

**UTAH TELECOMMUNICATION OPEN
INFRASTRUCTURE AGENCY**

FINANCIAL STATEMENTS

JUNE 30, 2006

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
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REPORT**

Board of Directors
Utah Telecommunication Open Infrastructure Agency
West Valley City, Utah

We have audited the accompanying basic financial statements of Utah Telecommunication Open Infrastructure Agency (UTOPIA), as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of UTOPIA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of UTOPIA, as of June 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a separate report dated December 8, 2006 on our consideration of UTOPIA's internal control over financial reporting and on our tests of compliance with certain provisions of laws and regulations, contracts and grant agreements 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 conjunction with this report in considering the results of our audit.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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. However, we did not audit the information and express no opinion on it.

December 8, 2006

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY MANAGEMENT DISCUSSION AND ANALYSIS

Introduction

The following is a discussion and analysis of the Utah Telecommunication Open Infrastructure Agency (UTOPIA) financial activities for the fiscal year ending June 30, 2006.

Description of Business

Fourteen Utah cities created UTOPIA to promote economic development and to improve the quality of life for their residents through the construction and operation of a wholesale, all fiber telecommunications infrastructure. The system is an open access network over which private providers of retail digital services reach customers in UTOPIA member cities.

Eleven of the current UTOPIA member cities provided sales tax pledges as partial loan guarantees to secure financing for the network. Phase I involved a total of 52 footprints (neighborhood service areas) and interconnecting rings in Midvale, Murray, Lindon, Orem, Payson, and West Valley City. With the exception of minor clean-up, all construction is complete and the footprints are in production. As of the end of June, 2006, 451 miles of duct had been placed along with 130 miles of aerial strand and 680 miles of fiber cable. Additionally, 63,500 fibers had been landed in community cabinets and approximately 54,000 splices had been completed. Within the 52 production footprints there are a total of 43,450 addresses. Phases II and III will complete the network in these cities and extend its reach into Brigham City, Centerville, Layton, Perry, and Tremonton. When completed, the network will pass in excess of 170,000 prospective subscribers.

Highlights

At June 30, 2006, of the addresses passed, 23,805 are marketable (able to receive services at the decision of the household or business). The remaining addresses are located in apartment buildings, condominium developments, or in areas isolated by right of way or pole access issues. Four service providers—AT&T, MStar, XMission, and Veracity—were actively marketing at least some of their services and a total of 4,844 homes and businesses had subscribed to services by fiscal year end. These subscribers selected services as indicated in Figure 1:

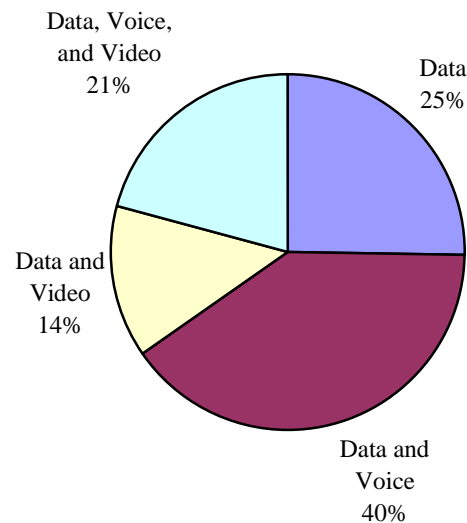


Figure 1

Chart showing breakdown of subscribers at June 30, 2006 by type of service selected.

Securing continuity of financing to continue network build out through Phase II has proved to be a major challenge for the Agency. The original business plan anticipated that a second round of bonding would have been completed in the first quarter of calendar year 2006 which would have been in time to avoid a construction stand down. This did not happen.

The Agency pursued a loan from the U.S. Department of Agriculture, Rural Utility Service (RUS) Broadband Loan Program designed to help communities with populations under 20,000. Six UTOPIA members—Brigham City, Centerville, Lindon, Payson, Perry, and Tremonton—qualify for loans under this program. The application provided for the funding necessary to almost completely build out these RUS-eligible cities. UTOPIA received approval of the loan on July 18, 2006. The unanticipated delay in funding led to an interruption in construction, in the release of new inventory of marketable addresses, and in the roll-out of service provider marketing plans. Consequently, the actual number of subscribers at year end fell below expectations.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
MANAGEMENT DISCUSSION AND ANALYSIS (Continued)**

Costs, to date, have been within business case expectations. Construction expenses were at, or below, projections and agency and network operation costs were also held below budget.

