

SOUTHERN TIER NETWORK, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2015

SOUTHERN TIER NETWORK, INC.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Southern Tier Network, Inc.
Corning, New York

We have audited the accompanying financial statements of Southern Tier Network, Inc. (a nonprofit corporation), which comprise the balance sheet as of December 31, 2015, and the related statement of activities and change in net assets and cash flows for the year then ended, and the related notes to the 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 fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southern Tier Network, Inc. as of December 31, 2015, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Prior Period Financial Statements and Report on Summarized Comparative Information

The financial statements of Southern Tier Network, Inc. as of December 31, 2014, were audited by other auditors whose report dated March 9, 2015, expressed an unmodified opinion on those statements. The summarized comparative information presented herein as of and for the year ended December 31, 2014, was derived from those financial statements and accordingly, we express no opinion and provide no assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2016, on our consideration of Southern Tier Network, Inc.'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. 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* in considering Southern Tier Network, Inc.'s internal control over financial reporting and compliance.

EFPR Group, CPAs, PLLC

EFPR Group, CPAs, PLLC
Corning, New York
March 30, 2016

SOUTHERN TIER NETWORK, INC.
Balance Sheets
December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 3,912,100	\$ 2,909,772
Accounts receivable	32,927	1,292,375
Grant receivable	160,754	-
Prepaid expenses	480	12,381
Total current assets	<u>4,106,261</u>	<u>4,214,528</u>
Property and Equipment		
Fiber optic cable plant	7,186,171	6,916,722
Construction in progress	186,375	90,858
Parts and supplies inventory - net	29,411	202,462
Total property and equipment	<u>7,401,957</u>	<u>7,210,042</u>
Less: Accumulated depreciation	(724,996)	(437,725)
Total property and equipment - net	<u>6,676,961</u>	<u>6,772,317</u>
Other Assets		
Indefeasible right of use - net	<u>882,756</u>	<u>920,724</u>
Total Assets	<u>\$ 11,665,978</u>	<u>\$ 11,907,569</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 293,858	\$ 512,804
Current portion of deferred revenue - installation	217,544	225,974
Deferred revenue - grants	347,205	-
Total current liabilities	<u>858,607</u>	<u>738,778</u>
Long-term Liabilities		
Deferred revenue - installation - net of current portion	<u>1,552,304</u>	<u>1,324,322</u>
Total Liabilities	<u>2,410,911</u>	<u>2,063,100</u>
Net Assets		
Unrestricted	<u>9,255,067</u>	<u>9,844,469</u>
Total Liabilities and Net Assets	<u>\$ 11,665,978</u>	<u>\$ 11,907,569</u>

The accompanying notes are an integral part of these financial statements.

SOUTHERN TIER NETWORK, INC.
Statements of Activities and Change in Net Assets
For the Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Support and Revenue		
Sales	\$ -	\$ 1,192,300
Installation	243,221	164,732
Carrier and enterprise	562,002	397,407
Grant revenue	160,754	-
Contributions	82,795	446,105
Total support and revenue	<u>1,048,772</u>	<u>2,200,544</u>
Expenses		
Cost of sales and installation		
Contractors	203,059	785,830
Design and engineering	87,222	193,070
Other costs	80,762	209,482
Total cost of sales and installation	<u>371,043</u>	<u>1,188,382</u>
Operating expenses		
Support services	420,538	232,706
Administrative	263,232	187,206
Pole attachment fees	77,688	69,358
Line maintenance	101,693	45,096
Insurance	27,723	17,149
Other operating expenses	54,647	12,867
Total operating expenses	<u>945,521</u>	<u>564,382</u>
Total expenses	<u>1,316,564</u>	<u>1,752,764</u>
Operating Income (Loss)	(267,792)	447,780
Non-Operating Income (Expense)		
Interest income	3,629	3,963
Depreciation expense	(287,271)	(280,664)
Amortization expense	(37,968)	(28,476)
Total non-operating income (expense)	<u>(321,610)</u>	<u>(305,177)</u>
Change in Net Assets	(589,402)	142,603
Net Assets - Beginning	<u>9,844,469</u>	<u>9,701,866</u>
Net Assets - Ending	<u>\$ 9,255,067</u>	<u>\$ 9,844,469</u>

The accompanying notes are an integral part of these financial statements.

