



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

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Auditor of State

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NEWS RELEASE

FOR RELEASE

May 14, 2007

Contact: Andy Nielsen
515/281-5834

Auditor of State David A. Vaudt today released an audit report on the Iowa Communications Network (ICN) for the year ended June 30, 2006. The ICN is responsible for the management, development and operation of the statewide telecommunications network which carries and switches full motion interactive video, voice and data traffic for Iowa's educational institutions and other authorized users.

The ICN reported revenues of \$35,765,959 for the year ended June 30, 2006, a 27% decrease from the prior year. The revenues included sales, rents and services of \$33,936,667, non-capital appropriations of \$1,704,719 and capital contributions of \$124,573. Expenses for the year ended June 30, 2006 totaled \$39,659,935, an 11% decrease from the prior year. Expenses included \$13,326,436 for direct expenses, \$8,235,229 for depreciation, \$9,728,277 for other operating expenses and \$8,369,993 for general and administrative expenses.

The significant decrease in revenues and expenses is due primarily to the retirement of certificates of participation in the prior year. Revenues also decreased in the current year as a result of decreased sales.

Vaudt recommended the Iowa Communications Network continue to improve controls over capital assets and financial statement presentation.

A copy of the audit report is available for review in the Iowa Communications Network office, in the Office of Auditor of State and on the Auditor of State's website at <http://auditor.iowa.gov/reports/reports.htm>.

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IOWA COMMUNICATIONS NETWORK
INDEPENDENT AUDITOR'S REPORTS
BASIC FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS

JUNE 30, 2006

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Iowa Communications Network

Officials

Governor

Honorable Thomas J. Vilsack
(Ended during January 2007)

Honorable Chester J. Culver
(Began during January 2007)

Director, Department of Management

Michael L. Tramontina
(Ended during January 2007)

Charles J. Krogmeier
(Began during January 2007)

Director, Legislative Services Agency

Dennis C. Prouty

Iowa Telecommunications and Technology Commission

		<u>Term Expires</u>
Betsy Brandsgard	Chairperson	Apr 2012
Michael W. Mahaffey	Commission Member	Apr 2007
Robert R. Hardman	Commission Member	Apr 2008
Pamela A. Duffy	Commission Member	Apr 2010
Timothy L. Lapointe	Commission Member	Apr 2011
David A. Vaudt, CPA	Non-Voting Ex-Officio Commission Member	Indefinite

Agency

John Gillispie
Kevin Heinzeroth

Executive Director
Chief Financial Officer

Iowa Communications Network



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Independent Auditor's Report

To the Members of the Iowa Telecommunications
and Technology Commission:

We have audited the accompanying basic financial statements of the Iowa Communications Network, as of and for the year ended June 30, 2006, listed in the table of contents. These financial statements are the responsibility of the Iowa Communications Network's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

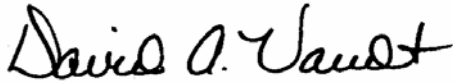
As discussed in Note 1, the financial statements of the Iowa Communications Network are intended to present the financial position and the changes in financial position and cash flows of only that portion of the financial reporting entity of the State of Iowa that is attributable to the transactions of the Iowa Communications Network. They do not purport to, and do not, present fairly the financial position of the State of Iowa as of June 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Iowa Communications Network at June 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

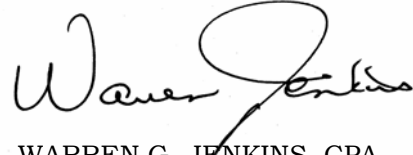
In accordance with Government Auditing Standards, we have also issued our report dated March 9, 2007 on our consideration of the Iowa Communications Network's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 7 through 10 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



DAVID A. VAUDT, CPA
Auditor of State



WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

March 9, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Iowa Communications Network (ICN) provides this Management's Discussion and Analysis of the ICN's annual financial statements. This narrative overview and analysis of the financial activities of the ICN is for the fiscal year ended June 30, 2006. We encourage readers to consider this information in conjunction with the ICN's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

The ICN continues to provide high quality, reasonably priced video, voice and data services to our authorized educational, judicial, medical and governmental authorized users. Here are some of the key financial highlights from fiscal year 2006.

