

March 8, 2010

Sharon G. Edmundson, Director, Fiscal Management Section
North Carolina Department of State Treasurer
State and Local Government Finance Division and the Local Government Commission
325 North Salisbury Street
Raleigh, NC 27603-1385

RE: Response to letter dated February 2, 2010

Dear Ms. Edmundson:

This letter follows our letter dated February 12, 2010, acknowledging receipt of your letter dated February 2, 2010 to MI-Connection Communications System (MI-Connection). We appreciate your attention and concerns regarding both our audited financial statements for the fiscal year ended June 30, 2009 as well as the long term financial stability of MI-Connection. This letter responds to your concerns and requests and expresses our desire to work with you and your office to resolve any remaining questions you may have.

1. Financial Weaknesses. Paragraph 2 of your letter expressed concern about signs of financial weakness at MI-Connection with respect to cash flows and liquidity. At the end of the paragraph you state: "The Board should review the operations of the System and take action to increase revenues and / or decrease expenditures, if possible, so that the System will cover its cost of operations."

Response: In order to understand the financial situation of MI-Connection, it is important to put current results into a longer term perspective. The System was acquired in December 2007, after many months of deliberation, and due diligence, and the development of a business plan and projections. The Towns made their acquisition decision based on a third party financial analysis, which was also verified by a second third party consultant, and reviewed by the Local Government Commission. The acquisition analysis anticipated that the System would have net losses for the first 3 ½ fiscal years and would not generate operating cash (monies remaining from gross operating revenues after payments of all operating expenses) until FY 2010. It was further anticipated that this period of operating cash loss would flow through to FY 2013, when the projections anticipated the system would have free cash flow exceeding the total of the prior year's losses. These initial projections showed that by the plan period FY 2013 – 2017, the System would generate \$36.2M in free cash flow (i.e. cash remaining after operations, capital projects and debt service). A key assumption in the business plan was that the acquired subscriber base would grow by 8 ½ to 9 percent per annum. The expected subscriber growth rate was derived from assumptions about the system's existing market penetration (based on Adelphia's numbers as submitted to the bankruptcy court), continued growth in the general economy, as well as increased

revenues per subscriber from new service offerings which would be available as a result of planned improvements to the System itself, including a major System upgrade and rebuild. The System upgrade and rebuild was completed in 2009, but unfortunately, the System has not experienced the expected subscriber growth. As of December 2009, the System had experienced about a 4 percent decline in its subscriber base (i.e., 676 subscribers less than the 15,826 acquisition subscribers). The deep recession has had a measurable negative impact on anticipated results. In addition, a number of the expenditure and revenue accounts varied from pre-purchase estimates. In light of these developments, the MI-Connection board, working closely with the operator it had contracted to operate the System (Bristol Virginia Utilities or BVU), has been reviewing its annual budgets and long term projections to make the necessary adjustments. Short and long term actions are outlined in the attached Financial Plan.

2. **Budgetary Problems in Audited Financial Statements.** Paragraph 3 of your letter expresses concern that the financial statements presented an unbalanced budget.

Response: We have reviewed your concerns and determined that there was an error in MI-Connection's classification of appropriations that resulted in the financial statements showing an unbalanced budget. While it is technically true that the budget was not presented as balanced, it was balanced from a practical standpoint as we will explain herein. MIC acquired the System on December 17, 2007 from Adelphia / Time Warner. The Town of Mooresville, NC, under an interlocal agency agreement with the Town of Davidson, NC, issued \$92 million in bond debt for the acquisition and the System upgrade. A portion of the \$92M was earmarked for working capital. Another portion was earmarked for the capital cost of the System upgrade after acquisition. In fact, the capital costs of the System upgrade were less than estimated. These borrowing proceeds thus became available as additional working capital. The system's revenues from operations and from borrowing proceeds remained in balance with operating and capital expenses throughout the entire fiscal year. No unfunded or unauthorized expenditures were made. This was accomplished by allocating to operating capital the borrowings intended to be available for operating capital and the freed-up borrowings that were not required for the system upgrade. Our error was in failing to reflect these borrowings for operating capital as budget line items for financing sources. However the system's finances were always in balance with revenues and other financing sources equaling expenditures. The apparent unbalanced budget amount of \$7.050M was fully funded by the working capital allowance and the under-spending of System upgrade funds.

