



Universal Service Administrative Company
Schools & Libraries Division

George McDonald
Vice President

March 11, 2005

Mr. Jeffrey Carlisle
Chief, Wireline Competition Bureau
Federal Communications Commission
Washington, D.C. 20554

RE: Funding for Schools and Libraries Universal Service Support Mechanism for Funding Year 2004

Dear Mr. Carlisle:

The purpose of this letter is to revise the January 31, 2005, filing, *Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2005*, which reported unused funds that, pursuant to Commission rules, would be carried forward and added to the Schools and Libraries Support Mechanism funding cap for Funding Year (FY) 2005.

In a Public Notice issued on June 28, 2004 (DA 04-1848), the Wireline Competition Bureau (Bureau) announced that the Schools and Libraries funding cap for FY 2004 would be \$2.4 billion pursuant to 47 CFR §54.507(a).

Under FCC rules, first priority for available funds is to be given to discount requests for telecommunications services and Internet access. To the extent available funds exceed those required for requests for these two service types, they are to be committed on discount requests for internal connections beginning with requests qualifying for the highest discounts and descending by discount percentage until the funds are fully utilized. See 47 C.F.R. §54.507(g).

USAC reviews requests for funding on a rolling basis well into the funding year and in limited instances after the funding year has ended. In order to be able to make internal connections commitments during the funding year, in consultation with the Bureau, USAC instituted the practice in 1998 of preparing an analysis of what proportion of pending requests awaiting commitment would likely be funded (parameter analysis). We receive data as input for the analysis from our operations support contractor. Based on that analysis and management's recommendation, the Schools & Libraries Committee of the USAC Board of Directors and Bureau staff determine the funding and denial thresholds for internal connections.

In January 2005, the Schools & Libraries Committee and Bureau staff approved the recommendation by USAC management to fund internal connections down to a discount percentage of 81% for FY 2004. Analysis performed within the last week, however,

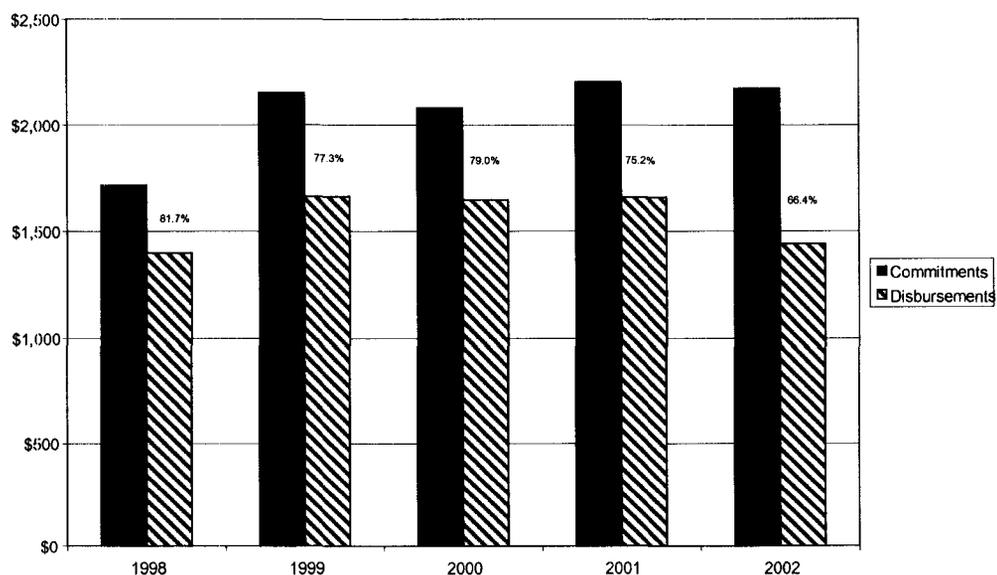
indicates that USAC erred in concluding that there was sufficient room within the \$2.4 billion cap on commitments to lower the funding threshold to 81% for internal connections. We project that commitments likely will exceed the cap by approximately \$159 million at the 81% funding threshold.

When USAC calculated the unused funds from prior years available to be carried forward and reported it to the Commission in the January 31 filing, we were not aware of the funding issue in FY 2004 that has now been identified. As a result of the error with respect to FY 2004, the \$170 million is no longer unused pursuant to Commission rules. This letter is intended to modify the January 31 filing in that regard.

USAC is committed to avoiding this type of error in the future. First, we emphasize that the process of developing the parameter analysis has worked successfully for the first six years of the program. We have initiated changes to the process, however, to ensure that this situation will not recur. Specifically, we will bring the entire process of developing the parameter analysis in-house and there will be continual, close coordination among those involved in its development.

It is also important to note that, because disbursements significantly lag commitments both in time and in total for each funding year, we are confident that if we committed up to \$2.559 billion for FY 2004, total disbursements would not exceed \$2.125 billion -- \$275 million below the FY 2004 funding cap. This trend is reflected in the historical ratio between commitments and disbursements as reflected in the chart below. The highest proportion of disbursements to commitments was in FY 1998, when it was 81.7%. In subsequent years, it has not exceeded 79%.

Comparison of Commitments and Disbursements by Funding Year
Dollars in Millions as of 12/31/04



USAC has identified three options that may address this issue.

- Commit above the Funding Cap for FY 2004

For several funding years, with Schools & Libraries Committee and Bureau approval, we considered the funding cap a cap on disbursements and made internal connections funding decisions based on an assumption that we would make commitments in excess of the annual disbursement cap. The thresholds were set based on an analysis of likely disbursements to the annual funding cap. As noted above, we could commit \$2.559 billion for FY 2004 with confidence that disbursements would be well below the funding cap.

- Carry Forward \$159 Million of Unused Funds from Prior Years into FY 2004

USAC reported in its second quarter 2005 demand filing of January 31, 2005, that there are unused funds from prior funding years totaling \$170 million available to carry forward (\$10 million each from 1999 and 2000, \$50 million from 2001, and \$100 million from 2002). While the expectation is that funds would be carried forward to FY 2005, if the Commission instead directed that \$159 million of that amount be carried forward to FY 2004, the issue would be resolved.

- Discontinue Internal Connections Commitments Below 85% and Cancel Commitments Made to Date

Based on a reanalysis with the corrected input, we estimate the \$2.4 billion would be sufficient to fully fund internal connections down to 85%, with pro-ration a possibility for requests at 84%. A decision could be to discontinue commitments below 85% (or 84% if there is a decision to make pro-rated commitments on those requests) and cancel FY 2004 commitments below that discount level made to date. We have made \$163 million in commitments on 2004 internal connections requests below 85% to date. Presumably, USAC would be required to seek recovery of any funds disbursed on such commitments. To date, USAC has disbursed approximately \$162,000 on those commitments. This result would be administratively burdensome and would cause considerable hardship to affected entities. We would be happy to provide additional information upon request.

Sincerely,



George McDonald
Vice President, Schools and Libraries Division

cc: Ms. Vickie Robinson, Deputy Chief, Telecommunications Access Policy Division, WCB