Kentucky 522

Foothills Rural Telephone Cooperative and Subsidiary

Staffordsville, Kentucky

Audited Financial Statements
December 31, 2013 and 2012

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

CONTENTS

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
Foothills Rural Telephone Cooperative

Report on the Financial Statements

I have audited the accompanying consolidated financial statements of Foothills Rural Telephone Cooperative and Subsidiary, which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audits. 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 financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's reparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

To the Board of Directors
Foothills Rural Telephone Cooperative - 2

Opinion

In my opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Foothills Rural Telephone Cooperative and Subsidiary as of December 31, 2013 and 2012, 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 21, 2014, on my consideration of Foothills Rural Telephone Cooperative'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.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 21, 2014

Foothills Rural Telephone Cooperative and Subsidiary

Consolidated Balance Sheets, December 31, 2013 and 2012

Assets	2013	2012
Current Assets:		
Cash and cash equivalents	$ 14,689,891	$ 6,772,365
Accounts receivable, less allowance for 2013 of $94,550 and 2012 of $85,102	674,410	623,340
Other accounts receivable	1,982,313	2,237,487
Materials and supplies, at average cost	1,276,242	1,053,611
Prepayments	345,748	361,803
	18,968,604	11,048,606
Other Assets:		
Investment securities available for sale	5,055,794	5,738,062
Investment in associated organization	20,805,872	20,022,701
Nonregulated investments	2,077,657	2,379,973
	27,939,323	28,140,736
Utility Plant, at original cost:		
In service	121,392,352	128,802,340
Under construction	4,099,188	5,699,780
	125,491,540	134,502,120
Less accumulated depreciation	68,016,031	73,831,139
	57,475,509	60,670,981
Total	$ 104,383,436	$ 99,860,323
Liabilities and Member's Equities		
Current Liabilities:		
Accounts payable	$ 1,923,031	$ 1,739,819
Current portion of long term debt	4,100,000	4,100,000
Customer deposits	213,606	210,709
Other current and accrued expenses	1,452,388	1,397,334
	7,689,025	7,447,862
Long Term Debt	13,902,908	15,748,650
Accrued Postretirement Benefits	4,019,015	3,960,977
Members' Equities:		
Memberships and capital investment	641,065	651,075
Patronage capital and retained earnings	80,641,247	74,711,751
Donated capital	124,537	124,537
Accumulated other comprehensive income	(2,634,361)	(2,784,529)
	78,772,488	72,702,834
Total	$ 104,383,436	$ 99,860,323

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

Consolidated Statements of Revenue and Comprehensive Income
for the years ended December 31, 2013 and 2012

	2013	2012
Operating Revenue:		
Basic local network services	$ 5,572,725	$ 3,591,112
Network access services	16,606,962	19,168,534
Billing and collection	510,982	558,243
Miscellaneous	685,888	421,859
Less provision for uncollectibles	(121,275)	(24,000)
	23,255,282	23,715,748
Operating Expenses:		
Plant specific operations	5,520,815	5,867,228
Plant nonspecific operations	1,974,496	1,791,826
Depreciation	7,012,306	6,865,944
Customer operations	1,649,224	1,738,198
Corporate operations	1,590,294	1,497,642
Taxes	1,334,543	1,712,802
	19,081,678	19,473,640
Operating margins	4,173,604	4,242,108
Nonoperating Margins		
Other nonoperating income	2,276,763	2,702,998
Non regulated activities	1,298,812	1,457,530
	3,575,575	4,160,528
Margins before interest charges	7,749,179	8,402,636
Interest Charges:		
Interest on long-term debt	698,699	1,089,772
Other	10,593	11,164
	709,292	1,100,936
Net Margins	7,039,887	7,301,700
Other Comprehensive Income:		
Postretirement benefits	150,168	(125,971)
Total Comprehensive Income	$7,190,055	$7,175,729

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

Statement of Changes in Consolidated Members' Equity
for the years ended December 31, 2012 and 2013

