KENTUCKY 525

# West Kentucky Rural Telephone Cooperative Corporation, Inc.

## Independent Auditor's Reports and Consolidated Financial Statements with Supplementary Information

December 31, 2016 and 2015

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## December 31, 2016 and 2015

## Contents

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# Independent Auditor's Report

To the Board of Directors
West Kentucky Rural Telephone Cooperative Corporation, Inc. and Subsidiaries
Mayfield, Kentucky

We have audited the accompanying consolidated financial statements of West Kentucky Rural Telephone Cooperative Corporation, Inc. (a Kentucky corporation) and subsidiaries, which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, comprehensive income, members' equity and cash flows for the year then ended, and the related notes to the consolidated financial statements.

***Management's Responsibility for the Consolidated 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 an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 consolidated 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 opinion.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of West Kentucky Rural Telephone Cooperative Corporation, Inc. and subsidiaries as of December 31, 2016, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated , on our consideration of West Kentucky Rural Telephone Cooperative Corporation, Inc. and subsidiaries' internal control over financial reporting and 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 or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

***Prior Year Audited by Other Auditors***

The 2015 consolidated financial statements were audited by other auditors and their report thereon, dated March 4, 2016 expressed an unmodified opinion.

BKD, LLP

Emmetsburg, Iowa
June 30, 2017

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Consolidated Balance Sheets
## December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 22,560,371 | $ 15,738,471 |
| Investments - available-for-sale | 1,081,075 | - |
| Investments - held-to-maturity | 1,080,651 | - |
| Certificates of deposit | 2,600,000 | - |
| Accounts receivable: | | |
| Due from customers | | |
| Less allowance of $78,466 and $63,820, respectively | 816,473 | 756,610 |
| Interexchange carriers | | |
| Less allowance of $206,363 and $192,925, respectively | 202,599 | 175,882 |
| Other | 25,303 | 137,338 |
| Refundable income taxes | - | 200,138 |
| Inventories at average cost | 907,761 | 785,631 |
| Prepayments | 655,291 | 1,605,856 |
| Prepaid post retirement benefits | - | 142,000 |
| Prepaid service contract | 20,489 | 20,489 |
| | 29,950,013 | 19,562,415 |
| **Other Noncurrent Assets** | | |
| Investments - available-for-sale | 34,145,170 | 40,813,089 |
| Investments - held-to-maturity | 1,881,472 | - |
| Certificates of deposit | 250,000 | - |
| Other investments | 3,967,489 | 4,999,288 |
| Intangibles, net of amortization | 2,100,000 | 2,700,000 |
| Prepayments | 1,017,282 | - |
| Prepaid service contract | 358,534 | 379,024 |
| Deferred income taxes | - | 196,982 |
| Goodwill | 2,519,628 | 2,799,587 |
| | 46,239,575 | 51,887,970 |
| **Property, Plant and Equipment** | | |
| Telephone plant in service | 150,206,759 | 148,631,777 |
| Less accumulated depreciation | 75,520,663 | 70,648,698 |
| | 74,686,096 | 77,983,079 |
| Plant under construction | 875,109 | 1,126,827 |
| | 75,561,205 | 79,109,906 |
| **Total Assets** | $ 151,750,793 | $ 150,560,291 |

| | 2016 | 2015 |
|---|---|---|
| **Liabilities and Members' Equity** | | |
| **Current Liabilities** | | |
| Current portion of long-term debt | $ 6,662,176 | $ 6,555,695 |
| Accounts payable: | | |
| Interexchange carriers | 877,619 | 1,227,364 |
| Other | 1,691,667 | 865,617 |
| Post retirement benefit other than pension | 14,000 | - |
| Advance billing and payments | 613,012 | 543,838 |
| Customer deposits | 118,488 | 126,766 |
| Accrued taxes | 873,558 | 1,381,923 |
| Other | 1,275,735 | 1,806,616 |
| | 12,126,255 | 12,507,819 |
| **Long-term Debt, less current portion** | 61,355,393 | 68,072,365 |
| **Other Noncurrent Liabilities and Deferred Credits** | | |
| Deferred income taxes | 3,265,666 | 3,445,228 |
| Deferred compensation | 1,053,173 | 1,011,905 |
| Postretirement benefits other than pension, less current portion | 305,100 | - |
| | 4,623,939 | 4,457,133 |
| **Members' Equity** | | |
| Memberships | 54,689 | 54,689 |
| Patronage capital assigned | 73,150,992 | 65,249,169 |
| Accumulated other comprehensive income | 439,525 | 219,116 |
| | 73,645,206 | 65,522,974 |
| **Total Liabilities and Members' Equity** | $ 151,750,793 | $ 150,560,291 |

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Consolidated Statements of Operations
## Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| **Operating Revenues** | | |
| Local network services | $ 4,986,402 | $ 4,876,016 |
| Network access services | 16,700,662 | 14,423,339 |
| Long distance services | 1,030,148 | 1,145,422 |
| Broadband services | 9,898,639 | 8,766,013 |
| Video services | 4,162,772 | 4,094,678 |
| Professional and management fee revenue | - | 773,728 |
| Security revenues | 320,410 | 297,860 |
| Retail sales revenues | 182,495 | 209,547 |
| Miscellaneous revenue | 1,617,552 | 1,708,910 |
| | 38,899,080 | 36,295,513 |
| **Operating Expenses** | | |
| Plant specific operations | 5,127,523 | 5,744,695 |
| Plant nonspecific operations | 1,446,917 | 1,518,671 |
| Cost of long distance services | 390,424 | 626,749 |
| Cost of broadband services | 2,889,510 | 3,119,607 |
| Cost of video services | 3,227,668 | 3,120,565 |
| Cost of goods sold - retail | 195,835 | 283,760 |
| Security expenses | 143,581 | 148,565 |
| Depreciation and amortization | 8,505,317 | 10,303,983 |
| Customer operations | 3,828,779 | 4,203,081 |
| Corporate operations | 2,872,962 | 4,013,116 |
| General taxes | 1,098,021 | 1,538,965 |
| | 29,726,537 | 34,621,757 |
| **Operating Margins** | 9,172,543 | 1,673,756 |
| **Other Income (Expenses)** | | |
| Interest and dividend income | 955,067 | 1,195,657 |
| Interest expense | (2,378,341) | (2,682,200) |
| Allowance for funds used during construction | 1,465 | 221,589 |
| Investment income | 830,924 | - |
| Gains on sale of investments | 183,892 | 1,785,744 |
| Income (loss) from partnerships | (2,897) | 26,092 |
| Other, net | (225,176) | (202,596) |
| | (635,066) | 344,286 |
| **Margins Before Income Taxes** | 8,537,477 | 2,018,042 |
| **Income Taxes** | 577,011 | 1,067,007 |
| **Net Margins** | $ 7,960,466 | $ 951,035 |

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Consolidated Statements of Comprehensive Income
## Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| **Net Margins** | $ 7,960,466 | $ 951,035 |
| **Other comprehensive income, net of tax:** | | |
| Unrealized losses on securities: | | |
| Unrealized holding gains (losses) arising during the period | 686,596 | (2,175,032) |
| Less: reclassification adjustment for gains included in net income | 121,369 | - |
| Post-retirement benefit plans: | | |
| Amortization of transition obligation | 44,621 | 9,900 |
| Net gain (loss) arising during period | (632,177) | 53,300 |
| **Comprehensive Income (Loss)** | $ 8,180,875 | $ (1,160,797) |

