

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

In the Matter of:

**ELECTRONIC APPLICATION OF PEOPLES RURAL)
TELEPHONE COOPERATIVE CORPORATION, INC.) CASE NO. 2017-00085
FOR A GENERAL ADJUSTMENT IN RATES)**

APPLICATION

Applicant Peoples Rural Telephone Cooperative Corporation, Inc. (“PRTC”), by counsel, pursuant to KRS 278.180, 807 KAR 5:001, Sections 14 and 16, and 807 KAR 5:011, Section 6, and consistent with the Public Service Commission of the Commonwealth of Kentucky’s (the “Commission”) May 29, 2013 order in Case No. 2013-00190 (the “2013 Rate Floor Order”) as well as with PRTC’s November 26, 2014 rate floor proceeding in Case No. 2014-00305 and its April 14, 2016 rate floor proceeding in Case No. 2016-00044, files this application (the “Application”) for authority to adjust its rates and charges for basic local exchange service and gives notice of its intention to increase the same rates and charges no later than June 1, 2017.

INTRODUCTION

This Application for a rate increase is necessitated by an order from the Federal Communications Commission (“FCC”) that fundamentally alters the cost structure of providing telecommunications services in high-cost rural areas, like those PRTC serves. *See In the Matter of Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov 18, 2011) (“ICC/USF Order”). For decades prior to the ICC/USF Order, high-cost carriers had received subsidies from the federal government’s “Universal Service Fund” (“USF”). Those USF subsidies were intended to fulfill the Federal Communications Act’s requirement that “[c]onsumers in all regions of the Nation, including . . . those in rural, insular,

and high cost areas, should have access to telecommunications and information services . . . that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.” 47 U.S.C. § 254(b)(3). The FCC found, however, that many rural consumers were paying rates that were less than those paid by consumers in urban areas. ICC/USF Order at ¶ 235. In consequence, the FCC’s ICC/USF Order sets a rate floor equal to the national average of local rates plus state regulated fees. *Id.* at ¶ 238. The ICC/USF Order also “limit[s] high-cost support where local end-user rates plus state regulated fees” do not meet that national rate floor; those carriers’ federal subsidies will be reduced “on a dollar-for-dollar basis . . . , to the extent that [the] carrier’s local rates (plus state regulated fees) do not meet the urban rate floor.” *Id.* at ¶ 239.

On June 10, 2014, the FCC altered the schedule for the imposition of rate floor penalties, effectively requiring carriers to ensure that their 2016 rate floor obligations are met no later than June 1, 2016. *See In the Matter of Connect America Fund et al.*, Report and Order, Declaratory Ruling, Order, Memorandum Opinion and Order, Seventh Order on Reconsideration, and Further Notice of Proposed Rulemaking, FCC 14-54, ¶¶ 79-80.

PRTC’s proposed rate adjustment is thus necessary to preserve its ability to receive these USF subsidies that are important to its ability to provide telephone and information services in its high-cost rural service territory. Without a minimum rate sufficient to meet the FCC’s new rate floor, high-cost carriers like PRTC will lose significant federal funding that has historically allowed these carriers to provide service to the most costly, rural customers. That loss of federal funding will threaten the financial existence of these rural carriers like PRTC, who have important obligations under federal and state law as carriers of last resort. Moreover, the loss of those subsidies would increase the pressure for PRTC to raise its rates even higher than the

federal rate floor sought here because any loss of federal funds would lead to a need for PRTC to make up that revenue directly from its customer-members.

* * * * *

In support of its Application, PRTC states as follows:

1. Pursuant to 807 KAR 5:001, Section 14(1): (i) the full name of the applicant is Peoples Rural Telephone Cooperative Corporation, Inc.; (ii) the mailing address of the applicant is 1080 Main Street South, P.O. Box 159, McKee, KY 40447-0159; and (iii) the electronic mailing address of the applicant is Keith.Gabbard@prtc.org.

2. Pursuant to 807 KAR 5:001, Section 14(2), PRTC states that it is currently in good standing in the Commonwealth of Kentucky, where it is incorporated. A certified copy of PRTC's Articles of Incorporation and all amendments thereto is on file with the Commission in Case No. 2014-00305.

3. Pursuant to 807 KAR 5:001, Section 16(1)(b)(1), PRTC provides the following statement of the reason the adjustment is requested. Further details are provided in Exhibit 1 of this Application.

a. PRTC was established in 1950 as a member owned cooperative to provide local telephone service to business and individual members within the exchanges of McKee, Annville, Booneville, and Sand Gap ("Service Territory"). PRTC is a rural incumbent local exchange carrier serving all of Owsley and Jackson Counties in eastern Kentucky. PRTC is a rural incumbent local exchange carrier serving all of Owsley and Jackson Counties in eastern Kentucky. At year-end 2016, PRTC provided 5,490 residential lines and 1,026 business lines to its members. PRTC is an eligible telecommunications carrier ("ETC") in the communities it serves and is also the carrier of last resort ("COLR") in its Service Territory. The Universal

Service Administrative Company reported that PRTC would receive \$3,690,138 universal service support including High Cost Loop Support (“HCLS”) to support its COLR responsibilities in its Service Territory for 2016 and \$3.4M in calendar year 2017.¹ As a high cost company, all HCLS revenues are crucial for the company to continue to meet its COLR responsibilities and to continue to bring advanced services to the communities it serves.

b. This proceeding was motivated by an order of the FCC that implemented “a rule to limit high-cost support where end-user rates do not meet a specified local rate floor.” See ICC/USF Order at ¶ 235.

c. Under the rule, local exchange carriers such as PRTC must meet a specified rate floor in each year in order to be eligible to receive the maximum possible amount of HCLS funding from the FCC. Failure to meet the rate floor by the deadline will result in a reduction in HCLS funding that the carrier could have otherwise received for that year. ICC/USF Order at ¶¶ 133, 238-40. Therefore, PRTC requires an adjustment of its rates to comply with the FCC’s 2017 rate floor, thereby maintaining eligibility for the 2017-2018 maximum amount of HCLS funding.

4. The requirements of 807 KAR 5:001, Section 16(1)(b)(2), are inapplicable because PRTC does not operate under an assumed name pursuant to KRS 365.015.

5. Pursuant to 807 KAR 5:001, Section 16(1)(b)(3), PRTC has attached its proposed tariff, in such form as is required by 807 KAR 5:011, as part of Exhibit 2. The proposed effective date of the proposed tariff is May 31, 2017, at least 30 days from the date the Application is filed.

¹ As of March 1, 2017: <http://www.universalservice.org/about/tools/fcc/filings/default.aspx>

6. Pursuant to 807 KAR 5:001, Section 16(1)(b)(4), PRTC has attached as part of Exhibit 2 its present tariff using italicizing, underscoring, and strikethroughs to show proposed revisions.

7. Pursuant to 807 KAR 5:001, Section 16(1)(b)(5), PRTC states that notice has been given in compliance with 807 KAR 5:001, Section 17, as described below:

a. Pursuant 807 KAR 5:001, Section 17(1), PRTC has posted at its place of business a copy of the Public Notice and will, within five days of the filing of the Application, post on its website a copy of the Public Notice and a hyperlink to the location on the Commission's website where the case documents are available. A copy of the Public Notice is attached hereto as part of Exhibit 3.

b. Pursuant to 807 KAR 5:001, Section 17(2), PRTC, which has more than twenty (20) customers and is not a sewage utility, has provided notice by has provided notice to its customers by including the notice with customer bills mailed no later than the date the Application is submitted to the Commission. A copy of the notice sent to customers is attached hereto as part of Exhibit 3.

c. Pursuant to 807 KAR 5:001, Section 17(3), an affidavit verifying PRTC's provision of the required notice to its customers is attached hereto as part of Exhibit 3.

d. Pursuant to 807 KAR 5:001, Section 17(4), PRTC states that the Public Notice attached to this Application as Exhibit 3 complies with all "Notice Content" requirements prescribed by regulation because it contains all of the following elements:

i. The proposed effective date and the date the proposed rates are expected to be filed with the Commission;

- ii. The present rates and proposed rates for each customer classification to which the proposed rates will apply;
- iii. The amount of the change requested in both dollar amounts and percentage change for each customer classification to which the proposed rates will apply;
- iv. The effect upon the average bill for each customer classification for the proposed rate change in basic local service;
- v. A statement that a person may examine this Application at PRTC's offices;
- vi. A statement that a person may examine this Application at the Commission's offices located at 211 Sower Boulevard, Frankfort, Kentucky, Monday through Friday, 8:00 a.m. to 4:30 p.m., or through the Commission's Web site at <http://psc.ky.gov>;
- vii. A statement that comments regarding the Application may be submitted to the Commission through its Web site or by mail to Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602;
- viii. A statement that the rates contained in this notice are the rates proposed by PRTC but that the Commission may order rates to be charged that differ from the proposed rates contained in the notice;
- ix. A statement that a person may submit a timely written request for intervention to the Public Service Commission, Post Office Box

615, Frankfort, Kentucky 40602, establishing the grounds for the request including the status and interest of the party; and

- x. A statement that if the Commission does not receive a written request for intervention within thirty (30) days of initial publication or mailing of the notice, the Commission may take final action on the Application.

8. The requirements of 807 KAR 5:001, Section 16(1)(b)(6), are inapplicable because PRTC is not a water district.

9. Pursuant to 807 KAR 5:001, Section 16(2), PRTC states that it notified the Commission in writing of its intent to file the Application on March 3, 2017, at least thirty (30) days but not more than sixty (60) days prior to filing the Application. A copy of the notice of intent is included as Exhibit 4 of this Application. Pursuant to 807 KAR 5:001, Section 16(2)(a), the notice of intent stated if the Application will be supported by a historical test period or a fully forecasted test period. Pursuant to 807 KAR 5:001, Section 16(2)(c), PRTC sent by electronic mail a .pdf copy of the notice of intent to the Attorney General's Office of Rate Intervention (rateintervention@ag.ky.gov) upon filing it with the Commission. A copy of this email, including the attached notice of intent, is included as part of Exhibit 4 of this Application.

10. The provisions of 807 KAR 5:001, Section 16(3), are inapplicable because PRTC is not an electric utility.

11. Pursuant to 807 KAR 5:001, Section 16(4)(a), a narrative summary of the particular circumstances that justify and support PRTC's Application, including a statement of the reason the adjustment is required, is attached hereto as Exhibit 1 and is incorporated herein

by reference. Exhibit 1 is filed subject to a Petition for Confidential Treatment pursuant to 807 KAR 5:001, Section 13, filed contemporaneously with this Application.

