

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, 2016 and 2015



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## INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying consolidated financial statements of Duo County Telephone Cooperative Corporation, Inc. and subsidiaries which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related statements of income, comprehensive income, patronage capital and other equities, and cash flows, for the years then ended and related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of Duo County Telephone Cooperative Corporation, Inc. and subsidiaries as of December 31, 2016 and 2015, 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 Matters**

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Duo County Telephone Cooperative Corporation, Inc. and subsidiaries' basic financial statements. The consolidating balance sheets and consolidating statements of revenue are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The consolidating balance sheets, consolidating statements of income and comprehensive income, and consolidating statements of cash flows are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic 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 in Schedules I – III, is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2017 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. and subsidiaries' internal control over financial reporting and compliance.

*Campbell, Myers & Rutledge, PLLC*

Certified Public Accountants

March 28, 2017

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
BALANCE SHEETS  
December 31, 2016 and 2015

ASSETS

	<u>2016</u>	<u>2015</u>
Current assets		
Cash and cash equivalents	\$ 3,995,631	\$ 1,957,271
Temporary cash investments	12,097,855	8,593,729
Cash, RUS construction fund	203	6,843
Marketable Securities	3,876,083	3,447,018
Accounts receivable, less allowance for doubtful accounts of \$54,189 in 2016 and \$54,189 in 2015.	1,148,872	1,145,410
Materials and supplies at average cost which is less than market	2,221,658	2,421,615
Accrued interest receivable	207,771	262,213
Prepaid expenses	595,744	623,776
Total current assets	24,143,817	18,457,875
Other assets		
Cash investments	25,592,141	34,713,267
Nonregulated investments	249,333	287,928
Investment in affiliated companies	58,850,927	47,482,613
Deferred charges	-	13,984
Total other assets	84,692,401	82,497,792
Telecommunication plant, at cost (substantially all pledged as collateral on long-term debt to RUS)		
Telecommunication plant in service	108,662,952	99,038,856
Telecommunication plant under construction	10,103,293	11,918,850
Nonoperating plant-land	52,008	52,008
Total	118,818,253	111,009,714
Less accumulated depreciation	(71,257,474)	(65,743,318)
Telecommunication plant, net	47,560,779	45,266,396
	\$ 156,396,997	\$ 146,222,063

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
BALANCE SHEETS, CONCLUDED  
December 31, 2016 and 2015

LIABILITIES AND MEMBERS' EQUITIES

	<u>2016</u>	<u>2015</u>
Current liabilities:		
Current portion of long-term debt	\$ 94,645	\$ 97,055
Accounts payable, includes construction contracts payable of \$1,152,252 in 2016 and \$67,989 in 2015	1,740,338	2,054,362
Customer deposits	9,500	9,800
Accrued expenses	<u>2,559,601</u>	<u>2,599,895</u>
Total current liabilities	<u>4,404,084</u>	<u>4,761,112</u>
Deferred income taxes	<u>11,420,834</u>	<u>11,214,643</u>
Total long term liabilities	11,420,834	11,214,643
Other liabilities and deferred credits:		
Deferred credit	<u>261,063</u>	<u>160,566</u>
Total other liabilities and deferred credits	<u>261,063</u>	<u>160,566</u>
Members' equities:		
Patronage capital	56,150,626	52,104,353
Other equities	83,270,412	77,886,654
Accumulated other comprehensive income (loss)	(682,178)	(1,370,307)
Other member capital	<u>1,572,156</u>	<u>1,465,042</u>
Total members' equities	<u>140,311,016</u>	<u>130,085,742</u>
	<u>\$ 156,396,997</u>	<u>\$ 146,222,063</u>

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

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
STATEMENTS OF INCOME  
For The Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Local network services	\$ 9,533,901	\$ 9,398,457
Network access services	10,926,735	10,565,963
Carrier billing and collection	53,683	88,217
Miscellaneous operating revenue	1,846,056	1,829,421
Uncollectible revenue	<u>(122,595)</u>	<u>(122,662)</u>
Total operating revenues	<u>22,237,780</u>	<u>21,759,396</u>
 Operating expenses:		
Plant specific operations	9,376,981	8,928,793
Plant nonspecific operations	2,124,337	1,886,877
Depreciation	6,603,650	6,526,732
Customer operations	1,329,379	1,276,521
Corporate operations	<u>2,560,102</u>	<u>2,595,533</u>
Total operating expenses	<u>21,994,449</u>	<u>21,214,456</u>
 Nonregulated Income	<u>446,123</u>	<u>908,222</u>
 Operating income	<u>689,454</u>	<u>1,453,162</u>
 Nonoperating income	14,538,283	9,966,480
Provision for income taxes	<u>(5,013,889)</u>	<u>(3,548,345)</u>
Nonoperating income net of taxes	<u>9,524,394</u>	<u>6,418,135</u>
 Income before interest	10,213,848	7,871,297
 Interest on long-term debt to RUS, net of interest capitalized \$40,682 in 2016 and \$83,747 in 2015	<u>-</u>	<u>(20,666)</u>
 Net Income	<u>\$ 10,213,848</u>	<u>\$ 7,850,631</u>