*See Notes to Consolidated Financial Statements*

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Statements of Consolidated Members' Equity
## Years Ended December 31, 2016 and 2015

| | Memberships | Patronage Capital Assigned | Accumulated Other Comprehensive Income | Total Members' Equity |
|---|---|---|---|---|
| Balance at December 31, 2014 | $ 54,689 | $ 64,359,079 | $ 2,330,948 | $ 66,744,716 |
| Net margins | | 951,035 | | 951,035 |
| Patronage capital retired | | (60,945) | | (60,945) |
| Unrealized loss from securities available for sale (net of $1,064,259 tax) | | | (2,175,032) | (2,175,032) |
| Postretirement benefits other than pension: | | | | |
| Amortization of transition obligation | | | 9,900 | 9,900 |
| Unrecognized gain | | | 53,300 | 53,300 |
| Balance at December 31, 2015 | 54,689 | 65,249,169 | 219,116 | 65,522,974 |
| Net margins | | 7,211,980 | | 7,211,980 |
| Patronage capital retired | | (58,643) | | (58,643) |
| Unrealized holding gains (losses) on securities: | | | | |
| Unrealized holding gains arising during the period (net of $338,996 tax) | | | 686,596 | 686,596 |
| Less: Reclassification adjustment (net of $62,523 tax) | | | 121,369 | 121,369 |
| Post retirement benefits other than pension: | | | | |
| Amortization of transition obligation (net of $3,579 tax) | | | 44,621 | 44,621 |
| Unrecognized loss (net of $8,423 tax) | | | (632,177) | (632,177) |
| Balance at December 31, 2016 | $ 54,689 | $ 72,402,506 | $ 439,525 | $ 72,896,720 |

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Consolidated Statements of Cash Flows
## Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| **Operating Activities** | | |
| Net margins | $ 7,960,466 | $ 951,035 |
| Adjustments to reconcile net margins | | |
| to net cash provided by operating activities: | | |
| Depreciation and amortization | 8,505,317 | 10,303,983 |
| Deferred income taxes | (395,694) | (1,633,499) |
| Patronage in business conducted with cooperatives | (13,608) | (15,370) |
| Equity (income) loss in unconsolidated affiliates | 2,897 | (26,092) |
| Realized gain on sale of available-for-sale investments | (183,892) | (1,785,744) |
| Loss on sale of investments | 44,626 | - |
| Realized gain on sale of property | (23,710) | (3,777) |
| Changes in assets and liabilities: | | |
| (Increase) Decrease in: | | |
| Receivables | 225,593 | 754,759 |
| Materials and supplies | (122,130) | 681,056 |
| Prepayments | 95,773 | 84,067 |
| Increase (Decrease) in: | | |
| Payables | 490,305 | (644,808) |
| Accrued taxes | (508,365) | 920,502 |
| Other | (740,635) | 278,167 |
| Net cash provided by operating activities | 15,336,943 | 9,864,279 |
| **Investing Activities** | | |
| Capital expenditures | (4,078,592) | (2,660,707) |
| Purchase of other investments | - | (1,137,500) |
| Purchases of certificates of deposits | (3,300,000) | - |
| Purchases of available-for-sale securities | (7,104,405) | (7,179,713) |
| Proceeds from sales/maturities of certificates of deposit | 3,150,000 | - |
| Proceeds from sales of available-for-sale securities | 7,142,363 | 6,166,823 |
| Proceeds from sales/maturities of held-to-maturity securities | 1,276,570 | - |
| Proceeds from sale of other investments | 1,042,510 | - |
| Proceeds from sales of equipment | 25,645 | 10,702 |
| Net cash used in investing activities | (1,845,909) | (4,800,395) |
| **Financing Activities** | | |
| Proceeds from long-term borrowing | - | 4,626,107 |
| Repayment of long-term debt | (6,610,491) | (6,301,643) |
| Patronage capital retired | (58,643) | (60,945) |
| Net cash used in financing activities | (6,669,134) | (1,736,481) |
| **Net Increase in Cash and Cash Equivalents** | 6,821,900 | 3,327,403 |
| **Cash and Cash Equivalents at Beginning of Year** | 15,738,471 | 12,411,068 |
| **Cash and Cash Equivalents at End of Year** | $ 22,560,371 | $ 15,738,471 |

## Note 1: Summary of Significant Accounting Policies

### *Basis of Presentation*

West Kentucky Rural Telephone Cooperative Corporation, Inc. and subsidiaries (herein referred to as "the Company") are providers of telecommunications exchange and local access services, broadband, video and telecommunications equipment in a service area located primarily in areas of Kentucky, Tennessee and Alabama.

The accounting policies of the Company conform to accounting principles generally accepted in the United States of America. Management uses estimates and assumptions in preparing its consolidated financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has evaluated subsequent events through June 30, 2017, the date the consolidated financial statements were available for issue. Telephone operations reflect practices appropriate to the telephone industry. The accounting records of the telephone company are maintained in accordance with the Uniform System of Accounts for Class A and B Telephone Companies prescribed by the Federal Communications Commission (FCC) as modified by the state regulatory authority.

### *Principles of Consolidation*

The consolidated financial statements include the accounts of the parent company, West Kentucky Rural Telephone Cooperative Corporation, Inc., and its 100% owned subsidiaries, Synergy Technology Partners, Inc. and Telecom Management Services, Inc. In addition Ardmore Telephone Company, Inc. is a 100% owned subsidiary of Synergy Technology Partners, Inc. All material intercompany transactions have been eliminated in consolidation.

### *Cash Equivalents*

All highly liquid investments with a maturity of three months or less at the time of purchase are considered cash equivalents.

### *Accounts Receivable*

Accounts receivable are reported net of an allowance for doubtful accounts. The allowance is based on management's estimate of the amount of receivables that will actually be collected.

### *Inventories*

Inventories include both merchandise held for resale and materials and supplies. Merchandise held for resale is recorded at the lower of cost or market with cost determined by the average cost method. Materials and supplies are recorded at average cost.

### *Investments*

Marketable securities bought and held principally for selling in the near future are classified as trading securities and carried at fair value. Unrealized holding gains and losses on trading securities are reported in earnings. Marketable securities classified as available-for-sale are carried at fair value with unrealized holding gains and losses recorded as a separate component of members' equity. Debt securities for which the Company has both the positive intent and ability to hold to maturity are classified as held-to-maturity and are carried at amortized cost. The Company uses the FIFO method of computing realized gains and losses.

Nonmarketable equity investments over which the Company has significant influence are reflected on the equity method. Other nonmarketable equity investments and certificates of deposit are stated at cost.

### *Goodwill and Intangibles*

Goodwill and intangible assets deemed to have indefinite lives are stated at the lower of cost or fair value. These assets are subject to periodic impairment tests. Intangible assets with definite lives are amortized.

A qualitative assessment is performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not the fair value of the reporting unit or indefinite-lived intangible asset is less than its carrying amount. If, based on the evaluation, it is determined to be more likely than not that the fair value is less than the carrying value, then the goodwill or indefinite-lived intangible is tested further for impairment. If the implied fair value of goodwill or the fair value of the indefinite-lived intangible is lower than their carrying amounts, an impairment loss is recognized in an amount equal to the difference. Subsequent increases in value are not recognized in the financial statements.

### *Property, Plant and Equipment*

Property, plant and equipment is capitalized at original cost including the capitalized cost of salaries and wages, materials, certain payroll taxes, and employee benefits.

The Company provides for depreciation for financial reporting purposes on the straight-line method by the application of rates based on the estimated service lives of the various classes of depreciable property. Assets under capital lease obligations and leasehold improvements are amortized over the shorter of the lease term or their respective estimated useful lives. These estimates are subject to change in the near term.

