

**NORTHCOUNTRY COOPERATIVE  
DEVELOPMENT FUND**

**FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED  
DECEMBER 31, 2012 AND 2011**



NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

Table of Contents

	<u>Page</u>
Independent Auditor's Report	1
Financial Statements:	
Balance Sheets	3
Statements of Operations	4
Statements of Stockholders' Equity (Deficit)	5
Statements of Cash Flows	6
Notes to Financial Statements	7



MAHONEY  
ULBRICH  
CHRISTIANSEN  
RUSS P.A.  
CERTIFIED PUBLIC ACCOUNTANTS

30 EAST PLATO BOULEVARD SAINT PAUL, MN 55107-1809  
TELEPHONE 651.227.6695 FACSIMILE 651.227.9796

## INDEPENDENT AUDITOR'S REPORT

Board of Directors and Members  
Northcountry Cooperative Development Fund  
Minneapolis, Minnesota

We have audited the accompanying financial statements of Northcountry Cooperative Development Fund, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations, stockholders' equity (deficit), and cash flows for the years then ended, and the related notes to 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 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.

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 Northcountry Cooperative Development Fund as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## Uncertainties Regarding the Deferred Income Tax Asset

As discussed in Note 10, NCDF has recorded a \$200,200 deferred income tax asset at December 31, 2012 and 2011. Utilization of the deferred income tax asset is dependent upon NCDF generating sufficient income within the net operating loss carryforward period. As discussed in Note 11, Management's projection of future income is heavily dependent upon future grant revenues. Due to the uncertainty of future income, it is at least reasonably possible that management's view of future income will change in the near term. Our opinion is not modified with respect to that matter.

*Maloney Ulbrich  
Christiansen Russ P.A.*

Saint Paul, Minnesota  
April 17, 2013

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

BALANCE SHEETS

December 31, 2012 and 2011

	2012	2011
<b>ASSETS</b>		
Cash and cash equivalents	\$ 628,438	\$ 618,539
Funds held for KSCR	43,840	70,258
Loans receivable, net of allowance	5,800,277	6,583,251
Accrued interest receivable	21,966	24,018
Other receivables	122	1,322
Prepaid expenses	5,453	1,866
Office equipment, net	20,279	22,621
Deferred income tax asset	200,200	200,200
Total assets	\$ 6,720,575	\$ 7,522,075
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
Notes payable	\$ 6,401,803	\$ 7,621,899
Funds due to KSCR	43,840	70,258
Accounts payable	27,890	4,106
Accrued expenses	4,222	10,280
Total liabilities	6,477,755	7,706,543
Stockholders' equity (deficit):		
Preferred stock, \$10 par value, 500,000 shares authorized, 97,596 and 47,892 shares outstanding in 2012 and 2011, respectively	975,960	478,922
Common stock - voting, \$10 par value, 1,000 shares authorized, 477 and 483 shares outstanding in 2012 and 2011, respectively	4,770	4,830
Common stock - nonvoting, \$10 par value, 500,000 shares authorized, 48,500 and 48,502 shares outstanding in 2012 and 2011, respectively	485,000	485,020
Additional paid-in capital	464,664	395,392
Retained earnings (accumulated deficit)	(1,687,574)	(1,548,632)
Total stockholders' equity (deficit)	242,820	(184,468)
Total liabilities and stockholders' equity (deficit)	\$ 6,720,575	\$ 7,522,075

See accompanying notes to financial statements.

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

STATEMENTS OF OPERATIONS

For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Interest income:		
Loans receivable	\$ 431,822	\$ 475,203
Operating cash investments	2,190	5,680
Total interest income	<u>434,012</u>	<u>480,883</u>
Interest expense	<u>(158,055)</u>	<u>(173,636)</u>
Net interest income	275,957	307,247
Reversal of (provision for) loan losses, net	<u>(58,197)</u>	<u>21,843</u>
Net interest income after provision for loan losses and loan recoveries	<u>217,760</u>	<u>329,090</u>
Noninterest income:		
Fees and service charges	49,694	45,005
Grant revenue	1,019	5,980
Other income	941	314
Total noninterest income	<u>51,654</u>	<u>51,299</u>
Income before noninterest expenses and other income (expenses)	<u>269,414</u>	<u>380,389</u>
Noninterest expenses:		
Compensation and employee benefits	233,134	305,028
Occupancy and equipment	55,962	70,250
Advertising	5,743	7,383
Contract services	100,370	76,299
Other	23,564	24,864
Expense reimbursements - affiliates	<u>(16,397)</u>	<u>(56,962)</u>
Total noninterest expenses	<u>402,376</u>	<u>426,862</u>
Loss before other income (expense)	<u>(132,962)</u>	<u>(46,473)</u>
Other income (expense):		
Grant - redemption of common stock	-	50,000
Write off of loan receivable - Paul Revere	-	<u>(739,746)</u>
Total other income (expense)	<u>-</u>	<u>(689,746)</u>
Loss before income taxes	<u>(132,962)</u>	<u>(736,219)</u>
Income tax expense	<u>-</u>	<u>(100)</u>
Net loss	<u>\$ (132,962)</u>	<u>\$ (736,319)</u>

