

**SOUTH CENTRAL RURAL TELEPHONE
COOPERATIVE CORPORATION, INC.**

**Report on Audit of Financial Statements
and Supplemental Data**

**For the Years Ended
June 30, 2014 and 2013**

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Independent Auditors' Report

Board of Directors
South Central Rural Telephone
Cooperative Corporation, Inc.
Glasgow, Kentucky 42141

Report on the Financial Statements

We have audited the accompanying financial statements of South Central Rural Telephone Cooperative Corporation, Inc., which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of operations, comprehensive income, changes in patronage capital and other 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

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our 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 we 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, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of South Central Rural Telephone Cooperative Corporation, Inc., as of June 30, 2014 and 2013, 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.

Other Matters

Supplemental Data

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the South Central Rural Telephone Cooperative Corporation, Inc.'s basic financial statements. The accompanying supplemental data on pages 18 and 19 is presented for purposes of additional analysis and are not a required part of the basic financial statements. This data is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such 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 our opinion, the schedules of operating expenses in pages 18 and 19 are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 24, 2014, on our consideration of the South Central Rural Telephone Cooperative Corporation, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering South Central Rural Telephone Cooperative Corporation, Inc.'s internal control over financial reporting and compliance.

Campbell, Myers & Rutledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

September 24, 2014

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
BALANCE SHEETS
June 30, 2014 and 2013

	<u>2014</u>	<u>Restated 2013</u>
Current assets:		
Cash and cash equivalents	\$ 5,803,829	\$ 3,893,591
Temporary cash investments	400,000	1,700,000
Accounts and notes receivable, less allowance for doubtful accounts of \$17,451 in 2014 and \$25,486 in 2013	932,419	1,601,447
Materials and supplies at average cost	2,971,861	3,758,618
Accrued interest receivable	4,859	4,859
Prepaid expenses	<u>1,939,605</u>	<u>1,700,534</u>
Total current assets	<u>12,052,573</u>	<u>12,659,049</u>
Other assets:		
Marketable securities	40,249,167	38,128,085
Nonregulated investments	1,563,354	2,067,795
Investment in affiliated companies	74,565,740	74,404,753
Other deferred charges	<u>1,297,458</u>	<u>150,063</u>
Total other assets	<u>117,675,719</u>	<u>114,750,696</u>
Telephone plant, at cost (substantially all pledged as collateral on long- term debt to RUS):		
Telephone plant in service	176,422,771	171,350,387
Telephone plant under construction	<u>7,306,059</u>	<u>4,919,109</u>
Total	183,728,830	176,269,496
Less accumulated depreciation	<u>137,013,065</u>	<u>133,719,702</u>
Telephone plant, net	<u>46,715,765</u>	<u>42,549,794</u>
	<u>\$ 176,444,057</u>	<u>\$ 169,959,539</u>

	<u>2014</u>	Restated <u>2013</u>
Current liabilities:		
Current portion of long-term debt	\$ 3,114,353	\$ 2,988,642
Accounts payable	5,146,722	3,554,033
Accrued expenses	<u>2,871,631</u>	<u>2,919,488</u>
Total current liabilities	<u>11,132,706</u>	<u>9,462,163</u>
Long-term liabilities:		
Long-term obligation to RUS and RTB	351,737	278,252
Other long-term liabilities	<u>10,515,644</u>	<u>13,200,714</u>
Total long-term liabilities	<u>10,867,381</u>	<u>13,478,966</u>
Other Liabilities		
Deferred taxes	<u>15,339,330</u>	<u>15,233,447</u>
Total other liabilities	<u>15,339,330</u>	<u>15,233,447</u>
Commitments		
Members' equities:		
Patronage capital	54,417,835	60,406,221
Accumulated other comprehensive loss	(8,568,232)	(12,157,318)
Other equities	91,778,405	82,187,544
Other member capital	<u>1,476,632</u>	<u>1,348,516</u>
Total members' equities	<u>139,104,640</u>	<u>131,784,963</u>
	<u>\$ 176,444,057</u>	<u>\$ 169,959,539</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATEMENTS OF OPERATIONS
 For the Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>Restated 2013</u>
Operating revenues:		
Basic local network service	\$ 7,514,374	\$ 7,744,627
Network access services revenues	13,552,985	14,055,138
Carrier billing and collection	431,297	441,272
Miscellaneous	<u>1,172,608</u>	<u>1,149,695</u>
Total operating revenues	<u>22,671,264</u>	<u>23,390,732</u>
Operating expenses:		
Plant specific operations	4,679,914	4,568,821
Plant nonspecific operations	2,180,071	2,185,744
Depreciation and amortization	8,978,849	9,997,004
Customer operations	1,675,309	1,644,153
Corporate operations	2,641,280	2,703,853
Other operating taxes	<u>1,103,574</u>	<u>1,052,112</u>
Total operating expenses	<u>21,258,997</u>	<u>22,151,687</u>
Operating income	<u>1,412,267</u>	<u>1,239,045</u>
Nonoperating net income	13,660,855	21,105,352
Provision for income taxes	<u>(4,069,994)</u>	<u>(9,956,519)</u>
Income before interest charges	<u>11,003,128</u>	<u>12,387,878</u>
Interest on long-term debt to RUS, net of interest capitalized of \$217,281 in 2014 and \$220,370 in 2013	(65,389)	(186,607)
Nonregulated net income (loss)	<u>(4,947,243)</u>	<u>(4,687,026)</u>
Net income	<u>\$ 5,990,496</u>	<u>\$ 7,514,245</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended June 30, 2014 and 2013

