



**INTERNET CORPORATION
FOR ASSIGNED NAMES AND NUMBERS**

Financial Statements

June 30, 2004 and 2003

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 2000
355 South Grand Avenue
Los Angeles, CA 90071-1568

Independent Auditors' Report

The Board of Directors
Internet Corporation for Assigned Names and Numbers:

We have audited the accompanying statements of financial position of Internet Corporation for Assigned Names and Numbers (ICANN) as of June 30, 2004 and 2003, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of ICANN's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Internet Corporation for Assigned Names and Numbers as of June 30, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

August 13, 2004

**INTERNET CORPORATION
FOR ASSIGNED NAMES AND NUMBERS**

Statements of Financial Position

June 30, 2004 and 2003

Assets	2004	2003
Cash and cash equivalents	\$ 2,539,344	1,356,416
Accounts receivable, net (note 3)	2,872,268	3,158,830
Property and equipment, net (note 4)	250,032	112,703
Other assets	35,625	80,998
Total assets	\$ 5,697,269	4,708,947
Liabilities and Net Assets		
Accounts payable and accrued liabilities	\$ 901,744	572,330
Deferred revenue	655,632	397,050
Loans payable (note 5)	—	3,705
Total liabilities	1,557,376	973,085
Net assets:		
Unrestricted	4,139,893	3,735,862
Total net assets	4,139,893	3,735,862
Total liabilities and net assets	\$ 5,697,269	4,708,947

See accompanying notes to financial statements.

**INTERNET CORPORATION
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Statements of Activities

Years ended June 30, 2004 and 2003

	2004	2003
Changes in unrestricted net assets:		
Support and revenue:		
Domain name registry and registrar fees	\$ 7,280,463	5,089,881
Address registry fees	535,000	535,000
Accreditation fees	1,176,147	1,026,719
Application fees	947,500	82,485
Contributed goods and services	6,370	193,851
Interest income	12,408	18,428
Other income	—	1,777
Net assets released from restrictions	15,000	293,728
Total support and revenue	9,972,888	7,241,869
Expenses (note 2):		
Personnel	3,065,888	2,329,740
Board and public meetings	775,688	930,455
Other meetings and travel	617,467	460,275
Professional services	3,329,095	1,552,360
General and administrative	1,780,719	1,037,557
Total expenses	9,568,857	6,310,387
Change in unrestricted net assets	404,031	931,482
Changes in temporarily restricted net assets:		
Contributions and grants	15,000	50,921
Net assets released from restrictions	(15,000)	(293,728)
Change in temporarily restricted net assets	—	(242,807)
Change in net assets	404,031	688,675
Net assets at beginning of year	3,735,862	3,047,187
Net assets at end of year	\$ 4,139,893	3,735,862

See accompanying notes to financial statements.

**INTERNET CORPORATION
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Statements of Cash Flows

Years ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Change in net assets	\$ 404,031	688,675
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	53,372	106,263
Loss on disposal of property and equipment	—	2,306
Bad debt expense	757,135	189,061
Changes in operating assets and liabilities:		
Accounts receivable	(470,573)	(1,194,240)
Other assets	45,373	(80,509)
Accounts payable and accrued liabilities	329,414	(53,833)
Deferred revenue	258,582	(99,419)
Net cash provided by (used in) operating activities	<u>1,377,334</u>	<u>(441,696)</u>
Cash flows from investing activities:		
Purchases of property and equipment	<u>(190,701)</u>	<u>—</u>
Net cash used in investing activities	<u>(190,701)</u>	<u>—</u>
Cash flows from financing activities:		
Principal payments on loan payable	<u>(3,705)</u>	<u>(20,986)</u>
Net cash used in financing activities	<u>(3,705)</u>	<u>(20,986)</u>
Net increase (decrease) in cash and cash equivalents	1,182,928	(462,682)
Cash and cash equivalents, beginning of year	<u>1,356,416</u>	<u>1,819,098</u>
Cash and cash equivalents, end of year	<u>\$ 2,539,344</u>	<u>1,356,416</u>
Supplemental disclosure of investing and financing activities:		
Cash paid during the year for interest	\$ 46	1,483

