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RECEIVED
MAR 4 2016
PUBLIC SERVICE
COMMISSION

March 3, 2016

VIA FEDERAL EXPRESS

Hon. James W. Gardner
Acting Executive Director
Kentucky Public Service Commission
211 Sower Blvd.
Frankfort KY 40601-8924

Re: ***Tariff Filing of Mountain Rural Telephone Cooperative Corporation, Inc.*; Case No. 2016-00047**

Dear Acting Executive Director Gardner:

On behalf of Mountain Rural Telephone Cooperative Corporation, Inc., I have enclosed for filing with the Public Service of the Commonwealth of Kentucky one (1) original and ten (10) copies of the following documents.

1) Application for a General Adjustment in Rates;
2) Motion for Waiver of Certain Rate Application Filing Requirements; and
3) Petition for Confidential Treatment.

Thank you, and if you have any questions with regard to this matter, please call me.

Very truly yours,

DINSMORE & SHOHL LLP

John E. Selent

JES/bmt
Enclosures

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RECEIVED
MAR 4 2016
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MOUNTAIN RURAL TELEPHONE	)	
COOPERATIVE CORPORATION, INC.	)	**CASE NO. 2016-00047**
FOR A GENERAL ADJUSTMENT IN RATES	)	

APPLICATION

Applicant Mountain Rural Telephone Cooperative Corporation, Inc. ("Mountain"), by counsel, pursuant to KRS 278.180, 807 KAR 5:001, Sections 14 and 16, and 807 KAR 5:011, Section 6 and consistent with the Public Service Commission of the Commonwealth of Kentucky's (the "Commission") May 29, 2013 order in Case No. 2013-00190 (the "2013 Rate Floor Order") as well as with Mountain's November 26, 2014 rate floor proceeding in Case No. 2014-00309, files this application (the "Application") for authority to adjust its rates and charges for basic local exchange service and gives notice of its intention to increase the same rates and charges effective June 1, 2016.

INTRODUCTION

This Application for a rate increase is necessitated by an order from the Federal Communications Commission ("FCC") that fundamentally alters the cost structure of providing telecommunications services in high-cost rural areas, like those Mountain serves. *See In the Matter of Connect America Fund et al.,* Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov 18, 2011) ("ICC/USF Order"). For decades prior to the ICC/USF Order, high-cost carriers had received subsidies from the federal government's "Universal Service Fund" ("USF"). Those USF subsidies were intended to fulfill the Federal Communications Act's requirement that "[c]onsumers in all regions of the Nation, including . . .

those in rural, insular, and high cost areas, should have access to telecommunications and information services . . . that are available at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. § 254(b)(3). The FCC found, however, that many rural consumers were paying rates that were less than those paid by consumers in urban areas. ICC/USF Order at ¶ 235. As a consequence, the FCC's ICC/USF Order sets a rate floor equal to the national average of local rates, plus state regulated fees. *Id.* at ¶ 238. The ICC/USF Order also "limit[s] high-cost support where local end-user rates plus state regulated fees" do not meet that national rate floor; those carriers' federal subsidies will be reduced "on a dollar-for-dollar basis . . . to the extent that [the] carrier's local rates (plus state regulated fees) do not meet the urban rate floor." *Id.* at ¶ 239.

On June 10, 2014, the FCC altered the schedule for the imposition of rate floor penalties, effectively requiring carriers to ensure that their 2016 rate floor obligations are met no later than June 1, 2016 (the "2014 Rate Floor Order"). *See In the Matter of Connect America Fund et al.*, Report and Order, Declaratory Ruling, Order, Memorandum Opinion and Order, Seventh Order on Reconsideration, and Further Notice of Proposed Rulemaking, FCC 14-54, ¶¶ 79-80.

Mountain's proposed rate adjustment is thus necessary to preserve its ability to receive these USF subsidies that are important to its ability to provide telephone and information services in its high-cost rural service territory. Without a minimum rate sufficient to meet the FCC's new rate floor, high-cost carriers like Mountain will lose significant federal funding that has historically allowed these carriers to provide service to the most costly, rural customers. That loss of federal funding will threaten the financial existence of these rural carriers like Mountain, who have important obligations under federal and state law as carriers of last resort. Moreover, the loss of those subsidies would increase the pressure for Mountain to raise its rates even higher than the federal rate floor sought here because any loss of federal funds would lead to a need for Mountain to make up that revenue directly from its customer-members.

* * * * * *

In support of its Application, Mountain states as follows:

1. Pursuant to 807 KAR 5:001, Section 14(1): (i) the full name of the applicant is Mountain Rural Telephone Cooperative Corporation, Inc.; (ii) the mailing address of the applicant is 425 Main Street, Suite A, P.O. Box 399, West Liberty, KY 41472; and (iii) the electronic mailing address of the applicant is SIson@MountainTelephone.com.

2. Pursuant to 807 KAR 5:001, Section 14(2), Mountain states that it is currently in good standing in the Commonwealth of Kentucky, where it is incorporated. A certified copy of Mountain's Articles of Incorporation and all amendments thereto is on file with the Commission in Case No. 2013-00194 (Exhibit 2 to Application).

3. Pursuant to 807 KAR 5:001, Section 16(1)(b)(1), Mountain provides the following statement of the reason the adjustment is requested. Further details are provided in Exhibit 1 of this Application.

a. Mountain is a rural incumbent local exchange carrier serving all of Elliott, Morgan, Menifee, Bath, and Wolfe Counties. Mountain was established in 1950 as a not-for-profit member owned cooperative to provide local telephone service to business and individual members within the exchanges Jeptha, Hazel Green, Campton, Ezel, Sandy Hook, West Liberty and Frenchburg in eastern Kentucky ("Service Territory"). Mountain provides 11,359 residential lines and 3,013 business lines to its members. Mountain is an eligible telecommunications carrier ("ETC"), and it is also the carrier of last resort ("COLR") in the Service Territory. In

2015, Mountain received \$3,768,252 from the High Cost Loop Support ("HCLS") Fund to support its COLR responsibilities in the Service Territory.

b. This proceeding was motivated by an order of the FCC that implemented "a rule to limit high-cost support where end-user rates do not meet a specified local rate floor." *See* ICC/USF Order at ¶ 235.

c. Under the rule, local exchange carriers such as Mountain must meet a specified rate floor in each year in order to be eligible to receive the maximum possible amount of HCLS funding from the FCC. Failure to meet the rate floor by the deadline will result in a reduction in HCLS funding that the carrier could have otherwise received for that year. ICC/USF Order at ¶¶ 133, 238-40. Therefore, Mountain requires an adjustment of its rates to comply with the 2014 Rate Floor Order, thereby maintaining eligibility for the fiscal year 2016 maximum amount of HCLS funding.

4. The requirements of 807 KAR 5:001, Section 16(1)(b)(2), are inapplicable because Mountain does not operate under an assumed name pursuant to KRS 365.015.

5. Pursuant to 807 KAR 5:001, Section 16(1)(b)(3), Mountain has attached its proposed tariff, in such form as is required by 807 KAR 5:011, as part of Exhibit 2. The proposed effective date of the proposed tariff is June 1, 2016, at least 30 days from the date the Application is filed.

6. Pursuant to 807 KAR 5:001, Section 16(1)(b)(4), Mountain has attached as part of Exhibit 2 its present tariff using italicizing, underscoring, and strikethroughs to show proposed revisions.

