



AUDITED CONSOLIDATED FINANCIAL STATEMENTS

TENNESSEE 545
NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION
AND SUBSIDIARY
LAFAYETTE, TENNESSEE

December 31, 2011 and 2010

TOTHEROW, HAILE & WELCH, PLLC
Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT

Board of Directors
North Central Telephone
Cooperative Corporation
Lafayette, Tennessee

We have audited the accompanying consolidated balance sheets of North Central Telephone Cooperative Corporation and Subsidiary as of December 31, 2011 and 2010, and the related consolidated statements of income and comprehensive income, changes in members' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of North Central Telephone Cooperative Corporation and Subsidiary as of December 31, 2011 and 2010, and the results of their operations and cash flows for the years 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 our report dated February 23, 2012, on our consideration of North Central Telephone Cooperative Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, 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 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 read in conjunction with this report in considering the results of our audits.

Totherow, Haile & Welch, PLLC

Certified Public Accountants

McMinnville, Tennessee
February 23, 2012

CONSOLIDATED

NORTH CENTRAL TELEPHONE COOPERATIVE

December 31, 2011

	2011	2010
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash - general	\$ 3,224,565	\$ 4,790,111
Cash - construction funds	1,365,705	475,280
Temporary cash investments	2,100,000	3,350,000
Telecommunications accounts receivable, less allowances of \$44,395 in 2011 and \$51,707 in 2010	1,789,483	1,239,134
Other accounts receivable	159,184	27,221
Grants receivable	0	254,581
Materials and supplies	554,167	486,686
Refundable tax deposit	10,800	0
Other current assets	287,496	65,059
TOTAL CURRENT ASSETS	\$ 9,491,400	\$ 10,688,072
<u>NONCURRENT ASSETS</u>		
Investments	\$ 23,538,349	\$ 20,547,698
Nonregulated investments	2,392,056	2,304,800
Goodwill, less accumulated amortization	652,983	813,143
Deferred tax asset	90,872	88,187
TOTAL NONCURRENT ASSETS	\$ 26,674,260	\$ 23,753,828
<u>PROPERTY, PLANT AND EQUIPMENT</u>		
Telecommunications plant in service	\$ 123,447,365	\$ 123,158,868
Telecommunications plant under construction	21,446,883	7,438,696
	\$ 144,894,248	\$ 130,597,564
Less accumulated depreciation	68,237,744	67,380,254
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 76,656,504	\$ 63,217,310
	<u>\$ 112,822,164</u>	<u>\$ 97,659,210</u>

See the notes to financial statements.

BALANCE SHEETS

CORPORATION AND SUBSIDIARY

and 2010

	2011	2010
<u>LIABILITIES AND MEMBERS' EQUITY</u>		
<u>CURRENT LIABILITIES</u>		
Notes payable	\$ 2,088,884	\$ 1,531,002
Accounts payable	4,451,510	3,638,873
Advance billings and payments	232,864	219,617
Customer deposits	279,987	301,323
Current maturities on long-term debt	6,251,833	5,271,136
Accrued federal and state taxes	127,610	382,698
Accrued interest	65,286	61,581
Accrued rents	673,966	640,835
Accrued salaries and wages	123,796	117,349
Accrued property taxes	616,167	382,950
Accrued vacation and sick leave benefits	1,516,354	1,636,320
Other current liabilities	336,681	337,434
	<hr/>	<hr/>
TOTAL CURRENT LIABILITIES	\$ 16,764,938	\$ 14,521,118
 <u>LONG-TERM DEBT</u>		
Rural Utilities Service	27,730,300	21,806,273
Rural Telephone Bank	11,122,419	10,190,740
Other long-term debt	3,886,664	852,867
 <u>OTHER LIABILITIES</u>		
Postretirement benefits other than pension	5,755,240	4,402,078
Deferred grant revenue	0	1,265,468
Deferred taxes	2,669,360	1,393,393
	<hr/>	<hr/>
TOTAL LIABILITIES	\$ 67,928,921	\$ 54,431,937
 <u>MEMBERS' EQUITY</u>		
	44,893,243	43,227,273
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	<u>\$ 112,822,164</u>	<u>\$ 97,659,210</u>

