

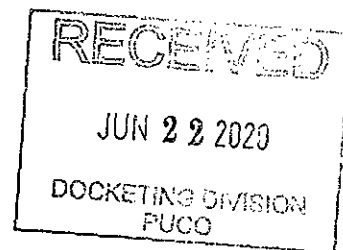
# Confidential Release

Case number: 13-1115-TP-COI

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Document Description: Five Year Service Improvement Plan

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*Case #13-1115-TP-COI*

*Page Count: 28 pages*

*Date Filed: 6/25/2014*

*Filed by: W. Adams*

*On Behalf of: Sherwood Mutual Telephone Association, Inc.*

*Summary of document: Five Year Service Improvement Plan*

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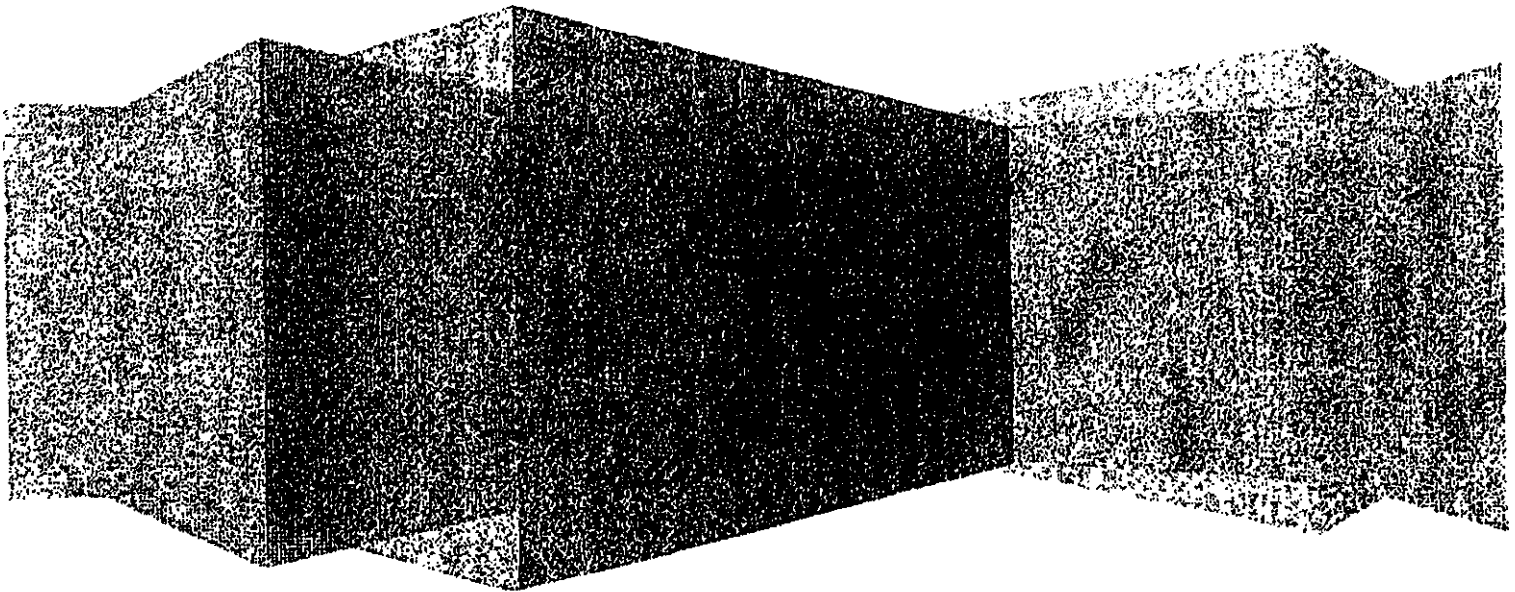
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**SHERWOOD MUTUAL TELEPHONE  
ASSOCIATION, INC.**

**CONFIDENTIAL**

**FIVE YEAR SERVICE  
IMPROVEMENT PLAN**



**SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.**

**FIVE YEAR SERVICE IMPROVEMENT PLAN**

**JULY 1, 2014**

**CONFIDENTIAL**

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## EXECUTIVE SUMMARY

Sherwood Mutual Telephone Association ("Sherwood" or "the Company") is a rural independent local exchange carrier ("RLEC") operating in northwestern Ohio. The Company operates under federal rate of return regulations as an average schedule company. The Company is an eligible telecommunications carrier and a recipient of high cost support for voice telephony services. As a condition for receiving this support, Sherwood offers broadband service which is designed to comply with the FCC's new broadband obligations<sup>1</sup>.

