

Confidential per WAC 480-07-160

**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC.  
AND SUBSIDIARIES**

Audited Consolidated Financial Statements

December 31, 2015 and 2014

**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

Audited Consolidated Financial Statements

December 31, 2015 and 2014

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**AUDITED CONSOLIDATED FINANCIAL STATEMENTS**

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1501 Regents Blvd., Suite 100  
Fircrest, WA 98466-6060

## Independent Auditor's Report

Board of Directors  
St. John Telephone, Inc. and Subsidiaries  
St. John, Washington

### **Report on Financial Statements**

We have audited the accompanying consolidated financial statements of St. John Telephone, Inc. and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the consolidated statements of income, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these 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 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 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.

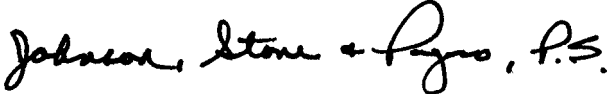
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of St. John Telephone, Inc. and Subsidiaries as of December 31, 2015 and 2014 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2016 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

  
JOHNSON, STONE & PAGANO, P.S.

March 4, 2016

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

December 31, 2015 and 2014

	2015	2014
<b><u>ASSETS</u></b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents		
Accounts receivable, less allowances for doubtful accounts		
Materials and supplies		
Nonregulated materials inventory		
Prepaid expenses		
Federal income tax receivable		
<b>Total Current Assets</b>		
<b>INVESTMENTS</b>		
Investments		
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Telecommunications plant in service		
Less allowances for depreciation		
<b>Total Telecommunications Plant</b>		
Nonregulated plant		
Less allowances for depreciation		
Plant under construction		
<b>Total Nonregulated Plant</b>		
<b>Total Property, Plant and Equipment</b>		
<b>TOTAL ASSETS</b>		

PETITION OF ST. JOHN TELEPHONE, INC. TO  
RECEIVE SUPPORT FROM THE STATE UNIVERSAL  
COMMUNICATIONS SERVICES PROGRAM -  
EXHIBIT 5, PAGE - 6

**REDACTED**

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

**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS (Continued)

December 31, 2015 and 2014

	2015	2014
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable		
Customers' deposits		
Taxes, other than income taxes		
Other current liabilities		
Deferred revenue		
Federal income taxes payable		
Installments on long-term debt due within one year		
<b>Total Current Liabilities</b>		
<b>LONG-TERM DEBT</b> , less portion classified as a current liability		
<b>OTHER LIABILITIES</b>		
Deferred income taxes		
<b>Total Liabilities</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value [REDACTED] share;		
Authorized [REDACTED] shares		
Issued and outstanding - (2015 [REDACTED] shares;		
2014 - [REDACTED] shares)		
Retained earnings		
<b>Total Stockholders' Equity</b>		
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>		

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EXHIBIT 5, PAGE - 7

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**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
<b>OPERATING REVENUES</b>		
Local network service revenues		
Network access service revenues		
Long distance network service revenues		
Miscellaneous revenues		
Cable television revenues and installations		
Uncollectible revenues (deduction)		
<b>Total Operating Revenues</b>		
<b>OPERATING EXPENSES</b>		
Plant specific operations		
Plant nonspecific operations		
Depreciation and amortization		
Customer operations		
Corporate operations		
Taxes, other than income taxes		
Other operating expenses		
<b>Total Operating Expenses</b>		
<b>Net Operating Income</b>		
<b>FIXED CHARGES</b>		
<b>OTHER INCOME</b>		
Interest and dividend income		
Other income (expense) - net		
<b>Total Other Income</b>		
<b>INCOME TAXES</b>		
Currently payable		
Deferred taxes		
<b>Total Income Taxes</b>		
<b>NET INCOME</b>		

PETITION OF ST. JOHN TELEPHONE, INC. TO  
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COMMUNICATIONS SERVICES PROGRAM -  
EXHIBIT 5, PAGE - 8

