

Kentucky 514
Peoples Rural Telephone
Cooperative Corporation
McKee, Kentucky
Audited Financial Statements
December 31, 2014 and 2013

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Independent Auditor's Report

To the Board of Directors
Peoples Rural Telephone Cooperative

Report on the Financial Statements

I have audited the accompanying financial statements of Peoples Rural Telephone Cooperative and Subsidiary, which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audits. I did not audit the financial statements of East Kentucky Network, LLC. As discussed in Note 2, these financial statements account for an investment in East Kentucky Network, LLC under the equity method. The investment was \$21,074,941 and \$20,587,861 at December 31, 2014 and 2013 respectively, and the equity in its net margins was \$1,498,639 and \$2,119,214 for the years then ended. The financial statements of East Kentucky Network, LLC were audited by other auditors, whose report has been furnished to me, and my opinion, insofar as it relates to amounts for East Kentucky Network, LLC is based solely on the report of the other auditors. I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's 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.

To the Board of Directors
Peoples Rural Telephone Cooperative - 2

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

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Peoples Rural Telephone Cooperative and Subsidiary as of December 31, 2014 and 2013, 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 January 29, 2015, on my consideration of Peoples Rural Telephone Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Report on Supplemental Information

My audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the consolidated financial statements is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and related directly to underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Alan M. Zumstein

Alan M. Zumstein, CPA
January 29, 2015

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidated Balance Sheets, December 31, 2014 and 2013

<u>Assets</u>	<u>2014</u>	<u>2013</u>
Current Assets:		
Cash and cash equivalents	\$ 2,551,048	\$ 2,349,929
Accounts receivable, less allowance for 2014 of \$118,857 and 2013 of \$43,460	103,270	236,163
Other receivables, connecting companies	129,103	72,176
Materials and supplies, at average cost	792,483	1,200,470
Prepaid insurance	2,047	127,914
	<u>3,577,951</u>	<u>3,986,652</u>
Other Assets:		
Marketable securities	5,367,081	5,211,341
Associated organizations	21,074,716	20,587,636
Nonregulated property	2,034,210	1,670,715
	<u>28,476,007</u>	<u>27,469,692</u>
Telecommunications Plant, at original cost:		
In service	73,992,867	74,836,241
Under construction	281,261	2,009,796
	<u>74,274,128</u>	<u>76,846,037</u>
Less accumulated depreciation	33,641,987	31,025,807
	<u>40,632,141</u>	<u>45,820,230</u>
Total	<u>\$ 72,686,099</u>	<u>\$ 77,276,574</u>
<u>Liabilities and Members' Equities</u>		
Current Liabilities:		
Accounts payable	\$ 416,293	\$ 2,284,619
Current portion of long term debt	3,500,000	3,500,000
Advance billings	458,837	434,602
Other current and accrued liabilities	1,018,932	571,259
	<u>5,394,062</u>	<u>6,790,480</u>
Long Term Debt	<u>15,450,069</u>	<u>18,762,960</u>
Accrued Postretirement Benefits	<u>8,606,273</u>	<u>8,250,246</u>
Members' Equities:		
Memberships and capital investment	212,781	211,051
Patronage capital	47,035,126	47,797,571
Donated capital	1,263,919	1,153,197
Accumulated other comprehensive income	(5,276,131)	(5,688,931)
	<u>43,235,695</u>	<u>43,472,888</u>
Total	<u>\$ 72,686,099</u>	<u>\$ 77,276,574</u>

