

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

December 31, 2015 and 2014

--oo0oo--

C O N T E N T S

Consolidated Financial Statements:

Independent Auditors' Report	Page 5
Consolidated Balance Sheets.....	8
Consolidated Statements of Operations.....	10
Consolidated Statements of Comprehensive Income	13
Consolidated Statements of Changes in Members' Equity	15
Consolidated Statements of Cash Flows	16
Notes to Consolidated Financial Statements	19

Consolidating Information:

Independent Auditors' Report on Consolidating Information.....	33
Schedule 1 - Consolidating Balance Sheets	34
Schedule 2 - Consolidating Statements of Operations	36
Schedule 3 - Consolidating Statements of Comprehensive Income.....	39

--oo0oo--

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, 2015 and 2014, 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 audit 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, 2015 and 2014, 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 19, 2016 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.

Sotherow, Paile, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
February 19, 2016

CONSOLIDATED BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

	2015	2014
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash - general	\$ 10,717,142	\$ 7,587,547
Cash - construction funds	10,977	2,179,852
Temporary cash investments	2,251,000	2,250,000
Telecommunications accounts receivable, less allowances of \$365,235 in 2015 and \$245,008 in 2014	1,380,508	1,483,610
Other accounts receivable	165,817	284,728
Materials and supplies	1,059,864	1,105,349
Refundable tax deposit	71,605	85,200
Other current assets	197,380	207,416
	<hr/>	<hr/>
TOTAL CURRENT ASSETS	\$ 15,854,293	\$ 15,183,702
 <u>NONCURRENT ASSETS</u>		
Investments	\$ 28,184,582	\$ 25,911,391
Nonregulated investments	2,388,209	2,923,400
Goodwill, less accumulated amortization	442,505	442,505
Deferred tax asset	77,323	92,355
	<hr/>	<hr/>
TOTAL NONCURRENT ASSETS	\$ 31,092,619	\$ 29,369,651
 <u>PROPERTY, PLANT AND EQUIPMENT</u>		
Telecommunications plant in service	\$ 172,252,847	\$ 159,234,735
Telecommunications plant under construction	3,491,073	7,080,156
	<hr/>	<hr/>
	\$ 175,743,920	\$ 166,314,891
Less accumulated depreciation	100,043,831	93,762,945
	<hr/>	<hr/>
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 75,700,089	\$ 72,551,946
	<hr/>	<hr/>
	<u>\$ 122,647,001</u>	<u>\$ 117,105,299</u>

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

CONSOLIDATED BALANCE SHEETS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

	2015	2014
<u>LIABILITIES AND MEMBERS' EQUITY</u>		
<u>CURRENT LIABILITIES</u>		
Accounts payable	\$ 1,002,851	\$ 1,363,126
Advance billings and payments	335,461	322,431
Customer deposits	435,714	406,137
Current maturities on long-term debt	5,497,970	4,809,661
Accrued federal and state taxes	480,694	223,810
Accrued interest	71,452	107,654
Accrued rents	622,434	626,979
Accrued salaries and wages	247,589	235,423
Accrued property taxes	427,095	397,617
Accrued vacation and sick leave benefits	1,529,762	1,495,401
Other current liabilities	487,576	418,199
	<hr/>	<hr/>
TOTAL CURRENT LIABILITIES	\$ 11,138,598	\$ 10,406,438
 <u>LONG-TERM DEBT</u>		
Rural Utilities Service	34,552,613	32,431,221
Rural Telephone Bank	9,148,262	9,685,911
Other long-term debt	2,640,981	3,816,177
 <u>OTHER LIABILITIES</u>		
Postretirement benefits other than pension	5,574,960	6,586,900
Deferred taxes	2,360,846	2,109,864
	<hr/>	<hr/>
TOTAL LIABILITIES	\$ 65,416,260	\$ 65,036,511
 <u>MEMBERS' EQUITY</u>		
Patronage capital	\$ 59,001,541	\$ 54,520,747
Accumulated other comprehensive loss	(1,770,800)	(2,451,959)
	<hr/>	<hr/>
TOTAL MEMBERS' EQUITY	\$ 57,230,741	\$ 52,068,788
	<hr/>	<hr/>
	<u>\$ 122,647,001</u>	<u>\$ 117,105,299</u>

