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DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES

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REPORT ON AUDIT OF CONSOLIDATED FINANCIAL  
STATEMENTS AND ADDITIONAL INFORMATION

For the Years Ended  
December 31, 2012 and 2011

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## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Duo County Telephone Cooperative Corporation, Inc.  
Jamestown, Kentucky 42629

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Duo County Telephone Cooperative Corporation, Inc. and Subsidiaries which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income and comprehensive income, patronage capital and other equities, and cash flows, for the years then ended, and 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 respective financial position of Duo County Telephone Cooperative Corporation, Inc. and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2013 on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Duo County Telephone Cooperative Corporation, Inc.'s internal control over financial reporting and compliance.

*Campbell, Myers & Rutledge, PLLC*

Certified Public Accountants

March 26, 2013

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
BALANCE SHEETS  
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 6,016,626	\$ 4,781,279
Temporary cash investments	7,320,746	12,525,588
Cash, RUS construction fund	35,547	72,214
Marketable Securities	2,520,294	-
Accounts receivable, less allowance for doubtful accounts of \$127,056 in 2012 and \$184,417 in 2011.	1,670,608	2,163,277
Materials and supplies at average cost which is less than market	2,182,369	2,214,257
Accrued interest receivable	131,223	151,684
Prepaid expenses	<u>326,662</u>	<u>227,574</u>
Total current assets	<u>20,204,075</u>	<u>22,135,873</u>
<b>Other assets</b>		
Cash investments	18,222,453	14,062,164
Nonregulated investments	214,329	352,860
Investment in affiliated companies	44,044,434	41,603,888
Deferred charges	<u>2,659,344</u>	<u>2,642,386</u>
Total other assets	<u>65,140,560</u>	<u>58,661,298</u>
<b>Telephone plant, at cost (substantially all pledged as     collateral on long-term debt to RUS)</b>		
Telephone plant in service	82,861,416	80,499,348
Telephone plant under construction	13,452,814	9,984,320
Nonoperating plant-land	<u>52,008</u>	<u>52,008</u>
Total	96,366,238	90,535,676
<b>Less accumulated depreciation</b>	<u>54,034,787</u>	<u>49,482,010</u>
Telephone plant, net	<u>42,331,451</u>	<u>41,053,666</u>
	<u>\$ 127,676,086</u>	<u>\$ 121,850,837</u>

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
BALANCE SHEETS  
December 31, 2012 and 2011

LIABILITIES AND MEMBERS' EQUITIES

	<u>2012</u>	<u>2011</u>
Current liabilities:		
Current portion of long-term debt	\$ 2,737,129	\$ 3,566,000
Accounts payable, includes construction contract payables of \$167,412 in 2012 and \$529,814 in 2011	746,441	1,659,871
Customer deposits	14,400	15,125
Income tax payable	1,427,309	-
Accrued expenses	<u>1,891,678</u>	<u>2,172,631</u>
Total current liabilities	<u>6,816,957</u>	<u>7,413,627</u>
Deferred income taxes	10,621,004	10,634,735
Long-term debt	<u>-</u>	<u>3,204,659</u>
Total long term liabilities	10,621,004	13,839,394
Other liabilities and deferred credits:		
Deferred credit	<u>164,503</u>	<u>161,084</u>
Total other liabilities and deferred credits	<u>164,503</u>	<u>161,084</u>
Members' equities:		
Patronage capital	48,867,699	46,726,796
Other equities	60,052,870	52,614,301
Accumulated other comprehensive income (loss)	16,066	-
Other member capital	<u>1,136,987</u>	<u>1,095,635</u>
Total members' equities	<u>110,073,622</u>	<u>100,436,732</u>
	<u>\$ 127,676,086</u>	<u>\$ 121,850,837</u>

