

**WASHINGTON 545
PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, IDAHO**

**FINANCIAL STATEMENTS
WITH INDEPENDENT AUDITORS' REPORT
Years ended December 31, 2009 and 2008**

REDACTED

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Pend Oreille Telephone Company
Glenns Ferry, Idaho

We have audited the accompanying balance sheets of Pend Oreille Telephone Company (a Idaho corporation) as of December 31, 2009 and 2008, and the related statements of income, stockholders' equity 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 audit 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 Pend Oreille Telephone Company as of 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 23, 2010, on our consideration of Pend Oreille Telephone Company's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. 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 audit.

Kiesling Associates LLP

Colorado Springs, Colorado
April 23, 2010

PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON

BALANCE SHEETS
December 31, 2009 and 2008

| | <u>2009</u> | <u>2008</u> |
|----------------------------------------|-------------|-------------|
| <u>ASSETS</u> | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | | |
| Special construction account | | |
| Marketable securities | | |
| Accounts receivable: | | |
| Due from customers | | |
| Interexchange carriers | | |
| Affiliates | | |
| Other | | |
| Materials and supplies at average cost | | |
| Inventory at average cost | | |
| Prepayments | | |
| OTHER NONCURRENT ASSETS | | |
| Marketable securities | | |
| Investment in lenders | | |
| Other investments | | |
| PROPERTY, PLANT AND EQUIPMENT | | |
| Telephone plant in service | | |
| Other property | | |
| Plant acquisition adjustment, net | | |
| Less accumulated depreciation | | |
| Plant under construction | | |
| Property held for future use | | |
| TOTAL ASSETS | | |

The accompanying notes are an integral part of these financial statements.

REDACTED

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**BALANCE SHEETS
December 31, 2009 and 2008**

| | <u>2009</u> | <u>2008</u> |
|----------------------------------------------------|-------------|-------------|
| <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u> | | |
| CURRENT LIABILITIES | | |
| Current portion of long-term debt | | |
| Accounts payable: | | |
| Interexchange carriers | | |
| Other | | |
| Advance billing and payments | | |
| Customer deposits | | |
| Accrued interest | | |
| Other accrued liabilities | | |
| | | |
| LONG-TERM DEBT, LESS CURRENT PORTION | | |
| | | |
| STOCKHOLDERS' EQUITY | | |
| Common stock - | | |
| | | |
| Retained deficit | | |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | | |

The accompanying notes are an integral part of these financial statements.

REDACTED

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**STATEMENTS OF INCOME
Years ended December 31, 2009 and 2008**

| | <u>2009</u> | <u>2008</u> |
|-------------------------------|-------------|-------------|
| OPERATING REVENUES | | |
| Local network services | | |
| Network access services | | |
| Internet services | | |
| Other nonregulated services | | |
| Miscellaneous | | |
| Uncollectible | | |
| OPERATING EXPENSES | | |
| Plant specific operations | | |
| Plant nonspecific operations | | |
| Cost of internet services | | |
| Depreciation and amortization | | |
| Customer operations | | |
| Corporate operations | | |
| General taxes | | |
| OPERATING INCOME | | |
| OTHER INCOME (EXPENSE) | | |
| Interest and dividend income | | |
| Interest during construction | | |
| Interest expense | | |
| Other, net | | |
| NET INCOME | | |

The accompanying notes are an integral part of these financial statements.

REDACTED

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**STATEMENTS OF STOCKHOLDERS' EQUITY
Years ended December 31, 2009 and 2008**

| | <u>Common Stock</u> <u>Shares</u> | <u>Amount</u> | <u>Retained</u> <u>Deficit</u> | <u>Total</u> <u>Stockholders'</u> <u>Equity</u> | <u>Annual</u> <u>Comprehensive</u> <u>Income</u> |
|----------------------------------|--------------------------------------|---------------|-----------------------------------|-------------------------------------------------------|--------------------------------------------------------|
| Balance at December 31, 2007 | | | | | |
| Net income | | | | | |
| Dividends paid, \$ per share | | | | | |
| Balance at December 31, 2008 | | | | | |
| Net income | | | | | |
| Dividends paid, \$ per share | | | | | |
| Balance at December 31, 2008 | | | | | |

The accompanying notes are an integral part of these financial statements.

