

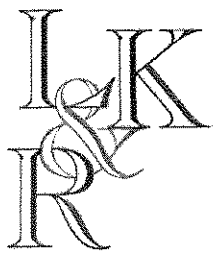
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Pay Tel Communications, Inc.

**FINANCIAL STATEMENTS
and Independent Auditor's Report**

December 31, 2013 and 2012

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Leeper, Kean & Rumley, L.L.P.
Certified Public Accountants and Consultants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
Pay Tel Communications, Inc.
Greensboro, North Carolina

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Report on the Financial Statements

We have audited the accompanying financial statements of Pay Tel Communications, Inc. (an S Corporation), which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of operations and retained earnings 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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.

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 financial statements referred to above present fairly, in all material respects, the financial position of Pay Tel Communications, Inc. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Leiper, Kram & Rumley, LLP

Greensboro, North Carolina
April 29, 2014

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Pay Tel Communications, Inc.

BALANCE SHEETS

December 31, 2013 and 2012

| | <u>Assets</u> | |
|--|---------------------|--------------------|
| | <u>2013</u> | <u>2012</u> |
| Current assets: | | |
| Cash | \$ 625,920 | 391,898 |
| Net accounts receivable | 615,495 | 583,527 |
| Prepaid expenses and other receivables | 315,672 | 409,125 |
| Notes receivable from related parties | 474,155 | - |
| Total current assets | <u>2,031,242</u> | <u>1,384,550</u> |
| Property and equipment, at cost: | | |
| Inmate communications equipment | 3,003,001 | 4,668,467 |
| Office furniture, equipment and software | 6,462,989 | 5,647,352 |
| Leasehold improvements | 1,698,017 | 1,688,064 |
| Vehicles | 450,998 | 571,784 |
| Total property and equipment | 11,615,005 | 12,575,667 |
| Less accumulated depreciation and amortization | <u>(6,336,285)</u> | <u>(7,248,080)</u> |
| Net property and equipment | <u>5,278,720</u> | <u>5,327,587</u> |
| Other assets: | | |
| Notes receivable from related parties | - | 1,005,644 |
| Net deferred contract costs and commissions | 650,159 | 362,971 |
| Settlement reserve deposits | 151,286 | 197,484 |
| Cash surrender value of Stockholder's life insurance | 54,866 | 52,115 |
| Deposits and other noncurrent assets | 83,955 | 144,780 |
| Total other assets | <u>940,266</u> | <u>1,762,994</u> |
| Total Assets | <u>\$ 8,250,228</u> | <u>8,475,131</u> |

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Pay Tel Communications, Inc.

BALANCE SHEETS

December 31, 2013 and 2012

Liabilities and Stockholders' Equity

| | <u>2013</u> | <u>2012</u> |
|---|---------------------|------------------|
| Current liabilities: | | |
| Working capital line of credit | \$ - | 734,100 |
| Current portion of equipment loans | 173,300 | 221,967 |
| Current portion of capitalized lease | 101,200 | - |
| Unearned revenues | 861,886 | 771,195 |
| Accounts payable | 3,200,270 | 2,976,473 |
| Accrued expenses and other liabilities | 632,322 | 545,116 |
| Due to stockholder | <u>229,230</u> | <u>229,230</u> |
| Total current liabilities | <u>5,198,208</u> | <u>5,478,081</u> |
| Noncurrent liabilities: | | |
| Noncurrent portion of equipment loans | 235,122 | 302,266 |
| Noncurrent portion of capitalized lease | <u>318,937</u> | <u>-</u> |
| Total noncurrent liabilities | <u>554,059</u> | <u>302,266</u> |
| Total liabilities | <u>5,752,267</u> | <u>5,780,347</u> |
| Stockholders' equity: | | |
| Common stock, 1,000 voting shares and 99,000 nonvoting shares authorized, issued and outstanding | 22,500 | 22,500 |
| Retained earnings | <u>2,475,461</u> | <u>2,672,284</u> |
| Total stockholders' equity | <u>2,497,961</u> | <u>2,694,784</u> |
| Total Liabilities and Stockholders' Equity | <u>\$ 8,250,228</u> | <u>8,475,131</u> |

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Pay Tel Communications, Inc.

STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

For the Years Ended December 31, 2013 and 2012

| | <u>2013</u> | <u>2012</u> |
|--|---------------------|---------------------|
| Net revenues | \$ 25,693,138 | 24,977,265 |
| Costs of revenues | <u>(16,561,647)</u> | <u>(16,261,941)</u> |
| Gross profit | <u>9,131,491</u> | <u>8,715,324</u> |
| Selling, general and administrative expenses: | | |
| Salaries and related expenses | (4,531,207) | (4,486,481) |
| Depreciation and amortization | (920,235) | (829,039) |
| Professional services | (860,292) | (526,492) |
| Other | (623,096) | (720,019) |
| Rents, maintenance and utilities | (596,666) | (533,232) |
| Computer supplies and support | (503,149) | (423,617) |
| Telephone and broadband | (353,694) | (457,034) |
| Property taxes, licenses and insurance | (283,110) | (306,923) |
| Research and development | <u>(76,999)</u> | <u>(89,985)</u> |
| Total selling, general and administrative expenses | <u>(8,748,448)</u> | <u>(8,372,822)</u> |
| Income from operations | 383,043 | 342,502 |
| Other nonoperating expenses | <u>(48,377)</u> | <u>(37,689)</u> |
| Net income before extraordinary item | 334,666 | 304,813 |
| Extraordinary item - loss on notes receivable from related parties | <u>(531,489)</u> | <u>-</u> |
| Net income (loss) | (196,823) | 304,813 |
| Retained earnings at beginning of year | <u>2,672,284</u> | <u>2,367,471</u> |
| Retained earnings at end of year | <u>\$ 2,475,461</u> | <u>2,672,284</u> |

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Pay Tel Communications, Inc.

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2013 and 2012

| | <u>Increase (Decrease) in Cash</u> | |
|--|------------------------------------|--------------------|
| | <u>2013</u> | <u>2012</u> |
| Operating activities: | | |
| Net income (loss) | (196,823) | 304,813 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization of property and equipment | 1,479,579 | 1,446,489 |
| Amortization of deferred contract costs | 252,170 | 244,787 |
| Amortization of other noncurrent assets | 82,425 | 100,074 |
| Allowance for doubtful accounts and other noncash activities | (45,553) | 39,736 |
| Net loss on disposal of property and equipment | 4,309 | - |
| Loss on notes receivable from related parties | 531,489 | - |
| Cash surrender value of Stockholder's life insurance | (2,751) | (3,260) |
| (Increase) decrease in related assets: | | |
| Accounts receivable and settlement reserve deposits | 54,246 | (40,900) |
| Prepaid expenses, deposits and other receivables | 93,454 | (165,962) |
| Net deferred contract costs | (295,373) | (257,561) |
| Increase (decrease) in related liabilities: | | |
| Accounts payable | (14,652) | (19,272) |
| Accrued expenses and other liabilities | 87,206 | (23,509) |
| Unearned revenues | 90,691 | (434,542) |
| Net cash provided by operating activities | <u>2,120,417</u> | <u>1,190,893</u> |
| Investing activities: | | |
| Purchases of property and equipment | (926,809) | (1,445,185) |
| Net proceeds from sale of property and equipment | 5,788 | - |
| Advances on notes receivable from related parties | - | (824) |
| Net cash used in investing activities | <u>\$ (921,021)</u> | <u>(1,446,009)</u> |

- Continued -

Pay Tel Communications, Inc.

STATEMENTS OF CASH FLOWS - CONTINUED For the Years Ended December 31, 2013 and 2012

| | <u>2013</u> | <u>2012</u> |
|--|-------------------|----------------|
| Financing activities: | | |
| Net borrowings from (repayments to) working capital line of credit | \$ (734,100) | 234,100 |
| Borrowings from equipment loans | - | 365,900 |
| Repayments on equipment loans | (115,811) | (100,000) |
| Payments on capitalized lease | (93,863) | - |
| Loan origination fees | (21,600) | (7,562) |
| Net cash provided by (used in) financing activities | <u>(965,374)</u> | <u>492,438</u> |
| Net increase in cash | 234,022 | 237,322 |
| Cash at beginning of year | <u>391,898</u> | <u>154,576</u> |
| Cash at end of year | <u>\$ 625,920</u> | <u>391,898</u> |

Supplemental Disclosures

| | | |
|---------------|------------------|---------------|
| Interest paid | <u>\$ 28,292</u> | <u>27,533</u> |
|---------------|------------------|---------------|

Noncash Investing and Financing Activities

During 2013, the Company had a noncash financing transaction relating to a capitalized lease on equipment totaling \$514,000.