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
For The Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Local network services	\$ 8,335,707	\$ 8,302,660
Network access services	9,555,695	9,044,811
Carrier billing and collection	103,771	115,994
Miscellaneous operating revenue	1,721,971	1,848,639
Uncollectible revenue	<u>(105,481)</u>	<u>(102,287)</u>
Total operating revenues	<u>19,611,663</u>	<u>19,209,817</u>
Operating expenses:		
Plant specific operations	7,885,604	7,008,339
Plant nonspecific operations	1,422,164	1,262,573
Depreciation	5,538,945	5,403,784
Customer operations	1,548,282	1,518,939
Corporate operations	2,409,932	2,646,098
Extraordinary items	<u>-</u>	<u>191,305</u>
Total operating expenses	<u>18,804,927</u>	<u>18,031,038</u>
Operating income	<u>806,736</u>	<u>1,178,779</u>
Nonoperating income	14,339,128	13,427,653
Provision for income taxes	<u>(5,587,289)</u>	<u>(5,361,199)</u>
Nonoperating income net of taxes	<u>8,751,839</u>	<u>8,066,454</u>
Income before interest and nonregulated income	9,558,575	9,245,233
Interest on long-term debt to RUS, net of interest capitalized \$108,424 in 2012 and \$145,851 in 2011	(310,572)	(444,770)
Nonregulated Income	<u>1,115,755</u>	<u>1,121,411</u>
Net Income	<u>10,363,758</u>	<u>9,921,874</u>
Other comprehensive income- change in unrealized gain (loss) on marketable securities	<u>16,066</u>	<u>-</u>
Total comprehensive income	<u>\$ 10,379,824</u>	<u>\$ 9,921,874</u>

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
STATEMENTS OF PATRONAGE CAPITAL AND OTHER EQUITIES  
For The Years Ended December 31, 2012 and 2011

	Patronage Capital			Accumulated Comprehensive Income	Other Equities
	Assignable	Assigned	Balance		
Balances, January 1, 2011	\$ 8,833,001	\$ 36,500,329	\$ 45,333,330	\$ -	\$ 44,871,053
Patronage capital assigned for the year ended December 31, 2011	(2,334,925)	2,334,925	-	-	-
Refund of overcollected Federal Excise tax for prior year	-	8,904	8,904	-	-
Adjustment for prior refunds	-	(2,946)	(2,946)	-	-
Transfer nonoperating margins for 2011	(7,743,248)	-	(7,743,248)	-	7,743,248
Net income for the year ended December 31, 2011	9,921,874	-	9,921,874	-	-
Distribution of patronage capital	-	(791,118)	(791,118)	-	-
Balances, December 31, 2011	<u>8,676,702</u>	<u>38,050,094</u>	<u>46,726,796</u>	<u>-</u>	<u>52,614,301</u>
Patronage capital assigned for the year ended December 31, 2012	(2,483,304)	2,483,304	-	-	-
Refund of overcollected Federal Excise tax for prior year	-	8,155	8,155	-	-
Adjustment for prior refunds	-	(1,283)	(1,283)	-	-
Transfer nonoperating margins for 2012	(7,438,569)	-	(7,438,569)	-	7,438,569
Net income for the year ended December 31, 2012	10,363,758	-	10,363,758	-	-
Other comprehensive income	-	-	-	16,066	-
Distribution of patronage capital	-	(791,158)	(791,158)	-	-
Balances, December 31, 2012	<u>\$ 9,118,587</u>	<u>\$ 39,749,112</u>	<u>\$ 48,867,699</u>	<u>\$ 16,066</u>	<u>\$ 60,052,870</u>

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
STATEMENTS OF CASH FLOWS  
For The Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Net income	\$ 10,363,758	\$ 9,921,874
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,538,945	5,403,784
Income from investment in affiliated companies	(13,719,519)	(12,651,225)
Refund of Federal Excise taxes	8,155	8,904
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	994,693	(331,323)
Decrease (increase) in inventory	31,888	(547,250)
Decrease (increase) in prepaid expenses	(99,088)	(85,499)
(Decrease) increase in accounts payable	(1,394,994)	334,733
(Decrease) increase in customer deposits	(725)	(2,874)
(Decrease) increase in deferred taxes	1,413,578	1,324,599
(Decrease) increase in accrued income taxes	-	-
(Decrease) increase in accrued expenses	<u>(280,953)</u>	<u>(84,737)</u>
Net cash provided by operating activities	<u>2,855,738</u>	<u>3,290,986</u>
 Cash flows from investing activities:		
Purchases of property, plant and equipment	(6,658,088)	(9,769,506)
Plant removal costs	(37,379)	(15,670)
Salvage recovered from retirement of plant	-	45,000
Decrease (increase) in nonregulated investments	138,531	(52,364)
Investment in affiliated companies	7,931,707	11,047,767
Investments - other	198,727	(359,928)
Purchases of temporary investments	(9,617,709)	(16,527,936)
Maturity of temporary investments	13,688,255	16,552,874
Purchases of marketable securities	(2,504,229)	-
Decrease (increase) in deferred charges	<u>(16,956)</u>	<u>(8,203)</u>
Net cash used in investing activities	<u>3,122,859</u>	<u>912,034</u>

