

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

Federal Universal Service Support Mechanisms Fund Size
Projections for the First Quarter 2005

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TABLE OF CONTENTS

INTRODUCTION.....	1
ADMINISTRATIVE EXPENSES AND INTEREST PROJECTION	2
ADMINISTRATIVE EXPENSES	2
INTEREST INCOME PROJECTION.....	4
FINANCIAL STATEMENTS.....	5
FUNDING REQUIREMENTS.....	5
HIGH COST SUPPORT MECHANISM.....	5
Eligible Telecommunications Carrier (ETC) Designation	5
High Cost Rural Support Mechanism	7
<i>High Cost Loop (HCL) Support</i>	7
<i>Local Switching Support (LSS)</i>	8
Interstate Common Line Support Mechanism (ICLS)	9
Interstate Access Support Mechanism (IAS).....	9
Non-Rural Forward-Looking Mechanism.....	10
High Cost Support Mechanism Summary.....	11
LOW INCOME SUPPORT MECHANISM.....	12
Lifeline Support	12
Link Up	13
Toll-Limitation Support.....	13
Low Income Support Mechanism Summary.....	14
RURAL HEALTH CARE SUPPORT MECHANISM	15
Funding Year 2000	15
Funding Year 2001	15
Funding Year 2002	16
Funding Year 2003	16
Funding Year 2004	17
Rural Health Care Support Mechanism Summary	19
SCHOOLS AND LIBRARIES SUPPORT MECHANISM.....	19
Funding Year 1998	19
Funding Year 1999	20
Funding Year 2000	21
Funding Year 2001	21
Funding Year 2002	22
Funding Year 2003	23
Funding Year 2004	23
Schools and Libraries Support Mechanism Summary	24
<i>Funding Year 1998 True-Up</i>	25
<i>Funding Year 1999 True-Up</i>	25
<i>Funding Year 2000 True-Up</i>	26
<i>Funding Year 2001 True-Up</i>	27
<i>Funding Year 2002 True-Up</i>	27
<i>1Q2005 Demand Estimate and Contribution Requirement</i>	28

TABLE OF CONTENTS

CONTRIBUTION BASE32
OPERATIONS33
CONCLUSION.....34

APPENDICES

HIGH COST

High Cost Support Projected by State by Study Area – 1Q2005	HC01
High Cost Support Projected by State – 1Q2005	HC02
Rural Study Areas with Competition – 1Q2005.....	HC03
Disaggregated Per Line Support by Zone – 1Q2005	HC04
High Cost Loop Support Projected by State by Study Area – 1Q2005	HC05
Safety Net Additive Support – 1Q2005.....	HC06
Local Switching Support Projected by State by Study Area – 1Q2005	HC07
Interstate Common Line Support Projected by State by Study Area – 1Q2005.....	HC08
Interstate Common Line Support Projected per Line – 1Q2005	HC09
Interstate Common Line Support Projected by State – 1Q2005.....	HC10
Interstate Access Support Projected by State by Study Area – 1Q2005	HC11
Interstate Access Support Projected per Line – 1Q2005.....	HC12
Interstate Access Support Projected by State – 1Q2005	HC13
High Cost Model Support Projected by Wire Center – 1Q2005	HC14
High Cost Model Support Projected by State – 1Q2005	HC15
High Cost Model Support Projected by Study Area – 1Q2005	HC16
CETC Reported Lines by Incumbent Study Area	
High Cost Loop Support – 1Q2005	HC17
CETC Reported Lines by Incumbent Study Area	
Interstate Common Line Support – 1Q2005	HC18
CETC Reported Lines by Incumbent Study Area	
Interstate Access Support – 1Q2005.....	HC19
CETC Reported Lines by Incumbent Study Area	
High Cost Model Support – 1Q2005	HC20
Interstate Common Line Support Projected by State by Study Area	
– Revised 4Q2004	HC21
Interstate Common Line Support Projected per Line – Revised 4Q2004	HC22
Interstate Common Line Support Projected by State – Revised 4Q2004.....	HC23
High Cost Model Support Projected by Wire Center – Revised 4Q2004	HC24
High Cost Model Support Projected by State – Revised 4Q2004	HC25
High Cost Model Support Projected by Study Area – Revised 4Q2004	HC26

LOW INCOME

Low Income Support Projected by State by Study Area – 1Q2005	LI01
Low Income Support Available by State – 1Q2005.....	LI02
Eligible Telecommunications Carriers – 3Q2004	LI03
Quarterly Low Income Support Disbursement Amounts by Company – 3Q2004.....	LI04

APPENDICES

Annual Low Income Support Amounts by State and Company Through 2Q2004.....	LI05
Historical Data: Support Amounts Claimed by ETCs Each Month January 1998 through September 2004.....	LI06
Low Income Support Distributed by State in 2001 and through 2Q2004.....	LI07
Lifeline Subscribers by State or Jurisdiction	LI08
Link Up Beneficiaries by State or Jurisdiction.....	LI09
Tier 1 Amounts Reported by All Companies – 2Q2004.....	LI10

RURAL HEALTH CARE

Funding Year 2002 Commitments – 3Q2004.....	RH01
Funding Year 2002 Authorizations – 3Q2004	RH02
Funding Year 2002 Disbursements to Service Providers through 3Q2004	RH03
Funding Year 2003 Commitments – 3Q2004.....	RH04
Funding Year 2003 Authorizations – 3Q2004	RH05
Funding Year 2003 Disbursements to Service Providers through 3Q2004	RH06
Funding Year 2004 Commitments – 3Q2004.....	RH07

SCHOOLS AND LIBRARIES

Funding Year 1998 Commitments – 3Q2004.....	SL01
Funding Year 1998 Authorizations – 3Q2004	SL02
Funding Year 1998 Disbursements to Service Providers through 3Q2004	SL03
Funding Year 1999 Authorizations – 3Q2004	SL04
Funding Year 1999 Disbursements to Service Providers through 3Q2004	SL05
Funding Year 2000 Authorizations – 3Q2004	SL06
Funding Year 2000 Disbursements to Service Providers through 3Q2004	SL07
Funding Year 2001 Authorizations – 3Q2004	SL08
Funding Year 2001 Disbursements to Service Providers through 3Q2004	SL09
Funding Year 2002 Authorizations – 3Q2004	SL10
Funding Year 2002 Disbursements to Service Providers through 3Q2004	SL11
Funding Year 2003 Commitments – 3Q2004.....	SL12
Funding Year 2003 Authorizations – 3Q2004	SL13
Funding Year 2003 Disbursements to Service Providers through 3Q2004	SL14
Funding Year 2004 Commitments – 3Q2004.....	SL15
Funding Year 2004 Authorizations – 3Q2004	SL16
Funding Year 2004 Disbursements to Service Providers through 3Q2004	SL17

APPENDICES

OTHER APPENDICES

Universal Service Administrative Company 1Q2005 Budget	M01
Fund Size Projections for 1Q2005.....	M02
Schedule of USF Receipts, Interest Income, and Cash Outlays:	
January 1, 2004 through September 30, 2004 – Cash Basis	M03
January 1, 2004 through September 30, 2004 – Accrual Basis	M04

**BEFORE THE FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554**

**FEDERAL UNIVERSAL SERVICE SUPPORT MECHANISMS
FUND SIZE PROJECTIONS FOR THE FIRST QUARTER 2005**

INTRODUCTION

The Universal Service Administrative Company (USAC) submits the Federal Universal Service Support Mechanisms fund size and administrative cost projections for the first quarter of calendar year 2005 (1Q2005), in accordance with Section 54.709 of the Federal Communications Commission's (FCC or Commission) rules.¹

USAC is the not-for-profit corporation responsible for administering the federal universal service support mechanisms: High Cost, Low Income, Rural Health Care, and Schools and Libraries.² USAC also performs the billing, collection, and disbursement functions for all of these universal service support mechanisms.

