Smithville Telephone Company, Incorporated

A Wholly-owned Subsidiary of Traceroad, Inc.

Auditor's Reports and Financial Statements

December 31, 2012 and 2011

BKD LLP
CPAs & Advisors

Smithville Telephone Company, Incorporated

A Wholly-owned Subsidiary of Traceroad, Inc.

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Contents

Independent Auditor's Report 1

Financial Statements

Balance Sheets 3

Statements of Operations and Retained Earnings 4

Statements of Cash Flows 5

Notes to Financial Statements 6

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards* 18

Schedule of Findings and Responses 20

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Independent Auditor's Report

Board of Directors
Smithville Telephone Company, Incorporated
Smithville, Mississippi

Report on the Financial Statements

We have audited the accompanying financial statements of Smithville Telephone Company, Incorporated (the Company), a wholly-owned subsidiary of Traceroad, Inc., which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations and retained earnings 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.

Auditor's Responsibility

Our responsibility is to express opinions 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 opinions.

Basis for Qualified Opinion

The Company has reported the long-term portion of its debt as a noncurrent liability in the accompanying 2012 balance sheet, which, in our opinion, should be reported as a current liability in accordance with accounting principles generally accepted in the United States of America. As described in Note 7, the Company's debt is callable due to a loan covenant violation. If the debt was reported as a current liability, current maturities of long-term debt would be increased by $276,976, and long-term debt would be decreased by $276,976 as of December 31, 2012.

Qualified Opinion

In our opinion, except for the effects on the 2012 balance sheet of not reporting long-term debt as a current liability as described in the "Basis for Qualified Opinion" paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Smithville Telephone Company, Incorporated as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

In accordance with *Government Auditing Standards*, we have also issued our report dated April 30, 2013 on our consideration of the Company's 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* and should be considered in assessing the results of our audit.

BKD, LLP

Jackson, Mississippi
April 30, 2013

Smithville Telephone Company, Incorporated
A Wholly-owned Subsidiary of Traceroad, Inc.
Balance Sheets
December 31, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash	$ 536,893	$ 580,304
Available-for-sale securities	497,671	580,050
Accounts receivable		
Telecommunications customers		
(Net of allowances of $500 for both 2012 and 2011)	3,214	5,442
Other, principally connecting companies	91,236	86,564
Materials and supplies inventories	1,729	2,619
Prepaid expenses	18,337	4,612
Total current assets	1,149,080	1,259,591
Noncurrent Assets		
Prepaid expenses	21,474	-
Deferred Income Taxes	9,308	-
Property, Plant and Equipment, at Cost		
Telecommunications plant in service	2,975,285	2,914,121
Less accumulated depreciation	(2,724,496)	(2,644,448)
	250,789	269,673
Total assets	$ 1,430,651	$ 1,529,264

	2012	2011
Liabilities and Stockholder's Equity		
Current Liabilities		
Current maturities of long-term debt	$ 91,000	$ 107,000
Accounts payable	413,632	149,071
Affiliated accounts payable	57,138	38,898
Customer deposits	-	200
Income taxes payable	-	15,035
Other liabilities	427	1,021
Deferred credits	87,208	168,373
Total current liabilities	649,405	479,598
Long-term Debt	276,976	367,666
Noncurrent Deferred Credits	-	71,140
Deferred Income Taxes	-	34,238
Stockholder's Equity		
Common stock, $100 par value		
Authorized 250 shares		
Issued and outstanding 84 shares	8,400	8,400
Additional paid-in capital	171	171
Retained earnings	495,699	568,051
Total stockholder's equity	504,270	576,622
Total liabilities and stockholder's equity	$ 1,430,651	$ 1,529,264

Smithville Telephone Company, Incorporated
A Wholly-owned Subsidiary of Traceroad, Inc.
Statements of Operations and Retained Earnings
Years Ended December 31, 2012 and 2011

	2012	2011
Operating Revenues		
Basic local services	$ 139,272	$ 149,706
Long distance and access charges	338,323	410,863
Miscellaneous	9,086	10,895
Uncollectible revenues	(3,343)	(3,820)
	483,338	567,644
Operating Expenses		
Plant specific operations	114,565	90,821
Plant nonspecific operations	53,587	26,381
Depreciation	69,986	116,508
Customer operations	62,751	55,394
Corporate operations	420,033	379,318
	720,922	668,422
Operating Taxes		
Credit for income taxes	(103,591)	(16,390)
Other operating taxes	13,997	16,891
	(89,594)	501
Operating Loss	(147,990)	(101,279)
Other Income (Expense)		
Investment earnings	17,678	28,383
Income from nonregulated operations	104,469	111,191
Provision for income taxes	(59,197)	(17,595)
Other, net	33,529	14,218
	96,479	136,197
Income (Loss) Available for Fixed Charges	(51,511)	34,918
Fixed Charges - Interest on Long-term Debt	20,841	25,590
Net Income (Loss)	(72,352)	9,328
Retained Earnings, Beginning of Year	568,051	558,723
Retained Earnings, End of Year	$ 495,699	$ 568,051