CONSOLIDATED STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2015 and 2014

	2015	2014
Operating revenues:		
Local network services revenue	\$ 5,046,422	\$ 4,803,950
Network access services revenue	18,432,355	17,785,671
Long distance network services revenue	287,778	289,490
Miscellaneous revenue	2,789,504	3,007,151
Less: Uncollectible revenue	<u>(162,600)</u>	<u>(162,600)</u>
TOTAL OPERATING REVENUES	\$ 26,393,459	\$ 25,723,662
Operating expenses:		
Plant specific operations expense	\$ 6,290,176	\$ 6,791,073
Plant nonspecific operations expense	2,833,425	2,731,523
Provision for depreciation and amortization	10,123,483	10,207,603
Customer operations expense	2,918,861	2,855,201
Corporate operations expense	2,949,906	2,738,735
Operating taxes	<u>888,830</u>	<u>900,687</u>
TOTAL OPERATING EXPENSES	<u>\$ 26,004,681</u>	<u>\$ 26,224,822</u>
OPERATING INCOME (LOSS)	\$ 388,778	\$ (501,160)
Other income:		
Income from investments	\$ 4,832,374	\$ 2,258,776
Interest income	147,636	36,651
Nonregulated income	2,216,244	1,427,393
Gain on sale of assets	<u>0</u>	<u>101,486</u>
TOTAL OTHER INCOME	\$ 7,196,254	\$ 3,824,306

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, 2015 and 2014

	2015	2014
Fixed charges:		
Interest expense	\$ 1,969,322	\$ 2,110,480
Interest charged to construction - credit	<u>(142,496)</u>	<u>(282,701)</u>
TOTAL FIXED CHARGES	<u>\$ 1,826,826</u>	<u>\$ 1,827,779</u>
INCOME BEFORE TAXES ON INCOME	\$ 5,758,206	\$ 1,495,367
Taxes on income	<u>1,277,412</u>	<u>249,389</u>
NET INCOME	<u><u>\$ 4,480,794</u></u>	<u><u>\$ 1,245,978</u></u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2015 and 2014

	2015	2014
Net income	\$ 4,480,794	\$ 1,245,978
Other comprehensive income (loss):		
Postretirement benefit other than pension:		
Unrecognized prior service cost	3,307,100	0
Unrecognized (loss) gain on assets	<u>(2,625,941)</u>	<u>4,178,009</u>
COMPREHENSIVE INCOME	<u>\$ 5,161,953</u>	<u>\$ 5,423,987</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, 2015 and 2014

	Patronage Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2013	\$ 53,274,769	\$ (6,629,968)	\$ 46,644,801
Net income for 2014	1,245,978	0	1,245,978
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized gain	<u>0</u>	<u>4,178,009</u>	<u>4,178,009</u>
Balance at December 31, 2014	\$ 54,520,747	\$ (2,451,959)	\$ 52,068,788
Net income for 2015	4,480,794	0	4,480,794
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized prior service cost	0	3,307,100	3,307,100
Unrecognized loss	<u>0</u>	<u>(2,625,941)</u>	<u>(2,625,941)</u>
Balance at December 31, 2015	<u>\$ 59,001,541</u>	<u>\$ (1,770,800)</u>	<u>\$ 57,230,741</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, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash received from customers	\$ 26,615,472	\$ 25,891,539
Cash paid to suppliers and employees	(15,218,218)	(14,946,346)
Interest received	147,636	36,651
Interest paid	(1,863,028)	(1,843,483)
Taxes paid	(1,600,271)	(1,702,529)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 8,081,591	\$ 7,435,832
Cash flows from investing activities:		
Construction and acquisition of plant	\$ (13,268,775)	\$ (11,411,665)
Plant removal costs	(78,096)	(110,702)
Salvage	75,246	0
Cash distribution from investments	2,559,182	2,448,370
Investment in nonregulated CPE	535,191	26,357
Proceeds from sale of assets	0	175,000
Decrease (Increase) in:		
Materials and supplies	45,485	125,272
Temporary investments	(1,000)	(450,000)
Nonregulated income	2,216,244	1,427,393
NET CASH USED BY INVESTING ACTIVITIES	\$ (7,916,523)	\$ (7,769,975)
Cash flows from financing activities:		
Debt proceeds	\$ 7,574,832	\$ 8,750,589
Payments on notes payable and long-term borrowings	(6,477,976)	(6,483,957)
Postretirement benefits other than pension	(330,781)	677,832
Decrease in customer deposits	29,577	31,550
NET CASH PROVIDED BY FINANCING ACTIVITIES	\$ 795,652	\$ 2,976,014
NET INCREASE IN CASH	\$ 960,720	\$ 2,641,871
CASH AT BEGINNING OF YEAR	9,767,399	7,125,528
CASH AT END OF YEAR	\$ 10,728,119	\$ 9,767,399