7. Pursuant to 807 KAR 5:001, Section 16(1)(b)(5), Mountain states that notice has been given in compliance with 807 KAR 5:001, Section 17, as described below:

a. Pursuant 807 KAR 5:001, Section 17(1), Mountain has posted at its place of business a copy of the Public Notice and will, within five days of the filing of the Application, post on its website a copy of the Public Notice and a hyperlink to the location on the Commission's website where the case documents are available. A copy of the Public Notice is attached hereto as part of Exhibit 3.

b. Pursuant to 807 KAR 5:001, Section 17(2), Mountain, which has more than twenty (20) customers and is not a sewage utility, has provided notice to its customers by including the notice with customer bills mailed no later than the date the Application is submitted to the Commission. A copy of the notice sent to customers is attached hereto as part of Exhibit 3.

c. Pursuant to 807 KAR 5:001, Section 17(3), an affidavit verifying Mountain's provision of the required notice to its customers is attached hereto as part of Exhibit 3.

d. Pursuant to 807 KAR 5:001, Section 17(4), Mountain states that the Public Notice attached to this Application as Exhibit 3 complies with all "Notice Content" requirements prescribed by regulation because it contains all of the following elements:

i. The proposed effective date and the date the proposed rates are expected to be filed with the Commission;

ii. The present rates and proposed rates for each customer classification to which the proposed rates will apply;

iii. The amount of the change requested in both dollar amounts and percentage change for each customer classification to which the proposed rates will apply;

iv. The effect upon the average bill for each customer classification for the proposed rate change in basic local service;

v. A statement that a person may examine this Application at Mountain's offices;

vi. A statement that a person may examine this Application at the Commission's offices located at 211 Sower Boulevard, Frankfort, Kentucky, Monday through Friday, 8:00 a.m. to 4:30 p.m., or through the Commission's Web site at http://psc.ky.gov;

vii. A statement that comments regarding the Application may be submitted to the Commission through its Web site or by mail to Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602;

viii. A statement that the rates contained in this notice are the rates proposed by Mountain but that the Commission may order rates to be charged that differ from the proposed rates contained in the notice;

ix. A statement that a person may submit a timely written request for intervention to the Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602, establishing the grounds for the request including the status and interest of the party; and

x. A statement that if the Commission does not receive a written request for intervention within thirty (30) days of initial publication or mailing of the notice, the Commission may take final action on the Application.

8. The requirements of 807 KAR 5:001, Section 16(1)(b)(6), are inapplicable because Mountain is not a water district.

9. Pursuant to 807 KAR 5:001, Section 16(2), Mountain states that it notified the Commission in writing of its intent to file the Application on January 15, 2016, at least thirty (30) days but not more than sixty (60) days prior to filing the Application. A copy of the notice of intent is included in Exhibit 4 of this Application. Pursuant to 807 KAR 5:001, Section 16(2)(a), the notice of intent stated that the Application will be supported by a historical test period. Pursuant to 807 KAR 5:001, Section 16(2)(c), Mountain sent by electronic mail a .pdf copy of the notice of intent to the Attorney General's Office of Rate Intervention (rateintervention@ag.ky.gov) upon filing it with the Commission. A copy of that email, including the attached notice of intent, is included as part of Exhibit 4 of this Application.

10. The provisions of 807 KAR 5:001, Section 16(3), are inapplicable because Mountain is not an electric utility.

11. Pursuant to 807 KAR 5:001, Section 16(4)(a), a narrative summary of the particular circumstances that justify and support Mountain's Application, including a statement of the reason the adjustment is required, is attached hereto as Exhibit 1 and is incorporated herein by reference. Exhibit 1 is filed subject to a Petition for Confidential Treatment pursuant to 807 KAR 5:001, Section 13, filed contemporaneously with this Application.

12. As more fully explained in Mountain's Motion for Waiver of Certain Rate Application Requirements ("Motion for Waiver") filed contemporaneously with this Application,

Mountain seeks waiver of 807 KAR 5:001, Section 16(4)(b), requiring the applicant's witnesses' prepared testimony.

13. The requirements of 807 KAR 5:001, Section 16(4)(c) are inapplicable because Mountain has gross annual revenues in excess of $5,000,000.00.

14. Pursuant to 807 KAR 5:001, Section 16(4)(d), Mountain estimates that the total amount of revenue increase resulting from the proposed rate adjustment will be approximately $198,000.00.

15. The requirements of 807 KAR 5:001, Section 16(4)(e), are inapplicable because Mountain is not an electric, gas, sewage, or water utility.

16. Pursuant to 807 KAR 5:001, Section 16(4)(f), Mountain states that the proposed rate adjustment will increase the average residential affected customer bill by $2.00 and the average business bill by $3.37. Additional details regarding the anticipated impact on affected customers are set forth in Exhibit 1.

17. Pursuant to 807 KAR 5:001, Section 16(4)(g), Mountain states that its proposed rate increase will affect both its Residential and Business customer classes. Mountain's analysis of customers' bills and the corresponding revenue impact are provided in Mountain's responses to the requirements of Section 16(4)(d) and 16(4)(f) in paragraphs 14 and 16 above.

18. Pursuant to 807 KAR 5:001, Section 16(4)(h), Mountain states that parts A and B of its 2014 RUS operating report, the most recently available to Mountain, containing its TIER calculation, which assesses Mountain's actual revenue position compared to its required operating revenues, are attached as Exhibit 5. To the extent the Commission believes this section imposes additional requirements relevant to this Application, Mountain respectfully

seeks waiver of those requirements for the reasons set forth in its accompanying Motion for Waiver.

19. As more fully explained in Mountain's Motion for Waiver, Mountain seeks waiver of 807 KAR 5:001, Section 16(4)(i), requiring a reconciliation of the rate base and capital used to determine revenue requirements.

20. Pursuant to 807 KAR 5:001, Section 16(4)(j), Mountain states that the current chart of accounts was provided in Case 2014-00309 and is unchanged.

21. Pursuant to 807 KAR 5:001, Section 16(4)(k), Mountain has attached its independent auditor's annual opinion report hereto as Exhibit 6. The other requirements of this section are inapplicable because Mountain's independent auditor has not indicated "the existence of a material weakness in [Mountain]'s internal controls."

22. The requirements in 807 KAR 5:001, Section 16(4)(l), are inapplicable because Mountain has not been audited by the FCC.

23. Pursuant to 807 KAR 5:001, Section 16(4)(m), Mountain states that its most recent PSC Form T is on file with the Commission.

24. Pursuant to 807 KAR 5:001, Section 16(4)(n), Mountain states a schedule identifying current depreciation rates used by major plant accounts was provided in Case 2014-00309 and is unchanged. To the extent the Commission believes this section requires more information than Mountain has provided, Mountain seeks waiver of 807 KAR 5:001, Section 16(4)(n) for the reasons set for in its Motion for Waiver.

25. Pursuant to 807 KAR 5:001, Section 16(4)(o), requiring a schedule of detailed information regarding all software, programs, and models used to prepare the Application,

Mountain states that it utilized no specialized software, program, or models, and relied on Microsoft Word and Microsoft Excel to prepare the Application and supporting exhibits.

26. The requirements of 807 KAR 5:001, Section 16(4)(p), are inapplicable because Mountain has never made a stock or bond offering.

27. As more fully explained in Mountain's Motion for Waiver, Mountain seeks waiver of 807 KAR 5:001, Section 16(4)(q), requiring the annual report to shareholders or members with statistical supplements. Mountain does not prepare such documents and instead presents its financial results to its members at its annual meeting.

28. As more fully explained in Mountain's Motion for Waiver, Mountain seeks waiver of 807 KAR 5:001, Section 16(4)(r), requiring monthly managerial reports.

29. The requirements of 807 KAR 5:001, Section 16(4)(s), are inapplicable because Mountain is not required to file the U.S. Securities and Exchange Commission's Form 10-K, Form 8-K, or Form 10-Q.

30. The requirements of 807 KAR 5:001, Section 16(4)(t), are inapplicable because Mountain has not had any amounts charged or allocated to it by an affiliate or general or home office, and has not paid any monies to an affiliate or a general or home office during the test period or during the previous three (3) calendar years.

31. The requirements of 807 KAR 5:001, Section 16(4)(u), are inapplicable because Mountain is not an electric, gas, sewage, or water utility.

32. The requirements of 807 KAR 5:001, Section 16(4)(v), are inapplicable because Mountain has fewer than 50,000 access lines.

33. The requirements of 807 KAR 5:001, Section 16(5), are inapplicable because Mountain's Application does not include any pro forma adjustments. To the extent the

Commission believes the requirements of this section apply to this Application, Mountain respectfully seeks waiver of those requirements for the reasons set forth in its accompanying Motion for Waiver.

34. The requirements of 807 KAR 5:001, Section 16(6), are inapplicable because Mountain is not requesting a general adjustment in rates supported by a fully forecasted test period.

35. The requirements of 807 KAR 5:001, Section 16(7), are inapplicable because Mountain is not requesting a general adjustment in rates supported by a fully forecasted test period.

36. The requirements of 807 KAR 5:001, Section 16(8), are inapplicable because Mountain is not requesting a general adjustment in rates supported by a fully forecasted test period.

37. Pursuant to ¶ 3.a of the 2013 Rate Floor Order, Mountain has provided an estimate of the annual revenue to be received in 2016 from HCLS in Exhibit 1, Attachment A.

