



**OFFICE OF AUDITOR OF STATE**  
**STATE OF IOWA**

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Auditor of State

State Capitol Building  
Des Moines, Iowa 50319-0004

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**NEWS RELEASE**

FOR RELEASE

July 14, 2006

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, 2005. 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 \$48,682,416 for the year ended June 30, 2005, a 3% decrease from the prior year. The revenues included sales, rents and services of \$36,131,363, non-capital appropriations of \$422,212, capital appropriations of \$11,415,000, capital contributions of \$204,819 and investment income of \$509,022. Expenses for the year ended June 30, 2005 totaled \$44,683,732, a less than 1% decrease from the prior year. Expenses included \$14,821,769 for direct expenses, \$9,780,677 for depreciation, \$10,320,347 for other operating expenses, \$8,056,280 for general and administrative expenses and \$1,056,502 for interest expense.

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, 2005**

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## Iowa Communications Network

### Officials

<u>Name</u>	<u>Title</u>
	<b>State</b>
Honorable Thomas J. Vilsack	Governor
Michael L. Tramontina	Director, Department of Management
Dennis C. Prouty	Director, Legislative Services Agency

### Iowa Telecommunications and Technology Commission

		<u>Term Expires</u>
Betsy Brandsgard	Chairperson	Apr 2006
Curtis Stamp	Commission Member	(Resigned)
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	Executive Director	
Denise Sturm, CPA	Finance Director	(Resigned)

**Iowa Communications Network**



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Auditor of State

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Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

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, 2005, 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 basic 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.

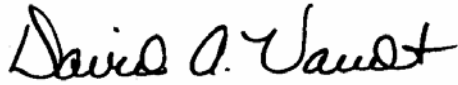
As discussed in Note 1, the financial statements of the Iowa Communications Network are intended to present the financial position and the changes in financial position and cash flows of only that portion of the financial reporting entity of the State of Iowa that is attributable to the transactions 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, 2005, 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, 2005, 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.

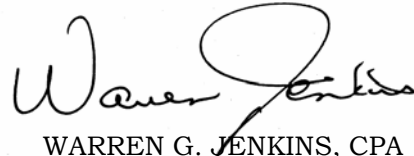
In accordance with Government Auditing Standards, we have also issued our report dated March 23, 2006 on our consideration of the Iowa Communications Network's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. 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 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 23, 2006

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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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, 2005. 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 2005.

- ICN operating revenues were \$36.1 million.
- Part III appropriations were transferred to the Iowa Department of Education.
- During fiscal year 2005, the ICN retired the outstanding Certificates of Participation early, saving \$1.3 million in future interest payments.
- The ICN delivered 278,467 hours of full-motion, interactive video to its authorized users in FY 2005. Since ICN's inception in 1993, it has delivered approximately 2.4 million hours of 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 2005.

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, cash flows from capital and related financing activities and cash flows from investing 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 FY05 ending cash and cash equivalents balance.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the 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 \$60.8 million at the end of 2005, compared to \$92.5 million at the end of the previous year. The decrease is due to the expenditure of the debt reserve funds to retire the outstanding debt. Unrestricted net assets represent assets used to meet the ICN's ongoing obligations to vendors and creditors. Unrestricted net assets decreased significantly from fiscal year 2004 to fiscal year 2005. Net assets invested in capital assets increased by \$28.4 million from fiscal year 2004. This change is primarily due to the acquisition and construction of capital assets, the decrease in depreciation expense and the retirement of capital debt.

	<u>June 30,</u>	
	<u>2005</u>	<u>2004</u>
<b>Assets</b>		
Current and other assets	\$ 14,908,014	38,722,995
Capital assets	45,890,970	53,776,469
<b>Total assets</b>	<u>60,798,984</u>	<u>92,499,464</u>
<b>Liabilities</b>		
Current liabilities	5,465,511	16,302,452
Noncurrent liabilities	-	24,862,222
<b>Total liabilities</b>	<u>5,465,511</u>	<u>41,164,674</u>
<b>Net Assets</b>		
Net assets:		
Invested in capital assets	45,890,970	17,499,247
Unrestricted	9,442,503	33,835,542
<b>Total net assets</b>	<u>\$ 55,333,473</u>	<u>51,334,789</u>

The next schedule helps to highlight the activity for fiscal year 2005 compared to fiscal year 2004.