Upon approval of the quarterly funding requirements for the universal service support mechanisms and the projected administrative expenses, and the submission of the contribution base amount, the Commission will establish a quarterly contribution factor. USAC will bill contributors on a monthly basis for their individual obligations based on the approved contribution factor, collect the funds, and distribute funds to eligible recipients based on the schedules filed herein.³

¹ 47 C.F.R. § 54.709(a)(3).

² 47 C.F.R. § 54.701.

³ See 47 C.F.R. §§ 54.709(a)(4), 54.201, 54.203, 54.515, 54.517, 54.301-54.307, 54.407, 54.413, 54.515, and 54.611.

ADMINISTRATIVE EXPENSES AND INTEREST PROJECTION

ADMINISTRATIVE EXPENSES

Section 54.709(a)(3) of the Commission's rules requires USAC to submit its projected quarterly budget at least 60 days prior to the start of the quarter.⁴ USAC includes any costs that can be directly attributed to the High Cost, Low Income, Rural Health Care, or Schools and Libraries Support Mechanisms in the projected administrative expenses of each mechanism. USAC's remaining joint and common costs including costs associated with the billing, collection, and disbursement of funds are included in the projected administrative expenses of the respective support mechanisms based on USAC's methodology for allocating costs.⁵ The allocation of billing, collection, and common costs also reflects the fact that the Commission directed that the costs associated with the Interstate Access Support Mechanism be allocated to the High Cost and Low Income Support Mechanisms.⁶

USAC projects a 1Q2005 consolidated budget of \$29.191 million. Direct costs for all support mechanisms total \$22.987 million.⁷ The detail for each mechanism is provided below. Joint and common costs (including billing, collection, and disbursement activities) are projected at

⁴ 47 C.F.R. § 54.709(a)(3).

⁵ See Letter from Robert Haga to Magalie Salas regarding Revisions to the Method for Allocating Costs Among the Four Universal Service Support Mechanisms, CC Docket Nos. 96-45 and 97-21 (Jan. 28, 2000); Letter from Robert Haga to Magalie Salas regarding Revisions to the Method for Allocating Costs Among the Four Universal Service Support Mechanisms, CC Docket Nos. 96-45 and 97-21 (Apr. 1, 1999).

⁶ See Letter from Robert Haga to Magalie Salas regarding Revisions to the Method for Allocating Costs Among the Four Universal Service Support Mechanisms, CC Docket Nos. 96-45 and 97-21 (Jan. 28, 2000); Letter from Robert Haga to Magalie Salas regarding Revisions to the Method for Allocating Costs Among the Four Universal Service Support Mechanisms, CC Docket Nos. 96-45 and 97-21 (Apr. 1, 1999).

⁷ This includes \$0.0850 million for High Cost data collection performed by NECA. Although USAC is required to pay for the data collection, USAC does not have the ability to directly oversee the data collection and cannot independently verify, monitor, or otherwise evaluate the cost of performing the data collection function. Consistent with the fiduciary obligations of its members to safeguard USAC assets and the Universal Service Fund, USAC's Board of Directors has requested clarification from the Commission concerning this matter. See letter from D. Scott Barash, USAC, to Irene Flannery, FCC (Dec. 10, 1999), Comments of the Universal Service Administrative Company to the *Further Notice of Proposed Rulemaking* in CC Docket No. 96-45, FCC 01-8 (Feb. 26, 2001).

\$6.2041 million and are allocated to each support mechanism, as detailed below, based on the current allocation methodology on file with the Commission.

1st Quarter 2005 Administrative Expenses (millions)

USF Mechanism	Direct Costs	USAC Common (including billing and collection)	Total
High Cost	6.7806	3.5363	10.3169
Low Income	1.4487	0.7446	2.1933
Rural Health Care	1.0220	0.0620	1.0840
Schools & Libraries	13.7359	1.8612	15.5971
Total	22.9872	6.2041	29.1913

Commission rules currently direct National Exchange Carrier Association (NECA) to continue performing certain universal service administrative functions for the High Cost Loop (HCL) Support Mechanism, specifically, the collection and processing of annual HCL data as well as the optional quarterly updates to that data.⁸ Recovery of HCL data collection expenses is properly attributable to the High Cost Support Mechanism because these functions are associated with the administration of the universal service support mechanisms. NECA bills these costs to USAC.⁹ NECA’s projected 1Q2005 expenses to perform these universal service-related functions are \$0.085 million.

USAC budgets for all of the costs associated with the High Cost Support Mechanism, including the HCL data collection performed by NECA. As discussed above, consistent with the fiduciary obligations of its members to safeguard USAC assets and the Universal Service Fund

⁸ 47 C.F.R. §§ 36.611-36.613.

⁹ 47 C.F.R. § 69.603.

Support Mechanisms, USAC's Board of Directors has requested clarification from the Commission concerning this matter.¹⁰

The 1Q2005 consolidated budget reflects, among other things, the following assumptions: (1) Programmatic budgets will be higher for each of the four support mechanisms due to the FCC-mandated USF oversight program to be conducted by the Officer of the Inspector General. The estimated cost in 2005 is \$30 million, and the 1Q2005 budget reflects a portion of this cost; (2) Program costs will be significantly higher for the High Cost and Low Income Support Mechanisms for systems development work required for program operations; (3) The Schools and Libraries Support Mechanism budget will be higher for the site visits initiative; and (4) Professional fees will be higher for consulting and services associated with a number of major IT initiatives approved by the USAC Board of Directors.

At this time, we are not including contingencies for changes that could be required by FCC action on pending proceedings, which could result in significant changes to the administration of the support mechanisms and in USAC's costs to administer the support mechanisms. There are numerous matters pending before the Commission that could have an impact on USAC's administrative budget.

Appendix M01 details USAC's administrative expense budget for 1Q2005. Appendix M02 details the fund size projections for 1Q2005.

INTEREST INCOME PROJECTION

For 1Q2005, USAC projects interest income of approximately \$0.341 million for the High Cost Support Mechanism, \$0.063 million for the Low Income Support Mechanism, \$0.026 million for the Rural Health Care Support Mechanism and \$3.829 million for the Schools and Libraries Support Mechanism. In sum, USAC projects total interest of \$4.259 million. As in previous

¹⁰ See letter from D. Scott Barash, USAC, to Irene Flannery, FCC (Dec. 10, 1999).

quarters, the projected interest income is being included as an offset to administrative expenses for each of the support mechanisms not projected to reach its funding cap, and reduces the amount that USAC will be required to collect from carriers for those support mechanisms that are funded at caps established by the Commission. Projected interest income is significantly lower than in previous quarters due to changes to USAC's investments directed by the FCC in September 2004.

FINANCIAL STATEMENTS

As of September 30, 2004, on a cash basis, USAC disbursed \$4,097 million in universal service support to service providers in 2004: \$2,538 million in High Cost support, \$564 million in Low Income support, \$19 million in Rural Health Care support, and \$976 million in Schools and Libraries support. On a cash basis, the total cash balance available to the universal service support mechanisms was \$3,392 million.

For the period ending September 30, 2004, on an accrual basis, USAC had a fund balance of \$3,537 million.

Appendices M03 and M04 provide the 2004 year-to-date statement of fund activity on a cash and accrual basis.

FUNDING REQUIREMENTS

HIGH COST SUPPORT MECHANISM

ELIGIBLE TELECOMMUNICATIONS CARRIER (ETC) DESIGNATION

A requirement for eligibility for receipt of High Cost support is that a common carrier must be designated as an eligible telecommunications carrier (ETC) by a state commission or the FCC in accordance with Subpart F of the FCC's Part 36 rules and Subpart D of its Part 54 rules. Qualified ETCs are eligible to receive funds from the High Cost Support Mechanism, which includes High Cost Loop (HCL) support, Interstate Access Support (IAS), Local Switching Support (LSS),

Interstate Common Line Support (ICLS), and non-rural forward-looking High Cost Model (HCM) support. Together, the projected requirements for these five components of the High Cost Support Mechanism and the USAC administrative expenses constitute the overall funding requirement for the High Cost Support Mechanism.

