



**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

**NEWS RELEASE**

FOR RELEASE October 27, 2006

Contact: Andy Nielsen  
515/281-5834

Auditor of State David A. Vaudt today released an audit report on the Office of Treasurer of State, Iowa Educational Savings Plan Trust (Trust) for the year ended June 30, 2006.

The Trust was created by the General Assembly under Chapter 12D of the Code of Iowa to encourage and make possible the attainment of higher education by the greatest number of citizens of the state. The purpose of the Trust is to allow U.S. citizens to invest money for future payment of higher education costs for designated beneficiaries. At June 30, 2006, the Trust had 63,946 participants and 105,256 beneficiaries.

Vaudt reported additions totaling \$389,157,244 for the year, a 21% increase over the prior year. Additions included \$279,194,953 of contributions from participants, \$512,652 of administrative fees, investment income of \$56,794, and a net increase in fair value of investments of \$109,392,845. The increase in additions was the result of increased contributions from participants and the net change in fair value of investments.

Deductions totaled \$45,900,881, a 64% increase over the prior year, and included \$45,623,274 in distributions to participants and beneficiaries and \$277,607 in administrative expenses. The significant increase in deductions was the result of an increase in distributions to beneficiaries for educational expenses.

A copy of the report is available for review in the Office of Treasurer of State, in the Office of Auditor of State and on the Auditor of State's web site at <http://auditor.iowa.gov/reports/reports.htm>.

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**OFFICE OF TREASURER OF STATE  
IOWA EDUCATIONAL SAVINGS PLAN TRUST**

**INDEPENDENT AUDITOR'S REPORTS  
FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION**

**JUNE 30, 2006**

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**Office of Treasurer of State  
Iowa Educational Savings Plan Trust**

**Officials**

Name

Title

**State**

Honorable Thomas J. Vilsack  
Michael L. Tramontina  
Dennis C. Prouty

Governor  
Director, Department of Management  
Director, Legislative Services Agency

**Agency**

Honorable Michael L. Fitzgerald  
Stefanie G. Devin  
Karen Austin  
Stephen Larson

Treasurer of State  
Deputy  
Deputy  
Deputy

**Office of Treasurer of State  
Iowa Educational Savings Plan Trust**



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Auditor of State

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Independent Auditor's Report

To the Honorable Michael L. Fitzgerald,  
Treasurer of State:

We have audited the accompanying financial statements, listed as exhibits in the table of contents of this report, of the Office of Treasurer of State, Iowa Educational Savings Plan Trust as of and for the year ended June 30, 2006. These financial statements are the responsibility of the Trust'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.

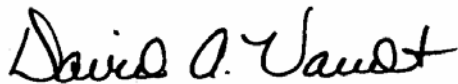
As discussed in Note 1, the financial statements of the Office of Treasurer of State, Iowa Educational Savings Plan Trust are intended to present the financial position and results of operations of only that portion of the financial reporting entity of the State of Iowa attributable to the transactions of the Iowa Educational Savings Plan Trust. 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, where applicable, 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 fiduciary net assets of the Office of Treasurer of State, Iowa Educational Savings Plan Trust at June 30, 2006, and the changes in fiduciary net assets 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 October 6, 2006 on our consideration of the Office of Treasurer of State, Iowa Educational Savings Plan Trust'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 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. Other supplementary information included in Schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in our audit of the aforementioned financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

October 6, 2006



## **Management's Discussion and Analysis**

The Office of Treasurer of State, Iowa Educational Savings Plan Trust (Trust) provides this Management's Discussion and Analysis of the Trust's annual financial statements. This narrative overview and analysis of the financial activities of the Trust is for the fiscal year ended June 30, 2006. We encourage readers to consider this information in conjunction with the Trust's financial statements, which follow this section.