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
STATEMENTS OF CASH FLOWS, CONCLUDED  
For The Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from financing activities:		
Distributions of patronage capital	\$ (791,158)	\$ (791,118)
Principal payments to Rural Utilities Service	(3,816,030)	(2,347,162)
Principal payments to CoBank	(217,500)	(217,500)
(Decrease) increase in deferred credits	3,419	35,369
Other member capital	<u>41,351</u>	<u>75,621</u>
Net cash (used) provided by financing activities	<u>(4,779,918)</u>	<u>(3,244,790)</u>
Net (decrease) increase in cash and cash equivalents	1,198,679	958,230
Cash and cash equivalents at beginning of year	<u>4,853,494</u>	<u>3,895,263</u>
Cash and cash equivalents at end of year	<u>\$ 6,052,173</u>	<u>\$ 4,853,493</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest, net of interest capitalized of \$108,424 in 2012 and \$145,851 in 2011	<u>\$ 392,290</u>	<u>\$ 460,581</u>
Income taxes	<u>\$ 4,086,347</u>	<u>\$ 3,944,590</u>

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

Principles of Consolidation:

The consolidated financial statements include the accounts of Duo County Telephone Cooperative Corporation, Inc. and its wholly owned subsidiaries, Diversified Holding Corporation and Cumberland Cellular, Inc. All material intercompany transactions have been eliminated.

General:

The Cooperative maintains its accounts in accordance with the Uniform System of Accounts prescribed for telephone companies by the Federal Communications Commission. The financial statements reflect the application of certain accounting policies described in this note.

Nature of Business:

Duo County Telephone Cooperative Corporation, Inc. Cooperative Corporation, Inc., provides telephone service in a four-county area of south central Kentucky. The Cooperative grants credit to customers, substantially all of whom are local residents and commercial businesses.

Estimates:

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

Telephone Plant:

Telephone plant is stated at original cost, which includes material, labor, transportation and such indirect items as engineering, supervision and employee fringe benefits. As property units are retired in the ordinary course of business, the cost of the property plus removal cost, less salvage, is charged to accumulated depreciation. Listed below are the major classes of telephone plant as of December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>	<u>Depreciation Rate</u>
Organization	\$ 41,918	\$ 55,514	-
Land	612,782	611,164	-
Buildings	7,674,756	7,669,519	2.7%
Central Office Equipment	19,900,374	18,147,668	7.5-11.9%
Cable and Wire Facilities	47,877,710	46,873,225	2.2-8.9%
Furniture and Office Equipment	1,400,749	1,437,935	7.5-8.7%
General Purpose Computers	942,913	1,253,129	15.8%
Vehicles	1,249,217	1,281,455	12.1%
Other Work Equipment	626,870	635,612	12.1%
Intangibles-CATV	1,529,507	1,529,507	-
Goodwill	1,004,620	1,004,620	-
	<u>\$ 82,861,416</u>	<u>\$ 80,499,348</u>	

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

1. Summary of Significant Accounting Policies, Continued:

Depreciation:

Depreciation is calculated by the straight-line method designed to amortize the cost of various classes of depreciable assets over their estimated useful lives.

Deregulated Customer Premises Equipment:

Deregulated CPE is stated at cost. The Cooperative provides for depreciation on a straight-line basis at an annual rate of depreciation which will amortize the cost of the equipment over its estimated useful life.

Cash and Cash Equivalents:

For purposes of the statement of cash flows, the Cooperative considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Nonregulated Investments:

This balance reflects the Cooperative's permanent net investment in deregulated CPE and internet equipment. Following is a summary of net income from deregulated operations for the years ended December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Income from operations	\$ 3,979,502	\$ 3,644,856
Expenses	<u>(2,863,748)</u>	<u>(2,523,445)</u>
Net income	<u>\$ 1,115,754</u>	<u>\$ 1,121,411</u>

Investment in Affiliated Companies:

This balance represents the Cooperative's investments in affiliates for the purpose of providing cellular telephone services. The subsidiary's investment in a cellular partnership is accounted for using the equity method. Additionally, the Cooperative's 20% investment in a partnership is accounted for using the equity method.

In March 2003, the Cooperative's affiliate Cumberland Cellular, Inc., purchased the assets of a cable television system in Russell County, Kentucky. The operations of the cable system are reflected in the financial statements of Cumberland Cellular, Inc. for 2012 and 2011.

In July 2006, the Cooperative's affiliate Cumberland Cellular, Inc., purchased the assets of a cable television system in Columbia- Adair County, Kentucky. The operations of the cable system are reflected in the financial statements of Cumberland Cellular, Inc. for 2012 and 2011.

