

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

December 31, 2017 and 2016

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TOTHEROW HAILE & WELCH, PLLC

Certified Public Accountants

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 consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of North Central Telephone Cooperative Corporation and Subsidiary as of December 31, 2017 and 2016, and the results of their 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 23, 2018 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, Haile, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
February 23, 2018

CONSOLIDATED BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

	2017	2016
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash - general	\$ 6,486,144	\$ 9,717,343
Cash - construction funds	3,901,340	7,937,212
Temporary cash investments	2,251,000	2,251,000
Telecommunications accounts receivable, less allowances of \$516,471 in 2017 and \$497,931 in 2016	949,308	1,020,098
Other accounts receivable	131,305	166,961
Materials and supplies	1,523,115	2,031,419
Refundable tax deposit	10,249	76,605
Other current assets	<u>209,615</u>	<u>249,357</u>
TOTAL CURRENT ASSETS	\$ 15,462,076	\$ 23,449,995
<u>NONCURRENT ASSETS</u>		
Investments	\$ 35,678,957	\$ 33,824,681
Nonregulated investments	708,533	1,457,399
Notes receivable	11,453	0
Goodwill, less accumulated amortization	442,505	442,505
Deferred tax asset	<u>53,857</u>	<u>67,019</u>
TOTAL NONCURRENT ASSETS	\$ 36,895,305	\$ 35,791,604
<u>PROPERTY, PLANT AND EQUIPMENT</u>		
Telecommunications plant in service	\$ 173,114,697	\$ 168,717,186
Telecommunications plant under construction	<u>15,279,418</u>	<u>7,845,247</u>
	\$ 188,394,115	\$ 176,562,433
Less accumulated depreciation	<u>105,011,621</u>	<u>97,451,922</u>
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 83,382,494	\$ 79,110,511
	<u>\$ 135,739,875</u>	<u>\$ 138,352,110</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, 2017 and 2016

	2017	2016
<u>LIABILITIES AND MEMBERS' EQUITY</u>		
<u>CURRENT LIABILITIES</u>		
Accounts payable	\$ 2,701,727	\$ 1,201,149
Advance billings and payments	402,860	378,345
Customer deposits	513,836	481,900
Current maturities on long-term debt	4,733,284	6,913,965
Accrued federal and state taxes	616,041	607,883
Accrued interest	40,240	103,886
Accrued rents	602,367	630,022
Accrued salaries and wages	301,222	283,430
Accrued property taxes	521,029	434,179
Accrued vacation and sick leave benefits	1,513,425	1,427,189
Other current liabilities	550,531	500,459
	<hr/>	<hr/>
TOTAL CURRENT LIABILITIES	\$ 12,496,562	\$ 12,962,407
 <u>LONG-TERM DEBT</u>		
Rural Utilities Service	36,754,300	41,079,140
Rural Telephone Bank	7,915,854	8,638,383
Other long-term debt	0	536,279
 <u>OTHER LIABILITIES</u>		
Postretirement benefits other than pension	6,719,100	5,159,000
Deferred taxes	1,951,706	2,749,570
	<hr/>	<hr/>
TOTAL LIABILITIES	\$ 65,837,522	\$ 71,124,779
 <u>MEMBERS' EQUITY</u>		
Patronage capital	\$ 73,095,153	\$ 68,704,831
Accumulated other comprehensive loss	(3,192,800)	(1,477,500)
	<hr/>	<hr/>
TOTAL MEMBERS' EQUITY	\$ 69,902,353	\$ 67,227,331
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	<u>\$ 135,739,875</u>	<u>\$ 138,352,110</u>

CONSOLIDATED STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2017 and 2016

