

# Overview of the Kansas Universal Service Fund

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Before the Telecom Study Committee  
November 6, 2013



# Universal Service

Both the Kansas Telecommunications Act of 1996 and the Federal Telecommunications Act of 1996 contain provisions to develop universal service funds to maintain and enhance universal service.

- Federal Universal Service Fund (FUSF) - 47 U.S.C. § 254
- Kansas Universal Service Fund (KUSF) – K.S.A. 66-2008

# Federal Universal Service Fund

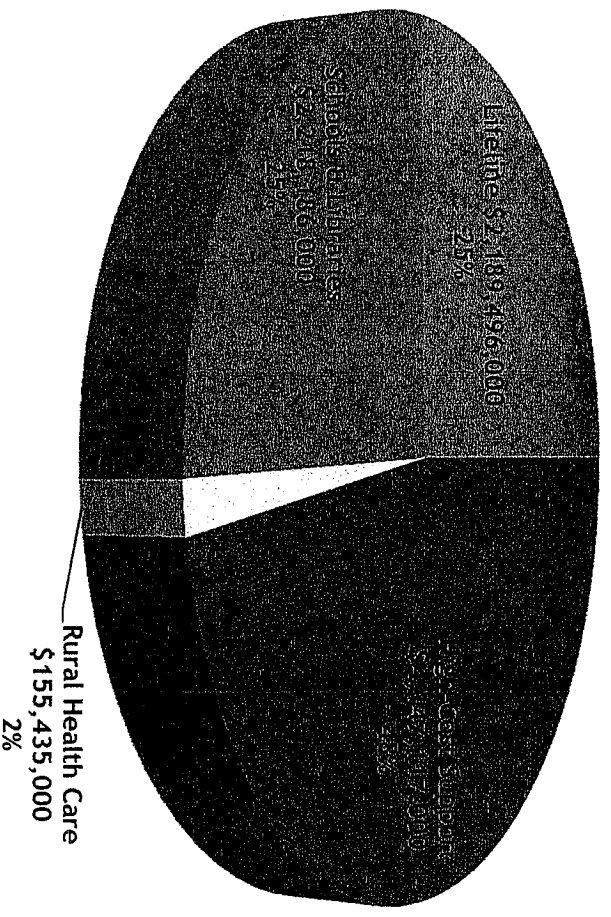
The Federal Communications Commission (FCC) established four programs to fulfill these goals. They are:

- The High-Cost program
- The Lifeline (low income) program, including initiatives for Native Americans
- The Schools and Libraries program, commonly referred to as E-rate
- The Rural Health Care program

These programs are funded by the FUSF. Telecommunications providers must contribute to the FUSF through an assessment on their interstate and international revenues. The assessment rate for the 4<sup>th</sup> quarter 2013 is 15.6%.

# Federal Universal Service Fund

2012 Federal Universal Service Fund  
Disbursements by Program (Unaudited)  
Total Fund Size - \$8.7 billion



■ High-Cost Support \$4,147,117,000

■ Rural Health Care \$155,435,000

■ Schools & Libraries \$2,218,186,000

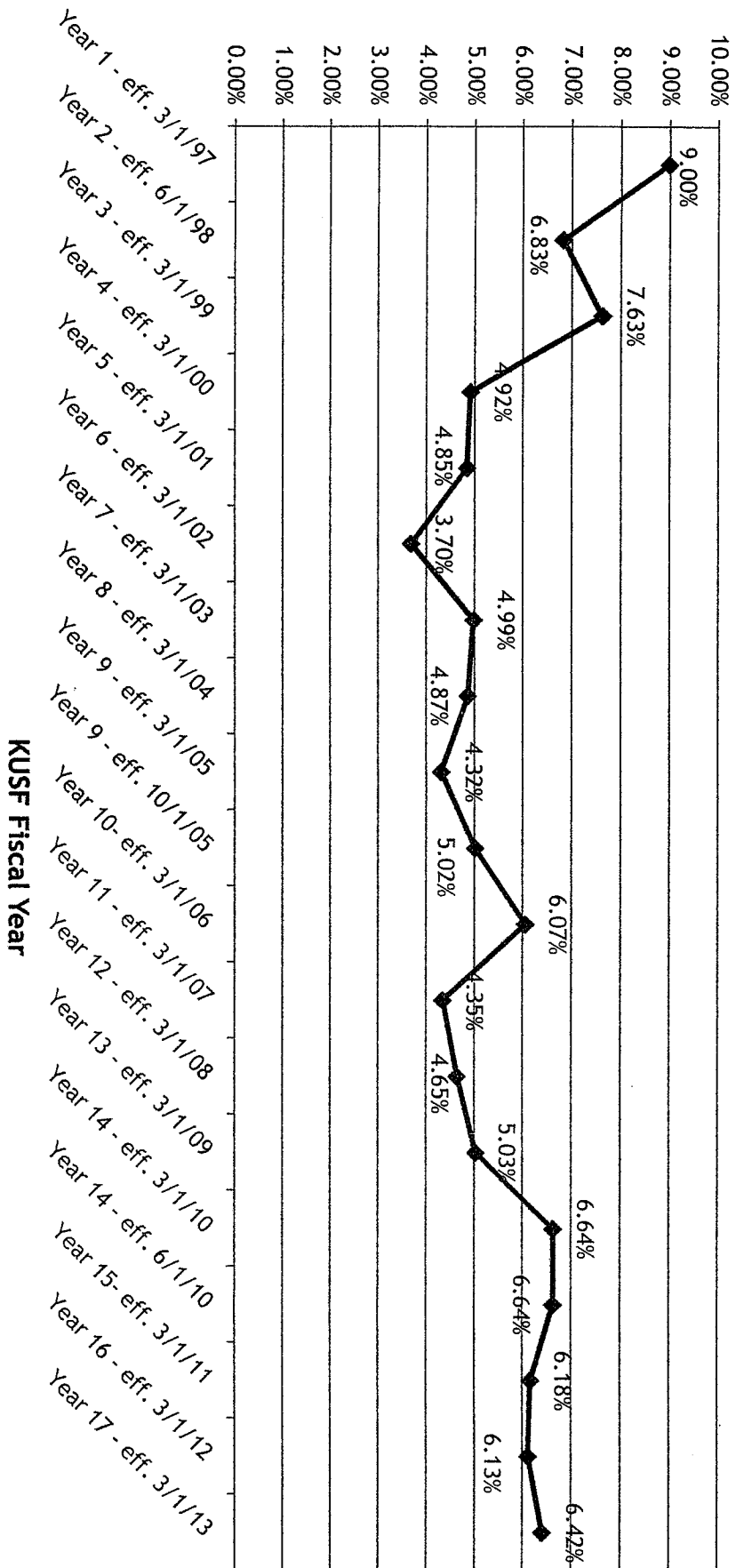
■ Lifeline \$2,189,496,000

## Kansas Universal Service Fund

- KUSF was created by the KCC and implemented March 1, 1997, as required by K.S.A. 66-2008.
- Purpose of the KUSF is to assure quality services are made available to all Kansans at affordable rates.
- Pursuant to K.S.A. 66-2008(a), every telecommunications carrier, telecommunications public utility, wireless telecommunications service provider and interconnected Voice over Internet Protocol (VoIP) provider that provides intrastate telecommunications services must contribute to the KUSF. The assessment may be passed through to customers.
- Current assessment rate is 6.42% on intrastate revenues.