### **USING THESE FINANCIAL STATEMENTS**

This discussion and analysis are intended to serve as an introduction to the Trust's financial statements, which consist of the Statement of Fiduciary Net Assets and the Statement of Changes in Fiduciary Net Assets (pages 10 and 11). They also include the notes to financial statements which begin on page 12. These financial statements provide information about the activities of the Trust as a whole and are based on the flow of economic resources measurement focus and the accrual basis of accounting. The flow of economic resources refers to all of the assets available to the Trust for the purpose of fulfilling its responsibilities to the other parties in the fiduciary relationship.

The financial statements are further described as follows:

The Statement of Fiduciary Net Assets presents the assets, liabilities and net assets of the Trust.

The Statement of Changes in Fiduciary Net Assets summarizes the additions to, deductions from and net increase or decrease in fiduciary net assets for the year.

The notes to financial statements provide additional information essential to a full understanding of the data provided in the financial statements.

### **FINANCIAL ANALYSIS OF THE TRUST**

During fiscal year 2006, the Trust received \$279,194,953 in contributions from participants and distributed \$45,623,274 to participants and beneficiaries.

The Trust's financial activity for the year ended June 30, 2006 resulted in an increase in fiduciary net assets of \$343,256,363.

## Management's Discussion and Analysis

Condensed financial information as of and for the years ended June 30, 2006 and 2005 is as follows:

	June 30, 2006	June 30, 2005
Current assets	\$ 1,467,247,534	\$ 1,123,982,154
Capital assets, net	2,441	7,860
Total assets	1,467,249,975	1,123,990,014
Current liabilities	21,341	17,743
Net assets held for the payment of higher education costs for designated beneficiaries	\$ 1,467,228,634	\$ 1,123,972,271
	Year Ended June 30, 2006	Year Ended June 30, 2005
Additions:		
Contributions	\$ 279,194,953	\$ 247,217,677
Net increase in fair value of investments	109,392,845	74,192,832
Other	569,446	559,252
Total additions	389,157,244	321,969,761
Deductions:		
Distributions	45,623,274	27,629,350
Administrative expenses	277,607	343,861
Total deductions	45,900,881	27,973,211
Net increase	343,256,363	293,996,550
Net assets beginning of year	1,123,972,271	829,975,721
Net assets end of year	\$ 1,467,228,634	\$ 1,123,972,271

The increase in contributions of \$31,977,276 over the prior year is due to more participants joining and saving. The increase in distributions of \$17,993,924 over the prior year is primarily due to beneficiaries withdrawing additional funds for educational expenses (see Schedule 3). The net increase in fair value of investments over the prior year is due to increasing net asset values (NAV) during the year.

### **CONTACTING THE OFFICE OF TREASURER OF STATE – IOWA EDUCATIONAL SAVINGS PLAN TRUST**

This financial report is designed to present users with a general overview of the Trust's finances and to demonstrate the Trust's accountability for the funds held in custody. If you have questions about the report or need additional financial information, please contact the Office of Treasurer of State, State Capitol Building, Des Moines, Iowa 50319.

## **Financial Statements**

**Exhibit A**

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Office of Treasurer of State  
Iowa Educational Savings Plan Trust

## Statement of Fiduciary Net Assets

June 30, 2006

**Assets**

## Current assets:

Cash	\$ 1,456,262
Investments	1,465,787,107
Prepaid expenses	4,165
Total current assets	<u>1,467,247,534</u>

## Noncurrent assets:

Capital assets, net	2,441
Total assets	<u>1,467,249,975</u>

**Liabilities**

Accounts payable	<u>21,341</u>
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**Net assets**

Held for the payment of higher education costs for designated beneficiaries	<u><u>\$ 1,467,228,634</u></u>
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See notes to financial statements.