Overview of Financial Statements

The financial statements included in this report have been prepared in compliance with generally accepted accounting principles. The balance sheet provides information about the Agency's resources and obligations at year end. The statement of revenues, expenses, and changes in net assets presents the results of business activities during the course of the year. The statement of cash flows presents changes in cash and cash equivalents, resulting from operational and investing activities. Notes to the financial statements provide required disclosures and other information that are essential to the full understanding of material data provided in the statements. The notes present information about the Agency's accounting policies, significant account balances, obligations, commitments, contingencies and subsequent events.

As expected, the financial statements reflect conditions typical of a capital-intensive start-up enterprise in the first years of its existence. Revenue volume increased more than ten-fold over the prior fiscal year but did not cover operating expenses. Marketing efforts of UTOPIA service providers continuously add new subscribers to the network and increase the Agency's gross revenues. As originally anticipated, an operating deficit is projected to continue for three more years. As explained below, there is sufficient cash to sustain operations over this period of time even though the Agency's negative net assets will grow until operational break-even has been achieved.

Table 1 - Summary of the Agency's Statement of Net Assets.

	<u>2006</u>	<u>2005</u>
Current and other assets	\$ 9,450,354	\$ 50,612,030
Capital Assets	<u>69,524,376</u>	<u>31,103,979</u>
Total Assets	<u><u>78,974,730</u></u>	<u><u>81,716,009</u></u>
Long-term liabilities outstanding	86,218,248	83,770,968
Other Liabilities	<u>11,181,444</u>	<u>6,015,250</u>
Total Liabilities	<u><u>97,399,692</u></u>	<u><u>89,786,218</u></u>
Invested in net capital assets, Net of related debt	(3,155,785)	(512,711)
Unrestricted	<u>(15,269,177)</u>	<u>(7,557,498)</u>
Net Assets	<u><u>\$ (18,424,962)</u></u>	<u><u>\$ (8,070,209)</u></u>

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
MANAGEMENT DISCUSSION AND ANALYSIS (Continued)**

Table 2 - Summary of the Agency's Statement of Revenues, Expenses and Changes in Fund Net Assets

	2006	2005
Revenues:		
Operating revenues	\$ 1,550,426	\$ 123,054
Non-operating revenues	228,233	
Interest income	922,583	1,273,277
Total Revenues	2,701,242	1,396,331
Expenditures:		
General and administrative	1,534,231	1,367,986
Network	4,630,652	2,607,386
Depreciation	2,643,074	509,732
Bond interest and fees	4,248,038	3,074,319
Total Expenditures	13,055,995	7,559,423
Change in net assets	(10,354,753)	(6,163,112)
Total net assets, beginning of year	(8,070,209)	(4,608,487)
Prior period adjustments	-	2,701,390
Total net assets, end of year	\$ (18,424,962)	\$ (8,070,209)

Budgetary Highlights and Financial Analysis

Table 3 presents a summary view of UTOPIA's financial performance for the fiscal year 2005-2006. This presentation supplements standard financial statements to show agency budget information in a form that permits ordinary citizens to understand where the funds come from and where they go.

Most of the variances between FY 2006 Actuals and Budget are not material and/or reflect the unavoidable imprecision of budgetary forecasts (See Lines 1, 2, 10, and 12). Others require some explanation. Line 4 shows a variance of \$1,200,788 in Supplier Financing. Most of this variance (\$1,092,332) is attributable to an arrangement with Tetra Tech Construction Services for them to perform engineering and right of way acquisition services in advance of receiving Phase II financing. UTOPIA's goal was to minimize construction delay as much as possible. The balance of the variance is a combination of interest expense on an outstanding operating loan from DynamicCity and arrangements with UTOPIA's electronics equipment suppliers.

The variance on Line 13 (\$7,788,791) reflects the accounting treatment of transactions related to construction in process and the acquisition of customer premise equipment inventory. The reported value of \$41,213,471 in the *Actual* column of that line is the net result of accruals for construction and inventory acquisition that supported future phase network deployment. The value in the *Budget* column did not include an estimate for these accounting adjustments.

A similar explanation is needed to describe the variance of \$2,692,812 shown on Line 14. As provided in the Indenture, UTOPIA had the option of replacing a \$6,500,000 debt service reserve escrow account with a payment surety of equal value. Accordingly, the Agency secured a letter of credit (LOC) from Key Bank to guarantee debt service payments in lieu of a cash deposit. This transaction, for which there were issuance costs, released the escrowed funds for other uses. Line 14 reflects the net effect of annual debt service payments and LOC fees, offset by the release of \$6,500,000 from the escrow account.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
MANAGEMENT DISCUSSION AND ANALYSIS (Continued)**

Final Comment

UTOPIA member cities launched the wholesale network project to facilitate economic development and to improve the quality of life for their residents. Since construction of the network has begun, there is evidence that these objectives are being served. Business location and expansion decisions have been influenced for the benefit of UTOPIA cities by the imminent availability of world-class connectivity. Competition for customers has prompted heavy marketing from incumbent providers and at least one of them offered extraordinary values exclusively to households in UTOPIA cities. Market acceptance of the services that are available over the network is very positive.