# Kansas Universal Service Fund

## History of KUSF Assessment

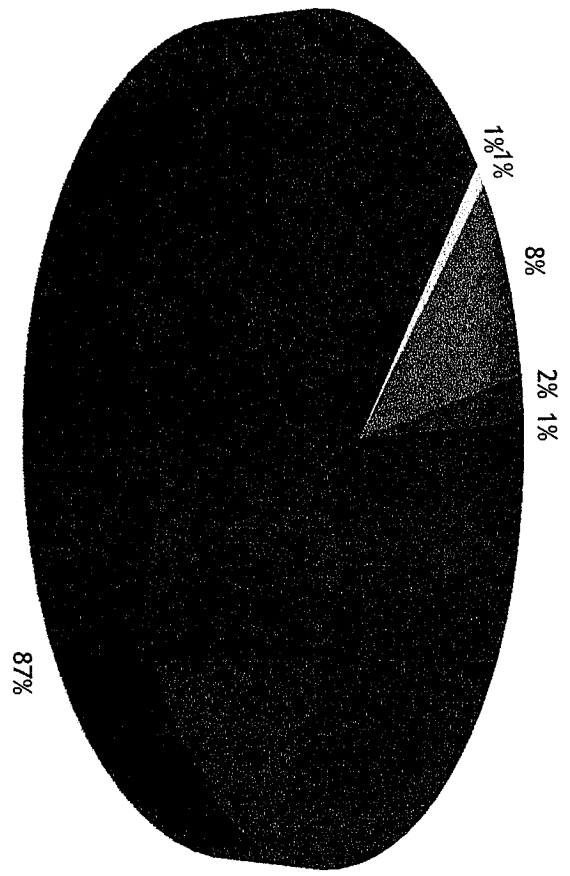


KUSF Fiscal Year

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# Kansas Universal Service Fund

## KUSF Gross Fund Size - March 1, 2013 \$61.6 million



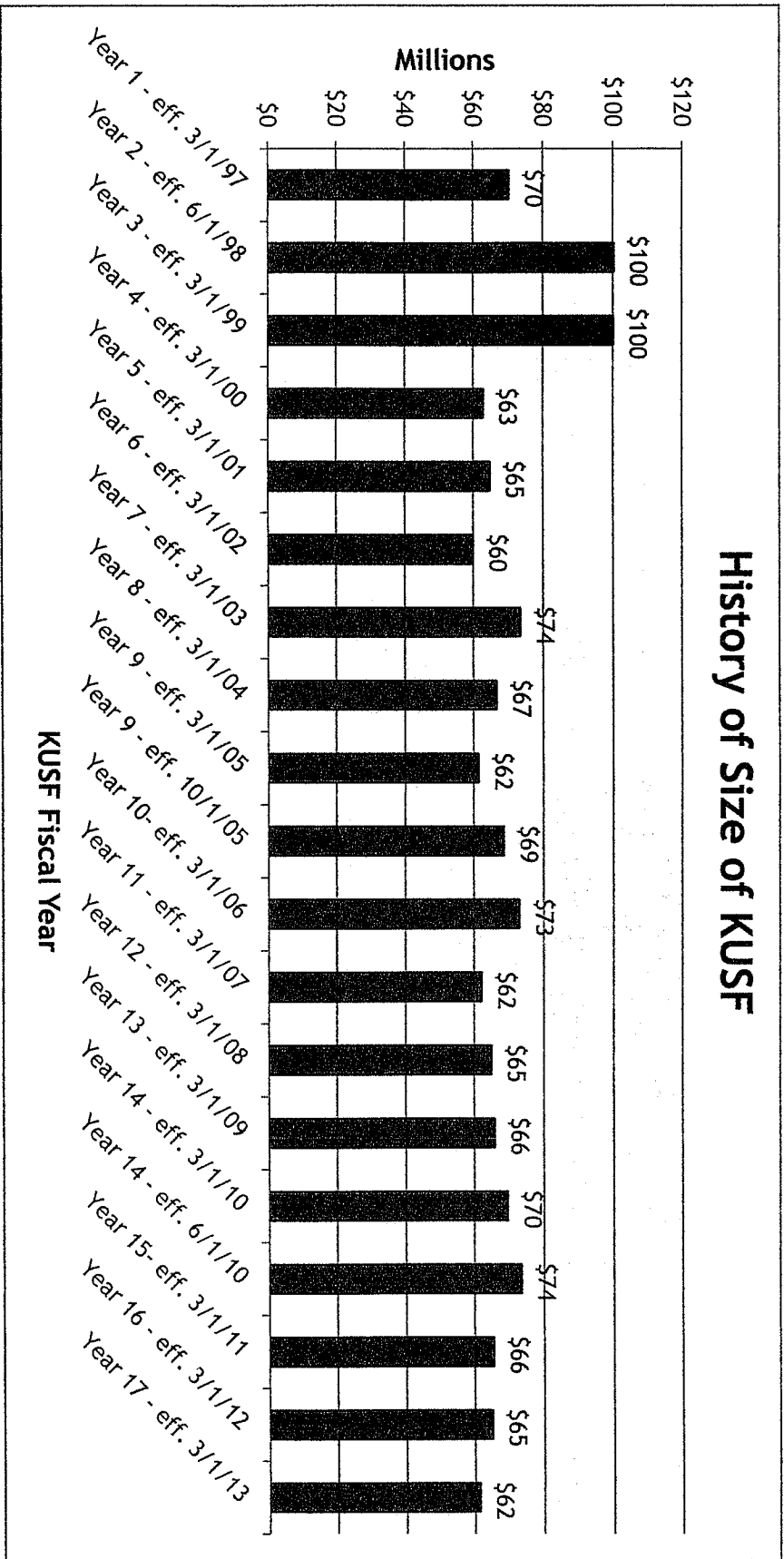
- High-Cost Support \$53,700,000 87%
- TAP \$636,000 1%
- KRSI \$869,000 1%
- Lifeline \$4,700,000 8%
- Kan-Ed\* \$1,300,000 2%
- Fund Admin. & Audits \$423,000 1%

• Annual Kan-Ed support was reduced from \$6M to \$3.75M as of 7/1/12. \$1.3 million represents the remaining amount paid between 3/1/13 and 6/30/13.

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# Kansas Universal Service Fund

## History of Size of KUSF



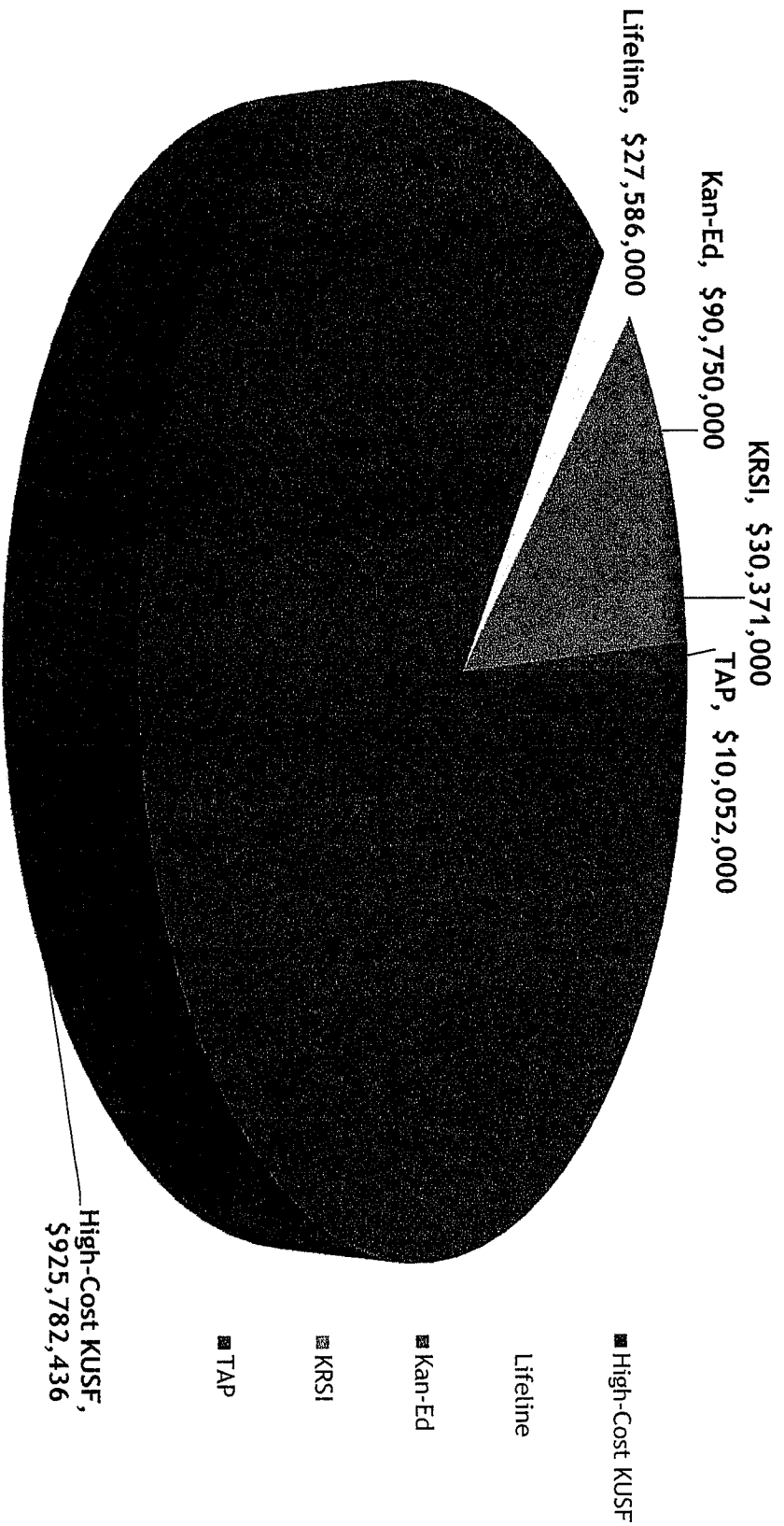
Additional information available at: <http://kcc.ks.gov/telecom/kusfhistory.pdf>

