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Mountain Rural Telephone Cooperative and Subsidiary

West Liberty, Kentucky

Audited Financial Statements
December 31, 2013 and 2012

Alan M. Zumstein
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Independent Auditor's Report

To the Board of Directors
Mountain Rural Telephone Cooperative

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's 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 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 Mountain Rural Telephone Cooperative and Subsidiary as of December 31, 2013 and 2012, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued a report dated February 25, 2014, on my consideration of Mountain Rural Telephone Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 25, 2014

Mountain Rural Telephone Cooperative Corporation and Subsidiary
Consolidated Balance Sheets, December 31, 2013 and 2012

Assets	2013	2012
Current Assets:		
Cash and cash equivalents	$ 16,468,290	$ 6,270,044
Accounts receivable, less allowance for 2013 of $98,564 and 2012 of $140,919	1,061,756	1,799,816
Materials and supplies, at average cost	1,680,399	2,328,882
Prepaid insurance	26,275	43,036
	19,236,720	10,441,778
Other Assets:		
Marketable securities	10,500,000	5,509,037
Associated organizations	20,428,447	19,700,086
Nonregulated property	2,761,482	2,381,530
	33,689,929	27,590,653
Telecommunications Plant, at original cost:		
In service	93,034,397	85,804,447
Under construction	26,968,950	26,539,543
	120,003,347	112,343,990
Less accumulated depreciation	48,479,734	43,346,334
	71,523,613	68,997,656
Total	$ 124,450,262	$ 107,030,087
Liabilities and Members' Equities		
Current Liabilities:		
Accounts payable	$ 1,865,164	$ 776,305
Current portion of long term debt	1,900,000	1,650,000
Customer deposits	89,335	89,316
Other current and accrued liabilities	2,684,114	2,521,970
	6,538,613	5,037,591
Long Term Debt	31,985,253	24,220,510
Accrued Postretirement Benefits	297,408	402,896
Members' Equities:		
Memberships and capital investment	130,790	134,127
Patronage capital	88,842,785	80,800,410
Donated capital	1,322,439	1,322,439
Accumulated other comprehensive income	(4,667,026)	(4,887,886)
	85,628,988	77,369,090
Total	$ 124,450,262	$ 107,030,087

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

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

	2013	2012
Operating Revenue:		
Local network services	$ 4,290,003	$ 3,943,055
Network access services	14,846,198	9,355,940
Carrier billing and collection	244,103	1,229,976
Basic cable revenues	156,654	223,243
Miscellaneous	483,653	550,706
Less provision for uncollectibles	(8,313)	(7,853)
	20,012,298	15,295,067
Operating Expenses:		
Plant specific operations	3,302,040	3,598,655
Plant nonspecific operations	1,167,370	1,021,468
Depreciation	5,606,937	5,543,435
Customer operations	1,300,042	1,414,548
Corporate operations	2,077,065	2,328,688
Other deductions	173,239	109,718
Taxes, other than income	1,274,527	1,116,705
	14,901,220	15,133,217
Operating margins	5,111,078	161,850
Nonoperating Margins		
Other income, principally interest	811,157	349,031
Income (loss) from limited liability companies	1,959,802	2,649,104
Non regulated net income	1,696,598	1,438,145
	4,467,557	4,436,280
Margins available for fixed charges	9,578,635	4,598,130
Fixed Charges:		
Interest on long-term debt	1,077,992	864,703
Provision for income taxes	(158,060)	1,003,698
Net margins	8,658,703	2,729,729
Items of comprehensive income:		
Accumulated postretirement benefits	220,860	220,860
Comprehensive Income	$ 8,879,563	$ 2,950,589

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

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

	Memberships	Patronage Capital	Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 136,644	$ 78,733,760	$ 1,322,756	$ (5,108,746)	$ 75,084,414
Comprehensive income:					
Net margins		2,729,729			2,729,729
Postretirement benefit obligation					
Amortization				220,860	
Adjustments				-	220,860
Total comprehensive income					2,950,589
Refunds of capital credits		(663,079)			(663,079)
Memberships issued, net	(2,517)				(2,517)
Other equities			(317)		(317)
Balance-December 31, 2012	134,127	80,800,410	1,322,439	(4,887,886)	77,369,090
Comprehensive income:					
Net margins		8,658,703			8,658,703
Postretirement benefit obligation					
Amortization				220,860	
Adjustments				-	220,860
Total comprehensive income					8,879,563
Refunds of capital credits		(616,328)			(616,328)
Memberships issued, net	(3,337)				(3,337)
Other equities			-		-
Balance-December 31, 2013	$ 130,790	$ 88,842,785	$ 1,322,439	$ (4,667,026)	$ 85,628,988