Other Member Capital:

This balance represents unclaimed distributions of patronage capital. After a statutory waiting period, these balances will be re-assigned to the Cooperative's existing patrons.

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

1. Summary of Significant Accounting Policies, Continued:

Postretirement Benefit Plans:

The Cooperative provides health care benefits to retired employees. The Cooperative has prefunded this amount. This cost is being amortized over a twenty-year period per the Kentucky Public Service Commission and the Federal Communication Commission. During 2012 and 2011, \$294,000 and \$240,000 were charged to operations.

The annual measurement date is July 1 for other postretirement benefits. The following tables provide information about changes in the benefit obligation and plan assets and the funded status of the Company's postretirement benefit plan:

Funded Status

	<u>2012</u>	<u>2011</u>
Accumulated Postretirement Benefit Obligation (APBO)	\$ (7,562,433)	\$ (5,876,429)
Assets	7,994,372	7,951,469
Unrealized Gain/ (Loss)	2,627,351	647,919
Unrecognized Initial Obligation	-	32,348
Prepaid Benefit Cost	<u>\$ 3,059,290</u>	<u>\$ 2,755,307</u>

Net Periodic Postretirement Benefit Cost

Service Cost	\$ 195,707	\$ 176,892
Amortization Cost		
Initial Obligation	-	32,348
Past Service Liability	-	-
Cumulative Gain/(Loss)	<u>105,819</u>	<u>2,100</u>
Total Amortization Cost	<u>105,819</u>	<u>34,448</u>
Interest Cost	371,574	318,472
Expected Return on Assets	<u>580,780</u>	<u>607,411</u>
Net Periodic Benefit Cost	<u>\$ 92,320</u>	<u>\$ (77,599)</u>

The discount rate used in determining the accumulated postretirement benefit obligation was 5% for 2012 and 2011.

For measurement purposes, an 8% annual rate increase in the cost of health care benefits was used for the year ended December 31, 2012. The rate is assumed to decline until level at 5% per year by the year 2016.

The effect of a 1% increase in the health care trend rates would have the following effects on the plan:

Postretirement benefit obligation	\$ 1,196,405
Net periodic benefit cost	174,774

Subsequent Events:

Management has evaluated subsequent events through March 26, 2013, the date which the financial statements were available to be issued.

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

1. Summary of Significant Accounting Policies, Concluded:

Reclassifications:

Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements.

Related Party Transactions:

Related party transactions have been eliminated during the consolidation of the financial statements for the year ended December 31, 2012 and 2011.

2. Mortgage Notes:

Long-term debt is represented by mortgage notes payable to the United States of America and CoBank. Principal and interest payments are due in both monthly and quarterly installments. It is estimated that installments of \$2,737,129 are payable within the next twelve months to the United States of America. The notes are scheduled to be repaid at various times from May, 2009, to April, 2023. At December 31, 2012, the Cooperative has unadvanced loan funds in amount of \$8,734,713.

As of December 31, 2012, the Cooperative has made advanced payments in the amount of \$7,557,445 on its mortgage notes payable to the United States of America.

Long-term debt to CoBank is due in quarterly installments of varying amounts through the year 2013.

Following is a summary of outstanding long-term debt:

	<u>2012</u>	<u>2011</u>
Due to United States of America:		
2% First Mortgage Notes	\$ -	\$ 341,679
5% First Mortgage Notes	1,224,294	1,602,935
4.8375% First Mortgage Notes	108,914	282,143
3.56% - 5.05% First Mortgage Notes	<u>9,232,298</u>	<u>11,984,025</u>
Total Due to the United States of America	10,565,506	14,210,782
Due to CoBank:		
7.97% First Mortgage Note	<u>55,781</u>	<u>273,281</u>
	10,621,287	14,484,063
Less unadvanced loans	(326,713)	(326,713)
Less RUS advanced payments	(7,557,445)	(7,386,691)
Less current maturities	<u>2,737,129</u>	<u>(3,566,000)</u>
	<u>\$ -</u>	<u>\$ 3,204,659</u>

The maturities of long-term debt for each of the five years succeeding the balance sheet date are as follows:

2013	\$2,737,129
------	-------------

Due to the amount of RUS advanced payments, the balance of long-term debt is shown as current.

The long-term debt agreements and the bylaws of the Cooperative contain restrictions on the return to patrons of capital credits. These restrictions require the maintenance of defined amounts of members' equity and working capital.

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

3. Cash and Cash Equivalents:

All deposits are in various financial institutions and are carried at cost.

