Approved: February 1, 2000 Carl Dean Holmes
Date

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairman Carl D. Holmes at 9:10 a.m. on January 20, 2000 in Room 522-S of the Capitol.

All members were present.

Committee staff present: Lynne Holt, Legislative Research Department
Mary Torrence, Revisor of Statutes
Jo Cook, Committee Secretary

Conferees appearing before the committee: Joe Lawhon Legislative Division of Post Audit
Janette Luehring, Chief of Telecommunications, Kansas Corporation Commission

Others attending: See Attached Guest List

Chairman Holmes requested bill introductions. Rep. McClure stated that during the briefings on 911 by Legislative Post Audit several recommendations were made, including the setting up of a task force. Rep. McClure moved that the committee should introduce a bill or bills carrying out the Post Audit 911 recommendations. Rep. Sloan seconded the motion. Motion carried.

Chairman Holmes introduced Joe Lawhon, Legislative Post Audit, who provided an overview of the Performance Audit Report on "Reviewing Payment From the Kansas Universal Service Fund" (Attachment 1). Mr. Lawhon provided some background information on universal service. He explained that, in simplified terms, the goal of universal service is to have affordable, quality telephone services available to all people. The Kansas Universal Service Fund was created by the 1996 Kansas Telecommunications Act. The KUSF is administered by the National Exchange Carrier Association, which also services at least 6 other states.

There were four questions asked in this audit. For reporting purposes the first two questions were combined. Question 1 is: On What Basis Are Moneys in the Universal Service Fund Collected and Distributed, and Are Reasonable Methods Used to Ensure That Those Amounts Are Appropriate? The Corporation Commission has worked with local telephone companies to determine how much funding they should receive from the KUSF. The Commission decided the companies would recover nearly all lost revenue from in-state access charge reduction from the Fund. To ensure the Fund has enough money, KCC staff calculate the amount companies must pay into the Fund. The Commission and the Fund administrator have established, and generally are carrying out, reasonable procedures for ensuring that the moneys in the Fund are collected and distributed appropriately. Few problems were identified by auditors.

The second question is 'What portion of the payments from the KUSF represent "High-Cost Recovery" and what portion represent "Revenue Neutrality"?' During the Fund's first two years more than $150 million had been paid out on a 'revenue-neutral' basis. This amount has been broken down into "high cost" and "make whole" amounts. Differences of opinion about the KUSF have generally centered on whether payments should be cost-based. Both the law and Fund have been challenged in court and the law is currently being challenged before the FCC. The Kansas Supreme Court has upheld the KCC's decision to not order increases in local services rates to make up for lost revenues, however, it did say that the Commission must move toward making payments based on company costs. The Commission has begun studying local company costs in an effort to move toward making cost-based payments.

Question 3 asks "How does the KUSF compare with other Universal Service Funds"? Along with Kansas, two other states used the Funds to make up moneys local companies lost when they were required to reduce their intrastate revenues. Other states use their funds for a variety of purposes, including high-cost support, E-911 and support for telecommunications services for schools, libraries and clinics.

Chairman Holmes welcomed Janette Luehring, Chief of Telecommunications for the Kansas Corporation Commission, who provided an update on the KUSF since the audit report (Attachment 2). The KCC staff continues to monitor the companies that submit annual reports and compare that list to the companies that file KUSF reports. The Commission has made significant progress in making the KUSF cost-based consistent with state and federal statutes. Also provided was a listing of dockets directly affecting the KUSF (Attachment 3). Ms. Luehring also distributed information from the KCC Public Affairs Division on the slamming and cramming complaints filed (Attachment 4).

Mr. Lawhon and Ms. Luehring then responded to questions from Rep. Krehbiel, Rep. Klein, Rep. Alldritt and Rep. Holmes.

Meeting adjourned at 9:45 a.m.

Next meeting will be a joint meeting with the House Education Committee on Monday, January 24, 2000 at 9:00 in Room 313-S.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: January 20, 2000

NAME	REPRESENTING
Joe Dick	KCKBPU
JC Long	UtiliCorp United
Cynthia Smith	KCPL
Rose Mulvany	KCC
Janet Buchanan	KCC
Joe Lawhon	Post Audit
Janette Luehring	KCC
Sandy Reams	KCC
Jeff Wasowski	KCC
Tom Gleason	Independent Telecom. Group
Mike Murray	Sprint
Bill Henry	Ks Govt Consulting
Jennifer Newton Reents	The Newton Kansan newspaper
Steve Montgomery	MCI Worldcom
Sandy Braden	McGill Gaches & Assoc

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: January 20, 2000

NAME	REPRESENTING
Jennifer Crow	Federico Consulting
Doug Lawrence	SWBell
Richard Veach	Pioneer Communications
Doug Smith	SITA
Michelle Martin	Rural Telephone
Mike Moffet	SWB
Charles Clark	"
Mark Caplinger	St Ind Tel Assn
Tom Day	KCC

PERFORMANCE AUDIT REPORT

Reviewing Payments From the Kansas Universal Service Fund

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
August 1999

99-17

HOUSE UTILITIES
DATE: 1-20-00
ATTACHMENT 1

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about $8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the Representatives, three are appointed by the Speaker of the House and two are appointed by the Minority Leader.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators or committees should make their requests for performance audits through the Chairman or any other member of the Committee. Copies of all completed performance audits are available from the Division's office.

LEGISLATIVE POST AUDIT COMMITTEE

Representative Kenny Wilk, Chair
Representative Richard Alldritt
Representative John Ballou
Representative Lynn Jenkins
Representative Ed McKechnie

Senator Lana Oleen, Vice-Chair
Senator Anthony Hensley
Senator Pat Ranson
Senator Chris Steineger
Senator Ben Vidricksen

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Barbara J. Hinton, Legislative Post Auditor

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Legislature of Kansas
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August 19, 1999

To: Members, Legislative Post Audit Committee

Representative Kenny Wilk, Chair
Representative Richard Alldritt
Representative John Ballou
Representative Lynn Jenkins
Representative Ed McKechnie

Senator Lana Oleen, Vice-Chair
Senator Anthony Hensley
Senator Pat Ranson
Senator Chris Steineger
Senator Ben Vidricksen

This report contains the findings, conclusions, and recommendations from our completed performance audit, *Reviewing Payments from the Kansas Universal Service Fund.*

The report also contains several appendices. One shows the anticipated payments to be made to local telephone companies for the Fund's third year of operation, and another provides a summary of each local telephone company's revenues and expenditures for calendar year 1998, as taken from the annual report submitted by each company. Other appendices are included as well.

The report includes one recommendation for the Commission to provide the Legislature with updates as issues related to the oversight of the Kansas Universal Service Fund are resolved. We would be happy to discuss this recommendation, the findings presented in this report, or any other items with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton

Barbara J. Hinton
Legislative Post Auditor

Question 1: On What Basis Are Moneys in the Universal Service Fund Collected and Distributed, and Are Reasonable Methods Used To Ensure That Those Amounts Are Appropriate?

The Corporation Commission has worked with local telephone companies to determine how much funding they would receive from the Kansas Universal Service Fund. *After the Telecommunications Act of 1996 required telephone companies to reduce in-State access charges to the same level as interstate access charges, Commission staff worked with all 41 local telephone companies in business in 1996 to determine how much revenue they would lose. The Commission decided the companies would recover nearly all of those losses, which were estimated to be about $106 million a year, from the Fund, a decision that significantly increased the size of the Fund. The Commission also decided that local telephone companies could be paid $36.88 per year for any new lines they began servicing after March 1, 1997, in high-cost areas. To ensure that the Fund has enough money, each year Commission staff calculate the amount telecommunications companies must pay into the Fund.* .... page 8

The Commission and the Fund administrator have established and generally are carrying out reasonable procedures for ensuring that the moneys in the Fund are collected and distributed appropriately. *The actions they take include verifying the access charge revenues companies said they lost, adjusting payments from the Fund for specific reasons, and contracting for audits that review the assessment rate, financial administration of the Fund, and the amounts companies paid into the Fund.* .... page 12

Outside auditors and our own analyses of Fund records identified a few problems. *Those problems include companies not reporting the same kinds or types of in-State revenues, some companies reporting gross revenues and others reporting net revenues, some companies not submitting the proper reports to the Fund administrator and to the Commission, some companies reporting different revenue amounts to the Fund administrator and to the Commission, audits not being started as soon as they should have been, and a lack of verification of the number of new high-cost lines that companies receive payments for.* .... page 14

other persons having knowledge about the telephone industry. We reviewed certain Fund financial records, such as income and expense statements prepared by the administrator. We also reviewed several audits of the Fund and spoke with the staff who conducted those audits. We also surveyed public service commission staff in several states.

In conducting this audit, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office.

For reporting purposes, we combined questions one and two. Our findings begin on page eight, after an overview of the Kansas Universal Service Fund.

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Overview of the Kansas Universal Service Fund

The Legislature Established the Kansas Universal Service Fund in 1996 As Part of the Kansas Telecommunications Act

The plan to establish a universal service fund in Kansas evolved over several years. In April 1994, the Kansas Corporation Commission initiated hearings to investigate issues related to competition in the telecommunications industry. In 1996, following those hearings, the Commission issued an order stating that a Kansas universal service fund should be created, and that the access rates for in-State (intrastate) calls should be reduced to the level of access rates for state-to-state (interstate) calls. (Access rates are the per-minute charges a long distance phone company pays to both the caller's local telephone company and the local telephone company of the party being called.) Access charges historically had been used to subsidize basic telephone service.

Also in 1994, the Legislature passed a resolution charging the Telecommunications Strategic Planning Committee with developing a Statewide plan for regulating telecommunications in a competitive environment and for ensuring and enhancing universal service in the State. That Committee, which included legislators, industry representatives, and consumers, met for 18 months. In January 1996, the Committee's recommendations included having the Corporation Commission administer a fund to support telecommunications equipment for people with disabilities.

A House bill initially introduced during the 1996 legislative session would have allowed the Secretary of Administration to extend KANS-A-N to qualifying hospitals and non-profit organizations. What emerged by the end of the session was a bill designed in part to reduce intrastate access charges and to replace the moneys companies lost, from a universal service fund, from rate increases approved by the Commission, or from both.

Amendments to the Federal Communications Act in 1996 had allowed states to set up universal service funds. However, federal law required state universal service funds to meet these general guidelines:

- quality services should be available at just, reasonable, and affordable rates everywhere in the country
- prices should be reasonably comparable for all consumers, including those in areas where the cost to provide telecommunications service is high
- states can't prohibit any entity from providing any interstate or intrastate telecommunications service
- state commissions determine who can receive universal service fund moneys, following certain guidelines
- all providers of telecommunications services should contribute to universal service funds
- mechanisms to support universal service should be specific, predictable, and sufficient
- state rules on universal service can't be inconsistent with federal rules

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The Kansas Telecommunications Act sets out a number of requirements related to the Kansas Universal Service Fund. One of the main things it did was change the way high-cost local services are subsidized. The major provisions or mandates are summarized below.

☎ The Act set public policy for universal phone service in Kansas.	☎ That public policy is to ensure that every Kansan has access to excellent telecommunications services at an affordable price, and that those customers realize the benefits of competition.
☎ It required local phone companies to reduce the access fees they charged on in-State long distance calls.	☎ Those rates had to be reduced to be the same as access charges on <u>interstate</u> calls. As a result, the state's 41 local telephone companies had to lower their access charges by about 2-4 cents a minute.
☎ It specifies that all local companies' lost revenues should be replaced.	☎ The Act made it clear that its effect would be "revenue neutral"; that is, the companies that lost revenues should be able to make them up from another source. Only local telephone companies have received payments from the Fund.
☎ It allows companies to increase local service rates to the statewide average.	☎ The law specifies that the amount raised by these increases would offset revenue losses from access charge reductions.
☎ It allows the KCC to decide how companies could make up the access fees they'd lost.	☎ The law authorized the Commission to change rates for specific services to offset those lost revenues, to make up those lost revenues through payments from the Kansas Universal Service Fund, or both.
☎ It finances several other programs through the Fund.	☎ These include providing vouchers to Kansans with speech or hearing impairments to buy the specialized equipment they need to use basic telecommunications services, and reimbursing companies who provide discounts to low-income Kansans for their local telephone service. This latter program is jointly funded through the Kansas and Federal Universal Service Funds.
☎ It requires all companies to pay into the Fund.	☎ Payments into the Fund must be equitable and nondiscriminatory among companies. The Commission accomplishes this through an assessment on telecommunications companies' intrastate revenues. The assessment rate began at 9% and is set at 7.63% in the current year for all but wireless companies, which pay 7.24% this year. Currently, about 375 companies pay into the Fund.
☎ It allows companies to pass these costs on to their customers.	☎ Phone companies pass the amount they are assessed on to their customers, either as a flat fee per telephone line or as a surcharge on the bill.
☎ It requires the Commission to periodically assess whether the costs of providing services justify modifying the Fund.	☎ The Commission can modify the Fund based on these assessments. It's required to report to the Legislature by January 1, 2000, whether and how it thinks the Fund should be modified.

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What Is "Universal Service"?

Very simply stated, "universal service" means that affordable, quality telephone services are available to all people. The concept of universal service has been public policy and present in federal and State law since the federal Mann-Elkins Act of 1910 and the 1911 Kansas Public Utility Act.

The Federal Communications Commission and the Kansas Corporation Commission define the telecommunications services that should be available to everyone. This evolving definition currently includes these services:

- incoming and outgoing calls that meet certain basic quality standards
- single-party service
- access to emergency services such as police and firefighters
- access to operator services
- access to services that allow long distance calls
- access to directory assistance

Only telecommunications providers that provide these services are eligible to receive moneys from universal service funds.

