

Pay Tel Communications, Inc.

**FINANCIAL STATEMENTS
and Independent Auditor's Report**

December 31, 2012 and 2011



INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
Pay Tel Communications, Inc.
Greensboro, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of Pay Tel Communications, Inc. (an S Corporation), 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 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of 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.

CONFIDENTIAL AND PROPRIETARY INFORMATION

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pay Tel Communications, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Leiper, Klem & Rumley, C.P.A.

Greensboro, North Carolina
April 17, 2013

Pay Tel Communications, Inc.

BALANCE SHEETS

December 31, 2012 and 2011

<u>Assets</u>	<u>2012</u>	<u>2011</u>
Current assets:		
Cash		
Net accounts receivable		
Prepaid expenses and other receivables		
Total current assets		
Property and equipment, at cost:		
Inmate communications equipment		
Office furniture, equipment and software		
Leasehold improvements		
Vehicles		
Total property and equipment		
Less accumulated depreciation and amortization		
Net property and equipment		
Other assets:		
Notes receivable from related parties, net		
Net deferred contract costs and commissions		
Settlement reserve deposits		
Cash surrender value of Stockholder's life insurance		
Deposits and other noncurrent assets		
Total other assets		
Total Assets		

Pay Tel Communications, Inc.

BALANCE SHEETS

December 31, 2012 and 2011

Liabilities and Stockholders' Equity

	<u>2012</u>	<u>2011</u>
Current liabilities:		
Working capital line of credit		
Current portion of equipment loans		
Unearned revenues		
Accounts payable		
Accrued expenses and other liabilities		
Total current liabilities		
Noncurrent portion of equipment loans		
Total liabilities		
Stockholders' equity:		
Common stock (Note 12)		
Retained earnings		
Total stockholders' equity		
Total Liabilities and Stockholders' Equity		

Pay Tel Communications, Inc.

STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Net revenues		
Costs of revenues		
Gross profit		
Selling, general and administrative expenses:		
Salaries and related expenses		
Depreciation and amortization		
Other		
Office and computer supplies		
Rents, maintenance and utilities		
Professional services		
Telephone and broadband		
Property taxes, licenses and insurance		
Research and development		
Total selling, general and administrative expenses		
Income (loss) from operations (Note 13)		
Other income (expenses)		
Income (loss) before extraordinary expenses		
Extraordinary expenses (Note 11)		
Net income (loss)		
Retained earnings at beginning of year		
Stockholder's distributions		
Retained earnings at end of year		

Pay Tel Communications, Inc.

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<u>Increase (Decrease) in Cash</u>		
Operating activities:		
Net income (loss)		
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization		
Amortization of deferred charges		
Amortization of deferred contract costs		
Amortization of other noncurrent assets		
Allowance for doubtful accounts and other noncash activities		
Net loss on disposal of property and equipment		
Cash surrender value of Stockholder's life insurance		
(Increase) decrease in related assets:		
Accounts receivable and settlement reserve deposits		
Prepaid expenses, deposits and other receivables		
Net deferred contract costs		
Increase (decrease) in related liabilities:		
Accounts payable		
Accrued expenses and other liabilities		
Unearned revenues		
Net cash provided by operating activities		
Investing activities:		
Purchases of property and equipment		
Net proceeds from sale of property and equipment		
Net (advances) repayments on notes receivable from related parties		
Net cash used in investing activities		

- Continued -

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS December 31, 2012 and 2011

(1) Nature of Business

Pay Tel Communications, Inc. (the "Company") owns and operates automated telephone communication systems in confinement facilities for use by inmates under contracts with the confinement facilities that typically range from three to five years and expire at various times beginning in 2013. The Company services its customers throughout the United States from its headquarters in Greensboro, North Carolina.

(2) Summary of Significant Accounting Policies

- (a) Revenue Recognition – Generally, revenues from automated calls from confinement facilities are recognized, net of unbillable returned call records and applicable sales taxes, at the time the call is completed. State and federal regulatory authorities govern certain rates the Company can charge customers for these services.

Generally, customers establish an electronic account through prepayments to the Company. When an electronic account becomes inactive, the Company either refunds the customer's unused balance or issues them a prepaid phone card that does not expire. At any time in the future, customers may use the prepaid phone card or return it to the Company for a refund.

