

1a

RECEIVED

FEB 14 2013

PUBLIC SERVICE
COMMISSION

SOUTH CENTRAL RURAL TELEPHONE
COOPERATIVE CORPORATION, INC.

Report on Audit of Financial Statements
and Supplemental Data

For the Years Ended
June 30, 2012 and 2011

CONTENTS

	<u>Pages</u>
Independent Auditors' Report	1-2
Financial Statements:	
Balance Sheets	3-4
Statements of Revenue	5
Statements of Patronage Capital and Other Equities	6
Statements of Cash Flows	7-8
Notes to Financial Statements	9-15
Supplemental Data:	
Statistical and Analytical Information	16-17
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	18-19

CAMPBELL, MYERS, & RUTLEDGE, PLLC

Certified Public Accountants

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

Skip R. Campbell, CPA
Sammie D. Parsley, CPA
Ryan A. Mosier, CPA
Jenna B. Pace, CPA

416 South Broadway
Glasgow, KY 42141
Telephone (270) 651-2165
Fax (270) 651-6677
www.cmr-cpa.com

Independent Auditors' Report

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

We have audited the accompanying balance sheets of South Central Rural Telephone Cooperative Corporation, Inc., as of June 30, 2012 and 2011, and the related statements of revenue, patronage capital and other equities, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 audit contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of South Central Rural Telephone Cooperative Corporation, Inc., as of June 30, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2012, on our consideration of South Central Rural Telephone Cooperative Corporation, Inc.'s 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 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* and should be considered in assessing the result of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplemental data, on pages 16 and 17, is presented for purposes of additional analysis and is not a required part of the financial statements. The supplemental data is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 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 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 basic financial statements taken as a whole.

Campbell, Myers & Rutledge, PLLC

Certified Public Accountants
September 26, 2012

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC
BALANCE SHEETS
June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	\$ 5,740,263	\$ 8,084,714
Temporary cash investments	1,700,000	1,700,000
Accounts and notes receivable, less allowance for doubtful accounts of \$21,330 in 2012 and \$13,144 in 2011	2,937,226	1,421,399
Materials and supplies at average cost	3,119,016	3,416,119
Accrued interest receivable	4,859	4,859
Prepaid expenses	<u>1,266,375</u>	<u>1,148,574</u>
Total current assets	<u>14,767,739</u>	<u>15,775,665</u>
Other assets:		
Marketable securities	30,185,026	23,985,084
Nonregulated investments	4,104,018	5,142,931
Investment in affiliated companies	70,082,534	62,560,259
Other deferred charges	<u>191,784</u>	<u>166,191</u>
Total other assets	<u>104,563,362</u>	<u>91,854,465</u>
Telephone plant, at cost (substantially all pledged as collateral on long- term debt to RUS):		
Telephone plant in service	165,037,295	159,052,610
Telephone plant under construction (estimated cost to complete \$0 in 2012 and \$0 in 2011)	<u>4,745,702</u>	<u>3,793,462</u>
Total	169,782,997	162,846,072
Less accumulated depreciation	<u>125,805,964</u>	<u>116,510,825</u>
Telephone plant, net	<u>43,977,033</u>	<u>46,335,247</u>
	<u>\$ 163,308,134</u>	<u>\$ 153,965,377</u>