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS December 31, 2013 and 2012

(1) Nature of Business

Pay Tel Communications, Inc. (the "Company") owns and operates automated telephone communication systems in confinement facilities for use by inmates under contracts with the confinement facilities that typically range from three to five years and expire at various times beginning in 2014. The Company services its customers throughout the United States from its headquarters in Greensboro, North Carolina.

(2) Summary of Significant Accounting Policies

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- (a) Revenue Recognition – Generally, revenues from automated calls from confinement facilities are recognized, net of unbillable returned call records and applicable sales taxes, at the time the call is completed. State and federal regulatory authorities govern certain rates the Company can charge customers for these services.

Generally, customers establish an electronic account through prepayments to the Company. When an electronic account becomes inactive, the Company either refunds the customer's unused balance or issues them a prepaid phone card that does not expire. At any time in the future, customers may use the prepaid phone card or return it to the Company for a refund. The Company recognizes into net revenues the balances of prepaid phone cards that show no activity for at least six months and which the Company believes, based upon historical redemption patterns, the likelihood of redemption by the customer is remote.

- (b) Credit Risk - Cash and accounts receivable are financial instruments which potentially subject the Company to credit risk. Management reviews outstanding receivable accounts on an ongoing basis, writes off the amounts deemed uncollectible and provides an additional reserve for uncollectible accounts based on past experience (see Notes 4 and 5).

At various times throughout the year, the Company had cash on deposit with a bank which exceeded the \$250,000 federally-insured limit.

- (c) Advertising costs - The Company expenses advertising costs as they are incurred. Advertising expenses for the years ended December 31, 2013 and 2012 were approximately \$151,000 and \$169,000, respectively.
- (d) Property and Equipment - Property and equipment are recorded at cost. Leasehold improvements are depreciated over estimated useful lives ranging from 7 to 39 years using the straight-line method for financial reporting purposes. All other property and equipment are depreciated over estimated useful lives ranging from 3 to 10 years using the straight-line method for financial reporting purposes.

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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- (e) Net Deferred Contract Costs and Commissions - Net deferred contract costs and commissions consist of payments to Company employees, inmate facilities and other third party providers related to certain inmate contracts. Deferred contract costs and commissions are amortized over the lives of the respective contracts. Accumulated amortization at December 31, 2013 and 2012 was \$294,755 and \$382,505, respectively.

The estimated future amortization expenses related to these deferred costs are as follows:

| | |
|---------------------------------------|-------------------|
| For the year ending December 31, 2014 | \$ 245,000 |
| 2015 | 160,000 |
| 2016 | 132,000 |
| 2017 | 98,000 |
| 2018 | <u>15,159</u> |
| Total maturities | <u>\$ 650,159</u> |

- (f) Income Taxes - The Company, with the consent of its stockholders ("Stockholders"), has elected under the Internal Revenue Code to be an S corporation. In general, pursuant to the election, taxable income is taxed to the Stockholders and is not taxed at the corporate level. Therefore, no provisions or liabilities for federal or state income taxes have been included in these financial statements. The Company, by expiration of the statute of limitations, is generally no longer subject to federal or state income tax examinations by tax authorities for the years ending December 31, 2009 or earlier.

The Company has adopted the accounting guidance for uncertainty in income taxes using the provisions of FASB Accounting Standards Codification 740, Income Taxes. Using that guidance, tax positions initially need to be recognized in the financial statements when it is more-likely-than-not the positions will not be sustained upon examination by the tax authorities. Such tax positions initially and subsequently need to be measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority assuming full knowledge of the positions and relevant facts. It also provides guidance for derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As of December 31, 2013 and 2012, the Company had no uncertain tax positions that qualify for either recognition or disclosure in the financial statements and has incurred no interest or penalties related to unrecognized tax liabilities.

- (g) Management Estimates - The preparation of the 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, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
- (h) Reclassifications - Certain reclassifications have been made to prior year balances to conform to current year presentation.

