Canby Telephone Association and Subsidiaries

Consolidated Financial Statements with Supplemental Information

Years Ended December 31, 2015 and 2014

AKT

CPAS AND BUSINESS CONSULTANTS

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Financial Statements with Supplemental Information

Years Ended December 31, 2015 and 2014

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Independent Auditors' Report

To the Board of Directors
Canby Telephone Association and Subsidiaries
Canby, Oregon

We have audited the accompanying consolidated financial statements of Canby Telephone Association (an Oregon cooperative corporation) and Subsidiaries (the Association), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive income, changes in members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Canby Telephone Association and Subsidiaries as of December 31, 2015 and 2014, and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Report on Consolidating Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information in Schedules I-III are presented for the 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 financial information has been subject to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling 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.

AKT LLP

Salem, Oregon
April 12, 2016

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2015 and 2014

ASSETS	2015	2014
Current Assets:		
Cash and cash equivalents	$ 3,903,895	$ 4,255,933
Marketable securities	3,040,448	3,093,223
Accounts receivable	1,654,686	1,723,495
Inventory	915,211	782,437
Income taxes receivable	42,000	129,570
Prepaid expenses	547,737	519,770
Total Current Assets	10,103,977	10,504,428
Other Assets and Investments:		
Other assets	80,986	82,115
Investments	1,037,606	1,039,091
Deferred income taxes	609,297	686,100
Goodwill	3,974,375	3,974,375
Total Other Assets and Investments	5,702,264	5,781,681
Property, Plant, and Equipment:		
Property, plant, and equipment	61,818,017	59,964,939
Less accumulated depreciation	42,012,326	40,732,308
Property, Plant, and Equipment, net	19,805,691	19,232,631
	$ 35,611,932	$ 35,518,740

See accompanying notes to consolidated financial statements.

LIABILITIES AND MEMBERS' EQUITY	2015	2014
Current Liabilities:		
Current portion of long-term debt	$ -	$ 189,625
Accounts payable	622,466	749,383
Accrued expenses	838,003	536,596
Patronage capital payable	29,577	29,599
Income taxes payable	3,561	46,349
Customer deposits and advance billings	961,618	945,111
Total Current Liabilities	2,455,225	2,496,663
Long-Term Liabilities:		
Deferred compensation	79,802	80,626
Other long-term liabilities	1,100,280	1,024,222
Total Long-Term Liabilities	1,180,082	1,104,848
Members' Equity:		
Memberships	47,401	47,401
Patronage capital	14,529,110	14,573,185
Accumulated earnings	17,948,296	17,696,784
Accumulated other comprehensive loss	(548,182)	(400,141)
Total Members' Equity	31,976,625	31,917,229
	$ 35,611,932	$ 35,518,740

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Operations

Years Ended December 31, 2015 and 2014

	2015	2014
Operating Revenues:		
Local network services	$ 2,536,985	$ 2,667,966
Network access services	7,327,150	7,284,120
Internet	3,147,837	2,901,023
Long distance	417,444	421,700
Video	1,858,050	1,737,734
Other non-regulated revenues	571,796	740,744
Miscellaneous operating	511,754	558,507
Total Operating Revenues	16,371,016	16,311,794
Operating Expenses:		
Plant specific	2,530,456	2,498,967
Plant nonspecific	1,135,190	1,203,175
Customer	1,606,644	1,716,066
Corporate	2,069,218	2,027,786
Depreciation and amortization	2,719,946	2,771,516
Operating income taxes	185,936	146,573
Other operating taxes	435,684	424,389
Internet	1,963,943	1,773,319
Long distance	471,400	445,284
Video	2,289,213	2,121,063
Other non-regulated expenses	809,297	678,594
Total Operating Expenses	16,216,927	15,806,732
Operating Margin	154,089	505,062
Other Income (Expense):		
Interest and investment income	153,627	250,395
Interest expense	(5,123)	(24,745)
Miscellaneous income (expense), net	(38,816)	160,931
Income tax expense	(27,101)	(49,751)
Total Other Income, net	82,587	336,830
Net Margin	$ 236,676	$ 841,892

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Years Ended December 31, 2015 and 2014

		2015		2014
Net Margin	$	236,676	$	841,892
Other Comprehensive Loss:				
Unrealized loss on marketable securities		(196,498)		(19,494)
Reclassification for realized losses on the sale of marketable securities, net of tax		81,286		10,590
Change in unrecognized prior service costs and unrealized losses on post-retirement benefit plan		(90,726)		(114,972)
Deferred tax asset on unrealized loss		57,897		1,400
Total Other Comprehensive Loss		(148,041)		(122,476)
Total Comprehensive Income	$	88,635	$	719,416