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



DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
AND SUBSIDIARIES  
STATEMENTS OF COMPREHENSIVE INCOME  
For The Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Net Income	\$ 10,213,848	\$ 7,850,631
Other comprehensive income		
Postretirement benefit other than pension:		
Unrecognized gain (loss) on assets	385,409	(125,532)
Change in unrealized gain (loss) on marketable securities	<u>302,720</u>	<u>(256,263)</u>
Total comprehensive income	<u>\$ 10,901,977</u>	<u>\$ 7,468,836</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, 2016 and 2015

	Patronage Capital			Accumulated Comprehensive Income	Other Equities
	Assignable	Assigned	Balance		
Balances, January 1, 2015	\$ 5,515,064	\$ 43,789,408	\$ 49,304,472	\$ (988,512)	\$ 73,620,240
Patronage capital assigned for the year ended December 31, 2014	(2,500,765)	2,500,765	-	-	-
Refund of overcollected Federal Excise tax for prior year	-	6,314	6,314	-	-
Adjustment for prior refunds	-	39	39	-	-
Transfer nonoperating margins for 2015	(4,265,784)	-	(4,265,784)	-	4,266,414
Postretirement benefit other than pension Unrecognized loss on assets	-	-	-	(125,532)	-
Net income for the year ended December 31, 2015	7,850,631	-	7,850,631	-	-
Other comprehensive income	-	-	-	(256,263)	-
Distribution of patronage capital	-	(791,319)	(791,319)	-	-
Balances, December 31, 2015	<u>6,599,146</u>	<u>45,505,207</u>	<u>52,104,353</u>	<u>(1,370,307)</u>	<u>77,886,654</u>
Patronage capital assigned for the year ended December 31, 2015	(2,473,688)	2,473,688	-	-	-
Refund of overcollected Federal Excise tax for prior year	-	7,445	7,445	-	-
Adjustment for prior refunds	-	663	663	-	-
Transfer nonoperating margins for 2016	(5,384,388)	-	(5,384,388)	-	5,383,758
Postretirement benefit other than pension Unrecognized loss on assets	-	-	-	385,409	-
Net income for the year ended December 31, 2016	10,213,848	-	10,213,848	-	-
Other comprehensive income	-	-	-	302,720	-
Distribution of patronage capital	-	(791,295)	(791,295)	-	-
Balances, December 31, 2016	<u>\$ 8,954,918</u>	<u>\$ 47,195,708</u>	<u>\$ 56,150,626</u>	<u>\$ (682,178)</u>	<u>\$ 83,270,412</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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Net income	\$ 10,213,848	\$ 7,850,631
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,603,650	6,526,732
Income from investment in affiliated companies	(7,100,877)	(8,243,686)
Refund of Federal Excise taxes	7,445	6,314
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	(15,694)	326,566
Decrease (increase) in inventory	199,957	(230,361)
Decrease (increase) in prepaid expenses	82,474	(102,498)
(Decrease) increase in accounts payable	(301,793)	1,062,460
(Decrease) increase in customer deposits	(300)	400
(Decrease) increase in deferred taxes	206,191	414,982
(Decrease) increase in accrued expenses	<u>(40,294)</u>	<u>7,714</u>
Net cash provided by operating activities	<u>9,854,607</u>	<u>7,619,254</u>
Cash flows from investing activities:		
Purchases of property, plant and equipment	(8,218,927)	(5,619,270)
Plant removal costs	(679,106)	(641,940)
Decrease (increase) in nonregulated investments	38,595	(50,626)
Investment in affiliated companies	8,944,768	3,934,154
Investments - other	(2,347,107)	1,026,465
Purchases of temporary investments	(12,097,855)	(8,593,729)
Maturity of temporary investments	8,593,729	4,360,290
Purchases of cash investments	(7,893,027)	(12,770,494)
Maturity of cash investments	8,407,772	9,711,458
Decrease (increase) in deferred charges	<u>13,984</u>	<u>7,562</u>
Net cash used in investing activities	<u>(5,237,174)</u>	<u>(8,636,130)</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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from financing activities:		
Capital distributions	\$ (4,000,000)	\$ -
Capital distributions received	2,000,000	-
Distributions of patronage capital	(790,914)	(791,319)
Principal payments to Rural Utilities Service	(2,410)	(25,701)
(Decrease) increase in deferred credits	100,497	15,220
Other member capital	<u>107,114</u>	<u>119,207</u>
Net cash (used) provided by financing activities	<u>(2,585,713)</u>	<u>(682,593)</u>
Net (decrease) increase in cash and cash equivalents	2,031,720	(1,699,469)
Cash and cash equivalents at beginning of year	<u>1,964,114</u>	<u>3,663,583</u>
Cash and cash equivalents at end of year	<u>\$ 3,995,834</u>	<u>\$ 1,964,114</u>
 Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest, net of interest capitalized of \$124,584 in 2016 and \$124,584 in 2015	<u>\$ 40,682</u>	<u>\$ 104,412</u>
Income taxes	<u>\$ 5,857,559</u>	<u>\$ 2,251,634</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 and its subsidiaries, provides telecommunication services 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.

