March 8, 2019

Dear,

Enclosed please find CTC's response to the City of Scandia Broadband RFP with a response due date of March 11, 2019.

CTC has a reputation of being one of the most flexible, successful and trusted broadband partners in Minnesota and around the Country. CTC staff are often asked to speak about our innovative and successful projects both locally and nationally to aid others in learning how to collaborate and build successful broadband projects – especially those in collaboration with public entities and private organizations with similar missions statements.

CTC is careful to select projects based on our intuition of being able to build and sustain a long-term partnership built on trust and proven results amongst all parties involved in the partnership.

Please contact me with questions about our response or to set-up a time to discuss in greater detail.

Sincerely,

Joe Buttweiler
Partnership Development Manager, CTC

**CTC Brainerd**
1102 Madison Street
Brainerd, MN 56401

**CTC Baxter**
14385 Edgewood Drive
Baxter, MN 56425

**CTC Crosby**
8 Third Avenue NW
Crosby, MN 56441

**(800) 753-9104**
**(218) 454-1234**
**goctc.com**

**Partnership Proposal**

Project Scope:

CTC will coordinate efforts with the City of Scandia to develop and apply for State Broadband grant funds or other possible grant opportunities which will enable construction of a fiber to the premise network capable of providing 1Gbps symmetrical internet services to 100% of establishments located within the City of Scandia.

Design work will build upon already completed preliminary design indicating approximately 251 miles of fiber optic cable need to be placed. See attachments: Scandia high level design cost estimate 8-13-18 and Scandia Design Reduced for more information.

Funding Application Assistance:

CTC has applied for and been awarded multiple Minnesota Border to Border Broadband grants in 2014 and 2015. In 2016 CTC prepared an application on behalf of Mille Lacs Energy Cooperative and was subsequently awarded marking the first broadband grant offered to an electric utility in the State of Minnesota. In addition to Minnesota broadband grants CTC or CTC staff has written numerous successful grant applications to USDA's Rural Utility Service which have resulted in broadband grant funding being awarded to CTC.

Construction:

The following timeline is anticipated to expeditiously complete this project:

June-September 2019: State Broadband Grant Application Creation and Submittal

December 2019-January 2020: Grant Application Awarded and Accepted by City of Scandia

January 2020-April 2020: Final Design Engineering, Construction bidding.

May 2020 – November 2020: Construction of FTTP network (100% completion)

August 2020: Begin Customer Installation and Turn-up of Customer Services.

Service Expectations:

The CTC proposal includes the execution of three (3) separate agreements between the City of Scandia and CTC.

Construction Agreement. The construction agreement requires CTC to initiate, manage, oversee and be responsible for all design, engineering and construction related activities in order to expedite successful customer installation and service delivery.

Lease Agreement. A lease agreement assigns CTC exclusive access to the city owned fiber optic network. The agreement assigns CTC to be responsible for 100% of all network management, maintenance and operating requirements. CTC is responsible for providing services to members (any resident or business subscribing to service becomes a member of the CTC cooperative and earns cooperative benefits including voting rights and capital credit patronage). CTC collects 100% of member revenue and a lease payment is made to the City of Scandia in exchange for the use of the fiber optic network. The City has no roles or responsibilities associated with operation, maintenance, services or upgrades to the fiber optic network.

Option and Right of First Refusal. Enables CTC to purchase the fiber optic asset from the City of Scandia for a pre-determined price at any time during the term of the lease agreement or at CTC's first option upon the lease term expiring.

Example agreements will be provided upon request.

Partnership Proposal:

CTC and the City shall work together to assemble a MN broadband grant application with each entity contributing the work which caters to its strengths. For example, CTC will provide technical, operational and network related components while the City solicits letters of support from residents, businesses and anchor institutions. The construction and lease agreement will specify the roles and responsibility of each organization relating to FTTP construction, operation, maintenance, service delivery, troubles and lease payments to the City by CTC.

Ownership of assets. The City of Scandia shall own the fiber optic cables. CTC will provide funding and ownership of all electronics (Alternate option for City to fund and own entire network and the electronics). CTC will also provide funding for all labor required to perform customer installation thus driving down the percentage of (not total grant funds sought) making the application more competitive.

The table below outlines some of the public-private partnerships CTC is currently involved in and the grant funding awarded for each project:

| Year | Partner | Objective | Results |
|---|---|---|---|
| 2010 | Brainerd ISD, Local Govt, Health Care | Build 10G fiber ring for ISD, Govt and Health Care use. Expand to private business and residential users. | Local partners have private fiber network. Over 4,000 private establishments have access to fiber optics |
| 2011 | Little Falls Community Development | Retain key business's in the community who do not have adequate broadband and attract new business. | Saved multiple key businesses which are now growing and attracted new anchor business. |
| 2012 | Arrowhead Electric Cooperative | Mentor and support electric cooperative's FTTP project in Cook County, MN | Fantastic partnership with nearly 3,000 FTTP connections. |
| 2013 | Crosslake Communications | Provide management services of City owned network | Overhauled network and managed services enabling the City to sell to a new private owner who is making additional investments to provide services to local residents. |
| 2014 | State of MN Broadband Grant | Connect 391 unserved establishments with FTTP | $4.2M project completed under budget and ahead of schedule. Grant contract closed out successfully. |
| 2015 | State of MN Broadband Grant | Connect 272 unserved establishments with FTTP | $1.6M project completed under budget and ahead of schedule. Grant contract closed out successfully. |
| 2017 | City of Long Prairie | Manage construction and offer FTTP services over a City owned network. | Succesfully constructed a $4M FTTP network and CTC services available to citizens of Long Prairie. |
| 2017 | Mille Lacs Energy Cooperative | Mentor and support electric cooperative's FTTP project in Aitkin County, MN | Mutually beneficial partnership with over 200 current establishments being served with more being scheduled as construction season resumes in Minnesota. |

## Cost Proposal:

Source of Capital Funding:

| | Total Cost | Grant Funds Requested | Scandia Funded | CTC Funded |
|---|---|---|---|---|
| Engineering | $ 1,407,715 | $ - | $ 1,407,715 | $ - |
| Construction | $ 9,321,290 | $ 5,000,000 | $ 4,321,290 | $ - |
| Customer Installation | $ 1,359,277 | $ - | $ - | $ 1,359,277 |
| Electronics | $ 1,289,500 | $ - | $ - | $ 1,289,500 |
| | $ 13,377,782 | $ 5,000,000 | $ 5,729,005 | $ 2,648,777 |
| | | | | |
| Grant funding as a percentage of total project cost: | | | 37.4% | |
| Scandia funding as a percentage of total project cost: | | | 42.8% | |
| CTC funding as a percentage of total project cost: | | | 19.8% | |

# Attachment C – Service Level Reponses

1. Provide the speed tiers (download and upload) and pricing structure that will be offered over the initial five years of the project.

**CTC** 

Baxter / (218) 454-1234 / 14385 Edgewood Drive
Crosby / (218) 545-3000 / 8 Third Avenue NW
Toll Free / (800) 753-9104 / www.goctc.com

LONG PRAIRIE

# Fiber Connection Packages

## GOLD* $162.35/month

Package Includes:

- 250Mbps/250Mbps High Speed Internet
- Digital TV Entertainment Package
- Big Value Tier TV Package
- High Definition
- DVR
- Ebill & Autopay

## SILVER* $131.35/month

Package Includes:

- 100Mbps/100Mbps High Speed Internet
- Digital TV Entertainment Package
- Local Phone Service & Features
- Ebill & Autopay

Telephone features include Caller ID, Call Waiting, Call Forwarding, 3-Way Calling, and Speed Dial.

## BRONZE* $121.35/month

Package Includes:

- 100Mbps/100Mbps High Speed Internet
- Digital TV Entertainment Package
- Ebill & Autopay

## SKITTER TV* $81.95/month

Package Includes:

- 100Mbps/100Mbps High Speed Internet
- Wireless Router & Support
- Roku Player (FREE)
- Skitter TV (30 Live Channels via Skitter app)
- Ebill & Autopay

## *Want Even Faster Internet?*

Call today to Upgrade your Internet Bundle to a faster speed. CTC offers the fastest Internet speeds available:

- 250Mbps
- 500Mbps
- 1 Gig (1,000 Mbps)

With symmetrical speeds, you can upload as fast as you can download.

Call CTC today at (800) 753-9104

Learn more about other services or order online at **www.goctc.com**

*Please call a CTC representative to verify exact services and pricing available for your home. Taxes and fees may apply.

## ADDITIONAL SERVICES

### INTERNET SERVICES*

| | |
|---|---|
| Internet Only - 1 Gig | $150.00 |
| Internet Only - 500M | $100.00 |
| Internet Only - 250M | $85.00 |
| Internet Only - 100M | $50.00 |
| Wireless Router Service | $7.95 |
| Tech Home | $5.95 |
| Tech Home Plus | $9.95 |
| Support | $14.95 |

### PHONE SERVICES*

| | |
|---|---|
| Local Phone | $14.95 |
| Voicemail | $3.50 |
| Inside Wire Maintenance | $1.95 |

*Prices reflect per month price

### TV SERVICES*

| | |
|---|---|
| Skitter | $31.95 |
| DVR | $9.95 |
| Whole Home DVR | $3.00 |
| HD Channels | $9.95 |
| Digital Set Top Box | $4.95 |
| Big Value Tier | $10.95 |
| HBO Movie Pack | $16.95 |
| Cinemax Movie Pack | $13.95 |
| HBO/Cinemax Movie Pack | $22.95 |
| Showtime Movie Pack | $14.95 |
| Showtime/The Movie Channel Pack | $17.95 |
| Starz/Encore Movie Pack | $13.95 |

*Prices reflect per month price

2. Please include proposed pricing information the specific un-discounted/rack rate pricing of unbundled internet-only service of 25 Mbps down and 3 Mbps upload and if offered, for service of 100 Mbps down and 20 Mbps upload, and 1G/1G.

CTC does not offer speeds lower than 100 Mbps download and 100Mbps upload. 100x100 = $50, 1Gb x 1Gb = $150.

3. Please describe the expected recovery time to a service level disruption to most common outages. Please describe the expected support level the City can expect from your service to the home and business owner.

Most trouble calls are able to be resolved remotely via our support centers located in Minnesota at the time of customer contact. In the event of a technician needing to be dispatched CTC works with members to determine the best time to meet with our technicians. Typically technicians are scheduled anywhere from same day to next business day. In the event of a voice (phone) related issue requiring a technician we will dispatch on weekends and holidays.

4. Please list the Internet Service Providers you can provide to the consumer of fiber internet.

We do not understand this question.

5. Please list the locations of customer service call centers and support locations that would be leveraged for end users support.

Brainerd, MN. Baxter, MN. Crosby, MN.

# Attachment A - Minimum Mandatory Requirements

Date: 3-8-19

Vendor: CTC

**Instructions:** Vendors should respond to the following questions by marking an "x" in either the yes or no column.

| No | Question | Yes | No |
|---|---|---|---|
| 1 | Can you or you affiliated partners provide Fiber to the Premises (FTTP) solution to all residents, businesses and anchor locations in Scandia, Minnesota? | X | |
| 2 | Can you or your affiliated partners provide Fiber to the Premises (FTTP) in Scandia, Minnesota using existing fiber backbone infrastructure? | X | x |
| 3 | Can you or your affiliated partners provide no later than 2022, provide all businesses and homes in Scandia access to high-speed broadband that meets the minimum download speeds of at least 25 megabits per second and minimum upload speeds of at least 3 megabits per second? | X | |
| 4 | Can you or your affiliated partners provide no later than 2022, provide all businesses and homes in Scandia access to high-speed broadband that meets the minimum download speeds of at least 100 megabits per second and minimum upload speeds of at least 20 megabits per second? | X | |

# Attachment B - Responsibility Assignment Matrix

Vendor:
Date:

**Instructions:** Vendors should indicate the expected roles in the partnership with the City of Scandia using the RACI model.
**R** = Responsible. **A** = Accountable. **C** = Consulted. **I** = Informed.
Vendors should indicate exactly one **A** (Accountable) for each role. In this Responsibility Assignment Matrix, unless otherwise

| Function or Role | Partner | Partner's Affiliates | Scandia | City's Representative |
|---|---|---|---|---|
| **Funding** | R | | AR | |
| **Project Management** | A | | I | I |
| **MN Deed Grant Application** | R | | | |
| **Permitting & ROW** | R | R | | |
| **Design/Engineering** | R | R | | |
| **QA/QC on Design/Engineering** | R | | | |
| **Warranties on Design/Engineering** | R | | | |
| **Construction** | R | R | | |
| **QA/QC on Construction** | R | R | | |
| **Warranties on Construction** | R | R | | |
| **Network Operations & Upgrades** | R | | | |
| **Customer Service** | R | | | |
| **Internet Service Provider (ISP)** | R | | N/A | |
| **Billing & Provisioning** | R | | | |

Vendors should indicate the expected roles in the partnership with the City using the RACI model. R = Responsible. A = Accountable. C = Consulted. I = Informed. Vendors should indicate exactly one A (Accountable) for each role. In the Responsibility

# Attachment C – Service Level Reponses

1. Provide the speed tiers (download and upload) and pricing structure that will be offered over the initial five years of the project.
2. Please include proposed pricing information the specific un-discounted/rack rate pricing of unbundled internet-only service of 25 Mbps down and 3 Mbps upload and if offered, for service of 100 Mbps down and 20 Mbps upload, and 1G/1G.
3. Please describe the expected recovery time to a service level disruption to most common outages. Please describe the expected support level the City can expect from your service to the home and business owner.
4. Please list the Internet Service Providers you can provide to the consumer of fiber internet.
5. Please list the locations of customer service call centers and support locations that would be leveraged for end users support.
6. Plan to identify potential customer base prior to implementation. What mechanism for take-rate estimates would the provider like to see for customer interest/potential customer base and engagement support from the City of Scandia, including the established Internet Focus Group in conjunction with the Economic Development Authority?

**Attachment D - Cost Proposal Form**

# Fiber to the Premises (FTTP) in Scandia, MN

Vendor:
Date:

__Instructions:__ Vendors are to fill out each tab according to their selected solution(s). Do NOT alter cost form!!! Please enter cost in Highlighted fields only. **Supplier must provide a single quote or financial proposal for the following:**

| | | Partner | City | |
|---|---|---|---|---|
| Total proposed FTTP Capital project cost to be funded by the Partner and City* | All inclusive Initial Cost** | 2648777 | 5729005 | |
| Annual proposed FTTP Operating cost to be funded by the Partner and City, both during the project and after completion | Annual all inclusive Cost** | 675000 | 0 | |
| | | **25 Mbps / 3 Mbps** | **100 Mbps/100 Mbps** | **1 Gbps/1 Gbps** |
| Monthly proposed cost to the fiber internet subscriber by internet speed, to include the combined fiber line and ISP cost | Monthly all inclusive Cost** | na | $50 | $150 |
| **Total Capital Investment by the partner into Scandia** | | $ 2648777 - | | |
| **Total Operating Cost by the partner** | | $ 675000 - | | |
| **Total Capital and Operating Cost to Scandia** | | $ 5729005 - | | |
| **Total monthly cost to the fiber internet subscriber** | | $ $50 OR $150 | OR OTHER SERVICE THEY SUBSCRIBE | |

*Partner must be able to breakdown project costs across customers that are considered "served" by the MN Deed Broadband definitions as they will be excluded from state funding request.