UTOPIA's Board of Directors and management will continue to work to assure that the trajectory of the project stays on track with initial projections.

Table 3 – Utah Telecommunication Open Infrastructure Agency Sources and Uses of Funds for Fiscal Year 2006.

	<u>Prior Year FY 2005</u>	<u>Budget FY 2006</u>	<u>Actual FY 2006</u>	<u>Variance</u>
Sources of funds				
1 Operations	\$ 123,054	\$ 1,475,000	\$ 1,531,849	\$ 56,849
2 Interest earnings	1,273,257	900,000	922,583	22,583
3 Insurance settlement	-	219,786	219,786	-
4 Supplier financing	25,718	-	1,200,788	1,200,788
5 Net bond proceeds	83,100,140	-	-	-
6 Leases	-	18,577	18,577	-
7 Smart Community conference	-	256,897	256,897	-
8 Beginning current net assets	(3,954,656)	37,593,854	37,593,854	-
9 Total	<u>80,567,513</u>	<u>40,464,114</u>	<u>41,744,334</u>	<u>1,280,220</u>
Uses of funds				
10 Agency expenses	1,367,986	1,516,300	1,534,231	(17,931)
11 Smart Community conference	-	248,450	248,450	-
12 Network expense	2,607,386	4,625,600	4,630,652	(5,052)
13 Capital investment	28,906,003	33,424,680	41,213,471	(7,788,791)
14 Debt service & reserves	10,092,284	649,084	(2,043,728)	2,692,812
15 Total	<u>42,973,659</u>	<u>40,464,114</u>	<u>45,583,076</u>	<u>(5,118,962)</u>
Net current assets	<u>\$ 37,593,854</u>	<u>\$ -</u>	<u>\$ (3,838,742)</u>	<u>\$ (3,838,742)</u>

BASIC FINANCIAL STATEMENTS

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF NET ASSETS
June 30, 2006

Assets

Current Assets

Cash		\$ 53,087
Restricted investments		6,438,848
Receivables		
Miscellaneous receivables	\$ 758,204	
Interest receivable - restricted investments	<u>28,612</u>	
Total Receivables		786,816
Prepaid expenses		<u>63,951</u>
Total Current Assets		<u><u>7,342,702</u></u>

Capital Assets

Construction in progress		10,081,326
Property and equipment, net		
Fiber optic network	59,430,014	
Office furniture and equipment	<u>13,036</u>	
Total Property and Equipment		<u>59,443,050</u>
Total Capital Assets		<u><u>69,524,376</u></u>

Other Assets

Restricted investments	506,043	
Deposit	164,500	
Deferred Charges	<u>1,437,109</u>	
Total Other Assets		<u><u>2,107,652</u></u>
Total Assets		<u><u>\$ 78,974,730</u></u>

The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF NET ASSETS (Continued)
June 30, 2006

Liabilities

Current Liabilities

Accounts payable	\$ 6,143,286
Compensated absences - current	26,060
Interest payable from restricted assets	441,376
Other liabilities payable from restricted assets	3,155,785
Capital lease payable - current	1,127,056
Notes payable - current	287,881

Total Current Liabilities	11,181,444
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Non-current Liability

Notes payable	1,519,804
Capital lease payable	207,314
Revenue bonds, net	84,456,585
Compensated absences	34,545

Total Liabilities	97,399,692
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Net Assets

Invested in capital assets, net of related debt:	(3,155,785)
Unrestricted	(15,269,177)

Total Net Assets	(18,424,962)
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Total Liabilities and Net Assets	\$ 78,974,730
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The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For The Year Ended June 30, 2006

Operating Revenues	
Customer access fees	\$ 1,445,375
Service provider fees	105,051
	<hr/>
Total Operating Revenues	1,550,426
Operating Expenses	
Payroll	648,547
Material & supplies	148,914
Professional services	736,770
Network	4,630,652
Depreciation	2,643,074
	<hr/>
Total Operating Expenses	8,807,957
Operating Loss	(7,257,531)
Nonoperating Revenues (Expenses)	
Interest income	922,583
Bond interest and fees	(4,248,038)
Income from Smart Communities Conference, net	8,447
Other	219,786
	<hr/>
Total Nonoperating Revenues (Expenses)	(3,097,222)
Change In Net Assets	(10,354,753)
Total Net Assets, Beginning of Year	(8,070,209)
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Total Net Assets, End of Year	\$ (18,424,962)
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The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF CASH FLOWS
For The Year Ended June 30, 2006