	<u>2012</u>	<u>2011</u>
Current liabilities:		
Current portion of long-term debt	\$ 2,868,156	\$ 2,962,912
Accounts payable	3,026,643	3,131,584
Accrued expenses	<u>2,727,109</u>	<u>2,708,313</u>
Total current liabilities	<u>8,621,908</u>	<u>8,802,809</u>
Long-term liabilities:		
Long-term obligation to RUS and RTB	406,575	2,849,757
Other long-term liabilities	<u>2,835,595</u>	<u>2,746,226</u>
Total long-term liabilities	<u>3,242,170</u>	<u>5,595,983</u>
Other Liabilities		
Deferred taxes	<u>14,260,312</u>	<u>9,756,193</u>
Total other liabilities	<u>14,260,312</u>	<u>9,756,193</u>
Commitments		
Members' equities:		
Patronage capital	65,194,280	67,228,315
Other equities	70,673,876	61,101,007
Other member capital	<u>1,315,588</u>	<u>1,481,070</u>
Total members' equities	<u>137,183,744</u>	<u>129,810,392</u>
	<u>\$ 163,308,134</u>	<u>\$ 153,965,377</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATEMENTS OF REVENUE
 For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Basic local network service	\$ 7,985,785	\$ 8,094,575
Network access services revenues	15,735,803	15,151,502
Carrier billing and collection	466,600	472,252
Miscellaneous	<u>1,074,385</u>	<u>1,040,402</u>
Total operating revenues	<u>25,262,573</u>	<u>24,758,731</u>
Operating expenses:		
Plant specific operations	4,508,131	4,452,703
Plant nonspecific operations	2,341,799	2,175,343
Depreciation and amortization	10,230,087	10,435,074
Customer operations	1,623,430	1,909,822
Corporate operations	3,077,046	3,447,275
Other operating taxes	<u>994,932</u>	<u>969,201</u>
Total operating expenses	<u>22,775,425</u>	<u>23,389,418</u>
Operating income	<u>2,487,148</u>	<u>1,369,313</u>
Nonoperating net income	18,726,988	13,332,905
Provision for Income Taxes	<u>(9,154,119)</u>	<u>(4,085,005)</u>
Income before interest charges	<u>12,060,017</u>	<u>10,617,213</u>
Interest on long-term debt to RUS, net of interest capitalized of \$126,841 in 2012 and \$0 in 2011	(13,547)	(277,458)
Nonregulated net income (loss)	<u>(2,462,708)</u>	<u>(2,561,446)</u>
Net income	<u>\$ 9,583,762</u>	<u>\$ 7,778,309</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATEMENTS OF PATRONAGE CAPITAL AND OTHER EQUITIES
 For the Years Ended June 30, 2012 and 2011

	Patronage Capital			Other Equities
	Assignable	Assigned	Balance	
Balances, July 1, 2011	\$ (466,686)	\$ 71,514,375	\$ 71,047,689	\$ 51,853,107
Distribution of patronage capital	-	(2,017,510)	(2,017,510)	-
Patronage capital assigned for the year ended December 31, 2011	(371,179)	371,179	-	-
Retirement of patronage capital of estates of deceased members	-	(453,231)	(453,231)	-
Transfer of unclaimed patronage capital	120,958	-	120,958	-
Refund of Federal excise tax	-	-	-	-
Net income for the year ended June 30, 2011:				
Operating margins	(1,469,591)	-	(1,469,591)	-
Nonoperating margins	-	-	-	9,247,900
Balances, June 30, 2011	(2,186,498)	69,414,813	67,228,315	61,101,007
Distribution of patronage capital	-	(2,024,929)	(2,024,929)	-
Patronage capital assigned for the year ended December 31, 2011	(73,805)	73,805	-	-
Retirement of patronage capital of estates of deceased members	-	(479,361)	(479,361)	-
Transfer of unclaimed patronage capital	459,362	-	459,362	-
Refund of Federal excise tax	-	-	-	-
Net income for the year ended June 30, 2012:				
Operating margins	10,893	-	10,893	-
Nonoperating margins	-	-	-	9,572,869
Balances, June 30, 2012	<u>\$ (1,790,048)</u>	<u>\$ 66,984,328</u>	<u>\$ 65,194,280</u>	<u>\$ 70,673,876</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATEMENTS OF CASH FLOWS
 For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities		
Net income	\$ 9,583,762	\$ 7,778,309
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,230,087	10,435,074
Changes in operating assets and liabilities:		
Decrease (increase) in temporary cash investments	-	-
Decrease (increase) in accounts and notes receivable	(1,515,827)	(256,776)
Decrease (increase) in inventory	297,103	(640,442)
Decrease (increase) in prepaid expenses	(117,801)	158,197
Increase (decrease) in accounts payable	(104,941)	1,067,073
Increase (decrease) in accrued expenses	18,796	152,214
Net cash provided by operating activities	<u>18,391,179</u>	<u>18,693,649</u>
Cash flows from investing activities:		
Purchases of property, plant and equipment	(7,587,732)	(8,993,909)
Plant removal costs	(64,925)	(59,142)
Salvage recovered from retirement of plant	205,756	276,906
Decrease (increase) in nonregulated investment	1,038,913	(1,640,656)
Decrease (increase) in other deferred charges	(25,593)	1,414,029
(Increase) in investment in affiliated companies	(7,522,275)	(2,375,049)
Purchases of Marketable Securities	(12,118,070)	(8,320,900)
Redemptions of Marketable Securities	5,918,129	5,649,251
Net cash used in investing activities	<u>(20,155,797)</u>	<u>(14,049,470)</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATEMENTS OF CASH FLOWS, CONCLUDED
 For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from financing activities:		
Distributions of patronage capital	\$ (2,024,929)	\$ (2,017,510)
Retirements of patronage capital	(479,361)	(453,231)
Principal payments to Rural Utilities Service	(216,791)	(290,529)
Principal payments to Federal Financing Bank	(2,746,120)	(2,637,837)
Increase (decrease) in other long-term liabilities	4,593,488	2,073,315
Federal excise tax refunds	-	-
Increase (decrease) in other member capital	(165,482)	117,884
Transfers of unclaimed patronage capital	<u>459,362</u>	<u>120,958</u>
Net cash provided (used) in financing activities	<u>(579,833)</u>	<u>(3,086,950)</u>
Net increase (decrease) in cash and cash equivalents	(2,344,451)	1,557,229
Cash and cash equivalents at beginning of year	<u>8,084,714</u>	<u>6,527,485</u>
Cash and cash equivalents at end of year	<u>\$ 5,740,263</u>	<u>\$ 8,084,714</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest (Net of \$126,842 capitalized in 2012 and 2011)	<u>\$ 140,389</u>	<u>\$ 277,458</u>
Income taxes	<u>\$ 4,650,000</u>	<u>\$ 2,375,000</u>

