

SOUTHERN TIER NETWORK, INC.

**Financial Statements
as of December 31, 2012
Together with
Independent Auditor's Report**

Bonadio & Co., LLP
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

March, 26, 2013

To the Board of Directors of the
Southern Tier Network, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of Southern Tier Network, Inc., which comprise the balance sheet as of December 31, 2012, and the related statements 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; 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.

Auditor's 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Southern Tier Network, Inc. as of December 31, 2012, 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.

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INDEPENDENT AUDITOR'S REPORT

(Continued)

Report on Summarized Comparative Information

We have previously audited the Southern Tier Network, Inc.'s 2011 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated April 30, 2012. In our opinion, the summarized comparative information presented herein as of December 31, 2011 and for the period from inception (January 7, 2011) through December 31, 2011 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2013 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 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.

SOUTHERN TIER NETWORK, INC.

BALANCE SHEET

DECEMBER 31, 2012

(With Comparative Totals for 2011)

	<u>2012</u>	<u>2011</u>
ASSETS		
OTHER ASSETS:		
Cash	\$ 1,939,132	\$ 725,643
Contributions receivable	5,762,790	8,700,000
Accounts receivable	117,125	-
Prepaid insurance	<u>7,982</u>	<u>7,288</u>
Total other assets	<u>7,827,029</u>	<u>9,432,931</u>
FIXED ASSETS:		
Construction in progress	2,163,790	114,492
Fiber optic cable plant	645,999	-
Parts and supplies inventory	<u>515,863</u>	<u>-</u>
	3,325,652	114,492
Less: Accumulated depreciation	<u>(9,421)</u>	<u>-</u>
Net fixed assets	<u>3,316,231</u>	<u>114,492</u>
	<u>\$ 11,143,260</u>	<u>\$ 9,547,423</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable	\$ 631,034	\$ 35,351
Deferred installation revenue	<u>101,400</u>	<u>-</u>
Total liabilities	<u>732,434</u>	<u>35,351</u>
NET ASSETS:		
Unrestricted	4,710,826	812,072
Temporarily restricted	<u>5,700,000</u>	<u>8,700,000</u>
Total net assets	<u>10,410,826</u>	<u>9,512,072</u>
Total liabilities and net assets	<u>\$ 11,143,260</u>	<u>\$ 9,547,423</u>

The accompanying notes are an integral part of these statements.

SOUTHERN TIER NETWORK, INC.

STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS FOR THE YEAR ENDED DECEMBER 31, 2012

(With Comparative Totals for the Period from Inception (January 7, 2011) to December 31, 2011)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>	
			<u>2012</u>	<u>2011</u>
SUPPORT AND REVENUE:				
Contributions	\$ 1,433,892	\$ -	\$ 1,433,892	\$ 9,700,000
Service revenue	13,125	-	13,125	-
Installation revenue	2,600	-	2,600	-
Interest income	86	-	86	-
Release from restriction	<u>3,000,000</u>	<u>(3,000,000)</u>	<u>-</u>	<u>-</u>
Total support and revenue	<u>4,449,703</u>	<u>(3,000,000)</u>	<u>1,449,703</u>	<u>9,700,000</u>
EXPENSES:				
Network operations	258,239	-	258,239	-
Administrative	107,576	-	107,576	37,105
Support services	107,468	-	107,468	-
Insurance	35,573	-	35,573	14,584
Professional fees	28,177	-	28,177	15,235
Depreciation	9,421	-	9,421	-
Office and supplies	1,422	-	1,422	99
Engineering fees	-	-	-	117,251
Poll attachment fees	<u>3,073</u>	<u>-</u>	<u>3,073</u>	<u>3,654</u>
Total expenses	<u>550,949</u>	<u>-</u>	<u>550,949</u>	<u>187,928</u>
CHANGE IN NET ASSETS	3,898,754	(3,000,000)	898,754	9,512,072
NET ASSETS - beginning of year/period	<u>812,072</u>	<u>8,700,000</u>	<u>9,512,072</u>	<u>-</u>
NET ASSETS - end of year	<u>\$ 4,710,826</u>	<u>\$ 5,700,000</u>	<u>\$ 10,410,826</u>	<u>\$ 9,512,072</u>

The accompanying notes are an integral part of these statements.

SOUTHERN TIER NETWORK, INC.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2012

(With Comparative Totals for the Period from Inception (January 7, 2011) to December 31, 2011)

	<u>2012</u>	<u>2011</u>
CASH FLOW FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 898,754	\$ 9,512,072
Adjustments to reconcile change in net assets to net cash flow from operating activities:		
Contributions - cash received	(4,371,102)	(1,000,000)
Depreciation	9,421	-
Changes in:		
Contribution receivable	2,937,210	(8,700,000)
Accounts receivable	(117,125)	-
Prepaid expense	(694)	(7,288)
Accounts payable	5,652	35,351
Deferred installation revenue	<u>101,400</u>	<u>-</u>
Net cash flow from operating activities	<u>(536,484)</u>	<u>(159,865)</u>
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	<u>(2,621,129)</u>	<u>(114,492)</u>
Net cash flow from investing activities	<u>(2,621,129)</u>	<u>(114,492)</u>
CASH FLOW FROM FINANCING ACTIVITIES:		
Contributions - cash received	<u>4,371,102</u>	<u>1,000,000</u>
Net cash flow from financing activities	<u>4,371,102</u>	<u>1,000,000</u>
CHANGE IN CASH	1,213,489	725,643
CASH - beginning of year/period	<u>725,643</u>	<u>-</u>
CASH - end of year	<u>\$ 1,939,132</u>	<u>\$ 725,643</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, 2012 were \$590,031.

The accompanying notes are an integral part of these statements.