- ICN operating revenues were \$33.9 million.
- During fiscal year 2006, the ICN received \$1.7 million in appropriations from the State for network equipment upgrades.
- The ICN delivered 252,891 hours of full-motion, interactive video to its authorized users in FY 2006. Since ICN's inception in 1993, it has delivered approximately 2.7 million hours in video to its users.

USING THIS ANNUAL REPORT

This discussion and analysis is intended to serve as an introduction to the ICN's basic financial statements. The ICN's basic financial statements consist of a series of financial statements. The Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Fund Net Assets and the Statement of Cash Flows (on pages 13 through 15) provide information about the activities of the ICN as a whole and present a longer-term view of the ICN's finances. These basic financial statements also include the Notes to Financial Statements that explain some of the information in the statements and provide more detail. Supplementary information is also in schedule form and is displayed on page 22.

REPORTING THE ICN AS A WHOLE

One of the most important questions asked about the ICN's finances is "Why does the ICN look like it loses money?" The ICN was designed to provide low-cost, full-motion interactive video to enhance educational and medical opportunities to rural Iowa. The State made a commitment to fund the capital investment in the Network through certificates of participation. That investment is not completely recovered through the ICN's rates. As the value of the Network is depreciated, the ICN does not fully recover the depreciation associated with the State's investment. ICN's Statement of Cash Flows highlights that revenues covered operational costs in 2006.

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Fund Net Assets report information about the ICN as a whole and about its activities in a way that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The ICN's financial statements include these statements:

The Statement of Net Assets presents all of the ICN's assets and liabilities, with the difference between the two reported as "net assets".

The Statement of Revenues, Expenses and Changes in Fund Net Assets presents information showing how the ICN's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the event or change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

The Statement of Cash Flows reports the net increase (or decrease) in cash and cash equivalents (highly liquid investments with a maturity of three months or less when purchased) for the fiscal year. This statement includes cash flows from operating activities, cash flows from non-capital financing activities and cash flows from capital and related financing activities. The resulting net increase (or decrease) in cash and cash equivalents is then added to the balance of cash and cash equivalents at the beginning of the year to determine the FY06 ending cash and cash equivalents balance.

The Notes to Financial Statements provide additional information essential to a full understanding of the data provided in the basic financial statements. The Notes to Financial Statements begin on page 16.

The Supplementary Information is displayed on page 22 and provides detailed information about operating revenues and expenses.

FINANCIAL ANALYSIS OF THE NETWORK

The ICN's assets totaled \$56 million at the end of 2006, compared to \$60.8 million at the end of the previous year. The decrease is due to the aging of the ICN's fixed assets and the resulting increase in the related accumulated depreciation. Net assets invested in capital assets decreased \$5.7 million from fiscal year 2005. This change is primarily due to the increase in accumulated depreciation. Unrestricted net assets represent assets used to meet the ICN's ongoing obligations to vendors and creditors. Unrestricted net assets increased from fiscal year 2005 to fiscal year 2006.

	June 30,	
	2006	2005
Assets		
Current and other assets	\$ 15,797,819	14,908,014
Capital assets	40,170,268	45,890,970
Total assets	<u>55,968,087</u>	<u>60,798,984</u>
Liabilities		
Current liabilities	4,528,590	5,465,511
Net Assets		
Invested in capital assets	40,170,268	45,890,970
Unrestricted	11,269,229	9,442,503
Total net assets	<u>\$ 51,439,497</u>	<u>55,333,473</u>

The next schedule helps to highlight the activity for fiscal year 2006 compared to fiscal year 2005.