**All Inclusive Cost: Including, but not limited to, travel, hotel, car rental and other accommodations.

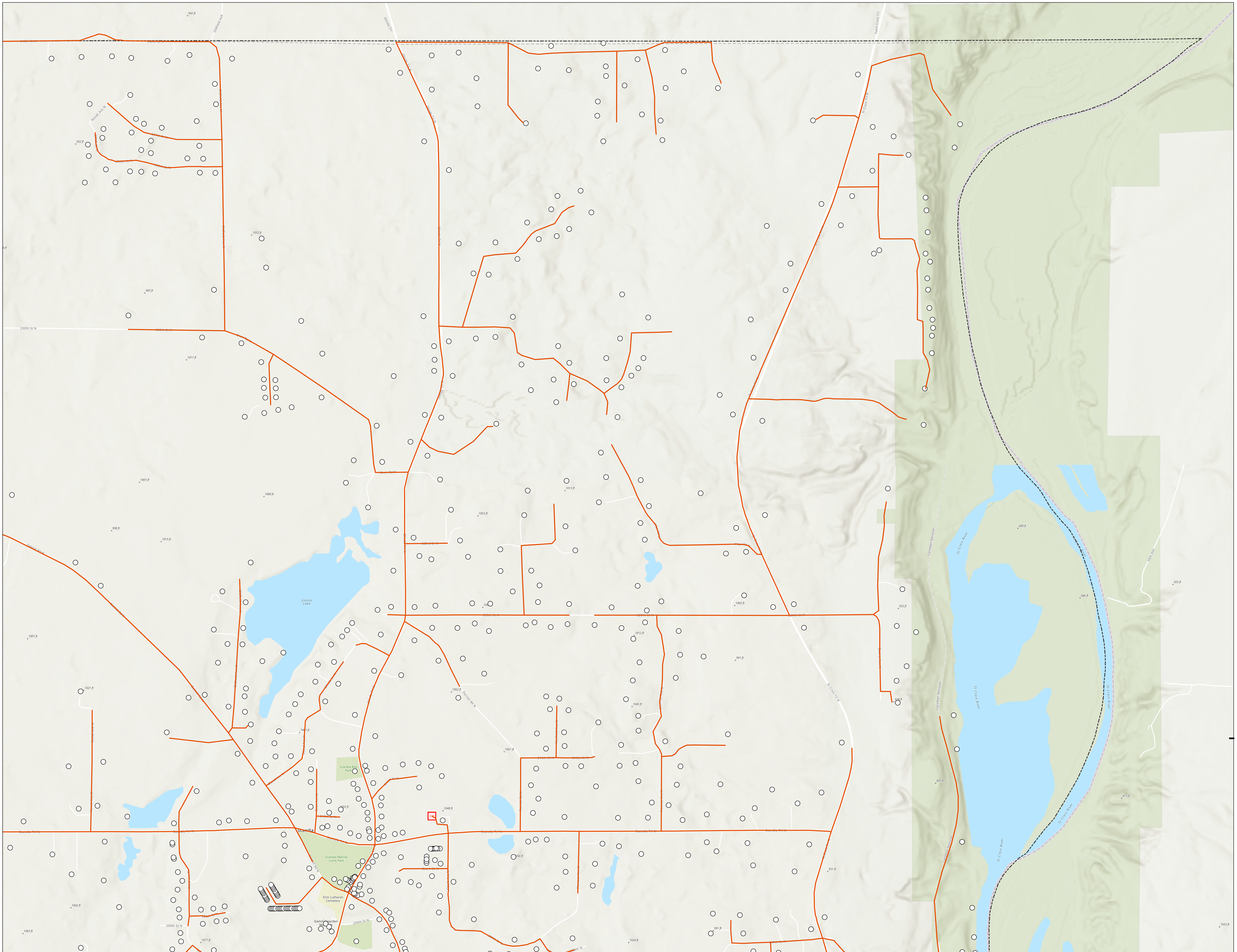
**Do NOT alter Score Sheet**
**Cost Proposals will be scored as follows: The points assigned to each offerors cost proposal will be based on the Lowest Proposal Cost or Highest Capital Investment. The offeror with the Lowest Proposed Cost or Highest Capital Investment will receive 100% of the cost points. All other offerors will receive a portion of the total cost points based on what percentage higher their Proposed Cost is than the Lowest Proposed Cost. An offeror who's Proposed Cost is more than double (200%) the Lowest Proposed Cost will receive no points. The formula to compute the Cost points is: Cost Points x (2 - (Proposed Cost/Lowest Proposed Cost)). The formula to compute the Investment points is: Investment Points x (Proposed Cost/Lowest Proposed Cost).**

This form doesn't consider a multitude of considerations. For example:
Is video offered? What is the customer take rate? Annual increase of labor and benefits. Will Scandia receive a lease payment from CTC?

## Consolidated Telecommunications Company
## High Level Plant and Access Estimate
## 2018 Scandia High Level Dedicated Plant Estimate - 100% Take Rate

| Phase Area | Corridor Mileage | | | | | | | | OSP | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Service Area | Rural Route Miles | Rural $$ Per mile cost | Lakeshore Route Miles | Lakeshore $$ | Suburban Route Miles | Suburban $$ | Urban Route Miles | Urban $$ | # of Subs | Total Miles | OSP Const. $ |
| *Rate/Unit* | | *$21,120* | | *$70,050* | | *$62,660* | | | | | |
| **Scandia CO** | 160.60 | $3,391,872 | 31.02 | $2,172,951 | 59.95 | $3,756,467 | | | 1785 | 251.57 | $9,321,290 |
| **Projects Total** | 160.60 | $3,391,872 | 31.02 | $2,172,951 | 59.95 | $3,756,467 | | | **1785** | **251.57** | **$9,321,290** |
| **Main Miles** | **92.43** | | **6.99** | | **27.52** | | | | | **126.94** | |
| **Drop Miles** | **68.17** | | **24.03** | | **32.43** | | | | | **124.63** | |

| Phase Area | Other | | | | | | Access Equipment | | | | | | | Engineer | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Service Area | Permits/Mile | Home Installation / Sub | Electrician / Sub | Cutover/Sub | FMDF/Term | Other Subtotal | ONT (Interior) | ONT (Exterior) | Electrical | OLT | Building - Hut / Land / w Power Plant | PON Cabinet | Access Subtotal | OSP Engineering | Total Estimated Project Cost |
| *Rate/Unit* | *$75.00* | *$395.00* | *$120.00* | *$215.50* | *$127.00* | | $400.00 | $400.00 | | $200.00 | | | | | |
| **Scandia CO** | $9,521 | $705,075 | $42,840 | $384,668 | $226,695 | **$1,368,798** | $606,900 | $107,100 | | $357,000 | $218,500 | | **$1,289,500** | $1,398,194 | **$13,377,782** |
| **Projects Total** | **$9,521** | **$705,075** | **$42,840** | **$384,668** | **$226,695** | **$1,368,798** | **$606,900** | **$107,100** | | **$357,000** | **$218,500** | | **$1,289,500** | **$1,398,194** | **$13,377,782** |
| **Main Miles** | | | | | | | | | | | | | | **$7,495** | ***/sub*** |
| **Drop Miles** | | | | | | | | | | | | | | **$53,177** | ***/mile*** |



**Central Office**

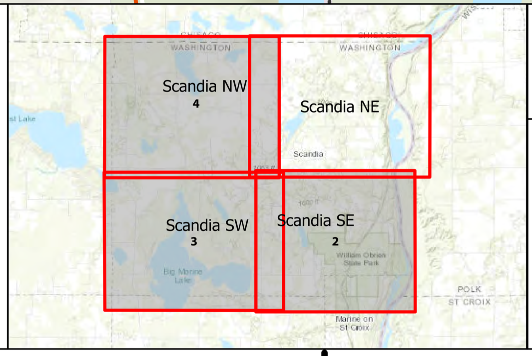
CO

**Construction Corridor**

**Service Drop**

**Scandia Township**

Feet
0 550 1,100





CNS
Cooperative Network Services, LLC
14 Main St SW - Menahga, MN 56464
218-564-3000


CTC

**Design Map**

*Map Name:* **Scandia NE**

*File Name:* Scandia Paper Maps

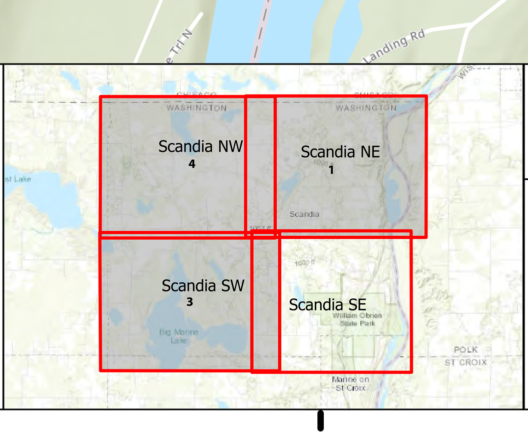
*Issue Date:* 8/2/2018


**Central Office** **Construction Corridor**

CO

**Service Drop** **Scandia Township**

Feet
0 550 1,100





Cooperative Network Services, LLC
14 Main St SW - Menahga, MN 56464
218-564-3000

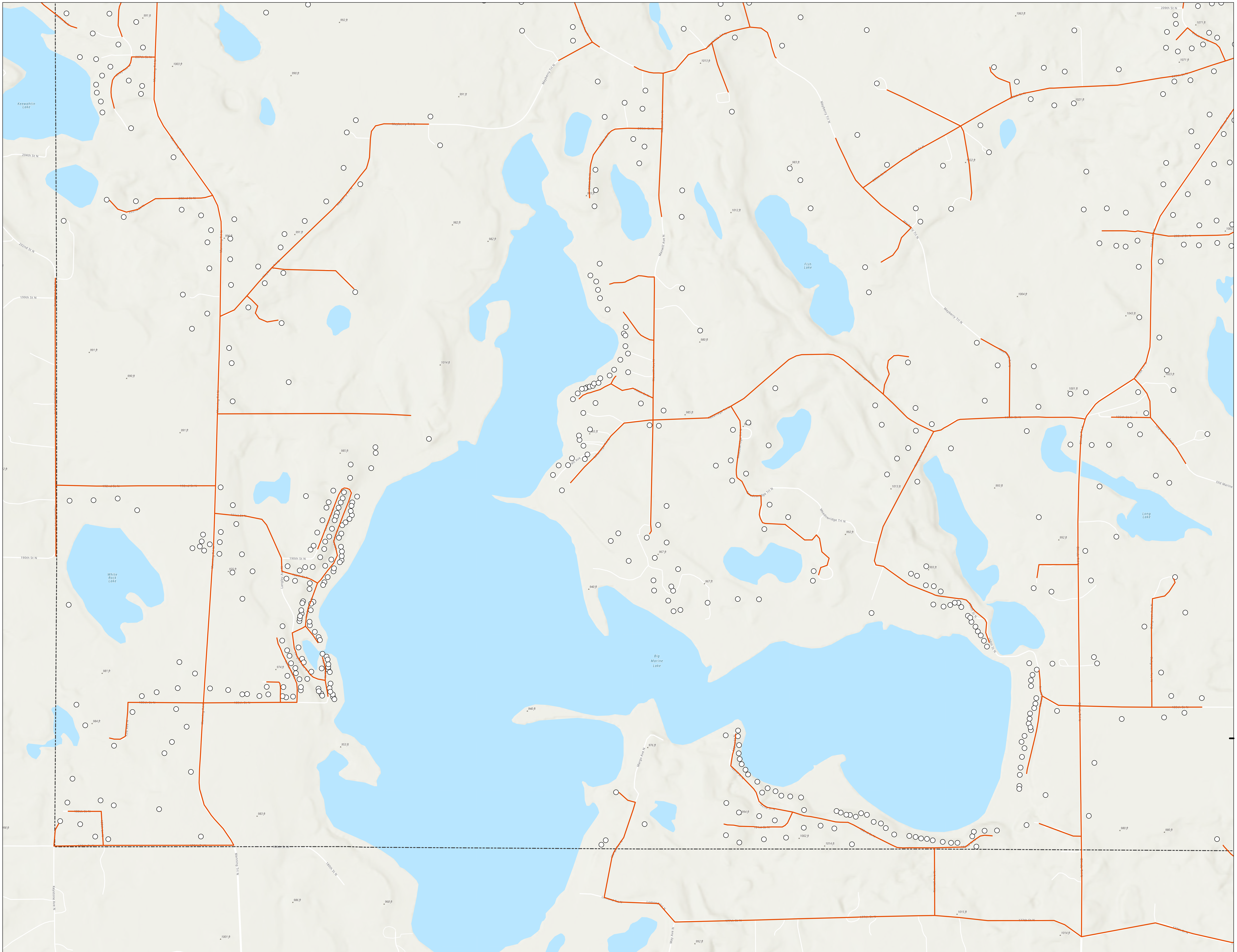

CTC

**Design Map**

*Map Name:* **Scandia SE**

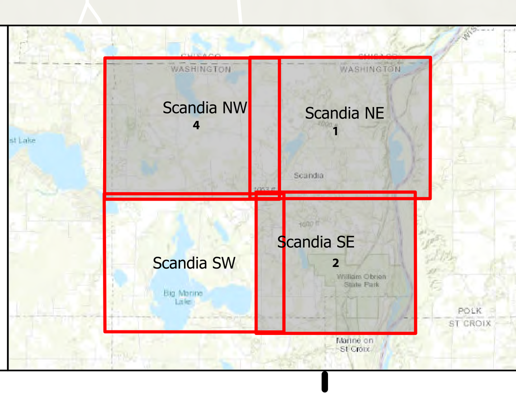
*File Name:* Scandia Paper Maps

*Issue Date:* 8/2/2018



| Central Office | Construction Corridor |
|---|---|
| CO | |
| **Service Drop** | **Scandia Township** |