	Memberships	Patronage Capital	Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 658,731	$ 68,523,382	$124,537	$ (2,658,558)	$ 66,648,092
Comprehensive income:					
Net margins		7,301,700			7,301,700
Postretirement benefit obligation					
Amortization				120,987	
Adjustment				(246,958)	(125,971)
Total comprehensive income					7,175,729
Net change in memberships	(7,656)				(7,656)
Refunds of capital credits		(1,113,331)			(1,113,331)
Other equities			-		-
Balance-December 31, 201	651,075	74,711,751	124,537	(2,784,529)	72,702,834
Comprehensive income:					
Net margins		7,039,887			7,039,887
Postretirement benefit obligation					
Amortization				150,168	
Adjustment					150,168
Total comprehensive income					7,190,055
Net change in memberships	(10,010)				(10,010)
Refunds of capital credits		(1,110,391)			(1,110,391)
Other equities			-		-
Balance-December 31, 201	$ 641,065	$ 80,641,247	$124,537	$ (2,634,361)	$ 78,772,488

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

Consolidated Statements of Cash Flows

for the years ended December 31, 2013 and 2012

	2013	2012
Cash Flows from Operating Activities:		
Net margins	$ 7,039,887	$ 7,301,700
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation	7,012,306	6,865,944
Accrued postretirement benefits	208,206	231,122
Income from subsidiary	(2,077,945)	(2,462,880)
Net change in current assets and liabilities:		
Receivables	336,924	(83,653)
Materials	(222,631)	178,044
Prepayments	16,055	(23,774)
Payables	50,392	(437,114)
Customer deposits	2,897	(7,639)
Other current and accrued liabilities	55,054	(366,329)
	12,421,145	11,195,421
Cash Flows from Investing Activities:		
Construction of plant	(3,746,238)	(5,411,820)
Salvage recovered from plant	(70,596)	(164,550)
Nonregulated investments	302,316	(75,113)
Investment in associated organizations	1,294,774	2,299,808
Change in investment securities	682,268	-
	(1,537,476)	(3,351,675)
Cash Flows from Financing Activities:		
Net increase in memberships and other equities	(10,010)	(7,656)
Retirements of capital credits	(1,110,391)	(1,113,331)
Advances on long term debt	2,213,902	480,000
Payments on long term debt	(4,059,644)	(3,562,482)
	(2,966,143)	(4,203,469)
Net increase in cash balances	7,917,526	3,640,277
Cash and cash equivalents - beginning	6,772,365	3,132,088
Cash and cash equivalents - end	$ 14,689,891	$ 6,772,365
Supplemental disclosures of cash flows information:		
Interest on long-term debt	$ 698,699	$ 1,089,772

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

Note 1 Summary of Significant Accounting Policies

Foothills 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, Cellular Services, LLC (Cellular Services). All significant inter-company accounts and transactions have been eliminated.

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, 2013, 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 of the respective financial institutions.

Telecommunications Revenue Recognition Revenues are recognized when earned regardless of the period in which they are billed. Bills are sent to customers on credit based on three (3) monthly billing cycles, with local service being billed a month in advance of service. Sales are concentrated in portions of five (5) southeastern Kentucky counties. Payments are due 20 days from the date of billing, at which time a disconnect notice is sent with payment to be within 10 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, 2013 or 2012. The number of access lines was 12,951 at 2013 and 13,336 at 2012.

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.

Video Revenue Recognition Cellular Services' headend equipment will allow the Cooperative with the capabilities to provide expanded video services with over 200 channels, high definition television, and Video on Demand. The monthly charge will be based on the capacity utilized by Foothills Telephone and other unrelated companies.

Fiber to the Home Activities The Cooperative has launched a fiber to the home (FTH) network. This network will establish the Cooperative as a full service network (FSN) provider allowing the Cooperative to provide video services, high speed internet, virtual private networks, and multiple voice lines to its customers. Plans are to complete the FSN in several phases by building in the most populated areas followed by the lower density areas. Long range plans for the Cooperative's system are to build on the initial network with additional equipment and facilities replacing existing copper facilities with fiber optics.

