

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

**Report on Audit of Consolidated Financial Statements
and Supplementary Information**

**For the Years Ended
June 30, 2016 and 2015**

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Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary, which comprise the consolidated balance sheets as of June 30, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, 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 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 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 consolidated financial statements based on our audits. 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 consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinions

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary, as of June 30, 2016 and 2015, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary's basic financial statements. The consolidating schedules on pages 18-21 and the statistical and analytical information on pages 22-23 are 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 consolidating information on pages 18-21 and the statistical and analytical information on pages 22-23 is 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 28, 2016, on our consideration of the South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary's internal control over financial reporting and compliance.

Campbell, Myers & Rutledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

September 28, 2016

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
BALANCE SHEETS
June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Current assets:		
Cash and cash equivalents	\$ 3,374,693	\$ 5,686,394
Temporary cash investments	500,000	400,000
Accounts and notes receivable, less allowance for doubtful accounts of \$55,935 in 2016 and \$13,978 in 2015	2,351,218	2,104,810
Materials and supplies at average cost	2,659,477	2,738,653
Accrued interest receivable	4,859	4,859
Prepaid expenses	2,995,945	3,752,135
Total current assets	<u>11,886,192</u>	<u>14,686,851</u>
Other assets:		
Marketable securities	40,525,960	40,129,510
Nonregulated investments	823,666	857,139
Investment in affiliated companies	66,464,071	60,600,861
Other deferred charges	1,422,384	4,524,700
Total other assets	<u>109,236,081</u>	<u>106,112,210</u>
Telephone plant, at cost		
Telephone plant in service	210,472,184	201,699,933
Telephone plant under construction	8,859,008	7,768,427
Total	<u>219,331,192</u>	<u>209,468,360</u>
Less accumulated depreciation	<u>156,974,150</u>	<u>152,295,105</u>
Telephone plant, net	<u>62,357,042</u>	<u>57,173,255</u>
	<u>\$ 183,479,315</u>	<u>\$ 177,972,316</u>

	<u>2016</u>	<u>2015</u>
Current liabilities:		
Current portion of long-term debt	\$ -	\$ 1,606,221
Accounts payable	5,200,433	4,738,001
Accrued expenses	<u>3,146,671</u>	<u>3,008,558</u>
Total current liabilities	<u>8,347,104</u>	<u>9,352,780</u>
Long-term liabilities:		
Deferred taxes	15,238,787	15,520,411
Other long-term liabilities	<u>10,873,628</u>	<u>11,391,814</u>
Total long-term liabilities	<u>26,112,415</u>	<u>26,912,225</u>
Members' equities:		
Patronage capital	46,334,548	50,086,074
Accumulated other comprehensive loss	(7,838,134)	(8,879,349)
Other equities	108,757,296	98,925,564
Other member capital	<u>1,766,086</u>	<u>1,575,022</u>
Total members' equities	<u>149,019,796</u>	<u>141,707,311</u>
	<u>\$ 183,479,315</u>	<u>\$ 177,972,316</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
STATEMENTS OF OPERATIONS
For the Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Basic local network service	\$ 7,171,828	\$ 7,303,580
Network access services revenues	12,473,308	12,808,359
Carrier billing and collection	445,975	430,314
Miscellaneous	<u>1,169,138</u>	<u>1,310,239</u>
Total operating revenues	<u>21,260,249</u>	<u>21,852,492</u>
Operating expenses:		
Plant specific operations	4,969,775	4,604,232
Plant nonspecific operations	2,601,804	2,450,587
Depreciation and amortization	8,917,896	9,196,787
Customer operations	1,839,547	1,817,563
Corporate operations	3,070,295	2,211,301
Other operating taxes	<u>1,233,318</u>	<u>1,149,318</u>
Total operating expenses	<u>22,632,635</u>	<u>21,429,788</u>
Operating income	<u>(1,372,386)</u>	<u>422,704</u>
Nonoperating net income	15,140,671	11,169,662
Provision for income taxes	<u>(5,308,939)</u>	<u>(4,022,503)</u>
Income before interest charges	<u>8,459,346</u>	<u>7,569,863</u>
Nonregulated net income (loss)	<u>(368,363)</u>	<u>(2,923,169)</u>
Net income	<u>\$ 8,090,983</u>	<u>\$ 4,646,694</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Net income	\$ 8,090,983	\$ 4,646,694
Other comprehensive income (loss)		
Postretirement benefit other than pension:		
Unrecognized gain/(loss) on assets	<u>1,041,215</u>	<u>(311,117)</u>
Comprehensive income	<u>\$ 9,132,198</u>	<u>\$ 4,335,577</u>

