



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

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Auditor of State

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Des Moines, Iowa 50319-0004

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NEWS RELEASE

FOR RELEASE June 10, 2005

Contact: Andy Nielsen
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Auditor of State David A. Vaudt today released an audit report on the Iowa Communications Network (ICN) for the year ended June 30, 2004. 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 \$50,021,102 for the year ended June 30, 2004. The revenues included sales, rents and services of \$33,328,703, non-capital appropriations of \$4,774,745, capital appropriations of \$10,762,103, capital contributions of \$434,000 and investment income of \$721,551. Expenses for the year ended June 30, 2004 totaled \$44,880,325, and included \$13,690,778 for direct expenses, \$10,111,340 for depreciation, \$10,624,016 for other operating expenses, \$7,844,926 for general and administrative expenses and \$2,390,744 for interest expense.

Vaudt recommended the Iowa Communications Network continue to improve controls over inventory and capital assets.

A copy of the audit report is available for review in the Office of Auditor of State.

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IOWA COMMUNICATIONS NETWORK
INDEPENDENT AUDITOR'S REPORTS
BASIC FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS
JUNE 30, 2004

Table of Contents

	<u>Page</u>
Officials	3
Independent Auditor's Report	5-6
Management's Discussion and Analysis	7-10
Basic Financial Statements:	<u>Exhibit</u>
Statement of Net Assets	A 13
Statement of Revenues, Expenses and Changes in Fund Net Assets	B 14
Statement of Cash Flows	C 15
Notes to Financial Statements	16-20
Supplementary Information:	<u>Schedule</u>
Schedule of Operating Revenues and Expenses	1 22
Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting	23-24
Schedule of Findings	25-26
Staff	27

Iowa Communications Network

Officials

<u>Name</u>	<u>Title</u>
	State
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
Mary A. Nelson	Commission Member	Apr 2004
Mark J. Schouten	Commission Member	Resigned
Timothy L. Lapointe	Commission Member	Apr 2005
Robert R. Hardman	Commission Member	Apr 2008
Pamela A. Duffy (Appointed)	Commission Member	Apr 2010
David A. Vaudt, CPA	Non-Voting Ex-Officio Commission Member	Indefinite

Agency

John Gillispie	Executive Director
Denise Sturm, CPA	Finance Director

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, 2004, 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, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions 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, 2004, 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, 2004, 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 included our report dated March 28, 2005 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 and contracts. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering 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. We did not audit the information and express no opinion thereon.

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 28, 2005

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, 2004. 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 2004.

- ICN operating revenues were \$33.0 million, including \$488 thousand in General Fund dollars to operate video. As in the previous years, ICN's reliance on the State General Fund continues to decrease.
- Part III appropriations were \$2.7 million and covered the payment for the related fiber leases and equipment maintenance.
- The ICN delivered 271,000 hours of full-motion, interactive video to its authorized users in FY 2004. Since ICN's inception in 1993, it has delivered approximately 2.1 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 2004.

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 FY04 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 \$92.5 million at the end of 2004, compared to \$98.1 million at the end of the previous year. Unrestricted net assets represent assets used to meet the ICN's ongoing obligations to vendors and creditors. Unrestricted net assets did not significantly change from fiscal year 2003 to fiscal year 2004. Net assets invested in capital assets, net of related debt increased by \$5.1 million from fiscal year 2003. This change is primarily due to the acquisition and construction of capital assets, the decrease in depreciation expense and the retirement of capital debt.

	June 30,	
	2004	2003
Assets		
Current and other assets	\$ 38,722,995	38,833,831
Capital assets	53,776,469	59,301,764
Total assets	92,499,464	98,135,595
Liabilities		
Current liabilities	16,302,452	15,750,749
Noncurrent liabilities	24,862,222	36,190,833
Total liabilities	41,164,674	51,941,582
Net Assets		
Net assets:		
Invested in capital assets, net of related debt	17,499,247	12,365,931
Unrestricted	33,835,542	33,828,081
Total net assets	\$ 51,334,789	46,194,012

The next schedule helps to highlight the activity for fiscal year 2004 compared to fiscal year 2003.