	2017	2016
Operating revenues:		
Local network services revenue	\$ 5,497,410	\$ 5,316,881
Network access services revenue	16,424,959	19,980,225
Long distance network services revenue	423,813	351,468
Miscellaneous revenue	2,696,324	2,577,500
Less: Uncollectible revenue	<u>(80,171)</u>	<u>(162,600)</u>
 TOTAL OPERATING REVENUES	 \$ 24,962,335	 \$ 28,063,474
Operating expenses:		
Plant specific operations expense	\$ 6,762,000	\$ 6,489,375
Plant nonspecific operations expense	2,690,624	2,776,285
Provision for depreciation and amortization	9,363,252	9,579,662
Customer operations expense	2,873,925	2,936,989
Corporate operations expense	3,113,651	3,034,194
Operating taxes	<u>916,270</u>	<u>938,165</u>
 TOTAL OPERATING EXPENSES	 <u>\$ 25,719,722</u>	 <u>\$ 25,754,670</u>
 OPERATING INCOME (LOSS)	 \$ (757,387)	 \$ 2,308,804
Other income:		
Income from investments	\$ 5,065,364	\$ 9,176,878
Interest income	241,839	175,485
Nonregulated income	2,232,690	2,348,203
Gain (Loss) on sale of assets	<u>26,313</u>	<u>(1,616)</u>
 TOTAL OTHER INCOME	 \$ 7,566,206	 \$ 11,698,950

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, 2017 and 2016

	2017	2016
Fixed charges:		
Interest expense	\$ 1,705,743	\$ 1,875,753
Interest charged to construction - credit	<u>(235,875)</u>	<u>(165,022)</u>
TOTAL FIXED CHARGES	<u>\$ 1,469,868</u>	<u>\$ 1,710,731</u>
INCOME BEFORE TAXES ON INCOME	\$ 5,338,951	\$ 12,297,023
Taxes on income	<u>948,629</u>	<u>2,593,733</u>
NET INCOME	<u><u>\$ 4,390,322</u></u>	<u><u>\$ 9,703,290</u></u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2017 and 2016

	2017	2016
Net income	\$ 4,390,322	\$ 9,703,290
Other comprehensive income (loss):		
Postretirement benefit other than pension:		
Unrecognized prior service cost	(800,900)	374,400
Unrecognized (loss) gain on assets	<u>(914,400)</u>	<u>(81,100)</u>
COMPREHENSIVE INCOME	<u>\$ 2,675,022</u>	<u>\$ 9,996,590</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, 2017 and 2016

	Patronage Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2015	\$ 59,001,541	\$ (1,770,800)	\$ 57,230,741
Net income for 2016	9,703,290	0	9,703,290
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized prior service cost	0	374,400	374,400
Unrecognized loss	0	(81,100)	(81,100)
Balance at December 31, 2016	\$ 68,704,831	\$ (1,477,500)	\$ 67,227,331
Net income for 2017	4,390,322		4,390,322
Other comprehensive income (loss):			
Postretirement benefit other than pension:			
Unrecognized prior service cost	0	(800,900)	(800,900)
Unrecognized loss	0	(914,400)	(914,400)
Balance at December 31, 2017	<u>\$ 73,095,153</u>	<u>\$ (3,192,800)</u>	<u>\$ 69,902,353</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, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	\$ 25,068,781	\$ 28,422,740
Cash paid to suppliers and employees	(13,748,920)	(15,093,899)
Interest received	241,839	175,485
Interest paid	(1,533,514)	(1,678,297)
Taxes paid	(2,488,237)	(3,003,597)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 7,539,949	\$ 8,822,432
Cash flows from investing activities:		
Construction and acquisition of plant	\$ (13,588,588)	\$ (13,000,475)
Plant removal costs	(124,296)	(79,721)
Salvage	74,636	88,496
Increase in investments	(264,276)	0
Cash distribution from investments	3,475,364	3,536,779
Proceeds from sale of assets	29,326	0
Investment in nonregulated CPE	748,866	930,810
Decrease (Increase) in:		
Materials and supplies	508,304	(971,555)
Nonregulated income	2,232,690	2,348,203
NET CASH USED BY INVESTING ACTIVITIES	\$ (6,907,974)	\$ (7,147,463)
Cash flows from financing activities:		
Debt proceeds	\$ 0	\$ 13,074,497
Payments on notes payable and long-term borrowings	(7,764,329)	(7,746,556)
Increase in notes receivable	(11,453)	0
Postretirement benefits other than pension	(155,200)	(122,660)
Increase in customer deposits	31,936	46,186
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	\$ (7,899,046)	\$ 5,251,467
NET INCREASE (DECREASE) IN CASH	\$ (7,267,071)	\$ 6,926,436
CASH AT BEGINNING OF YEAR	17,654,555	10,728,119
CASH AT END OF YEAR	\$ 10,387,484	\$ 17,654,555