	<u>2014</u>	Restated <u>2013</u>
Net income	\$ 5,990,496	\$ 7,514,245
Other comprehensive income (loss)		
Postretirement benefit other than pension:		
Unrecognized loss on assets	<u>3,589,086</u>	<u>(2,411,600)</u>
Comprehensive income	<u>\$ 9,579,582</u>	<u>\$ 5,102,645</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATEMENTS OF PATRONAGE CAPITAL AND OTHER EQUITIES
 For the Years Ended June 30, 2014 and 2013

	Patronage Capital			Accumulated Other Comprehensive Income (Loss)	Other Equities
	Assignable	Assigned	Balance		
Balances, July 1, 2012, Restated	\$ (659,537)	\$ 66,984,328	\$ 66,324,791	\$ (9,745,718)	\$ 71,038,711
Distribution of patronage capital	-	(2,039,255)	(2,039,255)	-	-
Patronage capital assigned for the year ended December 31, 2012	(882,477)	882,477	-	-	-
Retirement of patronage capital of estates of deceased members	-	(505,994)	(505,994)	-	-
Transfer of unclaimed patronage capital	261,267	-	261,267	-	-
Postretirement benefit other than pension					
Unrecognized loss on assets	-	-	-	(2,411,600)	-
Transition obligation	-	-	-	-	-
Net income for the year ended June 30, 2013:					
Operating margins	(3,634,588)	-	(3,634,588)	-	-
Nonoperating margins	-	-	-	-	11,148,833
Balances, June 30, 2013, Restated	(4,915,335)	65,321,556	60,406,221	(12,157,318)	82,187,544
Distribution of patronage capital	-	(2,037,617)	(2,037,617)	-	-
Patronage capital assigned for the year ended December 31, 2013	5,390,433	(5,390,433)	-	-	-
Retirement of patronage capital of estates of deceased members	-	(566,622)	(566,622)	-	-
Transfer of unclaimed patronage capital	216,218	-	216,218	-	-
Postretirement benefit other than pension					
Unrecognized loss on assets	-	-	-	3,589,086	-
Transition obligation	-	-	-	-	-
Net income for the year ended June 30, 2014:					
Operating margins	(3,600,365)	-	(3,600,365)	-	-
Nonoperating margins	-	-	-	-	9,590,861
Balances, June 30, 2014	<u>\$ (2,909,049)</u>	<u>\$ 57,326,884</u>	<u>\$ 54,417,835</u>	<u>\$ (8,568,232)</u>	<u>\$ 91,778,405</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>Restated 2013</u>
Cash flows from operating activities:		
Net income	\$ 5,990,496	\$ 7,514,245
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,978,849	9,997,004
Deferred taxes on income	105,883	973,135
Changes in operating assets and liabilities:		
Decrease (increase) in temporary cash investments	1,300,000	-
Decrease (increase) in accounts and notes receivable	669,028	1,347,380
Decrease (increase) in inventory	786,757	(639,602)
Decrease (increase) in prepaid expenses	(239,071)	(362,096)
Increase (decrease) in accounts payable	1,592,689	(393,818)
Increase (decrease) in accrued expenses	<u>(47,857)</u>	<u>192,379</u>
Net cash provided by operating activities	<u>19,136,774</u>	<u>18,628,627</u>
Cash flows from investing activities:		
Purchases of property, plant and equipment	(6,994,161)	(6,471,634)
Plant removal costs	(154,373)	(120,861)
Salvage recovered from retirement of plant	102,814	154,990
Decrease (increase) in nonregulated investment	504,441	2,036,223
Decrease (increase) in other deferred charges	(1,147,395)	10,758
(Increase) in investment in affiliated companies	(160,987)	(4,322,219)
Purchases of Marketable Securities	(4,632,266)	(19,437,978)
Redemptions of Marketable Securities	<u>3,811,184</u>	<u>11,494,919</u>
Net cash used in investing activities	<u>(8,670,743)</u>	<u>(16,655,802)</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATEMENTS OF CASH FLOWS, CONCLUDED
 For the Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from financing activities:		
Distributions of patronage capital	\$ (2,037,617)	\$ (2,039,255)
Retirements of patronage capital	(566,622)	(505,994)
Principal payments to Federal Financing Bank	(3,716,701)	(2,140,097)
Increase (decrease) in long-term liabilities	(2,579,187)	571,654
Increase (decrease) in other member capital	128,116	32,928
Transfers of unclaimed patronage capital	<u>216,218</u>	<u>261,267</u>
Net cash provided (used) in financing activities	<u>(8,555,793)</u>	<u>(3,819,497)</u>
Net increase (decrease) in cash and cash equivalents	1,910,238	(1,846,672)
Cash and cash equivalents at beginning of year	<u>3,893,591</u>	<u>5,740,263</u>
Cash and cash equivalents at end of year	<u>\$ 5,803,829</u>	<u>\$ 3,893,591</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest (\$217,281 capitalized in 2014 and 220,370 in 2013)	<u>\$ 362,286</u>	<u>\$ 304,977</u>
Income taxes	<u>\$ 3,964,000</u>	<u>\$ 8,983,384</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2014 and 2013