The High Cost Support Mechanism provides support to more than 1,500 study areas, including those served by both incumbent and competitive ETCs. The table below contains the number of study areas served by rural versus non-rural carriers and rate-of-return versus price cap carriers.

Count of Study Areas by Category							
	Incumbent Study Areas				Total Incumbent	Competitive Study Areas	Total Study Areas
	Rate-of-Return			Price Cap			
	Cost Companies	Average Schedule	Total				
Rural	754	488	1242	105	1347	140	1487
Non-Rural	5	1	6	80	86	115	201
Total	759	489	1248	185	1433	255	1688

Appendix HC01 displays the projected minimum amount of individual company support segregated by rural and non-rural status. Appendix HC01 also contains the projected minimum amount of per-month high cost support for each support mechanism that each ETC¹¹ will be eligible to receive (i.e., HCL, HCM, IAS, LSS, and ICLS). Appendix HC02 displays the total projected amount of High Cost support for 1Q2005 for each state or territory. HC03 displays rural study areas with competition. HC04 displays disaggregated per-line High Cost support by zone, consistent with the disaggregation plans filed with USAC.

¹¹ 47 C.F.R. § 36.631 and 47 C.F.R. §§ 54.301-54.303.

HIGH COST RURAL SUPPORT MECHANISM***High Cost Loop (HCL) Support***

High Cost Loop (HCL) support is calculated based on the results of the annual collection of 2002 incumbent local exchange carrier (LEC) loop cost and expense adjustment data that was submitted to the FCC and to USAC on October 1, 2003.¹² Growth in total HCL support for rural carriers is limited under Section 36.603(a) of the FCC's rules to the current level of funding increased yearly by the annual growth in supported rural loops. Effective July 1, 2001, HCL support increased for rural companies due to the *RTF Order*.¹³

Rural HCL support for calendar year 2005 will be less than the level of payments for 2004 because of a negative rural growth factor of -0.04 percent. Rural HCL support for calendar year 2005, therefore, is capped at \$1,056.300 million.

Pursuant to the *RTF Order*, safety net additive support is support above the HCL cap for carriers that make significant investment in rural infrastructure in years in which HCL is capped.¹⁴ To receive support, a rural carrier must show that growth in telecommunications plant in service (TPIS) per line is at least 14 percent greater than the study area's TPIS in the prior year. Carriers seeking to qualify for safety net additive support must provide written notice to USAC that a study area meets the 14 percent TPIS trigger.¹⁵ For 1Q2005, projected safety net additive support is \$3.666 million.

¹² Universal Service Fund (USF) 2003 Submission of 2002 Study Results (filed October 1, 2003) (*USF Data Submission*).

¹³ See *Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket Nos. 96-45, 00-256, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, FCC 01-157 (rel. May 23, 2001) (*RTF Order*).

¹⁴ See *RTF Order* at paras. 77 to 90.

¹⁵ See 47 C.F.R. § 36.605(c).

For 1Q2005, projected HCL support is \$315.350 million. Of this amount, \$267.602 million is associated with rural carriers and \$47.748 million is associated with competitive ETCs.

Furthermore, 1Q2005 Safety Net Additive support is projected to be \$3.666 million. USAC projects, therefore, that \$319.016 million will be required for 1Q2005. Based on these projections, total 2005 HCL support is estimated to be \$1,276.065 million.

Appendix HC05 displays projected monthly HCL support payments by state by study area for 1Q2005 in accordance with the hold-harmless provisions of the FCC's *Methodology Order*. Appendix HC06 displays projected monthly Safety Net Additive support payments by study area for 1Q2005. HCL projected support for non-rural carriers receiving high cost support is superseded by the projections listed in HC14, HC15, and HC16. Appendix HC17 displays competitive ETC lines reported for HCL support by incumbent study area.

Local Switching Support (LSS)

ETC study areas having 50,000 or fewer access lines are eligible to receive support for local switching costs.¹⁶ Local Switching Support (LSS) is the product of a carrier's annual unseparated local switching revenue requirement multiplied by its local switching support factor.¹⁷

For 1Q2005, LSS for companies participating in the Traffic Sensitive Pool is projected to be \$56.699 million for cost study areas and \$17.196 million for average schedule study areas. LSS for the non-Pool study areas is projected to be \$19.915 million for cost study areas and \$3.717 million for average schedule study areas for 1Q2005. In addition, 1Q2005 LSS for competitive ETCs is projected to be \$18.528 million. USAC projects, therefore, that \$116.055 million will be required for 1Q2005. Based on these projections, total 2005 LSS is estimated to be \$464.219 million.

Individual study area LSS projections per month are displayed in Appendix HC07.

¹⁶ See 47 C.F.R. § 54.301.

¹⁷ The LSS factor is defined as the difference between the 1996 weighted interstate Dial Equipment Minute (DEM) factor and the 1996 unweighted DEM factor.

INTERSTATE COMMON LINE SUPPORT MECHANISM (ICLS)

In the *MAG Order* released on November 8, 2001, the FCC reformed the interstate access charge and universal service support systems for rate-of-return carriers.¹⁸ Interstate Common Line Support (ICLS) is designed to permit each rate-of-return carrier to recover its common line revenue requirement, while ensuring that its subscriber line charges (SLCs) remain affordable to its customers.

For 1Q2005, ICLS for incumbent rate-of-return carriers is projected to be \$233.053 million. In addition, 1Q2005 ICLS for competitive ETCs is projected to be \$49.119 million. USAC projects, therefore, that \$282.172 million will be required for 1Q2005. Based on these projections, total 2005 ICLS is estimated to be \$1,126.588 million.

Appendices HC08, HC09, and HC10 detail USAC's 1Q2005 projection of ICLS by state by study area, per line, and by state, respectively. Appendix HC18 displays competitive ETC lines reported for ICLS by incumbent study area. Appendices HC21, HC22, and HC23 detail USAC's revised 4Q2004 projections of ICLS by state and by study area, per line, and by state, respectively.

INTERSTATE ACCESS SUPPORT MECHANISM (IAS)

Interstate Access Support (IAS) helps offset interstate access charges for price cap companies.¹⁹ The *Interstate Access Order* targets the support mechanism at \$650 million annually for five years.²⁰

¹⁸ See *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket Nos. 00-256, 96-45, 98-77, 98-166, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, FCC 01-304 (rel. Nov. 8, 2001) (*MAG Order*).

¹⁹ See *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Sixth Report and Order, *Low-Volume Long Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, FCC 00-193 (rel. May 31, 2000) (*Interstate Access Order*).

²⁰ See *Interstate Access Order* at para. 201.

The IAS projected industry-wide totals for 1Q2005 are \$42.204 million for rural carriers, \$107.919 million for non-rural carriers and \$36.361 million for competitive ETCs. Based on these calculations, USAC projects that \$186.484 million will be required for 1Q2005 and total 2005 IAS is estimated to be \$745.932 million.

Appendices HC11, HC12, and HC13 detail USAC's 1Q2005 projection of interstate access support by state by study area, per line, and by state, respectively. Appendix HC19 displays competitive ETC lines reported for IAS by incumbent study area.

NON-RURAL FORWARD-LOOKING MECHANISM

Under the most recent running of the model used to calculate forward-looking High Cost Model (HCM) support for non-rural carriers, non-rural carriers in ten states (Alabama, Kentucky, Maine, Mississippi, Montana, Nebraska, South Dakota, Vermont, West Virginia, and Wyoming) are eligible to receive forward-looking support in 2005.²¹

For 1Q2005, USAC projects that \$73.181 million will be required for HCM support (\$56.063 million for incumbent non-rural carriers and \$17.118 million for competitive ETCs). USAC projects, therefore, that \$73.181 million of HCM support will be required for 1Q2005. Based on these projections, total 2005 forward-looking support is estimated to be \$292.723 million.

Appendices HC14, HC15, and HC16 detail USAC's 1Q2005 projection of non-rural forward-looking support by wire center, by state, and by study area, respectively. Appendix HC20 displays competitive ETC lines reported for HCM support by incumbent study area. Appendices HC24, HC25, and HC26 detail USAC's revised 4Q2004 projections for HCM by wire center, state, and by study area, respectively.