0 540 1,080 Feet




CNS

Cooperative Network Services, LLC
14 Main St SW - Menahga, MN 56464
218-564-3000

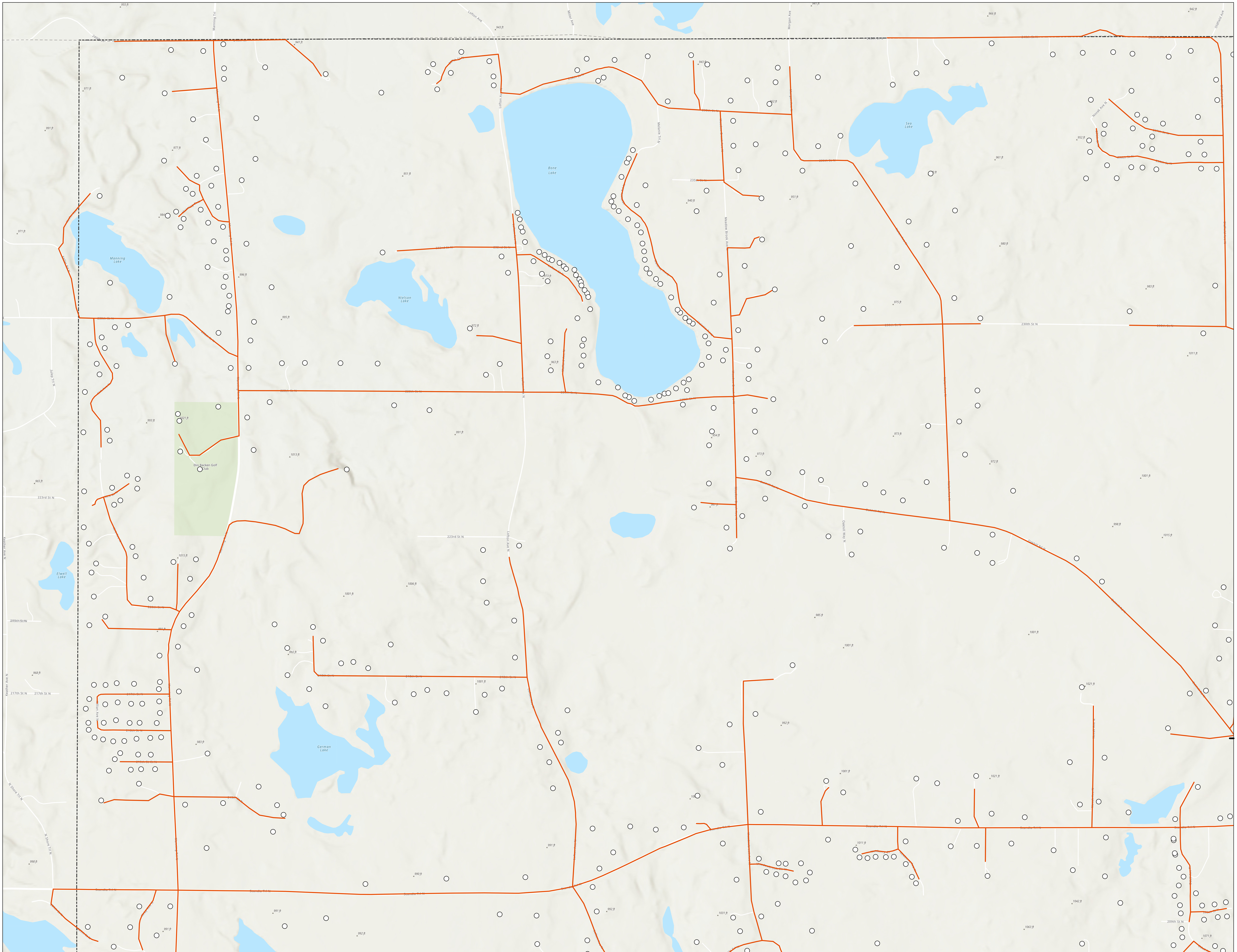
CTC

**Design Map**

Map Name: **Scandia SW**

File Name: Scandia Paper Maps

Issue Date: 8/2/2018

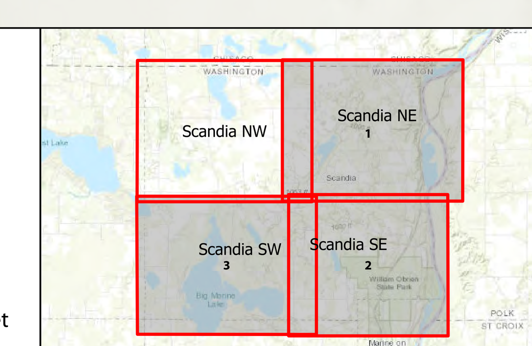



**Central Office** **Construction Corridor**

CO

**Service Drop** **Scandia Township**

0 550 1,100 Feet




CNS

*Cooperative Network Services, LLC*
14 Main St SW - Menahga, MN 56464
218-564-3000

CTC

***Design Map***

*Map Name:* **Scandia NW**

*File Name:* Scandia Paper Maps

*Issue Date:* 8/2/2018

OlsenThielen & Co., Ltd.
CPAS AND ADVISORS

# Minnesota 537 and 1104-A34 Consolidated Telephone Company and Subsidiaries

## Consolidated Financial Statements
## Together with
## Independent Auditors' Report

## December 31, 2016

**MINNESOTA 537 AND 1104-A34**
**CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES**

## CONTENTS

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### BOARD OF DIRECTORS AND KEY EMPLOYEES
### DECEMBER 31, 2016

| Name | Title |
|---|---|
| Morris Nelson | Chairperson |
| Kathy Kobliska | Vice-Chairperson |
| Paul Nieman Jr. | Treasurer |
| John Luce | Secretary |
| Mike Wetzel | Director |
| Stan Johnson | Director |
| Jerry Palm | Director |
| Chad Converse | Director |
| Kevin T. Larson | Chief Executive Officer/General Manager |
| Mark N. Roach | Chief Financial Officer |
| Kristi Westbrock | Chief Operations Officer |

Olsen Thielen & Co., Ltd.
CPAS AND ADVISORS

## INDEPENDENT AUDITORS' REPORT

Board of Directors
Consolidated Telephone Company
Brainerd, Minnesota

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Consolidated Telephone Company and subsidiaries, which comprise the consolidated balance sheet as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, members' equity and cash flows for the years then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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.



2675 Long Lake Road | Roseville, Minnesota | 55113-1117 | 651-483-4521 | 651-483-2467 FAX
300 Prairie Center Drive, Suite 300 | Eden Prairie, Minnesota | 55344-7908 | 952-941-9242 | 952-941-0577 FAX
otcpas.com

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Consolidated Telephone Company and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued a report dated April 17, 2017 on our consideration of Consolidated Telephone Company and subsidiaries' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Consolidated Telephone Company and subsidiaries' internal control over financial reporting and compliance.

Olsen Thielen + Co., Ltd.

Roseville, Minnesota
April 17, 2017

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEET
### DECEMBER 31, 2016 AND 2015

ASSETS

| | **2016** | 2015 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and Cash Equivalents | **$ 4,278,895** | $ 2,617,636 |
| Cash - RUS Construction Fund | **1,225,740** | 394,056 |
| Due from Customers | **184,347** | 186,377 |
| Other Accounts Receivable, Net | **1,024,670** | 2,125,924 |
| Income Tax Receivable | **27,309** | – |
| Current Portion of Notes Receivable | **224,106** | 240,773 |
| Materials and Supplies, Net | **1,307,457** | 1,436,852 |
| Inventory for Resale | **46,309** | 57,806 |
| Prepayments | **197,640** | 569,883 |
| Total Current Assets | **8,516,473** | 7,629,307 |
| INVESTMENTS AND OTHER ASSETS: | | |
| Investment Securities | **989,394** | 613,973 |
| Notes Receivable | **1,082,391** | 868,789 |
| Intangibles | **74,250** | 90,750 |
| Prepayments | **224,533** | 345,944 |
| Other Investments | **1,638,051** | 1,593,420 |
| Prefunded Pension Deposit | **989,413** | – |
| Total Investments and Other Assets | **4,998,032** | 3,512,876 |
| PROPERTY, PLANT AND EQUIPMENT: | | |
| In Service | **111,540,618** | 103,042,717 |
| Under Construction | **1,126,899** | 925,062 |
| Total | **112,667,517** | 103,967,779 |
| Less Accumulated Depreciation | **39,438,805** | 37,115,377 |
| Net Property, Plant and Equipment | **73,228,712** | 66,852,402 |
| TOTAL ASSETS | **$ 86,743,217** | $ 77,994,585 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEET (Continued)
### DECEMBER 31, 2016 AND 2015

LIABILITIES AND MEMBERS' EQUITY

| | **2016** | 2015 |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Current Portion of Long-Term Debt | **$ 4,529,000** | $ 4,605,000 |
| Accounts Payable | **3,123,087** | 1,954,344 |
| Other Accrued Taxes | **96,211** | 103,291 |
| Income Taxes Payable | **–** | 143,541 |
| Other Accrued Liabilities | **1,227,012** | 1,056,281 |
| Customer Deposits | **46,321** | 47,197 |
| Total Current Liabilities | **9,021,631** | 7,909,654 |
| LONG-TERM DEBT | **42,909,654** | 38,727,588 |
| OTHER LIABILITIES: | | |
| Accrued Compensated Absences | **104,016** | 106,009 |
| Post Retirement Benefits Other Than Pension | **308,494** | 348,494 |
| Deferred Revenue | **43,032** | 55,274 |
| Other Credits | **300,000** | 300,000 |
| Total Other Liabilities | **755,542** | 809,777 |
| MEMBERS' EQUITY: | | |
| Memberships | **50,610** | 53,130 |
| Patronage Capital | **31,413,190** | 27,921,734 |
| Nonpatronage Capital | **3,088,308** | 3,088,308 |
| Accumulated Deficit of Subsidiaries | **(495,718)** | (515,606) |
| Total Members' Equity | **34,056,390** | 30,547,566 |
| TOTAL LIABILITIES AND MEMBERS' EQUITY | **$ 86,743,217** | $ 77,994,585 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF OPERATIONS
### YEARS ENDED DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|---|---|---|
| OPERATING REVENUES: | | |
| Local Network | **$ 4,942,648** | $ 4,646,753 |
| Network Access | **11,444,791** | 11,527,655 |
| Internet Services | **4,067,544** | 3,544,584 |
| Video Services | **5,034,195** | 4,242,008 |
| Long Distance | **684,490** | 698,680 |
| Other Nonregulated | **467,512** | 492,539 |
| Miscellaneous | **717,447** | 675,464 |
| Uncollectibles, Net | **(69,162)** | (81,088) |
| Total Operating Revenues | **27,289,465** | 25,746,595 |
| OPERATING EXPENSES: | | |
| Plant and Maintenance | **4,185,538** | 4,047,816 |
| Depreciation and Amortization | **5,705,841** | 5,494,170 |
| Plant Support | **1,471,781** | 1,536,258 |
| Customer | **2,661,838** | 2,287,762 |
| Corporate | **2,323,938** | 2,255,427 |
| Internet | **1,217,872** | 953,271 |
| Video Services | **4,183,830** | 3,588,261 |
| Long Distance | **519,841** | 535,868 |
| Other Nonregulated | **745,451** | 601,351 |
| Operating Taxes | **106,264** | 111,593 |
| Total Operating Expenses | **23,122,194** | 21,411,777 |
| OPERATING MARGINS | **4,167,271** | 4,334,818 |
| OTHER INCOME (EXPENSE): | | |
| Dividend and Interest Income | **26,214** | 28,269 |
| Equity in Income of Limited Liability Companies | **417,968** | 456,372 |
| Interest Expense | **(825,219)** | (970,839) |
| Allowance of Funds Used During Construction | **64,351** | – |
| Miscellaneous, Net | **(47,650)** | (7,573) |
| Gain on Sale of Spectrum | **–** | 2,286,689 |
| Gain on Sale of Investments | **–** | 4,340 |
| Net Other Income (Expense) | **(364,336)** | 1,797,258 |
| NET MARGINS BEFORE INCOME TAXES | **3,802,935** | 6,132,076 |
| INCOME TAX EXPENSE | **10,621** | 148,791 |
| NET MARGINS | **$ 3,792,314** | $ 5,983,285 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
### YEARS ENDED DECEMBER 31, 2016 AND 2015

| | **2016** | 2015 |
|---|---|---|
| NET MARGINS | **$ 3,792,314** | $ 5,983,285 |
| OTHER COMPREHENSIVE LOSS: | | |
| Unrealized Loss on Available-for-Sale Securities | **–** | (8,605) |
| Reclassification Adjustment for Gains Recorded in the Statement of Operations | **–** | (4,340) |
| Other Comprehensive Loss | **–** | (12,945) |
| COMPREHENSIVE INCOME | **$ 3,792,314** | $ 5,970,340 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF MEMBERS' EQUITY
### YEARS ENDED DECEMBER 31, 2016 AND 2015

| | Memberships | | | | Accumulated Other | | |
|---|---|---|---|---|---|---|---|
| | Number | Amount | Patronage Capital | Non-Patronage Capital | Comprehen-sive Gain | Accumulated Deficit of Subsidiaries | Total |
| BALANCE on December 31, 2014 | 5,570 | $ 55,700 | $ 22,081,941 | $ 3,088,308 | $ 12,945 | $ (537,009) | $ 24,701,885 |
| Net Margins | | | 5,961,882 | | | 21,403 | 5,983,285 |
| Other Comprehensive Loss | | | | | (12,945) | | (12,945) |
| Change in Memberships, Net | (257) | (2,570) | | | | | (2,570) |
| Retirement of Estates | | | (133,729) | | | | (133,729) |
| Excise Tax Refunds | | | 11,640 | | | | 11,640 |
| BALANCE on December 31, 2015 | 5,313 | 53,130 | 27,921,734 | 3,088,308 | – | (515,606) | 30,547,566 |
| Net Margins | | | **3,772,426** | | | **19,888** | **3,792,314** |
| Change in Memberships, Net | **(252)** | **(2,520)** | | | | | **(2,520)** |
| Retirement of Estates | | | **(306,489)** | | | | **(306,489)** |
| Excise Tax Refunds | | | **25,519** | | | | **25,519** |
| BALANCE on December 31, 2016 | **5,061** | **$ 50,610** | **$ 31,413,190** | **$ 3,088,308** | **$ –** | **$ (495,718)** | **$ 34,056,390** |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF CASH FLOWS
### YEARS ENDED DECEMBER 31, 2016 AND 2015

| | **2016** | 2015 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Margins | **$ 3,792,314** | $ 5,983,285 |
| Adjustments to Reconcile Net Margins to Net Cash Provided By Operating Activities: | | |
| Depreciation and Amortization | **5,705,841** | 5,494,170 |
| Gain on Sale of Spectrum | **–** | (2,286,689) |
| Gain on Sale of Investments | **–** | (4,340) |
| Income on LLC Investments | **(417,968)** | (456,372) |
| Distributions from LLCs | **373,337** | 409,894 |
| Changes in Assets and Liabilities: | | |
| Due from Customers | **2,030** | (18,309) |
| Other Accounts Receivable | **(18,133)** | (15,621) |
| Income Tax Receivable | **(27,309)** | 2,900 |
| Inventory for Resale | **11,497** | (10,311) |
| Prepayments | **493,654** | (536,151) |
| Accounts Payable | **192,565** | (610,343) |
| Other Accrued Taxes | **(7,080)** | (8,506) |
| Income Taxes Payable | **(143,541)** | 143,541 |
| Other Accrued Liabilities | **170,731** | (27,349) |
| Accrued Compensated Absences | **(1,993)** | (55) |
| Deferred Revenue | **(12,242)** | (17,526) |
| Post Retirement Benefits Other than Pension | **(40,000)** | – |
| Net Cash Provided By Operating Activities | **10,073,703** | 8,042,218 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to Property, Plant and Equipment | **(11,684,594)** | (8,613,743) |
| Salvage, Net of Cost of Plant Removal | **8,400** | 43,339 |
| Proceeds from Construction Grants | **1,706,108** | 794,288 |
| (Increase) Decrease in RUS Construction Fund | **(831,684)** | 820,682 |
| (Increase) Decrease in Materials and Supplies | **129,395** | (328,996) |
| Proceeds from Sale of Spectrum | **–** | 2,900,000 |
| Prefunded Pension Deposit | **(989,413)** | – |
| Purchase of Investment Securities | **(375,421)** | (12,356) |
| Sales and Maturities of Investment Securities | **–** | 133,866 |
| Sale of Other Investments | **–** | 1,327 |
| Loans Made | **(500,000)** | – |
| Loans Collected | **303,065** | 328,875 |
| Net Cash Used In Investing Activities | **(12,234,144)** | (3,932,718) |

