



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

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NEWS RELEASE

FOR RELEASE October 13, 2003

Contact: Andy Nielsen
515/281-5515

Auditor of State David A. Vaudt today released an audit report on the Iowa Communications Network (ICN) for the year ended June 30, 2002. 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 \$56,356,623 for the year ended June 30, 2002. The revenues included sales, rents and services of \$31,827,208, a contract settlement of \$7,000,000, non-capital appropriations of \$4,513,320, capital appropriations of \$12,168,597 and investment income of \$847,498. Expenses for the year ended June 30, 2002 totaled \$52,547,676, including \$15,501,860 for direct expenses, \$15,393,446 for depreciation, \$9,921,913 for other operating expenses, \$7,830,000 for general and administrative expenses and \$3,681,936 for interest expense.

The significant increase in revenues is primarily due to the favorable outcome of a contract settlement from a manufacturer for discontinuing the supply and support of network parts.

Vaudt recommended the Iowa Communications Network 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
FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
JUNE 30, 2002

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Iowa Communications Network

Officials

<u>Name</u>	<u>Title</u>
	State
Honorable Thomas J. Vilsack	Governor
Cynthia P. Eisenhower	Director, Department of Management
Dennis C. Prouty	Director, Legislative Services Agency

Iowa Telecommunications and Technology Commission

		<u>Term Expires</u>
(Before May 2002)		
Betsy Brandsgard	Chairperson	Apr 2006
Mark J. Schouten	Commission Member	Apr 2007
Richard H. Opie	Commission Member	Apr 2002
Mary A. Nelson	Commission Member	Apr 2004
Timothy L. Lapointe	Commission Member	Apr 2005
Richard D. Johnson	Non-Voting Ex-Officio Commission Member	Dec 31, 2002

(After May 2002)		
Betsy Brandsgard	Chairperson	Apr 2006
Mark J. Schouten	Commission Member	Apr 2007
Robert R. Hardman	Commission Member	Apr 2008
Mary A. Nelson	Commission Member	Apr 2004
Timothy L. Lapointe	Commission Member	Apr 2005
Richard D. Johnson	Non-Voting Ex-Officio Commission Member	Dec 31, 2002
David A. Vaudt	Non-Voting Ex-Officio Commission Member	Indefinite

Agency

Harold M. Thompson	Executive Director (Through June 30, 2002)
Michael Bacino	Interim Executive Director (July 1 through Dec 9, 2002)
John Gillespie	Executive Director (Effective Dec 10, 2002)
Denise Sturm, CPA	Finance Director

Iowa Communications Network



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Auditor of State

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Des Moines, Iowa 50319-0004

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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, 2002, as 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 that 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, 2002, 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, 2002, 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.

As described in Note 8 to the financial statements, during the year ended June 30, 2002, the Iowa Communications Network adopted Governmental Accounting Standards Board Statement Number 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments; Statement Number 37, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus; and Statement Number 38, Certain Financial Statement Note Disclosures. The Iowa Communications Network also changed the capital asset capitalization threshold as described in Note 8.

In accordance with Government Auditing Standards, we have also included our report dated July 3, 2003 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 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 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 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

July 3, 2003

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, 2002. 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 2002.

- ICN operating revenues were \$31.8 million and net nonoperating revenues were \$8.5 million, including a \$7 million contract settlement from a manufacturer for discontinuing the supply and support of network parts.
- The ICN received \$3.5 million from the tobacco securitization funds for the purchase of equipment to further the network upgrade.
- The ICN delivered 293,000 hours of full-motion, interactive video to its authorized users in FY 2002. Since ICN's inception in 1993, it has delivered over 1.5 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 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 the financial statements that explain some of the information in the statements and provide more detail. Supplementary information is also in schedule form and begins on page 24.

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.

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in 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 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 FY02 ending cash and cash equivalents balance.

The notes 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 can be found beginning on page 16.

The supplementary information begins on page 24 and provides detailed information about operating revenues and expenses.

FINANCIAL ANALYSIS OF THE NETWORK

The ICN's assets totaled \$104.1 million at the end of 2002 compared to \$112.4 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 decreased by \$2.6 million from fiscal year 2001 to fiscal year 2002. This change is primarily due to the decrease in the value of inventory from the deployment of assets into the field and the decrease in network sales, rents and services. Net assets invested in capital assets, net of related debt increased by \$6.4 million from fiscal year 2001. This change is primarily due to the acquisition and construction of capital assets, depreciation expense, and the retirement of capital debt.