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part of the financial statements.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
STATEMENTS OF PATRONAGE CAPITAL AND OTHER EQUITIES
For the Years Ended June 30, 2016 and 2015

	Patronage Capital			Accumulated Other Comprehensive Income (Loss)	Other Equities
	Assignable	Assigned	Balance		
Balances, July 1, 2014	\$ (2,909,049)	\$ 57,326,884	\$ 54,417,835	\$ (8,568,232)	\$ 91,778,405
Distribution of patronage capital	-	(1,525,566)	(1,525,566)	-	-
Patronage capital assigned for the year ended December 31, 2014	3,140,518	(3,140,518)	-	-	-
Retirement of patronage capital of estates of deceased members	-	(521,661)	(521,661)	-	-
Transfer of unclaimed patronage capital	215,931	-	215,931	-	-
Postretirement benefit other than pension Unrecognized loss on assets	-	-	-	(311,117)	-
Recalculation of prior year allocated loss	(5,360,467)	5,360,467	-	-	-
Net income for the year ended June 30, 2015:					
Operating margins	(2,500,465)	-	(2,500,465)	-	-
Nonoperating margins	-	-	-	-	7,147,159
Balances, June 30, 2015	(7,413,532)	57,499,606	50,086,074	(8,879,349)	98,925,564
Distribution of patronage capital	-	(1,499,997)	(1,499,997)	-	-
Patronage capital assigned for the year ended December 31, 2015	2,276,953	(2,276,953)	-	-	-
Retirement of patronage capital of estates of deceased members	-	(510,855)	(510,855)	-	-
Transfer of unclaimed patronage capital	75	-	75	-	-
Postretirement benefit other than pension Unrecognized income on assets	-	-	-	1,041,215	-
Net income for the year ended June 30, 2016:					
Operating margins	(1,740,749)	-	(1,740,749)	-	-
Nonoperating margins	-	-	-	-	9,831,732
Balances, June 30, 2016	<u>\$ (6,877,253)</u>	<u>\$ 53,211,801</u>	<u>\$ 46,334,548</u>	<u>\$ (7,838,134)</u>	<u>\$ 108,757,296</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Net income	\$ 8,090,983	\$ 4,646,694
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,712,009	10,856,179
Deferred taxes on income	(281,624)	181,081
Changes in operating assets and liabilities:		
Decrease (increase) in temporary cash investments	(100,000)	-
Decrease (increase) in accounts and notes receivable	(246,408)	278,973
Decrease (increase) in inventory	79,176	233,208
Decrease (increase) in prepaid expenses	756,190	(1,812,530)
Increase (decrease) in accounts payable	462,432	(454,571)
Increase (decrease) in accrued expenses	138,113	136,927
Net cash provided by operating activities	<u>19,610,871</u>	<u>14,065,961</u>
Cash flows from investing activities:		
Purchases of property, plant and equipment	(13,974,852)	(11,175,293)
Plant removal costs	(203,592)	(170,169)
Salvage recovered from retirement of plant	113,357	133,715
Decrease (increase) in nonregulated investment	33,473	706,215
Decrease (increase) in other deferred charges	3,102,316	(3,058,066)
(Increase) in investment in affiliated companies	(5,863,210)	(363,610)
Purchases of Marketable Securities	(13,443,125)	(7,033,657)
Redemptions of Marketable Securities	<u>13,839,575</u>	<u>7,153,314</u>
Net cash used in investing activities	<u>(16,396,058)</u>	<u>(13,807,551)</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
STATEMENTS OF CASH FLOWS, CONCLUDED
For the Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from financing activities:		
Distributions of patronage capital	\$ (1,499,997)	\$ (1,525,566)
Retirements of patronage capital	(510,855)	(521,661)
Principal payments to Federal Financing Bank	(1,606,221)	(3,114,353)
Increase (decrease) in long-term liabilities	(2,327,086)	524,433
Increase (decrease) in other member capital	417,570	98,390
Transfers of unclaimed patronage capital	<u>75</u>	<u>215,931</u>
Net cash provided (used) in financing activities	<u>(5,526,514)</u>	<u>(4,322,826)</u>
Net increase (decrease) in cash and cash equivalents	(2,311,701)	(4,064,416)
Cash and cash equivalents at beginning of year	<u>5,686,394</u>	<u>9,750,810</u>
Cash and cash equivalents at end of year	<u>\$ 3,374,693</u>	<u>\$ 5,686,394</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest (\$237,170 capitalized in 2016 and \$241,585 in 2015)	<u>\$ 26,134</u>	<u>\$ 148,297</u>
Income taxes	<u>\$ 4,769,500</u>	<u>\$ 5,070,000</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

