

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit
of the County of Monroe, New York)

Financial Statements as of
December 31, 2015
Together with
Independent Auditor's Report

Bonadio & Co., LLP
Certified Public Accountants

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit of the County of Monroe, New York)

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INDEPENDENT AUDITOR'S REPORT

March 7, 2016

To the Board of Directors of
Upstate Telecommunications Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of Upstate Telecommunications Corporation (UTC) (a discretely presented component unit of the County of Monroe, New York), as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise UTC's basic financial statements as listed in the table of contents.

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.

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 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 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.

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INDEPENDENT AUDITOR'S REPORT

(Continued)

Opinion

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

Report on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 - 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 7, 2016 on our consideration of UTC'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 UTC's internal control over financial reporting and compliance.

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit of the County of Monroe, New York)

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2015

The following Management's Discussion and Analysis (MD&A) of Upstate Telecommunications Corporation's (UTC) financial position provides an overview of UTC's financial activities for the years ended December 31, 2015 and 2014. The MD&A should be read in conjunction with UTC's financial statements and related notes, which follow the MD&A.

FINANCIAL HIGHLIGHTS

- The assets and deferred outflows of UTC exceeded its liabilities at December 31, 2015 by \$720 thousand. The liabilities of UTC exceeded its assets and deferred outflows at December 31, 2014 by \$3.00 million.
- UTC's net position increased by \$3.7 million as a result of 2015 operations and increased by \$2.9 million as a result of 2014 operations.
- UTC's total operating revenues were \$7.32 million and \$7.39 million in 2015 and 2014, respectively.
- UTC's total operating expenses were \$3.61 million and \$4.49 million in 2015 and 2014, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements of UTC are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Government Accounting Standards Board (GASB). The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting, which requires that transactions be recorded when they occur, not when its related cash receipt or disbursement occurs.

The Statement of Net Position depicts UTC's financial position at December 31, the end of UTC's fiscal year. The statements present all the financial assets and deferred outflows and liabilities of UTC with the difference between them reported as net position.

The Statement of Revenues, Expenses and Changes in Net Position reports operating revenues and expenses, non-operating revenues and expenses, and the changes in net position for the year ended December 31. The change in net position combined with the previous year's net position total, reconciles to the net position total for the reporting period.

The Statement of Cash Flows reports cash activities for the year resulting from operating activities, investing activities, and capital and related financing activities. The net result of these activities, added to the beginning of the year cash balance, reconciles to the total cash balance at the end of the year.

NOTES TO FINANCIAL STATEMENTS

The financial statements also include notes that explain the information in the financial statements. They are essential to a full understanding of the data provided in the financial statements.

FINANCIAL ANALYSIS

The analysis below summarizes the statements of net position (Table 1) and changes in net position (Table 2) of UTC as of and for the years ended December 31, 2015 and 2014.

Table 1 - Statements of Net Position

| | <u>2015</u> | <u>2014</u> |
|--------------------------------------|--------------------|-----------------------|
| Assets: | | |
| Current assets | \$ 2,204,135 | \$ 1,763,707 |
| Noncurrent assets | <u>12,688,721</u> | <u>12,169,266</u> |
| Total assets | <u>14,892,856</u> | <u>13,932,973</u> |
| Deferred outflows of resources: | | |
| Gain on interest rate swap liability | <u>355,387</u> | <u>789,821</u> |
| Total deferred outflows of resources | <u>355,387</u> | <u>789,821</u> |
| Liabilities: | | |
| Current liabilities | 291,241 | 290,108 |
| Long-term liabilities | <u>14,236,794</u> | <u>17,427,908</u> |
| Total liabilities | <u>14,528,035</u> | <u>17,718,016</u> |
| Net position: | | |
| Net investment in capital assets | 249,272 | 240,896 |
| Restricted for debt service | 8,818,916 | 7,302,661 |
| Unrestricted | <u>(8,347,980)</u> | <u>(10,538,779)</u> |
| Total net position | <u>\$ 720,208</u> | <u>\$ (2,995,222)</u> |

UTC's total assets increased \$960 thousand in 2015. The principal components of this change include an increase of approximately \$317 thousand in cash and an increase of \$1.5 million in limited use assets. Offsetting the increases were a reduction of \$293 thousand in capital assets (principally reflecting the current year depreciation of existing assets), and a reduction of \$703,000 in principal owed on the direct financing lease (per the established amortization schedule).