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, 2015 and 2014

	2015	2014
Net income	\$ 4,480,794	\$ 1,245,978
Nonregulated income	(2,216,244)	(1,427,393)
Gain on sale of assets	0	(101,486)
Income from investments	<u>(4,832,374)</u>	<u>(2,258,776)</u>
Net loss from regulated operations	\$ (2,567,824)	\$ (2,541,677)
Adjustments to reconcile net loss from regulated operations to net cash provided by operating activities:		
Depreciation and amortization	\$10,123,483	\$10,207,603
Deferred taxes on income	266,014	(390,412)
Decrease (Increase) in:		
Customer and accounts receivable	222,013	167,877
Current and accrued assets - other	10,036	22,743
Refundable tax deposit	13,595	(5,830)
Increase (Decrease) in:		
Accounts payable	(360,275)	5,237
Advance billings and payments	13,030	38,810
Accrued federal and state taxes	256,884	133,884
Accrued interest	(36,202)	(15,704)
Accrued rents	(4,545)	(2,788)
Accrued salaries and employee benefits	46,527	36,894
Accrued property taxes	29,478	(290,095)
Other current liabilities	<u>69,377</u>	<u>69,290</u>
TOTAL ADJUSTMENTS	<u>\$10,649,415</u>	<u>\$ 9,977,509</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 8,081,591</u>	<u>\$ 7,435,832</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

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 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 \$79,293 and \$84,288 at December 31, 2015 and 2014, 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, 2015 and 2014

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 \$128,376 in 2015 and \$126,157 in 2014.
- (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 \$12,328,045 was uninsured at December 31, 2015.

Restricted cash consists of employees' savings and flex plan accounts in which \$72,887 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, 2015 and 2014

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, 2015, the Cooperative has received \$24,964,000 in loan proceeds and \$24,715,709 of the grant portion.

Note D – Investments:

	<u>2015</u>	<u>2014</u>
NECA Services, Inc. stock - at cost	\$ 10,000	\$ 10,000
Cash value of life insurance	217,644	241,231
Investment in Kentucky RSA #3 cellular partnership (25%)	20,968,619	19,452,119
Investment in Bluegrass Network, LLC (20%)	5,359,949	4,570,178
Investment in Bluegrass Telecom, LLC (20%)	333,154	342,042
Qualified patronage capital certificates – NRTC	244,427	271,135
Tennessee 220 MHZ Radio	147,224	147,224
Tennessee Independent Telecom Group (IRIS Networks) (10.556%)	893,425	867,322
Synergy Wireless, Inc. – at cost	10,000	10,000
Deposits	<u>140</u>	<u>140</u>
	<u>\$28,184,582</u>	<u>\$25,911,391</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, 2015 and 2014

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, 2015 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	\$93,402,000	\$27,683,345	\$2,962,338	\$17,910,809
Total liabilities	\$ 8,178,000	\$ 883,600	\$1,252,344	\$ 9,502,927
Total equity	\$85,224,000	\$26,799,745	\$1,709,994	\$ 8,407,882
Net income	\$16,066,000	\$ 3,948,855	\$ 236,780	\$ 247,184