1. Summary of Significant Accounting Policies:

Nature of Business:

South Central Rural Telephone Cooperative Corporation, Inc. (the Cooperative), 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. The Cooperative maintains its accounts in accordance with the Uniform System of Accounts prescribed for telephone companies by the Federal Communications Commission. The consolidated financial statements include the accounts of the Cooperative and its wholly-owned subsidiary, South Central Telcom, LLC. All significant intercompany accounts and transactions have been eliminated.

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, 2016 and 2015 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, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Organization	\$ 20,039	\$ 20,039
Land	714,831	710,978
Buildings	8,482,156	8,003,759
Central Office Equipment	54,803,419	56,488,955
Station Equipment	997,697	997,697
Cable and Wire Facilities	134,532,201	124,705,650
Furniture and Office Equipment	719,231	705,202
General Purpose Computers	4,252,096	4,179,993
Vehicles	5,814,994	5,752,140
Garage and Work Equipment	135,520	135,520
	<u>\$ 210,472,184</u>	<u>\$ 201,699,933</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 consolidated financial statements for the years ended June 30, 2016 and 2015 was \$10,712,009 and \$10,856,179 respectively.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

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, 2016 and 2015, net of intercompany transactions:

	SCRTC		Telcom	
	2016	2015	2016	2015
Income from operations	\$19,517,161	\$17,866,467	\$4,565,332	\$4,135,245
Expenses	19,885,524	20,789,636	4,456,151	3,939,863
Net Income (loss)	<u>\$ (368,363)</u>	<u>\$ (2,923,169)</u>	<u>\$ 109,181</u>	<u>\$ 195,382</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, 2016 and 2015, is unbilled revenue of \$0 and \$7,893, 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.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

1. Summary of Significant Accounting Policies, Concluded:

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:

	<u>Percentage Owned</u>	<u>2016</u>	<u>2015</u>
RSA #3 Partnership	25%	\$ 20,660,259	\$ 19,031,219
RSA #4 Partnership	50%	32,560,178	29,762,597
Cumberland Cellular Partnership	12.5%	7,751,450	6,910,057
Bluegrass Network, LLC	20%	5,160,079	4,570,308
Bluegrass Telcom, LLC	20%	332,105	326,680
		<u>\$ 66,464,071</u>	<u>\$ 60,600,861</u>

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. The notes were repaid during the fiscal year 2016.

	<u>2016</u>	<u>2015</u>
Due to United States of America		
4.1710% First Mortgage Notes - FFB	\$ -	\$ 1,606,221
Advance Payments	-	-
	-	1,606,221
Less current maturities	-	(1,606,221)
Total	\$ -	\$ -

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.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

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.

	2016		2015	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Insured	\$ 3,874,693	\$ 5,717,024	\$ 6,086,394	\$ 6,585,385
Uninsured:				
Uncollateralized	-	-	-	-
Total cash and temporary investments	<u>\$ 3,874,693</u>	<u>\$ 5,717,024</u>	<u>\$ 6,086,394</u>	<u>\$ 6,585,385</u>

4. Pension Plan:

All eligible non-union employees of the Cooperative participate in the National Telephone Association (NTCA) Pension 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. 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.

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, 2016 and 2015 were \$1,228,528 and \$1,138,310, 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, 2016</u>	<u>January 1, 2015</u>
Fair value of plan assets	\$ 1,664,524,653	\$ 1,637,126,366
Present value of accumulated benefits	<u>(1,835,127,306)</u>	<u>(1,690,108,999)</u>
Overfunded/(Unfunded)	<u>\$ (170,602,653)</u>	<u>\$ (52,982,633)</u>

	<u>Pension Benefits</u>	
	<u>January 1, 2016</u>	<u>January 1, 2015</u>
Weighted – average assumptions as of January 1:		
Valuation interest rate	7.00%	7.00%
Expected return on plan assets	7.00%	7.00%
Rate of compensation increase	age related	age related

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

5. 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, 2016 and 2015.