Smithville Telephone Company, Incorporated
A Wholly-owned Subsidiary of Traceroad, Inc.
Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	2012	2011
Operating Activities		
Net income (loss)	$ (72,352)	$ 9,328
Items not requiring (providing) cash		
Depreciation	69,986	116,508
Deferred income taxes	(43,546)	(48,182)
Changes in		
Accounts receivables	(2,444)	24,143
Materials and supplies inventories	890	291
Prepaid expenses	(35,199)	383
Accounts payable	(96,247)	59,643
Deferred credits	(152,505)	239,513
Income taxes payable	(15,035)	8,964
Other liabilities	(594)	(16,196)
Net cash provided by (used in) operating activities	(347,046)	394,395
Investing Activities		
Additions to plant, net of salvage	(2,630,781)	(1,122,311)
Sales of available-for-sale securities	82,379	-
Net cash used in investing activities	(2,548,402)	(1,122,311)
Financing Activities		
Principal payments on long-term debt	(106,690)	(109,571)
Proceeds from BIP grant	2,958,727	1,188,434
Net cash provided by financing activities	2,852,037	1,078,863
Increase (Decrease) in Cash	(43,411)	350,947
Cash, Beginning of Year	580,304	229,357
Cash, End of Year	$ 536,893	$ 580,304
Supplemental Cash Flows Information		
Interest paid	$ 20,976	$ 25,710
Purchases of property and equipment with trade payables	$ 379,048	$ 71,410
Income taxes paid (refunds received)	$ 12,873	$ 24,973

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Reporting Entity and Nature of Operations

Smithville Telephone Company, Incorporated (the Company) is a wholly-owned subsidiary of Traceroad, Inc. The accounting policies of the Company conform to accounting principles generally accepted in the United States of America and reflect practices appropriate to the telephone industry. The Company provides local telephone exchange carrier services in portions of the Mississippi Counties of Monroe and Itawamba. The accounting records of the Company are maintained in accordance with the Uniform System of Accounts prescribed by the Federal Communications Commission (FCC) and the Mississippi Public Service Commission (MPSC).

Use of Estimates

The preparation 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.

Cash Equivalents

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2012 and 2011, the Company had no cash equivalents.

At December 31, 2012, the Company's cash accounts did not exceed federally insured limits.

Pursuant to legislation enacted in 2010, the Federal Deposit Insurance Corporation (FDIC) fully insured all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are subject to the $250,000 limit on FDIC insurance per covered institution.

Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Trading securities are recorded at fair value, with changes in fair value included in earnings. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts, if any, are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The Company invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term, and that such change could materially affect the amounts reported in the accompanying balance sheets.

Accounts Receivable

The Company generally grants credit to all customers. In certain cases, a deposit may be collected prior to the provision of service. Accounts receivable are stated at the amount billed to customers. The Company provides an allowance for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Accounts receivable are ordinarily due 20 days after the issuance of the invoice. Accounts are considered delinquent after they are due. Delinquent receivables are written based on individual credit evaluation and specific circumstances of the customer.

Materials and Supplies Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Property, Plant and Equipment

Telecommunications plant in service is stated at original cost of construction, including capitalized costs such as taxes and payroll-related expenses.

Depreciation

Depreciation on telecommunications plant is provided using the composite straight-line method using rates approved by the MPSC. Renewals and betterments of units of property are charged to telecommunications plant in service. The original cost of depreciable property retired, together with removal cost, less any salvage realized, is charged to accumulated depreciation. No gain or loss is recognized with ordinary retirements of depreciable property. Repairs and renewals of minor items of property are charged to maintenance expense.

Long-lived Asset Impairment

The Company evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value, and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended December 31, 2012 or 2011.

Income Taxes

The Company accounts for the income taxes in accordance with income tax accounting guidance, Accounting Standards Codification [ASC] 740, *Income Taxes*. The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and the tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. Income tax expense is allocated between operating and nonoperating activities of the Company based on relative taxable income of those activities.