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

| | |
|---|---|
| Buildings | 35-40 years |
| Furniture and equipment | 7-15 years |
| Vehicles and work equipment | 5-10 years |
| Cable and wire facilities | 15-20 years |
| Other plant and equipment | 5-10 years |

Renewals and betterments of units of telephone property are charged to telephone plant in service. When telephone plant is retired, its cost is removed from the asset account and charged against accumulated depreciation less any salvage realized. No gains or losses are recognized in connection with routine retirements of depreciable telephone property. Repairs and renewals of minor items of telephone property are included in plant specific operations expense.

### *Asset Retirement Obligations*

Generally accepted accounting principles require entities to record the fair value of a liability for legal obligations associated with an asset retirement in the period in which the obligations are incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset.

The Company has determined it does not have a material legal obligation to remove long-lived assets, and accordingly, there have been no liabilities recorded for the years ended December 31, 2016 and 2015.

### *Long-Lived Assets*

The Company would provide for impairment losses on long-lived assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. Based on current conditions, management does not believe any of its long-lived assets are impaired.

### *Income Taxes*

The parent company (the Company) is organized under the cooperative laws of the State of Kentucky. The Company has obtained an exemption from federal income taxes under code section 501(c)12. With respect to cooperative operations, the financial statements reflect no provision or liability for income taxes. However, as more fully explained in Note 7, the Company has provided for income taxes on certain portions of its operations.

Income taxes are accounted for using a liability method and provide for the tax effects of transactions reported in the financial statements including both taxes currently due and deferred. Deferred taxes are adjusted to reflect deferred tax consequences at current enacted tax rates. Deferred income taxes related to nonpatronage sourced activities reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred taxes arise from difference in book and tax basis of plant, goodwill and certain investments. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible, when the assets and liabilities are recovered or settled. Temporary differences related to patronage sourced activities are not expected to offset tax liabilities when the differences are recovered or settled.

### *Revenue Recognition*

The Company recognizes revenues when earned regardless of the period in which they are billed. The Company is required to provide telephone service to subscribers within its defined service territory.

Local network service, broadband and video revenues are recognized over the period a subscriber is connected to the network.

Network access and long distance service revenues are derived from charges for access to the Company's local exchange network. The interstate and intrastate access revenues are based upon the Company's tariffs for access charges filed with the relevant regulatory agencies. Network access and long distance revenues are recognized at the time a call is placed based on the minutes of traffic processed at tariffed or contracted rates.

Reported network access revenues for Ardmore Telephone Company are estimates subject to settlement adjustments in the near term resulting from changes in expense and plant investment levels and rate of return experience.

In accordance with tariffs filed with the FCC by the National Exchange Carriers Association (NECA), the Company recognizes the regulated portion of internet revenue as network access services and the non-regulated portion of internet revenue as internet services in the statement of operations. Revenue billed to customers for internet included in network access services totaled $671,441 and $651,339 in 2016 and 2015, respectively.

The Company recognizes taxes charged to customers on a net basis in the consolidated statements of operations.

### *Patronage Capital*

Revenues in excess of costs and expenses are assigned to patrons on a patronage basis in accordance with the Company's bylaws and are represented by patronage capital.

### *Fair Value Measurements*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company determines the fair value of its financial assets and liabilities based on the fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

### *Reclassifications*

Certain reclassifications have been made to the 2015 financial statements to conform with the 2016 presentation.

## Note 2: Investments

The amortized cost and fair value of available-for-sale and held-to-maturity securities are as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| December 31, 2016: | | | | |
| Available-for-sale equity securities: | | | | |
| Mutual funds | $ 29,969,711 | $ 1,590,545 | $ (17,372) | $ 31,542,884 |
| Stocks | 1,486,936 | 716,740 | - | 2,203,676 |
| Certificates of deposit | 900,000 | 290,460 | - | 1,190,460 |
| Corporate bonds | 230,000 | 59,225 | - | 289,225 |
| Total | $ 32,586,647 | $ 2,656,970 | $ (17,372) | $ 35,226,245 |
| Amounts classified as: | | | | |
| Investments - available-for-sale (current assets) | | | | $ 1,081,075 |
| Investments - available-for-sale (noncurrent assets) | | | | 34,145,170 |
| Total | | | | $ 35,226,245 |
| Held-to-Maturity: | | | | |
| U.S. government securities | $ 1,480,802 | $ 16,227 | $ (1,626) | $ 1,495,403 |
| Corporate bonds | 1,481,321 | 15,699 | - | 1,497,020 |
| Total | $ 2,962,123 | $ 31,926 | $ (1,626) | $ 2,992,423 |
| Amounts classified as: | | | | |
| Investments - held-to-maturity (current assets) | $ 1,080,651 | | | |
| Investments - held-to-maturity (noncurrent assets) | 1,881,472 | | | |
| Total | $ 2,962,123 | | | |

December 31, 2015:

| | | | | |
|---|---|---|---|---|
| Available-for-sale equity securities: | | | | |
| Mutual funds | $ 28,249,029 | $ 466,449 | $ - | $ 28,715,478 |
| Stocks | 1,301,311 | 583,844 | - | 1,885,155 |
| U.S. government securities | 2,452,150 | - | (13,561) | 2,438,589 |
| Corporate bonds | 3,211,056 | 83,075 | - | 3,294,131 |
| Certificates of deposit | 4,100,000 | 379,736 | - | 4,479,736 |
| Total | $ 39,313,546 | $ 1,513,104 | $ (13,561) | $ 40,813,089 |
| Amounts classified as: | | | | |
| Investments - available-for-sale | | | | $ 40,813,089 |

Management evaluates the need for recording an other than temporary impairment for these investments annually. Based on the nature and financial information available for each individual investment, the length of time and extent of its fair value being below cost (generally less than twelve months at December 31, 2016) and the Company's ability and intent to hold the investments for a sufficient time to allow for the recovery of the cost of the investment, an other than temporary impairment has not been recognized as of December 31, 2016 and 2015.

Proceeds from sales of available-for-sale securities were $7,142,363 and $6,166,823 in 2016 and 2015, respectively. The gross realized gains on sales of available-for-sale securities totaled $185,134 and $2,023,700 in 2016 and 2015, respectively, and the gross realized losses totaled $1,242 and $237,956 in 2016 and 2015, respectively. The change in net unrealized holding gains (losses) on available-for-sale securities included as a separate component of comprehensive income before tax totaled $1,209,484 and $(3,239,291) in 2016 and 2015, respectively.

Investments measured at fair value are valued at Level 1 in the fair value hierarchy.