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

Consolidated Statements of Revenue and Comprehensive Income
for the years ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating Revenue:		
Local network services	\$ 4,789,712	\$ 4,524,422
Network access services	9,964,985	9,926,781
Carrier billing and collection	288,860	184,061
Basic cable revenues	-	75,996
Premium cable revenues	-	7,776
Miscellaneous	117,449	431,481
Less provision for uncollectibles	(66,421)	(97,980)
	<u>15,094,585</u>	<u>15,052,537</u>
Operating Expenses:		
Plant specific operations	3,969,315	4,112,310
Plant nonspecific operations	1,334,519	1,111,194
Depreciation	3,871,122	3,303,006
Programming costs	-	65,457
Customer operations	1,073,824	1,032,891
Corporate operations	1,635,991	1,500,731
Taxes, other than income	860,573	711,187
	<u>12,745,344</u>	<u>11,836,776</u>
Operating margins	<u>2,349,241</u>	<u>3,215,761</u>
Nonoperating Margins		
Other income, principally interest	118,597	88,024
Income (loss) from limited liability companies	1,498,639	2,119,213
Non regulated net income	(3,699,347)	(337,232)
	<u>(2,082,111)</u>	<u>1,870,005</u>
Margins available for fixed charges	267,130	5,085,766
Fixed Charges:		
Interest on long-term debt	691,002	849,114
Provision for income taxes	(92,598)	606,796
Net margins	(331,274)	3,629,856
Comprehensive Income:		
Postretirement benefits	412,800	(2,418,372)
Net Comprehensive Income	<u>\$ 81,526</u>	<u>\$ 1,211,484</u>

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

Statements of Stockholder's and Member's Equities
for the years ended December 31, 2013 and 2014

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Other Equities</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Members' Equity</u>
Balance - Beginning of year	\$ 208,191	\$ 44,542,146	\$ 1,022,994	\$ (3,270,559)	\$ 42,502,772
Comprehensive income:					
Net income		3,629,856			3,629,856
Amortization				345,000	345,000
Adjust postretirement benefits				(2,763,372)	(2,763,372)
Total comprehensive income					1,211,484
Patronage refund		(374,431)			(374,431)
Other equities			130,203		130,203
Memberships, net	<u>2,860</u>				<u>2,860</u>
Balance - December 31, 2013	211,051	47,797,571	1,153,197	(5,688,931)	43,472,888
Comprehensive income:					
Net income		(331,274)			(331,274)
Amortization				3,176,172	3,176,172
Adjust postretirement benefits				(2,763,372)	(2,763,372)
Total comprehensive income					81,526
Patronage refund		(431,171)			(431,171)
Other equities			110,722		110,722
Memberships, net	<u>1,730</u>				<u>1,730</u>
Balance - December 31, 2014	<u>\$ 212,781</u>	<u>\$ 47,035,126</u>	<u>\$ 1,263,919</u>	<u>\$ (5,276,131)</u>	<u>\$ 43,235,695</u>

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

Consolidated Statements of Cash Flows
for the years ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash Flows from Operating Activities:		
Net margins	\$ (331,274)	\$ 3,629,856
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation	3,871,122	3,303,006
Net loss (profit) in limited liability companies	(1,498,639)	(2,119,213)
Accumulated postretirement benefits	893,827	626,510
Net change in current assets and liabilities:		
Receivables	(103,858)	(1,767,625)
Material and supplies	407,987	8,123
Prepayments	125,867	21,946
Payables	(1,688,502)	3,132,676
Advance billings	24,235	17,850
Accrued expenses	447,673	(167,782)
	<u>2,148,438</u>	<u>6,685,347</u>
Cash Flows from Investing Activities:		
Construction of plant	(1,776,160)	(6,728,669)
Salvage, net of removals	3,093,127	(68,547)
Marketable securities	(155,740)	(133,763)
Associated organizations	1,011,559	1,231,439
Nonregulated property	(363,495)	(282,572)
	<u>1,809,291</u>	<u>(5,982,112)</u>
Cash Flows from Financing Activities:		
Advances of long term debt	1,277,749	3,317,843
Payments on long term debt	(4,590,640)	(4,343,127)
Fund postretirement benefits	(125,000)	(125,000)
Memberships and capital investments	1,730	2,860
Retirements of capital credits	(431,171)	(374,431)
Increase in donated capital	110,722	130,203
	<u>(3,756,610)</u>	<u>(1,391,652)</u>
Net increase in cash balances	201,119	(688,417)
Cash and cash equivalents - beginning of period	<u>2,349,929</u>	<u>3,038,346</u>
Cash and cash equivalents - end of period	<u>\$ 2,551,048</u>	<u>\$ 2,349,929</u>
Supplemental disclosures of cash flows information:		
Interest on long-term debt	\$ 691,148	\$ 847,561

