

**WHIDBEY TELEPHONE COMPANY  
AND SUBSIDIARIES**

Audited Consolidated Financial Statements

December 31, 2009 and 2008

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

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**AUDITED CONSOLIDATED FINANCIAL STATEMENTS**

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Independent Auditor's Report

To the Board of Directors  
Whidbey Telephone Company  
Langley, Washington

We have audited the accompanying consolidated balance sheets of Whidbey Telephone Company and Subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholder's equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. 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 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 Whidbey Telephone Company and Subsidiaries 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.

*Johnson, Stone & Pagano, P.S.*  
JOHNSON, STONE & PAGANO, P.S.

April 30, 2010

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b><u>ASSETS</u></b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents (Notes 1 and 2)	██████████	██████████
Accounts receivable		
Trade (Notes 3 and 7)	██████████	██████████
Other (Note 12)	██████████	██████████
Materials and supplies (Note 1)	██████████	██████████
Prepayments and deposits	██████████	██████████
<b>Total Current Assets</b>	██████████	██████████
<b>OTHER ASSETS</b>		
Investments (Notes 2 and 4)	██████████	██████████
Deferred charges (Note 5)	██████████	██████████
<b>Total Other Assets</b>	██████████	██████████
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
(Notes 1, 6 and 7)		
Telecommunications plant in service	██████████	██████████
Less allowances for depreciation	██████████	██████████
Telecommunications plant under construction	██████████	██████████
Plant held for future use	██████████	██████████
Nonoperating plant	██████████	██████████
<b>Total Telecommunications Plant</b>	██████████	██████████
Nonregulated plant	██████████	██████████
Less allowances for depreciation	██████████	██████████
Nonregulated plant under construction	██████████	██████████
<b>Total Nonregulated Plant</b>	██████████	██████████
<b>Total Assets</b>	\$ ██████████	██████████

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

	<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]
Short-term notes payable (Note 7)	[REDACTED]	[REDACTED]
<b>Total Current Liabilities</b>	[REDACTED]	[REDACTED]
<b>LONG-TERM DEBT</b> , less portion classified as a current liability (Note 7)	[REDACTED]	[REDACTED]
<b>Total Liabilities</b>	[REDACTED]	[REDACTED]
<b>STOCKHOLDER'S EQUITY</b>		
Capital stock (Note 9)	[REDACTED]	[REDACTED]
Retained earnings	[REDACTED]	[REDACTED]
Accumulated other comprehensive income (loss)	[REDACTED]	[REDACTED]
<b>Total Stockholder's Equity</b>	[REDACTED]	[REDACTED]
 <b>Total Liabilities and Stockholder's Equity</b>	 [REDACTED]	 [REDACTED]

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>OPERATING REVENUES (Note 1)</b>		
[REDACTED]	[REDACTED]	[REDACTED]
<b>Total Operating Revenues</b>	[REDACTED]	[REDACTED]
<b>OPERATING EXPENSES</b>		
[REDACTED]	[REDACTED]	[REDACTED]
<b>Total Operating Expenses</b>	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
<b>OTHER OPERATING INCOME</b>	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
<b>OTHER INCOME, EXPENSE AND TAXES - NET</b>		
[REDACTED]	[REDACTED]	[REDACTED]
<b>Total Other Income, Expense and Taxes - Net</b>	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
<b>FIXED CHARGES AND RELATED ITEMS - NET</b>		
[REDACTED]	[REDACTED]	[REDACTED]
	\$	
	[REDACTED]	[REDACTED]