²¹ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order and Order on Reconsideration, DA 03-4070 (rel. Dec. 24, 2003); see also *Wireline Competition Bureau Releases Estimated State-By-State High-Cost Universal Service Support Amounts for Non-Rural Carriers for 2004*, CC Docket No. 96-45, Public Notice, DA 03-4071 (rel. Dec. 24, 2003).

HIGH COST SUPPORT MECHANISM SUMMARY

As discussed above, USAC estimates 1Q2005 funding requirement as follows: \$319.016 million for HCL support; \$116.055 million for LSS; \$282.172 million for ICLS; \$186.483 million for IAS; and \$73.181 million for HCM for a total of \$976.907 million. Sections 54.709(b) and 54.709(c) of the Commission’s rules require USAC to adjust the size of the projected support requirements to reflect adjustments based on actual dollar amounts compared to the projection included in the prior period.²² Increases in the size of the funding requirement for the previous period are added to the projected requirements; decreases from the prior period are subtracted from the projected revenue requirements.

Results for 3Q2004 contributed to an under-funded condition, for which the instant filing proposes to adjust the 1Q2005 requirements. The total adjustment to the 1Q2005 fund requirement based on actual results will increase the funding needed by \$15.057 million. The detailed explanation for the adjustment is described below.

Reason for the Prior Period Adjustment	Adjustment in Millions
The 3Q2004 billings were higher than expected due to higher revenues reported by contributors in their annual true-up filings	(\$6.028) M
Distributions were greater than expected in 3Q2004.	21.112 M
Interest earned was more than estimated.	(0.659) M
Bad debt expense was higher than anticipated	3.168 M
2003 administrative expenses were lower than anticipated	(2.536) M
Total Prior Period Adjustment	\$15.057 M

Note: Columns on table may not add perfectly due to rounding

The total fund requirement of \$976.907 million, increased by the prior-period adjustment of \$15.057 million, increased by administrative costs of \$10.317 million, and reduced by the projected interest

²² 47 C.F.R. §§ 54.709(b) and 54.709(c).

of \$0.341 million, results in a total projected funding requirement for the High Cost Support Mechanism for 1Q2005 of \$1,001.940 million.

Appendix M02 details the individual components of the funding requirement for the quarter.

LOW INCOME SUPPORT MECHANISM

LIFELINE SUPPORT

All ETCs must offer Lifeline support to qualified low-income consumers.²³ ETCs providing Lifeline support in accordance with Subpart E of Section 54 of the Commission's rules are entitled to receive funding from the federal Low Income Support Mechanism for the waiver of charges and reduced rates provided to qualified low-income subscribers.²⁴ Lifeline support provides funding from the interstate jurisdiction of up to \$10.00 per low-income subscriber per month. This can consist of a baseline amount of between \$3.50 and \$6.50 (Tier One),²⁵ an additional \$1.75 per subscriber if the state commission authorizes a reduction in local rates equal to that amount (Tier Two), and up to an additional \$1.75 from the federal mechanism available if the state provides support for the low-income subscriber as well (Tier Three).²⁶ Further, the *Tribal Order*²⁷ makes

²³ See 47 C.F.R. §§ 54.201.

²⁴ 47 C.F.R. §§ 54.401 - 54.417.

²⁵ Tier One support, which compensates the carrier for not charging the subscriber line charge (SLC) to eligible low-income customers, ranges from \$3.50 to \$6.50. See *Interstate Access Order* at para. 70 (permitting the baseline subscriber line charge to increase for price cap carriers from \$3.50 to \$4.35 effective July 1, 2000, and to increase again from \$4.35 to \$5.00 effective July 1, 2001); *MLG Order* at para. 42 (permitting rate-of-return carriers to increase their baseline subscriber line charge to \$5.00 effective January 1, 2002); *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, Access Charge Reform, and Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, FCC 02-161 (rel. June 5, 2002) (*2002 SLC Order*) (authorizing an increase in the baseline subscriber line charge for price cap and rate-of-return carriers to \$6.00, effective July 1, 2002, and to \$6.50, effective July 1, 2003).

²⁶ Tier Three support is equal to one-half of a state-funded amount up to \$3.50. For example, if a carrier operating in a state that has a matching program that provides \$3.50 in support through the matching program reduces its intrastate rates by \$10.00 for low-income customers, the customer would experience a total monthly rate reduction of \$13.50 (\$3.50 in interstate charges and \$10.00 in intrastate charges) of which \$10.00 would be funded from the federal jurisdiction and \$3.50 from the state matching program.

²⁷ See *In the Matter of Federal-State Joint Board on Universal Service; Promoting Deployment and Subscriber in Unserved and Underserved Areas, Including Tribal and Insular Areas*, Twelfth Report and Order, Memorandum Opinion and Order, and Further Notice of Proposed Rulemaking, CC Docket No. 96-45, FCC 00-208 (June 30, 2000) (*Tribal Order*).

available up to an additional \$25 per low-income subscriber per month to eligible residents of tribal lands (Tier Four).²⁸

For 1Q2005, USAC projects that \$183.394 million will be required for Lifeline support. Based on this projection, total 2005 Lifeline support is estimated to be \$733.576 million.

LINK UP

Link Up support compensates ETCs up to \$30 for revenue foregone in offering discounted service initiation fees to qualified low-income individuals. The *Tribal Order* authorized additional Link Up support of up to \$70 per qualified low-income subscriber residing on eligible tribal lands.²⁹ For 1Q2005, USAC projects that \$8.541 million will be required for Link Up support. Based on this projection, total 2005 Link Up support is estimated to be \$34.164 million.

TOLL-LIMITATION SUPPORT

Toll Limitation Support (TLS) compensates ETCs for providing voluntary toll-limitation based on the carrier's incremental cost of providing toll-limitation services. The FCC has defined these costs as the costs that carriers otherwise would not incur if they did not provide toll-limitation service to a given customer.³⁰ Toll limitation consists of toll blocking, which permits consumers to elect not to allow the completion of outgoing toll calls, and toll limitation, which allows consumers to specify a certain amount of toll usage that may be incurred per month or per billing cycle.³¹ For 1Q2005, USAC projects that \$1.294 million will be required for TLS. Based on this projection, total 2005 TLS is estimated to be \$5.176 million.

²⁸ 47 C.F.R. § 54.400(e); *see also Tribal Order*. On August 31, 2000, the FCC stayed the implementation of the federal Lifeline and Link Up rule amendments only to the extent that they apply to qualifying low-income consumers living near reservations.

²⁹ *Tribal Order* at para. 59.

³⁰ *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776 (1997) at para. 386 (*First Report and Order*) (subsequent history omitted).

³¹ 47 C.F.R. § 54.400(b), (c).

LOW INCOME SUPPORT MECHANISM SUMMARY

As discussed above, the estimated 1Q2005 funding requirement for the Low Income Support Mechanism is as follows: \$183.394 million for Lifeline, \$8.541 million for Link Up, and \$1.294 million for Toll Limitation Service, for a total of \$193.229 million. Results for 3Q2004 contributed to an under-funded condition, for which the instant filing proposes to adjust the 1Q2005 requirements. The total adjustment to the 1Q2005 funding requirement based on actual results will increase the funding needed by \$0.532 million. The detailed explanation for the adjustment is described below.

Reason for the Prior Period Adjustment	Adjustment in Millions
The 3Q2004 billings were higher than expected due to higher revenues reported by contributors in their annual true-up filings.	(\$3.550) M
Distributions were higher than expected in 3Q2004.	2.876 M
Interest earned was more than estimated for 3Q2004.	(0.037) M
Bad debt expense was higher than anticipated	2.067 M
Administrative expenses were lower than expected in 2003	(0.823) M
Total Prior Period Adjustment	\$0.532 M

Note: Columns on table may not add perfectly due to rounding.