Office of Treasurer of State  
Iowa Educational Savings Plan Trust

## Statement of Changes in Fiduciary Net Assets

Year ended June 30, 2006

Additions:	
Contributions from participants	\$ 279,194,953
Net increase in fair value of investments	109,392,845
Administrative fees	512,652
Investment income	56,794
Total additions	<u>389,157,244</u>
Deductions:	
Distributions to participants and beneficiaries	45,623,274
Administrative expenses:	
Salaries	91,497
Travel	10,178
Supplies	9,385
Contractual services for outside consultants and independent contractors	6,226
Other contractual services	29,392
Advertising	115,135
Software maintenance	10,375
Depreciation	5,419
Total deductions	<u>45,900,881</u>
Net increase in fiduciary net assets	343,256,363
Net assets beginning of year	<u>1,123,972,271</u>
Net assets end of year	<u>\$ 1,467,228,634</u>

See notes to financial statements.

Office of Treasurer of State  
Iowa Educational Savings Plan Trust

Notes to Financial Statements

June 30, 2006

**(1) Summary of Significant Accounting Policies**

The Iowa Educational Savings Plan Trust (Trust) is a part of the Office of Treasurer of State of Iowa. The Trust was created by the General Assembly under Chapter 12D of the Code of Iowa, with the Treasurer of State as the trustee. The General Assembly finds the general welfare and well-being of the state are directly related to educational levels and skills of the citizens of the state and a vital and valid public purpose is served by the creation and implementation of programs which encourage and make possible the attainment of higher education by the greatest number of citizens of the state.

The purpose of the Trust is to allow participants to invest money for future payment of higher education costs for designated beneficiaries.

The financial statements of the Trust have been prepared in conformity with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board.

A. Reporting Entity

For financial reporting purposes, the Trust has included all funds, organizations, agencies, boards, commissions and authorities. The Trust 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 Trust are such that exclusion would cause the Trust'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 Trust 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 Trust. The Trust has no component units which meet the Governmental Accounting Standards Board criteria.

B. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The Trust is accounted for using the economic resources measurement focus and the accrual basis of accounting. Additions are recorded when earned and deductions are recorded when a liability is incurred, regardless of the timing of related cash flows.

In reporting the financial activity of the Trust, the Trust 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.

The Trust is a fiduciary fund type and is classified as a private purpose trust for financial statement purposes. A private purpose trust is used to report a trust arrangement under which principal and income benefit individuals, private organizations or other governments. The Trust is used to account for resources which may be expended only for higher education costs of designated beneficiaries.

C. Capital Assets

Capital assets are defined by the Trust as assets with initial, individual costs in excess of \$5,000. Such assets are recorded at historical cost. Depreciation of all exhaustible assets is charged as an expense against operations. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Capital assets are depreciated over a five year life.

The cost of normal maintenance and repair that do not add to the value of the asset or materially extend asset lives are not capitalized.

**(2) Deposits and Investments**

The Trust's deposits with the Office of Treasurer of State throughout the period and 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.

The Office of Treasurer of State has an agreement with the Vanguard Group to invest funds for the Iowa Educational Savings Plan Trust in specified investment portfolios. Investments in the Trust are not bank deposits and are not insured by federal depository insurance or any other government agency.

Investments are stated at fair value. The Trust's investments at June 30, 2006 are all invested in portfolios that hold Vanguard mutual funds. Due to the nature of investments in mutual funds, there is no assurance the accounts under the Trust will generate any specific rate of return and there is no assurance the accounts will not decrease in value. Mutual funds are not subject to risk categorization. The Office of Treasurer of State has determined the Trust accounts will initially be invested in the Vanguard portfolios according to the age-based savings track or individual portfolio selected by the participant as follows:

Ages	Savings Track A	Savings Track B	Savings Track C	Savings Track D
Age 5 and younger	Aggressive Growth	Aggressive Growth	Growth	Moderate Growth
Age 6 through 10	Aggressive Growth	Growth	Moderate Growth	Conservative Growth
Age 11 through 15	Growth	Moderate Growth	Conservative Growth	Income
Age 16 through 18	Moderate Growth	Conservative Growth	Income	Conservative Income
Age 19 and older	Income	Conservative Income	Money Market	Money Market

In addition to the four age-based savings tracks, there are eight individual portfolio options, including: Aggressive Growth, Growth, Moderate Growth, Conservative Growth, Income, Bond Index, Conservative Income and Money Market.