The 1998 Legislature made few changes to the Act, including placing a cap of 8.89% on the assessment rate imposed on telecommunications companies. Two bills regarding the Fund were introduced but not passed in 1999. Senate Bill 86 would change the definition of "universal service" and required the assessment companies pay into the Fund to be specified on customer bills. Senate Bill 290's provisions include deleting the current law's references to "revenue neutrality" and authorizing the Corporation Commission to base payments from the Fund on costs.

The Corporation Commission Issued the First Major Order Setting Out The Basics for the Kansas Universal Service Fund's Operation in December 1996; The Fund Became Operational in March 1997

The Fund has been in operation for two full years. State law required the Commission to choose a neutral, competent, and bonded third party to administer the Fund. Kansas is one of at least seven states to have chosen the National Exchange Carrier Association (NECA) to act as fiscal agent for their statewide universal service funds. NECA, which was formed in 1983 by the Federal Communications Commission as a not-for-profit corporation, also provides a variety of services for the FCC and the 1,000 local telephone companies included in its membership.

The following table shows the amounts paid into and out of the Kansas Universal Service Fund during its first two years of existence.

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Sprint/United to begin charging for directory assistance and to increase their charges for calls from pay phones, which helped offset about $8 million in lost revenues.

Commission records and Commission staff we talked with cited these reasons for not allowing Southwestern Bell to increase its local rates to cover the reduction in access charges:

- residential ratepayers had expressed strong opposition to rate increases during public hearings in August 1996
- the Commission wanted to retain flexibility regarding local telephone rates
- because all companies had to contribute to the Fund, Southwestern Bell's customers would have had to pay both the increased local rates and an assessment into the Fund

Because of the Commission's decision, almost all the cost of replacing these lost revenues has been paid through the Fund. That helps explain why the Fund is so large–currently about $100 million. The box on the next page provides more detail about the Commission's decisions in this area.

To meet the requirements in State law for supplemental funding, the Commission also decided that local telephone companies could be paid additional amounts for any new lines they began servicing after March 1, 1997, in high cost areas. The Commission has defined "high cost lines" as those in an area with fewer than 10,000 local telephone lines. New high cost lines can include newly installed lines (for example, lines put in place to serve a new housing development) or existing high cost lines acquired from another telephone company. The Commission set the amount companies would receive from the Fund for each new line for a residence or single-line business in high cost areas at $36.88 a year.

In developing the $36.88 figure, Commission staff were influenced by guidelines established by the Federal Communications Commission. In general, those guidelines say

- local telephone companies are responsible for generating enough revenue to cover the first 100% of the national average cost per local line (approximately $250 per year)
- if costs exceed the national average, local phone companies could obtain some funding from the Federal Universal Service Fund, along with increased customer revenues
- because payments from the Federal Fund don't cover all costs above the national average, Commission staff calculated an amount to "fill in the gap." The amount they calculated was $36.88 per line for a residence or single-line business in a high cost area, and the Commission approved that figure in December 1996.

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Why Is the Kansas Universal Service Fund So Large?

One of the concerns legislators expressed during this audit was why the Kansas Universal Service Fund was so large. This profile provides some background information.

The 1996 Kansas Telecommunications Act required incumbent companies that provided local phone services to reduce their intrastate access charges, but it allowed them to recoup the revenues they would lose so that the impact of the law would be "revenue neutral."

The Act also created a Kansas Universal Service Fund, and gave the Corporation Commission the authority to decide how much of those lost revenues should be recovered from higher telephone rates and how much should be paid out of the Fund. All telecommunications companies operating in Kansas must contribute to that Fund.

An early version of the Act apparently envisioned that companies that had price caps, e.g., Southwestern Bell, would recoup lost revenues through increased rates for other services, not through payments from the Fund. Other companies would recoup their lost revenues through the Fund, which would have amounted to about $30 million a year.

The final version of the bill didn't specify whether losses were to be recovered through price increases or through the Fund; that was left up to the Commission to decide.

When the Commission began to hold hearings later in 1996 to implement the Fund, Commission staff estimated the Fund would reach $111 million in its third year of operation, when all access charge reductions were expected to be in place. That estimate assumed all lost access fee revenues would be replaced through the Fund.

In testimony before the Commission, Southwestern Bell staff suggested that the Commission allow Southwestern Bell to increase its local rates by $4.50 a month over three years. That would have increased Southwestern Bell's revenues by about $59 million, thus decreasing its draw on the Fund by the same amount.

The Commission decided not to allow Southwestern Bell to increase its local rates, but it did allow Southwestern Bell and Sprint/United to eliminate free directory assistance and to increase the charge for pay phone calls. These changes increased the revenues these companies would earn—and decreased their draw on the Fund—by about $8 million.

The Commission considered at least two reasons for not allowing Southwestern Bell to increase its rates:

- At hearings in August 1996, residential telephone customers strongly opposed rate increases. Because Southwestern Bell, like all companies, still would have had to pay into the Fund and could pass along its Fund assessment to its customers, local rates for Southwestern Bell customers could have risen by $5.30 a month. Under the current plan, those customers pay only about $2 a month more to support the Kansas Universal Service Fund.
- The Commission wanted to retain the flexibility to decrease the amount paid from the Fund to a company with price-cap regulation, such as Southwestern Bell, if a cost study later determined the company didn't need as much money to make up for the revenues it lost.

If the Fund were to be based on costs for providing universal service in high-cost areas, it might be smaller or larger than it is now.

NECA data show that local telephone companies that receive payments from the Fund added about 7,000 new high cost lines during the Fund's first two years of operation. Those 7,000 new high-cost lines will cost the Kansas Fund about $250,000 this year.

To ensure that the Fund has enough money, each year Commission staff calculate the amount telecommunications companies must pay into the Fund. The costs of the Fund have been spread among all telecommunications companies operating in Kansas (and all their customers, since companies may pass their costs on to them). Commission staff perform a number of steps to figure out how much to assess all telecommunications companies for the Fund's operations. These steps include:

- determining how much the Fund will need to pay out
- determining what "assessment rate" will need to be applied to those companies' in-State retail revenues to cover the Fund's obligations
- obtaining Commission approval for that assessment rate

Once the assessment rate is approved, Kansas telecommunications companies must pay the amount they owe to the Fund's administrator each month. Companies that provide local phone service receive a payment from the Fund each month as well.

We aren't able to provide information about how much each company paid into the Fund because State law makes information confidential. However, each year Commission staff prepare an estimate of how much each local telephone company will pay into and receive from the Fund. The estimate for the third year of the Fund's existence, which began on March 1, 1999, is included as Appendix B.

The Commission and the Fund Administrator Have Established and Generally Are Carrying Out Reasonable Procedures for Ensuring that the Moneys in the Fund Are Collected and Distributed Appropriately

The Commission through the administrator is responsible for ensuring that all telecommunications companies pay in what they owe to the Fund, and that local phone companies are paid the correct amounts. As previously mentioned, the Commission has contracted with the National Exchange Carriers Association (NECA) to administer the Fund.

Reasonable methods for collecting and distributing Fund moneys would include the following:

- making sure the revenue lost figures reported by local telephone companies are accurate

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- making sure the Fund's assessment rate is calculated correctly
- making sure all Kansas telecommunications companies report all their intrastate revenues and apply the assessment rate correctly
- making sure any amounts due to and due from the Fund are calculated properly
- making sure that amounts due the Fund are paid on a timely basis

During this audit, we reviewed federal and State laws, the NECA contract, and NECA policies and procedures to see if the requirements and guidelines contained in these documents were adequate to ensure that Fund moneys were properly collected and distributed. We concluded they were.

We also reviewed the actions Commission and NECA officials have taken to determine whether Fund moneys are accurately collected and distributed. Based on our reviews, we concluded the actions these staff have taken were sufficient for the most part. Those actions included the following:

- <u>verifying the amount of access charge revenues that local telephone companies reported they lost.</u> Commission staff traced the per-minute rates companies had reported to rates the Commission had approved. (While Commission staff didn't attempt to verify that each company had reported the correct amount of minutes of usage, they did perform a trend analysis of reported minutes of usage, looking for significant variations from normal trends, and investigated any significant differences. In addition, because companies use minutes of usage to bill each other, that figure is monitored closely within the industry.) When errors from either review were detected, Commission staff required adjustments to reported figures as appropriate.

- <u>adjusting the amounts companies should receive from the Fund if new information suggests those payments should be raised or lowered.</u> For example, adjustments would be needed:
  - to increase a company's payments when it adds new high cost lines
  - to decrease a company's payments when it earns new revenue because it increased rates to the statewide average, as the law allows

- <u>contracting for special audits to look at the following</u>:
  - *the accuracy of the assessment rate charged for the second year of the Fund's operation.* This audit conducted by an independent certified public accounting firm concluded the 6.83% assessment rate Commission staff developed should have been 6.91%. That means companies were assessed 0.08% less than they should have been. The Commission took this to mean that its staff had done a good job. It had the staff factor in adjustments the auditors had identified when staff computed the assessment rate for the Fund's third year.

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- *NECA's financial administration of the Fund.* An independent certified public accounting firm has conducted two audits. The first was an audit of the Fund's financial statements. The second was an audit that evaluated the procedures and controls used by NECA staff to administer the Fund. Neither audit found any significant problems.
- *the accuracy of the amounts paid into the Fund by telecommunications companies.* NECA staff have completed 16 audits of companies that accounted for about 75% of the Fund's revenues during the first year. Overall, these audits found that companies were reporting and remitting the correct amounts to the Fund administrator. These audits found that an additional $21,000 was owed to the Fund.

Outside Auditors and Our Own Analyses of Fund Records Identified A Few Problems with the Implementation of Collection and Distribution Processes

These problems aren't major issues, but they need to be fixed. Most of the problems concern the amount of in-State revenues companies report, which is the basis for computing how much each telecommunications company owes the Fund. For the most part, the Commission and NECA already have initiated corrective action. Our findings are summarized below:

- <u>Companies currently may not be reporting the same kinds or types of in-State revenues</u>. State law requires that contributions to the Fund be based on companies' retail, intrastate revenues. Modern telecommunications sometimes make "in-State" hard to define. For example, a call from a wireless phone may start and end in Kansas but use a tower in Missouri. Inconsistency in how companies account for or report these revenues would affect how much companies are required to pay into the Fund. The Commission is attempting to provide Kansas telecommunications carriers with additional instructions to allow them to properly account for these revenues and report appropriate information to NECA.

- <u>Some companies are reporting gross revenues, while others are reporting net revenues</u>. According to an independent auditor's survey, about 70% of a sample of telecommunications companies said they reported gross revenues to NECA, while the rest said they reported net revenues, which are gross revenues reduced by amounts deemed uncollectible. The Commission didn't require any companies to change what they had previously reported to NECA once it became aware of this problem. Until it reached a formal decision on how revenues should be reported for the Fund's third year, it required companies to report gross

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revenues. On August 13, the Commission ordered companies to report net revenues.

- Some companies didn't submit the proper reports to NECA and the Commission. Telephone companies operating in Kansas are supposed to submit certain information to each entity. An independent audit and subsequent Commission investigation showed that nine companies had reported to the Commission and not to NECA, and 63 companies had reported to NECA and not the Commission. Commission and NECA staff have contacted these companies and are working to determine whether any amounts are owed to the Fund or whether additional regulatory information should be submitted to the Commission.

- Some companies reported very different revenue amounts to the Commission and NECA without explaining the difference. The Commission now requires companies to reconcile any differences between the two reports, which are based on slightly different time periods.

- Audits of telecommunications companies weren't started as soon as they should have been. Both State law and a Commission order required there to be audits of the information provided by telecommunications companies. Although the Fund's first year of operation ended February 28, 1998, Commission staff didn't sign a contract with NECA, the Fund administrator, to conduct those audits until early 1999. Because of that late start, the Commission didn't receive the results of the last company audit until July 1999, nearly halfway into the Fund's third year.

- There's been no verification of the number of new "high-cost" lines companies have begun serving since the Fund was created in 1996. Since the Fund was established, about 7,000 new high cost lines have become eligible for the additional payment. NECA staff told us that when companies report additional high cost lines NECA staff perform only a "reasonableness review" of that data. Subsequent audits of five companies have looked at company records to verify any reported changes in the number of high cost lines. No problems were found.

  The company-reported additional lines will result in an additional expenditure of about $250,000 this year. While it may not be cost-effective for the Commission to adopt more extensive control procedures at this time, this could become a larger issue in the future if the Fund payment for each high cost line is increased or if the number of high cost lines increases significantly.

Conclusion

The Corporation Commission and the National Exchange Carriers Association generally have carried out their responsibilities for operating the Kansas Universal Service Fund in an effective manner. A few problem areas need to be addressed to ensure that telephone companies aren't paying too much or too little, and that they are being treated consistently. Steps are being taken to deal with those problems.

Recommendation

The Corporation Commission should continue to address the areas of concern we identified, such as discrepancies in how telephone companies report intrastate revenues. As these issues are resolved, the Commission should provide periodic updates to the Legislative Post Audit Committee and other appropriate legislative committees.

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What Portion of the Payments from the Kansas Universal Service Fund Represents "High-Cost Recovery," And What Portion Represents "Revenue Neutrality"?

During the Fund's first two years, more than $150 million was paid out to satisfy the requirement that the revenues companies lost by reducing their intrastate access charges "shall be recovered on a revenue neutral basis." This represents about 96% of all payments from the Fund. Up to $500,000 was paid for new telephone lines in high-cost areas. The rest of the payments from the Fund were used to pay for small programs and administrative costs.

There's been a lot of confusion and debate about what Kansas' Universal Service Fund should pay for, in part because the "revenue neutral" provisions in State law don't seem consistent with the requirements in federal law that payments from universal service funds should be based on costs. As a result, the Kansas Telecommunications Act has been challenged both in State court and before the Federal Communications Commission. The Kansas Supreme Court has upheld the Kansas Corporation Commission's interpretation of the law, but it said the Commission must move toward making payments from the Fund based on costs. The Commission has begun proceedings to identify telephone company costs and determine how a cost-based Fund would work. These and other issues are discussed in the sections that follow.

