

SOUTHERN TIER NETWORK, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2016

SOUTHERN TIER NETWORK, INC.

TABLE OF CONTENTS

<u>AUDITED FINANCIAL STATEMENTS</u>	<u>PAGE</u>
INDEPENDENT AUDITORS' REPORT	1 - 2
BALANCE SHEETS	3
STATEMENTS OF ACTIVITIES AND CHANGE IN NET ASSETS	4
STATEMENTS OF CASH FLOWS	5
NOTES TO FINANCIAL STATEMENTS	6 - 10
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 <i>GOVERNMENT AUDITING STANDARDS</i>	11 - 12
SCHEDULE OF FINDINGS AND RESPONSES	13

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 sheets as of December 31, 2016 and 2015, and the related statements of activities and change in net assets and cash flows for the years 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 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 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, 2016 and 2015, and the changes in its net assets and its 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 April 12, 2017, 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
April 12, 2017

SOUTHERN TIER NETWORK, INC.
Balance Sheets
December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 3,074,512	\$ 3,912,100
Accounts receivable	284,610	32,927
Grant receivable	1,115,753	160,754
Prepaid expenses	2,873	480
Total current assets	4,477,748	4,106,261
Property and Equipment		
Fiber optic cable plant	9,815,885	7,186,171
Construction in progress	1,268,081	186,375
Parts and supplies inventory - net	-	29,411
Total property and equipment	11,083,966	7,401,957
Less: accumulated depreciation	(1,049,542)	(724,996)
Total property and equipment - net	10,034,424	6,676,961
Other Assets		
Indefeasible right of use - net	1,136,786	882,756
Total Assets	\$ 15,648,958	\$ 11,665,978
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 235,832	\$ 293,858
Deferred revenue - current portion	1,809,172	564,749
Total current liabilities	2,045,004	858,607
Long-term Liabilities		
Deferred revenue - long-term portion	4,510,735	1,552,304
Total Liabilities	6,555,739	2,410,911
Net Assets		
Unrestricted	9,093,219	9,255,067
Total Liabilities and Net Assets	\$ 15,648,958	\$ 11,665,978

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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Support and Revenue		
Installation	\$ 307,699	\$ 243,221
Carrier and enterprise	678,316	562,002
Grant revenue	333,187	160,754
Contributions	47,600	82,795
Other revenue	4	-
Total support and revenue	<u>1,366,806</u>	<u>1,048,772</u>
Expenses		
Cost of sales and installation		
Contractors	17,753	203,059
Design and engineering	26,612	87,222
Other costs	88,295	80,762
Total cost of sales and installation	<u>132,660</u>	<u>371,043</u>
Operating expenses		
Support services	344,566	420,538
Administrative	220,321	263,232
Grant expense	228,464	-
Pole attachment fees	94,697	77,688
Line maintenance	63,399	101,693
Insurance	10,927	27,723
Other operating expenses	74,087	54,647
Total operating expenses	<u>1,036,461</u>	<u>945,521</u>
Total expenses	<u>1,169,121</u>	<u>1,316,564</u>
Operating Income (Loss)	197,685	(267,792)
Non-Operating Income (Expense)		
Interest income	2,981	3,629
Depreciation expense	(324,546)	(287,271)
Amortization expense	(37,968)	(37,968)
Total non-operating income (expense)	<u>(359,533)</u>	<u>(321,610)</u>
Change in Net Assets	(161,848)	(589,402)
Net Assets - Beginning	<u>9,255,067</u>	<u>9,844,469</u>
Net Assets - Ending	<u>\$ 9,093,219</u>	<u>\$ 9,255,067</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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating Activities		
Changes in net assets	\$ (161,848)	\$ (589,402)
Adjustments		
Depreciation expense	324,546	287,271
Amortization expense	37,968	37,968
Loss on disposal of assets	-	44,627
Inventory reserve	-	40,931
Changes in assets and liabilities		
Accounts receivable	(251,683)	1,259,448
Grant receivable	(954,999)	(160,754)
Prepaid expenses	(2,393)	11,901
Accounts payable	(58,026)	(260,199)
Deferred revenue	4,202,854	566,757
Net cash flow from operating activities	<u>3,136,419</u>	<u>1,238,548</u>
Cash Flows from Investing Activities		
Purchase of property and equipment	(3,711,420)	(236,220)
Purchase of indefeasible right of use	(291,998)	-
Sale of inventory	29,411	-
Net cash flow from investing activities	<u>(3,974,007)</u>	<u>(236,220)</u>
Net Change in Cash and Cash Equivalents	(837,588)	1,002,328
Cash and Cash Equivalents - Beginning	<u>3,912,100</u>	<u>2,909,772</u>
Cash and Cash Equivalents - Ending	<u>\$ 3,074,512</u>	<u>\$ 3,912,100</u>

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 years ended December 31, 2016 and 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, 2016 and 2015, 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, 2016 and 2015, 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 twenty-five years.

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 three years. 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 is 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. During 2016, remaining fiber optic cable inventory was sold at its estimated market value (acquisition cost net of an allowance). At December 31, 2015, the inventory allowance was \$40,931.

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.

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-seven 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 \$140,000 and \$127,000 was recognized as expense under the terms of the agreement during 2016 and 2015, respectively.

