

SOUTHERN TIER NETWORK, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2017

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
SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS	13

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of Southern Tier Network, Inc. (a nonprofit corporation), which comprise the balance sheets as of December 31, 2017 and 2016, 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, 2017 and 2016, 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 19, 2018, 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 solely 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 effectiveness of Southern Tier Network's 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 19, 2018

SOUTHERN TIER NETWORK, INC.
Balance Sheets
December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 3,928,190	\$ 3,074,512
Accounts receivable	109,956	284,610
Grant receivable	668,015	1,115,753
Prepaid expenses	117,080	2,873
Total current assets	<u>4,823,241</u>	<u>4,477,748</u>
Property and Equipment		
Fiber optic cable plant	9,987,892	9,815,885
Construction in progress	5,423,589	1,268,081
Total property and equipment	<u>15,411,481</u>	<u>11,083,966</u>
Less: accumulated depreciation	(1,459,005)	(1,049,542)
Total property and equipment - net	<u>13,952,476</u>	<u>10,034,424</u>
Other Assets		
Indefeasible right of use - net	<u>1,114,517</u>	<u>1,136,786</u>
Total Assets	<u>\$ 19,890,234</u>	<u>\$ 15,648,958</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 241,730	\$ 235,832
Accrued liabilities	4,096	-
Deferred revenue - current portion	5,263,296	1,809,172
Total current liabilities	<u>5,509,122</u>	<u>2,045,004</u>
Long-term Liabilities		
Deferred revenue - long-term portion	<u>5,622,937</u>	<u>4,510,735</u>
Total Liabilities	<u>11,132,059</u>	<u>6,555,739</u>
Net Assets		
Unrestricted	<u>8,758,175</u>	<u>9,093,219</u>
Total Liabilities and Net Assets	<u>\$ 19,890,234</u>	<u>\$ 15,648,958</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, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Support and Revenue		
Installation	\$ 361,007	\$ 307,699
Carrier and enterprise	780,764	678,316
Grant revenue	349,954	333,187
Contributions	201,976	47,600
Other revenue	-	4
Total support and revenue	<u>1,693,701</u>	<u>1,366,806</u>
Expenses		
Cost of sales and installation		
Contractors	105,235	17,753
Design and engineering	32,400	26,612
Commission expense	2,793	-
Other costs	293,402	88,295
Total cost of sales and installation	<u>433,830</u>	<u>132,660</u>
Operating expenses		
Support services	487,058	344,566
Administrative	261,092	220,321
Grant expense	54,129	228,464
Pole attachment fees	116,732	94,697
Line maintenance	56,782	63,399
Insurance	27,406	10,927
Other operating expenses	135,909	74,087
Total operating expenses	<u>1,139,108</u>	<u>1,036,461</u>
Total expenses	<u>1,572,938</u>	<u>1,169,121</u>
Operating Income	120,763	197,685
Non-Operating Income (Expense)		
Interest income	3,333	2,981
Depreciation expense	(409,463)	(324,546)
Amortization expense	(49,677)	(37,968)
Total non-operating expense	<u>(455,807)</u>	<u>(359,533)</u>
Change in Net Assets	(335,044)	(161,848)
Net Assets - Beginning	<u>9,093,219</u>	<u>9,255,067</u>
Net Assets - Ending	<u>\$ 8,758,175</u>	<u>\$ 9,093,219</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, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities		
Changes in net assets	\$ (335,044)	\$ (161,848)
Adjustments		
Depreciation expense	409,463	324,546
Amortization expense	49,677	37,968
Changes in assets and liabilities		
Accounts receivable	174,654	(251,683)
Grant receivable	447,738	(954,999)
Prepaid expenses	(114,207)	(2,393)
Accounts payable	5,898	(58,026)
Accrued liabilities	4,096	-
Deferred revenue	4,566,326	4,202,854
Net cash flow from operating activities	<u>5,208,601</u>	<u>3,136,419</u>
Cash Flows from Investing Activities		
Purchase of property and equipment	(4,327,515)	(3,711,420)
Purchase of indefeasible right of use	(27,408)	(291,998)
Sale of inventory	-	29,411
Net cash flow from investing activities	<u>(4,354,923)</u>	<u>(3,974,007)</u>
Net Change in Cash and Cash Equivalents	853,678	(837,588)
Cash and Cash Equivalents - Beginning	<u>3,074,512</u>	<u>3,912,100</u>
Cash and Cash Equivalents - Ending	<u>\$ 3,928,190</u>	<u>\$ 3,074,512</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 the Southern Tier region of upstate New York. The network will connect 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, 2017 and 2016.

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, 2017 and 2016, 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, 2017 and 2016, 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 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 basis over the estimated useful lives, which range from three to twenty-five years.