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, 2017 and 2016

	2017	2016
Net income	\$ 4,390,322	\$ 9,703,290
Nonregulated income	(2,232,690)	(2,348,203)
(Gain) Loss on sale of assets	(26,313)	1,616
Income from investments	<u>(5,065,364)</u>	<u>(9,176,878)</u>
Net loss from regulated operations allowances of \$516,471 in 2017 and Adjustments to reconcile net loss from regulated operations to net cash provided by operating activities:	\$ (2,934,045)	\$ (1,820,175)
Depreciation and amortization	\$ 9,363,252	\$ 9,579,662
Deferred taxes on income	(784,702)	399,028
Decrease (Increase) in:		
Customer and accounts receivable	106,446	359,266
Current and accrued assets - other	39,742	(51,977)
Refundable tax deposit	66,356	(5,000)
Increase (Decrease) in:		
Accounts payable	1,500,578	198,298
Advance billings and payments	24,515	42,884
Accrued federal and state taxes	8,158	127,189
Accrued interest	(63,646)	32,434
Accrued rents	(27,655)	7,588
Accrued salaries and employee benefits	104,028	(66,732)
Accrued property taxes	86,850	7,084
Other current liabilities	<u>50,072</u>	<u>12,883</u>
TOTAL ADJUSTMENTS	<u>\$10,473,994</u>	<u>\$10,642,607</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 7,539,949</u>	<u>\$ 8,822,432</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

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 \$84,411 and \$51,838 at December 31, 2017 and 2016, 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, 2017 and 2016

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 \$63,568 in 2017 and \$113,877 in 2016.
- (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 \$11,225,459 was uninsured at December 31, 2017.

Restricted cash consists of employees' savings and flex plan accounts in which \$64,136 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, 2017 and 2016

Note C – Investments:

	<u>2017</u>	<u>2016</u>
NECA Services, Inc. stock - at cost	\$ 10,000	\$ 10,000
Cash value of life insurance	304,369	190,093
Investment in Kentucky RSA #3 cellular partnership (25%)	28,005,894	26,367,219
Investment in Bluegrass Network, LLC (20%)	5,728,326	5,783,854
Investment in Bluegrass Telecom, LLC (20%)	339,041	333,154
Qualified patronage capital certificates – NRTC	43,580	205,938
Tennessee 220 MHZ Radio	147,224	147,224
Tennessee Independent Telecom Group (IRIS Networks) (10.556%)	940,383	777,059
Codero Holdings	150,000	0
Synergy Wireless, Inc. – at cost	10,000	10,000
Deposits	<u>140</u>	<u>140</u>
	<u>\$35,678,957</u>	<u>\$33,824,681</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, 2017 and 2016

Note C – (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, 2017 of selected financial information from the financial statements of the investments in which North Central Communications, Inc. owns a significant percentage:

	Kentucky RSA #3 cellular <u>partnership</u>	Bluegrass <u>Network, LLC</u>	Bluegrass <u>Telecom, LLC</u>	Tennessee Independent <u>Telecom Group</u>
Total assets	\$121,561,342	\$29,422,469	\$2,608,079	\$17,981,244
Total liabilities	\$ 9,537,768	\$ 780,840	\$ 898,085	\$ 9,123,620
Total equity	\$112,023,574	\$28,641,629	\$1,709,994	\$ 8,857,624
Net income	\$ 18,554,700	\$ 2,346,264	\$ 668,598	\$ 420,919