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

Consolidated Statements of Cash Flows
for the years ended December 31, 2013 and 2012

		2013		2012
Cash Flows from Operating Activities:				
Net margins	$	8,658,703	$	2,729,729
Adjustments to reconcile to net cash provided by operating activities:				
Depreciation		5,606,937		5,543,435
Net loss (profit) in limited liability companies		(1,959,802)		(2,649,104)
Accumulated postretirement benefits		115,372		707,562
Net change in current assets and liabilities:				
Receivables		650,746		(1,067,435)
Material and supplies		648,483		(1,749,012)
Prepayments		16,761		16,343
Payables		1,176,173		190,160
Advance billings		19		2,940
Accrued expenses		162,144		(125,293)
		15,075,536		3,599,325
Cash Flows from Investing Activities:				
Construction of plant		(8,029,531)		(13,153,183)
Salvage, net of removals		(103,362)		(249,726)
Marketable securities		(4,990,963)		511,256
Associated organizations		1,231,440		2,299,808
Nonregulated property		(379,952)		185,216
		(12,272,368)		(10,406,629)
Cash Flows from Financing Activities:				
Advances of long term debt		10,038,322		8,255,481
Payments on long term debt		(2,023,579)		(1,607,142)
Fund postretirement benefits		-		(600,000)
Memberships and capital investments		(3,337)		(2,517)
Retirements of capital credits		(616,328)		(663,079)
Increase in donated capital		-		(317)
		7,395,078		(5,382,426)
Net increase in cash balances		10,198,246		(1,424,878)
Cash and cash equivalents - beginning of period		6,270,044		7,694,922
Cash and cash equivalents - end of period	$	16,468,290	$	6,270,044
Supplemental disclosures of cash flows information:				
Interest on long-term debt	$	1,082,444	$	844,757
Income taxes paid		(158,060)		1,003,698

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

Note 1. Summary of Significant Accounting Policies

Mountain 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, Mountain Telecommunications, Inc. (Mountain Telecommunications). All significant inter-company accounts and transactions have been eliminated. During 2012 Mountain Telecommunications purchased the assets of the cable television company that operated in parts of the same service territory as the Cooperative.

New Business Venture The Cooperative has began construction to launch an expanded services network. This network will establish 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 will also be able to provide high speed internet and virtual private networks. It will be able to provide voice on internet protocol (VoIP) in the future. This is accomplished through Fiber to the Home (FTTH) technology.

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

Off Balance Sheet Risk The Corporation has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2013, the financial institutions reported deposits in excess of the $250,000 FDIC insured limit on several of the accounts. Deposits and repurchase agreements in excess of the FDIC limits are 100% secured with collateral from each respective financial institution.

Telecommunications Revenue Recognition Revenues are recognized when earned regardless of the period in which they are billed. Bills are sent to customers on credit the first of each month with local service being billed a month in advance of service. Sales are concentrated in a portion of five (5) southeastern Kentucky counties. Payments are due 10 days from the date of billing. If payment has not been made, then customers are subject to disconnect on the 21st day of the month. The allowance for uncollectible accounts is based on the aging of accounts receivable. Accounts are written off when they are deemed to be uncollectible. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2013 or 2012. The number of access lines was 14,539 at 2013 and 14,934 at 2012.

During 2013 the Cooperative converted from recognizing interstate revenues from the average schedule to the cost basis of recovery. The cost basis is expected to provide additional revenues. 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.

CATV Revenue Recognition Mountain Telecommunications recognizes when earned regardless of the period in which they are billed. Mountain Telecommunications purchases cable transmissions from networks at various amounts based on the number of customers receiving the service. Mountain Telecommunications' sales are concentrated in four (4) southeastern Kentucky counties. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2013 and 2012. The number of CATV customers was 236 for 2013 and 352 for 2012. As customers are being connected through FTTH, they become customers of Mountain Telephone.