Telecommunications Plant:

Telecommunications 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, 2016 and 2015:

	<u>2016</u>	<u>2015</u>	Depreciation <u>Rate</u>
Organization	\$ -	\$ 1,133	0.0%
Land	663,570	663,570	0.0%
Buildings	7,909,735	7,905,609	2.7%
Central Office Equipment	24,924,576	25,216,727	7.5-11.9%
Cable and Wire Facilities	68,093,575	58,309,781	2.2-8.9%
Furniture and Office Equipment	1,390,772	1,398,644	7.5-8.7%
General Purpose Computers	1,240,016	1,209,848	15.8%
Vehicles	1,300,706	1,293,958	12.1%
Other Work Equipment	605,875	505,459	12.1%
Intangible - CATV	1,529,507	1,529,507	0.0%
Goodwill	1,004,620	1,004,620	0.0%
	<u>\$ 108,662,952</u>	<u>\$ 99,038,856</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, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Income from operations	\$ 4,560,589	\$ 4,141,857
Expenses	(4,114,466)	(3,233,635)
Net income	<u>\$ 446,123</u>	<u>\$ 908,222</u>

Investment in Affiliated Companies:

This balance represents the Cooperative's investments in affiliates for the purpose of providing cellular telephone services, video services and broadband services. Duo County Telephone Cooperative Corporation, Inc. owns 20% of Bluegrass Network, LLC. Cumberland Cellular, Inc. owns 20% of Bluegrass Telecom and 62.5% of Cumberland Cellular Partnership. All of these investments are 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 2016 and 2015.

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 2016 and 2015.

Other Equities:

This balance represents accumulated margins from non-patronage source income primarily from subsidiary operations.

Other Member Capital:

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

1. Summary of Significant Accounting Policies, Continued:

Postretirement Benefit Plans:

The Corporation sponsors a defined benefit plan that provides medical insurance coverage to retirees and their dependents. Participating retirees who were employed as of July 30, 2004 and their dependents contributed 0% of the project cost of coverage. For employees hired after July 30, 2004 the Corporation contributed 100% until spouse and retiree were 65. For employees hired after December 1, 2012, the Corporation pays no health insurance for retirees.

The following sets forth the accumulated post-retirement benefit obligation, the change in plan assets, and the component of accrued post-retirement benefit cost and net periodic benefit cost as of December 31, 2016 and 2015.

	<u>2016</u>	<u>2015</u>
Accumulated post-retirement benefit obligation, beginning	\$ 9,232,692	\$ 8,910,030
Service cost	214,955	230,350
Interest cost	409,528	408,910
Employer Contributions	(1,130,998)	(1,078,038)
Actuarial loss/(gain)	513,880	761,440
Accumulated post retirement benefit obligation, ending	<u>\$ 9,240,057</u>	<u>\$ 9,232,692</u>
Fair value of plan assets - beginning of year	\$ 11,078,533	\$ 10,517,532
Actual Return	830,520	803,194
Employer Contributions	1,130,998	1,078,038
Unrealized gain/(loss)	(1,175,486)	(1,320,231)
Fair value of plan assets - end of year	<u>\$ 11,864,565</u>	<u>\$ 11,078,533</u>
Unfunded status	\$ (2,624,508)	\$ (1,845,841)
Unrecognized net actuarial loss	1,579,865	1,965,274
Net amount recognized	<u>\$ 4,204,373</u>	<u>\$ 3,811,115</u>
Unfunded status	\$ (2,624,508)	\$ (1,845,841)
Current liabilities	-	-
Noncurrent liabilities	<u>\$ (2,624,508)</u>	<u>\$ (1,845,841)</u>
Service cost	\$ 214,955	\$ 230,350
Interest cost	409,528	408,910
Amortization of net actuarial gain	30,824	63,034
Expected return on assets	(830,520)	(803,194)
Net periodic benefit cost	<u>\$ (175,213)</u>	<u>\$ (100,900)</u>

The discount rate used in determining the accumulated postretirement benefit obligation was 4.5% and 4.5% for the years ending December 31, 2016 and 2015, respectively

Expected benefit payments from the plan for the year ending December 31, 2016 total \$281,967.