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

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY**

Years Ended December 31, 2009 and 2008

	<u>Capital Stock</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
<b>BALANCE AT DECEMBER 31, 2007</b>	██████████	██████████	██████████	██████████
Distributions to ██████████		██████████		██████████
██████████		██████████		██████████
Other comprehensive income: Unrealized loss on investments			██████████	██████████
<b>Comprehensive Income</b>	_____	_____	_____	██████████
<b>BALANCE AT DECEMBER 31, 2008</b>	██████████	██████████	██████████	██████████
Distributions to ██████████		██████████		██████████
██████████		██████████		██████████
Other comprehensive income: Unrealized gain on investments			██████████	██████████
<b>Comprehensive Income</b>	_____	_____	_____	██████████
<b>BALANCE AT DECEMBER 31, 2009</b>	\$ ██████████	██████████	██████████	██████████

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



**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from customers and settlements	[REDACTED]	[REDACTED]
Cash paid to vendors, suppliers and employees	[REDACTED]	[REDACTED]
Interest and dividends received	[REDACTED]	[REDACTED]
Interest paid	[REDACTED]	[REDACTED]
Income taxes paid	[REDACTED]	[REDACTED]
<b>Net Cash Provided by Operating Activities</b>	[REDACTED]	[REDACTED]
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	[REDACTED]	[REDACTED]
Salvage on retired property, plant and equipment	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
Proceeds from sale of investments	[REDACTED]	[REDACTED]
Purchase of investments	[REDACTED]	[REDACTED]
<b>Net Cash Used by Investing Activities</b>	[REDACTED]	[REDACTED]
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Distributions to [REDACTED]	[REDACTED]	[REDACTED]
Proceeds from short-term debt	[REDACTED]	[REDACTED]
Proceeds from long-term debt	[REDACTED]	[REDACTED]
<b>Net Cash Provided by Financing Activities</b>	[REDACTED]	[REDACTED]
<b>Net Increase in Cash and Cash Equivalents</b>	[REDACTED]	[REDACTED]
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	[REDACTED]	[REDACTED]
<b>Cash and Cash Equivalents at End of Year</b>	[REDACTED]	[REDACTED]

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

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Net income	\$ [REDACTED]	[REDACTED]
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	[REDACTED]	[REDACTED]
Partnership distribution included in net income and not included in operating activities	[REDACTED]	[REDACTED]
Realized gain on sale of investments	[REDACTED]	[REDACTED]
Noncash operating income	[REDACTED]	[REDACTED]
(Increase) decrease in assets:		
Accounts receivable	[REDACTED]	[REDACTED]
Materials and supplies	[REDACTED]	[REDACTED]
Prepayments and deposits	[REDACTED]	[REDACTED]
Increase (decrease) in liabilities:		
Accounts payable	[REDACTED]	[REDACTED]
Taxes, other than income taxes	[REDACTED]	[REDACTED]
Other current liabilities	[REDACTED]	[REDACTED]
Federal income taxes payable	[REDACTED]	[REDACTED]
	<hr/>	<hr/>
<b>Net Cash Provided by Operating Activities</b>	<b>[REDACTED]</b>	<b>[REDACTED]</b>

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

## WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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

##### *Principles of Consolidation*

The consolidated financial statements include the accounts of Whidbey Telephone Company ("Company") and its wholly-owned subsidiaries [REDACTED] (collectively, "Company and Subsidiaries"). All material intercompany accounts and transactions have been eliminated in consolidation.

##### *Organization and Regulation*

The Company is a local exchange telecommunications company. The Company, together with its subsidiary [REDACTED] provides local exchange, [REDACTED] and other telecommunications services, including digital subscriber lines, to South Whidbey Island and Point Roberts, Washington. The Company also provides internet access services and web-hosting services to customers in western Washington, located both within and outside its local exchange service areas. [REDACTED]

[REDACTED] The Company and each of its subsidiaries are organized under the laws of the State of Washington.

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

##### *Accounting Records*

Accounting records are maintained in accordance with the Uniform System of Accounts ("USOA") prescribed by the Federal Communications Commission ("FCC"), and, to the extent permitted by the USOA, accounting principles generally accepted in the United States of America. The accounting methods observed by the Company for book and recording purposes are subject to the concurrence of the Washington Utilities and Transportation Commission ("WUTC").

