FOOTHILLS RURAL TELEPHONE COOPERATIVE
AND SUBSIDIARY
KY 522

FINANCIAL REPORT

DECEMBER 31, 2019

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Jones, Nale & Mattingly PLC

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Foothills Rural Telephone Cooperative and Subsidiary
Staffordsville, Kentucky

We have audited the accompanying consolidated financial statements of Foothills Rural Telephone Cooperative and Subsidiary (the Cooperative), which comprise the consolidated balance sheet as of December 31, 2019, and the related consolidated statements of income and comprehensive income, changes in members' equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Certified Public Accountants and Advisors
642 South Fourth Street, Suite 300 Louisville, Kentucky 40202 tel: 502.583.0248 fax: 502.589-1680 www.jnmcpa.com

Opinion

In our 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, 2019, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 13, Foothills Rural Telephone Cooperative and Subsidiary have adopted Financial Accounting Standards Update 2014-09, *Revenue from Contracts with Customers.* Our opinion is not modified with respect to this matter.

Correction of Error

As described in Note 15 to the financial statements, the Cooperative discovered errors resulting in an understatement of amounts previously reported for deferred tax liabilities and income tax expense. In addition, the Cooperative discovered an error resulting in an understatement of prepaid income taxes and overstatement of income tax expense. Accordingly, amounts presented for deferred tax liabilities, prepaid income taxes and income tax expense have been restated in the 2018 financial statements now presented, and a cumulative effect adjustment has been made to patronage capital as of January 1, 2018. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2020, on our consideration of Foothills Rural Telephone Cooperative and Subsidiary's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Cooperative's internal control over financial reporting and compliance.

Prior Period Financial Statements

The consolidated financial statements of Foothills Rural Telephone Cooperative and Subsidiary, as of and for the year ended December 31, 2018 were audited by other auditors whose report dated February 14, 2019 expressed an unmodified opinion on those statements.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 28, 2020

FOOTHILLS RURAL TELEPHONE COOPERATIVE AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
December 31, 2019 and 2018

	2019	2018
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 20,270,255	$ 13,418,853
Accounts receivable, less allowance for doubtful accounts of $69,988 in 2019 and $112,871 in 2018	714,333	687,428
Other receivables	992,372	1,260,711
Materials and supplies, at average cost	1,309,005	1,428,068
Prepaid income taxes	128,075	2,278,075
Prepaid expenses	449,870	585,975
Total current assets	23,863,910	19,659,110
NON-CURRENT ASSETS		
Investment securities	2,715,008	2,702,712
Associated organizations	33,530,672	30,501,044
Pension plan prefunding	1,962,824	1,917,304
Nonregulated investments	2,930,423	1,789,577
Total non-current assets	41,138,927	36,910,637
PROPERTY AND EQUIPMENT		
In service	135,944,439	135,398,599
Under construction	482,716	376,666
	136,427,155	135,775,265
Less accumulated depreciation	83,425,724	79,464,035
	53,001,431	56,311,230
	$ 118,004,268	$ 112,880,977

The Notes to Consolidated Financial Statements are an integral part of these statements.

	2019	2018
LIABILITIES AND MEMBERS' EQUITIES		
CURRENT LIABILITIES		
Current portion of long-term debt	$ 11,715	$ 11,715
Accounts payable	776,363	1,018,042
Customer deposits	185,346	193,706
Accrued expenses	2,138,935	1,767,966
Total current liabilities	3,112,359	2,991,429
NON-CURRENT LIABILITIES		
Long-term debt, less current portion	185,262	196,906
Accumulated postretirement benefits	6,506,556	4,346,655
Deferred tax liabilities	2,870,000	2,600,000
Total non-current liabilities	9,561,818	7,143,561
MEMBERS' EQUITIES		
Memberships and capital investments	637,588	638,101
Patronage capital and retained earnings	108,374,595	103,866,870
Donated capital	124,537	124,537
Accumulated comprehensive income (loss)	(3,806,629)	(1,883,521)
Total members' equities	105,330,091	102,745,987
	$ 118,004,268	$ 112,880,977

FOOTHILLS RURAL TELEPHONE COOPERATIVE AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
Years Ended December 31, 2019 and 2018