Note E – Nonregulated investments:

	<u>2015</u>	<u>2014</u>
Nonregulated customer premises equipment	\$8,432,457	\$7,850,575
Less accumulated provisions for depreciation	<u>6,044,248</u>	<u>4,927,175</u>
TOTAL	<u>\$2,388,209</u>	<u>\$2,923,400</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. During 2015, the Company did not record any goodwill impairment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

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>2015</u>	<u>2014</u>
Land	\$ 802,242	\$ 798,654
Buildings	9,387,920	9,232,132
Central office equipment	46,173,439	42,550,687
Outside plant network	98,618,317	90,316,427
Furniture and office equipment	2,573,831	2,525,360
Vehicles and other work equipment	<u>2,912,046</u>	<u>3,052,596</u>
Telecommunications plant in service as contained on the Cooperative's records	\$160,467,795	\$148,475,856
Land	\$ 35,000	\$ 35,000
Building	214,756	214,756
CATV equipment	75,545	75,545
Central office equipment	4,781,870	4,765,149
Outside plant network	3,267,383	3,222,920
Office furniture and fixtures	47,459	47,459
Equipment	1,948,376	1,631,200
Vehicles	<u>1,414,663</u>	<u>766,850</u>
Telecommunications plant in service as contained on the Subsidiaries' records	\$ <u>11,785,052</u>	\$ <u>10,758,879</u>
Total telecommunications plant in service	<u>\$172,252,847</u>	<u>\$159,234,735</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 5.82 percent for 2015 and 6.49 percent for 2014. The provision for depreciation in 2015 and 2014 was \$9,083,839 and \$9,179,262, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

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 \$1,125,695 in 2015 and \$1,028,341 in 2014.

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, 2015 and 2014

Note H – (Cont'd)

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

	<u>2015</u>	<u>2014</u>
2.92% to 5.15% Rural Utilities Service notes, matures January 2, 2018	\$ 7,510,259	\$ 9,869,031
5.00% to 5.13% Rural Telephone Bank notes, matures January 2, 2029	9,679,601	10,199,348
4.00% Citizens Bank of Lafayette	1,163,752	1,574,389
4.00% Farmers National Bank, matures July 16, 2018	708,185	972,018
1.35% to 2.36% Rural Utilities Service notes, matures December 31, 2025	11,836,273	6,367,054
1.93% to 3.99% Rural Utilities Service notes, matures June 17, 2031	21,978,707	21,841,756
4.00% Macon Co. Bank & Trust Co., matures December 21, 2016	1,478,136	1,923,331
Less cushion of credit	<u>(2,515,087)</u>	<u>(2,003,957)</u>
	\$51,839,826	\$50,742,970
Less current maturities	<u>5,497,970</u>	<u>4,809,661</u>
TOTAL	<u>\$46,341,856</u>	<u>\$45,933,309</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>
2016	\$ 5,497,970
2017	5,395,610
2018	4,943,783
2019	3,244,086
2020	3,341,079
Beyond five years	<u>29,417,298</u>
TOTAL	<u>\$51,839,826</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

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 unit 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>2015</u>	<u>2014</u>
Accumulated postretirement obligation attributable to:		
Retirees	\$ 6,285,271	\$ 5,598,300
Fully eligible plan participants	1,240,450	225,100
Other active plan participants	<u>7,636,749</u>	<u>10,268,300</u>
Total accumulated postretirement benefit obligation	\$15,162,470	\$16,091,700
Fair value of plan assets	<u>(9,587,500)</u>	<u>(9,504,800)</u>
Net unfunded status	<u>\$ 5,574,970</u>	<u>\$ 6,586,900</u>

Amounts recognized in other comprehensive income:

Unrecognized prior service cost	\$ 3,307,100	\$ 0
Unrecognized net loss	<u>(5,077,900)</u>	<u>(2,451,959)</u>
Total included in other comprehensive income	<u>\$(1,770,800)</u>	<u>\$(2,451,959)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