##### *Cash and Cash Equivalents*

The Company and Subsidiaries consider all highly liquid debt instruments to be cash equivalents.

##### *Materials and Supplies*

Materials and supplies are stated at average cost.

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

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

***Fair Value Measurements***

On January 1, 2009, the Company adopted applicable authoritative guidance related to fair value measurements that defines fair value, provides a framework to measure the fair value of assets and liabilities and requires certain disclosures about those measurements. The guidance establishes a hierarchy to prioritize the inputs that underlie a fair value measurement and requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs essentially distinguish the relative reliability of inputs to fair value measurements. Level 1 inputs are more reliable and objective than Level 2 inputs which are in turn more reliable and objective than Level 3 inputs. In arriving at a fair value measure, the Company is required to determine the level in the fair value hierarchy within which a fair value measurement ultimately falls and provide disclosure of such determinations (see Note 4).

***Regulated Telecommunications Plant, Maintenance and Depreciation***

Regulated telecommunications plant is stated at original cost. The cost of additions to plant includes contracted work, direct labor, materials and overhead. When units of property are retired, the original cost plus removal costs, less salvage, is charged to accumulated depreciation with no gain or loss recognized. The costs of normal maintenance and repairs are charged to operating expense. Depreciation is computed using the straight-line method for financial reporting and accelerated methods for income tax purposes (see Note 6).

***Allowance for Funds Used During Construction***

Interest applicable to funds used for long-term construction projects is capitalized as a part of the cost of the asset and depreciated over the asset's estimated useful life. No interest was capitalized in 2009; interest capitalized totaled [REDACTED] in 2008.

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

Services provided by the Company and Subsidiaries include local network, [REDACTED] and network access services, as well as other services. In the normal course of business of the Company and Subsidiaries, certain [REDACTED] and network access service revenues are subject to out-of-period adjustments. Such adjustments are normal occurrences and are recorded by the Company and Subsidiaries during the year in which they become determinable.

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 end users of telecommunication services.

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

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

***Revenue Recognition, Major Customers and Services (Continued)***

For some of the services that the Company and Subsidiaries provide to their respective customers, the Company and Subsidiaries rely upon services and facilities supplied to the Company and Subsidiaries by other companies. Any material disruption of the services or facilities supplied to the Company and Subsidiaries by other companies could potentially have an adverse effect upon the operating results of the Company and Subsidiaries.

***Federal Income Taxes***

[REDACTED]

[REDACTED]

***Comprehensive Income***

Total comprehensive income, according to authoritative guidance, is presented in the Consolidated Statements of Stockholder's Equity.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount 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.

***Reclassifications***

Certain reclassifications have been made to the previously reported 2008 financial statements in order to make them comparable with the 2009 financial statements.

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

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

***Subsequent Events***

The management of the Company evaluated for subsequent events and transactions for potential recognition and disclosure through April 30, 2010, the date the financial statements were issued. All such material transactions or disclosures identified have been included in these financial statements.

**NOTE 2 - CONCENTRATION OF CREDIT RISK**

The Company and its subsidiaries maintain cash balances at various financial institutions in western Washington. Accounts at each of the financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) with basic coverage up to \$250,000 at December 31, 2009 and 2008. The Company and its subsidiaries' non-interest bearing accounts have unlimited FDIC deposit insurance through June 30, 2010. [REDACTED]

The Company has an account with a broker-dealer with investments in a government obligations fund and an account with a dealer-broker with investments including a money market fund and certain securities. Securities held at such institutions are each insured by the Securities Investor Protection Corporation up to \$500,000 for brokerage accounts, of which \$100,000 of the total available applies to any cash claims.

The Company's accounts receivable are subject to potential credit risk as they are unsecured.

