Canby Telephone Association and Subsidiaries

Consolidated Financial Statements with Supplemental Information

Years Ended December 31, 2013 and 2012

AKT
CPAs and Business Consultants

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 and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, 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 that 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, 2013 and 2012, 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 3, 2014

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Financial Statements with Supplemental Information

Years Ended December 31, 2013 and 2012

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CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2013 and 2012

ASSETS	2013	2012
Current Assets:		
Cash and cash equivalents	$ 4,943,782	$ 3,404,757
Marketable securities	2,026,129	2,645,040
Accounts receivable	1,804,097	1,922,190
Inventory	537,512	566,004
Prepaid expenses	560,270	534,325
Total Current Assets	9,871,790	9,072,316
Other Assets and Investments:		
Other assets	79,855	119,465
Investments	1,008,864	992,081
Deferred income taxes	878,000	1,025,000
Goodwill	3,974,375	3,974,375
Total Other Assets and Investments	5,941,094	6,110,921
Property, Plant, and Equipment:		
Property, plant, and equipment	56,758,996	54,424,430
Less accumulated depreciation	37,823,035	34,978,488
Property, Plant, and Equipment, net	18,935,961	19,445,942
	$ 34,748,845	$ 34,629,179

See accompanying notes to consolidated financial statements.

LIABILITIES AND MEMBERS' EQUITY	2013	2012
Current Liabilities:		
Current portion of long-term debt	$ 304,500	$ 304,500
Accounts payable	231,097	663,497
Accrued expenses	535,069	444,777
Patronage capital payable	29,555	26,134
Income taxes payable	41,711	64,420
Current deferred tax liability	42,000	51,500
Customer deposits and advance billings	888,291	849,610
Total Current Liabilities	2,072,223	2,404,438
Long-Term Liabilities:		
Long-term debt	189,625	494,125
Deferred compensation	78,061	117,315
Other long-term liabilities	1,143,949	983,643
Total Long-Term Liabilities	1,411,635	1,595,083
Members' Equity:		
Memberships	47,401	47,173
Patronage capital	14,642,625	14,647,281
Accumulated earnings	16,852,626	15,958,330
Accumulated other comprehensive loss	(277,665)	(23,126)
Total Members' Equity	31,264,987	30,629,658
	$ 34,748,845	$ 34,629,179

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Operations

Years Ended December 31, 2013 and 2012

	2013	2012
Operating Revenues:		
Local network services	$ 5,351,651	$ 5,681,600
Network access services	7,298,423	6,862,256
Miscellaneous operating	633,409	708,710
Total Operating Revenues	13,283,483	13,252,566
Operating Expenses:		
Plant specific	3,910,883	4,226,256
Plant nonspecific	1,397,728	1,249,328
Customer	1,673,766	1,732,878
Corporate	2,113,084	2,316,057
Selling, general, and administrative	23,037	15,684
Depreciation and amortization	2,664,435	2,759,364
Total Operating Expenses	11,782,933	12,299,567
Operating taxes:		
Operating income taxes	260,665	219,200
Other operating taxes	418,673	428,180
Total Operating Taxes	679,338	647,380
Total Operating Expenses and Taxes	12,462,271	12,946,947
Operating Margin	821,212	305,619
Other Income (Expense):		
Interest and investment income	121,696	154,628
Interest expense	(43,217)	(86,048)
Miscellaneous income, net	104,321	290,805
Income tax (expense) benefit	(29,472)	19,300
Total Other Income, net	153,328	378,685
Net Margin	$ 974,540	$ 684,304

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Years Ended December 31, 2013 and 2012

	2013	2012
Net Margin	$ 974,540	$ 684,304
Other Comprehensive Loss:		
Unrealized loss on marketable securities	(70,268)	(21,904)
Reclassification for realized losses on the sale of marketable securities	7,948	513
Change in unrecognized prior service costs and unrealized losses on post-retirement benefit plan	(192,219)	-
Total Other Comprehensive Loss	(254,539)	(21,391)
Total Comprehensive Income	$ 720,001	$ 662,913

