

SOUTHERN TIER NETWORK, INC.

**Financial Statements
as of December 31, 2014 and 2013
Together with
Independent Auditor's Report**

Bonadio & Co., LLP
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

March 9, 2015

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 sheets as of December 31, 2014 and 2013, 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; 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 audits. We conducted our audits 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 audits 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, 2014 and 2013, 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.

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INDEPENDENT AUDITOR'S REPORT

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 9, 2015 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 SHEETS

DECEMBER 31, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
CURRENT ASSETS:		
Cash	\$ 2,909,772	\$ 1,735,151
Accounts receivable	1,292,375	182,405
Contributions receivable	-	2,762,790
Prepaid expenses	<u>12,380</u>	<u>7,703</u>
Total current assets	<u>4,214,527</u>	<u>4,688,049</u>
FIXED ASSETS:		
Fiber optic cable plant	6,916,723	6,044,681
Construction in progress	90,858	497,665
Parts and supplies inventory	<u>202,462</u>	<u>191,382</u>
	7,210,043	6,733,728
Less: Accumulated depreciation and amortization	<u>(437,725)</u>	<u>(157,062)</u>
Net fixed assets	<u>6,772,318</u>	<u>6,576,666</u>
OTHER ASSETS:		
Indefeasible right of use, net	<u>920,724</u>	<u>-</u>
Total other assets	<u>920,724</u>	<u>-</u>
	<u>\$ 11,907,569</u>	<u>\$ 11,264,715</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable	\$ 512,804	\$ 461,675
Deferred installation revenue	<u>1,550,296</u>	<u>1,101,174</u>
Total liabilities	<u>2,063,100</u>	<u>1,562,849</u>
NET ASSETS:		
Unrestricted	9,844,469	7,001,866
Temporarily restricted	<u>-</u>	<u>2,700,000</u>
Total net assets	<u>9,844,469</u>	<u>9,701,866</u>
Total liabilities and net assets	<u>\$ 11,907,569</u>	<u>\$ 11,264,715</u>

The accompanying notes are an integral part of these statements.

SOUTHERN TIER NETWORK, INC.

**STATEMENTS OF ACTIVITIES AND CHANGE IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013**

	2014			2013		
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
SUPPORT AND REVENUE:						
Sales	\$ 1,192,300	\$ -	\$ 1,192,300	\$ -	\$ -	\$ -
Installation	164,732	-	164,732	62,166	-	62,166
Carrier and enterprise	397,407	-	397,407	184,756	-	184,756
Contributions	446,105	-	446,105	326,106	-	326,106
Release from restriction	2,700,000	(2,700,000)	-	3,000,000	(3,000,000)	-
Total support and revenue	<u>4,900,544</u>	<u>(2,700,000)</u>	<u>2,200,544</u>	<u>3,573,028</u>	<u>(3,000,000)</u>	<u>573,028</u>
EXPENSES:						
Cost of sales and installation:						
Contractors	785,830	-	785,830	171,538	-	171,538
Design and engineering	193,070	-	193,070	119,924	-	119,924
Other	209,482	-	209,482	301,490	-	301,490
Total cost of sales and installation	<u>1,188,382</u>	<u>-</u>	<u>1,188,382</u>	<u>592,952</u>	<u>-</u>	<u>592,952</u>
Operating:						
Support services	232,706	-	232,706	235,116	-	235,116
Administrative	187,206	-	187,206	215,899	-	215,899
Pole attachment fees	69,358	-	69,358	28,110	-	28,110
Line maintenance	45,096	-	45,096	27,485	-	27,485
Insurance	17,149	-	17,149	21,835	-	21,835
Other	12,867	-	12,867	15,828	-	15,828
Total operating	<u>564,382</u>	<u>-</u>	<u>564,382</u>	<u>544,273</u>	<u>-</u>	<u>544,273</u>
Total expenses	<u>1,752,764</u>	<u>-</u>	<u>1,752,764</u>	<u>1,137,225</u>	<u>-</u>	<u>1,137,225</u>
EXCESS (DEFICIENCY) OF SUPPORT AND REVENUE OVER EXPENSES BEFORE INTEREST AND DEPERECIATION	3,147,780	(2,700,000)	447,780	2,435,803	(3,000,000)	(564,197)
INTEREST INCOME	3,963	-	3,963	2,878	-	2,878
DEPRECIATION EXPENSE	(309,140)	-	(309,140)	(147,641)	-	(147,641)
CHANGE IN NET ASSETS	2,842,603	(2,700,000)	142,603	2,291,040	(3,000,000)	(708,960)
NET ASSETS - beginning of year	<u>7,001,866</u>	<u>2,700,000</u>	<u>9,701,866</u>	<u>4,710,826</u>	<u>5,700,000</u>	<u>10,410,826</u>
NET ASSETS - end of year	<u>\$ 9,844,469</u>	<u>\$ -</u>	<u>\$ 9,844,469</u>	<u>\$ 7,001,866</u>	<u>\$ 2,700,000</u>	<u>\$ 9,701,866</u>

The accompanying notes are an integral part of these statements.

