rules. The financial audit, by the independent auditing firm Arthur Andersen, LLP, was conducted of the USF as well as the High Cost, Low Income, Schools and Libraries, and Rural Health Care Programs as of December 31, 1998, and related combined and combining statements of changes in fund balances and cash flows from inception (September 17, 1997) through December 31, 1998. Audited financial statements for 1999 are not yet available.

Additionally, independent auditors from Arthur Andersen conducted an examination of the 1998 operations and internal controls for USAC and the High Cost and Low Income Programs. In the same year, Deloitte & Touche examined the operations and internal controls of the Rural Health Care Program and PricewaterhouseCoopers examined the internal controls of the Schools and Libraries Program. Similar examinations for 1999 operations are not yet available.

In the spring of 1998, the Senate Commerce Committee directed the GAO to investigate USAC's administrative procedures and internal controls governing the Schools and Libraries Program. The purpose of that review was to evaluate efforts to maintain the integrity of the program as a means of avoiding waste, fraud or abuse. The GAO report, "Schools and Libraries Program: Actions Taken to Improve Operational Procedures Prior to Committing Funds," (March 1999) indicates that the key recommendations that the GAO believes are needed have been implemented. In all cases, the auditors found no material issues of concern in any of the audits they undertook.

USAC continually monitors the universal service support mechanisms in an effort to identify and eliminate any waste, fraud and abuse.



## Assessment of Contractor Performance

**U** SAC contracted with the National Exchange Carrier Association, Inc. (NECA) for support services necessary to administer the High Cost and Low Income Programs during the period covered by this report. The contractor performed the tasks associated with this contract in a fully satisfactory manner.

**U** SAC contracted with PricewaterhouseCoopers, LLP (PwC) for customer service/support, forms processing, web site development and maintenance and program integrity assurance for the Rural Health Care Program during the period covered by this report. The contractor performed the tasks associated with this contract in a fully satisfactory manner.

**U** SAC contracted with NECA for customer service and support, forms processing, web site development and maintenance, as well as program integrity assurance for the Schools and Libraries Program during the period covered by this report. The contractor performed the tasks associated with this contract in a fully satisfactory manner.

**U** SAC contracted with NECA for billing, collections, and disbursement functions for all four universal service support mechanisms during the period covered by this report. The contractor performed the tasks associated with this contract in a fully satisfactory manner.

**1999 USAC Board of Directors**

- David Abramson**.....Intermedia.NET
- Anne L. Bryant**.....National School Boards Association, Executive Director
- John (“Tony”) A. Butler**.....Butler Enterprises, President
- Edwin H. Eichler**.....Pigeon Telephone Company, President
- Heather B. Gold**.....**Chair, High Cost and Low Income Committee**,  
Intermedia Communications, Vice President, Industry Policy
- Frank Gumper**.....Bell Atlantic, Vice President of Federal Regulatory Planning
- Kevin Hess**.....TDS Telecom, Vice President - Federal Affairs
- Martha Hogerty**.....Office of the Public Counsel, Missouri Public Counsel
- James Jackson**.....General Communications, Inc., Regulatory Attorney
- Isiah C. Lineberry**.....Rural Health Policy Center, Penn State  
Geisinger Health System, Deputy Director
- Dr. Henry Marockie**.....**Vice Chair, Board of Directors**  
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Vice President of Network Financial Management
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Executive Director
- Allan Thoms**.....Iowa Utilities Board  
Chair
- Thomas Wheeler**.....Cellular Telecommunications Industry Association  
President

# **APPENDIX: Financial Reports**

ARTHUR ANDERSEN LLP

**Universal Service Administrative Company**

**Financial Statements as of December 31, 1998**

**For the Period September 17, 1997 (inception) through December 31, 1998**

**Together With**

**Report of Independent Public Accountants**

# ARTHUR ANDERSEN LLP

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of the

Universal Service Administrative Company:

We have audited the accompanying combined and combining statements of financial position of the Universal Service Administrative Company (a Delaware corporation) (the "Company") as of December 31, 1998, and the related statement of revenue and expenses and cash flows for the period from September 17, 1997 (inception) through December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 audits provide 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 Universal Service Administrative Company as of December 31, 1998, and the revenue and expenses and its cash flows for the period from September 17, 1997 (inception) through December 31, 1998 in conformity with generally accepted accounting principles.

