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AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

December 31, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

Board of Directors
North Central Telephone
Cooperative Corporation
Lafayette, Tennessee

We have audited the accompanying consolidated financial statements of North Central Telephone Cooperative Corporation and Subsidiary which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations, comprehensive income, changes in members' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audits opinion.



Opinion

In our opinion, the 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, 2012 and 2011, and the results of its operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Jotherow, Spate, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
March 1, 2013

CONSOLIDATED BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

	2012	2011
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash - general	\$ 4,126,921	\$ 3,224,565
Cash - construction funds	1,235,139	1,365,705
Temporary cash investments	1,550,000	2,100,000
Telecommunications accounts receivable, less allowances of \$15,137 in 2012 and \$44,395 in 2011	1,850,465	1,789,483
Other accounts receivable	181,774	159,184
Materials and supplies	1,650,499	554,167
Refundable tax deposit	0	10,800
Other current assets	128,699	287,496
	<hr/>	<hr/>
TOTAL CURRENT ASSETS	\$ 10,723,497	\$ 9,491,400
<u>NONCURRENT ASSETS</u>		
Investments	\$ 27,358,622	\$ 23,538,349
Nonregulated investments	2,588,791	2,392,056
Goodwill, less accumulated amortization	442,505	652,983
Deferred tax asset	135,457	90,872
	<hr/>	<hr/>
TOTAL NONCURRENT ASSETS	\$ 30,525,375	\$ 26,674,260
<u>PROPERTY, PLANT AND EQUIPMENT</u>		
Telecommunications plant in service	\$ 135,478,664	\$ 123,447,365
Telecommunications plant under construction	13,299,870	21,446,883
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	\$ 148,778,534	\$ 144,894,248
Less accumulated depreciation	75,561,632	68,237,744
	<hr/>	<hr/>
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 73,216,902	\$ 76,656,504
	<hr/>	<hr/>
	<u>\$ 114,465,774</u>	<u>\$ 112,822,164</u>

See the notes to financial statements.

CONSOLIDATED BALANCE SHEETS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

	2012	2011
<u>LIABILITIES AND MEMBERS' EQUITY</u>		
<u>CURRENT LIABILITIES</u>		
Notes payable	\$ 1,817,414	\$ 2,088,884
Accounts payable	3,751,426	4,451,510
Advance billings and payments	311,580	232,864
Customer deposits	348,053	279,987
Current maturities on long-term debt	5,372,730	6,251,833
Accrued federal and state taxes	738,274	127,610
Accrued interest	161,379	65,286
Accrued rents	779,478	673,966
Accrued salaries and wages	188,280	123,796
Accrued property taxes	641,022	616,167
Accrued vacation and sick leave benefits	1,619,424	1,516,354
Other current liabilities	215,825	336,681
	<hr/>	<hr/>
TOTAL CURRENT LIABILITIES	\$ 15,944,885	\$ 16,764,938
 <u>LONG-TERM DEBT</u>		
Rural Utilities Service	26,611,284	27,730,300
Rural Telephone Bank	10,625,115	11,122,419
Other long-term debt	3,187,035	3,886,664
 <u>OTHER LIABILITIES</u>		
Postretirement benefits other than pension	7,347,246	5,755,240
Deferred taxes	2,920,626	2,669,360
	<hr/>	<hr/>
TOTAL LIABILITIES	\$ 66,636,191	\$ 67,928,921
 <u>MEMBERS' EQUITY</u>		
Patronage capital	\$ 53,054,022	\$ 47,895,134
Accumulated other comprehensive loss	(5,224,439)	(3,001,891)
	<hr/>	<hr/>
TOTAL MEMBERS' EQUITY	\$ 47,829,583	\$ 44,893,243
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	<u>\$ 114,465,774</u>	<u>\$ 112,822,164</u>

CONSOLIDATED STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2012 and 2011

