

**WASHINGTON 544 KALAMA**  
**KALAMA TELEPHONE COMPANY, INC.**  
(A Wholly-Owned Subsidiary of  
Scatter Creek, Ltd.)

Audited Financial Statements

December 31, 2009 and 2008

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Independent Auditor's Report

Board of Directors  
Kalama Telephone Company, Inc.  
Kalama, Washington

We have audited the accompanying balance sheets of Kalama Telephone Company, Inc. (a wholly-owned subsidiary of Scatter Creek, Ltd.) as of December 31, 2009 and 2008, and the related statements of operations and retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. 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 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kalama Telephone Company, Inc. at December 31, 2009 and 2008, 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.

In accordance with Government Auditing Standards, we have also issued a report dated April 6, 2010, on our consideration of Kalama Telephone Company, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audits.

*Johnson, Stone & Pagano, P.S.*

**JOHNSON, STONE & PAGANO, P.S.**

April 6, 2010

AUDITED FINANCIAL STATEMENTS

**WASHINGTON 544 KALAMA  
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BALANCE SHEETS

December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b><u>ASSETS</u></b>		
<b>CURRENT ASSETS</b>		
Cash	● [REDACTED]	● [REDACTED]
Short-term investments	[REDACTED]	[REDACTED]
Telecommunications accounts receivable, less allowances for doubtful accounts	[REDACTED]	[REDACTED]
Materials and supplies - at average cost	[REDACTED]	[REDACTED]
Recoverable federal income taxes	[REDACTED]	[REDACTED]
<b>Total Current Assets</b>	[REDACTED]	[REDACTED]
<b>NONCURRENT ASSETS</b>		
Unamortized debt issuance expense	[REDACTED]	[REDACTED]
Deferred federal income tax benefits	[REDACTED]	[REDACTED]
<b>Total Noncurrent Assets</b>	[REDACTED]	[REDACTED]
<b>PROPERTY, PLANT, AND EQUIPMENT</b>		
Telecommunications plant in service	[REDACTED]	[REDACTED]
Less allowances for depreciation	[REDACTED]	[REDACTED]
Telecommunications plant under construction	[REDACTED]	[REDACTED]
<b>Total Telecommunications Plant</b>	[REDACTED]	[REDACTED]
<b>Total Assets</b>	[REDACTED]	[REDACTED]

	<u>2009</u>	<u>2008</u>
<b><u>LIABILITIES AND STOCKHOLDER'S EQUITY</u></b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	● [REDACTED]	● [REDACTED]
Taxes, other than income taxes	[REDACTED]	[REDACTED]
Other current liabilities	[REDACTED]	[REDACTED]
Due to affiliated companies	● [REDACTED]	● [REDACTED]
Installments on long-term debt due within one year	[REDACTED]	[REDACTED]
<b>Total Current Liabilities</b>	[REDACTED]	[REDACTED]
<b>LONG-TERM DEBT</b> , less portion classified as current liability	[REDACTED]	[REDACTED]
<b>Total Liabilities</b>	[REDACTED]	[REDACTED]
<b>STOCKHOLDER'S EQUITY</b>		
Common stock		
Class A	[REDACTED]	[REDACTED]
Class B	[REDACTED]	[REDACTED]
Retained earnings	[REDACTED]	[REDACTED]
<b>Total Stockholder's Equity</b>	[REDACTED]	[REDACTED]
<b>Total Liabilities and Stockholder's Equity</b>	\$ [REDACTED]	[REDACTED]

**WASHINGTON 544 KALAMA  
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**STATEMENTS OF OPERATIONS AND RETAINED EARNINGS**