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Changes in Members' Equity

Years Ended December 31, 2013 and 2012

	Member-ships	Patronage Capital	Accumulated Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2011	$ 46,707	$ 14,734,037	$ 15,120,068	$ (1,735)	$ 29,899,077
Net margin	-	-	684,304	-	684,304
Paid to estates	-	(86,756)	-	-	(86,756)
Forfeitures of unclaimed equities	-	-	153,958	-	153,958
Unrealized holding loss on marketable securities	-	-	-	(21,391)	(21,391)
Net membership change	466	-	-	-	466
Balance, December 31, 2012	$ 47,173	$ 14,647,281	$ 15,958,330	$ (23,126)	$ 30,629,658
Net margin	-	79,932	894,608	-	974,540
Paid to estates	-	(84,583)	-	-	(84,583)
Unrealized holding loss on marketable securities	-	-	-	(62,320)	(62,320)
Change in unrecognized transition obligation and unrealized losses on post-retirement benefit plan	-	-	-	(192,219)	(192,219)
Net membership change	228	-	-	-	228
Other adjustments	-	(5)	(312)	-	(317)
Balance, December 31, 2013	$ 47,401	$ 14,642,625	$ 16,852,626	$ (277,665)	$ 31,264,987

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Cash Flows

Years Ended December 31, 2013 and 2012

		2013		2012
Cash Flows from Operating Activities:				
Net margin	$	974,540	$	684,304
Adjustments to reconcile net margin to net cash provided by operating activities:				
Depreciation and amortization		2,664,435		2,759,364
Nonregulated depreciation		470,313		434,831
Loss on sale of investments and marketable securities		7,882		1,985
Gain on nonregulated asset sales		-		(42,080)
Change in deferred taxes		137,500		130,200
Noncash patronage		(4,276)		(5,314)
Changes in assets and liabilities:				
Accounts receivable		118,093		386,033
Inventory		28,492		16,478
Prepaid expenses		(25,945)		(104,203)
Accounts payable		(432,400)		(101,358)
Accrued expenses		90,292		(1,073,983)
Income taxes		(22,709)		55,745
Other long-term liabilities		(31,913)		(26,547)
Customer deposits and advance billings		38,681		196,119
Deferred compensation		39,254		(6,116)
Net Cash Provided by Operating Activities		4,052,239		3,305,458
Cash Flows from Investing Activities:				
Capital expenditures		(2,624,767)		(3,049,287)
Purchase of investments and marketable securities		(357,150)		(2,339,697)
Proceeds from investments and marketable securities		893,353		642,596
Change in other assets		(38,898)		7,515
Net Cash Used by Investing Activities	$	(2,127,463)	$	(4,738,873)

See accompanying notes to consolidated financial statements.

		2013		2012
Cash Flows from Financing Activities:				
Change in line of credit	$	-	$	(500,000)
Principal payments on long-term debt		(304,500)		(304,500)
Proceeds from memberships		228		466
Payments to estates		(84,583)		(86,756)
Patronage capital paid, net		3,104		(21,048)
Net Cash Used by Financing Activities		(385,751)		(911,838)
Net Increase (Decrease) in Cash and Cash Equivalents		1,539,025		(2,345,253)
Cash and cash equivalents, beginning		3,404,757		5,750,010
Cash and cash equivalents, ending	$	4,943,782	$	3,404,757
Non-cash investing activity:				
Contributions of fixed assets for additional equity investment	$	-	$	22,852
Cash Paid During the Year for Interest	$	43,217	$	86,048
Cash Paid During the Year for Taxes	$	273,681	$	118,807

See accompanying notes to consolidated financial statements.

Note 1 - Organization and Summary of Significant Accounting Policies

Organization
Canby Telephone Association (the Association) is an Oregon cooperative corporation providing internet, entertainment, and communications 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 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 the 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 application of accounting principles generally accepted in the United States of America by the Association 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 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 2013 and 2012. 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.

The Association files informational and income tax returns in the United States and various state and local jurisdictions. With limited exceptions, the Association is no longer subject to examinations before 2010.

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.