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

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

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

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

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

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

Off Balance Sheet Risk The Corporation has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2014, the financial institutions reported deposits in excess of the \$250,000 FDIC insured limit on several of the accounts. Deposits and repurchase agreements in excess of the FDIC limits are 100% secured with collateral from each respective financial institution.

Telecommunications Revenue Recognition Revenues are recognized when earned regardless of the period in which they are billed. Bills are sent to customers on credit approximately the 1st of the month with local service being billed a month in advance of service. Sales are concentrated in portions of two southeastern Kentucky counties. Payments are due 15 days from the date of billing. If payment has not been made, then customers are subject to disconnect in another 15 days. The allowance for uncollectible accounts is based on the aging of accounts receivable. Accounts are written off when they are deemed to be uncollectible. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2014 or 2013. The number of customers are as follows:

	<u>2014</u>	<u>2013</u>
Access lines	6,830	7,087
Total number of customers	6,445	6,666
Telephone customers	6,132	6,348
Broadband customers	4,011	3,992
Cable television customers	3,785	3,829

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.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

CATV Revenue Recognition CATV revenue is recognized when earned regardless of the period in which they are billed. Cable transmission is purchased from networks at various amounts based on the number of customers receiving the service. Sales are concentrated in two southeastern Kentucky counties. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2014 and 2013. As customers are being connected through FTTH, they become customers of Peoples Telephone. During 2014 all customers were transferred to FTTH.

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

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

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

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

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

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

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

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

Advertising Advertising costs are expensed as incurred.

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

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

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

Telecommunications and CATV Plant Telecommunications and CATV plant are stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. Interest capitalized during the year was \$53,326 for 2014 and \$75,464 for 2013.

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

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

	<u>2014</u>	<u>2013</u>
Telecommunications Plant:		
General support	\$12,912,034	\$12,327,111
Central office switching	1,926,900	1,916,531
Central office transmission	12,946,890	11,658,332
Cable and wire facilities	45,020,944	43,880,495
Intangibles	5,844	5,844
	<u>72,812,612</u>	<u>69,788,313</u>
CATV Plant:		
Distribution and headend plant	1,180,255	4,401,716
General support	-	38,212
Intangibles	-	608,000
	<u>1,180,255</u>	<u>5,047,928</u>
Total	<u>\$73,992,867</u>	<u>\$74,836,241</u>

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

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

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.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

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

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

Effective January 1, 2008, the Cooperative adopted the provisions of the Income Taxes Topic of the FASB ASC that pertains to accounting for uncertainty in income taxes. The Cooperative had no prior unrecognized tax benefits as a result of the implementation. Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statutes, regulations, and rules. There are no tax positions for which the ultimate deductibility is highly uncertain included in the accompanying financial statements. The Cooperative recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Cooperative did not recognize any interest or penalties during the years ended December 31, 2014 or 2013. The Cooperative's income tax return is subject to possible examination by taxing authorities until the expiration of related statutes of limitations on the return, which is generally three years.

Significant Event During 2014 all the CATV plant that was purchased through Peoples Telecom was abandoned as customers were all transferred to FTTH. This resulted in a loss on the disposal of those assets of approximately \$3 million.

Subsequent Events Management has evaluated subsequent events through January 23, 2015, the date the financial statements were available to be issued. During the next three (3) years, Peoples Telephone anticipates that it will remove approximately 70% of its existing copper plant. The retired plant should be fully-depreciated at the time it is removed.