Operating Activities	
Cash received from customers and users	\$ 1,075,577
Payments to suppliers	(394,921)
Payments to employees	(613,309)
	<u>67,347</u>
Net Cash From Operating Activities	
Cash Flows From Investing Activity	
Interest Income	<u>1,015,235</u>
Net Cash From Investing Activity	
Cash Flows From Capital and Related Financing Activities	
Purchase of property and equipment	(39,440,245)
Bond interest and fees	(4,473,071)
Principal paid on capital lease	(288,298)
Deposits on leases	(150,000)
Restricted cash - net increase	43,139,883
	<u>(1,211,731)</u>
Net Cash From Capital and Related Financing Activities	
Net Increase (Decrease) in Cash and Cash Equivalents	(129,149)
Cash and Cash Equivalents, Beginning of Year	<u>182,236</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 53,087</u></u>

The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF CASH FLOWS (Continued)
For The Year Ended June 30, 2006

Reconciliation of Operating Loss to Net Cash from Operating Activities

Operating loss	\$ (7,257,531)
Adjustments to reconcile operating loss to net cash from operating activities	
Misc Income	228,233
Depreciation expense	2,643,074
(Increase) decrease in current assets	
Accounts receivables	(659,402)
Prepaid expenses	46,503
Increase (decrease) in current liabilities	
Accounts payable	9,261,800
Accrued liabilities	26,732
Liabilities payable from restricted assets	(4,178,382)
Deferred revenue	(43,680)
Net Cash From Operating Activities	\$ 67,347

Supplemental Information

Noncash Investing, Capital, and Financing Activities

Deferred bonds costs of \$211,410 were amortized to bond interest expense.

Interest expense of \$29,486 was added to the balance of notes payable.

Additions to outside plant includes \$259,739 financed by a capital lease, \$1,092,332 financed by a note payable, and \$271,155 of capitalized interest.

The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF ACCOUNTING POLICIES

Reporting Entity

Utah Telecommunication Open Infrastructure Agency (UTOPIA), a separate legal entity and political subdivision of the State of Utah, was formed on March 5, 2002, by an Interlocal Cooperative Agreement pursuant to the provisions of the Utah Interlocal Cooperation Act. UTOPIA's Interlocal Cooperative Agreement has a term of fifty years. During June 2004, the Board of Directors voted to amend the interlocal agreement with the member cities to allow pledging and non-pledging members. The pledging members were required to pledge sales tax revenue from their cities to partially guarantee payment of the bonds, and in return for the pledge, they would be the first to receive UTOPIA's services. The non-pledging cities did not pledge their sales tax revenue but their cities' network will be built when financing can be arranged that does not require a loan guarantee. UTOPIA's original membership consisted of 18 founding member municipalities. As of the date of this report, there were 11 pledging members and 3 non-pledging members in UTOPIA. UTOPIA's purpose is to design, finance, build, operate, and maintain an open, wholesale, public telecommunication infrastructure that has the capacity to deliver high-speed connections to every home and business in the member communities.

Summary of Significant Accounting Policies

The accounting policies of UTOPIA conform to accounting principles generally accepted in the United States of America as applicable to government entities. UTOPIA has elected, under GASB Statement 20, to follow the pronouncements issued by the Financial Accounting Standards Board and Interpretations issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The following is a summary of the more significant policies.

The Reporting Entity

In evaluating how to define UTOPIA for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in the related GASB pronouncement. The basic, but not the only, criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability of fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether UTOPIA is able to exercise oversight responsibilities. UTOPIA does not have any component units, nor is it a component unit of any primary government.

Financial Statement Presentation and Basis of Accounting

UTOPIA prepares its financial statements on an enterprise fund basis, using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private businesses, where the intent is that all costs of providing certain goods and services to the general public be financed or recovered primarily through user charges, or where it has been deemed that periodic determination of net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 1 SUMMARY OF ACCOUNTING POLICIES (Continued)

Financial Statement Presentation and Basis of Accounting (Continued)

Proprietary funds distinguish 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 a proprietary fund's principal ongoing operations.

Restricted Assets

UTOPIA maintains investments held by Wells Fargo for safekeeping of funds relating to future construction, debt service reserves and a contract with a supplier. When both restricted and unrestricted assets are available, it is UTOPIA's policy to use restricted assets first, then unrestricted assets as they are needed.