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

1. Summary of Significant Accounting Policies, Continued:

For measurement purposes, an 8% annual rate increase in the per capita cost of covered health care benefits was used for the year ended December 31, 2016. The anticipated future rates are as follows:

2017	6.50%
2018	6.00%
2019	5.00%
2020	5.00%
2021	5.00%
2022-2025	5.00%

An additional 1% increase in the trend utilized for measurement purposes in 2016 would have resulted in an increase in the accumulated postretirement benefit obligation of approximately \$1,600,000.

Subsequent Events:

Management has evaluated subsequent events through March 28, 2017, the date which the financial statements were available to be issued.

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 years ended December 31, 2016 and 2015.

2. Mortgage Notes:

Long-term debt is represented by mortgage notes payable to the United States of America. Principal and interest payments are due in both monthly and quarterly installments. It is estimated that installments of \$94,645 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, 2016, the Cooperative has unadvanced loan funds in amount of \$8,734,713.

As of December 31, 2016, the Cooperative has made advanced payments in the amount of \$362,163 on its mortgage notes payable to the United States of America.



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

2. Mortgage Notes, Concluded:

Following is a summary of outstanding long-term debt:

	<u>2016</u>	<u>2015</u>
Due to United States of America:		
5% First Mortgage Notes	\$ 456,808	\$ 582,003
3.56% - 5.05% First Mortgage Notes	326,713	1,454,886
Total due to the United States of America	783,521	2,036,889
Less unadvanced loans	(326,713)	(326,713)
Less RUS advanced payments	(362,163)	(1,613,121)
Less current maturities	(94,645)	(97,055)
	\$ -	\$ -

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

2017	\$94,645
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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.

3. Cash and Cash Equivalents:

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

	<u>2016</u>		<u>2015</u>	
	<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Carrying Amount</u>	<u>Bank Balance</u>
Insured (FDIC)	\$ 959,611	\$ 777,036	\$ 1,009,193	\$ 838,766
Uninsured				
Collateral held by pledging bank's trust department in Cooperative's name	3,036,223	2,793,762	954,921	1,347,534
Total deposit	\$ 3,995,834	\$ 3,570,798	\$ 1,964,114	\$ 2,186,300

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

4. 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.

Cost and fair value of the company's available-for-sale securities at December 31, 2016 and 2015 have been segregated as follows:

	<u>December 31, 2016</u>		
	<u>Cost</u>	<u>Market</u>	<u>Unrealized Gain/(Loss)</u>
Cash Equivalents	\$ 192,833	\$ 192,833	\$ -
Equity Securities	<u>3,380,530</u>	<u>3,683,250</u>	<u>302,720</u>
Total Available-For-Sale	<u>\$ 3,573,363</u>	<u>\$ 3,876,083</u>	<u>\$ 302,720</u>

	<u>December 31, 2015</u>		
	<u>Cost</u>	<u>Market</u>	<u>Unrealized Gain/(Loss)</u>
Cash Equivalents	\$ 146,265	\$ 146,265	\$ -
Equity Securities	<u>3,557,016</u>	<u>3,300,753</u>	<u>(256,263)</u>
Total Available-For-Sale	<u>\$ 3,703,281</u>	<u>\$ 3,447,018</u>	<u>\$ (256,263)</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 \$302,720 have been included in accumulated other comprehensive income for the year ended December 31, 2016 and (\$256,263) for December 31, 2015.