12. As more fully explained in PRTC's Motion for Waiver of Certain Rate Application Requirements ("Motion for Waiver") filed contemporaneously with this Application, PRTC seeks waiver of 807 KAR 5:001, Section 16(4)(b), requiring the applicant's witnesses' prepared testimony.

13. The requirements of 807 KAR 5:001, Section 16(4)(c) are inapplicable because PRTC has gross annual revenues in excess of \$5,000,000.00.

14. Pursuant to 807 KAR 5:001, Section 16(4)(d), PRTC estimates that the total amount of revenue resulting from the proposed rate adjustment will be a net increase of \$128,690.

15. The requirements of 807 KAR 5:001, Section 16(4)(e), are inapplicable because PRTC is not an electric, gas, sewage, or water utility.

16. Pursuant to 807 KAR 5:001, Section 16(4)(f), PRTC states that the proposed rate adjustment will increase the average residential affected customer bill by \$3.00 and the average business affected customer bill by \$3.90. Additional details regarding the anticipated impact on affected customers are set forth in Exhibit 1.

17. Pursuant to 807 KAR 5:001, Section 16(4)(g), PRTC states that PRTC's Residential and Business customer classes will be affected by the proposed rate adjustment. PRTC's analysis of customers' bills and the corresponding revenue impact are provided in PRTC's responses to the requirements of Section 16(4)(d) and 16(4)(f) in paragraphs 14 and 16 above.

18. Pursuant to 807 KAR 5:001, Section 16(4)(h), PRTC states that parts A and B of its 2016 RUS operating report containing its TIER calculation, which assesses PRTC's actual revenue position compared to its required operating revenues, is attached as Exhibit 5. To the extent the Commission believes this section imposes additional requirements relevant to this Application, PRTC respectfully seeks waiver of those requirements for the reasons set forth in its accompanying Motion for Waiver.

19. As more fully explained in PRTC's Motion for Waiver, PRTC seeks waiver of 807 KAR 5:001, Section 16(4)(i), requiring a reconciliation of the rate base and capital used to determine revenue requirements.

20. Pursuant to 807 KAR 5:001, Section 16(4)(j), PRTC states the its current chart of accounts was provided in Case 2014-00305 and is unchanged.

21. Pursuant to 807 KAR 5:001, Section 16(4)(k), a copy of PRTC's independent auditor's annual opinion report is included in Exhibit 6. The other requirements of this section are inapplicable because PRTC's independent auditor has not indicated "the existence of a material weakness in [PRTC]'s internal controls."

22. The requirements in 807 KAR 5:001, Section 16(4)(l), are inapplicable because PRTC has not been audited by the FCC.

23. Pursuant to 807 KAR 5:001, Section 16(4)(m), PRTC states that its most recent PSC Form T is on file with the Commission.

24. Pursuant to 807 KAR 5:001, Section 16(4)(n), PRTC states a schedule identifying current depreciation rates used by major plant accounts was provided in Case 2014-00305 and is unchanged. To the extent the Commission believes this section requires more information than

PRTC has provided, PRTC seeks waiver of 807 KAR 5:001, Section 16(4)(n) for the reasons set for in its Motion for Waiver.

25. Pursuant to 807 KAR 5:001, Section 16(4)(o), requiring a schedule of detailed information regarding all software, programs, and models used to prepare the Application, PRTC states that it utilized no specialized software, program, or models, and relied on Microsoft Word and Microsoft Excel to prepare the Application and supporting exhibits.

26. The requirements of 807 KAR 5:001, Section 16(4)(p), are inapplicable because PRTC has never made a stock or bond offering.

27. The requirements of 807 KAR 5:001, Section 16(4)(q), are inapplicable because PRTC does not provide a formal annual report to its members. Instead, PRTC invites its members to an annual meeting to review and discuss its operations. To the extent the Commission believes this section requires the provision of additional materials, PRTC seeks waiver of those requirements for the reasons set forth in its accompanying Motion for Waiver.

28. As more fully explained in PRTC's Motion for Waiver, PRTC seeks waiver of 807 KAR 5:001, Section 16(4)(r), requiring monthly managerial reports.

29. The requirements of 807 KAR 5:001, Section 16(4)(s), are inapplicable because PRTC is not required to file the U.S. Securities and Exchange Commission's Form 10-K, Form 8-K, or Form 10-Q.

30. The requirements of 807 KAR 5:001, Section 16(4)(t), are inapplicable because PRTC has not had any amounts charged or allocated to it by an affiliate or general or home office, and has not paid any monies to an affiliate or a general or home office during the test period or during the previous three (3) calendar years.

31. The requirements of 807 KAR 5:001, Section 16(4)(u), are inapplicable because PRTC is not an electric, gas, sewage, or water utility.

32. The requirements of 807 KAR 5:001, Section 16(4)(v), are inapplicable because PRTC has fewer than 50,000 access lines.

33. The requirements of 807 KAR 5:001, Section 16(5), are inapplicable because PRTC's Application does not include any pro forma adjustments. To the extent the Commission believes the requirements of this section apply to this Application, PRTC respectfully seeks waiver of those requirements for the reasons set forth in its accompanying Motion for Waiver.

34. The requirements of 807 KAR 5:001, Section 16(6), are inapplicable because PRTC is not requesting a general adjustment in rates supported by a fully forecasted test period.

35. The requirements of 807 KAR 5:001, Section 16(7), are inapplicable because PRTC is not requesting a general adjustment in rates supported by a fully forecasted test period.

36. The requirements of 807 KAR 5:001, Section 16(8), are inapplicable because PRTC is not requesting a general adjustment in rates supported by a fully forecasted test period.

37. Pursuant to ¶ 3.a of the 2013 Rate Floor Order, PRTC has provided an estimate of the annual revenue to be received in 2017 from HCLS in Exhibit 1, Attachment A.

38. Pursuant to ¶ 3.b of the 2013 Rate Floor Order, PRTC has provided an estimate of the annual revenue to be lost due to adjustment of terminating access rates in the "Financial Support for Filing" section of Exhibit 1.

39. Pursuant to ¶ 3.c of the 2013 Rate Floor Order, PRTC has provided an estimate of the annual revenue to be generated by the tariff changes in Exhibit 1 and in response to the requirements of 807 KAR 5:001, Section 16(4)(d), in paragraph 14 above.

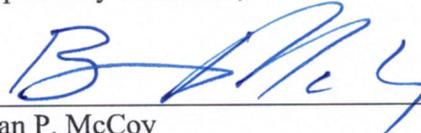
40. Pursuant to ¶ 3.d of the 2013 Rate Floor Order, PRTC has provided an estimate of historical line counts in Exhibit 1, Attachment B. As more fully explained in PRTC's Motion for Waiver, PRTC seeks partial waiver of ¶ 3.d of the 2013 Rate Floor Order, insofar as it requests projected line losses beyond those provided in Exhibit 1.

41. Pursuant to ¶ 3.e of the 2013 Rate Floor Order, PRTC has provided historical and projected Universal Service Support information in the narrative response of Exhibit 1 and in Attachment A thereto. As is certified annually to the Commission, these funds are used by PRTC to provide voice and advanced data services to its customers, thereby providing its communities with access to critical communications and broadband services.

42. Pursuant to ¶ 3.f of the 2013 Rate Floor Order, PRTC states that narrative support for the proposed rate adjustment is contained in this Application and in Exhibit 1

WHEREFORE, Peoples Rural Telephone Cooperative Corporation, Inc. respectfully requests that the Public Service Commission of the Commonwealth of Kentucky enter a final order approving PRTC's proposed revisions to the applicable tariffs and grant all other relief to which it is entitled.

Respectfully submitted,



Brian P. McCoy
Triplett & McCoy Law Office
464 Main St. South / P.O. Box 1294
McKee, KY 40447
T: 606-287-3280
F: 888-236-7146
brian@triplettmccoy.com
*Counsel to Peoples Rural Telephone
Cooperative Corporation, Inc.*

April 28, 2017

CERTIFICATE OF SERVICE

I certify that, on the date this Application was filed with the Kentucky Public Service Commission, a true and accurate copy of the foregoing was served by Federal Express or by hand delivery upon the persons listed below.

Kentucky Attorney General
Office of Rate Intervention
700 Capitol Avenue, Suite 118
Frankfort, Kentucky 40601-3449

On this the 28th day of April, 2017.



*Counsel for Peoples Rural Telephone Cooperative
Corporation, Inc.*

Company information

The full name and address the company is Peoples Rural Telephone Coop. Corp., Inc. (“PRTC”), 1080 Main Street South, P.O. Box 159, McKee, KY 40447-0159. PRTC was established in 1950 as a member-owned cooperative to provide local telephone service to business and individual members within the exchanges of McKee, Annville, Booneville, and Sand Gap (“Service Territory”). PRTC is a rural incumbent local exchange carrier serving all of Owsley and Jackson Counties in eastern Kentucky. At year-end 2016, PRTC provided 5,490 residential lines and 1,026 business lines to its members.

PRTC is an eligible telecommunications carrier (“ETC”) in the communities it serves and is also the carrier of last resort (“COLR”) in its Service Territory. The Universal Service Administrative Company reported that PRTC would receive \$3,690,138 in universal service support including High Cost Loop Support (“HCLS”) to support its COLR responsibilities in its Service Territory for 2016 and \$3.4M in calendar year 2017.¹ As a high cost company, all HCLS revenues are crucial for the company to continue to meet its COLR responsibilities and to continue to bring advanced services to the communities it serves. As discussed below, PRTC’s receipt of its full HCLS support requires it to meet minimum pricing levels imposed by the Federal Communications Commission (“FCC”).

A schedule of the company’s quarterly high cost support is provided in Attachment A of this Exhibit. Historic access line counts as reported to the National Exchange Carrier Association, are provided in Attachment B.

¹ As of March 1, 2017: <http://www.universalservice.org/about/tools/fcc/filings/default.aspx>

Description and Reason for Filing

With this filing, PRTC proposes to increase its basic residential local service rates by \$3.00, to \$21.00 per month and to raise business rates by \$3.90 to \$25.00. PRTC will offset this increase to its members by expanding local calling area to include the entire state of Kentucky. Additionally, the company will provide all of its members with voicemail service, a savings of \$3.95 per month.