	2012	2011
Operating revenues:		
Local network services revenue	\$ 4,832,176	\$ 5,156,214
Network access services revenue	15,103,382	13,897,999
Long distance network services revenue	131,005	313,552
Miscellaneous revenue	2,662,424	2,710,283
Less: Uncollectible revenue	<u>(127,732)</u>	<u>(102,174)</u>
TOTAL OPERATING REVENUES	\$ 22,601,255	\$ 21,975,874
Operating expenses:		
Plant specific operations expense	\$ 5,764,850	\$ 6,519,522
Plant nonspecific operations expense	2,093,108	1,656,836
Provision for depreciation and amortization	8,027,034	7,846,788
Customer operations expense	2,194,150	2,296,149
Corporate operations expense	3,177,701	3,808,682
Operating taxes	<u>824,368</u>	<u>788,293</u>
TOTAL OPERATING EXPENSES	<u>\$ 22,081,211</u>	<u>\$ 22,916,270</u>
OPERATING INCOME (LOSS)	\$ 520,044	\$ (940,396)
Other income (loss):		
Income from investments	\$ 6,655,163	\$ 5,350,770
Interest income	26,465	19,483
Loss from disposition of assets	0	(14,700)
Impairment of goodwill	(210,478)	(160,160)
Loss from impairment of investment	0	(50,000)
Nonregulated income	<u>1,305,559</u>	<u>1,323,869</u>
TOTAL OTHER INCOME	\$ 7,776,709	\$ 6,469,262

See the notes to financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2012 and 2011

	2012	2011
Fixed charges:		
Interest expense	\$ 2,217,504	\$ 2,142,588
Interest charged to construction - credit	<u>(604,398)</u>	<u>(476,952)</u>
TOTAL FIXED CHARGES	<u>\$ 1,613,106</u>	<u>\$ 1,665,636</u>
INCOME BEFORE TAXES ON INCOME	\$ 6,683,647	\$ 3,863,230
Taxes on income	<u>1,524,759</u>	<u>1,797,449</u>
NET INCOME	<u>\$ 5,158,888</u>	<u>\$ 2,065,781</u>



CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2012 and 2011

	2012	2011
Net income	\$ 5,158,888	\$ 2,065,781
Other comprehensive income (loss):		
Postretirement benefit other than pension:		
Unrecognized loss on assets	(2,222,548)	(500,316)
Transition obligation	<u>0</u>	<u>100,504</u>
COMPREHENSIVE INCOME	<u>\$ 2,936,340</u>	<u>\$ 1,665,969</u>

See the notes to financial statements.



CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2012 and 2011

	Patronage Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
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	\$ 47,895,134	\$ (3,001,891)	\$ 44,893,243
Net income for 2012	5,158,888	0	5,158,888
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized loss	0	(2,222,548)	(2,222,548)
Balance at December 31, 2012	<u>\$ 53,054,022</u>	<u>\$ (5,224,439)</u>	<u>\$ 47,829,583</u>

See the notes to financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from customers	\$ 22,517,683	\$ 21,293,562
Cash paid to suppliers and employees	(13,462,526)	(13,706,096)
Interest received	26,465	19,483
Interest paid	(1,517,013)	(1,661,931)
Taxes paid	(1,496,127)	(1,345,131)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 6,068,482	\$ 4,599,887
Cash flows from investing activities:		
Construction and acquisition of plant	\$ (4,574,697)	\$ (22,603,475)
Plant removal costs	(90,379)	(9,512)
Salvage	0	8,750
Disposition of asset	0	(14,700)
Cash distribution from investments	2,834,889	2,310,119
Investment in nonregulated CPE	(196,735)	(87,256)
Decrease (Increase) in:		
Grants receivable	0	254,581
Materials and supplies	(1,096,332)	(67,481)
Temporary investments	550,000	1,250,000
Nonregulated income	1,305,559	1,323,869
NET CASH USED BY INVESTING ACTIVITIES	\$ (1,267,695)	\$ (17,635,105)
Cash flows from financing activities:		
Debt proceeds	\$ 3,114,603	\$ 18,409,823
Payments on notes payable and long-term borrowings	(6,581,124)	(6,981,741)
Postretirement benefits other than pension	(630,542)	953,351
Decrease in customer deposits	68,066	(21,336)
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	\$ (4,028,997)	\$ 12,360,097
NET INCREASE (DECREASE) IN CASH	\$ 771,790	\$ (675,121)
CASH AT BEGINNING OF YEAR	4,590,270	5,265,391
CASH AT END OF YEAR	\$ 5,362,060	\$ 4,590,270