See accompanying notes to financial statements.

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND  
STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

For the Years Ended December 31, 2012 and 2011

	Preferred Stock Shares	Preferred Stock Amount	Common Stock - Voting Shares	Common Stock - Voting Amount	Common Stock - Nonvoting Shares	Common Stock - Nonvoting Amount	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
Balance, December 31, 2010	39,748	\$ 397,480	532	\$ 5,320	53,500	\$ 535,000	\$ 383,172	\$ (809,351)	\$ 511,621
Preferred stock:									
Transfer from notes payable	7,848	78,480	-	-	-	-	-	-	78,480
Stock dividend	296	2,962	-	-	-	-	-	(2,962)	-
Common stock:									
Issuance of common stock	-	-	24	240	-	-	13,370	-	13,610
Redemption of common stock	-	-	(71)	(710)	-	-	(4,000)	-	(4,710)
Redemption of common stock for grant	-	-	-	-	(5,000)	(50,000)	-	-	(50,000)
Reclassification	-	-	(2)	(20)	2	20	-	-	-
Capital contributions	-	-	-	-	-	-	2,850	-	2,850
Net loss	-	-	-	-	-	-	-	(736,319)	(736,319)
Balance, December 31, 2011	47,892	478,922	483	4,830	48,502	485,020	395,392	(1,548,632)	(184,468)
Preferred stock:									
Transfer from notes payable	50,000	500,000	-	-	-	-	-	-	500,000
Reclassification of patronage dividend	(296)	(2,962)	-	-	-	-	2,962	-	-
Common stock:									
Issuance of common stock	-	-	12	120	-	-	9,360	-	9,480
Redemption of common stock	-	-	(3)	(30)	-	-	(230)	-	(260)
Reclassification	-	-	(15)	(150)	(2)	(20)	6,150	(5,980)	-
Capital contributions	-	-	-	-	-	-	51,030	-	51,030
Net loss	-	-	-	-	-	-	-	(132,962)	(132,962)
Balance, December 31, 2012	97,596	\$ 975,960	477	\$ 4,770	48,500	\$ 485,000	\$ 464,664	\$ (1,687,574)	\$ 242,820

See accompanying notes to financial statements.



NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2012 and 2011  
Increase (Decrease) in Cash and Cash Equivalents

	2012	2011
Cash flows from operating activities:		
Net loss	\$ (132,962)	\$ (736,319)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation	9,328	5,103
Provision for (reversal of) loan losses	58,197	(21,843)
Grant - redemption of common stock	-	(50,000)
Write off of loan receivable	-	739,746
Changes in operating assets and liabilities:		
Receivables	3,252	7,070
Prepaid expenses	(3,587)	2,784
Accounts payable	23,784	(4,257)
Accrued expenses	(6,058)	1,653
Net cash from operating activities	(48,046)	(56,063)
Cash flows from investing activities:		
Collections on loans receivable	1,912,748	1,840,198
Issuance of loans receivable	(1,187,971)	(2,797,430)
Purchase of office equipment	(6,986)	(26,100)
Net cash from investing activities	717,791	(983,332)
Cash flows from financing activities:		
Issuance of notes payable	88,857	437,960
Repayments on notes payable	(808,953)	(78,941)
Proceeds from issuance of common stock	9,480	13,610
Proceeds from additional paid in capital contribution	51,030	2,850
Redemption of common stock	(260)	(4,710)
Net cash from financing activities	(659,846)	370,769
Net increase (decrease) in cash and cash equivalents	9,899	(668,626)
Cash and cash equivalents - beginning of year	618,539	1,287,165
Cash and cash equivalents - end of year	\$ 628,438	\$ 618,539
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 158,055	\$ 173,636
Preferred stock issued in exchange for note payable	\$ 500,000	\$ 78,480
Grant revenue due to redemption of common stock	\$ -	\$ 50,000

See accompanying notes to financial statements.

# NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

## NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

### 1. ORGANIZATION

Northcountry Cooperative Development Fund (NCDF) is a member-owned and member-governed financial intermediary providing loans to support the growth and development of cooperative enterprises. NCDF provides financing to consumer, worker, housing and producer cooperatives and their members in the upper Midwest and around the United States.

NCDF obtains funds from its members as well as from non-member institutions interested in supporting the cooperative economy, including foundations, religious organizations, community groups, cooperative coalitions, financial institutions and socially responsible organizations.

NCDF was formed in 1978 and is organized as a cooperative association under Chapter 308A of Minnesota law and is certified as a Community Development Financial Institution (CDFI) by the United States Department of Treasury.

NCDF has more than 150 member cooperatives and more than 200 individual members in 31 states.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Use of Estimates** - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to material change are the allowance for loan losses and the valuation allowance for the deferred income tax asset.

**Cash Equivalents** - NCDF considers all investment instruments purchased with original maturities of three months or less to be cash equivalents.

**Credit Risk** - Financial instruments that potentially subject NCDF to credit risk include cash on deposit at banks. NCDF has not experienced any losses in such accounts. As of December 31, 2012 and 2011, balances exceed the insured limits by approximately \$169,000 and \$337,000 respectively. NCDF does not believe it is exposed to any significant concentration of credit risk on cash.

Additionally, loans receivable subject NCDF to a credit risk. Generally, loans are collateralized by property, equipment and inventory of the borrower.

(Continued)

# NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

## NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

**Loans Receivable** - NCDF provides commercial and cooperative home ownership (share) loans to members in the upper Midwest and around the United States. The ability of the members to honor their contracts is dependent upon sound management of the cooperative, general economic conditions and the value of real estate collateral in the member's geographic area.

Loans receivable are stated at unpaid principal balances, less an allowance for loan losses. Interest on loans is recognized over the term of the loan and is calculated using the simple-interest method on principal amounts outstanding. The accrual of interest on loans is discontinued at the time the loan is 120 days delinquent unless the credit is well-secured and in process of collection.

Loans are placed on non-accrual status or charged off if all or a portion of the loan is deemed to be uncollectible by management based on economic conditions, business conditions and collection efforts. It is NCDF's policy that any loan that is more than 120 days delinquent shall be charged off unless management determines that pay off of the loan is imminent, whether through collections, liquidation or foreclosure. The Board of Directors must approve the charge off of any loan, generally upon recommendation from the Loan and Finance Committees.

All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Non-refundable commitment fees are recognized upon receipt. Loan fees are recognized as income upon closing of the loan because incremental direct costs incurred on each loan exceed the fees charged.

**Allowance for Loan Losses** - The allowance for loan losses is a non-cash reserve established against potential or expected losses on loans. Each loan in the portfolio is assigned a risk rating and each rating has a corresponding percentage that must be set aside as an allowance. The ratings and the allowance are evaluated regularly by management based upon qualitative factors that are subjective and require a high degree of management judgment. These factors include adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral and prevailing economic conditions. The Loan Committee establishes initial risk ratings at the time loans are approved and must approve any changes to ratings. In addition, on a quarterly basis, the Loan Committee reviews and approves all risk ratings and the allowance for loan losses. The Board of Directors reviews the allowance and risk ratings at least annually.

(Continued)

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the loan is uncollectible. Subsequent recoveries are credited to income.

**Office Equipment** - Office equipment is capitalized at cost. Depreciation is provided using the straight-line method over estimated useful lives of three to seven years. When an asset is retired or sold, its cost and related accumulated depreciation are removed from the account and the resulting gain or loss is reflected in the statement of operations. Accumulated depreciation was \$37,566 and \$128,288 as of December 31, 2012 and 2011.

**Fair Value Measurements** - NCDF determines fair value, when necessary, based on the assumptions that market participants would use when pricing the asset or liability. Valuation techniques require using inputs representing the assumptions that would be made by market participants in pricing the asset or liability. NCDF does not currently have any financial assets or liabilities that are measured at fair value on a recurring or non-recurring basis.

**Income Taxes** - NCDF is taxed as a cooperative and is subject to the provisions of Subchapter T of the Internal Revenue Code. The bylaws require NCDF to annually distribute net income from patronage to its members, based on their patronage with NCDF. The distributions may be in the form of cash, stock or allocated surplus, which reduces NCDF's income tax liability. However, losses in NCDF's patronage business may, at the Board's discretion, be carried forward to offset future distributions of net income from patronage. Members of NCDF receiving qualified patronage dividends consent to include them in their taxable income.

