

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

December 31, 2016 and 2015

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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 consolidated balance sheets as of December 31, 2016 and 2015, 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, 2016 and 2015, 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 24, 2017 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.

Satherow, Harte, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
February 24, 2017

CONSOLIDATED BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

	2016	2015
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash - general	\$ 9,717,343	\$ 8,178,610
Cash - construction funds	7,937,212	2,549,509
Temporary cash investments	2,251,000	2,251,000
Telecommunications accounts receivable, less allowances of \$497,931 in 2016 and \$365,235 in 2015	1,020,098	1,380,508
Other accounts receivable	166,961	165,817
Materials and supplies	2,031,419	1,059,864
Refundable tax deposit	76,605	71,605
Other current assets	249,357	197,380
TOTAL CURRENT ASSETS	\$ 23,449,995	\$ 15,854,293
<u>NONCURRENT ASSETS</u>		
Investments	\$ 33,824,681	\$ 28,184,582
Nonregulated investments	1,457,399	2,388,209
Goodwill, less accumulated amortization	442,505	442,505
Deferred tax asset	67,019	77,323
TOTAL NONCURRENT ASSETS	\$ 35,791,604	\$ 31,092,619
<u>PROPERTY, PLANT AND EQUIPMENT</u>		
Telecommunications plant in service	\$ 168,717,186	\$ 172,252,847
Telecommunications plant under construction	7,845,247	3,491,073
	\$ 176,562,433	\$ 175,743,920
Less accumulated depreciation	97,451,922	100,043,831
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 79,110,511	\$ 75,700,089
	<u>\$ 138,352,110</u>	<u>\$ 122,647,001</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, 2016 and 2015

	2016	2015
<u>LIABILITIES AND MEMBERS' EQUITY</u>		
<u>CURRENT LIABILITIES</u>		
Accounts payable	\$ 1,201,149	\$ 1,002,851
Advance billings and payments	378,345	335,461
Customer deposits	481,900	435,714
Current maturities on long-term debt	6,913,965	5,497,970
Accrued federal and state taxes	607,883	480,694
Accrued interest	103,886	71,452
Accrued rents	630,022	622,434
Accrued salaries and wages	283,430	247,589
Accrued property taxes	434,179	427,095
Accrued vacation and sick leave benefits	1,427,189	1,529,762
Other current liabilities	500,459	487,576
TOTAL CURRENT LIABILITIES	\$ 12,962,407	\$ 11,138,598
<u>LONG-TERM DEBT</u>		
Rural Utilities Service	41,079,140	34,552,613
Rural Telephone Bank	8,638,383	9,148,262
Other long-term debt	536,279	2,640,981
<u>OTHER LIABILITIES</u>		
Postretirement benefits other than pension	5,159,000	5,574,960
Deferred taxes	2,749,570	2,360,846
TOTAL LIABILITIES	\$ 71,124,779	\$ 65,416,260
<u>MEMBERS' EQUITY</u>		
Patronage capital	\$ 68,704,831	\$ 59,001,541
Accumulated other comprehensive loss	(1,477,500)	(1,770,800)
TOTAL MEMBERS' EQUITY	\$ 67,227,331	\$ 57,230,741
	<u>\$ 138,352,110</u>	<u>\$ 122,647,001</u>

CONSOLIDATED STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2016 and 2015

	2016	2015
Operating revenues:		
Local network services revenue	\$ 5,316,881	\$ 5,046,422
Network access services revenue	19,980,225	18,432,355
Long distance network services revenue	351,468	287,778
Miscellaneous revenue	2,577,500	2,789,504
Less: Uncollectible revenue	<u>(162,600)</u>	<u>(162,600)</u>
TOTAL OPERATING REVENUES	\$28,063,474	\$26,393,459
Operating expenses:		
Plant specific operations expense	\$ 6,489,375	\$ 6,290,176
Plant nonspecific operations expense	2,776,285	2,833,425
Provision for depreciation and amortization	9,579,662	10,123,483
Customer operations expense	2,936,989	2,918,861
Corporate operations expense	3,034,194	2,949,906
Operating taxes	<u>938,165</u>	<u>888,830</u>
TOTAL OPERATING EXPENSES	<u>\$25,754,670</u>	<u>\$26,004,681</u>
OPERATING INCOME	\$ 2,308,804	\$ 388,778
Other income:		
Income from investments	\$ 9,176,878	\$ 4,832,374
Interest income	175,485	147,636
Nonregulated income	2,348,203	2,216,244
Gain (Loss) on sale of assets	<u>(1,616)</u>	<u>0</u>
TOTAL OTHER INCOME	\$11,698,950	\$ 7,196,254