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# Kansas Universal Service Fund

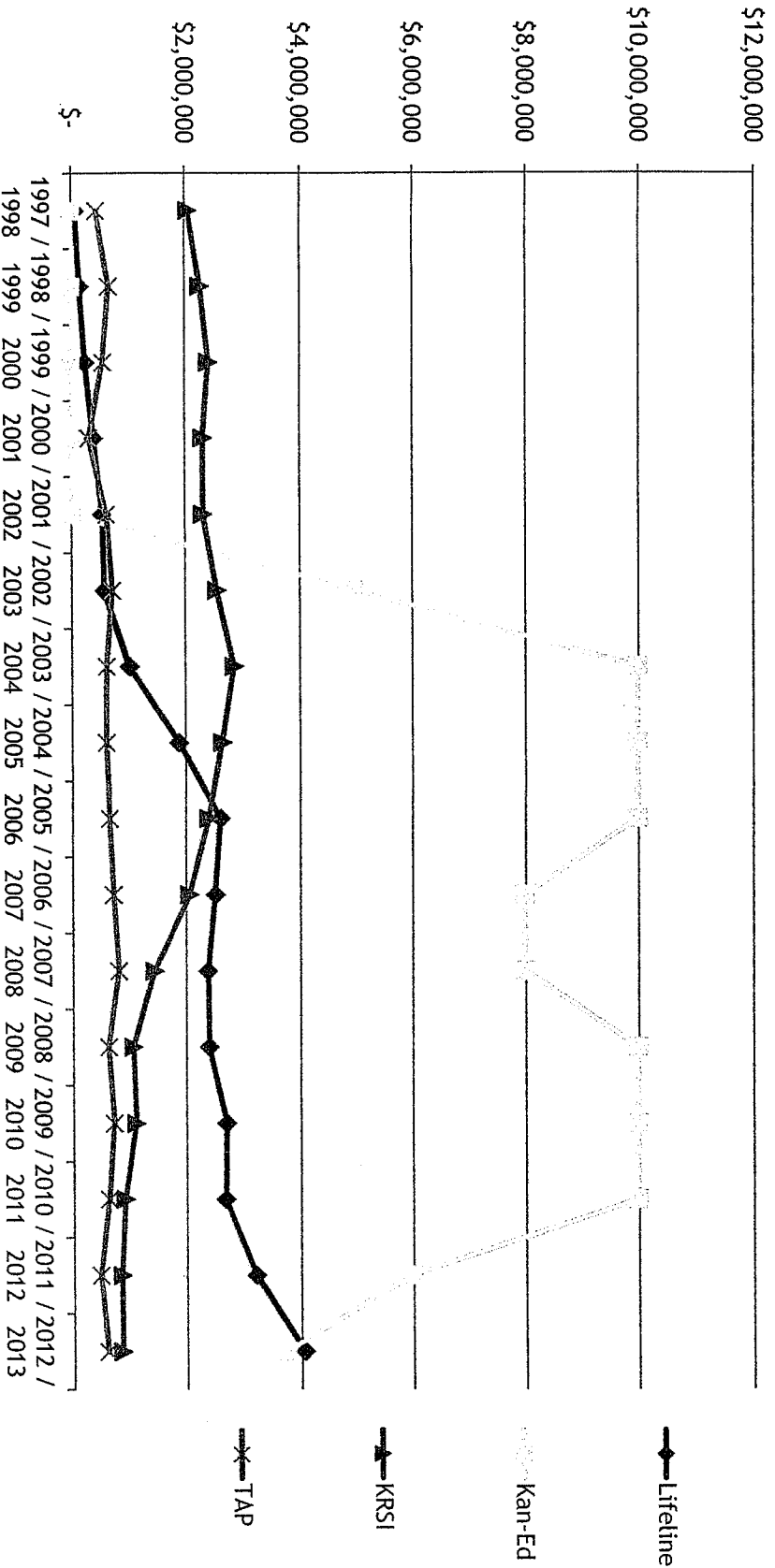
## KUSF Support by Program Since Inception (3/97 - 2/13) 1.1 Billion Total



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# Kansas Universal Service Fund

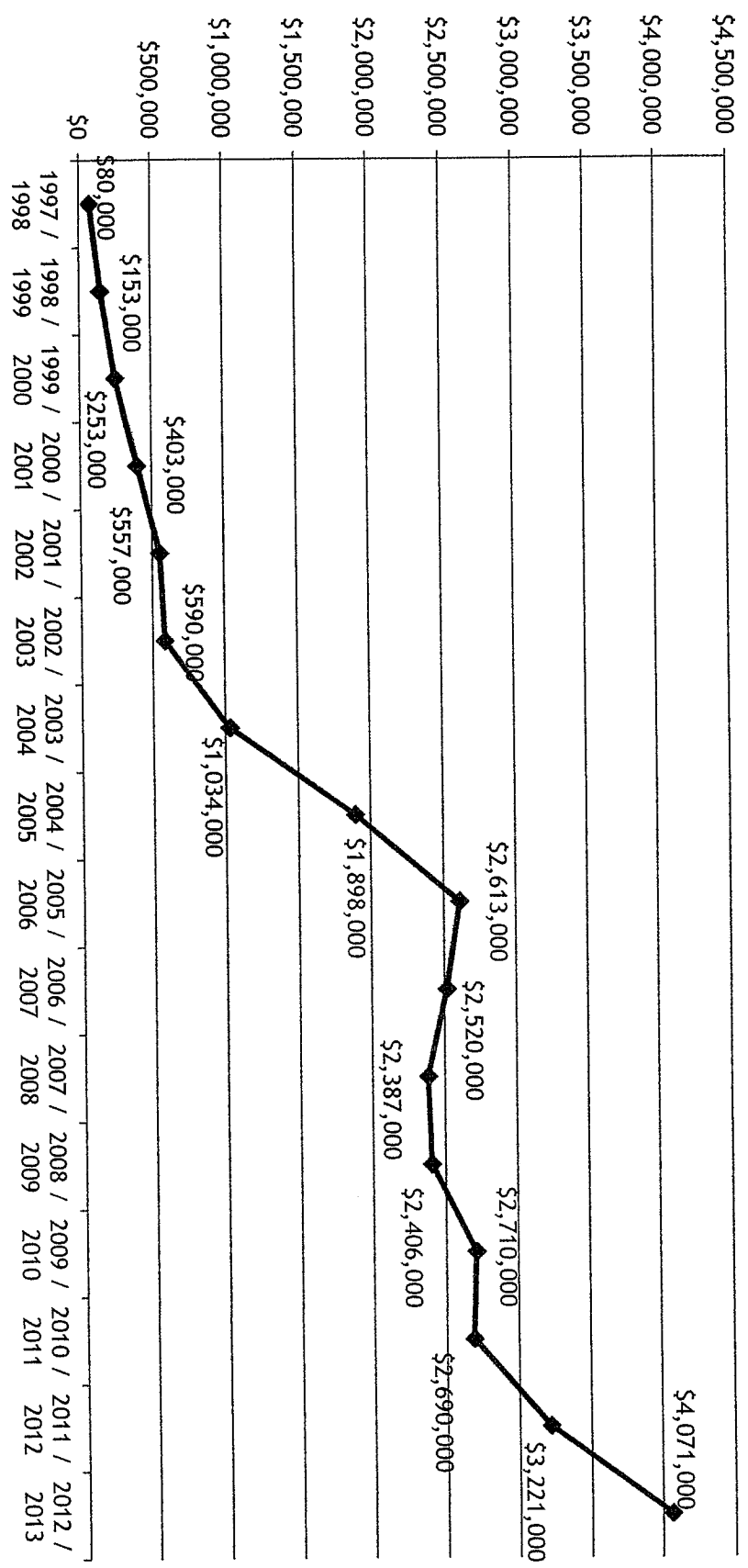
## KUSF Program Funding By KUSF Fiscal Year