Income taxes are provided for the tax effects of the transactions reported in the financial statements and consist of taxes currently due plus deferred income taxes related primarily to the difference between the basis of loans receivable for financial and income tax reporting, which consists of the allowance for loan losses. The deferred income tax asset includes the future tax return consequences of that difference, which will be deductible when the loans are written off. A deferred income tax asset is also recognized for operating losses that are available to offset future taxable income. The deferred income taxes are reflected at income tax rates applicable to the period in which the deferred income taxes are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred income taxes are adjusted through the provision for income taxes. If it is more likely than not that all or some portion of the deferred income tax asset will not be realized, a valuation allowance is recognized.

Federal and state tax authorities generally have the right to examine income tax returns for a period of three years after they are filed. The Cooperative is not currently under examination by any taxing jurisdiction. Any interest or penalties associated with income tax positions are reported in other noninterest expenses. There were no such interest or penalties in 2012 and 2011.

(Continued)

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Presentation of Write Off of Loan Receivable** - In 2011, NCDF incurred a loss on a large loan. Due to the size of the loss, the loss has been presented in other income (expense) for comparative purposes.

**Reclassifications** - Dividends classified as preferred stock dividends in 2011 were reclassified as patronage dividends. The patronage dividends issued in 2011 for net income received in 2010 were approved by the NCDF Board of Directors in 2011. This reclassification had no effect on stockholders' equity (deficit).

3. **LOANS RECEIVABLE**

The following table presents the recorded investment in loans by portfolio segment and the allowance for loan losses as of December 31:

	2012	2011
Cooperative housing mortgage loans	\$ 3,070,905	\$ 2,614,881
Cooperative business mortgage loans	1,023,549	972,414
Cooperative business loans	1,734,337	3,014,366
Loans to individuals to purchase cooperative housing	314,568	266,475
Total loans	6,143,359	6,868,136
Less allowance for loan losses	(343,082)	(284,885)
	\$ 5,800,277	\$ 6,583,251

The following table presents the change in the allowance for loan losses in 2012 and 2011:

Beginning balance	\$ 284,885	\$ 306,728
Provision for loan losses	58,197	720,923
Loans charged off	-	(742,766)
Ending balance	\$ 343,082	\$ 284,885

During 2011, NCDF wrote off \$739,746, the full amount of a loan to the Paul Revere Community Cooperative.

(Continued)

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

3. **LOANS RECEIVABLE (Continued)**

The following table presents the aging of loans by portfolio segment at December 31, 2012:

	Cooperative housing mortgage loans	Cooperative business mortgage loans	Cooperative business loans	Loans to individuals to purchase cooperative housing	Total
Current	\$ 3,070,905	\$ 1,023,549	\$ 1,734,337	\$ 307,296	\$ 6,136,087
90 + days	-	-	-	7,272	7,272
Total	<u>\$ 3,070,905</u>	<u>\$ 1,023,549</u>	<u>\$ 1,734,337</u>	<u>\$ 314,568</u>	<u>\$ 6,143,359</u>

The following table presents the allowance for loan losses by portfolio segment in 2012:

Beginning balance	\$ 89,393	\$ 28,860	\$ 159,537	\$ 7,095	\$ 284,885
Provision	129,945	25,630	(96,734)	(644)	58,197
Ending balance	<u>\$ 219,338</u>	<u>\$ 54,490</u>	<u>\$ 62,803</u>	<u>\$ 6,451</u>	<u>\$ 343,082</u>

The following table and the accompanying explanations present informative data regarding the credit quality of loans receivable at December 31, 2012:

A	\$ 1,669,817	\$ 552,905	\$ 29,049	\$ 188,712	\$ 2,440,483
B	753,460	215,510	1,137,587	66,639	2,173,196
C	319,507	106,437	567,702	46,803	1,040,449
F	328,121	148,697	-	12,413	489,231
	<u>\$ 3,070,905</u>	<u>\$ 1,023,549</u>	<u>\$ 1,734,338</u>	<u>\$ 314,567</u>	<u>\$ 6,143,359</u>

The following categories are used to assess the risk profile of the loan portfolio:

Category	Description of Creditworthiness	Allowance %
A	Highest credit quality, borrower is stable and reliable	0 - 1
B	Good borrower, but some recent internal or external changes	1.5 - 5
C	Good borrower, but recent significant internal or external changes and challenges	3 - 5
D	Borrower is either rebounding or heading into a period of significant difficulties	6 - 10
E	Relatively weak borrower facing some internal or external challenges	10 - 15
F	Weak borrower facing significant challenges	25 plus
G	Doubtful	Up to 100

(Continued)

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

3. **LOANS RECEIVABLE (Continued)**

Other information as of December 31, 2012:

- All loans are individually reviewed for impairment
- Management has determined that there are no impaired loans
- There are no loans on non-accrual status

4. **KSCR FUNDS**

NCDF entered into an agreement to provide loan servicing functions, for a fee, for the KSCR Fund. NCDF accumulates principal and interest collections, net of remitting interest due to investors of the KSCR Fund, for use in providing additional loans on behalf of the KSCR Fund. The KSCR Fund and its investors bear all risk of loss pertaining to these loans.

At December 31, 2012 and 2011, NCDF is servicing \$150,211 and \$127,246 of loans for the KSCR Fund, which are not included in loans receivable.

5. **NOTES PAYABLE**

Notes payable, including accrued interest, are summarized as follows:

	2012	2011
Senior loans payable:		
Institutional	\$ 2,533,045	\$ 2,902,315
Subordinate loans payable:		
Cooperatives	1,613,134	1,678,578
Individuals	353,513	641,006
Institutional	500,000	1,000,000
Institutional EQ2	1,402,111	1,400,000
	\$ 6,401,803	\$ 7,621,899

(Continued)

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

5. **NOTES PAYABLE (Continued)**

Notes payable at December 31, 2012 have interest rates ranging from 0.75% to 5%, are unsecured, and mature through 2021. Principal maturities of notes payable, including accrued interest, are as follows:

Accrued interest	\$ 142,794
Due on demand – 30 days	167,980
Due on demand – 90 days	883,460
2013	1,570,192
2014	691,773
2015	902,604
2016	333,000
2017	45,000
Thereafter	<u>1,665,000</u>
	<u>\$ 6,401,803</u>

6. **LEASE OBLIGATIONS**

NCDF leased its office space under the terms of an operating lease agreement which expired March 31, 2012. NCDF then leased its office space on a month to month basis until it signed a new lease on July 1, 2012. Monthly rent under the new lease is \$800 and expires on June 30, 2013.

Rent expense was \$18,038 in 2012 and \$38,595 in 2011. Through March 31, 2012, a portion of the rent expense was reimbursed by affiliated organizations under an agreement (Note 9).

7. **RETIREMENT PLAN**

NCDF has established a salary reduction plan with matching contributions for participating employees. The plan has received IRS approval under Section 408(p) of the Internal Revenue Code. The plan covers all employees who have met certain service requirements. NCDF will match the elective contributions of an employee in an amount not exceeding 3% of the employee's compensation. Matching contributions were \$4,199 for 2012 and \$6,787 for 2011.

8. **STOCKHOLDERS' EQUITY**

**Preferred Stock** - At the discretion of the Board of Directors, NCDF may pay holders of Class A preferred stock an annual dividend of up to 8% in the form of cash, additional shares of Class A preferred stock or equity credits. The Class A preferred stock has no voting rights and shares may only be transferred upon the approval of the Board of Directors. The Class A preferred stock has a liquidation preference over other equity. No dividends were declared or issued during 2012 or 2011.

(Continued)



NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

8. **STOCKHOLDERS' EQUITY (Continued)**

Pursuant to an exchange agreement, one of NCDF's lenders agreed to convert \$500,000 of its outstanding note payable of \$1,000,000 into NCDF preferred stock on December 31, 2012.

**Additional Paid-In Capital** - Additional paid-in capital requirements are determined on a multi-tiered format based on the assets of the member. Effective April 2012, NCDF amended its requirements for members. During 2012, members contributed \$51,030 of additional paid-in capital to meet the amended requirements.

9. **TRANSACTIONS WITH AFFILIATED ORGANIZATIONS**

Several directors of NCDF were employed by, or directors of, NCDF member organizations or other organizations that may be borrowers from, lenders to, or hold common or preferred stock in NCDF. Such lending activities were in the ordinary course of business at normal credit terms including interest rates and collateralization and do not represent more than a normal risk of collection.

NCDF is part of the Northcountry Family of Organizations. Affiliated organizations include Northcountry Cooperative Foundation and Common Properties Management Cooperative.