	<u>2012</u>		<u>2011</u>	
	<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Carrying Amount</u>	<u>Bank Balance</u>
Insured (FDIC)	\$ 902,360	\$ 892,833	\$ 941,374	\$ 929,830
Uninsured:				
Collateral held by pledging bank's trust				
Department in Cooperative's name	5,149,813	5,327,365	2,862,946	2,862,946
Governmental Securities	-	-	1,049,173	1,049,173
Uncollateralized	-	-	-	-
Total Deposit	<u>\$ 6,052,173</u>	<u>\$ 6,220,198</u>	<u>\$ 4,853,493</u>	<u>\$ 4,841,949</u>

4. Pension Plan:

The Cooperative has a non-contributory defined benefit pension plan covering substantially all of its employees. Effective July 1, 1984, the Cooperative changed from its original plan to one sponsored by the National Telephone Cooperative Association.

At the time of transfer to the new Plan, the Cooperative funded all past service costs. Contributions to this Plan for the years ended December 31, 2012 and 2011 were \$510,624 and \$500,581. The fund covers all vested benefits under the Plan. The Plan has been approved by the Internal Revenue Service. As the Cooperative is only one of several employers participating in the Plan, it is not practicable to determine if the vested benefits of the Cooperative's employees exceed the Cooperative's portion of the Plan assets.

The accumulated plan benefit information using the latest actuarial information applicable for each plan year is as follows:

	<u>January 1, 2012</u>	<u>January 1, 2011</u>
Accumulated benefit obligation	\$(1,774,457,676)	\$(1,271,879,210)
Plan assets at fair value	<u>1,290,330,635</u>	<u>1,325,350,746</u>
Funded Status	<u>\$ (484,127,041)</u>	<u>\$ 53,471,536</u>

Additionally, the Cooperative has a 401 (K) Plan. The terms of the Plan call for an elective contribution from employees of 1% or more of their salaries while the Cooperative contributes 1% of their salary. Total pension expenses related to the Plan for 2012 and 2011 were \$31,491 and \$33,237.

5. Investments:

Marketable securities have been classified as available-for-sale according to management's intent. Realized gains and losses on all marketable securities are determined by specific identification and are charged or credited to earnings.

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

5. Investments, Concluded:

Cost and fair value of the company's available-for-sale securities at December 31, 2012 have been segregated as follows:

	<u>Cost</u>	<u>Market</u>	<u>Unrealized Gain/(Loss)</u>
Cash Equivalents	\$ 1,049,836	\$ 1,049,836	\$ -
Equity Securities	<u>1,454,392</u>	<u>1,470,458</u>	<u>16,066</u>
Total Available-For-Sale	<u>\$ 2,504,228</u>	<u>\$ 2,520,294</u>	<u>\$ 16,066</u>

Available-for-sale securities are carried in the financial statements at fair market value and included in other investments on the financial statements. Net unrealized holding gains and losses in the amount of \$16,066 have been included in accumulated other comprehensive income for the year ended December 31, 2012. The Cooperative had no marketable securities for the year ended December 31, 2011.

6. Temporary Cash Investments:

In 1996, the Cooperative adopted Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities". This statement addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities.

All debt securities of the Cooperative are considered to be held to maturity. The carrying amounts and approximate market value of held to maturity investments are:

	<u>Amortized Cost</u>	<u>Net Unrealized Gains(Losses)</u>	<u>Market Value</u>
U.S. Treasury Securities - 2012	<u>\$29,114,598</u>	<u>\$ 100,902</u>	<u>\$ 29,215,500</u>
U.S. Treasury Securities - 2011	<u>\$28,596,980</u>	<u>\$ 64,241</u>	<u>\$ 28,661,221</u>

The maturities of held to maturity investments and their approximate market value at December 31, 2012 and 2011, were as follows:

	<u>2012</u>		<u>2011</u>	
	<u>Amortized Cost</u>	<u>Market Value</u>	<u>Amortized Cost</u>	<u>Market Value</u>
Due in one year or less (included in cash and Temporary Cash Investments)	\$ 10,892,144	\$10,880,747	\$14,534,816	\$ 14,492,473
Due after one year	<u>18,222,454</u>	<u>18,334,753</u>	<u>14,062,164</u>	<u>14,168,748</u>
	<u>\$ 29,114,598</u>	<u>\$ 29,215,500</u>	<u>\$ 28,596,980</u>	<u>\$ 28,661,221</u>

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONCLUDED

7. Provision for Income Taxes:

The Corporation has been exempt from federal income taxes as a cooperative telephone company under Section 501(c)(12) of the Internal Revenue Code. In 1991, the Internal Revenue Service issued a Technical Advice Memorandum, which interprets certain types of revenues to be excluded in determining when the Cooperative satisfies the 85 percent income test to qualify for tax exempt status. By applying these interpretations, the Cooperative does not qualify in the current year for the tax exempt status. The Company's provision for income taxes differs from applying the statutory U.S. federal income tax rate to income before income taxes. The primary differences result from providing for state income taxes and from deducting certain expenses for financial statement purposes but not for federal tax purposes.