The Company recognizes into net revenues the balances of prepaid phone cards for which the Company believes, based upon historical redemption patterns, the likelihood of redemption by the customer is remote.

- (b) Credit Risk - Cash and accounts receivable are financial instruments which potentially subject the Company to credit risk. Management reviews outstanding receivable accounts on an ongoing basis, writes off the amounts deemed uncollectible and provides an additional reserve for uncollectible accounts based on past experience (see Notes 4 and 5).

- [REDACTED]
- (c) Advertising costs - The Company expenses advertising costs as they are incurred. Advertising expenses for the years ended December 31, 2012 and 2011 were approximately [REDACTED] and [REDACTED].

- (d) Property and Equipment - Property and equipment are recorded at cost. Leasehold improvements are [REDACTED]

Pay Tel Communications, Inc.

**NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

- (e) Net Deferred Contract Costs and Commissions - Net deferred contract costs and commissions consist of payments to Company employees and inmate facilities related to certain inmate contracts. Deferred contract costs and commissions are amortized over the lives of the respective contracts. Accumulated amortization at December 31, 2012 and 2011 was [REDACTED] respectively.

The estimated future amortization expenses related to these deferred costs are as follows:

For the year ending December 31, 2013	[REDACTED]
2014	[REDACTED]
2015	[REDACTED]
2016	[REDACTED]
2017	[REDACTED]
Thereafter	[REDACTED]
Total maturities	[REDACTED]

- (f) Income Taxes - The Company, with the consent of its voting stockholder ("Stockholder"), has elected under the Internal Revenue Code to be an S corporation. In general, pursuant to the election, taxable income is taxed to the stockholders and is not taxed at the corporate level. Therefore, no provisions or liabilities for federal or state income taxes have been included in these financial statements. The Company, by expiration of the statute of limitations, is generally no longer subject to federal or state income tax examinations by tax authorities for the years ending December 31, 2008 or earlier.

The Company has adopted the accounting guidance for uncertainty in income taxes using the provisions of FASB Accounting Standards Codification 740, Income Taxes. Using that guidance, tax positions initially need to be recognized in the financial statements when it is more-likely-than-not the positions will not be sustained upon examination by the tax authorities. Such tax positions initially and subsequently need to be measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority assuming full knowledge of the positions and relevant facts. It also provides guidance for derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As of December 31, 2012 and 2011, the Company had no uncertain tax positions that qualify for either recognition or disclosure in the financial statements and has incurred no interest or penalties related to unrecognized tax liabilities.

- (g) Management Estimates - The preparation of the 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, 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.
- (h) Reclassifications - Certain reclassifications have been made to prior year balances to conform to current year presentation.

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

(3) **Notes Receivable from Related Parties and Other Receivables**

The Company has notes receivable from various trusts established by the Stockholder. No interest has been charged on the outstanding balance. When the cash surrender value of the underlying insurance policies that are funded by the Company exceed the cost of such insurance policies, interest will be charged at the prevailing rates.

(4) **Billing and Collection Arrangements**

The Company primarily utilizes its own internally developed and supported billing and collection system whereby customers establish an electronic account through prepayments to the Company. The accompanying balance sheets [REDACTED] at December 31, 2012 and 2011, respectively. These totals, which if unused are refunded on prepaid phone cards, represent the net amounts prepaid by customers for the acceptance of future calls.

The Company has partnered with third party providers to administer a debit system at inmate facilities where an inmate can transfer funds from their facility trust account to their own telephone account in order to make calls. Unused amounts are returned to the inmate's account upon release from the facility. Net accounts receivable in the accompanying balance sheets include [REDACTED] in amounts due from the third party providers at December 31, 2012 and 2011, respectively. Total allowances for doubtful accounts receivable accounts at December 31, 2012 and 2011 were [REDACTED]

The Company also utilizes the billing and collection services of various Local Exchange Carriers ("LECs"). The LECs bill and collect from the party that accepts the call under month-to-month contracts with the Company.

