

**FINGER LAKES REGIONAL
TELECOMMUNICATIONS DEVELOPMENT CORP.**

CANANDAIGUA, NEW YORK

AUDITED FINANCIAL STATEMENTS

AND

INDEPENDENT AUDITORS' REPORT

DECEMBER 31, 2008 AND 2007

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Finger Lakes Regional Telecommunications Development Corp.

We have audited the accompanying statement of financial position of Finger Lakes Regional Telecommunications Development Corp. as of December 31, 2008, and the related statements of activities and changes in deficiency in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The 2007 financial statements were audited by other auditors and, in their report dated March 28, 2008, they expressed an unqualified opinion on those financial statements.

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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Finger Lakes Regional Telecommunications Development Corp. as of December 31, 2008, and the changes in deficiency in net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Mengel, Metzger, Barr & Co. LLP

Rochester, New York
February 6, 2009

FINGER LAKES REGIONAL TELECOMMUNICATIONS DEVELOPMENT CORP.

STATEMENTS OF FINANCIAL POSITION

| <u>ASSETS</u> | December 31, | |
|---|--------------|--------------|
| | 2008 | 2007 |
| <u>CURRENT ASSETS</u> | | |
| Cash and cash equivalents | \$ 1,043,383 | \$ 2,214,797 |
| Prepaid expenses | 2,146 | 2,182 |
| TOTAL CURRENT ASSETS | 1,045,529 | 2,216,979 |
| <u>PROPERTY AND EQUIPMENT</u> | | |
| Construction-in-progress | 1,240,222 | 115,291 |
| <u>OTHER ASSET</u> | | |
| Security deposits | - | 3,000 |
| | \$ 2,285,751 | \$ 2,335,270 |
| <u>LIABILITIES AND DEFICIENCY IN NET ASSETS</u> | | |
| <u>CURRENT LIABILITIES</u> | | |
| Accounts payable - trade | \$ 36,500 | \$ 13,574 |
| Current portion of deferred revenue - County of Ontario | 40,000 | - |
| TOTAL CURRENT LIABILITIES | 76,500 | 13,574 |
| <u>OTHER LIABILITIES</u> | | |
| Deferred revenue - County of Ontario | 930,000 | 1,000,000 |
| Long-term debt - County of Ontario | 1,500,000 | 1,500,000 |
| | 2,430,000 | 2,500,000 |
| <u>UNRESTRICTED DEFICIENCY IN NET ASSETS</u> | | |
| | (220,749) | (178,304) |
| | \$ 2,285,751 | \$ 2,335,270 |

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

FINGER LAKES REGIONAL TELECOMMUNICATIONS DEVELOPMENT CORP.

STATEMENTS OF ACTIVITIES AND CHANGES IN DEFICIENCY IN NET ASSETS

| | Year ended December 31, | |
|---|-------------------------|---------------------|
| | 2008 | 2007 |
| Revenue | \$ 30,000 | \$ - |
| Costs and expenses: | | |
| Application fees and marketing | 55,302 | 199,769 |
| Education and training | 198 | 368 |
| Insurance | 8,714 | 12,781 |
| Legal and professional | 54,088 | 51,489 |
| Network operations | 1,911 | 1,000 |
| Office expense | 1,468 | 1,500 |
| | <u>121,681</u> | <u>266,907</u> |
| LOSS FROM OPERATIONS | (91,681) | (266,907) |
| Other income: | | |
| Interest income | 49,236 | 88,603 |
| | <u>49,236</u> | <u>88,603</u> |
| INCREASE IN DEFICIENCY IN NET ASSETS | (42,445) | (178,304) |
| Unrestricted deficiency in net assets at beginning of year | <u>(178,304)</u> | <u>-</u> |
| UNRESTRICTED DEFICIENCY IN NET ASSETS AT END OF YEAR | <u>\$ (220,749)</u> | <u>\$ (178,304)</u> |

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

FINGER LAKES REGIONAL TELECOMMUNICATIONS DEVELOPMENT CORP.