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# Kansas Universal Service Fund

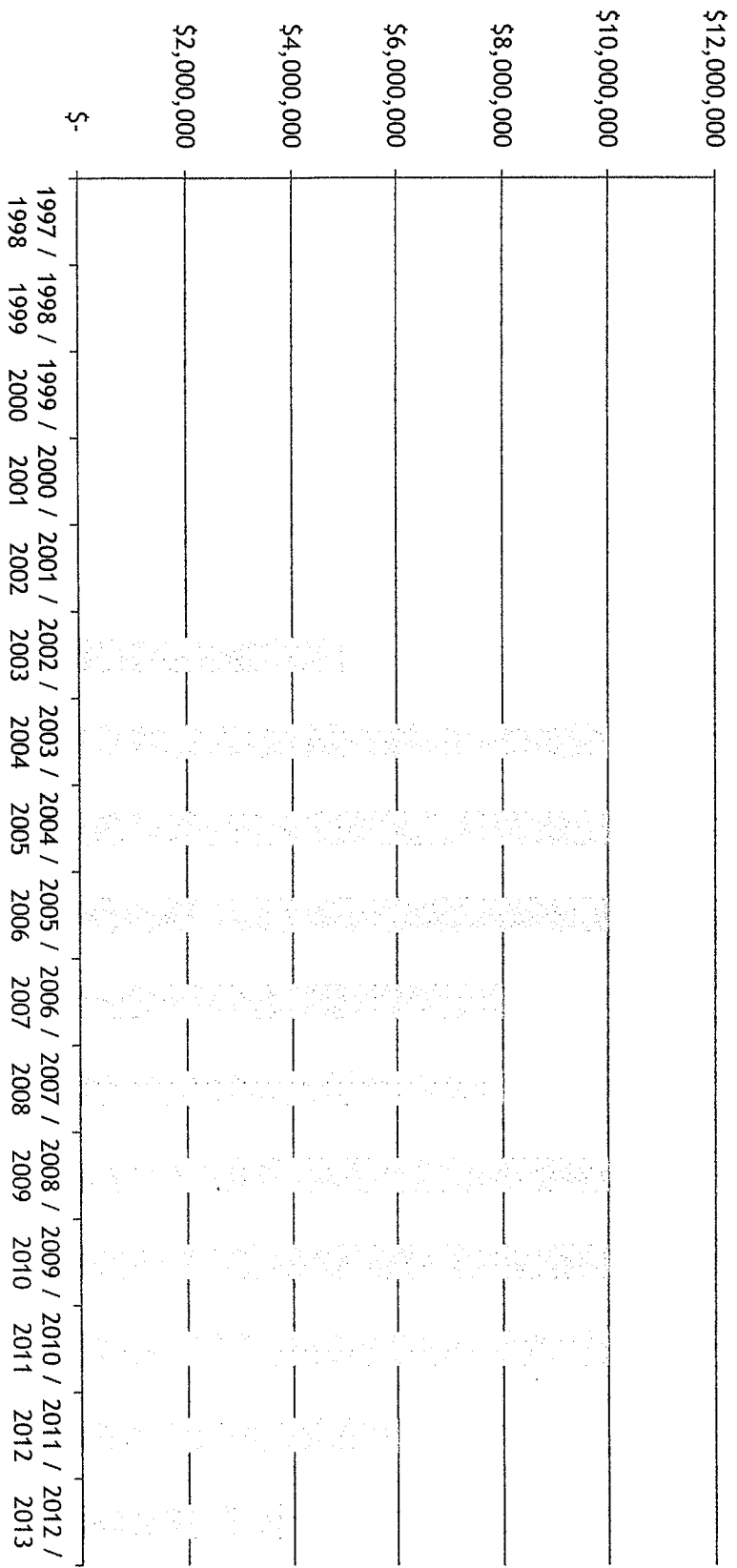
## Lifeline



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# Kansas Universal Service Fund

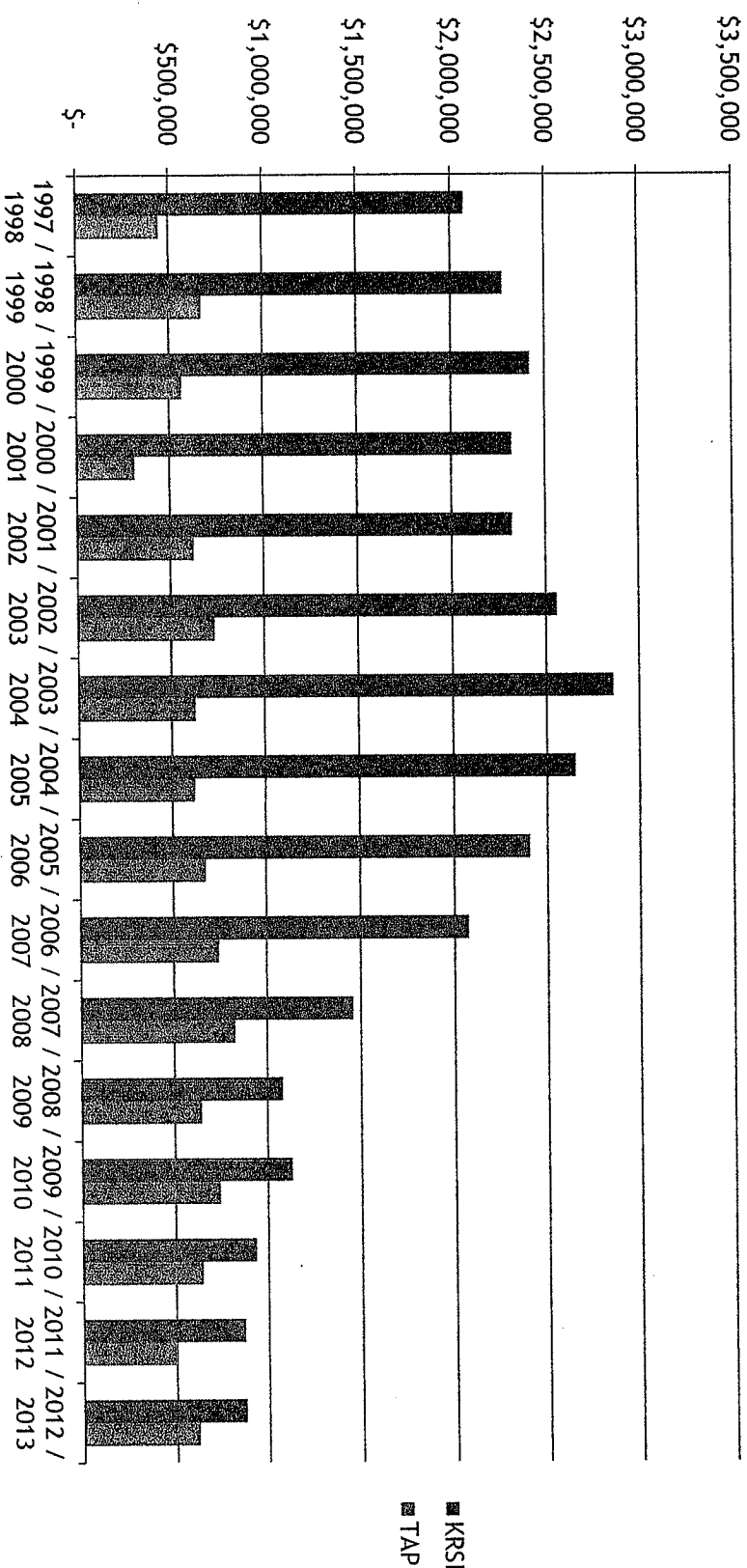
## Kan-Ed Funding from KUSF



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# Kansas Universal Service Fund

## Kansas Relay Service and Telecommunications Access Program Funding



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# Kansas Universal Service Fund

## High-Cost Support

- Initial KUSF high-cost support amount available for incumbent local exchange carriers was equal to the revenue lost when access charge reductions were implemented pursuant to state statute.
- While the initial amount of KUSF support was set to replace lost access revenues, which was revenue neutral and not necessarily cost based, K.S.A. 66-2008(c) requires that the Commission periodically review the KUSF to determine if the cost to provide service justifies modification of support.