	<u>2016</u>	<u>2015</u>
Accumulated post-retirement benefit obligation, beginning	\$ 29,776,477	\$ 28,376,002
Service cost	910,914	960,974
Interest cost	1,329,233	1,320,250
Employer contributions	(777,742)	(753,480)
Actuarial loss/(gain)	<u>(1,267,711)</u>	<u>(127,269)</u>
Accumulated post retirement benefit obligation, ending	<u>\$ 29,971,171</u>	<u>\$ 29,776,477</u>
Fair value of plan assets - beginning of year	\$ 17,580,775	\$ 16,696,977
Employer contributions	777,742	753,480
Unrealized gains on assets	779,875	1,091,292
Benefits paid	<u>(910,914)</u>	<u>(960,974)</u>
Fair value of plan assets - end of year	<u>18,227,478</u>	<u>17,580,775</u>
Unfunded status	\$ 11,743,693	\$ 12,195,702
Unrecognized net actuarial loss	<u>7,838,135</u>	<u>8,879,350</u>
Net amount recognized	<u>\$ 3,905,558</u>	<u>\$ 3,316,352</u>
Unfunded status	\$ 11,743,693	\$ 12,195,702
Current liabilities	<u>874,891</u>	<u>884,938</u>
Noncurrent liabilities	<u>\$ 10,868,802</u>	<u>\$ 11,310,764</u>
Service cost	\$ 910,914	\$ 960,974
Interest cost	1,329,233	1,320,250
Amortization of net actuarial gain	320,514	378,163
Expected return on assets	<u>(1,275,923)</u>	<u>(1,274,606)</u>
Net periodic benefit cost	<u>\$ 1,284,738</u>	<u>\$ 1,384,781</u>
Net amount recognized (included in other comprehensive income)	<u>\$ 1,041,215</u>	<u>\$ (311,117)</u>
Amounts in other comprehensive income expected to be realized in the subsequent year - actuarial gain	<u>\$ 320,514</u>	<u>\$ 378,163</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

5. Postretirement Benefits, Concluded:

The Discount rate used in determining the accumulated postretirement benefit obligation was 4.5% for the years ending June 30, 2016 and 2015, respectively.

Expected benefit payments from the plan for year ending June 30, 2017 total \$874,981.

The Cooperative contributes to a 401(h) trust that will be used to fund post-retirement benefits for future retirees. These monies are invested with NTCA, who manages such funds for cooperatives. NTCA invests in common stocks, high quality bonds, and US government securities. The estimated rates of return for plan assets are 7.00% and is based on recent historical performance. The investments of the assets are 98% in various Vanguard Funds and 2% in cash.

For measurement purposes, a 7.0% annual rate of increase in the per capita cost of covered health care benefits was used for the year ended June 30, 2016. The anticipated future rates are as follows:

2016	7.00%
2017	6.50%
2018	6.00%
2019	5.00%
2020	5.00%
2021-2025	5.00%

An additional 1% increase in the trend utilized for measurement purposes in 2016 would have resulted in an increase in the accumulated postretirement benefit obligation of approximately 5.9 million.

6. Marketable Securities:

All debt securities of the Cooperative are considered to be held to maturity. The maturities of held to maturity investments and their approximate market values at June 30, 2016 and 2015, were as follows:

	Amortized Cost	Net Unrealized Gains (Losses)		Market Value
June 30, 2016	\$ 41,025,960	\$ (84,358)	\$	40,941,602
June 30, 2015	\$ 40,529,510	\$ (1,899,126)	\$	38,630,384
				<u>Amortized Cost</u>
Due in one year or less (included in Temporary Cash Investments)			\$	500,000
Due after one year				40,525,960
Balances, June 30, 2016			\$	<u>40,941,602</u>
				<u>Market Value</u>
Due in one year or less (included in Temporary Cash Investments)			\$	400,000
Due after one year				40,129,510
Balances, June 30, 2015			\$	<u>39,030,384</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

7. Income Taxes:

The Cooperative 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 2016 and 2015 consists of the following:

Provision for Income Taxes:	<u>2016</u>	<u>2015</u>
Current tax expense	\$ 5,590,563	\$ 3,841,422
Deferred tax (benefit)	<u>(281,624)</u>	<u>181,081</u>
Total	<u>\$ 5,308,939</u>	<u>\$ 4,022,503</u>

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

	<u>2016</u>	<u>2015</u>
Differences in depreciation methods	<u>\$ 15,238,787</u>	<u>\$ 15,520,411</u>

The Cooperative 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, 2016 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 Cooperative 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 2013.

