

Kentucky 514
Peoples Rural Telephone
Cooperative Corporation
McKee, Kentucky
Audited Financial Statements
December 31, 2017 and 2016

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Independent Auditor's Report

To the Board of Directors
Peoples Rural Telephone Cooperative
McKee, Kentucky

Report on the Financial Statements

I have audited the accompanying consolidated financial statements of Peoples Rural Telephone Cooperative Corporation and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of revenue and comprehensive income, changes in members' equities, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated 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 consolidated financial statements based on my audits. I did not audit the financial statements of East Kentucky Network, LLC. As discussed in Note 3, these financial statements account for an investment in East Kentucky Network, LLC under the equity method. The investment was \$31,296,836 and \$27,263,709 at December 31, 2017 and 2016 respectively, and the equity in its net margins was \$9,614,796 and \$12,851,898 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on

To the Board of Directors
Peoples Rural Telephone Cooperative

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 consolidated 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Peoples Rural Telephone Cooperative Corporation and Subsidiary as of December 31, 2017 and 2016, and the results of its operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplemental Information

My audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 16-17 are 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, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued a report dated January 31, 2018, on my consideration of Peoples Rural Telephone Cooperative Corporation'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
January 31, 2018

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidated Balance Sheets, December 31, 2017 and 2016

<u>Assets</u>	<u>2017</u>	<u>2016</u>
Current Assets:		
Cash and cash equivalents	\$ 1,579,290	\$ 3,212,734
Accounts receivable, less allowance for 2017 of \$165,705 and 2016 of \$92,595	35,847	111,007
Other receivables, connecting companies	218,224	158,930
Materials and supplies, at average cost	593,177	853,973
Prepaid insurance	33,164	61,240
	<u>2,459,702</u>	<u>4,397,884</u>
Other Assets:		
Investments held to maturity	7,548,852	7,814,152
Associated organizations	31,297,267	27,263,709
Nonregulated property	1,649,743	1,572,638
Deferred debits	1,918,499	1,055,000
	<u>42,414,361</u>	<u>37,705,499</u>
Telecommunications Plant, at original cost:		
In service	69,987,031	73,487,784
Under construction	1,184,110	419,182
	<u>71,171,141</u>	<u>73,906,966</u>
Less accumulated depreciation	32,925,535	34,732,491
	<u>38,245,606</u>	<u>39,174,475</u>
Total	<u>\$ 83,119,669</u>	<u>\$ 81,277,858</u>
<u>Liabilities and Members' Equities</u>		
Current Liabilities:		
Accounts payable	\$ 668,850	\$ 250,122
Current portion of long term debt	1,540,000	1,500,000
Other current and accrued liabilities	1,344,513	1,284,671
	<u>3,553,363</u>	<u>3,034,793</u>
Long Term Debt	<u>4,998,376</u>	<u>10,575,779</u>
Accrued Postretirement Benefits	<u>8,396,314</u>	<u>9,228,092</u>
Members' Equities:		
Memberships and capital investment	219,451	217,011
Patronage capital	67,204,973	61,113,912
Donated capital	1,652,466	1,558,802
Other comprehensive income (loss)	(2,905,274)	(4,450,531)
	<u>66,171,616</u>	<u>58,439,194</u>
Total	<u>\$ 83,119,669</u>	<u>\$ 81,277,858</u>

