

**BEAVER CREEK COOPERATIVE
TELEPHONE COMPANY AND
SUBSIDIARY**

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
Beaver Creek Cooperative Telephone Company and Subsidiary
Oregon City, Oregon

We have audited the accompanying consolidated financial statements of Beaver Creek Cooperative Telephone Company (an Oregon cooperative corporation) and Subsidiary (the Company), 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 Beaver Creek Cooperative Telephone Company and Subsidiary 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 audit was 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

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AKT LLP

BEAVER CREEK COOPERATIVE TELEPHONE COMPANY AND SUBSIDIARY**Consolidated Balance Sheets**

December 31, 2015 and 2014

| ASSETS | <u>2015</u> | <u>2014</u> |
|---|--------------------------|--------------------------|
| Current Assets: | | |
| Cash and cash equivalents | \$ 70,250 | \$ 23,156 |
| Accounts receivable, less allowance for doubtful accounts of \$5,000 at December 31, 2015 \$12,000 at 2014 | 775,935 | 940,375 |
| Materials and supplies | 121,112 | 165,122 |
| Prepaid expenses | 85,440 | 81,206 |
| Marketable securities | <u>-</u> | <u>75</u> |
| Total Current Assets | <u>1,052,737</u> | <u>1,209,934</u> |
| Other Assets and Investments: | | |
| Investments | 942,575 | 1,764,798 |
| Other assets | <u>1,200</u> | <u>1,600</u> |
| Total Other Assets and Investments | <u>943,775</u> | <u>1,766,398</u> |
| Property, Plant, and Equipment: | | |
| Regulated plant in service | 20,589,035 | 20,337,574 |
| Nonregulated plant in service | <u>21,677,401</u> | <u>21,505,588</u> |
| | 42,266,436 | 41,843,162 |
| Less accumulated depreciation | <u>28,798,439</u> | <u>27,191,388</u> |
| Property, Plant, and Equipment, net | <u>13,467,997</u> | <u>14,651,774</u> |
| | <u>\$ 15,464,509</u> | <u>\$ 17,628,106</u> |

| LIABILITIES AND MEMBERS' EQUITY | <u>2015</u> | <u>2014</u> |
|---|-----------------------------|-----------------------------|
| Current Liabilities: | | |
| Current portion of long-term debt | \$ 614,333 | \$ 1,564,339 |
| Current portion of capital lease obligation | 41,806 | 39,114 |
| Line of credit | - | 1,969,986 |
| Accounts payable | 1,252,242 | 685,606 |
| Bank overdraft | - | 204,525 |
| Advance billing and customer deposits | 465,838 | 452,772 |
| Income taxes payable | 462 | 713 |
| Accrued expenses | <u>495,164</u> | <u>515,509</u> |
| Total Current Liabilities | <u>2,869,845</u> | <u>5,432,564</u> |
| | | |
| Long-Term Liabilities: | | |
| Long-term debt | 7,260,815 | 6,254,286 |
| Capital lease obligation | 69,444 | 111,250 |
| Other long-term liabilities | <u>54,280</u> | <u>61,465</u> |
| Total Long-Term Liabilities | <u>7,384,539</u> | <u>6,427,001</u> |
| | | |
| Members' Equity: | | |
| Controlling Interest | | |
| Memberships and other equities | 76,334 | 86,822 |
| Patronage capital | 5,166,671 | 5,741,597 |
| Accumulated other comprehensive loss | <u>-</u> | <u>(25,478)</u> |
| Total Controlling Interest | 5,243,005 | 5,802,941 |
| Noncontrolling Interest | <u>(32,880)</u> | <u>(34,400)</u> |
| Total Members' Equity | <u>5,210,125</u> | <u>5,768,541</u> |
| | <u>\$ 15,464,509</u> | <u>\$ 17,628,106</u> |

BEAVER CREEK COOPERATIVE TELEPHONE COMPANY AND SUBSIDIARY**Consolidated Statements of Operations**