	<u>June 30,</u>	
	<u>2003</u>	<u>2002</u>
NET ASSETS:		
Current and other assets	\$ -	\$ 39,579,889
Capital assets	-	64,559,893
Total assets	<u>-</u>	<u>104,139,782</u>
Current liabilities	-	16,920,730
Noncurrent liabilities	-	46,849,443
Total liabilities	<u>-</u>	<u>63,770,173</u>
Net assets:		
Invested in capital assets, net of related debt	-	7,585,450
Unrestricted	-	32,784,159
Total net assets	<u>\$ -</u>	<u>\$ 40,369,609</u>

The next schedule helps to highlight the activity for fiscal year 2002 compared to fiscal year 2001.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS:	<u>Year ended June 30.</u>	
	<u>2003</u>	<u>2002</u>
Operating revenues:		
Sales, rents and services	\$ 31,982,299	31,827,208
Operating expenses:		
Direct expenses	14,935,868	15,501,860
Depreciation expense	11,289,596	15,393,446
Other operating expense	10,301,414	9,921,913
General and administrative expenses	7,831,555	7,830,000
Total operating expenses	<u>44,358,433</u>	<u>48,647,219</u>
Operating loss	<u>(12,376,134)</u>	<u>(16,820,011)</u>
Nonoperating revenues (expenses):		
Non-capital appropriations from State of Iowa	5,613,360	4,513,320
Investment income	746,850	847,498
Contract settlement	-	7,000,000
Interest expense	(3,066,152)	(3,681,936)
Amortization expense	(218,521)	(218,521)
Net nonoperating revenues	<u>3,075,537</u>	<u>8,460,361</u>
Loss before other revenues	<u>(9,300,597)</u>	<u>(8,359,650)</u>
Capital appropriations from State of Iowa	15,125,000	12,168,597
Increase in net assets	5,824,403	3,808,947
Net assets beginning of year	<u>40,369,609</u>	<u>36,560,662</u>
Net assets end of year	<u>\$ 46,194,012</u>	<u>40,369,609</u>

The ICN's sales for fiscal year 2002 were down about 5.7 percent, at \$31.8 million compared to \$33.8 million for fiscal year 2001. Voice services provided the ICN with just over \$12 million in sales while data services produced \$9.3 million in sales. The ICN's video subsidy from the State's General Fund was \$2.1 million.

As previously stated, the ICN received a \$7 million contract settlement from a manufacturer for discontinuing the supply and support of network parts.

The ICN's largest individual expense is depreciation expense, which accounts for 29.3% of all expenses. Depreciation expense is followed by personnel expense of 12.5%, voice costs of 12.1%, and system maintenance of 11.5% of all expenses.

CAPITAL ASSETS AND DEBT ADMINISTRATION

The ICN's investment in capital assets for its business-type activities at June 30, 2002 was \$168.3 million, with accumulated depreciation of \$103.7 million, leaving a net book value of \$64.6 million. This investment in capital assets includes equipment and fiber optic cable, with a major portion (37.2%) 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, 2002, the ICN had \$57 million in certificates of participation outstanding compared to \$66 million at June 30, 2001. 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 2003 fiscal year budget. Management anticipates most product sales to remain steady through fiscal year 2003, although the ICN expects to see an increase in sales for video services as K-12 authorized users become eligible for Universal Service Fund discounts related to the delivery of that service. The ICN also expects to see a decrease in sales associated with voice services. Also, ICN's video subsidy from the State General Fund will be reduced to \$1 million in FY 2003. This forecast should result in an overall decrease in ICN revenue for fiscal year 2003.

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, P.O. Box 587, Johnston, IA 50131.

Financial Statements

Iowa Communications Network

Iowa Communications Network

Statement of Net Assets

June 30, 2002

Assets

Current assets:

Cash and cash equivalents (note 2)	\$ 29,741,107
Accounts receivable, net (note 3)	1,275,619
Interest receivable	7,868
Due from other state agencies	2,940,715
Inventory	<u>3,661,860</u>
Total current assets	<u>37,627,169</u>

Noncurrent assets:

Capital assets, net (note 4)	64,559,893
Prepaid expense	1,079,001
Debt issuance costs	<u>873,719</u>
Total noncurrent assets	<u>66,512,613</u>

Total assets104,139,782**Liabilities**

Current liabilities:

Accounts payable	4,326,512
Due to other state agencies	87,758
Deferred revenue	164,622
Interest payable	1,796,568
Compensated absences	420,270
Certificates of participation, current (note 5)	<u>10,125,000</u>
Total current liabilities	16,920,730

Noncurrent liabilities:

Certificates of participation, net (note 5)	<u>46,849,443</u>
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Total liabilities63,770,173**Net Assets**

Invested in capital assets, net of related debt	7,585,450
Unrestricted	<u>32,784,159</u>
Total net assets	<u><u>\$ 40,369,609</u></u>

See notes to financial statements.