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**STATEMENTS OF CASH FLOWS
Years ended December 31, 2009 and 2008**

| | <u>2009</u> | <u>2008</u> |
|--------------------------------------------------------------------------------------|-------------|-------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | | |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | | |
| Amortization | | |
| Patronage in business conducted with cooperatives | | |
| Changes in assets and liabilities: | | |
| (Increase) Decrease in: | | |
| Accounts receivable | | |
| Material and supplies | | |
| Prepayments | | |
| Increase (Decrease) in: | | |
| Accounts payable | | |
| Advanced billings | | |
| Customer deposits | | |
| Other | | |
| Net cash provided by operating activities | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | | |
| Purchase of other investments | | |
| Proceeds from sale of other investments | | |
| Salvage, net of cost of removing plant | | |
| Net cash used in investing activities | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term borrowing | | |
| Repayment of long-term debt | | |
| Change in special construction account | | |
| Dividends paid | | |
| Net cash used in financing activities | | |
| Net Increase (Decrease) in Cash and Cash Equivalents | | |
| Cash and Cash Equivalents at Beginning of Year | | |
| Cash and Cash Equivalents at End of Year | | |

The accompanying notes are an integral part of these financial statements.

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Pend Oreille Telephone Company (herein referred to as "the Company") is a provider of telecommunications exchange, local access and internet services in a service area located in northeast Washington. The Company is a wholly-owned subsidiary of Rural Telephone Company, which is a wholly-owned subsidiary of Martell Enterprises, Inc., both of which are Idaho companies.

The accounting policies of the Company conform to accounting principles generally accepted in the United States of America. Management uses estimates and assumptions in preparing its financial statements. Those estimates and assumptions 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. Management has evaluated subsequent events through April 23, 2010, the date the financial statements were available for issue. Telephone operations reflect practices appropriate to the telephone industry. The accounting records of the telephone company are maintained in accordance with the Uniform System of Accounts for Class A and B Telephone Companies prescribed by the Federal Communications Commission (FCC) as modified by the Washington Utilities Commission (WUC).

Cash Equivalents

All highly liquid investments with a maturity of three months or less at the time of purchase are considered cash equivalents.

Accounts Receivable

Accounts receivable are reported net of an allowance for doubtful accounts. The allowance is based on management's estimate of the amount of receivables that will actually be collected. At December 31, 2009, management has determined that all receivables will be collected and no allowance has been recorded.

Inventory

Inventory is stated at the lower of cost or market with cost determined by the average cost method.

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

Marketable securities bought and held principally for selling in the near future are classified as trading securities and carried at fair value. Unrealized holding gains and losses on trading securities are reported in earnings. Marketable securities classified as available-for-sale are carried at fair value with unrealized holding gains and losses recorded as a separate component of stockholders' equity. Debt securities for which the Company has both the positive intent and ability to hold to maturity are classified as held-to-maturity and are carried at amortized cost. The Company uses the specific identification method of computing realized gains and losses. As of December 31, 2009 and 2008, all marketable securities have been categorized as held to maturity.

Nonmarketable equity investments and certificates of deposit are stated at cost, which approximates fair value.

Property, Plant and Equipment

Telephone plant in service is capitalized at original cost including the capitalized cost of salaries and wages, materials, certain payroll taxes, employee benefits and interest incurred during the construction period.

The Company provides for depreciation for financial reporting purposes on the straight-line method by the application of rates based on the estimated service lives of the various classes of depreciable property as approved by the WUC. These estimates are subject to change in the near term.

Renewals and betterments of units of telephone property are charged to plant in service. When telephone plant is retired, its cost is removed from the asset account and charged against accumulated depreciation less any salvage realized. No gains or losses are recognized in connection with routine retirements of depreciable telephone property. Repairs and renewals of minor items of telephone property are included in plant specific operations expense.