*The accompanying notes are an integral part of the consolidated financial statements.*

**MINNESOTA 537 AND 1104-A34**
**CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)**
**YEARS ENDED DECEMBER 31, 2016 AND 2015**

| | 2016 | 2015 |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Increase (Decrease) in Customer Deposits | **$ (876)** | $ 4,786 |
| Proceeds from Issuance of Long-Term Debt | **9,025,117** | 1,116,000 |
| Principal Payments of Long-Term Debt | **(4,636,737)** | (4,516,945) |
| Advanced Payments on Long-Term, Debt, net | **(282,314)** | (3,437,947) |
| Change in Memberships, Net | **(2,520)** | (2,570) |
| Excise Tax Refund | **25,519** | 11,640 |
| Retirement of Patronage Capital | **(306,489)** | (133,729) |
| Net Cash Used In Financing Activities | **3,821,700** | (6,958,765) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | **1,661,259** | (2,849,265) |
| CASH AND CASH EQUIVALENTS at Beginning of Year | **2,617,636** | 5,466,901 |
| CASH AND CASH EQUIVALENTS at End of Year | **$ 4,278,895** | $ 2,617,636 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Increase (Decrease) in Accounts Payable for Plant | **$ 976,178** | $ (307,998) |
| Increase (Decrease) in Accounts Payable for Materials and Supplies | **–** | (61,327) |
| (Increase) Decrease in Accounts Receivable for Construction Grant | **1,119,387** | (1,219,031) |

*The accompanying notes are an integral part of the consolidated financial statements.*

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Nature of Operations

The Company is a member owned cooperative who is a provider of communications services in north central Minnesota. The Company provides local telephone service, broadband internet service, video service and access to long distance telephone service through its Incumbent Local Exchange Carrier Network (ILEC) and providing service as a Competitive Local Exchange Carrier (CLEC) in Brainerd, Nisswa and Crosby, Minnesota. The revenues reported on the statement of operations reflect the relative importance of each type of service. The principal market for these services are local residential and business customers residing in each of the exchanges the Company serves.

### Basis of Accounting

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America including certain accounting practices prescribed by the Federal Communications Commission (FCC) and the state regulatory commission in the state of Minnesota.

### Subsequent Events

In preparing these financial statements, the Company has evaluated for recognition or disclosure the events or transactions that occurred through April 17, 2017, the date the consolidated financial statements were available to be issued.

### Accounting Estimates

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Contel Systems, Inc. (Contel) and C-I Communications, Inc. (C-I Comm). All significant intercompany transactions and accounts have been eliminated.

### Cash Equivalents

The Company considers all highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Receivables

Receivables are stated at the amounts the Company expects to collect from outstanding balances. The Company provides for probable uncollectible amounts through charges to earnings and credits to the valuation allowances based on management's assessment of the current status of individual accounts. Balances that are still outstanding after the Company has used reasonable collection efforts are written off through charges to the valuation allowances and credits to receivable accounts. Changes in the valuation allowances have not been material to the financial statements. The valuation allowance was $191,300 and $308,800 in 2016 and 2015.

### Inventories

Materials and supplies are recorded at average cost. Inventory of computer equipment and telephone systems for resale are recorded at the lower of average cost or market. The Company has a valuation allowance set-up for probable obsolete inventory. The valuation allowance was $42,000 in 2016 and 2015.

### Investment Securities

Readily marketable investments in debt and equity securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses recorded in other comprehensive income. Unrealized losses on available-for-sale securities are charged against earnings when a decline in fair value below the cost basis is determined to be other-than temporary. Investments accounted for using the equity method of accounting and investments which do not have readily determinable fair market values are not affected by this accounting principle. Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the average cost method. Fair value is determined by references to quoted prices in active markets.

### Other Investments

The equity method is used for limited liability company interests of greater than 3%. Under the equity method, the Company's investment reflects the original cost and recognition of the Company's share of undistributed earnings or losses of the entity. Other long-term investments are accounted for under the cost method of accounting. This method requires the Company to periodically evaluate whether non-temporary decreases in values of the investments have occurred, and if so, to write the investments down to net realizable values. As the Company is exempt from disclosing estimated fair values, the Company does not estimate fair values for cost method investments if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair values.

### Property and Depreciation

Property and equipment are recorded at original cost. Additions, improvements or major renewals are capitalized. If the assets are sold, retired or otherwise disposed of in the ordinary course of business, the cost plus removal costs less salvage is charged to accumulated depreciation and the original cost is removed from the asset accounts. Any gains or losses on non-telecommunication property and equipment retirements are reflected in current year operations.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Property and Depreciation (Continued)

Grant money received for reimbursement of capital expenditures was accounted for as a deduction from the cost of the asset. The resulting statement of financial position presentation reflects the Company's net investment in the assets in property, plant and equipment. Depreciation is calculated and recorded based on the reduced cost of the investment therefore the impact of prior grants received is reflected in earnings as a reduction in depreciation. Grant funds are shown as inflows in the investing activities section of the statement of cash flows.

Depreciation is computed using the straight-line method based on estimated service or remaining useful lives of the various classes of depreciable assets. Use of this methodology requires the periodic revision of the depreciation rates. In the evaluation of asset lives, multiple factors are considered, including expected future retirements, technology changes and the adequacy of depreciation reserves. Composite depreciation rates are:

| | **2016** | 2015 |
|---|---|---|
| Telecommunications Plant | **5.2%** | 5.4% |
| Nonregulated Equipment | **7.3** | 5.7 |

### Other Intangible Assets

Other intangible assets consist of customer lists and non-compete covenants. Intangible assets determined to have an indefinite useful life are not amortized, and intangible assets with a determinable life are amortized over their useful life of 15 years.

### Patronage Capital

Amounts received from the furnishing of telecommunications, video and internet service in excess of operating costs and amounts approved by the Board of Directors are assigned to patrons on a patronage basis. In addition, gains on sales of patronage sourced investments are also allocated to patrons on a patronage basis. Income from subsidiaries would be allocated to members when received by the Parent in the form of a dividend.

### Revenue Recognition

Revenues are recognized when earned. Local service and originating intrastate access services are based on tariffs filed with the state regulatory commission and retained by the Company. Interstate and terminating intrastate access revenues are billed based on tariffs filed with the FCC, reported to the National Exchange Carrier Association, and distributed based on cost based settlements which include eligible funds governed by the Universal Service Administrative Company. Access revenues based on cost based settlements are estimated pending completion of final cost studies. Non-regulated revenue for broadband internet, video, customer premise equipment, and other miscellaneous services is highly competitive and based on open market conditions.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Allowance for Funds Used During Construction

The Company includes in its telecommunications plant accounts an average cost of debt used for the construction of the plant, and includes the amounts in the statement of operations. The amounts capitalized were $64,351 in 2016 and $0 in 2015.

### Presentation of Taxes Collected From Customers

Sales, excise, and other taxes are imposed on most of the Company's sales to nonexempt customers. The Company collects the taxes from customers and remits the entire amounts to the governmental authorities. The Company's accounting policy is to exclude the taxes collected and remitted from revenues and expenses.

### Postretirement Benefit Plan

The Company sponsors a defined benefit plan to provide group health insurance, subject to copayment provisions, to all retired employees who are receiving NTCA retirement benefits. The plan provides group health insurance to a maximum age of 65. The plan is not currently being funded. The liability recorded on the books meets the Accumulated Postretirement Benefit Obligation at December 31, 2016 and 2015. The periodic benefit cost is not material to the financial statements. At December 31, 2016 and 2015, there are no unamortized prior service cost amounts that are included in accumulated other comprehensive income.

### Income Taxes and Excise Tax Refunds

The Company is a cooperative organized and operated on a nonprofit basis and filed returns on net unrelated business income as a tax-exempt organization under Section 501(c)12 of the Internal Revenue Code in 2016, but filed returns as a taxable cooperative in 2015 as explained in Note 11. Income taxes are also provided based on income reported in the financial statements of Contel Systems, Inc. and C-I Communications, Inc., which are taxable subsidiaries. The provision for income taxes consists of an amount currently payable for taxes. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized.

Under the Internal Revenue Code, a telephone cooperative is entitled to a refund for overpayment of federal excise taxes by its patrons. The amount of the refund is limited to excise taxes paid which are attributable to net margins. The excise tax refund will be allocated to patrons' capital credits along with net margins.

The Company reviews income tax positions taken or expected to be taken in income tax returns to determine if there are any income tax uncertainties. The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by taxing authorities, based on the technical merits of the positions. The Company has identified no income tax uncertainties.

### Advertising Expenses

Advertising costs are expensed as incurred. Total advertising expenses were $199,364 and $199,560 for 2016 and 2015.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Fair Value Measurements

Under generally accepted accounting principles, 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. The accounting standards establish a three-level fair value hierarchy that prioritizes information used in developing assumptions when pricing an asset or liability as follows:

Level 1 - Observable inputs such as quoted prices in active markets;

Level 2 - Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and,

Level 3 - Unobservable inputs where there is little or no market data, which requires the reporting entity to develop its own assumptions.

The Company uses observable market data, when available, in making fair value measurements. Fair value measurements are classified according to the lowest level input that is significant to the valuation.

The Company holds certain assets that are required to be measured at fair value on a recurring basis. The fair value of the Company's investment securities were determined based on Level 1 inputs.

## NOTE 2 - INTANGIBLE ASSETS

The Company has non-compete covenants and customer lists acquired through various purchases as follows:

| | **December 31, 2016** | | |
|---|---|---|---|
| | **Cost** | **Accumulated Amortization** | **Net Balance** |
| Amortized Intangibles: | | | |
| Non-Compete Covenant | **$ 200,000** | **$ (139,999)** | **$ 60,001** |
| Customer List | **69,500** | **(55,251)** | **14,249** |
| Totals | **$ 269,500** | **$ (195,250)** | **$ 74,250** |

| | December 31, 2015 | | |
|---|---|---|---|
| | Cost | Accumulated Amortization | Net Balance |
| Amortized Intangibles: | | | |
| Non-Compete Covenant | $ 200,000 | $ (126,666) | $ 73,334 |
| Customer List | 69,500 | (52,084) | 17,416 |
| Totals | $ 269,500 | $ (178,750) | $ 90,750 |

## NOTE 2 - INTANGIBLE ASSETS (Continued)

Amortization expense and future amortization expense expected on intangible assets is as follows:

| | |
|---|---|
| Actual Amortization Expense: | |
| **2016** | **$ 16,500** |
| 2015 | 16,500 |
| Expected Amortization Expense: | |
| 2017 | $ 16,500 |
| 2018 | 16,500 |
| 2019 | 16,500 |
| 2020 | 16,500 |
| 2021 | 8,250 |

## NOTE 3 - INVESTMENT SECURITIES

The cost and fair values of investment securities available-for-sale at December 31, 2016 and 2015 were as follows:

| | **2016** | | | |
|---|---|---|---|---|
| Description | **Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
| Short Term Bond Mutual Funds | **$ 100,754** | **$ –** | **$ –** | **$ 100,754** |
| Municipal Bond Mutual Funds | **888,640** | **–** | **–** | **888,640** |
| Total | **$ 989,394** | **$ –** | **$ –** | **$ 989,394** |

| | 2015 | | | |
|---|---|---|---|---|
| Description | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Short Term Bond Mutual Funds | $ 100,447 | $ – | $ – | $ 100,447 |
| Municipal Bond Mutual Funds | 513,526 | – | – | 513,526 |
| Total | $ 613,973 | $ – | $ – | $ 613,973 |

Proceeds from sales and maturities of investment securities available-for-sale during 2016 and 2015 were $0 and $133,866. Gross gains (losses) on those sales and maturities were $0 and $4,340 in 2016 and 2015.

The Company holds investments in a variety of investment funds. In general, its investments are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of the investments will occur in the near term and such changes could be material to the amounts reported in the balance sheet.

## NOTE 4 - OTHER INVESTMENTS

Other investments are recorded at cost or cost plus equity in undistributed earnings and losses and consist of the following:

| | Percent of Ownership | 2016 | 2015 |
|---|---|---|---|
| Equity Method Investments: | | | |
| Central Transport Group, LLC | 20.00% | **$ 187,687** | $ 196,465 |
| Independent Emergency Services, LLC | 14.29 | **508,754** | 528,740 |
| Pinnacle Publishing, LLC | 4.48 | **333,081** | 346,141 |
| Consolidated West, LLC | 50.00 | **5,275** | 6,525 |
| Cooperative Network Services, LLC | 5.00 | **347,476** | 263,936 |
| Alpenglow Technologies | 40.00 | **57,278** | 50,613 |
| WISP Services, LLC | 20.00 | **3,516** | 6,016 |
| Cost Method Investments: | | | |
| Solix Inc., Stock | | **100,000** | 100,000 |
| Broadband Visions, LLC | 1.16 | **68,426** | 68,426 |
| RTFC Patronage Capital and SCC's | | **26,558** | 26,558 |
| Total | | **$ 1,638,051** | $ 1,593,420 |

The Company is a co-investor in seven limited liability companies which it records on the equity method of accounting.

Central Transport Group, LLC was formed to provide fiber optic transport facilities to the Company and its co-investors. The Company recorded $170,250 of lease revenue from this LLC in miscellaneous revenue in 2016 and 2015. The Company also paid $56,622 and $57,736 in circuit expenses in 2016 and 2015 which are included in plant and maintenance expenses.

Independent Emergency Services, LLC was formed to provide enhanced 911 telecommunications and data base services. The Company recorded $57,244 and $57,103 of special access revenue from this LLC in network access revenue in 2016 and 2015. The Company also paid $2,110 in circuit expenses in 2016 and 2015 which are included in plant and maintenance expenses.

Pinnacle Publishing, LLC was formed to provide directory services. The Company recorded $3,799 of directory revenue from this LLC in 2016 and $3,628 in 2015. The Company paid $28,634 and $28,071 in directory publishing expenses to Pinnacle Publishing, LLC in 2016 and 2015 which are included in customer expenses.

The Company has a 50% ownership in Consolidated West, LLC which was formed to provide telecommunication services.