	Year ended June 30,	
	2004	2003
Statement of Revenues, Expenses and Changes in Fund Net Assets:		
Operating revenues:		
Sales, rents and services	\$ 33,328,703	31,982,299
Operating expenses:		
Direct expenses	13,690,778	14,935,868
Depreciation expense	10,111,340	11,289,596
Other operating expenses	10,624,016	10,301,414
General and administrative expenses	7,844,926	7,831,555
Total operating expenses	42,271,060	44,358,433
Operating loss	(8,942,357)	(12,376,134)
Non-operating revenues (expenses):		
Non-capital appropriations from the State of Iowa	4,774,745	5,613,360
Investment income	721,551	746,850
Interest expense	(2,390,744)	(3,066,152)
Amortization expense	(218,521)	(218,521)
Net non-operating revenues	2,887,031	3,075,537
Loss before other revenues	(6,055,326)	(9,300,597)
Capital appropriations from the State of Iowa	10,762,103	15,125,000
Capital contributions	434,000	-
Increase in net assets	5,140,777	5,824,403
Net assets beginning of year	46,194,012	40,369,609
Net assets end of year	\$ 51,334,789	46,194,012

The ICN's sales for fiscal year 2004 were up 4.2 percent at \$33.3 million compared to \$32.0 million for fiscal year 2003. Data services provided the ICN with just under \$14.0 million in sales while voice services provided the ICN with \$10.5 million in sales. The ICN's video subsidy from the State's General Fund was \$487,500.

The ICN's largest individual expense is depreciation expense, which accounts for 24.0% of all expenses. Depreciation expense is followed by personnel expense of 17.0%, system maintenance costs of 16.8%, data costs of 13.9%, voice costs of 11.2% and video costs of 6.3% of all expenses.

CAPITAL ASSETS AND DEBT ADMINISTRATION

The ICN's investment in capital assets for its business-type activities at June 30, 2004 was \$170.1 million, with accumulated depreciation of \$116.3 million, leaving a net book value of \$53.8 million. This investment in capital assets includes equipment and fiber optic cable, with a major portion (55.6%) of the assets invested in cable. This 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.

At June 30, 2004, the ICN had approximately \$36 million in certificates of participation outstanding compared to approximately \$47 million at June 30, 2003. The certificates of participation were extinguished March 1, 2005 for \$25.3 million for a savings of \$1.3 million had the certificates been allowed to mature. 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 2005 fiscal year budget. Management anticipates most product sales to remain steady through fiscal year 2005. Also, ICN's video subsidy from the State General Fund will be discontinued in FY 2005. This forecast should result in little or no change in ICN revenue for fiscal year 2005.

ICN's forecast for fiscal year 2005 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 2005 revenues from USAC for the support of video services to schools and libraries are estimated at \$3.9 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, 2004

Assets

Current assets:

Cash and cash equivalents (note 2)	\$ 32,746,546
Accounts receivable, net (note 3)	1,511,713
Interest receivable	3,088
Due from other state agencies	2,011,834
Inventory	1,339,539
Total current assets	<u>37,612,720</u>

Noncurrent assets:

Capital assets, net (note 4)	53,776,469
Prepaid expense	673,597
Debt issuance costs	436,678
Total noncurrent assets	<u>54,886,744</u>

Total assets92,499,464**Liabilities**

Current liabilities:

Accounts payable	2,855,752
Due to other state agencies	86,603
Deferred revenue	254,968
Interest payable	1,152,178
Compensated absences	537,951
Certificates of participation (note 5)	11,415,000
Total current liabilities	<u>16,302,452</u>

Noncurrent liabilities:

Certificates of participation (note 5)	<u>24,862,222</u>
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Total liabilities41,164,674**Net Assets**

Invested in capital assets, net of related debt	17,499,247
Unrestricted	33,835,542
Total net assets	<u>\$ 51,334,789</u>

See notes to financial statements.