SOUTHERN TIER NETWORK, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
CASH FLOW FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 142,603	\$ (708,960)
Adjustments to reconcile change in net assets to net cash flow from operating activities:		
Contributions - cash received	(3,208,895)	(3,326,106)
Depreciation and amortization	309,140	147,641
Changes in:		
Contribution receivable	2,762,790	3,000,000
Accounts receivable	(1,109,970)	(65,280)
Prepaid expenses	(4,677)	279
Accounts payable	11,129	(578,867)
Deferred access revenue	<u>449,122</u>	<u>999,774</u>
Net cash flow from operating activities	<u>(648,758)</u>	<u>(531,519)</u>
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchases of fixed assets	(436,316)	(2,998,568)
Purchase of indefeasible right of use	<u>(949,200)</u>	<u>-</u>
Net cash flow from investing activities	<u>(1,385,516)</u>	<u>(2,998,568)</u>
CASH FLOW FROM FINANCING ACTIVITIES:		
Contributions - cash received	<u>3,208,895</u>	<u>3,326,106</u>
Net cash flow from financing activities	<u>3,208,895</u>	<u>3,326,106</u>
CHANGE IN CASH	1,174,621	(203,981)
CASH - beginning of year	<u>1,735,151</u>	<u>1,939,132</u>
CASH - end of year	<u>\$ 2,909,772</u>	<u>\$ 1,735,151</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, 2014 and 2013 were \$449,540 and \$409,508, respectively.

The accompanying notes are an integral part of these statements.

SOUTHERN TIER NETWORK, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

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 selling or 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 (GAAP).

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.

Cash

Cash consists of 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, 2014 and 2013, no allowance was considered necessary.

Accounts Receivable

STN extends credit to its customers. Accounts receivable are stated at the amount billed. At December 31, 2014 and 2013, 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Indefeasible Right of Use

Indefeasible right of use represents STN's indefeasible right to use specific strands of dark fiber owned by third parties to connect STN's fiber optic network in lieu of STN 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.

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.

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 STN 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 STN'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 STN's fiber optic network.

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, 2014 and 2013, 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 GAAP 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 \$143,000 and \$126,000 was recognized as expense under the terms of the agreement during 2014 and 2013, respectively.

4. TEMPORARILY RESTRICTED NET ASSETS

STN's temporarily restricted net assets were 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

Approximately 84% and 100% of STN's access revenue was derived from four customers in the years ended December 31, 2014 and 2013, respectively.

STN's contribution income was 100% from Steuben, Schuyler, and Chemung Counties for the years ended December 31, 2014 and 2013.

STN's contribution receivable was 99% due from Corning, Inc. at December 31, 2013. The outstanding receivable balance was paid in full during 2014 and no contribution receivable was recorded at December 31, 2014.

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

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 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, 2014 have terms ranging from one to twenty-five years, with the latest expiring in July 2039.

As of December 31, 2014, deferred installation revenue is expected to be recognized as income in the following years:

2015	\$	225,974
2016		170,384
2017		170,384
2018		169,450
2019		143,877
Thereafter		<u>670,227</u>
	\$	<u>1,550,296</u>

6. CUSTOMER ARRANGEMENTS (Continued)

Future Carrier and Enterprise Payments to be Received

STN 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 follows for the years ending December 31:

2015	\$	459,581
2016		460,279
2017		460,128
2018		439,108
2019		370,262
Thereafter		<u>1,670,112</u>
	\$	<u>3,859,470</u>

7. INDEFEASIBLE RIGHTS OF USE

Maintenance Fee

In conjunction with its purchase of the indefeasible right to use specific strands of dark fiber owned and maintained by a third party, STN 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, at which time \$25,000 will be paid per year through the term of the agreement, twenty-five years. Future annual maintenance payments under the terms of the agreement are as follows for the years ending December 31:

2015	\$	5,000
2016		10,000
2017		15,000
2018		20,000
2019		25,000
Thereafter		<u>475,000</u>
	\$	<u>550,000</u>

Commitment to Maintain

In conjunction with STN's agreement to acquire the indefeasible right of use for specific strands of dark fiber in Steuben County, STN is to perform all required maintenance on the fibers for the term of the agreement, thirty years.

7. FUNCTIONAL EXPENSES

STN's expenses on a functional basis are as follows for the years ended December 31, 2014 and 2013.

	<u>2014</u>	<u>2013</u>
Program operations	\$ 1,856,839	\$ 1,045,422
General and administrative	<u>205,065</u>	<u>239,444</u>
	<u>\$ 2,061,904</u>	<u>\$ 1,284,866</u>

8. LETTER OF CREDIT

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. This letter of credit has been renewed through February 8, 2016.

9. COMMITMENTS

STN has contracted with ECC Technologies (ECC) to perform operating and capital construction activities for STN. Under the terms of this contract, STN 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, STN will pay ECC for on-demand engineering and design services.

10. SUBSEQUENT EVENTS

Subsequent events have been evaluated through March 9, 2015, which is the date the financial statements were available to be issued.

**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 9, 2015

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, 2014, 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 9, 2015.

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.