CONSOLIDATED STATEMENTS OF
NORTH CENTRAL TELEPHONE COOPERATIVE

For the years ended

	2011	2010
Operating revenues:		
Local network services revenue	\$ 5,156,214	\$ 5,418,995
Network access services revenue	13,897,999	10,158,980
Long distance network services revenue	313,552	460,387
Miscellaneous revenue	2,710,283	2,558,041
Less: Uncollectible revenue	<u>(102,174)</u>	<u>(136,174)</u>
TOTAL OPERATING REVENUES	\$ 21,975,874	\$ 18,460,229
Operating expenses:		
Plant specific operations expense	\$ 6,519,522	\$ 4,518,271
Plant nonspecific operations expense	1,656,836	2,094,443
Provision for depreciation and amortization	7,846,788	6,974,794
Customer operations expense	2,296,149	2,191,320
Corporate operations expense	3,808,682	3,497,614
Operating taxes	<u>788,293</u>	<u>549,141</u>
TOTAL OPERATING EXPENSES	<u>\$ 22,916,270</u>	<u>\$ 19,825,583</u>
OPERATING LOSS	\$ (940,396)	\$ (1,365,354)
Other income (loss):		
Income from investments	\$ 5,350,770	\$ 3,067,824
Interest and dividends	19,483	142,087
Loss from disposition of assets	(14,700)	(172,897)
Impairment of goodwill	(160,160)	0
Loss from impairment of investment	(50,000)	(300,000)
Nonregulated income	<u>1,323,869</u>	<u>909,127</u>
TOTAL OTHER INCOME	\$ 6,469,262	\$ 3,646,141

See the notes to financial statements.

INCOME AND COMPREHENSIVE INCOME

CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

	2011	2010
Fixed charges:		
Interest expense	\$ 2,142,588	\$ 1,848,661
Interest charged to construction - credit	<u>(476,952)</u>	<u>(489,066)</u>
TOTAL FIXED CHARGES	<u>\$ 1,665,636</u>	<u>\$ 1,359,595</u>
INCOME BEFORE TAXES ON INCOME	\$ 3,863,230	\$ 921,192
Taxes on income	<u>1,797,449</u>	<u>757,185</u>
NET INCOME	\$ 2,065,781	\$ 164,007
Other comprehensive income (loss):		
Postretirement benefit other than pension:		
Unrecognized gain (loss) on assets	(500,316)	(407,644)
Transition obligation	<u>100,504</u>	<u>100,507</u>
COMPREHENSIVE INCOME (LOSS)	<u>\$ 1,665,969</u>	<u>\$ (143,130)</u>

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2011 and 2010

	Patronage Capital	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2009	\$ 45,665,346	\$ (2,294,943)	\$ 43,370,403
Net income for 2010	164,007	0	164,007
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized loss on assets	0	(407,644)	(407,644)
Transition obligation	0	100,507	100,507
Balance at December 31, 2010	\$ 45,829,353	\$ (2,602,080)	\$ 43,227,273
Net income for 2011	2,065,781	0	2,065,781
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized loss on assets	0	(500,318)	(500,318)
Transition obligation	0	100,507	100,507
Balance at December 31, 2011	<u>\$ 47,895,134</u>	<u>\$ (3,001,891)</u>	<u>\$ 44,893,243</u>

See the notes to financial statements.

CONSOLIDATED STATEMENTS

NORTH CENTRAL TELEPHONE COOPERATIVE

For the years ended

	2011	2010
Cash flows from operating activities:		
Cash received from customers	\$ 21,293,562	\$ 18,427,975
Cash paid to suppliers and employees	(13,706,096)	(10,019,595)
Interest received	19,483	142,087
Interest paid	(1,661,931)	(1,351,700)
Taxes paid	(1,345,131)	(1,352,308)
	<hr/>	<hr/>
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 4,599,887	\$ 5,846,459
Cash flows from investing activities:		
Construction and acquisition of plant	\$ (22,603,475)	\$ (12,339,601)
Plant removal costs	(9,512)	(127,858)
Salvage	8,750	11,582
Disposition of asset	(14,700)	(170,749)
Cash distribution from investments	2,310,119	2,587,671
Investment in nonregulated CPE	(87,256)	(288,974)
Collection on notes receivable	0	3,567
Decrease (Increase) in:		
Grants receivable	254,581	123,971
Materials and supplies	(67,481)	(119,519)
Temporary investments	1,250,000	661,879
Nonregulated income	1,323,869	909,127
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NET CASH USED BY INVESTING ACTIVITIES	\$ (17,635,105)	\$ (8,748,904)

OF CASH FLOWS

CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

	2011	2010
Cash flows from financing activities:		
Debt proceeds	\$ 18,409,823	\$ 6,211,292
Payments on notes payable and long-term borrowings	(6,981,741)	(5,129,824)
Postretirement benefits other than pension	953,351	196,183
Decrease in customer deposits	<u>(21,336)</u>	<u>(11,075)</u>
NET CASH PROVIDED BY FINANCING ACTIVITIES	<u>\$ 12,360,097</u>	<u>\$ 1,266,576</u>
NET DECREASE IN CASH	\$ (675,121)	\$(1,635,869)
CASH AT BEGINNING OF YEAR	<u>5,265,391</u>	<u>6,901,260</u>
CASH AT END OF YEAR	<u><u>\$ 4,590,270</u></u>	<u><u>\$ 5,265,391</u></u>