Exhibit B

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

Year ended June 30, 2004

Operating revenues:	
Sales, rents and services (includes video subsidization of \$487,500)	<u>\$ 33,328,703</u>
Operating expenses:	
Direct expenses	13,690,778
Depreciation expense	10,111,340
Other operating expenses	10,624,016
General and administrative expenses	<u>7,844,926</u>
Total operating expenses	<u>42,271,060</u>
Operating loss	<u>(8,942,357)</u>
Non-operating revenues (expenses):	
Non-capital appropriations from the State of Iowa	4,774,745
Investment income	721,551
Interest expense	(2,390,744)
Amortization expense	<u>(218,521)</u>
Net non-operating revenues	<u>2,887,031</u>
Loss before other revenues	<u>(6,055,326)</u>
Capital appropriations from the State of Iowa	10,762,103
Capital contributions	434,000
Total other revenues	<u>11,196,103</u>
Increase in net assets	5,140,777
Net assets beginning of year	<u>46,194,012</u>
Net assets end of year	<u><u>\$ 51,334,789</u></u>

See notes to financial statements.

Iowa Communications Network

Statement of Cash Flows

Year ended June 30, 2004

Cash flows from operating activities:	
Cash received from customers	\$ 32,755,904
Cash paid for goods and services	(21,955,435)
Cash paid for salaries and benefits	(7,166,303)
Net cash provided by operating activities	<u>3,634,166</u>
Cash flows from non-capital financing activities:	
State appropriations	<u>4,774,745</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(5,127,616)
Interest paid	(2,642,057)
Principal paid on capital debt	(10,745,000)
State appropriations	22,623,565
Capital contributions	434,000
Net cash provided by capital and related financing activities	<u>4,542,892</u>
Cash flows from investing activities:	
Interest received on investments	<u>721,503</u>
Net increase in cash and cash equivalents	13,673,306
Cash and cash equivalents beginning of year	<u>19,073,240</u>
Cash and cash equivalents end of year	<u>\$ 32,746,546</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	<u>\$ (8,942,357)</u>
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation expense	10,111,340
Loss on disposal of capital assets and inventory	541,571
(Increase) in accounts receivable	(357,974)
(Increase) in due from other state agencies	(198,089)
Decrease in inventory	2,043,802
Decrease in prepaid expense	216,467
(Decrease) in deferred revenue	(16,736)
Increase in accounts payable	221,457
(Decrease) in due to other state agencies	(18,389)
Increase in compensated absences	33,074
Total adjustments	<u>12,576,523</u>
Net cash provided by operating activities	<u>\$ 3,634,166</u>

See notes to financial statements.

Iowa Communications Network

Notes to Financial Statements

June 30, 2004

(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 their statement of net assets. Their 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, except for the cash invested at Wells Fargo Bank Iowa, N.A. for payment of debt.

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 extend 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, 2004.

Noncurrent Liabilities/Debt Issuance Costs

Noncurrent debt and other obligations are reported as liabilities in the Enterprise Fund. Certificates of participation (COPS) premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the COPS using the straight-line method, which approximates the effective interest method. COPS are reported net of the applicable premium or discount.

Net Assets

The ICN classifies net assets in the following categories:

Invested in capital assets, net of related debt – Capital assets, net of accumulated depreciation and outstanding debt attributable to the acquisition, construction or improvement of those assets.