SOUTHERN TIER NETWORK, INC.
Statements of Cash Flows
For the Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities		
Changes in net assets	\$ (589,402)	\$ 142,603
Adjustments		
Contributions - cash received	-	(3,208,895)
Depreciation expense	287,271	280,664
Amortization expense	37,968	28,476
Loss on disposal of assets	44,627	148,702
Inventory reserve	40,931	-
Changes in assets and liabilities		
Contribution receivable	-	2,762,790
Accounts receivable	1,259,448	(1,109,970)
Grant receivable	(160,754)	-
Prepaid expenses	11,901	(4,677)
Accounts payable	(260,199)	(398,411)
Deferred revenue - installation	219,552	449,122
Deferred revenue - grants	347,205	-
Net cash flow from operating activities	<u>1,238,548</u>	<u>(909,596)</u>
Cash Flows from Investing Activities		
Purchase of property and equipment	(236,220)	(175,478)
Purchase of indefeasible right of use	-	(949,200)
Net cash flow from investing activities	<u>(236,220)</u>	<u>(1,124,678)</u>
Cash Flows from Financing Activities		
Contributions - cash received	-	3,208,895
Net Change in Cash and Cash Equivalents	1,002,328	1,174,621
Cash and Cash Equivalents - Beginning	<u>2,909,772</u>	<u>1,735,151</u>
Cash and Cash Equivalents - Ending	<u>\$ 3,912,100</u>	<u>\$ 2,909,772</u>

Non-Cash Operating and Investing Activities

Non-cash operating and investing activities related to property and equipment purchases included in accounts payable at December 31, 2015 and 2014, were \$41,253 and \$449,540, respectively.

The accompanying notes are an integral part of these financial statements.

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies and Scope of Business

Scope of Business - Southern Tier Network, Inc. (the "Organization") is a not-for-profit, local development corporation (LDC) based in Corning, New York and was formed to provide stewardship for the construction and management of a whole-sale, Municipal Based Open Access optical fiber telecommunications system and promote economic development within Steuben, Schuyler, and Chemung counties. The network will connect the three counties and create an environment for improved telecommunications competition, reliability and diversity. The Organization will do so by selling or leasing high speed fiber optic capacity to enterprise, carrier and other entities that desire to manage and control their own telecommunications services. The network aids economic development by attracting new business, improving communications among health care providers and educational institutions, supporting individual county emergency services E-911 communications systems, and partnering with private enterprises.

Method of Accounting - The Organization maintains its books and prepares its financial statements on the accrual basis of accounting.

Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation - Financial statement presentation follows the recommendations of ASC 958-205, *Presentation of Financial Statements*. Under ASC 958-205, the Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. All financial transactions of the Organization have been recorded as unrestricted net assets for the year ended December 31, 2015.

Cash and Cash Equivalents - Cash and cash equivalents include time deposits, certificates of deposit, and all highly liquid debt instruments with original maturities of three months or less. The Organization maintains cash and cash equivalents at financial institutions which periodically may exceed federally insured limits.

Accounts Receivable - The Organization extends credit to its customers. Accounts receivable are stated at the amount billed. At December 31, 2015 and 2014, no allowance was considered necessary. Accounts receivable are considered impaired if full principal payments are not received in accordance with the contractual terms. It is the Organization's policy to charge off uncollectible contracts receivable when management determines the receivable will not be collected.

Grant Receivable - Grants receivable consist of amounts due from state or local agencies based on the terms of the related grant agreement and are stated at the amount the Organization expects to collect from balances outstanding at year end. The Organization records an allowance for doubtful accounts in anticipation of future write-offs to the extent deemed necessary based on past experience. At December 31, 2015 and 2014, no allowance was considered necessary.

Indefeasible Right of Use - Indefeasible right of use represents the Organization's indefeasible right to use specific strands of dark fiber owned by third parties to connect the Organization's fiber optic network in lieu of the Organization building fiber in the same area. The cost of acquiring indefeasible rights of use is amortized using the straight-line method over the term of the agreement.

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

Property and Equipment - Property and equipment are recorded at cost, if purchased, or at fair market value, if donated, less accumulated depreciation. The Organization capitalizes fixed asset purchases greater than \$5,000 that have useful lives greater than one year. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Construction in progress is recognized as the accumulation of costs related to fixed assets through the date that the fixed assets are placed in service. Depreciation and amortization are provided on the straight-line bases over the estimated useful lives, which range from three to twenty-five years.

Parts and supplies inventory consists of fiber optic cable purchased by the Organization for the construction of the fiber optic network. Inventory is recognized as the accumulation of costs related to fixed assets through the date that the fixed assets are placed in service. Fiber optic cable inventory is valued at acquisition cost net of an allowance. At December 31, 2015 and 2014, the inventory allowance was \$40,931 and \$-, respectively.

Sales - Sales represent amounts received or receivable related to the transfer of installed fiber optic cable to a third party. For such transfers, revenue is recognized at the time of the transfer as the Organization relinquishes its rights to the transferred assets.

Contribution Revenue - In accordance with ASC 958-605, *Revenue Recognition*, contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. Revenues in which donor restrictions are met within the same period are classified as unrestricted revenues. Donated services are recognized as contributions in accordance with ASC 958-605 if the services (a) create or enhance non-financial assets or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased by the Organization.

Revenue and Deferred Installation Revenue - Deferred installation revenue represents amounts received from customers related to each customer's initial connection to the Organization's fiber optic network. These amounts are deferred and recognized as installation revenue on a straight-line basis over the terms of each customer's contract for access to the network, which range from one to twenty-five years. Carrier and enterprise revenue represents amounts from customers for continuing use of the Organization's fiber optic network.