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2011 and 2010

	2011	2010
Comprehensive income (loss)	\$ 1,665,969	\$ (143,130)
Other comprehensive loss - Postretirement benefits other than pension	399,812	307,137
Nonregulated income	(1,323,869)	(909,127)
Income from investments	(5,350,770)	(3,067,824)
Loss from disposition of assets	14,700	172,897
Impairment of goodwill	160,160	0
Impairment of investment	50,000	300,000
 Net loss from regulated operations	 \$ (4,383,998)	 \$ (3,340,047)
 Adjustments to reconcile net loss from regulated operations to net cash provided by operating activities:		
Depreciation and amortization	\$ 7,899,575	\$ 7,114,286
Deferred taxes on income	1,273,282	(200,353)
 Decrease (Increase) in:		
Customer and accounts receivable	(682,312)	(32,254)
Current and accrued assets - other	(222,437)	48,799
Refundable tax deposit	(10,800)	9,579
 Increase (Decrease) in:		
Accounts payable	812,637	2,627,723
Advance billings and payments	13,247	11,979
Accrued federal and state taxes	(255,088)	231,118
Accrued interest	3,705	7,895
Accrued rents	33,131	17,182
Accrued salaries and employee benefits	(113,519)	(558,536)
Accrued property taxes	233,217	(86,326)
Other current liabilities	(753)	(4,586)
 TOTAL ADJUSTMENTS	 \$ 8,983,885	 \$ 9,186,506
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 \$ 4,599,887	 \$ 5,846,459

See the notes to financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note A – North Central Telephone Cooperative Corporation and Subsidiary provides retail telecommunications services to Macon County, Tennessee and surrounding counties including a portion of southern Kentucky. North Central Telephone Cooperative Corporation and Subsidiary has adopted the following accounting policies:

(1) Principles of Consolidation:

North Central Telephone Cooperative Corporation (Cooperative) owns 100% of the outstanding common stock of North Central Communications, Inc. and Subsidiaries (Subsidiary). North Central Communications, Inc. and Subsidiaries were formed for the purpose of providing long distance and other telephone services, computer sales, leasing and services and security systems. The consolidated financial statements include the accounts of North Central Communications, Inc. and Subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

(2) The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(3) For purposes of financial statement presentation, the Cooperative and Subsidiary consider all highly-liquid investments with a maturity of three months or less to be cash equivalents. Cash equivalents consist primarily of treasury bills and notes and commercial paper with original maturities of 90 days or less. Certificates of deposit and other securities with original maturities over 90 days are classified as temporary investments.

(4) Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for doubtful accounts based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to accounts receivable. No interest is charged on accounts receivable balances that are past due. Past due accounts receivable are based upon contractual terms as defined on customer invoices. Accounts receivable past due 90 days or more amounted to \$241,290 and \$93,655 at December 31, 2011 and 2010, respectively.

The allowance for doubtful accounts is based upon a credit review of the accounts receivable, past bad debt experience, current economic conditions and other pertinent factors which form a basis for determining the adequacy of the allowance. The allowance represents an estimate based upon these and other factors and, it is at least reasonably possible that a change in the estimate will occur in the near term.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note A – (Cont'd):

- (5) Material and supplies are valued at average cost accumulated in perpetual inventory records, which are periodically adjusted to physical counts.
- (6) Employee vacation and sick leave benefits are accrued as the benefits are earned according to an established policy.
- (7) Revenue is recorded upon the billing of telecommunication services net of sales tax.
- (8) The Cooperative's expenditures for maintenance and repairs are charged to operations as they are incurred and betterments are capitalized. Original costs of properties retired are eliminated from property accounts and removal costs are charged to the allowance for depreciation. Salvage value of retired property is credited to the allowance for depreciation.
- (9) Advertising costs are charged to expense as incurred. These costs amounted to \$127,883 in 2011 and \$187,534 in 2010.
- (10) Various amounts in the financial statements have been reclassified for comparative purposes.

Note B – Concentrations of Credit Risks:

Deposits

The Cooperative and Subsidiary maintains its cash in several commercial banks located within its trade area. Accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 on interest bearing accounts and unlimited coverage on non-interest bearing accounts. Approximately \$6,464,349 was uninsured at December 31, 2011.

Restricted cash consists of an employees' savings account in which \$64,315 has been deposited.

Accounts receivable

Telecommunications services are provided to the customers within its trade area on a credit basis in the ordinary course of business. Generally, the accounts receivable generated by the sale of these services are unsecured.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note C – Broadband Initiatives Program:

During 2010, the Cooperative applied for, and was awarded, a loan and grant combination to construct an updated broadband network in its service area under the Broadband Initiatives Program (the Program). The total amount awarded to the Cooperative was \$49,679,709, of which \$24,964,000 represents eligible loan proceeds and \$24,715,709 of which will be awarded as a grant. Under the Program, the Cooperative will be reimbursed for eligible costs associated with the construction of the broadband facilities over a three year period. As of December 31, 2011, the Cooperative has received \$12,032,656 in loan proceeds and \$11,942,662 of the grant portion.