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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(3) **Notes Receivable from Related Parties and Extraordinary Item**

The Company has notes receivable from various trusts established by the Stockholder related to split-dollar life insurance policies. No interest has been charged on the outstanding balances. In 2013, the trusts notified the Company that the underlying life insurance policies were going to be surrendered in 2014 and that the net cash surrender value would be inadequate to fully repay the amounts advanced by the Company in prior years. The Company determined that the trusts were not going to repay \$531,489 which has been recorded as an extraordinary loss in the accompanying 2013 statement of operations and retained earnings.

(4) **Billing and Collection Arrangements**

The Company primarily utilizes its own internally developed and supported billing and collection system whereby customers establish an electronic account through prepayments to the Company. The accompanying balance sheets include \$861,886 and \$771,195 in unearned revenues at December 31, 2013 and 2012, respectively. These totals, which if unused are refunded, represent the net amounts prepaid by customers for the acceptance of future calls.

The Company has partnered with third party providers to administer a debit system at inmate facilities where an inmate can transfer funds from their facility trust account to their own telephone account in order to make calls. Generally, unused amounts are returned to the inmate's account upon release from the facility. Net accounts receivable in the accompanying balance sheets include approximately \$402,000 and \$287,000 in amounts due from the third party providers at December 31, 2013 and 2012, respectively. Total allowances for doubtful accounts receivable accounts at December 31, 2013 and 2012 were approximately \$6,000 and \$45,000, respectively.

The Company also utilizes the billing and collection services of various Local Exchange Carriers ("LECs"). The LECs bill and collect from the party that accepts the call under month-to-month contracts with the Company.

(5) **Settlement Reserve Deposits and Letters of Credit**

A LEC has required the Company to have a settlement reserve deposit for the future payment of unbillable and/or uncollectible amounts owed to them upon contract termination. The Company recorded settlement reserve liabilities contingent upon the ultimate recognition of bad debts, as determined by the LEC, totaling \$45,000 and \$130,000 at December 31, 2013 and 2012, which is included in accrued expenses and other liabilities in the accompanying balance sheets. Another LEC required the Company to provide a non-collateralized letter of credit totaling approximately \$69,000 as of December 31, 2012. The Company had additional outstanding letters of credit totaling approximately \$160,000 related to inmate contracts and regulatory requirements at December 31, 2012. The letters of credit were replaced with surety bonds in 2013. As of December 31, 2013, surety bonds totaling approximately \$189,000 were in place.

Pay Tel Communications, Inc.

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NOTES TO FINANCIAL STATEMENTS December 31, 2013 and 2012

(6) Lines of Credit and Equipment Loan

The Company has a working capital line of credit with a bank, with maximum borrowings of \$2,000,000 and an equipment line of credit with maximum available borrowings of \$1,000,000. The lines of credit incur interest on the outstanding balances at the one-month LIBOR (0.17% at December 31, 2013) plus 2.5%. Interest only payments are due monthly through maturity in April 2015. The equipment line is available to make equipment purchases and may be termed out under separate loan agreements and amortized over a period not to exceed thirty-six months.

The Company has an equipment loan with an outstanding principal balance of \$408,422 at December 31, 2013. The loan bears interest at the one-month LIBOR plus 2.5%. Subject to possible daily interest rate changes, payments of principal totaling \$14,583 plus applicable interest are due monthly through April 2016, when all outstanding principal and interest is due.

The scheduled maturities of the equipment loans are as follows:

| | |
|---------------------------------------|-------------------|
| For the year ending December 31, 2014 | \$ 174,996 |
| 2015 | 174,996 |
| 2016 | <u>58,430</u> |
| Total maturities | <u>\$ 408,422</u> |

At December 31, 2012, the Company had a working capital line of credit with another bank, with maximum borrowings of \$2,000,000 and a \$1,000,000 equipment line of credit, with maximum available borrowings of \$334,100. The lines of credit incurred interest on the outstanding balances at the daily LIBOR plus 2.5% with a 4% floor. Interest only payments were due monthly through maturity in April 2013 when the line was repaid in full. The company also had two equipment loans with another bank with outstanding principal balances of \$158,333 and \$365,900 at December 31, 2012. Both loans incurred interest at the daily LIBOR plus 2.5% with a 4% floor. Payments of principal totaling \$8,333 and \$10,164 were due monthly through July 2014 and December 2015, respectively. The lines of credit and equipment loans were replaced in 2013 by the new bank noted above.