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

CONSOLIDATED STATEMENTS OF OPERATIONS (CONTD)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2016 and 2015

	2016	2015
Fixed charges:		
Interest expense	\$ 1,875,753	\$ 1,969,322
Interest charged to construction - credit	<u>(165,022)</u>	<u>(142,496)</u>
TOTAL FIXED CHARGES	<u>\$ 1,710,731</u>	<u>\$ 1,826,826</u>
INCOME BEFORE TAXES ON INCOME	\$ 12,297,023	\$ 5,758,206
Taxes on income	<u>2,593,733</u>	<u>1,277,412</u>
NET INCOME	<u>\$ 9,703,290</u>	<u>\$ 4,480,794</u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2016 and 2015

	2016	2015
Net income	\$ 9,703,290	\$ 4,480,794
Other comprehensive income (loss):		
Postretirement benefit other than pension:		
Unrecognized prior service cost	374,400	3,307,100
Unrecognized (loss) gain on assets	<u>(81,100)</u>	<u>(2,625,941)</u>
COMPREHENSIVE INCOME	<u>\$ 9,996,590</u>	<u>\$ 5,161,953</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, 2016 and 2015

	Patronage Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
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	0	(2,625,941)	(2,625,941)
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	<u>\$ 68,704,831</u>	<u>\$ (1,477,500)</u>	<u>\$ 67,227,331</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, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	\$ 28,422,740	\$ 26,615,472
Cash paid to suppliers and employees	(15,093,899)	(15,218,218)
Interest received	175,485	147,636
Interest paid	(1,678,297)	(1,863,028)
Taxes paid	(3,003,597)	(1,600,271)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 8,822,432	\$ 8,081,591
Cash flows from investing activities:		
Construction and acquisition of plant	\$ (13,000,475)	\$ (13,268,775)
Plant removal costs	(79,721)	(78,096)
Salvage	88,496	75,246
Cash distribution from investments	3,536,779	2,559,182
Investment in nonregulated CPE	930,810	535,191
Decrease (Increase) in:		
Materials and supplies	(971,555)	45,485
Temporary investments	0	(1,000)
Nonregulated income	2,348,203	2,216,244
NET CASH USED BY INVESTING ACTIVITIES	\$ (7,147,463)	\$ (7,916,523)
Cash flows from financing activities:		
Debt proceeds	\$ 13,074,497	\$ 7,574,832
Payments on notes payable and long-term borrowings	(7,746,556)	(6,477,976)
Postretirement benefits other than pension	(122,660)	(330,781)
Decrease in customer deposits	46,186	29,577
NET CASH PROVIDED BY FINANCING ACTIVITIES	\$ 5,251,467	\$ 795,652
NET INCREASE IN CASH	\$ 6,926,436	\$ 960,720
CASH AT BEGINNING OF YEAR	10,728,119	9,767,399
CASH AT END OF YEAR	\$ 17,654,555	\$ 10,728,119

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTD)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

For the years ended December 31, 2016 and 2015

	2016	2015
Net income	\$ 9,703,290	\$ 4,480,794
Nonregulated income	(2,348,203)	(2,216,244)
Loss on sale of assets	1,616	0
Income from investments	<u>(9,176,878)</u>	<u>(4,832,374)</u>
Net loss from regulated operations	\$ (1,820,175)	\$ (2,567,824)
Adjustments to reconcile net loss from regulated operations to net cash provided by operating activities:		
Depreciation and amortization	\$ 9,579,662	\$10,123,483
Deferred taxes on income	399,028	266,014
Decrease (Increase) in:		
Customer and accounts receivable	359,266	222,013
Current and accrued assets - other	(51,977)	10,036
Refundable tax deposit	(5,000)	13,595
Increase (Decrease) in:		
Accounts payable	198,298	(360,275)
Advance billings and payments	42,884	13,030
Accrued federal and state taxes	127,189	256,884
Accrued interest	32,434	(36,202)
Accrued rents	7,588	(4,545)
Accrued salaries and employee benefits	(66,732)	46,527
Accrued property taxes	7,084	29,478
Other current liabilities	<u>12,883</u>	<u>69,377</u>
TOTAL ADJUSTMENTS	<u>\$10,642,607</u>	<u>\$10,649,415</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 8,822,432</u>	<u>\$ 8,081,591</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