During the Fund's First Two Years, More Than $150 Million, or 96% of the Total, Has Been Paid Out on a "Revenue-Neutral" Basis

As described earlier, the Kansas Telecommunications Act required the 41 local telephone companies operating in Kansas in 1996 to lower their intrastate access charges to the same level as interstate charges. Historically, it's been assumed, the revenues these companies earned from the higher in-State access charges subsidized their local phone services.

The Act also allowed local phone companies to recover any revenues they lost so that the impact of the law would be "revenue neutral." This provision in essence continued whatever subsidy had existed before.

Acting within the authority granted by law, the Commission decided to replace companies' lost revenues primarily through the Fund, rather than allowing them to offset these losses by raising customers' rates for other services.

This notion of "revenue neutrality" is what virtually all payments from the Fund have been based on so far. Of the $158 million paid from the Fund during its first two years of existence:

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- about $152 million (96%) was paid to local companies to offset the revenues they lost by reducing their intrastate access charges; in other words, to keep them "revenue neutral"
- nearly $6 million was paid for other programs (those programs are listed in the table on page 6)
- up to $500,000 was paid to local phone companies for new lines in high-cost areas (those added after March 1, 1997, when the Fund began operating)
- about $250,000 was paid for NECA's administrative costs

The table on the next page shows the amounts paid to each company that received payments from the Kansas Universal Service Fund during the Fund's first two years.

As the table shows, Southwestern Bell's and Sprint/United's payments increased substantially during the second year. That's because they were allowed to reduce their access charges over two years.

The table also shows that five local companies didn't receive any payments from the Fund. Two reported that they hadn't lost any revenues. The other three reported that they had lost revenues, but when they raised their basic phone rates to the statewide minimum average, they made up those revenue losses and didn't require any moneys from the Fund.

The Commission's staff has prepared information breaking down the revenue neutral payments from the Fund into two categories—a "make whole" amount and a "high cost" amount. The "high-cost" amount they've computed is simply the number of "high-cost" lines for residences and single-line businesses served by each company, multiplied by the $36.88 figure Commission staff developed and the Commission adopted. Everyone agrees that $36.88 doesn't reflect companies' actual costs. The "make whole" amount they've developed is simply the high cost figure subtracted from the total "revenue neutral" payment made to companies.

This information isn't meaningful in answering the question posed by this audit. However, it was used during the 1999 legislative session when the Legislature was considering amending State law to delete references to "revenue neutrality." The "high cost" figure the Commission adopted was used to show approximately how much each company would receive from the Fund if that shift had been made, and if the current funding for new high cost lines, $36.88, were applied to existing high cost lines. For informational purposes only, using the Commission staff's methodology, we've provided in Appendix C a similar breakdown for each of the 41 local telephone companies that have received payments from the Fund.

Finally, as part of this audit some people had thought we might be able to identify companies' actual costs for providing high-cost universal services through the

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Amounts Paid to Local Telephone Companies from the Kansas Universal Service Fund To Replace Access Revenues Lost

Telecommunications Company	Year 1 3/97-2/98	Year 2 3/98-2/99	Total
Southwestern Bell	$39,126,434	$58,518,828	$97,645,262
United Telephone of Kansas (Sprint)	8,095,859	12,710,157	20,806,016
Rural Telephone	3,465,121	3,661,704	7,126,825
Sunflower Telephone	1,277,160	1,270,266	2,547,426
S & T Telephone Coop	951,348	1,120,369	2,071,717
Golden Belt Telephone Assn.	797,880	883,512	1,681,392
Wilson Telephone	833,352	835,260	1,668,612
Twin Valley Telephone	693,264	701,305	1,394,569
Pioneer Telephone Assn.	734,040	655,632	1,389,672
Wheat State Telephone	670,671	671,604	1,342,275
Kan-Okla Telephone Assn.	642,036	643,520	1,285,556
S & A Telephone	548,976	549,238	1,098,214
Cunningham Telephone	533,448	533,448	1,066,896
H & B Communications	534,204	525,510	1,059,714
JBN Telephone	526,476	517,176	1,043,652
Home Telephone	516,780	518,076	1,034,856
Blue Valley Telephone	475,152	470,454	945,606
Moundridge Telephone	419,136	429,692	848,828
Haviland Telephone	417,568	384,569	802,137
South Central Telephone	349,728	343,995	693,723
Craw-Kan Telephone Coop.	295,740	295,740	591,480
Totah Telephone	273,072	273,486	546,558
Madison Telephone	269,088	269,142	538,230
Tri-County Telephone	233,688	233,997	467,685
United Telephone Assn.	249,708	213,501	463,209
South Central of Kiowa	172,653	172,655	345,308
Bluestem Telephone	169,320	169,590	338,910
S & T Communications of Dighton	87,336	221,904	309,240
Rainbow Telephone	135,564	137,192	272,756
Peoples Mutual Telephone	123,744	125,022	248,766
Columbus Telephone	97,106	75,282	172,388
Zenda Telephone	81,924	82,086	164,010
Gorham Telephone	36,702	36,649	73,351
Cass County Telephone	31,172	32,027	63,199
LaHarpe Telephone	31,428	31,248	62,676
Mutual Telephone	23,692	24,661	48,353
Council Grove Telephone	0	0	0
Elkhart Telephone	0	0	0
MO-KAN Dial	0	0	0
Southern Kansas Telephone	0	0	0
Wamego Telephone	0	0	0
Total	$63,920,570	$88,338,497	$152,259,067

Source: NECA payment records

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information they reported to NECA, the Fund's administrator. (The Corporation Commission currently doesn't have this level of detailed cost information for each company.) If so, that information then could be compared with the payments companies have received from the Fund to help assess whether they are getting more or less than their actual costs. However, companies don't report detailed cost information to NECA. And even if they did, that information is confidential and we wouldn't have been able to report it. Appendix D provides a summary of revenue and expense information that the 41 local telephone companies submitted to the Commission in their 1998 annual reports.

There's Been a Lot of Confusion and Debate About What The Universal Service Fund Was Intended To Pay For

As described in the previous section, virtually all payments from the Kansas Universal Service Fund to-date have been made to achieve "revenue neutrality." However, some legislators thought or expected that payments from the Fund would be made explicitly to help local companies operating in Kansas "recover" some of the cost of providing universal services in high-cost areas. Their confusion may have stemmed from the following:

- although the Kansas law sets up provisions for revenue neutrality, that Act also says the Commission must periodically review the Fund to determine whether telecommunications providers' <u>costs</u> justify changes to the Fund
- the Federal Telecommunications Act of 1996, as interpreted by FCC orders, requires payments from universal service funds to be based on the costs of providing services
- the federal Act also says that a state's regulations can't be "inconsistent with" federal rules on universal service

The link between replacing lost revenues and promoting universal telephone service is unclear. That's why the law and its implementation have been challenged in the courts. It's also why the Commission is studying the costs that local telephone companies incur to provide telephone service. Through this study, the Commission will determine whether and how much support from the Fund local telephone companies really require to ensure universal service. These events are discussed in the next sections of the report.

Differences of opinion about the Kansas Universal Service Fund led to the Kansas law and the Fund being challenged in court. Parties to the main lawsuit in State court included the Citizens' Utility Ratepayer Board, the Kansas City Fiber Network, and several cellular companies. In an opinion issued in August 1997, the Appeals Court ruled that the Commission's orders implementing the Fund should be set aside. The Court's reasons were that the revenue neutral concept and a "no audit"

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provision of the Act were inconsistent with the federal Act, and that the Fund wasn't related to the cost of universal service.

That decision was appealed to the Kansas Supreme Court. In its March 1998 opinion, the Supreme Court affirmed the Commission's orders implementing the Fund. The Court concluded that

- "revenue neutrality" wasn't prohibited by or contrary to the federal Act
- the Commission wasn't required to order increases in local service rates to make up for lost revenues.
- the initial amount in the Fund, based on the amounts local telecommunications providers lost when the law required decreases in access rates, was appropriate

The Court also said that "revenue neutrality" was "transitional," and that the Commission was aware of its responsibilities to examine costs and modify the Fund to reflect information on costs.

Kansas' law also is being challenged before the Federal Communications Commission. Western Wireless Corporation has filed a petition for preemption, asking the FCC to set aside the Kansas law. The company asserts that the Fund isn't competitively neutral and isn't related to the cost of providing universal service. It also says that the "revenue neutrality" provisions discriminate against companies that want to enter Kansas markets, because a large percentage of Fund moneys aren't available to telecommunications providers that weren't in business in Kansas in 1996.

The Commission's counter-arguments have included these points:

- the Fund hasn't prevented new companies from doing business in the State
- part of the Fund—the $36.88 paid for <u>new</u> high cost lines—is available to new companies
- the "revenue neutral" provisions are transitional, and the Commission is working toward having the Fund be based on costs.

In the *Western Wireless* case, the Commission has said:

> *The Kansas Legislature chose to protect universal service through the initial revenue neutrality mechanism. The revenue neutrality mechanism is not permanent. The KCC must reduce [Kansas Universal Service Fund] funding to levels which do not make up for all that the incumbent [local exchange carriers] lost through the rate cut, if the cost studies show the full amount is not needed to keep revenues from falling below costs.*

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No one is predicting when the FCC will issue its decision, and that decision could be appealed in federal courts. Both Kansas Corporation Commission and Federal Communications Commission officials told us they don't know exactly what preemption would mean to the Kansas Universal Service Fund.

The Commission Has Begun Studying Local Telephone Company Costs So It Can Move Toward Making Cost-Based Payments from the Fund

The Commission has initiated two proceedings to begin identifying local companies' costs, as described below:

- Proceedings related to Southwestern Bell's costs (docket #98-SWBT-677-GIT) began in April 1998. The Commission has stated it intends to look at each company's costs, but started with Southwestern Bell because that company receives the most from the Fund. The Commission further stated that it needed to determine whether existing access and toll rates contain cross-subsidies. Southwestern Bell and Commission staff have disagreed over whether this is an appropriate inquiry and over what documents Southwestern Bell should produce. The company has been ordered to produce a study of costs that the company has incurred.

- More generic proceedings (docket #99-GIMT-326-GIT) were initiated in November 1998 to determine what modifications are necessary to ensure that Fund support for local phone services is based on the cost of providing those services. In this docket, the Commission will look at issues including these:

  - the definition of a cost-based mechanism
  - what services the Kansas Universal Service Fund should support
  - what cost methodology should be used to determine the cost of universal service
  - the best mechanism to satisfy the definition of a cost-based Fund mechanism that also satisfies other goals in the state and federal acts
  - whether there are areas in Kansas that have proportionally fewer households with telephone service and, if so, what can be done to increase that proportion
  - determining a "just, reasonable and affordable rate"
  - the appropriate definition of subsidy

  Hearings were held the week of June 14. During testimony before the Commission, industry representatives proposed at least two approaches for evaluating costs–using "forward-looking costs" and using historic costs. Commission decisions on these and related issues are expected this summer.

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The method for determining cost-based payments also is in flux at the federal level. The Federal Communications Commission currently determines its high-cost payments from the Federal Universal Service Fund based on programs that were in operation before the Federal Telecommunications Act was passed in 1996. The FCC has said it will use "forward-looking economic costs," but it hasn't yet determined the best way to determine those costs and relate them to making payments from the federal Fund.

The FCC has decided that costs for large companies and for small companies shouldn't be determined in exactly the same way. Implementation of the cost model for large companies is expected within the next year. Small, rural telecommunications companies won't be using forward-looking economic costs until at least 2001.

Conclusion

The implementation of the Kansas Universal Service Fund has caused both questions and controversy. It also has resulted in legal challenges, both in the courts and before the Federal Communications Commission. Further, both the Federal Communications Commission and the Kansas Corporation Commission are in the process of developing or refining their policies related to implementing and operating universal service funds. As a result, this whole area is in a state of flux, and is likely to be so for some time. The Corporation Commission has begun hearings to move Kansas toward a cost-based approach to funding universal service, which appears to be called for by both State and federal law. Given the number of parties, competing interests, and complexities involved in the telecommunications arena, this process is likely to take some time. Because things seem to be headed in the right direction, the Legislature may want to give this process time to evolve before considering any action in this area.

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How Does the Kansas Universal Service Fund Compare with Other Universal Service Funds?

The Kansas Fund is similar to and different from each fund we looked at. The Federal Universal Service Fund and the Kansas Fund generally don't duplicate each other. One program, Lifeline, is funded by both; for that program, State moneys increase Federal funding. Among the six state funds we looked at, only Georgia's is based on making up revenues the companies lost when access fees were reduced, like the Kansas Fund. The funds vary widely in size, in how moneys are collected, and in what programs benefit from fund moneys. Our comparisons are summarized below.

The Federal Universal Service Fund Will Spend More Than $4 Billion on Four Programs

The Federal Universal Service Fund was created in 1983, with the divestiture of AT&T, to help ensure that affordable, quality telecommunications services would be available for all Americans, wherever they live. Until 1996, the Federal Universal Service Fund funded two programs—a high-cost program for companies and a low-income program for consumers. The Federal Telecommunications Act of 1996 expanded the Federal Universal Service Fund to provide support for a schools and libraries program and a rural health care providers program.