The amortized cost and fair value of debt securities at December 31, 2016, by contractual maturity date are shown below. Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations without call or prepayment penalties.

| | Amortized Cost | Fair Value |
|---|---|---|
| Available-for-Sale: | | |
| Due in one year or less | $ 830,000 | $ 1,081,075 |
| Due after one year through three years | 300,000 | 398,610 |
| Equity securities | 31,456,647 | 33,746,560 |
| | $ 32,586,647 | $ 35,226,245 |
| Held-to-Maturity: | | |
| Due in one year or less | $ 1,080,651 | $ 1,086,705 |
| Due after one year through three years | 786,082 | 804,438 |
| Due after five years | 1,095,390 | 1,101,280 |
| | $ 2,962,123 | $ 2,992,423 |

## Note 3: Other Investments

Other investments consist of the following:

| | 2016 | 2015 |
|---|---|---|
| Tennessee Independent Telecommunications Group, LLC | $ 890,579 | $ 893,476 |
| Associated Network Partners, Inc. | 738,124 | 1,780,634 |
| Codero | 1,000,000 | 1,000,000 |
| Rural Trust Insurance Company | 993,500 | 993,500 |
| National Telecom Corporation | 179,933 | 179,933 |
| CoBank | 147,538 | 133,930 |
| Synergy Wireless, LLC | 10,000 | 10,000 |
| Other | 7,815 | 7,815 |
| | $ 3,967,489 | $ 4,999,288 |

The Company has a 10.556% percent ownership interest in Tennessee Independent Telecommunications Group, LLC (IRIS) which provides transport facilities, IP and tandem switch leasing. The following is condensed financial data for IRIS:

| | December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Assets | $ 16,880,794 | $ 17,910,809 |
| Liabilities | (8,444,089) | (9,502,927) |
| Equity | $ 8,436,705 | $ 8,407,882 |

| | Years Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Revenues | $ 16,606,980 | $ 14,876,720 |
| Expenses | (16,578,157) | (14,629,536) |
| Net Income | $ 28,823 | $ 247,184 |

The investments in IRIS is being accounted for on the equity method. For investments accounted for under the equity method, the Company recognizes its proportionate share of the income and losses accruing to it under the terms of the partnership agreement. All other investments are accounted for on the cost method.

## Note 4: Goodwill and Intangibles

As a result of changes in accounting standards for goodwill, private companies are allowed to elect to amortize goodwill. During 2016 the Company elected to adopt this change. This resulted in recognizing $279,959 of amortization in the consolidated statement of operations. The accounting change is to be applied prospectively, resulting in no changes being made to prior year statements.

The gross carrying amounts of goodwill, accumulated amortization and accumulated impairment loss were as follows for the years ending December 31:

| | 2016 | 2015 |
|---|---|---|
| Goodwill | $ 2,799,587 | $ 2,799,587 |
| Accumulated amortization | (279,959) | - |
| Goodwill, net | $ 2,519,628 | $ 2,799,587 |

The Company amortizes goodwill on the straight-line method over ten years unless a shorter useful life if more appropriate. The weighted average amortization period is ten years. Amortization expense was $279,959 for the year ended December 31, 2016.

Intangible assets at December 31 consist of the following:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Gross Amount | Accumulated Amortization | Gross Amount | Accumulated Amortization |
| Amortized Intangibles | | | | |
| Customer base | $ 4,000,000 | $ 2,800,000 | $ 4,000,000 | $ 2,400,000 |
| Regulatory rights | 2,000,000 | 1,400,000 | 2,000,000 | 1,200,000 |
| | $ 6,000,000 | $ 4,200,000 | $ 6,000,000 | $ 3,600,000 |
| Unamortized Intangibles | | | | |
| Trade name | $ 300,000 | | $ 300,000 | |

Amortization expense was $879,959 and $600,000 for the years ending December 31, 2016 and 2015, respectively.

Estimated amortization expense for the next five years is:

| | |
|---|---|
| 2017 | $ 879,959 |
| 2018 | 879,959 |
| 2019 | 879,959 |
| 2020 | 279,959 |
| 2021 | 279,959 |

The Company's future cash flows are not materially impacted by its ability to extend or renew agreements related to its amortizable intangible assets.

The Company annually assesses its recorded balances of goodwill and indefinite lived intangible assets for impairment. The fair value of goodwill and indefinite lived intangibles is based on level 3 inputs of the fair value hierarchy. The estimated fair value is derived from various valuation techniques, including market capitalization, comparable sales, and discounted cash flows. As a result, the Company determined no impairment needed to be recorded for the years ended December 31, 2016 and 2015.

## Note 5: Property, Plant and Equipment

Property, plant and equipment includes the following:

| | 2016 | 2015 |
|---|---|---|
| Telephone plant in service: | | |
| Land | $ 1,427,671 | $ 1,434,171 |
| Buildings | 7,393,879 | 7,320,151 |
| Furniture and office equipment | 3,010,834 | 2,849,175 |
| Vehicles and work equipment | 5,163,738 | 4,638,725 |
| Switching equipment | 30,132,624 | 31,060,578 |
| Outside plant | 97,852,859 | 96,211,119 |
| Other plant and equipment | 5,216,878 | 5,109,582 |
| Organization | 8,276 | 8,276 |
| Total property, plant and equipment | $150,206,759 | $148,631,777 |

Depreciation on depreciable property resulted in composite rates of 5.15% and 5.38% for 2016 and 2015, respectively.

Depreciation expense was $7,625,358 and $9,703,983 for the years ending December 31, 2016 and 2015, respectively.

## Note 6: Long-Term Debt

Long-term debt consists of:

| | 2016 | 2015 |
|---|---|---|
| RDUP BIP mortgage notes - 2.27% - 3.71% | $ 49,485,982 | $ 51,509,701 |
| RDUP mortgage notes - 3.91% - 7.00% | 12,592,768 | 15,928,390 |
| RTB mortgage notes - 5.17% - 6.05% | 1,613,819 | 2,164,969 |
| CoBank mortgage note - 4.18% | 4,325,000 | 5,025,000 |
| Total long-term debt | 68,017,569 | 74,628,060 |
| Less current portion | 6,662,176 | 6,555,695 |
| | $ 61,355,393 | $ 68,072,365 |

The annual requirements for principal payments on long-term debt for the next five years are as follows:

| | |
|---|---|
| 2017 | $ 6,662,176 |
| 2018 | 6,916,420 |
| 2019 | 7,916,220 |
| 2020 | 3,034,872 |
| 2021 | 2,460,253 |

Substantially all assets of the Company are pledged as security for the long-term debt under certain loan agreements with the Rural Development Utilities Program (RDUP) and Rural Telephone Bank (RTB). These mortgage notes are to be repaid in equal monthly and quarterly installments covering principal and interest beginning after date of issue and expiring by 2030.

The mortgage to the United States of America, underlying the RDUP notes, contains certain restrictions on the declaration or payment of cash dividends, redemption of capital stock or investment in affiliated companies except as might be specifically authorized in writing in advance by the RDUP noteholders.

The security and loan agreements underlying the CoBank notes contain certain restrictions on distributions to stockholders, and investment in or loans to others. The Company is restricted from making any distributions if the distributions would cause the violation of any of the required financial ratios per the loan agreement, except as might be specifically authorized in writing in advance by the CoBank noteholders. In addition, the Company is required to maintain certain financial ratios for current assets to current liabilities, net worth to total assets, long-term debt to operating cash flow and debt service coverage.

Cash paid for interest net of amounts capitalized for 2016 and 2015 totaled $2,378,341 and $2,461,363, respectively.

At December 31, 2016, of the funds available for long-term notes and lines of credit, all funds were advanced.

During 2010, the Company applied for, and was awarded, a loan and grant combination to construct an updated broadband network in its service area. The total amount awarded to the Company was $123,800,000, of which $61,900,001 represents eligible loan proceeds and $61,899,999 which will be awarded as a grant. Under the Program, the Company will be reimbursed for eligible costs associated with the construction of the broadband facilities over a specified period of time. As of December 31, 2016, the Company has received $55,502,302 in loan proceeds and $55,502,299 of the grant portion.

Under the provisions of the loan contract, advances of loan funds shall be deposited in a special construction account and held in trust for the government until disbursed. The loan contract restricts disbursements to such expenditures as RDUP may authorize. All payments from the trust accounts are subject to RDUP approval.