38. Pursuant to ¶ 3.b of the 2013 Rate Floor Order, Mountain has provided an estimate of the annual revenue to be lost due to adjustment of terminating access rates in the "Financial Support for Filing" section of Exhibit 1.

39. Pursuant to ¶ 3.c of the 2013 Rate Floor Order, Mountain has provided an estimate of the annual revenue to be generated by the tariff changes in Exhibit 1 and in response to the requirements of 807 KAR 5:001, Section 16(4)(d), in paragraph 14 above.

40. Pursuant to ¶ 3.d of the 2013 Rate Floor Order, Mountain has provided an estimate of historical line counts in Exhibit 1, Attachment B. As more fully explained in

Mountain's Motion for Waiver, Mountain seeks partial waiver of ¶ 3.d of the 2013 Rate Floor Order, insofar as it requests projected line losses beyond those provided in Exhibit 1.

41. Pursuant to ¶ 3.e of the 2013 Rate Floor Order, Mountain has provided historical and projected universal service support information in the narrative response of Exhibit 1 and in Attachment A thereto. As is certified annually to the Commission, these funds are used by Mountain to provide voice and advanced data services to its customers, thereby providing its communities with access to critical communications and broadband services.

42. Pursuant to ¶ 3.f of the 2013 Rate Floor Order, Mountain states that narrative support for the proposed rate adjustment is contained in this Application and in Exhibit 1.

WHEREFORE, Mountain Rural Telephone Cooperative Corporation, Inc., respectfully requests that the Public Service Commission of the Commonwealth of Kentucky enter a final order approving Mountain's proposed revisions to the applicable tariffs and grant all other relief to which it is entitled.

Respectfully submitted,

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Counsel to Mountain Rural Telephone Cooperative Corporation, Inc.

CERTIFICATE OF SERVICE

I certify that, on the date this Application was filed with the Kentucky Public Service Commission, a true and accurate copy of the foregoing was served by Federal Express or by hand delivery upon the persons listed below.

Kentucky Attorney General
Office of Rate Intervention
700 Capitol Avenue, Suite 118
Frankfort, Kentucky 40601-3449

On this the 3rd day of March, 2016.

____
Counsel to Mountain Rural Telephone Cooperative Corporation, Inc.

10188956v1

Description and Reason for Filing

With this filing, Mountain Rural Telephone Cooperative Corporation, Inc. ("Mountain") proposes to increase its basic residential local service rates by $2.00, to $18.00 and its business rates by $3.37, from $17.63 to $21.00 per month. Mountain will offset those increases by expanding local calling for all of its subscribers to include twenty (20) rate centers in the ten (10) counties surrounding its service area. This filing is made in response to the November 18, 2011 order by the Federal Communications Commission that mandates minimum local residential service rate levels as a condition of continue receipt of certain federal universal service supports. In that Order[1] (the so-called "Transformation Order") the FCC required that local exchange rates be set at or above a rate floor of $10, as of June 1, 2012; $14 as of June 1, 2013; and at an "urban rate" – at that time undefined – on or before June 1, 2014 ("2014 rate floor".) The Transformation Order mandated that Companies with rate levels below the applicable rate floor be penalized with a dollar for dollar reduction in federal high cost loop support ("HCLS").

On March 20, 2014 the FCC released the results of its controversial urban rate floor survey[2] that established the 2014 rate floor of $20.46; if implemented, this floor would have become the basis on which HCLS recipients below the floor would be subject to the loss of funding as required by the FCC's Transformation Order. On June 20, 2014 the FCC issued an Order on Reconsideration[3] that modified the proposed 2014 urban rate floor to allow for a phase-in of the residential rate floor. Under its revised implementation schedule, companies were given the option to implement the rates over a 4-year period:

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[1] *In the Matter of Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov 18, 2011)
[2] *Wireline Competition Bureau Announces Results of Urban Rate Survey for Voice Services; Seeks Comment on Petition for Extension of Time to Comply with New Rate Floor*, Public Notice, DA 14-384, Released March 20, 2014
[3] Report and Order, Declaratory Ruling, Order, Memorandum Opinion And Order, Seventh Order On Reconsideration, and Further Notice of Proposed Rulemaking, FCC 14-54 (June 10, 2014)

> Therefore, we waive the application of section 54.318(b) for lines reported July 1, 2014, with a rate of $14 or above. Commencing January 2, 2015 (reflecting rates as of December 1, 2014), and thereafter, through June 30, 2016, we waive section 54.318(b) to the extent reported lines are greater than or equal to $16. For the period between July 1, 2016, and June 30, 2017, we waive section 54.318(b) to the extent reported rates are greater than or equal to $18, or the 2016 rate floor, whichever is lower. For the period between July 1, 2017, and June 30, 2018, we waive section 54.318(b) to the extent reported rates are greater than or equal to $20, or the 2017 rate floor, whichever is lower.[4]

Proposed Revisions and Customer Impact

With this filing, Mountain's basic residential rates are proposed to rise to $18.00. In its 2013 filing,[5] Mountain was forced to raise residential rates by $3.37, forecasting a revenue increase of $466K. In its 2014 filing[6] the company again raised its residential rates by $2 but offset the increase by including its $3.50 Caller ID service in its basic service rate and reducing by $3.50 packages and upgrades that included Caller ID functionality. As a result, the company's implementation of the 2014 rate floor resulted in an annualized net revenue *reduction* of $60K.

With this filing, Mountain proposes to increase its residential rates by $2, to $18. Because its business rates are currently $17.63, absent a change to those rates, Mountain's business subscribers will pay a lower rate for local service than that paid by its residential subscribers. Rather than introduce an inexplicable rate disparity, Mountain proposes to increase its business rates to $21, preserving the historic rate structure for all Mountain subscribers. Mountain believes this business rate increase is further warranted by its proposed expanded local calling area that the company expects will provide a significant benefit to its business subscribers.

[4] *Ibid.*, para. 80
[5] *Application of Mountain Rural Telephone Cooperative Corporation, Inc. For a General Adjustment in Rates*, Case 2013-00194, Exhibit 1
[6] *Application of Mountain Rural Telephone Cooperative Corporation, Inc. For a General Adjustment in Rates* Case 2014-00309, Exhibit 1

For all subscribers, Mountain again proposes to provide value-added benefits to all of its subscribers by increasing the number of exchanges included as extended area service ("EAS"). This will allow all Mountain's subscribers to enjoy a wider scope of local (i.e., toll-free) calling. With this filing, Mountain will expand local calling to the counties surrounding its service area that form its community of interest; local exchanges in Rowan, Carter, Johnson, Lawrence, Magoffin, Breathitt, Lee, Powell, Bath, and Montgomery counties will be incorporated in the company's EAS area. Depending on their individual communities of interest, Mountain expects that for many of its subscribers, particularly its business customers, the expanded local calling will mitigate the local rate increase and may actually offer savings through the elimination of toll charges.

By expanding its EAS, Mountain will forgo intrastate originating switched access fees previously billed to the interexchange carriers on these former toll routes. Mountain will use a contracted interexchange carrier as its underlying service provider to terminate the traffic to these exchanges. As shown in Attachment C of this Exhibit, Mountain estimates that the annual cost of this greatly expanded calling area will be approximately $98K per year for a net change of $198K. Even without these offsets, however, as shown in the financial support section of this Exhibit, the impact of the FCC's Transformation Order warrants the rate increase proposed in this filing.

Company information

The full name and address of the Company is Mountain Rural Telephone Cooperative Corporation, Inc., 425 Main Street, Suite A, P.O. Box 399, West Liberty, KY 41472-0399. Mountain was established in 1950 as a member-owned cooperative to provide local telephone service to business and individual members within the exchanges of Jeptha, Hazel Green, Campton, Ezel, Sandy Hook, West Liberty and Frenchburg in eastern Kentucky. Mountain is a rural incumbent local exchange carrier serving all or parts of Elliott, Morgan, Menifee, Bath, and Wolfe Counties. Mountain provides approximately 11,359 residential lines and 3,013 business lines to its members.

Mountain is an eligible telecommunications carrier ("ETC") in the communities it serves and is also the carrier of last resort ("COLR") in its service area. In 2015, Mountain received $3,768,252 from the High Cost Loop Support ("HCLS") Fund to support its COLR responsibilities in its service territory. As a high cost company, all HCLS revenues are crucial for Mountain to continue to meet its COLR responsibilities and to bring advanced services to the communities it serves.