	2019	2018
Operating revenues:		
Local network service	$ 4,156,613	$ 3,687,820
Network access service	14,589,874	15,138,160
Carrier billing and collection	336,172	349,577
Miscellaneous	1,224,353	1,155,478
Less provision for uncollectibles	(32,400)	(90,000)
Total operating revenues	20,274,612	20,241,035
Operating expenses:		
Plant specific operations	6,571,526	6,448,173
Plant non-specific operations	1,442,101	1,782,333
Depreciation	6,506,448	6,379,172
Customer operations	2,117,677	2,149,001
Corporate operations	2,126,607	2,091,034
Taxes, other than income	917,656	982,359
Total operating expenses	19,682,015	19,832,072
Operating income	592,597	408,963
Other income (expense):		
Other nonoperating income	435,035	8,875
Interest on long-term debt	(5,021)	(50,590)
Other interest expense	(817)	(875)
Income in associated organizations	4,759,427	1,069,317
Total other income	5,188,624	1,026,727
Income before income taxes	5,781,221	1,435,690
Income tax benefit (expense)	(957,770)	(172,481)
Net income before nonregulated income	4,823,451	1,263,209
Nonregulated income	1,544,850	1,303,977
Net income	6,368,301	2,567,186
Other comprehensive income (loss)		
Accumulated postretirement benefits	(1,923,108)	150,168
Total comprehensive income	$ 4,445,193	$ 2,717,354

The Notes to Consolidated Financial Statements are an integral part of these statements.

FOOTHILLS RURAL TELEPHONE COOPERATIVE AND SUBSIDIARY

STATEMENTS OF CHANGES IN MEMBERS' EQUITIES
Years Ended December 31, 2019 and 2018

		Patronage Capital							Accumulated Other	
	Memberships	Assigned	Assignable	Unassigned	Unlocated	Retirements	Total	Other Equities	Comprehensive (Loss)	Total
Balance, January 1, 2018, as previously stated	$ 629,592	$ 92,898,393	$ 9,308,319	$ 31,199,996	$ 1,099,163	$ (30,655,350)	$ 103,850,521	$ 124,537	$ (2,033,689)	$ 102,570,961
Prior period adjustment				(906,729)			(906,729)			(906,729)
Balance, January 1, 2018, as restated	629,592	92,898,393	9,308,319	30,293,267	1,099,163	(30,655,350)	102,943,792	124,537	(2,033,689)	101,664,232
Allocate margins		5,275,598	(9,308,319)	4,032,721			- -	- -	- -	- -
Net income	- -	- -	2,567,186	- -	- -	- -	2,567,186	- -	- -	2,567,186
Postretirement benefit obligations										
Amortization	- -	- -	- -	- -	- -	- -	- -	- -	150,168	150,168
Adjustment	- -	- -	- -	- -	- -	- -	- -	- -	- -	- -
Memberships issued, net	8,509	- -	- -	- -	- -	- -	- -	- -	- -	8,509
Refunds of capital credits	- -	- -	- -	- -	- -	(1,655,921)	(1,655,921)	- -	- -	(1,655,921)
Other equities	- -	- -	- -	- -	11,813	- -	11,813	- -	- -	11,813
Balance, December 31, 2018	638,101	98,173,991	2,567,186	34,325,988	1,110,976	(32,311,271)	103,866,870	124,537	(1,883,521)	102,745,987
Allocate margins		2,919,369	(2,567,186)	(352,183)			- -			- -
Net income	- -	- -	6,368,301	- -	- -	- -	6,368,301	- -	- -	6,368,301
Postretirement benefit obligations										
Amortization	- -	- -	- -	- -	- -	- -	- -	- -	150,168	150,168
Adjustments	- -	- -	- -	- -	- -	- -	- -	- -	(2,073,276)	(2,073,276)
Memberships issued, net	(513)	- -	- -	- -	- -	- -	- -	- -	- -	(513)
Refunds of capital credits	- -	- -	- -	- -	- -	(1,890,037)	(1,890,037)	- -	- -	(1,890,037)
Other equities	- -	- -	- -	- -	29,461	- -	29,461	- -	- -	29,461
Balance, December 31, 2019	$ 637,588	$ 101,093,360	$ 6,368,301	$ 33,973,805	$ 1,140,437	$ (34,201,308)	$ 108,374,595	$ 124,537	$ (3,806,629)	$ 105,330,091

The Notes to Consolidated Financial Statements are an integral part of these statements.