How universal service funds are used

	Federal	Kansas	Additional information
High cost support	✓	(a)	Three federal programs provide support for lines in high cost areas. Federal support is moving toward being based on costs.
Maintain revenue neutrality		✓	Revenue neutrality is not a goal of the federal act.
Discounted telecommunications services for people with low incomes	✓	✓	Lifeline is a joint federal-state program. Federal funding increases with state participation. Link-up, a federal program, covers some telephone connection charges for eligible households. Only the federal Link-up is offered in Kansas.
Discounted telecommunications services (including Internet access) for eligible schools and libraries	✓		Discounts range from 20% to 90%, depending on economic need and location. The federal fund reimburses telecommunications companies for the amount of the discount.
Discounted telecommunications services for rural health care providers	✓		Discounts help ensure that isolated health care providers pay no more for telemedicine than their urban counterparts. The federal fund reimburses telecommunications companies for the amount of the discount.
Telecommunications services for people with disabilities		✓	Federal funding for these services is not available through the universal service fund.

(a) Payments from Kansas' Fund are primarily made to reimburse local phone companies for the revenues they lost when they had to reduce their in-state access charges (to keep them "revenue neutral"). However, local companies that add new phone lines in high-cost areas receive $36.88 per year from the Fund to help offset costs. Those payments represent a minimal portion, less than 0.3%, of the total amount paid from the Fund to date.

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Brief descriptions of the four federal programs in the table on the preceding page allow comparisons with programs Kansas provides through its universal service fund.

With the possible exception of some portion of high-cost support, the federal and Kansas universal service funds don't duplicate or overlap each other. Some argue there is some duplication of high-cost support. That's based on the assumption that higher access revenues formerly earned by local telephone companies covered some of the same costs that high-cost payments from the Federal Universal Service Fund cover. Because the revenue neutral payments made from the Kansas Fund replace access revenues local companies lost, payments from the Kansas Fund may now duplicate some portion of the payments from the Federal Fund. However, whether there really is duplication can't be determined until federal and State studies of local telephone company costs (as described in question 2) are completed.

The Federal Universal Service Fund now collects and pays out more than $4 billion for those programs, as detailed in the table below:

Estimated Cost of Programs Funded by the Federal Universal Service Fund
(in millions)

Program	Estimated Cost	Program Period	Estimated Amount Going to Kansas
High Cost	$1,733	Jan 99 to Dec 99	$ 63.7
Low-income	463	Jan 99 to Dec 99	0.4
Schools and Libraries	1,925	Jan 98 to June 99	10.2
Rural Health	400	Jan 98 to June 99	not available
Total	$ 4,521		$ 74.3

Source: Universal Service Administrative Company

The federal and Kansas Universal Service Funds also have similarities and differences in how they are funded and administered, summarized in the table below. A

Contributions and administration		
	Federal	Kansas
Who must contribute	All providers of interstate telecommunications; contribution may be passed along to customers	All providers of in-state telecommunications except paging services; contribution may be passed along to customers
Assessment rate on company revenues (current year)	About 3% to fund the low-income and high-cost programs; about 0.6% for the schools and libraries program and the rural health care program	About 7.5%
Who administers the fund	Universal Service Administrative Company (a not-for-profit subsidiary of the National Exchange Carriers Association)	National Exchange Carriers Association

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more detailed comparison is presented in Appendix E. This appendix includes a table that originally appeared in the report "Recommendations of the Kansas Universal Service Fund (KUSF) Working Committee to the 1999 Legislature," which was prepared by staff of the Kansas Legislative Research Department.

Other States Generally Don't Use Their Universal Service Funds The Same Way Kansas Does, and They Vary Widely in How They Collect Funds and How Much They Spend

We compared aspects of the Kansas Universal Service Fund with those of six other states that have had universal service funds in operation since at least 1997: Arkansas, California, Georgia, Vermont, Washington, and Wyoming. We found that those states vary in their funding and in the programs they support with universal service fund moneys.

The funds' expenditures range in size from $3 million in Wyoming to $780 million in California. Kansas' fund, at $91 million, was second to California's in overall size. California's contribution rate is also the closest to Kansas'.

There also are significant differences in what moneys are assessed. Four of the other six states assess the revenues of telecommunications providers, but one of those four assesses both intrastate revenues and interstate revenues.

The table below summarizes these comparisons with other states.

Collections and expenditures

	KS	AR	CA	GA	VT	WA	WY
amount collected in most recent year (in millions)	$89.7	$13.7*	$782.5	$30.0	$5.2	$10.0	$9.9
expenditures in most recent year (in millions)	$91.4	$8.6*	$782.5	$30.0	$5.6	$10.0	$3.0
basis for payments into the fund	6.83% (6.49% for wireless) assess-ment on company intrastate revenues	1.0% assess-ment on company intrastate revenues	5.57% surcharge on customer bills for intrastate services	1.5% assess-ment on company intrastate revenues	1.06% assess-ment on company intrastate <u>and</u> interstate revenues	.0156¢ per minute surcharge on long distance; companies pay	2.0% assess-ment on company intrastate services

* Figures for Arkansas are for the fund's initial 16 months.

Source: LPA survey

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Kansas, Georgia, and Arkansas use their universal service funds to make up moneys local phone companies lost when they were required to reduce intrastate revenues. Only Georgia and Kansas use universal service fund moneys to make up amounts lost when the state ordered in-State access rates to be lowered to match interstate access rates. Georgia's fund is smaller than Kansas' because the largest phone company in Georgia isn't allowed to make up its losses through the fund, and because Georgia is phasing in its reduction over five years and it just completed year three. (A Georgia official estimated that, at the end of the fifth year, local phone companies that collect through the fund would have reduced their in-State access charge revenues by a total of $55 million, and about $45 million of that amount would be replaced through its fund.) Arkansas makes up revenues lost as a result of federal and state mandates and Arkansas Public Service Commission action; so far there has been no mandate to reduce intrastate access charges.

The table below summarizes how Kansas and the other states we surveyed use their universal service funds.

States use their universal service funds–	KS	AR	CA	GA	VT	WA	WY
–for high cost support	(a)		✓			✓	✓
–to make up revenues lost as a result of legislative or Commission action	✓	✓		✓			
–for discounted telecommunications services for people with low incomes	✓		✓		✓		
–for telecommunications services for people with disabilities	✓		✓		✓		
–for E-911 (which provides location and telephone number information to emergency services dispatchers)					✓		
–discounted services for schools, libraries, clinics, etc.			✓				

(a) See the footnote on page 24.

Source: LPA survey

This table illustrates that states use their universal service funds for a variety of purposes–including providing E-911 and telecommunications services for people with disabilities. Such decisions are made within each state. A more detailed comparison between Kansas and other states is included in Appendix F.

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Conclusion

Within the general area of defining and funding universal service, it's apparent that a variety of approaches have been taken at both the state and federal levels. The universal service funds at the federal level and within several states are moving toward a cost-based approach to supporting universal local phone services, although at least two states are using their funds to offset the impact of mandatorily reducing telephone companies' revenues. Given the development of federal guidance for cost-based support and the eventual resolution of legal challenges, it's possible that states' universal service funds may gradually become more similar.

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Appendix A
Scope Statement

This appendix contains the scope statement approved by the Legislative Post Audit Committee for this audit on March 16, 1999. The audit was requested by Representative Alldritt.

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SCOPE STATEMENT

Reviewing Payments from the Kansas Universal Service Fund

When the Legislature passed the Kansas Telecommunications Act of 1996, it authorized creation of the Kansas Universal Service Fund. That Fund was intended to help ensure all Kansans would have access to a first-class telecommunications infrastructure that provided excellent service at an affordable price, and to promote access for both rural and urban consumers to a full range of telecommunications services, including advanced services like Internet hook-ups.

Every telecommunications carrier, public utility, and wireless service provider that offers telecommunications services within Kansas is required to contribute to the Fund. These moneys primarily come from surcharges phone companies levy on their customers. This money may be used to compensate telecommunications companies for revenues they've lost in charging "equalized" interstate and intrastate rates. It also may be used to recover shortfalls caused by the need to rebalance intrastate rates to maintain parity with interstate access rates, by additional investments needed to provide universal service and enhanced universal service, and by certain changes in federal rules or certain requirements mandated by a legislative, regulatory or judicial authority.

During the first 15 months of the Fund's existence, more than $98 million was collected and more than $66 million was paid out. Projected collections and distributions from June 1998 to May 1999 are $68.7 million and $100 million, respectively.

The Kansas Corporations Commission is responsible for overseeing the Fund. The Fund's day-to-day administration is carried out by the National Exchange Carrier Association under contract with the Commission. The administrator is responsible for collecting and auditing all relevant information from companies that receive moneys from or provide moneys to the Fund, verifying the amount each company owes the Fund, collecting all moneys owed, and distributing the amounts owed to qualified companies.

Recently, legislators have expressed an interest in knowing what the basis is for the distributions made to individuals telephone companies, and whether those distributions are being made in accordance with the intent of the law. A performance audit addressing these concerns would answer the following questions.

1. **Has the Corporation Commission established reasonable methods for collecting and distributing moneys in the Kansas Universal Service Fund?** In answering this question, we'd review State and federal laws relevant to universal service and the use of the Fund, and would interview Commission officials to determine what criteria have been established for such things as the

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amount each company pays into the Fund, which companies are eligible to receive payments, and how much those payments should be. We'd assess whether these criteria and the rules and procedures adopted for implementing them appear to be reasonable and to address the requirements outlined in law. We'd conduct additional work as needed.

2. **Have the Commission and the Fund's administrator taken adequate steps to ensure that companies are entitled to the amounts they receive from the Fund?** To answer this question, we'd interview Commission officials to determine what procedures they've established to ensure that the Fund's administrator is paying out only the amounts companies are entitled to receive under the law and Commission guidelines. We'd interview officials from the National Exchange Carrier Association (the Fund's administrator) to determine what they do to audit or verify the amounts claimed by individual companies or carriers. On a sample basis, we'd look at any audits or verification work done by the Association to ensure that payments made from the Fund are in accordance with the law and Commission guidelines. We'd conduct additional work as needed.

3. **What portion of the Kansas Universal Service Fund's disbursements represent high cost recovery, and what portion represents revenue neutrality.** We'd contact the Fund's administrators to determine what information they may have to identify how much of the total disbursements are represented by each of these two components. As needed, we'd analyze the Fund's accounting records or conduct other testwork.

4. **How does the Kansas Universal Service Fund compare with other universal service funds?** To answer this question, we would compare the purpose, size, funding, and operation of the Kansas Universal Service Fund to similar funds in other states and to the federal universal service fund. For the federal fund, we would assess how it is similar or different from the Kansas Fund, and determine whether there is any potential duplication or overlap.

Estimated time to complete: 8-10 weeks

Appendix B

Estimated Amount of Kansas Universal Service Fund Support To Be Received by Local Telephone Companies For the Year Beginning March 1, 1999

The following table shows the amount Commission staff estimate the Fund will pay to each local telephone company in the current year (March 1, 1999-February 29, 2000). The table also provides an estimate of how much of that amount each local telephone company can collect from its own customers (the "annual assessment").

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KANSAS CORPORATION COMMISSION
KUSF Net Payable to Companies
(For the Year Begiining March 1, 1999)

Telecommunications Company		Expected Payment From The KUSF	Annual Assessment To Support The KUSF	Net Payable To Company
SW Bell***		$65,042,907	$32,975,769	$32,067,138
Sprint/United of KS***		14,349,993	2,535,965	11,814,028
Rural**		3,661,706	194,284	3,467,422
Sunflower**		1,267,970	14,551	1,253,419
S & T**	(a)	1,038,692	43,491	995,201
Golden Belt		883,514	110,874	772,640
Wilson		835,895	41,184	794,711
Twin Valley		705,395	43,614	661,781
Wheat State		671,600	39,096	632,504
KanOkla**		644,595	38,524	606,071
S & A**		549,064	11,723	537,341
Cunningham		533,448	26,496	506,952
Home**		526,675	27,846	498,829
JBN		522,661	49,320	473,341
H & B Comm**		518,031	0	518,031
Pioneer**		513,194	0	513,194
Blue Valley**		467,017	30,426	436,591
Moundridge		431,891	47,268	384,623
Haviland**		357,275	0	357,275
South Central**		342,089	0	342,089
CrawKan		295,743	233,352	62,391
Totah**		274,727	23,594	251,133
Madison		269,310	14,940	254,370
Tri-County		235,244	39,917	195,327
United Telephone Assn**		182,462	0	182,462
So Cent of Kiowa		172,653	14,040	158,613
Bluestem		169,685	18,591	151,094
Rainbow		145,335	36,216	109,119
Peoples Mutual		125,402	27,522	97,880
Zenda		82,145	4,356	77,789
Columbus**		41,409	0	41,409
Gorham		36,567	1,523	35,044
Cass County		33,019	8,951	24,068
LaHarpe**		31,184	4,423	26,761
Mutual		24,984	8,748	16,236
MoKan Dial**		0	29,064	(29,064)
Wamego		0	91,476	(91,476)
Elkhart		0	28,242	(28,242)
Council Grove**		0	0	0
Southern KS**		0	36,256	(36,256)
Totals		$ 95,983,481	$ 36,851,642	$ 59,131,839

*These amounts are based on support calculations as of March 1, 1999. The support payable and assessment amounts are subject to change as companies report changes in their number of access lines.

**These companies signed the ILEC Stipulation and have experienced local service rate increases as part of the movement to the statewide average. Due to the local service increase, the company's customers are assessed less than $1.50 per access line. The combined assessment for all companies that signed the ILEC Stipulation covers the complete assessment amount for the ILECs.

***SW Bell's & Sprint/United of KS' assessments are for local service only. The assessment reported does not include assessments for long distance and private line services.

(a) S&T and S&T of Dighton are now a combined company; therefore, its combined KUSF support is shown. In prior years, S&T's and S&T of Dighton's KUSF support were shown separately.