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2012 and 2011

	2012	2011
Net income	\$ 5,158,888	\$ 2,065,781
Nonregulated income	(1,305,559)	(1,323,869)
Income from investments	(6,655,163)	(5,350,770)
Loss from disposition of assets	0	14,700
Impairment of goodwill	210,478	160,160
Impairment of investment	0	50,000
 Net loss from regulated operations	 \$ (2,591,356)	 \$ (4,383,998)
Adjustments to reconcile net loss from regulated operations to net cash provided by operating activities:		
Depreciation and amortization	\$ 8,104,678	\$ 7,899,575
Deferred taxes on income	206,681	1,273,282
Decrease (Increase) in:		
Customer and accounts receivable	(83,572)	(682,312)
Current and accrued assets - other	158,797	(222,437)
Refundable tax deposit	10,800	(10,800)
Increase (Decrease) in:		
Accounts payable	(700,084)	812,637
Advance billings and payments	78,716	13,247
Accrued federal and state taxes	610,664	(255,088)
Accrued interest	96,093	3,705
Accrued rents	105,512	33,131
Accrued salaries and employee benefits	167,554	(113,519)
Accrued property taxes	24,855	233,217
Other current liabilities	(120,856)	(753)
TOTAL ADJUSTMENTS	\$ 8,659,838	\$ 8,983,885
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 \$ 6,068,482	 \$ 4,599,887

See the notes to financial statements.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

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 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 \$81,804 and \$241,290 at December 31, 2012 and 2011, 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, 2012 and 2011

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 \$160,020 in 2012 and \$127,883 in 2011.
- (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 \$5,809,637 was uninsured at December 31, 2012.

Restricted cash consists of an employees' savings account in which \$59,934 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, 2012 and 2011

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, 2012, the Cooperative has received \$14,590,024 in loan proceeds and \$14,414,160 of the grant portion.

Note D -- Investments:

	<u>2012</u>	<u>2011</u>
NECA Services, Inc. stock - at cost	\$ 10,000	\$ 10,000
Cash value of life insurance	243,904	307,130
Investment in Kentucky RSA #3 cellular partnership (25%)	21,565,751	18,162,750
Investment in Bluegrass Network, LLC (20%)	3,649,484	3,195,120
Investment in Bluegrass Telecom, LLC (20%)	342,419	360,140
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%)	1,047,658	1,003,803
Synergy Wireless, Inc. – at cost	10,000	10,000
Deposits	<u>140</u>	<u>140</u>
	<u>\$27,358,622</u>	<u>\$23,538,349</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, 2012 and 2011

Note D – (Cont'd):

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

The following is a summary as of December 31, 2012 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 partnership	Bluegrass Network, LLC	Bluegrass Telecom, LLC	Tennessee Independent Telecom Group
Total assets	\$90,402,615	\$18,898,754	\$2,965,596	\$20,394,176
Total liabilities	\$ 5,438,947	\$ 651,339	\$1,255,602	\$10,525,615
Total equity	\$84,963,668	\$18,247,415	\$1,709,994	\$ 9,868,561
Net income	\$23,211,379	\$ 3,271,818	\$ 596,967	\$ 415,470

Note E – Nonregulated investments:

	<u>2012</u>	<u>2011</u>
Nonregulated customer premises equipment	\$5,752,973	\$5,231,032
Less accumulated provisions for depreciation	<u>3,164,182</u>	<u>2,838,976</u>
TOTAL	<u>\$2,588,791</u>	<u>\$2,392,056</u>

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. The Company wrote off identified goodwill of \$210,478 and \$160,160 for 2012 and 2011, respectively, 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

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>2012</u>	<u>2011</u>
Franchises	\$ 236	\$ 236
Land	818,654	818,654
Buildings	8,733,887	8,328,082
Central office equipment	37,583,461	32,026,524
Outside plant network	73,831,150	68,396,586
Furniture and office equipment	2,444,097	2,367,492
Vehicles and other work equipment	<u>2,980,417</u>	<u>2,904,932</u>
Telecommunications plant in service as contained on the Cooperative's records	\$126,391,902	\$114,842,506
Land	\$ 35,000	\$ 35,000
Building	212,506	212,506
CATV equipment	75,545	75,545
Central office equipment	4,742,125	4,590,545
Outside plant network	2,519,999	2,444,782
Office furniture and fixtures	40,827	40,622
Equipment	988,168	833,727
Vehicles	<u>472,592</u>	<u>372,132</u>
Telecommunications plant in service as contained on the Subsidiaries' records	<u>\$ 9,086,762</u>	<u>\$ 8,604,859</u>
Total telecommunications plant in service	<u>\$135,478,664</u>	<u>\$123,447,365</u>

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 5.94 percent for 2012 and 6.14 percent for 2011. The provision for depreciation in 2012 and 2011 was \$7,091,189 and \$7,097,985, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

Note G – (Cont'd)

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 \$935,845 in 2012 and \$748,803 in 2011.

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 January 13, 2013. The outstanding balance of the note at December 31, 2012 is \$1,817,414.

Long-term debt is represented by mortgage notes payable to the United States of America, Macon Bank and Trust Company, and Farmer's National Bank. Substantially all assets are pledged as security for the long-term debt.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

Note H – (Cont'd)

The following is a summary of outstanding long-term debt:

	<u>2012</u>	<u>2011</u>
1.354% to 1.402% Rural Utilities Service notes	\$ 618,270	\$ 0
4.1% to 5.1545% Rural Utilities Service notes	16,156,741	20,859,945
5.0% to 5.13% Rural Telephone Bank notes	11,093,951	11,539,730
5.0% Farmers National Bank, matures October 22, 2013	565,754	855,760
5.75% Farmers National Bank, matures October 12, 2015	1,025,302	1,203,125
Rural Utilities Service notes, matures June 17, 2031	14,033,555	12,032,656
5.0% Macon Co. Bank & Trust Co., matures December 21, 2016	<u>2,302,591</u>	<u>2,500,000</u>
	\$45,796,164	\$48,991,216
Less current maturities	<u>5,372,730</u>	<u>6,251,833</u>
TOTAL	<u>\$40,423,434</u>	<u>\$42,739,383</u>

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

Long-term debt matures as follows:

<u>Year ending</u> <u>December 31,</u>	<u>Amount</u>
2013	\$ 5,372,730
2014	4,195,689
2015	4,398,462
2016	4,956,698
2017	3,443,744
Beyond five years	<u>23,428,841</u>
TOTAL	<u>\$45,796,164</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

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>2012</u>	<u>2011</u>
Accumulated postretirement obligation attributable to:		
Retirees	\$ 6,570,325	\$ 4,143,460
Fully eligible plan participants	777,052	1,035,865
Other active plan participants	<u>8,255,960</u>	<u>7,768,989</u>
 Total accumulated postretirement benefit obligation	 \$15,603,337	 \$12,948,314
Fair value of plan assets	<u>(8,256,091)</u>	<u>(7,193,074)</u>
 Net unfunded status	 <u>\$ 7,347,246</u>	 <u>\$ 5,755,240</u>

Amounts recognized in other comprehensive income:

Unrecognized net loss	\$(5,224,439)	\$(3,001,892)
 Total included in other comprehensive income	 <u>\$(5,224,439)</u>	 <u>\$(3,001,892)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

Note I – (Cont'd):

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

	<u>2012</u>	<u>2011</u>
Benefits earned during the year	\$ 510,335	\$ 417,675
Interest on accumulated postretirement benefit obligation	728,043	664,103
Actual return on plan assets	(287,946)	(435,380)
Net amortization of transition obligation over 20 years	<u>0</u>	<u>100,507</u>
Postretirement benefit cost	<u>\$ 950,432</u>	<u>\$ 746,905</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 2012, 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>2012</u>	<u>2011</u>
Discount rate	5.00%	5.50%
Rate of compensation increase	3.00%	3.00%
Expected return on plan assets	7.27%	7.60%

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.

The medical cost trend rate in 2012 was approximately 8.0% grading down to an ultimate rate in 2021 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 2012 net periodic postretirement benefit cost by \$451,368 and would have increased the postretirement benefit obligation as of December 31, 2012 by \$2,839,208.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

Note I – (Cont'd):

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. Management is reviewing the possibility of returning a portion of plan assets in 2013.

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>
2013	\$ 414,171
2014	422,454
2015	430,903
2016	439,521
2017	448,312
Years 2018 – 2022	<u>2,379,693</u>
TOTAL	<u>\$4,535,054</u>

The Cooperative did not make a contribution to the plan in 2012 and an annual contribution to the plan is not anticipated in 2013.

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 \$810,580 for 2012 and \$745,197 for 2011.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

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>2012</u>	<u>2011</u>
Current income tax expense:		
Federal	\$1,061,884	\$ 309,812
State	253,488	214,356
Deferred income tax expense (benefit):		
Federal	166,935	1,159,073
State	<u>39,743</u>	<u>108,698</u>
Income tax before valuation	\$1,522,050	\$1,791,939
Valuation of deferred tax asset	<u>2,709</u>	<u>5,510</u>
	<u>\$1,524,759</u>	<u>\$1,797,449</u>

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

	<u>2012</u>	<u>2011</u>
Deferred tax asset	\$ 171,566	\$ 124,273
Deferred tax liability	<u>(2,920,626)</u>	<u>(2,669,360)</u>
	\$(2,749,060)	\$(2,545,087)
Valuation allowance	<u>(36,109)</u>	<u>(33,401)</u>
Net deferred tax liability	<u>\$(2,785,169)</u>	<u>\$(2,578,488)</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 \$1,415,000, which is available to offset future state taxable income. This carryforward will expire in 2 to 13 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012 and 2011

Note K – (Cont'd)

North Central Security Services, Inc. has a net operating loss carryforward of approximately \$1,930,000, which is available to offset future state taxable income. This carryforward will expire in 3 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. Penalties and interest, if any, that are assessed by income tax authorities are included in operating expenses. No interest or penalties were recognized during the years ending December 31, 2012 and 2011.

Note L – Labor Force

Approximately 80% of the Cooperative's labor force is subject to a collective bargaining agreement. A three and one half year agreement was negotiated and approved for the period January 1, 2013 to June 30, 2016 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.

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, 2012 and before the date these financial statements were available to be issued, March 1, 2013, and determined that no additional disclosures are necessary.