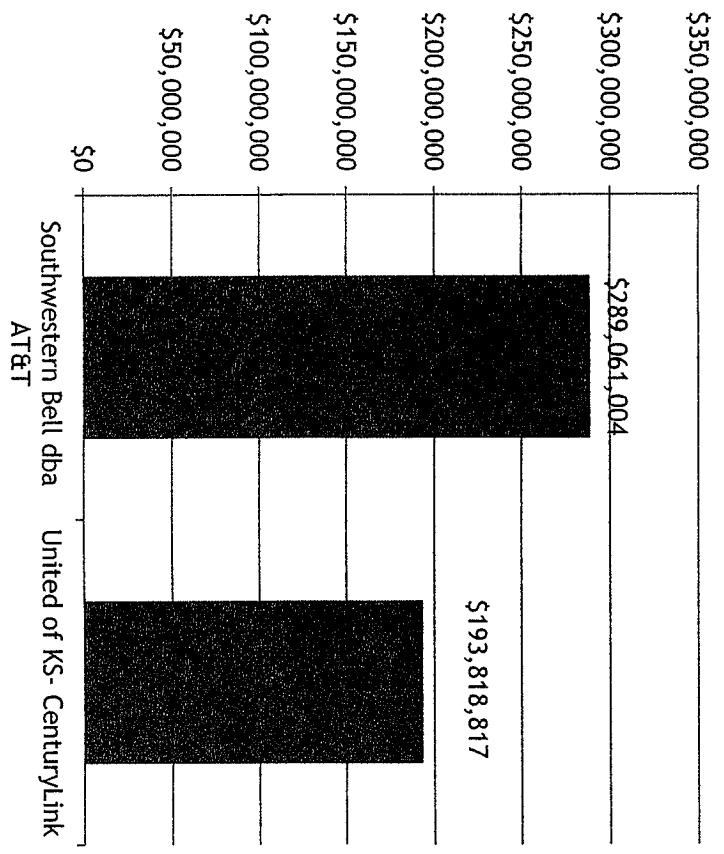
# Kansas Universal Service Fund

## High-Cost Support

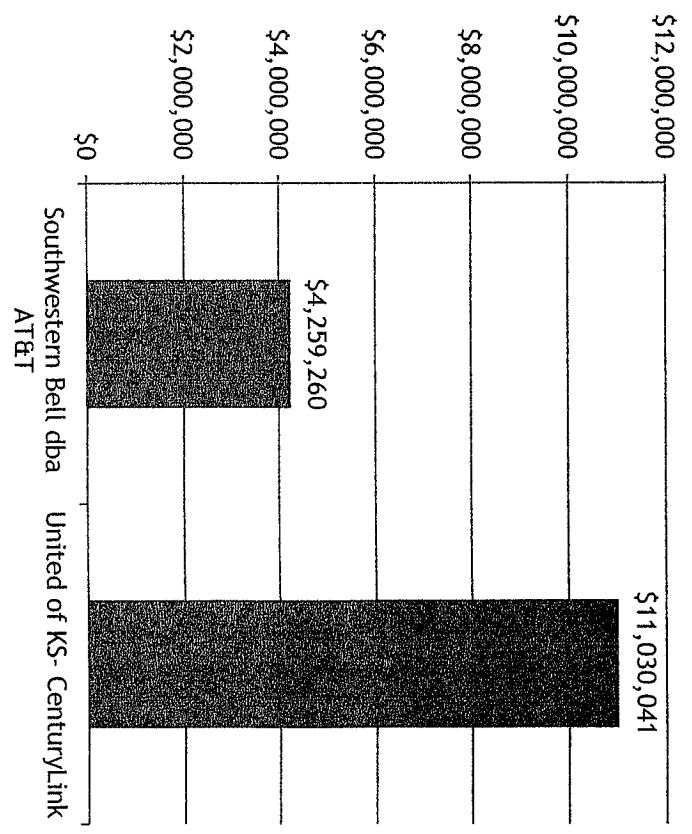
- Implementing a cost-based KUSF – Price Cap Carriers
  - FCC determined that support for price cap carriers, such as AT&T & CenturyLink, should be based on the cost to provide service if the network were being built given current technology rather than based on historical costs. The FCC developed a model to determine the forward looking costs of providing service and support.
  - The Commission followed suit with the KUSF high-cost model for AT&T & CenturyLink.

# Kansas Universal Service Fund

### Total High-Cost KUSF Received by Price Cap Regulated Carriers 3/97-2/13



### Annual High-Cost KUSF Support Received by Price Cap Carriers During Current KUSF Year (3/13-2/14)



\* AT&T was under price cap regulation until 10/7/11 when it became an electing carrier.



# Kansas Universal Service Fund

## High-Cost Support

- Implementing a cost-based KUSF – Rate of Return Carriers
  - Rate of Return (ROR) carriers' support based on embedded costs (K.S.A. 66-2008(e)).
    - ✓ Completed 47 ROR carrier audits, including 2<sup>nd</sup> audits of some carriers.
    - ✓ 2 ROR carrier requests for additional KUSF support are pending.
      - Peoples Telecommunications filed a request on May 1, 2013, requesting an additional \$806,538 in KUSF support. An Order is pending.
      - Wamego Telecommunications Company filed a request on September 20, 2013, for an additional \$4.1 million in KUSF support.

# KUSF Audits

## Overview

- Timeline of audits
  - 240 day timeframe under which Commission makes its determination
  - Based on a filed Procedural Schedule
- Staff and consultants sponsor testimony over various topics
  - Separations (Interstate vs. Intrastate)
  - Regulated and non-regulated allocations
  - Affiliate transactions
  - Rate base and income statement adjustments
  - Capital Structure, cost of long-term debt, and return on equity

# KUSF Audits

## Discovery Process

- Staff and consultants analyze, audit and review a company's filing and conduct an audit which consists of two parts:
  - In-house Review – Staff issues data requests to each company during the course of the audit. Staff and consultants issued an average of 128 data requests per filing over the last ten years.
  - On-site Audit – Staff also goes on-site to company headquarters to inspect records, tour company facilities, and to confer with management and consultants.
- Staff and consultants use the information gathered through the audit process to support its final recommendation to the Commissioners.

# KUSF Audits

## Types of Expenditures Reviewed

- Adjusted Expenditures (routine/non-controversial)
  - Advertising
  - Dues, Donations, and Lobbying
  - Depreciation Expense
  - Taxes (Property, Income, etc.)
  - Interest Expense
  - Payroll, Benefits, Payroll Taxes
  - Non-Recurring Expenses
- Expenditures Reviewed (not typically adjusted)
  - Executive Salaries
  - Fiber to the Home (FTTH)
  - Corporate Headquarters Expense

# KUSF Audits

## Rate Base / Rate of Return

- Revenue Requirement = (Rate Base \* Rate of Return) + Operating Expenses & Maintenance (O&M) + Admin & General Expenses (A&G) + Depreciation + Taxes
- Rate Base represents investor-supplied plant facilities and other investments required to provide utility service to consumers
- Rate of Return consists of Cost of Debt and Cost of Equity
- Cost of Equity (shareholder return) is the most contentious issue due to subjectivity
- There is an opportunity to earn a fair return but no guarantee

# KUSF Audits

## Sample Revenue Requirement Schedule

LAHARPE TELEPHONE COMPANY, INC.  
 KANSAS JURISDICTIONAL  
 STAFF REVENUE REQUIREMENT  
 FOR THE TEST YEAR ENDED DECEMBER 31, 2011