The organizations had an agreement whereby NCDF paid for certain expenses and was reimbursed by these organizations. NCDF was reimbursed \$16,397 and \$56,962 in 2012 and 2011 for salaries, occupancy, telephone, computer and office supplies under this agreement. The reimbursements have reduced noninterest expenses.

At December 31, 2011, NCDF had an unsecured subordinated loan receivable from Northcountry Cooperative Federal Credit Union totaling \$50,000. The loan bore interest at 5.00% originally and the interest rate was reduced to 1% in April 2012. In November 2012, Northcountry Cooperative Federal Credit Union was purchased by South Metro Federal Credit Union and the balance remaining was repaid in December 2012.

10. **INCOME TAXES**

NCDF has Federal net operating loss carry forwards of approximately \$1,660,000 that begin to expire in 2027. Minnesota net operating loss carry forwards of approximately \$1,785,000 begin to expire in 2022.

The deferred income tax asset consists of \$270,000 and \$251,000 for Federal income taxes as of December 31, 2012 and 2011 and \$210,000 and \$195,000 for state income taxes as of December 31, 2012 and 2011.

(Continued)

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

10. **INCOME TAXES (Continued)**

Realization of the deferred income tax asset is dependent upon sufficient future taxable income during the net operating loss carry forwards period. Management expects it is more likely than not that a portion of the deferred income tax assets may not be realized, accordingly, a deferred income tax valuation allowance of \$279,800 and \$245,800 has been recorded at December 31, 2012 and 2011. The deferred income tax valuation allowance increased by \$34,000 in 2012 and \$161,300 in 2011.

Utilization of the deferred income tax asset is dependent upon NCDF generating sufficient income within the net operating loss carryforward period. As discussed in Note 11, Management's projection of future income is heavily dependent upon future grant revenues. Due to the uncertainty of future income, it is at least reasonably possible that management's view of future income will change in the near term.

NCDF's provision for income taxes differs from applying the statutory Federal income tax rates to income before income taxes. The primary difference results from the change in the deferred income tax valuation allowance, which was increased due to the likelihood that NCDF will not generate sufficient taxable income to fully utilize the deferred tax asset.

The 2011 provision for income taxes consisted of a Minnesota state minimum fee.

11. **STOCKHOLDERS' DEFICIT AND MANAGEMENT'S PLANS**

NCDF incurred approximately \$1,200,000 of loan losses on two large cooperative housing projects during 2007, 2008 and 2011, causing a deficit in stockholders' equity. The stockholders' deficit creates an uncertainty about NCDF's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Management and the Board are aggressively pursuing a plan to increase stockholders' equity and net income.

In 2012, NCDF:

1. Converted \$500,000 of notes payable held by Northwest Area Foundation in NCDF to preferred stock and restructured the remaining \$500,000 of notes payable to forgive interest payments due in 2012 and 2013, reducing interest expense.
2. Raised more than \$60,000 in stockholder's equity through a combination of the sale of common stock to new members and additional capital contributions from current members.
3. Reduced interest rates on notes payable by reducing interest rates offered to new and renewing notes payable and paying down the highest cost notes payable.
4. Took steps to reduce operating expenses by cutting occupancy and staffing costs.

(Continued)

NORTHCOUNTRY COOPERATIVE DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

11. **STOCKHOLDERS' DEFICIT AND MANAGEMENT'S PLANS (Continued)**

In 2013, NCDF expects to:

1. Raise an additional \$36,000 in stockholders' equity through a combination of the sale of common stock to new members and additional capital contributions from current members.
2. Raise an additional \$500,000 in stockholder's equity through the sale of preferred stock and conversion of a portion of notes payable to preferred stock.
3. Increase interest income by issuing \$2 million or more in new loans, which will increase loans receivable to \$7.5 million by December 31, 2013.
4. Continue to control interest expense by reducing the cost of capital by paying down high rate notes payable while raising additional moderate rate notes payable, reducing the average interest rate paid on notes payable from 2.5% in 2012 to 2.2% in 2013.
5. Continue to implement fund raising plan and raise \$125,000 in grant and donation revenue.

12. **COMMITMENTS**

NCDF has made commitments of approximately \$1,345,000 to lend funds in the normal course of business to meet the financing needs of its members. These are commitments to extend credit that involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the financial statements.

13. **SUBSEQUENT EVENTS**

Management has evaluated subsequent events through April 17, 2013, the date on which the financial statements were available for issue, and identified no further significant events or transactions to disclose.