The Company can provide broadband which satisfies the current FCC requirement (4 Mbps / 1Mbps) to 100% of its customers. Sherwood continues to invest in network additions and maintenance of existing plant to meet customer demand and ensure quality service at affordable rates.

## PRESENT SERVICE CAPABILITIES

Sherwood is a single exchange company with that exchange also named Sherwood. The Sherwood study area is approximately 35 square miles. At December 2013, the company served 922 access lines detailed below.

Table 1. Access Lines	
Single Party Residential Lines	761
Single Party Business Lines	31
Multi-line Business Lines	130
Total Access Lines	922

At this time, Sherwood offers broadband at speeds which exceed the 4 Mbps / 1 Mbps requirement to 100% of their customers. Sherwood's customers are served by a network consisting of both fiber optics and copper. The company uses a combination of fiber to the home ("FTTH") network architecture which allows the company to offer higher broadband speeds deeper into its network. In other areas the Company uses traditional DSL over copper loops. Sherwood intends to have FTTH architecture in place for 100% of its customers by the end of 2015. Sherwood currently markets broadband with 10 Mbps download speeds to 100% of its customers.

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<sup>1</sup> Per Paragraph 587 of the USE/ICC Transformation Order.

## PROPOSED SERVICE IMPROVEMENTS

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Even though Sherwood is presently able to provide 4 Mbps / 1 Mbps broadband service to 100% of its study area and 100% of its customers, continued capital investment is anticipated. As noted, additional FTTH projects may be undertaken to provide customers with speeds in excess of the FCC requirement. Because these investments do not relate to the provision of 4 Mbps / 1 Mbps broadband, there is no quantification of the expenses in this plan.

In the normal course of business, the Company incurs maintenance and repairs expense which relate to the telecommunications network and support assets. Over the last two years, the Company has averaged approximately \$220,000 per year in plant expenses. It is anticipated that this level of expenditure will be incurred on an ongoing basis even if no further improvements to the broadband network are implemented. The Company will continue to respond to the needs of its customer base and the desire for broadband speed which is even faster than the FCC's minimum requirement. At the same time, the Company will continue to offer the services which universal service mechanisms support, including:

1. Voice Grade access to the Public Switched Telephone Network, and
2. Local Usage, and
3. Access to emergency service, and
4. Toll limitations for low-income customers

Simultaneously, the Company will be following the FCC's actions on the transition to an all-IP based network which will be a further use of capital dollars. Funds received from the universal service support mechanisms, in combination with all other revenue streams will allow the Company to maintain and upgrade the telecommunications network. This support will also help to keep rates affordable, in accordance with universal service principles. These funds may be used to deploy new or advanced technologies and new services, depending on customer demand and regulatory requirements.

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## CONCLUSION

In this filing the Company projects certain expenditures or investments which it anticipates will be incurred over the next five years. It should be noted that any estimates are based on today's technology and may change over the five year planning period. Ultimately the goal of this plan is to identify investments required to meet the broadband requirements set forth by the FCC. If the Company is able to accomplish these goals at a lower cost than is predicted in the plan it would be under no obligation to spend the amounts identified in this plan.

Certain statements in this document are "forward-looking statements" which may describe strategies, goals, outlook or other non-historical matters, or project expenses and/or capital investment. These statements are only predictions and involve known and unknown risks, uncertainties, and other factors that may cause our actual results to differ materially from those expressed or implied by such forward-looking statements.

Forward-looking statements speak only as of the date on which they are made. As set forth in 47 C.F.R. Section 54.313(a)(1), the Company recognizes the obligation to file annual progress reports on this five year plan. At that time the Company will update or revise any forward-looking statements included in this plan.



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**SHERWOOD MUTUAL TELEPHONE  
ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY  
(An Ohio Mutual Company)**

**SHERWOOD, OHIO**

**FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2013 AND 2012**

CONFIDENTIAL

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March 5, 2014

CONFIDENTIAL

Board of Directors and Members  
Sherwood Mutual Telephone Association, Inc.  
P. O. Box 4572  
Sherwood, Ohio 43556-0572

### INDEPENDENT AUDITORS' REPORT

We have audited the accompanying consolidated balance sheet of SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC. AND ITS WHOLLY-OWNED SUBSIDIARY (An Ohio Mutual Company) as of December 31, 2013 and 2012, and the related consolidated statements of income, changes in members' 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 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 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 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

Board of Directors and Members  
Sherwood Mutual Telephone Association, Inc.  
March 5, 2014

CONFIDENTIAL

*Opinion*

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sherwood Mutual Telephone Association, Inc. and its wholly-owned subsidiary as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental information on page 18 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Respectfully submitted,