For the age-based savings tracks, participant accounts will be exchanged (units held will be exchanged for a number of units of equal value) for the next portfolio in the year the beneficiary reaches the minimum qualifying age for the next portfolio. The Office of Treasurer of State may change the investments at any time.

Although money contributed to the Trust is invested in portfolios that hold Vanguard mutual funds, neither the Trust nor any of the portfolios is itself a mutual fund. Each portfolio invests in one or more Vanguard mutual funds.

At June 30, 2006, the Trust had investments in the following portfolios:

Investment Portfolio	Market Value at June 30, 2006
Aggressive Growth	\$ 606,624,238
Growth	360,042,962
Moderate Growth	268,258,742
Conservative Growth	123,090,568
Income	62,678,485
Conservative Income	12,102,311
Money Market	31,636,050
Bond Index	1,353,751
Total	\$ 1,465,787,107

**Concentration of Credit Risk:**

The various portfolios hold Vanguard mutual funds and, accordingly, disclosure of concentration of credit risk is not applicable.

**Credit Risk:**

The Aggregate Growth portfolio invests entirely in stock mutual funds and, therefore, is not subject to credit risk. The remaining portfolios are exposed to varying unrated levels of credit risk.

**Interest Rate Risk:**

The Aggressive Growth portfolio invests entirely in stock mutual funds and, therefore, is not subject to interest rate risk. The remaining portfolios are exposed to varying levels of interest rate risk. Interest rate risk is not disclosed because the portfolios are 2a7-like pools.

**(3) Participant Contributions**

Any United States citizen age 18 years or older with a valid social security number and a desire to save for the future educational expenses of a young person may be a participant. The amount a participant may contribute is unlimited, except no contribution may cause the aggregate balance of all accounts held on behalf of a single beneficiary to exceed \$239,000 (in 2006). The minimum amount of any one contribution is \$25. Contributions are not required to be made each year.

Participant contributions up to \$2,500 (in 2006) per account are deductible for State of Iowa income tax purposes. Earnings are tax exempt for state income tax purposes if the funds are spent for specified qualified higher education expenses of a beneficiary. A similar federal tax deduction does not exist for the participant's contributions. Earnings are exempt for federal income tax purposes if funds are spent for specified qualified higher education expenses. Unless extended, federal tax-free treatment of qualified withdrawals will expire on December 31, 2010. Earnings on non-qualified withdrawals are subject to federal income tax and a 10% federal penalty, as well as applicable state and local income taxes.



**(4) Capital Assets**

A summary of capital assets activity for the year ended June 30, 2006 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Equipment	\$ 59,134	-	-	59,134
Less accumulated depreciation	(51,274)	(5,419)	-	(56,693)
Capital assets, net	\$ 7,860	(5,419)	-	2,441

**(5) Administrative Fees**

Chapter 12D.2(14) of the Code of Iowa allows the Treasurer of State, as trustee, to establish, impose and collect administrative fees and charges in connection with transactions of the Trust. The Trust contracts with the Vanguard Group to invest funds in specified investment portfolios. The Trust also contracts with Upromise Investment Advisors, LLC to provide record keeping and administrative services.

Participants were charged an asset-based fee of 0.65% for each investment option, which was reduced to 0.62% when average plan assets exceeded \$1.25 billion during February 2006. This asset-based fee incorporates the Trust's management fee, which includes fees paid to Vanguard and Upromise for their services to the Trust, and the annual fees and expenses of the underlying mutual funds in which each Portfolio invests. The fees are deducted from each Portfolio's total assets and, therefore, reduce the value of the Portfolio units. During the year ended June 30, 2006, Vanguard and Upromise retained or were paid management and services fees totaling \$7,459,489.