Deferred outflows of resources declined \$434 thousand in 2015, reflecting the reduction in value of the interest rate swap.

Total liabilities decreased \$3.19 million in 2014. The principal components of this change include a reduction of \$3.3 million in long term liabilities (\$2.9 million due to debt and capital lease payments plus a \$434 thousand reduction in the swap liability value).

FINANCIAL ANALYSIS (Continued)

Table 2 shows the changes in net position for the years ended December 31, 2015 and 2014.

Table 2 - Changes in Net Position

| | <u>2015</u> | <u>2014</u> |
|--|---------------------|---------------------|
| Revenues: | | |
| Maintenance and support services | \$ 6,260,867 | \$ 6,295,356 |
| Leasing revenue | 925,298 | 924,095 |
| Interest on investment in direct-financing lease | 136,520 | 162,007 |
| Other | <u>1,438</u> | <u>7,982</u> |
| Total revenues | <u>7,324,123</u> | <u>7,389,440</u> |
| Expenses: | | |
| Hosting, training, and implementation | 697,138 | 1,603,378 |
| Network management and maintenance | 1,044,130 | 847,094 |
| Interest, amortization, and fees | 705,219 | 835,959 |
| Depreciation | 312,001 | 429,010 |
| Management services and support | 358,083 | 331,981 |
| Copier maintenance | 246,922 | 227,329 |
| Other program expenses | 165,287 | 127,377 |
| Professional fees | 77,139 | 64,949 |
| Other administration expenses | <u>261</u> | <u>21,718</u> |
| Total expenses | <u>3,606,180</u> | <u>4,488,795</u> |
| Operating income | 3,717,943 | 2,900,645 |
| Nonoperating expenses | <u>(2,513)</u> | <u>(14,881)</u> |
| Change in net position | <u>\$ 3,715,430</u> | <u>\$ 2,885,764</u> |

Total revenues decreased approximately \$65 thousand in 2015. This change is partially driven by a reduction of \$25 thousand in interest on investment in the direct financing lease per the established amortization schedule.

Total expenses decreased approximately \$880 thousand in 2015. The change was a result of fewer expenses incurred in 2015 for telephony, network and computer refresh projects and due to additional one-time expenses incurred in 2014 for transitioning to a new mainframe host vendor that were not incurred in 2015. Depreciation decreased in 2015 by approximately \$117 thousand.

FUTURE FACTORS

UTC's second Microcomputer refresh was scheduled for 2015. Work continued in 2015 but a majority of the expenses will be incurred in 2016 (subject to customer scheduling direction). UTC will continue its ongoing administrative, maintenance and operating activities in support of Monroe County's (the County) information technology needs.

The UTC Board approved a resolution to take all steps necessary to dissolve the organization and to work with the County to transition its functions, assets and liabilities to the County. UTC is in the process of planning for this transition.

CONTACTING ADMINISTRATION

This financial report is designed to provide citizens, taxpayers, customers, investors and creditors with a general overview of UTC's finances and to show the accountability for the money received. If you have questions about this report or need additional financial information, contact Upstate Telecommunications Corporation, at 50 West Main Street, Suite 8100, Rochester, New York, 14614.

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit of the County of Monroe, New York)

STATEMENT OF NET POSITION
DECEMBER 31, 2015

ASSETS

CURRENT ASSETS:

| | |
|---|------------------|
| Cash | \$ 1,307,854 |
| Prepaid expenses and other current assets | 192,784 |
| Current portion of investment in direct-financing lease | <u>703,497</u> |
| Total current assets | <u>2,204,135</u> |

NONCURRENT ASSETS:

| | |
|--|-------------------|
| Capital assets, net | 980,679 |
| Investment in direct-financing lease, net of current portion | 2,889,126 |
| Limited use assets | <u>8,818,916</u> |
| Total noncurrent assets | <u>12,688,721</u> |
| Total assets | <u>14,892,856</u> |

DEFERRED OUTFLOWS OF RESOURCES

| | |
|--------------------------------------|----------------|
| Gain on interest rate swap liability | <u>355,387</u> |
| Total deferred outflows of resources | <u>355,387</u> |