*Lally Group, PC*  
*Jackson, Michigan*

March 5, 2014

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY  
(An Ohio Mutual Company)  
SHERWOOD, OHIO

CONSOLIDATED BALANCE SHEET  
DECEMBER 31, 2013 AND 2012

**CONFIDENTIAL**

ASSETS

	2013	2012
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 93,035	\$ 437,302
Accounts receivable - telecommunications - net of allowance for doubtful accounts of \$26,418 in 2013 and \$7,770 in 2012	49,499	76,552
Interest receivable	17,178	13,233
Materials and supplies	136,627	38,686
Prepaid taxes	2,650	24,247
Prepaid expenses	40,003	30,201
Total current assets	<u>338,992</u>	<u>620,221</u>
<b>NONCURRENT ASSETS:</b>		
Investments - affiliated	1,717,727	1,597,060
Investments - nonaffiliated	20,816	91,159
Notes receivable	950,000	950,000
Deferred charges	3,329	7,785
Total noncurrent assets	<u>2,691,872</u>	<u>2,646,004</u>
<b>PROPERTY, PLANT, AND EQUIPMENT:</b>		
Telecommunications plant in service	8,049,488	7,221,300
Telecommunications plant under construction	0	42,198
CATV equipment - analog	3,944	3,944
	<u>8,053,432</u>	<u>7,267,442</u>
Less: Depreciation reserve	4,143,619	3,854,358
Net book value	<u>3,909,813</u>	<u>3,413,084</u>
 Total assets	 <u>\$ 6,940,877</u>	 <u>\$ 6,679,309</u>

(The accompanying notes are an integral part of these financial statements)

**CONFIDENTIAL**

**LIABILITIES AND MEMBERS' EQUITY**

	<u>2013</u>	<u>2012</u>
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 194,482	\$ 110,882
Accrued taxes	<u>5,286</u>	<u>6,038</u>
Total current liabilities	<u>199,768</u>	<u>116,920</u>
 <b>MEMBERS' EQUITY:</b>		
Memberships issued	8,850	9,965
Patronage capital	5,359,082	5,252,759
Retained earnings	1,444,449	1,308,674
Other comprehensive income (loss)	<u>(71,252)</u>	<u>(6,909)</u>
Total members' equity	<u>6,740,909</u>	<u>6,562,389</u>
 <b>Total liabilities and members' equity</b>	 <u><b>\$ 6,940,677</b></u>	 <u><b>\$ 6,679,309</b></u>

(The accompanying notes are an integral part of these financial statements)

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY

CONSOLIDATED STATEMENT OF INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

CONFIDENTIAL

	2013	2012
<b>OPERATING REVENUES:</b>		
Basic local network services	\$ 187,758	\$ 170,421
Network access services	734,016	731,779
CATV and internet revenues	588,465	575,973
Miscellaneous	21,022	15,893
Less:		
Uncollectible revenues	16,236	27,605
Total operating revenues	<u>1,495,025</u>	<u>1,468,461</u>
<b>OPERATING EXPENSES:</b>		
Plant specific operations	115,860	109,454
Plant nonspecific operations	103,220	113,116
Depreciation and amortization	233,574	211,139
Customer operations	110,516	113,057
Corporate operations	282,256	300,264
CATV programming fees	314,030	310,140
Total operating expenses	<u>1,139,456</u>	<u>1,157,170</u>
<b>GROSS OPERATING INCOME</b>	355,569	309,291
<b>OPERATING TAXES:</b>		
Other operating taxes	<u>17,479</u>	<u>14,530</u>
<b>OPERATING INCOME</b>	<u>338,090</u>	<u>294,761</u>
<b>NONOPERATING INCOME (DEDUCTIONS):</b>		
Interest income	47,692	57,712
Nonregulated income	110,159	80,036
Recovery of undeposited funds	2,720	11,410
Income taxes	(1,140)	0
Total nonoperating income (deductions)	<u>158,431</u>	<u>149,158</u>
<b>NET INCOME</b>	497,521	443,919
<b>OTHER COMPREHENSIVE INCOME (LOSS):</b>		
Unrealized gain (loss) on securities	<u>(64,343)</u>	<u>(33,353)</u>
<b>NET COMPREHENSIVE INCOME</b>	<u>\$ 433,178</u>	<u>\$ 410,566</u>

(The accompanying notes are an integral part of these financial statements)



SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

CONFIDENTIAL

	<u>MEMBERSHIP</u>	<u>PATRONAGE CAPITAL</u>	<u>RETAINED EARNINGS</u>	<u>OTHER COMPREHENSIVE INCOME (LOSS)</u>	<u>TOTAL</u>
BALANCE -					
JANUARY 1, 2012	\$ 8,410	\$ 5,214,519	\$ 1,170,419	\$ (138,556)	\$ 6,254,792
Memberships - net	1,555				1,555
Income (loss) from:					
Sherwood Mutual		295,076	145,566	(33,353)	407,289
SherTel Cable			3,277		3,277
Change in Accounting				165,000	165,000
Method - Com Net					
Retirement of capital					
credits		(256,836)	(12,688)		(269,524)
BALANCE -					
DECEMBER 31, 2012	9,965	5,252,759	1,306,574	(6,909)	6,562,389
Memberships - net	(1,315)				(1,315)
Income (loss) from:					
Sherwood Mutual		338,443	153,035	(64,343)	427,135
SherTel Cable			6,043		6,043
Retirement of capital					
credits		(232,140)	(21,203)		(253,343)
BALANCE -					
DECEMBER 31, 2013	<u>\$ 8,650</u>	<u>\$ 5,359,062</u>	<u>\$ 1,444,449</u>	<u>\$ (71,252)</u>	<u>\$ 6,740,909</u>

(The accompanying notes are an integral part of these financial statements)

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY  
CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

CONFIDENTIAL

OPERATING ACTIVITIES:	2013	2012
Net comprehensive income	\$ 433,178	\$ 410,566
Adjustments to reconcile net comprehensive income to net cash provided by operating activities:		
Depreciation and amortization	233,574	211,139
Equity in (income) loss in investments	(112,491)	(81,153)
Unrealized (gain) loss on securities	64,343	33,353
Changes in operating assets and liabilities:		
(Increase) Decrease in:		
Accounts receivable	31,337	18,066
Other current assets	(90,091)	13,572
Other noncurrent assets	4,456	3,440
Increase (Decrease) in:		
Accounts payable	79,315	15,696
Accrued taxes	(751)	(184)
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	<u>642,870</u>	<u>624,515</u>
INVESTING ACTIVITIES:		
Purchase of property, plant, and equipment	(730,303)	(542,126)
Investments in affiliated	(2,176)	(160,333)
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	<u>(732,479)</u>	<u>(702,459)</u>
FINANCING ACTIVITIES:		
Increase (Decrease) in memberships	(1,315)	1,555
Retirement of capital credits	(253,343)	(269,524)
NET CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES	<u>(254,658)</u>	<u>(267,969)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(344,267)</u>	<u>(345,913)</u>
CASH AND CASH EQUIVALENTS - BEGINNING	<u>437,302</u>	<u>783,215</u>
CASH AND CASH EQUIVALENTS - ENDING	<u>\$ 93,035</u>	<u>\$ 437,302</u>
SUPPLEMENTAL DISCLOSURES:		
Interest paid (net of \$0 capitalized)	\$ 0	\$ 0
Income taxes paid	\$ 1,140	\$ 0
Retirement of Telecommunications plant (at cost)	\$ 67,846	\$ 5,642

(The accompanying notes are an integral part of these financial statements)

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONFIDENTIAL

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The consolidated financial statements include the accounts of Sherwood Mutual Telephone Association, Inc. and its wholly-owned subsidiary, Sherel CATV, Inc., (collectively referred to as the Company) after elimination of all significant inter-company balances and transactions in consolidation.

The Company provides telecommunication services to member subscribers in the Sherwood, Ohio area. The accounting policies of the Company conform to accounting principles generally accepted in the United States of America (US GAAP) and reflect practices appropriate to the telephone industry. The accounting records were maintained in accordance with Part 32 Uniform System of Accounts and the Nonregulated Activity Requirements prescribed by the Public Utilities Commission of Ohio and the Federal Communications Commission.

The Company operates as a Section 501(c) (12) Corporation as defined by the Internal Revenue Code (IRC).

Concentrations of Credit Risk -

The Company grants credit to member subscribers, substantially all of whom are located in the Sherwood, Ohio area. The Company also grants credit to connecting toll companies located throughout the United States.

Financial instruments that potentially subject the Company to credit risk include investments in Com Net, Inc., Horizon Telcom, Inc., Horizon PCS, Inc., Broadband Network Group, LLC, SAA Bright.NET, Inc., and Defiance Holdings, LLC. Future changes in economic conditions may make the investments less valuable. Com Net, Inc., Horizon Telcom, Inc., Horizon PCS, Inc., Broadband Network Group, LLC, SAA Bright.NET, Inc., and Defiance Holdings, LLC all have restrictive ownership rights.

