

Kentucky 522
Foothills Rural Telephone Cooperative
and Subsidiary
Staffordsville, Kentucky
Audited Financial Statements
December 31, 2015 and 2014

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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, 2015 and 2014, 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 did not audit the financial statements of East Kentucky Network, LLC. As discussed in Note 3, these financial statements account for an investment in East Kentucky Network, LLC under the equity method. The investment was \$23,907,978 and \$20,864,241 at December 31, 2015 and 2014 respectively, and the equity in its net margins was \$5,802,853 and \$1,069,928 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 financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's

To the Board of Directors
Foothills Rural Telephone Cooperative

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.

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, 2015 and 2014, 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 March 10, 2016, 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.

Report on Supplemental Information

My audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the consolidated financial statements 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.

Alan Zumstein

Alan M. Zumstein, CPA
March 10, 2016

Foothills Rural Telephone Cooperative and Subsidiary
Consolidated Balance Sheets, December 31, 2015 and 2014

<u>Assets</u>	<u>2015</u>	<u>2014</u>
Current Assets:		
Cash and cash equivalents	\$ 15,798,166	\$ 16,173,152
Accounts receivable, less allowance for 2015 of \$50,307 and 2014 of \$53,096	668,976	681,716
Other accounts receivable	1,655,309	1,531,275
Materials and supplies, at average cost	1,187,672	1,213,807
Prepayments	487,776	559,296
	<u>19,797,899</u>	<u>20,159,246</u>
Other Assets:		
Investment securities available for sale	5,076,587	5,060,642
Investment in associated organization	23,907,978	20,864,241
Nonregulated investments	1,515,046	1,811,009
	<u>30,499,611</u>	<u>27,735,892</u>
Utility Plant, at original cost:		
In service	131,894,748	123,737,323
Under construction	2,228,209	6,784,630
	134,122,957	130,521,953
Less accumulated depreciation	77,709,373	72,902,441
	<u>56,413,584</u>	<u>57,619,512</u>
Total	<u>\$ 106,711,094</u>	<u>\$ 105,514,650</u>
<u>Liabilities and Member's Equities</u>		
Current Liabilities:		
Accounts payable	\$ 1,135,629	\$ 1,237,218
Current portion of long term debt	4,150,000	4,100,000
Customer deposits	200,806	207,506
Other current and accrued expenses	2,047,029	1,520,959
	<u>7,533,464</u>	<u>7,065,683</u>
Long Term Debt	<u>8,041,117</u>	<u>11,247,584</u>
Accrued Postretirement Benefits	<u>4,109,878</u>	<u>4,065,784</u>
Members' Equities:		
Memberships and capital investment	608,476	628,314
Patronage capital and retained earnings	88,627,647	84,866,941
Donated capital	124,537	124,537
Accumulated other comprehensive income	(2,334,025)	(2,484,193)
	<u>87,026,635</u>	<u>83,135,599</u>
Total	<u>\$ 106,711,094</u>	<u>\$ 105,514,650</u>

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

Consolidated Statements of Revenue and Comprehensive Income
for the years ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating Revenue:		
Basic local network services	\$ 7,830,024	\$ 6,450,616
Network access services	12,918,868	14,721,980
Billing and collection	450,711	482,228
Miscellaneous	1,042,965	902,826
Less provision for uncollectibles	<u>(84,000)</u>	<u>(74,000)</u>
	<u>22,158,568</u>	<u>22,483,650</u>
Operating Expenses:		
Plant specific operations	6,055,460	5,274,275
Plant nonspecific operations	2,551,165	2,038,640
Depreciation	5,932,046	5,726,805
Customer operations	1,895,967	1,717,401
Corporate operations	1,820,660	1,629,008
Taxes	<u>1,297,819</u>	<u>1,380,356</u>
	<u>19,553,117</u>	<u>17,766,485</u>
Operating margins	<u>2,605,451</u>	<u>4,717,165</u>
Nonoperating Margins		
Other nonoperating income	6,109,275	1,391,664
Less related income taxes	(1,958,711)	(136,052)
Non regulated activities	<u>(1,140,670)</u>	<u>166,461</u>
	<u>3,009,894</u>	<u>1,422,073</u>
Margins before interest charges	<u>5,615,345</u>	<u>6,139,238</u>
Interest Charges:		
Interest on long-term debt	505,310	615,659
Other	<u>9,643</u>	<u>10,177</u>
	<u>514,953</u>	<u>625,836</u>
Net Margins	5,100,392	5,513,402
Other Comprehensive Income:		
Postretirement benefits	<u>150,168</u>	<u>150,168</u>
Total Comprehensive Income	<u><u>\$5,250,560</u></u>	<u><u>\$5,663,570</u></u>