FOOTHILLS RURAL TELEPHONE COOPERATIVE AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 6,368,301	$ 2,567,186
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	6,506,448	6,379,172
Accumulated postretirement benefits	236,793	233,938
Income from associated organizations	(4,759,427)	(1,070,216)
Change in assets and liabilities, net of the effects of investing and financing activities:		
Accounts receivable	(26,905)	(232,980)
Other receivables	268,339	- -
Material and supplies	119,063	78,703
Prepaid income taxes	2,150,000	(734,804)
Prepaid expenses	136,105	64,453
Accounts payable	(241,679)	227,363
Customer deposits	(8,360)	9,700
Deferred tax liabilities	270,000	150,000
Accrued expenses	370,969	(521,068)
Net cash provided by operating activities	11,389,647	7,151,447
CASH FLOWS FROM INVESTING ACTIVITIES		
Plant additions	(3,176,227)	(2,191,286)
Salvage, net of removal cost	(21,321)	(23,460)
Nonregulated property	(1,140,846)	(698,278)
Associated organizations	1,730,698	1,838,450
Purchase of securities	(12,296)	90,886
Net cash (used in) investing activities	(2,619,992)	(983,688)
CASH FLOWS FROM FINANCING ACTIVITIES		
Prefund pension plan	(513)	363,899
Membership and other equities	(1,860,576)	8,509
Retirements of capital credits	(45,520)	(1,655,920)
Payments on long-term debt	(11,644)	(2,208,598)
Net cash (used in) financing activities	(1,918,253)	(3,492,110)
Net increase in cash and cash equivalents	6,851,402	2,675,649
Cash and cash equivalents:		
Beginning of year	13,418,853	10,743,204
End of year	$ 20,270,255	$ 13,418,853
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash payments for interest	$ 5,838	$ 51,465
Income taxes paid	- -	757,285

The Notes to Consolidated Financial Statements are an integral part of these statements.

NOTES TO CONSOLIDATED 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 significant 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.

Nature of Business

The Cooperative has completed construction allowing it to expand its 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 is also able to provide high speed internet, virtual private networks, and voice over internet protocol (VoIP). This is accomplished through Fiber to the Home (FTTH) technology.

Estimates

The preparation of consolidated financial statements in accordance 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 consolidated 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 consolidated financial statements.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Cooperative considers temporary investments having original maturities of three months or less to be cash equivalents. The Cooperative maintains its cash balances, which may exceed the federally insured limit, with several financial institutions. Management believes that credit risk related to the accounts is minimal.

Investment Securities

Investment securities consist of certificates of deposit in local banks and are carried at cost, which approximates fair value, and are held to maturity. Fair value is determined by quoted prices for similar certificates of deposit in active markets (Level 2) as defined under U.S GAAP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Accounts Receivable

Accounts receivable are stated at face amount less an allowance for doubtful accounts. The allowance for doubtful 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 ten percent of outstanding accounts receivable at December 31, 2019 and 2018. The number of access lines was 12,016 for 2019 and 12,093 at 2018.

Materials and Supplies

Materials and supplies are composed primarily of telephone material and supplies used in the telecommunications plant. The inventory is valued at the lower of cost or net realizable value, cost being determined by the average cost method.

Telecommunications Revenue Recognition

Revenues are recognized when earned. 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.

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 provide 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 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.

Taxes

Foothills Telephone and Cellular Services' are required to collect, on behalf of taxing authorities, excise taxes, sales, school taxes, and franchise fees. The Cooperative's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Note 1. Summary of Significant Accounting Policies (Continued)

Risk Management

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

Advertising

Advertising costs are expensed as incurred. For the years ended December 31, 2019 and 2018, these costs were $218,016 and $196,937, respectively.

Telecommunications and Video 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 $39,046 for both 2019 and 2018.

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.

Provision has been made for depreciation on the basis of estimated lives of assets (as prescribed by the Public Service Commission of Kentucky) using the straight-line method. Rates are as follows:

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

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 that pays income taxes on its net income. Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of investments in associated organizations. The deferred tax assets and liabilities represent future tax return consequences of those differences, which will either be taxable or deductible when the assets or liabilities are recovered or settled.

Note 1. Summary of Significant Accounting Policies (Continued)

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, 2019 and 2018.

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 for federal and four years for state.

Comprehensive Income

Comprehensive income includes both net income 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 March 28, 2020, the date the consolidated financial statements were available to be issued. During January 2020, Cellular Services purchased a cable television system from an unrelated party for approximately $3.5 million.

Recently issued accounting pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The standard requires all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheets at the date of lease commencement. Leases will be classified as either finance or operating. This distinction will be relevant for the pattern of expense recognition in the statements of income. This standard will be effective for the year ending December 31, 2021.

In June 2016, the FASB issued ASU No. 2016-13 (ASU 2016-13), *Financial Instruments – Credit Losses*. This guidance replaces the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan and financing receivables, held-to-maturity debt securities and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. This standard is effective for the year ending December 31, 2023.

Management is currently in the process of evaluating the impact of the adoption of these ASU's on the Cooperative's financial statements.