CONSOLIDATING INFORMATION



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 2012 and 2011 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 34 through 39 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
March 1, 2013

CONSOLIDATING BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>ASSETS</u>				
<u>CURRENT ASSETS</u>				
Cash - general	\$ 3,217,545	\$ 909,376	\$ 0	\$ 4,126,921
Cash - construction funds	1,235,139	0	0	1,235,139
Temporary cash investments	600,000	950,000	0	1,550,000
Telecommunications accounts receivable	1,769,922	80,543	0	1,850,465
Other accounts receivable	181,774	0	0	181,774
Advance to related company	24,500	5,717,201	(5,741,701)	0
Materials and supplies	1,589,974	60,525	0	1,650,499
Other current assets	128,699	0	0	128,699
TOTAL CURRENT ASSETS	\$ 8,747,553	\$ 7,717,645	\$ (5,741,701)	\$ 10,723,497
<u>NONCURRENT ASSETS</u>				
Investment in subsidiary	\$ 33,096,829	\$ 0	\$ (33,096,829)	\$ 0
Investments	253,906	27,104,716	0	27,358,622
Nonregulated investments	2,588,791	0	0	2,588,791
Goodwill - net	0	442,505	0	442,505
Deferred tax asset	0	135,457	0	135,457
TOTAL NONCURRENT ASSETS	\$ 35,939,526	\$ 27,682,678	\$ (33,096,829)	\$ 30,525,375
<u>PROPERTY, PLANT AND EQUIPMENT</u>				
Telecommunications plant in service	\$ 126,391,902	\$ 9,086,762	\$ 0	\$ 135,478,664
Telecommunications plant under construction	13,276,775	23,095	0	13,299,870
	\$ 139,668,677	\$ 9,109,857	\$ 0	\$ 148,778,534
Less accumulated depreciation	70,180,790	5,380,842	0	75,561,632
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 69,487,887	\$ 3,729,015	\$ 0	\$ 73,216,902
	<u>\$ 114,174,966</u>	<u>\$ 39,129,338</u>	<u>\$ (38,838,530)</u>	<u>\$ 114,465,774</u>

CONSOLIDATING BALANCE SHEETS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2012

	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	\$ 1,817,414	\$ 0	\$ 0	\$ 1,817,414
Accounts payable	3,287,732	463,694	0	3,751,426
Advance billings and payments	256,923	54,657	0	311,580
Advance from related company	5,717,201	24,500	(5,741,701)	0
Customer deposits	348,053	0	0	348,053
Current maturities on long-term debt	4,873,976	498,754	0	5,372,730
Accrued federal and state taxes	50,535	687,739	0	738,274
Accrued interest	62,957	98,422	0	161,379
Accrued rent	747,416	32,062	0	779,478
Accrued salaries and wages	176,054	12,226	0	188,280
Accrued property taxes	608,610	32,412	0	641,022
Accrued vacation and sick leave benefits	1,619,424	0	0	1,619,424
Other current liabilities	100,710	115,115	0	215,825
TOTAL CURRENT LIABILITIES	\$ 19,667,005	\$ 2,019,581	\$ (5,741,701)	\$ 15,944,885
<u>LONG-TERM DEBT</u>				
Rural Utilities Service	26,611,284	0	0	26,611,284
Rural Telephone Bank	10,625,115	0	0	10,625,115
Other long-term debt	2,094,733	1,092,302	0	3,187,035
<u>OTHER LIABILITIES</u>				
Postretirement benefits other than pension	7,347,246	0	0	7,347,246
Deferred tax liability	0	2,920,626	0	2,920,626
TOTAL LIABILITIES	\$ 66,345,383	\$ 6,032,509	\$ (5,741,701)	\$ 66,636,191
<u>MEMBERS' EQUITY</u>				
Capital stock	\$ 0	\$ 8,100,000	\$ (8,100,000)	\$ 0
Patronage capital	53,054,024	0	0	53,054,024
Accumulated comprehensive loss	(5,224,441)	0	0	(5,224,441)
Retained earnings	0	24,996,829	(24,996,829)	0
TOTAL MEMBERS' EQUITY	\$ 47,829,583	\$ 33,096,829	\$ (33,096,829)	\$ 47,829,583
	<u>\$ 114,174,966</u>	<u>\$ 39,129,338</u>	<u>\$ (38,838,530)</u>	<u>\$ 114,465,774</u>

