

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

December 31, 2013 and 2012



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 financial statements of North Central Telephone Cooperative Corporation and Subsidiary which comprise the balance sheets as of December 31, 2013 and 2012, 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 and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit 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, 2013 and 2012, 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.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated February 14, 2014 on our consideration of North Central Telephone Cooperative Corporation and Subsidiary'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audits.

Iotherow, Spate, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
February 14, 2014

CONSOLIDATED BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

	2013	2012
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash - general	\$ 5,354,749	\$ 4,126,921
Cash - construction funds	1,770,779	1,235,139
Temporary cash investments	1,800,000	1,550,000
Telecommunications accounts receivable, less allowances of \$148,191 in 2013 and \$48,319 in 2012	1,698,951	1,850,465
Other accounts receivable	237,264	181,774
Materials and supplies	1,230,621	1,650,499
Refundable tax deposit	79,370	0
Other current assets	230,159	128,699
TOTAL CURRENT ASSETS	\$ 12,401,893	\$ 10,723,497
<u>NONCURRENT ASSETS</u>		
Investments	\$ 26,100,985	\$ 27,358,622
Nonregulated investments	2,949,757	2,588,791
Goodwill, less accumulated amortization	442,505	442,505
Deferred tax asset	88,603	135,457
TOTAL NONCURRENT ASSETS	\$ 29,581,850	\$ 30,525,375
<u>PROPERTY, PLANT AND EQUIPMENT</u>		
Telecommunications plant in service	\$ 144,515,058	\$ 135,478,664
Telecommunications plant under construction	11,279,573	13,299,870
	\$ 155,794,631	\$ 148,778,534
Less accumulated depreciation	84,483,935	75,561,632
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 71,310,696	\$ 73,216,902
	<u>\$ 113,294,439</u>	<u>\$ 114,465,774</u>

See the accompanying independent accountants' report and notes to the financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2013 and 2012

	2013	2012
Operating revenues:		
Local network services revenue	\$ 4,747,372	\$ 4,832,176
Network access services revenue	16,059,929	15,103,382
Long distance network services revenue	82,484	131,005
Miscellaneous revenue	2,464,483	2,662,424
Less: Uncollectible revenue	<u>(162,600)</u>	<u>(127,732)</u>
TOTAL OPERATING REVENUES	\$23,191,668	\$22,601,255
Operating expenses:		
Plant specific operations expense	\$ 6,728,162	\$ 5,764,850
Plant nonspecific operations expense	2,482,203	2,093,108
Provision for depreciation and amortization	9,666,406	8,027,034
Customer operations expense	2,678,217	2,194,150
Corporate operations expense	3,162,706	3,177,701
Operating taxes	<u>929,450</u>	<u>824,368</u>
TOTAL OPERATING EXPENSES	<u>\$25,647,144</u>	<u>\$22,081,211</u>
OPERATING INCOME (LOSS)	\$ (2,455,476)	\$ 520,044
Other income (loss):		
Income from investments	\$ 4,334,793	\$ 6,655,163
Interest income	22,395	26,465
Impairment of goodwill	0	(210,478)
Nonregulated income	<u>1,148,756</u>	<u>1,305,559</u>
TOTAL OTHER INCOME	\$ 5,505,944	\$ 7,776,709

See the accompanying independent accountants' report and notes to the financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2013 and 2012

	2013	2012
Fixed charges:		
Interest expense	\$ 2,025,405	\$ 2,217,504
Interest charged to construction - credit	<u>(375,992)</u>	<u>(604,398)</u>
TOTAL FIXED CHARGES	<u>\$ 1,649,413</u>	<u>\$ 1,613,106</u>
INCOME BEFORE TAXES ON INCOME	\$ 1,401,055	\$ 6,683,647
Taxes on income	<u>1,180,308</u>	<u>1,524,759</u>
NET INCOME	<u>\$ 220,747</u>	<u>\$ 5,158,888</u>



CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2013 and 2012

	2013	2012
Net income	\$ 220,747	\$ 5,158,888
Other comprehensive income (loss):		
Postretirement benefit other than pension:		
Unrecognized loss on assets	<u>(1,405,529)</u>	<u>(2,222,548)</u>
COMPREHENSIVE INCOME (LOSS)	<u>\$ (1,184,782)</u>	<u>\$ 2,936,340</u>

See the accompanying independent accountants' report and notes to the financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2013 and 2012

	Patronage Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
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	<u>0</u>	<u>(2,222,548)</u>	<u>(2,222,548)</u>
Balance at December 31, 2012	\$ 53,054,022	\$ (5,224,439)	\$ 47,829,583
Net income for 2013	220,747	0	220,747
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized loss	<u>0</u>	<u>(1,405,529)</u>	<u>(1,405,529)</u>
Balance at December 31, 2013	<u>\$ 53,274,769</u>	<u>\$ (6,629,968)</u>	<u>\$ 46,644,801</u>

See the accompanying independent accountants' report and notes to the financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	\$ 23,287,692	\$ 22,517,683
Cash paid to suppliers and employees	(17,704,645)	(13,462,526)
Interest received	22,395	26,465
Interest paid	(1,687,434)	(1,517,013)
Taxes paid	(3,168,034)	(1,496,127)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 749,974	\$ 6,068,482
Cash flows from investing activities:		
Construction and acquisition of plant	\$ (7,629,883)	\$ (4,574,697)
Plant removal costs	(149,317)	(90,379)
Salvage	19,000	0
Cash distribution from investments	5,592,430	2,834,889
Investment in nonregulated CPE	(360,966)	(196,735)
Decrease (Increase) in:		
Materials and supplies	419,878	(1,096,332)
Temporary investments	(250,000)	550,000
Nonregulated income	1,148,756	1,305,559
NET CASH USED BY INVESTING ACTIVITIES	\$ (1,210,102)	\$ (1,267,695)
Cash flows from financing activities:		
Debt proceeds	\$ 6,862,853	\$ 3,114,603
Payments on notes payable and long-term borrowings	(6,000,093)	(6,581,124)
Postretirement benefits other than pension	1,334,302	(630,542)
Decrease in customer deposits	26,534	68,066
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	\$ 2,223,596	\$ (4,028,997)
NET INCREASE IN CASH	\$ 1,763,468	\$ 771,790
CASH AT BEGINNING OF YEAR	5,362,060	4,590,270
CASH AT END OF YEAR	\$ 7,125,528	\$ 5,362,060

See the accompanying independent accountants' report and notes to the financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2013 and 2012

	2013	2012
Net income	\$ 220,747	\$ 5,158,888
Nonregulated income	(1,148,756)	(1,305,559)
Income from investments	(4,334,793)	(6,655,163)
Impairment of goodwill	0	210,478
Net loss from regulated operations	\$ (5,262,802)	\$ (2,591,356)
Adjustments to reconcile net loss from regulated operations to net cash provided by operating activities:		
Depreciation and amortization	\$ 9,666,406	\$ 8,104,678
Deferred taxes on income	(377,248)	206,681
Decrease (Increase) in:		
Customer and accounts receivable	96,024	(83,572)
Current and accrued assets - other	(101,460)	158,797
Refundable tax deposit	(79,370)	10,800
Increase (Decrease) in:		
Accounts payable	(2,393,537)	(700,084)
Advance billings and payments	(27,959)	78,716
Accrued federal and state taxes	(648,348)	610,664
Accrued interest	(38,021)	96,093
Accrued rents	(149,711)	105,512
Accrued salaries and employee benefits	(113,774)	167,554
Accrued property taxes	46,690	24,855
Other current liabilities	133,084	(120,856)
TOTAL ADJUSTMENTS	\$ 6,012,776	\$ 8,659,838
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 749,974	\$ 6,068,482

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

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 \$60,414 and \$81,804 at December 31, 2013 and 2012, 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, 2013 and 2012

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 \$121,773 in 2013 and \$160,020 in 2012.
- (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 \$6,635,343 was uninsured at December 31, 2013.