We have reviewed the Budget Policies Manual again, and we now understand the reporting error. We now understand how such appropriations should have been classified. We will correctly classify such appropriations in future financial reports.

3. **Expenditures in Excess of Authorized Appropriations.** In paragraph 4 of your letter, you express concern that certain expenditures were made without an authorized appropriation in the budget or a budget amendment.

Response: In the relevant period (Fiscal Year 2009), which was the first full year of operations following the System upgrade; we discovered that a number of the expenditure and revenue accounts varied from pre-purchase estimates. Our original FY 2009 budget was

based on those pre-purchase estimates because we did not have operating experience. As we developed operating experience, we reviewed and adjusted our performance estimates monthly. The Board regularly reviewed the system's financial performance at every monthly board meeting and authorized reallocations among various expense accounts as well as use of the borrowing proceeds to cover the variances in revenue and expense estimates. System financial statements were presented and reviewed at each MI-Connection Board meeting based on the variations from the original FY 2009 estimated budget so we could track precisely where our pre-purchase estimates varied from our actual experience. The Board was aware of and in agreement with the expenditures in excess of the original estimated budget items for the three expense categories that exceeded the original budget. Again, we made a formal reporting error by not formally adopting a budget amendment as required by North Carolina General Statutes. While the Board did adopt an amended budget in January 2009, it still showed some budget categories as variance and the necessary appropriations were not made by formal board vote. We are aware of this procedural deficiency, and management and the Board are ensuring that no expenditures in excess of authorized amounts will be made unless and until the necessary formal amendment to the budget has been adopted by the Board for such items. For example, BVU now prepares and distributes to the Board a restated budget periodically, with notations of key variances and projections adjusted based on actual data. As a result of these reports, the Board proactively approved an adjusted budget at its January 2010 meeting.

4. Internal Control System Weaknesses. Paragraph 5 of your letter expresses concern that the auditor's report to management which noted several internal control system deficiencies and you urged us to develop a corrective action plan to eliminate these weaknesses.

Response: Corrective actions were taken immediately in response to the weaknesses identified and reported by the audit firm; accordingly, we do not expect such findings to be reported for FY 2010. These actions are discussed in the Corrective Action Plan attached hereto.

Again, thank you for your letter and diligence. Should you have questions regarding the information in this letter or the attachments or would like to meet to discuss the MI-Connection operations, please feel free to contact John Kasberger at (704) 360-1802,

Best Regards,

Mi-Connection Communications System Board



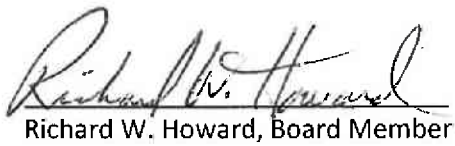
John Kasberger, Board Member



Ken Essex, Board Member

John N. Venzon, Board Member

Dawn Huston, Board Member



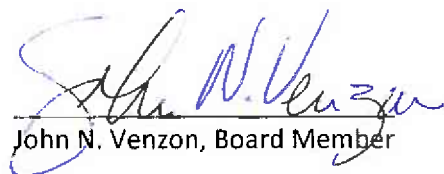
Richard W. Howard, Board Member

Steven A. Miller, Board Member

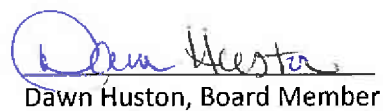
Best Regards,

Mi-Connection Communications System Board

John Kasberger, Board Member


John N. Venzon, Board Member

Ken Essex, Board Member


Dawn Huston, Board Member

Richard W. Howard, Board Member

Steven A. Miller, Board Member

Best Regards,

Mi-Connection Communications System Board

John Kasberger, Board Member

Ken Essex, Board Member

John N. Venzon, Board Member

Dawn Huston, Board Member

A handwritten signature in black ink, appearing to read 'S.A. Miller', written over a horizontal line.