LIABILITIES

CURRENT LIABILITIES:

| | |
|---------------------------------------|----------------|
| Accounts payable and accrued expenses | <u>291,241</u> |
| Total current liabilities | <u>291,241</u> |

LONG-TERM LIABILITIES

| | |
|---|------------------|
| Due and payable within one year - | |
| Capital lease obligation | 315,797 |
| Bonds payable | <u>2,575,000</u> |
| Total long-term liabilities due and payable within one year | <u>2,890,797</u> |

| | |
|----------------------------------|-------------------|
| Due and payable after one year - | |
| Interest rate swap liability | 355,387 |
| Capital lease obligation | 415,610 |
| Bonds payable | <u>10,575,000</u> |

Total long-term liabilities due and payable after one year 11,345,997

Total long-term liabilities 14,236,794

Total liabilities 14,528,035

NET POSITION

| | |
|----------------------------------|--------------------|
| Net investment in capital assets | 249,272 |
| Restricted for debt service | 8,818,916 |
| Unrestricted | <u>(8,347,980)</u> |
| Total net position | <u>\$ 720,208</u> |

The accompanying notes are an integral part of these statements.

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit of the County of Monroe, New York)

STATEMENT OF REVENUES, EXPENSES AND CHANGE IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2015

| | |
|--|--------------------|
| OPERATING REVENUE: | |
| Maintenance and support services | \$ 6,260,867 |
| Leasing revenue | 925,298 |
| Interest on investment in direct-financing lease | 136,520 |
| Other | <u>1,438</u> |
| Total revenues | <u>7,324,123</u> |
| OPERATING EXPENSES: | |
| Project costs - | |
| Hosting, training, and implementation | 697,138 |
| Network management and maintenance | 1,044,130 |
| Interest and fees | 705,219 |
| Depreciation | 312,001 |
| Management services and support | 358,083 |
| Copier maintenance | 246,922 |
| Other | <u>165,287</u> |
| Total project costs | <u>3,528,780</u> |
| Administration - | |
| Professional fees | 77,139 |
| Other | <u>261</u> |
| Total administration | <u>77,400</u> |
| Total expenses | <u>3,606,180</u> |
| OPERATING INCOME | <u>3,717,943</u> |
| NONOPERATING EXPENSES: | |
| Investment loss, net | <u>(2,513)</u> |
| Total nonoperating expenses | <u>(2,513)</u> |
| CHANGE IN NET POSITION | <u>3,715,430</u> |
| NET POSITION - beginning of year | <u>(2,995,222)</u> |
| NET POSITION - end of year | <u>\$ 720,208</u> |

The accompanying notes are an integral part of these statements.

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit of the County of Monroe, New York)

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015

| | |
|---|---------------------|
| CASH FLOW FROM OPERATING ACTIVITIES: | |
| Cash received from maintenance and support services | \$ 6,260,867 |
| Cash received from leasing revenue | 925,298 |
| Cash received from interest on investment in direct-financing lease | 136,520 |
| Cash received from other operating revenues | 876 |
| Cash payments for interest and fees | (710,671) |
| Cash payments for other operating expenses | (121,000) |
| Cash payments to suppliers | <u>(2,570,336)</u> |
| Net cash flow from operating activities | <u>3,921,554</u> |
| CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | |
| Repayment on capital lease obligation | (301,680) |
| Repayment on bonds payable | <u>(2,455,000)</u> |
| Net cash flow from capital and related financing activities | <u>(2,756,680)</u> |
| CASH FLOW FROM INVESTING ACTIVITIES: | |
| Payments under direct-financing lease | 670,713 |
| Investment management fees | (2,513) |
| Purchases of limited use assets | (11,464,517) |
| Proceeds from sale of limited use assets | <u>9,948,262</u> |
| Net cash flow from investing activities | <u>(848,055)</u> |
| CHANGE IN CASH | 316,819 |
| CASH - beginning of year | <u>991,035</u> |
| CASH - end of year | <u>\$ 1,307,854</u> |
| NON-CASH TRANSACTION: | |
| Copier equipment included in accounts payable at year-end | <u>\$ 18,697</u> |

(Continued)

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit of the County of Monroe, New York)

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015

| | |
|--|---------------------|
| RECONCILIATION OF CHANGE IN OPERATING INCOME TO NET CASH FLOW FROM OPERATING ACTIVITIES: | |
| Operating income | \$ 3,717,943 |
| Adjustments to reconcile change in operating income to net cash flow from operating activities: | |
| Depreciation expense | 312,001 |
| Changes in: | |
| Prepaid expenses and other current assets | (90,264) |
| Accounts payable and accrued expenses | (17,564) |
| Other operating revenues | <u>(562)</u> |
| Net cash flow from operating activities | <u>\$ 3,921,554</u> |

The accompanying notes are an integral part of these statements.