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2004 and 2003

(1) Organization

Internet Corporation for Assigned Names and Numbers (ICANN) was established in September 1998 under the laws of the state of California. ICANN coordinates a select set of the Internet's technical management functions such as the assignment of protocol parameters, the management of the domain name system, the allocation of internet protocol (IP) address space, and the management of the root server system. Categories of internet domains include Generic Top Level Domains (gTLDs) which include the .com, .net, .org, and .edu domains and Country Code Top Level Domains (ccTLDs), examples of which are .us, .uk, and .fr. ICANN generates income from fees received from domain name registrars and related accreditation activities. Its primary sources of revenue are as follows:

- **Domain name registry and registrar fees** – Amounts contributed by organizations responsible for the registration and administration of Internet Domain Names.
- **Address registry fees** – Amounts contributed by organizations responsible for the assignment and administration of Internet addresses.
- **Accreditation fees** – Amounts paid in connection with initial and renewal accreditation of organizations engaged in the registration and administration of domain names in the .com, .net, .biz, .info, .museum, .name, and .org Internet domains.
- **Application fees** – Amounts paid in connection with processing of applications to become accredited domain name registrars or to become operators of new gTLD registries, see note 2.

ICANN also receives contributions and grants from other organizations.

ICANN has three supporting organizations which serve as advisory bodies to the ICANN board of directors with respect to Internet policy issues and structure within three specialized areas, including the system of IP addresses, the domain name system, and parameters for Internet protocols. The supporting committees are the primary source of substantive policy recommendations for matters lying within their respective specialized areas. The three supporting committees are the Address Supporting Organization (ASO), the Protocol Supporting Organization (PSO), and the Domain Name Supporting Organization (DNSO), which was restructured effective July 1, 2004 and is now the Generic Names Supporting Organization (GNSO). The supporting committees are not separately incorporated entities. The ASO and PSO were formed through memorandums of understanding where neither the Secretary nor Council members of either committee shall be entitled to any compensation or reimbursement of expenses from ICANN.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements are prepared on the accrual basis of accounting.

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June 30, 2004 and 2003

ICANN recognizes contributions, including unconditional promises to give, as revenue in the period received. Contributions and net assets are classified based on the existence or absence of donor-imposed restrictions. As such, the net assets of ICANN and changes therein are classified and reported as follows:

- ***Unrestricted net assets*** – Net assets that are not subject to donor-imposed stipulations and that may be expendable for any purpose in performing the objectives of ICANN.
- ***Temporarily restricted net assets*** – Net assets subject to donor-imposed stipulations that may or will be met either by actions of ICANN and/or the passage of time. As the restrictions are satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying financial statements as net assets released from restrictions.
- ***Permanently restricted net assets*** – Net assets subject to donor-imposed stipulations that resources be maintained in perpetuity. Investment income generated from these funds is available for general support of ICANN’s programs and operations unless otherwise stipulated by the donor. As of June 30, 2004 and 2003, ICANN had no permanently restricted net assets.

(b) *Functional Allocation of Expenses*

Expenses that can be identified with a specific program or supporting service are charged directly to the related program or supporting service. Expenses that are associated with more than one program or supporting service are allocated based on methods determined by management. As of and for the years ended June 30, 2004 and 2003, ICANN’s expenses are classified as follows:

	2004	2003
Program services	\$ 6,602,511	4,354,167
Supporting services:		
Management and general	2,966,346	1,956,220
Total	\$ 9,568,857	6,310,387

(c) *Cash and Cash Equivalents*

Cash and cash equivalents include deposits in bank and money market accounts.

(d) *Property and Equipment*

Property and equipment are stated at cost or, for contributed items, at fair market value at date of contribution. The equipment and furniture are being depreciated using an accelerated method over estimated useful lives of five to seven years. Fixtures are being depreciated using the straight-line method over the useful life or the remaining lease term, whichever is shorter.

(e) *Deferred Revenue – Accreditation Fees*

Accreditation fees attributable to future activities include cash and cash equivalents and are reflected as deferred revenue until earned.

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June 30, 2004 and 2003

(f) Promises to Give

Unconditional promises to give that are expected to be collected within one year are recorded at estimated net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the estimated future cash flows. Conditional promises to give are not included as support until the conditions are substantially met. Unconditional promises to give are included within accounts receivable in the accompanying statements of financial position.