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Appendix C

Allocation of Kansas Universal Service Fund Access Charge Reduction Payments Into a High Cost Amount and a Make-Whole Amount Fund Years 1 and 2

The following table shows the total amount of access charge reduction moneys paid to each local exchange carrier for years 1 and 2, broken down into an amount for "high-cost" support and the remaining "make whole" amount, using a methodology developed by the Commission. This methodology uses the number of high cost lines reported by each local exchange carrier and a $36.88 value for every high-cost line which the Commission adopted in its December 27, 1996 order. The methodology is described in the box below.

number of high-cost lines	multiplied by	$36.88	equals	amount of high-cost support paid to each carrier
(we used the average of what the companies reported at beginning and end of each Fund year)		(the value for each high-cost line, per Commission order of December 27, 1996)		

Subtract that amount from the total amount paid to each local exchange carrier to arrive at a figure Commission staff refer to as the "make whole" amount.

total amount paid to each local exchange carrier	minus	amount of high-cost support paid to each carrier	equals	"make whole" amount

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Allocation of Kansas Universal Service Fund Access Charge Reduction Payments Into a High Cost Amount and a Make Whole Amount

Carrier Name	March 1997 - February 1998					March 1998 - February 1999					
	Total Payment	Make Whole Amount	% Make Whole Amount	High Cost Amount	% of High Cost Amount	Total Payment	Make Whole Amount	% Make Whole Amount	High Cost Amount	% of High Cost Amount	Total Paid
Southwestern Bell Telephone Company	$39,126,434	$31,336,272	80%	$7,790,162	20%	$58,518,828	$50,728,666	87%	$7,790,162	13%	$97,645,262
United Telephone of Kansas (Sprint)	$8,095,859	$4,447,321	55%	$3,648,538	45%	$12,710,157	$9,004,270	71%	$3,705,887	29%	$20,806,016
Rural Telephone Service Co., Inc.	$3,465,121	$3,133,053	90%	$332,068	10%	$3,661,704	$3,328,493	91%	$333,211	9%	$7,126,825
Sunflower Telephone Company, Inc.	$1,277,160	$1,154,276	90%	$122,884	10%	$1,270,266	$1,142,016	90%	$128,250	10%	$2,547,426
S & T Telephone Coop. Assn.	$951,348	$898,757	94%	$52,591	6%	$1,120,369	$1,067,778	95%	$52,591	5%	$2,071,717
The Golden Belt Tel. Assn., Inc.	$797,880	$610,179	76%	$187,701	24%	$883,512	$697,305	79%	$186,207	21%	$1,681,392
Wilson Telephone Company, Inc.	$833,352	$765,456	92%	$67,896	8%	$835,260	$766,092	92%	$69,168	8%	$1,668,612
Twin Valley Telephone, Inc.	$693,264	$618,139	89%	$75,125	11%	$701,305	$620,114	88%	$81,191	12%	$1,394,569
Pioneer Telephone Association, Inc.	$734,040	$245,159	33%	$488,881	67%	$655,632	$142,594	22%	$513,038	78%	$1,389,672
The Wheat State Telephone Company, Inc.	$670,671	$595,749	89%	$74,922	11%	$671,604	$594,820	89%	$76,784	11%	$1,342,275
The Kan-Okla Telephone Assn., Inc.	$642,036	$569,456	89%	$72,580	11%	$643,520	$569,576	89%	$73,944	11%	$1,285,556
S & A Telephone Company, Inc.	$548,976	$518,698	94%	$30,278	6%	$549,238	$518,443	94%	$30,795	6%	$1,098,214
Cunningham Tel. Company, Inc.	$533,448	$484,508	91%	$48,940	9%	$533,448	$484,508	91%	$48,940	9%	$1,066,896
H & B Communications, Inc.	$534,204	$505,364	95%	$28,840	5%	$525,510	$496,670	95%	$28,840	5%	$1,059,714
JBN Tel. Co. Inc.	$526,476	$446,852	85%	$79,624	15%	$517,176	$431,117	83%	$86,059	17%	$1,043,652
Home Telephone Company, Inc.	$516,780	$455,744	88%	$61,036	12%	$518,076	$455,417	88%	$62,659	12%	$1,034,856
The Blue Valley Tel. Company	$475,152	$379,043	80%	$96,109	20%	$470,454	$374,345	80%	$96,109	20%	$945,606
The Moundridge Telephone Company	$419,136	$338,885	81%	$80,251	19%	$429,692	$343,061	80%	$86,631	20%	$848,828
Haviland Tel. Company, Inc.	$417,568	$286,091	69%	$131,477	31%	$384,569	$250,584	65%	$133,985	35%	$802,137
South Central Telephone Assn., Inc.	$349,728	$316,352	90%	$33,376	10%	$343,995	$310,619	90%	$33,376	10%	$693,723
The Craw-Kan Tel. Coop., Inc.	$295,740 (a)	$0	0%	$295,740	100%	$295,740	$0	0%	$295,740	100%	$591,480
The Totah Telephone Company, Inc.	$273,072	$227,562	83%	$45,510	17%	$273,486	$227,146	83%	$46,340	17%	$546,558
Madison Telephone Company, Inc.	$269,088	$243,383	90%	$25,705	10%	$269,142	$243,326	90%	$25,816	10%	$538,230
The Tri-County Telephone Assn., Inc.	$233,688	$121,112	52%	$112,576	48%	$233,997	$119,982	51%	$114,015	49%	$467,685
United Telephone Assn., Inc.	$249,708	$83,416	33%	$166,292	67%	$213,501	$47,209	22%	$166,292	78%	$463,209
South Central Telecommunication of Kiowa, Inc.	$172,653	$147,980	86%	$24,673	14%	$172,655	$147,983	86%	$24,673	14%	$345,308
Bluestem Telephone Company	$169,320	$132,956	79%	$36,364	21%	$169,590	$133,042	78%	$36,548	22%	$338,910
S & T Communications of Dighton, Inc.	$87,336	$51,304	59%	$36,032	41%	$221,904	$185,872	84%	$36,032	16%	$309,240
Rainbow Telephone Coop Assn., Inc.	$135,564	$73,827	54%	$61,737	46%	$137,192	$70,568	51%	$66,624	49%	$272,756
Peoples Mutual Telephone Company	$123,744	$77,331	62%	$46,413	38%	$125,022	$77,852	62%	$47,170	38%	$248,766
Columbus Telephone Co., Inc.	$97,106	$33,414	34%	$63,692	66%	$75,282	$11,590	15%	$63,692	85%	$172,388
Zenda Telephone Company, Inc.	$81,924	$74,327	91%	$7,597	9%	$82,086	$74,378	91%	$7,708	9%	$164,010
Gorham Telephone Company	$36,702	$25,730	70%	$10,972	30%	$36,649	$25,179	69%	$11,470	31%	$73,351
Cass County Telephone	$31,172	$20,864	67%	$10,308	33%	$32,027	$20,539	64%	$11,488	36%	$63,199
LaHarpe Telephone Company, Inc.	$31,428	$17,819	57%	$13,609	43%	$31,248	$17,639	56%	$13,609	44%	$62,676
Mutual Telephone Company	$23,692	$9,788	41%	$13,904	59%	$24,661	$10,112	41%	$14,549	59%	$48,353
Total	**$63,920,570**	**$49,446,166**	**77%**	**$14,474,404**	**23%**	**$88,338,497**	**$73,738,905**	**83%**	**$14,599,593**	**17%**	$152,259,067

Note a: Amount of revenue needed to remain revenue neutral was less than the amount of high cost reimbursement the company was eligible for. Therefore the high cost amount was reduced to the revenue neutral amount.

Note b: The following companies increased their rates to move toward the statewide rural average rates, the additional revenue was more than enough to cover the amount needed to remain revenue neutral:

Council Grove Telephone Co.; Elkhart Telephone Company, Inc.; MO-KAN Dial, Inc.; The Southern Kansas Tel. Company, Inc.; Wamego Telephone Company, Inc.

Appendix D

Revenues and Expenditures for the 41 Local Exchange Carriers Providing Local Telephone Service in Kansas Calendar Year 1998

Kansas telecommunications providers must file an annual report with the Kansas Corporation Commission. That report is a public document. Commission staff prepared the attached table using information contained in the annual reports submitted by the 41 local exchange companies operating in Kansas in 1998. The table shows operating revenues and operating expenses, and it categorizes other income and expense classifications to arrive at the net income reported by each local exchange carrier.

Operating revenues include all income earned within the State of Kansas. Some revenues were earned through the provision of interstate services, which are regulated by the Federal Communications Commission. Other revenues were earned through the provision of intrastate services, which are regulated by the Kansas Corporation Commission. Still other revenues were earned through non-regulated services.

In Kansas, Southwestern Bell and Sprint/United have chosen price cap regulation, whereas the other local exchange carriers have chosen rate-of-return regulation. In general, price cap regulation allows companies to become as profitable as their own expertise allows. That's because these companies have a known revenue stream, and if they can reduce their costs, more money will available for profit. On the other hand, companies selecting rate-of-return regulation will generate a specific profit which is known ahead of time. These companies are allowed to charge prices that recover all of their costs plus a specified amount of profit.

The data shown in the table is <u>not</u> the data that would be used to make a rate-of-return calculation.

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Revenues and Expenditures Reported by Kansas Local Exchange Carriers

For Calendar Year 1998

(Expressed in thousands)

Count	Carrier Name	Operating Revenue	Operating Expenses	Taxes Paid	Other Income And Expenses	Interest Expense	Subtotal	Non Regulated Income	Net Income
1	Southwestern Bell	$927,106	($710,963)	($104,932)	$3,950	($32,189)	$82,972	0	$82,972
2	Sprint/United								
	United of Southeastern	$4,158	($1,477)	($1,453)	($0)	($4)	$1,224	($109)	$1,115
	United of Southcentral	$8,635	($4,804)	($1,895)	$264	($171)	$2,029	$20	$2,049
	United of Eastern	$44,641	($24,478)	($9,175)	$1,570	($1,115)	$11,442	($12)	$11,430
	United of Kansas	$58,515	($47,422)	($4,152)	$2,716	($2,241)	$7,417	($506)	$6,911
2	Subtotal Sprint/United	$115,950	($78,181)	($16,675)	$4,549	($3,531)	$22,112	($607)	$21,505
3	Pioneer Telephone	$23,187	($15,176)	($1,274)	$147	($201)	$6,683	0	$6,683
4	Rural Telephone	$21,740	($17,074)	($754)	$297	($1)	$4,208	$505	$4,713
5	Southern Kansas Telephon	$11,820	($6,792)	($534)	$74	($53)	$4,515	$83	$4,598
6	Craw-Kan Telephone	$10,528	($7,748)	($937)	$1,147	($7)	$2,983	0	$2,983
7	Sunflower Telephone	$6,454	($5,764)	($558)	$1	($3)	$131	0	$131
8	United Telephone Assn.	$6,337	($3,852)	($605)	$0	($7)	$1,874	0	$1,874
9	Golden Belt Telephone	$6,119	($3,750)	($356)	$89	($1)	$2,102	($11)	$2,091
10	Blue Valley Telephone	$5,765	($2,830)	($396)	$423	($223)	$2,739	($1,525)	$1,214
11	S & T Telephone	$5,747	($3,051)	($708)	$446	($603)	$1,831	0	$1,831
12	MO-KAN Dial	$5,245	($3,929)	($680)	$21	$0	$657	0	$657
13	Moundridge Telephone	$4,237	($2,686)	($643)	$390	($245)	$1,054	$18	$1,072
14	JBN Telephone	$4,198	($2,341)	($726)	$136	($399)	$869	$80	$949
15	Kan-Okla Telephone	$4,085	($2,995)	($464)	$232	($0)	$857	($8)	$849
16	Haviland Telephone	$4,029	($2,557)	($598)	$57	($422)	$509	0	$509
17	Twin Valley Telephone	$3,981	($2,523)	($214)	$501	($219)	$1,525	($974)	$551
18	Wamego Telephone	$3,946	($2,219)	($700)	$443	($138)	$1,332	$23	$1,355
19	Wheat State Telephone	$3,845	($2,725)	($532)	$21	$0	$609	0	$609
20	Wilson Telephone	$3,559	($2,866)	($203)	$374	($126)	$739	0	$739
21	Tri-County Telephone	$3,190	($2,187)	($215)	($2)	($1)	$785	0	$785
22	Home Telephone	$3,026	($2,058)	($282)	$391	($153)	$924	0	$924

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Revenues and Expenditures Reported by Kansas Local Exchange Carriers For Calendar Year 1998 (Expressed in thousands)									
Count	Carrier Name	Operating Revenue	Operating Expenses	Taxes Paid	Other Income And Expenses	Interest Expense	Subtotal	Non Regulated Income	Net Income
Count	Carrier Name	Operating Revenue	Operating Expenses	Taxes Paid	Other Income And Expenses	Interest Expense	Subtotal	Non Regulated Income	Net Income
23	Elkhart Telephone	$2,945	-$2,536	-$131	-$19	-$1	$259	0	$259
24	Totah Telephone	$2,555	-$1,945	-$219	$494	-$134	$751	0	$751
25	South Central Telephone	$2,260	-$1,754	-$150	$526	-$242	$640	0	$640
26	Cunningham Telephone	$2,256	-$1,422	-$118	$274	$0	$989	$81	$1,070
27	H & B Communications	$1,997	-$1,634	-$180	$284	-$74	$394	0	$394
28	Peoples Mutual Telephone	$1,920	-$1,228	-$305	$124	-$1	$510	0	$510
29	Rainbow Telephone	$1,829	-$1,268	-$144	$789	$0	$1,207	0	$1,207
30	Columbus Telephone	$1,736	-$1,134	-$119	-$178	$0	$305	0	$305
31	S & A Telephone	$1,599	-$1,255	-$124	-$1	-$0	$218	0	$218
32	Bluestem Telephone	$1,458	-$1,150	-$130	-$2	-$0	$176	0	$176
33	Council Grove Telephone	$1,353	-$881	-$182	$0	-$0	$290	0	$290
34	S & T Communications of D	$1,300	-$987	-$123	-$82	-$319	-$211	0	-$211
35	Madison Telephone	$1,276	-$989	-$153	$14	-$0	$147	-$76	$71
36	South Central of Kiowa	$1,064	-$384	-$314	-$88	$0	$279	0	$279
37	Mutual Telephone	$528	-$361	-$22	$217	-$0	$362	0	$362
38	Gorham Telephone	$515	-$613	$7	$157	-$14	$52	0	$52
39	Zenda Telephone	$473	-$474	-$16	$58	-$0	$41	0	$41
40	LaHarpe Telephone	$432	-$336	-$107	$19	-$4	$5	$124	$129
41	Cass County Telephone	$410	-$297	-$17	$2	-$40	$58	$1	$58
	Total	$1,211,999	-$904,914	-$135,535	$16,278	-$39,351	$148,477	-$2,286	$146,191

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Appendix E

Comparison of the Federal Universal Service Fund and The Kansas Universal Service Fund

The following is an extract from a report titled *Recommendations of the Kansas Universal Service Fund Working Committee to the 1999 Kansas Legislature*, issued in December 1998. This report was prepared primarily by staff from the Legislative Research Department.