UPSTATE TELECOMMUNICATIONS CORPORATION
(A Discretely Presented Component Unit of the County of Monroe, New York)

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015

1. THE ORGANIZATION

Upstate Telecommunications Corporation (UTC), is a New York not-for-profit corporation organized in March 2005 to provide technology and telecommunications services to Monroe County (the County). UTC was formed as a local development corporation of the County. All service revenue derived by UTC is currently received solely from the County and as such UTC's existence is dependent upon this continuing relationship. UTC is included as a discretely presented component unit within the County's basic financial statements due to the County's ability to impose will on UTC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

UTC's financial statements are prepared in conformity with accounting principles generally accepted in the United States as set forth by the Governmental Accounting Standards Board (GASB) for proprietary funds.

Basis of Presentation

GASB requires the classification of net position into three categories defined as follows:

- Net investment in capital assets - This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets, if applicable. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of net investment in capital assets. Rather, that portion of the debt is included in the same net position component as the unspent proceeds.
- Restricted net position - This component of net position consists of amounts which have external constraints placed on their use imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net position - This component of net position consists of net position that does not meet the definition of "net investment in capital assets," or "restricted."

When both restricted and unrestricted resources are available for use, it is UTC's policy to use restricted resources first, and then unrestricted resources as they are needed.

Cash

Cash includes cash on hand, demand deposits and savings accounts.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets

Capital assets are recorded at cost, if purchased, or fair value at the date of donation. UTC capitalizes equipment purchases with a cost greater than \$1,000, and which have useful lives greater than one year. Capital assets consist of photocopying equipment used by its primary customer. Depreciation is provided using the straight-line method over the assets' estimated useful lives, or seven (7) years, or the lease term, whichever is shorter.

Investment in Direct-Financing Lease

The cost of telecommunications equipment purchased by UTC and leased to the County is recorded as a direct-financing lease. Unearned income is calculated using the interest rate in place on the bonds that were issued to facilitate the purchase of the underlying equipment. Lease principal payments are recognized concurrent with the repayment schedule on the outstanding bonds. Investment in direct-financing lease is stated at unpaid principal balances, less an allowance for losses, if applicable. Management periodically evaluates the lease for collectability based on inherent collection risks and adverse situations that may affect the borrower's ability to repay. If no contractual payments have been received for a period of time the lease would be considered delinquent. After all collection efforts are exhausted, any amounts deemed uncollectible based upon an assessment of the debtor's financial condition are written off. As of December 31, 2015, management determined that an allowance is not necessary.

Limited Use Assets

Limited use assets consist of funds required under the bond indenture and are invested by the trustee in money market funds, commercial paper, mortgage backed securities or U.S. government obligations and are recorded at fair market value based on quoted market prices. Interest, dividends, investment management fees, and gains (losses) on limited use assets are shown as investment income (loss), net in the accompanying financial statements. Limited use assets are exposed to various risks, such as interest rate, market, and credit risk. Due to the level of risk associated with certain limited use assets, it is at least reasonably possible that changes in the values of limited use assets will occur in the near term and that such change could materially affect the amounts reported in the accompanying financial statements.

Income Taxes

UTC is exempt from Federal reporting requirements under Internal Revenue Service Revenue Procedure 95-48, 1992 C.C. 418 as a governmental unit or affiliate of a governmental unit as described in the procedure.

Revenue Recognition

- Interest on investment in direct-financing lease - The interest imputed over the term of the direct-financing lease is recorded in this financial category.
- Maintenance and Support Services - Under UTC's agreement with the County, annual payments received are also intended to cover operating costs incurred in connection with the agreement such as maintenance of equipment, technology upgrades, license fees, and technology support. The portion of the County's annual payment not allocated to interest or payment of principal is recorded as maintenance and support revenue.
- Leasing Revenue - Leasing revenue is recognized in accordance with the operating lease agreement with the County (See Note 8). Amounts recorded are intended to cover UTC's costs for maintenance, insurance, management fees, and other costs associated with servicing the installed equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Deferred Outflows of Resources

In addition to assets, the Statement of Net Position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. UTC entered into an interest rate swap contract in order to hedge the risk that the interest rate on its variable-rate debt will negatively affect cash flows. UTC's interest rate swap contract has proven to be an effective hedging instrument in 2015. An effective hedging instrument's gain is reported as a deferred outflow on the Statement of Net Position.