**REDACTED**

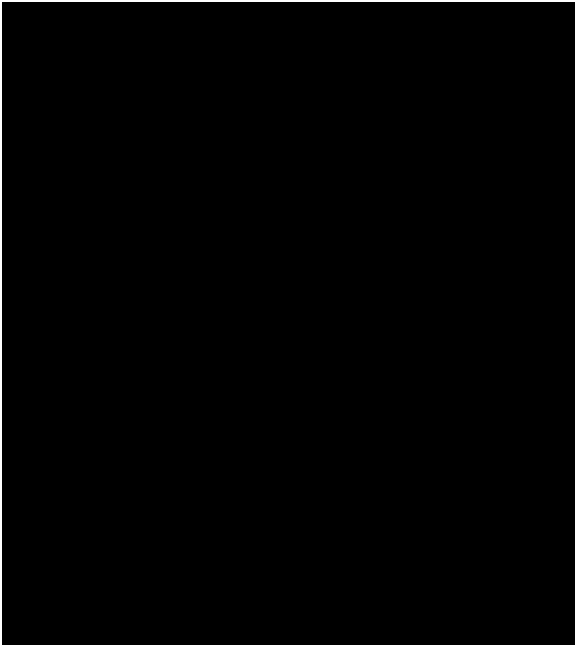
The accompanying notes are an integral part of these consolidated financial statements.



**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

Years Ended December 31, 2015 and 2014

	<u>Common Stock</u>	<u>Retained Earnings</u>	<u>Total</u>
<b>BALANCE AT DECEMBER 31, 2013</b>			
Dividends declared - net			
Redemption of stock			
Sale of stock			
Net income for the year			
<b>BALANCE AT DECEMBER 31, 2014</b>			
Dividends declared - net			
Redemption of stock			
Net income for the year			
<b>BALANCE AT DECEMBER 31, 2015</b>			

**WASHINGTON 533 ST. JOHN  
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**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income		
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation of telecommunications plant		
Depreciation and amortization of nonregulated plant and other assets		
Deferred income taxes		
Net change in operating assets and liabilities		
<b>Net Cash Provided by Operating Activities</b>		
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to telecommunications plant		
Additions to nonregulated plant		
Salvage on retired telecommunications plant		
Patronage dividend received		
<b>Net Cash Used by Investing Activities</b>		
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Dividends paid		
Payments on long-term debt		
Advance payments unapplied - net		
Redemption of stock		
Sale of stock		
<b>Net Cash Used by Financing Activities</b>		
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>		
<b>Cash and Cash Equivalents at Beginning of Year</b>		
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>		

PETITION OF ST. JOHN TELEPHONE, INC. TO  
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EXHIBIT 5, PAGE - 10

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**WASHINGTON 533 ST. JOHN  
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**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
<b>COMPONENTS OF NET CHANGE IN OPERATING ASSETS AND LIABILITIES</b>		
(Increase) decrease in assets		
Accounts receivable		
Materials and supplies		
Nonregulated materials inventory		
Prepaid expenses		
Federal income taxes receivable		
Increase (decrease) in liabilities		
Accounts payable		
Taxes, other than income taxes		
Other current liabilities		
Deferred revenue		
Federal income taxes payable		
<b>Net Change in Operating Assets and Liabilities</b>		
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid during the year for		
Interest		
Federal income taxes		

PETITION OF ST. JOHN TELEPHONE, INC. TO  
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EXHIBIT 5, PAGE - 11

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**WASHINGTON 533 ST. JOHN  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

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

***Principles of Consolidation and Operations***

The consolidated financial statements include the accounts of St. John Telephone, Inc. (the "Company") and its wholly-owned subsidiaries, St. John Cable Company, Colfax Highline Cable Company and Coin Telecom, Inc. (the "Subsidiaries"). All material intercompany accounts and transactions have been eliminated in consolidation.

St. John Telephone, Inc. is a local exchange telecommunications company. The Company, together with its subsidiary Coin Telecom, Inc., provides local exchange, network access, long distance access, other telecommunications services and broadband access services to customers in St. John and the surrounding vicinity in rural Whitman County in eastern Washington State. St. John Cable Company provides cable television and broadband access services to customers in St. John and the surrounding vicinity. Colfax Highline Cable Company provides cable television and broadband access services to customers in Colfax and the surrounding vicinity in eastern Washington State. Effective August 1, 2014, Coin Telecom, Inc. was merged with and into the Company.