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Changes in Members' Equity

Years Ended December 31, 2015 and 2014

	Memberships	Patronage Capital	Accumulated Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2013	$ 47,401	$ 14,642,625	$ 16,852,626	$ (277,665)	$ 31,264,987
Net margin	-	-	841,892	-	841,892
Paid to estates	-	(69,482)	-	-	(69,482)
Excise tax refund		2,414			2,414
Unrealized holding loss on marketable securities	-	-	-	(7,504)	(7,504)
Change in unrecognized transition obligation and unrealized losses on post-retirement benefit plan	-	-	-	(114,972)	(114,972)
Other adjustments	-	(2,372)	2,266	-	(106)
Balance, December 31, 2014	$ 47,401	$ 14,573,185	$ 17,696,784	$ (400,141)	$ 31,917,229
Net margin	-	-	236,676	-	236,676
Paid to estates	-	(44,075)	14,836	-	(29,239)
Unrealized holding loss on marketable securities	-	-	-	(57,315)	(57,315)
Change in unrecognized transition obligation and unrealized gain on post-retirement benefit plan	-	-	-	(90,726)	(90,726)
Balance, December 31, 2015	$ 47,401	$ 14,529,110	$ 17,948,296	$ (548,182)	$ 31,976,625

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Cash Flows

Years Ended December 31, 2015 and 2014

	2015	2014
Cash Flows from Operating Activities:		
Net margin	$ 236,676	$ 841,892
Adjustments to reconcile net margin to net cash provided by operating activities:		
Depreciation and amortization	2,719,946	2,771,516
Nonregulated depreciation	499,667	511,466
Loss on sale of investments and marketable securities	80,347	8,894
Change in deferred taxes	137,666	151,300
Changes in assets and liabilities:		
Accounts receivable	68,809	188,159
Inventory	(132,774)	(244,925)
Prepaid expenses	(27,967)	40,500
Accounts payable	(126,917)	618,817
Accrued expenses	301,407	(99,004)
Income taxes	44,782	(124,932)
Other long-term liabilities	(14,668)	(234,699)
Customer deposits and advance billings	16,507	(50,737)
Deferred compensation	(824)	2,565
Net Cash Provided by Operating Activities	3,802,657	4,380,812
Cash Flows from Investing Activities:		
Capital expenditures	(3,792,673)	(3,579,652)
Purchase of investments and marketable securities	(2,256,399)	(2,620,627)
Proceeds from investments and marketable securities	2,112,134	1,505,508
Change in other assets	1,129	(2,260)
Net Cash Used by Investing Activities	$ (3,935,809)	$ (4,697,031)

See accompanying notes to consolidated financial statements.

	2015	2014
Cash Flows from Financing Activities:		
Principal payments on long-term debt	$ (189,625)	$ (304,500)
Excise tax refunds received	-	2,414
Payments to estates, net	(29,239)	(69,482)
Patronage capital paid, net	(22)	(62)
Net Cash Used by Financing Activities	(218,886)	(371,630)
Net Decrease in Cash and Cash Equivalents	(352,038)	(687,849)
Cash and Cash Equivalents, beginning	4,255,933	4,943,782
Cash and Cash Equivalents, ending	$ 3,903,895	$ 4,255,933
Cash Paid During the Year for Interest	$ 5,167	$ 24,768
Cash Paid During the Year for Taxes	$ 70,099	$ 169,805

See accompanying notes to consolidated financial statements.

Note 1 - Organization and Summary of Significant Accounting Policies

Organization
Canby Telephone Association (CTA or the Association) is an Oregon cooperative corporation providing telecommunications, broadband, and entertainment services within and around the city of Canby, Oregon.

DirectLink of Oregon, Inc. (DLO) is a wholly-owned subsidiary of the Association. DLO activity is limited to nonregulated activities including the lease of fiber and office space in the general vicinity of Canby, Oregon.

Mt. Angel Telephone Company (MATC) is an Oregon corporation providing telecommunications and broadband services within and around the city of Mt. Angel, Oregon. MATC was purchased by the Association effective January 1, 2008.

Basis of Consolidation
The consolidated financial statements of the Association include the accounts of the Association and its wholly-owned subsidiaries, DLO and MATC. All material intercompany transactions and balances have been eliminated in consolidation.

Basis of Accounting
The Association's financial statements are prepared on the accrual basis of accounting in conformity with the accounting principles generally accepted in the United States of America applicable to regulated enterprises.