Roseland, New Jersey  
June 19, 1999

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

STATEMENT OF FINANCIAL POSITION

DECEMBER 31, 1998

(in thousands)

ASSETS

CASH AND CASH EQUIVALENTS (Note 2)	\$5,665
RESTRICTED NET ASSETS APPLICABLE TO UNIVERSAL SERVICE FUND (USF) (Note 1)	<u>1,403,645</u>
Total assets	<u>\$1,409,310</u>

LIABILITIES AND FUND BALANCE

ACCOUNTS PAYABLE (Note 2)	\$5,665
RESTRICTED FUND BALANCE APPLICABLE TO USF (Note 1)	<u>1,403,645</u>
Total liabilities and fund balance	<u>\$1,409,310</u>

The accompanying notes to financial statements are an integral part of this statement.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

STATEMENT OF REVENUE AND EXPENSES

FOR THE PERIOD SEPTEMBER 17, 1997 (INCEPTION) THROUGH DECEMBER 31, 1998

(in thousands)

REVENUE:		
Contract Revenue		<u>\$4,496</u>
EXPENSES:		
Personnel and related expenses		183
General and administrative	382	
Depreciation and amortization		2
Contractual expenses (Notes 1 and 2)	<u>3,929</u>	
Total expenses	<u>4,496</u>	
Net Income		<u>\$ -</u>

The accompanying notes to financial statements are an integral part of this statement.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

STATEMENT OF CASH FLOWS

FOR THE PERIOD SEPTEMBER 17, 1997 (INCEPTION) THROUGH DECEMBER 31, 1998

(in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:

Contract revenue received	\$4,496
Other cash received	4,910
Cash paid for administrative costs	<u>(3,741)</u>
Net cash provided by operating activities	5,665
CASH AND CASH EQUIVALENTS, beginning of period	<u>-</u>
CASH AND CASH EQUIVALENTS, end of period	<u><u>5,665</u></u>
RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Changes in operating assets and liabilities-	
Increase in restricted net assets applicable to USF	(\$1,403,645)
Increase in payable to National Exchange Carrier Association (NECA)	5,665
Increase in restricted fund balance applicable to USF	<u>1,403,645</u>
Net cash provided by operating activities	<u><u>\$5,665</u></u>

The accompanying notes to financial statements are an integral part of this statement.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1998

(in thousands)

(1) ORGANIZATION AND BASIS OF PRESENTATION:

The Federal Communications Commission ("FCC") in its Report and Order in CC Docket No. 96-45 ("Universal Service Order") released May 8, 1997 determined that the National Exchange Carrier Association, Inc. ("NECA") should serve as the temporary administrator of the universal service support mechanisms, collectively referred to herein as the Universal Service Fund ("USF"), established pursuant to Section 254 of the Communications Act of 1934, as amended.

The Universal Service Administrative Company ("USAC") was formed, effective September 17, 1997, at the direction of the FCC as an independent wholly-owned subsidiary of NECA. USAC's Board of Directors consists of independent directors representing a cross-section of stakeholders in Universal Service. The FCC also directed NECA to establish two unaffiliated not for profit corporations, referred to herein as the Schools and Libraries Corporation ("SLC") and the Rural Health Care Corporation ("RHC"). SLC and RHC were formed effective September 17, 1997. The SLC and RHC Board of Directors consists primarily of a subset of the USAC Board.

USAC performs billing and collection functions for all the universal service programs - high cost, low income, schools and libraries and rural health care (the "Programs"). It also collects information regarding contributing entities' end-user telecommunications revenues, submits to the FCC projections of demand and administrative expenses for the high cost and low income programs and submits quarterly universal service contribution data to the FCC.

The functions of SLC and RHC include, but are not limited to: administering the application process for eligible schools, libraries and rural health care providers, creating and maintaining a website and related operational infrastructure for such processes, performing outreach and public education functions, submitting to the FCC projections of demand and administrative expenses, informing USAC of support to be disbursed, authorizing audits of schools, libraries, and rural health care providers and any other administrative function not specifically assigned to USAC.

NECA was appointed by the FCC as the temporary administrator of the USF. Effective November 20, 1998, USAC was appointed the permanent administrator. SLC and RHC will continue to perform their designated functions. NECA performs administrative services for USAC under contract whereby NECA is compensated by USAC in accordance with NECA's Cost Accounting and Procedures Manual. Effective January 1, 1999, SLC and RHC were merged into USAC as the Schools and Libraries Division ("SLD") and the Rural Health Care Division ("RHCD"), respectively.