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidated Statements of Revenue and Comprehensive Income
for the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating Revenue:		
Local network services	\$ 5,416,890	\$ 5,832,277
Network access services	9,882,649	10,360,796
Carrier billing and collection	82,026	186,820
Miscellaneous	87,273	54,975
Less provision for uncollectibles	<u>(30,782)</u>	<u>(39,338)</u>
	<u>15,438,056</u>	<u>16,395,530</u>
Operating Expenses:		
Plant specific operations	3,966,702	4,070,359
Plant nonspecific operations	1,463,206	1,616,380
Depreciation	3,813,381	4,510,467
Customer operations	1,183,726	1,061,128
Corporate operations	1,721,504	1,765,602
Taxes, other than income	<u>860,561</u>	<u>860,597</u>
	<u>13,009,080</u>	<u>13,884,533</u>
Operating margins	<u>2,428,976</u>	<u>2,510,997</u>
Nonoperating Margins		
Interest and other income (losses)	811,228	250,808
Income (loss) from limited liability companies	9,614,796	12,851,898
Less related income taxes	(4,500,000)	(4,638,161)
Non regulated net income (loss)	<u>(1,243,900)</u>	<u>(1,595,064)</u>
	<u>4,682,124</u>	<u>6,869,481</u>
Margins available for fixed charges	7,111,100	9,380,478
Fixed Charges:		
Interest on long-term debt	<u>547,069</u>	<u>620,046</u>
Net Margins	6,564,031	8,760,432
Other Comprehensive Income:		
Postretirement benefits	<u>1,545,257</u>	<u>412,800</u>
Net Comprehensive Income	<u>\$ 8,109,288</u>	<u>\$ 9,173,232</u>

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Statements of Member's Equities
for the years ended December 31, 2016 and 2017

		Patronage Capital							
	Memberships	Assignable	Assigned	Unassigned	Retirements	Total	Other Equities	Other Comprehensive Income (Loss)	Total Members' Equities
Balance - December 31, 2015	\$ 214,741	\$ 6,307,859	\$ 31,227,504	\$ 28,112,103	\$ (12,724,898)	\$ 52,922,568	\$ 1,399,233	\$ (4,863,331)	\$ 49,673,211
Assign margins		(6,307,859)	1,748,649	4,559,210		-			-
Comprehensive income:									
Net income		8,760,432				8,760,432			8,760,432
Amortization								412,800	
Adjust postretirement benefits								-	412,800
Total comprehensive income									9,173,232
Patronage refund					(569,088)	(569,088)			(569,088)
Other equities							159,569		159,569
Memberships, net	2,270								2,270
Balance - December 31, 2016	217,011	8,760,432	32,976,153	32,671,313	(13,293,986)	61,113,912	1,558,802	(4,450,531)	58,439,194
Assign margins		(8,760,432)	302,923	8,457,509		-			-
Comprehensive income:									
Net income		6,564,031				6,564,031			6,564,031
Amortization								412,800	
Adjust postretirement benefits								1,132,457	1,545,257
Total comprehensive income									8,109,288
Patronage refund					(472,970)	(472,970)			(472,970)
Other equities							93,664		93,664
Memberships, net	2,440								2,440
Balance - December 31, 2017	\$ 219,451	\$ 6,564,031	\$ 33,279,076	\$ 41,128,822	\$ (13,766,956)	\$ 67,204,973	\$ 1,652,466	\$ (2,905,274)	\$ 66,171,616

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidated Statements of Cash Flows
for the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities:		
Net margins	\$ 6,564,031	\$ 8,760,432
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation	3,813,381	4,510,467
Net loss (profit) in limited liability companies	(9,614,796)	(12,851,898)
Accumulated postretirement benefits	838,479	852,824
Net change in current assets and liabilities:		
Receivables	(498,264)	1,547
Material and supplies	260,796	(99,943)
Prepayments	28,076	(43,997)
Accounts payables	932,858	24,734
Advance billings	-	-
Accrued expenses	59,842	284,098
	<u>2,384,403</u>	<u>1,438,264</u>
Cash Flows from Investing Activities:		
Construction of plant	(2,843,774)	(1,567,227)
Salvage, net of removals	(40,738)	(12,153)
Purchase of investments held to maturity	265,300	(1,660,221)
Associated organizations	5,581,238	9,429,693
Nonregulated property	(77,105)	(46,236)
Deferred plant retirement	(863,499)	(1,055,000)
	<u>2,021,422</u>	<u>5,088,856</u>
Cash Flows from Financing Activities:		
Advances of long term debt	-	-
Payments on long term debt	(1,999,600)	(1,572,016)
Advances/receipts from cushion of credit	(3,537,803)	(4,250,000)
Fund postretirement benefits	(125,000)	(125,000)
Memberships and capital investments	2,440	2,270
Retirements of capital credits	(472,970)	(569,088)
Increase in donated capital	93,664	159,569
	<u>(6,039,269)</u>	<u>(6,354,265)</u>
Net increase in cash balances	(1,633,444)	172,855
Cash and cash equivalents - beginning of period	<u>3,212,734</u>	<u>3,039,879</u>
Cash and cash equivalents - end of period	<u>\$ 1,579,290</u>	<u>\$ 3,212,734</u>
Supplemental disclosures of cash flows information:		
Interest on long-term debt	\$ 547,069	\$ 620,046
Income taxes paid	4,500,000	4,638,161