Property and Equipment

Property and equipment are stated at cost, which includes capitalization of interest costs incurred during construction. Normal maintenance and repair expenses that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related fixed asset. The net book value of property sold or otherwise disposed of is removed from the property and accumulated depreciation accounts and the resulting gain or loss is included as non-operating revenues or expenses.

Depreciation of property and equipment was computed using the straight-line method over the following estimated useful lives

Fiber optic network	5-25 years
Office furniture and equipment	3-5 years

Retirement Plans

UTOPIA participates in two retirement plans. UTOPIA participates in a defined contribution plan and in the Utah Retirement System. Retirement plan costs are combined with employee benefits and are recorded on an accrual basis. It is UTOPIA's policy to fund the retirement plan costs as they are incurred.

Cash and Cash Equivalents

All non-restricted amounts are considered to be cash and cash equivalents for cash flow statement purposes.

Allowance for Doubtful Accounts

UTOPIA has not set up an allowance for doubtful accounts.

Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 CASH AND INVESTMENTS

UTOPIA's deposit and investment policy is to follow the Utah Money Management Act. However, UTOPIA does not have a separate deposit or investment policy that addresses specific types of deposit and investment risks to which UTOPIA is exposed.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 2 CASH AND INVESTMENTS (Continued)

Utah State law requires that UTOPIA funds be deposited with a "qualified depository" as defined by the Utah Money Management Act. "Qualified depository" includes any depository institution which has been certified by the Utah State Commissioner of Financial Institutions as having met the requirements as defined in Rule 11 of the Utah Money Management Act. Rule 11 establishes the formula for determining the amount of public funds which a qualified depository may hold in order to minimize risk of loss and defines capital requirements which an institution must maintain to be eligible to accept public funds.

The Utah Money Management Act also governs the scope of securities allowed as appropriate temporary investments for UTOPIA and conditions for making investment transactions. Investment transactions are to be conducted through qualified depositories or primary reporting dealers.

As of June 30, 2006, UTOPIA had the following deposits and investments:

<u>Deposit and investment type</u>	<u>Fair Value</u>
Cash on deposit	\$ 69,067
Investments in money market funds	6,941,855
	\$ 7,010,922

Cash on Deposit:

Custodial credit risk – deposits. In the case of deposits, this is the risk that in the event of a bank failure, UTOPIA's deposits may not be returned to it. As of June 30, 2006, \$0 of the \$69,067 balance of deposits was exposed to custodial credit risk because it was uninsured and uncollateralized. UTOPIA has no policy to manage this type of risk.

Investment in money market funds:

Interest rate risk. The risk that changes in the interest rate will have an adverse affect on the fair value of an investment. UTOPIA's investment in money market funds are not subject to interest rate risk.

Credit risk. This is the risk that an issuer or other counter party to an investment will not fulfill its obligations. As of June 30, 2006 the money market funds in which UTOPIA has investments were unrated.

Concentration of Credit Risk. This is the risk of loss attributable to the magnitude of UTOPIA's investment in a single issuer. UTOPIA's investment in money market funds is not subject to a concentration of credit risk.

Custodial credit risk – investments. This is the risk that, in the event of the failure if the counterparty to a transaction, UTOPIA will not be able to recover the value of its investments that are in the possession of an outside party. UTOPIA's investment in money market funds has no custodial credit risk.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 RESTRICTED ASSETS

Restricted assets consist of investments consist of the following:

Future constructions costs	\$ 1,641,961
Future interest payments on bonds	4,796,887
Restricted by contract with supplier	506,043
	\$ 6,944,891

NOTE 4 PROPERTY AND EQUIPMENT

The following summarizes UTOPIA's property and equipment as of June 30, 2006:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital Assets not being depreciated				
Construction in Progress	\$ 18,930,249	\$ 27,834,387	\$ (36,683,310)	\$ 10,081,326
Total Capital Assets not being depreciated	18,930,249	27,834,387	(36,683,310)	10,081,326
Other Capital Assets				
Outside Plant	4,292,131	40,990,215	-	45,282,346
Inside Plant	7,144,074	5,168,090	-	12,312,164
Customer Premise Equipment	1,225,331	3,754,089	-	4,979,420
Office Furniture and Equipment	24,905	-	-	24,905
Total Other Capital Assets at historical cost	12,686,441	49,912,394	-	62,598,835
Less Accumulated Depreciation				
Outside Plant	(59,742)	(1,010,663)	-	(1,070,405)
Inside Plant	(406,743)	(1,338,589)	-	(1,745,332)
Customer Premise Equipment	(40,029)	(288,150)	-	(328,179)
Office Furniture and Equipment	(6,197)	(5,672)	-	(11,869)
Total Accumulated Depreciation	(512,711)	(2,643,074)	-	(3,155,785)
Other Capital Assets, Net	12,173,730	47,269,320	-	59,443,050
Property and Equipment, Net	\$ 31,103,979	\$ 75,103,707	\$ (36,683,310)	\$ 69,524,376

Depreciation expense of \$2,643,074 was charged to operating expense for the year ended June 30, 2006. During the year, UTOPIA incurred interest expense of \$3,381,287 of which \$271,155 was capitalized and is included in construction in progress.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 5 LONG-TERM DEBT

The following is a summary of the changes in long-term debt obligations for the year ended June 30, 2006.