Note A – North Central Telephone Cooperative Corporation and Subsidiary provides retail tele-communications 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 \$51,838 and \$79,293 at December 31, 2016 and 2015, 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, 2016 and 2015

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 \$113,877 in 2016 and \$128,376 in 2015.
- (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 \$18,785,509 was uninsured at December 31, 2016.

Restricted cash consists of employees' savings and flex plan accounts in which \$44,603 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, 2016 and 2015

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>2016</u>	<u>2015</u>
NECA Services, Inc. stock - at cost	\$ 10,000	\$ 10,000
Cash value of life insurance	190,093	217,644
Investment in Kentucky RSA #3 cellular partnership (25%)	26,367,219	20,968,619
Investment in Bluegrass Network, LLC (20%)	5,783,854	5,359,949
Investment in Bluegrass Telecom, LLC (20%)	333,154	333,154
Qualified patronage capital certificates – NRTC	205,938	244,427
Tennessee 220 MHZ Radio	147,224	147,224
Tennessee Independent Telecom Group (IRIS Networks) (10.556%)	777,059	893,425
Synergy Wireless, Inc. – at cost	10,000	10,000
Deposits	<u>140</u>	<u>140</u>
	<u>\$33,824,681</u>	<u>\$28,184,582</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, 2016 and 2015

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, 2016 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	\$116,690,000	\$28,981,127	\$2,963,114	\$16,880,794
Total liabilities	\$ 11,221,000	\$ 685,761	\$1,253,120	\$ 8,444,089
Total equity	\$105,469,000	\$28,295,366	\$1,709,994	\$ 8,436,705
Net income	\$ 33,252,000	\$ 2,495,621	\$ 206,622	\$ 28,823

Note E – Nonregulated investments:

	<u>2016</u>	<u>2015</u>
Nonregulated customer premises equipment	\$8,684,267	\$8,432,457
Less accumulated provisions for depreciation	<u>7,226,868</u>	<u>6,044,248</u>
TOTAL	<u>\$1,457,399</u>	<u>\$2,388,209</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 2016, the Company did not record any goodwill impairment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

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>2016</u>	<u>2015</u>
Land	\$ 798,654	\$ 802,242
Buildings	9,443,181	9,387,920
Central office equipment	37,310,410	46,173,439
Outside plant network	104,159,576	98,618,317
Furniture and office equipment	2,545,088	2,573,831
Vehicles and other work equipment	<u>2,044,820</u>	<u>2,912,046</u>
Telecommunications plant in service as contained on the Cooperative's records	\$156,301,729	\$160,467,795
Land	\$ 35,000	\$ 35,000
Building	214,756	214,756
CATV equipment	75,545	75,545
Central office equipment	4,781,870	4,781,870
Outside plant network	3,319,757	3,267,383
Office furniture and fixtures	47,459	47,459
Equipment	2,027,963	1,948,376
Vehicles	<u>1,913,107</u>	<u>1,414,663</u>
Telecommunications plant in service as contained on the Subsidiaries' records	\$ <u>12,415,457</u>	\$ <u>11,785,052</u>
Total telecommunications plant in service	<u>\$168,717,186</u>	<u>\$172,252,847</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 5.41 percent for 2016 and 5.82 percent for 2015. The provision for depreciation in 2016 and 2015 was \$8,635,574 and \$9,083,839, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

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 \$1,010,547 in 2016 and \$1,125,695 in 2015.