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

Peoples Rural Telephone Cooperative
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, and high definition television. 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, 2017, 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, 2017 or 2016. The number of customers are as follows:

	<u>2017</u>	<u>2016</u>
Access lines	6,611	6,640
Total number of customers	6,276	6,222
Telephone customers	5,958	5,948
Broadband customers	4,448	4,264
Cable television customers	3,475	3,622

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.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

FTTH 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, 2017 and 2016.

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, investment securities, trade accounts payable, 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.

Peoples Rural Telephone Cooperative
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. There was no interest required to be capitalized during 2017 or 2016.

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>2017</u>	<u>2016</u>
Telecommunications Plant:		
General support	\$14,093,227	\$13,963,886
Central office switching	1,626,382	1,568,283
Central office transmission	12,634,420	12,498,243
Cable and wire facilities	39,790,792	44,007,112
Intangibles	5,844	5,844
	<u>68,150,665</u>	<u>72,043,368</u>
CATV Plant:		
General support	225,785	44,007
Headend plant	1,366,378	1,303,419
Cable and wire facilities	244,203	96,990
	<u>1,836,366</u>	<u>1,444,416</u>
Total	<u>\$69,987,031</u>	<u>\$73,487,784</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%

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Deferred Plant Retirement During 2016 the Cooperative retired switching and transmission plan that had book value remaining. The PSC has allowed the book value remaining to be amortized over a four (4) year period.

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.

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, 2017 or 2016. 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.

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.

Subsequent Events Management has evaluated subsequent events through January 31, 2018, the date the financial statements were available to be issued. During the next two (2) 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. Investment Securities

The Cooperative classifies its investment in securities as held to maturity, available for sale, or trading categories in accordance with provisions of the *Financial Instruments Topic* of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"). Investment securities are classified as held to maturity when the Cooperative has the positive intent and ability to hold the securities until maturity. Held to maturity securities are stated at amortized cost. Investment securities not classified as held to maturity are classified as available for sale and are carried at fair market value, with unrealized gains and losses, net of tax, reported as a separate component in stockholders' equity.

Investments securities are all considered held to maturity and consist of Certificates of Deposits in local banks.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 3. Associated Organizations

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 4. 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.

The following is a summary of non-regulated activities for Peoples Telephone:

	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$248,774	\$860,909	(\$612,135)
Internet activities	33,587	281,192	(247,605)
Long distance services	511,895	1,710,047	(1,198,152)
Fiber to the Home [FTTH]	3,332,568	2,854,009	478,559
Total - 2017	<u>\$4,126,824</u>	<u>\$5,706,157</u>	<u>(\$1,579,333)</u>

	<u>Income</u>	<u>Expenses</u>	<u>Net</u>
Customer premises equipment	\$245,712	\$860,909	(\$615,197)
Internet activities	26,990	255,258	(228,268)
Long distance services	683,212	2,368,068	(1,684,856)
Fiber to the Home [FTTH]	3,297,157	2,668,889	628,268
Total - 2016	<u>\$4,253,071</u>	<u>\$6,153,124</u>	<u>(\$1,900,053)</u>

Note 5. Deferred Debits

Deferred debits are as follows:

	<u>2017</u>	<u>2016</u>
Deferred plant retirement	\$791,250	\$1,055,000
Pension plan prefunding	1,127,248	-
	<u>\$1,918,498</u>	<u>\$1,055,000</u>

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 6. Long Term Debt

All telecommunications assets, except motor vehicles, are pledged as collateral on the long term debt due RUS. The long term debt payable to RUS is due in monthly installments of various amounts through 2032.