## Note 7: Income Taxes

Income taxes reflected in the Consolidated Statements of Operations consist of the following:

| | 2016 | 2015 |
|---|---|---|
| Federal income taxes: | | |
| Current tax expense | $ 827,707 | $ 2,159,990 |
| Deferred tax benefit | (401,541) | (1,355,804) |
| State income taxes: | | |
| Current tax expense | 144,998 | 540,516 |
| Deferred tax expense (benefit) | 5,847 | (277,695) |
| Total income tax expense | $ 577,011 | $ 1,067,007 |

Cash paid for income taxes and estimated income taxes for 2016 and 2015 totaled $767,510 and $3,237,741, respectively.

Income tax refunds of $36,285 were received during 2016.

Deferred federal and state tax liabilities and assets reflected in the Consolidated Balance Sheets are summarized as follows:

| | 2016 | 2015 |
|---|---|---|
| Deferred Tax Liabilities | | |
| Federal | $ 2,904,974 | $ 2,721,730 |
| State | 545,200 | 723,498 |
| Total Deferred Tax Liabilities | 3,450,174 | 3,445,228 |
| Deferred Tax Assets | | |
| Federal | 147,387 | 155,616 |
| State | 37,121 | 41,366 |
| Total Deferred Tax Assets | 184,508 | 196,982 |
| Net Deferred Tax Liabilities | $ 3,265,666 | $ 3,248,246 |

A valuation allowance is required to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of the evidence, both positive and negative, management determined that no valuation allowance was required at December 31, 2016 and 2015, to reduce the deferred tax assets to the amount that will more likely than not be realized.

Prepaid income taxes of $200,138 appearing on the Balance Sheets at December 31, 2015, reflect overpayments of estimated taxes.

The tax provision differs from the expense that would result from applying the federal statutory rates to operations before income taxes because of state income taxes being deductible in determining taxable margins and the Company being permitted to exclude from taxable margins, margins generated from patronage sourced activities if those margins are appropriately allocated to patrons as capital credits. This excluded income will vary from year to year, resulting in fluctuations in the effective rate and income tax expense.

The Company has evaluated its income tax positions and has determined that there are no uncertain income tax positions that need to be recorded or reported in the financial statements at December 31, 2016.

The Company's federal and state income tax returns for years 2013 to present remain subject to examination.

## Note 8: Prepaid Service Contracts

Ardmore Telephone Company, Inc. has entered into an agreement with Tennessee Independent Telecommunications Group, LLC d/b/a Iris Networks (IRIS) for access to IRIS fiber optic network and other facilities. The terms of this agreement are for twenty consecutive years and six months commencing in January of 2015. In consideration for this indefeasible right of use, the Company prepaid IRIS $420,000. This amount is being expensed using the straight line method over the term of the contract. As of December 31, 2016 and 2015, the prepaid service contract was $379,023 and $399,513, respectively.

## Note 9: Labor Agreement

Approximately 45% of the Company's labor force is subject to a collective bargaining agreement. A three-year agreement was negotiated and approved for the period November 1, 2016 to October 31, 2019 between the Company and the International Brotherhood of Electrical Workers.

## Note 10: Concentrations of Credit Risk

The Company grants credit to customers, all of whom are located in the franchised service area, and telecommunications intrastate and interstate long distance carriers.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash equivalents and temporary investments. The Company places its temporary investments in several financial institutions which limits the amount of credit exposure in any one financial institution.

The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

Of the Company's cash and cash equivalents, approximately $13,869,000 at December 31, 2016 was maintained in accounts at financial institutions in excess of the amount insured by an agency of the federal government.

## Note 11: Benefit Plan

Ardmore Telephone Company, Inc., a wholly-owned subsidiary of Synergy Technologies Partners, Inc., has a 401(k) plan covering substantially all of its employees. The Company makes matching contributions to the plan of one-half of the employee contribution up to 4% of the employee's salary. The Company's contribution to the plan for 2016 and 2015 was $13,510 and $15,730, respectively.

## Note 12: Deferred Compensation

The Company and Telecom Management Services, Inc. have implemented a deferred compensation agreement for certain management personnel. The plan is maintained in brokerage accounts and is held by the Company. Under the terms of the plan, an amount determined by the Board of Directors of the Company will be paid to an account established on behalf of the management personnel. The deferred compensation is to be paid to the individuals upon retirement or other reasons of discontinued service to the respective or other reasons of discontinued service to the respective Company. Included in securities available for sale of the Consolidated Balance Sheets is $927,016 at December 31, 2016, that is a part of the deferred compensation agreements.

## Note 13: Pension Plan

The Company and Telecom Management Service, Inc. have adopted the retirement and security program of the National Telephone Cooperative Association as a pension plan covering all employees meeting certain age and length of service requirements for which it pays approximately 80% of the cost. The benefits are based on length of service and employee compensation. The Companies funding policy is to contribute, monthly, the amounts that are within the guidelines of the Internal Revenue Service. The Cooperative's cost was $471,057 and $502,263 for 2016 and 2015, respectively. Telecom Management Services, Inc.'s cost was $78,991 and $97,602 for 2016 and 2015, respectively.

## Note 14: Post Retirement Benefit Plan

The Company has a post retirement benefit plan for retirees that provides health insurance to retired employees and their spouses. Employee contributions are not required. The plan anticipates that benefits offered under the plan will be adjusted periodically in accordance with the changes adopted for the active employees. The Company makes contributions to a health savings account. Contributions are limited to the amounts permitted under the Internal Revenue Service rules for determining tax deductible contributions.

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Notes to Consolidated Financial Statements
## December 31, 2016 and 2015

The following table sets forth the separate funded statuses of the plans and the amounts recognized in the Cooperative's consolidated balance sheet as of December 31, 2016:

| | West Kentucky Rural Telephone Cooperative Corporation, Inc. | Telecom Management Services, Inc. | Total |
|---|---|---|---|
| Post-retirement plan obligations and funded status: | | | |
| Projected benefit obligation at December 31 | $ 3,309,300 | $ 200,100 | $ 3,509,400 |
| Post-retirement plan assets at fair value at December 31 | 3,190,300 | - | 3,190,300 |
| Funded status | $ (119,000) | $ (200,100) | $ (319,100) |
| Employer contributions | $ 163,000 | $ 12,600 | $ 175,600 |
| Plan participant contributions | 167,100 | 1,200 | 168,300 |
| Benefits paid | $ 330,100 | $ 13,800 | $ 343,900 |
| Amounts recognized in the balance sheet | | | |
| Current liabilities | $ - | $ 14,000 | $ 14,000 |
| Noncurrent liabilities | 119,000 | 186,100 | 305,100 |
| Net amount recognized | $ 119,000 | $ 200,100 | $ 319,100 |
| Amounts recognized in accumulated other comprehensive income: | | | |
| Net actuarial loss (gain) | $ 1,238,900 | $ 10,400 | $ 1,249,300 |
| Transition obligation | - | 93,500 | 93,500 |
| Total | $ 1,238,900 | $ 103,900 | $ 1,342,800 |
| Other changes in plan assets and benefit obligations previously recognized in changes in comprehensive income: | | | |
| Net loss (gain) | $ 617,300 | $ 23,300 | $ 640,600 |
| Amortization of transition obligation | (38,300) | (9,900) | (48,200) |
| Total recognized on other comprehensive income | 579,000 | 13,400 | 592,400 |
| Net periodic benefit cost | 19,100 | 24,200 | 43,300 |
| Total recognized in net periodic benefit cost and other comprehensive income | $ 598,100 | $ 37,600 | $ 635,700 |
| Estimated amortization from accumulated other comprehensive income into net periodic benefit cost in 2017 are: | | | |
| Net loss (gain) | $ 68,000 | $ - | $ 68,000 |
| Amortization of transition obligation | $ - | $ 9,900 | $ 9,900 |
| **Plan Assets** | | | |
| VEBA II Trust | $ 3,190,300 | $ - | $ 3,190,300 |