Note I – (Cont'd):

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

	<u>2015</u>	<u>2014</u>
Benefits earned during the year	\$ 415,100	\$ 621,200
Interest on accumulated postretirement benefit obligation	709,300	787,800
Expected return on plan assets	<u>(712,900)</u>	<u>(684,800)</u>
Postretirement benefit cost	<u>\$ 411,500</u>	<u>\$ 724,200</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 2015, 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>2015</u>	<u>2014</u>
Discount rate	5.25%	5.25%
Rate of compensation increase	3.00%	3.00%
Expected return on plan assets	7.50%	7.50%

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 2015 was approximately 8.0% grading down to an ultimate rate in 2023 of 4.0%. 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 2015 net periodic postretirement benefit cost by \$209,000 and would have increased the postretirement benefit obligation as of December 31, 2015 by \$1,945,500.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

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 plan assets in 2014.

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>
2016	\$ 573,200
2017	605,100
2018	637,900
2019	688,500
2020	715,100
Years 2021 – 2023	<u>3,948,700</u>
TOTAL	<u>\$7,168,500</u>

The Cooperative did not make a contribution to the plan in 2015 and an annual contribution to the plan is not anticipated in 2016.

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 \$843,278.53 for 2015 and \$926,425 for 2014.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

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>2015</u>	<u>2014</u>
Current income tax expense:		
Federal	\$ 867,702	\$ 543,497
State	143,696	95,720
Deferred income tax expense (benefit):		
Federal	213,521	(323,800)
State	<u>52,493</u>	<u>(66,320)</u>
Income tax before valuation	\$1,277,412	\$ 249,097
Valuation of deferred tax asset	<u>0</u>	<u>292</u>
	<u>\$1,277,412</u>	<u>\$ 249,389</u>

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

	<u>2015</u>	<u>2014</u>
Deferred tax asset	\$ 77,323	\$ 92,355
Deferred tax liability	<u>(2,325,029)</u>	<u>(2,074,047)</u>
	\$(2,247,706)	\$(1,981,692)
Valuation allowance	<u>(35,817)</u>	<u>(35,817)</u>
Net deferred tax liability	<u><u>\$(2,283,523)</u></u>	<u><u>\$(2,017,509)</u></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 deferred tax liability is the result of timing differences related to the difference in financial reporting depreciation and income tax depreciation.

North Central Computer Technologies, Inc. has a net operating loss carryforward of approximately \$1,253,524, which is available to offset future state taxable income. This carryforward will expire in 1 to 11 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015 and 2014

Note K – (Cont'd)

North Central Security Services, Inc. has a net operating loss carryforward of approximately \$1,743,512, which is available to offset future state taxable income. This carryforward will expire in 1 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, 2015 and 2014.

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 – Deferred Compensation

The Cooperative has implemented a deferred compensation plan for certain management personnel. The plan is maintained by Wells Fargo. Under the terms of the plan, an amount determined by the Board of Directors of the Cooperative will be paid to an account established on behalf of the management personnel. The deferred compensation is to be paid to the individuals upon retirement or other reasons of discontinued service to the Cooperative. During 2015, contributions to the deferred compensation plan totaled \$15,000. Included in the cash accounts of the Consolidated Balance Sheets is \$15,000 at December 31, 2015 that is included in the deferred compensation plan.

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, 2015 and before the date these financial statements were available to be issued, February 19, 2016, 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, 2015 and 2014, and our report thereon dated February 19, 2016, 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 in Schedules 1, 2 and 3 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 19, 2016