	Year ended June 30,	
	2006	2005
Operating revenues:		
Sales, rents and services	\$ 33,936,667	36,131,363
Operating expenses:		
Direct expenses	13,326,436	14,821,769
Depreciation expense	8,235,229	9,780,677
Other operating expenses	9,728,277	10,320,347
General and administrative expenses	8,369,993	8,056,280
Total operating expenses	39,659,935	42,979,073
Operating loss	(5,723,268)	(6,847,710)
Non-operating revenues (expenses):		
Non-capital appropriations from the State of Iowa	1,704,719	422,212
Investment income	-	509,022
Interest expense	-	(1,056,502)
Amortization expense	-	(172,778)
Other expense	-	(475,379)
Net non-operating revenues (expenses)	1,704,719	(773,425)
Loss before other revenues	(4,018,549)	(7,621,135)
Capital appropriations from the State of Iowa	-	11,415,000
Capital contributions	124,573	204,819
Change in net assets	(3,893,976)	3,998,684
Net assets beginning of year	55,333,473	51,334,789
Net assets end of year	\$ 51,439,497	55,333,473

The ICN's sales for fiscal year 2006 were down 6.1 percent at \$33.9 million compared to \$36.1 million for fiscal year 2005. The decrease in sales is primarily due to a decrease in installation revenues, which were \$1.5 million in fiscal year 2006 compared to \$3.4 million in fiscal year 2005. Data services provided the ICN with \$16.7 million in sales while voice services provided the ICN with \$10.1 million in sales.

The ICN's largest individual expense is depreciation expense, which accounts for 20.8% of all operating expenses. Depreciation expense is followed by personnel expense of 19.2%, data costs of 18.2%, system maintenance costs of 16.9%, voice costs of 11.4%, outside plant costs of 2.6%, video costs of 2.4% and network installation costs of 2.2% of all expenses. Operating expenses are shown in detail on page 22.

Capital appropriations from the State of Iowa to the ICN decreased by \$11.4 million from fiscal year 2005. This was due to the early retirement of the Certificates of Participation, resulting in a savings of \$1.3 million in future interest payments.

CAPITAL ASSETS

The ICN's investment in capital assets at June 30, 2006 was \$135.4 million, with accumulated depreciation of \$95.3 million, leaving a net book value of \$40.1 million. This investment in capital assets includes equipment and fiber optic cable, with 46.7% of the depreciable assets invested in cable. Cable represents the primary investment in the ICN's backbone, which is used to deliver telecommunication services to our customers. Additional information about ICN's capital assets is presented in Note 4 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

ICN's management considered many factors when setting the 2007 fiscal year budget. Management anticipates most product sales to remain steady through fiscal year 2007. This forecast should result in little or no change in ICN revenue for fiscal year 2007.

ICN's forecast for fiscal year 2007 includes funding from the Federal Communications Commission (FCC) Universal Service Fund (USF). Payments from this fund are to be used to ensure the benefits of telecommunications reach students across the country. On September 30, 2004, the FCC began treating funding commitment decision letters (FCDLs) issued for the University Service Schools and Libraries and Rural Health Care Support Mechanisms as budgetary obligations, requiring there be monies on hand to cover a request before granting the funding requests. Universal Service Administrative Company (USAC) began tracking the amount of unobligated USF monies on hand to support new funding commitments. USAC expects that, going forward, at various times, it may have less unobligated cash on hand than the total dollar value of new commitments ready to be issued requiring approvals for new requests for funding be delayed. The ICN has been providing video services to schools and libraries who are dependent on this funding to pay ICN for these services. ICN's 2007 revenues from USAC for the support of video services to schools and libraries are estimated at \$2.1 million.

CONTACTING THE IOWA COMMUNICATIONS NETWORK FINANCIAL MANAGEMENT

This financial report is designed to present users with a general overview of the ICN's finances and to demonstrate the ICN's accountability for the funds generated. If you have questions about the report or need additional financial information, please contact the Finance Division, Iowa Communications Network, Hoover Building, Level A, 1305 E. Walnut St., Des Moines, Iowa 50319.