1. Summary of Significant Accounting Policies:

General:

The Cooperative maintains its accounts in accordance with the Uniform System of Accounts prescribed for telephone companies by the Federal Communications Commission. The financial statements reflect the application of certain accounting policies described in this note.

Nature of Business:

South Central Rural Telephone Cooperative Corporation, Inc., provides telephone service in a nine-county area of south central Kentucky. The Company grants credit to customers, substantially all of whom are local residents and commercial businesses.

Estimates:

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

Telephone Plant:

The telephone plant in service and under construction at June 30, 2014 and 2013 is stated substantially at original cost, which includes material, labor, transportation and such indirect items as engineering, supervision, employee fringe benefits and interest on funds used during construction. As property units are retired in the ordinary course of business, the cost of the property plus removal cost, less salvage, is charged to accumulated depreciation. Listed below are the major classes of the telephone plant as of June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>	<u>Depreciation Rate</u>
Organization	\$ 20,039	\$ 20,039	-
Land	520,950	514,751	-
Buildings	7,665,613	7,577,731	2.70%
Central Office Equipment	49,169,998	50,003,365	7.5-11.9%
Station Equipment	997,697	997,697	-
Cable and Wire Facilities	108,254,811	102,738,620	2.2-9.4%
Furniture and Office Equipment	719,099	712,918	7.50%
General Purpose Computers	3,891,903	3,752,049	15.80%
Vehicles	5,047,141	4,897,697	10.1-12.1%
Garage and Work Equipment	135,520	135,520	7.50%
	<u>\$ 176,422,771</u>	<u>\$ 171,350,387</u>	

Depreciation:

Depreciation is calculated by the straight-line method designed to amortize the cost of various classes of depreciable assets over their estimated useful lives.

Depreciation for the years ended June 30, 2014 and 2013 was \$8,978,849 and \$9,997,004, respectively.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2014 and 2013

1. Summary of Significant Accounting Policies, Continued:

Deregulated Customer Premises Equipment:

Deregulated CPE is stated at cost. The Cooperative provides for depreciation on a straight-line basis at an annual rate of depreciation which will amortize the cost of the equipment over its estimated useful life.