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 and Farmer's National Bank are unsecured.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

Note H – (Cont'd)

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

	<u>2016</u>	<u>2015</u>
2.92% to 5.15% Rural Utilities Service notes, matures January 2, 2029	\$ 5,453,381	\$ 7,510,259
5.00% to 5.13% Rural Telephone Bank notes, matures January 2, 2029	9,203,970	9,679,601
4.00% Citizens Bank of Lafayette	0	1,163,752
4.00% Farmers National Bank, matures July 16, 2018	433,527	708,185
1.35% to 2.36% Rural Utilities Service notes, matures December 31, 2025	24,114,882	11,836,273
1.93% to 3.99% Rural Utilities Service notes, matures June 17, 2031	20,852,151	21,978,707
4.00% Macon Co. Bank & Trust Co., matures June 4, 2018	657,876	1,478,136
Less cushion of credit	<u>(3,548,020)</u>	<u>(2,515,087)</u>
	\$57,167,767	\$51,839,826
Less current maturities	<u>6,913,965</u>	<u>5,497,970</u>
TOTAL	<u>\$50,253,802</u>	<u>\$46,341,856</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>
2017	\$ 6,913,965
2018	5,122,016
2019	4,708,179
2020	4,833,160
2021	4,962,354
Beyond five years	<u>30,628,093</u>
TOTAL	<u>\$57,167,767</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

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>2016</u>	<u>2015</u>
Accumulated postretirement obligation attributable to:		
Retirees	\$ 7,311,700	\$ 6,285,271
Fully eligible plan participants	1,333,400	1,240,450
Other active plan participants	<u>6,954,300</u>	<u>7,636,749</u>
Total accumulated postretirement benefit obligation	\$15,599,400	\$15,162,470
Fair value of plan assets	<u>(10,440,400)</u>	<u>(9,587,500)</u>
Net unfunded status	<u>\$ 5,159,000</u>	<u>\$ 5,574,970</u>

Amounts recognized in other comprehensive income (loss):

Unrecognized prior service cost	\$ 3,681,500	\$ 3,307,100
Unrecognized net loss	<u>(5,159,000)</u>	<u>(5,077,900)</u>
Total included in other comprehensive income (loss)	<u>\$(1,477,500)</u>	<u>\$(1,770,800)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

Note I – (Cont'd):

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

	<u>2016</u>	<u>2015</u>
Benefits earned during the year	\$ 446,900	\$ 415,100
Interest on accumulated postretirement benefit obligation	754,500	709,300
Expected return on plan assets	<u>(719,100)</u>	<u>(712,900)</u>
Postretirement benefit cost	<u>\$ 482,300</u>	<u>\$ 411,500</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 2016, 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>2016</u>	<u>2015</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 2016 was approximately 7.5% 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 2016 net periodic postretirement benefit cost by \$240,600 and would have increased the postretirement benefit obligation as of December 31, 2016 by \$2,323,400.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

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.

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>
2017	\$ 617,800
2018	642,200
2019	689,200
2020	707,700
2021	698,700
Years 2022 – 2026	<u>4,044,700</u>
TOTAL	<u>\$7,400,300</u>

The Cooperative did not make a contribution to the plan in 2016 and an annual contribution to the plan is not anticipated in 2017.

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 \$956,727 for 2016 and \$843,279 for 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016 and 2015

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>2016</u>	<u>2015</u>
Current income tax expense:		
Federal	\$1,768,426	\$ 867,702
State	426,279	143,696
Deferred income tax expense:		
Federal	365,363	213,521
State	<u>33,665</u>	<u>52,493</u>
Income tax expense	<u>\$2,593,733</u>	<u>\$1,277,412</u>

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

	<u>2016</u>	<u>2015</u>
Deferred tax asset	\$ 102,836	\$ 113,140
Deferred tax liability	<u>(2,749,570)</u>	<u>(2,360,846)</u>
	<u>\$(2,646,734)</u>	<u>\$(2,247,706)</u>
Valuation allowance	<u>(35,817)</u>	<u>(35,817)</u>
Net deferred tax liability	<u>\$(2,682,551)</u>	<u>\$(2,283,523)</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 \$1,074,591, 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, 2016 and 2015

Note K – (Cont'd)

North Central Security Services, Inc. has a net operating loss carryforward of approximately \$1,416,169, 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, 2016 and 2015.