	Year ended June 30,	
	2005	2004
<b>Operating revenues:</b>		
Sales, rents and services	\$ 36,131,363	33,328,703
<b>Operating expenses:</b>		
Direct expenses	14,821,769	13,690,778
Depreciation expense	9,780,677	10,111,340
Other operating expenses	10,320,347	10,624,016
General and administrative expenses	8,056,280	7,844,926
<b>Total operating expenses</b>	<b>42,979,073</b>	<b>42,271,060</b>
<b>Operating loss</b>	<b>(6,847,710)</b>	<b>(8,942,357)</b>
<b>Non-operating revenues (expenses):</b>		
Non-capital appropriations from the State of Iowa	422,212	4,774,745
Investment income	509,022	721,551
Interest expense	(1,056,502)	(2,390,744)
Amortization expense	(172,778)	(218,521)
Other expense	(475,379)	-
<b>Net non-operating revenues</b>	<b>(773,425)</b>	<b>2,887,031</b>
<b>Loss before other revenues</b>	<b>(7,621,135)</b>	<b>(6,055,326)</b>
Capital appropriations from the State of Iowa	11,415,000	10,762,103
Capital contributions	204,819	434,000
<b>Increase in net assets</b>	<b>3,998,684</b>	<b>5,140,777</b>
<b>Net assets beginning of year</b>	<b>51,334,789</b>	<b>46,194,012</b>
<b>Net assets end of year</b>	<b>\$ 55,333,473</b>	<b>51,334,789</b>

The ICN's sales for fiscal year 2005 were up 8.4 percent at \$36.1 million compared to \$33.3 million for fiscal year 2004. Data services provided the ICN with just over \$17.0 million in sales while voice services provided the ICN with \$9.7 million in sales.

The ICN's largest individual expense is depreciation expense, which accounts for 22.8% of all operating expenses. Depreciation expense is followed by personnel expense of 17.6%, data costs of 17.6%, system maintenance costs of 16.4%, voice costs of 10.9%, installation costs of 3.4% and video costs of 2.5% of all operating expenses. Operating expense is shown in detail on page 22.

#### **CAPITAL ASSETS AND DEBT ADMINISTRATION**

The ICN's investment in capital assets for its business activities at June 30, 2005 was \$133.7 million, with accumulated depreciation of \$87.8 million, leaving a net book value of \$45.9 million. This investment in capital assets includes equipment and fiber optic cable, with 47.1% 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.

The remaining certificates of participation were retired March 1, 2005. Had the certificates been paid at maturity in fiscal year 2007, an additional \$1.3 million of interest would have been paid. More detailed information about ICN's long-term liabilities is presented in Note 5 to the financial statements.

## **ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

ICN's management considered many factors when setting the fiscal year 2006 budget. Management anticipates most product sales to remain steady through fiscal year 2006, with the exception of voice which was 14.0% lower than the previous year forecast. This forecast should result in little or no change in ICN revenue for fiscal year 2006.

ICN's forecast for fiscal year 2006 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 request for funding be delayed. The ICN has been providing video services to schools and libraries who are dependant on this funding to pay ICN for these services. ICN's 2006 revenues from USAC for the support of video services to schools and libraries are estimated at \$2.5 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, 2005

**Assets**

## Current assets:

Cash and cash equivalents (note 2)	\$ 7,866,744
Accounts receivable, net (note 3)	2,750,664
Due from other state agencies	3,231,434
Inventory	475,239
<b>Total current assets</b>	<u>14,324,081</u>

## Noncurrent assets:

Capital assets - non depreciable, (note 4)	442,938
Capital assets - depreciable, net (note 4)	45,448,032
Prepaid expense	583,933
<b>Total noncurrent assets</b>	<u>46,474,903</u>

**Total assets**60,798,984**Liabilities**

## Current liabilities:

Accounts payable	2,908,246
Due to other state agencies	1,696,783
Deferred revenue	324,678
Compensated absences	535,804
<b>Total liabilities</b>	<u>5,465,511</u>

**Net Assets**

Invested in capital assets	45,890,970
Unrestricted	9,442,503
<b>Total net assets</b>	<u>\$ 55,333,473</u>

See notes to financial statements.