The provision for income taxes consists of the following:

	<u>2012</u>	<u>2011</u>
Current Income Tax Expense	\$ 5,587,289	\$ 4,047,738
Deferred Income Taxes	<u>-</u>	<u>1,313,461</u>
Provision for Income Taxes	<u>\$ 5,587,289</u>	<u>\$ 5,361,199</u>

The Cooperative follows the recognition requirements for uncertain income tax positions as required by generally accepted accounting principles. The Company has no tax position at December 31, 2012 for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The Cooperative's policy is to classify income tax related interest and penalties in interest expense and other expenses, respectively. No such interest or penalties were recognized during the periods presented.

The Company files income tax returns in the U.S. federal jurisdiction, and various state and local jurisdictions. The Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2009.

## ADDITIONAL INFORMATION

# CAMPBELL, MYERS, & RUTLEDGE, PLLC

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### Independent Auditors' Report on Consolidating Information

Board of Directors  
Duo County Telephone Cooperative Corporation, Inc.  
Cooperative Corporation, Inc.  
Jamestown, Kentucky 42629

We have audited the consolidated financial statements of Duo County Telephone Cooperative Corporation, Inc. and Subsidiary as of and for the years ended December 31, 2012 and 2011, and our report thereon dated March 26, 2013, which expressed an unmodified opinion on those financial statements appears on pages one and two. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information presented in Schedule I and II is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Campbell, Myers & Rutledge, PLLC*

Certified Public Accountants

March 26, 2013

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION INC.  
SCHEDULE I – CONSOLIDATING BALANCE SHEET  
December 31, 2012

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
<b>ASSETS</b>					
Cash and equivalents	\$ 3,548,951	\$ 141,011	\$ 2,326,664	\$ -	\$ 6,016,626
Temporary cash investments	2,707,723	-	4,613,023	-	7,320,746
Cash, RUS construction fund	35,547	-	-	-	35,547
Marketable securities	-	-	2,520,294	-	2,520,294
Accounts receivable	1,352,188	-	829,162	(1)(510,742)	1,670,608
Material and supplies - Regulated	948,874	-	1,233,495	-	2,182,369
Accrued interest receivable	43,767	-	87,456	-	131,223
Prepayments	326,662	-	-	-	326,662
	<u>8,963,712</u>	<u>141,011</u>	<u>11,610,094</u>	<u>(510,742)</u>	<u>20,204,075</u>
Total current assets					
Other assets	3,670,124	-	14,552,329	-	18,222,453
Cash investments	65,374,250	65,239,914	40,314,532	(14,680,000) (2)	40,314,532
Investments in affiliated company	-	-	-	(115,934,164) (3)	-
Other investments	3,689,983	-	39,919	-	3,729,902
Nonregulated investments	214,329	-	-	-	214,329
Deferred charges	2,659,827	(483)	-	-	2,659,344
	<u>75,608,513</u>	<u>65,239,431</u>	<u>54,906,780</u>	<u>(130,614,164)</u>	<u>65,140,560</u>
Total other assets					
Telephone plant in service	64,137,141	-	18,776,283	-	82,913,424
Telephone plant under construction	12,159,044	-	1,293,770	-	13,452,814
Total telephone plant	76,296,185	-	20,070,053	-	96,366,238
Depreciation reserve	45,263,307	-	8,771,480	-	54,034,787
Total telephone plant less reserve	31,032,878	-	11,298,573	-	42,331,451
Total assets	<u>\$ 115,605,103</u>	<u>\$ 65,380,442</u>	<u>\$ 77,815,447</u>	<u>\$ (131,124,906)</u>	<u>\$ 127,676,086</u>
<b>LIABILITIES AND EQUITY</b>					
Accounts payable	\$ 1,011,905	\$ 3,676	\$ 241,602	(510,742) (1)	\$ 746,441
Customer deposits	14,400	-	-	-	14,400
Accrued liabilities	1,675,391	2,516	213,771	-	1,891,678
Current portion of long-term debt	2,681,348	-	55,781	-	2,737,129
Total current liabilities	<u>5,383,044</u>	<u>6,192</u>	<u>511,154</u>	<u>(510,742)</u>	<u>5,389,648</u>
Deferred income taxes-noncurrent	-	-	12,048,313	-	12,048,313
Total long-term debt	-	-	-	-	-
Other deferred credits	164,503	-	-	-	164,503
Capital stock	-	7,400,000	7,280,000	(14,680,000) (2)	-
Patronage capital credits	48,867,699	-	-	-	48,867,699
Total retained margins	60,052,870	57,974,250	57,959,914	(115,934,164) (3)	60,052,870
Accumulated other comprehensive income(loss)	-	-	16,066	-	16,066
Other equities	1,136,987	-	-	-	1,136,987
Retained margins and capital credits	<u>110,057,556</u>	<u>65,374,250</u>	<u>65,255,980</u>	<u>(130,614,164)</u>	<u>110,073,622</u>
Total liabilities and equity	<u>\$ 115,605,103</u>	<u>\$ 65,380,442</u>	<u>\$ 77,815,447</u>	<u>\$ (131,124,906)</u>	<u>\$ 127,676,086</u>