SOUTHERN TIER NETWORK, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2012

1. THE ORGANIZATION

Southern Tier Network, Inc. (STN) is a not-for profit, local development corporation (LDC) based in Corning, New York and 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. STN will do so by leasing high speed fiber optic capacity to enterprise, carrier, and other entities that desire to manage and control their own telecommunications services. This network will aid 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Financial Reporting

STN reports its activities and related net assets using the following net asset classifications:

- Unrestricted net assets include resources that are available for the support of STN's operating activities and net investment in property and equipment.
- Temporarily restricted net assets include resources that have been contributed to STN subject to certain time restrictions, as defined by the donor.

Comparative Information

The financial statements include certain prior year summarized comparative information in total, but not by net asset classification. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with STN's financial statements as of December 31, 2011 and for the period from inception (January 7, 2011) through December 31, 2011, from which the summarized information was derived.

Cash

Cash consists of two bank accounts which, at times, may exceed federally insured limits. STN has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk with respect to cash.

Contribution Receivable

STN records contribution receivable and contribution revenue when an unconditional promise to give is received. STN records an allowance for doubtful accounts in anticipation of future write-offs to the extent deemed necessary based on past experience. At December 31, 2012 and 2011, no allowance was considered necessary.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounts Receivable

STN extends credit to its customers. Accounts receivable are stated at the amount billed. At December 31, 2012 no allowance was considered necessary. Receivables are considered impaired if full principal payments are not received in accordance with the contractual terms. It is STN's policy to charge off uncollectible contracts receivable when management determines the receivable will not be collected.

Fixed Assets

Fixed assets are stated at cost or, if donated, at fair value at the date of donation. STN 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 basis over the estimated useful lives, which range from three to twenty-five years.

Deferred Installation Revenue

Deferred installation revenue represents amounts received from customers related to each customer's initial connection to STN's fiber optic network. These amounts are deferred and recognized as revenue on a straight-line basis over the terms of each customer's lease for access to the network, all of which are currently ten years.

Income Taxes

STN 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. STN 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 of a governmental unit described in the procedure.

For tax-exempt entities, their tax-exempt status itself is deemed to be an uncertainty, since events could potentially occur to jeopardize their tax-exempt status. As of December 31, 2012 and 2011, STN does not have a liability for unrecognized tax benefits, nor does it file federal or New York State income tax returns.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

3. ADMINISTRATIVE SERVICES

STN has contracted with Southern Tier Central Regional Planning and Development Board (STC) to provide management, accounting and specialist services. STC's Executive Director is the Chair of the Board of STN. Approximately \$108,000 and \$37,105 was recognized as expense under the terms of the agreement during 2012 and 2011, respectively.

4. TEMPORARILY RESTRICTED NET ASSETS

STN's temporarily restricted net assets are restricted for STN's initial capital costs for the construction of the fiber optic ring, as well as operating cash flow needs during the construction period.

5. CONTRIBUTION AND CONTRIBUTION RECEIVABLE

STN's contribution income was 99% from Steuben, Schuyler, and Chemung Counties, respectively, for the year ended December 31, 2012. STN's contribution income was 100% from Corning, Inc. for the period from inception (January 7, 2011) through December 31, 2011.

STN's contribution receivable was 99% and 100%, respectively, due from Corning, Inc. at December 31, 2012 and 2011. There is no set schedule for when payments related to this contribution receivable will be received. The arrangement allows for STN to request and receive cash payments on the contribution receivable as cash flow needs dictate.

6. CUSTOMER ARRANGEMENTS

Deferred Installation Revenue

STN enters into agreements with customers to provide access to STN'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 revenue and are being recognized as earned using the straight-line method over the terms of the agreements, which are currently ten years and expire in 2022.

Deferred revenue to be recognized as income is as follows for the years ending December 31:

2013	\$	10,400
2014		10,400
2015		10,400
2016		10,400
2017		10,400
Thereafter		<u>49,400</u>
	\$	<u>101,400</u>

Future Lease Payments to be Received

STN leases continuing use of its fiber optic network under the terms of agreements with STN's customers. These agreements require monthly recurring payments by the customer to access to the fiber optic network under non-cancelable leases. The terms of these leases are currently for ten years, expiring in 2022.

Lease payments to be received are as follows for the years ending December 31:

2013	\$	69,300
2014		69,300
2015		69,300
2016		69,300
2017		69,300
Thereafter		<u>333,000</u>
	\$	<u>679,500</u>

7. FUNCTIONAL EXPENSES

STN's expenses on a functional basis are as follows for the year ended December 31, 2012 and the period from inception (January 7, 2011) through December 31, 2011.

	<u>2012</u>	<u>2011</u>
Program	\$ 267,660	\$ -
General and administrative	<u>283,289</u>	<u>187,928</u>
	<u>\$ 550,949</u>	<u>\$ 187,928</u>

8. CONTINGENCY

On February 8, 2012, STN entered into an irrevocable standby letter of credit with a financial institution for \$75,000 at 1.25% interest, with an unrelated beneficiary. This letter of credit was required as an element of on-going construction activities.

9. SUBSEQUENT EVENTS

Subsequent events have been evaluated through March 26, 2013, which is the date the financial statements were available to be issued.

On January 16, 2013, STN received a payment of \$1,500,000 on the contribution receivable in the normal course of the contributor's provision of cash for operating expenses and capital expenditures.

**INDEPENDENT AUDITOR'S 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**

March 26, 2013

To the Board of Directors of
Southern Tier Network, Inc.:

We have audited, in accordance with the auditing standards generally accepted in the United States 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., which comprise the balance sheet as of December 31, 2012, and the related statements of activities and change 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 26, 2013.

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.

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INDEPENDENT AUDITOR'S 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

(Continued)

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.