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

Statement of Changes in Consolidated Members' Equity
for the years ended December 31, 2014 and 2015

		Patronage Capital				Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
	Memberships	Assigned	Assignable	Unassigned	Unlocated	Retirements	Total	
Balance - Beginning of year	\$ 641,065	\$ 78,267,466	\$ 7,039,887	\$ 19,445,293	\$ 1,097,226	\$ (25,208,625)	\$ 80,641,247	\$ 78,772,488
Allocate margins		5,409,321	(7,039,887)	1,645,440	(14,874)		-	-
Comprehensive income:								
Net margins			5,513,402				5,513,402	5,513,402
Postretirement benefit obligation								
Amortization								
Adjustment							150,168	150,168
Total comprehensive income								5,663,570
Net change in memberships	(12,751)							(12,751)
Refunds of capital credits						(1,256,289)	(1,256,289)	(1,256,289)
Other equities					(2,552)	(28,867)	(31,419)	(31,419)
Balance-December 31, 2014	628,314	83,676,787	5,513,402	21,090,733	1,079,800	(26,493,781)	84,866,941	83,135,599
Allocate margins		-	(5,513,402)	-	(14,874)		(5,528,276)	(5,528,276)
Comprehensive income:								
Net margins			5,100,392				5,100,392	5,100,392
Postretirement benefit obligation								
Amortization								
Adjustment							150,168	150,168
Total comprehensive income								5,250,560
Net change in memberships	(19,838)							(19,838)
Refunds of capital credits						(1,481,417)	(1,481,417)	(1,481,417)
Other equities					49,061	(28,867)	20,194	20,194
Balance-December 31, 2015	\$ 608,476	\$ 83,676,787	\$ 5,100,392	\$ 21,090,733	\$ 1,113,987	\$ (28,004,065)	\$ 82,977,834	\$ 86,905,098

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

Consolidated Statements of Cash Flows
for the years ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities:		
Net margins	\$ 5,100,392	\$ 5,513,402
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation	5,932,046	5,726,805
Accrued postretirement benefits	194,262	196,937
Income from subsidiary	(5,805,549)	(1,072,623)
Net change in current assets and liabilities:		
Receivables	(210,802)	359,658
Materials	26,135	62,435
Prepayments	71,520	(213,548)
Payables	(2,081)	(601,739)
Customer deposits	(6,700)	(6,100)
Other current and accrued liabilities	526,070	68,571
	<u>5,825,293</u>	<u>10,033,798</u>
Cash Flows from Investing Activities:		
Construction of plant	(4,568,563)	(5,782,297)
Salvage recovered from plant	(15,824)	(88,511)
Nonregulated investments	295,963	266,648
Investment in associated organizations	2,761,812	1,014,254
Change in investment securities	(15,945)	(4,848)
	<u>(1,542,557)</u>	<u>(4,594,754)</u>
Cash Flows from Financing Activities:		
Net increase in memberships and other equities	(19,838)	(44,170)
Retirements of capital credits	(1,481,417)	(1,256,289)
Advances on long term debt	1,023,225	1,472,737
Payments on long term debt	(4,179,692)	(4,128,061)
	<u>(4,657,722)</u>	<u>(3,955,783)</u>
Net increase in cash balances	(374,986)	1,483,261
Cash and cash equivalents - beginning	<u>16,173,152</u>	<u>14,689,891</u>
Cash and cash equivalents - end	<u>\$ 15,798,166</u>	<u>\$ 16,173,152</u>
Supplemental disclosures of cash flows information:		
Interest on long-term debt	\$ 505,310	\$ 615,659
Income taxes paid	\$ 1,958,711	\$ 136,052

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

Foothills Rural Telephone Cooperative and Subsidiary
Notes to 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, 2015, 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, 2015 or 2014. The number of access lines was 12,612 at 2015 and 12,921 at 2014.