Note D – Investments:

	<u>2011</u>	<u>2010</u>
NECA Services, Inc. stock - at cost	\$ 10,000	\$ 10,000
Cash value of life insurance	307,130	355,847
Investment in Kentucky RSA #3 cellular partnership (25%)	18,162,750	15,466,500
Investment in Bluegrass Network, LLC (20%)	3,195,120	2,837,218
Investment in Bluegrass Telecom, LLC (20%)	360,140	363,376
Qualified patronage capital certificates – NRTC	342,042	342,042
Tennessee 220 MHZ Radio	147,224	147,224
Tennessee Independent Telecom Group (IRIS Networks) (10.556%)	1,003,803	965,351
Crossroads Wireless, Inc.	0	50,000
Synergy Wireless, Inc. – at cost	10,000	10,000
Deposits	<u>140</u>	<u>140</u>
	<u>\$23,538,349</u>	<u>\$20,547,698</u>

Ownership percentages are in parentheses for investments in which North Central Communications, Inc. owns a significant portion of the investment. All other investments are carried at cost.

Investments carried at cost are not normally evaluated for impairment because it is not practical to estimate fair value due to insufficient information being available. An evaluation is performed, however, if economic or market concerns warrant such an evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent or ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery of fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note D – (Cont'd):

During 2010, information became available concerning the fair value of Crossroads Wireless, Inc., a cost method investment. The investment in Crossroads Wireless, Inc. was evaluated for impairment because of an adverse change in the economic condition of the company. As a result of the evaluation North Central Communications, Inc. identified a realized loss of \$300,000. During 2011, management evaluated the balance of the Crossroads investment and deemed it necessary to write down the remaining balance of its investment. This resulted in an additional impairment of \$50,000. The severity of the impairment (fair value is approximately equal to 0% of cost) and the duration of the impairment correlate to the weak credit resources available in 2011 and the company's pending bankruptcy. Based on management's evaluation of the near term prospects and present financial condition of the investee, management believes the impairment to be necessary for the year ended December 31, 2011.

Management has not identified any circumstances that may have a significant adverse effect on the fair value of any other cost method investment.

The following is a summary as of December 31, 2011 of selected financial information from the financial statements of the investments in which North Central Communications, Inc. owns a significant percentage:

	Kentucky RSA #3 cellular <u>partnership</u>	Bluegrass <u>Network, LLC</u>	Bluegrass <u>Telecom, LLC</u>	Tennessee Independent <u>Telecom Group</u>
Total assets	\$75,267,191	\$16,668,926	\$2,942,408	\$21,104,029
Total liabilities	\$ 3,920,678	\$ 693,329	\$1,232,414	\$11,650,938
Total equity	\$71,346,513	\$15,975,597	\$1,709,994	\$ 9,453,091
Net income	\$16,585,308	\$ 2,789,507	\$ 495,335	\$ 364,272

Note E – Nonregulated investments:

	<u>2011</u>	<u>2010</u>
Nonregulated customer premises equipment	\$5,231,032	\$4,398,568
Less accumulated provisions for depreciation	<u>2,838,976</u>	<u>2,093,768</u>
TOTAL	<u>\$2,392,056</u>	<u>\$2,304,800</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note E – (Cont'd):

Nonregulated customer premises equipment is stated at cost. The Cooperative provides for depreciation on a straight-line basis at an annual rate of depreciation, which will amortize the cost of the equipment over its estimated useful life.

Note F – Goodwill is reviewed annually or sooner if deemed necessary, for impairment. Goodwill represents the excess cost over fair value of net assets acquired through acquisitions. During 2011, the Company wrote off identified goodwill of \$160,160 related to the Company's purchase of a cable company located within the Company's trade area in 2005. The amount of the impairment was based on the current estimated fair value of the customer base originally purchased.

Note G – Telephone plant in service and under construction is stated at cost. Listed below are the major classes of the telephone plant as of December 31:

	<u>2011</u>	<u>2010</u>
Franchises	\$ 236	\$ 236
Land	818,654	818,654
Buildings	8,328,082	5,722,314
Central office equipment	32,026,524	37,680,928
Outside plant network	68,396,586	66,914,946
Furniture and office equipment	2,367,492	2,331,142
Vehicles and other work equipment	<u>2,904,932</u>	<u>2,976,368</u>
Telecommunications plant in service as contained on the Cooperative's records	\$114,842,506	\$116,444,588
Land	\$ 35,000	\$ 35,000
Building	212,506	208,524
CATV equipment	75,545	75,545
Central office equipment	4,590,545	3,323,498
Outside plant network	2,444,782	2,444,783
Office furniture and fixtures	40,622	39,469
Equipment	833,727	470,072
Vehicles	<u>372,132</u>	<u>117,389</u>
Telecommunications plant in service as contained on the Subsidiaries' records	\$ <u>8,604,859</u>	\$ <u>6,714,280</u>
Total telecommunications plant in service	<u>\$123,447,365</u>	<u>\$123,158,868</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note G – (Cont'd)

The Cooperative provides for depreciation on a straight-line basis of annual rates, which will amortize the depreciable property over its estimated useful life. Such provision as a percentage of the average balance of telephone plant in service was 6.14 percent for 2011 and 6.17 percent for 2010. The provision for depreciation in 2011 and 2010 was \$7,097,985 and \$6,567,804, respectively.