8. Subsequent Event:

Management has evaluated subsequent events through September 28, 2016, the date the financial statements were available to be issued. In September, 2016, the Cooperative made a prepayment of approximately \$3,983,000 to the National Telephone Cooperative Association Pension Plan. The cooperative will be amortizing this amount over fifteen years.

SUPPLEMENTARY INFORMATION



CAMPBELL, MYERS AND RUTLEDGE, PLLC

Cindy L. Greer, CPA ▪ L. Joe Rutledge, CPA ▪ Jonathan W. Belcher, CPA ▪ R. Brent Billingsley, CPA

Skip R. Campbell, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

Independent Auditors' Report
on Consolidating and Supplementary Information

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

We have audited the consolidated financial statements of South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary as of and for the years ended June, 2016 and 2015, and our report thereon dated September 28, 2016, which expressed an unmodified opinion on those financial statements appears on pages 1-2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information presented on pages 18-21 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. The statistical and analytical information also is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The consolidating and other supplementary 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 our opinion, the consolidating information on pages 18-21 and the statistical and analytical information on pages 22-23, is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Campbell, Myers & Rutledge, PLLC
Certified Public Accountants
Glasgow, Kentucky

September 28, 2016

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
SCHEDULE I – CONSOLIDATING BALANCE SHEET
June 30, 2016

	South Central Rural Telephone Cooperative Corporation, Inc	South Central Telcom, LLC	Consolidating Entries	Consolidated Totals
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 2,078,634	\$ 1,296,059	\$ -	\$ 3,374,693
Temporary cash investments	500,000	-	-	500,000
Accounts and notes receivable, less allowance for doubtful accounts of \$55,935	987,732	2,204,066	(840,580)	2,351,218
Materials and supplies at average cost	2,659,477	-	-	2,659,477
Accrued interest receivable	4,859	-	-	4,859
Prepaid expenses	2,995,945	-	-	2,995,945
Total current assets	<u>9,226,647</u>	<u>3,500,125</u>	<u>(840,580)</u>	<u>11,886,192</u>
Other assets:				
Marketable securities	40,525,960	-	-	40,525,960
Nonregulated investments	823,666	-	-	823,666
Investment in affiliated companies	82,420,682	-	(15,956,611)	66,464,071
Other deferred charges	1,249,413	172,971	-	1,422,384
Total other assets	<u>125,019,721</u>	<u>172,971</u>	<u>(15,956,611)</u>	<u>109,236,081</u>
Telephone plant, at cost (substantially all pledged as collateral on long- term debt to RUS):				
Telephone plant in service	187,335,784	23,136,400	-	210,472,184
Telephone plant under construction	8,859,008	-	-	8,859,008
Total telephone plant	<u>196,194,792</u>	<u>23,136,400</u>	<u>-</u>	<u>219,331,192</u>
Less accumulated depreciation	<u>147,185,290</u>	<u>9,788,860</u>	<u>-</u>	<u>156,974,150</u>
Telephone plant, net	49,009,502	13,347,540	-	62,357,042
TOTAL ASSETS	<u>\$ 183,255,870</u>	<u>\$ 17,020,636</u>	<u>\$ (16,797,191)</u>	<u>\$ 183,479,315</u>
LIABILITIES AND MEMBERS' EQUITIES				
Current liabilities:				
Accounts payable	\$ 4,976,988	\$ 1,064,025	(840,580)	\$ 5,200,433
Accrued expenses	3,146,671	-	-	3,146,671
Total current liabilities	<u>8,123,659</u>	<u>1,064,025</u>	<u>(840,580)</u>	<u>8,347,104</u>
Long-term liabilities				
Deferred taxes	15,238,787	-	-	15,238,787
Other long-term liabilities	10,873,628	-	-	10,873,628
Total long-term liabilities	<u>26,112,415</u>	<u>-</u>	<u>-</u>	<u>26,112,415</u>
Members' equities:				
Patronage capital	46,334,548	-	-	46,334,548
Accumulated other comprehensive loss	(7,838,134)	-	-	(7,838,134)
Other equities	108,757,296	15,956,611	(15,956,611)	108,757,296
Other member capital	1,766,086	-	-	1,766,086
Total members' equities	<u>149,019,796</u>	<u>15,956,611</u>	<u>(15,956,611)</u>	<u>149,019,796</u>
TOTAL LIABILITIES AND MEMBERS' EQUITIES	<u>\$ 183,255,870</u>	<u>\$ 17,020,636</u>	<u>\$ (16,797,191)</u>	<u>\$ 183,479,315</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
SCHEDULE II – CONSOLIDATING STATEMENT OF OPERATIONS
For the Year Ended June 30, 2016