Years Ended December 31, 2015 and 2014

| | <u>2015</u> | <u>2014</u> |
|-------------------------------------|---------------------|---------------------|
| Operating Revenues: | | |
| Local network services | \$ 1,247,272 | \$ 1,122,183 |
| Network access services | 2,467,833 | 2,943,398 |
| Miscellaneous operating | 372,957 | 411,925 |
| Internet | 1,607,620 | 1,649,278 |
| CLEC | 260,852 | 230,328 |
| Long distance | 98,658 | 97,208 |
| Wireless | 180,201 | 213,659 |
| Cable television | 1,583,626 | 1,639,622 |
| Other nonregulated revenues | 37,369 | 66,693 |
| Total Operating Revenues | <u>7,856,388</u> | <u>8,374,294</u> |
| Operating Expenses: | | |
| Plant specific | 1,129,984 | 1,077,593 |
| Plant nonspecific | 388,910 | 630,958 |
| Customer | 702,072 | 714,909 |
| Corporate | 1,115,808 | 953,943 |
| Depreciation and amortization | 847,274 | 886,677 |
| Other taxes | 155,378 | 190,909 |
| Internet | 665,733 | 1,114,995 |
| CLEC | 432,448 | 384,767 |
| Long distance | 150,239 | 168,134 |
| Wireless | 193,500 | 202,249 |
| Cable television | 1,869,399 | 1,892,250 |
| Other nonregulated expenses | 298,877 | 208,676 |
| Total Operating Expenses | <u>7,949,622</u> | <u>8,426,060</u> |
| Operating Loss | <u>(93,234)</u> | <u>(51,766)</u> |
| Other Income (Expense) | | |
| Interest and dividend income | 38,568 | 48,330 |
| Other income (expense), net | 3,063 | (2,825) |
| Interest expense | (521,448) | (606,607) |
| Income tax expense | (300) | (130,287) |
| Total Other Expense, net | <u>(480,117)</u> | <u>(691,389)</u> |
| Loss Before Noncontrolling Interest | (573,351) | (743,155) |
| Noncontrolling Interest | <u>(1,520)</u> | <u>(28,594)</u> |
| Net Loss | <u>\$ (574,871)</u> | <u>\$ (771,749)</u> |

See accompanying notes to consolidated financial statements.

BEAVER CREEK COOPERATIVE TELEPHONE COMPANY AND SUBSIDIARY**Consolidated Statements of Comprehensive Income**Years Ended December 31, 2015 and 2014

| | <u>2015</u> | <u>2014</u> |
|---|---------------------|---------------------|
| Net Loss | \$ (574,871) | \$ (771,749) |
| Other Comprehensive Loss: | | |
| Unrealized loss on marketable securities | (38) | (37) |
| Realized loss due to other-than-temporary decline in marketable securities | <u>25,516</u> | <u>-</u> |
| Other comprehensive income (loss) | <u>25,478</u> | <u>(37)</u> |
| Total Comprehensive Loss | <u>\$ (574,909)</u> | <u>\$ (771,786)</u> |

BEAVER CREEK COOPERATIVE TELEPHONE COMPANY AND SUBSIDIARY

Consolidated Statements of Changes in Members' Equity

Years Ended December 31, 2015 and 2014

| | Member- ships and other Equities | Patronage Capital | Accumulated Other Comprehensive Loss | Total Controlling Interest | Non- Controlling Interest | Total |
|--|---|----------------------|---|----------------------------------|---------------------------------|---------------------|
| Balance, December 31, 2013 | \$ 99,072 | \$ 6,516,704 | \$ (25,441) | \$ 6,590,335 | \$ (62,994) | \$ 6,527,341 |
| Net margin (loss) | - | (771,749) | - | (771,749) | 28,594 | (743,155) |
| Unrealized loss on marketable securities | - | - | (37) | (37) | - | (37) |
| Net membership decrease | (53) | - | - | (53) | - | (53) |
| Other capital credit activity, net | <u>(12,197)</u> | <u>(3,358)</u> | <u>-</u> | <u>(15,555)</u> | <u>-</u> | <u>(15,555)</u> |
| Balance, December 31, 2014 | 86,822 | 5,741,597 | (25,478) | 5,802,941 | (34,400) | 5,768,541 |
| Net margin (loss) | - | (574,871) | - | (574,871) | 1,520 | (573,351) |
| Unrealized loss on marketable securities | - | - | (38) | (38) | - | (38) |
| Realized loss due to other-than-temporary decline in marketable securities | - | - | 25,516 | 25,516 | - | 25,516 |
| Net membership increase | 279 | - | - | 279 | - | 279 |
| Other capital credit activity, net | <u>(10,767)</u> | <u>(55)</u> | <u>-</u> | <u>(10,822)</u> | <u>-</u> | <u>(10,822)</u> |
| Balance, December 31, 2015 | <u>\$ 76,334</u> | <u>\$ 5,166,671</u> | <u>\$ -</u> | <u>\$ 5,243,005</u> | <u>\$ (32,880)</u> | <u>\$ 5,210,125</u> |

BEAVER CREEK COOPERATIVE TELEPHONE COMPANY AND SUBSIDIARY**Consolidated Statements of Cash Flows**

Years Ended December 31, 2015 and 2014

| | <u>2015</u> | <u>2014</u> |
|---|------------------|------------------|
| Cash Flows from Operating Activities: | | |
| Net loss | \$ (574,871) | \$ (771,749) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 847,274 | 886,677 |
| Nonregulated depreciation | 830,725 | 764,017 |
| Loss attributable to noncontrolling interest | 1,520 | 28,594 |
| Noncash patronage | (35,305) | (39,527) |
| Loss on investments | 25,553 | - |
| Change in deferred taxes | - | 129,817 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 164,440 | 41,157 |
| Materials and supplies | 44,010 | 19,974 |
| Prepaid expenses | (4,234) | 37,981 |
| Accounts payable | 566,636 | 374,234 |
| Bank overdraft | (204,525) | 204,525 |
| Accrued expenses | (20,345) | (1,822,841) |
| Income taxes payable | (251) | 151 |
| Advanced billing and customer deposits | 13,066 | 170,322 |
| Deferred revenue | - | (42,500) |
| Other long-term liabilities | (7,185) | 58,097 |
| | <u>1,646,508</u> | <u>38,929</u> |
| Net Cash Provided by Operating Activities | | |
| Cash Flows from Investing Activities: | | |
| Capital expenditures | (493,822) | (448,739) |
| Purchase of investments | - | (28,532) |
| Proceeds from investments | 146,538 | 137,934 |
| | <u>(347,284)</u> | <u>(339,337)</u> |
| Net Cash Used by Investing Activities | | |