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>OPERATING REVENUES</b>		
Local network service revenues	██████████	██████████
Network access service revenues	██████████	██████████
Miscellaneous revenues	██████████	██████████
Uncollectible revenues (deduction)	██████████	██████████
<b>Total Operating Revenues</b>	██████████	██████████
<b>OPERATING EXPENSES</b>		
Plant specific operations	██████████	██████████
Plant nonspecific operations	██████████	██████████
Depreciation	██████████	██████████
Customer operations	██████████	██████████
Corporate operations	██████████	██████████
<b>Total Operating Expenses</b>	██████████	██████████
<b>OPERATING TAXES</b>		
Taxes, other than income	██████████	██████████
Federal income tax benefits	██████████	██████████
<b>Total Operating Tax Benefits</b>	██████████	██████████
<b>Net Operating Loss</b>	██████████	██████████
<b>FIXED CHARGES</b>	██████████	██████████
<b>OTHER INCOME (EXPENSE)</b>		
Interest and dividend income	██████████	██████████
Nonregulated income - net	██████████	██████████
Gain on sale of stock	██████████	██████████
Miscellaneous income	██████████	██████████
Nonoperating federal income taxes	██████████	██████████
<b>Total Other Income</b>	██████████	██████████
<b>Net Loss</b>	██████████	██████████
<b>RETAINED EARNINGS AT BEGINNING OF YEAR</b>	██████████	██████████
<b>Retained Earnings at End of Year</b>	██████████	██████████

**WASHINGTON 544 KALAMA  
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STATEMENTS OF CASH FLOWS

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	● [REDACTED]	[REDACTED]
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation of telecommunications plant	[REDACTED]	[REDACTED]
Depreciation and amortization of other assets	[REDACTED]	[REDACTED]
Deferred federal income taxes	[REDACTED]	[REDACTED]
Gain on sale of stock	[REDACTED]	[REDACTED]
Net change in operating assets and liabilities	[REDACTED]	[REDACTED]
<b>Net Cash Provided by Operating Activities</b>	[REDACTED]	[REDACTED]
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net change in short-term investments	[REDACTED]	[REDACTED]
Proceeds from sale of stock	[REDACTED]	[REDACTED]
Additions to telecommunications plant	[REDACTED]	[REDACTED]
Salvage on retired telecommunications plant	[REDACTED]	[REDACTED]
<b>Net Cash Used by Investing Activities</b>	[REDACTED]	[REDACTED]
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments on long-term debt	[REDACTED]	[REDACTED]
<b>Net Cash Used by Financing Activities</b>	[REDACTED]	[REDACTED]
<b>Net Increase (Decrease) in Cash</b>	[REDACTED]	[REDACTED]
<b>CASH AT BEGINNING OF YEAR</b>	[REDACTED]	[REDACTED]
<b>Cash at End of Year</b>	● [REDACTED]	● [REDACTED]



**WASHINGTON 544 KALAMA  
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STATEMENTS OF CASH FLOWS (Continued)

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>COMPONENTS OF NET CHANGE IN OPERATING ASSETS AND LIABILITIES</b>		
(Increase) decrease in assets:		
Telecommunications accounts receivable	[REDACTED]	[REDACTED]
Materials and supplies	[REDACTED]	[REDACTED]
Recoverable federal income taxes	[REDACTED]	[REDACTED]
Increase (decrease) in liabilities:		
Accounts payable	[REDACTED]	[REDACTED]
Taxes, other than income taxes	[REDACTED]	[REDACTED]
Other current liabilities	[REDACTED]	[REDACTED]
Due to affiliated companies	[REDACTED]	[REDACTED]
<b>Net Change in Operating Assets and Liabilities</b>	<b>\$ [REDACTED]</b>	<b>[REDACTED]</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid during the year for:		
Interest	\$ [REDACTED]	[REDACTED]
Income taxes	\$ [REDACTED]	[REDACTED]

## **NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### ***Telephone Industry***

Kalama Telephone Company, Inc. (“Company”) is a local exchange telecommunications company providing local exchange and other telecommunications services to customers in Kalama and the surrounding vicinity in southwest Washington State.

Regulatory changes in the telecommunications industry have modified, or could modify, the manner in which the Company's approved telecommunication tariffed rates are calculated, as well as modify the manner in which the Company recovers its revenue requirements. Implementation of modifications and the outcome of regulatory proceedings may adversely affect certain current or future revenue streams of the Company.