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

Monthly service fees derived from local telephone, internet 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 the limit of $250,000 per depositor per bank. At December 31, 2013, the Association had $3,469,811 in uninsured cash equivalents ($517,998 in 2012).

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 generally does not require collateral or other security to support accounts receivable. Credit risk associated with receivables is periodically reviewed by management and, if required, an allowance for doubtful accounts is established. Receivables from subscribers are due 30 days after the issuance of the invoice. Receivables from other exchange carriers are typically outstanding from 30-60 days before payment is received. Delinquent accounts are written off to uncollectible expense when it is determined that the account will not be collected. Receivables past due more than 90 days are considered delinquent. No allowance for doubtful accounts was recorded at December 31, 2013 and 2012.

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, mortgage and notes payable. The Association estimates that the fair value of all of these non-derivative financial instruments, other than marketable securities (see Note 2) at December 31, 2013 and 2012 does not differ materially from the aggregate carrying value of its financial instruments recorded in the accompanying balance sheets.

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

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.

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. Goodwill is evaluated for impairment and adjusted accordingly on an annual basis. No impairment was needed during 2013 or 2012.

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 charges 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.

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 the Oregon Exchange Carriers Association (OECA). 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.

The Association and MATC participate in various pooling arrangements with the NECA and OECA. The OECA Optional pool closed in July 2013 and as a result the Association and MATC are no longer members of any of the OECA pools.

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 up to 24 months (NECA pool only), are recorded in the year in which such adjustments become determinable, based upon studies prepared by outside consultants.

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

Network Access Revenues, continued
The Association and MATC receive funding from the state universal service funds. These support revenues are included in the network access revenues in the accompanying consolidated financial statements.

In 2013, the Association and MATC received $5,660,609 ($5,392,929 in 2012) in interstate access revenues administered through the NECA Pools. In 2013, the Association and MATC received $987,638 from the Oregon Universal Service Fund ($607,763 in 2012).

National Broadband Plan and FCC Order
In 2010 the FCC issued the National Broadband Plan which outlined a long-term plan to increase broadband penetrations 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 moved 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.

As of December 31, 2013 the Association is transitioning its local rates and is not subject to the $250 per line support cap. Furthermore, for the period ended December 31, 2013 the impacts to the Association related to the 5% annual decline in switched access revenues have not been significant.

The overall reform process will take place in phases and will take several years to implement. Furthermore, the Order includes a Further Notice of Proposed Rulemaking, the FCC has issued numerous Orders for Reconsideration and continues to seek comments on various items. As a result, the ultimate outcome of these proceedings and their impact is uncertain at this time.

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

Subsequent Events
The Association has evaluated subsequent events through April 3, 2014, which is the date the consolidated financial statements were available to be issued.

Note 2 - Marketable Securities

As mentioned in Note 1, at December 31, 2013 and 2012, all marketable securities have been categorized as available for sale and are stated at fair value in the consolidated financial statements, with unrealized gains and losses included in accumulated other comprehensive loss as a separate component of members' equity.

The Association has adopted a hierarchical disclosure framework, which among other matters requires enhanced disclosure about investments that are measured and reported at fair value. This framework prioritizes and ranks the level of market price observability used in measuring investments at fair value. The Association's marketable securities are measured and reported at fair value on a recurring basis based on quoted prices available in active markets for identical investments as of the reporting date (Classification Level 1). There have been no changes to the methodologies used at December 31, 2013 and 2012.

At December 31, the Association's securities consisted of the following:

	2013	2012
Fair Value:		
Municipal and Corporate Bonds, Government Securities	$ 292,481	$ 886,428
Mutual Funds	1,733,648	1,758,612
	2,026,129	2,645,040
Cost	2,111,575	2,668,166
Gross unrealized holding losses	$ 85,446	$ 23,126

Gross unrealized holding losses of $85,446 and $23,126 are included in accumulated other comprehensive loss at December 31, 2013 and 2012, respectively. Realized gains and losses are determined on the basis of specific identification. Proceeds from the sale of marketable securities for the year ended December 31, 2013 were $893,353 ($583,498 in 2012) resulting in a gross realized loss of $7,948 for the year ended December 31, 2013 ($513 loss for the year ended December 31, 2012).