Restricted cash consists of an employees' savings account in which \$94,974 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, 2013 and 2012

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, 2013, the Cooperative has received \$18,715,588 in loan proceeds and \$18,529,383 of the grant portion.

Note D – Investments:

	<u>2013</u>	<u>2012</u>
NECA Services, Inc. stock - at cost	\$ 10,000	\$ 10,000
Cash value of life insurance	174,740	243,904
Investment in Kentucky RSA #3 cellular partnership (25%)	20,024,619	21,565,751
Investment in Bluegrass Network, LLC (20%)	4,080,918	3,649,484
Investment in Bluegrass Telecom, LLC (20%)	342,042	342,419
Qualified patronage capital certificates – NRTC	298,022	342,042
Tennessee 220 MHZ Radio	147,224	147,224
Tennessee Independent Telecom Group (IRIS Networks) (10.556%)	1,013,280	1,047,658
Synergy Wireless, Inc. – at cost	10,000	10,000
Deposits	<u>140</u>	<u>140</u>
	<u>\$26,100,985</u>	<u>\$27,358,622</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, 2013 and 2012

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, 2013 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	\$84,880,697	\$21,206,777	\$2,993,969	\$19,157,915
Total liabilities	\$ 6,081,555	\$ 802,187	\$1,283,975	\$ 9,615,041
Total equity	\$78,799,142	\$20,404,590	\$1,709,994	\$ 9,542,874
Net income	\$14,335,474	\$ 3,157,175	\$ 398,324	\$ (325,687)

Note E – Nonregulated investments:

	<u>2013</u>	<u>2012</u>
Nonregulated customer premises equipment	\$7,041,847	\$5,752,973
Less accumulated provisions for depreciation	<u>4,092,090</u>	<u>3,164,182</u>
TOTAL	<u>\$2,949,757</u>	<u>\$2,588,791</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 \$0 and \$210,478 for 2013 and 2012, 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, 2013 and 2012

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>2013</u>	<u>2012</u>
Franchises	\$ 0	\$ 236
Land	818,654	818,654
Buildings	9,263,533	8,733,887
Central office equipment	39,441,021	37,583,461
Outside plant network	79,178,721	73,831,150
Furniture and office equipment	2,488,424	2,444,097
Vehicles and other work equipment	<u>3,027,945</u>	<u>2,980,417</u>
Telecommunications plant in service as contained on the Cooperative's records	\$134,218,298	\$126,391,902
Land	\$ 35,000	\$ 35,000
Building	214,756	212,506
CATV equipment	75,545	75,545
Central office equipment	4,754,900	4,742,125
Outside plant network	3,186,197	2,519,999
Office furniture and fixtures	47,459	40,827
Equipment	1,510,311	988,168
Vehicles	<u>472,592</u>	<u>472,592</u>
Telecommunications plant in service as contained on the Subsidiaries' records	<u>\$ 10,296,760</u>	<u>\$ 9,086,762</u>
Total telecommunications plant in service	<u>\$144,515,058</u>	<u>\$135,478,664</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 6.80 percent for 2013 and 5.94 percent for 2012. The provision for depreciation in 2013 and 2012 was \$8,692,798 and \$7,091,189, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

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 \$973,608 in 2013 and \$935,845 in 2012.

Note H – A description of notes payable follows:

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

Note H – (Cont'd)

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

	<u>2013</u>	<u>2012</u>
1.354% to 1.402% Rural Utilities Service notes	\$ 0	\$ 618,270
2.1061% to 4.4387% Rural Utilities Service notes, matures June 17, 2031	17,587,102	16,156,741
5.0% to 5.13% Rural Telephone Bank notes, matures January 2, 2029	10,640,491	11,093,951
4.0% Citizens Bank of Lafayette	1,728,639	0
4.0% Farmers National Bank, matures July 16, 2018	1,225,382	0
5.0% Farmers National Bank	0	565,754
5.75% Farmers National Bank	0	1,025,302
1.354% to 2.42% Rural Utilities Service notes, matures December 31, 2025	2,667,901	0
2.92% to 5.1545% Rural Utilities Service notes, matures June 17, 2031	12,516,170	14,033,555
4.0% Macon Co. Bank & Trust Co., matures December 21, 2016	<u>2,110,653</u>	<u>2,302,591</u>
	\$48,476,338	\$45,796,164
Less current maturities	<u>4,435,326</u>	<u>5,372,730</u>
TOTAL	<u>\$44,041,012</u>	<u>\$40,423,434</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>
2014	\$ 4,435,326
2015	4,513,755
2016	5,755,815
2017	4,254,169
2018	3,193,990
Beyond five years	<u>26,323,283</u>
TOTAL	<u>\$48,476,338</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

