

An Audit Report on

The Public Utility Commission of Texas's Administration of the Texas Universal Service Fund

December 2004

Report No. 05-015



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Overall Conclusion

The Public Utility Commission of Texas (Commission), through its contractor that administers the fund, correctly distributed the majority of the funds from the Texas Universal Service Fund (TUSF). However, because the Commission did not monitor the contractor or include all necessary contract provisions, the Commission cannot ensure that the contractor consistently administers the TUSF in accordance with laws and regulations. Our audit identified the following:

- Neither the Commission nor the TUSF administrator has an effective process in place to identify telecommunications companies that may not be paying their mandatory TUSF assessments. We could not determine whether approximately 334 companies paid their mandatory assessments to the TUSF; the potential lost revenue is approximately \$2.27 million for the three quarters of fiscal year 2003 that we tested. One hundred and seven of the companies accounted for the majority of the potential lost revenue. The TUSF administrator reported that TUSF revenue for fiscal year 2003 was estimated at \$549 million. Additionally, one company from our sample (out of a total of 1,700 companies paying assessments to the TUSF) indicated to us that it may have charged customers the TUSF fee but did not remit the assessment to the TUSF.
- While the Commission's administration of the Lifeline Discount Program substantially complies with laws and regulations, the following areas need improvement:
 - The eligibility of approximately 191,000 of 400,000 Lifeline Discount Program customers was never determined. The Commission did not perform any procedures to verify that the eligibility requirements were being verified by the telecommunications companies when providing the discount to customers. Telecommunications companies are reimbursed for this program from the TUSF.
 - For the Lifeline Discount Program, the TUSF administrator reimbursed 40 percent of the telecommunications companies \$145,763 more from the TUSF than is allowed by the Texas Administrative Code (out of total Lifeline Discount Program reimbursements of \$17 million). Additionally, some eligible applicants may be incorrectly excluded from receiving the discount available through this program.

About the Texas Universal Service Fund (TUSF)

State law requires the Commission to adopt rules requiring local exchange companies to establish a universal service fund. All telecommunications companies with access to the customer base pay into the TUSF. The companies are authorized to pass their costs on to their customers as a fee on telephone bills. The TUSF is used to help provide basic, local telecommunications service at reasonable rates in high-cost rural areas, relay services for the deaf and hard of hearing, and other services.

The Commission pays the contracted administrator approximately \$757,200 per year to administer the TUSF. The TUSF is audited annually by an external certified public accounting firm that renders an opinion on the presentation of the changes in the TUSF's fund balance.



This audit was conducted in accordance with Texas Government Code, Section 321.0132.

For more information regarding this report, please contact Craig Kinton, Audit Manager, or John Keel, State Auditor, at (512) 936-9500.

Subsequent Event

During audit fieldwork, the Commission verified the eligibility of all customers who were self-enrolled in the Lifeline Discount Program. It also hired a contractor to oversee the self-enrollment process rather than relying on the telecommunications companies.

Summary of Information Technology Review

The information technology portion of the audit was designed to test the e-government automatic enrollment process and to determine whether the data used for sampling and testing was reliable. Participants in other state assistance programs administered by the Department of Human Services (DHS) are automatically enrolled in programs funded by the TUSF. (Our audit scope covered fiscal year 2003. At the beginning of fiscal year 2005, DHS was abolished. The Health and Human Services Commission now administers the state assistance programs that provide automatic enrollment in TUSF programs.)

The process that individual telecommunications companies used to download DHS's enrollment data each month and match it to their client billing systems appeared to be working. Because each telecommunications company obtains and matches the eligible participants itself, we were not able to determine whether the data received from telecommunications companies for testing was reliable.

Detailed Results

Chapter 1

Telecommunications Companies Could Generally Provide Support for the Amounts They Were Reimbursed for Two TUSF Programs

For two programs we audited, telecommunications companies were able to provide support for 97 to 98 percent of the amounts they were reimbursed from the Texas Universal Service Fund (TUSF). The TUSF bases its reimbursements to companies participating in the following two programs on the number of telephone lines the companies use:

- **Texas High-Cost Program.** For this program, our testing of 66 percent of reimbursements showed that the telecommunications companies could provide support for 97 percent of the total telephone lines for which they were reimbursed. The Texas High-Cost Program is designed to reimburse telecommunications companies for services they provide to rural areas, which typically cost more than services in urban areas. In fiscal year 2003, this program had disbursements of \$443 million (76 percent of all TUSF disbursements), making it the TUSF's largest program.
- **Small and Rural Incumbent Local Exchange Program.** For this program, 98 percent of the line-count worksheets and other support submitted by the telecommunications companies we tested appeared reasonable and accurate. We reviewed 35 of the 55 companies in this program. The Small and Rural Incumbent Local Exchange Program is designed to reimburse eligible telecommunications companies that provide service in the study areas of small and rural local exchange companies in the state. With fiscal year 2003 disbursements of \$100 million, this program accounted for 17 percent of all disbursements made from the TUSF. It is the TUSF's second largest program.

Chapter 2

Not All Revenue Due to the TUSF Is Being Collected

TUSF Assessments

The TUSF is to receive a payment equaling 3.6 percent of the taxable revenue receipts from each telecommunications company that has access to the customer base, including but not limited to providers of wireline and wireless telecommunications services. The TUSF administrator reported that TUSF revenue for fiscal year 2003 was approximately \$549 million.

Neither the Commission nor the TUSF administrator has an effective process in place to identify telecommunications companies that may not be paying their mandatory TUSF assessment. We could not determine whether at least 334 telecommunications companies paid their mandatory assessments to the TUSF during the three quarters of fiscal year 2003 that we tested. Potential lost revenue is approximately \$2.27 million. The top 12 companies accounted for 67 percent (\$1.5 million) of the potential lost revenue. We included these companies in our sample, and they either indicated that they did not pay their assessments or they did not respond to our request for proof of payment to the TUSF. Furthermore, the top 107 companies

represented 97 percent of the \$2.27 million in question. The remaining 200-plus companies collectively owed \$67,000.

The TUSF administrator has policies and procedures stating that it will compare a list of the companies that pay assessments to the TUSF with the list provided by the Comptroller of Public Accounts (Comptroller). The Comptroller collects the Telecommunications Infrastructure Fund (TIF) assessment, and the companies that are required to pay assessments to the TUSF appear to be similar to those required to pay assessments to the TIF. We identified the 334 companies that may not have paid their assessments by comparing the two lists. However, the TUSF administrator indicated that it had not made this comparison in two years. TIF uses a federal identification number to identify the telecommunications companies, but the TUSF administrator does not use this number, which makes comparison much more difficult. For our comparison, we used company names and revenue amounts. We worked with the TUSF administrator to identify some companies that paid assessments to the TUSF.

We tested a sample of the companies identified as not having paid their mandatory assessments to the TUSF during the period audited. One of these companies (out of a total of 1,700 companies paying assessments to the TUSF) indicated to us that it may have charged customers the TUSF fee but did not remit the assessment to the TUSF. We have referred this company to the State Auditor's Office's Special Investigations Unit for further review.

We also determined that, for the period tested, there was a \$300 million difference between the total taxable receipts reported by the telecommunications companies to the TUSF and the total taxable receipts reported by the telecommunications companies to the TIF Board. The companies reported total receipts of \$11.5 billion to TUSF and \$11.8 billion to TIF. Given the similarities in the definitions of each fund's taxable receipts, the revenue reported should also be similar. If the total receipts reported to the TUSF had equaled those reported to TIF, TUSF could have collected \$11.6 million more during the period tested.

The contracted TUSF administrator did notify the Commission during fiscal year 2003 that it had identified some companies that did not file with the TUSF. The TUSF administrator also indicated that these companies were sent letters of noncompliance. However, the administrator did not collect funds from these companies. The Commission pays the contractor approximately \$757,200 per year to administer the TUSF.

In addition, an external certified public accounting firm conducts a financial statement opinion audit of the TUSF each year. This type of audit determines whether the statements of changes in fund balance are presented in accordance with generally accepted accounting principles. It does not provide assurances that all required companies pay assessments to the TUSF.

Recommendations

The Commission should:

- Improve the process used to identify and collect TUSF assessments from telecommunications companies that are required to pay assessments to the TUSF.
- Investigate to determine whether additional revenue should have been collected in prior fiscal years.
- Improve the process used to monitor the contract with the TUSF administrator.

The TUSF administrator should consider using a method of identifying telecommunications companies that would make it easier to compare its list of companies with the list of companies paying assessments to the TIF.