Basic Financial Statements

Iowa Communications Network

Iowa Communications Network

Statement of Net Assets

June 30, 2006

Assets	
Current assets:	
Cash and cash equivalents	\$ 9,529,245
Accounts receivable, net	1,548,396
Due from other state agencies	2,934,439
Inventory	1,012,839
Total current assets	15,024,919
Noncurrent assets:	
Capital assets - non depreciable	116,988
Capital assets - depreciable, net	40,053,280
Prepaid expense	772,900
Total noncurrent assets	40,943,168
Total assets	55,968,087
Liabilities	
Current liabilities:	
Accounts payable	3,670,885
Due to other state agencies	78,686
Deferred revenue	188,981
Compensated absences	590,038
Total liabilities	4,528,590
Net Assets	
Invested in capital assets	40,170,268
Unrestricted	11,269,229
Total net assets	\$ 51,439,497

See notes to financial statements.

Exhibit B

Iowa Communications Network
Statement of Revenues, Expenses and
Changes in Fund Net Assets
Year ended June 30, 2006

Operating revenues:	
Sales, rents and services	<u>\$ 33,936,667</u>
Operating expenses:	
Direct expenses	13,326,436
Depreciation expense	8,235,229
Other operating expenses	9,728,277
General and administrative expenses	8,369,993
Total operating expenses	<u>39,659,935</u>
Operating loss	(5,723,268)
Non-operating revenues:	
Non-capital appropriations from the State of Iowa	<u>1,704,719</u>
Loss before other revenues	(4,018,549)
Other revenues:	
Capital contributions	<u>124,573</u>
Decrease in net assets	(3,893,976)
Net assets beginning of year	<u>55,333,473</u>
Net assets end of year	<u><u>\$ 51,439,497</u></u>

See notes to financial statements.

Iowa Communications Network

Statement of Cash Flows

Year ended June 30, 2006

Cash flows from operating activities:	
Cash received from customers	\$ 35,300,233
Cash paid for goods and services	(25,123,414)
Cash paid for salaries and benefits	(7,574,459)
Net cash provided by operating activities	<u>2,602,360</u>
Cash flows from non-capital financing activities:	
State appropriations	<u>1,704,719</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(2,769,151)
Capital contributions	124,573
Net cash used by capital and related financing activities	<u>(2,644,578)</u>
Net increase in cash and cash equivalents	1,662,501
Cash and cash equivalents beginning of year	<u>7,866,744</u>
Cash and cash equivalents end of year	<u>\$ 9,529,245</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	<u>\$ (5,723,268)</u>
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation expense	8,235,229
Loss on disposal of capital assets and inventory	254,624
Decrease in accounts receivable	1,202,268
Decrease in due from other state agencies	296,995
Increase in inventory	(537,600)
Increase in prepaid expense	(188,967)
Decrease in deferred revenue	(135,697)
Increase in accounts payable	762,639
Decrease in due to other state agencies	(1,618,097)
Increase in compensated absences	54,234
Total adjustments	<u>8,325,628</u>
Net cash provided by operating activities	<u>\$ 2,602,360</u>

See notes to financial statements.

Iowa Communications Network

Notes to Financial Statements

June 30, 2006

(1) Summary of Significant Accounting Policies

The Iowa Communications Network (ICN) is responsible for the management, development and operation of the statewide telecommunications network. The ICN carries and switches full motion interactive video and voice and data traffic for Iowa's educational institutions and other authorized users.

The financial statements of the ICN have been prepared in conformity with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. The more significant of the ICN's accounting policies are described below:

A. Reporting Entity

For financial reporting purposes, the ICN has included all funds, organizations, agencies, boards, commissions and authorities. The ICN has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the ICN are such that exclusion would cause the ICN's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the ICN to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the ICN. The ICN has no component units which meet the Governmental Accounting Standards Board criteria.