This filing is made in response to the FCC's November 18, 2011 order (the "Transformation Order")² mandating minimum local residential service rate levels as a condition to continued receipt of certain federal universal service support. The FCC ordered that Local Exchange Carriers would remain eligible to receive HCLS in a study area only if their rates for residential local exchange service are at or above the rate floor on June 1 of every year, beginning in 2012.³ Failure to meet the rate floor results in forfeiture of the HCLS that the carrier would have otherwise received for that year.⁴ The rate floors were established as follows: \$10.00, effective June 1, 2012; \$14.00, effective June 1, 2013; \$16.00, effective December 1, 2014; \$18.00 effective June 1, 2016; and \$20.00 effective June 1, 2017.⁵

This is PRTC's third rate increase necessitated by the FCC's rate floor. In its 2014 filing,⁶ PRTC offset its rate increase with improvements to broadband speeds and the inclusion

² *In the Matter of Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov. 18, 2011).

³ See Transformation Order; *Wireline Competition Bureau Announces Results of Urban Rate Survey for Voice Services; Seeks Comment on Petition for Extension of Time to Comply with New Rate Floor*, Public Notice, DA 14-384 (March 20, 2014) (establishing 2014 Rate Floor); Report and Order, Declaratory Ruling, Order, Memorandum Opinion And Order, Seventh Order On Reconsideration, and Further Notice of Proposed Rulemaking, FCC 14-54 (June 10, 2014) ("Reconsideration Order") (modifying 2014 Rate Floor to allow for a phase-in of the residential rate floor).

⁴ Transformation Order at ¶ 239

⁵ Reconsideration Order at ¶ 80.

⁶ See generally, *In the Matter of: Tariff Filing of Peoples Rural Telephone Cooperative Corporation, Inc.* KY P.S.C. Case 2014-00305

of Caller ID with its basic service package; in its 2016 filing,⁷ PRTC offset its increase by expanding local calling to twenty-four adjacent exchanges.⁸ Absent a stay by the FCC, PRTC will be forced to request a fourth local rate increase to a yet to be determined urban rate in June, 2018.

Proposed Revisions and Customer Impact

With this filing, PRTC proposes to raise its residential rates by \$3 to \$21.00, satisfying the 2017 residential rate floor of \$20.00, and its business rates by \$3.90 to \$25.00.

PRTC anticipates that its average residential subscriber will have an 8.9% increase in monthly local service charges and its business customers will have an increase of 10.3%.⁹ In order to mitigate the effect of the increases, PRTC proposes to again provide value-added benefits to its all of subscribers by increasing the number of exchanges included as extended area service (“EAS”) to allow PRTC’s subscribers to enjoy toll-free calling state wide. By doing so, PRTC will provide its members with an EAS area that will convert more than half its remaining toll routes to local; combined with its prior filing, nearly 80% of the historic domestic toll calling by its subscribers will cease to be billable calls effective with this change. PRTC believes

The FCC’s Transformation Order is intended to raise all local rates to be comparable to the national “urban average.” This EAS expansion will allow PRTC to provide a correspondingly urban level of local calling. Additionally, because the Transformation Order currently anticipates another rate increase in June, 2018, PRTC’s proposed increase to its residential subscribers may allow it to avoid, or at least minimize, its need to raise rates yet again next year.

⁷ See generally, *In the Matter of: Tariff Filing of Peoples Rural Telephone Cooperative Corporation, Inc.* KY P.S.C. Case 2016-00044

⁸ See generally, *In the Matter of: Tariff Filing of Peoples Rural Telephone Cooperative Corporation, Inc.* KY P.S.C. Case 2016-00044

⁹ When measured against the typical service. Approximately 5-10% of PRTC subscribers purchase only a basic phone line from the company. The remainder purchase additional services, including features, long distance calling, broadband and other services that are not included in the base percentage for this rate change.

Financial Impact

As a consequence of expanding its EAS calling scope, PRTC will forgo intrastate originating switched access fees previously billed to the interexchange carriers on routes it will convert from toll to EAS. Additionally, to terminate the traffic to these exchanges, PRTC will pay a contracted interexchange carrier as its underlying service provider. Hence, the terminating charges and the lost interexchange carrier revenues are costs that PRTC expects to incur in expanding its EAS calling.

PRTC proposes to raise rates for residential and business subscribers to \$21.00 and \$25.00, respectively and to provide state-wide local calling. While its proposed local rate increases are above what are mandated by the 2017 rate floor, they are balanced by the cost of its expanded EAS and the value of the expanded toll to PRTC's subscribers.

In its 2016 EAS expansion, PRTC estimated that its residential rate increase minus its cost of expanding EAS would generate a modest annual net loss of \$21K. After its 2016 EAS expansion, however, PRTC experienced a 137% increase in calls on its network to the newly converted local calling areas – far above the stimulation it had anticipated. As a result, PRTC's annual loss associated with its expanded calling is more than double its previous estimate of \$21K. The volume of traffic carried on its network suggests that the company's effort to bring value to its members has been largely successful, PRTC is seeking to balance the costs of its local calling expansions with local rate increases. Accordingly, PRTC is seeking an increase of \$3 – \$1 more than the 2017 rate floor requires – for its residential subscribers and \$3.90 for its business customers. PRTC will also provide voicemail to all of its residential and business subscribers.

Depending on their individual calling needs and rates paid for toll charges, PRTC expected its 2016 and 2017 rate rebalancing filings would offer an opportunity for its members to reduce their monthly telephone service charges by converting previously billed toll to unbilled EAS while bringing customer traffic back onto its landline telephone network. As the larger consumer of long distance, PRTC's business customers in particular are expected to enjoy the greatest savings for state-wide calling. Following its last rate floor filing and expanded local calling, PRTC's monthly toll bills to its long distance customers was reduced by approximately \$5 per line. Accordingly, the rates proposed in this filing reflect the balance of the value added services PRTC seeks to provide its members.

As described in Attachment C of this Exhibit, PRTC estimates that its residential and business rate increases minus the costs associated with its greatly expanded calling area will create a net impact of approximately \$128,690 per year. Even without the expanded EAS offset, however, as shown in the financial support section of this Exhibit, the impact of the FCC's Transformation Order warrants the rate increase proposed in this filing.

Financial Support for Filing

The FCC's Transformation Order included two requirements that had an immediate impact on state revenues and local service. First, the Transformation Order imposed financial penalties on companies that fail to meet the annual residential rate floor. Second, the Transformation Order capped and reduced charges associated with state access and reciprocal compensation. Combined, these items reduced state revenues and introduced additional potential losses that put pressure on PRTC to raise its local service rates to meet the FCC's rate floor.

Beginning in June 2017, companies that fail to meet the 2017 rate floor will lose a dollar in HCLS funding for every dollar they are below the residential rate floor. PRTC is seeking to

increase its local exchange rates to meet the rate floor and avoid a reduction in its HCLS. As shown below, raising its residential rates allows PRTC to avoid losing \$131,760 per year in HCLS, which constitutes approximately 4% of its total anticipated Universal Service Support.

	Subscribers	Current Rate	FCC Floor	Retained HCLS
Residential Based on year end 2016	5,490	\$ 18.00	\$ 20.00	\$ 131,760
Annual Universal Service Support (See Attachment 1)				\$3,387,018
Support at risk absent a rate increase				4%

Included in the FCC’s Transformation Order is a requirement that carriers cap and reduce their reciprocal, state, and interstate inter-carrier compensation rates (“Access Cap”). The initial Access Cap was based on fiscal year 2011 revenues.¹⁰ As mandated by the FCC, the Access Cap is reduced by 5% *each year*. As shown in the step-down of Eligible Access Recovery (as depicted in the following table), the cumulative FCC-mandated reduction in PRTC’s access revenue recovery through the upcoming fiscal period ending June, 2018 is [REDACTED].

	Access Cap	Incremental Reduction	Cumulative Reduction	Percent Lost
FY2011 10/1-9/30	[REDACTED]			
7/2012 - 6/2013	[REDACTED]	[REDACTED]	[REDACTED]	-5%
7/2013 - 6/2014	[REDACTED]	[REDACTED]	[REDACTED]	-10%
7/2014 - 6/2015	[REDACTED]	[REDACTED]	[REDACTED]	-14%
7/2015 - 6/2016	[REDACTED]	[REDACTED]	[REDACTED]	-19%
7/2016 - 6/2017	[REDACTED]	[REDACTED]	[REDACTED]	-23%
7/2017 - 6/2018	[REDACTED]	[REDACTED]	[REDACTED]	-26%
Six-year Aggregate Reduction				

This is the third rate increase filed by PRTC to meet the FCC residential rate floor. In its December 1, 2014 and June 1, 2016 filings, PRTC forecast a net increase in revenues of \$79K per year, and experienced net *reduction* of \$45K per year, respectively. This filing expands the

¹⁰ October 1, 2010 through September 30, 2011.

definition of local calling to be state-wide, creating net revenues of \$129K per year. As shown above, however, PRTC's aggregate net revenue increases resulting from its three filings remain well below the cumulative reduction in access revenues. Combined, the three filings have resulted in anticipated net revenues of \$312K through the 2017-2018 fiscal period; [REDACTED] in cumulative FCC-mandated reduction in its access revenue recovery for the same period.

Summary

The FCC's Transformation Order continues to dramatically change the revenue sources that have been historically available to high cost rural telephone companies like PRTC and which have been used to meet their COLR obligation and to expand the availability of advanced broadband services to their customers. Unfortunately, for many of these affected companies, doing so requires upward pressure on local service rates. Because PRTC faces competition and is a not-for-profit, member-owned cooperative, the company would not have chosen to impose rate increases on its subscribers absent compelling pressure from the FCC. As shown in this documentation, PRTC has no realistic options except to meet the FCC's 2017 Rate Floor, and it is proposing reasonable measures to mitigate the effects of the rate change. For these reasons, PRTC respectfully requests that its tariff revisions be approved.