The total fund requirement of \$193.229 million, increased by the prior-period adjustment of \$0.532 million, increased for administrative expenses of \$2.193 million, and reduced by the projected interest income of \$0.063 million results in a total projected funding requirement for the Low Income Support Mechanism for 1Q2005 of \$195.891 million.

Appendix LI01 provides projected Low Income support amounts by state by study area for 1Q2005. Appendix LI02 provides detail on Low Income funding amounts available in each of the states and territories for 1Q2005. Appendix LI03 provides a list of eligible telecommunications carriers (ETCs) for 3Q2004. Appendix LI04 provides detail on quarterly company-specific Low Income support disbursement amounts for 3Q2004. Appendix LI05 provides detail on annual

company-specific Low Income support amounts through 2Q2004. Appendix LI06 provides historical data of monthly support amounts claimed by ETCs from January 1998 through September 2004. Appendix LI07 provides detail on Low Income support distributed by state from 2001 through 2Q2004. Appendices LI08 and LI09 provide subscribership information by state or jurisdiction for Lifeline and Link Up support, respectively. Appendix LI10 shows the Tier 1 amounts reported by all companies during 2Q2004.

RURAL HEALTH CARE SUPPORT MECHANISM

FUNDING YEAR 2000

Funding Year 2000 began on July 1, 2000 and ended on June 30, 2001. All Funding Year 2000 applications have been reviewed and processed. USAC issued funding commitments to rural health care providers for Funding Year 2000 totaling \$10.756 million. Based on information provided by the applicants as of September 30, 2004, USAC projects that Funding Year 2000 demand for support will total approximately \$10.314 million. The FCC previously authorized the collection of \$10.316 million for the Funding Year 2000. Of the \$10.316 million collected, \$10.314 million has been disbursed. An adjustment will be made to increase collections or to decrease collections by the \$0.002 million that has not been disbursed when we have completed processing appeals.

FUNDING YEAR 2001

Funding Year 2001 began on July 1, 2001 and ended on June 30, 2002. All Funding Year 2001 applications have been reviewed and processed. USAC issued funding commitments to rural health care providers for Funding Year 2001 totaling \$19.689 million. The FCC previously authorized the collection of \$18.575 million for Funding Year 2001. Of the \$18.575 million collected, \$18.553 million has been disbursed. An adjustment will be made to increase collections or

to decrease collections by the \$0.022 million that has not been disbursed when USAC has completed processing any applications that are submitted based on appeals that have been approved.

FUNDING YEAR 2002

The Funding Year 2002 application filing window opened on January 28, 2002. Funding Year 2002 began on July 1, 2002, and ended on June 30, 2003. As of September 30, 2004, 2,785 Form 466/468 packets had been received. The status of those packets is provided below.

FUNDING YEAR 2002	
Packets Completely Processed	2,589
Denied	93
Withdrawn by Applicant	103
Total Packets Received for Funding Year 2002	2,785

As of September 30, 2004, funding commitments have been issued totaling \$23.360 million. Based on information provided by the applicants, USAC now estimates Funding Year 2002 demand will be \$22.403 million. The FCC previously authorized the collection of \$22.259 million for Funding Year 2002. Based on the revised estimate of demand, USAC recommends the FCC increase collections for Funding Year 2002 by \$0.144 million in 1Q2005.

Funding commitments made during 3Q2004 are included in Appendix RH01. Authorized funding by applicant during 3Q2004 and disbursements made to service providers through 3Q2004 are listed in Appendices RH02 and RH03, respectively.

FUNDING YEAR 2003

The Funding Year 2003 application filing window opened on March 26, 2003. Funding Year 2003 began on July 1, 2003, and ended on June 30, 2004. A total of 2,624 Forms 465 were posted for Funding Year 2003. In addition, as of September 30, 2004, 3,085 Form 466 packets had been received. The status of those packets is provided below.

FUNDING YEAR 2003	
Packets Completely Processed	2,309
Packets Awaiting Supervisory Approval Only	86
Complete – Ready to Process	1
Withdrawn by Applicant	178
Denied	37
Incomplete – Require Forms and/or Clarification	474
Total Packets Received for Funding Year 2003	3,085

As of September 30, 2004, funding commitments have been issued totaling \$21.065 million. Based on information provided by the applicants, USAC now estimates Funding Year 2003 demand will be \$26.171 million. This estimate projects the current monthly demand by linear regression into future funding years. The FCC previously authorized the collection of \$26.123 million for Funding Year 2003. Based on the revised estimate of demand, USAC recommends the FCC increase collections for Funding Year 2003 by \$0.048 million in 1Q2005.

Funding commitments made during 3Q2004 are included in Appendix RH04. Authorized funding by applicant during 3Q2004 and disbursements made to service providers through 3Q2004 are listed in Appendices RH05 and RH06, respectively.

FUNDING YEAR 2004

The Funding Year 2004 application filing window opened on March 29, 2004. Funding Year 2004 began on July 1, 2004, and will end on June 30, 2005. As of September 30, 2004, 2,485 Forms 465 have been posted. In addition, of September 30, 2004, 1,042 packets have been received including 262 packets from applicants seeking support for Internet access only. The status of Funding Year 2004 packets is provided below.

FUNDING YEAR 2004	
Packets Completely Processed	193
Packets Awaiting Supervisory Approval Only	206
Complete – Ready to Process	184
Withdrawn by Applicant	7
Denied	4
Incomplete – Require Forms and/or Clarification	448
Total Packets Received for Funding Year 2004	1,042

As of September 30, 2004, funding commitments have been issued totaling \$0.163 million.

Based on information provided by the applicants as of September 30, 2004, USAC estimates Funding Year 2004 demand will be \$42.956 million. The FCC previously authorized the collection of \$20.844 million for the first two quarters of Funding Year 2004. Based on the revised estimate of demand, USAC recommends the FCC authorize the collection of \$11.056 million in 1Q2005, to meet total projected demand. Funding commitments made during 3Q2004 are included in Appendix RH07.

The recent FCC actions regarding the USF cash reserve, the accounting changes required by the FCC, and the application of the federal Antideficiency Act to the USF, have affected USAC's ability to make new funding commitments in the Rural Health Care Support Mechanism. USAC has sufficient funds to cover prior funding commitments that remain outstanding, but USAC must have additional funds to permit new commitments to be made. In anticipation of the conversion to government accounting rules, and recognizing the impact of pending decisions that funding commitments be treated as obligations and that the Antideficiency Act applies to the USF, USAC suspended issuance of all Rural Health Care Support Mechanism funding commitments in mid-August 2004. USAC continued to review and process applications, however, and expects to begin issuing new funding commitments by late November, if not sooner, depending on the availability of additional funds.

RURAL HEALTH CARE SUPPORT MECHANISM SUMMARY

The estimated 1Q2005 demand requirement for the Rural Health Care Support Mechanism is \$11.248 million. The total prior period adjustment to the 1Q2005 requirement is (\$0.473) million.

The detailed explanation for the adjustment is as follows:

Reason for the Prior Period Adjustment	Adjustment in Millions
The 3Q2004 billings were higher than expected due to higher revenues reported by contributors in their annual true-up filings	(\$0.008) M
Interest earned was higher than estimated for the 3Q2004.	(\$0.033) M
Bad Debt Expense was higher than anticipated in 3Q2004	(\$0.448) M
2003 administrative expenses were higher than anticipated	\$0.016 M
Total Prior Period Adjustment	(\$0.473) M

Note: Columns on table may not add perfectly due to rounding.

The total fund requirement of \$11.248 million, decreased by the prior-period adjustment of \$0.473 million, increased by administrative expenses of \$1.084 million, and reduced by the deduction of projected interest of \$0.026 million, results in a total projected funding requirement for the Rural Health Care Support Mechanism for 1Q2005 of \$11.833 million.