We think that the table provides a lot of good comparative information, but we didn't attempt to verify the accuracy of every statement made in this table.

Comparison of Federal Universal Service and Kansas Universal Service Support Mechanisms. Below is a comparison of federal universal service support mechanisms and state universal support mechanisms.

Federal Universal Services Support Mechanisms	Kansas Universal Service Fund
Definition of Universal Service: single-party service; voice grade access to the public switched network; Dual Tone Multifrequency (DTMF) Signaling or its functional equivalent; access to emergency services including 911 and E911; access to operator services; access to interexchange services; access to directory assistance; and toll limitation services for qualifying low-income customers.	Same with three exceptions: No toll limitation services for low-income customers[1] and inclusion of stored program controlled switching with vertical service capability. Also, the Kansas Act provides for *equal* access to long distance services. (The Federal Act does not require *equal* access to interexchange service, only access to such service, among those services eligible for universal service support.)
Advanced or enhanced universal services are not eligible for universal service support although the FCC's inquiry on Section 706 is exploring whether advanced service capability or advanced service should be eligible. "Advanced service capability" is defined in Section 706(c)(1): "without regard to any transmission media or technology," as "high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics, and video telecommunications using any technology."	Enhanced universal services are eligible for KUSF support. These services include: signaling system seven capability, with CLASS service capability; basic and primary rate ISDN capability, or the technological equivalent; full-fiber interconnectivity, or the technological equivalent, between central offices; and broadband capable facilities to all schools, hospitals, public libraries, and state and local government facilities which request broadband services. ISDN and broadband facility deployment are conditioned upon a firm customer order and KCC approval.
Contributions. Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to federal universal service support mechanisms.	Same, with the exception of providers of paging services.
Receipt of Funds. Eligible telecommunications carriers designated under Section 214(e) of the Federal Act.[2] Exceptions are Internet access providers and cable companies, which are not telecommunications carriers, to be eligible for support from schools and libraries and rural health E-rate programs.	All eligible telecommunications carriers under Section 214 (e) of the Federal Act. Also, receipt of funds authorized for such carriers to offset revenues lost due to reductions in interstate access reductions (no comparable component at federal level).

[1]Although not explicitly included in the definition of "universal service," toll-limitation services are available from any company designated as an "eligible telecommunications carrier," as defined in Section 214(e)(1) of the Federal Act. This designation is a precondition in the Kansas Act (K.S.A. 66-2008 (c)) for receipt of KUSF support. Presently, only incumbent local telephone companies have been so designated.

[2]Section 214(e) requires an eligible telecommunications carrier to offer the services supported by federal universal service support mechanisms either by using a combination of its own facilities or a combination of its own facilities and resale of another carrier' s facilities (including the services offered by another eligible telecommunications carrier); and advertise the availability of such services and the charges therefor using media of general distribution.

Federal Universal Services Support Mechanisms	Kansas Universal Service Fund
Funding for Lines. Universal service support is authorized for single line residential lines and single line business lines.	Residential and all single line business lines, pursuant to the KCC' s Order on Reconsideration, 190,492-U, February 3, 1997. However, the KCC makes no distinction between primary and secondary residential lines.
High-Cost Assistance. High-cost assistance is provided to carriers serving high-cost (rural) areas for high-cost loops, DEM weighting, and long-term support (common lines) based on formulas. SWBT is not eligible for high-cost support but Sprint/United is.	Support is provided to carriers serving rural areas of the state. Purposes for which the KUSF may be used: replacing, on a revenue neutral basis, revenues lost due to reduced intrastate access charges; shortfalls resulting from changes in federal rules related to access revenue requirements; a percentage increase in access lines over a 12-month period prior to request; infrastructure expenditures necessary to serve additional customers within a company's service area; additional investments required to provide universal service and enhanced universal service; and infrastructure investments responding to facility or service requirements of the Legislature (such as Internet access requirements addressed below), regulatory (FCC or KCC), or judicial authority. SWBT has received KUSF support for revenues lost due to reduced intrastate access and is eligible to receive funding for other uses of KUSF.
Lifeline Program. Federal universal service support to qualified subscribers is currently a maximum of $6.75 per month ($7.00 effective March 1999) per primary line, assuming a state match. Eligibility criteria must be based on income or factors related to income, as determined by each state.	Lifeline support from the KUSF currently totals $3.00 per month per primary line ($3.50 effective March 1999). The state' s eligibility criteria include Temporary Assistance to Families; Food Stamps; Medicaid; Supplemental Security Assistance; General Assistance; and Food Distribution Program (United Tribes).
Link Up. Federal universal service support is available for eligible telecommunications carriers which offer qualifying low-income customers a reduction of their connection charges equal to one half of the carrier' s customary connection charge or $30, whichever is less.	No KUSF support is used for the Link Up program although Kansas participates in the program.
Telecommunications Relay Services Fund. Telecommunications relay service (TRS) was mandated by the Americans with Disabilities Act and is regulated by the FCC. It is funded through the National Exchange Carriers Association (NECA). NECA collects funds from approximately 3,000 companies based on their interstate revenues and disburses funds to the 13 providers that offer interstate telecommunications relay services.	**Kansas Relay Services Program.** The Kansas Relay Services program funds dual party relay services (operator assistance) for Kansans who are speech and hearing impaired. This program was funded for several years prior to the Kansas Act through assessments against all telephone carriers (local, long distance, and resellers). The assessments were computed on an access-line or access-minute basis. However, K.S.A. 66-2002 (g) of the Kansas Act shifted the funding to the KUSF. The amount budgeted from the KUSF for this program for 12 months beginning June 1, 1998 is $2.4 million.

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Federal Universal Services Support Mechanisms	Kansas Universal Service Fund
Terminal Access Program. Federal universal service support is not[a] available to meet requirements in Section 255 (c) of the Federal Act: "A provider of telecommunications shall ensure that the service is accessible to and usable by individuals with disabilities, if readily achievable. "Manufacturers of telecommunications equipment and customer premises equipment are required to ensure that the "equipment is designed, developed, and fabricated to be accessible to and usable by individuals with disabilities, if readily achievable."	**Telecommunications Access Program.** This program was not funded prior to the Kansas Act. Established by K.S.A. 66-2002 (g) of the Kansas Act, this program funds telecommunications equipment for persons with disabilities (hearing, visual, speech, mobility, and cognitive). The amount budgeted from the KUSF for this program for 12 months beginning June 1, 1998, is $1.1 million. The total amount expended from October 1, 1997 through November 30, 1998, was $879,300. The total number of applications recorded for that period was 2,141. The largest number of applications came from Johnson County (536).
Discounts for Schools and Libraries. Federal universal service support mechanisms fund discounts (20 percent to 90 percent) for eligible telecommunications services. Assessments are based on telecommunications carriers' interstate and intrastate end-user telecommunications revenues.	The KCC concurred in the federal discount program and in the same discount levels for intrastate services as was applied to interstate services to eligible schools and libraries. However, the KCC elected not to expand the program which would have required additional support from the KUSF.
Discounts for Rural Health Care Providers. Federal universal service support mechanisms fund discounts for eligible telecommunications services. The amount of the discount will be the differential between the rural rate and an amount no higher than the urban rate for similar services. Federal universal support mechanisms will support reduced rates on intrastate services provided to eligible health care providers. [3]	No direct KUSF support is used for the rural health care discount program.

a. In the original report, "not" was inadvertently omitted.

[3] The FCC clarified in its order (December 30, 1997, para. 247) that discounts also apply to intrastate services. This point was not addressed in the Federal Act, as it was for the schools and libraries program.

Appendix F

Other States' Universal Service Funds

The table on the following pages shows how universal service funds in other states compare to the Kansas Universal Service Fund. We focused on the purpose of each fund, what programs the fund supports, how moneys are collected for the fund, and who receives moneys from the fund.

The states we chose were listed in a report by The National Regulatory Research Institute as having operational universal service funds. That report, *State Universal Service Funding and Policy: An Overview and Survey*, included information from 50 states and the District Columbia. It was published in September 1998.

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Question	Kansas	Arkansas	California	Georgia	Vermont	Washington	Wyoming
Date the Fund became operational	March 1997	September 1997	'79 - Deaf and Disabled Telecommunications Program; '84 - Universal Lifeline Telephone Service; '88 - High Cost Fund A; '97 - High Cost Fund B, CA Teleconnect Fund	July 1996	October 1994	approximately 1985	February 1997
Purpose(s) of the Fund	to allow carriers to recover revenues lost as a result of rate rebalancing to interstate access rates and to pay for a program to ensure service for people with low incomes, relay services, and equipment for people with special needs	to promote and assure the availability of universal service at rates that are reasonable and affordable, and to provide for reasonably comparable services and rates between rural and urban areas.	to meet the goal of providing basic services to 95% of all customers in California	to "make whole" certain local exchange carriers by paying them an amount equal to the revenue they lost from reducing their intrastate access rates down to the 1995 level of interstate access rates	to provide a method for funding certain telecommunication services and an emergency 911 system	to support companies that provide telephone service and have a cost of providing service that is above 115% of the statewide average cost of service	to support customers whose cost of local service is greater than the average statewide cost of local service; to keep local rates affordable
Programs the Fund supports	replacement for revenue lost as a result of reduction of intrastate access rates	reductions in federal universal fund revenues	CA High Cost Fund A (CHCF-A) - subsidies for 17 ILECs to reduce disparity in rates	replacement for revenue lost as a result of reduction of intrastate access rates	emergency 911 system	high cost support	high cost support
	Telecommunications Access Program	reductions in intrastate carrier common line charges, as ordered by the Arkansas Commission	CA High Cost Fund B (CHCF-B) - subsidies to providers of local services in high-cost areas served by five ILECs to reduce disparity in rates		Lifeline program		
	Kansas Relay Services Inc.	reductions in switched access revenues	Universal Lifeline (ULTS) - to provide discounted basic telephone services to low-income customers		Telecommunications relay service which really consists of two parts: the relay service and an equipment purchase program		
	Lifeline	reductions in net revenues received from intrastate carrier common line pool, access charge pools, or intralata toll poll.	Teleconnect - to provide discounted services to qualifying schools, libraries, hospitals and clinics, and community organizations				
			Deaf and Disabled Telecommunications (DDTP) (2 programs) - to provide relay service and communications devices				

Question	Kansas	Arkansas	California	Georgia	Vermont	Washington	Wyoming
Were there discussions about limiting the size of the fund?	yes; legislators thought more revenue requirement would be made up by rate rebalancing and fund would be about $30M	no	the Commission must adopt a budget for each; Teleconnect had a statutory 0.41% surcharge (later lowered)	Thoughts were to minimize the size of the fund, but no specific numbers assigned.	no, knew fund size would be small, about a $4 to $5 million fund	none that our contact knew of	not when law was first debated because good data wasn't available. Since then, yes.
Did your state mandate reductions for intrastate access rates?	yes	no, reduction to intrastate access rates isn't allowable until after first three years of fund's existence	no, but a Commission decision in '94 forced companies' rates to be based on cost, and some went down	yes	no, but that issue is now being considered as part of an on-going rate case. Main issue of the case has to do with local rates.	not when the fund was created, but in December 1998 all carriers (large and small) were directed to reduce their terminating access rate to cost	no, but on a case-by-case basis, the Commission has worked with companies to get access rates reduced
If intrastate access rates were reduced, to what level?	interstate rates	n/a		Intrastate access rates should be reduced to the level that interstate access rates were in 1995.	n/a	n/a	For example, U.S. West had access rates at about 10 cents per minute, and they will be reduced to 1.5 cents later this year.
If intrastate access rates were reduced, was the reduction immediate or phased-in?	immediate for rural local exchange carriers; phased-in for big LECs	n/a		Reduction to be phased in over five years, 20% reduction each year.	n/a	n/a	There have been several reductions.
Revenues							
revenues (in millions) for the most recent full fund year	$89.8M	$13.7M	projected for '98: $782.5M	$30M	$5.2M	$10M	$9.9M
		(Note: first year was a 16-month period)			(Note: trying to spend down accumulated fund balance this year)		(Note: the Fund collected too much this year and will collect far less next year)
Do any groups of providers get special considerations?	the assessment rate for wireless providers is reduced by the percentage of wireless to wireless calls	no	paging companies are excluded	wireless are excluded	no, but are considering having wireless pay more because of additional costs to be incurred to have wireless served by E-911 system.	no	no