SCHEDULE 1 - CONSOLIDATING BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>ASSETS</u>				
<u>CURRENT ASSETS</u>				
Cash - general	\$ 9,282,286	\$ 1,434,856	\$ 0	\$ 10,717,142
Cash - construction funds	10,977	0	0	10,977
Temporary cash investments	1,101,000	1,150,000	0	2,251,000
Telecommunications accounts receivable	1,254,272	126,236	0	1,380,508
Other accounts receivable	165,817	0	0	165,817
Advance to related company	0	4,177,100	(4,177,100)	0
Materials and supplies	914,728	145,136	0	1,059,864
Refundable tax deposits	71,605	0	0	71,605
Other current assets	183,534	13,846	0	197,380
TOTAL CURRENT ASSETS	\$ 12,984,219	\$ 7,047,174	\$ (4,177,100)	\$ 15,854,293
<u>NONCURRENT ASSETS</u>				
Investment in subsidiary	\$ 34,076,856	\$ 0	\$ (34,076,856)	\$ 0
Investments	227,644	27,956,938	0	28,184,582
Nonregulated investments	2,388,209	0	0	2,388,209
Goodwill - net	0	442,505	0	442,505
Deferred tax asset	0	77,323	0	77,323
TOTAL NONCURRENT ASSETS	\$ 36,692,709	\$ 28,476,766	\$ (34,076,856)	\$ 31,092,619
<u>PROPERTY, PLANT AND EQUIPMENT</u>				
Telecommunications plant in service	\$ 160,467,795	\$ 11,785,052	\$ 0	\$ 172,252,847
Telecommunications plant under construction	3,487,823	3,250	0	3,491,073
	\$ 163,955,618	\$ 11,788,302	\$ 0	\$ 175,743,920
Less accumulated depreciation	91,537,515	8,506,316	0	100,043,831
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 72,418,103	\$ 3,281,986	\$ 0	\$ 75,700,089
	<u>\$ 122,095,031</u>	<u>\$ 38,805,926</u>	<u>\$ (38,253,956)</u>	<u>\$ 122,647,001</u>

SCHEDULE 1 - CONSOLIDATING BALANCE SHEETS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2015

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>LIABILITIES AND MEMBERS' EQUITY</u>				
<u>CURRENT LIABILITIES</u>				
Accounts payable	\$ 448,022	\$ 554,829	\$ 0	\$ 1,002,851
Advance billings and payments	245,109	90,352	0	335,461
Advance from related company	4,026,600	150,500	(4,177,100)	0
Customer deposits	435,714	0	0	435,714
Current maturities on long-term debt	5,223,312	274,658	0	5,497,970
Accrued federal and state taxes	0	480,694	0	480,694
Accrued interest	37,025	34,427	0	71,452
Accrued rent	591,119	31,315	0	622,434
Accrued salaries and wages	230,014	17,575	0	247,589
Accrued property taxes	381,167	45,928	0	427,095
Accrued vacation and sick leave benefits	1,510,491	19,271	0	1,529,762
Other current liabilities	252,428	235,148	0	487,576
TOTAL CURRENT LIABILITIES	\$ 13,381,001	\$ 1,934,697	\$ (4,177,100)	\$ 11,138,598
<u>LONG-TERM DEBT</u>				
Rural Utilities Service	34,552,613	0	0	34,552,613
Rural Telephone Bank	9,148,262	0	0	9,148,262
Other long-term debt	2,207,454	433,527	0	2,640,981
<u>OTHER LIABILITIES</u>				
Postretirement benefits other than pension	5,574,960	0	0	5,574,960
Deferred tax liability	0	2,360,846	0	2,360,846
TOTAL LIABILITIES	\$ 64,864,290	\$ 4,729,070	\$ (4,177,100)	\$ 65,416,260
<u>MEMBERS' EQUITY</u>				
Capital stock	\$ 0	\$ 8,100,000	\$ (8,100,000)	\$ 0
Patronage capital	59,001,541	0	0	59,001,541
Accumulated comprehensive loss	(1,770,800)	0	0	(1,770,800)
Retained earnings	0	25,976,856	(25,976,856)	0
TOTAL MEMBERS' EQUITY	\$ 57,230,741	\$ 34,076,856	\$ (34,076,856)	\$ 57,230,741
	<u><u>\$ 122,095,031</u></u>	<u><u>\$ 38,805,926</u></u>	<u><u>\$ (38,253,956)</u></u>	<u><u>\$ 122,647,001</u></u>

SCHEDULE 2 - CONSOLIDATING STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2015