Note 1 Summary of Significant Accounting Policies, continued

Business Venture The Cooperative has launched 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, high definition television and Video on Demand. It also is able to provide high speed internet, virtual private networks and voice on internet protocol (VoIP). This is accomplished through Fiber to the Home (FTTH) technology.

Utility Taxes Foothills Telephone and Cellular Services' is required to collect, on behalf of taxing authorities, excise taxes, sales, school taxes, and franchise fees. Foothills Telephone and Foothills Telecom's policy is to exclude taxes from revenue when collected and expenses when paid and instead, record collection and payment of 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, other receivables, investments, inventories, other assets, trade accounts payable, accrued expenses and liabilities, 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 electric 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.

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.

Note 1 Summary of Significant Accounting Policies, continued

Utility Plant Telecommunications and video 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. Interest capitalized during the year was $119,796 for 2013 and $74,084 for 2012.

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:

	2013	2012
General support	$12,682,671	$12,583,046
Central office switching	2,394,945	9,306,219
Central office transmission	23,117,110	27,181,764
Cable and wire facilities	77,581,460	74,447,988
General plant	3,453	3,453
Subtotal telecommunications plant	115,779,639	123,522,470
Headend equipment	4,736,195	4,596,711
Other video plant	876,518	683,159
Subtotal video plant	5,612,713	5,279,870
	$121,392,352	$128,802,340

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

	Foothills	Cellular
General support	2.7% - 15.8%	
Central office switching and headend	7.5%	5.0%
Central office transmission	11.9%	
Cable and wire facilities	5.1% - 9.4%	5.1% - 6.6%

Advertising Advertising costs are expensed as incurred.

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. Cellular Services is a "C" corporation for federal and state income tax purposes.

The Cooperative's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes the Cooperative has no uncertain tax positions resulting in an accrual of tax expense or benefit. 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, 2013 and 2012. The Cooperative's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

Note 1 Summary of Significant Accounting Policies, continued

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

Subsequent Events Management has evaluated subsequent events through February 21, 2014, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2 Investments

Cellular Services is a partner in East Kentucky Network, LLC (EKN). EKN provides cellular service, fiber connections, paging, and other services in eastern Kentucky. EKN is comprised of Cellular Services and four (4) other independent telephone companies. The investment is accounted for using the equity method of accounting and includes capital investments.

Note 3 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 Foothills Long Distance (FLD). FLD revenues are billed and collected through Foothills Telephone. A monthly fee is recorded based on telephone usage. FLD 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:

	Income	Expenses	Net
Customer premises equipment	$248,882	$266,131	($17,249)
Internet activities	3,953,629	2,707,707	1,245,922
Long distance services	418,616	361,505	57,111
Fiber to the home video	3,900,935	3,887,907	13,028
Total - 2013	$8,522,062	$7,223,250	$1,298,812

	Income	Expenses	Net
Customer premises equipment	$241,472	$315,049	($73,577)
Internet activities	4,076,692	2,647,520	1,429,172
Long distance services	470,175	411,386	58,789
Fiber to the home video	3,675,153	3,632,007	43,146
Total - 2012	$8,463,492	$7,005,962	$1,457,530

Note 4 Long Term Debt

All telecommunications assets, except motor vehicles, are pledged as collateral on the long term debt due RUS, Rural Telephone Bank ("RTB") and National Bank for Cooperatives ("CoBank"). Long term debt is as follows:

	2013	2012
RUS, Broadband, 2.43% - 3.33%	$2,896,855	$747,440
CoBank, 6.25%	15,106,053	19,101,210
	18,002,908	19,848,650
Less current portion	4,100,000	4,100,000
Long term portion	$13,902,908	$15,748,650

During 2012 the long term debt payable to RUS and RTB was refinanced with proceeds from CoBank and are included with the debt due from CoBank.

Principal payments for the next five years are as follows: 2014 - $4,100,000; 2015 - $4,100,000; 2016 - $4,100,000; 2017 - $3,200,000; 2018 - $400,000.