The following is a summary of scheduled maturities of marketable debt securities as of December 31, 2013:

	Amortized Cost	Fair Value
Amounts maturing in:		
One year or less	$ 245,000	$ 245,752
After one year through five years	46,000	46,729

Note 3 - Inventory

Inventory consists of the following:

	2013	2012
Telecommunications materials and supplies	$ 512,014	$ 509,020
Video and wireless materials and supplies	25,498	56,984
	$ 537,512	$ 566,004

Note 4 - Investments

Investments consist of the following:

	2013	2012
RTFC subordinated certificates and allocated capital credits	$ 324,675	$ 324,675
CHR Solutions Inc.	302,677	302,677
ANPI Holding, Inc.	248,309	248,309
Consolidated Business Services, LLC	44,747	43,215
CoBank, equity investment and patronage allocations	56,569	41,218
Other investments	31,987	31,987
	$ 1,008,864	$ 992,081

Shares of RTFC subordinated certificates are purchased as a condition of obtaining long-term financing from the RTFC. Holders of subordinated certificates are entitled to patronage dividends.

CoBank is a cooperative bank. Borrowers are required to invest a minimum of $1,000 or 2% of their loan, whichever is less. Patronage dividends are paid annually in cash and in stock at the discretion of the board of directors of CoBank.

Effective September 1, 2012 the Association, along with two other telecommunications companies, formed Consolidated Business Services, LLC to consolidate various administrative functions. Services currently being provided to the companies include accounting, regulatory reporting, management services, and human resources. All three companies have a one-third ownership interest and any net income or loss will be distributed evenly to each company. The Association accounts for the investment using the equity method of accounting whereby the investment is recorded at cost and adjusted for the Association's share of income or loss. In 2013, the Association contributed $12,441 in cash and recorded a net gain of $813 from this investment (the Association contributed $21,176 in cash and $22,852 in furniture and equipment and recorded a net loss of $813 from this investment in 2012).

Note 5 - Other Assets

Other assets consist of the following at December 31:

	2013	2012
Deferred compensation	$ 78,061	$ 117,315
Nonregulated leased phone equipment	1,794	2,150
	$ 79,855	$ 119,465

Deferred compensation assets represent amounts to be used for payment of deferred credits.

Note 6 - Property, Plant, and Equipment

Listed below are the major classes of property, plant, and equipment in service at December 31:

	2013	2012
Canby Telephone Association		
Cable and wire facilities	$ 24,529,928	$ 23,529,483
Central office	12,895,797	11,935,758
Land, buildings, and support	8,098,518	7,945,571
Amortizable assets	55,890	55,890
Video and satellite equipment	4,490,961	4,589,400
	$ 50,071,094	$ 48,056,102

Note 6 - Property, Plant, and Equipment, continued

DirectLink of Oregon, Inc.		
Buildings	$ 201,778	$ 201,778
Land and support	169,332	169,332
Cable and wire	298,601	298,601
	669,711	669,711
Mt. Angel Telephone Company		
Land and support	1,058,647	1,065,233
Central office	2,630,713	2,534,862
Cable and wire facilities	2,314,402	2,098,522
Under construction	14,429	-
	6,018,191	5,698,617
Total Property, Plant, and Equipment	$ 56,758,996	$ 54,424,430

Note 7 - Long-Term Debt

Long-Term Debt consists of the following:

	2013	2012
Mortgage note payable to CoBank, at 5.72% at December 31, 2013 and 2012, payable in quarterly principal only installments of $76,125, interest payable monthly, collateralized by substantially all real and personal property, due in 2015.	$ 494,125	$ 798,625
Less current portion	304,500	304,500
	$ 189,625	$ 494,125

Future maturities of long-term debt are as follows:

2014	$ 304,500
2015	189,625
	$ 494,125

The long-term debt agreement contains restrictions on the payment of dividends and redemption of capital stock by MATC. The terms of the long-term debt agreement require the maintenance of defined amounts of stockholders' equity and certain financial ratios. Management believes MATC is in compliance with these covenants at December 31, 2013 and 2012.