Notes Receivable that potentially subject the company to credit risk include notes from Sherwood Banc Corporation and Defiance Holdings, LLC.

Use of Estimates -

The process of preparing financial statements in conformity with US GAAP requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Cash and Cash Equivalents -

The Company considers highly liquid investments with maturities of ninety days or less to be cash equivalents. Securities with maturities between ninety days and one year are considered temporary investments.

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONFIDENTIAL

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Cash and Cash Equivalents - (Continued):

As of December 31, 2013, all of the Company's deposits are within the federally insured limits.

Allowance for Doubtful Accounts -

The Company estimated an allowance for doubtful accounts beginning in 2012 by analyzing historical collection percentages based on the age of the receivables collected and applying those percentages to current accounts receivable balances. Receivables are written off when the Company determines that they are uncollectible.

The allowance for doubtful accounts was \$26,418 and \$7,770 at December 31, 2013 and 2012, respectively.

Materials and Supplies -

Inventories are stated at the lower of cost or market on the first-in, first-out (FIFO) method. A physical inventory was taken by management on December 31, 2013.

Telephone Plant and Depreciation -

Telephone plant in service and under construction was stated substantially at original cost. Management was of the opinion that any adjustments that might be required to record properties at original cost would not be material. The Company provided for depreciation on a straight-line basis at annual rates which will amortize the depreciable property over its estimated useful life. Depreciation for book purposes has been computed in accordance with rates authorized by the Public Utilities Commission of Ohio.

At the time the plant is retired, the retirements credited to telephone plant together with removal costs less salvage, are charged to the depreciation reserve, unless the retirement is of an extraordinary or abnormal nature.

Long-Lived Assets -

Long-lived assets, identifiable intangibles, and associated goodwill are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the expected future cash flow from the use of the asset and its eventual disposition is less than the carrying amount of the asset, an impairment loss is recognized and measured using the asset's fair value.

Comprehensive Income -

Comprehensive income includes net income and all other changes in equity during a period except those resulting from investments by or distributions to shareholders. Other comprehensive income for the periods presented consists of fair value changes of the investments described in Note 4.

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

**CONFIDENTIAL**

Revenue Recognition -

Toll access services are furnished in conjunction with ComNet, Inc., Century Link, and other long-distance carriers. During 2013 and 2012, the Company received monthly access revenues based upon annual average cost separation studies. Access and local service revenues are substantially recognized when such services are performed.

Maintenance -

Accounting for maintenance and repairs was in conformity with the Uniform System of Accounts prescribed by the Public Utilities Commission of Ohio.

2. INVESTMENT IN TELEPHONE PLANT AND CABLE ASSETS:

Telephone plant in service was stated primarily at cost as explained in Note 1. Listed below are the major classes of the telephone plant as of December 31, 2013 and 2012, as well as the amount of cable assets as of December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Land	\$ 7,094	\$ 7,094
Buildings	184,782	184,025
Central office equipment	2,083,545	1,951,025
Pole lines	19,183	19,184
Aerial cable	82,282	82,282
Buried cable	5,540,067	4,841,280
Aerial wire	2,929	2,932
Furniture	6,208	6,208
Office equipment	24,426	24,426
General purpose computers	13,077	25,594
Motor vehicles	64,651	64,651
Work equipment	<u>31,244</u>	<u>12,599</u>
Telephone plant in service	<u>\$8,049,488</u>	<u>\$7,221,300</u>
CATV equipment	<u>\$ 3,944</u>	<u>\$ 3,944</u>

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**CONFIDENTIAL**

2. INVESTMENT IN TELEPHONE PLANT AND CABLE ASSETS (Continued):

The Company provides for depreciation on a straight-line basis at annual rates which will amortize the depreciable property over its estimated useful life. During 2001, the Company was granted new depreciation accrual rates by the Public Utilities Commission of Ohio (PUCO). Individual plant depreciation rates for 2013 and 2012 are as follows:

	2013	2012
Buildings	2.77%	2.77%
Central office equipment - hardware	6.67	6.67
Central office equipment - software	20.00	20.00
Circuit equipment	7.14	7.14
Pole lines	7.00	7.00
Aerial cable	6.25	6.25
Buried cable	5.00	5.00
Aerial wire	10.38	10.38
Furniture	4.75	4.75
Office equipment	11.68	11.68
General purpose computers	14.29	14.29
Motor vehicles	10.59	10.59
Work equipment	5.00	5.00

In addition to depreciation accrual rates, the Company implemented an adjustment to depreciation reserves in the amount of \$220,170 amortizable over five years beginning January 1, 2012. The amortization amounted to \$44,034 for 2013 and is shown as a reduction of depreciation expense.