Attachments to this Exhibit:

Attachment A: Company's Quarterly Universal Service Support 2016-2017

Attachment B: National Exchange Carrier Association Report of Access Lines

Attachment C: Rate Design Exhibit

**Peoples Rural Telephone Cooperative
Case 2017-00085**

Exhibit 1, Attachment A

Report Cycle	State	SAC	Study Area Name	Connect America Fund ICC Monthly Support	HCL Monthly Support	ICLS Monthly Support	Total High Cost Monthly	HCL Quarterly Support
1Q16	KY	260415	PEOPLES RURAL COOP	\$ 142,102	\$ 314,576	\$ 215,176	\$ 671,854	\$ 943,728
2Q16	KY	260415	PEOPLES RURAL COOP	\$ 142,102	\$ 306,404	\$ 215,176	\$ 663,682	\$ 919,212
3Q16	KY	260415	PEOPLES RURAL COOP	\$ 142,102	\$ 294,490	\$ 228,434	\$ 665,026	\$ 883,470
4Q16	KY	260415	PEOPLES RURAL COOP	\$ 142,102	\$ 314,576	\$ 215,176	\$ 671,854	\$ 943,728
2016 Annualized Total High Cost Loop Support								\$ 3,690,138

1Q17	KY	260415	PEOPLES RURAL COOP	\$ 120,104	\$ 283,991	\$ 209,649	\$ 613,744	\$ 851,972
2Q17	KY	260415	PEOPLES RURAL COOP	\$ 120,104	\$ 280,512	\$ 209,649	\$ 610,265	\$ 841,537
2017 Annualized Total High Cost Loop Support								\$ 3,387,018

Exhibit 1, Attachment B has been omitted from the public filing. It has been provided under a petition for confidential treatment

Peoples Rural Telephone Cooperative
Case 2017-00085

Exhibit 1, Attachment C

End User Rate Revisions	Demand	Current	Proposed	Impact	Monthly	Annualized
Residential Lines	4,666	\$ 18.00	\$ 21.00	\$ 13,998		
Business Lines	1,004	\$ 21.10	\$ 25.00	\$ 3,916		
Local Exchange Revenue	5,670			\$ 17,914	\$ 17,914	\$ 214,963

EAS Expansion Cost	Demand	Rate	Impact	Monthly	Annualized
Lost Originating Access (Exc. Stimulation)		\$ 0.03320			
Cost to Terminate Stimulation:				\$ 7,189	\$ (86,274)
Net Monthly Impact (ignores Attrition)				\$ 10,724	\$ 128,690

**Peoples Rural Telephone Cooperative
Case 2017-00085**

Exhibit 2

- Proposed Tariff Pages (Proposed)
- Proposed Tariff Pages (Proposed with Black Line)

Proposed Tariff Pages (To be Filed)

LOCAL EXCHANGE SERVICE

III. LOCAL EXCHANGE SERVICE RATES AND CHARGES

1. The rates quoted herein also entitle the subscribers of this exchange to call, without additional charge, subject to usage caps provided for in (2), below, the exchanges listed in Section C of this Tariff.
2. Services are for normal residential and business use, exclusive of autodialing, telemarketing, or other similar services that would generate unusually high volumes of outbound traffic. The Company reserves the right to identify and modify the terms of service to subscribers identified as exceeding typical usage including the introduction of usage caps, if necessary.

A. Residence Monthly Local Exchange Access Line Rates (1)

<u>Exchange</u>	<u>NPA/NXX</u>	<u>1-Party</u>
McKee	(606-287)	\$21.00 (I)
Annville	(606-364)	\$21.00 (I)
Sand Gap	(606-965)	\$21.00 (I)
Boonville	(606-593)	\$21.00 (I)

(1) Rates for Access Line Service do not include a charge for an instrument or other customer premises equipment.

Issue Date: April 28, 2017
Effective Date: May 31, 2017

Issued by: /s/ Keith Gabbard
Keith Gabbard, Manager

By Authority of Order of the Public Service Commission in
Case No. 2017-00085 dated _____.

LOCAL EXCHANGE SERVICE

III. LOCAL EXCHANGE SERVICE RATES AND CHARGES

C. LOCAL CALLING AREAS

All Company exchanges will receive local calling to any exchange within the State of
Kentucky.

(C)
|
(C)

Issue Date: April 28, 2017
Effective Date: May 31, 2017

Issued by: /s/ Keith Gabbard
Keith Gabbard, Manager

By Authority of Order of the Public Service Commission in
Case No. 2017-00085 dated _____.

LOCAL EXCHANGE SERVICE

III. LOCAL EXCHANGE SERVICE RATES AND CHARGES (continued)

B. Business Monthly Local Exchange Access Line Rates (1)

<u>Exchange</u>	<u>NPA/NXX</u>	<u>1-Party</u>	<u>PBX</u>
McKee	(606-287)	\$25.00 (I)	\$34.00
Annville	(606-364)	\$25.00 (I)	\$34.00
Sand Gap	(606-965)	\$25.00 (I)	\$34.00
Boonville	(606-593)	\$25.00 (I)	\$34.00

(1) Rates for Access Line Service do not include a charge for an instrument or other customer premises equipment.

Issue Date: April 28, 2017

Effective Date: May 31, 2017

Issued by: /s/ Keith Gabbard

Keith Gabbard, Manager

By Authority of Order of the Public Service Commission in
Case No. 2017-00085 dated _____.

Proposed Tariff Pages (with Black Line)

LOCAL EXCHANGE SERVICE

III. LOCAL EXCHANGE SERVICE RATES AND CHARGES

1. The rates quoted herein also entitle the subscribers of this exchange to call, without additional charge, subject to usage caps provided for in (2), below, the exchanges listed in Section C of this Tariff.
2. Services are for normal residential and business use, exclusive of autodialing, telemarketing, or other similar services that would generate unusually high volumes of outbound traffic. The Company reserves the right to identify and modify the terms of service to subscribers identified as exceeding typical usage including the introduction of usage caps, if necessary.

A. Residence Monthly Local Exchange Access Line Rates (1)

<u>Exchange</u>	<u>NPA/NXX</u>	<u>1-Party</u>
McKee	(606-287)	\$18.00 <u>\$21.00 (I)</u>
Annville	(606-364)	\$18.00 <u>\$21.00 (I)</u>
Sand Gap	(606-965)	\$18.00 <u>\$21.00 (I)</u>
Boonville	(606-593)	\$18.00 <u>\$21.00 (I)</u>

(1) Rates for Access Line Service do not include a charge for an instrument or other customer premises equipment.

Issue Date: ~~April 18, 2016~~ April 28, 2017
Effective Date: ~~June 1, 2016~~ May 31, 2017

Issued by: /s/ Keith Gabbard
Keith Gabbard, Manager

By Authority of Order of the Public Service Commission in
Case No. 2017-00085 dated _____.

LOCAL EXCHANGE SERVICE

III. LOCAL EXCHANGE SERVICE RATES AND CHARGES

C. LOCAL CALLING AREAS

All Company exchanges will receive local calling to ~~the areas listed below:~~ any exchange within the State of Kentucky. (C)

(C)

Annville
Beattyville
Berea
Boonville
Brodhead
Buckhorn
Canoe
Corbin
Dwarf
E. Bernstadt
Hazard
Irvine
Jackson
Kirksville
Leatherwood
Livingston
London
Manchester
McKee
Mt Vernon
Oneida
Richmond
Sand Gap
Viceo
Waco

Issue Date: ~~April 18, 2016~~ April 28, 2017
Effective Date: ~~June 1, 2016~~ May 31, 2017

Issued by: /s/ Keith Gabbard
Keith Gabbard, Manager

By Authority of Order of the Public Service Commission in
Case No. 2017-00085 dated _____.

LOCAL EXCHANGE SERVICE

III. LOCAL EXCHANGE SERVICE RATES AND CHARGES (continued)

B. Business Monthly Local Exchange Access Line Rates (1)

<u>Exchange</u>	<u>NPA/NXX</u>	<u>1-Party</u>	<u>PBX</u>
McKee	(606-287)	\$21.10 <u>25.00</u> (I)	\$34.00
Annville	(606-364)	\$21.10 <u>25.00</u> (I)	\$34.00
Sand Gap	(606-965)	\$21.10 <u>25.00</u> (I)	\$34.00
Boonville	(606-593)	\$21.10 <u>25.00</u> (I)	\$34.00

(1) Rates for Access Line Service do not include a charge for an instrument or other customer premises equipment.

Issue Date: ~~April 18, 2016~~April 28, 2017

Effective Date: ~~June 1, 2016~~May 31, 2017

Issued by: /s/ Keith Gabbard
Keith Gabbard, Manager

By Authority of Order of the Public Service Commission in
Case No. 2017-00085 dated _____.



CUSTOMER NOTICE AFFIDAVIT

AFFIDAVIT

I, Jodi Gabbard, am a representative of Peoples Rural Telephone Coop. Corp., Inc., and am authorized to make this statement on its behalf.

I attest that the customer notice accompanying this affidavit was sent to all customers as a bill insert on April 28, 2017, in accordance with Section 17(2) of 807 KAR 5:001. I declare under penalty of perjury that the foregoing is true and correct.

Signature: Jodi Gabbard

Subscribed and sworn to me before this 28th day of April, 2017.



Mick Bingham
Notary Republic

My commission expires: 5-20-20

General Manager: Keith Gabbard

P.O. Box 159 U.S. Highway 421 McKee, Kentucky 40447

McKee: (606) 287-7101 Booneville: (606) 593-5000

Fax: (606) 287-8332 Email: prtc@prtcnet.org

On or around April 28, Peoples Rural Telephone Coop. Corp., Inc. will file with the KY Public Service Commission an increase in basic local service rates charged to residential subscribers due to a Federal Communication Commission mandate. With this change, residential rates are proposed to increase by \$3 from \$18 to \$21. Business rates are proposed to increase \$3.90 from \$21.10 to \$25. If approved by the PSC, the effective date of this rate change will be May 31, 2017. We anticipate the average residential and business increases will be 8.9% and 10.3%, respectively, however based on their calling patterns, many of our members may actually see a reduction in their bills.

With this change all calls within the state of Kentucky will become local calls and you will no longer be charged toll for completing direct dialed calls anywhere in the Commonwealth, regardless of who your long distance carrier is.

This increase is mandated by recent changes enacted by the Federal Communications Commission which set minimal local service rate levels as a condition of continued receipt of federal high cost support that allows us to deploy fiber optic facilities and support advanced voice and broadband services. Because this support is vital to the economic health of our community, we had no choice but to request this rate increase.