Note 8 - Members' Equity

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.

Note 9 - Employee Benefit Plans

At December 31, 2011, the Association elected to terminate its participation in the noncontributory, multi-employer, defined-benefit pension plan (the Plan) administered by the Retirement and Security Program of the National Telephone Cooperative Association (NTCA), which covered all full-time eligible employees, and contributed 7.7% in 2011 of each eligible employee's annual salary to the Plan. The decision to terminate participation in the Plan constituted a settlement of benefits. The final settlement of the Plan issued by the NTCA was $2,922,365. During 2011, the Association paid $1,766,700 with the remaining balance of $1,155,665 paid in August 2012. Pension costs included current service costs that are accrued and funded on a current basis. The final termination date for the plan was March 1, 2012 resulting in total Plan costs of $84,410 in 2012.

The Association participates in a contributory, multi-employer, defined-contribution saving plan administered by NTCA, which covers all full-time eligible employees. Employees are not required to make contributions to participate in the plan. Prior to March 1, 2012 employer contributions were 4% with a 2% match for those employees that contributed 2%. Effective March 1, 2012 the plan was amended to allow for employer contributions of 8% plus a dollar for dollar match of up to 4%. Effective May 1, 2013 the plan was further amended to allow employer contribution of 4% plus a dollar for dollar match of up to 4%. Additionally, it includes a 4% supplemental employer contribution for employees hired prior to May 1, 2013. The employer also reimburses the participant for any plan fees. Employer contributions to the plan were $448,710 in 2013 ($403,819 in 2012).

Effective January 1, 2013, all employees of MATC were transferred to the Association. As a result, all employee and employer contributions into MATC's 401(k) profit sharing plan (the Plan) ceased as of that date. The total contributions to the profit sharing portion of the Plan were $25,178 in 2012.

Note 10 - Income Taxes

The following is a summary of the significant components of the deferred tax assets and liabilities as of December 31:

	2013	2012
Current:		
Accrual to cash adjustment	$ (42,000)	$ (52,000)
Marketable securities adjustment	-	500
Current deferred income tax liability	$ (42,000)	$ (51,500)
Noncurrent:		
Property, plant, equipment and goodwill	$ 838,000	$ 963,000
Post-retirement health benefits accrual	40,000	62,000
Noncurrent deferred income tax asset	$ 878,000	$ 1,025,000

Income tax expense (benefit) consists of the following:

	2013	2012
Operating:		
Deferred provision	$ 137,500	$ 130,200
Current payable	125,028	95,400
Over accrual	(1,863)	(6,400)
Operating income tax	$ 260,665	$ 219,200
Nonoperating:		
Current payable	$ 29,472	$ 18,600
Over accrual	-	(37,900)
Nonoperating income tax (benefit)	$ 29,472	$ (19,300)

Note 10 - Income Taxes, continued

The provision for income taxes differs from the amount computed by applying the current statutory federal and state income tax rates to earnings before income taxes due to the effects of state taxes (net of federal benefit), nondeductible items, net operating loss deductions, prior year over or under accruals, the use of accelerated depreciation for income tax purposes and the patronage deduction allowed for margins allocated to patrons.

Note 11 - Other Long-Term Liabilities

The Association sponsors a post-retirement benefit plan (the Plan) that provides medical, and dental, benefits for eligible retired employees and their spouses. The liability for such benefits is unfunded.

At December 31, 2011, the Association amended the Plan to freeze plan benefits and cover only current retirees and those who had accepted an early retirement offer in 2012. The decision to freeze the Plan constituted a curtailment of benefits and resulted in one-time gain from the reduction of the projected benefit obligation of $457,536 as it was anticipated there would be no additional participants in the plan and no future service period or costs. As a result of additional employees who accepted early retirement being included in the plan a new plan valuation was obtained as of December 31, 2013. This resulted in an increase in the accumulated benefit obligation and the resulting amounts being recognized in accumulated other comprehensive income as noted in the table below.