Long term debt is as follows:

	<u>2017</u>	<u>2016</u>
Telecommunications loans:		
RUS, 1.945 - 4.168%	\$10,551,232	\$12,249,547
Less Cushion of Credit	<u>(10,029,597)</u>	<u>(6,491,794)</u>
	521,635	5,757,753
RUS Broadband loan 2.2287% - 4.3994%	<u>6,016,741</u>	<u>6,318,026</u>
	6,538,376	12,075,779
Less current portion	<u>1,540,000</u>	<u>1,500,000</u>
Long term portion	<u>\$4,998,376</u>	<u>\$10,575,779</u>

Principal payments for the next five years are as follows: 2018 - \$1,540,000; 2019 - \$1,560,000; 2020 - \$1,580,000; 2021 - \$1,595,000; 2022 - \$1,605,000. The Cooperative expects to continue making payments in the Cushion of Credit during 2018. The Cooperative has made additional principal payments over the past several years. This is not expected to continue.

Note 7. Patronage Capital

The long term debt agreement contains restrictions on the return to patrons of capital contributed by them. The restrictions relate in general to the Cooperative's net worth and assets, as defined. The net worth of the Cooperative at December 31, 2017, was 81%.

Note 8. Pension Plan

All eligible non-union employees of the Cooperative participate in the National Telephone Cooperative Association (NTCA) Pension Plan ("R&S Plan"), a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The Plan sponsor's identification number is 52-0741336 and the Plan Number is 333. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

The Cooperative's contributions to the R&S Plan in 2017 and 2016 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 \$366,163 in 2017 and \$348,940 in 2016. There have been no significant changes that affect the comparability of 2017 and 2016.

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 over 80 percent funded at January 1, 2017 and 2016 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

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 8. Pension Plan, continued

each year as part of the actuarial valuation of the plan and may change as a result of plan experience. There have been no significant changes that affect the comparability of 2017 and 2016.

The NTCA Board of Directors amended the 2016 R&S Program specifications at the recommendation of the Plan Trust Committee to include the following changes:

- Basic contribution rates will increase by 19%.
- The program's current surcharge will expire at the end of 2016, and a new surcharge contribution of 50% of the member's elected contribution rate will begin in 2017. This surcharge is expected to continue for approximately 12 years.
- A prefunding option was added to allow members the option to prefund their future surcharge contributions in a single payment prior to the start of the new surcharge effective in 2017.
- Beginning January 1, 2016, for members that have adopted the Rule-of-85 ("ROE") provision, the ROE charge will apply to both the member's elected employer contribution rate and any required employee contribution rate.

Over the past several years, various actions have been taken to sustain the reserve of funds available to help meet the program's legally required minimum contribution amount. However, adverse economic conditions and regulatory changes have negatively affected all pension plans, including the R&S Program. Despite prudent decision-making by the program's trust committee, the R&S Program's minimum contribution amount is projected to exceed the current reserve and member contributions alone will not meet the minimum requirement. This expectation has led the program's actuary to recommend the new surcharge contribution beginning in 2017. The R&S Program is offering prefunding to give members flexibility in addressing this situation at their company.

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

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

During 2017, the Cooperative prefunded the surcharge in an amount of \$1,143,692. This amount will be amortized over the 12 year period the surcharge is expected to continue.

Note 9. 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.

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 9. Accumulated Postretirement Benefits, continued

For measurement purposes, a 6.5% annual rate of increase, decreasing by 0.5% per year until 5.0% 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 4.30% for 2017 and 2016. The expected rate of return on assets is 7.0%. There have been no significant changes that affect the comparability of 2017 and 2016.

The funded status of the plan was as follows:

	<u>2017</u>	<u>2016</u>
Projected benefit obligation	(\$11,763,515)	(\$12,121,681)
Plan assets at fair value	<u>3,367,201</u>	<u>2,893,589</u>
Funded status	<u>(\$8,396,314)</u>	<u>(\$9,228,092)</u>

The following sets forth the accumulated postretirement benefit obligation, the change in plan assets, and the components of accrued postretirement benefit cost and other comprehensive income:

	<u>2017</u>	<u>2016</u>
Benefit obligation at beginning of year	<u>\$9,228,092</u>	<u>\$8,913,068</u>
Components of net periodic benefit cost:		
Service cost	409,069	328,158
Interest cost	503,996	533,744
Expected return on assets	<u>(227,865)</u>	<u>(176,702)</u>
Net periodic benefit cost	685,200	685,200
Actuarial adjustment	(1,132,457)	-
Benefits paid	(259,521)	(245,176)
Contributions to plan	<u>(125,000)</u>	<u>(125,000)</u>
Benefit obligation at end of year	<u>\$8,396,314</u>	<u>\$9,228,092</u>
Change in plan assets:		
Fair value of plan assets-beginning of year	\$2,893,589	\$2,462,747
Employer contributions	125,000	125,000
Change in fair value of plan assets	348,612	305,842
Benefits paid	<u>-</u>	<u>-</u>
Fair value of plan assets-end of year	<u>\$3,367,201</u>	<u>\$2,893,589</u>
Amounts recognized in the balance sheet consists of:		
Noncurrent liabilities	<u>\$8,396,314</u>	<u>\$9,228,092</u>
Amounts included in other comprehensive income:		
Unrecognized actuarial gain (loss)	<u>(\$2,905,274)</u>	<u>(\$4,450,531)</u>
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	\$9,040,000	
Net periodic benefit cost	730,000	

Peoples Rural Telephone Cooperative
Notes to Financial Statements

Note 9. Accumulated Postretirement Benefits, continued

The projected retiree benefit payments are expected to be as follows: 2018 - \$250,000; 2019 - \$250,000; 2020 - \$248,000; 2021 - \$247,000; 2022 - \$250,000.

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.

* * * * *

Peoples Rural Telephone Cooperative Corporation
and Subsidiary
Consolidating Balance Sheet, December 31, 2017

<u>Assets</u>	<u>Telephone</u>	<u>Telecom</u>	<u>Eliminations</u>	<u>Consolidated</u>
Current Assets:				
Cash and cash equivalents	\$ 1,541,318	\$ 37,972		\$ 1,579,290
Accounts receivable, less allowance for Telephone of \$165,705	8,864	26,983		35,847
Other receivables, connecting companies	503,688		(285,464)	218,224
Material and supplies, at average cost	593,177			593,177
Prepayments	33,164			33,164
	<u>2,680,211</u>	<u>64,955</u>	<u>(285,464)</u>	<u>2,459,702</u>
Other Assets:				
Investments held to maturity	7,548,852			7,548,852
Associated organizations	33,444,118		(2,146,851)	31,297,267
Nonregulated	1,649,743			1,649,743
Deferred debits	1,918,499			1,918,499
	<u>44,561,212</u>	<u></u>	<u>(2,146,851)</u>	<u>42,414,361</u>
Utility Plant, at original cost:				
In service	68,150,665	1,836,366		69,987,031
Under construction	320,782	863,328		1,184,110
	<u>68,471,447</u>	<u>2,699,694</u>		<u>71,171,141</u>
Less accumulated depreciation	32,596,704	328,831		32,925,535
	<u>35,874,743</u>	<u>2,370,863</u>		<u>38,245,606</u>
Total	<u>\$ 83,116,166</u>	<u>\$ 2,435,818</u>	<u>\$ (2,432,315)</u>	<u>\$ 83,119,669</u>
<u>Member's Equities and Liabilities</u>				
Current Liabilities:				
Accounts payable	\$ 665,347	\$ 288,967	\$ (285,464)	\$ 668,850
Current portion of long term debt	1,540,000			1,540,000
Accrued expenses	1,344,513			1,344,513
	<u>3,549,860</u>	<u>288,967</u>	<u>(285,464)</u>	<u>3,553,363</u>
Long Term Debt	<u>4,998,376</u>			<u>4,998,376</u>
Accumulated Postretirement Benefits	<u>8,396,314</u>			<u>8,396,314</u>
Members' Equities:				
Memberships and capital investments	219,451	6,865,832	(6,865,832)	219,451
Patronage capital and retained earnings	67,204,973	(4,718,981)	4,718,981	67,204,973
Donated capital	1,652,466			1,652,466
Other comprehensive income (loss)	(2,905,274)			(2,905,274)
	<u>66,171,616</u>	<u>2,146,851</u>	<u>(2,146,851)</u>	<u>66,171,616</u>
Total	<u>\$ 83,116,166</u>	<u>\$ 2,435,818</u>	<u>\$ (2,432,315)</u>	<u>\$ 83,119,669</u>