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. DEPOSITS WITH FINANCIAL INSTITUTIONS AND INVESTMENTS

Policies

UTC follows an investment and deposit policy, the overall objective of which is to adequately safeguard the principal amount of funds invested or deposited; investments shall be sufficiently liquid in order to meet obligations as they become due; and funds shall be invested in such a way as to earn the maximum yield possible given the first two objectives.

UTC's monies shall be deposited in a bank or banks designated by the Board of Directors; and, to the extent practicable, consistent with the cash requirements of UTC, all such money shall be deposited in interest bearing accounts.

UTC is incorporated as a not-for-profit and as such is not required to maintain collateral on its accounts.

Interest Rate Risk

Interest rate risk is the risk that the fair value of investments will be affected by changing interest rates. UTC has an investment policy that limits its deposits to certain investments as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

UTC's policy is to minimize the risk of loss due to failure of an issuer or other counterparty to an investment to fulfill its obligations. UTC's investment and deposit policy authorizes the reporting entity to purchase the following types of investments:

- Direct or indirect obligations of the State or any municipality, instrumentality, or political subdivision thereof, or the United States of America or any instrumentality thereof;
- Obligations, the full and timely payment of the principal and interest of which are directly and unconditionally guaranteed by the State or United States of America;
- Bankers' acceptances of, or certificates of deposits issued by, or time deposits or other banking arrangements or deposits with a Bank with a rating of investment grade at all times by a Rating Agency;

3. DEPOSITS WITH FINANCIAL INSTITUTIONS AND INVESTMENTS (Continued)

Credit Risk (Continued)

- Commercial paper of any Corporation which has been classified for rating purposes by a Rating Agency as Prime - 1 and by Standard & Poor's as A-1;
- Money market funds or other mutual funds which have been classified with at least an AAA rating as determined by Standard & Poor's Rating Group or AAA rating as determined by Moody's Investor's Service, Inc.

Total cash and limited use assets by type as of December 31, 2015 are as follows:

| | <u>Carrying Values</u> | <u>Bank Balances</u> |
|------------------------------------|------------------------|----------------------|
| U.S. government money market funds | \$ 8,818,916 | \$ 8,818,916 |
| Cash | <u>1,307,854</u> | <u>1,307,854</u> |
| | <u>\$ 10,126,770</u> | <u>\$ 10,126,770</u> |

At December 31, 2015, 100% of UTC's deposits, excluding those held by Trustee, were deposited in one financial institution.

4. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2015 was as follows:

| | Balance <u>01/01/15</u> | <u>Additions</u> | <u>Deletions</u> | Balance <u>12/31/15</u> |
|---|----------------------------|---------------------|------------------|----------------------------|
| Depreciable capital assets: | | | | |
| Copier equipment | <u>\$ 3,097,776</u> | <u>\$ 18,697</u> | <u>\$ -</u> | <u>\$ 3,116,473</u> |
| Total depreciable capital assets | <u>3,097,776</u> | <u>18,697</u> | <u>-</u> | <u>3,116,473</u> |
| Less: Accumulated depreciation on copier equipment | <u>(1,823,793)</u> | <u>(312,001)</u> | <u>-</u> | <u>(2,135,794)</u> |
| Total capital assets, net | <u>\$ 1,273,983</u> | <u>\$ (293,304)</u> | <u>\$ -</u> | <u>\$ 980,679</u> |