Regulation
The Association is subject to limited regulation by the Public Utility Commission of Oregon (PUC) and the Federal Communications Commission (FCC). The Association maintains its accounting records in accordance with the Uniform System of Accounts, as prescribed by the FCC, and adopted by the PUC. As a result, the Association's application of accounting principles generally accepted in the United States of America differs in certain respects from the application by nonregulated entities. Such differences primarily concern the time at which certain items enter into the determination of net margin.

Regulatory and legislative actions, as well as future regulations, could have a significant impact on the Association's future operations and financial condition. See Note 1, National Broadband Plan and FCC Order.

Estimates
The Association uses estimates and assumptions in preparing consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Comprehensive Income
The Association reports comprehensive income. The purpose of reporting comprehensive income is to report all changes in equity of an enterprise that result from recognized transactions and other economic events of the period other than transactions with members in their capacity as members.

Income Tax
The Association has been granted an exemption from Federal income taxes, except for "unrelated" business income, under Section 501(c)(12) of the Internal Revenue Code. The Association is also exempt from state income taxes. However, in any year for which greater than 15% of gross revenue is derived from nonmember services, the Association becomes a taxable cooperative. The Association was exempt from income taxes in 2015 and 2014. Federal and state taxes payable by taxable cooperatives are computed differently from taxes payable by other corporations, primarily because cooperatives are allowed to deduct margins allocated or paid to patrons within 8 ½ months after the end of each taxable year. DLO is a taxable corporation and files a separate tax return. MATC is a taxable corporation and files a separate tax return but will share in apportionment of the Federal tax bracket.

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Income Tax, continued
The Association follows accounting standards generally accepted in the United States of America related to the recognition of uncertain tax positions. The Association recognizes accrued interest and penalties associated with uncertain tax positions as part of the income tax provision, when applicable. There were no amounts accrued in the financial statements related to uncertain tax positions.

Income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due and deferred income taxes. Deferred taxes represent the future tax return consequences of differences between the financial statement and the tax basis of assets and liabilities, which will either be taxable or deductible when the related assets or liabilities are recorded or settled. Income tax expense is the tax payable or refundable for the period, plus or minus the change in deferred tax assets and liabilities during the period.

Revenue Recognition
The Association recognizes revenues when earned regardless of the period in which they are billed.

Monthly service fees derived from local telephone, flat rate toll (long distance), broadband and video services are billed in advance. Advance billings are recorded as a liability and subsequently transferred to income in the period earned. Access charges (see Note 1, Network Access Revenue), long-distance and other revenues based on usage are billed in arrears.

Cash and Cash Equivalents
The Association considers all highly liquid investment securities purchased with a maturity of 3 months or less to be cash equivalents. The Association maintains its cash in bank deposit accounts that are insured by the Federal Deposit Insurance Corporation (FDIC) up to a limit of $250,000 per depositor per bank. At December 31, 2015, the Association had $3,097,150 in uninsured cash equivalents ($3,523,595 in 2014).

The Association has not experienced any losses in its bank deposit accounts and believes it is not exposed to any significant credit risk on cash.

Marketable Securities
The Association has classified all marketable securities as available for sale. These investments are stated at fair value in the consolidated financial statements with accumulated unrealized gains and losses reported as a separate component of members' equity.

Accounts Receivable
The Association extends credit to its customers. An allowance for doubtful accounts is considered, based upon management's review of the year-end accounts receivable aging and past credit and collections history. Receivables are written off when the Association determines an account is uncollectible. Past due status is determined based on the age of the past due account. No allowance for doubtful accounts was recorded at December 31, 2015 and 2014.

Fair Value of Financial Instruments
The Association's financial instruments, none of which are held for trading purposes, include cash and cash equivalents, marketable securities, receivables, accounts payable, and notes payable. The Association estimates that the fair value of all of these non-derivative financial instruments at December 31, 2015 and 2014 does not differ materially from the aggregate carrying value of its financial instruments recorded in the accompanying consolidated balance sheets.

Inventory
Inventory held for resale and telecommunication materials and supplies are stated at the lower of average cost or market. Cost is determined principally by the average cost method.

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Goodwill
The Association records goodwill as the difference between the value of the Association's investment in MATC and MATC's related equity and was generated from the acquisition of MATC by the Association in 2008. Goodwill is evaluated for impairment and adjusted accordingly on an annual basis. No impairment was needed during 2015 or 2014.

Investments
Investments in which the Association holds a 20%-50% interest are accounted for on the equity method. Investments accounted for on the equity method are recorded at cost and adjusted for the Association's share of income or loss. Investments in which the Association holds less than a 20% interest are recorded at cost and income is recorded when dividends are received.