Individual plant depreciation rates are as follows:

	<u>Percent</u>
Buildings	2.6
Central office equipment	6.7 – 21.0
Public telephone equipment	15.1
Poles, cable and wire	1.7 – 8.8
Furniture and office equipment	6.7 – 16.4
Vehicles and other work equipment	6.4 – 10.8
DBS and internet equipment	18.8

The Subsidiary provides for depreciation on a straight-line basis at annual rates, which will amortize the depreciable property over its useful life. Depreciation charged to expense on the Subsidiary's records amounted to \$748,803 in 2011 and \$406,990 in 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note H – A description of notes payable follows:

The Cooperative has entered into a note payable with Citizen's Bank for \$2,500,000 that accumulates interest at a rate of 4.65% and is payable quarterly. The note matures on April 25, 2012. The outstanding balance of the note at December 31, 2011 is \$2,088,884.

Long-term debt is represented by mortgage notes payable to the United States of America and Farmer's National Bank. Substantially all assets are pledged as security for the long-term debt. The following is a summary of outstanding long-term debt:

	<u>2011</u>	<u>2010</u>
2% to 4% Rural Utilities Service notes	\$ 3,155,787	\$ 3,378,420
4.1% to 5.1545% Rural Utilities Service notes	17,704,158	23,073,454
5.0% to 5.13% Rural Telephone Bank notes	11,539,730	10,538,447
5.0% Farmers National Bank, matures October 22, 2013	855,760	1,130,695
5.75% Farmers National Bank, matures October 12, 2015	1,203,125	0
Rural Utilities Service notes, matures June 17, 2031	12,032,656	0
5.0% Macon Co. Bank & Trust Co., matures December 21, 2016	<u>2,500,000</u>	<u>0</u>
	\$48,991,216	\$38,121,016
Less current maturities	<u>6,251,833</u>	<u>5,271,136</u>
TOTAL	<u>\$42,739,383</u>	<u>\$32,849,880</u>

Principle and interest installments on the above notes are due quarterly and monthly. The Rural Utilities Service notes have various maturity dates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note H – (Cont'd):

Long-term debt matures as follows:

<u>Year ending December 31.</u>	<u>Amount</u>
2012	\$ 6,251,833
2013	6,406,991
2014	6,492,776
2015	6,814,584
2016	4,322,777
Beyond five years	<u>18,702,255</u>
TOTAL	<u>\$48,991,216</u>

Note I – As required by the Retirement Benefit Topic of the FASB ASC, the Cooperative accrues all postretirement benefits other than pensions. Under the prescribed accrual method, the Cooperative's obligation for these postretirement benefits is to be fully accrued by the date employees attain full eligibility for such benefits. The cost of medical benefits for current and future associate retirees was recognized as determined under the projected united credit cost method.

Substantially all of the Cooperative's employees are covered under postretirement medical plans. The determination of postretirement benefit cost for postretirement medical benefit plan is based on comprehensive hospital, medical and surgical benefit provisions.

The following table sets forth the plan's funded status and the amounts recognized in the Cooperative's Consolidated Balance Sheet as of December 31:

	<u>2011</u>	<u>2010</u>
Accumulated postretirement obligation attributable to:		
Retirees	\$ 4,143,460	\$ 3,778,396
Fully eligible plan participants	1,035,865	965,435
Other active plan participants	<u>7,768,989</u>	<u>6,909,509</u>
Total accumulated postretirement benefit obligation	\$12,948,314	\$11,653,340
Fair value of plan assets	<u>(7,193,074)</u>	<u>(7,251,262)</u>
Net unfunded status	<u>\$ 5,755,240</u>	<u>\$ 4,402,078</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note I – (Cont'd):

Amounts recognized in other comprehensive income:

Unrecognized net gains	\$ (3,001,892)	\$ (2,501,577)
Unamortized transition obligation	<u>0</u>	<u>(100,503)</u>
Total included in other comprehensive income	<u>\$ (3,001,892)</u>	<u>\$ (2,602,080)</u>

Postretirement benefit cost is composed of the following for the year ended December 31:

	<u>2011</u>	<u>2010</u>
Benefits earned during the year	\$ 417,675	\$ 409,060
Interest on accumulated postretirement benefit obligation	664,103	622,738
Actual return on plan assets	(435,380)	(422,688)
Net amortization of transition obligation over 20 years	<u>100,507</u>	<u>100,507</u>
Postretirement benefit cost	<u>\$ 746,905</u>	<u>\$ 709,617</u>

The Medicare and Prescription Drug, Improvement and Modernization Act of 2003 provides for a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to the benefit established by the law. Currently, for the plan, the Medicare Part D Subsidy is a reduction to premiums paid for by participants that are at least 65 years old. For 2011, premiums for this group of participants were approximately \$50 less than it would have been without the adjustment.