Note 2. Investments

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

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

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

Notes to Financial Statements

Note 3. Non Regulated Activities, continued

The following is a summary of non-regulated activities:

	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$238,471	\$634,186	(\$395,715)
Internet activities	9,269	193,186	(183,917)
Long distance services	829,070	1,564,221	(735,151)
Fiber to the Home [FTTH]	3,002,806	2,559,523	443,283
Total - 2014	<u>\$4,079,616</u>	<u>\$4,951,116</u>	<u>(\$871,500)</u>

	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$538,200	\$586,001	(\$47,801)
Internet activities	6,301	131,841	(125,540)
Long distance services	558,641	1,153,307	(594,666)
Fiber to the Home [FTTH]	1,575,243	1,144,468	430,775
Total - 2013	<u>\$2,678,385</u>	<u>\$3,015,617</u>	<u>(\$337,232)</u>

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:

	<u>2014</u>	<u>2013</u>
Telecommunications loans:		
RUS, 1.945 - 4.234%	\$11,929,521	\$14,507,860
RUS Broadband loan 2.2287% - 4.3994%	7,020,548	6,637,198
RTB, 5% - 5.84%	-	1,117,902
	<u>18,950,069</u>	<u>22,262,960</u>
Less current portion	<u>1,535,000</u>	<u>3,500,000</u>
Long term portion	<u>\$15,450,069</u>	<u>\$18,762,960</u>

The long term debt payable to RUS is due in monthly installments of various amounts through 2032. Unadvanced loan funds of \$5,192,420 for plant additions, were available from RUS at December 31, 2014. These funds will be used for the FTTH project as described earlier.

Principal payments for the next five years are as follows: 2015 - \$1,535,000; 2016 - \$1,640,000; 2017 - \$1,690,000; 2018 - \$1,745,000; 2019 - \$1,500,000. The Cooperative expects to make an additional principal payment during 2015 of approximately \$500,000.

Notes to Financial Statements

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, 2014, was 56%.

Patronage capital consisted of:

	<u>2014</u>	<u>2013</u>
Assigned	\$30,188,049	\$28,824,857
Assignable	(331,274)	3,629,856
Unassigned	29,482,828	27,216,164
Retirements to date	<u>(12,304,477)</u>	<u>(11,873,306)</u>
Total	<u>\$47,035,126</u>	<u>\$47,797,571</u>

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.

The Corporation's contributions to the R&S Plan in 2014 and 2013 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 \$363,396 in 2014 and \$356,125 in 2013. There have been no significant changes that affect the comparability of 2014 and 2013.

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, 2014 and 2013 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. The eligibility and participating cost of coverage for retirees and dependents is based on age, years of service, and employment date.

For measurement purposes, an 8.5% annual rate of increase, decreasing by 0.5% per year until 5.5% per year, in the per capita cost of covered health care benefits was assumed. The discount rate used in determining the accumulated benefit obligation was 4.5% for 2014 and 4.5% for 2013.

Notes to Financial Statements

Note 8. Accumulated Postretirement Benefits, continued

The funded status of the plan was as follows:

	<u>2014</u>	<u>2013</u>
Projected benefit obligation	(\$10,913,900)	(\$10,374,566)
Plan assets at fair value	<u>2,307,627</u>	<u>2,124,320</u>
Funded status	<u>(\$8,606,273)</u>	<u>(\$8,250,246)</u>

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

	<u>2014</u>	<u>2013</u>
Benefit obligation at beginning of year	<u>\$8,250,246</u>	<u>\$5,330,364</u>
Components of net periodic benefit cost:		
Service cost	334,011	206,333
Interest cost	488,004	458,482
Expected return on assets	<u>(136,815)</u>	<u>(136,815)</u>
Net periodic benefit cost	685,200	528,000
Adjustment	0	2,763,373
Benefits paid	(204,173)	(246,491)
Contributions to plan	<u>(125,000)</u>	<u>(125,000)</u>
Benefit obligation at end of year	<u>\$8,606,273</u>	<u>\$8,250,246</u>

The projected retiree benefit payments are expected to be as follows: 2015 - \$267,000; 2016 - \$262,000; 2017 - \$258,000; 2018 - \$267,000; 2019 - \$270,000.