You may examine this application at the offices of Peoples Rural Telephone Coop. Corp., Inc. located at 1080 Main Street South, McKee, KY 40447 during regular business hours or at the offices of the Kentucky Public Service Commission located at 211 Sower Boulevard, Frankfort, Kentucky, Monday through Friday, 8:00 a.m. to 4:30 p.m., or through the commission's Web site at <http://psc.ky.gov>.

Comments regarding the application may be submitted to the Public Service Commission through its Web site or by mail to Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602. Rates contained in this notice are the rates proposed by the Company but the Public Service Commission may order rates to be charged that differ from the proposed rates contained in this notice.

You may submit a timely written request for intervention to the Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602, establishing the grounds for the request including the status and interest of the party. If the Commission does not receive a written request for intervention within thirty (30) days of initial publication or mailing of this notice, the Commission may take final action on the application.

Eileen Bodamer

From: Eileen Bodamer
Sent: Friday, March 03, 2017 11:41 AM
To: 'rateintervention@ag.ky.gov'
Cc: Keith.Gabbard@prtc.org
Subject: Notice of Intent to file CASE 2017-00085
Attachments: PRTC LOI.pdf

Please accept the attached letter as notice of intent to file a general adjustment in rates.

Eileen M Bodamer



770.649.1886 / (f) 770.645.6545 / mobile 770.363.5870
415 Hepplewhite Dr., Johns Creek GA 30022



Executive Director Talina R. Matthews
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

March 3, 2017

Subject: Case No. 17-00085

Dear Executive Director Matthews:

Peoples Rural Telephone Cooperative gives this notice pursuant to 807 KAR 5:001 Section 16(2) of its intent to file no sooner than thirty (30) days from today, but not more than sixty (60) days from today, an application for a general adjustment in its rates. The general adjustment in rates will be supported by a twelve (12) month historical test period that may include adjustments for known and measurable changes.

The anticipated rate application is intended to meet the rate floor mandated in 47 CFR § 54.318, compliance with which is required to ensure that Peoples Rural Telephone Cooperative continues to receive high cost support that is essential to its operations. (See In the matter of Connect America Fund, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov. 18, 2011).)

The FCC's June 10, 2014 Order (See Report and Order, Declaratory Ruling, Order, Memorandum Opinion and Order, Seventh Order On Reconsideration, and Further Notice of Proposed Rulemaking, FCC 14-54) requires TELCO to have reported line rates greater than or equal to \$20, commencing July 1, 2017 (reflecting rates as of June 1, 2017)¹.

A copy of this notice is being emailed to the Attorney General's Office of Rate Intervention by electronic mail at rateintervention@ag.ky.gov.

Please refer any questions to me at 606 287-5401 or keith.gabbard@prtc.org

Sincerely,

A handwritten signature in blue ink, appearing to read "Keith Gabbard".

Keith Gabbard, CEO

Cc via email: Eileen Bodamer, Bodamer Consulting

General Manager: Keith Gabbard

P.O. Box 159 U.S. Highway 421 McKee, Kentucky 40447

McKee: (606) 287-7101 Booneville: (606) 593-5000

Fax: (606) 287-8332 Email: prtc@prtcnet.org



NAVIGATION

- Reports**
- Op. Report-Telecom
- Certification
- Point Of Contact
- Part A
- Part B
- Part C
- Part D
- Part E
- Part F
- Part G
- Part H
- Part I
- Notes

Part A: Balance Sheet

Your response is required by 7 U.S.C. 901 et seq. and subject to federal laws and regulations regarding confidential information, will be treated as confidential. Complete the following fields, and press the 'Save' button when finished. The Balance Prior Year figures have been brought forward from the December 2015 submission and cannot be edited here. If these figures need to be corrected please revise them in that submission and resubmit.

ASSETS	Balance Prior Year	Balance End of Period	LIABILITIES AND STOCKHOLDERS' EQUITY	Balance Prior Year	Balance End of Period
CURRENT ASSETS			CURRENT LIABILITIES		
1. Cash and Equivalents	6,494,159	10,137,023	25. Accounts Payable	281,971	252,352
2. Cash-RUS Construction Fund	384,802	434,364	26. Notes Payable		
3. Affiliates:			27. Advance Billings and Payments	60,250	141,557
a. Telecom, Accounts Receivable	390,429	298,336	28. Customer Deposits		
b. Other Accounts Receivable			29. Current Mat. L/T Debt	3,840,415	6,208,508
c. Notes Receivable			30. Current Mat. L/T Debt-Rur. Dev.		
4. Non-Affiliates:			31. Current Mat.-Capital Leases		
a. Telecom, Accounts Receivable			32. Income Taxes Accrued		
b. Other Accounts Receivable			33. Other Taxes Accrued	436,570	393,231
c. Notes Receivable			34. Other Current Liabilities	562,003	749,856
5. Interest and Dividends Receivable			35. Total Current Liabilities (25 thru 34)	5,183,209	7,745,504
6. Material-Regulated	329,618	787,185	LONG-TERM DEBT		
7. Material-Nonregulated	424,412	66,787	36. Funded Debt-RUS Notes	14,057,380	5,867,271
8. Prepayments	17,243	61,240	37. Funded Debt-RTB Notes		
9. Other Current Assets			38. Funded Debt-FFB Notes		
10. Total Current Assets (1 thru 9)	10,040,663	11,784,935	39. Funded Debt-Other		
NONCURRENT ASSETS			40. Funded Debt-Rural Develop. Loan		
11. Investment in Affiliated Companies			41. Premium (Discount) on L/T Debt		
a. Rural Development			42. Reacquired Debt		
b. Nonrural Development	25,241,058	28,874,654	43. Obligations Under Capital Lease		
12. Other Investments			44. Adv. From Affiliated Companies		
a. Rural Development			45. Other Long-Term Debt		
b. Nonrural Development			46. Total Long-Term Debt (36 thru 45)	14,057,380	5,867,271
13. Nonregulated Investments	1,526,403	1,572,638	OTHER LIABILITIES & DEF. CREDITS		
14. Other Noncurrent Assets			47. Other Long-Term Liabilities	8,913,068	9,228,092
15. Deferred Charges		1,055,001	48. Other Deferred Credits		
16. Jurisdictional Differences			49. Other Jurisdictional Differences		
17. Total Noncurrent Assets (11 thru 16)	26,767,461	31,502,293	50. Total Other Liabilities and Deferred Credits (47 thru 49)	8,913,068	9,228,092
PLANT, PROPERTY, AND EQUIPMENT			EQUITY		
18. Telecom, Plant-in-Service	77,304,357	72,043,368	51. Cap. Stock Outstand & Subscribed		
19. Property Held for Future Use			52. Additional Paid-in Capital		
20. Plant Under Construction	383,388	450,724	53. Treasury Stock		
21. Plant Adj., Nonop. Plant & Goodwill			54. Membership and Cap. Certificates	214,740	217,010
22. Less Accumulated Depreciation	36,729,279	34,501,260	55. Other Capital		
23. Net Plant (18 thru 21 less 22)	40,958,476	37,992,832	56. Patronage Capital Credits	43,388,322	49,461,751
24. Total Assets (10+17+23)	77,786,600	81,280,060	57. Retained Earnings or Margins	6,009,881	8,760,432
			58. Total Equity (51 thru 57)	49,612,943	58,439,193
			59. Total Liabilities and Equity (35+46+50+58)	77,786,600	81,280,060

Total Equity = 71.9 % of Total Assets



NAVIGATION

- Reports**
- Op. Report-Telecom
- Certification
- Point Of Contact
- Part A
- Part B
- Part C
- Part D
- Part E
- Part F
- Part G
- Part H
- Part I
- Notes

Part B: Statements of Income and Retained Earnings or Margins

Your response is required by 7 U.S.C. 901 et seq. and subject to federal laws and regulations regarding confidential information, will be treated as confidential. Complete the following fields, and press the 'Save' button when finished. The Prior Year figures have been brought forward from the December 2015 submission and cannot be edited here. If these figures need to be corrected please revise them in that submission and resubmit.

Item	Prior Year	This Year
1. Local Network Services Revenues	5,614,470	5,817,008
2. Network Access Services Revenues	7,792,184	6,719,011
3. Long Distance Network Services Revenues	2,869,373	3,613,132
4. Carrier Billing and Collection Revenues	264,774	186,647
5. Miscellaneous Revenues	194,577	53,849
6. Uncollectible Revenues	44,936	39,338
7. Net Operating Revenues (1 Thru 5 Less 6)	16,690,442	16,350,309
8. Plant Specific Operations Expense	3,715,959	3,833,140
9. Plant Nonspecific Operations Expense (Excluding Depreciation & Amortization)	1,465,379	1,598,884
10. Depreciation Expense	3,897,993	4,422,821
11. Amortization Expense		
12. Customer Operations Expense	1,077,003	1,054,747
13. Corporate Operations Expense	1,592,239	1,734,783
14. Total Operating Expenses (8 Thru 13)	11,648,573	12,644,375
15. Operating Income or Margins (7 less 14)	4,641,869	3,705,934
16. Other Operating Income and Expense		
17. State and Local Taxes		
18. Federal Income Taxes		
19. Other Taxes	1,894,324	5,477,115
20. Total Operating Taxes (17+18+19)	1,894,324	5,477,115
21. Net Operating Income or Margins (15+16-20)	2,947,545	(1,771,181)
22. Interest on Funded Debt	640,505	620,046
23. Interest Expense - Capital Leases		
24. Other Interest Expense		
25. Allowance for Funds Used During Construction		
26. Total Fixed Charges (22+23+24-25)	640,505	620,046
27. Nonoperating Net Income	5,574,783	13,051,710
28. Extraordinary Items		
29. Jurisdictional Differences		
30. Nonregulated Net Income	(1,871,942)	(1,900,051)
31. Total Net Income or Margins (21+27+28+29+30-26)	6,009,881	8,760,432
32. Total Taxes Based on Income		
33. Retained Earnings or Margins Beginning-of-Year		
34. Miscellaneous Credits Year-to-Date		
35. Dividends Declared (Common)		
36. Dividends Declared (Preferred)		
37. Other Debits Year-to-Date		
38. Transfers to Patronage Capital		
39. Retained Earnings or Margins End-Of-Period [(31+33+34)-(35+36+37+38)]	6,009,881	8,760,432
40. Patronage Capital Beginning-of-Year	32,325,481	31,905,473
41. Transfers to Patronage Capital		
42. Patronage Capital Credits Retired	420,006	557,057
43. Patronage Capital End-Of-Year (40+41-42)	31,905,473	31,348,416
44. Debt Service Payments for the period(principal interest on long term debt)	3,840,415	6,208,508
45. Cash Ratio [(14+20-10-11) / 7]	0.5839	0.8378
46. Operating Accrual Ratio [(14+20+26) / 7]	0.8618	1.1482