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Revenue Bonds					
2004 Revenue bond	\$ 85,000,000	\$ -	\$ -	\$ 85,000,000	\$ -
Less unamortized discount	(595,000)	-	51,585	(543,415)	
Total revenue bonds	84,405,000	-	51,585	84,456,585	-
Capital lease					
Murray	1,362,929	-	(257,506)	1,105,423	1,105,423
Payson	-	259,739	(30,792)	228,947	21,633
Notes payable					
Members	135,750	-	-	135,750	-
DynamicCity	550,117	29,486	-	579,603	94,200
Tetra Tech	-	1,092,332	-	1,092,332	193,681
Compensated absences	25,367	35,238	-	60,605	26,060
Total Long-Term Debt	<u>\$ 86,479,163</u>	<u>\$ 1,416,795</u>	<u>\$ (236,713)</u>	<u>\$ 87,659,245</u>	<u>\$ 1,440,997</u>

Revenue Bonds

UTOPIA issued Revenue Bonds. The revenues of UTOPIA are pledged to pay the debt service on the revenue bonds. Interest on these bonds is payable in semiannually at varying interest rates ranging from 2.50% to 5.75%. The rates vary such that the bonds may be remarketed at a price equal to the principal amount plus accrued interest. The revenue bonds mature on July 1, 2026. The following summarizes UTOPIA's revenue bonds debt service requirements as of June 30, 2006.

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 700,000	\$ 2,054,813	\$ 2,754,813
2008	1,700,000	2,699,938	4,399,938
2009	1,800,000	2,651,188	4,451,188
2010	2,400,000	2,579,688	4,979,688
2011	2,900,000	2,488,688	5,388,688
2012-2016	21,400,000	9,669,563	31,069,563
2017-2021	27,700,000	6,994,813	34,694,813
2022-2026	25,900,000	2,080,813	27,980,813
2027	500,000	12,188	512,188
	85,000,000	<u>\$ 31,231,688</u>	<u>\$ 116,231,688</u>
Less unamortized discount	(543,415)		
Total	<u>\$ 84,456,585</u>		

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 5 LONG-TERM DEBT (Continued)

Capital Leases

Capital Leases consists of the following:

UTOPIA is obligated under a lease for the use of a fiber optic network from Murray City, a member city. Because the terms and options contained in the lease have effectively created a financing arrangement, UTOPIA is required to record this transaction as a capital lease. Lease payments are \$250,000 each year including imputed interest at 3.25% unless additional funding is obtained, in which case, the total amount of \$1,124,357 will be paid in 2007. The capitalized cost of fiber optic network was \$1,585,532 with accumulated deprecation of \$88,087. Management anticipates exercising the purchase option during the next fiscal year. \$ 1,105,423

UTOPIA is obligated under a lease for the use of a fiber optic network from Payson City. Because the terms and options contained in the lease have effectively created a financing arrangement, UTOPIA is required to record this transaction as a capital lease. Lease payments are \$30,792 each year including imputed interest at 4%. The capitalized cost of fiber optic network was \$259,739 with accumulated depreciation of \$6,061. 228,947

Less current portion	(1,127,056)
Total Capital Leases	\$ 207,314

Minimum lease payments for the years ending June 30 are as follows:

Murray City Capital Lease	
2007	\$ 1,124,357
Less amounts representing interest	(18,934)
Present value of future minimum lease payments	\$ 1,105,423

Payson City Capital Lease	
2007	30,792
2008	30,792
2009	30,792
2010	30,792
2011	30,792
2012-2015	123,167
Total minimum lease payments	277,127
Less: amount representing interest	(48,180)
Present value of net minimum lease payments	228,947

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 5 LONG-TERM DEBT (Continued)

Notes Payable

The notes payable consists of the following:

Note payable to Tetra Tech, balance due in quarterly installments of \$250,000 starting September 30, 2006 through June 30, 2007 with the remaining balance due September 30, 2007, including interest at 8% annual rate.	\$ 1,092,332
Amounts owed to non-pledging members. These amounts will be paid when UTOPIA begins to build the network in the respective member's city. Management does not anticipate making any payments in the next fiscal year.	135,750
Note payable due to DynamicCity. Payment by UTOPIA is contingent upon UTOPIA having paid all other then current debts due to DynamicCity. The balance includes accrued interest at 7.25%. Management does not anticipate making any payments in the next fiscal year.	422,603
Amounts due to DynamicCity for services rendered prior to UTOPIA issuing bonds. By contract, DynamicCity agreed to defer payment on 30% and 20% of the original balance of \$314,000 until UTOPIA issues its 2nd and 3rd bonds respectively. UTOPIA issued its 2nd bond in October 2006, therefore, \$94,200 of this balance is considered current.	<div style="border-top: 1px solid black;">157,000</div>
	1,807,685
Less current portion	<div style="border-top: 1px solid black;">(287,881)</div>
	<div style="border-top: 1px solid black; border-bottom: 3px double black;">\$ 1,519,804</div>

NOTE 6 PENSION PLAN

Plan Description

UTOPIA contributes to the Local Governmental Noncontributory Retirement System which is a cost sharing multiple-employer defined benefit pension plan administered by the Utah Retirement Systems (Systems). The Systems provide refunds, retirement benefits, annual cost of living adjustment and death benefits to plan members and beneficiaries in accordance with retirement statutes.

The Systems are established and governed by the respective sections of Chapter 49 of the Utah Code Annotated 1953 as amended. The Utah Retirement Office Act in Chapter 49 provides for the administration of the Utah Retirement Systems and Plans under the direction of the Utah State Retirement Board (Board) whose members are appointed by the Governor. The Systems issue a publicly available financial report that includes financial statements and required supplementary information for the State and School Contributory Retirement System and State and School Noncontributory Retirement System. A copy of the report may be obtained by writing to the Utah Retirement Systems, 540 East 200 South, Salt Lake City, Utah 84102 or by calling 1-800-365-8772.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 6 PENSION PLAN (Continued)

Funding Policy

Plan members are required to contribute a percent of their covered salary (all or part may be paid by the employer) to the respective systems to which they belong. UTOPIA is required to contribute 11.09% of the covered salary to the Noncontributory System. The contribution rates are the actuarially determined rates. The contribution requirements of the Systems are authorized by statute and specified by the Board.

UTOPIA's contribution to the Noncontributory System for the years ending June 30, 2006, 2005 and 2004 were \$20,541, \$14,817 and \$4,518, respectively. The contributions were equal to the required contributions for each year.

UTOPIA is legally obligated to contribute to the retirement systems as long as they have employees meeting membership requirements.

UTOPIA contributes to a non-contributory defined contribution retirement benefit plan covering substantially all employees. Currently all of the assets and income of the 457 Plan are held in trust by the plan administrator for the exclusive benefit of the participants or their beneficiaries rather than as assets of UTOPIA. Employer contributions under this plan during the years ended June 30, 2006, 2005 and 2004, were \$55,328, \$32,132 and \$21,393, respectively.

NOTE 7 OPERATING LEASE

UTOPIA has entered into various operating leases to secure network operations facilities, office space and equipment. The current year's expense related to operating leases was \$647,092. These leases range from 3 years to 15 years, with renewal options up to 20 years. Total remaining minimum lease payments at June 30, 2006 are as follows:

2007	\$	536,049
2008		393,150
2009		265,814
2010		272,563
2011		279,548
2012-2016		1,266,055
2017-2021		304,969
2022-2026		185,290
		185,290
	\$	3,503,438

NOTE 8 COMMITMENTS AND CONTRACTS

UTOPIA entered into various contracts with contractors, vendors and suppliers to provide the construction and equipment needed for the network.

In conjunction with the revenue bonds issued during the year, UTOPIA was required to obtain a letter of credit. If UTOPIA fails to pay the bonds, the letter of credit will be used to pay the bonds. UTOPIA pays an annual fee for this line of credit.

Contract with DynamicCity

During 2002 UTOPIA entered into a contract with DynamicCity to manage the construction of the fiber optic network. DynamicCity has agreed to defer certain portions of the payments owed to them from UTOPIA.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 8 COMMITMENTS AND CONTRACTS (Continued)

Contract with DynamicCity (Continued)

DynamicCity has agreed to pay UTOPIA a royalty based on DynamicCity's gross revenues from intellectual property developed while designing UTOPIA's fiber optic network. Each year DynamicCity will pay 1% of their gross revenues to UTOPIA until UTOPIA has received \$1,000,000 during that year. At that point, DynamicCity will pay UTOPIA 2% of gross revenues until UTOPIA has received \$12,000,000 during that year. During the year ending June 30, 2006 DynamicCity did not have any of this type of gross revenues. As a result, UTOPIA did not receive any royalty payments.