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 (except investment securities), 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 cannot be traded in the market, and is specifically for telecommunications companies and, therefore, a value other than its outstanding principal cannot be determined.

The company invests idle funds with local banks in money markets, certificates of deposits, and U.S. Treasury Notes. 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.

Advertising Advertising costs are expensed as incurred.

Telecommunications and CATV Plant Telecommunications and CATV plant are stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. Interest capitalized during the year was $554,229for 2013 and $84,769 for 2012.

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

Note 1. Summary of Significant Accounting Policies, continued

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

	2013	2012
Telecommunications Plant:		
General support	$9,427,527	$9,516,740
Central office switching	1,346,213	1,375,930
Central office transmission	17,077,547	16,621,865
Cable and wire facilities	64,450,426	57,557,228
Intangibles	2,434	2,434
	92,304,147	85,074,197
CATV Plant:		
General support	3,000	3,000
Distribution plant	622,750	622,750
Intangibles	104,500	104,500
	730,250	730,250
Total	$93,034,397	$85,804,447

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

	Telephone	Telecom
General support	2.7%-15.8%	20.0%
Central office switching	7.5%	
Central office transmission	10.0%	
Cable and wire facilities	5.1%-9.4%	6.67%-10.0%

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. Mountain Telecommunications is a "C" corporation that pays income taxes on its net income.

The Cooperative's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes the Cooperative has no uncertain tax positions resulting in an accrual of tax expense or benefit. The Cooperative recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Cooperative did not recognize any interest or penalties during the years ended December 31, 2013 and 2012. The Cooperative's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

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.

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.

Subsequent Events Management has evaluated subsequent events through February 25, 2014, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments

The amounts for East Kentucky Network, LLC ("EKN") represents Mountain Telecommunications' investment in a limited liability corporation with other telephone companies in eastern Kentucky for the purpose of providing cellular telephone, paging, and other services. The investment is accounted for using the equity method since Mountain Telecommunications is a one-fifth owner. EKN pays 50% of the income allocated in cash.

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 Mountain Telephone Long Distance ("MTLD"). MTLD revenues are billed and collected through the Cooperative. A monthly fee is recorded based on telephone usage. MTLD purchases minutes of long distance to resell to its customers from an unrelated party.

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

The following is a summary of non regulated activities:

	Income	Expenses	Net
Customer premises equipment	$940,963	$1,797,756	($856,793)
Internet activities	3,097,436	956,847	2,140,589
Long distance services	835,618	395,434	440,184
Video services	817,469	844,851	(27,382)
Total - 2013	$5,691,486	$3,994,888	$1,696,598

	Income	Expenses	Net
Customer premises equipment	$600,583	$1,485,349	($884,766)
Internet activities	2,851,330	883,565	1,967,765
Long distance services	904,518	405,056	499,462
Video services	453,111	597,427	(144,316)
Total - 2012	$4,809,542	$3,371,397	$1,438,145

Note 4. Long Term Debt

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

	2013	2012
RUS loans:		
4.1715% and 5%	$2,623,451	$3,567,222
Advance payments	(1,044,919)	(994,278)
	1,578,532	23,297,566
RUS Broadband Loan 2.27%-4.45%	32,306,721	23,297,566
	33,885,253	25,870,510
Less current portion	1,900,000	1,650,000
Long term portion	$31,985,253	$24,220,510

The long term debt payable to RUS and RTB is due in monthly and quarterly installments of various amounts through 2043. The Cooperative has loan funds available from RUS in the amount of $7,183,874 for telecommunications plant and $5,905,343 for broadband activities at December 31, 2013. These funds will be used for the FSN project as described earlier.

Principal payments for the next five years are as follows: 2014 - $1,900,000; 2015 - $1,925,000; 2016 - $2,000,000; 2017 - $1,950,000; 2018 - $1,900,000.

Note 5. Patronage Capital

The long term debt agreement contains restrictions on the return to patrons of capital contributed by them. The restrictions relate in general to the Cooperative's net worth and assets, as defined. The net worth of the Cooperative at December 31, 2013, was 71%.