Income Taxes - The Organization is a not-for-profit corporation organized pursuant to sections 402 and 1411 of the New York State Not-for-Profit Corporation law and is, therefore, exempt from income taxes. The Organization is also exempt from Federal reporting requirements under Internal Revenue Service Revenue Procedure 95-48, 1995-2 C.B. 418 as a governmental unit or affiliate or a governmental unit described in the procedure.

In accordance with ASC 740-10-50, the Organization recognizes the tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities. Management believes that the Organization is currently operating in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no liability for unrecognized tax benefits has been included on the Organization's financial statements.

Subsequent Events - Management has evaluated subsequent events through the date of the report, which is the date the financial statement were available to be issued.

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

Note 2. Administrative Services

The Organization has contracted with the Southern Tier Central Regional Planning and Development Board (STC) to provide management, accounting and specialist services. The STC's Executive Director is the Chair of the Board of the Organization. Approximately \$127,000 and \$143,000 was recognized as expense under the terms of the agreement during 2015 and 2014, respectively.

Note 3. Contributions and Contributions Receivable

The Organization's contribution income was from Broome and Yates Counties for the year ended December 31, 2015 and from Steuben, Schuyler, and Chemung Counties for the year ended December 31, 2014.

Approximately 84% of the Organization's access revenue was derived from four customers in 2014.

All of the Organization's sales were derived from one contract with Steuben County in 2014.

Note 4. Customer Arrangements

Deferred Installation Revenue - The Organization enters into agreements with customers to provide access to the Organization's fiber optic network. Certain agreements require customers to make up-front payments related to establishing their connection to the fiber optic network. These up-front payments have been recorded as deferred installation revenue and are being recognized as income using the straight-line method over the terms of the agreements. Agreements in place through December 31, 2015 have terms ranging from one to twenty-five years, with the latest expiring in July 2039.

As of December 31, 2015, deferred installation revenue is expected to be recognized as income in the following years:

2016	\$ 217,544
2017	201,768
2018	200,835
2019	176,058
2020	166,905
Thereafter	<u>806,738</u>
	<u>\$ 1,769,848</u>

Future Carrier and Enterprise Payments to be Received - The Organization allows continuing use of its fiber optic network under the terms of non-cancellable customer agreements requiring monthly payments for terms of up to twenty-five years. Payments to be received under the terms of these agreements are as following for the years ending:

2016	\$ 589,122
2017	588,671
2018	584,407
2019	538,563
2020	482,477
Thereafter	<u>2,312,934</u>
	<u>\$ 5,096,174</u>

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

Note 5. Infeasible Right of Use

Maintenance Fee - In conjunction with its purchase of the infeasible right to use specific strands of dark fiber owned and maintained by a third party, the Organization is required to pay an annual maintenance fee of \$5,000 beginning in year 2 of the agreement (2015), increasing by \$5,000 annually until year 5, at which time \$25,000 will be paid per year through the remaining twenty-five year term of the agreement. Future annual maintenance payments under the terms of the agreement are as follows for the years ending December 31:

2016	\$	10,000
2017		15,000
2018		20,000
2019		25,000
2020		25,000
Thereafter		450,000
		\$ 545,000

Commitment to Maintain - In conjunction with the Organization's agreement to acquire the infeasible right of use for specific strands of dark fiber in Steuben County, the Organization is to perform all required maintenance on the fibers for the term of the agreement.

Note 6. Functional Expense

The Organization's expenses on a functional basis are as follows for the years ended December 31:

	<u>2015</u>	<u>2014</u>
Program operations	\$ 1,350,338	\$ 1,856,839
General and administrative	291,465	205,065
Total	\$ 1,641,803	\$ 2,061,904

Note 7. Letter of Credit

The Organization maintains a letter of credit at a local institution. The total amount available to borrow is \$75,000 with an interest rate fixed at 1.25%. This letter of credit was required as an element of on-going construction activities and has been renewed through February 8, 2017.

Note 8. Commitments

The Organization has contracted with ECC Technologies (ECC) to perform operating and capital construction activities. Under the terms of this contract, the Organization must pay ECC a fixed monthly payment of \$19,333 through December 31, 2016. This agreement is set to automatically renew for 12-month periods thereafter, with a 5% fee increase annually through the end of 2017. In addition, the Organization will pay ECC for on-demand engineering and design services.

Note 9. Reclassifications

Certain reclassifications have been made to the December 31, 2014 financial statement presentation to correspond to the current year's format. Net assets and changes in net assets are unchanged due to these reclassifications.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Southern Tier Network, Inc
Corning, New York

We have audited, in accordance with the 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 Southern Tier Network, Inc. (a nonprofit corporation), which comprise the balance sheet as of December 31, 2015, and the related statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 30, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Southern Tier Network, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Southern Tier Network, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Southern Tier Network, Inc.'s internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southern Tier Network, Inc.'s financial statements are free from 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

EFPR Group, CPAs, PLLC

EFPR Group, CPAs, PLLC
Corning, New York
March 30, 2016