The following table sets forth the separate funded statuses of the plans and the amounts recognized in the Cooperative's consolidated balance sheet as of December 31, 2015:

| | West Kentucky Rural Telephone Cooperative Corporation, Inc. | Telecom Management Services, Inc. | Total |
|---|---|---|---|
| Post-retirement plan obligations and funded status: | | | |
| Projected benefit obligation at December 31 | $ 2,656,400 | $ 174,100 | $ 2,830,500 |
| Post-retirement plan assets at fair value at December 31 | 2,972,500 | - | 2,972,500 |
| Funded status | $ 316,100 | $ (174,100) | $ 142,000 |
| Employer contributions | $ 151,800 | $ 12,500 | $ 164,300 |
| Plan participant contributions | 161,300 | 400 | 161,700 |
| Benefits paid | $ 313,100 | $ 12,900 | $ 326,000 |
| Amounts recognized in the balance sheet | | | |
| Noncurrent assets | $ 316,100 | $ - | $ 316,100 |
| Current liabilities | - | (6,600) | (6,600) |
| Noncurrent liabilities | (119,000) | (167,500) | (286,500) |
| Net amount recognized | $ 197,100 | $ (174,100) | $ 23,000 |
| Amounts recognized in accumulated other comprehensive income: | | | |
| Net actuarial loss (gain) | $ 659,900 | $ (12,900) | $ 647,000 |
| Transition obligation | - | 103,400 | 103,400 |
| Total | $ 659,900 | $ 90,500 | $ 750,400 |
| Other changes in plan assets and benefit obligations previously recognized in changes in comprehensive income: | | | |
| Net loss (gain) | $ 52,800 | $ (91,700) | $ (38,900) |
| Amortization of transition obligation | (14,300) | (9,900) | (24,200) |
| Total recognized on other comprehensive income | 38,500 | (101,600) | (63,100) |
| Net periodic benefit cost (income) | (9,200) | 24,200 | 15,000 |
| Total recognized in net periodic benefit cost and other comprehensive income | $ 29,300 | $ (77,400) | $ (48,100) |
| **Plan Assets** | | | |
| VEBA II Trust | $ 2,972,500 | $ - | $ 2,972,500 |
| **Cash Flows** | | | |
| **Contributions** | | | |
| The Cooperative expects its contributions to the post retirement benefit plan in 2017 to be: | $ 171,900 | $ 14,000 | $ 185,900 |

**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

| | | | |
|---|---|---|---|
| 2017 | $ 171,900 | $ 14,000 | $ 185,900 |
| 2018 | 171,000 | 14,800 | 185,800 |
| 2019 | 2,017 | 5,600 | 7,617 |
| 2020 | 170,300 | 6,100 | 176,400 |
| 2021 | 170,200 | 7,400 | 177,600 |
| 2022 | 906,100 | 58,500 | 964,600 |

## Assumptions

The key actuarial assumptions used to determine the post-retirement benefit obligation as of December 31, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|---|---|---|
| Weighted-average assumptions used to determine postretirement benefit obligations at December 31: | | |
| Discount rate | 5.25 % | 5.25 % |
| Health care inflation: | | |
| Initial rate | 5.50 % | 6.00 % |
| Ultimate rate | 5.00 % | 5.00 % |
| Year ultimate rate achieved | 2018 | 2018 |
| Discount rate | 4.00 | 5.25 |

## Note 15: Regulatory Matters

The Company received 39% of its 2016 revenues from access revenues and assistance provided by the Federal Universal Service Fund. The manner in which access revenues and Universal Service Funds are determined has been modified in several recent Federal Communications Commission proceedings. Changes include modifications to rate-of-return support including caps on the recovery of certain expenditures, and reductions in terminating access charges billed with eventual transition to a bill-and-keep framework for the exchange of traffic between carriers.

On March 30, 2016, the FCC released a Report and Order, Order on Reconsideration, and Further Notice of Proposed Rulemaking to reform USF. The order in this proceeding (1) provides support for standalone broadband; (2) requires broadband deployment based on the number of locations lacking service and cost of providing service; (3) requires allowances for capital investments and further limits operational expenses; and (4) phases out support for area served by qualifying competitors. In addition, the FCC created a new Universal Service Support mechanism named the Alternative Connect America Model (A-CAM). The Order allows eligible rate-of-return carriers to elect A-CAM or remain on a revised version of the legacy rate-of-return funding. Carriers not eligible for the A-CAM will fall under the revised version of the legacy rate-of-return funding. The Order provides a total budget of $2 billion for Universal Service Support to cover the A-CAM and legacy rate-of-return mechanisms.

The Company was not eligible to elect A-CAM support, and therefore will remain a legacy rate-of-return carrier. The amount of support that will be received is not certain due to constraints on the FCC's budget.

Whether a rate-of-return carrier chooses model-based support or remains on legacy mechanisms, it will be required to meet service obligations, adhere to reporting obligations, and retain records.

## Note 16: Commitments

The Company has extended into purchase commitments totaling approximately $1,900,000 for plant purchases.

## Supplementary Information

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## Independent Auditor's Report on Supplementary Information

To the Board of Directors
West Kentucky Rural Telephone Cooperative Corporation, Inc. and Subsidiaries
Mayfield, Kentucky

Our audit was conducted for the purpose of forming an opinion on the 2016 consolidated financial statements as a whole. The statements listed in the table of contents are presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The 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 information is fairly stated in all material respects in relation to the 2016 consolidated financial statements as a whole.

BKD, LLP

Emmetsburg, Iowa
June 30, 2017

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Consolidating Balance Sheet
## December 31, 2016

| Assets | West Kentucky Rural Telephone Cooperative Corp, Inc. | Synergy Technology Partners, Inc. and Subsidiary | Telecom Management Services, Inc. | Intercompany Eliminations | Consolidated |
|---|---|---|---|---|---|
| **Current Assets** | | | | | |
| Cash and cash equivalents | $ 20,601,591 | $ 1,377,844 | $ 580,936 | $ | $ 22,560,371 |
| Investments - available-for-sale | 1,081,075 | | | | 1,081,075 |
| Investments - held-to-maturity | 1,080,651 | | | | 1,080,651 |
| Certificates of deposit | 2,600,000 | | | | 2,600,000 |
| Accounts receivable: | | | | | |
| Due from customers | | | | | |
| Less allowance of $78,466 | 757,295 | 59,178 | | | 816,473 |
| Interexchange carriers | | | | | |
| Less allowance of $206,363 | 164,590 | 38,009 | | | 202,599 |
| Affiliates | 192,046 | | 821,560 | (1,013,606) | |
| Other | 13,576 | 5,522 | 6,205 | | 25,303 |
| Inventories at average cost | 512,761 | 395,000 | | | 907,761 |
| Prepayments | 619,347 | 15,146 | 20,798 | | 655,291 |
| Prepaid service contract | | 20,489 | | | 20,489 |
| | 27,622,932 | 1,911,188 | 1,429,499 | (1,013,606) | 29,950,013 |
| **Other Noncurrent Assets** | | | | | |
| Investment in affiliates | 9,721,431 | | | (9,721,431) | |
| Investments - available-for-sale | 33,107,145 | | 1,038,025 | | 34,145,170 |
| Investments - held-to-maturity | 1,881,472 | | | | 1,881,472 |
| Certificates of deposit | 250,000 | | | | 250,000 |
| Other investments | 2,826,451 | 147,538 | 993,500 | | 3,967,489 |
| Intangibles, net of amortization | | 2,100,000 | | | 2,100,000 |
| Prepayments | 1,002,875 | 14,407 | | | 1,017,282 |
| Prepaid service contract | | 358,534 | | | 358,534 |
| Goodwill | | 2,519,628 | | | 2,519,628 |
| | 48,789,374 | 5,140,107 | 2,031,525 | (9,721,431) | 46,239,575 |
| **Property, Plant and Equipment** | | | | | |
| Telephone plant in service | 103,178,344 | 46,766,062 | 262,353 | | 150,206,759 |
| Less accumulated depreciation | 37,059,698 | 38,272,155 | 188,810 | | 75,520,663 |
| | 66,118,646 | 8,493,907 | 73,543 | | 74,686,096 |
| Plant under construction | 161,687 | 713,422 | | | 875,109 |
| | 66,280,333 | 9,207,329 | 73,543 | | 75,561,205 |
| **Total Assets** | $ 142,692,639 | $ 16,258,624 | $ 3,534,567 | $ (10,735,037) | $ 151,750,793 |