Patronage capital consisted of:

	2013	2012
Assigned	$85,313,775	$82,745,103
Assignable	8,658,703	2,729,729
Unassigned	27,003,596	26,842,539
Retirements to date	(32,133,289)	(31,516,961)
Total	$88,842,785	$80,800,410

Note 6. 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.

Note 6. Pension Plan, continued

The Corporation's contributions to the R&S Plan in 2013 and 2012 represent less than 5 percent of the total contributions made to the plan by all participating employers. The Corporation made contributions to the plan of $405,722 in 2013 and $394,293 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012.

In the R&S Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act ("PPA") of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the R&S Plan was between 65 percent and 80 percent funded at January 1, 2013 and 2012 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

Note 7. Accumulated Postretirement Benefits

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

The funded status of the plan was as follows:

	2013	2012
Projected benefit obligation	($13,355,105)	($12,437,640)
Plan assets at fair value	13,057,697	12,034,744
Funded status	($297,408)	($402,896)

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

	2013	2012
Benefit obligation at beginning of year	$402,896	$516,194
Components of net periodic benefit cost:		
Service cost	130,584	108,125
Interest cost	644,819	621,882
Expected return on assets	(441,563)	(396,167)
Net periodic benefit cost	333,840	333,840
Benefits paid	(439,328)	(447,138)
Contributions to plan	-	-
Adjust comprehensive income	-	-
Benefit obligation at end of year	$297,408	$402,896

For measurement purposes, a 9% annual rate of increase, decreasing by 0.5% per year until 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 5.0% for 2013 and 2012.

The projected retiree benefit payments are expected to be as follows: 2014 - $352,000; 2015 - $348,000; 2016 – $327,000; 2017 - $270,000; 2018 - $267,000.

Note 8. 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 $78,124,579, of which $38,281,044 is in the form of a grant. The remaining funds must be secured with RUS debt. The Cooperative started the project during June 2010. The Grant initially required that the project be completed within three (3) years from the date of the Grant, however, RUS has granted an extension on the project until September 30, 2015.

Note 9. Commitments

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

Note 10. Contingencies

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

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Additional Consolidating Information

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Independent Auditor's Report

To the Board of Directors
Mountain Rural Telephone Cooperative

My report on the audits of the consolidated financial statements of Mountain Rural Telephone Cooperative and Subsidiary as of December 31, 2013 and 2012, and for the years then ended appears on pages 1 - 2. My audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies. The supplementary consolidating information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in my opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 25, 2014

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

Assets	Telephone	Telecom	Eliminations	Consolidated
Current Assets:				
Cash and cash equivalents	$ 13,130,502	$ 3,337,788		$ 16,468,290
Accounts receivable, less allowance for Telephone of $98,564	1,066,483		(4,727)	1,061,756
Material and supplies, at average cost	1,680,399			1,680,399
Prepayments	26,275			26,275
	15,903,659	3,337,788	(4,727)	19,236,720
Other Assets:				
Marketable securities	10,500,000			10,500,000
Associated organizations	24,706,120	20,428,447	(24,706,120)	20,428,447
Nonregulated and others	2,761,482			2,761,482
	37,967,602	20,428,447	(24,706,120)	33,689,929
Utility Plant, at original cost:				
In service	92,304,147	730,250		93,034,397
Under construction	26,968,950			26,968,950
	119,273,097	730,250		120,003,347
Less accumulated depreciation	48,696,467	(216,733)		48,479,734
	70,576,630	946,983		71,523,613
Total	$124,447,891	$24,713,218	($24,710,847)	$124,450,262

Member's Equities and Liabilities	Telephone	Telecom	Eliminations	Consolidated
Current Liabilities:				
Accounts payable	$ 1,865,164	$ 4,727	$ (4,727)	$ 1,865,164
Current portion of long term debt	1,900,000			1,900,000
Customer deposits	89,335			89,335
Accrued expenses	2,681,743	2,371		2,684,114
	6,536,242	7,098	(4,727)	6,538,613
Long Term Debt	31,985,253			31,985,253
Accumulated Postretirement Benefits	297,408			297,408
Members' Equities:				
Memberships and capital investments	130,790	4,780,000	(4,780,000)	130,790
Patronage capital and retained earnings	88,842,785	19,926,120	(19,926,120)	88,842,785
Donated capital	1,322,439			1,322,439
Accumulated comprehensive income	(4,667,026)			(4,667,026)
	85,628,988	24,706,120	(24,706,120)	85,628,988
Total	$124,447,891	$24,713,218	($24,710,847)	$124,450,262