Note 2. Fair Value Measurements

U.S. GAAP provides a framework for fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The methodology for measuring fair value specifies a three-tier hierarchy of valuation techniques based upon whether the inputs to those valuation techniques are based on quoted prices of identical assets or liabilities (Level 1), significant other observable inputs (Level 2), or significant other unobservable inputs that reflect a company's own assumptions of market participant valuation (Level 3).

The Cooperative's investment securities measured at fair value on a recurring basis are as follows:

		Fair value measurements using:	
	Fair value	Unadjusted quoted prices (Level 1)	Significant other observable inputs (Level 2)
December 31, 2019			
Certificates of deposit	$ 2,715,008	$ --	$ 2,715,008
	$ 2,715,008	$ --	$ 2,715,008
December 31, 2018			
Certificates of deposit	$ 2,702,712	$ --	$ 2,702,712
	$ 2,702,712	$ --	$ 2,702,712

Note 3. Associated Organizations

The amounts for East Kentucky Network, LLC ("EKN") represents Cellular Service's investment in a limited liability company with other telephone companies in eastern Kentucky for the purpose of providing cellular telephone, paging, and other services. The investment is accounted for using the equity method since Cellular Services is a 20% member and has the ability to significantly influence EKN's operations and financial policies. EKN has been paying distributions of approximately 50% of the income allocated in cash during the following year. The following is summarized financial information of EKN as of and for the years ended December 31, 2019 and 2018:

	2019	2018
Assets	$ 200,788,162	$ 178,938,066
Liabilities	$ 33,134,801	$ 26,432,862
Equity	$ 167,653,361	$ 152,505,204
Revenues and other income	$ 132,935,842	$ 116,740,801
Expenses and other expenses	$ 118,866,602	$ 111,739,659
Net income	$ 14,069,240	$ 5,001,142

Note 4. Telecommunications Plant

The major classification of plant service is:

	2019	2018
Telecommunications Plant:		
General support	$ 17,570,123	$ 17,215,142
Central office switching	1,323,901	1,181,725
Central office transmission	16,180,528	17,569,772
Cable wire facilities	88,826,705	88,373,348
Intangibles	3,453	3,453
	123,904,710	124,343,440
Video Plant:		
Headend equipment	6,325,593	6,329,308
Cable and other video plant	5,714,135	4,725,850
	12,039,728	11,055,158
Total	$ 135,944,438	$ 135,398,598

Note 5. Nonregulated Activities

Deregulated customer premises equipment is stated at cost; material held for lease or resale is stated at average cost. Customer Premises Equipment (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 the Cooperative. A monthly fee is recorded based on telephone usage. FLD purchases minutes of long distance to resell to its customers from an unrelated party. Nonregulated 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.

Note 5. Nonregulated Activities (Continued)

The following is a summary of nonregulated activities as of December 31:

	2019	2018
Investments	$ 229,175	$ 227,456
Material and supplies	1,320	1,327
Plant assets	5,518,986	5,072,389
Reserve for depreciation	(2,819,058)	(3,511,595)
	$ 2,930,423	$ 1,789,577

	Income	Expenses	Net
Customer premises equipment	$ 204,640	$ 770,297	$ (565,657)
VoIP	303,018	84,885	218,133
Internet activities	6,133,575	4,027,329	2,106,246
Long distance services	193,045	215,384	(22,339)
Fiber to home video	5,121,149	5,312,682	(191,533)
Total - 2019	$ 11,955,427	$ 10,410,577	$ 1,544,850

	Income	Expenses	Net
Customer premises equipment	$ 206,627	$ 349,890	$ (143,263)
VoIP	228,917	84,885	144,032
Internet activities	5,551,336	3,628,604	1,922,732
Long distance services	565,072	559,128	5,944
Fiber to home video	5,012,677	5,638,145	(625,468)
Total - 2018	$ 11,564,629	$ 10,260,652	$ 1,303,977

Note 6. Long-Term Debt

All telecommunications assets, except motor vehicles, are pledged as collateral on the long-term debt due to the U.S. Department of Agriculture, Rural Development ("USDA").

Long-term debt is as follows as of December 31, 2019 and 2018:

	2019	2018
RUS Broadband Loan 2.132%-3.426%	$ 196,977	$ 208,621
Less current portion	11,715	11,715
Long-term portion	$ 185,262	$ 196,906

Note 6. Long-Term Debt (Continued)

Principal payments for the next five years and thereafter are as follows:

2020	$	11,715
2021		11,900
2022		12,200
2023		12,400
2024		12,700
Thereafter		136,062
	$	196,977

Note 7. 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, 2019 and 2018 was 93% and 92%, respectively.

Note 8. Pension Plan

All eligible non-union employees of the Cooperative participate in the National Telephone Cooperative Association (NTCA) Pension Plan ("R&S Plan"), a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The Plan sponsor's identification number is 52-0741336 and the Plan Number is 333. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers. There have been no significant changes that affect the comparability of 2019 and 2018.