Weighted average assumptions to determine benefit obligations and net periodic cost for the years ended December 31:

	<u>2011</u>	<u>2010</u>
Discount rate	5.50%	5.75%
Rate of compensation increase	3.00%	6.00%
Expected return on plan assets	7.60%	8.40%

The Cooperative's expected rate of return on plan assets is determined by the plan's historical long-term investment performance, current asset allocation, and estimates of future long-term return by asset class.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note I – (Cont'd):

The medical cost trend rate in 2011 was approximately 9.0% grading down to an ultimate rate in 2020 of 5.0%. A one percentage point increase in the assumed medical cost trend rates for each future year would have increased the aggregate of the service and the interest components of the 2011 net periodic postretirement benefit cost by \$337,817 and would have increased the postretirement benefit obligation as of December 31, 2011 by \$2,081,806.

The plan attempts to mitigate investment risks by balancing between equity and debt classes of investments. Currently, the plan is invested in mutual funds with a target allocation of approximately 65% domestic and international stocks, 15% investment grade bonds, 10% high yield bonds, and 10% real estate. Although changes in interest rates may affect the fair value of a portion of the investment portfolio and cause unrealized gains and losses, such gains and losses would not be realized unless the investments are sold. In addition, no plan assets are expected to be returned to the Cooperative in 2011.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid from the plan:

<u>Year</u>	<u>Amount</u>
2012	\$ 360,524
2013	364,129
2014	367,771
2015	371,448
2016	375,162
Years 2017 – 2021	<u>1,932,843</u>
TOTAL	<u>\$3,771,877</u>

The Cooperative did not make a contribution to the plan in 2011 and an annual contribution to the plan is not anticipated in 2012.

Note J – The Cooperative has adopted the retirement and security program of the National Telephone Cooperative Association as a pension plan covering all employees meeting certain age and length of service requirements for which it pays approximately 80% of the cost. The Cooperative funds the pension plan by making monthly contributions into the program based on salaries. The Cooperative's cost was \$745,197 for 2011 and \$764,996 for 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note K – As required by the Income Tax Topic of FASB ASC, the Company recognizes deferred tax assets and liabilities for future tax consequences of events that have been previously recognized in the Company's financial statements and tax returns. The measurement of deferred tax assets and liabilities is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. Measurement is computed using applicable current tax rates.

	<u>2011</u>	<u>2010</u>
Current income tax expense:		
Federal	\$ 309,812	\$ 454,196
State	214,356	84,042
Deferred income tax expense (benefit):		
Federal	1,159,073	181,855
State	<u>108,698</u>	<u>35,032</u>
Income tax before valuation	\$1,791,939	\$ 755,125
Valuation of deferred tax asset	<u>5,510</u>	<u>2,060</u>
	<u>\$1,797,449</u>	<u>\$ 757,185</u>

The Company's total deferred tax assets and liabilities at December 31 are as follows:

	<u>2011</u>	<u>2010</u>
Deferred tax asset	\$ 126,333	\$ 116,078
Deferred tax liability	<u>(2,669,360)</u>	<u>(1,393,393)</u>
	\$(2,543,027)	\$(1,277,315)
Valuation allowance	<u>(35,461)</u>	<u>(27,891)</u>
Net deferred tax liability	<u>\$(2,578,488)</u>	<u>\$(1,305,206)</u>

The deferred tax asset is primarily the result of net operating losses that are carried forward for state income tax reporting purposes from North Central Communication's investment in its wholly owned subsidiaries.

The individual companies included in the consolidation are responsible for their own tax liabilities. All companies are no longer subject to Internal Revenue or state taxing authority examinations beyond the statute of limitations for the respective taxing authorities.

North Central Computer Technologies, Inc. has a net operating loss carryforward of approximately \$1,745,000, which is available to offset future state taxable income. This carryforward will expire in 3 to 14 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2011 and 2010

Note K – (Cont'd)

North Central Security Services, Inc. has a net operating loss carryforward of approximately \$1,860,000, which is available to offset future state taxable income. This carryforward will expire in 4 to 15 years.

The Companies are no longer subject to federal or state income tax examinations for years beyond the statute of limitations of the respective taxing authorities.

Note L – Labor Force

Approximately 80% of the Cooperative's labor force is subject to a collective bargaining agreement. A two-year agreement was negotiated and approved for the period January 1, 2011 to December 31, 2012 between the Cooperative and the Communications Workers of America.