Note L – Labor Force

Approximately 80% of the Cooperative's labor force is subject to a collective bargaining agreement. A one year agreement was approved for the period June 30, 2016 to June 30, 2017 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 2016, 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, 2016 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, 2016 and before the date these financial statements were available to be issued, February 24, 2017, 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, 2016 and 2015, and our report thereon dated February 24, 2017, 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 24, 2017

SCHEDULE 1 - CONSOLIDATING BALANCE SHEETS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
<u>ASSETS</u>				
<u>CURRENT ASSETS</u>				
Cash - general	\$ 7,992,795	\$ 1,724,548	\$ 0	\$ 9,717,343
Cash - construction funds	7,937,212	0	0	7,937,212
Temporary cash investments	1,101,000	1,150,000	0	2,251,000
Telecommunications accounts receivable	934,764	85,334	0	1,020,098
Other accounts receivable	166,961	0	0	166,961
Advance to related company	244,150	3,385,741	(3,629,891)	0
Materials and supplies	1,819,847	211,572	0	2,031,419
Refundable tax deposits	76,605	0	0	76,605
Other current assets	239,632	9,725	0	249,357
TOTAL CURRENT ASSETS	\$ 20,512,966	\$ 6,566,920	\$ (3,629,891)	\$ 23,449,995
<u>NONCURRENT ASSETS</u>				
Investment in subsidiary	\$ 38,459,746	\$ 0	\$ (38,459,746)	\$ 0
Investments	200,093	33,624,588	0	33,824,681
Nonregulated investments	1,457,399	0	0	1,457,399
Goodwill - net	0	442,505	0	442,505
Deferred tax asset	0	67,019	0	67,019
TOTAL NONCURRENT ASSETS	\$ 40,117,238	\$ 34,134,112	\$ (38,459,746)	\$ 35,791,604
<u>PROPERTY, PLANT AND EQUIPMENT</u>				
Telecommunications plant in service	\$ 156,301,729	\$ 12,415,457	\$ 0	\$ 168,717,186
Telecommunications plant under construction	7,822,693	22,554	0	7,845,247
	\$ 164,124,422	\$ 12,438,011	\$ 0	\$ 176,562,433
Less accumulated depreciation	88,013,978	9,437,944	0	97,451,922
TOTAL PROPERTY, PLANT AND EQUIPMENT	\$ 76,110,444	\$ 3,000,067	\$ 0	\$ 79,110,511
	\$ 136,740,648	\$ 43,701,099	\$ (42,089,637)	\$ 138,352,110

SCHEDULE 1 - CONSOLIDATING BALANCE SHEETS (CONT'D)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

December 31, 2016

	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	\$ 663,920	\$ 537,229	\$ 0	\$ 1,201,149
Advance billings and payments	278,498	99,847	0	378,345
Advance from related company	3,193,241	436,650	(3,629,891)	0
Customer deposits	481,900	0	0	481,900
Current maturities on long-term debt	6,627,883	286,082	0	6,913,965
Accrued federal and state taxes	0	607,883	0	607,883
Accrued interest	38,774	65,112	0	103,886
Accrued rent	630,022	0	0	630,022
Accrued salaries and wages	263,738	19,692	0	283,430
Accrued property taxes	400,800	33,379	0	434,179
Accrued vacation and sick leave benefits	1,397,508	29,681	0	1,427,189
Other current liabilities	271,676	228,783	0	500,459
TOTAL CURRENT LIABILITIES	\$ 14,247,960	\$ 2,344,338	\$ (3,629,891)	\$ 12,962,407
<u>LONG-TERM DEBT</u>				
Rural Utilities Service	41,079,140	0	0	41,079,140
Rural Telephone Bank	8,638,383	0	0	8,638,383
Other long-term debt	388,834	147,445	0	536,279
<u>OTHER LIABILITIES</u>				
Postretirement benefits other than pension	5,159,000	0	0	5,159,000
Deferred tax liability	0	2,749,570	0	2,749,570
TOTAL LIABILITIES	\$ 69,513,317	\$ 5,241,353	\$ (3,629,891)	\$ 71,124,779
<u>MEMBERS' EQUITY</u>				
Capital stock	\$ 0	\$ 8,100,000	\$ (8,100,000)	\$ 0
Patronage capital	68,704,831	0	0	68,704,831
Accumulated comprehensive loss	(1,477,500)	0	0	(1,477,500)
Retained earnings	0	30,359,746	(30,359,746)	0
TOTAL MEMBERS' EQUITY	\$ 67,227,331	\$ 38,459,746	\$ (38,459,746)	\$ 67,227,331
	\$ 136,740,648	\$ 43,701,099	\$ (42,089,637)	\$ 138,352,110