The Cooperative's contributions to the R&S Plan in 2019 and 2018 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 $737,626 in 2019 and $675,990 in 2018.

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 and 80 percent funded at January 1, 2019 and 2018, respectively, 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.

The NTCA Board of Directors amended the 2018 R&S Program specifications at the recommendation of the Plan Trust Committee to include the following changes:

Note 8. Pension Plan (Continued)

- Basic contribution rates will increase by 19%.
- The program's current surcharge will expire at the end of 2018, and a new surcharge contribution of 50% of the member's elected contribution rate will begin in 2019. This surcharge is expected to continue for approximately 12 years.
- A prefunding option was added to allow members the option to prefund their future surcharge contributions in a single payment prior to the start of the new surcharge effective in 2019.
- Beginning January 1, 2018, for members that have adopted the Rule-of-85 ("ROE") provision, the ROE charge will apply to both the member's elected employer contribution rate and any required employee contribution rate.

Over the past several years, various actions have been taken to sustain the reserve of funds available to help meet the programs legally required minimum contribution amount. However, adverse economic conditions and regulatory changes have negatively affected all pension plans, including the R&S Program. Despite prudent decision-making by the program's trust committee, the R&S Program's minimum contribution amount is projected to exceed the current reserve and member contributions alone will not meet the minimum requirement. This expectation has led the program's actuary to recommend the new surcharge contribution beginning in 2020. The R&S Program is offering prefunding to give members flexibility in addressing this situation at the Cooperative.

The prefunding contribution is expected to fund the member's surcharge contribution for approximately 12 years.

- Each member's prefunding contribution will be maintained in a notional account within the R&S Program and used to pay that member's surcharge contributions.
- Each member's prefunding account is maintained separately from other member's prefunding accounts.
- Account funds will be invested with other R&S Program assets and grow at the same rate as the program's overall investment returns.
- An annual statement will be provided to each member showing their specific prefunding account activity.

During 2016, the Cooperative prefunded the surcharge in an amount of $2,078,772. This amount will be amortized over the 12-year period the surcharge is expected to continue.

Contributions rates are as follows:

	2017 and after	2016 and before
Employer contributions	10.70%	8.30%
Employee contributions	4.00%	4.00%
Rate of 85 charges	5.50%	5.50%

Note 9. Accumulated Postretirement Benefits

The Cooperative sponsors a defined benefit plan that provides medical insurance coverage for employees hired before February 1, 2006 to retirees and their dependents. Employees hired after that date are not eligible to receive paid health insurance after retirement. 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. There have been no significant changes that affect the comparability of 2019 and 2018.

The following illustrates the plan for the years ended December 31, 2019 and 2018:

	2019	2018
Benefit obligation, beginning of year	$ 7,834,179	$ 4,262,885
Service cost	265,333	519,376
Interest cost	443,213	345,385
Benefits paid	(243,206)	(396,230)
Expected return on assets	292,704	(393,761)
Actuarial (gain) loss	2,095,817	3,496,524
Benefit obligation, end of year	$ 10,688,040	$ 7,834,179
Fair value of plan assets, beginning of year	$ 3,487,524	$ 3,653,360
Actual return on plan assets	937,166	230,394
Employer contributions	- -	- -
Benefits paid	(243,206)	(396,230)
Fair value of plan assets, end of year	$ 4,181,484	$ 3,487,524
Reconciliation of funded status:		
Funded status	$ (6,506,556)	$ (4,346,655)
Net amount recognized at year end	$ (6,506,556)	$ (4,346,655)
Amounts recognized in the balance sheet consists of:		
Noncurrent assets (liabilities)	$ (6,506,556)	$ (4,346,655)
Amounts included in accumulated other comprehensive income:		
Unrecognized actuarial gain (loss)	$ (3,806,629)	$ (1,883,521)

Note 9. Accumulated Postretirement Benefits (Continued)

		2019		2018
Components of net periodic benefit cost:				
Service cost	$	265,333	$	519,376
Interest cost		443,213		345,385
Expected return on plan assets		(292,704)		(393,761)
Amortization cost		213,550		213,550
Net periodic benefit cost	$	629,392	$	684,550

		2019		2018
Weight-average assumptions as of December 31:				
Discount rate		4.30%		4.30%
Expected return on plan assets		7.00%		7.00%
Rate of compensation increase		3.00%		3.00%
Effect of 1% trend sensitivity for medical plan:				
Projected benefit obligation	$	12,568,964		
Net periodic benefit cost	$	945,661		

The projected retiree benefit payments are expected to be as follows: 2020 - $381,000; 2021 - $372,000; 2022 - $368,000; 2023 - $377,000; 2024 - $370,000.