The following table presents the estimated status of the plan at December 31 based on the valuation as of December 31, 2013:

Obligations and Funded Status:	2013	2012
Accumulated postretirement benefit obligation:		
Active plan participants	$ 1,040,250	$ 819,110
Accumulated postretirement benefit obligation	1,040,250	819,110
Fair value of plan assets	-	-
Net unfunded status of the plan	$ 1,040,250	$ 819,110
Amounts Recognized in Accumulated Other Comprehensive Income:		
Unrecognized prior service cost	$ 210,966	$ -
Net actuarial loss	(403,185)	-
Unrecognized prior service cost and unrealized losses	$ (192,219)	$ -
Accrued Postretirement Benefit Expense	$ 848,031	$ 819,110
Postretirement Expenses Includes the Following Components:		
Interest on accumulated postretirement benefit obligation	$ 45,399	$ 45,000
Changes in Plan Assets and Benefit Obligation Recognized in Other Comprehensive Income:		
Net actuarial loss	$ (403,185)	$ -
Amortization of prior service cost	210,966	-
	$ (192,219)	$ -
Total recognized in net periodic benefit cost and other comprehensive income	$ (146,820)	$ -
Benefit Payments	$ 67,216	$ 53,373

Note 11 - Other Long-Term Liabilities, continued

Assumptions
For measurement purposes, an 8% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2013 (7% in 2012). The rate was assumed to decrease gradually to 5% at 2017 and remain at that level thereafter. The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 4.5% in 2013 (5.5% in 2012).

Cash Flows
The Cooperative does not expect to contribute to its post-retirement benefit plan in 2014.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Post-retirement Benefits	
2014	$ 63,479
2015	67,288
2016	70,989
2017	74,538
2018	78,265
Years 2019 - 2022	82,178

MATC sponsors a non-qualified defined benefit, post-retirement benefit plan which provides certain health care benefits for retired employees and their respective spouses until the date of the retired employee's death. Benefits are based on years of service and the average employee's compensation of the five highest years of employment.

The annual measurement date is December 31 for the post-retirement benefit plan. The following tables provide information about changes in the benefit obligation and plan assets and the funded status of MATC's post-retirement benefit plan:

Obligations and Funded Status

	2013	2012
Benefit obligation at December 31	$ 117,000	$ 179,000
Fair value of plan assets at December 31	-	-
Net unfunded status of the plan	$ (117,000)	$ (179,000)
Benefit payments	$ (12,620)	$ (12,620)
Noncurrent plan liabilities	$ (117,000)	$ (179,000)
Other post-employment obligations	682	682
Less current portion	12,620	17,115
	$ (103,698)	$ (161,203)

Assumptions
Weighted average assumptions used in the accounting for MATC's postretirement benefit plan were:

	2013	2012
Weighted-average assumptions used to determine benefit obligations at December 31:	5.75%	5.75%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31:	5.75%	5.75%

Note 11 - Other Long-Term Liabilities, continued

Cash Flows
MATC does not expect to contribute to its post-retirement benefit plan in 2014.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Post-retirement Benefits		
2014	$	12,620
2015		12,620
2016		12,620
2017		12,620
2018		12,620
Years 2019 - 2022		63,105

Note 12 - Related Party

The Association entered into an agreement with Consolidated Business Services, LLC (CBS, LLC) in 2012 (Note 4) whereby CBS, LLC will provide accounting, regulatory reporting, management services and human resource services for the Association. During 2012, the employees of CBS, LLC remained on the payroll of the Association resulting in billings to CBS, LLC for labor and benefit expenses. Effective January 1, 2013, all CBS, LLC employees were moved to CBS, LLC payroll from their respective companies. CBS provided accounting, regulatory, and management services to the Association and MATC in the amount of $775,577 in 2013. At December 31, 2013, there was a receivable of $8,165 due from CBS, LLC and $25,539 payable to CBS, LLC for such labor and expenses ($22,501 was receivable from and $63,666 payable to CBS, LLC at December 31, 2012).

On September 1, 2012, MATC entered into a rental agreement for the use of their office building with CBS, LLC. MATC received rental payments of $21,000 ($7,000 during 2012).