SCHEDULE 2 - CONSOLIDATING STATEMENTS OF OPERATIONS

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2016

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Operating revenues:				
Local network services revenue	\$ 4,873,886	\$ 442,995	\$ 0	\$ 5,316,881
Network access service revenue	19,722,725	257,500	0	19,980,225
Long distance network services revenue	335,953	15,515	0	351,468
Internet and video revenues	6,757,611	6,315,158	(13,072,769)	0
Security systems revenue	0	1,369,226	(1,369,226)	0
Lease revenue	0	1,327,107	(1,327,107)	0
Miscellaneous revenue	2,553,739	282,361	(258,600)	2,577,500
Less: Uncollectible revenue	(162,600)	0	0	(162,600)
TOTAL OPERATING REVENUES	\$ 34,081,314	\$ 10,009,862	\$ (16,027,702)	\$ 28,063,474
Operating expenses:				
Plant specific operations expense	\$ 7,280,045	\$ 536,437	\$ (1,327,107)	\$ 6,489,375
Plant nonspecific operations expense	2,746,116	30,169	0	2,776,285
Internet and video expenses	5,296,524	7,421,370	(12,717,894)	0
Security equipment cost of goods sold and monitoring expenses	0	403,556	(403,556)	0
Provision for depreciation	8,569,115	1,010,547	0	9,579,662
Customer operations expense	2,777,588	166,601	(7,200)	2,936,989
Corporate operations expense	2,081,007	1,204,587	(251,400)	3,034,194
Operating taxes	737,346	200,819	0	938,165
TOTAL OPERATING EXPENSES	\$ 29,487,741	\$ 10,974,086	\$ (14,707,157)	\$ 25,754,670
OPERATING INCOME (LOSS)	\$ 4,593,573	\$ (964,224)	\$ (1,320,545)	\$ 2,308,804

SCHEDULE 2 - CONSOLIDATING STATEMENTS OF OPERATIONS (CONTD)

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2016

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Other income:				
Income from subsidiaries	\$ 5,582,890	\$ 0	\$ (5,582,890)	\$ 0
Income from investments	0	9,176,878	0	9,176,878
Interest income	169,895	19,990	(14,400)	175,485
Impairment of intangible assets	0	0	0	0
Gain on sale of asset	0	(1,616)	0	(1,616)
Nonregulated income	<u>1,027,658</u>	<u>0</u>	<u>1,320,545</u>	<u>2,348,203</u>
TOTAL OTHER INCOME	\$ 6,780,443	\$ 9,195,252	\$ (4,276,745)	\$ 11,698,950
Fixed charges:				
Interest expense	\$ 1,835,748	\$ 54,405	\$ (14,400)	\$ 1,875,753
Interest charged to construction - credit	<u>(165,022)</u>	<u>0</u>	<u>0</u>	<u>(165,022)</u>
TOTAL FIXED CHARGES	\$ 1,670,726	\$ 54,405	\$ (14,400)	\$ 1,710,731
INCOME BEFORE				
TAXES ON INCOME	\$ 9,703,290	\$ 8,176,623	\$ (5,582,890)	\$ 12,297,023
Taxes on income	<u>0</u>	<u>2,593,733</u>	<u>0</u>	<u>2,593,733</u>
NET INCOME	<u>\$ 9,703,290</u>	<u>\$ 5,582,890</u>	<u>\$ (5,582,890)</u>	<u>\$ 9,703,290</u>

SCHEDULE 3 - CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION AND SUBSIDIARY

Year ended December 31, 2016

	North Central Telephone Cooperative, Corp.	North Central Communications, Inc. and Subsidiaries	Reclassifications /Eliminations	Total
Net income	\$ 9,703,290	\$ 5,582,890	\$ (5,582,890)	\$ 9,703,290
Other comprehensive income (loss):				
Postretirement benefit other than pension:				
Unrecognized prior service cost	374,400	0	0	374,400
Unrecognized loss	(81,100)	0	0	(81,100)
COMPREHENSIVE INCOME	<u>\$ 9,996,590</u>	<u>\$ 5,582,890</u>	<u>\$ (5,582,890)</u>	<u>\$ 9,996,590</u>