Note D – Nonregulated investments:

	<u>2017</u>	<u>2016</u>
Nonregulated customer premises equipment	\$9,238,082	\$8,684,267
Less accumulated provisions for depreciation	<u>8,529,549</u>	<u>7,226,868</u>
TOTAL	<u>\$ 708,533</u>	<u>\$1,457,399</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 E – 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 2017, the Company did not record any goodwill impairment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note F – 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>2017</u>	<u>2016</u>
Land	\$ 798,654	\$ 798,654
Buildings	9,660,805	9,443,181
Central office equipment	39,434,820	37,310,410
Outside plant network	104,688,051	104,159,576
Furniture and office equipment	2,594,403	2,545,088
Vehicles and other work equipment	<u>2,302,073</u>	<u>2,044,820</u>
Telecommunications plant in service as contained on the Cooperative's records	\$159,478,806	\$156,301,729
Land	\$ 35,000	\$ 35,000
Building	214,756	214,756
CATV equipment	75,545	75,545
Central office equipment	5,266,786	4,781,870
Outside plant network	3,398,875	3,319,757
Office furniture and fixtures	49,030	47,459
Equipment	2,335,808	2,027,963
Vehicles	<u>2,260,091</u>	<u>1,913,107</u>
Telecommunications plant in service as contained on the Subsidiaries' records	<u>\$ 13,635,891</u>	<u>\$ 12,415,457</u>
Total telecommunications plant in service	<u>\$173,114,697</u>	<u>\$168,717,186</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 5.31 percent for 2017 and 5.41 percent for 2016. The provision for depreciation in 2017 and 2016 was \$8,454,912 and \$8,635,574, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note F – (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 \$976,714 in 2017 and \$1,010,547 in 2016.

Note G – 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 and Farmer's National Bank are unsecured.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note G – (Cont'd)

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

	<u>2017</u>	<u>2016</u>
2.92% to 5.15% Rural Utilities Service notes, matures January 2, 2029	\$ 1,501,742	\$ 5,453,381
5.00% to 5.13% Rural Telephone Bank notes, matures January 2, 2029	8,625,677	9,203,970
4.00% Farmers National Bank, matures July 16, 2018	147,547	433,527
1.35% to 2.36% Rural Utilities Service notes, matures December 31, 2025	23,304,014	24,114,882
1.93% to 3.99% Rural Utilities Service notes, matures June 17, 2031	19,790,864	20,852,151
4.00% Macon Co. Bank & Trust Co., matures June 4, 2018	0	657,876
Less cushion of credit	<u>(3,966,406)</u>	<u>(3,548,020)</u>
	\$49,403,438	\$57,167,767
Less current maturities	<u>4,733,284</u>	<u>6,913,965</u>
TOTAL	<u>\$44,670,154</u>	<u>\$50,253,802</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>
2018	\$ 4,733,284
2019	4,708,179
2020	4,833,160
2021	4,962,354
2022	5,095,928
Beyond five years	<u>25,070,533</u>
TOTAL	<u>\$49,403,438</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note H – 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>2017</u>	<u>2016</u>
Accumulated postretirement obligation attributable to:		
Retirees	\$ 8,619,300	\$ 7,311,700
Fully eligible plan participants	1,133,256	1,333,400
Other active plan participants	<u>9,135,044</u>	<u>6,954,300</u>
Total accumulated postretirement benefit obligation	\$ 18,887,600	\$ 15,599,400
Fair value of plan assets	<u>(12,168,500)</u>	<u>(10,440,400)</u>
Net unfunded status	<u>\$ 6,719,100</u>	<u>\$ 5,159,000</u>

Amounts recognized in other comprehensive income (loss):