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
SCHEDULE II CONSOLIDATING STATEMENT OF INCOME AND COMPREHENSIVE INCOME  
For the Year Ended December 31, 2012

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
Local network services revenue	\$ 2,792,919	\$ -	\$ 5,542,788	\$ -	\$ 8,335,707
Network access service revenue	9,555,695	-	-	-	9,555,695
Carrier billing and collection revenue	103,771	-	-	-	103,771
Miscellaneous revenues	1,218,322	-	503,649	-	1,721,971
Less: Uncollectible revenues	<u>(19,608)</u>	<u>-</u>	<u>(85,873)</u>	<u>-</u>	<u>(105,481)</u>
Total operating revenues	<u>13,651,099</u>	<u>-</u>	<u>5,960,564</u>	<u>-</u>	<u>19,611,663</u>
Plant specific operating expenses	4,020,572	-	3,865,032	-	7,885,604
Plant nonspecific operating expenses	1,422,164	-	-	-	1,422,164
Depreciation and amortization expense	3,987,561	-	1,551,384	-	5,538,945
Customer operations expense	1,391,553	-	156,729	-	1,548,282
Corporate operations expense	1,743,612	1,635	664,685	-	2,409,932
Extraordinary items	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total operating expenses	<u>12,565,462</u>	<u>1,635</u>	<u>6,237,830</u>	<u>-</u>	<u>18,804,927</u>
Telephone operating income (loss)	<u>1,085,637</u>	<u>(1,635)</u>	<u>(277,266)</u>	<u>-</u>	<u>806,736</u>
Nonoperating income	8,582,412	7,551,588	13,305,926	(7,549,307) (1)	14,339,128
Provision from income taxes	118,322	646	5,468,321	(7,551,491) (1)	5,587,289
Nonoperating income net of taxes	<u>8,464,090</u>	<u>7,550,942</u>	<u>7,837,605</u>	<u>(15,100,798)</u>	<u>8,751,839</u>
Income before interest and nonregulated income	9,549,727	7,549,307	7,560,339	(15,100,798)	9,558,575
Interest on funded debt, net	(301,724)	-	(8,848)	-	(310,572)
Nonregulated income	<u>1,115,755</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,115,755</u>
Net income	10,363,758	7,549,307	7,551,491	(15,100,798)	10,363,758
Other comprehensive income-change in unrealized gain (loss) on marketable securities	<u>-</u>	<u>-</u>	<u>16,066</u>	<u>-</u>	<u>16,066</u>
Total comprehensive income	<u>\$ 10,363,758</u>	<u>\$ 7,549,307</u>	<u>\$ 7,567,557</u>	<u>\$ (15,100,798)</u>	<u>\$ 10,379,824</u>

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
SCHEDULE III CONSOLIDATING STATEMENT OF CASH FLOWS  
For the Year Ended December 31, 2012