SCHOOLS AND LIBRARIES SUPPORT MECHANISM

FUNDING YEAR 1998

As of September 30, 2004, Funding Year 1998 commitments and amounts authorized for payment were as follows:

FUNDING YEAR 1998					
	Commitments		Authorized for Payment		Auth/Com
	Millions of Dollars	% of Total Commitments	Millions of Dollars	% of Total Authorized for Payment	% of Committed Authorized for Payment
Telecommunications	\$ 676.0	39.4%	\$ 507.9	36.3%	75.1%
Internet Access	\$ 134.2	7.8%	\$ 94.9	6.8%	70.7%
Internal Connections	\$ 904.4	52.8%	\$ 798.0	57.0%	88.2%
TOTAL	\$1,714.6		\$1,400.8		81.7%

Note: Columns on table may not add perfectly due to rounding.

No Funding Year 1998 applications remain in the program integrity assurance (PIA) review process.

Funding commitments made to applicants during 3Q2004 are included in Appendix SL01. Authorized funding by applicant during 3Q2004 and cumulative payments made to service providers through 3Q2004 are included in Appendices SL02 and SL03, respectively.

FUNDING YEAR 1999

As of September 30, 2004, Funding Year 1999 commitments and amounts authorized for payment were as follows:

FUNDING YEAR 1999					
	Commitments		Authorized for Payment		Auth/Com
	Millions of Dollars	% of Total Commitments	Millions of Dollars	% of Total Authorized for Payment	% of Committed Authorized for Payment
Telecommunications	\$ 635.0	29.5%	\$ 454.0	27.3%	71.5%
Internet Access	\$ 149.3	6.9%	\$ 95.8	5.8%	64.2%
Internal Connections	\$1,367.2	63.6%	\$1,112.3	66.9%	81.4%
TOTAL	\$2,151.5		\$1,662.1		77.3%

Note: Columns on table may not add perfectly due to rounding.

No Funding Year 1999 applications remain in the PIA review process.

Authorized funding by applicant during 3Q2004 and cumulative payments made to service providers through 3Q2004 are listed in Appendices SL04 and SL05, respectively.

FUNDING YEAR 2000

FUNDING YEAR 2000					
	Commitments		Authorized for Payment		Auth/Com
	Millions of Dollars	% of Total Commitments	Millions of Dollars	% of Total Authorized for Payment	% of Committed Authorized for Payment
Telecommunications	\$ 718.4	34.5%	\$ 473.4	28.8%	65.9%
Internet Access	\$ 219.3	10.5%	\$ 134.8	8.2%	61.5%
Internal Connections	\$ 1,144.8	55.0%	\$1,035.4	63.0%	90.4%
TOTAL	\$ 2,082.5		\$ 1,643.6		78.9%

Note: Columns on table may not add perfectly due to rounding.

As of September 30, 2004, one potentially fundable Funding Year 2000 application remained under review, pending a decision by the FCC.

Authorized funding by applicant during 3Q2004 and cumulative payments made to service providers through 3Q2004 are listed in Appendices SL06 and SL07, respectively.

FUNDING YEAR 2001

FUNDING YEAR 2001					
	Commitments		Authorized for Payment		Auth/Com
	Millions of Dollars	% of Total Commitments	Millions of Dollars	% of Total Authorized for Payment	% of Committed Authorized for Payment
Telecommunications	\$ 762.3	34.6%	\$ 516.9	31.3%	67.8%
Internet Access	\$ 225.7	10.2%	\$ 148.8	9.0%	65.9%
Internal Connections	\$1,215.8	55.2%	\$ 987.7	59.8%	81.2%
TOTAL	\$2,203.8		\$1,653.4		75.0%

Note: Columns on table may not add perfectly due to rounding.

As of September 30, 2004, six potentially fundable Funding Year 2001 applications remained in the PIA review process.

Authorized funding by applicant during 3Q2004 and cumulative payments made to service providers through 3Q2004 are listed in Appendices SL08 and SL09, respectively.

FUNDING YEAR 2002

FUNDING YEAR 2002					
	Commitments		Authorized for Payment		Auth/Com
	Millions of Dollars	% of Total Commitments	Millions of Dollars	% of Total Authorized for Payment	% of Committed Authorized for Payment
Telecommunications	\$ 859.1	39.1%	\$ 583.4	41.1%	67.9%
Internet Access	\$ 230.4	10.5%	\$ 155.9	11.0%	67.7%
Internal Connections	\$ 1,099.4	50.2%	\$ 679.0	47.9%	61.8%
TOTAL	\$ 2,188.9		\$ 1,418.3		64.8%

Note: Columns on table may not add perfectly due to rounding.

The SLD continues to review and process the remaining 80 potentially fundable applications that were not included in a regular commitment wave and will issue Funding Commitment Decision Letters (FCDLs) on an individual basis as reviews are completed and commitments resume based on available funds.

Authorized funding by applicant during 3Q2004 and cumulative payments to service providers through 3Q2004 are listed in Appendices SL10 and SL11, respectively.

FUNDING YEAR 2003

FUNDING YEAR 2003					
	Commitments		Authorized for Payment		Auth/Com
	Millions of Dollars	% of Total Commitments	Millions of Dollars	% of Total Authorized for Payment	% of Committed Authorized for Payment
Telecommunications	\$ 878.9	34.0%	\$ 348.3	43.6%	39.6%
Internet Access	\$ 240.2	9.3%	\$ 134.3	16.8%	55.9%
Internal Connections	\$1,462.9	56.6%	\$ 316.4	39.6%	21.6%
TOTAL	\$2,582.0		\$ 799.0		30.9%

Note: Columns on table may not add perfectly due to rounding.

As of September 30, 2004, 827 applications remained in the PIA review process.

Funding commitments made to applicants during 3Q2004 are included in Appendix SL12.

Authorized funding by applicant during 3Q2004 and cumulative payments to service providers through 3Q2004 are listed in Appendices SL13 and SL14, respectively.

FUNDING YEAR 2004

FUNDING YEAR 2004					
	Commitments		Authorized for Payment		Auth/Com
	Millions of Dollars	% of Total Commitments	Millions of Dollars	% of Total Authorized for Payment	% of Committed Authorized for Payment
Telecommunications	\$355.3	46.5%	\$ 2.9	39.2%	0.81%
Internet Access	\$101.0	13.2%	\$ 4.5	60.8%	4.4%
Internal Connections	\$307.6	40.3%	\$ 0.0	0.4%	0.0%
TOTAL	\$763.9		\$ 7.4		0.97%

Note: Columns on table may not add perfectly due to rounding.

As of September 30, 2004, 25,728 applications, about 65% of all applications certified for processing, had received at least one FCDL.

Funding commitments made to applicants during 3Q2004 are included in appendix SL15. Authorized funding by applicant during 3Q2004 and cumulative payments to service providers through 3Q2004 are listed in appendices SL16 and SL17, respectively.

SCHOOLS AND LIBRARIES SUPPORT MECHANISM SUMMARY

In a series of actions from December 1999 through December 2002, the FCC used \$477.160 million of undisbursed Funding Year 1998 funds to reduce collection requirements for the Universal Service Fund. Consistent with the Commission's direction in the *Schools and Libraries First Report and Order*, the FCC used a total of \$852.116 million of undisbursed Funding Years 1999 and 2000 collections to stabilize contributions to the Universal Service Fund and offset collections for 3Q2002, 4Q2002, and 1Q2003.³²

In the *Schools and Libraries Third Report and Order and Second Further Notice of Proposed Rulemaking*, the Commission amended its rules so that available unused funds from prior years would be carried forward on an annual basis in the second quarter of each calendar year for use in the next full funding year, and to codify the requirement that USAC file quarterly estimates of unused funds from prior funding years when it submits its projection of Schools and Libraries program demand for the upcoming quarter.³³ The Commission modified the schedule to implement the process for Funding Year 2003 and directed USAC to carry forward \$420 million of unused prior year funds for use in Funding Year 2003.³⁴ In accordance with the *Third Report and Order*, the FCC announced that

³² See *Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, First Report and Order, FCC 02-175 (June 13, 2002) (*Schools and Libraries First Report and Order*).

³³ See *Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, Third Report and Order and Second Further Notice of Proposed Rulemaking, FCC 03-323 (December 23, 2003) (*Schools and Libraries Third Report and Order and Second Further Notice of Proposed Rulemaking*).