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

1. Summary of Significant Accounting Policies:

General:

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

Nature of Business:

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

Estimates:

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

Telephone Plant

The telephone plant in service and under construction at June 30, 2012 and 2011 is stated substantially at original cost, which includes material, labor, transportation and such indirect items as engineering, supervision, employee fringe benefits and interest on funds used during construction. As property units are retired in the ordinary course of business, the cost of the property plus removal cost, less salvage, is charged to accumulated depreciation. Listed below are the major classes of the telephone plant as of June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>	<u>Depreciation Rate</u>
Organization	\$ 20,039	\$ 20,039	-
Land	514,751	514,751	-
Buildings	7,538,363	7,522,897	2.70%
Central Office Equipment	49,045,022	48,866,917	7.5-11.9%
Station Equipment	997,697	997,697	-
Cable and Wire Facilities	97,375,060	91,766,291	2.2-9.4%
Furniture and Office Equipment	778,122	785,542	7.50%
General Purpose Computers	3,700,287	3,714,762	15.80%
Vehicles	4,932,434	4,728,194	10.1-12.1%
Garage and Work Equipment	135,520	135,520	7.50%
	<u>\$ 165,037,295</u>	<u>\$ 159,052,610</u>	

Depreciation:

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

Depreciation for the years ended June 30, 2012 and 2011 was \$10,230,087 and \$10,435,074, respectively.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC
 NOTES TO FINANCIAL STATEMENTS, CONTINUED
 June 30, 2012 and 2011

1 Summary of Significant Accounting Policies, Continued.

Deregulated Customer Premises Equipment:

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

Nonregulated Investments:

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

Following is a summary of net income (loss) from deregulated operations for the years ending June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Income from operations	\$ 14,522,568	\$ 14,326,194
Expenses	<u>(16,985,276)</u>	<u>(16,887,640)</u>
Net income (loss)	<u>\$ (2,462,708)</u>	<u>\$ (2,561,446)</u>

Cash and Cash Equivalents:

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

Accounts and Notes Receivable:

Included in accounts and notes receivable at June 30, 2012 and 2011, is unbilled revenue of \$79,115 and \$48,979, respectively. The company estimates uncollectable accounts as a percentage of monthly revenues and compares this to invoices dated over 90 days when they are considered uncollectible. The board of directors write off receivables as a charge to the allowance for credit losses, in their estimation, it is probable that the receivable is worthless.

Other Member Capital:

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

Inventories:

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

Subsequent Events:

Management has evaluated subsequent events through September 26, 2012, the date which the financial statements were available to be issued.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
NOTES TO FINANCIAL STATEMENTS, CONTINUED
June 30, 2012 and 2011

1. Summary of Significant Accounting Policies, Concluded:

Reclassifications:

Certain reclassifications have been made to the 2011 financial statement presentation to correspond to the current year's format. Total equity and net income are unchanged due to these reclassifications.

Related Party Transactions:

The Company had a receivable from its 100% owned subsidiary (South Central Telcom, LLC) in the amount of \$567,914 and \$78,434 for the years ended June 30, 2012 and 2011, respectively.