Note M – Commitments and Contingencies

The Cooperative is a guarantor for loans in the amount of \$550,000. These loans are the obligation of TN Independent Telecommunications Group d/b/a Iris Networks, a related party.

The Cooperative accrues pole rental based on contracts it has with other utility companies. These contracts establish the rate per pole the Cooperative pays to attach to these entities. Currently one electric cooperative has invoiced the Cooperative for attachment rates that are significantly higher than the contract amounts. Management is currently trying to resolve this matter and believes it will be successful. At December 31, 2011 the accrued pole rent has been accrued at the contact rate not the invoiced rate.

Note N – Subsequent events are transactions or events that occur subsequent to the date of the financial statements and before the issuance of those financial statements. Management has evaluated transactions and events that occurred subsequent to December 31, 2011 and before the date these financial statements were available to be issued, February 23, 2012, and determined that no additional disclosures are necessary.

CONSOLIDATING INFORMATION

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INDEPENDENT AUDITORS' REPORT ON CONSOLIDATING INFORMATION

Board of Directors
North Central Telephone
Cooperative Corporation
Lafayette, Tennessee

Our report on our audits of the consolidated financial statements of North Central Telephone Cooperative Corporation and Subsidiary for 2011 and 2010 appears on page five. Those audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information contained on pages 32 through 35 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual companies. Such information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Totherow, Haile & Welch, PLLC
Certified Public Accountants

McMinnville, Tennessee
February 23, 2012

CONSOLIDATING

NORTH CENTRAL TELEPHONE

December 31,

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>ASSETS</u>				
<u>CURRENT ASSETS</u>				
Cash - general	\$ 2,464,116	\$ 760,449	\$ 0	\$ 3,224,565
Cash - construction funds	1,365,705	0	0	1,365,705
Temporary cash investments	1,100,000	1,000,000	0	2,100,000
Telecommunications accounts receivable	1,676,815	112,668	0	1,789,483
Other accounts receivable	159,184	0	0	159,184
Grant receivable	0	0	0	0
Advance to related company	0	6,158,660	(6,158,660)	0
Materials and supplies	506,400	47,767	0	554,167
Refundable tax deposit	10,800	0	0	10,800
Other current assets	81,778	205,718	0	287,496
TOTAL CURRENT ASSETS	\$ 7,364,798	\$ 8,285,262	\$ (6,158,660)	\$ 9,491,400
<u>NONCURRENT ASSETS</u>				
Investment in subsidiary	\$ 30,923,218	\$ 0	\$ (30,923,218)	\$ 0
Investments	317,129	23,221,220	0	23,538,349
Nonregulated investments	2,392,056	0	0	2,392,056
Goodwill - net	0	652,983	0	652,983
Deferred tax asset	0	90,872	0	90,872
TOTAL NONCURRENT ASSETS	\$ 33,632,403	\$ 23,965,075	\$ (30,923,218)	\$ 26,674,260
<u>PROPERTY, PLANT AND EQUIPMENT</u>				
Telecommunications plant in service	\$ 114,842,506	\$ 8,604,859	\$ 0	\$ 123,447,365
Telecommunications plant under construction	21,385,618	61,265	0	21,446,883
	\$ 136,228,124	\$ 8,666,124	\$ 0	\$ 144,894,248
Less accumulated depreciation	63,792,098	4,445,646	0	68,237,744
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 72,436,026	\$ 4,220,478	\$ 0	\$ 76,656,504
	<u>\$ 113,433,227</u>	<u>\$ 36,470,815</u>	<u>\$ (37,081,878)</u>	<u>\$ 112,822,164</u>

BALANCE SHEETS

COOPERATIVE CORPORATION AND SUBSIDIARY

2011

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>LIABILITIES AND MEMBERS' EQUITY</u>				
<u>CURRENT LIABILITIES</u>				
Notes payable	\$ 2,088,884	\$ 0	\$ 0	\$ 2,088,884
Accounts payable	3,985,018	466,492	0	4,451,510
Advance billings and payments	189,108	43,756	0	232,864
Advance from related company	6,158,660	0	(6,158,660)	0
Customer deposits	279,987	0	0	279,987
Current maturities on long-term debt	5,777,020	474,813	0	6,251,833
Accrued federal and state taxes	0	127,610	0	127,610
Accrued interest	65,286	0	0	65,286
Accrued rent	647,025	26,941	0	673,966
Accrued salaries and wages	114,866	8,930	0	123,796
Accrued property taxes	573,753	42,414	0	616,167
Accrued vacation and sick leave benefits	1,516,354	0	0	1,516,354
Other current liabilities	233,473	103,209	0	336,682
TOTAL CURRENT LIABILITIES	\$ 21,629,434	\$ 1,294,165	\$ (6,158,660)	\$ 16,764,939
<u>LONG-TERM DEBT</u>				
Rural Utilities Service	27,730,300	0	0	27,730,300
Rural Telephone Bank	11,122,419	0	0	11,122,419
Other long-term debt	2,302,592	1,584,072	0	3,886,664
<u>OTHER LIABILITIES</u>				
Postretirement benefits other than pension	5,755,240	0	0	5,755,240
Deferred tax liability	0	2,669,360	0	2,669,360
TOTAL LIABILITIES	\$ 68,539,985	\$ 5,547,597	\$ (6,158,660)	\$ 67,928,922
<u>MEMBERS' EQUITY</u>				
Capital stock	\$ 0	\$ 8,100,000	\$ (8,100,000)	\$ 0
Patronage capital	44,893,242	0	0	44,893,242
Retained earnings	0	22,823,218	(22,823,218)	0
TOTAL MEMBERS' EQUITY	\$ 44,893,242	\$ 30,923,218	\$ (30,923,218)	\$ 44,893,242
	\$ 113,433,227	\$ 36,470,815	\$ (37,081,878)	\$ 112,822,164