Note 3. Deferred Revenue

Deferred revenue consisted of the following as of December 31, 2016:

	<u>Current Portion</u>	<u>Long-term Portion</u>	<u>Total</u>
Installation	\$ 303,643	\$ 2,406,126	\$ 2,709,769
Grant - PSIG	289,031	-	289,031
Grant - Other	1,216,498	2,104,609	3,321,107
Total	<u>\$ 1,809,172</u>	<u>\$ 4,510,735</u>	<u>\$ 6,319,907</u>

Deferred revenue consisted of the following as of December 31, 2015:

	<u>Current Portion</u>	<u>Long-term Portion</u>	<u>Total</u>
Installation	\$ 217,544	\$ 1,552,304	\$ 1,769,848
Grant - PSIG	180,000	-	180,000
Grant - Other	167,205	-	167,205
Total	<u>\$ 564,749</u>	<u>\$ 1,552,304</u>	<u>\$ 2,117,053</u>

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, 2016 have terms ranging from one to twenty-seven years, with the latest expiring in November 2044.

As of December 31, 2016, deferred installation revenue is expected to be recognized as income in the following years:

2017	\$ 303,644
2018	308,341
2019	279,830
2020	267,371
2021	233,006
Thereafter	1,317,577
	<u>\$ 2,709,769</u>

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

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:

2017		\$	718,461
2018			717,517
2019			685,456
2020			617,408
2021			402,608
Thereafter			<u>2,778,437</u>
			<u>\$ 5,919,887</u>

Note 5. Infeasible Right of Use

Infeasible right of use consisted of the following at December 31:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Ending Balance</u>
Infeasible right of use - Steuben County	\$ 949,200	\$ -	\$ 949,200
Infeasible right of use - Ontario County	-	291,998	291,998
Total infeasible right of use	<u>949,200</u>	<u>291,998</u>	<u>1,241,198</u>
Less, amortization expense	66,444	37,968	104,412
Infeasible right of use - net	<u>\$ 882,756</u>	<u>\$ 254,030</u>	<u>\$ 1,136,786</u>

Maintenance Fee - In conjunction with the Organization's agreement to acquire the infeasible right to use specific strands of dark fiber in Steuben County, 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 6 (2019), 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:

2017		\$	15,000
2018			20,000
2019			25,000
2020			25,000
2021			25,000
Thereafter			<u>425,000</u>
			<u>\$ 535,000</u>

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 and Ontario County's, the Organization is to perform all required maintenance on the fibers for the term of the agreement.

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

Note 6. Functional Expense

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

	<u>2016</u>	<u>2015</u>
Program operations	\$ 1,295,955	\$ 1,401,633
General and administrative	235,680	240,170
Total	<u>\$ 1,531,635</u>	<u>\$ 1,641,803</u>

Note 7. Commitments and Contingencies

Letter of Credit

The Organization maintains a letter of credit at a local financial 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.

Line of Credit

In August 2016, the Organization obtained a \$1,000,000 revolving line of credit and a \$2,000,000 demand line of credit from Manufacturers and Traders Trust Company to help temporarily finance the extension of existing broadband services into Allegany, Broome, Tioga, and Tompkins Counties. The lines are collateralized by a security interest in the assets of the project. Interest is payable monthly on outstanding balances at interest rates of 2.75% and 2.45%, respectively, over the one-month London InterBank Offered Rate ("LIBOR"). At December 31, 2016, the line's effective rates of interest were 3.52% and 3.22%, respectively. No borrowings occurred during 2016.

Note 8. Commitments

The Organization has contracted with ECC Technologies (ECC) to perform admin, operating/sales and capital construction activities. As of the date of the audit, management is in process of negotiating a new multi-year agreement. The current agreement is month to month based on the prior contract which consisted of a fixed monthly fee and ended December 31, 2016. 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, 2015 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 sheets as of December 31, 2016, 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 April 12, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Southern Tier Network'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's internal control. Accordingly, we do not express an opinion on the effectiveness of Southern Tier Network'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 the 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described as 2016-001 and 2016-002 in the accompanying schedule of findings and responses that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southern Tier Network'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*.

Southern Tier Network's Response to Findings

Southern Tier Network's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Southern Tier Network's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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
April 12, 2017

SOUTHERN TIER NETWORK, INC.
Schedule of Findings and Responses
For the Year ended December 31, 2016

FINDINGS - FINANCIAL STATEMENT AUDIT

FINDING 2016-001 - INTERNAL CONTROL OVER FINANCIAL REPORTING

Significant Deficiency - Subsidiary Contract Database: During our audit, we noted several instances where the Organization's subsidiary contract database, which was designed by a former employee, did not agree or reconcile with the general ledger. This database acts as the subsidiary ledger for property and equipment and contract based revenue. Other potential issues include, but are not limited to, human error and inefficient financial reporting due to the amount of manual calculations and inputs involved.

Recommendation: We recommend that the Organization explore externally developed software packages or review its current operating procedures to enhance the efficiency and accuracy of financial reporting.

Management Response: *Management agrees with the auditors and is reviewing potential upgrades to the database as well as potential off the shelf software options.*

FINDING 2016-002 - INTERNAL CONTROL OVER FINANCIAL REPORTING

Significant Deficiency - Organizational Communication: During our audit, we noted several instances where communication from ECC Technologies' resources to the Organization's administrative and accounting personnel was not effective and where the ineffectiveness had a negative impact on the Organization's ability to carry out and account for activities with appropriate timeliness and controls. The most significant issue related to the Organization's ability to close the books in a timely manner, which delayed the start of the audit.

Recommendation: We recommend that the Organization establish formal procedures with ECC Technologies' to improve communication and the year end close process.

Management Response: *Management agrees with the auditors and is working with the subcontractor to update and enhance current standard operating procedures. Management is also researching potential methods and procedures to ensure information is communicated timely between contractor and company.*