The Company is a small rate-of-return carrier operating in eastern Washington State. The Federal Communications Commission ("FCC") Report and Order and Further Notice of Proposed Rulemaking, ("FCC 11-161"), reformed the universal service and intercarrier compensation systems. These reforms modified the manner in which the Company recovers its telecommunications revenue requirements.

***Regulation***

The Company is subject to the accounting and rate regulation policies of the Washington Utilities and Transportation Commission ("WUTC") and adheres to the FCC Uniform System of Accounts for Class B telephone companies as prescribed by the FCC under Part 32.

***Cash and Cash Equivalents***

For purposes of the statements of cash flows, the Company considers cash to be cash on hand, in checking accounts and in certificates of deposit with original maturities of three months or less.

***Materials and Supplies***

Materials and supplies are stated at the lower of cost (first-in, first-out) or market.

***Investments***

Investments in stocks are stated at cost which approximates fair value.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

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

***Accounting for Long-Lived Assets***

The Company periodically reviews its long-lived assets such as property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. At December 31, 2015 and 2014, management has determined that there were no material impairment charges to be recorded as of those dates.

***Property, Plant and Equipment***

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

***Telecommunications Plant Retirements***

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

***Advertising Costs***

Costs incurred for advertising are expensed as incurred. Advertising expenses were ██████ in 2015 and ██████ in 2014.

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

Services provided by the Company and Subsidiaries include local network, long distance network and network access services, digital subscriber lines, broadband and internet access services and video services. In the normal course of the Company's business, certain network access service revenues are subject to out-of-period adjustments. Such adjustments are normal occurrences and are recorded by the Company 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 an end user of telecommunication services.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

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

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

Revenues for certain interstate access services are currently received through tariffed access charges filed by the National Exchange Carrier Association ("NECA") with the Federal Communication Commission ("FCC") on behalf of the NECA member companies. These access charges currently 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 currently 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.

The FCC 11-161 modified and replaced the existing system with universal service reform and intercarrier compensation reform. A Connect America Fund has been established to replace all existing high-cost support mechanisms and set broadband service requirements. Alongside the broadband service rules, reforms to establish a framework to limit reimbursements for excessive capital and operating expenses were implemented as of July 1, 2012 and phase outs of certain support payments occurred. Intercarrier compensation reform adopts a uniform bill-and-keep framework as the ultimate end state for all telecommunications traffic exchanged with the Company. Intercarrier compensation rates are capped and the disparity between intrastate and interstate terminating end office rates are being brought to parity in two steps as outlined in FCC 11-161. The state's public utilities commissions will be overseeing the modifications to rates in intrastate tariffs. Limits on carriers' total eligible recovery will reflect existing downward trends on intercarrier compensation revenues with declining switching costs and minutes of use.

More recent universal service reform became effective July 2015. The FCC froze the National Average Cost per Loop ("NACPL") that serves as the threshold for support calculations of the High Cost Loop Support ("HCLS") revenues. The actual NACPL compared to the frozen NACPL is just one factor that impacts the Company's HCLS revenues in 2015. This recent reform caused no significant impact on the Company's revenues for 2015.

The Company continues to review the reforms and modifications to the support that the Company receives, and understands that those reforms and modifications could have an adverse effect on the Company's revenues and cash flow. Revenue impacts are subject to change based upon future data collections and further clarification from the FCC.

Revenues for intrastate access services are received through tariffed access charges filed by the Company at the WUTC. Once filed, the tariffed access charges become effective if specifically approved by the WUTC or allowed to become effective by operation of law. The intrastate switched access charges are billed by the Company to intrastate interexchange carriers. Intrastate special access charges are also billed to intrastate interexchange carriers

**WASHINGTON 533 ST. JOHN  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

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

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

that order such services and, in some cases, to retail customers that order special access services. Before July 1, 2014, the switched access charges associated with carrier common line and state universal service fund were pooled with all Washington Exchange Carrier Association ("WECA") member companies and the Company received a distribution of net revenues based upon the Company's proportionate share of WUTC approved revenue objectives of all participating WECA member companies.