	South Central Rural Telephone Cooperative Corporation, Inc.	South Central Telcom, LLC	Consolidating Entries	Consolidated Totals
Operating revenues:				
Basic local network service	7,171,828	-	-	7,171,828
Network access services revenues	12,473,308	-	-	12,473,308
Carrier billing and collection	445,975	-	-	445,975
Other	1,169,138	-	-	1,169,138
	<u>\$ 21,260,249</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 21,260,249</u>
Operating expenses:				
Plant specific operations	4,969,775	-	-	4,969,775
Plant nonspecific operations	2,601,804	-	-	2,601,804
Depreciation and amortization	8,917,896	-	-	8,917,896
Customer operations	1,839,547	-	-	1,839,547
Corporate operations	3,070,295	-	-	3,070,295
Other operating taxes	1,233,318	-	-	1,233,318
Total operating expenses	<u>22,632,635</u>	<u>-</u>	<u>-</u>	<u>22,632,635</u>
Operating income	(1,372,386)	-	-	(1,372,386)
Nonoperating net income	15,140,671	258	(258)	15,140,671
Provision for income taxes	(5,308,939)	-	-	(5,308,939)
Nonregulated net income (loss)	<u>(368,363)</u>	<u>109,181</u>	<u>(109,181)</u>	<u>(368,363)</u>
Net Income	<u>\$ 8,090,983</u>	<u>\$ 109,439</u>	<u>\$ (109,439)</u>	<u>\$ 8,090,983</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
SCHEDULE III – CONSOLIDATING BALANCE SHEET
June 30, 2015

	South Central Rural Telephone Cooperative Corporation, Inc	South Central Telcom, LLC	Consolidating Entries	Consolidated Totals
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 4,444,160	\$ 1,242,234	\$ -	\$ 5,686,394
Temporary cash investments	400,000	-	-	400,000
Accounts and notes receivable, less allowance for doubtful accounts of \$13,978	827,742	2,097,524	(820,456)	2,104,810
Materials and supplies at average cost	2,738,653	-	-	2,738,653
Accrued interest receivable	4,859	-	-	4,859
Prepaid expenses	3,752,135	-	-	3,752,135
Total current assets	<u>12,167,549</u>	<u>3,339,758</u>	<u>(820,456)</u>	<u>14,686,851</u>
Other assets:				
Marketable securities	40,129,510	-	-	40,129,510
Nonregulated investments	857,139	-	-	857,139
Investment in affiliated companies	72,209,642	-	(11,608,781)	60,600,861
Other deferred charges	4,157,929	366,771	-	4,524,700
Total other assets	<u>117,354,220</u>	<u>366,771</u>	<u>(11,608,781)</u>	<u>106,112,210</u>
Telephone plant, at cost (substantially all pledged as collateral on long- term debt to RUS):				
Telephone plant in service	184,370,396	17,329,537	-	201,699,933
Telephone plant under construction	7,768,427	-	-	7,768,427
Total telephone plant	<u>192,138,823</u>	<u>17,329,537</u>	<u>-</u>	<u>209,468,360</u>
Less accumulated depreciation	<u>143,738,957</u>	<u>8,556,148</u>	<u>-</u>	<u>152,295,105</u>
Telephone plant, net	48,399,866	8,773,389	-	57,173,255
TOTAL ASSETS	<u>\$ 177,921,635</u>	<u>\$ 12,479,918</u>	<u>\$ (12,429,237)</u>	<u>\$ 177,972,316</u>
LIABILITIES AND MEMBERS' EQUITIES				
Current liabilities:				
Current portion of long-term debt	\$ 1,606,221	\$ -	\$ -	\$ 1,606,221
Accounts payable	4,687,320	922,338	(871,657)	4,738,001
Accrued expenses	3,008,558	-	-	3,008,558
Total current liabilities	<u>9,302,099</u>	<u>922,338</u>	<u>(871,657)</u>	<u>9,352,780</u>
Long-term liabilities				
Deferred taxes	15,520,411	-	-	15,520,411
Other long-term liabilities	11,391,814	-	-	11,391,814
Total long-term liabilities	<u>26,912,225</u>	<u>-</u>	<u>-</u>	<u>26,912,225</u>
Members' equities:				
Patronage capital	50,086,074	-	-	50,086,074
Accumulated other comprehensive loss	(8,879,349)	-	-	(8,879,349)
Other equities	98,925,564	11,557,580	(11,557,580)	98,925,564
Other member capital	1,575,022	-	-	1,575,022
Total members' equities	<u>141,707,311</u>	<u>11,557,580</u>	<u>(11,557,580)</u>	<u>141,707,311</u>
TOTAL LIABILITIES AND MEMBERS' EQUITIES	<u>\$ 177,921,635</u>	<u>\$ 12,479,918</u>	<u>\$ (12,429,237)</u>	<u>\$ 177,972,316</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE
CORPORATION, INC. AND SUBSIDIARY
SCHEDULE IV – CONSOLIDATING STATEMENT OF OPERATIONS
For the Year Ended June 30, 2015