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.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

(2) Deposits

The ICN's deposits with the Treasurer of State of \$6,398,488 and the Trustee – Wells Fargo Bank Iowa, N.A. of \$26,348,058 at June 30, 2004 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, 2004 consisted of the following:

Accounts receivable	\$ 1,681,744
Less allowance for doubtful accounts	<u>(170,031)</u>
Accounts receivable, net	<u><u>\$ 1,511,713</u></u>

(4) Capital Assets

Capital assets activity for the year ended June 30, 2004 is as follows:

	Balance Beginning of Year	Increases	Decreases	Balance End of Year
Capital assets not being depreciated:				
Construction in progress	\$ 364,838	1,170,590	28,800	1,506,628
Capital assets being depreciated:				
Equipment	105,583,358	4,305,926	4,026,825	105,862,459
Fiber optic cable	62,644,806	89,263	-	62,734,069
Total capital assets being depreciated	168,228,164	4,395,189	4,026,825	168,596,528
Less accumulated depreciation for:				
Equipment	(79,570,028)	6,978,728	3,075,891	(83,472,865)
Fiber optic cable	(29,721,210)	3,132,612	-	(32,853,822)
Total accumulated depreciation	(109,291,238)	10,111,340	3,075,891	(116,326,687)
Total capital assets being depreciated, net	58,936,926	(5,716,151)	950,934	52,269,841
Total capital assets, net	<u>\$ 59,301,764</u>	<u>(4,545,561)</u>	<u>979,734</u>	<u>53,776,469</u>

(5) Long-term Liabilities

A summary of changes in long-term liabilities for the year ended June 30, 2004 is as follows:

	Balance Beginning of Year	Additions (Current Year Amortization)	Deductions	Balance End of Year	Current Portion
Certificates of participation	\$ 46,935,833	86,389	10,745,000	36,277,222	11,415,000

Certificates of Participation

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 certificates mature over the next 3 years with interest rates ranging from 3.65% to 6.50%. The remaining principal balance at June 30, 2004 was \$36,450,000 and the unamortized discount was \$172,778.

The following is a schedule by year of the future minimum payments required:

Year Ending June 30,	Principal	Interest	Total
2005	\$ 11,415,000	1,944,556	13,359,556
2006	12,135,000	1,201,207	13,336,207
2007	12,900,000	408,829	13,308,829
Total	36,450,000	\$ 3,554,592	40,004,592
Less: Unamortized discount	(172,778)		
Certificates of participation, net	\$ 36,277,222		

During the year ended June 30, 2004, \$10,745,000 of certificates of participation were retired.

(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, 2004, 2003 and 2002. Contribution requirements are established by state statute. The ICN's contributions to IPERS for the years ended June 30, 2004, 2003 and 2002 were \$323,100, \$298,747 and \$299,977, 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).

(8) Subsequent Event

During the fiscal year ending June 30, 2005, the ICN retired the remaining balance of the certificates of participation, resulting in a net savings of approximately \$1.3 million of future interest expense.

Supplementary Information

Schedule 1

Iowa Communications Network
Schedule of Operating Revenues and Expenses
Year ended June 30, 2004

Operating revenues:	
Sales, rents and services:	
Video services	\$ 6,274,643
Video subsidization from the State of Iowa	487,500
Voice services	10,500,688
Data services	13,999,593
Equipment sales	145,394
Installation fees	1,675,437
Other revenues, including \$149,961 recovery of bad debt	245,448
Total operating revenues	<u>33,328,703</u>
Operating expenses:	
Direct expenses:	
Voice costs	4,723,014
Data costs	5,873,291
Video costs	2,674,704
Installation costs	419,769
Total direct expenses	<u>13,690,778</u>
Depreciation expense	<u>10,111,340</u>
Other operating expenses:	
Network equipment	579,542
System maintenance	7,087,901
Outside plant costs	1,168,241
System utility costs	87,433
System repair costs	155,669
Other system costs	72,975
Network installation costs	930,684
Loss on disposal of capital assets and inventory	541,571
Total other operating expenses	<u>10,624,016</u>
General and administrative expenses:	
Personnel	7,199,377
Travel	127,410
Administrative services	87,077
Professional fees	140,051
Rent	1,320
Other general and administrative	289,691
Total general and administrative expenses	<u>7,844,926</u>
Total operating expenses	<u>42,271,060</u>
Operating loss	<u>\$ (8,942,357)</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

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

Independent Auditor's Report on Compliance
and on Internal Control over Financial Reporting

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, 2004, and have issued our report thereon dated March 28, 2005. We conducted our audit in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

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. However, we noted an immaterial instance of non-compliance that is described in the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the ICN's operations for the year ended June 30, 2004 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the ICN. Since our audit was based on tests and samples, not all transactions that might have had impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

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 a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. 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 condition is 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 condition described in the accompanying Schedule of Findings is a material weakness. The prior year reportable condition has not been resolved.