| | <u>2015</u> | <u>2014</u> |
|--|----------------------------|--------------------------|
| Cash Flows from Financing Activities: | | |
| Change in line of credit | \$ - | \$ 1,769,986 |
| Principal payments on long-term debt | (1,202,473) | (1,469,769) |
| Principal payments on capital lease obligation | (39,114) | (17,624) |
| Change in memberships | 279 | (12,250) |
| Patronage capital paid, net | <u>(10,822)</u> | <u>(3,358)</u> |
| Net Cash Provided (Used) by Financing Activities | <u>(1,252,130)</u> | <u>266,985</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | 47,094 | (33,423) |
| Cash and Cash Equivalents, beginning | <u>23,156</u> | <u>56,579</u> |
| Cash and Cash Equivalents, ending | \$ <u><u>70,250</u></u> | \$ <u><u>23,156</u></u> |
| Cash Paid During the Year for Interest | \$ <u><u>522,618</u></u> | \$ <u><u>620,908</u></u> |
| Cash Paid During the Year for Taxes | \$ <u><u>300</u></u> | \$ <u><u>450</u></u> |
| Non-Cash Financing Activity: Refinance Line of Credit into Long-Term Debt, net of Subordinated Capital Certificates | \$ <u><u>1,258,996</u></u> | \$ <u><u>-</u></u> |

BEAVER CREEK COOPERATIVE TELEPHONE COMPANY and SUBSIDIARY

Notes to Consolidated Financial Statements

Years Ended December 31, 2015 and 2014

Note 1 - Organization and Summary of Significant Accounting Policies

Organization

Beaver Creek Cooperative Telephone Company (the Company) is an Oregon cooperative corporation providing telecommunications, cable television, wireless telephone, and internet/DSL services to its members on a cooperative basis. The service area is in the general vicinity of Beaver Creek and Oregon City, Oregon.

Basis of Consolidation

The consolidated financial statements of the Company include the accounts of the Company and its wholly-owned subsidiary, Telsystems West, Inc. (TWI). TWI is the majority shareholder of both MegAvail, Inc. (91.18% ownership) and Randax, LLC (86.62% ownership). All material intercompany transactions and balances have been eliminated in consolidation.

The noncontrolling interest amount shown in the consolidated financial statements represents the ownership of noncontrolling shareholders.

Basis of Accounting

The Company's consolidated 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 Company is subject to limited regulation by the Public Utility Commission of Oregon (PUC) and the Federal Communications Commission (FCC). The Company 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 Company's application of accounting principles generally accepted in the United States of America differs in certain respects from the application by non-regulated 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 Company's future operations and financial condition. See Note 1, National Broadband Plan and FCC Order.

Estimates

The Company uses estimates and assumptions in preparing the 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 disclosures of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investment securities with a maturity of 3 months or less to be cash equivalents. The Company maintains its cash in bank deposits that at times may exceed federally insured limits, which is generally \$250,000 per account per bank. At December 31, 2015 and 2014 the Company did not have any funds in any one bank that exceeded the federally insured limit.

The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash.

Accounts Receivable

The Company extends credit to its customers. An allowance for doubtful accounts is maintained, based upon management's review of the year-end accounts receivable aging and past credit and collections history. Receivables are written off when the Company determines an account is uncollectible. Past due status is determined based on the age of the past due accounts.

BEAVER CREEK COOPERATIVE TELEPHONE COMPANY and SUBSIDIARY

Notes to Consolidated Financial Statements

Years Ended December 31, 2015 and 2014

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

Fair Value of Financial Instruments

The Company's financial instruments, none of which are held for trading purposes, include cash and cash equivalents, marketable securities, receivables, accounts payable, line of credit, capital lease obligation, and notes payable. The Company 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.

Materials and Supplies

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.

Marketable Securities

The Company 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.

Investments

Investments in which the Company 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 Company's share of income or loss. Investments in which the Company holds less than a 20% interest are recorded at cost and income is recorded when dividends are received.

Property, Plant, and Equipment

Regulated 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 property 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.

Nonregulated equipment in service and under construction and TWI's 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 14.29%. 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 Allocations

The net margin or loss of the Company is allocated to its members annually, in proportion to the patron's annual charges for eligible services.

Comprehensive Income

The Company 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 Company 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 Company 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 Company becomes a taxable cooperative. The Company 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. Telsystems West, Inc. and its subsidiaries are taxable corporations and file separate tax returns.