Richard W. Howard, Board Member

Steven A. Miller, Board Member

MI-Connection Communications System Corrective Action Plan

The MI-Connection Board received copies of the audited financials for Fiscal Year 2009 from the Auditors on November 19, 2009. When the report was presented, the System operator (Bristol Virginia Utilities or BVU) reported to the Board that it had promptly rectified the weaknesses in MI-Connection's internal control system identified in the Auditors report when they were revealed during the audit process. Specifically, BVU advised the Board that BVU has taken the following actions to address the audit findings:

1. **Journal Entries:** All journal entries are now reviewed and approved by two senior managers at BVU, BVU's Controller and its Chief Financial Officer, before posting and such review and approval is documented in writing on the actual journal entry or system voucher report.
2. **Revenue and Accounts Receivable:** The Controller for BVU is now reviewing and approving the billing data before such data is entered into the Central Service Association accounting system. Such review and approval is documented in writing on the billing journal voucher.
3. **Inventory Observation:** The discrepancy discussed in the Fiscal Year 2009 audit report was unusual due to the high level of inventory items on hand during that period for the System rebuild construction. We expect to carry lower System inventories going forward. As of October 1, 2009, we have instituted quarterly internal inventory counts by the warehouse manager at the System operations and reviewed by BVU's Purchasing and Inventory Manager.

The Board expects the above-mentioned initiatives have corrected the weaknesses in the internal control system and that these improvements will be reflected in future Auditors reports. However, should additional weaknesses be identified in future reports, the Board will take immediate corrective action.

Dated: March 8, 2010

Mi-Connection Communications System Board



John Kasberger, Board Member



Ken Essex, Board Member

John N. Venzon, Board Member

Dawn Huston, Board Member



Richard W. Howard, Board Member

Steven A. Miller, Board Member

Dated: March 8, 2010

Mi-Connection Communications System Board

John Kasberger, Board Member



John N. Venzon, Board Member

Richard W. Howard, Board Member

Ken Essex, Board Member



Dawn Huston, Board Member

Steven A. Miller, Board Member

Dated: March 8, 2010

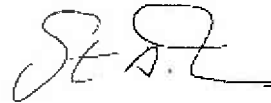
Mi-Connection Communications System Board

John Kasberger, Board Member

Ken Essex, Board Member

John N. Venzon, Board Member

Dawn Huston, Board Member

A handwritten signature in black ink, appearing to read "S.A. Miller", written over a horizontal line.

Richard W. Howard, Board Member

Steven A. Miller, Board Member

MI-Connection Communications System Financial Plan

The MI-Connection Board, working with the System operator, Bristol Virginia Utilities (BVU), is taking and will continue to take the following actions to review the operations of the System and to increase revenues and/or decrease expenditures, if possible, so that the System will cover its costs of operations within a reasonable time period.

1. Development and Pursuit of Medium and Long Term Strategies to Increase Revenues

The MI-Connection Board is actively encouraging BVU to pursue new sources of revenue by introducing new products and targeting new types of customers. These include:

Voice Product Launch: MI-Connection's recent rebuild enabled us to launch voice service, which currently generates over \$60,000 in monthly revenue. When we reach market maturity for this product, we expect these revenues to triple.

Small and Medium Commercial Customer Growth: Commercial customer revenues are a key strategy and growth opportunity. We are adding approximately 10 commercial customers per month with each account adding annualized billing of at least \$1,500. We expect this number to double in the coming months.

Large Enterprise Customer Growth: We have begun offering fiber-to-the-premise services to large commercial customers. This allows us to provide high-bandwidth data circuits at market competitive prices. Through these fiber-to-the-premise connections we are also able to offer SIP Trunking and SIP/PRI phone services. These products open up new and lucrative commercial markets serving large enterprise accounts that could not be served by our pre-rebuild infrastructure.