**NOTE 3 - ACCOUNTS RECEIVABLE**

The trade accounts receivable balances at December 31, 2009 and 2008 consist of:

	<u>2009</u>	<u>2008</u>
Accounts receivable - subscribers	[REDACTED]	[REDACTED]
Accounts receivable - interexchange carriers and exchange carrier associations	[REDACTED]	[REDACTED]
Allowance for doubtful accounts (deduction)	[REDACTED]	[REDACTED]



**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

**NOTE 4 - INVESTMENTS (Continued)**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

NOTE 4 - INVESTMENTS (Continued)

The table is almost entirely obscured by black redaction bars. Only a few small, illegible fragments of text are visible within the grid structure.



**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

**NOTE 6 - PROPERTY, PLANT AND EQUIPMENT AND DEPRECIATION**  
(See Note 1)

Major classes of the telecommunications plant assets in service as of December 31, 2009 and 2008 are:

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

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

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

***Nonregulated Plant***

[REDACTED]

***Depreciation Expense***

The provision for depreciation on regulated telecommunications plant and nonregulated plant in service is:

	<u>2009</u>	<u>2008</u>
Regulated telecommunications plant	[REDACTED]	[REDACTED]
Nonregulated plant	[REDACTED]	[REDACTED]

Depreciation provision on average total depreciable property was [REDACTED] in 2009 and [REDACTED] in 2008.

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

**NOTE 7 - LONG-TERM DEBT AND SHORT-TERM NOTES PAYABLE**

[REDACTED]

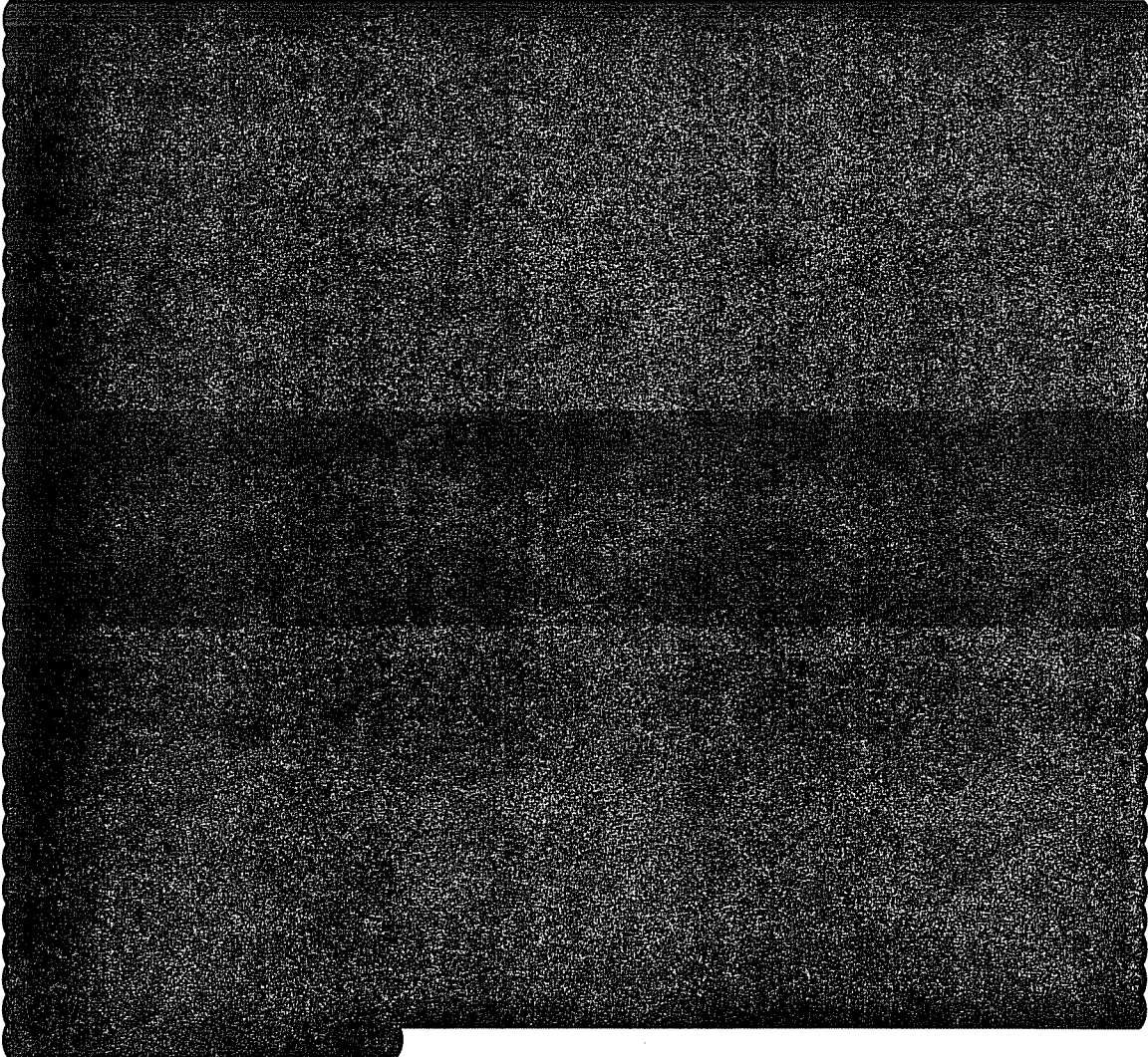
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**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