A schedule of the Mountain's quarterly high cost support is provided in Attachment A of this exhibit. Historic access line counts as reported the National Exchange Carrier Association, are provided in Attachment B.

Financial Support for Filing

While Mountain proposes to offset its increase in local service rates with a substantial increase in its EAS calling scope, Mountain is doing so to minimize the impact on its members while meeting the FCC's rate floor. Were it not for the financial penalties imposed on companies that fail to meet the FCC residential rate floor, Mountain would not otherwise be making this adjustment.

Companies who fail to meet the 2016 rate floor will experience a dollar for dollar reduction in HCLS beginning in July, 2016. As shown below, Mountain is seeking to increase its basic rates by $2 (before offsets) and by doing so will retain approximately 5.7% of its total HCLS support, or $273K per year.

	Subscribers	Current Rate	FCC Floor	At Risk
Residential Estimate year end 2015	11,359	$ 16.00	$ 18.00	$ 272,616
Annual HCLS (using 2016 projections)				$4,808,406
Support at risk absent a rate increase				5.7%

Included in the FCC's Transformation Order is a requirement that carriers cap and reduce not only their reciprocal, state and interstate inter-carrier compensation rates but also the overall revenues Mountain is allowed to collect. Under the formula specified in the Transformation Order, the FCC capped terminating access revenues from intercarrier compensation at the levels collected in the FCC's 2011 initial base period[7] and established a phase-down of those allowed amounts over the subsequent 5 years. With this change, Mountain cannot collect more than its current capped revenue amount net 5% *each year*. As shown in the step-down of Eligible Access Recovery (as depicted in the following table), the cumulative FCC-mandated reduction in Mountain's access revenue recovery has been nearly a [redacted] loss in revenues through the current fiscal period.

	Access Cap	Reduction
FY2011 10/1-9/30	[redacted]	[redacted]
2012-2013 Fiscal Period	[redacted]	[redacted]
2013-2014 Fiscal Period	[redacted]	[redacted]
2014-2015 Fiscal Period	[redacted]	[redacted]
2015-2016 Fiscal Period	[redacted]	[redacted]
Cumulative Reduction		[redacted]

This is the third rate increase filed by Mountain to meet the FCC rate floor. Mountain previously met the 2013 rate floor by increasing its residential service rate by $3.37 to $14 on June 1, 2013. Its December 1, 2014 filing raised residential rates by $2 while offering a discount

[7] October 1, 2010 through September 30, 2011.

of $3.50 to its Caller ID subscribers. With this filing, Mountain seeks a residential and business rate increase of $2 and $3.47, respectively, but will dramatically increase the calling scope available to its members. Mountain estimates that its three filings in total, ignoring the access line loss and calling stimulation, have increased local revenues by $1.5M, which is less than the cumulative FCC-imposed reduction in access revenues.

Summary

The FCC's Transformation Order continues to dramatically change the revenue sources that have been historically available to rural telephone companies like Mountain and which have been used to meet their COLR obligation and to expand the availability of advanced broadband services to their customers. Unfortunately, for many of these affected companies, doing so requires upward pressure on local service rates. Mountain has attempted to offset this pressure by meeting the community of interest needs of its members. As shown in this documentation, Mountain has no other realistic options available to it, and it respectfully requests that its tariff revisions be approved.

Attachments to this Exhibit:

Attachment A: Company's quarterly high cost support 2015-2016

Attachment B: National Exchange Carrier Association Report of Access Lines

Attachment C: Rate Design Exhibit

Mountain Rural Telephone Cooperative **Exhibit 1, Attachment A**
Case 2016-00047

Report Cycle	State	SAC	Study Area Name	Connect America Fund ICC Monthly Support	HCL Monthly Support	ICLS Monthly Support	SNA Monthly Support	Total High Cost Monthly	HCL Quarterly Support
1Q15	KY	260414	MOUNTAIN RURAL COOP	$ 167,348	$ 268,921	$ 355,387	$ -	$ 791,656	$ 806,763
2Q15	KY	260414	MOUNTAIN RURAL COOP	$ 167,348	$ 305,915	$ 355,387	$ -	$ 828,650	$ 917,745
3Q15	KY	260414	MOUNTAIN RURAL COOP	$ 167,348	$ 340,624	$ 366,454	$ -	$ 874,426	$ 1,021,872
4Q15	KY	260414	MOUNTAIN RURAL COOP	$ 167,348	$ 340,624	$ 366,454	$ -	$ 874,426	$ 1,021,872
2015 Total High Cost Loop Support									$ 3,768,252

1Q16	KY	260414	MOUNTAIN RURAL COOP	$ 162,864	$ 402,495	$ 366,454	$ -	$ 931,813	$ 1,207,485
2Q16	KY	260414	MOUNTAIN RURAL COOP	$ 162,864	$ 398,906	$ 366,454	$ -	$ 928,224	$ 1,196,718
2016 Annualized Total High Cost Loop Support									$ 4,808,406

The Exhibit 1(B) attachment has been omitted from the public filing. It has been provided under a petition for confidential treatment

REDACTED

Mountain Rural Telephone Cooperative **Exhibit 1, Attachment C**
Case 2016-00047

Rate Design Analysis

	Current	**Proposed**	
Residential Lines	11,377	11,377	
Business Lines	2,997	2,997	
Residential Rate	$ 16.00	$ 18.00	
Business Rate - 1st	$ 17.63	$ 21.00	
Business Rate - add'l	$ 17.63	$ 21.00	
MRTC regulated charges			
Originating access	[redacted]		
Cost to terminate			
Aggregate Monthly losses / cost onsets			$ 8,172.92
Annualized			$ 98,075.07
Residential Revenues	$ 182,032.00	$ 204,786.00	
Business Revenues	$ 52,837.11	$ 62,937.00	
	$ 239,373.74	$ 264,054.70	
Aggregate Revenue Increase			$ 24,680.97
Annualized			$ 296,171.61
Net Impact - Annualized			$ 198,096.54

Mountain Rural Telephone Cooperative Corporation, Inc. **Exhibit 2**
Case 2016-00047

- Proposed Tariff Pages (Proposed)
- Proposed Tariff Pages (Proposed with Black Line)

Mountain Rural Telephone Cooperative Corporation, Inc. **Exhibit 2**
Case 2016-00047

Proposed Tariff Pages (To be Filed)

Mountain Rural Telephone Cooperative Corporation, Inc. **Exhibit 2**
Case 2016-00047

Proposed Tariff Pages (with Black Line)

CUSTOMER NOTICE AFFIDAVIT

AFFIDAVIT

I, Angie Pennington, am a representative of Mountain Rural Telephone Cooperative Corporation, Inc. and am authorized to make this statement on its behalf.

I attest that the customer notice accompanying this affidavit was sent to all customers as a bill insert on March 1, 2016, in accordance with Section 17(2) of 807 KAR 5:001. I declare under penalty of perjury that the foregoing is true and correct.

Signature: Angie Pennington

Subscribed and sworn to me before this 1st day of March, 2016.

Teresa Litteral
Notary Republic

My commission expires: 7-13-2017

On or around March 1st, Mountain Rural Telephone Coop. Corp, Inc. has or will file with the KY Public Service Commission a change in basic local service rates charged to its subscribers due to a Federal Communication Commission mandate. With this change, residential rates are proposed to increase from $16 to $18. Business rates will increase from $17.63 to $21. If approved by the PSC, the effective date of this rate change will be June 1, 2016. We anticipate the average *local service* bill increase will be 6.85% and 7.7% for residential and business subscribers, respectively. Because we are greatly expanding our free calling areas, for many of our members, there may be a rate reduction based on where they call.

With this change, calls to the ten counties adjacent to our service area will become local calls. You will enjoy free calling to Rowan, Carter, Johnson, Lawrence, Magoffin, Breathitt, Lee, Powell, Bath, and Montgomery Counties.

The need to modify basic service rates is mandated by recent changes enacted by the Federal Communications Commission which set minimal local service rate levels as a condition of continued receipt of federal high cost support that allows us to deploy fiber optic facilities and support advanced voice and broadband services. Because this support is vital to the economic health of our community, we have no choice but to request this rate modification.

You may examine this application at the offices of Mountain Rural Telephone Coop. Corp, Inc. located at 425 Main Street, Suite A West Liberty, KY 41472 during regular business hours or at the offices of the Kentucky Public Service Commission located at 211 Sower Boulevard, Frankfort, Kentucky, Monday through Friday, 8:00 a.m. to 4:30 p.m., or through the commission's Web site at http://psc.ky.gov.