Kentucky 514
Peoples Rural Telephone
Cooperative Corporation
McKee, Kentucky
Audited Financial Statements
December 31, 2016 and 2015

Alan M. Zumstein
Certified Public Accountant
1032 Chetford Drive
Lexington, Kentucky 40509

CONTENTS

Independent Auditors' Report	1 - 2
Restated Consolidated Financial Statements:	
Balance Sheets	3
Statements of Revenue and Comprehensive Income	4
Statements of Changes in Member's Equities	5
Statements of Cash Flows	6
Notes to Financial Statements	7 - 14
Supplementary Information	
Additional Consolidating Information:	
Balance Sheet	15
Statement of Revenue and Comprehensive Income	16
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	17 - 18
Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Telephone Borrowers	19 - 20

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

Independent Auditor's Report

To the Board of Directors
Peoples Rural Telephone Cooperative

Report on the Financial Statements

I have audited the accompanying financial statements of Peoples Rural Telephone Cooperative Corporation and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audits. I did not audit the financial statements of East Kentucky Network, LLC. As discussed in Note 2, these financial statements account for an investment in East Kentucky Network, LLC under the equity method. The investment was \$27,263,709 and \$23,841,504 at December 31, 2016 and 2015 respectively, and the equity in its net margins was \$12,851,898 and \$5,525,905 for the years then ended. The financial statements of East Kentucky Network, LLC were audited by other auditors, whose report has been furnished to me, and my opinion, insofar as it relates to amounts for East Kentucky Network, LLC is based solely on the report of the other auditors. I conducted my 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 I 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 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, I express no such opinion. An audit also

To the Board of Directors
Peoples Rural Telephone Cooperative

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.

I believe the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Peoples Rural Telephone Cooperative Corporation and Subsidiary as of December 31, 2016 and 2015, and the results of their operations and 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*, I have also issued a report dated February 2, 2017, on my consideration of Peoples Rural Telephone Cooperative Corporation's internal control over financial reporting and my 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 my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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 internal control over financial reporting and compliance.

Report on Supplemental Information

My audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information 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 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 my opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 2, 2017

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidated Balance Sheets, December 31, 2016 and 2015

<u>Assets</u>	<u>2016</u>	<u>2015</u>
Current Assets:		
Cash and cash equivalents	\$ 3,212,734	\$ 3,039,879
Accounts receivable, less allowance for 2016 of \$92,595 and 2015 of \$52,253	111,007	142,494
Other receivables, connecting companies	158,930	310,082
Materials and supplies, at average cost	853,973	754,030
Prepaid insurance	61,240	17,243
	<u>4,397,884</u>	<u>4,263,728</u>
Other Assets:		
Investments held to maturity	7,814,152	6,153,931
Associated organizations	27,263,709	23,841,504
Nonregulated property	1,572,638	1,526,402
Deferred plant retirement	1,055,000	-
	<u>37,705,499</u>	<u>31,521,837</u>
Telecommunications Plant, at original cost:		
In service	73,487,784	78,595,448
Under construction	419,182	383,398
	<u>73,906,966</u>	<u>78,978,846</u>
Less accumulated depreciation	34,732,491	36,873,284
	<u>39,174,475</u>	<u>42,105,562</u>
Total	<u>\$ 81,277,858</u>	<u>\$ 77,891,127</u>
<u>Liabilities and Members' Equities</u>		
Current Liabilities:		
Accounts payable	\$ 250,122	\$ 406,480
Current portion of long term debt	1,500,000	1,400,000
Other current and accrued liabilities	1,284,671	1,000,573
	<u>3,034,793</u>	<u>2,807,053</u>
Long Term Debt	<u>10,575,779</u>	<u>16,497,795</u>
Accrued Postretirement Benefits	<u>9,228,092</u>	<u>8,913,068</u>
Members' Equities:		
Memberships and capital investment	217,011	214,741
Patronage capital	61,113,912	52,922,568
Donated capital	1,558,802	1,399,233
Other comprehensive income (loss)	(4,450,531)	(4,863,331)
	<u>58,439,194</u>	<u>49,673,211</u>
Total	<u>\$ 81,277,858</u>	<u>\$ 77,891,127</u>

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidated Statements of Revenue and Comprehensive Income
for the years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating Revenue:		
Local network services	\$ 5,832,277	\$ 5,614,470
Network access services	10,360,796	10,661,556
Carrier billing and collection	186,820	264,775
Miscellaneous	54,975	213,157
Less provision for uncollectibles	<u>(39,338)</u>	<u>(44,936)</u>
	<u>16,395,530</u>	<u>16,709,022</u>
Operating Expenses:		
Plant specific operations	4,070,359	3,826,624
Plant nonspecific operations	1,616,380	1,465,379
Depreciation	4,510,467	4,078,663
Customer operations	1,061,128	1,077,003
Corporate operations	1,765,602	1,615,079
Taxes, other than income	<u>860,597</u>	<u>658,560</u>
	<u>13,884,533</u>	<u>12,721,308</u>
Operating margins	<u>2,510,997</u>	<u>3,987,714</u>
Nonoperating Margins		
Interest and other income (losses)	250,808	(50,844)
Income (loss) from limited liability companies	12,851,898	5,525,905
Less related income taxes	(4,638,161)	(1,235,764)
Non regulated net income (loss)	<u>(1,595,064)</u>	<u>(1,576,625)</u>
	<u>6,869,481</u>	<u>2,662,672</u>
Margins available for fixed charges	9,380,478	6,650,386
Fixed Charges:		
Interest on long-term debt	<u>620,046</u>	<u>640,505</u>
Net Margins	8,760,432	6,009,881
Other Comprehensive Income:		
Postretirement benefits	<u>412,800</u>	<u>412,800</u>
Net Comprehensive Income	<u>\$ 9,173,232</u>	<u>\$ 6,422,681</u>

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Statements of Stockholder's and Member's Equities
for the years ended December 31, 2015 and 2016

	Memberships	Patronage Capital				Total	Other Equities	Accumulated Other Comprehensive Income	Total Members' Equity
		Assignable	Assigned	Unassigned	Retirements				
Balance - December 31, 2014	\$ 212,781	\$ (33,316)	\$ 30,188,049	\$ 29,482,828	\$ (12,304,477)	\$ 47,333,084	\$ 1,263,919	\$ (5,276,131)	\$ 43,533,653
Assign margins		331,270	1,039,455	(1,370,725)	-	-	-	-	-
Comprehensive income:									
Net income		6,009,905			6,009,905				6,009,905
Amortization							412,800		412,800
Adjust postretirement benefits									
Total comprehensive income					(420,421)	(420,421)			6,422,705
Patronage refund									(420,421)
Other equities						135,314			135,314
Memberships, net	1,960								1,960
Balance - December 31, 2015	214,741	6,307,859	31,227,504	28,112,103	(12,724,898)	52,922,568	1,399,233	(4,863,331)	49,673,211
Assign margins		(6,307,859)	1,748,649	4,559,210	-	-	-	-	-
Comprehensive income:									
Net income		8,760,432			8,760,432				8,760,432
Amortization							412,800		412,800
Adjust postretirement benefits									
Total comprehensive income					(569,088)	(569,088)			9,173,232
Patronage refund									(569,088)
Other equities						159,569			159,569
Memberships, net	2,270								2,270
Balance - December 31, 2016	\$ 217,011	\$ 8,760,432	\$ 32,976,153	\$ 32,671,313	\$ (13,293,986)	\$ 61,113,912	\$ 1,558,802	\$ (4,450,531)	\$ 58,439,194

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidated 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 margins	\$ 8,760,432	\$ 6,009,881
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation	4,510,467	4,078,663
Net loss (profit) in limited liability companies	(12,851,898)	(5,525,905)
Accumulated postretirement benefits	852,824	844,595
Net change in current assets and liabilities:		
Receivables	1,547	2,531,555
Material and supplies	(99,943)	38,453
Prepayments	(43,997)	(15,196)
Accounts payables	24,734	(2,761,571)
Advance billings	-	(458,837)
Accrued expenses	284,098	(18,359)
	<u>1,438,264</u>	<u>4,723,279</u>
Cash Flows from Investing Activities:		
Construction of plant	(1,567,227)	(5,121,061)
Salvage, net of removals	(12,153)	(133,064)
Purchase of investments held to maturity	(1,660,221)	(786,850)
Associated organizations	9,429,693	2,759,116
Nonregulated property	(46,236)	507,808
Deferred plant retirement	(1,055,000)	-
	<u>5,088,856</u>	<u>(2,774,051)</u>
Cash Flows from Financing Activities:		
Advances of long term debt	-	2,187,537
Payments on long term debt	(1,572,016)	(1,814,811)
Advances/receipts from cushion of credit	(4,250,000)	(1,425,000)
Fund postretirement benefits	(125,000)	(125,000)
Memberships and capital investments	2,270	1,960
Retirements of capital credits	(569,088)	(420,397)
Increase in donated capital	159,569	135,314
	<u>(6,354,265)</u>	<u>(1,460,397)</u>
Net increase in cash balances	172,855	488,831
Cash and cash equivalents - beginning of period	<u>3,039,879</u>	<u>2,551,048</u>
Cash and cash equivalents - end of period	<u>\$ 3,212,734</u>	<u>\$ 3,039,879</u>
Supplemental disclosures of cash flows information:		
Interest on long-term debt	\$ 620,046	\$ 641,825

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

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Peoples Rural Telephone Cooperative (the “Cooperative”) maintains its records in accordance with policies prescribed or permitted by the Kentucky Public Service Commission (“PSC”) and the United States Department of Agriculture, Rural Utilities Service (“RUS”) Uniform System of Accounts, which conform in all material respects with generally accepted accounting principles in all material respects. The more significant of these policies are as follows:

Principles of Consolidation The consolidated financial statements include the accounts of the Cooperative and its wholly-owned subsidiary, Peoples Telecom, LLC (“Peoples Telecom”). All significant inter-company accounts and transactions have been eliminated.