5. INVESTMENT IN DIRECT-FINANCING LEASE

UTC has leased its telecommunications equipment to the County under the terms of a direct-financing lease agreement that states that UTC will be paid average annual payments of approximately \$6,200,000 per year by the County commencing February 7, 2005 and terminating February 2, 2021. The annual lease payments also cover certain operating costs such as maintenance, technology upgrades and license fees. The annual continuation of this agreement is solely dependent upon appropriations granted by the Monroe County Legislature under the annual budgetary process and therefore is not guaranteed. The portion of the annual lease payments relating to the operating costs and future equipment upgrades have not been included in the investment in direct-financing lease on the accompanying balance sheet. The following table summarizes the components of the direct-financing lease at December 31, 2015:

| | |
|---------------------------------------|---------------------|
| Future lease payments - gross | \$ 3,865,922 |
| Less: Unearned income (3.8% interest) | <u>(273,299)</u> |
| | <u>\$ 3,592,623</u> |

Future scheduled payments under this agreement are as follows for the years ending December 31:

| | |
|------|---------------------|
| 2016 | \$ 703,497 |
| 2017 | 723,989 |
| 2018 | 729,454 |
| 2019 | 733,551 |
| 2020 | <u>702,132</u> |
| | <u>\$ 3,592,623</u> |

Revenue Concentration

In 2015, the County accounted for 98% of total revenue for UTC.

6. LONG-TERM DEBT

Long-term debt activity for the year ended December 31, 2015 was as follows:

| Description | Balance 01/01/15 | Increases | Decreases | Balance 12/31/15 | Due in One Year | Due in More Than One Year |
|---|----------------------|-------------|-----------------------|----------------------|---------------------|---------------------------------|
| Series 2005 Variable Rate Demand Revenue Bonds | <u>\$ 15,605,000</u> | <u>\$ -</u> | <u>\$ (2,455,000)</u> | <u>\$ 13,150,000</u> | <u>\$ 2,575,000</u> | <u>\$ 10,575,000</u> |
| Capital lease | <u>\$ 1,033,087</u> | <u>\$ -</u> | <u>\$ (301,680)</u> | <u>\$ 731,407</u> | <u>\$ 315,797</u> | <u>\$ 415,610</u> |

6. LONG-TERM DEBT (Continued)

Bonds Payable

UTC issued Series 2005 Variable Rate Demand Information Technology Revenue Bonds (the Bonds) in order to fund a telecommunications and technology project. The Bonds were issued on March 30, 2005 in the amount of \$32,465,000 and mature on March 1, 2020. The bondholders are paid interest monthly on the bonds at a variable rate (0.06% at December 31, 2015) as determined by the bank semi-annually on January 1 and July 1 of each year. The Bonds are subject to redemption, prior to maturity, at the option of the issuer. The Bonds are collateralized under the terms of the bond agreement. The collateral on the bonds is an interest in UTC's management contract with the County (see Note 9) and an interest in UTC's lease with the County (see Note 5). UTC pays interest to the bank monthly at a variable rate as determined by the bank. Cash paid for interest was \$565,329 in 2015. Interest expense was \$559,877 in 2015.

The bond agreement requires a letter of credit to be maintained with the bank in the amount of \$13,329,645, of which \$13,150,000 is available to pay the principal on the Bonds and \$179,645 is available to pay interest on the bonds. The letter of credit may be reduced as the outstanding principal is reduced. The letter of credit expires on March 31, 2017 at which time the Bonds will be callable unless an extension on the letter of credit is approved. The Bonds are subject to mandatory sinking fund installments on March 1 of each year which commenced on March 1, 2007, and are used to repay the outstanding bonds and will continue annually each year until the outstanding principal amount of the Bonds has been paid.

The schedule of sinking fund repayments is as follows:

| <u>Payment Date</u> | <u>Installment</u> |
|---------------------|----------------------|
| 2016 | \$ 2,575,000 |
| 2017 | 2,650,000 |
| 2018 | 2,670,000 |
| 2019 | 2,685,000 |
| 2020 | <u>2,570,000</u> |
| | <u>\$ 13,150,000</u> |

The Bonds contain a remarketing feature that permits the bonds to be remarketed on a weekly basis for purposes of resetting interest rates on the outstanding bonds. Failure of the Bonds to be remarketed would require the use of UTC's letter of credit to purchase any un-marketed bonds. In the event a tender advance is made on the letter of credit, UTC would be required to repay the bank subject to the terms of the agreement on demand.

Letter of Credit Covenants

In connection with the letter of credit agreement, UTC is required to meet certain financial and operational covenants. As of December 31, 2015, UTC was in compliance with these covenants.