Nonregulated Investments:

This balance reflects the Cooperative's permanent investment in deregulated CPE, net of applicable depreciation, plus deregulated inventory and accounts receivable, less deregulated accounts payable.

Following is a summary of net income (loss) from deregulated operations for the years ending June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Income from operations	\$ 15,684,571	\$ 14,682,020
Expenses	<u>(20,631,814)</u>	<u>(19,369,046)</u>
Net income (loss)	<u>\$ (4,947,243)</u>	<u>\$ (4,687,026)</u>

Cash and Cash Equivalents:

For purposes of the statement of cash flows, the Cooperative considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Accounts and Notes Receivable:

Included in accounts and notes receivable at June 30, 2014 and 2013, is unbilled revenue of \$9,090 and \$36,124, respectively. The Company estimates uncollectable accounts as a percentage of monthly revenues and compares this to invoices dated over 90 days when they are considered uncollectible. The board of directors write off receivables as a charge to the allowance for credit losses, in their estimation, it is probable that the receivable is worthless.

Other Member Capital:

This balance represents unclaimed distributions of patronage capital. After a statutory waiting period, these balances will be re-assigned to the Cooperative's existing patrons.

Inventories:

Inventory is valued at average cost. Inventory consists of materials and expendable supplies held for future consumption or capitalization. The cost is recorded as an expense or capitalized as inventory items are consumed.

Subsequent Events:

Management has evaluated subsequent events through September 24, 2014, the date which the financial statements were available to be issued.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2014 and 2013

1. Summary of Significant Accounting Policies, Concluded:

Reclassifications:

Certain reclassifications have been made to the 2013 financial statement presentation to correspond to the current year's format. Total equity and net income are unchanged due to these reclassifications.

Related Party Transactions:

The Company was indebted to 100% owned subsidiary (South Central Telcom, LLC) in the amount of \$1,875,842 and \$1,732,748 for the years ended June 30, 2014 and 2013 respectively.

South Central Telcom, LLC pays South Central Rural Telephone Cooperative for switch port costs and billing and collection services on a monthly basis.

South Central Telcom, LLC provides content to South Central Rural Telephone Cooperative for its cable television services. Content is charged on a monthly basis at cost plus 10% to the Cooperative.

South Central Rural Telephone Cooperative performs and contracts construction services for the addition of plant and infrastructure for its subsidiary. These amounts are billed to the subsidiary when completed and ready to be placed in service. As of June 30, 2014 and 2013, South Central Rural Telephone had \$871,948 and \$128,984 of construction included in deferred charges for South Central Telcom, LLC.

Investment in Affiliated Companies:

This balance reflects the Cooperative's investment in partnerships and limited liability companies with other telephone companies in Kentucky, for the purpose of providing cellular telephone services and local telephone service. The investment is accounted for using the equity method. Investments in affiliated companies are listed as follows:

	Percentage <u>Owned</u>	<u>2014</u>	<u>2013</u>
RSA #3 Partnership	25%	\$ 19,066,785	\$ 18,045,416
RSA #4 Partnership	50%	30,294,064	29,896,129
Cumberland Cellular Partnership	12.5%	6,754,487	6,979,500
Bluegrass Network, LLC	20%	3,881,048	3,649,613
Bluegrass Telcom, LLC	20%	320,997	325,420
South Central Telcom, LLC	100%	14,248,359	15,508,675
		<u>\$ 74,565,740</u>	<u>\$ 74,404,753</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2014 and 2013

2. Long-Term Debt:

Long-term debt is represented by mortgage notes payable to the United States of America. Principal and interest payments are due in quarterly installments. It is estimated that quarterly installments of \$750,000 are payable within the next twelve months. The notes are scheduled to be repaid during the year 2015. At June 30, 2014, the Cooperative has advance payments in amount of \$1,254,484 that may be applied to the installments after the application of \$2,456,730 during the current year.