**Exhibit B**

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Iowa Communications Network  
Statement of Revenues, Expenses and  
Changes in Fund Net Assets

Year ended June 30, 2005

Operating revenues:	
Sales, rents and services	\$ 36,131,363
Operating expenses:	
Direct expenses	14,821,769
Depreciation expense	9,780,677
Other operating expenses	10,320,347
General and administrative expenses	8,056,280
Total operating expenses	<u>42,979,073</u>
Operating loss	<u>(6,847,710)</u>
Non-operating revenues (expenses):	
Non-capital appropriations from the State of Iowa	422,212
Investment income	509,022
Interest expense	(1,056,502)
Amortization expense	(172,778)
Other expense	(475,379)
Net non-operating expenses	<u>(773,425)</u>
Loss before other revenues	<u>(7,621,135)</u>
Capital appropriations from the State of Iowa	11,415,000
Capital contributions	204,819
Total other revenues	<u>11,619,819</u>
Increase in net assets	3,998,684
Net assets beginning of year	<u>51,334,789</u>
Net assets end of year	<u>\$ 55,333,473</u>

See notes to financial statements.

Iowa Communications Network

Statement of Cash Flows

Year ended June 30, 2005

Cash flows from operating activities:	
Cash received from customers	\$ 33,742,522
Cash paid for goods and services	(22,186,801)
Cash paid for salaries and benefits	(7,586,376)
Net cash provided by operating activities	<u>3,969,345</u>
Cash flows from non-capital financing activities:	
State appropriations	<u>422,212</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(2,705,906)
Interest paid	(2,208,680)
Principal paid on capital debt	(36,450,000)
State appropriations	11,415,000
Capital contributions	204,819
Other	(38,702)
Net cash used by capital and related financing activities	<u>(29,783,469)</u>
Cash flows from investing activities:	
Interest received on investments	<u>512,110</u>
Net decrease in cash and cash equivalents	(24,879,802)
Cash and cash equivalents beginning of year	<u>32,746,546</u>
Cash and cash equivalents end of year	<u>\$ 7,866,744</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	<u>\$ (6,847,710)</u>
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation expense	9,780,677
Loss on disposal of capital assets and inventory	810,728
(Increase) in accounts receivable	(1,238,951)
(Increase) in due from other state agencies	(1,219,600)
Decrease in inventory	864,300
Decrease in prepaid expense	89,664
Increase in deferred revenue	69,710
Increase in accounts payable	52,494
Increase in due to other state agencies	1,610,180
(Decrease) in compensated absences	(2,147)
Total adjustments	<u>10,817,055</u>
Net cash provided by operating activities	<u>\$ 3,969,345</u>

See notes to financial statements.



Iowa Communications Network

Notes to Financial Statements

June 30, 2005

**(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, 2005.

Net Assets

The ICN classifies net assets in the following categories:

Invested in capital assets – Consists of 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 \$7,866,744 at June 30, 2005 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, 2005 consisted of the following:

Accounts receivable	\$ 2,808,475
Less allowance for doubtful accounts	(57,811)
Accounts receivable, net	<u>\$ 2,750,664</u>

**(4) Capital Assets**

Capital assets activity for the year ended June 30, 2005 is as follows:

	Balance Beginning of Year	Increases	Decreases	Balance End of Year
Capital assets not being depreciated:				
Construction in progress	\$ 1,506,628	72,500	1,136,190	442,938
Capital assets being depreciated:				
Equipment	105,862,459	3,522,344	38,946,811	70,437,992
Fiber optic cable	62,734,069	67,600	-	62,801,669
Total capital assets being depreciated	168,596,528	3,589,944	38,946,811	133,239,661
Less accumulated depreciation for:				
Equipment	(83,472,865)	6,653,090	38,315,735	(51,810,220)
Fiber optic cable	(32,853,822)	3,127,587	-	(35,981,409)
Total accumulated depreciation	(116,326,687)	9,780,677	38,315,735	(87,791,629)
Total capital assets being depreciated, net	52,269,841	(6,190,733)	631,076	45,448,032
Total capital assets, net	\$ 53,776,469	(6,118,233)	1,767,266	45,890,970

**(5) Certificates of Participation**

A summary of changes in certificates of participation for the year ended June 30, 2005 is as follows:

Balance Beginning of Year	Remaining Unamortized Discounts	Deductions	Balance End of Year
\$ 36,277,222	172,778	36,450,000	-

The Iowa Department of General Services, on behalf of the State of Iowa, sold certificates of participation for the ICN with a face value of \$114,530,000 during fiscal years 1992 and 1993. The certificates of participation represent an ownership interest of the certificate holders in a lease purchase agreement. The principal on these certificates were called on March 1, 2005 and the certificates were redeemed in their entirety by June 30, 2005.