LINE NO. *	DESCRIPTION	A	* STAFF
1	PROFORMA RATE BASE		\$1,544,801
2	STAFF RATE OF RETURN	<u>9.2739%</u>	
3	OPERATING INCOME REQUIRED		143,263
4	PROFORMA OPERATING INCOME	<u>261,442</u>	
5	DIFFERENCE		(118,179)
6	INCOME TAX FACTOR	<u>1.25610</u>	
7	NET PROFORMA REVENUE INCREASE / (DECREASE)		(\$148,445)
8	LESS: PROFORMA INTEREST EXPENSE		<u>0</u>
9	NET PROFORMA REVENUE INCREASE		<u><u>(\$148,445)</u></u>

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# KUSF Audits

## Sample ROR Schedule

LAHARBE TELEPHONE COMPANY, INC.  
 DOCKET NO. 12-LHP7-875-AUD  
 STAFF ADJUSTED AND PRO FORMA OPERATING INCOME STATEMENT  
 FOR THE TEST YEAR ENDED DECEMBER 31, 2011  
 SCHEDULE B-1  
 Page 1 of 1  
 PASS THROUGH ENTITY

Line No.	Acct. No.	Description	A Applicant Book Balance	B Applicant Cost Study Adjustments	C Applicant Cost Study Balance	D Applicant Proforma Adjustments	E Applicant Proforma Balance	F Staff Adjustments	G Staff Adjusted Balance	H Increase / Decrease	I Intra-state	J Staff Adjusted Intra-state Balance	K Staff Adjusted Intra-state Balance	L Staff Pro Forma Adjustments	M Staff Pro Forma Adjusted Intra-state Balance
<b>Operating Revenues</b>															
1	5001	Local Network Services Revenues	\$58,330	\$0	\$58,330	\$0	\$58,330	\$1,674	\$60,024	0.000000	1.000000	\$0	\$60,024		\$60,024
2	5069	Other Basic Area Revenue	42,506	0	42,506	0	42,506	0	42,506	0.000000	1.000000	\$0	42,506		42,506
3	5069	Federal High Cost Loan Support	723,095	0	723,095	(560,404)	362,691	348,081	710,772	0.000000	1.000000	0	710,772	(148,445)	710,772
4	5100	Kansas Universal Service Support	161,317	0	161,317	0	161,317	(13,901)	147,416	0.000000	1.000000	0	147,416		(1,029)
5	5080	Network Access Revenue	780,164	0	780,164	(4,585)	775,579	4,585	780,164	1.000000	0.000000	747,501	32,665		32,665
6	5100	Long Distance Network Service Rev	0	0	0	0	0	0	0	0.000000	0.000000	0	0		0
7	5270	Billing and Collection	9,068	0	9,068	0	9,068	0	9,068	0.000000	1.000000	1,856	7,212		7,212
8	5230	Directory Revenue	915	0	915	0	915	0	915	0.000000	1.000000	0	915		915
9	5260	Misc Revenue	39	0	39	0	39	0	39	0.000000	1.000000	0	39		39
10	5280	Non-regulated revenue	(34,728)	0	(34,728)	0	(34,728)	0	(34,728)	0.000000	1.000000	(34,728)	0		0
11	5300	Uncollectible Revenue	0	0	0	0	0	0	0	0.000000	1.000000	0	0		0
12		Total revenues	1,740,726	0	1,740,726	(564,989)	1,575,737	340,439	1,716,176			714,629	1,001,547	(148,445)	853,102
19		Total Plant Specific Operations Exp.	208,433	(6,820)	201,613	0	201,613	(4,775)	196,838			74,720	122,118	0	122,118
25		Total Plant Non-Specific Operations Exp.	351,309	(5,534)	345,775	0	345,775	4,345	350,120			113,081	236,439	0	236,439
30		Total Customer Operations Expense	34,046	(104)	33,942	0	33,942	5,613	39,555			13,879	25,676	0	25,676
34		Total Corporate Operations Expense	378,518	1,309	379,727	50,000	429,727	(61,896)	367,831			178,557	189,274	0	189,274
44		Total Oper. Taxes & Other Oper. Exp.	388,572	68,262	456,834	(120,388)	336,446	(67,086)	269,360			102,765	166,597	(30,266)	136,331
45		Total Operating Expenses	1,360,878	57,013	1,417,891	(70,388)	1,347,505	(123,399)	1,223,704			483,599	740,105	(50,266)	709,839
46		Net Operating Income	\$379,848	(\$57,013)	\$322,835	(\$294,601)	\$28,234	\$464,238	\$492,472			\$231,030	\$261,442	(\$118,179)	\$143,263

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# KUSF Audits

## Outcome

- 94% of KUSF audits in the last 10 years have settled
- Increases Requested in last 10 years      \$29,256,962
- Increases Granted in last 10 years      \$5,513,047
- Through the audit process, the KUSF has decreased by almost \$3.6 M.



8-25

## Kansas Universal Service Fund

- All KUSF Eligible Telecommunications Carriers (ETCs) are eligible to receive support from the KUSF. This includes 38 incumbent carriers and 8 competitive ETCs.
- Pursuant to the Identical Support Rule, the CETCs receive the same amount of per-line support as the incumbent local exchange carrier. Pursuant to HB 2201, the identical support rule will end and CETC support will be phased-out over 4 years. First CETC support reduction will occur March 1, 2014.