### ***Organization***

The Company is a wholly-owned subsidiary of Scatter Creek, Ltd. The Company is affiliated with Tenino Telephone Company, Scatter Creek Cellular, Inc., TENKAL Company, and Scatter Creek Infonet, Inc. through common ownership by Scatter Creek, Ltd.

### ***Regulation***

The Company is subject to the accounting rules and rate regulation policies of the Washington Utilities and Transportation Commission (“WUTC”) and the Federal Communications Commission (“FCC”) and, adheres to the FCC Uniform System of Accounts for a Class B telephone company as prescribed by the FCC under Part 32.

### ***Cash***

For purposes of the statement of cash flows, the Company considers cash to be cash on hand, in checking accounts, and money market accounts.

### ***Short-term Investments***

Short-term investments consist of financial institution certificates of deposits.

### ***Unamortized Debt Issuance Expense***

Costs incurred to obtain financing for telephone plant additions are capitalized and amortized over the respective loan period.

### ***Telecommunications Plant***

Telecommunications plant is stated at cost and is depreciated on a straight-line basis for accounting purposes. Lives used for calculating depreciation are in accordance with the rules of the WUTC and are based on the estimated economic useful lives of the assets. Likewise, lives used for calculating depreciation on all other property and equipment are based on the estimated economic useful lives of the assets.

**NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

***Telecommunications Plant Retirements***

When an asset is retired or otherwise disposed of, the cost of the asset is removed from the asset account and charged to the related allowance for depreciation. Similarly, the cost of removal and salvage proceeds are charged or credited to the allowance for depreciation. Consequently, no gain or loss upon disposition is recognized.

***Revenue Recognition, Major Customers and Services***

Services provided by the Company include primarily local network and network access services. Network access service revenues, which represent a major portion of the Company's operating revenues, are derived from the provision of exchange access services to interexchange carriers or to an end user of telecommunication services beyond the Company's local network.

Revenues for interstate access services are received through tariffed access charges filed by the National Exchange Carrier Association ("NECA") with the Federal Communications Commission ("FCC") on behalf of the NECA member companies. These access charges are billed by the Company to interstate interexchange carriers and pooled with like-revenues from all NECA member companies. The pooled access charge revenues received by the Company are based upon the actual cost of providing interstate access services, plus a return on the investment dedicated to providing these services. Pooled access charge revenues are estimated at December 31 each year and are subject to adjustment. Such adjustments are normal occurrences and are recorded by the Company during the year in which they occur.

Revenues for intrastate access service are received through tariffed access charges filed by the Company and the Washington Exchange Carrier Association ("WECA") and approved by Washington Utilities Telecommunication Commission ("WUTC"). The access charges are billed by the Company to intrastate interexchange carriers. The carrier common line and state universal service fund revenues are pooled with all WECA member companies. The traffic sensitive revenues are considered bill and keep based on tariffed rates.

For some of the services that the Company provides to its customers, the Company relies upon services and facilities supplied to it by other companies. Any material disruption of the services or facilities supplied to the Company by other companies could potentially have an adverse effect upon the Company's operating results.

**NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

***Federal Income Taxes***

The Company provides federal income taxes for the effects of transactions reported in the financial statements and consists of taxes currently due and deferred income taxes. [REDACTED]

The Company utilizes the liability method of accounting for income taxes as set forth in authoritative literature. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance, if any, is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

Authoritative guidance provides for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the Company's financial statements. Management is of the opinion that the income tax positions taken by the Company meet the more-likely-than-not threshold that the tax returns filed by the Company have greater than a 50 percent chance of being sustained under examination by the Internal Revenue Service. The Company's federal income tax returns for the tax years ended December 31, 2008, 2007 and 2006 remain subject to examination.

***Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles 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 may differ from those estimates and assumptions used in preparing the accompanying financial statements.

***Subsequent Events***

The management of the Company evaluated for subsequent events through April 6, 2010, the date the financial statements were issued. All such material transactions or disclosures identified have been included in these financial statements.