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

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

	Telephone	Telecom	Eliminations	Consolidated
Operating Revenues:				
Local network services	$ 4,290,003			$ 4,290,003
Network access services	14,846,198			14,846,198
Carrier billing and collection	244,103			244,103
Cable revenues		156,654		156,654
Miscellaneous	483,653			483,653
Less provision for uncollectibles	(8,313)			(8,313)
	19,855,644	156,654		20,012,298
Operating Expenses:				
Plant specific operations	3,136,955	165,085		3,302,040
Plant non specific operations	1,161,408	5,962		1,167,370
Depreciation	5,564,561	42,376		5,606,937
Customer operations	1,275,094	24,948		1,300,042
Corporate operations	2,054,950	22,115		2,077,065
Other deductions	173,239			173,239
Taxes, other than income	1,256,210	18,317		1,274,527
	14,622,417	278,803		14,901,220
	5,233,227	(122,149)		5,111,078
Nonoperating Margins:				
Other income, principally interest	808,417	2,740		811,157
Income in limited liability companies	1,998,453	1,959,801	(1,998,452)	1,959,802
Nonregulated net income and other	1,696,598			1,696,598
	4,503,468	1,962,541	(1,998,452)	4,467,557
Margins available for interest charges	9,736,695	1,840,392	(1,998,452)	9,578,635
Interest Charges:				
Long term debt	1,077,992			1,077,992
Provision for income taxes		(158,060)		(158,060)
Net Margins	8,658,703	1,998,452	(1,998,452)	8,658,703
Items of comprehensive income:				
Accumulated postretirement benefits	220,860			220,860
Net Comprehensive Income	$8,879,563	$1,998,452	($1,998,452)	$8,879,563

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

Supplementary Information

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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
Mountain Rural Telephone Cooperative

I have audited the financial statements of Mountain Rural Telephone Cooperative Corporation as of and for the years ended December 31, 2013 and 2012, and have issued my report thereon dated February 25, 2014. I conducted my audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

To the Board of Directors
Mountain Rural Telephone Cooperative - 2

Compliance and Other Matters

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

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

Alan M. Zumstein

Alan M. Zumstein, CPA
February 25, 2014

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

Board of Directors
Mountain 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 Mountain Rural Telephone Cooperative ("the Cooperative"), which comprise the balance sheet as of December 31, 2013, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated January 29, 2014. In accordance with *Government Auditing Standards*, we have also issued my report dated January 29, 2014, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and my schedule of findings and recommendations related to my audit have been furnished to management.

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

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;

- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the telephone system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles, and;
- Comply with the requirements for the detailed schedule of investments.

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

Alan Zumstein

Alan M. Zumstein, CPA
January 29, 2014

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To the Board of Directors
Mountain Rural Telephone Cooperative

I have audited the financial statements of Mountain Rural Telephone Cooperative for the year ended December 31, 2013, and have issued my report thereon dated February 25, 2014. I conducted my audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR Part 1773, Policy on audits of the Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

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

No reports, other than my independent auditor's report, and my independent auditor's report on internal control over financial reporting and compliance and other matters, all dated February 25, 2014, or summary of recommendations related to my audit have been furnished to management.

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

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

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

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

Comments on Compliance with Specific RUS Loan and Security Instrument Provisions

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

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

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

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

Comments on Other Additional Matters

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

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

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

Mountain Telephone formed a wholly-owned subsidiary, Mountain Telecommunications, Inc., which provides cable television services in Mountain Telephone's service territory 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 $830,000. The investment is comprised of the following:

	Investment	Profits
Beginning of year	$4,780,000	$17,927,668
Activity for 2013	-	1,998,453
End of year	$4,780,000	$19,926,121

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

Alan M. Zumstein

Alan M. Zumstein, CPA
February 25, 2014