Independent Auditor's Report on Compliance with Aspects of Contractual
Agreements and Regulatory Requirements

Board of Directors
North Central Telephone
Cooperative Corporation
Lafayette, Tennessee

We have audited, 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, the financial statements of North Central Telephone Cooperative Corporation, which comprise the balance sheet as of December 31, 2016, and the related statements of operations, comprehensive income, changes in members' equity and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 24, 2017. In accordance with *Government Auditing Standards*, we have also issued our report dated February 24, 2017, on our consideration of North Central Telephone Cooperative Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that North Central Telephone Cooperative Corporation failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, Sec. 1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding North Central Telephone Cooperative Corporation's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding North Central Telephone Cooperative Corporation's accounting and records to indicate that North Central Telephone Cooperative Corporation did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts;

Clear construction accounts and accrue depreciation on completed construction;

Record and properly price the retirement of plant;

Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Maintain adequate control over materials and supplies;

Prepare accurate and timely Financial and Operating Reports;

Obtain written RUS approval to enter into any contract agreement or lease with an affiliate as defined in Sec. 1733.33 (e)(2)(i).

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Comply with the requirements for the detailed schedule of investments.

This report is intended solely for the information and use of the board of directors, management, and RUS and supplemental lenders and is not intended to be and should be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Jotherow, Haile, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
February 24, 2017

North Central Telephone
Cooperative Corporation
Lafayette, Tennessee

Detailed schedule of investments

	<u>North Central Communications, Inc.</u>
Book value of investments as of 12/31/14	\$ 32,911,276
Dividends paid during 2015	(1,000,000)
Undistributed earnings (losses) as of 12/31/15	<u>2,165,580</u>
Book value of investments as of 12/31/13	\$ 34,076,856
Dividends paid during 2016	(1,200,000)
Undistributed earnings (losses) as of 12/31/16	<u>5,582,890</u>
Book value of investments as of 12/31/16	<u><u>\$ 38,459,746</u></u>



Board of Directors
North Central Telephone
Cooperative Corporation
Lafayette, Tennessee

We have audited the financial statements of North Central Telephone Cooperative Corporation as of December 31, 2016 and 2015 and for the years ended December 31, 2016 and 2015 and have issued our report thereon dated February 24, 2017. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered North Central Telephone Cooperative Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness North Central Telephone Cooperative's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of North Central Telephone Cooperative Corporation's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Cooperative's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Cooperative's financial statements that is more than inconsequential will not be prevented or detected by the Cooperative's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Cooperative's internal control.

Our consideration of the internal control was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies that we consider to be material weaknesses, as defined above.

Board of Directors
North Central Telephone
Cooperative Corporation
Lafayette, Tennessee
Page 2

Compliance

As part of obtaining reasonable assurance about whether North Central Telephone Cooperative Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This communication is intended solely for the information and use of the Board of Directors, management, the Rural Utilities Service, and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties.

Sotherow, Paule, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
February 24, 2017



To the Board of Directors of
North Central Telephone
Cooperative Corporation

We have audited the consolidated financial statements of North Central Telephone Cooperative Corporation for the year ended December 31, 2016 and have issued our report thereon dated February 24, 2017. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated December 8, 2016. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by North Central Telephone Cooperative Corporation are described in Note A to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2016. We noted no transactions entered into by the Company during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

Management's estimate of the allowance for doubtful accounts is based on historical sales, historical loss levels, and an analysis of the collectability of the individual accounts. We evaluated the key factors and assumptions used to develop the estimate of the allowance for doubtful accounts in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of the deferred tax asset encompasses the temporary differences in tax reporting and financial statement presentation based on future expected financial trends of the Company. We evaluated the key factors and assumptions used to develop the estimate of the deferred tax asset in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of the accrued postretirement benefits is based on the actuarial findings of an independent actuary for the cost of medical benefits for current and future associate retirees. We evaluated the key factors and assumptions used to develop the estimate of the accrued postretirement benefits in determining that it is reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.

Disagreements with management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated February 24, 2017.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Company's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Company's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not condition to our retention.

This information is intended solely for the use of the Board of Directors and management of North Central Telephone Cooperative Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Sotheron, Spate, & Welch, PLLC

Certified Public Accountants
McMinnville, Tennessee
February 28, 2017