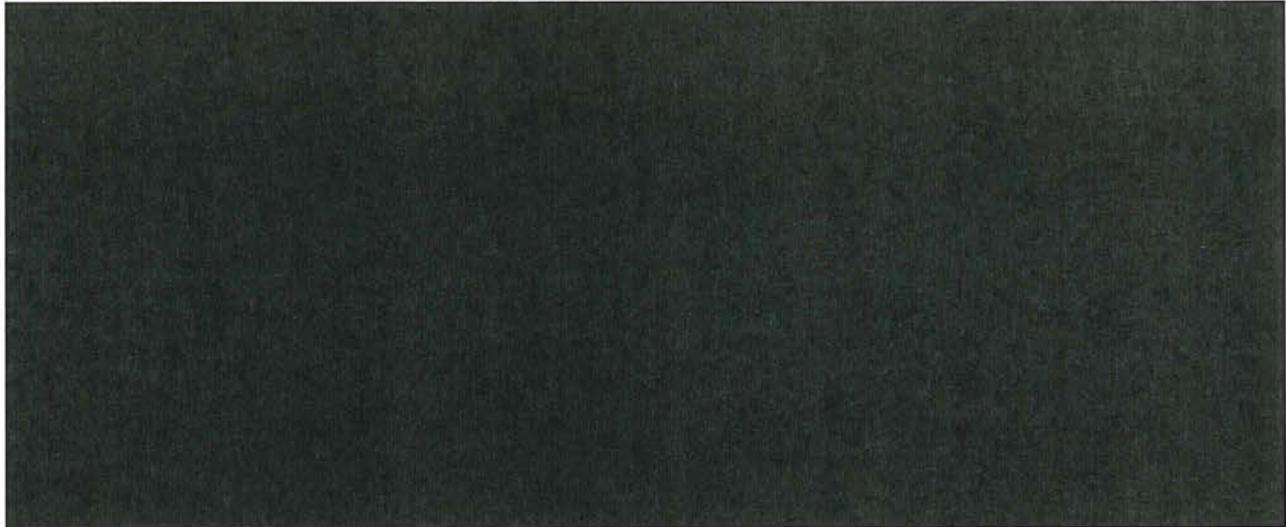
(5) **Settlement Reserve Deposits and Letters of Credit**



Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

(6) **Lines of Credit and Equipment Loan**



The lines of credit and equipment loans are secured by all the property, equipment and other assets, certain cash accounts, the personal guarantee of the Stockholder, the assignment of all confinement facility contracts and the assignment of a certain life insurance policy on the Stockholder. The lines of credit and equipment loans also contain various covenants pertaining to the maintenance of certain financial ratios and various other matters. Stockholder dividends are specifically limited by the loan agreements.

The scheduled maturities of the equipment loans are as follows:

For the year ending December 31, 2013	
2014	
2015	
Total maturities	



(7) **Guarantee of Debt**



Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

(8) **Operating Leases and License Agreements**

[REDACTED]

Future minimum payments due are as follows:

	<u>Office & Warehouse</u>	<u>Other</u>	<u>Total</u>
For the year ending December 31, 2013	[REDACTED]		
2014			
2015			
2016			
2017			
Thereafter			
Total future minimum payments due	[REDACTED]		

Total rent expense for 2012 and 2011 was [REDACTED] respectively.

(9) **Change in revenue recognition estimate**

As a result of access to more detailed information, which affected the timing of the recognition of certain

[REDACTED]

(10) **Profit Sharing Plan**

The Company has a retirement plan covering all employees who are at least 21 years of age and have at least one year of eligible service as defined in the plan. The retirement plan includes 401(k) and profit

[REDACTED]

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

(11) Other Legal Matters



(12) Common Stock

Through August 11, 2011, the Company had 100,000 shares of common stock authorized and 100 shares issued and outstanding. On August 12, 2011, the Company amended the articles of incorporation resulting in the division of the authorized shares into 1,000 shares of voting stock and 99,000 shares of non-voting stock. The 100 shares of outstanding common stock were converted into 100 shares of voting stock. Effective January 1, 2012, the Company converted each share of outstanding voting stock into 10 shares of voting stock and 990 shares of non-voting stock.

(13) Nationwide Expansion



(14) Subsequent Events

Management has evaluated subsequent events through April 17, 2013, the date which the financial statements were available to be issued.