Funds collected from contributions by USAC are restricted as to their intended use related to the universal service support mechanisms discussed above. Accordingly, such funds, together with related assets and liabilities have been reflected as "restricted net assets applicable to USF" in the accompanying statement of financial position. Available funds are maintained and invested by USAC. In addition to payments to service providers and for administrative expenses, USAC provides funds to SLC and RHC to support the functions they are obligated to carry out as described above. Such funding is reflected as "Administrative Costs-SLC & RHC" in the information presented below for the USF Fund balance. As of December 31, 1998, SLC and RHC had unexpended cash balances of \$2 and \$600, respectively. Since the activities of SLC and RHC have been included in the information presented below for the Schools and Libraries and Rural Health Care programs, such cash balances together with related assets and liabilities are also included therein and payments to SLC and RHC have been reduced accordingly. USAC administrative costs include amounts specific to the administration of the high cost and low income programs and common costs for billing, collection and administration for all the programs. NECA administrative costs include amounts for high cost data collection incurred by NECA.

Financial information as of December 31, 1998 and for the period from September 17, 1997 (inception) through December 31, 1998 for the USF is as follows-

1998		Rural				
<u>SUMMARY STATEMENT OF NET ASSETS APPLICABLE TO USF</u>	<u>High Cost</u>	<u>Low Income</u>	<u>Schools &amp; Libraries</u>	<u>Health Care</u>	<u>Total USF</u>	
<b>ASSETS:</b>						
Cash and cash equivalents						
Receivable from contributors	\$ -	\$ 56,418	\$1,170,408	\$ 87,254	\$1,314,080	
Allowance for doubtful accounts	155,302	42,671	117,726	9,448	325,147	
Interest receivable	(3,826)	(1,094)	(1,600)	(157)	(6,677)	
Prepaid and other assets	-	43	766	61	870	
Fixed assets, net	447	86	117	92	742	
	<u>54</u>	<u>54</u>	<u>54</u>	<u>198</u>	<u>360</u>	
Total assets	151,977	98,178	1,287,471			
96,896	1,634,522					
<b>LIABILITIES:</b>						
Payable to service providers	142,407	80,677	-	-	223,074	
Payable to contributors	1,257	518	117	10	1,902	
Accounts payable and accrued expenses	-	-	5,811	90	5,901	
Interfund payable (receivable)	<u>9,849</u>	<u>(9,849)</u>	<u>-</u>	<u>-</u>	<u>-</u>	
Total liabilities	<u>153,513</u>	<u>71,336</u>	<u>5,928</u>	<u>100</u>	<u>230,877</u>	
Restricted fund balance applicable to USF	<u>\$ (1,536)</u>	<u>\$ 26,842</u>	<u>\$1,281,543</u>	<u>\$ 96,796</u>	<u>\$1,403,645</u>	

SUMMARY STATEMENT OF CHANGES IN FUND BALANCE	1998					
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF	
ADDITIONS TO FUND BALANCE:						
Amounts billed to contributors		\$1,701,594	\$487,833	\$1,284,200	\$100,731	\$3,574,358
Interest income		3,032	3,641	28,430		2,135
Other income		285	83	127		11
Total additions	1,704,911	491,557	1,312,757	102,877	3,612,102	
DEDUCTIONS FROM FUND BALANCE:						
Amounts paid and due to providers		1,696,751	461,345	-	-	2,158,096
Refunds paid and due to contributors		2,451	937	1,342	104	4,834
Allowance for doubtful accounts		3,826	1,094	1,600	157	6,677
Administrative costs-						
NECA		2,158	-	-	-	2,158
USAC		1,261	1,339	948	948	4,496
SLC & RHC		-	-	27,324	4,872	32,196
Total deductions		1,706,447	464,715	31,214	6,081	2,208,457
Net change in fund balance	(1,536)	26,842	1,281,543	96,796	1,403,645	
BEGINNING FUND BALANCE	-	-	-	-	-	-
ENDING FUND BALANCE	\$ (1,536)	\$ 26,842	\$ 1,281,543	\$ 96,796	\$ 1,403,645	

SUMMARY STATEMENT OF CASH FLOWS	1998					
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF	
CASH FLOWS FROM OPERATING ACTIVITIES:						
Cash received from contributors		\$1,546,234	\$ 445,237	\$1,166,590	\$91,295	\$3,249,356
Cash paid to contributors	(1,212)		(411)	(1,214)	(95)	(2,932)
Cash paid to service providers		(1,554,344)	(380,678)			(1,935,022)
Cash paid for administrative expenses		(3,419)	(1,339)	(22,461)	(5,696)	(32,915)
Interest received		3,032	3,598	27,664		2,074
Interfund transfers		9,849	(9,849)			
Net cash provided by operating activities		140	56,558	1,170,579	87,578	1,314,855
CASH FLOWS FROM INVESTING ACTIVITIES—						
Purchase of fixed assets		(140)	(140)	(171)	(324)	(775)
Net cash used in investing activities	(140)	(140)	(171)	(324)	(775)	
CASH FLOWS FROM FINANCING ACTIVITIES						
Increase in cash and cash equivalents	-	56,418	1,170,408	87,254		1,314,080
CASH AND CASH EQUIVALENTS, beginning of period	-	-	-	-	-	-