Vanguard and Upromise provide an annual payment to the Treasurer of State for oversight of the Trust. This fee is to be used by the Treasurer of State for the payment of expenses for Trust operations. Neither the State of Iowa nor the Treasurer of State is permitted to earn any profit at any time or in any way from the Trust. The annual fee received by the Treasurer of State for fiscal year 2006 was \$512,652. The annual fee is adjusted annually by the Consumer Price Index.

**(6) Subsequent Event**

On October 2, 2006, the Office of Treasurer of State launched a new college savings plan sold exclusively through financial advisors. The Iowa Advisors 529 Plan includes a multi-manager investment line-up, online account access and in-state tax deductions for Iowa residents.

**Schedule 1**

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Office of Treasurer of State  
Iowa Educational Savings Plan Trust

Account Information by Investment Portfolio

June 30, 2006

<u>Investment Portfolio</u>	<u>Account Value</u>
Aggressive Growth	\$ 606,624,238
Growth	360,042,962
Moderate Growth	268,258,742
Conservative Growth	123,090,568
Income	62,678,485
Conservative Income	12,102,311
Money Market	31,636,050
Bond Index	<u>1,353,751</u>
Total	<u><u>\$ 1,465,787,107</u></u>

Total Number of Participants - 63,946

Total Number of Beneficiaries - 105,256

See accompanying independent auditor's report.

Office of Treasurer of State  
Iowa Educational Savings Plan Trust

Summary of Expenses for Outside Consultants and Independent Contractors

Year ended June 30, 2006

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Type of Service	Amount
Legal consulting services	\$ 3,873
Professional services	<u>2,353</u>
Total	<u>\$ 6,226</u>

See accompanying independent auditor's report.

**Schedule 3**

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Office of Treasurer of State  
Iowa Educational Savings Plan Trust

Summary of Distributions to Participants and Beneficiaries

Year ended June 30, 2006

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Type of Distribution	Amount
Qualified withdrawals for educational expenses of beneficiaries	\$ 27,793,885
Rollover withdrawals to other qualified state tuition plans	16,531,060
Non-qualified withdrawals	<u>1,298,329</u>
Total	<u>\$ 45,623,274</u>

See accompanying independent auditor's report.



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

David A. Vaudt, CPA  
Auditor of State

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Des Moines, Iowa 50319-0004

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

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 Honorable Michael L. Fitzgerald,  
Treasurer of State:

We have audited the accompanying financial statements of the Office of Treasurer of State, Iowa Educational Savings Plan Trust, as of and for the year ended June 30, 2006, and have issued our report thereon dated October 6, 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

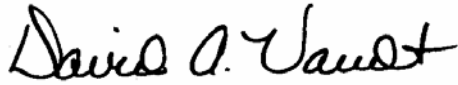
In planning and performing our audit, we considered the Office of Treasurer of State, Iowa Educational Savings Plan Trust's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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. We noted no matters involving the internal control over financial reporting and its operation we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Office of Treasurer of State, Iowa Educational Savings Plan Trust'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 or other matters 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 Office of Treasurer of State, Iowa Educational Savings Plan Trust, citizens of the State of Iowa and other parties to whom the Office of Treasurer of State, Iowa Educational Savings Plan Trust 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 Office of Treasurer of State, Iowa Educational Savings Plan Trust 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

October 6, 2006

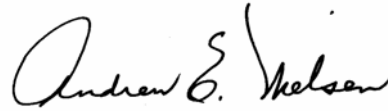
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Office of Treasurer of State  
Iowa Educational Savings Plan Trust

Staff

This audit was performed by:

Ronald D. Swanson, CPA, Manager  
Jennifer R. Edgar, CPA, Senior Auditor  
Michael J. Hackett, Staff Auditor  
Michelle L. Harris, 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