Question	Kansas	Arkansas	California	Georgia	Vermont	Washington	Wyoming
Can a company pass on its Fund obligation to its customers? As a separate charge (explicit) or in another charge (implicit)?	pass on; may be implicit or explicit	yes, explicit	explicit on customer bills; surcharge for each program listed separately	can NOT pass on the USF contribution as an additional charge	yes, explicit	implicit within the access rate	explicit charge on customers bills
Are Fund revenues raised through an assessment rate?	yes	yes	yes, as a surcharge	yes	yes	no	yes
If so, what revenues are assessed?	intrastate revenues; this has not been satisfactorily defined to date	intrastate revenues, as defined in FCC docket 96-45, in the order released May 8, 1997	surcharge is on everything except discounted services under ULTS, charges on resale services, public coin phone and phone debit cards, contracts before 9/15/94, usage charges to coin phones, directory advertising, & one-way radio paging	companies are expected to report gross intrastate revenues	all interstate and intrastate revenues (the total Vermont bill)	n/a	yes
What is the assessment rate or surcharge rate?	statutorily, not more than 8.89% until 1/1/2000; assessment rates for Year 2 (3/1/98-2/28/99) were 6.49 for wireless beginning 10/98, 6.83% for others and wireless before 10/98	1% assessment on company intrastate revenues	surcharge on customer intrastate bills for 1998 - 5.57% (breakdown: ULTS - 2.4%; CHCF-A - 0; CHCF-B - 2.87%; Teleconnect - 0.05%; DDTP - 0.25%) ; total surcharge for '99 is 4.03%	current assessment rate is 1.5%; it started at .5% and has been increased as access rates are reduced	1.06% assessment on all intrastate and interstate revenues billed in Vermont	a surcharge of .0156 cents per minute on long distance calls for which a long distance carrier pays an access charge to a local exchange company. Surcharge applies to both the originating and terminating ends of the call.	assessment on customers has varied; will be 2% on July 1, 1999
Are assessments on gross or net revenues?	has been on net; now is on gross	gross	n/a	gross. The issue of uncollectible accounts has not come up.	net	(doesn't use assessment)	gross

Question	Kansas	Arkansas	California	Georgia	Vermont	Washington	Wyoming
Expenditures							
expenditures (in millions) for the most recent full fund year	$91.4M	$8.6M (Note: first year was a 16 month period)	projected for '98: $782.5M	$30.0M	$5.6M	$10M	$3.0M
Who can receive moneys from the fund?	telecommunications public utilities, carriers, and providers of wireless service the KCC says are eligible (only LECs now)	eligible telecommunications carriers	ULTS - carriers are reimbursed for the difference between the regular and the discounted rate	paid to incumbent local exchange carriers. About 20 of 31 ILECS receive payments from the fund.	E-911 - paid to a state board; Relay Services Program - paid to the Department of Public Services (a contractor operates the program)	15-20 local exchange carriers whose local costs are greater than 115% of the state's average cost per loop	only incumbent local exchange companies receive payments
	National Exchange Carriers Assn., for administrative costs	National Exchange Carriers Assn., for administrative costs	CHCF-A - 17 small LECs whose basic rates otherwise would be too high for universal service; CHCF-B - competitors of big LECs in high-cost areas		Lifeline - paid to telephone companies who have issued credits to eligible customers		
			Teleconnect - carriers providing discounted services; DDTP - has been carriers, now centralized state funding		National Exchange Carriers Assn., for administrative costs		
For each program, what are the criteria for getting money?	carriers that provided switched local exchange services before 1/1/96 or their successors can receive "revenue neutral" payments. "High cost" is available to all LECs. LECs are reimbursed for Lifeline. SWBT sends payment voucher for relay services. Eligible people get vouchers for TAP, which KRSI pays.	Companies submit requests for reimbursement. The only funds paid out thus far are as a result of reductions in intraLATA toll pool revenues.	Trust funds are being established; companies keep documentation. For the high cost funds, funding is limited to specific companies, who draw from trustee accounts overseen by administrative committees.	The Georgia Telephone Association submits payment requests on behalf of all ILECs. Those requests calculate and compare switched access intrastate revenues, what would have been vs. what is, and calculates the difference. That difference is the make whole payment amount.	The appropriation process limits funds available for the E-911 and Relay programs. Lifeline isn't limited by a budget.	Companies with loop costs above 115% are guaranteed a certain rate of return on their investment. The payment made is whatever amount needs to be paid to allow these companies to achieve their target rate of return.	Companies bill customers the true cost of local service, but customers pay only up to 130% of the statewide average price for local service. For those with higher costs, the telephone company issues a credit for the balance and the state fund makes up the difference.

Appendix G

Agency Response

On July 30, we provided copies of the draft audit report to the Kansas Corporation Commission. The Commission's response is included as this Appendix. After carefully reviewing the response, we made some minor clarifications to the draft audit that didn't affect any of our findings or conclusions.

Kansas Corporation Commission

Bill Graves, Governor John Wine, Chair Cynthia L. Claus, Commissioner Brian J. Moline, Commissioner

August 13, 1999

RECEIVED
AUG 13 1999
LEGISLATIVE POST AUDIT

Barbara J. Hinton
Legislative Post Auditor
Mercantile Bank Tower
800 Southwest Jackson Street, Suite 1200
Topeka, Kansas 66612-2212

RE: Response of the Kansas Corporation Commission to the Post Audit Legislative Report "Reviewing Payments from the Kansas Universal Service Fund"

Dear Ms. Hinton:

Thank you for the opportunity to respond the Post Legislative Audit's Report entitled "Reviewing Payments from the Kansas Universal Service Fund." We appreciate the efforts of the audit team and its willingness to work with Commission staff and National Exchange Carriers Association (NECA) to learn the details of an area we consider extensive and complex. The auditors spent numerous hours with Commission staff in order to obtain an understanding of the regulatory background of telecommunications, the Kansas universal service fund mechanism and how the fund operates.

The Recommendations of the auditors are that the Kansas Corporation Commission (Commission) continue to address the areas of concern identified in the Report and provide periodic reports to the Legislative Post Audit Committee. The Commission concurs in the report in general and notes that the report is accurate to the extent it provides information as requested in the scope provisions. The Commission provides the following additional information regarding the findings and related matters:

<ins>Companies currently may not be reporting the same kinds or types of in-State revenues</ins>. The Commission recognizes the importance of ensuring consistency in the revenue reported and is addressing potential areas of discrepancy. Some carriers have raised possible areas of discrepancy and the Commission has issued an Order addressing those issues. Further, the Commission has directed NECA to post on its web site any letters from NECA or relevant Commission orders that provide guidance to the carriers on revenue reporting. The results of the carrier audits, which may apply to numerous companies, will be posted on the web site to attain consistency in revenue reporting.

1500 SW Arrowhead Road, Topeka, Kansas 66604-4027 785.271.3100 www.kcc.state.ks.us

Some companies are reporting gross revenues, while others are reporting net revenues. The Commission permitted companies which had reported and paid into the fund on gross revenue basis to "true-up" their contributions to a net basis for the first two years. For the third year, the Commission directed companies to report on a gross revenue basis. The parties presented further evidence and argument whether companies should be assessed on revenues which include bad debt. The Commission recently determined that companies should report revenue net of bad debt.

Some companies didn't submit the proper reports to NECA and the Commission. On March 17, 1999, Staff submitted a Notice of Filing of Report on Discrepancies in Reporting to the Commission, which detailed the reconciliation Staff performed between companies that reported to NECA for the first year of the KUSF (with a year end of February 1998) and companies that provided an Annual Report to the Commission (for the year ended December 1997). Timing differences resulted when companies started doing business in January or February 1998. These companies were required to begin reporting to NECA (KUSF year 1), but would not have submitted a 1997 Annual Report. Timing differences will account for some discrepancies each year. Additionally, many companies become certificated in Kansas knowing that they will not begin to do business in the state immediately. Carriers that do not have Kansas revenues are not required to report to NECA. All companies identified in the reconciliation process are sent a NECA package and/or sent an Annual Report.

As stated in the report, the KCC and NECA have initiated corrective actions to minimize future discrepancies, including:

1. When the KCC issues an order granting a new carrier a certificate of authority, the order specifically orders the company to report revenues for KUSF purposes to NECA.
2. Every two weeks, the KCC sends an activity report to NECA. The report identifies new carriers, mergers, name changes, etc., and enables NECA to send a packet to the carrier.
3. Staff performs an annual reconciliation, comparing who reported to NECA and the KCC, in addition to comparing if a company who filed an annual report the previous year filed a report the current year.

Some companies reported very different revenue amounts to the Commission and NECA without explaining the difference. On April 13, 1999, Staff provided a Notice of Filing of Report on Discrepancies in Reporting of Revenues, detailing the discrepancies of revenues reported to the Commission and NECA. The KCC Annual Reports are for the calendar year, January 1 through December 31. NECA reports are for the fiscal year, March 1 through February 28. For example, these timing differences may be significant due to the volume of calls during the holiday season. Additionally, a company must report all of its revenues on the Annual Report, but only Intrastate Retail Revenues are reported to NECA. Some revenues reported on the Annual Report, but not to NECA include: wholesale revenues, franchise fees, rent revenues, and carrier and billing revenues. For larger companies, (i.e. SWBT, AT&T, Sprint), these revenues can be significant. As stated in the Report, the Commission and NECA have initiated corrective actions. The KCC now requires companies to reconcile any differences between the two reports.

Audits of telecommunications companies weren't started as soon as they should have been. The first set of audits, involving sixteen carriers, has been completed. NECA submitted revised criteria for the selection of carriers for the next set of audits. After a review of the criteria and any comments submitted by the parties, the Commission will establish the selection criteria and issue orders to commence the next set of audits. The findings of audits were not significant. As stated in the Report on page 14, the audits found that an additional $21,000 was owed to the fund. Relative to the overall size of the fund, this is a small percentage. Further, it appears there is substantial compliance with revenue reporting and payment of appropriate assessments.

There's been no verification of the number of new "high-cost" lines companies have begun serving since the Fund was created in 1996. Currently, companies self-report to NECA the number of new lines. The number of lines reported to NECA is reviewed during the carrier audits. Further, NECA evaluates the requests for reasonableness based on available information, such as the increase in the number of lines as compared to those previously reported. The Commission Staff is currently exploring methods for verifying the line counts without creating a significant burden on the carriers while still providing satisfactory verification.

Update on Commission dockets related to the KUSF:

Docket No. 98-SWBT-677-GIT: This docket was generally initiated to investigate Southwestern Bell Telephone Company's (SWBT's) cost to provide local service. The Commission Staff is continuing to review data from SWBT. The Commission will determine in this proceeding how to implement any modifications in SWBT's KUSF support.

Docket No. 99-GIMT-326-GIT: This docket was initiated to review the KUSF mechanism and modify the mechanism to the extent necessary to transition the KUSF to a cost based fund. A hearing was conducted in June 1999. After submission of briefs, the Commission held an administrative meeting to discuss the issues and formulate a decision on the merits. An order is currently being drafted.

Funds in other states: The following information supplements the data provided in the report regarding other state universal funds. Some states with funds were not included in the NRRI report reviewed by the auditors and some of the funds have only recently been implemented. Although the charts provide some information regarding the variations in the funds, the variations are numerous and difficult to concisely articulate. However, such variations cause significant differences in the size of the funds, the amount assessed, and the distributions to the carriers and should be taken into consideration when comparing the state funds.

There are different participation guidelines for the regional Bell operating companies (RBOC) among the states. Arizona, Arkansas and Vermont do not allow their RBOC in the fund at this time. Participation by the RBOC is allowed in California, Wyoming, Colorado, Nebraska, Oklahoma, Texas, and Kansas. In states with RBOC participation, participation criteria differs among the states. For example, in Texas participation is based on forward-looking cost criteria. In Kansas distributions are primarily based on revenue neutrality to recover access charge reductions. Colorado placed a cap on their funds, effective July 1, 1999, the date that U.S. West became eligible for receipts from the fund. Nebraska's fund is revenue neutral to cover access charge reductions for 3 years for non-rural companies and 4 years for rural companies. At the end of this period the Nebraska fund will transition to a cost basis.

The number of lines assessed, the number of lines supported, and local rates all affect fund size and assessment amount. Wyoming, a rural state, has a $10 million dollar fund, but has 230,000 access lines and has increased local rates up to as high as $45 a month. Arizona supports the lines of only 1 company. Kansas has approximately 1,630,000 access lines and 36 companies currently receive money from the fund.

We will carefully review and consider the findings in the report as we move forward with modifications to the fund and as we develop further implementation and reporting procedures.

Sincerely,

John Wine
Chair

Cynthia L Claus

Cynthia Claus
Commissioner

Brian Moline

Brian Moline
Commissioner

1-58

QUESTION	Arizona	Colorado	Nebraska	Oklahoma	Texas
Date fund became operational	1997	July, 1998	July, 1999	High cost fund-1996, Oklahoma Universal Service Fund-Feb., 1999	January, 1999
Purpose(s) of Fund	Provides support for High Cost Areas only	Support high cost areas- moneys flow between net payers and net receivers, funds are not deposited in a state fund.	To allow carriers (3 years for non-rurals and 4 years for rurals) a revenue neutral transitional period to recover support based on the net of local rate increases and access reductions. After the transition period, support will be based on the actual cost of providing service determined by using the BCPM cost model, (the NPSC approved cost model).	1-High cost fund-Provide necessary funding required to maintain revenue neutrality for ILECS seeking HCF funding and who elect to become access providers. 2)Make available quality universale service at just, reasonable, and affordable rates.	Competitively neutral mechanism to enable all residenta to obtain basic telecom services.
Programs Fund Supports	High Cost	Method to provide support for high cost areas. Support only 1 Primary Residential Line and 1 access line for Single-Line Business.	High Cost Support, Lifeline, and Linkup Rate Assistance Program	a)E-911 equipment and teacher technology training, b)Incoming toll-free numbers and Internet Access Lines to various entities (public schools, libraries, county offices), c) Lifeline Programs	a) High cost support b) LifeLine & Link-up support c)Relay Services (Hearing impaired & speech impaired) d) Administration costs
		High Cost fund Administration		d) Revenue reductions/expense increases due to a change in state/federal laws or regulatory orders, e) Attorney Generals' efforts/fights against telephone fraud.	
Were there discussions about limiting the size of the fund		Yes. Fund was capped at $60 million, effective when US West became eligible for support.			Yes, but the high cost fund is based on forward-looking cost models, the size of the fund is derived from those calculations.