CASH AND CASH EQUIVALENTS, end of period    \$ \_\_\_\_\_ - \$ 56,418 \$1,170,408    \$ 87,254    \$ 1,314,080  
 -4-

Payments to SLC and RHC of \$27,324 and \$4,872, respectively, reflected above represent actual expenditures or commitments and consist of the following-

	<u>SLC</u>	<u>RHC</u>
Personnel and related expenses	\$1,784	\$464
General and administrative	2,199	773
Depreciation and amortization	-	33
Contractual expenses	<u>23,241</u>	<u>3,602</u>
	<u>\$27,324</u>	<u>\$4,872</u>

(2) SIGNIFICANT ACCOUNTING POLICIES:

These accounting policies relate to the USF activities described above.

Use of 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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents-

USAC considers all highly liquid securities, purchased with an original maturity of three months or less, to be cash equivalents.

Allowance for Doubtful Accounts-

USAC has provided for a reserve for doubtful accounts for all known bankruptcies and contributors which have discontinued operations.

Fixed Assets-

Fixed assets are carried at cost. Depreciation of furniture and equipment is calculated on a straight-line basis over the estimated useful lives of those assets (five years). Amortization of leasehold improvements is calculated on a straight-line basis over the remaining period of the respective leases or the estimated useful lives of the improvements, whichever is less. Amortization of software is calculated on a straight-line basis over the estimated useful lives of those assets (three to five years). Maintenance and repairs are charged to operations as incurred.

Accounts Payable-

During the period ended December 31, 1998, USAC entered into a contract with NECA whereby NECA provided all administrative and cash management services to USAC. Accounts payable represents administrative costs incurred by and due to NECA on behalf of USAC and intercompany cash transactions.

(3) COSTS OF COMPUTER SOFTWARE DEVELOPMENT:

The AICPA has adopted Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" effective for financial statements for fiscal years beginning after December 15, 1998. The statement requires that certain costs of materials and services consumed in developing or obtaining internal-use computer software be capitalized. Earlier application is encouraged in fiscal years for which annual financial statements have not been issued. Management has elected to capitalize these costs beginning in 1999. Had management elected early adoption, approximately \$987 of expenses would have been capitalized in 1998.

(4) COMMITMENTS TO SERVICE PROVIDERS (unaudited):

Beginning in November 1997, the management of SLC began developing operational procedures to administer the application process through which eligible schools and libraries apply for universal service funding. As of December 31, 1998 SLC had made funding commitments to eligible schools and libraries totaling \$283,332. Of this amount, \$206,454 in commitments were actually issued to applicants. Commitments issued to applicants included those for telecommunications, Internet access and dedicated services, and for internal connections at the 90 percent discount band. Finalization of funding commitments for internal connections below the ninety percent discount band have not yet been issued to applicants and represent the difference in the above amounts.

Beginning in March 1998, the management of RHC began developing operational procedures to administer the application process through which eligible rural health care providers apply for universal service funding. To date, RHC's operational procedures are still under review and no commitments have been made to eligible rural health care providers.

(5) INCOME TAXES:

USAC is a not-for-profit organization subject to income taxes related to permanent and temporary differences such as meals expense and financial accounting versus tax depreciation. Income taxes for the period are immaterial and included as a component of administrative costs.

(6) COMMITMENTS:

Obligations to make future minimum lease payments under noncancelable operating leases (without providing for escalation clauses, the effect of which is not expected to be significant) are: \$274 (1999); \$317 (2000); \$324 (2001), \$330 (2002); and \$337 (2003 and thereafter). Rental expense related to premises and equipment, including payments under month-to-month leases, amounted to \$15 during the period.

(7) RETIREMENT PLANS:

USAC has a 401(k) Retirement Savings Plan ("the Plan") covering all USAC regular employees. The Plan is both contributory and noncontributory and all contributions are subject to certain limitations as prescribed by the Plan Document and government regulations. Employees are immediately vested in the employer contribution, which is funded on a current basis. The Plan employer contribution charged to operations was \$10 during the period.