[REDACTED]

[REDACTED]

[REDACTED]

**NOTE 3 - TELECOMMUNICATIONS ACCOUNTS RECEIVABLE**

The telecommunications accounts receivable balance at December 31, 2009 and 2008 consists of:

	<u>2009</u>	<u>2008</u>
Due from customers and agents	[REDACTED]	[REDACTED]
Due from exchange carriers and exchange carrier associations	[REDACTED]	[REDACTED]
Other accounts receivable	[REDACTED]	[REDACTED]
Allowances for doubtful accounts (deduction)	[REDACTED]	[REDACTED]

The Company extends credit to its business and residential customers based upon a written credit policy. Service interruption is the primary vehicle for controlling losses. Telecommunications accounts receivable are recorded when subscriber bills, carrier access bills, and exchange carrier associations settlement statements are rendered and are presented in the balance sheet net of the allowances for doubtful accounts. Certain exchange carrier associations' settlements are subject to out-of-period adjustments and are recorded during the year in which they become determinable. Telecommunications accounts receivable are written off when they are determined to be uncollectible.

[REDACTED]

**NOTE 4 - INVESTMENT IN STOCKS**

[REDACTED]

**NOTE 5 - TELECOMMUNICATIONS PLANT IN SERVICE AND DEPRECIATION**

Telecommunications plant in service is stated at cost. Listed below are the major classes of the telecommunications plant as of December 31:

	<u>2009</u>	<u>2008</u>
General support facilities	[REDACTED]	[REDACTED]
Central office equipment	[REDACTED]	[REDACTED]
Cable and wire facilities	[REDACTED]	[REDACTED]
Intangible assets	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]

Provision has been made for depreciation of the major classes of the telecommunications plant at straight-line rates as follows:

General support facilities	
Buildings	[REDACTED]
Furniture and office equipment	[REDACTED]
Vehicles and other work equipment	[REDACTED]
Central office equipment	[REDACTED]
Cable and wire facilities	[REDACTED]

**NOTE 6 - LONG-TERM DEBT**

Long-term debt consists of the following:

	<u>Current Annual Installments of Principal</u>	<u>Principal Amount</u>	
		<u>2009</u>	<u>2008</u>
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Less principal installments of long-term debt due within one year		[REDACTED]	[REDACTED]
		[REDACTED]	[REDACTED]

At December 31, 2009, maturities on long-term debt in the next five years and thereafter are as follows:

2010	[REDACTED]
2011	[REDACTED]
2012	[REDACTED]
2013	[REDACTED]
2014	[REDACTED]
Thereafter	[REDACTED]
	[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

**NOTE 6 - LONG-TERM DEBT (Continued)**

[REDACTED]

[REDACTED]

**NOTE 7 - FEDERAL INCOME TAXES**

The Company recognizes deferred federal income taxes for differences between the basis of assets and liabilities for financial statement and income tax purposes. The deferred tax assets and liabilities represent future federal income tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. The differences relate to the depreciable assets' lives and methods of calculating depreciation for financial and income tax reporting purposes.

The tax effects of temporary differences that give rise to significant portions of deferred tax (assets) liabilities consist of the following:

	<u>2009</u>	<u>2008</u>
Telecommunications plant	[REDACTED]	[REDACTED]
Nonregulated assets	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]

The provision for federal income taxes (benefits) is allocated between operating and nonoperating income as follows:

	<u>2009</u>	<u>2008</u>
Operating Federal Income Taxes		
Current benefits	[REDACTED]	[REDACTED]
Deferred income tax benefits	[REDACTED]	[REDACTED]
Nonoperating Federal Income Taxes		
Currently payable	[REDACTED]	[REDACTED]
Deferred income taxes	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]



**NOTE 7 - FEDERAL INCOME TAXES** (Continued)

Components of provisions for federal income tax benefits are as follows:

	<u>2009</u>	<u>2008</u>
Currently payable (benefits)	[REDACTED]	[REDACTED]
Deferred income tax benefits	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]

**NOTE 8 - COMMON STOCK**

[REDACTED]

**NOTE 9 - LEASES**

[REDACTED]

**NOTE 10 - PENSION PLAN**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]		
[REDACTED]		
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]