The Company has a 5% interest in Cooperative Network Services, LLC, which was formed to provide fiber optic transport facilities to telecommunications cooperatives. The Company recorded lease revenue of $115,566 and $116,110 in miscellaneous revenue in 2016 and 2015. The Company also paid $393,609 and $340,183 in circuit and internet expenses in 2016 and 2015 which are included in plant and maintenance and internet expenses. In addition, the Company paid Cooperative Network Services, LLC $880,580 and $786,631 in engineering fees related to the fiber to the home project that is included in property, plant and equipment.

**NOTE 4 - OTHER INVESTMENTS (Continued)**

The Company has a 40% interest in Alpenglow Technologies, LLC, which was formed to provide information technology and consulting services mainly to the Company's customers. The Company also paid $48,000 for services provided by Alpenglow Technologies, LLC in 2016 and 2015.

The Company purchased a 20% interest in WISP Services, LLC in 2013. WISP Services LLC provides engineering and design for wireless voice and broadband networks. In 2016, the Company, along with the four other members of WISP Services, LLC have agreed to guarantee a $500,000 line of credit with Rural Telephone Finance Cooperative. The Company would be required to pay the guaranteed portion not to exceed $100,000 if WISP Services, LLC defaults. The balance outstanding on the WISP Services, LLC line of credit at December 31, 2016 is $343,467. No liability has been recorded at December 31, 2016 related to this guarantee. The Company paid $43,915 and $1,815 for services provided by WISP Services, LLC in 2016 and 2015.

The Company's share of net income (loss) from the investment in LLCs is as follows:

| | 2016 | 2015 |
|---|---|---|
| Independent Emergency Services, LLC | $ 180,014 | $ 242,951 |
| Central Transport Group, LLC | 91,222 | 95,461 |
| Pinnacle Publishing, LLC | 4,277 | 6,752 |
| Cooperative Network Services, LLC | 83,540 | 72,128 |
| Alpenglow Technologies, LLC | 62,665 | 57,414 |
| Consolidated West, LLC | (1,250) | 750 |
| WISP Services, LLC | (2,500) | (19,084) |
| Total | $ 417,968 | $ 456,372 |

The following presents the summarized nonaudited financial information for Independent Emergency Services, LLC, Central Transport Group, LLC, Pinnacle Publishing, LLC, Consolidated West, LLC, WISP Services, LLC, Cooperative Network Services, LLC, and Alpenglow Technologies, LLC at December 31:

| | 2016 | 2015 |
|---|---|---|
| Results of Operations: | | |
| Revenues | $ 34,191,000 | $ 37,041,000 |
| Operating Income | 3,525,000 | 3,764,000 |
| Net Income | 3,454,000 | 3,800,000 |
| Financial Position: | | |
| Assets | 23,511,000 | 23,517,000 |
| Liabilities | 4,029,000 | 5,062,000 |
| Members' Equity | 19,481,000 | 18,455,000 |

## NOTE 5 - NOTES RECEIVABLE

Notes are receivable from:

| | 2016 | 2015 |
|---|---|---|
| Triumph Boats, 0% rural economic development note which is receivable in monthly installments of $6,852 through October 2021. The note is secured by a letter of credit. | **$ 308,334** | $ 390,556 |
| St. Gabriel's Hospital, 0% rural economic development note which is receivable in monthly installments of $3,333 through June 2016. The note was secured by land and building. | **–** | 16,667 |
| Mission Township, 0% rural economic development note which is receivable in monthly installments of $5,833 through June 2019. Mission Township chose to start making payments in 2010. The note was secured by land. | **–** | 70,000 |
| St. Joseph's Medical Center, 0% rural economic development note which is receivable in monthly installments of $7,708 through October 2021. The note is secured by land and building. | **262,083** | 354,583 |
| Lindar Corporation, 0% rural economic development note which is receivable in monthly installments of $3,473 through September 2023. The note is secured by equipment. | **236,080** | 277,756 |
| T&E Properties, 0% rural economic development note which is receivable in monthly installments of $5,208 through April 2026. This note is secured by land and building | **500,000** | – |
| Total | **1,306,497** | 1,109,562 |
| Less Amount Due Within One Year | **224,106** | 240,773 |
| Long-Term Notes Receivable | **$ 1,082,391** | $ 868,789 |

## NOTE 6 - PROPERTY, PLANT AND EQUIPMENT

The Company’s investment in property, plant and equipment consists of the following:

| | Service Life (Years) | 2016 | 2015 |
|---|---|---|---|
| Telecommunications Plant: | | | |
| In Service | 4.0 to 40.0 | **$ 106,271,924** | $ 98,184,867 |
| Under Construction | | **1,126,899** | 925,062 |
| Nonregulated Equipment | 3.0 to 20.0 | **5,268,694** | 4,857,850 |
| Total | | **112,667,517** | 103,967,779 |
| Less Accumulated Depreciation | | **39,438,805** | 37,115,377 |
| Net | | **$ 73,228,712** | $ 66,852,402 |

Depreciation expense was $5,689,341 in 2016 and $5,477,670 in 2015.

The Company has been the recipient of multiple State of Minnesota Border to Border grants which are to be used to construct broadband facilities in unserved and underserved locations in the state. The Company was awarded $2,030,000 in 2014, which they received and invested $2,024,247 in broadband facilities. They were also awarded $759,525 in 2015, which they have invested $586,721 in broadband facilities as of December 31, 2016.

## NOTE 7 - LINE OF CREDIT

The Company has a revolving credit demand loan agreement with a financial institution which enables the Company to borrow up to $3,000,000 at an interest rate equal to the interest rate in effect for an advance plus two hundred fifty (250) basis points. At December 31, 2016, the interest rate was 3.55%. The line of credit was renewed March 1, 2016 and will expire February 28, 2018, and is unsecured. There was no balance outstanding on this line of credit at December 31, 2016 and 2015.

## NOTE 8 - LONG-TERM DEBT

Long-term debt is as follows:

| | 2016 | 2015 |
|---|---|---|
| RUS Traditional Loan - 4.33% to 4.54% Interest | $ – | $ 480,466 |
| RUS Broadband Loan - 2.85% to 4.71% interest | 4,139,752 | 4,684,013 |
| Federal Financing Bank - 1.40% to 2.71% Interest | 52,279,255 | 47,075,513 |
| RUS Cushion of Credit - 5% Interest | (10,444,071) | (10,161,758) |
| Rural Economic Development Loans, 0% | 1,463,718 | 1,254,354 |
| Total | 47,438,654 | 43,332,588 |
| Less Amount Due Within One Year | 4,529,000 | 4,605,000 |
| Long-Term Debt | $ 42,909,654 | $ 38,727,588 |

The mortgage notes payable to the Rural Utilities Service (RUS) and to the Federal Financing Bank (FFB) are secured by substantially all assets of the Company. These notes are payable in equal monthly and quarterly installments of principal and interest beginning two to three years after the date of the issue and were to be fully repaid at various times from 2016 to 2036.

In 2010, the Company was approved for a RUS Traditional Telecommunications loan funded through the FFB for $49,644,000 at rates to be determined at the time of advance. The Company has been advancing funds on this loan to fund construction between 2011 and 2016. As of December 31, 2016, the Company has unadvanced loan commitments of $159,610 related to this loan. In 2015, the Company was approved for an additional RUS Traditional Telecommunications loan funded through the FFB for $12,265,000 at rates to be determined at the time of advance. As of December 31, 2016, the Company has unadvanced loan commitments of $4,549,883 related to this loan. The loan funds are to be used to finance construction costs.

All loan funds are deposited in the RUS Construction Fund and disbursements are restricted to construction costs and other expenditures authorized by the loan agreement, subject to RUS approval.

The Economic Development loans are payable in monthly installments with various maturities through 2026. The proceeds from the loans were advanced to local businesses under similar terms as the loans payable.

## NOTE 8 - LONG-TERM DEBT (Continued)

Cash payments for interest (net of interest earned on the cushion of credit) were $826,776 in 2016 and $970,839 in 2015.

Principal payments required during the next five years are: 2017 - $4,529,000; 2018 - $4,758,000; 2019 - $4,816,000; 2020 - $4,807,000; and 2021 - $4,810,000.

Long-term debt agreements contain restrictions on patronage dividends and redemptions of equity capital. Patronage capital available for distribution totaled $2,844,000 as of December 31, 2016.

## NOTE 9 - PATRONAGE CAPITAL

Patronage capital consists of:

| | **2016** | 2015 |
|---|---|---|
| Assignable | **$ 3,797,945** | $ 5,973,522 |
| Assigned to Date | **38,690,668** | 32,717,146 |
| Total | **42,488,613** | 38,690,668 |
| Less Retired to Date | **11,075,423** | 10,768,934 |
| Balance at End of Year | **$ 31,413,190** | $ 27,921,734 |

## NOTE 10 - LEASE AND OTHER COMMITMENTS

The Company has entered into a long-term commitment for the lease of fiber optic facilities.

Rent expense and future commitments for the lease are as follows:

| | |
|---|---|
| Expense: | |
| **2016** | **$ 48,633** |
| 2015 | 48,633 |
| | |
| Commitments: | |
| 2017 | $ 48,633 |
| 2018 | 48,633 |
| 2019 | 48,633 |
| 2020 | 48,633 |
| 2021 | 48,633 |
| Later Years | 145,900 |
| Total Commitments | $ 389,065 |

In 2016, the Company entered into a commitment to construct a fiber optic network for the City of Long Prairie Minnesota. Once construction of the network is completed, CTC will lease and operate the network with an option to take ownership of the network after 20 years.

## NOTE 11 - INCOME TAXES

The Company's tax status is determined by whether or not 85% or more of its revenues are membership sourced as outlined by IRS rules. If the Company meets the 85% requirement, it is a tax-exempt cooperative, and the Company is subject to income tax only on net unrelated business income. Otherwise, as a non-exempt cooperative, income tax is paid on taxable income from non-patronage sources such as investment and directory advertising income. The Company generally will not pay income tax on net margins from patronage sources, provided the margins are allocated to members as capital credits on a timely basis. In certain circumstances, the Alternative Minimum Tax may be applied to patronage sources of income. In 2016 and 2015, the Company was a tax-exempt cooperative. Total tax expense on the statement of operations is due to the current year tax provision expense.

Federal and state income tax return operating loss carryovers on Contel Inc. as of December 31, 2016, were $84,200 and $171,900 and will expire from 2019 through 2032. Cash paid for income taxes was $181,471 in 2016 and $2,350 in 2015.

The components of deferred income taxes at December 31, 2016 and 2015 are as follows:

| | **2016** | 2015 |
|---|---|---|
| Deferred Tax Assets: | | |
| Intangibles | **$ 889** | $ 8,889 |
| Net Operating Losses | **33,674** | 68,786 |
| Fixed Assets | **60,480** | 53,529 |
| Valuation Allowance | **(95,043)** | (131,204) |
| Total Deferred Tax Assets | **$ –** | $ – |

An allowance has been recorded which offsets the total deferred tax assets related to intangible assets amortization and net operating losses on the subsidiaries books due to the uncertainty of the realization of these future tax benefits.

## NOTE 12 - RETIREMENT PLANS

The Company participates in the National Telecommunications Cooperative Association (NTCA) 401(k) plan. The Company contributed 1% of non-union employees' eligible salaries if they contributed 2% or more, and contributed 3% for union employees who contributed 6% or more. In April 2016, the Company instituted a 3% discretionary contribution to non-union employees. The Company's total cost of this plan for was approximately $134,000 for 2016 and approximately $52,000 for 2015.

The Company contributes to a multiple-employer defined benefit plan described below. The risks of participating in multiple-employer plans are different from single employer plans as follows: (1) assets contributed to the multiple-employer plan by one employer may be used to provide benefits to employees of other participating employers, (2) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers, and (3) if the Company chooses to stop participating in a plan, the Company may be required to pay a withdrawal liability.

## NOTE 12 - RETIREMENT PLAN (Continued)

The Company's participation in multiple-employer plan is outlined in the table below. Unless otherwise noted, the information provided below is from the Plan's most recent Form 5500 filing which covers the plan years 2015 and 2014. At the date the financial statements were issued, Form 5500 was not available for the year ending 2016.

| | |
|---|---|
| Plan Name: | Retirement & Security Program For Employees of NTCA and its Members |
| Employer Identification Number | 52-0741336 |
| Pension Plan Number | 333 |
| Pension Protection Act Zone Status at the Plan's Year End: | |
| December 31, 2016 | *At Least 80% Funded* |
| December 31, 2015 | *At Least 80% Funded* |
| Plan Subject to Funding Improvement Plan | No |
| Plan Subject to Rehabilitation Plan | No |
| Employer Subject to Contribution Surcharge | Yes |
| Company Contributions to the Plan for the Year Ended: | |
| December 31, 2016 | $ 959,756 |
| December 31, 2015 | $ 854,689 |
| Expiration Date of Collective-Bargaining Agreements | – |
| Minimum Contributions Required in the Future | – |

Substantially all employees of the Company participate in the Plan. Employees are eligible to receive an annuity or lump-sum payment at retirement based on an average of prior years' compensation. The Company makes contributions to the Plan based on 19.91% and 21.08% of each non-union and union (respectively) employee's compensation. The contribution for non-union employees consists of a 14.10% employer contribution, rule of 85 charges of .80%, PBGC insurance of .50% and a contribution surcharge of 4.51%. The contribution for union employees consists of a 15.10% employer contribution, rule of 85 charges of .80%, PBGC insurance of .70% and a contribution surcharge of 4.48%.

At the February 2016 meeting of the NTCA Board of Directors, the Board approved an option to allow participating member companies in the R&S Program to make a prefunding contribution to reduce expected future surcharge contributions. The prefunding amount is intended to reflect the member company's share, calculated as of January 1, 2015, of surcharge contributions required in 2018 and beyond to fund the R&S Program's unfunded value of benefits earned to date using R&S Program actuarial valuation assumptions. A member company's prefunding contribution will be credited to a notional account established for this purpose. Thereafter, the surcharge contributions otherwise due from a member company will be deducted from its notional account. The member company will be exempt from the obligation to pay surcharge contributions so long as the notional account is greater than zero. In addition, the member company will be exempt from PBGC variable rate premiums through 2029. However, changes in interest rates, asset returns and other plan experience different from expected, plan assumption changes, and other factors may have an impact on the period of time during which a member company is exempt from the surcharge contributions. The prefunded pension deposit is reflected as a non-current asset on the balance sheet.

## NOTE 13 - CONCENTRATIONS

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. The Company places its cash and cash equivalents with high credit quality financial institutions and, by policy, limits the amount of credit exposure to any one financial institution. Concentrations of credit risk with respect to trade receivables are limited due to the Company's large number of customers. As of December 31, 2016, the Company had a credit risk concentration as a result of depositing $6,033,018 in excess of FDIC insurance coverage in three banks.

In 2016 and 2015, the Company received 42% and 45% of its revenues from network access revenues, including assistance provided by the Federal Universal Service Fund for deployment of voice and broadband services. Federal and State regulation reform continues to have a significant influence on the revenues of the Company.

In 2011, the FCC approved an Order on Intercarrier Compensation and Universal Service Fund (USF) reform and announced the issuance of a Further Notice of Proposed Rulemaking on long-term USF reform and transition toward a National Broadband Plan. The Order required the reduction of access revenue on an annual basis.