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>2013</u>	<u>2012</u>
Accumulated postretirement obligation attributable to:		
Retirees	\$ 7,930,174	\$ 6,570,325
Fully eligible plan participants	1,327,203	777,052
Other active plan participants	<u>9,960,708</u>	<u>8,255,960</u>
Total accumulated postretirement benefit obligation	\$19,218,085	\$15,603,337
Fair value of plan assets	<u>(9,131,008)</u>	<u>(8,256,091)</u>
Net unfunded status	<u>\$10,087,077</u>	<u>\$ 7,347,246</u>

Amounts recognized in other comprehensive income:

Unrecognized net loss	<u>\$(6,629,968)</u>	<u>\$(5,224,439)</u>
Total included in other comprehensive income	<u>\$(6,629,970)</u>	<u>\$(5,224,439)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

Note I – (Cont'd):

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

	<u>2013</u>	<u>2012</u>
Benefits earned during the year	\$ 588,830	\$ 510,335
Interest on accumulated postretirement benefit obligation	791,486	728,043
Actual return on plan assets	<u>(874,917)</u>	<u>(287,946)</u>
Postretirement benefit cost	<u>\$ 505,399</u>	<u>\$ 950,432</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 2013, 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>2013</u>	<u>2012</u>
Discount rate	4.50%	5.00%
Rate of compensation increase	3.00%	3.00%
Expected return on plan assets	7.27%	7.27%

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 2013 was approximately 8.0% grading down to an ultimate rate in 2022 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 2013 net periodic postretirement benefit cost by \$535,023 and would have increased the postretirement benefit obligation as of December 31, 2013 by \$3,502,210.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

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 began returning 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>
2014	\$ 476,670
2015	486,203
2016	495,927
2017	505,845
2018	515,962
Years 2019 – 2022	<u>2,105,125</u>
TOTAL	<u>\$4,585,732</u>

The Cooperative did not make a contribution to the plan in 2013 and an annual contribution to the plan is not anticipated in 2014.

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 \$826,443 for 2013 and \$810,580 for 2012.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013 and 2012

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>2013</u>	<u>2012</u>
Current income tax expense:		
Federal	\$1,381,719	\$1,061,884
State	175,837	253,488
Deferred income tax expense (benefit):		
Federal	(362,616)	166,935
State	<u>(14,632)</u>	<u>39,743</u>
Income tax before valuation	\$1,180,308	\$1,522,050
Valuation of deferred tax asset	<u>0</u>	<u>2,709</u>
	<u>\$1,180,308</u>	<u>\$1,524,759</u>

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

	<u>2013</u>	<u>2012</u>
Deferred tax asset	\$ 124,712	\$ 171,566
Deferred tax liability	<u>(2,496,524)</u>	<u>(2,920,626)</u>
	\$(2,371,812)	\$(2,749,060)
Valuation allowance	<u>(36,109)</u>	<u>(36,109)</u>
Net deferred tax liability	<u>\$(2,407,921)</u>	<u>\$(2,785,169)</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.

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, 2013 and 2012

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 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. 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, 2013 and 2012.