Depreciation has been charged as follows:

	2013	2012
Depreciation - accrual rates	\$277,608	\$255,143
Amortization of reserves	(44,034)	(44,034)
Subtotal	233,574	211,109
Amortization - organizational costs and goodwill	0	30
Total depreciation expense	<u>\$233,574</u>	<u>\$211,139</u>

The Company has no purchase commitments as of March 5, 2014.

Investments - affiliated:

The accounting method and carrying values of investments consisted of the following at December 31, 2013 and 2012.

	Accounting Method	2013	2012
Com Net, Inc. Common Shares	Fair Value	\$ 200,000	\$ 194,000
Com Net, Inc. Preferred Shares	Fair Value	100,000	100,000
SAA Bright.NET, Inc.	Equity	80,415	72,702
Broadband Network Group, LLC	Equity	4,205	4,005
Defiance Holdings, LLC	Equity	1,333,107	1,226,353
Total		<u>\$1,717,727</u>	<u>\$1,597,060</u>

SHERWOOD MUTUAL TELEPHONE ASSOCIATION, INC.  
AND ITS WHOLLY-OWNED SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONFIDENTIAL

3. RELATED PARTY TRANSACTIONS:

Com Net, Inc. (Com Net) -

Com Net consists of a group of local exchange companies engaged in a joint venture to provide their customers better communication capabilities. The purpose of Com Net is to provide quality services at a reduced cost. The investment has ownership restrictions and limited marketability. The Company is one of 22 companies owning common stock. During 2013, the Company began recording its investment in Com Net at fair market value. The change in methodology resulted in a prior period adjustment of \$165,000. The increase in value for 2013 and 2012, in the amount of \$6,000 and \$11,000, respectively, is reflected in the income statement as unrealized gain (loss) on securities.

During 2012, the Company exchanged a note receivable from Independents Fiber Network, LLC in the amount of \$73,000 for preferred shares in Com Net. The Company also purchased an additional \$27,000 of preferred shares in 2012.

SAA Bright.NET, Inc. (SAA) -

SAA consists of three local exchange companies providing Internet access to greater Northwestern Ohio and Northeastern Indiana. The investment has ownership restrictions and limited marketability. SAA maintains its own staff. The Company has directors that are also directors of SAA. This income is reflected in nonregulated income.

Broadband Network Group, LLC (BNG) -

The purpose of BNG was to create a fiber ring for local exchange carriers. This company is an affiliate of Com Net. BNG is owned by 16 local exchange carriers who are included in the ComNet ownership group. This income is reflected in nonregulated income.

Defiance Holdings, LLC (DH) -

The purpose of DH was to purchase a wireless provider of Internet and other services. DH is owned with two local exchange phone companies that are also members of SAA. The LLC has elected to be treated as a C-Corporation and is accounted for on the equity method. Ownership in the LLC has restrictions and limited marketability. DH maintains its own staff. The Company has directors that are also directors of DH. This income is reflected in nonregulated income.

The Company has loaned DH a total of \$450,000. (See Note 5)

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3. RELATED PARTY TRANSACTIONS (Continued):

Income and expenses - affiliated:

During 2013 and 2012, the Company received income from and incurred expenses to affiliated companies as follows:

	2013 <u>Income</u>	2013 <u>Expenses</u>	2012 <u>Income</u>	2012 <u>Expenses</u>
Com Net, Inc.	\$ 0	\$ 84,481	\$ 0	\$ 130,704
SAA Bright.NET, Inc.	0	68,224	0	71,363
Bright Long Distance, Ltd.	0	65,602	0	74,043
Defiance Holdings, LLC	12,000	7,885	12,000	7,906
BNG	19,869	0	25,216	0
Total	<u>\$ 31,869</u>	<u>\$ 226,192</u>	<u>\$ 37,216</u>	<u>\$ 284,006</u>

Notes Receivable - affiliated:

During 2012, the Company exchanged a note receivable from Independents Fiber Network, LLC, an affiliate of Com Net, for Com Net preferred stock (see above).

Defiance Holdings, LLC - interest accruing at 5.0% per annum payable in quarterly installments - due on demand - unsecured. The Company loaned an additional \$160,000 in 2011. As of December 31, 2013, the outstanding balance amounted to \$450,000.