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Operating revenues:				
Local network services revenue	\$ 4,627,159	\$ 419,263	\$ 0	\$ 5,046,422
Network access service revenue	18,170,713	261,642	0	18,432,355
Long distance network services revenue	269,848	17,930	0	287,778
Internet and video revenues	5,945,726	5,990,051	(11,935,777)	0
Security systems revenue	0	1,372,089	(1,372,089)	0
Lease revenue	0	1,202,127	(1,202,127)	0
Miscellaneous revenue	2,746,177	301,927	(258,600)	2,789,504
Less: Uncollectible revenue	<u>(162,600)</u>	<u>0</u>	<u>0</u>	<u>(162,600)</u>
 TOTAL OPERATING REVENUES	 \$ 31,597,023	 \$ 9,565,029	 \$ (14,768,593)	 \$ 26,393,459
Operating expenses:				
Plant specific operations expense	\$ 6,948,323	\$ 543,980	\$ (1,202,127)	\$ 6,290,176
Plant nonspecific operations expense	2,814,361	19,064	0	2,833,425
Internet and video expenses	4,564,719	7,415,552	(11,980,271)	0
Security equipment cost of goods sold and monitoring expenses	0	399,190	(399,190)	0
Provision for depreciation	8,997,788	1,125,695	0	10,123,483
Customer operations expense	2,847,471	78,590	(7,200)	2,918,861
Corporate operations expense	1,983,456	1,217,850	(251,400)	2,949,906
Operating taxes	<u>720,082</u>	<u>168,748</u>	<u>0</u>	<u>888,830</u>
 TOTAL OPERATING EXPENSES	 \$ 28,876,200	 \$ 10,968,669	 \$ (13,840,188)	 \$ 26,004,681
 OPERATING INCOME (LOSS)	 \$ 2,720,823	 \$ (1,403,640)	 \$ (928,405)	 \$ 388,778

SCHEDULE 2 - CONSOLIDATING STATEMENTS OF OPERATIONS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2015

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Other income:				
Income from subsidiaries	\$ 2,165,580	\$ 0	\$ (2,165,580)	\$ 0
Income from investments	0	4,832,374	0	4,832,374
Interest income	128,220	19,416	0	147,636
Impairment of intangible assets	0	0	0	0
Gain on sale of asset	0	0	0	0
Nonregulated income	<u>1,287,839</u>	<u>0</u>	<u>928,405</u>	<u>2,216,244</u>
 TOTAL OTHER INCOME	 \$ 3,581,639	 \$ 4,851,790	 \$ (1,237,175)	 \$ 7,196,254
Fixed charges:				
Interest expense	\$ 1,874,730	\$ 94,592	\$ 0	\$ 1,969,322
Interest charged to construction - credit	<u>(142,496)</u>	<u>0</u>	<u>0</u>	<u>(142,496)</u>
 TOTAL FIXED CHARGES	 \$ 1,732,234	 \$ 94,592	 \$ 0	 \$ 1,826,826
 INCOME BEFORE TAXES ON INCOME	 \$ 4,570,228	 \$ 3,353,558	 \$ (2,165,580)	 \$ 5,758,206
Taxes on income	<u>89,434</u>	<u>1,187,978</u>	<u>0</u>	<u>1,277,412</u>
 NET INCOME	 <u>\$ 4,480,794</u>	 <u>\$ 2,165,580</u>	 <u>\$ (2,165,580)</u>	 <u>\$ 4,480,794</u>

SCHEDULE 3 - CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2015

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Net income	\$ 4,480,794	\$ 2,165,580	\$ (2,165,580)	\$ 4,480,794
Other comprehensive income (loss):				
Postretirement benefit				
other than pension:				
Unrecognized prior service cost	3,307,100	0	0	3,307,100
Unrecognized loss	<u>(2,625,941)</u>	<u>0</u>	<u>0</u>	<u>(2,625,941)</u>
COMPREHENSIVE INCOME	<u>\$ 5,161,953</u>	<u>\$ 2,165,580</u>	<u>\$ (2,165,580)</u>	<u>\$ 5,161,953</u>