In March 2016, the FCC released an Order and Further Notice of Proposed Rulemaking (FNPRM) that reforms the High Cost USF Program supporting rate-of-return carriers. The following changes have been implemented to modernize the program: 1) Annual Rate of Return Reduction from 11.25% to 9.75% (25 basis point reduction per year) beginning July 1, 2016; 2) Provides support for stand-alone broadband; 3) Requires broadband deployment based on the number of locations lacking service and the cost of providing service; 4) Requires allowances for capital investments and limits on operational expenses; and 5) Phases out support for areas served by a qualifying competitor .

The FNPRM also created two paths to a Connect America Fund for rate of return carriers. The model based (A-CAM support) option is voluntary and is a fixed amount of support for ten years. The legacy mechanism reforms the existing Interstate Common Line Support (ICLS) mechanism to support stand-alone broadband and will now be known as the Connect America Fund Broadband Loop Support (CAF BLS).

The Company did not elect to receive A-CAM support and thus will continue to be compensated under legacy USF Mechanisms.

The FCC has also created a self-effectuating mechanism to ensure the $2 billion National budget for Universal Service Support is not exceeded. The first reduction in support was applied to all Rate of Return Companies beginning September 2016. In 2017, the budget control mechanism support reductions will only apply to those companies remaining under legacy regulations.

## NOTE 14 - CONTINGENCIES

The Company is a defendant in the legal proceedings arising in the normal course of its operations. While the outcome of these matters cannot be predicted with certainty, management presently believes the disposition of these proceedings will not have a material impact on the financial position of the Company.

## NOTE 15 - SUBSEQUENT EVENTS

In January 2017, the Company was awarded a $4,936,996 broadband grant from the Minnesota Department of Employment and Economic Development. The grants provide up to 50% of the cost of developing broadband for improved high-speed Internet in unserved or underserved residences and businesses in northwestern Kandiyohi County. The Company will provide the remaining 50% matching funds. Expenditures and construction for this grant will begin in 2017.

## INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTARY INFORMATION

Board of Directors
Consolidated Telephone Company
Brainerd, Minnesota

We have audited the consolidated financial statements of Consolidated Telephone Company and subsidiaries as of and for the years ended December 31, 2016 and 2015, and our report thereon dated April 17, 2017, which expressed an unmodified opinion on those financial statements, appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole.

The consolidating information on pages 27-31 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

The supplementary information on pages 32-34, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and except for that portion marked "not audited", was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. That information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, that information is fairly stated in all material respects in relation to the financial statements as a whole. The information marked "not audited" has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Olsen Thielen + Co., Ltd.

Roseville, Minnesota
April 17, 2017

OlsenThielen & Co., Ltd.
CPAS AND ADVISORS

# Minnesota 537 and 1104-A34 Consolidated Telephone Company and Subsidiaries

## Consolidated Financial Statements Together with Independent Auditors' Report

## December 31, 2017

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONTENTS

**MINNESOTA 537 AND 1104-A34**
# CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

## BOARD OF DIRECTORS AND KEY EMPLOYEES
## DECEMBER 31, 2017

| Name | Title |
| --- | --- |
| Morris Nelson | Chairperson |
| Kathy Kobliska | Vice-Chairperson |
| Paul Nieman Jr. | Treasurer |
| John Luce | Secretary |
| Mike Wetzel | Director |
| Kirk Smith | Director |
| Jerry Palm | Director |
| Chad Converse | Director |
| Kevin T. Larson | Chief Executive Officer/General Manager |
| Mark N. Roach | Chief Financial Officer |
| Kristi Westbrock | Chief Operations Officer/Assistant General Manager |

# INDEPENDENT AUDITORS' REPORT

Board of Directors
Consolidated Telephone Company
Brainerd, Minnesota

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Consolidated Telephone Company and subsidiaries, which comprise the consolidated balance sheet as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income, members' equity and cash flows for the years then ended, and the related notes to the financial statements.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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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otcpas.com

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Consolidated Telephone Company and subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued a report dated April 13, 2018 on our consideration of Consolidated Telephone Company and subsidiaries' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Consolidated Telephone Company and subsidiaries' internal control over financial reporting and compliance.

Olsen Thielen & Co., Ltd.

Roseville, Minnesota
April 13, 2018

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEET
### DECEMBER 31, 2017 AND 2016

ASSETS

| | 2017 | 2016 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and Cash Equivalents | $ 6,138,926 | $ 4,278,895 |
| Cash - RUS Construction Fund | 485,835 | 1,225,740 |
| Due from Customers, Net | 228,866 | 184,347 |
| Other Accounts Receivable, Net | 968,745 | 1,024,670 |
| Income Tax Receivable | – | 27,309 |
| Current Portion of Notes Receivable | 180,285 | 224,106 |
| Materials and Supplies, Net | 1,130,521 | 1,307,457 |
| Inventory for Resale | 45,356 | 46,309 |
| Prepayments | 298,856 | 197,640 |
| Total Current Assets | 9,477,390 | 8,516,473 |
| INVESTMENTS AND OTHER ASSETS: | | |
| Investment Securities | – | 989,394 |
| Notes Receivable | 700,495 | 1,082,391 |
| Intangibles, Net | 138,999 | 74,250 |
| Prepayments | 136,177 | 224,533 |
| Other Investments | 1,366,061 | 1,638,051 |
| Prefunded Pension Deposit | 3,162,331 | 989,413 |
| Total Investments and Other Assets | 5,504,063 | 4,998,032 |
| PROPERTY, PLANT AND EQUIPMENT: | | |
| In Service | 112,842,444 | 111,540,618 |
| Under Construction | – | 1,126,899 |
| Total | 112,842,444 | 112,667,517 |
| Less Accumulated Depreciation | 42,936,835 | 39,438,805 |
| Net Property, Plant and Equipment | 69,905,609 | 73,228,712 |
| TOTAL ASSETS | $ 84,887,062 | $ 86,743,217 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEET (Continued)
### DECEMBER 31, 2017 AND 2016

LIABILITIES AND MEMBERS' EQUITY

| | **2017** | 2016 |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Current Portion of Long-Term Debt | **$ 4,670,000** | $ 4,529,000 |
| Accounts Payable | **2,182,529** | 3,123,087 |
| Other Accrued Taxes | **86,764** | 96,211 |
| Income Taxes Payable | **9,596** | – |
| Other Accrued Liabilities | **1,297,786** | 1,227,012 |
| Customer Deposits | **44,127** | 46,321 |
| Total Current Liabilities | **8,290,802** | 9,021,631 |
| LONG-TERM DEBT | **38,797,012** | 42,909,654 |
| OTHER LIABILITIES: | | |
| Accrued Compensated Absences | **103,943** | 104,016 |
| Post Retirement Benefits Other Than Pension | **299,613** | 308,494 |
| Deferred Revenue | **53,136** | 43,032 |
| Other Credits | **300,000** | 300,000 |
| Total Other Liabilities | **756,692** | 755,542 |
| MEMBERS' EQUITY: | | |
| Memberships | **48,110** | 50,610 |
| Patronage Capital | **34,123,161** | 31,413,190 |
| Nonpatronage Capital | **3,088,308** | 3,088,308 |
| Accumulated Deficit of Subsidiaries | **(486,602)** | (495,718) |
| Accumulated Other Comprehensive Income | **269,579** | – |
| Total Members' Equity | **37,042,556** | 34,056,390 |
| TOTAL LIABILITIES AND MEMBERS' EQUITY | **$ 84,887,062** | $ 86,743,217 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF OPERATIONS
### YEARS ENDED DECEMBER 31, 2017 AND 2016

| | **2017** | 2016 |
|---|---|---|
| OPERATING REVENUES: | | |
| Local Network | **$ 4,628,539** | $ 4,942,648 |
| Network Access | **10,261,181** | 11,444,791 |
| Internet Services | **5,471,841** | 4,067,544 |
| Video Services | **5,516,914** | 5,034,195 |
| Long Distance | **711,995** | 684,490 |
| Other Nonregulated | **568,292** | 467,512 |
| Miscellaneous | **682,536** | 717,447 |
| Uncollectibles, Net | **(71,440)** | (69,162) |
| Total Operating Revenues | **27,769,858** | 27,289,465 |
| OPERATING EXPENSES: | | |
| Plant and Maintenance | **5,084,814** | 4,185,538 |
| Depreciation and Amortization | **5,782,188** | 5,705,841 |
| Plant Support | **1,466,844** | 1,471,781 |
| Customer | **2,479,860** | 2,661,838 |
| Corporate | **2,369,343** | 2,323,938 |
| Internet | **1,271,668** | 1,217,872 |
| Video Services | **4,574,500** | 4,183,830 |
| Long Distance | **496,069** | 519,841 |
| Other Nonregulated | **804,946** | 745,451 |
| Operating Taxes | **102,312** | 106,264 |
| Total Operating Expenses | **24,432,544** | 23,122,194 |
| OPERATING MARGINS | **3,337,314** | 4,167,271 |
| OTHER INCOME (EXPENSE): | | |
| Dividend and Interest Income | **23,061** | 26,214 |
| Equity in Income of Limited Liability Companies | **358,110** | 417,968 |
| Interest Expense | **(766,155)** | (825,219) |
| Allowance of Funds Used During Construction | **11,446** | 64,351 |
| Miscellaneous, Net | **28** | (47,650) |
| Net Other Income (Expense) | **(373,510)** | (364,336) |
| NET MARGINS BEFORE INCOME TAXES | **2,963,804** | 3,802,935 |
| INCOME TAX EXPENSE | **7,089** | 10,621 |
| NET MARGINS | **$ 2,956,715** | $ 3,792,314 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
### YEARS ENDED DECEMBER 31, 2017 AND 2016

| | **2017** | 2016 |
|---|---|---|
| NET MARGINS | **$ 2,956,715** | $ 3,792,314 |
| OTHER COMPREHENSIVE INCOME: | | |
| Prefunded Pension Deposit Gains | **269,579** | – |
| Other Comprehensive Income | **269,579** | – |
| COMPREHENSIVE INCOME | **$ 3,226,294** | $ 3,792,314 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF MEMBERS' EQUITY
### YEARS ENDED DECEMBER 31, 2017 AND 2016

| | Memberships | | Patronage | Non-Patronage | Accumulated Deficit of | Accumulated Other Comprehensive | |
|---|---|---|---|---|---|---|---|
| | Number | Amount | Capital | Capital | Subsidiaries | Income | Total |
| BALANCE on December 31, 2015 | 5,313 | $ 53,130 | $ 27,921,734 | $ 3,088,308 | $ (515,606) | $ – | $ 30,547,566 |
| Net Margins | | | 3,772,426 | | 19,888 | | 3,792,314 |
| Change in Memberships, Net | (252) | (2,520) | | | | | (2,520) |
| Retirement of Estates | | | (306,489) | | | | (306,489) |
| Excise Tax Refunds | | | 25,519 | | | | 25,519 |
| BALANCE on December 31, 2016 | 5,061 | 50,610 | 31,413,190 | 3,088,308 | (495,718) | – | 34,056,390 |
| Net Margins | | | **2,947,599** | | **9,116** | | **2,956,715** |
| Prefunded Pension Deposit Gains | | | | | | **269,579** | **269,579** |
| Change in Memberships, Net | **(250)** | **(2,500)** | | | | | **(2,500)** |
| Retirement of Estates | | | **(267,175)** | | | | **(267,175)** |
| Excise Tax Refunds | | | **29,547** | | | | **29,547** |
| BALANCE on December 31, 2017 | **4,811** | **$ 48,110** | **$ 34,123,161** | **$ 3,088,308** | **$ (486,602)** | **$ 269,579** | **$ 37,042,556** |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF CASH FLOWS
### YEARS ENDED DECEMBER 31, 2017 AND 2016

| | 2017 | 2016 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Margins | **$ 2,956,715** | $ 3,792,314 |
| Adjustments to Reconcile Net Margins to Net Cash Flows From Operating Activities: | | |
| Depreciation and Amortization | **5,782,188** | 5,705,841 |
| Prefunded Pension Surcharges Relieved | **60,979** | – |
| Income on LLC Investments | **(358,110)** | (417,968) |
| Distributions from LLCs | **630,100** | 373,337 |
| Changes in Assets and Liabilities: | | |
| Due from Customers | **(44,519)** | 2,030 |
| Other Accounts Receivable | **(1,648)** | (18,133) |
| Income Tax Receivable | **27,309** | (27,309) |
| Inventory for Resale | **953** | 11,497 |
| Prepayments | **(12,860)** | 493,654 |
| Accounts Payable | **(131,386)** | 192,565 |
| Other Accrued Taxes | **(9,447)** | (7,080) |
| Income Taxes Payable | **9,596** | (143,541) |
| Other Accrued Liabilities | **70,774** | 170,731 |
| Accrued Compensated Absences | **(73)** | (1,993) |
| Deferred Revenue | **10,104** | (12,242) |
| Post Retirement Benefits Other than Pension | **(8,881)** | (40,000) |
| Net Cash Flows From Operating Activities | **8,981,794** | 10,073,703 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to Property, Plant and Equipment | **(3,241,027)** | (11,684,594) |
| Salvage, Net of Cost of Plant Removal | **–** | 8,400 |
| Proceeds from Construction Grants | **57,573** | 1,706,108 |
| Change in RUS Construction Fund | **739,905** | (831,684) |
| Change in Materials and Supplies | **176,936** | 129,395 |
| Prefunded Pension Deposit | **(1,964,318)** | (989,413) |
| Purchase of Investment Securities | **(22,657)** | (375,421) |
| Sales and Maturities of Investment Securities | **1,012,051** | – |
| Purchase of Intangible Assets | **(91,979)** | – |
| Loans Made | **(24,502)** | (500,000) |
| Loans Collected | **450,219** | 303,065 |
| Net Cash Flows From Investing Activities | **(2,907,799)** | (12,234,144) |

*The accompanying notes are an integral part of the consolidated financial statements.*

## MINNESOTA 537 AND 1104-A34
## CONSOLIDATED TELEPHONE COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)
### YEARS ENDED DECEMBER 31, 2017 AND 2016

| | **2017** | 2016 |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Change in Customer Deposits | **$ (2,194)** | $ (876) |
| Proceeds from Issuance of Long-Term Debt | **1,434,610** | 9,025,117 |
| Principal Payments of Long-Term Debt | **(4,884,885)** | (4,636,737) |
| Advanced Payments on Long-Term, Debt, Net | **(521,367)** | (282,314) |
| Change in Memberships, Net | **(2,500)** | (2,520) |
| Excise Tax Refund | **29,547** | 25,519 |
| Retirement of Patronage Capital | **(267,175)** | (306,489) |
| Net Cash Flows From Financing Activities | **(4,213,964)** | 3,821,700 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | **1,860,031** | 1,661,259 |
| CASH AND CASH EQUIVALENTS at Beginning of Year | **4,278,895** | 2,617,636 |
| CASH AND CASH EQUIVALENTS at End of Year | **$ 6,138,926** | $ 4,278,895 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Change in Accounts Payable for Plant | **$ (809,172)** | $ 976,178 |
| Change in Accounts Receivable for Construction Grant | **57,573** | 1,119,387 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Nature of Operations

Consolidated Telephone Company (the Company) is a member owned cooperative who is a provider of communications services in north central Minnesota. The Company provides local telephone service, broadband internet service, video service and access to long distance telephone service through its Incumbent Local Exchange Carrier Network (ILEC) and providing service as a Competitive Local Exchange Carrier (CLEC) in numerous communities in northern and central Minnesota. The revenues reported on the statement of operations reflect the relative importance of each type of service. The principal market for these services are local residential and business customers residing in each of the exchanges the Company serves.