4. INVESTMENTS - NONAFFILIATED:

As of December 31, 2013, the Company owns the following (adjusted for stock dividends):

Horizon Telcom, Inc.	544 "A" shares
Horizon Telcom, Inc.	1,633 "B" shares

Fair market values for Horizon Telcom, Inc. A and B shares are available from Pink Sheet quotations, which is a market that is very thinly traded.

Values are as follows:

	Market 2013	Market 2012
Horizon Telcom, Inc. "A"	\$ 7,762	\$ 28,286
Horizon Telcom, Inc. "B"	<u>13,084</u>	<u>62,870</u>
Total	20,816	91,158
Less: Prior year's market value	<u>91,158</u>	<u>135,611</u>
Increase (decrease) in value	<u>\$ (70,342)</u>	<u>\$ (44,353)</u>

Reflected in financial statements as:

Other comprehensive income:		
Unrealized gain (loss) on securities	<u>\$ (70,342)</u>	<u>\$ (44,353)</u>



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5. NOTES RECEIVABLE:

Sherwood Banc Corporation - interest accruing at 4.0% per annum - due January 20, 2016 - collateral for the loan is 100,000 shares of The Sherwood State Bank stock - note amount \$500,000. As of December 31, 2013 and 2012, the outstanding balance amounted to \$500,000. The Company has a director that is also a director of the Sherwood Banc Corporation.

Defiance Holdings, LLC (DH) - interest accruing at 5.0% per annum - due on demand. As of December 31, 2013, the outstanding balance amounted to \$450,000. See Note 3 regarding related party transactions.

6. NONREGULATED ACTIVITY:

Following is a summary of net income from nonregulated investments for the years ended December 31, 2013 and 2012:

	2013	2012
Nonregulated, nonmember revenue	\$ 28,868	\$ 25,189
Nonregulated, nonmember (expenses)	(31,200)	(28,306)
Income in SAA Bright.NET, Inc.	7,713	193
Income in Broadband Network Group, LLC	200	(1,473)
Income in Defiance Holdings, LLC	104,578	82,433
Net income	<u>\$110,159</u>	<u>\$ 80,036</u>

Nonregulated equipment is stated net of accumulated depreciation. The Company depreciates these assets on a straight-line basis over their estimated useful lives.

	2013	2012
Nonregulated assets (at cost)	\$ 1,193	\$ 1,193
Less: Depreciation reserve	<u>1,193</u>	<u>1,193</u>
	<u>\$ 0</u>	<u>\$ 0</u>

7. PENSION PLAN:

The Company has a Simplified Employee Pension (SEP) plan for the benefit of the employees. This is a defined contribution plan whereby the board of directors establishes the amount of contribution, if any, annually. During 2013 and 2012, the board approved contributions amounting to \$9,782 and \$7,573, of which \$9,782 and \$7,573 were unpaid at December 31, 2013 and 2012, respectively.

8. CAPITAL CREDITS:

The Company has a policy of retiring all capital credits that are over a certain period. This policy is reviewed annually.

During 2013, the Company declared retirement of 60% of the unpaid capital credits for 1998, plus \$10 per member from 2012 totalling \$143,104 paid in November 2013. The Company also retired capital credits for estates and former members in the amount of \$110,239.

During 2012, the Company declared retirement of the remaining one-half of unpaid Patronage capital credits for 1995, and 10% of the Patronage capital credits allocated for 2011 totalling \$170,977 paid in November 2012. The Company also retired capital credits for estates and former members in the amount of \$98,547.

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9. PROVISION FOR UNDEPOSITED FUNDS:

The Company included a loss provision for funds that were applied to the customers account but failed to get credited to the Company's bank account. The amount of undeposited funds was \$19,291 and \$26,677 for 2011 and 2010, respectively. During 2012, the insurance claim for \$10,000 was collected in addition to \$1,410 of other recoveries. The company collected an additional \$2,720 in other recoveries during 2013.

10. FEDERAL TAX STATUS:

This Company operates as a tax-exempt corporation as defined by the United States Treasury, Internal Revenue Code Section 501(c) (12). One of these requirements is that the Company must obtain 85% or more of its gross income from members. Management believes it has met this requirement for 2013 and 2012, and does not incur a tax obligation on its member based revenues.

The Company files a non-consolidated U.S. Corporation income tax return for its wholly-owned subsidiary and computes and allocates its federal income tax on a separate returns basis.

The Company has determined its provision for federal income tax to amount to \$1,140 and \$578 for 2013 and 2012, respectively.