(g) Contributed Goods and Services

The value of significant donated goods is reflected as contributions in the accompanying financial statements. For the year ended June 30, 2004, ICANN received \$6,370 in contributed goods. No contributed goods were received for the year ended June 30, 2003.

Contributed services are recognized only if the services (a) create or enhance long-lived assets or (b) require specialized skills, are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation. For the year ended June 30, 2003, contributed legal services totaled \$193,851 and are included in the accompanying statements of activities as contributed services and professional services expense. No contributed legal services were received during the year ended June 30, 2004.

(h) Application Fees

As described in note 1, application fees represent amounts paid to ICANN in connection with the processing of applications to either become accredited domain name registrars requiring an application fee of \$2,500 or to become an operator of a new gTLD. Each application to become an operator of a new gTLD requires a nonrefundable application fee determined by the board of directors. In 2004, ICANN solicited new sponsored TLD applications at \$45,000 per application. In 2003, the only application fees received were those for registrar accreditations and for the operator to run an existing registry (.org) with application fees of \$2,500 and \$45,000 per application, respectively.

Application fees totaled \$947,500 and \$82,485 for the years ended June 30, 2004 and 2003, respectively.

(i) Income Taxes

ICANN is exempt from federal and state income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

(j) Concentration of Credit Risk

ICANN holds a majority of its cash and cash equivalents at two financial institutions. Cash and cash equivalents consist of cash on deposit, money market accounts, and commercial paper. ICANN is exposed to credit loss for the amount of cash in excess of the federally insured limit of \$100,000 in

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the event of nonperformance by the counterparties. At June 30, 2004 and 2003, ICANN had cash in banks in excess of Federal Deposit Insurance Corporation (FDIC) insurance limits of approximately \$2,099,000 and \$1,326,000, respectively.

(k) Use of Estimates

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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(l) Reclassifications

Certain reclassifications have been made to the 2003 financial data to conform with the 2004 presentation.

(3) Accounts Receivable

Accounts receivable include amounts receivable from the following constituencies for various registry and accreditation fees at June 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
ccTLDs	\$ 426,912	459,356
gTLDs	1,848,558	1,578,030
IP address registries	1,292,761	1,211,010
Other	103,545	112,463
	<u>3,671,776</u>	<u>3,360,859</u>
Less allowance for doubtful accounts	<u>(799,508)</u>	<u>(202,029)</u>
	<u>\$ 2,872,268</u>	<u>3,158,830</u>

(4) Property and Equipment

Property and equipment at June 30, 2004 and 2003 consist of the following:

	<u>2004</u>	<u>2003</u>
Computer equipment	\$ 513,134	322,433
Furniture and fixtures	44,195	44,195
Leasehold improvements	112,315	112,315
Total	<u>669,644</u>	<u>478,943</u>
Less accumulated depreciation	<u>(419,612)</u>	<u>(366,240)</u>
	<u>\$ 250,032</u>	<u>112,703</u>

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Depreciation expense totaled \$53,372 and \$106,263 for the years ended June 30, 2004 and 2003, respectively.

(5) Loans Payable

ICANN subleases office space from the University of Southern California (USC). Included in the June 30, 2003 loans payable were two loans payable to USC for leasehold improvements made on ICANN's behalf by USC. ICANN made monthly principal and interest (at 8% per annum) payments through September 2003. At June 30, 2003, amounts due to USC under these loans totaled \$3,705. No amounts were outstanding at June 30, 2004.

(6) Legal Matters

In the ordinary course of business, ICANN is subject to lawsuits and other potential legal actions. Management is unable, at this time, to determine the probable outcome or the effect, if any, that these actions may have on the financial position and the ongoing operations of ICANN. Accordingly, the accompanying financial statements do not include a provision for any losses that may result from ICANN's current involvement in legal matters.

(7) Related Party Transactions

The services of ICANN's current president and chief executive officer were provided to ICANN through a professional services agreement with a company in which the president has an interest. Total payments under this contract for the fiscal years ended June 30, 2004 and 2003, including fees for professional services and reimbursed travel-related expenses, telecommunications, information technology supplies and support, and office supplies, were \$557,009 (for a twelve-month period) and \$184,727 (for a four-month period), respectively.