### Basis of Accounting

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America including certain accounting practices prescribed by the Federal Communications Commission (FCC) and the state regulatory commission in the state of Minnesota.

### Subsequent Events

In preparing these financial statements, the Company has evaluated for recognition or disclosure the events or transactions that occurred through April 13, 2018, the date the consolidated financial statements were available to be issued. Except as discussed below in Note 15, there were no subsequent events that required recognition or disclosure in the financial statements.

### Accounting Estimates

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Contel Systems, Inc. (Contel) and C-I Communications, Inc. (C-I Comm). All significant intercompany transactions and accounts have been eliminated.

### Cash Equivalents

The Company considers all highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Receivables

Receivables are stated at the amounts the Company expects to collect from outstanding balances. The Company provides for probable uncollectible amounts through charges to earnings and credits to the valuation allowances based on management's assessment of the current status of individual accounts. Balances that are still outstanding after the Company has used reasonable collection efforts are written off through charges to the valuation allowances and credits to receivable accounts. Changes in the valuation allowances have not been material to the financial statements. The valuation allowance was $194,300 and $191,300 in 2017 and 2016.

### Inventories

Materials and supplies are recorded at average cost. Inventory of computer equipment and telephone systems for resale are recorded at the lower of average cost or market. The Company has a valuation allowance set-up for probable obsolete inventory. The valuation allowance was $52,000 and $42,000 in 2017 and 2016.

### Investment Securities

Readily marketable investments in debt and equity securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses recorded in other comprehensive income. Unrealized losses on available-for-sale securities are charged against earnings when a decline in fair value below the cost basis is determined to be other-than temporary. Investments accounted for using the equity method of accounting and investments which do not have readily determinable fair market values are not affected by this accounting principle. Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the average cost method. Fair value is determined by references to quoted prices in active markets.

### Other Investments

The equity method is used for limited liability company interests of greater than 3%. Under the equity method, the Company's investment reflects the original cost and recognition of the Company's share of undistributed earnings or losses of the entity. Other long-term investments are accounted for under the cost method of accounting. This method requires the Company to periodically evaluate whether non-temporary decreases in values of the investments have occurred, and if so, to write the investments down to net realizable values. As the Company is exempt from disclosing estimated fair values, the Company does not estimate fair values for cost method investments if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair values.

### Property and Depreciation

Property and equipment are recorded at original cost. Additions, improvements or major renewals are capitalized. If the assets are sold, retired or otherwise disposed of in the ordinary course of business, the cost plus removal costs less salvage is charged to accumulated depreciation and the original cost is removed from the asset accounts. Any gains or losses on non-telecommunication property and equipment retirements are reflected in current year operations.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Property and Depreciation (Continued)

Grant money received for reimbursement of capital expenditures was accounted for as a deduction from the cost of the asset. The resulting statement of financial position presentation reflects the Company's net investment in the assets in property, plant and equipment. Depreciation is calculated and recorded based on the reduced cost of the investment therefore the impact of prior grants received is reflected in earnings as a reduction in depreciation. Grant funds are shown as inflows in the investing activities section of the statement of cash flows.

Depreciation is computed using the straight-line method based on estimated service or remaining useful lives of the various classes of depreciable assets. Use of this methodology requires the periodic revision of the depreciation rates. In the evaluation of asset lives, multiple factors are considered, including expected future retirements, technology changes and the adequacy of depreciation reserves. Composite depreciation rates are:

| | **2017** | 2016 |
|---|---|---|
| Telecommunications Plant | **5.1%** | 5.2% |
| Nonregulated Equipment | **6.2** | 7.3 |

### Other Intangible Assets

Other intangible assets consist of customer lists and non-compete covenants. Intangible assets determined to have an indefinite useful life are not amortized, and intangible assets with a determinable life are amortized over their useful life of 5-15 years.

### Patronage Capital

Amounts received from the furnishing of telecommunications, video and internet service in excess of operating costs and amounts approved by the Board of Directors are assigned to patrons on a patronage basis. In addition, gains on sales of patronage sourced investments are also allocated to patrons on a patronage basis. Income from subsidiaries would be allocated to members when received by the Parent in the form of a dividend.

### Revenue Recognition

Revenues are recognized when earned. Local service and originating intrastate access services are based on tariffs filed with the state regulatory commission and retained by the Company. Interstate and terminating intrastate access revenues are billed based on tariffs filed with the FCC, reported to the National Exchange Carrier Association, and distributed based on cost based settlements which include eligible funds governed by the Universal Service Administrative Company. Access revenues based on cost based settlements are estimated pending completion of final cost studies. Non-regulated revenue for broadband internet, video, customer premise equipment, and other miscellaneous services is highly competitive and based on open market conditions.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Allowance for Funds Used During Construction

The Company includes in its telecommunications plant accounts an average cost of debt used for the construction of the plant, and includes the amounts in the statement of operations. The amounts capitalized were $11,446 in 2017 and $64,351 in 2016.

### Presentation of Taxes Collected From Customers

Sales, excise, and other taxes are imposed on most of the Company's sales to nonexempt customers. The Company collects the taxes from customers and remits the entire amounts to the governmental authorities. The Company's accounting policy is to exclude the taxes collected and remitted from revenues and expenses.

### Postretirement Benefit Plan

The Company sponsors a defined benefit plan to provide group health insurance, subject to copayment provisions, to all retired employees who are receiving NTCA retirement benefits. The plan provides group health insurance to a maximum age of 65. The plan is not currently being funded. The liability recorded on the books meets the Accumulated Postretirement Benefit Obligation at December 31, 2017 and 2016. The periodic benefit cost is not material to the financial statements. At December 31, 2017 and 2016, there are no unamortized prior service cost amounts that are included in accumulated other comprehensive income.

### Income Taxes and Excise Tax Refunds

The Company is a cooperative organized and operated on a nonprofit basis and filed returns on net unrelated business income as a tax-exempt organization under Section 501(c)12 of the Internal Revenue Code as explained in Note 11. Income taxes are also provided based on income reported in the financial statements of Contel Systems, Inc. and C-I Communications, Inc., which are taxable subsidiaries. The provision for income taxes consists of an amount currently payable for taxes. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized.

Under the Internal Revenue Code, a telephone cooperative is entitled to a refund for overpayment of federal excise taxes by its patrons. The amount of the refund is limited to excise taxes paid which are attributable to net margins. The excise tax refund will be allocated to patrons' capital credits along with net margins.

The Company reviews income tax positions taken or expected to be taken in income tax returns to determine if there are any income tax uncertainties. The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by taxing authorities, based on the technical merits of the positions. The Company has identified no income tax uncertainties.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Advertising Expenses

Advertising costs are expensed as incurred. Total advertising expenses were $277,774 and $199,364 for 2017 and 2016.

### Fair Value Measurements

Under generally accepted accounting principles, 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. The accounting standards establish a three-level fair value hierarchy that prioritizes information used in developing assumptions when pricing an asset or liability as follows:

Level 1 - Observable inputs such as quoted prices in active markets;

Level 2 - Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and,

Level 3 - Unobservable inputs where there is little or no market data, which requires the reporting entity to develop its own assumptions.

The Company uses observable market data, when available, in making fair value measurements. Fair value measurements are classified according to the lowest level input that is significant to the valuation.

The Company held certain assets that were required to be measured at fair value on a recurring basis. The fair value of the Company's investment securities were determined based on Level 1 inputs.

### Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which provides guidance for accounting for revenue from contracts with customers. The new guidance outlines a single comprehensive model for companies to use in accounting for revenue from contracts with customers. This ASU is effective for annual and interim periods beginning after December 15, 2018 with early adoption permitted. It can be adopted using either a retrospective approach or a modified retrospective approach. The Company is currently evaluating this guidance to determine the impact it may have on its financial statements.

In February 2016, FASB issued ASU 2016-02, *Leases (Topic 842),* which provides guidance for accounting for leases. The new guidance requires companies to recognize the assets and liabilities for the rights and obligations created by leased assets, initially measured at the present value of the lease payments. The accounting guidance for lessors is largely unchanged. This ASU is effective for annual and interim periods beginning after December 15, 2019 with early adoption permitted. It is to be adopted using the modified retrospective approach. The Company is currently evaluating this guidance to determine the impact it may have on its financial statements.

## NOTE 2 - INTANGIBLE ASSETS

The Company has non-compete covenants and customer lists acquired through various purchases as follows:

| | **December 31, 2017** | | |
|---|---|---|---|
| | **Cost** | **Accumulated Amortization** | **Net Balance** |
| Amortized Intangibles: | | | |
| Non-Compete Covenant | **$ 200,000** | **$ (153,332)** | **$ 46,668** |
| Customer List - Consolidated Telephone Company | **69,500** | **(58,418)** | **11,082** |
| Customer List - Contel Systems, Inc. | **91,979** | **(10,730)** | **81,249** |
| Totals | **$ 361,479** | **$ (222,480)** | **$ 138,999** |

| | December 31, 2016 | | |
|---|---|---|---|
| | Cost | Accumulated Amortization | Net Balance |
| Amortized Intangibles: | | | |
| Non-Compete Covenant | $ 200,000 | $ (139,999) | $ 60,001 |
| Customer List - Consolidated Telephone Company | 69,500 | (55,251) | 14,249 |
| Totals | $ 269,500 | $ (195,250) | $ 74,250 |

Amortization expense and future amortization expense expected on intangible assets are as follows:

| | |
|---|---|
| Actual Amortization Expense: | |
| **2017** | **$ 27,230** |
| 2016 | 16,500 |
| Expected Amortization Expense: | |
| 2018 | $ 34,896 |
| 2019 | 34,896 |
| 2020 | 34,896 |
| 2021 | 26,646 |
| 2022 | 7,665 |

## NOTE 3 - INVESTMENT SECURITIES

The Company held investments in a variety of investment funds. The investments held were completely sold during 2017.

The cost and fair values of investment securities available-for-sale at December 31, 2016 were as follows:

| | 2016 | | | |
|---|---|---|---|---|
| Description | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Short-Term Bond Mutual Funds | $ 100,754 | $ – | $ – | $ 100,754 |
| Municipal Bond Mutual Funds | 888,640 | – | – | 888,640 |
| Total | $ 989,394 | $ – | $ – | $ 989,394 |

## NOTE 3 - INVESTMENT SECURITIES (Continued)

Proceeds from sales and maturities of investment securities available-for-sale during 2017 and 2016 were $1,012,051 and $0. Gross gains (losses) on those sales and maturities were $17,689 and $0 in 2017 and 2016.

## NOTE 4 - OTHER INVESTMENTS

Other investments are recorded at cost or cost plus equity in undistributed earnings and losses and consist of the following:

| | Percent of Ownership | **2017** | 2016 |
|---|---|---|---|
| Equity Method Investments: | | | |
| Central Transport Group, LLC | 20.00% | **$ 162,826** | $ 187,687 |
| Independent Emergency Services, LLC | 14.29 | **304,662** | 508,754 |
| Pinnacle Publishing, LLC | 4.48 | **306,959** | 333,081 |
| Consolidated West, LLC | 50.00 | **4,025** | 5,275 |
| Cooperative Network Services, LLC | 5.00 | **399,069** | 347,476 |
| Alpenglow Technologies, LLC | 40.00 | **41,520** | 57,278 |
| WISP Services, LLC | 20.00 | **(47,984)** | 3,516 |
| Cost Method Investments: | | | |
| Solix Inc., Stock | | **100,000** | 100,000 |
| Broadband Visions, LLC | 1.16 | **68,426** | 68,426 |
| RTFC Patronage Capital and SCC's | | **26,558** | 26,558 |
| Total | | **$ 1,366,061** | $ 1,638,051 |

The Company is a co-investor in seven limited liability companies which it records on the equity method of accounting.

Central Transport Group, LLC was formed to provide fiber optic transport facilities to the Company and its co-investors. The Company recorded $ 153,599 and $170,250 of lease revenue from this LLC in miscellaneous revenue in 2017 and 2016. The Company also paid $56,622 and $56,622 in circuit expenses in 2017 and 2016 which are included in plant and maintenance expenses.

Independent Emergency Services, LLC was formed to provide enhanced 911 telecommunications and data base services. The Company recorded $57,244 of special access revenue from this LLC in network access revenue in 2017 and 2016. The Company also paid $2,110 in circuit expenses in 2017 and 2016 which are included in plant and maintenance expenses.

Pinnacle Publishing, LLC was formed to provide directory services. The Company recorded $128 of directory revenue from this LLC in 2017 and $3,799 in 2016. The Company paid $25,976 and $28,634 in directory publishing expenses to Pinnacle Publishing, LLC in 2017 and 2016 which are included in customer expenses.

## NOTE 4 - OTHER INVESTMENTS (Continued)

The Company has a 50% ownership in Consolidated West, LLC which was formed to provide telecommunication services. This entity does not have any operations.

The Company has a 5% interest in Cooperative Network Services, LLC, which was formed to provide fiber optic transport facilities to telecommunications cooperatives. The Company recorded lease revenue of $115,566 in miscellaneous revenue in 2017 and 2016. The Company also paid $320,786 and $393,609 in circuit and internet expenses in 2017 and 2016 which are included in plant and maintenance and internet expenses. In addition, the Company paid Cooperative Network Services, LLC $270,778 and $880,580 in engineering fees related to the fiber to the home project that is included in property, plant and equipment.

The Company has a 40% interest in Alpenglow Technologies, LLC, which was formed to provide information technology and consulting services mainly to the Company's customers. The Company also paid $48,000 for services provided by Alpenglow Technologies, LLC in 2017 and 2016.

The Company purchased a 20% interest in WISP Services, LLC in 2013. WISP Services LLC provides engineering and design for wireless voice and broadband networks. In 2016, the Company, along with the four other members of WISP Services, LLC have agreed to guarantee a $500,000 line of credit with Rural Telephone Finance Cooperative. The Company would be required to pay the guaranteed portion not to exceed $100,000 if WISP Services, LLC defaults on their line of credit. The balance outstanding on the WISP Services, LLC line of credit at December 31, 2017 is $360,967. In 2017, the Company recorded a $50,000 equity loss on this investment as an estimate of the potential liability associated with this guarantee. The Company paid $26,071 and $43,915 for services provided by WISP Services, LLC in 2017 and 2016.