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 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. The Cooperative purchases cable transmissions from networks at various amounts based on the number of customers receiving the service.

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.

Foothills Rural Telephone Cooperative and Subsidiary
Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies, continued

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.

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 \$138,278 for 2015 and \$119,796 for 2014.

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.

Foothills Rural Telephone Cooperative and Subsidiary
Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies, continued

The major classification of plant in service is:

	<u>2015</u>	<u>2014</u>
General support	\$14,847,022	\$13,034,207
Central office switching	2,291,234	2,493,900
Central office transmission	26,372,285	23,958,434
Cable and wire facilities	81,542,108	77,930,751
General plant	<u>3,453</u>	<u>3,453</u>
Subtotal telecommunications plant	<u>125,056,102</u>	<u>117,420,745</u>
Headend equipment	5,355,171	4,836,565
Other video plant	<u>1,483,475</u>	<u>1,480,013</u>
Subtotal video plant	<u>6,838,646</u>	<u>6,316,578</u>
	<u>\$131,894,748</u>	<u>\$123,737,323</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>Foothills</u>	<u>Cellular</u>
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, 2015 and 2014. 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.

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.

Foothills Rural Telephone Cooperative and Subsidiary
Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies, continued

Subsequent Events Management has evaluated subsequent events through March 10, 2016, 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:

	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$234,060	\$251,486	(\$17,426)
Internet activities	4,895,321	5,333,554	(438,233)
Long distance services	464,014	318,887	145,127
Fiber to the home video	4,530,613	5,360,751	(830,138)
Total - 2015	<u>\$10,124,008</u>	<u>\$11,264,678</u>	<u>(\$1,140,670)</u>

	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$235,719	\$226,262	\$9,457
Internet activities	4,152,680	3,543,560	609,120
Long distance services	421,536	342,204	79,332
Fiber to the home video	4,190,557	4,722,005	(531,448)
Total - 2014	<u>\$9,000,492</u>	<u>\$8,834,031</u>	<u>\$166,461</u>

Note 4 Long Term Debt

All telecommunications assets, except motor vehicles, are pledged as collateral on the long term debt due RUS and National Bank for Cooperatives ("CoBank"). During 2012 the long term debt payable to RUS was refinanced with proceeds from CoBank and are included with the debt due from CoBank.

Foothills Rural Telephone Cooperative and Subsidiary
Notes to Financial Statements

Note 4 Long Term Debt, continued

Long term debt is as follows:

	<u>2015</u>	<u>2014</u>
RUS, Broadband, 2.132% - 3.426%	\$5,075,380	\$4,236,689
CoBank, 2.71% and 6.25%	<u>7,115,737</u>	<u>11,110,895</u>
	12,191,117	15,347,584
Less current portion	<u>4,150,000</u>	<u>4,100,000</u>
Long term portion	<u><u>\$8,041,117</u></u>	<u><u>\$11,247,584</u></u>

Principal payments for the next five years are as follows: 2016 - \$4,150,000; 2017 - \$2,700,000; 2018 - \$850,000; 2019 - \$230,000; 2020 - \$240,000.

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, 2015, was 82%.

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 2015 and 2014 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 \$497,639 in 2015 and \$543,790 in 2014. There have been no significant changes that affect the comparability of 2015 and 2014.

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, 2015 and 2014 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.

Foothills Rural Telephone Cooperative and Subsidiary
Notes to Financial Statements

Note 7 Accumulated Postretirement Benefits, continued

The funded status of the plan was as follows:

	<u>2015</u>	<u>2014</u>
Projected benefit obligation	(\$6,981,080)	(\$6,897,963)
Plan assets at fair value	<u>2,871,202</u>	<u>2,832,179</u>
Total	<u>(\$4,109,878)</u>	<u>(\$4,065,784)</u>

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

	<u>2015</u>	<u>2014</u>
Benefit obligation at beginning of year	<u>\$4,065,784</u>	<u>\$4,019,015</u>
Components of net periodic benefit cost:		
Service cost	55,242	192,979
Interest cost	346,976	335,106
Expected return on assets	<u>(72,386)</u>	<u>(198,253)</u>
Net periodic benefit cost	329,832	329,832
Benefits paid	(285,738)	(283,063)
Accumulated other comprehensive accounting	-	-
Benefit obligation at end of year	<u>\$4,109,878</u>	<u>\$4,065,784</u>

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 2015 and 2014. The projected retiree benefit payments are expected to be as follows: 2016 - \$281,000; 2017 - \$272,000; 2018 - \$268,000; 2019 - \$267,000; 2020 - \$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 and completed during 2015.