Nature of Business The Cooperative is constructing an expanded services network. This network establishes the Cooperative as a full service network (“FSN”) provider allowing it to provide expanded video services with over 200 channels, and high definition television. It is also able to provide high speed internet and virtual private networks which will allow it to provide voice on internet protocol (“VoIP”). This is accomplished through Fiber to the Home (“FTTH”) technology.

Cash and Cash Equivalents The Cooperative considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents.

Off Balance Sheet Risk The Corporation has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2016, the financial institutions reported deposits in excess of the \$250,000 FDIC insured limit on several of the accounts. Deposits and repurchase agreements in excess of the FDIC limits are 100% secured with collateral from each respective financial institution.

Telecommunications Revenue Recognition Revenues are recognized when earned regardless of the period in which they are billed. Bills are sent to customers on credit approximately the 1st of the month with local service being billed a month in advance of service. Sales are concentrated in portions of two southeastern Kentucky counties. Payments are due 15 days from the date of billing. If payment has not been made, then customers are subject to disconnect in another 15 days. The allowance for uncollectible accounts is based on the aging of accounts receivable. Accounts are written off when they are deemed to be uncollectible. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2016 or 2015. The number of customers are as follows:

	<u>2016</u>	<u>2015</u>
Access lines	6,640	6,641
Total number of customers	6,222	6,289
Telephone customers	5,948	6,002
Broadband customers	4,264	4,129
Cable television customers	3,622	3,726

Interstate revenues are recognized on the cost basis recovery method. Compensation for intrastate/interlata service is received through tariffed access charges as filed with the FCC. These access charges are billed to the interlata long distance carrier and retained by the Cooperative.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

FTTH CATV Revenue Recognition CATV revenue is recognized when earned regardless of the period in which they are billed. Cable transmission is purchased from networks at various amounts based on the number of customers receiving the service. Sales are concentrated in two southeastern Kentucky counties. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2016 and 2015.

Sales Taxes Peoples Telephone and Peoples Telecom are required to collect, on behalf of the State of Kentucky, sales taxes based on 6 percent of gross sales from customers and a 3 percent school tax from certain counties on most gross sales. Peoples Telephone and Peoples Telecom's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Fair Value Measurements The Fair Value Measurements and Disclosures Topic of the FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal, or most advantageous, market for the asset or liability in an orderly transaction between market participants at the measurement date. The Fair Values Measurements Topic establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs when possible. The three levels of inputs used to measure fair value are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities

Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.

Level 3: Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The carrying amounts of the Cooperative's cash and cash equivalents, investment securities, trade accounts payable, and other liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets and liabilities are not considered financial instruments because they represent activities specifically related to the Cooperative. Long term debt can not be traded in the market, and is specifically for telecommunication cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

The Cooperative may, and also does, invest idle funds in local banks money market accounts and CD's. The inputs used to measure idle funds are Level 1 measurements, as these funds are exchange traded funds in an active market.

Advertising Advertising costs are expensed as incurred.

Comprehensive Income Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in funded status of postretirement benefits.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

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

Telecommunications and CATV Plant Telecommunications and CATV plant are stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. There was no interest required to be capitalized during 2016 or 2015.

Any difference between the purchase price of existing CATV plant facilities and cost when first dedicated to public service is recorded as an acquisition adjustment and are being amortized over a period of 15 years.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expenses. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to plant. The units of property replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation. The major classification of plant in service is:

	<u>2016</u>	<u>2015</u>
Telecommunications Plant:		
General support	\$13,963,886	\$13,359,803
Central office switching	1,568,283	1,920,356
Central office transmission	12,498,243	14,546,746
Cable and wire facilities	44,007,112	47,471,608
Intangibles	5,844	5,844
	<u>72,043,368</u>	<u>77,304,357</u>
CATV Plant:		
General support	44,007	-
Headend plant	1,303,419	1,252,506
Cable and wire facilities	96,990	38,585
	<u>1,444,416</u>	<u>1,291,091</u>
Total	<u>\$73,487,784</u>	<u>\$78,595,448</u>

Depreciation Provision has been made for depreciation on the basis of estimated lives of assets, using the straight-line method. Rates are as follows:

	<u>Telephone</u>	<u>Telecom</u>
General support	2.7%-15.8%	20.0%
Central office switching	7.5%	
Central office transmission	10.0%	
Cable and wire facilities	5.1%-9.4%	5.0%-10.0%

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Risk Management The Cooperative is exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Income Taxes The Cooperative is exempt from federal and state income taxes under IRS Code Section 501(c)(12). Certain unrelated business activities are subject to federal income taxes.

Peoples Telecom is a limited liability company that is taxed as a partnership for federal and state income tax purposes.

Effective January 1, 2008, the Cooperative adopted the provisions of the Income Taxes Topic of the FASB ASC that pertains to accounting for uncertainty in income taxes. The Cooperative had no prior unrecognized tax benefits as a result of the implementation. Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statures, regulations, and rules. There are no tax positions for which the ultimate deductibility is highly uncertain included in the accompanying financial statements. The Cooperative recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Cooperative did not recognize any interest or penalties during the years ended December 31, 2016 or 2015. The Cooperative's income tax return is subject to possible examination by taxing authorities until the expiration of related statutes of limitations on the return, which is generally three years.

Subsequent Events Management has evaluated subsequent events through February 2, 2017, the date the financial statements were available to be issued. During the next three (3) years, Peoples Telephone anticipates that it will remove approximately 70% of its existing copper plant. The retired plant should be fully-depreciated at the time it is removed.

Note 2. Investment Securities

The Cooperative classifies its investment in securities as held to maturity, available for sale, or trading categories in accordance with provisions of the *Financial Instruments Topic* of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"). Investment securities are classified as held to maturity when the Cooperative has the positive intent and ability to hold the securities until maturity. Held to maturity securities are stated at amortized cost. Investment securities not classified as held to maturity are classified as available for sale and are carried at fair market value, with unrealized gains and losses, net of tax, reported as a separate component in stockholders' equity.

Investments securities are all considered held to maturity and consist of Certificates of Deposits in local banks.

Note 3. Associated Organizations

The amounts for East Kentucky Network, LLC represents the Cooperative's investment in a limited liability corporation with other telephone companies in eastern Kentucky for the purpose of providing cellular telephone, paging, and other services. The investment is accounted for using the equity method since the Cooperative is a one-fifth owner.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 4. Non Regulated Activities

Deregulated customer premises equipment is stated at cost; material held for lease or resale is stated at average cost. CPE also includes inside wire revenues and expenses. Depreciation is provided on a straight-line basis at 11.9% per year.

The Cooperative provides long distance telephone service under the name of Peoples Long Distance (PLD). PLD revenues are billed and collected through Peoples Telephone. A monthly fee is recorded based on telephone usage. PLD purchases minutes of long distance to resell to its customers from an unrelated party.

Non regulated investments also include amounts that the Cooperative has invested to provide internet services to its customers. The Cooperative pays an unrelated party for the help desk and access to the internet system.

The following is a summary of non-regulated activities:

	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$245,712	\$860,909	(\$615,197)
Internet activities	26,990	255,258	(228,268)
Long distance services	683,212	2,368,068	(1,684,856)
Fiber to the Home [FTTH]	3,297,157	2,668,889	628,268
Total - 2016	<u>\$4,253,071</u>	<u>\$6,153,124</u>	<u>(\$1,900,053)</u>
	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$235,136	\$644,059	(\$408,923)
Internet activities	12,402	179,931	(167,529)
Long distance services	842,087	2,439,507	(1,597,420)
Fiber to the Home [FTTH]	3,182,165	2,880,235	301,930
Total - 2015	<u>\$4,271,790</u>	<u>\$6,143,732</u>	<u>(\$1,871,942)</u>

Note 5. Long Term Debt

All telecommunications assets, except motor vehicles, are pledged as collateral on the long term debt due RUS. Long term debt is as follows:

	<u>2016</u>	<u>2015</u>
Telecommunications loans:		
RUS, 1.945 - 4.168%	\$12,249,547	\$13,304,647
Less Cushion of Credit	<u>(6,491,794)</u>	<u>(2,008,236)</u>
	5,757,753	11,296,411
RUS Broadband loan 2.2287% - 4.3994%	<u>6,318,026</u>	<u>6,601,384</u>
	12,075,779	17,897,795
Less current portion	<u>1,500,000</u>	<u>1,400,000</u>
Long term portion	<u>\$10,575,779</u>	<u>\$16,497,795</u>

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 5. Long Term Debt, continued

The long term debt payable to RUS is due in monthly installments of various amounts through 2032.

Principal payments for the next five years are as follows: 2017 - \$1,500,000; 2018 - \$1,450,000; 2019 - \$1,010,000; 2020 - \$814,000; 2021 - \$800,000. The Cooperative expects to continue making payments in the Cushion of Credit during 2017.

Note 6. Patronage Capital

The long term debt agreement contains restrictions on the return to patrons of capital contributed by them. The restrictions relate in general to the Cooperative's net worth and assets, as defined. The net worth of the Cooperative at December 31, 2016, was 75%.

Note 7. Pension Plan

All eligible non-union employees of the Cooperative participate in the National Telephone Cooperative Association (NTCA) Pension Plan ("R&S Plan"), a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The Plan sponsor's identification number is 52-0741336 and the Plan Number is 333. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

The Cooperative's contributions to the R&S Plan in 2016 and 2015 represent less than 5 percent of the total contributions made to the plan by all participating employers. The Corporation made contributions to the plan of \$348,940 in 2016 and \$330,786 in 2015. There have been no significant changes that affect the comparability of 2016 and 2015.

In the R&S Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act ("PPA") of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the R&S Plan was between 65 percent and 80 percent funded at January 1, 2016 and 2015 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience. There have been no significant changes that affect the comparability of 2016 and 2015.

Note 7. Accumulated Postretirement Benefits

The Cooperative sponsors a defined benefit plan that provides medical insurance coverage to retirees and their dependents. The eligibility and participating cost of coverage for retirees and dependents is based on age, years of service, and employment date.