	<u>2014</u>	<u>2013</u>
Due to United States of America		
4.1710% First Mortgage Notes - FFB	\$ 4,720,574	\$ 8,437,274
Advance Payments	<u>1,254,484</u>	<u>5,170,380</u>
	3,466,090	3,266,894
Less current maturities	<u>(3,114,353)</u>	<u>(2,988,642)</u>
Total	<u>\$ 351,737</u>	<u>\$ 278,252</u>

The maturities of long-term debt for each of the five years succeeding the balance sheet date is as follows:

2014	\$ 3,114,353
2015	<u>351,737</u>
Total	<u>\$ 3,466,090</u>

The long-term debt agreements and the bylaws of the Cooperative contain restrictions on the return to patrons of capital credits. These restrictions require the maintenance of defined amounts of members' equity and working capital.

3. Cash and Temporary Investments:

All deposits are in various financial institutions and are carried at cost. Temporary Investments reflect Certificates of Deposit held at various financial institutions. Insured amounts reflect those covered by FDIC or by collateral pledged by the respective financial institutions.

	2014		2013	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Insured	\$ 5,320,229	\$ 5,320,229	\$ 5,593,591	\$ 5,878,619
Uninsured:				
Uncollateralized	<u>883,600</u>	<u>1,153,690</u>	<u>-</u>	<u>82,506</u>
Total cash and temporary investments	<u>\$ 6,203,829</u>	<u>\$ 6,473,919</u>	<u>\$ 5,593,591</u>	<u>\$ 5,961,125</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2014 and 2013

4. Pension Plan:

The Cooperative has a defined benefit pension plan covering substantially all of its employees. In October, 1988, the Cooperative approved the retroactive purchase of all prior service benefits as of December 31, 1988, at a cost of \$487,804. Contributions to the Plan for the years ended June 30, 2014 and 2013 were \$1,081,151 and \$989,677, respectively. The Plan has been approved by the Internal Revenue Service. As the Cooperative is only one of several employers participating in the Plan, it is not practicable to determine if the vested benefits of the Cooperative's employees exceed the Cooperative's portion of the Plan assets.

The following table presents certain information regarding the Plan's status as a whole, derived from actuarial valuations performed as of the dates indicated:

	<u>Pension Benefits</u>	
	<u>January 1, 2014</u>	<u>January 1, 2013</u>
Fair value of plan assets	\$ 1,532,374,435	\$ 1,368,763,503
Present value of accumulated benefits	<u>(1,527,578,554)</u>	<u>(1,386,628,324)</u>
Overfunded/(Unfunded)	<u>\$ (4,795,881)</u>	<u>\$ (17,864,821)</u>

	<u>Pension Benefits</u>	
	<u>January 1, 2014</u>	<u>January 1, 2013</u>
Weighted – average assumptions as of January 1:		
Valuation interest rate	7.00%	7.25%
Expected return on plan assets	7.00%	7.25%
Rate of compensation increase	age related	age related

5. Income Taxes:

The Corporation has been exempt from federal income taxes as a cooperative telephone company under Section 501(c)(12) of the Internal Revenue Code. In 1991, the Internal Revenue Service issued a Technical Advice Memorandum, which interprets certain types of revenues to be excluded in determining when the Cooperative satisfies the 85 percent income test to qualify for tax exempt status. By applying these interpretations, the Cooperative does not qualify in the current year for the tax exempt status. The Company's provision for income taxes differs from applying the statutory U.S. federal income tax rate to income before income taxes. The primary differences result from providing for state income taxes and from deducting certain expenses for financial statement purposes but not for federal tax purposes.

The provision for income taxes for 2014 and 2013 consists of the following:

Provision for Income Taxes:	<u>2014</u>	<u>2013</u>
Current tax expense	\$ 3,964,111	\$ 8,983,384
Deferred tax (benefit)	<u>105,883</u>	<u>973,135</u>
Total	<u>\$ 4,069,994</u>	<u>\$ 9,956,519</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2014 and 2013

5. Income Taxes, Concluded:

A cumulative net deferred tax liability is included in other liabilities. The components of the liability are as follows:

	<u>2014</u>	<u>2013</u>
Differences in depreciation methods	<u>\$ 15,339,330</u>	<u>\$ 15,233,447</u>

The Company follows the recognition requirements for uncertain income tax positions as required by generally accepted accounting principles. The Company has no tax position at June 30, 2013 for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The Company's policy is to classify income tax related interest and penalties in interest expense and other expenses, respectively. No such interest or penalties were recognized during the periods presented.

The Company files income tax returns in the U.S. federal jurisdiction, and various state and local jurisdictions. The Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2011.