* * * * *

Foothills Rural Telephone Cooperative Corporation and Subsidiary
Consolidating Balance Sheet, December 31, 2015

<u>Assets</u>	<u>Foothills Telephone</u>	<u>Cellular Services</u>	<u>Eliminations</u>	<u>Consolidated</u>
Current Assets:				
Cash and cash equivalents	\$13,520,840	\$2,277,326		\$15,798,166
Accounts receivable, less allowance for 2015 of \$50,307	668,976			668,976
Other accounts receivable	1,773,332		(118,023)	1,655,309
Materials and supplies, at average cost	1,187,672			1,187,672
Prepayments	487,776			487,776
	<u>17,638,596</u>	<u>2,277,326</u>	<u>(118,023)</u>	<u>19,797,899</u>
Other Assets:				
Investment securities available for sale	4,976,587	100,000		5,076,587
Investment in associated organization	29,636,166	23,907,978	(29,636,166)	23,907,978
Nonregulated investments	1,515,046			1,515,046
	<u>36,127,799</u>	<u>24,007,978</u>	<u>(29,636,166)</u>	<u>30,499,611</u>
Telecommunications Plant, at original cost:				
In service	125,056,102	6,838,646		131,894,748
Under construction	2,218,218	9,991		2,228,209
	<u>127,274,320</u>	<u>6,848,637</u>		<u>134,122,957</u>
Less accumulated depreciation	74,329,621	3,379,752		77,709,373
	<u>52,944,699</u>	<u>3,468,885</u>		<u>56,413,584</u>
Total	<u>\$106,711,094</u>	<u>\$29,754,189</u>	<u>(\$29,754,189)</u>	<u>\$106,711,094</u>
<u>Liabilities and Member's Equities</u>				
Current Liabilities:				
Accounts payable	\$1,135,629	\$118,023	(\$118,023)	\$1,135,629
Current portion of long term debt	4,150,000			4,150,000
Customer deposits	200,806			200,806
Other current and accrued expenses	2,047,029			2,047,029
	<u>7,533,464</u>	<u>118,023</u>	<u>(118,023)</u>	<u>7,533,464</u>
Long Term Debt	<u>8,041,117</u>			<u>8,041,117</u>
Accrued Postretirement Benefits	<u>4,109,878</u>			<u>4,109,878</u>
Members' Equities:				
Memberships and capital investment	608,476	8,257,826	(8,257,826)	608,476
Patronage capital and retained earnings	88,627,647	21,378,340	(21,378,340)	88,627,647
Donated capital	124,537			124,537
Accum other comprehensive income	(2,334,025)			(2,334,025)
	<u>87,026,635</u>	<u>29,636,166</u>	<u>(29,636,166)</u>	<u>87,026,635</u>
Total	<u>\$106,711,094</u>	<u>\$29,754,189</u>	<u>(\$29,754,189)</u>	<u>\$106,711,094</u>

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

Consolidating Statement of Revenue and Comprehensive Income
for the year ended December 31, 2015