Supplemental Information

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidating Balance Sheets

December 31, 2013

ASSETS	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Current Assets:					
Cash and cash equivalents	$ 887,795	$ 650,935	$ 3,405,052	$ -	$ 4,943,782
Marketable securities	50,317	1,733,648	242,164	-	2,026,129
Accounts receivable	140,586	6,427	1,727,301	(70,217)	1,804,097
Inventory	36,493	-	501,019	-	537,512
Prepaid expenses	35,085	3,061	522,124	-	560,270
Total Current Assets	1,150,276	2,394,071	6,397,660	(70,217)	9,871,790
Other Assets and Investments:					
Note receivable	-	800,000	-	(800,000)	-
Other assets	1,794	-	78,061	-	79,855
Investments	42,323	-	966,541	-	1,008,864
Investments, affiliate	-	-	9,250,757	(9,250,757)	-
Deferred income taxes	878,000	-	-	-	878,000
Goodwill	-	-	-	3,974,375	3,974,375
Total Other Assets and Investments	922,117	800,000	10,295,359	(6,076,382)	5,941,094
Property, Plant, and Equipment:					
Property, plant, and equipment	6,018,191	669,711	50,071,094	-	56,758,996
Less accumulated depreciation	4,697,472	385,497	32,740,066	-	37,823,035
Property, Plant, and Equipment, net	1,320,719	284,214	17,331,028	-	18,935,961
	$ 3,393,112	$ 3,478,285	$ 34,024,047	$ (6,146,599)	$ 34,748,845

LIABILITIES AND MEMBERS' and STOCKHOLDER'S EQUITY	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Current Liabilities:					
Current portion of long-term debt	$ 304,500	$ -	$ -	$ -	$ 304,500
Accounts payable	79,048	6,488	215,778	(70,217)	231,097
Accrued expenses	27,945	-	507,124	-	535,069
Patronage capital payable	-	-	29,555	-	29,555
Income taxes payable	38,710	3,001	-	-	41,711
Current deferred tax liability	42,000	-	-	-	42,000
Customer deposits and advance billings	-	-	888,291	-	888,291
Total Current Liabilities	492,203	9,489	1,640,748	(70,217)	2,072,223
Long-Term Liabilities:					
Long-term debt	989,625	-	-	(800,000)	189,625
Deferred compensation	-	-	78,061	-	78,061
Other long-term liabilities	103,698	-	1,040,251	-	1,143,949
Total Long-Term Liabilities	1,093,323	-	1,118,312	(800,000)	1,411,635
Members' and Stockholder's Equity:					
Memberships	-	-	47,401	-	47,401
Common stock	36,275	9,887,729	-	(9,924,004)	-
Patronage capital	-	-	14,642,625	-	14,642,625
Accumulated earnings (deficit)	1,770,994	(6,341,537)	16,852,626	4,570,543	16,852,626
Accumulated other comprehensive income (loss)	317	(77,396)	(277,665)	77,079	(277,665)
Total Members' and Stockholder's Equity	1,807,586	3,468,796	31,264,987	(5,276,382)	31,264,987
	$ 3,393,112	$ 3,478,285	$ 34,024,047	$ (6,146,599)	$ 34,748,845

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidating Statements of Operations