11. DIRECTOR COMPENSATION:

In 2012, the company changed the director compensation arrangement. The new arrangement provides for a base pay of \$8,000 plus an amount equal to 1.5% of the net profit of the Company before taxes. The directors have elected to forgo the compensation increase that would have resulted from the amortization of depreciation reserves. The amount equal to 1.5% of the net profit (excluding the amortization of depreciation reserves) amounts to \$6,275 and \$5,765 for the years ended December 31, 2013 and 2012, respectively.

12. FAIR VALUE MEASUREMENTS:

US GAAP establishes a fair value measurement framework, including a hierarchy that prioritizes inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy under US GAAP are distinguished by inputs to the valuation methodology summarized as follows:

Level 1 (highest priority) – Quoted market prices for identical assets or liabilities in active markets at the measurement date.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in inactive markets; and model-driven valuations in which all significant inputs or significant value drivers are observable in active markets.

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12. FAIR VALUE MEASUREMENTS (CONTINUED):

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Level 3 (lowest priority) - Management's best estimate of what market participants would use in pricing the instrument at the measurement date and model-driven valuations which are unobservable and significant to the fair value measurement.

The assessed level is based on the lowest level of any input that is significant to the fair value measurement. During 2013, the Company began recording their investment in Com Net, Inc. common stock at fair value. Prior to 2013, the Company recorded this investment at cost. The Company's investment in Com Net, Inc. remains a Level 3 classification in the fair value hierarchy. There were no other changes in the methodologies used as of December 31, 2013 and 2012.

Following is a description of the valuation methodologies used for amounts measured at fair value.

Level 1 inputs - Descriptions of the valuation methodologies used for assets measured at fair value are as follows: common stocks, corporate bonds and U.S. government securities valued at the closing price reported on the active market on which the individual securities are traded.

Level 3 inputs - Descriptions of the valuation methodologies used for assets measured at fair value are as follows: common and preferred stocks, which are closely held, valued at cost and affiliated investments valued at cost, fair market value, or using the equity method.

Assets at Fair Value as of December 31, 2013

Assets	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Stocks/partnerships	\$20,816	\$0	\$1,717,727	\$1,738,543

Assets at Fair Value as of December 31, 2012

Assets	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Stocks/partnerships	\$91,159	\$0	\$1,597,060	\$1,688,219

Change in Level 1 value:

The following table represents the change in the Level 1 fair value hierarchy as disclosed in the above tables.

	<u>2013</u>	<u>2012</u>
Beginning Level 1 value	\$91,159	\$135,511
Change in market value	(70,343)	(44,352)
Ending Level 1 value	<u>\$20,816</u>	<u>\$ 91,159</u>

These methods may produce a fair value measurement that may not be indicative of net realizable value or future fair values. Management believes its valuation methods are appropriate, but the use of different methodologies or assumptions could result in a different fair value measurement at the measurement date.

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13. CHANGE IN ACCOUNTING PRINCIPLE:

During 2013, the Company began using the fair value method for reporting its investment in Corn Net, Inc. common stock. This investment had been reported using the cost method. The change in accounting method resulted in a prior period adjustment of \$165,000 to other comprehensive income, reflected on the Statement of Changes in Members' Equity; \$6,000 and \$11,000 of unrealized gain on securities is reflected on the Income statement for the years ended December 31, 2013 and 2012, respectively.

14. SUBSEQUENT EVENTS:

The Company has evaluated subsequent events through March 5, 2014, the date which the financial statements were available to be issued.

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SUPPLEMENTARY INFORMATION

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SCHEDULE OF REVENUE SOURCES  
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Subscriber Sources Revenues:		
Basic local telephone services	\$ 187,758	\$ 170,421
Subscriber line revenues	92,764	91,924
High Speed Internet	342,374	399,099
Cable Television service	250,434	261,426
Long Distance	62,338	73,559
Miscellaneous	24,785	16,977
Less:		
Bundled Discounts	28,106	86,036
Total Subscriber revenues	<u>932,347</u>	<u>927,370</u>
Carrier Access Billing:		
Interstate Carrier	82,431	86,248
Intrastate Carrier	157,961	223,597
Interstate special access	124,575	30,394
Intrastate special access	17,834	23,593
Less:		
Uncollectible revenues - Carriers	16,236	27,605
Total Carrier revenues	<u>366,565</u>	<u>336,227</u>
NECA:		
Interstate Common Line Support (ICLS)	133,963	139,170
Local Switching Support (LSS)	68,913	63,657
High Cost Loop Support (HCLS)	3,261	1,188
Other settlements	(24)	(1,151)
Total NECA revenues	<u>196,113</u>	<u>202,864</u>
Total Operating Revenues	<u>\$ 1,495,025</u>	<u>\$ 1,466,461</u>