6. Marketable Securities:

The maturities of held to maturity investments and their approximate market values at June 30, 2014 and 2013, were as follows:

All debt securities of the Cooperative are considered to be held to maturity. The carrying amounts and approximate market value of held to maturity investments are:

	Amortized Cost	Net Unrealized Gains (Losses)	Market Value
June 30, 2014	\$ 40,649,167	\$ (1,771,665)	\$ 38,877,502
June 30, 2013	\$ 39,828,085	\$ (1,844,966)	\$ 37,983,119
June 30, 2012	\$ 31,885,026	\$ 165,893	\$ 32,050,919
	Amortized Cost		Market Value
Due in one year or less (included in Temporary Cash Investments)	\$ 400,000		\$ 400,000
Due after one year	40,249,167		38,477,502
Balances, June 30, 2014	<u>\$ 40,649,167</u>		<u>\$ 38,877,502</u>
Due in one year or less (included in Temporary Cash Investments)	\$ 1,700,000		\$ 1,700,000
Due after one year	38,128,085		36,283,119
Balances, June 30, 2013	<u>\$ 39,828,085</u>		<u>\$ 37,983,119</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2014 and 2013

7. Postretirement Benefits:

The Corporation sponsors a defined benefit plan that provides medical and life insurance coverage to retirees and their dependents. Participating retirees and dependents contribute 0% of the projected cost of coverage. The plan is partially funded.

The following sets forth the accumulated post-retirement benefit obligation, the change in plan assets, and the component of accrued post-retirement benefit cost and net periodic benefit cost as of June 30, 2014 and 2013.

	<u>2014</u>	<u>2013</u>
Accumulated post-retirement benefit obligation, beginning	\$ 28,390,149	\$ 23,715,063
Service cost	956,246	1,004,664
Interest cost	1,257,034	1,258,028
Employer contributions	(766,472)	(749,241)
Actuarial loss/(gain)	(3,589,086)	2,237,779
Benefits paid	<u>2,128,131</u>	<u>923,856</u>
Accumulated post retirement benefit obligation, ending	<u>\$ 28,376,002</u>	<u>\$ 28,390,149</u>
Fair value of plan assets - beginning of year	\$ 14,315,966	\$ 12,683,239
Employer contributions	766,742	749,241
Unrealized gains on assets	4,015,400	1,807,342
Benefits paid	<u>(2,128,131)</u>	<u>(923,856)</u>
Fair value of plan assets - end of year	<u>16,969,977</u>	<u>14,315,966</u>
Unfunded status	\$ 11,406,025	\$ 14,074,183
Unrecognized net actuarial loss	<u>8,568,233</u>	<u>12,157,319</u>
Net amount recognized	<u>\$ 2,837,792</u>	<u>\$ 1,916,864</u>
Unfunded status	\$ 11,406,025	\$ 14,074,183
Current liabilities	<u>893,682</u>	<u>877,560</u>
Noncurrent liabilities	<u>\$ 10,512,343</u>	<u>\$ 13,196,623</u>
Service cost	\$ 956,246	\$ 1,004,664
Interest cost	1,257,034	1,258,028
Amortization of net actuarial gain	352,835	526,264
Expected return on assets	<u>(1,232,037)</u>	<u>(1,039,357)</u>
Net periodic benefit cost	<u>\$ 1,334,078</u>	<u>\$ 1,749,599</u>
Net amount recognized (included in other comprehensive income)	<u>\$ 3,589,086</u>	<u>\$ (2,411,600)</u>
Amounts in other comprehensive income expected to be realized in the subsequent year - actuarial gain	<u>\$ 352,835</u>	<u>\$ 526,264</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2014 and 2013

7. Postretirement Benefits, Concluded:

The Discount rate used in determining the accumulated postretirement benefit obligation was 4.5% for the years ending June 30, 2014 and 2013, respectively.

Expected benefit payments from the plan for year ending June 30, 2015 total \$893,682.

For measurement purposes, a 7.26% annual rate of increase in the per capita cost of covered health care benefits was used for the year ended June 30, 2014. The anticipated future rates are as follows:

2015	5.50%
2016	5.00%
2017	5.00%
2018	5.00%
2019	5.00%
2020-2022	5.00%

An additional 1% increase in the trend utilized for measurement purposes in 2014 would have resulted in an increase in the accumulated postretirement benefit obligation of approximately 6.2 million.