Note 9. Commitments

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

Note 10. Significant Event

The Cooperative was awarded a Broadband Initiatives Program ("BIP") Grant from the United States of America through the Department of Agriculture, Rural Utilities Service ("RUS"). The project would provide access to broadband internet service to the counties served in southeastern Kentucky. The total project cost is \$25,514,182, of which \$17,859,928 is in the form of a grant. The remaining funds must be secured with RUS debt. The Cooperative started the project during the last quarter of 2010. The Grant required that the project be completed within three (3) years from the date of the Grant; however, RUS granted a two (2) year extension to June 2015.

Note 11. Contingencies

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

* * * * *

Peoples Rural Telephone Cooperative
and Subsidiary
Consolidating Balance Sheet, December 31, 2014

<u>Assets</u>	<u>Telephone</u>	<u>Telecom</u>	<u>Eliminations</u>	<u>Consolidated</u>
Current Assets:				
Cash and cash equivalents	\$ 2,485,092	\$ 65,956		\$ 2,551,048
Accounts receivable, less allowance for Telephone of \$118,857	103,270			103,270
Other receivables, connecting companies	1,442,835		(1,313,732)	129,103
Material and supplies, at average cost	792,483			792,483
Prepayments	2,047			2,047
	<u>4,825,727</u>	<u>65,956</u>	<u>(1,313,732)</u>	<u>3,577,951</u>
Other Assets:				
Marketable securities	5,367,081			5,367,081
Associated organizations	20,938,312		136,404	21,074,716
Nonregulated	2,034,210			2,034,210
	<u>28,339,603</u>	<u></u>	<u>136,404</u>	<u>28,476,007</u>
Utility Plant, at original cost:				
In service	72,812,612	1,180,255		73,992,867
Under construction	281,261			281,261
	<u>73,093,873</u>	<u>1,180,255</u>		<u>74,274,128</u>
Less accumulated depreciation	33,574,202	67,785		33,641,987
	<u>39,519,671</u>	<u>1,112,470</u>		<u>40,632,141</u>
Total	<u>\$ 72,685,001</u>	<u>\$ 1,178,426</u>	<u>\$ (1,177,328)</u>	<u>\$ 72,686,099</u>
<u>Member's Equities and Liabilities</u>				
Current Liabilities:				
Accounts payable	\$ 415,195	\$ 1,314,830	\$ (1,313,732)	\$ 416,293
Current portion of long term debt	3,500,000			3,500,000
Advance billings	458,837			458,837
Accrued expenses	1,018,932			1,018,932
	<u>5,392,964</u>	<u>1,314,830</u>	<u>(1,313,732)</u>	<u>5,394,062</u>
Long Term Debt	<u>15,450,069</u>			<u>15,450,069</u>
Accumulated Postretirement Benefits	<u>8,606,273</u>			<u>8,606,273</u>
Members' Equities:				
Memberships and capital investments	212,781	4,589,848	(4,589,848)	212,781
Patronage capital and retained earnings	47,035,126	(4,726,252)	4,726,252	47,035,126
Donated capital	1,263,919			1,263,919
Accumulated comprehensive income	(5,276,131)			(5,276,131)
	<u>43,235,695</u>	<u>(136,404)</u>	<u>136,404</u>	<u>43,235,695</u>
Total	<u>\$ 72,685,001</u>	<u>\$ 1,178,426</u>	<u>\$ (1,177,328)</u>	<u>\$ 72,686,099</u>