**NOTE 7 - LONG-TERM DEBT AND SHORT-TERM NOTES PAYABLE (Continued)**



**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

**NOTE 7 - LONG-TERM DEBT AND SHORT-TERM NOTES PAYABLE (Continued)**

[REDACTED]

[REDACTED]

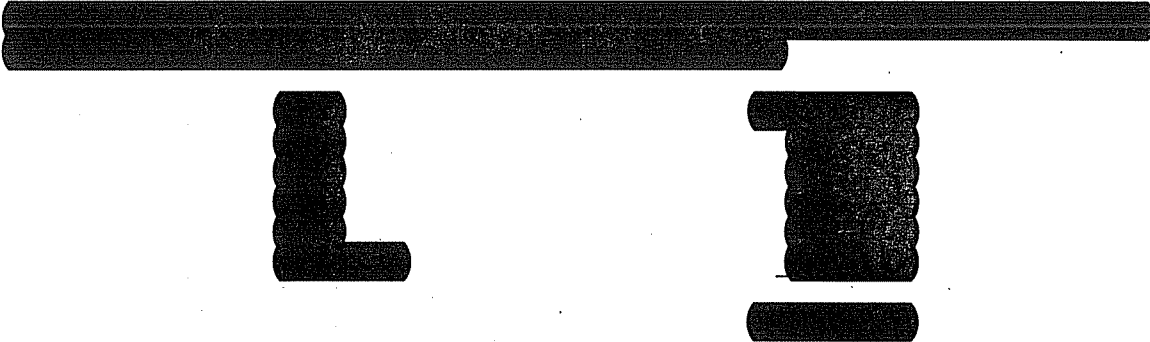
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**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