Unrecognized prior service cost	\$ 2,767,100	\$ 3,681,500
Unrecognized net loss	<u>(5,959,900)</u>	<u>(5,159,000)</u>
Total included in other comprehensive income (loss)	<u>\$(3,192,800)</u>	<u>\$(1,477,500)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note H – (Cont'd):

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

	<u>2017</u>	<u>2016</u>
Benefits earned during the year	\$ 472,500	\$ 446,900
Interest on accumulated postretirement benefit obligation	816,200	754,500
Expected return on plan assets	<u>(783,000)</u>	<u>(719,100)</u>
Postretirement benefit cost	<u>\$ 505,700</u>	<u>\$ 482,300</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 2017, 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>2017</u>	<u>2016</u>
Discount rate	4.25%	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 2017 was approximately 7.0% 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 2017 net periodic postretirement benefit cost by \$246,700 and would have increased the postretirement benefit obligation as of December 31, 2017 by \$3,152,600.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note H – (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.

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>
2018	\$ 694,700
2019	730,100
2020	742,300
2021	724,800
2022	766,600
Years 2023 – 2027	<u>4,142,900</u>
TOTAL	<u>\$7,801,400</u>

The Cooperative did not make a contribution to the plan in 2017 and an annual contribution to the plan is not anticipated in 2018.

Note I – 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 \$1,019,121 for 2017 and \$956,727 for 2016.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note J – 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>2017</u>	<u>2016</u>
Current income tax expense:		
Federal	\$1,550,013	\$1,768,426
State	183,316	426,279
Deferred income tax expense:		
Federal at 2017 rate	141,942	365,363
At newly enacted federal tax rate	(957,238)	0
State	<u>30,596</u>	<u>33,665</u>
Income tax expense	<u>\$ 948,629</u>	<u>\$2,593,733</u>

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

	<u>2017</u>	<u>2016</u>
Deferred tax asset	\$ 101,674	\$ 102,836
Deferred tax liability	<u>(1,951,706)</u>	<u>(2,749,570)</u>
	\$(1,850,032)	\$(2,646,734)
Valuation allowance	<u>(47,817)</u>	<u>(35,817)</u>
Net deferred tax liability	<u>\$(1,897,849)</u>	<u>\$(2,682,551)</u>

During 2017, Congress passed the Tax Cuts and Jobs Act of 2017, which changed the corporate tax rate to a flat 21% of taxable income. This change in the corporate rate resulted in a decrease in deferred taxes of \$957,238 and was included in taxes on income as a benefit.

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 \$977,208, which is available to offset future state taxable income. This carryforward will expire in 1 to 10 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017 and 2016

Note J – (Cont'd)

North Central Security Services, Inc. has a net operating loss carryforward of approximately \$1,152,267, which is available to offset future state taxable income. This carryforward will expire in 1 to 14 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, 2017 and 2016.

Note K – Labor Force

Approximately 80% of the Cooperative's labor force is subject to a collective bargaining agreement. An agreement was approved for the period January 1, 2018 to June 30, 2020 between the Cooperative and the Communications Workers of America.

Note L – 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 2017, there were no contributions to the deferred compensation plan. Included in the cash accounts of the Consolidated Balance Sheets is \$15,000 at December 31, 2017 that is included in the deferred compensation plan.

Note M – 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, 2017 and before the date these financial statements were available to be issued, February 23, 2018, and determined that no additional disclosures are necessary.

CONSOLIDATING INFORMATION



TOTHEROW HAILE & WELCH, PLLC

Certified Public Accountants

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, 2017 and 2016, and our report thereon dated February 23, 2018, 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 23, 2018