Exhibit B

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

Year ended June 30, 2002

Operating revenues:	
Sales, rents and services (includes video subsidization of \$2,116,871)	<u>\$ 31,827,208</u>
Operating expenses:	
Direct expenses	15,501,860
Depreciation expense	15,393,446
Other operating expenses	9,921,913
General and administrative expenses	<u>7,830,000</u>
Total operating expenses	<u>48,647,219</u>
Operating loss	<u>(16,820,011)</u>
Nonoperating revenues (expenses):	
Non-capital appropriations from State of Iowa	4,513,320
Investment income	847,498
Contract settlement	7,000,000
Interest expense	(3,681,936)
Amortization expense	<u>(218,521)</u>
Net nonoperating revenues	<u>8,460,361</u>
Loss before other revenues	(8,359,650)
Capital appropriations from State of Iowa	<u>12,168,597</u>
Increase in net assets	3,808,947
Net assets beginning of year	<u>36,560,662</u>
Net assets end of year	<u><u>\$ 40,369,609</u></u>

See notes to financial statements.

Iowa Communications Network

Statement of Cash Flows

Year ended June 30, 2002

Cash flows from operating activities:	
Cash received from customers	\$ 31,172,443
Cash payments for goods and services	(25,297,758)
Cash payments for salaries and benefits	(6,586,642)
Net cash used for operating activities	<u>(711,957)</u>
Cash flows from non-capital financing activities:	
State appropriations	<u>4,513,320</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(12,051,151)
Interest paid	(3,878,242)
Principal paid on capital debt	(9,672,551)
Cash received from contract settlement	7,000,000
State appropriations	<u>12,168,597</u>
Net cash used for capital and related financing activities	<u>(6,433,347)</u>
Cash flows from investing activities:	
Proceeds from sale of investments	2,745,000
Interest received on investments	<u>935,468</u>
Net cash provided by investing activities	<u>3,680,468</u>
Net increase in cash and cash equivalents	1,048,484
Cash and cash equivalents at the beginning of year	<u>28,692,623</u>
Cash and cash equivalents at the end of year	<u>\$ 29,741,107</u>
Reconciliation of operating loss to net cash used for operating activities:	
Operating loss	<u>\$ (16,820,011)</u>
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation expense	15,393,446
Decrease in accounts receivable	62,250
Decrease in inventory	2,827,759
Decrease in prepaid expense	1,974
(Decrease) in deferred revenue	(144)
(Decrease) in accounts payable	(1,664,544)
(Decrease) in due to other state agencies	(440,984)
(Decrease) in retainage payable	(45,939)
(Decrease) in compensated absences	<u>(25,764)</u>
Total adjustments	<u>16,108,054</u>
Net cash used for operating activities	<u>\$ (711,957)</u>

See notes to financial statements.

Iowa Communications Network

Notes to Financial Statements

June 30, 2002

(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 applied to governmental units. 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 included 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 account for operations (a) that are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to customers on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

C. Measurement Focus

Enterprise Funds are accounted for on a cost of services or “capital maintenance” measurement focus. This means that all assets and liabilities, whether current or non-current, associated with their activity are included on their statement of net assets. Their reported 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 nonoperating 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 nonoperating 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 Iowa Code.

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, they 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 in Enterprise Funds as projects are constructed. Interest incurred during the construction phase of Enterprise Fund 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 (see note 8). 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 that do not add to the value of the asset or materially extend asset lives are not capitalized.

Depreciation is computed using a 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 and compensatory pay are recorded as liabilities. These liabilities for compensated absences are based on rates of pay in effect at June 30, 2002.