2. Improve the Financial/Operational Expertise of the System's Top Management

To improve the System's financial/operational results, a General Manager with more advanced financial and operational expertise was required. In October 2009, with the MI-Connection Board's approval, BVU (the System operator) hired a new System General Manager, Alan Hall. Mr. Hall has 23 years of industry experience, including leadership roles in marketing and operations for national cable operators (Time Warner, Adelphia and Charter Communications).

Mr. Hall has since reorganized the System's operations, which is resulting in decreased operating costs, and has initiated a strong push in customer acquisition, which is leading to increased System revenues. Below are some examples of the reorganization and the cost savings measures:

- In the process of bringing installation work in-house, this is projected to produce savings of \$50,000 per month over our current contract labor expense, reducing the total cash needed to operate the System (a portion of these savings will be capital dollars).
- Revamped our promotional product bundles to be competitive with other service providers. In the majority of our service area, we are the only single-source provider offering video, data and voice on a single bill. Our marketing is targeted at increasing our market penetrations and improving our financial performance.

- **Capital Budget & Expenditures:** Each month, along with the review of the monthly profit and loss results, the System manager also completes a capital budget to actual report by specific capital category for review. The original FY 2010 budget presented a \$3.6M capital budget. As of January 31, 2010, seven months into FY 2010, MI-Connection has only expended or committed \$1.61M of capital, representing only 44% of the FY 2010 capital budget. It is anticipated that MI-Connection's FY 2010 capital budget will only be \$3.101M, a 14% reduction from early FY 2010 budget projections. This savings is a direct result of the attention to the fiscal health of MI-Connection and management's direction to save costs and grow the system.
- In the process of converting to a new billing and work force management system. This new billing system will automate a number of manual processes and increase both our office and field efficiencies, allowing us to further reduce costs.

3. Independent Expert Analysis of System Operations.

The MI-Connection Board decided that an independent evaluation of the System operations and cash flow was needed to determine further areas for improvement in financial results. In October 2009, the Board approved such a study.

In January 2010, the MI-Connection Board formally retained Buford Media Group, LLC (Buford). As an initial step, Buford has conducted an overall System cash flow analysis and benchmarking which was presented to the Board on February 25th. The report identified several areas to pursue potential operating efficiencies and cost reductions. The MIC Board plans to begin work immediately with the System operator to study and develop a more detailed plan to achieve operating efficiencies and cost reductions while maintaining the high level of customer service needed to operate successfully. The Board expects that over time these initiatives will result in significant improvements to MI-Connection's financial situation.

In addition to the above-mentioned initiatives, the Board will continue to work diligently to look for other ways to strengthen and improve the System's financial situation.

Dated: March 8, 2010

Mi-Connection Communications System Board



John Kasberger, Board Member



Ken Essex, Board Member

John N. Venzon, Board Member

Dawn Huston, Board Member



Richard W. Howard, Board Member

Steven A. Miller, Board Member

Dated: March 8, 2010

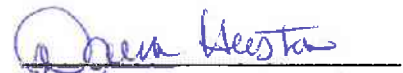
Mi-Connection Communications System Board

John Kasberger, Board Member



John N. Venzon, Board Member

Ken Essex, Board Member



Dawn Huston, Board Member

Richard W. Howard, Board Member

Steven A. Miller, Board Member

Dated: March 8, 2010

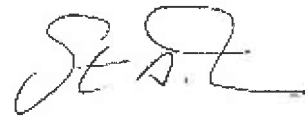
Mi-Connection Communications System Board

John Kasberger, Board Member

Ken Essex, Board Member

John N. Venzon, Board Member

Dawn Huston, Board Member

A handwritten signature in black ink, appearing to read 'S.A. Miller', written over a horizontal line.

Richard W. Howard, Board Member

Steven A. Miller, Board Member