All lines of credit and equipment loans are secured by all the property, equipment and other assets, certain cash accounts, the personal guarantee of a certain Stockholder, the assignment of all confinement facility contracts and the assignment of a certain life insurance policy on a certain Stockholder. The lines of credit and equipment loans also contain various covenants pertaining to the maintenance of certain financial ratios.

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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(7) Capitalized Lease

The Company has a capital lease for equipment with a total cost of approximately \$514,000. Payments of approximately \$8,856 including principal and interest are due monthly through February 2018. Accumulated depreciation on the equipment was approximately \$89,500 at December 31, 2013.

Future minimum lease payments under the capitalized lease and the present value of the net minimum lease payments are as follows:

| | | |
|---|------|-------------------|
| For the year ending December 31, | 2014 | \$ 104,602 |
| | 2015 | 106,266 |
| | 2016 | 106,266 |
| | 2017 | 106,266 |
| | 2018 | <u>8,856</u> |
| Total minimum lease payments | | 432,256 |
| Less amount representing interest | | <u>(12,119)</u> |
| Present value of net minimum lease payments | | <u>\$ 420,137</u> |

(8) Guarantee of Debt

The Company has fully guaranteed the debt of a Limited Liability Company ("LLC") owned by certain stockholders (Note 10) totaling approximately \$1,275,000 and \$1,271,000 at December 31, 2013 and 2012, respectively. The guarantee is not scheduled to expire. The Company would be required to provide a cash payment pursuant to the guarantee if the LLC were to default on the loan and it not be cured by the LLC or its owners. Because the estimated fair value of the LLC's collateral exceeds the amount of the debt obligation, significant losses are not anticipated. There is currently no recorded liability for potential losses under this guarantee, nor is there any liability for the Company's obligation to "stand ready" to fund such guarantee.

(9) Profit Sharing Plan

The Company has a retirement plan covering all employees who are at least 21 years of age and have at least one year of eligible service as defined in the plan. The retirement plan includes 401(k) and profit sharing features. Employees may contribute up to \$23,000 to the plan, and the Company makes matching contributions equal to a discretionary percentage of the covered employees' contributions. Employees are fully vested in Company contributions after three years of eligible service. The Company made matching contributions of \$68,400 and \$72,000 to the plan for 2013 and 2012, respectively and profit sharing contributions of \$39,900 for 2013.

Pay Tel Communications, Inc.

NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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(10) Operating Leases and License Agreements

The Company leases its office and warehouse headquarters (approximately 49,000 square feet) from the LLC (Note 8). The lease requires monthly payments of \$17,500 and expires in October 2018. The agreement also requires the Company to be responsible for all property taxes, insurance and operating expenses. Total rent paid to the LLC in each of 2013 and 2012 was \$210,000. The Company also has certain license agreements and leases various operations and office equipment, off-site storage and co-location facilities under separate lease agreements from third parties.

Future minimum payments are due as follows:

| | <u>Office & Warehouse</u> | <u>Other</u> | <u>Total</u> |
|---------------------------------------|-----------------------------------|------------------|------------------|
| For the year ending December 31, 2014 | \$ 210,000 | 548,000 | 758,000 |
| 2015 | 210,000 | 320,000 | 530,000 |
| 2016 | 210,000 | 304,000 | 514,000 |
| 2017 | 210,000 | 229,000 | 439,000 |
| 2018 | <u>175,000</u> | <u>4,000</u> | <u>179,000</u> |
| Total future minimum payments due | <u>\$1,015,000</u> | <u>1,405,000</u> | <u>2,420,000</u> |

Total rental expense related to the operating leases for 2013 and 2012 was \$310,216 and \$309,193, respectively.

(11) Contingency

During 2013, the Florida Department of Revenue ("Florida") completed an audit of the Company's activities in the state and assessed the Company approximately \$385,000 for the period from June 1, 2006 through May 31, 2013. Including interest, the total amount charged by Florida was approximately \$500,000.

In 2012, Florida completed a separate telecommunications tax audit of the Company which resulted in no additional tax due. The audit Florida completed in 2013 was for sales and use tax which the Company believes amounts to a tax on the same revenue that the Company currently pays with the telecommunications tax.

The Company has filed a protest for the assessment on the premise that the sales and use tax does not apply to the Company based on the application of Florida tax laws. No liability for this assessment has been recorded as of December 31, 2013.

(12) Subsequent Events

Management has evaluated subsequent events through April 29, 2014, the date which the financial statements were available to be issued.