6. LONG-TERM DEBT (Continued)

Capital Lease Obligation

UTC has entered into a note payable agreement with a bank requiring quarterly payments of \$86,012, including interest at 4.6%, through January 2018. The related equipment collateralizes the capital lease obligation. This agreement allows UTC to purchase the leased equipment at the end of the lease term for \$1.

Future scheduled payments under this agreement are as follows for the years ending December 31:

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|--------|-------------------|------------------|-------------------|
| 2016 | \$ 315,797 | \$ 28,249 | \$ 344,046 |
| 2017 | 330,576 | 13,470 | 344,046 |
| 2018 | <u>85,034</u> | <u>978</u> | <u>86,012</u> |
| Totals | <u>\$ 731,407</u> | <u>\$ 42,697</u> | <u>\$ 774,104</u> |

7. INTEREST RATE SWAP

Objectives

UTC entered into an interest rate swap agreement with M&T Bank in order to mitigate the volatile risk of the variable rate of the bonds for the period December 1, 2008 through December 1, 2016. The ultimate objective of the interest rate swap contract is to “fix” much of UTC’s interest payment on the variable-rate bonds at 3.80%. This rate is intended to be a lower interest rate than UTC could have obtained by issuing fixed-rate debt.

Hedge Effectiveness

UTC used the consistent critical terms method to evaluate the hedge effectiveness of the interest rate swap contract. This method evaluates effectiveness by qualitative consideration of the critical terms of the hedgeable item (i.e., variable-rate debt) and the hedging derivative instrument (i.e. interest rate swap). Under the consistent critical terms method, if the critical terms of the hedgeable item and the hedging derivative instrument are the same, or similar, the changes in cash flows of the hedging derivative instrument will offset substantially the changes in cash flows of the hedgeable item. UTC considered the interest rate swap contract to be effective due to the fact that the changes in cash flow from the interest rate swap substantially offset the changes in price of the variable-rate debt and there was no cash transaction at inception of contract.

7. INTEREST RATE SWAP (Continued)

Terms

The terms of the interest rate swap agreement were as follows:

| <u>Notional Amount</u> | <u>Counter-Party Credit Rating *</u> | <u>Effective Date</u> | <u>Maturity Date</u> | <u>Terms</u> |
|------------------------|--------------------------------------|-----------------------|----------------------|--|
| \$13,150,000 | A- | 12/1/2008 | 12/1/2016 | Payments to be made the first of every month commencing on 1/1/2009 to and including the termination date subject to adjustment in accordance with the following business day convention at a fixed rate of 3.80%. |

* As noted by Standard and Poor's

The fair value balances and notional amounts of derivative instruments outstanding at December 31, 2015 classified by type, and the changes in fair value of such derivative instruments for the year then ended are as follows:

| <u>Description</u> | <u>Changes in Fair Value</u> | | <u>Fair Value at 12/31/15</u> | | <u>Notional</u> |
|-------------------------------|------------------------------|---------------|-------------------------------|---------------|-----------------|
| | <u>Classification</u> | <u>Amount</u> | <u>Classification</u> | <u>Amount</u> | |
| <i>Cash flow hedges:</i> | | | | | |
| Pay-fixed interest rate swaps | Deferred outflows | \$ 355,387 | Long-term liability | \$ (355,387) | \$13,150,000 |

The fair value of the interest rate swap was estimated using a proprietary pricing service, which considers the assumptions used to estimate fair value to be proprietary information and declines to make such information available.

Credit Risk

At December 31, 2015, UTC was not exposed to credit risk because the interest rate swap had a negative fair value. However, should interest rates change such that the fair value of the swap becomes positive, UTC would be exposed to credit risk in the amount of the swap's fair value.

Interest Rate Risk

UTC is exposed to interest rate risk on its interest rate swaps. On its pay-fixed, receive-variable interest rate swap, as the Securities Industry and Financial Markets Association (SIFMA) Muni Swap Index decreases; UTC's net payment increases.

Basis Risk

At December 31, 2015, UTC was not exposed to basis risk because the variable payment received from the counterparty is determined on the same basis used to calculate the bond floating rate for the associated bonds.

7. INTEREST RATE SWAP (Continued)

Termination Risk

Either UTC or its counterparty may terminate the hedging derivative instrument if the other party fails to perform under the terms of the contract. Termination could result in UTC being required to make a termination payment.