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 \$5,288,925 and the Trustee – Wells Fargo Bank Iowa, N.A. of \$24,452,182 at June 30, 2002 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, 2002 consisted of the following:

Accounts receivable	\$ 1,482,376
Less allowance for doubtful accounts	<u>(206,757)</u>
Accounts receivable, net	<u>\$ 1,275,619</u>

(4) Capital Assets

Capital assets activity for the year ended June 30, 2002 is as follows:

	Balance Beginning of Year	Increases	Decreases	Balance End of Year
Capital assets not being depreciated:				
Construction in progress	\$ -	561,457	124,619	436,838
Capital assets being depreciated:				
Equipment	96,860,624	12,444,190	4,107,744	105,197,070
Fiber optic cable	63,371,475	39,770	788,279	62,622,966
Total capital assets being depreciated	160,232,099	12,483,960	4,896,023	167,820,036
Less accumulated depreciation for:				
Equipment	(68,568,289)	11,958,936	3,419,213	(77,108,012)
Fiber optic cable	(23,940,825)	3,434,510	786,366	(26,588,969)
Total accumulated depreciation	(92,509,114)	15,393,446	4,205,579	(103,696,981)
Total capital assets being depreciated, net	67,722,985	(2,909,486)	690,444	64,123,055
Total capital assets, net	\$ 67,722,985	(2,348,029)	815,063	64,559,893

(5) Long-term Liabilities

A summary of changes in long-term liabilities for the year ended June 30, 2002 is as follows:

	Balance Beginning of Year	Additions (Current Year Amortization)	Deductions	Balance End of Year	Current Portion
Certificates of participation	\$ 66,448,054	86,389	9,560,000	56,974,443	10,125,000
Notes payable	112,551	-	112,551	-	-
Total long-term liabilities	<u>\$ 66,560,605</u>	<u>86,389</u>	<u>9,672,551</u>	<u>56,974,443</u>	<u>10,125,000</u>

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 holder in a lease purchase agreement. The certificates mature over the next 5 years with interest rates ranging from 3.65% to 6.50%. The remaining principal balance at June 30, 2002 was \$57,320,000 and the unamortized discount was \$345,557.

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

Year Ending June 30,	Principal	Interest
2003	\$ 10,125,000	3,286,448
2004	10,745,000	2,642,059
2005	11,415,000	1,944,556
2006	12,135,000	1,201,207
2007	<u>12,900,000</u>	<u>408,829</u>
Total	57,320,000	<u>\$ 9,483,099</u>
Less: Unamortized discount	<u>(345,557)</u>	
Certificates of participation, net	<u>\$ 56,974,443</u>	

During the year ended June 30, 2002, \$9,560,000 of the certificates of participation were retired.

Notes Payable

The Treasurer of State of Iowa may enter into financing agreements on behalf of state agencies in accordance with Chapter 12 of the Code of Iowa. During fiscal year 1997, the Treasurer of State entered into two financing agreements totaling \$999,200 on behalf of the ICN for equipment for the implementation of the Iowa Hub. The notes had an interest rate of 5.70% and matured in January of 2002. During the year ended June 30, 2002, the remaining \$112,551 of notes 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 payroll. Contribution requirements are established by state statute. The ICN's contributions to IPERS for the years ended June 30, 2002, 2001, and 2000 were \$299,977, \$275,779, and \$255,126, 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) Accounting Changes

Governmental Accounting Standards Board Statement Number 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments; Statement Number 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus; and Statement Number 38, Certain Financial Statement Note Disclosures were implemented during fiscal year 2002. The statements create new basic financial statements for reporting the ICN's financial activities.

For reporting purposes, the State of Iowa implemented a new capitalization policy and the ICN adopted new capitalization thresholds for reporting capital assets. Capital assets below the new thresholds with a net book value totaling \$313,699 were written-off during the year ended June 30, 2002.

The ICN changed the method used to value inventory from the first-in/first-out (FIFO) to the last-in/first-out (LIFO) cost flow method during the year ended June 30, 2002.

Adoption of these statements, the change in the capitalization threshold and the change in the method of valuing inventory did not have a material effect on the net assets of the Network. Accordingly, the beginning net assets of the ICN is the same as its fund equity at the end of the prior year.

Iowa Communications Network

Supplementary Information

Schedule 1

Iowa Communications Network
Schedule of Operating Revenues and Expenses
Year ended June 30, 2002

Operating revenues:	
Sales, rents and services:	
Video services	\$ 2,667,206
Video subsidization	2,116,871
Voice services	12,024,652
Data services	9,342,221
Transmitter services	972,366
Subscription fees	3,249,498
Installation fees	1,070,325
Other revenues, including \$195,905 recovery of bad debt	384,069
Total operating revenues	<u>31,827,208</u>
Operating expenses:	
Direct expenses:	
Voice costs	6,354,853
Data costs	5,408,591
Video costs	2,033,637
Subscription services	862,553
Installation costs	842,226
Total direct expenses	<u>15,501,860</u>
Depreciation expense	<u>15,393,446</u>
Other operating expenses:	
Network equipment	323,657
System maintenance	6,052,923
Outside plant costs	1,521,971
System utility costs	98,265
System repair costs	301,631
Other system costs	73,858
Network installation costs	461,912
Loss on capital asset and inventory disposal	1,087,696
Total other operating expenses	<u>9,921,913</u>
General and administrative expenses:	
Personnel	6,563,180
Travel	60,835
Administrative services	117,755
Professional fees	151,723
Rent	2,462
Other general and administrative	934,045
Total general and administrative expenses	<u>7,830,000</u>
Total operating expenses	<u>48,647,219</u>
Operating loss	<u>\$ (16,820,011)</u>

See accompanying independent auditor's report.