Uncertain tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50%; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment.

The Company recognizes any interest and penalties on income taxes as a component of other operating expense.

Revenue Recognition

Revenues are recognized when earned, regardless of the period in which they are billed. Telephone toll and access services are furnished in conjunction with AT&T and various interexchange carriers.

Local service revenues include revenues derived from the provision of basic flat rate message service; enhanced services such as call waiting, call forwarding and touchtone services; certain nonrecurring charges such as central office line connection charges; and revenues derived through messages which originate or terminate in the Company's service area through the provision of elective measured extended area calling plans.

The interstate access charges are based upon tariffs filed by the National Exchange Carrier Association (NECA) with the FCC on behalf of member companies. These access charges are billed by the Company to the interstate interexchange carriers and pooled with like revenues from all NECA member companies. The portion of the pooled access charge revenues received by the Company is based upon nationwide average schedule costs of providing interstate access service, plus a return on the investment dedicated to providing that service.

Compensation for intrastate-interlata toll and access services is based upon access charge tariffs filed with the MPSC. The Company's intrastate-intralata toll and access revenues are based upon a special settlement arrangement with the intrastate-intralata long distance carrier. Compensation for intrastate-intralata access services is received under a primary carrier plan. Access charges are billed by the Company to the primary intralata interexchange carrier using tariffed access rates filed with the MPSC and are retained by the Company. Toll revenues are billed to the end user at the primary carrier's toll rates and are remitted to the primary carrier.

Taxes collected from customers and remitted to governmental authorities are presented in the accompanying statements of operations and retained earnings on a net basis.

Current Economic Environment

The current economic environment presents businesses with difficult circumstances and challenges, which, in some cases, could result in declines in the volume of business, constraints on liquidity and difficulty obtaining financing. The accompanying financial statements have been prepared using values and information currently available to the Company. Additionally, a portion of the Company’s customers were significantly impacted by a storm in April 2011. This event, coupled with the general economic environment, could ultimately have an adverse impact on future operating results and the Company’s ability to meet debt covenants or maintain sufficient liquidity.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 financial statement presentation. These reclassifications had no effect on net earnings.

Note 2: Restricted Cash

Included in cash is $453,408 and $274,706 as of December 31, 2012 and 2011, respectively, which is restricted for construction purposes under the approval of the Rural Utilities Service (RUS).

Note 3: Available-for-sale Securities

The cost, which approximates fair value, of available-for-sale securities was $497,671 and $580,050 at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, the entire amount of available-for-sale securities was invested in mutual funds.

Note 4: Telecommunications Plant in Service

The major classes of telecommunications plant and their related straight-line depreciation rates are as follows:

	2012	2011	Rates
Land	$ 40,478	$ 40,478	0.0%
Buildings	244,064	244,064	2.9%
Central office equipment	744,534	683,370	5.0 - 8.0%
Station connections	44,761	44,761	10.0%
Buried cable	1,590,269	1,590,269	3.0%
Furniture and office equipment	93,783	93,783	7.5%
Vehicles	153,376	153,376	16.0%
Tools and other work equipment	59,259	59,259	16.0%
Radio equipment	4,761	4,761	16.0%
	$ 2,975,285	$ 2,914,121	

Application of these rates has resulted in composite rates as applied to average depreciable telecommunications plant investment of 2.38% and 3.49% for 2012 and 2011, respectively.

Note 5: Broadband Infrastructure Program (BIP) Grant

During 2010, the Company was awarded $7,110,866 in RUS grant funding under the Broadband Infrastructure Program of the American Recovery and Reinvestment Act of 2009 for plant expansion. In accordance with Part 32 of the Uniform System of Accounts for Telecommunications Companies prescribed by the FCC, contributions in the form of money or its equivalent toward the construction of telecommunications plant are credited to the accounts charged with the cost of such construction. The proceeds drawn from the BIP grant not yet expended are recorded as a deferred credit.

The following is a summary of both the BIP grant plant expenditures and deferred credits as of December 31, 2012 and 2011.