Repairs of other property, as well as renewals of minor items, are charged to plant specific operations expense. A gain or loss is recognized when other property is sold or retired.

Asset Retirement Obligations

Generally accepted accounting principles require entities to record the fair value of a liability for legal obligations associated with an asset retirement in the period in which the obligations are incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset.

PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Asset Retirement Obligation (Continued)

The Company has determined it does not have a material legal obligation to remove long-lived assets, and accordingly, there have been no liabilities recorded for the years ended December 31, 2009 and 2008.

Software

The Company capitalizes software costs (including right-to-use fees) associated with externally acquired software for internal use. Software maintenance and training costs are expensed as incurred. Capitalized software is generally amortized on a straight-line basis over its useful life, not to exceed five years.

Income Taxes

Revenue Recognition

The Company recognizes revenues when earned regardless of the period in which they are billed. The Company is required to provide telephone service to subscribers within its defined service territory.

Local network service and internet revenues are recognized over the period a subscriber is connected to the network.

Network access revenues are derived from charges for access to the Company's local exchange network. The interstate portion of access revenues is based on a cost separation procedure settlement formula administered by the National Exchange Carrier Association (NECA) which is regulated by the FCC. The intrastate portion of access revenues are billed based on an individual company tariff access charge structure based on expense and plant investment of the Company as approved by the WUC. The tariffs developed from this structure are used to charge the connecting carrier and recognize revenues in the period the traffic is transported based on the minutes of traffic carried.

Reported network access revenues are estimates subject to settlement adjustments in the near term resulting from changes in expense and plant investment levels and rate of return experience.

Revenues from network access and long distance network services were increased by approximately \$ and \$ in 2009 and 2008, respectively, as a result of adjustments to prior years' estimates.

PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition (Continued)

The Company recognizes taxes charged to customers on a net basis in the statement of income.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were \$ and \$ in 2009 and 2008, respectively.

Fair Value Measurements

Recent accounting guidance for financial assets and liabilities presented at fair value defines "fair value", establishes a framework for measuring fair value, and expands disclosures related to fair value measurements. The guidance does not expand the use of fair value measurements in financial statements, but rather standardizes its definition and application in generally accepted accounting principles. The guidance provides for the use of three levels of input in determining fair value measurements. (Level 1 - quoted market prices; Level 2 - observable inputs of quoted market prices for similar or inactive items; and Level 3 - unobservable inputs.) The company deferred until January 1, 2009 the adoption of this guidance for all non-financial assets and liabilities that are recognized or disclosed on a non-recurring basis. This includes goodwill, intangibles and non-financial long-lived assets that are measured at fair value in impairment testing.

Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform with the 2009 presentation.

REDACTED

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 2. SECURITIES INVESTMENTS

The amortized cost and fair value of held-to-maturity securities are:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|-------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| <u>December 31, 2009:</u> | | | | |
| Held-to-Maturity: | | | | |
| US Government Obligations | | | | |
| Amounts classified as: | | | | |
| Current marketable securities | | | | |
| Noncurrent marketable securities | | | | |
| Total | | | | |
| <u>December 31, 2008:</u> | | | | |
| Held-to-Maturity: | | | | |
| US Government Obligations | | | | |
| Amounts classified as: | | | | |
| Current marketable securities | | | | |
| Noncurrent marketable securities | | | | |
| Total | | | | |

Investments measured at fair value are valued at level one in the fair value hierarchy.

The amortized cost and fair value of debt and marketable equity securities at December 31, 2009, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

| | Amortized Cost | Fair Value |
|----------------------------------------|-------------------|------------|
| Held-to-Maturity: | | |
| Due in one year or less | | |
| Due after one year through three years | | |

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment includes the following:

| | <u>2009</u> | <u>2008</u> |
|-------------------------------------|-------------|-------------|
| Telephone plant in service: | | |
| Land | | |
| Buildings | | |
| Furniture and office equipment | | |
| Vehicles and work equipment | | |
| Switching equipment | | |
| Outside plant | | |
| Subtotal | | |
| Other property: | | |
| Internet equipment | | |
| Plant acquisition adjustment, net | | |
| Total property, plant and equipment | | |

Depreciation on depreciable property resulted in composite rates of 1.63% and 1.29% for 2009 and 2008, respectively.