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

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David A. Vaudt, CPA
Auditor of State

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, 2002, and have issued our report thereon dated July 3, 2003. 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, 2002 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.

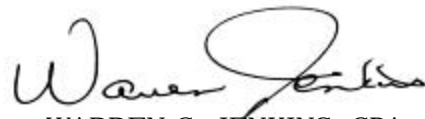
A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected 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 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

July 3, 2003

Iowa Communication Network

Schedule of Findings

Year ended June 30, 2002

Findings Related to the Financial Statements:

INSTANCES OF NON-COMPLIANCE:

Capital Assets – Chapter 10.4(7A) of the Iowa Administrative Code requires a physical inventory of personal property to be taken and the results reconciled with property records at least once every two years. Also, 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 ICN capitalizes network assets valued at \$5,000 and above. The policy states that like assets will not be grouped on the capital asset listing and that the original purchase order document used to buy the asset will be tracked by the ICN. The following were noted:

- A physical inventory is not taken at least once every two years by someone having no responsibility for the assets.
- Three hundred seventy-eight locations having network assets valued under the \$5,000 capitalization policy limit were included on the capital asset listing.
- Office furniture and office panels were grouped on the capital asset listing and the original purchase order document was not tracked by the ICN.
- Twenty of the three hundred nineteen items tested did not agree with the ICN's records.
- Another thirty-nine assets were observed at ICN locations but were not included on the ICN's listing. Ownership of those assets could not be determined.

Recommendation – While we recognize the difficulty in managing multiple outlying locations, it is important to maintain accurate and up-to-date listings of equipment. The ICN should implement procedures to ensure accurate reporting and compliance with the Iowa Administrative Code and the ICN's own capitalization policy.

Response – The ICN also recognizes the importance of an accurate and up-to-date listing of equipment. The ICN is currently establishing procedures to ensure that a complete asset inventory is conducted. The ICN has removed the balances of the locations having network assets under \$5,000 as well as the value of the office furniture and office panels from the balance sheet and inventory listings. The ICN will take steps to ensure that the invoice document is referenced in its documentation for fixed asset additions.

Conclusion – Response accepted.

REPORTABLE CONDITION:

Inventory – The ICN is responsible for maintaining an accurate inventory listing. During fieldwork, inventory test counts were taken for comparison to the ICN's records. The following conditions were noted:

- Sixteen of forty-seven items tested did not agree with the quantity reported on ICN's records. The net understatement variance was \$2,291, consisting of four items where the item count resulted in more than the quantity reported on the ICN listing and twelve items where the count was less than the quantity reported.
- The ICN changed computer software for tracking inventory and a complete inventory was performed after year-end on August 15, 2002. However, the ICN could not locate the supporting documentation to reconcile the changes between the two computer software system records.

Recommendation – An inventory count at fiscal year-end should be reconciled to the inventory system and supporting documentation should be retained.

Response – The ICN will take steps to ensure that all supporting records that document reconciliation of the inventory system are maintained. The ICN is reviewing its inventory procedures and will take steps to ensure that all inventory items are accounted for properly.

Conclusion – Response accepted.

Findings Related to Required Statutory Reporting:

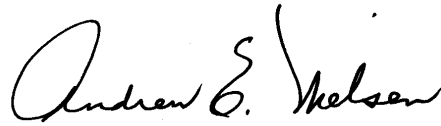
No matters were noted.

Iowa Communications Network

Staff

This audit was performed by:

Ronald D. Swanson, CPA, Manager
Randi J. Rowedder, CPA, Senior Auditor II
Karen L. Brustkern, CPA, Senior Auditor
Jeremy J. Howard, CPA, Staff Auditor
Travis J. Bovy, Assistant Auditor
Nicole B. Tenges, Assistant Auditor

A handwritten signature in black ink, reading "Andrew E. Nielsen". The signature is fluid and cursive, with the first name "Andrew" and last name "Nielsen" clearly legible.

Andrew E. Nielsen, CPA
Deputy Auditor of State