The Company was indebted to 100% owned subsidiary (South Central Telcom, LLC) in the amount of \$19,681 and \$0 for the years ended June 30, 2012 and 2011 respectively.

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

Investment in Affiliated Companies:

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

	Percentage Owned	<u>2012</u>	<u>2011</u>
RSA #3 Partnership	25%	\$ 17,368,627	\$ 15,242,304
RSA #4 Partnership	50%	27,713,175	23,820,272
Cumberland Cellular Partnership	12.5%	6,712,007	6,350,932
Bluegrass Network, LLC	20%	2,995,229	2,637,328
Bluegrass Telcom, LLC	20%	339,968	340,084
South Central Telcom, LLC	100%	<u>14,953,528</u>	<u>14,169,339</u>
		<u>\$ 70,082,534</u>	<u>\$ 62,560,259</u>

2. Commitments:

In June, 1994, the Cooperative executed notes to RUS and the Rural Telephone Bank in the amount of \$13,435,000 and \$13,559,700, respectively. These funds are being used to finance construction of additional telephone lines and facilities and the operation of the telephone system. As of June 30, 2012, \$22,384,918 of these funds have been advanced. At June 30, 2012, construction contracts for approximately \$27,000,000 have been awarded.

3. Long-Term Debt:

Long-term debt is represented by mortgage notes payable to the United States of America. Principal and interest payments are due in quarterly installments. It is estimated that quarterly installments of \$717,000 are payable within the next twelve months. The notes are scheduled to be repaid during the year 2015. At June 30, 2012, the Cooperative has advance payments in amount of \$7,302,640 that may be applied to the installments after the application of \$819,302 during the current year.

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 NOTES TO FINANCIAL STATEMENTS, CONTINUED
 June 30, 2012 and 2011

3. Long-Term Debt, Concluded:

	<u>2012</u>	<u>2011</u>
Due to United States of America		
2% First Mortgage Notes	-	216,791
4.1710% First Mortgage Notes - FFB	<u>3,274,731</u>	<u>5,595,878</u>
	3,274,731	5,812,669
Less current maturities	<u>(2,868,156)</u>	<u>(2,962,912)</u>
Total	<u><u>406,575</u></u>	<u><u>2,849,757</u></u>

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

2013	2,868,156
2014	<u>406,575</u>
Total	<u><u>3,274,731</u></u>

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

4. Cash and Cash Equivalents:

All deposits are in various financial institutions and are carried at cost

	2012		2011	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Insured (FDIC)	\$ 5,704,140	\$ 6,262,709	\$ 8,084,714	\$ 9,512,779
Uninsured:				
Uncollateralized	<u>36,123</u>	<u>32,698</u>	-	<u>49,134</u>
Total deposits	<u><u>\$ 5,740,263</u></u>	<u><u>\$ 6,295,407</u></u>	<u><u>\$ 8,084,714</u></u>	<u><u>\$ 9,561,913</u></u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
NOTES TO FINANCIAL STATEMENTS, CONTINUED
June 30, 2012 and 2011

5. Pension Plan:

The Cooperative has a defined benefit pension plan covering substantially all of its employees. In October, 1988, the Cooperative approved the retroactive purchase of all prior service benefits as of December 31, 1988, at a cost of \$487,804. Contributions to the Plan for the years ended June 30, 2012 and 2011 were \$773,130 and \$721,783, respectively. The Plan has been approved by the Internal Revenue Service. As the Cooperative is only one of several employers participating in the Plan, it is not practicable to determine if the vested benefits of the Cooperative's employees exceed the Cooperative's portion of the Plan assets.

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

	<u>Pension Benefits</u>	
	<u>January 1, 2012</u>	<u>January 1, 2011</u>
Fair value of plan assets	\$ 1,380,786,158	\$ 1,257,135,975
Present value of accumulated benefits	<u>(1,267,739,443)</u>	<u>(1,212,404,328)</u>
Overfunded/(Unfunded)	<u>\$ 113,046,715</u>	<u>\$ 44,731,647</u>

	<u>Pension Benefits</u>	
	<u>January 1, 2012</u>	<u>January 1, 2011</u>
Weighted – average assumptions as of January 1:		
Valuation interest rate	7.50%	7.50%
Expected return on plan assets	7.50%	7.50%
Rate of compensation increase	age related	age related