Comments regarding the application may be submitted to the Public Service Commission through its Web site or by mail to Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602. Rates contained in this notice are the rates proposed by the Company but the Public Service Commission may order rates to be charged that differ from the proposed rates contained in this notice.

You may submit a timely written request for intervention to the Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602, establishing the grounds for the request including the status and interest of the party. If the Commission does not receive a written request for intervention within thirty (30) days of initial publication or mailing of this notice, the Commission may take final action on the application.

Mountain Telephone

Telephone: (606)743-3121
Facsimile: (606)743-3635
Post Office Box 399
West Liberty, Ky. 41472-0399

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard, P.O. Box 615
Frankfort, KY 40602-0615

January 12, 2016

Dear Mr. Derouen:

Mountain Rural Telephone Cooperative ("MRTC") gives this notice pursuant to 807 KAR 5:001 Section 16(2) of its intent to file no sooner than thirty (30) days from today, but not more than sixty (60) days from today, an application for a general adjustment in its rates. The general adjustment in rates will be supported by a twelve (12) month historical test period that may include adjustments for known and measurable changes.

The anticipated rate application is intended to meet the rate floor mandated in 47 CFR § 54.318, compliance with which is required to ensure that MRTC continues to receive high cost support that is essential to its operations. (See In the matter of Connect America Fund, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov. 18, 2011).)

The FCC's June 10, 2014 Order (See Report and Order, Declaratory Ruling, Order, Memorandum Opinion And Order, Seventh Order On Reconsideration, and Further Notice of Proposed Rulemaking, FCC 14-54) requires MRTC to have reported line rates greater than or equal to $18, commencing July 1, 2016 (reflecting rates in effect as of June 1, 2016)[1].

A copy of this notice is being emailed to the Attorney General's Office of Rate Intervention by electronic mail at rateintervention@ag.ky.gov.

Please refer any questions to me at 606-743-3121 or SIson@MountainTelephone.com.

Sincerely,

Shayne Ison

Shayne Ison, General Manager

Cc via email: Jim Stevens, KY PSC
Eileen Bodamer, Bodamer Consulting

[1] Paragraph 80.

Your Rural Cooperative

Eileen Bodamer

From:	Angela Pennington <apennington@mountaintelephone.com>
Sent:	Wednesday, January 13, 2016 8:47 AM
To:	rateintervention@ag.ky.gov; wjstevens@ky.gov; Eileen Bodamer
Cc:	'Shayne Ison'
Subject:	FW:
Attachments:	Scan0348.pdf

A letter stating our intent to meet the rate floor is attached. Please contact me with questions.

Angela Pennington
Office Manager
Mountain Telephone
Ph: 606.743.3121
Fax: 606.743.3635

USDA-RUS

This data will be used by RUS to review your financial situation. Your response is required by 7 U.S.C. 901 et seq. and, subject to federal laws and regulations regarding confidential information, will be treated as confidential.

OPERATING REPORT FOR TELECOMMUNICATIONS BORROWERS

BORROWER NAME: Mountain Rural Telephone Cooperative Corporation, Inc.

(Prepared with Audited Data)

INSTRUCTIONS-Submit report to RUS within 30 days after close of the period. For detailed instructions, see RUS Bulletin 1744-2. Report in whole dollars only.

PERIOD ENDING: December, 2014

BORROWER DESIGNATION: KY0506

CERTIFICATION

We hereby certify that the entries in this report are in accordance with the accounts and other records of the system and reflect the status of the system to the best of our knowledge and belief.

ALL INSURANCE REQUIRED BY 7 CFR PART 1788, CHAPTER XVII, RUS, WAS IN FORCE DURING THE REPORTING PERIOD AND RENEWALS HAVE BEEN OBTAINED FOR ALL POLICIES.

DURING THE PERIOD COVERED BY THIS REPORT PURSUANT TO PART 1788 OF 7CFR CHAPTER XVII
(Check one of the following)

[X] All of the obligations under the RUS loan documents have been fulfilled in all material respects

[ ] There has been a default in the fulfillment of the obligations under the RUS loan documents. Said default(s) is/are specifically described in the Telecom Operating Report

Ronnie Ison 3/31/2015
DATE

PART A. BALANCE SHEET

ASSETS	BALANCE PRIOR YEAR	BALANCE END OF PERIOD	LIABILITIES AND STOCKHOLDERS' EQUITY	BALANCE PRIOR YEAR	BALANCE END OF PERIOD
CURRENT ASSETS			**CURRENT LIABILITIES**		
1. Cash and Equivalents	23,630,502	30,464,561	25. Accounts Payable	1,865,164	674,137
2. Cash-RUS Construction Fund			26. Notes Payable		
3. Affiliates:			27. Advance Billings and Payments		
a. Telecom, Accounts Receivable	(86,948)	(104,017)	28. Customer Deposits	89,335	110,427
b. Other Accounts Receivable	4,727	262,127	29. Current Mat. L/T Debt	1,900,000	2,000,000
c. Notes Receivable			30. Current Mat. L/T Debt-Rur. Dev.		
4. Non-Affiliates:			31. Current Mat.-Capital Leases		
a. Telecom, Accounts Receivable			32. Income Taxes Accrued	758,015	757,016
b. Other Accounts Receivable	1,148,704	930,079	33. Other Taxes Accrued	145,308	174,821
c. Notes Receivable			34. Other Current Liabilities	1,778,420	1,785,585
5. Interest and Dividends Receivable			**35. Total Current Liabilities (25 thru 34)**	6,536,242	5,501,986
6. Material-Regulated	1,680,399	902,032	**LONG-TERM DEBT**		
7. Material-Nonregulated			36. Funded Debt-RUS Notes	31,985,253	34,544,805
8. Prepayments	26,275	1,930	37. Funded Debt-RTB Notes		
9. Other Current Assets			38. Funded Debt-FFB Notes		
10. Total Current Assets (1 Thru 9)	26,403,659	32,456,712	39. Funded Debt-Other		
NONCURRENT ASSETS			40. Funded Debt-Rural Develop. Loan		
11. Investment in Affiliated Companies			41. Premium (Discount) on L/T Debt		
a. Rural Development			42. Reacquired Debt		
b. Nonrural Development	24,706,120	23,911,312	43. Obligations Under Capital Lease		
12. Other Investments			44. Adv. From Affiliated Companies		
a. Rural Development			45. Other Long-Term Debt		
b. Nonrural Development	309,143	385,822	**46. Total Long-Term Debt (36 thru 45)**	31,985,253	34,544,805
13. Nonregulated Investments	2,452,339	2,628,860	**OTHER LIAB. & DEF. CREDITS**		
14. Other Noncurrent Assets			47. Other Long-Term Liabilities	(4,369,618)	(4,260,815)
15. Deferred Charges			48. Other Deferred Credits		
16. Jurisdictional Differences			49. Other Jurisdictional Differences		
17. Total Noncurrent Assets (11 thru 16)	27,467,602	26,925,994	50. Total Other Liabilities and Deferred Credits (47 thru 49)	(4,369,618)	(4,260,815)
PLANT, PROPERTY, AND EQUIPMENT			**EQUITY**		
18. Telecom, Plant-in-Service	92,304,147	112,589,933	51. Cap. Stock Outstand. & Subscribed		
19. Property Held for Future Use			52. Additional Paid-in-Capital		
20. Plant Under Construction	26,968,950	10,702,572	53. Treasury Stock		
21. Plant Adj., Nonop. Plant & Goodwill			54. Membership and Cap. Certificates	130,790	129,527
22. Less Accumulated Depreciation	48,696,467	54,735,328	55. Other Capital	1,322,439	1,322,439
23. Net Plant (18 thru 21 less 22)	70,576,630	68,557,177	56. Patronage Capital Credits	50,747,954	56,094,242
24. TOTAL ASSETS (10+17+23)			57. Retained Earnings or Margins	38,094,831	34,607,699
			58. Total Equity (51 thru 57)	90,296,014	92,153,907
	124,447,891	127,939,883	**59. TOTAL LIABILITIES AND EQUITY (35+46+50+58)**	124,447,891	127,939,883

Total Equity = 72.03% % of Total Assets

USDA-RUS	BORROWER DESIGNATION
OPERATING REPORT FOR TELECOMMUNICATIONS BORROWERS	KY0506
	PERIOD ENDING
INSTRUCTIONS- See RUS Bulletin 1744-2	December, 2014