QUESTION	Arizona	Colorado	Nebraska	Oklahoma	Texas
Did your state mandate reductions for instrastate access rates?		In 1991, the Colorado Commission expanded local calling areas and at that time, they were supportable costs. In 1998, state law was changed, now high cost support is based on cost models.	Yes. Each company had to: (1) Increase local rates to a level at , or above, the affordability benchmarks of $17.50 for residential service and $27.50 for business. (2) The company had to reduce access rates to cost (non-rurals) or the NECA interstate rates (rurals). (3) Any company exceeding a 12% Rate of Return is subject to an earnings adjustment, which reduces the support received.	Yes in HB 1815	Yes, on Aug. 9, 1999, the PUC adopted the final computation of rate reductions for rural and non-rural carriers. If a company doesn't reduce access rates, then fund support is decreased by CCL, RIC, and Toll Revenues.
If intrastate access rates were reduced, to what level?		Not applicable in new fund.	Cost of Access for Non-Rural companies and NECA interstate rate for Rural companies.	Interstate rates	Varies by carrier. For SWBT, reduction was approximately $.023. Toll rates were also reduced.
If intrastate access rates were reduced, was the reduction immediate or phased-in?			Transitional-each company must meet the 3 above-referenced requirements by the end of the transitional period.	Phased-in	Immediate
REVENUES					
Revenues (in millions) for the most recent full fund year (Fund size)	$1million	$31.4 million, capped at $60million when US West became eligible in July, 99	$50 million	$20 million (year ended June, 99) $14.5 million FY 2000, had reserve of $8.6 million, lowering current year's assessment rate.	Expect fund size to be $493 million for FY 2000, including $15 million for Lifeline, $13 million for Relay Texas, and remainder for High cost, administration, and special equipment distribution.
Do any groups of providers get special considerations?	No.	No. Must be non-discriminatory & competitively neutral.	no	no	no
Can a company pass on its Fund obligation to its customers? As a separate charge (explicit) or in another charge (implicit)?	yes.	Yes. Jurisdictional companies must pass on to customers & include in tariffs. Non-jurisdictional can pass on, but at their option.		Yes, at company's option	Yes, permitted to recover, but not encouraged to do so in a separate charge. If separate charge is used, it is to be consistently labeled on the bill

QUESTION	Arizona	Colorado	Nebraska	Oklahoma	Texas
Did your state mandate reductions for instrastate access rates?		In 1991, the Colorado Commission expanded local calling areas and at that time, they were supportable costs. In 1998, state law was changed, now high cost support is based on cost models.	Yes. Each company had to: (1) Increase local rates to a level at , or above, the affordability benchmarks of $17.50 for residential service and $27.50 for business. (2) The company had to reduce access rates to cost (non-rurals) or the NECA interstate rates (rurals). (3) Any company exceeding a 12% Rate of Return is subject to an earnings adjustment, which reduces the support received.	Yes in HB 1815	Yes, on Aug. 9, 1999, the PUC adopted the final computation of rate reductions for rural and non-rural carriers. If a company doesn't reduce access rates, then fund support is decreased by CCL, RIC, and Toll Revenues.
If intrastate access rates were reduced, to what level?		Not applicable in new fund.	Cost of Access for Non-Rural companies and NECA interstate rate for Rural companies.	Interstate rates	Varies by carrier. For SWBT, reduction was approximately $.023. Toll rates were also reduced.
If intrastate access rates were reduced, was the reduction immediate or phased-in?			Transitional-each company must meet the 3 above-referenced requirements by the end of the transitional period.	Phased-in	Immediate
REVENUES					
Revenues (in millions) for the most recent full fund year (Fund size)	$1million	$31.4 million, capped at $60million when US West became eligible in July, 99	$50 million	$20 million (year ended June, 99) $14.5 million FY 2000, had reserve of $8.6 million, lowering current year's assessment rate.	Expect fund size to be $493 million for FY 2000, including $15 million for Lifeline, $13 million for Relay Texas, and remainder for High cost, administration, and special equipment distribution.
Do any groups of providers get special considerations?	No.	No. Must be non-discriminatory & competitively neutral.	no	no	no
Can a company pass on its Fund obligation to its customers? As a separate charge (explicit) or in another charge (implicit)?	yes.	Yes. Jurisdictional companies must pass on to customers & include in tariffs. Non-jurisdictional can pass on, but at their option.		Yes, at company's option	Yes, permitted to recover, but not encouraged to do so in a separate charge. If separate charge is used, it is to be consistently labeled on the bill

	Arizona	Colorado	Nebraska	Oklahoma	Texas
UESTION					
Are Fund revenues raised thruough an assessment rate?	Yes.	yes.	yes	yes	yes
If so, what revenues are assessed?	Category 2 providers are assessed on Intrastate Toll Revenues collected.	Intrastate Retail Revenues Collected	all Intrastate service Revenues	Intrastate Retail Billed Revenues	All taxable interstate and intrastate revenues
What is the assessment rate or surcharge rate?	Category 1 contributors (local service providers) assessed $.01211 per access line. Category 1 wireless providers assessed $.01211 per interconnecting trunk. Category 2 (intrastate toll providers) assessed .1391% on toll revenues.	3.1% effective July 1999	6.95%	0.46%	3.58%
Are assessments on gross or net revenues?	Intrastate Toll Revenues Collected	Gross Intrastate		Billed Revenues-Gross	Taxable Revenues
EXPENDITURES					
Expenditures (in millions) for the most recent full Fund year	$1 million	$31.5 million	$50 million anticipated	$5.8 million estimated	FY 2000 will be first full implemented fund year. Anticipate $493 million fund.
Who can receive moneys from the Fund?	Any eligible telecommunication provider, currently only 1 company	34 companies are eligible, however only 7 companies are currently receiving support. U.S. West came under the program July 1, 1999.	Local telephone companies. There are 42 in Nebraska, it's anticipated that 30 will receive support the first year.	Eligible Service Providers	For High cost fund, Eligible Telecommunication providers serving areas other than small or rural ILEC study areas.
For each program, what are the criteria for getting money?	Support is calculated as Benchmark Local Rate less cost for service, net of any Federal USF.	Based on cost of providing service	Must have a net loss of revenues between local rate increases and access reductions.	1. LECS serving less then 75,000 lines-embedded costs greater than revenues.	Eligible providers based on: difference between FLEC cost of services with Revenue benchmark, less any Federal USF.

QUESTION	Arizona	Colorado	Nebraska	Oklahoma	Texas
	a) Small carriers-support area is all exchanges in state and embedded costs are used.			2. LECs serving more than 75,000 access lines-use OCC methodology for calculating costs of service.	
	b) Intermediate carriers-support area is all exchanges or other area determined by Commission and embedded costs are used for 1st 3 years, then TSLRIC. Can ask for waiver to use FCC model.				
	c) Large carriers-support area is US Census Block Groups and TSLRIC costs are required, but may request waiver to use FCC model. Cost study must identify individual support areas for which funding is requested.				

Update on the KUSF
January 20, 2000

Legislative Post Audit Report

Since the Legislative Post Audit Report

- the Commission has clarified what constitutes in-state revenues and that all companies should report revenues net of uncollectible revenues.
- Staff continues to monitor the companies that submit annual reports and compare that list to the companies that file KUSF reports with NECA. Companies are now required to reconcile the revenues reported in their annual reports with the revenue amounts submitted to NECA for universal service purposes.
- The first set of carrier audits of carriers was completed and the second set are in process.
- Verification of the number of lines reported to NECA is done as part of the carrier audit.
- Staff has recently suggested the Commission solicit comments on a possible process for applications for additional KUSF due to increased line counts.

Update on the Kansas Universal Service Fund

This past year the Commission has made significant progress in making the Kansas Universal Service Fund cost-based consistent with state and federal statutes.

- the Commission generic proceeding, Docket No. 99-GIMT-326-GIT, to determine what modifications to the fund mechanism were necessary to make the fund cost-based. (326 Docket)
    - determined that forward-looking economic costs should be used for Southwestern Bell and Sprint. chose FCC's Synthesis proxy cost model
    - selected input values, benchmark, addressed targeting of support, portability
    - cost based support for Southwestern Bell and Sprint established
    - delayed implementation for rural companies, wait for FCC action
- Southwestern Bell cost docket (677)
- Sprint cost docket (455)

- Commission order establishing assessment rate for year four (236) effective March 1, 2000; staff directed to file per line assessment calculations within 48 hours of order release (order released January 19, 2000)
    - rate for wireless 4.66%
    - rate for wireline telecommunications carriers 4.92%

HOUSE UTILITIES

DATE: 1-20-00

ATTACHMENT 2

KCC Staff
Year 4 KUSF Calculations

Current KUSF	$	100
Docket 784-Rural Access Reductions (Increases Fund)		14
Docket 326-Cost-based for SWBT & Sprint (Decreases Fund)		(4)
Docket 677: (Decreases Fund)		
SWBT forgoes $15 million		(15)
SWBT rebalancing March 1, 2000		(33)
Total Year 4 KUSF	$	63

~~**Proprietary**~~

Kansas Corporation Commission Staff
Calculation of Rebalancing for SWBT

Exhibit SKR-1
Revision 1

677 S&A Rebalancing

	Phase One (3/1/2000)	Phase Two (10/1/00)		Phase Three (10/1/01)		Phase Four (10/1/02)	
Current KUSF	$ 65,042,904						
"Forgone Amount"	15,021,452						
Subtotal (1)	**$ 50,021,452**						
		Change	**Total**	**Change**	**Total**	**Change**	**Total**
Per 326 Order/677 S&A							
KUSF Support	$ 8,485,542	$ -	$ 8,485,542	$ -	$ 8,485,542	$ -	$ 8,485,542
Basket 1	22,500,000	2,500,000	25,000,000	-	25,000,000	-	25,000,000
Basket 3	10,000,000	2,500,000	12,500,000	2,500,000	15,000,000	1,535,910	16,535,910
Subtotal	$ 40,985,542	5,000,000	45,985,542	2,500,000	48,485,542	1,535,910	50,021,452
Hold-Harmless	$ 9,035,910	(5,000,000)	4,035,910	(2,500,000)	1,535,910	(1,535,910)	-
Total for SWBT (1)	**$ 50,021,452**		**$ 50,021,452**		**$ 50,021,452**		**$ 50,021,452**
KUSF Reduction	$ 47,521,452		$ 52,521,452		$ 55,021,452		$ 56,557,362
Total KUSF for SWBT	**$ 17,521,452**		**$ 12,521,452**		**$ 10,021,452**		**$ 8,485,542**

1-19-2000

KUSF:

- 94-478: audits of the KUSF, no affect on size of the fund or assessment for year 4
- 98-677: SWBT cost to provide local service for KUSF purposes; reduces size of KUSF by $15 million (amt forgone by SWBT) and the assessment rate for all end-users (rural and non-rural; wireline and wireless)
- 99-156&173: Western Wireless and Sprint PCS applications for eligible telecommunications carrier status; potential increase in size of fund if additional eligible telecommunications carriers are designated; also depends on future Commission decision regarding support for primary line only
- 00-326: modification of KUSF to make support cost based; decreases size of fund due to decrease in SWBT's and Sprint's KUSF draws
- 00-784: rural access charge reductions; increases size of fund approximately 14 million due to decreases in rural company access charges which are required to be recovered through the KUSF
- 00-236: the KUSF assessment for the fourth year of the fund will be established
- 00-448: Council Grove Telephone's request for supplemental KUSF funding; may increase fund approximately $470,000
- 00-455: investigation into Sprint's cost to provide local service and consideration of rate-rebalancing

The overall KUSF fund will decrease in year four from approximately $100 million to $65 to $70 million. In October additional amounts will be rebalanced to SWBT's rates and the fund will decrease an additional $5 million. Due to the overall reduction in the KUSF, the assessment for year four, effective March 1, 2000, should be in the range of 4-5 %.

Competition issues:

- 96-230: continuation of OCCS
- 97-149: SWBT's prices for interconnection, unbundled network elements and wholesale discount for resold services
- 97-290: AT&T arbitration with SWBT
- 97-411: SWBT's application to obtain section 271 approval to provide in-region interLATA toll services
- 98-712: implementation of intraLATA toll dialing parity and related cost recovery
- 99-156 & 173: designation of additional eligible telecommunication carriers
- 99-326: portability of KUSF support
- 99-706: long term contracts

The Western Wireless complaint filed with the FCC overlaps KUSF and competition issues.

HOUSE UTILITIES

DATE: 1-20-00

ATTACHMENT 3

HOUSE UTILITIES
DATE: 1-20-00
ATTACHMENT 4

Complaint System

Year	Complaint Code	Code Description	Total
1996	612	Slamming - Long Distance Service	283
	613	Cramming	1
	907	Deceptive/Overzealous Marketing	65
Total for Year			**349**
1997	612	Slamming - Long Distance Service	370
	613	Cramming	3
	907	Deceptive/Overzealous Marketing	78
Total for Year			**451**
1998	612	Slamming - Long Distance Service	150
	613	Cramming	15
	907	Deceptive/Overzealous Marketing	25
Total for Year			**190**
1999	612	Slamming - Long Distance Service	36
	613	Cramming	12
	907	Deceptive/Overzealous Marketing	29
Total for Year			**77**
Grand Total			**1067**