6. Income Taxes:

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

The provision for income taxes for 2012 and 2011 consists of the following:

Provision for Income Taxes:	<u>2012</u>	<u>2011</u>
Current tax expense	\$ 4,650,000	\$ 2,707,200
Deferred tax (benefit)	<u>4,504,119</u>	<u>1,377,805</u>
Total	<u>\$ 9,154,119</u>	<u>\$ 4,085,005</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC
NOTES TO FINANCIAL STATEMENTS, CONTINUED
June 30, 2012 and 2011

6. Income Taxes, Concluded:

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

	<u>2012</u>	<u>2011</u>
Differences in depreciation methods	\$ 14,260,312	\$ 9,756,193

The Company follows the recognition requirements for uncertain income tax positions as required by generally accepted accounting principles. The Company has no tax position at June 30, 2012 for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The Company's policy is to classify income tax related interest and penalties in interest expense and other expenses, respectively. No such interest or penalties were recognized during the periods presented.

The Company files income tax returns in the U.S. federal jurisdiction, and various state and local jurisdictions. The Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2009.

7. Postretirement Benefits:

The Corporation provides health care benefits to retired employees. The actuarially computed accumulated postretirement benefit obligation at June 30, 2012, is \$23,715,063. This cost is being amortized over a twenty-year period per the Kentucky Public Service Commission and the Federal Communication Commission. During the year ended June 30, 2012 and 2011, \$1,380,000 was charged to operations. This amount represents the actuarially computed net postretirement benefit cost for the year, which includes service cost, amortization of the initial obligation and the interest cost.

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Net postretirement benefit liability	\$ 3,649,959	\$ 3,460,812
Less current portion included in accrued expenses	<u>(814,364)</u>	<u>(714,586)</u>
Other long-term liabilities	<u>\$ 2,835,595</u>	<u>\$ 2,746,226</u>

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 NOTES TO FINANCIAL STATEMENTS, CONCLUDED
 June 30, 2012 and 2011

8. Marketable Securities:

The maturities of held to maturity investments and their approximate market values at June 30, 2012 and 2011, were as follows:

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

	Amortized Cost	Net Unrealized Gains (Losses)	Market Value
June 30, 2012	\$ 31,885,026	\$ 165,893	\$ 32,050,919
June 30, 2011	\$ 25,685,084	\$ (181,690)	\$ 25,503,394
June 30, 2010	\$ 23,013,434	\$ (3,495)	\$ 23,009,939
		Amortized Cost	Market Value
Due in one year or less (included in Temporary Cash Investments)		\$ 1,700,000	\$ 1,700,000
Due after one year		<u>30,185,026</u>	<u>30,350,919</u>
Balances, June 30, 2012		<u>\$ 31,885,026</u>	<u>\$ 32,050,919</u>
Due in one year or less (included in Temporary Cash Investments)		\$ 1,700,000	\$ 1,700,000
Due after one year		<u>23,985,084</u>	<u>23,803,394</u>
Balances, June 30, 2011		<u>\$ 25,685,084</u>	<u>\$ 25,503,394</u>

9. Litigation:

A former contracted employee of the cooperative filed suit against the cooperative claiming wrongful termination. The ultimate resolution of the matter, which is expected to occur within one year, could result in a loss of up to \$500,000 which has been accrued in these financial statements.

The Cooperative is subject to other claims and investigations that arise in the ordinary course of business. Management and the Cooperative's legal counsel do not anticipate any material effect on the Cooperative's financial statements as a result of these other actions.

SUPPLEMENTAL DATA

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATISTICAL AND ANALYTICAL INFORMATION
 June 30, 2012 and 2011

	2012	2011	2010	2009	2008	2007
<u>Telephone Plant in Service - June 30:</u>	\$ 165,037,295	\$ 159,052,610	\$ 151,667,798	\$ 146,442,521	\$ 137,862,853	\$ 134,714,486
Investment per subscriber - June 30	6,622	6,271	5,916	5,615	5,151	4,977
Investment per dollar of operating revenue	6.38	6.15	5.86	5.52	5.20	5.01
<u>Depreciation Reserve - June 30:</u>	125,805,964	116,510,825	105,998,914	96,212,435	87,237,940	78,487,142
Percent of plant in service	76.23%	73.25%	69.89%	65.70%	63.28%	58.26%
Annual depreciation	10,230,087	10,435,074	9,821,839	9,345,336	8,729,217	8,745,096
Percent of annual depreciation to plant in service	6.20%	6.56%	6.48%	6.38%	6.33%	6.49%
<u>Average Annual Revenue Per Subscriber:</u>						
Local service	320	319	323	324	323	322
Toll service and access charges	650	616	629	641	607	626
Total operating revenue	1,014	976	1,009	1,020	991	994
<u>Number of Stations - June 30:</u>						
Residence:						
Main stations	21,654	21,998	22,184	22,436	22,840	22,997
Business:						
Main stations (access lines)	3,269	3,365	3,451	3,645	3,925	4,072
Total main stations	24,923	25,363	25,635	26,081	26,765	27,069