	South Central Rural Telephone Cooperative Corporation, Inc.	South Central Telcom, LLC	Consolidating Entries	Consolidated Totals
Operating revenues:				
Basic local network service	7,303,580	-	-	7,303,580
Network access services revenues	12,808,359	-	-	12,808,359
Carrier billing and collection	430,314	-	-	430,314
Other	<u>1,310,239</u>	-	-	<u>1,310,239</u>
	<u>\$ 21,852,492</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 21,852,492</u>
Operating expenses:				
Plant specific operations	4,604,232	-	-	4,604,232
Plant nonspecific operations	2,450,587	-	-	2,450,587
Depreciation and amortization	9,196,787	-	-	9,196,787
Customer operations	1,817,563	-	-	1,817,563
Corporate operations	2,211,301	-	-	2,211,301
Other operating taxes	<u>1,149,318</u>	-	-	<u>1,149,318</u>
Total operating expenses	<u>21,429,788</u>	<u>-</u>	<u>-</u>	<u>21,429,788</u>
Operating income	422,704	-	-	422,704
Nonoperating net income	11,169,662	8,709	(8,709)	11,169,662
Provision for income taxes	(4,022,503)	-	-	(4,022,503)
Nonregulated net income (loss)	<u>(2,923,169)</u>	<u>195,382</u>	<u>(195,382)</u>	<u>(2,923,169)</u>
Net Income	<u>\$ 4,646,694</u>	<u>\$ 204,091</u>	<u>\$ (204,091)</u>	<u>\$ 4,646,694</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATISTICAL AND ANALYTICAL INFORMATION
 June 30, 2016 and 2015

	2016	2015
<u>Telephone Plant in Service - June 30:</u>	\$ 187,335,784	\$ 184,370,396
Investment per subscriber - June 30	8,003	7,890
Investment per dollar of operating revenue	8.81	8.44
 <u>Depreciation Reserve - June 30:</u>	 147,185,290	 143,738,957
Percent of plant in service	78.57%	77.96%
Annual depreciation	8,917,896	9,196,787
Percent of annual depreciation to plant in service	4.76%	4.99%
 <u>Average Annual Revenue Per Subscriber:</u>		
Local service	306	313
Toll service and access charges	533	548
Total operating revenue	908	935
 <u>Number of Stations - June 30:</u>		
Residence:		
Main stations	20,420	20,328
Business:		
Main stations (access lines)	2,988	3,041
Total main stations	23,408	23,369

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, 2016 and 2015

	2016		2015	
	Amount	Percent	Amount	Percent
Local network service	\$ 7,171,828	33.73%	\$ 7,303,580	33.42%
Network access and long- distance network service	12,473,308	58.67%	12,808,359	58.61%
Miscellaneous	<u>1,615,113</u>	<u>7.60%</u>	<u>1,740,553</u>	<u>7.97%</u>
Total operating revenue	<u>21,260,249</u>	<u>100.00%</u>	<u>21,852,492</u>	<u>100.00%</u>
Cost of telephone service, net of other income and expenses	<u>13,169,266</u>	<u>61.94%</u>	<u>17,205,798</u>	<u>78.74%</u>
Net income	<u>\$ 8,090,983</u>	<u>38.06%</u>	<u>\$ 4,646,694</u>	<u>21.26%</u>

Source of Funds Invested in
Total Assets:

Members' equities	\$149,019,796	81.32%	\$141,707,311	79.64%
Long-term liabilities	26,112,415	14.25%	26,912,225	15.13%
Other liabilities	<u>8,123,659</u>	<u>4.43%</u>	<u>9,302,099</u>	<u>5.23%</u>
Total assets	<u>\$183,255,870</u>	<u>100.00%</u>	<u>\$177,921,635</u>	<u>100.00%</u>