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, 2013 and before the date these financial statements were available to be issued, February 14, 2014, 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

We have audited the consolidated financial statements of North Central Telephone Cooperative Corporation and Subsidiary as of and for the years ended December 31, 2013 and 2012, and our report thereon dated February 14, 2014, which expresses an unmodified opinion on those financial statements, appears on page 5. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information on pages 34 through 39 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements, themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information 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 14, 2014

CONSOLIDATING BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>ASSETS</u>				
<u>CURRENT ASSETS</u>				
Cash - general	\$ 4,216,454	\$ 1,138,295	\$ 0	\$ 5,354,749
Cash - construction funds	1,770,779	0	0	1,770,779
Temporary cash investments	600,000	1,200,000	0	1,800,000
Telecommunications accounts receivable	1,601,206	97,745	0	1,698,951
Other accounts receivable	237,264	0	0	237,264
Advance to related company	0	5,188,304	(5,188,304)	0
Materials and supplies	1,139,411	91,210	0	1,230,621
Refundable tax deposits	0	79,370	0	79,370
Other current assets	229,979	180	0	230,159
TOTAL CURRENT ASSETS	\$ 9,795,093	\$ 7,795,104	\$ (5,188,304)	\$ 12,401,893
<u>NONCURRENT ASSETS</u>				
Investment in subsidiary	\$ 33,678,460	\$ 0	\$ (33,678,460)	\$ 0
Investments	184,739	25,916,246	0	26,100,985
Nonregulated investments	2,949,757	0	0	2,949,757
Goodwill - net	0	442,505	0	442,505
Deferred tax asset	0	88,603	0	88,603
TOTAL NONCURRENT ASSETS	\$ 36,812,956	\$ 26,447,354	\$ (33,678,460)	\$ 29,581,850
<u>PROPERTY, PLANT AND EQUIPMENT</u>				
Telecommunications plant in service	\$ 134,218,298	\$ 10,296,760	\$ 0	\$ 144,515,058
Telecommunications plant under construction	11,236,234	43,339	0	11,279,573
	\$ 145,454,532	\$ 10,340,099	\$ 0	\$ 155,794,631
Less accumulated depreciation	78,129,485	6,354,450	0	84,483,935
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 67,325,047	\$ 3,985,649	\$ 0	\$ 71,310,696
	\$ 113,933,096	\$ 38,228,107	\$ (38,866,764)	\$ 113,294,439

CONSOLIDATING BALANCE SHEETS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2013

	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	\$ 0	\$ 0	\$ 0	\$ 0
Accounts payable	1,017,250	340,639	0	1,357,889
Advance billings and payments	215,418	68,203	0	283,621
Advance from related company	5,121,804	66,500	(5,188,304)	0
Customer deposits	374,587	0	0	374,587
Current maturities on long-term debt	4,181,962	253,364	0	4,435,326
Accrued federal and state taxes	78,750	11,176	0	89,926
Accrued interest	49,159	74,199	0	123,358
Accrued rent	597,705	32,062	0	629,767
Accrued salaries and wages	195,092	15,050	0	210,142
Accrued property taxes	655,712	32,000	0	687,712
Accrued vacation and sick leave benefits	1,483,788	0	0	1,483,788
Other current liabilities	160,997	187,912	0	348,909
TOTAL CURRENT LIABILITIES	\$ 14,132,224	\$ 1,081,105	\$ (5,188,304)	\$ 10,025,025
<u>LONG-TERM DEBT</u>				
Rural Utilities Service	29,450,168	0	0	29,450,168
Rural Telephone Bank	10,152,325	0	0	10,152,325
Other long-term debt	3,466,501	972,018	0	4,438,519
<u>OTHER LIABILITIES</u>				
Postretirement benefits other than pension	10,087,077	0	0	10,087,077
Deferred tax liability	0	2,496,524	0	2,496,524
TOTAL LIABILITIES	\$ 67,288,295	\$ 4,549,647	\$ (5,188,304)	\$ 66,649,638
<u>MEMBERS' EQUITY</u>				
Capital stock	\$ 0	\$ 8,100,000	\$ (8,100,000)	\$ 0
Patronage capital	53,274,769	0	0	53,274,769
Accumulated comprehensive loss	(6,629,968)	0	0	(6,629,968)
Retained earnings	0	25,578,460	(25,578,460)	0
TOTAL MEMBERS' EQUITY	\$ 46,644,801	\$ 33,678,460	\$ (33,678,460)	\$ 46,644,801
	\$ 113,933,096	\$ 38,228,107	\$ (38,866,764)	\$ 113,294,439