Plant acquisition adjustments of \$_____ have been approved by the Washington Utilities Commission and are included as a component of property, plant and equipment due to the underlying assets which produced the adjustments. The adjustments are being amortized over 15 years.

Estimated amortization expense for the next five years is:

2010
2011
2012
2013
2014

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 4. LONG-TERM DEBT

Long-term debt consists of:

| | 2009 | 2008 |
|--------------------------|------|------|
| RDUP mortgage notes - 5% | | |
| Less unadvanced funds | | |
| Total long-term debt | | |
| Less current portion | | |

The annual requirements for principal payments on long-term debt for the next five years are as follows:

2010
2011
2012
2013
2014

Substantially all assets of the Company are pledged as security for the long-term debt under certain loan agreements with the Rural Development Utilities Program (RDUP). These mortgage notes are to be repaid in equal monthly and quarterly installments covering principal and interest beginning after date of issue and expiring by 2012.

Cash paid for interest net of amounts capitalized for 2009 and 2008 totaled \$ and \$, respectively.

Unadvanced funds at December 31, 2009 and 2008 for long-term notes and lines of credit totaled \$ and \$, respectively.

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 4. LONG-TERM DEBT (Continued)

Under the provisions of the loan contract, advances of loan funds shall be deposited in a special construction account and held in trust for the government until disbursed. The loan contract restricts disbursements to such expenditures as RDUP may authorize. All payments from the trust accounts are subject to RDUP approval.

The mortgage to the United States of America, underlying the RDUP notes, contains certain restrictions on the declaration or payment of cash dividends, redemption of capital stock or investment in affiliated companies except as might be specifically authorized in writing in advance by the RDUP noteholders.

NOTE 5. EMPLOYEE BENEFITS

NOTE 6. RELATED PARTY TRANSACTIONS

NOTE 7. CONCENTRATIONS OF CREDIT RISK

The Company grants credit to local service customers, all of whom are located in the franchised service area, and telecommunications intrastate and interstate long distance carriers. The Company is subject to competition for telecommunications services including telecommunications exchange services offered by other providers in the franchised area.

**PEND OREILLE TELEPHONE COMPANY
GLENN'S FERRY, WASHINGTON**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 7. CONCENTRATIONS OF CREDIT RISK (Continued)

The Company received approximately 67% of its 2009 revenues from access revenues and assistance provided by the Federal Universal Service Fund. As a result of the Telecommunications Act of 1996, the manner in which access revenues and Universal Service Funds are determined is currently being modified by regulatory bodies.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash equivalents. The Company places its cash equivalents in several financial institutions which limits the amount of credit exposure in any one financial institution.

The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

NOTE 8. REGULATORY ACCOUNTING

For its telephone operations, the Company follows generally accepted accounting principles for regulated enterprises. Accordingly, the Company defers certain cost and obligations and depreciates plant and equipment over lives approved by regulators. While the Company continues to believe the current regulatory and competitive environment supports this accounting treatment, should conditions change the Company would be required to write-off these deferred cost and obligations and evaluate the net carrying value of its plant and equipment for any impairment losses absent the future recovery currently permitted by the regulators.



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF THE CONSOLIDATED FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Pend Oreille Telephone Company
Glenns Ferry, Idaho

We have audited the accompanying financial statements of Pend Oreille Telephone Company as of and for the year ended December 31, 2009, and have issued our report thereon dated April 23, 2010. Our opinion on the consolidated financial statements and this communication, insofar as they relate to Pend Oreille Telephone Company, is based solely on the report of other auditors. 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

REDACTED

To the Board of Directors
Pend Oreille Telephone Company

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pend Oreille Telephone 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.

REDACTED

To the Board of Directors
Pend Oreille Telephone Company

This report is intended solely for the information and use of the board of directors, management, and the Rural Development Utilities Program, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Colorado Springs, Colorado
April 23, 2010