³⁴ *Id.*

\$150 million in unused funds from Funding Year 2001 would be carried forward to increase disbursements to schools and libraries in Funding Year 2004.³⁵

The following sections provide information about the use of funds for each funding year, including adjustments made by the Commission, and USAC’s projections of unused funds from prior funding years available for carrying forward to increase disbursements to schools and libraries.

Funding Year 1998 True-Up

As of September 30, 2004, \$1,400.775 million of Funding Year 1998 support had been disbursed. The estimated Funding Year 1998 balance is based on the following:

FUNDING YEAR 1998	Adjustments in Millions
Amount Authorized and Actually Collected	\$ 1,925.000 M
Amount Disbursed	(1,400.775) M
Administrative Expenses (21 months)	(41.791) M
Amount Applied to Adjust 2000, 2001, and 2002 Collections	(477.160) M
Contingency Amount for Pending Appeals and Invoice Deadline Extension Requests	(5.274) M
Estimated Remaining Balance	\$0.000 M

USAC estimates that a contingency amount of \$5.274 million should be reserved to pay appeals pending at the FCC and to pay invoices on funding requests that may be granted extended invoice deadlines pursuant to FCC order. Based on these figures, and in order to preserve the contingency amount, no Funding Year 1998 funds are available to carry forward.

Funding Year 1999 True-Up

As of September 30, 2004, \$1,662.133 million of Funding Year 1999 support had been disbursed. The estimated remaining Funding Year 1999 balance is based on the following:

³⁵ See *Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, Carryover of Unused Funds for Funding Year 2004, DA 04-1848 (June 28, 2004).

FUNDING YEAR 1999	Adjustments in Millions
Amount Authorized and Actually Collected	\$ 2,250.000 M
Amount Disbursed	(1,662.133) M
Administrative Expenses	(32.316) M
Amount Applied to Adjust 3Q2002 Collections	(256.160) M
Amount Applied to Adjust 4Q2002 Collections	(212.927) M
Amount Carried Forward to Funding Year 2003	(50.000) M
Potential Additional Disbursements on Committed FRNs	(4.800) M
Contingency Amount for Pending Appeals and Invoice Deadline Extension Requests	(11.664) M
Estimated Remaining Balance	\$20.000 M

USAC’s projection of the remaining Funding Year 1999 funds includes an estimate of funds needed to pay additional disbursements on committed funding requests and a contingency reserve to pay pending appeals and to make disbursements on funding requests that may be granted extended invoice deadlines pursuant to FCC order. Based on these figures, USAC estimates that \$20 million of Funding Year 1999 funds is available to carry forward.

Funding Year 2000 True-Up

As of September 30, 2004, \$1,643.582 million of Funding Year 2000 support had been disbursed. The estimated remaining Funding Year 2000 balance is based on the following:

FUNDING YEAR 2000	Adjustments in Millions
Amount Authorized and Actually Collected	\$ 2,250.000 M
Amount Disbursed	(1,643.582) M
Administrative Expenses	(32.235) M
Amount Applied to Adjust 4Q2002 Collections	(136.849) M
Amount Applied to Adjust 1Q2003 Collections	(246.180) M
Amount Carried Forward to Funding Year 2003	(160.000) M
Potential Additional Disbursements on Committed FRNs	(1.418) M
Remaining Uncommitted Requests	(1.658) M
Contingency Amount for Pending Appeals and Invoice Deadline Extension Requests	(18.078) M
Estimated Remaining Balance	\$10.000 M

USAC’s projection of the remaining Funding Year 2000 funds includes estimates of funds needed to pay additional disbursements on committed funding requests and disbursements on

remaining requests that have not received funding commitments, as well as a contingency reserve to pay pending appeals and to make disbursements on funding requests that may be granted extended invoice deadlines pursuant to FCC order. Based on these figures, USAC estimates that \$10 million of Funding Year 2000 funds is available to carry forward to increase disbursements to schools and libraries in Funding Year 2005.

Funding Year 2001 True-Up

As of September 30, 2004, \$1,653.398 million of Funding Year 2001 support had been disbursed. The estimated remaining Funding Year 2001 balance is based on the following:

FUNDING YEAR 2001	Adjustments in Millions
Amount Authorized and Actually Collected	\$ 2,250.000 M
Amount Disbursed	(1,653.398) M
Administrative Expenses	(30.559) M
Amount Carried Forward to Funding Year 2003	(210.000) M
Amount Carried Forward to Funding Year 2004	(150.000) M
Potential Additional Disbursements on Committed FRNs	(66.197) M
Remaining Uncommitted Requests	(40.750) M
Contingency Amount for Pending Appeals and Invoice Deadline Extension Requests	(49.096) M
Estimated Remaining Balance	\$50.000 M

USAC’s projection of the remaining Funding Year 2001 funds includes estimates of funds needed to pay additional disbursements on committed funding requests and disbursements on remaining requests that have not yet received funding commitments, as well as a contingency reserve to pay pending appeals and to make disbursements on funding requests that may be granted extended invoice deadlines pursuant to FCC order. Based on these figures, USAC estimates that \$50 million of Funding Year 2001 funds is available to carry forward.

Funding Year 2002 True-Up

As of September 30, 2004, \$1,418.222 million of Funding Year 2002 support had been disbursed. The estimated remaining Funding Year 2002 balance is based on the following:

FUNDING YEAR 2002	Adjustments in Millions
Amount Authorized and Actually Collected	\$ 2,250.000 M
Amount Disbursed	(1,418.222) M
Administrative Expenses (unaudited)	(38.531) M
Potential Additional Disbursements on Committed FRNs	(303.975) M
Remaining Uncommitted Requests	(67.254) M
Contingency Amount for Pending Appeals and Invoice Deadline Extension Requests	(322.018) M
Estimated Remaining Balance	\$100.000 M

USAC’s projection of the remaining Funding Year 2002 funds includes estimates of funds needed to pay additional disbursements on committed funding requests and disbursements on requests that have not yet received funding commitments, as well as a contingency reserve to pay pending appeals and to make disbursements on funding requests that may be granted extended invoice deadlines pursuant to FCC order. Based on these figures, USAC estimates that \$100 million of Funding Year 2002 funds is available to carry forward.

1Q2005 Demand Estimate and Contribution Requirement

Pursuant to FCC order, USAC was required to change the Universal Service Fund (USF) accounting system to conform with government accounting standards on October 1, 2004.³⁶ Based on further FCC direction provided on September 27, 2004, funding commitment decision letters in the Schools and Libraries and Rural Health Care Support Mechanisms are now considered “obligations” for accounting purposes. Also on September 27, 2004, the Commission informed USAC that the federal Antideficiency Act, 31 U.S.C. §1341, now applies to the USF. Because the Antideficiency Act generally requires that “unobligated” resources be available before an obligation can be incurred, USAC must ensure that the unobligated USF cash balance is sufficient to cover any new funding commitments it plans to make or other obligations it may incur.

³⁶ See *Application of Generally Accepted Accounting Principles for Federal Agencies and Generally Accepted Auditing Standards to the Universal Service Fund*, CC Docket No. 96-45, Order, FCC 03-232 (rel. Oct. 3, 2003).

In view of the large cash reserve in the USF that accumulated largely because actual Schools and Libraries Support Mechanism disbursements significantly lag behind the issuance of funding commitments, the Commission applied a total of \$550 million of the undisbursed balance from prior years to reduce Schools and Libraries Support Mechanism collections in 2004. The Commission applied \$200 million of the cash balance in both 2Q2004 and 3Q2004. In 4Q2004, the Commission used \$150 million to maintain the contribution factor at the level of the 3Q2004 contribution factor.³⁷

The recent FCC actions regarding the USF cash reserve, the accounting changes required by the FCC, and the application of the federal Antideficiency Act to the USF, have affected USAC's ability to make new funding commitments in the Schools & Libraries Support Mechanism. USAC has sufficient funds to cover prior funding commitments that remain outstanding, but USAC must have additional funds to permit new commitments to be made. In anticipation of the conversion to government accounting rules, and recognizing the impact of pending decisions that funding commitments be treated as obligations and that the Antideficiency Act applies to the USF, USAC suspended issuance of all Schools & Libraries Support Mechanism funding commitments in early August 2004. USAC continued to review and process applications, however, and expects to begin issuing new funding commitments by late November, if not sooner, depending on the availability of additional funds.