CONSOLIDATING STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2012

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Operating revenues:				
Local network services revenue	\$ 4,431,808	\$ 400,368	\$ 0	\$ 4,832,176
Network access service revenue	14,806,543	296,839	0	15,103,382
Long distance network services revenue	121,286	9,719	0	131,005
Internet and video revenues	4,085,983	3,842,505	(7,928,488)	0
Security systems revenue	0	1,107,870	(1,107,870)	0
Lease revenue	0	1,147,486	(1,147,486)	0
Miscellaneous revenue	2,714,743	89,772	(142,091)	2,662,424
Less: Uncollectible revenue	<u>(126,200)</u>	<u>(1,532)</u>	<u>0</u>	<u>(127,732)</u>
 TOTAL OPERATING REVENUES	 \$ 26,034,163	 \$ 6,893,027	 \$ (10,325,935)	 \$ 22,601,255
Operating expenses:				
Plant specific operations expense	\$ 6,495,459	\$ 416,877	\$ (1,147,486)	\$ 5,764,850
Plant nonspecific operations expense	2,079,054	14,054	0	2,093,108
Internet and video expenses	3,427,860	5,094,677	(8,522,537)	0
Security equipment cost of goods sold and monitoring expenses	0	336,016	(336,016)	0
Provision for depreciation	7,091,189	935,845	0	8,027,034
Customer operations expense	2,109,614	91,736	(7,200)	2,194,150
Corporate operations expense	2,479,115	833,477	(134,891)	3,177,701
Operating taxes	<u>703,114</u>	<u>121,254</u>	<u>0</u>	<u>824,368</u>
 TOTAL OPERATING EXPENSES	 \$ 24,385,405	 \$ 7,843,936	 \$ (10,148,130)	 \$ 22,081,211
 OPERATING INCOME (LOSS)	 \$ 1,648,758	 \$ (950,909)	 \$ (177,805)	 \$ 520,044

CONSOLIDATING STATEMENTS OF OPERATIONS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2012

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Other income (loss):				
Income from subsidiaries	\$ 3,573,611	\$ 0	\$ (3,573,611)	\$ 0
Income from investments	0	6,655,163		6,655,163
Interest income	18,398	21,504	(13,437)	26,465
Impairment of intangible assets	0	(210,478)		(210,478)
Nonregulated income	<u>1,127,754</u>	<u>0</u>	<u>177,805</u>	<u>1,305,559</u>
 TOTAL OTHER INCOME	 \$ 4,719,763	 \$ 6,466,189	 \$ (3,409,243)	 \$ 7,776,709
Fixed charges:				
Interest expense	\$ 2,023,737	\$ 207,204	\$ (13,437)	\$ 2,217,504
Interest charged to construction - credit	<u>(604,398)</u>	<u>0</u>	<u>0</u>	<u>(604,398)</u>
 TOTAL FIXED CHARGES	 \$ 1,419,339	 \$ 207,204	 \$ (13,437)	 \$ 1,613,106
INCOME BEFORE				
TAXES ON INCOME	\$ 4,949,182	\$ 5,308,076	\$ (3,573,611)	\$ 6,683,647
Taxes on income (benefit)	<u>(209,706)</u>	<u>1,734,465</u>	<u>0</u>	<u>1,524,759</u>
 NET INCOME	 <u>\$ 5,158,888</u>	 <u>\$ 3,573,611</u>	 <u>\$ (3,573,611)</u>	 <u>\$ 5,158,888</u>

CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2012

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Net income	\$ 5,158,888	\$ 3,573,611	\$ (3,573,611)	\$ 5,158,888
Other comprehensive income (loss):				
Postretirement benefit other than pension:				
Unrecognized loss	<u>(2,222,548)</u>	<u>0</u>	<u>0</u>	<u>(2,222,548)</u>
 COMPREHENSIVE INCOME	 <u>\$ 2,936,340</u>	 <u>\$ 3,573,611</u>	 <u>\$ (3,573,611)</u>	 <u>\$ 2,936,340</u>