Rollover Risk

UTC is exposed to rollover risk on the interest rate swap because the interest rate swap contract terminates prior to the maturity of the hedged debt. If the option to terminate the hedging derivative instrument is exercised, UTC will be re-exposed to the risks being hedged by the hedging derivative instrument.

Hedging Derivative Instrument Payments and Hedged Debt

As of December 31, 2015, aggregate debt service requirements of UTC's variable-rate debt and net receipts/payments on the associated hedging derivative instrument (interest rate swap) are noted in the table below. The amounts in the table below assume that the current interest rates on the variable-rate bonds and the current reference rates of the interest-rate swap will remain the same for their term. In addition, since the interest rate swap contract terminates on 12/1/2016, the table shows the payments through that date rather than the maturity date of the variable-rate bonds, which is 3/1/2020.

At December 31, 2015, aggregate debt service requirements of UTC's debt and net payments on the related hedging derivative instrument (interest rate swap) are as follows:

| <u>Year ending</u> | <u>Principal</u> | <u>Interest</u> | <u>Hedging Derivative, net</u> | <u>Net Cash Flows</u> |
|--------------------|---------------------|-----------------|------------------------------------|-----------------------|
| 12/31/2016 | <u>\$ 2,575,000</u> | <u>\$ 7,931</u> | <u>\$ 393,919</u> | <u>\$ 2,976,850</u> |

8. OPERATING LEASE AGREEMENT

UTC has leased copier equipment to the County under the terms of an operating lease agreement commencing December 18, 2007 and terminating December 17, 2019. The annual lease payment also covers certain operating costs such as maintenance, technology upgrades, insurance, and management fees. The annual continuation of this agreement is solely dependent upon appropriations granted by the Monroe County Legislature under the annual budgeting process and therefore is not guaranteed. The assets being leased to the County have a cost of \$3,116,473, accumulated depreciation of \$2,135,794, and a carrying value of \$980,679.

Future payments expected under this agreement are as follows for the years ending December 31:

| | |
|------|---------------------|
| 2016 | \$ 926,523 |
| 2017 | 927,774 |
| 2018 | 926,067 |
| 2019 | <u>896,374</u> |
| | <u>\$ 3,676,738</u> |

9. COMMITMENTS

Management Services Agreement

UTC has a long-term contract with the County known as the Information Technology Systems and Service Agreement (the Agreement). Under an amendment of the Agreement, effective April 1, 2014, the County provides certain administrative services to manage and support the day-to-day business activities of UTC. UTC is billed by the County quarterly, based on the actual cost incurred. The management fee for these services was \$358,083 in 2015. At December 31, 2015, UTC had a liability to the County in the amount of \$81,978, for fourth quarter management fees.

10. ACCOUNTING PRONOUNCEMENTS ISSUED NOT YET IMPLEMENTED

In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application*. The objective of this Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. UTC is required to adopt the provisions of this Statement for the year ending December 31, 2016.

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* which supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* and amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 64, 74, and 82. Statement No. 76 reduces the number of categories of authoritative generally accepted accounting principles (GAAP) hierarchy and the framework for selecting those principles to two categories. The primary category "Category A" will consist of officially established GASB Statements and GASB Interpretations heretofore issued and currently in effect. The second category "Category B" will consist of GASB Technical Bulletins, GASB Implementation Guides when presented in the form of a *Comprehensive Implementation Guide*, and literature of the AICPA cleared by the GASB. The goal of Statement No. 76 is to help governments apply financial reporting guidance with less variability, therefore improving usefulness and comparability of financial statement information among state and local governments. UTC is required to adopt the provisions of Statement No. 76 for the year ending December 31, 2016, and should be adopted retroactively, with early adoption permitted.

11. SUBSEQUENT EVENT

On January 21, 2016, the UTC Board approved a resolution to take all steps necessary to dissolve the Corporation and to work with the County to transition its functions, assets and liabilities to the County. UTC is in the process of planning for this transition.

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 7, 2016

To the Board of Directors of
Upstate Telecommunications Corporation:

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 Upstate Telecommunications Corporation (UTC), a public benefit corporation and a discretely presented component unit of the County of Monroe, New York, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise UTC's basic financial statements, and have issued our report thereon dated March 7, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered UTC 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 UTC's internal control. Accordingly, we do not express an opinion on the effectiveness of UTC'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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(Continued)

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 UTC'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.