**(6) 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, 2005, 2004 and 2003. Contribution requirements are established by state statute. The ICN's contributions to IPERS for the years ended June 30, 2005, 2004 and 2003 were \$338,719, \$323,100 and \$298,747, respectively, equal to the required contributions for each year.

**(7) 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).

**Supplementary Information**

**Schedule 1**

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Iowa Communications Network  
Schedule of Operating Revenues and Expenses  
Year ended June 30, 2005

Operating revenues:	
Sales, rents and services:	
Video services	\$ 5,851,676
Voice services	9,651,625
Data services	17,020,086
Equipment sales	29,643
Installation fees	3,392,302
Other revenues, including \$149,961 recovery of bad debt	186,031
Total operating revenues	<u>36,131,363</u>
Operating expenses:	
Direct expenses:	
Voice costs	4,700,482
Data costs	7,575,323
Video costs	1,072,152
Installation costs	1,473,812
Total direct expenses	<u>14,821,769</u>
Depreciation expense	<u>9,780,677</u>
Other operating expenses:	
Network equipment	654,043
System maintenance	7,028,665
Outside plant costs	871,072
System utility costs	114,229
System repair costs	151,510
Other system costs	72,080
Network installation costs	618,020
Loss on disposal of capital assets and inventory	810,728
Total other operating expenses	<u>10,320,347</u>
General and administrative expenses:	
Personnel	7,584,229
Travel	106,744
Administrative services	147,892
Professional fees	102,722
Other general and administrative	114,693
Total general and administrative expenses	<u>8,056,280</u>
Total operating expenses	<u>42,979,073</u>
Operating loss	<u><u>\$ (6,847,710)</u></u>

See accompanying independent auditor's report.



**OFFICE OF AUDITOR OF STATE**  
**STATE OF IOWA**

David A. Vaudt, CPA  
Auditor of State

State Capitol Building  
Des Moines, Iowa 50319-0004

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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, 2005, and have issued our report thereon dated March 23, 2006. 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.

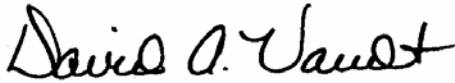
Compliance and Other Matters

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 23, 2006

Iowa Communication Network

Schedule of Findings

Year ended June 30, 2005

**Findings Related to the Financial Statements:**

**INSTANCE OF NON-COMPLIANCE:**

No matters were noted.

**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 adjustment to the accounting records when assets are transferred between inventory and capital assets,
- 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 expand our capitalization policy to include procedures for adjusting the accounting records for the transfer between capital assets and inventory, the procedures for reconciling the effect of removal of items from asset sites and their effect on the consolidated asset entries. In addition the ICN will include in the capitalization policy the procedures for determining obsolete items.

Conclusion – Response accepted.

- 2) Account Review – The following misstatements were identified during the audit of the ICN’s fiscal year 2005 financial statements:

- An account used by the ICN to record discounts given to libraries and the Department of Education for school districts was misstated by \$203,746.
- An incorrect accounts payable amount of \$70,181 was recorded.
- An accounts receivable amount of \$1,482,681 was not properly recorded.
- Journal entries were inadvertently duplicated in the amount of \$166,923.

As a result of the identification of the misstatements identified above, adjustments were made by ICN to these accounts.

Recommendation – The ICN should establish procedures to ensure accounts are reviewed for accuracy and proper presentation.

Iowa Communication Network

Schedule of Findings

Year ended June 30, 2005

Response – The ICN will implement steps to review journal entries and account balances as outlined in the ICN general ledger procedures document to catch misstated and incorrectly recorded accounts receivable and accounts payable entries. ICN asset and liability accounts will be reviewed on a monthly basis to ensure the accuracy of the information recorded.

Conclusion - Response accepted.

**Findings Related to Required Statutory Reporting:**

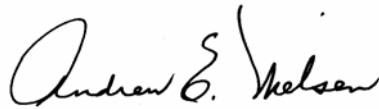
No matters were noted.

Iowa Communications Network

Staff

This audit was performed by:

Suzanne R. Hanft, CPA, Manager  
Timothy D. Houlette, CPA, Senior Auditor  
Jedd D. Moore, Staff Auditor  
Ryan J. Sisson, Assistant Auditor  
Karen L. Kibbe, Assistant Auditor  
Marta M. Sobieszkoda, Assistant Auditor  
Janet M. Tiefenthaler, 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