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
Cash flows from operating activities:					
Net income	\$ 10,363,758	\$ 7,549,307	\$ 7,551,491	\$ (15,100,798)	\$ 10,363,758
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	3,987,561	-	1,551,384	-	5,538,945
Income from investment in affiliated companies	(8,203,671)	(7,551,491)	(13,065,155)	15,100,798	(13,719,519)
Refund of Federal Excise taxes	8,155	-	-	-	8,155
Changes in operating assets and liabilities:					
Decrease (increase) in accounts receivable	491,418	-	(7,467)	510,742	994,693
Decrease (increase) in inventory	17,536	-	14,352	-	31,888
Decrease (increase) in prepaid expenses	(99,088)	-	-	-	(99,088)
(Decrease) increase in accounts payable	(415,557)	470	(469,165)	(510,742)	(1,394,994)
(Decrease) increase in customer deposits	(725)	-	-	-	(725)
(Decrease) increase in deferred taxes	-	-	1,413,578	-	1,413,578
(Decrease) increase in accrued income taxes	-	-	-	-	-
(Decrease) increase in accrued expenses	(255,367)	-	(25,586)	-	(280,953)
Net cash provided by operating activities	<u>5,894,020</u>	<u>(1,714)</u>	<u>(3,036,568)</u>	<u>-</u>	<u>2,855,738</u>
Cash flows from investing activities:					
Purchases of property, plant and equipment	(5,226,253)	-	(1,431,835)	-	(6,658,088)
Plant removal costs	(37,379)	-	-	-	(37,379)
Salvage recovered from retirement of plant	-	-	-	-	138,531
Decrease (increase) in nonregulated investments	138,531	-	7,931,707	-	7,931,707
Investment in affiliated companies	-	-	(1,273)	-	198,727
Investments - other	200,000	-	(3,779,434)	-	(9,617,709)
Purchases of temporary investments	(5,838,275)	-	9,679,030	-	13,688,255
Maturity of temporary investments	4,009,225	-	(2,504,229)	-	(2,504,229)
Purchases of marketable securities	-	-	14,557	-	(16,956)
Decrease (increase) in deferred charges	<u>(31,998)</u>	<u>485</u>	<u>14,557</u>	<u>-</u>	<u>(16,956)</u>
Net cash used in investing activities	<u>(6,786,149)</u>	<u>485</u>	<u>9,908,523</u>	<u>-</u>	<u>3,122,859</u>

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
SCHEDULE III CONSOLIDATING STATEMENT OF CASH FLOWS CONCLUDED  
For the Year Ended December 31, 2012

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
Cash flows from financing activities:					
Capital stock called	\$ 6,000,000	\$ -	\$ (6,000,000)	\$ -	\$ -
Distributions of patronage capital	(791,158)	-	-	-	(791,158)
Principal payments to Rural Utilities Service	(3,816,030)	-	-	-	(3,816,030)
Principal payments to CoBank	-	-	(217,500)	-	(217,500)
(Decrease) increase in deferred credits	3,419	-	-	-	3,419
Other member capital	41,351	-	-	-	41,351
Net cash (used) provided by financing activities	<u>1,437,582</u>	<u>-</u>	<u>(6,217,500)</u>	<u>-</u>	<u>(4,779,918)</u>
Net (decrease) increase in cash and cash equivalents	545,453	(1,229)	654,455	-	1,198,679
Cash and cash equivalents at beginning of year	<u>3,039,045</u>	<u>142,240</u>	<u>1,672,209</u>	<u>-</u>	<u>4,853,494</u>
Cash and cash equivalents at end of year (Notes 1 and 4)	<u>\$ 3,584,498</u>	<u>\$ 141,011</u>	<u>\$ 2,326,664</u>	<u>\$ -</u>	<u>\$ 6,052,173</u>
Supplemental disclosures of cash flow information:					
Cash paid during the year for:					
Interest, net of interest capitalized of \$108,424 in 2012 and \$145,851 in 2011	\$ 383,442	\$ -	\$ 8,848	\$ -	\$ 392,290
Income taxes	<u>81,000</u>	<u>175</u>	<u>4,005,172</u>	<u>-</u>	<u>4,086,347</u>

# CAMPBELL, MYERS, & RUTLEDGE, PLLC

## Certified Public Accountants

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### Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors  
Duo County Telephone Cooperative Corporation, Inc.  
Jamestown, Kentucky 42629

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Duo County Telephone Cooperative Corporation, Inc., which comprise the balance sheets as of December 31, 2012 and 2011 and the related statements of income and comprehensive income, patronage capital and other equities, and cash flows for the years then ended, and related notes to the financial statements, and have issued our report thereon dated March 26, 2013.

#### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Duo County Telephone Cooperative Corporation, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Duo County Telephone Cooperative Corporation, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Duo County Telephone Cooperative Corporation, Inc.'s internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Duo County Telephone Cooperative Corporation, Inc.'s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Campbell, Myers & Ratledge, PLLC*

Certified Public Accountants

March 26, 2013