PART B. STATEMENTS OF INCOME AND RETAINED EARNINGS OR MARGINS

ITEM	PRIOR YEAR	THIS YEAR
1. Local Network Services Revenues	4,290,003	4,651,498
2. Network Access Services Revenues	14,796,449	12,146,608
3. Long Distance Network Services Revenues	49,748	37,434
4. Carrier Billing and Collection Revenues	244,103	1,377,405
5. Miscellaneous Revenues	483,654	565,509
6. Uncollectible Revenues	8,313	8,186
7. Net Operating Revenues (1 thru 5 less 6)	19,855,644	18,770,268
8. Plant Specific Operations Expense	3,136,955	3,447,282
9. Plant Nonspecific Operations Expense (Excluding Depreciation & Amortization)	1,161,408	1,333,509
10. Depreciation Expense	5,564,561	6,471,598
11. Amortization Expense		
12. Customer Operations Expense	1,275,094	1,302,825
13. Corporate Operations Expense	2,054,950	1,946,874
14. Total Operating Expenses (8 thru 13)	13,192,968	14,502,088
15. Operating Income or Margins (7 less 14)	6,662,676	4,268,180
16. Other Operating Income and Expenses		
17. State and Local Taxes	1,256,210	1,294,224
18. Federal Income Taxes		
19. Other Taxes		
20. Total Operating Taxes (17+18+19)	1,256,210	1,294,224
21. Net Operating Income or Margins (15+16-20)	5,406,466	2,973,956
22. Interest on Funded Debt	1,077,992	1,188,510
23. Interest Expense - Capital Leases		
24. Other Interest Expense	170	134
25. Allowance for Funds Used During Construction		
26. Total Fixed Charges (22+23+24-25)	1,078,162	1,188,644
27. Nonoperating Net Income	2,419,671	(493,140)
28. Extraordinary Items		
29. Jurisdictional Differences		
30. Nonregulated Net Income	1,910,728	1,666,818
31. Total Net Income or Margins (21+27+28+29+30-26)	8,658,703	2,958,990
32. Total Taxes Based on Income		
33. Retained Earnings or Margins Beginning-of-Year	29,572,268	38,094,831
34. Miscellaneous Credits Year-to-Date		
35. Dividends Declared (Common)		
36. Dividends Declared (Preferred)		
37. Other Debits Year-to-Date		
38. Transfers to Patronage Capital	136,140	6,446,122
39. Retained Earnings or Margins End-of-Period [(31+33+34) - (35+36+37+38)]	38,094,831	34,607,699
40. Patronage Capital Beginning-of-Year	51,228,142	50,747,954
41. Transfers to Patronage Capital	136,140	6,446,122
42. Patronage Capital Credits Retired	616,328	1,099,834
43. Patronage Capital End-of-Year (40+41-42)	50,747,954	56,094,242
44. Annual Debt Service Payments	3,055,381	2,994,696
45. Cash Ratio [(14+20-10-11) / 7]	0.4475	0.4968
46. Operating Accrual Ratio [(14+20+26) / 7]	0.7820	0.9049
47. TIER [(31+26) / 26]	9.0310	3.4894
48. DSCR [(31+26+10+11) / 44]	5.0080	3.5460

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

Independent Auditor's Report

To the Board of Directors
Mountain Rural Telephone Cooperative

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audits. I did not audit the financial statements of East Kentucky Network, LLC. As discussed in Note 2, these financial statements account for an investment in East Kentucky Network, LLC under the equity method. The investment was $20,864,241 and $20,428,451 at December 31, 2014 and 2013 respectively, and the equity in its net margins was $1,447,353 and $2,119,214 for the years then ended. The financial statements of East Kentucky Network, LLC were audited by other auditors, whose report has been furnished to me, and my opinion, insofar as it relates to amounts for East Kentucky Network, LLC is based solely on the report of the other auditors. I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

To the Board of Directors
Mountain Rural Telephone Cooperative – 2

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

Opinion

In my opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mountain Rural Telephone Cooperative and Subsidiary as of December 31, 2014 and 2013, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplemental Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued a report dated February 27, 2015, on my consideration of Mountain Rural Telephone Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 27, 2015

Kentucky 506

Mountain Rural Telephone Cooperative and Subsidiary

West Liberty, Kentucky

Audited Financial Statements
December 31, 2014 and 2013

Alan M. Zumstein
Certified Public Accountant
1032 Chetford Drive
Lexington, Kentucky 40509

CONTENTS

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CERTIFIED PUBLIC ACCOUNTANT

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To the Board of Directors
Mountain Rural Telephone Cooperative – 2

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

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Alan M. Zumstein

Alan M. Zumstein, CPA
February 27, 2015

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

Assets	2014	2013
Current Assets:		
Cash and cash equivalents	$ 23,270,865	$ 16,468,290
Accounts receivable, less allowance for 2014 of $87,943 and 2013 of $98,564	826,062	1,061,756
Materials and supplies, at average cost	902,033	1,680,399
Prepaid insurance	1,930	26,275
	25,000,890	19,236,720
Other Assets:		
Marketable securities	10,500,000	10,500,000
Associated organizations	20,864,241	20,428,447
Nonregulated property	3,014,683	2,761,482
	34,378,924	33,689,929
Telecommunications Plant, at original cost:		
In service	112,592,933	93,034,397
Under construction	10,702,572	26,968,950
	123,295,505	120,003,347
Less accumulated depreciation	54,735,436	48,479,734
	68,560,069	71,523,613
Total	$ 127,939,883	$ 124,450,262
Liabilities and Members' Equities		
Current Liabilities:		
Accounts payable	$ 674,136	$ 1,865,164
Current portion of long term debt	2,000,000	1,900,000
Customer deposits	110,427	89,335
Other current and accrued liabilities	2,717,422	2,684,114
	5,501,985	6,538,613
Long Term Debt	34,544,805	31,985,253
Accrued Postretirement Benefits	185,353	297,408
Members' Equities:		
Memberships and capital investment	129,527	130,790
Patronage capital	90,701,940	88,842,785
Donated capital	1,322,439	1,322,439
Accumulated other comprehensive income	(4,446,166)	(4,667,026)
	87,707,740	85,628,988
Total	$ 127,939,883	$ 124,450,262

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

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

	2014	2013
Operating Revenue:		
Local network services	$ 4,651,498	$ 4,290,003
Network access services	12,184,043	14,846,198
Carrier billing and collection	1,377,404	244,103
Basic cable revenues	64,416	156,654
Miscellaneous	565,510	483,653
Less provision for uncollectibles	(8,187)	(8,313)
	18,834,684	20,012,298
Operating Expenses:		
Plant specific operations	3,581,953	3,302,040
Plant nonspecific operations	1,333,509	1,167,370
Depreciation	6,471,598	5,606,937
Customer operations	1,318,860	1,300,042
Corporate operations	1,960,054	2,077,065
Other deductions	181,835	173,239
Taxes, other than income	1,308,586	1,274,527
	16,156,395	14,901,220
Operating margins	2,678,289	5,111,078
Nonoperating Margins		
Other income, principally interest	725,907	811,157
Income (loss) from limited liability companies	1,447,353	1,959,802
Non regulated net income	159,085	1,696,598
	2,332,345	4,467,557
Margins available for fixed charges	5,010,634	9,578,635
Fixed Charges:		
Interest on long-term debt	1,188,510	1,077,992
Provision for income taxes	863,134	(158,060)
Net margins	2,958,990	8,658,703
Items of comprehensive income:		
Accumulated postretirement benefits	220,860	220,860
Comprehensive Income	$ 3,179,850	$ 8,879,563

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

Statements of Changes in Members' Equity
for the years ended December 31, 2013 and 2014

	Memberships	Patronage Capital	Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 134,127	$ 80,800,410	$ 1,322,439	$ (4,887,886)	$ 77,369,090
Comprehensive income:					
Net margins		8,658,703			8,658,703
Postretirement benefit obligation					
Amortization				220,860	
Adjustments				-	220,860
Total comprehensive income					8,879,563
Refunds of capital credits		(616,328)			(616,328)
Memberships issued, net	(3,337)				(3,337)
Other equities			-		-
Balance-December 31, 2013	130,790	88,842,785	1,322,439	(4,667,026)	85,628,988
Comprehensive income:					
Net margins		2,958,990			2,958,990
Postretirement benefit obligation					
Amortization				220,860	
Adjustments				-	220,860
Total comprehensive income					3,179,850
Refunds of capital credits		(1,099,835)			(1,099,835)
Memberships issued, net	(1,263)				(1,263)
Other equities			-		-
Balance-December 31, 2014	$ 129,527	$ 90,701,940	$ 1,322,439	$ (4,446,166)	$ 87,707,740