Property, Plant, and Equipment
Telecommunications plant in service and under construction is stated at cost, including estimated overhead expense. Depreciation is calculated on a straight-line basis over the estimated life of the classes of buildings and equipment in accordance with rates consistent with industry standards. Depreciation rates range from 2% to 33.3%. Costs of plant retired are eliminated from telecommunications plant accounts and such costs plus removal expenses, less salvage, are charged to accumulated depreciation in accordance with industry practice.

Video and satellite equipment in service and under construction and DLO property and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated life of the classes of equipment. Depreciation rates range from 2% to 33.3%. Maintenance, repairs, and replacements are charged to expense as incurred. When property or equipment is sold or otherwise disposed of, the asset account and the related accumulated depreciation accounts are relieved, and any gain or loss is included in operations.

Patronage Allocation
Patronage capital is derived from margins retained from operations and refunds of federal excise taxes, both of which are allocated to the accounts of individual patrons and are subject to retirement at the discretion of the Board of Directors.

Nonpatronage income, net of expenses, is recorded to accumulated earnings. Amounts included in accumulated earnings are not subject to allocation to the accounts of individual members. Losses sustained by the Association may be allocated to the accounts of individual patrons or offset to accumulated earnings at the discretion of the Board of Directors in accordance with the Association's bylaws.

Network Access Revenues
Network access revenue is received under a system of access charges. Access charges represent a methodology by which local telephone companies, including the Association, charge the long-distance carrier for access and interconnection to local facilities. The Association has elected to file access tariffs through the National Exchange Carriers Association (NECA) and directly with the PUC for these charges. These access tariffs are subject to approval by the FCC for interstate charges and the PUC for intrastate charges.

When network access revenues have been received pursuant to the settlement and access agreements above, they are then either placed into a common pooling arrangement with other exchange carriers for redistribution or kept by the Association. The redistributions are made according to formulas established by the governing boards of the pools and are generally based upon expenses incurred and investments maintained.

CTA and MATC participate in various pooling arrangements with NECA.

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Network Access Revenues, continued

Settlement, access, and pool distribution revenues are recorded when the amounts become determinable. Related expenses are recorded when incurred. Subsequent true-ups and retroactive adjustments, which are generally allowed for a period of 24 months, are recorded in the year in which such adjustments become determinable, based upon studies prepared by outside consultants.

CTA and MATC receive funding from the Oregon Universal Service Fund (OUSF). These support revenues are included in the network access revenues in the accompanying consolidated financial statements.

In 2015, CTA and MATC received $5,584,424 ($5,473,503 in 2014) in interstate access revenues administered through the NECA Pools. In 2015, CTA and MATC received $975,748 from the OUSF ($1,007,948 in 2014). The current funding levels for the OUSF are determined in accordance with PUC Order 13-162 which ends on June 30, 2016. In March 2016 the PUC issued order 16-093 related to OUSF. The order is for a 5 year term beginning January 1, 2017 and calls for annual reductions to the OUSF that will result in an overall reduction of not less than 15.2% over the 5 year term for rural companies. In addition rural companies will be subject to a re-allocation process over the term of the order but no company can have its support reduced by more than 20% over this period as a result of this process. The full impact of the order can not be determined at this this time

National Broadband Plan and FCC Order

In 2010 the FCC issued the National Broadband Plan which outlined a long-term plan to increase broadband penetration rates and services throughout the United States of America. The plan further outlined a proposed long-term phase-out of access charges (referred to as Intercarrier Compensation) and to move to support mechanisms based on broadband services rather than the current Universal Service High Cost Loop Fund administered by USAC.

In response to the plan, the FCC on October 27, 2011, approved Report and Order 11-161 (the Order), that begins the process of reforming the universal service and intercarrier compensation (ICC) systems and adopts support for broadband-capable networks as an express universal service principle. The Order further creates the Connect America Fund which will ultimately replace all existing high-cost support mechanisms as well as help facilitate ICC reforms.

The key provisions of the Order include:

- Capping the federal universal service fund at current levels.
- Placing limitations on capital and operating spending.
- Establishing local rate benchmarks.
- Capping the per-line support amount for the universal service high cost loop fund at $250 per month.
- Phase out of local switching support and the establishment of the CAF for recovery of investment and expenses related to the provision of switching services.
- Reforming the ICC system by adopting a plan to transition from access charges to a bill and keep framework. The transition period for rate-of-return carriers such as the Association is approximately 9 years from the date of the order.
- Adoption of a monthly Access Recovery Charge as a transitional recovery mechanism to mitigate the impact of reduced intercarrier revenues.

The Order was effective December 29, 2011 and implementation began July 1, 2012. As of the implementation date CAF recovery is calculated based on the frozen fiscal year 2011 interstate switched access revenue requirement, plus certain 2011 intrastate access revenues, and will decline annually by 5% during the transition period.