The Plan's investments measured at fair value on a nonrecurring basis as follows:

			Fair value measurements using:			
		Fair value		Unadjusted quoted prices (Level 1)		Significant other observable inputs (Level 2)
December 31, 2019						
Stocks	$	2,383,446	$	2,383,446	$	- -
Investment grade debt instruments		752,667		- -		752,667
High-yield debt instruments		418,148		- -		418,148
Real assets		543,593		- -		543,593
Other		83,630		- -		83,630
	$	4,181,484	$	2,383,446	$	1,798,038
December 31, 2018						
Stocks	$	1,987,889	$	1,987,889	$	- -
Investment grade debt instruments		627,754				627,754
High-yield debt instruments		348,752				348,752
Real assets		453,378				453,378
Other		69,750				69,750
	$	3,487,524	$	1,987,889	$	1,499,635

Note 10. Income Taxes

The components of income tax expense (benefit) are as follows:

	December 31, 2019	December 31, 2018
Current:		
Federal	506,643	- -
State	181,127	22,481
	687,770	22,481
Deferred:		
Federal	216,000	120,000
State	54,000	30,000
	270,000	150,000
`	$ 957,770	$ 172,481

The deferred tax liabilities in the accompanying balance sheets consist of the following components:

	December 31, 2019	December 31, 2018
Deferred tax liabilities:		
Federal	$ 2,296,000	$ 2,080,000
State	574,000	520,000
	$ 2,870,000	$ 2,600,000

Note 11. 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 12. Contingencies

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

Note 13. Revenue Recognition

Adoption of accounting pronouncement

The Cooperative adopted ASU 2014-09, *Revenue from Contracts with Customers* as of January 1, 2019 using a modified retrospective method. The new standard replaces existing revenue recognition rules with a single comprehensive model to use in accounting for revenue arising from contracts with customers. The adoption of ASU 2014-09 had no material impact on earnings or equity of the Cooperative.

Under ASU 2014-09, the timing of recognition of revenue for each performance obligation may differ from the timing of the customer billing, creating a contract asset or contract liability. Short-term contract liabilities are classified as customer deposits. The Cooperative has no contract assets or long-term contract liabilities.

Nature of goods and services

The following is a description of principal activities from which the Cooperative generates its revenues.

Telecommunications revenues – The Cooperative's regulated sources of revenue are local network services, network access services (interstate and intrastate/interlata), carrier billing, video revenue and other service charges. The Cooperative's nonregulated sources of revenue are customer premises and equipment, internet activities, long distance services, video services, and security/surveillance/bus systems.

Significant judgments

Revenues from sales of equipment are recognized when control has transferred to the customer. Telecommunication service revenues are recognized as the related service is provided. Services are deemed to be highly interrelated when the method and timing of transfer and performance risk are the same. Highly interrelated services that are determined to not be distinct have been grouped into a single performance obligation. Each month of services promised is a performance obligation. The series of monthly service performance obligations promised over the course of the contract are combined into a single performance obligation for purposes of the allocation.

The Cooperative has made judgments regarding transaction price, including but not limited to issues relating to variable consideration, time value of money and returns. When determined to be significant in the context of the contract, these items are considered in the valuation of transaction price at contract inception or modification, as appropriate.

Multiple performance obligations

The Cooperative sells bundled service and equipment offerings. In these instances, the Cooperative recognizes its revenue based on the relative standalone selling prices for each distinct service or equipment performance obligation or bundles thereof. The Cooperative estimates the standalone selling price of the device or accessory to be its retail price excluding discounts. The Cooperative estimates the standalone selling price of telecommunication service to be the price offered to customers on month-to-month contracts.

Note 13. Revenue Recognition

From time to time, the Cooperative may offer certain promotions to incentivize customers to switch to, or to purchase additional services from the Company. Under these types of promotions, an eligible customer may receive an incentive in the form of a discount off additional services purchased shown as a rebate or credit to the customer's monthly bill. Rebates are amortized over the life of the contract and are recognized when included in the customer's monthly bill.

Disaggregation of revenue

In the following table, revenue for the years ended December 31, 2019 and 2018 is disaggregated by type of service and timing of revenue recognition. Telecommunication service revenues are recognized over time and equipment sales at a point in time.