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. 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 treated, for tax reporting purposes, as an entity exempt from tax under Section 115 of the Internal Revenue Code as an instrumentality of government. Accordingly, the Organization is not required to file tax returns.

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

Note 2. Administrative Services

The Organization contracted with the Southern Tier Central Regional Planning and Development Board (STC) during 2016 and part of 2017 to provide management, accounting and specialist services. STC's Executive Director is the Chair of the Board of the Organization. Approximately \$48,000 and \$140,000 was recognized as expense under the terms of the agreement during 2017 and 2016, respectively.

Note 3. Deferred Revenue

Deferred revenue consisted of the following as of December 31, 2017:

	<u>Current Portion</u>	<u>Long-term Portion</u>	<u>Total</u>
Installation	\$ 413,695	\$ 3,591,984	\$ 4,005,679
Grant - PSIG	446,043	-	446,043
Grant - Contracts	4,403,558	2,030,953	6,434,511
Total	<u>\$ 5,263,296</u>	<u>\$ 5,622,937</u>	<u>\$ 10,886,233</u>

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

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 - Contracts	1,216,498	2,104,609	3,321,107
Total	\$ 1,809,172	\$ 4,510,735	\$ 6,319,907

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, 2017 have terms ranging from one to twenty-nine years, with the latest expiring in January 2047.

As of December 31, 2017, deferred installation revenue is expected to be recognized as income in the following years:

2018	\$	413,695
2019		384,822
2020		369,292
2021		338,115
2022		298,646
Thereafter		2,201,109
		\$ 4,005,679

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-seven years. Payments to be received under the terms of these agreements are as following for the years ending:

2018	\$	822,935
2019		775,862
2020		735,934
2021		676,439
2022		614,520
Thereafter		2,332,999
		\$ 5,958,689

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

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	<u>291,998</u>	<u>27,408</u>	<u>319,406</u>
Total infeasible right of use	1,241,198	27,408	1,268,606
Less, amortization expense	<u>(104,412)</u>	<u>(49,677)</u>	<u>(154,089)</u>
Infeasible right of use - net	<u>\$ 1,136,786</u>	<u>\$ (22,269)</u>	<u>\$ 1,114,517</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:

2018	\$ 20,000
2019	25,000
2020	25,000
2021	25,000
2022	25,000
Thereafter	<u>400,000</u>
	<u>\$ 520,000</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.

Note 6. Functional Expense

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

	<u>2017</u>	<u>2016</u>
Program operations	\$ 1,735,034	\$ 1,295,955
General and administrative	<u>297,044</u>	<u>235,680</u>
Total	<u>\$ 2,032,078</u>	<u>\$ 1,531,635</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 7, 2019.

SOUTHERN TIER NETWORK, INC.
Notes to Financial Statements

Line of Credit

The Organization maintains 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 line is collateralized by a security interest in the assets of the project. Interest is payable monthly at 2.45% over the one-month London InterBank Offered Rate ("LIBOR"). At December 31, 2017 and 2016, the effective rate of interest was 4.01% and 3.22%, respectively. No borrowings occurred during fiscal years ending December 31, 2017 and 2016.

Commitments

The Organization has contracted with ECC Technologies (ECC) to perform administrative, operating/sales and capital construction activities. Under the terms of this contract, the Organization must pay ECC a fixed monthly fee through December 31, 2019. Future payments under the terms of the agreement are as follows for the years ending December 31:

2018	\$ 361,008
2019	371,838
Total	<u>\$ 732,846</u>

In addition, the Organization will pay ECC for on demand network support, engineering and design services at agreed upon hourly rates, and a fixed commission percentage on recurring and lump sum lease and maintenance revenues and IRU revenues.

**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, 2017, 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 19, 2018.

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 entity'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 entity'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 19, 2018

SOUTHERN TIER NETWORK, INC.
Summary Schedule of Prior Year Findings
For the Year ended December 31, 2017

FINDINGS - FINANCIAL STATEMENT AUDIT

FINDING 2016-001 - INTERNAL CONTROL OVER FINANCIAL REPORTING

Significant Deficiency - Subsidiary Contract Database: During our prior year 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.

Status: During 2017, the Organization contracted with a software engineer to redevelop the subsidiary contract database. As a result, this prior year finding was appropriately addressed and resolved during the current fiscal year.

FINDING 2016-002 - INTERNAL CONTROL OVER FINANCIAL REPORTING

Significant Deficiency - Organizational Communication: During our prior year 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.

Status: During 2017, the Organization agreed to terms with the subcontractor to extend their working relationship through 2019. Additionally, the Organization expanded the Chief Executive Officer's role from part-time in 2016 to full-time in 2017. While the combination of these operational business decisions allowed for more efficient and timely communication, we feel, based upon our experience throughout the audit and also conversations with management, there is still room for improvement. As a result, this prior year finding was reported as a deficiency for the 2017 audit.