Management's Response

The PUC acknowledges that there may be telecommunications companies that are required to pay into the Universal Service Fund, but do not. Although the number of companies found by the SAO – 334 – may appear high, the amount of potential lost revenue calculated by the SAO is less than 1% of the total fund amount.

The SAO relied on a comparison of companies paying into the TUSF and companies paying into the Telecommunications Infrastructure Fund (TIF) to support its finding that 334 companies who should be paying into the USF are not. While a list of TIF fund contributors is a good starting point for checking the degree of compliance for companies who should be paying into the USF, it is not valid to make a direct comparison. PURA §56.022 provides that the USF is funded by a uniform charge payable by “each telecommunications provider that has access to the customer base.” The TIF is funded by an annual assessment on “each telecommunications utility and each commercial mobile service provider doing business in this state.” “Telecommunications provider” and “telecommunications utility” are defined in Public Utility Regulatory Act §51.002, and are not exactly the same. Both terms are very broad, and include companies that can be hard to identify because they are not subject to licensing or registration requirements related to their telecommunications activities.

The PUC takes seriously its duty to enforce the requirements of the Public Utility Regulatory Act, and will continue to look for cost effective ways to collect TUSF assessments, including amounts that may be due from past years.

While the SAO was conducting this audit, the PUC had already begun taking steps to improve its administration of the TUSF. The PUC has consolidated its contract administration functions into a single position to improve efficiency and accountability of the contract oversight process. Implementation of automatic enrollment in the Lifeline program, which is funded by the TUSF, has also caused the agency to review and look for ways to improve its relationship with the TUSF administrator.

The PUC agrees that it would be valuable to have a list of all companies that are required to pay into the TUSF that could be cross checked against information used by the Comptroller for the TIF. As stated above, although it is difficult to identify all of the companies required to pay into the TUSF, the PUC continues to seek cost effective ways to improve compliance with statutory requirements.

Auditor's Follow-up Comment

The definitions of a telecommunications utility and a telecommunications provider contain numerous common elements, although they are not identical. Because of this, we feel that the comparison is valid and the total amount of taxable receipts reported by telecommunications companies to the TIF fund should be similar to the total amount of taxable receipts reported to the TUSF. Additionally, the TUSF administrator indicated that it intended to use the list of companies from TIF to compare reporting companies as a method to comply with its existing policy.

Chapter 3

Administration of the Lifeline Discount Program Substantially Complies with Laws and Regulations

The Lifeline Discount Program

Telecommunications companies were required by law to provide a discount to customers qualifying for the Lifeline Discount Program on the customers' telephone bills. Companies also received applications for participants who did not qualify for automatic enrollment in the program.

The Commission's administration of the Lifeline Discount Program, which provides discounted telephone services to eligible low-income customers and is funded by reimbursements to telecommunications companies from the TUSF, substantially complies with laws and regulations. However, we identified the following areas that need improvement:

- In fiscal year 2003, the Commission reported that 40 percent (26 of 65) of the companies participating in the program were reimbursed a total of \$145,763 more from the TUSF than allowed by the Texas Administrative Code (TAC). Reimbursements totaled \$17 million (\$3.50 per customer, per month; TAC Section 26.412) during that time. The Commission's contract did not require the TUSF administrator to verify that reimbursements were at the level set by the TAC. This creates a risk that future reimbursements could continue to be greater than the amount the TAC allows. The Lifeline Discount Program represents 3 percent of the disbursements from the TUSF.
- The eligibility of approximately 191,000 of 400,000 Lifeline Discount Program customers was never determined. The Commission did not perform any procedures to verify that the eligibility requirements were being verified by the telecommunications companies when providing the discount to customers. This situation could allow ineligible customers to receive the discount. The companies we tested estimate that between 50 and 75 percent of their Lifeline Discount Program customers are self-enrolled. We could not determine the self-enrolled customers' eligibility because the telecommunications companies could not separately identify the self-enrolled customers from the automatically enrolled customers. This situation occurred before the implementation of a new automatic enrollment process.
- Some eligible applicants may be incorrectly excluded from receiving the Lifeline discount. One telecommunications company uses two different applications interchangeably for customers who want to apply for the Lifeline Discount Program. One version incorrectly excludes applicants who qualify for the discount according to the TAC. The application requires recipients to currently

be receiving services from the State of Texas; however, TAC, Section 26.412, requires that recipients receive services from the State or that recipients' incomes be at 125 percent of the poverty level. The company estimates that approximately 50 percent of its customers in the program are self-enrolled.