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

Consolidating Statements of Revenue and Comprehensive Income
for the year ended December 31, 2014

	<u>Telephone</u>	<u>Telecom</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating Revenues:				
Local network services	\$ 4,789,712			\$ 4,789,712
Network access services	9,964,985			9,964,985
Carrier billing and collection	288,860			288,860
Basic cable revenues				-
Premium cable revenues				-
Miscellaneous	117,264	295,144	(294,959)	117,449
Less provision for uncollectibles	(66,421)			(66,421)
	<u>15,094,400</u>	<u>295,144</u>	<u>(294,959)</u>	<u>15,094,585</u>
Operating Expenses:				
Plant specific operations	3,848,685	120,630		3,969,315
Plant non specific operations	1,334,519			1,334,519
Depreciation	3,803,337	67,785		3,871,122
Programming costs				-
Customer operations	1,073,824		-	1,073,824
Corporate operations	1,612,996	22,995		1,635,991
Taxes, other than income	860,573			860,573
	<u>12,533,934</u>	<u>211,410</u>		<u>12,745,344</u>
	<u>2,560,466</u>	<u>83,734</u>	<u>(294,959)</u>	<u>2,349,241</u>
Nonoperating Margins:				
Other income, principally interest	118,597			118,597
Income in limited liability companies	(1,540,433)		3,039,072	1,498,639
Nonregulated net income and other	(871,500)	(3,122,806)	294,959	(3,699,347)
	<u>(2,293,336)</u>	<u>(3,122,806)</u>	<u>3,334,031</u>	<u>(2,082,111)</u>
Margins available for interest charges	<u>267,130</u>	<u>(3,039,072)</u>	<u>3,039,072</u>	<u>267,130</u>
Interest Charges:				
Long term debt	<u>691,002</u>			<u>691,002</u>
Provision for income taxes	<u>(92,598)</u>			<u>(92,598)</u>
Net Margins	(331,274)	(3,039,072)	3,039,072	(331,274)
Items of Comprehensive Income:				
Postretirement benefits	<u>412,800</u>			<u>412,800</u>
Net Comprehensive Income	<u>\$ 81,526</u>	<u>\$ (3,039,072)</u>	<u>\$ 3,039,072</u>	<u>\$ 81,526</u>

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

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

To the Board of Directors
Peoples Rural Telephone Cooperative

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Peoples Rural Telephone Cooperative, which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated January 29, 2015. My report includes a reference to other auditors who audited the financial statements of East Kentucky Network, LLC, as described in my report on Peoples Rural Telephone's financial statements. This report does not include the results of the other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Alan Zumstein

Alan M. Zumstein, CPA
January 29, 2015

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

Board of Directors
Peoples Rural Telephone Cooperative

Independent Auditor's Report

I have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Peoples Rural Telephone Cooperative ("the Cooperative"), which comprise the balance sheet as of December 31, 2014, 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, 2015. In accordance with *Government Auditing Standards*, we have also issued my report dated January 29, 2015, 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, 2015, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Board of Directors
Peoples Rural Telephone Cooperative - 2

- Maintain adequate control over material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written 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 telecommunications 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, which are listed below.

My audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The detail of investments is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and related directly to underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

	<u>Investment</u>	<u>Profits</u>	<u>Returns</u>
Beginning of year	\$4,294,013	\$25,829,686	(\$9,536,063)
Activity for 2014	-	1,498,639	(1,011,559)
End of year	<u>\$4,294,013</u>	<u>\$27,328,325</u>	<u>(\$10,547,622)</u>

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

	<u>Investment</u>	<u>Profits</u>
Beginning of year	\$4,589,848	(\$1,687,180)
Activity for 2014	-	(3,039,072)
End of year	<u>\$4,589,848</u>	<u>(\$4,726,252)</u>

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

Alan Zumstein

Alan M. Zumstein, CPA
January 29, 2015