STATEMENTS OF CASH FLOWS

| | Year ended December 31, | |
|---|-------------------------|--------------|
| | 2008 | 2007 |
| <u>CASH FLOWS - OPERATING ACTIVITIES</u> | | |
| Change in deficiency in net assets | \$ (42,445) | \$ (178,304) |
| Adjustments to reconcile change in deficiency in net assets to net cash used for operating activities: | | |
| Changes in certain assets and liabilities affecting operations: | | |
| Prepaid expenses | 36 | (2,182) |
| Trade accounts payable | 22,926 | 13,574 |
| Deferred revenue - County of Ontario | (30,000) | - |
| NET CASH USED FOR OPERATING ACTIVITIES | (49,483) | (166,912) |
| <u>CASH FLOWS - INVESTING ACTIVITIES</u> | | |
| Decrease (increase) in security deposits | 3,000 | (3,000) |
| Increase in construction-in-progress | (1,124,931) | (115,291) |
| NET CASH USED FOR INVESTING ACTIVITIES | (1,121,931) | (118,291) |
| <u>CASH FLOWS - FINANCING ACTIVITIES</u> | | |
| Increase in deferred revenue - County of Ontario | - | 1,000,000 |
| Proceeds from long-term debt - County of Ontario | - | 1,500,000 |
| NET CASH PROVIDED FROM FINANCING ACTIVITIES | - | 2,500,000 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (1,171,414) | 2,214,797 |
| Cash and cash equivalents at beginning of year | 2,214,797 | - |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | \$ 1,043,383 | \$ 2,214,797 |

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

FINGER LAKES REGIONAL TELECOMMUNICATIONS DEVELOPMENT CORP.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

NOTE A: THE ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Organization

Finger Lakes Regional Telecommunications Development Corp. (the "Organization") is a not-for-profit corporation that was formed to develop, operate, market and manage a municipal-based open access fiber optic backbone in Ontario County. The Organization is managed by a local board of directors.

Basis of accounting

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

Financial statement presentation

The Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted Net Assets: Represents all resources over which the Governing Board has discretionary control to use in carrying on the Organization's operations in accordance with the guidelines established for the Organization. The Board may designate portions of the current unrestricted net assets for specific purposes, projects or investment.

Temporarily Restricted Net Assets: Consists of all resources currently available for use, but limited by donor imposed restrictions that expire by the passage of time or can be fulfilled or otherwise removed by actions of the Organization. The Organization had no temporarily restricted net assets at December 31, 2008 and 2007.

Permanently Restricted Net Assets: Represents the principal amount of gifts and bequests accepted with the donor-stipulation that the principal be maintained intact in perpetuity and that only the investment income earned may be expended for general purposes. The Organization had no permanently restricted net assets at December 31, 2008 and 2007.

Cash and cash equivalents

Cash and cash equivalents consist of various accounts at a financial institution located in New York. Amounts at the financial institution are insured by the Federal Deposit Insurance Corporation up to \$250,000. Total uninsured balances aggregate approximately \$854,000 at December 31, 2008. The Organization has not experienced any losses in such accounts and believes it is not exposed to any significant risk in cash and cash equivalents.

FINGER LAKES REGIONAL TELECOMMUNICATIONS DEVELOPMENT CORP.

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2008 AND 2007

NOTE A: THE ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Cont'd

Property and equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method on a basis considered adequate to depreciate the assets over their estimated useful lives, which are generally twenty-five years.

Expenditures for renewals and betterments are capitalized while expenditures for repairs and maintenance are charged to activities as incurred. Upon sale or retirement, the related cost and accumulated depreciation are removed from the accounts and any related gain or loss is reflected in the statement of activities.

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 amounts of assets and liabilities and disclosure of contingent assets and liabilities at December 31, 2008 and 2007 and the reported amounts of revenue and expenses for the years then ended. Actual results could differ from those estimates.

Tax exempt status

The Organization is a non-profit organization exempt from federal and state income taxation under IRS Code Section 501(c)(3) and applicable state regulations.

Reclassifications

Certain 2007 amounts have been reclassified to conform with the 2008 presentation.

NOTE B: OPERATIONS

The time line for the Organization's future development will depend on the ability to obtain suitable financing, which may be in the form of conventional or municipal bond financing. The proceeds from the financing will be used to finance the design, engineering and construction of municipal-based open access fiber optic backbone in Ontario County and parts of Wayne County. Additionally, a portion of the proceeds will be used to cover the project's operating expenses until such time as the Organization generates positive cash flow.