For measurement purposes, an 8.5% annual rate of increase, decreasing by 0.5% per year until 5.5% per year, in the per capita cost of covered health care benefits was assumed. The discount rate used in determining the accumulated benefit obligation was 4.5% for 2016 and 2015. There have been no significant changes that affect the comparability of 2016 and 2015.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 7. Accumulated Postretirement Benefits, continued

The funded status of the plan was as follows:

	<u>2016</u>	<u>2015</u>
Projected benefit obligation	(\$12,121,681)	(\$11,375,815)
Plan assets at fair value	<u>2,893,589</u>	<u>2,462,747</u>
Funded status	<u><u>(\$9,228,092)</u></u>	<u><u>(\$8,913,068)</u></u>

The following sets forth the accumulated postretirement benefit obligation, the change in plan assets, and the components of accrued postretirement benefit cost and other comprehensive income:

	<u>2016</u>	<u>2015</u>
Benefit obligation at beginning of year	<u>\$8,913,068</u>	<u>\$8,606,273</u>
Components of net periodic benefit cost:		
Service cost	328,158	350,370
Interest cost	533,744	507,222
Expected return on assets	<u>(176,702)</u>	<u>(172,392)</u>
Net periodic benefit cost	685,200	685,200
Other comprehensive income	-	-
Benefits paid	(245,176)	(253,405)
Contributions to plan	<u>(125,000)</u>	<u>(125,000)</u>
Benefit obligation at end of year	<u><u>\$9,228,092</u></u>	<u><u>\$8,913,068</u></u>
Change in plan assets:		
Fair value of plan assets-beginning of year	\$2,462,747	\$2,307,627
Employer contributions	125,000	125,000
Change in fair value of plan assets	305,842	30,120
Benefits paid	<u>-</u>	<u>-</u>
Fair value of plan assets-end of year	<u><u>\$2,893,589</u></u>	<u><u>\$2,462,747</u></u>
Amounts recognized in the balance sheet consists of:		
Noncurrent liabilities	<u><u>\$9,228,092</u></u>	<u><u>\$8,913,068</u></u>
Amounts included in other comprehensive income:		
Unrecognized actuarial gain (loss)	<u><u>(\$4,450,531)</u></u>	<u><u>(\$4,863,331)</u></u>

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

Postemployment benefit obligation	\$9,935,000
Net periodic benefit cost	738,000

The projected retiree benefit payments are expected to be as follows: 2017 - \$250,000; 2018 - \$250,000; 2019 - \$248,000; 2020 - \$247,000; 2021 - \$250,000.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 9. Commitments

The Cooperative has various agreements outstanding with local contractors. Under these agreements, the contractors will perform certain construction, maintenance, and other work at specified hourly rates or unit cost, or on an as needed basis. The duration of these contracts are one to three years.

Note 10. Contingencies

The Cooperative, occasionally, is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the final outcome will not have a material adverse effect on the financial statements.

* * * * *

Peoples Rural Telephone Cooperative
and Subsidiary
Consolidating Balance Sheet, December 31, 2016

<u>Assets</u>	<u>Telephone</u>	<u>Telecom</u>	<u>Eliminations</u>	<u>Consolidated</u>
Current Assets:				
Cash and cash equivalents	\$ 2,757,235	\$ 455,499		\$ 3,212,734
Accounts receivable, less allowance for Telephone of \$92,595	111,007			111,007
Other receivables, connecting companies	187,329		(28,399)	158,930
Material and supplies, at average cost	853,973			853,973
Prepayments	61,240			61,240
	<u>3,970,784</u>	<u>455,499</u>	<u>(28,399)</u>	<u>4,397,884</u>
Other Assets:				
Investments held to maturity	7,814,152			7,814,152
Associated organizations	28,874,654		(1,610,945)	27,263,709
Nonregulated	1,572,638			1,572,638
Deferred plant retirement	1,055,000			1,055,000
	<u>39,316,444</u>	<u></u>	<u>(1,610,945)</u>	<u>37,705,499</u>
Utility Plant, at original cost:				
In service	72,043,368	1,444,416		73,487,784
Under construction	450,724	(31,542)		419,182
	<u>72,494,092</u>	<u>1,412,874</u>		<u>73,906,966</u>
Less accumulated depreciation	34,501,260	231,231		34,732,491
	<u>37,992,832</u>	<u>1,181,643</u>		<u>39,174,475</u>
Total	<u>\$ 81,280,060</u>	<u>\$ 1,637,142</u>	<u>\$ (1,639,344)</u>	<u>\$ 81,277,858</u>
<u>Member's Equities and Liabilities</u>				
Current Liabilities:				
Accounts payable	\$ 252,324	\$ 26,197	\$ (28,399)	\$ 250,122
Current portion of long term debt	1,500,000			1,500,000
Accrued expenses	1,284,671			1,284,671
	<u>3,036,995</u>	<u>26,197</u>	<u>(28,399)</u>	<u>3,034,793</u>
Long Term Debt	<u>10,575,779</u>			<u>10,575,779</u>
Accumulated Postretirement Benefits	<u>9,228,092</u>			<u>9,228,092</u>
Members' Equities:				
Memberships and capital investments	217,011	6,288,471	(6,288,471)	217,011
Patronage capital and retained earnings	61,113,912	(4,677,526)	4,677,526	61,113,912
Donated capital	1,558,802			1,558,802
Other comprehensive income (loss)	(4,450,531)			(4,450,531)
	<u>58,439,194</u>	<u>1,610,945</u>	<u>(1,610,945)</u>	<u>58,439,194</u>
Total	<u>\$ 81,280,060</u>	<u>\$ 1,637,142</u>	<u>\$ (1,639,344)</u>	<u>\$ 81,277,858</u>

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidating Statements of Revenue and Comprehensive Income
for the year ended December 31, 2016

	<u>Telephone</u>	<u>Telecom</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating Revenues:				
Local network services	\$ 5,817,009	\$ 15,268		\$ 5,832,277
Network access services	10,332,142	28,654		10,360,796
Carrier billing and collection	186,647	173		186,820
Miscellaneous	53,849	296,080	(294,954)	54,975
Less provision for uncollectibles	(39,338)			(39,338)
	<u>16,350,309</u>	<u>340,175</u>	<u>(294,954)</u>	<u>16,395,530</u>
Operating Expenses:				
Plant specific operations	3,833,139	237,220		4,070,359
Plant non specific operations	1,598,884	17,496		1,616,380
Depreciation	4,422,821	87,646		4,510,467
Customer operations	1,054,747	6,381	-	1,061,128
Corporate operations	1,734,783	30,819		1,765,602
Taxes, other than income	838,953	21,644		860,597
	<u>13,483,327</u>	<u>401,206</u>		<u>13,884,533</u>
Operating Income	<u>2,866,982</u>	<u>(61,031)</u>	<u>(294,954)</u>	<u>2,510,997</u>
Nonoperating Margins:				
Interest and other income (losses)	250,808			250,808
Income in limited liability companies	12,800,902		50,996	12,851,898
Less provision for related taxes	(4,638,161)			(4,638,161)
Nonregulated net income (loss)	<u>(1,900,053)</u>	<u>10,035</u>	<u>294,954</u>	<u>(1,595,064)</u>
	<u>6,513,496</u>	<u>10,035</u>	<u>345,950</u>	<u>6,869,481</u>
Margins available for interest charges	<u>9,380,478</u>	<u>(50,996)</u>	<u>50,996</u>	<u>9,380,478</u>
Interest Charges:				
Long term debt	<u>620,046</u>			<u>620,046</u>
Net Margins	8,760,432	(50,996)	50,996	8,760,432
Other Comprehensive Income:				
Postretirement benefits	<u>412,800</u>			<u>412,800</u>
Net Comprehensive Income	<u>\$ 9,173,232</u>	<u>\$ (50,996)</u>	<u>\$ 50,996</u>	<u>\$ 9,173,232</u>

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

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

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*

To the Board of Directors
Peoples Rural Telephone Cooperative

I 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 financial statements of Peoples Rural Telephone Cooperative, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated February 2, 2017. My report includes a reference to other auditors who audited the financial statements of East Kentucky Network, LLC, as described in my report on Peoples Rural Telephone's financial statements. This report does not include the results of the other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered Peoples Rural Telephone's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Peoples Rural Telephone's internal control. Accordingly, we do not express an opinion on the effectiveness of Peoples Rural Telephone'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.

My 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 my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

To the Board of Directors
Peoples Rural Telephone Cooperative - 2

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Peoples Rural Telephone's financial statements are free of material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my 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 my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization'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 organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Alan Zumstein

Alan M. Zumstein, CPA
February 2, 2017

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

Independent Auditor's Report on Compliance with Aspects of Contractual
Agreements and Regulatory Requirements for Telephone Borrowers

Board of Directors
Peoples Rural Telephone Cooperative

Independent Auditor's Report

I 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 financial statements of Peoples Rural Telephone Cooperative ("the Cooperative"), which comprise the balance sheet as of December 31, 2016, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated February 2, 2017. In accordance with *Government Auditing Standards*, we have also issued my report dated February 2, 2017, on my consideration of the Cooperative's internal control over financial reporting and on my 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 related to my audit have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative 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 and clarified in the RUS policy memorandum dated February 7, 2017, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative's 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 my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative 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;

Board of Directors
Peoples Rural Telephone Cooperative - 2

- Maintain adequate control over material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written approval of the RUS to enter into any contract, agreement, or lease with an affiliate as defined in part 1773.33 (e)(2)(i);
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles, and;
- Comply with the requirements for the detailed schedule of investments, which are listed below.

My audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The detail of investments is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and related directly to underlying accounting and other records used to prepare the basic financial statements. The 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 my opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Peoples Telephone is a one-fifth (1/5) owner of East Kentucky Network, LLC, which provides cellular and other communication services in Eastern Kentucky. The initial investment was \$10,000. The investment is comprised of the following:

	<u>Investment</u>	<u>Profits</u>	<u>Returns</u>
Beginning of year	\$4,294,013	\$32,854,229	(\$13,306,738)
Activity for 2016	-	12,851,466	(9,429,261)
End of year	<u>\$4,294,013</u>	<u>\$45,705,695</u>	<u>(\$22,735,999)</u>

During 2004, Peoples Telephone formed a wholly-owned subsidiary, Peoples Telecom, LLC, which provides telecommunications services outside of the Cooperative's service territory. The initial investment was \$1,130,000. The investment is comprised of the following:

	<u>Investment</u>	<u>Profits</u>
Beginning of year	\$6,026,084	(\$4,626,530)
Activity for 2016	261,955	(50,564)
End of year	<u>\$6,288,039</u>	<u>(\$4,677,094)</u>

This report is intended solely for the information and use of the board of directors, management, 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 distributions is not limited.

Alan Zumstein

Alan M. Zumstein, CPA
February 2, 2017