	2012	2011
Construction expenditures		
Telephone plant under construction	$ 2,958,727	$ 834,595
Telephone plant in service	-	221,134
	$ 2,958,727	$ 1,055,729
Grant proceeds		
Amount recorded as offset to plant	$ 2,958,727	$ 1,055,729
Deferred credits	-	132,705
Total grant receipts	$ 2,958,727	$ 1,188,434

Note 6: April 27, 2011 Storms

On April 27, 2011, the Town of Smithville, Mississippi and surrounding area were significantly impacted by an EF-5 tornado. The Company received insurance proceeds for property damage of approximately $413,000 and business interruption of approximately $13,000. Property damage recoveries were netted against the related expenditures or deferred for future recognition. The deferred credits for property damage recoveries are anticipated by management to be expended within two years and are carried in the accompanying balance sheets at December 31, 2012 and 2011, as follows:

	2012	2011
Current deferred credits		
Property damage	$ 87,208	$ 35,668
Noncurrent deferred credits		
Property damage	-	71,140

Note 7: Long-term Debt

Substantially all assets are pledged as collateral for long-term debt due to RUS, an agency of the United States of America, and are represented by 2% and 5% mortgage notes. These notes are for 24 and 35 years, and principal and interest are payable in quarterly and monthly installments totaling approximately $128,000 on an annual basis. The notes mature at various times from 2014 to 2022.

During 2012, the Company failed to meet its required times-interest-earned ratio (TIER) requirement under its agreement with RUS. This condition allows RUS, if they choose to, upon notification to the Company, to accelerate long-term maturities of debt to current. However, to date, the Company has not received such notification from RUS.

The following is a summary of long-term debt:

	2012	2011
RUS 2% mortgage notes	$ -	$ 20,379
RUS 5% mortgage notes	367,976	454,287
	367,976	474,666
Less current maturities	(91,000)	(107,000)
	$ 276,976	$ 367,666

The estimated aggregate annual maturities of long-term debt at December 31, 2012, are:

2013	$ 91,000
2014	92,000
2015	94,000
2016	78,000
2017	3,000
Thereafter	9,976
	$ 367,976

Note 8: Dividend Restrictions

Under the terms of the RUS mortgage agreements, dividend and other capital distributions are restricted. At December 31, 2012, the Company had no retained earnings available for payment of dividends.

Note 9: Income Taxes

The Company, for income tax purposes, is included in the consolidated income tax return of Traceroad, Inc., which files income tax returns in the U.S. federal jurisdiction and the State of Mississippi. For financial statement purposes, the Company computes its income tax by applying the statutory rate to its pretax income reported in the financial statements (separate return method). The Company is no longer subject to U.S. federal and state income tax examinations for years before 2009.

For tax purposes, the Company uses accelerated depreciation. The income tax effects of the difference in book and tax depreciation have been recorded as deferred income taxes.

The provisions (credits) for income taxes include these components:

	2012	2011
Operating		
Current		
Federal	$ (50,283)	$ 77,316
State	(9,762)	(45,524)
	(60,045)	31,792
Deferred		
Federal	(37,709)	(42,330)
State	(5,837)	(5,852)
Total operating	(43,546)	(48,182)
	(103,591)	(16,390)
Other		
Current		
Federal	50,283	(37,558)
State	8,914	55,153
Total other	59,197	17,595
Total income tax provision (benefit)	$ (44,394)	$ 1,205

The components of net deferred tax assets and liabilities recognized in the accompanying balance sheets due to temporary differences and carryforwards are as follows:

	2012	2011
Deferred tax liabilities		
Accelerated tax depreciation	$ (19,697)	$ (34,238)
Deferred tax assets		
Net operating loss carryforward	29,005	-
Net deferred tax assets (liabilities)	$ 9,308	$ (34,238)

The Company's effective tax rate differs from the federal statutory rate due to the effects of lower income tax brackets for federal taxes.

Note 10: Pension Plan

The Company provides a simplified employee pension plan for its employees. The Company may make, at its discretion, contributions up to 15% of all participants' gross wages on an annual basis. In 2012 and 2011, the Company contributed $63,000 and $20,000, respectively, to the plan.

Note 11: Nonregulated Operations

The Company provides internet access, customer premise equipment and inside wire maintenance to customers in the general vicinity of its local exchange area. Details of the nonregulated operations are as follows:

	2012	2011
Revenue		
Lease, maintenance contracts and internet access	$ 229,908	$ 220,056
Expenses		
Maintenance, connection and installation and other costs	125,439	108,865
	$ 104,469	$ 111,191

Although the Company has identified the principal revenues and expenses of nonregulated operations, certain interdependence and overlaps between regulated and nonregulated operations exist, particularly as to sharing of commercial office and administrative expenses. Accordingly, the information provided may not be indicative of the operating results of nonregulated activities conducted as an independent unit.

Note 12: Disclosures About Fair Value of Assets and Liabilities

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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the inputs and valuation methodologies used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Available-for-sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include investments in mutual funds.