Note 5 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, 2013, was 77%. Patronage capital consisted of:

	2013	2012
Assigned to date	$78,267,466	$72,520,332
Assignable margins	7,039,887	7,301,700
Unassigned nonoperating margins	19,445,293	17,799,854
Patronage capital unlocated	1,097,226	1,097,226
Retirements to date	(25,208,625)	(24,007,361)
Total	$80,641,247	$74,711,751

Note 6 Pension Plan

All eligible employees of the Cooperative participate in the NTCA Retirement and Security 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 2013 and 2012 represent less than 5 percent of the total contributions made to the plan by all participating employers. The Cooperative made contributions to the plan of $491,879 in 2013 and $506,693 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012.

Note 6 Pension Plan, continued

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 88 percent and 80 percent funded at January 1, 2013 and 2012 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.

Note 7 Accumulated Postretirement Benefits

The Cooperative sponsors a defined benefit plan that provides medical insurance coverage to retirees and their dependents until they reach age 65. Participating retirees and dependents do not contribute to the projected cost of coverage. Employees qualify with a minimum age of 55 and meeting the Rule of 85.

The funded status of the plan was as follows:

	2013	2012
Projected benefit obligation	($6,506,273)	($6,222,121)
Plan assets at fair value	2,487,258	2,261,144
Total	($4,019,015)	($3,960,977)

The components of net periodic postretirement benefit costs are as follows:

	2013	2012
Benefit obligation at beginning of year	$3,960,977	$3,603,884
Components of net periodic benefit cost:		
Service cost	191,948	210,747
Interest cost	318,210	312,199
Expected return on assets	(180,326)	(163,933)
Net periodic benefit cost	329,832	359,013
Benefits paid	(271,794)	(248,878)
Accumulated other comprehensive accounting	-	246,958
Benefit obligation at end of year	$4,019,015	$3,960,977

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 5.5% for 2013 and 2012.

The projected retiree benefit payments are expected to be as follows: 2014 - $261,000; 2015 - $262,000; 2016 – $258,000; 2017 - $267,000; 2018 - $270,000.

Note 8 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.

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 Significant Event

The Cooperative was awarded a Broadband Initiatives Program ("BIP") Grant from the United States of America through the Department of Agriculture, Rural Utilities Service ("RUS"). The project would provide broadband internet service to the counties served in southeastern Kentucky. The total project cost is $21,818,512, of which $14,680,738 is in the form of a grant. The remaining funds must be secured with RUS debt and general funds. The Cooperative started the project during 2012. The Grant requires that the project be completed within three (3) years from the date of the Grant, however, RUS has granted an extension on the project until September 30, 2015.

* * * * * *

Additional Consolidating Information

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
Foothills Rural Telephone Cooperative

My report on the audits of the accompanying consolidated financial statements of Foothills Rural Telephone Cooperative and Subsidiary as of December 31, 2013 and 2012, and for the years then ended appears on page 1. My audits were conducted for the purpose of forming an opinion on the basic financial statements taken 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. The supplementary consolidating information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in my opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

Alan M. Zumstein
Alan M. Zumstein, CPA
February 21, 2014

Foothills Rural Telephone Cooperative Corporation and Subsidiary
Consolidating Balance Sheet, December 31, 2013