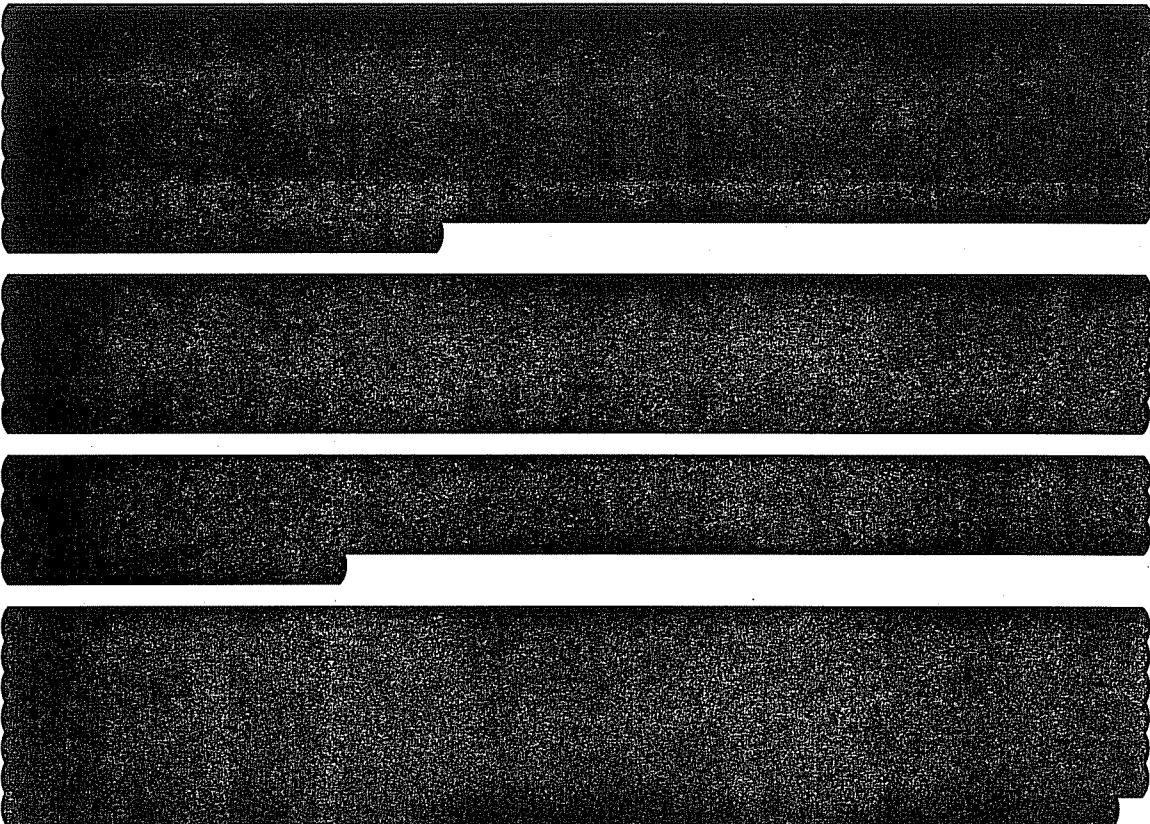
December 31, 2009 and 2008

**NOTE 7 - LONG-TERM DEBT AND SHORT-TERM NOTES PAYABLE (Continued)**



The table for Note 7 is completely redacted with black bars. It appears to be a table with at least two columns, as indicated by the two vertical bars in the center of the redaction.

**NOTE 8 - FEDERAL INCOME TAXES**



The table for Note 8 is completely redacted with black bars. It appears to be a table with at least two columns, as indicated by the two vertical bars in the center of the redaction.

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

**NOTE 8 - FEDERAL INCOME TAXES (Continued)**

2008

**COMPONENTS OF PROVISION FOR FEDERAL  
INCOME TAXES**

[REDACTED]	[REDACTED]
------------	------------

**NOTE 9 - CAPITAL STOCK**

[REDACTED]	[REDACTED]	[REDACTED]
------------	------------	------------

[REDACTED]	[REDACTED]	[REDACTED]
------------	------------	------------

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



**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

**NOTE 10 - LEASES AND SERVICE AGREEMENTS**

[REDACTED]

[REDACTED]

[REDACTED]