Year Ended December 31, 2013 Schedule II

	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Operating Revenues:					
Local network services	$ 588,919	$ -	$ 4,887,593	$ (124,861)	$ 5,351,651
Network access services	1,291,132	-	6,007,291	-	7,298,423
Miscellaneous operating	185,516	64,202	399,190	(15,499)	633,409
Total Operating Revenues	2,065,567	64,202	11,294,074	(140,360)	13,283,483
Operating Expenses:					
Plant specific	416,289	-	3,634,954	(140,360)	3,910,883
Plant nonspecific	140,520	-	1,257,208	-	1,397,728
Customer	334,981	-	1,338,785	-	1,673,766
Corporate	181,344	-	1,931,740	-	2,113,084
Selling, general, and administrative	-	23,037	-	-	23,037
Depreciation and amortization	208,638	13,302	2,442,495	-	2,664,435
Total Operating Expenses	1,281,772	36,339	10,605,182	(140,360)	11,782,933
Operating taxes:					
Operating income taxes	248,900	11,765	-	-	260,665
Other operating taxes	41,174	5,967	371,532	-	418,673
Total Operating Taxes	290,074	17,732	371,532	-	679,338
Total Operating Expenses and Taxes	1,571,846	54,071	10,976,714	(140,360)	12,462,271
Operating Margin	493,721	10,131	317,360	-	821,212
Other Income (Expense):					
Interest and investment income	14,464	75,306	61,926	(30,000)	121,696
Interest expense	(72,970)	-	(247)	30,000	(43,217)
Miscellaneous income, net	(40,928)	822	144,427	0	104,321
Income tax expense	-	(29,472)	-	-	(29,472)
Income from subsidiaries	-	-	451,074	(451,074)	-
Total Other Income (Expense), net	(99,434)	46,656	657,180	(451,074)	153,328
Net Margin	$ 394,287	$ 56,787	$ 974,540	$ (451,074)	$ 974,540

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidating Statements of Cash Flows

Year Ended December 31, 2013

	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Cash Flows from Operating Activities:					
Net margin	$ 394,287	$ 56,787	$ 974,540	$ (451,074)	$ 974,540
Adjustments to reconcile net margin to net cash provided by operating activities:					
Depreciation and amortization	208,638	13,302	2,442,495	-	2,664,435
Nonregulated depreciation	-	-	470,313	-	470,313
Net income from Subsidiaries	-	-	(451,074)	451,074	-
(Gain) Loss on sale of investments and marketable securities	(2,461)	(6,920)	17,263	-	7,882
Change in deferred taxes	137,500	-	-	-	137,500
Noncash patronage	-	-	(4,276)	-	(4,276)
Changes in assets and liabilities:					
Accounts receivable	4,695	(2,610)	80,780	35,228	118,093
Inventory	20,662	-	7,830	-	28,492
Prepaid expenses	(15,359)	(155)	(10,431)	-	(25,945)
Accounts payable	14,321	5,682	(417,175)	(35,228)	(432,400)
Accrued expenses	(21,492)	-	111,784	-	90,292
Income taxes	11,190	(47,357)	13,458	-	(22,709)
Other long-term liabilities	(57,505)	-	25,592		(31,913)
Customer deposits and advance billings	-	-	38,681	-	38,681
Deferred compensation	-	-	39,254	-	39,254
Net Cash Provided by Operating Activities	694,476	18,729	3,339,034	-	4,052,239
Cash Flows from Investing Activities:					
Capital expenditures	(333,130)	-	(2,291,637)	-	(2,624,767)
Purchase of investments and marketable securities	(17,142)	(278,169)	(61,839)	-	(357,150)
Proceeds from investments and marketable securities	65,200	243,396	584,757	-	893,353
Change in other assets	356	-	(39,254)	-	(38,898)
Net Cash Used by Investing Activities	$ (284,716)	$ (34,774)	$ (1,807,973)	$ -	$ (2,127,463)

	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Cash Flows from Financing Activities:					
Principal payments on long-term debt	$ (304,500)	$ -	$ -	$ -	$ (304,500)
Proceeds from memberships	-	-	228	-	228
Payments to estates	-	-	(84,583)	-	(84,583)
Patronage capital paid, net	-	-	3,104	-	3,104
Net Cash Used by Financing Activities	(304,500)	-	(81,251)	-	(385,751)
Net Increase (Decrease) in Cash and Cash Equivalents	105,260	(16,045)	1,449,810	-	1,539,025
Cash and Cash Equivalents, beginning	782,535	666,980	1,955,242	-	3,404,757
Cash and Cash Equivalents, ending	$ 887,795	$ 650,935	$ 3,405,052	$ -	$ 4,943,782
Cash Paid During the Year for Interest	$ 72,970	$ -	$ 247	$ (30,000)	$ 43,217
Cash Paid During the Year for Taxes	$ 100,210	$ 75,136	$ 98,335	$ -	$ 273,681