5. 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 - 2016	\$ 41,452,125	\$ 1,274,454	\$ 42,726,579
U.S. Treasury Securities - 2015	\$ 46,326,164	\$ 990,413	\$ 47,316,577

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

5. Temporary Cash Investments, Concluded:

The maturities of held to maturity investments and their approximate market value at December 31, 2016 and 2015, were as follows:

	<u>2016</u>		<u>2015</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)	\$ 15,859,984	\$ 17,239,206	\$ 11,612,897	\$ 12,618,621
Due after one year	<u>25,592,141</u>	<u>25,487,373</u>	<u>34,713,267</u>	<u>34,697,956</u>
	<u>\$ 41,452,125</u>	<u>\$ 42,726,579</u>	<u>\$ 46,326,164</u>	<u>\$ 47,316,577</u>

6. 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 and the Corporation files separate corporate tax returns for the parent and each of the subsidiaries. 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 for 2016 and 2015 consists of the following:

	<u>2016</u>	<u>2015</u>
Current income tax expense	\$ 4,740,139	\$ 3,133,363
Deferred income taxes	<u>206,190</u>	<u>414,982</u>
Provision for income taxes	<u>\$ 4,946,329</u>	<u>\$ 3,548,345</u>

A cumulative net deferred tax liability is included in other liabilities. The components of the liability are as follows:

	<u>2016</u>	<u>2015</u>
Differences in Depreciation Methods	<u>\$ 11,420,834</u>	<u>\$ 11,214,643</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, 2016 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 2013.

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

7. Deferred Charges:

Following is a summary of amounts recorded as deferred charges approved by RUS per 1773.33(h) as of December 31, 2016 and 2015:

Deferred Debits:	<u>2016</u>	<u>2015</u>
Information Systems	\$ -	\$ 13,984
	<u>\$ -</u>	<u>\$ 13,984</u>
Deferred Credits:		
Other Deferred Taxes	\$ 261,063	\$ 160,566

8. 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, 2016 and 2015 were \$597,783 and \$533,536. 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, 2016</u>	<u>January 1, 2015</u>
Accumulated benefit obligation	\$(2,187,608,714)	\$(2,216,633,171)
Plan assets at fair value	<u>1,569,167,300</u>	<u>1,603,076,144</u>
Funded Status	<u>\$ (618,441,414)</u>	<u>\$ (613,557,027)</u>

Additionally, the Cooperative has an elective 401 (K) Plan with the Company providing matching contributions as defined in the Savings Plan adoption agreement. Total pension expenses related to the Plan for 2016 and 2015 were \$32,263 and \$32,309.

## ADDITIONAL INFORMATION



CAMPBELL, MYERS AND RUTLEDGE, PLLC

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Skip R. Campbell, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

Independent Auditor's Report  
on Consolidating Information

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

We have audited the consolidated financial statements of Duo County Telephone Cooperative Corporation, Inc. and subsidiaries as of and for the years ended December 31, 2016 and 2015, and our report thereon dated March 28, 2017, 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 Schedules I and II and III are 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 28, 2017

**DUO COUNTY TELEPHONE COOPERATIVE CORPORATION INC.**  
**SCHEDULE I – CONSOLIDATING BALANCE SHEET**

December 31, 2016

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
<b>ASSETS</b>					
Cash and equivalents	\$ 1,490,560	\$ 132,896	\$ 2,372,175	\$ -	\$ 3,995,631
Temporary cash investments	4,902,307	-	7,195,548	-	12,097,855
Cash, RUS construction fund	203	-	-	-	203
Marketable securities	-	-	3,876,083	-	3,876,083
Accounts receivable	1,082,583	-	677,105	(1)(610,816)	1,148,872
Material and supplies - Regulated	1,401,429	-	820,229	-	2,221,658
Accrued interest receivable	49,707	-	158,064	-	207,771
Prepayments	459,731	-	136,013	-	595,744
Total current assets	<u>9,386,520</u>	<u>132,896</u>	<u>15,235,217</u>	<u>(610,816)</u>	<u>24,143,817</u>
Other assets					
Cash investments	5,353,551	-	20,238,590	-	25,592,141
Investments in affiliated company	79,178,414	79,053,872	48,321,825	(2,680,000) (2)	48,321,825
				(155,552,286) (3)	
Other investments	10,488,818	-	40,284	-	10,529,102
Nonregulated investments	249,333	-	-	-	249,333
Deferred charges	-	-	-	-	-
Total other assets	<u>95,270,116</u>	<u>79,053,872</u>	<u>68,600,699</u>	<u>(158,232,286)</u>	<u>84,692,401</u>
Telephone plant in service	87,937,238	-	20,725,714	-	108,662,952
Telephone plant under construction	9,040,528	-	1,114,773	-	10,155,301
Total telephone plant	96,977,766	-	21,840,487	-	118,818,253
Depreciation reserve	57,611,455	-	13,646,019	-	71,257,474
Total telephone plant less reserve	39,366,311	-	8,194,468	-	47,560,779
Total assets	<u>\$ 144,022,947</u>	<u>\$ 79,186,768</u>	<u>\$ 92,030,384</u>	<u>\$ (158,843,102)</u>	<u>\$ 156,396,997</u>
<b>LIABILITIES AND EQUITY</b>					
Accounts payable	\$ 2,031,626	\$ 5,838	\$ 313,690	(610,816) (1)	\$ 1,740,338
Customer deposits	9,500	-	-	-	9,500
Accrued liabilities	2,212,784	2,516	344,301	-	2,559,601
Current portion of long-term debt	94,645	-	-	-	94,645
Total current liabilities	4,348,555	8,354	657,991	(610,816)	4,404,084
Deferred income taxes-noncurrent	-	-	11,420,834	-	11,420,834
Total long-term liabilities	-	-	11,420,834	-	11,420,834
Other deferred credits	261,063	-	-	-	261,063
Total other liabilities and deferred credits	261,063	-	-	-	261,063
Capital stock	-	1,400,000	1,280,000	(2,680,000) (2)	-
Patronage capital credits	56,150,626	-	-	-	56,150,626
Total retained margins	83,270,412	77,778,414	77,773,872	(155,552,286) (3)	83,270,412
Accumulated other comprehensive income(loss)	(1,579,865)	-	897,687	-	(682,178)
Other equities	1,572,156	-	-	-	1,572,156
Retained margins and capital credits	139,413,329	79,178,414	79,951,559	(158,232,286)	140,311,016
Total liabilities and equity	<u>\$ 144,022,947</u>	<u>\$ 79,186,768</u>	<u>\$ 92,030,384</u>	<u>\$ (158,843,102)</u>	<u>\$ 156,396,997</u>

**DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.**  
**SCHEDULE II - CONSOLIDATING STATEMENT OF INCOME AND COMPREHENSIVE INCOME**  
**For the Year Ended December 31, 2016**

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
Local network services revenue	\$ 2,637,299	\$ -	\$ 6,896,602	\$ -	\$ 9,533,901
Network access service revenue	10,926,735	-	-	-	10,926,735
Carrier billing and collection revenue	53,683	-	-	-	53,683
Miscellaneous revenues	1,384,950	-	461,106	-	1,846,056
Less: Uncollectible revenues	<u>(15,135)</u>	<u>-</u>	<u>(107,460)</u>	<u>-</u>	<u>(122,595)</u>
<b>Total operating revenues</b>	<u>14,987,532</u>	<u>-</u>	<u>7,250,248</u>	<u>-</u>	<u>22,237,780</u>
Plant specific operating expenses	4,116,272	-	5,260,709	-	9,376,981
Plant nonspecific operating expenses	2,124,337	-	-	-	2,124,337
Depreciation and amortization expense	4,871,623	-	1,732,027	-	6,603,650
Customer operations expense	1,178,343	-	151,036	-	1,329,379
Corporate operations expense	<u>1,696,147</u>	<u>2,165</u>	<u>861,790</u>	<u>-</u>	<u>2,560,102</u>
<b>Total operating expenses</b>	<u>13,986,722</u>	<u>2,165</u>	<u>8,005,562</u>	<u>-</u>	<u>21,994,449</u>
Nonregulated income	<u>446,123</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>446,123</u>
<b>Telephone operating income (loss)</b>	<u>1,446,933</u>	<u>(2,165)</u>	<u>(755,314)</u>	<u>-</u>	<u>689,454</u>
Nonoperating income	8,823,915	8,086,779	13,797,943	(8,083,924) (1)	14,538,283
Provision from income taxes	<u>57,000</u>	<u>690</u>	<u>4,956,199</u>	<u>-</u>	<u>5,013,889</u>
<b>Nonoperating income net of taxes</b>	<u>8,766,915</u>	<u>8,086,089</u>	<u>8,841,744</u>	<u>(16,170,354)</u>	<u>5,726,208</u>
Income before interest	10,213,848	8,083,924	8,086,430	(16,170,354)	10,213,848
Interest on funded debt, net	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Net income</b>	10,213,848	8,083,924	8,086,430	(16,170,354)	10,213,848
Other comprehensive income and post retirement benefits	<u>385,409</u>	<u>-</u>	<u>302,720</u>	<u>-</u>	<u>688,129</u>
<b>Total comprehensive income</b>	<u>\$ 10,599,257</u>	<u>\$ 8,083,924</u>	<u>\$ 8,389,150</u>	<u>\$ (16,170,354)</u>	<u>\$ 10,901,977</u>



DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
SCHEDULE III CONSOLIDATING STATEMENT OF CASH FLOWS  
For the Year Ended December 31, 2016