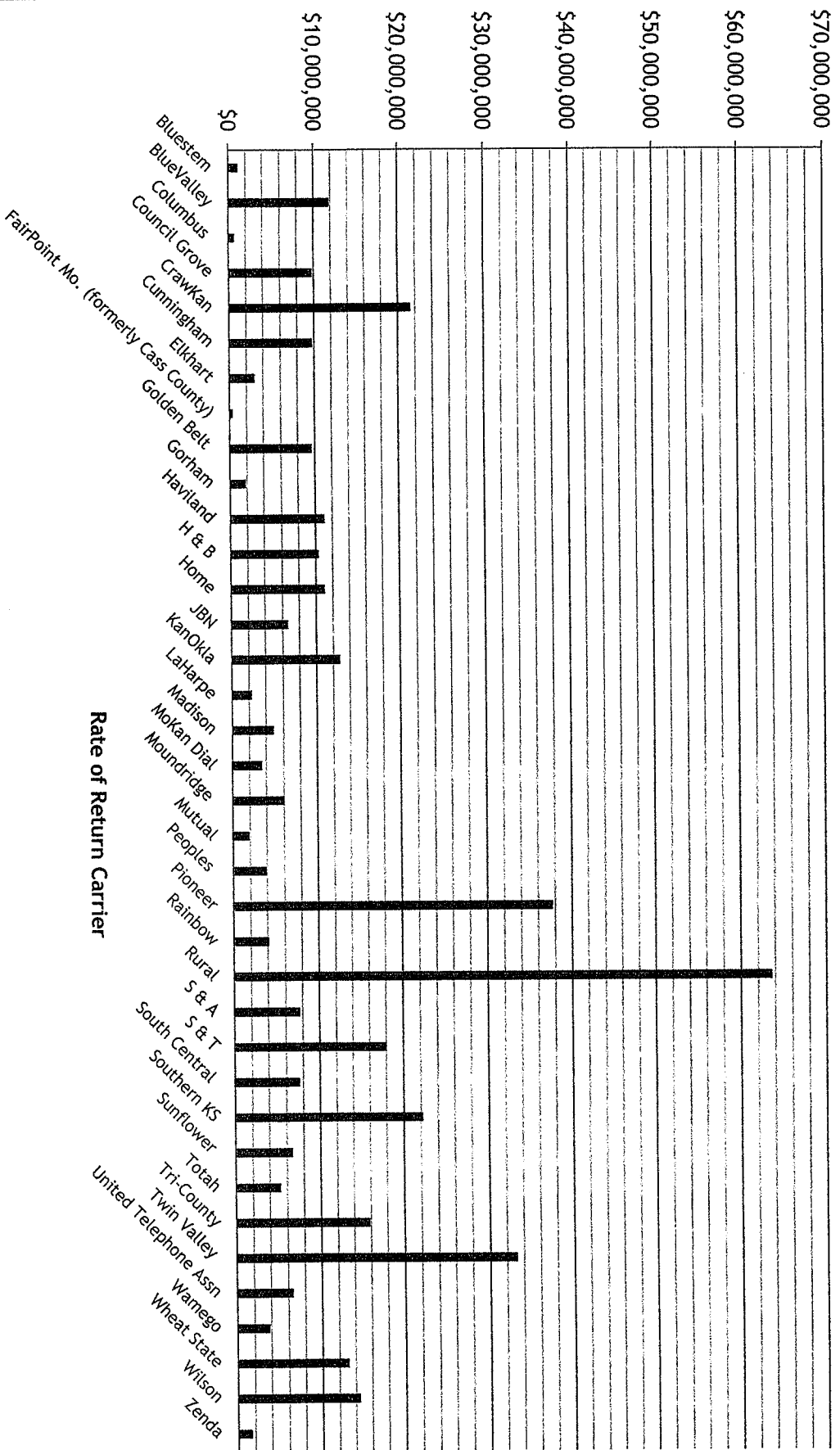
# Kansas Universal Service Fund

## Annual ETC Certification Process

- Annual ETC self-certification forms required to be filed beginning with 2001 data year.
- KCC began requiring ETCs to file more comprehensive certification data in 2006 to ensure FUSF support was used as intended.
- KCC began requiring ETCs to certify use of KUSF support in 2008.
- ETC certification process a good indicator of when a carrier may be receiving more support than necessary. KCC Staff has recommended 4 carriers be audited as a result of failing the ETC certification. Two carriers were audited and KUSF support was subsequently reduced. The other 2 carriers were beginning to make significant infrastructure investments; therefore, the KCC did not proceed with the audit.

# Kansas Universal Service Fund

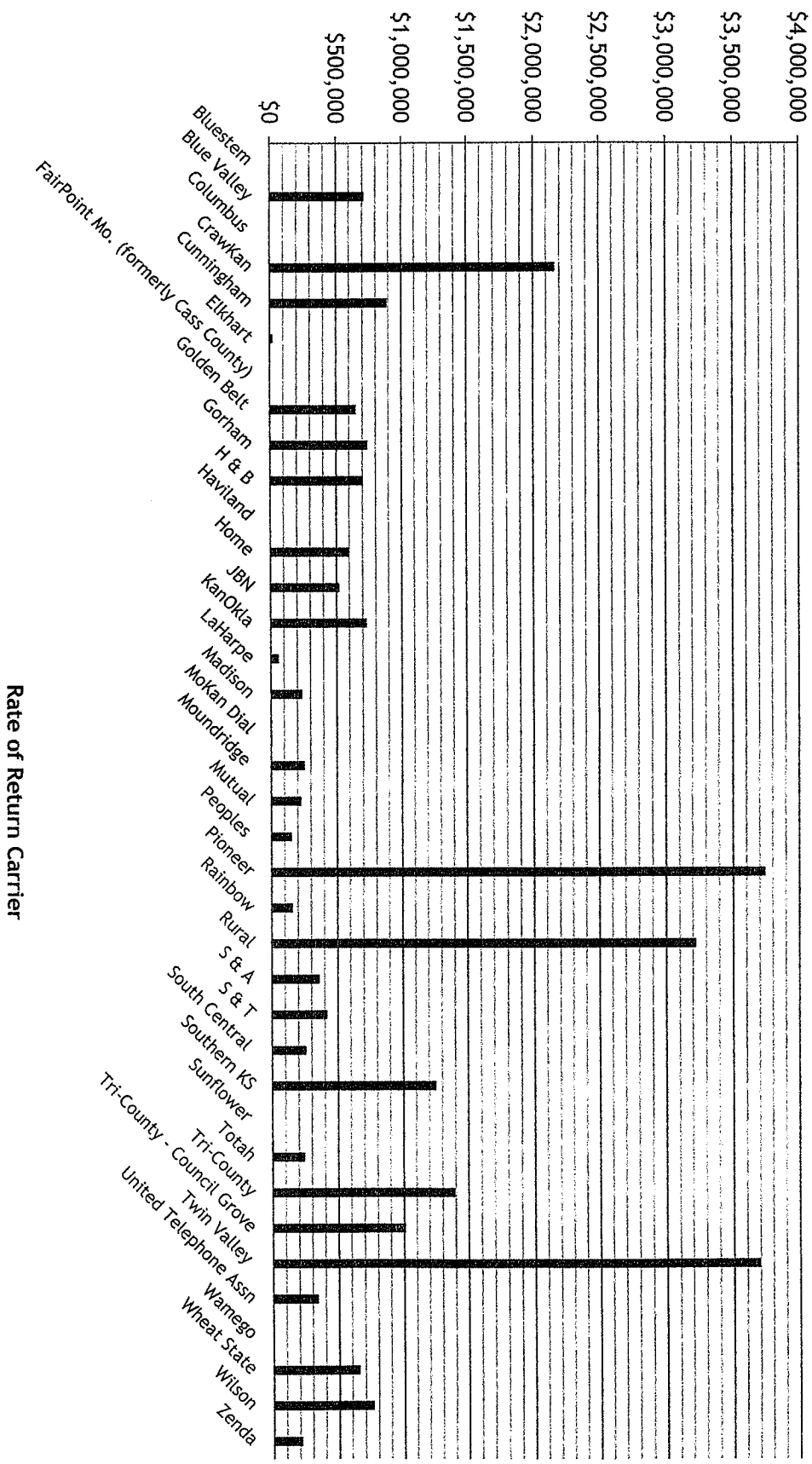
Total High-Cost KUSF Received By ROR Carriers Since Fund Inception



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# Kansas Universal Service Fund

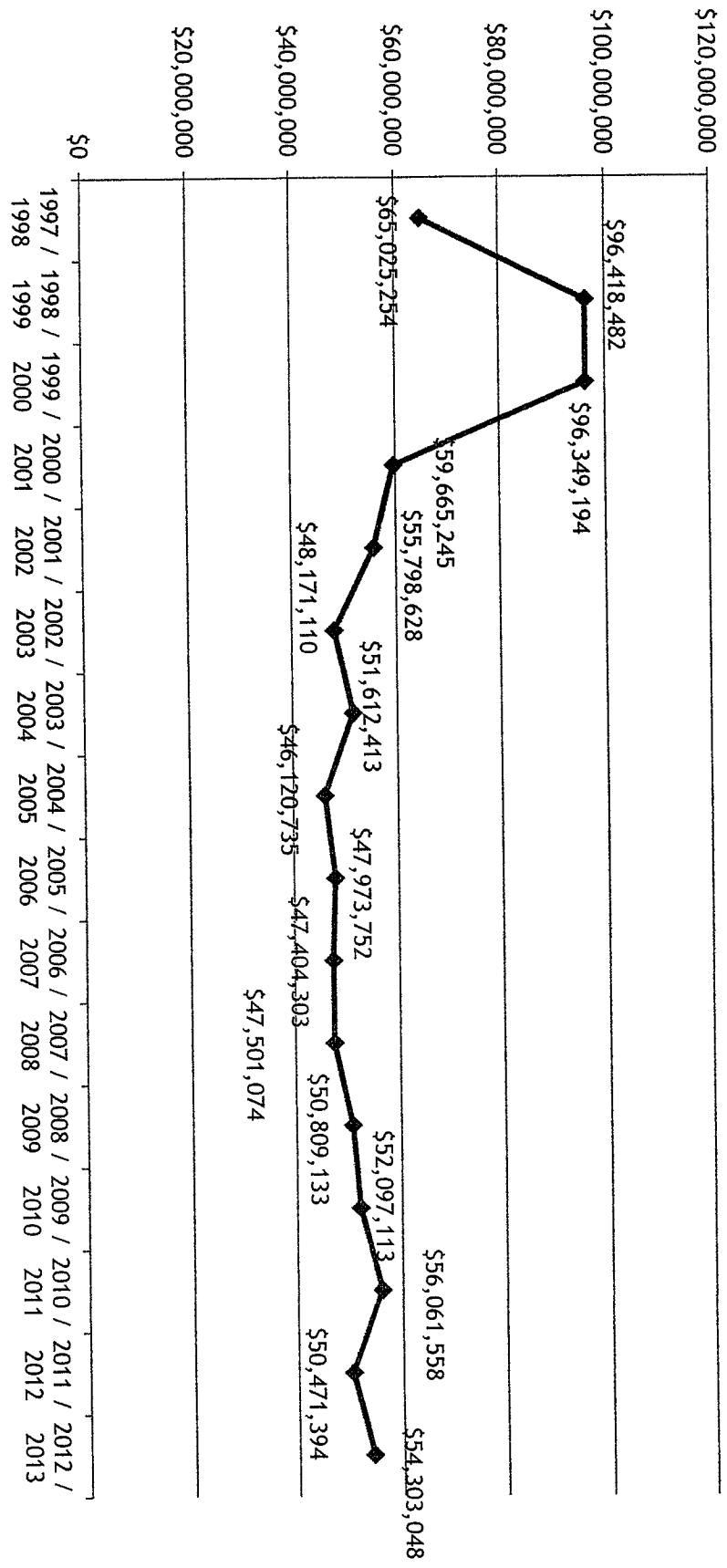
Annual High-Cost KUSF for ROR Carriers (Mar. 2013-Feb. 2014)