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

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

	2014	2013
Cash Flows from Operating Activities:		
Net margins	$ 2,958,990	$ 8,658,703
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation	6,471,598	5,606,937
Net loss (profit) in limited liability companies	(1,447,353)	(1,959,802)
Accumulated postretirement benefits	108,805	115,372
Net change in current assets and liabilities:		
Receivables	(116,076)	650,746
Material and supplies	778,366	648,483
Prepayments	24,345	16,761
Payables	(839,258)	1,176,173
Advance billings	21,092	19
Accrued expenses	33,308	162,144
	7,993,817	15,075,536
Cash Flows from Investing Activities:		
Construction of plant	(4,382,508)	(8,029,531)
Salvage, net of removals	(393,182)	(103,362)
Marketable securities	-	(4,990,963)
Associated organizations	1,011,559	1,231,440
Nonregulated property	1,014,435	(379,952)
	(2,749,696)	(12,272,368)
Cash Flows from Financing Activities:		
Advances of long term debt	4,520,728	10,038,322
Payments on long term debt	(1,861,176)	(2,023,579)
Fund postretirement benefits	-	-
Memberships and capital investments	(1,263)	(3,337)
Retirements of capital credits	(1,099,835)	(616,328)
Increase in donated capital	-	-
	1,558,454	7,395,078
Net increase in cash balances	6,802,575	10,198,246
Cash and cash equivalents - beginning of period	16,468,290	6,270,044
Cash and cash equivalents - end of period	$ 23,270,865	$ 16,468,290
Supplemental disclosures of cash flows information:		
Interest on long-term debt	$ 1,187,564	$ 1,082,444
Income taxes paid	863,134	(158,060)

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

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

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

Principles of Consolidation The consolidated financial statements include the accounts of the Cooperative and its wholly-owned subsidiary, Mountain Telecommunications, Inc. (Mountain Telecommunications). All significant inter-company accounts and transactions have been eliminated. During 2010 Mountain Telecommunications purchased the assets of the cable television company that operated in parts of the same service territory as the Cooperative.

Nature of Business The Cooperative has substantially completed construction to launch an expanded services network. This network will establish the Cooperative as a full service network (FSN) provider allowing it to provide expanded video services with over 200 channels, high definition television and Video on Demand. It will also be able to provide high speed internet and virtual private networks. It will be able to provide voice on internet protocol (VoIP) in the future. This is accomplished through Fiber to the Home (FTTH) technology.

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

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

Telecommunications Revenue Recognition Revenues are recognized when earned regardless of the period in which they are billed. Bills are sent to customers on credit the first of each month with local service being billed a month in advance of service. Sales are concentrated in a portion of five (5) southeastern Kentucky counties. Payments are due 10 days from the date of billing. If payment has not been made, then customers are subject to disconnect on the 21st day of the month. The allowance for uncollectible accounts is based on the aging of accounts receivable. Accounts are written off when they are deemed to be uncollectible. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2014 or 2013. The number of access lines was 14,345 at 2014 and 14,539 at 2013.

Interstate revenues are recognized on the cost basis recovery method. Compensation for intrastate/interlata service is received through tariffed access charges as filed with the FCC. These access charges are billed to the interlata long distance carrier and retained by the Cooperative.

CATV/Video Revenue Recognition CATV/video revenue is recognized when earned regardless of the period in which they are billed. Cable transmission is purchased from networks at various amounts based on the number of customers receiving the service. Mountain Telecommunications' sales are concentrated in four (4) southeastern Kentucky counties. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2014 and 2013. All customers were connected through FTTH and became customers of Mountain Telephone during 2014.

Taxes The Cooperative's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Note 1. Summary of Significant Accounting Policies, continued

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

> Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities
>
> Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.
>
> Level 3: Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

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

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

The company invests idle funds with local banks in money markets, certificates of deposits, and U.S. Treasury Notes. The inputs used to measure idle funds are Level 1 measurements, as these funds are exchange traded funds in an active market.

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

Advertising Advertising costs are expensed as incurred.

Telecommunications and CATV Plant Telecommunications and CATV plant are stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. Interest capitalized during the year was $433,435 for 2014 and $554,229 for 2013. All CATV plant was removed from service during 2014.

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

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

The major classification of plant in service is:

	2014	2013
Telecommunications Plant:		
General support	$9,638,025	$9,427,527
Central office switching	1,346,068	1,346,213
Central office transmission	21,353,869	17,077,547
Cable and wire facilities	80,249,537	64,450,426
Intangibles	2,434	2,434
	112,589,933	92,304,147
CATV Plant:		
General support	3,000	3,000
Distribution plant	-	622,750
Intangibles	-	104,500
	3,000	730,250
Total	$112,592,933	$93,034,397

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

	Telephone	Telecom
General support	2.7%-15.8%	20.0%
Central office switching	7.5%	
Central office transmission	10.0%	
Cable and wire facilities	5.1%-9.4%	6.67%-10.0%

Income Taxes The Cooperative is exempt from federal and state income taxes under IRS Code Section 501(c)(12). Certain unrelated business activities are subject to federal income taxes. Mountain Telecommunications is a "C" corporation that pays income taxes on its net income.

The Cooperative's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes the Cooperative has no uncertain tax positions resulting in an accrual of tax expense or benefit. The Cooperative recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Cooperative did not recognize any interest or penalties during the years ended December 31, 2014 and 2013. The Cooperative's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

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

Risk Management The Cooperative is exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Note 1. Summary of Significant Accounting Policies, continued

Subsequent Events Management has evaluated subsequent events through February 27, 2015, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments

The amounts for East Kentucky Network, LLC ("EKN") represents Mountain Telecommunications' investment in a limited liability corporation with other telephone companies in eastern Kentucky for the purpose of providing cellular telephone, paging, and other services. The investment is accounted for using the equity method since Mountain Telecommunications is a one-fifth owner. EKN has been paying 50% of the income allocated in cash during the following year.

Note 3. Non Regulated Activities

Deregulated customer premises equipment is stated at cost; material held for lease or resale is stated at average cost. CPE also includes inside wire revenues and expenses. Depreciation is provided on a straight-line basis at 11.9% per year.

The Cooperative provides long distance telephone service under the name of Mountain Telephone Long Distance ("MTLD"). MTLD revenues are billed and collected through the Cooperative. A monthly fee is recorded based on telephone usage. MTLD purchases minutes of long distance to resell to its customers from an unrelated party.

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

The following is a summary of non regulated activities:

	Income	Expenses	Net
Customer premises equipment	$727,628	$1,628,380	($900,752)
Internet activities	3,008,213	1,142,566	1,865,647
Long distance services	855,352	345,704	509,648
Video services	1,035,847	1,083,671	(47,824)
Total - 2014	$5,627,040	$4,200,321	$1,426,719

	Income	Expenses	Net
Customer premises equipment	$940,963	$1,797,756	($856,793)
Internet activities	3,097,436	956,847	2,140,589
Long distance services	835,618	395,434	440,184
Video services	817,469	844,851	(27,382)
Total - 2013	$5,691,486	$3,994,888	$1,696,598

Notes to Financial Statements

Note 4. Long Term Debt

All telecommunications assets, except motor vehicles, are pledged as collateral on the long term debt due RUS and Rural Telephone Bank (RTB). Long term debt is as follows:

	2014	2013
RUS loans:		
4.1715% and 5%	$2,087,007	$2,623,451
Advance payments	(1,098,153)	(1,044,919)
	988,854	1,578,532
RUS Broadband Loan 2.27%-4.45%	35,555,951	32,306,721
	36,544,805	33,885,253
Less current portion	2,000,000	1,900,000
Long term portion	$34,544,805	$31,985,253

The long term debt payable to RUS and RTB is due in monthly and quarterly installments of various amounts through 2043. The Cooperative has loan funds available from RUS in the amount of $7,183,874 for telecommunications plant and $1,384,615 for broadband activities at December 31, 2014. These funds will be used for the FSN project as described earlier.