	2019	2018
Regulated income:		
Local network services	$ 4,156,613	$ 3,687,820
Network access services	14,589,874	15,138,160
Carrier billing and collections	336,172	349,577
Miscellaneous	1,224,353	1,155,478
	$ 20,307,012	$ 20,331,035
Nonregulated income:		
Customer premises equipment	$ 204,640	$ 206,627
VoIP	303,018	228,917
Internet activities	6,133,575	5,551,336
Long distance services	193,045	565,072
Fiber to the home video	5,121,149	5,012,677
	$ 11,955,427	$ 11,564,629

Contract cost liabilities

Contract cost liabilities include customer deposits. The balance in contract liabilities was $185,346 and $193,706 as of December 31, 2019 and 2018, respectively.

Note 14. Risks and Uncertainties

Subsequent to December 31, 2019, local, U.S., and world governments have encouraged self-isolation to curtail the spread of the global pandemic, coronavirus disease (COVID-19), by mandating temporary work stoppage in many sectors and imposing limitations on travel and size and duration of group meetings. Most industries are experiencing disruption to business operations and the impact of reduced consumer spending. There is unprecedented uncertainty surrounding the duration of the pandemic, its potential economic ramifications, and any government actions to mitigate them. Accordingly, while management cannot quantify the financial and other impact to the Cooperative as of March 28, 2020, management believes that a material impact on the Cooperative's financial position and results of future operations is reasonably possible.

Note 15. Correction of Error

The Cooperative discovered it omitted deferred tax liabilities related to its investment in an affiliated organization and did not properly adjust prepaid income taxes. The Cooperative has restated its 2018 previously issued consolidated financial statements to reflect the correction of these errors. The effect of the correction decreased income tax expense from $757,285 to $172,481, increased deferred tax liabilities from zero to $2,600,000 and increased prepaid income taxes from zero to $2,278,075. The cumulative effect of the correction decreased beginning patronage capital as of January 1, 2018 by $906,729.

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INDEPENDENT AUDITOR'S REPORT ON
THE SUPPLEMENTARY INFORMATION

To the Board of Directors
Foothills Rural Telephone Cooperative and Subsidiary
Staffordsville, Kentucky

We have audited the consolidated financial statements of Foothills Rural Telephone Cooperative and Subsidiary as of December 31, 2019, and our report thereon dated March 28, 2020, which expressed an unmodified opinion on those consolidated financial statements, appears on pages 1 and 2. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information found on pages 23 and 24, is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 28, 2020

Certified Public Accountants and Advisors
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FOOTHILLS RURAL TELEPHONE COOPERATIVE AND SUBSIDIARY

CONSOLIDATING BALANCE SHEET
December 31, 2019

	Foothills Rural Telephone Cooperative	Cellular Services	Eliminations	Consolidated
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$ 13,978,587	$ 6,291,668	$ - -	$ 20,270,255
Accounts receivable, net	714,333	- -	- -	714,333
Other receivables	1,125,441	- -	(133,069)	992,372
Materials and supplies, at average cost	1,309,005	- -	- -	1,309,005
Prepaid income taxes	- -	128,075	- -	128,075
Prepaid expenses	449,612	258	- -	449,870
	17,576,978	6,420,001	(133,069)	23,863,910
NON-CURRENT ASSETS				
Investment securities	2,615,008	100,000	- -	2,715,008
Associated organizations	43,435,577	33,530,672	(43,435,577)	33,530,672
Pension plan prefunding	1,962,824	- -	- -	1,962,824
Nonregulated investments	2,930,423	- -	- -	2,930,423
Total non-current assets	50,943,832	33,630,672	(43,435,577)	41,138,927
PROPERTY AND EQUIPMENT				
In service	123,904,710	12,039,729	- -	135,944,439
Under construction	395,145	87,571	- -	482,716
	124,299,855	12,127,300	- -	136,427,155
Less accumulated depreciation	77,725,300	5,700,424	- -	83,425,724
	46,574,555	6,426,876	- -	53,001,431
	$ 115,095,365	$ 46,477,549	$ (43,568,646)	$ 118,004,268

	Foothills Rural Telephone Cooperative	Cellular Services	Eliminations	Consolidated
LIABILITIES AND MEMBERS' EQUITIES				
CURRENT LIABILITIES				
Current portion of long-term debt	$ 11,715	$ - -	$ - -	$ 11,715
Accounts payable	775,365	134,067	(133,069)	776,363
Customer deposits	185,346	- -	- -	185,346
Accrued expenses	2,101,030	37,905	- -	2,138,935
Total current liabilities	3,073,456	171,972	(133,069)	3,112,359
NON-CURRENT LIABILITIES				
Long-term debt, less current portion	185,262	- -	- -	185,262
Accumulated postretirement benefits	6,506,556	- -	- -	6,506,556
Deferred tax liabilities	- -	2,870,000	- -	2,870,000
Total non-current liabilities	6,691,818	2,870,000	- -	9,561,818
MEMBERS' EQUITIES				
Memberships and capital investments	637,588	8,257,826	(8,257,826)	637,588
Patronage capital and retained earnings	108,374,595	35,177,751	(35,177,751)	108,374,595
Donated capital	124,537	- -		124,537
Accumulated comprehensive (loss)	(3,806,629)	- -		(3,806,629)
Total members' equities	105,330,091	43,435,577	(43,435,577)	105,330,091
	$ 115,095,365	$ 46,477,549	$ (43,568,646)	$ 118,004,268