Subsequent Event

During audit fieldwork, the Commission instituted a new self-enrollment process. It mailed letters to all participants requiring them to send proof of eligibility. Those who did not provide proof were removed from the program. In addition, the Commission began using a contractor to oversee the self-enrollment process, rather than relying on the telecommunications companies to perform this function. The Commission provided the new contractor with the list of self-enrolled customers who were able to verify their eligibility.

Recommendations

The Commission should:

- Develop procedures to review TUSF reimbursements to the telecommunications companies on a monthly level.
- Ensure that all telecommunications companies use the criteria established in the TAC to determine customers' eligibility for the Lifeline Discount Program.

Management's Response

The administration of the Lifeline Discount Program has changed substantially since FY 2003, the period audited by the SAO. Beginning in April 2004 with the implementation of automatic enrollment required by PURA §17.004(f), administration of the Lifeline Discount Program was shifted from the telecommunications companies themselves to the third party administrator. Use of a third party administrator and automatic enrollment has greatly improved the accuracy of eligibility determinations, including self-enrolled participants. The PUC is continuing to work to improve the accuracy and efficiency of the enrollment process.

The SAO determined that in FY 2003, telecommunication companies were reimbursed a total of \$145,763 more than allowed by law. That amount represents an error rate of less than one percent of the \$17 million program. However, even that amount of money should not be paid out inappropriately. As stated above, the PUC has consolidated its contract administration functions into a single position which will enhance the agency's ability to work with the contract administrator and further improve accuracy and accountability.

TUSF Fund Balance Information

The TUSF had revenues of more than \$549 million and expenditures of more than \$583 million in fiscal year 2003. The Commission reported that the TUSF's fund

Table 1

TUSF Balance as of August 31	
2002	\$105 million
2003	\$ 70 million
2004 ^a	\$ 14 million
2005 ^a	\$ 42 million
2006 ^a	\$ 57 million
2007 ^a	\$ 60 million
^a Estimated	

Source: Self-reported data from the Commission

balance decreased from fiscal year 2002 to fiscal year 2004, in part because the Commission reduced the percentage rate used to calculate telecommunications companies' assessments to the TUSF in an attempt to decrease the fund balance. In addition, the Fifth Circuit Court of Appeals' decision in *AT&T Corp. v. Public Utility Commission of Texas*, 2004 WL 1334688 (5th Cir.2004) specified that Texas's assessing of interstate and international calls for purposes of TUSF is preempted by federal law. Therefore, the TUSF lost revenue from interstate and international telephone calls. To counter this, the rate was increased in July 2004 from 3.6 percent of total revenue to 5.65 percent of intrastate revenue.

Other Information

Objective, Scope, and Methodology

Objective

Our audit objective was to determine whether the Public Utility Commission of Texas administered the Texas Universal Service Fund (TUSF) in accordance with applicable laws and regulations.

Scope

We reviewed the expenditures for the Texas High-Cost Program and the Small and Rural Incumbent Local Exchange Program for fiscal year 2003. We tested telecommunications companies' compliance in contributing to the fund from October 2002 to June 2003.

Methodology

To assess the Lifeline Discount Program, we obtained data from the National Exchange Carrier Association (NECA), the Department of Human Services (DHS), and various telecommunications companies. (At the beginning of fiscal year 2005, DHS was abolished; the Health and Human Services Commission now administers the state assistance programs that provide automatic enrollment in TUSF programs.) We performed numerous analytical procedures to determine whether the program participants were eligible to receive the discount available through this program by comparing database information.

To assess whether the Texas High-Cost Program and the Small and Rural Incumbent Local Exchange Program reimbursed the telecommunications companies the correct amounts, we used the NECA data and the data provided by various telecommunications companies to determine whether the companies could provide support for the numbers of lines claimed for reimbursement.

We also compared the NECA data to data received from the Telecommunications Infrastructure Fund Board to determine whether the TUSF is receiving all of its revenue.

Project Information

Our fieldwork was conducted from November 2003 to November 2004. This audit was conducted in accordance with generally accepted government auditing standards. The following members of the State Auditor's staff conducted the audit:

- Verma L. Elliott, MBA (Project Manager)
- Anthony Patrick, MBA (Assistant Project Manager)
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- Tressie Landry, CIA
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