The fiber optic backbone will be available or open to any entity within Ontario County and parts of Wayne County that wishes to use it. The Organization will contract with the private sector for operating and administrative services.

FINGER LAKES REGIONAL TELECOMMUNICATIONS DEVELOPMENT CORP.

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2008 AND 2007

NOTE B: OPERATIONS, Cont'd

The Organization plans to generate a significant portion of its ongoing revenue by leasing space on the fiber optic backbone to two different customer types. These customer types are described below:

Carrier – These customers will include nationally and regionally-known wireless providers and internet service providers.

Enterprise – These customers will typically consist of hospitals, school districts, colleges and private businesses.

The Organization will charge both customer types a maintenance fee in addition to the lease revenues described above.

Carrier revenues are expected to be generated beginning in June 2009. In addition to lease revenue, carriers will be charged a maintenance fee to cover operations and maintenance expenses. A total of six carriers are expected to begin leasing space on the backbone sometime between June 2009 and July 2011.

Enterprise revenues are expected to be generated also beginning in June 2009. The Organization expects that nineteen customers will begin leasing space on the backbone sometime between June 2009 and July 2011. Additionally, a maintenance fee will be charged to the customer to cover operations and maintenance expenses.

NOTE C: CONSTRUCTION-IN-PROGRESS

The Organization began developing the fiber optic backbone in October 2007. Construction in progress represents the costs incurred before the respective segments of the fiber optic backbone are placed into service. At December 31, 2008 and 2007, the construction in progress was \$1,240,222 and \$115,291, respectively. The entire fiber optic backbone is expected to be 163.9 miles in total length and will cost approximately \$5,800,000.

FINGER LAKES REGIONAL TELECOMMUNICATIONS DEVELOPMENT CORP.

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2008 AND 2007

NOTE D: TRANSACTIONS WITH THE COUNTY OF ONTARIO

Long-term debt

On September 15, 2006, the Organization entered into an agreement with the County of Ontario (the "County") whereby the County extended it a one-time interest-free loan in the amount of \$1,500,000. The loan will be repaid to the County upon retirement of the Organization's bonded debt, or the termination date of the agreement (Year 2033), whichever occurs earlier.

Deferred revenue

The County paid to the Organization a one-time prepayment for all services rendered pursuant to the agreement in the amount of \$500,000 as well as an additional \$500,000 one-time prepayment for connecting all buildings in the Hopewell Complex to a single point where it will then be connected to the rest of the ring pursuant to the agreement. These amounts have been recorded as deferred revenue and are being recognized as earned revenue when the services have been performed in accordance with the terms of the agreement beginning April 2008. At December 31, 2008 and 2007, deferred revenue was \$970,000 and \$1,000,000, respectively. The deferred revenue will be amortized over the term of the contract at a rate of \$40,000 per year over twenty-five years. The contract with the County is at a below market rate, which is not ascertainable at this time.

Costs and expenses

The County, in consideration for the above-referenced services and to cover monthly maintenance costs, will allow the Organization to use County meeting rooms, use the County Web server to host the initial Organization website, the services of the Chief Information Officer to serve as the Chief Executive Officer of the Organization and the services of other County employees or officers to serve on the Organization's Board of Directors or perform other duties as authorized by the County's Board of Supervisors. No amounts have been recorded for the County's contributed services during the years ended December 31, 2008 and 2007.

NOTE E: COMMITMENTS

Empire Pipeline, Inc.

Beginning in September 2009, a portion of the Organization's revenues will be derived from payments to be made by Empire State Pipeline (a joint venture) and Empire Pipeline, Inc. (collectively "Empire") as a result of a Host Community Benefit Agreement (the "Agreement") entered into between Empire and the Organization on July 1, 2007. The agreement is related to a separate payment-in-lieu-of-tax ("PILOT") agreement entered into between Empire and the Ontario County Industrial Development Agency. The Agreement stipulates that Empire pay the Organization \$379,237 annually for twenty-five years. Specifically, Empire is required to make payments of \$189,619 on September 1 and December 1, 2009. Thereafter, quarterly payments of \$94,809 will be due beginning on March 1, 2010. The payments will be guaranteed by National Fuel Gas Company, a publicly-traded corporation and parent organization of Empire. These payments will provide a guaranteed revenue stream to the Organization, and will be recognized as revenue when the payments become due and payable.