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 28, 2005

Iowa Communication Network

Schedule of Findings

Year ended June 30, 2004

Findings Related to the Financial Statements:

INSTANCE OF NON-COMPLIANCE:

Capital Assets – Chapter 7A.30 of the Code of Iowa requires each Department of the state to keep a written, detailed, up-to-date inventory of all real and personal property belonging to the state. 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 following items were noted:

- The total amount reported for capital assets reconciles to the amount documented in ICN’s general ledger. However, the general ledger amount does not reconcile to the amount reported on the Access database which is used to track the detail of capital assets. An additional \$231,867 is reported on the Access database.
- The ICN utilizes a manual depreciation spreadsheet to support total accumulated depreciation and current year depreciation expense. The total amount reported for accumulated depreciation does not reconcile to the amount documented on the manual depreciation spreadsheet. In addition, the spreadsheet does not contain the detail necessary to support amounts representing increases and decreases in accumulated depreciation during the year.
- The ICN includes amounts representing transfers to and from inventory as increases and decreases to capital assets and accumulated depreciation. Increases and decreases to capital assets and accumulated depreciation should only include newly acquired assets and disposals of capital assets.
- The capitalization policy does not address certain areas related to the accounting of ICN’s capital assets. The policy does not address adjustments made to the accounting records when assets are transferred between inventory and capital assets. The policy also does not address ICN’s consolidating entries, the depreciation method used and the effect of the deletion and transfer of individual items within the consolidating entry.

Recommendation – The ICN should implement procedures to ensure accurate reporting and compliance with the Code of Iowa. Supporting documents should be maintained to ensure accurate reporting of capital asset activity, including increases and decreases. ICN’s capitalization policy should address issues relating to accounting for transfers between capital assets and inventory and consolidating entries.

Response – The ICN has adjusted the general ledger to ensure that the fixed asset balance reconciles to our fixed asset inventory system. Additionally, ICN will take steps to ensure that adequate documentation is maintained to support accumulated depreciation balances and changes in depreciation expense. ICN will adjust its capitalization policy to address the challenges of moving assets between locations and from inventory to capital assets.

Conclusion – Response accepted.

Iowa Communication Network

Schedule of Findings

Year ended June 30, 2004

REPORTABLE CONDITION:

Inventory – The ICN is responsible for maintaining an accurate inventory listing. Supporting documentation for three of twenty-two items could not be located to support the recorded valuation.

Recommendation – The ICN should maintain appropriate documentation to support the recorded valuation of inventory items.

Response – The ICN will take steps to ensure that adequate documentation is maintained that supports valuation of inventory items.

Conclusion – Response accepted.

Findings Related to Required Statutory Reporting:

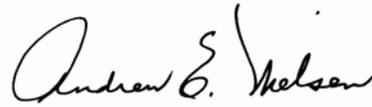
No matters were noted.

Iowa Communications Network

Staff

This audit was performed by:

Suzanne R. Hanft, CPA, Manager
Timothy D. Houlette, CPA, Senior Auditor
Nicole B. Tenges, Staff Auditor
Daniel L. Grady, Assistant Auditor
Donald N. Miksch, Assistant Auditor
Jessica L. Christensen, Assistant Auditor
Karen L. Kibbe, Assistant Auditor
Heather L. Templeton, Staff Auditor

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

Andrew E. Nielsen, CPA
Deputy Auditor of State