SCHEDULE 1 - CONSOLIDATING BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>ASSETS</u>				
<u>CURRENT ASSETS</u>				
Cash - general	\$ 5,449,364	\$ 1,036,780	\$ 0	\$ 6,486,144
Cash - construction funds	3,901,340	0	0	3,901,340
Temporary cash investments	1,101,000	1,150,000	0	2,251,000
Telecommunications				
accounts receivable	813,487	135,821	0	949,308
Other accounts receivable	131,305	0	0	131,305
Advance to related company	463,462	498,825	(962,287)	0
Materials and supplies	1,265,663	257,452	0	1,523,115
Refundable tax deposits	8,455	1,794	0	10,249
Other current assets	163,634	45,981	0	209,615
TOTAL CURRENT ASSETS	\$ 13,297,710	\$ 3,126,653	\$ (962,287)	\$ 15,462,076
<u>NONCURRENT ASSETS</u>				
Investment in subsidiary	\$ 39,820,551	\$ 0	\$ (39,820,551)	\$ 0
Investments	314,369	35,364,588	0	35,678,957
Nonregulated investments	708,533	0	0	708,533
Notes receivable	0	11,453	0	11,453
Goodwill - net	0	442,505	0	442,505
Deferred tax asset	0	53,857	0	53,857
TOTAL NONCURRENT ASSETS	\$ 40,843,453	\$ 35,872,403	\$ (39,820,551)	\$ 36,895,305
<u>PROPERTY, PLANT AND EQUIPMENT</u>				
Telecommunications plant in service	\$ 159,478,806	\$ 13,635,891	\$ 0	\$ 173,114,697
Telecommunications plant under construction	13,412,233	1,867,185	0	15,279,418
	\$ 172,891,039	\$ 15,503,076	\$ 0	\$ 188,394,115
Less accumulated depreciation	94,679,234	10,332,387	0	105,011,621
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 78,211,805	\$ 5,170,689	\$ 0	\$ 83,382,494
	\$ 132,352,968	\$ 44,169,745	\$ (40,782,838)	\$ 135,739,875

SCHEDULE 1 - CONSOLIDATING BALANCE SHEETS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2017

	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	\$ 2,088,211	\$ 613,516	\$ 0	\$ 2,701,727
Advance billings and payments	295,204	107,656	0	402,860
Advance from related company	264,325	697,962	(962,287)	0
Customer deposits	513,836	0	0	513,836
Current maturities on long-term debt	4,585,737	147,547	0	4,733,284
Accrued federal and state taxes	98,850	517,191	0	616,041
Accrued interest	40,240	0	0	40,240
Accrued rent	602,367	0	0	602,367
Accrued salaries and wages	274,968	26,254	0	301,222
Accrued property taxes	521,029	0	0	521,029
Accrued vacation and sick leave benefits	1,342,895	31,230	0	1,374,125
Accrued group health deduction	139,300	0	0	139,300
Other current liabilities	294,399	256,132	0	550,531
TOTAL CURRENT LIABILITIES	\$ 11,061,361	\$ 2,397,488	\$ (962,287)	\$ 12,496,562
<u>LONG-TERM DEBT</u>				
Rural Utilities Service	36,754,300	0	0	36,754,300
Rural Telephone Bank	7,915,854	0	0	7,915,854
<u>OTHER LIABILITIES</u>				
Postretirement benefits other than pension	6,719,100	0	0	6,719,100
Deferred tax liability	0	1,951,706	0	1,951,706
TOTAL LIABILITIES	\$ 62,450,615	\$ 4,349,194	\$ (962,287)	\$ 65,837,522
<u>MEMBERS' EQUITY</u>				
Capital stock	\$ 0	\$ 8,100,000	\$ (8,100,000)	\$ 0
Patronage capital	73,095,153	0	0	73,095,153
Accumulated comprehensive loss	(3,192,800)	0	0	(3,192,800)
Retained earnings	0	31,720,551	(31,720,551)	0
TOTAL MEMBERS' EQUITY	\$ 69,902,353	\$ 39,820,551	\$ (39,820,551)	\$ 69,902,353
	\$ 132,352,968	\$ 44,169,745	\$ (40,782,838)	\$ 135,739,875

SCHEDULE 2 - CONSOLIDATING STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2017