B. Fund Accounting

The ICN is reported for accounting purposes as an Enterprise Fund. The operations of the fund are accounted for with self-balancing accounts which comprise its assets, liabilities, net assets, revenues and expenses. Enterprise Funds are used to report activities for which fees are charged to external users for goods or services.

C. Measurement Focus

Enterprise Funds are accounted for on a cost of services or "capital maintenance" measurement focus. This means all assets and liabilities, whether current or non-current, associated with their activity are included on the Statement of Net Assets. Fund equity is reported as net assets. Enterprise Fund operating statements present increases (revenues) and decreases (expenses) in net assets.

In reporting the financial activity of its Enterprise Fund, the ICN applies all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

D. Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

Enterprise Funds are accounted for using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred.

The ICN distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an Enterprise Fund's principal ongoing operations. All revenues and expenses not meeting this definition are reported as either non-operating revenues and expenses or other revenues and expenses.

E. Budgets and Budgetary Accounting

Budgetary control is exercised over the ICN through the annual budgetary process prescribed in Chapter 8 of the Code of Iowa.

F. Assets, Liabilities and Net Assets

The following accounting policies are followed in preparing the basic financial statements:

Cash and Cash Equivalents

The ICN makes deposits with the Treasurer of State and with other specific custodial banks. The cash balance is pooled and invested by the Treasurer of State.

For purposes of the statement of cash flows, all short-term cash investments that are highly liquid are considered to be cash equivalents. Cash equivalents are readily convertible to known amounts of cash and, at the day of purchase, have a maturity date no longer than three months.

Accounts Receivable/Due from Other State Agencies

Accounts receivable and due from other state agencies primarily represent unpaid charges for network services provided to authorized users.

Inventory

Inventory consists primarily of materials and supplies held for deployment to network locations and is valued at cost which approximates market. The last-in/first-out (LIFO) cost flow method is used.

Capital Assets

All capital assets purchased or constructed are reported at cost. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included in the capitalized value of the asset constructed, net of interest earned on the investment proceeds over the same period.

For network assets, the ICN's capitalization policy includes any location, equipment, fiber or parts purchased and used to enhance, maintain, or expand the functionality, capacity and capability of the ICN's communications network and services valued at \$5,000 and above. When network assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized as income or loss for the period.

The costs of normal maintenance and repair not adding to the value of the asset or materially extending asset lives are not capitalized.

Depreciation is computed using the straight-line method over the following estimated useful lives:

<u>Asset</u>	<u>Years</u>
Equipment	3-7
Fiber optic cable	20

Accounts Payable

Accounts payable consists primarily of outstanding invoices for contractual services.

Compensated Absences

Employees accumulate a limited amount of earned but unused vacation, sick leave and compensatory time hours for subsequent use or for payment upon termination, death, or retirement. The cost of earned vacation, sick leave and compensatory pay are recorded as liabilities. These liabilities for compensated absences are based on rates of pay in effect at June 30, 2006.

Net Assets

The ICN classifies net assets in the following categories:

Invested in capital assets – Capital assets, net of accumulated depreciation.

Unrestricted – Net assets not subject to externally imposed restrictions which may be used to meet current obligations for any purpose or designated for specific purposes by action of management.

(2) Deposits

The ICN's deposits with the Treasurer of State of \$9,529,245 at June 30, 2006 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds. All interest on investments in the Treasurer of State's investment pool is retained in the fund holding the cash balance.

(3) Accounts Receivable

Receivables at June 30, 2006 consisted of the following:

Accounts receivable	\$ 1,643,567
Less allowance for doubtful accounts	(95,171)
Accounts receivable, net	<u>\$ 1,548,396</u>

(4) Capital Assets

Capital assets activity for the year ended June 30, 2006 is as follows:

	Balance Beginning of Year	Increases	Decreases	Balance End of Year
Capital assets not being depreciated:				
Construction in progress	\$ 442,938	52,988	378,938	116,988
Capital assets being depreciated:				
Equipment	70,437,992	2,491,680	855,965	72,073,707
Fiber optic cable	62,801,669	434,917	-	63,236,586
Total capital assets being depreciated	133,239,661	2,926,597	855,965	135,310,293
Less accumulated depreciation for:				
Equipment	(51,810,220)	4,830,159	769,845	(55,870,534)
Fiber optic cable	(35,981,409)	3,405,070	-	(39,386,479)
Total accumulated depreciation	(87,791,629)	8,235,229	769,845	(95,257,013)
Total capital assets being depreciated, net	45,448,032	(5,308,632)	86,120	40,053,280
Total capital assets, net	\$ 45,890,970	(5,255,644)	465,058	40,170,268

(5) Pension and Retirement Benefits

The ICN contributes to the Iowa Public Employees Retirement System (IPERS), which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.70% of their annual covered salary and the ICN is required to contribute 5.75% of annual covered payroll for the years ended June 30, 2006, 2005 and 2004. Contribution requirements are established by state statute. The ICN's contributions to IPERS for the years ended June 30, 2006, 2005 and 2004 were \$332,433, 338,719 and \$323,100, respectively, equal to the required contributions for each year.

(6) Risk Management

State employee benefits for health, dental, long-term disability and life insurance coverage are insured through commercial insurers. There were no significant reductions in insurance coverage for the prior year and settlements have not exceeded coverage for the past three fiscal years.

The State of Iowa self-insures on behalf of its agencies for losses related to workers' compensation, its motor vehicle fleet, property damage and torts. A contingent fund exists under Section 29C.20 of the Code of Iowa to provide compensation for loss or damage to state property (casualty losses).

Iowa Communications Network

Supplementary Information

Schedule 1

Iowa Communications Network
Schedule of Operating Revenues and Expenses
Year ended June 30, 2006

Operating revenues:	
Sales, rents and services:	
Video services	\$ 5,518,043
Voice services	10,073,674
Data services	16,735,489
Equipment sales	28,221
Installation fees	1,518,868
Other revenues	110,520
Total operating revenues	<u>33,984,815</u>
Less: bad debt expense	(48,148)
Net operating revenues	<u>33,936,667</u>
Operating expenses:	
Direct expenses:	
Voice costs	4,522,494
Data costs	7,224,711
Video costs	962,380
Installation costs	616,851
Total direct expenses	<u>13,326,436</u>
Depreciation expense	<u>8,235,229</u>
Other operating expenses:	
Network equipment	561,653
System maintenance	6,700,813
Outside plant costs	1,040,840
System utility costs	110,705
System repair costs	128,777
Other system costs	66,264
Network installation costs	864,601
Loss on disposal of capital assets and inventory	254,624
Total other operating expenses	<u>9,728,277</u>
General and administrative expenses:	
Personnel	7,628,693
Travel	171,546
Administrative services	203,067
Professional fees	182,601
Other general and administrative	184,086
Total general and administrative expenses	<u>8,369,993</u>
Total operating expenses	<u>39,659,935</u>
Operating loss	<u>\$ (5,723,268)</u>

See accompanying independent auditor's report.



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

David A. Vaudt, CPA
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Independent Auditor's Report on Internal Control
over Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance with
Government Auditing Standards

To the Members of the Iowa Telecommunications
and Technology Commission:

We have audited the financial statements of the Iowa Communications Network (ICN) as of and for the year ended June 30, 2006, and have issued our report thereon dated March 9, 2007. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the ICN's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the ICN's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying Schedule of Findings.

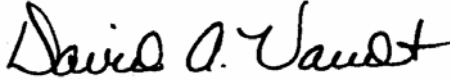
A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe the reportable conditions described in the accompanying Schedule of Findings are material weaknesses.

Compliance and Other Matters

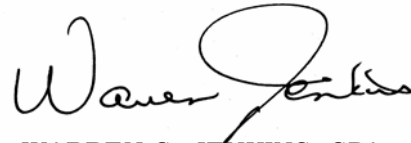
As part of obtaining reasonable assurance about whether the ICN's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance that are required to be reported under Government Auditing Standards.