CAMPBELL, MYERS AND RUTLEDGE, PLLC

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Skip R. Campbell, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

Independent Auditors' 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 consolidated financial statements of South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary which comprise the consolidated balance sheets as of June 30, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, patronage capital and other equities, and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated September 28, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary'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. and subsidiary's internal control. Accordingly, we do not express an opinion on the effectiveness of South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary'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. and subsidiary'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 28, 2016



CAMPBELL, MYERS AND RUTLEDGE, PLLC

Cindy L. Greer, CPA ▪ L. Joe Rutledge, CPA ▪ Jonathan W. Belcher, CPA ▪ R. Brent Billingsley, CPA

Skip R. Campbell, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

Independent Auditors' 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. and subsidiary, which comprise the balance sheets as of June 30, 2016 and 2015, and the related statements of operations, comprehensive income, 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 28 2016. In accordance with *Government Auditing Standards*, we have also issued our report dated September 28, 2016, on our consideration of South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. 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. and subsidiary 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 28, 2016, 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. and subsidiary'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. and subsidiary's accounting and records to indicate that South Central Rural Telephone Cooperative Corporation, Inc. and subsidiary did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts;

Clear construction accounts and accrue depreciation on completed construction;

Record and properly price the retirement of plant;

Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Maintain adequate control over materials and supplies;

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:

<u>Deferred Debits:</u>	<u>2016</u>	<u>2015</u>
Special Project	\$ -	\$ 211,292
Prepaid Insurance	32,263	28,790
Job Orders	200,276	88,737
South Central Telcom Construction	<u>1,189,845</u>	<u>4,195,881</u>
	<u>\$ 1,422,384</u>	<u>\$ 4,524,700</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.

	<u>RSA #3</u>	<u>RSA #4</u>	<u>RSA #5</u>	<u>Bluegrass Network LLC</u>	<u>Bluegrass Telecom LLC</u>	<u>Total</u>
Book Value of Investment as of 12/31/13	\$ 19,066,785	\$ 30,294,064	\$ 6,754,487	\$ 3,881,048	\$ 320,997	\$ 60,317,381
Dividends as of 12/31/14	\$ 2,375,000	\$ 5,000,000	\$ 1,239,550	\$ -	\$ 78,105	
Undistributed Earnings/(Loss) as of 12/31/14	\$ 2,339,434	\$ 4,468,533	\$ 1,395,120	\$ 689,260	\$ 83,788	
Return of Capital as of 12/31/14	\$ -	\$ -	\$ -	\$ -	\$ -	
Book Value of Investment as of 12/31/14	\$ 19,031,219	\$ 29,762,597	\$ 6,910,057	\$ 4,570,308	\$ 326,680	\$ 60,600,861
Dividends as of 12/31/15	\$ 2,387,500	\$ 4,300,000	\$ 807,344	\$ 200,000	\$ 50,850	
Undistributed Earnings/(Loss) as of 12/31/15	\$ 4,016,540	\$ 7,097,581	\$ 1,648,737	\$ 789,771	\$ 56,275	
Investment Advances as of 12/31/15	\$ -	\$ -	\$ -	\$ -	\$ -	
Book Value of Investment as of 12/31/15	\$ 20,660,259	\$ 32,560,178	\$ 7,751,450	\$ 5,160,079	\$ 332,105	\$ 66,464,071

During the course of our audit, it was noted that the Cooperative was not able to produce a detailed accounts receivable subsidiary ledger for the period ending June 30, 2016 and reconcile it back to the general ledger. Such a reconciliation and detail is necessary when reviewing month end aged accounts receivable and verifying the amount presented in the general ledger. We recommend a month end accounts receivable subsidiary ledger be maintained and reconciled back to the general ledger monthly. The Cooperative agrees with this finding and will maintain an end of the month detail of the accounts receivable subsidiary ledger.

Our review of detail property records indicated that the Cooperative should make efforts to review its use of work orders. It was noted that during service installation, the classification of exempt materials caused accounting to incorrectly close work-orders to incorrect accounts. We suggest that the Cooperative review the use of these work orders when exempt materials are used and change their policy. The Cooperative agrees with this finding and has implemented the changes.

During the course of our audit, we noted that the Cooperative could strengthen its controls within the contract review process. If an additional layer of review could be added within contractor invoices and stake sheets, it would minimize the risk of being improperly invoiced for construction services. The Cooperative agrees with this finding and will stress the importance of this finding to engineering and add an additional layer of review when reconciling contractor invoices to stake sheets.

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 28, 2016