| Liabilities and Members' Equity | West Kentucky Rural Telephone Cooperative Corp, Inc. | Synergy Technology Partners, Inc. and Subsidiary | Telecom Management Services, Inc. | Intercompany Eliminations | Consolidated |
|---|---|---|---|---|---|
| **Current Liabilities** | | | | | |
| Current portion of long-term debt | $ 5,962,176 | $ 700,000 | $ | $ | $ 6,662,176 |
| Accounts payable: | | | | | |
| Interexchange carriers | 793,741 | 83,878 | | | 877,619 |
| Affiliates | 399,947 | 613,659 | | (1,013,606) | |
| Other | 981,755 | 599,648 | 110,264 | | 1,691,667 |
| Post retirement benefit other than pension | | | 14,000 | | 14,000 |
| Advance billing and payments | 613,012 | | | | 613,012 |
| Customer deposits | 89,438 | 29,050 | | | 118,488 |
| Accrued taxes | 498,537 | 144,607 | 230,414 | | 873,558 |
| Other | 880,889 | 60,747 | 334,099 | | 1,275,735 |
| | 10,219,495 | 2,231,589 | 688,777 | (1,013,606) | 12,126,255 |
| **Long-term Debt, less current portion** | 57,730,393 | 3,625,000 | | | 61,355,393 |
| **Other Noncurrent Liabilities and Deferred Credits** | | | | | |
| Deferred income taxes | 903,370 | 2,427,238 | (64,942) | | 3,265,666 |
| Deferred compensation | | | 1,053,173 | | 1,053,173 |
| Postretirement benefits other than pension, less current portion | 119,000 | | 186,100 | | 305,100 |
| | 1,022,370 | 2,427,238 | 1,174,331 | | 4,623,939 |
| **Members' Equity** | | | | | |
| Memberships | 54,689 | | | | 54,689 |
| Common stock | | 4,600,000 | 200,000 | (4,800,000) | |
| Patronage capital assigned | 73,150,992 | | | | 73,150,992 |
| Additional paid-in capital | | 3,490,755 | 770,762 | (4,261,517) | |
| Accumulated other comprehensive income | 514,700 | | (75,175) | | 439,525 |
| Retained earnings | | (115,958) | 775,872 | (659,914) | |
| | 73,720,381 | 7,974,797 | 1,671,459 | (9,721,431) | 73,645,206 |
| **Total Liabilities and Members' Equity** | $ 142,692,639 | $ 16,258,624 | $ 3,534,567 | $ (10,735,037) | $ 151,750,793 |

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Consolidating Statement of Operations
## Year Ended December 31, 2016

| | West Kentucky Rural Telephone Cooperative Corp, Inc. | Synergy Technology Partners, Inc. and Subsidiary | Telecom Management Services, Inc. | Intercompany Eliminations | Consolidated |
|---|---|---|---|---|---|
| **Operating Revenues** | | | | | |
| Local network services | $ 3,422,842 | $ 1,563,560 | $ | $ | $ 4,986,402 |
| Network access services | 13,787,052 | 2,913,610 | | | 16,700,662 |
| Long distance services | 703,699 | 326,449 | | | 1,030,148 |
| Broadband services | 7,827,182 | 2,071,457 | | | 9,898,639 |
| Video services | 4,162,772 | | | | 4,162,772 |
| Professional and management fee revenue | | | 2,335,693 | (2,335,693) | |
| Security revenues | 282,999 | 37,411 | | | 320,410 |
| Retail sales revenues | 182,495 | | | | 182,495 |
| Miscellaneous revenue | 1,426,872 | 190,680 | | | 1,617,552 |
| | 31,795,913 | 7,103,167 | 2,335,693 | (2,335,693) | 38,899,080 |
| **Operating Expenses** | | | | | |
| Plant specific operations | 3,977,181 | 1,121,996 | 28,346 | | 5,127,523 |
| Plant nonspecific operations | 1,060,695 | 386,222 | | | 1,446,917 |
| Cost of long distance services | 265,791 | 124,633 | | | 390,424 |
| Cost of broadband services | 1,963,746 | 925,764 | | | 2,889,510 |
| Cost of video services | 3,227,668 | | | | 3,227,668 |
| Cost of goods sold - retail | 195,835 | | | | 195,835 |
| Security expenses | 143,581 | | | | 143,581 |
| Depreciation and amortization | 6,493,317 | 1,972,353 | 39,647 | | 8,505,317 |
| Customer operations | 3,165,980 | 1,108,484 | 439,533 | (885,218) | 3,828,779 |
| Corporate operations | 2,389,534 | 714,698 | 1,219,205 | (1,450,475) | 2,872,962 |
| General taxes | 962,676 | 135,734 | (389) | | 1,098,021 |
| | 23,846,004 | 6,489,884 | 1,726,342 | (2,335,693) | 29,726,537 |
| **Operating Margins** | 7,949,909 | 613,283 | 609,351 | | 9,172,543 |
| **Other Income (Expenses)** | | | | | |
| Interest and dividend income | 851,308 | 54,535 | 49,224 | | 955,067 |
| Interest expense | (2,278,105) | (100,236) | | | (2,378,341) |
| Allowance for funds used during construction | 1,465 | | | | 1,465 |
| Investment income | 808,199 | | 22,725 | | 830,924 |
| Gains on sale of investments | 185,134 | | (1,242) | | 183,892 |
| Income (loss) from partnerships | (2,897) | | | | (2,897) |
| Other, net | (221,389) | | (3,787) | | (225,176) |
| | (656,285) | (45,701) | 66,920 | | (635,066) |
| **Margins Before Income Taxes and Equity Earnings of Subsidiaries** | 7,293,624 | 567,582 | 676,271 | | 8,537,477 |
| **Income Taxes** | 249,349 | 115,964 | 211,698 | | 577,011 |
| **Margins Before Equity Earnings of Subsidiaries** | 7,044,275 | 451,618 | 464,573 | | 7,960,466 |
| **Equity Earnings of Subsidiaries** | 916,191 | | | (916,191) | |
| **Net Margins** | $ 7,960,466 | $ 451,618 | $ 464,573 | $ (916,191) | $ 7,960,466 |

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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 the Consolidated Financial Statements Performed in Accordance With *Government Auditing Standards*

To the Board of Directors
West Kentucky Rural Telephone Cooperative Corporation, Inc. and Subsidiaries
Mayfield, Kentucky

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 West Kentucky Rural Telephone Cooperative Corporation, Inc. and subsidiaries, which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, comprehensive income, members' equity and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated June 30, 2017.