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
Cash flows from operating activities:					
Net income	\$ 10,213,848	\$ 8,083,924	\$ 8,086,430	\$ (16,170,354)	\$ 10,213,848
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	4,871,623	-	1,732,027	-	6,603,650
Income from investment in affiliated companies	(8,083,924)	(8,086,430)	(7,100,877)	16,170,354	(7,100,877)
Refund of Federal Excise taxes	7,445	-	-	-	7,445
Changes in operating assets and liabilities:					
Decrease (increase) in accounts receivable	(42,577)	-	32,999	(6,116)	(15,694)
Decrease (increase) in inventory	(27,206)	-	227,163	-	199,957
Decrease (increase) in prepaid expenses	13,003	-	69,471	-	82,474
(Decrease) increase in accounts payable	860,174	514	(1,168,597)	6,116	(301,793)
(Decrease) increase in customer deposits	(300)	-	-	-	(300)
(Decrease) increase in deferred taxes	-	-	206,191	-	206,191
(Decrease) increase in accrued expenses	28,911	-	(69,205)	-	(40,294)
Net cash provided by operating activities	<u>7,840,997</u>	<u>(1,992)</u>	<u>2,015,602</u>	<u>-</u>	<u>9,854,607</u>
Cash flows from investing activities:					
Purchases of property, plant and equipment	(7,120,214)	-	(1,098,713)	-	(8,218,927)
Plant removal costs	(679,106)	-	-	-	(679,106)
Decrease (increase) in nonregulated investments	38,595	-	-	-	38,595
Investment in affiliated companies	2,000,000	-	6,944,768	-	8,944,768
Investments - other	(2,347,107)	-	-	-	(2,347,107)
Purchases of temporary investments	(4,902,307)	-	(7,195,548)	-	(12,097,855)
Maturity of temporary investments	2,610,729	-	5,983,000	-	8,593,729
Purchases of cash investments	(2,943,154)	-	(4,949,873)	-	(7,893,027)
Maturity of cash investments	6,453,874	-	1,953,898	-	8,407,772
Decrease (increase) in deferred charges	13,984	-	-	-	13,984
Net cash used in investing activities	<u>(6,874,706)</u>	<u>-</u>	<u>1,637,532</u>	<u>-</u>	<u>(5,237,174)</u>

DUO COUNTY TELEPHONE COOPERATIVE CORPORATION, INC.  
SCHEDULE III CONSOLIDATING STATEMENT OF CASH FLOWS, CONCLUDED  
For the Year Ended December 31, 2016

	Duo County Telephone Cooperative Corp., Inc.	Diversified Holding Corporation	Cumberland Cellular, Inc.	Consolidating Entries	Consolidated Totals
Cash flows from financing activities:					
Capital distributions	\$ -	\$ (2,000,000)	\$ (2,000,000)	\$ -	\$ (4,000,000)
Capital distributions received	-	2,000,000			2,000,000
Distributions of patronage capital	(790,914)	-	-	-	(790,914)
Principal payments to Rural Utilities Service	(2,410)	-	-	-	(2,410)
(Decrease) increase in deferred credits	100,497	-	-	-	100,497
Other member capital	107,114	-	-	-	107,114
Net cash (used) provided by financing activities	<u>(585,713)</u>	<u>-</u>	<u>(2,000,000)</u>	<u>-</u>	<u>(2,585,713)</u>
Net (decrease) increase in cash and cash equivalents	380,578	(1,992)	1,653,134	-	2,031,720
Cash and cash equivalents at beginning of year	<u>1,110,185</u>	<u>134,888</u>	<u>719,041</u>	<u>-</u>	<u>1,964,114</u>
Cash and cash equivalents at end of year (Notes 1 and 4)	<u>\$ 1,490,763</u>	<u>\$ 132,896</u>	<u>\$ 2,372,175</u>	<u>\$ -</u>	<u>\$ 3,995,834</u>
Supplemental disclosures of cash flow information:					
Cash paid during the year for:					
Interest, net of interest capitalized of \$40,682 in 2016 and \$83,747 in 2015	<u>\$ 40,682</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 40,682</u>
Income taxes	<u>\$ 42,750</u>	<u>\$ 175</u>	<u>\$ 5,814,634</u>	<u>\$ -</u>	<u>\$ 5,857,559</u>



CAMPBELL, MYERS AND RUTLEDGE, PLLC

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INDEPENDENT AUDITOR'S 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. and subsidiaries, which comprise the balance sheets as of December 31, 2016 and 2015 and the related statements of operations, comprehensive income, patronage capital and other equities, and cash flows for the years then ended, and related notes to the consolidated financial statements, and have issued our report thereon dated March 28, 2017.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Duo County Telephone Cooperative Corporation, Inc. and subsidiaries' 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. and subsidiaries' internal control. Accordingly, we do not express an opinion on the effectiveness of Duo County Telephone Cooperative Corporation, Inc. and subsidiaries' 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. and subsidiaries' 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 & Rutledge, PLLC*