FOOTHILLS RURAL TELEPHONE COOPERATIVE AND SUBSIDIARY

CONSOLIDATING STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
Year Ended December 31, 2019

	Foothills Rural Telephone Cooperative	Cellular Services	Eliminations	Consolidated
Operating revenues:				
Local network service	$ 3,024,216	$ 1,168,135	$ (35,738)	$ 4,156,613
Network access service	14,471,015	118,859	- -	14,589,874
Carrier billing and collection	336,172	- -	- -	336,172
Miscellaneous	1,126,821	97,532	- -	1,224,353
Less prevision for uncollectibles	(32,400)	- -	- -	(32,400)
Total operating revenues	18,925,824	1,384,526	(35,738)	20,274,612
Operating expenses:				
Plant specific operations	5,571,020	1,036,244	(35,738)	6,571,526
Plant non-specific operations	1,400,491	41,610	- -	1,442,101
Depreciation	5,758,690	747,758	- -	6,506,448
Customer operations	2,079,259	38,418	- -	2,117,677
Corporate operations	1,938,035	188,572	- -	2,126,607
Taxes, other than income	885,244	32,412	- -	917,656
Total operating expenses	17,632,739	2,085,014	(35,738)	19,682,015
Operating income	1,293,085	(700,488)	- -	592,597
Other income (expense):				
Other nonoperating income (expense)	434,137	898	- -	435,035
Interest on long-term debt	(5,021)	- -	- -	(5,021)
Other interest expense	(817)	- -	- -	(817)
Income in associated organizations	3,102,067	4,759,427	(3,102,067)	4,759,427
Total other income (expense)	3,530,366	4,760,325	(3,102,067)	5,188,624
Income before income taxes	4,823,451	4,059,837	(3,102,067)	5,781,221
Income tax benefit (expense)	- -	(957,770)	- -	(957,770)
Net income before nonregulated income	4,823,451	3,102,067	(3,102,067)	4,823,451
Nonregulated income	1,544,850	- -	- -	1,544,850
Net income	6,368,301	3,102,067	(3,102,067)	6,368,301
Other comprehensive income (loss)				
Accumulated postretirement benefits	(1,923,108)	- -	- -	(1,923,108)
Total comprehensive income	$ 4,445,193	$ 3,102,067	$ (3,102,067)	$ 4,445,193

Jones, Nale & Mattingly PLC

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Foothills Rural Telephone Cooperative and Subsidiary
Staffordsville, Kentucky

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Foothills Rural Telephone Cooperative and Subsidiary (the Cooperative), as of and for the year ended December 31, 2019, and the related notes to the consolidated financial statements, and have issued our report thereon dated March 28, 2020.

Internal Control Over Financial Reporting

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

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

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Compliance and Other Matters

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

Purpose of this Report

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

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 28, 2020

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

Board of Directors
Foothills Rural Telephone Cooperative and Subsidiary
Staffordsville, Kentucky

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Foothills Rural Telephone Cooperative and Subsidiary (the Cooperative), which comprise the balance sheet as of December 31, 2019, and the related statements of income and comprehensive income, changes in members' equities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 28, 2020. In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2020 on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us 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 and Grantees*, §1773.33, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding 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 our audit, we 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;

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- Obtain written permission from RUS to enter into any contract, agreement, or lease with an Subsidiary as defined in Part 1773.33 (e)(2)(i);
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles, and;
- Comply with the requirements for the detailed schedule of investments, which is listed below.

During 2004, the Cooperative formed a wholly owned Subsidiary, Cellular Services, which provides telecommunications services outside of the Cooperative's service territory and is also 20% owner of East Kentucky Network, LLC, that provides cellular and other communication services in Eastern Kentucky. The initial investment was $1,130,000. The investment in Cellular Services, Inc. is comprised of the following:

	Investments	Profits (less Dividends)
Beginning of year	$ 11,757,826	$ 28,897,608
Activity for 2019	- -	2,780,143
End of year	$ 11,757,826	$ 31,677,751

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for telecommunication borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 28, 2020