Assets	Foothills Telephone	Cellular Services	Eliminations	Consolidated
Current Assets:				
Cash and cash equivalents	$12,553,773	$2,136,118		$14,689,891
Accounts receivable, less allowance for 2013 of $94,550	674,410			674,410
Other accounts receivable	2,008,545		(26,232)	1,982,313
Materials and supplies, at average cost	1,276,242			1,276,242
Prepayments	345,748			345,748
	16,858,718	2,136,118	(26,232)	18,968,604
Other Assets:				
Investment securities available for sale	4,955,794	100,000		5,055,794
Investment in associated organization	26,241,012	20,805,872	(26,241,012)	20,805,872
Nonregulated investments	2,077,657			2,077,657
	33,274,463	20,905,872	(26,241,012)	27,939,323
Telecommunications Plant, at original cost:				
In service	115,779,639	5,612,713		121,392,352
Under construction	3,963,204	135,984		4,099,188
	119,742,843	5,748,697		125,491,540
Less accumulated depreciation	65,493,257	2,522,774		68,016,031
	54,249,586	3,225,923		57,475,509
Total	$104,382,767	$26,267,913	($26,267,244)	$104,383,436
Liabilities and Member's Equities				
Current Liabilities:				
Accounts payable	$1,922,362	$26,901	($26,232)	$1,923,031
Current portion of long term debt	4,100,000			4,100,000
Customer deposits	213,606			213,606
Other current and accrued expenses	1,452,388			1,452,388
	7,688,356	26,901	(26,232)	7,689,025
Long Term Debt	13,902,908			13,902,908
Accrued Postretirement Benefits	4,019,015			4,019,015
Members' Equities:				
Memberships and capital investment	641,065	8,257,826	(8,257,826)	641,065
Patronage capital and retained earnings	80,641,247	17,983,186	(17,983,186)	80,641,247
Donated capital	124,537			124,537
Accum other comprehensive income	(2,634,361)			(2,634,361)
	78,772,488	26,241,012	(26,241,012)	78,772,488
Total	$104,382,767	$26,267,913	($26,267,244)	$104,383,436

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

Consolidating Statement of Revenue and Comprehensive Income
for the year ended December 31, 2013

	Foothills Telephone	Cellular Services	Eliminations	Consolidated
Operating Revenue:				
Basic local network services	$5,397,178	$244,556	($69,009)	$5,572,725
Network access services	16,606,962			16,606,962
Billing and collection	510,982			510,982
Miscellaneous	685,888			685,888
Less provision for uncollectibles	(121,275)			(121,275)
	23,079,735	244,556	(69,009)	23,255,282
Operating Expenses:				
Plant specific operations	5,190,319	399,505	(69,009)	5,520,815
Plant nonspecific operations	1,974,496			1,974,496
Depreciation	6,618,079	394,227		7,012,306
Customer operations	1,645,742	3,482		1,649,224
Corporate operations	1,568,513	21,781		1,590,294
Taxes	1,319,781	14,762		1,334,543
	18,316,930	833,757	(69,009)	19,081,678
Operating margins	4,762,805	(589,201)		4,173,604
Nonoperating Margins				
Other nonoperating income	1,687,562	2,077,945	(1,488,744)	2,276,763
Non regulated activities	1,298,812			1,298,812
	2,986,374	2,077,945	(1,488,744)	3,575,575
Margins before interest charges	7,749,179	1,488,744	(1,488,744)	7,749,179
Interest Charges:				
Interest on long-term debt	698,699			698,699
Other	10,593			10,593
	709,292			709,292
Net Margins	7,039,887	1,488,744	(1,488,744)	7,039,887
Other Comprehensive Income: Accumulated postretirement benefits	150,168			150,168
Net Comprehensive Income	$7,190,055	$1,488,744	($1,488,744)	$7,190,055

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

Supplementary Information

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
Foothills Rural Telephone Cooperative

I have audited the financial statements of Foothills Rural Telephone Cooperative as of and for the years ended December 31, 2013 and 2012, and have issued my report thereon dated February 21, 2014. I conducted my audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered Foothills Telephone's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Foothills Telephone's internal control over financial reporting. Accordingly, I do no express an opinion on the effectiveness of Foothills Telephone's internal control over financial reporting.

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 over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as defined previously.

To the Board of Directors
Foothills Rural Telephone Cooperative
Page - 2

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Foothills Telephone's financial statements are free of material misstatement, I performed test 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*.

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 21, 2014

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
Foothills 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 Foothills Rural Telephone Cooperative ("the Cooperative"), which comprise the balance sheet as of December 31, 2013, 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 21, 2014. In accordance with *Government Auditing Standards*, we have also issued my report dated February 21, 2014, 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 and my schedule of findings and recommendations 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, 2014, 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;

- Maintain adequate control over material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- 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.