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Operating revenues:				
Local network services revenue	\$ 5,043,045	\$ 454,365	\$ 0	\$ 5,497,410
Network access service revenue	16,162,588	262,371	0	16,424,959
Long distance network services revenue	410,161	13,652	0	423,813
Internet and video revenues	7,703,109	6,417,815	(14,120,924)	0
Security systems revenue	0	1,472,113	(1,472,113)	0
Lease revenue	0	1,151,078	(1,151,078)	0
Miscellaneous revenue	2,662,399	292,525	(258,600)	2,696,324
Less: Uncollectible revenue	<u>(80,171)</u>	<u>0</u>	<u>0</u>	<u>(80,171)</u>
 TOTAL OPERATING REVENUES	 \$ 31,901,131	 \$ 10,063,919	 \$ (17,002,715)	 \$ 24,962,335
Operating expenses:				
Plant specific operations expense	\$ 7,376,641	\$ 536,437	\$ (1,151,078)	\$ 6,762,000
Plant nonspecific operations expense	2,653,030	37,594	0	2,690,624
Internet and video expenses	6,131,680	7,427,468	(13,559,148)	0
Security equipment cost of goods sold and monitoring expenses	0	468,580	(468,580)	0
Provision for depreciation	8,386,538	976,714	0	9,363,252
Customer operations expense	2,664,942	216,183	(7,200)	2,873,925
Corporate operations expense	1,838,423	1,526,628	(251,400)	3,113,651
Operating taxes	<u>646,176</u>	<u>270,094</u>	<u>0</u>	<u>916,270</u>
 TOTAL OPERATING EXPENSES	 <u>\$ 29,697,430</u>	 <u>\$ 11,459,698</u>	 <u>\$ (15,437,406)</u>	 <u>\$ 25,719,722</u>
 OPERATING INCOME (LOSS)	 \$ 2,203,701	 \$ (1,395,779)	 \$ (1,565,309)	 \$ (757,387)

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

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2017

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Other income:				
Income from subsidiaries	\$ 2,810,805	\$ 0	\$ (2,810,805)	\$ 0
Income from investments	0	5,065,364	0	5,065,364
Interest income	234,729	21,510	(14,400)	241,839
Gain on sale of asset	0	26,313	0	26,313
Nonregulated income	<u>667,381</u>	<u>0</u>	<u>1,565,309</u>	<u>2,232,690</u>
 TOTAL OTHER INCOME	 \$ 3,712,915	 \$ 5,113,187	 \$ (1,259,896)	 \$ 7,566,206
Fixed charges:				
Interest expense	\$ 1,707,744	\$ 12,399	\$ (14,400)	\$ 1,705,743
Interest charged to construction - credit	<u>(235,875)</u>	<u>0</u>	<u>0</u>	<u>(235,875)</u>
 TOTAL FIXED CHARGES	 \$ 1,471,869	 \$ 12,399	 \$ (14,400)	 \$ 1,469,868
 INCOME BEFORE TAXES ON INCOME	 \$ 4,444,747	 \$ 3,705,009	 \$ (2,810,805)	 \$ 5,338,951
Taxes on income	<u>54,425</u>	<u>894,204</u>	<u>0</u>	<u>948,629</u>
 NET INCOME	 <u>\$ 4,390,322</u>	 <u>\$ 2,810,805</u>	 <u>\$ (2,810,805)</u>	 <u>\$ 4,390,322</u>

SCHEDULE 3 - CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2017

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Net income	\$ 4,390,322	\$ 2,810,805	\$ (2,810,805)	\$ 4,390,322
Other comprehensive income (loss):				
Postretirement benefit other than pension:				
Unrecognized prior service cost	(800,900)	0	0	(800,900)
Unrecognized loss	<u>(914,400)</u>	<u>0</u>	<u>0</u>	<u>(914,400)</u>
COMPREHENSIVE INCOME	<u>\$ 2,675,022</u>	<u>\$ 2,810,805</u>	<u>\$ (2,810,805)</u>	<u>\$ 2,675,022</u>