	<u>Foothills Telephone</u>	<u>Cellular Services</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating Revenue:				
Basic local network services	\$7,600,768	\$298,265	(\$69,009)	\$7,830,024
Network access services	12,918,868			12,918,868
Billing and collection	450,711			450,711
Miscellaneous	1,042,965			1,042,965
Less provision for uncollectibles	(84,000)			(84,000)
	<u>21,929,312</u>	<u>298,265</u>	<u>(69,009)</u>	<u>22,158,568</u>
Operating Expenses:				
Plant specific operations	5,625,020	499,449	(69,009)	6,055,460
Plant nonspecific operations	2,550,467	698		2,551,165
Depreciation	5,481,324	450,722		5,932,046
Customer operations	1,890,537	5,430		1,895,967
Corporate operations	1,798,869	21,791		1,820,660
Taxes	1,266,322	31,497		1,297,819
	<u>18,612,539</u>	<u>1,009,587</u>	<u>(69,009)</u>	<u>19,553,117</u>
Operating margins	<u>3,316,773</u>	<u>(711,322)</u>		<u>2,605,451</u>
Nonoperating Margins				
Other nonoperating income	3,439,242	5,805,549	(3,135,516)	6,109,275
Less related income taxes		(1,958,711)		(1,958,711)
Non regulated activities	(1,140,670)			(1,140,670)
	<u>2,298,572</u>	<u>3,846,838</u>	<u>(3,135,516)</u>	<u>3,009,894</u>
Margins before interest charges	<u>5,615,345</u>	<u>3,135,516</u>	<u>(3,135,516)</u>	<u>5,615,345</u>
Interest Charges:				
Interest on long-term debt	505,310			505,310
Other	9,643			9,643
	<u>514,953</u>			<u>514,953</u>
Net Margins	5,100,392	3,135,516	(3,135,516)	5,100,392
Other Comprehensive Income:				
Accumulated postretirement benefits	150,168			150,168
Net Comprehensive Income	<u>\$5,250,560</u>	<u>\$3,135,516</u>	<u>(\$3,135,516)</u>	<u>\$5,250,560</u>

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

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

To the Board of Directors
Foothills 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 Foothills Rural Telephone Cooperative, which comprise the balance sheets as of December 31, 2015 and 2014, 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 March 10, 2016. My report includes a reference to other auditors who audited the financial statements of East Kentucky Network, LLC, as described in my report on Foothills 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 Foothills 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 Foothills Rural Telephone's internal control. Accordingly, we do not express an opinion on the effectiveness of Foothills 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
Foothills Rural Telephone Cooperative

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Foothills Rural 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*.

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
March 10, 2016

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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, 2015, 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 March 10, 2016. In accordance with *Government Auditing Standards*, we have also issued my report dated March 10, 2016, 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, 2013, 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;

Board of Directors
Foothills Rural Telephone Cooperative

- 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 approval of the RUS to enter into any contract, agreement, or lease with an affiliate as defined in Part 1773 (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.

Foothills Telephone formed a wholly-owned subsidiary, Cellular Services, LLC, which communications and video service and also is a one-fifth (1/5) owner of a limited liability company that provides cellular and other communications services. The initial investment was \$820,000. The investment is comprised of the following:

	<u>Investment</u>	<u>Profits</u>
Balance, beginning of year	\$8,257,826	\$18,249,538
Activity for 2015	-	3,128,802
Balance, end of year	<u>\$8,257,826</u>	<u>\$21,378,340</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
March 10, 2016

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March 10, 2016

To the Board of Directors
Foothills Rural Telephone Cooperative Corporation

I have audited the financial statements of Foothills Rural Telephone Cooperative Corporation for the year ended December 31, 2015, and have issued my report thereon dated March 10, 2016. Professional standards require that I provide you with the following information related to my audit.

My Responsibility under U.S. Generally Accepted Auditing Standards As stated in my engagement letter, my responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. My audit of the financial statements does not relieve you or management of your responsibilities.

Planned Scope and Timing of the Audit I performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters.

Significant Audit Findings There was no significant findings as a result of my audit procedures performed.

Adoption of New Accounting Principles Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of my engagement letter, I will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Foothills Rural Telephone are described in the Notes to the financial statements. During the year ended December 31, 2015, there were no significant new accounting principles adopted.

Unusual Transactions Lacking Authoritative Guidance I noted no transactions entered into by Foothills Rural Telephone during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting Estimates Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Difficulties Encountered in Performing the Audit I encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatement Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. There were no significant audit adjustments required, nor were there any significant uncorrected misstatements not posted into the general ledger of Foothills Rural Telephone

Disagreements with Management For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. I am pleased to report that no such disagreements arose during the course of my audit.

Management Representations I have requested certain representations from management that are included in the management representation letter dated March 10, 2016.

Consultation with Other Accountants In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to Foothills Rural Telephone's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, my professional standards require the consulting accountant to check with me to determine that the consultant has all the relevant facts. I did not consult with any outside accountants regarding accounting and auditing issues relevant to Foothills Rural Telephone

Other Audit Findings or Issues There were no other audit findings or other issues required by my professional standards to be reported to the audit committee.

This information is intended solely for the use of the Audit Committee, Board of Directors, and management of Foothills Rural Telephone and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Alan Zumstein

Alan M. Zumstein, CPA