Certified Public Accountants

March 28, 2017



INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS  
OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS  
FOR TELECOMMUNICATION BORROWERS

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

We have audited, 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, the consolidated financial statements of Duo County Telephone Cooperative Corporation and subsidiaries, which comprise the balance sheet as of December 31, 2016 and 2015, and the related statements of income, comprehensive income and patronage capital and other equities, changes in cash flows for the year ended, and the related notes to the financial statements, and have issued our report thereon dated March 28, 2017. In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2017, on our consideration of Duo County Telephone Cooperative Corporation, Inc. and subsidiaries' 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. No reports other than the reports referred to above have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that Duo County Telephone Cooperative Corporation, Inc. and subsidiaries failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, Policy on Audits of Rural Utilities Service Borrowers, &1773.33 clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding Duo County Telephone Cooperative Corporation, Inc. and subsidiaries' noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding Duo County Telephone Cooperative Corporation, Inc. and subsidiaries' accounting and records to indicate that Duo County Telephone Cooperative Corporation, Inc. and subsidiaries did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts;

Clear construction accounts and accrue depreciation on completed construction;

Record and properly price the retirement of plant;

Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Maintain adequate control over materials and supplies;

Prepare accurate and timely Financial and Operating Reports;

Obtain RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the telecommunication system;

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);

Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and

Comply with the requirements for the detailed schedule of investments. A detailed schedule of investments is as follows:

Diversified Holding is a wholly owned subsidiary which invests in businesses providing cellular telephone service and cable television service. The Cooperative accounts for the investment on the equity basis.

Bluegrass Network LLC represents the Cooperative's 20% investment in a partnership which provides cellular telephone service. The Cooperative accounts for the investment on the equity basis.

Investment in Subsidiary Company:  
 Original Investment Cost - 1997      \$            -

Investment Advances:

	<u>Diversified Holding Corp.</u>	<u>Bluegrass Network LLC</u>
12/31/90	\$ 3,400,000	\$ -
12/31/91	1,100,000	-
12/31/92	130,000	-
12/31/93	300,000	-
12/31/94	540,000	5,000
12/31/95	160,000	341,000
12/31/96	-	400,000
12/31/97	-	190,000
12/31/98	-	-
12/31/99	-	-
12/31/00	-	-
12/31/01	-	-
12/31/02	-	-
12/31/03	3,000,000	-
12/31/04	770,000	-
12/31/05	-	-
12/31/06	3,000,000	-
12/31/07	1,000,000	-
12/31/08	-	-
12/31/09	-	-
12/31/10	-	-
12/31/11	-	-
12/31/12	(6,000,000)	-
12/31/13	(6,000,000)	-
12/31/14	-	-
12/31/15	-	-
12/31/16	(2,000,000)	(200,000)
 Total Contributions	 \$ (600,000)	 \$ 736,000

Undistributed (Losses) Earnings:

	Diversified <u>Holding Corp.</u>	Bluegrass <u>Network LLC</u>
12/31/90	\$ 19,208	\$ -
12/31/91	89,940	-
12/31/92	(23,732)	-
12/31/93	14,582	-
12/31/94	122,030	-
12/31/95	469,230	158
12/31/96	600,451	15,389
12/31/97	876,694	32,110
12/31/98	678,663	182,619
12/31/99	844,128	216,047
12/31/00	662,365	193,730
12/31/01	788,508	149,778
12/31/02	984,763	146,181
12/31/03	958,217	141,384
12/31/04	2,055,836	231,989
12/31/05	2,877,511	257,798
12/31/06	4,777,093	248,792
12/31/07	5,683,016	288,504
12/31/08	6,490,036	386,497
12/31/09	6,945,556	424,140
12/31/10	7,336,840	389,346
12/31/11	7,174,008	557,902
12/31/12	7,549,307	654,364
12/31/13	5,054,551	631,435
12/31/14	3,876,399	689,259
12/31/15	4,789,291	789,910
12/31/16	8,083,924	499,125
Total Undistributed (Losses) Earnings	79,778,415	7,126,457
Original Investment and Investment Advances	1,400,000	936,000
Partnership Distribution as of 12/31/16	(2,000,000)	(2,412,883)
Book Value 12/31/16	\$79,178,415	\$ 5,649,574

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

*Campbell, Myers & Rutledge, PLLC*  
Glasgow, Kentucky

March 28, 2017