UTOPIA has agreed to pay DynamicCity 10% of UTOPIA's Adjusted Net Income for 20 years beginning July 2004. If DynamicCity meets certain performance criteria, UTOPIA agreed to pay DynamicCity an additional 10% of UTOPIA's Adjusted Net Income for 20 years beginning July 2004.

If DynamicCity does not meet the performance criteria for a given year or month, UTOPIA is not obligated to pay the additional 10% of Adjusted Net Income for that year or month. DynamicCity has agreed to defer receipt of these payments of Adjusted Net Income, if the payment would cause UTOPIA to fail to meet any debt service requirements related to building the network. If UTOPIA needs to defer these payments, DynamicCity can net them against payment of royalties to UTOPIA. For the year ending June 30, 2006 UTOPIA did not have Adjusted Net Income, as described in the contract.

DynamicCity has also agreed to make an operating loan in the amount of \$350,000 available to UTOPIA.

NOTE 9 PLEDGING MEMBERS LIABILITY

The 11 Pledging Member's of UTOPIA have pledged sales and use tax revenues to partially guarantee payment of UTOPIA's Revenue bonds. In return for the pledge, these members will be among the first cities to receive UTOPIA's services. In July 2004 UTOPIA issued an \$85,000,000 revenue bond. The first four years of bond payments will be made from a debt reserve fund, funded by the debt. From that point on, until the bonds are due in July 2026, net revenues from UTOPIA will reimburse the debt service fund for payments on the bond debt. To the extent that there are insufficient net revenues to pay the debt service, the 11 Pledging Members are required to reimburse the UTOPIA debt service fund of any shortfall by their respective percentages of ownership up to a specific dollar amount. The Pledging Member's percentage of the Debt Service Reserve shortfall is listed below, with a corresponding annual maximum liability. Any amounts paid by Pledging Members to UTOPIA to reimburse the debt service fund will be a loan to be repaid by UTOPIA.

On July 1, 2007, the Pledging Member's will be required to deposit the amounts specified below into the UTOPIA Series 2004 Bond Debt Service Reserve Fund. These funds will remain on deposit until the sooner of the bonds being retired or 20 years from July 1, 2007. To the extent that the initial projects operate profitably, UTOPIA has plans on issuing a total of \$340,000,000 in bonds. Any bonds or debt issued or incurred by UTOPIA will not constitute debt of the Pledging Members.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 9 PLEDGING MEMBERS LIABILITY (Continued)

<u>Pledging Member</u>	<u>Share of Total Pledge</u>	<u>Due On July 1, 2007 On Phase I Financing</u>	<u>Due On July 1, 2007 On Subsequent Financing</u>	<u>Maximum Pledge *</u>
Brigham City	3.33%	\$ 67,191	\$ 268,765	\$ 335,956
Centerville	3.31%	66,825	267,301	334,126
Layton	16.62%	335,394	1,341,574	1,676,968
Lindon	3.06%	308,681	-	308,681
Midvale	6.03%	608,337	-	608,337
Murray	12.24%	1,235,039	-	1,235,039
Orem	21.70%	2,189,704	-	2,189,704
Payson	2.58%	259,920	-	259,920
Perry	0.82%	16,483	65,931	82,414
Tremonton	2.51%	50,695	202,779	253,474
West Valley City	27.82%	2,806,999	-	2,806,999
	<u>100.00%</u>	<u>\$ 7,945,268</u>	<u>\$ 2,146,350</u>	<u>\$ 10,091,618</u>

* = These amounts are also the annual maximum debt service that can be required of the Pledging Members.

NOTE 10 SUBSEQUENT EVENTS

Subsequent to year end, UTOPIA entered into various contracts with contractors, vendors and suppliers to provide the construction and equipment needed for the network.

UTOPIA issued \$30,000,000 Taxable Adjustable Rate Telecommunication Revenue Bonds, Series 2006 subsequent to year end.. Although the bonds were issued with interest at a variable rate adjusted weekly, all variable interest rates have been swapped to synthetic fixed interest rates to minimize interest rate exposure. Subject to prior redemption or tender provisions, the bonds will mature in 2026.

UTOPIA entered into basis rate swap agreements on both of its revenue bonds (Series 2004 and Series 2006), which are designed to minimize interest rate exposure over the life of the respective bonds.

Subsequent to year end, UTOPIA made the decision to bring in-house curb-to-home construction activities. These activities had formerly been outsourced.