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 21, 2014

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

To the Board of Directors
Foothills Rural Telephone Cooperative

I have audited the financial statements of Foothills Rural Telephone Cooperative for the year ended December 31, 2013, and have issued my report thereon dated February 21, 2014. I conducted my audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR Part 1773, Policy on audits of the Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing my audit of the financial statements of Foothills Telephone for the year ended December 31, 2013, I considered its internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over financial reporting that I consider to be a material weakness.

7 CFR Part 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions and other additional matters. I have grouped my comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, I performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, material control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR Part 1773.33(e)(2) related transactions, depreciation rates, a schedule of deferred debits and credits and a schedule of investments, upon which I express an opinion. In addition, my audit of the financial statements also included the procedures specified in 7 CFR Part 1773.38-.45. My objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, I express no opinion thereon.

No reports, other than my independent auditor's report, and my independent auditor's report on internal control over financial reporting and compliance and other matters, all dated February 21, 2014, or summary of recommendations related to my audit have been furnished to management.

My comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions and other additional matters as required by 7 CFR Part 1773.33 are presented below.

Comments on Certain Specific Aspects of the Internal Control Over Financial Reporting

I noted no matters regarding Foothills Telephone's internal control over financial reporting and its operation that I consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records;
- the process for accumulating and recording labor, material and overhead costs, and the distribution of these costs to construction, retirement, and maintenance and other expense accounts, and;
- the material controls.

Comments on Compliance with Specific RUS Loan and Security Instrument Provisions

At your request, I have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts, and grants. The procedures I performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract, agreement, or lease between the borrower and Foothills Telephone for the year ended December 31, 2013:
    1. Obtained and read a borrower-prepared schedule of new written contracts, agreements, or leases entered into during the year between the borrower and an affiliate as defined in Section 1773.33(e)(i), of which there were none.
    2. Reviewed Board of Director minutes to ascertain whether board-approved written contracts are included in the borrower-prepared schedule (of which none were noted).
    3. Noted no existence of written RUS approval since there were no contracts listed by the borrower.
- Procedures performed with respect to the requirement to submit a *Operating Report for Telecommunications Borrowers* to RUS:
    1. Agreed amounts reported in *Operating Report for Telecommunications Borrowers* to Foothills Telephone's records as of December 31, 2013.

The results of my tests indicate that, with respect to the items tested, Foothills Telephone complied in all material respects, with the specific RUS loan and security instrument provisions referred to below. With respect to items not tested, nothing came to my attention that caused me to believe that Foothills Telephone had not complied, in all material respects, with those provisions. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has not entered into any contract, agreement, or lease with an affiliate as defined in Section 1773.33(e)(i), and
- The borrower has submitted its *Operating Report for Telecommunications Borrowers*, as of December 31, 2013, represented by the borrower as having been submitted to RUS is in agreement with its audited records in all material respects.

Comments on Other Additional Matters

In connection with my audit of Foothills Telephone, nothing came to my attention that caused me to believe that Foothills Telephone failed to comply with respect to:

- The reconciliation of continuing property records to controlling general ledger plant accounts addressed at 7 CFR Part 1773.33(c)(1);
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR 1773.33(c)(3) and (4);
- Approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR Part 1773.33(c)(5);
- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standard No. 57, Related Party Transactions, for the year ended December 31, 2013, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR Part 1773.33(f); and,
- The detailed schedule of investments.

My audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR Part 1773(h) and provided below is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in my audit of the basic financial statements and, in my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Foothills Telephone has a wholly-owned subsidiary, Cellular Services, LLC, which is a one-fifth owner of a cellular and other communications services limited liability company. The initial investment was $820,000. The investment is as follows:

	Investment	Profits
Balance, beginning of year	$8,257,826	$16,494,379
Activity for 2013		1,488,807
Balance, end of year	$8,257,826	$17,983,186

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 distribution is not limited.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 21, 2014