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

Peoples Rural Telephone Cooperative Corporation and Subsidiary
Consolidating Statement of Revenue and Comprehensive Income
for the year ended December 31, 2017

	<u>Telephone</u>	<u>Telecom</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating Revenues:				
Local network services	\$ 5,376,656	\$ 40,234		\$ 5,416,890
Network access services	9,807,153	75,496		9,882,649
Carrier billing and collection	82,026			82,026
Miscellaneous	87,724	294,503	(294,954)	87,273
Less provision for uncollectibles	<u>(30,782)</u>	<u></u>	<u></u>	<u>(30,782)</u>
	<u>15,322,777</u>	<u>410,233</u>	<u>(294,954)</u>	<u>15,438,056</u>
Operating Expenses:				
Plant specific operations	3,656,697	310,005		3,966,702
Plant non specific operations	1,421,247	41,959		1,463,206
Depreciation and amortization	3,715,755	97,626		3,813,381
Customer operations	1,175,588	8,138	-	1,183,726
Corporate operations	1,703,167	18,337		1,721,504
Taxes, other than income	<u>844,459</u>	<u>16,102</u>	<u></u>	<u>860,561</u>
	<u>12,516,913</u>	<u>492,167</u>	<u></u>	<u>13,009,080</u>
Operating Income	<u>2,805,864</u>	<u>(81,934)</u>	<u>(294,954)</u>	<u>2,428,976</u>
Nonoperating Margins:				
Interest and other income (losses)	811,228			811,228
Income in limited liability companies	9,573,341		41,455	9,614,796
Less provision for related taxes	<u>(4,500,000)</u>	<u></u>	<u></u>	<u>(4,500,000)</u>
Nonregulated net income (loss)	<u>(1,579,333)</u>	<u>40,479</u>	<u>294,954</u>	<u>(1,243,900)</u>
	<u>4,305,236</u>	<u>40,479</u>	<u>336,409</u>	<u>4,682,124</u>
Margins available for interest charges	<u>7,111,100</u>	<u>(41,455)</u>	<u>41,455</u>	<u>7,111,100</u>
Interest Charges:				
Long term debt	<u>547,069</u>	<u></u>	<u></u>	<u>547,069</u>
Net Margins (Loss)	<u>6,564,031</u>	<u>(41,455)</u>	<u>41,455</u>	<u>6,564,031</u>
Other Comprehensive Income:				
Postretirement benefits	<u>1,545,257</u>	<u></u>	<u></u>	<u>1,545,257</u>
Net Comprehensive Income	<u>\$ 8,109,288</u>	<u>\$ (41,455)</u>	<u>\$ 41,455</u>	<u>\$ 8,109,288</u>

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

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

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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, 2017 and 2016, 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 31, 2018. 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

To the Board of Directors
Peoples Rural Telephone Cooperative

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 tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of 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 31, 2018

ALAN M. ZUMSTEIN
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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 Corporation
McKee, Kentucky

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, 2017, 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 31, 2018. In accordance with *Government Auditing Standards*, we have also issued my report dated January 31, 2018, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above related to my audit have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2018, 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 approval of the RUS to enter into any contract, agreement, or lease with an affiliate as defined in part 1773.33 (e)(2)(i);
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles, and;
- Comply with the requirements for the detailed schedule of investments, which 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	\$45,705,695	(\$22,735,999)
Activity for 2017	-	9,614,796	(5,581,238)
End of year	<u>\$4,294,013</u>	<u>\$55,320,491</u>	<u>(\$28,317,237)</u>

During 2004, Peoples Telephone formed a wholly-owned subsidiary, Peoples Telecom, LLC, which provides telecommunications services outside of the Cooperative'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	\$6,288,471	(\$4,677,526)
Activity for 2017	577,361	(41,455)
End of year	<u>\$6,865,832</u>	<u>(\$4,718,981)</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 31, 2018