The Company's share of net income (loss) from the investment in LLCs is as follows:

| | **2017** | 2016 |
|---|---|---|
| Independent Emergency Services, LLC | **$ 195,908** | $ 180,014 |
| Central Transport Group, LLC | **75,139** | 91,222 |
| Pinnacle Publishing, LLC | **(9,438)** | 4,277 |
| Cooperative Network Services, LLC | **85,009** | 83,540 |
| Alpenglow Technologies, LLC | **64,242** | 62,665 |
| Consolidated West, LLC | **(1,250)** | (1,250) |
| WISP Services, LLC | **(51,500)** | (2,500) |
| Total | **$ 358,110** | $ 417,968 |

## NOTE 4 - OTHER INVESTMENTS (Continued)

The following presents the summarized nonaudited financial information for Independent Emergency Services, LLC, Central Transport Group, LLC, Pinnacle Publishing, LLC, Consolidated West, LLC, WISP Services, LLC, Cooperative Network Services, LLC, and Alpenglow Technologies, LLC at December 31:

| | **2017** | 2016 |
|---|---|---|
| Results of Operations: | | |
| Revenues | **$ 32,292,000** | $ 34,191,000 |
| Operating Income | **3,410,000** | 3,448,000 |
| Net Income | **3,407,000** | 3,454,000 |
| Financial Position: | | |
| Assets | **23,677,000** | 23,631,000 |
| Liabilities | **5,331,000** | 4,150,000 |
| Members' Equity | **18,346,000** | 19,481,000 |

## NOTE 5 - NOTES RECEIVABLE

Notes are receivable from:

| | **2017** | 2016 |
|---|---|---|
| Triumph Boats, 0% rural economic development note which is receivable in monthly installments of $6,852 through October 2021. The note was secured by a letter of credit. | **$ –** | $ 308,334 |
| Green Forest Recycling, 0% rural economic development note which is receivable in monthly installments of $370 through October 2022. The note is secured by land and building. | **24,500** | – |
| St. Joseph's Medical Center, 0% rural economic development note which is receivable in monthly installments of $7,708 through October 2021. The note is secured by land and building. | **161,875** | 262,083 |
| Lindar Corporation, 0% rural economic development note which is receivable in monthly installments of $3,473 through September 2023. The note is secured by equipment. | **194,405** | 236,080 |
| T&E Properties, 0% rural economic development note which is receivable in monthly installments of $5,208 through April 2026. This note is secured by land and building | **500,000** | 500,000 |
| Total | **880,780** | 1,306,497 |
| Less Amount Due Within One Year | **180,285** | 224,106 |
| Long-Term Notes Receivable | **$ 700,495** | $ 1,082,391 |

## NOTE 6 - PROPERTY, PLANT AND EQUIPMENT

The Company's investment in property, plant and equipment consists of the following:

| | Service Life (Years) | **2017** | 2016 |
|---|---|---|---|
| Telecommunications Plant: | | | |
| In Service | 4.0 to 40.0 | **$ 107,573,750** | $ 106,271,924 |
| Under Construction | | **–** | 1,126,899 |
| Nonregulated Equipment | 3.0 to 20.0 | **5,268,694** | 5,268,694 |
| Total | | **112,842,444** | 112,667,517 |
| Less Accumulated Depreciation | | **42,936,835** | 39,438,805 |
| Net | | **$ 69,905,609** | $ 73,228,712 |

Depreciation expense was $5,754,958 in 2017 and $5,689,341 in 2016.

The Company has been the recipient of a State of Minnesota Border to Border grant which is to be used to construct broadband facilities in unserved and underserved locations in the state. The Company was awarded $759,525 in 2015, which they have invested $656,064 in broadband facilities as of December 31, 2017.

## NOTE 7 - LINE OF CREDIT

The Company has a revolving credit demand loan agreement with a financial institution which enables the Company to borrow up to $3,000,000 at an interest rate equal to the interest rate in effect for an advance plus two hundred fifty (250) basis points. At December 31, 2017, the interest rate was 3.55%. The line of credit was renewed March 1, 2016 and will expire September 1, 2018, and is unsecured. There was no balance outstanding on this line of credit at December 31, 2017 and 2016.

## NOTE 8 - LONG-TERM DEBT

Long-term debt is as follows:

| | **2017** | 2016 |
|---|---|---|
| RUS Broadband Loan - 2.85% to 4.71% Interest | **$ 3,574,433** | $ 4,139,752 |
| Federal Financing Bank - 1.40% to 2.71% Interest | **50,005,976** | 52,279,255 |
| RUS Cushion of Credit - 5% Interest | **(10,965,439)** | (10,444,071) |
| Rural Economic Development Loans, 0% | **852,042** | 1,463,718 |
| Total | **43,467,012** | 47,438,654 |
| Less Amount Due Within One Year | **4,670,000** | 4,529,000 |
| Long-Term Debt | **$ 38,797,012** | $ 42,909,654 |

## NOTE 8 - LONG-TERM DEBT (Continued)

The mortgage notes payable to the Rural Utilities Service (RUS) and to the Federal Financing Bank (FFB) are secured by substantially all assets of the Company. These notes are payable in equal monthly and quarterly installments of principal and interest beginning two to three years after the date of the issue and were to be fully repaid at various times from 2017 to 2036.

In 2010, the Company was approved for a RUS Traditional Telecommunications loan funded through the FFB for $49,644,000 at rates to be determined at the time of advance. The Company has been advancing funds on this loan to fund construction between 2011 and 2017. As of December 31, 2017, the Company no longer has any unadvanced loan commitments related to this loan. In 2015, the Company was approved for an additional RUS Traditional Telecommunications loan funded through the FFB for $12,265,000 at rates to be determined at the time of advance. As of December 31, 2017, the Company has unadvanced loan commitments of $3,274,883 related to this loan. The loan funds are to be used to finance construction costs.

All loan funds are deposited in the RUS Construction Fund and disbursements are restricted to construction costs and other expenditures authorized by the loan agreement, subject to RUS approval.

The Economic Development loans are payable in monthly installments with various maturities through 2026. The proceeds from the loans were advanced to local businesses under similar terms as the loans payable.

Cash payments for interest (net of interest earned on the cushion of credit) were $766,147 in 2017 and $826,776 in 2016.

Principal payments required during the next five years are: 2018 - $4,670,000; 2019 - $4,768,000; 2020 - $4,808,000; 2021 - $4,913,000; and 2022 - $5,020,000.

Long-term debt agreements contain restrictions on patronage dividends and redemptions of equity capital. Patronage capital available for distribution totaled $4,900,000 as of December 31, 2017.

## NOTE 9 - PATRONAGE CAPITAL

Patronage capital consists of:

| | **2017** | 2016 |
|---|---|---|
| Assignable | **$ 2,977,146** | $ 3,797,945 |
| Assigned to Date | **42,488,613** | 38,690,668 |
| Total | **45,465,759** | 42,488,613 |
| Less Retired to Date | **11,342,598** | 11,075,423 |
| Balance at End of Year | **$ 34,123,161** | $ 31,413,190 |

## NOTE 10 - LEASE AND OTHER COMMITMENTS

The Company has entered into a long-term commitment for the lease of fiber optic facilities through December 2028 for networks in Little Falls and Long Prairie, Minnesota.

Rent expense and future commitments for the leases are as follows:

| | |
|---|---|
| Expense: | |
| **2017** | **$ 132,133** |
| 2016 | 48,633 |
| Commitments: | |
| 2018 | $ 173,883 |
| 2019 | 327,333 |
| 2020 | 324,233 |
| 2021 | 326,083 |
| 2022 | 327,833 |
| Later Years | 1,747,341 |
| Total Commitments | $ 3,226,706 |

## NOTE 11 - INCOME TAXES

The Company's tax status is determined by whether or not 85% or more of its revenues are membership sourced as outlined by IRS rules. If the Company meets the 85% requirement, it is a tax-exempt cooperative, and the Company is subject to income tax only on net unrelated business income. Otherwise, as a non-exempt cooperative, income tax is paid on taxable income from non-patronage sources such as investment and directory advertising income. The Company generally will not pay income tax on net margins from patronage sources, provided the margins are allocated to members as capital credits on a timely basis. In certain circumstances, the Alternative Minimum Tax may be applied to patronage sources of income. In 2017 and 2016, the Company was a tax-exempt cooperative. Total tax expense on the statement of operations is due to the current year tax provision expense.

Federal and state income tax return operating loss carryovers on Contel Inc. as of December 31, 2017, were $80,300 and $168,500 and will expire from 2019 through 2032. Cash paid (received) for income taxes was ($29,816) in 2017 and $181,471 in 2016.

The components of deferred income taxes at December 31, 2017 and 2016 are as follows:

| | **2017** | 2016 |
|---|---|---|
| Deferred Tax Assets: | | |
| Intangibles | **$ –** | $ 889 |
| Net Operating Losses | **24,090** | 33,674 |
| Fixed Assets | **59,172** | 60,480 |
| Valuation Allowance | **(83,262)** | (95,043) |
| Total Deferred Tax Assets | **$ –** | $ – |

## NOTE 11 - INCOME TAXES (Continued)

An allowance has been recorded which offsets the total deferred tax assets related to intangible assets amortization and net operating losses on the subsidiaries books due to the uncertainty of the realization of these future tax benefits.

On December 22, 2017, the President of the United States signed the Tax Cuts and Jobs Act, which changes the Federal corporate income tax rate to 21%. The new rate is effective for tax years beginning after January 1, 2018.

## NOTE 12 - RETIREMENT PLANS

The Company participates in the National Telecommunications Cooperative Association (NTCA) 401(k) plan. The Company contributed 1% of non-union employees' eligible salaries if they contributed 2% or more, and contributed 3% for union employees who contributed 6% or more. In April 2016, the Company instituted a 3% discretionary contribution to non-union employees. The Company's total cost of this plan for was approximately $162,000 for 2017 and approximately $134,000 for 2016.

The Company contributes to a multiple-employer defined benefit plan described below. The risks of participating in multiple-employer plans are different from single employer plans as follows: (1) assets contributed to the multiple-employer plan by one employer may be used to provide benefits to employees of other participating employers, (2) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers, and (3) if the Company chooses to stop participating in a plan, the Company may be required to pay a withdrawal liability due to the nature of multiple-employer defined benefit pension plans.

The Company's participation in multiple-employer plan is outlined in the table below. Unless otherwise noted, the information provided below is from the Plan's most recent Form 5500 filing which covers the plan years 2016 and 2015. At the date the financial statements were issued, Form 5500 was not available for the year ending 2017.

| | |
|---|---|
| Plan Name: | Retirement & Security Program For Employees of NTCA and its Members |
| Employer Identification Number | 52-0741336 |
| Pension Plan Number | 333 |
| Pension Protection Act Zone Status at the Plan's Year End: | |
| December 31, 2016 | *At Least 80% Funded* |
| December 31, 2015 | *At Least 80% Funded* |
| Plan Subject to Funding Improvement Plan | No |
| Plan Subject to Rehabilitation Plan | No |
| Employer Subject to Contribution Surcharge | Yes |
| Company Contributions to the Plan for the Year Ended: | |
| December 31, 2017 | $ 942,891 |
| December 31, 2016 | $ 959,756 |
| Expiration Date of Collective-Bargaining Agreements | – |
| Minimum Contributions Required in the Future | – |

**NOTE 12 - RETIREMENT PLAN (Continued)**

Substantially all employees of the Company participate in the Plan. Employees are eligible to receive an annuity or lump-sum payment at retirement based on an average of prior years' compensation. The Company makes contributions to the Plan based on 19.39% and 20.41% of each non-union and union (respectively) employee's compensation for 2017 and 19.91% and 21.08% of each non-union and union (respectively) employee's compensation for 2016. The 2017 contribution for non-union employees consists of a 14.10% employer contribution, rule of 85 charges of .78%, and a contribution surcharge of 4.51%. The 2017 contribution for union employees consists of a 15.10% employer contribution, rule of 85 charges of .83% and a contribution surcharge of 4.48%.

In 2016, the NTCA Board of Directors approved an option to allow participating companies in the multiple-employer plan to make a prepayment to the plan to enhance the Plan's funded status. The prepayment amount will reduce future surcharge contributions for approximately 10 years. However, changes in interest rates and asset returns may impact the 10 year period. In 2017 and 2016, the Company made prepayments of $1,964,318 and $989,413 to the plan. As of December 31, 2016, total prepayment of $3,162,331 is recorded in other long-term assets and $269,579 unrealized gain is recorded in accumulated other comprehensive income.

**NOTE 13 - CONCENTRATIONS**

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. The Company places its cash and cash equivalents with high credit quality financial institutions and, by policy, limits the amount of credit exposure to any one financial institution. Concentrations of credit risk with respect to trade receivables are limited due to the Company's large number of customers. As of December 31, 2017, the Company had a credit risk concentration as a result of depositing $7,893,197 in excess of FDIC insurance coverage in two banks.

In 2017 and 2016, the Company received 38% and 42% of its revenues from network access revenues, including assistance provided by the Federal Universal Service Fund for deployment of voice and broadband services. Federal and State regulation reform continues to have a significant influence on the revenues of the Company.

In 2011, the FCC approved an Order on Intercarrier Compensation and Universal Service Fund (USF) reform and announced the issuance of a Further Notice of Proposed Rulemaking on long-term USF reform and transition toward a National Broadband Plan. The Order required the reduction of access revenue on an annual basis.

## NOTE 13 - CONCENTRATIONS

In March 2016, the FCC released an Order and Further Notice of Proposed Rulemaking (FNPRM) that reforms the High Cost USF Program supporting rate-of-return carriers. The following changes have been implemented to modernize the program: 1) Annual Rate of Return Reduction from 11.25% to 9.75% (25 basis point reduction per year) beginning July 1, 2016; 2) Provides support for stand-alone broadband; 3) Requires broadband deployment based on the number of locations lacking service and the cost of providing service; 4) Requires allowances for capital investments and limits on operational expenses; and 5) Phases out support for areas served by a qualifying competitor .

The FNPRM also created two paths to a Connect America Fund for rate of return carriers. The model based (A-CAM support) option is voluntary and is a fixed amount of support for ten years. The legacy mechanism reforms the existing Interstate Common Line Support (ICLS) mechanism to support stand-alone broadband and will now be known as the Connect America Fund Broadband Loop Support (CAF BLS).

The Company did not elect to receive A-CAM support and thus will continue to be compensated under legacy USF Mechanisms.

The FCC has also created a self-effectuating mechanism to ensure the $2 billion National budget for Universal Service Support is not exceeded. The first reduction in support was applied to all Rate of Return Companies beginning September 2016. In 2017, the budget control mechanism support reductions will only apply to those companies remaining under legacy regulations.

## NOTE 14 - CONTINGENCIES

The Company is a defendant in the legal proceedings arising in the normal course of its operations. While the outcome of these matters cannot be predicted with certainty, management presently believes the disposition of these proceedings will not have a material impact on the financial position of the Company.

## NOTE 15 - SUBSEQUENT EVENTS

Effective January 1, 2018, the Company's' wholly-owned subsidiary C-I Communications, Inc., was merged into Consolidated Telephone Company. C-I Communications, Inc. was dissolved with all assets and operations being taken over by the Company.

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