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012				
Mutual funds	$ 497,671	$ 497,671	$ -	$ -
December 31, 2011				
Mutual funds	580,050	580,050	-	-

Note 13: Related Parties

The Company provides billing and collection services to an affiliate. Amounts due to the affiliate were $26,136 and $23,448 at December 31, 2012 and 2011, respectively.

Additionally, the Company had $31,002 and $15,450 at December 31, 2012 and 2011, respectively, due to the parent company for income taxes paid on the Company's behalf.

Note 14: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the financial statements were available to be issued.

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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Directors
Smithville Telephone Company, Incorporated
Smithville, Mississippi

We have audited the financial statements of Smithville Telephone Company, Incorporated (the Company), a wholly-owned subsidiary of Traceroad, Inc., as of and for the year ended December 31, 2012, and have issued our report thereon dated April 30, 2013 which expressed a qualified opinion because of a departure from accounting principles generally accepted in the United States of America. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses, and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Company's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2012-01, 2012-02 and 2012-03 to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Other Matters

We also noted certain additional matters that we reported to the Company's management in a separate letter dated April 30, 2013.

The Company's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Company's responses, and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the governing body, management, others within the Company and the Rural Utility Service, and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

Jackson, Mississippi
April 30, 2013

Smithville Telephone Company, Incorporated
A Wholly-owned Subsidiary of Traceroad, Inc.
Schedule of Findings and Responses
Year Ended December 31, 2012

Reference Number	Finding
2012-01	***Criteria or Specific Requirement*** – Management is responsible for establishing and maintaining effective internal control over financial reporting.

Condition – Management relies on its outside auditors to assist in the preparation of external financial statements and related footnote disclosures.

Context – Under auditing standards generally accepted in the United States of America, outside auditors cannot be considered a part of the Company's internal control structure, and the design of the Company's internal control structure does not include procedures for the preparation of external financial statements.

Effect – Potentially material misstatements in the financial statements and related footnote disclosures could occur and not be prevented or detected by the Company's internal control structure.

Cause – The Company has not designed internal control procedures for preparing external financial statements.

Recommendation – Management should periodically evaluate the benefits of developing internal control procedures or other compensating controls over the preparation of external financial statements and implement those changes it deems appropriate for which benefits are determined to exceed costs.

View of Responsible Officials and Planned Corrective Actions – Management acknowledges this finding and, at this point, considers the cost of additional personnel to correct the condition in excess of the benefits that would be derived. Management will continue to monitor the condition for future cost versus benefit.

Reference Number	Finding
2012-02	***Criteria or Specific Requirement*** – Management is responsible for establishing and maintaining effective internal control over financial reporting.
	Condition – Limited separation of functions exist within the accounting system.
	Context – There are incompatible duties within cash receipts, cash disbursements, payroll and billing.
	Effect – Potentially material misstatements in the financial statements or material misappropriations of assets due to error or fraud could occur and not be prevented or detected in a timely manner.
	Cause – The Company has not designed internal control procedures for separation of duties in various functional accounting areas.
	Recommendation – Management should periodically evaluate the cost versus the benefits of developing internal control procedures or other compensating controls over the functional accounting areas and implement those changes it deems appropriate for which benefits are determined to exceed costs.
	View of Responsible Officials and Planned Corrective Actions – Management acknowledges this finding and, at this point, considers the cost of additional personnel to correct the condition in excess of the benefits that would be derived. Management will continue to monitor the condition for future cost versus benefit.

Reference Number	Finding
2012-03	***Criteria or Specific Requirement*** – Management is responsible for establishing and maintaining effective internal control over financial reporting. ***Condition*** – The design of the Company's accounting process does not provide for appropriate review of journal entries recorded to adjust accounts in significant transaction areas. ***Context*** – There is no process providing for the review of journal entries. ***Effect*** – Potentially material misstatements in the financial statements or material misappropriations of assets due to error or fraud could occur and not be prevented or detected in a timely manner. ***Cause*** – The Company has not designed internal control procedures for appropriate review of journal entries recorded to adjust accounts in significant transaction areas. ***Recommendation*** – Management should periodically evaluate the benefits of developing internal control procedures or other compensating controls over the review of journal entries and implement those changes it deems appropriate for which benefits are determined to exceed costs. ***View of Responsible Officials and Planned Corrective Actions*** – Management acknowledges this finding and, at this point, considers the cost of additional personnel to correct the condition in excess of the benefits that would be derived. Management will continue to monitor the condition for future cost versus benefit.