Effective July 1, 2014, the WUTC implemented a state universal communications service program ("State USF Program") that temporarily replaced the terminated universal service support pool ("Traditional USF") administered by WECA and also replaced the cumulative reduction in support the Company received from the federal Connect America Fund ("CAF"). The State USF Program began January 2015 which resulted in a cash flow issue for some of the companies that met the WUTC criteria to be eligible for such support. The WUTC granted a one-time partial distribution in 2014 of the State USF Program equal to the amount the Company received from the Traditional USF for 2012 in the amount of [REDACTED]. The remainder of the annual distribution, which was comprised of the cumulative reduction in CAF support of [REDACTED], was disbursed in January 2015. Subsequent annual disbursements comprised of the Traditional USF and the disbursement of the cumulative CAF deficit support are scheduled to occur in January of the following State USF Program years, assuming the Company continues to be eligible under the program. The State USF Program year runs from July 1 to June 30, therefore, the Company accrued [REDACTED] in 2014 as a receivable due from the State USF Program for the period July 1, 2014 to June 30, 2015, and deferred revenue of [REDACTED] in 2014 for the unearned portion. In 2015, the Company received [REDACTED] from the State USF Program, for the period July 1, 2015 to June 30, 2016, and recorded deferred revenue of [REDACTED] for the unearned portion. The State USF Program is scheduled to last for five program years.

As of July 31, 2014, WECA terminated the pooling of originating carrier common line ("CCL") minutes of use and the Company opted to keep its existing originating CCL rate, which was allowed by the WUTC to become effective as a matter of law.

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.

**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

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

***Federal Income Taxes***

The Company and Subsidiaries provide federal income taxes for the effects of transactions reported in the financial statements and consists of taxes currently due and deferred income taxes. The Company and Subsidiaries file federal income taxes on a consolidated basis. The consolidated tax liability of the affiliated group is based on each company's contributions to consolidated taxable income.

The Company and Subsidiaries utilize the liability method of accounting for income taxes. 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 is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

The Company's federal income tax returns for the tax years ended previous to December 31, 2012 are closed to examination.

***Use of Estimates***

The preparation of consolidated 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 consolidated financial statements.

***Subsequent Events***

The management of the Company and Subsidiaries evaluated for subsequent events and transactions for potential recognition and disclosure through March 4, 2016, the date the financial statements were available to be issued. All identified material events or transactions have been recorded or disclosed.

**NOTE 2 - CONCENTRATION OF CREDIT RISK**

The Company and Subsidiaries maintain cash balances at various financial institutions. Accounts at each of the institutions are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation up to \$250,000. The Company and Subsidiaries periodically maintain cash balances in excess of the federally insured limits. At December 31, 2015, the Company's and Subsidiaries' cash balances exceeded the insured amount by [REDACTED].



**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

**NOTE 2 - CONCENTRATION OF CREDIT RISK (Continued)**

The Company and Subsidiaries accounts receivable are subject to potential credit risk as they are concentrated in and around St. John and Colfax, Washington, and are unsecured.

**NOTE 3 - ACCOUNTS AND NOTE RECEIVABLE**

The accounts receivable balance at December 31 consists of:

	<u>2015</u>	<u>2014</u>
Due from customers		
Due from exchange carriers and exchange carrier associations		
Allowances for doubtful accounts (deduction)		

The Company and Subsidiaries extend credit to its business and residential customers based upon a written credit policy. Service interruption is the primary vehicle for controlling losses. Accounts receivable are recorded when subscriber bills, carrier access bills and exchange carrier associations settlement statements are rendered and are presented in the balance sheets 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. The allowances for doubtful accounts are estimated based on the Company and Subsidiaries historical losses, the existing economic conditions in the telecommunications and cable television industry and the financial stability of its customers. There were no of accounts receivable outstanding ninety days or more after the date of the invoice on which they were first billed.