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# Kansas Universal Service Fund

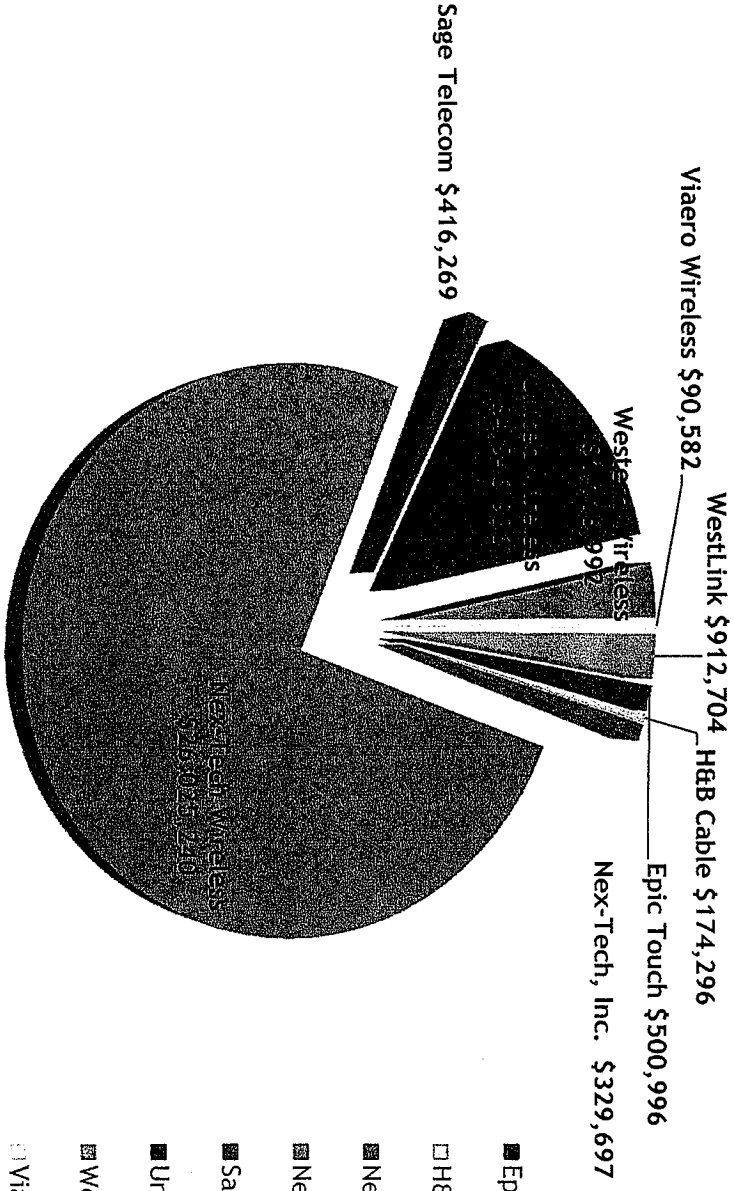
## High-Cost Funding by KUSF Fiscal Year



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# Kansas Universal Service Fund

## Total High-Cost CETC Support Received

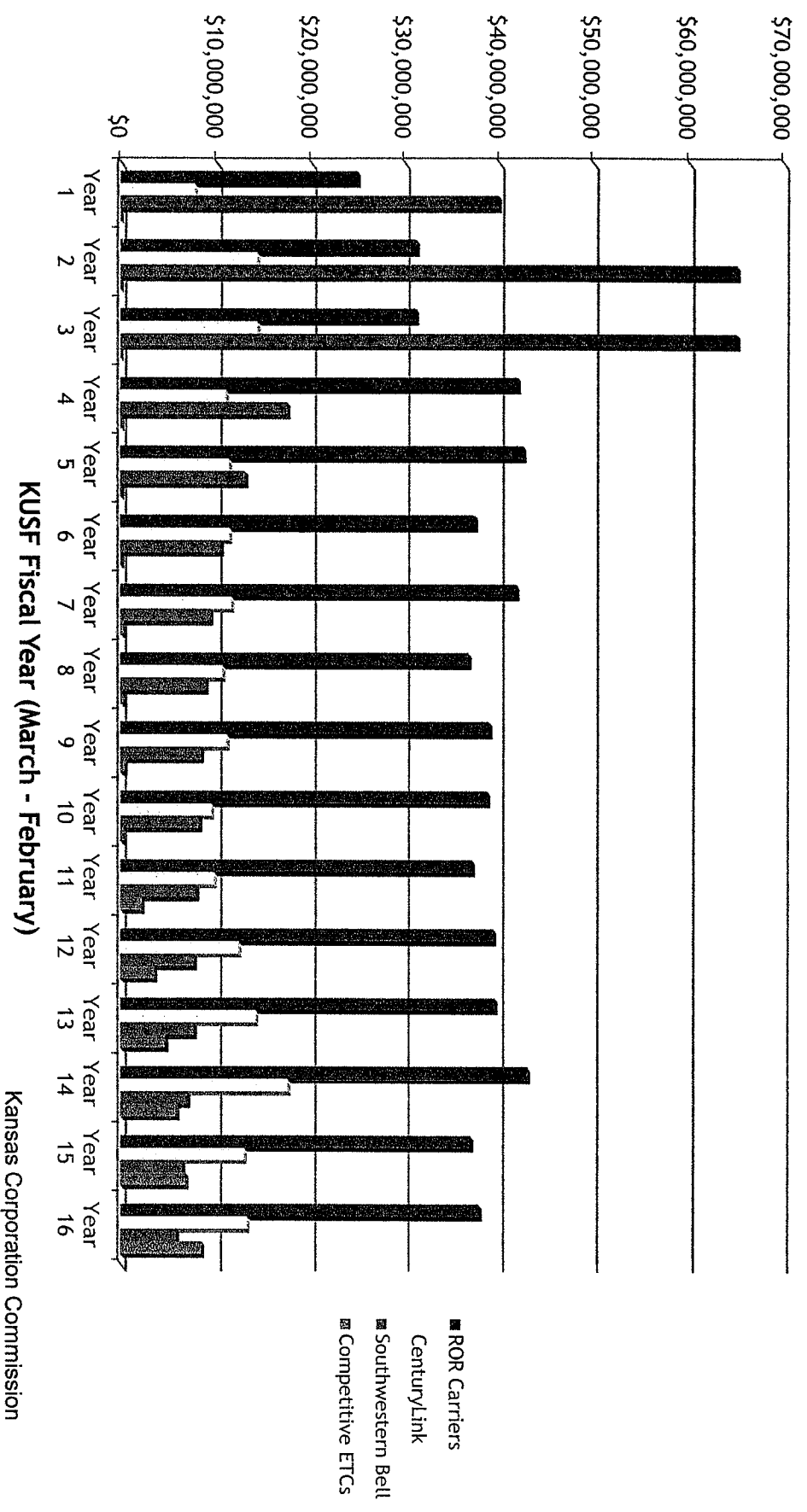


- Epic Touch
- HBB Cable
- Nex-Tech, Inc.
- Nex-Tech Wireless
- Sage Telecom
- United Wireless
- Western Wireless
- Viaero Wireless
- Westlink

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# Kansas Universal Service Fund

## KUSF High-Cost Support Received by Year



KUSF Fiscal Year (March - February)

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Thank you. Questions?

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