³⁷ The Commission announces the quarterly contribution factor by Public Notice. *See* CC Docket No. 96-45, Public Notices, DA 04-621 (rel. March 5, 2004); DA 04-1613 (rel. June 7, 2004); DA 04-2976 (rel. September 16, 2004).

Commission regulations provide “[t]he annual funding cap on federal universal service support for schools and libraries shall be \$2.250 billion per funding year.”³⁸ Historically, applicant demand has exceeded the annual \$2.250 billion cap placed on the Schools and Libraries Support Mechanism. The Commission has also viewed stability in the USF contribution factor as a goal. Thus, USAC has requested authority to collect an amount equal to one-quarter of the annual cap each quarter. Demand again exceeded the cap for Funding Year 2004 (July 1, 2004 to June 30, 2005) — \$4.278 billion compared to \$2.250 billion.

As noted above, in determining the contribution factors for the last three quarters of 2004, the FCC applied \$200 million of the cash balance in 2Q2004, \$200 million in 3Q2004, and \$150 million in 4Q2004 to reduce collections for the Schools and Libraries Support Mechanism. Under the accounting rules in place at the time, the FCC’s actions to manage the cash balance of the USF would have had no effect on disbursement or commitment amounts for any of the universal service programs. However, under government accounting rules that require funds on hand to be sufficient to cover all outstanding funding commitments (which are now considered to be obligations), and with the application of the Antideficiency Act to the USF, the decisions to collect less than one-quarter of the annual disbursement cap now effectively limit future funding commitments to less than the \$2.250 billion annual cap unless those funds are recovered in future quarters.

Therefore, in order to collect the one-quarter of the annual cap each quarter as USAC has requested in the past, and in order to begin to collect the shortfall created over the previous three quarters, USAC requests authority to collect \$837.500 million to meet program demand in 1Q2005, as shown below.

³⁸ 47 C.F.R. § 54.507.

ESTIMATE OF 1Q2005 PROGRAM DEMAND	ESTIMATE IN MILLIONS
One-quarter of annual \$2.25 billion program cap	\$ 562.500 M
One-half of funds used by the FCC in 2Q2004 to reduce collections	100.000 M
One-half of funds used by the FCC in 3Q2004 to reduce collections	100.000 M
One-half of funds used by the FCC in 4Q2004 to reduce collections	75.000 M
Projected 1Q2005 Program Demand	\$837.500 M

As USAC has done in every quarter since the Commission set the \$2.250 billion cap, USAC proposes to collect \$562.500 million, an amount equal to one-quarter of the annual \$2.250 billion cap. In addition, however, USAC proposes to recover \$275 million of the funds used by the FCC in the 2Q2004, 3Q2004, and 4Q2004.

This includes collecting \$100 million used by the FCC in 2Q2004, consisting of undisbursed funds from prior funding years, as well as an additional \$175 million, which is one-half of the amount used by the FCC in 3Q2004 and 4Q2004. USAC intends to propose recovery of the remaining \$275 million in its 2Q2005 quarterly filing. If this approach is adopted, then USAC will have collected the full \$2.250 billion for funding year 2004 and will have recovered the uncollected funds from the last quarter of funding year 2003 (2Q2004 calendar year) by July 31, 2005. Thus, the proposed approach for both funding years 2003 and 2004 would restore funding to the \$2.250 billion annual cap set forth in Commission regulations.

Results for 3Q2004 contribute to an over-funded condition for which the instant filing proposes to adjust the 1Q2005 requirements. The total adjustment to the 1Q2005 fund requirement based on actual results will decrease the funding needed by \$(10.806) million. The explanations for the adjustment are described below:

REASON FOR THE PRIOR PERIOD ADJUSTMENT	ADJUSTMENT IN MILLIONS
3Q2004 billings were higher than projected	\$ (11.897) M
Interest earned was higher than projected.	(4.731) M
Bad debt expense was higher than anticipated.	5.823 M
Total Prior Period Adjustment	\$ (10.806) M

Note: Columns on table may not add perfectly due to rounding.

The fund requirement of \$837.500 million, which includes administrative expenses of \$15.597 million, decreased by the prior-period adjustment of (\$10.806) million, and reduced by the projected interest of \$3.829 million, results in a projected collection requirement of \$822.865 million for the Schools and Libraries Support Mechanism for 1Q2005.

CONTRIBUTION BASE

USAC collects quarterly interstate and international revenue information from carriers on the FCC Form 499-Q four times each year and submits aggregate information on a quarterly basis to the FCC (March 2, June 1, September 1, and December 2).³⁹ Based on these filings, the FCC establishes the contribution factor for the upcoming quarter. Telecommunications providers qualifying for the *de minimis* exemption from contribution requirements need not complete the Form 499-Q. USAC reports and the FCC uses projected collected revenues in order to determine the contribution factor.

Approximately 5,415 FCC Forms 499-Q were distributed to carriers in late September 2004. Interstate telecommunications service providers are required to complete this form, reporting January - March 2005 projected revenue information, and return it by November 1, 2004.

³⁹ The Form 499-Q includes a box for each of the quarterly filing submissions. Carriers check the appropriate box to indicate the quarter for which revenue information is being reported.

OPERATIONS

USAC invoices and receives contributions from more than 2,200 telecommunications companies each month. Over the course of the year, USAC disburses funds to service providers as appropriate under each of the support mechanisms. USAC has been able to maintain the uncollectible rate below 1 percent of the total funds billed to contributing telecommunications carriers.

USAC continues to assist the FCC in its USF collection enforcement efforts. USAC works closely with the FCC to obtain compliance from carriers not remitting required contributions, and provides required documentation monthly to assist the FCC in issuing Notices of Apparent Liability (NALs) against non-payers. USAC also assists the FCC by working with carriers to achieve compliance with filing and contribution requirements; by providing information to the FCC regarding carriers that have not filed a Form 499; by providing monthly reports listing non-payers by amount owed and by type of carrier; by contacting the FCC to determine which non-paying carriers, if any, have petitioned the FCC regarding their funding obligation; and by providing the FCC with call log information and written correspondence of carriers that have not filed a petition with the FCC.

In conjunction with the FCC, USAC will launch Phase I of the Red Light Rule implementation in November 2004. The Red Light Rule requires federal agencies to withhold benefits to any debtor that has an unresolved delinquency with any federal agency.

After the Red Light Rule is implemented, USAC will place an administrative hold on any contributor account that reflects a one day delinquency to the Fund or an outstanding balance with the FCC. In addition, any Service Provider Identification Number (SPIN) sharing the same Taxpayer Identification Number (TIN) as a delinquent contributor will be put on administrative hold until the delinquent obligation is resolved. USAC will also hold USF payments for any non-

USF FCC funds that have outstanding balances due and perform USF to USF administrative offsets (Force Netting) on all balances delinquent more than one business day. USAC may take other administrative actions as directed by the FCC to fully implement the requirements of the Red Light Rule.

USAC is in discussions with the FCC about dismissing SLD and RHC applications if the applying entities are delinquent and do not respond within thirty days of receiving notification of the debt.

CONCLUSION

At their October 18, 2004 meetings, USAC's High Cost & Low Income Committee, Rural Health Care Committee, and Schools & Libraries Committee passed resolutions authorizing the 1Q2005 support mechanism funding requirements described herein. At its October 19, 2004, meeting, the USAC Board of Directors adopted a resolution authorizing the inclusion of the 1Q2005 administrative expenses and 1Q2005 funding base in this report to the Commission.

Respectfully submitted,

UNIVERSAL SERVICE
ADMINISTRATIVE COMPANY

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