CONSOLIDATING STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2013

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Operating revenues:				
Local network services revenue	\$ 4,368,562	\$ 378,810	\$ 0	\$ 4,747,372
Network access service revenue	15,773,055	286,874	0	16,059,929
Long distance network services revenue	73,791	8,693	0	82,484
Internet and video revenues	4,441,194	4,535,123	(8,976,317)	0
Security systems revenue	0	1,265,475	(1,265,475)	0
Lease revenue	0	1,184,108	(1,184,108)	0
Miscellaneous revenue	2,476,652	129,922	(142,091)	2,464,483
Less: Uncollectible revenue	<u>(162,600)</u>	<u>0</u>	<u>0</u>	<u>(162,600)</u>
 TOTAL OPERATING REVENUES	 \$ 26,970,654	 \$ 7,789,005	 \$ (11,567,991)	 \$ 23,191,668
Operating expenses:				
Plant specific operations expense	\$ 7,273,803	\$ 472,723	\$ (1,018,364)	\$ 6,728,162
Plant nonspecific operations expense	2,468,637	13,566	0	2,482,203
Internet and video expenses	3,816,392	6,191,357	(10,007,749)	0
Security equipment cost of goods sold and monitoring expenses	0	348,311	(348,311)	0
Provision for depreciation	8,692,798	973,608	0	9,666,406
Customer operations expense	2,590,731	94,686	(7,200)	2,678,217
Corporate operations expense	2,538,055	925,286	(300,635)	3,162,706
Operating taxes	<u>720,469</u>	<u>208,981</u>	<u>0</u>	<u>929,450</u>
 TOTAL OPERATING EXPENSES	 \$ 28,100,885	 \$ 9,228,518	 \$ (11,682,259)	 \$ 25,647,144
 OPERATING INCOME (LOSS)	 \$ (1,130,231)	 \$ (1,439,513)	 \$ 114,268	 \$ (2,455,476)

CONSOLIDATING STATEMENTS OF OPERATIONS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2013

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Other income (loss):				
Income from subsidiaries	\$ 1,781,631	\$ 0	\$ (1,781,631)	\$ 0
Income from investments	0	4,334,793	0	4,334,793
Interest income	13,468	22,364	(13,437)	22,395
Impairment of intangible assets	0	0	0	0
Nonregulated income	<u>1,263,024</u>	<u>0</u>	<u>(114,268)</u>	<u>1,148,756</u>
 TOTAL OTHER INCOME	 \$ 3,058,123	 \$ 4,357,157	 \$ (1,909,336)	 \$ 5,505,944
Fixed charges:				
Interest expense	\$ 1,889,922	\$ 148,920	\$ (13,437)	\$ 2,025,405
Interest charged to construction - credit	<u>(375,992)</u>	<u>0</u>	<u>0</u>	<u>(375,992)</u>
 TOTAL FIXED CHARGES	 \$ 1,513,930	 \$ 148,920	 \$ (13,437)	 \$ 1,649,413
INCOME BEFORE				
TAXES ON INCOME	\$ 413,962	\$ 2,768,724	\$ (1,781,631)	\$ 1,401,055
Taxes on income	<u>193,215</u>	<u>987,093</u>	<u>0</u>	<u>1,180,308</u>
 NET INCOME	 <u>\$ 220,747</u>	 <u>\$ 1,781,631</u>	 <u>\$ (1,781,631)</u>	 <u>\$ 220,747</u>

CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2013

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Net income	\$ 220,747	\$ 1,781,631	\$ (1,781,631)	\$ 220,747
Other comprehensive income (loss):				
Postretirement benefit other than pension:				
Unrecognized loss	<u>(1,405,529)</u>	<u>0</u>	<u>0</u>	<u>(1,405,529)</u>
COMPREHENSIVE INCOME (LOSS)	<u>\$ (1,184,782)</u>	<u>\$ 1,781,631</u>	<u>\$ (1,781,631)</u>	<u>\$ (1,184,782)</u>