8. Restatement of Previously Issued Financial Statements:

The Company has restated its previously issued financial statements for June 30, 2013, primarily to reflect the correction of errors related to its accounts payable and other assets.

The effect on previously issued financial statements is as follows:

	<u>June 30, 2013</u>
Members Equities:	
Patronage Capital	
As Previously Reported	\$ 61,346,791
As Restated	\$ 60,406,221
Other Equities	
As Previously Reported	\$ 81,983,484
As Restated	\$ 82,187,544
Total Assets	
As Previously Reported	\$ 169,774,841
As Restated	\$ 169,959,539
Accounts Payable	
As Previously Reported	\$ 2,632,825
As Restated	\$ 3,554,033
Nonoperating net income	
As Previously Reported	\$ 20,973,355
As Restated	\$ 21,105,352

SUPPLEMENTAL DATA

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATISTICAL AND ANALYTICAL INFORMATION
 June 30, 2014 and 2013

	2014	2013
<u>Telephone Plant in Service - June 30:</u>	\$ 176,422,771	\$ 171,350,387
Investment per subscriber - June 30	7,403	7,021
Investment per dollar of operating revenue	6.82	6.62
<u>Depreciation Reserve - June 30:</u>	137,013,065	133,719,702
Percent of plant in service	77.66%	78.04%
Annual depreciation	8,978,849	9,997,004
Percent of annual depreciation to plant in service	5.09%	5.83%
<u>Average Annual Revenue Per Subscriber:</u>		
Local service	315	317
Toll service and access charges	587	594
Total operating revenue	951	958
<u>Number of Stations - June 30:</u>		
Residence:		
Main stations	20,726	21,189
Business:		
Main stations (access lines)	3,106	3,215
Total main stations	23,832	24,404

Computations involving number of subscribers are based on the number of subscribers at June 30.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATISTICAL AND ANALYTICAL INFORMATION, CONCLUDED
 June 30, 2014 and 2013

	2014		Restated 2013	
	Amount	Percent	Amount	Percent
Local network service	\$ 7,514,374	33.14%	\$ 7,744,627	33.11%
Network access and long- distance network service	13,552,985	59.78%	14,055,138	60.09%
Miscellaneous	<u>1,603,905</u>	<u>7.08%</u>	<u>1,590,967</u>	<u>6.80%</u>
Total operating revenue	<u>22,671,264</u>	<u>100.00%</u>	<u>23,390,732</u>	<u>100.00%</u>
Cost of telephone service, net of other income and expenses	<u>16,680,768</u>	<u>73.58%</u>	<u>15,876,487</u>	<u>67.88%</u>
Net income	<u>\$ 5,990,496</u>	<u>26.42%</u>	<u>\$ 7,514,245</u>	<u>32.12%</u>

Source of Funds Invested in

Total Assets:

Members' equities	\$ 139,104,640	78.84%	\$ 131,863,669	77.59%
Long-term liabilities	26,206,711	14.85%	28,712,413	16.89%
Other liabilities	<u>11,132,706</u>	<u>6.31%</u>	<u>9,383,457</u>	<u>5.52%</u>
Total assets	<u>\$ 176,444,057</u>	<u>100.00%</u>	<u>\$ 169,959,539</u>	<u>100.00%</u>



CAMPBELL, MYERS AND RUTLEDGE, PLLC

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Independent Auditor's Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit
of Financial Statements Performed in
Accordance With *Government Auditing Standards*

Board of Directors
South Central Rural Telephone
Cooperative Corporation, Inc.
Glasgow, Kentucky 42141

We 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 South Central Rural Telephone Cooperative Corporation, Inc. as of and for the years ended June 30, 2014 and 2013, and the related statements of operations, comprehensive income, changes in member's equity and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated September 24, 2014.