This report, a public record by law, is intended solely for the information and use of the officials and employees of the Iowa Communications Network, citizens of the State of Iowa and other parties to whom the Iowa Communications Network may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the Iowa Communications Network during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.



DAVID A. VAUDT, CPA
Auditor of State



WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

March 9, 2007

Iowa Communication Network

Schedule of Findings

Year ended June 30, 2006

Findings Related to the Financial Statements:

REPORTABLE CONDITIONS:

- 1) Written Policies – The ICN’s capitalization policy identifies network assets as any location, equipment, fiber or parts purchased and used to enhance, maintain or expand the functionality, capacity and capability of the ICN’s communications network and services. These assets are used to provide telecommunication services to the ICN’s users.

The capitalization policy does not address certain areas related to ICN’s accounting of capital assets, such as:

- procedures for the depreciation method used for consolidated entries, as well as the effect of a deletion or transfer of individual items within the consolidated entry, and
- procedures for determining obsolete items.

Recommendation – The ICN should expand its capitalization policy to address the areas identified above.

Response – The ICN will modify its capitalization policy to include the procedures for depreciation of, as well as, the effect of deletion or transfer of individual items within the consolidation entry. The ICN will add to its capitalization policy the procedures for determining obsolete items.

Conclusion – Response accepted.

- 2) Segregation of Duties – Inventory – During our review of internal control, the existing procedures are evaluated in order to determine incompatible duties, from a control standpoint, are not performed by the same employee. This segregation of duties helps to prevent losses from employee error or dishonesty and, therefore, maximizes the accuracy of the ICN’s financial statements. ICN maintains an inventory for routine maintenance, repair and replacement of network equipment. The employees responsible for maintaining and updating inventory records are also responsible for performing test counts which are used to adjust the inventory records.

Recommendation – The ICN should establish adequate segregation of duties to ensure inventory counts are verified by persons independent of those in charge of the inventory records.

Response – The ICN will establish segregation of duties to the level possible with the limited number of employees we have. The ICN has taken steps to segregate shipping and receiving duties of inventory and will take steps to ensure that inventory counts are verified by persons independent of those in control of inventory records.

Conclusion – Response accepted.

Iowa Communication Network

Schedule of Findings

Year ended June 30, 2006

- 3) Accounts Receivable Reconciliation – An accounts receivable reconciliation between the Access database system and the general ledger is completed on a daily basis by ICN personnel. The Access database system tracks the detail of accounts receivable and billings. The reconciliation ensures the accuracy of billings and adjustments. However, the reconciliation is not independently reviewed and documentation supporting the reconciliation is not retained.

Recommendation – ICN personnel should ensure the accounts receivable reconciliation is reviewed by a person independent of the reconciliation and billings process and supporting documentation to support the reconciliation is retained.

Response – The ICN will ensure the accounts receivable reconciliation is reviewed by a person independent of the reconciliation and billing process and supporting documentation is retained.

Conclusion – Response accepted.

INSTANCE OF NON-COMPLIANCE:

No matters were noted.

Findings Related to Required Statutory Reporting:

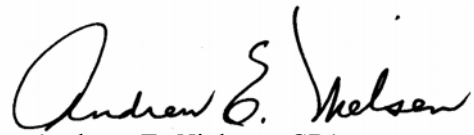
No matters were noted.

Iowa Communications Network

Staff

This audit was performed by:

Suzanne R. Hanft, CPA, Manager
Timothy D. Houlette, CPA, Senior Auditor
Karen L. Kibbe, Assistant Auditor
Marta M. Sobieszkoda, Assistant Auditor
Gelu Sherpa, Assistant Auditor

A handwritten signature in black ink that reads "Andrew E. Nielsen". The signature is written in a cursive style with a large initial 'A' and 'N'.

Andrew E. Nielsen, CPA
Deputy Auditor of State