**NOTE 4 - INVESTMENTS**

Investments consist of the following:

	<u>2015</u>	<u>2014</u>
<u>Investments in Stocks</u>		
St. John Telephone, Inc.		
Grange Patronage Stock Dividend		
Pioneer Telephone Holding Company, Inc.		
Total Investments in Stocks		

Investments in stocks are carried at cost, the difference between fair value and cost at December 31, 2015 and 2014 is not considered material.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

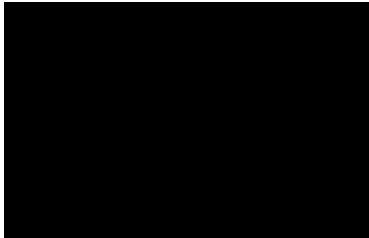
**NOTE 5 - PROPERTY, PLANT AND EQUIPMENT**

***Telecommunications Plant in Service***

Telecommunications plant in service is stated at cost. Listed below are the major classes of the telecommunications plant as of December 31, 2015 and 2014:


	<u>2015</u>	<u>2014</u>
General support facilities		
Central office equipment		
Cable and wire facilities		

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

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

***Nonregulated Plant***

Nonregulated plant is recorded at original cost. Listed below are the major classes of nonregulated plant as of December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
St. John Telephone, Inc.		
Land		
Nonregulated telecommunications equipment		
Internet equipment		
Paging equipment		
Motel building		
Mini storage building		
St. John Cable Company		
Cable television equipment		
Colfax Highline Cable Company		
General support assets		
Cable television equipment		
 Total Nonregulated Plant		

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

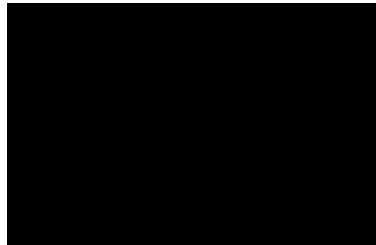
December 31, 2015 and 2014

**NOTE 5 - PROPERTY, PLANT AND EQUIPMENT (Continued)**

*Nonregulated Plant (Continued)*

Provisions have been made for depreciation of major classes of nonregulated plant at straight-line rates as follows:

- Nonregulated telecommunications equipment
- Internet equipment
- Paging equipment
- Motel and mini storage building
- Cable television equipment
- General support assets



**Depreciation Expense**

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

	<u>2015</u>	<u>2014</u>
Telecommunications plant		
Nonregulated plant		
Total Depreciation Expense		

**NOTE 6 - LONG-TERM DEBT**

Long-term debt consists of the following:

	<u>Current Annual Installments of Principal</u>	<u>Principal Amount</u>
	<u>2015</u>	<u>2014</u>
Rural Utilities Service ("RUS") - first mortgage notes		
- due September 2029		
Advance payments unapplied - net		
Less principal installments on long-term debt due within one year		
Total Long-term Debt		

**WASHINGTON 533 ST. JOHN  
ST. JOHN TELEPHONE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2015 and 2014

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

At December 31, 2015, maturities on long-term debt for the next five years and thereafter are as follows:

2016  
2017  
2018  
2019  
2020  
Thereafter



Substantially all of the Company's telecommunications plant now owned and hereafter acquired is subject to first and supplemental mortgage agreements executed to the Rural Utilities Service. The terms of the mortgage agreements restrict distributions to stockholders, redemptions of capital stock and investments in affiliated companies. Allowable distributions are based on minimum net worth requirements defined in the agreements. The Company must also maintain certain interest coverage under the mortgage agreements.

The Advance payment unapplied - net, represents voluntary unscheduled payments by the Company in excess of amounts due and payable under the Cushion of Credits Payments Program noted in the Rural Electrification Act. The cushion of credit is intended to enable the Company to deposit funds and have those funds available to make scheduled debt payments or installments. If the Company made less than or no payment when their debt payment was due, the cushion of credit would automatically add to or make the Company's debt payment systematically for the Company. By law, cushion of credit accounts earn five percent interest annually, accrued daily and recorded quarterly. In 2015, the Company added [REDACTED] to its cushion of credit, which included interest earned on the cushion of credit of [REDACTED]. In 2014, the Company added [REDACTED] to its cushion of credit, which included interest earned on the cushion of credit of [REDACTED].