Internal Control over Financial Reporting

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Campbell, Myers & Rutledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

September 24, 2014



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

Board of Directors
South Central Rural Telephone
Cooperative Corporation, Inc.
Glasgow, Kentucky 42141

Independent Auditor's Report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of South Central Rural Telephone Cooperative Corporation, Inc., which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of income, comprehensive income and patronage capital and other equities, and cash flows for the years ended, and the related notes to the financial statements, and have issued our report thereon dated September 24, 2014. In accordance with *Government Auditing Standards*, we have also issued our report dated September 24, 2014, on our consideration of South Central Rural Telephone Cooperative Corporation, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that South Central Rural Telephone Cooperative Corporation, Inc. 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 clarified in the RUS policy memorandum dated September 24, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding South Central Rural Telephone Cooperative Corporation, Inc.'s noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding South Central Rural Telephone Cooperative Corporation, Inc.'s accounting and records to indicate that South Central Rural Telephone Cooperative Corporation, Inc. 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;

Prepare accurate and timely Financial and Operating Reports;

Obtain 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 electric system;

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Comply with the requirements for the detailed schedule of deferred debits and deferred credits which is as follows:

Deferred Debits:	<u>2014</u>	<u>2013</u>
Special Project	\$ 417,771	\$ -
Job Orders	7,739	21,079
South Central Telcom Construction	<u>871,948</u>	<u>128,984</u>
	<u>\$ 1,297,458</u>	<u>\$ 150,063</u>

Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures); and

Comply with the requirements for the detailed schedule of investments. A detailed schedule of investments is as follows:

RSA #3 Partnership represents the Cooperative's 25% investment in a partnership which provides cellular telephone service. The Cooperative accounts for the investment on the equity basis.

RSA #4 represents the Cooperative's 50% investment in a partnership which provides cellular telephone service. The Cooperative accounts for the investment on the equity basis.

Cumberland Cellular Partnership represents the Cooperative's 12.5% investment in a partnership which provides cellular telephone service. The Cooperative accounts for the investment on the equity basis.

Bluegrass Network LLC represents the Cooperative's 20% investment in a partnership which provides cellular telephone service. The Cooperative accounts for the investment on the equity basis.

Bluegrass Telcom represents the Cooperative's 20% investment in a partnership which provides cellular telephone service. The Cooperative accounts for the investment on the equity basis.

South Central Telcom is a wholly owned subsidiary which invests in providing telephone, cable television and internet services to non-member patrons. The Cooperative accounts for the investment on the equity basis.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
Investment in Affiliated Companies

	<u>RSA #3</u>	<u>RSA #4</u>	<u>RSA #5</u>	<u>Bluegrass Network LLC</u>	<u>Bluegrass Telecom LLC</u>	<u>South Central Telcom LLC</u>	<u>Total</u>
Book Value of Investment as of 12/31/11	\$ 17,368,627	\$ 27,713,174	\$ 6,712,008	\$ 2,995,230	\$ 339,968	\$ 14,953,527	\$ 70,082,534
Dividends as of 12/31/12	\$ 5,127,250	\$ 7,673,500	\$ 2,321,684	\$ -	\$ 88,040	\$ -	
Undistributed Earnings/(Loss) as of 12/31/12	\$ 5,804,039	\$ 9,856,455	\$ 2,589,176	\$ 654,383	\$ 73,492	\$ 555,148	
Book Value of Investment as of 12/31/12	\$ 18,045,416	\$ 29,896,129	\$ 6,979,500	\$ 3,649,613	\$ 325,420	\$ 15,508,675	\$ 74,404,753
Dividends as of 12/31/13	\$ 2,562,500	\$ 5,112,500	\$ 2,011,379	\$ 400,000	\$ 48,673	\$ -	
Undistributed Earnings/(Loss) as of 12/31/13	\$ 3,583,869	\$ 5,510,435	\$ 1,786,366	\$ 631,435	\$ 44,250	\$ 739,684	
Return of Capital as of 12/31/13	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,000,000	
Book Value of Investment as of 12/31/13	\$ 19,066,785	\$ 30,294,064	\$ 6,754,487	\$ 3,881,048	\$ 320,997	\$ 14,248,359	\$ 74,565,740

During the course of our audit, it was noted that the Cooperative was not taking an annual inventory of exempt materials. An annual inventory was being conducted of other inventory; however, due to the nature and size of the account, we recommended that an annual inventory be conducted to ensure that the balance of exempt materials was accurately reported within the financial statements. The Cooperative agrees with this finding and to conduct an annual inventory of exempt materials and reconcile this to the annual financial statements.

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

Campbell, Myers & Rutledge, PLLC
Glasgow, Kentucky

September 24, 2014