CONSOLIDATING STATEMENTS OF

NORTH CENTRAL TELEPHONE COOPERATIVE

Year ended

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Operating revenues:				
Local network services revenue	\$ 4,711,447	\$ 444,767	\$ 0	\$ 5,156,214
Network access service revenue	13,592,355	322,142	(16,498)	13,897,999
Long distance network services revenue	303,623	9,929	0	313,552
Internet and video revenues	3,951,268	3,402,008	(7,353,276)	0
Security systems revenue	0	1,007,263	(1,007,263)	0
Lease revenue	0	628,684	(628,684)	0
Miscellaneous revenue	2,648,520	68,963	(7,200)	2,710,283
Less: Uncollectible revenue	<u>(102,000)</u>	<u>(174)</u>	<u>0</u>	<u>(102,174)</u>
 TOTAL OPERATING REVENUES	 \$ 25,105,213	 \$ 5,883,582	 \$ (9,012,921)	 \$ 21,975,874
Operating expenses:				
Plant specific operations expense	\$ 6,199,550	\$ 319,972	\$ 0	\$ 6,519,522
Plant nonspecific operations expense	2,285,520	16,498	(645,182)	1,656,836
Internet and video expenses	3,412,311	4,309,536	(7,721,847)	0
Security equipment cost of goods sold and monitoring expenses	0	326,655	(326,655)	0
Provision for depreciation	7,097,985	748,803	0	7,846,788
Customer operations expense	2,208,955	94,394	(7,200)	2,296,149
Corporate operations expense	3,118,365	690,317	0	3,808,682
Operating taxes	<u>649,715</u>	<u>138,578</u>	<u>0</u>	<u>788,293</u>
 TOTAL OPERATING EXPENSES	 \$ 24,972,401	 \$ 6,644,753	 \$ (8,700,884)	 \$ 22,916,270
 OPERATING INCOME (LOSS)	 \$ 132,812	 \$ (761,171)	 \$ (312,037)	 \$ (940,396)

INCOME AND COMPREHENSIVE INCOME

CORPORATION AND SUBSIDIARY

December 31, 2011

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Other income (loss):				
Income from subsidiaries	\$ 2,653,337	\$ 0	\$ (2,653,337)	\$ 0
Income from investments	0	5,350,770	0	5,350,770
Interest and dividend income	40,199	115,991	(136,707)	19,483
Loss from disposition of assets	(14,700)	0	0	(14,700)
Impairment of goodwill	0	(160,160)	0	(160,160)
Impairment of investment	0	(50,000)	0	(50,000)
Nonregulated income (loss)	<u>1,011,832</u>	<u>0</u>	<u>312,037</u>	<u>1,323,869</u>
TOTAL OTHER INCOME	\$ 3,690,668	\$ 5,256,601	\$ (2,478,007)	\$ 6,469,262
Fixed charges:				
Interest expense	\$ 2,112,681	\$ 166,614	\$ (136,707)	\$ 2,142,588
Interest charged to construction - credit	<u>(476,952)</u>	<u>0</u>	<u>0</u>	<u>(476,952)</u>
TOTAL FIXED CHARGES	\$ 1,635,729	\$ 166,614	\$ (136,707)	\$ 1,665,636
INCOME BEFORE TAXES ON INCOME				
Taxes on income	<u>121,970</u>	<u>1,675,479</u>	<u>0</u>	<u>1,797,449</u>
NET INCOME	\$ 2,065,781	\$ 2,653,337	\$ (2,653,337)	\$ 2,065,781
Other comprehensive income (loss):				
Postretirement benefit other than pension:				
Unrecognized loss on assets	(500,316)	0	0	(500,316)
Transition obligation	<u>100,504</u>	<u>0</u>	<u>0</u>	<u>100,504</u>
COMPREHENSIVE INCOME	<u>\$ 1,665,969</u>	<u>\$ 2,653,337</u>	<u>\$ (2,653,337)</u>	<u>\$ 1,665,969</u>