Principal payments for the next five years are as follows: 2015 - $2,000,000; 2016 - $2,200,000; 2017 - $2,200,000; 2018 - $2,250,000; 2019 - $2,100,000.

Note 5. Patronage Capital

The long term debt agreement contains restrictions on the return to patrons of capital contributed by them. The restrictions relate in general to the Cooperative's net worth and assets, as defined. The net worth of the Cooperative at December 31, 2014, was 71%.

Patronage capital consisted of:

	2014	2013
Assigned	$89,327,364	$85,313,775
Assignable	2,958,990	8,658,703
Unassigned	31,648,710	27,003,596
Retirements to date	(33,233,124)	(32,133,289)
Total	$90,701,940	$88,842,785

Note 6. Pension Plan

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

Note 6. Pension Plan, continued

The Corporation's contributions to the R&S Plan in 2014 and 2013 represent less than 5 percent of the total contributions made to the plan by all participating employers. The Corporation made contributions to the plan of $400,585 in 2014 and $405,722 in 2013. There have been no significant changes that affect the comparability of 2014 and 2013.

In the R&S Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act ("PPA") of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the R&S Plan was between 65 percent and 80 percent funded at January 1, 2014 and 2013 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

Note 7. Accumulated Postretirement Benefits

The Cooperative sponsors a defined benefit plan that provides medical insurance coverage to retirees and their dependents. Participating retirees and dependents do not contribute to the projected cost of coverage. Employees qualify with a minimum age of 55 and meeting the Rule of 85.

The funded status of the plan was as follows:

	2014	2013
Projected benefit obligation	($14,272,570)	($13,355,105)
Plan assets at fair value	14,087,217	13,057,697
Funded status	($185,353)	($297,408)

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

	2014	2013
Benefit obligation at beginning of year	$297,408	$402,896
Components of net periodic benefit cost:		
Service cost	130,107	130,584
Interest cost	690,692	644,819
Expected return on assets	(486,959)	(441,563)
Net periodic benefit cost	333,840	333,840
Benefits paid	(445,895)	(439,328)
Contributions to plan	-	-
Adjust comprehensive income	-	-
Benefit obligation at end of year	$185,353	$297,408

For measurement purposes, a 8% annual rate of increase, decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefits was assumed. The discount rate used in determining the accumulated benefit obligation was 5.0% for 2014 and 2013.

The projected retiree benefit payments are expected to be as follows: 2015 - $450,000; 2016 - $448,000; 2017 – $427,000; 2018 - $417,000; 2019 - $367,000.

Note 8. Significant Event

The Cooperative was awarded a Broadband Initiatives Program ("BIP") Grant from the United States of America through the Department of Agriculture, Rural Utilities Service ("RUS"). The project would provide broadband internet service to the counties served in southeastern Kentucky. The total project cost is \$78,124,579, of which \$38,281,044 is in the form of a grant. The remaining funds must be secured with RUS debt. The Cooperative started the project during June 2010. The Grant initially required that the project be completed within three (3) years from the date of the Grant, however, RUS has granted an extension on the project until September 30, 2015. The project is substantially complete as of December 31, 2014.

Note 9. Commitments

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

Note 10. Contingencies

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

* * * * * *

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

Assets	Telephone	Telecom	Eliminations	Consolidated
Current Assets:				
Cash and cash equivalents	$ 19,964,560	$ 3,306,305		$ 23,270,865
Accounts receivable, less allowance for Telephone of $87,943	1,088,189		(262,127)	826,062
Material and supplies, at average cost	902,033			902,033
Prepayments	1,930			1,930
	21,956,712	3,306,305	(262,127)	25,000,890
Other Assets:				
Marketable securities	10,500,000			10,500,000
Associated organizations	23,911,312	20,864,241	(23,911,312)	20,864,241
Nonregulated and others	3,014,683			3,014,683
	37,425,995	20,864,241	(23,911,312)	34,378,924
Utility Plant, at original cost:				
In service	112,589,933	3,000		112,592,933
Under construction	10,702,572			10,702,572
	123,292,505	3,000		123,295,505
Less accumulated depreciation	54,735,328	108		54,735,436
	68,557,177	2,892		68,560,069
Total	$127,939,884	$24,173,438	($24,173,439)	$127,939,883
Member's Equities and Liabilities				
Current Liabilities:				
Accounts payable	$ 674,137	$ 262,126	$ (262,127)	$ 674,136
Current portion of long term debt	2,000,000			2,000,000
Customer deposits	110,427			110,427
Accrued expenses	2,717,422			2,717,422
	5,501,986	262,126	(262,127)	5,501,985
Long Term Debt	34,544,805			34,544,805
Accumulated Postretirement Benefits	185,353			185,353
Members' Equities:				
Memberships and capital investments	129,527	4,780,000	(4,780,000)	129,527
Patronage capital and retained earnings	90,701,940	19,131,312	(19,131,312)	90,701,940
Donated capital	1,322,439			1,322,439
Accumulated comprehensive income	(4,446,166)			(4,446,166)
	87,707,740	23,911,312	(23,911,312)	87,707,740
Total	$127,939,884	$24,173,438	($24,173,439)	$127,939,883

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

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

	Telephone	Telecom	Eliminations	Consolidated
Operating Revenues:				
Local network services	$ 4,651,498			$ 4,651,498
Network access services	12,184,043			12,184,043
Carrier billing and collection	1,377,404			1,377,404
Cable revenues		64,416		64,416
Miscellaneous	565,510			565,510
Less provision for uncollectibles	(8,187)			(8,187)
	18,770,268	64,416		18,834,684
Operating Expenses:				
Plant specific operations	3,447,282	134,671		3,581,953
Plant non specific operations	1,333,509	-		1,333,509
Depreciation	6,471,598	-		6,471,598
Customer operations	1,302,825	16,035		1,318,860
Corporate operations	1,946,874	13,180		1,960,054
Other deductions	181,835			181,835
Taxes, other than income	1,294,224	14,362		1,308,586
	15,978,147	178,248		16,156,395
	2,792,121	(113,832)		2,678,289
Nonoperating Margins:				
Other income, principally interest	723,468	2,439		725,907
Income in limited liability companies	(794,808)	1,447,353	794,808	1,447,353
Nonregulated net income and other	1,426,719	(1,267,634)		159,085
	1,355,379	182,158	794,808	2,332,345
Margins available for interest charges	4,147,500	68,326	794,808	5,010,634
Interest Charges:				
Long term debt	1,188,510			1,188,510
Provision for income taxes		863,134		863,134
Net Margins	2,958,990	(794,808)	794,808	2,958,990
Items of comprehensive income:				
Accumulated postretirement benefits	220,860			220,860
Net Comprehensive Income	$3,179,850	($794,808)	$794,808	$3,179,850

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

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

To the Board of Directors
Mountain Rural Telephone Cooperative

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Mountain Rural Telephone Cooperative, which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated February 27, 2015. My report includes a reference to other auditors who audited the financial statements of East Kentucky Network, LLC, as described in my report on Mountain Rural Telephone's financial statements. This report does not include the results of the other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

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

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

To the Board of Directors
Mountain Rural Telephone Cooperative - 2

Compliance and Other Matters

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

Purpose of this Report

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

Alan M. Zumstein

Alan M. Zumstein, CPA
February 27, 2015

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

Board of Directors
Mountain Rural Telephone Cooperative

Independent Auditor's Report

I have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Mountain Rural Telephone Cooperative ("the Cooperative"), which comprise the balance sheet as of December 31, 2014, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated February 27, 2015. In accordance with *Government Auditing Standards*, we have also issued my report dated February 27, 2015, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above related to my audit have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2015, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;

Board of Directors
Mountain Rural Telephone Cooperative - 2

- 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 material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written approval of the RUS to enter into any contract, agreement, or lease with an affiliate as defined in Part 1773 (e)(2)(i);
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles, and;
- Comply with the requirements for the detailed schedule of investments, which are listed below.

Mountain Telephone formed a wholly-owned subsidiary, Mountain Telecommunications, Inc., which provides cable television services in Mountain Telephone's service territory and also is a one-fifth (1/5) owner of a limited liability company that provides cellular and other communications services. The initial investment was $830,000. The investment is comprised of the following:

	Investment	Profits
Beginning of year	$4,780,000	$19,926,121
Activity for 2014	-	(794,808)
End of year	$4,780,000	$19,131,313

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

Alan Zumstein
Alan M. Zumstein, CPA
February 27, 2015