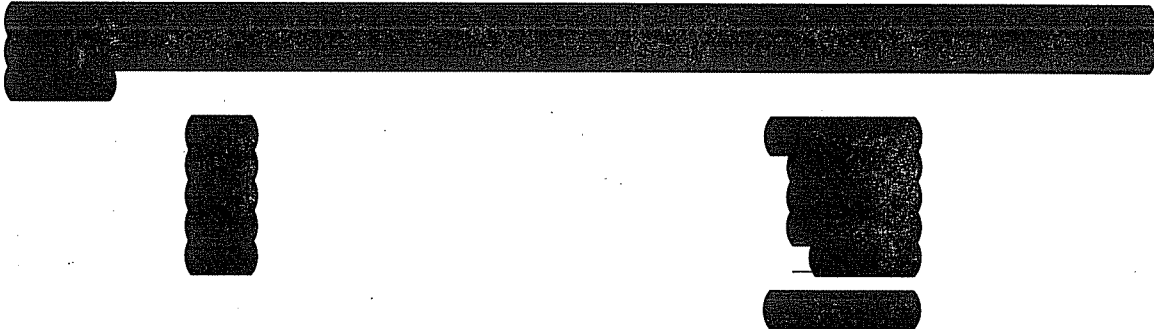
[REDACTED]

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

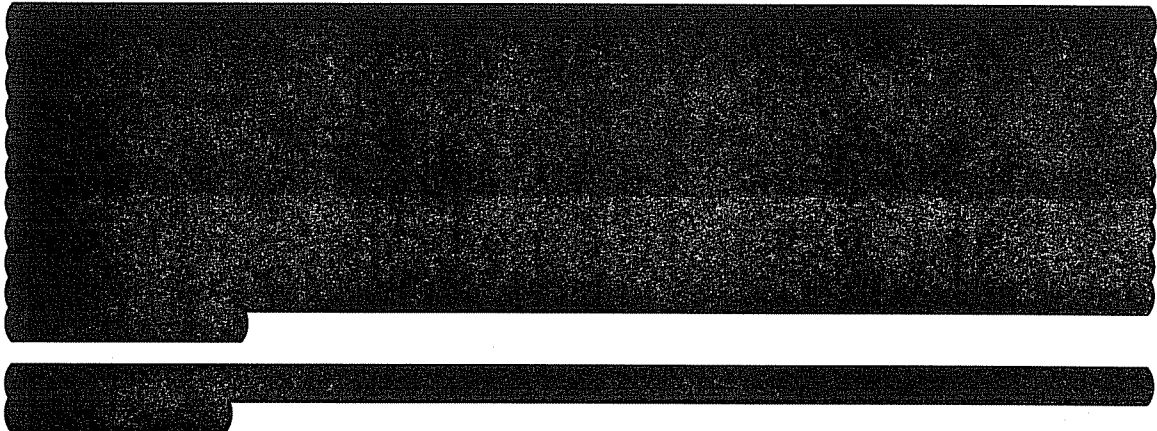
December 31, 2009 and 2008

**NOTE 10 - LEASES AND SERVICE AGREEMENTS (Continued)**



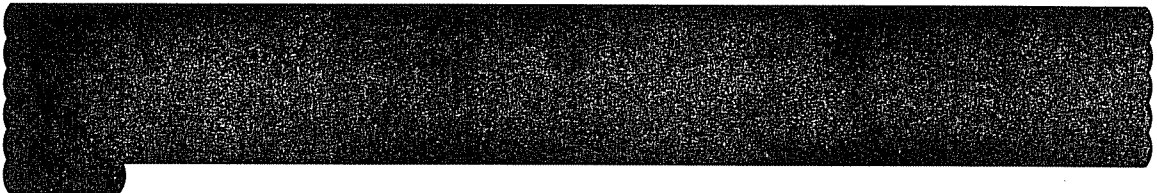
The content of Note 10 is redacted. It appears to be a table with two columns, but the data is obscured by black bars.

**NOTE 11 - 401(k) PLAN**



The content of Note 11 is redacted. It appears to be a table with two columns, but the data is obscured by black bars.

**NOTE 12 - OTHER RELATED PARTY TRANSACTIONS**



The content of Note 12 is redacted. It appears to be a table with two columns, but the data is obscured by black bars.

**WHIDBEY TELEPHONE COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2009 and 2008

**NOTE 12 - OTHER RELATED PARTY TRANSACTIONS (Continued)**

[REDACTED]

[REDACTED]