**NOTE 7 - FEDERAL INCOME TAXES**

The Company and Subsidiaries recognize deferred 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 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 following:

- Depreciable assets' lives and methods of calculating depreciation for financial and income tax reporting.

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

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

	<u>2015</u>	<u>2014</u>
Plant and equipment		

Components of the provisions for income taxes are as follows:

	<u>2015</u>	<u>2014</u>
Current		
Deferred		

**NOTE 8 - LEASES**

In March 2014, the Company began leasing certain telecommunications facilities, bandwidth and transport services from a local telecommunications provider at [REDACTED] per month, which was then amended to [REDACTED] per month due to increased capacity as of March 2015 until March 2017. The Company is leasing other facilities on a month-to-month basis at [REDACTED] per month. In May 2015, the Company began leasing certain telecommunication services from another telecommunication provider at [REDACTED] per month until May 2018. The Company was leasing certain telecommunications facilities on a month-to-month basis at [REDACTED] per month until March 2015. Total lease expense was [REDACTED] in 2015 and [REDACTED] in 2014. The Company subleases some of these facilities to another telecommunications provider and a customer outside of its local exchange boundary. The current sublease agreements are month-to-month with current monthly income of [REDACTED].

The Company also leases certain telecommunications facilities from the Port of Whitman County. The term of the lease consists of a twenty-year lease commencing August 31, 2004 and expiring August 31, 2024, unless terminated earlier by either party pursuant to the lease agreement. The Company pays monthly rents of [REDACTED] and monthly taxes of [REDACTED]. Expense for this agreement was [REDACTED] for 2015 and 2014. The Company leases certain telecommunications facilities under a separate ten-year lease with the Port of Whitman County that expires November 2022 for [REDACTED] per year.

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**NOTE 8 - LEASES (Continued)**

The Company and Subsidiaries have various other land and building leases that run month-to-month, year-to-year, or expire on or before July 2024. The annual amounts paid under these leases were [REDACTED] in 2015 and [REDACTED] in 2014. The Company has several sublease agreements that run month-to-month or expire on or before April 2026. The amounts received under these subleases were [REDACTED] for 2015 and [REDACTED] for 2014.

Future minimum payments for the next five years under the terms of the agreements referred to above in this Note 8, as determined by the current monthly or scheduled payments, are as follows:

2016	
2017	
2018	
2019	
2020	

**NOTE 9 - PENSION PLAN**

The Company has a pension plan covering all of its eligible employees. All employees over 21 years of age and after one year of service with the Company are covered under the plan. Company contributions are [REDACTED] of the qualified employees' wages. All accrued pension costs are funded through a trust. The fund covers all vested benefits under the plan. Pension expense for the years ended December 31, 2015 and 2014 were [REDACTED] and [REDACTED], respectively.

**NOTE 10 - COMMITMENTS AND CONTINGENCIES**

The FCC continues to pursue universal service reform as stated in Note 1 under Revenue Recognition, Major Customers and Services. The FCC is proposing to migrate legacy Universal Service Fund ("USF") funding to a model based support called Alternative Connect America Cost Model ("A-CAM"). Preliminary calculations indicate a significant negative impact on revenues if the A-CAM model was adopted by the Company. The A-CAM model would be a voluntary election for all independent rate-of-return telephone companies once it is effective. However, the FCC will continue to develop some form of a new funding mechanism to transition all rate-of-return carriers away from the current legacy support mechanism of companies that do not elect the A-CAM model based support plan.

Confidential per WAC 480-07-160

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**NOTE 10 - COMMITMENTS AND CONTINGENCIES (Continued)**

As noted in Note 1, the FCC froze the NACPL to satisfy the annual HCLS funding cap for 2015. In 2016, in order for the HCLS funding to meet the overall cap an estimated pro rata expense adjustment factor has been established to calculate the actual HCLS distribution to all of the independent telephone companies that receive HCLS funding. This will cause a reduction of approximately [REDACTED] to the Company's calculated HCLS revenues beginning in 2016.