## *Internal Control Over Financial Reporting*

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the consolidated financial statements, we considered the Company's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company'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 Company's consolidated 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 significant deficiencies or material weaknesses and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

We observed the following matters that we consider to be material weaknesses:

- **Criteria**: In order for the Company to fulfill its reporting requirements, prepare complete financial statement disclosures and prepare tax returns, it must put in place personnel and properly designed controls to ensure fairly stated financial statements.

  **Condition**: The Company has utilized accounting assistance from another party to draft financial statements, prepare tax returns and assist with the preparation of certain normal annual closing entries.

  **Cause**: The Company has a limited number of personnel.

  **Effect**: Lack of experience in preparing financial statements and normal closing entries could result in incomplete disclosures and/or incorrect presentation of information which could have an adverse impact on users of the financial statements.

  **Recommendation**: While putting in place the personnel and properly designed controls may not be a cost effective solution to completing the Company's reporting requirements, management should strive to educate staff on changing reporting requirements.

  **Management's Response**: The Company does review and approve the results of these activities. It also prioritizes staff education through attendance at many industry specific events, and believes this approach provides a cost effective solution in light of their limited resources.

- **Criteria**: Complete segregation of duties and a formal risk assessment process are essential in maintaining internal controls over financial reporting and managing the information technology system of the Company.

  **Condition**: The Company's limited resources and personnel do not allow for complete segregation of duties or a formal risk assessment and monitoring system.

  **Cause**: The Company has a limited number of personnel and it therefore is not able to dedicate the required resources to maintain complete segregation of duties or prepare formal risk assessment and monitoring systems.

  **Effect:** Due to the lack of a formal internal control and information technology system and segregation of duties, there is a potential for an employee to perpetrate and conceal a theft of assets from the Company.

  **Recommendation**: Complete segregation of incompatible duties in the accounting department may not be possible at the current staffing levels. Management and those charged with governance should be aware of the limitations of the internal control system as currently implemented and should remain alert for opportunities to improve the segregation of duties through the reallocation of duties or reassignment of responsibilities.

  **Management's Response**: The Company periodically performs informal risk assessments and monitors the business risk associated with assignment of personnel to various activities.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the Company's consolidated financial statements are free of 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 consolidated 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.

***West Kentucky Rural Telephone Cooperative Corporaiton Inc.'s Response to Findings***

The Company's response to the findings identified in our audit are described above. West Kentucky Rural Telephone Cooperative Corporation Inc.'s response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

***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 Company's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Emmetsburg, Iowa
June 30, 2017

BKD LLP
CPAs & Advisors

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## Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements For Telecommunications Borrowers

To the Board of Directors
West Kentucky Rural Telephone Cooperative Corporation, Inc. and Subsidiaries
Mayfield, Kentucky

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 West Kentucky Rural Telephone Cooperative Corporation, Inc. and subsidiaries, which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, comprehensive income, members' equity and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated June 30, 2017. In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2017, on our consideration of West Kentucky 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 and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that West Kentucky Rural Telephone Cooperative Corporation, Inc. failed to comply with the terms, covenants, provision, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and the clarified RUS policy memorandum dated February 7, 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 West Kentucky 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 West Kentucky Rural Telephone Cooperative Corporation, Inc.'s accounting and records to indicate that West Kentucky 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 the 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 written approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers substantially all of the telecommunications system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements;
- Comply with the requirements for the detailed schedule of investments.

# West Kentucky Rural Telephone Cooperative Corporation, Inc.
## Schedule of Subsidiary and Affiliate Investments
### December 31, 2016 and 2015

| Entity Name | Synergy Technology Partners, Inc. | Telecom Management Services, Inc. | Tennessee Independent Telecommunications Group, LLC |
|---|---|---|---|
| Principal Business | Telecommunications | Telecommunications | Telecommunications |
| Ownership Percentage | 100% | 100% | 10.556% |
| Accounting method | Consolidated | Consolidated | Equity |
| Year ended December 31, 2015 | | | |
| Original Investment | $ 4,600,000 | $ 200,000 | $ 884,576 |
| Prior years | 3,490,755 | 770,762 | 55,555 |
| Earnings (losses) | | | |
| Prior years | (729,156) | 250,623 | (72,747) |
| Current year | 161,578 | 60,677 | 26,092 |
| Book value of investment December 31, 2015 | 7,523,177 | 1,282,062 | 893,476 |
| Year ended December 31, 2016 | | | |
| Investment advances | | | |
| Current year | | | |
| Earnings (losses) | | | |
| Current year | 451,618 | 464,573 | (2,897) |
| Book value of investment December 31, 2016 | $ 7,974,795 | $ 1,746,635 | $ 890,579 |

This report is intended solely for the information and use of the board of directors and management of the Company, the Rural Development Utilities Programs 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.

BKD, LLP

Emmetsburg, Iowa.
June 30, 2017

BKD LLP
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To the Board of Directors
West Kentucky Rural Telephone Cooperative Corporation, Inc. and Subsidiaries
Mayfield, Kentucky

As part of our audit of the consolidated financial statements of West Kentucky Rural Telephone Cooperative Corporation, Inc. and subsidiaries, as of and for the year ended December 31, 2016, we wish to communicate the following to you.

**Auditor's Responsibility Under 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**

An audit performed 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 is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing auditing procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

These standards require communication of significant matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Such matters are communicated in the remainder of this letter or have previously been communicated during other phases of the audit. The standards do not require the auditor to design procedures for the purpose of identifying other matters to be communicated with those charged with governance.

An audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Our engagement letter more specifically describes your responsibilities.

**Qualitative Aspects of Significant Accounting Policies and Practices**

*Significant Accounting Policies*

The Company's significant accounting policies are described in Note 1 of the audited consolidated financial statements.

No unusual accounting policies or accounting methods were identified.

*Alternative Accounting Treatments*

We had discussions with management regarding alternative accounting treatments within accounting principles generally accepted in the United States of America for policies and practices for material items, including recognition, measurement and disclosure considerations related to the accounting for specific transactions as well as general accounting policies, as follows:

No matters reportable.

*Management Judgments and Accounting Estimates*

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following areas involve significant estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- Depreciable lives of fixed assets
- Allowance for doubtful accounts
- Rate of return on NECA settlements
- Non-pension post-retirement obligation

*Financial Statement Disclosures*

The following areas involve particularly sensitive financial statement disclosures for which we are prepared to discuss the issues involved and related judgments made in formulating those disclosures:

- Revenue recognition
- Regulatory matters
- Significant estimates and concentrations
- Determination of fair values
- Equity method of investments

**Audit Adjustments**

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments which, in its judgment, are required to prevent the financial statements from being materially misstated. Some adjustments proposed were not recorded because their aggregate effect is not currently material; however, they involve areas in which adjustments in the future could be material, individually or in the aggregate.

Areas in which adjustments were proposed include:

*Proposed Audit Adjustments Recorded*

- Equity earnings on investments

- Income tax accrual
- Accrued liabilities
- Depreciation expense

*Proposed Audit Adjustments Not Recorded*

- Attached is a summary of uncorrected misstatements we aggregated during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements as a whole.

**Auditor's Judgments About the Quality of the Entity's Accounting Principles**

During the course of the audit, we did not identify any new or changes to accounting policies or application of new accounting pronouncements.

**Other Material Written Communications**

Listed below are other material written communications between management and us related to the audit:

- Management representation letter (attached)

This letter is intended solely for the information and use of the board of directors, management of the Company, the Federal Communications Commission (FCC), Universal Service Administrative Company (USAC), and the relevant state and local regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

Emmetsburg, Iowa
June 30, 2017