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

SOUTH CENTRAL RURAL TELEPHONE COOPERATIVE CORPORATION, INC.
 STATISTICAL AND ANALYTICAL INFORMATION, CONCLUDED
 June 30, 2012 and 2011

	2012		2011		2010		2009		2008		2007	
	Amount	Percent										
Local network service	\$ 7,985,785	31.61%	\$ 8,094,575	32.69%	\$ 8,267,734	31.96%	\$ 8,446,381	31.74%	\$ 8,651,380	32.62%	\$ 8,711,603	32.38%
Network access and long-distance network service	15,735,803	62.29%	15,151,502	61.20%	16,113,769	62.29%	16,717,694	62.83%	16,238,990	61.23%	16,936,392	62.94%
Miscellaneous	1,540,985	6.10%	1,512,654	6.11%	1,488,914	5.76%	1,443,942	5.43%	1,631,542	6.15%	1,257,984	4.68%
Total operating revenue	25,262,573	100.00%	24,758,731	100.00%	25,870,417	100.00%	26,608,017	100.00%	26,521,912	100.00%	26,905,979	100.00%
Cost of telephone service, net of other income and expenses	15,678,811	62.06%	16,980,422	68.58%	19,149,737	74.02%	15,905,159	59.78%	15,154,891	57.14%	15,992,862	59.44%
Net income	\$ 9,583,762	37.94%	\$ 7,778,309	31.42%	\$ 6,720,680	25.98%	\$ 10,702,858	40.22%	\$ 11,367,021	42.86%	\$ 10,913,117	40.56%
Source of Funds Invested in Total Assets:												
Members' equities	\$ 137,183,744	84.00%	\$ 129,810,392	84.31%	\$ 128,887,488	84.21%	\$ 119,461,375	81.53%	\$ 110,885,600	79.05%	\$ 107,782,734	80.67%
Long-term liabilities	17,502,482	10.72%	15,352,176	9.97%	16,624,122	10.86%	19,160,626	13.08%	22,865,511	16.30%	19,354,880	14.49%
Other liabilities	8,621,908	5.28%	8,802,809	5.72%	7,541,228	4.93%	7,899,471	5.39%	6,529,048	4.65%	6,459,592	4.84%
Total assets	\$ 163,308,134	100.00%	\$ 153,965,377	100.00%	\$ 153,052,838	100.00%	\$ 146,521,472	100.00%	\$ 140,280,159	100.00%	\$ 133,597,206	100.00%

CAMPBELL, MYERS, & RUTLEDGE, PLLC

Certified Public Accountants

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

Skip R. Campbell, CPA
Sammie D. Parsley, CPA
Ryan A. Mosier, CPA
Jenna B. Pace, CPA

410 South Broadway
Glasgow, KY 42141
Telephone (270) 651-2167
Fax (270) 651-4677
www.cmr-cpa.com

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

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

We have audited the financial statements of South Central Rural Telephone Cooperative Corporation, Inc., as of and for the years ended June 30, 2012 and 2011, which collectively comprise the South Central Rural Telephone Cooperative Corporation, Inc.'s basic financial statements and have issued our report thereon dated September 26, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audit contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of South Central Rural Telephone Cooperative Corporation, Inc. is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered South Central Rural Telephone Cooperative Corporation, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of South Central Rural Telephone Cooperative Corporation, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of South Central Rural Telephone Cooperative Corporation, Inc.'s internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether South Central Rural Telephone Cooperative Corporation, Inc.'s 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 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*.

We noted certain matters that we reported to management of South Central Rural Telephone Cooperative Corporation, Inc., in a separate letter dated September 26, 2012.

This report is intended solely for the information and use of management, the board of directors, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Campbell, Myers & Rutledge, PLLC

Certified Public Accountants
September 26, 2012